Sonoma County Board of Supervisors' Independent Citizens' Pension Committee

January 15, 2019

Dear Sonoma County Board of Supervisors,

The attached Document is the final Communication Report that the Independent Citizens Pension Committee has been working on over the last year. We are hopeful this report will help improve future Pension communications.

Respectfully,

Jack Atkins, Sandy Coyle, John Hadzess, Martin Jones, and Anthony Withington

Committee Members

The Citizens' Committee on pensions was given the authority and the responsibility to review County communications regarding pensions. One of the deliverables for the Committee is to review the County's State of the Retirement System Report for accuracy and clarity and provide feedback to improve readability and transparency. In anticipation of this Report, the Committee's Communication Work Group reviewed reports prior to April 2018 for these criteria, suggests standards for future reports and offers several critiques which may be used to improve future communications.

Why effective communications are important

It's critical for policy makers to have information that is accurate, complete, clear and unbiased to make good policy decisions. Effective communications will contribute to better, more comprehensive understanding of the pension issue on the part of policy makers, employees, and the public and contribute to achieving the goals set by the County.

Standards for Evaluating Communications

To provide clarity of the standards as stated in the Committee's charter, the Committee proposes the following four standards to be used in evaluating pension related communications.

- **Factual accuracy** – For information to be valuable, and for conclusions and potential actions to be appropriate, any communication regarding the pension system must be based on the best and most current facts available. Facts in a report must originate from a reliable source, preferably a source available to the public.
- **Clarity** – Even though the pension cost issues are complex, an effort should be made to present the concepts in a manner that can be understood by a variety of stakeholders.
- **Completeness, full disclosure and transparency** – Full disclosure of all material and relevant facts should be the standard. Omissions of material facts can lead readers to flawed conclusions.
- **Objective and Unbiased** – Communications should be objective and avoid biases that arise from the perspective of those creating the communication. The Citizens' Committee is situated in a unique position to make sure County communications are fair, constructive and objective, as originally intended.

Communications for review and evaluation (See Appendix for specific evaluations of each communication reviewed.)

- January 2015 Pension Update Report by staff to BOS
- Multiple documents related to June 2016 Budget Hearings, including reports from County administrative staff, SCERA, Segal Consulting Actuaries
- CAO report June 2016
- SCERA newsletter article, Fall 2016, "A Program That Works for Everyone"
- February 2017 staff power point presentation to BOS
- Pension Fact Sheet (August 2017)
- CAFR June 30,2017

- Citizens Financial Report December 31, 2017
- SCERA power point presentation to Citizens Committee, February 2018
- Amicus brief

Summary of Findings

In November 2011 the BOS Ad Hoc committee published a comprehensive report, which laid out in detail the problem associated with unsustainable pension costs and identified three goals and nine strategies to achieve those goals. For that work the BOS is to be commended.

Since 2011, some of the communications that the County has produced have been difficult to understand by members of the public Reports which omit pertinent facts related to debt, expense and risk cloud a clear understanding of the challenge that remains. In some instances, omissions can steer readers to the wrong conclusion, and in other cases the omission represents a missed opportunity to provide helpful information to policymakers.

An example of a missed opportunity is with the Amicus Brief which quotes metrics that understate current pension costs to the County and overstates the County's level of funding by omitting reference to the costs of the POBs. The Brief could have made a more persuasive argument had these costs been included.

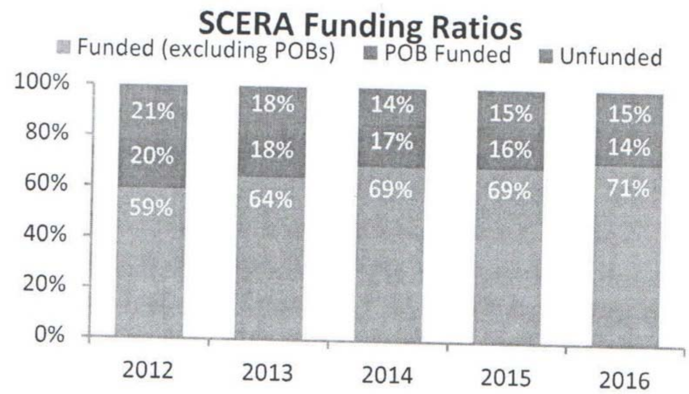
In reviewing the above reports, we have observed several recurring themes in the reports from the County and from SCERA.

1) Track progress against the goal the BOS set in 2011. At that time, a goal was set to reduce pension costs then running about 20% of total compensation to 10% in 10 years. While some of the communications include a projection of future costs which depicts when the cost goal will be achieved, none of the graphs included the original timeline from the 2011 Ad Hoc Report which projected reaching the cost containment goal in 2021. Each time the trend graph is updated, the date at which the cost containment goal is projected to be achieved is further in the future. It is important to include the full history of these projections so the progress toward the goal can be accurately evaluated, and to the extent possible identify reasons forecasts have been modified.

2) Report pension costs as a percent of pensionable payroll and of total compensation. In the 2011 Ad Hoc Report the BOS adopted a cost goal stated in terms of pension costs as a percentage of total compensation. The first Citizens' Advisory Committee pointed out a difficulty in tracking progress when data for total compensation cannot be found in County financial statements, and when the County and SCERA use different metrics when describing relative cost levels. SCERA, and most pension funds, measure costs as a percentage of pensionable payroll. What's more, use of different metrics by the County and by SCERA creates an opportunity for miscommunication when terms are not used carefully. Stating the costs in a consistent manner between the County and SCERA would make the reporting clearer and easier to understand.

3) Recognize the obligation on POBs in reporting the level of funding. The funded ratio is a common and useful metric with which to gauge the relative financial health of a pension plan. The ratio states the amount of assets in the plan as a percentage of the assets that should be in the plan at any point in time, regardless of the source of the assets. When borrowed funds from POBs are used to fund a plan the use of the funded ratio can lead to misunderstanding the financial health of the employer who sponsors the plan. While proceeds from POBs improve the funding of the plan itself, they do not change the liabilities the County faces to provide additional funding. Issuing POBS is like refinancing a mortgage. The total debt does not change, only to whom the debt is owed changes. <u>The funding level from the County's perspective is not improved by issuing POBs.</u>

The Auditor, Controller, Tax Collector has produced a chart showing the funding level of the pension plan that is easy to understand and avoids the misleading aspects of using the funded ratio when POBs are involved. An example of that chart from the Citizens' Report as of June 30, 2017 is below for illustration.



While it may be acceptable for SCERA and SCERA's actuaries, when addressing SCERA's board to use the funded ratio as typically calculated, when those same parties participate in a forum with County officials, the BOS has a duty to make sure the audience is not misled by use of the funded ratio which does not reflect POBs debt used to reduce unfunded liabilities.

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4) Continue to make full disclosure of the risk associated with assumptions that are likely to change. To be thorough and transparent, assumptions both positive and negative should be clearly stated. Risks associated with changes in the assumptions and the probability of changes should be clearly disclosed. For instance:

a) Changes to the discount rate have a material effect on pension costs. A sensitivity analysis showing the impact of a range of rate changes on the UAAL gives the reader a broader appreciation for the risks.

b) The 2003B POB is set to have a balloon payment of $21M in 2023. An explanation of the assumptions for payoff or reissuance is warranted.

c) Employees have been paying 3% toward the UAAL since 2004. The assumption on whether these payments will be discontinued in 2023 when the agreement expires should be stated.

1. Adopt the Standards stated above as the standard for all County communications on pension related matters. [Committee approved adoption on 7/12/2018 to be used to measure review of future communications]
2. Any report to the BOS or the public must clearly state that pension cost and obligations are reported from the county's perspective, and be clearly explained. For example the unfunded pension and outstanding pension obligation bond debt chart is a good way to represent up to date information.
3. Consider including a presentation from the ACTTC, at the annual presentation on pensions.
4. Encourage the Board of Supervisors to utilize the Citizen's Committee resources to provide input to draft communications regarding pension matters, including and not limited to the county's fact sheet.
5. Because supervisors focus is the financial health of the County and how the pension fund and its cost impact the wellbeing of the County, we recommend that Supervisors request those who present to the BOS include the following three topics as the focus of their presentations.

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a. *From the County's perspective*, what is the level of funding, which recognizes the County's obligations to pay both the UAAL and the POBs?
b. What is the cost to the County of funding pensions compared to establish metric including the same metric as SCERA uses which is cost over pensionable payroll? The cost metric should also be regularly compared to the cost containment goal adopted in the 2011 Ad Hoc Pension Report.
c. Include the performance of the investment portfolio to the Board of Supervisors.