



## DEPARTMENT OF FIRE AND POLICE PENSIONS

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### REPORT TO THE BOARD OF FIRE AND POLICE PENSION COMMISSIONERS

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September 15, 2011

ITEM: A.1

FROM:  Michael A. Perez, General Manager

SUBJECT: BOARD REVIEW OF OUTSIDE COUNSEL'S OPINION ON VESTING OF  
RETIREE HEALTH BENEFITS AND POSSIBLE BOARD ACTION

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#### RECOMMENDATIONS

That the Board:

1. Review the opinion from outside counsel on vesting of retiree health benefits and discuss this opinion with outside counsel and the System actuary as part of the Board's assessment of the potential effect of recently negotiated health subsidy changes on the City's contribution for Fiscal Year 2011-2012;
2. Provide direction to Staff, counsel and the actuary regarding any additional information the Board may require in order to consider an adjustment to the City contribution rate; and,
3. Consider requesting the City Attorney to provide direction, either directly or through outside fiduciary counsel, on whether adjusting the City contribution rate is consistent with the Board's fiduciary responsibility.

#### BACKGROUND

Based on the June 30, 2010 valuation and the budget approved by the Board in June 2011, the expected July 15, 2011 City contribution to our System was \$472 million. The City and the Unions recently negotiated changes to retiree health subsidy benefit increases to reduce the City's retiree health liabilities. A key change was to "freeze" retiree health subsidy increases for members and their qualified survivors that retire or enter DROP on or after July 15, 2011, unless such members opt to pay an additional 2% contribution to the pension system.

Until it was changed in July 2011, the Los Angeles Administrative Code provided the Board discretion to increase health subsidies within certain limits for all retired members and qualified survivors. With the change to the Administrative Code, this discretion would be removed for members and qualified survivors whose health subsidy increases were "frozen."

In a report to the Mayor and City Council dated April 7, 2011, City Administrative Officer (CAO) Miguel Santana indicated that while the current retiree healthcare subsidy is a vested benefit, the discretionary adjustments that increase the medical subsidy are not vested. From comments made to the City Council on April 12, 2011, the CAO made it clear that the current subsidy could

be frozen for both active and retired members, but that the CAO's Office had received direction to only pursue freezing benefits for active members. Both the City and unions recognize there is a dispute as to whether the frozen benefits are, in fact, already vested, as indicated in the Letters of Agreement between the City and the unions.

At the July 7, 2011 Board meeting, CAO Staff appeared and asked the Board to consider the effect that the recently negotiated changes would have on liabilities. They also asked the Board to authorize a new actuarial valuation that includes these changes, so that the City's July 15, 2011 contribution could be recalculated and reduced. CAO Staff indicated that in anticipation of this possibility, they would be providing the LAFPP System part of the \$472 million payment expected July 15, 2011. A payment of \$428 million was in fact made to LAFPP by the City on July 15, 2011.

The CAO relied on a March 2011 report by The Segal Company, in its role as actuary for the City, which projected savings of \$68 million in the 2011-12 City contribution to LAFPP if a freeze was implemented. The CAO later modified the City's estimated savings to \$44 million. It is our understanding that this was to reflect the fact that members in DROP as of July 15, 2011 were to be exempted from the "freeze", whereas in the Segal report only members who were actually retired were exempted.

At the July 7th Board meeting, the actuary advised the Board that the City may realize reduced, zero, or negative savings from their changes. This was because, as just discussed, the deal struck between the City and the unions was different from the assumptions the actuary made for the March 2011 study. With this input from the actuary and to help address the CAO's request, the Board took two actions on July 7th.

First, it authorized a request for outside counsel to opine on whether members and qualified survivors have a vested right to the Board increasing retiree health subsidies in accordance with the Administrative Code provisions in effect prior to the "freeze." The Board reasoned this opinion was necessary to allow it to properly consider the City's request to recalculate the City's contribution to the System based on negotiated changes to "freeze" certain benefits; and to have members opt to make an additional 2% pension contribution that would guarantee them and their qualified survivors the current method where the Board can exercise its discretion to increase health subsidies. Freezing benefits for members (and their qualified survivors) who do not opt in and having an additional 2% contribution from members who opt in creates lower liabilities and additional assets, the CAO argues, for the System. If recognized immediately, these savings could reduce the City's 2011-12 contribution.

Although the issue of whether members and qualified survivors have vested rights to the Board exercising its discretion to increase retiree health subsidy benefits has been discussed for years, there has been no public opinion rendered on the matter. The City Attorney approved the Board's request for outside counsel to opine on whether members and qualified survivors have a vested right to the Board increasing retiree health subsidies in accordance with the Administrative Code provisions in effect prior to the "freeze."

The second action the Board took was authorizing an actuarial study to calculate the effect the retiree health subsidy changes would have on the Fiscal Year 2011-12 contribution rate, once the opt in period closes on September 29, 2011 at 5:00PM. At that point, Staff will provide information related to members opting in, members who entered DROP early, and other information relevant

to this study, to The Segal Company. The Segal Company anticipates their study will be finished by mid to late October. Staff will schedule this matter for the Board at the earliest opportunity.

## **DISCUSSION**

Christopher W. Waddell of the law firm Olson Hagel & Fishburn LLP appears before the Board today with the attached opinion. Mr. Waddell's biography is attached for the Board's review. Some of the key documents related to the vesting of pension benefits provided to Mr. Waddell are provided in report B.1. of today's agenda.

In summary, Mr. Waddell opined that:

1. The current subsidy constitutes a vested right for active LAFPP members, retirees and their qualified survivors; and,
2. Future subsidy increases as determined by the Board pursuant to existing Administrative Code provisions are vested for active LAFPP members, retirees and their qualified survivors.

In light of the above, Staff recommends that the Board discuss these matters with both outside counsel and The Segal Company to better understand whether a change to the valuation is consistent with its fiduciary responsibilities. Based on this discussion, it may be prudent for the Board to receive additional advice from counsel in this area before taking any action to reduce the City's contribution. Section 17 of Article XVI of the California Constitution (Prop. 162) states, in relevant part:

The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

As such, we believe the Board should consider requesting the City Attorney, either directly or through outside fiduciary counsel, to research the issue further and to advise the Board as soon as possible on how to proceed.

Attachments (2)