- **Board of Directors**
  Finance and Insurance Committee

7/9/2013 Board Meeting

8-1

Subject

Approve the selection of a third-party Other Post Employment Benefits (OPEB) trust provider; and authorize execution of an agreement(s) with the board-approved provider

Executive Summary

Staff is requesting board approval to contract with a third-party Other Post Employment Benefit (OPEB) trust provider to administer and invest monies contributed by Metropolitan to pre-fund OPEB for employees and retirees. The Office of the Chief Financial Officer will provide oversight and periodic reporting on the status of Metropolitan's OPEB trust.

Details

Background

Metropolitan has paid for its OPEB costs, representing medical premium costs for retirees of Metropolitan, on a pay-as-you-go basis, which is a common practice among public agencies. However, pay-as-you-go funding defers the payment of these costs until the employee retires instead of funding the cost of OPEB as the benefit is earned while the employee is working for Metropolitan.

Statement No. 45 of the Governmental Accounting Standards Board (GASB 45) requires that agencies account for and recognize OPEB costs over the active service of employees. This requires the payment of the present value of future benefits being earned by current employees, plus the amortization of the unfunded liability that represents benefits earned by current and retired employees not yet funded (the Annual Required Contribution, “ARC”). The ARC is determined by Metropolitan’s outside actuary, Bartel Associates, LLC.

Metropolitan’s unfunded liability for OPEB is approximately $545 million based upon the most recent actuarial valuation. The current biennial budget provides for pre-funding OPEB payments of $5 million in FY 2012/13 and $10 million in FY 2013/14, and projects increasing the contribution annually by $5 million in future biennial budgets until the annual payments are equal to the ARC.

Establishing an Irrevocable Section 115 Trust

An irrevocable Section 115 Trust is a government sponsored and controlled trust that provides a tax-exempt base for funding retiree health benefits. Advantages of the trust include more predictable costs, tax exemption for interest earnings, and a higher discount rate in the calculation of the actuarial determined OPEB liability. The use of a higher discount rate is appropriate as pre-funding contributions may be invested in higher yielding securities, such as equities, than would otherwise be available if maintained and invested internally. The sole purpose of the trust will be to fund retiree health benefits.

Metropolitan has evaluated the options of establishing an irrevocable Section 115 Trust by hiring an administrator and investment manager(s), or utilizing an already established external Section 115 Trust, such as the California Employer’s Retiree Benefit Trust (CERBT) managed by CalPERS. Staff has concluded that the time and costs associated with Metropolitan establishing its own independent Section 115 Trust would be more costly than utilizing an existing Trust.

Evaluation Process

Metropolitan developed evaluation criteria, and gathered and analyzed data on the following third-party OPEB trust providers:

California Employer's Retiree Benefit Trust. CERBT was established on January 1, 2008, and is managed by CalPERS. Its service offices are in Sacramento, and CERBT currently manages about $2.5 billion of assets. CERBT is a nonprofit, multi-employer trust (similar to the PERS pension fund.) Also, approximately 345 municipal agencies, including six of Metropolitan's member agencies and the Association of California Water Agencies participate in the CERBT.

Public Agency Retirement Services (PARS). PARS has been managing OPEB trust funds since 1996. Its service offices are in Los Angeles, and PARS currently manages about $500 million in OPEB trust assets. PARS is a for-profit, private entity that manages both multi-employer and single employer trusts. PARS utilizes the services of U.S. Bank and Highmark Funds.

PFM Asset Management (PFMAM). PFMAM is the asset management company within the PFM Group. PFM has been managing OPEB trust funds since 2007 and currently has $1.8 billion of assets under management. Its service offices are in Los Angeles and San Francisco, while its investment management staff are in Harrisburg, Pennsylvania. PFMAM is a for-profit entity that provides single employer trusts.

Evaluation Criteria

The three OPEB Trust providers were evaluated based on the following criteria:

Fees. Fees include both management fees and the cost of investment vehicles (e.g., mutual funds).

Structure. Structure involves the different parties to the agreement, such as the trustee and investment manager, as well as the legal structure of the trust (e.g., multi-employer or single-employer).

Investment options. Investment options considered the spectrum of investment options available to Metropolitan (e.g., customized vs. model portfolios).

Returns/Performance. Returns measures the investment performance of the different providers over different periods of time.

Start-up cost and effort. Reflecting the level of staff, legal, and other efforts to establish the trust.

Ongoing administration. A measure of the estimated level of effort to maintain the trust, ensure that the program is properly functioning, and monitoring performance. In addition, the reporting and consulting support provided by the trust was included in this criterion.

Portability. Portability measures the ease in which Metropolitan would be able to move any monies deposited into the trust to another OPEB Trust provider.

Fiduciary risk. Fiduciary risk is a measure of the protection the trust provides to Metropolitan. Each of the providers takes on a different level of fiduciary responsibility for managing the trust.

Recommendation

Based upon this review and criteria, it was clear that each of the providers have the necessary experience, expertise, and investment options to assist Metropolitan with establishing or joining a Section 115 Trust and to administer and invest the OPEB funding payments. Also, the investment performance of each of the providers were similar over various time periods. The main difference among the three providers was fees, with CERBT having the lowest overall fees for administration and investment management. Assuming an initial $40 million of assets under management, the annual cost for CERBT is $60,000 (15 basis points) compared to PARS at $392,000 (98 basis points) or PFMAM at $244,000 (61 basis points). PARS and PFMAM do provide the ability to customize the investment allocation to a greater extent than CERBT, but this was not deemed to be enough of an advantage to justify the increase in costs.

Based on the foregoing analysis, staff is recommending that CERBT be selected to administer and invest Metropolitan's pre-funding of OPEB benefits. Should the Board approve contracting with CERBT, Metropolitan will contribute $5 million and $10 million during FY 2012/13 and 2013/14, respectively. Funding for these contributions is included in the current biennial budget. In addition, at the June 11, 2013 Board meeting, the Board approved contributing approximately $25 million of reserves into the Trust.

Policy

Memoranda of Understanding with employee bargaining units

California Environmental Quality Act (CEQA)

CEQA determination for Options #1 and #2:

The proposed actions are not defined as a project under CEQA because they involve continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed actions are not subject to CEQA because they involve other government fiscal activities which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed actions are not subject to CEQA pursuant to Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

Board Options

Option #1

Adopt the CEQA determination that the project is not subject to CEQA and authorize the General Manager, with approval of the General Counsel, to execute a contract with CERBT to administer and invest Metropolitan's pre-funding of OPEB benefits.
Fiscal Impact: Helps to reduce liability for OPEB by approximately $40 million for the current biennial budget. The liability will be reduced further in future years if the Board approves continued funding of these payments and increases the amounts over time up to the ARC.

Option #2

Adopt the CEQA determination that the project is not subject to CEQA, direct staff to select PFMAM or PARS for the administration and investment of amounts contributed to pre-funding of OPEB benefits, and authorize the General Manager, with approval of the General Counsel, to execute the necessary contracts with the selected OPEB Trust provider.
Fiscal Impact: Same as Option #1, except the annual fees paid to the provider will be approximately $180,000 to $330,000 higher than the cost of CERBT.

Staff Recommendation

Option #1

6/27/2013
Gary Breaux *Date*
Chief Financial Officer

6/27/2013
Jeffrey Kightlinger *Date*
General Manager

Ref# cfo12623413