

Administrator's Corner



Oscar Peters
Retirement Administrator

SBCERS' INVESTMENT PORTFOLIO

The amount of a retirement allowance paid by the Retirement System is determined by a formula based on years of service and

salary. The allowance is independent of the investment earnings of the System as the retirement benefit is guaranteed by the plan sponsors, who are the County and other government employers that participate in the Santa Barbara County Employees' Retirement System (SBCERS). Of course, on a secondary level, good investment returns affect our members as they reduce retirement costs paid by the employer and thereby free up funds for other services or higher salaries or benefits.

SBCERS' investment returns for the last five years are 11.8% on an annualized basis, which is generally at the median of institutional investors but considerably better than the average individual investor.

Members may want to compare their personal investment model to the asset allocation model that the Retirement System uses. The table on page 7 lists SBCERS' investment allocations and the indexes against which they are benchmarked. Most of these allocations can be mimicked using passive index portfolios. Eighty-five to ninety percent of SBCERS' return is provided by the asset allocation. The remainder comes from the skill of the investment managers that we hire. An individual investor could invest in the three primary asset classes (bonds, domestic stocks, international stocks) using index mutual funds and come very close to matching our return. However the investor would need to maintain the weightings of the classes and periodically rebalance back to the target by selling the best performing assets and investing in the lagging asset classes.

Two of these asset categories, Real Estate/Real Return and Private Equity, would be hard for an individual investor to mimic. Within the Real Return category we have core Real Estate. There are publicly-traded REITs (Real Estate Investment Trusts) that generally have good cash flow and modest market volatility that may not coincide with other equity markets. SBCERS' other asset in this category is a hedge fund of funds. This is an investment that would be difficult to replicate. A hedge fund of funds invests in many funds doing many different types of investments. All of the investments are expected to add value. However, they add different levels of return depending on market conditions. We look to this fund to return between .0% and 1.0% every month with an average of 7.5% per year. To be successful

In This Issue

New Member Contribution Rates	2
Retiree Health Insurance Subsidy	3
Your Retirement Plan: What's Your IQ?	4
Change In Interest Crediting Policy	6

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New Member Contribution Rates

Member contributions to the Retirement System are set at rates recommended by SBCERS' actuary, and based on the individual member's plan and age of entry into the System. Member contribution rates often change following an actuarial experience study, which is typically conducted every three years. However, due to the appointment of a new Retirement System actuary, experience studies were conducted in both 2006 and 2007.

As the result of the 2007 Investigation of Experience, Milliman, SBCERS' new actuary, recommended a number of changes in actuarial methods and assumptions. The actuary recommended that the System's liabilities for salary growth be projected on the basis of service rather than age, which alters the pattern of expected salary growth over an employee's career. In addition, the investigation revealed that members are living longer (and therefore drawing retirement benefits for a longer period of time). Both of these factors impact member contribution rates.

The Board of Retirement has approved new member rates for 2008-09 based on the new actuarial assumptions. The new rates were also submitted to the County for the Board of Supervisors' approval.

Generally speaking, contributions for members with lower ages of entry will decrease effective July 1, 2008, while members with higher ages of entry may see an increase in their contributions. To see the new member rate schedule, please go to www.sbcers.org.

Retiree Health Insurance Subsidy

Retired members of the Santa Barbara County Employees' Retirement System (SBCERS) who participate in County-sponsored health plans currently receive a health insurance subsidy of \$15 per month per year of service toward their premium costs. Retired members that do not participate in these health plans currently receive a cash "in lieu" benefit of \$4 per month per year of service. The legal, tax and financing issues surrounding payment of these benefits are quite complex.

SBCERS has made these payments to retired members through funding derived primarily from investment earnings of the Retirement System. As of June 30, 2007, SBCERS had approximately \$94 million in reserves to pay these benefits for retired and active members of the System. However, it was determined that a change in the manner the benefit is provided was necessary in order to insure compliance with IRS rules.

Over the last three years, SBCERS and the County have worked to address this issue. As a result, the County proposed, effective July 1, 2008, to assume responsibility for payment of the non-taxable health subsidy for current retirees enrolled in the County's health plans.

In light of the County's proposal, the Retirement Board took the following actions at its May 28, 2008, meeting: accepted the County's proposal to assume responsibility for payment of the tax-exempt benefit; retained approximately \$78 million as a Retired Member Benefit Reserve (RMBR) as a source of funds should the plan sponsor fail to pay the health subsidy sometime in the future; and directed that should the County fail to provide the subsidy in the future, SBCERS would commence providing a supplemental benefit in an equivalent amount on a taxable basis. Also, by treating the RMBR as valuation assets, the contribution rate charged to the employer will be reduced by approximately the same annual amount needed to fund current retiree health subsidies (approximately \$7 million/year).

Because the \$4 per month cash benefit is not a health benefit, but a supplemental retirement benefit, SBCERS will continue to pay that benefit on a taxable basis from System funds earmarked for that purpose.

The Board of Retirement spent several months weighing the pros and cons of various alternatives and carefully considered the opinions expressed by many retirees and active members, as well as the plan sponsors of the Retirement System. We believe that the actions taken on May 28 represent the best possible course of action of the options currently available.

Your Retirement Plan: What's Your IQ?

Your retirement plan is a valuable benefit and, for those of you who retire from SBCERS, an important part of your future financial security. Do you feel you understand your retirement benefits? Are you doing as much as you can to maximize your benefit from SBCERS? Take this quiz and find out how much you know.

1. Which leave benefits can increase your retirement allowance?

- a. Grandfathered holiday leave
- b. Sick leave
- c. Vacation
- d. Sick leave and vacation

(d) Both sick leave and vacation can incrementally increase your lifetime retirement allowance. For most of our members, their unused sick leave balance at the time of retirement (up to 2088 hours) is automatically converted to retirement service credit. Vacation converted to cash (VCO) during the member's final average salary period adds to the compensation base on which the retirement allowance is calculated.

2. Except for General Plan 2 participants, members who retire and receive a retirement allowance from SBCERS will receive an annual cost-of-living adjustment (COLA) in what amount?

- a. A rate established annually by the Board of Supervisors
- b. The same percentage amount that Social Security benefits increase as of January 1 of that year
- c. The Consumer Price Index for LA Orange/Riverside, up to a 3% maximum
- d. A flat rate of 3%

(c) Retirees receive an annual COLA equivalent to the CPI, rounded to the nearest half-percent, up to a maximum of 3%. If the CPI exceeds 3% in any year, the remainder is "banked" for credit in future years when the CPI increase is less than 3%. General Plan 2 retirees do not receive a COLA.

3. Except for General Plan 2 participants, and unless other arrangements are made at the time of retirement, a member's spouse automatically receives what percentage of the member's monthly benefit allowance after the member's death?

- a. 50%
- b. 60%
- c. 75%
- d. 100%

(b) A qualified surviving spouse receives a 60% continuance of the member's allowance after the member's death. At the time of retirement, a member may elect to increase the spousal continuance benefit to 100%, but the member's lifetime allowance will be reduced in order to fund the increased benefit to the surviving spouse. General Plan 2 members have a 50% continuance benefit.

4. In addition to purchasing Additional Retirement Credit, qualifying SBCERS members can improve their retirement benefit by purchasing available service credit for:

- a. Regular service previously refunded
- b. Extra help worked prior to membership
- c. An unpaid medical leave of absence
- d. All of the above

(d) Eligible members may redeposit contributions previously withdrawn from the Retirement System and/or “buy back” service credit for certain periods of employment that have not otherwise been credited to the member’s account. In addition, members employed prior to July 15, 1977, may purchase other qualifying government service such as military time. Purchase of these types of service credit is much less costly than buying Additional Retirement Credit, because the member is only required to pay the member’s portion of the cost.

5. In addition to investing the funds of the Retirement System, the Board of Retirement has the following responsibilities:

- a. Establishing the retirement benefit formulas granted to members
- b. Determining which members can purchase prior military time
- c. Assuring comparable retirement benefits with other retirement systems in the state
- d. None of the above

(d) With certain limited exceptions, the Retirement Board does not determine what benefits members receive. The County Board of Supervisors (or District Board of Directors) has authority and responsibility to determine retirement benefit levels, typically through the collective bargaining process for represented employees. The Retirement System generally administers the benefits adopted by the employer.

6. A member who terminates employment may request a refund from the Retirement System. The refund that the member will receive consists of:

- a. Only the amount of the member’s contributions to the System
- b. All member contributions, plus interest earned on those contributions
- c. All member contributions and interest earned, plus any “pickup” of member contributions paid by the employer
- d. All member and employer contributions, plus interest earned

(b) A member requesting a refund will receive the total amount of his/her contributions and associated interest. Members may also choose to leave their contributions on deposit after termination. If the member is vested, he/she can apply for retirement benefits when eligible to retire.

How did you do? If you’d like to test your knowledge further, more questions and answers are available on-line at the SBCERS website. If you feel you would like to know more about your retirement benefits, you may want to attend one of our Question & Answer Sessions where you will receive a presentation from a Retirement Benefits Representative and can ask questions about your retirement benefits. Or, if you are within five years of your planned retirement date, consider registering for a Pre-Retirement Planning Workshop. A list of scheduled workshops is posted on our website, at www.sbcers.org.

Change In Interest Crediting Policy

SBCERS is a defined benefit retirement system designed to provide a lifetime retirement allowance to members based on service to the County of Santa Barbara or participating special district. Funding for the benefit comes from employer and member contributions (currently in a 5:1 ratio), and investment earnings generated from those contributions. In a defined benefit plan, the employer bears all of the market risk. If the Fund suffers a significant loss, the employer may be required to make up the loss in higher contributions. While members do not bear any market risk, they make contributions to the System and should be entitled to interest on their account.

It has been SBCERS' practice to credit member accounts with the actuarial assumed rate of return, which has been 8.16% in recent years. However, the County Employees Retirement Law allows the Board of Retirement to determine that a higher or lower interest rate is appropriate. Since the member is taking no market risk, there is a belief that the member interest rate should reflect a risk-free rate of return. The risk-free rate is generally lower than the actuarial assumed, market-based rate of return.

Earlier this year, the Board of Retirement approved establishing a policy for crediting interest to member accounts. The new policy, which begins June 30, 2008, is to credit interest to member accounts equivalent to the yield of the five-year Treasury note, not to exceed the actuarial assumed rate.

What does this change mean?

For the many members who "buy back" service credit, the cost will reflect a lower interest rate beginning in 2008.

For the vast majority of members who retire from the System, there is no change in benefits received from SBCERS. The rare exception to this may be for a member who elects Optional Settlement 1, which guarantees if all member contributions have not been paid out prior to the member's death, that the balance will be paid to his/her estate or beneficiary. Any remainder paid to the member's estate or beneficiary will likely be somewhat less because the account will have earned less interest.

Similarly, for a member who dies prior to retirement, if the balance of his/her account is paid to a surviving family member, the total account balance will likely be less.

The primary impact will be on members who terminate employment and withdraw their contributions. Their contributions will not have earned as much interest while on deposit with SBCERS.

The primary function of SBCERS is to provide lifetime retirement benefits to eligible members and their beneficiaries. The new interest crediting policy supports this mission, while providing a reasonable rate of return for members who do not retire from the System.

Adminstrator's Corner

continued from page 1

with this type of investment, you need investors that have been doing this for a long time and understand the risks of the market in which they invest. A core publicly-traded REIT would be an alternate portfolio choice for real return.

In Private Equity, we invest with the advice of a consultant in funds that invest in special situations (when a company wants to divest itself of a part of its business); leveraged buyouts (you can buy control of a company using cash and borrowed money, then reposition it while earning enough income to cover the interest on the loans); and finally, venture capital (investing in start-up companies). It is interesting that on average the return on private equity is about the same

as for publicly traded stocks. However, the best funds provide a significantly better return. In this investment category, access to the best funds will determine if you get a good risk-adjusted return. An individual investor could use small cap universes to approximate the risk and return of private equity.

As you can see, SBCERS invests in a greater number of vehicles than most individual investors. We invest both passively in an index and with active managers. It is very difficult to find active managers that will provide returns in excess of benchmark indices over an extended period. At the Retirement System, we find this one of the most challenging parts of the investment process.

Asset Category	Reference Benchmark	Target Allocation
Cash (Money Market)	30-day Treasury bill	1%
Bonds	Lehman Universal	25%
Domestic Stock	Russell 3000	47%
Large Core	Russell 1000	20.0%
Large Value	Russell 1000 Value	13.5%
Large Growth	Russell 1000 Growth	8.5%
Small Value	Russell 2000 Value	2.5%
Small Growth	Russell 2000 Growth	2.5%
International Stock	MSCI World X US	17%
Developed	MSCI EAFE + Canada	15.0%
Emerging	MSCI Emerging (free)	2.0%
Real Estate/Real Return	NCREIF Index	5%
Private Equity		5%

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