

**JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS**

455 Golden Gate Avenue
San Francisco, California 94102-3688

Report

TO: Members of the Judicial Council

FROM: Ernesto V. Fuentes, AOC Human Resources Director, 415-865-4262
ernesto.fuentes@jud.ca.gov

DATE: September 17, 2009

SUBJECT: Statement of Policy for Prefunding Other Postemployment Benefits and
Establishing Qualified Irrevocable Trusts in the Trial Courts

Issue Statement

In December 2006, the Governor created the Public Employee Post-Employment Benefits Commission, chaired by Gerald L. Parsky (Commission). The Commission was charged with identifying the unfunded liability of California's public employers' other post employment benefits (OPEB)¹ and proposing a plan, or plans, to address any liability. The Commission issued its final report in January 2008.² One of the Commission's 34 recommendations is that public employers should adopt prefunding as a policy and budget priority.

The Parsky report and recommendations do not address OPEB liabilities in the judicial branch. Currently there is no specific policy or guidelines for trial courts that are considering prefunding OPEBs and establishing qualified irrevocable trusts.

Recommendation

The AOC recommends that the Judicial Council, effective October 23, 2009, adopt the following policy directives to provide trial courts with guidance and authorization protocols for prefunding OPEB obligations:

1. Courts offering other postemployment benefits (OPEB), such as retiree health insurance, should consider prefunding as a financial goal. In considering to prefund OPEB, each trial court should take into account its current and future financial

¹ Other Post Employment Benefits, or OPEB, are any benefits provided employees after their employment, during retirement. Health insurance, life insurance, vision and dental insurance are the primary components.

² The full Parsky Commission Report can be found at www.pebc.ca.gov.

condition and determine whether prefunding is in the best interest of the court in balancing and reconciling the branch's goals to provide access to the courts.

2. Given the difficult financial condition of the State Budget, the Judicial Council should establish a moratorium on authorizing prefunding of OPEB. This moratorium on prefunding should last for a two-year period, ending June 30, 2011. The Judicial Council should delegate to the Administrative Director of the Courts (ADC) the authority to grant exceptions to this moratorium. The ADC will consider exceptions on a case-by-case basis. Factors creating exceptions may include extenuating circumstances beyond the control of the court and/or contractual obligations under a memorandum of understanding that require prefunding. Additionally, courts must consult with the AOC Finance Division in determining a court's ability to prefund these benefits.
3. a. Trial courts prefunding their OPEB, in accordance with this policy and working in conjunction with the AOC Finance Division must follow Government Accounting Standards Board Standard 43 and establish a qualified irrevocable trust that follows the Internal Revenue Code section 115.

b. Numerous entities provide such qualified trusts. However, the California Employer's Retiree Benefit Trust available through the California Public Employees' Retirement System (CalPERS) and Public Agency Retirement Services are the providers of qualified trusts authorized by the Judicial Council. Trial courts seeking to use other providers for establishing a qualified irrevocable trust must receive prior approval from the Administrative Director of the Courts.

c. A court must not make itself a fiduciary for the qualified irrevocable trust.
4. Trial courts prefunding their OPEB must follow the Judicial Council's *Statement of Investment Policy for the Trial Courts*, adopted in 2004. The policy requires that the Judicial Council or its designee, the Administrative Director of the Courts, approve all investments.
5. Trial courts prefunding their OPEB by establishing a qualified irrevocable trust must contact the AOC Human Resources Division. The division will coordinate a trial court's application through review by the AOC Finance Division and the Office of the General Counsel and final approval by the Administrative Director of the Courts.

Rationale for Recommendation

The Judicial Council's Court Executives Advisory Committee (CEAC) established the Working Group on Court Staff Retirement Costs and Planning in November 2006. The working group's charge was to review and address, among other things, retiree health costs.

The Administrative Office of the Courts (AOC) Finance Division, using the services of Marsh Mercer Kroll Consulting, performed a baseline actuarial analysis of each trial court's OPEB liability. It should be noted that most but not all trial courts provide OPEB to their retirees. The results of the analysis were provided to each trial court in September 2007. According to this initial analysis, the trial courts have an aggregate unfunded actuarial accrued liability (UAAL) for retiree health insurance of approximately \$1.29 billion. To date, only two trial courts have prefunded their OPEB liability. Staff is aware that a few other courts are considering prefunding.

This proposed policy will provide statewide directives for courts on the prefunding of OPEB, including specifying allowable investment options. In addition, the policy will establish a two-year moratorium on prefunding OPEB for all trial courts, except those that request an exemption as a result of special circumstances. The CEAC working group has been charged with researching multiple issues related to pensions and other postemployment benefits and will continue its work. Therefore, the working group decided that the instant policy, applicable only to prefunding a courts' OPEB through the establishment of an irrevocable trust, should be an AOC recommendation to the council.

It is important to note that the proposed policy does not establish a new requirement for Judicial Council approval of this type of investment. The Judicial Council's 2004 *Statement of Investment Policy for the Trial Courts* lists the specific investments trial courts are authorized to make. It further requires authorization for "other investments, as approved by the Judicial Council, or its designee, the Administrative Director of the Courts (ADC), that complies with the Statement of Investment Policy." The proposed policy on prefunding and irrevocable trusts provides direction and authorization protocols when courts are considering a specific type of "other investment" (prefunding and irrevocable trusts) referenced in the 2004 investment policy. Even without the proposed policy, trial courts planning investments other than those listed in the 2004 investment policy are required to obtain approval from the Administrative Director of the Courts.

Additionally, the proposed policy does not address whether OPEB liabilities are a legal obligation of the courts. It does not address whether courts must continue to pay retiree health costs on a yearly, "pay-as-you-go" basis; that remains a local decision. The policy seeks only to provide direction to courts, as a continuation of the 2004 investment policy, when considering the establishment of an irrevocable trust as an investment to pay OPEB liabilities.

As indicated above, the policy would include a two-year moratorium on court establishment of an irrevocable trust for purposes of prefunding OPEB. One reason for this is that a small number of courts have indicated interest in investing court funds immediately for this purpose. A difficulty, though, is that the Judicial Branch is currently facing substantial one-time and ongoing reductions in funding for courts statewide this

fiscal year, and the council and the Trial Court Budget Working Group has reviewed not only the availability of state-level resources but also local funds to determine statewide funding allocations. If a court establishes an irrevocable trust and invests resources in the funds in the current uncertain fiscal environment, such an investment could affect the court's ability to absorb reductions, as well as possibly result in the appearance that other courts not proceeding with such investments are relatively better resourced.

Another issue is that investment of scarce court resources in such a fund would place the court out of step with any potential future overall statewide solution for the funding of OPEB liabilities, an issue not only for the judicial branch but also for the entire executive branch. The proposed moratorium would allow time for the state to develop a statewide approach to addressing these costs.

Alternative Actions Considered

Currently, there is no specific policy on prefunding OPEBs and establishing qualified irrevocable trusts. While the 2004 *Statement of Investment Policy for the Trial Courts* addresses all investments, the proposed policy provides specific direction for this particular type of investment.

The alternatives are taking no action and continuing to rely upon the 2004 policy that provides no specifics and no direction to the courts.

Comments From Interested Parties

The policy was originally reviewed by CEAC, and then reviewed by all executive officers. The working group reviewed and discussed the proposed comments and made appropriate changes in the proposed policy. The concern expressed was whether the proposed policy impacted a court's OPEB as a legal liability. The proposed policy does not address the legal liability issue, but rather the funding of the liability. Having addressed that question, the CEAC supports the proposed policy. Additionally, the Trial Court Presiding Judges Advisory Committee reviewed the policy and offered no opposition. All comments and suggestions provided were reviewed and incorporated, where feasible, in the final draft.

Implementation Requirements and Costs

The proposed policy involves no cost to participating courts.