DISCUSSION CALENDAR – AGENDA ITEM NO. 3
BUDGET AND FINANCE COMMITEE MEETING
June 12, 2013

TO: Budget and Finance Committee, Orange County Fire Authority

FROM: Lori Zeller, Assistant Chief
Business Services Department

SUBJECT: **Status Update - Orange County Employees' Retirement System**

Summary:
This agenda item is submitted to provide a status update regarding steps taken during May 2013, to improve the Orange County Employees' Retirement System's (OCERS) financial policies, procedures, and practices.

Recommended Action:
Receive and file the report.

Background:
In 2010 and 2011, accounting issues were identified at OCERS impacting actuarial calculations of the value of assets and liabilities attributable to the various plan sponsors. The total accounting values at OCERS were correct, but the attribution of values to individual plan sponsors required adjustment. A large amount of work was performed by OCERS and plan sponsor staff members to correct the issues, and ongoing improvement plans were established by OCERS. Following these events, the OCFA's Budget and Finance Committee directed OCFA staff to provide routine updates to the Committee regarding financial activities occurring at OCERS.

Actions Taken/Financial Policies & Practices – May 2013

OCERS BOARD OF RETIREMENT – May 20, 2013:

PRELIMINARY DECEMBER 31, 2012 VALUATION
Mr. Paul Angelo of The Segal Company reviewed the initial results of the December 31, 2012 Actuarial Valuation (Attachment 1). This is the first valuation to reflect the impact of the recent lowering of OCERS assumed earnings rate from 7.75% to 7.25%. A full actuarial report will be delivered to the Board on June 17, 2013, for final consideration and adoption.

ACTUARIAL FUNDING POLICY-RESPONSE TO RAEL & LETSON
Mr. Paul Angelo provided a response to the Rael & Letson letter for informational purposes only (Attachments 2 and 3). No Board action will take place on this item until June 17th.

COMPENSATION STUDY
Representatives of The Hay Group presented the results of their compensation study comparing OCERS Management salaries to those of other employers in both the private and public sector (Attachment 4). Following the presentation, the OCERS Board Ad-Hoc Compensation Committee discussed an initial draft of an OCERS Compensation Philosophy document (Attachment 5). No action was taken on this item, as some members of the Board requested

additional information prior to taking action. In addition, OCFA staff requested an opportunity for plan sponsors to participate in the dialogue and provide feedback to OCERS regarding the draft Compensation Philosophy document.

Staff will continue to monitor actions taken by OCERS to improve its financial policies and practices, and will report back in July regarding progress made during the next month.

Impact to Cities/County:
Any increase or decrease in OCFA's retirement costs will impact the OCFA's overall budget, which can potentially impact the funds available for services provided to the communities we serve. In addition, annual changes to OCFA's salary and benefit costs impact the charges passed on to OCFA's contract members.

Fiscal Impact:
Any changes to the amortization of future UAALs will apply, at the earliest, to the 2013 actuarial valuation, and would be implemented in July 2015 (although more likely to occur in July 2016). Longer amortization periods result in lower contributions and lower contribution volatility. Conversely, shorter amortization periods get to full funding sooner, but at the price of higher current contributions and higher contribution volatility. It is not possible to quantify in advance the full future cost impact associated with adopting any of the alternative amortization periods for future changes in UAAL simply because the plan's future changes in UAAL are not yet identified.

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Attachments:
1. OCERS December 31, 2012 Actuarial Valuation (on file in the Office of the Clerk)
2. Letter from Rael & Letson December 10, 2012
3. Letter from the Segal Company May 16, 2013
4. The Hay Group Compensation Study (on file in the Office of the Clerk)
5. OCERS Compensation Philosophy

Attachment 2

RAEL & LETSON
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MEMORANDUM

TO: Mark Nichols
Executive Director, Association of Orange County Deputy Sheriffs

FROM: Jonathan Hassen and Wendy Londa

DATE: December 10, 2012

RE: Orange County Employees' Retirement System - Funding Policy Options

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As requested, we have examined various funding policy options available to the Orange County Employees' Retirement System (OCERS) in light of the Plan's current funded position, employer contribution levels and market losses experienced in the last five years. The information below highlights possible options as well as their viability.

Funding Policy Options for OCERS

We have analyzed the impact on the Plan of nine funding policy changes. A few of these options are variations of the legal provisions in the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 ("PRA") as signed by President Obama on June 25, 2010. This legislation was passed in an effort to help fundamentally sound private sector pension plans which had become financially challenged by the economic downturn in the last few years. Although the law only applies to the private sector, some of the funding relief provisions would be considered reasonable for the public sector. The options we evaluated are as follows:

1. Restart the amortization period of all amortization bases to a fixed and declining 25-year period as of December 31, 2011 (25-year layered)[1].

2. Restart the amortization period of all amortization bases to a fixed and declining 30-year period as of December 31, 2011 (30-year layered).

3. Extend the amortization period for valuation value investment losses incurred in the 2011 Plan Year from 15 years to 30 years.

4. Smooth the market value investment loss incurred in the 2011 Plan Year over 7 years.

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[1] With the exception of actuarial assumption bases with amortization periods currently exceeding 25 years.

5. Smooth the market value investment loss incurred in the 2011 Plan Year over 10 years

6. Combination of options 1 and 4: restart the amortization period of all amortization bases to a fixed and declining 25-year period and smooth the market value investment loss incurred in the 2011 Plan Year over 7 years.

7. Combination of options 1 and 5: restart the amortization period of all amortization bases to a fixed and declining 25-year period and smooth the market value investment loss incurred in the 2011 Plan Year over 10 years.

8. Combination of options 2 and 4: restart the amortization period of all amortization bases to a fixed and declining 30-year period and smooth the market value investment loss incurred in the 2011 Plan Year over 7 years.

9. Combination of options 2 and 5: restart the amortization period of all amortization bases to a fixed and declining 30-year period and smooth the market value investment loss incurred in the 2011 Plan Year over 10 years.

As expected, the above options have a favorable impact on the employer contribution rate for the Fiscal Year beginning July 1, 2013, although to varying degrees. The estimated savings for General and Safety members combined are shown in the chart below.

Funding Option	***Estimated Reduction in Employer Contributions***	***Estimated Reduction in Employer Contribution Rate***
1[1]	$49,737,000	3.07%
2[2]	$74,494,000	4.60%
3	$12,530,000	0.77%
4	$3,300,000	0.20%
5	$5,775,000	0.36%
6	$52,073,000	3.22%
7	$53,825,000	3.32%
8	$76,600,000	4.73%
9	$78,179,000	4.83%

[1] For Safety members, Option 1 (restart amortization over 25 years) is an estimated reduction in the Safety employer contribution of **$12,760,000** with an associated **3.44%** estimated reduction in the Safety employer contribution rate.

[2] For Safety members, Option 2 (restart amortization over 30 years) is an estimated reduction in the Safety employer contribution of **$20,117,000** with an associated **5.43%** estimated reduction in the Safety employer contribution rate.

Although the PRA relief afforded to private sector multiemployer pension plans only offered relief for the two plan years ending after August 31, 2008, we have not priced any funding policy options specific to the 2008 and 2009 investment years in our analysis. Since the Plan incurred an investment loss in the 2008 calendar year and investment losses are recognized over 5 years (20% per year) for purposes of determining the valuation value of assets, the Plan has already recognized 80% of the $2.2 billion investment loss incurred in the 2008 Plan Year. The loss will have been fully recognized as of December 31, 2012. The Plan could retroactively utilize an extended amortization or smoothing period for the investment loss incurred in the 2008 Plan Year and apply the associated reduction as a credit to subsequent employer contributions. However, we have assumed this is not a desirable option for purposes of this analysis.

As a comparable alternative to the private sector pension relief offered for the 2008 and 2009 Plan Years, we have included in Options 3-5 the impact of recognizing the investment loss incurred in the 2011 Plan Year over an extended period. If the Plan were to incur a significant investment loss in a subsequent plan year, both years could be afforded some variation of pension relief. For your information, the chart on page 6 shows some modified versions of relief adopted by other major public retirement systems.

Additional discussion on these funding policy options is included below. Please note that the options presented in our analysis are for illustration only and other alternative funding policies may, for example, consist of combinations of the above.

Discussion of Options

Option 1 entails collapsing all current amortization bases, with the exception of actuarial assumption bases with amortization periods currently exceeding 25 years, into one base and amortizing that base over 25 years. Each new base resulting from actuarial gains or losses, assumption changes or plan provision changes would be amortized over the applicable OCERS stipulated period. The OCERS Plan currently amortizes changes in the unfunded actuarial accrued liability over various periods depending on the cause of the change. For instance, actuarial assumption changes are amortized over 30 years whereas experience gains or losses are amortized over 15 years. This option would mitigate the effect of any future losses incurred.

Option 2 is similar to Option 1 except that all current amortization bases would collapse into one base and be amortized over 30 years. Note that the Pension Relief Act of 2010 provided a one-time option to private sector defined benefit plans to amortize the investment losses incurred in the two plan years following August 31, 2008 over an amortization period of 30 years with all future bases amortized using current rules (generally over 15 years).

Under current Government Accounting Standards (GASB), a 30-year amortization period is considered acceptable. However, under new Government Accounting Standard guidelines (GASB 67/68, as amended by GASB 50), investment experience will need to be recognized over a 5-year period and demographic experience will need to be recognized over the average future working lifetime of plan participants. In general, the average future working lifetime varies by population but is generally 15-25 years. These new standards will take effect for fiscal years beginning after June 15, 2013 for pension plans and after June 15, 2014 for employers. Note that accounting compliance under GASB is completely separate from funding requirements and may be determined under different methodologies.

Option 3 isolates the valuation value investment loss incurred during the 2011 Plan Year and extends the time to amortize the loss to 30 years rather than 15 years as under the current funding policy. Note that the Plan incurred a total experience loss of $272.1 million in the 2011 Plan Year. However, this was comprised of an investment loss of $388.9 million offset by a demographic gain of $116.8 million. Under Option 3, the $388.9 million investment loss would be amortized over an extended period of 30 years to provide temporary relief.

Option 4 uniquely targets the market value investment loss incurred during the 2011 Plan Year by applying a smoothing period of 7 years rather than the current 5-year smoothing methodology in the determination of the valuation value of assets. Note that the smoothing period used to determine the valuation value of assets would revert back to the current 5-year smoothing methodology effective with the market value investment gains or losses incurred in the 2012 Plan Year. This would provide employers with additional time to pay off the 2011 asset loss.

Option 5 is similar to Option 4 but extends the smoothing period from 7 years to 10 years. As expected, this option provides further relief by spreading the market losses over 10 years; this is a reasonable time frame given the extent of the loss and comparability to private sector relief which also afforded pension plans with the option to smooth losses incurred in the two plan years ending after August 31, 2008 over 10 years. Bear in mind, this only affects the loss for the 2011 Plan Year. All future gains or losses would be smoothed according to the current method although future losses could also be smoothed over an extended period.

Options 6-9 are combinations of Options 1-2 and 4-5. These options involve combining the 25 or 30-year collapsed amortization of all bases along with a 7 or 10-year extended smoothing period of the investment loss incurred in the 2011 Plan Year for purposes of determining the valuation value of assets. In aggregate, these options produce the greatest cost savings although the savings are not significantly higher than Options 1 and 2 on a stand-alone basis. Note that PRA relief provided private sector plans with the option to both amortize net investment losses incurred in the 2008 and 2009 Plan Years over 30 years and to extend the smoothing period for recognizing such losses to 10 years. Options 6-9 are similar in nature to these relief provisions.

Amortization Options

Note that the amortization options included in this analysis (Options 1 and 2) are considered fixed and declining amortization methods or "closed" amortization periods. The base is initially established at the effective date and the calculated amortization amount covers both the interest and principal owed on the base. By the end of the 30-year amortization period, the amortization base has been fully paid off. This is the amortization methodology currently utilized by OCERS. Subsequent to the restart amortization of the unfunded actuarial liability established as of December 31, 2004 (currently amortized over 23 years), OCERS incorporated a "closed" layered approach for subsequent experience gains and losses. This results in a new amortization base each year to the extent unfunded liabilities differ from actuarial expectations. This base is amortized over 15 years which is similar in length to private sector multiemployer pension plans.

An alternative to the fixed and declining or "closed" amortization approach is a rolling or "open" amortization method. A rolling amortization method resets the amortization period to the stipulated period each year and replaces the previous year's base with a new or "open" amortization base. The drawback of a rolling or "open" amortization method is that the base never fully gets paid off because the amortization period resets each year. As a result, the amortization amounts are lower than under a fixed and declining method after the first year. This approach can be advantageous in difficult financial times because it provides the Plan with a longer period of time to recover from financial struggles. On the negative side, it can prevent a Plan from recognizing fruitful financial gains in periods of economic prosperity. Since our analysis of funding policy Options 1 and 2 reflects a fresh reset of the amortization period to 25 and 30 years as of December 31, 2011 respectively, there is no difference between the "closed" and "open" amortization approaches in the initial year of establishment. The difference in methods would only come into play in subsequent years to the extent the plan's unfunded liability deviated from actuarial expectations.

Consider the following examples of the estimated effect on the Plan's December 31, 2012 amortization payment if the Plan were to incur a valuation value investment loss of $500 million versus a gain of $500 million in the 2012 Plan Year assuming the Plan had previously established Option 2 as of December 31, 2011 (30-year restart amortization of all bases):

Amortization Method	***2012 Amortization with Valuation Value Gain of $500m in the 2012 Plan Year***	***2012 Amortization with Valuation Value Loss of $500m in the 2012 Plan Year***
Closed	$214,557,000	$303,591,000
Open	$225,932,000	$282,752,000

As shown above, an investment loss results in a lower amortization payment under the rolling or "open" amortization approach while an investment gain results in a lower amortization payment under the fixed and declining or "closed" amortization approach. Although public sector pension plans are generally considered ongoing plans and thus may reasonably select an "open" amortization period, we would not recommend this method over a period in exceed of 20 years. A 30-year rolling amortization period is simply too long in our view.

Other Major California Public Retirement Systems

For illustration purposes, we've listed below the amortization methods for experience gains and losses followed by a sampling of major public retirement systems in California based on their most recently published actuarial valuation reports. Note that there are certain exceptions and not all amortization bases are amortized over the stated period:

Public Retirement System	***Amortization Approach for Experience G/L***
LACERS	Switched from 5-year recognition of investment gains and losses to 7-year recognition in 2010. Combined bases and amortized over 30-year fixed and declining period in 2012. Subsequent gain/loss bases amortized over 15-year fixed and declining period (layered).
LACERA	30-year fixed and declining (layered).
SBCERS	Switched from 15-year fixed and declining period to 17-year rolling "open" amortization period in 2010.
VCERA	15-year fixed and declining period (layered).
SDCERS	15-year fixed and declining period (layered).
SFERS	15-year rolling "open" amortization period.

Other Considerations

One issue to keep in mind when selecting a funding policy is the potential for negative amortization. This occurs when scheduled amortization payments do not cover the interest accrued on the outstanding balance (Unfunded Actuarial Accrued Liability, or UAAL). In this case, the amount by which the interest exceeds the payment is added to the outstanding balance, thus increasing the UAAL. Although negative amortization is not a desired feature of an amortization schedule, it is important to note that the long-term health of the Plan should be the main focus. If the funded ratio continues to improve and contributions are at a manageable rate, negative amortization is acceptable for a short period of time.

Note that, as of December 31, 2011, certain existing amortization bases are operating in a negative amortization environment and there is the potential for negative amortization under a combined amortization funding policy approach. Depending on future investment and demographic experience, a minimum funding requirement may be considered such as interest on the UAAL.

In the December 31, 2011 actuarial valuation, several assumptions were updated by the actuary and the impact of those changes was amortized over a 30-year period allocated among general and safety member participant groups. At the time, the investment return assumption was maintained at 7.75% although the actuary recommended a reduction in the assumption. However, we understand that OCERS recently voted to lower the investment return assumption by 50 basis points. This reduction in the investment rate assumption will further increase actuarial liabilities and employer contributions. To prevent significant increases in the contribution rate due to pivotal assumptions such as the investment return assumption, some systems have opted to phase-in the effect of the change over a period of years. These assumptions should continue to be monitored and reviewed for reasonability

We are available to discuss the options or other analysis included in this memo in further detail. Please let us know if you have any questions.

APPENDIX

ASSOCIATION OF ORANGE COUNTY DEPUTY SHERIFFS

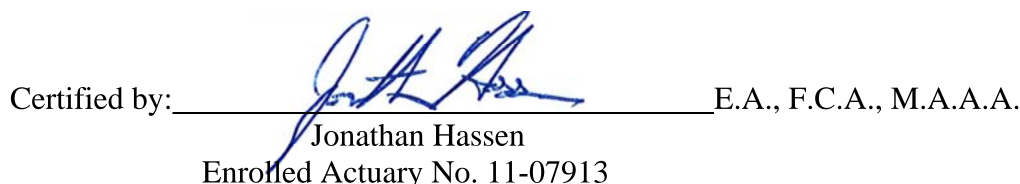
STATEMENT OF ACTUARIAL OPINION

The analysis presented in this memorandum is based on the information included in the actuarial valuation reports for the Orange County Employees' Retirement System for the 2010, 2011 and 2012 Plan Years as well as the actuarial assumption review for the December 31, 2011 actuarial valuation as prepared by The Segal Group, Inc. All data, methods and assumptions are the same as used in the December 31, 2011 actuarial valuation, except where noted otherwise.

Future actuarial measurements may differ significantly from the current measurements presented in this memorandum due to factors such as plan experience differing from that anticipated by the economic or demographic assumptions, changes in economic or demographic assumptions, increases or decreases expected as part of the natural operation of the methodology used for these measurements and changes in plan provisions or applicable law. Due to the limited scope of our assignment, we did not perform an analysis of the potential range of future measurements.

Actuarial computations presented in this letter are for purposes of determining alternative funding policy options. The calculations in this letter have been made on a basis consistent with our understanding of OCERS current funding requirements. Determinations for purposes other than meeting these requirements may be significantly different from the results contained in this letter. Accordingly, additional determinations may be needed for other purposes. Rael & Letson's work is prepared solely for the internal business uses of the Association of Orange County Deputy Sheriffs. Rael & Letson's advice is not intended to be a substitute for qualified legal or accounting counsel. Note that we have not explored any legal issues with respect to the proposed funding policy options.

On the basis of the foregoing, we hereby certify that, to the best of our knowledge and belief, this funding policy options memorandum is complete and accurate and has been prepared in accordance with generally recognized and accepted actuarial principles and practices. We are actuaries for Rael & Letson, are members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.



Certified by:__________________________________E.A., F.C.A., M.A.A.A.
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Reviewed by:__________________________________E.A., A.S.A., F.C.A., M.A.A.A.
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VIA E-MAIL AND USPS

May 16, 2013

Mr. Steve Delaney
Chief Executive Officer
Orange County Employees Retirement System
2223 Wellington Avenue
Santa Ana, CA 92701-3101

Re: Comments Related to Memo Prepared by Rael & Letson

Dear Steve:

As requested, we have provided our comments related to the memo prepared by Rael & Letson (the actuary retained by the Association of Orange County Deputy Sheriffs) dated December 10, 2012. In that memo, Rael & Letson presented various options for consideration by the OCERS Board for changing either the smoothing of prior investment losses or the amortizing of OCERS' current Unfunded Actuarial Accrued Liabilities (UAAL), along with combinations of both changes.

Asset Smoothing Periods

Currently, a five-year period is used by the Board to smooth out any annual investment gains or losses before such amounts are recognized in the UAAL and amortized as part of the employer's contribution rate. In the Rael & Letson memo, they suggest using a longer smoothing period only for the 2011 investment losses, which would recognize that year's losses over either seven or ten years. Any investment gains after 2011 would still be smoothed over five years; however, according to Rael & Letson, "future losses could also be smoothed over an extended period".

We recommend against these proposals because they would result in investment gains being targeted for faster recognition than investment losses. This would result in an asset smoothing method that would be biased relative to the market value in that it would be expected to produce values systematically higher than market value even if average investment returns match the assumed return used in the smoothing method. Such a biased method would be inconsistent with generally accepted actuarial practices.

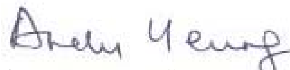
Amortization Periods for UAAL

The Rael & Letson memo also provided options where the employer's contribution rates may be temporarily reduced (in exchange for higher contributions later on) by using longer periods of 25 or 30 years to amortize the System's current UAAL. These proposals are slight variations to alternatives that we have already provided for consideration by the Board. Please refer to slide 47 of our March 18 PowerPoint presentation (which was also discussed on April 15), where we show the effect of reamortizing the current UAAL over 25 or 30 years.

We estimated that reamortizing the December 31, 2011 current UAAL over 30 years would reduce the average employer contribution rate by 4.7% of payroll. That result is comparable to the 4.6% of payroll rate reduction estimated by Rael & Letson under their Funding Option #2. We also showed that reamortizing the December 31, 2011 UAAL over 25 years would reduce current costs by 2.9%. This differs from the Rael & Letson result of 3.07% under their Funding Option #1 only because they have excluded any current amortization layers with amortization periods longer than 25 years. As we have discussed with the Board, if this is the Board's intent then similar results could be obtained in a more straightforward manner by reamortizing the current UAAL over some period between 25 and 30 years.

Please let us know if you have any comments or questions.

Sincerely,



Paul Angelo, FSA, MAAA, FCA, EA
Senior Vice President and Actuary

Andy Yeung, ASA, MAAA, EA
Vice President and Associate Actuary

AYY/gxk

cc: Brenda Shott
Julie Wyne

ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM

MEMORANDUM

DATE: May 9, 2013

TO: Members, Board of Retirement

FROM: Brenda Shott, Assistant CEO Finance and Internal Operations
Cynthia Hockless, HR Manager/Director of Administrative Services

SUBJECT: **2012 Compensation Study**

Recommendation:

Approve OCERS Pay Philosophy as recommended by the Ad Hoc Compensation Committee.

Background:

OCERS contracted with the Hay Group, a human resources consulting firm, in August 2012 to conduct a compensation study of the OCERS direct employees (twenty-two individuals who are management level and above). The purpose of the study is to provide an objective and comprehensive comparison of OCERS' total compensation (salary, bonus and benefits) between OCERS and other public and private sector employees. The intended use of the Hay Group's report was to review OCERS current pay structure against the market and its competitiveness in recruiting new employees and retaining existing employees. The study results are planned to be used as a tool for aligning pay structure with strategic goals with the ultimate outcome being a well-rounded compensation package that is in line with OCERS pay philosophy. The results of Hay Group's work were presented to the Ad Hoc Compensation Committee on April 26, 2013.

Prior to engaging in evaluating specific modifications to the existing pay structure, it is important to first decide and document the strategic and philosophical principles that should be used to design, implement and administer the compensation program to attract, retain and motivate talented employees. The Ad Hoc Compensation Committee met a second time on May 8, 2013 to specifically discuss OCERS' pay philosophy. Based upon information received from the Hay Group, suggested input from the executive management team and the Committee's thorough discussions and deliberations, the Committee is recommending the OCERS Pay Philosophy (Attachment 1) for approval by the Board of Retirement. Once a pay philosophy is established, the next step in the process would be to use that philosophy as the guiding principle to develop the salary structure for OCERS direct employees using the market data received from Hay Group. The salary structure will then be reviewed and vetted by the Ad Hoc Compensation Committee resulting in a recommended salary structure being brought back to the Board of Retirement for adoption at the next regularly scheduled Board meeting.

The Hay Group's presentation is included with this report as Attachment 2. Representatives from Hay Group will be presenting their study results to the Board of Retirement on May 20, 2013.

Attachments 3 and 4 include additional financial information requested by Committee Member Lindholm. The data being provided is intended to give the Board a 10 year trend analysis of OCERS total compensation budgeted costs compared to membership and county revenue. Attachment 5 provides historical portfolio returns compared to county revenue.

Submitted by:

Brenda Shott
Assistant CEO, Finance & Internal Operations

OCERS COMPENSATION PHILOSOPHY

PURPOSE AND BACKGROUND

The philosophy behind the Orange County Employees Retirement System's ("OCERS") compensation program is to create a pay structure with the goal of attracting, developing and retaining strong leaders who support OCERS' mission and values. We believe our compensation program is a management tool that when aligned with an effective communication plan is designed to support, reinforce, and align our values, business strategy, operation & financial needs through professional and proficient staff that provide secure retirement benefits to our members with the highest standards of excellence.

The underlying philosophy governing OCERS' compensation program is designed to accomplish the following:

- Provide pay levels that are externally competitive among peers within our industry and with published market data for similar sized organizations.
- Recognize and reward individual performance, initiatives, growth in job proficiency and achievement of stated goals.
- Provide management the flexibility to make compensation decisions within budgetary guidelines.

OCERS' compensation program is designed to attract, develop, motivate, and retain talented employees who drive the agency's success. We strive to provide a base salary that generally meets the market between the 50th and 75th percentile when employees are fully proficient and meeting expectations. We believe that an employee consistently performing above expectations and that is proficient in his or her role should be rewarded with a higher base pay than the target midpoint. Employees who are either still developing their proficiency level or do not meet expectations would have a base salary that is below the target midpoint. In addition to base salary, OCERS will utilize the Pay for Performance ("P4P") incentive based program as a way to meet strategic goals of the agency. The P4P incentive pay will be available to all employees and will be based on individual goals that relate to the agency goals as well as overall performance.

In alignment with our organization's culture, we will strive to communicate openly about the goals of the agency and the design of the compensation program. The compensation process is intended to be fair and uncomplicated so that all employees and managers understand the goals and the outcome of the process.

OCERS retains the services of nationally recognized consulting firms to assist the agency in benchmarking compensation. The most recent compensation study was conducted in January, 2013.

COMPENSATION STRATEGY

Competitive Set: OCERS' will benchmark all positions with comparable positions at other governmental entities; including California based retirement systems, and with published general market survey data for organizations that have similar sized budgets and/or assets under management. We believe that this definition of a competitive set is most representative of our market for attracting and retaining employees.

Degree of Competitiveness: The target midpoint for salary ranges will generally be between the 50th and 75th percentile of market base pay, which recognizes the higher reported average labor cost in Orange

County in comparison with other employers surveyed statewide and nationally. Positions similarly valued by the market and/or by OCERS will be grouped together for the purpose of developing internal equity. Positions grouped together will be assigned the same salary range. The group will be defined as a pay grade. The target midpoint for a pay grade will be calculated by blending the market data for all positions in the group. The ranges will be developed adding and subtracting 20%-25% from the established midpoint. Individual placement against the target midpoint will be based on education, experience and internal equity at the time of hiring.

Adjustment to ranges: On an annual basis, during OCERS budget development, the approved base salary ranges will be adjusted by U.S Bureau of Labor and Statistics' most recently published 12 month Consumer Price Index-All Urban Consumers for the Los Angeles-Riverside-Orange County area. The automatic adjustment to the approved salary range will not automatically impact any individual's salary.

Movement within salary ranges: OCERS' will use an annual merit pool to award annual salary increases to employees. Increases will be awarded based on an employee's performance during the preceding calendar year. The amount of base pay increases awarded to each employee may include both a component of cost of living (same CPI index as used to adjust the range annually) and a merit increase, to provide movement of employees within their given salary range. The merit portion of base pay adjustments will be awarded based upon the written annual performance evaluation prepared by the employee's direct supervisor and reviewed by the Executive responsible for the respective department. Such evaluation will address the employee's job proficiency, demonstration of meeting stated job expectations, and achievement of stated individual goals. The merit portion of salary increases will be 0-2% of base pay for Meets Expectations, 2.5%-5% of base pay for Exceeds Expectations and 5.5% - 8% of base pay for Exceptional Performance (an Exceptional Performance rating will require approval by both the CEO and the Board Chairman). Individuals receiving "Needs Improvement" or "Does Not Meet Expectations" in the annual performance evaluation will not receive any increase to salary (neither merit nor cost of living).

The annual funding of the merit pool will be based upon both the performance of the portfolio for the year in which employees' performance is being evaluated and the county's governmental funds tax revenue for the most recent available financial statements or financial updates as follows:

- Merit pool is NOT funded at all if OCERS portfolio has negative returns AND the county's governmental funds tax revenue declined from the previous year.
- Merit pool is funded at one half of the normal level if OCERS portfolio earns positive return.
- Merit pool is funded at the normal level if the OCERS portfolio achieves the actuarial assumed rate of return AND the county's governmental funds tax revenue growth is positive.
- Merit pool is funded at one and a half times the normal level if OCERS portfolio earns more than one and a half times the actuarial assumed rate of return and the county's governmental funds tax revenue growth is at least 3%
- The CEO may request from the Board of Retirement a special budgetary provision to recognize extraordinary performance in special situations.

Incentive Pay: OCERS utilizes a Pay for Performance (P4P) program to reward employees for outstanding performance and for an individual's contribution to the achievement of the goals set in OCERS' Annual Business Plan and OCERS' Strategic Plan. The P4P program offers an individual incentive of up to 2.5% of their existing base pay as non-base building lump sum payment (to align with

the County's current P4P program). The P4P incentive must be re-earned during each measuring period and is considered "at risk" pay (meaning it is not guaranteed nor promised to the employee as a regular salary item each year). The funding and annual administration for the P4P program will be consistent with the funding methodology and administrative thresholds for the merit pool.

Review of philosophy: The compensation philosophy will be reviewed every 2 years or on an as needed basis either by the full Board of Retirement directly or initially by an ad hoc committee designated by the Chairman of the Board that will make recommendations to the full Board. Revisions will be made to the philosophy as needed to keep pace with current market conditions. Every four (4) years a compensation study shall be conducted.

Version Control:

Version	Date	Changes from previous version
1.0	05/09/2013	Initial Draft –to Board

Review:

Reviewed by	Signature	Date

Approval:

Approved by	Signature	Date