

## **PENSION REFORM ACTION PLAN July 2011\***

This report to the League of California Cities Employee Relations and Revenue and Taxation Policy Committees and the Board of Directors is designed to address the League's 2011 Strategic Goal related to Pension Sustainability by providing information and recommendations that may be of assistance toward meeting the competing challenges of maintaining high-quality public services while providing fair and reasonable pensions for employees.

### **THE PROBLEM**

Pension costs for many California municipalities continue to increase, threatening the delivery of basic public services, compromising general fund budgets, and indeed, posing a long-term fiscal challenge to the State itself. A former CalPERS actuary warned that by 2014 it will be common for local governments to budget 50% of a police officer's salary, 40% of a fire fighter's salary and 25% of a miscellaneous employee's salary for their pensions; contributions that are fiscally unsustainable. Many cities face 25% or more increases in pension contribution costs in the next three years and those rates are likely to remain high for a decade or more. Causes of the problem include:

1. Large losses on pension investments due to the Great Recession.
2. Enhanced benefit formulas granted after 1999 (SB400/AB616).
3. Increased life span of retired employees.

### **A PRINCIPLED APPROACH**

Public retirement systems should provide fair benefits for career employees, and:

1. Recognize the value of attracting and retaining high performing public employees to design and deliver vital public services to local communities.
2. Recognize and support the value of a dependable, sustainable, employer provided Defined Benefits Plan (DBP) for career employees; supplemented with other retirement options including personal savings (e.g. 457 Plan).
3. Public pension costs should be shared by employees and employers (taxpayers).
4. Be portable across all public agencies to sustain a competent cadre of California public servants.

### **STAGES OF A SOLUTION**

Many of the steps below can, are, and should be taken locally and immediately, as part of the collective bargaining process to move local pension costs in a more sustainable direction. Further, State action is necessary to return the PERS (or other state-authorized pension systems) to a more sustainable framework. Many of the actions below are and will be presented

\*Minor edits were made to this document on Nov. 23, 2011. For a copy of the changes please email [nkarl@cacities.org](mailto:nkarl@cacities.org).

to the State Legislature for enactment. We believe the League of California Cities should engage the unions, Legislature, and Governor in the legislative process to formally change the structure of PERS thus protecting the fiscal integrity of cities and PERS retirement for public employees. This could include jointly sponsoring an initiative if legislative change is insufficient.

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### **ACTIONS CITIES CAN AND ARE TAKING NOW AT THE COLLECTIVE BARGAINING TABLE TO REDUCE COSTS**

1. Have employees pay the employee's share of PERS costs: 7-8% for miscellaneous employees and 8-9% for safety employees.
2. Provide a two-tier retirement system with new hires being placed in a reduced benefit tier.
3. Allow employees to pick-up a portion of the employer's PERS costs up to PERS limits through negotiation to better share the normal costs of pensions.
4. Base final retirement salary on the three highest years worked.
5. Eliminate the PERS contract option of including Employer Paid Member Contribution (EPMC) in the calculation of an employee's base pay for retirement purposes.

A City Managers Department survey in February 2011 indicates one in five cities responding to the survey have implemented a second tier for new hires. Further, the majority of cities surveyed (61%) are currently negotiating pension reforms.

### **ACTIONS NEEDED FROM THE STATE TO RESTORE THE SUSTAINABILITY OF PENSION PROGRAMS**

Courts have held that current and former local government employees have rights to the pensions promised them at hiring. As such, the following recommendations most likely would not pertain to former employees or the prospective benefits of current employees.

A Defined Benefit Plan is the most effective vehicle to accumulate and distribute pension benefits and is the preferred retirement system for municipal employees. According to staff of the National Institute of Retirement Security, dollar for dollar, a Defined Benefit Plan yields considerably more (46%) retirement savings than a Defined Contribution Plan.

The subsequent action items can be considered individually or in combination to improve the sustainability of PERS, thus, re-designing a system that will contribute to safeguarding public pensions. The following recommendations, with support from labor, would level the field on a statewide basis and lead to a maintainable PERS for public employees.

1. Repeal SB400/AB616 returning to more sustainable PERS benefit formulas of 2% at 60 for miscellaneous employees and 2% at 55 for safety employees.

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2. Have PERS provide a broader range of formula choices with lower benefit local options for all types of member classes.
3. Base final retirement salary on three highest paid years worked.
4. Prohibit enhancing the second tier pension formulas for twenty years.
5. Calculate benefits only on base salary eliminating all "spiking." No overtime, vacation or sick leave included in the pension calculation.
6. Eliminating the purchase of "air time" (purchase of time not served)
7. Eliminate the availability of Employer Paid Member Contribution (EPMC).
8. Require employees to pay the employees share of PERS (e.g. 7-8% for miscellaneous employees and 8-9% for safety employees.)
9. Remove caps on the percentages employees can pay for the total cost of PERS programs.
10. Give Government agencies through the collective bargaining process the option to extend retirement ages for miscellaneous employees up to social security retirement ages. Seek minimum (floor) retirement age of 60 for miscellaneous employees and 55 for safety employees before earning full retirement benefits.
11. Prohibit retroactive pension benefit increases.
12. Meet any retirement needs for part-time employees with alternatives to a Defined Benefit Plan.
13. Delete the 1,000 hours rule for part-time employee mandatory enrollment in CalPERS.
14. Prohibit employees and employers from taking contribution "holidays."
15. Provide employers with a hybrid pension system option that caps the Defined Benefit PERS pension at an annual maximum retiree benefit equal to 70% of the retiring employees' eligible base pay (determined by averaging the 3 highest year's pay) and supplement the DBP with a risk managed PERS defined contribution plan. A DCP should integrate with a DBP not, as some pension revision plans suggest, substitute for it.
16. Eliminate the requirement that any negotiated changes in pension benefits under the Public Employees' Retirement Law (PERL) be voted on twice by the affected employees.

#### **ADDITIONAL STEPS THAT APPEAR NECESSARY TO RESTORE PERS TO SUSTAINABILITY AND PROVIDE TRANSPARENCY**

1. Pension sustainability cannot be fully achieved without addressing the benefits of both current and future employees. To the extent permitted by federal and state law, a well-designed State Constitutional Amendment or comprehensive legislative overhaul is needed for prospective retirement formula reductions and incremental retirement age increases for current employees to guarantee their already accrued benefits, while making the plan sustainable, affordable and market competitive on a going-forward basis. The amendment should also include a risk-managed PERS Defined Contribution Plan for public agencies.
2. The PERS Board needs to be restructured with a substantial increase in independent public members (preferably with financial expertise) to ensure greater representation of tax payer interests with regard to public pension decisions.

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3. Set uniform standards and definitions for disability benefits and evaluate the level of benefit that is considered as tax exempt. The tax exempt portion should either be eliminated or allowed on a proportional basis to the severity of the disability.
4. If the above reforms prove unfeasible or ineffective, consider a standard public employee pension system where one benefit level is offered to every employee as a further option to restore sustainability to PERS.
5. While not addressed in this paper, Other Post-Employment Benefits (OPEB), such as retiree health care, represents another unfunded liability for many local agencies and must be addressed through comprehensive reform measures.
6. Develop a program with the State to ensure that pension programs offered by localities are fully transparent, and that professional actuarial evaluations of unfunded components of OPEB's and Pension Plans are completed.
7. To the extent permitted by federal and state law prohibit payment of pension benefits to a public employee convicted of a felony related to fraudulently enhancing those benefits.

While pension reform is a primary fiscal challenge facing local agencies, it represents but one of several financial challenges that, when combined, represent a "Perfect Storm" that is leading to the insidious erosion of fiscal solvency of local governments. While some changes may take years, delay in dealing with the problem, only makes the situation worse.

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