Cal PERS Basics and Pension Reform

Cities Association of
Santa Clara County
May 12, 2011

Pension Basics

- Defined Benefit Plan

  A guaranteed annual pension based on factors such as retirement age, years of service, and salary

- Defined Contribution Plan

  A promise to pay a certain amount of money into a pension fund with the amount paid out dependent upon the performance of the portfolio

CalPERS Basics

- Normal Cost =

  Value of benefits earned by active employees during the current fiscal year

- Unfunded accrued actuarial liability =

  Amount of accrued pension liabilities that exceed assets

- Actuarial report for cities prepared annually in October with rate set for two years in future and one or two years rate estimate

CalPERS Basics

- Employer contribution rate = Normal Cost + amortization of unfunded liability
- Employee rate is set by statute and does not change
  - Miscellaneous = 7 or 8%
  - Safety = 9%
- Employee rate can be paid by employee or employer (EPMC)
  - If paid by employer, pay is usually “grossed up” by EPMC amount
- Interest on assets have funded 65 - 75% of retirement benefits

CalPERS Basics

- Retirement formulas = Service years x final average compensation x benefit factor

- Example:

  35 years x $100,000 x 2.7 = $94,500

- Example with “grossed up” EPMC:

  35 years x $108,000 x 2.7 = $102,060

CalPERS Basics

- Current problem:
  - Pension costs increasing rapidly
  - Pension costs for cities will have risen 25 - 40% in next few years from 2009-10 base
  - Rates will stay high for years to come
  - Cost of pensions is threatening basic public services

CalPERS Basics

- Causes of problem:
  - Enhanced benefit formulas
  - Drop in value of assets due to dot.com bust and "Great Recession" and to chasing of returns
  - Early retirement and increased life span of employees

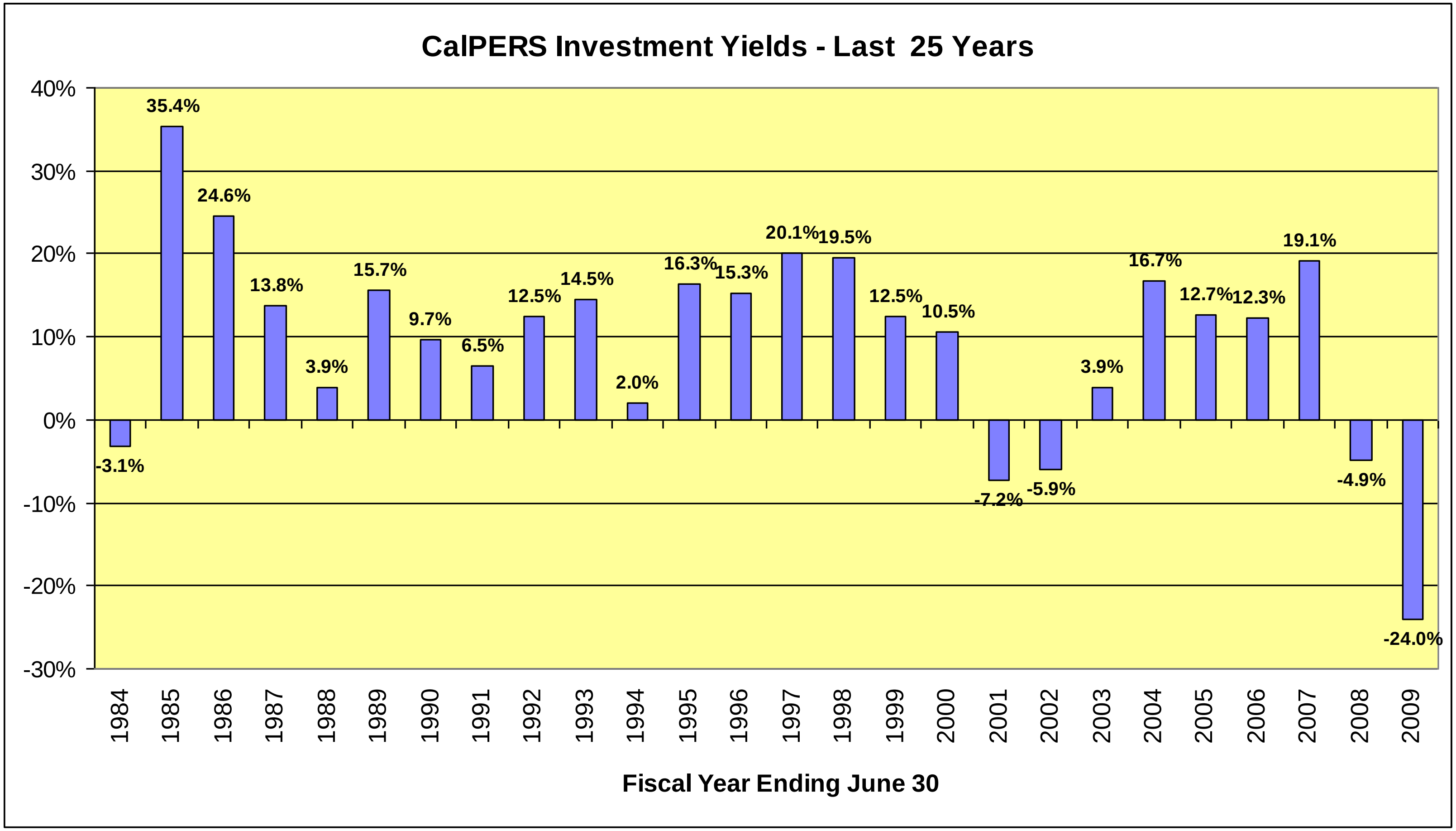
Enhanced Benefits

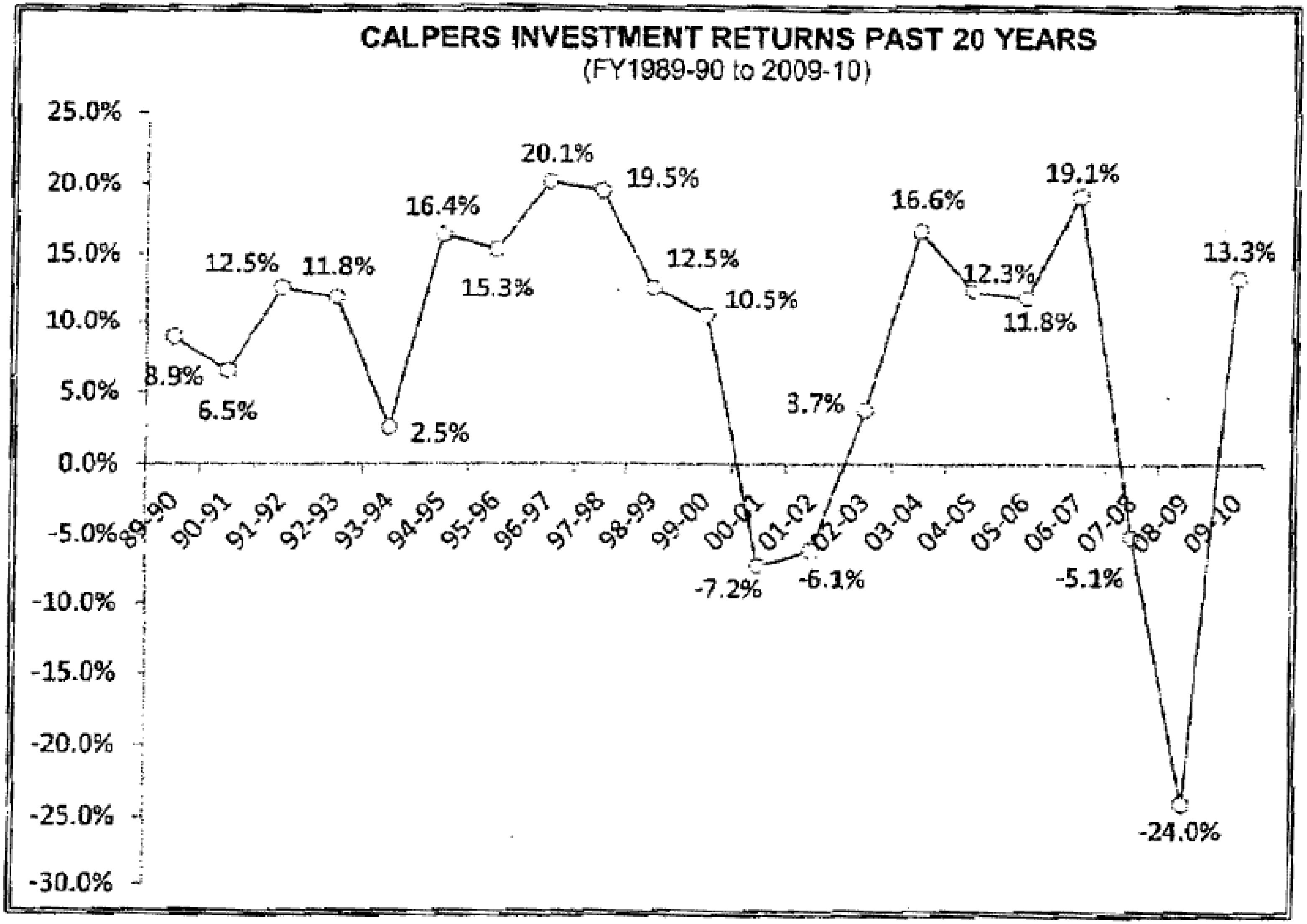
- State law allowed higher benefits in era of "super funding"
  - SB 400 (Public Safety) 1999
  - AB 616 (Miscellaneous) 2000
  - CalPERS estimated "zero cost" to new benefits
- Common enhanced formulas
  - Miscellaneous 2.5 @ 55 or 2.7 @ 55
  - Public Safety 3 @ 50

Investment Losses

- CalPERS assumes investment return of 7.75%
- Historically, returns have been above this level
  - Return last 20 years was 7.9%
- Because returns follow economic cycle, actuarial methods “smooth” the gains and losses to lessen impacts and provide predictability
- Two catastrophic losses in last decade have caused unprecedented impacts on rates

Investment Losses: 1984 - 2009





CALPERS INVESTMENT RETURNS PAST 20 YEARS
(FY1989-90 to 2009-10)
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
-5.0%
-10.0%
-15.0%
-20.0%
-25.0%
-30.0%
89-90
90-91
91-92
92-93
93-94
94-95
95-96
96-97
97-98
98-99
99-00
00-01
01-02
02-03
03-04
04-05
05-06
06-07
07-08
08-09
09-10
8.9%
6.5%
12.5%
11.8%
2.5%
16.4%
15.3%
20.1%
19.5%
12.5%
10.5%
-7.2%
-6.1%
3.7%
16.6%
12.3%
11.8%
19.1%
-5.1%
-24.0%
13.3%

Investment Losses

- "Do the math!"
  - More than 45% of portfolio value lost in Great Recession
  - Previous loss in dot-com bust was 33%
  - Latest return of 13.3% in 2010 brings us back to 62% of portfolio in 06/07!
  - New asset allocation plan adopted in December is more conservative
  - Rates will be impacted for several decades

Demographic Study

- CalPERS-wide study scheduled every five years to verify assumptions on life expectancy, retirement, and salary increases
- Completed in 2010 for use in 2011/12 rate setting
- First study that reflects enhanced benefit formulas

Demographic Study

- Conclusions:
  - Longer post retirement life expectancy
  - Earlier retirement ages (after enhanced benefits)
  - Higher salary increases than projected
- Approximate impacts on plans:
  - 1.1 – 1.7% of payroll increase for miscellaneous
  - 1 – 2% increase for public safety
- Impacts on higher plans more severe

What Else Is Out There?

- Change to investment assumption rate
  - Based on new asset allocation, Chief Actuary recommended .25 basis point reduction
  - Avoided this time but inevitable?
- Cash flow considerations
  - Pensions over $100,000 increasing rapidly with enhanced retirement
  - Baby boomer retirement wave
- GASB proposal to shorten amortization
- Impact of furloughs/lower wages on contributions

Need for Pension Reform

- Pensions are becoming fiscally unsustainable in our “new normal” economy
- Public pensions now outstripping private pensions
- Taxpayer outrage in time of economic downturn
- Need a pension plan that is:
  - **Affordable**
  - **Adequate**
  - **Appropriate**

Pension Reform

- Public Employees Retirement Law (PERL) limits what can be done
- Concept of "vested rights" strong in California, but being litigated in other states
- LOCC Survey
  - Second tier pensions being adopted
    - 2 @ 60 for miscellaneous
    - 3 @ 55 or 2 @ 50 for safety
    - Three year average final compensation

Pension Reform

- LOCC Survey (cont)
  - Trend is toward employees paying EPMC
    - 8% miscellaneous
    - 9% safety
  - Some cities have employees paying portion of employer cost
    - Can be done via contract amendment or MOU
  - 62% of responding cities considering changes to pension plans

Governor’s Pension Reform Plan

- Prohibit pension spiking
- Prohibit retroactive pension increases
- Eliminate purchase of “air time”
- Prohibit pension holidays
- Prohibit employer paid member contributions
- Impose pension benefit cap
- Offer hybrid option
- Loss of pension for felony conviction

Little Hoover Commission

- Added recommendations:
  - Allow authority to change retirement benefits for current employees
  - Cap pensions or pensionable salaries
  - Change pension eligibility ages
  - Pension increases to be submitted to voters

League City Managers Dept Pension Reform Committee

- Recommendations that are currently possible:
  - Employees pay full employee share
  - Have employees pick up portion of employer cost
  - Provide two-tier system for new hires
    - Base retirement on three highest years

League City Managers Dept Pension Reform Committee

- Recommendations that will require changes to PERL:
  - Repeal enhanced benefit formulas
  - Tighten pensionable wages
  - Eliminate purchase of "air time"
  - Prohibit retroactive pension increases
  - Change PERS vesting period
  - Provide more formula choices with lower benefit local options

Other Pension Reform Proposals

- California Foundation for Fiscal Responsibility
- Former Assemblyman Roger Niello
- California United for Fiscal Reform

- “If we don’t fix it, it will be done to us!”

Myths and Misconceptions

- Two-tier retirement systems don't save money
  - Not true: you have to pay the unfunded liability anyway, and normal cost is substantially less
    - Savings starts within first several years depending on turnover rate
- Your employer rates are covering costs
  - Not true: currently CalPERS payment structure does not even fully cover interest costs ("negative amortization")
- Retirement benefits cap at 90% of pay
  - This is true for Safety, but Miscellaneous can exceed 100% depending upon years of service

Questions?