

League of California Cities **A Framework for Public Pension Reform¹**

General Pension Reform Principles

The task force assigned to work on this issue for the members of the League of California Cities felt very strongly that any serious discussion of public pension reform must begin with a set of principles/goals. Until goals are defined, the task force believed it would be at least premature and perhaps self-defeating to make any recommendations on the benefit levels needed to achieve a public agency's goals. In keeping with this direction, the task force recommended and the League Board of Directors adopted the following principles to guide any benefit reform recommendations:

- The primary goal of a public pension program should be to provide a full-career employee with pension benefits that maintain the employees' standard of living in retirement.
- The proper level of public pension benefits should be set with the goal of providing a fair and adequate benefit for employees and fiscally sustainable contributions for employers and the taxpayers.
- Public pension benefits should be supported with proper actuarial work to justify pension levels. Policy-makers should reject any and all attempts to establish pension benefits that bear no relation to proper actuarial assumptions and support.
- Pension benefits should be viewed in the context of an overall compensation structure whose goal is the recruitment and retention of employees in public sector jobs. In recognition of competitive market forces, any change in the structure of retirement benefits must be evaluated in concert with other adjustments in compensation necessary to continue to attract and retain an experienced and qualified workforce.
- The reciprocity of pension benefits within the public sector should be maintained to ensure recruitment and retention of skilled public employees - particularly in light of the retirement of the post World War II "Baby Boom" generation which will result in unprecedented demands for new public sector employees.

¹ This report constitutes the recommendations of the League Pension Reform Task Force that was accepted by the League of California Cities Board of Directors for distribution as a discussion draft.

- Perceived abuses of the current defined benefit retirement programs need to be addressed. Benefit plans which result in retirement benefits which exceed the levels established as appropriate to maintain employees' standard of living should be reformed. It is in the interest of all public employees, employers and taxpayers that retirement programs are fair, economically sustainable and provide for an acceptable level of benefits for all career public employees, *without providing excessive benefits for a select few*.
- The obligation to properly manage public pension systems is a fiduciary responsibility that is shared by PERS, employers and employees. This joint responsibility is necessary to provide quality services while ensuring long-term fiscal stability. These parties need to be held accountable to ensure a high level of protection against mismanagement of public resources that could jeopardize a community's ability to maintain services and provide fair compensation for its workforce.
- Charter cities with independent pension systems should retain the constitutional discretion to manage and fund such pension plans.

Reform Recommendations

Public employee defined benefit programs have been appropriately criticized in a number of areas. The following reform recommendations address short-comings within some defined benefit retirement programs, while preserving the aspects of the program that have served the employees, employers and taxpayers of California well for over 60 years.

Pension Benefit Levels

Principles: Public pension benefit plans should:

- Allow career-employees to maintain standard of living post-retirement.
- Be designed with consideration of age at retirement, length of service, compensation level and applicability of Social Security.
- Be supported with proper actuarial work to support reasonable pension levels. Policy-makers should reject any and all attempts to establish pension benefits that are not supported with proper actuarial assumptions and work.
- Promote career public service without creating incentives to work past retirement age, nor disincentive to early retirement. Employees who voluntarily choose to either work beyond retirement age or retire early should not be penalized or rewarded.

Recommendations

- Maintain the defined benefit plan as the central pension plan for public employees in California.
- Rollback/repeal public retirement plans that provide benefits in excess of levels required to maintain a fair, standard of living² that are not financially sustainable and are not supported by credible actuarial work. The new and exclusive benefit formulas to achieve these goals should be:
 1. **Safety Employees:** 3% @ 55 formula, offset by 50% of anticipated social security benefit for safety employees with social security coverage. Safety employees retain the current cap on retirement at 90% of final compensation.
 2. **Miscellaneous Employees(Non-safety):** 2% @ 55 formula, offset by 50% of anticipated social security benefit for miscellaneous employees with social security coverage. A cap of 100% of final compensation is placed on newly-hired, miscellaneous(non-safety) employees.
- The above formulas should incorporate a “Three-Year-Average” for “final compensation” calculation. All “Highest Final Year” compensation calculations should be repealed for newly-hired employees.
- Provide alternatives to a defined benefit plan for job classifications not intended for career public service employment.
- Give employers greater flexibility to determine when a part-time employee is entitled to public pension benefits. The current hourly threshold in PERS is too low.

Rate Volatility

Principles

- Responsible fiscal planning suggests the need to “manage” volatility in defined benefit plan contribution rates.
- Rates have historically been relatively constant and comparable to rates currently paid by most public agency employers.
- Recent rate volatility is primarily due to large fluctuations in annual investment returns for the retirement plan investment portfolios, causing significant changes in plan funding status.
- Normal Costs for defined benefit plans have remained relatively constant over time.

² This should be determined in accordance with a Cal PERS 2001 target replacement benefit study and/or the Aon Georgia State Replacement Ration Study (6th update since 1988).

Recommendations

- Public Agency retirement contribution rates, over time, should be constructed to stay within reasonable ranges around the historical “normal cost” of public pension plans in California. Sound actuarial methods should be adopted to limit contribution volatility while maintaining a defensible funding policy.
- Establish “reserve” funding for public pension systems that will help smooth the volatility of pension benefit costs. Plan surpluses are to be retained within plan assets, but should be reserved for amortization of future unfunded liabilities, and should not be used to offset plans’ normal cost contribution rates.

Shared Risk

Principles

- Currently, in most local jurisdictions, employers shoulder the burden of rate volatility risk – both positive and negative. This principle should be carefully examined with the intent of better spreading the risk of rate volatility among both employers and employees.
- Negotiated labor agreements containing language whereby employers “pick-up” employees’ retirement contributions are assumed to be part and parcel of a “total compensation” package; this implies that agencies with Employer Paid Member Contributions would also typically reflect correspondingly lower base salaries.

Recommendations

- When employer contribution rates exceed the “normal costs” threshold, employees should be expected to take some of the financial responsibility for those excessive increases.

Disability Retirement

Principles

- Retirement-eligible employees who are injured in the workplace should be entitled to full disability retirement benefits; disability retirement benefits should, however, be tied to individual’s employability and be structured so as to encourage return to work, where applicable.
- Larger disability reform measures should be considered outside of the scope of general pension reform.

Recommendations

- Full tax-exempt disability retirement should be retained for employees who are injured and cannot work in any capacity
- Reform the disability pension provisions of public retirement systems to restrict benefits when a public employee can continue to work at the same or similar job after sustaining a work-related injury.
- Employees eligible for disability retirement should be first afforded applicable service retirement benefits, and THEN provided disability retirement benefits up to applicable “cap” on total retirement benefits.

Portability of Plan Benefits

Principles

- Reciprocity of public agency retirement benefits is critical to recruitment of qualified, experienced public sector employees.
- Limiting portability of retirement plan benefits to non-public sector employment helps in the retention of senior and management level employees.

Recommendation

- Any pension reform package should retain transferability of retirement benefits across public sector employers. No employee currently in a defined benefit plan should be required to involuntarily give up a defined benefit formula before retirement.

Tiered Plans

Principles

- Agencies should strive to avoid multi-tiered compensation structures where there are large discrepancies in benefits accruing to employees. In addition to having adverse impacts on recruitment and employee morale, multi-tiered approaches can raise issues of comparable worth and equity.

Recommendations

- Any pension reform measures should seek to minimize disparity between current and prospective public agency employees.
- Any reduction(s) or change(s) to current Defined Benefit plans should be considered in context of other compensation issues that will tend, over time, to “equate” compensation plans within and across public agency employers.

Management Oversight

Principles

- The obligation to properly manage public pension systems is a fiduciary responsibility that is shared by PERS, employers and employees. This joint responsibility is necessary to provide quality services while ensuring long-term fiscal stability. These parties need to be held responsible to ensure a high level of protection against mismanagement of public resources that could jeopardize a community's ability to maintain services and provide fair compensation for its workforce.

Recommendations

- Public agencies that do not make the Annual Required Contribution under GASB 27 should be made subject to appropriate oversight.
- The membership of the Public Employees and Retirement System Board should be changed to achieve both a better balance of employer and employee representatives as well as a better balance of public agency representatives.

Conclusion

Defined benefit retirement plans have been the traditional approach for close to 60 years in California and have produced fair and sustainable retirement benefits that have been central to recruiting and retaining quality public employees. Defined benefit plans should be retained as the central component of public pension systems in California.

