THE PUBLIC RETIREMENT JOURNAL

Pension Reform, Future Contribution Rates and Other Fun Stuff

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Agenda

- Governor Brown's Pension Proposal
  - Background
  - Little Hoover Commission
- CalPERS Analysis of Governor Browns Proposal
- GASB Pension Exposure Draft
- What Can you Do About Increasing Pension Costs?
  - Short Term
  - Long Term

Background

Background
CalPERS Contribution Rates

- Likely to continue to increase and remain high for 20-30 years
- Absent extended very high investment returns
  - 10-15% for several years
  - None predicted by independent investment advisors

Background
Unfunded Liability

- CalPERS Asset Smoothing Defers Recognition of Asset Losses
  - Modification of corridor extended deferral further
- Results in Continuation of Significant Difference Between Market and Actuarial Funded Status
- No Bright Line Test of What is Well or Poorly Funded Plan
  - Contribution Policy can have a big impact
  - What you are doing about contribution level is more important then current Funded Status

Governor Brown's

Pension Proposal

Governor's Pension Proposal

Current Employees (Subject to Constitutional Review)

1. Eliminates Air Time and Additional Retirement Service Credit Purchase
2. Forfeit Benefits for Felony Related to Official Duties
    a. Does not include service < commission of felony
3. No Retroactive Benefit Enhancements

Governor's Pension Proposal

Current Employees (Subject to Constitutional Review)

4. Members pay 50% of Normal Cost
   a. 3 Year Phase In
   b. Miscellaneous:
      a. 2@55 — 7% → ≈9+%
      b. 2.7@55 — 8% → ≈9+%
      c. Safety 2@50: — 9% → ≈11+%
      d. Safety 3@50: — 9% → ≈13+%
5. Agency Can Not Pay Any Portion of Member Rate
6. Offered Hybrid Plan (in Lieu of Current Formula)
7. Limited Ability to Work After Retirement

Governor's Pension Proposal
Hybrid Plan

- Defined Benefit/Defined Contribution and Social Security (if applicable)
- Target 75% of Final Compensation
  - Full Career (30/35 Years of Service) at Normal Retirement Age
- Normal Retirement Age:
  - Safety: age 57
  - Miscellaneous: age 67

Governor's Pension Proposal
Hybrid Plan

- Early Retirement:
  - Actuarial Reduction for Retirement < Normal Retirement Age
  - Safety – Age 52
  - Miscellaneous – Age 57
- Benefit Cap
  - IRS Limits
  - 2012:
    - With Social Security ≈$110,000
    - Without Social Security ≈$132,000

Governor's Pension Proposal

New Employees – Hired $\geq$ 7/1/2013

8. Hybrid Plan or Other Plan With No Greater Risk to Employer
9. Three-Year Final Compensation
10. Calculate Benefits Based on Regular, Recurring Pay

Governor's Pension Proposal

Employers

11. Prohibit Contribution Holidays
    a. Minimum Contribution of Employer Normal Cost

Governor's Pension Proposal

Governance

12. Change CalPERS Board Makeup
    a. Eliminate State Personnel Board Representative
    b. Eliminate Insurance Company Executive
    c. Add Four Members:
        i. One with Health Insurance Expertise
        ii. One Local Agency Elected Official
        iii. Two with Financial Expertise
        iv. Appointed by the Governor

Governor's Pension Proposal
PEMHCA

13. State Vesting
    a. Minimum service increased to 15 years
    b. 25 years to get to 100%
    c. Actuarial reduction for retirement < Normal Retirement Age

Little Hoover Commission
Legislature Must:

- Create new (hybrid) pension options
- Pensionable Wages:
  - Limit Pensionable Wages to Base Pay
  - Mandate five-year average
- Discourage early retirement
- Set uniform standards for
  - retirees returning to work and continuing to receive pensions
  - disability benefits.

Little Hoover Commission
Legislature Must:

- Exclude service in an elected office.
- Eliminate “air time” service purchase
- Strengthen standards for revoking or reducing pensions of those convicted of crimes involving public trust
- Prohibit contribution “holidays,” except under rare circumstances

Little Hoover Commission
Legislature Must:

- Prohibit retroactive pension increases
- Require annual adjustment of (employee & employer) pension contributions based on an equal sharing of the normal costs of the plan
- Require retirement boards to add a majority (or a substantial minority) of independent, public members
- Require additional pension disclosure

Little Hoover Commission
State and Local Governments Must:

- Explore options for coordinating pension benefits with Social Security
- Submit all proposed pension increases to voters

Little Hoover Commission

State Controller's

Public Retirement Systems Annual Report

- Expand to include additional disclosure
- Timely report production
- Consider administrative fees to pension systems as a funding source

Little Hoover Commission
Legislature Should:

- Give state and local governments authority to alter future accruals

CalPERS Analysis of Governor Brown's Pension Proposal

CalPERS Analysis of Governor's Pension Proposal

- Released February 14th
- Based on Governor's 12 point Plan
- Not based on Governor's January 31st Draft Constitutional Amendment or February 2nd Draft Legislation

Safety
Benefits Valued

	Not Eligible for Social Security	Eligible for Social Security
■ DC Plan Target	25%	25%
■ DB Plan	50%	25%
■ Normal Retirement Age	57	57
■ Benefit Factor at NRA	1.667%	0.833%
■ PRSA	50%	25%

Safety
Benefits Valued

	Not Eligible for Social Security	Eligible for Social Security
■ IDR	50%	50%
■ COLA	2% with PPPA	2% with PPPA
■ Member Contribution	50% of Total Normal Cost	50% of Total Normal Cost
■ Early Retirement	6% Reduction per Year Retirement < NRA	6% Reduction per Year Retirement < NRA

Miscellaneous Benefits Valued

	Not Eligible for Social Security	Eligible for Social Security
DC Plan Target	25%	25%
DB Plan	50%	25%
Normal Retirement Age	67	67
Benefit Factor at NRA	1.429%	0.714%
PRSA	50%	25%

Miscellaneous Benefits Valued

	Not Eligible for Social Security	Eligible for Social Security
■ COLA	2% with PPPA	2% with PPPA
■ Member Contribution	50% of Total Normal Cost	50% of Total Normal Cost
■ Early Retirement	6% Reduction per Year Retirement < NRA	6% Reduction per Year Retirement < NRA

Assumptions

- Consistent with June 30, 2010 CalPERS Valuations
  - Except Retirement Rates
- Public Agency Expected Retirement Ages:
  - Miscellaneous 62.5
  - Safety 57.3

Assumptions

- Likely Understates Safety Disability Cost:
  - IDR Benefit Remains at 50% (Current Year)
  - But DB Maxes Out at 50% (3 Year Average)
- Could be Mitigated if DC Account Forfeited when Accepting Disability Benefit

Public Agency Safety Results

	Not Eligible for Social Security	Eligible for Social Security
■ DC Plan	11.0%	11.0%
■ DB Plan	15.1	10.2
■ Total	26.1%	21.2%
■ Member Cost	13.1%	10.6%
■ Employer Cost	13.1%	10.6%

Public Agency Safety Results

	Not Eligible for Social Security	Eligible for Social Security
■ Employer Cost	13.1%	10.6%
■ 2@50 Normal Cost	16.9%	16.9%
■ 3@55 Normal Cost	18.2%	18.2%
■ 3@50 Normal Cost	19.9%	19.9%
■ 2@50 Savings	3.8%	6.3%
■ 3@55 Savings	5.1%	7.6%
■ 3@50 Savings	6.8%	9.3%

- Above Current Employer Normal Costs estimated by Bartel Associates; not included in CalPERS Report

Public Agency Miscellaneous Results

	Not Eligible for Social Security	Eligible for Social Security
■ DC Plan	6.4%	6.4%
■ DB Plan	7.1	3.8
■ Total	13.5%	10.2%
■ Member Cost	6.8%	5.1%
■ Employer Cost	6.8%	5.1%

Public Agency Safety Results

	Not Eligible for Social Security	Eligible for Social Security
■ Employer Cost	6.8%	5.1%
■ 2@60 Normal Cost	7.0%	7.0%
■ 2@55 Normal Cost	8.1%	8.1%
■ 2.7@55 Normal Cost	10.5%	10.5%
■ 2@60 Savings	0.2%	1.9%
■ 2@55 Savings	1.3%	3.0%
■ 2.7@55 Savings	3.7%	5.4%

- Above Current Employer Normal Costs estimated by Bartel Associates; not included in CalPERS Report

State Results

- Modest savings for State:
  - Miscellaneous,
  - Schools,
  - Fire (3%@55)
- Modest additional cost for State:
  - Fire (2.5%@55)
  - CHP
- Lower Savings for State than Public Agencies:
  - Higher Member Contribution Rates

Pension and OPEB Discount Rates

CERBT Alternative Investment Mixes

- Additional CERBT asset allocations
  - Agency selects one option on or after July 1, 2011
- Target asset allocations

Asset Classifications	Option 1	Option 2	Option 3
Global Equity	66.0%	50.1%	31.6%
US Nominal Bonds	18.0%	23.9%	42.4%
REIT's	8.0%	8.0%	8.0%
U.S. Inflation Linked Bonds	5.0%	15.0%	15.0%
Commodities	3.0%	3.0%	3.0%
Total	100.0%	100.0%	100.0%

CERBT Alternative Investment Mixes

- CalPERS reported expected returns (20 year period):

	Option 1	Option 2	Option 3
75% Confidence Limit[1]	5.80%	5.60%	5.25%
50% Confidence Limit	**7.61%**	**7.06%**	**6.39%**
25% Confidence Limit	9.43%	8.52%	7.47%
Standard Deviation	11.73%	9.46%	7.27%

- Agency selects discount rate, not CalPERS
- Requirement that discount rate cannot be greater than 50% confidence limit rate

CERBT Discount Rate Development

- 1st 10 years expected returns – based on asset advisors 10 year projections
- Significantly higher returns assumed > 10 years
  - based on long term historical returns
  - implies investment losses in 1st 10 years
  - achievable?

CERBT Discount Rate Development

- Bartel Associates Recommendation:
  Select rate at 55% or 60% confidence limit

	Option 1	Option 2	Option 3
	55% Confidence Limit		
Discount Rate	**7.25%**	**6.75%**	**6.25%**
Maximum Discount Rate	7.61%	7.06%	6.39%
Margin for Adverse Deviation	(0.36%)	(0.31%)	(0.14%)
	60% Confidence Limit		
Discount Rate	**7.00%**	**6.50%**	**6.00%**
Maximum Discount Rate	7.61%	7.06%	6.39%
Margin for Adverse Deviation	(0.61%)	(0.56%)	(0.39%)

Pension & OPEB Discount Rates

- Discount rates are function of:
  - Real rates of return &
  - Inflation
- Outside (independent) investment advisors:
  - Significantly lower real rates of return
  - Bond returns in particular
- Do not be surprised if "***What is an appropriate discount rate?***" continues to be a major topic of discussion

GASB Pension Exposure Draft

GASB Pension Exposure Draft
What Is It?

- Exposure Draft to Change GASB 25 & 27
- Issued June 2011
- Final Standard Likely by June 30

Who Does It Apply To?

- Employers with DB &/or DC plans administered through trusts in which:
  - Contributions are irrevocable
  - Assets are dedicated and used only to provide pensions to plan members
  - Assets protected from creditors
- Agencies participating in CalPERS & other California retirement systems

Effective Date?

- Generally fiscal years beginning after June 15, 2013
- Fiscal years beginning after June 15, 2012 for employers meeting **all** of following:
  - Single employer
  - No unconditional special funding situations
  - One or more plans with Plan Net Position (generally plan assets) of $1 billion or more for first plan year ending after June 15, 2010
  - No plans are cost-sharing plans

Single and Agent Employers Recognize

- Net Pension Liability:
  - Recognized in financial statement
  - Equal to:
    - Total Pension Liability
      net of
    - Plan Net Position

Total Pension Liability (Actuarial Accrued Liability)

- Entry Age Normal level percent of pay cost method
- Based on:
  - Benefit terms,
  - Additional legal agreements in force on valuation date
  - Anticipated ad hoc changes to the extent considered substantively automatic:
    - Ad-hoc COLAs and
    - other ad hoc postemployment benefit changes
- Calculated at employer fiscal year end
  - OK to roll forward from a prior date provided within 24 months of most recent employer fiscal year end

Assumptions

- Generally based on Actuarial Standards of Practice
- Discount rate – blended rate based on:
  - Long term rate of return of plan investments to the extent
    - Projected plan assets expected to be available to pay benefits:
    - Plan assets expected to be invested using long term strategy
  - 30-year high quality (AA/Aa or higher) tax exempt municipal bond rate for benefit payments without available projected plan assets or if plan assets not expected to be invested using long term strategy

Plan Net Position - Assets

- At fiscal year end
- Dedicated to provide pension benefits

Pension Expense

- Change in Total Pension Liability (AAL)

  minus

- Change in Plan Net Position (MVA)

Change in Total Pension Liability (AAL)

- Immediate recognition for:
  - Service Cost based on same method and assumptions as noted above
  - Interest using blended discount rate as noted above
  - Benefit changes
  - Inactive Gains/Losses and Assumption Changes
  - Other changes
  - Data adjustments
  - Etc.
- Deferred recognition for active Gains/Losses and Assumption Changes.
  - Recognized over closed period based on liability weighted average of remaining future service (likely ≈6-8 years)

Change in Plan Net Position (MVA)

- Immediate for
  - expected investment earnings
- Deferred recognition for
  - investment gains/losses over five year closed period

Cost Sharing Multiple-Employer Pensions (CalPERS Risk Pools)

- Risk Pool's net pension liability calculated same as for single and agent employers
- Agency reports based on proportionate share of Risk Pool's net pension liability
  - Based on projected long-term contributions
- Deferred recognition over closed period based on liability weighted average remaining future service for:
  - Change in employer's expected proportion of total employer-related contributions,
  - Effects of differences between actual recognized contribution and expected proportionate share of total employer-related contributions

GASB Pension Exposure Draft
Other Issues

- Defined Contribution Pensions, Recognize:
  - Expense for contributions for period as defined by plan's terms
  - Expenditures for amounts contributed
  - Liability for difference
- Special funding situations
  - Special provisions apply to entities other than the employer that are legally required to contribute to the employer's plan
- Employers with pension plans not funded through qualified trusts:
  - Will be addressed later and
  - Should continue to apply Statement Nos. 27/50
- Employers with OPEB:
  - Will be addressed later and
  - Should continue to apply Statement No. 45

What Can You Do About Increasing Pension Costs?

What Can You Do About Increasing Pension Costs?

- Short Term
  - Employer Paid Member Contributions (EMPC)
  - Employees Pay Portion of Employer Rate
  - Early Retirement Window
  - CalPERS Pooled Plan – Side Fund
- Long Term
  - 2nd Tier
  - CalPERS non-Pooled Plans
  - Pension Reform
  - Understand the Issues

EPMC
Contract Amendment

- §20692
- EPMC paid each pay period
- EMPC reported in year before retirement
- CalPERS says "vested right" – can not be changed for current employees
- Impact included in contribution rates

EPMC Resolution

- EPMC paid each pay period
- If EPMC reported as PERSable wages:
  - "PERS on PERS"
    - Compound effect of employer & member rate on portion of member contribution paid
    - e.g. 9% x (20% + 9%) = 2.6%
  - Reported each pay period as Special Compensation
- CalPERS says not "vested right"

Employees Pay Portion of Employer Contribution Rate - §20516

- Limited to benefit improvements $\geq$ January 1, 1979
- Normal Cost – Goes on “forever”
- Actuarial Liability Increase
  - Statute:
    - Maximum 30 years
    - From implementation of Cost Sharing
  - CalPERS:
    - 20 years
    - From implementation of benefit improvement

Employees Pay Portion of Employer Contribution Rate - §20516

- Can be cumulative, e.g.
  - 3%@50 + Highest Year
  - 2.7%@55 + Highest year + 2%@55

Early Retirement Window §20903 - 2 Yrs Additional Svc Credit

- Specified job classification, department, etc.
- 90-180 day window
- Disclose under GC §7507
- Generally does not save money if positions are filled

Early Retirement Window
§20903 - 2 Yrs Additional Svc Credit

- Additional "Cost":
  - Estimated by agency not CalPERS
  - Factored into future rates (2 years later) based on actual election

Early Retirement Window

- Establish own incentive:
  - For example
    - Enhanced retiree medical benefit
    - Supplemental plan
  - Generally does not save money if positions are filled

CalPERS Pooled Plan Side Fund

- Created when Risk Pools created in June 30, 2003 Valuation
- Pool treats side fund as contribution receivable
- Fixed 7¾% interest rate
- Can likely borrow at much lower rate
  - Unless amortization period is long
- Can be significant & immediate savings

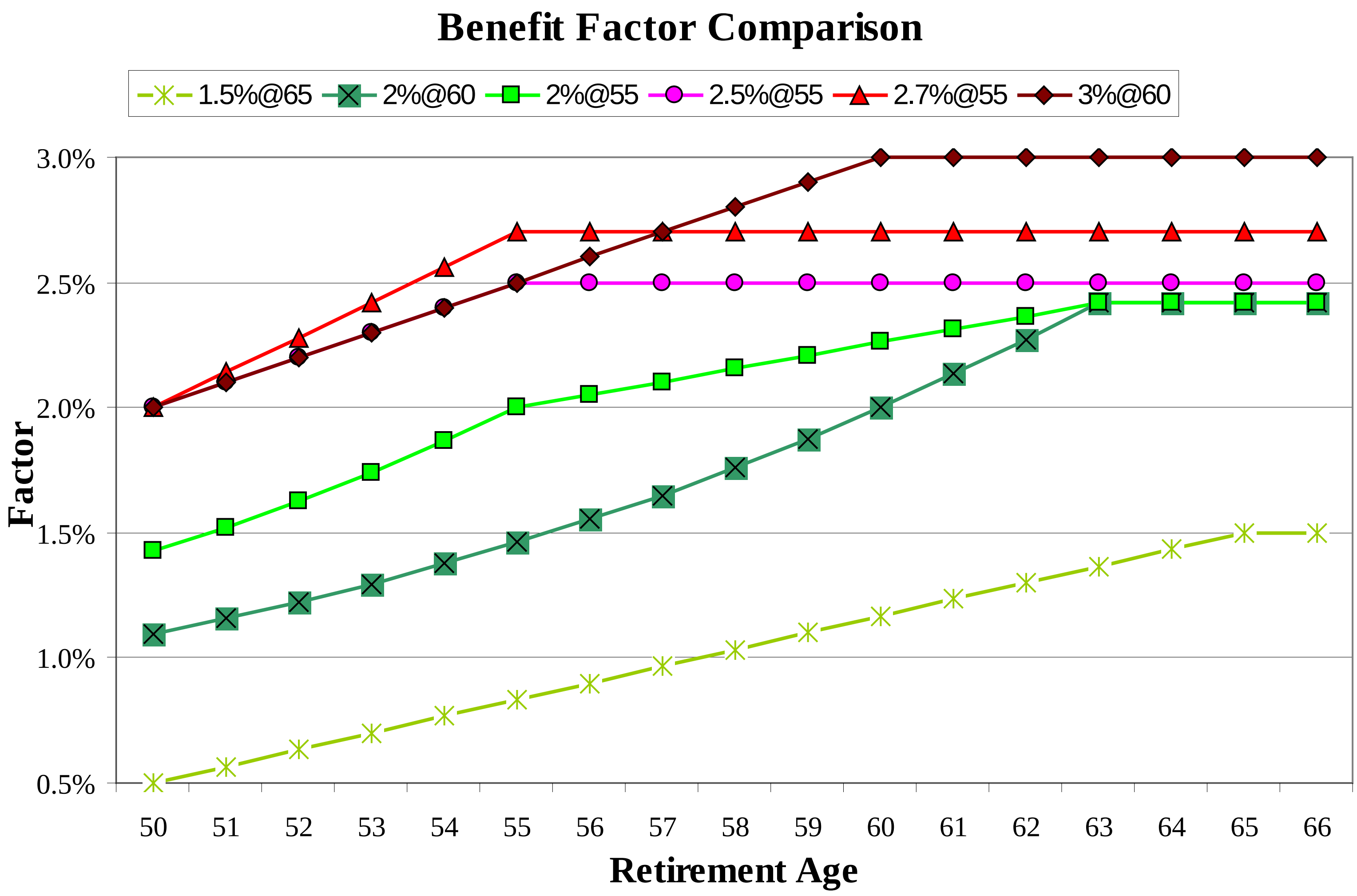
Impact of 2nd Tier Retirement Formula

- California Vested Rights:
  - Retirement formula when hired generally believed
    - Can't be reduced unless provided with something of equal or greater value
    - Individual right – can't be bargained away
- 2nd Tier Formula:
  - Lower formula for future hires, e.g. July 1, 2011
- Existing UAL amortized over total (Tier 1 & Tier 2) payroll
- Impact different for pooled and un-pooled plans

Impact of 2nd Tier Retirement Formula – Un-Pooled Plans

- Savings on reduction of normal cost only for Tier 2
- Takes several years to become significant
- CalPERS 2 year valuation lag:
  - Savings may also lag 2 years
  - Can ask CalPERS for accelerated savings

Miscellaneous (CalPERS)

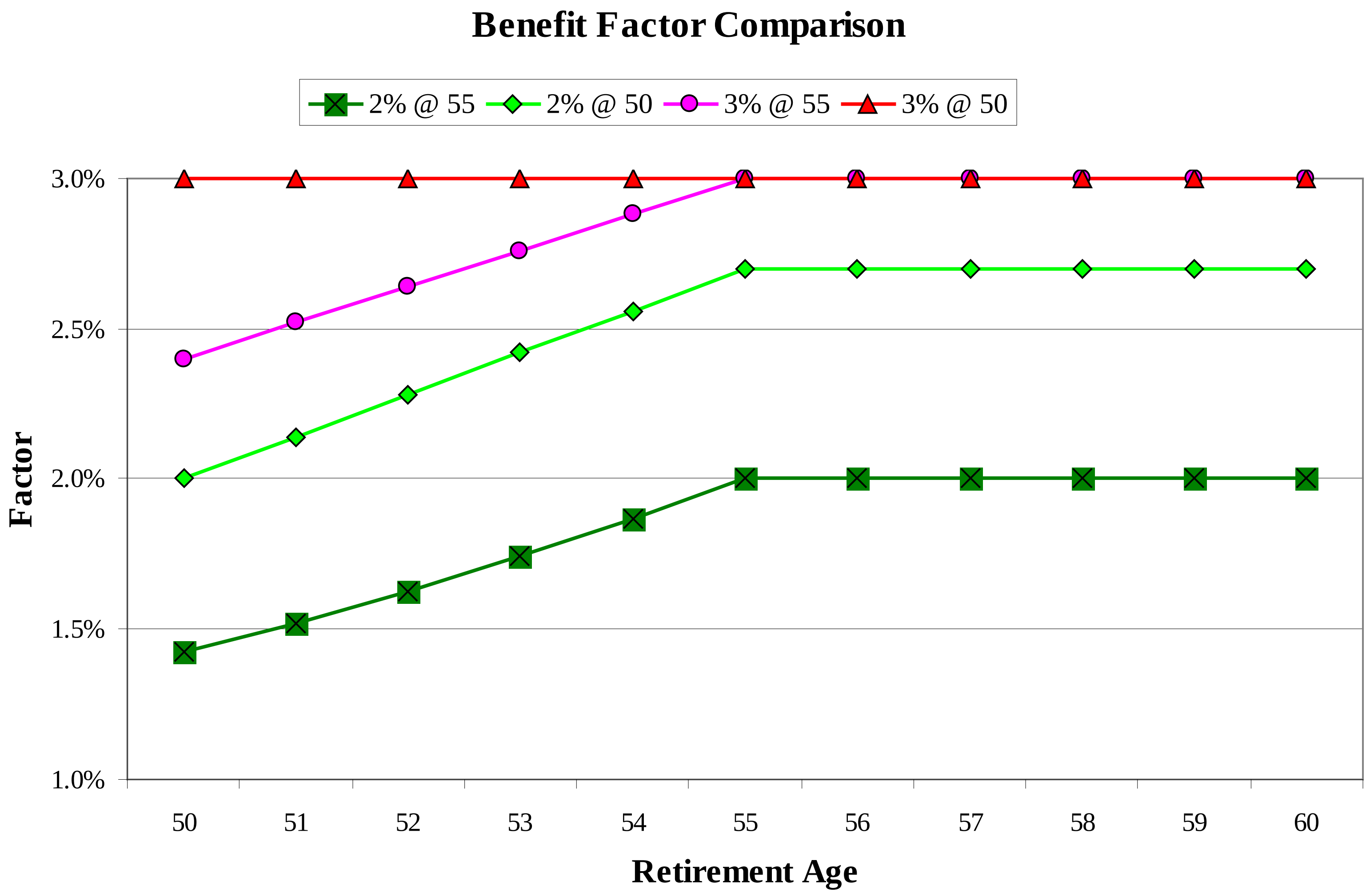


Note: Miscellaneous has no benefit cap

Miscellaneous (CalPERS)

Age	1.5%@65	2%@60	2%@55	2.5%@55	2.7%@55	3%@60
50	0.500%	1.092%	1.426%	2.000%	2.000%	2.000%
51	0.567%	1.156%	1.522%	2.100%	2.140%	2.100%
52	0.633%	1.224%	1.628%	2.200%	2.280%	2.200%
53	0.700%	1.296%	1.742%	2.300%	2.420%	2.300%
54	0.767%	1.376%	1.866%	2.400%	2.560%	2.400%
55	0.833%	1.460%	2.000%	2.500%	2.700%	2.500%
56	0.900%	1.552%	2.052%	2.500%	2.700%	2.600%
57	0.967%	1.650%	2.104%	2.500%	2.700%	2.700%
58	1.033%	1.758%	2.156%	2.500%	2.700%	2.800%
59	1.100%	1.874%	2.210%	2.500%	2.700%	2.900%
60	1.167%	2.000%	2.262%	2.500%	2.700%	3.000%
61	1.233%	2.134%	2.314%	2.500%	2.700%	3.000%
62	1.300%	2.272%	2.366%	2.500%	2.700%	3.000%
63	1.367%	2.418%	2.418%	2.500%	2.700%	3.000%
64	1.433%	2.418%	2.418%	2.500%	2.700%	3.000%
65	1.500%	2.418%	2.418%	2.500%	2.700%	3.000%
Member Contribution Rate	2%	7%	7%	8%	8%	8%

Safety (CalPERS)



Note: Safety has 90% benefit cap

Safety (CalPERS)

Age	2% @ 55	2% @ 50	3% @ 55	3% @ 50
50	1.426%	2.00%	2.40%	3.00%
51	1.522%	2.14%	2.52%	3.00%
52	1.628%	2.28%	2.64%	3.00%
53	1.742%	2.42%	2.76%	3.00%
54	1.866%	2.56%	2.88%	3.00%
55	2.00%	2.70%	3.00%	3.00%
56	2.00%	2.70%	3.00%	3.00%
57	2.00%	2.70%	3.00%	3.00%
58	2.00%	2.70%	3.00%	3.00%
59	2.00%	2.70%	3.00%	3.00%
60	2.00%	2.70%	3.00%	3.00%
	Member Contribution Rate			
	8%	9%	9%	9%

Impact of 2nd Tier Retirement Formula – Un-Pooled Plans

Payroll Projection	Tier 1	Tier 2	Total
2011/12	$9,600,000	$ 400,000	$10,000,000
2012/13	9,499,000	826,000	10,325,000
↓	↓	↓	↓
2020/21	7,068,000	6,268,000	13,336,000

- Normal Cost:
  - 3@50 19%
  - 2@50 14%

Impact of 2nd Tier Retirement Formula – Un-Pooled Plans

Projected Savings:	Dollar	% Total Pay
2011/12	$ 20,000	0.2%
2012/13	41,300	0.4%
↓	↓	↓
2020/21	313,400	2.3%

Impact of 2nd Tier Retirement Formula – Un-Pooled Plans

- Sample Normal Costs (excludes ancillary benefits):
  - Miscellaneous

2%@60	6.9%
2%@55	8.3%
2.5%@55	9.5%
2.7%@55	10.7%
3%@60	11.5%

  - Safety

2%@55	13.5%
2%@50	14.7%
3%@55	17.4%
3%@50	19.0%

- Further adjustments: Highest Year, Post Retirement Survivor Allowance, COLA

Impact of 2nd Tier Retirement Formula – Pooled Plans

- Tier 1 employees remain in pool
  - Payroll is closed
  - CalPERS will move to level $ amortization
- Tier 2 employees go into different pool:
  - No side fund component to rate
  - Similar savings

Message

- Second tier likely saves very little in the short run
- Real savings comes from having employees pay:
  - Employee contribution
  - Benefit improvement
- Equality:
  - Have 1st tier employees pay higher rate than 2nd tier
  - Base difference on normal costs

Appendices

- Governor's Pension Proposal:
  - Hanson Bridgett - http://www.hansonbridgett.com/Publications/pdf/~/media/Files/Publications/Pension-reforms-alert--2012-02-07.ashx
  - February 2012 PERS PAC Alert
- Anthony T. Oliveira, *The Local Challenges of Pension Reform*