To: **MCCMC Mayors Select Committee**

From: **Larry Chu**
Vice Mayor, City of Larkspur
MCCMC President (2007-08); Executive Committee (2006-10)

Date: **October 25, 2010**

RE: **Creation of an Ad-Hoc Committee to Study Retirement Benefits**

Background:

At MCCMC meeting on September 22nd, I provided a memo to the membership which summarized the history of California's public employee pension systems since the passage of SB 400 in 1999. Although the sustainability of these benefit plans have been questioned since then, this issue did not garner much attention until 2008 when the economy turned.

In effect, the model is to privatize the gains, but socialize the risks. When investment returns did not meet actuarial expectations, the employers (cities/towns) were required to make up the difference at the expense of local programs and services.

In 2009, the Marin Managers Association began to study this issue. Ken Nordhoff presented their recommendations to the MCCMC on October 23rd of last year. He also presented these recommendations to the North Bay and Redwood divisions of the League of California Cities. However, I was told by the League's Regional Public Affairs Manager Chuck Dalldorf that this would not be a priority until after the November 2010 elections since the League would need support on other statewide initiatives from the various groups representing public employees.

At the MCCMC meeting on April 28th, I provided an oral report on a study conducted for Governor Schwarzenegger by the Stanford Institute for Economic Policy Research. This was a comprehensive independent study of the unfunded liability in the State's three pension funds. This was the same study presented by Joe Nation, the faculty advisor, at our meeting on September 22nd.

Throughout the spring and summer, I have been in regular communications with about a dozen and a half elected representatives from a variety of local agencies to exchange ideas on how to deal with the economic impact of the unfunded pension liability on our respective jurisdictions. We are now at a point where the next step is to build on what the MMA has done by forming an ad-hoc committee of the MCCMC to make policy recommendations for reducing the costs and the risks associate with retirement benefits, and to devise a plan for implementation.

Committee Objectives:

This committee would consist of one representative and an alternate from each city or town. Each member would select their representative. To reduce learning curve, I would recommend councilmembers who have (1) already been working on this problem in some capacity or (2) a functional knowledge of business, finance, accounting, and/or employee benefits.

I don't know how often the committee would need to meet, but I would like to be able to initially report back to the general membership at the January 26th meeting. We will also report on a monthly basis as with other committees.

This process will also include time for getting feedback and information from the managers and finance directors. However, if there is a need to have something for the next cycle of labor negotiations with the labor groups, the committee will have to work quickly.

This role of the committee is not to debate the merits or shortcomings of the actuarial methodologies regardless of whether it is the fund managers or SIEPR. The committee would be tasked with the following:

- A recognition and acceptance that the current system as structured is not sustainable;
- A recognition and acceptance that the current regulatory actuarial requirements are understated;
- Expand the scope of this discussion from pension to all post-retirement benefits which would include health care, life insurance, and other forms of deferred compensation;
- Get a true and realistic assessment of the unfunded liability;
- Create policy statements that address the above and identifies an end-game, even if some measure may take decades to achieve or realize;
- Come up with a set of alternatives that are in our local control that achieves lowering the costs as well as lowering the risks.

Due to the complex nature of the problem and the legal aspects of what is currently in the various labor agreements, I expect that our discussions will run on parallel courses for different sets of recommendations. Some options may be easy to identify, achieve a consensus, and implement. Others may take much longer.

New Legislation:

On October 20th, Governor Schwarzenegger signed two pieces of pension reform legislation which could help pave the way for similar policies at the local level.

SBX6 22 establishes a new tier which will be applied to employees hired on or after 1/15/11. First, this tier adopts the benefit levels that existed before SB 400. For example, for miscellaneous, the 2% @ 55 years (up to 2.5% @ 63 years) will go back to 2% @ 60 years (up to 2.418% @ 63 years). For peace officers and firefighters, the 3% @ 50 years will go back to 2.5% @ 55 years. Second, the current one-year final compensation formula for calculating retirement benefits will go to the highest annual average in the last three years. However, there is no change in defining what goes into compensable earnings.

SB 867 provides statutory requirements to increase transparency. A public employee retirement system Board of Administration must now provide an actuarial report containing investment returns, amortization period, and discount rates using specific analytical guidelines to the Legislature, the Governor, and the Treasurer any time new contribution rates are adopted. The analysis would include:

- Discount rate used to report pension liabilities and how those liabilities would be valued if a risk-free discount rate was used;
- Investment return assumed for projecting contributions and how those contributions would change if a lower investment return assumption was used;
- Period over which unfunded liabilities are amortized and how contributions would change if unfunded liabilities were amortized over a period equal to the estimated average remaining service periods of employees covered by the contributions;
- Market value of assets and how that value differs from its chosen actuarial value for those assets.

The Treasurer is also required to analyze the proposed change and to write an opinion to the Legislature.

Action Requested:

To discuss the formation of an ad-hoc committee to study retirement benefits, to provide comments and any additional direction on the objectives for this committee, and to approve the formation of this committee.

Attachments:

Ken Nordhoff presentation on pension reform (10/28/09)
MMA letter to the League of California Cities (11/2/09)
SIEPR report on reform of California pension systems (4/2/10)
Larry Chu memo to MCCMC on pension reform (9/17/10)
Joe Nation presentation on SIEPR report (9/22/10)