



Strengthening the Voice of Business



Los Angeles Area
Chamber of Commerce



Public Pension Reform: The Roadmap

February 2010



Disclaimer

This presentation contains both reform principles agreed upon by the business groups identified on the cover page, and opinions that are solely my own. Please see the original Chamber/VICA/CCA/BizFed pension reform letter for further clarification.

All pension fund data is from the funds' Comprehensive Annual Financial Reports or city financial documents unless otherwise noted.

In 2006, city leaders said...

There are "very significant errors in [Rubalcava's] estimates and assumptions."

"The city of Los Angeles has done an exceptional job in managing our retirement benefits."

Former CAO William Fujioka

Rubalcava's presentation was "based on faulty assumptions which are largely disputed."

Rob Wilcox
Deputy City Controller

"Clearly, Mr. Rubalcava has a different opinion than our experts. In the pension world, we typically use a wide spectrum of years when looking at our performance. We look at one, three, five and 10 years."

Robert Aguallo
Former GM, LACERS



<http://tinyurl.com/5892m5>

All you need to know about pensions

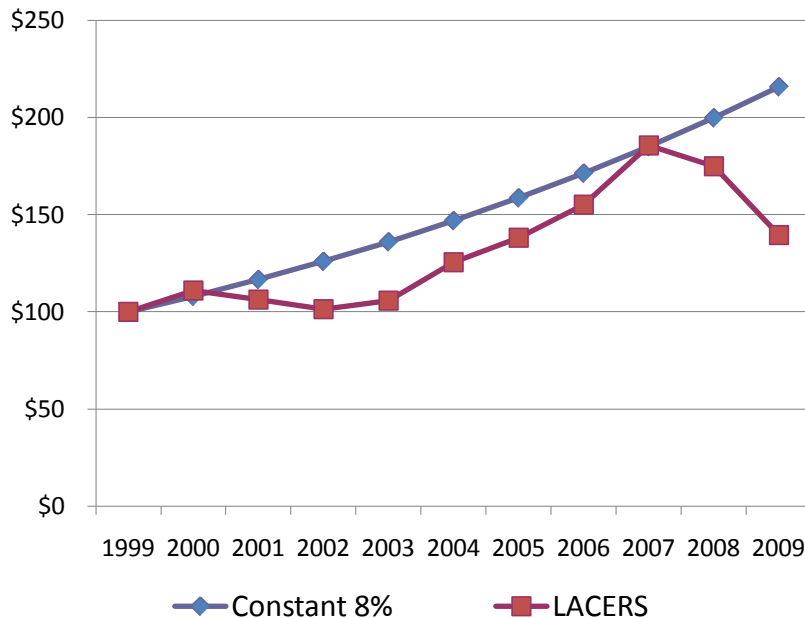
Pensions are horrendously complex, but for policy purposes, there's only four things that matter. Everything else is noise.

- ❖ **Nonsense assumptions:** Pension plans forecast 8% annual returns. It cannot happen long-term.
- ❖ **Asymmetry of risk:** When they fail to earn 8% a year, taxpayers are on the hook, not workers.
- ❖ **Big numbers:** Contribution amounts soon to exceed 40% of payroll, or more than 70% of payroll for safety employees. More than 33% of total revenues at many cities/agencies.
- ❖ **Endgame:** One more recession in the next decade is likely to push your city into Chapter 9 bankruptcy.

A decade of fantasy...meets reality

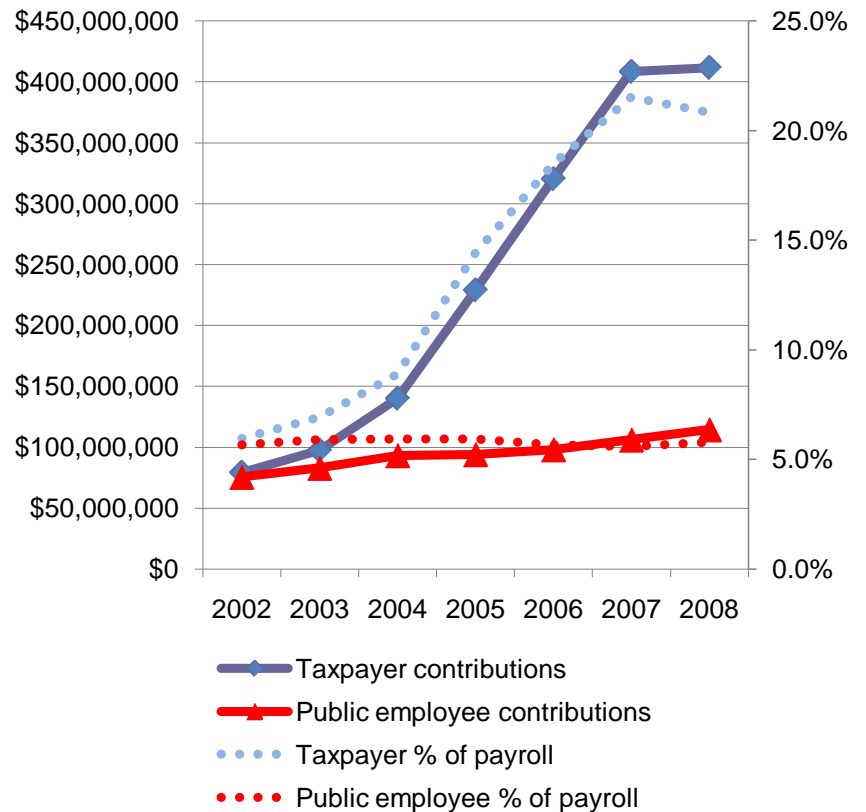
The Eight Percent Myth has had disastrous consequences for the taxpayers of Los Angeles and California. Going forward, the bill only gets higher.

LACERS investment return since 1999



LACERS performance '99 – '09: 3.39%
 CALPERS performance '99 – '09: 2.95%

Contributions to LACERS



Pension reform – now or later?

In the future, local govt. labor/pension costs *will* be lower than they are today. The only question – will this be done *now* via negotiation, the ballot box, or *later* in Ch. 9?

Do it now

- A real shot at avoiding Ch. 9.
- Cities retain capital assets.
- Employees can still get a pension.
- OPEB benefits can be kept, but employees pay for them, not taxpayers.
- Payroll, services get cut, but public safety spending is maintained and cuts elsewhere are contained.
- Some elected officials may get re-elected.

Wait until later

- Over 50% of LA County cities in Ch. 9 within five years?
- Capital assets will be sold by desperate councils/mayors.
- Defined benefit pension likely to be gutted by bankruptcy judge.
- No OPEB benefits for workers.
- Diminution of city credit, assets, cash flows, service delivery -- including huge hit to public safety.
- Will elected officials get recalled?

BizFed has a plan for NOW

In January, four business groups (BizFed, the LA Chamber, CCA, and VICA) came together to with a series of eight recommendations for immediate reform at LA City.

For current workers

- Raise worker contribution rates and let them float.
- Reduce/eliminate OPEB (health) benefits or make employees pay for their own OPEB benefits.
- Service credit purchase based on actuarial value.

For new hires only

- Raise the retirement age.
- Lower service credit formula and cap benefits at 65% of final pay
- No spiking – calculate benefit on last three year average base pay only

If you run your own pension fund...(LA City & County)

- Consolidate all three city pension funds into a single organization.
- Raise the number of Mayor/Supervisor-appointed board members, and require financial backgrounds.

If your city participates in ~~CALPERS...~~

Then you have much less control than LA City or LA County. Reform of benefits will have to be sooner, and more drastic, to prevent Chapter 9.

- ❖ **No control of actuarial assumptions:** CALPERS & CALSTRS will stick with their 7.75% - 8.00% investment return hallucination until they run out of excuses, which could take forever.
- ❖ **No control over accounting tricks:** CALPERS & CALSTRS boards using 15 year smoothing, MVA corridor adjustments, & other legerdemain to postpone the inevitable. Your city will be like a frog in a pot of slowly heating water.
- ❖ **Implement the BizFed plan now:** And you may be able to avoid bankruptcy.
- ❖ **In the long run:** The only way to stop the bleeding is to move to a defined contribution (401k-style) retirement system.

Your labor unions will say...

Public employee unions can be expected to fight all pension reform. Below are some of their very common arguments – and our rebuttals.



Claim

“

Most public employees retire with a pension of less than \$35K/year. The benefits are not egregious so there can't be a huge public policy problem here.

”

fact

It's not the size of the pensions that matters, it's who pays for them. Employees – aided by the 8% Myth – never saved enough to pay for their pensions, leaving us on the hook.

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Source: <http://bit.ly/dwciIN>

Myth

“ Cops and firefighters don’t live as long as civilians after they retire because their jobs are so difficult, so they deserve generous pensions and an early retirement age. ”

fact

According to extensive CALPERS data, cops and firefighters live as long or longer than civilian government employees. Thus, there is no reason they should retire as early as age 50.

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Claim

“ It was the market crashes of 2000 – 2003 and 2007 – 2009 that caused this mess. Pension deficits will ease as the market recovers, forestalling the need for hasty reforms. ”

fact

Pension fund boards must plan for all market cycles. By adhering to the Eight Percent Myth, they failed to prepare for such events. We must reform by reducing benefits and/or switching to 401ks to prevent this from happening again.

Your labor unions will say...

Public employee unions can be expected to fight all pension reform. Below are some of their very common arguments – and our rebuttals.



Claim

“

Saving for retirement is hard. Public employees shouldn't have to worry about it. We deserve pensions for the hard work we do.

”

fact

Yes, it is hard. We in the private sector have to do it largely without the benefit of pensions. It requires disciplined savings and careful investment. Public employees are not a privileged class of citizen who deserve exemption from reality.

What your Chamber can do NOW...

Business groups must engage in the pension reform process if we want real reform, instead of higher taxes & fees. What you can do to **stop the bleeding**.

- ❖ **Fight tax increases:** Faced with higher required contributions to CALPERS & CALSTRS, your city will ask for higher taxes “to protect city services.” In reality, the money will be flushed into the black hole of the pension system.
- ❖ **Study your benefit structure:** Each city has different pension benefits, governed by collective bargaining agreements. Study your city’s benefits and compare to neighboring cities. Call your city controller for details.
- ❖ **Look for truly egregious sweetheart deals:** Some cities pay the employer contribution AND the employee contribution. Publicize these ridiculous contracts to raise awareness.
- ❖ **Learn how to reform the system:** Some cities allow for new pension tiers to be created by ordinance. Some allow voters to do this at the ballot box. Learn what needs to be done in your city.

What your Chamber can do NOW...

Business groups must engage in the pension reform process if we want real reform, instead of higher taxes & fees. What you can do to **stop the bleeding**.

- ❖ **Reduce OPEB costs immediately:** Unlike pensions, which are vested benefits, Other Post-Employment Benefits (OPEB – mainly health insurance subsidies) can be eliminated for current employees and retirees. You can push your cities to find immediate savings here.
- ❖ **Work with Mayor and Council to create new benefits tier:** If you believe you can, push for a defined contribution (401k-style) plan. These plans are individual accounts with no recourse to taxpayers. If this is impossible, reform the defined benefit system along the lines of the BizFed model.
- ❖ **Raise awareness:** Write op-eds, speak at Council, engage thought leaders. Many voters still don't know about sweetheart pension deals.
- ❖ **Support the CFFR initiative in November:** The California Foundation for Fiscal Responsibility is pushing a statewide solution. <http://bit.ly/duEHU5>

If your city declares bankruptcy...

I expect at least half of LA County cities, school districts and other government entities to declare Chapter 9 this decade. Here's what to do if it happens to you.

- ❖ **Existing pensions will be hard to touch:** Even for a 22-year-old worker hired the day before your city files Ch. 9, it will be hard to reform pensions for current workers and retirees. OPEB benefits, workers comp benefits, salaries, layoffs and tax increases will have to come first.
- ❖ **A crisis is a terrible thing to waste – don't do it:** If your city goes bankrupt because of excessive pension costs, you cannot allow the city to emerge from bankruptcy with a defined benefit plan of any kind. You must restructure into a defined contribution (401k) type plan.
- ❖ **New contracts might be written by the judge:** Be ready to hire counsel, file amicus briefs.
- ❖ **Educate voters as to why it happened:** Labor groups will dissemble, obfuscate, confuse. But CA cities will only go Ch. 9 because of labor/pension costs



Strengthening the Voice of Business



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Thank you

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Appendix: details of the BizFed Plan

The following slides present more detailed components of the BizFed-led plan

1. Raise employee contributions

Most government employees pay between 0% and 8% into their pension plans. To truly pay for these benefits, their contributions must be higher.

- ❖ Every 1% increase in employee contribution rates would save taxpayers in Los Angeles City \$40 million.
- ❖ The BizFed plan calls for higher base contribution levels to reflect the true cost, and value to employees, of pension benefits.
- ❖ BizFed also calls for employee contributions to rise or fall dollar for dollar with taxpayer contributions in response to investment results.
- ❖ Higher & variable employee contributions helps to equalize the exposure of taxpayers and employees.
- ❖ These changes may be applicable to current employees, though this is largely untested in court.
- ❖ **Special case:** In some cities, the city pays for the employee contribution. This must stop immediately.

2. Raise the retirement age

Government employees in LA County cities retire at far younger ages than private sector workers. There is no reason for this special treatment.

- ❖ According to CFFR, raising the retirement age by five years halves a pension liability, depending on key assumptions.
- ❖ Many general employees in SoCal cities retire before the age of 60. Many sworn public safety officers retire before the age of 55.
- ❖ BizFed plan advocates the normal Social Security retirement age (66) for most city employees. Plan calls for fire and police officers to qualify for retirement at Social Security age minus 6 – 8 years to reflect younger age at hire of most safety officers.
- ❖ These changes would be applicable to new hires only.

3. Lower annual service credit

Pension benefits = years of service x service credit formula x final salary. BizFed is calling for lower service credit and lower caps on final pensions.

CALPERS pension tiers

Current Service Credit

Miscellaneous – First Tier	2.5% @ 63
Police, Fire and Highway Patrol	3.0% @ 50

- ❖ BizFed has proposed specific pension tiers to LA City (2.0% @ 66 miscellaneous, 2.25% @ ~60) to LA City. It has not offered specific recommendations to neighboring cities.
- ❖ These new tiers would apply to new hires only.
- ❖ BizFed proposal caps total benefits @ 65% to 75% of total salary for all govt. employees.
- ❖ Some employees will earn full pensions up to a decade before retirement age, so BizFed plan will require some bridging strategy.

4. Service credit purchase changes

In some pension funds, rules allow employees with prior government service to purchase service credits. The valuation formula used at LACERS is too low.

- ❖ LAFPP and other pension funds require employees to purchase credits at full actuarial value.
- ❖ LACERS uses a different formula, one more generous to employees.
- ❖ BizFed supports League of Women Voters efforts to price service credit purchases at full actuarial value.
- ❖ The savings will be relatively small, but this is an easy loophole to close and it should be done.
- ❖ This recommendation has limited applicability outside the City of Los Angeles.

5. Reduce spiking

Pension fund formulas (see above) are calculated often based on the highest calendar year of pay, including bonus pay, unused vacation days, sick days, overtime, etc.

- ❖ BizFed recommends formulas based on the average of final or highest 3 years of salary, to avoid last-year promotions designed to spike pensions.
- ❖ Many cities have egregious spiking problems (see scandals in Contra Costa County) but finding out about them takes determined effort.
- ❖ Local chambers can add a lot of value by analyzing service credit formulas and filing FOIA requests on highest earners in each of their cities.
- ❖ Pension spiking is dishonest, immoral and highly widespread.
- ❖ It is more common among senior management of cities and counties, so employee unions often don't fight attempts to close these loopholes.

6. More mayor-appointed board members

Pension boards have employee-elected, retiree-elected, and Mayor/Council/State-appointed members. BizFed calls for more members who are answerable to taxpayers, and that all pension board members have capital markets experience.

- ❖ BizFed recommends more board members who are appointed by elected officials directly responsible to taxpayers.
- ❖ Employee- and retiree-elected pension board members have a direct conflict with taxpayer interests. They are tasked with protecting pension benefits first, often at the expense of taxpayers.
- ❖ Employee- and retiree-elected board members frequently lack even basic financial backgrounds. Even mayor- and governor-appointed members are often lawyers, former legislators, etc.
- ❖ While there have notable conflicts by financial executives on pension boards, pension funds still need capital markets expertise.
- ❖ Limited room for CALPERS participants to do anything about this.

7. Consolidate the pension funds

Los Angeles City maintains three pension funds: LACERS, LA FPP, and WPERP. There are immediate savings available from consolidation.

- ❖ Duplicative costs include: management and staff, CAO & council oversight, investment management contracts, office costs and professional services.
- ❖ The funds can and should be kept separate, but run by a single agency, like CALPERS with its several funds for different employee types.
- ❖ BizFed calls for the back-office consolidation of all three funds into one office. There would still be separate pension boards.
- ❖ Former City Controller Laura Chick recommended this in her 2007 audit, citing \$7MM in annual savings on investment management fees alone.
- ❖ I estimate total savings of \$20MM to \$40MM annually from full integration.
- ❖ **Special case:** This recommendation is completely unique to Los Angeles City and is not applicable to other cities.

8. Restructure health care benefits

Unlike pensions, which are subject to the “like benefit” restriction, OPEB benefits can be reduced for current employees and possibly retirees.

- ❖ Cities pay up to \$1200/month to subsidize “Cadillac” health insurance for retirees until they are eligible for Medicare, or in some cases, forever.
- ❖ Unlike pensions, cities have put aside no money to fund health subsidies.
- ❖ As unvested benefits, health subsidies can be reduced or revoked, meaning immediate savings to taxpayers. 2009 court rulings in San Diego concur.
- ❖ Los Angeles spends \$350 million annually to fund OPEB benefits. LAUSD has an unfunded liability of \$10 billion+. LA County: \$28 billion+.
- ❖ **Employees and current retirees have never paid a cent for these valuable benefits.** If they want to keep some/all of these benefits, they should pay for them, not taxpayers.

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