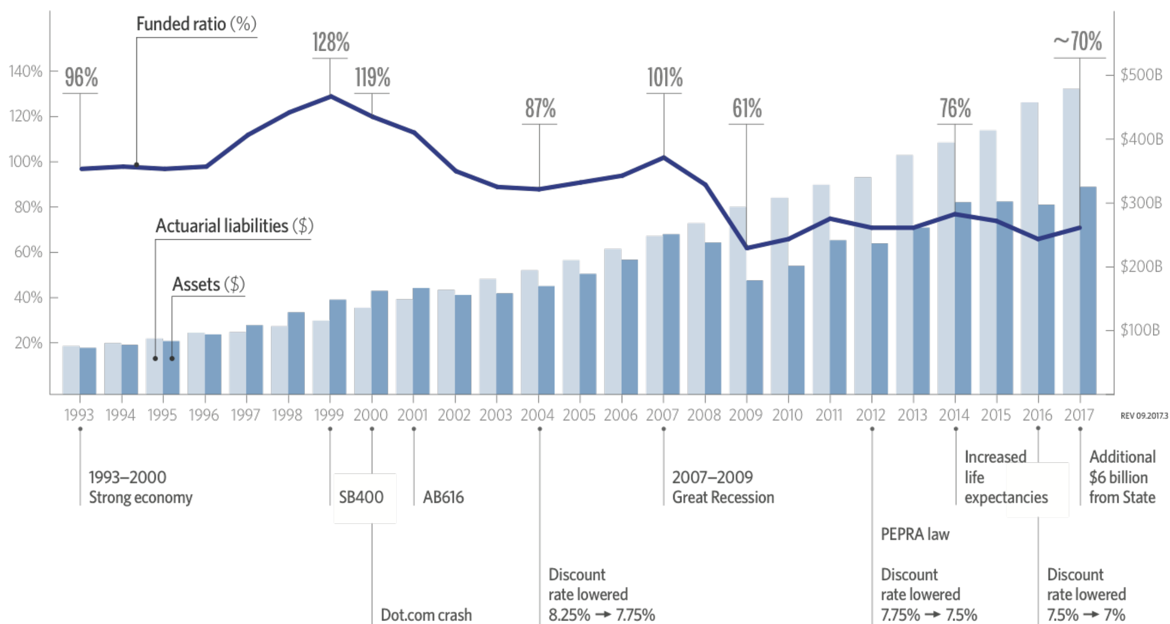
**Retirement Security in California: An Update**

Numerous media outlets are reporting on the issue of pensions, fueled by increases in outlays for future pension payments by municipal governments as well as school districts. These stories are reigniting the debate about the sustainability of California's pension system. It comes after multiple failed attempts over the past seven years to put a measure on the ballot and break promises to public employees about their retirement security. These attacks were led by failed former San Jose Mayor Chuck Reed, Enron billionaire John Arnold and extremist right wing former San Diego Councilmember Carl DeMaio.

This comes just four years after Governor Jerry Brown's signature on the Public Employee Pension Reform Act, described in the Governor's Office press release as "sweeping pension reform…that saves billions of taxpayer dollars by capping benefits, increasing the retirement age, stopping abusive practices and requiring state employees to pay at least half of their pension costs." CalPERS projects savings from this measure at $65 billion to 85 billion. More than 200,000 employees now work under these reforms.

Contrary to the bleak picture painted by the media, Moody's now rates CalPERS and CalSTRS at "Aa2" – among its highest ratings. As the chart below shows, pensions are cyclical. CalPERS projections show a period of pension cost increases, followed by leveling, followed by reductions. This is a pattern that has repeated over decades.

Historical Factors Impact Funded Status (1993-2017)



**CalPERS investment portfolio has seen positive returns every year since 2010**. In three of the eight fiscal years since then, it fell short of the discount rate with returns of 0.1 percent, 2.4 percent, and 0.6 percent. It handily beat the market in the other five: 13.3 percent, 21.7 percent, 13.2 percent, 18.4 percent and 11.2 percent.

Put another way: Despite market volatility, since 1988, when the construction of the current CalPERS portfolio began, CalPERS returns have averaged 8.4 percent annually.

**SB 400, the 1999 California legislation that changed benefits for public workers** was passed by a strong bipartisan majority of the state legislature, signed by Governor Gray Davis and supported by the California Public Employees' Retirement System (CalPERS) Board of Administration, was a product of its time. The cost for this benefit increase was $500 million per year over 30 years.

When SB 400 became law, CalPERS was 137 percent funded and contributions by state and public agencies had dropped to at or near zero. Taxpayers saved billions of dollars by making lower or no contributions, while public employees continued to make full contributions towards their retirement.

Then, due to the fraud and abuse perpetrated by Wall Street bankers, the worst recession since the Great Depression hit and investors across the globe watched as trillions of dollars in asset values were wiped out. CalPERS' lost $69 billion in the first year and over the next two years their funded status dropped by 40 percent.

The claim that SB 400 is the driving force behind the unfunded liability defies math. The one year loss of $69 billion due to Wall Street abuses would have funded the SB 400 benefit for 138 years.

**While hindsight is 20/20, unions, employees, employers and pension administrators are working to sustain pension systems for generations to come.** Hundreds of unions have negotiated agreements that include higher employee contributions and benefit adjustments.

In addition to the changes mandated by the Governor and Legislature, CalPERS has established a process to take an innovative, integrated view of its assets and liabilities. It cut $300 million annually in investment fees, exited hedge funds, and eliminated high-fee Wall Street investment managers. It continues to promote good governance in the companies in which it invests to improve value and further cut risk in its portfolio.

**CalSTRS has been stabilized by Governor Brown's signing of Assembly Bill 1469**, enacted as part of the 2014-15 budget, that concluded a decade-long effort to close CalSTRS' nearly $74 billion funding gap.

Increases in pension contributions for all parties took effect July 1, 2014, and are being phased in over the next several years. Contributions rates for CalSTRS members increased from 8 percent of payroll to 8.15 percent of payroll in the first fiscal year.

CalSTRS members hired prior to January 1, 2013, who were not subject to provisions of the Public Employees' Pension Reform Act of 2013, have seen their contributions increase by a total of 2.25 percent of payroll phased in over the last three fiscal years. Contribution increases for CalSTRS members hired after January 1, 2013, who were subject to the provisions of PEPRA, are being phased in with their total increases capped at 1.205 percent.

The bottom line is that California pension plans continue to be among the best managed and most solvent in the nation, despite the catastrophic Wall Street debacle that wreaked havoc on pensions as well as individual retirement savings.

## Q&A About Pensions

### Is state spending for pensions soaring?

Pensions are one of the smallest percentages of state spending – and increases for pensions have been slower than the overall increase in state spending. Pension costs represent about 3.2 percent of total state spending for the Fiscal Year 2016-17 budget. In comparison, 30 percent of the total state budget is earmarked for public education, 8.5 percent for higher education, and 6.2 percent is for corrections. Governor Brown has not proposed increasing taxes to pay for pensions in any of his budgets.

### What about the "$100,000 Club"?

The average CalPERS pension payment is $2,794 per month. Only 3 percent receive more than $100,000 – most of which were in senior executive positions. On the other hand, 65.2 percent receive less than $2,999 per month – hardly enough to live on in California.

### Are most firefighters and police officers retiring at age 50 with their full pay?

Public safety workers would have to begin their career at age 20 or younger and work continuously for 30 years, with the highest 3 percent at age 50 benefit formula, to retire at age 50 with 90 percent of pay. This is a small fraction of the workforce; CalPERS safety members who retire with 30 or more years of service represent just three percent of CalPERS' total retiree population.

### Are pension costs "squeezing out" other services at the local and state level?

No. Over the long term pension costs have not increased dramatically as a percentage of budgets for the majority of public agencies.

State and local government pension contributions constitute a small percentage of spending. Pension contributions as a percentage of direct expenditures for California state and local governments ranged from 3.1 percent in 1994 to 4.4 percent in 2012, with a low of 1.7 percent in 2002. Pension contributions combined with salary and wages accounted for 31 percent of direct California expenditures in 2012 (latest data available).

**Will "reforming" the pension system will solve all fiscal problems facing our state and our communities?**

No. Eliminating retirement security for teachers, firefighters, police officers and other public employees is bad for the economy, will force more Californians to turn to other taxpayer-funded social services, and will result in untold short-term costs with no guarantee of saving taxpayers in the long run. The nonpartisan Legislative Analyst says pension-changing proposals could strap taxpayers with billions more in costs during the next few years.

That happened in places that have passed so-called pension "reform." According to the *San Jose Mercury News*, that city's police department became woefully short-handed, crime soared, and it was unable to fill its police training ranks with new recruits when then-Mayor Chuck Reed began his "reforms" – most of which have been reversed. San Diego also is experiencing higher costs. And taxpayers in both cities paid millions in lawyers' fees ($5 million in San Jose alone) for pension measures that have been ruled unconstitutional in courts. In Sacramento, the city forced police officers to increase contributions to their pensions, resulting in significant declines in its ranks – so much so that the city had to increase pay significantly and offer bonus payments.

California's public retirement systems actually are better off than they were during Gov. Jerry Brown's first term in office years ago. CalPERS was about 55 percent funded in the early 1980s, the final years of Gov. Brown's first term and following another severe recession.

As an investigative report by McClatchy Newspapers noted: "There's simply no evidence that state pensions are the current burden to public finances that their critics claim."

**Why aren't government workers contributing more to their pensions and why are taxpayers are on the hook to pay those costs?**

They are. Pensions largely are paid for by employee contributions and investment income – not taxpayers! Public employees pay up to an average 12 percent into their own retirement.

Teachers contribute 8 percent of their salaries to their pensions, do not receive Social Security and most teachers over the age of 65 do not receive retiree health care benefits either. They pay for their pensions with every paycheck.

**Didn't communities like Stockton and San Bernardino go bankrupt because of pensions?**

Stockton's bankruptcy wasn't caused by the city's police officers and garbage truck drivers, but from a combination of circumstances and decisions including lavish borrowing to construct a waterfront ballpark and entertainment center. Stockton's then-city manager has said pensions were NOT responsible for the city's bankruptcy.

In a ruling criticizing Wall Street creditors in the Stockton Bankruptcy case, U.S. Bankruptcy Judge Christopher Klein agreed that the bankruptcy was not driven by pensions, saying a host of decisions and circumstances led to the city's financial woes including developments and tax breaks that could not be sustained because of the housing crisis and recession.

In San Bernardino, pension costs last fiscal year totaled just 4 percent of its budget shortfall. That means even if pensions were eliminated entirely, San Bernardino would still have had a $43 million budget hole.

**Why are unions and public employees blocking pension changes?**

Public employees have been part of the solution to ensure public pension systems are financially sound. More than 600 new agreements have been signed in more than 400 jurisdictions where public employees are contributing more.

The reforms approved by the Legislature and signed by Gov. Jerry Brown amount to a reduction of somewhere between $60 billion and $100 billion in the benefits promised to public employees. Take for example, a public employee making an average salary of $40,000 and working for 30 years. Prior to the new state law, this worker would retire with a pension of $24,000. Now that worker will receive $15,600, a reduction of $8,400, which is not a lot to live on in California.

A recent study by the Center for Retirement Research at Boston College says that pension "reforms" made at the state and local level will restore the state's public pension funds to pre-financial crisis levels. The study, "State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform," looked at changes in 32 plans in 15 states (including CalPERS and CalSTRS). It notes that recently-enacted cuts to public employees "will, over time, improve the financial outlook for plans and help ease their impact on other budget priorities." Researchers also found "in most cases, reforms fully offset or more than offset the impact of the financial

crisis."http://crr.bc.edu/briefs/state-and-local-pension-costs-pre-crisis-post-crisis-and-post-reform/

**Can CalPERS pensioners can "spike" their retirement benefit upward by manipulating the income that gets included in their final year of compensation**?

No. The Public Employees' Pension Reform Act of 2013 (PEPRA) included several measures to reduce abuses. It requires that final compensation be defined, as it is now for new state employees, as the highest average annual compensation over a three-year period. This change prevents employees from artificially increasing the compensation used to determine pension benefits. PEPRA also removed the opportunity for employees to buy "airtime," additional retirement service credit for time not actually worked.

**But why are public pension benefits so excessive?**

They aren't. The average CalPERS pension is about $31,500 per year. Unlike the private sector, many public employees, like teachers, firefighter and police, don't get Social Security and their CalPERS pension may be their sole source of retirement income. Just 3 percent of CalPERS retirees receive the much-publicized $100,000 per year or higher pensions. The vast majority of the $100,000-plus pensions go to retired executives such as city managers and county executives, physicians, and senior managers of police and fire departments.

**Don't pensions hurt the state economy?**

Just the opposite: CalPERS retirees *benefit* the state economy and CalPERS also invests in California. Of its roughly $302 billion portfolio in June 2016, CalPERS invested $27.3 billion in California-based companies and projects, generating a ripple effect of economic activity across the state. CalPERS' investments in California support jobs, economic activity, infrastructure, and business expansion. The economic impact of CalSTRS payments results in more than 92,815 jobs and $11 billion in total output.

**But didn't Senate Bill 400 (1999) cause employer costs to soar over the next 10 years?**

No. The cost of SB 400 was then, and is now $500 million a year. This equals less than 1/2 of 1% of the current state budget. These costs were budgeted for and have not changed. The increased costs in pensions were driven primary by Wall Street abuses which caused by the great recession.

**Is CalPERS 7.5 percent assumed annual rate of investment return too high and unachievable?**

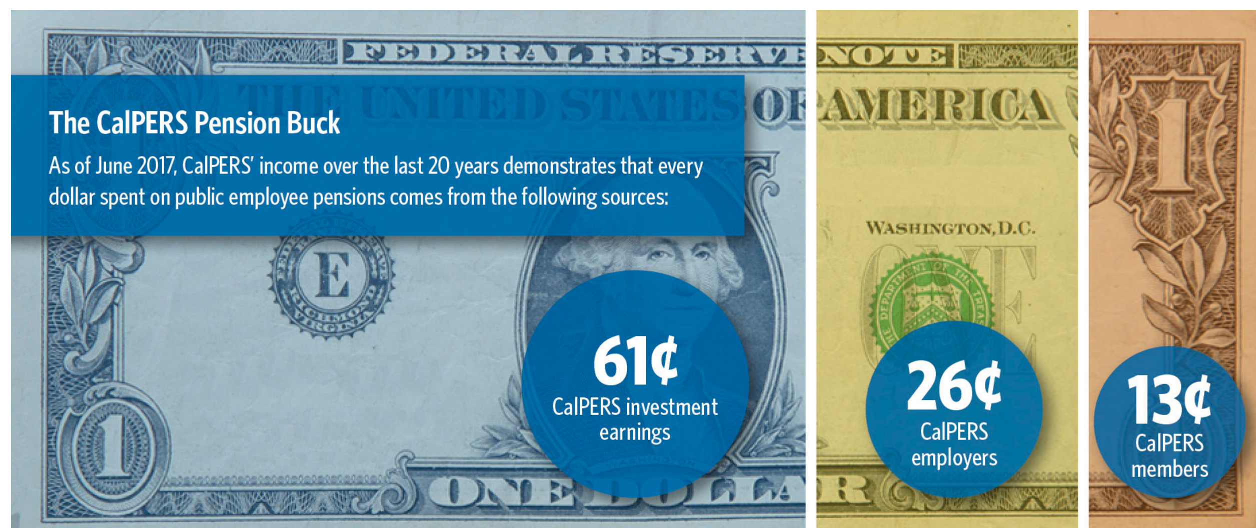
CalPERS investments earned 13.2 percent in Fiscal Year 2012-13, 18.4 percent in Fiscal Year 2013-14, 2.4 percent in Fiscal Year 2014-15, and 0.6 percent in Fiscal Year 2015-16. CalPERS assumed rate of investment return is a long-term average. Any given year is likely to be higher or lower than the assumed rate.

CalPERS investments have earned an average annual return of 6.8 percent over the last five years, 5.1 percent over the past 10 years, and 7 percent over the past 20 years. Since 1988, when CalPERS began using the external custodian, the Fund has earned 8.3 percent annually.

A Wilshire study conducted for CalPERS recently projected annual earnings over the next 30 years at 7.83 percent.

**Why are taxpayers and the State paying the total cost of pensions?**

They aren't. Investment earnings pay the majority of the costs of public pensions. For every dollar paid in pensions, 61 cents is from CalPERS investments. Public employees who are CalPERS members pay a part of their pensions as well. Each month they contribute a percentage of their paychecks toward their pensions. Through collective bargaining agreements negotiated in recent years, state employees pay more toward their pensions - some up to 15.25 percent of each monthly paycheck.



## Highlights of the Public Employee Pension Reform Act of 2012

### Caps Pensionable Salaries

- Caps pensionable salaries at the Social Security contribution and wage base of $110,100 (or 120 percent of that amount for employees not covered by Social Security).

### Establishes Equal Sharing of Pension Costs as the Standard

- Californian state employees are leading the way and are paying for at least 50 percent of normal costs of their pension benefits. Requires new employees to contribute at least half of normal costs, and sets a similar target for current employees, subject to bargaining.

### Eliminates Equal Sharing of Pension Costs as the Standard

- California state employees are leading the way and are paying for at least 50 percent of normal costs of their pension benefits. Requires new employees to contribute at least half of normal costs, and sets a similar target for current, employees, subject to bargaining.
- Eliminates current restrictions that impede local employers from having their employees help pay for pension liabilities.
- Permits employers to develop plans that are lower cost and lower risk if certified by the system's actuary and approved by the legislatures.
- Provides additional authority to local employers to require employees to pay for a greater share of pension costs through impasse proceedings if they are unsuccessful in achieving the goal of 50-50 cost sharing in 5 years.
- Directs state savings from cost sharing toward additional payments to reduce the state's unfunded liability.

### Unilaterally Rolls Back Retirement Ages and Formulas

- Increases retirement ages by two years or more for all new public employees.
- Rolls back the retirement benefit increases granted in 1999 and reduces the benefits below the levels in effect for decades.
- Eliminates all 3 percent formulas going forward.
- For local miscellaneous employees: 2.5 percent at 55 changes to 2 percent at 62; with a maximum of 2.5 percent at 67.
- For local fire and police employees: 3 percent at 50 changes to 2.7 percent at 57;
- Establishes consistent formulas for all new employees going forward.

**Ends Abuses**

- Requires three-year final compensation to stop spiking for all new employees.
- Calculates benefits based on regular, recurring pay to stop spiking for all new employees.
- Limits post-retirement employment for all employees.
- Felons will forfeit pension benefits
- Prohibits retroactive pension increase for all employees.
- Prohibits pension holidays for all employees and employers.
- Prohibits purchases of service credit for all employees.