COUNTY OF MARIN

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September 11, 2012

Marin County Board of Supervisors
3501 Civic Center Drive
San Rafael, CA 94903

SUBJECT: Informational Report on State Pension Reform

Dear Supervisors,

RECOMMENDATION
Accept Informational Report.

SUMMARY
On the last day of the FY 2011-12 legislative session, the Legislature approved the California Public Employees' Pension Reform Act of 2013 (PEPRA) with passage of AB 340 (Furutani) and AB 197 (Buchanan). Although PEPRA does not create a lower cost hybrid plan for new employees, it does achieve several of your Board's goals such as equal sharing of normal costs for new employees, limits on pension spiking, less costly pension benefit levels for new employees, and a benefits cap. What follows is an initial review of the Reform Act, particularly as relates to your Board's Pension Reform Policy Guidelines of December, 2011 (see Attachment A).

OVERVIEW
Pension reform is a high priority for your Board. Your policy guidelines support statewide reform efforts to create more sustainable benefit levels with the goal of a level playing field statewide, including:

- Lower cost hybrid defined benefit (DB)/defined contribution (DC) pension options;
- Prohibiting unfunded retroactive pension increases;
- Providing employers new options to prevent pension "spiking";
- Prohibiting retirement systems from granting ad-hoc COLA's to retirees without the support of the Board or the employer's governing board;
- Exploring limits on 'double-dipping' between other government agencies; and
- Capping pension benefits to a certain percentage of pay or dollar amount.

Based on our initial review, the PEPRA achieves 9 of the Governor's 12 points for pension reform. Though it does not include a hybrid DB/DC plan, it does include a hard cap on the amount of compensation that can be used when calculating a retirement benefit. The other two points that were not included in the final legislations do not directly impact the County because they address the CalPERS Board as well as a proposal to increase State retiree health care vesting. Your

Board has already implemented some of the reform points, such as three-year final compensation and no purchases of service credits.

More significant reform provisions included in the PEPRA include the following:

Pension Benefit Cap

- Establishes a cap on the amount of compensation that can be used to calculate a retirement benefit for new members equal to the Social Security wage index limit ($110,100) for employees who participate in Social Security, or 120% of that limit ($132,120) if they do not participate in Social Security.
  - Prohibits an employer from offering a defined benefit (DB) plan, or combination of DB plans, on compensation in excess of the above compensation cap.
  - Allows employers to provide contributions to a defined contribution (DC) plan for compensation in excess of the cap provided that the plan and the contribution comply with federal law. (Employees who receive an employer contribution to a DC plan will not have a vested right to the employer contribution.)

New/lower Pension Tiers Requiring Additional Years of Service

- Specifies that the retirement formula for the DB plan will be 2% at age 62 for all new non-safety employees, excluding teachers. The earliest an employee would be eligible to retire is age 52 with a 1% factor and the maximum retirement factor of 2.5% is provided at age 67.
- Specifies three retirement formulas for the DB plan that will apply to new safety employees. The three formulas are: 2% at age 57; 2.5% at age 57; and, 2.7% at age 57. New employees would be offered the plan option that is closest to the current plan.

Sharing of Pension Costs

- Requires contributions from new employees to the DB plan equal to one-half of normal cost of the DB.
- Requires that final compensation be defined for all new employees as the highest average annual compensation over a three-year period.
- Authorizes local agencies, including counties, to negotiate cost sharing agreements that include the costs of the unfunded pension liability. Cost sharing must be by agreement between the employer and employee representatives; however, additional new authority provides that the agreement may be reached bargaining unit-by-bargaining unit, rather than requiring all safety or all non-safety employees to agree.

Limitations on Eligible Pay Types Used to Calculate Pensions

- Eliminates pension spiking for new employees with a strict definition of "pensionable compensation." The new definition does not include payments for items such as vacation, sick leave, vehicle allowance, uniform allowance, and employer contributions to defined benefit plans.
- Prohibits a retroactive enhancement to a benefit formula.

- Prohibits the purchase of non-qualified time ("airtime") after January 1, 2013.

Other Reforms

- Specifies that local elected members first elected on or after January 1, 2013 may not receive a retirement benefit for the elected service based on compensation earned in any other public employment. The retirement benefit for the elected service shall only be based on compensation earned for that service.
- Prohibits contribution holidays. Pension boards may suspend contributions if a plan is 120 percent funded or if the retirement system determines that additional contributions would jeopardize the tax status or otherwise harm the plan.
- Restricts the use of retired annuitants. Prohibits a retired annuitant from returning to service before 180 days has passed unless the employer certifies the appointment is necessary to fill a critically needed position before 180 days and the appointment has been approved by the governing body of the employer in a public meeting. (The 180 prohibition does not apply to a retiree who is a public safety officer or firefighter.)
- Requires public officials and employees to forfeit pension and related benefits if they are convicted of a felony in carrying our official duties, in seeking an elected office or appointment, or in connection with obtaining salary or pension benefits.
- Prohibits certain cash payments from being counted as compensation earnable for retirement purposes in '37 Act counties.
- Provides '37 Act retirement boards with more independence to perform audits and assess penalties relating to pension spiking.

INITIAL ANALYSIS

The PEPRA mandates statewide a number of reform elements your Board adopted years ago – such as prohibiting the purchase of "airtime;" requiring 50/50 sharing of normal costs; and requiring the average of the highest three years' earnings for pension calculations.

Beyond these reforms, there are essentially three broad categories of cost savings that should be realized in the County as a result of the PEPRA, including (1) lower normal costs as a result of the lower tiers; (2) eliminating the employer pick-up of employee contributions for new employees; and (3) limiting pensionable earnings to prevent pension "spiking." While it does not include a hybrid defined benefit/defined contribution plan for new employees, it does implement hard caps on pensionable earnings; mandates benefit formulas less costly than those recently negotiated with our bargaining units – requiring more years of service; prohibits unfunded retroactive pension increases; and limits pension spiking.

As a result of the $132,000 cap on pensionable earnings, the PEPRA would substantially reduce the number of retirees earning pensions above $100,000 annually. In addition, ongoing savings will be generated by limiting the income that is considered pensionable – excluding auto and uniform allowance – as well as by eliminating the employee retirement pick-up for new employees, currently 2% of salary for Miscellaneous and 3% for Safety.

While it is still early, Cal-PERS' initial estimates of the fiscal impact of the benefit formula change on Cal-PERS local agency plans show some promise that 1937 Act Plans, such as in Marin, will also experience material savings over the long term as new hires after January 1, 2013 replace exiting workers. Cal-PERS' initial estimates would indicate savings of approximately 1% to 3% of salary for new workers. We would need to work with our actuary to estimate the specific impacts for the County.

NEXT STEPS

Over the next few weeks, we will work with our actuary to assess the estimated impacts of the Act on the County's employer pension costs. Once we have quantified the estimated savings of PEPRA, we will return to your Board to provide the estimated savings for Marin County as well as the implications for our legislative platform and ongoing discussions with our bargaining units.

Should you have any questions, please feel free to contact me.

Sincerely,

Matthew H. Hymel
County Administrator

COUNTY OF MARIN

Attachment A

Pension Reform Policy Guidelines

December 2011

The Marin County Board of Supervisors recognizes that public employee retirement costs are unsustainable without reform. Given the economic downturn and changing demographics, the increased costs of post-employment benefits compete with limited public resources for vital services to our residents, including health and human services, public safety, parks, roads, transportation and many other services. Our overall goal to guide pension reform is to be fair to our employees and fiscally responsible to our residents.

We have already taken several steps to control our pension costs. They include:

- capping pension COLAs to 2% annually
- requiring employees to pay 50% of the cost for any COLA's and 50% of the cost for enhanced formulas
- using the average of the highest three years' earnings for pension calculations
- negotiating new, lower cost 2% @ 61 ¼ tiers for new miscellaneous employees
- reducing the long-term liability for retiree health by at least $18 million over the past 4 years by creating a lower cost defined contribution plan for new hires and adopting more cost-effective health plans

We are currently negotiating with our safety bargaining groups for new, lower cost pension tiers. In addition, we will begin work this spring to create a trust to more proactively address our unfunded retiree health liabilities.

Our Board supports statewide efforts to create more sustainable benefit levels. Although we would prefer statewide solutions, we are also willing and expect the need to pursue Marin-specific solutions. Our support of pension reform includes, but is not limited to:

- creating lower cost hybrid defined benefit/defined contribution pension options
- prohibiting unfunded retroactive pension increases
- providing employers new options to exclude certain pay types from being pension-eligible to prevent pension "spiking"
- prohibiting retirement systems from granting ad hoc COLA's to retirees without the support of the Board of Supervisors or the employer's governing board
- exploring limits on so-called 'double-dipping' between other government agencies
- capping pension benefits to a certain percentage of pay or dollar amount

We welcome participation from all stakeholders to help us influence change at the State level to provide further options for the County to control costs.

Governor's 12-Point Plan. The Board supports the Governor's 12-Point Pension Reform Plan, as it contains many of the policy options for which we have been advocating to make pensions more sustainable. For example, the plan includes:

- a comprehensive statewide plan for all public employees to enable a fair and even playing field for recruiting future talent
- options that would better share costs between the employer and the employee
- prohibition on retroactive pension benefit enhancements that create unfunded liabilities
- increases to the retirement age for new employees
- three-year averaging for benefit calculations
- limitations on pensions to base pay to control spiking
- prohibition of "air-time" purchases of service credits and pension holidays

However, other elements require further details in order to take a fully informed position. For instance, we need to better understand the estimated normal costs of the proposed hybrid pension plan for new employees, and the legal viability of requiring a 50-50 contribution split of normal costs for existing employees. Once these details are available from the Governor's Department of Finance, we will review them to ensure they are consistent with the County's goals.

Governor's 12-Point Plan

Implemented by County

- Prohibit the purchase of service credit for time not actually worked
- Prohibit pension holidays if a plan becomes fully funded
- Prohibit pension "spiking" with 3-year final compensation for new employees

Requires State legislation or Statewide ballot measure

- Require new and current employees to pay 50% of normal pension costs
- Increase retirement age for new employees (67 for Misc; Safety TBD)
- Prohibit retroactive pension increases
- Limit compensation to regular pay only for new employees
- Prohibit any pension benefits to for felons convicted on the job
- Restructure retirement board governance
- Limit post-retirement public employment to 960 hours per year for all
- Hybrid option: 2/3 DB and 1/3 DC for new employees with total target of 75% of pay over 35 years for Misc. and 30 years for Safety
- Reduce State retiree health care costs with longer minimum service levels