INVITEE RESPONSE TO GRAND JURY REPORT

Report Title: **The Budget Squeeze: *How Will Marin Fund Its Public Employee Pensions?***

Report Date: **June 5, 2017** Response Date: **August 5, 2017**

Agency Name: CalPERS Agenda Date: August 1, 2017

Response by: Marcie Frost Title: CEO

FINDINGS

- I (we) agree with the findings numbered: N/A
- I (we) disagree *partially* with the findings numbered: R8
- I (we) disagree *wholly* with the findings numbered: N/A

(Attach a statement specifying any portions of the findings that are disputed; include an explanation of the reasons therefor.)

RECOMMENDATIONS

- Recommendations numbered R5 have been implemented.

  (Attach a summary describing the implemented actions.)

- Recommendations numbered _____ have not yet been implemented, but will be implemented in the future.

  (Attach a timeframe for the implementation.)

- Recommendations numbered _____ require further analysis.

  (Attach an explanation and the scope and parameters of an analysis or study, and a timeframe for the matter to be prepared for discussion by the officer or director of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This timeframe shall not exceed six months from the date of publication of the grand jury report.)

- Recommendations numbered _____ will not be implemented because they are not warranted or are not reasonable.

  (Attach an explanation.)

Date: 8/1/17 Signed: Brad Padmo for Marcie Frost

Number of pages attached 2

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August 1, 2017

Mr. Jay Hamilton-Roth, Foreperson
Marin County Grand Jury
3501 Civil Center Drive, Suite 275
San Rafael, California 94903

Dear Mr. Hamilton-Roth and members of the Civil Grand Jury,

Re: The Budget Squeeze: How Will Marin Fund Its Public Employee Pensions?

On behalf of the California Public Employees' Retirement System (CalPERS), I want to thank you for the opportunity to respond to the report titled *The Budget Squeeze: How Will Marin Fund Its Public Employee Pensions?* I will share with you the work that CalPERS is doing to ensure the long-term sustainability of the pension fund and address some specific recommendations from the report.

About CalPERS
For 85 years, through economic growth and near global financial collapse, CalPERS has provided financial retirement security for state, school, and public agency members who pursue careers in public service. Our pension fund serves 1.8 million members, beneficiaries and their families.

As of June 30, 2017, we have approximately 68 percent of the assets needed to pay long-term promised benefits. This is an increase in the funded status of our plan by 3 percent over the previous year due to recent strong investment returns. CalPERS earned an 11.2 percent return on its investments at the end of the 2016-17 fiscal year.

The pension earned by the majority of CalPERS members is modest for life-time careers in public service. Our school retirees earn on average $1,562 per month as of June 30, 2016. Local government retirees earn approximately $3,570 per month for the same time period.

Nevertheless, we are acutely aware of the impact pension costs are having on California's public employers and CalPERS is taking steps to mitigate these impacts to lower costs of the system and protect our active and retired members.

Reducing risk, costs and complexity

CalPERS has a sound management approach that integrates our assets and liabilities as we fund the system. We continue to examine how to balance the risks to the system, while creating a positive and sustainable fund for the future. Our leadership team and Board regularly evaluates changes in financial, economic, and demographic conditions so we can make important decisions that will help bolster the long-term sustainability of our fund.

In December 2016, our Board approved reducing CalPERS discount rate from 7.5 percent to 7.0 percent over the next three years, recognizing the low return environment that financial experts predict over the next decade. While this change will increase employer contribution rates, it brings needed cash into the system, reduces the long-term probability of the funded ratio falling below undesirable levels, and improves the likelihood that our investments will earn the assumed rate of return in the future. It also reduces the volatility of future employer contributions.

CalPERS has also been a leader in reducing investment fees and expenses. Costs to manage our investment portfolio have declined by approximately $281 million over the last six years. Contributors to the savings include transitioning assets from external managers to internal management, reducing external management fees, and decreasing the number of outside consultants and advisors.

Cost savings achieved through the 2013 Public Employees' Pension Reform Act (PEPRA) which CalPERS supported are also helping to strengthen the fund. For FY 2017-18, nearly $67 million in savings will be realized through the reduction of required contributions as employees hired on or after January 1, 2013, are placed into lower benefit levels. These PEPRA related savings are expected to increase as more new employees join our system over the next 15-20 years.

CalPERS role as a pension administrator

Pension benefits are a shared responsibility between employers, employees and CalPERS. Currently, sixty-two cents for every dollar paid in retirement benefits comes from investment returns, while employers and employees contribute 25 and 13 cents respectively. However, CalPERS does not set benefit levels. Retirement benefits provided by participating employers are negotiated between the employer and its employees or set by the Legislature. CalPERS administers the retirement benefits included in the employer's retirement benefit contract. In 1999 and 2001, the Legislature passed and the Governor enacted Senate Bill (SB) 400 (Stats. 1999, Ch. 555) and Assembly Bill (AB) 616 (Stats. 2001, Ch. 782), respectively. SB 400 increased retirement benefit formulas for state miscellaneous and safety members and added higher local safety member benefit formula options that could be contracted for by public agencies. AB 616 added higher local miscellaneous benefit formula options that can be contracted for by public agencies. It should be noted that following the enactment of SB 400 and AB 616, at least 28 public agencies in Marin County amended

their contracts to provide a higher benefit formula for their employees. These are decisions that employers and elected officials made, along with their employees, that has been a contributing factor to cost increases.

Responses to Report Recommendations

The report recommends (R5) that "[f]or the purposes of transparency, ... CalPERS should publish an actuarial analysis of the effect of Cost of Living Allowances (COLA) on unfunded liabilities on an annual basis."

The PERL requires CalPERS to pay COLA increases to retirees each May, if applicable. Our team provides the Board and the public with COLA related information before those payments go into effect, generally sometime in the winter or spring. Currently, COLAs account for approximately 14 to 18 percent of both the normal cost and the accrued liability, with miscellaneous plans falling towards the lower end of the range and safety plans near the upper end. This information was presented to our Board on November 15, 2016 and is available on our website. In addition, our annual Actuarial Valuation[1] and Optional Benefit Listing[2] publications available online provide COLA information and estimates. Until 2011, the PERL required CalPERS to publish an annual *Cost of Living Report.* In 2012, to lessen burdens on state agencies and consolidate and streamline reporting requirements, the Legislature repealed the law requiring CalPERS to submit the annual *Cost of Living Report* along with another 200 reports from different state agencies. Most of the information we included in that annual report is now available on our website and in our actuarial reports.

Your report also recommends (R8) that "[p]ublic agencies and public employee unions should begin to explore how introduction of defined contribution (DC) programs can reduce unfunded liabilities for public pensions."

CalPERS believes that a retirement plan should include a defined benefit (DB) component and a retirement system must meet the needs of both members and employers to be successful. DB plans have proven time and again to be the cornerstone of retirement security. For employees that means a predictable income and peace of mind in retirement. For employers, they are important for recruiting and retaining their workforces. Numerous studies conducted by public, private, non-profit, and academic institutions have evaluated the costs and benefits of closing DB plans and replacing them with DC plans. These studies have all found that DB plans are more cost-effective in terms of plan administration, provide better member benefits, have higher investment returns than DC plans, and help employers recruit and retain talent.

A recent study by the Center for Retirement Research at Boston College compared investment returns between DB and DC plans between 1992 and 2012. The study

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[1] California Public Employees' Retirement System (CalPERS), *Actuarial Valuation for CalPERS Miscellaneous Risk Pool.* CalPERS, June 2015. Web. 10 July 2017.
[2] CalPERS *Optional Benefits Listing.* CalPERS, July 2017. Web. 11 July 2017.

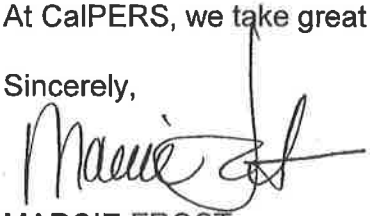
found that DB plans outperformed DC plans for this 20-year period.[3] A 2013 study by Tower Watson also found that DB plan investment returns have outperformed DC plans over the last 15 years.[4] Both studies also noted the higher administrative costs of DC plans. Switching to a DC plan would mean foregoing the better investment returns and paying higher administrative and pension management fees, while providing inadequate retirement benefits to members.

In February 2015, the National Institute on Retirement Security published the issue brief *Case Studies of State Pension Plans that Switched to Defined Contribution Plans.*[5] The study analyzes the impact of three state public retirement systems that switched from DB to DC plans. According to the study, switching to a DC plan reduced retirement benefits for participants, but did not improve funding issues or reduce DB plan costs. After reexamining the issue and finding that a DB plan would cost less and provide better benefits for its members, one state switched back to a DB plan. Another state found that it invested considerable resources in hiring and training new employees only to have those employees leave with training and experience and their DC balances to work for employers with DB plans.[6]

Once again, I want to thank you for the opportunity to respond to the report and for your attention to this important matter. I hope that I have demonstrated that CalPERS is doing its part to ensure the long-term sustainability of the system. As always, we are available to answer questions or provide you additional information on the soundness of the system. Please feel free to contact me at (916) 795-3829.

At CalPERS, we take great pride in serving those who serve California.

Sincerely,



MARCIE FROST
Chief Executive Officer

cc: The Honorable Judge Kelly V. Simmons

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[3] Munnell, Alicia H., Jean-Pierre Aubry, and Caroline V. Crawford. *Investment Returns: Defined Benefit Vs. Defined Contribution Plans.* Number 15-21. Center for Retirement Research at Boston College, December 2015, Web. 10 July 2017.
[4] Tower Watson. *DB Versus DC Investment Returns: The 2009-2011 Update.* Tower Watson, May 2013. Web. 10 July 2017.
[5] National Institute on Retirement Security (NIRS). Public Pension Resource Guide. *Case Studies of State Pension Plans that Switched to Defined Contribution Plans.* NIRS, February 2015. Web. 11 July 2017.
[6] Alaskan Public Pension Coalition. *Returning Alaska to a Defined Benefit System: A Benefit for Alaskans and a Savings for the State.* Alaskan Public Pension Coalition, February 2010. Web. 12 July 2017.