REFORMING STATE EMPLOYEE RETIREMENT COMPENSATION

ENSURING PENSION AND HEALTH CARE PROMISES DON'T BANKRUPT OUR STATE

"At the same time we cannot make this budget just about cuts. There are also some great opportunities for structural reform. … So let's use this crisis as an opportunity." (Gov. Arnold Schwarzenegger, 6/2/09)

Retirement promises made to state employees amounting to hundreds of billions of dollars of unfunded debt threaten to consume growing portions of the state General Fund and squeeze out funding for higher education, welfare, environmental protection and more programs. Promises made to existing employees cannot and should not be changed, but action must be taken to reduce the escalating costs of state employees' pensions and retirement health care benefits moving forward. Recently, states and cities across the country have adopted significant reforms in order to rein in costs. Governor Schwarzenegger knows that solving our budget deficit must be about more than just cuts, it must also be about long-term reform to help our state budget remain balanced in the future. No long-term fix is more important to our budget's solvency than reforming state employee retirement compensation. Additionally, the Governor proposes reform to retiree health care benefits.

Pension Reform

Background: *In 1999, the Legislature and Governor Davis enacted SB 400 to retroactively and prospectively boost pension benefits for any employee who retired on or after January 1, 2000. SB 400 also enhanced the average monthly compensation formula used in computing retirement allowances and provided a cost of living retirement allowance increase for state and school retirees who retired prior to 1998. In 2002, another bill (SB 183) expanded the definition of the State Safety retirement category to include many non-safety classifications (such as billboard inspectors and milk inspectors), further enhancing the retirement benefit for employees in those classifications.*

The Governor proposes reforming these unsustainable retiree pension formulas, for new hires only, in order to protect existing employees' pensions and ensure that new promises do not incur debt that is overly burdensome on our state budget. This would result in a **savings** of $74 billion in reduced pension payouts and $19 billion in reduced costs of retiree health benefits through 2040.

For new employees hired on or after July 1, 2009 this proposal would:

- Return to pre-SB 400 retirement formulas for Miscellaneous, Industrial, State Safety, and Peace Officer retirement categories.
- Repeal the SB 183 expanded definition of the State Safety retirement category.
- Change the benefit formula for Firefighter and Highway Patrol from 3 percent at age 50 to 3 percent at 55.
- Compute final compensation for Peace Officers, Firefighters, and Highway Patrol based on the highest 3 years instead of the highest 1 year.

Retirement Category	Current Retirement Formulas	Proposed Formulas
Miscellaneous - First Tier	2.5% at Age 63+ (2% at Age 55)	2.418% at Age 63+ (2% at Age 60)
Miscellaneous - Second Tier	1.25% at Age 65+	1.25% at Age 65+
Industrial	2.5% at Age 63+ (2% at 55)	2.418% at Age 63+ (2% at 60)
State Safety (Pre-SB183)	2.5% at age 55+	2% at Age 55+
Peace Officer	3% at Age 50+*	2.5% at Age 55+
Firefighter	3% at Age 50+*	3% at Age 55+
Highway Patrol	3% at Age 50+	3% at Age 55+

*SB 400 changed the formula to 3% at age 55, but 3% at age 50 was collectively bargained under the previous Administration.

By removing the floor before which state employees must contribute to their own pensions, the Governor proposes to save $65 million annually. This would result in $2 billion in pension cost savings through 2040. The current contribution levels are: Miscellaneous/Industrial – 5 percent of salary over $513; Safety – 6 percent of salary over $317; Peace Officer/Firefighter – 8 percent of salary over $238; Highway Patrol – 8 percent of salary over $864.

Increasing transparency, understanding, and accountability, and providing critical information to budget planners and legislators, The Governor proposes legislation to: (1) require CalPERS to submit a report that in plain language describes (i) the investment return it assumes for projecting contributions and unfunded liabilities, (ii) the market value of its assets and how that value differs from its chosen actuarial value for those assets, and (iii) contributions and unfunded liabilities assuming returns lower than its investment return assumption; (2) require the Treasurer (or another entity) to evaluate this report and provide its opinion of the report to the Legislature; and (3) require the Legislature to review these reports.

<u>Retiree Health Care Reform</u>

In 2004, the federal Governmental Accounting Standards Board began requiring governmental entities to report unfunded liabilities for retiree health care and Other Post-Employment Benefits (OPEB) as they were already required to report in the case of pensions. In response, Governor Schwarzenegger established the bipartisan Public Employee Post Employment Benefits Commission (PEBC) to propose ways for addressing pension and retiree health care promises. In January 2008, the PEBC made 34 recommendations including adopting pre-funding liabilities both as a policy and as a budget priority, and making sure employer contributions to retiree health care reward longer careers. The Governor endorsed the PEBC's recommendations and directed the Department of Finance and Department of Personnel Administration (DPA) to develop options to reduce the state's $48 billion accrued actuarial liability (AAL) for OPEB without raising taxes or increasing General Fund expenditures.

California should have the authority to seek competitive bids in order to lower the cost of retiree health care coverage. The state should not be tied to only one health care provider. The Governor proposes to provide the state with the authority to purchase health care from a provider other than CalPERS, giving the state instead of CalPERS the ability to determine plan design and levels of premiums.

- Savings: $180 million savings in 2009-10; $323 million savings annually with a growth rate of 3 percent.

Lengthen health care vesting to reward longer careers. New employees would fully vest for lifetime health care benefits only after 25 years of service, rather than the current 50-percent after 10 years and 100-percent after 20 years.

- Savings: $49 billion reduction to the AAL through 2040.

State health care contribution for retirees. Change the state's contribution for retiree health for employees hired on or after July 1, 2009 from 100 percent of the average HMO premium to match the contribution required from the state in the case of active employees (generally 85 percent of premium).

- Savings: $19 billion reduction to the AAL through 2040.