Twelve Point Pension Reform Plan

October 27, 2011

The pension reform plan I am proposing will apply to all California state, local, school and other public employers, new public employees, and current employees as legally permissible. It also will begin to reduce the taxpayer burden for state retiree health care costs and will put California on a more sustainable path to providing fair public retirement benefits.

1. Equal Sharing of Pension Costs: All Employees and Employers

While many public employees make some contribution to their retirement – state employees contribute at least 8 percent of their salaries – some make none. Their employers pay the full amount of the annual cost of their pension benefits. The funding of annual normal pension costs should be shared equally by employees and employers.

My plan will require that all new and current employees transition to a contribution level of at least 50 percent of the annual cost of their pension benefits. Given the different levels of employee contributions, the move to a contribution level of at least 50 percent will be phased in at a pace that takes into account current contribution levels, current contracts and the collective bargaining process.

Regardless of pacing, this change delivers real near-term savings to public employers, who will see their share of annual employee pension costs decline.

2. "Hybrid" Risk-Sharing Pension Plan: New Employees

Most public employers provide employees with a defined benefit pension plan. The employer (and ultimately the taxpayer) guarantees annual pension benefits and bears all of the risk of investment losses under those plans. Most private sector employers, and some public employers, offer only 401(k)-type defined contribution plans that place the entire risk of loss on investments on employees and deliver no guaranteed benefit.

I believe that all public employees should have a pension plan that strikes a fair balance between a guaranteed benefit and a benefit subject to investment risk. The "hybrid" plan I am proposing will include a reduced defined benefit component and a defined contribution component that will be managed professionally to reduce the risk of employee investment loss. The hybrid plan will combine those two components with Social Security and envisions payment of an annual retirement benefit that replaces 75 percent of an employee's salary. That 75 percent target will

be based on a full career of 30 years for safety employees, and 35 years for non-safety employees. The defined benefit component, the defined contribution component, and Social Security should make up roughly equal portions of the targeted retirement income level. For employees who don't participate in Social Security, the goal will be that the defined benefit component will make up two-thirds, and the defined contribution component will make up the remaining one-third, of the targeted retirement benefit.

The State Department of Finance will study and design hybrid plans for safety and non-safety employees, and will fashion a cap on the defined benefit portion of the plans to ensure that employers do not bear an unreasonable liability for high-income earners.

3. Increase Retirement Ages: New Employees

Over time, enriched retirement formulas have allowed employees to retire at ever-earlier ages. Many non-safety employees may now retire at age 55, and many safety employees may retire at age 50, with full retirement benefits. As a consequence, employers have been required to pay for benefits over longer and longer periods of time.

The retirement age for non-safety workers in 1932, when the state created its retirement system, was 65. The retirement age for a state highway patrol officer in 1935 was 60. The life expectancy of a twenty-year old who began working at that time was mid-to-late 60s, meaning that life expectancy beyond retirement was a relatively short period of time. Now with a growing life expectancy, pensions will pay out not just for a few years, but for several decades, requiring public employers to pay pension benefits over much longer periods of time. Under current conditions, many years can separate retirement age from the age when an employee actually stops working. No one anticipated that retirement benefits would be paid to those working second careers.

We have to align retirement ages with actual working years and life expectancy. Under my plan, all new public employees will work to a later age to qualify for full retirement benefits. For most new employees, retirement ages will be set at the Social Security retirement age, which is now 67. The retirement age for new safety employees will be less than 67, but commensurate with the ability of those employees to perform their jobs in a way that protects public safety.

Raising the retirement age will reduce the amount of time retirement benefits must be paid and will significantly reduce retiree health care premium costs. Employees will have fewer, if any, years between retirement and reaching the age of Medicare eligibility, when a substantial portion of retiree health care costs shift to the federal government under Medicare.

4. Require Three-Year Final Compensation to Stop Spiking: New Employees

Pension benefits for some public employees are still calculated based on a single year of "final compensation." That one-year rule encourages games and gimmicks in the last year of employment that artificially increase the compensation used to determine pension benefits. My plan will require that final compensation be defined, as it is now for new state employees, as the highest average annual compensation over a three-year period.

5. Calculate Benefits Based on Regular, Recurring Pay to Stop Spiking: New Employees

Where not controlled, pension benefits can be manipulated by supplementing salaries with special bonuses, unused vacation time, excessive overtime and other pay perks. My plan will require that compensation be defined as the normal rate of base pay, excluding special bonuses, unplanned overtime, payouts for unused vacation or sick leave, and other pay perks.

6. Limit Post-Retirement Employment: All Employees

Retirement with a pension should not translate into retiring on a Friday, returning to full-time work the following Monday, and collecting a pension and a salary. Retired employees often have experience that can deliver real value to public employers, though, so striking a reasonable balance in limiting post-retirement employment is appropriate. Most employees who retire from state service, and from other CalPERS member agencies, are currently limited to working 960 hours per year for a public employer, and do not earn any additional retirement benefits for that work. My plan will limit all employees who retire from public service to working 960 hours or 120 days per year for a public employer. It also will prohibit all retired employees who serve on public boards and commissions from earning any retirement benefits for that service.

7. Felons Forfeit Pension Benefits: All Employees

Although infrequent, recent examples of public officials committing crimes in the course of their public duties have exposed the difficulty of cutting off pension benefits those officials earned during the course of that criminal conduct. My plan will require that public officials and employees forfeit pension and related benefits if they are convicted of a felony in carrying out official duties, in seeking an elected office or appointment, or in connection with obtaining salary or pension benefits.

8. Prohibit Retroactive Pension Increases: All Employees

In the past, a number of public employers applied pension benefit enhancements like earlier retirement and increased benefit amounts to work already performed by current employees and retirees. Of course, neither employee nor employer pension contributions for those past years of work accounted for those increased benefits. As a result, billions of dollars in unfunded liabilities continue to plague the system. My plan will ban this irresponsible practice.

9. Prohibit Pension Holidays: All Employees and Employers

During the boom years on Wall Street, when unsustainable investment returns supported "fully-funded" pension plans, many public employers stopped making annual pension contributions and gave employees a similar pass. The failure to make annual contributions left pension plans in a significantly weakened position following the recent market collapse. My plan will prohibit all employers from suspending employer and/or employee contributions necessary to fund annual pension costs.

10. Prohibit Purchases of Service Credit: All Employees

Many pension systems allow employees to buy "airtime," additional retirement service credit for time not actually worked. When an employee buys airtime, the public employer assumes the full risk of delivering retirement income based on those years of purchased service credit. Pensions are intended to provide retirement stability for time actually worked. Employers, and ultimately taxpayers, should not bear the burden of guaranteeing the additional employee investment risk that comes with airtime purchases. My plan will prohibit them.

11. Increase Pension Board Independence and Expertise

In the past, the lack of independence and financial sophistication on public retirement boards has contributed to unaffordable pension benefit increases. Retirement boards need members with real independence and sophistication to ensure that retirement funds deliver promised retirement benefits over the long haul without exposing taxpayers to large unfunded liabilities.

As a starting point, my plan will add two independent, public members with financial expertise to the CalPERS Board. "Independence" means that neither the board member nor anyone in the board member's family, who is a CalPERS member, is eligible to receive a pension from the CalPERS system, is a member of an organization that represents employees eligible to or who receive a pension from the CalPERS system, or has any material financial interest in an entity that contracts with CalPERS. My plan also will replace the State Personnel Board representative on the CalPERS board with the Director of the California Department of Finance.

True independence and expertise may require more. And while my plan starts with changes to the CalPERS board, government entities that control other public retirement boards should make similar changes to those boards to achieve greater independence and greater sophistication.

12. Reduce Retiree Health Care Costs: State Employees

The state and the nation have seen the costs of health care skyrocket. The state's retiree health care premium costs have increased by more than 60 percent in the last five years and will almost double over ten years. This approach has to change.

My plan will reduce the taxpayer burden for health care premium costs by requiring more state service to become eligible for health care benefits at retirement. New state employees will be required to work for 15 years to become eligible for the state to pay a portion of their retiree health care premiums. They will be required to work for 25 years to become eligible for the maximum state contribution to those premiums. My plan also will change the anomaly of retirees paying less for health care premiums than current employees.

Contrary to current practice, rules requiring all retirees to look to Medicare to the fullest extent possible when they become eligible will be fully enforced.

Local governments should make similar changes.