



REPORT TO LAW & LEGISLATION COMMITTEE City of Sacramento

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STAFF REPORT
August 16, 2005

Honorable Members of the
Law and Legislation Committee

Subject: Position on Legislation Related to Pension Reform

Location/Council District:
Citywide.

Recommendation:

This report recommends that the Law and Legislation Committee support the League of California Cities' Pension Reform Task Force goals on pension reform and proposed legislative actions and continue to participate in the efforts of the Task Force.

Contact: Patti Bisharat, Government Affairs Manager, 808-8197

Presenters: Patti Bisharat, Government Affairs Manager, 808-8197

Department: City Manager's Office

Organization No: 0310

Summary:

It has been requested that the City consider opposing two state proposals related to pension reform, Assembly Constitutional Amendment 5, the California Public Employee Defined Contribution Plan, and a proposed initiative by Governor Arnold Schwarzenegger. There are several other bills that have been introduced related to this issue. All of the legislation would impose requirements on local government that would limit our flexibility to choose the type of pension provided to city employees.

This report recommends that the Law and Legislation Committee adopt a position supporting the efforts of the League of California Cities' Pension Reform Task Force. This position is consistent with the Council adopted legislative principles related to retaining local control over issues impacting the City.

Committee/Commission Action: None.

Background Information:

A number of state legislative items have been introduced which would impose requirements on local government relative to the pension plans offered to employees. One of the critical debates on this issue is the defined benefit versus the defined contribution approach to pension plans.

Defined Benefit Contribution and Defined Contribution Plans

In California, most public employees are covered by a defined benefit (DB) retirement plan which provides participants with a guaranteed annual pension based upon age at retirement, years of service, and salary. The California Public Employees' Retirement System (PERS) administers the retirement plans for state employees and classified school employees, while the California State Teachers' Retirement System (STRS) administers the plans for teachers. Many local government entities, including the City of Sacramento, contract with PERS to administer their retirement plans. Additionally, twenty counties have chosen to establish their own retirement systems under the County Employees Retirement Law of 1937 Act ('37 Act).

Funding for defined benefit retirement systems generally come from three sources - employee contributions, employer contributions, and interest earnings. Employee contributions are generally a fixed percentage amount, while employer contributions generally vary from year to year. In many instances the employer contribution is negotiated as part of contracts with labor organizations.

Defined contribution (DC) plans include 401(k), 403(b), or public sector 457 plans. A participant's benefit from a DC plan is based upon the contribution by the participant, any employer contributions, and investment gains or losses. A DC plan is primarily a savings accumulation program, not technically a pension program. A DC plan does not provide a guaranteed benefit level at retirement nor do they include disability or death benefits. The balance in a DC account can be paid out as either a lump sum or partial lump sum, in installment payments, or it can be used to purchase an annuity.

Pension Reform Efforts

Recently, there has been a great deal of debate related to the need to reform the public employee retirement system. Governor Schwarzenegger and several California legislators have expressed concerns regarding the rising costs of retirement benefits for public employees. To address these concerns, there have been a number of legislative measures proposed including an initiative supported by the Governor and several bills authored by various State legislators. Recently, the Governor announced that he would withdraw his pension reform initiative proposal. However, in addition to ACA 5, more than a dozen bills were introduced during the first session related to pension reform.

Senate President pro Tem Don Perata recently introduced pension proposals that will be introduced during special session. According to Senator Perata, these measures will

stabilize the budget, prevent pension abuse, and protect workers and taxpayers. There are three key issues that these bills would address:

- Smoothing (Rate Stabilization): The goal is to minimize the impact on the funded status of the plans; to minimize the volatility of the employer's contribution; and to minimize the average future employer contribution.
- Spiking (Benefit Manipulation): The goal is to limit the practice of inflating the salary upon which the lifetime pension is based.
- Chief's Disease (Industrial Disability Retirement): The goal is to stop the abuse of disability retirement by those who apply for disability when they prepare to retire to gain tax advantage. The goal is also to prevent abuse by those who receive a disability benefit and then accept a similar, physically demanding or high stress position with a different employer.

League of California Cities - Pension Reform Task Force

In response to these legislative pension reform efforts, the League of California Cities (League) has created a Pension Reform Task Force. This group includes several stakeholders from the League, the California Association of Counties, PERS, the University of California, the California Association of Police Chiefs, the California Association of Fire Chiefs, and the Governor's Administration. This task force has provided opportunities for communications with labor and the Governor's Administration to discuss various legislative and regulatory proposals. The task force has identified a set of goals that will be crucial to further discussions on pension reform including, but not limited to:

- Retain the Defined Benefit Plan as the primary retirement for public employment
- Stabilize Employer contribution rates to smooth the impact of volatile investment earnings
- Reduce long term costs of public pension systems
- Establish fair benefits for public employees for effective recruiting and retention of a skilled, quality workforce.
- Establish industrial disability retirement benefits that provide fair benefits for an injured employee

To implement these goals, the task force prepared a report that suggested support of the following legislative actions:

- Defined Benefit Plan - Support a defined benefit plan as the primary model for public pension. Oppose any action that imposes a single pension system model as the only pension system option open to a public employer.
- New Tier - Any new benefit structure would apply to newly hired employees only to reduce long term costs of public pension systems.
- Employer Rate Smoothing - Support a sound, rate-smoothing plan to reduce the volatility of employer contribution rates.

- Disability Retirement - Narrow disability retirement benefits to prohibit disability retirement benefits when a retiree accepts a substantially similar position and to permit post industrial disability medical check-up by the employer.
- Benefits - Support a defined benefit plan that establishes a fair retirement for career employees and maintains their standard of living in retirement.

Conclusion

Pension reform in the public employee retirement system is a complex and evolving issue that will require a great deal of discussion and debate. There are more than a dozen bills related to pension reform that are in various stages of the legislative process. Additionally, there are a variety of stakeholders with contrasting positions and concerns.

Staff is recommending that the Law & Legislation Committee adopt a position supporting the League of California Cities' Pension Reform Task Force goals on pension reform and proposed legislative actions and continue to participate in the efforts of the Task Force.

Financial Considerations:

None.

Environmental Considerations:

None.

Policy Considerations:

The recommended position is consistent with the Council adopted legislative principles related to retaining local control over issues impacting the City.

Emerging Small Business Development (ESBD):

None.

Respectfully Submitted by: 
Patti Bisharat

Recommendation Approved:


KEN NISHIMOTO
Assistant City Manager