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TO: TOWN COUNCIL

FROM: TOWN MANAGER

RE: CONSENT ITEM
SACRAMENTO REGIONAL MANAGERS GROUP PRINCIPLES AND RECOMMENDATIONS FOR PENSION REFORM

ISSUE
The Sacramento Regional Managers Group developed guiding principles and recommendations for public pension reforms and asks for support from local managers.

RECOMMENDATION
Receive and file as information. I plan to sign in support of the Sacramento Regional Managers Group paper on "Guiding Principles and Recommendations for Pension Reform" unless Council decides that I should not.

CEQA
There are no CEQA issues with a personnel matter such as this.

MONEY
State and local governments will save money over time if government pensions are changed in the manner recommended in the guiding principles.

DISCUSSION
Sacramento Regional Managers have been meeting to work out a position on government pension reform. Other manager groups around the State have done the same, most recently groups in the Bay area and Southern California. Each group has prepared an issues and recommendation paper and through the League it is expected that a single document, supported by the cities and towns, will emerge.

Attached is the paper developed by the Sacramento Regional Managers. At the end of July the document will be circulated for signatures and I plan to join in the effort to support the findings and recommendations detailed in the paper.

SACRAMENTO REGIONAL MANAGERS GROUP WORKING ON PENSION REFORM

Guiding Principles and Recommendations for Pension Reform

Background on Pension Reform Proposals

In 2004 the League of California Cities began working on proposals to facilitate Pension Reform. The League's action was based on the growing concern that public employee pensions would become fiscally unsustainable in the near future unless steps were taken to reform the defined benefits program offered by CalPERS and other public employee retirement agencies. The League asked the City Manager's Department Standing Task Force on CalPERS to lead this effort. This Task Force generated a report in 2005 that was accepted by the League's Board of Directors.

California counties have also recognized the need to address pension reform. In 2004 the County Administrative Officers Association of California (CAOAC) appointed a working group to develop recommendations for pension system reform. The result of this effort was eventually presented by California State Association of Counties (CSAC) staff to its Government Finance and Operations Policy Committee in January 2005, and later adopted by the Board of Directors of CSAC.

The reports generated by the League and CAOAC/CSAC efforts were completed in 2005 and updated in 2009. While these reports were completed through separate processes and under separate organizations, the recommendations were very consistent in concluding that local government employers in California need to consider strategies to address the rising current and future costs of pensions. In fact, local cities, counties and special districts have formed management associations and reached agreements to collaborate on pension reform. Some of these associations, including groups in San Diego, Marin and San Joaquin counties, have developed Memorandums of Understanding that endorse guiding principles with levels of defined benefits which would be negotiated over time with their respective labor organizations.

In December 2009, Sacramento Valley Division city managers met in Yuba City to discuss pension reform and receive a briefing on the reform principles that have been proposed by the League City Managers Standing Task Force. The city managers attending the meeting generally supported the concept of forming an association of local government managers to develop a draft MOU for the region. It was determined at that meeting that the regional focus for the MOU should not be defined by the League's Sacramento Valley Division. The Sacramento Valley Division encompasses all cities north of Sacramento to the Oregon border. The regional focus needed to be from a labor market point of view which suggests a smaller area. In addition, county governments need to be included. These conclusions led to the belief that the seven county region of

Amador, El Dorado, Placer, Sacramento, Sutter, Yolo and Yuba would be a more appropriate region to consider a potential MOU.

On January 21, the MBCF Executive Management Group invited city managers and county administrators from the regional area to a meeting in Folsom to further discuss the regional MOU concept. The result of this meeting was the formation of a regional task force composed of staff from the cities of Elk Grove, Sacramento, Rancho Cordova, Lincoln, Davis, Folsom, Ione and Woodland and counties of Amador, Sacramento and El Dorado that committed to work on the concept. Members of this group met on February 18 in Rancho Cordova. The outcome of that meeting was a commitment to present a draft regional MOU for the larger regional group to review on March 18. Additional meetings of the regional task force occurred in April to further refine the draft regional MOU.

The draft regional MOU builds upon the guiding principles, conclusions and recommendations of the previous reports issued by the League and CSAC. The format for presenting this information is similar to the formats used by the management groups in San Diego, Marin and San Joaquin. Therefore, the following section of this document present the Guiding Principles and Reform Recommendations for further consideration and discussion.

Guiding Principles

1. Maintain the Commitment to a Defined Benefit Program: While understanding the need to implement pension reform and control present and future pension costs, the outcome of this effort is to improve the fiscal sustainability of the existing defined benefit program and not to transition to a defined contribution program usually associated with the private sector such as a 401(k). Defined benefit programs have generally out performed defined contribution programs and have proven to be less expensive to manage while offering superior benefits. However, the existing level of the defined benefit program is not sustainable from a fiscal standpoint for local governments.

2. Stated purpose of public pension programs: The primary purpose of a public pension program should be to provide a full-career employee with pension benefits which, when combined with private savings or other sources of post employment income, will maintain the employee's standard of living in retirement. Public employers should offer Defined Contribution programs that employees are encouraged to fund as savings plans to supplement their Defined Benefit program.

3. Maintaining Reciprocity: The reciprocity of pension benefits within the public sector should be maintained to ensure recruitment and retention of skilled public employees, particularly in light of the retirement of the post World War II "Baby Boom" generation, which will result in unprecedented demand for public sector employees.

4. Eliminate Abuse: Public pension systems provide an important public benefit by assisting public agencies to recruit and retain quality employees. Perceived and actual fraud and abuse must be eliminated to restore the public trust and preserve the overall public value of these systems. Examples of abuse include "spiking" and examples of fraud includes illegally increasing compensation for the sole purpose of increasing pension benefits.

5. Reduce and Contain Costs: Public Pension reform should provide for immediate and long-term cost relief. Therefore, a shared contribution between the employer and existing and future employees is a critical element of this effort.

6. Increase Predictability of Costs for Employee and Employer: Responsible financial planning requires predictability. Employers must be able to predict their financial obligations in future years. Employees should have the security of an appropriate and predictable level of income for their retirement after a career in public service. Community interests are protected by predictable future costs which will enable public services to be accurately forecasted and appropriately funded.

7. Provide for Equitable Sharing of Costs and Risks Between Employee and Employer: Equitable sharing of pension costs and risks promotes shared responsibility for the financial health of pension systems and reduces the incentive for either employees or employers to advocate changes that result in disproportionate costs to the other party, while diminishing the exclusive impact on employers for costs resulting from increases in unfunded liability.

8. Increase Pension System Accountability: Public pension systems boards have a constitutional duty to (a) protect administration of the system to ensure benefits are available to members and (b) minimize employer costs. The constitutional provisions and state statutes governing such boards should promote responsible financial management and discourage conflicts of interest.

Local Reform Proposals

Acting on a regional basis for reforms could provide solutions whereby no one local agency is advantaged, or disadvantaged, by pension reform. Therefore, it is proposed that the Sacramento regional group support a reduced level of retirement benefits for all new city and county employees in the region as a goal to be achieved in the future. The partner agencies recommend current employees pay for a portion of their pensions and a new pension tier for those city and county employees hired on or after July 1, 2011, consistent with existing contracts, with the following features:

1. Allow for prospective benefit changes to be developed and implemented under regulations and laws pertaining to the CalPERS and the County Employees Retirement Law of 1937, as amended. Existing lower benefit tiers should be

offered to better reflect changing life expectancy trends and an aging population as well as take into account segments of our workforce who are living longer and may wish to have longer public service careers;

2. Develop, as an option for local governments, programs and incentives for agencies to put defined contribution plans in place for classes of employees or workgroups;
3. Recognize the contributions of employees into Social Security for those agencies that remain in that system and/or provide other defined contribution options such as 457 and 401(k) plans and actively encourage employees to utilize these plans;
4. Change for future hires effective July 1, 2011, or as soon as possible thereafter, the safety plans to 2%@50 and the miscellaneous plans to 2%@60 and the computation of highest compensation earnable based upon the three year average.
5. All public employers should take prudent actions to avoid inflating pension costs by decisions including conversion of benefits into cash, late career appointments and advance step increases that result in inflation of highest compensation earnable;
6. Employer Paid Member Contribution (EPMC – IRS Code Section 414(h)) should be discontinued as compensable earning for retirement calculation purposes;
7. Obtain flexibility from CalPERS and 1937 Act Pension Systems to allow employees to move into a lower level tier in the case of two-tier plans if advantages exist for an employee to do so;
8. In the event of future surplus funding that could reduce or eliminate required annual pension payments, employers should continue to make such payments, if possible, to CalPERS and 1937 Act systems or establish internal pension reserve funds in order to reduce future employer rate volatility;
9. Carefully manage disability retirements to retain full disability benefits for those who are injured and cannot work in any capacity, but restrict disability benefits for those who are able to work (in same or similar job) after work-related injury; and
10. Transition from employers funding the employee share of pension costs to employees paying these costs.

Reform Proposals that require State legislative change:

1. <u>Final Compensation Earnable Determination for 1937 Act County Retirement Systems</u>: Reverse the impacts of the *Deputy Sheriffs' Association v. Ventura County* and subsequent judicial decisions that greatly expanded the factors used to determine final compensation earnable. Restrict final compensation earnable determination base salary compensation irrespective of any pay differentials or other remuneration paid in cash.

2. Sunset Selection of Specified Benefit Options: For agencies that have not implemented the following, and for agencies that have abandoned the following in favor of other benefit options, close the following as future benefit options for public agencies when selection of such benefits would result in a benefit enhancement:

    a. Miscellaneous employee benefit formulas that exceed two percent (2%) at age sixty (60).

    b. Safety employee benefit formulas that exceed two percent (2%) at age fifty (50).

    c. Computation of highest compensation earnable based upon a single year.

    d. Optional safety membership.

3. Retroactive Enhancement in Benefit Formulas: Ban retroactive benefit enhancements.

4. Exclusion from Benefits: Provide maximum flexibility to public agencies to exclude from receipt of retirement benefits non-career employees including those in temporary, provisional and contract employment. As an example, allow temporary employees to work up to 1500 hours per year instead of the existing level of 960 hours.

5. Retirement Benefit Cost Sharing: Normal costs of the retirement benefits shall require equal percentage contributions from employees and employer. Permit employers and employees to share responsibility for all retirement system costs, including unfunded liabilities as result of the collective bargaining process.

6. Cost of Living Adjustments (COLA's) for Retirement Benefits: Eliminate the option for public agencies to increase their annual COLA increases above two percent (2%).

7. Legislative action to develop new pension tiers should better reflect employer and employee choice, and could include a hybrid of defined benefit and defined contribution plans established for new hire employees, as well as offered on a once in a life time basis to existing public sector staff in order to encourage existing staff to consider other alternatives to defined benefit plans.

8. Reform disability presumptions, and tighten up the definition of safety employees, both of which currently drive up employer costs.

9. Industrial Disability Retirement (IDR): Implement cost saving efficiencies including:

a. Provide public agencies maximum flexibility to rehabilitate and/or accommodate disabled workers and return those workers to the same or similar employment in lieu of IDR.

b. Provide public agencies maximum flexibility to provide alternative employment to disabled employees in lieu of IDR.

c. Employees eligible for IDR should first be afforded applicable service retirement benefits, and then provided IDR benefits up to the applicable "cap" on total retirement benefits.

10. Change CalPERS Board membership to achieve better employee/employer balance and greater public agency representation.