



City Council Study Session

November 30, 2010

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Agenda

- Defined Benefit vs Defined Contribution Plans
- Pension Terminology
- Current Pension Trends
- Thinking About Goals
 - Principles
 - Goals

Defined Benefit VS Defined Contribution



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Defined Benefit/Defined Contribution

Defined Benefit Plan

- Guaranteed annual pension based on retirement age, years of service and salary
 - California Public Sector
 - CalPERS
 - 1937 Act Systems
 - Private Sector – Generally only very large employers

Defined Contribution Plan

- Employer contribution is a fixed dollar amount; benefit based on contributions and investment earnings offset by expenses
 - Public Sector – 457 Plan
 - Private Sector – 401(k) Plan



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Defined Benefit/Defined Contribution

Defined Contribution Plan		Defined Benefit Plan
Contribution	What is "Defined"?	Benefit
Amount paid to <u>employee</u> each year	What is the "Contribution" as employees render service?	Whatever is necessary to fund promised benefits
Balance of accumulated contributions (including investment earnings)	What is the "Benefit" provided?	Amount paid to <u>former employee</u> each year
Who Accepts Risk & Reward		
Employee	Inflation	Employer
Employee	Mortality	Employer
Employee	Investment Return	Employer
Employee	Retirement	Employer



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Terminology



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Pension Terminology (cont.)

Vested Right: As determined by CA Supreme Court

- Generally believed members have three contractual rights:
 - Right to payment of promised benefits:
 - Employee must be eligible to continue earning benefit formula in place when hired.
 - Cannot be reduced or eliminated unless traded for something of equal or greater value.
 - Individual right, can not be negotiated away.
 - Obligation of the employer to fund the benefits
 - Obligation of the employer to provide an actuarially sound retirement fund
- Check with City Attorney

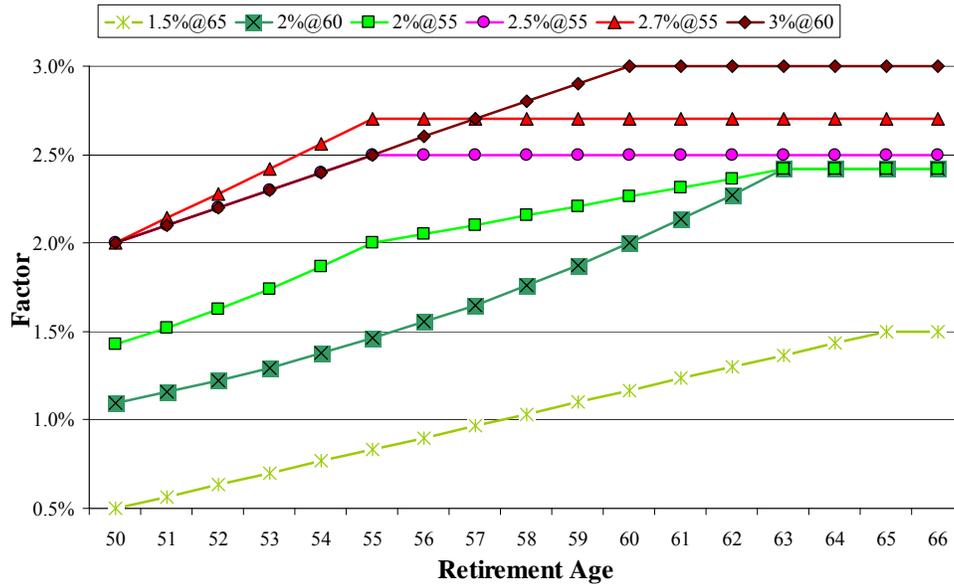
Pension Terminology (cont.)

CalPERS Retirement formulas

- Options vary based on
 - Type of employer [State, School, Local Public Agency]
 - Occupation [Miscellaneous, Safety]
 - Contract between Agency and CalPERS
- Benefit is Product of 3 things :
 - Benefit factor at retirement age
 - City service
 - Average Earnings: highest year or average of the highest 3 years

Miscellaneous (CalPERS)

Benefit Factor Comparison



Note: Miscellaneous has no benefit cap



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Miscellaneous (CalPERS)

Age	<u>1.5%@65</u>	<u>2%@60</u>	<u>2%@55</u>	<u>2.5%@55</u>	<u>2.7%@55</u>	<u>3%@60</u>
50	0.500%	1.092%	1.426%	2.000%	2.000%	2.000%
51	0.567%	1.156%	1.522%	2.100%	2.140%	2.100%
52	0.633%	1.224%	1.628%	2.200%	2.280%	2.200%
53	0.700%	1.296%	1.742%	2.300%	2.420%	2.300%
54	0.767%	1.376%	1.866%	2.400%	2.560%	2.400%
55	0.833%	1.460%	2.000%	2.500%	2.700%	2.500%
56	0.900%	1.552%	2.052%	2.500%	2.700%	2.600%
57	0.967%	1.650%	2.104%	2.500%	2.700%	2.700%
58	1.033%	1.758%	2.156%	2.500%	2.700%	2.800%
59	1.100%	1.874%	2.210%	2.500%	2.700%	2.900%
60	1.167%	2.000%	2.262%	2.500%	2.700%	3.000%
61	1.233%	2.134%	2.314%	2.500%	2.700%	3.000%
62	1.300%	2.272%	2.366%	2.500%	2.700%	3.000%
63	1.367%	2.418%	2.418%	2.500%	2.700%	3.000%
64	1.433%	2.418%	2.418%	2.500%	2.700%	3.000%
65	1.500%	2.418%	2.418%	2.500%	2.700%	3.000%

Member Contribution Rate

2% 7% 7% 8% 8% 8%



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Pension Terminology (cont.)

Contribution Rate

- Sum of the “Normal Cost” and “Amortization”

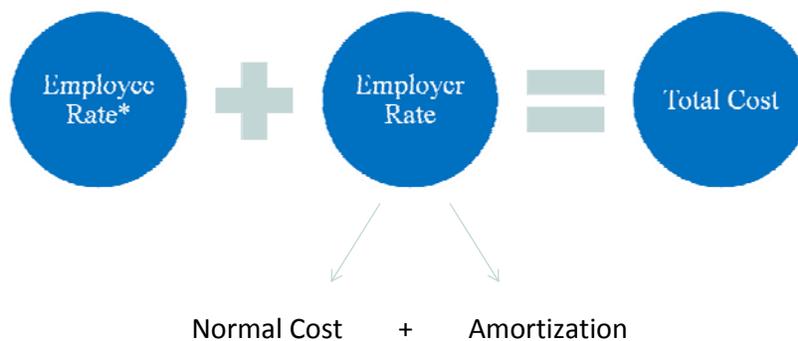
Normal Cost

- “Value” of benefits earned by active employees during current fiscal year
- Employee & Employer component
- Normally stable from year-to-year

Amortization

- Current year payment of short fall (or excess of) assets compared to liability
- Can fluctuate from year to year

CalPERS Retirement Cost



* Some or all of the employee rate may be paid by the employer

Current Pension Trends



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Current Pension Trends

- CalPERS:
 - Miscellaneous Second Tier
 - 2@55 & 2@60
 - Final 3 Year Average Compensation
 - Have employees pay:
 - All or larger portion of member rate
 - Portion of employer rate increase due to enhanced formula



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Current Pension Trends

- Non-CalPERS Public Sector:
 - Some, more creative, formulas, e.g. Orange County
 - Have employees pay:
 - All or larger portion of member rate
 - Portion of employer rate increase due to enhanced formula
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 - Some, more creative, formulas, e.g. Orange County
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Current Pension Trends

- Private Sector:
 - Generally
 - Larger/union based employers retained Defined Benefit Plans
 - Smaller/non-union based employers moved to Defined Contribution Plans
 - Movement from Defined Benefit to Defined Contribution Plans
 - Easier to explain
 - Regulatory environment
 - Accounting rules
 - Predictable costs



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Current Pension Trends

- What changes is CalPERS looking at?
 - Continued recognition of 6/30/09 asset losses
 - Investment return
 - Currently 7¾%
 - Like decrease to 7½% or 7¼%
 - Rates will increase ≈2 percentage points for each ¼% investment return decrease



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League of California Cities



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League of California Cities Recommended General Pension Reform Principles

“Any serious discussion of public pension reform must begin with a set of principles/goals....”

- Primary Goal – Provide full-career employees with benefits that maintain standard of living into retirement
- Set benefit level:
 - Fair & adequate and
 - Fiscally sustainable for employers and taxpayers
- Base all pension benefits on proper actuarial work



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League of California Cities Recommended General Pension Reform Principles (cont)

- View pensions in context of overall compensation. Changes in retirement benefits must be evaluated in concert with other compensation.
- Maintain reciprocity
- Address perceived abuses: Plans resulting in benefits that are higher than necessary
- Managing pensions is shared responsibility between:
 - System
 - Employees
 - Employers



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League of California Cities Reform Recommendations

- Maintain defined benefit plan as central benefit
- Rollback/repeal excessive benefit plans
- Benefit formulas
 - Miscellaneous
 - 2% @55 offset by 50% of Social Security
 - 100% cap
 - Average of highest 3 years

League of California Cities Reform Recommendations (cont.)

- Alternatives to defined benefit for non-career job classifications
- Give employers flexibility to determine when part-time employees are entitled to pension benefits
- Rate volatility
 - Keep within reasonable distance of normal cost
 - Establish reserve funding
- Shared risk
 - If employer rate exceeds normal cost, employees should be expected to share some financial responsibility

League of California Cities Reform Recommendations (cont.)

- Disability retirement
 - Full disability benefits should be retained for those who are injured and can not work in any capacity
 - Restrict disability benefits for those able to work (in same or similar job) after work-related injury
- Retain
 - Reciprocity and
 - Vested rights

League of California Cities Reform Recommendations (cont.)

- Tiered plans
 - Minimize disparity between current and prospective employees
 - Consider changes in context of other compensation issues
- Oversight
 - Agencies that fail to contribute the Annual Required Contribution should be subject to oversight
 - CalPERS Board membership should be changed:
 - Better employee/employer balance
 - More public agency representation