

## Draft Guiding Principles for 2005-06 Pension Reform

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In response to legislative, administrative, and initiative proposals early this year, CSAC staff has worked with a technical advisory group to develop proposed principles to guide our participation in discussions about reform of public pension systems. Our efforts have been guided by a firm belief that a legislative solution to pension reform is the best course to ensuring reform with clear cost-benefit outcomes for local government retirement systems and for taxpayers.

This document has been prepared with the understanding that it remains a work in progress and should be flexible in order to accommodate CSAC's coalition-building efforts. Staff will continue to modify and refine this document as necessary, under the guidance of our technical advisors and the Government Finance and Operations Policy Committee.

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### Preamble

Public pension reform has garnered widespread interest and has generated significant debate among policy leaders about the appropriate remedy for actual and perceived abuse, rising costs, and accountability to taxpayers. CSAC welcomes this discussion and approaches the concept of reform with the overarching goal of ensuring public trust in public pension systems, and empowering local elected officials to exercise sound fiduciary management of pensions systems, as well as maintaining a retirement benefit sufficient to assure recruitment and retention of a competent local government workforce. Proposed reforms should meet these broad goals, as well as CSAC's guiding principles.

The guiding principles and reform proposals are listed below and are intended to apply to new public employees hired after June 30, 2007 in both PERS and 1937 Act retirement systems.

### Guiding Principles

- ❖ **PROTECT LOCAL CONTROL AND FLEXIBILITY**  
Local elected officials should be able to develop pension systems that meet the needs of their workforce, maintain principles of sound fiduciary management, and preserve their ability to recruit and retain quality employees for key positions that frequently pay less than comparable positions in the private sector. A statewide mandated retirement system is neither appropriate nor practical, given the diversity of California's communities. Further, a mandated defined contribution retirement system could force a reconsideration of the decision of local governments not to participate in Social Security.
- ❖ **ELIMINATE ABUSE**  
Public pension systems provide an important public benefit by assisting public agencies to recruit and retain quality employees. Any fraud or abuse must be eliminated to ensure the public trust and to preserve the overall public value of these systems.
- ❖ **REDUCE AND CONTAIN COSTS**  
Public pension reform should provide for cost relief for government, public employees, and taxpayers.
- ❖ **INCREASE PREDICTABILITY OF COSTS AND BENEFITS 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.

- ❖ **STRENGTHEN LOCAL CONTROL TO DEVELOP PLANS WITH 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.
- ❖ **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.

## Reform Proposals

*The following proposals represent specific reforms that serve to promote the principles outlined above. Proposals that directly affect employee benefits are intended to apply only to employees hired after June 30, 2007.*

- ❖ Restrict public safety retirement eligibility to only those groups of employees who must endanger their own physical safety to protect the public as a major component of their employment.
- ❖ Establish a formula cap for public safety at 2% at 50 and a formula cap of 2% at 60 for miscellaneous employees. The cost of any defined benefit or defined contribution retirement enhancements beyond the base pension formula must be paid in full by the employee for the duration of his/her employment, unless the employer agrees to share not more than 50% of the cost.
- ❖ Require that "final compensation" be calculated using highest three-year average, as opposed to a single highest year.
- ❖ Provide local agencies the option to implement defined contribution retirement plans within both PERS and 1937 Act systems, as stand-alone benefits or hybrid systems. Remove barriers to providing defined contribution plans to individual employee units within retirement membership categories.
- ❖ Amend the County Employees Retirement Act to eliminate the cost of the *Ventura* court decision by removing factors outside direct salary in determining "final compensation." Note: awaiting definition of "direct salary."
- ❖ Limit application of pension formula increases to prospective service in order to avoid unfunded liability resulting from extension of benefits retroactively. All costs for the extension of retroactive benefits are the sole responsibility of the employee.
- ❖ Limit pension benefits to career employees by excluding from eligibility temporary employees and contract employees. Within the PERS system, seek a definition of "employee" that restricts the effect of the *Cargill v. Metropolitan Water District* case.
- ~~❖ Require that surplus excess earnings be used according to the following priorities: pay down unfunded liability, offset employer cost for Pension Obligation Bond (POB) debt service, and pay for benefits in effect as of January 1, 2006. Surplus excess earnings may not be used to pay for enhanced pension benefits.~~
- ~~❖ Stabilize contribution rates and promote cost predictability; for example, by requiring use of sound actuarial techniques for the multi-year "smoothing" of market gains and losses.~~

- ❖ Utilization of rate stabilization "best practices" including: 5-year direct rate smoothing; establish a rate funding corridor of 85%-115% of assets after system is 100% funded; if funding level is outside of the corridor, provide a 5-15 year time frame for adjustment of rates to get back into the funding corridor; rate funding corridor should not be utilized to pay for new benefits; rate stabilization surcharge may be utilized.
- ❖ Pension Obligation Bond debt service should be disclosed in both employer and pension system actuarial reports.
- ❖ Upon agreement, permit employers and employees to share responsibility for all retirement system costs, including unfunded liabilities.
- ❖ Retirement boards and arbiters should not have the authority to grant pension formula increases nor should they act as advocates for pension formula increases. Note the PERS mission statement: "Our mission is to advance the financial and health security for all who participate in the System."
- ❖ Clarify the two-fold responsibility of retirement boards to (a) protect retirement system assets for the benefit of participants and (b) minimize employer contributions.
- ❖ Reform Industrial Disability Retirement (IDR) (see attachment).

*Note: These items continue to be reviewed and will be further clarified by additional discussion with our technical advisors under the direction of the GFO policy committee.*

Attachment

## Pension Reform Issues: Industrial Disability Retirement (IDR)

In response to IDR reform discussions, CSAC traditionally has supported the principle of provision of IDR to safety employees who are unable to continue their safety employment due to a bona fide job-connected disabling injury or illness. CSAC also has traditionally recognized that IDR can be extremely expensive, and that responsible reforms are warranted to limit the cost to truly legitimate claims. Possible reforms include, but are not limited to:

1. IDR should be discontinued for any period of time the disabled employee participates in similar work with another public agency, even if that agency participates in a different pension system. The definition of "similar" work would be based upon the criteria used by the agency pursuant to the *Nolan vs. City of Anaheim* case for original IDR determination.
2. Raise the age limit for the employer to reevaluate disability status of the IDR recipient from 55 to 59. (See SB 105 (Speier).)
3. Employees who qualify for both an IDR and a regular service retirement should be required to choose one or the other option, and the current practice of providing both benefits by tax sheltering 50% of the service retirement for such employees should be discontinued. This would not apply to other Workers' Compensation benefits for which the employee may be qualified.
4. ~~A new and more precise definition of "safety employee" for purposes of qualification for safety retirement benefits should be designed to discourage continuing benefit creep. Such definition should not be so restrictive as to prevent promotion to positions in the same occupational series.~~
5. ~~IDR benefits should be restricted to both safety employees and injuries or illnesses clearly linked to activities related to protecting the safety of the public (i.e. field or custodial activities). IDR should not be provided to safety employees disabled due to injuries common to non-safety employees.~~
6. The determination of IDR should be based upon "predominant cause," i.e. a job-connected illness or injury is the principal causation of the disability.
7. ~~"Rebuttable presumptions" shall not constitute causation for IDR. Some disabling injuries and illnesses for safety employees are deemed to be rebuttable presumptions (including heart, cancer, pneumonia, meningitis, hernia, blood-borne pathogen, biochemical substances, and lower back). This is true for causation standards for PERS IDR, which is linked to workers' compensation causation, and is true for 1937 Act Retirement systems for "blood-borne pathogens." This generally means that they are deemed job connected, unless the employer can prove otherwise, unlike other injuries for which the employee must demonstrate at least a de minimus job nexus. All existing presumptive injuries should be reviewed and eliminated if they cannot meet a standard of reasonableness. Such a standard should include a determination that although specific causation may not be possible, there is a substantial likelihood that the origin of the illness or injury is job connected.~~
8. ~~Public employers should have increased medical management of safety employees claiming temporary disability (prior to claiming IDR) including: employer right to initiate an IDR and avoid one year of Labor Code 4850 payments, and more aggressive opportunities for employers to offer alternative employment to injured workers. This reform would apply to 1937 Act employers and PERS employers where the employee is assigned to a rehabilitation program. The date of application by an employer for a successful IDR is the effective start date of the IDR. This date is established regardless of any existing leave balances available to the employee or the employee's participation in a rehabilitation program. Employees will qualify for advance IDR payments while awaiting resolution of the application pursuant to Labor Code Section 4850.3.~~

9. ~~Labor Code 4850 benefits should be limited to one time for the same injury or cumulative trauma related to an injury already having received this benefit.~~
10. ~~Separation of IDR funding from retirement funding. In large agencies in which one half of safety employee retirements are IDR, a new successful IDR claim makes no immediate impact on retirement funding and therefore is virtually invisible to fiscal controls. This encourages weak management of IDR claims. Dual funding and reporting for IDR and regular retirement benefit costs would increase scrutiny of this benefit. It should be noted, however, that conversion to a dual payment system would be initially complicated.~~
11. ~~Change the 1937 Act job causation standard for IDR from "substantial" to "preponderance of evidence", and change the PERS job causation standard for IDR from a workers' compensation causation to "preponderance of evidence."~~
12. Eliminate overlapping IDR benefits and workers' compensation benefits when payable for the same injury by establishing an offset between the two systems. (See SB 916 (Speier), AB 514 (Richman).)
13. If some or all of the above cost saving reforms can be achieved, support for increased IDR benefits for employees who are totally disabled from any work (as opposed to occupationally disabled) as part of a package of reforms.