PECG INFORMER

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Professional Engineers in California Government

CalPERS Costs and Controversy on the RISE

Public employee pensions are increasingly in the criticism crosshairs of a growing number of politicians and the news media. As **life expectancy** increases, retirees grow in number and live longer, putting a financial strain on the ability of pension funds to pay the benefits earned by public servants during their careers. Years of **low inflation** (resulting in reduced pension fund investment returns) and the **2008 economic recession** added to the problem.

Public employee pension plan detractors come from several sources. Some are envious of the "defined benefit" plan which, unlike a 401(k), guarantees calculated pension payments for those who dedicate their careers to public service. Others simply don't like public employees or believe their pensions are excessive.

Now, added to the chorus are those who have concerns that the financial burden of the increased cost of public employee pensions can encroach upon funding for other public services and/or are unsustainable, potentially resulting in financial chaos down the road.

So, What's Really Going on at CalPERS, and Where Are We Headed?

The largest public employee pension plan is the California Public Employees Retirement System (**CalPERS**), which governs pensions for about 1.8 million public servants – state employees, many local agency and some school employees (teachers are in a different plan), and retirees. CalPERS calculates the funds needed to provide these pensions in the future, assesses public agencies for annual payments, and invests the money to achieve a maximum rate of return to fund current and future pensions. Employee labor organizations and public agencies negotiate the employees' share of the funding, typically on a percentage of salary basis.

The CalPERS **Board has 13 members**. Six are elected by employees and retirees. (PECG members and other state employees vote for a state employee representative and two at-large members. The other three are elected by retirees and local agency and school employees.) The other seven Board members are the State Controller (Betty Yee), the State Treasurer (John Chiang), the Director of CalHR (Richard Gillihan), a representative of the State Personnel Board, one Legislative appointee, and two appointees by the Governor. These 13 Board members are **responsible for all decisions** regarding the pension plan and, due to voter-approved ballot measures over the years, are relatively independent of political interference. (The Board is also responsible for state employee health benefit plans.)

The returns or earnings of CalPERS investments have varied widely, earning more than 20% some years, and losing money on occasion in others, such as during the recession. Over the last 20 years, **the average return has been 7.8%** per year, which was slightly above the 7.5% assumed earnings rate for the future.

While the fund of $300 billion is about the same as it was before the recession, the financial downturn took a big bite out of the CalPERS portfolio, as it did for almost everyone who didn't keep their money under their mattress. As a result, CalPERS recently decided to reduce their assumed earnings or "discount rate" for the future from 7.5% to 7.0%. This was based on lower earnings in recent years, continuing inflation averaging less than 1%, and a change to a **"risk mitigation" investment strategy**. In essence, CalPERS decided to put less money into what they consider to be "volatile" investments, such as stocks, and more into "stable" investments, such as real estate.

This has proven to be costly in the short run. CalPERS earned $900 million less since September than they would have if they had continued their previous level of investment in the stock market, which has nearly tripled since its low point during the recession.

In lowering their assumed rate to **7.0% for the future,** CalPERS in December projected a 6.2% earning rate over the next 10 years. This was downgraded to 5.8% in February, which could result in another reduction in their projected "discount" or earnings rate.

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CalPERS COSTS AND CONTROVERSY ON THE RISE

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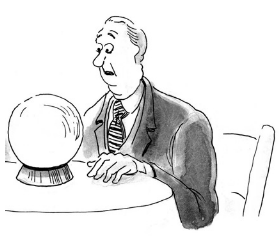
Why Do Projected Earnings Matter?



These decisions have a direct impact on the money the public agencies must pay into CalPERS each year, which in turn can apply pressure to increase employee contributions. If CalPERS assumes, as they have been doing, that their future earnings will be less than in the past, then they must increase the inflow of money from employers (and employees) to keep the system financially stable. Thus, investment strategies and earnings projections not only affect the funding required to maintain a secure retirement system, but can add fuel to the inflammatory voices who criticize public employee pensions as no longer being "financially sustainable".

Public employees' pensions have always been a **vested right** – you may get fired or laid off, your salary may be reduced, but you have a vested right to the pension you were promised when you were hired. However, as pensions become more expensive and the political and philosophical clamor continues to grow, court challenges and potential ballot measures could weaken that principle. In the last few years, employee (as well as employer) contributions have increased – you now pay 8% of salary toward your pension benefits, up from 5% in the past – and recent hires came on board with a less favorable pension plan than their predecessors.

The facts about public employee pensions are fairly straightforward. People are living longer, so the increased retirement years put a financial strain on pension systems. However, the average CalPERS pension is only $2,600 per month, hardly an exorbitant amount, and changes have been made to ensure that employees are absorbing an increased share of the added financial cost. As the public and elected decision makers become more aware of the facts surrounding public employee pensions, the problems and solutions can be addressed objectively, rather than hysterically or politically.

PECG's ROLE

For several years, PECG has been a leader and active participant in **Californians for Retirement Security**, a coalition of public employee organizations dealing directly with retirement issues in the Legislature, the media, and, if necessary, proposed ballot measures. PECG will also be in court as needed to protect against efforts to reduce or eliminate your pension rights. Together with other organizations, PECG will fight to ensure that your vested pension rights are protected, now and in the future!