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The elephant in the room

by Jonathan Holtzman

The elephant of the pension world, the California Public Employees' Retirement System (CalPERS), has led the state, cities, counties, and other government agencies to the edge of ruin yet continues to stand in the way of pension and benefits reform. Around the millennium, CalPERS famously sold "3% at 50" retirement plans (which allow safety members with 30 years of service to retire at age 50 at 90% of their final pay) to governmental agencies, arguing that such plans would cost nothing additional. Now, pretending to be the protector of employees and retirees, it continues to throw obstacles in the way of reducing pension funds.

CalPERS has also set the standard for overly optimistic forecasting, assuming an average 7.75 percent return, even as its five-year return slid to just over one half of one percent — placing it in the 99th percentile of pension funds for that period. The average local government pension is now about 74 percent funded, having dropped from over 100 percent since the recession began. That's the elephant in the room that no one, especially CalPERS, seems willing to face forthrightly.

So what has CalPERS done to "make things right"? For the most part, it has tried to cover its trail. It has adopted a progressively broader "smoothing" of assets — first moving from five to 15 years, then untethering the smoothing from the market value of assets, and now adopting "super-smoothing" to mask the effect of finally lowering its earnings assumption to 7.5 percent.

CalPERS would argue that smoothing is intended to benefit its participant agencies, which are already in rate shock as the cost of the amortized unfunded liabilities and changes in financial assumptions have already begun to pull them underwater. But the truth is that it's afraid to rock the boat too violently for fear of greater public scrutiny.

More important, CalPERS has decided to make a name for itself as the foremost opponent of pension reform. Among other things, CalPERS has:

- issued an unsigned policy paper arguing that little can be done to reduce the cost of current employee pensions because of "vesting" principles;
- argued that bankruptcy cannot reduce pension benefits for current employees;

- filed an *amicus* (friend-of-the-court) brief in the recent *Orange County* case before the California Supreme Court arguing that virtually all retirement benefits are vested;
- adopted a punitive "withdrawal" investment return rate of 3.8 percent for government agencies that will not put future employees into CalPERS, while maintaining that its 7.5 percent return rate is otherwise reasonable;
- refused to offer a new option of leaner pension plans for future employees;
- issued a press release welcoming a proposal by San Jose unions to move to CalPERS, without consulting city managers or elected officials;
- argued that adopting lower-cost second-tier plans costs more money than it saves; and
- refused to allow lower employee contribution rates for participants in second-tier plans.

What should be done? First and foremost, the governance of CalPERS must be overhauled. The governor's pension reform proposal is a good start. Second, the paid management of CalPERS must be changed. CalPERS has become a self-satisfied bureaucracy. Getting everyday answers from its staff is almost impossible. And when answers come, they are often contradictory. CalPERS needs to treat its participating agencies as stakeholders, not adversaries.

Third, CalPERS must again become a leader in providing innovative ideas for reform of pension and health care plans. Of course, it has a fiduciary obligation to covered employees and retirees — what that means in terms of vesting will need to be fought in the courts. CalPERS should stay out of that fight because it has a conflict of interest; under the state constitution, it also has obligations to public agencies. It should use its considerable resources to develop plans to solve the problems it had a hand in creating.

The funds CalPERS manages and all the money it spends on administration (including lobbying, advocacy, and attorneys) comes from the taxpayers. Yet the people and institutions that rely on public services will be the ultimate victims of CalPERS' obstinacy. To mix a metaphor, the elephant should start pulling its own weight.



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