Executive Summary
Little Hoover Commission Testimony
of Girard Miller
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My remarks today are submitted as an individual and not as a representative of any organization with which I am or was previously affiliated, including my current or prior employers. I would ask that the media follow my written instructions on proper attribution as a <u>consultant and commentator</u> without organizational affiliation.

<u>Nature and Size of the Problem:</u>

Although most people think of pensions, you need to look at all public employee retiree benefits including retiree medical benefits. Almost half of the total deficit is from retiree health care deficits.

In California, our pension plans statewide are approximately 30% underfunded today, and retiree medical benefits plans are more than 90% underfunded.

For California, I estimate the 2010 combined actuarial deficit for all state and local retirement plans to exceed $325 billion, using mainstream methodologies and current market levels.

$325 billion in retirement system obligations is almost equal to the total outstanding bonded debt of the state and all political subdivisions combined. Unlike the bond issues, however, this debt was never approved by the voters.

That's roughly $8,000 for every man, woman and child, and $22,000 for every working adult. The *additional* financial burden for inadequately funded public retirement plans from this day forward will be roughly $1,300 annually per household.

California's average pubic-retiree medical benefits plan has never saved a penny to pay for vested obligations, and is in worse financial shape today than the federal Medicare program (which is projected to become insolvent in 2016).

Given the state constitution's tax-limitation provisions and the extraordinary 2/3 majority voting requirements for taxing increases, there is presently no practical alternative to more layoffs and furloughs, hiring freezes for the next decade, and further shrinkage of public services as a result of retirement plan deficits.

<u>How did we get here?</u> Most objective observers would point to a combination of the following structural trends and problems:

- **Unsustainable, irreversible, unfunded and constitutionally protected benefits increases often were awarded retroactively, resulting in chronic deficits.**
    - **For example, irrational and irrevocable benefits increases were awarded in California during the 1998-2000 internet bubble period. To pay for them, pension trustees and elected officials deluded themselves to believe that the Dow Jones Industrials Average would now stand at 28,000 instead of the 11,000 level we just reached last week. After intense lobbying by labor interests, policymakers bet the ranch on that pipedream.**
- **Over the last 50 years, American longevity increased by 5 years for people who reached the age of 65, yet we actually reduced the average retirement age for public employees. The Social Security retirement age has been raised from 65 to 67 but public pension plans have not followed suit. Shorter working career periods and longer retirement periods are a toxic combination in a retirement system.**
- **Employee pension contributions have been insufficient, leaving the employers to pick up the tab.**
- **Salaries consistently grew at a faster rate than actuaries had assumed, which created unfunded liabilities. In many cases, government salaries grew faster than those of most taxpayers, while pension benefits were increased as well.**
- **Cost of living allowances or pension enhancements were granted to retirees without proper actuarial funding.**
- **Retiree medical benefits that once cost employers a few hundred dollars monthly for a handful of retirees now cost more than $10-12,000 a year while the number of retirees receiving these benefits has exploded.**
- **Many employers have failed to make their annually required contributions.**
- **Structural abuses such as pension-spiking have been tolerated.**
- **Labor arbitrators have ignored the evolution of retirement benefits in the private sector.**
- **Governmental accounting standards have lagged the corporate sector.**

California must provide a legal framework to enable dysfunctional benefits plans to be modified, terminated, frozen or converted to a viable structural form that enables the employer to resolve a financial crisis without resorting to bankruptcy or defaults on other obligations.   I would also suggest that every new public employee should have a legal right to elect into a defined contribution plan, which will change the playing field over time.

Taken together, my recommendations would reduce our state's retirement funding problems by 30 to 40 percent, and produce positive results for our state and local governments in the credit markets that will save even more jobs.

Governance

The reported shortcomings in governance at CalPERS have coincided with dismal results in the capital markets, which further undermines confidence in the entire system.

I strongly encourage the Commissioners to review the work of the widely respected Government Finance Officers Association which has published a Recommended Practice concerning retirement plan governance.

Among GFOA's recommendations:

a. ***Balanced board composition.*** **The governing boards must have independent trustees -- just like the mutual fund industry.**

b. ***Codification of fiduciary duties.*** **Trustees of retirement plans in California should be held to the highest standards of behavior and accountability, with personal liability for violations.**

c. ***Require a code of conduct.*** **Behaviors and activities of pension marketeers should be controlled by state laws that subject violators to civil and criminal penalties. Conduct violations should disqualify a trustee from voting on any matter related to the infraction.**

The appendix to my written testimony contains specific statutory language.

Constitutional Amendment

I'd now like to explain why we need to amend California's constitution. There are two reasons:

> **(1) The current constitution has been interpreted by the courts to entitle incumbent employees to receive benefits for *future* service based on current plan designs. There is unfortunately no other way for California to assure sustainable funding without amending the constitution to restore the right of the people's elected representatives to change future benefits for incumbent employees if they have become unaffordable.**
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> **(2) The tax limitations imposed by Proposition 13 have hamstrung the ability of the state and its local agencies to raise revenues to properly fund both pension and retiree medical obligations for prior service -- even if they are successful in bargaining with employee associations for a fair cost-sharing arrangement to remedy the crushing unfunded liabilities that have accrued in their retirement systems.**

Accordingly, I urge this Commission to design a referendum amendment of the California constitution to provide the following:

- **Public employees must pay half of the cost of their retirement benefits.**
- **Public employers must make their actuarially required contributions on a timely basis.**
- **Younger public employees must wait to retire when they reach the retirement age under Social Security, with the exception of qualified public safety officers. For older workers, the legislature should gradually increase retirement eligibility ages.**
- **Public employers must be allowed to bargain with employees to reduce or modify benefits of incumbent employees for services they provide thereafter. They must also be empowered to freeze the current benefits plan or transfer it to an employee beneficiary association. Payments to retirees cannot be reduced through such actions, of course.**
- **No retirement benefits increase may be awarded for prior service unless fully funded or approved by a majority of voters.**
- **Guaranteed retirement medical benefits for younger employees must begin no sooner than the minimum age for Medicare and must apply to the retiree only, and not for dependents or survivors. Public employers can still provide a supplemental defined contribution plan for dependent benefits, and for retiree medical benefits commencing at an earlier age.**
- **A public employer should be empowered to levy additional taxes to fund its liabilities, after approval by a qualified majority of voters. Specific details are provided in my written testimony.**
- **A majority of the members of a retirement plan's governing board must be independent trustees.**

<u>Statutory Reforms</u>

In addition to the foregoing language for a constitutional amendment, several additional reforms should be enacted by statute.

- **Labor arbitrators must consider total compensation and prevailing retirement benefits levels offered in the private sector.**

- **For new employees, the pension formula should be reduced to sustainable and sufficient levels. Employers with the financial capacity to provide additional retirement benefits can add-on a supplemental defined contribution plan without having to fear that they can never turn back.**

- **No cost-of-living or inflationary increase may be awarded to retirees unless the retirement plan is properly funded or approved by a majority of voters. Pension plans must retain a reserve for adverse markets before they increase benefits in the future.**

- **CalPERS must offer participating agencies greater flexibility in plan designs.**

- **Before it increases retirement benefits, the governing body of a public employer must review in public a multi-year fiscal sustainability analysis.**

- **Newly hired public employees should have the option to participate instead in a defined contribution retirement program.**

- **Finally, the Commission should take a close look into disability pensions, which have been persistently abused in some jurisdictions.**