Peace Officers Research Association
*of California*

**Statement of Ron Cottingham to the Little Hoover Commission**

Good Morning Commissioners. I am Ron Cottingham, a Lieutenant in the San Diego Sheriff's Department where I have worked for 37 years.  Since 2003 I have served as the president of the Peace Officers Research Association of California (PORAC).

PORAC was founded in 1953 by peace officers to protect the economic, professional and social welfare of public safety members in California.  PORAC has more than 890 member organizations and represents 62,000-plus members.  We are the largest statewide public safety association in the United States.

You will find our members working in cities and for counties; in public schools, community colleges, and on college and university campuses; in courts, in jails, and in public agencies in every community.  We are there to protect the public on our streets, in our airports and on rail, in our parks, and on our waterfronts.

Thank you for the opportunity to talk with you about the current state of the 85 California public employee pension systems that serve more than 2.2 million active and retired Californians.[i]  For more than 70 years these funds have provided retirement security to California’s public employees.

In 2007 and 2008, I was fortunate to participate as a member of the governor’s California Public Employee Post-Employment Benefits Commission, chaired by Gerald Parsky. We worked throughout 2007 to get beyond the poisonous rhetoric and to the facts about how pension retirement systems work.  After serving on the governor’s commission I know the importance of taking a studied look at the complex issues confronting our retirement security system.

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We learned four major lessons while serving on that Commission:

1. While our retirement commitments are significant and must be measured appropriately every year, they are the result of projecting all potential costs out over 30 years.

2. The evidence is clear that in thinking about retirement security we must take a long-term perspective. It is the only way to strengthen the systems that administer benefits.

3. We also learned that the primary requirement for a healthy system is to make sure that plan participants make regular payments into the retirement funds so that over time they can earn enough to meet pension obligations.

4. The peace officers who retire in California spend 30 years doing a job that is inherently dangerous, consistently confrontational and more dangerous each year to do on a daily basis.

While the details have changed because of the market crash in 2008, our basic findings about public pensions still hold valid.

First, while funded ratios for California pension funds are down from their peak in 2000 (before the dot com bust) they are still well within the healthy range. And the recovery over the last few months is making them healthier. In fact, actual earnings have averaged 7.9% on the assumed earning rate.

Second, while it is true that the total amount of pension contributions continues to grow, the amount as a total percentage of a growing public sector budget has remained relatively constant.

These findings lead us to make recommendations about the need for consistency of funding over time, the appropriateness of smoothing as a means of limiting the volatility of contributions, and the need for transparency, accountability, and improvements in plan design. Another critical commission finding is encompassed in a quote from the Chairman Gerald Parsky. He said,

*"With respect to funding these critical benefits, it is important to emphasize that each public agency in California faces different funding constraints, personnel needs, and organizational purposes. A one-size-fits-all approach is neither appropriate nor practical."*[ii]

The efficient and productive pension system that earns from investments as much as 75 percent of what it pays out in benefits to working Californians is a vital part of public service. Today we can work to improve that system, and also separate the hyperbole from reality as we focus on three critical aspects of retirement security:

1. The country is recovering from the worst economic decline since the Great Depression. However profound these current financial woes are, it is important that we don't employ a knee-jerk reaction that will cause undue harm to the pension system. We should not mix up systemic economic problems with the cost of providing benefits for public employees. The problems with state and local budgets are the result of economic decline and we need to focus on stimulating the economy, not undermining a historically effective system of retirement security.

2. Our defined benefit pension systems were designed to be flexible and to evolve over time while providing guaranteed, adequate retirement benefits for large numbers of workers at a reasonable cost. The systems and those they serve should be allowed to use that flexibility to evolve with the times. The system is sound if we allow it to adapt to changing circumstances.

3. Each local employer and each pension system evolves through negotiations between the employers and their employees. We need to respect the give and take

> and embrace the diversity and flexibility of a system that changes over time. There is no one-size-fits-all adaptation that can accommodate every situation. The solutions to particular local situations must be allowed to develop in each of the communities according to their specific needs.

This is the worst economy that our nation has faced in our lifetime. This economic crisis – and the Wall Street excesses and corporate abuses that drove it – is the real threat to retirement security for all Californians.

Here are the facts: California's pension funds were almost fully funded until the recent stock market crash. Employee contributions to pension plans are lower today than they were in the early 1980s. And the funded status of plans is better than in the early 1980s. Between October 9, 2007 – the peak of the market – and October 9, 2008, equities declined by 42 percent. State and local defined benefit plans, which held roughly 70 percent of their assets in equities saw a decline in the value of their equities of $1.0 trillion.

Across the country pension funds have lost value in their portfolios and have a lower projected ability to meet their long-term obligations. Most experts refer to this as the funded ration or funding level. A recent study on funding state and local pensions by the Center for Retirement Research at Boston College found:

- State and local plans, which were headed toward full funding, were knocked off track by the financial crisis in 2008.
- Most pensions exceeded the normal healthy level of 80 percent funded in 2008 before the stock market collapse.
- The collective funding ratio dropped to an estimated 78 percent in 2009 from 84 percent in 2008.[iii]

Not all of the problems, however, are external. The reality of retirement is also altered from the spiking abuses that you hear about.

It is not tolerable and it reflects poorly on all public employees, including public safety officer's when the final year pay of an employees' base pay is artificially inflated.

The problem becomes a lightning rod. The truth is that 75 percent of California peace officer's retirement compensation is less than $36,000 a year. Most do not receive Social Security and health care benefits continue to be negotiated as the markets fluctuate. Less than 1 percent of retired public employees receive benefit levels exceeding $100,000.

Our members join policymakers in strongly objecting to the practices that allow some high level employees to compound their salary and attempt to qualify for pensions that they and their employers did not contribute to over the years. The legislature is considering tighter rules that will eliminate the excessive compensation of those who seek to game the system by taking a pay raise out of line with their peers during the last years of their employment. The new laws would also limit the ability of those top level employees who attempt to double dip. These reforms would give pension funds the tools to better enforce their local regulations and contracts.

There are also legislative efforts underway to protect the assets of current and future retirees through the establishment of stronger ethics and reporting rules to ensure that public dollars do not go into the pockets of Wall Street style placement agents. Over the years we have worked hard to protect the investments of our members and California taxpayers by eliminating fraud, reducing conflicts of interest and prohibiting pension trustees from marketing to other funds. We want to strengthen those safeguards.

Our members are acutely aware of the importance of survivor and disability benefits because we work in dangerous occupations and have a great likelihood of injury and even death on the job. There is no other system that can guarantee this kind of protections for our members and their families.

Also -- the majority of public employees, especially public safety employees and teachers, do not participate in the Social Security system. That means that neither we nor our employers pay into Social Security.  It also means that we receive no Social Security benefits – we have to rely only on our pensions for our retirement security.

There are no easy solutions to the funding challenges facing local governments across the country.  Whatever approaches governments and their employees may choose in their negotiations, they too will need to take a long view. They must fund the retirement commitments they have made to current and retired employees while remaining competitive in what they offer to the next generation of men and women who will serve the public.

Some, just as Professor Alicia Munnell, the director of the Center for Retirement Research, have said that: “States and localities have little in the way of public options to fix the problems quickly.  Really what we need to do is wait -- wait for the economy to recover and the stock market to recover.”[iv]

We are not waiting.  Public employees are working with their employers to find solutions that help improve government finances while protecting retirement security.  Peace officers are making bargaining concessions that represent a step backward in their compensation package.  We have seen layoffs, and have accepted the concomitant responsibilities and increased dangers on the job as part of our professional challenge.

Last year the California Highway Patrol members decided to give up raises in order to help fund more of their retirement benefits.

Currently, most California pension plans are working with local government employers to maintain an affordable level of payments.  Whether through smoothing, or other means, they are designing cash flow mechanisms that allow new retirement investments while easing the immediate pressure on employers.  One of the major recommendations of the commission was that pension funds assist government employers by reducing the volatility on pension contributions and most funds have done that effectively.

The answer is a studied approach. Too often a proposed change that appears to dramatically save employers' money becomes inconsequential. For example, if the state of California were to wipe out our state and school retirements altogether and provide nothing, it would save an average of about $4 billion a year. We have cut state budgets by over $45 billion and face another $20 billion deficit today. Wiping out pensions completely would have done little to dent this deficit. Proposals for two-tier pensions do even less, because the savings don't materialize for 20 years and the cost savings are relatively small compared to the size of the deficits.

Throughout the state not every local government is in the same financial situation. For every community that is facing layoffs there is another with a large reserve that they can draw upon the get through the tough years. As we go to the bargaining table we respect those differences and our members are willing to be flexible. The solution, however, is a mutual concern and bargaining is necessary.

As these discussions and negotiations are underway there are golden opportunities to mount significant, fact-based and collaborative efforts that will ultimately strengthen local pension systems.

Every retirement benefit negotiated over the years was paid for out of the total compensation package offered by that specific employer. When a bargaining team decides to divert compensation towards pensions or health care or vacation or any other item, the total compensation package does not change. That is why retirement benefits negotiated at the bargaining table should only be changed at the bargaining table.

I want to dispel some of the claims we have heard in recent months. There has been an escalation of irresponsible claims designed to heighten fears about the public budget. We believe that the recent study commissioned by the governor from well-meaning students at the Stanford Institute for Economic Policy Research is fatally flawed. Responsible experts have said clearly that false assumptions and misplaced calculations garnered headlines due to the Stanford imprimatur. The critics deserve to be heard.

A claim from the governor is that over the last decade state pension costs have skyrocketed.

The truth is, like many California employers, our State government took four years of pension contribution holidays during the stock market boom of the late 1990s where they did not contribute fully to the pension plan even while employees continued to make contributions to their retirement.  If you look at the figures released by CalPERS last year you will also see that for four years (1998 to 2001) the level of payments made by the state were significantly lower than they had been in the years preceding this payment holiday as well as significantly below the years that followed.  During that same period school employers made no employer contributions.

This reduction in the amount of employer payments not only caused some of the underfunding of pension plans, but conveniently gives those who want to confuse the issue several years where employer contributions rates were reduced from previous levels by 87 and 100 percent.  When you calculate from a contribution at or near zero to a normal level of contributions needed to meet the actuarially required contribution level, you can claim that the increases are enormous. But if the holiday had not been taken, the gradual growth of inflation would have seen a similar gradual growth of payments.

***History of the Expected Contribution Requirements***[v]

*The following table shows the history the employer contributions set by CalPERS based on projected payroll for the State plans and the Schools pool going back to fiscal year 1996-1997.*

| ***Fiscal Year*** | ***Total State Contributions*** | ***Total School Contributions*** |
|---|---|---|
| *1996-97* | *$1,236,447,373* | *$ 416,694,314* |
| *1997-98* | *1,223,327,746* | *317,571,853* |
| *1998-99* | *766,067,149* | *0* |
| *1999-00* | *159,460,097* | *0* |
| *2000-01* | *156,722,747* | *0* |
| *2001-02* | *677,244,769* | *0* |
| *2002-03* | *1,189,559,722* | *228,972,653* |
| *2003-04* | *2,212,518,481* | *869,501,830* |
| *2004-05* | *2,547,364,178* | *903,570,002* |
| *2005-06* | *2,428,720,628* | *826,672,339* |
| *2006-07* | *2,665,262,125* | *841,504,282* |
| *2007-08* | *2,746,929,250* | *919,528,538* |
| *2008-09* | *3,025,181,372* | *966,316,743* |
| *2009-2010* | *$3,287,572,458* | *$1,081,377,863* |

If you ask CalPERS they will tell you that as a percentage of total state payroll the costs of pensions have not fluctuated much over many years. They will tell you also that the total cost paid for pensions out of state coffers has increased primarily because of growth in the work force and an increase in hourly pay rates. Here is a quote from a CalPERS memo reporting on contribution rates for one recent year:

*"Overall, the required contributions for the State plans have increased by $262.4 million between fiscal year 2008-2009 and fiscal year 2009-2010. The main reason for this increase is the growth in payroll for all State plans between the June 30, 2007 valuation and the June 30, 2008 valuation. This growth in payroll was a combination of pay increases granted to existing employees as well as the growth in the number of active employees."*[vi]

The truth is that current contribution levels are not much different from what was paid by the state 30 years ago. In fact, virtually every employer category at the state level is paying less as a percentage towards retirement than they did in the early 1980s:

- State Misc. 1981/82 rate was 19.563, 2009/10 rate is 16.917, difference: -2.646%.
- State Safety 1981/82 rate was 20.409%, 2009/10 rate is 18.099%, difference: -2.31%.
- CHP rate 1981/82 was 31.995%, 2009/10 rate is 28.438%, difference: -3.557%.

The fact is that actual contributions are lower today than they were in the 1980s. And the funded status of plans is better than in the early 1980s.

The Sacramento Bee was fair enough to list many of the reasons for our budget problems in an article that touched on Wall Street abuses and the crumbling housing market, as well as a concern over pensions. They were fair enough not to take the easy attack or indulge in popular demagoguery by blaming all of our woes on the pay and benefits of public employees. The facts presented by the Sacramento Bee articles indicate that more than 82 percent of the 143 local government plans they surveyed are funded at a healthy level.[vii]

Like the national experts, the Bee rates anything over 80 percent funded as in good shape or better and the vast majority of California's local government funds are valued at 80 percent or above. In fact, more than 37 percent of the funds surveyed, including 14 county and 39 city plans, are extremely healthy with more than 90 percent funded ratios.

Only two of the pension plans surveyed by the Bee are considered to be of serious concern with less than 70 percent funded ratios. The national studies released recently by the Pew Center and the Center for Retirement Research agree that funds over 70 percent funded are within the healthy range.

All you have to do is examine the chart that accompanies the articles to see that even after the market downturn the vast majority of California pension funds have a normal or better funded ratio. We continue to bargain because we are both committed to one clear principle – the current system works and needs to be improved and we should not undermine a strong formula for retirement security. Our retirement system is worth protecting.

We will continue to work to find reasoned and effective solutions that both help with the short term crisis in public funding caused by the disastrous economy and to improve the long-term sustainability of a secure retirement system. Clearly, sustainability cannot be ensured if we attempt to force changes that take a one-size-fits-all perspective. Equally clear is that we need legislative action to strengthen the framework of our system and make sure that our public pension funds operate transparently and with good management.

I want to conclude by reading part of a statement made in March by the board of one of our brother law enforcement organizations – the Los Angeles Police Protective League. It dramatically captures the threat to public service and, down the road, to public finances, should our elected leaders attempt to undermine the successful system of retirement security that most public officials and employees are working to strengthen:

*Defined benefit plans for LAPD officers have been around since June 7, 1899, and have proven to work. The Los Angeles Fire and Police Pension system, since the economic downturn, is currently 96.2% funded. Members contribute up to 9% of their bi-weekly pay, which adds up to $120,287,911 for the 2010-2011 fiscal year. Even with this sizable amount, the majority of the money needed to fund the pension systems comes from investments not contributions by the City or police officers.*

*The real crisis is the jerry-rigged defined contribution system, which sprung up from a tax loophole in the 1980s. As private companies abandoned their defined benefit plans, they pushed employees into defined contribution plans. Their employees were now forced* *to take both the risk of investment, along with longevity risks---the chance that they would outlive their assets.*

*The most sobering news came this week from the Employee Benefit Research Institute, which is the leading organization that surveys Americans and their preparations for retirement. A staggering 54% of Americans have less than $25,000 saved for retirement. Less than half of all Americans are aware of how much money they will need to save for retirement. As the era of defined contribution plans has grown, Americans are realizing that they cannot afford to retire. Defined contribution plans work great for millionaires, or maybe even for those with high salaries. However, the past century has proven the efficacy of defined benefit plans, with tens of millions of Americans comfortably retiring under these pension plans. As defined contribution plans stagger into their third decade of existence, evidence points to the failure of providing Americans with any semblance of a secured or dignified retirement.*

*If one believes that Americans should retire in poverty, then they will also agree with elected officials who believe that the era of defined benefit plans is over.*[viii]

Thank you for the opportunity to visit with you.

**Background**

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[i] California Research Bureau, Public Retirement System Survey, December, 2007.
[ii] Public Employee Post-Employment Benefits Commission, Final Report: Funding Pensions and Retiree Health Care for Public Employees, January 2008.
[iii] Center for Retirement Research, The Funding of State and Local Pensions: 2009-2013, April 2010.
[iv] Center for Retirement Research, The Funding of State and Local Pensions: 2009-2013, April 2010.
[v] CalPERS, State and Schools Employer Contribution Rates for the Fiscal Year July 1, 2009 through June 30, 2010, May 12, 2009.
[vi] CalPERS, State and Schools Employer Contribution Rates for the Fiscal Year July 1, 2009 through June 30, 2010, May 12, 2009.
[vii] Sacramento Bee, The Public Eye: A Bee Investigation, April 11, 2010.
[viii] Los Angeles Police Protective League, Fighting for your pensions, March 15, 2010.