FORM GEN. 160

CITY OF LOS ANGELES

INTER-DEPARTMENTAL CORRESPONDENCE

Date: October 25, 2012

To: The City Council
Mayor Antonio R. Villaraigosa

From: Miguel A. Santana, City Administrative Officer

Subject: **RESPONSE TO VERBAL MOTION REGARDING PENSION REFORM FOR NEW HIRES – LACERS (C.F. 10-1250)**

On September 25, 2012, the City Council instructed the City Administrative Officer (CAO) to continue meeting with labor representatives to find common ground and to avoid litigation regarding the proposed LACERS Tier II for new hires, and to report back on the results of the discussions.

CAO staff and the independent actuary met with labor representatives on October 2nd and October 18th. During these meetings various questions about Tier II, including questions regarding the plan design, financial impacts, and anticipated cost savings were answered. Labor was also provided with the enclosed "myth-conceptions" and "fact sheet" documents, which address several of the concerns brought forth by labor.

Labor has requested that the City postpone its consideration of Tier II, indicating that it will pursue a request to obtain an alternative actuarial study. The CAO has not received any alternative plan designs from labor for the City's consideration during these meetings.

MAS: 0713044

Enclosures: "Myth-Conceptions" New LACERS Tier for New Hires (Tier II)
Fact Sheet – City Contribution Impact of LACERS Tier II

"MYTH-CONCEPTIONS"
NEW LACERS TIER FOR NEW HIRES (TIER II)

#	Myth	Fact
1	LACERS Tier II will change the retirement benefits for current City employees.	LACERS Tier II will only apply to new City employees hired on or after July 1, 2013.
2	A current City employee that leaves City service and returns to the City will become a member of LACERS Tier II.	A current City employee who leaves City service and does not withdraw his/her LACERS membership contributions will continue his/her Tier I membership upon returning to City service. If the City employee withdraws his/her LACERS membership contributions, then he/she will become a Tier II member upon returning to City service.
3	LACERS Tier II penalizes workers that start with the City when they are relatively young.	The decision for an employee to retire is a personal choice and voluntary. The average age of a LACERS new hire is approximately 36 years old. Tier II increases the normal retirement age to 65 to reflect that people are starting their City career at a later age, living longer and working longer.
4	LACERS Tier II eliminates all survivor continuance benefits.	A Tier II member may voluntarily elect, at the time of retirement, whether he/she would like to purchase a survivor continuance for his/her surviving spouse. The purchase is made through a permanent reduction in the member's retirement allowance. Tier I members have this same option if they want to provide a continuance to an ineligible spouse or a continuance larger than 50% to an eligible surviving spouse.

"MYTH-CONCEPTIONS"
NEW LACERS TIER FOR NEW HIRES (TIER II)

#	Myth	Fact
5	A LACERS Tier II member that started with the City at age 20 and retires at age 55 with 35 years of service will retire into poverty.	A Tier II member may decide to retire at age 55, as long as he/she has at least 10 years of service. The retirement factors for Tier II have been developed as actuarial equivalents based on a member retiring at age 65 with a maximum factor of 2.00% per year of service. This means that if a member begins collecting his/her pension at an age under 65, then his/her retirement factor will be actuarially decreased. For example, a member that retires at age 55 will be entitled to a retirement factor of 0.77% per year of service. An employee who stops working at age 55 would have a choice of collecting his/her pension beginning at age 55 with a benefit factor of 0.77%, or waiting to begin his/her pension until age 65, in which case the 2.00% factor would be utilized. The "actuarial equivalent" factors mean that either of those choices has the same value.
6	The LACERS Tier II employee contribution is too volatile for workers and will always escalate.	The independent actuary has calculated the initial Tier II employee contribution to be 10% of salary. The Tier II employee contribution is calculated by taking 75% of the plan's Normal Cost *plus* 50% of the plan's Unfunded Actuarial Liability. During good economic years, the contribution rate is anticipated to decrease and during challenging economic years, the contribution rate is anticipated to increase. To minimize volatility for members, the employee contribution rate will adjust every three years, with the first rate adjustment in 2017.

"MYTH-CONCEPTIONS"
NEW LACERS TIER FOR NEW HIRES (TIER II)

#	Myth	Fact
7	LACERS Tier II eliminates reciprocity with other retirement systems.	Tier II does <u>not</u> eliminate and/or modify reciprocity agreements with other retirement systems.
8	It is illegal for the City to unilaterally adopt LACERS Tier II without bargaining with employee organizations.	The City Council has the legal authority to establish a new LACERS Tier that is only applicable to new hires. There is no legal obligation to engage in collective bargaining for future employees. The authority comes from the City Charter and is based on case law. The City's position is consistent with its past practice in negotiating previous new tiers.
9	The CAO has refused to talk with labor and has not kept labor informed about LACERS Tier II.	The CAO has met with labor representatives at least a dozen times since January 2010 to discuss proposed plan designs. The CAO has commissioned actuarial studies that took into consideration 14 plan designs, including 2 plan designs that were suggested by labor. While there is disagreement over whether there is an obligation to bargain, the CAO has always been transparent and willing to meet to discuss with labor. The City's position is consistent with its past practice in negotiating previous new tiers.
10	LACERS Tier II will not save the City any money.	An independent actuary was hired to calculate the estimated annual cost savings for the City. According the actuarial analysis, the City will save between $30 million to $70 million during a 5-year period, between $169 million to $309 million during a 10-year period, and between $3.9 billion to $4.3 billion during a 30-year period.

"MYTH-CONCEPTIONS"
NEW LACERS TIER FOR NEW HIRES (TIER II)

#	Myth	Fact
11	If Tier II is implemented, the City's pension costs for Tier I will significantly increase because the costing methodology will switch from the Projected Unit Credit (PUC) Method to the Entry Age Normal (EAN) Method.	Tier II does not dictate which funding policy will be utilized for Tier I. The impact of transitioning the Tier I costing methodology from PUC to EAN is currently being studied, however, no decisions to enact any changes have been made to date. Under EAN, a Plan's Normal Cost is calculated as a level percentage of pay over a member's career. The contribution amount remains relatively stable over time. Under PUC, a Plan's Normal Cost increases as the member gets closer to retirement. In general, the PUC initially incurs a smaller contribution than the EAN during the first several years of the member's career. In later years, the cost for the same member will result in the PUC incurring a higher contribution than EAN. The current funding methodology for Tier I is PUC. As the current workforce ages, the PUC methodology, by definition, will likely calculate an increase to the Plan's Normal Cost. This will happen regardless of whether Tier II is implemented or not.
12	The City has not studied the impact of Tier II pension costs under the Projected Unit Credit (PUC) Method and Entry Age Normal (EAN) Method.	The independent actuarial analysis takes into consideration both the EAN and PUC costing methodologies. The results of the analysis indicate Tier II, over a 30-year period, will save the City \$3.9 billion under PUC and \$4.3 billion under EAN.

"MYTH-CONCEPTIONS"
NEW LACERS TIER FOR NEW HIRES (TIER II)

#	Myth	Fact
13	LACERS Tier II will significantly increase the City's costs of current LACERS members because Tier I members will become part of a closed system. In a closed system, the unfunded liability and amortization payments for Tier I will significantly increase.	The establishment of Tier II does <u>not</u> increase Tier I costs because Tier II does not change the Tier I benefits and actuarial assumptions. A closed system is <u>not</u> a guarantee that the City's Tier I costs will rise significantly. This is evidenced by the six separate retirement tiers of the Los Angeles Fire and Police Pension System (LAFPP). LACERS and LAFPP costs are calculated as a "level percentage of total payroll." We anticipate the LACERS actuary will continue to utilize this same methodology and therefore, there would be no increase in the City's contribution rates caused merely by establishing a new retirement tier.
14	LACERS Tier II will lead to significant recruitment and retention problems for the City.	There is no concrete information available to know with certainty if recruitment and retention will be impacted. If any problems arise, the City Council has Charter authority to make future benefit modifications. In addition, the City may look at the total compensation package, such as salaries and other benefits, and determine if any adjustments are necessary to address specific circumstances.
15	LACERS Tier II will lead to escalating workers' compensation costs for the City.	There is no concrete information available to know with certainty if future workers' compensation costs will escalate because of Tier II. The general trend in the frequency of claims in relation to age suggests that the highest percentage of claims is attributed to employees aged 45-49. This does not appear to correlate with retirement age, as the average LACERS member retires at age 60.

#	Myth	Fact
16	LACERS Tier II is not necessary because all active LACERS members now contribute 11% of salary.	The City recently reached agreements with several employee organizations to implement an increased employee contribution towards LACERS. Today, the majority of LACERS members contribute 11% of salary. In exchange, these contributing members received a vested right to future retiree medical subsidy increases. Notwithstanding this action, the City remains in dire fiscal condition and further long term cost containment must be implemented to ensure the City's continued fiscal stability.
17	The City Council and Mayor have not made changes to the Los Angeles Fire and Police Pension System (LAFPP).	The City Council and Mayor approved pension reform measures that impact members of the LAFPP. For active employees, agreement was reached with labor representatives for LAFPP members to be able to elect to contribute an additional 2% of salary to the retirement system. In exchange, contributing members will receive a vested right to future increases to the maximum retiree healthcare subsidy. Tier VI was approved by Los Angeles voters under Measure G during the March 2011 election. Tier VI became effective on July 1, 2011, and was developed after City representatives and labor representatives met extensively and reached a consensus on plan design.

"MYTH-CONCEPTIONS"
NEW LACERS TIER FOR NEW HIRES (TIER II)

#	Myth	Fact
18	The City Council and Mayor have the authority to reform the Department of Water and Power Retirement System.	The City Charter does not grant the City Council and Mayor the authority to make benefit changes to the Department of Water and Power Retirement System. The approving authority for benefit changes to the DWP Retirement System is the Board of Water and Power Commissioners, subject to adoption by the DWP Retirement Board of Administration.
19	A Social Security pension is a better retirement alternative for City workers than LACERS Tier II.	The proposed LACERS Tier II retirement factor is more generous than Social Security. Tier II members may retire at Age 65 and receive a retirement factor that yields 2% per year of service. For example, a member with 30 years of service and average City worker salary of $72,000 will earn $43,200 in retirement (60% of his/her current salary). Social Security pays significantly less and has a normal retirement age of 67. Social Security does not permit retirees to collect any pension benefits at all before age 62.
20	It is better for the City to just adopt a new pension plan that incorporates the same design features as the recently approved State of California pension reform plan.	The City is pursuing LACERS Tier II because it is a better fit for Los Angeles. The new State plan actually *increases* the retirement factor from 2.418% (at age 63) to 2.5% (at age 67) per year of service. It also caps the maximum pensionable compensation at $132,100, which is a disservice to higher income employees. If the City adopted the new State plan, the level of cost savings to the City would be drastically reduced as compared to Tier II.

"MYTH-CONCEPTIONS"
NEW LACERS TIER FOR NEW HIRES (TIER II)

#	Myth	Fact
21	The business community is not serious about reforming the City's pension plans.	On August 15, 2012, former Mayor Riordan and representatives of the Los Angeles Chamber of Commerce addressed members of the EERC during public comment. They indicated that the business community is very concerned about the City's escalating pension costs and warned that they are considering pursuing a ballot initiative.
22	Any ballot initiatives that are passed, such as former Mayor Riordan's plan, cannot impact current City employee salaries, pensions, and other benefits.	A ballot initiative that has successfully been approved by Los Angeles voters may not infringe on any vested pension rights and current labor agreements that have been previously approved and ratified between the City and labor. However, the plan mentioned by former Mayor Riordan to the EERC on August 15, 2012, does not seek to modify the current salaries and benefits. Rather, former Mayor Riordan's plan is to tie future salary increases to the percentage of City contributions towards the retirement systems. For example, salaries of LACERS members would be frozen if the City's contribution exceed 15% of payroll (25% of payroll for sworn LAFPP members).

FACT SHEET – CITY CONTRIBUTION IMPACT OF LACERS TIER II

On September 25, 2012, the City Council voted 14-0 to approve the first reading of an ordinance establishing a new retirement tier (Tier II) for future hires of the Los Angeles City Employees' Retirement System (LACERS). Tier II is anticipated to save the City up to $4.3 billion over a 30-year period. Labor asserts that Tier II will significantly increase the City's pension contributions to Tier I due to Tier I becoming a closed tier and anticipated changes in actuarial costing methodology.

Impacts of a Closed Tier

A closed retirement tier, in and of itself, is not a guarantee that the City's Tier I contribution will rise significantly. The establishment of Tier II does not increase Tier I costs because Tier II does not change the Tier I benefits and actuarial assumptions. Tier II does not create new Tier I unfunded liabilities.

The assertion that a closed system will increase Tier I pension costs is based on a specific amortization methodology that LACERS does not currently utilize. If the LACERS actuary calculates the amortization payments for Tier I as a percent of the frozen tier's decreasing payroll, and that basis is used to determine the City's contribution, then the contribution rates will rise (assuming the plan continues to have an unfunded liability). Initial amortization payments of losses would be larger and subsequent payments would be either a level percentage of Tier I payroll or a level dollar amount, but would decrease as a percentage of total payroll. There is no requirement that the City's contribution payments be calculated this way and we don't expect it will be.

The industry normal practice is to calculate the amortization payments as a level percentage of total payroll (Tier I plus Tier II payroll). The LACERS actuary already utilizes a level percentage of total payroll when calculating the City's contribution for Tier I. There is no reason to believe the LACERS actuary will recommend modifying the amortization methodology. In addition, it is important to note that the Los Angeles Fire and Police Pension System (LAFPP) has six separate tiers and has not encountered any escalated spikes in contribution costs due to the establishment of a new tier. The LAFPP utilizes the same actuary as LACERS. The LAFPP utilizes a level percentage of total payroll for Tiers III through VI. If LACERS continues to utilize this same method, then there would be no change in the contribution rates caused merely by establishing Tier II.

Calculating amortization payments as a "level percentage of total payroll" is an industry normal practice.

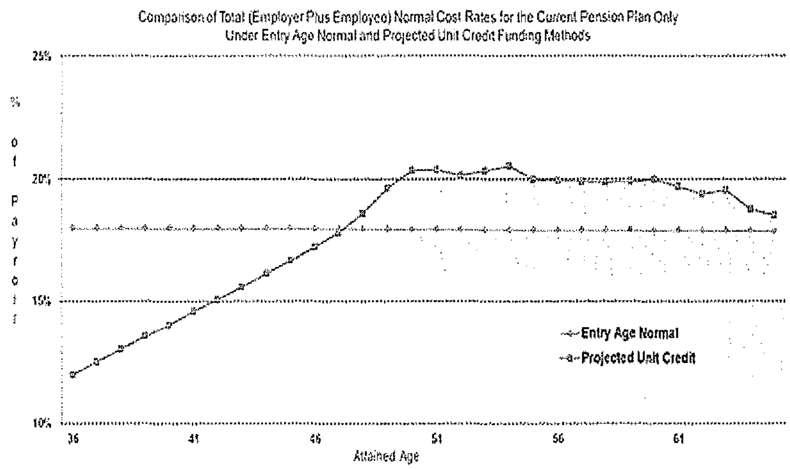
Actuarial Costing Methodologies

LACERS currently utilizes the Projected Unit Credit (PUC) as its actuarial costing methodology. Under PUC, the plan's Normal Cost increases as the member gets closer to retirement. The LACERS Board of Administration adopted a policy that if the City adopts a new retirement tier, the costing methodology for the new retirement tier would be Entry Age Normal (EAN). Under EAN, a plan's Normal Cost is calculated as a level percentage of pay over a member's career. The contribution amount under EAN remains relatively stable (as a percentage of payroll) over time. In general, the PUC initially incurs a smaller contribution than the EAN during the first several years of the member's career. In later years, the cost for the same member will result in the PUC incurring a higher contribution than EAN. While both

FACT SHEET –
CITY CONTRIBUTION IMPACT OF LACERS TIER II

PUC and EAN are viable actuarial costing methodologies, EAN is the retirement sector's industry best practice. Both LAFPP and the DWP Retirement System utilize EAN as their actuarial costing methodology.

The following graph illustrates how the pension costs of a member are allocated under the EAN and PUC. During the first 10 years of the member's career, the costs of the member under EAN are more than the PUC. However at the 11th year, the member costs are equivalent. After 11 years, the member costs under EAN are less than the PUC.



The City contracted with an independent actuary (per Charter Section 1168) to determine Tier II costs. The actuarial analysis takes into consideration both the EAN and PUC costing methodologies. The results of the analysis indicate Tier II, over a 30-year period, will save the City $3.9 billion under PUC and $4.3 billion under EAN. The following chart illustrates the City's savings from Tier II:

Tier II does not dictate which actuarial costing methodology will be utilized for Tier I.

LACERS is currently studying the impact of changing the costing methodology of Tier I members from PUC to EAN, however, no decisions to enact any changes have been made to date. As the current LACERS workforce ages, the PUC methodology, by definition, will likely calculate an increase to the Plan's Normal Cost. This will happen regardless of whether Tier II is implemented or not.

Conclusion

Labors' claims that the City's pension contributions to LACERS will increase because of implementation of Tier II are inaccurate. Tier II, in and of itself, will not lead to increased Tier I pension costs. The City will save approximately $4 billion over 30 years if Tier II is implemented.

Year	Fiscal Year	Actual* Annual	Actual* Cumulative	EAN* Annual	EAN* Cumulative
1	2014	$1,502	**$1,502**	$4,682	**$4,682**
5	2018	$10,769	**$29,879**	$21,696	**$70,028**
10	2023	$42,647	**$168,997**	$67,081	**$308,804**
15	2028	$102,970	**$552,380**	$121,502	**$805,122**
20	2033	$175,088	**$1,271,698**	$184,394	**$1,596,491**
25	2038	$251,233	**$2,373,844**	$258,511	**$2,737,035**
30	2043	$333,771	**$3,870,224**	$343,576	**$4,281,952**

"Actual" is the difference between the PUC method (current benefits) and EAN method (proposed benefits). "EAN" utilizes EAN methodology for current and proposed benefits.