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February 12, 2018

Ms. Priya Mathur
President, CalPERS Board of Administration
400 Q Street
Sacramento, CA 95812

RE: **CalPERS Board of Administration Pending Action on Amortization Modification (Finance and Administration Committee Item 7 A).**

Dear President Mathur,

On behalf of the League of California Cities (League), I would like to express my appreciation for you and the CalPERS Board of Administration's (Board) willingness to work with the local employer community as we navigate through uncertain times and rising fiscal challenges.

As outlined in the League's Retirement System Sustainability Study, unfunded pension liabilities are approaching unsustainable levels for some of our cities. These increases alone will undoubtedly result in significant fiscal challenges ranging from service reductions, workforce reductions, or in some instances insolvency or even bankruptcy. Given the wide range of impacts this potential change may have on our cities the **League has not taken a formal position on the current proposal to shorten the amortization schedule from 30 years to 20 years.**

As noted in the 2017 Asset Liability Management Workshop presentation (attachment 1, page 5 of 55), CalPERS staff expects 10-year market returns to average approximately 6.1 percent—significantly below the 7.00 percent discount rate. It is likely that a modified amortization change would result in a short-term spike in employer and in some cases employee contributions. Such policy changes for some agencies could place significant fiscal strains on already tightening city budgets in the event investment returns fall below estimates.

Outlined below are additional options that the Board may wish to consider when trying to balance the desire to bring the CalPERS fund in line with industry best practices as well as taking into account the distressed agencies who may require more flexibility in managing their pension obligations.

Amortization Opt Out for Distressed Agencies: The current amortization policy allows for an *opt-in* provision for agencies that choose to adopt a 20-year amortization schedule. However as stated by CalPERS staff this option is seldom used by agencies. Conversely, it may be beneficial to explore an opt-out provision whereby all agencies are converted to a 20-year amortization schedule that would include **a clear and definable opt out provision for agencies who are unable to make the anticipated increased payments resulting from a shorter amortizations period.** To be clear, this concept differs from the current "Fresh Start" option agencies have. Fresh Start allows agencies to aggregate their assumptions to the lower amortization denominator. In theory, the "opt out" provision would allow a financially distressed agency to continue the same course of a 30-year amortization schedule for all gains and losses. Such criteria should not be created in a vacuum—but rather be carefully crafted to include appropriate stakeholder outreach to ensure that agencies are not forced to reduce public services past acceptable levels for residents. The League would welcome the opportunity to sit down with CalPERS actuarial staff to explore finically distressed criteria specifics.

Tiered Systems for Agencies Depending on Fiscal Health

As noted in Attachment 1 of item 7A, page 5 25 years (for amortization gains and losses) is not recommended by staff. However, such timing still falls within acceptable industry standards. The Board may wish to look into a tiered system whereby agencies who are deemed capable of affording a 20-year schedule would be placed in that amortization tier. Furthermore, agencies who are struggling can be placed in a 25 year amortization period and agencies who are deemed to be in significant hardship can opt out to remain on a 30 year amortization period. Again, such criteria should be carefully crafted with appropriate stakeholder input.

Eliminating the "Ramp Down" Polices for UAL Payments

League members have not expressed concerns with the proposal to eliminate the current 5-year "Ramp Down" policy in place. In fact, eliminating the ramp down would likely result in more manageable payments over the next 25 years as opposed to higher payments for 20 years after the initial "Ramp Up" period has expired.

Establishing an Employer Discretionary Pre-fund Trust:

Although not directly associated with the pending agenda item, the League would support CalPERS establishing an employer discretionary prefunding trust, similar to what CalPERS offers for healthcare liabilities. Local agencies have the authority to provide Sec 115 trust accounts through private companies. However, private companies inherently have to build in a profit variable where CalPERS would not. Additionally, such a prefunded trust would allow agencies to use one-time moneys to pre-pay unfunded liabilities thus cutting down the total amount being amortized long term.

Working with All Stakeholders in Finding Common Ground on Alternative Approaches to UAL Reduction

We understand that the recommendation by staff is rooted in three very laudable goals; benefit security, intergenerational equity, and contribution stability. Cities undeniably support these aims; however, it is important to bear in mind the range of impacts such a change will have on local agencies vis-à-vis their individual contributions amount as a percentage of payroll and general fund budget.

The League appreciates the collaborative spirit in which this policy has been discussed. We remain ready and willing to be a partner with the Board and CalPERS staff with this and all items which affect local agencies ability to remain fiscally solvent and provide critical services to the public.

Should you have any questions regarding the Leagues position, please feel free to contact me directly at 916-658-8210 or at dhutchings@cacities.org

Sincerely,

D. Hutchings

Dane Hutchings
Legislative Representative

cc: Members, CalPERS Board of Administration
Chair and Members, CalPERS Finance and Administration Committee
Marcie Frost, CalPERS Chief Executive Officer
Scott Terando, CalPERS Chief Actuary
Brad Pacheco, CalPERS Deputy Executive Officer, Communications and Stakeholder Relations
Tom Dyer, Chief Deputy Legislative Secretary, Office of Governor Edmund G. Brown Jr.
Michael Cohen, Director, California Department of Finance