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NEW ATTACK ON PERS FUNDS

4 [by Bruce Poyer]

Last year, Governor Deukmejian failed in his attempt to provide "employer contribution relief" in the Public Employees' Retirement System (PERS). The Governor had wanted the largest public employer in California, the state itself, to "save" about \$300 million in pension contributions, so that this amount could be added to his proposed \$1 billion "rainy-day" general budget surplus. When the legislature finally refused to go along with the legally shaky "employer contribution relief" proposal, the Governor implied that both PERS and the legislature were to blame for some final cuts which he made in state general budget appropriations.

This year, instead of trying to divert PERS funds to a state surplus, the Governor is seeking to utilize PERS funds to pay directly for programs previously funded by general tax revenues. The Governor recently vetoed a legislative appropriation of state funds for special education programs in elementary schools and community colleges. As an alternative, he is encouraging legislative enactment of SB 698 (Morgan, R., Los Altos Hills), which appropriates PERS funds to support these programs.

Employee Protection Against Raids on PERS -- Fortunately, the legislature has taken many steps over the years to insure that the pension fund savings of public employees in California cannot be legally diverted or otherwise misallocated to unrelated programs, and the courts have enforced these protections. In recent years, Governor Deukmejian himself has signed into law several important additions to these protections.

First, the legislature long ago provided that PERS funds must be kept in the Public Employees Retirement Fund. In 1967, the legislature defined this fund as a trust "created and administered solely for the benefit of the members and retired members of the system and their survivors and beneficiaries." (Government Code, Title 2, Div. 5, Part 3, Para. 20200.)

Second, the legislature in 1971 specified that it would be the PERS Board's responsibility to adjust public employer contributions to PERS from time to time, "pursuant to actuarial valuation of the liability for benefits on account of the employees of all public employers." (Government Code, Para. 20750.9.) The Board must make the actuarial valuations and report the new contribution rates to the Governor, the legislature, and the governing body of every other public employer in PERS, before March 1 of any year. This procedure was clearly intended to keep the adjustment of PERS rates separate from the legislature's annual battle over the general budget, which traditionally comes to a head by June 30, the end of the fiscal year.

The PERS Board honors its March 1 deadline for the actuarial determination of employer contribution rates. But the state must then appropriate funds for the greater part of total public agency contributions to PERS. In recent years, the legislature has not acted in time to keep the state's pension appropriation separate from the general budget battle. The legislature thus makes it easier for anyone who may be interested in raiding PERS funds, or just in politicizing the system.

The Key Role of the PERS Board -- It is clear that the PERS Board must play the key role in setting employer rates, and must do so on the basis of its periodic actuarial valuations of the system. In the last year of Governor Jerry Brown's administration, the legislature disregarded the PERS Board's recommendation and set employer contribution rates calculated to "save" the state about \$87 million. This raid was approved by the

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Governor and the legislature, opposed by the PERS Board, and declared illegal by a California Appellate Court in 1982, in *Valdes v. Cory*. The case was brought by the California State Employees' Association and the California School Employees' Association. The Court in *Valdes* clearly defined the employer's pension contribution as a deferred wage, which was earned by the employee and paid by the employer for work performed by the employee. The pension contribution of the employer was therefore a legal employment contract, and the Court held that the public agency employer has a continuing obligation to meet the terms of that employment contract. Further, it made no difference that the legislature and the Governor had sought to reduce the public employer's pension contribution by utilizing funds in the PERS "reserve for deficiencies," since the Court defined this reserve as an inseparable part of the Public Employees' Retirement Fund.

The PERS Board also has the authority to reduce the contribution rates of the state employer, or a school employer, or a public agency employer--although it may legally do so only if it first determines that the actuarial integrity of the system would not be adversely affected by the reduction. (Government Code, Para. 20760.) It is this authority of the Board which has been both used and abused by the Deukmejian administration.

Deukmejian's Raid of 1987 -- By March 1 of last year, the PERS Board had recommended employer contribution rates based on its actuarial evaluation, and had reported these rates to the Governor and the legislature. But the legislature did not act on the Board's recommended rates before the Governor proposed a different set of rates calculated to "save" the state enough to build up his "rainy-day" general budget surplus. PERS Board member Mossman, who is Director of the Governor's Department of Personnel Administration, made the Governor's recommendation to the PERS Board meeting of June 18, in the form of the motion for "employer contribution relief." The total amount of such "relief" finally involved in the motion was \$477 million, of which about \$300 million was the state's share of the raid.

A number of questions were immediately raised about the legality of Mossman's motion. Among the first to question the vote was Sid McCausland, the Chief Executive Officer of PERS, who advised Board members in writing that they could not legally approve such a diversion of public employee pension funds, since they are required as fiduciaries to hold these funds in trust for the exclusive benefit of members of the pension plan. The state officials on the PERS Board (led by Mossman, Unruh, and Cory) then moved to dismiss McCausland from his position. Their motion carried by 7-6. The PERS Board then returned an identical 7-6 vote to recommend the diversion of PERS funds for use in building up the state's general budget surplus, as requested by Governor Deukmejian. Following is the line-up of PERS Board votes on these two crucial motions:

*For dismissing McCausland
and diverting PERS funds*

Mossman: Director, State Department
of Personnel Administration
Unruh: State Treasurer
Cory: State Controller
Chavez: representing the State
Personnel Board
Fradd: Governor's appointee
Marshall: Governor's appointee
Watson: joint appointee of Assembly
Speaker and Senate Rules Committee

*Against dismissing McCausland
and diverting PERS funds*

Carlson: elected by state members of PERS
Ellis: elected by all PERS members
Petrosino: elected by public agency
members of PERS
Saunders: elected by retired members of
PERS
Valdes: elected by all PERS member
Willard: elected by school members of
PERS

The elected members made it clear that they regarded a "yes" vote on the question of "employer contribution relief" as a violation of the fiduciary obligations of Board members. Elected member Valdes announced that if the funds were actually diverted, the employee organizations would again challenge that action in court.

Although McCausland was summarily fired by PERS Board action, the 1986 legislature finally refused to accept the PERS Board's June recommendation on "employer contribution relief." Obviously, it became clear to many legislators that this "relief" was a legally risky diversion of PERS funds that probably could not survive the promised court challenge. Further, some legal authorities contend that legislators who act on PERS funding issues are themselves bound by the same fiduciary obligations that apply to PERS Board members.

Deukmejian's Raid of 1987 -- In this year's raid on PERS, the Governor is obviously still relying on the PERS Board's 7-6 vote of last year. That vote could be carried over, or a similar vote could be returned again by the seven ex-officio and appointed members. And the legislature could then vote to raid PERS, with the approval of the PERS Board. In that event, three additional statutes enacted by the legislature in 1982 and 1983, and signed into law by Governor Deukmejian, would have to be carefully considered. All were passed after the Court's *Valdes* decision, and all were intended to add to existing statutes protecting PERS funds from raids by Governors or by legislators.

First, the legislature provided in 1982 that "notwithstanding any other provision of law, funds in the reserve against deficiencies shall not be used to pay any employers' contribution required by this chapter to be paid by the state, any school employer, or any contracting agency." (Government Code, Para. 20203.2.) Next, the legislature provided in 1983 that "notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of the system, investments for the benefit of the system, and the provision of benefits to the members and retired members of the system and their survivors and beneficiaries." (Government Code, Para. 20203.3.)

Finally, the legislature in 1983 added the following fiduciary standard to protect PERS funds: "The (PERS) Board and its officers and employees shall discharge their duties with respect to the system solely in the interest of the participants and beneficiaries for the exclusive purpose of both of the following: (1) providing benefits to members, retired members, and their survivors and beneficiaries; and (2) defraying reasonable expenses of administering the system." (Government Code, Para. 20205.8.) This protection was added to California law many years after it was legislated in ERISA in 1974, for protection of employees in all of the nation's private sector pension plans. It is a fiduciary standard which now binds all PERS Board members, including those appointed as well as those elected to the Board, and including those who hold other state office.

Conclusion -- As PERS assets have come to exceed the total annual state budget, raids on PERS funds (or laundered diversions thereof) have become increasingly tempting to politicians. Unfortunately, these attacks can make PERS, one of the nation's largest and most successful pension systems, an object of constant political turmoil, and can put its basic funding at risk.

If the legislature proceeds this year with the direct appropriation of PERS funds, as proposed in SB 698, it would have to do so in direct conflict with several of the above Government Code protections, including those signed into law by the Governor himself. There would inevitably be lawsuits to stop this direct kind of raid. However, the bigger problem is the PERS Board, which apparently lacks the ability to function with fiduciary responsibility. PERS members should encourage their employee organizations to seek additional legislation which is needed to protect system members from the conflicts of interest that clearly confront state officials who are also PERS Board members.

-- Bruce Poyer

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