

2009-2010 Civil Grand Jury
City and County of San Francisco

PENSION TSUNAMI
The Billion Dollar Bubble

Report Released: JUNE 2010

Purpose of the Civil Grand Jury

California state law requires that all 58 counties impanel a Grand Jury to serve during each fiscal year (Penal Code section 905, California Constitution, Article I, Section 23). In San Francisco, the presiding judge of the Superior Court impanels two grand juries. The Indictment Grand Jury has sole and exclusive jurisdiction to return criminal indictments. The Civil Grand Jury scrutinizes the conduct of public business of county government.

The function of the Civil Grand Jury is to investigate the operations of the various officers, departments and agencies of the government of the City and County of San Francisco. Each civil grand jury determines which officers, departments and agencies it will investigate during its term of office. To accomplish this task, the grand jury is divided into committees, which are assigned to the respective departments, or areas, which are being investigated. These committees visit government facilities, meet with public officials and develop recommendations for improving City and County operations.

The 19 members of the Civil Grand Jury serve for a period of one year from July through June 30 the following year, and are selected at random from a pool of 30 prospective grand jurors. During that period of time it is estimated that a minimum of approximately 500 hours will be required for grand jury service. By state law, a person is eligible if a citizen of the United States, 18 years of age or older, of ordinary intelligence and good character, and has a working knowledge of the English language.

Applications to serve on the Civil Grand Jury are available by contacting the Civil Grand Jury office:

- by phone (415) 551-3605 (weekdays 8:00-4:30)
- in person at the Grand Jury Office, 400 McAllister Street, Room 008, San Francisco, CA 94102.
- online by completing the [application](#) at

<http://www.sfsuperiorcourt.org/Modules/ShowDocument.aspx?documentid=1988>

State Law Requirement

Pursuant to state law, reports of the Civil Grand Jury do not identify the names or identifying information about individuals who provided information to the Civil Grand Jury.

Departments and agencies identified in the report must respond to the Presiding Judge of the Superior Court within the number of days specified, with a copy sent to the Board of Supervisors. As to each finding of the Civil Grand Jury, the response must either (1) agree with the finding, or (2) disagree with it, wholly or partially, and explain why. Further, as to each recommendation made by the Civil Grand Jury, the responding party must either report (1) that the recommendation has been implemented, with a summary explanation of how it was implemented; (2) the recommendation has not been implemented, but will be implemented in the future, with a time frame for the implementation; (3) the recommendation requires further analysis, with an explanation of the scope of that analysis and a time frame for the officer or agency head to be prepared to discuss it (less than six months from the release of this report); or (4) that recommendation will not be implemented because it is not warranted or reasonable, with an explanation of why that is. (California Penal Code, Sections 933, 933.05.)

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The current constitutional requirement to pay unsustainable public pension obligations is a promise without a plan”

~Girard Miller

Little Hoover Commission, April 22, 2010

PURPOSE OF THIS REPORT

The purpose of this report is to alert public officials and citizens that fundamental adjustments must be made to the City’s employee pension program. The San Francisco Controller has projected the pension and health care costs to increase from \$413 million for the current fiscal year to nearly \$1 billion¹ in five years. These obligations will increasingly impact the general fund and threaten to move resources from other needs of the City. Reform must be undertaken in order to find a balance between keeping the City’s promise to retired workers and maintaining the critical services that make our City great.

I. SUMMARY

Over the past twelve months the San Francisco Civil Grand Jury investigated the increasing retiree Pension and Health Benefit costs that will approach \$1 billion in five years, which is about 1/3 of the City’s current General Fund. Pension and health benefits enjoyed by San Francisco retirees are unsustainable.

During recent periods of economic prosperity our City officials, along with compassionate voters, created relatively generous pensions for many City employees. But with the recent economic downturn and loss of millions in the City’s pension fund, these increasing costs threaten to jeopardize the City’s financial future.

The Grand Jury is concerned that the public may conclude from our findings that all city workers receive excessive retirement benefits or gain from abusive pension practices. This is simply not true for the vast majority of city workers. The typical public servant who goes to work every day to serve the public will receive a modest pension after many years of service to the City. The Grand Jury and the public should be grateful for the dedication and hard work of the majority of city employees.

The 2008 economic crisis caused a decline in the City’s pension fund of approximately \$3 billion or 25% of the fund balance as of June 30, 2009. While Employee contributions to the pension fund have remained constant at 7.5% of wages, the City’s contribution rate has increased rapidly. The City’s rate was 0% until 2004, will be 13.56% next year (FY 2010-2011), and is estimated to be 30% in five years.

Over the past years, SFERS has maintained a fully funded pension plan. That has now changed. The City’s actuarial firm, Cheiron, is projecting an increasing unfunded liability over the next five years. The funded status is projected to decline from 91% next year to

¹ San Francisco Office of the Controller’s “Pension and Retiree Health History and Future Scenarios, FY 2005-06 to FY2014-15.”

68% in FY 2014-15. Pension experts advise plan administrators to maintain at least an 80% funding level.

The Jury compiled a list of 900 retirees receiving pension payments exceeding \$100,000, referred to in the California Pension Reform website as the “\$100 K Club.” The Jury found significant disparities in the pension benefits paid to Police, Firefighters and Miscellaneous retirees. (See Appendix C.)

Since 2002 the City has “picked up” the employees’ 7.5% contribution for members of the Service Employee International Union (SEIU) Local 1021 and other smaller collective bargaining units, consisting of 9,883 employees. The annual cost to the City has been over \$60 million. In May 2010, the City and SEIU Local 1021 entered into an agreement that employees would pay their own 7.5% contributions, and in return employees’ wages would increase by 6% effective July 1, 2010. This “swap” was described as “cost neutral” for budgetary purposes. However, the swap will have a significant financial impact on the City’s future pension obligations. The failure to consider the cost of pension obligations was a major oversight on the part of the City’s negotiation team.

Proposition H, passed by San Francisco voters in 2002, was a charter amendment that changed the formula for Police and Firefighter retirement benefits. The maximum retirement benefit for Police and Firefighters was set by charter amendment to 90% of the highest pensionable compensation. Proposition H mandated that the City and Safety employees’ representatives “meet and confer” on a “material pension cost-sharing arrangement.” The Jury found no evidence that the City and the bargaining agents for Safety employees established such a cost-sharing arrangement.

The Jury estimates the Safety employees’ contributions to be approximately \$13 million annually over the next thirteen years under a 50% cost-sharing arrangement. The Jury has recommended that the City Attorney seek a court order requiring SFERS to comply with the City Charter.

The Office of the Controller estimates that the expected increase next year in the funding of pension and health benefit costs will impact the City’s General Fund by approximately \$63 million. This shift in resources may require reductions in funding to basic services, affecting all San Franciscans, but with the greatest impact on the poor and the middle class.

Unless serious pension reform is undertaken, our children and grandchildren, who were too young to vote at the time, may be saddled with the costs of benefits of former public employees who bargained in good faith. Decisions were made based on claims by City officials, SFERS, and labor groups that it would cost nothing; these errors may now be constitutionally irreversible.

With the current legal protections in place, the City will need to focus on the employees’ contribution levels, and on redefining the system for future employees. New hires may forever have less generous benefits.

II. INTRODUCTION

The 2008-2009 Civil Grand Jury's report, "Pensions: Beyond Our Ability to Pay," was meant to be a wakeup call to the City. Instead, the required respondents rejected all but one of the findings and recommendations with a tepid response: "If there is pension spiking, it is wrong," and "The data that the Grand Jury presented could not be verified."²

The City employee contributions have remained flat while the employer's contribution rate has increased rapidly. The recent economic crisis resulted in a decline in the pension fund of approximately \$3 billion or 25% of the fund balance as of June 30, 2009³. The loss incurred to the fund during fiscal 2008-09, in spite of the actuarial five-year averaging methodology, has caused the employer's contribution rate, which was 0% in FY 2003-04, to skyrocket to 9.49% this fiscal year (2009-2010). It is estimated to increase to 30% in FY 2014-15.⁴

Defined Benefit (DB) plans have been largely abandoned by the private sector in favor of Defined Contribution (DC) or 401(k)-type plans. Other cities and other states are offering DC plans or a combination of the two. The Jury is not recommending one type over the other. California's constitution has been interpreted to protect the rights of public employees to an entitlement to receive the same benefits for their entire lifetime. There is consensus among many legal experts that it is virtually impossible to reduce retirees' benefits prospectively or to change retirement ages for current employees.

Action by the City is hamstrung on the one side by powerful public employee union influences in both the state legislature and on the pension board and, on the other, by the 2/3 majority voting requirements for taxing authority in the State's constitution.

The findings and recommendations contained herein are central to the Grand Jury's report and are presented to city agencies and departments for their response.

III. METHODOLOGY

The Jury began its investigation in October 2009. The investigation consisted of an inquiry into and an examination of the following: departmental and online database documents, local and national data, correspondence, litigation, literature, newspaper articles, letters to the editor, testimony, internet sites, the City Charter, Civil Service rules,⁵ Proposition H (2002), Proposition D (2010), memoranda of understanding (MOU), civilian complaints, SFERS employment and retirement system data, Cheiron's⁶ actuarial valuation report and stress-testing charts,⁷ and confidential interviews.

² Responses to 2008-09 SF Civil Grand Jury report on "Pensions, Beyond Our Ability to Pay."

³ San Francisco City and County Employees Retirement System audit report for June 30, 2009.

⁴ Cheiron "Projections Stress Testing Employer Contribution Rates." See Appendix D.

⁵ Rule 109 Position Classification and Related Rules and related rules. (See References) www.sfgov3.org/index.aspx

⁶ SFERS actuarial consultant

⁷ Available at SFERS (San Francisco Employee Retirement System) in San Francisco

The Jury conducted interviews with citizens, employees, government officials and Safety personnel from the following:

- Citizen complainants
- San Francisco Employee Retirement System (SFERS)
- San Francisco Department of Human Resources
- San Francisco City Attorney's Office

IV. DISCUSSION

SAN FRANCISCO'S PENSION SYSTEM

There are various pension arrangements, but most fall into one of two basic categories – Defined Benefit (DB) and Defined Contribution (DC). The Department of Labor describes these plans as follows:⁸

A defined benefit plan promises a specified monthly benefit at retirement. The plan may state this promised benefit as an exact dollar amount, such as \$100 per month at retirement. Or, more commonly, it may calculate a benefit through a plan formula that considers such factors as salary and service — for example, 1 percent of average salary for the last 5 years of employment for every year of service with an employer. The benefits in most traditional defined benefit plans are protected, within certain limitations, by federal insurance provided through the Pension Benefit Guaranty Corporation.

A defined contribution plan, on the other hand, does not promise a specific amount of benefits at retirement. In these plans, the employee or the employer (or both) contribute to the employee's individual account under the plan, sometimes at a set rate, such as 5 percent of earnings annually. These contributions generally are invested on the employee's behalf. The employee will ultimately receive the balance in their account, which is based on contributions plus or minus investment gains or losses. The value of the account will fluctuate due to the changes in the value of the investments. Examples of defined contribution plans include 401(k) plans, 403(b) plans, employee stock ownership plans, and profit-sharing plans.

The San Francisco pension plan for public employees is a Defined Benefit (DB) plan, similar to that for many or most public agencies, which use the product of salary, length of service, and a factor to provide a predictable life pension amount.

Current San Francisco pensions are based on the highest twelve consecutive months of earnings, years of service, and a factor. The factor at the time of full retirement is 3% for

⁸ <http://www.dol.gov/dol/topic/retirement/typesofplans.htm>

Safety employees (Police and Fire), and 2.3% for other (Miscellaneous) employees. For new employees hired after July 1, 2010, pensions will be based on the highest two-year average⁹ (instead of one year). Miscellaneous employees can retire at full pension at age 60; Safety personnel can retire at full pension earlier at age 55.

The maximum starting retirement benefit for Police and Fire is 90% of pensionable income, with a 75% maximum for Miscellaneous employees.

Under San Francisco's plan, most employees contribute 7.5% of salary. Safety employees hired after July 1, 2010, will contribute 9%.⁹

The City makes contributions to the plan based upon an annual actuarial valuation of the pension fund to ensure that the fund has sufficient assets to cover its benefit payouts. When times were good, the City paid zero percent (until 2004), but with recent years of economic malaise, the City must now pay 9.49%. The City and County of San Francisco has a current annual pension liability of \$287 million for FY 2009-10 (see Figure 1). A combination of too high estimates on investment returns, and too low annual employee contributions may lead to a billion-dollar pension crisis in San Francisco within five years.

HEALTH BENEFITS

All San Francisco employees hired before January 10, 2009, have a right to lifetime retiree health benefits after only five years on the job, a right vested in the City Charter. For about 60,000 employees – on-the-job or retired – the City has a debt obligation. Workers and retirees may subscribe to various health plans, for instance Blue Cross, Kaiser or others,¹⁰ with varying costs and benefits, depending on the plan and on bargaining agreements between the City and employee unions.

Employees hired after January 10, 2009 pay 2% of salary, and the City pays 1% into a new trust fund to pay for retiree health benefits.¹¹

The costs of retiree medical benefits have escalated dramatically with medical inflation over the past 25 years. Benefits that once cost employers a few hundred dollars monthly for a handful of retirees now cost more than \$10-12,000 a year for a rapidly-growing legion of Baby Boomer retirees. Granting these benefits before retirees achieve Medicare age, and to dependents and survivors, has escalated the costs even further.¹²

Unlike pensions, health benefits for most retirees are not pre-funded but are paid directly out of the City's General Fund ("pay as you go"). In 2001, the City expended \$17 million on

⁹ San Francisco Proposition D, passed by voters on June 8, 2010

¹⁰ Health Service System, City and County of San Francisco. <http://www.myhss.org/>

¹¹ S.F. Proposition D, June 8, 2010. <http://www.smartvoter.org/2008/06/03/ca/sf/meas/B/>

¹² <http://www.lhc.ca.gov/studies/activestudies/pension/MillerApr10.pdf>

retiree health care. By 2011, that amount will have grown to \$140 million and is expected to rise unabated.¹³

Mercer Consulting (an actuarial firm hired by the City) reported on June 30, 2008, that the City's unfunded liability for health benefits was \$4 billion.¹⁴ The City has set up a Health Benefit Trust Committee (Controller, Treasurer and Executive Director of SFERS) to work on funding alternatives to address this problem.

PENSION COSTS

The Billion-Dollar Bubble

The City Controller has projected the City's pension and health benefit costs to increase from approximately \$400 million for the current fiscal year to nearly \$1 billion in five years (see Figure 1). The balloon payment due in 2015 is equivalent to approximately 1/3 of the current \$3 billion General Fund.

The Controller's Budget Analyst has estimated that changes in pension and health benefits will increase each year through 2015 (see Figure 2). The Analyst has estimated that the General Fund will be negatively impacted for the increases in pension and health benefit costs by approximately \$63 million in FY 2010-11. The projected negative impact on the General Fund will remain at approximately \$60 million for each fiscal year through FY 2015.¹⁵

Who Pays the Piper?

Employee pension contributions have remained flat while the City's contribution rates have increased significantly. The SFERS actuary presented a report titled "Projections Stress Testing Contribution Rates" to the San Francisco Employee Retirement System (SFERS) board in February 2010¹⁶. The stress test scenarios were developed using different investment return options for each fiscal year during a twenty-year period. The two scenarios presented in the Controller's department of Budget and Analysis report were the "Baseline" and the "Negative 5-Year Moderate" projections. The Grand Jury reviewed both projections and found the "Negative 5-Year Moderate" projection to represent a more conservative investment return option of 4.5% over the "Baseline" assumption of 7.5% (Figure 3b). The trend over the next five years is an ever-increasing employer contribution rate, 9.49% for the current fiscal year (2010) and expected to increase to 30% by 2015 In (Figure 3a).

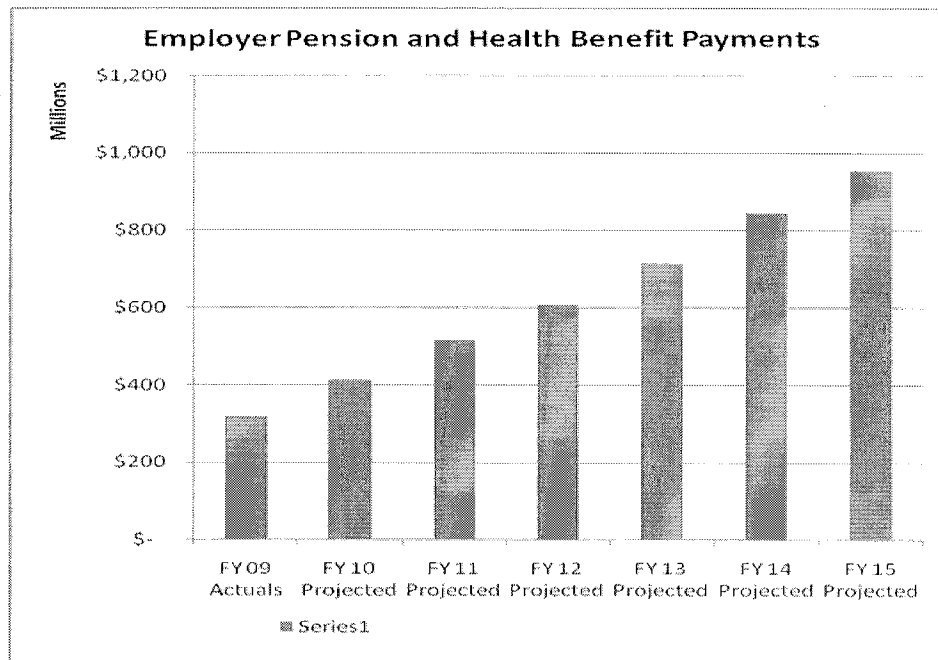
¹³ Controller Department of Budget and Analysis. See Appendix B for Controller's Analysis.

¹⁴ Mercer Consulting Health Benefit Actuarial Valuation Report, fiscal year 2007-08.

¹⁵ In the Controller's analysis, he estimates that 61% of the total pension and retiree health benefit costs are funded by the General Fund. See Appendix B for Controller's analysis

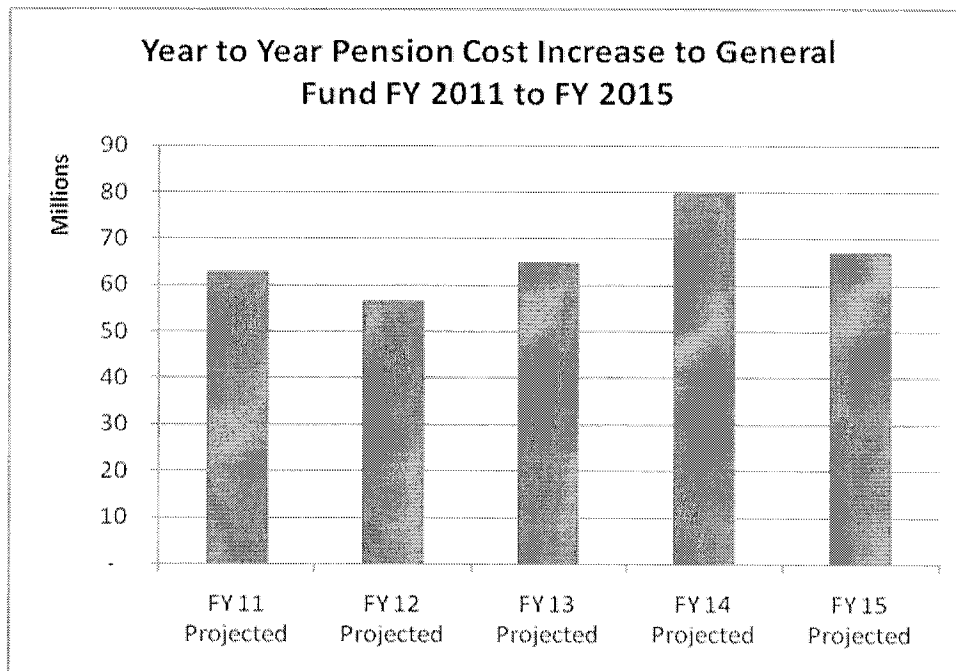
¹⁶ Controller Department of Budget and Analysis. See Appendix B for Controller's Analysis..

Figure 1



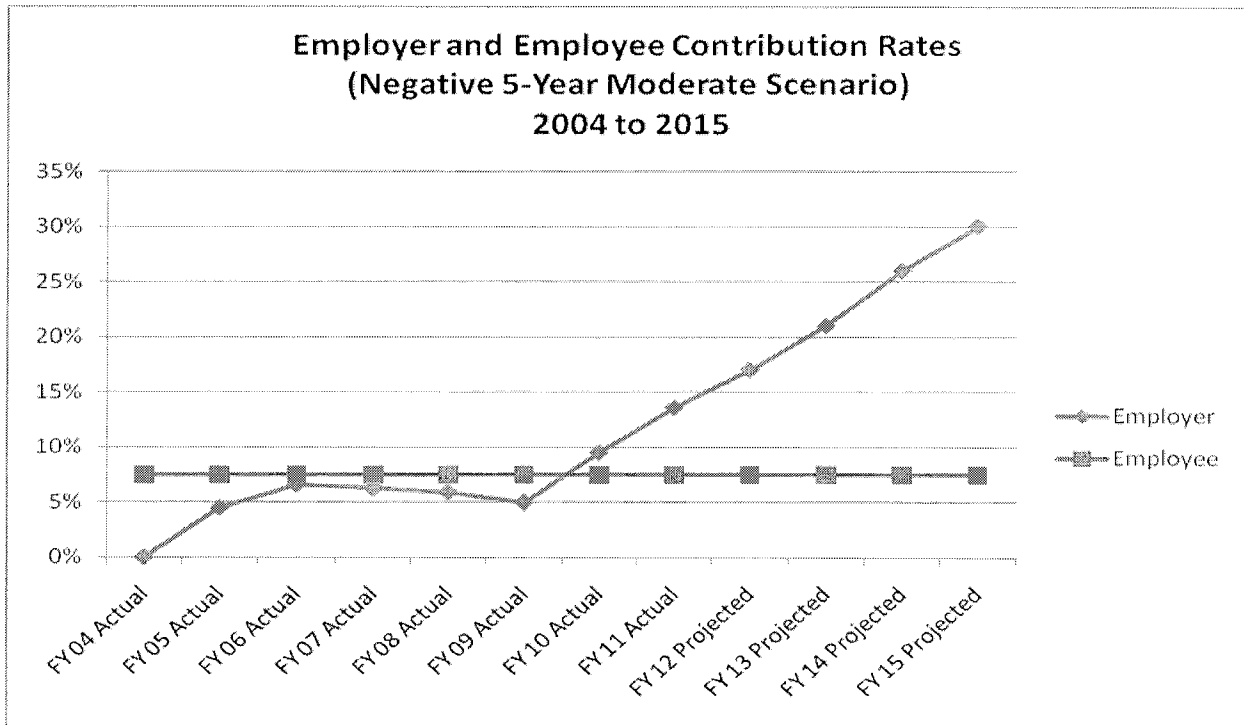
Source: Controller Department of Budget and Analysis.
See Appendix B for Controller's Analysis.

Figure 2



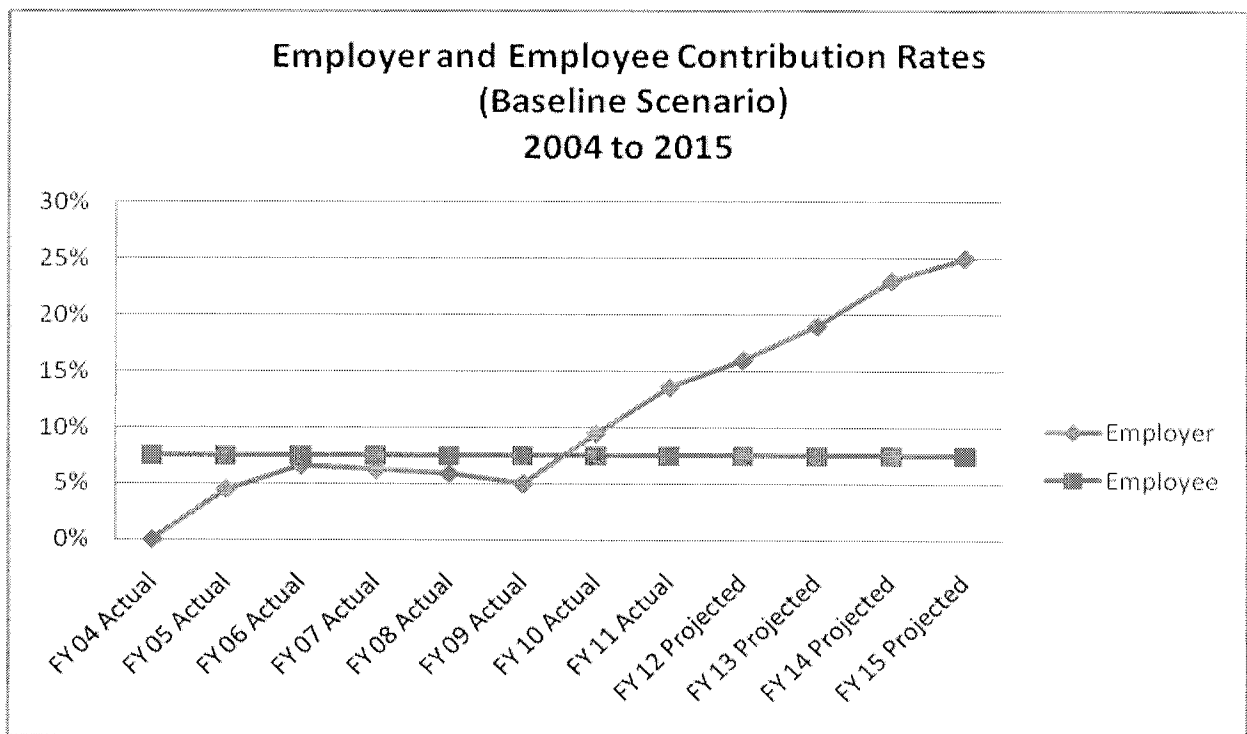
Source: Controller Department of Budget and Analysis.
See Appendix B for Controller's Analysis.

Figure 3a



Source: Cheiron "Projections Stress Testing Employer Contribution Rates" Appendix D

Figure 3b



Source: Cheiron "Projections Stress Testing Contribution Rates," Appendix D

Over a period of many years, the City has agreed through collective bargaining to waive certain groups of employees' pension contributions and pay or "pick up" the employees' 7.5% contribution. The absence of a significant employee contribution rate has incentivized employee organizations to pursue ever-increasing retirement benefits at no real cost to employees. Both employee organizations and government officials may perceive that the true cost of increases to retirement and health benefits are hidden from the public by opaque government accounting and City budgeting procedures, and thus choose to ignore the fiscal discipline to pay today for today's costs of services.

Since 2002 the City has "picked up" the employees' 7.5% contribution for members of the Service Employee International Union (SEIU) Local 1021 and other smaller collective bargaining units, consisting of 9883 employees. The annual cost to the City has been over \$60 million. For Safety employees, whose pension cost is higher, the City pays the difference between 9.0% and the employee contribution rate of 7.5%.

In May 2010, the City and SEIU Local 1021 entered into an agreement that employees would pay their own 7.5% contributions, and, in return for this concession, the City agreed to increase the employees' base wage by 6%, effective July 1, 2010. This arrangement is referred to in the amendment to the MOU between the City and SEIU Local 1021 as a "swap." The swap, in effect, relieved the City of approximately \$60 million in payments for employees' contributions to the pension plan; however, the City had to increase pay by 6% for all the members of SEIU and other labor bargaining organizations which approximates a swap amount of \$60 million. The swap was described as "cost neutral" for budgetary purposes. However, the swap will have a significant financial impact on the City's future pension obligations.

Prior to this agreement, the 7.5% contribution paid by the City was excluded from pensionable compensation. However, the 6% increase in wages is now pensionable income. Thus, the conversion of non-pensionable to pensionable compensation will increase the retirement benefits for thousands of city workers.

The City's negotiating representatives in the Department of Human Resources (DHR) did not engage an actuary to complete an evaluation to estimate the pension liability for the 6% increase.

The 6% increase in wages would provide a comparable 6% increase in pension; therefore, an SEIU employee who would have retired with, say, a \$20,000 annual pension would realize an additional \$1,200 annual lifetime benefit. For a retiring employee with a life expectancy of 29.6 years (from IRS longevity tables), and assuming an interest rate of 7.75%,¹⁷ then the present value of this benefit would be \$13,784.¹⁸

¹⁷ 7.75% is the interest rate assumed by Cheiron in actuarial valuation.

¹⁸ See online calculator to compute Present Value

http://www.engineeringtoolbox.com/discrete-payments-compounding-formulas-d_1234.html

The Grand Jury has estimated that the “swap” arrangement between the City and SEIU Local 1021, and other unions representing city workers, will result in approximately \$136 million in unfunded pension obligations. The City will be required to fund this future pension obligation, unless a fair cost-sharing arrangement between the City and labor unions can be implemented.

A New Twist – The Unfunded Pension Liability

SFERS had maintained a strong and improving funding ratio from 1999 to 2008. In 1999 the funding ratio was 103% and the surplus status continued through 2008.

In FY 2008-09, the funded status declined to a ratio of 97% due primarily to a net loss of approximately \$3.5 billion, which represented a 22%¹⁹ decline in plan net assets. In order to mitigate the impact of the investment performance volatility on the City’s contribution rate, Cheiron’s actuaries utilize a 5-year “smoothing” technique. Without the impact of smoothing, the market value of the pension fund assets to liabilities would have declined from 103% to about 72%. A further decline in the funded status is expected over the next twenty years, according to Cheiron’s actuaries²⁰.

The Cheiron “Negative 5-Year Moderate” projection shows an increasing unfunded liability²¹ over the next five years. The funded status is projected to decline from 91% in the next fiscal year to 68% in FY 2014-15. Experts advise at least an 80% funding level.²²

If current practices do not change, the unfunded pension liability will present a financial burden for The City, and ultimately the taxpayer.

¹⁹ The City and County of San Francisco Audit Report for SFERS of June 30, 2009.

²⁰ See Appendix D. Cheiron’s “Projections Stress Testing Employer Contribution Rates.”

²¹ Note: The unfunded liability is the accrued liability for past services which were not funded by prior contributions and investments.

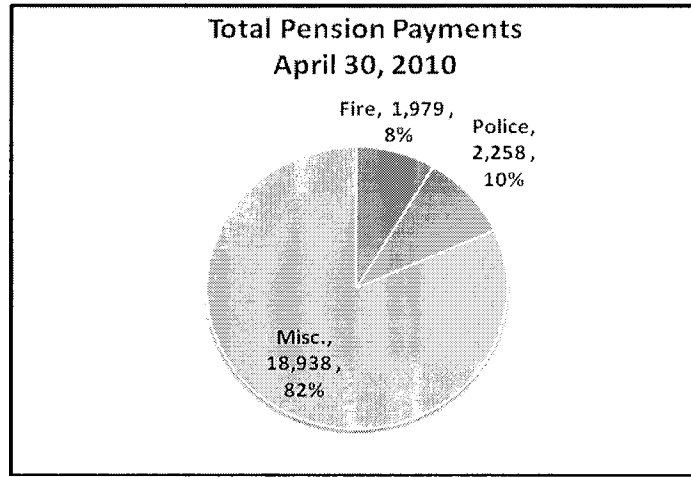
²² See Pew report on Unfunded Pension liability.

PENSION PIE

The Grand Jury obtained the SFERS April 30, 2010, payroll data for all retirees receiving an annual pension of \$75,000 or more. The total payroll consisted of 23,175 retirees.

Figure 5 shows the total population by retiree group.

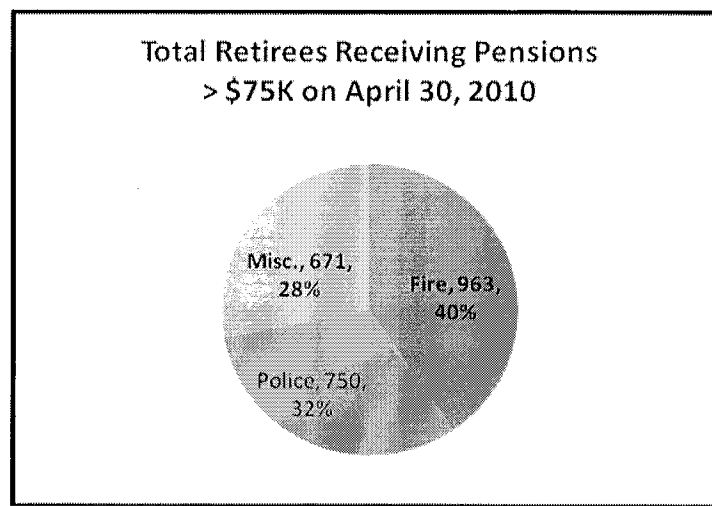
Figure 5



Source: SFERS April 30, 2010 Payroll.

Figure 6 shows a population of 2,384 retirees who receive a pension greater than \$75,000. The distribution in the chart shows the number of retirees by group and the group total as a percent of the total population.

Figure 6



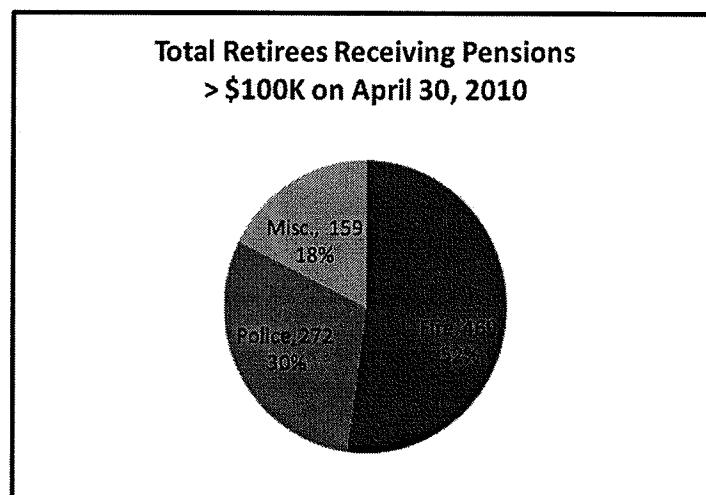
Source: SFERS April 30, 2010 Payroll.

Retirees within each group that receive pensions greater than \$75,000:

- Of the 1,979 retired firefighters, 963 or 49%.
- Of the 2,258 retired police officers, 750 or 33%.
- Of the 18,938 retired miscellaneous, only 671 or 4%.

Figure 7 shows a population of 900 retirees who receive a pension greater than \$100,000. The distribution in the chart shows the number of retirees by group and the group total as a percent of the total population.

Figure 7



Source: SFERS April 30, 2010 Payroll.

Retirees within each group that receive pensions greater than \$100,000:

- Of the 1,979 retired firefighters, 469 or 24%.
- Of the 2,258 retired police officers, 272 or 12%.
- Of the 18,938 miscellaneous retirees, only 159 or 1%.

Table 1

AVERAGE STATISTICS FOR SAFETY AND MISCELLANEOUS RETIREES

Source: Cheiron Actuarial Valuation dated July 1, 2009.

	Average Age At Retirement Or Disability	Average Current Age	Average Annual Pension
Old Police ²³	51	73	\$64,557
New Police	51	58	56,520
Total Police	51	69	62,701
Old Fire	54	73	72,684
New Fire	52	58	71,853
Total Fire	54	70	72,505
Old Misc.	59	75	30,934
New Misc.	58	65	21,065
Total Misc.	58	70	\$26,073

Table 1²⁴ shows, for all retirees, the average age of retirement, the average current age, and average annual pension. Employees hired prior to 1976 fall under the Old Plan, when overtime was included in pensionable income. Those hired after 1976 belong to the New Plan when overtime was not included. The number of Old Plan members is declining every year as older members retire.

²³ "Old" indicates employees hired before November, 1976, before which time Overtime was included in pensionable compensation. "New" indicates employees hired after November, 1976.

²⁴ Cheiron Actuarial Valuation dated July 1, 2009.

Slicing the Pension Pie: Some More Equal Than Others

The distribution of annual pension benefits of \$75K or more among the three retirement groups shows a significant disparity between Safety (Police and Fire) and Miscellaneous employees. This difference would be expected based in part on the increasing retirement benefits that have been awarded to Safety employees by voters over many years. In particular, the practice of paying Safety retirees retroactive benefit increases has created a form of deferred compensation for this select group that will continue to grow over their lifetime. In addition, the 2008-09 Civil Grand Jury issued a report²⁵ on abusive pension practices among Safety employees and found many incidences of pension spiking, accomplished by accumulating excessive pensionable compensation in the final year of work.

The disparity in pension benefit payments between retired police officers and firefighters cannot be attributed solely to pay differences, since the city attempts to maintain wage parity for Safety employees. The Grand Jury investigated Safety employees' pension benefits for FY 2008-09 and the ten months ended April 30, 2010. The practice of pension spiking appears at a much higher rate among firefighters than among police officers. This is discussed further in the section Pension Spiking.

The \$100k Club

Nine hundred retirees receive pension benefits of over \$100,000. Safety retiree positions represent 82% of the Club and Miscellaneous only 18%.

A list of all retiree positions receiving a pension of \$100K or more can be found in Appendix C and at the California Pension Reform website.²⁶

PROPOSITION H – POLICE & FIREFIGHTER RETIREMENT PLAN

Proposition H, passed by San Francisco voters in 2002, was a charter amendment that changed the formula for Police and Firefighter retirement benefits. For those who retired at age 50, the Charter Amendment provided a service credit of 2.4% of salary for each year of service²⁷. For those retiring at age 55, the service credit for entire career became 3% of salary. The maximum retirement benefit for Police and Firefighters was 90% of their highest pensionable compensation in a twelve-month period. The charter amendment as it appeared in the November, 2002 voters pamphlet follows:

²⁵ See 2008-09 SF Civil Grand Jury report on "Pensions, Beyond Our Ability to Pay."

²⁶ California Pension Reform. <http://www.californiapensionreform.com/>

²⁷ Pensionable income times 2.4% times years of service

Section A8.595-11 (e) SOURCES OF FUNDS:

Any year in which, based upon the retirement system's annual actuarial valuation, the employer contribution rate exceeds 0%, the employee organizations representing safety members shall jointly meet and confer with city representative to implement a cost sharing arrangement between the city and employee organizations. Such arrangement will effect a material reduction of the cost impact of employer contributions on the city's general fund.

The dollar value of the cost sharing arrangement shall not exceed the total annual cost to the retirement system of improving the police and fire safety retirement plans to the 3% @ 55 benefit level or the total employer contribution required by the retirement system, whichever is lesser. Such cost sharing arrangement shall not require an employee contribution in excess of the limits set elsewhere in this charter.

The meet and confer process, including all impasse procedures under section A8.590-1 et seq., shall be concluded not later than April 1st except by mutual agreement of the parties. The cost sharing arrangement must be finalized to permit implementation effective July 1.

The retirement board's authority under charter section 12.100 and in section A8.510 concerning the annual setting of the rates of contribution are not subject to the meet and confer process, including all impasse procedures under section A8.590-1 et seq.

The following excerpts were selected from the voter's pamphlet:

A paid argument in favor of Proposition H, the Commissioners of the San Francisco Retirement System Board wrote:

The current surplus in the retirement fund is more than enough to pay for this vitally needed upgrade of pensions for police officers, firefighters, and paramedics. As an added protection, Proposition H requires that public Safety employees enter into negotiations to pay for pension upgrades in the unlikely event that the surplus is no longer sufficient. This is an important new precedent in fiscal responsibility and we urge the entire City to support it.

The voter pamphlet did not include one opponent argument to Proposition H.

The Anticipated Fiscal Impact of Prop H

In the November, 2002, Voters Pamphlet, the former City Controller issued the following statement on the fiscal impact of Proposition H:

Should the proposed amendment be adopted, in my opinion, the cost to the City and County would increase, as estimated by the Retirement System Actuary, by about \$28 million per year for the next 20 years, dropping after 20 years to an ongoing cost of approximately \$8.2 million per year.

However, no cash would be required since the City's Retirement System currently has a large surplus. While the cost of this proposal would reduce that surplus, the City nonetheless should not be required to make employer contributions to the Retirement System for at least the next ten years. The Amendment also provides that if the City is required to make employer contributions to the Retirement System, the City will negotiate a cost-sharing agreement with the police officers and firefighters to cover all or part of the cost of providing the additional retirement benefits through employee contributions.

The proponents of Proposition H included many prominent civic and political leaders in San Francisco and California. The proposition was passed by the voters in the November, 2002 election.

The Chickens Come Home to Roost

When Proposition H was passed in November 2002, the employer's contribution to the Police and Firefighters' pension plan was zero.²⁸ In the Cheiron actuarial valuation report, the unfunded pension liability as of July 1, 2009, for Prop H was approximately \$276 million²⁹, to be amortized over a period of thirteen years. The annual amortization of the unfunded pension liability for the next thirteen years will be approximately \$26 million. The City and Safety employees should establish an arrangement to share the annual cost.

The estimated amount of the employer's contribution in fiscal 2010-11 will be approximately \$39 million. The City Controller has projected that the employer's contribution for fiscal 2014-15 will increase to approximately \$123 million.

Proposition H mandated (and still mandates) two critical actions on the part of the employer (the City) and employee (Safety personnel) for each fiscal year. The first action is to determine if the City's contribution rate exceeds 0%. If the City's contribution rate does exceed 0%, the City and the labor unions representing Safety employees are required to "meet and confer" for the purpose of implementing a "cost-sharing arrangement." The Charter Amendment (Proposition H), subsection A8.595.11 (e), stipulates that "such arrangement will effect a material reduction of the cost impact of employer's contributions on the City's general fund."

²⁸ Note: The City was paying the Police and Firefighters' employee contributions (7.5%) through fiscal 2002-03. Since fiscal 2003-04, Firefighters and Police have been responsible for paying the employee contribution themselves.

²⁹ Cheiron 7/1/2009 Actuarial Valuation Report, page 20.

The City's contribution rate has exceeded 0% for fiscal 2004-05 to the current fiscal year. The actual and projected City contributions to Police and Firefighter pensions for the same period are summarized in Table 2 below.

The Grand Jury interviewed officials in the City's Department of Human Resources, the City Attorney's Office and the San Francisco Employees Retirement System and examined the Safety employee's Memoranda of Understanding (MOU) to determine if the provisions of the Charter Amendment subsection A8.595.11 (e) were complied with. In the course of our investigation, some City officials asserted that certain concessions were made by Safety personnel during the negotiations for amendments to the MOU. The Grand Jury found no concessions that resulted in a "material reduction" of the cost impact on the City's contribution rates.

In conclusion, there appears to be no evidence that the City and Safety employees' representatives met to confer on a material pension cost-sharing arrangement as mandated by the Charter Amendment. Furthermore, the City may be in violation of the law by not enforcing the City Charter Amendment that was passed by the voters in November 2002. The Grand Jury estimated that the cost to Safety employees under a 50% cost-sharing arrangement for FY 2004-05 through FY 2008-09 would have been approximately \$52 million (see Table 2). The Grand Jury has found no evidence that Safety employees have made any such contributions. The City's projected contribution rate to the pension plan will increase significantly over the next five years.

Table 2

Employer (City and County of San Francisco) Contributions (\$ in millions)

Member Plan	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	Total
Firefighter Plan		\$6	\$10	\$10	\$9	\$9	44
Police Plan		8	13	13	13	13	60
Total		14	23	23	22	22	104
50% cost share		\$7	\$12	\$12	\$11	\$11	52

Source: SFERS Annual Report for Fiscal Year Ended June 30, 2008

PENSION SPIKING

Pension Spiking is an end-of-career promotion or an excessive raise to increase or "spike" workers' final pensionable income during the last year of employment. During the final year of employment, a worker is often elevated to a higher position and the employer is required to pay higher compensation under the principle of "like work, like pay."

The amount of a retiree's pension is often based upon the final year's compensation. Therefore, it has been possible for some soon-to-be retired employees to increase their final

pensionable income for the purpose of inflating their retirement benefits. For San Francisco employees hired before November 1976 (Old Plan members), overtime pay is included in the final year's pensionable income, but for New Plan member (hired after November, 1976) overtime pay is not included. The Jury found instances of nursing supervisors being allowed to have two concurrent jobs and earn pensions on both, sometimes referred to as pension-pyramiding.

Certain pay enhancements have been determined to be included or not included in final pensionable pay by City Charter and Memoranda of Understanding (MOUs)³⁰ negotiated between the City and the unions. In addition, a 2006 lawsuit³¹ involving Safety employees and the San Francisco Employees Retirement Board clarified some issues. From the MOUs and the 2006 litigation, the following elements are either included or excluded from pensionable earnings:

<u><i>Included</i></u>	<u><i>Not included</i></u>
Canine pay	Holiday pay
Training pay	On Call Premiums
Motorcycle pay	Night Shift Differential pay
Retention pay	Bilingual pay
Paramedic License pay	Hazardous Materials pay
Paramedic Clinical Assignment pay	Emergency Medical Technician pay
Terrorism Response Training pay	Apparatus Operator pay
Experienced Officer Incentive pay	Unused sick and vacation pay
Field Training pay	
Bomb Squad/SWAT Team pay	

Any serious pension reform measure must address the problem of pension spiking.

The following example is used to illustrate the cost of pension spiking:

For a Safety employee with 25 years of service, an increase in pensionable income of, say, \$10,000 will have the effect of increasing the pension by \$7,500 annually for life ($\$10,000 \times 25 \times 3$). For a 55-year-old retiree with a life expectancy of 29.6 years (from IRS longevity tables), and assuming an interest rate of 7.75%, then the present value of this benefit is \$86,152.³²

San Francisco's 2008-2009 Grand Jury report found that the "practice of pension spiking may be institutionalized and ongoing within San Francisco's Safety employees, especially the Fire Department. Approximately 25% of Safety personnel that retired in the last ten years received an increase of 10% or greater in their last year prior to retirement. For just the

³⁰ See MOU's for Police and Fire in <http://www.sfdhr.org/index.aspx?page=54>

³¹ See *Les Adams, et al. v. Retirement Board of the City and County of San Francisco, et al.* Case 3 301634 Filed in Superior Court on March 9, 2006

³² See online calculator to compute Present Value
http://www.engineeringtoolbox.com/discrete-payments-compounding-formulas-d_1234.html

ten-year period of 1998 to 2008, the Jury estimates that spiking will cost active members of SFERS and the City at least \$132 million.”³³

The current Grand Jury examined the Safety retirees for the fiscal year 2008-09 and the ten months ended April 30, 2010. The total number of retirees during this period was 134 and 107 for Police and Fire, respectively.

A 10% or greater increase in a retiree’s hourly pensionable rate over the hourly wage rate in any given year was used to identify possible pension spiking. The Jury found few instances of pension spiking among Police retirees for the period. However, seventy one Firefighter retirees received a 10% or more increase in pension income in their final year before retirement. This represented approximately 68% of the total number of Firefighters who retired during the period.³⁴

The current Jury examined the Miscellaneous (non-Safety employees) retirement records of 6615 retirees. The incidence of apparent pension spiking was:

- 371 or 8% of the 4559 New Plan retirees;
- 639 or 31% of the 2056 Old Plan retirees.

The difference may reflect the legacy of overtime pay being included in pensionable compensation for Old Plan retirees.

SFERS BOARD MEETINGS

Absent Public Voice

The Jury attended nine of the SFERS board meetings. The board typically “meets once a month to review and approve important elements of Retirement System business.”³⁵ The Retirement Board is composed of seven members: three elected by active members of the bargaining units (Police, Fire and Miscellaneous); three appointed by the Mayor in accordance with §12.100 of the San Francisco City Charter; and one by the President of the Board of Supervisors.³⁶

In attending the monthly Board meetings, the Jury noticed the lack of attendance of certain members of the board. One of three commissioners representing the public has not been appointed by the Mayor for at least six months. Another resigned May 17, 2010. The attendance of one of the remaining two public commissioners was spotty, about half of the

³³ See the 2009 SF Civil Grand Jury Report: “Pensions: Beyond Our Ability to Pay”

³⁴ The Grand Jury spreadsheet analysis of pension spiking is based on SFERS data on Firefighter retirees.

³⁵ SFERS Annual Report for Fiscal Year Ended June 30, 2008: “The Retirement Board ... oversees Plan administration, pension fund investment, member benefits, and actuarial funding. Within the scope of their duties, the Board establishes policies governing the administration, management, and operation of the retirement plans; manages the investment of the Retirement System’s assets; reviews and approves benefit determinations; and approves actuarial and economic assumptions used to meet long-term benefit promises of the SFERS Pension Plan.”

³⁶ SFERS Annual Report for Fiscal Year Ended June 30, 2008

Attendance by SFERS Board Members

<i>15 meetings July 14, 2009 through June 8, 2010</i>	ATTENDANCE
ELECTED BY THE MEMBERSHIP UNIONS	
Casciato (Police)	80%
Driscoll (Fire)	87%
Meiberger (Miscellaneous), retired	93%
PUBLIC MEMBERS APPOINTED BY THE MAYOR	
Peterson (resignation effective 5/17/2010)	93%
Wright	53%
Kim (resignation effective Sept. 16, 2009)	80%
BOARD OF SUPERVISORS	
Elsbernd, Ex-officio member	100%

Source: SFERS minutes <http://www.sfers.org/index.aspx?page=57>

meetings. Attendance is particularly important for the public members of the Board because they represent the voice of the people. With two of the three public commissioner positions vacant and the second public commissioner present about half of the time, the people are not being heard.

PENSION REFORM ALTERNATIVES

Current Employees versus New Hires

States have begun to make a number of changes – primarily for new hires – as it is difficult for most states, as in California, to change pensions for current employees or retirees. Most have a state constitution contract clause that mirrors the Federal language. For example, Article I, section 9 of the California constitution provides, in part, “A...law impairing the obligation of contracts may not be passed.”

While the very-much-needed and justifiable formula reductions and increases in the retirement age for new employees would be a good start, it would do next to nothing to address the dire financial condition San Francisco faces in the next few years with its rising pension costs and unfunded liabilities, as opposed to twenty to thirty years into the future when the savings from changes applicable only to new employees will materialize (such as San Francisco’s recently-passed Proposition D which uses for pensionable income a two-year average instead of one year, and increases from 7.5% to 9% the Safety employees’ contribution to the pension fund).

In fact, as Girard Miller³⁷, Pension Consultant and Commentator, emphasized in his April 22, 2010, address to the California State Legislature,³⁸ there is evidently no other way to assure sustainable finances for retirement plans without amending the State's constitution to restore the right of the people's elected representatives to change future benefits for incumbent employees if they have become unaffordable or to allow local voters to approve taxes to fulfill these obligations.

What Other States Are Doing

Some states are doing a far better job than others of managing this bill coming due. In 2000, slightly more than half the states had fully funded pension systems. By 2006, that number had shrunk to six states. By 2008, only four—Florida, New York, Washington and Wisconsin—could make that claim.

Many states have made recent changes in their pension systems, as reported by The Pew Center on the States 2010.³⁹ Illinois has passed a landmark law which requires new employees to wait until age 67 (previously 62) to receive full retirement benefits, and puts a ceiling on pensionable income equal to the Social Security earnings cap (now \$106,800) to curb pension spiking and pension-pyramiding (collecting pensions from simultaneous government jobs).⁴⁰ It sets a new standard for public pension plans that San Francisco should seriously consider.

Some states now have either DC or hybrid plans, including Alaska, Georgia, New Jersey, Oregon and Utah. Alaska, Georgia, and Oregon fundamentally restructured their retirement provisions, replacing traditional DB plans with alternatives. Alaska created new plans for teachers and public employees. Georgia and Oregon enacted hybrid programs that combined traditional DBs with DC plans. New Jersey has curbed pension-pyramiding by requiring that pensions be collected from only one job in their statewide system. Utah will replace its present DB plans (for future enrollment) as of July 2011, to be replaced by a system which will give future employees a choice between a DC plan and a combination of DB and DC plans.

V. CONCLUSION

This report is a warning of a deepening crisis in the City's financial condition. The urgency of the problem requires that the Mayor, the Board of Supervisors, City employees and citizens work together to address and resolve this problem. We cannot wait.

³⁷ Girard Miller is the Public Money columnist for GOVERNING, and also a senior strategist for the PFM Group.

³⁸ http://www.lhc.ca.gov/studies/activestudies/pension/Public_Notice_04-22-10%20-%20revised.pdf

³⁹ http://www.ncpers.org/Files/pew_final_embargoed.pdf

⁴⁰ <http://www.governing.com/authors/Girard-Miller.html>

VI. FINDINGS & RECOMMENDATIONS

Findings	Recommendations
A. <i>San Francisco Pension Plan</i>	
<p>A1. San Francisco's Defined Benefit Plan retirement benefits are financially unsustainable without significant cutbacks in jobs and city services.</p>	<p>A1. The San Francisco City Charter should be amended, as follows:</p> <p>For new employees, the pension multiplier should be set at a level to provide fiscally sound future pensions – fair to employees and taxpayers alike.</p> <p>For new Miscellaneous employees, the retirement age to receive full benefits should be comparable to that of Social Security and/or private sector recipients, and be fair to employees and taxpayers alike.</p> <p>The Jury recommends that City officials consider a hybrid retirement plan with components of both Defined Benefit and Defined Contribution, 401(k)-type, in the next negotiated contract in 2012.</p> <p>No cost-of-living or other increase should be awarded to retirees unless the pension fund is found through a multi-year analysis to be actuarially sound and fully funded.</p> <p>SFERS and actuaries for the City should research other public and private sector data to determine fair pension benefits and the results should be reported at SFERS board meetings and to the Board of Supervisors to lead to a sustainable plan.</p>
<p>A2. For current employees and retirees, pension benefits are guaranteed by City Charter and protected by Federal and State constitutional provisions prohibiting impairment of contract.</p>	

Findings	Recommendations
B. <i>Pension Costs</i>	
<p>B1. The City's pension and health benefit costs are expected to increase from approximately \$400 million for the current fiscal year to nearly \$1 billion in five years, a billion-dollar bubble that the City cannot realistically afford.</p> <p>Current pension rules are producing an ever-increasing employer contribution rate, from 0% in 2004, to 9.49% in 2010 and to 30% by 2015. This will impact the General Fund, and could make it very difficult for the City to sustain funding for police and fire, public health, human services, cultural and artistic programs. It will disproportionately affect the poor and the needy, and tax the middle class.</p>	<p>B1. The Mayor and the Board of Supervisors should prepare a plan within the next year to fund the projected \$1 billion in pension costs.</p>
<p>B2. The Department of Human Resources and SEIU Local 1021 entered into an agreement that Miscellaneous employees would pay their own 7.5% contribution, and, in return, the base wages were increased by 6%, effective July 1, 2010. There was no actuarial valuation to estimate the resulting pension liability for the City. This agreement resulted in a substantial increase in pension obligations for the City without voter approval.</p>	<p>B2. The Department of Human Resources (DHR) should not enter into agreements with the employee unions which increase the City's future pension obligations without voter approval.</p> <p>DHR should engage the City's professional Actuary to investigate any increase in pensionable compensation.</p>
<p>B3. 2,384 retirees receive pensions greater than \$75,000.</p>	<p>B3. DHR should compare the retirement benefits in other California cities to determine whether the pension benefits are excessive. The results should be reported to the Mayor and Board of Supervisors.</p>

Findings	Recommendations
C. <i>Proposition H: Police & Firefighter Retirement Plan</i>	
<p>C1. Proposition H, passed by voters in 2002, requires that if the City's contribution rate to the pension fund exceeds 0%, then the City and the Safety employee unions must "meet and confer" to implement a "cost-sharing" arrangement to reduce the cost impact of the employer's contributions on the City's General Fund. The City's contribution rate <u>has</u> exceeded 0% for fiscal 2004-05 to the present.</p> <p>The City and County of San Francisco is not in compliance with the requirements of the City Charter resulting from the passage of Proposition H. There have been no "meet and confer" sessions to establish a "cost-sharing" arrangement.</p> <p>The City Attorney has not mandated that the SFERS Board comply with these requirements of the Charter Amendment resulting from Proposition H.</p>	<p>C1. The City Attorney should initiate legal action against the SFERS Board to enforce the requirements of the Charter amendment to "meet and confer" and "cost-sharing" provisions of Proposition H, as stipulated in Charter § A8.595-11 (e).</p> <p>The Jury recommends that the City Attorney and /or his representatives present to the Board of Supervisors and SFERS Board the following documents regarding § A8.595-11 (e) of the City Charter:</p> <ol style="list-style-type: none"> 1. A legal opinion on the charter section. 2. Documentation regarding the dates and times that the City and the Police and Firefighters unions met to confer and to implement a cost-sharing arrangement as required in the section. 3. A legal opinion regarding fiduciary duties of the SFERS Board to comply with it. 4. A legal opinion regarding SFERS duty to revise the Safety employee contribution rate to comply with the Charter section. 5. A legal opinion regarding possible remedies to enforce compliance.
C2. The unfunded pension liability for Proposition H as of July 1, 2009, was approximately \$276 million ⁴¹ , amortized over thirteen years to about \$26 million annually.	C2. The City and Safety employees should establish an arrangement to share the annual \$26 million cost as required by the City Charter

⁴¹ Cheiron 7/1/2009 Actuarial Valuation Report, page 20.

Findings	Recommendations
D. <i>Pension Spiking</i>	
<p>D1. The soon-to-be retired have been able to increase final pensionable compensation to inflate retirement benefits.</p> <p>The Jury found instances of nursing supervisors being allowed to have two concurrent jobs and earn pensions on both, sometimes referred to as pension-pyramiding.</p>	<p>D1. San Francisco should take steps to curb abuses from pension spiking by limiting the final pensionable income an employee can claim at retirement and from pension-pyramiding. The Jury suggests the following:</p> <ul style="list-style-type: none"> • Use a three-year average to determine pensionable income, similar to Federal rules. • Limit final pensionable compensation to 120% of the rank pay rate as determined by Civil Service job classification. • The Controller should perform an independent review of pensions to determine whether the practice of pension spiking is ongoing. • Disallow employees from drawing pensions from two simultaneous City jobs. • Pensionable compensation should not include pay for two separate pay types, known as pension-pyramiding.
E. <i>Health Benefits</i>	
<p>E1. For current employees and retirees, health benefits are “vested” after 10 years.</p> <p>Unlike pensions, health benefits for most City workers are not pre-funded, but are paid directly out of the City’s General Fund. In 2001, the City expended \$17 million on retiree health care. By 2007, that amount had grown to \$130 million and continues to rise. Mercer Consulting reported on June 30, 2008, that the City’s unfunded liability for retiree health benefits was \$4 billion.</p>	<p>E1. Department of Human Resources and collective bargaining units should meet and confer to determine a cost-sharing arrangement to pre-fund the \$4 billion unfunded liability for retiree health care obligations.</p>

Findings	Recommendations
F. SFERS Board Meetings	
F1. There are seven SFERS board members: three are elected by the members; three are appointed by the Mayor; and the seventh Commissioner comes from the ranks of the Board of Supervisors. One of the three public members has not been appointed for at least six months.	F1. The Mayor needs to appoint two Commissioners to represent the public's interest.
F2. Minutes of the SFERS board meetings record attendance of the board members. When the members representing the public are absent, the interest of the public is eroded.	F2. It is important for the public Commissioners appointed by the Mayor to attend the Board meetings. They should attend regular monthly Board meetings or resign.

VII. REQUEST FOR RESPONSE

Responses to the findings and recommendations in this report are required by the Board of Supervisors and city offices and departments in accordance with the following list and state law.¹⁰ Responses are to be in writing and addresses to the Honorable James McBride, Presiding Judge, Superior Court of California, City and County of San Francisco, San Francisco Civil Center Courthouse, 400 McAllister Street, San Francisco, California, 94102.

<i>Board of Supervisors:</i>	<i>90 days</i>
<i>Office of the Mayor:</i>	<i>60 days</i>
<i>Office of the City Attorney:</i>	<i>60 days</i>
<i>Office of the Controller:</i>	<i>60 days</i>
<i>San Francisco Fire Department</i>	<i>60 days</i>
<i>Office of Human Resources;</i>	<i>60 days</i>
<i>San Francisco Retirement Board:</i>	<i>60 days</i>

VIII. REQUIRED RESPONSES

	REQUIRED RESPONSES TO FINDINGS					
RESPONDENT	A SF Pension Plan	B Pension Costs	C Prop H (Police & Fire)	D Pension Spiking	E Health Benefits	F SFERS Board Meetings
<i>Response 90 Days</i>						
BOS	X	X	X	X	X	X
<i>Response 60 Days</i>						
Mayor	X	X	X	X	X	X
City Attorney			X			
Controller		X	X		X	
Human Resources			X		X	
SFERS		X		X	X	
SFERS Board			X	X		X
SFFD				X		

	REQUIRED RESPONSES TO RECOMMENDATIONS									
RESPONDENT	S.F. Pension Plan	Pension Costs			Prop H		Pension Spike	Health	SFERS Board Meetings	
	A1	B1	B2	B3	C1	C2	D1	E1	F1	F2
BOS	X	X	X	X	X	X	X	X		
Mayor	X	X	X	X	X	X	X	X	X	X
City Attorney					X	X		X		
Controller		X	X				X	X		
Human Resources			X	X	X	X	X	X		
SFERS			X							
SFERS Board					X	X				X
SFFD							X			

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