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Fitch: CalPERS Decision Raises Pension Obligations.

Fitch Ratings-San Francisco-22 August 2014: A recent decision by the board of the California Public Employees' Retirement System (CalPERS) will raise funding pressures on public employers, Fitch Ratings says. The state, school districts and local governments are already facing materially higher projected contributions caused by past investment results and recent actuarial changes intended to improve the sustainability of the plans over time. We expect legal and institutional battles to continue given the high stakes of pension reform for both public employers and employees.

The actuarial value of CalPERS' unfunded pension liabilities was $57.4 billion, as of the most recent valuation date. The Aug. 20 decision expands the definition of pensionable compensation for most newly hired public workers, allowing temporary and special assignment payments, among numerous categories of compensation outside of workers' base pay, to be included along with base pay in pension calculations.

The expanded definition of pensionable compensation exposes public employers to higher pension liabilities and contribution expenses, and appears to be a step backward from recent reforms. The Public Employees' Pension Reform Act of 2013 (PEPRA) narrowed the definition of pensionable compensation for public employees in an effort to address "pension spiking," the inflation of base pay for purposes of pension benefit calculations. This decision expands the definition of pensionable compensation, in apparent conflict with PEPRA, and will increase pension costs for public employers if implemented.

The magnitude of impact from this decision is not yet clear, but it raises more questions about the sustainability of California's pension reform efforts, which continue to face legal and institutional challenges. Particularly worrisome to Fitch is the absence of detailed information on the analysis of its projected costs. The decision has been sharply criticized by Gov. Jerry Brown, who cited its conflicts with recent state legislation intended to reduce pension costs. City-led pension reform efforts in San Diego and San Jose remain mired in litigation while this CalPERS decision appears to open up a new front for challenging reform efforts.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.