



Agenda Item 5

December 11, 2012

ITEM NAME: State Legislative Proposal: Policy and Technical Amendments to the Public Employees' Retirement Law (PERL)

PROGRAM: Legislation

ITEM TYPE: Action

RECOMMENDATION

Sponsor legislation to make the following policy and technical changes to sections of the Government Code administered by California Public Employees' Retirement System (CalPERS).

EXECUTIVE SUMMARY

This proposal would make several changes to various benefit, administrative, and investment provisions identified by staff as necessary for the maintenance and good governance of CalPERS and to ensure that its statutes are clear.

STRATEGIC PLAN

This proposal supports Strategic Goal A to improve long-term pension and health benefit sustainability.

BACKGROUND

These laws govern CalPERS and the processes by which it operates. During the course of normal operations, areas are identified where the law has not been kept current with the duties CalPERS is expected to perform. In these cases, legislative corrections are required.

ANALYSIS

Benefit Issues

PERS/STRS Right of Election

Existing law allows CalPERS members to retain CalPERS membership when assuming employment that otherwise requires mandatory participation in California State Teachers' Retirement System (CalSTRS) under specified conditions. For example, a vested CalPERS member who accepts employment with an employer that would otherwise require participation in CalSTRS can elect to remain in CalPERS regardless of whether a break in service occurred. However, a member with less than five years of service credit is not allowed to retain CalPERS membership if the member experiences any break in service, however nominal, between CalPERS employment and CalSTRS employment.

Under specified conditions similar to those required of CalPERS members, CalSTRS members may elect to retain CalSTRS membership when taking a job subject to mandatory CalPERS participation. However, CalSTRS members are allowed a vaguely defined break in service between CalPERS and CalSTRS-covered positions, such as a weekend or a school district's summer break.

This proposal allows a break in service of no more than 120 days for a non-vested CalPERS member to be eligible to retain CalPERS membership in a CalSTRS-covered position, as long as the member meets all other eligibility requirements in current law. Allowing a 120-day maximum break in service would make CalPERS administration of this election equitable with CalSTRS administration and would eliminate confusion for our school members and employers.

Administrative Issues

Employer Contracting Process

One of the goals of the CalPERS Organization re-structuring was to provide customer transaction processing under a single division, Customer Account Services Division (CASD). A particular focus was to provide consistent and standardized contracting services that simplify the process for our CalPERS employers, particularly those who contract for multiple program services. On the pension side a public agency agrees to enter into the system through a contract between the governing body and the CalPERS Board of Administration (Board). However, under the Public Employees' Medical and Hospital Care Act (PEMHCA) a contract requirement does not exist, but rather a public agency's governing body may choose to provide health benefits for its employees through PEMCHA by only adopting a resolution by majority vote and filing it with the Board. This proposal would allow, but not require, the Board to request a public agency enter into a contract to participate in PEMCHA. The use of a contract would enable CalPERS to better clarify the responsibilities and protect the rights of both the contracting agency and CalPERS. It would also improve overall administration of the System by consolidating, standardizing, and simplifying the contracting process for the pension and health programs.

Existing law authorizes the CalPERS Board to refuse to contract with, or agree to a contract amendment proposed by any public agency for any pension benefit provisions that are not specifically authorized, and that the Board determines would adversely affect the administration of the System. These contracts and contract amendments serve to identify the status of employers and the pension benefits they provided to their employees under the PERL. This proposal would clarify that the Board has the authority to refuse to enter into a contract with a public agency for retirement benefits that the Board determines would adversely affect the System, such as when CalPERS has factual knowledge that a potential contracting agency is facing legal issues. It would also provide this same authority to the Board with respect to contracts for health benefits.

Paperless Benefit Statement

Existing law requires the Board to mail a printed copy of the benefit-payment statement to CalPERS disability and service retired members, non-member spouses or beneficiaries receiving benefit payments via electronic funds transfer (EFT), unless the Board receives a written request not to mail this information. Furthermore, existing law requires the Board to notify persons subject to this statute of their right to request that no copy of the benefit-payment information be mailed. Members receiving payments via EFT who elect not to receive paper benefit statements have the ability to view their statements online through my|CalPERS. (Note: Judges' and Legislators' Retirement Systems also use the same process for their retired members, non-member spouses, and beneficiaries.)

The State Controller's Office prints and mails benefit statements each month to approximately 92% of the EFT population on behalf of CalPERS at a current annual cost of \$2.8 million.

This proposal would provide the Board the option to only mail a printed copy of the benefit-payment information if the member, non-member spouse or beneficiary requests it. If the Board chooses to exercise this option, the Board would also be required to notify members, non-member spouses and beneficiaries of their right to receive a printed benefit statement, which could be accomplished in a variety of ways, such as providing the option on retirement forms, EFT request forms, or including it on the CalPERS website and on my|CalPERS. When CalSTRS recently implemented a similar change, approximately 22% of their members receiving EFT payments elected to continue receiving mailed benefit statements.

Board Member Employer Reimbursement

Existing law allows CalPERS to reimburse elected CalPERS Board Members' employers for the "direct and reasonable costs incurred by employing a replacement" while the Board Members are fulfilling the CalPERS Board responsibilities. In practice, employers typically do not hire a replacement; rather, the duties of elected Board Members have been absorbed within their employers' existing resources, making it difficult to identify replacement costs. This proposal clarifies and simplifies the process by authorizing CalPERS to reimburse employers for the time a Board Members spends fulfilling CalPERS Board responsibilities based on the cost of their salaries and benefits, as opposed to the cost of engaging a replacement.

Investment Issue

Proposition 21 Conformity

Government Code section 20204, enacted in 1982 by AB 860 (Elder), allows the CalPERS Board to sell exchange-traded call options only through an exchange, and only with respect to stock owned by the System. It also prohibits the Board from

selling common stock that is obligated under an unexpired written call option, unless the Board first enters into a closing purchase transaction. Finally, it authorizes the Board to purchase exchange-traded options only through an exchange and only for the purpose of a closing purchase transaction.

This authorization to include a covered call-option trading strategy in CalPERS overall investments program predates both Proposition 21 of 1984, which amended the State Constitution to expand CalPERS ability to invest pursuant to a modern portfolio theory, and Proposition 162 of 1992, which also amended the Constitution to grant retirement boards plenary authority over investments.

Section 20204 could be interpreted to create restrictions on investment products that CalPERS may want to pursue and which were not common place at the time that this law was originally enacted. For example, this statutory provision could be interpreted to prohibit CalPERS from selling exchange-traded call options not tied to common stock owned by CalPERS, as well as options on currency, interest rates, bonds, and commodities. By prohibiting CalPERS sale of non-equity exchanged-traded options without consideration of other assets, this statutory provision may negatively impact the management of Fixed Income portfolios, Currency Overlay portfolios, and Commodities portfolios. It also has the potential to limit CalPERS ability to reduce its counterparty risk in these types of transactions, as the over-the-counter (OTC) derivatives market moves to a more transparent exchange-traded model as a result of recent federal legislation.

With the adoption of Proposition 21, which eliminated the need for all CalPERS investment vehicles to be specifically authorized in statute, it is likely Section 20204 was repealed by implication. Similarly, this section is inconsistent with the plenary authority over investments and fiduciary duty accorded the CalPERS Board by Proposition 162. Therefore, the proposal would repeal Section 20204.

BENEFITS/RISKS

Benefits

- This proposal would ensure CalPERS administers the PERL in an efficient manner by eliminating ambiguity that leads to conflicting interpretations and unnecessary confusion.
- Allowing a 120-day maximum break in service would establish greater equity and conformity between CalPERS and CalSTRS administration of this membership election and may reduce employer confusion surrounding when it is appropriate to provide election forms to CalPERS members entering CalSTRS-covered service.
- Conforms the pension and health contracting processes administered by CalPERS.

- Improves the CalPERS Board's ability to protect the System from adverse impacts, such as contracting with public agencies facing identified legal issues.
- This proposal may provide an estimated savings of \$1.4 million to \$2.6 million per year in administrative cost depending on the number of members choosing paperless benefits statements.

Risks

- Health benefits contracting agencies may have to expend resources to establish contracts with CalPERS.
- Entities that are eligible to contract with CalPERS under statute may be refused by the Board, generating potential challenges to those refusals in the legal, public, and/or political arenas.
- Potential increase in inquiries from members that currently receive a paper statement and wish to continue without interruption.
- Not having these investment products available for portfolio construction could result in an increase to the portfolios' risk profile relative to a similar portfolio that is allowed to own these products.

DANNY BROWN, Chief
Office of Governmental Affairs

ROBERT UDALL GLAZIER
Deputy Executive Officer
External Affairs

ANN BOYNTON
Deputy Executive Officer
Benefit Programs Policy and Planning