



## Agenda Item 6b

February 20, 2013

**ITEM NAME:** Senate Bill 13 – Pension Reform Clarifying Legislation

As Introduced December 3, 2012

**PROGRAM:** Pension

**ITEM TYPE:** Action

### **RECOMMENDATION**

Adopt a Support position on Senate Bill (SB) 13 because it would clarify ambiguities and correct defects in recently enacted pension reform statutes and would assist the California Public Employees' Retirement System (CalPERS) staff in the implementation of pension reform and in the orderly and efficient administration of the System.

### **EXECUTIVE SUMMARY**

SB 13 clarifies and corrects several substantive drafting errors and/or oversights in the newly enacted Public Employees' Pension Reform Act of 2013 (PEPRA), as established by Assembly Bill (AB) 340 (Furutani, Chapter 296, Statutes of 2012) and in other statutory changes made by AB 340 to the Public Employees' Retirement Law (PERL). Among other things, SB 13 addresses issues related to new judges' retirement benefits, standardizes use of the term "new members" in key provisions, requires new legislative employees to pay half of normal pension costs, repeals a duplicative code section, corrects a drafting error regarding industrial disability retirement benefits for CalPERS safety members, and closes the State Alternate Retirement Program (ARP) to new members effective January 1, 2013, rather than July 1, 2013.

The PEPRA and related pension reform statutes impose significant changes on public retirement systems and upon the retirement benefits available to public employees that become new members of those systems on or after January 1, 2013. However, there were several critical drafting errors in the bill that were not identified or corrected prior to the passage of AB 340 and its original clean-up bill, AB 197 (Buchanan, Chapter 297, Statutes of 2012). SB 13 seeks to correct these errors on an urgency basis and, if passed, would become effective immediately upon enactment.

The Board of Administration's (Board) Legislative Policy Standards do not specifically address the issues in SB 13. However, the issues SB 13 proposes to

clarify or correct are similar to the statutory issues the Board attempts to correct when sponsoring its annual housekeeping legislation. SB 13 promotes orderly and efficient implementation of the pension reform provisions and if these changes are not made, implementation efforts may be delayed, suspended, or become subject to unnecessary legal or regulatory challenge.

### **STRATEGIC PLAN**

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

### **BACKGROUND**

On September 12, 2012, Governor Brown signed into law AB 340 and AB 197, which included the PEPRA and related pension reform changes to the PERL, Judges' Retirement System (JRS) law, and Legislators' Retirement System (LRS) law. These statutory provisions became effective on January 1, 2013. AB 340 made many changes to the retirement benefits for public employees. Many of these new pension reform provisions apply to "new members" and not to existing or "classic members" (those members who entered into membership with a retirement system on or before December 31, 2012). The distinction between the two types of members is very important when it comes to determining the member's appropriate retirement formula, final compensation periods, caps on compensation, contribution amounts, and other rights to and limitations on retirement benefits.

For public employees newly hired on or after January 1, 2013, and certain employees returning to public service on or after January 1, 2013, the pension reform provisions of AB 340 generally provide reduced defined benefit pension formulas with increased normal retirement ages, establish a new definition of pensionable compensation (the types of pay that can be used to calculate retirement benefits), impose a three-year final compensation period, establish a cap on the pensionable compensation that can be used to calculate pension benefits and require a contribution rate of at least 50 percent of the normal costs of pension benefits. For existing and future employees, the bill generally prohibits retroactive benefit increases, imposes certain benefit forfeitures for employees convicted of job-related felonies, prohibits Additional Service Credit purchases, and requires strict adherence to federal contribution and benefit limits established by the Internal Revenue Code (IRC) for public pensions. In addition, AB 340 closes the LRS to new members, requires equal retiree health benefit vesting periods for non-represented and represented employees, prohibits employer pension contribution holidays, and imposes limitations on public employment after retirement. AB 340 exempts charter cities and charter counties that operate their own public retirement systems, as well as the University of California, from the provisions of the PEPRA.

SB 13 makes various changes to provisions in AB 340. In addition to the technical and clarifying changes proposed by SB 13, CalPERS staff has identified several

areas of the existing PERL that would benefit from clarification and greater conformity with the new laws, and staff will be pursuing non-urgent legislation to address those issues. CalPERS staff is also developing regulations to clarify areas of the new laws, and to identify new processes necessary to implement pension reform changes.

Furthermore, as part of PEPRA implementation, CalPERS has issued several Circular Letters explaining CalPERS implementation plans and providing instructions to its participating employers. CalPERS staff anticipates issuing several additional Circular Letters as SB 13 and CalPERS own proposed conformity legislation are enacted.

## **ANALYSIS**

### **1. Proposed Changes Contained in SB 13**

As discussed above, SB 13 proposes to amend certain provisions of PEPRA and the PERL. Because SB 13 is an urgency bill, these changes would take effect immediately upon enactment. Specifically, SB 13 proposes to do the following:

- Exempt new judges from the new PEPRA retirement formulas which results in the new judges receiving the retirement formulas included in the applicable JRS law, and clarify new judges are required to have an initial contribution rate of at least 50 percent of the normal cost rate.
- Replace the term “new employees” with “new members” in the PEPRA provision relating to defined benefit formulas for safety members.
- Replace the term “new employees” with “new members” in the PEPRA provision relating to the requirement for new members employed by certain public employers to have an initial contribution rate of at least 50 percent of the normal cost rate, or the current contribution rate of similarly situated employees, whichever is greater.
- Clarify that legislative employees that are new members under the PEPRA are required to have an initial contribution rate of at least 50 percent of the normal cost.
- Clarify that if the initial contribution rate for new members employed by specified employers is greater than 50 percent of the normal cost rate, that greater rate must be agreed to through collective bargaining.
- Replace the term “new employees” with “new members” in the PEPRA section that prohibits the offering of replacement benefits for members and

any survivors or beneficiaries whose retirement benefits are limited under the IRC.

- Repeal a duplicative code section included originally in PEPRA that changed the benefit calculation for industrial disability retirements for safety members. The same statute was also included by AB 340 in the PERL.
- Change the effective date for closing the ARP, from July 1, 2013, to January 1, 2013.
- Clarify that accumulated additional contributions will be used to calculate one of the benefit options for CalPERS safety members eligible for industrial disability retirement benefits and who retire on or after January 1, 2013.

## 2. Clarifying Intent and Correcting Errors in PEPRA

The PEPRA and related pension reform changes to the PERL, JRS law, and LRS law impose significant implementation challenges on public retirement systems. With most complex legislation, follow-up legislation is necessary to correct drafting oversights and facilitate orderly implementation of the new statutory provisions. The PEPRA is no different, and SB 13 is the Legislature's first clean-up bill to address several of the most critical deficiencies in the new law. These changes, if approved, will assist CalPERS staff with pension reform implementation and should help minimize legal challenges over the ambiguous statutes originally included in the pension reform bill.

For example, the provision related to new judges is necessary to correct an erroneous cross-reference in PEPRA and to make clear that the PEPRA retirement formulas do not apply to new judges, and subjects new judges to a contribution rate of at least 50 percent of the normal costs. Also, replacing the term "new employees" with "new members" in several sections is necessary because these terms are not synonymous. These amendments clarify that: 1) the new defined benefit formulas apply to new members in the safety classification; 2) all new members employed by contracting agencies, school employers, judicial branch and the California State University are required to contribute at least 50 percent of the normal cost rate; and, 3) the limitation to participate in a replacement benefit plan applies to new members rather than new employees. Further, the equal sharing of normal costs and the prohibition against employer-paid member contributions provisions in the original PEPRA statute did not include a reference to legislative employees, and SB 13 makes clear that these provisions will also apply to new members employed by the Legislature. Finally, the original PEPRA statute required the contribution rate for the new members specified to be at least 50 percent of the normal cost rate, or the current contribution rate for similarly situated employees, whichever is greater. SB 13

makes clear that if the rate is to be greater than 50 percent of the normal cost rate, that higher rate must have been reached through collective bargaining.

### 3. The State Alternate Retirement Program

Pursuant to existing PERL statutes (prior to AB 340), State miscellaneous and industrial employees hired on or after August 11, 2004, must be enrolled in the ARP, which requires these employees to contribute into a defined contribution account in lieu of earning CalPERS defined benefit service credit. After two years of service, ARP participants begin earning CalPERS service credit, and the employee may convert the first two years into CalPERS service credit by electing to do so within a three-month period between the beginning of their 47<sup>th</sup> month and the end of their 49<sup>th</sup> month of employment. State employees enrolled in the ARP are considered CalPERS members from the beginning of their service, so this provision would not have any impact on determining whether a public employee is a new member for the purposes of the PEPRA.

The PEPRA closes the ARP to new members on and after July 1, 2013. SB 13 would retroactively close the ARP to new members on January 1, 2013. Because this bill cannot be enacted prior to January 1, 2013, the State is continuing to enroll new hires in the ARP after January 1. If this provision is signed into law, the California Department of Human Resources will be required to enroll affected new hires into CalPERS and the State will be required to pay the employer contributions for that service. This provision would not impact required ARP participation for State employees hired before January 1, 2013.

### 4. Costs

#### Administrative Costs

CalPERS staff does not anticipate these changes will significantly impact the cost of CalPERS ongoing PEPRA and related pension reform implementation efforts but will likely require some additional communication to stakeholders, if the bill is enacted. Therefore, SB 13's impact on CalPERS administrative costs is likely to be minor.

#### Benefit Costs

Unknown, minor savings to the State by imposing the PEPRA equal sharing of normal costs requirement and the prohibition against employer-paid member contributions on new members employed by the Legislature. There are also likely unknown costs to the State by closing the ARP to new members on January 1, 2013, rather than July 1, 2013.

## **BENEFITS/RISKS**

### 1. Benefits of SB 13

- Clarifies ambiguous PEPRA and related pension reform provisions that might otherwise require the Board to develop and adopt additional regulations and/or additional procedures necessary for CalPERS to implement the PEPRA and related pension reform provisions.
- Minimizes the costs associated with possible legal challenges brought to clarify ambiguous pension reform provisions.
- Assists CalPERS continuing implementation of the PEPRA and related pension reform provisions.
- Helps ensure uniform implementation of the PEPRA and related pension reform provisions by all affected public retirement systems and public employers.

### 2. Risks Should SB 13 Not be Enacted

- Failure to clarify ambiguous provisions of the PEPRA and related pension reform provisions affecting CalPERS may subject implementation to unnecessary delay.
- Failure to correct provisions of the PEPRA and related pension reform provisions may subject CalPERS to unnecessary legal or regulatory challenge and to the costs associated with defending such challenges.

## **ATTACHMENTS**

Attachment 1 – Legislative History

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