



## **Agenda Item 5 (Revised)**

October 14, 2014

**ITEM NAME:** Proposed Regulations to the CalPERS Plans in Accordance with the Internal Revenue Service Rules

**PROGRAM:** Legal Office

**ITEM TYPE:** Action

### **RECOMMENDATION**

Approve the proposed regulations and the initiation of the rulemaking process to make technical amendments to the plan provisions for the Public Employees' Retirement Fund (PERF), the Legislators' Retirement Fund (LRF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), and the Supplemental Contributions Plan (SCP) (individually the "Plan", and collectively "the Plans") in accordance with the Internal Revenue Service (IRS) rules.

### **EXECUTIVE SUMMARY**

Staff recommends that the California Public Employees' Retirement System (CalPERS) Board of Administration (Board) approve the initiation of the regulatory process to clarify and make explicit certain technical provisions required of tax-qualified plans in accordance with the IRS rules. The Plans recently received favorable determination letters from the IRS regarding plan qualification as to form. In this regard, these proposed regulations are intended to amend the Plans in accordance with certain technical IRS rules governing tax-qualified plans. In most instances, the regulations are substantially similar to, or the same as, the IRS model language for qualified pension plans on these technical rules and, as such, there is limited flexibility to modify or otherwise deviate from such language. To ensure that the Plans' provisions are consistent with IRS rules, staff recommends approving the regulatory amendments to make explicit certain technical provisions required of tax-qualified plans that are intended to be declarative of existing law.

Similar amendments were proposed to the State Peace Officers' and Firefighters' Plan (POFF). However, these changes were made in statute given the time sensitivity concerning the pending termination of the POFF.

### **STRATEGIC PLAN**

This agenda item supports Strategic Goals A. In this regard, it supports Goal A (Improve Long-term Pension and Health Sustainability) by making explicit certain technical provisions required of tax-qualified, governmental pension plans like the CalPERS Plans.

## **BACKGROUND**

On January 28, 2011, CalPERS submitted determination letter applications to the IRS for all six of CalPERS tax-qualified Plans. The purpose of these applications was to obtain determinations from the IRS that the Plans are tax-qualified under Section 401(a) of the Internal Revenue Code (IRC). A favorable determination letter expresses the IRS's opinion that the terms of the plan conform to the requirements of IRC Section 401(a). In 2013, we received such favorable determination letters for the Plans. These proposed regulations to the Plans are in accordance with the IRS rules and are consistent with the favorable determination letters. The amendments are not intended to be substantive in nature, but rather clarify existing technical provisions of the law governing tax-qualified plans. The proposed regulations accompanying this Agenda Item are in accordance with the IRS rules.

## **ANALYSIS**

The package of proposed regulations contains five sets of regulations, one for each Plan. In some instances, the same regulation will apply to all Plans and, as such, the amendment will appear five times so the appropriate language is incorporated into each Plan. However, in other instances, a proposed amendment may be limited to a specific Plan, given the unique nature of the Plan's design. As tax-qualified plans, the Plans are already subject to these technical IRS rules and comply with them in operation; the amendments merely document these requirements. Accordingly, the collective group of amendments is not intended to be substantive, but rather declarative of existing law and current practice. The proposed technical amendments include the following:

- Regulation Sections 553, 599.100, 599.120, 599.140 and 599.160 define the terms "board," "plan" and "system," as applicable.
- Regulation Sections 553.1, 599.101, 599.121, 599.141 and 599.161 make explicit that each Plan is intended to satisfy the requirements of a tax-qualified plan in accordance with IRC Section 401(a) by meeting the requirements of a "governmental plan" within the meaning of IRC Section 414(d). As a governmental plan, CalPERS is exempt from certain IRC provisions otherwise applicable to tax-qualified plans.
- Regulation Sections 553.2, 599.102, 599.122, 599.142 and 599.162 make explicit that the reversion of the each Plan's trust fund assets is prohibited except as permitted by Revenue Ruling 91-4.
- Regulation Sections 553.3, 599.123, 599.143 and 599.163 make explicit that a member's right to his or her accrued benefits is non-forfeitable upon attainment of normal retirement age to the extent funded and subject to certain forfeiture exceptions currently provided for by statute.
- Regulation Sections 553.4, 599.124, 599.144 and 599.164 make explicit that distributions from the Plans will be made in accordance with a reasonable and good faith interpretation of the minimum distribution requirements under IRC Section 401(a)(9).

- Regulation Section 553.5 makes explicit that member contributions to the PERF will be made in accordance with the IRC Section 415(c) limits to the extent applicable. While we do not necessarily anticipate a situation where this limit will apply to member contributions in the current environment, this language is consistent with the IRS rules and required nevertheless.
- Regulation Section 553.6 makes explicit that the actuarial assumptions used to pay definitely determinable benefits from the PERF in accordance with IRC Section 401(a)(25) are not subject to employer discretion, but are instead set by the Board in accordance with Section 20132 of the California Government Code and Article 16, Section 17(e) of the California Constitution.
- Regulation Section 599.145 incorporates IRC Section 401(a)(17) compensation limits into JRF II so it is explicit that the amount of compensation used in a member's benefit calculation will be limited accordingly.
- Regulation Section 599.146 makes explicit that in instances where a member does not make an election to take a mandatory distribution from JRF II directly or elect to roll it over to another eligible retirement plan, the distribution will be paid directly to an IRA designated by the Board if the amount exceeds \$1,000.

#### **BUDGET AND FISCAL IMPACTS**

We do not anticipate any budget or fiscal impact other than the staff time associated with promulgating the proposed regulations.

#### **BENEFITS/RISKS**

The primary benefit of approving the proposed regulatory action is that CalPERS will be making technical amendments to the Plans in accordance with the IRS rules. The proposed regulations will provide further assurances as to the tax-qualified nature of the Plans and are consistent with the determination letters on plan qualification.

#### **ATTACHMENTS**

Attachment 1 – Proposed Regulatory Action by CalPERS

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