



Agenda Item 5

December 16, 2014

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

PROGRAM: Legal Office

ITEM TYPE: Action

RECOMMENDATION

Staff recommends the Pension and Health Benefits Committee (PHBC) approve the regulations for submission to the Office of Administrative Law (OAL) that make technical amendments to the plan provisions for the Public Employees' Retirement Fund (PERF), the Legislators' Retirement Fund, the Judges' Retirement Fund, the Judges' Retirement Fund II (JRF II), and the Supplemental Contributions Plan (individually the "Plan", and collectively the "Plans") in accordance with the Internal Revenue Service (IRS) rules. The regulations will be added to Chapter 2 of Division 1 of Title 2 of the California Code of Regulations as Article 1.5, Sections 553, 553.1, 553.2, 553.3, 553.4, 553.5 and 553.6; Subchapter 2.1, Article 1, Sections 599.100, 599.101 and 599.102; Subchapter 2.2, Article 1, Sections 599.120, 599.121, 599.122, 599.123 and 599.124; Subchapter 2.3, Article 1, Sections 599.140, 599.141, 599.142, 599.143, 599.144, 599.145 and 599.146; Subchapter 2.4, Article 1, Sections 599.160, 599.161, 599.162, 599.163 and 599.164.

EXECUTIVE SUMMARY

The California Public Employees' Retirement System (CalPERS) Board of Administration (Board) approved 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 regulations are intended to be declarative of existing law and ensure that the Plans' provisions are consistent with IRS rules. The proposed regulations were released to the public for comment on October 31, 2014. As anticipated, we have not received any public comment, although the comment period does not end until December 15, 2014. To the extent we receive any public comment within this timeframe, we will orally update the PHBC.

STRATEGIC PLAN

This agenda item supports Strategic Goal 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 October 15, 2014, the Board approved the proposed regulatory action to initiate the rulemaking process to make explicit certain technical provisions required of the CalPERS Plans in accordance with the IRS rules. As discussed in the October 14, 2014, PHBC Agenda Item, 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 regulations conform to 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 package of proposed regulations for which we are requesting final approval contain 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 result in changes, but rather be 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 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.

ANALYSIS

The Notice of Proposed Regulatory Action (Attachment 1) was published in the California Regulatory Notice Register 2014, No. 44-Z, File No. Z2014-1021-01, on October 31, 2014 (Attachment 2). The 45-day comment period commenced on October 31, 2014, and will close on December 15, 2014. As anticipated, we have not received any public comment. To the extent we receive any public comment within this timeframe, we will orally update the PHBC. Additionally, pursuant to Government Code Section 11346.8, the Board did not schedule a public hearing on this matter. However, any interested person had until December 1, 2014, to request a public hearing, and no such request was received.

Because we have not received any public comment or new information to revisit the original proposed regulations, staff recommends the PHBC approve the original proposed regulations for submission to OAL for review and adoption.

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 regulations is that CalPERS will be making technical amendments to the Plans in accordance with the IRS rules to explicitly conform with federal law. 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 – Notice of Proposed Regulatory Action
- Attachment 2 – California Regulatory Notice Register 2014
- Attachment 3 – Proposed Regulations to the CalPERS Plans

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