Agenda Item 6a

December 15, 2015

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

PROGRAM: Legislation

ITEM TYPE: Action

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

EXECUTIVE SUMMARY
Staff seeks approval of the following legislative proposals. The first three are technical in nature and would (1) standardize the rate of interest CalPERS pays on delayed death benefit payments to a fixed interest rate, (2) resolve inconsistencies in statutes relating to the assessment of interest on delinquent employer payments, and (3) clarify the timing and process by which the CalPERS Board of Administration (Board) may reduce member benefits when their employer is transferred into the Terminated Agency Pool and has not paid past due amounts. The last proposal is policy in nature and would designate employers as the party responsible for the administrative costs of the Replacement Benefit Plan.

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

BACKGROUND
CalPERS benefit programs and administrative processes are subject to numerous statutory requirements, several of which have been identified by staff as outdated, subject to confusion among stakeholders, or which otherwise represent an opportunity to realize efficiencies through their modification or clarification. In these cases, legislative changes appropriate for the continued administration and good governance of CalPERS are recommended.

ANALYSIS
The following are technical amendments to the Government Code:

Interest on Delayed Payment of Death Benefits

Existing law requires CalPERS to pay death benefits within 45 days of receipt of all necessary documentation. CalPERS is also required to pay interest for each day beyond 45 that payment is not made, at a rate per annum of six percent or the net earnings rate in effect at the time of the payment, whichever is higher. CalPERS uses the rate of investment earnings for the prior fiscal year, minus expenses, for purposes of determining the net earnings rate that applies to delayed payments made during the next calendar year. This imposes an administrative cost on CalPERS to adjust the my|CalPERS automated system on an annual basis to reflect the proper interest rate, and provides beneficiaries interest on delayed payment of death benefits at varying rates from year to year that may represent only a minimal difference in their total benefit payment.

This proposal would change the interest rate to be paid on delayed payments of death benefits to a fixed interest rate of seven percent per annum simple (non-compounding), which is the default interest rate established by Article XV, Section 1 of the California Constitution.

To ensure consistency in the payment of death benefits and reduce CalPERS administrative costs, staff recommends setting the interest rate for death benefit payments made more than 45 days after receipt of all necessary documentation at the rate specified in Article XV, Section 1 of the State Constitution.

Interest and Penalty Assessments for Non-Payment

Current law has two applicable code sections that apply when participating agencies have not paid contributions in a timely manner. One section identifies the actuarial interest rate (currently 7.5 percent) as the interest rate to be applied. The other section identifies 10 percent interest on late payments, and an additional 10 percent penalty assessment for agencies with repeated delinquencies, which may be imposed once during each 30-day period that the amount remains unpaid.

In order to provide conformity in the statutory framework for imposing interest and penalties on contracting agencies that do not remit contributions in a timely manner, staff recommends replacing the interest charged for amounts due and unpaid at the actuarial interest rate, with the higher of a 10 percent interest rate or investment return rate for the prior fiscal year, and conforming the provisions of the other applicable code section to these changes. In addition, staff recommends clarifying in statute that the penalty assessment for a contracting agency more than three months delinquent is in addition to the interest charged to contracting agencies until their payment is received.

Terminated Agency Pool Process

Currently, the Terminated Agency Pool (TAP) exists within the Public Employees' Retirement Fund (PERF) to provide for the payment of benefits to members who are employees of agencies which have terminated their contracts with CalPERS. When the contract between a public agency and CalPERS is terminated on a voluntary or involuntary basis, the associated assets and liabilities of that agency are transferred into the TAP. Other than a fixed schedule of payments established at the time of contract termination, terminated agencies generally do not make ongoing contributions, and members of agencies that do not pay the contributions required to fully fund their benefits are subject to benefit reductions.

During CalPERS recent actions to increase affected members' benefit security and mitigate the TAP's potential funding status risk, staff identified imprecise statutory provisions regarding the process for moving a contracting agency plan into the TAP, collecting any payment due, and possible reductions in members' benefits if the amount remains unpaid. Specifically, two statutory provisions imply that the transfer of assets to the TAP will take place before any recovery from a terminated agency, while another implies that the transfer will occur after CalPERS has made efforts to recover the deficiency. Failure to clarify these provisions potentially exposes contracting agency members to a greater risk of reduction in benefits due to market fluctuations during the termination process because employer assets may not be moved promptly to the TAP.

In order to better conform statute to CalPERS' best practices and improve the sustainability of the TAP, staff recommends changes to specify that CalPERS may take action to reduce member benefits only after their employers' plan has been placed in the TAP and the employer fails to remit the contributions necessary to fully fund the liabilities of the plan.

The following is a policy change requiring its own legislative bill:

Replacement Benefit Plan Administrative Costs

Tax-qualified pension plans such as CalPERS must comply with various federal laws regarding defined benefit (DB) plan benefit payments, which include a limit ($210,000 in 2015 for people who retire between the ages of 62 and 65, with the annual limit reduced for people who retire under the age of 62) on the annual benefit that can be paid to a DB member that first enters the system before January 1, 2013. In order to make full payment to members whose benefits exceed this threshold, CalPERS issues "replacement benefits" from a Replacement Benefits Plan (RBP) implemented in 1998 as a separate benefit plan funded by their former CalPERS employers on a "pay-as-you-go" basis at the beginning of each calendar year.

Under existing law, the administrative costs of this plan are paid by the member. Generally, these costs have been paid thru investment earnings instead of thru a direct charge to participants. However, as administrative and compliance costs have increased over the years, this practice is no longer feasible. While the costs of making monthly RBP benefit payments to each member are fixed, the amounts paid can vary widely from participant to participant, from just a few dollars to thousands of dollars, causing what would appear to be a nominal direct charge on participants to become a substantial reduction in some members' RBP benefit.

In order to ensure sufficient funding of administrative costs for the RBP and allow participants to continue to receive their full benefit amounts, staff recommends statutory changes to require participating employers to pay an administrative fee to the RBP. Designating employers as the party responsible for funding the costs of administration of this program is consistent with the practices for other CalPERS benefit programs.

BUDGET AND FISCAL IMPACTS

Setting the interest paid on delayed payments for death benefits at a fixed seven percent would have saved CalPERS approximately $750,000 in 2011-12. However, any future costs or savings of this proposed change would depend on the difference between the proposed rate and whichever rate existing law would apply from year to year, with investment earnings between six and seven percent in a particular year representing a potential cost to the PERF. Setting the interest rate at a fixed amount avoids administrative costs of my|CalPERS system changes due to readjusting the interest rate annually.

Assessing an administrative fee on participating RBP employers would not have any direct financial impact on CalPERS. The fee would vary based on the number of participating employers and members, as well as the complexity of any future administrative and compliance efforts undertaken by CalPERS staff.

Standardizing the interest rate imposed on delinquent employer payments and clarifying the TAP process have the potential to reduce or avoid unnecessary administrative actions, collections, and litigation costs.

BENEFITS/RISKS

1. **Benefits**
    - Fixing the interest rate at seven percent for delayed death benefit payments would make such payments consistent over time, similar to other provisions that relate to interest on CalPERS benefit payments.
    - Charging employers that participate in the RBP an administrative fee will allow recipients to continue to receive their full benefit amounts and fully fund CalPERS administrative costs.
    - Clarifying the rate of interest and penalties on late payments may reduce potential confusion among employers and help ensure prompt payment.
    - Clarifying the timing of plan transfers to the TAP may protect member benefits from reduction and help ensure the sustainability of the Pool.

2. **Risks**
   - To the extent the administrative costs are not paid by the employer, participants in the RBP will bear these costs directly.
   - Failure to resolve inconsistencies in statutes relating to the assessment of interest on delinquent employer payments increases the potential for administrative appeals and other actions that would require the commitment of additional System resources.
   - Failure to clarify the timing of plan transfers to the TAP increases the potential for administrative appeals and other actions that would require the commitment of additional System resources.

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