CalPERS

Pension and Health Benefits Committee

Agenda Item 12

June 14, 2016

Item Name: The California Public Employees' Pension Reform Act – An Update Since Implementation

Program: Pension

Item Type: Information

Executive Summary

The Public Employees' Pension Reform Act of 2013 (PEPRA) resulted in multiple changes in administering a defined benefit plan. This agenda item provides a recollection of the activities that have occurred since the passage of Assembly Bill (AB) 340; the current environment, including some statistical data and the planned path forward for the remaining implementation activities.

Strategic Plan

This item is presented in support of the California Public Employees' Retirement System's (CalPERS) implementation of PEPRA and related pension reform changes to the Public Employees' Retirement Law (PERL) and in accordance with Goal A of CalPERS' Strategic Plan. Goal A is to improve the long-term pension and health benefit sustainability, by implementing the new pension reform changes and by educating employers and other stakeholders of the new definition of pensionable compensation so they can make informed decisions about retirement security and understand how pension reform changes may impact retirement benefits.

Background

On September 12, 2012, Governor Brown signed into law AB 340 which included the PEPRA and related pension reform changes to the PERL and Legislators' Retirement System law. These statutory provisions became effective on January 1, 2013. This legislation added, amended, and repealed numerous sections of the Government Code relating to public employees' retirement benefits. PEPRA creates a new tier of members subject to a lower set of benefit formulas and requires members to pay their own contributions. While it begins to define pensionable compensation for new members and limits payments and compensation that may be used to calculate a defined benefit for new members, it is silent about other payments that have historically been allowed under the law before PEPRA. Senate Bill (SB) 13 signed into law October 4, 2013, provided requirements for exclusions from pensionable compensation items that are collectively bargained with represented state employees or imposed on non-represented state employees.

Shortly after AB 340's passage, staff began implementation efforts to align processes with the new requirements. Staff began their efforts with communications to employers, this included posting Frequently Asked Questions to the website, releasing circular letters, conducting webinars and providing presentations throughout the state.

Next, we began modifying the system to identify the new formulas and rates, to determine a member's status (classic *versus* new), to perform new audits on pensionable compensation data submitted by employers, and to allow employers to identify members by bargaining unit (for cost sharing purposes). In addition, multiple computer-based training classes were developed to aide employers in gathering appropriate documentation and understanding impacts to their processes.

Finally, CalPERS began the process of introducing regulations to aide in the clarification of some areas of the statute. The beginning regulations covered many of the foundational or fundamental needs to support the regulations, such as our scope and authority to administer, definitions of new terms or phrases introduced in PEPRA, and further description of calculation processes.

In April 2014, CalPERS introduced draft regulations for reportable compensation under PEPRA. After initial Board of Administration (Board) approval, the draft regulations were released for public comment. Following the end of the public comment period, the Board held a public hearing to allow stakeholders and other members of the public to provide feedback on the regulations. In August 2014, the Board approved the draft regulation package to move forward for final approvals and adoption by the Office of Administrative Law (OAL). However, final signatures could not be attained and the package was unable to be submitted to OAL for adoption and ultimately expired.

Analysis

<u>Current State</u>

PEPRA is fully implemented (with the exception of three areas discussed in next steps below) and as a result employers are starting to realize savings. By June 30, 2016, we anticipate approximately 29 percent of the active member population will be accruing benefits under the new, lower, benefit formulas prescribed by PEPRA. The percentage of members covered by the new formulas will come as a surprise to many since it will take decades before all members are under the new formulas. The rate of increase in the percentage of members under the new formulas will slow in coming years as some of the future employment turnover will come from PEPRA members.

In addition to the new benefit formulas, PEPRA members have their benefits based on their three-year highest average compensation, are subject to a significantly lower pensionable earnings cap and are required to contribute at least half of the normal cost as a member contribution. All of these provisions result in savings to their employers.

The approximate employer normal cost savings due to PEPRA for the State plans range from 1.2 percent of payroll for Miscellaneous plans to 5.1 percent of payroll for Peace Officers plans as of the June 30, 2015, valuation. For the Schools pool, the employer normal cost savings was approximately 1.7 percent. Savings for local agencies will vary depending on the benefit provisions they elected to provide to their employees and the demographics of their work forces. However, these savings are likely to be greater, on average, than the savings for the State plans since the State had made more changes to control costs prior to the implementation of PEPRA than the local agencies did.

In addition to the savings on PEPRA members, employers are establishing agreements with their labor partners resulting in the member paying for a portion of the employer share.

As expected, the retirements related to those with new member appointments have not yet materialized. By June 30, 2016, CalPERS will have processed approximately 150 retirements where the member had at least one new member appointment. The low volume results from a new member not being able to retire unless they previously earned service credit under a classic appointment. The only exception is a member receiving an industrial disability retirement.

In short, while there have been only a few retirements under these new formulas, PEPRA is already resulting in a bending of the cost curve.

<u>Next Steps</u>
It is critical to move forward with completion of the remaining implementation tasks. With the exponential increasing trend of new member appointments and the resulting risk to employers and members as well as CalPERS, resolution is necessary.

Staff are reconvening a team of stakeholders to resolve the final outstanding items. The list of deliverables will include an updated draft regulation package for pensionable compensation and a new proposed regulation to address the excessive liability statute, requiring the new employer to bear the cost of the excessive liability, caused by the significant pay increase, allocated to prior employers. Also included on the list will be final resolution of the transit worker members either through the outcome of pending appeals or via current legislation, AB 1640.

The activities to complete these deliverables will include significant stakeholder engagement, including state administration, our employer community, and labor associations.

Budget and Fiscal Impacts
Any operational costs associated with the upcoming workload are anticipated to be minimal and absorbable with the current budget.

Benefits and Risks
As identified above, all employers are experiencing cost savings as a result of the enactment of PEPRA via reduced normal costs and increased member paid contributions. It is anticipated this trend will continue as more new member appointments are created and further cost sharing agreements are reached.

While the new member retirement population is not yet significant, based on the trend of active appointments, it will undoubtedly become so. It is critical the remaining items be resolved to ensure consistent application by all employers and CalPERS.

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