



Finance and Administration Committee Agenda Item 7b

November 15, 2016

Item Name: Collections & Termination Process for Public Agencies

Program: FINANCIAL OFFICE

Item Type: Information

Executive Summary

At the September 2016 meeting of the Finance and Administration Committee (“FAC”) staff was asked to provide an overview of the process with respect to the collection of employer pension contributions, the termination of employer contracts, and the reduction in pension benefits to members in the event that an employer contract is terminated and the employer does not fully pay its pension obligations to the California Public Employees’ Retirement System (“CalPERS” or “System”).

Strategic Plan

This agenda item supports CalPERS Strategic Plan Goal A: improve long-term pension and health benefit sustainability.

Background

The process for collections and contract terminations, both involuntary and voluntary, including the potential reduction in benefits to members if an employer does not pay its pension obligations to CalPERS, is guided by provisions in the California Public Employees’ Retirement Law (“PERL”), particularly “Part 3. Chapter 5. Article 5. Termination of Contracts”. The process involves cross-program collaboration within CalPERS and contains multiple steps, decision points, and safeguards.

The Public Employees Retirement Fund (“PERF”) is a trust that holds and invests the assets needed to pay retirement benefits that participating agencies have agreed to provide to their employees. The California Constitution and state statutes define the trust relationship and the rights and duties of the Board, the public agencies, and the members of the System. The CalPERS Board has the fiduciary duty to ensure the integrity of the System in order to pay benefits. CalPERS does not have the authority to forgive employer contributions that are necessary to sustain the soundness of the System.

When a public agency voluntarily chooses to provide retirement benefits to its employees at various levels (e.g., 3% at 50, 2% at 55) through the System, the public agency contracts with CalPERS and agrees to be bound by the statutory provisions governing the System. This includes agreeing to make its eligible employees members of the System and to timely pay required contributions. Employer contribution rates are determined by periodic actuarial valuations in accordance with state law. Actuarial valuations are based, in part, on the benefit formulas the agency has adopted and the employee groups covered.

Participating public agencies may voluntarily terminate their relationship with CalPERS. However, termination does not eliminate the agency’s obligation to pay required contributions to

CalPERS to fund benefits accrued prior to termination. Instead, state law provides for a valuation of the assets and the liabilities of the employer at the time of termination. Because termination effectively closes the pension plan for that employer, any unfunded liabilities as of the effective date of termination must be fully paid by the employer. It should be noted that the total liability at termination is calculated using a risk-free discount rate based on the duration of the remaining liabilities in order to “immunize” the System from funding risk going forward.

The PERL also provides for the involuntary termination of public agency contracts. Specifically, Government Code section 20572 sets forth the provisions governing involuntary terminations and provides the Board the authority, by resolution adopted by a majority vote, to terminate the contract if:

- The contracting agency fails to pay any installment of required contributions for 30 days after a demand for payment; or
- The contracting agency fails to provide information with respect to that agency’s employees required for the administration of the system for three months after a demand for the information; or
- CalPERS determines that the agency is no longer in existence.

Moreover, section 20577 requires the Board to reduce member benefits in proportion to the amount of the employer’s deficiency in paying the required contributions. In limited situations, when a deficiency exists, section 20577.5 allows the Board to merge a terminated plan into the Terminated Agency Pool (“TAP”) without benefit reduction or with a lesser reduction if the Board has made all reasonable efforts to collect the amount necessary to fully fund the liabilities of the plan and if the Board finds that the merger of the plan into the TAP without benefit reduction would not impact the TAP’s actuarial soundness.¹

The “Analysis” section below describes the detailed process staff follows to ensure all reasonable efforts are made to collect pension obligations and that contract terminations and the reduction in member benefits in the event an employer defaults on its obligations are carried out as prescribed by law.

Analysis

The recent escalation in seriously delinquent cases has led staff to focus carefully on the collection and termination process. The collection and termination functions now report directly up to the Chief Financial Officer (“CFO”). A key development has been the establishment of the Case Management Team (“CMT”). Chaired by the CFO, the oversees the collection and termination process and includes, in addition to the CFO, CMT representatives from the Financial Office (“FINO”), ACTO, Legal Office (“LEGO”), Customer Service Support (“CSS”), Communications and Stakeholder Relations (“CSR”), and Office of Audit Services OFAS. The roles of each participating group are as follows:

- FINO
 - Owns and leads the overall collection and termination process.
 - Contract Support Unit (“CSU”) within FINO manages this process.
- ACTO
 - Performs actuarial valuations and determines benefit reduction percentages.

¹ Although section 20577.5 permits merger into the TAP without benefit reductions, section 20578, subdivision (b) caps the level of benefits at the level that was in place 36 months prior to contract termination. The stated intent of this cap is to discourage employers from increasing benefits prior to going into the TAP with the expectation that those benefit increases would be funded by the TAP.

- LEGO ▪ Provides legal input and opinions. Validates, when required, that “all reasonable efforts” have been made to collect on monies owed.
- CSS ▪ Compiles member data for FINO.
- Determines actual benefit reductions for members and issues ‘Intent to Adjust Benefit’ notifications.
- CSR ▪ Provides advice re: communications and stakeholder relations.
- OFAS ▪ Performs audits of terminating cases.

Cross-divisional efforts resulted in the development of a process with a shared approach between CSS, FINO, ACTO and OFAS. Process enhancements were developed to the application of the PERL relative to public agency terminations from an enterprise-wide prospective. The following improvements promote efficiency and effectiveness of the process to reduce risk to the fund.

- Employer education regarding contract termination unfunded liability responsibilities and consequences of failure to pay.
- Improved coordination between ACTO and FINO staff handling accounting tasks including termination invoice and discussions with employers regarding amounts owed.
- Centralizing pension contract and collection functions to improve services to employers and mitigate the risk of nonpayment.
- Enhanced coordination between pension contract and collection staff in regards to contract compliance, identifying responsible parties, performing financial assessments, repayment options, and services delivery.
- Collection staffs participate in CMT meetings to improve communication and expedite resolutions to complex cases.
- Development of contract reporting regarding status of active and inactive rate plans, areas of risks to improve employer education.
- Coordinate with OFAS and FINO to standardize review criteria for inactive plans, and provide cross-divisional support on employer reviews.
- Streamline end-to-end process for employer communication, member notification and benefit reductions.

Voluntary Terminations

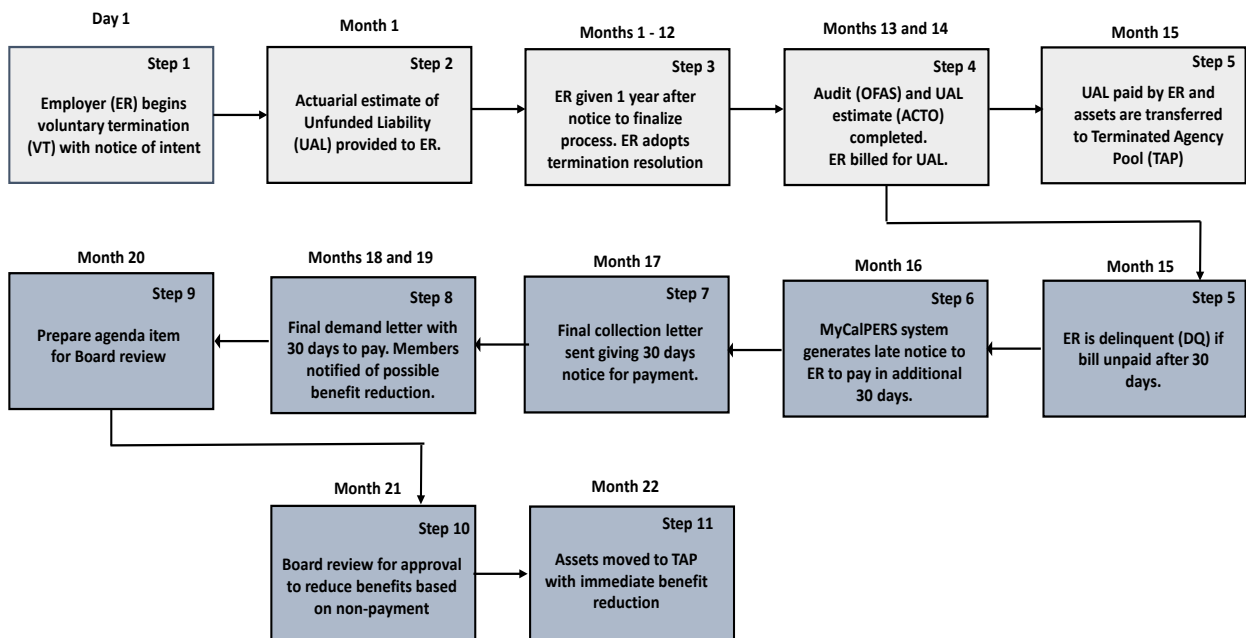
Employers may also terminate their contracts on a voluntary basis. Under section 20570, the governing body of an employer may terminate a contract by the adoption of a resolution giving notice of intention to terminate and by the adoption, not less than one yeathereafter, of a resolution terminating the contract. Termination shall be effective with Board approval on the date designated in the resolution terminating the contract.

During the one year from the time CalPERS receives the notice of intention to terminate and the resolution terminating the contract, staff works closely with the employer to ensure they fully understand the implications of voluntary termination [Step 1]. In particular, ACTO calculates a preliminary termination valuation and estimates the unfunded liability the employer will need to pay to CalPERS at termination. Staff discusses this unfunded liability with the employer and attempts to verify the employer’s financial ability to pay this obligation [Step 2]. It should be noted that the termination unfunded liability amount is provided to every employer for each of their plans on an annual bases through the annual valuation report prepared by ACTO, including the calculation under a hypothetical termination using a discount rate of 2.0%.

If the employer decides not to proceed with the termination at this point, the process ends and the employer remains status quo, provided that the employer stays current in the payment of its obligations. If the employer proceeds, staff would terminate the contract upon receipt of the employer's final resolution to terminate [Step 3]. After termination, ACTO performs a final valuation and determines the final unfunded liability after OFAS completes a final audit of the rate plan. The employer is then billed for the unfunded liability [Step 4]. Under section 20573, the board may "negotiate the effective date of termination and the terms and conditions of the termination and of the payment of unfunded liabilities." If the employer pays the bill within 30 days, the assets and liabilities of the rate plan are moved to the TAP [Step 5]. However, if the employer becomes delinquent in the payment of this bill, the collection process starts and is followed according to the illustration below [Steps 5 to 11]. In certain circumstances we may consider allowing an agency to pay its term liability over more than one payment (with interest). If the agency misses a payment we could seek default and reduce benefits

As indicated in the illustration below, the process from the time an employer adopts a resolution giving notice of intention to terminate to the actual termination and the payment of the final unfunded liability takes roughly 15 months. If the employer becomes delinquent in paying its final unfunded liability in a voluntary termination, the collection process is initiated to recover amounts owed. . The benefit reduction process is similar to the involuntary termination process outlined in Illustration 2 following, but the timeframes are more compressed because the contract has already been terminated.

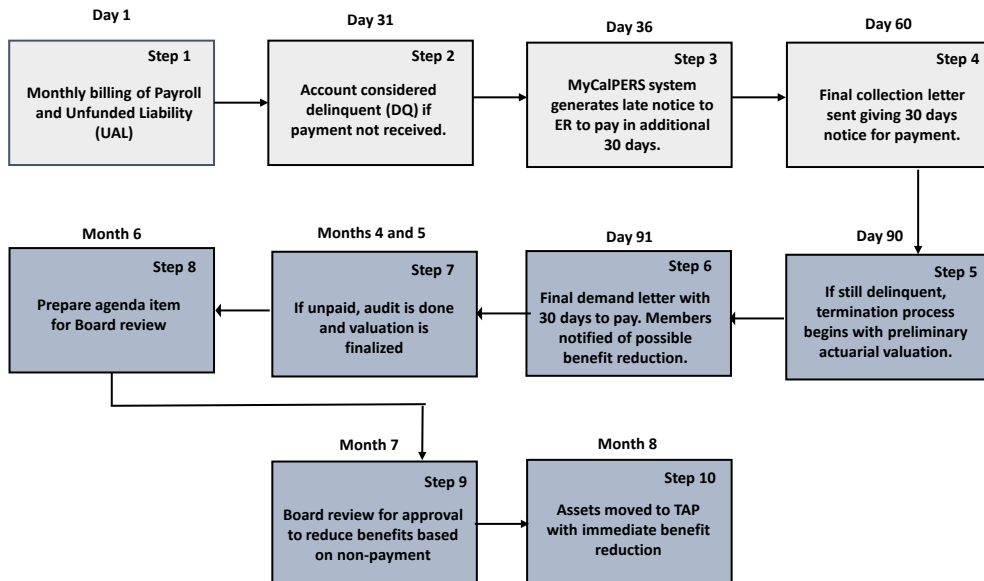
Voluntary Termination Process and Timeline



Involuntary Terminations

As indicated below, the process from the time an employer becomes delinquent to the point of involuntary contract termination takes approximately 8 to 10 months. After the termination is completed, OFAS delivers its final audit, ACTO completes its final valuation, and the employer is billed for its final unfunded liability. If the employer fails to pay this obligation, the reduction in benefits takes place 14 to 17 months after the process began. This overall length of time is driven by the employer payment delinquency requirements and the employer and member notification requirements in order to proceed with termination and reduce benefits to members under the law, as well as staff’s efforts to ensure that collections and terminations are carried out with the proper care and fairness to all parties warranted by the seriousness of the issue being addressed. While the process below shows a 14 to 17 month timeframe, each situation is different and the timeline may vary depending on the specific circumstances of each case. In addition, as staff continues to learn from experience, adjustments may be made to the process.

Involuntary Termination Process and Timeline



Budget and Fiscal Impacts

This is an information item and does not create any budget or fiscal impact at this time. The staff resources to implement the processes shown above have been included in the budget for FY 2016-17. If the caseload of contract terminations increases in the future, staff will address additional budget requirements at that time.

Benefits and Risks

Having clearly defined and rigorous processes for collections, contract terminations and potential reductions in retiree pension benefits provides certain benefits, including the following:

- Ensures timely resolution of routine collections issues.

- Ensures that serious collections issues receive timely attention from the proper levels of management within CalPERS.
- Strengthens overall pension funding by eliminating the unfunded liabilities of employers, who cannot or will not pay their unfunded liabilities at termination, through a corresponding reduction in benefits.

Risks include the following:

- Benefit reductions could trigger potential litigation against CalPERS.
- While employers are contractually obligated to pay their required contributions, contract terminations with a reduction in benefits exposes CalPERS to reputational risk.

Attachments

None

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