



Pension and Health Benefits Committee Agenda Item 5

November 15, 2016

Item Name: State Legislative Proposal: Policy and Technical Amendments to the Public Employee's Retirement Law

Program: Legislation

Item Type: Action

Recommendation

Sponsor legislation to make technical and minor policy 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 Board of Administration (Board) to sponsor legislation that would:

- Clarify how CalPERS calculates final compensation for members with multiple employers;
- Clarify eligible conditions for changing an optional settlement;
- Make additional technical changes to provisions affecting future optional settlements;
- Remove non-operational conditions on employment after disability retirement;
- Clarify CalPERS authority to hold pre-retirement information seminars for all members;
- Require employers report classic member special compensation separately from payrate;
- Clarify the definitions for "disability" and "incapacity for performance of duty";
- Provide misclassified school members an opportunity to remain in CalPERS;
- Ensure new members in the state Second Tier Plan are eligible for disability benefits; and
- Clarify the existing ability of non-vested members to retain CalPERS membership when entering positions covered by the California State Teachers' Retirement System (CalSTRS).

Strategic Plan

This proposal supports Strategic Goal A to improve long-term pension and health benefit 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processes are subject to numerous statutory requirements, several of which have been identified by staff as outdated, subject to confusion among stakeholders, or which otherwise represent an opportunity to realize efficiencies through their modification or clarification.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 proposed technical amendments to sections of the Government Code:

Clarifying the Calculation of Final Compensation for Members With Multiple Employers

A public agency may contract with CalPERS to substitute a one-year final compensation period instead of a three-year final compensation period. The optional one-year final compensation period is not available to new members under the California Public Employees' Pension Reform Act of 2013 (PEPRA). In order to determine a member's final compensation for purposes of calculating his or her retirement benefit, staff must identify whether the member's service is subject to a one-year or three-year final compensation period. If a member has multiple employers that contracted for different final compensation periods, CalPERS staff identifies both the 12-month and 36-month consecutive period of employment where his or her average annual compensation was highest (which may or may not overlap), calculates both final compensation amounts, and applies the correct amount to the service rendered under each employer in order to determine the member's retirement benefit.

Members whose public agency service is subject to both the one-year and three-year final compensation periods frequently seek to have their highest compensated consecutive 12-month period of employment apply to all of his or her CalPERS service, rather than the service with the specific public agency that contracted for the benefit. While clarifying changes were made to the statutory definitions of final compensation for state and school members in 1992, Administrative Law Judges have consistently upheld CalPERS same application of the law in regard to service performed for contracting agencies.

In order to avoid member confusion and reduce staff workload associated with responding to administrative appeals, staff recommends clarifying in statute that the one-year final compensation calculation only applies to service credit accrued with public agencies that elect to contract for that benefit, and shall not be used to calculate final compensation for any service credit accrued with an agency that elected the three-year final compensation calculation.

Conditions for Changing a Retirement Settlement Option

When a member retires, the retirement benefit settlement option he or she elects becomes irrevocable after 30 days, unless he or she experiences a qualifying event. The specified qualifying events are the death of the option beneficiary, marriage, legal separation, or the annulment or dissolution of a marriage. Current law provides that an eligible member's election to change his or her optional settlement is irrevocable when the member originally elected no optional settlement or optional settlement 1 but does not provide that an eligible member's election to change his or her optional settlement is irrevocable when the member originally elected Option 2, 3, or 4. Staff recommends clarifying that an eligible member's election to change his or her optional settlement due to a qualifying event is irrevocable when the member originally elected Option 2, 3, or 4.

In addition, current law requires a member to provide specified documentation in order to verify a qualifying event, and requires the same documentation for members experiencing either a legal separation, dissolution of marriage, or annulment. However, annulment treats the marriage as if it never occurred; therefore, there is no community property interest awarded to the member or his or her former spouse that the member would otherwise be required to document. Staff recommends clarifying in statute that the annulment of a marriage is distinct from legal

separation or dissolution, and that only a court document confirming the annulment must be provided to CalPERS.

Retirement Options Simplification Cleanup

Last year's Board-sponsored Retirement Options Simplification legislation eliminated and consolidated existing retirement optional settlements for members retiring on or after January 1, 2018. Staff recommends clarifying or removing outdated and inoperative provisions from existing statutes related to CalPERS optional settlements, which have been identified since the passage of last year's legislation.

In addition, since 1996, CalPERS has paid benefits to retired members and their former spouses that are subject to court-ordered community property settlements through the flexibility provided by the multiple lifetime beneficiary provisions of the existing Optional Settlement 4, as found in regulations. Staff recommends adding statutory provisions under the Flexible Beneficiary Option 4 established by last year's Board-sponsored Retirement Options Simplification legislation to further clarify how court ordered benefits will be administered consistent with existing practice.

Remove Non-operational Conditions on Employment after Disability Retirement

Existing law allows a member who retired for disability and has not reached the mandatory age for retirement to be employed without reinstatement in a position different from the one from which they retired, when they are determined not to be disabled for that subsequent position by the Board. However, during this employment, his or her allowance will be reduced to an amount that, when combined with the compensation received, equals the maximum compensation for a person in the position that was held at the time of retirement. The operative statute is effective on, and after, January 1, 2013 and superseded a similar statute concerning the effect of employment on disability retirement allowances.

Although the provisions of each statute are almost identical, maintaining both in the Public Employees' Retirement Law (PERL) could become a source of confusion for members. Therefore, staff recommends repealing the inoperative section of law.

Pre-retirement Information Seminars

Existing law requires CalPERS to provide structured pre-retirement information seminars to members who have attained age 45 to enhance members' awareness of the CalPERS features, benefits, and services, help them understand the importance of financial and estate planning, and actions they can take to achieve retirement security. In recent years, CalPERS has recognized the value of life-cycle education for members at all stages of their careers. This proposal would remove references to age limit in the seminar requirement and expand the various modes to provide member education and training.

Identifying and Reporting Special Compensation Separately from Payrate

Existing law requires that employers provide member-specific information that the Board may require in the administration of the System, and in a manner as required the Board. CalPERS regularly informs employers of their duty to properly identify and report member special compensation and payrate through various manuals, documents, and circulars. Staff reviews the compensation data reported by employers, and that is necessary to determine and pay benefits. Often, the various forms of member compensation reported is not clearly identified, or is reported within payrates, leaving staff to analyze and work with employers to identify whether

a particular item of pay, and the amounts, are pensionable, in order to ensure compliance. This process requires a great deal of involvement and timely response from employers, which commonly results in significant delays in processing members' retirement benefits. While current statute requires employers to report special compensation separately from payrate for new PEPRAs members, it does not explicitly require employer reporting for Classic members to be performed in the same manner.

In order to reduce potential reporting errors and aid in the accurate calculation of benefits, staff recommends statutory changes to require employers to identify and report special compensation for Classic members separate from their payrate.

Clarify the definitions for "Disability" and "Incapacity for Performance of Duty"

Existing law requires the Board, or in the case of a local safety member, the governing board of the contracting agency, to make a determination of a member's disability or incapacity for performance of duty based on competent medical authority. However, current law does not specify a minimum period of disability or incapacity that would allow a member to begin to receive CalPERS disability or industrial disability benefits. For all members except non-school local safety members, CalPERS requires a competent medical professional to certify whether a member's disability is anticipated to be permanent, less than six months in duration, six months to one year in duration, one to two years in duration, or some other period in duration. Staff uses this information in the disability determination process and the required re-evaluation of a disability or industrial disability benefit recipient who is under the applicable minimum voluntary retirement age. Research by the CalPERS Retirement Research and Planning Division staff of comparable state and federal retirement systems, including CalSTRS, the State Teachers' Retirement System of Ohio, and the Social Security Administration, has identified the industry best practice as setting a 12-month minimum.

To adopt best practices in defining what constitutes a "disability," staff recommends amending existing law to clarify that the terms "disability" and "incapacity for performance of duty" mean a disability that is expected to last at least 12 consecutive months, or will result in death.

Election to Remain Covered under CalPERS for Misclassified School Employees

In past years, there has been some uncertainty among school employers as to which school employee positions should be reported to CalSTRS and which positions should be reported to CalPERS. As a result, some school employers have reported certain employees to CalPERS that should have been reported to CalSTRS, and vice versa. In 2015, CalSTRS sponsored Assembly Bill (AB) 963 (Chapter 782) to clarify the Education Code definition of "Creditable Service" and expand and clarify the position classifications that should be reported to CalSTRS. AB 963 also allowed a one-time election for CalSTRS members who should have been reported to CalPERS to continue to have their service reported to CalSTRS or to have their service reported to CalPERS.

Staff recommends similar amendments to the PERL to permit CalPERS members who should have been reported to CalSTRS, a one-time election to continue to have their service reported to CalPERS or to have their service reported to CalSTRS. Members that do not make an election during the proposed six-month election period would automatically continue to have their service reported to CalPERS.

PEPRA Second Tier Disability Benefits

Existing law provides for disability and industrial disability allowances for “classic” members of the state second tier retirement plans. When PEPRA was adopted in 2012, it established a lower retirement benefit formula for state second tier employees who first become members on or after January 1, 2013, in new sections of the PERL. However, the two code sections that provide for disability and industrial disability allowances for all state second tier retirement plans were not amended to include the new state second tier formula for “new members” subject to the lower PEPRA retirement formulas. This puts second tier employees under PEPRA at risk of technically not being eligible for disability or industrial disability benefits.

Staff recommends amending existing law to include references to the section of law adopted by PEPRA to properly identify “new members” subject to the new state second tier PEPRA formula as being eligible for disability and industrial disability retirement benefits.

Other Technical Changes

This proposal will also make corrections to inaccurate code section references and other technical changes to the PERL in accordance with other provisions of state and federal law.

The following is a proposed minor policy change to statute requiring its own legislation:

Non-Vested Members to Retain CalPERS Membership

Subject to specified conditions, existing law allows CalPERS members to elect to retain CalPERS membership when they are appointed to a new position that is otherwise subject to mandatory participation in CalSTRS. A vested CalPERS member who is appointed to a position that would otherwise require participation in CalSTRS can elect to remain in CalPERS regardless of whether a break in service occurs between their CalPERS covered employment and their subsequent CalSTRS covered employment. However, a CalPERS member with less than five years of service credit is not allowed to elect to remain in CalPERS if the member experiences any break in service, however nominal, between their CalPERS covered employment and their subsequent CalSTRS covered employment.

Under specified conditions similar to those required of CalPERS members, CalSTRS members may elect to retain CalSTRS membership when appointed to a new position that is otherwise subject to mandatory CalPERS participation. CalSTRS members are allowed a break in service between CalPERS and CalSTRS covered positions, such as a weekend or a school district’s summer break.

Staff recommends amending existing law to provide that non-vested CalPERS members may have a break in service of up to 120 days between their CalPERS covered employment and CalSTRS covered employment to be eligible to remain in CalPERS, as long as the member meets all other eligibility requirements in current law. In addition, staff recommends certain clarifying changes to existing law to further facilitate administration of these elections. Staff believes that the proposed amendments would provide greater equity and conformity between CalPERS’ and CalSTRS’ administration of these elections, reduce confusion for school members and employers, and reduce the use of CalPERS resources to address invalid elections and respond to related administrative appeals.

Budget and Fiscal Impacts

Not applicable



Benefits and Risks

Benefits:

Ensures CalPERS administers the PERL in an efficient manner by minimizing potential ambiguity that may lead to conflicting interpretations among members, employers and other stakeholders.

Risks:

Continuing to administer ambiguous or conflicting provisions of the PERL may result in the misallocation of CalPERS resources that could otherwise be mitigated with the proposed clarifying technical changes.

Mary Anne Ashley, Chief
Legislative Affairs Division

Doug P. McKeever
Deputy Executive Officer
Benefit Programs Policy and Planning