Finance and Administration Committee

Agenda Item 6a

November 14, 2017

Item Name: Proposed Regulation for Employer Actuarial Liability Significant Increase

Program: Actuarial Office

Item Type: Action

Recommendation
Approve the proposed regulation establishing criteria to define a significant increase in actuarial liability due to increased compensation paid to a nonrepresented employee, as specified in Government Code (GC) Section 20791.

Executive Summary
GC Section 20791 requires the California Public Employees' Retirement System (CalPERS) Board of Administration (Board) to define a significant increase in actuarial liability to a contracting agency due to increased compensation paid to a nonrepresented employee and implement program changes to ensure that the contracting agency that creates the significant increase bears the increased liability. The adoption of the proposed regulation would assist with the implementation and administration of the pension reform statutes enacted by Assembly Bill 340 (Stats. 2012, Ch. 296), which includes the Public Employees' Pension Reform Act (PEPRA) of 2013. The proposed regulation would implement CalPERS' interpretation of GC Section 20791 by defining a significant increase in actuarial liability for contracting agencies due to increased compensation paid to a nonrepresented employee and clarifying how the increased actuarial liability will be allocated between an impacted agency and the respective causative agency or agencies.

Strategic Plan
This proposed regulation supports the 2017-22 CalPERS Strategic Plan goal to strengthen the long-term sustainability of the pension fund.

Background
GC Section 20791 requires the Board to define what constitutes a significant increase in actuarial liability to a contracting agency due to increased compensation paid by a subsequent employer to a nonrepresented employee. It also requires the Board to implement program changes to ensure that the contracting agency that creates the significant increase in actuarial liability bears the increased liability. GC Section 20791 does not provide criteria for the Board to use to determine what constitutes a significant increase in actuarial liability due to increased compensation, nor does it specify when the increase in actuarial liability should be calculated. Rather, such determinations are left to the Board's discretion.

Currently, when an increase in compensation occurs for a member, all employers in the member's career share the increased actuarial liability. This regulation establishes criteria for

defining impacted agencies, causative agencies, and significant increases in actuarial liability due to increases in compensation occurring when a member changes employment between contracting agencies. In those instances when a significant increase in actuarial liability is identified in accordance with GC Section 20791 and this proposed regulation, the actuarial liability increases will be allocated to the causative agency or agencies.

Analysis

CalPERS recommend that the following criteria be used to determine when a significant increase in actuarial liability due to increased compensation has occurred:

1. A contracting agency's actuarial liability with respect to a member is increased by a minimum of $25,000 per year of service allocated to the contracting agency due to increased compensation paid by a subsequent employer;
2. There is a minimum increase of $65,000 between the highest annual compensation paid to the member by the contracting agency and the member's highest annual compensation as of the earlier of the member's date of retirement or death; and
3. There is a minimum 10 percent compound average growth rate between the two compensation amounts referenced in Criterion 2. This rate shall be calculated over the number of years between the date the member's employment terminated with the contracting agency and the earlier of the date of the member's retirement or death.

Criterion 1 (Actuarial Liability Test) sets the threshold to identify a significant increase in actuarial liability as compared to the actuarial liability that would be reasonably expected. Criteria 2 and 3 (Compensation Test) constitute the method to identify whether an increase in compensation caused a significant increase in actuarial liability. The Criteria take into account reasonable compensation growth over time which may occur when a member works for the same employer or multiple employers for an extended amount of time and retires with a high final compensation at the end of his or her career. The Compensation Test ensures that CalPERS takes both the value and growth of compensation increases into consideration. Satisfaction of these criteria will be determined as of the earlier of the date of retirement or death of the member on or after January 1, 2013.

Section 20791 also requires the Board to implement program changes to ensure that a contracting agency that creates the significant increase in actuarial liability bears the increased liability, including any portion of that liability that otherwise would be borne by another contracting agency or agencies. The proposed regulation clarifies how the increased actuarial liability will be allocated between an impacted agency and the respective causative agency or agencies.

This regulation defines an *impacted* agency as a contracting agency that has a significant increase in actuarial liability due to increased compensation paid by one or more subsequent employers, as defined by this proposed regulation. This proposed regulation defines a *causative* agency as a contracting agency that employed a member who was previously employed by an impacted agency and that meets either of the following two criteria:

1. The compound average growth rate between the highest annual compensation paid by the contracting agency and the highest annual compensation paid by the impacted agency was 10 percent or greater; or
2. The contracting agency employed a member who was previously employed by a causative agency under Criterion 1 above and the highest annual compensation paid to

the member by the contracting agency is greater than the highest annual compensation paid by such causative agency.

Budget and Fiscal Impacts

Administrative Costs

CalPERS will incur some administrative costs to comply with GC Section 20791. It is expected that there will be immediate increased workload to establish internal processes and procedures and review retirements since 2013. CalPERS team members estimate that costs incurred will be absorbed into existing budgets and resources. The PEPRA pensionable compensation limit is expected to limit increased workload over time.

Benefits and Risks

This proposed regulation would implement CalPERS' interpretation of GC Section 20791 and help ensure consistent application of GC Section 20791.

Attachments

Attachment 1 – Proposed Regulation
Attachment 2 – Excessive Employer Actuarial Liability

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