November 14, 2017

Item Name: State Legislative Proposal: Technical Amendments to the Public Employees' Retirement Law (PERL)

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
CalPERS team members seek approval of the CalPERS Board of Administration (Board) to sponsor policy and technical legislation that would:

- Shorten the timeframe in which a contracting agency can voluntarily terminate its participation in CalPERS and require a terminating agency to notify past and present employees of its intention to terminate.
- Add a Chief Operating Officer (COO) and a Chief Health Director (CHD) to the list of employees for which the Board has authority to set compensation, conditions of employment, and performance standards.
- Require members who elect to purchase service credit, a tier conversion, or to redeposit for prior service on or after January 1, 2019, to pay any remaining balances within 60 days of the member's retirement date.
- Allow CalPERS to collect any overpayment made to or on the behalf of any member, former member, or beneficiary from any future CalPERS benefit payment that may be payable.
- Limit the categories of direct authorizations that retirees and beneficiaries may request CalPERS to deduct from their allowances and pay on their behalf.

Strategic Plan
This proposal supports the 2017-22 CalPERS Strategic Plan goals to strengthen the long-term sustainability of the pension fund, and to reduce complexity across the enterprise.

Background

CalPERS benefit programs and administrative processes are subject to numerous statutory requirements, several of which have been identified by team members as outdated, subject to confusion among stakeholders, or which otherwise represent an opportunity to realize efficiencies through their modification or clarification.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 policy changes requiring their own legislative bills:

Contracting Agency Voluntary Termination Process

Existing law allows a contracting agency to voluntarily terminate its retirement plan contract with CalPERS. A contracting agency is required to wait at least one year from the adoption of a resolution of intention to terminate its contract before adopting its final termination resolution or ordinance. The one-year waiting period requires contracting agencies that have available funds to delay payment of termination costs, which increases the risk of default due to changes in financial status or market fluctuations.

Additionally, existing law does not limit the length of time a contracting agency may take to adopt the required final termination resolution or ordinance. Consequently, some contracting agencies delay finalizing their terminations but nevertheless stop reporting their employees' service and contributions to CalPERS before the termination effective date. Allowing contracting agencies to terminate their contracts in a timelier and more transparent manner may potentially reduce their total benefit liability costs and reduce potential confusion among the impacted parties.

Moreover, under existing law, when a contracting agency fails to pay the full termination costs, the Board declares the agency in default and reduces the agency's current and former employees' retirement benefits as of the date the Board declares default. Providing a more flexible voluntary termination timeframe for contracting agencies may improve the likelihood that they will pay their full termination costs.

This proposal would shorten the approval timeline for voluntary contract terminations, ensure affected employees and former employees of a terminating agency receive timely notice during the decision-making process, and clarify Board authority through the following:

- Allow the governing body of a contracting agency to formally terminate its contract via resolution or ordinance not less than 90 days, and not more than one year, after providing the Board notice of its intent to voluntarily terminate the contract.
- Provide that a contracting agency's voluntary termination effective date cannot be earlier than the date its governing body approves a resolution or ordinance to formally terminate its contract.
- Require a contracting agency to notify impacted employees, retirees and beneficiaries in writing of its intention to voluntarily terminate its contract within seven days of its governing body providing notice to the Board.

- Require a contracting agency that is eligible to voluntarily terminate its contract by a vote of the electorate, to provide written notice to its impacted employees, retirees and beneficiaries at least 90 days prior to the vote of the electorate.
- Allow CalPERS to release retiree and beneficiary contact information to a contracting agency that provides the Board notice of its intent to voluntarily terminate its contract.
- Remove the provision in existing law that allows the Board not to impose a reduction in benefits of current and former employees of a contracting agency whose contract has been involuntarily terminated by the Board without full payment in accordance with Government Code section 20577.

Compensation of Key Employees
Currently, the Board has statutory authority to appoint and fix the compensation of an executive officer, a general counsel, a chief actuary, a chief investment officer, a chief financial officer, and other investment office management positions. The Legislature's rationale for placing salary setting authority with the Board is to ensure the Board has the ability to compensate certain executive and investment management positions in alignment with what they might make in other sectors.

The Deputy Executive Officer (DEO), Operations and Technology is responsible for several key enterprise functions including the administration and overall management of human resources, business and strategic planning, retirement policy, business intelligence, operational and facilities management, and information technology. These duties are common to Chief Operating Officer (COO) positions in health and financial services organizations of similar size and complexity. Currently, the DEO, Operations and Technology has a maximum annual salary of $185,220. In comparison, in 2016, the maximum salary ranges for COO position at the State Compensation Insurance Fund was $392,436, and at the California Health Benefit Exchange (Covered CA) was $221,712. Recently, the Teachers' Retirement Board received statutory salary setting authority for the California State Teachers' Retirement System's COO position, which has a proposed annual salary range of between $204,000 and $296,000.

In addition, CalPERS has experienced salary compaction issues between the DEO, Operations and Technology, and its subordinate information technology leadership team. Currently, the DEO, Operations and Technology is classified as a Career Executive Assignment (CEA) Level C, with a monthly salary range of between $10,688 and $15,435. The DEO's direct subordinate, the Chief Information Officer, shares the same monthly salary range of between $9,625 and $11,465 with its direct report Information Technology Division Chiefs.

CalPERS is the largest public employer purchaser of health benefits in California and the second largest employer purchaser in the nation after the federal government. In 2016, it spent $8.6 billion dollars to provide health benefits for 1.4 million current and former employees and dependents of over 1,200 government agencies. As head of the CalPERS Health Policy and Benefits Branch, the Chief Health Director (CHD) is responsible for the administration and overall management of CalPERS' health benefits program, including health policy research, health plan contracting and administration, member enrollment and eligibility, and the CalPERS Long-Term Care Insurance Program.

Historically, CalPERS has faced challenges recruiting candidates and retaining incumbents in the CHD position due to the specialized knowledge, skills, and experience needed to be successful, as well as its lower compensation structure compared to what is provided by other public and private sector employers with equivalent positions. Currently, the CHD position is classified as a CEA Level C, with an annual salary range between $128,256 and $185,220. This lags in comparison to similar positions at other state agencies such as the Director of the California Department of Public Health, with a maximum salary of $246,236 per year; the Executive Director of Covered CA with a maximum salary of $436,800 per year; and the Chief Deputy Director for Programs at Covered CA with a maximum salary of $244,596 per year. Since 2002, the average tenure for the CalPERS CHD position (or its equivalent) has been approximately three years, which may have negatively impacted CalPERS' ability to execute ongoing program initiatives to reduce costs and improve participants' health outcomes. This proposal would improve recruitment and retention for these two key CalPERS leadership positions through the following:

- Add a COO and a CHD to the list of employees for which the Board has authority to establish the classifications with the California Department of Human Resources; as well as the authority to set compensation, conditions of employment, and performance standards.

Cancellation of Installment Payments upon Retirement

CalPERS credits an active member's account with service credit upon his or her election to purchase eligible approved leave or service, conduct a tier conversion, or make a redeposit for prior service. An active member may elect to make installment payments to CalPERS over up to 180 monthly payroll periods (or the semi-monthly, bi-weekly, or quad-weekly equivalent) from his or her paycheck, or retirement allowance, if he or she has not completed his or her installment payments at the time of retirement. If a member continues to make installment payments into retirement and then subsequently passes away with an outstanding balance, CalPERS will continue to deduct the required monthly payment from his or her beneficiary's monthly allowance, or deduct the unpaid balance from any lump-sum death benefit payments. If the member does not provide for an ongoing monthly survivor allowance or a lump-sum death benefit payment, there is an unpaid balance that cannot be collected.

Team member research found that CalPERS requirements for installment payments are unique among public retirement systems. Their survey of eleven other retirement systems found that none of the systems allowed their members to continue installment payments into retirement for any reason. Team members propose to address this difference by cancelling installment payments for members' service credit-related purchases made on or after January 1, 2019 upon the member's retirement or preretirement death. The proposal would allow members to pay any remaining balance within 60 days of their retirement date, and allow the survivor or beneficiary of a deceased active or inactive member to pay any remaining balance within 60 days of the member's date of preretirement death. This change would not impact the ability of retired members under existing law to elect to purchase retirement service credit for their active duty military service performed prior to CalPERS membership and make installment payments by deductions from their retirement allowance. More specifically, the proposed amendments would:

- Require members who elect to purchase service credit, a tier conversion, or to redeposit for prior service on or after January 1, 2019, to pay any remaining balances within 60 days of the member's retirement date.
- Require the survivor or beneficiary of a member who elects to purchase service credit, a tier conversion, or to redeposit for prior service on or after January 1, 2019, to pay any remaining balances within 60 days of the member's preretirement death.
- Reduce service credited to the member's account in proportion to the balance unpaid on the 61st day of retirement or the 61st day after the date of the member's preretirement death.
- Convert any remaining unpaid balances for tier conversions to an actuarial equivalent reduction in the member's, beneficiary's or survivor's allowance.
- Make other technical amendments to existing law to implement this proposal.

The following are proposed technical amendments to the Government Code:

Collection of Benefit Overpayments After the Death of a Benefit Recipient
Under existing law, CalPERS is authorized to correct errors and collect overpayments. Existing law also provides that payments issued by direct deposit or warrant after the date of death of the benefit recipient shall be refunded to the retirement system.

In some circumstances, CalPERS may be unable to recover overpayment balances once a benefit recipient is deceased. At the time of the benefit recipient's death, there may be existing overpayment balances due, or a benefit adjustment or overpayment made after the death of the benefit recipient resulting in an overpayment.

- This proposal would expand the ability of CalPERS to collect any overpayment made to or on behalf of any member, former member, or beneficiary from any future CalPERS benefit or payment that may be payable.

Limiting Payment Types Eligible for the Direct Authorization (DA) Program
Existing law allows retirees and beneficiaries to authorize deductions from their retirement allowance for group insurance premiums, association dues, life insurance, shares or obligations to a credit union, recurrent fees payable to a state agency, and charitable contributions. In addition, existing regulations further specify procedures for retirement allowance deductions for group insurance plans, life insurance, association dues, and credit union payments.

This proposed change provides greater specificity regarding which existing types of direct authorizations may be processed by the DA Program on a going-forward basis, and may affect future vendor requests for deduction types on and after the effective date of the statutory change. For example, it eliminates authorization for vendor payment types such as purchasing United States saving bonds and public transportation passes, however the DA Program may not, at present, be receiving such requests. Specifically, it would:

- Limit the types of direct authorizations vendors may request CalPERS to create for the purpose of deducting from benefit payments.
- Limit chartered credit union payments to only those approved by the Board as of the effective date of the statutory change.
- Limit charitable contributions to only those plans approved by the Board as of the date of the statutory change.

Budget and Fiscal Impacts

Team members do not believe there will be any benefit program cost or savings related to adjusting the contracting agency voluntary termination process, or improving CalPERS ability to recruit and retain top performing COOs and CHOs. While the anticipated payment of higher salaries for these two executive positions will increase administrative costs, these changes have the potential to provide administrative cost savings through planning and process efficiencies.

The financial losses attributable to retired members passing away with a service credit election balance will gradually be reduced by requiring members to pay their future service credit elections in full within 60 days of retirement, and by requiring the survivors or beneficiaries of members that make service credit elections in the future to pay any remaining installment payment balances within 60 days of the date of the member's preretirement death. It will also decrease program area workload related to processing outstanding balances and reduce overall risk to the fund.

Allowing CalPERS to collect any overpayment made to, or on the behalf of, a benefit recipient from future CalPERS benefits that may be payable will, in the future, reduce the amount of financial losses attributable to deceased members' overpayment receivables.

Limiting the payment types eligible for participation in the DA Program has potential unkown, but minor costs associated with changes to the my|CalPERS system, which will be offset by savings from reduced long-term workload associated with CalPERS team members no longer processing new and terminated deduction types.

Benefits and Risks

1. <u>Benefits</u>

   Contracting Agency Voluntary Termination Process

   - Provides a more flexible voluntary termination timeframe for contracting agencies that are able and willing to execute their termination sooner than currently allowed.

- Provides impacted CalPERS program areas the sufficient time to properly complete all necessary voluntary contract termination steps, which ensures timely terminations and reduces the risk of agency defaults.
- Reduces potential disparities between the estimated preliminary and final termination costs for contracting agencies, and limits potential changes of their financial condition or increase in their liability.
- Ensures agencies properly notify impacted members, including former employees, of their intention to terminate their CalPERS contract and the potential impact on their retirement benefits.

Compensation of Key Employees

- Allows CalPERS to compete against other public sector employers to recruit and retain the highest quality executive talent.
- Supports succession management goals and objectives.
- Reduces recruiting and onboarding costs associated with high turnover.
- Mitigates potential salary compaction issues among CalPERS Information Technology leadership.

Cancellation of Installment Payments upon Retirement

- Mitigates future financial losses by requiring members, survivors, or beneficiaries to pay any remaining service credit or redeposit for prior service balances at retirement or preretirement death.
- Aligns CalPERS' business practices with the business practices of peer pension systems.

Collection of Benefit Overpayments After the Death of a Benefit Recipient

- Reduces the number of overpayments.
- Reduces the amount of System resources needed to identify responsible parties.

Limiting Payment Types Eligible for the DA Program

- Limiting the payment types eligible for participation in the DA Program has the potential to reduce system complexity and administrative costs.

2. <u>Risks</u>

   Contracting Agency Voluntary Termination Process

   - The timeframe could provide for a disparity between preliminary and final termination costs if the termination finalizes towards the maximum of the one year timeframe.
   - Legislative change could generate greater awareness of voluntary contract terminations and increase interest in, and inquiries to, CalPERS.

   Cancellation of Installment Payments upon Retirement

   - Fails to mitigate existing risks of financial loss for service credit purchase elections made prior to January 1, 2019.

Collection of Benefit Overpayments After the Death of a Benefit Recipient

- Potentially eliminates a benefit to a beneficiary when he or she may not have been the recipient of the benefit overpayment.

Limiting Payment Types Eligible for Participation in the DA Program

- Limiting the payment types eligible for participation in the DA Program has the potential to temporarily increase CalPERS team member workload associated with responding to inquiries from third-party vendors, current retirees and beneficiaries regarding the proposed changes.

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Mary Anne Ashley, Chief
Legislative Affairs Division

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Charles Asubonten
Chief Financial Officer