



Pension and Health Benefits Committee Agenda Item 5

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 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 legislation that would:

- Clarify that when the final compensation of a CalPERS member applying for concurrent retirement is based on the compensation reported to his or her reciprocal retirement system, the definitions of compensation earnable or pensionable compensation contained in the PERL and its associated regulations will apply;
- Provide that when a member identifies with an established group or class, but is the only member to receive an increase in compensation earnable, the member's compensation earnable will be limited to the average increase in compensation earnable for members within the member's same group or class of employment;
- Memorialize existing case law and policy, which disqualify applications for disability retirement (DR) or industrial disability retirement (IDR) when a member separates from employment, except in particular circumstances where the separation is related to a disability;
- Allow the governing body of a contracting agency to delegate to CalPERS the authority to make the determination of disability for DR and IDR benefits for its safety members;
- Clarify the conditions under which the disability of a DR or IDR benefit recipient may be reevaluated; and,
- Reduce the number of retired one-time death benefit payment options that public agencies and school employers may contract for in the future.

Strategic Plan

This proposal supports the following 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processes are subject to numerous statutory requirements, several of which have been identified by team members as outdated, subject to confusion among stakeholders, or which otherwise represent an opportunity to realize efficiencies through their modification or clarification.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 proposed technical amendments to sections of the Government Code:

Clarifying the Definition of Final Compensation for Purposes of Concurrent Retirement

The PERL and its associated regulations identify the elements of compensation that can be recognized as compensation earnable for purposes of calculating CalPERS benefits. When a CalPERS member retires concurrently from a reciprocal retirement system and has qualifying service in both systems, CalPERS calculates the member's retirement allowance based on the highest average compensation earned under either system. However, CalPERS and its reciprocal systems define compensation differently.

In accordance with existing statutory language and consistent with existing case law, CalPERS excludes elements of compensation reported to reciprocal retirement systems from members' CalPERS benefit calculations when they are determined to be non-reportable under the CalPERS definition of compensation earnable. Despite the current statutory language and case law, over 25 percent of reciprocity cases where CalPERS has applied its definition of compensation earnable to the compensation reported by a member's other retirement system are appealed by the member.

Consistent with the business practices of the reciprocal systems and the method by which CalPERS currently calculates the benefits of members applying for concurrent retirement, this proposed change clarifies that when the final compensation of a CalPERS member applying for concurrent retirement is based on the compensation reported to his or her reciprocal retirement system, it will be subject to the definitions of compensation earnable and pensionable compensation contained in the PERL and its associated regulations.

Clarifying Limits on Compensation Earnable Based on Group or Class of Employment

Under existing law, increases in compensation earnable (which consists of payrate and special compensation) for a member who is not in a group or class of employment is limited during his or her final compensation period, and the two years immediately preceding the final compensation period, to the average increase in compensation earnable over the same period for all employees of that employer that have the same membership classification (miscellaneous, safety, industrial, etc.). Existing law also limits increases in special compensation for a member who is not in a group or class of employment to the amount which the CalPERS Board determines is received by similarly situated members in the closest related group or class. However, the law does not explicitly limit increases in compensation earnable during a member's final compensation period if that member identifies with, or is part of a group or class of employment and is the only member in that group or class to receive an increase in compensation earnable.

CalPERS compensation review policies and procedures currently limit the compensation earnable of a member who is not part of a group or class of employment by comparing his or her compensation earnable to that which the Board determines is received by similarly situated members in the closest related group or class, and not what is received by all employees of the employer that share the same membership classification, as specified in statute. Absent clarifying language, CalPERS will continue to contend with appeals regarding the method it uses to apply limits to average increases in compensation earnable to prevent pension spiking.



This proposal provides that when a member identifies with an established group or class, but is the only member to receive an increase in compensation earnable, his or her compensation earnable will be limited to the average increase in compensation earnable for members within his or her same group or class of employment, as specified. It also clarifies that when a member is not part of a group or class, his or her compensation earnable is limited to the average increase in compensation earnable that the Board determines is received by similarly situated members in the closest related group or class. Finally, it adds a requirement to the definition of payrate for school members that payrate be determined pursuant to a publicly available pay schedule to ensure consistency with the definition of payrate for state and contracting agency members.

Clarifying the Terms of Disqualification for Disability and Industrial Disability Retirement

Existing law provides that in determining whether a member is eligible to retire for disability, the member must (1) be incapacitated physically or mentally for the performance of his or her duties, and (2) have the right to reinstate the employment relationship if the employee recovers and is no longer disabled.

While the first element is clearly and expressly provided for in statute, the second element is established in case law and precedential Board decisions. CalPERS team members refer to four precedential decisions adopted by the Board in evaluating the validity of an application for DR/IDR benefits:

- *Anthony Haywood vs American River Fire Protection District* – The Court of Appeals ruled that when an employee is fired for cause, and the discharge is neither the ultimate result of a disabling medical condition nor preemptive of an otherwise valid claim for disability retirement, termination of the employment relationship renders the employee ineligible for disability retirement because the employee is unable to reinstate the employment relationship if the employee recovers and is no longer disabled.
- *Jeffrey Smith vs City of Napa* – The Court of Appeals ruled that to be preemptive of an otherwise valid claim, the right to a disability retirement must have matured before the employee was terminated. To be matured, there must have been an unconditional right to immediate payment at the time of termination, which occurs only by a CalPERS finding that the member is eligible for disability retirement.
- *Robert Vandergoot vs California Department of Forestry and Fire Protection* – Further defined Haywood in that a member's separation from employment in lieu of termination is a distinction without difference as it relates to a member who voluntarily resigns and agrees to not seek, transfer to, apply for, or accept any employment in any capacity with the department he or she is resigning from because the employee is unable to reinstate the employment relationship if the employee recovers and is no longer disabled.
- *Phillip D. MacFarland vs California State Prison, Sacramento, California Department of Corrections and Rehabilitation* – Further applied the Vandergoot, Haywood, and Smith decisions as they relate to an employee who so chose to resign in lieu of termination because such an employee is unable to reinstate the employment relationship if the employee recovers and is no longer disabled.

This proposal memorializes existing law and policy to specify that a member is ineligible to retire for disability if he or she separates from employment for any reason, except when the separation is related to disability as specified below, and, as a result, is not entitled to return to his or her former position. This proposal further illustrates disqualifying separations as including, but not limited to, voluntary resignation, resignation with disciplinary action pending, rejection on probation, and mutual agreement. In addition, it clarifies that a member may be eligible to apply

to retire for disability, if the separation from employment was the ultimate result of a disabling medical condition or preemptive of an otherwise valid claim for disability retirement.

Contracting Agency Delegation of Authority to Determine Disability and Industrial Disability

Existing law provides that the governing body of a contracting agency is responsible for making DR and IDR determinations for its own local safety members, while CalPERS is responsible for making such determinations for all other CalPERS members. Existing law also requires a contracting agency to make its determination within six months and submit a resolution to CalPERS once the determination is made. In addition, existing law allows the governing body of a contracting agency to delegate any authority or duty conferred or imposed under the disability retirement provisions of the PERL to a subordinate officer, subject to conditions it may impose. In letters and the Public Agency Reference Guide, CalPERS has informed public agencies that if the governing body chooses to delegate the responsibility for making a determination of disability, they must submit a resolution to the System evidencing the delegation of authority.

Recently, the Rancho Santa Fe Fire Protection District contacted CalPERS and requested that CalPERS perform the determination of disability retirement on its behalf. However, existing law does not appear to authorize the agency to delegate this duty to CalPERS.

This proposal allows the governing body of a contracting agency to delegate to CalPERS the authority to process applications for DR and IDR and make the final determination of disability for DR and IDR benefits for local safety members through the adoption of a written resolution submitted to CalPERS. It also allows, but does not require, CalPERS to assess a fee for the service. Finally, the proposal codifies the current practice of requiring the governing body of a contracting agency to submit a resolution to the Board when delegating any authority or duty to a subordinate officer.

Clarifying Conditions for Reevaluating the Status of Disability and Industrial Disability Retirees

In accordance with existing law, the Board (or in the instance of a local safety member, the governing body of a contracting agency) may reevaluate a recipient of a DR or IDR benefit who is under the minimum age for voluntary retirement for service.

In addition, existing law requires the Board (or in the instance of a local safety member, the governing body of a contracting agency) to cause a reevaluation to be made under the following circumstances:

- A member submits an application for reinstatement and is at least six months under the age of compulsory retirement for service applicable to members of the class or category in which it is proposed to employ him or her; or
- A member submits an application for reinstatement to the position held at retirement, or any position in the same class, and was incapacitated for performance of duty in the position at the time of a prior reinstatement to another position.

While the vast majority of Administrative Law Judges who hear administrative appeals regarding DR and IDR reevaluations have interpreted existing law consistent with CalPERS interpretation, a recent superior court decision found that an employer may initiate a medical reevaluation of a recipient of DR or IDR benefits only when a member is under the minimum age for voluntary retirement for service and has also submitted an application for reinstatement.



To avoid future appeals and adverse decisions, this proposal clarifies that a recipient of a DR or IDR benefit may be reevaluated if the member is under the minimum age for voluntary retirement for service, but has not submitted an application for reinstatement.

In addition, this proposal maintains the requirement that a reevaluation must occur under the following circumstances:

- A member submits an application for reinstatement is at least six months less than the age of compulsory retirement for service applicable to members of the class or category in which it is proposed to employ him or her.
- A member submits an application for reinstatement to the position held at retirement, or any position in the same class, and was incapacitated for performance of duty in the position at the time of a prior reinstatement to another position.

Reducing the Number of Contract Options for Retiree One-Time Death Benefits

Under existing law, a public agency or school employer may either provide the statutory minimum retiree death benefit payment, or elect to contract for a higher retiree death benefit amount payable to the designated beneficiaries of its deceased retirees. For public agencies, existing law provides a \$500 one-time death benefit to the designated beneficiaries of retired public agency members upon their death. The public agency may, however, elect to contract for a \$600, \$2,000, \$3,000, \$4,000, or \$5,000 retiree death benefit. Existing law provides a \$2,000 one-time death benefit to the designated beneficiaries of retired school members upon their death. A school employer may, however, elect to contract for a \$3,000, \$4,000, or \$5,000 retiree death benefit payment.

An outside study of defined benefit (DB) administration practices by Cost Effectiveness Measurement Benchmarking, Inc. has identified seven CalPERS “rule sets” for one-time death benefits, while peer pension systems, on average, reported only four. This condition contributes to CalPERS higher complexity score versus its peers, which generally indicates the DB program may have opportunities to reduce costs and improve service quality to its members. Currently, approximately 2.1 percent of public agencies contract for the \$600 retired death benefit, 0.2 percent of public agencies contract for the \$3,000 retired death benefit, and no public agencies contract for the \$4,000 retired death benefit. No school employers contract for the \$3,000 or \$4,000 retired death benefit options.

This proposal reduces the menu of retiree death benefit options for public agencies to the \$500 statutory minimum and the \$2,000 or \$5,000 contract options by eliminating the \$600, \$3,000, and \$4,000 contract options, prospectively. It also reduces the menu of retiree death benefit options for school employers to the \$2,000 statutory minimum and the \$5,000 contract option by eliminating the \$3,000 and \$4,000 contract options, prospectively. Employers that currently contract for either the \$600 or \$3,000 retired death benefit option will continue to provide that contracted benefit amount to the beneficiaries of all their existing and future retirees.

Budget and Fiscal Impacts

- Clarifying the definitions of final compensation for purposes of concurrent retirement and compensation earnable may result in future benefit cost savings, and reduce administrative costs associated with responding to unnecessary administrative appeals.
- More consistent application of DR and IDR eligibility and reevaluation requirements may result in future benefit cost savings, and reduce administrative costs associated with responding to unnecessary administrative appeals.



- Allowing contracting agencies to delegate to CalPERS their authority to determine disability for DR and IDR benefits for their safety members may require additional System resources, which may be offset by service charges to participating employers.
- Reducing the menu of retiree death benefit contract options may reduce benefit program administrative costs.

Benefits and Risks

1. Benefits

- Ensures the PERL is administered in an efficient manner by minimizing potential ambiguity that may lead to conflicting interpretations among members, employers and other stakeholders.
- Clarifying the definition of final compensation for purposes of concurrent retirement conforms statute to existing processes, and has the potential to reduce risks associated with member appeals.
- Clarifying the definition of compensation earnable conforms statute to current practice, and has the potential to reduce risks associated with member appeals.
- Memorializing in statute existing case law and Board precedential decisions related to eligibility for DR and IDR benefits for members subject to disciplinary action has the potential to reduce risks associated with member appeals.
- Allowing contracting agencies to delegate to CalPERS responsibility for making disability determinations for their safety members provides for more consistent, independent and unbiased DR and IDR determinations, especially for smaller agencies that are not called upon to make such determinations on a regular basis.
- Reducing the menu of retiree one-time death benefit contract options reduces the complexity and costs to administer the System.

2. 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.

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