



## Finance and Administration Committee Agenda Item 6a

December 19, 2017

**Item Name:** Service Credit Purchase, Tier Conversion, and Redeposits

**Program:** Pension

**Item Type:** Action

### **Recommendation**

Sponsor legislation to require members who elect to purchase or convert service credit on or after January 1, 2019, to pay any remaining balances on the member's retirement date, or to elect an actuarial equivalent reduction (AER), in lieu of making installment payments into retirement. The same payment options will also be provided to the survivor or beneficiary upon notification from CalPERS following the member's pre-retirement death.

### **Executive Summary**

Members that elect to purchase or convert service credit through installment payments and retire prior to paying off their service credit election in full are currently required to either pay their balance in full or have the monthly installment payment amount deducted from their retirement allowance until paid in full, not to exceed 180 monthly payroll periods or the equivalent. When the members who choose to continue installment payments into retirement pass away and there is no continuing monthly benefit for a survivor or beneficiary, the remaining balance cannot be collected.

In order to reduce complexity and to support the ongoing efforts to strengthen the financial policies of the pension fund, this proposal will require members who elect to purchase or convert service credit on or after January 1, 2019, to pay any remaining balances on the member's retirement date, or to elect an AER, which is a permanent reduction in their retirement allowance. An AER payment option ensures that the remaining service credit purchase balance and the lifetime monthly payments are equivalent in value. The same payment options will also be provided to the survivor or beneficiary upon notification from CalPERS following the member's pre-retirement death.

This legislation will also allow members who retire on or after January 1, 2019, who elected to purchase or convert service credit prior to January 1, 2019, the additional payment option of electing an AER on their retirement date. The same payment option will also be provided to survivors or beneficiaries upon notification from CalPERS following the member's pre-retirement death.

This proposal will be implemented on a prospective basis and will not impact the ability of retired members, under existing law, to elect to purchase service credit for his or her active duty military service performed prior to CalPERS membership, and to make installment payments by deductions from his or her retirement allowance for that service.

## **Strategic Plan**

This proposal supports the 2017-22 CalPERS Strategic Plan goals to reduce complexity across the enterprise and supports the ongoing efforts to strengthen the financial policies of the pension fund.

## **Background**

CalPERS provides over 50 different types of service credit that eligible members may purchase before their retirement date. CalPERS team members determine eligibility by reviewing submitted service credit requests, business partner contracts, and the Public Employees' Retirement Law (PERL). If the member is eligible to purchase service credit, there are four payment method options: a lump sum payment (i.e. personal check, money order), plan-to-plan transfer or rollover from a qualified retirement plan (i.e. 457, 401(k)) or individual retirement account, an installment payment plan, or an initial partial payment with an installment payment plan for the remaining balance.

If a member elects a payment option that includes an installment payment plan, the member may choose the duration of the payment period, not to exceed 180 monthly payroll periods or the equivalent. If the member retires while still making installment payments on a service credit election, the member may choose to pay the remaining balance in full, otherwise, the payments automatically continue as a deduction from the member's retirement allowance. Members electing a tier conversion (which converts a member's past Second Tier service to the First Tier retirement formula) have a fifth payment method. Under this payment method, members can also elect an AER.

## **Analysis**

As of December 2017, over 39,400 members have elected to purchase service credit and have established an installment payment plan. Account maintenance on these accounts is very labor intensive as accounts are in a constant fluid state. Account maintenance activities include ensuring the appropriate deduction has occurred, partial payment processing, reviewing and adjusting accounts for suspensions, and community property calculations.

Of the 39,400 members, 58 percent (23,022) are retirees. The outstanding liability for retirees is \$383 million. When these members pass away and there is no continuing monthly benefit for a survivor or beneficiary, the remaining balance cannot be collected.

Requiring members to pay the balance in full at the time of retirement will eliminate the need to maintain member accounts into retirement, which will reduce workload and complexity. If a member is unable to pay the balance in full at the time of retirement, the member can elect an AER. The AER payment option ensures that the remaining balance and the lifetime monthly payments are equivalent in value. This payment option creates a benefit to members who do not have the resources to pay a lump sum remaining balance, while also reducing complexity and supports the ongoing efforts to strength the financial policies of the pension fund.

More specifically, the proposed amendments will:

- Require members who elect to purchase or convert service credit on or after January 1, 2019, to pay any remaining balances on the member's retirement date, or to elect an AER, in lieu of making installment payments into retirement.
- Require the survivor or beneficiary of a member who elects to purchase or convert service credit on or after January 1, 2019, to pay any remaining balances at the time of the member's pre-retirement death, or to elect an AER, in lieu of making installment payments.



- Provide members who retire on or after January 1, 2019, who elected to purchase or convert service credit prior to January 1, 2019, the option to elect an AER on their retirement date. The same additional payment option will also be provided to survivors or beneficiaries upon notification from CalPERS following the member's pre-retirement death.

This change will not impact the ability of retired members, under existing law, to elect to purchase service credit for their active duty military service performed prior to CalPERS membership, and to make installment payments by deductions from their retirement allowance for that service. Current retirees, survivors, and beneficiaries who have elected installment payments for a service credit purchase or conversion prior to January 1, 2019 will also not be impacted by this proposal.

### Review of Proposed Options

CalPERS team members considered the three options presented below. Under each option the retiree, survivor or beneficiary continues to pay the service credit balance through monthly deductions from their retirement allowance.

Option
1. Retirees, survivors, or beneficiaries, will not receive an increase in their retirement allowance until the balance is paid in full.
2. Retirees, survivors, or beneficiaries, will receive an increase in their retirement allowance incrementally, as the balance is paid down each month.
3. Require retirees under the unmodified allowance or option 1 (no ongoing allowance for a beneficiary) to use the increase in their retirement allowance to pay the service credit balance until the balance is paid in full.

Thorough research of these options has shown that each option creates additional risks, and significantly increases workload and complexity. Specifically, these three options will:

- Create financial hardships for retired members unable to continue installment payments into retirement without also receiving the immediate and full benefit increase.
- Increase complexity for retirement adjustments and member account maintenance.
- Require significant changes to the my|CalPERS system, impacting benefits, service credit, payroll, and financial reporting.
- Increase risks related to compliance with federal tax rules governing distributions from tax-qualified plans.

Furthermore, option three could create additional complexities as the benefit increase may not be sufficient to pay the minimum monthly installment payment. In addition, option three could create inequities with the service credit payment options provided to members, depending on their retirement option chosen.

Based on a thorough review of the options, CalPERS team members concluded that this legislative proposal is the best means to reduce complexity across the enterprise and to continue to strengthen the financial policies of the pension fund.



**Budget and Fiscal Impacts**

Any implementation costs associated with revising publications, educational materials, training materials, and updating the CalPERS website can be absorbed through regular ongoing efforts and yearly cycle reviews. There will be minimal costs associated with updating the my|CalPERS system.

**Benefits and Risks**

Providing members, survivors, and beneficiaries who cannot afford to pay the balance in full at retirement or at the time of the member's pre-retirement death with an additional payment option is a viable alternative to maintain their service credit purchase and receive a benefit increase in their retirement allowance. An additional benefit is the reduction in complexity as well as the continued support of the ongoing efforts to strengthen the financial policies of the pension fund.

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