CalPERS

Board of Administration
Agenda Item 9b

June 20, 2018

Item Name: AB 1912 Public Employees' Retirement: Joint Powers Agreements Liability

As Amended May 9, 2018

Sponsor: Service Employees International Union, California

Program: Legislation

Item Type: Action

Recommendation
Adopt a **SUPPORT, IF AMENDED** position on Assembly Bill (AB) 1912 because this bill provides protection to current and future members employed by Joint Powers Agencies (JPAs) who are members of the California Public Employees' Retirement System (CalPERS).

Executive Summary
Among other things, AB 1912 requires a Joint Powers Authority (JPA) that currently participates in a public retirement system to specify in its joint powers agreement the apportionment of JPA retirement obligations to the retirement system among the member agencies, as specified. It also requires the CalPERS Board of Administration (Board) to apportion those liabilities among the member agencies when they fail to reach agreement, as specified. In addition, the bill prohibits CalPERS from contracting with a JPA whose member agencies do not accept joint and several liability, and extends CalPERS lien authority to member agencies of a JPA that terminates its contract. It also requires CalPERS to consider and exhaust all options and necessary actions prior to reducing retirement benefits paid from the Terminated Agency Pool (TAP).

An analysis of AB 1912, as amended April 19, 2018, was presented to the Finance and Administration Committee at its May meeting. However, that analysis did not reflect amendments to the bill made immediately prior to the meeting. Most notably, they:

- Removed the proposed requirement for member agencies of JPAs that contract with public retirement systems to be jointly and severally liable for the JPA's retirement liabilities, to instead allow them to reach agreement to apportion liability. Failure to do so would activate the proposed requirement that a systems' governing Board apportion liability among the JPA member agencies, as specified.
- Removed the proposed requirement for CalPERS to revise its existing contracts with JPAs to apply joint and several liability for their member agencies.
- Modified the proposed requirement that the Board file suit against all terminating agencies and terminating JPA member agencies to compel payment of any outstanding retirement obligations prior to reducing affected members' benefits, to instead consider and exhaust all options and necessary actions, including evaluating whether to bring suit against JPA member agencies to compel payment.

The Committee heard testimony from the bill's sponsor and stakeholders during the public comment period, but did not adopt a position on the bill.

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

Background
Existing law allows two or more public agencies to jointly exercise common powers to create JPAs to fulfill a service for the member agencies. Pursuant to Government Code (GC) section 6500, member agencies that can exercise joint powers include, but are not limited to, federal agencies, state departments, counties, cities, special districts, school districts, and federally recognized Native American tribes.

Currently, CalPERS provides retirement benefits for 1,511 public agencies and 162 are JPAs. JPAs are established under the Joint Exercise of Powers Act. A JPA is a new, separate organization created by the member agencies, that is legally independent from them. The joint powers agreement describes the size, structure, and membership of the JPA's governing board and documents the JPA's powers and functions. Historically, member agencies of JPAs that contract with CalPERS for retirement benefits have disclaimed liability for the debts and obligations of the JPAs.

CalPERS' 2016 Annual Valuation Reports identified 24,724 CalPERS members that earned service through a contracting JPA, which is approximately 3 percent of the public agency participant total. The combined Unfunded Actuarial Liability for the contacting JPAs is approximately $855 million, which represents a combined funded status of 75 percent.

In the past year, CalPERS has: 1) terminated and placed one JPA that participated in the System into the TAP for failure to pay the required contributions for its current and former employees and retirees; and 2) denied four JPAs that applied to become contracting agencies, but had not required their own member agencies to be jointly and severally liable for their debts and liabilities, including their pension obligations. Three of four JPAs initially appealed CalPERS' decision, but ultimately withdrew their appeals. CalPERS was unsuccessful in its attempts to collect the required contributions from a defunct JPA, or its member agencies that had limited their liability for the debts and obligations of the JPA. As a result, its former employees' retirement benefits were reduced by approximately 63 percent. Attaching liability for a JPA's retirement benefits to its member agencies will help ensure that current and future CalPERS members receive their promised retirement benefits.

In accordance with Internal Revenue Service guidance and as set forth in Circular Letter No. 200-022-13, when a prospective public agency requests to contract with CalPERS for retirement benefits, the agency is required to complete a New Applicant Questionnaire to determine whether it is eligible to participate in the System. Currently, JPAs seeking to contract with CalPERS are, among other things, required to have their member agencies accept liability for all debts and liabilities of the JPA, including retirement obligations in its Joint Powers Agreement. This has led some prospective agencies to challenge CalPERS' determinations or abandon the contracting process. Memorializing this policy in statute will help ensure that current and future public employees receive their retirement benefits.

Analysis

1. Specifically, AB 1912:
   - Eliminates the ability of JPA member agencies to disclaim liability for the debts, liabilities, and obligations of the JPA to a public retirement system.
   - Requires current and former member agencies of a JPA that contracts with a public retirement system to reach mutual agreement to apportion the JPA's retirement liability.
   - Requires the governing board of a public retirement system to apportion the liability, as specified, when the member agencies are unable to reach mutual agreement, and allows any later agreement among JPA member agencies to supersede its apportionment.
   - Prohibits, as of January 1, 2019, CalPERS from contracting with a JPA whose member agencies do not accept joint and several liability for pension obligations.
   - Extends CalPERS' lien authority to the assets of a JPA's current and former member agencies.
   - Removes the authority of the Board to elect not to reduce member benefits as their employers' liabilities and assets are moved into the Terminated Agency Pool.
   - Requires CalPERS, prior to reducing the retirement benefit of a member as provided for in existing law, to consider and exhaust all options and necessary actions, including evaluating whether to bring a civil action against any and all of the member agencies that are parties to a terminated JPA, to compel payment of a terminated agency's retirement obligations, to include reasonable attorney's fees and other costs.
   - Allows CalPERS, at the request of a terminating JPA within a specified time prior to termination, to contract to preserve the highest final compensation for the JPA's members.

2. <u>Arguments in Support</u>
   According to the Orange County of Professional Firefighters Association (OCPFA), "[p]rotecting our members' safety, working conditions, and their hard-earned retirement benefits are top priorities …" Furthermore, OCPFA states that "[w]e cannot allow bad actors in a JPA to forfeit their responsibility to employees who have loyally served their community," and that, "[i]n the case of our Firefighters, they have played by the rules and risk their lives on a daily basis to save property and people throughout Orange County. They have contributed to their retirement plans and it should not be possible for a unilateral action to deny their hard-earned pension benefits."

3. <u>Arguments in Opposition</u>
   A coalition consisting of, among other, the California Association of Joint Powers Authorities, California Fire Chiefs Association, California Special Districts Association, California State Association of Counties, Fire Districts Association of California, League of California Cities, and Urban Counties of California contend that the "… constitutional debt limit prohibits an agency from incurring indebtedness beyond the agency's ability to pay the debt back from revenues received in the same fiscal year without the approval of two-thirds of its voters. These safeguards were placed in the state's constitution to avoid a situation in which the holders of an issue of bonds might compel an increase in taxes or foreclose on an agency's assets."

   This coalition also contends that the bill, among other things:

   "… places substantial burdens and costly unworkable requirements on local agencies"

"… makes issuing a servicing future bonds more costly through higher interest costs and additional required insurance.

"… creates a new avenue of protracted and costly litigation for retirement systems, state and local agencies."

<u>CalPERS Concerns</u>
CalPERS team members identified four concerns with the bill. First, the bill no longer subjects current JPA member agencies to joint and several liability for the JPA's retirement obligations, and now provides for apportionment of liabilities by mutual agreement provided that the agreement equals the total retirement liability of the JPA. It does not, however, establish a timeline for that agreement to be reached. In addition, it requires a retirement board to apportion liability when the member agencies do not reach agreement, based upon the share of service received from the JPA by the member agency, or population of each member agency, to equal the total retirement liability.

Not placing a deadline on JPA member agencies to reach agreement following enactment of AB 1912, and each time its agency membership changes, allows a delay in any decision until the time the JPA requests to terminate its retirement contract, or has defaulted on its terms. This increases the likelihood of delays in the termination process, and may cause retirement boards to apportion liability on an expedited basis that the affected member agencies may later challenge through administrative and court actions. Team members recommend amendments to either provide a deadline for mutual agreement by the member agencies to be reached, or the addition of an option for a retirement system to subject JPA member agencies to joint and several liability should they not reach agreement. In either case, staff recommends including a provision that a retirement board have sole discretion and authority to determine liability should JPA member agencies not reach mutual agreement.

Second, it requires CalPERS, prior to reducing the retirement benefits of the members of a defaulting JPA as provided for in existing law, to consider and exhaust all options and necessary actions, including evaluating whether to bring a civil action against any and all of the member agencies that are parties to a terminated JPA. This provision replaced a mandatory requirement to file suit against a terminating agency to compel payment with the requirement to consider and exhaust all options and necessary actions, as specified, and better preserves the Board's ability to exercise its fiduciary duties to the System. Nevertheless, team members recommend further amendments to clarify that the decision to sue and initiate other collection efforts should be consistent with the Board's fiduciary duties.

Third, JPA member agency liability extends only to pension obligations and not to all debts and liabilities of the JPA. This is not necessarily a fiscal issue for CalPERS, but rather it goes to whether the agency would be eligible under the Internal Revenue Services' guidance regarding the types of entities that may participate in a governmental plan. In November 2011, the IRS issued an advance notice of proposed rulemaking (ANPRM) aimed at clarifying existing IRS guidance with respect to employer eligibility to participate in a governmental plan under IRC section 414, subdivision (d) (Notice). CalPERS has aligned its eligibility review process for contract applicants to include the definitions and the "facts and circumstances" test set forth in the ANPRM, in addition to the requirements of the PERL. One of the "major" factors in determining an agency's eligibility to participate in a governmental plan is whether "a State (or political subdivision thereof) has fiscal responsibility for the general debts and other liabilities of the entity (including funding responsibility for the employee benefits under the entity's plans)." Therefore, team members recommend further amendments to prohibit the member agencies of a JPA seeking to participate in a public retirement system from limiting their liability for the debts, liabilities, and obligations of the JPA.

Finally, the bill adds an unnecessary section to the Government Code-proposed section 20575.1. This provision appears to be modeled after section 20575, which allows a voluntarily terminating agency to ensure that its employees service at the terminating agency will be credited with their ultimate final compensation. Any voluntarily terminating JPA can already avail itself of this provision.

Budget and Fiscal Impacts

1. Benefit Costs
   Undetermined.

2. Administrative Costs
   CalPERS team members are unable to estimate at this time, the cost to work with the existing contracting 160 JPAs to amend their JPA agreements to apportion liability among the member agencies and, in the event their member agencies are unable to reach mutual agreement, for the System itself to apportion liabilities based on the JPA services each member agency receives, or by population.

   The litigation costs for CalPERS to defend its apportionment determinations, pursue legal action against member agencies and place a lien on the assets of a terminated JPA are undetermined, but may be significant.

Benefits and Risks

1. Benefits:
   - According to the California State Retirees, this bill "will protect employees and retirees of these JPAs by ensuring that their retirement benefits will be paid in full, as promised, even if a JPA dissolves or terminates their contract with a pension system."
   - Ensures that member agencies forming JPAs will be liable for its pension obligations.
   - Makes explicit CalPERS' authority to prohibit a JPA from participating in CalPERS if the JPA's member agencies are not financially liable for the retirement benefits.
   - Helps ensure payment of current and future JPA employees' retirement benefits.

2. Risks:
   - According to the opponents, this measure "gives exclusive authority to the retirement agency to assign liability" and it "would be virtually impossible for the JPAs governmental body, let alone a retirement agency, to retroactively assign equitable retirement specific liabilities to potentially hundreds of agencies."

Attachments

Attachment 1 – Legislative History
Attachment 2 – Support & Opposition

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