CalPERS

Finance and Administration Committee

Agenda Item 6a

September 25, 2018

Item Name: Final Proposed Regulation for Employer Actuarial Liability Significant Increase

Program: Actuarial Office

Item Type: Action

Recommendation

Approve the final 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

This proposed regulation will implement the California Public Employees' Retirement System's (CalPERS) interpretation of GC Section 20791 by defining a significant increase in actuarial liability 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. GC Section 20791 only requires allocation of actuarial liability between CalPERS contracting agencies. Therefore, the actuarial liability of the State and most school employers will not be impacted by GC Section 20791 and the proposed regulation. The 45-day public comment period for the proposed regulation closed on April 2, 2018, wherein CalPERS team members did not receive any public comments. Therefore, the proposed regulation is unmodified from the version the Board of Administration (Board) approved for public comment in November 2017.

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. However, 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.

At the November 2017 Board meeting, CalPERS team members recommended that the following criteria be used to determine when a significant increase in actuarial liability due to increased compensation paid to a nonrepresented employee 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.

GC 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 proposed 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 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.

The Board approved the proposed regulation at the November 2017 Board meeting, after which CalPERS filed a Notice of Proposed Regulatory Action with the Office of Administrative Law (OAL), initiating a 45-day public comment period where interested parties could submit public comments relevant to the proposed regulation. CalPERS team members did not receive any public comments during this period, and thus did not make any changes to the proposed regulation approved by the Board at the November 2017 meeting.

Analysis

The Notice of Proposed Regulatory Action was published in the California Regulatory Notice Register (File Number Z-2018-0205-01) on February 16, 2018. The 45-day comment period commenced on February 16, 2018 and closed on April 2, 2018. CalPERS team members did not receive any public comments or requests for a public hearing during this period.

With Board approval of the final proposed regulation, the rulemaking package will be prepared and submitted to OAL, which has 30 days to review the package. If OAL approves the proposed regulation, OAL will file the regulation with the Secretary of State for official publication in the California Code of Regulations. The regulation is anticipated to be effective by January 2019.

Budget and Fiscal Impacts

CalPERS will incur some administrative costs to comply with GC Section 20791. It is expected that there will be an immediate increased workload to establish internal processes and procedures and review retirements since 2013. The pensionable compensation limit under the Public Employees' Pension Reform Act of 2013 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 – Text of proposed regulation
Attachment 2 – Calculation Example

Nina Ramsey
Senior Actuarial Assistant

Randall Dziubek
Deputy Chief Actuary

Scott Terando
Chief Actuary