



California Public Employees' Retirement System  
P.O. Box 942709  
Sacramento, CA 94229-2709  
(888) CalPERS (or 888-225-7377)  
TTY: (877) 249-7442  
[www.calpers.ca.gov](http://www.calpers.ca.gov)

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## Circular Letter

December 3, 2012

TO: **ALL CALPERS EMPLOYERS**

SUBJECT: **IMPLEMENTATION OF PUBLIC EMPLOYEES' PENSION REFORM ACT OF 2013**

The purpose of this Circular Letter is to confirm CalPERS current interpretation of the Public Employees' Pension Reform Act of 2013 (PEPRA) and related Public Employees' Retirement Law (PERL) amendments in Assembly Bill (AB) 340, passed by the California Legislature on August 31, 2012, and signed by the Governor on September 12, 2012.

Recent news about the enactment of pension reform has generated increased attention and questions from our employers, members, and stakeholders. We created this Circular Letter to provide a summary of the provisions outlined in the bill as they apply to CalPERS retirement and health benefits. We also include information on my|CalPERS system modifications and explain what actions employers need to take to comply with the new provisions that change how they do business with CalPERS.

This Circular Letter is not intended to provide a comprehensive summary of PEPRA and related law changes. The current interpretations discussed below address the key areas of the bill that may directly affect CalPERS interactions with our members and employers. Our pension reform team continues to analyze PEPRA provisions and the resulting impacts. As CalPERS moves ahead with implementing PEPRA and related amendments to the PERL, our interpretations may be revised. CalPERS strongly recommends that all employers review AB 340 in its entirety to understand how the changes in law will affect their organization and employees.

### **MEMBERSHIP AND BENEFIT FORMULAS**

#### ***Definition of a New Member***

A new member is defined in PEPRA as any of the following:

- A new hire who is brought into CalPERS membership for the first time on or after January 1, 2013, and who has no prior membership in any California public retirement system.
- A new hire who is brought into CalPERS membership for the first time on or after January 1, 2013, and who is not eligible for reciprocity with another California public retirement system.

- A member who first established CalPERS membership prior to January 1, 2013, and who is rehired by a different CalPERS employer after a break in service of greater than six months.

Effective January 1, 2013, every new enrollment will be tested against this definition of “new member”, regardless of whether the enrollment is for a first-time CalPERS member or an existing CalPERS member.

It is important to note that if a member has a break in service of more than six months but returns to service with the same employer, the member would not be considered a new member under PEPRA. All State agencies, including CSU, are treated as a single employer under PEPRA, as are all school employers.

CalPERS refers to all members that do not fit within the definition of a new member as “classic members”. All existing CalPERS members as of December 31, 2012, will retain the existing benefit levels for future service with the same employer. Because the new member determination is made on an appointment-by-appointment basis, classic members will be tested against the “new member” definition upon each new appointment and, in some cases, may become “new members” for services under a new appointment. PEPRA does not require retroactive reductions to benefits earned for prior service, even where a member separates from service and is later re-hired as a new member by a new employer and becomes subject to the applicable PEPRA formula. In these cases, the member’s “classic member” service will be calculated separately from his or her service as a “new member”.

CalPERS will develop a form for employers to use when a member hired by a CalPERS agency is considered a classic member as a result of membership with a previous reciprocal retirement system. Employers must complete the form and retain it in the individual’s employment records for auditability purposes.

my|CalPERS will be updated to include fields on the enrollment page where employers will identify if the new hire is coming from a reciprocal agency and prompt the employer for the necessary data elements which subject them to reciprocity. It will be extremely important for employers to properly identify the status of members at the time of hire.

Based on the information provided by the employer, my|CalPERS will automatically determine the proper benefit group for each member. In addition, CalPERS will create for each employer a report identifying their recent enrollments and the correct corresponding formula based on the information provided at enrollment. If an employer believes the enrollment is incorrect, they may contact CalPERS to review and correct the data as necessary. Employers must store, in their own databases, the participant details necessary to categorize individuals as new members or classic members.

**Important!** These system enhancements are not yet available. All member enrollments with an effective date of January 1, 2013, or later should be held until employers receive notification that the transaction may be processed.

Throughout the upcoming months, CalPERS will create and/or update forms and publications to assist employers with enrollment transactions for new members. A Circular Letter will be sent to employers as those resources become available.

### **Benefit Formulas**

The reduced benefit formulas and increased retirement age provisions under PEPRA create new defined benefit formulas for all new miscellaneous (non-safety) and safety members.

For new safety members, the law provides for three possible retirement formulas and requires that new safety members be provided with the new formula that is closest to the formula offered to classic members of the same classification and that provides a lower benefit at 55 years of age than the formula offered to classic members. The three new defined benefit formulas for new safety members include a normal retirement age of 50 and a maximum benefit at age 57.

For all new miscellaneous members, with the exception of State Tier II, the new defined benefit formula is 2% at age 62, with an early retirement age of 52 and a maximum benefit factor of 2.5% at age 67. For State Tier II members, the new formula is 1.25% at age 67.

Please refer to the tables below to see how the reduced benefit formulas compare to current formulas.

<b>Current Miscellaneous Formula</b>	<b>New Miscellaneous Formula</b>
1.5% @ 65	1.5% @ 65 (retain existing formula)
1.25% @ 65	1.25% @ 67
All others	2% @ 62

<b>Current Safety Formula</b>	<b>New Safety Formula</b>
3% @ 50, 3% @ 55, 2% @ 50	2.7% @ 57
2.5% @ 55	2.5% @ 57
2% @ 55, 2.5% @ 60, ½ @ 55	2% @ 57

The new formulas will be implemented in my|CalPERS to take effect on January 1, 2013. The legislatively mandated formulas and provisions will be merged with the employer's existing optional provisions, with some exceptions, effective on December 31, 2012, to create the new benefit groups.

No formal contract amendments are necessary to implement the new mandated benefit groups. CalPERS will work with employers to update the employer's contract(s) either at the time of a future amendment or as soon as practicable. CalPERS estimates that it will take approximately two years to complete this update process for all employers.

## **EMPLOYER AND MEMBER CONTRIBUTIONS**

### ***Normal Cost Contributions***

For public agencies, school employers, CSU, and the judicial branch, a new member's initial contribution rate will be at least 50% of the total normal cost rate for their defined benefit plan or "the current contribution rate of similarly situated employees, whichever is greater", except where it would cause an existing Memorandum of Understanding (MOU) to be impaired. If an employer determines that an existing MOU is impaired, and communicates that decision to CalPERS using the required certification form, then any otherwise impaired contribution rate agreement will apply to new members through the duration of the MOU. Once the impaired MOU is amended, extended, renewed, or expires, the new requirements will apply.

CalPERS interprets "similarly situated members" to mean those employees that are in the same benefit group (meaning those employees with the same benefit formula). The member contribution rate is not required to change for classic members of a public agency or school district.

State employees, including both classic and new members (excluding new CSU members and new judicial branch members), will pay the statutory rates determined through bargaining and provided for by statute. See [Proposed Changes in Member Contribution Rates for State Employees](#) for changes that PEPRA imposes on State member contributions available on CalPERS On-Line.

CalPERS will be sending a letter to each employer this month outlining the benefit formula applicable to new members, as well as the employer and member contribution rates that will be effective January 1, 2013, for new members. For classic members, employers should refer to the June 30, 2011 actuarial valuation report that was mailed in November 2012 to determine what amount reflects 50% of the total normal cost for classic members. In addition, a new report will be added in my|CalPERS that will identify member and corresponding member rates by group and plan. The *Appointment Details and Events* page in my|CalPERS will also display the appropriate contribution rates for members.

Beginning January 1, 2018, public agencies that have collectively bargained in good faith and completed impasse procedures (including mediation and fact-finding) will be able to unilaterally require classic members to pay up to 50% of the total normal cost of their pension benefit. It is important to note that the employee contribution may only be increased up to an 8% contribution rate for miscellaneous members, a 12% contribution rate for local police officers, local firefighters, and county peace officers, or an 11% contribution rate for all other local safety members.

### ***Cost Sharing of Employer Contributions***

Some public agencies have amended their CalPERS contract to have their members pay a portion of the employer's contribution. These contributions are paid in addition to the member contribution rate. Under existing law, such employer cost sharing contract amendments were required to be tied to a benefit improvement. This requirement will be eliminated as of January 1, 2013, when the new amendments to the PERL go into

effect. In addition, under the new law, cost sharing agreements may differ by bargaining unit or for classifications of employees subject to different benefit levels as agreed to in an MOU. The new law also permits cost sharing of the employer costs for non-represented employees as approved in a resolution passed by the public agency.

***Employer Paid Member Contributions (EPMC)***

PEPRA prohibits EPMC for new members, employed by public agencies, school employers, the judicial branch, or CSU, unless an employer's existing MOU would be impaired by this restriction. It is up to each employer to determine if an MOU would be impaired by this restriction on EPMC for new members. The impaired MOU must have an effective date of January 1, 2013, or earlier.

If the employer determines that an existing MOU is impaired, then any stated EPMC agreements will apply to new members through the duration of the MOU. CalPERS must receive the full required member contributions, regardless of the amounts paid by the member or the employer. Once the impaired MOU is amended, extended, renewed, or expires, EPMC will no longer be permitted for new members. CalPERS will implement a manual validation procedure to ensure EPMC is not being reported on payroll for new members.

Employers must notify CalPERS in writing if they determine that their MOU is impaired and provide a certification to CalPERS, signed by the agency's presiding officer, confirming that application of Section 7522.30(c) of PEPRA would cause an existing MOU to be impaired. CalPERS will provide a form to employers for this certification. More information on the certification and the form will be sent to employers in a future Circular Letter.

EPMC may continue to be reported for classic members pursuant to existing PERL provisions. Employers who wish to eliminate or reduce EPMC for classic members are able to do so under existing law through collective bargaining and contract amendments. Existing PERL statutes allow employers to periodically increase, reduce or eliminate employer paid member contributions.

***Pension Holiday***

The combined employer and member contributions required, in any fiscal year, cannot be lower than the total year's normal cost.

Some employers currently have a surplus in their plan and presently pay less than the total normal cost. CalPERS will review each employer in this category and determine whether this provision must be implemented at the start of the next fiscal year. A letter will be sent to affected employers notifying them of their required contribution amounts.

**PENSIONABLE COMPENSATION**

***Compensation Caps***

This provision caps the annual pensionable compensation that can be used to calculate final compensation for new members.

Presently, there is a compensation cap in place for first-time members hired after January 1, 1996. The compensation cap is set by the Internal Revenue Service and is referred to as the 401(a)(17) limit. CalPERS will continue to cap contributions for affected classic members at the 401(a)(17) limit.

New member contribution caps are effective January 1, 2013. The new member cap for 2013 will be \$113,700 (100% of the 2013 Social Security contribution and benefit base) for members that participate in Social Security or \$136,440 (120% of the 2013 contribution and benefit base) for those employees that do not participate in Social Security. Adjustments to the caps are permitted annually based on changes to the Consumer Price Index for All Urban Consumers.

Employers will report full pay rate and actual earnings for all members in my|CalPERS and the system will flag and notify the employer when the contribution limit has been reached for that calendar year. Member contributions must stop when the member's actual earnings reach the contribution limits outlined above.

Note that this does not necessitate a change to your file formatting structure; rather it is related to how employers track and report payroll. Reporting up to the compensation cap for new members will occur in the same manner it does currently for classic members subject to the 401(a)(17) limit.

Currently, CalPERS does not cap employer contributions at the 401(a)(17) limit and we do not intend to cap employer contributions at the PEPRA limits for at least the next two years. We are conducting further analysis to determine if employer contributions will be capped beginning with the 2015/2016 fiscal year. We will share the new information with you in a future Circular Letter once a final decision has been made.

### ***Three-Year Final Compensation***

PEPRA requires that a three-year final compensation period be used to calculate the average final compensation for a retirement calculation for all new members. Some employers, including the State, already provide for a three-year final compensation period.

Public employers are also prohibited from adopting a final compensation period of less than three years for classic members who are currently subject to three-year final compensation.

### ***Pensionable Compensation***

PEPRA introduces a new term "pensionable compensation" for the purposes of determining reportable compensation for new members. PEPRA broadly defines pensionable compensation, and while it specifically excludes some forms of compensation, it does not clearly identify which forms of pay fall within the scope of pensionable compensation. CalPERS is evaluating what forms of compensation are considered as pensionable compensation and how they should be reported. We will update employers on this issue in a future Circular Letter that we anticipate will be sent later this month.

### ***Excessive Compensation***

This new PERL provision requires the CalPERS Board to “define a significant increase in actuarial liability due to increased compensation paid to a non-represented employee”. The Board is further directed to implement program changes to ensure that a public agency that creates a significant increase in actuarial liability bears the increased cost associated with that liability.

CalPERS will develop the program changes necessary to assess the cost of excessive compensation to the employer that paid the excessive compensation. This provision will apply to any significant increase in actuarial liability that is determined after January 1, 2013, regardless of when excessive compensation was paid.

CalPERS is working to develop the program changes and definitions necessary to administer these provisions and anticipates promulgating regulations to address these new requirements. Updates on this issue will be provided to employers in a future Circular Letter.

### **WORKING AFTER RETIREMENT**

PEPRA includes two provisions applicable to working after retirement. These provisions include restrictions, including, but not limited to:

- All employees who retire from public service will be prohibited from working more than 960 hours per calendar or fiscal year for any public employer in the same public retirement system that the individual is retired from without reinstating from retirement.
- A 180-day waiting period is required for all employees who retire from a public employer before a retiree can return to work without reinstating from retirement, except under certain specified circumstances. The 180-day waiting period starts from the date of retirement.
- Any public retiree appointed to a full-time position on a State board or commission will be required to suspend their retirement allowance and become an active member of CalPERS, unless the appointment is non-salaried.

As currently required, employers must continue to report in my|CalPERS all the hours worked by any CalPERS retired annuitant in order to monitor the 960-hour cap per fiscal year. CalPERS retirees who are hired as independent contractors or consultants with a direct relationship, for purposes of this section, are considered retired annuitants and must also be reported and tracked in my|CalPERS.

The 180-day waiting period provision applies without exception to retirees who receive either a golden handshake or some other employer incentive to retire. Retired annuitants who started working before January 1, 2013, are not impacted by the 180-day waiting period.

my|CalPERS plans to validate the 180-day waiting period for all new enrollments and will flag any potential violations of this waiting period for additional review. Potential violations will not prohibit the online my|CalPERS enrollment; however, when enrolling a retiree under the certification-resolution exception to the 180-day waiting period, the

employer must submit a copy of the certification-resolution to CalPERS. The rest of the enrollment process will remain the same as today.

## **PENSION AND HEALTH BENEFIT CHANGES**

### ***Industrial Disability Retirement (IDR) Benefits***

In addition to the current calculation options of the IDR benefit for a member, this provision adds a calculation for a safety member who qualifies for an IDR that may result in a higher benefit than 50% of salary. An actuarial reduced retirement formula, as determined by the actuary for each quarter year of service age less than 50, will be used to determine if the IDR benefit is greater for the safety member who qualifies for IDR. These provisions remain in effect only until January 1, 2018. After that date, the new IDR provisions will not apply unless the date is extended by statute.

### ***Retroactive Pension Benefit Enhancements***

Public employers will be prohibited from granting retroactive pension benefit enhancements that would apply to service performed prior to the operative date of the enhancement. An increase to a retiree's annual cost-of-living adjustment within existing statutory limits is not considered to be an enhancement to a retirement benefit.

CalPERS will develop a list of those existing optional benefits that are considered to be retirement benefit enhancements and therefore subject to this restriction. CalPERS also plans to promulgate a regulation interpreting and clarifying this provision. Additional information will be sent to employers in a future Circular Letter.

### ***Replacement Benefit Plans***

PEPRA prohibits public employers from providing new employees a plan of replacement benefits to supplement retirement benefits that are limited by Internal Revenue Code Section 415(b). This provision also prohibits public employers from offering a replacement benefit plan to any employee group that was not provided this benefit prior to January 1, 2013.

CalPERS will continue to offer replacement benefit plans for classic members not impacted by this provision.

### ***Health Benefit Vesting Schedule***

This provision generally prohibits employers from providing a more advantageous health benefit vesting schedule to certain individuals (namely a public employee who is elected or appointed, a trustee, excluded from collective bargaining, exempt from civil service, or a manager) than it does for other public employees, including represented employees, of the same public employer who are in related retirement membership classifications. In the event that bargaining groups under one employer have established different vesting schedules, the non-represented employees must align with the least advantageous of the groups in related membership classifications, such as State miscellaneous.



If an employer has established tiered vesting schedules based upon date of hire, then all non-represented employees must be subject to the same tiered vesting schedules as represented employees of the same membership classifications.

***Additional Retirement Service Credit (ARSC)***

The ability to purchase non-qualified service, or “airtime”, will be eliminated on January 1, 2013. An official application must be submitted and stamped as received by CalPERS on or before December 31, 2012. Only applications from individuals who qualify to purchase ARSC on or before December 31, 2012, will be accepted. CalPERS is reviewing whether other types of nonqualified service credit may be impacted by this prohibition.

The prohibition on future “airtime” service credit purchases does not prohibit purchases of qualified service credit. For example, service credit purchases for qualified military service will still be allowed.

***Felony Forfeiture of Pension Benefits***

Any current or future public official or employee convicted of a felony while carrying out his or her official duties, in seeking an elected office or appointment, and/or in connection with obtaining salary or pension benefits, will be required to forfeit any pension or related benefit earned from the date of the commission of the felony.

**OTHER RETIREMENT PROGRAMS**

***Alternate Retirement Program (ARP)***

ARP, a retirement savings program that certain State employees are automatically enrolled in for two years from their initial hire date, will be eliminated. The bill provides that all new members hired on or after July 1, 2013, will no longer be enrolled in the program. An urgency legislative amendment was introduced to change the ARP elimination date from July 1, 2013 to January 1, 2013. CalPERS will continue to monitor the bill and work with the State Controller’s Office and the California Department of Human Resources to determine how to enroll new State miscellaneous and industrial members beginning January 1, 2013. Once a process has been identified, we will notify State employers.

Members currently enrolled in ARP will continue to participate in ARP pursuant to existing statutory requirements.

CalPERS does not administer ARP. For program details on the ARP savings plan, contact the California Department of Human Resources at [www.calhr.ca.gov](http://www.calhr.ca.gov).

***Legislative Retirement System (LRS)***

These provisions prohibit new members, including constitutional, statutory elected officers and the Insurance Commissioner, who assume office for the first time on or after January 1, 2013, from enrolling in LRS. Members already enrolled in LRS prior to January 1, 2013, will continue to participate in the plan until they separate or retire.

my|CalPERS will be modified to remove LRS enrollment as an option for new members. The current process that allows new members to elect optional membership into CalPERS will not change.

### **ADDITIONAL INFORMATION**

#### ***CalPERS On-Line***

For more information on PEPRA and how it impacts current and future CalPERS members, visit the [Pension Reform Impacts](http://www.calpers.ca.gov) page on CalPERS On-Line at [www.calpers.ca.gov](http://www.calpers.ca.gov). This page features the latest updates regarding PEPRA including a question and answer section and links to additional resources. In addition, the video "Pension Reform: A Discussion with CalPERS Experts" highlights how pension reform impacts employers.

#### ***Teleconferences***

CalPERS will conduct a series of teleconferences to address questions you may have relating to the information in this Circular Letter. Please register online via the [Pension Reform Impacts](http://www.calpers.ca.gov) page.

<b>Date</b>	<b>Time</b>	<b>Agency Type</b>
Dec 10	9:30 to 11:30 am	Public Agency
Dec 10	1:30 to 3:30 pm	School
Dec 11	9:30 to 11:30 am	State
Dec 12	9:30 to 11:30 am	Public Agency
Dec 13	9:30 to 11:30 am	School
Dec 14	9:30 to 11:30 am	State

#### ***my|CalPERS Changes***

CalPERS will provide more detailed information regarding my|CalPERS changes in the coming weeks.

#### ***Contact Us***

Please share this information with your employees to help answer their questions and provide additional information on the changes. If you have any questions, please call the CalPERS Customer Contact Center at **888 CalPERS** (or **888-225-7377**).

KAREN DeFRANK, Chief  
Customer Account Services Division