Attachment 1

California Public Employees' Retirement System
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Preliminary Analysis of the Conference Committee Report (AB 340)

August 30, 2012

INTRODUCTION

On August 28, 2012, the Conference Committee on Public Employee Pensions released its Conference Report (Report) and voted to send it to the Legislative Floor for an up or down vote. The Report is the culmination of many months of analysis and investigation into public pensions in California.

This preliminary analysis is based on CalPERS staff's initial review of the Report and addresses the various proposals in contrast to existing law, pros and cons, and operational and implementation issues A much more detailed review and vetting would be needed for full understanding and implementation, and we expect that this process would reveal areas where clarification, including technical amendments, would be needed if this Report is enacted as statute. These comments are not intended to address all issues that could arise if the bill becomes law.

ANALYSIS

Changes in Retirement Benefits

1. **Reduced Benefit Formulas & Increased Retirement Ages**

The Report would create a new defined benefit formula of 2% at age 62 for non-safety public employees with an early retirement age of 52 and a maximum benefit factor of 2.5% at age 67. The Report would further create three new defined benefit formulas for public safety employees with a normal retirement age of 50 and a maximum retirement age at 57, as follows:

	Earliest Ret Age	Maximum Factor Age
Basic Formula	1.426% at Age 50	2% at Age 57
Option Plan 1	2% at Age 50	2.5% at Age 57
Option Plan 2	2% at Age 50	2.7% at Age 57

The safety formula offered by the employer would be the formula that is closest to and provides a lower benefit at age 55, than the formula provided to members in the same retirement classifications offered by the employer on December 31, 2012. However, employers and employees in the Option Plan One or Option Plan 2 could agree in a Memorandum of Understanding (MOU) to be subject to a lower plan option subject to other requirements.

The Report would require that all State, school, and local employers offer public employees, excluding judges, who first become members on or after January 1, 2013, as specified, one of these newly created benefit formulas unless a lower benefit is already in place. However, these requirements would not apply to the University of California and charter cities and charter counties that do not participate in CalPERS or a 1937 Act County Retirement System.

For purposes of this provision a “new member” would be defined as: (a) An individual who has never been a member of any public retirement system prior to January 1, 2013; (b) an individual who has moved between retirement systems and was not subject to reciprocity, as specified; or (c) an individual who has moved between public employers within a retirement system after a break in service that is greater than six months as specified. A change in employment between state entities or from one school employer to another is not considered as service with a new employer.

Finally, all new State miscellaneous and industrial members would no longer be required to participate in the Alternate Retirement Plan (ARP), although employees hired before July 1, 2013 would continue to participate in the ARP. (Note: The bill says July 1, 2013 but we believe this was a drafting error and should be January 1, 2013.)

Current Law

CalPERS provides a defined benefit plan for employees of the State of California, more than 1,500 school districts, and nearly 1,600 contracting public agencies. Benefits paid under the State and school plans are determined by statute and typically through the ratification of a MOU between the employer and its employees. For State employees, this occurred as recently as 2011. The table below shows the benefit formulas by retirement category that were agreed to through negotiations for all new State employees over the last two years. The effective date of these new formulas varied by bargaining unit with most going in effect on October 15, 2010 and the last one becoming effective on January 15, 2011. The school plan has not changed since the year 2000 and provides a benefit formula of 2 percent at age 55.

Retirement Category	Benefit Formula		
	Earliest Retirement Age	Normal Retirement Age	Maximum Factor Age
State Miscellaneous	1.092% at Age 50	2% at Age 60	2.418% at Age 63
State Industrial	1.092% at Age 50	2% at Age 60	2.418% at Age 63
State Safety (BU 12, 16, 18 & 19)	1.426% at Age 50	2% at Age 55	2.5% at Age 60
State Safety (Other BU)	1.426% at Age 50	2% at Age 55	
POFF (BU 8)	2.4% at Age 50	3% at Age 55	
POFF (Other BU)	2% at Age 50	2.5% at Age 55	
CHP	2.4% at Age 50	3% at Age 55	

Local public agencies can select from a variety of benefit formulas set in statute. Most local public agencies adopting a new benefit formula do so after completing contract negotiations with their employee groups. The table below lists the benefit formula options and the percentage of employer rate plans in each formula as of the June 30, 2011 annual valuations.

<table>
<tr><th colspan="4">Percentage of Local Miscellaneous Plans by Benefit Formula</th></tr>
<tr><td>Earliest Retirement Age</td><td>Normal Retirement Age</td><td>Maximum Factor Age</td><td>% of Plans</td></tr>
<tr><td>1.092% at Age 50</td><td>2% at Age 60</td><td>2.418% at Age 63</td><td>18%</td></tr>
<tr><td>1.426% at Age 50</td><td>2% at Age 55</td><td>2.418% at Age 63</td><td>51%</td></tr>
<tr><td>2% at Age 50</td><td colspan="2">2.5% at Age 55</td><td>11%</td></tr>
<tr><td>2% at Age 50</td><td colspan="2">2.7% at Age 55</td><td>13%</td></tr>
<tr><td>2% at Age 50</td><td colspan="2">3% at Age 60</td><td>6%</td></tr>
<tr><th colspan="4">Percentage of Local Safety Plans by Benefit Formula</th></tr>
<tr><td>Earliest Retirement Age</td><td>Normal Retirement Age</td><td>Maximum Factor Age</td><td>% of Plans</td></tr>
<tr><td>1.426% at Age 50</td><td colspan="2">2% at Age 55</td><td>7%</td></tr>
<tr><td>2% at Age 50</td><td>2% at Age 50</td><td>2.7% at Age 55</td><td>13%</td></tr>
<tr><td colspan="3">3% at Age 55</td><td>20%</td></tr>
<tr><td colspan="3">3% at Age 50</td><td>60%</td></tr>
</table>

Comments

The impact on employers and employees would vary based on each employer's current level of benefits and whether the employees had previously elected as a group not to participate in Social Security. To the extent that the new formulas lower the retirement benefit, employer contribution rates would decrease over time as current employees retire and employees subject to the new formulas make up a larger percentage of the workforce. This change would, in some circumstances, result in a lower retirement benefit for employees than they currently earn.

For example, currently the average State Miscellaneous employee retires at age 60 with 23 years of service. Based on this average and the current 2 percent at age 60 benefit formula, a State Miscellaneous employee would receive 46 percent of his or her final compensation at retirement. Under the proposed formula, however, this same State employee would only receive 41.4 percent of his or her final compensation at retirement. An even bigger difference results when the proposed miscellaneous formula is compared to the most popular local miscellaneous formula of 2 percent at age 55 which would provide 53 percent of final compensation at age 60 with 23 years of service. A similar difference would result when the most popular local safety formula, 3 percent at age 50, with the new proposed safety option plan two formula. For a local safety employee that retires with 25 years of service at age 54, the current 3 percent at age 50 formula would result in a benefit of 75 percent of final compensation, while the proposed safety option plan two formula would result in a benefit of 60 percent of final compensation.

2. **<u>Cap Compensation Earnable for the Purposes of Calculating Pension Benefits</u>**

The Report would limit the amount of compensation that may be used to calculate the retirement benefit for new members, excluding judges, hired after January 1, 2013 to 100 percent of the amount of earnings subject to taxation by the Social Security's Old-Age, Survivors, and Disability Insurance Program, otherwise known as the "Contribution and

Benefit Base," for those employees participating in Social Security, or 120 percent of the Social Security contribution and benefit base for those employees not participating in Social Security. For earnings in 2012, the contribution and benefit base is $110,100. The compensation cap would be adjusted annually based on changes in the Consumer Price Index (CPI) for all Urban Consumers. In addition, the Legislature would reserve the right to modify the annual CPI adjustments to the compensation cap prospectively.

A public employer would also be prohibited from offering a defined benefit or any combination of defined benefits, including a defined benefit offered by a private provider, on compensation in excess of this limitation. However, the employer could contribute to a defined contribution plan on behalf of an employee for compensation in excess of the limitation, subject to some limitations.

Current Law

Current State law imposes benefit limits, as a percentage of final compensation, on safety employees. The pensions for safety employees for both the State and local agencies are capped at either 80 percent or 90 percent of final compensation, depending on employment classification. Miscellaneous public employees are not subject to similar pension limits, although generally are covered by lower benefit formulas and are generally unlikely to reach 80 or 90 percent of final compensation.

Internal Revenue Code (IRC) 401(a)(17) already limits the amount of annual compensation that may be taken into account for purposes of determining retirement benefits paid by a pension plan to employees who were first hired on or after July 1, 1996. For 2012, the IRC 401(a)(17) limit is $250,000. This amount is adjusted annually for inflation.

Comments

In general, this change would not impact the pension benefits of the majority of CalPERS members. For new members earning more than the Social Security contribution and benefit base, however, this change would result in a lower CalPERS retirement benefit (but could appear to result in a modest increase in take home pay since the employee's contribution to the retirement fund would be based on a capped amount and hence smaller). It is possible that this change could ultimately have an adverse impact on public sector recruitment in areas that have historically experienced recruitment challenges due to higher pay for similar jobs in the private sector.

3. **<u>Members to Contribute At Least One-Half of the Total Annual Normal Cost</u>**

This Report would require all new members, as defined, to contribute at least 50 percent of the total annual normal cost of their pension benefit to the pension plan as determined by the actuary. An employee contribution could be more than 50 percent of the total annual normal cost if an increased contribution rate has been agreed to through the collective bargaining process and agreed to in an MOU, subject to additional requirements.

The bill establishes the standard of equal cost-sharing between the State and its employees. This standard creates the expectation that employees pay at least 50 percent of the normal cost for pensions, and finds that this equal sharing is currently the standard for most State employees, such as State miscellaneous employees. In addition, exempt employees, such as managers and appointees outside the civil service, are subject to the same contribution rate increases as their associated rank and file members shown in the table below. In addition, any savings realized by the State as a result of these additional employee contributions would be required to be allocated to any unfunded liability, subject to appropriation in the annual budget act.

	Employee Contribution Rates		
	Current	July 1, 2013	July 1, 2014
POFF BU 6	9%	10%	11%
State Safety (BU 1,3,4,7,9,10,11,14,15,17,20,21)	9%	10%	11%
POFF (BU 7 & 8)	10%	11.5%	13%
Industrial	8%	9%	
Tier II (State Misc. & Ind.)	0%	1.5%	
State Safety (BU 2)	10%	11%	
State Misc (BU 5)	10%	11%	
CHP	10%	11.5%	

For contracting agencies and school districts, the intent would be to increase the employee's contribution to 50 percent of the total annual normal cost through collective bargaining. However, if that is not accomplished through negotiations by 2018, the employer could increase employee contributions up to eight percent of pay for local miscellaneous and school members, up to 12 percent of pay for local police, firefighters, and county peace officers, and up to 11 percent of pay for all other local safety members.

Current Law

Normal cost is the contribution amount determined by the plan actuaries as necessary to fund an employee's benefit if specific investment and economic assumptions are met. When plan assets fall below this amount, such as when the investment and economic assumptions are not met, unfunded liability is created. Contributions toward annual pension costs generally come from both employees and employers. The employee contribution rate is generally fixed by statute or MOU, and typically varies from approximately five percent to 11 percent of an employee's salary. For employees who are contributing to Social Security, the pension contribution is in addition to their contribution to Social Security. The employer contribution is determined on an annual basis by CalPERS actuaries and includes normal costs and unfunded liabilities.

A provision in the Public Employees' Retirement Law (PERL) permits employee sharing of the cost of benefit improvements by amending the employer's contract with CalPERS.

Comments

This proposal would likely have a more significant impact on safety members than miscellaneous members because the normal cost for safety members is generally higher. This impact would be mitigated to the extent that new employees would be subject to a somewhat lower benefit formula. This proposal would add administrative workload to educate and inform all members annually about their upcoming contribution rates.

4. **Close Legislators' Retirement System (LRS) to New Members**

This Report would close the LRS to new members by prohibiting statewide constitutional officers and legislative statutory officers newly elected on or after January 1, 2013 from participating in the LRS. However, these individuals would be eligible for membership in CalPERS, as they are under current statute.

Current Law

The LRS was established in 1947. Members originally covered under the LRS include:
- Assembly and Senate Members
- Constitutional Officers
- Legislative Statutory Officers (Secretary of the Senate, Chief Clerk of the Assembly, Sergeant at Arms of the Senate, and Sergeant at Arms of the Assembly.)

In 1990, Proposition 140 amended the State Constitution (Section 4.5 of Article IV) to preclude Senate and Assembly members first elected on or after November 7, 1990 from participating in any retirement system other than the federal Social Security program. Senate and Assembly members elected before the passage of Proposition 140 are allowed to continue their membership in LRS.

Since 1990, the only new members allowed into the LRS are Constitutional Officers and Legislative Statutory Officers. There are currently only 14 active members of the LRS.

Comments

There do not appear to be significant disadvantages to closing the LRS to new members from an operational perspective. The Report does not appear to specifically address ongoing funding for the current and retired members of LRS, but we assume that the Legislature would continue to fund the LRS appropriately.

5. **Imposing Federal Contribution and Benefit Limits**

The Report would require all public retirement systems in California to adhere to the federal compensation limit under IRC Section 401(a)(17) for members who first join the retirement system on or after January 1, 2013. In addition, the Report would prohibit public retirement systems from administering a Replacement Benefit Plan (RBP) for any person who becomes a member of a specific system, such as CalPERS, on or after January 1, 2013.

Current Law

Among many key requirements for tax-qualified pension plans, federal law imposes a limit on the annual benefit amount that may be paid by a plan to a member and a limit on the annual compensation amount that can be used to compute retirement benefits, as follows:

- IRC 401(a)(17) limits the amount of annual compensation that may be taken into account for purposes of determining retirement benefits paid by a pension plan. This does not limit the salary a member may be paid; it limits the amount of salary that may be counted toward pension benefits. This limit is adjusted annually for inflation, and in 2012, the IRC 401(a)(17) limit is $250,000.The IRC 401(a)(17) limit applies to employees who were first hired on or after July 1, 1996.

- IRC 415(b) limits the annual benefit a member can receive from a pension plan. This limit is adjusted annually for inflation, and varies depending on the age of the member at retirement, among other factors. In 2012, the IRC 415(b) limit for a member who retires at 62 with a straight-life annuity is $200,000.

- Determination of whether a member's retirement benefit will be subject to the IRC 415(b) limit is made at retirement. The benefit limit is lower for members that retire before age 62 and certain safety employees.

- Some "grandfathered" members are not subject to the IRC 415(b) limitation and can receive higher benefits. They include persons who were members of CalPERS prior to January 1, 1990, provided the employer has provided no new or enhanced benefits since October 14, 1987 (e.g., one-year instead of three-year final compensation). However, if the employer has made a change in benefits since October 14, 1987, any increase in the allowance due to the enhanced benefit is not included in the "grandfathered" benefit, and is subject to the benefit limits.

For CalPERS members with a pension benefit amount that would be in excess of the IRC 415(b) limit (generally, $200,000 in 2012), the PERL provides for payment of the excess amount through the CalPERS-administered Replacement Benefit Plan (RBP), which is separate from the pension trust fund. The RBP permits the payment of benefits that exceed the IRC 415(b) limit. RBP payments are made on a quarterly basis and are treated as wages to the retiree. Because pension trust fund assets are not used to pay RBP benefits, the RBP operates on a pay-as-you-go basis. The RBP may not be used to pay benefits that exceed the IRC 401(a)(17) limit, if applicable, (in 2012, $250,000 of compensation that may be taken into account to determine benefits).

Comments

This change would not significantly impact CalPERS benefits or the administration of the System because CalPERS currently adheres to the federal compensation limit under IRC 401(a)(17) for all members to whom that section applies. In addition, this requirement would operate in concert with the limitation on pensionable income at 100 percent of Social

Security wage and contribution base so members would not achieve a retirement benefit at levels that would trigger federal statutory limits.

6. **Equal Health Benefit Vesting for Non-Represented and Represented Employees**

The Report would prevent a public employer from providing specific employees with health benefit vesting that is more advantageous than that provided generally to other public employees, including represented employees, of the same public employer who are in related retirement membership classification. Specifically, this prohibition would apply to employees who are: elected or appointed, a trustee, excluded from collective bargaining, exempt from civil service or an excluded manager.

Current Law

The CalPERS Health Benefits Program (Program) is governed by the Public Employees' Medical and Hospital Care Act (PEMHCA), and is administered by the CalPERS Board of Administration (Board). Every year, the Board determines health plan availability, covered benefits, health premiums, and co-payments. The Program purchases health benefits for the State of California and more than 1,100 public agency and school employers. The benefit design does not vary.

While the State is mandated into PEMHCA by statute, public agencies and school districts can elect to contract with CalPERS more selectively. This allows separate employee groups to negotiate different contribution levels and vesting schedules with their employers. A separate employee group can be based on an employee's member classification, bargaining unit, or excluded status.

Comments

This change would not significantly impact CalPERS benefits or the administration of the System.

7. **Prohibit Purchases of Airtime**

The Report would prohibit any member, current or future, of a public retirement system from purchasing nonqualified service, commonly referred to as "airtime," after January 1, 2013, unless the member had an official application on file with a public retirement system prior to January 1, 2013. This prohibition would not apply to other service credit purchases that do not fall within the scope of IRC Section 415(n)(3)(C), such as service credit purchases for military leave, maternity leave or service prior to membership.

Current Law

The IRC provides that a defined benefit plan, such as CalPERS, may permit members to purchase up to five years of nonqualified service credit, so called because it does not correspond to any service actually performed for a participating employer, subject to certain limitations described in the IRC. The amount of service that may be purchased under this provision cannot exceed five years, and a member purchasing nonqualified service credit must have been a participant in the retirement plan for at least five years before being eligible to purchase the nonqualified service.

State law, enacted in 2003, allows eligible active CalPERS members with at least five years of credited State service to purchase up to five years of Additional Retirement Service Credit (ARSC). Inactive and retired members are ineligible for this purchase unless they make their election while still active members. Only one service credit purchase may be made by a member, even if the member chooses to purchase less than the maximum of five years, and credit must be purchased in whole-year increments. Approximately 49,000 members have elected to purchase ARSC. Of that total, 34,000 members have completed their payments for the service credits and the remaining members continue to make payments under installment plans.

ARSC is intended to be cost-neutral to employers. The member pays the full present value cost of the additional service credit. That cost is an estimate that includes assumptions with respect to the age at retirement, salary at retirement, age at death, and the retirement system's investment return.

Comments

While service credit purchases on a present value method are not expected to increase employer contributions, they do increase the risk to the employer in the form of higher volatility in employer rates if underlying assumptions, such as investment returns, do not occur as expected in the future. As such, this Report would appear to create neither a significant cost increase nor savings to the employer. It would, however, result in lowering risk to employers.

The Legislature provided public employees the option to purchase "airtime" in 2003, and therefore has the authority to remove this option for new public employees. However, eliminating this service credit purchase option for existing members of the retirement system may be subject to legal challenge on the basis that it is an impairment of vested rights.

Additional Protection for the Trust

1. **<u>Prohibit Retroactive Pension Increases</u>**

The Report would prohibit public employers from granting retroactive pension benefit increases to current and future employees. Pension benefit increases could not be applied to service credit earned prior to the effective date of the contract amendment.

Current Law

Under current law, the State is authorized to negotiate with designated employee-representative organizations for retirement and other benefit formulas. Most contracting agencies also engage in collective bargaining to determine employee salary and benefits. When employers agree to improve age and/or benefit factors for their employees who participate in CalPERS various retirement plans, the requires that the improved benefit formula apply not only to services rendered by active members on or after the effective date of the contract, but also to past service rendered for that employer by active members.

Comments

The application of this requirement to new employees would not appear to have a significant impact since the Report would also establish a maximum benefit formula for new employees. To the extent public employers might seek to provide retirement benefit formula increases to current employees in the future, this provision would reduce the costs to increase benefit formulas because increased formulas would not apply retroactively, and would reduce employer rate volatility that would otherwise be triggered by retroactive formula increases.

2. **Prohibit Pension Holidays**

The Report would require that the contribution to the defined benefit plan by the employer and employee would not be less than the total annual normal cost for the plan year.

Current Law

Retirement boards have exclusive actuarial authority and the responsibility to establish employer contribution rates that properly fund the retirement benefits of its members, as established by the State Constitution and by statute. Employees typically contribute a fixed percentage of their earnings to the plan. The employee contribution rate is generally fixed by statute or MOU. The employer contribution for a fiscal year is generally the difference between the employee contribution and the amount necessary to fund the system.

Employer rates are based on the actuarial accrued liability. The actuarial accrued liability is usually the amount needed on hand to pay for all accrued benefits. If assets on hand exceed the actuarial accrued liability, then the employer rate would be less than the normal cost of benefits. If the assets are less than the actuarial accrued liability, the employer rate would be greater than the normal cost of benefits.

Comments

In 2005, the Board adopted an Employer Rate Stabilization Policy (Policy) to help reduce volatility in employer contribution rates. This Policy made changes to the Board's existing actuarial asset smoothing and amortization policies, and added a new minimum contribution policy. In order to minimize employer contribution holidays, this Policy requires that any surplus be amortized over a period of 30 years. Under this Policy, employers can still obtain a full contribution holiday especially if they are very well funded. The 30-year period was selected to be consistent with the Governmental Accounting Standards Board (GASB) requirement that any surplus cannot be amortized over a period exceeding 30 years.

For those situations when an employer's plan is 100 percent funded, the Report would still require employer contributions which would strengthen the trust. This provision appears to apply to the employer, not to CalPERS, and hence appears to be consistent with the Board's constitutional authority to set rates.

3. **Calculate Benefits Based on Regular, Recurring Pay**

This Report would define, for the purposes of determining new members' retirement benefits, "pensionable compensation" as a member's normal monthly rate of pay or base pay paid in cash to similarly situated members of the same employment group or class for services rendered on a full-time basis during normal working hours, pursuant to a publicly available pay schedule. Further, "pensionable compensation" could not exceed 100 percent of the federal Social Security contribution and benefit base for members participating in Social Security or 120 percent for members not participating in Social Security.

"Pensionable compensation" would not include any of the following:

- Any compensation paid to increase a member's retirement benefit;
- Compensation that has been provided in-kind to the member or paid to a third-party and converted to a cash payment to the member;
- Any one-time or ad hoc payment;
- Severance payments received by the member while still employed;
- Payments for unused vacation, annual leave, personal leave, sick leave, or compensatory time off;
- Payments for additional services rendered outside normal working hours;
- Any employer-provided payments or allowances for housing, vehicles, or uniforms;
- Any overtime pay, except as specified;
- Employer contributions to deferred compensation or defined contribution plans;
- Any bonus;
- Any form of compensation a public retirement board determines is inconsistent with the definition in this code section; and
- Any other form of compensation a public retirement board determines should not be pensionable compensation.

For new members, final compensation would be determined using the highest three-year average of "pensionable compensation."

Current Law

The current definition of final compensation is the highest average "compensation earnable" by a member during 12 or 36 consecutive months of employment at any time during employment with a CalPERS-covered employer. For CalPERS purposes, "compensation earnable" is comprised of *pay rate* and *special compensation* and must be in written schedules, ordinances, or similar documents that are available for public scrutiny.

Pay rate means the normal monthly rate of pay or base pay of the member pursuant to publically available pay schedules paid in cash to similarly situated members of the same group or class of employment for services rendered on a full-time basis during normal working hours. Special compensation is limited to compensation that is received by a member pursuant to a labor policy or agreement for similarly situated members of a group or class of employment and is reported in addition to and separately from pay rate.

Comments

This change would have a more significant impact on local agency safety members than miscellaneous members because historically more than 95 percent of local safety members have received special compensation that is creditable to their pension benefits. Using regular rates of pay to calculate the final compensation for new employees would protect the pension trust by reducing compensation volatility

4. **Require Three-Year Final Compensation**

The Report would require that pension systems determine the final compensation for all employees hired on or after January 1, 2013 based on the employee's highest annual compensation earnable averaged over a consecutive 36-month period.

Current Law

Under current law, State employees hired on and after January 15, 2011, have their final compensation amount determined by the highest average compensation earnable earned in a 36-month consecutive time period. School members are currently subject to a final compensation period of 12 months.

Local government employers have the option to contract for final compensation periods of either 12 months or 36 months. Currently, 62 percent of local agency miscellaneous plans are subject to a final compensation amount determined by the highest average compensation earned in a 12-month consecutive time period and 71 percent of local agency safety plans use a 12-month consecutive time period.

Comments

This provision would not result in any change for State employees, but would have an impact on school districts. The impact on local contracting agencies would depend on whether each contracting agency has contracted for one-year or three-year final compensation. For those employers that are required to move to a three-year final compensation period for new employees, this provision would add protection to the pension trust by spreading compensation changes over a longer period of time. This provision would streamline CalPERS administration over time by aligning calculation methodologies.

5. **Final Compensation for Local Elected Members**

This Report would require the final compensation for local elected members first elected on or after January 1, 2013 to be based on the highest average annual pensionable compensation earned by the member during the period of service as a local elected member. If local elected member's service is less than 36 months, the entire period of that individual's service would be used to determine the final compensation.

Current Law

Current law provides "optional" membership to some officials elected or appointed to a fixed term of office with a city or county. Optional members of CalPERS are excluded from membership unless and until they elect such membership.

For local officials elected on or after July 1, 1994, current law requires that the final compensation for credit earned for service as a local elected member be based on the highest average annual compensation earned in the city or county elective service.

Comments

This provision would not impact CalPERS because currently, local elected members' CalPERS pension benefits associated with that city or county elective service are calculated using the final compensation earned for such city or county elective service.

Broader Employment Issues

1. **Felons Forfeit Pension Benefits**

The Report would expand the existing felony forfeiture provision to apply to all current and future public employees and would expand the list of felonies covered by that provision to include:

1. A felony for conduct arising out of or in the performance of the public employee's official duties, in pursuit of the office or appointment, or in connection with obtaining salary, disability retirement, service retirement, or other benefits; and
2. A felony that was committed within the scope of a public employee's official duties against or involving a child who he or she has contact with as part of his or her official duties.

A public employee convicted of a felony under these circumstances by a state or federal trial court under state or federal law would forfeit all of the retirement benefits earned or accrued after the date of the commission of the felony.

Current Law

In limited circumstances, current law requires elected officials who are elected or reelected to public office on or after January 1, 2006, and who are convicted of a felony involving accepting or giving or offering to give any bribe, embezzlement of public funds, extortion or theft of public money, perjury, or conspiracy to commit such crimes arising directly out of his or her official duties as an elected public officer, to forfeit all rights and benefits under and membership in any public retirement system that are attributable to service in the public office held when the felony occurred. To the extent the member might be eligible for health benefit vesting, the forfeiture of retirement service credit can result in the loss of health benefit coverage as well.

Comments

This proposal would expand felony forfeiture provisions that currently apply to elected public officials by expanding the scope of felonies covered and by applying them to all current and future public employees. Although the Legislature has the authority to apply these provisions to newly hired public employees, application to current employees may not be constitutional in all cases. Therefore, this provision could be subject to legal challenge based on the argument that it impairs the vested rights of current members of the pension system.

2. **Limit Post-Retirement Public Employment**

The Report would make the following changes to post-employment rules:

- Limit all employees who retire from public service from working more than 960 hours or 120 days per year for any public employer in the same public retirement system from which the retiree receives benefits.
- Require a 180-day "sit-out" period before a retiree could return to work except under the following circumstances:
  - The governing body of the employer in a public meeting certifies that the appointment is necessary to fill a critically needed position, and cannot do so using a consent calendar.
  - For State employment, CalHR may make the determination that the appointment fills a critically needed position or delegate the determination to an individual State agency. If it delegates this determination: CalHR must audit the delegated agency’s appointment process.
  - The retiree is eligible to participate in the Faculty Early Retirement Program for California State University academic employees pursuant to collective bargaining.
  - The retiree is a public safety officer or firefighter.
  - The retiree is a trustee, administrator or fiscal advisor appointed to address academic or financial weaknesses in a school or community college district, pursuant to specified requirements.
  - The retiree is a subordinate judicial officer whose position, upon retirement, is converted to a judgeship and he or she returns to work in the converted position.
  - The retiree is a person taking office as a judge, as specified.
- Require the 180-day "sit-out" period for retirees who received either a golden handshake or some other employer incentive to retire; no exceptions.

- Require a public retiree appointed to a full-time State board or commission to suspend his or her retirement allowance and become an active member of CalPERS, or to serve without compensation. If a retiree serves as a non-salaried appointee, he or she does not earn any service credits or benefits for such service. This provision does not apply to appointees to the Parole Board.

Current Law

Under the PERL, retired annuitants may be employed by a public agency under specified conditions, generally to address a short-term or specialized need, and with restrictions on the amount of time worked in a year. For State employees, classified school employees, and CalPERS contracting agencies, retired annuitants are limited to 960 hours or 120 working days per year and must be filling a position needing a specialized skill or during an emergency, with limited exemptions.

Comments

It is unlikely that this provision would have any measurable fiscal impact on CalPERS retirement system funding, risk level, or contribution rates. CalPERS and other retirement systems may incur workload costs associated with auditing employers for compliance, but these changes would not significantly impact CalPERS benefits or the administration of the System.

3. **Actuarially Reduced Industrial Disability Retirement Benefits for CalPERS Public Safety Members**

The Report would provide a safety member who qualifies for an Industrial Disability Retirement, an actuarially reduced retirement formula, as determined by the CalPERS actuary, for each quarter year of service age less than age 50, if that amount would be higher than 50 percent.

Current Law

Local safety members who become disabled as the result of a work-related injury or illness are eligible to receive industrial disability. This benefit pays the member 50 percent of the member’s compensation as a lifetime retirement benefit. If the member is eligible to retire for service retirement, and the member’s retirement allowance would be greater than 50 percent of the member’s compensation, the member will receive a service retirement instead of an industrial disability allowance.

Comments

Some public safety members become disabled late in their careers but before reaching minimum retirement age. In this case, they have earned enough years of service to equal a benefit greater than 50 percent of compensation if they were to be eligible to retire on service retirement. For example, under certain CalPERS formulas, a member receives three percent of compensation for each year of service. A member who has 25 years of service at age 47 would receive 50 percent of his or her compensation for those 25 years upon retirement. This change appears reasonable in that it allows members to receive a benefit that is more closely aligned to their years of service.

4. **Contracting Agency Liability for Excessive Compensation**

The Report would require CalPERS (for plans we administer) to develop requirements for defining a significant increase in actuarial liability for a former contracting agency due to excessive compensation paid by a subsequent contacting agency (which may occur due to final compensation being applied to all years of service), and to develop a plan to assess that excess liability to the contracting agency that paid the excessive compensation.

Current Law

Generally, reciprocity for public pension benefits allows public employees to change employers without a loss of benefits. This portability of benefits may be limited in several ways, depending on the employer(s) and the retirement system(s) involved. A form of salary reciprocity exists for CalPERS members moving between public employers in CalPERS-covered service, including the State, schools, and contracting agencies, whereby the member's highest compensation earnable for any CalPERS employer is used to calculate his or her retirement benefit.

Liabilities to cover the cost of benefits paid to members for service with multiple CalPERS employers is calculated when the actuarial office performs its annual valuations of each employer's plan. This is considered "transferred members' liability" and is shared among the member's current and former employers through changes in their annual contribution rates.

Comments

Reciprocity eliminates the adverse consequences a member might otherwise suffer when moving from one retirement system to another. This provision tasks CalPERS with developing a process that retains the advantages of reciprocity while reducing the long-term risk for government agencies that do not pay their employees excessive contributions and more explicitly the implications to agencies that choose to pay excessive compensation.

Because this provision would allow CalPERS to establish the guidelines for what constitutes a "significant increase in actuarial liability" that makes one contracting agency responsible for a portion of another's benefit liabilities, CalPERS would also consider the administrative expense of tracking member compensation, making additional actuarial computations, and executing the transfers during the development process, with an eye toward keeping those costs at a reasonable level while meeting the Legislature's intent. It is also unlikely that CalPERS would be able to promulgate the necessary regulations to implement this provision by January 1, 2013.

FISCAL ANALYSIS

Due to the timing of the Conference Committee hearing and release of the Report, the actuarial staff was unable to complete a fiscal costing to be included in this preliminary analysis. However, the actuarial office hopes to be able to provide some high-level estimates at the special Board meeting on Wednesday, August 29, 2012.

ADMINISTRATION AND IMPLEMENTATION ISSUES

The provisions contained in the Report would go into effect on January 1, 2013. Despite the aggressive timeline, staff believes CalPERS could implement the new defined benefit formulas and the other various components contained in the Report as required. However, it would require an enterprise-wide effort with redirection of resources from other mission-critical projects and services. Service levels would almost certainly be negatively impacted as program staff is redirected from their core workload priorities to this implementation.

It is important to note that these changes would result in amendments to all of the approximately 2,200 contracting agency contracts. CalPERS would work with these agencies to ensure that updated contracts reflect the new benefit levels. Public agency contract changes would not be executed before January 1, 2013. However, the statute would still apply and we would not expect this to impair implementation of the statute.

In addition, we do not yet know how the changes contained in the Report would affect the processes and systems of our participating employers. Implementation of these proposals would require extensive business partner education and outreach to ensure correct reporting occurs. Any difficulties that employers experience adjusting to the new laws could result in further service-level delays, reporting errors, and increased workload for CalPERS staff.

Implementation would require expenditure of funds to reprogram computer systems, revise published materials and forms, train staff on new requirements, promulgate regulations, and realign business processes. These implementation activities would be primarily funded from the PERF (to the extent they apply to PERF benefits), and are anticipated to cost less than $25 million.

Vested Rights

Based on our initial review of the Report, we believe that two proposals in the Report could raise vested rights issues. There are two aspects of the Report that may be subject to challenge based on an argument that they impair the vested rights of existing employees, including: (i) the elimination of the ability of current employees to purchase nonqualified service credit under existing terms prior to retirement; and (ii) felony forfeiture by existing members who have already acquired substantial rights to their pensions. CalPERS has published a summary of vested rights and that document is available on our website: *Vested Rights of CalPERS Members – Protecting the pension promises made to public employees*.

Conforming Amendments

Other aspects of the Report would likely require further clarification or amendments to address implementation issues. At a minimum, conforming amendments to the PERL and regulations would also be necessary and cannot be accomplished by January 1, 2013.

CONCLUSION

The Conference Committee Report has the potential to have a far-reaching impact on public pensions in California. Our preliminary review finds that most of the changes could have moderate impact on the administration of CalPERS. Over time, these proposals would ultimately improve our administration by eliminating current complexities in final compensation periods, compensation calculations and the multitude of benefit formulas. Until the phase-out of current employees occurs, it would require dual administration of these provisions by CalPERS. We look forward to working with the Legislature, the Governor, our employers and members to fully implement this legislation, should it be enacted.