

INITIAL STATEMENT OF REASONS

Proposed Amendment for the Addition of Section 571.1 to Chapter 2 of Division 1 of Title 2 of the California Code of Regulations (CCR).

The proposed regulation is necessary to assist with the implementation and administration of the new pension reform statutes enacted by Assembly Bill (AB) 340 (Stats. 2012, Ch. 296).

PROBLEM THE PROPOSED REGULATIONS INTEND TO ADDRESS

On September 12, 2012, Governor Brown signed into law AB 340 which included the California Public Employees' Pension Reform Act (PEPRA) and related pension reform changes to the Public Employees' Retirement Law (PERL). These statutory provisions became effective on January 1, 2013. This legislation adds, amends, and repeals numerous sections of the California Government Code relating to public employees' retirement benefits.

Some of the new PEPRA statutes do not fully define certain terms and phrases, and accordingly retirement systems are required to interpret how those terms and phrases will be interpreted and implemented. It is necessary for CalPERS to interpret these words and phrases so it can properly implement the pension reform legislation and administer the retirement system (System) consistently on behalf of its members and employers.

PURPOSE, BENEFITS, OR GOALS OF THE AUTHORIZING STATUTES

Legislation was enacted in 2012, which introduced comprehensive pension reform provisions to help ensure that public pensions would be sustainable, secure, and cost-effective into the future. The pension reform legislation brought numerous changes to California public retirement systems, including, for example, a cap on the amount of compensation that can be used to calculate retirement benefits for new members, new mandatory retirement formulas for new members, and various restrictions or prohibitions of practices that were allowed prior to the enactment of the pension reform statutes. The pension reform provisions, collectively, are expected to result in significant savings to the State of California, local agencies, and school employers.

CalPERS is required, along with most other California public retirement systems, to administer and implement the pension reform statutes by modifying its plan or plans to comply with the provisions of AB 340. Government Code section 7522.02(a)(1) provides in part that, "Notwithstanding any other law, except as provided in this article, on and after January 1, 2013, this article shall apply to all state and local public retirement systems and to their participating employers, including the Public Employees' Retirement System" Senate Bill (SB) 13 (Stat. 2013, Ch. 528) amended PEPRA, in part, by adding Section 7522.2(h), which authorizes each public retirement system to adopt regulations to comply with PEPRA. Further, the CalPERS Board of Administration is authorized to

adopt regulations based on the Board's plenary authority and fiduciary responsibility over the assets of the public retirement system and exclusive responsibility to administer the System in a manner that will assure prompt delivery of benefits and related services to the members and their beneficiaries, pursuant to the California Constitution (Section 17 of Article XVI) and in accordance with the PERL (Government Code, Title 2, Division 5, Part 3, sections 20120-20124).

RATIONALE FOR DETERMINATION THAT ADOPTION IS REASONABLY NECESSARY TO ADDRESS THE PROBLEM

The proposed regulation is necessary to implement and administer the System as a result of the changes mandated by the pension reform legislation. The proposed regulation will assist with CalPERS implementation and administration of the new pension reform statutes by clarifying CalPERS interpretation of certain PEPPA provisions and by providing a list of pay items that qualify as Pensionable Compensation as a result of the new pension reform statutes. This regulation will also assist CalPERS staff, CalPERS-covered employers, and members to ensure uniform compliance with the pension reform provisions by providing clarity for statutory terms and phrases that might be interpreted to have more than one meaning. In addition, this proposed regulation serves to provide formal notice to CalPERS-covered employers and members of the interpretation CalPERS will use in these issues, and to ensure common understanding and consistency in the application and implementation of the new statutory provisions for all CalPERS-covered employers and members. The proposed regulation is consistent with existing law, including the PEPPA provisions and related pension reform changes to the PERL, and are reasonably necessary to effectuate the purpose of these statutes.

SPECIFIC PURPOSE FOR THE ADOPTION OF THE PROPOSED REGULATION

Purpose of the Proposed Addition of Section 571.1 Pensionable Compensation.

The proposed addition of section 571.1 to the CCR seeks to clarify CalPERS interpretation of what is considered Pensionable Compensation and what should be reported to CalPERS for a "new member," gaining common understanding and uniform compliance amongst all participating employers.

Until January 1, 2013, employers continued to submit reportable compensation on behalf of all their "classic" employees that are CalPERS members. Classic members remain unchanged under the original statutes and regulations. On September 12, 2012, when Governor Brown signed into law AB 340, reporting to CalPERS for "new members" changed. PEPPA now defines Pensionable Compensation for "new members" (generally those brought into membership after January 1, 2013) and limits payments and compensation that

may be used to calculate a defined benefit for “new members.” PEPRA also excludes specified payments from being Pensionable Compensation.

In addition, on October 4, 2013, Governor Brown signed into law Senate Bill 13, PEPRA clean-up legislation. While it included several items of technical corrections, it did not make specific changes to the definition of Pensionable Compensation. However, it did include a provision that would allow a pay item to be excluded from Pensionable Compensation if agreed upon through collective bargaining with represented state employees or imposed on non-represented state employees. Such information must be provided to CalPERS and detailed in the memorandum of understanding.

This proposed regulation should help avoid any confusion about pensionable compensation for “new members” at the time that they retire.

BENEFITS ANTICIPATED FROM THE REGULATORY ACTION

Without the adoption of this regulation, there are significant risks. Not all CalPERS-covered employers may interpret the new legislation consistent with CalPERS interpretation, and that could lead to inconsistent application of these new laws. CalPERS may achieve cost savings as a result of decreased litigation and administrative appeals related to the definition of Pensionable Compensation as employers and members become more aware of what compensation is or isn't reportable to CalPERS.

NECESSITY

Section (a) – Pensionable Compensation criteria. These criteria outline and better define the requirements of each item of Pensionable Compensation. Without these requirements, the statute may be too vague to enforce. In addition, employers would be able to individually interpret the statute, which would reduce consistency, transparency and may not adhere to the intent of the reform.

Section (b) – Exclusive List. The provided list is essential to give all employers the name and description of all items that can be reported to CalPERS. This list also serves to aid employers in having a comprehensive list to use while bargaining as well as member education. The list promotes consistency and transparency of items reported across all CalPERS employers.

Section (c) – Exclusions. The goal of CalPERS in drafting this section was to obtain full disclosure of the method, reason or timing of items that would not be allowed to be considered Pensionable Compensation. This allows both the staff and employers to have a firm understanding of what cannot be used to calculate their retirement allowance limiting the number of appeals and providing better customer service.

TECHNICAL, THEORETICAL AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS RELIED UPON BY THE AGENCY

Assembly Bill 340 (Stats. 2012, Ch. 296).

Senate Bill 13 (Stats. 2013, Ch 528)

An Economic Impact Assessment was prepared and relied upon pursuant to section 11346.3(b).

Economic and Fiscal Impact Statement (STD. 399) was prepared and relied upon.

BUSINESS IMPACT

The proposed regulation will not have a significant adverse economic impact on business because the primary reporting requirements of the regulations have already been in place for members hired before January 1, 2013.

ALTERNATIVES TO THE REGULATORY ACTION AND CalPERS REASON FOR REJECTING THOSE ALTERNATIVES

CalPERS considered not listing the reportable items of Pensionable Compensation in a regulation. Although CalPERS would use this list internally to determine members' final compensation, CalPERS members and covered employers might challenge the validity of the exclusive list if it was not formalized in a regulation. This alternative could leave numerous covered employers without a common understanding of what would be considered Pensionable Compensation to be used in the final compensation calculation. Therefore, to provide notice to CalPERS members and covered employers, CalPERS seeks to promulgate the proposed regulation to ensure common understanding and consistent application of which pay items would be allowable as Pensionable Compensation.

CalPERS considered four possible alternatives which included:

- 1) Promulgating a regulation that did not list the individual pay items, but only the criteria outlined in AB 340 and SB 13;
- 2) Promulgating a regulation that listed pay items considered Pensionable Compensation for Public agencies and Schools only, or
- 3) Promulgating three regulations; one for each employer type of State, Public Agency and School.
- 4) Promulgating a regulation that encompassed all employer types and detailed what CalPERS determined to be Pensionable Compensation and would use in the members' final compensation calculation.

The first two alternative left CalPERS-covered employers without a clear direction of what pay items would be included in their members' final compensation calculation. Since these alternatives would result in each employer making inconsistent determinations on what should be considered Pensionable Compensation, CalPERS determined that neither option reasonably effectuated the purpose of Government Code section 7522.34.

The third option resulted in distinguishing between different types of employers, which is not supported by AB 340.

CalPERS concluded that the more reasonable interpretation is the fourth alternative. Under this option, there will be common understanding and consistent application of what items CalPERS-covered employers should report as Pensionable Compensation. This alternative provides the highest possible compliance with AB 340.

As CalPERS has identified no burden on private persons by the proposed action, CalPERS has not identified any reasonable alternatives that would be as effective or less burdensome.

CalPERS will consider any reasonable alternatives proposed through the public comment period associated with this regulatory action.

ALTERNATIVES TO THE REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESS

The proposed regulations are designed to apply to CalPERS, its members, and covered employers. CalPERS has not identified any adverse impacts on small businesses. As CalPERS has identified no adverse impact on small businesses caused by the proposed regulatory action, it has not identified any reasonable alternatives that were considered that would lessen the impact on small businesses.