

INITIAL STATEMENT OF REASONS

Proposed Amendment of Sections 588, 588.1, 588.2, 588.3, 588.4, 588.6, 588.7, and 588.8 and Repeal of Sections 588.5, 588.9, and 588.10 of Article 7.6 of Subchapter 1 of Chapter 2 of Division 1 of Title 2 of the California Code of Regulations (CCR)

The proposed regulatory action is necessary to clarify the California Public Employees' Retirement System's (CalPERS) operational procedures for maintaining risk pools and to refine criteria for rate plans to enter and cease participation in a risk pool in accordance with Government Code (Gov. Code) section 20840. The action aligns regulations with current practices and explicitly defines thresholds and criteria for rate plans to enter or cease participation in a risk pool.

PROBLEMS THE PROPOSED REGULATORY ACTION INTENDS TO ADDRESS

Before the introduction of risk pooling, contributions for contracting agencies were determined solely by the experience of their own members within their rate plans. This often resulted in significant fluctuations in contributions for smaller agencies. Assembly Bill 1974 (Chapter 1133, Statutes of 2002) added Gov. Code section 20840, which established CalPERS Board of Administration (board) authority to create, combine, or eliminate risk pools for contracting agencies participating in the retirement system. The purpose of the risk pools is to stabilize contributions and spread risk among multiple agencies. Risk pooling allows CalPERS actuaries to first calculate the total actuarial results for the entire risk pool and then allocate unexpected experience evenly across the contracting agencies participating in the risk pool.

In 2004, CalPERS promulgated regulations to establish the details of the administration of contracting agency risk pools. Rate plans that shared the same benefit formula for active members would be grouped together in a risk pool. Inactive benefit plans (those with no active members) would be combined in an inactive pool. In 2009, the original risk pool regulations were updated. No further amendments have been made to the regulations.

PEPRA Legislative Changes

The California Public Employees' Pension Reform Act of 2013 (PEPRA) introduced one new service retirement formula for miscellaneous members and three for safety members. In 2014, CalPERS combined separate risk pools into two consolidated pools: the Miscellaneous Risk Pool and the Safety Risk Pool. This change aggregated classic benefit pools that were projected to shrink with their associated PEPRA benefit pools preserving the ability to adequately distribute demographic risk. These combinations were formalized by the board through resolution number 03-03-AESD. This legislative change and subsequent process change have made some of the language and terms in the current regulations outdated, such as reference to a plan's superfunded status.

Superfunded is a term to describe when a plan's assets exceed the present value of benefits. Current regulations require the actuary to annually determine whether a pooled plan is superfunded. However, this practice is now outdated due to PEPRA.

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Changes in Rate Plan Size

Under current regulations, a non-pooled plan is required to enter a risk pool if its active member count is less than 100 on any valuation date. Once a plan enters a risk pool, there is no provision for CalPERS to cease its participation in the risk pool and reinstate it as a non-pooled plan, even if its active member count later far exceeds 100. Some plans within risk pools have active member counts that have grown to several hundred. This is problematic because risk pools were not originally designed to accommodate plans of this size, which can affect overall performance and outcomes of the risk pool.

This proposed regulatory action explicitly defines new thresholds and criteria for determining risk pool participation that provides flexibility. These thresholds were carefully structured to avoid overlap, ensuring that two plans of identical size would not simultaneously be entering and ceasing participation in the pool, or that one plan could be entering when a slightly smaller plan was ceasing participation. Under the proposed framework, only smaller plans can enter the pool, while only larger plans can leave. This design prevents conflicting movements and maintains consistency in the administration of risk pools. The new criteria for exiting a risk pool are expected to better support the goals of risk pooling while offering agencies some flexibility.

Procedural Changes

Procedural changes have occurred, necessitating conforming amendments to the current regulations. For example, procedural changes have occurred with respect to side funds. Side funds were originally created to account for differences in the funded status between individual plans and the risk pool they joined. They were particularly useful when all contracting agencies contributed to the pool's Unfunded Accrued Liability (UAL) as a percentage of payroll. However, since the consolidation of risk pools, no new side funds have been established.

PURPOSE, BENEFITS, OR GOALS OF THE AUTHORIZING STATUTES

Under Gov. Code section 20121, the board has authority to make rules as it deems proper.

Gov. Code section 20840 requires the board to establish, by regulation, the criteria for contracting agency participation in a risk pool and circumstances under which a contracting agency may cease participation in a risk pool. The purpose of risk pools is to mitigate demographic risks for smaller contracting agencies and reduce the likelihood of large changes in required contributions for smaller contracting agencies.

RATIONALE FOR DETERMINATION THAT REGULATORY ACTION IS REASONABLY NECESSARY TO ADDRESS THE PROBLEMS

The proposed regulatory action is necessary to clarify CalPERS operational procedures for maintaining risk pools and to refine criteria for rate plans to enter and cease participation in a risk pool. Adoption of this proposed regulatory action will ensure the fairness, stability, and sustainability of risk pools, allow CalPERS to effectively manage the program in alignment with its intended goals, and benefit contracting agencies by providing clarity about participation in risk pools.

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SPECIFIC PURPOSE AND NECESSITY FOR THE ADOPTION OF THE PROPOSED REGULATORY ACTION

Section 588. Risk Pools—Definitions

Purpose: The purpose of this change is to reorganize the section to include the necessary amendments. This clause was originally included in subsections (a) and (b) of section 588 and was moved as part of the reorganization and renumbering of the proposed amendments to section 588.

Necessity: The reorganization of this section is necessary to include the proposed amendments.

Section 588(a)

Purpose: The purpose of this change is to clarify the definition of “rate plan” and ensure the definition aligns with current actuarial and administrative practices.

Necessity: The proposed change is necessary to explicitly identify the factors—benefit level, enrollment level, and member category—that determine a “rate plan.”

Section 588(b)

Purpose: The purpose of this paragraph is to define the term “non-pooled plan” and ensure the definition aligns with current actuarial and administrative practices.

Necessity: The proposed change is necessary to clarify how CalPERS maintains rate plans that do not participate in a risk pool.

Section 588(c)

Purpose: The purpose of this change is to remove the term “Side Fund” and define the term “pooled plan.”

Necessity: The proposed change is necessary because the term “Side Fund” is outdated. Since the consolidation of risk pools, no new side funds have been established. The new term “pooled plan” is necessary to align with how CalPERS calculates the UAL and prepares valuation reports for rate plans within the risk pools. The proposed change ensures the definition reflects current actuarial and administrative practices.

Section 588.1 Risk Pools--Required Participation for Existing Contracting Agencies; Effective Date for Mandated Benefits for New and Existing Contracting Agencies

Purpose: The purpose of this change is to specify that participation in a risk pool for existing contracting agencies is contingent upon the actuary determining that such participation will not be unfavorable to other agencies in the risk pool. The purpose of this change is also to clarify the effective date of mandated benefits and to conform with terms defined in proposed amendments to section 588.

Necessity: The proposed change is necessary to allow the CalPERS actuary's determination that participation will not be unfavorable to other agencies in the risk

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pool and to protect the stability of the risk pool and ensure equitable treatment of all participants. Without this safeguard, the inclusion of plans with disproportionately high liabilities could impose undue financial burdens on existing agencies in the risk pool. Clarifying the effective date of mandated benefits is necessary to clarify when financial obligations begin. The proposed change is also necessary to conform with the proposed amendments to section 588 and ensure the language aligns with current actuarial and administrative practices.

Section 588.2 Risk Pools--Required Participation for New Contracting Agencies

Purpose: The purpose of this change is to conform with terms defined in proposed amendments to section 588.

Necessity: The proposed change is necessary to clarify the application of mandatory participation requirements for new contracting agencies, including accounting for situations where multiple rate plans are grouped into a single pooled or non-pooled plan.

Section 588.3 Risk Pools--Optional Participation

Purpose: The purpose this change is to refine the eligibility criteria, procedural requirements, and effective dates for contracting agencies with non-pooled plans to voluntarily participate in a risk pool. The purpose of this change is also to specify that such pooled plans must remain in a risk pool unless subject to mandatory removal under the criteria defined in proposed amendments to section 588.7.

Necessity: The proposed change is necessary to continue to provide contracting agencies the flexibility to enter a risk pool when their non-pooled plan size is 100 or more active members while also imposing a new limit to that size of 150 active members. Creating a threshold of 150 active members and clarifying that following the exercise of this option the plan may not cease participation in the risk pool unless they meet the threshold for mandatory removal from the risk pool is necessary to prevent excessive transition in and out of risk pools.

Section 588.4. Risk Pools--County Offices of Education, School Districts and Community College Districts

Purpose: The purpose of this change is to remove unnecessary language.

Necessity: The proposed removal of 'notwithstanding Section 588.1' is necessary to clarify that county offices of education, school districts, and community college districts are not required to participate in risk pools.

Repeal of Section 588.5. Risk Pools--Amortization of Side Funds

Purpose: The purpose of this repeal is to eliminate unnecessary provisions regarding the amortization of side funds.

Necessity: The repeal is necessary to conform with the proposed removal of the 'side funds' definition from section 588 and remove outdated references to the amortization of side funds. Since the consolidation of risk pools, no new side funds have been established.

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Section 588.6. Risk Pools--Assignment to Risk Pools

Purpose: The purpose of this change is to conform with the terms defined in proposed amendments to section 588 and clarify that assignment to a risk pool is based on the miscellaneous or safety member classification.

Necessity: The proposed change is necessary to address shrinking classic benefit pools due to PEPPRA legislative changes and conform to the 2014 board action that combined risk pools based on member classification. Updating this language will align with current actuarial and administrative practices.

Section 588.7. Risk Pools – Leaving and Transferring Between Risk Pools

Section 588.7(a)

Purpose:

Section 588.7(a): The purpose of this change is to clarify the procedural requirements and effective dates for contracting agencies participating in a Safety risk pool to transfer assets and liabilities of a pooled plan. The purpose of this change is also to conform with terms defined in proposed amendments to section 588 and reorganize this section to include the necessary amendments.

Section 588.7(a)(1): The purpose of this change is to clarify that contracting agencies may combine safety plans in one of two ways described in proposed paragraphs (A) and (B).

Section 588.7(a)(1)(A): The purpose of this paragraph is to stipulate that contracting agencies may elect to transfer assets and liabilities of a pooled plan comprised of Safety members into another of its pooled plans comprised of Safety members.

Section 588.7(a)(1)(B): The purpose of this paragraph is to stipulate that contracting agencies may elect to transfer assets and liabilities of a pooled plan comprised of Safety members into another of its non-pooled plans comprised of Safety members and clarify operational procedures for removal from the risk pool.

Section 588.7(a)(2): The purpose of this paragraph is to prohibit contracting agencies from transferring the assets and liabilities of a pooled plan or non-pooled plan after making an election pursuant to paragraph (1) of this subsection.

Necessity: The proposed changes are necessary to provide contracting agencies with the flexibility to transfer assets and liabilities among its Safety pooled or non-pooled plans and provide equitable treatment to all contracting agencies, some of whom have Safety categories combined for valuation purposes while others do not. The proposed changes are also necessary to prevent excessive transfers of assets and liabilities and maintain the stability of pooled and non-pooled plans.

Section 588.7(b)

Purpose: The purpose of this change is to remove outdated references to side funds and transfers of assets and liabilities between risk pools. The proposed change also establishes that CalPERS will remove a pooled plan from a risk pool under certain circumstances.

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Necessity: The proposed change is necessary because the term “Side Fund” is outdated. Since the consolidation of risk pools, no new side funds have been established. The proposed change is also necessary to address the lack of ability in existing regulations for a pooled plan to cease participation in a risk pool. Additionally, the proposed change is necessary to clarify that pooled plans can no longer move from one risk pool to another.

Section 588.7(b)(1)

Purpose: The purpose of this paragraph is to define the eligibility criteria, procedural requirements, and effective dates for contracting agencies with pooled plans to voluntarily cease participation in a risk pool. The purpose of this paragraph is also to specify that following the exercise of this option such a plan must remain a non-pooled plan unless subject to mandatory participation under the criteria defined in current regulations.

Necessity: This subsection is necessary to provide contracting agencies the flexibility to cease participation in a risk pool when their plan size grows to 150 or more, but less than 200, active members. Refining the threshold to 150 to 199 active members, requiring actuarial approval, and clarifying that the plan may not subsequently participate in a risk pool unless they meet the threshold for mandatory participation in the risk pool is necessary to provide a buffer from the newly defined mandatory removal threshold of 200 active members, ensure the stability of the non-pooled plan, and prevent excessive transition in and out of risk pools.

Section 588.7(b)(2)

Purpose: The purpose of this subsection is to define the eligibility criteria and effective dates for mandatory removal of a pooled plan from a risk pool.

Necessity: This paragraph is necessary to establish the criteria when a pooled plan becomes too large, where their membership size is sufficient to spread risk internally and risk sharing becomes unnecessary, such that they must cease participation in a risk pool. A threshold of 200 or more active members was set high enough to ensure stability for plans transitioning into or out of a risk pool. Historical data show it is unlikely for plans with less than 100 active members to grow to or exceed 200 active members, let alone within a few short years. Furthermore, there is no history of a plan growing to or exceeding 200 active members and later shrinking to less than 100 active members. Removing large plans from risk pools prevents undesirable levels of cross-subsidies between agencies and maintains the intent of enacting risk pooling.

Section 588.7(b)(3)

Purpose: The purpose of this change is to clarify when a contracting agency must terminate its participation in a risk pool and to include all sections of the Government Code that address the termination of any member category now included in 588(a).

Necessity: This proposed change is necessary to align with statutory requirements governing the termination of contracts.

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Section 588.7(c)

Purpose: The purpose of this paragraph is to ensure that when a pooled plan ceases participation in a risk pool, the agency's rate plan continues to include mandated benefits under Gov. Code section 20840 if those benefits are not already applicable to the agency and its employees when the agency entered the risk pool.

Necessity: This subsection is necessary to ensure continuation of mandated benefits for active members in the risk pool after the pooled plan ceases participation in a risk pool.

Section 588.8. Risk Pools--Classification of Benefit Provisions

Purpose:

Section 588.8: The purpose of this change is to clarify the reason for separating benefit provisions into various classifications.

Section 588.8(a): The purpose of this subsection is to define "Class 0 benefit provisions."

Section 588.8(b), (b)(1), (b)(2): The purpose of these changes is to clarify the definition of "Class 1 benefit provisions" and their cost allocation to applicable rate plans.

Section 588.8(c), (c)(1), (c)(2): The purpose of these changes is to clarify the definition of "Class 2 benefit provisions" and that contracting agencies will be responsible for any resulting increase in accrued liability.

Section 588.8(d), (d)(1), (d)(2): The purpose of these changes is to clarify the definition of "Class 3 benefit provisions" and their cost allocation as between rate plans.

Necessity: The proposed change is necessary to clarify how benefit provisions are separated, prevent misclassification of benefit provisions, and ensure the cost of benefit provisions are allocated equitably among contracting agencies in a risk pool. The proposed change adds a Class 0 benefit to account for the service retirement benefit formula now that risk pools include multiple formulas for active members. The change also clarifies that the allocation of the full cost of any, not just a one-time, increase in accrued liability related to Class 2 benefit provisions is necessary to ensure all costs are equitably allocated to that contracting agency. Explicitly defining mandatory benefit provisions as Class 3 benefit provisions is necessary to ensure accurate classification and equitable allocation of those benefits. The proposed changes also include necessary renumbering and conforming changes to Class 1, Class 2, and Class 3 benefit provisions based on proposed amendments to section 588.8 and 588.8(a).

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Repeal of Section 588.9 Risk Pools--Merger of Risk Pools

Purpose: The purpose of this repeal is to remove outdated provisions allowing for the merger of risk pools when the number of contracting agencies in a risk pool is determined by the actuary to be too small.

Necessity: The repeal is necessary due to the consolidation of risk pools into two pools: the Miscellaneous Risk Pool and the Safety Risk Pool.

Repeal of Section 588.10 Risk Pools--Superfunded Status

Purpose: The purpose of this repeal is to eliminate outdated provisions regarding superfunded status.

Necessity: The repeal is necessary because the actuary's annual determination of superfunded status has been rendered outdated due to PEPRA.

BENEFITS ANTICIPATED FROM THE REGULATORY ACTION

The proposed regulatory action aims to clarify CalPERS operational procedures for maintaining risk pools and refine criteria for rate plans to enter or cease participation in a risk pool. The proposed regulatory action ensures the fairness, stability, and sustainability of risk pools, allows CalPERS to effectively manage the program in alignment with its intended goals, and provides clarity and uniformity for contracting agencies, CalPERS team members, and stakeholders.

DOCUMENTS RELIED UPON BY THE AGENCY

The following documents were relied upon in developing this proposed regulatory action:

- Gov. Code section 20840
- CCR sections 588 – 588.10
- CalPERS Resolution Number 03-03-AESD
- Economic and Fiscal Impact Statement (STD. 399)
- Contribution Allocation Policy

BUSINESS IMPACT

The proposed regulatory action will not have any impact on private businesses. The proposed regulatory action will only directly impact CalPERS and its contracting agencies. Based on preliminary 2025 data, approximately 14 contracting agencies would be subject to mandatory removal from a risk pool. The implementation would not take effect until the June 30, 2026 valuation date. Contribution requirements would remain unaffected until the 2028-29 fiscal year, and financial reporting changes would not occur until the June 30, 2027 measurement date.

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ECONOMIC IMPACT ASSESSMENT

CalPERS is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed regulatory action. In accordance with Gov. Code section 11346.3(b), CalPERS has made the following assessments regarding the proposed regulatory action:

Creation or Elimination of Jobs within the State of California

The proposed regulatory action will not create or eliminate any jobs within the State of California. The proposed regulatory action serves only to clarify CalPERS operational procedures for maintaining risk pools and refine the criteria for rate plans to enter and cease participation in a risk pool.

Creation of New Businesses or Elimination of Existing Businesses within the State of California

The proposed regulatory action will not create new businesses or eliminate any existing businesses. The proposed regulatory action serves only to clarify CalPERS operational procedures for maintaining risk pools and refine the criteria for rate plans to enter and cease participation in a risk pool.

Expansion of Businesses within the State of California

The proposed regulatory action will not expand or prevent the expansion of any existing businesses within the State of California. The proposed regulatory action serves only to clarify CalPERS operational procedures for maintaining risk pools and refine the criteria for rate plans to enter and cease participation in a risk pool.

Benefits of the Regulation to the Health and Welfare of California Residents, Worker Safety, and the State's Environment

The proposed regulatory action will not affect the health and welfare of California residents, worker safety, or the State's environment. The proposed regulatory action serves only to clarify CalPERS operational procedures for maintaining risk pools and refine the criteria for rate plans to enter and cease participation in a risk pool.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The proposed regulatory action will not have a significant, statewide adverse economic impact directly affecting businesses, including the ability for California businesses to compete with businesses in other states. The proposed regulatory action serves only to clarify CalPERS operational procedures for maintaining risk pools and refine the criteria for rate plans to enter and cease participation in a risk pool.

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ALTERNATIVES TO THE REGULATORY ACTION AND CALPERS' REASON FOR REJECTING THOSE ALTERNATIVES

CalPERS has not identified any reasonable alternatives that would be as effective and less burdensome than the proposed regulatory action. Regulatory action was determined to be the most transparent and consistent means of providing clarity to contracting agencies, ensuring the fairness, stability, and sustainability of risk pools, and allowing CalPERS to effectively manage the program in alignment with its intended goals. 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 regulatory action will only apply to CalPERS and its contracting agencies. CalPERS has not identified any adverse impacts on small private businesses. Therefore, CalPERS has not identified any reasonable alternatives that would lessen the impact on small businesses.

DUPLICATION OR CONFLICT WITH OTHER STATE OR FEDERAL REGULATIONS

CalPERS has evaluated and determined the proposed regulatory action is not inconsistent or incompatible with existing state and federal regulations.