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PENSION REFORM UPDATE – JUST THE TIP OF THE ICEBERG?

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Effective January 1, 2013, the California Public Employees' Pension Reform Act of 2013 ("PEPRA") made sweeping changes to public pensions in California. But even as public employers and retirement systems have begun grappling with these numerous and complex changes, several recent legislative developments suggest that California pension reform may only be in its early stages. First, PEPRA, like any comprehensive legislation, had a few technical glitches that needed correction. At the end of last year, several clean up bills passed through the California legislature. Although the changes were primarily technical, one of these bills in particular, AB 1222, temporarily exempts certain transit workers from PEPRA. Second, mayors of several cities have proposed a statewide ballot initiative to amend the California Constitution to limit vested rights – perhaps the biggest obstacles to more extensive pension reform – to already-accrued benefits.

CLEAN-UP LEGISLATION

SB-13

Governor Brown signed SB-13, the much anticipated California Public Employees' Pension Reform of 2013 ("PEPRA") technical clean-up legislation, into law on October 4, 2013. Although mostly technical clean-up, SB-13 resolves several key questions about PEPRA's application that have perplexed public retirement systems since the law became effective last year. Most notably, SB-13:

Provides that it clarifies existing law, meaning that it is generally effective January 1, 2013, PEPRA's original effective date.

Clarifies that federally-regulated Taft-Hartley multiemployer union plans are exempt from PEPRA.

Incorporates AB 1222's temporary exemption from PEPRA of certain employees of transit agencies that receive federal grant funds as described more fully below in the discussion of AB 1222.

Clarifies that legacy or classic employees – those first hired before January 1, 2013 – who, without terminating employment, become members of a different defined benefit retirement system of the same employer will be treated as a legacy or classic employee under the new system. This is helpful clarification for those employers whose employees may participate in more than one retirement system.

Confirms that PEPRA doesn't prohibit an employer from offering a defined contribution plan or even a defined-contribution-only program on or after January 1, 2013, even if the employer didn't offer a defined contribution plan before that date. Employers may now consider providing a PEPRA-compliant defined contribution plan instead of the PEPRA-mandated defined benefit plan to new members.

Clarifies that, for purposes of determining normal cost, the retirement system's actuary may use either (1) a single contribution rate – like has been used by PERS or STRS, or (2) an age-based contribution rate – like generally has been used by the '37 Act systems.

More precisely prescribes the method for adjusting the PEPRA-mandated cap on pensionable compensation for inflation, and the Consumer Price Index to be used for this purpose.

Clarifies that the rate of employer contributions to a defined contribution plan based on compensation above PEPRA pensionable compensation is limited to the defined benefit plan employer contribution rate. For example, an employer who contributes 10% of payroll to its defined benefit plan may not contribute more than 10% of compensation above the pensionable compensation cap to a defined contribution plan for a new member.

Confirms that a retirement system must limit the pensionable compensation used to calculate the PEPRA-mandated new member contributions to the same cap used to calculate benefits. This may require changes for retirement systems that may have interpreted PEPRA differently.

Clarifies that the normal cost rate used to calculate the PEPRA-mandated employer and new member contributions is determined using all of the factors, including benefit formula, eligibility, vesting, ancillary benefits, and COLAs, normally used by the actuary in determining the normal cost, giving system actuaries more guidance on how to calculate normal cost for this purpose.

Clarifies that the contribution rate for new members may be more than 50% of normal cost only if agreed to through collective bargaining, eliminating the confusing requirement that it equal the rate of similarly situated members if higher.

Permits the exclusion from represented employees' pensionable compensation any items that are, in addition to those already excluded by PEPRA, agreed in an MOU to be non-pensionable, if the employer provides a copy of the MOU to the retirement system; and, permits the employer to apply this exclusion to non-represented employees who are "aligned with" the represented employees, if it provides a copy of the publicly-available pay schedule detailing the exclusion to the retirement system.

Confirms that PEPRA's prohibition against providing a more favorable retiree health benefit vesting schedule to certain management or non-represented employees than that provided to other public employees who are in related retirement membership classifications doesn't require an employer to change the vesting schedule of any employee who was subject to a specific vesting schedule pursuant to a statute, a resolution, or an employment contract before January 1, 2013. This provides reassurance to employers that they may continue to provide more favorable health benefit vesting schedules negotiated or agreed to before January 1, 2013, for certain management employees.

Clarifies that a retired annuitant who is a public safety officer or a firefighter must be hired to perform a function or functions regularly performed by a safety officer or firefighter in order to qualify for the public safety exception to the 180-day "sit-out" requirement for rehiring retired annuitants without reinstatement.

Repeals the PEPRA-enacted rule authorizing a safety member of a public retirement system who retires for industrial disability to, until January 1, 2018, receive a disability retirement equal to the greater of specified benefit amounts.

AB 1222

In early September of last year, the U.S. Department of Labor refused to certify transit grants to certain California transit agencies indicating that the application of PEPRA to affected public transit employees violates section 13(c) of the Federal Transportation Act by interfering with their collective bargaining rights to negotiate over pensions. Since the DOL's position could lead to the loss of billions of dollars in federal transit fund grants, Governor Brown responded by signing AB 1222 into law on October 4, 2013, which, as urgency legislation, became effective immediately. AB 1222 temporarily exempts from PEPRA public employees whose collective bargaining rights are protected by section 13(c) until January 1, 2015, or when a federal district court rules that PEPRA doesn't violate that section's requirements, whichever is earlier. If, on the other hand, the court upholds the DOL's ruling, the bill permanently excepts these employees from PEPRA.

AB 1222 raises several questions for California public transit agencies. First, does the PEPRA exemption apply to all transit employees or only represented employees or only to transit employees actually affected by grant funds? Recently CalPERS sent information to employers that did not answer this question. Instead, it issued Circular Letter 200-075-13, requiring participating transit agencies to certify, individual-by-individual, whether an employee is impacted by AB 1222. While the AB 1222 language is not clear, since section 13(c) protects unrepresented as well as represented employees, many agencies are interpreting the exemption to apply to all California public transit employees whose employers receive federal transit grants. We understand that the Office of Labor Management Standards and the DOL have indicated that given the reference in AB 1222 to any "public employee whose interests are protected under subsection (b) of Section 5333 of Title 49 of the United States Code," then the employees covered by the AB 1222 exemption would be, except under unusual circumstances, all employees of any transit authority or agency that has ever received funds certified under section 13(c).

Second, when is AB 1222 effective: January 1, 2013, or October 4, 2013? Since SB-13, which was amended to include the same provisions as AB 1222, provides that it clarifies existing law, we believe it is reasonable to interpret the provisions as taking effect January 1, 2013.

Transit districts, particularly those that have stand-alone retirement plans, and have already implemented PEPRA, even if only for non-represented employees, may want to carefully review options. For example, is it possible to collectively bargain no-longer-legally-mandated changes? Should the retirement plan be amended (and administrative changes made) to implement AB 1222 retroactively immediately, or should the employer (and the retirement plan administrator) wait until a court decides this issue before making final changes to documents and processes? Litigation has already been filed – the Sacramento Regional Transit District (working with the Governor's Office) sued the DOL, challenging its position that PEPRA violate section 13(c) on October 4, the same day AB 1222 became law.

AB 1380

Besides generally clarifying that PEPRA supersedes any inconsistent provisions in the County Employees' Retirement Law of 1937 ("CERL"), AB 1380 clarifies that:

> The inclusion of overtime premium pay for hours worked in a normal work week that exceeds a statutory maximum workweek in compensation earnable doesn't apply to members subject to PEPRA.

The 36-month final compensation averaging period for new members must be consecutive, not any 36 months.

Members who are subject to PEPRA are not eligible for the one-year final compensation averaging period.

Final compensation for a member who has less than three years of service will be determined by averaging the member's pay over his or her actual service.

Airtime purchases – purchases of service credit not related to any actual public service – apply only to applications received before January 1, 2013.

The provision applicable in some CERL systems permitting members to discontinue making member contributions after 30 years of service doesn't apply to members subject to PEPRA.

Existing provisions for employer-paid member contributions (EPMCs) don't apply to members subject to PEPRA.

Existing provisions in the CERL that allow a member to retire at a specified age or a specified age and years of service don't apply to members subject to PEPRA.

Service credit for elected officials' uncompensated service doesn't apply to elected officials who are subject to PEPRA.

Supplemental and replacement benefit plans otherwise permitted under CERL may not, to the extent prohibited by PEPRA, be provided to any member subject to PEPRA.

The existing provision permitting elective officers with two consecutive terms in office to retire at the minimum retirement age doesn't apply to elected officials subject to PEPRA.

Existing provisions permitting retroactive benefit enhancements – those applicable to service before the enhancement was adopted – don't apply effective January 1, 2013.

Member contributions may be based on either the member's age at entry or a single rate.

The PEPRA pensionable compensation cap – the Social Security wage base for employees subject to Social Security or 120% of that amount for those not subject to Social Security – will, in addition to the tax code's annual compensation limit, apply to a member who is subject to PEPRA.

If any provision permitting reemployment of retired annuitants – other than the more restrictive 720 hour or 90-day post-retirement employment limit for reemployment in positions requiring special skills or knowledge – conflicts with PEPRA, PEPRA controls.

New members must pay one-half of the cost of any cost-of-living adjustments, and employers may not pay any portion of the member's share of that cost.

SB 220

Besides generally clarifying that PEPRA supersedes any inconsistent provisions in the Public Employees' Retirement Law ("PERL"), SB 220 clarifies that:

> The CalPERS Board of Administration has the authority to administer the PEPRA- required changes.
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> The PERL's existing definitions of compensation earnable and payrate don't apply to new members.
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> The contribution rate for state employees who have elected Second Tier benefits – originally created to be a non-contributory formula – will increase by 1.5% annually until they equal at least 50% of the normal cost (AB 220 also adds other references to Second Tier benefits to the PERL).
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> Existing provisions for employer-paid member contributions are prohibited for new members, except to the extent that this prohibition would impair an MOU in effect on January 1, 2013.
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> Airtime purchases – purchases of service credit not related to any actual public service –apply only to applications received before January 1, 2013.
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> If a member who has accrued a benefit under both the PEPRA-mandated 2 @ 62 formula and a pre-PEPRA formula with a minimum retirement age of less than age 52 retires when he or she is younger than age 52, his or her benefit under the PEPRA- mandated formula will be actuarially reduced for retirement at the younger age.
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> A member who (1) retired from a public retirement system other than CalPERS, (2) was appointed to a state board or commission, and (3) elected, pursuant to PEPRA, to re- instate as a new member of PERS qualifies, upon his or her subsequent retirement, as an annuitant under the Public Employees' Medical and Hospital Care Act ("PEMHCA"), eligible to resume his or her suspended retiree medical benefits.

THE PENSION REFORM ACT OF 2014

In October of last year, San Jose Mayor Chuck Reed, joined by the mayors of several other California cities, proposed a statewide ballot initiative for the November 2014 ballot entitled The Pension Reform Act of 2014 ("PRA"). The initiative – now in the signature-gathering phase – would require 807,615 signatures – 8% of the total votes cast in the gubernatorial election – in order to qualify for the November ballot. The PRA, if approved by voters, would, among other things:

> Similar to rules applicable to private pensions under the Employee Retirement Income Security Act of 1974 ("ERISA"), limit vested rights to pensions and retiree medical benefits to those that are earned and vested incrementally, as the employee actually performs work, allowing government employers to change future, as yet unearned, benefits for current employees.

Provide clear authority to governmental employers to negotiate changes in future pension and retiree medical benefits.Except the provisions of any existing labor agreement in effect as of the effective date from its provisions until the agreement's expiration, renewal or extension after that date, but require specific language in a resolution, MOU or voter initiative enacted or adopted before the PRA's effective date to establish a vested contractual right to future pension or retiree medical benefits.

Specifically permit government employers whose pension or retiree medical plans are substantially underfunded to reduce the rate of accrual for future benefits, reduce cost of living adjustments, increase the retirement age for future benefits, require employees to pay a larger share of the cost of benefits, and make other bargained changes.

Require pension and retiree medical plans that are less than 80% funded to adopt a stabilization plan, requiring actions designed to achieve 100% funding within 15 years while preserving basic government services.