Public Pension Reform (AB 340 and AB 197): A Primer

I. Overview and Bill Summary

AB 340 (Furutani, Chapter 296, Statutes of 2012) makes substantial and wide-ranging changes to the public employee pension laws in California. The measure takes effect Jan. 1, 2013, although not all of its provisions will be effective immediately. AB 197 (Buchanan, Chapter 297, Statutes of 2012) makes technical cleanup changes to AB 340.

This package of reforms was negotiated between the Governor and primarily the Democrats on the Conference Committee on Pensions, which consisted of Assembly Members Warren Furutani (D-Long Beach), Michael Allen (D-Santa Rosa), and Jim Silva (R-Huntington Beach) as well as Senators Gloria Negrete McLeod (D-Chino), Joe Simitian (D-Palo Alto), and Mimi Walters (R-Laguna Niguel).

The measures are intended to implement comprehensive pension reform through the enactment of the California Public Employees' Pension Reform Act of 2013 (PEPRA) as well as other statutory changes.

PEPRA applies to all public employers and pension plans on or after Jan. 1, 2013 with the exception of the University of California, as well as charter cities and charter counties that do not participate in the California Public Employees' Retirement System (CalPERS) or the '37 Act System including the cities of Los Angeles, San Francisco, Fresno, San Diego, and San Jose. It also excludes any retirement plan approved by the voters of any entity before Jan. 1, 2013. For cities that have not yet adopted a defined benefit plan, the measures will only become effective if they choose to implement a defined benefit plan.

While the reforms have been passed by the Legislature and signed by the Governor, the League understands that CalPERS (and other retirement systems) will be adopting regulations and/or policy to implement many of the provisions of the reform package. CalPERS has a dedicated webpage "Pension Reform Impacts" where periodic updates on the implementation of AB 340 will be provided.[1]

Following is information on AB 340 and AB 197, categorized as follows:

1. Pensionable Income Cap; Restrictions on Supplemental Defined Benefit (DB) Plans; Limits on Employer Contributions
2. New Defined Benefit Tiers for Miscellaneous and Safety Members
3. Cost Sharing and Employer Paid Member Contributions (EPMC)
4. Final Average Earnings (FAE) Calculation for New Members
5. Retiree Restrictions
6. Regular, Recurring Pay
7. Forfeiture of Retirement Benefits upon Felony Conviction
8. Elimination of Purchasing Unqualified Service Credit or "Air Time"
9. Retroactive Benefit Increases
10. Pension Holidays
11. Health Vesting
12. Industrial Disability Retirement (IDR)
13. Current Members v. New Members
14. Comparing League Policy and the Conference Committee Report

[1]The CalPERS webpage is: http://www.calpers.ca.gov/index.jsp?bc=/employer/program-services/pension-reform-impacts.xml

1) Pensionable Income Cap; Restrictions on Supplemental Define Benefit (DB) Plans; Limits on Employer Contributions

Pensionable Income Cap:
This measure establishes a cap on the amount of compensation that can be used to calculate a retirement benefit for all new members of a public retirement system equal to the Social Security wage index limit ($113,700) for employees who participate in Social Security or 120% of that limit ($136,440) if they do not participate in Social Security. These amounts are scheduled to increase with CPI. [Govt. Code Sect. 7522.10 (c)]

Adjustments to the cap are permitted annually based on changes to the Consumer Price Index (CPI) for all Urban Consumers. [Govt. Code Sect. 7522.10 (d)(1)]

The Legislature is authorized to modify the CPI prospectively. [Govt. Code Sect.7522.10 (d)(2)]

Restrictions on Supplemental Defined Benefit (DB) Plans:
This measure prohibits employers from offering a defined benefit or any combination of defined benefits, including a privately provided defined benefit, on compensation in excess of the new cap. [Govt. Code Sect.7522.10 (e)]

Employers are prohibited from providing new members with a supplemental defined benefit plan. [Govt. Code Sect. 7522.18 (a)(b)]

Limits on Employer Contributions on Compensation above the Cap
Employers are prohibited from making contributions for new members to any qualified retirement plan on pensionable compensation above the amount specified in Section 401(a)(17) of Title 26 of the United State Code ($250,000). [Govt. Code Sect. 7522.42 (a)]

This measure provides that a contribution made by an employer to an employee's deferred contribution plan is not a vested right. [Govt. Code Sect. 7522.10 (f)(2)]

Limits on Employer Contributions to Defined Contribution (DC) Plans for Employees Above Cap
This measure authorizes employers to make contributions to a defined contribution plan for employees so long as the plan and contributions meet federal limits and requirements. [Govt. Code Sect. 7522.10 (f)(1)]

However, there is a limitation on employer contributions for employees above the compensation caps.

The new law provides that any employer contributions to any employee defined contribution plan above the pensionable compensation limits shall not, when combined with the employer's contribution to the employee's retirement benefits below the compensation limit, exceed the employer's contribution level, as a percentage of pay, required to fund the retirement benefits of employees with income below the compensation limits. [G.C. Sect. 7522.10(g)] See example below.

Example of limitations on combined defined benefit and defined contribution payments to employees with salaries above $110,000:

Employer's Contribution as % of Salary To Employees Below $110,000 DB Pension Cap	***10%***	***15%***	***20%***
Maximum Contribution to $250,000 employee			
First $110,000 salary (D.B.)	$11,000	$16,500	$22,000
Next $140,000 salary (D.C.)	$14,000	$21,000	$28,000*
TOTAL	$25,000	$37,500	$50,000

**Current federal limit on employer contributions to D.C. Plan: $50,000*

2) New Retirement Formulas for Miscellaneous and Safety Members

Miscellaneous Members:
The formula option for new miscellaneous members will be 2% at 62. This formula is equivalent to a maximum retirement factor of 2.5% at age 67. [Govt. Code Sect. 7522.20 (a)]

The new DB formulas for new members applies only to the amount of compensation allowed under the pensionable compensation cap as required in Govt. Code Sect. 7522.10. [Govt. Code Sect. 7522.25]

Safety Members:
There will be three formulas for new safety members including: 2% at 57; 2.5% at 57; and 2.7% at 57. [Govt. Code Sect. 7522.25 (a)(b)(c)(d)]

New members receive the formula that is closest to the formula for employees in their retirement classifications first hired on 12/31/2012. The new formula must be lower at age 55 than the prior formula offered to current members in the same job classification.

The new DB formulas for new members applies only to the amount of compensation allowed under the pensionable compensation limit as required in Govt. Code Sect. 7522.10. [Govt. Code Sect. 7522.25]

3) Cost Sharing and Employer Paid Member Contributions (EPMC)

New Members:
Normal Cost: New members will be required to pay at least 50% of normal cost and prohibits employers from paying this contribution on the employee's behalf. [Govt. Code Sect. 7522.30 (c)]

The law allows new members to pay more than 50% of the normal cost if the increase has been agreed to in collective bargaining and under the following conditions:

- An employer is prohibited from contributing a greater rate to the plan for non-represented, managerial, or supervisorial employees than the employer contributes to other public employees.
- An employer can only increase employee contribution rates if agreed to in a memorandum of understanding (MOU) that has been collectively bargained.
- An employer cannot use impasse procedures to implement greater cost sharing above the 50% of normal cost. [Govt. Code Sect.7522.30 (e)(1)(2)(3)]

Employer Cost: This measure increases the ability of employers to cost share by authorizing employers and employees to agree to share the costs of the employer contribution, including the Unfunded Actuarial Accrued Liability (UAAL), and prohibits the use of impasse procedures from being used to implement a cost sharing arrangement on any contribution amount above what is required in law. [Govt. Code Sect. 20516 (a)(b)]

Prior to this new rule, the Public Employee Retirement Law (PERL) required employee cost sharing above the statutory limits to be limited to the cost of an optional benefit. This measure allows employees to pay, if agreed to, any portion (or all) of the employer cost.

Member costs sharing of employer cost under Govt. Code Sect. 20516 may be bargained on a unit-by-unit basis if agreed to in an MOU. [Govt. Code Sect. 20516(c)]

Current Members:
Normal Cost: After Jan. 1, 2018 employers may—subject to good faith bargaining—require current employees to pay at least 50% of the normal cost so long as the employee contribution does not exceed 8% for miscellaneous, 12% for police and fire, and 11% for all other local safety members. This section should not be construed as an obligation on employers to require current members to pay 50% of normal costs. [Govt. Code Sect. 20516.5 (b)(c)]

Employer Cost: This measure increases the ability of employers to cost share by authorizing employers and employees to agree to share the costs of the employer contribution, including the UAAL, and prohibits the use of impasse procedures from being used to implement a cost sharing arrangement on any contribution amount above what is required in law. [Govt. Code Sect. 20516 (a)(b)]

Prior to this new rule the PERL required employee cost sharing above the statutory limits to be limited to the cost of an optional benefit. This measure allows employees to pay, if agreed to, any portion (or all) of the employer cost.

Member costs sharing of employer cost under Govt. Code Sect. 20516 may be bargained on a unit-by-unit basis if agreed to in an MOU. [Govt. Code Sect. 20516(c)]

4) Final Average Earnings (FAE) Calculation for New Members

For new members this measure requires that final compensation be calculated on the highest average annual pensionable compensation earned by a member during a period of at least 36-consecutive months. This is otherwise known as the 3-year average. [Govt. Code Sect. 7522.32 (a)]

5) Working after Retirement; Retirees

Retired persons are required to sit out for at least 180 days before returning to work for an employer in the same retirement system that which they receive a retirement allowance. [Govt. Code Sect. 7522.56 (f)]

An exception can be made if the governing body certifies that the nature of the employment and that the appointment is necessary to fill a critically needed position and the 180 days has not yet passed. This

also requires governing body approval in a properly noticed public meeting and cannot be placed on a consent calendar. [Govt. Code Sect.7522.56 (f)(1)]

This 180-day sit out rule does not apply to a public safety officer or firefighter. [Govt. Code Sect. 7522.56 (f)(4)]

This measure also provides that a retiree that accepted a retirement incentive (e.g., Golden Handshake or cash incentive) upon retirement must sit out the 180 days and the exception cannot be used. [Govt. Code Sect. 7522.56 (g)]

A retiree is prohibited from working for a public employer for 12 months after receiving unemployment insurance and must certify to the employer that he or she has not received any such payments in the 12 months prior to working as a retiree. [Govt. Code Sect. 7522.56(e)]

6) Regular, Recurring Pay

The measure defines "pension compensation" for a new member of any public retirement system as the normal monthly rate of pay or base pay of the member 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, pursuant to a publically available pay schedule. [Govt. Code Sect.7522.34 (a)]

Pension compensation under the new law does not include:

- Compensation paid to enhance a retirement benefit;
- Compensation previously provided "in-kind" and converted to cash in the final comp period;
- One-time or ad hoc payments;
- Terminal pay;
- Pay for unused sick leave or time off;
- Pay for work outside of normal hours;
- Any employer provided allowance including uniform, housing, vehicle allowances; and,
- Pay for overtime, except planning overtime, extended duty workweek, or pay defined in federal Labor Code Section 207(k) of Title 29 of the United States Code. [Govt. Code Sect.7522.34 (c)(1-12)]

It should be noted that the provisions outlined for regular, recurring pay, while the language is not identical to the PERL, the League understands that these restrictions on pay are already in the PERL. Not much, if anything, will change in the PERL related to these provisions.

7) Forfeiture of Retirement Benefits upon Felony Conviction

This measure requires that public officials and employees forfeit pension benefits if they are convicted of a felony related to the performance of official duties, related to seeking an elected office or appointment, in connection with obtaining salary or pension benefits, or committed against a child who the official or employee has contact with as part of his or her official duties. [Govt. Code Sect. 7522.72 (b)(1) and (2), (c)(1); Govt. Code Sect. 7522.74 (b)(1) and (2), (c)(1)]

Only pensions benefits earned or accrued after the earliest date of the commission of the felony are subject to forfeiture. Benefits earned or accrued prior to this date are not subject to forfeiture [Govt. Code Sect. 7522.72(c); Govt. Code Sect. 7522.74(c)]

These provisions apply to employees hired both before and after January 1, 2013. [Govt. Code Sect. 7522.72 (a); Govt. Code Sect. 7522.74 (a)]

8) Elimination of Purchasing Unqualified Service Credit or "Airtime"

This measure prohibits a public retirement system from allowing the purchase of unqualified service credit. This refers to the purchase of service credit that an individual has not actually worked. [Govt. Code Sect. 7522.46(a)]

9) Retroactive Benefit Increases

This measure requires that any retirement enhancements to formulas or benefits must occur prospectively and not retroactively. [Govt. Code Sect. 7522.44]

10) Pension Holidays

This measure prohibits all employers from suspending employer and/or employee contributions necessary to fund annual pension normal costs. [Govt. Code Sect. 7522.52(a)]

Additionally, this new law allows a public retirement system to suspend contributions under limited circumstances:

- The plan is funded more than 120%;
- The excess earnings could result in disqualification of plans tax deferred status; and,
- The board finds that additional contributions would conflict with its fiduciary responsibility [Govt. Code Sect. 7522.52 (b)(1)(2)(3)]

11) Equal Health Vesting

This measure prohibits a public employer from providing a better health benefit vesting schedule for excluded and exempt employees than for represented employees in the same retirement class. [Govt. Code Sect. 7522.40]

12) Industrial Disability Retirement (IDR)

Current law provides that a local safety member who becomes disabled as a result of a work-related injury or illness is eligible to receive an industrial disability. If a member is eligible for and IDR they receive 50% of their 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% of their compensation, the member will receive a service retirement and not an IDR allowance.

This measure allows a safety member, who qualifies for an IDR, to receive the greater of:

- 50% of the member's final compensation plus an annuity purchased with his or her accumulated contributions, if any;
- A service retirement, if the member qualifies for service retirement; and,
- An actuarially reduced retirement formula, as determined by the actuary, for each quarter year of service age less than 50, if that amount would be higher than 50% of salary. [Govt. Code Sect. 7522.66]

This new law allows members that are disabled before reaching retirement age to receive an actuarially reduced benefit. This provision, according to CalPERS, allows members to receive a benefit that is more closely aligned to their years of service.

These new provisions related to IDR are a "pilot project" and therefore are only in effect until Jan. 1, 2018, at which time the law is repealed, unless a later enacted statute, that is enacted before Jan. 1, 2018, deletes or extends that date.

13) Current Members v. New Members

Questions have been raised about which pension reform provisions apply to current and new members. The short answer is that most of the provisions in the package apply to new employees while some of the provisions apply to current employees. A chart of which reforms apply to current and new members is below.

New Members:
This measure defines a new member as:

- An individual who has never been a member of any public retirement system prior to Jan. 1, 2013.
- An individual who becomes a member of a public retirement system for the first time on or after Jan. 1, 2013, and who was a member of another public retirement system prior to that date, but who was not subject to reciprocity.
- An individual who moved between retirement systems with more than a 6-month break in service.
- An individual who moved between public employers within a retirement system after more than a 6-month break in service.

Current Members:
This measure also provides that individuals who are employed by any public employer before Jan. 1, 2013, and who become employed by another public employer after the law takes effect Jan. 1, 2013 will be eligible to receive the retirement plan offered to employees by the subsequent employer before the law takes effect (Dec. 31, 2012).

Proposal	Current Members	New Members
Pension Cap		✓
Increase Retirement Age		✓
Cost Sharing	✓	✓
3-Yr Average		✓
Retiree Restrictions/6-month sit out	✓	✓
Final Comp Reg. Pay		✓
Felony Forfeiture		✓

Eliminate Airtime	✓	✓
No Retroactive Increases		✓
No Pension Holidays	✓	✓

14) Comparing League Policy and the New Law

The following is a comparison between League policy and some of the more substantial provisions of the new law.[2]

Pension Reform	**Does League Policy and the New Law Align?**
Cap Pensionable Income	X No
Increased Retirement Ages	✓ Yes
New Cost Sharing Authority	✓ Yes
Prohibit Pension Spiking/ 3-Year Average	✓ Yes
Eliminate Double Dipping	✓ Yes
Base Retirement on Regular, Recurring Pay	✓ Yes
Forfeit Pension Benefits Upon Felony Conviction	X No
Eliminate Airtime	✓ Yes
Eliminate Retroactive Benefit Increases	✓ Yes
Eliminate Pension Holidays	✓ Yes

[2] For a full comparison and analysis of League policy and AB 340 please visit the League's Pension Information Center at www.cacities.org/pensions