

“PUBLIC EMPLOYEES PENSION REFORM ACT OF 2012”

THE IMPACT OF AB 340 AND AB 197 ON CERL SYSTEMS

September 5, 2012

The Legislature has passed, and the Governor appears ready to sign into law, AB 340 and its “trailer” bill, AB 197, changing public employee retirement plans and benefit calculations starting January 1, 2013. The following summarizes the impact on the members and beneficiaries of retirement systems governed by the County Employees’ Retirement Law of 1937 (CERL).

Generally speaking, the vast majority of changes in the law will apply only to new employees hired (or rehired) after January 1, 2013.

Note that many of the changes as to future hires appear in new Government Code sections 7522 *et seq.*, not in the CERL provisions found at Government Code sections 31450, *et seq.* This continues a recent trend of the Legislature of placing laws that apply to public employee retirement systems generally, not just the twenty CERL systems, in the 7500 series of the Code.

A. CURRENT ACTIVE EMPLOYEES

The reduced benefit formulas and limits on calculating “compensation earnable” (i.e., pensionable compensation) contained in the Act do not apply to current employees. However, the clarification of what is excluded from compensation earnable and the additional auditing responsibilities each retirement system must perform, and procedures it must adopt rein in “pension spiking,” will apply to current active employees.

Also, provisions requiring a county or district to identify the pay period in which compensation was earned, regardless of when it was reported or paid, and limiting the reporting of compensation to the retirement system to only compensation earnable, will apply.

In addition, the retirement board may assess the county and districts reasonable fees to cover the cost of audit, adjustment or correction when the board determines that the county or district knowingly failed to report compensation in accordance with the new provisions.

Finally, the governing bodies of employers will be able to collectively bargain with their respective employees to require payment of all or part of the member and employer contributions, so long as they are uniformly applied and do not violate laws in place as of December 31, 2012.

1. CHANGES THAT WILL APPLY TO CURRENT ACTIVE EMPLOYEES

- Employers cannot adopt an enhanced benefit formula after January 1, 2013 and apply it to past service
- The retirement system must now determine whether compensation was paid to enhance a member's retirement benefit, which could include:
 - compensation that was previously paid in kind that was converted to cash during the member's final average salary measuring period (like furnishing a car, then converting that to an auto allowance)
 - one time or ad-hoc payments provided to a member but not all similarly situated members in the grade or class,
 - payments made solely due to the termination of the member, with the exception of unused vacation, leave or compensatory time that does not exceed what the member could earn and receive in cash in each 12-month period during the final average salary measuring period
- The member can challenge the board's determination that compensation was paid for the sole purpose of enhancing the member's pension including judicial review by writ of mandate
- A county or district must report only compensation earnable to the retirement system, and must certify what pay period in which the compensation was earned regardless of when it was paid
- If the county or district knowingly fails to report compensation correctly, the retirement system can audit and assess fees to cover the cost of the audit, correction or adjustment necessary and the county or district may not pass this cost on to employees
- The retirement board may also audit the county or district to determine correctness of retirement benefits, reportable compensation, and enrollment in or reinstatement to the system

2. UNCHANGED FOR CURRENT ACTIVE EMPLOYEES

- There are no benefit formula reductions
- There are no changes in how we calculate final average salary, unless a current employee terminates employment and becomes a "new employee" (defined below) under the new Act, or a current employee receives compensation determined by the Board to be paid to enhance the member's retirement benefit (see above)

3. POSSIBLE CHANGES FOR CURRENT ACTIVE EMPLOYEES

- The Board of Supervisors or governing bodies of districts may negotiate with employees under collective bargaining to require that employees pay all or part of member and employer contributions (both normal cost and unfunded liability cost), as long as it is uniformly applied, agreed to in a memorandum of understanding, and does not violate the law in place as of December 31, 2012
- The Board of Supervisors or governing bodies of districts may require that members pay 50 percent of normal cost of benefits, as long as it is no more than 14% above the normal rate established for general members, 33% of the normal rate established for safety members who are local police officers, firefighters and county peace officers and 37% above the normal rate established for safety members other than local police officers, firefighters and county peace officers, as long as it does not violate the law in place as of December 31, 2012

B. CURRENT RETIREES

There is no change in current retirees' benefits. There are, however, changes to the ability to return to work after retirement (but there is a question about whether this might violate other CERL provisions.)

1. CHANGES THAT WILL APPLY TO CURRENT RETIREES

- The Act restricts the ability of a retiree to return to work for a public employer in the same retirement system without reinstatement to active service and a suspension of the retirement benefit unless it is during an emergency to prevent stoppage of public business or because the retired person has skills needed to perform work of limited duration, as long as the retiree did not receive unemployment benefits arising from the prior employment. In either case, the work shall not exceed 960 hours in a calendar or fiscal year at a specific rate of pay and the retiree cannot come back to work before 180 days after retirement unless the employer certifies that the nature of employment and the appointment is necessary to fill a critically needed position sooner than 180 days and the employer's governing body approves it in a public meeting, or the retiree is a safety member. A retired member who received a retirement incentive must wait at least 180 days to return to work.
- Returning to work as a member of a state board or commission is also limited depending upon the circumstances of the appointment.

2. UNCHANGED FOR CURRENT RETIREES

- There is no change to a retiree's benefit formula or final average salary used to calculate their retirement allowance

- There is no change to the Cost of Living Adjustment (COLA) provisions and supplemental COLA (“STAR” or “Dollar Power” COLA) provisions.

C. NEW EMPLOYEES HIRED ON OR AFTER JANUARY 1, 2013

A “new employee” is defined as an employee who is first elected or appointed by any public employer on or after January 1, 2013 and who was not employed by any other public agency prior to that date, unless they terminated from the other public employer and did not establish reciprocity with the new employer’s retirement system. A “new member” of a retirement system is an employee who first becomes a member of a public retirement system on or after January 1, 2013 who was not a member of a public retirement system prior to that date unless reciprocity is established or did not have a break in active membership for more than six months.

1. CHANGES FOR NEW EMPLOYEES

- For “new employees” who become “new members” of the retirement system, an employer must adopt a new defined benefit formula for both general and safety members unless that employer has a benefit formula in place (either defined benefit or defined contribution) that is equal to or lower than the formula described in the new Act. An employer cannot offer a supplemental defined benefit plan to new employees or new groups of employees not currently covered under an existing plan.
- General member benefit formula that allows retirement at age 52 with 5 years of service at 1.0%, increasing to 2.5% at 67
- No disability retirement for general members contained in the legislative language, (but there is a question about whether current CERL sections would apply)
- Limiting compensation for both general and safety members used to calculate the retirement benefit to 100% of the Social Security level if covered by Social Security or 120% of the Social Security level if not covered, adjusted by changes in the Consumer Price Index for all Urban Consumers annually on January 1st following the annual valuation. (System members likely are not covered by Social Security)
- Limiting “compensation earnable” (i.e., pensionable compensation) to the normal monthly rate of pay or base pay paid to similarly situated members of the same group or class of employment for full-time services during normal working hours
- Pensionable compensation may not include any compensation determined by the board to be paid solely to enhance a member’s retirement benefit, including but not limited to
 - In kind benefits being converted to cash payments during the member’s measuring period
 - One time or ad hoc payments

- Separation payments paid in connection with termination from employment, except the amount not exceeding what could be earned and payable during the final compensation period
- Pensionable compensation also may not include:
 - Any payments for unused vacation, annual leave, personal leave, sick leave, or compensatory time off, regardless of when reported or paid, except the amount not exceeding what could be earned and payable during the final compensation period
 - Payment for services rendered outside of normal working hours, overtime (unless FLSA time)
 - Employer provided allowances like housing, auto, or uniform
 - Employer contribution to deferred compensation or defined contribution plans
 - Any bonuses paid in addition to base pay
 - Any other compensation the retirement board determines is in excess of the member's monthly rate of pay or base pay as paid to similarly situated members of the same group or class for full-time services during normal working hours
 - Any other compensation the retirement board determines should not be pensionable compensation
- Employers may not offer any defined benefit, including those offered by private providers, on compensation in excess of the Social Security limit, but can offer contributions to a defined contribution plan, subject to limitations, if it conforms with federal law. This does not create a vested right to continue to receive the employer contribution
- No new supplemental defined benefit plans may be offered to new employees or groups of employees not currently covered
- Employers and employees must equally share normal cost and employees must pay at least 50% unless it is collectively bargained for the employee to pay more. The normal cost rate is the annual actuarially determined normal cost of the defined benefit plan expressed as a percentage of payroll
- The normal cost provisions apply unless there is a collective bargaining agreement in place that applies on January 1, 2013, until that agreement is renewed, amended or extended
- Final average salary will be measured over a three year period

- Three safety member benefit formulas to choose from that each allows retirement at age 50 with 5 years of service. The Basic Safety Plan provides 1.426% at 50, increasing to 2% at 57 and over. The Safety Option One Plan provides 2% at 50, increasing to 2.5% at 57 and over. The Safety Option Two Plan provides 2% at 50, increasing to 2.7% at 57 and over
- The safety employers choice between the three safety formulas is limited to the formula that provides a lower benefit at 55 years of age than the formula provided to safety members on December 31, 2012
- On or after January 1, 2013 safety employer and employees can negotiate a change to a lower safety benefit formula for new employees of that bargaining unit hired on or after the effective date of the agreement if collectively bargained and agreed to in a memorandum of understanding
- The safety employer who negotiates a lower benefit formula for new employees shall not provide different defined benefits to non-represented, managerial or supervisory employees than the employer provides for other employees in the same membership classifications
- Safety members can receive a service connected disability retirement equal to the greater of 50% of final compensation attributable to the defined benefit plan plus an annuity purchased with accumulated member contributions, or a service retirement if qualified, or an actuarially reduced factor determined by the actuary for each quarter year that his/her service age is less than 50 years of age multiplied by years of safety service. This section is repealed as of January 1, 2018 unless there is a later enacted statute extending its provisions
- Internal Revenue Code Section 401(a)(17) limits apply to the compensation that can be considered when calculating a retirement benefit, like they do now. An employer cannot make contributions to any qualified retirement plan on compensation in excess of the limit. The 2012 limit is \$250,000
- An employer cannot establish a replacement benefit plan for benefits that are limited by Internal Revenue Code Section 415. The 2012 limit is \$200,000 for age 62, adjusted downward the earlier a member retires, unless certain rules apply
- Officers elected or appointed to a city council or board of supervisors on or after January 1, 2013 will have their retirement benefit based on highest average annual pensionable compensation earned by the member during the period of each elective office
- Forfeiture of benefits by convicted felons

- No purchase of non-qualified service credit (e.g., “air time”) under Section 415(n)(3)(C) of the Internal Revenue Code unless the purchase began prior to January 1, 2013
- Employers may not contribute less than normal cost unless the plan is funded above 120% per the system’s actuary, the actuary determines that continuing to accrue excess earnings could result in disqualification of the plan’s tax exempt status under the Internal Revenue Code, and the board determines that receipt of any additional contributions would conflict with its state constitutional fiduciary duties