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Subject: Implementation of California Public Employees' Pension Reform Act, AB 340 and AB 197 – "New Members"

Summary: In September 2012, Governor Brown signed AB 340 and AB 197 which changes the way pension benefits are calculated for new members and modifies some elements of pay and contributions requirements for both new and current members. This memorandum describes certain procedures and rules that apply to new members. Should you have any questions, you are encouraged to contact StanCERA staff at 209-525-6393.

New Members hired on or after January 1, 2013

1. Payroll reporting (31542)

As of January 1, 2013, AB 340 requires all plan sponsors within the StanCERA System to identify the pay period in which compensation was earned, regardless of when it was reported or paid. This requirement is meant to facilitate implementation and monitoring of all aspects of the new legislation, including the determination of pay elements used to enhance a member's retirement benefit (see below for those pay elements that are reportable and allowed to be used in determining compensation earnable).

2. Commission of a felony (7522.74)

If a public employee first employed by a public employer is convicted of a felony arising out of the performance of his or her official duties, then that employee will forfeit any benefit earned on and after the date of the commission of the felony. The monitoring of this requirement of AB 340 will ultimately be the responsibility of the plan sponsor and should be reported to StanCERA.

3. Definition of a "New" Member (7522.02)

Any employee that is designated a new member is automatically enrolled in the new tier of benefits (StanCERA Tier 6) prescribed by AB 340. AB 340 defines a new member as any of the following:

1. An individual who becomes a member of any public retirement system for the first time on or after January 1, 2013, and who was not a member of any other public retirement system prior to that date.
2. An individual who becomes a member of a public retirement system for the first time on or after January 1, 2013, and who was a member of another public retirement system prior to that date, but who was not subject to current reciprocity rules.

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3. An individual who was an active member in a retirement system and who, after a break in service of more than six months, returned to active membership in that system with a *new* employer.

The following is a link to a flow chart that describes all potential reciprocity situations and the resulting tier placement of the member.

[Potential Reciprocity Situations & Resulting Tier Placement](#)

4. Highly Paid Employees – contributions to defined contribution/deferred compensation plans (7522.10)

AB 340 limits the salary used to calculate a member's retirement benefit to the social security wage base in effect for the year in which retirement contributions were made on that salary (see below for more details). As a result, "highly compensated employees" (those earning more than the social security wage base) will have their ultimate retirement benefit capped.

AB 340 allows an employer to contribute to a defined contribution/deferred compensation plan for highly compensated employees with the following limitation: the employer contributions to the defined contribution/deferred compensation plan along with the regular employer contributions to the defined benefit plan cannot be greater than the employer contributions (*as a percentage of payroll*) made to the defined benefit plan for lesser compensated employees. An example may make this clearer.

Assume the social security wage base cap in effect is \$100,000. Assume further that the total employer retirement contribution rate is 10% of pay and the highly compensated employee in this example makes \$150,000. The annual employer contribution limit to a defined contribution/deferred compensation plan is \$5,000 ($[(150,000 - 100,000) \times 10\% = \$5,000]$).

Each year the social security wage base adjusts for inflation. The wage base in effect for 2013 is \$113,700.

StanCERA has no means to monitor this element of AB 340 and as such, the responsibility will be that of the employer.

5. Flat employee rates

On December 12, 2012 the StanCERA Board voted to approve flat employee contribution rates for all new members. This means all new members will pay the same employee contribution rate regardless of their entry age (age at which they were first hired into a public retirement system). Consequently, as of January 1, 2013, all new General members will pay a flat rate of 7.50% and all new Safety members will pay a flat rate of 13.0%.

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6. Social Security Integration

On December 12, 2012 the StanCERA Board voted to approve the elimination of social security integration with the new formulas. This means that new members will no longer pay a reduced rate below the first \$350 of salary. It also means that new members will no longer have a reduction offset to their retirement benefit. The combination of the lack of integration along with the flat employee rate means that employers will only have to report employee contributions based on a single rate.

Be aware that this decision by the Board does NOT mean new members are not a part of the Old Age, Survivor and Disability Insurance program. Both the employer and employee will still contribute and the employee/survivor will receive benefits at the onset of retirement, death or disability. The only difference is that the employee will no longer pay a slightly reduced

StanCERA member contribution rate based and their retirement benefit from StanCERA will no longer be offset or reduced.

7. Benefits/Formulas default option for safety (7522.20, 7522.25)

AB 340 mandates new retirement formulas for all new members hired on or after January 1, 2013. For general members, there is only 1 formula which StanCERA will begin implementing on January 1, 2013. For Safety members, AB 340 provides a choice of 3 different formulas, whereby, the default option is the formula that is closest in cost to the current formula, but not greater.

The default Safety formula that StanCERA will begin implementing on January 1, 2013 is very similar to the Tier 2 Safety formula currently in effect for County Safety members (2.0% @50). AB 340 refers to this formula as *Safety Option Plan Two*.

While StanCERA will implement this formula for all new StanCERA Safety members, each StanCERA employer will have the ability to contract for one of the two lower Safety formulas in the future should they so desire.

The other two formulas, *Safety Option Plan One* and the *Basic Safety Plan*, along with the default option being implemented by StanCERA can best be described by their benefit multiplier at age 57:

| | |
|---|------|
| <i>Basic Safety Plan</i> | 2.0% |
| <i>Safety Option Plan One</i> | 2.5% |
| <i>Safety Option Plan Two (default)</i> | 2.7% |

Please see our Member handbook on our website for the factors at all ages for the default formulas for both General and Safety that StanCERA will begin implementing on January 1, 2013.

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8. Pensionable Compensation

a. Board of Retirement responsibility (7522.34 (c) (1))

While AB 340 is very specific on certain items that may or may not be included in the calculation of pensionable compensation, it is ambiguous on others. Ultimately, AB 340 does confer the responsibility for determining what may or may not be included in pensionable compensation to the Board of Retirement.

b. Social Security wage base limitation (7522.10 (c), (d))

AB 340 disallows the use of compensation in excess of the Social Security wage base to be used in the calculation of a member's retirement benefit. For the calendar year 2013, this amount is \$113,700. The base (limit) is indexed each year with inflation.

c. Reporting wages under the limit

As a result of the social security wage base limitation, employers will no longer be allowed to report wages above this limit at the point in time it is reached in the calendar year. However, actual hours worked beyond the limit will still need to be reported to StanCERA. Employee contributions will also need to stop when the limit is reached.

d. Allowable pay elements

On December 12, 2012 the StanCERA Board voted to approve base pay only in the calculation of pensionable compensation for new members.

e. Definition of similarly situated members (7522.34)

Throughout the new legislation the term “similarly situated members” is used. Currently, there is proposed clean up legislation that would more clearly define similarly situated members as “*those members that share the same retirement formula*”.

9. Employee contributions (7522.30 (a), 7522.30 (e))

AB 340 sets the standard that the employee contribution rate be at least 50% of the total aggregate normal cost required to fund their benefit. The normal cost is the level percentage of payroll contribution required to fund an employee's additional year of service credit that will be earned in the year in which those contributions will be made. Through the negotiation process, the employer and employee may bargain to increase this proportion.

The employer and employee may also bargain to have employees pay any amount up to the total cost of the plan which could include the unfunded liability.

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10. Employer “pick-ups” (7522.30 (a), (f))

AB 340 no longer allows employer pick up of employee contributions for new members, unless there is a current agreement in place that allows for it. However, when that agreement expires, the employer will no longer be allowed to pick up these contributions.

11. Sick leave conversion to service credit

Sick leave conversion to service credit will continue to be allowed for new members. AB 340 deals only with elements of compensation (as opposed to service credit) that can be used to increase a member’s retirement benefit.

12. Vesting

Retirement benefit vesting for new members takes place when five years of service credit have been earned. The 10-year membership requirement no longer applies.

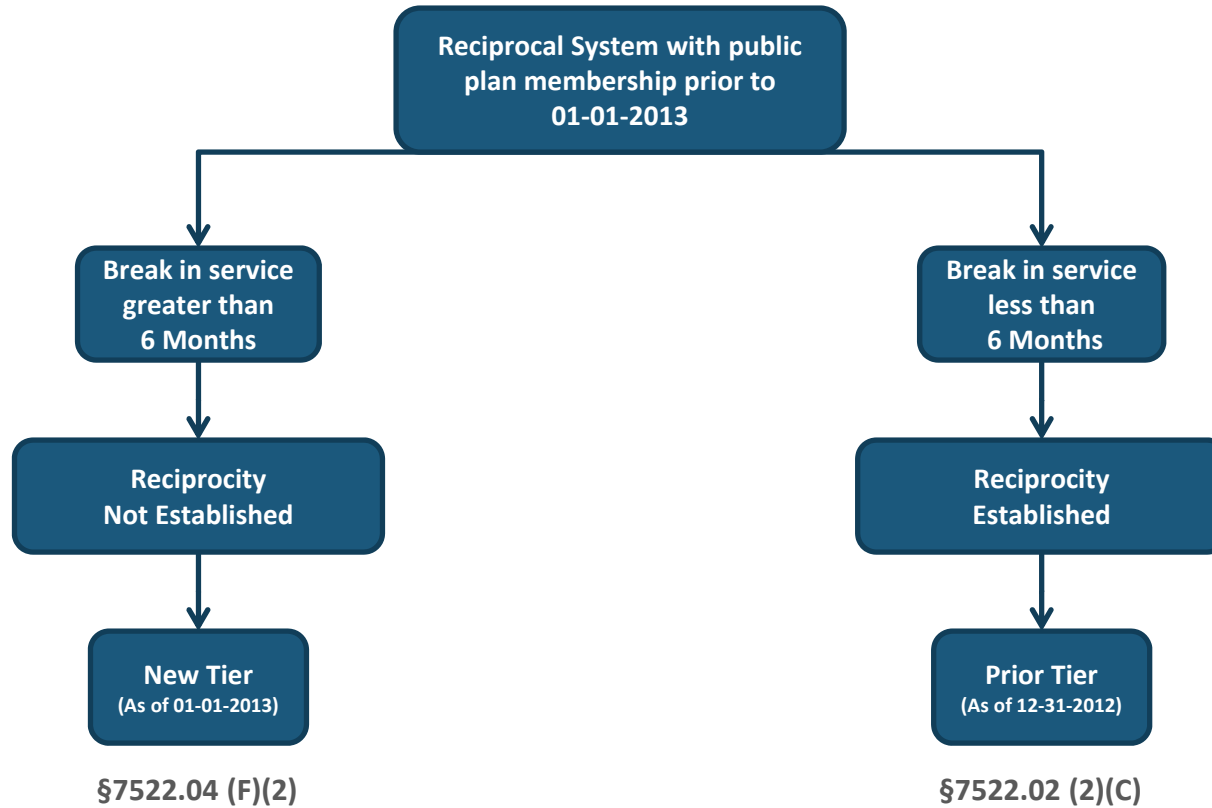
13. Retirement ages

AB 340 imposes new early retirement ages for new members. For general members, the earliest one can retire is age 52. Safety members may still retire at age 50, however, the ability to retire at any age with 20 years of service is no longer available. Please see the member handbooks available on our website for early retirement ages and their associated benefit multipliers.

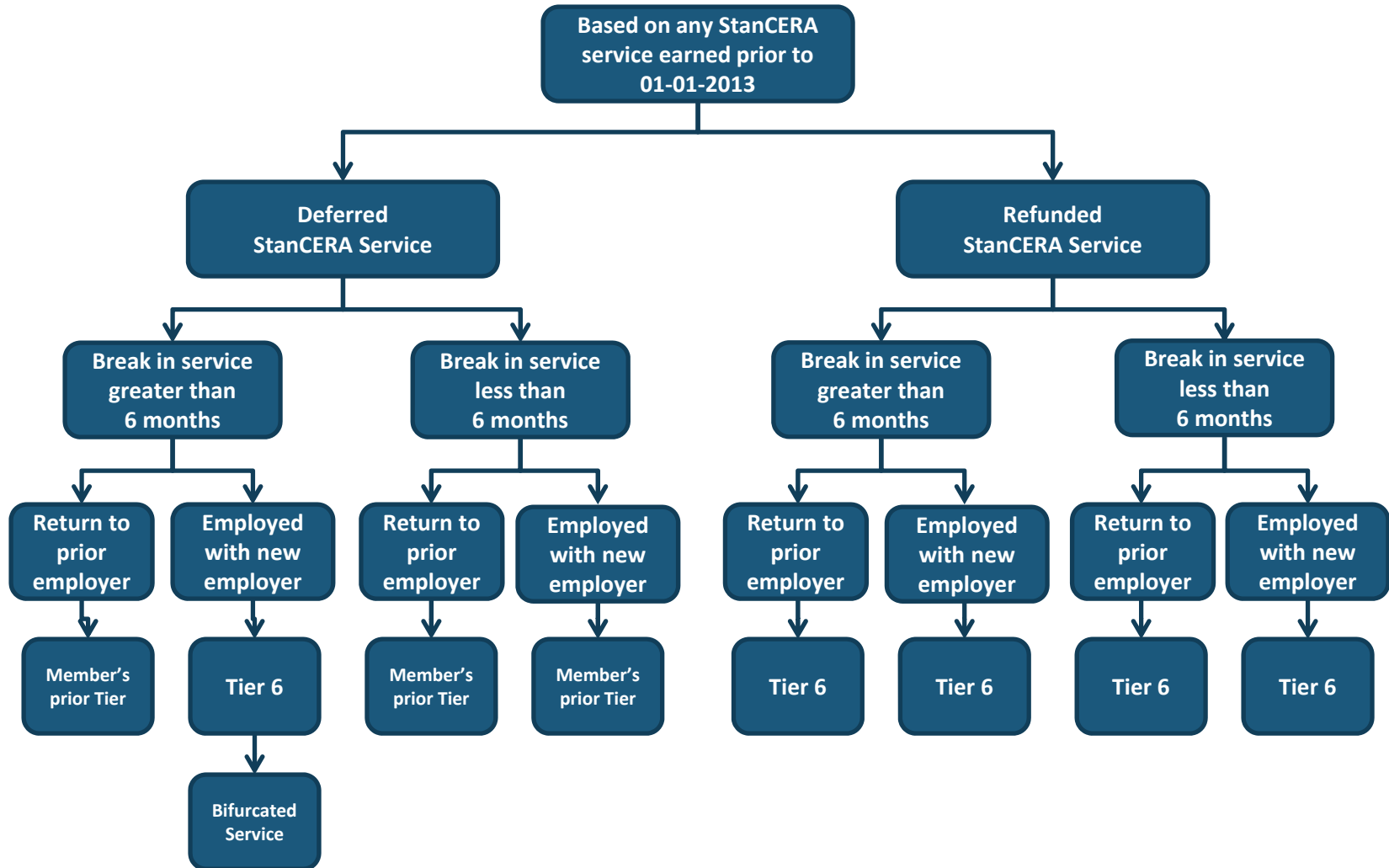
14. Redeposits

New members will still be able to redeposit contributions to purchase service credit for past employment or an approved leave of absence for which StanCERA retirement contributions were not made. StanCERA is currently in the process of revising the payment methodology. Please contact StanCERA for more details.

Non-Prior StanCERA Member



Prior StanCERA Member ONLY



Prior StanCERA Member

