INITIAL STATEMENT OF REASONS

Proposed Amendment to Add Section 579.9 of Article 6 of Subchapter 1 of Chapter 2 of Division 1 of Title 2 of the California Code of Regulations (CCR).

The proposed regulation is necessary to assist with the implementation and administration of Government Code (GC) Section 20791, added by Assembly Bill (AB) 340 (Stats. 2012, Ch. 296). It would implement CalPERS' interpretation of GC Section 20791 by defining a significant increase in actuarial liability due to increased compensation paid to a nonrepresented employee and establishing criteria to identify the impacted and causative agency or agencies. The proposed regulation would also clarify when the significant increase in actuarial liability will be determined and how it will be allocated between an impacted agency and the respective causative agency or agencies.

PROBLEMS THE PROPOSED REGULATION INTENDS TO ADDRESS

On September 12, 2012, Governor Brown signed into law AB 340 which included the California Public Employees' Pension Reform Act (PEPRA) and related amendments to the Public Employees' Retirement Law (PERL). These statutory provisions became effective on January 1, 2013. This legislation added GC Section 20791, which requires the CalPERS Board of Administration (Board) to define a significant increase in actuarial liability due to increased compensation paid to a nonrepresented employee. It also requires the Board to implement program changes to ensure that a contracting agency that creates the significant increase in actuarial liability bears the increased liability. GC Section 20791 only requires allocation of actuarial liability between CalPERS contracting agencies. Therefore, the actuarial liability of the State and most school employers will not be impacted by GC Section 20791 and the proposed regulation.

GC Section 20791 does not provide criteria for the Board to use to determine what constitutes a significant increase in actuarial liability due to increased compensation paid to a nonrepresented employee, nor does it specify when the increase in actuarial liability should be calculated and how it should be allocated. Rather, such determinations are left to the Board's discretion.

PURPOSE, BENEFITS, OR GOALS OF THE AUTHORIZING STATUTES

Currently, when an increase in compensation occurs for a member, all employers in the member's career share the increased actuarial liability. When a member was employed by more than one employer, CalPERS calculates his or her retirement or survivor benefits and all of his or her employers' actuarial liabilities based in part on the member's final compensation, as defined by the PERL.

GC Section 20791 provides that if a contracting agency pays compensation to a nonrepresented employee that causes a significant increase in actuarial liability for another contracting agency, the Board must ensure that the contracting agency that creates the significant increase in actuarial liability bears that increase.

RATIONALE FOR DETERMINATION THAT ADOPTION IS REASONABLY NECESSARY TO ADDRESS THE PROBLEM

The proposed regulation is necessary to define a significant increase in actuarial liability due to increased compensation paid to a nonrepresented employee, as required by GC Section 20791. The proposed regulation is also necessary to establish criteria to identify impacted contracting agencies and causative contracting agencies, and to clarify when the significant increase in actuarial liability will be determined and how the increased liability will be allocated. The criteria established in the regulation will assist CalPERS team members to ensure transparent and consistent application of GC Section 20791, and provide clarity to contracting agencies and CalPERS members on the system's interpretation of GC Section 20791.

The proposed regulation is consistent with the PERL, including GC Section 20791. The proposed regulation is reasonably necessary to effectuate the purpose of GC Section 20791.

SPECIFIC PURPOSE FOR THE ADOPTION OF THE PROPOSED REGULATION

Purpose of the Proposed Regulation

Section 579.9, subdivision (a): To define a significant increase in actuarial liability due to increased compensation by specifying an *Actuarial Liability Test* and *Compensation Test*. In addition, this subdivision specifies that CalPERS will determine whether a significant increase in actuarial liability due to increased compensation has occurred as of the earlier of the member's date of retirement or death on or after January 1, 2013.

Section 579.9, subdivision (b): To define the term "impacted agency" for purposes of the proposed regulation.

Section 579.9, subdivision (c): To define the term "causative agency" for purposes of the proposed regulation.

Section 579.9, subdivision (d): To clarify how a significant increase in actuarial liability due to increased compensation will be allocated between the impacted agency and its respective causative agency or agencies.

BENEFITS

The proposed regulation will help CalPERS implement GC Section 20791 in a transparent and consistent manner and provide clarity to contracting agencies and CalPERS members regarding the system's interpretation of GC Section 20791.

NECESSITY

Section 579.9, subdivision (a): This subdivision is necessary to implement GC Section 20791's requirement that the Board define a significant increase in actuarial liability due to increased compensation paid to a nonrepresented employee. Criterion 1 (Actuarial Liability Test) under subdivision (a)(1) sets the threshold to identify a significant increase in actuarial liability as compared to the actuarial liability that would be reasonably expected. Criteria 2 and 3 (Compensation Test) under subdivision (a)(2) constitute the method to identify whether an increase in compensation caused a significant increase in actuarial liability. The Criteria takes into account reasonable compensation growth over time which may occur when a member works for the same employer or multiple employers for an extended amount of time and retires with a high final compensation at the end of his or her career. The Compensation Test ensures that CalPERS takes both the value and growth rate of compensation increases into consideration.

This subdivision is also necessary to clarify that CalPERS will determine whether a significant increase in actuarial liability due to increased compensation has occurred as of the earlier of the member's date of retirement or death on or after January 1, 2013. Since the employers' actuarial liability for a member can change significantly during the member's career due to events such as death, termination, or disability retirement, CalPERS team members determined that assessing employers' actuarial liability at the member's retirement or death is the most efficient and accurate method of implementing GC Section 20791.

Section 579.9, subdivision (b): GC Section 20791 provides that upon identifying a significant increase in actuarial liability due to increased compensation, the system actuary shall assess the increase to the employer that created it and adjust its rates to account for the increased liability. CalPERS has interpreted this provision to require CalPERS to identify the contracting agency that has been impacted by a significant increase in actuarial liability due to increased compensation. This subdivision is necessary to define an impacted agency for purposes of allocating actuarial liability between the impacted agency and the causative agency or agencies under GC Section 20791 and subdivision (d) of the proposed regulation.

Section 579.9, subdivision (c): GC Section 20791 provides that upon identifying a significant increase in actuarial liability due to increased compensation, the system actuary shall assess the increase to the employer that created it and adjust its rates to account for the increased liability. CalPERS has interpreted this provision to require CalPERS to identify the contracting agency or agencies that created the significant increase in actuarial liability due to increased compensation. This subdivision is necessary to define a causative agency for purposes of allocating actuarial liability between the impacted agency and the causative agency or agencies under GC Section 20791 and subdivision (d) of the proposed regulation.

Criterion 1 applies a test on the compound average growth rate between the member's highest annual compensation at the impacted agency and a subsequent employer to determine whether the highest annual compensation paid to the member by the subsequent employer is greater than the amount that is reasonably expected. The subsequent employer will be a causative employer if the compound average growth rate in highest annual compensation is at least ten percent.

Criterion 2 provides that a contracting agency that subsequently employed a member who was previously employed by a causative agency under Criterion (1) above and that pays the member a highest annual compensation greater than the highest annual compensation paid by such causative agency will also be a causative agency.

This subdivision clarifies that neither Criteria 1 nor 2 are met where the highest annual compensation paid by the contracting agency is for service performed by the member while covered by a memorandum of understanding or while a member of a recognized employer organization under GC Section 3501.

Section 579.9, subdivision (d): GC Section 20791 provides that upon identifying a significant increase in actuarial liability due to increased compensation, the system actuary must assess the increase to the employer that created it and adjust its rates to account for the increased liability. This subdivision is necessary to clarify how actuarial liability will be allocated between the impacted agency and the causative agency or agencies.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS

AB 340 (Stats. 2012, Ch. 296)
Economic and Fiscal Impact Statement (STD. 399)

BUSINESS IMPACT

The proposed regulation is not expected to have any impact on business because it will only directly impact CalPERS contracting agencies, and not private businesses. The intent of the proposed regulation is to help implement GC Section 20791 by establishing criteria for defining a significant increase in actuarial liability due to increased compensation and clarifying how such increased actuarial liability will be allocated between impacted and causative CalPERS contracting agencies.

ECONOMIC IMPACT ASSESSMENT
The proposed regulation is consistent with existing law and is necessary to help implement GC Section 20791. In accordance with GC Section 11346.3(b), CalPERS has made the following assessments regarding the proposed regulation:

Creation or Elimination of Businesses and Jobs within the State of California
The proposed regulation is not intended to create or eliminate any jobs or businesses within the State of California. It will only impact CalPERS contracting agencies, and not private businesses.

Expansion of Businesses within the State of California
The proposed regulation will not expand or prevent the expansion of any existing businesses within the State of California. The proposed regulation will only directly impact CalPERS contracting agencies, and not private businesses.

Benefit of the Regulation to the Health and Welfare of California Residents, Worker Safety, and the State's Environment
The proposed regulation will not affect the health and welfare of California residents, worker safety, or the State's environment. The proposed regulation will only impact actuarial liabilities for affected CalPERS contracting agencies and will not change benefits for CalPERS members or survivors.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS
The proposed regulation will not have a significant statewide adverse economic impact directly affecting business, including the ability of businesses in California to compete with businesses in other states. The intent of the proposed regulation is to implement GC Section 20791 by establishing criteria for defining a significant increase in actuarial liability due to increased compensation and clarifying how such increased actuarial liability will be allocated between impacted and causative contracting agencies. The proposed regulation will only directly impact CalPERS contracting agencies, and not private businesses.

ALTERNATIVES TO THE REGULATORY ACTION AND CALPERS' REASON FOR REJECTING THOSE ALTERNATIVES
CalPERS did not deem any alternatives to be as efficient or effective as the proposed regulation. Regulatory action was determined to be the most transparent and consistent means of implementing GC Section 20791, and providing clarity to contracting agencies and CalPERS members on the system's interpretation of this GC section. 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 regulation will only apply to CalPERS and its contracting agencies. GC Section 20791 and the proposed regulations will not apply to private businesses. As CalPERS has not identified any impacts to small businesses caused by the proposed regulatory action, it has not identified any reasonable alternatives that would lessen the impact on small businesses.

DUPLICATION OR CONFLICT WITH OTHER STATE AND FEDERAL REGULATIONS

The proposed regulation does not duplicate and is not in conflict with other State and federal regulations.