January 2023 News

California's Historic Pension Reform Act Turns 10!

The California Public Employees' Pension Reform Act of 2013 took effect on January 1, 2013. Referred to as "PEPRA," it applies to all state and local public retirement systems, including CalPERS and County pension systems. PEPRA was passed in the Great Recession when pension reform advocates cited CalPERS funding shortfalls as a basis to gut retirement benefits for public sector workers. The narrative, according to those "reformers," was that public services would be curtailed as public agencies are forced to allocate even greater portions of their operating budgets to fund runaway pension costs.

Thankfully, that narrative turned out to be hyperbolic, and the more extreme proposals never saw the light of day. In its place, though, came PEPRA, which does incorporate some commonsense reforms, combined with a new two-tier system that significantly reduced pension benefits for future workers. Ten years in, that future has now arrived.

The dividing line for the two-tier system is January 1, 2013. Employees hired before that date are referred to as Classic Members. Those hired on or after that date are referred to as New Members. Ten years ago, all public employees were Classic Members. But over the past decade, as many baby boomers have retired and younger generations have advanced, more and more of the workforce are New Members. In fact, it's become somewhat common for local agencies to now employ more New Members than Classic. And that ratio is only accelerating towards New Members as more Classic Members retire.

Ten years ago, most agencies were seeking concessions from public employee organizations to balance their budgets. Revenue had fallen and costs exploded in the Great Recession. That placed public employees squarely in the crosshairs. Ten years later, the tables have turned. Agencies are scrambling to recruit and retain a skilled workforce during one of the toughest labor shortages in a generation. That future was not quite envisioned or respected when PEPRA passed.

But we've been here before. Pension benefits – particularly a retirement formula – was used during the 2000's to promote employee retention and longevity with a single employer. Referred to as "golden handcuffs," the logic was that employees would not leave one employer to work for another and risk giving up the higher pension formula that they had secured at their current agency. Public employee organizations negotiated for pension formula enhancements, and public agencies agreed. As a result, it was not uncommon to see employees work for a single public agency for 20 years or longer.

These days, all New Members have the same retirement benefits regardless of which agency they work for. The golden handcuffs are off. Now, many employees are finding it more lucrative to leave one agency to work for another. Sometimes a small differential in pay, or new hire sign-on bonuses, are enough to lure workers away from their current agency. With pay data now so readily available to the public online, it's not hard for New Members to find out what other agencies will pay for the same work. Historically, employees were reluctant to move and would leave their agency only for promotions. Now, many employees choose a new employer for a lateral position.

With PEPRA now setting a level playing field for pension benefits, agencies must be more creative in offering perks. For some agencies, that means offering active employees an employer match into employee 457 deferred compensation accounts. For others, that means offering or restoring longevity pay – a benefit many agencies eliminated in the

Great Recession but are now coming to appreciate how this incentive helps secure a stable and knowledgeable workforce.

What began as mostly a state-wide problem, with some local bargaining over how much and when employees would contribute towards pension costs, the effects of pension reform are now a local problem. There is uncertainty over when and if there will be some relief provided at the state level. Currently, pension systems such as CalPERS cannot provide New Members with a higher retirement formula absent new legislation.

Below are some of the major changes PEPRA has already made in its first ten years:

Pension Formula: Classic Members (those hired before 2013) could have a variety of formulas, including the 2% @ 60 Plan, the 2% @ 55 Plan, the 2.5% @ 55 Plan, the 2.7% @ 55 Plan, and the 3% @ 60 Plan. The latter two plans, in particular, are known for their enhanced benefits. New Members (those hired on or after January 1, 2013) have the same reduced 2% @ 62 plan, which is fixed by law. The maximum benefit factor is now 2.5% @ age 67.

Definition of Final Compensation: For many Classic Members, their formula is applied to their single highest year of pensionable compensation. For New Members, PEPRA requires "final compensation" to be based on the highest average annual pensionable compensation earned by the employee during a period of at least 36 consecutive months. The compensation must be set forth on a publicly available pay schedule that can be used to calculate the amount of the employee's retirement benefit. CalPERS requires the formulas be adopted by the public agency through an appropriate resolution for a group or class of employees and be available for public review.

Pensionable Compensation: PEPRA changed what kinds of income are considered pensionable. Base wages and salary are included, of course. But other specialty pay items are included too. These amounts are combined and used as a total figure to calculate how much the retiree will get in monthly retirement checks. The Government Code defines what is pensionable for Classic Members (defined as "compensation earnable" which includes special compensation). PEPRA defines what is pensionable for New Members. Everything that is pensionable for New Members is also pensionable for Classic Members. In addition, Classic Members have additional pensionable items not available to New Members, including:

- Any one-time or ad hoc payments (Off-Salary-Schedule Payments)
- Bonuses and Severance
- Housing or transportation reimbursements
- Overtime allowances
- Temporary Upgrade Pay
- Unused Vacation Time
- Uniform Allowances

Pension Contributions: For Classic Members, contributions are broken down between an employer rate and an employee rate. For Classic Members, the employee rate is a fixed percentage – either 7% or 8% of pay, depending on the pension formula. The employer rate fluctuates. Some pension funds – including CalPERS – were "super-funded" 20 years ago, and the employer rate was set at 0%. The employer rate has skyrocketed since the Great Recession. Today, it is not uncommon to have an employer rate at around 20-30% of salary. That's a big increase in a small amount of time.

For New Members, pension contributions are broken down by "normal cost." The New Member pays 50% of the normal cost, and the employer pays 50% of the normal cost. This is typically around 6.5% of salary for each, for a total of 13%, but that number has been increasing. The employer pays 100% of other costs beyond the normal cost rate.

When employee contributions are made on the employee side, they go into an account for each employee that can be withdrawn with interest if the employee does not vest into a pension benefit. When contributions are made on the employer side, they simply go towards helping the employer pay for the cost of retirement benefits and to help reduce the agency's unfunded liability with the pension system.

If negotiated in a collective bargaining agreement, both Classic Members and New Members can make contributions known as "cost-sharing," which are additional employee contributions towards the employer's account. Cost-sharing became more common around 2018 or so but has become less common since COVID and during the current competitive labor market.

Pension Caps: PEPRA imposed a cap on pensionable compensation for New Members. The cap is different depending on whether the employer participates in Social Security. If the employer does, the cap is $113,700 annually. If the employer does not, the cap is

$136,440 annually. These are the amounts for 2013. The cap increases each year depending on changes in the Consumer Price Index for All Urban Consumers. For 2023, the caps are $160,200 and $192,240, respectively.

The average pension payout for a typical retiree is much less than these caps. According to the latest published CalPERS figures, for example, for fiscal year 2020-2021, the average annual retiree allowance was just under $40,000 per year, or $3,281 per month. The average retirement age was 58 and the average years of service were 20. Nearly 60% of all service retirees receive less than $3,000 per month.

Purchasing Service Credit (Buying Air-Time): Starting January 1, 2013, PEPRA eliminated the ability for employees to purchase "air-time." This was challenged and upheld by the California Supreme Court in *Cal Fire Local 2881 v. CalPERS* (2019) 6 Cal.5th 965. However, the ability to purchase service credit for qualified military service is still available.

No Suspension of Contributions: Total employer and employee contributions towards the plan may not be less than the plan's normal cost rate for that defined benefit plan for that fiscal year. However, contributions may be suspended if the plan is funded by more than 120% (*i.e.* "superfunded" according to a certain metric) and other criteria are met.

Retroactive Benefit Enhancement: Prior to January 1, 2013, retirement benefits were increased either retroactively or prospectively. Any enhancement to a public retirement system's retirement formula or benefit that is adopted on or after January 1, 2013, will apply *only* to service performed on or after the operative date of the enhancement. If a member is reclassified to a position that results in a higher retirement formula or benefit, only future service will be credited under that higher retirement formula or benefit. Cost of living adjustments that are within existing statutory limits are not considered a retirement benefit enhancement. An example of a retirement benefit enhancement is the CalPERS Pre-Retirement Option 2W Death Benefit and Post-Retirement Survivor Allowances and the Industrial Disability Retirement for Local Miscellaneous Members.

Felony Forfeiture: Any current or future public official or employee convicted of a felony while carrying out his or her official duties is required to forfeit any pension or related benefits earned from the date of the commission of the felony.

Working After Retirement: For retirees who work for a public employer in the same retirement system from which they retired (or one with reciprocity), PEPRA requires a

180-day waiting period beginning on the date of retirement. PEPRA also prohibits the retiree from working more than 960 hours per calendar or fiscal year, depending on the retirement system. For CalPERS, it is per fiscal year.

Conclusion: Agencies and employee organizations must now learn to adapt to PEPRA. This is considerably more difficult given the current labor challenges. We are likely to see further developments during PEPRA's second decade. PEPRA may need to be amended legislatively. But PEPRA has already transformed the landscape for public sector workers in California, some intended, and some not intended. If you have specific PEPRA questions, please contact your employee organization or professional staff for assistance.

News Release - CPI Data!

The U.S. Department of Labor, Bureau of Labor Statistics, publishes monthly consumer price index figures that look back over a rolling 12-month period to measure inflation.

7.1% - CPI for All Urban Consumers (CPI-U) Nationally

7.1% - CPI-U for the West Region

6.0% - CPI-U for the Los Angeles Area

6.0% - CPI-U for San Francisco Bay Area (from October)

7.5% - CPI-U for the Riverside Area

6.7% - CPI-U for San Diego Area

Questions & Answers about Your Job

Each month we receive dozens of questions about your rights on the job. The following are some GENERAL answers. If you have a specific problem, talk to your professional staff.

Question: I'm a member of our employee organization. The City has been hiring new staff from outside the City and they're starting them at a higher pay rate than current employees, including me. I've worked for the City for years. I was even promoted from one of the positions that I now manage. There is no real difference when it comes to the new employees' experience or qualifications versus the current employees who fill those same jobs. The outside hires are getting paid more to do the same work than the current staff. This practice is destroying morale. Can it be challenged?

Answer: This practice can be challenged if it violates the MOU and/or any personnel rules and regulations, such as the City's hiring policy. It may also be challenged if the starting rate that the City starts new employees at is above the published salary range for the position. Otherwise, there is not a basis or mechanism to challenge it.

This practice isn't common historically speaking. Usually, new employees start at the bottom of the range, though hiring policies may allow for the new hire to negotiate the initial step or range placement. Due to the current competitive labor market, many agencies are finding that they have to offer new employees a higher initial starting rate than would typically be the case.

For existing employees, a common rule is to start at a rate that is at least 5% above the employee's current rate of pay. This means current employees sometimes receive a higher step or range placement than a new hire. It just so happens the current market has things inverted from what typically occurs.

But the Association can still raise the issue with the employer. The Association can explain what is occurring and how it destroys morale and creates resentment and hostility between workers. The Association can even suggest ideas for remedying the disparity, such as moving current employees to a higher pay rate. Some employers are simply unaware it is happening or that morale is low as a result. A meeting could serve to put the employer on notice about both concerns.

While there is no guarantee the employer will fix this, it could still be

worthwhile for the Association to raise it with the employer and have an informal conversation to try and resolve it.

Question: My employer is requiring me to provide personal information to a third party that has been contracted to review our benefits and do an annual enrollment. I would prefer not to share more information with a third party than I am required to by law. The City even provided my social security number to this company. The vendor is "Building Blocks." They require me to respond to three questions – Marital Status, Tobacco User, and Disabled? I do not want to answer these questions, nor have my answers shared with this third party. I do not see what business it is of theirs. The vendor said I will not have benefits if I do not answer their questions and sign their documents. I would like to know if this is required or if I can decline to answer the questions and still receive my benefits.

Answer: Yes, these are typical questions and information that a vendor would need to obtain to enroll you in these benefits. If you do not provide answers, it is likely you will not be enrolled.

You should confirm that your employer is requiring you to provide your personal information to a third party. Assuming the answer is yes, this does comply with the California Privacy Rights Act ("CPRA"). Effective January 1, 2020, employers must provide disclosures to employees about the categories of personal information collected and its purpose. Assuming you were provided notice that the personal information you identified – such as our Social Security Number – would need to be provided to a third party such as "Building Blocks," you would need to provide this information to the third party for the purpose of administering your benefits.

It is worth noting that personal information collected from applicants, current and former employees, contractors, emergency contacts, and dependents/spouses for the purpose of administering benefits is allowed by CPRA. (Civ. Code § 1798.145).

Question: The City recently informed me that my probation is being extended. My probation was supposed to end in early November, after completing 1040 hours (6-month probation). My probation is now extended one month to early December. I am told the reason is due to my use of leave during the probationary period. I used two days of vacation, one day of bereavement, five

days of COVID-19 leave, and four days of City holidays. I do not think it is fair to have my probation extended due to the City holidays and the use of COVID leave. The City says their policy requires 1040 hours worked. Is this something I can challenge?

Answer: The terms for probationary periods are generally defined by the MOU or personnel rules. If it requires an employee to work 1040 hours, then this likely cannot be challenged. But the employee organization can propose in bargaining next time to revise it to make it more flexible going forward. And it's worth asking about not having the COVID leave and holidays count against you.

Keep in mind the other time will likely have to be made up before you can pass probation. It is quite common that emergencies and health problems arise, and an employee is off an extended amount of time during the probationary period. In those cases, it is appropriate to extend the probationary period for the same length of time the employee was out on a leave of absence. It is important that the probationary period is not arbitrarily extended. Instead, it should only be extended by the number of days of your leave. You should also receive written notice of the extension of the probationary period before the period expires. If you pass the 6-month probationary period without any extension from the City, you may be able to argue that you are already permanent and it is too late for the City to extend the probationary period.

Question: I receive education pay on my paycheck. I would like to have it included in my hourly pay rate. I was contacted by a PERS representative who said to have this change made because education pay is not considered pensionable. At some point it was going into PERS and the representative informed me that changed and now I may actually owe them money. Is this correct? And what can I do to get this counted towards my pension?

Answer: It's not likely that you owe CalPERS any money. If anything, it may just be that the education pay that was previously reported as pensionable compensation does not ultimately get included in your retirement calculations.

Finding a way to get around this may be challenging. The Public Employees' Pension Reform Act of 2013 (PEPRA) made it a lot harder for public agencies to find ways to "spike" an employee's pensionable compensation. For

example, pensionable compensation must now be paid pursuant to a publicly available pay schedule which is adopted by the agency's governing board after complying with public meeting laws. Pensionable compensation must also be paid in cash to similarly situated members of the same group or class of employment. It cannot be done on a case-by-case basis anymore.

The good news is that certain types of education pay are still pensionable even for New Members. In addition to having to meet the PEPRA requirements, any education pay must satisfy California Code of Regulations Section 571(a)(2). That section specifically excludes reimbursement to an employee for the cost of an application or test, books, tuition, or travel (*e.g.,* your typical tuition reimbursement). But it does allow for educational incentive pay to be pensionable. This is extra compensation paid to employees who complete educational courses, certificates, and degrees which enhance their ability to do their job. And it must be for something above the minimum requirements for the position. If the "education pay" you receive meets this definition, you should be able to get it reported as pensionable compensation.

Question: I am being assigned work at a higher-level position. The person who performed the duties recently left the City. Now, management is pushing the duties down to me. They have not opened a recruitment and there is no plan to fill the position as far as I know. I guess their motto is "make-do with less." I am thinking of just not doing some of the higher-class work because it is not something that should be assigned to me. That is the only way I know to push the issue with management. If I continue to do the work, they will drag their feet and give me the run around. What do you think?

Answer: It can be difficult to follow an instruction from a supervisor that an employee strongly believes is incorrect, unwarranted, or not applicable to the duties of his or her assigned position. However, for public employees, it is usually best to follow the adage, "Obey now, grieve later." It would not be wise to refuse the additional work because if you do not follow an instruction, direction, or order of a supervisor in your chain of command, you can be subjected to possible disciplinary action including termination.

Here, the employer will likely assert it is management's right to assign you work.

With that said – your MOU or personnel rules may have language regarding additional pay for performing higher-level work. Your best recourse is to reach out to your professional staff to review your specific language and see if it applies to your situation. If you do have a grievance, a remedy may include getting higher-class pay, or not having the higher-class duties assigned to you. Filing a grievance may also prompt the employer to finally open a recruitment after all.

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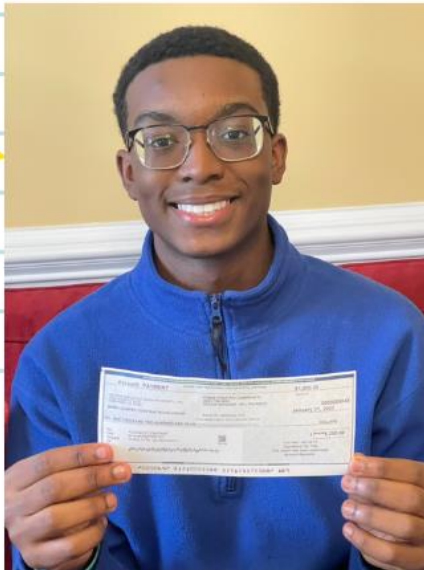

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