Costa Mesa Pension Oversight Committee

CMPOC Fast Facts

PEPRA – The Public Employees' Pension Reform Act

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This edition of Fast Facts will discuss *PEPRA, the Public Employees' Pension Reform Act. PEPRA was created to address structural concerns related to California public employee pensions. Recognized as a positive step to help agencies better manage future pension costs, most provisions of PEPRA apply only to employees hired after December 31, 2012 who have not prior PERS service. Thus, it will not provide immediate relief for the many cities, counties and public agencies who face increasing employee pension costs.*

Summary of PEPRA

The Public Employees' Pension Reform Act ("PEPRA") was passed in 2012 and most of its provisions went into effect on January 1, 2013. PEPRA was designed to address a wide range of issues involving public employee pensions. Because PEPRA's new benefits formulas apply only to employees hired after January 1, 2013, they will not provide material short-term savings, but they will result in savings in the long run as new employees are hired and ultimately retire. In addition, PEPRA reforms many of the aspects of public employee pension system that resulted in the current underfunding status such as retroactively enhanced benefits, contribution holidays, and "spiking" of pensionable compensation. PEPRA also creates negotiating tools public agencies can use to achieve equal sharing of normal benefit costs with employees. Below is a brief description of the provisions of PEPRA that are most pertinent to the City of Costa Mesa.

Reductions in Benefit Formulas

PEPRA creates a reduced tier of benefits for new employees. PEPRA does not change benefit formulas for existing employees. Generally, lateral hires from other agencies or Costa Mesa employees that are rehired are not new employees under PEPRA. Any person who is a new employee may only be offered the applicable pension benefit plan specified in PEPRA.

Basic Benefits Formulas For Non-safety Employees

The formula for non-safety employees is called the "2 percent at age 62" formula. The normal age of retirement is 62 and the employee receives a benefit equal to 2% of pensionable compensation for each year of service. Therefore, an employee who retires at the age of 62 after 30 years of service would receive an annual pension benefit equating to 60% of his or her pensionable compensation. The minimum age to receive retirement benefits is 52, and employee's pension benefit is reduced if the employee retires before the age of 62.

Basic Benefits Formulas for Safety Employees

There are different benefit formula plans for safety employees (police officers and firefighters), but in general the "normal age" of retirement for a safety employee under PEPRA is 57 with a 2.7 percent benefit. The minimum age for a safety employee to receive retirement benefits is 50 and the employee's pension benefit is reduced if the employee retires before the age of 57.

Provisions Regarding Employee Pension Contributions

PEPRA provides that the standard for pension contribution sharing should be employers and employees paying an equal share of normal costs with employees paying at least 50 percent of normal contributions ("normal" costs/contributions is the amount of money required to fund the anticipated pension benefit for a currently active employee). Through negotiations, employees can agree to pay more than 50 percent of the normal cost, but an employer cannot impose a higher contribution rate through any labor negotiation.

PEPRA changes the law in that, under PEPRA, employers are not permitted to pay any part of required employee contributions for new employees, i.e., Employer Paid Member Contributions (EPMC). PEPRA does not impact the payment of EPMC's for existing employees.

Under PEPRA, an employer may impose a 50 percent employee contribution rate for normal costs on January 1, 2018. This applies to all employees unless there is a provision in the applicable contract negotiation specifying otherwise. If imposed, the 50 percent employee contribution rate cannot exceed 8 percent of pay for miscellaneous employees or 12 percent of pay for police officers and firefighters.

Employers are not required to make changes to current employee contribution levels, including the payment of EPMC's, unless they so choose. PEPRA simply provides additional negotiating tools, including the ability to impose higher employee contributions after negotiating impasse beginning in 2018.

Limitations When Calculating Pensionable Compensation/Anti-Spiking

PEPRA makes several changes to the method by which pensionable compensation is calculated.

When calculating an employee's pensionable compensation, the average of the highest three years of the new employee's compensation is used. PEPRA also requires pension benefits for all new employees to be calculated based on the employee's base pay, defined as the normal monthly rate of pay paid in cash to similarly situated members in the same group or class of employment.

Compensation paid to enhance an employee's retirement benefit ("spiking") must be excluded. Examples of compensation that cannot be included in pensionable compensation include: overtime, bonuses, severance pay, cash-outs for unused leave time, vacation or sick leave, and payments for additional services rendered by the employee outside of normal working hours.

Cap on Pensionable Compensation

For new employees, in addition to a reduced benefit formula and limiting pensionable compensation to the 3-year average of base pay, PEPRA sets a cap on pensionable compensation. For those who participate in Social Security, the cap equates to the Social Security wage index limit, approximately $113,000. For new employees who are excluded from Social Security, the cap equates to 120 percent of the value of the Social Security wage index limit – approximately $136,000. The amount of the cap is increased each year to reflect changes in the Consumer Price Index

Elimination of "Air Time"

Before PEPRA, agencies could offer members the opportunity to purchase up to five years of service credit, sometimes called "air time." PEPRA prohibits a retirement system from allowing employees to purchase of air time service credit on or after January 1, 2013.

Prohibition of Contribution Holidays

Contribution holidays occur when an employer decides not to fund the normal cost of the pension benefits in a given year. This normally happens when the pension benefits are determined to be "overfunded" (when CalPERS advises the sponsoring agency that adequate funds are in place to pay future pensions). PEPRA prohibits contribution holidays. With limited exceptions, employer and employee contributions together must equal or exceed the normal cost of benefits for the given fiscal year.

Prohibition of Retroactive Benefit Enhancement

PEPRA prohibits a public agency from granting retroactive pension benefit enhancements that apply to service preformed before the date of the enhancement. This limitation applies to new and existing employee benefits.