BILL NUMBER: Assembly Bill 1425 (Simitian) as amended August 19, 2010

SUMMARY

This bill is aimed at eliminating abuses in the benefits paid out by CalSTRS and CalPERS. This bill seeks to curtail compensation practices that have been undertaken by some public employers and their employees in order to increase their final compensation, thereby inflating their retirement benefit (known popularly as "spiking"). By precluding certain types of compensation from the calculation of a member's retirement benefit, this bill would increase the extent to which retirement benefits paid to public employees reflect the annual compensation they earned while employed and would establish minimum standards and requirements for all public retirement systems. In addition, this bill aims to reduce the incidence of retirees returning to work immediately after retirement (known as "double-dipping") by requiring a 180-day separation from service after retirement.

BOARD POSITION

Sponsor, if amended to limit, without a rebuttal process, salary increases for all members during their final compensation period and the two years prior to 10 percent annually and delay the effective date to facilitate implementation.

PURPOSE OF THE BILL

This bill seeks to restrict the abuse and manipulation of public pension funds and retirement benefits through spiking and the unrestricted ability to return to work immediately after retirement.

LEGISLATIVE HISTORY

SB 1094 – Soto (2005) specified that, for members of CalSTRS, housing stipends and car allowances are fringe benefits that are excluded from the definition of creditable compensation. This bill was held in the Senate Public Employment and Retirement Committee.

Chapter 1021, Statutes of 2000 (AB 2700 – Lempert) made all compensation for creditable service creditable to CalSTRS and credited members and employer contributions for service in excess of 1.000 years of service per school year to the Defined Benefit Supplement Program.

Chapter 1028, Statutes of 2000 (AB 821 – PER&SS) changed the definition of "final compensation" for those members of CalSTRS with 25 years of creditable service from the highest average annual compensation earnable during any period of three consecutive school years to any period of 12 consecutive months.

Chapter 482, Statutes of 1997 (SB 471 – Burton) made minor, technical changes to the definition of "creditable compensation," and related technical changes to other sections of the Teachers' Retirement Law.

Chapter 1165, Statutes of 1996 (AB 3032 – Burton), among other provisions, repealed the definitions of "compensation" and "salary" and added the definition of "creditable compensation," making clarifying amendments as appropriate.

Chapter 468, Statutes of 1993 (AB 631 – Cannella) clarified the definitions of "compensation" and "salary" for the purposes of calculating a CalSTRS retirement benefit in order to make it more difficult to "spike" a member's final compensation or otherwise to improperly inflate benefit amounts. Prohibited the making of ad hoc adjustments to compensation when the purpose is to enhance a member's retirement benefit.

PROGRAM BACKGROUND

Potential Impairment of Contract
This bill applies to all current and future active members of CalSTRS. Applying such provisions to existing members could constitute an impairment of contract if it reduced the benefit paid to current members without an offsetting increase. The potential reduction in the Defined Benefit (DB) Program benefit resulting from the limitation in final compensation, however, could be offset by the increase in benefits paid from the Defined Benefit Supplement (DBS) Program as a result of the additional compensation that would be credited to that program, particularly for those members who earned the recharacterized compensation earlier in their career.

Return to Work Restrictions
Imposing a limitation on earnings for all members who retire could have an impact on school employers. Under current law, effective July 1, 2010, retired members under age 60 have their benefit reduced by the amount of compensation earned in CalSTRS-covered service during the first six months of retirement. This change was enacted to conform to federal restrictions imposed on pensions plans paying benefits to members retiring before normal retirement age, which is age 60 for CalSTRS. No such federal limit exists for those over normal retirement age, but this bill would impose such a restriction on all retired members during the first 180 days after retirement. No exemptions to this limitation are allowed. This restriction is intended to reduce the incidence of members, regardless of age, retiring and returning to work within the retirement plan, a not uncommon occurrence in many retirement plans, and the subject of much media scrutiny. This change would, however, limit the pool of available staff to replace other employees who leave employment, making it potentially difficult for employers to fill critical vacancies. In addition, as under current law, the member bears the entire financial impact of returning to work before the 180 day period has ended, even though the employer was the one who instigated the premature return to work.

ANALYSIS:

Existing Law:

Under current law, benefits are paid to retiring members of the DB Program based on the age, service credit and final compensation at retirement. Final compensation is based on the average annual full-time salary rate (or "compensation earnable") over one or three years, depending on the number of years of service. Generally, any compensation, including salary and remuneration in addition to salary, earned by a person for performing creditable service is included in the determination of final compensation, unless the compensation is:

- Paid for service in excess of 1.000 years of service credit in any school year,
- Paid for a limited number of times, or

- Determined by CalSTRS to have been paid for principal purpose of enhancing the retirement benefit. (This determination is subject to rebuttal by the member or employer.)

Under those circumstances, the contributions paid by the member and employer are credited to the DBS Program and, therefore, not included in final compensation. Some compensation paid to members, however, is not credited to any CalSTRS retirement program. Excluded compensation includes lump-sum payments of accrued vacation, severance pay and reimbursements for substantiated job-related expenses.

Other retirement systems, such as those administered pursuant to the County Employees Retirement Law of 1937, include lump-sum vacation payouts and overtime pay in final compensation. SB 1425 compels public retirement systems to abide by certain minimum standards. Although CalSTRS and CalPERS already include most of such safeguards, the intention of SB 1425 is to improve the existing protections afforded by the Teachers' Retirement Law and Public Employees' Retirement Law, respectively.

This bill:

SB 1425 specifies which types of compensation are included in a member's final compensation for the purpose of determining retirement benefits. Salary would continue to be credited to the DB Program. However, salary is further defined as being compensation paid for performing service or using employer approved leave over the course of a specific time period. In addition, "remuneration that is paid in addition to salary or wages" would now be credited to the DBS Program and would, therefore, not be included in final compensation. "Remuneration that is paid in addition to salary or wages" is defined to include:

- Reimbursements or allowances for unsubstantiated expenses (such as car allowances or housing allowances), which currently are credited to the DB Program.
- Cash in lieu of health or other benefits, which currently may be credited to the DB Program.
- Payments made for a limited number of times (current law also requires that these payments be transferred to DBS).
- Compensation that is payable for meeting specified criteria if it is not paid in proportion to service performed or leave used.
- Compensation that is payable for attaining a specific age threshold.
- Compensation that is payable for meeting performance-related criteria if it is not used as the basis for subsequent increases in salary or wages, which currently may be credited to the DB Program.
- Compensation for an agreement to terminate employment, unless it is otherwise excluded from the definition of "creditable compensation."
- Any other payments the Teachers' Retirement Board (Board) determines to be "remuneration that is paid in addition to salary or wages."

The bill also includes a new creditable compensation principle to strengthen CalSTRS ability to review a member's creditable compensation for consistency with other members who have previously or subsequently held the same position.

In addition, SB 1425 requires contributions on a member's salary increase to be credited to DBS if the member is not or could not be under a bargaining agreement and if the increase is more than 25 percent during a five-year period of service that ends in the last year in which the member's final compensation is determined. A salary increase received when a member moves from one employer to another is exempt from this cap. The cap can be raised by the Board if the 10 largest CalSTRS employers have an average salary increase that exceeded 5 percent in any year during the five-year period.

SB 1425 also requires all retired members who retire on or after January 1, 2012, and who return to CalSTRS-covered service within 180 days of retirement to have their DB benefit reduced by the amount of compensation earned during the 180 day period. Currently, this provision only applies to retired CalSTRS members who are under age 60. In addition, the bill delays the disbursement of DBS lump-sum payments until 180 days have elapsed. Similar restrictions would apply to retired Cash Balance (CB) Benefit Program participants.

The bill delineates employer responsibilities when hiring a retired CB participant, including informing the participant of employment limitations after retirement, maintaining accurate records of earnings, and reporting those earnings to CalSTRS, which reflects current law for the DB Program. Language exempting employers from liability for any amount paid to a retiree in excess of earnings limitations in the similar DB statute is deleted by the bill.

The bill also adds a penalty under the CB Benefit Program for late or improper adjustments to employer reporting received more than 60 days after discovery or notification by the system that parallels an existing penalty for the DB Program.

Except as provided, the provisions of this bill would be effective July 1, 2011. SB 1425 would apply to all current and future active members.

Similar provisions in this bill are applicable to CalPERS. In addition, AB 1987 (Ma) makes parallel changes applicable to local retirement systems, including county retirement systems. SB 1425 would take effect only if AB 1987 is enacted.

OTHER STATES' INFORMATION

In May 2010, the National Conference of State Legislatures provided a preliminary version of their annual report of state pensions and retirement legislation. Drawing from that report, the following summarizes some of the legislation that is being pursued or has been enacted in other states.

In Vermont, the Teachers Retirement System would cap compensation growth for the purposes of calculating final compensation at 10 percent per year for the final compensation period. In Colorado, the increase in compensation that counts towards final compensation is limited to 8 percent annually. Colorado also requires retired members who go back to work for a Public Employees' Retirement Association-covered employer to make member contributions that will not be credited to their accounts.

In Maryland, a member who retired based on a $25,000 final compensation would be exempt from the earnings limitation, an increase from the current limit of $10,000. Mississippi subjects retirees to a 90-day separation from state service. After the 90 days, those retirees may return to work while employers are required to make contributions. Illinois provides for the suspension of annuities for members who enter most of the statewide retirement plans on or after January 1, 2011, and who return to covered service after retirement. New Mexico has extended the separation from service period for retirees covered by the Public Employees Retirement Act from 90 days to 12 months. In Utah, the benefit paid to retired members is cancelled if they return to work with a Utah Retirement System-covered employer within one year after retirement, and they can earn additional service credit. Two years of service must be completed in order to receive the additional service credit.

FISCAL IMPACT

Benefit Program Cost – It is anticipated that there would be an immediate savings to the fund due to a decrease in annual benefit costs; however, these savings would be offset by a decrease in annual contributions. Therefore, there would be an anticipated net savings to the fund of approximately $10 million annually.

Administrative Costs/Savings – One-time technology costs are estimated at up to $5 million. One-time employer training costs for changes to how creditable compensation is reported to the DB and DBS programs are estimated at approximately $100,000. These one-time costs would be paid from resources currently available to CalSTRS. In addition, it is estimated that up to 15 positions would be needed to implement and administer SB 1425, including seven positions for implementation efforts, two additional audit staff and as many as six positions for customer service issues and communication.

SUPPORT

CalPERS
California School Boards Association (if amended)
City of Fountain Valley (if amended)
Glendale City Employees Association
Los Angeles County Employees Retirement Association
League of California Cities (if amended)
Organization of SMUD Employees
San Bernardino Public Employees Association
San Luis Obispo County Employees Association
Santa Rosa City Employees Association
Service Employees International Union, Local 1000
State Treasurer Bill Lockyer

OPPOSITION

California Association of School Business Officials
California Peace Officers Association
California State Association of Counties (unless amended)
California Special Districts
County of Los Angeles
Humboldt County Superintendent of Schools
San Mateo County Board of Supervisors
State Sheriffs’ Association
Visalia Unified School Districts
Western Municipal Water Districts

SUPPORTING ARGUMENTS

Provides additional means for preventing spiking and returning to work immediately after retirement.

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