



Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 4

MEETING DATE: September 16, 2020

SUBJECT: Implementation of Supreme Court Decision

SUBMITTED FOR: ___ Consent X Deliberation and Action ___ Receive and File

RECOMMENDATION

Staff recommends the Board issue an Order that calls for five categories of pay items to be excluded from the “compensation earnable” and “pensionable compensation” of all members that retired, or will retire, after January 1, 2013. Specifically, the Order directs Staff to make various retroactive and prospective corrections for the purpose of putting the system and the members in the same general position they would have been in had the pay items been excluded as of January 1, 2013.

PURPOSE

This item supports the Strategic Management Plan by providing transparent communication to stakeholders regarding the standards by which SCERS administers the retirement plan.

BACKGROUND

The California Public Employees' Pension Reform Act of 2013 (“PEPRA”) made certain amendments to the County Employees Retirement Law of 1937, including to the definition of “compensation earnable.” After PEPRA, Government Code section 31461 now reads as follows:

- (a) “Compensation earnable” by a member means the average compensation as determined by the board, for the period under consideration upon the basis of the average number of days ordinarily worked by persons in the same grade or class of positions during the period, and at the same rate of pay. The computation for any absence shall be based on the compensation of the position held by the member at the beginning of the absence. Compensation, as defined in Section 31460, that has been deferred shall be deemed “compensation earnable” when earned, rather than when paid.

- (b) “Compensation earnable” does not include, in any case, the following: . . .

-
- (2) Payments for unused vacation, annual leave, personal leave, sick leave, or compensatory time off, however denominated, whether paid in a lump sum or otherwise, in an amount that exceeds that which may be earned and payable in each 12-month period during the final average salary period, regardless of when reported or paid.
 - (3) Payments for additional services rendered outside of normal working hours, whether paid in a lump sum or otherwise.

The preceding became effective on January 1, 2013. Following the enactment of PEPRA, labor organizations around the state filed suit, challenging the constitutionality of the newly amended Section 31461 as applied to legacy members. In light of the lawsuits, SCERS made the decision to abide by certain pre-existing settlement agreements and to forbear from implementing the PEPRA amendments. Consequently, SCERS continued to include certain pay items in compensation earnable that other county systems found excludable under the new Section 31461(b).

On July 30, 2020, the California Supreme Court issued a landmark decision rejecting the various constitutional challenges to Section 31461. *Alameda County Deputy Sheriff's Assoc. et al., v. Alameda County Employees' Retirement Assn.*, 9 Cal.5th 1032 (2020) ("*Alameda*"). Specifically, the Court held that the PEPRA amendments to Section 31461 are constitutional and not in violation of the vested rights of legacy members. The Court further held that the amendments to Section 31461 must be applied even if contrary to the terms of pre-existing settlement agreements.

DISCUSSION

When litigation over the PEPRA amendments was pending, SCERS elected to err on the side of overpaying rather than underpaying its members. But with the Supreme Court having issued a definitive ruling, SCERS must now take steps to correct what turned out to be disapproved position. Specifically, SCERS must now take steps to put SCERS and SCERS members in the same general position they would have been in had SCERS rigorously implemented the PEPRA amendments to Section 31461 from the outset. To that end, the proposed Order:

- Identifies the member population affected by the *Alameda* decision ("Affected Population");
- Identifies five categories of pay items – previously included in the compensation earnable (and in one instance, as pensionable compensation) of the Affected Population – that must now be excluded in light of *Alameda* ("New Exclusions");
- Orders prospective and retroactive corrections to the benefits of the Affected Population in light of the New Exclusions; and
- Orders prospective and retroactive corrections to the contributions of the Affected Population in light of the New Exclusions.

A. Affected Member Population

In *Alameda*, the Court found that County retirement boards have no discretion to provide, and members no right to receive, benefits in excess of and contrary to what is required by the PEPRA amendments to Section 31461. Those amendments came into effect on January 1, 2013 and affects any and all members who retired after that date. Thus, the *Alameda* decision impacts SCERS members who retired, and will retire, on and after January 1, 2013 (“Affected Population”).

B. New Pay Item Exclusions

SCERS’ *Final Compensation Policy* (Policy No. 024) sets forth a list of pay items that have been and are currently included in the compensation earnable of Legacy members, including those in the Affected Population. SCERS’ *Compensation Earnable Policy for Overtime, CTO-Expired, and CTO-Over-Max* (Policy No. 25) sets out an additional pay item that SCERS historically included but ceased including as of April 2019. Altogether, there are five categories of pay items identified in those policies that must now be excluded from the compensation earnable of the Affected Population (and in one instance, the pensionable compensation of PEPRA members):

- Standby pay
- Animal allowance (for both Legacy members and PEPRA members)
- The portion of differentials, allowances, or other incentives that include overtime or CTO-expired/CTO-over-max
- Vacation cash-in in excess of the maximum permitted in a single calendar year (or fiscal year, as applicable) under the member’s labor agreement or employer policy, resulting from a designated final compensation period that straddles two calendar years (or fiscal years, as applicable).
- Insurance subsidy offset

Standby pay, animal allowance, and differentials paid for overtime hours are, by definition, “[p]ayments for additional services rendered outside of normal working hours.” Those pay items must therefore be excluded under Section 31461(b)(3). Increasing vacation cash-ins by straddling calendar years results in payments in excess of “that which may be earned and payable in each 12-month period during the final average salary period.” The *Alameda* court specifically recognized Section 31461(b)(2) to “prevent this practice.” The insurance subsidy offset is not a form of “compensation” at all at all but rather a refund of Social Security tax that was overpaid on an employee’s health insurance subsidy. To include it as “compensation earnable” is a form of double-counting fundamentally incompatible with Section 31461(a) and PEPRA generally.

C. Prospective and Retroactive Corrections to Member Benefits

The Order directs Staff to make prospective corrections to the Affected Population’s benefits – i.e., adjusting benefits on a going forward basis so as to reflect the elimination of the New Exclusions from the members’ final compensation. Those prospective corrections are expected to involve reasonable administrative workload that can be handled with existing resources, with one exception. With respect to differentials paid on overtime, SCERS may encounter practical

limitations on its ability to gather the data necessary to recreate the members' final compensation and achieve perfect adjustments. In the coming weeks, Staff will consider whether it would be possible to make prospective corrections for that pay item—consistent with members' rights—that involve a uniform proximate adjustment rather than surgical, individualized adjustments.

In addition, the Order directs Staff to make retroactive corrections to benefit overpayments without recouping them from members. In other words, the Order directs Staff not to recoup from the Affected Population any overpayments made on the New Exclusions from January 1, 2013 to August 30, 2020. Under California law, there is no mandatory obligation for SCERS to recoup amounts from retirees that were overpaid before the Supreme Court clarified applicable law in *Alameda*, unless ordered to do so by the Internal Revenue Service and/or a final, non-appealable, order of a court of competent jurisdiction. See *City of Oakland v. Oakland Police and Fire Retirement System*, 224 Cal.App.4th 210 (2014); *Blaser v. State Teachers' Retirement System*, 37 Cal.App.5th 349 (2019). SCERS' tax counsel has advised that this path forward should not jeopardize SCERS' tax qualification status, so long as the resulting shortfall is corrected via the Actuarial Accrued Liability as part of the annual actuarial valuable process.

D. Prospective and Retroactive Corrections to Member Contributions

The Order directs Staff to make prospective corrections to member contributions -- i.e., to cease collecting contributions on the New Exclusions on a going forward basis. As of the August 31, 2020 payroll, SCERS should no longer take contributions from the Affected Population in connection with the New Exclusions. If that directive cannot logistically be implemented on a timely basis, then those overpaid contributions from August 31 forward should be refunded to such active members as soon as practical.

The Order also directs Staff to make retroactive corrections to the contributions collected from the Affected Population in connection with the New Exclusions. Active and deferred members will be receiving contribution refunds (plus interest) that were collected on the New Exclusions from January 1, 2013 forward. For the most part, retired members will not be receiving refund payments for overpaid contributions, because the overpaid benefits they received (and which SCERS will not seek to recoup) will generally offset refundable contributions and related interest.

E. Next steps

The directives in the Order override and supersede any contrary terms in the *Final Compensation Policy* (Policy No. 024) and the *Compensation Earnable Policy for Overtime, CTO-Expired, and CTO-Over-Max* (Policy No. 25). In the coming months, Staff will be proposing specific amendments to those policies to conform them with Government Code section 31461, the *Alameda* decision, and this Order.

ATTACHMENT

- Board Order

Prepared by:

Reviewed by:

/S/

/S/

Stephen Lau
General Counsel

Eric Stern
Chief Executive Officer



Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
September 16, 2020

MOTION:

Implementation of Supreme Court Decision

THE BOARD OF RETIREMENT hereby finds, declares, and orders as follows:

1. The California Public Employees' Pension Reform Act of 2013 ("PEPRA") made certain amendments to the County Employees Retirement Law of 1937, including to the definition of "compensation earnable" in Government Code section 31461. Those amendments became effective on January 1, 2013. Following the enactment of PEPRA, multiple lawsuits commenced challenging the constitutionality of those amendments.
2. On July 30, 2020, the California Supreme Court issued a decision rejecting those constitutional challenges. *Alameda County Deputy Sheriff's Assoc. et al., v. Alameda County Employees' Retirement Assn.*, 9 Cal.5th 1032 (2020) ("*Alameda*"). Specifically, the Court held that the PEPRA amendments to Section 31461 were constitutional and not in violation of the vested rights of Legacy members. The Court further held that the amendments to Section 31461 must be applied even if contrary to the terms of pre-existing settlement agreements. The Court also clarified the scope and meaning of the various "compensation earnable" exclusions set forth in Section 31461.
3. With the *Alameda* decision having clarified the constitutionality and meaning of Section 31461, SCERS must now take steps to comply with that decision. In particular, SCERS must now bring itself into prospective and retroactive compliance with Section 31461 by excluding certain pay items from the compensation earnable and pensionable compensation of SCERS members.

4. For all SCERS Legacy members who retired, or will retire, on and after January 1, 2013, the following categories of pay items are hereby excluded from their compensation earnable:

- Standby Pay
- Animal Allowance
- Insurance Subsidy Offset
- Vacation cash-in in excess of the maximum permitted in a single calendar year (or fiscal year, as applicable) under the member's labor agreement or employer policy, resulting from a designated final compensation period that straddles two calendar years (or fiscal years, as applicable).

In addition, Animal Allowance is hereby excluded from the pensionable compensation of SCERS PEPRA members. (The exclusions identified in this Paragraph 4 shall be referred to collectively as the "New Exclusions.")

5. For Active and Deferred Members who will retire on or after January 1, 2013, Staff shall:

a. Direct Participating Employers to cease collecting member and employer contributions on New Exclusions as of the August 31, 2020 payroll. Since that directive cannot logistically be implemented on a timely basis, overpaid contributions from August 31 forward should be refunded to such active members as soon as practical.

b. Work with Participating Employers to return contributions to active members plus interest earnings, consistent with the Error Correction Policy, that were collected on New Exclusions from January 1, 2013 forward.

c. Return contributions to deferred members plus interest earnings, consistent with the Error Correction Policy, that were collected on New Exclusions from January 1, 2013 forward.

d. Provide a Notice of Correction to each affected member.

6. For Retired Members who retired on or after January 1, 2013, Staff shall:

a. Adjust retirement allowances for members who retired on or after January 1, 2013 to reflect the New Exclusions, beginning with the August 31, 2020 retiree payroll. (For the avoidance of doubt, this population includes members whose retirement occurs on or after January 1, 2013 but whose Final Compensation period wholly or partially predates January 1, 2013.)

b. With respect to benefit overpayments that occurred prior to the August 31, 2020 payroll, refrain from recouping those amounts from retirees unless ordered to do so by the Internal Revenue Service and/or a final, non-appealable, order of a court of competent jurisdiction; SCERS will correct the overpayments by reconciling employer contributions through the actuarial valuation process.

c. Recoup any benefit overpayments made on and after the August 31, 2020 payroll consistent with the Error Correction Policy.

d. Recognize that SCERS has over-collected member contributions on New Exclusions from January 1, 2013 forward. For the most part, no actual refund payments to this group will be necessary because overpaid benefits will offset refundable contributions and related interest earnings. However, SCERS will refund over-collected member contributions plus interest earnings, consistent with the Error Correction Policy, retroactive to January 1, 2013, to the extent the value of such exceeds the marginal increase in retirement allowances the member received from the New Exclusions.

e. Provide a Notice of Correction to each affected member.

7. Staff shall draft conforming amendments to the Final Compensation Review Policy for approval by the Board at a future meeting.

8. Regarding the Compensation Earnable Policy for Overtime, CTO-Expired, and CTO-Over-Max ("Overtime Policy"):

a. The effective date of the Overtime Policy is hereby revised from April 28, 2019 to January 1, 2013. Thus, any portion of allowances or other differentials earned as a result of overtime, CTO-expired or CTO-over-max hours must be excluded from compensation earnable and pensionable compensation calculations for retirements occurring on or after January 1, 2013. (For the avoidance of doubt, this population includes members whose retirement occurs on or after January 1, 2013 but whose Final Compensation period wholly or partially predates January 1, 2013.)

b. For members retiring on or after August 31, 2020, Staff shall adjust retirement allowances to reflect the new effective date of the Overtime Policy. For this group, Staff should also return contributions plus interest earnings, consistent with the Error Correction Policy, that were collected on differentials earned as a result of overtime, CTO-expired or CTO-over-max hours, from January 1, 2013 forward.

c. For members who retired between January 1, 2013 and August 30, 2020, Staff shall develop a plan for correcting, as applicable, (1) retirement allowances on a going forward basis, (2) past benefit overpayments, and (3) past contribution overpayments. Staff shall present that correction plan at a future Board meeting.

d. Staff shall draft conforming amendments to the Overtime Policy for approval by the Board at a future meeting.

9. This Order overrides and supersedes any provisions to the contrary in any SCERS policy in effect as of the date of this Order, including the Final Compensation Policy (Policy No. 024) and the Compensation Earnable Policy for Overtime, CTO-Expired, and CTO-Over-Max (Policy No. 25).

I HEREBY CERTIFY that the above order was passed and adopted on September 16, 2020 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

Richard B. Fowler II
Board President

Eric Stern
Chief Executive Officer and
Board Secretary