



MEMORANDUM

Subject: CalPEPRA and Final Compensation Review at SCERS

For all retirement applications filed on or after January 1, 2013, the California Public Employees Reform Act of 2013 (CalPEPRA) requires that the Sacramento County Employees' Retirement System (SCERS) review and determine whether any pay elements received by the retirement applicant in the final average salary period were provided for the purpose of enhancing the applicant's retirement benefit. If SCERS determines that a pay element was provided for the purpose of enhancing the applicant's benefit, the pay element will be excluded from the final compensation amount used to calculate the applicant's retirement allowance.

The discussion that follows will provide information about how the required final compensation review will be conducted for retirement applicants who were members in SCERS prior to January 1, 2013, and how it might impact your retirement benefit.

Retirement-Eligible Compensation

The pay received by a member in each pay check is typically comprised of base salary and certain differentials, allowances, incentives or other pay elements, depending on the member's job classification, grade or status, and possibly, the member's participation in a given bargaining unit.

The rules for determining whether a compensation element is eligible for pension benefit purposes were originally established in court decisions from the 1990s. These rules have now been codified by CalPEPRA.

As a general rule, a compensation element paid in cash in the normal course of regular employment will be considered when calculating the pension benefit. This includes payments received, while working, related to the cash-out of accrued vacation leave by members permitted to sell-back leave.

There are exceptions to this general rule, however, and some payments received by the member are not considered when calculating the pension benefit, for example: (1) Payments for overtime; and (2) Payments made at and associated with the termination of employment ('terminal pay'). In addition, payments related to the cash-out of accrued leave in any year are limited to the amount of leave the member can accrue in one year.

A summary of the compensation elements that are typically included in final compensation can be found on the SCERS website as an Exhibit to the Retirement Handbook.

SCERS has always reviewed the compensation paid to members in the final average salary period to assure that it was comprised of retirement-eligible pay elements. However, CalPEPRA now mandates an expanded level of review of the pay elements in the final average salary period for retirement applications filed on or after January 1, 2013. Specifically, SCERS must now review the pay elements to assess whether an otherwise permissible pay element was paid for the purpose of enhancing the member's retirement benefit. If SCERS determines that it was, the pay element is to be excluded from the final compensation used to calculate the retirement benefit.

Final Compensation Standard of Review

The review mandated by CalPEPRA focuses on why a pay element was provided – that is, whether it was provided for the purpose of enhancing the member's retirement benefit. If an otherwise eligible pay element meets that criterion, it can still be paid to the member, but it will not be considered for pension benefit purposes.

A situation where a pay element might be excluded under the CalPEPRA standard would be where the compensation was previously provided in-kind or paid to a third party on behalf of the member, but was converted to a cash payment to the member in the final compensation period – for example, if a member previously had a car provided by the employer but shifts to a cash car allowance, or if the employer previously paid a health insurance company for health care coverage for the member but the member opts to receive a cash-back payment instead.

Other examples where the CalPEPRA standard might result in a pay element being excluded would be: (1) A one-time or ad hoc payment not given to similarly situated members in the same job classification or grade; or (2) Severance or separation pay received by the member prior to the termination of employment.

As discussed in the section that follows, the employer and retirement applicant will have an opportunity to present information to show that the pay element was not provided to enhance the retirement benefit and therefore should be included in final compensation.

As a general rule, it is anticipated that regular, recurring pay elements provided to all qualified members in a given job classification or grade will not be excluded from final compensation under the CalPEPRA standard, particularly if the pay elements were also received by the member prior to the final average salary period. A similar outcome is anticipated with respect to the cash-out of leave by those members who are authorized to do so, particularly if the member was cashing-out leave prior to the final average salary period.

However, as explained on the prior page, if it is determined that an otherwise permissible pay element was provided for the purpose of enhancing the member's benefit, it will be excluded from the final compensation amount used to calculate the retirement benefit.

Final Compensation Review Process

The final compensation review commences when SCERS receives the retirement application and takes place at the same time as the other steps being taken to process the retirement application.

All pay elements in the final average salary period will undergo the required review. However, the scope of review corresponds to the degree to which compensation in the final average salary period exceeds the compensation prior to that period and/or the nature of the pay element(s) in question. A small increase in compensation in the final average salary period and/or common, wide-spread pay elements require less review. A larger increase in compensation or an unusual or isolated pay element requires more review.

In some cases, SCERS may require additional information in order to complete assessment of a pay element. It is expected that in most cases the necessary information will be obtained from the employer.

If SCERS determines that there is evidence that a pay element may have been provided for the purpose of enhancing the applicant's retirement benefit, the applicant and/or the employer will be notified and given an opportunity to submit additional information to rebut that assessment.

If it is still believed that the pay element was provided for the purpose of enhancing the applicant's retirement benefit, and the applicant chooses not to contest that decision, SCERS will finalize the retirement benefit calculation. Should the applicant choose to contest the recommendation, the matter will be presented to the SCERS Board for final determination on whether the pay element should be excluded from the calculation of the retirement benefit.

The SCERS Board will consider the matter in open session at the next scheduled SCERS Board Meeting. The retirement applicant and/or the employer will have an opportunity to submit additional written information, and the SCERS Board will make its determination on the written record.

If the SCERS Board determines that a pay element will be excluded from the final compensation used to calculate the retirement benefit, the employer and the retirement applicant will be so notified, and will have an opportunity to seek review of the decision by a court of law.

Issuance of the First Benefit Check

The final compensation review process will not delay issuance of the first retirement benefit check. However, the amount of the first benefit check (and, if necessary, subsequent benefit checks) could be impacted if the final compensation review process has not been completed when all other necessary retirement processing elements have been completed.

The key factor in whether the amount of the first benefit check might be impacted by the final compensation review is the length of time between when the retirement application is submitted and the date of retirement. The earlier the retirement application is submitted relative to the retirement date, the more time there is to conduct the required final compensation review, and the greater the likelihood that the review will be completed by the time all the other necessary steps have been taken to issue the first benefit check.

If there is insufficient time to complete the final compensation review prior to issuance of the first benefit check, a 'hold-back' amount based on the pay element(s) under review will be applied to the first benefit check, and if necessary, to subsequent benefit checks until a determination has been made regarding final compensation.

While the amount of a potential hold-back will vary, members should consider the possibility that initial (and possibly subsequent) benefit payments could be less than the benefit estimates they have received, and should assess how the possibility of a reduced benefit could impact their decision to retire and/or the timing of submission of the retirement application relative to the date of retirement. SCERS will not review compensation elements and/or advise members whether particular pay elements might be excluded prior to the submission of a retirement application.

Future benefit payments will be adjusted appropriately when the review has been completed and a determination made regarding final compensation. If all potential pay elements are included in final compensation, subsequent benefit payments will reflect the higher benefit and include payment of any retroactive amounts due to the hold-back. If SCERS determines that a pay element will be excluded from final compensation, the reduced benefit level will be made permanent. If the retirement applicant or the employer elect to contest that decision in court, the benefit payments will continue to include the hold-back unless/until there is a final court ruling that the pay element be included in the benefit calculation.

Due to federal tax law considerations, if and when a final decision has been reached that a pay element will be excluded from the calculation of the retirement benefit, it will be the responsibility of the employer to provide any refund of the retirement contributions made by the member on the excluded pay element.