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Agenda Item 6a

March 15, 2011

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: Assembly Bill 89 (Hill) – As introduced
Compensation Limit for Determining Retirement Benefits

II. PROGRAM: Legislation

III. RECOMMENDATION: Support, if amended

To incorporate Internal Revenue Code (IRC) section 401(a)(17) directly.

IV. ANALYSIS:

Summary

Assembly Bill (AB) 89 is intended to require all public retirement systems in California to adhere to the federal compensation limit under IRC Section 401(a)(17) when calculating retirement benefits for members who first join the retirement system on or after January 1, 2012.

Background

IRC Section 401(a)(17) limits the amount of annual compensation that can be used to compute a retirement benefit under qualified retirement plans. The compensation limit does not limit the salary payable to an employee by his or her employer. Rather, it limits the amount of compensation taken into account under the retirement plan. The compensation limit for the 2011 calendar year is $245,000. This compensation limit applies to retirement system employees who were first hired on or after July 1, 1996.

Currently, the CalPERS administration of the IRC Section 401(a)(17) compensation limit is administered through a manual process. An employer notifies CalPERS via letter that its employee has reached the earnings limit. Pay rate and earnings continue to be reported to CalPERS, which allows the employee to continue accruing service credit. Employee contributions however, cease being reported, and any employee contributions reported after CalPERS receives manual notification are refunded to the member. CalPERS plans to incorporate an automated means to monitor employee compensation and identify those contributions that exceed the limit in the new myICalPERS system.

Impetus for the Introduction of AB 89

Under federal law, public institutions can be exempt from the compensation limits. According to recent media reports, in 1999, the University of California Retirement System (UCRS) sought an exemption from the 401(a)(17) limits from the Internal Revenue Service. The exemption was granted in 2007 thus allowing UCRS to calculate pensions on the employees' total salaries. But the university never implemented the change.

Recently, 26 high-level UC executives sent a letter to the Board of Regents demanding the UC calculate their retirement benefits on their entire salaries. Currently, UCRS recognizes only the first $245,000 of the income of UCRS members subject to the IRC Section 401(a)(17) limits. According to the UC, the retirement benefits the executives are seeking would add $5.5 million a year to the pension liability and an additional $51 million to make the changes retroactive to 2007, as the executives are demanding.

Proposed Changes

Specifically, AB 89 would:

- Limit total compensation used to determine retirement benefits for all public retirement plan members in California to the amount prescribed in IRC Section 401(a)(17).

- Specify that this compensation limit applies to all members of a public retirement system first hired on or after January 1, 2012.

Legislative History

2010 AB 194 (Torrico)—Would have specified that, for the purpose of determining the retirement benefit payable to a member of a public retirement system first hired on or after January 1, 2011, the maximum salary recognized shall not exceed $217,483 and adjusted annually for inflation. Vetoed. *CalPERS Position: None*

2000 AB 334 (Peschetti)—Required the salaries of persons employed in permanent positions in State civil service be indexed to the California Consumer Price Index for the previous calendar year, as determined by the Department of Industrial Relations, and would require those salaries to be adjusted as of July 1 of the fiscal year to reflect any increase in the consumer price index. Held in Committee. *CalPERS Position: None*

1994 AB 3254 (Haynes)—Would require that the annual percentage increase in average annual compensation per full time employee not exceed the annual percentage increase in average compensation per employee in the private sector of the same time period. Would require each State agency to: 1) annually calculate a public pay equity ceiling, 2) file an annual public pay equity report with the Controller, and 3) make equitable adjustments in arbitration awards and labor contracts. Failed in Committee. *CalPERS Position: None*

Issues

1. Arguments in Support

   According to the Author:

   "The last thing California needs at a time when public entities are grappling with budget deficits is increasing benefits for employees making more than $245,000"…

   "Assembly Bill 89 would close a loophole that allows tax-exempt institutions like the University of California to award pension benefits to public employees above the federal limit."

2. Arguments by those in Opposition

   There is currently no known opposition.

3. Mirrors Federal Law in State Law

   AB 89 mirrors the federal government's compensation limit in State statute with the intent of forcing all public retirement systems in California to adhere to the federal limit for members who first join the retirement system on or after January 1, 2012. Conforming State law to federal law would eliminate any advantage of seeking an exemption to the IRC Section 401(a)(17).

   However, staff recommends that the bill be amended to incorporate IRC section 401(a)(17) directly. While the bill appears to mirror section 401(a)(17), staff believes it would be better to incorporate it directly to avoid inconsistencies between State and federal law.

4. My|CalPERS Would Not Be Impacted

   The functionality and business rules to automate the administration of the IRC Section (a)(17) compensation limit has already been built into my|CalPERS. Since the compensation limits in AB 89 are the same as the federal

compensation limits there is no need to develop new requirements for my|CalPERS.

5. Legislative Policy Standards

The Board's Legislative Policy Standards recommend a neutral position on proposals that do not significantly affect the benefit interests of our stakeholders and do not significantly impact CalPERS benefits or the administration of the System. However, in light of the current fiscal environment it is beneficial that all retirement systems are consistent with the treatment of compensation over the IRC Section 401(a)(17) limit. Therefore, staff recommends the Board adopt a support, if amended to clarify that it incorporate IRC section 401(a)(17) directly .

V. STRATEGIC PLAN:

This item is not a specific product of the Annual or Strategic Plans, but is a part of the regular and ongoing workload of the Office of Governmental Affairs.

VI. RESULTS/COSTS:

Program Cost

None identified.

Administrative Costs

None identified.

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