REPORT TO CITY COUNCIL

Approved by:

Wendy Silva ____________________

Wendy Silva, Director of Human Resources

Arnoldo Rodriguez ____________________

Arnoldo Rodriguez, City Manager

Council Meeting of: July 17, 2019

Agenda Number: B-8

SUBJECT:

Consideration of a Minute Order Authorizing the Mayor to Sign a Letter in Opposition to California Senate Bill 266 (Leyva) Regarding CalPERS Benefit Adjustments for Disallowed Compensation

RECOMMENDATION:

It is recommended that the City Council (Council) approve the letter in opposition to Senate Bill 266 (Leyva) and authorize the Mayor to execute the letter on behalf of the City.

SUMMARY:

The League of California Cities has issued an Action Alert urging its membership to oppose Senate Bill 266 regarding CalPERS benefit adjustments for disallowed compensation and notify their California legislative representatives of such opposition. Staff has reviewed the proposed legislation and concurs with the League's recommendation to oppose the bill. The attached letter, if approved, will be distributed as indicated in the letter. The bill was heard by the Assembly Public Employment and Retirement committee in June and passed out of that committee on a 7-0 vote. The bill is slated to be heard next by the Assembly Appropriations Committee mid-August.

DISCUSSION:

The City of Madera is a member of the California Public Employees Retirement System (CalPERS). CalPERS is a defined benefit pension system. During the course of an individual's employment, contributions are made to the system based on a percent of an individual's compensation that is allowed by statute to be considered as compensation for the purpose of calculating the basis for pension benefits. At a minimum, pension benefits are calculated based on base salary. However, additional forms of pay such as uniform allowance, education incentives, and longevity pay may also be considered when calculating pension benefits. These are commonly referred to as PERSable compensation. What may or may not be considered PERSable compensation is defined by statute in the California Government Code. As with any code section, City staff and CalPERS staff do their best to apply the correct interpretation of the language over time. However, as in any situation, mistakes can be made or interpretations can be modified. During employment, the contributions to CalPERS to fund the pension benefit are based on the best interpretation of PERSable compensation at that time.

SB 266, titled Public Employees' Retirement System: disallowed compensation: benefit adjustments, is sponsored by the California Professional Firefighters and was introduced by Senator Connie Leyva of Senate District 20, which covers portions of Los Angeles and San Bernardino Counties. As proposed, SB 266 will require public agencies to directly pay retirees and/or their beneficiaries disallowed retirement benefits. Disallowed retirement benefits are pension overpayments made by CalPERS that occur when CalPERS determines after a retiree has been awarded a pension that a mistake was made in interpreting what is or is not PERSable compensation. As amended, SB 266 places 100 percent of the total liability for such overpayments on public agencies—abdicating all responsibility previously held by CalPERS to ensure that retirement benefits are calculated and administered correctly.

Currently, when a correction occurs or if interpretations change, the retiree's pension is adjusted appropriately going forward, and the following occurs:

- The retiree reimburses CalPERS for the pension overpayment received. The pension system must recoup that overpayment from the retiree because it is unlawful to pay out a benefit that is not legally allowable or earned.
- The retiree is reimbursed by CalPERS for contributions they made on the pay that was assumed to be PERSable compensation while employed.
- The City receives a credit against its future pension contributions for contributions they made on the pay that was assumed to be PERSable compensation.

Using a hypothetical example, if SB 266 becomes law, this will be the effect on the City of Madera:

Hypothetical Scenario: The City of Madera and the Madera Police Officers' Association (MPOA) enter into a new labor agreement that includes a new form of incentive pay. Based on current understanding of the Government Code and information as published by CalPERS, the City and MPOA interpret this new incentive pay to be considered PERSable compensation.

- The compensation is reported each pay cycle to CalPERS *(every 2 weeks)*.
- The City pays its Employer Contribution and Employer Paid Member Contributions based off the combination of base pay and this new incentive.
- The Employee pays their portion of the Employee contribution based off the combination of base pay and this new incentive.

At this point, the pension benefit has been funded by these contributions.

- Officer John Doe files for retirement with CalPERS.

- CalPERS reviews the reported compensation for John Doe over the course of his career and calculates his pension benefit. This compensation review includes review of published salary schedules and review of special compensation components such as incentive pay.
- CalPERS provides the calculated pension benefit information to Officer Doe and Officer Doe proceeds with his retirement.

5 years later…a different person at CalPERS looks at Officer Doe's retirement calculation and pension benefit and decides that the incentive pay should not have been considered PERSable compensation, finding that Officer Doe has received a pension overpayment.

- CalPERS will credit the City's pension plan for the contributions made by the City towards the pension benefit for the incentive pay.
- Officer Doe is not required to return the pension overpayments, but the City will be responsible to reimburse CalPERS for said overpayments.
- The City will be responsible for paying Officer Doe or his beneficiary a lifetime benefit that represents the difference between CalPERS' initial pension calculation and its revised pension calculation. This will be the actuarial equivalent present value of the difference, and the retiree chooses whether to receive this as a lump sum payment or an annuity.

As this example demonstrates, SB 266 creates the potential for significant unfunded pension liabilities should CalPERS simply change its mind regarding the applied definition of PERSable compensation. Staff recommends opposition to SB 266 based on policy, operational cost, and legal concerns that will inevitably face virtually every state and local government agency should this measure be signed into law.

FINANCIAL IMPACT:
Expressing opposition to SB 266 supports protecting the City's revenues and fund balance position against unnecessary pension obligations.

CONSISTENCY WITH THE VISION MADERA 2025 PLAN:
The information contained herein is not addressed by the Vision Madera 2025 plan, nor is the information in conflict with that plan.

ALTERNATIVES:
Council can approve the letter as presented, request modifications, or take no action.

ATTACHMENTS:

1. Letter opposing SB 266.

July 18, 2019

The Honorable Lorena Gonzalez
Chair, Assembly Appropriations Committee
State Capitol Building, Room 2114
Sacramento, CA 95814

RE: **Notice of Opposition - SB 266 (Leyva) [as amended June 17, 2019]**

Dear Assembly Member Gonzalez:

The City of Madera must respectfully oppose SB 266, which would require public agencies to directly pay retirees and/or their beneficiaries for disallowed retirement benefits. Disallowed retirement benefits are pension overpayments made by CalPERS that occur when CalPERS determines after a retiree has been awarded a pension that a mistake was made in interpreting what is or is not pensionable compensation. As amended, SB 266 places 100 percent of the total liability for such overpayments on public agencies, abdicating all responsibility previously held by CalPERS to ensure that retirement benefits are calculated and administered correctly. Our objections to this measure are rooted in policy, operational cost, and legal concerns that will inevitably face virtually every local government agency should this measure be signed into law.

CalPERS has no incentive to properly advise on or calculate benefits.
In its current form, SB 266 provides no incentive for CalPERS to properly and correctly advise public entities on or accurately calculate pension benefits at the time of retirement. Instead, SB 266 places sole responsibility on the employer for any errors or misinterpretations made by CalPERS.

While SB 266 requires CalPERS to review and issue determinations on proposed items of compensation, there is nothing that holds CalPERS responsible should they offer a different determination at a later date. It is common knowledge amongst CalPERS contracting agencies that if you want a differing opinion from CalPERS, simply call back and speak to someone else.

Additionally, at the time of retirement, CalPERS reviews all reported compensation to ensure that pension benefits are calculated correctly before issuing a final retirement benefit calculation. Should they change their mind at a later date about their own calculation, SB 266 makes the public entity solely responsible for CalPERS' error. Obligating additional pension liabilities created outside of their control on public agencies who are already struggling with existing pension liabilities makes bad policy and little fiscal sense.

Public entities will be penalized for decisions made outside of their control.
SB 266 places financial penalties on public agencies for decisions they were not a participant to. Specifically, if an item of compensation is determined to not be pensionable, the public entity must:

- Refund active employees any contributions made by the employee him/herself *as well as any contributions made by the employer on his/her behalf*. The employer receives no funds back from CalPERS to make these payments, and they must therefore be absorbed by current local revenues.
- Reimburse CalPERS for their overpayment to retired individuals while the retirees keep the overpayments received. The local entity already funded the pension obligation through prior contributions and will now be required to pay for the benefit twice.

Public entities will be forced to make gifts of public funds.
Under SB 266, the City of Madera may find itself in the position to be issuing monthly payments to former employees and/or their beneficiaries for a disallowed benefit. Forcing public entities to make payments on disallowed benefits constitutes a gift of public funds, in violation of Section 6, Article 16 of the California Constitution. Such violation would leave a public agency left to defend itself from costly litigation lawsuits filed by members of the public for continuing to pay a benefit that has been determined to be precluded by statute.

While the City of Madera understands that pension payment adjustments can be difficult for retirees to absorb, the City strongly believes that public entities make good faith efforts in administering their benefits. Penalizing them for errors outside of their control makes for bad policy, inflates pension obligations, and puts public entities in the legal crosshairs for unlawful expenditure of public funds.

For these reasons, the City of Madera opposes SB 266 (Leyva).

Sincerely,

Andrew J. Medellin
Mayor

cc: Senator Connie Leyva
Senator Anna M. Caballero
Assembly Member Frank Bigelow
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