

Date of Hearing: June 23, 2021

ASSEMBLY COMMITTEE ON PUBLIC EMPLOYMENT AND RETIREMENT

Jim Cooper, Chair

SB 278 (Leyva) – As Amended March 23, 2021

SENATE VOTE: 35-0

SUBJECT: Public Employees' Retirement System: disallowed compensation: benefit adjustments

SUMMARY: Establishes requirements relating to the reporting of disallowed compensation by state, school or contracting agency employers to the California Public Employees' Retirement System (CalPERS) and retirement benefits paid to CalPERS retirees and their survivors or beneficiaries, among other provisions. Specifically, **this bill:**

- 1) Defines for these specific purposes, "disallowed compensation" to mean compensation reported for a member by the state, school employer, or a contracting agency that CalPERS subsequently determines is not in compliance with the Public Employees' Pension Reform Act (PEPRA) of 2013; existing laws regarding compensation earnable, as specified, or CalPERS' administrative regulations.
- 2) Provides that if CalPERS determines that compensation reported by the state, school employer, or a contracting agency is disallowed compensation, CalPERS must require the state, school employer, or a contracting agency to discontinue reporting the disallowed compensation; however, this only applies to determinations made on or after January 1, 2017, if an appeal is filed and the member, retired member, survivor, or beneficiary has not exhausted their administrative or legal remedies.
- 3) Establishes that *for an active CalPERS member*, all contributions made on the disallowed compensation must be credited against future contributions to the benefit of the state, school employer, or contracting agency that reported the disallowed compensation, and any contribution paid by, or on behalf of, the member including contributions as specified, must be returned to the member by the employer that reported the disallowed contribution.
- 4) Establishes *for a retired member, survivor, or beneficiary* whose final compensation at the time of retirement was predicated upon disallowed compensation, the contributions made on such compensation must be credited against future contributions to the benefit of the state, school employer, or contracting agency that reported disallowed compensation and CalPERS must permanently adjust the benefit of the affected retired member, survivor, or beneficiary to reflect the exclusion of the disallowed compensation.

In addition, for a retired member, survivor, or beneficiary in this regard, repayment and notice requirements must apply only if all of the following conditions are satisfied:

- a) The compensation was reported to CalPERS and contributions were made on that compensation while the member was actively employed; *and*,
 - b) The compensation was agreed to in a memorandum of understanding (MOU) or collective bargaining agreement (CBA) between the employer and the recognized employee organization as compensation for pension purposes; *and*,
 - c) The determination by CalPERS that compensation was disallowed was made after the date of retirement; *and*,
 - d) The member was not aware that the compensation was disallowed at the time it was reported.
- 5) Provides that if the immediately aforementioned conditions are not satisfied, the state, school employer, or contracting agency that reported the contributions on the disallowed compensation must do both of the following:
- a) Pay to CalPERS, as a direct payment, the full cost of any overpayment of the prior paid benefit made to an affected retired member, survivor, or beneficiary resulting from the disallowed compensation; *and*,
 - b) Pay to the retired member, survivor, or beneficiary, as a lump sum or as an annuity based on that amount, the actuarial equivalent present value (AEPV) representing the difference between the monthly allowance that was based on the disallowed compensation and the adjusted monthly allowance calculated, as specified, for the duration that the allowance is projected to be paid by the system to the retired member, survivor, or beneficiary.
- Here, the payment or payments must be made by the state, school employer, or contracting agency that reported the contributions on the disallowed compensation as an annuity unless the retired member, survivor, or beneficiary and that the state, school employer, or contracting agency, as may be applicable, mutually agree to a lump sum payment or payments.
- 6) Requires CalPERS to provide a notice to the state, school employer, or contracting agency that reported the contributions on the disallowed compensation and to the affected retired member, survivor, or beneficiary, including at minimum, all of the following:
- a) The amount of the overpayment to be paid by the state, school employer, or contracting agency to CalPERS, as described; *and*,
 - b) The AEPV owed to the retired member, survivor, or beneficiary, as described; *and*,

- c) Written disclosure of the state, school employer, or contracting agency's obligations to the retired member, survivor, or beneficiary, as provided.
- 7) Requires CalPERS, upon request, to provide the state, school employer, or contracting agency with contact information data in its possession of a relevant retired member, survivor, or beneficiary for the state, school employer, or contracting agency to fulfill their obligations, as provided, and that the recipient of the contact information keep it confidential.
 - 8) Authorizes employers and contracting agencies of CalPERS, as provided, to submit an additional compensation item that is proposed to be included or contained in a MOU adopted, or a CBA entered into, on and after January 1, 2022, if the compensation item is intended to form the basis of a pension benefit calculation, to CalPERS for review for consistency of the proposal with the PEPR, and existing law relating to "compensation earnable," as specified, and CalPERS' administrative regulations. In addition, as to CalPERS' review, it is provided that:
 - a) A submission to CalPERS must include only the compensation item language and description of how it meets the criteria listed in CalPERS regulations, as specified,¹ along with any other supporting documents or requirements that CalPERS deems necessary to complete its review.
 - b) CalPERS must provide guidance regarding the submission within 90 days of the receipt of all information required to make the review.
 - c) CalPERS must periodically publish a notice of the proposed compensation language submitted, as provided, for review and the guidance provided by CalPERS.
 - 9) Expressly establishes that the provisions for these purposes do not alter or abrogate any responsibility of the state, a school employer, or a contracting agency to meet and confer in good faith with the employee organization regarding the impact of the disallowed compensation or the effect of any disallowed compensation on the rights of the employees and the obligations of the employer to its employees, including employees who, due to the passage of time and promotion may have become exempt from inclusion in a bargaining unit, but whose benefit was the product of collective bargaining.
 - 10) Expressly establishes that the provisions for these purposes do not affect or otherwise alter a party's right to appeal any determination regarding disallowed compensation made by CalPERS.

¹ Section 571(a) and 571.1(b) of Title 2 of the California Code of Regulations are relating to "special compensation," and "pensionable compensation," respectively.

- 11) Provides, for educational entities participating in CalPERS, that the final responsibility for funding prescribed payments, as specified, is that of the educational entity that is the actual employer of the employee. A county superintendent of schools must have final responsibility for funding payments for its own employees and not those of other educational entities that participate in CalPERS under the auspices of a county superintendent of schools pursuant to contract.
- 12) States legislative findings and intent for these purposes, including balancing the interests of public access and personal privacy.

EXISTING LAW:

- 1) Provides, among other things, under the California Constitution that, "the members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system."
- 2) Establishes the Public Employees' Retirement Law (PERL), a comprehensive framework of retirement and other benefits for public employees who work for employers participating in CalPERS, and for which CalPERS is charged with administering the system pursuant to the PERL; the California Constitution; other State and federal laws and regulations, and legal standards regarding fiduciary duty.
- 3) Expressly provides regarding the PERL that its purpose is to effect economy and efficiency in the public service by providing a means whereby employees who become superannuated or otherwise incapacitated may, without hardship or prejudice, be replaced by more capable employees, and to that end provide a retirement system consisting of retirement compensation and death benefits.
- 4) Provides that, in its discretion and upon any terms it deems just, CalPERS may correct errors or omissions of any active or retired member, or any beneficiary of an active or retired member, as specified.
- 5) Requires that, in the event of an erroneous payment to a CalPERS member or beneficiary, CalPERS has three years from the date of payment to collect the erroneous payment from the member or beneficiary. However, in the case of fraud, CalPERS has 10 years from the discovery of the erroneous payment to collect.
- 6) Establishes the PEPRA of 2013 (Chapter 296, Statutes of 2012) which, among other provisions, limit the types of compensation that can be counted towards the calculation of pension benefits for new members. Pursuant to the PEPRA, this is referred to as "limitations on pensionable compensation."

- 7) Requires, pursuant to the PEPRA, CalPERS to limit the pensionable compensation used to calculate the contributions required of any employer or a new member to the amount of compensation that would be used for calculating a defined benefit as set forth under federal law (Section 430 (b) of Title 42 of the United States Code on January 1, 2013) and the Consumer Price Index for All Urban Consumers, as specified.
- 8) States the intent of the Legislature in implementing PEPRA that the Board has all powers reasonably necessary to invest the assets associated with, and to administer and implement the provisions of the PEPRA, to the extent and with the same effect as if the provisions of the act are contained in the PERL.
- 9) Permits a contracting agency to report an amount for each member that is equal to a uniformly applied percentage of salary in lieu of computing and reporting the actual compensation attributable for each individual member, if the contracting agency has agreed in a memorandum of understanding pursuant to existing law, as specified, that the aggregate amount to be reported for all members within a class of membership classification bears a reasonable relation to the aggregate amount that would otherwise be required to be reported for purposes of compensation earnable.
- 10) Defines “compensation” to mean remuneration paid out of funds controlled by the employer in payment for the member’s services performed during normal working hours or for time during which the member is excused from work because of holidays, sick leave or industrial disability leave.
- 11) Defines “compensation earnable” to mean the payrate and special compensation of the member, as defined and limited pursuant to existing law, and “payrate” to mean the normal monthly rate of pay or base pay of the member paid in cash to similarly situated members of the same group or class of employment for services rendered on a full-time basis during normal working hours, pursuant to publicly available pay schedules. For members who are not in a group or class, payrate means the monthly rate of pay or base pay of the member, paid in cash and pursuant to publicly available pay schedules for services rendered on a full-time basis during normal working hours, subject to certain limitations, as specified.
- 12) Provides that a CalPERS member may request a meeting to be conducted by the member’s employer, for the employer to explain to the member, the elements of the member’s past or current compensation that were, or will be, reported to CalPERS as compensation earnable. The information provided at the meeting must be provided orally and in writing to the member.

FISCAL EFFECT: According to the Senate Appropriations Committee, CalPERS indicates that this bill would result in implementation costs, likely in the low hundreds of thousands of dollars annually, to review additional MOUs and calculate employer costs in cases when a retirement benefit must be adjusted. Additionally, the bill could result in additional costs to the State to the extent that state agencies or school employers must cover the costs of disallowed

overpayments. The magnitude is unknown (and would depend on future actions), but is potentially significant. Contributions based on disallowed compensation would be credited against future contributions, but employers would be required to make immediate payments to make affected retirement members whole.

COMMENTS: According to the author, “[This bill] protects a retiree’s already promised and paid-for collectively bargained benefits in cases where the benefit is disallowed by CalPERS after the member has already retired. It also sets parameters for resolving future disputes over active and retired employees’ collectively-bargained pensionable compensation.

“In 2012, after serving the public for nearly 30 years, a firefighter employed by the City of Davis retired. Prior to retiring, the firefighter requested an official retirement estimate from CalPERS, which provided a projection of retirement benefits as of the firefighter’s estimated retirement date. Based on the information provided by CalPERS in their official retirement estimate, the firefighter made the decision to retire.”

Further, the author states that, “In 2017, CalPERS notified the long-retired firefighter that the City of Davis had reported certain disallowed compensation, which CalPERS believed was not pensionable compensation. Consequently, CalPERS sought to collect the overpayment reimbursement—not from the City of Davis that had mistakenly reported the special compensation, but from the retired firefighter. The reimbursement sought by CalPERS included a lump sum amount of \$42,000 and a sizable future reduction in the retired firefighter’s monthly retirement allowance.

“Unfortunately, several other firefighters, law enforcement, and school retirees have also reported similar stories across multiple CalPERS employers.”

1) Retirement “Estimates” vs. Final Calculation

Generally, upon receiving a telephonic inquiry from a CalPERS member to calculate a retirement benefit from the system upon retirement, CalPERS is able to provide an estimate of what that member’s retirement *might* be at that point in time, sans any and all other information that is required to reasonably provide a more accurate estimate. This also holds true for CalPERS’ free online service tool available to its members in which each member can securely access their CalPERS account that includes a plethora of information, including estimates on a future retirement allowance. It is noted that CalPERS’ secure online account access service and its telephonic service clearly express that such information provided is for informational purposes and estimates only.

To receive a more detailed or exact figure of a retirement benefit, CalPERS members are required to submit a written request in the form of a prescribed retirement application at the time of retirement to their employer, or CalPERS. This form is the official notice to an employer and/or CalPERS that a member is planning to retire, and enables CalPERS to thoroughly vet the service history (including service credit), and pensionable compensation earned by the member.

Generally, this vetting process is quite tedious and time consuming prior to a member receiving an official statement of the monthly retirement allowance that the member can expect for their lifetime, including additional benefits that the member may select which may affect the monthly retirement allowance payable to the member for life, and any remainder to their survivors or beneficiaries thereafter.

2) The Pension Promise

Generally, it is common knowledge that a promise made, is a promise that must be kept. This also holds true for public employees who have embarked on a career of public service that, while not as immediately financially rewarding when compared to comparable nonpublic sectors, offers future commitments or entitlements to the employee in exchange for many years of loyal public service, such as a guaranteed income in retirement (i.e., a pension), that for the most part, is virtually nonexistent today in the nonpublic employment sector arena.

The promise of a pension begins at the moment when a public employer participating in a public employee retirement system offers the prospective employee a job, and the prospective employee accepts that offer (assuming that the prospective employee is otherwise eligible to elect membership in the public employee retirement system). Thus, under traditional common law principles and contract law, an offer has been made and accepted, and consideration has been exchanged among each party in return for something from the other. Here, the exchange is years of service by the employee for an income while employed, and a pension provided by the employer to the employee upon the retirement of the employee. Quite simply, this forms the basis of a legally contractual obligation among parties.

The pension promise is a reasonable expectation that is a naturally inherent part of the components to public employment, and contract (again, offer, acceptance, and exchange of consideration), and requires satisfactory performance of the contractual obligations by each party to the agreement. To receive the pension promise, the promise remains only if the employee has vested (i.e., obtained a legal entitlement) by reaching the statutorily requisite minimum age and years of service to retire and receive a pension under historical and existing California law, and by long-standing and well-established judicial interpretation. In California, “[a] pension right constitutes something more than a mere gratuity.”²

3) Financial Clawbacks from Retirees and Permanent Reductions to a Lifetime Retirement Benefit After Years In Retirement:

In an unrelated, but may be tangentially relevant judicial decision as to public employee retirement (specifically, vested interests), the California Supreme court’s decision in *CAL FIRE Local 2881*, stated, among other things, that “[No] reasonable employee would agree to defer

² *Kern v. City of Long Beach* (1947) 29 Cal.2nd 848, 851

significant portions of [their] compensation without a vesting guarantee, and no reasonable employer would imagine that employees had agreed to work on such terms.”³

As to this bill, a public employee (and likely others whom may be similarly situated) has performed many years of loyal public service in exchange for a return commitment by the employer to provide a pension, which has in fact been provided. Thusly, and technically, both parties have satisfied their contractual obligation to the other. Although the amount of a retirement benefit is in dispute (following the author’s detail regarding this bill), this may or may not be directly attributed to the actions of the employer.

Numerous items of compensation are offered, negotiated, and agreed to by thousands of employees (or their employee representatives) and employers throughout the state. An employer may not immediately be aware at that time that what is or was offered as compensation for purposes of retirement, may be deemed “disallowed” in the future. This equally applies to employees (or their representatives) who reach agreement on such items.

It is acknowledged that among the many thousands of public employers throughout the state that are participating in CalPERS, there are numerous employees in each public agency whom are responsible for matters concerning human resources, payroll, and employee benefits (including retirement). It is also acknowledged that these human resources personnel change from time to time (if not frequently), and new personnel may not be fully knowledgeable of the intricacies of matters involving public employee retirement.

Regardless, as to employers, employees (or employee representatives), *ignorantia juris non excusat* (i.e., ignorance of the law is not an excuse [defense]).⁴

For purposes of this bill, CalPERS, pursuant to existing law (and judicial interpretation, if applicable), determines whether certain compensation items reported and remitted to it by an employer are permissible (i.e., allowable). Any items deemed as impermissible (and removed from the retirement benefit calculation) are due to substantial changes to public employee retirement law resulting from enactment and effectuation of the Public Employee’s Pension Reform Act (PEPRA) of 2013⁵, other Sections of the Government, and as interpreted by judicial decision, to which CalPERS is obligated to abide.

a) Other Important Items to Consider

Many public employees in California decide to retire based on the thoroughness and accuracy of the information that CalPERS provides to them relating to their retirement *at that time*, among other important considerations. The decision by an individual to retire and be able to do so with financial security in retirement is nothing less than a significant decision

³ See *CAL FIRE Local 2881 v. California Public Employee’s Retirement System* (2019) 6 Cal. 5th 965.

⁴ Black’s Law Dictionary, 8th Edition

⁵ Chapter 296, Statutes of 2012 (Assembly Bill 340, Furutani), and more specifically, Sections 7522 and 7522.34 of the Government code relating to “pensionable compensation.”

and an achievement of a lifelong milestone. It is also a life changing event for them and their family. Millions of CalPERS' members who are retired or active members of the system (and by extension, also their families) rely on CalPERS' timeliness, thoroughness, experience, and expertise in this regard.

According to the author's rationale for this bill, a public employee (and perhaps more whom are similarly situated) has retired after many years of loyal public service, and the employer has provided a pension in return; however, several years after retiring, the retiree has suffered a substantially ongoing financial detriment through no fault of their own following a determination by CalPERS (again, several years later after the employee has retired) that certain components of the compensation in which the retirement benefit was originally based, are not permissible (i.e., are disallowed).

This bill addresses three key items: 1) Whether any or all agreements relating to compensation subsequent to the job offer and acceptance (including those via subsequent collective bargaining agreement(s)), become an indelible and tangible part of the employment which must be either subsumed into, or replaced by, the original if the terms of such agreements may include items of compensation that are statutorily, or by judicial interpretation, impermissible for purposes of calculating a retirement benefit; 2) the reasonableness of the expectation by the employee or retiree to rely (including, detrimentally rely) on the commitment and deferring compensation for purposes of receiving a reasonable retirement allowance, and 3) the party responsible for paying the disallowed compensation of which the employee did not know, nor had a reason to suspect or know, that such compensation may or would, in the future, harm, damage, or reduce the expectation (without regard to whether the harm, damage or reduction would have a de minimus or substantial effect).

As noted in a judicial decision, "Pensions induce competent persons to enter and remain in public employment," and "[i]t is obvious that this purpose is thwarted if a public employee could be deprived of pension benefits."⁶

4) The Proposed Solution By This Bill

Under existing law, the employer contributes its share of retirement costs to CalPERS for each employee participating in the system. Here, even on disallowed compensation, it is more likely than not, that the employer has contributed its share of costs on disallowed compensation over a few, several or numerous years, which is (and has been) credited to the employer's account by CalPERS. Because CalPERS is required to administer the law as it exists, it may not pay more to a retired member than what is permissible not only under state law, but also pursuant to federal laws and regulations.

⁶ *Kern v. City of Long Beach* (1947) 29 Cal.2nd 848

To that end, the ambitions of this bill seek to resolve the aforementioned key items by ensuring that CalPERS only pays what is permissible under law; requiring the employer to make up the difference by paying the disallowed compensation to the retiree, and ensuring that the pension promise made, is the promise that is maintained. Finally, this bill also may help to bridge the two sides of the Grand Canyon relating to actual knowledge or reasonable awareness of the law and ignorance of the law (if CalPERS is offered an opportunity to review compensation items in agreements between employers and their employees), so as to mitigate (or at least minimize) the potential that financial harm occurs in retirement in relation to the purposes of this bill.

5) Comments by Supporters

In addition to similar statements provided by the author, the California Professional Firefighters (CPF) state in part that, “[c]alPERS-administered retirement benefits are funded by statutorily-required employee contributions, employer contributions, the earnings made on CalPERS’ investments, and, in some cases, additional negotiated employee contributions. In many instances, employees forgo pay raises or cost-of-living adjustments or agree to pay additional contributions over and above the statutory requirements in order to pay for these collectively bargained retirement benefits.

“Generations of hard-working members of California’s middle class have dedicated their careers to public service – often earning less over the course of their career when compared to their private industry counterparts – to earn and pay for the promise of a secure retirement.”

The CPF further states that, “[e]mployers have a legal and actuarial obligation to correctly report pension-eligible compensation to CalPERS as a result of employer bargaining. If an item of compensation is later determined to be improper, it is appropriate policy to require the employer to bear the actuarial liability of that promise made to their retiree. It is the employer’s sole responsibility to ensure that any offers for compensation be consistent with state law and regulation for the express purpose of correctly calculating an employee’s future service credit and final compensation for retirement. It is also the employer’s obligation to meet and confer with the employee organization regarding the disputed item of compensation to immediately remedy the error with respect to active employees. [This bill] would protect the promised and paid for pensions of CalPERS retirees through a number of mechanisms, as well as putting in place steps to ensure that similar miscalculations do not happen again in the future.”

6) Comments by Opponents

The County of Nevada and several others state in part that, “[This bill] would place 100 percent of the total liability for disallowed retirement benefits on public agencies – abdicating all responsibility previously held by CalPERS. This measure will place sole responsibility on the employer – even if the employer exercises their right to have CalPERS review their compensation proposal, [as provided in the bill].”

Several of these similarly-situated employers also state that in their particular circumstance, “[this bill] would require [them] to issue direct General Fund payments to retirees, which would trigger [General Accounting Standards Board (GASB) 68] reporting requirements, that would require it to track and report these liabilities. Such additional responsibilities [would] require the County to hire costly outside actuarial and legal experts to ensure [compliance to federal laws.]”

Finally, the County of Nevada states that, “[u]nder [this bill], the County of Nevada would be issuing unlawful, payments to former employees and/or their beneficiaries. Continued payment of a disallowed benefit to a retiree would constitute a gift of public funds, in violation of Section 6, of Article XVI of the California Constitution,” which, “would leave the public agency left to defend itself from costly litigation lawsuits filed by members of the public.”

A number of other opponents state similar concerns, among others.

7) Prior or Related Legislation

Senate Bill 634 (Senate Committee on Labor, Public Employment and Retirement, 2021) would make technical, conforming, and noncontroversial changes to public employee retirement laws administered by the California State Teachers’ Retirement System (CalSTRS), CalPERS, and 1937 Act County Retirement Systems. Among other provisions, this bill addresses overpayments issued to a deceased CalPERS member or beneficiary of the member, and deductions from subsequent payments or benefits paid by CalPERS as a result of the death. This bill is currently pending in the Assembly Committee on Public Employment and Retirement.

Senate Bill 411 (Cortese, 2021) would grant discretionary authority to CalPERS relating to reinstatement of retirees to active membership if they work more than the 960-hour per fiscal year limit under current law in CalPERS-covered positions, and to address violations in a manner that does not impose harsh financial terms on retirees. This bill is currently pending in the Assembly Committee on Public Employment and Retirement.

Senate Bill 266 (Leyva, 2019) was similar to this bill and would have implemented substantially similar procedures by which the entity that reported disallowed compensation would bear the cost of the over-reporting for a retired member. This bill was passed by the Senate and Assembly and was ordered to engrossment and enrolling; however, it was withdrawn from that process and died on the Senate Inactive File.

Senate Bill 1124 (Leyva, 2018) was substantially similar to Senate Bill 266 discussed above. This bill was vetoed by the Governor who stated that:

“I share the author's view that a pension must be correctly calculated according to the law in the first instance so that retirees never find themselves on the hook for overpayments. Clearly, remedies are needed to correct such situations.

“But I'm concerned that this bill's broad provisions could be easily abused to circumvent limitations in law intended to protect the government-and ultimately taxpayers-from

pension spiking. Indeed, in the case of an error, this bill would effectively perpetuate that error for the rest of a member's life, at substantial taxpayer expense. Before changing the law in the way that this bill does, I encourage the Legislature to develop policies to prevent such errors in the first place. Such policies might include requiring CalPERS to review and approve any proposals for pensionable compensation in a memorandum of understanding before the memorandum is finalized. Then, if errors still occurred after CalPERS's review, the penalties and ongoing costs in this bill might be warranted."

REGISTERED SUPPORT / OPPOSITION:

Support

California Professional Firefighters (*Sponsor*)
 California Labor Federation, AFL-CIO
 Peace Officers Research Association of California

Opposition

Association of California Community College Administrators
 Association of California School Administrators
 California Association of Joint Powers Authorities
 California Association of School Business Officials
 California County Superintendents Educational Services Association
 California School Boards Association
 California Special Districts Association
 California State Association of Counties
 City of Belmont
 City of Carlsbad
 City of Rancho Cucamonga
 County of Nevada
 League of California Cities
 Los Angeles County Superintendent of Schools
 Orange County Department of Education
 Riverside County Office of Education
 San Bernardino County District Advocates for Better Schools
 School Employers Association of California

Analysis Prepared by: Michael Bolden / P. E. & R. / (916) 319-3957