SENATE COMMITTEE ON APPROPRIATIONS
Senator Sabrina Cervantes, Chair
2025 - 2026 Regular Session

AB 1054 (Gipson) - Public employees' retirement: deferred retirement option program

Version: June 25, 2026
Urgency: No
Hearing Date: August 3, 2026

Policy Vote: L., P.E. & R. 5 - 0
Mandate: No
Consultant: Robert Ingenito

Bill Summary: AB 1054 would establish a Deferred Retirement Option Program (DROP) for participating State Bargaining Unit (BU) 5 peace officers (CAHP) and State BU 8 firefighters (CalFire Local 2881), as specified.

Fiscal Impact:

- The California Public Employees Retirement System (CalPERS) estimates one-time implementation costs of $1.8 million to establish DROP. The majority of these costs would be associated with information technology system enhancements. Additional one-time costs would include conducting the initial actuarial analysis, adopting regulations, developing educational and training materials, updating internal procedures, and responding to increased call center activity during implementation.

  CalPERS would incur ongoing administrative costs potentially reaching $800,000 annually, depending on the number of members who elect to participate in the program. These costs would support member enrollment and elections, payroll processing, account balance tracking and distributions, member education and customer service, and actuarial and legal support (Public Employment Retirement Fund).

- The California Department of Forestry and Fire Protection (CAL FIRE) anticipates that this bill would have an unknown fiscal impact (General Fund). The Department notes that while the bill stipulates that CalPERS must certify the DROP as cost neutral before it can be implemented, this bill would allow for continued employer contributions to the employee's DROP account to be collectively bargained, and exempt this increase from the bill's cost-neutral requirements.

- The California Highway Patrol (CHP) estimates that this bill could result in significant ongoing personnel costs by allowing retirement-eligible officers to remain in their positions rather than retire and be replaced by lower-cost newly appointed officers. Based on participation rates observed in similar DROP programs, CHP assumes that approximately 87 percent of eligible retiring officers would participate, resulting in an estimated 331 new DROP participants annually. After accounting for some employees leaving the program before the maximum five-year participation period, CHP estimates participation could grow to approximately 1,500 officers by the fifth year.

CHP estimates that each participating officer could increase department costs by approximately $7,800 per month compared to replacing the employee with a newly appointed officer. This includes both higher salary costs and increased CalPERS employer contributions associated with retaining more senior employees. Based on projected participation levels, CHP estimates additional personnel costs could increase from $31 million in the first year to $140 million annually by the fifth year (Motor Vehicle Account).

CHP notes that its estimates are limited to salary and pension contribution differences and do not include other potential costs, such as overtime, backfill staffing, workers' compensation, industrial disability leave, administrative workload, academy planning impacts, salary increases, or other compensation affecting retirement calculations. Actual costs could be significantly higher and continue beyond the five-year period depending on employee participation, retention duration, and the number of officers who otherwise would have retired and been replaced.

- The bill could result in potential long-term cost pressures on the CalPERS retirement fund of an unknown but potentially significant amount, potentially in the millions to tens of millions of dollars annually. Prior CalPERS actuarial analyses of proposed DROP programs have found that, when employees act in their own financial interest, DROP programs are unlikely to be cost-neutral because they may provide benefits beyond those employees would otherwise receive under the existing retirement system. For example, approximately 75 percent of peace officers already work beyond the maximum retirement age. For these employees, participation in the DROP program could result in additional retirement benefits that would not have otherwise been paid during their continued employment. Over time, these additional liabilities could increase CalPERS' unfunded liability and require higher state and local employer contributions.

Background: DROP Plans allow eligible employees to continue working while directing their pension contributions into a separate account rather than continuing to accrue benefits under their defined benefit pension plan. The employee continues to receive salary and benefits, but upon entering DROP, they generally stop accruing additional defined benefit pension service credits and begin accumulating DROP benefits. When the employee eventually retires, they receive their regular pension allowance plus a lump-sum payment representing the balance of their DROP account, which may generally be rolled over into an eligible tax-advantaged account.

DROP programs can be particularly attractive to highly compensated employees whose pension benefits are limited by statutory compensation caps. Once an employee reaches the applicable pensionable compensation limit, additional pension contributions may no longer increase their defined benefit allowance. Redirecting those contributions into a DROP account can therefore provide an additional retirement benefit.

DROP accounts may also provide tax planning advantages. The IRS generally treats DROP accounts separately from 401(k), 457(b), and IRA accounts for contribution limit purposes, allowing eligible employees who have maximized contributions to those accounts to make additional pre-tax contributions, subject to applicable limitations. In addition, the lump-sum distribution may provide greater flexibility in managing retirement income, including delaying taxable withdrawals, allowing tax-deferred assets to continue growing, and potentially reducing exposure to income-based federal charges, such as Medicare's Income-Related Monthly Adjustment Amount (IRMAA) surcharge.

Employers may support DROP programs because they can encourage experienced employees to remain in the workforce longer, provide an additional tool in collective bargaining, and potentially reduce pension costs by ending defined benefit accruals earlier than would otherwise occur. Depending on program design, employers may also avoid certain future pension contributions associated with continued benefit accrual.

However, DROP programs have raised concerns because prior local programs have resulted in instances of abuse and because program design can affect the financial condition of a pension system. By diverting employee and employer contributions away from the pension trust, a DROP program may reduce the assets available for investment, potentially lowering future investment earnings and increasing unfunded pension liabilities. DROP programs also create additional liquidity demands because they require lump-sum payments, whereas traditional pension benefits are paid over many years, allowing pension assets to remain invested and generate returns over a longer period.

Liquidity risks may be amplified during periods of market stress. If a pension system must sell assets to fund large DROP payouts during a financial downturn, it may reduce the system's ability to recover investment losses and generate future returns. As a result, the structure and timing of DROP payments can create additional financial risks for pension systems.

Proposed Law: This bill, among other things, would do the following:

- Establish the DROP Program as a voluntary program within PERS for employees of BU 5 (Highway Patrol) and BU 8 (Firefighters).

- Require certain actions to occur, including completion of an actuarial analysis to determine the proposed program will be cost neutral, before the program becomes effective and applicable.

- Require members who elect to participate in the program to meet certain requirements, including waiving any claims with respect to age and other discrimination in employment laws relative to the program.

- Establish a program account for each participant and would require the Board of Administration of CalPERS to, among other things and at least once annually, provide a statement to the participant that displays the value or balance of the participant's program account.

- Authorize the participant to designate a person or persons as beneficiaries of the participant's program account at any time during the program period from their election date to the deferred retirement calculation date.

- Require, beginning on July 1, 2027, and on that date every five consecutive fiscal years thereafter, the CalPERS Board of Administration to submit a report of an actuarial analysis to specified entities.

- Entitle participants who entered the program prior to the effective date of any modifications by the Legislature to elect whether to become subject to those modified provisions or to remain subject to the program as it existed on the participant's election date.

- Specify that the Legislature reserves the right to suspend the program through legislative action ratified by the Governor under certain circumstances. If the Legislature and the Governor approve the program's suspension, the bill would terminate all participants' benefit accrual and would prohibit any participant, eligible spouse, or beneficiary from having any vested right to any prospective program benefit, as specified.

Related Legislation:

- AB 704 (Calderon, 2009) would have created a DROP program for excluded and exempt employees of state BUs 5, 6 (Corrections), 7 (Protective Services and Public Safety), and 8. The bill died in the Assembly Appropriations committee.

- AB 991 (Calderon, 2008) would have established a DROP as a supplemental benefit program in CalPERS for exempted and excluded employees in BUs 5, 6, 7, and 8. This bill died in the Assembly Appropriations Committee.

- SB 274 (Soto, Chapter 897, Statutes of 2003) established the DROP as an optional benefit program for safety members of counties operating retirement systems under the County Employees' Retirement Law of 1937 ('37 Act).

- SB 1409 (Soto, 2002) would have enacted a DROP for local safety members whose employers contract for the option. This bill was vetoed by the Governor.

- AB 293 (Shelley, 2001) would have enacted a DROP for members in BUs 5, 6, and 8. This bill was vetoed by the Governor because of concerns that the details specified in the bill should be the subject of collective bargaining where, if agreed to, they could be included in a Memorandum of Understanding and ratified by the Legislature.

- SB 193 (Soto, 2001) would have enacted a DROP for local safety members whose employers contracted with CalPERS for the option. This bill was vetoed by the Governor due to cost concerns but in his veto message the Governor stated, in part, "I would be open to considering a truly cost neutral program for local government."

- AB 2030 (Correa, 2000) would have established a DROP for school members and local contracting agency members whose employer contracts with CalPERS for the DROP. This bill died in the Senate Appropriations Committee.

- SB 1312 (Ortiz, 2000) would have enacted a DROP for state members subject to collective bargaining and for local members whose employers contract with CalPERS for this option. This bill was vetoed by the Governor.

Staff Comments: As noted above, this bill would create a new deferred retirement program for CHP officers and CAL FIRE firefighters. The bill would give officers and firefighters an incentive to keep working later in their careers by allowing them to accumulate money that they could cash out in a single lump sum check when they retire.

The Motor Vehicle Account (MVA) is the primary funding source for the California Highway Patrol and the Department of Motor Vehicles. The MVA has experienced a structural deficit since 2021-22, with expenditures exceeding revenues by $60 million in 2025-26 and a projected $112 million in 2026-27. Absent additional actions to address the fund’s condition, approving proposals that increase MVA expenditures would further worsen the fund’s existing structural imbalance. The MVA could become insolvent as early as 2028-29.

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