

# **CALCULATING “FINAL AVERAGE SALARY” FOR RETIREMENT BENEFITS**

**Presentation to the Board of Retirement  
Contra Costa County Employees' Retirement Association**

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The business of relationships.<sup>SM</sup>

# PURPOSE OF TODAY'S MEETING

- **Open, public discussion for the Board and all interested persons – employers, employees, retirees, the public**
- **No action will be taken today – informational session only**

# THIS PRESENTATION

- How retirement benefits are calculated
- What goes into “final compensation” (aka “final average salary” or “FAS”)
- CCCERA’s implementation of FAS
- CCCERA’s current policies
- Changing legal and economic landscape
- Current questions
- The Retirement Board’s duties
- The Retirement Board’s authority
- Some factors to consider
- Next steps

# WHAT GROUPS SHOULD BE INTERESTED IN THIS?

- **NOT MEMBERS WHO RETIRED BEFORE SEPTEMBER, 1997**
- Those retired since September, 1997 and continuing to receive benefits
- Current active and deferred members who will receive future benefits
- Future new hires

# HOW IS THE RETIREMENT BENEFIT CALCULATED?

- Statutory formulas – multipliers

Years of credited service

x

Age factor at retirement

x

% of “Final Average Salary”

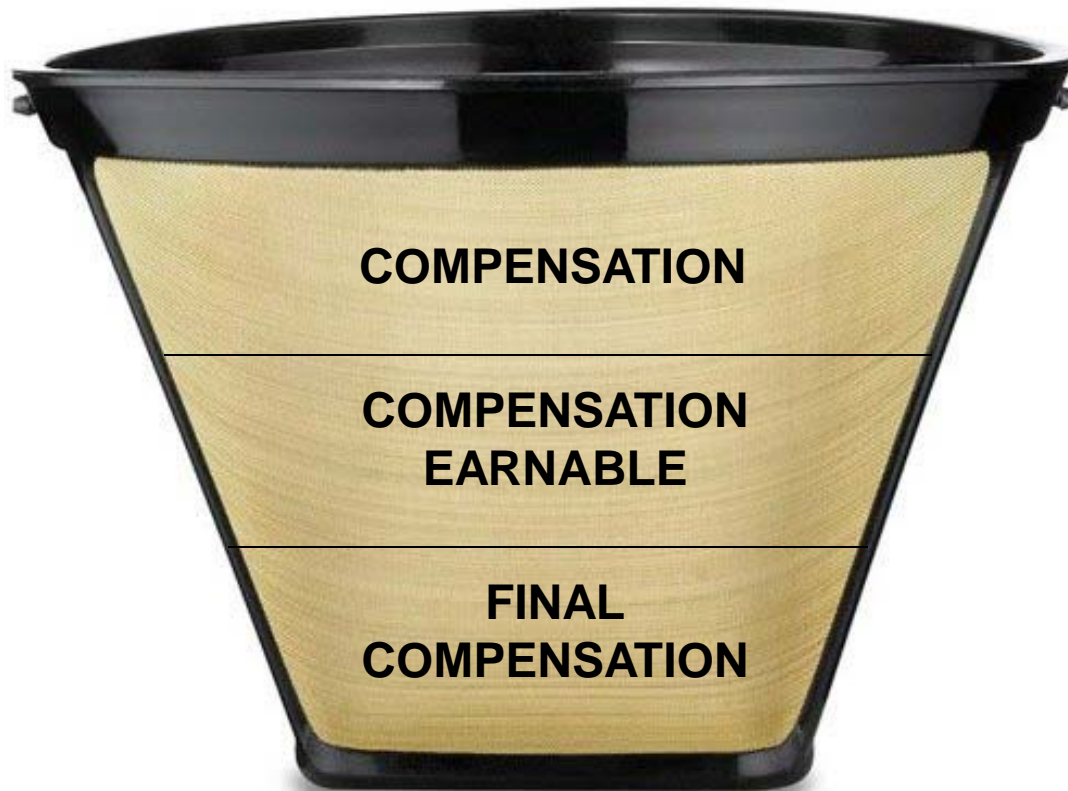
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Benefit

# WHAT IS “FINAL AVERAGE SALARY”?

- The impact of *Ventura*
- Statutory, 3-level “filtering” process to determine what amounts the employee receives are included and what are not
  - “Compensation”
  - “Compensation earnable”
  - “Final compensation” (“FAS”)

# THE FILTERING PROCESS



# LEVEL 1 – “COMPENSATION”

- **Cash remuneration for services, paid by the employer to the employee**
  - Filters out value of “in kind” (non-cash) benefits, like uniforms, Blackberries, use of auto, etc.
  - Filters out value of lodging, fuel, laundry, etc.
  - Filters out money paid to third parties on behalf of employee, like insurance premiums, pension contribution pick-ups, etc.
- **What is paid in cash to employee and what is paid in kind or to others is up to employers to set – Retirement Board has no say at this level**

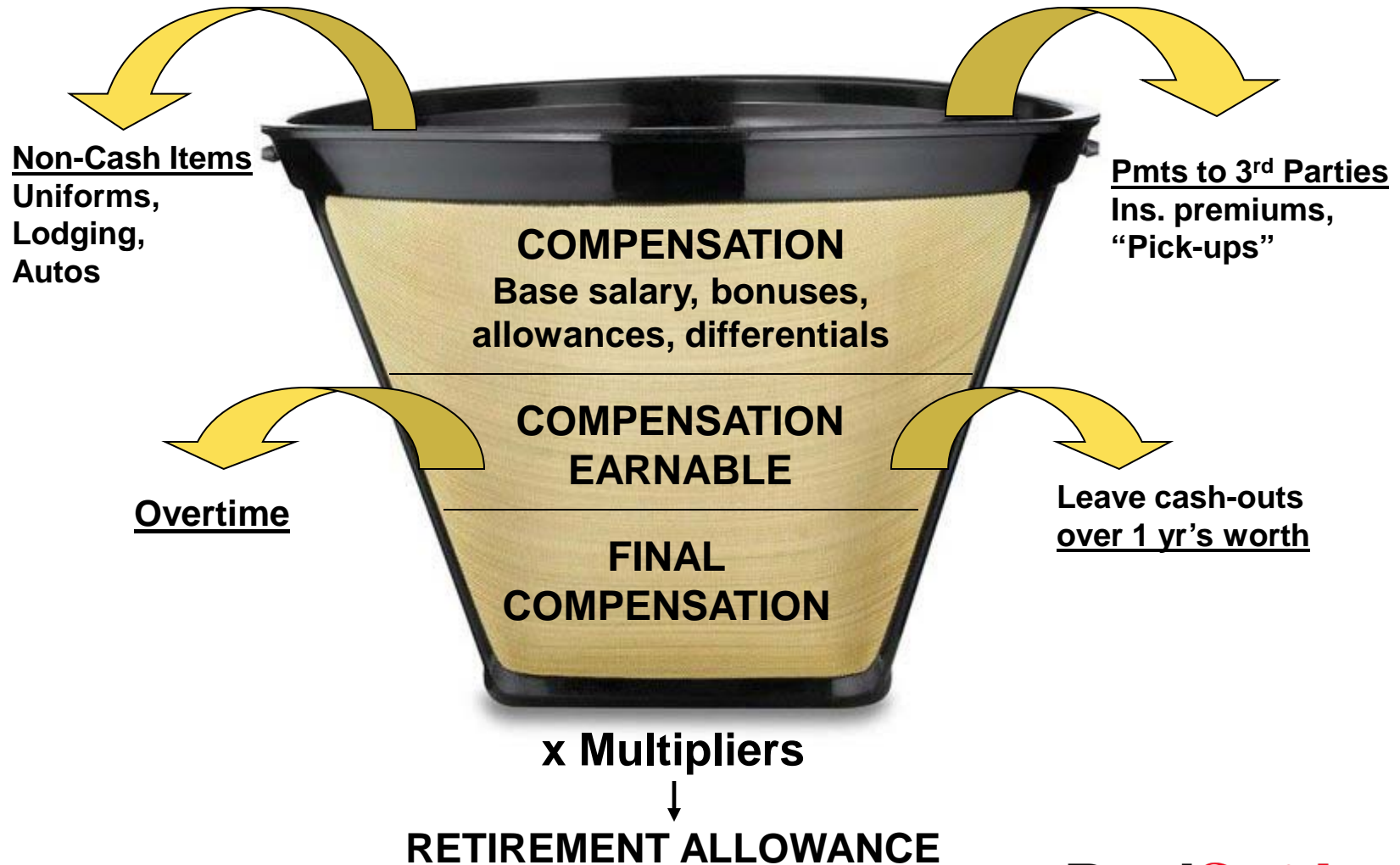
## LEVEL 2 – “COMPENSATION EARNABLE”

- **“Compensation” for the average number of days ordinarily worked by employees in same grade/class – counted when *earned* rather than when *paid*.**
  - **Filters out payments for overtime**
  - **Filters out payments not earned during the final period, even if paid during the period**
- **Employers’ policies and MOUs set the average “earned and payable” amounts**

## **LEVEL 3 – “FINAL COMPENSATION”**

- **All “compensation earnable” paid during the selected final period**
  - **One year for Tiers 1 and 3, Safety A**
  - **One year average of three years for Tier 2, Safety C**
  - **Usually the last year(s) of employment – customarily the highest paid year(s)**

# RECAP OF THE FILTERING PROCESS



# CCCERA'S IMPLEMENTATION OF FAS

- Sept. 1997 – *Ventura* changes the rules
- December, 1997 – CCCERA adopts “Compensation” policy based on employer practices
- Statewide litigation ensues over what is in, what is out, who is affected
- 1999 – CCCERA settles local litigation and sets its policies
  - Pre- Sept. 1997 retirees (*Paulson, Walden*)
  - Current and future actives, too
  - Policies follow employer “earn codes” and board direction to staff

# CCCERA'S IMPLEMENTATION OF FAS

- **CCCERA implements County's and districts' leave and cash-out policies**
  - **Applies same to all retirees, regardless of retirement date**
  - **Board considers "terminal pay" and directs staff to include portion in FAS**
  - **Policies appear in Board regulations, handbooks, annual statements to members, retirement planning seminars and counseling sessions**

# CCCERA'S CURRENT POLICIES

- If employer allows employees to cash-out value of vacation, sick, administrative and other leave time annually during service, CCCERA includes the annual amounts in FAS.
- If employer allows employees to cash out value of vacation, sick, administrative and other leave time at termination, CCCERA includes one year's worth in FAS (can differ depending on tier and group).
- If employer allows employees to “straddle” two fiscal years' cash-outs in one 12 month period during service, CCCERA includes both amounts in FAS.

# CCCERA'S CURRENT POLICIES

- County ordinance grants additional service credit to *all* members for accumulated sick leave at termination. This does not reduce the one-year's sick leave cash-out included in FAS if employer allows.
- CCCERA contribution rates include terminal pay assumptions in order to fund the cost of these inclusions.
- Board has voted to “de-pool” large employers to better align each employer's practices with their contribution rates.

# CHANGING LANDSCAPE

- Most recent judicial rulings aim to eliminate “distortions” caused by inclusion of terminal pay and final year conversions of non-cash items to cash
  - “There is nothing in CERL which suggests the Legislature intended pensions should vary so widely on the basis of accrued and unused leave, rather than on the basis of age, years of service and salary.” *Salus v. SDCERA (2004)*
- Weakened economy and local government deficits spark new questions about level of public employee pension benefits

# CURRENT QUESTIONS

- Final year conversions and incentives payable only at termination
  - How much, if any, should be permitted?
- Leave accruals paid at termination
  - How much, if any, should be permitted?
- “Straddling” two fiscal years
  - How much, if any, should be permitted?

# EXAMPLE #1

For 20 years, employee gets use of an employer-owned car, and gets sick leave only on a “use it or lose it” basis. In the year before retirement, the employer agrees to pay her a cash car allowance instead, and the right to the cash value of her accrued sick leave when she retires. The employer also promises an additional cash incentive for announcing her retirement, payable *only* at retirement.

Under current policy, the employee gets all of these items included in calculating her retirement allowance:

- the cash car allowance
- the cash for accrued sick leave
- the retirement incentive

## EXAMPLE #2

Employer allows cash-out of 160 hours vacation time earned every *fiscal* year. Employee has 350 vacation hours accrued from 2008 and earlier. In June, 2009, employee cashes out 160 of the old vacation hours, and another 160 old hours again in July, 2009. Employee retires December 31, 2009, and cashes out another 160 hours earned in calendar year 2009 (80 for the second half of the 2008-9 fiscal year and 80 for first half of the 2009-10 fiscal year), plus the remaining 30 hours left uncashed from the earlier years.

Under current policy, the employee gets 160 + 160 + 160 hours' worth (480 hours, or about  $\frac{1}{4}$  of a year) included in calculating his retirement allowance.

# THE RETIREMENT BOARD'S DUTIES

- Duty to preserve and protect the fund; to pay lawful benefits that are promised and earned, and to collect sufficient contributions to support the benefits
- Duty not to “perpetuate an erroneous interpretation of the law” – *Ventura*
- Duty to act fairly and equitably to members and their beneficiaries, across generations
- Subordinate duty to minimize employer contributions, consistent with fiduciary duties

# SCOPE OF THIS BOARD'S AUTHORITY

- Board cannot change employers' policies, MOUs
- Board has broad discretion to decide whether to change any of its own FAS policies – including
  - To whom any changes would apply
  - How any changes would be implemented
- However, CCCERA's current policies and practices may affect to whom any changes should apply

# SOME FACTORS TO CONSIDER

- Are policy changes better addressed by the County and district employers?
- Have CCCERA members relied on longstanding practices about what compensation will be counted in “final average salary”?
- Has the retirement system been collecting contributions to support the current level of benefits?
- Could CCCERA successfully administer different FAS policies for different employees and retirees?
- Would there likely be costly and protracted litigation over any policy changes?

# NEXT STEPS

- Review all relevant data
- Consider members' views
- Consider employers' views
- Consider the public's views
- Consult with counsel to discuss legal options
- Deliberate and take appropriate action, if any

**QUESTIONS?**