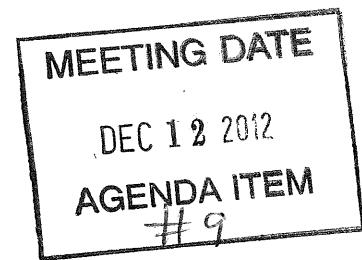


Memorandum



Date: December 12, 2012

To: Board of Retirement
Marilyn Leedom, Retirement Chief Executive Officer

From: Karen Levy, General Counsel

Subject: Consideration of Amendments to CCCERA's Policy For Determining Which Pay Items Are "Compensation" For Retirement Purposes

This memorandum summarizes the provisions of Assembly Bill 340 regarding compensation for retirement purposes for members of the new retirement benefit formulas established by the California Public Employees' Pension Reform Act of 2013 ("CalPEPRA" or "PEPRA"). This memorandum also proposes amendments to CCCERA's Policy For Determining Which Pay Items Are "Compensation" For Retirement Purposes based on these PEPRA provisions. This memorandum does *not* address any changes to current "legacy" members of the CCCERA retirement system.¹

I. PEPRA Definition of "Pensionable Compensation"

Pursuant to PEPRA, "pensionable compensation" is used to calculate final compensation for retirement purposes.

Government Code Section 7522.34(a) defines "pensionable compensation" as:

"Pensionable compensation" of a new member of any public retirement system means 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.

Government Code Section 7522.34(b) provides:

Compensation that has been deferred shall be deemed pensionable compensation when earned rather than when paid.

¹ Assembly Bill 197 contains amendments to compensation for retirement purposes for current members. CCCERA's implementation of AB 197 has been temporarily stayed pursuant to a court order entered on November 28, 2012 in the matter of *Contra Costa County Deputy Sheriffs Association, et al., v. CCCERA, et al.*, Contra Costa County Superior Court, Case No. N12-1870. The Court Order requires that CCCERA continue to follow its policy as to current, "legacy" members, until after this matter is heard and decided.



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Government Code Section 7522.34(c) excludes from “pensionable compensation” the following:

- (1) Any compensation determined by the board to have been paid to increase a member’s retirement benefit under that system.
- (2) Compensation that had previously been provided in kind to the member by the employer or paid directly by the employer to a third party other than the retirement system for the benefit of the member and which was converted to and received by the member in the form of a cash payment.
- (3) Any one-time or ad hoc payments made to a member.
- (4) Severance or any other payment that is granted or awarded to a member in connection with or in anticipation of a separation from employment, but is received by the member while employed.
- (5) Payments for unused vacation, annual leave, personal leave, sick leave, or compensatory time off, however denominated, whether paid in a lump sum or otherwise, regardless of when reported or paid.
- (6) Payments for additional services rendered outside of normal working hours, whether paid in a lump sum or otherwise.
- (7) Any employer-provided allowance, reimbursement, or payment, including, but not limited to, one made for housing, vehicle, or uniforms.
- (8) Compensation for overtime work, other than as defined in Section 207(k) of Title 29 of the United States Code.
- (9) Employer contributions to deferred compensation or defined contribution plans.
- (10) Any bonus paid in addition to the compensation described in subdivision (a).
- (11) Any other form of compensation a public retirement board determines is inconsistent with the requirements of subdivision (a).
- (12) Any other form of compensation a public retirement board determines should not be pensionable compensation.

II. NORMAL MONTHLY RATE OF PAY OR BASE PAY OF A MEMBER

PEPRA describes compensation used to calculate retirement benefits as “pensionable compensation.” This is not a term that is currently used in the County Employees Retirement Law of 1937 (“CERL”), which up until the enactment of PEPRA was the main body of law governing the CCCERA retirement benefit structure. PEPRA defines “pensionable compensation” to mean “the normal monthly rate of pay or base pay of a member” PEPRA does *not* define the terms “normal monthly rate of pay” and “base pay.”

While PEPRA does not define the terms “normal monthly rate of pay” and “base pay,” the identical terms have been used in the CalPERS’ statute governing compensation subject to retirement for many years, and have been further defined in CalPERS’ Regulation 571. Since the identical language is used both in PEPRA and the statutes and regulations governing CalPERS, and PEPRA covers CalPERS as well as the twenty CERL systems, under governing law a consistent definition of these terms would be appropriate. See *Ventura County Deputy*



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Sheriffs' Assn. v. Ventura County (1997) 16 Cal. 4th 483, 504 ("The Legislature is presumed to be aware of other statutes on the same or analogous subject matter in which the same language is used. Since we have no reason to think that the Legislature intended that the same specifically defined term take on a different meaning in computing the pension of a county employee, the construction of "compensation earnable" should be consistent under CERL...and PERL...")

CalPERS' existing definition of compensation subject to retirement under the Public Employees Retirement Law ("PERL") includes two components:

- (1) "Payrate," defined as "the normal monthly rate of pay or base pay of the member paid in cash to similarly situated members of the same group of class of employment for services rendered on a full-time basis during normal working hours, pursuant to publicly available pay schedules." (Govt. Code § 20636(b)(1).)
- (2) "Special compensation," which includes items such as special skills or special assignment compensation. Examples include: holiday pay, bonuses, educational incentive pay, maintenance and noncash payments, out-of-class pay, marksmanship pay, hazard pay, motorcycle pay, paramedic pay, emergency medical technician pay, Peace Officer Standards and Training (POST) certificate pay, and split shift differential. (Govt. Code § 20636(g)(3).)

It appears that the Legislature has adopted the first component, "payrate," for the new PEPRAs benefits plan; but there has been no adoption of the "special compensation" component. The Legislature has also adopted a list of exclusions from "pensionable compensation." For CCCERA, this means that compensation for retirement purposes for PEPRAs members will be limited to "the normal monthly rate of pay or base pay" of members and will not include special items of compensation such as special skills, education, assignment, or shift pay.

IV. OTHER APPROACHES

We are aware that a number of CERL systems have adopted a different approach, including in "pensionable compensation" items of compensation that are in addition to base pay for special skills, education, or special shift pay. On the other hand, others have adopted a "base pay only" or "base pay plus waiting for future developments" approach. We are not aware of any formal position taken by CalPERS on this matter, although we do expect that CalPERS will issue a formal position since the PEPRAs provision apply to CalPERS as well as all CERL systems.

Should the CCCERA Board decide to adopt a "base pay only" approach, we believe this decision should be adopted subject to further clarification of the law, including legislative and decisional law, as well as clarification from CalPERS on how they intend to implement "pensionable compensation" as to their PEPRAs members.

Should it be later clarified that more than "base pay only" should be included in "pensionable compensation", CCCERA may have under-collected contributions and may have to collect additional contributions from employers and members to fund the inclusion of the additional pay items in "pensionable compensation."



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Should the CCCERA Board decide instead to include in "pensionable compensation" special skills, education, assignment or special shift pay in addition to base pay, we believe this decision should also be adopted subject to further legislative or judicial clarification, as well as clarification on CalPERS' position. Should it be later clarified that "pensionable compensation" is limited to base pay only, CCCERA will have over-collected contributions from employers and members and may have to adjust such overpayments of contributions.

V. RECOMMENDATION

We believe that the PEPRA definition of "pensionable compensation" limits compensation for purposes of retirement to base pay only, as that term is used in the PERL. Specifically, to be pensionable, the compensation must be:

- (1) the normal monthly rate of pay or base pay of the member
- (2) paid in cash to similarly situated members in the same grade or class of employment
- (3) for services rendered on a full-time basis during normal working hours,
- (4) pursuant to publicly available pay schedules.

Additionally, the compensation must not fall within any of the specific exclusions listed in 7522.34(b), such as: termination or during-service payouts for unused vacation or sick leave; housing allowance, automobile allowance and uniform allowance; on-call and call-back pay for services rendered outside of normal working hours; conversion of in-kind benefits into cash during the final compensation period; one-time or ad hoc payments, bonus payments, severance pay, retirement incentive pay; and any compensation determined by the board to have been paid to increase a member's retirement benefit under the CCCERA system.

Our recommendation is to adopt this definition of "pensionable compensation" as an addendum applicable to PEPRA members only (not current, "legacy" members of CCCERA), subject to further legislative or judicial interpretation, and subject to staff's monitoring of any formal actions taken by CalPERS implementing this provision.

Should the Retirement Board desire to adopt the alternative approach, that of including in "pensionable compensation" base pay *plus* pay for special skill, education, assignment and special shift pay, we recommend that this decision also be made subject to further legislative or judicial interpretation, and subject to staff's monitoring of any formal actions taken by CalPERS implementing this provision.

Making a determination now as to what shall be included in "pensionable compensation" is required primarily for purposes of setting future contribution rates. Since the PEPRA definition of "pensionable compensation" applies only to new members of the system who are unlikely to be retiring anytime soon, the Board has the ability to make its best judgment on the state of the law under the circumstances now prevailing, and to adjust as necessary to developments that are likely to occur during the coming year.

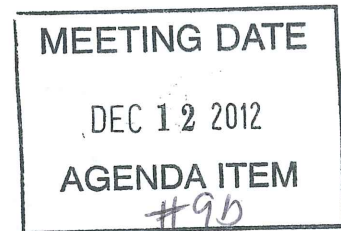


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CONTRA COSTA COUNTY EMPLOYEE'S RETIREMENT ASSOCIATION

**DETERMINING WHICH PAY ITEMS ARE "COMPENSATION"
FOR RETIREMENT PURPOSES**

Adopted: 12/05/97
Amended: 01/13/98
Amended: 03/10/10
Amended: _____



PURPOSE:

The California Supreme Court decision in Ventura County Deputy Sheriff's Association v. Board of Retirement, 16 Cal.4th 483 (1997) changed a previously accepted construction of the statutory framework governing the compensation includible in the calculation of pensions under the 1937 Retirement Act.

In keeping with this ruling, the Retirement Board has re-examined the criteria it previously used to determine which pay items are compensation includible under Government Code Section 31460. The Board recognizes that any change in policy must not jeopardize the actuarial soundness of the retirement system.

Effective October 1, 1997, the following general principles will be applied in determining which pay items are subject to retirement contributions and included in pension calculations.

POLICY:

1. Compensation includes all payments for services performed.

All cash payments given as remuneration either for services rendered or for special skills or qualifications (ie. merit pay, longevity pay, standby pay, bilingual pay, holiday pay, educational incentive pay, etc.) are included in compensation.

2. Compensation does not include "the monetary value of other advantages furnished to a member," but does include cash payments in lieu of such other advantages.

In-kind benefits and reimbursements for job-related expenses are excluded.

With regard to cash payments in lieu of such advantages, the Board will evaluate how closely the pay item in question resembles, or functions as an effective substitute for salary.

Cash payments for items of “advantage” that the employee would otherwise purchase with salary are included.

3. “Overtime” compensation is not included in compensation earnable if it is in excess of what is considered normal working hours.

If the time worked is ordinarily expected to be worked, then it is included regardless of its formal characterization as overtime for pay purposes.

The fact that payments are made in a lump-sum will not prevent their inclusion within compensation earnable if they are accrued for time regularly worked, and simply withheld to a later date within the same year.

4. Remuneration paid in cash for time earned is considered “final compensation” and is limited by the following:

- a. Annual “cash-out”
The value of accrued time, such as vacation, holiday or sick leave, that is sold back to the employer by the employee each year under a “cash-out” agreement, is includible in compensation earnable.
- b. Lump sum at termination
Only the portion of accrued time (such as vacation, holiday or sick leave) that is paid in the form of a lump sum at termination, and that represents time earned during the final compensation period is includible in compensation.

5. Members affected

This Policy shall be effective as to the calculation of retirement allowances for those members of CCCERA whose original date of membership in the retirement system is on or before December 31, 2010.

CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

**ADDENDUM TO POLICY FOR DETERMINING WHICH PAY ITEMS ARE
"COMPENSATION" FOR RETIREMENT PURPOSES**

PURPOSE:

This Addendum to the Policy for Determining Which Pay Items are "Compensation" for Retirement Purposes, adopted December 5, 1997, and amended January 13, 1998 ("Policy"), reflects the Retirement Board's re-examination of the Policy since its adoption and the Retirement Board's decision to revise certain aspects of the Policy with respect to persons who become members of the retirement system on and after January 1, 2011. This Addendum is made as of March 10, 2010 and shall be referenced in communications to affected members regarding the Policy following its adoption.

POLICY:

Notwithstanding anything to the contrary in the Policy, the following policies and procedures shall be effective as to the determination of "compensation," "compensation earnable" and "final compensation," as defined in the County Employees Retirement Law of 1937, Government Code sections 31450, et seq.

1. Remuneration paid in cash for time earned is considered "final compensation" and is limited by the following:

- a. Annual "cash out"
The value of accrued time, such as vacation, holiday, sick or administrative leave, that is both earned and sold back to the employer by the employee during the final compensation period under a "cash-out" agreement, is includable in compensation earnable.
- b. Lump sum at termination
Only the portion of accrued time (such as vacation, holiday, sick or administrative leave) that is paid in the form of a lump sum at termination, and that represents time both earned and cashable during the final compensation period, is includable in compensation earnable.

2. Additional examples of amounts that are not included in "compensation earnable"

- a. For each year of the final compensation period, leave amounts sold back during any twelve-month period that were accrued over two or more fiscal or calendar years, and that exceed the amount that was both earned and cashable during service in that twelve-month period.

- b. Incentives, bonuses and other payments to the extent they may not be received in cash during service, but only upon termination or retirement.
- c. Conversion of in-kind benefits and other advantages to cash during the final compensation period.

3. Members affected

This Addendum shall be effective as to the calculation of retirement allowances for those members of CCCERA whose original date of membership in the retirement system is on or after January 1, 2011 and before January 1, 2013.

CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

SECOND ADDENDUM TO POLICY FOR DETERMINING WHICH PAY ITEMS ARE "COMPENSATION" FOR RETIREMENT PURPOSES

PURPOSE:

The Policy for Determining Which Pay Items are "Compensation" for Retirement Purposes was adopted on December 5, 1997 and amended January 13, 1998 and March 10, 2010 ("Policy"). This Second Addendum is made as of _____, 2012 and shall be referenced in communications to affected members regarding the Policy following its adoption. The purpose of this Second Addendum is to implement provisions of the California Public Employees' Pension Reform Act of 2013 ("PEPRA") relating to member compensation included in pensionable compensation. (California Government Code Article 4; § 7522.34.)

LEGAL AUTHORITY:

Pursuant to PEPRA, "pensionable compensation" is used to calculate members' retirement allowances.

Government Code Section 7522.34(a) defines "pensionable compensation" as:

"Pensionable compensation" of a new member of any public retirement system means 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.

Government Code Section 7522.34(b) provides:

Compensation that has been deferred shall be deemed pensionable compensation when earned rather than when paid.

Government Code Section 7522.34(c) excludes from "pensionable compensation" the following:

- (1) Any compensation determined by the board to have been paid to increase a member's retirement benefit under that system.
- (2) Compensation that had previously been provided in kind to the member by the employer or paid directly by the employer to a third party other than the retirement system for the benefit of the member and which was converted to and received by the member in the form of a cash payment.
- (3) Any one-time or ad hoc payments made to a member.

- (4) Severance or any other payment that is granted or awarded to a member in connection with or in anticipation of a separation from employment, but is received by the member while employed.
- (5) Payments for unused vacation, annual leave, personal leave, sick leave, or compensatory time off, however denominated, whether paid in a lump sum or otherwise, regardless of when reported or paid.
- (6) Payments for additional services rendered outside of normal working hours, whether paid in a lump sum or otherwise.
- (7) Any employer-provided allowance, reimbursement, or payment, including, but not limited to, one made for housing, vehicle, or uniforms.
- (8) Compensation for overtime work, other than as defined in Section 207(k) of Title 29 of the United States Code.
- (9) Employer contributions to deferred compensation or defined contribution plans.
- (10) Any bonus paid in addition to the compensation described in subdivision (a).
- (11) Any other form of compensation a public retirement board determines is inconsistent with the requirements of subdivision (a).
- (12) Any other form of compensation a public retirement board determines should not be pensionable compensation.

POLICY:

Notwithstanding anything to the contrary in the Policy, the following policies and procedures shall be effective as to the determination of "pensionable compensation" as defined in the PEPR, Government Code section 7522.34.

1. **"Pensionable compensation" is limited as defined in Government Code Section 7522.34 to "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."**
2. **The following are examples of amounts that are *not* included in "pensionable compensation":**
 - (a) **Payments during service and termination payments for unused vacation, annual leave, personal leave, sick leave or compensatory time off, regardless of when reported or paid.**
 - (b) **Allowance, reimbursement, or payment such as housing allowance, automobile allowance, or uniform allowance.**
 - (c) **Payments for services rendered outside of normal working hours, including standby pay, on-call pay and call-back pay. Payments for overtime are also *not* included in "pensionable compensation."**
 - (d) **Conversion of in-kind benefits and other advantages to cash during the final compensation period. Examples: conversion of the use of an automobile to an automobile allowance during the final compensation period.**

- (e) One-time or ad hoc payments made to a member.
 - (f) Bonus payments.
 - (g) Severance pay, retirement incentive pay, separation bonus, or other form of payment provided to a member in connection to the extent they may not be received in cash during service, but only upon termination or retirement.
 - (h) Any compensation determined by the board to have been paid to increase a member's retirement benefit under the CCCERA system; any other form of compensation that the board determines is inconsistent with the definition of "pensionable compensation"; any other form of compensation that the board determines should not be pensionable compensation.
3. Each of the CCCERA participating employers shall provide to CCCERA its publicly available pay schedules for all of its employees. CCCERA staff will determine pensionable compensation based on each employer's publicly available pay schedules.

MEMBERS AFFECTED

This Second Addendum shall be effective as to the calculation of retirement allowances for those members of CCCERA who are "new members" of the retirement system (as defined in the PEPR, Government Code section 7522.04(f), on or after January 1, 2013.