



Finance Committee

City of Arts & Innovation

TO: FINANCE COMMITTEE **DATE: JUNE 12, 2019**

FROM: FINANCE DEPARTMENT **WARDS: ALL**

SUBJECT: REPLACEMENT BENEFIT PLAN ADMINISTERED BY THE CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM – DIRECT SUBMITTAL

ISSUE:

Receive information on the Replacement Benefit Plan administered by the California Public Employees' Retirement System.

RECOMMENDATION:

That the Finance Committee receive information on the Replacement Benefit Plan administered by the California Public Employees' Retirement System.

LEGISLATIVE HISTORY:

Internal Revenue Code (IRC) section 415(b) limits the amount of benefits that an individual may receive from a tax qualified defined benefit pension plan like California Public Employees' Retirement System (CalPERS).

In 1989 and 1990, the IRC section 415(b) limits and a "grandfather" election were enacted in state law by two (2) CalPERS' sponsored bills (Senate Bill (SB) 200 (Stats. 1989, Ch. 1305) and SB 2373 (Stats. 1990, Ch. 798). These bills also created a replacement benefit program intended to ensure that members affected by the IRC section 415 limits are provided, to the extent reasonable, with commensurate replacement benefits.

In 1996, Congress enacted the Small Business Job Protection Act of 1996, which amended IRC section 415 by adding subdivision (m) which allows governmental pension plans to provide benefits that exceed the limit from a "qualified governmental excess benefit arrangement".

In 2001, CalPERS adopted regulations to establish the Replacement Benefit Plan (RBP) in CCR, title 2, sections 589 through 589.10. Every CalPERS employer is deemed to participate in the RBP in accordance with Government Code section 21761.3

Effective January 1, 2013, the 2012 California Public Employees' Pension Reform Act (PEPRA) limited retirement allowances under Government Code section 7522.10, for all PEPRA employees. The compensation limit for PEPRA members is adjusted each year with the 2019 limit of \$149,016 for Non-Social Security Participants.

BACKGROUND:

There are now close to 1,000 CalPERS members that have retirement benefits that exceed the IRC section 415(b) limit. Approximately one-third of the participants in the RBP are safety members. CalPERS expects the number of RBP participants to temporarily increase as more classic members retire, however, the 2012 PEPRA law reduced participation in the program in the future.

Any retirement benefit that exceeds the IRC section 415(b) limit cannot be paid from a pension plan's trust fund, like the Public Employees' Retirement Fund. These members receive pension benefits up to the IRC section 415(b) limit from the Public Employees' Retirement Fund and any benefits above the limit are paid from the RBP.

The Internal Revenue Service annually adjusts the 415(b) limit to account for cost-of-living adjustments (COLAs). If benefits exceed the limit, then CalPERS invoices all prior employers proportionately to pay the member's excess benefits into the RBP.

Effective January 1, 2019, the limitation on the annual benefit under a defined benefit pension plan is \$225,000 for participants that retire at age 62 to 65. The limit is actuarially reduced for members who retire before age 62.

DISCUSSION:

All agencies participate in the RBP based on their contract with CalPERS. IRC section 415(b) regulations require that all service be combined when determining if the member should be placed in the RBP. Members are required to participate in the RBP each year in which their allowance exceeds their personalized dollar limit. Limited allowances are retested every January against the new IRC section 415(b) annual limit using the members age at retirement.

The City is typically invoiced in January each year for the RBP amounts. For members who are eligible for the Cost of Living Adjustment (COLA), a supplemental COLA invoice is issued in late March once the COLA factor is known. However, retirements and adjustments happen all year long, so it is possible to receive invoices throughout the year for new retirees, or for a retiree who is due an adjustment.

As the limit for someone subject to IRC section 415(b) cannot be determined until retirement, budgeting for these potential invoices is difficult. The City uses the most recent year's invoice as a budget guide and update the budget based on each year's new invoice.

Questions have arisen as to why the City would have to pay a replacement benefit contribution at all if we did not pay the former employee the salary that caused his or her retirement allowance to exceed the IRC section 415(b) limit. One of the essential tenets of the CalPERS retirement allowance calculation is that the member's highest career salary (highest 12 or 36 month salary average) must be used as the final compensation. The only exception to this is for service in certain elected office positions. Therefore, a law change would be required to limit replacement benefit contributions to certain employers and any such change to California retirement law would also have to be in compliance with the Internal Revenue Code.

Over the last five years, the City has paid approximately \$2.4 million in replacement benefit funds to former City of Riverside employees.

FISCAL IMPACT:

There is no direct fiscal impact associated with presentation of this report.

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availability of funds: Marie Ricci, Assistant Chief Financial Officer
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Approved as to form: Gary G. Geuss, City Attorney

Attachments:

1. Presentation
2. CalPERS Replacement Benefit Plan Fact Sheet
3. CalPERS 2019 Compensation Limit letter 200-003-19