Retiree Benefits: Avoiding Compliance and Regulatory Landmines

Virtual Conference

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ACHRO
Association of Chief Human Resource Officers

EEO
Equal Employment Officers

Workshop Panel

Julianna Mosier

Vice Chancellor, Human Resources

State Center Community College District

Marcus Wu

Attorney & Partner

Pillsbury Winthrop Shaw Pittman LLP

Michelle McKay Underwood

Vice President

School Services of California

Maureen Toal

Executive Vice President, Consulting

PARS | Public Agency Retirement Services

IRS Audits

IRS Audits

- State Center Community College District's Experience
- What Can Districts Do to Potentially Avoid IRS Audits?
- If a District is Audited, Like State Center Was, What Is Your Advice as to How to Approach It?

CalSTRS and CalPERS Issues

CalPERS and CalSTRS Rates

Employer Pension Contributions Continue to Increase

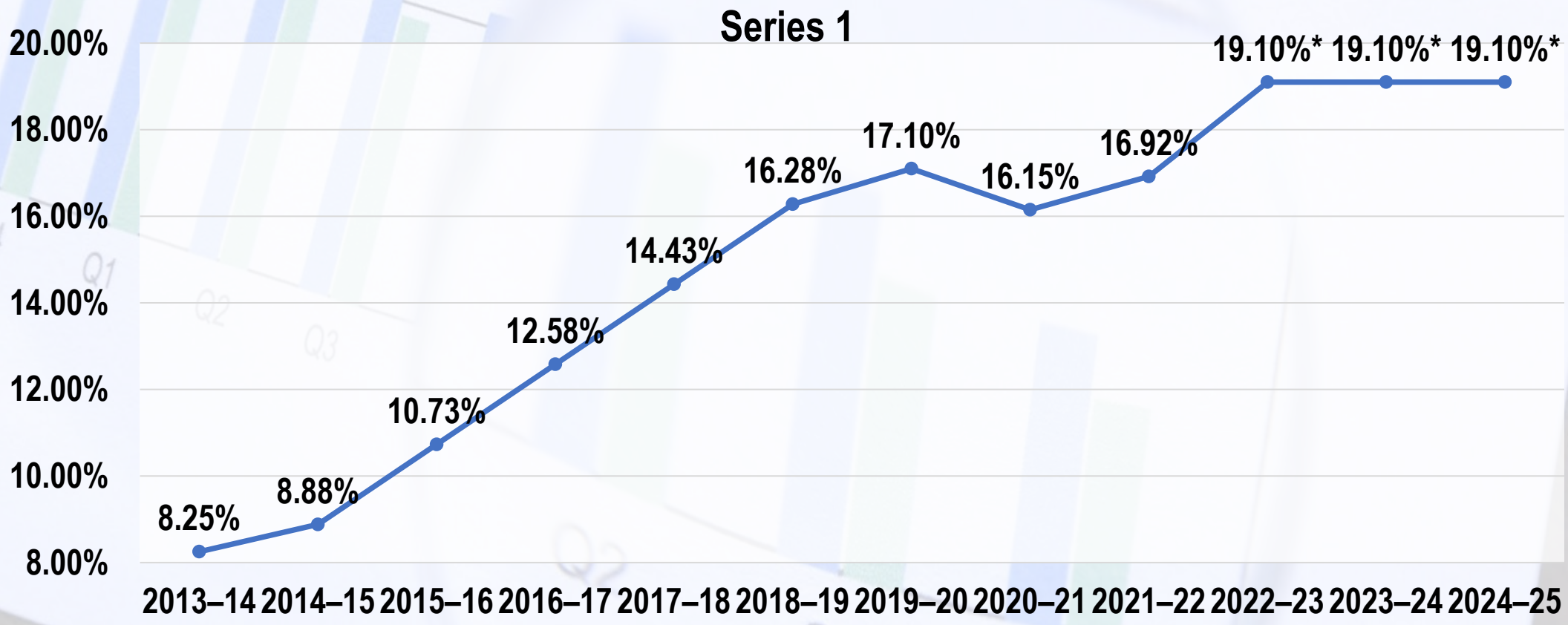
CalSTRS Full Funding Plan

- As part of the 2014–15 State Budget, the California State Teachers' Retirement System (CalSTRS) Full Funding Plan (Assembly Bill [AB] 1469) was put in place to propel the retirement system to be fully funded in 32 years
- The plan included statutory employer and state contribution rates initially, and then gave authority to the CalSTRS Board—for the first time—to increase contribution rates (with some constraints) to fully exhaust the unfunded liability by 2046
- Initially, the employer contribution rate was set to increase evenly over a seven year period, with equal increases detailed in statute; at the end of that ramp up period the CalSTRS Board could increase or decrease the contribution rate by a percentage point each year, with a maximum employer contribution rate of 20.25% as follows:
  - ❑ "For fiscal year 2021–22 and each fiscal year thereafter, the board shall increase or decrease the percentages . . . to reflect the contribution required to eliminate by June 30, 2046, the remaining unfunded actuarial obligation . . . as determined by the board based upon a recommendation from its actuary."

CalSTRS Full Funding Plan

- The steady statutory increase was disrupted—in a positive way—for several years as the state subsidized the employer contribution rate by sending funds to CalSTRS on behalf of school districts, and thereby lowering the employer contribution rate
- The 2021–22 employer contribution enjoys a state subsidy, but is insufficient to mitigate the need for a year–over–year increase due to statewide shrinking CalSTRS-eligible payroll as educators left the profession in 2020–21 and have not been replaced
  - ❑Because the payroll upon which the employer contribution rate is applied has shrunk, so too has the contribution sent to CalSTRS by employers shrunk

CalSTRS Employer Rates Under the Full Funding Plan



*Rates beyond 2021−22 are CalSTRS' estimates

CalSTRS Employee Rates

- Employee contributions for CalSTRS have marginally increased from 8.15% in 2014–15

Year	Pre-PEPRA* Employees	Post-PEPRA Employees
2014–15	8.15%	8.15%
2015–16	9.20%	8.56%
2016–17	10.25%	9.205%
2017–18	10.25%	9.205%

*Public Employees' Pension Reform Act

- The contribution rate for Post-PEPRA CalSTRS (2% at 62) members is based, in part, on the normal cost of benefits and may increase or decrease in future years

CalPERS Rates

- The employer contribution to the California Public Employees' Retirement System (CalPERS) increased from 20.70% in 2020–21 to 22.91% in 2021–22
  - ❑"Classic" members continue to pay 7%
  - ❑Contributions from "New" members remains at 7% in 2021–22 even though their benefit is less than what is received by "Classic" members
- Estimates of the resulting future contribution rate increases for school employers are as follows:

	Actual	Projected				
	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27
Employer Contribution Rate	22.91%[1]	26.10%	27.10%	27.70%	27.80%	27.60%

[1]Adopted by CalPERS Board in April 2021; rates in the subsequent years are subject to change based on board decision

CalPERS-Related Legislation

New Pension Laws Taking Effect in 2022

SB 278

- If at first you don't succeed, try, try again
- Now signed by Governor Gavin Newsom, SB 278 is Senator Connie Leyva's (D-Chino) third attempt to shift liability to the employer when a retiree's benefit is determined to be out of compliance with law and subsequently reduced
  - ❑ Jerry Brown vetoed similar legislation when he was Governor
    - ❖ "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."
  - ❑ Senator Leyva opted not to send substantially similar legislation to Governor Gavin Newsom in 2019 although it had been approved by the Legislature

SB 278

- When a retiree's CalPERS pension is reduced post-retirement, due to the inclusion of compensation agreed to under a collective bargaining agreement that is later determined to be non–pensionable, the public employer that reported contributions on the disallowed compensation must cover the difference between the pension as originally calculated and as reduced by CalPERS
  - ❑Pay to the system 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
  - ❑Pay a penalty equal to 20% of the amount calculated between the monthly allowance that was based on the disallowed compensation and the adjusted monthly allowance calculated for the duration that allowance is projected to be paid by the system to the retired member
  - ❑90% of the penalty to be paid shall be paid by the employer as restitution to the affected retired member who was impacted by disallowed compensation and 10% shall be paid to the system, which shall not be applied to normal contributions or additional contributions that would stand to the credit of the employer, or a member's individual account

SB 411

- In 2019, CalPERS' Office of Audit Service and Public Agency Review performed a random audit of 38 public agencies and 23 schools and found that among these 61 employers, 44 were not in compliance with the statutory reporting requirements relating to the appointments of Retired Annuitants (RAs)
  - These violations ranged from untimely submittal of payroll data, inaccurate information submitted, or a complete lack of reporting, to CalPERS.

SB 411

- Under PEPRA, when a retired member violates these restrictions, CalPERS must reinstate the retired member to active service
- Additionally, the Public Employees' Retirement Law imposes the following penalties:
  - ❑The retired member must reimburse the system for any retirement allowance received during the period of violation
  - ❑Pay active member contributions and interest on those contributions for that period
  - ❑Pay for various administrative expenses
- The employer must pay employer contributions and interest on those contributions for the period of violation and, in certain cases, various administrative expenses

SB 411

- This bill grants discretion to CalPERS relating to reinstatement of retirees to active membership if they work more than the 960-hour limit:
  - ❑Grants CalPERS discretionary authority whether to require a retired member who works in violation of the post-retirement employment limitations to reinstate as an active member.
  - ❑Requires a Retired Annuitant (RA) who is in violation of the post-retirement employment rules to pay employee contributions plus interest that otherwise would have been due to CalPERS for the employment period or periods, only if the RA is reinstated to active membership
  - ❑Requires an employer that violates the post-retirement employment rules to pay employer contributions plus interest that would have been paid for the period or periods of unlawful employment, only if the RA is reinstated to active membership

Employing Retired Annuitants

Executive Order Provides Some Flexibility

Employing Retired Annuitants

Requirement	Status
CalPERS 180-day break-in-service requirement	Suspended
CalPERS work-hour limitation of 960 hours	Suspended
CalSTRS 180-day separation-from-service requirement	In effect
CalSTRS requirement for board resolution to bypass $0 earnings limitation during 180-day separation-from-service period	Suspended
CalSTRS earnings limitation ($48,428 in 2021–22)	In effect

- CalSTRS requirements for employing retired annuitants during the 180-day separation-from-service period remain:
  - ❑The retiree must have reached normal retirement age
  - ❑The retiree could not have received a retirement incentive
  - ❑The retiree cannot be backfilling his/her own position
  - ❑Documentation of the employee's eligibility, excluding the board resolution, is still required prior to commencing work

Post Employment Benefits

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Retirement Incentives

Cash Payments – Post Employment

What are the Restrictions on Paying Out Cash Post Employment?

IRS: "Bona fide severance plans are not deferred compensation under 457(f) if: (1) compensation is only payable on involuntary severance from employment, voluntary termination for good reason, an early retirement incentive plan, or a window program…be paid by the end of the second calendar year following the year in which the severance from employment occurs."

- Maximum payout of 2 times salary
- Payout can be spread over 2 tax years
- Subject to immediate taxation from participant standpoint
- Subject to employer and employee payroll taxes

What are the Penalties for Paying Out Cash Longer Than That?

- Cash payouts longer than this are considered "ineligible deferred compensation" and employees can be taxed and penalized as if money was received in first year
- Retirement plans like 403(b) or 401(a) are excluded

Post Employment 403(b) Plans

What are the Restrictions/ Benefits on Using 403(b) Plan Post-Employment?

- *Employer* ***contributions to a 403(b) plan permitted up to 5 years post-employment*** (not to exceed $58,000 annually by employer (2021)
- *Defined contribution* - unlike a defined benefit/pension, there is ***no further obligation beyond stated contribution level***
- Allows employer to ***fix the cost up-front but spread costs out past first year*** for cash flow and budgetary reasons
- Employer ***avoids payroll taxes*** (which in turn creates savings)
- Participants are ***not taxed until the benefit is received***
- ***Can annuitize - distribution options*** can include lump sum, fixed payouts, and lifetime benefit
- Participants have ***IRA rollover capability*** or to other qualified plans
- ***Can convert accumulated sick leave and vacation time*** for tax deferral
- ***Avoid ineligible deferred compensation issues*** and penalties for EE/ER

IRS Constructive Receipt/Other Rules

What is IRS Constructive Receipt?

- Can not offer the choice between a taxable and non-taxable incentive
  - Healthcare benefit is non-taxable
  - Cash or retirement plan benefit is taxable

What are the Penalties to Employer/Employees for Violating IRS Constructive Receipt Rule?

How Do You Avoid Violating Age Discrimination in Employment Act (ADEA)?

- Do not condition it upon age, but rather years of service or other neutral criteria
  - Example: Eligibility based on STRS or PERS criteria of age and service

What is the EEOC Guidance on Incentives?

- Have an enrollment window of at least 30 days

Retirement/Separation Incentives

What Should You Do and Don't Do in Communicating Incentives to Employees?

- ***Never give the appearance of trying to push someone toward retirement***; strictly be informational
- ***Carefully prepare enrollment materials*** to explain the incentive and its value
- Make sure to ***provide information on IRS rules and tax implications***
- ***Conduct informational orientations*** as the enrollment window opens at times/locations to maximize attendance
- ***Hold one-on-one meetings/zooms as enrollment window closes*** to collect packets and answer any final questions
- ***Put information on website/in employee lunchrooms/HR Department***/ at campus sites
- Encourage their ***spouses or financial planners to attend***
- ***Encourage them to contact STRS/PERS/Social Security*** to determine other retirement benefits (coordinated workshops)

Unique Factors for CCDs

- **Adjunct Replacement**

- **Faculty Obligation Number**
  - Including the ability to replace Full-time Faculty with Adjunct Faculty for up to one year without impacting the FON if resignations/retirements come within the last 45 “Duty Days”

- **50% Law**

- **Categorical Programs**

- **Timeline**
  - End-of-Year, Mid-Year and combination approaches

Other Important Considerations

- Use firms with expertise in analysis, consulting, design, and communication of incentives for higher education
  - Typically not the everyday expertise of district staff particularly in communicating incentive
- Analyze the burdens on HR, business/finance and other staff
- Be careful using 403(b) firms who may not understand how to set up 403(b)'s for post employment employer contributions
- Use legal counsel to help avoid legal, IRS, state issues (employee benefits attorneys)
- Talk to other community college districts to find out what has worked and what doesn't

IRC Section 115 Trusts

Section 115 Trusts

What is an IRC Section 115 Trust?

IRC Section 115 trusts are one of two vehicles available to public agencies to fund post-retirement healthcare benefits (other is a VEBA)

- Exclusive to the public sector
- Must be "integral function or essential function of the government entity
- Not governed by more stringent regulations that apply to "VEBA" trusts
- Any income derived from a Section 115 Trust is tax exempt
  - *Gross income does not include-- (1) income derived from any public utility or the exercise of any essential governmental function and accruing to a State or any political subdivision thereof, or the District of Columbia; or (2) income accruing to the government of any possession of the United States, or any political subdivision thereof.*

What are the Investment Restrictions for a Section 115 Trust?

- Investment restrictions that apply to the general fund (CA Govt Code 53601) are not applicable to assets held in Irrevocable Section 115 Trust
- Assets can be diversified - invested per Govt Code Section 53216

Section 115 Trusts

Why can Post Employment Benefits Such as Pension and OPEB be Funded in this Type of Trust?

- IRS has deemed through Private Letter Rulings (PLRs) post employment benefits (retiree healthcare or pension) as essential government functions
  - A PLR ensures tax qualified status whereby any income accumulated in such trusts is excluded from taxes

Once Assets are in the Trust, How can They be Used?

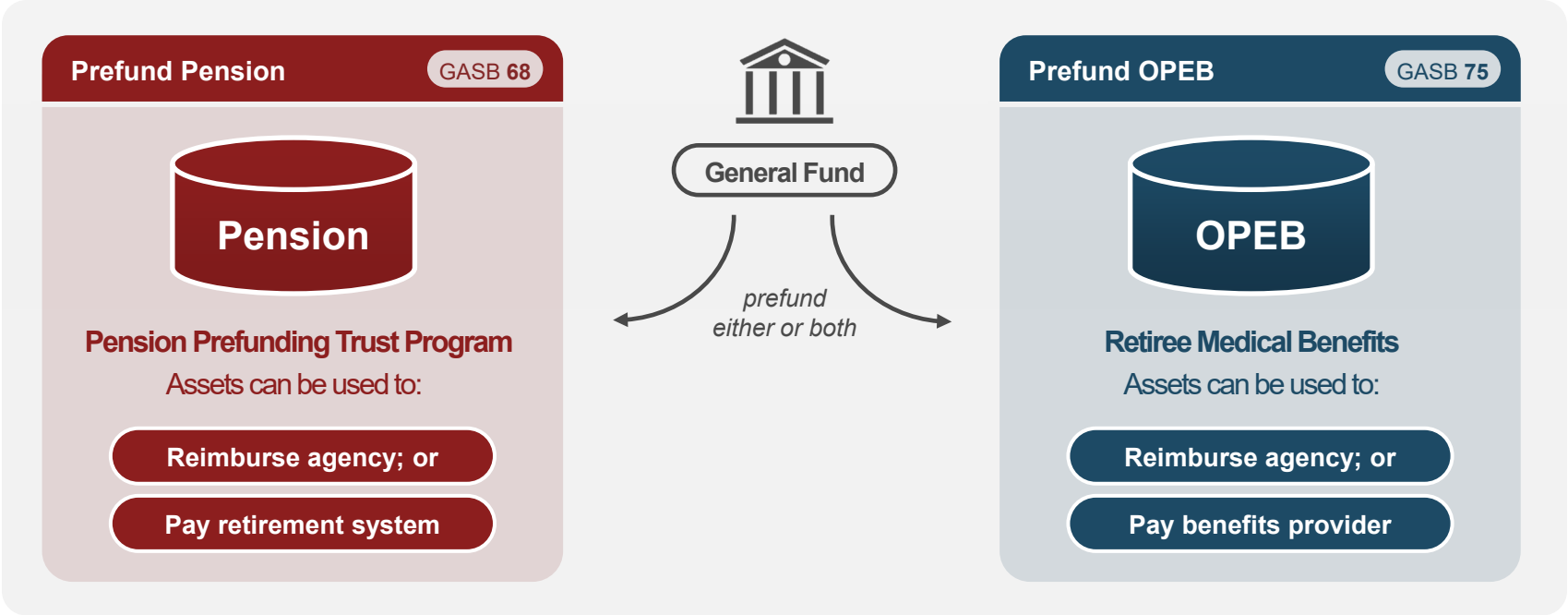
- Reimbursing a district for retirement system (STRS/PERS) or retiree healthcare costs
- Transferring assets directly to the retirement system or healthcare provider
- Paying plan expenses (actuarial valuation or audit)

Section 115 Trusts and GASB

What are GASB Rules for a Contribution to be Considered an Asset and Offset an OPEB liability on Financial Statements?

1. Be in an irrevocable trust (Assets can only be accessed for pension/OPEB costs)
2. Be for retiree healthcare benefits only such as medical, dental, vision etc. (Exclusive benefit)
3. Not be accessible by creditors

Post Employment Benefits Trust



Subaccounts

Pension and OPEB assets are individually sub-accounted, and can be divided by dept., bargaining group, or cost center

Dual Purpose

Assets in the Section 115 Combination Trust can be used to address any or all post employment benefit costs

Separate Investing

Allows separate investment strategies for pension and OPEB accounts.

Distribution Access

Trust funds are available anytime; pension for pension and OPEB for OPEB.

Economies-of-Scale

Pension and OPEB assets are aggregated for fee and investment purposes

IRS Approved

Trust concept was approved for first time with IRS Private Letter Ruling in 2015

Supplemental Defined Contribution and Defined Benefit Plans

PEPRA and Supplemental Plans

What Types of Supplemental Plans Are Allowed Post-PEPRA?

NO longer can do supplemental defined benefit plans

- 401(a) defined benefit plans were used for many years as incentive plans since 401(a) DB's allowed for post employment contributions
- 403(b) regulatory changes now allow 403(b) plans to be used for post employment benefits
- Can set up 401(a) defined contribution plans

What is a 401(a) Defined Contribution Plan and How Might it be Used by a District?

How Do They Differ From Voluntary 403(b) and 457 Plans? What is Meant by 401(a) Plans Being Mandatory?

401(a), 403(b), 457 – All Available in CCDs

What Are Limits on Employer and Employee Contributions in 2021 for Each Plan Type?

Plan Type	Contribution Limit
401(a)	$58,000
403(b)	$19,500*
457	$19,500*

**Employees aged 50 or older may contribute an additional $6,500 as a "catch up contribution"*

The total contribution limit for both employee and employer contributions to 403(b) plans under section 415(c)(1)(A) increased from $57,000 to $58,000 ($64,500 if age 50 or older).

How Can These Plans Be Used in Coordination with Each Other for Employees?

Plan	Employer/Employee Contributions While Employed	Post Employment – Employer Only
403(b)	$58,000	$58,000
457(b)	$26,000	0
401(a)	$58,000	0
TOTAL MAXIMUM CONTRIBUTIONS	$137,000	$58,000

Governmental Plan Rules

How Do Governmental Plan Rules Differ from Private Sector Ones?

- ERISA vs Non-ERISA
- No top heavy and discrimination rules
- Gives flexibility in plan design to community college districts that is not available to private sector

What Regulatory Bodies Have Jurisdiction Over Governmental Plans?

- IRS
- Not Department of Labor
- Others

Next Steps?

Questions?