



# Board of Retirement Regular Meeting

## Sacramento County Employees' Retirement System

### Agenda Item 14

**MEETING DATE:** October 17, 2018

**SUBJECT:** Compensation Earnable Policy for Overtime and Expired CTO– DISCUSSION DRAFT

**SUBMITTED FOR:**  Consent  **Deliberation and Action**  **Receive and File**

### RECOMMENDATION

Staff recommends the Board approve a discussion draft of the proposed policy for distribution to stakeholders. The policy establishes that any portion of an allowance or other pay differential that includes overtime or expired compensatory time off (CTO-expired) hours must be excluded from Final Compensation activity after the pay period ending December 22, 2018.

### PURPOSE

This item supports the 2018-19 Strategic Management Plan initiative to maintain and improve Stakeholder Relations by reviewing and updating Board policies and to communicate to employers and members the standards by which SCERS administers the retirement plan. This item also supports the Strategic Management Plan’s goal to improve fund sustainability.

### DISCUSSION

In 1997, the California Supreme Court issued its seminal decision, *Ventura County Deputy Sheriffs’ Assoc. v. Board of Retirement, et al.* (1997) 16 Cal.4<sup>th</sup> 483 (“*Ventura*”) interpreting, for the first time, the definition of “compensation earnable” in section 31461 of the County Employees Retirement Law of 1937 (“CERL”) (Gov. Code §31450 et seq.). In *Ventura*, the Court held that, comparing the County Systems to CalPERS, various types of pay should be included in the retirement allowance calculations of CERL members.

Following several years of litigation after the *Ventura* decision, the SCERS Board entered into a class action settlement agreement to resolve its post-*Ventura* litigation (*Ventura* Agreement). The *Ventura* Agreement included a list of 25 “included” and eight “excluded” pay elements with respect to compensation earnable. For reference, compensation earnable consist of wages and remuneration used to determine member contributions, as well as the wages and other remuneration used to compute Final Compensation.

The Board implemented the *Ventura* Agreement without changing the pensionability of any items included in the *Ventura* Agreement. Among the pay items included in the *Ventura* list were: “differentials,” “incentive pays” and “allowances”: (i) shift differential; (ii) management differential;

(iii) K-9 differential; (iv) “additional pay for possession of educational degrees or required certificates;” and (v) “assignment differentials based upon a percentage of base pay.”

Among the items excluded from the Ventura list were: (i) “overtime-includes CTO-expired;” (ii) “terminal pay;” and (iii) “Fair Labor Standards Act adjustment,” which is described as “Differential paid when the value of overtime per FLSA guidelines is greater than that negotiated.” Accordingly, the *Ventura Agreement* established that compensation associated with overtime and CTO-expired was never intended to be included in compensation earnable.

### Historical Practice

Beginning with the adoption of the Ventura Agreement and continuing to the present implementation of PEPR, SCERS has relied on the list of “included” items to identify the compensation earnable used to collect contributions and the Final Compensation used to compute retirement benefits for legacy members. In general, base wages and pay differentials earned by legacy members are included in compensation earnable, while overtime and CTO-expired hours are not included. However, through its payroll system, Sacramento County has historically collected—and SCERS has accepted—employer and employee retirement contributions on allowances and pay differentials attached to overtime and CTO-expired hours earned by legacy members. Upon further legal review, SCERS has concluded that the inclusion of such pay items in retirement calculations does not reflect the letter or the spirit of the statutory exclusion of overtime from pension calculations under the County Employees Retirement Law, SCERS’ *Ventura Agreement*, or case law.

### Correcting the Practice

The Board has the authority to decide what should be included in compensation earnable within the parameters of the statutory language. Specifically, Government Code Section 31461 provides that retirement boards “determine” compensation earnable. Admittedly, the scope and limitations on this authority are currently being litigated in two cases that are pending before the California Supreme Court: *ACDSA v. Alameda CERA* (S247095) (“*Alameda*”) and *MAPE v. Marin CERA* (S237460) (“*Marin*”). However, neither case is addressing whether a Board can determine that a pay element associated with overtime and overtime based differentials should not be included in compensation earnable.

Correcting the practice since its inception would require the recalculation of almost every retirement allowance awarded since the 2004 *Ventura Agreement*. That would likely expose SCERS to significant litigation risk from impacted retirees and current members, and a court may apply an estoppel argument to prevent SCERS from applying its change in practice retroactively.

To balance fairness to members with the Board’s fiduciary obligation to administer the plan in accordance with governing documents, Staff recommends excluding in the Final Compensation period any portion of earnings on allowances or pay differentials influenced by overtime or expired-CTO hours earned after the pay period ending December 22, 2018. Effective the pay period beginning December 23, 2018, SCERS will not accept the remittance of retirement contributions from the employer or employee for any portion of earnings on allowances or pay differentials influenced by overtime or expired-CTO hours.

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Because SCERS will continue to include earnings on allowances or pay differentials based on by overtime or expired-CTO hours through December 22, 2018, those earnings can continue to be counted toward the highest Final Compensation period, as long as those pay items were earned no later than December 22, 2018. Therefore, SCERS will not be refunding member contributions under this policy. In addition, this policy will not affect a member's ability to select an alternate final average salary period, i.e. a period that does not coincide with the final one year or three years of employment. Should a member retire in the future and want to select a final average salary period that pre-dates the implementation of this policy, the member will be able to do so and any allowances and/or pay differentials earned during the chosen period will be included in the member's earnable compensation.

This policy effectively applies only to legacy members. In compliance with PEPRA, SCERS members hired on or after January 1, 2013, generally do not receive pensionable compensation or make retirement contributions for earnings outside of base pay.

### **FISCAL AND ADMINISTRATIVE IMPACT**

Staff believes the impact of this policy is limited to Sacramento County and its employees. It is difficult to determine a fiscal impact to Sacramento County, but implementation of this policy will likely lead to employer and employee payroll savings due to the exclusion of overtime and CTO-expired retirement contributions. To the extent overtime is worked and expired-CTO is used, Staff believes the savings to Sacramento County are likely to be significant because the Sacramento County payroll system captures retirement contributions on more than 350 pay differentials for legacy members, regardless of whether those differentials were earned on base pay or overtime/CTO-expired. SCERS also acknowledges that Sacramento County will need to modify its payroll system to accommodate this policy.

### **NEXT STEPS**

Over the previous two months, SCERS Staff has conducted outreach to employers and several employee groups in anticipation of this policy. Upon approval by the Board, Staff will distribute the Discussion Draft to employers and employee groups for comment. Staff will evaluate any comments for incorporation in the policy, with the expectation that the Board will be presented with a final policy for consideration at its regular meeting on December 19, 2018.

### **ATTACHMENTS**

Compensation Earnable Policy for Overtime and Expired CTO—DISCUSSION DRAFT

Prepared by:

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Robert Gaumer  
General Counsel

Reviewed by:

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Eric Stern  
Chief Executive Officer



## COMPENSATION EARNABLE POLICY FOR OVERTIME AND CTO-EXPIRED DISCUSSION DRAFT

**Revision Date:**      **October 17, 2018**

**Policy Number:**      **025**

### **PURPOSE**

The purpose of this policy is to require the exclusion of overtime and expired compensatory time off (CTO-expired) from compensation earnable when applied to allowances and pay differentials earned by legacy SCERS members.

### **POLICY**

Any portion of allowances or other differentials earned as a result of overtime or CTO-expired hours must be excluded from compensation earnable and Final Compensation calculations on a prospective basis, beginning with the pay period commencing December 23, 2018.

### **EFFECTIVE DATE**

Beginning with the pay period commencing December 23, 2018, SCERS will not accept the remittance of retirement contributions from the employer or employee for any portion of allowances or other differentials that are paid as a result of overtime or expired-CTO hours. For all pay periods thereafter, SCERS will exclude from the Final Compensation calculation any portion of allowances or other differentials that include overtime or expired-CTO hours.

### **APPLICATION**

#### Overtime

Overtime wages are not included in compensation earnable. Allowances or other differentials that are the result of overtime hours are also not included in compensation earnable.

#### Compensatory Time Off

Compensatory time off used as personal time (for vacation, illness, or other absence) is included in compensation earnable. Allowances or other differentials that include CTO are also included in compensation earnable.

#### Compensatory Time Off-Expired

Under Sacramento County employment practices, a CTO hour has a shelf life of one year. After the expiration of that year, the CTO hours accrued by eligible employees are paid in the same manner as overtime hours. These payments are then referred to as "CTO-expired."

Compensation received for expired CTO hours is not included in compensation earnable. Allowances or other differentials that are based on CTO-expired are not included in compensation earnable.

### **FLSA Overtime**

For Miscellaneous members, any hours worked over 80 hours a pay period (40 hours a week) is considered “overtime” and cannot be included in compensation earnable. However, Safety members are permitted to work a regularly scheduled workweek that exceeds 40 hours per week. Regardless, all hours included in the regularly scheduled workweek will be included in compensation earnable, along with any applied allowances and pay differentials. Any hours over that amount, as well as allowances or other differentials that include hours in excess of regularly scheduled workweek, are considered “overtime” and will not be included in compensation earnable, including any applied allowances or pay differentials.

### **BACKGROUND**

Many SCERS members have the ability to earn allowances and pay differentials, which act as a flat rate or a percentage of pay increase to the member’s base salary. In most cases, for members hired before January 1, 2013 (legacy members), these allowances and differentials are included as compensation earnable and augment a member’s final average salary. When members work overtime hours or earn CTO hours, by agreement with the employer, the allowances and pay differentials are included as additional compensation. Under statute, compensation earned by working overtime cannot be included in compensation earnable.

Through its payroll system, Sacramento County has historically collected—and SCERS has accepted—employer and employee retirement contributions on allowances and pay differentials, regardless of whether they were attached to base wages, overtime, and CTO-expired hours earned by legacy members. Upon further legal review, SCERS has concluded that the inclusion of such pay items in Final Compensation and retirement calculations does not reflect the letter or the spirit of the statutory exclusion of overtime-type payments from compensation earnable calculations under the County Employees Retirement Law, SCERS’ Post-*Ventura* Settlement Agreements, or case law.

### **RESPONSIBILITIES**

Executive Owner: Chief Executive Officer

### **POLICY HISTORY**

<b>Date</b>	<b>Description</b>
10-17-18	Board adopted policy Discussion Draft.