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Special Hearing on Internal Revenue Code Section 415 and California's Public Pension Systems

Assembly Committee on Public Employees, Retirement, and Social Security

Senate Committee on Public Employment and Retirement

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JOINT HEARING

SENATE PUBLIC EMPLOYMENT AND RETIREMENT COMMITTEE

AND

ASSEMBLY PUBLIC EMPLOYEES, RETIREMENT & SOCIAL SECURITY

COMMITTEE

STATE OF CALIFORNIA

ROOM 4202

SACRAMENTO, CALIFORNIA

SPECIAL HEARING

ON

INTERNAL REVENUE CODE SECTION 415

AND

CALIFORNIA'S PUBLIC PENSION SYSTEMS

TUESDAY, JUNE 6, 1989

1:15 P.M.
July 27, 1989

FOREWORD

This is a transcript of the Joint Committee hearing of the Assembly Committee on Public Employees, Retirement and Social Security and the Senate Committee on Public Employment and Retirement, held on June 6, 1989 regarding Internal Revenue Code Section 415 and its effects on public employee retirement systems.

The California Legislature oversees five public retirement systems: the Public Employees' Retirement System (PERS), the Judges' Retirement System (JRS), the Legislators' Retirement System (LRS), the State Teachers' Retirement System (STRS), and the counties and districts which fall under the County Employees' Retirement Law of 1937 ('37 Act).

Section 415 places annual limits on the amount of pension benefits that an individual can receive in both public and private qualified retirement plans. These limits are essentially 100 percent of final compensation or $98,000. In addition, it appears that if under the retirement plan design, there is even the potential for someone to exceed these limits (i.e. no reference to the section 415 maximum amount in statute) then the plan could also be declared out of compliance by the IRS.

California retirement plans can take advantage of a federal grandfather clause which will allow all current members of the systems to be exempt from these limits. However, if the grandfather clause is chosen for current employees, all employees hired after January 1, 1990, will be subject to lower private sector limits. Taking no action could result in the disqualification of the California retirement plans and the loss of their tax-exempt status.

The purpose of the Joint Hearing was to bring together key representatives from California retirement systems and retirement benefits consulting firms to address the many unanswered questions about Section 415 compliance. The experts seemed to agree that public retirement systems in California should adopt legislation taking advantage of the grandfather provision for current employees. However, serious questions remain on how to administer Section 415 limits, to what extent future employees will be adversely affected by the new lower limits, and how to ensure that these individuals are treated equitably.
Senator Newton Russell has authored SB 200 and SB 875 which would bring PERS, LRS, JRS, and '37 Act counties into compliance. Senator Cecil Green is carrying SB 869 which applies to Los Angeles County only. Assemblyman Dave Elder is the author of AB 50, the Section 415 compliance bill for STRS (copies of these bills are included as an Appendix to this transcript).

We welcome your thoughts and comments on Section 415 compliance.

Thank you for your interest on this issue of great importance to public employees in our state.

DAVE ELDER, Chairman
Assembly Committee on
Public Employees, Retirement
and Social Security

CECIL GREEN, Chairman
Senate Public Employment
and Retirement
Committee
APPEARANCES

MEMBERS PRESENT

ASSEMBLYMAN DAVE ELDER, Chairman
Assembly Committee on Public Employees, Retirement & Social Security

SENATOR CECIL GREEN, Chairman
Senate Committee on Public Employment & Retirement

SENATOR NEWTON RUSSELL

SENATOR DON ROGERS

ASSEMBLYMAN CURTIS TUCKER, JR.

STAFF PRESENT

JIM BALD, Consultant
Assembly Minority Caucus

TOM BRANAN, Consultant
Assembly Committee on Public Employees, Retirement & Social Security

DAVE COX, Special Consultant
Joint Committees on Public Retirement

DAVE FELDERSTEIN, Consultant
Senate Committee on Public Employment & Retirement

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Assembly Committee on Public Employees, Retirement & Social Security
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DAVID LeSUEUR, F.S.A. Principal
Towers, Perrin Forster & Crosby

LINDA PAULSON
Heron, Burchette, Ruckert and Rothwell

BUD TREECE, Vice Chair & Chief Negotiator
Coalition of County Unions
CO-CHAIRMAN ELDER: Greetings. Senator Russell, other Members, as you are aware, Section 415 of the federal Internal Revenue Code places both dollar and percentage limits on the amounts that public and private pension plans may pay their retired members. While initially these limits created an impairment of contract problem for many public retirement systems, Congress amended the law in 1988 to include a grandfather clause which would exempt public employees that were hired before January 1, 1990 from all the 415 limits.

However, for current employees to be eligible for this window, a plan must adopt the grandfather provision by the end of 1989. If a system adopts the grandfather provision, all employees hired after 01/01/90 will be subject to the private sector 415 limits that are lower than the limits presently available for the public sector. If a system does not adopt the grandfather provision, all current and future employees will be subject to the present public sector limits. However, if a single member exceeds those public limits, the entire plan could be disqualified.

The purpose of this symposium is to continue the dialogue as to whether California public pension plans should comply with the federal restrictions contained in Section 415 of the Internal Revenue Code, and if so, how do they best comply?

In preparing for this symposium, there have been numerous workshops held throughout the state to provide individuals with a basic understanding of the technical aspects of 415 and the problems associated with compliance. Unfortunately, it seems that every time we hold a meeting on 415, the end result is that for every question we answer, new questions emerge, and I'm sure that will be the case for today's hearing.

Therefore, this symposium should not be considered the final word on 415 compliance, but should be considered only one step in the learning process. I might inject here, it seems rather unfortunate that we have to go to these lengths to try to understand what it is we think the federal government means to do for us.

The questions and issues that we will be discussing today have been proposed by plan administrators, representatives of management and labor, actuaries, our legal counsel, and concerned California taxpayers.
Today we have California's largest public retirement systems represented, including the Public Employees' Retirement System, the State Teachers' Retirement System, the numerous systems operating under the provisions of the County Retirement Law of 1937, and the retirement system of the University of California.

It is of interest to note that each system is approaching the compliance issue differently:

One, the '37 Act systems are sponsoring SB 875 by Senator Russell, who is here with us today.

Two, the PERS system is sponsoring SB 200 by Senator Russell.

Three, the University of California has chosen to comply subject to the approval of the Board of Regents.

Four, it is understood that the Los Angeles County Retirement System has reached a management-labor negotiated compromise that will satisfy the 415 provisions. I understand that this plan will be presented to us later on in this afternoon's hearing.

And five, due to the unique combination of its members and benefits structure, STRS is exploring the possibility of complying with the public limits without adopting the grandfather provision.

I would like to take a minute or two to discuss the general format that we will follow during this afternoon's meeting. After the statements by Senator Green and Senator Russell, and any Member of either the Senate Public Employment and Retirement Committee or the Assembly Public Employees, Retirement, and Social Security Committee, we will ask for general statements from any member of the panel who would care to speak. The panel members should try to limit their comments to five minutes or less.

We will then begin addressing specific questions to selected members of the panel. We will entertain answers not only from the individual to whom the question is addressed, but also from any other panel member who cares to respond.

I believe that the success of this symposium depends upon a healthy dialogue between members of the panel, so I would encourage each of you to actively participate in each question. If a panel member does not feel qualified to answer a question specifically addressed to him or her, please feel free to say so, and we will open it up to the group to answer the question.

I should note that questions will be addressed to the panel members not only by Senator Green, Senator Russell and myself, but by Members of the two policy committees.
In addition, if one panel member wishes to ask another panelist a question, they are encouraged to do so, but please do so through the Chair.

After all questions have been answered, I would suggest that we open the discussion to the audience, if time permits.

Finally, as you can see, today's hearing is being recorded by a court reporter. We will release a transcript of this hearing as soon as possible. We hope that it will be useful to all interested parties.

If there are no questions, I would like to ask Senator Russell if he would care to make an opening statement.

SENATOR RUSSELL: Thank you, Mr. Chairman.

As you, Assemblyman Elder have indicated, I am the author of SB 875 and 200. They are the two legislative measures that deal with PERS and '37 Act county plans, with the exception of Los Angeles County which has removed itself from that purview.

These are plans that are designed to take advantage of the grandfather option that Chairman Elder has indicated. It gives them the opportunity to do that.

Unfortunately, we only have until the end of the year to decide whether or not to adopt the grandfather provision. This decision is extremely important, as it could affect the retirement allowance of thousands of California citizens.

Making an intelligent decision requires thorough knowledge of the complexities of the 415 limits and the impact of those limits on California retirement plans. In my opinion, understanding the various fundamentals related to the compliance question can only be accomplished through seminars such as this one.

I want to compliment Chairman Elder and Chairman Green, the Members of both policy committees, and those individuals that have consented to serve on the panel, for your interest and your effort in contributing to the solution of an extremely difficult problem.

I thank you, Mr. Elder.

CO-CHAIRMAN ELDER: Thank you, Senator Russell.

Senator Green is en route to the hearing room, and we will hold his statement in abeyance until he arrives.

Mr. Grossman, why don't we start with you and proceed across here if you have an opening statement.

MR. GROSSMAN: No.
CO-CHAIRMAN ELDER: Mr. James.

MR. JAMES: Good afternoon. I'm Drew James from C&B Consulting, and I just want to make a brief comment.

It's a pleasure and a privilege to be here today, and we are very eager to participate and listen to the comments.

I think this is an important symposium. I think it's going to set some important directions for the future, and we're eager to get going.

CO-CHAIRMAN ELDER: We'll stipulate that all of you thanked us for having the hearing. I appreciate Mr. James doing that so we could incorporate your comments by reference. Mr. King.

MR. KING: Thank you and good afternoon.

I am Jon King, a consulting actuary representing Buck Consultants. Buck is an international employee benefits firm founded in 1916 by George Buck, an attorney working with the City of New York. He recognized the need to fund retirement systems. He had just written and literally invented pension actuarial mathematics as it is known today.

To this day, we specialize in the public employee benefit issues, being the actuary to over 25 statewide retirement systems.

You should all review our booklet, The Taxation of Public Sector Retirement Systems written by our Research Department. It includes a discussion of all the qualification requirements of public plans, including Section 415 requirements. I will leave a copy with Dave Cox for the Committees' use.

MR. KING: I chose my remarks today, focusing on three nontechnical details that I fear would otherwise be overlooked or misunderstood. These three issues are as follows.

Why Section 415 is a problem to every public retirement system in the State of California, even if they don't have anyone, and I repeat, anyone who is likely to exceed the Section 415 limits.

Second, why IRS enforcement of Section 415 is more likely than it has been in the past.

And third, and most importantly, what else is necessary to meet IRS qualification issues. After all, it would be a shame to solve the Section 415 problem and overlook other issues which also threaten the plan's qualification.

Turning to my first issue, Section 415 is a serious problem to virtually every public retirement system in California.
It doesn't matter how low paid or how poor the plan benefit formula is. All that matters is that the IRS requires all pension plans to contain language which precludes the possibility of anyone ever exceeding the Section 415 limits.

I am not familiar with even one California public retirement system that meets this requirement.

The second issue has to do with the potential for IRS enforcement, which has heretofore been lacking in the public sector. There are several reasons that future enforcement is more likely than in the past, including --

CO-CHAIRMAN ELDER: They need the money.

MR. KING: That's the fourth reason and the overriding concern.

The first one I had was that Congress and the IRS recognized the constitutional dilemma you faced and believed they solved that with the TAMRA election. They don't like to solve issues twice.

The second issue is that the IRS can now divide and conquer. They clearly have the power to disqualify the plan only with respect to highly compensated employees. In other words, they can accelerate the taxes associated with noncompliance on the movers and shakers, without incurring the wrath of the rank and file.

And finally, and of very recent vintage, Internal Revenue Bulletin 1869 was rescinded just last week by the proposed and temporary regulations under 410(b) of the Internal Revenue Code. Internal Revenue Bulletin 1869 had essentially said that the government was going to take a hands off approach on discrimination and coverage issues of public sector employers.

The third and perhaps most important issue has to do with other IRS requirements. It doesn't seem to me that we've accomplished much if we solve the Section 415 problem, and then the IRS disqualifies the plan based on some other "gotcha". One section of the handbook I mentioned discusses all of the areas where public retirement system compliance is necessary for qualification. I am sorry, but time does not permit even a cursory discussion of this issue. Suffice it to say that I believe the complete qualification audit of each, or at least a sample, public retirement system should be considered as a decision is reached on Section 415 problems. In any event, a complete qualification audit should be performed as soon as possible.

In review, I remind you I believe Section 415 is a problem that needs a solution for every California public retirement system. Second, future IRS enforcement, even though by no means a certainty, is at a minimum much more likely than it was in the
past. And finally, you need to do a lot more than solve Section 415 if you want to meet all of the IRS requirements for a qualified plan. Thank you.

CO-CHAIRMAN ELDER: Thank you, Mr. King. Ms. Paulson.

MS. PAULSON: Mr. Chairman, we don't have prepared remarks.

CO-CHAIRMAN ELDER: Mr. LeSueur.

MR. LESUEUR: I have no opening statement.

CO-CHAIRMAN ELDER: Why don't we just continue on down the line. Does anyone have an opening statement? Mr. Altman.

MR. ALTMAN: Yes, sir, Mr. Chairman, a very brief statement.

We feel certainly that the implications of Section 415(b)(10), which are the exclusions or the grandfather we're talking about today, merit great consideration. But we want to raise the issue at the earliest moment of our concerns over the rest of Section 415, in particular Section 415(e), the combined plan limitations. Several of the PERS and PERS members are eligible for Section 457, 403(b), or even 401(k) plans, and these plans must be factored into the equation as well.

So, I would just urge the Assembly to look at the entire picture. Jumping at the grandfather offered by -- under 415(b), which deals with defined benefit plans only, is not a complete solution to the 415 problems. Thank you.

CO-CHAIRMAN ELDER: Thank you, Mr. Altman. Now Ms. Lund from PERS.

MS. LUND: I'm Sandy Lund, Assistant Executive Officer for Public Employees' Retirement System. I also thank you for the opportunity to be a part of this panel today of actuaries, attorneys, and plan administrators, along with employers.

As a group, we are interested today in pooling what knowledge we have regarding the limits the federal government has placed on payment of benefits from public retirement systems, and more immediately, to shed light on what the advantages are for our systems to elect to bring our plans into compliance with the federal limitations, using this unique grandfather opportunity available to us this year.

The questions we are faced with don't have easy answers. While the attorneys and the actuaries participating on the panel may have answers as to what the law requires and how to calculate limits, it will be up to the administrators of the plans of the California public retirement systems to decide, based on this
information, whether to work towards bringing our plans into compliance, and if so, how to go about doing this. Because of the differences in our plans, there may well be a separate best solution for each separate plan. In this regard, PERS has sponsored a bill, SB 200, authored by Senator Russell, which will add the required 415 language to the law in order to bring California PERS into compliance.

I agree with the prior speaker that, from all appearances, the federal government appears to be increasing its seriousness as it relates to the regulation of benefits provided by public employers for their employees.

Last year, we said it couldn't be done. We could not comply with 415. And for that reason, not for California alone, but for public pension systems in general, the federal government did pass this one-time opportunity under the grandfather clause.

The question now facing us is: will the federal government enforce the 415 limits after January 1st, 1990, and can we, as plan administrators and board members, afford to gamble that they won't?

After attending several presentations on this issue, I am convinced that our public pension systems, our members, the employers, and ultimately the taxpayers of the state stand to lose an unestimated but a very, very large sum of money to additional taxes if we are not extremely careful in exercising our fiduciary duty as plan administrators and as board members to do our very best to protect the qualification status of our plans.

And I thank you for this opportunity, Assemblyman.

CO-CHAIRMAN ELDER: Thank you. Anyone else wish to make a statement? Mr. Mosman.

MR. MOSMAN: Just a brief statement, Assemblyman Elder, Senator Russell.

I want to also thank you for the opportunity. Jim Mosman, I'm the Chief Executive Officer, State Teachers' Retirement System.

The question of 415 compliance will be before our board this month, June 23rd. Because of the inherent complexity of the issue, the staff has not made a formal recommendation to the board at this point in time, and we're hopeful that the hearing today will shed additional information that will aid us in doing that.

I must confess, I've personally been to a number of presentations on this issue, and every time I leave one of them, I walk out, it seems, with more questions than when I went in.
Our initial analysis of the STRS data base and our beneficiaries indicates that we believe that few, if any, STRS benefit recipients are currently out of compliance with Section 415. However, because of the severe consequences of noncompliance with Section 415 even if one member were to be discovered, I am leaning to a recommendation which would support building Section 415 limits into our plan for all new members.

I would, of course, be interested in learning of any pitfalls to this approach that might come out today.

With me today, behind me and previously introduced, is Ms. Paulson from the law firm of Heron, Burchette, Ruckert and Rothwell. She is an expert on tax matters as they relate to pension plans.

A couple of the previous speakers indicated the desirability of having not only the Section 415 question, but the entire issue of tax compliance relating to the entire plan looked at. We have, in fact, hired the Heron, Burchette firm to look at the entire issue of tax compliance with both federal and State law; Section 415 is one of the issues, of course, that they will be looking at. We expect recommendations from their firm in the near future.

Again, I'm looking forward to the testimony today.

CO-CHAIRMAN ELDER: All right, any other presenters?

Mr. Coon.

MR. COON: Thank you. My name is Wendell Coon. I represent the Department of Personnel Administration.

I just wanted to make a couple of points very quickly here. We're in the process of trying to figure out the implications of 415, too. We have 150-160,000 people in the PERS system, and a few in STRS, and so we're interested in that part of it.

But as the group may be aware, we have further responsibility to administer a lot of other programs for State employees. And all of these programs figure into the IRS formula for trying to determine whether an employer is in compliance with the 415 limits or not. And those things include things like our flexible spending accounts, and flexible benefit programs under Section 125 and 129, the 403(b) programs, 457, 401(k), the employer pickup.

One of the things, my chief uneasiness, I think, about all of this is that in a lot of the literature, the impact of those elements on the overall program don't seem to quite get the attention they should have. It's probably possible to design a good retirement system which would meet the law, but once the impact from all of those are considered, you know, it may be a different question.
So, to the extent that I can get other folks to worry about those questions, I'm interested in doing that also.

Thank you.

CO-CHAIRMAN ELDER: Mr. Coon, I think it is curious that people have not been more interested. I suppose they would get very interested if we did nothing and their paychecks were reduced by some 25 percent of the cost of the retirement system benefits. In our case, that would be substantial.

Our employees are typically in PERS, paying from 5 to 10 percent, in the case of public safety, and their agencies are paying from about 12 percent to as high as 50 percent, depending upon the classification.

So, when you take 25 percent of that, and then figure out how much money that is in terms of taxes, and then reduce that off of their net income; I shocked the Sergeant who was driving me over here today to suggest to her that her take-home pay would be reduced by about $300 a month. That got her attention.

As you can see, this is of pressing import to the Members of our Committees. Mr. Descamp.

MR. DESCAMP: Thank you, Chairman Elder, Senator Russell, Senator Green.

I'm John Descamp. I'm the Retirement Administrator for the Sacramento County Employees' Retirement System, and I also serve as President of the State Association of County Retirement Systems, otherwise known as SACRS.

As can be seen from a reading of TRA '86 and TAMRA of '88, as they relate to Section 415, this is a very complex and complicated issue, and one that requires cooperation and consultation with all parties if we are to act responsibly and prudently in dealing with the matter.

I and my fellow SACRS administrators and fiduciaries have, through our individual and collective efforts, acting from within and independent from our association, and through our hired consultant, attempted to bring to the attention of the Legislature the importance of addressing this matter in a public forum and acting decisively on the matter. We were successful in sponsoring what is SB 875, and we're very thankful to Senator Russell for authoring the bill.

As fiduciaries, we have a responsibility to discharge our duties with care, skill, prudence and diligence. With respect to this issue and over the last year, we believe that we have done so by bringing this matter to the attention of the Legislature,
encouraging and participating in the dissemination of information with respect to this issue, and making ourselves available for explanation, consultation and appropriate action when necessary.

Following this symposium, and any subsequent similar informational meetings, we strongly recommend and hope that all parties will work together to assist the Legislature in developing a comprehensive and decisive response to the Section 415 debacle in order to protect the benefit systems' participants and beneficiaries, minimize employer contributions, and defray reasonable expenses of administering the systems.

I thank you and your staff for assisting us in that endeavor.

CO-CHAIRMAN ELDER: Thank you, Mr. Descamp. All right, Ms. Ahn.

MS. AHN: Assemblyman Elder, Senator Russell, my name is Sandra Ahn. I am the Director of Executive and Financial Programs for the University of California system-wide benefit programs.

Our benefit programs include four retirement plans under the umbrella name of University of California Retirement System. UCRS is a governmental retirement defined benefit plan, covering approximately 88,000 faculty and staff at our nine UC campuses, and three national laboratories with contracts through the Department of Energy. UCRS administers its benefits in conformance with the applicable federal law, including the defined benefit limit of Section 415 and other sections of the Internal Revenue Code, such as 401, et cetera.

Consequently, the specific changes to Section 415 in the Tax Act of 1986 did not require a policy change. UCRS will recommend to its Board of Regents that we file for the special grandfather election, which will permit the plan to pay the full accrued benefits to its current membership. For members after 01/01/90, we will then follow the applicable federal limits.

The current defined benefit limits applicable to governmental plans provide advantages for early retirement; that is, any retirement age below Social Security retirement age. While the grandfather election will result in the loss of this advantage, we prefer to avoid reducing benefits to our current members and face the possible cutbacks for hires in the future. Our reason simply is that given the legislative history of pension and tax law, it is impossible to predict with any certainty what the outcomes will be. Consequently, UCRS is seeking the method that will minimize a reduction to its current membership.

Thank you.
CO-CHAIRMAN ELDER: Thank you, Ms. Ahn. Next, I'd like to recognize Chairman Cecil Green of the Senate Public Employment and Retirement Committee for his opening statement.

CO-CHAIRMAN GREEN: Thank you, Mr. Chairman, Mr. Elder. First of all, I want to thank Mr. Elder for arranging the use of his meeting room today for today's seminar. I think that compliance with IRS Code Section 415 is one of the most important problems that faces this Legislature during his session. At the beginning of this session, Senator Russell, sitting on my left, agreed to carry two bills that have served as vehicles for Section 415 compliance. And at Senator Russell's suggestion, Dave Cox was hired to staff this Section 415 compliance effort.

As Chairman of the Senate policy committee, I want to thank Senator Russell personally for the work that he has already put into finding a solution to this major problem.

And in addition to that, this morning I met with representatives of the Los Angeles County Retirement System. One of my bills that is in the Assembly may be used to put a new tier of benefits into place for county employees hired after January 1st, 1990. This new tier will comply with Section 415, we feel.

I plan to have this bill in print for as long as possible and looked at by as many experts as we can find to be sure that we are complying with the federal law with as little impact as possible on the benefits of the county employees.

I think the Legislature's efforts on this matter are starting to show significant progress, and this seminar is proof of that.

I want to thank all of you, all the people that are here today to testify, because without your help and without your expertise, we'll never accomplish this major goal.

With that, I think that we'll have the problem fixed, and there's a solution to the problem, and all of us are part of that team. I want to be part of it. Mr. Felderstein, who is our consultant, wants to be part of it, and I know all of you want to be part of it.

So, let's get it done, get the job done, get a good conclusion, and we'll comply with 415.

Thank you, Mr. Elder.

CO-CHAIRMAN ELDER: Thank you, Senator Green.

I can't help but observe that we are, ourselves, members of
retirement systems, being in the Legislative Retirement System, and this will have an effect on the Legislative Retirement System contribution levels.

I wondered if Mr. Kinney might take under advisement a question relative to whether we have any conflict of interest in proposing solutions to this dilemma. I'd be anxious if you'd consult with our good friends at Common Cause and elsewhere as to how we might get out of this difficulty created by our federal government. So, Mr. Kinney, you might write that down and get back to us sometime in the near future.

All right, our first question, I have a two-part question, and I'd like to begin with Mr. Grossman, if he's ready.

What is a qualified plan?

MR. GROSSMAN: A qualified plan is a retirement plan that meets various requirements in Section 401(a) of the Internal Revenue Code.

CO-CHAIRMAN ELDER: What tax advantages are available to employees covered by qualified plans in the public sector, Mr. Leavitt?

MR. LEAVITT: There are several tax advantages that are available to qualified plans. One of them, obviously, is not a benefit that is needed by public employers, and that is the deductibility of the contributions.

From the employee's point of view, however, the contribution by the employer is not taxable at the time it is made, but rather is deferred and taxed when it is received, not when it's made or when it vests.

Also, the assets of the fund are tax exempt, which permit pretax accumulation, which we all know is a significant advantage over time.

And lastly, there are some -- fewer today than previously, but still some -- favorable tax treatments available upon receipt of primarily lump sum distributions from qualified plans.

Also, I ought to add that qualified plans permit things such as the pickup of employee contributions, which is widely used by many of the systems here where the -- I think you know -- the employer picks up under Code Section 414(h)(2) the employee contribution, converting it into a before-tax contribution.

CO-CHAIRMAN ELDER: Has any public pension plan ever been disqualified? Does anybody know of any public plan being disqualified? Mr. King.
MR. KING: If you'll accept hearsay, I've heard of one that was disqualified about -- I heard five years ago. Would you care for the hearsay? Do you want to track it down? St. Joseph, Missouri.

CO-CHAIRMAN ELDER: The City of St. Joseph, Missouri?

MR. KING: Yes. I just say that if you want to check one. I don't know that they have, but I heard that secondhand.


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CO-CHAIRMAN ELDER: Has any public pension plan ever been disqualified? I throw that out to the group. Does anybody know of any public plan being disqualified? Mr. King.

MR. KING: If you'll accept hearsay, I've heard of one that was disqualified about -- I heard five years ago. Would you care for the hearsay? Do you want to track it down? St. Joseph, Missouri.

CO-CHAIRMAN ELDER: The City of?

MR. KING: Yes. I just say that if you want to check one. I don't know that they have, but I heard that secondhand.

CO-CHAIRMAN ELDER: All right. Anyone else know of any public pension plan ever being disqualified? Never happened before? That's helpful. Mr. LeSueur, what is Section 415, and what kind of plans does 415 apply to?

MR. LeSUEUR: Section 415 is, in the Internal Revenue Code, a section that describes how qualified plans need to limit their benefits. So, Section 415 applies only to plans that want to be qualified under Section 401(a) of the Code, which has previously been described to us, the advantages of being a qualified plan.
MR. LEAVITT: Mr. Chairman, could I add?

CO-CHAIRMAN ELDER: Certainly.

MR. LEAVITT: That means that 415 does not apply to 457 plans of deferred compensation. They are not qualified plans.

On the other hand, plans such as 401(k) plans are qualified plans and are subject to the 415 limits. Also, 403(b) annuities are subject to the limits.

CO-CHAIRMAN ELDER: How about Section 125 of the Internal Revenue Code.

MR. LEAVITT: Section 125 plans are not retirement plans subject to 401(a), so they are not subject to the 415 limits either. They do, as was pointed out previously, though, impact on 415 limits because they reduce taxable compensation against which the 415 limit is measured.

I should note for the sake of completeness that 457 and 401(k) also reduce taxable compensation and impact on 415 that way, but the benefits paid by the 457 plan are not subject to the 415 limits.

CO-CHAIRMAN ELDER: I would encourage the panel that it's better to be a little -- if you're going to err, err on being more complete than you think necessary, because this is new to a lot of us.

Mr. Altman, are deferred compensation plans sponsored by governmental employers qualified plans? Are they subject to 415 limitations?

MR. ALTMAN: Mr. Chairman, effectively reiterating what was just said, the so-called 457 plans are not directly limited by these maximum benefit limitations of Section 415. However, they do have, as my colleague describes, something of a back door effect by reducing compensation that is otherwise figured into the IRS equations.

CO-CHAIRMAN ELDER: So as far as the percentage of 100 percent limit --

MR. ALTMAN: That's correct, you're lowering the compensation so that the limit of 100 percent of compensation is a lower number.

CO-CHAIRMAN ELDER: So, that's a sort of a "gotcha"; right?

MR. ALTMAN: Yeah, it's one of the many little tricks hidden in this area.
CO-CHAIRMAN ELDER: Then I think I asked you, are they subject to the Section 415 limitations, and I think your answer was yes, in a back door sort of way.

MR. ALTMAN: Yes, the benefits provided, no, but they do impact the 415 limitations of an individual.

CO-CHAIRMAN ELDER: And the same answer for other plans like 403(b) and --

MR. ALTMAN: No, the answer's different for 403(b) and 401(k). The employee's and employer contribution into these plans are factored in both as a contribution and as a reduction in salary, so they are covered. 403(b) and 401(k) are covered, both from a benefit limitation and a reduction in salary point of view.

CO-CHAIRMAN ELDER: All right. Jon King, are post-retirement cost-of-living adjustments, COLAS, limited by Section 415? And if so, how?

MR. KING: Essentially, the pension benefits that are paid from a retirement plan are subject to an annual limit, and those annual limits are adjusted by cost-of-living provisions within the Internal Revenue Code.

CO-CHAIRMAN ELDER: Up or down?

MR. KING: They are adjusted up, and frankly, I don't recall if it goes down if there's a floor. Somebody else might be also to answer that.

CO-CHAIRMAN ELDER: So, it's your testimony, then, that there is an escalation provision in the percentages or the limits?

MR. KING: Not in the percentages. In the dollar limits. It's always 100 percent.

However, the dollar benefit that results from applying the 100 percent limitation to an employee would then be indexed, but not the 100 percent number. The 100 is always 100 percent.

CO-CHAIRMAN ELDER: So if your 100 percent were, at the time of retirement, $2,000 a month, that 100 percent still applies, but the $2,000 a month has a price escalator in it?

MR. KING: That 2,000 could go up.

CO-CHAIRMAN ELDER: Could go up.

MR. KING: Yes, providing the plan is drafted properly.
CO-CHAIRMAN ELDER: And our COLAS, the most popular is a 2 percent compounded COLA. Are they more generous than that, and will you then be able to stay under it?

MR. KING: I'm not sure of the exact IRS position on what's acceptable and what's not, but it's the IRS's definition of cost-of-living that counts.

The public plan in California's definition of the cost-of-living is really immaterial. It's just -- you can do what you want with cost-of-living, as long as you check your answer versus the IRS limits. They use their own definition.

CO-CHAIRMAN ELDER: Yet to be established?

MR. KING: Well, I mean, there are definitions. I can't quote you chapter and verse on what it is, but it's the IRS Code that controls the maximum. It's the State Legislature that controls basic amount.

CO-CHAIRMAN ELDER: Anyone else want to add to that? First I have Mr. LeSueur, then Mr. Altman, and then Ms. Ahn.

MR. LeSUEUR: Just to clarify the cost-of-living increase, the IRS limits are based on a national CPI index, and they would be indexed on the full CPI increase. So, whereas many of the the local PERS or the State PERS are often based on local CPI indexes with some kind of a maximum, so as long as the actual CPI increase the plan members are receiving is less than the national full CPI, then you'll be okay.

CO-CHAIRMAN ELDER: Mr. Altman.

MR. ALTMAN: Yes, sir. It's my understanding that the cost-of-living adjustments provided under most public retirement systems in this state could run afoul of the 415 limitations. The limitation is the lesser of 100 percent of, I believe, it's three-year final compensation, or it was $90,000, and that $90,000 figure escalates.

But the 100 percent of final compensation does not escalate, and the retiree collecting benefits over 15 or 20 years could find themselves in the position where their actual benefit, because of the COLA, is running afoul of the 100 percent limitation.

Now, I've looked for some confirmation, but I believe that is my understanding.

CO-CHAIRMAN ELDER: But that individual really wouldn't be affected, would they?

MR. ALTMAN: Well, affected as I understand it --

CO-CHAIRMAN ELDER: Their agency would.
MR. ALTMAN: Their COLA, as I understand it, would effectively be frozen out. It couldn't exceed the 100 percent of compensation.

CO-CHAIRMAN ELDER: And of course, even though the contract that they entered employment on says otherwise...

MR. ALTMAN: That's a dilemma.

CO-CHAIRMAN ELDER: Ms. Ahn, then Mr. Leavitt, then Senator Russell has a question.

MS. AHN: I think there's a possible point of confusion here.

The current governmental limits are higher than the private sector limits. And I think what these gentlemen are referring to is the indexation of the private sector limits.

It is possible, I believe as a nonattorney, that there will be a limit on the governmental dollars until the private sector limits cross over and the entire schedule increases. That is, governmental plans have been given an advantage to date. Until the private sector limits catch up with those governmental limits, I do not believe the governmental limits are indexed.

But, I defer to the other panelists for clarification.

CO-CHAIRMAN ELDER: Mr. Leavitt.

MR. LEAVITT: I think there is confusion here because there are several parts of the 415 limits that are adjusted, and maybe we ought to take a look at them all and try and put them in perspective.

As has been pointed out, the limit is the lesser of $90,000 or 100 percent of average three-year compensation. The $90,000 limit is adjusted for cost-of-living increases, and as has been pointed out, it currently is about a little bit over $98,000. That's one of the adjustments.

That is compared at the time somebody retires with the 100 percent of pay limit to see what the 415 limitation on that employee's benefit will be. Once the employee retires, the Internal Revenue Code contains a cost-of-living adjustment for the 100 percent of pay limit. Otherwise, what would happen is, as the $90,000 limit went up so that future retirees could get higher benefits, prior retirees who were kept by whatever limit would hit the 100 percent of their pay limit.

So, for employees who have terminated employment, the 100 percent of pay limit also is adjusted for cost-of-living increases if the plan provides for that. These are not automatic increases.
The other thing that I think Ms. Ahn was talking about referred to the fact that the early retirement limits for public plans currently have a $75,000 floor at age 55, whereas, the private sector limits do not. That $75,000, however, is not adjusted for cost-of-living increases.

The early retirement private sector limits are reduced limited from the $90,000 limit, which is adjusted. So, at some point in the future, if Congress doesn't play games and change this again -- as I think many of us think they will -- the $75,000 public sector limit will be overtaken on early retirement by the private sector limit.

SENATOR RUSSELL: Just to be sure I heard what you said, the cost-of-living is on top of the final benefit, that $90,000, which you say is $98,000 and will continue to go up based on cost-of-living. Does that mean that we should, in our plan, mirror the federal cost-of-living, CPI, whatever it is?

MR. LEAVITT: Well, in terms of the maximum benefit limitation, I think the answer is definitely yes. The plans currently have cost-of-living adjustment provisions for the benefits. Not all plans have them, but many plans do. That is a benefit payment provision which is the subject of employer and labor-management negotiation.

What we're talking about is really not what the benefit is going to be, but what the maximum benefit permissible under the Internal Revenue Code will be. And I think you definitely want to take advantage of the full extent that Congress has given you, and so you would want to include in the 415 provision that you added to your statutes the cost-of-living adjustment.

SENATOR RUSSELL: Now, the second equation to that, I think you said, was that dollar limit, as the cost-of-living increases, if a person lives long enough, and has a certain benefit, they could cross over the highest salary that they had when they were working.

I'm a little unsure as to whether that puts them out of compliance, or whether there is a cost-of-living factor if the plans provide for it in that dollar maximum also. Is there a cost-of-living --

MR. LEAVITT: Yes, there is. That's what I was trying to explain.

If the plan provides for it for terminated employees, the 100 percent of pay limit for them also increases so that they cannot exceed -- so they will not, just by virtue of the cost-of-living provision in the plan, exceed their final pay, and therefore the 415 limit.

- 18 -
SENATOR RUSSELL: Is there any disadvantage to doing that? It sounds like the logical thing to do. Is there a downside to it that we don't know about?

MR. LEAVITT: Not that I can see.

SENATOR RUSSELL: Thank you, Mr. Chairman.

CO-CHAIRMAN ELDER: There are two others that have comments here. I would caution you that we certainly want to encourage this, but we in the Committee have 60 questions, and we should get to all of it. We are on question number 5.

Mr. King, for your comment.

MR. KING: I just wanted to point out that I'd like to add the answer to Senator Russell's question.

I think that what you use to index -- you have to use the federal CPI to index the maximums. That's by law.

What you choose to do with your plans is -- a plan design issue, it would certainly ease administration if you adopted the federal cost-of-living, because then you wouldn't have to check people out each and every year after they're retired.

So, it would be a good idea from an administration, but from a plan design point, it depends on what you're trying to do.

CO-CHAIRMAN ELDER: Thank you, Mr. King. That's a good point.

CO-CHAIRMAN GREEN: I have a broad question, Mr. Elder. I think this one is to Mr. Friend.

The issue in front of us a complex one, and I think from your experience, you probably can answer this one.

What are other states and retirement systems doing with this 415?

MR. FRIEND: We understand that the State of New York has already embraced the grandfather clause, and that the State of Texas is considering this grandfather clause quite seriously.

The implication of such action is to put further pressure on this state and other states, and their local jurisdictions, because the divide and conquer concept, as has been mentioned before, is a powerful one.

To the extent that the entire public sector might have resisted, there might have been a stronger argument for the solid position
taken, but in light of this capitulation and the inclination to
sort of so-called play it safe, we're of the opinion that this
kind of action will lead us down this particular path.

I might also note that there are some six states that are -- and
California's among them -- that are subject to the anti-cutback
concept, either constitutionally, statutorily, or through court
decisions. These six states are going to be confronted
immediately with this decision before the end of 1990, when the
legislation suggests the deadline might occur, and as has been
observed here by Mr. Elder, the deadline is, for all intents and
purposes, the end of this year, because once an employee is
hired in the subsequent year and no decision has been made, then
that person would be protected by the constitution, or
statutory, or decision, and then there'd be a conflict if later
on in the year it were embraced retroactively.

So, that's a long-winded answer to your question.

CO-CHAIRMAN ELDER: Some of these will be repetitive, but
you understand that in order to make sure that we ask all the
questions, this is unavoidable, as we could not anticipate that
some of your answers would go beyond the narrow framing of our
original question. But to make sure that we are getting full
and complete answers, and if you think it's been addressed in
the transcript, you can make it as brief as appropriate.

This will be to Mr. Leavitt. How did the 1986 and '88 Tax
Reform Acts affect Section 415?

MR. LEAVITT: Well, the 1986 Act was the time when, as a
result of lobbying by state and local governmental employers and
plans, Congress first dealt with this issue of the lack of 415
limitations in governmental plans. It came up in the context of
the early retirement reductions.

To put it into perspective, these limits that we talk about --
$98,000, or 100 percent of final average three-year pay -- are
limitations on benefits payable at Social Security retirement
age, currently 65.

If a person retires and begins receiving benefits before that
time, the 415 provisions require an actuarial reduction --
require a reduction in the maximum benefit. As originally
enacted, that reduction had a floor of $75,000 at age 55, and
had reductions from age 62 not from age 65.

In 1986, as a revenue-raising item, because in the private
sector the cutting back the 415 limits reduces the amount of
funding that employers may put into plans which therefore
reduces the deductions and provides more tax revenue, or
provides more taxable income, a way to cut the deficit, the early retirement reductions were reduced. The $75,000 floor was removed, and the adjustments were made from age 65 rather than from age 62.

Congress was approached by state and local government with the issue of 415, and for some reason believed that by exempting governmental plans from these early retirement reductions would solve the problem. And that's what happened in the Tax Reform Act of 1986.

Currently, public plans are subject to the old pre-Tax Reform Act limitations. That means, reductions do have a $75,000 floor at age 55, and are reduced from age 62 rather than age 65. Also, there was a special $50,000 floor that was put in for safety members.

What that did, however, unfortunately, rather than solving the problem for public plans, was brought into sharp perspective the fact that there was a problem because you don't need an exception from a rule that doesn't apply to you. And therefore, it became crystal clear that the 415 limits did apply to governmental plans, and state and local governments turned their attention to try and point out to Congress the rock and hard place that they were in if they didn't have a 415 provision. And in California and in other states, as has been pointed out, they couldn't merely add a 415 provision because that would be violating the constitutionally protected rights of employees to continue accruing benefits at promised levels.

Congress, in TAMRA in 1988, provided the grandfather provision that has been described, but to exact their pound of flesh, Congress would eliminate the governmental early retirement reductions for employers that elect the grandfather. So, as you know, the price for protecting your current members is giving up the more beneficial early retirement reductions for new employees who become members after 1989.

CO-CHAIRMAN ELDER: They've been sold out historically in the past, so they felt that that was okay.

We have a comment from Ms. Lund.

MS. LUND: I'd just like to make a comment. As far as I've heard, it's kind of hard to get a feel for why we're concerned about these particular limits. So far, it sounds like it's only going to hit the highly compensated, or the people that get a very high percentage of benefits, as in 100 percent of final compensation or $90,000.

Just to put a little perspective on this, I'd like to talk briefly, if I might, about what we see the problem to be at PERS.
We see it to be hitting probably the lower employees -- lower paid employees, and I think this is key. We have people currently who are clerks who have worked 40 years who are going to be hit by this.

Further, the 100 percent of final compensation is kind of misunderstood. We have a final compensation that we pay benefits on at PERS and at every retirement system. However, on this, we're probably talking about a different final compensation amount. That compensation amount will be reduced by the employer-paid employee contributions to a retirement system.

So, off the bat, you take away from the final compensation we're calculating benefits on the amount that is paid before tax.

In addition, any amount an employee pays to a deferred compensation program, such as maybe $7500 in the last year before retirement, or because you can double up before retirement, you could be reducing your final compensation by as much as $15,000, plus the amount the employer has paid in an employer-paid employee contributions.

So, if you have a $30,000 final comp. person, they could be reducing their final compensation, either unknowingly or maybe they can't do anything about it, by deferred compensation contributions or by the fact that the employer has been paying the employee's contributions.

So, we're talking about two final compensations here one which may be much lower than the second, and I do believe it is a serious problem, not just one that affects the highly paid employees.

I did want to make that clear before we went on. Thank you.

CO-CHAIRMAN ELDER: Ms. Lund, you're not saying that the retirement itself will be reduced?

MS. LUND: Yes, I am.

CO-CHAIRMAN ELDER: Aren't you saying really that if these limits are violated, that the contribution going in and the contribution from the employer going into the retirement system will be subject to income taxes?

MS. LUND: What I'm trying to say, as I understand it, we're going to have to calculate defined benefit, then we calculate the limit. The limit is 100 percent of final compensation.

What I'm trying to do is give you a brief capsule about how we would calculate that 100 percent of final comp. limit, and we
have to pay the lower under the 415 language that we're thinking about adhering to in order to come into compliance with 415. So, that's the limit on the current benefit.

CO-CHAIRMAN ELDER: This leads to the next question. For purposes of applying Section 415 limitations, what income does compensation include? What income does compensation not include?

That one I would direct to Mr. LeSueur.

MR. LeSUEUR: For purposes of doing the 100 percent of compensation test we've been talking about for Section 415, compensation is defined first as the highest consecutive three years during the career, not necessarily the final three, but the highest consecutive three years. And compensation for that test alone is basically taxable income. So, it would not include any Section 457 deferrals. It would not include any 401(k) deferrals, any flexible spending account type plans. All those amounts would be excluded for the definition of pay for doing this 100 percent test.

Now, you can use your own definition for calculating what the retirement benefit is, but it's only for purposes of doing this test that compensation that the IRS uses is basically W-2 pay.

CO-CHAIRMAN ELDER: All right.

We have two more questions before we're going to take a break. This question is for Mr. Leavitt.

What must be done to the County Employees' Retirement Law of 1937 in order to satisfy 415 with respect to qualifying under 401(a)?

MR. LEAVITT: It would be necessary to amend the statute to add a limitation on benefits under 415.

CO-CHAIRMAN ELDER: Mr. Mosman.

MR. MOSMAN: Just a clarifying question.

Does that mean that we wouldn't have to necessarily go through the statute and amend the precise defined benefits schedules, but we could merely kind of cross index the 415 with a general section, saying: "In no event shall any benefit provided by these sections exceed those provided by the Internal Revenue Service"?

MR. LEAVITT: Yes, as a matter of fact, it is permissible under the Internal Revenue Code to incorporate by reference the provisions of Section 415, and more and more
employers are doing that because it makes it easier to keep up with the constant changes that Congress makes. You don't have to amend your plans every other month or year.

CO-CHAIRMAN ELDER: Mr. Descamp.

MR. DESCAMP: But Mr. Leavitt, in getting back to what you said before in answer to a question on COLAS, if you incorporate 415 by reference, I believe you also recommend that there be a sentence in there that addresses the COLA; is that correct?

MR. LEAVITT: I think it ought to be clear that what is being adopted includes the COLA for -- what Mr. Descamp is talking about is the application of the COLA to post-separated employees, the COLA to the 100 percent of pay limit, so that that would be operative, yes.

CO-CHAIRMAN ELDER: Mr. King, you had your hand up.

MR. KING: Thank you. I just wanted to point out the New York amendment actually was a one-paragraph amendment.

CO-CHAIRMAN ELDER: Very good. The last question before we take our break -- we're going to take a five-minute break -- in cases where reciprocity between systems covered by different employers applies, is there an aggregation of plans? Now, this would be for any plan administrator who'd care to respond.

MR. DESCAMP: On the basis of the advice that we've obtained from TPF&C and from Jones Day, we understand that there's not a direct aggregation of plans.

In effect what I mean is, that as long as the benefits you receive individually from the respective systems that you have reciprocity with does not, in and of itself, exceed the benefits under 415, then you do not have an aggregation of plans.

However, I think that there is a subordinate question, and that question is: with respect to service credit that an individual may receive in a plan for service which was in another plan, even though reciprocity does not apply -- and this is a question for anybody who might answer this question -- is there a consideration there that we need to address?

CO-CHAIRMAN ELDER: You're talking about like military credits?

MR. DESCAMP: Military credit, yes. That would be an example. There's another example, for example, a person in a '37 Act county can receive credit in PERS in that county system if they cannot receive the credit in PERS itself.
MR. LeSUEUR: The principle in that calculation is that all the plans for a single employer have to be aggregated. So, if you have a plan that counts service from someplace else, it really doesn't affect -- it doesn't change. You still have to take whatever benefits you're earning from that particular plan, even if it counts service, no matter where it counts service from. The total benefit would have to be compared to the Section 415 limitations, but it would not affect -- if, for example, you're in a county plan and it counts service while you're in PERS, the PERS plan you were in is not affected by that particular calculation. You would still look at the PERS benefit by itself to see whether it met the 415 limit.

CO-CHAIRMAN ELDER: We don't have consensus on this, it seems. Mr. James.

MR. JAMES: I just wanted to add that I think it's important to point out here that we're talking about employer-provided benefits, so if you have any amounts that are paid by the employee, for example, those would not count towards the 415 limit directly, the benefit limits. I think that's important to add here.

CO-CHAIRMAN ELDER: I think this will tend to complicate counseling for retirement, won't it, for our employees? Can you imagine that we can hire enough people that can follow this to advise people what their retirement is going to be?

Ms. Lund, then we're going to take the break.

MS. LUND: This is one of our large concerns at PERS. We are a multi-employer plan. Will we have to monitor every single piece of a potential retiree's allowance to see if one of those might be going over 100 percent for that particular employer, and if so, what should we tell them about any plans they have to defer any compensation? Should they quit deferring compensation to raise the final compensation for the test, or just what?

It takes us way beyond where we are today as far as trying to administer and counsel employees so they can make their best choice.

CO-CHAIRMAN ELDER: It might be better just to pay them the money and let them pay the taxes, and then recalculate what we have to put into the plan.

Do we have that as an option?

MS. LUND: We can do that, but not only will we have to recalculate their benefit, they have to pay the taxes, but we also, as plan administrators, then have other risks, such as
potentially the taxability of our earnings on the fund, which raises a whole other specter of fiduciary and financial problems.

CO-CHAIRMAN ELDER: So we might have to buy tax-exempt State bonds, or something.

All right, we're going to take a short break.

(Thereupon a brief recess was taken.)

CO-CHAIRMAN ELDER: Okay, that concludes the break.

We are going to commence again with the questions. Senator Green will take over this portion of the hearing for questions, and then we have more questions for Senator Russell to pose, and of course I would remind those Members of the Committee that they interject a question at any time, as also the panel members if they hear something at variance with their understanding of the present reality.

CO-CHAIRMAN GREEN: Thank you, Mr. Elder.

I'd start with how are ancillary benefits which are not directly related to retirement income benefits affected by 415?

Who would like to field that one? Mr. King.

MR. KING: They're not affected.

CO-CHAIRMAN GREEN: They're not affected. Why not?

MR. KING: 415 is a limitation on retirement benefits.

There would be some possibility, for instance, if a disability benefit wasn't drafted correctly, then a disability benefit could be covered by the Section 415 limits, especially when you factor -- we haven't talked about the ten-year phase in rule, but if you had a disability benefit that wasn't drafted properly, and it looked just like a retirement benefit, then it would be subject.

I mean, regular disability benefits aren't subject to 415, but if they're drafted as a retirement benefit, they are, and you could have real problems with service-connected disabilities, say, in the first year of eligibility.

But bottom line, ancillary benefits after retirement will increase or affect some benefits, but ancillary benefits before retirement are not affected.

CO-CHAIRMAN GREEN: All right. Can you explain the ten-year or phase in period? What does that rule mean?
MR. KING: Well, you need to have -- the full limits under Section 415 are only applicable after someone has ten years of participation or service in the plan. If they only have one year of service, literally the limits are cut to one-tenth of what we thought we were saying; in other words, $9,800 and change, or 10 percent of compensation.

CO-CHAIRMAN GREEN: It's 10 percent per year, in other words.

MR. KING: Yes.

CO-CHAIRMAN GREEN: Say, for instance, a person ten years after five years in a plan, then he's frozen in at 50 percent of the final salary?

MR. KING: Yes.

CO-CHAIRMAN GREEN: Do you have any follow through on that one?

Number two, what is the distinction between employer and employee contribution when paying full retirement benefits? There is a distinction between the two as far as 415 is concerned.

Ms. Paulson.

MS. PAULSON: Senator Green, the distinction between employer and employee provided benefits is basically that the limitations of 100 percent of compensation, or $98,000, apply to the employer-provided portion of the benefits.

When you're looking at the benefit that a particular employee is entitled to at retirement, you have to go through a series of actuarial calculations and determine the portion of that benefit that is attributable to employee contributions and the portion of that benefit that is attributable to employer contributions.

There are some combined plan limitations that play in here, but generally the 100 percent of the high three years of compensation, or the $98,000, only applies to the employer-provided portion of the benefit.

414(h) pickup payments are considered to be employer contributions, and they're on that side of the equation and not on the employee side of the equation.

SENATOR RUSSELL: So, there's a fudge factor, then, for plans where the employee makes contributions so he could actually go above the 98,000?

MS. PAULSON: Well, Senator Russell, I wouldn't exactly characterize it as a fudge factor, but yes, you can -- the
employee-provided portion of the benefit does allow, within certain limits, the retirement benefit to exceed the $98,000 or well, it can exceed the $98,000.

SENATOR RUSSELL: One other question, and it maybe ties in with number one.

If you have a high paid person coming in after 1990, and you've got this kind of a plan, and they're maxed out, can there be a separate plan of some sort, whether it's money in a sock, or whether it's a bond, an annuity, or something, completely separate that would be taxable to both the employer and employee.

Would that impact on the regular plan?

MS. PAULSON: Section 415 only applies to benefits under qualified plans. Any other Key Man plans, or plans of deferred compensation which are currently taxable to the employee, or taxable at retirement and the employee has no entitlement to it prior to retirement, those do not affect the 415 qualified plan limits.

SENATOR RUSSELL: Thank you.

MR. LEAVITT: Senator Russell, I'd like to point out in elaborating on that, that in the public sector, because of Section 457 of the Internal Revenue Code, you have an additional problem that the private sector employers do not have when you are talking about unfunded plans, or any plans of deferred compensation, whether or not they are elective or nonelective.

In the private sector, you may know that what happens with executives is that their benefits in excess of the 415 limits are provided by their employers under Top Hat plans, or SERPs, or things like that, supplemental plans that are paid directly by the employer when the executive retires. And those amounts under the tax law, if they are properly structured, are not taxable to the employees until they're actually received.

In the public sector, however, Section 457 in the eyes of the IRS applies to all deferred compensation. That means that attempts by governmental employers to provide these payments such as you're describing on a nontaxable basis have to be fit within the parameters of Section 457.

Now, 457, of course, is the section that provides for deferred compensation plans that you're probably all familiar with: the $7500 a year; you can double up just before retirement, and so on. However, that section is much broader than that, and if you have a deferred compensation -- if you have deferred compensation that is provided that is not subject to the $7500 limit, that otherwise is not subject to the various rules to be an eligible plan under 457, then under Section 457(f), it becomes an ineligible plan, and the amount will be taxed to the
employee at the time the employer defers it, or the employee defers it, unless it is subject to a substantial risk of forfeiture by being subject to the provisions of substantial services.

Now, that works fine while the employee is still working. You can take for your higher paid employee and defer amounts of compensation under 457(f), but as soon as that employee retires, that entire amount that's been deferred will be taxable because there's no more substantial service that's being provided.

So, the other half of the 415 dilemma in the public sector is this pervasive application of Section 457 by the IRS, which was, in a back door way, validated by Congress in TAMRA when they prevented the IRS from applying 457 to bona fide plans of vacation plans, severance plans, sick pay plans, and so on, which the IRS was also trying to apply 457 to because, if you think about it, those plans also defer compensation in the sense that when you have a vacation pay plan or sick pay plan, often you can carry over from one year to the next unused six days, or whatever. That, in the eyes of the IRS, is deferring compensation.

Congress said no, 457 doesn't apply to that in TAMRA, but by silence, they validated the IRS position that it does apply to all other nonelective deferred compensation.

SENATOR RUSSELL: Money that's put aside in a supplemental plan in order to more fully compensate a high paid employee, how does the 415 plan evaluate that as it relates to the 415, or does it? It's part of their income? It's considered as a total amount of their income, and 415 will reach out and figure that in some way?

MR. LEAVITT: If the amount of this deferred compensation is excluded from taxable income, then it will not be counted for 415 purposes under the 100 percent of pay limit, whether it's an eligible 457 plan, you know, a $7500 contribution or whatever, or whether it's an ineligible 457(f) plan that is not taxed because it's not vested in the sense that you have to keep working to get it.

So, there is that 415 impact. But otherwise, 415 will not apply to the payment of those dollars when the employee actually gets them.

SENATOR RUSSELL: I guess this is a question that probably I'll get an answer later but not for now, but it seems to me there needs to be some way in which we can accommodate the 415, but for those few people, perhaps like the President of the University of California, or some physicians or high paid
speciality people in State government, some way to compensate them, over and above the regular plan which, after 1990, will have these limits.

Is there a simple way of doing that?

MR. LEAVITT: I think, unfortunately, there isn't a simple way.

I agree with you that this is a significant problem for paying talented and qualified employees. Unfortunately, governmental employers in the Tax Reform Act of 1986 were lumped together with tax-exempt employers when, for the first time, tax-exempt employers were made eligible for 457.

The possibility for abuse in the payment of compensation is much greater in the tax-exempt organization area than it is in the governmental area, and so Congress has been very leery about providing opportunities under Section 457 for the payment of benefits.

Now, there is some possibility that that will be worked out, and there are efforts to try and get Congress to exempt nonelective deferred compensation of governmental employers from Section 457. Unfortunately, as was mentioned earlier, when Congress thinks it has solved a problem, it doesn't like to have to go back and solve it again. So, it's anybody's guess whether there'll be a satisfactory resolution.

SENATOR RUSSELL: One quick question to Ms. Ahn.

I understand that the University has limited or will be limiting in their plan the future, say, President of the University.

Without going into details, just a simple yes or no, is the University planning some sort of additional outside extra compensation to make up for that reduction that a future President would have to receive?

MS. AHN: We are pursuing some alternatives. Whether it would be direct comp. or perhaps a nonqualified plan has not been decided.

SENATOR RUSSELL: Thank you.

MR. JAMES: Senator Russell, can I jump in here?

One of the things that may be considered -- I haven't fully thought this out -- there may be some way of developing a reciprocity agreement among systems to take care of those people who happen to go over the 415 limits.

As I say, I haven't fully thought it out, but I'll put the target on the wall if anybody wants to take a shot at it.
MR. FRIEND: I just wanted to comment on the difference between an excess plan, which has been mentioned here, and a "Supplemental Executive Retirement Plan", which we hear an awful lot about, these SERPs.

One is for such things as Section 415 limit excess benefits; that is the excess plan. And the other is used generally in connection with compensation in excess of $200,000, which is a special private sector kind of a problem. It doesn't apply, normally, in the public sector.

When we're talking about excess plans, which may be a solution to this problem -- and that's what you were referring to, Senator Russell -- except for the Section 457 problem which was mentioned here, when we talk about the excess plan, it certainly stands as a good solution to the kind of thing that Sandy Lund mentioned earlier, which is for the low paid employee who could very well exceed Section 415 limits because of the 100 percent of compensation area. These are long service employees whose multiplier times years of service would lead to that 100 percent kind of result.

These people probably do not have a problem with the $7500 issue, which was mentioned. On the other hand, the higher paid employee would.

I do believe that there is an awful lot of pressure on the Congress to remediate some of this issue that was mentioned, and that we may have a window of opportunity in the suggestion you make.

MR. KING: Thank you. I would like to disagree with Mr. Friend on one score, and that is, Buck feels that the $200,000 limitation is applicable to the public sector. That's another one of those "gotchas" that we think you should review.

MR. LeSUEUR: I think that's been mentioned before, that the section -- any employee contributions picked up under that section on a pretax basis are considered employer contributions for purposes of Section 415. So, they do not reduce the 415 limit.
CO-CHAIRMAN GREEN: Do you know of anyone that is not using 414(h)(2)?

MR. LeSUEUR: Sure, there are plans that are still where the employee contributions are still being made on a post-tax basis.

CO-CHAIRMAN GREEN: So there's a lot of effort out there under 414?

MR. LeSUEUR: There's a lot of plans who have used 414(h), but there are still plans where the employee contribution is being made by the employee from his after-tax income.

CO-CHAIRMAN GREEN: The next would be, are employee contributions which are not picked up subject to 415 limitations?

MR. LEAVITT: Senator Green, yes, they are, but they're not subject to the $90,000, 100 percent of pay limit. They're subject to the defined contribution limit, which is $30,000 or 25 percent of compensation. That is a limit on contributions into the plan, not benefits from the plan.

CO-CHAIRMAN GREEN: I see. In other words, that's going to affect the little person, as Ms. Lund said earlier in testimony.

SENATOR RUSSELL: Let me clarify what you said, Mr. Leavitt.

You're saying the employee over the ensuing years of his career, or her career, cannot put in, of his own money, more than $30,000? Is that what you said?

MR. LEAVITT: Each year. That $30,000 or 25 percent is an annual limit.

It gets more complicated because an employee who is making contributions that are not picked up is therefore subject to both the defined benefit limit for the employer contributions, the $90,000 and 100 percent limit, and the defined contribution limit of $30,000 or 25 percent limit for the employee contributions. And by virtue of being subject to both limitations, there is a combined limitation that applies as well, which I won't go into at this point unless somebody really --

SENATOR RUSSELL: But for practical purposes, we don't need to worry about the $30,000, do we, in our public plans?
MR. LEAVITT: No.

SENATOR RUSSELL: Thank you.

CO-CHAIRMAN GREEN: Maybe a scenario of this case (where the $30,000 annual limit applies), maybe an employee has been in the system, has opted out, taken their money, then bought back. Would that one given buy-in period follow this rule?

MR. LEAVITT: It would be -- if it was an unpicked up employee contribution, the answer is yes.

I guess another situation in which you would have to worry about that limit is for systems that have 401(k) plans, and some of them do. Those are defined contribution plans that are also subject to that $30,000/25 percent limitation, and that limitation is an employer by employer limitation. So, you'd have to aggregate the employee contribution to the retirement plan as well as the 401(k) plan.

CO-CHAIRMAN GREEN: Mr. Descamp.

MR. DESCAMP: Senator Russell, a question for Mr. Leavitt.

If an individual is redepositing previously withdrawn contributions, as you just described, and the total amount of the redeposit exceeds $30,000, but that amount is composed of interest which was previously earned on the contributions while they were in the system and interest which is charged to the individual because of the redeposit itself, is the interest also considered as a part of that 30,000, or is it simply the contributions that were made?

MR. LEAVITT: I'm not sure, off the top of my head. I think it would all be subject to the limit, but I'd want to look at it further. Maybe someone else knows.

CO-CHAIRMAN GREEN: Any other one have an answer to that one? That's one for research.

MR. KING: That's our position.

CO-CHAIRMAN GREEN: Mr. Elder.

CO-CHAIRMAN ELDER: There is a substantial unfunded health care liability for public agencies in the State of California. We rather casually estimated it at something around $100 billion for the 4,000 special districts, 58 counties, 600 cities, and 1100 school districts, all unfunded. My AB 1104 last year set up a prefunding mechanism which is voluntary.

I wonder, how would any excesses that are considered as far as plan design, if they were deposited into accounts for employers
for their unfunded health care liability or retirement health benefits, could that help to reduce and resolve this problem to some extent? Does anyone have a thought on that?

CO-CHAIRMAN GREEN: Mr. LeSueur.

MR. LeSUEUR: I presume what you're talking about would be taking some assets from the retirement system and earmarking them for retiree medical benefits; is that what you mean?

CO-CHAIRMAN ELDER: Yes, if the employment of those assets would put you over the limits of the plan.

MR. LeSUEUR: Well, Section 415, first of all, only deals with limitations on retirement benefits.

To the extent that you have retiree medical funds, that's a separate issue. But it is, on the overall qualification of your plans issue, that is a problem in that one of the provisions of a qualified plan is that you are restricted in the amount of benefits you pay to -- for retiree medical benefits.

In fact, there is a section of the Code which specifies how you set that up. One of the -- in fact, one of the rulings is you cannot, under a qualified plan, take excess assets or assets from a retirement plan and just move it over to a retiree medical plan. So, that currently, again, for qualified plans, would not be allowed.

CO-CHAIRMAN GREEN: Thank you.

The next question: What's the difference between straight-life annuities and joint and survivor annuities, and does the difference matter for Section 415? Mr. James.

MR. JAMES: The limitations under Section 415 apply to benefits that are paid in the form of straight-life annuity. And there is an exception for a joint and survivor annuity.

Essentially, a joint and survivor annuity is a form which provides some post retirement death benefit for beneficiaries of the retiree. There is an exception with respect to joint and survivor annuities that meet ERISA qualified joint and survivor annuity requirements. So that is, if a plan is designed to pay out benefits in the form of a qualified joint-survivor annuity, which meets certain restrictions under the Code, then that can be provided within the limitations, without adjusting the limitations.

CO-CHAIRMAN GREEN: In other words, like we have our STRS, PERS have survivor benefits in those retirement systems, and that would come in within the 100 percent rule?
MR. JAMES: As long as it meets the requirements of a qualified joint-survivor annuity, and there's a lengthy section in the Code that deals with that with respect to how much can be -- how much has to be provided in the form of a post retirement death benefit, and how those benefits have to be provided, when they're provided. Quite a lengthy section.

CO-CHAIRMAN GREEN: Thank you.

Another question would be: Given the fact that PERS contains over 2400 individual contracts, if one contract would have an employee exceeding the limits, would the entire PERS program be disqualified under 415? I think that's a very key question on what we're talking about.

MR. LeSUEUR: I'll venture an opinion.

First of all, I think we should point out that whether-- the issue again is not whether one individual exceeds the limit. The issue is whether the plan itself allows the limit to be theoretically exceeded. So that, even if no one ever exceeds the limit, if it's possible theoretically in the plan to exceed these limits, then you technically could be disqualified.

CO-CHAIRMAN GREEN: Putting it in perspective with our plans as we have here in the state, it's possible that an employee, then, is currently exceeding those numbers today. If one employee exceeded by what we're doing today, then we would be disqualified from the 415 plan.

MR. LeSUEUR: Again, I think if there -- let's get to the question of the 2400 different individual contracts.

My opinion on that would be that they would be regarded as individual employers, even though they're all covered under the umbrella of PERS the plan. So that each one of them would have to look at their benefit structure. If one plan was disqualified, it would not automatically disqualify all the other plans.

CO-CHAIRMAN GREEN: In other words, if one of those 2400 could exceed, then it would only affect that one contract and not the entire PERS plan?

MR. LeSUEUR: That's correct.

It isn't necessary that anybody actually exceed, just in that one contract, in that one individual contract, it's possible that the plan provisions do not limit the benefits.

CO-CHAIRMAN GREEN: Mr. King.

MR. KING: Senator Green, I basically agree with Mr. LeSueur.

- 35 -
I would like to point out that the IRS has its own definition of what a plan is, and it could well differ from what anybody in this room thinks is.

It generally revolves around a cordoned off group of assets. And to the extent you had a problem in one plan, whether it's cordoned assets, then any damage in any area of qualification would be limited to that plan.

But if you really don't have cordoned assets, you may have one big plan, and then a problem within any one area could poison the whole umbrella. So, it's really a facts and circumstances issue, and I think it's one you should, you know, perhaps should be addressing and making recommendations on.

CO-CHAIRMAN GREEN: Yes, thank you. Ms. Paulson.

MS. PAULSON: Senator Green, that was basically the point that I was going to make, too, was that you may very well, for PERS purposes -- I have not looked at the PERS plan. I'm counsel to STRS, and I've looked at their plan, but not necessarily PERS.

If it is determined that it's one plan, one participant could disqualify in one of their contracting agencies could disqualify the entire plan.

CO-CHAIRMAN GREEN: That's the point.

MS. PAULSON: Yes.

CO-CHAIRMAN GREEN: And that's what PERS is basically, is that we have a fund for 2400 agencies that we invest, basically, and they are a participant of the plan, but they're 2400 contracts.

SENATOR RUSSELL: Ms. Lund, are the PERS assets cordoned off? I'm not sure what he means by cordoned off. Are they put in separate bank accounts, or are they merely recorded on paper? How are they handled?

MS. LUND: That's a good question, Senator Russell. I don't know what the definition of cordoned off is. Every time we calculate annual rates by employer, we value the assets and the liability by employer. So, we know how many dollars an employer has for assets. What we don't know, though, is which stocks and which bonds belong to that employer. So, the stocks and bonds are in a big pool.

SENATOR RUSSELL: Mr. King, can you define cordoned off?

MR. KING: Yes, thank you, Senator. The issue of how the investments are actually held is immaterial. It's more an accounting issue and a plan design issue.
If each contribution is accounted for properly, and held within that contracting agency, and if benefits are paid out for that contracting agency's retirees and other beneficiaries only from their funds, that's, I think, sufficient accounting for the IRS.

The other thing you'd have to be wary of is on plan design side, if, let's say, contracting agency A went belly-up. Are the assets of contracting agency B available to the beneficiaries of contracting agency A? If they are, there's not separate accounts and separate assets.

SENATOR RUSSELL: I presume, then, that the proper accounting procedures are evident in the PERS system, and that there's no problem with cordon them off.

MS. LUND: Well, the answer to that, of course, Senator Russell, is that we account for everything appropriately.

But, we're coming dangerously close, I think, to defining PERS as a single employer system.

SENATOR RUSSELL: Who is coming close to that?

MS. LUND: We all here. We're saying --

SENATOR RUSSELL: In this discussion?

MS. LUND: Yes, in this discussion. If we're doing that, then --

SENATOR RUSSELL: I didn't get that. I didn't understand that. You'd have 2400 different plans, and if they're properly accounted for, which I believe is the way you do it anyway, then there's no problem, and their 2400 different plans will be considered as separate plans. So, if there's a ringer in one of them, it doesn't affect the others.

That's the way I understand the discussion today.

MR. LEAVITT: Senator Russell, I think there's a more fundamental issue which was mentioned, and that is that it's not only whether somebody actually exceeds the 415 limit, but whether the plan precludes the possibility.

Since the plans we're talking about are all statutory plans, if the PERS statute does not limit benefits to the 415 limits, then all 2400 would be disqualified. Similarly, if the '37 Act is not amended, then all of the '37 Act plans would be disqualified technically, and so on.

So, it is very important for the Legislature to recognize the role that it plays here, because it is the legislature that provides the means for the various employers to comply.
SENATOR RUSSELL: Thank you.

CO-CHAIRMAN GREEN: Mr. King.

MR. KING: I agree with Mr. Leavitt that if you solve the 415 through some, you know, overriding provision, you won't have the problem in any of the 2400, so you'd think the problem has gone away.

Well, it hasn't, because there's still other qualification issues. And so, I do think you want to focus somewhere down the line of whether you have one plan or 2400 plans.

CO-CHAIRMAN GREEN: Mr. Descamp.

MR. DESCAMP: Thank you, Senator Green.

I think for purposes of the record, and Mr. Leavitt can correct me if I'm wrong, he's quoting Treasury Regulation Section 4.415-1(d).

MR. LEAVITT: I think that's right. You're talking about the regulation that provides that it has to -- that a plan has to preclude the possibility of exceeding 415?

MR. DESCAMP: Right.

CO-CHAIRMAN GREEN: Thank you, Mr. Leavitt. Mr. Bald.

MR. BALD: Thank you. We've heard a lot here today about qualification and disqualification. I would like to hear somebody tell me the consequences of disqualification. Someone enumerate.

CO-CHAIRMAN GREEN: That was going to be my next question, Mr. Bald.

MR. BALD: How about Ms. Lund?

CO-CHAIRMAN GREEN: If, for instance, we are disqualified on our tax exempt status as far as PERS is concerned, because of something, whether it be tied together or not tied together, what would be the ramifications of PERS to our tax exempt status, and what would be the raise by employer and employee to fix that problem?

MS. LUND: How did I draw this question?

CO-CHAIRMAN GREEN: Very simple, I gave it to you. You're the expert from PERS.
MS. LUND: The luck of the draw. If we were to become disqualified, then, as I understand it, first of all, all of the money that the employer pays to buy our benefit this year becomes immediately taxable.

So, for example, if the State is paying $200 a month to PERS as an employer contribution -- not as the employee pickup, but the employer contribution -- that will appear, $200 a month times 12 months, is $2400 a year would be added to my gross for taxable -- reportable taxable income to the IRS and Franchise Tax Board.

This is money that I may never see. It's money the employer pays into the system on my behalf, but also, more globally, on the behalf of all State employees.

If I don't retire, if I take a refund, I never see that money. However, I will be taxed on it every year from now until I terminate or retire. That's one big impact on the employees.

On another front, as I understand it, we stand a pretty grave risk if we become disqualified of having all of our earnings on our $51.4 billion taxed. If that occurs, with the understanding that about 63 percent of our money that comes into the system each year comes from our investments, that 63 percent then is taxable. And if you take that big a piece out of the pie, somebody's got to fill that in. That's either got to be by increasing the employee's contributions, which is again another impact on the employee, or by increasing the employer rate into PERS. It's got to be made up from somewhere.

That all ultimately rolls down to the taxpayer, because it's an additional increased cost to doing governmental business.

CO-CHAIRMAN GREEN: Do you have any rule of thumb guesstimate of how much?

MS. LUND: No, I don't. The basic "lots and lots".

(Laughter.)

CO-CHAIRMAN GREEN: Well, we have lots and lots of investments.

MS. LUND: That's right.

CO-CHAIRMAN GREEN: It's a double whammy. Number one is the income tax the employee, and then it's the income tax by the State on the investments that we make. So, it's the double whammy.

Basically who it's going to hurt are the employees themselves, because as it goes by, we won't have the funds to pay the retirement dollar.
MS. LUND: That's right, and we, as administrators and, of course, as board members, have a fiduciary responsibility, I believe, not to allow this to happen. So, I haven't focused so much on how much is that going to cost. I focused, as a fiduciary and an administrator, on how to keep this from happening.

CO-CHAIRMAN GREEN: And let me be party to that, too.

MS. LUND: Thank you.

CO-CHAIRMAN GREEN: Ms. Paulson.

MS. PAULSON: Senator Green, Ms. Lund is exactly right with some of the consequences of disqualification.

What she did not mention is that all of the amount attributable to accrued benefits for each and every employee in the system that they are currently vested in that are attributable to employer contributions are taxable as of the date of disqualification.

So, if an employee has a lump sum of $100-120,000 worth of accrued benefit in the plan, they're going to get taxed on that, and they're not going to have access to those funds until they retire, so the problem isn't just on an ongoing basis. It's even more dramatic.

CO-CHAIRMAN GREEN: They're going to live with it for along time.

Mr. LeSueur.

MR. LeSUEUR: I was also going to add that just in the funds on an ongoing basis actually would not be taxable to the employee until they're vested. So, it isn't -- Sandy had mentioned the possibility of being taxed on it and never getting the money. Actually, that couldn't happen, but that's about the only good news about becoming disqualified.

The other thing I was going to mention is that another result of becoming disqualified is that the employee contributions that are now being picked up on a pretax basis would not -- that could no longer be done, because that's only under a qualified plan that that could happen.

MS. LUND: That was going to be my point. I did leave that out.

The advantage we have now for employer pickup, we would lose immediately as employees.

CO-CHAIRMAN GREEN: This might be a good time -- did you have a question, Mr. Elder?
CO-CHAIRMAN ELDER: If that's true, I think we might want to have 50-year vesting.

(Laughter.)

CO-CHAIRMAN ELDER: Consider it all employee contribution. They could take it back when they retired.

It reminds of me of what happens in the Philippines. I've heard that when a person retires, they get five years' of retirement contribution, five years' worth of compensation at one time.

So, they give them a five-year compensation when they retire. What would prevent us from simply cutting a check upon retirement for the full amount of the employer's assets and employee's assets, and not have any retirement compensation?

MR. JAMES: I believe what you'd be dealing with there is the immediate taxation of all that money in the year that it's paid. You'd have a pretty big tax bill.

CO-CHAIRMAN ELDER: But these checks would be of --

MR. JAMES: If you had enough to pay the taxes and still have an adequate benefit, then as long as the money is there to pay it out when it's needed --

CO-CHAIRMAN ELDER: Some of these would be in the range of $500-600,000 checks.

MR. JAMES: That's right. There'd have to be substantial liquidity available to pay these out.

CO-CHAIRMAN GREEN: Mr. King.

MR. KING: You'd still have 415 problems in the calculation of how you got to the $500,000 lump sum.

CO-CHAIRMAN ELDER: It would be basically all their money plus the employer's money, at interest that's earned on the fund, times the number of years.

It's more than a gold watch, really. It would be a substantial amount of money.

Do you have any thoughts on that? What would happen, of course, is that the check would be subject to taxes at maximum federal rates and maximum State rates, probably. And then the net would be available to produce income for the individual, either through the purchase of fixed income products, savings or whatever, and I think that you can tell what the maximum rates are, and there is no income averaging anymore, so you basically are stuck.

CO-CHAIRMAN GREEN: Mr. LeSueur.

- 41 -
MR. LeSUEUR: It sounds like what you're describing is more of a defined contribution concept, where each year the employer puts the money in, the employee puts the money in, and at retirement, the employee gets it all in one lump sum.

But Section 415 still does apply if you want to be qualified and not be taxable to the employee during his active career. Section 415 limits those types of plans, so the employer contribution is limited, for example, to $30,000 each year, or 25 percent of pay, that's been referred to before.

CO-CHAIRMAN GREEN: Mr. Mosman.

MR. MOSMAN: That was going to be precisely my point. It seems to me that would be tantamount to a defined contribution plan, similar, for instance, to the State's 457 plan, where you essentially have that option now when you retire, either to take the accumulated contributions as a lump sum, or to spread them out over a period of time.

CO-CHAIRMAN GREEN: Thank you. I think this is a good time, because of this issue, I'm pretty proud of Los Angeles County. I'd like to have Mr. Deise and Mr. Treece explain to you how they have reached an agreement, labor and the County, at this given time on this issue that's in front of us today, because that's the biggest part of the '37 Act counties in the state. It's one little thing that I think we've got straightened out. Who wants to start, Mr. Treece or Mr. Deise?

MR. TREECE: Let me say, first of all, I think that what we have reduced to writing in the concept of our agreement is available for you all to pick up and look at.

My remarks are pretty much from the labor side of the table.

It's a little alarming to me to hear most of the remarks made today geared toward resolving the 415 situation in a way that will actually reduce future employee benefits. Essentially create a two-tier system.

When we first looked at what the impact of the federal tax laws in this area would have on us, it didn't take a whole long time before we figured out that we faced the potential of having an additional tier in our retirement system, of which we already have too many, but this one would be a substantially lower one.

Obviously, we took the matter seriously, and we do expect over the course of time to share our experience in what solution we came up with, understanding that our solution may not work for every county retirement plan.

We're also trying to put a little bit of a new face on part of the reputation of Los Angeles County. Sometimes we get criticized for dragging our feet, or coming in late, or not being prepared.
Part of my fear in explaining early, up front, what our solution is, is that now the reverse will be true, and there will be a tendency for folks to think that we have not thought this out; that maybe we don't know what we're doing, and that we're rushing to conclusion, and ultimately we'll create a huge pitfall.

So, I would like the Members of the Legislature and those others present to understand that we have been working and discussing in an environment of labor and management this problem for about the last two years.

Our solution, from the Union's standpoint, was to present to County management for adoption through amendments to the '37 Act, what we describe as a floor offset multiple plan arrangement for employees to be hired after January 1st of 1990. The key to the arrangement is a new plan which we will be describing, because of the many tiers we have, as Plan F, which will be technically a defined contribution plan. This plan, in conjunction with the existing County retirement plans, will allow new employees greater total benefits under the Section 415 limits than would the existing employee contributory plans standing alone without the supplemental defined contribution plan.

It's quite -- I think it's probably too simple, the way that it works, for people to believe that it's real, but in reality, a certain portion of the employee contribution that is otherwise required to be contributed under the existing defined benefit plans will find its way into the defined contribution plan. No County contributions, no employer money, goes into our new Plan F. Thus, both the employee and the County contribution rates will remain the same, essentially the same as they are currently. This is what we like to look at as a cost neutral plan to both the employee and the employer.

Then, when the employee is entitled to receive a benefit from either the Safety Plan B or the General Plan D, a benefit in the same amount will be paid from both Plan F and the defined benefit plan to an amount of benefit that will be essentially equal to what the benefit would have been had there not had been the 415 limit situation put in, thereby eliminating any part of a two-tiered system.

The way that we arrived at our solution in L.A. County seems to me to be a little bit differently than what I hear the discussion going on on behalf of PERS and the teachers' plans, and perhaps some of the other county plans, in that we utilized an old-fashioned process that's embodied in State law, and it's called the collective bargaining process.

We -- with all respect to the plan administrators that are in this room and participating in the discussion, it is my belief, from the labor point of view, that the people who determine what
employees hired after January 1st of 1990 will be entitled to in
benefits, since benefits is a part of the terms and conditions
of employment, really is the responsibility --
joint responsibility of the employer and the certified employee
groups that represent the employees that work for that employer.

And at the risk of offending the administrators, it's my
judgment that they do not play a role in determining what the
benefit levels will be, but simply to perform the ministerial
functions once those benefits have been negotiated between the
employee bargaining representatives and the employer.

Will our plan, or what we call the floor offset arrangement, or
defined contribution, result in every employee receiving exactly
the same benefit as employees before the 415 limitations?

Because of all the variables that are involved, and some of the
legal requirements, it's possible that some minor variations may
occur. However, as far as we're able to determine, there is no
better way to sustain current level of benefits for new-hired
employees after January, 1990, than the proposition that we have
currently agreed to with the County management.

Is it possible to do nothing and leave the 415 limitations out
of our County plans and just hope that the IRS stays away, as
they have so far?

Certainly that's possible, but in light of the attention that
this situation has received, it certainly doesn't seem prudent
to us. There are certain adverse consequences to all employees
in our plans if we lose our tax qualified status, and the
approach to do nothing seems ill-advised to me, especially in
light of the fact that we believe that, given a proper
examination and analysis, study of the various plans, that it is
possible to come up with a scenario that will provide a
continuation of the same level of benefits for employees hired
after January 1st of 1990 equal to those that our existing
employees have.

So, all of this, of course, is based on the assumption that it
is not the employer's desire to reduce retirement benefits for
new-hired employees.

CO-CHAIRMAN GREEN: Senator Russell.

SENATOR RUSSELL: I thought I was listening carefully,
but I'm not clear how you meet the dollar limit and how you meet
the 100 percent of pay?

I recognize the place of collective bargaining in the
negotiations, but you can collectively bargain till the cows
come home on any area, but if it doesn't meet what the IRS says,
and you fall out of compliance, there are penalties to pay.
I don't understand what you did in your plan to meet the things that we've been talking about today.

CO-CHAIRMAN GREEN: Mr. Deise, do you have an answer to that?

MR. DEISE: Let me take a crack at it. I'm Don Deise, and I represent L.A. County here. If we need some technical, I think Mr. Grossman down there or Mr. Leavitt can fill you in on it, because they worked out many of the details on this plan.

The Code, as I understand it, allows for an increased cap if you receive both a defined contribution plan and a defined benefit plan offered by the same employer. That is what is being proposed here. Basically, as I think Mr. Leavitt spoke to earlier, you then are allowed approximately 125 percent of the limit of the 415 limit as your cap.

What this would, in effect, do is create a defined contribution plan with the employee's contribution, and a defined benefits plan with the employer's contribution, offered by one employer. So, we would then have a cap that is roughly 125 percent of the caps that you see listed in the 415 limits.

The other part of the legislation there also contains a clause that nothing in this Act will allow us to go over the 415 limit. So, if by inadvertence we did some how, it would be capped.

SENATOR RUSSELL: Thank you.

CO-CHAIRMAN GREEN: So that gives the protection to the plan actually by putting that in the legislation itself.

MR. DEISE: Yes, sir. We approached this from two points of view, I guess. First, we wanted to protect the plan. Second, that we wanted to try and provide a replacement benefit that was equal, if we could, to what employees are currently getting. We tried to approach it on an evenhanded basis that we would spend the same amount of money that we're spending, and we'd provide the same benefit if possible. And we believe through this, working with the coalition, and really principally this is their proposal, that one has come out that we can all endorse.

CO-CHAIRMAN GREEN: Was this modeled after any other jurisdiction, or is this your own plan?

MR. DEISE: I don't know. I guess you'd have to ask Mr. Grossman. He's mostly the architect of this.

MR. GROSSMAN: As far as I know, this is the only such arrangement.
CO-CHAIRMAN GREEN: Thank you. Mr. Mosman.

MR. MOSMAN: Thank you, Senator. A couple questions that just strike me after a cursory glance at this.

One, if you're basically guaranteeing the same benefit that you ordinarily would have had through the old plan, and you're guaranteeing that, how do you get away from it being considered as a defined benefit, even though you're calling it two separate plans?

And then secondly, assuming that it does work, the defined contribution plan, is that then considered a 457 plan, or is what you called earlier a noneligible 457 plan?

MR. GROSSMAN: The defined contribution plan is a qualified plan. It's not a 457 plan.

It doesn't guarantee, and I think Bud made the point. The plan does not, by its terms, guarantee that every participant will get exactly the same dollar amount, or any dollar amount.

There is the potential that a particular participant may get somewhat more or somewhat less due to the fact that this is defined contribution plan.

We think, though, that in the overall context of how the plan will operate, the cost to the employee and the employer will not change, and the overall level of benefits will stay roughly the same.

CO-CHAIRMAN GREEN: I think on Line 15 of the Article itself, it:

"provide approximately the same level of retirement benefits to persons who become members on or after January 1st, 1990"

So, it's approximate.
Yes, Mr. Elder.

CO-CHAIRMAN ELDER: It seems to me that this approach from labor's point of view allows for you to ratchet back the contribution of the employer if you find that you get too much going in to stay within compliance, and in effect, that comes back to the table in terms of more to bargain for. Wasn't that some of your thinking?

MR. TREECE: Mr. Chairman, it’s our understanding, and like I say, this was not a hastily arrived at proposal, but in a cursory review by the Los Angeles County Retirement Association plan actuaries, they believe that the contributions on behalf of both the Board of Supervisors and the participating employees will remain constant, going for the new-hires, as it is today.

- 46 -
CO-CHAIRMAN ELDER: This question is for anyone. What about if we were buying life insurance for employees that had cash values established in them as part of the mix which, upon their retirement, were presented to them as fully paid up policies, which would have substantial cash values.

Has that been considered as an option by any of you rather creative people?

MR. LEAVITT: I'll take a crack at answering it. Life insurance is an ancillary benefit. If the life insurance as life insurance was given to the employees, then it would have no 415 impact, I don't believe. If the cash value was used to pay retirement benefits, then the life insurance would just be a different funding vehicle, like buying stocks or bonds or whatever, and wouldn't change the equation.

CO-CHAIRMAN ELDER: If you're presented with a fully paid up $300,000 policy upon retirement, you have substantial cash value which are subject to taxation.

It seems to me, in that scenario, individuals could cash in the policy, which of course is a taxable event, or, if they're more sophisticated, they could borrow against the cash value at no tax consequence. There would be no tax consequence unless they died, in which case it would be less painful than the death, presumably, and paid for out of the estate.

So, I just wondered if anyone's thrown fully paid up life insurance into the mix?

One of the concerns I have about retirement systems generally is the fact that employees in their years of service, when they have a death, the family is left in pretty tough shape because their pension really doesn't provide much in the way of death benefits.

So, I felt that this might be a way to really give more with less.

MR. GROSSMAN: If there's any subject that's more obtuse than Section 415, it's probably the income taxation treatment of insurance in a qualified plan.

I think what happens when the life insurance policy is distributed out at the time of retirement, this assumes the fellow hasn't died. When it's distributed out, you would take the cash value at that point, and that's part of the retirement benefit. I suspect it just goes into the 415 calculation as a lump sum amount. So, I don't think you've gained anything.

Now, there are some interesting insurance products available that have rather obscure cash values. And the design of that product is to try to get around this problem.
The IRS has said that they will take a close look at insurance products being distributed out of qualified plans at other than reasonable cash values. So, I suspect this is not an avenue to go down too far.

CO-CHAIRMAN GREEN: Thank you, Ms. Martinez.

MS. MARTINEZ: Yes, I had a question or really a comment. The agreement reached in Los Angeles is really a separate issue because Los Angeles is a separate employer with a separate retirement plan, the collective bargaining process makes sense.

When PERS and STRS are looking at how to comply and what to do for the employees, you're talking about a retirement system with thousands of employers, where the collective bargaining is done in each of those separate school districts, or separate cities or counties.

I guess my comment is that the collective bargaining model or coming up with a solution at this point that will be put in legislation, does not appear to work well with the efforts of PERS and STRS to comply.

CO-CHAIRMAN GREEN: I think you're absolutely correct. This legislation is aimed at only L.A. County and that one system.

I'm sure that there will be other people putting in legislation aimed in a different way, but that's what this legislation will be.

MS. MARTINEZ: It would appear that these arguments would have to occur after the fact, though, after compliance.

CO-CHAIRMAN GREEN: I would hope that we'd have a lot of compliance legislation here before January 1st, 1990. Who was next? Mr. Descamp.

MR. DESCAMP: Thank you, Senator Green. First of all, I'd like to state that there seemed to be some more or less an implication that other entities that didn't collectively bargain into a solution perhaps acted inappropriately.

I believe that those entities under the '37 Act, for example, have acted very appropriately, particularly with respect to this complex issue.

My personal position was, you don't bargain something you don't know anything about. It's been an ever-changing thing. It's been a slurpy, slimy, slippery law that's changed periodically, and just when you thought you knew what you were looking at, it changed again.
I and many of my counterparts felt that it wasn't something for bargaining, again, until we figured it out; until, to use a term in Workers' Compensation, it was permanent and stationary. Perhaps it's not permanent and stationary yet.

I don't mean to disparage L.A.'s efforts, because if indeed they've reached agreement on this thing and it works, that's fine. But I would have a concern that, on the basis of what we hear here now, that we're all going to go out and try to mirror L.A. County and accept this as being the real thing.

Unfortunately, the material that's been provided to me has the following phrases. A portion of the employee contribution required under existing Plan B or D would, quote, "find its way," unquote, into Plan F. Employee and employer rates would not change. The money to F would be determined by retirement systems upon actuarial advice. At retirement a benefit, quote-unquote:

"in some form would be paid from Plan F and subtracted from the defined benefit [plan] before application of Section 415 "

These things all sound fine here, and they may very well be fine. My concern is, however, I don't have anything in this document that's been provided at this point that tells me what it is that they're going to do.

I would need, in order to consider it seriously, to define "find its way"; to define "in some form".

Again, I don't mean to be critical, but my concern is that we may all throw up our hands and say, "Free at last! Free at last! Thank God almighty, free at last," because of this proposal, and that we won't go on with the discussion with respect to trying to comply with 415 whether or not we have agreement.

CO-CHAIRMAN GREEN: You're absolutely right, but I think we've all got to go in a direction, and that this is the first answer of one county in the state. There are a lot of answers and a multitude of problems, and there's going to be a multitude of answers to each individual problem. Mr. Leavitt.

MR. LEAVITT: I was just going to make one quick comment, and that is that the proposal that has been presented to you on behalf of Los Angeles County and its unions attempts to deal with both issues at the same time, and there are two issues.

One of them is how to keep the plans qualified dealing with the 415 situation, and whether or not the grandfather is the best way to go.
The second issue is, if you do that, then how does the employer respond in terms of providing benefits for new employees.

It is not necessarily, I do not believe, to deal with both of those at the same time, although it might be desirable to do so. The reality is, that time is running out, as has been said earlier. The deadline is the end of this year to adopt the grandfather provision, protecting all your current employees.

CO-CHAIRMAN GREEN: What must a government employer do in order to qualify for the grandfather provision protections? Mr. Leavitt, can you handle that?

MR. LEAVITT: Sure. The special grandfather rule that TAMRA added, I think, has been alluded to several times this afternoon. It is a protection for all current members, or actually, members who become members before 1990. And the way they're protected is, the 415 limit becomes their accrued benefit under the plan, not counting amendments to the plan that increase benefits after, I think, it's October of '87.

In other words, the benefit for a member who becomes a member before 1990, if the grandfather is adopted, can never exceed the 415 limit if there are no benefit increases after 1987.

CO-CHAIRMAN GREEN: So under grandfathering would be those people that are in the systems currently today and the plan of today, we're going to change our way of operation starting January 1st, 1990 for all new hires.

MR. LEAVITT: By subjecting the new hires, people who first become members after 1989, to the private sector 415 limits, which means 415 without the favorable early retirement reductions that currently governmental plans are subject to.

CO-CHAIRMAN GREEN: Like our safety employees.

MR. LEAVITT: The safety -- the $50,000 floor for safety employees, which is also indexed for cost-of-living and is now up to about $54,000, that would be retained.

It's the $75,000 floor, and reducing benefits from age 62 rather than 65 that would be lost.

CO-CHAIRMAN GREEN: Mr. Coon.

MR. COON: Thank you, Senator Green. One question I had is, it's never been exactly clear to me what grandfather -- when we talk about grandfathering. The question really would be, if we accept the grandfathering and the PERS plan is accepted like it is, and IRS says okay, does the grandfathering affect in any way the behavior of employees who are participating in these other programs which also contribute to exceeding the 415 limit? Like, if somebody's putting $9,000 in a 403(b) account, or
they're putting $5,000 into a flexible spending account for child care, the question would be: can that behavior continue as it is also, although under the new rules, that in combination with the pension plan would be in excess?

CO-CHAIRMAN GREEN: Mr. Leavitt.

MR. LEAVITT: I think the answer is, because those employees who are grandfathered would not have to worry about exceeding the 415 limitation, they could continue doing all those salary reductions that they were doing before, without having to worry abut the impact under 415.


MR. LEAVITT: So long as there are no benefit increases after October of '87, that would be -- you would not have to worry about 415 for current members.


MS. MARTINEZ: What happens to someone who is a member before 01/01/90, and then changes jobs and perhaps goes to another system that has reciprocity? Would they suddenly become one of the new employees subject to the new lower limits, or do they get to retain their old limits?

MR. LEAVITT: I think they would retain the old limits in the old plan, and I think be subject to the new limits in the new plan, because they would first become a member of the new system after 1990, or after 1989.


MR. GROSSMAN: Well, I was going to go back to the previous point.

The grandfather protection under the defined benefit limitations, there may be some impact under the combined plan limitations if you have defined contribution and defined benefit plans together. Again, you're protected on the defined benefit side. You just can't simply forget 415 on the defined contribution side, even if you're under the grandfather provision. There may be some impact.

CO-CHAIRMAN GREEN: Thank you. Does that answer your question, Ms. Martinez?

MS. MARTINEZ: Just one other thing.

Is the grandfather by system or by employer? For example, let's say I stay in PERS but I go to another employer. Does that make a difference?
MR. LEAVITT: The statute talks about plans, so we're back to the discussion we had earlier about what is a plan.

The reality is that in the public sector, these terms in the Internal Revenue Code, employer and plan, don't fit quite as neatly as they do in the private sector. And there are a lot of questions about who is the employer when you have State instrumentalities, and agencies, and whatever. But the actual language in the grandfather is when you first become a participant in the plan maintained by the employer before January 1, 1990.

CO-CHAIRMAN GREEN: Thank you.

MR. LEAVITT: I'm not sure I can elaborate much more on what that means.

CO-CHAIRMAN GREEN: Mr. Descamp.

MR. DESCAMP: I would like to point out or observe, if you will, that a way around 415 -- and Mr. Leavitt or Mr. Grossman can confirm this -- is under reciprocity.

If you split your time between two respective systems, therefore two employers, the likelihood of approaching 415 from either plan would be considerably reduced. Is that not true?

CO-CHAIRMAN GREEN: That's up to debate.

CO-CHAIRMAN ELDER: Because you wouldn't have enough years.

CO-CHAIRMAN GREEN: Mr. Grossman.

MR. GROSSMAN: I think that contemplates actually shifting employment, which is sort of a severe thing to do, possibly, but that would be the case in the private sector. If you got a maximum benefit from Ford, you could then go to work for General Motors and get a maximum benefit from General Motors.

There is some upward limit or upward -- if your benefit gets too big, there are some tax consequences on the back end, but not for 415 purposes.

CO-CHAIRMAN GREEN: Thank you. To what extent are surplus funds held by public retirement systems subject to the 415 limits? In other words, any of our surplus funds, which we don't have any, but we say we do. Mr. Leavitt.

MR. LEAVITT: Senator, you're talking about surplus funds in the retirement systems?
CO-CHAIRMAN GREEN: In the retirement system. Like under PERS, we have surplus dollars that stay there from year to year. How would it affect those surplus dollars?

MR. LEAVITT: Well, the 415 defined benefit limits do not apply to plan assets; they apply to the benefits that the system pays. So, the existence or not of surplus, I think, is irrelevant for 415 purposes. It's what the surplus would be used for that might or might not have an impact under 415.

CO-CHAIRMAN GREEN: In other words, 415 does not address itself to either the surplus or even an unfunded liability?

MR. LEAVITT: Correct. It focuses on the benefits that are paid, not on the funding of those benefits. This is the defined benefit portion of 415 that I'm talking about.

CO-CHAIRMAN GREEN: Mr. Bald.

MR. BALD: Let me try, Senator. Suppose quarterly payments were paid to retirees, as is done by PERS. We call them IDDA funds. I don't know if you're familiar with them. Would --

CO-CHAIRMAN GREEN: Supplemental, what we use the surplus for.

MR. BALD: They're supplemental to the ordinary retirement payments. Would they be -- how would they be treated under 415?

MR. LEAVITT: These are supplemental retirement payments?

CO-CHAIRMAN GREEN: Nonguaranteed. We have a surplus, and because they make us a certain amount of dollars, we give an extra IDDA fund or amount of compensation to that retiree under the surplus funds. Mr. King.

MR. KING: I imagine the IDDA benefits would be included as part of the retirement benefit, and subsequently, would be tested against the 415 limits of the IRS.

CO-CHAIRMAN GREEN: The answer, then, is that the surplus funds would be affected under 415. Ms. Lund.

MS. LUND: I don't know what we're defining as surplus funds. First of all, we've never admitted to having surplus funds, either, at PERS or anywhere else.

CO-CHAIRMAN GREEN: We don't admit it, but we have some.
MS. LUND: But those IDDA benefits are really, by any other name, a cost-of-living benefit. And I believe they're going to come under the same cost-of-living test that we've talked about earlier.

Now, there are other excess assets which are identified as surplus by employer and held in PERS, and that's a different kind of surplus fund.

But if you're talking IDDA, I think you're talking the cost-of-living test.

CO-CHAIRMAN GREEN: That would come under 415. All right, at this point thank you very much, panel, and we'll go back to Assemblyman Elder.

CO-CHAIRMAN ELDER: Thank you, Senator Green.

To Mr. Descamp, to what extent are trustees of a plan responsible for seeing that their plan complies with the 415 provisions?

MR. DESCAMP: I believe that the trustees of the plans have only the responsibility to do what they have the authority to do. 415 compliance, in and of itself, is a limitation on the benefits. The boards of retirement have no authority to place limitations on benefits in this regard.

I think that as fiduciaries of the system, they have instead an obligation, in light of the 415 disqualification ramifications, to communicate with the people who have the authority to do something with respect to the limits. And that's what they've done, i.e., or for example, this symposium that's here. We have communicated to the Legislature that there is an issue that needs to be addressed, and it's being addressed.

We have also communicated in our respective systems with, in L.A.'s case for example, with the labor organizations and with the employer, because if there is going to be an adjustment made, whether it be to cover the lost benefit or whatever, it's going to have to be an adjustment that's made per collective bargaining agreements.

CO-CHAIRMAN ELDER: Mr. Mosman.

MR. MOSMAN: I think the boards are put in a rather awkward position, though, because, for instance, say our board takes -- at the next meeting, takes the position that we should proceed to elect the grandfather, and then for whatever reason, say the legislation is not forthcoming during this session, we find ourselves on January 1, then, where? The board has essentially recognized that, you know, we are not in compliance with 415. There has not been the necessary legislation to change the plan design, so come January 1, we all find ourselves in a very awkward position.
CO-CHAIRMAN ELDER: That raises a point. Mr. Grossman, on that point, if the trustees of a plan cause compliance legislation to be introduced, but because of disagreements between labor and management, the legislation is not enacted, are the trustees still at risk? What should they do next?

MR. GROSSMAN: I'm frankly somewhat puzzled as to what the obligations of the trustee would be.

I really think, since the trustees do not have the power to amend the plans that they're administering, they're under a fairly limited duty, if any.

I don't really know how to answer the question any further.

CO-CHAIRMAN ELDER: Well, we haven't heard from Mr. Kinney today, so please advise us of your thoughts on this matter.

MR. KINNEY: I think one of our problems is that we're dealing with an almost insoluble problem on the basic assumption that we have to have it done by what some may consider an unreasonable due date, the 31st of December, and that if not, terrible, horrendous things are going to happen because the IRS is going to come down on us.

I'm not a tax lawyer. It's my understanding that the IRS has some degree, even perhaps a large degree, of discretion in that when there's a good faith attempt to comply with something, that they will make adjustments for it.

Could this be addressed? Do they have that type of discretion? Will they have that type of discretion here?

CO-CHAIRMAN ELDER: Mr. Grossman.

MR. GROSSMAN: In matters similar to these, they have been known in the past to grant extension after extension after extension on dates for compliance with these kinds of provisions, but one cannot rely, going into it, that these extensions or other relief will be granted.

In a lot of cases, the relief isn't granted until the due dates have passed, and you just simply don't know what they're going to do.

I haven't heard -- I'm not sure this is a burning issue back in Washington with the IRS right now.

They're into these very important issues, as for example, coming with new guidelines on Social Security integration for defined benefit plans, which is -- they've recognized that their regulations are incomprehensible, so now they're coming out with guidelines to interpret their regulations.
I'm not sure this is a burning issue, and I think December 31 will come and go without hearing from them. As a result, I think this is a real deadline that one cannot simply ignore.

CO-CHAIRMAN ELDER: I would offer at this point, if anyone thinks it worth doing, to get the appropriate person, if not myself and probably not myself, to write a letter asking for an additional year in which to bring California into compliance or to not bring it into compliance, in which case I suppose we'd have a lawsuit to consider, which is really my first preference. Mr. Leavitt.

MR. LEAVITT: The IRS does have some discretion as to whether to enforce the law, although just recently, a couple of days ago, the tax court upheld the IRS in its refusal to grant that discretion to a plan that violated 415 which was disqualified by the IRS. So, the IRS has taken a hard view on this in proper situations in its eye.

However, I'd like to remind you that it's not only an issue as to whether the trustees or the employers, or whoever, it's also an issue as to whether the Legislature should be acting. And in the eyes of the IRS in determining whether there is good cause for granting an extension, particularly after the fact, it will not only be whether there has been a labor-management impasse, or whatever, that has prevented the adoption, but whether the Legislature of the various states, which was put on notice by Congress that it could solve this problem by electing the grandfather, did so.

And I think we need to keep in mind that when you have a legislative plan, such as the plans we're talking about here, there are a lot of parties involved, and it's difficult to look at only some of them. You have to look at everybody's proper role.

The other thing that I would say, Chairman Elder, about your suggestion about asking the IRS for another year, is that in reality, under the law as passed by Congress in TAMRA, the deadline for adopting the grandfather provision is the end of 1990. However, as was pointed out earlier, your problem is that once you start hiring employees in 1990 without 415 in your plans, you cannot then cut back their benefits consistent with the constitutional protections that those employees have.

So, your effective deadline, which is not an IRS deadline but a California deadline, is the end of this year.

CO-CHAIRMAN ELDER: Mr. Friend.

MR. FRIEND: This point that has just been made is a very important one.
We believe that IRS or that the Congress, when it adopted this language, anticipated that all the states would have that extra 12 months. And in fact, de facto, we do not have that here in California.

And I believe that on the strength of that, it would likely be the case that the Treasury would extend that deadline for California and the other five states, subject to this constitutional problem, if the facts were made known, and if a delegation were appropriately approached -- were to appropriately approach the authorities. And I would be salutary about that opportunity.

**CO-CHAIRMAN ELDER:** You're saying that because of our constitutional prohibition against impairment of contract, that we do have something else that has to be waived in terms of amendment to the Constitution, which can only occur by a vote of the people, or how are we supposed to get around that?

**MR. FRIEND:** I'm suggesting that the language that was written, the grandfather language, intended for you to have an extra year, which I don't believe the draft people recognized would not be there. And in consequence, if you were to approach the Treasury Department and point out that that extra year is not available to you, that they very well may recognize the problem and extend that extra year to you as a consequence.

I think it is worth approaching the Treasury Department with that point in mind, particularly if there is a clear indication of your intent, that is the leadership intent, to comply is in the works.

**CO-CHAIRMAN ELDER:** Ms. Paulson.

**MS. PAULSON:** Assemblyman Elder, through our office in Washington, and one of my Washington partners who's here, we have made some inquiries already with respect to the possibility of Congressional relief.

Now, we did not narrow our inquiries simply to an additional year to comply with the election process because of the constitutional issues raised by California constitutional law, but we were seriously rebuffed in our efforts at the joint committee.

**CO-CHAIRMAN ELDER:** They thought this thing up.

**MS. PAULSON:** They thought this thing up, and they think they've fixed it, and they don't want to hear anything more about it. And that was what they told us, sort of point-blank, "We've already fixed it. We're tired of hearing public employers coming in here, moaning about the poor treatment and the disparity in treatment."
They don't want to hear about it. They want public plans and private plans to basically all follow the same requirements, and they were not at all persuaded that public plans need more in the way of relief from the qualification requirements.

Now, the additional year to allow us to comply and not violate the constitutional provisions, that's a narrow enough issue, affects very few people, and particularly if the states involved indicate that they are attempting to work within their collective bargaining processes and get the appropriate legislation enacted in a timely fashion, without impairing the constitutional rights of people hired after 01/01/90. That kind of technical correction probably stands a better chance.

I don't know if I would be so optimistic as Mr. Friend, to characterize it as a salutary proposition. I'm not sure I'm that optimistic, but that certainly is a better possibility than other kinds of relief.

CO-CHAIRMAN ELDER: Mr. Leavitt on this point.

MR. LEAVITT: I was just going to agree with everything that was said, but I think one other point that I would make is, you need to ask yourself, if you're going to ask for another year why you're asking for it.

From the point of view of the IRS, you are now in session. You've had this symposium. What more will you know a year from now? Why can you not take action now?

CO-CHAIRMAN ELDER: What symposium?

(Laughter.)

MR. LEAVITT: I didn't say you understand any of this, but I'm not sure that any of it is going to be more understandable in the future.

CO-CHAIRMAN GREEN: I think that's the key, is understanding what you've all told us.

MR. LEAVITT: But the question is, how much more will you know in a year?

The other side of the coin, I think, is, while you can argue that it would give time for the labor-management process to go forward, the reality is that Congress did not give the private sector time to do that when ERISA became effective with 415 limits. While parts of ERISA were imposed upon, collectively bargained plans at late dates, I don't believe 415 was one of them. I may be wrong. Was that one that was delayed?

MR. KING: Yes.
CO-CHAIRMAN ELDER: The private sector is clearly the enemy as far as Washington is concerned. We're simply just semi-culpable here. Mr. Deise.

MR. DEISE: The only thing I wanted to add was, I think we're in the danger of singing the same song we sang at this time last year, because we went back there last time, or a little later, last year and said we couldn't get our act together by January 1st of '89, and they gave us another year. I guess if I was them, I'd ask, how many more years do you want?

CO-CHAIRMAN ELDER: As many as we can get, I guess is answer.

Mr. Descamp.

MR. DESCAMP: In response to that statement, they changed it on us, and that changed the way we approached it.

But other than that, there are three reasons why we would need more time. The first is that we're still in the information gathering/educational process. This symposium answered a lot of questions, but it brought up a lot of questions that need answers.

Two, we would need to involve ourselves, or appropriately should involve ourselves, in collective bargaining, and the time constraints with respect to that.

And third, this is going to require a lot of exchanging of information from sources that we heretofore did not have to exchange information with; retooling in order to administer these provisions.

Sandy Lund and I, for example, have been talking it seems like every day and through my nightmares on this issue. And there's an awful lot of information that's going to have to be set up.

To retrieve simply from, in this case, a '37 Act county, we will have to have a way of getting information from the county that we don't get now.

So simply put, there's more than one reason why we would require time.

CO-CHAIRMAN ELDER: All right. On that cheerful note, I had a question here: Do you advise pension plans in California to follow New York's lead to grandfather current plan participants and subject future hires to lower benefit limits? What are your alternatives and associated risks, Mr. Leavitt?
MR. LEAVITT: As I think I've made clear, we do recommend the adoption of the grandfather, because we believe that there is a fiduciary responsibility to the current members, and the grandfather provision takes care of them totally.

CO-CHAIRMAN ELDER: What about litigation? Has anyone tried that?

MR. LEAVITT: Not, not that I'm aware of.

CO-CHAIRMAN ELDER: Why are public agencies so timid in this regard? I mean, you crease somebody's fender out here on the street, and you're going to wind up in the Supreme Court of California, if anyone has their way about it. What have you got to lose? Why haven't you sued? Is that the reason, we haven't been damaged yet?

MR. LEAVITT: Well, what you have is the plans in the state have voluntarily chosen to be qualified plans. There is no requirement that an employer sponsor a qualified plan.

What the IRS and the Treasury Department and Congress have said is that if you want to be a qualified plan and take advantage of the favorable tax aspects that we described before, then you have to comply with various rules.

And what a lawsuit would be claiming was that some of those rules didn't have to be complied with, while the benefits ought to be received. And I'm not sure how a court would respond to that.

CO-CHAIRMAN ELDER: Isn't there litigation on the basis that it's vague; it's not administrable; you can't determine what these things mean; that the regulations are, frankly, incomprehensible?

MR. LEAVITT: Let me remind you that the private sector has been complying with these rules for almost 15 years now on their plans. These rules came into the law -- in 1974 ERISA was passed, effective 1976.

Nobody likes these rules. I don't want to be seen as an advocate for them, because I don't like them either. But I'm advocating what I think is the prudent position, which is, if you want to have a qualified plan and give your employees the benefits, the need to ensure that.

CO-CHAIRMAN ELDER: I guess that's really kind of the impression that I have gotten from this hearing, that we're just sort of getting in a line and walking off to the slaughter house here. It just seems like we're being very conciliatory, and it seems to me that we fight a lot in the Legislature, in fact I think it's one of the things we do best.
And it just seems to me that the impression is being created, and I think you need to elaborate on that statement that this is not something that everybody is recommending. It is just a final consequence of regulations passed by the federal government.

I see a whole bunch of hands on that one. Mr. Friend, and then the second tier here with Mr. Mosman.

MR. FRIEND: One comment that I think is important to make here, and that is, the Treasury Department feels that it has been benign neglect on its part not to have enforced Section 415 up until now. It has been applicable. They have, however, recognized the constitutional impairment problem, and this is their solution to that particular problem.

The Congress is looking for tax expenditures, and I think that I'm inclined to agree with the previous speaker, that there would be very little basis that we could use for arguing vagueness or any other position in opposition to that point.

CO-CHAIRMAN ELDER: So, Mr. Leavitt, you're recommending compliance and grandfathering. That's your recommendation?

MR. LEAVITT: Yes. I mean, if we looked at the issue globally, and we were starting with a clean slate, and asking ourselves how can you, as governments, which, after all, are nontaxable, provide benefits to your employees, we might come out with a different answer.

Private sector employers do not have the ability that you have to shelter assets from federal income tax. Qualified plans are the only way that they can do that on a retirement basis.

You have a lot more flexibility.

That doesn't mean you have total flexibility, although that might be an area for litigation and disagreement between state and federal officials.

However, we are not writing on a clean slate with PERS, and STRS, and the '37 Act, and other plans, because these are plans that have chosen to provide the benefits of qualification through pickups and others to their employees.

So, my view and recommendation is that, whether you like it or not, you need to protect the assets and protect the rights of the employees by grandfathering.

CO-CHAIRMAN ELDER: That's what you counsel. You counsel that we should act, and that we should take advantage of the grandfather provisions.

And that's your recommendation, Mr. Friend?
MR. FRIEND: That is correct. I feel the same way. And my major reason -- or really, there are two reasons. First of all, New York and Texas coming along; and secondly, there's one very strong position that they can take, even though you could, for example, accumulate funds with tax shelters in the states without trusts, and that is the pickup. You subject your employees to taxability on pickup. They hold the cards on giving you a qualification letter in respect of Section 414(h).

CO-CHAIRMAN ELDER: I'm going to ask all of you the same question.

Mr. LeSueur, do you recommend the same thing? Do you recommend that we comply, and that we seek the grandfather provision?

MR. LeSUEUR: Fortunately, I don't have to make a recommendation, but if I were, I would at this point say that I'd prefer to wait. I don't see any other alternatives yet.

SENATOR RUSSELL: How long do you want to wait?

MR. LeSUEUR: I'd like to wait and see if we could get an extension. That's what I would recommend, seeing if there's an extension, and then see if that gives you more time to possibly find another solution.

At this point, I don't see another solution.

CO-CHAIRMAN ELDER: Mr. Mosman, we're going to ask you. Is that what you recommend at this point?

MR. MOSMAN: Just one point. I mean, in terms of an extension, at least our experience or my previous experience when I was with the Department of Personnel Administration, is just to ask IRS a question and get a response is going to take you a year. IRS does not respond to anything on a timely basis.

That's kind of a major gamble, to put off doing anything right now, assuming that six months from now, IRS might say that, "Okay, you've got another year."

SENATOR RUSSELL: Mr. Chairman, on Mr. LeSueur's question.

CO-CHAIRMAN ELDER: I was going go ask, what we're into is asking everyone what they counsel at this point. I just thought we'd do that, and then when we get through that exercise, we'll continue on with more questions.

SENATOR RUSSELL: I had a question on his response.

CO-CHAIRMAN ELDER: All right.
SENATOR RUSSELL: You said we should wait. Our session ends in September. And whatever we do, if we're going to do anything, has to be crafted and developed and passed by the 15th of September so that it goes down to the Governor's Office.

Other than the collective bargaining issue, which is a legitimate issue -- I don't understand what benefit there would be to wait, unless you expect the Congress to change the law again immediately.

MR. LeSUEUR: From what I'm hearing, there are certainly a lot of public employers who don't want to comply. And I don't think there has been a very concerted effort to try to change things, or at least, since we're still in the education stage at this point now, it may not be realistic to expect Congress or the IRS to change, but why not give it a try, is my position.

SENATOR RUSSELL: Sort of gang up on them.

MR. LeSUEUR: Right.

CO-CHAIRMAN ELDER: Ms. Paulson.

MS. PAULSON: Assemblyman Elder, at this point I believe our recommendation is also to make the election to comply with Section 415.

As I indicated earlier, we've already had some with people with regard to modifications to the election in a more generic fashion, admittedly, than just an extension.

I'm not encouraged that we will even be able to get an extension. I'm certainly not encouraged that we'll be able to get any other kind of relief.

I think that the risks of noncompliance and the risks of not taking this opportunity to basically wipe out the difficulties of the past should be taken.

CO-CHAIRMAN ELDER: Mr. King.

MR. KING: Thank you, Mr. Chairman.

CO-CHAIRMAN ELDER: Same question.

MR. KING: Yes, I would certainly not let 1989 slip by without taking some form of legislative action to adopt the TAMRA election.

Note that such action would not preclude later action in 1990 or later years to do something additional for employees hired after 1990.
I would like to point out that I think L.A. County does have a clever idea. I'd like to point out that I'm not sure everybody realizes it, it is within the context of adopting that TAMRA election, that's part of their proposal, so I would be in favor of that part of it.

Relative to the later suggestion of changing to two different plans, there's a lot of merit to that, because you have the advantage of higher combined limits than you do of having just the defined benefit, or just the defined contribution plan.

On the other hand, and you've made the statement that the things will be actuarially equivalent. One thing I can guarantee to this Committee or Committees is that the actuarial assumptions will be wrong. We just don't know which way.

Their action, you know, the tail end of their action, creating the new Plan F, or whatever, will definitely create winners and losers. We just don't know who they are until -- time will tell who those winners and losers will be.

And I would point out that even if you did adopt something like an L.A. County approach, that you would eventually -- you could switch that, because I think the California Constitution would allow people to trade benefits, types of benefits. So, you might be able to do something and switch gears later on. I'd be a little careful in that area.

Thank you.

CO-CHAIRMAN ELDER: Mr. James.

MR. JAMES: I would agree with the majority opinion at this point.

I think what you have to do is, you have to look at the current employees, take care of them first. You're going to have an opportunity to deal with the problem of future participants down the road. I think there are ways to deal with the problem for them. It's going to be some time before we have to worry about getting the 415 limits for those employees.

I think we have to just take care of things as they need taking care of.

CO-CHAIRMAN ELDER: Mr. Grossman.

MR. GROSSMAN: Unless we're dealing with a plan that, for some reason, is within the existing governmental 415 limits and is better off just sticking with them and not making the grandfather election, I think most plans are better off making the grandfather election.
I also think, in terms of who the winners and losers will be in L.A. County, I think the employees collectively will be winners. Some may win a little more than others, but basically they're going to have something that we think is good, and we think this is the only way to achieve it.

And the last comment I would make is, asking the staff of the Joint Tax Committee for any relief for anything, other than going in and suggesting new taxes to impose on yourself, is not going to get very far.

What you might try, though, perhaps in a more responsive ear in the Treasury or maybe the Internal Revenue Service, is if they feel capable of making an administrative extension on this provision. I don't know if they can, and I don't know if they'd be receptive, but that may be a place to look.

CO-CHAIRMAN ELDER: All right, Mr. Kinney.

MR. KINNEY: As an alternative, perhaps, as I recollect when we prepared the pickup legislation, that's when we decided we had to become qualified.

Perhaps pickup is not worth all the grief that's going on with this.

Is the process reversible? That is, if we chose to elect not to pick up and say we don't want to be a qualified plan, then what happens?

CO-CHAIRMAN ELDER: Mr. Leavitt.

MR. LEAVITT: Yes, it's possible to reverse a pickup. Of course, you lose the tax advantages that the pickup had.

CO-CHAIRMAN ELDER: It took us a year to implement it here in the Assembly. We were paying taxes for a year longer than we needed to.

MR. LEAVITT: I wouldn't advocate that. As I pointed out, if you decide to do away with your tax qualified status, then you fly right in the face of Section 457(f), because while 401 qualified plans are not subject to 457, once you stop being a qualified plan you become subject to 457, and then you would have to deal with the 457(f) rules, and you'd have the problem with taxing the deferred compensation as soon as people either become vested or stop working.

CO-CHAIRMAN ELDER: Same answer?

MS. PAULSON: Yes, Assemblyman Elder. My point was simply going to be that you subject the participants to
immediate taxation whenever they can get their hands on the benefits, rather than allowing the participants to defer tax on the benefits until they actually receive them at retirement.

CO-CHAIRMAN ELDER: Mr. King.

MR. KING: I would couch it as out of the frying pan and into the fire.

CO-CHAIRMAN ELDER: And Mr. Grossman.

MR. GROSSMAN: Likewise.

CO-CHAIRMAN ELDER: Same answer, okay. Mr. Kinney, what do you recommend at this point?

MR. KINNEY: Further study.

(Laughter.)

CO-CHAIRMAN ELDER: How did I know you were going to answer it that way? Mr. Huffacker, City of Porterville.

MR. HUFFACKER: Thank you, Mr. Chairman. I think I would concur that we should grandfather. However, I am also concerned whether or not there's been enough dialogue with the contracting agencies. I think, using the term that Senator Russell said, maybe ganging up on them might come out as a result of that.

CO-CHAIRMAN ELDER: All right, Ms. Lund.

MS. LUND: I believe we should adopt this grandfather clause this year, in accordance with the opportunity provided by the federal government. While there may not have been enough dialogue, there has certainly been time enough to have enough dialogue. We have begun this a year and a half ago.

As one who has participated in the dialogue for a year and a half, I don't know that another year of dialogue is really going to help.

CO-CHAIRMAN ELDER: You are not the universe of the world. It's very nice that you have been dialoguing with people, but I would tell you the people out there who have not been involved in dialogue miss it and would like to have an opportunity to partake in the activities you have for a year and a half.

You're going to deny them the right to have this one year of dialogue.

MS. LUND: No, that's fine. I just wish them better luck than I've had in getting any farther.

- 66 -
CO-CHAIRMAN ELDER: I prefer not to have any more dialogue beyond this hearing, frankly. Mr. Mosman, what is your counsel?

MR. MOSMAN: Well, because -- based upon the evaluation we've done thus far, we see almost no impact in terms of the ceilings that are set by 415, and maybe some potential minor impact in terms of the floor, I think that it's in the best interest of our system to opt for the grandfather.

CO-CHAIRMAN ELDER: How does AB 944 square with this? As you may know, I'm running a bill that sets up the employees paying for an annuity product for part of the employee's portion of the STRS contribution. And the other half, the employer's half, would continue to be invested as it is.

Would that qualify on the 50-50 program, an annuity product for the employees from the employee's side?

Instead of having them continue to pay 8 percent from the employee into STRS, and 8 percent from the employer into STRS, we would have 8 percent from the employer, and 8 percent into an annuity product.

Would that get us into the 50-50 limit situation, or do annuities qualify?

MR. MOSMAN: Assemblyman, that might solve one problem, but it worsens another problem in terms of the system's funding.

Anytime we start diverting funding out of the currently unfunded defined benefit plan into a defined contribution plan, then you exacerbate the unfunding of the defined benefit.

CO-CHAIRMAN ELDER: Why, if you have the benefits, which is what would happen?

MR. MOSMAN: You have the benefits, but you don't have the funding for the defined benefit plan.

CO-CHAIRMAN ELDER: You don't have the funding for the full benefit now, and if we cut the benefit in half, we cut --

MR. MOSMAN: Okay, you're talking about cutting the benefit in half --

CO-CHAIRMAN ELDER: You'd have to, because only part of it would be going into an annuity, so we reduce our problem by half. The question is, does an annuity product from the employee's contribution qualify on this 50-50 limit proposal that's being sort of suggested by Mr. Grossman? Do you know if annuities qualify?
MR. GROSSMAN: It depends on how that's structured. The annuity could just be another defined benefit plan, in which case you just add the two together. Or, it could be a defined contribution plan of some sort.

CO-CHAIRMAN ELDER: That's what it is.

MR. GROSSMAN: In which case you could take advantage of the expanded limits, but it's not 50-50. It's a little more.

CO-CHAIRMAN ELDER: We'll continue to explore it. Mr. Coon, what is your recommendation?

MR. COON: I just have a couple observations in regard to it. I know you can't talk about problems like this forever, but I think if you took a vote on who really understood, you know, you may not find people who are experts on it.

For example, I asked earlier about what exactly did the grandfathering cover, and these two gentlemen -- I don't know if you noticed it -- each answered it differently in regard to the 403(b) and the flexible spending account being grandfathered differently. We got a different answer, and some of that information you need to make an intelligent decision in regard to this.

In regard to what the administration would want to do about this, we haven't had a chance to talk about it yet, and I really can't say anything.

CO-CHAIRMAN ELDER: So the administration has no position on this.

MR. COON: No, we need to gather the information.

CO-CHAIRMAN ELDER: That would be helpful, and I hope that your Department will take this to your agency and try to get a recommendation.

MR. COON: We plan to do that.

CO-CHAIRMAN ELDER: It would be kind of ridiculous to pass bills and then have them vetoed by the Governor. Mr. Descamp, what is your recommendation?

MR. DESCAMP: I personally would recommend that we would comply in order to take advantage of the grandfathering clause.

However, I would point out that your respective Committees' consultants have determined that there's been no concerted effort on the part of state legislatures across the country, as a group, to address these issues in the Congress. And whether it be with respect to getting a more favorable grandfathering provision, or whether it be with communicating the impossibility
of complying without a great deal of harm to the systems themselves or to the state as a result of lost revenue, that should be considered in addition to complying.

In other words, comply, and continue the process of making our problems known through a concerted effort through the legislatures.

My suspicion, again, is that there have been a few systems, like New York, and in this case California, that have looked into the issue, discussed whether or not to comply, perhaps complied, in the process of complying, et cetera. But there's been no collective effort.

I think that perhaps -- perhaps I'm giving state legislatures more credit than they're due, and I hope not -- but I think that if there is this concerted effort, that maybe by then you will get the ears that have to be responsive, and that we will have some relief.

CO-CHAIRMAN ELDER: All right, Ms. Ahn.

MS. AHN: The University of California will be seeking approval from its Regents to elect the grandfather election.

However, I think one of the problems we face today is a system like L.A. County and ourselves, where we are single employers, face one set of problems. Systems like PERS and STRS, where there are multiple contracts, I believe, face another set of problems.

We have reciprocity agreements with PERS. We also have staff members prior to 1961 that were covered under PERS. So, we have a special interest in what happens with PERS.

Having done very little research and being a nonattorney, I do, however, know that there are special provisions in the federal law as it pertains to multi-employer plans, those that are collectively bargained. There are some specific rules, provisions, actually advantageous provisions to multi-employer plans, not to be confused with a multiple employer plan, that is perhaps not collectively bargained, and perhaps not subject to these more favorable rules.

It is possible, and I think worth exploring, whether or not systems like PERS and STRS could be covered under the multi-employer rules to give them the relief that they would not have to aggregate all of the benefits that they would pay out to a member who has been employed by multiple agencies.

Now, I haven't discussed this with either PERS or STRS. I haven't discussed this with legal counsel, but it is a possibility.
If you assume that the federal government has basically ignored governmental plans all these years, they perhaps may not be sensitive to the way we operate, and may not be sensitive to the structure of a system like PERS and STRS versus a multiple employer plan in the private sector.

I think it could be argued that there are more similarities to the multi-employer plans, those collectively bargained in the private sector, and perhaps relief could be sought so that those more advantageous provisions would apply.

That's just something I offer for those systems to consider. We have an interest in it, but I haven't heard too much discussion along that line. It's a narrow piece of law, but it might offer some relief.

**CO-CHAIRMAN ELDER:** Mr. Treece, what you are recommending is basically to go ahead and go forward. You've developed a rather creative alternative in concert with Mr. Deise and your counsel. I guess you recommend from that that we grandfather and go forward.

**MR. TREECE:** Well, I don't think it's appropriate that someone from my position make a recommendation on PERS or other plans that I'm not involved with, nor have any responsibility for.

You've asked a couple of questions about risk and who bears responsibility.

From my point of view, given the way the courts look at the level and standard of care required of unions in today's society, I would certainly encourage those unions representing State employees, or other PERS contracted agencies, to get very involved in it, I guess, for a couple of reasons: what's going to happen to their members in the future; and certainly, where their liability lies if they do nothing.

When I think about your question about what should we do, and should we go back, collectively or individually, back to Congress, I think that the answer to that is more or less held in what is the reason for Congress enacting the changes. And it seems to me that it's a revenue-producing measure for them.

We can go back and perhaps even lobby successfully to avoid having to make these changes and deal with this, only to turn around and find the hand in our other pocket, because ultimately, it seems that the time is here when they're going to be collecting more money from us. They're either going to be taxing other benefits, liked they've tried in the past.
In Los Angeles County, we do not participate in Social Security, and we all know that there's a large move afoot to mandate that all public employees belong to Social Security. That would automatically reduce our members' take-home pay by about, what, 7.6 percent, or something like that.

So, perhaps one way to look at it is what's the best alternative? What's the most palatable?

From our perspective, given our solution to the situation, yes, we are working with the Board of Supervisors to obtain the necessary legislation to go forward and to adopt the 415 limits and the grandfathering provisions.

CO-CHAIRMAN ELDEN: Mr. Deise, same answer?

MR. DEISE: Basically. If we were a year and a half ago doing this, I would think we should make an assault on Washington. But from everything we understand, and everything we hear, we are getting absolutely no -- nobody listening to us back there.

Further, everything I hear is, this is just the tip of the iceberg; that they have discovered that this is where a lot of the money that they have never tapped before is, in the public pension plans, and they're coming after it. I suspect this is the first of several runs they're going to make.

From what we know at this point, and the solution we think we have crafted, I guess I would say the best course right now is to recommend that we go ahead, at least in Los Angeles County, and accept the grandfather, and try and work to improve the situation in the future.

CO-CHAIRMAN ELDEN: All right. This is for everyone: If there is no agreement on specific language ready by the end of the legislative session, could we qualify the enacted intent language, stating that we want to be in compliance but need more time for the specific language?

In other words, it is our intent to comply. We just haven't figured out what we have to specifically write to do it.

MR. DEISE: Just one thing I was going to mention, and I think -- I don't think we're in compliance right now with the current law. And I suspect that there are -- I'd ask John, he may know better than I. I think there are probably several in the '37 Act that are not in compliance with the current law.

CO-CHAIRMAN ELDEN: We don't want any admissions of guilt here.
I think that perhaps that's a good question for our consultants to explore with John at some other time. If he has some information like that, I'm sure he'll want to make it available to us.

Mr. Leavitt.

MR. LEAVITT: I think I would answer that since the January 1st, 1990 deadline is a California deadline, the Congress has given you until the end of 1990 to actually amend your plan, I would think that if you could come up with some way to cut off people's constitutional rights to the higher benefit without coming out with the specific language -- and I'm not sure how you'd do that -- in other words, if you can deal with it on a state level that you could do something such as you suggest, I would probably recommend, however, adopting simple Section 415 language by incorporating Section 415 by reference, and then working out the details to the extent necessary afterwards.

CO-CHAIRMAN ELDER: Anyone else?

So, if we had intent language in place, and we were to pass that and deal with the question of new hires following the January 1 of 1990, I guess we'd have to give them notice in the hiring process that any public employee hired in California after January 1, 1990 is to be advised that their pension benefits as described may be amended to comply with federal Internal Revenue Service Section 415 and other applicable statutes of the federal government.

MR. LEAVITT: If you did that, you would have until the end of 1990 to elect the grandfather, if that's what you chose to do.

CO-CHAIRMAN ELDER: We have four hands going up. Mr. Friend, and then Mr. LeSueur.

MR. FRIEND: I think you said it very well. I think that to advise the newly hired employee after January 1 of the restriction to which he would be exposed would create some temporary constitutional change.

New York has already done that when it introduced Tier Three back in the mid-'70s, and a temporary law, in effect, finally made it permanent.

This would work well and would satisfy the requirement, giving you an extra year for purposes of perfecting the language.

CO-CHAIRMAN ELDER: Mr. LeSueur.

MR. LeSUEUR: This is actually a comment and a question for the rest of the panel.
My recollection of TAMRA was that actually the deadline is the end of the plan year that starts after 1989. So, if your plan year was July 1st to June 30th, that really gives you till June 30th, 1990. Is that your understanding?

I mean, that's an additional six months we're talking about for plan years that are not calendar years.

CO-CHAIRMAN ELDER: Why are we talking plan years? I never heard anybody talk about plan years.

Our reports are prepared on a fiscal basis. I mean, I'm trying to understand the distinction between plan year and the calendar year.

Most people's plan year for them is their anniversary date of hire.

MR. LeSUEUR: For IRS purposes, you're allowed to have a plan year, which is different than a fiscal year. It's something defined in each plan document, which may or may not be a calendar year or a fiscal year.

CO-CHAIRMAN ELDER: Ms. Paulson. We'll explore that. I'm not sure I understand everything I heard, but we will explore it.

MS. PAULSON: Let me see if I can explain that just a little better. The 01/01/90 problem is that the way that the statute has defined eligible participant is someone who is a participant on 01/01/90. Anyone who is employed in PERS or STRS, or in any of the other California retirement systems, if they're employed on 01/01/90, they're a participant on 01/01/90, and they've got a constitutionally protected benefit. That's the deadline for California.

Ordinarily, the compliance with the 415 election would not have to be adopted, or the election would not have to be made, until the end of the first plan year, beginning after January 1, 1990.

I don't know about all the rest of them, but I believe the STRS plan year is a fiscal year. It begins on July 1. So technically, they would have until June 30th, 1990 to make the election -- 1991 to make the election, but in the meantime, they've got participants who are not qualified participants, according to the statutory definition, who've been accruing benefits perhaps in excess of 415 limits, who then have constitutional entitlements to those benefits. That's the nature of the 01/01/90 deadline.

In addition, I'd like to -- I think your concept of leaving some of the technical details of compliance out of the initial legislation is a very good one.
We don't even know all the questions that need to be asked. All
the reporting forms need to be redesigned.

But I think you have to have something a little stronger than
just intent language. I think it has to be that benefits will
be limited in accordance with Section 415. And we'll figure out
the details of how we're going to amend the plans to comply with
that limitation until a later date, but I think that you have to be
more specific than just, "we think we're going to try to
comply."

**CO-CHAIRMAN ELDER:** I understood you to say June 30,
'91. I thought I understood Mr. LeSueur to say June 30, 1990.

**MS. PAULSON:** No, I said June 30, 1990, and he corrected
me because it's the first -- the end of the first plan year,
beginning after June 1, 1990, which would be July 30, 1991.

**CO-CHAIRMAN ELDER:** So in effect we'd have 18 months
rather than 12.

apologize.

**CO-CHAIRMAN ELDER:** Okay, Mr. King.

**MR. KING:** I would like to commend the Chairman on the
careful selection of his wording when he said, "to amend the
California plans to comply with Section 415 and other Internal
Revenue Service requirements."

I think that's important, because as we've discussed a little
bit, there are a lot of other qualification issues, including
nondiscrimination issues. I think if you solve 415, and you
haven't solved these others, you could be back in the same boat
where you've got to cut back and you can't.

So, I think your language is excellent, and I encourage you not
to leave out the part about "other federal requirements."

**SENATOR RUSSELL:** Can I ask you a question on this
point?

**CO-CHAIRMAN ELDER:** One last point, and then I'm going
to turn it over to Senator Russell.

Mr. Kinney, it has been suggested that there is a California
State constitutional prohibition against limiting benefits
previously promised to the vested members of the California
public retirement systems.

Where exactly in the Constitution is this prohibition to be
found?
MR. KINNEY: I'm afraid we're dealing with a misunderstanding here.

It isn't a constitutional prohibition within one constitution. It is a provision that almost everyone knows about, and that's the constitutional prohibition against the unreasonable impairment of contracts.

The provision exists in both constitutions. California courts have for years so indicated.

So, a retirement system, a statutory retirement system in California, once it is enacted and rights vested under it, those rights exist for the entire lives of the members.

And it doesn't even help to amend the California Constitution, because -- and there's a court case involving that with respect to the judges.

So, it's absolutely necessary to have some kind of language in here that will preclude immediate vesting on January 1, 1990, so we can buy some time.

CO-CHAIRMAN ELDERS: Speaking of the judges, it seems to me they really have a serious problem with respect to this. Their pension calls for 75 percent of the salary of a sitting justice, and whenever the judiciary gets a salary increase, they automatically get bumped up to a much higher pension benefit here in California. So, it's easy for them to get over 100 percent of their salary when they were a judge.

Senator Russell.

SENATOR RUSSELL: One of you commented about the New York law is just one paragraph.

They opted for the grandfather clause. How, in one paragraph, did they take care of everybody, old and new? Does anybody know?

MR. KING: Senator Russell, I do have a copy of the language that was modeled after it. One of the other panelists may have the precise language, but I'd have to dig it out of my file here.

If you come back to me in a few minutes, I would read it, if you'd care to.

SENATOR RUSSELL: Okay. It sounds like it was sort of a boilerplate, blanket type of an approach, which Assemblyman Elder seems to be talking about. Is that correct?
MR. KING: Yes, it is fairly boilerplate. I don't see-- frankly, when the Chairman talked about his intent, he wasn't too many words short of the actual New York State amendment.

SENATOR RUSSELL: Have you looked at the two bills I'm carrying, and would they fit into this category of the New York approach and what Assemblyman Elder is talking about?

MR. KING: I'm afraid I was not provided copies of all of those bills.

SENATOR RUSSELL: Has anyone seen the bills?

MS. LUND: Sandy Lund, PERS.
Our language was crafted after -- essentially after the New York language.

SENATOR RUSSELL: Okay.

MR. DEISE: Senator Russell, I have a copy here of something that was sent to me back of February, which is dated -- it's the State of New York and sent November 23, '88, which I believe is theirs. It's very short, and it substantially is about the same as your bill is. It just says:

"Notwithstanding any other law to the contrary, all members of the public retirement system to which the State or municipality contributes who join on or after January 1st, 1990, the benefits payable shall be subject to the limitations set forth in Section 415 of the Internal Revenue Code."

And it goes on to explain that a little more, but it doesn't cover more than a page and a half.

SENATOR RUSSELL: Then they worked out the details later on.

MR. DEISE: I don't know what they did. I just have this, and I can make it available.

CO-CHAIRMAN ELDER: One question on this, is the federal government itself subject to these limitations on their pensions for their employees? Does anyone know the answer to that? Mr. Friend.

MR. FRIEND: The federal government has found itself doing things which, perhaps, they should say, "Do as I say, not as I do." They've been derelict in allowing themselves to violate Section 401(k), for example, and a whole host of other rules which they imposed upon the employers of this country.
I would doubt very much whether the federal government has imposed upon itself these rules.

Does anybody know any different than that?

CO-CHAIRMAN ELDER: Wouldn't it make them money? I mean, since they don't make any contributions into the retirement system, their employees would have to pay a tax on the contribution. It seems to me they would be making money out of it, because they have no intention of funding the pensions, which are going in the hole at 50 billion a year, and that's outside the federal deficit.

Mr. Grossman, you were about to make a point earlier on the question of the general language.

MR. GROSSMAN: I think that's all that there is in the State of New York. I don't think there was any more language or any more contemplated.

CO-CHAIRMAN ELDER: We have gotten very close to covering all of the questions that were to be posed in this hearing. We have reviewed the record of questions that were to be posed and come to the conclusion that by the additional questions asked by Senators Russell and Green, and some of the staff people, and some of the questions you asked of yourselves, that we basically have covered all 60 questions that we had originally intended to ask.

I would simply think at this time that we would like to, in light of what we have all heard here today, suggest a closing statement by each of you, and it doesn't have to be real long, but take as long as you need.

Why don't we start with you, Mr. Descamp.

MR. DESCAMP: I simply would like to state that this is a difficult situation; that there are traditionally two groups that argue these types of issues. Those groups are employee-oriented groups or employer-oriented groups. I'm here representing the people who are in neither one; I'm here representing the people who represent retirement systems and their members.

As I've stated before, this is a rather odious law that's been passed. It creates an enormous number of administrative and other difficulties. One way or the other, we're pushed against the wall, and we have to do something.

As stated earlier by most of the people who are on this panel, it would appear that in order to act prudently, we have to recommend that you, the Legislators, pass legislation in order to enable us to comply with the provisions.
As I again stated earlier, I would still like to see personally some kind of concerted effort on the part of this Legislature and other legislatures to address the issues that have arisen as a result of this symposium.

I thank you very much for taking the opportunity to set this thing up and to answer a lot of questions that I particularly had and the people that I represent had. Thank you.

CO-CHAIRMAN ELDER: Mr. Coon.

MR. COON: I'd really like to thank you for the opportunity to be here. I think when these occurrences happen, I end up smarter than I was, and I'm still concerned about what I don't know about all of this.

As I indicated, the administration has not taken a position yet, but we are anxious to, you know, come to gather the knowledge we need and come to conclusion about it, and we plan to do that.

CO-CHAIRMAN ELDER: Mr. Mosman.

MR. MOSMAN: We haven't even begun to address the administrative nightmares that we, as retirement administrators, will face if and when we have to implement this. So, I have no reason to like Section 415. In fact, I have great distaste for what it will require us to do.

But nevertheless, based upon what I've heard today, and in conjunction with what I've heard earlier and what I'm hearing from our attorneys, I still think it's in the system's best interest to opt for the grandfather and move ahead.

CO-CHAIRMAN ELDER: Ms. Lund.

MS. LUND: Thank you. The federal government is not telling us that we have to limit our benefits. We can pay whatever benefits it is we care to pay.

What they are telling us is that if we step outside the boundaries, we're going to lose our qualification.

I'm not convinced that the federal government cares, one way or another, whether we remain qualified as plans. As a matter of fact, they may hope we step outside the boundaries so that we will become disqualified, and therefore, they can begin to tax the benefits, the contributions that flow into the system, and the earnings the system makes. So, I think that's a key issue.

We have, as administrators, brought this to the attention of the Legislature in two bills that Senator Russell is carrying. I believe we have placed the responsibility in the right hands, and wish you well in your decision whether to pass the bills or whether to hold on to the bills.
I can guarantee you that we, as plan administrators, board members, unions, and all the rest of us, employers, will continue to study the problem, and hopefully, to come up with creative solutions before we need them. Thank you.

MR. HUFFACKER: Mr. Chair, I want to say thank you for inviting me to participate. It was very enlightening, and I concur that we should proceed with the grandfather. Thank you.

CO-CHAIRMAN ELDER: All right, Mr. James.

MR. JAMES: I also would like to thank you. I think one of the things that is very commendable is the process that's gone on here today. I think 415 is really just the tip of the iceberg. There's a lot of things happening at the federal level that are threatening the pension plans of not only public but private employers, and I think it's very important to be able to react quickly and to make sure that the voices are heard. And I think this is an excellent way to do it. Thank you.

CO-CHAIRMAN ELDER: Mr. King, I inadvertently skipped over Mr. Kinney and his closing comments, if he has any now. He has none, so Mr. King.

MR. KING: I would also like to add my thanks and compliment the Members of the Legislature here for their level of understanding and taking the time to sit here and listen to all of us technicians.

CO-CHAIRMAN ELDER: Ms. Paulson.

MS. PAULSON: Let me add my voice of thanks. I know that Mr. Mosman and Ms. Morrill and I are going to be spending a lot more time together than probably they would like in the process of considering further our recommendations to them in connection with 415 compliance.

This has been an extremely instructive symposium, and I've gained a great deal of valuable additional information.

CO-CHAIRMAN ELDER: Mr. LeSueur.

MR. LeSUEUR: I also say thank you for the opportunity to participate in the symposium.

I would like to make -- just add one comment on something that I think should be followed up as a legislative something to seek in Washington, and that is, one solution that we talked about that maybe hasn't been brought out enough is -- to the whole problem -- is to somehow have nonqualified plans, which in the private sector are called excess plans, to replace any benefits that are above and beyond the Section 415 limits.
Right now, the private sector has the mechanism to do that in a tax efficient way. Public plans do not have that mechanism because you're limited by Section 457. I think that's an inequitable way that you're treated. So, I think that is a reasonable goal and objective, to try to get that kind of change to happen in Washington.

I know that has been worked on in the past and so far has been unsuccessful. I think it is a reasonable objective.

CO-CHAIRMAN ELDER: All right, Mr. Friend.

MR. FRIEND: I, too, enjoyed our work here together and commend the legislative representatives who are here and pursuing this issue for their endeavors.

I'd like to reinforce these comments with respect to pursuing this excess plan approach. I think that this is the way that we might solve this problem. We would not have to go in the direction of creating sister plans, defined benefit, and defined contribution plans, if we could eliminate the imposition of Section 457 through good lobbying, giving the public sector the same kind of advantages that the private sector has, permitting the use of excess plan, unfunded excess plans, so that when, for example, the Section 415 limit would apply, contributions coming from the respective employers would be split into two parts: one part going into the trust, and one part, one little sliver, going out to pay excess benefits to those people who would be limited as to their benefits as unfunded supplements to make up the difference of the lost benefit. That this would be such a simple, straightforward solution. Ultimately there would have to be some administrative work done to make that possible, but it would be relatively straightforward and solve this problem.

I do think that there's an awfully good argument to go before the Treasury and assert this position.

CO-CHAIRMAN ELDER: Mr. Leavitt.

MR. LEAVITT: I'd also like to thank you for the opportunity to be here today and to commend you all for staying awake during all of the discussion.

Seriously, the questions that you've asked demonstrate the importance that you place upon this and the degree of attention that you're giving to it.

I'd like to echo the sentiments that you should not give up in Washington, although I think that that has to be tempered with some sense of realism. For the past two and a half years now, I have been working with many other people in Washington to try
and deal with first the issue of 415, the issue of 457 and
nonelective deferred compensation, and more recently Section 89,
another of, I'm sure, your favorite topics, not with very much
success from the point of view of state and local government
employers.

We were successful in winning the grandfather because we were
able to demonstrate there was a real need.

Reality is that what is happening in Washington, unfortunately,
is that your Congressmen and Senators, and their staffs perhaps
more importantly, are beginning to view you, state and local
government officials, as a special interest group, no different
than the doctors, the realtors, you name it. And we know that's
not true, and it is incumbent upon each of us to try and convey
that message.

The other reality within which we are working is that the
federal budget, the federal coffers, forego $50 billion a year
in tax revenue in the pension area. They forego $32 billion a
year in tax revenue with respect to health benefits.

These are large numbers that Congress has increasingly been
focusing upon. And in that focus, they are losing sight of the
difference between public and private plans.

While I think it's important to keep reminding them that there
are differences and valid reasons for treating public plans
differently, I think that it would be imprudent to tie your
hopes and dreams to that, and to not move forward with something
that would put the plans in compliance in the interim.

CO-CHAIRMAN ELDER: What are those differences? What do
you see as the differences?

I mean, if we're going to make the argument, I don't really see
a heck of a lot of difference. The salaries have come up
dramatically in the public sector side, as compared to where
they were when these benefit levels were established many years
ago.

MR. LEAVITT: I guess my statement was a very general
statement, not only referring to pensions but some examples.
You have many policemen and firemen on your payrolls who are
different than employees of private industry, because they are
in, oftentimes, life-threatening situations. And benefit plans,
service-connected disability, for example, and other aspects,
the length of time that a person can serve in certain
occupations, that's a difference. More fundamentally --

CO-CHAIRMAN ELDER: Refinery workers and construction
workers are killed in greater number.
I hear what you're saying, I just want to make the counter argument. Length of service, clearly, is a barrier.

MR. LEAVITT: Another difference that comes to mind, not related to pensions, but to -- well, related to the general issue of discrimination. The pension rules for the private sector are largely driven by nondiscrimination rules which attempt to ensure that all employees benefit from the plans.

There is no reason, in my view, to be concerned about discrimination among public plans. And historically, the IRS has not been very concerned. They're not enforced, the discrimination rules against public plans.

However, when it came to Section 89, which is the new discrimination test in health care, Congress applied those rules to government. And efforts to obtain exemptions for state and local government from Section 89 were rebuffed because there was not a recognition on Capitol Hill of the differences in the employee-employer situation between state and local government employers and private sector employers.

It may be that the reality is that the differences are narrowing, and to the extent that's true, then it may be more difficult. And maybe the people in Washington have some justification for their positions.

However, I still do believe that they are casting too wide a net, and there are opportunities, if they are marshaled carefully and properly utilized, to set yourself aside where you are different.

I do think that if every time a law is passed, you go and try and gain an exemption, then all you'll be doing is reinforcing their belief that you're no different from the doctors and realtors who are looking for exemptions, you know, under every rock.

But if you carefully utilize the opportunity to point out where you really are different when there is a reality, then I think there is some hope that you'll get special treatment. But again, I'm afraid that 415 probably isn't one of those areas.

As a matter of fact, I had one of my associates go back and check the legislative history of 415 to try and figure out whether Congress said anything about this rule, and whether it should apply to governmental plans. There was only one instance in the legislative history leading up to ERISA, which adopted the 415 limits. In 1973, there was a colloquy between Senator Bentsen and I forget who the other Senator was, and the issue -- they were talking about the 415 limits, and Senator Bentsen asked whether it was the intention that they should apply to governments. And the response was no, there was no reason why the President's pension, the Chief Justice of the Supreme Court,
and other governmental employees should not be subject to the same limits. And that's the only reference in the legislative history that we could find in the entire process leading up to all of ERISA that discussed this.

So, this was an area, to the extent it was discussed, where it was recognized there wasn't a difference.

CO-CHAIRMAN ELDER: Thank you for the bad news there. I thought I'd draw you out on it.

Mr. Treece, your closing comment about this whole matter.

MR. TREECE: Well, today's been a unique opportunity for me, representing labor in the legislative process in a forum such as this. I want to thank you, Mr. Chairman, and Senators Green and Russell, for inviting me to participate.

I would -- obviously will be back, talking about our proposal and our bill, and urging you all to pass what we believe will be beneficial to Los Angeles County Employees.

I would encourage all those that have picked up the written document that was distributed today to look beyond the cover memorandum, so that you're not inclined to be driven by what was meant to be generalities, and terms like "find its way" are very specific once you get past that memorandum and get into the legislation.

Also, I appreciate the opportunity to give labor's viewpoint about the importance of the collective bargaining process in looking at the legislation and the changes that need to be made.

I thank you again.

SENATOR RUSSELL: Mr. Chairman, on that last comment, may I ask?

CO-CHAIRMAN ELDER: Senator Russell.

SENATOR RUSSELL: I talked with Mr. Grossman about your plan, and he indicated to me that probably Los Angeles County, because of the uniqueness of their operation down there or whatever, that your plan would not be very readily replicated in other areas.

Is that, from your perspective, a reasonably accurate statement?

MR. TREECE: That's what I'm told by Mr. Grossman. Part of what we did before we came to the conclusion that -- and crafted our agreement with the County, was to have the plan actuary for the L.A. County Retirement Association also review
the plan, and run some actuarial numbers to see how it would turn out, and about what the defined contribution plan percentages would be.

And it was also their opinion, they concurred that, since they deal with at least other '37 Act counties' retirement plans, that the plan indeed probably would not be a straight across the board fix. There may be some '37 Act county plans that really are almost in compliance in terms of their salary levels, their benefit levels, may not exceed that. They may have to do something with the single highest year, as opposed to the three-year averaging, and some of those things. But in terms of the straight across benefit, they may not need to do anything.

It's also a difference in the contribution rates in Los Angeles County as opposed to other plans. Some counties, the employer pays not in a pickup proposition, but actually pays the employee's contribution. So, there are a lot of factors that may have to be looked at. And indeed, it probably isn't a straight across the board fix.

SENATOR RUSSELL: Thank you.

CO-CHAIRMAN GREEN: One of the things to finish that off with is, there's going to be some winners and losers, no question. But if we don't take an action, we'll all be losers.

CO-CHAIRMAN ELDER: Ms. Ahn.

MS. AHN: I'd just like to thank you for this opportunity to address all of you.

CO-CHAIRMAN ELDER: All right. With that, Senator Russell --

SENATOR RUSSELL: One final statement. I think we owe a great deal of credit to Mr. Dave Cox, who was the one who organized this symposium, and certainly to the two Chairmen, who accepted my suggestion and went to the leadership to employ Mr. Cox as a consultant. So, I think we owe Mr. Cox and the both Chairmen a great deal of credit for today and what will be happening.

CO-CHAIRMAN GREEN: To me, I think the thanks is to this panel, because a lot of you have taken your day at your expense, no pay by this State. You've traveled; you've done all the things to answer our questions here, and I give you a lot of accolades and my thanks as the Chairman of the Senate PERS Committee for being here today, giving us the answers we've got, and I'm sure we're going to go in a direction so we'll all try to end up at the end of this year with an answer and a fix, so we'll all be the winners rather than losers.
CO-CHAIRMAN ELDER: In conclusion, I would like to thank Beth Martinez of my staff, who's helped put this hearing together, and Tom Branan, also of my staff, for their work in coordinating with Mr. Cox.

I appreciate very much all of your time and effort in this. I hope that the transcript that is produced out of this hearing will, to some extent, lighten your future requirements at further hearings in other locations. We intend to make this available through the kind offices of PERS and STRS to the various contracting agencies, so that they can wade through these hearings and understand the complexities, or appreciate at least, the complexities of this issue, and to some extent, minimize what must be a regular routine of appearing in hearing after hearing after hearing all around the State of California, at least, and probably other places, although we can't really affect other places.

So with that, I would like to thank everyone for their attention and for your contribution today. Again, thanks.

(Thereupon this Joint Hearing of the Assembly and Senate Committees was adjourned at approximately 5:35 P.M.)

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APPENDIX

AB 50 (ELDER)
STATE TEACHERS' RETIREMENT SYSTEM

SB 200 (RUSSELL)
PUBLIC EMPLOYEES' RETIREMENT SYSTEM
LEGISLATORS' RETIREMENT SYSTEM
JUDGES' RETIREMENT SYSTEM

SB 869 (GREEN)
LOS ANGELES COUNTY

SB 875 (RUSSELL)
'37 ACT COUNTIES
BILL NUMBER: AB 50

BILL TEXT

AMENDED IN SENATE JULY 17, 1989
AMENDED IN ASSEMBLY JUNE 27, 1989
AMENDED IN ASSEMBLY JUNE 5, 1989
AMENDED IN ASSEMBLY FEBRUARY 9, 1989

INTRODUCED BY Assembly Member Elder

DECEMBER 6, 1988

An act to amend Section 22218.6 of , and to add Section 22514 to, the Education Code, and to amend Section 3543.2 of the Government Code, relating to the State Teachers' Retirement System , and making an appropriation therefor .

LEGISLATIVE COUNSEL'S DIGEST

AB 50, as amended, Elder. STRS: reports on the return on assets :
IRC 415 limitations :
(1) The existing State Teachers' Retirement Law requires the retirement system to submit annual reports to the Legislature, which include specified information regarding rates of return by asset type. This bill would require that report also to include the book valuation return on a 5-year, 3-year, 2-year, and 1-year basis.

(2) Existing federal income tax laws provide special benefit limitations for public retirement plans. Public retirement plans risk loss of their federal tax-exempt status unless they elect to be bound by specified benefit payment limitations. A public retirement plan may elect to exempt members who became plan participants prior to January 1, 1990, from these limitations if the plan also elects to be bound by these limitations for all members who join on or after that date.

The existing State Teachers' Retirement Law provides specified benefits upon retirement for members of the State Teachers' Retirement System (STRS). This bill would make that election for purposes of that law. This bill would provide that benefits payable to any person who becomes a member on or after January 1, 1990, shall be subject to the Section 415 limitations, as specified, and would require the Teachers' Retirement Board to provide to each employer a related notice for distribution to each person who, for the first time, becomes a member on or after January 1, 1990. This bill would also expand the scope of representation under the statutes governing public school employer-employee relations to include alternative compensation or benefits for employees adversely affected by those pension
BILL NUMBER: AB 50

BILL TEXT

limitations. This new expansion would impose state-reimbursable, state-mandated local negotiating costs since it would expand the subjects which are negotiable under the existing statutes relating to public school employer-employee relations. This bill would also make related legislative findings and declarations. This bill would also appropriate $100,000 from the Teachers' Retirement Fund to the Teachers' Retirement Board for expenditure for these purposes.

3 The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement, including the creation of a State Mandates Claims Fund to pay the costs of mandates which do not exceed $1,000,000 statewide and other procedures for claims whose statewide costs exceed $1,000,000.

This bill would provide that, if the Commission on State Mandates determines that this bill contains costs mandated by the state, reimbursement for those costs shall be made pursuant to those statutory procedures and, if the statewide cost does not exceed $1,000,000, shall be made from the State Mandates Claims Fund.


THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. The Legislature hereby finds and declares that it is the intent of the Legislature in enacting this act that members of the State Teachers' Retirement System not be adversely impacted by the application of Section 415 of the Internal Revenue Code. The State Teachers' Retirement System is encouraged to work closely with...
teacher organizations to develop a supplemental plan which maintains the future retirement benefits of its members while maintaining the fiscal integrity of the Teachers' Retirement Fund. The supplemental plan should not result in any additional liability to the employer.

The State Teachers' Retirement System is further encouraged to monitor the benefits of its members and notify affected individuals of their options, if deemed appropriate by the State Teachers' Retirement System.

SEC. 2. Section 22514 is added to the Education Code, to read:

22514. (a) Notwithstanding any other provision of this part, the benefits payable to any person who becomes a member on or after January 1, 1990, shall be subject to the limitations set forth in Section 415 of the Internal Revenue Code without regard to Section 415(b)(2)(F) of the Internal Revenue Code.

(b) Notwithstanding any other law, the benefits payable to any person who became a member prior to January 1, 1990, shall not be less than the accrued benefit of the member under this system (determined without regard to any amendment to the system made after October 14, 1987) as provided in Section 415(b)(10) of the Internal Revenue Code.

(c) For purposes of the limitation set forth in subdivision (b), the term 'amendment' is deemed to mean the payment limitations set forth in Section 415 of the Internal Revenue Code. For purposes of any payment limitations made pursuant to Section 415 of the Internal Revenue Code, this system is deemed the 'primary plan.'

(d) The board shall provide to each employer a notice of the content and effect of subdivision (a) for distribution to each person who, for the first time, becomes a member on or after January 1, 1990.

SEC. 3. Section 22218.6 of the Education Code is amended to read:

22218.6. The board shall submit an annual report to the legislature, which report shall include:

(a) A copy of the annual audit performed pursuant to Section 22220.

(b) A review by a consultant, a summary of any changes in actuarial assumptions from the previous year, a review of the system's asset mix strategy, a market review of the economic and financial environment in which investments were made, and a summary of the system's general investment strategy.

(c) A description of the investments of the system, including the concentration of stocks and bonds, at cost and market value, including dividends and coupons, and a summary of major changes that occurred since the previous year.

(d) The following information regarding the rate of return of the system by asset type:

(1) Time-weighted return on a five-year, three-year, two-year, and
one-year basis.
(2) Dollar-weighted return on a five-year, three-year, two-year, and one-year basis.
(3) Book valuation return on a five-year, three-year, two-year, and one-year basis.
(4) Portfolio return comparisons which compare investment returns with an alternative theoretical portfolio of comparable funds, universes, and indexes.
(5) Returns as credited to employer accounts.
(6) Returns as reported in annual reports.
(7) Returns as reported by the Controller.
(e) A transaction summary which shall adequately review the system's custodial relationship and daily cash management, purchases, sales, turnover, private placements, soft dollar purchases, and transaction costs such as commissions, dealer spreads and accommodations.

(f) The system shall report on the use of outside investment advisers and managers and any participation in corporate annual meetings and shareholder voting.
(g) A statement of actuarial gains and losses, including the components of the employer contribution rate, and the sensitivity of the statement information to changes in the economic or noneconomic actuarial assumptions.
(h) A discussion of the system portfolio of the system containing the following information:
(1) Concentration, current holdings at cost and market value, risk characteristics (R-squared, Beta, standard error), fundamentals (P/E, dividend yield, measures of growth, size, earnings quality, debt/equity) of equities.
(2) Concentration, current holdings at cost and market value, maturity, duration, quality, coupon, and current yield of fixed income instruments.
(3) Current holdings at cost and market value of real estate equities.
(4) Current holdings at cost and market value of mortgages.
(5) Securities lending activity.
(6) Options and forward commitments.

(7) Cash and cash equivalents.
(i) Include a performance review of asset allocation, of equities due to market timing, sector selection, stock selection and trading, of fixed income instruments due to interest rate anticipation skills, credit analysis, sector trading and swapping and of value added over indexing (alpha).
(j) A review of the system's custodial relationship and daily cash management and a summary of the system's investment transactions, including purchases, sales, turnover, private placements, soft dollar purchases, and transaction costs such as commissions, dealer spreads and accommodations.
(k) A review of the role of any outside managers and advisers, stockholder voting, and changes in investment staff or reorganization.

SEC. 4. Section 3543.2 of the Government Code is amended to read:

3543.2. (a) The scope of representation shall be limited to matters relating to wages, hours of employment, and other terms and conditions of employment. ’Terms and conditions of employment’ mean health and welfare
benefits as defined by Section 53200, leave, transfer and reassignment policies, safety conditions of employment, class size, procedures to be used for the evaluation of employees, organizational security pursuant to Section 3546, procedures for processing grievances pursuant to Sections 3548.5, 3548.6, 3548.7, and 3548.8, and the layoff of probationary certificated school district employees, pursuant to Section 44959.5 of the Education Code, and alternative compensation or benefits for employees adversely affected by pension limitations pursuant to Section 22514 of the Education Code. In addition, the exclusive representative of certificated personnel has the right to consult on the definition of educational objectives, the determination of the content of courses and curriculum, and the selection of textbooks to the extent such matters are within the discretion of the public school employer under the law. All matters not specifically enumerated are reserved to the public school employer and may not be a subject of meeting and negotiating, provided that nothing herein may be construed to limit the right of the public school employer to consult with any employees or employee organization on any matter outside the scope of representation.

(b) Notwithstanding Section 44944 of the Education Code, the public school employer and the exclusive representative shall, upon request of either party, meet and negotiate regarding causes and procedures for disciplinary action, other than dismissal, including a suspension of pay for up to 15 days, affecting certificated employees. If the public school employer and the exclusive representative do not reach mutual agreement, then the provisions of Section 44944 of the Education Code shall apply.

(c) Notwithstanding Section 44955 of the Education Code, the public school employer and the exclusive representative shall, upon request of either party, meet and negotiate regarding procedures and criteria for the layoff of certificated employees for lack of funds. If the public school employer and the exclusive representative do not reach mutual agreement, then the provisions of Section 44955 of the Education Code shall apply.

(d) Notwithstanding Section 45028 of the Education Code, the public school employer and the exclusive representative shall, upon the request of either party, meet and negotiate regarding the payment of additional compensation based upon criteria other than years of training and years of experience. If the public school employer and the exclusive representative do not reach mutual agreement, then the provisions of Section 45028 of the Education Code shall apply.

SEC. 5. There is hereby appropriated from the Teachers' Retirement Fund to the Teachers' Retirement Board the sum of one hundred thousand dollars ($100,000) for expenditure to carry out the purposes of Sections 1 and 2 of this act.

SEC. 6. Notwithstanding Section 17510 of the Government Code, if the Commission on State Mandates determines that this act contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made pursuant to Part 7
(commencing with Section 17500) of Division 4 of Title 2 of the Government Code. If the statewide cost of the claim for reimbursement does not exceed one million dollars ($1,000,000), reimbursement shall be made from the State Mandates Claims Fund. Notwithstanding Section 17580 of the Government Code, unless otherwise specified in this act, the provisions of this act shall become operative on the same date that the act takes effect pursuant to the California Constitution.
An act to add Sections 9361.13, 21200.6, and 75076.6 9359.01, 21200.01, and 75075.01 to , and to add and repeal Section 20123.5 of, the Government Code, relating to public retirement systems, making an appropriation therefor, and declaring the urgency thereof, to take effect immediately.

LEGISLATIVE COUNSEL'S DIGEST


Existing federal income tax laws provide special benefit limitations for public retirement plans. Public retirement plans risk loss of their federal tax-exempt status unless they elect to be bound by specified benefit payment limitations. A public retirement plan may elect to exempt members who became plan participants prior to January 1, 1990, from these limitations if the plan also elects to be bound by these limitations for all members who join on or after that date.

The existing Legislators' Retirement Law, Public Employees' Retirement Law, and Judges' Retirement Law, provide specified benefits upon retirement for their members. This

(1) This bill would make those elections for purposes of these laws the Legislators' Retirement Law and the Judges' Retirement Law .

(2) This bill would require the Board of Administration of PERS, in cooperation with various public entities, to conduct a study of the impact of Section 415 of the Internal Revenue Code upon benefits, as specified, and to make related recommendations to the Legislature by March 1, 1990. This requirement would be repealed as of January 1, 1991.

This Bill would provide that retirement rights conferred by the Public Employees' Retirement Law upon any person who for the first time becomes a member on or after January 1, 1990, are not vested to the extent that those rights are affected by changes in the Internal Revenue Code, as specified, including Section 415 limitations and cost-of-living adjustments. This bill would require the system to provide to each employer a related notice for
distribution to each person who for the first time becomes a member on or after January 1, 1990. This bill would make related legislative findings and declarations.

This bill would also appropriate $100,000 from the Public Employees' Retirement Fund to the Board of Administration for expenditure for these purposes.

(3) This bill would declare that it is to take effect immediately as an urgency statute.


THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 9359.01 is added to the Government Code, to read:

(a) Notwithstanding any other provision of this part, the benefits payable to any person who becomes a member on or after January 1, 1990, shall be subject to the limitations set forth in Section 415 of the Internal Revenue Code.

(b) Notwithstanding any other law, the benefits payable to any person who became a member prior to January 1, 1990, shall be subject to the greater of the following limitations as provided in Section 415(b)(10) of the Internal Revenue Code:

(1) The limitations set forth in Section 415 of the Internal Revenue Code.

(2) The accrued benefit of a member under this system (determined without regard to any amendment to the system made after October 14, 1987).

(c) For purposes of the limitation set forth in paragraph (2) of subdivision (b), the term 'amendment' is deemed to mean the payment limitations set forth in Section 415 of the Internal Revenue Code. For purposes of any payment limitations made pursuant to Section 415 of the Internal Revenue Code, this system is deemed the 'primary plan.'
the benefits payable to any person who becomes a member on or after January 1, 1990, shall be subject to the limitations set forth in Section 415 of the Internal Revenue Code.

(b) Notwithstanding any other law, the benefits payable to any person who became a member prior to January 1, 1990, shall be subject to the greater of the following limitations as provided in Section 415(b)(10) of the Internal Revenue Code:

(1) The limitations set forth in Section 415 of the Internal Revenue Code.

(2) The accrued benefit of a member under this system (determined without regard to any amendment to the system made after October 14, 1987).

(c) For purposes of this section, a person is deemed to become a member of this system on the date of hire by an employer which is a member of this system. For purposes of the limitation set forth in paragraph (2) of subdivision (b) the term "amendment" is deemed to mean the payment limitations set forth in Section 415 of the Internal Revenue Code. For purposes of any payment limitations made pursuant to Section 415 of the Internal Revenue Code, this system is deemed the "primary plan".

SEC. 3. Section 75076.6 is added to the Government Code, to read:

20123.5. (a) It is the intent of the Legislature, in enacting this section, to ensure that each member of the Public Employees' Retirement System be provided retirement benefit commensurate, to the extent possible, with the services rendered without violating the intent and purposes of Section 415 of the Internal Revenue Code. However, time restraints prohibit a thorough analysis, by the end of the 1989 Legislative year, of the retirement benefits which would be affected by the private sector limits contained in Section 415 of the Internal Revenue Code.

(b) The board shall, in cooperation with the Legislative Analyst, the Department of Personnel Administration, the public agencies which contract with the Public Employees' Retirement System, the counties which participate under the County Employees Retirement Law of 1937, and affected employee organizations, conduct a study to review the benefits under the Public Employees' Retirement Law and shall report to the Legislature by March 1, 1990, as to the impact that Section 415 of the Internal Revenue Code will have on the future membership of the system and also to recommend to the Legislature any changes in the benefits, including cost-of-living adjustments, that may be necessary to ensure that all future members receive benefits, that, in total, will be as close as possible to the actuarial value of the benefits that the member would have been entitled to had the federal limits not been in place. However, in
no instance, shall the recommended benefits exceed the private sector limitations set forth in Section 415 of the Internal Revenue Code.

(c) It is the intent of the Legislature, in authorizing this study, that to the extent possible, the cost to the employer for any recommended alternative benefit plans shall be equivalent to the cost of the benefits in effect prior to January 1, 1990.

(d) This section shall remain in effect only until January 1, 1991, and as of that date is repealed, unless a later enacted statute, which is chaptered before January 1, 1991, deletes or extends that date.

SEC. 3. Section 21200.01 is added to the Government Code, to read:

21200.01. (a) Notwithstanding any other provision of law, the retirement rights conferred by this part upon any person who for the first time becomes a member on or after January 1, 1990, shall not be vested to the extent that those rights are affected by changes in the Internal Revenue Code relating to limitations upon public retirement systems, including, but not limited to, private sector limits contained in Section 415 of the Internal Revenue Code and including all cost-of-living adjustments. The limitation imposed by Section 415 shall be adjusted pursuant to Section 415(d)(1)(A) and (B).

(b) The board shall provide to each employer a notice of the content and effect of subdivision (a) for distribution to each person who for the first time becomes a member on or after January 1, 1990.

(c) It is the intent of the Legislature to enact legislation during the plan-year of the Public Employees' Retirement System beginning after January 1, 1990, that would exempt all members of the Public Employees' Retirement System who joined the system prior to January 1, 1990, from the Section 415 limits as permitted by the 'grandfather' provision contained in the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). This subdivision shall become inoperative on January 1, 1992.

SEC. 4. Section 75075.01 is added to the Government Code, to read:

75075.01. (a) Notwithstanding any other provision of this part, the benefits payable to any person who becomes a member on or after January 1, 1990, shall be subject to the limitations set forth in Section 415 of the Internal Revenue Code.

(b) Notwithstanding any other law, the benefits payable to any person who became a member prior to January 1, 1990, shall be subject to the greater of the following limitations as provided in Section 415(b)(10) of the Internal Revenue Code:

(1) The limitations set forth in Section 415 of the Internal Revenue Code
(2) The accrued benefit of a member under this system (determined without regard to any amendment to the system made after October 14, 1987).

(c) For purposes of the limitation set forth in paragraph (2) of subdivision (b), the term 'amendment' is deemed to mean the payment limitations set forth in Section 415 of the Internal Revenue Code. For purposes of any payment limitations made pursuant to Section 415 of the Internal Revenue Code, this system is deemed the 'primary plan.'

SEC. 5. There is hereby appropriated from the Public Employees' Retirement Fund to the Board of Administration of the Public Employees' Retirement System the sum of one hundred thousand dollars ($100,000) for expenditure to carry out the purposes of Sections 2 and 3 of this act.

SEC. 6. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:

In order that elections for the legislators' Retirement System, the Public Employees' Retirement System, and the Judges' Retirement System to be bound by certain federal income tax limitations for public retirement systems may be made in a timely manner, it is necessary

In order that the research necessary to determine the nature and extent of the effects upon the benefits payable by the Public Employees' Retirement System may be commenced at the earliest possible time, it is necessary that this act take effect immediately.
An act to amend Section 31580.2 of, and to add Article 2.1 (commencing with Section 31510) to Chapter 3 of Part 3 of Division 4 of Title 3 of, the Government Code, relating to the County Employees Retirement Law of 1937.
Bill Number: SB 869

Bill Text

Extra money made available thereby is needed for compliance with Section 415 of the Internal Revenue Code.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement, including the creation of a State Mandates Claims Fund to pay the costs of mandates which do not exceed $1,000,000 statewide and other procedures for claims whose statewide costs exceed $1,000,000.

This bill would provide that, if the Commission on State Mandates determines that this bill contains costs mandated by the state, reimbursement for those costs shall be made pursuant to those statutory procedures and, if the statewide cost does not exceed $1,000,000, shall be made from the State Mandates Claims Fund.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.


The People of the State of California Do Enact as Follows:

Section 1. Article 2.1 (commencing with Section 31510) is added to Chapter 3 of Part 3 of Division 4 of Title 3 of the Government Code, to read:

Article 2.1. Additional Plan for Counties of the First Class
31510. (a) This article shall be applicable to all members of the retirement system of any county of the first class, as defined by Section 28020, as amended by Chapter 1204 of the Statutes of 1971, and Section 28022, as amended by Chapter 43 of the Statutes of 1961.

(b) The purpose of this article is to provide a defined contribution plan which, in conjunction with retirement benefit provisions otherwise contained in this chapter, will provide approximately the same level of retirement benefits to persons who become members on or after January 1, 1990, and are subject to the limitations set forth in Section 415 of the Internal Revenue Code of 1986, as they would receive under the other retirement benefit provisions in the absence of those limitations, while not affecting the rate of either member or employer contributions to the retirement system. In addition, it is intended that subdivisions (c) and (d) constitute an election under Section 415(b)(10)(C) of the Internal Revenue Code of 1986 with respect to all retirement plans within the retirement system.

(c) Notwithstanding any other provision of this part, the benefits payable to any person who becomes a member on or after January 1, 1990, shall be subject to the limitations set forth in Section 415 of the Internal Revenue Code of 1986, as adjusted pursuant to Section 415(d)(1)(A) and (B).

(d) Notwithstanding any other law, the benefits payable to any person who became a member prior to January 1, 1990, shall not be subject to the limitations set forth in Section 415(b) of the Internal Revenue Code of 1986, except to the extent required by subsection (b)(10)(A) of Section 415.

(f) The retirement benefits of all persons who become members on or after January 1, 1990, in Safety Plan B or General Plan D shall be governed by this chapter applicable to those plans and by this article.

(g) In the event of a conflict, this article shall supersede and prevail over other provisions or application of provisions otherwise contained in this chapter.

31510.1. Unless the context otherwise requires, the definitions contained in this section govern the construction of this article.

(a) 'Board' means the board of retirement.
(b) 'Employer' means the county, district, or agency whose employees are members of the retirement system of the county.
(c) 'General Plan F' means the defined contribution plan established in accordance with this article for the benefit of certain members of General Plan D.
(d) 'Plan F' means General Plan F and Safety Plan F, collectively.
(e) 'Prior plan' means Safety Plan B or General Plan D, as the context requires.

(f) 'Safety Plan F' means the defined contribution plan established in accordance with this article for the benefit of certain members in Safety Plan B.
31510.2. (a) The board of supervisors of any county subject to this article shall establish two defined contribution retirement plans authorized by Section 401 of the Internal Revenue Code of 1986. The terms of the plans shall be mutually agreed to by the employer and employee representatives. The plans shall be known as General Plan F and Safety Plan F.

(b) Any general member described in subdivision (f) of Section 31510 shall participate in General Plan F, and any safety member described in subdivision (f) of Section 31510 shall participate in Safety Plan F, after commencement of his or her participation in the prior plan.

(c) The board, upon the advice of the actuary, shall determine the portion of the member contributions otherwise required under the prior plan that shall be credited to plan F in lieu of being credited to the other plan. In doing so, the board shall provide for the level of contributions to plan F that is the minimum amount sufficient to satisfy the purposes set forth in subdivision (b) of Section 31510.

(d) The right of the member to benefits derived from member contributions vests upon the commencement of participation in plan F.

(e) In the event that a member or beneficiary becomes entitled to receive a benefit in the form of an annuity under the terms of the prior plan, the member’s account in plan F shall be converted to the same form of annuity as is payable to the member or beneficiary from the prior plan. The amount of the annuity payable under the prior plan, calculated prior to the application of this article (including the limitations set forth in Section 415 of the Internal Revenue Code of 1986), shall be reduced by the amount of the annuity generated under plan F as described in the preceding sentence. The amount payable from plan F shall be paid at the same time and in the same manner as the annuity payable from the prior plan or may be provided through an annuity contract purchased from an insurance company, at the discretion of the board. Notwithstanding the foregoing, if the member’s account in plan F does not exceed three thousand five hundred dollars ($3,500), it shall be paid to the member or beneficiary as a lump-sum payment, in lieu of the benefit otherwise payable under plan F.

(f) If a member or beneficiary becomes entitled to receive the member’s accumulated contributions and interest from the prior plan, the member or beneficiary shall receive the member’s account balance from plan F at that time and in the same manner.

(g) In applying the limitations set forth in Section 415 of the Internal Revenue Code of 1986, benefits or annual additions in qualified retirement plans maintained by an employer separate from the retirement system shall be reduced first. Any additional reduction shall be made to the benefits from plans within the retirement system other than plan F, and then lastly to the annual addition to plan F.

(h) Plan F shall be administered in accordance with subsection (a) of Section 410 of the Internal Revenue Code of 1986 and the Treasury Regulations issued thereunder. The plan shall state that it is intended to be a profit-sharing plan wherein contributions are determined without regard to current or accumulated profits.
31510.3. It is intended that the excess of benefits payable from the retirement system upon disability over the benefits that would be payable in the event of the member's normal termination of employment at such time not be subject to the limitations set forth in Section 415 of the Internal Revenue Code of 1986. If the Internal Revenue Service rules that the excess is subject to those limitations, an employer which is subject to this article shall provide a disability benefit equal to the portion of the benefit in excess of those limitations, through a long-term disability plan which shall be separate from the retirement system. The terms of that long-term disability plan shall be mutually agreed to by the employer and employee representatives and adopted by majority resolution of the board of supervisors.

31510.4. It is intended that the maintenance of plan F not affect the rate of either member or employer contributions to the retirement system. The board may set a rate of regular interest credited with respect to contributions to the prior plan made by members participating in plan F that is different than the rate of regular interest credited with respect to other contributions, if necessary to effectuate that intent.

SEC. 2. Section 31580.2 of the Government Code is amended to read:
31580.2. In counties where the board of retirement and board of investment have appointed personnel pursuant to Section 31522.1, the respective boards shall annually adopt a budget covering the entire expense of administration of the retirement system which expense shall be charged against the earnings of the retirement fund. The expense incurred in any year shall not exceed eighteen-hundredths of 1 percent of the total assets of the retirement system. However, in any county of the first class as, as defined by Section 28020, as amended by Chapter 1204 of the Statutes of 1971, and Section 28022, as amended by Chapter 43 of the Statutes of 1961, until January 1, 1992, the expense incurred in that county in any intervening year shall not exceed eighteen-hundredths of 1 percent of the total assets of the retirement system provided, that any expense incurred in that county in any such intervening year which exceeds fifteen-hundredths of 1 percent shall be restricted to capital improvements and related services necessary to modernize and improve the system administration and, on and after January 1, 1992, the expense incurred in any county of the first class, as defined by Section 28020, as amended by Chapter 1204 of the Statutes of 1971, and Section 28022, as amended by Chapter 43 of the Statutes of 1961, in any year shall not exceed fifteen-hundredths of 1 percent of the total assets of the retirement system.

The extra money made available by the amendments made to this section, in the 1989 portion of the 1989-90 Regular Session of the Legislature is needed for compliance with Section 415 of the Internal Revenue Code.

SEC. 3. Notwithstanding Section 17500 of the Government Code, if the Commission on State Mandates determines that this act contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made pursuant to Part 7 (commencing with Section 17501) of Division 4 of Title 2 of the
Government Code. If the statewide cost of the claim for reimbursement does not exceed one million dollars ($1,000,000), reimbursement shall be made from the State Mandates Claims Fund. Notwithstanding Section 17580 of the Government Code unless otherwise specified in this act, the provisions of this act shall become operative on the same date that the act takes effect pursuant to the California Constitution.

SEC. 3. No reimbursement is required by this act pursuant to Section 6 of Article XIIIIB of the California Constitution because this act is in accordance with the request of a local agency or school district which desires legislative authority to carry out the program specified in this act. Notwithstanding Section 17580 of the Government Code, unless otherwise specified in this act, the provisions of this act shall become operative on the same date that the act takes effect pursuant to the California Constitution.
An act to add Section 31673.5 to, and to add and repeal Section 31537 of, the Government Code, relating to public retirement systems, and declaring the urgency thereof, to take effect immediately.

LEGISLATIVE COUNSEL'S DIGEST


Existing federal income tax laws provide special benefit limitations for public retirement plans. Public retirement plans risk loss of their federal tax-exempt status unless they elect to be bound by specified benefit payment limitations. A public retirement plan may elect to exempt members who became plan participants prior to January 1, 1990, from these limitations if the plan also elects to be bound by these limitations for all members who join on or after that date.

The existing County Employees Retirement Law of 1937 provides specified benefits upon retirement for members. This bill would make those elections for new members on or after January 1, 1990, for purposes of that law, except as provided.

This bill would request each county retirement board to assist PERS in the conduct of a specified study, would encourage those boards to ascertain, as specified, the impact of Section 415 of the Internal Revenue Code upon retirement benefits, as specified, and to make related identifications for the Legislature. These provisions would be repealed as of January 1, 1991.

This bill would provide that the retirement rights conferred by the County Employees Retirement Law of 1937 upon any person who for the first time becomes a member on or after January 1, 1990, are not vested to the extent that those rights are affected by changes in the Internal Revenue Code, as specified, including Section 415 private sector limitations. This bill would require each retirement board to provide to each employer a related notice for distribution to each person who for the first time becomes a member on or after January 1, 1990. This requirement would impose
upon the affected counties state-reimbursable state-mandated local
program costs.

The bill would make related legislative findings and declarations.
This bill would not apply to Los Angeles County.

The California Constitution requires the state to reimburse local
agencies and school districts for certain costs mandated by the
state. Statutory provisions establish procedures for making that
reimbursement, including the creation of a State Mandates Claims
Fund to pay the costs of mandates which do not exceed $1,000,000
statewide and other procedures for claims whose statewide costs
exceed $1,000,000.

This bill would provide that, if the Commission on State
Mandates determines that this bill contains costs mandated by the
state, reimbursement for those costs shall be made pursuant to
those statutory procedures and, if the statewide cost does not
exceed $1,000,000, shall be made from the State Mandates Claims
Fund.

This bill would declare that it is to take effect immediately as an urgency
statute.

State-mandated local program: no yes .

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 31673.5 is added to the Government Code, to
read:

31673.5. (a) Notwithstanding any other provision of this chapter, the retirement allowance payable to any person who becomes a member
on or after January 1, 1990, shall in no event exceed the
limitation imposed by Section 415 of the Internal Revenue Code of
1986, which is hereby incorporated by reference. That limitation
shall be adjusted in accordance with Section 415(d)(1)(A) and (B)
of that code.

(b) This section shall not apply in a county of the first
class as defined by Section 28020, as amended by Chapter 1294 of
the Statutes of 1971, and Section 28022, as amended by Chapter 43
of the Statutes of 1961.

SEC. 2.

SECTION 1. Section 31537 is added to the Government Code, to
read:

31537. (a) It is the intent of the Legislature, in enacting
this act, to ensure that each member of a county retirement system
affected by the private sector limits contained in Section 415 of
the Internal Revenue Code be provided a retirement benefit
commensurate, to the extent possible, with the services rendered
without violating the intent and purposes of Section 415 of the
Internal Revenue Code. However, time restraints prohibit a thorough
analysis, by the end of the 1989 legislative year, of the
retirement benefits which would be affected by the private sector
limits contained in Section 415 of the Internal Revenue Code.

(b) Each board is requested to assist the Public Employees’
Retirement System in its report to the Legislature, as required by
Section 20123.5. Each board is encouraged to ascertain, to the
extent possible and in conjunction with its actuarial evaluation
which is required by Section 31453 or any annual evaluation
conducted pursuant to board policy, the impact that Section 415 of
the Internal Revenue Code will have on the future membership of
each county retirement system, and also to identify for the
Legislature any changes in the benefits, including cost-of-living
adjustments, that may be necessary to ensure that all future
members receive benefits that, in total, will be as close as
possible to the actuarial value of the benefits that the member
would have been entitled to had the federal limits not been in
place. However, in no instance, shall the recommended benefits
exceed the private sector limitations set forth in Section 415 of
the Internal Revenue Code.

(c) It is the intent of the Legislature in authorizing these
studies, that to the extent possible, the cost to the employer for
any recommended alternative benefit plans shall be equivalent to the
cost of the benefits in effect prior to January 1, 1990.

(d) This section shall not apply in a county of the first
class as defined by Section 28020, as amended by Chapter 1204 of
the Statutes of 1971, and Section 28022, as amended by Chapter 43
of the Statutes of 1981.

(e) This section shall remain in effect only until January 1,
1991, and as of that date is repealed, unless a later enacted
statute, which is chaptered before January 1, 1991, deletes or
extends that date.

SEC. 2. Section 31673.1 is added to the Government Code, to
read:

31673.1. (a) Notwithstanding any other provision of law, the
retirement rights conferred by this part upon any person who for
the first time becomes a member on or after January 1, 1990,
shall not be vested, to the extent that those rights are affected
by changes in the Internal Revenue Code relating to limitations
upon public retirement systems, including, but not limited to,
private sector limits contained in Section 415 of the Internal
Revenue Code. The limitation imposed by Section 415 shall be
adjusted pursuant to Section 415(d)(1)(A) and (B).

(b) Each retirement board shall provide to each employer a
notice of the content and effect of subdivision (a) for
distribution to each person who for the first time becomes a member on or after January 1, 1990.

(c) It is the intent of the Legislature to enact legislation during 1990, that would exempt all members of a county retirement system who joined the system prior to January 1, 1990, from the Section 415 limits as permitted by the "grandfather" provision contained in the Technical and Miscellaneous Revenue Act of 1988. This subdivision shall become inoperative on January 1, 1992.

(d) This section shall not apply in a county of the first class as defined by Section 28020, as amended by Chapter 1204 of the Statutes of 1971, and Section 28022, as amended by Chapter 43 of the Statutes of 1961.

SEC. 3. Notwithstanding Section 17610 of the Government Code, if the Commission on State Mandates determines that this act contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made pursuant to Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code. If the statewide cost of the claim for reimbursement does not exceed one million dollars ($1,000,000), reimbursement shall be made from the State Mandates Claims Fund. Notwithstanding Section 17580 of the Government Code, unless otherwise specified in this act, the provisions of this act shall become operative on the same date that the act takes effect pursuant to the California Constitution.

SEC. 4. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:

In order for that the research necessary to determine the nature and extent of the effects of changes in provisions of the Internal Revenue Code relating to limitations upon public retirement systems, upon benefits payable by county retirement systems under the County Employees Retirement Law of 1937 to avoid, in a timely manner, risking loss of their federal tax-exempt status, as soon as possible may be commenced at the earliest possible time, it is necessary that this act take effect immediately.