



Select Committee on Pension Policy

Excess Compensation

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What Is The Issue?

- Employers are billed for the additional pension costs of excess compensation
 - Designed to mitigate impacts on retirement systems
- Some policy makers may question if current provisions are sufficient
- May seek increased employer billings



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Committee Activity

- Excess compensation discussed as part of pension spiking briefing
 - May SCPP meeting
- Committee was briefed on a recent bill addressing excess compensation
 - Introduced last session, but didn't pass
- Executive committee directed staff to
 - Prepare a more detailed briefing on excess compensation
 - Include the bill



Today's Briefing

- Background on excess compensation
- Impact on pension systems
- Policy and cost implications
- HB 2441



Some Payments Defined As Excess Compensation

- Annual leave cash outs above 240 hours
- Cash outs of any other form of leave
- Payments for personal expenses
- Portion of any payment, including overtime or bonuses, exceeding twice the regular rate of pay
- Termination or severance payments
- Only applies to payments included in AFC



Employers Are Generally Billed For Excess Compensation

- Charged present value of the lifetime increase in pension
- Calculated by DRS at retirement
- Three-step process
 - Determine amount of excess compensation
 - Calculate increase in monthly benefit
 - Calculate present value of increase using actuarial factors



Provisions Designed To Mitigate Pension Impact

- Billing employers offsets some of the costs of overtime, bonuses, cash outs, and lump sums
- Don't offset all costs
- Don't prohibit pay practices or limit benefit calculations
- May provide a disincentive for certain pay practices



Provisions Require Public Disclosure By Employers

- Before entering into labor contracts containing excess compensation
- Employers must disclose at a public meeting
 - Nature of compensation
 - Estimate of billings



Excess Compensation Can Create Unexpected Costs

- Regular contributions are collected based on many assumptions
 - Including future salary increases
- Excess compensation has potential to increase salaries beyond what was assumed for funding
- Benefits based on higher-than-expected salaries create additional cost to the system
- Extra cost is not funded at retirement
 - Passed on to other employers and members



Impact Of Overtime And Bonuses Is Not Known

- Data doesn't break out earnings at the necessary level of detail
 - New employer reporting system is planned
- Staff analysis and employer billings data suggest that large increases may be relatively infrequent
 - Most increases within salary growth expectations
 - Eleven billings for overtime/bonuses in last three years
- Overtime and bonuses that remain a stable percentage of compensation don't create unexpected costs



Other States

- WSIPP is gathering data on excess compensation in other states
- Part of a statutorily mandated pension study
- Will report to SCPP in December



Policy Preview

- Key policy question
 - Is the current definition of excess compensation sufficient, or should it be expanded?
- Key policy considerations
 - Intergenerational equity
 - Contractual rights
 - HR policy
 - Cost implications



Excess Compensation Can Impact Intergeneration Equity

- Intergenerational Equity (IE) says costs shouldn't be passed to future generations
 - Adopted as an SCPP goal
 - Goal 5e
- Excess compensation can create unfunded costs at retirement
 - Costs are passed to other plan participants and future taxpayers
 - Runs counter to IE



Contractual Rights May Limit Policy Makers' Flexibility

- Current members likely have contractual rights to use excess compensation in benefit calculations
- Courts generally held members have a contractual right to the benefit formula
 - AFC is part of the benefit formula
 - Includes overtime, bonuses, cash outs, and other types of excess compensation
- Changing AFC for new hires doesn't impact contractual rights
- Billing employers doesn't impact members' contractual rights



Increasing Billings May Negatively Impact HR Policies

- Pay practices linked to excess compensation may serve HR needs
 - Overtime can manage labor shortages
 - Bonuses can help with recruitment and retention
 - Standard in certain industries
- Billing employers can create a disincentive
 - May limit flexibility in providing compensation
 - May impact ability to recruit, retain, and manage the workforce
- SCPP adopted a goal on balanced long-term management of the pension systems
 - Create stability, competitiveness, and adaptability, with responsiveness to HR policies for recruitment and retention
 - Goal 2



Increasing Billings May Impact Cost Sharing And Plan Costs

- Increasing excess compensation billings will likely result in a savings to the retirement systems
 - Cost sharing shift
 - Reduction in liabilities
- If employers don't change pay practices
 - Additional contributions will offset more of the costs
 - Effectively shifts more costs to employers paying excess compensation
- If employers change pay practices to avoid billings
 - Could reduce the amount of excess compensation paid
 - Could decrease AFC and lower plan's liability



Bill Addressing Excess Compensation Was Introduced Last Session

- HB 2441 would have expanded definition of excess compensation
- New definition would include increases in AFC exceeding 50 percent of "regular" earnings
- Targets overtime, bonuses, cash outs, and lump sums
- Passed the House, and the Senate Ways and Means committee
- Did not pass the Legislature
- Bill draft and fiscal note included in materials



Policy And Cost Implications Of HB 2441

- Will likely generate more employer billings
 - Flag additional compensation as excess compensation
 - May take time for employers to change pay practices
- Will likely apply to a relatively small percentage of calculations
 - Staff analysis suggests AFC increases exceeding 50 percent occur infrequently
 - Large increase may be perceived as abuse and can garner media attention.
- Could impact employers' ability to recruit, retain, and manage workforce
- Will likely result in a savings



Conclusion

- Excess compensation can create unexpected costs for pension system
 - Extreme cases may be perceived as abuse
- Provisions are designed to mitigate impacts
 - Some policy makers may question if sufficient
- Policy makers will likely consider implications for
 - Intergenerational equity
 - Contractual rights
 - HR policies
- Policy makers may weigh benefits to the retirement system against potential impacts on employers



Possible Next Steps

- Take no further action at this time
- Additional study
- Recommend HB 2441 to the 2013 Legislature
 - Requires updated bill draft
- Direct staff to explore other options
- Executive Committee will discuss today

