California State Social Security Administrator Program (SSSAP)

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EFFECT OF SOCIAL SECURITY COVERAGE ON CALPERS BENEFITS

Most members[1] of CalPERS contribute to Social Security/OASDI[2]; these contributions are collected via payroll taxes under the authority of the Federal Insurance Contributions Act (FICA). Questions often arise about the effect on CalPERS benefits of Social Security coverage. The purpose of this Bulletin is to clarify these matters.

There are three major areas of impact that will be covered in this Bulletin: (1) the offset/reduction in a member's contributions to CalPERS; (2) the $133.33 reduction to a member's "final compensation," and thus to her/his CalPERS retirement benefits; and (3) the prohibition against being covered by the 1959 Survivor Benefit, and the impact on the Post-Retirement Survivor Allowance (PRSA). An "Additional Historical Background" Appendix is also included, for those who want to know in more depth the historical and statutory basis for these areas of impact.

1. OFFSET/REDUCTION OF CalPERS CONTRIBUTIONS

Most CalPERS members and employers are well aware that, for members subject to Social Security coverage, a member's monthly earnings are typically reduced by $133.33[3] before contributions to CalPERS are computed. They may also be aware that this reduction is specified in the California Government Code (G.C.), such as sections 20677, 20677.4, 21354, 21354.1, 21354.3, 21354.4, 21354.5 .

However, they may not understand the basis for this offset/reduction, and in some cases may mistakenly believe this has something to do with the federal Social Security Administration (SSA), and its laws and regulations. Although this offset/reduction is applied only to members that have Social Security coverage in addition to their CalPERS coverage[4], this reduction results from state law, not federal law[5].

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[1] The largest groups of CalPERS members who do not contribute to Social Security are (1) certificated school employees [e.g., teachers, credentialed administrators] who are members of CalSTRS; and (2) most "public safety" employees [e.g., police officers, firefighters, correctional officers, etc.].

[2] OASDI: Old-Age, Survivors, and Disability Insurance; the formal name for Social Security.

[3] Or by the bi-weekly equivalent ($61.54), or the quad-weekly or semi-monthly equivalents.

[4] Unless a "public agency" employer has chosen to make its employees subject to the "Supplemental" retirement formula (20515), under which, for CalPERS purposes, the employees' earnings and final compensation are not "modified," because of Social Security coverage.

[5] If you were to ask someone at the Social Security Administration about the "$133.33 CalPERS Social Security offset/reduction," they would in all likelihood have no idea what you were talking about, since this has nothing to do with the federal laws they administer.

The state laws do not actually specify the amount of $133.33; they say, "The normal rate of contribution … shall be reduced by one-third as applied to compensation not exceeding four hundred dollars ($400) per month" for service that has concurrent Social Security coverage. (E.g., G.C. 20677, 20677.4) This "one-third …$400" offset/reduction is historically related to the "Maximum Taxable Earnings" (MTE) that are subject to Social Security taxes[6]. For example, in 2013, the MTE is $113,700; but in 1959, for example, the MTE was $4,800 a year—which equates to $400 a month. The common $133.33 offset/reduction, therefore, is simply the "one-third" reduction of the $400 monthly equivalent of the historical MTE.

Since nearly all workers currently earn more than $400 per month, $133.33 is by far the most common monthly reduction to an employee's earnings before CalPERS contributions are computed. But if an employee's earnings are less than $400 a month—e.g., for a City Council member paid only a small amount ($25, $50) per meeting—their earnings subject to CalPERS contributions would be reduced by one third, not by $133.33.

This $133.33 reduction has remained essentially unchanged since it was first enacted in 1959, despite frequent cost-of-living increases in Social Security's MTE limit. However, in subsequent years, during contract negotiations, employee representatives would sometimes bargain for greater reductions in payroll *deductions* (such as CalPERS contributions) from an employee's pay, rather than pay raises.[7] Consequently, for some employee groups, this contribution offset amount has been statutorily increased over the years[8], which has tended to mask the provision's original link to Social Security's MTE.

Paying retirement contributions to both systems (CalPERS and Social Security) was perceived as financially burdensome for many members. Thus, in 1959, when many classified school members obtained Social Security coverage, the California Legislature specified that the member's contributions to CalPERS would be reduced, for members who also had Social Security coverage.

Although the common $133.33 offset/modification is currently a rather minor reduction in a member's contributions to CalPERS, at the time it was first enacted, this represented for most members a significant ***one-third*** reduction in their contributions to CalPERS.

Since a member's *contributions* were being reduced, the Legislature also specified that a lower level of *retirement benefits* would be provided to CalPERS members who had Social Security coverage in addition to CalPERS coverage.

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[6] For more information about the MTE, see: http://www.socialsecurity.gov/planners/maxtax.htm .

[7] For example, a $100 reduction in a member's contributions to CalPERS may provide more "take home pay" than a $100 pay increase.

[8] E.g., to $513, for most "state miscellaneous" employees.

However, remember that such members would now ultimately be entitled to ***two*** retirement benefits: one from CalPERS, and one from Social Security; and the combined retirement benefits would be higher than the former benefit under CalPERS alone. Such members would also be covered by the survivor benefits available under Social Security.

2. REDUCTION TO CalPERS "FINAL COMPENSATION"

Final compensation for CalPERS purposes is computed as a monthly figure. For service that was subject to Social Security as well as to CalPERS, the reduction is $133.33 to the member's average monthly final compensation.[9]

Since member pay rates have increased substantially over time, this $133.33 reduction in final compensation has (like the reduction to CalPERS contributions) come to seem rather minor in its effect. It should be noted, however, that when first instituted in 1959 (when the average CalPERS member's payrate was less than $400 per month), this final compensation reduction constituted a ***one-third*** reduction in CalPERS benefits, for service subject to Social Security coverage.

3. 1959 SURVIVOR BENEFIT COVERAGE PROHIBITION; POST-RETIREMENT SURVIVOR ALLOWANCE EFFECT

CalPERS members with Social Security coverage (and thus, with the survivor benefits provided by Social Security) cannot also have pre-retirement 1959 Survivor Coverage for the same employment[10]. This prohibition precludes the employer from having to fund two different (and substantial) survivors' benefits.

The Post-Retirement Survivor Allowance (PRSA) payable to the survivor of a qualifying member is one-half (50%) of the retired member's unmodified allowance based on service **not** subject to the modification for Social Security; while it is one-quarter (25%) of the retired member's unmodified allowance based on service that **was** subject to the modification for Social Security[11].

These prohibitions/reductions are based on the reduced need for CalPERS survivor benefits for members who are also covered by Social Security.

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[9] Technically, the reduction is stated: "The fraction specified in the above table shall be reduced by one-third as applied to that part of final compensation that does not exceed four hundred dollars ($400) per month." (E.g., 21354, 21354.1, 21354.3, 21354.4, 21354.5).

[10] E.g., 21573(g), 21577, 21583; the "federal system" mentioned in these sections is the Social Security/OASDI system [see section 20033].

[11] Sections 21624, 21626, 21627, 21628, 21629, 21630.

IMPACT OF PEPRA

As was announced in our Circular Letter dated May 28, 2013[12], the Public Employees' Pension Reform Act (PEPRA) of 2013 has made the offset/reduction to both CalPERS member contributions and final compensation generally not applicable to "new members" enrolled in any of the new PEPRA formulas.

It should be remembered that PEPRA did *not* have any effect on Social Security and/or Medicare coverage; it was purely a state law, and did not change any federal statutes. Thus, although the offsets/reductions to both CalPERS member contributions and final compensation no longer apply to "new members" under PEPRA, this does **not** have any effect on a member's and employer's existing obligations to pay Social Security and Medicare contributions.

It is interesting to note that PEPRA also limits "pensionable compensation" to the maximum contribution and benefit base for Social Security[13].

SUMMARY:

CalPERS members not subject to PEPRA, who have Social Security coverage in addition to CalPERS, pay slightly less in employee contributions to CalPERS because of the $133.33 offset/reduction; however, they also receive (correspondingly) slightly lower retirement benefits, because of the $133.33 reduction to final compensation. The death benefits available to the member's survivor(s) may also be lower.

This is because of provisions in California state law, and does not affect obligations under federal Social Security laws.

[12] http://www.calpers.ca.gov/eip-docs/employer/cir-ltrs/2013/200-024-13.pdf

[13] Government Code 7522.10(c) specifies that pensionable compensation "shall not exceed the following applicable percentage of the contribution and benefit base specified in Section 430(b) of Title 42 of the United States Code."

APPENDIX

ADDITIONAL HISTORICAL BACKGROUND:

During the decade of the 1950s, most public employees in California did ***not*** have survivors' benefits through their retirement systems[14], including CalPERS[15]. Increasing numbers of employees were concerned about this, and obtaining Social Security coverage (which includes survivor benefits, of course) was viewed as one means of achieving coverage for survivors of a deceased CalPERS member.

Classified school employees who were members of CalPERS obtained Social Security coverage via an election held on November 4, 1959. Those so electing obtained Social Security coverage retroactive to January 1, 1956; classified school employees who became CalPERS members after 1959 were mandatorily placed in Social Security coverage from their date of membership[16].

State miscellaneous[17] employees likewise obtained Social Security coverage via an election held on November 6, 1961. As with school members, State employee members so electing obtained Social Security coverage retroactive to January 1, 1956, and most state employees[18] who became CalPERS members after 1961 were mandatorily placed in Social Security coverage from their date of membership.

Employees who participate in Social Security contribute a fixed percentage of their earnings, up to a "Maximum Taxable Earnings" (MTE) amount. Currently, this fixed percentage is 6.2%, and the MTE is $113,700. Historical tax rates and MTE amounts may be found on the Social Security Administration's website.[19]

The 1959 law (when classified school members had their election for Social Security coverage) stated that an employee's contributions to CalPERS would be reduced by one-third, of earnings which do "not exceed the monthly equivalent of the maximum annual amount subject to contribution under the federal system." [20] In 1959 the MTE was $4,800. (The monthly equivalent of the yearly MTE was thus $400 a month.)

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[14] The CalPERS 1957 Survivor Benefit and 1959 Survivor Benefit did not come into existence until those specified legislative years, of course.

[15] At that time, CalPERS was known as the "State Employees' Retirement System" (SERS).

[16] There are a few exceptions to this; for example, employees of some County Offices of Education (COE) do not have Social Security coverage, although the school districts they administer do have such coverage.

[17] "Warden" members (i.e., Department of Fish and Game) and "forestry" members (i.e., Department of Forestry and Fire Protection, now known as CAL FIRE) also participated in the November 6, 1961 election for Social Security coverage.

[18] Exceptions included California Highway Patrol members, and other state "safety" members.

[19] http://www.socialsecurity.gov/planners/maxtax.htm; http://www.socialsecurity.gov/OACT/ProgData/taxRates.html.

[20] G.C. section 20601.5, former; this provision was repealed in 1971, but its substance was included in other, later sections.

CalPERS retirement formulas were explained to members and employers in different terms back in 1959. The "2% @ 60" formula[21] wasn't created until 1970[22], for example. The most common retirement formula for miscellaneous members in 1959 was generally referred to as the "1/60th formula[23]."

The 1/60th formula provided a benefit of 1.6667%, multiplied by a Benefit Factor based on a member's age at retirement; e.g., at age 55, this was .725357 for men and .740718 for women[24]; at age 60, it was 1.000 for both sexes; at age 65[25] and older, it was 1.329903 for men and 1.351046 for women. (In our current terminology, we would most likely describe this retirement formula as "1⅔% @ 60."[26])

CalPERS members with Social Security coverage, in addition to having Social Security survivor benefits, were also entitled to Social Security retirement benefits; this meant that such persons would ultimately be entitled to two separate retirement benefits: one from CalPERS, and one from Social Security.

The California Legislature thus created a new (lower) retirement formula that was known as the "1/90th formula." For persons covered by Social Security, their service subject to Social Security would now be subject to this "1/90th formula," while their earlier service[27] not subject to Social Security remained under the higher 1/60th formula. For members who had service under both formulas (i.e., who had service both before January 1, 1956, as well as after), they were described as being subject to the "1/60th to 1/90th" formula.

The 1/90th formula[28] provided a lower benefit of 1.1111%, multiplied by the Benefit Factors previously described. (In our current terminology, we would most likely describe this retirement formula as "1.11% @ 60"; or perhaps, "1 and one-ninth @ 60.")

As described earlier in this Bulletin, contributions to CalPERS were also decreased by about one-third, as were CalPERS retirement benefits (i.e., final compensation), for members subject to the new 1/90th formula. Because of these changes, this

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[21] This was the most common retirement formula for "miscellaneous" members prior to the higher "2% @ 55" formula created by SB 400 in 1999.
[22] G.C. section 21251.13 (former); now 21353.
[23] Section 21251.1 (former).
[24] Separate Benefit Factors for men and women remained in the law until 1977; e.g., 21251.13 (former). When this law changed, the "Best Factors" (i.e., the higher factors for either gender) were used for both sexes.
[25] At the time, the minimum retirement age for Social Security was 65, while the minimum retirement age under CalPERS was 55.
[26] Although this terminology seems very unfamiliar to us nowadays, it is still the way the formulas are described in the law—except that the higher "fraction of *one-fiftieth*" is now used, rather than 1/60th; see sections 21353, 21353.5, 21354, 21354.1, 21354.3, 21354.4, 21354.5, etc.
[27] Prior to the retroactive coverage date of January 1, 1956, in most cases.
[28] Section 21251.14 (former).

became known as the “modified” formula for retirement (cf. the “full” formula, for service *not* covered by Social Security).

Although the $1/90^{th}$ formula provided a lower retirement benefit, it again must be remembered that qualifying members would now be entitled to ***two*** retirement benefits: one from CalPERS, and one from Social Security; and the combined retirement benefits would be higher than under the previous $1/60^{th}$ formula alone.

Members who received Social Security coverage retroactive to January 1, 1956 were required to pay contributions retroactively for this coverage; however, since they had already paid more to CalPERS for this period than they should have under the new “modified” formula (with its $133.33[29] reduction in earnings subject to CalPERS contributions), this retroactive payment was accomplished by a transfer of funds from the member’s CalPERS account to the Social Security Administration.

If the amount that could be transferred was insufficient to cover the total retroactive cost, the member was required to make installment payments for the difference.

[29] From 1956 through 1958, when the MTE was $4,200, this reduction was $116.67 monthly.