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<u>CalPERS Option Elections</u>

Unmodified: If a Member employee picks the Unmodified Option (no optional survivor elections), then upon Member's death, all retirement benefits cease. Example: H works 30 years and deducts from his paycheck $100,000 in mandatory contributions during the course of his employment. H retires and receives $5,000/month for 5 years (split with former W 50-50 post retirement), and then unexpectedly, H is involved in an auto accident and dies. After 5 years of retirement, there remains $50,000 in mandatory contributions left in the CalPERS account. However, upon the death of H, all remaining benefits (including the $50,000) revert to CalPERS and nothing is paid out to W or H's estate after H's death.

Option 1: Option 1 provides that regardless of the death of Member or Beneficiary, the mandatory contributions paid into the CalPERS Plan will be paid out. Example: H made mandatory contributions over the course of his employment of $100,000 and upon retirement receives $5,000/month with a cost of the Option 1 benefit of $5/month (Adjusted down to $4,995). After five years of retirement, H and W both die in an auto accident and $50,000 remains in H's mandatory contribution account. This $50,000 is paid to the estate of H and/or W. NOTE: After approximately 10 years these mandatory contributions are considered "paid out" to Employee-such that CalPERS would pay out nothing upon the death of H and W.

Option 2 and 2W: Option 2 provides a lifetime benefit to a named beneficiary upon Member's death which is equal to the lifetime benefit Member was entitled to while living. Example: H and W receive $5,000/month upon retirement less the cost of option 2 of $200/month (Adjusted Gross monthly with reduction becomes $4,800/month). H dies. W now receives the entire $4,800/month until W's death. NOTE: With the addition of the 'W' in the '2W' the gross adjusted does not "pop up" to the unmodified level in the event of W's death. So even though the "life insurance" protection is no longer necessary due to W's death-the gross adjusted that reverts to H remains at $4,800/month with a 2W election. With a "2" election if W dies, the $4,800 'pops up' to $5,000/month and reverts to H, because the protection is no longer needed.

Option 3 and 3W: These options are similar to option 2 and 2W, except only one-half of the benefits are paid and therefore the cost is less. Same analysis with the 'W' added.

Option 4: Option 4 allows a more customized benefit in that it allows the combining of different options together, (such as 4/2W and 1 for example). Option 4 is also the Community Property Election or "court ordered election"-where Member is required by court order, entered pursuant to Family Code section 2610, to elect an Option 4 to provide a community property interest to a former spouse equal to their community property interest.

Survivor Continuance vs Option Continuance: Some-but not all-employers offer a survivor continuance which is paid in addition to the selected option portion of the retirement benefits after death of member spouse. A survivor continuance is payable by statute only to an eligible survivor as long as that person remains an eligible survivor. An eligible survivor is a surviving spouse married to the member at least one year prior to retirement and continuously thereafter until the member's death. Example:

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Member receives $6,000/month while member is alive and elected option 2. The option portion is $2,000/month and the survivor continuance portion is $4,000. They divorce and former spouse is entitled to $3,000 while member is alive as former spouse's 50% community interest. However, because of the divorce, former spouse is no longer an eligible survivor for the survivor continuance and so after member's death, former spouse is only eligible to receive the full option 2 $2,000/month option election.

Cost allocation of option when member is already retired: After retirement-the option election is irrevocable (Example: Member Spouse cannot replace an Option 2w election with an Option 4 community property election).

With option 2/2w-the cost allocation becomes a bit of a problem because the surviving spouse 'takes over' the deceased spouse's share, which can cause quite a windfall for former spouse.

This "windfall" complicates the question of how to equitably divide the CalPERS account and the cost of the survivor benefit. There are a few practical options:

1. (Split cost recommended where the community property interest is the majority) The parties can split the cost and split the potential chance of receiving the survivor benefit "windfall". Example: option 2w elected. Gross adjusted option benefit is $4,800/month (unmodified would have been $5k/month), Cost of benefit is $200 a month-W's share is allocated $100 of the reduction and H's share is allocated $100. While both parties are living H receives $2,400/month and W receives $2,400/month.

a. W dies: W's share reverts to H and H begins receiving $4,800/month.

b. H dies: W begins receiving $4,800/month.

2. (W pays entire cost) Same example but the $200 reduction is allocated 100% against W such that W receives $2,300/month and H receives $2,500/month. When W has a very small community interest or W is significantly younger-causing very high survivor benefit costs-it should be suggested that W pays the entire cost.

a. W dies: W's share reverts to H and H begins receiving $4,800/month.

b. H dies: W begins receiving $4,800/month.

3. (H Pays) Same Example but the $200 reduction is allocated 100% against H such that W receives $2,500/month and H receives $2,300/month.

a. W dies: H begins receiving $4,800/month.

b. H dies: A Trust is set up for the benefit of H's estate and H's estate continues to receive $2,500. (See discussion below for this option)

4. (Actuary Option) An actuary evaluates the present value of the survivor benefit and the community property percentage interest in the CalPERS account is adjusted up/down for W accordingly (depending on who agrees to “take on” the reduction allocation for the cost of the survivor benefit).

Regarding option #3 above-A pair of 2010 cases involving the same parties discussed the mandate to value a survivor benefit as a charge to a nonmember spouse. See Marriage of Sonne (2010) 48 C4th 118; Marriage of Sonne (2010) 185 CA4th 1564. The appellate court (in both an original (and later depublished) decision and on remand from the supreme court) sought to minimize what could be the harsh effect of charging the full value of the survivor benefit to the nonmember spouse under the mandate for equal division, by suggesting that at the death of the member, the survivor option might be paid into a trust. Under a trust instrument, any benefit in excess of the nonmember’s share could be paid to the member’s heirs, thus limiting the survivor benefit charge to the nonmember spouse and increasing the nonmember’s right to share the community interest in the benefit during the member’s lifetime.

Of course the problem with the revocable trust option is CalPERS will only set up a trust if it is requested by the beneficiary of the survivor option. That beneficiary would have a right to cancel the trust at any time. Thus, the rights of the member’s heirs under such an arrangement may be unenforceable.

ANOTHER Method to consider-the IRMO <u>Smith</u> method as applied to CalPERS-the Military approach.

ANOTHER Method-complete and total buy out. (in this case the 2/2w or 3/3w can be revoked)

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