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April 9, 2007

Ms. Diane F. Boyer-Vine
Legislative Counsel
State of California
State Capitol, Room 3021
Sacramento, California 95814

Mr. Gregory P. Schmidt
Secretary of the Senate
State Capitol, Room 400
Sacramento, California 95814

Mr. E. Dotson Wilson
Chief Clerk of the Assembly
State Capitol, Room 3196
Sacramento, California 95814

Re: Effectiveness of the Extended Service Incentive Program, G.C. Section 75089.1

Dear Ms. Boyer-Vine, Mr. Schmidt, and Mr. Wilson:

Attached is the Judicial Council report required under Government Code section 75089.1 on the effect of the extended service program.

If you have any questions related to this report, please contact Ernest Fuentes, Director, Human Resources Division at 415-865-4262.

Sincerely,

William C. Vickrey
Administrative Director of the Courts

WCV/JN
Enclosures
cc: Members of the Judicial Council
Kathleen T. Howard, Director, AOC Office of Governmental Affairs
Ernest V. Fuentes, Director, AOC Human Resources Division
Judicial Administration Library (2 copies)

EFFECTIVENESS OF THE EXTENDED SERVICE INCENTIVE PROGRAM

Government Code section 75085 et seq. established the Extended Service Incentive Program (ESIP) to provide enhanced retirement benefits for judges who continue in service beyond retirement age. The statute directed the board of administration of the California Public Employees' Retirement System (CalPERS) to implement the program no later than July 1, 2001. (See Assem. Bill 1955 [Migden]; Stats. 2000, ch. 961.) CalPERS instituted the program on January 1, 2001. The bill also directed the Judicial Council to report to the Legislature, by January 1, 2006, regarding costs and effects of the program, including:

A. An analysis of the effects, if any, of the program on judges' length of service; and

B. Recommendations to ensure that the Judges' Retirement System (JRS) and the Judges' Retirement System II (JRS II) provide appropriate incentives to attract and retain judges of the highest quality from all areas of legal practice.

This report provides a detailed response to each of these items, as well as supporting data.

A. Analysis of Program's Effects on the Length of Service of JRS Judges and on Cost to State

Description of Issues and Program

- Judges reach the maximum benefit payable under the JRS retirement formula after 20 years in service. Many judges choose not to stay on the bench after 20 years because they receive no additional benefit and because they are required to continue contributing 8 percent of their salaries into the retirement system. Under ESIP, JRS judges continue making the 8 percent contribution but will realize a benefit by continuing as active judges. (ESIP does not apply to JRS II members.)

- ESIP addresses the need to retain the most experienced judges who are eligible for retirement. The people of California lose vital judicial resources and experience when long-serving and capable judges leave public service.

- ESIP provides an incentive for longer service to our most experienced judges, an alternative to private judging, and a creative financial reward that does not add to the state's costs. It also eliminates the financial penalty to continued service previously imposed on these judges.

How the Extended Service Incentive Program Works

Under ESIP, which became effective on January 1, 2001, a judge who is at least 60 years of age with 20 or more years of service is automatically enrolled in the program. During the ESIP period, the judge continues to receive his or her full salary and continues to contribute 8 percent to the retirement system. To receive the ESIP benefit, the judge is required to stay in service at least 36 months past the time he or she is eligible for retirement. The ESIP benefit is 20 percent of the judge's salary for the first 60 months of participation and 8 percent from the 61st through the 120th month. The maximum period a judge can participate is 10 years.

When the judge retires after having served at least 36 additional months, the ESIP benefit is calculated based on the number of additional months multiplied by the appropriate percentage of salary, with interest indexed to 30-year U.S. Treasury Bonds. The most recent interest rate credited to judicial accounts was 5 percent. The ESIP benefit is payable to the judge as a lump sum, on the judge's retirement. Most often, the ESIP balance is rolled over to an Individual Retirement Account.

Current Participation and Cost-Effectiveness of ESIP

As of the June 30, 1997, CalPERS JRS Actuarial Valuation, 1,338 judges were participating in JRS; 48 were at least age 60 with 20 or more years of service. Then, in 2001, ESIP was instituted. The CalPERS Actuarial Valuation of June 30, 2005, shows only 815 judges in JRS, but nearly 120 of these were still serving at 60 years of age or older with 20-plus years of service credit. According to CalPERS and the Judges' Retirement System, approximately 110 judges were participating in ESIP as of December 2006. While the empirical evidence is not conclusive, the ESIP incentive seems to have had a dramatic effect in encouraging longer service, demonstrating the program's effectiveness in rewarding and retaining our most experienced judges and justices.

Moreover, the program is cost effective. For each superior court judge eligible for full retirement who remains on the bench, there is a net annual savings of approximately $128,475. The following scenarios demonstrate that cost savings.

Scenario 1: A judge with an annual salary of $171,648 receives an annual ESIP commitment of $34,329, for a total cost of $205,977.

Scenario 2: A retired judge receives 75 percent of pay, or $128,736, and a new (replacement) judge is appointed at a salary of $171,648, plus a JRS II employer rate of 19.848% or an additional $34,068 for a total cost of $334,452 for a single judicial position.

The difference between scenario 2 ($334,452) and scenario 1 ($205,977) is $128,475 — the net savings to the state for each judge who remains on the bench as a direct result of the Extended Service Incentive Program.

B. Recommendation for Encouraging Long Service by Judges in the Judges' Retirement System II

In addition to reporting on the effects and cost of ESIP, Govt. C. sec. 75089.1 also requires the Judicial Council to recommend "ways to encourage long service by judges in the Judges' Retirement System II, including whether and how to establish an Extended Service Incentive Program for members of the Judges' Retirement System II."

During the twelve years of JRS II, the average age of a new judge has crept up to 51. This is primarily due to trial court unification, enacted in 1997, which eliminated municipal courts, for which judges were required to have only five years membership in the state bar. Now all new judges appointed or elected to the trial court must have at least ten years membership in the state bar, resulting in an increase in the average age of judge at appointment or election. Therefore, judges who do not wish to work until age 70 will "retire" from the bench before becoming eligible for a retirement allowance. With a reduced minimum service required for a defined benefit (from 20 years to 10 years) and a lowered age for minimum retirement (from age 65 to 63), judges can choose either to leave the bench with a benefit of 37.5 percent of salary or to continue enhancing that minimum retirement allowance by 3.75 percent for each year in excess of 10 until the maximum benefit of 75 percent of salary is reached at 20 years. At that point most JRS II judges will be close to 70 years of age.

Background

The Judges' Retirement System II was enacted in 1994 to create a different retirement system for judges first elected or appointed to judicial office on or after November 9, 1994. As members of JRS II, judges have a portion of their monthly judicial salaries (currently 8 percent) deducted each month and put into their JRS II accounts. Each month JRS II judges accrue monetary credits equal to 18 percent of their monthly salaries. In addition, they receive interest credited at the net earnings rate achieved by the JRS II Fund on its investments during the preceding fiscal year.

To qualify for service retirement from JRS II, a judge must be at least 65 years old with at least 20 years of service, or age 70 with at least 5 years of service.

JRS II judges who leave office before accruing five or more years of service will be paid the amount of contributions made to the system. They will not be considered retired judges. Judges who leave office after accruing five or more years of service but do not meet the eligibility requirements for service retirement under Government Code section 75522 will be paid the amount of their monetary credits, including any interest earned. The judges will then be considered retired for purposes of judicial assignments but will be eligible for continued health benefit coverage.

Rationale for Recommendation

When JRS II was enacted in 1994, the average age of new judges was approximately 45.5 years. Based on the data available at that time, the "average" judge would have been eligible to retire at 65 and would receive a benefit of 75 percent of final pay (3.75 percent multiplied by 20 years of service).

Today, the entry age of new judges into JRS II is approximately 51. This was not unexpected, in light of the five-year increase in the minimum attorney experience required for judicial appointment that resulted from the unification of trial courts.

Currently, under JRS II, the "average" new judge is required to work until age 70 to be eligible to retire and receive a defined benefit. Before reaching that age, the average judge is eligible to receive only monetary credits with interest; this is similar to what is known as a cash balance plan, which, depending on market performance, may be a substantially lower benefit that lacks the purchasing-power protection of a normal retirement annuity.

The JRS II benefit formula, particularly the significant difference between the payouts for judges who retire before age 65 and payouts for those who retire when they are eligible for a defined benefit, acts as a significant disincentive for retirement prior to eligibility for the latter benefit. Actuaries describe the structure as "back-loaded." Such extreme back-loading of benefit accruals is not a characteristic of other plans sponsored by the state or by other public or private sector employers.

For personal and professional reasons, judges may need or wish to retire before qualifying for a defined benefit retirement. A judge may recognize that he or she has lost the energy, patience, or temperament needed for successful performance of judicial duties and is willing to retire early if it is economically feasible. A judge's obligations to a spouse, significant other, or dependents may force a decision in favor of leaving judicial office.

In conclusion, it appears that ESIP has made a positive impact in retaining JRS judges. For JRS II judges the most critically needed reform would allow retirement at an earlier age with fewer years of service. The Judicial Council is recommending that the JRS II formula be modified to allow judges to retire with a defined benefit at age 63 and 10 years of service. Once that objective is achieved, attention should be paid to ensuring that the incentives in JRS II do not deter extended service for JRS II judges. While a good defined-benefit plan is a proven tool for attracting the best and the brightest and retaining them as active employees with long careers, adding extended service incentives to JRS II should remain a future option.

A modified version of ESIP for JRS II would serve as an additional incentive for judges to finish their professional careers from the bench. Every means should be used to retain our most experienced and talented judges. To quote Chief Justice Ronald M. George from his remarks during his 2007 State of the Judiciary address, "We want to attract and retain individuals from the public and private sectors at the height of their legal careers and take advantage of their skills for a sustained period." The key reform needed to achieve the Chief Justice's objective is a reform of the JRS II formula to allow more flexibility. Given the success of ESIP in slowing the rate of judicial retirements for JRS judges, similar incentive options within JRS II should be explored to serve the judicial branch strategic goal of retaining highly qualified and experienced judges.