

**BEFORE THE BOARD OF TRUSTEES
TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS**

In the Matter of:)
)
Alice Mical,)
)
Petitioner)
)

RECOMMENDED DECISION OF THE CLAIMS HEARING COMMITTEE

I. Introduction

Pursuant to the provisions of 80 Ill. Adm. Code 1650.650, an administrative review hearing was held on October 23, 2013 in Springfield, Illinois, to consider Cross Motions for Summary Judgment in the administrative review claim of Alice Mical (Mical), a member of the Teachers' Retirement System of the State of Illinois (TRS or the System). Present were Presiding Hearing Officer Ralph Loewenstein, Claims Hearing Committee Chairman Sonia Walwyn, and Claims Hearing Committee members Cynthia O'Neill and Mark Bailey. By agreement of the parties, the matter was presented to the Committee for hearing solely upon the record.

Mical filed the instant administrative review to challenge staff's application of the TRS conversion rule [80 Ill. Adm. Code 1650.450 (c)(6)] which reduced Mical's final six years of TRS-creditable earnings. As a result, Mical's initial annual annuity was reduced from \$93,186.40 to \$81,843.12. It is Mical's contention that her employer, Wilmette S.D. 39 (Wilmette) offered its administrators at all times during her employment with Wilmette an I.R.C. Sec. 125 cafeteria plan with a cash-in-lieu-of-insurance option, thus making her health insurance creditable under the TRS flexible benefit rule [80 Ill. Adm. Code 1650.450 (b)(6)].

It is staff's position that in the 2002-03 school year, Mical did not receive cash in lieu of health insurance. Thereafter, in the six subsequent school years until her retirement in the 2008-09 school year, Mical did receive this option which caused her to run afoul of the TRS conversion rule.

Based upon a careful review of Wilmette's salary records, the affidavits of the witnesses, and all other documentary evidence and legal arguments submitted by the parties, the Claims Hearing Committee finds that staff properly applied the TRS conversion rule in calculating Mical's "salary" for retirement annuity determination purposes.

II. Analysis and Factual Determinations

Between 1997 and 2009, Mical was employed as an administrator at Wilmette. She was Wilmette's administrator for human resources from 1997 through 2008. During the 2008-09 school year, Mical served as Wilmette's administrator for special projects. She retired from her employment at Wilmette in June 2009 and began receiving TRS retirement annuity payments in October 2009.

TRS performed an audit of Mical's creditable earnings, which resulted in a reduction of those earnings for each of the last six years of her employment at Wilmette. In letters dated April 30, 2010, TRS advised Mical and Wilmette that Mical's creditable earnings would be reduced for the 2003 through 2009 school years as a result of a violation of the TRS conversion rule, 80 Ill. Admin. Code 1650.450(c)(6). Specifically, TRS reduced Mical's earnings by the annual cost of health and dental insurance plus the TRS contributions which Wilmette had paid on the value of that insurance.

This resulted in Mical's creditable earnings being reduced by \$13,026.59 for the 2003-04 school year; by \$13,026.59 for the 2004-05 school year; by \$15,557.51 for the 2005-06 school year; by \$22,325.17 for the 2006-07 school year; by \$26,448.75 for the 2007-08 school year; and by \$26,448.75 for the 2008-09 school year.

During the course of Mical's employment with Wilmette, the District had a number of policies with regard to compensation for administrators, which changed over the years. The policy in effect between June 22, 1998 and September 15, 2003 provided that the compensation package for District administrators included, among other things, salary and insurance. With respect to insurance, the policy provided that at the time of employment, each District administrator could elect to pay premiums for health, dental, and vision insurance. In subsequent years, the administrator would continue to pay the original insurance premium and the Board of Education would

absorb any additional increases.

During the 2001-02 and 2002-03 school years, Mical did not receive insurance through the District but rather had insurance through her spouse.

The Compensation for Administrators policy was revised effective September 15, 2003, and remained in effect until August 22, 2005. The 2003 administrator compensation policy provided that the compensation package for administrators included, in part, salary and insurance. With respect to insurance, administrators were to receive compensation for single or family insurance up to an amount of \$12,000.00 annually in addition to \$100,000.00 of life insurance, dental insurance, vision insurance, and long-term disability insurance.

In the 2003-04 school years, Mical received a large salary increase. In explaining the salary increase, the District broke it down on its spreadsheet to show the cost of insurance, dental and vision in addition to her salary. For the 2003-04 school year, she “purchased” from her Section 125 plan contributions medical insurance, dental insurance for the family, and vision insurance. During the 2004-05 school year, she did not purchase any insurance.

Effective August 22, 2005, the Compensation for Administrators policy was once again amended. The policy provided that administrators who submitted notice to the District on or before June 30, 2005 of their intent to retire prior to July 1, 2008, would continue to be paid as additional compensation an amount equivalent to the total premium cost of medical, dental, and vision insurance until his or her date of retirement. There were also provisions for administrators giving such notice who obtained medical, dental, or vision insurance through a spousal plan in lieu of insurance coverage through the District to have their compensation increased to an amount equivalent to the cost of the spouse’s plan as long as the cost of the plan was lower than purchasing coverage through the District. Individuals giving notice of intent to retire by June 30, 2005 were grandfathered through the date of the administrator’s retirement. New and current administrators who did not submit a notice of intent to retire before June 30, 2005 would have their medical, dental, and vision insurance paid by the District directly to the provider.

Mical had given her notice of intent to retire on June 24, 2005, and as a result, the revised policy with regard to medical insurance directly affected Mical and one other District administrator. For school years 2005-06 and 2006-07, Mical purchased medical insurance through the District and in 2007-08 and 2008-09, she did not

purchase medical insurance through the District. She continued to receive compensation that included amounts for insurance during the years she did not obtain insurance through the school district.

Mical argues that there was no conversion because the District had a flexible benefit plan out of which she purchased or declined to purchase insurance on a yearly basis, dependent upon her need. The problem is that it does not appear that any of the compensation policies of the District were applied in any consistent manner, but rather, that the compensation policies were tailored to the individual needs of Mical and one other employee who subsequently did not choose to appeal the TRS staff determination denying conversion to salary of medical insurance previously paid by the District.

In particular, the Claims Hearing Committee considered the following:

1. There is no evidence that Mical received compensation in the form of salary for medical, dental, and vision insurance prior to the 2003-04 school year.

2. The affidavit of Wilmette Superintendent McGee stated in pertinent part:

It was determined that the Board would not provide Board-paid insurance benefits, but would increase each administrator's salary in an amount equal to the premium cost of that administrator's insurance. As individual insurance costs varied, this increase was a different amount for each administrator, but the policy was applied consistently to the entire group. We did not offer these administrators the choice of insurance or an equivalent amount of cash.

3. In Mical's case, the compensation increase for the 2003-04 and subsequent school years was specifically broken down to show a separate line item for the cost of insurance, which supports the TRS staff determination that this was a conversion into salary of health insurance premiums previously paid directly by the school district.

4. After the revised policy went into effect in 2003, it was not applied evenly to the other administrators in the District. In particular,

a. Administrator Horowitz declined dental insurance but did not

receive cash in lieu of that coverage.

- b. Administrator Littmann took no insurance, but did not receive a salary increase based upon the amount that the insurance would have cost.
- c. Superintendent McGee had a contract for the 2002-07 school years, which provided that he would be paid compensation and the Board would directly pay for his medical insurance (which was not included in his reportable compensation to TRS). This salary provision was contrary to the policy existing when the contract was signed, which allowed the administrators to buy insurance. After the policy was changed in 2003, there was no change to the Superintendent's contract.

5. Memos dated July 13, 2004 from Mical (known at that time as Alice Reardon) to herself, and from Superintendent McGee to Reardon dated July 6, 2006, both separately list insurance as a separate line item in determining the compensation package of Mical. As part of the review process after Mical's retirement, Mr. Nohelty, who was then serving as the human resources director at Wilmette, attempted to explain both memos to conform to Mical's position that the insurance had always been included as part of the compensation package and that the above memos were in error. His explanation is unconvincing.

6. The District continued to include as part of Mical's "salary" the insurance premium amount even though she did not actually retire until June 30, 2008, as required by the 2005 revised employment compensation policy.

7. Finally, salary increases for Mical in years subsequent to 2003-04 were not based upon the entire compensation package, but rather, excluded any increases based upon the amount paid for insurance. While this in and of itself might not be sufficient to make a determination that there was a conversion, it is yet another indicator that a conversion occurred in this case.

III. The TRS Conversion Rule Was Correctly Applied

The "TRS conversion rule" looks at compensation, creditable and non-creditable, due or payable in a member's last seven school years of employment. The rule is authorized by the Pension Code, 40 ILCS 5/16-121, which defines

“salary” for TRS purposes as:

The actual compensation received by a teacher during any school year and recognized by the system in accordance with rules of the board. For purposes of the Section, “school year” includes the regular school term plus any additional period for which a teacher is compensated and such compensation is recognized by the rules of the board.

The TRS conversion rule prohibits “conversion” of non-creditable earnings into salary in the last years before retirement. The conversion rule is found at 80 Ill. Admin. Code 1650.450 (c)(6):

Any amount paid in lieu of discontinued or decreased non-reportable benefits, or reported in lieu of previously non-reported compensation, where the conversion occurs in the member’s final seven years of service. If any form of non-creditable or non-reported compensation in any of the member’s last seven creditable school years of employment exceeds that of any other subsequent year, the System will presume the difference to have been converted into salary in the subsequent year. To overcome the presumption, the member must submit documentary evidence to the System that clearly and convincingly proves that the change in compensation structure was due to a change in a collectively bargained agreement applicable to all individuals covered by the agreement, a change in employer policies affecting a group of similarly situated members some of whom are not within seven years of retirement eligibility, or a change in family status, and not to increase final average salary.

The rationale for the conversion rule is explained in the TRS Employer Guide, Chapter 3: Creditable Earnings, pages 10 and 11, as follows:

Salary Conversions

TRS must make informed actuarial predictions of its future liabilities. It cannot act as a prudent, informed plan and at the same time allow members to withhold contributions on substantial earnings amounts until the last few years before retirement. Therefore, the definition of salary reportable to TRS as creditable earnings excludes converted benefits. Any amount paid in lieu of discontinued or decreased

nonreportable benefits (or reported in lieu of previously nonreported compensation) will be excluded from creditable earnings if the change in compensation structure occurs during the member's final seven years of service.

If a non-reportable benefit item is discontinued or decreased within the member's last seven creditable school years of employment, TRS presumes the benefit was converted to salary for the purpose of increasing the member's final average salary. To overcome this presumption, the member or employer must submit evidence to TRS that clearly and convincingly proves that the change in compensation structure was due to:

- *a change in a collectively bargained agreement applicable to all individuals covered by the agreement,*
- *a change in employer policies affecting a group of similarly situated members, some of whom are not within seven years of retirement eligibility, or*
- *a change in family status.*

The documentation must clearly establish that the change in compensation structure was not for the purpose of increasing the member's final average salary.

Example:

Administrator A received a \$2,500 travel allowance annually. Three years before retirement, Administrator A's travel allowance was discontinued and his salary was increased. For each of the final three years of service, TRS will exclude \$2,500 of Administrator A's salary from creditable earnings.

Example:

Administrator B received board-paid health insurance. Five years before retirement, Administrator B's employer converted the board-provided insurance benefit into a flexible benefit plan and began offering him the option to receive \$10,000 cash in lieu of health

insurance. The flexible benefit plan was not offered to any other employees. For each of the final five years of service, TRS will exclude the \$10,000 flexible benefit plan compensation from Administrator B's creditable earnings.

As determined by the Committee, Mical's factual situation was that explained in the second example above regarding conversion of board-paid health insurance.

IV. The TRS Flexible Benefit Rule Does Not Apply

The TRS flexible benefit rule cited by Mical, found at 80 Ill. Admin. Code 1650.450(b)(6), does recognize certain amounts as salary for TRS creditable earning purposes if used to finance options in a flexible benefit plan offered by the employer:

Amounts that would otherwise qualify as salary under subsections (b)(1) through (b)(5) but are not received directly by the member because they are used to finance benefit options in a flexible benefit plan; provided, however, that to be reportable, a flexible benefit plan cannot include non-qualifying deferred compensation. For the System's purposes, a flexible benefit plan is an option offered by an employer to its employees covered under the System to receive an alternative form of creditable compensation in lieu of employer-provided insurance.

However, the conversion rule discussed above takes precedence over the flexible benefit rule in Mical's situation, because Mical was unable to demonstrate that she had a flexible benefit option in the 2002-03 school year. Also, Mical failed to establish that Wilmette offered its administrators an across-the-board option to receive cash in lieu of health insurance benefits.

V. Conclusion

The hearing record does not support Mical's claim that at all times during her employment with Wilmette, she and all other administrators received a gross salary with health and dental insurance offered with a full cash value option through Wilmette's Section 125 Cafeteria plan. There is simply no evidence that prior to the 2003-04 school year, Mical had a cash-in-lieu-of-insurance option or

that after the 2003-04 school year all administrators had such an option.

The Committee finds that TRS staff correctly concluded that Mical violated the TRS conversion rule in the 2003-04 through 2008-09 school years by the change in her compensation structure to report health and dental insurance. Furthermore, Mical failed to overcome the presumption of conversion by failing to show an-across-the-board change in salary structure affecting all administrators in Wilmette.

V. Notice of Right to File Exceptions

Exceptions to the Claim Hearing Committee's Proposed Decision must be filed within fifteen (15) days of receipt by the Petitioner. A Final Decision will be issued by the Board of Trustees after it has considered the Claims Hearing Committee's Proposed Decision and any exceptions filed by the Petitioner.