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TO: State and County Directors
State and County Personnel and Payroll Staff

FROM: Bart Asato, Program Specialist Supervisor 
Employees' Retirement System

SUBJECT: The Role of Recurring Differentials in Calculating Excess Pension Costs (a.k.a Pension Spiking)

The Employees' Retirement System (ERS) is providing guidance as to the types of pay that may be reported to the ERS as a "recurring differential" for benefit computation purposes for employees or former employees with an ERS membership date prior to July 1, 2012 (Tier 1) as it relates to excess pension costs (EPCs). The issue of recurring differentials does not apply to employees or former employees with an ERS membership date after June 30, 2012 (Tier 2) as such pay is not reportable for benefit computation purposes.

EPCs, also referred to as pension spiking, are calculated on an individual basis as part of a Tier 1 member's retirement benefit when the member retires, as set forth in Section 88-100, Hawaii Revised Statutes (HRS). If it is determined that an excess maximum retirement allowance resulting from significant non-base pay increase(s) has occurred, the member's last employer will be required to make additional employer contributions or EPC, equal to the actuarial cost of ERS providing the additional benefits.

During the calculation process, the breakdown of the Tier 1 member's monthly eligible compensation between base pay and non-base pay (eligible compensation = base pay + non-base pay) is calculated. HRS section 88-21 defines "base pay" as "the normal periodic payments of money for service, the right to which accrues on a regular basis in proportion to the service performed; *recurring differentials*; and elective salary reduction contributions under sections 125, 403(b), and 457(b) of the Internal Revenue Code of 1986, as amended." (Emphasis added).

A "recurring differential," as it relates to EPCs, is a differential that is being earned in proportion to the normal periodic payments of money for service, the right to which accrues on a regular basis in proportion to the services performed or is a flat amount. Only differentials that are earned (paid or



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accrued) on a monthly basis may qualify as recurring differentials. Differentials that have the ability to fluctuate (for reasons other than unpaid leaves of absences) as it is determined based on the number of hours or shift work that the employee works in the month to meet the conditions set to earn the differential are not considered a recurring differential. Although the determination of whether a payment constitutes a “recurring differential” is dependent upon the actual circumstances at hand, the following examples may prove helpful to employers in making such determinations:

1. Recurring Differential Examples:

- a. Employee receives a shortage differential rate of \$350 a month, in addition to the employee’s basic rate of pay. The \$350 shall not adjust up if the employee works more than full-time. The \$350 may or may not be adjusted down for unpaid leaves of absences or terminations.
- b. Employee receives a monthly differential that is a percentage of, and is in addition to, their basic rate of pay.
- c. Employee receives a chair differential of \$1,200 a year, in addition to the employee’s basic rate of pay. The \$1,200 differential is paid at a set \$100 per month.

Such amounts should be deemed “recurring differentials” and be reported in the Payroll File Layout Sequence number 40, Non-Basic Rate of Pay Amount field.

2. Not a Recurring Differential Examples:

- a. Employee receives a working condition differential, in addition to the employee’s basic rate of pay, such as the \$0.50 per hour for those assigned to work in a correctional facility.
- b. Employee receives a night shift differential, in addition to the employee’s basic rate of pay, such as the \$3.50 per hour for those assigned to work the night shift.
- c. Employee receives a temporary hazard differential, in addition to the employee’s basic rate of pay, such as the 25% of a rate of pay per hour for those assigned to work under a hazardous condition.
- d. Employee receives a differential that may be earned on potential overtime and can therefore fluctuate above or below a flat amount (for reasons other than unpaid leaves of absence).

These amounts would not constitute a “recurring differential” and should be reported in the Payroll File Layout Sequence number 39, Tier 1 Other Pay Amount field.

As a general reminder, pay that has been determined to be reportable as “compensation” to the ERS and used in the calculations of member’s benefits, must have the appropriate employee and employer contributions deducted.

Should you have any questions regarding ERS employer reporting, please contact our Employer Reporting Team at dbf.ers.eemployerteam@hawaii.gov.