

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 2700

Assembly Member Lempert (As amended 5/26/00)

Position:

Sponsor

Proponents:

CTA

Opponents:

None known

SUMMARY

This bill makes all compensation for creditable service creditable to the State Teachers' Retirement Plan. It also requires the Teachers' Retirement Board (Board) to establish and administer a Defined Benefit Supplement (DBS) Program for member and employer contributions on compensation earned for creditable service in excess of 1.000 years of service per school year. The DBS Program, as well as definitions related to creditable compensation, would become effective July 1, 2002. This bill also contains numerous technical amendments.

HISTORY

Chapter 678, Statutes of 1998, (AB 1166—PER&SS) clarified the minimum standards for full time employment.

Chapter 1165, Statutes of 1996, (AB 3032—Burton) defined the terms "creditable compensation" and "final compensation" for purposes of determining benefits and contributions. Provided that any employer or person who reports compensation and salary inconsistent with the provisions of the bill would be required to reimburse the system for any overpayments.

Chapter 390, Statutes of 1995, (AB 1122—Cannella) amended the definition of "full time" to include minimum standards for various members of the Defined Benefit (DB) Program.

Chapter 76, Statutes of 1988, (AB 763—Frizzelle) authorized the Board to determine what payments are or are not compensation and salary for retirement purposes when compensation and salary issues are in question.

SUMMARY OF LATEST AMENDMENTS

The May 24, 2000 amendments make technical and clarifying changes, including:

- Changes the method for calculating compensation earnable to be based on the member's highest pay rate, if a minimum level of service is performed at that rate. The minimum level of service required to use the highest pay rate would be at least .900 of a year of service.

- Clarifies that extracurricular activities are creditable if performed as part of a member's contract duties such as coaching and supervising student clubs, if performed by a member who is otherwise performing creditable service.
- Clarifies that contributions on compensation earned for service that exceeds 1.000 in a school year or compensation that represents a one-time, lump-sum payment (such as compensation for achieving certification from a national board) would be credited under the DBS Program
- Provides that the DBS Program, as well as definitions related to creditable compensation, would become effective July 1, 2002.
- Patterns the administration of the DBS after the Cash Balance (CB) Benefit Program, which provides nominal accounts for members, a guaranteed interest rate based on 30-year Treasuries, immediate vesting for both employer and employee contributions, a lump sum or annuitized distribution upon termination of employment, and a one-year waiting period to receive a benefit under circumstances other than retirement, disability or death.

CURRENT PRACTICE

Under current law, California State Teachers' Retirement System (CalSTRS) calculates a member's retirement benefit under the DB Program using (1) the member's credited service, (2) a factor based on the member's age at retirement and (3) the member's final compensation (which generally is the highest annual average compensation earnable over a three year period).

The member's service credit is determined annually according to the creditable service performed by the member. The actual determination of service credit is based on the ratio of compensation earned by the member to the compensation that would be earnable by the member if service were performed on a full-time basis the entire school year. "Full-time" means the days or hours of creditable service the employer requires to be performed by a class of employees in a school year to earn compensation earnable as defined in statutes and specified under a collective bargaining agreement. However, the employer's full-time requirement cannot be less than the statutory minimum standard for the related class of employees.

Creditable service includes activities performed for an employer in a position that requires a credential, certificate or permit under the Education Code or under standards adopted by the Board of Governors of the California Community Colleges. Positions under which creditable service is performed include teacher, instructor, principal, superintendent, counselor, health professional and librarian.

The member's final compensation generally is the highest average annual compensation earnable by the member for creditable service performed during any period of three consecutive years. For members who earn less than a full year of service credit or receive compensation at multiple pay rates during a school year, the annual compensation earnable is determined by adding the compensation earned and dividing by the service credit for that year. Generally, for members with multiple pay rates, additional service at lower pay rates will result in a lower annual compensation earnable.

Creditable compensation is money paid for creditable service, unless otherwise excluded by statutory provisions. In order to be creditable, compensation must be paid to everyone in a class of employees in the same dollar amount, the same percentage of salary, or the same percentage of the amount being distributed.

Current law excludes several types of payments from creditable compensation, including:

- Money paid for creditable service in excess of the full-time equivalent for the position
- Money paid for overtime, overload, summer school and intercession
- Stipends paid to department chairs when release time is not granted by the employer
- Bonus payments, such as pay-for-performance
- Allowances
- Payments under a contract option
- Non-cash compensation

DISCUSSION

Crediting Service and Compensation – In the early 1970's, when the current retirement plan was designed, K-12 education generally was provided for nine months a year, and community college instruction used full-time faculty to a greater degree. The current method of determining what compensation is creditable reflects the means by which education was provided at that time. As a result, summer school and intersession service is not creditable, and the plan assumes that members largely work only one job, and on a full-time basis.

Since then, a number of changes have occurred in the provision of education, including more year-round schools, summer school and the shift in community colleges to more part-time based instruction. In addition, administrators are increasingly being compensated based in part on their performance. This bill would make all compensation for creditable service creditable for purposes of determining a CalSTRS retirement benefit and would reflect the changes in education. By changing the current definition of creditable compensation, it would allow compensation that currently is not creditable to be counted in determining a member's retirement benefit.

This bill also changes the definition of creditable compensation to include not only compensation that is *paid* to everyone in a class but also compensation that is *payable* to everyone in the class. The purpose of this change is to permit members to receive benefits based on full compensation, without the retirement system being subjected to inadequate funding when compensation is restructured late in a member's career. It would also provide a basis for increasing total compensation earnable so that all members in a similar class could benefit from additional types of compensation, including pay for performance services.

- Administration of the DB Program – Excluding certain types of service and compensation from what is creditable for retirement increases the complexity of administering the DB Program. CalSTRS spends considerable resources to monitor employer compliance with creditable service and compensation requirements. When errors are discovered, they often are found to

be the result of the employer misunderstanding what compensation is creditable. This bill would substantially reduce the amount of time spent by CalSTRS staff in monitoring employer reports, as well as the time employers spend adjusting for previously incorrect data because all creditable compensation would be credited to member accounts. As a result, the current coding structure used by the CalSTRS could be streamlined.

- **DBS Program** – This bill requires the Board to establish and administer a DBS Program for service in excess of 1.000 year of service per school year and lump sum payments (such as compensation for achieving certification from a National Board). The DBS Program would be patterned after the CB Benefit Program for purposes of administration of the member’s supplement accounts. For each member with earnings for service in excess of full-time, the member and employer contributions would be credited to a Defined Benefit Supplement account within the Gain and Loss Reserve, a segregated account within the Teachers’ Retirement Fund. Contributions would be credited with interest at a guaranteed minimum rate. The balance in the account would be available to the member upon retirement or separation. This program would become effective July 1, 2002.

FISCAL IMPACT

Benefit Program Costs – This bill would increase contributions for both employers and members. The estimated annual statewide cost to employers would be equivalent to about \$175 million, or about .5 percent of all districts’ budgets, beginning in 2002-03. The changes will also increase on General Fund contributions to the DB Program and the Supplemental Benefit Maintenance Account, because the amount of creditable compensation earned in the DB Program would increase. Based on survey data received from employers, the estimated net annual General Fund cost would be approximately \$15 million, beginning in 2003-04.

According to estimates by the CalSTRS’ actuary, this bill would have the following actuarial impact:

	Present value cost (in millions)	Percent of pay to fund
Normal cost increase of future service		0%
Actuarial obligation for prior service	\$235	.071%
Increased contributions	(\$67)	(.021%)
Total costs during funding period	\$168	.050%

These estimates do not reflect potential changes in the rate of retirement, which may or may not occur as a result of the changes in the bill.

This actuarial impact would result in the following expenditures over the first three full fiscal years (in millions of dollars):

	2003-04	2004-05	2005-06
Total benefit payment increase	\$.3	\$.9	\$ 1.4
Annual increase in contributions needed to fund benefit:			
Defined Benefit Program	70	73	76
Defined Benefit Supplement	\$136	\$142	\$148

Administrative Costs – CalSTRS would incur initial implementation costs to modify existing CalSTRS reporting programs to reflect the expanded creditable service and compensation. Ongoing efficiencies would be realized in reporting and audit activities because substantially fewer contributions by employers will be incorrectly reported to CalSTRS.

POSITION

Sponsor. AB 2700 provides consistent treatment of compensation earned by CalSTRS members by providing retirement credit for all creditable service regardless of when it is performed. It would also simplify reporting for employers and eventually allow for streamlining administration of the DB Program.