

BILL NUMBER: [AB 1667](#) (Cooper) as amended August 25, 2022

SUMMARY

Among other provisions, AB 1667 requires that when a benefit is overpaid, the party responsible for the error that caused the overpayment must pay CalSTRS the full amount of the resulting overpayment, except in instances of CalSTRS error, in which case the overpayment must be recovered with interest on an annual basis from the General Fund and employers, as specified. AB 1667 also requires CalSTRS to provide advisory letters on the proper reporting of compensation to specified parties and states that if compensation reported consistent with such a letter is later deemed to be reported in error, any resulting overpayment is deemed an error of the system and must be recovered as specified. AB 1667 prescribes various processes for employer audit notifications and appeals and requires final audit reports to be published on the CalSTRS website. The bill mandates that CalSTRS annually provide resources to interpret and clarify the applicability of creditable compensation and creditable service laws, specifies when new interpretations may be applied and provides that if compensation reported consistent with such resources is later deemed to be reported in error, any resulting overpayment is deemed an error of the system and must be recovered as specified.

BOARD POSITION

Support. It is the board's policy to take a support position on bills that improve the delivery of benefits and services and provide more effective and efficient administration of the retirement plan. AB 1667 improves benefit reporting through additional resources for employers and addresses equity issues in CalSTRS' audit appeals process by ensuring all members affected by an audit have the opportunity to request an appeal. AB 1667 improves the retirement security of our members by reducing the burden of paying back inadvertent overpayments. While the bill adds significant complexity and administrative costs for CalSTRS, staff has worked with the author's office and bill sponsors to make AB 1667 more feasible to administer and to provide prudent sources of funds to cover the cost of overpayments and protect the plan's tax-qualified status.

REASON FOR THE BILL

According to the author, AB 1667 will protect retirees by ensuring they are not held liable for prior overpayments, except in cases of member error. AB 1667 is intended to reduce future employer mistakes by requiring CalSTRS to provide timely, consistent and accurate compensation reporting guidance. In addition, AB 1667 will create a more transparent and accountable audit process that will work for all stakeholders.

ANALYSIS

Existing Law:

CalSTRS Benefits

CalSTRS administers a hybrid retirement system, including a traditional defined benefit plan (the Defined Benefit Program) and a supplemental cash balance plan (the Defined Benefit Supplement Program). CalSTRS also provides disability and survivor benefits. Members do not contribute to or receive Social Security for their CalSTRS service, so they rely on their CalSTRS' pension as their primary source of income in retirement.

CalSTRS' Defined Benefit (DB) Program provides monthly lifetime retirement benefits to eligible educators based on years of service, age at retirement and final compensation. Under current law, final compensation is based on the highest average annual compensation earnable over a one- or three-year consecutive period, depending on the number of years of service provided and a member's benefit formula. Compensation earnable is determined using a member's average full-time pay rate plus any remuneration in addition to salary earned during the same school year.

The Teachers' Retirement Law delineates what is, and is not, creditable compensation and whether such compensation should be reported to the to the DB Program or the Defined Benefit Supplement (DBS) Program. Compensation for regular salary and ongoing remuneration in addition to salary, as specified, are reported to the DB Program and included in a member's final compensation. Compensation for creditable service that exceeds one year in a school year, or is paid a limited number of times for CalSTRS 2% at 60 members, is credited to the DBS Program and is not included in final compensation. Other types of compensation, such as compensation for unused accumulated leave or fringe benefits, is not creditable compensation and does not count toward any CalSTRS benefit.

Existing law requires employers to report all creditable compensation for a member's creditable service to CalSTRS and to specify the compensation type and full-time pay rate so that it may be appropriately credited to either the DB Program or DBS Program. Accurate reporting of compensation is critical to determining correct benefits and ensuring contributions are predictable and sufficient to pay those benefits. To help employers accurately report, CalSTRS developed regulations to clarify statute regarding creditable compensation.

Recoupment of Overpayments

The Internal Revenue Code (IRC) specifies requirements for maintaining qualified plan status, which allows the plan, employers and members to receive tax-deferred benefits. One requirement for defined benefit plans, such as those provided by CalSTRS, is to pay members a "definitely determinable" benefit that is specified in the plan rules and is adhered to in operation.¹ Payments that exceed what should have been paid under the plan's "definitely determinable" benefit formula must be recovered to avoid disqualification and loss of a plan's tax-advantaged status. This is because the member receiving the extra payment was not entitled to it under the terms of the plan.

Internal Revenue Service guidance provides various permitted methods for correcting overpayments, including recoupment from the recipient of the payments or another entity, in addition to adjusting the benefit to the correct amount going forward. Congress is currently deliberating on further changes to the corrections process that provide more flexibility for plans not to recoup overpayments from any party and still maintain tax-qualified status as part of the "SECURE 2.0" retirement reform package.

In addition, Section 17 of Article XVI of the California Constitution establishes that the board has a fiduciary duty over the administration of the plan and its assets, which "shall be held for the exclusive purposes of providing benefits" to members and their beneficiaries. Therefore, CalSTRS must correct overpayments.

¹ Treasury Regulation section 1.401-1(b)(1)(i) states that a defined benefit plan must "provide systematically for the payment of definitely determinable benefits" to employees. Benefits are "definitely determinable" if "the benefits on behalf of each participant are determined in accordance with a stipulated formula that is not subject to the discretion of the employer." (Revenue Ruling 74-385; 1974-2 C.B. 130).

Furthermore, current law limits CalSTRS' right to recover overpaid amounts from members and beneficiaries. When an overpayment results from correcting a system error, CalSTRS is prohibited from collecting all incorrect payments made more than three years prior to commencing recovery. When an overpayment results from employer error, member error or fraud, CalSTRS must commence collection within three years of discovering the incorrect payment to collect the full amount from the member or beneficiary. Additionally, current law limits reduction of future benefit payments to recover overpaid amounts to 5% in the case of system or employer error and to 15% in the case of inaccurate information or nonsubmission of information by the benefit recipient. Current law also provides that if the full amount of the overpayment is not expected to be collected over the lifetime of the member or beneficiary, CalSTRS may collect the difference between the actuarial value of the expected payments and the total amount overpaid from the employer.

Employer Audits and Appeals

Current law authorizes CalSTRS to conduct employer audits as the board determines necessary. The purpose of the audits process is to promote accurate reporting of payroll information, which ensures correct benefits are paid and the fund is protected for our members. CalSTRS makes findings on the employer's reporting practices based on a review of sampled reporting transactions. As part of the draft and final audit reports, CalSTRS identifies employer reporting errors and communicates those findings to the employer as well as the sampled members. If an audit finds that a reporting error is potentially more widespread, the finding is identified as appearing to be systemic in nature. At that point, CalSTRS requests the employer determine whether it misreported for any additional members beyond those in the audit sample, identify those additional members (also known as the systemic population) and make corrections for all affected members.

Existing regulations outline the administrative remedy process available for the audited employer and sampled members as follows:

- An applicant (defined as a member, former member, participant, former participant or beneficiary) or entity affected by the preliminary findings of an audit may provide a written response to the preliminary audit findings.
- CalSTRS will inform the applicant or entity of their right to an administrative hearing.
- If an applicant or entity disagrees with the final audit report, they may request an administrative hearing within 90 days from the date of the final audit report.
- If a request for administrative hearing is not made timely, the final audit report is finalized, and the right to hearing is waived.

Only the sampled members are known to CalSTRS and identified in a final audit report's confidential appendix. Any other members whose reporting may be changed as a result of the audit findings and subsequent reporting corrections are generally unknown to CalSTRS, unless the employer specifically identifies those systemic members and communicates them to CalSTRS. Since CalSTRS does not know which members are part of the systemic population, the system cannot notify those members of the finding or of their right to request an administrative hearing in a timely manner. Therefore, members in the systemic population typically do not know that their benefits were impacted because of an audit finding until after the window of time to request an administrative hearing has passed. This creates inconsistency in the treatment of members and their ability to appeal benefit changes stemming from employer audits and employer re-reporting.

This Bill:

Specifically, AB 1667:

- Defines “exclusive representative” as an employee organization recognized or certified as the exclusive negotiating representative of public school employees in an appropriate unit of a public school employer.
- Requires CalSTRS to provide prior written notice of an intended audit, as specified, to the affected public agency and the exclusive representative or representatives of the members that may be affected by the audit. The public agency is responsible for providing CalSTRS with the name and contact information of the exclusive representative.
- Requires the public agency being audited to cooperate in good faith and provide all information to CalSTRS and the exclusive representative in a timely manner.
- Allows the public agency and the exclusive representative to provide additional information relevant to an audit, which CalSTRS is required to consider in preparing the audit findings.
- Requires CalSTRS, prior to issuing the final audit report, to provide the public agency and exclusive representative: the preliminary audit findings, the statutes being addressed by the audit and a list of every member then known by CalSTRS to be affected by the audit.
- Requires CalSTRS to:
 - Specify a period of at least 60 days during which the recipients of the preliminary audit findings may provide a written response to those findings.
 - Consider the responses in preparing the final report.
 - Specify a period of at least 60 days during which the public agency must provide CalSTRS and the exclusive representative a list of any members affected by the audit that were not included in the list provided by CalSTRS.
- Requires CalSTRS to provide the final audit report to the public agency, the exclusive representative and each member known to be affected by the audit, with an explanation of either the public agency’s or member’s appeal rights, which include a 90-day period to request an administrative hearing.
- In the case of a member that is later found to be affected by an audit, requires CalSTRS to provide the final audit report to the member, former member or their beneficiaries, with an explanation of their appeal rights.
- Specifies the right to an administrative hearing is waived and the findings of the final audit report are deemed the board’s final determination if the public agency or member fails to request an administrative hearing within the 90-day period provided.
- Requires all final employer audit reports to be published on the CalSTRS website, excluding personal information regarding members.
- Requires CalSTRS to annually provide resources to interpret and clarify the applicability of creditable compensation and creditable service, prevents new or different interpretations of those applications from taking effect until after notice is provided to employers and exclusive representatives, and specifies that new interpretations do not apply retroactively, except as specified.
- Specifies that changes to interpretations of creditable compensation and creditable service must not take effect before the next July 1, except as specified.
- Clarifies that employers are responsible for the rules in effect at the time compensation is reported, except when expressly superseded, and if compensation reported in accordance with the system’s rules is later determined to have been reported in error, the resulting overpayment is deemed an error of the system.

- Effective July 1, 2023, permits an employer or an exclusive representative to submit a request to CalSTRS, as specified, for an “advisory letter,” which is defined as a written determination issued to an employer or an exclusive representative in response to the requestor’s submission relating to compensation that is included, or is proposed to be included, in a publicly available written contractual agreement in order for CalSTRS to provide formal written guidance for the proper reporting of such compensation.
- Permits a submission for an advisory letter to be denied by CalSTRS if it involves an issue that is in litigation with the affected employer or member and permits the submission to be withdrawn by the requestor at any time before an advisory letter is provided.
- Requires CalSTRS to provide an advisory letter within 30 days of the receipt of all information requested by the system, unless an extension is necessary for good cause, and specifies when an advisory letter may be superseded.
- Specifies that if compensation reported in accordance with an advisory letter is later determined to have been reported in error by the employer or on behalf of a member to whom the letter expressly relates, the resulting overpayment is deemed an error of the system.
- Permits only the employer or a member to whom an advisory letter expressly relates to use and rely upon or offer as evidence of an error by the system, the advisory letter in an action brought by the system if the system determines all material facts related to the compensation were disclosed in the submission and the employer reported compensation in reliance on the advisory letter. “Material facts” are facts that would have changed the determination made in an advisory letter.
- Permits county superintendents of schools to draw requisitions against the county school service fund and the funds of employing agencies for purposes of remitting contributions, assessments or any other payment required by the board, including any overpayments deemed to be an error of an employing agency.
- Requires all amounts overpaid to be recovered as follows:
 - Amounts overpaid due to inaccurate information, untimely submission, nonsubmission of information or on the basis of fraud by or on behalf of a benefit recipient are recovered from that recipient.
 - Amounts overpaid due to inaccurate information, untimely submission or nonsubmission of information by an employer that reports directly to CalSTRS are recovered from that employer.
 - Amounts overpaid due to inaccurate information, untimely submission or nonsubmission of information by a county superintendent that reports directly to CalSTRS on behalf of an employer are recovered from that county superintendent, and if the overpayment is a result of an employer error, as specified, the county superintendent may recover the applicable amounts from that employer.
 - Amounts overpaid due to an error by the system are recovered with regular interest from the date of the overpayment as follows beginning July 1, 2024:
 - 85% of this amount resulting from benefit adjustments that take place within the fiscal year ending in the immediately preceding calendar year are made as a continuous appropriation from the General Fund to the Controller each July 1 for transfer to the Teachers’ Retirement Fund.
 - 15% of this amount resulting from benefit adjustments that take place within the fiscal year ending in the immediately preceding calendar year are recovered from all employers that report directly to the system in amounts proportionate to their share of contributions for that fiscal year, including the contributions of those

employers for whom a county superintendent of schools reports. A county superintendent of schools that reports directly to the system on behalf of employers may recover amounts proportionate to each employer's share of contributions for that fiscal year from those employers.

- If employers do not pay required amounts within 30 days, includes regular interest from the initial due date of the amount owed and allows the board or the county superintendent to request the State Controller to reduce subsequent payments to the county or school district, as appropriate, by the amount owed in order to pay CalSTRS.
- Clarifies that CalSTRS' ability to correct benefits is not limited by these overpayment recovery provisions.
- Repeals the requirement that, in instances of employer error, CalSTRS must collect the difference between the actuarial value of the expected payments and the total amount overpaid from the employer.
- Makes other various technical and conforming changes, as required.

Discussion

AB 1667 addresses the denial of due process rights to members in the systemic population affected by employer audit findings by providing a mechanism for CalSTRS to know which members those are. Under the bill, all members affected by an audit receive the final audit report and notice of the window period to request an administrative hearing if they disagree with the final audit report. By extending due process rights to these systemic population members, AB 1667 helps to ensure equity for members in CalSTRS' audit appeals process.

In addition, the bill places new responsibilities on CalSTRS to include the exclusive representative in the audit process and post final employer audit reports online, requiring CalSTRS to modify existing practices. CalSTRS typically provides an opportunity to submit responses to preliminary audit findings during a 15- or 30-day window. This bill requires a minimum window of 60 days, lengthening the overall audit timeline and making it more challenging to meet the audit standard of timeliness. CalSTRS staff are already preparing to post final employer audit reports to CalSTRS.com as part of a continuing effort to improve communications about the audit process with members, employers and stakeholders.

While CalSTRS staff currently provide training and informal guidance to employers on a regular basis, the new formal process for advisory letters is expected to significantly increase workload for benefits and legal staff. Given the numerous factors that contribute to how compensation is reportable, each request for an advisory letter will need to be reviewed for the unique circumstances of the compensation in question. Employers may be incentivized by the bill to submit requests for formal advisory letters on numerous compensation questions to avoid liability for reporting errors. As such, the volume of advisory letters resulting from the bill, while unknown, is expected to be high. Notably, however, the new advisory letter process, in combination with enhanced resources to interpret and clarify the applicability of creditable compensation and creditable service laws, is expected to improve employer understanding of CalSTRS reporting requirements and improve consistency of guidance provided by staff, both of which are expected to improve the accuracy of benefits for CalSTRS members.

For occasional instances when benefit overpayments continue to occur, AB 1667 assigns the cost to the party responsible for the error that caused the overpayment, except in instances of CalSTRS error, in which case the overpayment must be recovered from the General Fund and employers, as

specified. While this reduces the burden of overpayments on retired members for errors that were not their fault, it also increases costs and legal risks. The bill is likely to increase litigation over the proper assigning of liability for reporting errors. At the same time, if AB 1667 is successful in reducing the number of benefit errors, CalSTRS may also experience decreased costs associated with processing benefit adjustments and collecting overpayments.

Overall, despite the challenges and additional costs and responsibilities created by AB 1667, there are several aspects of the bill that improve clarity and understanding of compensation reporting and transparency around the audit process for members, employers and exclusive representatives. As such, AB 1667 builds on CalSTRS ongoing efforts to improve benefit reporting, build trust and ensure the accuracy of our member's retirement benefits.

LEGISLATIVE HISTORY

SB 278 (Leyva, Chapter 331, Statutes of 2021) provided that, when a CalPERS pension is reduced postretirement, due to the inclusion of compensation agreed to under a collective bargaining agreement that is later determined to be disallowed, the employer must cover the difference between the pension as originally calculated and as reduced by CalPERS.

AB 2260 (Assembly PER&SS, Chapter 207, Statutes of 2010) brought CalSTRS into compliance with federal law that requires members to be paid a "definitely determinable" benefit by requiring overpayments above the "definitely determinable" benefit that could not be collected from the member to be collected from the employer when the overpayment was made due to employer error.

SB 627 (Assembly PE&R, Chapter 859, Statutes of 2003) extended CalSTRS' authority to recover overpayments from subsequent benefits and the associated limitations on recovery of overpayments to the Cash Balance Benefit Program.

AB 2700 (Lempert, Chapter 1021, Statutes of 2000) extended CalSTRS' authority to recover overpayments from subsequent benefits and the associated limitations on recovery of overpayments to the DBS Program.

SB 2682 (Green, Chapter 739, Statutes of 1988) set a three-year statute of limitations on actions by or against CalSTRS for adjustments of errors or omissions for purposes of payments into or out of the retirement fund and provided for the application of that period to erroneous payments.

AB 62 (Elder, Chapter 1006, Statutes of 1986) restricted the collection of overpayments from subsequent benefits to no more than 5% if the overpayment was due to system or employer error and no more than 15% if the error was due to inaccurate or nonsubmission of information by a benefit recipient. The bill also required a report to the board with specified information regarding overpayments and underpayments.

AB 3191 (Bannai, Chapter 314, Statutes of 1978) authorized the board to assess penalties and interest on employers for late or improper adjustments and required employers to reimburse the system for any disbursements that resulted from erroneous employer information.

AB 1481 (Bannai, Chapter 659, Statutes of 1977) required CalSTRS to recover overpayments made to or on behalf of a benefit recipient or former member to be collected from subsequent

benefits instead of from the death benefit and permitted that recovery to occur simultaneously with any suit for restitution by the system.

SB 854 (Marler, Chapter 742, Statutes of 1973) required CalSTRS to collect overpayments not recovered before or immediately following the death of a benefit recipient or former member from a death benefit payable by the system. The bill also provided that losses or gains resulting from overpayments or underpayments must be debited or credited to the appropriate reserve in the Teachers' Retirement Fund.

PROGRAM BACKGROUND

Employer Reporting

Compensation is negotiated and structured in a variety of ways by more than 1,700 CalSTRS employers statewide. For example, an agreement used by one employer might include payments for years of experience and educational attainment as part of the salary schedule, while another employer may pay a flat stipend explicitly in addition to salary for the same purpose. The manner in which compensation is structured, described and paid, and not just its purpose, is important in assessing proper reporting for CalSTRS purposes.

Due to the volume of reporting CalSTRS receives from employers, it is impossible to review all reported pay for accuracy. Therefore, CalSTRS relies on employers to provide accurate reporting. To help employers apply the creditable compensation laws and regulations and clarify reporting requirements, CalSTRS staff regularly provide Employer Directives, Employer Circulars, training and point-in-time assistance on these topics. Additionally, CalSTRS has embarked on a pension administration system modernization effort, which has a primary goal of ensuring the most accurate reporting from employers. Once the pension administration system is complete, it is expected to reduce errors and the need for benefit adjustments.

Recoupment of Overpayments

After a member's or beneficiary's benefit effective date, CalSTRS may receive additional information or discover an error that reduces the benefit for the remainder of the member's or beneficiary's lifetime. Although benefit overpayments affect a very small portion of CalSTRS' total benefit recipients, these types of errors can be difficult for those affected because, in addition to the reduced benefit, CalSTRS reduces the monthly allowance by an additional percentage in order to recoup overpaid amounts. For each fiscal year from 2016-2017 through 2020-2021, between 0.4% and 1.2% of members receiving an unmodified service retirement benefit from CalSTRS experienced a decrease in their benefit that then resulted in an overpayment. Additionally, most benefit adjustments are made within the first year following a benefit effective date. For the same timeframe, the median estimated overpayment was less than \$250, and the median reduction to a member's unmodified monthly allowance was less than \$5.

FISCAL IMPACT

Program Costs/Savings – From the 2016-17 through 2020-21 fiscal years, at least some portion of approximately 50% of the total number of overpayments made to members retired more than three years was written off indicating that the overpayment was likely a result of system error and

uncollectable based on CalSTRS' statute of limitations.² Based on the time period analyzed, if 50% of the all overpaid amounts were determined to be system error, under AB 1667, CalSTRS would have been required to annually collect approximately \$225,000 to \$450,000 proportionately from all employers and approximately \$1.28 million to \$2.55 million from the state. An average annual amount of approximately \$500,000 would have continued to be uncollectable due to the statute of limitations, and the remaining \$2 million to \$3.5 million would have been collected annually from employers, mainly K-12 school districts and community college districts, due to a determination that the overpayment was the result of employer error.

Administrative Costs/Savings – Increased upfront and ongoing costs, including a need for additional staff, to create a process and work units to review and provide advisory letters on compensation, implement changes to the audit resolution and appeals processes, and collect overpayments from employers and the state. This includes hiring approximately 12 additional benefits program staff, seven additional legal staff, three additional audit services staff and 13 additional financial services staff at a cost of approximately \$5.1 million annually. Required administrative system changes would create unknown, but likely significant, costs and delays for the new pension administration system and additional costs for the accounting and legacy pension administration systems.

SUPPORT

California Teachers Association (Sponsor)
California Retired Teachers Association (Sponsor)
California County Superintendents Educational Services Association (Sponsor)
Amador County Unified School District
Association of California Community College Administrators
Association of California School Administrators
Association of California Suburban School Districts
California Alliance for Retired Americans
California Association of School Business Officials
California Association of Suburban School Districts
California Federation of Teachers, AFL-CIO
California Labor Federation, AFL-CIO
California School Employees Association
County Departments of Education: Orange and Tehama
County Offices of Education: Alameda, Calaveras, Colusa, Contra Costa, El Dorado, Fresno, Humboldt, Imperial, Kern, Lake, Lassen, Los Angeles, Madera, Marin, Mariposa, Mendocino, Merced, Mono, Monterey, Napa, Placer, Plumas, Riverside, Sacramento, San Benito, San Diego, San Joaquin, San Mateo, Santa Barbara, Santa Clara, Solano, Tehama, Trinity, Ventura, Yolo and Yuba

² The 2016-17 through 2020-21 fiscal years included fairly significant data clean-up efforts to prepare for the new pension administration system. In addition, these years captured an instance of delayed legislative implementation that created a number of overpayments that were written off by some amount. With data clean-up efforts removed from the analysis, approximately 24% of the overpayments were written off by some amount. With both data clean-up and the delayed legislative implementation removed, that proportion would be reduced to approximately 4%. Therefore, the fiscal years included in the analysis may include a higher proportion of overpayments deemed to be system error than a "typical" fiscal year.

County Superintendents of Schools: Fresno, Kern, Nevada, Riverside, San Bernardino and Tuolumne
Delta Kappa Gamma California
Faculty Association of California Community Colleges
Plumas Unified School District
School Employers Association of California
Small School Districts' Association

OPPOSITION

Department of Finance

ARGUMENTS

- Pro: Reduces the burden of benefit overpayments for members.
- Provides appeal rights to members that are part of the systemic population for an employer audit finding.
- Increases transparency and access to employer audits.
- Provides a process for employers and exclusive representatives to obtain written guidance from CalSTRS.
- Con: Results in increased costs to the system, employers and the state and requires additional CalSTRS staffing resources.

LEGISLATIVE STAFF CONTACT

Meredith Bartles
Plan Design Specialist,
CalSTRS Governmental Relations,
(916) 414-1982
mbartles@calstrs.com

John Maradik-Symkowick
Manager,
CalSTRS Governmental Relations,
(916) 414-1977
jmaradik-symkowick@calstrs.com

Joycelyn Martinez-Wade
Director,
CalSTRS Governmental Relations,
(916) 414-1980
jmwade@calstrs.com