CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 1733	**Assembly Member Wildman (As amended 3/30/00)**
Position:	**Support, if amended**
Proponents:	**CTA (Sponsor)**
Opponents:	**Unknown**

SUMMARY

AB 1733 eliminates the earnings limit for California State Teachers' Retirement System (CalSTRS) members who retired for service.

HISTORY

Chapter 1, Statutes of 1997 (AB 18—Mazzoni) retroactively made operative the provisions of Chapter 948, Statutes of 1996 (AB 1068-Mazzoni). These bills exempted the earnings limit members who retired on or before July 1, 1996 and were subsequently hired to alleviate the teacher shortage caused by the passage of the Class Size Reduction Program in Grades K-3.

Chapter 965, Statutes of 1998 (AB 2765—Assembly PER&SS) extended the exemption for class size reduction to members who retired on or before July 1, 1998 and extended the sunset to July 1, 2002. It also extended until July 1, 2003 (1) an exemption for members appointed as a trustee or administrator by the Superintendent of Public Instruction or assigned by the Superintendent or (2) employed to fill on an emergency basis an administrative position that was vacated due to circumstances beyond the control of the employer.

Chapter 40, Statutes of 1999 (AB 335—Mazzoni) extended the existing earnings limitation exemption for retired teachers who returned to the classroom as a result of the K-3 Class Size Reduction Program to include the recently authorized Grade 9 class size reduction program, and future expansions of the class size reduction programs authorized by Part 28 of the Education Code.

AB 81 (Cunneen) would have exempted from the earnings limit members who retired for service on or before July 1, 1998 if they were subsequently employed by a high school to teach math or science. AB 81 failed passage in the Assembly Revenue and Taxation Committee.

AB 141 (Knox) extends for an additional six months the current exemption from the earnings limitation for retired members who are employed on an emergency basis to fill an administrative position that is vacated due to circumstances beyond the control of the employer.

AB 1736 (Ducheny) exempts from the earnings limitation members who retired on or before July 1, 2000 and return to the classroom to provide direct remedial instruction to pupils in K-12, inclusive.

SB 1505 (Alarcon) suspends for five years the statutory earnings limitation for CalSTRS members who (1) retired on or before January 1, 2000 and (2) return to K-12 schools or County Offices of Education to provide direct classroom instruction or to provide support for various programs, such as student interns or the Beginning Teacher Support and Assessment Program.

CURRENT PRACTICE

Current law permits a member who retired for service to earn compensation of up to $19,050 for creditable service during the 1999-2000 school year, without a reduction in the retirement allowance. The limit is indexed annually to increases in the All-Urban California Consumer Price Index. In 2000-2001, the earnings limit will be $19,650. Any creditable earnings in excess of this amount result in a dollar-for dollar reduction in the retirement allowance up to the annual allowance. There are exemptions from this limit, including:

- A retired member who retired for service and who is appointed as a trustee or administrator. This exemption sunsets on July 1, 2003.
- A retired member who is employed on an emergency basis to fill an administrative position. This exemption also sunsets on July 1, 2003.
- A retired member who retired for service on or before July 1, 1998, and is employed either to (1) provide direct classroom instruction to in any statutorily authorized class size reduction program; or (2) temporarily fill a position vacated by a teacher who transferred to a classroom in the same district because of the Class Size Reduction Program. This exemption, which sunsets on July 1, 2002, is subject to the following conditions:

    1. The member must be treated as part of a distinct class of temporary employees within the existing bargaining unit.
    2. The employing school district must submit documents to CalSTRS to substantiate the eligibility of the member for the exemption.

DISCUSSION

The requirements of the CalSTRS earnings limit are necessary, among other reasons, to ensure compliance with federal tax law, which prohibits tax-qualified plans, such as the CalSTRS Defined Benefit (DB) Program, from paying benefits to members who are working under the retirement system. If the DB Program lost its tax qualified status, both CalSTRS and the CalSTRS members would be liable for income tax for the investment earnings of the program.

The current earnings limit of $19,050 represents approximately one-half of the average earnable salary in California for CalSTRS members, which, as of June 30, 1999 was approximately $45,000. If the earnings limit is repealed, the tax-qualified status of the DB Program could be jeopardized because members could “retire” in the future and immediately return to work, which could determine to be inconsistent with the federal law. The bill should be amended to eliminate that increased jeopardy.

There are two potential options available to address this problem. For example, if a retired member is beyond the normal retirement age of age 60 and returns to work, any amount of earnings probably would not jeopardize the tax qualified status of the DB Program. Alternatively, a one-year break in service between the time of retirement and the time of return to service would also provide an appropriate degree of assurance that the member had in fact retired before returning to service.

This bill may encourage early retirement because eliminating the earnings limitation will make it possible for a retired member to receive a retirement allowance and salary that exceed the total compensation this member received before retiring. If the elimination in the limit did encourage an earlier retirement, this would result in an actuarial cost to the program because the program will have fewer years to collect and invest contributions for the benefit. Although a similar but lesser effect would occur if the bill was amended to apply only to members who retired after age 60, this fiscal effect would largely be eliminated if the bill was amended to require the member to wait a year after retirement before becoming eligible.

Although eliminating the earnings limit could encourage an earlier retirement due to an initial total increase in income, this short-term gain to the member may come at the expense of long-term increase in the retirement allowance the member would have realized if he or she continued to work to a later age and earned additional service credit. When the member is no longer able to work, he or she will receive only the original service retirement allowance, as opposed to the higher benefit the member would have received by earning additional service credit.

FISCAL IMPACT

Benefit Program Costs – To the extent that eliminating the earnings limitation encourages members to retire sooner, the bill will increase the actuarial cost to the DB Program. The actuary has not, however, calculated the magnitude of that cost. If eliminating the earnings limit has no impact on retirement behavior, there would be no actuarial impact on the program, because the actuarial valuation of the program assumes that members do not work beyond the earnings limit. To the extent such additional service does occur, the resulting reduction in allowance payments represents an actuarial gain. If the earnings limit was eliminated, and those allowance reductions no longer occurred, the program would forego that unanticipated actuarial gain, which has an estimated annual value of $1.2 million.

Administrative Costs – This bill will result in minimal one-time implementation costs. In addition, this bill would decrease the level of staff resources used currently to calculate and offset excess earnings by reducing future allowance payments. Other tasks, such as notifying retired members that they are approaching the earnings limit, would be eliminated.

POSITION

Support, if amended to exempt members from the earnings limit only if one year has elapsed since retirement without the member forming creditable service.