CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 2700	**Assembly Member Lempert (As amended 8/31/00)**
Position:	**Sponsor**
Proponents:	**CTA**
Opponents:	**None known**

SUMMARY

This bill makes all compensation for creditable service creditable to the State Teachers' Retirement Plan effective July 1, 2002 or July 1, 2003, depending on increases in state funding for school districts in 2001-02. It also credits member and employer contributions on compensation earned for creditable service in excess of 1.000 years of service per school year to the Defined Benefit Supplement (DBS) Program established in Chapter 74, Statutes of 25000 (AB 1509—Machado). This bill also contains numerous technical amendments and appropriates funds to implement that program. Finally, it reduces the General Fund appropriation to the Defined Benefit (DB) Program from the current 3.102 percent of creditable compensation in the prior calendar year to 2.5385 percent in 2000-01 and 1.975 percent in 2001-02.

HISTORY

Chapter 74, Statutes of 2000 (AB 2700—Machado) requires that 25 percent of the contributions by a member of the DB Program be credited for the next 10 years to the member's account in the DBS Program, which was established in the bill.

Chapter 967, Statutes of 1998 (AB 2804—Honda) reduced the General Fund contribution to the DB Program from 4.3 percent of the prior calendar year creditable compensation to 3.102 percent.

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 DB Program.

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

CURRENT PRACTICE

Under current law, the 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.

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

Under current law, a General Fund transfer to the Teachers' Retirement Fund (TRF) equal to 3.102 percent of the total creditable compensation paid in the previous calendar year is made to finance benefit increases approved in the 1998 Teachers Recruitment and Retention Benefits Package. In 2000-01, the General Fund transfer is $556 million. An additional amount, up to 1.505 percent of total creditable compensation, would be transferred to the TRF to amortize any unfunded actuarial obligation or to eliminate any normal cost deficit attributable to benefits in effect as of July 1, 1990. No transfer is currently required for such purposes.

DISCUSSION

<u>Crediting Service and Compensation</u> – 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 intercession 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.

<u>Administration of the DB Program</u> – 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 can be streamlined.

General Fund Appropriation – This bill reduces the General Fund appropriation to the DB Program from the current 3.102 percent of the creditable compensation in the prior calendar year to 2.5385 percent in fiscal year 2000-01 and 1.975 percent in 2001-02. This reduces the General Fund transfer to the DB Program by 35 percent beginning January 1, 2001. This reduced contribution rate is equal to the current normal cost of benefits that became effective January 1, 1999. In addition, the DB Program will continue to be protected against adverse experience in the pre-1990 benefits.

FISCAL IMPACT

Benefit Program Costs – This bill will 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 or 2003-04, depending on the state funding for school districts.

According to the CalSTRS' actuary, this bill would result in a one-time increase of $235 million in the actuarial obligation for prior service credit.

Reducing the General Fund contribution to the DB Program would reduce the present value of contributions by $3,474 million over the next 30 years, equal to $200 million annually.

Administrative Costs – CalSTRS will 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. CalSTRS also will incur costs to implement the DBS Program, established in Chapter 74, Statutes of 2000 and which will be credited with member and employer contributions on compensation earned for creditable service in excess of 1.000 years of service per school year. The implementation costs are estimated to be $600,000. This bill provides for an appropriation to cover these costs for the current year to permit implementation of Chapter 74.

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.