Bill Number: **Assembly Bill 1844 (Hernandez) as amended May 23, 2008**

SUMMARY

AB 1844 contains proposals of the Governor's Public Employee's Benefits Commission (PEBC). This bill, among other things, includes provisions regarding fraud against retirement systems and Other Post Employment Benefits (OPEB) reporting requirements for local public agencies.

PURPOSE OF THE BILL

The Governor established the Public Employee Post-Employment Benefits Commission in early 2007 to propose ways to address pension and retiree health care obligations to ensure that local governments and the State can adequately provide benefits to retired public employees. AB 1844 will help increase transparency with public employee benefits through enhanced reporting requirements and also help curb fraud in the various retirement systems by providing retirement systems the tools they need to detect and prosecute fraudulent activity.

BOARD POSITION

Support. It is the policy of the Board to support legislation that preserves the assets and minimizes the liabilities of the funds administered by CalSTRS. This bill will help increase transparency with public employee benefits through enhanced reporting requirements and help curb fraud in the various retirement systems by providing the tools they need to detect and prosecute fraudulent activity

SUMMARY OF AMENDMENTS

The amendments of May 23, 2008:

1) Adds a technical amendment to include "Part 14" (Cash Balance Benefit Program) to Section 22010 of the Education Code of the Teachers' Retirement Law relating to retirement benefit application fraud;

2) Adds requirement that any agency that provides OPEB benefits to also submit its most recent actuarial valuation to the Controller within nine months of the close of each fiscal year in which the agency is required to file a Governmental Accounting Standards Board (GASB) 45 Statement.

2) Requires the Controller to post this information on the Controller's website.

LEGISLATIVE HISTORY

AB 2350 (Garrick—2008) Makes legislative findings regarding the importance of prefunding retiree healthcare benefits as a policy and a budget priority. AB 2350 is currently pending referral in the Assembly Rules Committee.

SB 1123 (Wiggins—2008), Includes other OPEB benefits within the subject matter of a state or local retirement system's statement of actuarial impact upon future annual costs when authorizing an increase in benefits. Requires the future annual costs of OPEB benefits to be made at public meetings 2 weeks prior to adoption. Requires an actuary to be present to provide information at the meeting where the adoption of the new benefit is considered. Creates the California Actuarial Advisory Panel to provide impartial and independent information on pensions, OPEB benefits, and best practices to the Legislature, Governor and public agencies. SB 1123 is pending before the Senate Public Employment and Retirement Committee.

SB 1514 (Margette—2008), Includes OPEBs within the subject matter of the actuary's statement provided for legislative review prior to authorizing an increase in benefits; and requires future annual OPEB costs to be made public at least two weeks prior to public meeting adoption. SB 1514 is currently pending before the Senate Public Employment and Retirement Committee.

AB 36 (Niello—2007), Imposes criminal penalties on California State Teachers' Retirement System (CalSTRS) members, beneficiaries, participants and those who assist them in making false material statements or representations in order to receive CalSTRS benefits. Makes it a crime for a person to accept a benefit payment from CalSTRS with the knowledge that he or she is not entitled to the benefit. AB 36 is pending before the Senate Public Employees and Retirement Committee.

AB 545 (Walters—2007), Authorizes CalPERS to request information from insurers and the Employment Development Department (EDD) in order to investigate the eligibility and unlawful application or receipt of benefits provided by CalPERS. AB 545 is currently pending before the Senate Banking, Finance and Insurance Committee.

AB 456 (Torrico—2005) Imposed criminal penalties on CalSTRS members, beneficiaries, participants and those who assist them for making false material statements or representations in order to receive CalSTRS benefits. It also made it a crime for a person to accept a benefit payment from CalSTRS with the knowledge he or she is not entitled to the benefit. AB 456 died on concurrence on the Assembly Floor.

AB 5X (Torrico—2005) Imposed criminal or civil penalties on CalSTRS members, beneficiaries, participants and those who assist them, for making false material statements or representations in order to receive CalSTRS benefits, and made it a crime for a person to accept a benefit payment for CalSTRS with the knowledge he or she is not entitled to the benefit. AB 5X was held in the Assembly Appropriations Committee.

Chapter 622, Statutes of 2002 (AB 2471—Pacheco) created a new felony for making false material statements while under oath in workers' compensation cases. Provided that a person who makes, presents, aids, conspires or causes false or fraudulent material statements to be made while under oath in such cases is guilty of a felony punishable by 2, 3, or 5 years and/or a fine up to $50,000, or double the value of the fraud, whichever is greater.

PROGRAM BACKGROUND

The Public Employee Post-Employment Benefits Commission, established by the Governor in December 2006, was charged with proposing ways to address pension and retiree health care obligations to ensure that local governments and the State can adequately provide pensions and other post employment benefits, which are any benefits provided post-employment, other than pensions, to retired public employees. The Commission issued its report, *Funding Pensions and Retiree Health Care for Public Employees*, on January 7, 2008, after a year's effort by the bipartisan 12-member group. AB 1844 includes several provisions intended to implement some of the recommendations of the PEBC. Specifically, AB 1844 includes recommendations 9, 10, and 26 of the Commission's final report.

Recommendation 9 Government Code Section 7504.5	Legislation should be enacted directing the State Controller's Office to develop a simple and inexpensive procedure to regularly collect and report OPEB data from California public agencies. To minimize reporting requirements for public agencies, all the data collected for this report should be contained in the Governmental Accounting Standards Board (GASB) 45 actuarial valuation report.
Recommendation 10 Government Code Section 7504	The State Controller's Office should publish the annual report of public pensions, which is required in current law, within 12 months of the receipt of data but in no case longer than 18 months after the end of the fiscal year.
Recommendation 26 Education Code Section 22010	Legislation should be enacted which would make it a crime to make a fraudulent claim for a retirement or disability benefit or to keep a payment made on the basis of a fraudulent claim;

Existing law requires a state or local retirement system and local legislative bodies to secure the services of an enrolled actuary, who is to perform a valuation of the system, and provide a statement of the actuarial impact upon future annual costs before authorizing increase in public retirement plan benefits. Existing law also requires the future annual costs of the public retirement plan benefits, as determined by the actuary, to be made public at a public meeting at least 2 weeks prior to adoption of any increases in the benefits.

Reporting of OPEB Liabilities

It is in the public's interest for public retirement systems and employers providing OPEB benefits to report on the status and adequacy of funding for these benefits. Current reporting mechanisms do not provide for the timely and accurate disclosure of pension and OPEB liabilities.

Prefunding refers to the deposit of assets in advance of their actual need to cover accumulated and future costs. Typically, prefunding is linked to the deposit of assets into an irrevocable trust account, with investment earnings increasing available funds over time.

The majority of public agencies in California do not currently prefund their OPEB liabilities. Instead, most rely on pay-as-you-go to cover current year costs without consideration of accumulated liabilities or future costs. Over the long term, the total cost to prefund OPEB benefits will be less than pay-as-you-go because prefunding enables the employer to fund benefits as they are earned and to use the resulting investment returns to help pay for the benefits. Each year of prefunding immediately reduces the long-term unfunded liability.

GASB Statement 45 requires that governmental entities report in their financial statements the current and future costs of health and other benefits that are promised to their employees in retirement similar to the way pensions are reported today. So, in short, all post employment benefits, other than pension benefits are accounted for as they are earned as opposed to only when they are paid as is now the case. The PEBC has recently found that the accumulated unfunded liability for the retiree health care promised to California's public sector employees is $118 billion. Currently, there is no requirement in State law, that this figure be presented to the State Controller as pension liabilities are.

CalSTRS currently provides for the payment of Medicare Part A premiums for eligible members under the Medicare Premium Payment Program (MPPP), which is considered an OPEB. CalSTRS does not pre-fund the MPP Program. Instead, sufficient employer contributions are redirected each month to pay the current premiums and related administrative costs, and provide an appropriate reserve. CalSTRS chose this method of funding rather than pre-funding the total amount. Money in the Teachers' Health Benefits Fund can only be used for health benefits. When the MPP Program began, it was very difficult to know how much was required to properly fund the program, because CalSTRS was uncertain about the number of retired members who would actually qualify for the benefit. If too much money was credited to the Teachers' Health Benefits Fund from contributions that otherwise would have been credited to the Defined Benefits (DB) Program, those excess funds would have to be used to fund health benefits and could not be reallocated to fund pension benefits. As a result, the Board elected to fund the MPP Program on an as-needed basis, but manage the financing of the DB Program as if the MPP Program was credited with the total estimated cost of that program.

Increasing Transparency

There is a lack of consistency between the information an agency is required to make public before adopting an improvement in retirement benefits compared to that required when it adopts or changes OPEB benefits.

Existing law, beginning with Section 7500 of the Government Code, requires the State Controller's Office to publish an annual report of public pensions. In accordance with Government Code Section 7504 CalSTRS annually submits audited financial statements to the State Controller and the State Controller then compiles and publishes a report on the financial condition of the State's retirement system. However, the requirement does not specify a particular time frame for the State Controller to complete their report. As a result, the latest report that has been compiled was completed July 26, 2007, for the fiscal year ended June 30, 2005.

Fraudulent Claims

CalSTRS provides retirement, disability and survivor benefits to certified public school employees, their families and beneficiaries under the Defined Benefit, Defined Benefit Supplement and Cash Balance Benefit Programs. The Teachers' Retirement Law (TRL) allows benefit overpayments to a member or beneficiary to be collected through deductions from subsequent benefit payments, whether the overpayment was due to an error on the part of CalSTRS or the employer, or inaccurate information provided by the benefit recipient. In some instances, CalSTRS will file a civil law suit in order to collect overpayments.

Occasionally, through its audit process CalSTRS will find instances of fraud. Typically, in cases where fraud is suspected, CalSTRS auditors stop the audit and consult the Chief Auditor and General Counsel. If the Chief Auditor and the General Counsel agree that an investigation is necessary, the case is referred to the county district attorney or the State Attorney General for prosecution. CalSTRS' Legal staff stated that at least 5 cases of fraud from 2003-07 were referred to law enforcement for criminal investigation and prosecution.

Within the 1937 Act (County Employees' Retirement Act of 1937), each county retirement board rules on the disability applications within its own system. The CalPERS Board makes disability determinations for all state, school, and public agency members, except for local safety members, and also makes determinations as to whether disabilities are the result of a job-related injury or illness. Local public agencies within CalPERS have the responsibility for making disability determinations for local safety members, as well as for deciding whether the disability is the result of a job-related injury or illness.

This bill includes identical language as contained in AB 36 (Niello—2007), relating to retirement benefit application fraud. AB 36 (which is currently pending before the Senate Public Employment and Retirement Committee), seeks to impose criminal penalties on CalPERS, CalSTRS and '37 Act county retirement system members, beneficiaries, participants and those who assist them, for making false material statements or representations in order to receive benefits. In December 2007, the Board adopted a "support" position on AB 36 just prior to the bill's passage to the Senate.

ANALYSIS

Assembly Bill 1844:

- Requires that those public agencies that provide post-retirement benefits other than pensions shall also report information in regard to those other post-retirement benefits (OPEBs) within nine months of the close of the fiscal year in which the agency is required to file a GASB statement 45;

- Requires the Controller to develop a cost-effective procedure for collecting this information which shall be submitted to the Controller electronically and posted on the Controller's Web site;

- Requires the Controller to publish the report on the financial condition of the State's public retirement systems within 12 months of the receipt of the financial and actuarial statements and no later than 18 months after the end of the applicable fiscal year.

- Makes it a crime for a person to make or present false material statements and representations in connection with public employees' retirement system benefits and applications, or to aid or abet someone in this regard. Makes it a crime for a person to knowingly accept, with the intent to keep for personal benefit, a payment from the retirement system with the knowledge that one was not entitled to the benefit.

<u>Transparency and Accountability</u>

The PEBC's final report included a statement regarding post-retirement benefits that said, "in order to build awareness, support, and trust by taxpayers, including the employers of public agencies, the process through which benefits are adopted, modified and/or paid for needs to be open, transparent and defensible." The Commission was critical on the status and adequacy of retirement systems and employer funding of OPEB benefits and felt the current reporting mechanisms do not provide for the timely and accurate disclosure of pension and OPEB liabilities.

Recommendation 9 in the PEBC's Final Report proposes that legislation be introduced directing the State Controller's Office to develop a cost-efficient procedure to regularly collect and report OPEB data from California public agencies which normally are contained in the GASB 45 actuarial valuation report periodically required of each public agency and in the agency's GASB 45 footnote. The Commission stated, "part of the governing process is to create accurate and timely reports on the business of governing. It is in the public's interest for public retirement systems and employers providing pension and OPEB benefits to report on the status and adequacy of funding for these benefits."

Each public retirement system is required to have an actuarial valuation performed at least once every three years. CalSTRS employs a full-time internal actuary and contracts with an external actuary to perform statutorily required valuations and prepare reports to the Legislature and the Governor on a variety of topics. In addition, CalSTRS is required to have annual financial audits and submit audited annual financial reports to the State Controller within six months of the close of the fiscal year. The State Controller is then required to compile and publish an annual report on the financial condition of all state and local public retirement systems.

The language contained in Section 7504.5 relating to the development of a similar report for OPEB benefits provided by public agencies may need revision. The language assumes that the same entities that would be reporting under GASB 45 would also be reporting under the provisions of Government Code Section 7504. In fact, GASB 45 applies to actual public employer agencies whereas Section 7504 applies to public retirement systems.

It should be noted, however, that CalSTRS may actually have reporting requirements under GASB 43, which applies to the actual systems administering OPEB benefits and although in its current form the legislation does not impact CalSTRS, if the inconsistencies are addressed CalSTRS may be impacted. The PEBC's obvious intention is to receive information from local public employer agencies and not large transparent entities such as CalSTRS and CalPERS.

Timeliness in Reporting Data

Recommendation 10 in the PEBC's Final Report would require the State Controller's Office to publish the annual report of public pensions, which is required by current law, within 12 months of the receipt of data but in no case longer than 18 months after the end of the fiscal year. Staff assumes CalSTRS would provide a copy of its existing annual report to the State Controller to fulfill this requirement and this recommendation would not have great implications for CalSTRS.

Fraud

There is currently no specific statute which defines as fraud those activities associated with public retirement system member's fraudulent application for benefits and no clear penalties for such fraud. Recommendation 26 in the Commission's Final Report recommends that legislation be introduced to make it a crime to make a fraudulent claim for a retirement or disability benefit or to keep a payment made on the basis of a fraudulent claim. The language drafted for this provision is identical to the language found in AB 36 (Niello—2007) and will provide a deterrent to potential fraud against public retirement systems by establishing civil and criminal penalties.

AB 1844 does not require CalSTRS to investigate and report instances where false information has been provided for the purpose of receiving a benefit. Unlike CalPERS, which employs investigative staff to do this work, CalSTRS has neither an investigative unit, nor staff experienced with investigating fraud. If enacted in its current form, CalSTRS will continue to report cases of suspected fraud to the Attorney General.

The CalPERS Fraud Investigation Unit focuses on cases of suspected industrial disability benefit fraud, mostly by its safety members. In addition to surveillance, the unit provides support to benefit program staff involved in litigation. Several other public agencies have established and maintain fraud units for the purpose of evaluating and investigating cases of alleged disability benefit fraud. These public agencies include the California Highway Patrol, the Department of Insurance, the State Compensation Insurance Fund and the Los Angeles City Police Department.

This bill prohibits a benefit applicant or recipient from making a "knowingly false material statement" but does not address minor statements the person knows to be false or punish someone for making a material false statement he or she did not know was false.

FISCAL IMPACT

Benefit Program Cost – Unknown potential cost savings by discouraging individuals who would otherwise consider committing fraud in order to receive or increase benefit to which they are not entitled.

Administrative Costs/Savings – None. All information needed by CalSTRS in order to report to the Controller's office is already available.

SUPPORT

Public Employee Post-Employment Benefits Commission (Sponsor)
Association for Los Angeles Deputy Sheriffs
California Federation of Teachers
California Public Employees' Retirement System
California School Employees Association
California State Association of Counties
California State Employees Association
California Teachers Association
El Dorado Irrigation District
Howard Jarvis Taxpayers Association
Los Angeles County Probation Officers Union
Organization of SMUD Employees
Professional Engineers in California Government
Riverside County Sheriffs' Association
San Bernardino Public Employees Association
San Diego County Court Employees Association
San Luis Obispo County Employees Association
Santa Rosa City Employees Association
Service Employees International Union, Local 1000

OPPOSITION

None known

LEGISLATIVE STAFF CONTACT

Mike Mello
Legislative Analyst,
CalSTRS Legislative Affairs,
229-4681
mmello@calstrs.com

Mary Anne Ashley
Manager,
CalSTRS Legislative Affairs,
229-3891
mashley@calstrs.com

Jennifer Baker
Director,
CalSTRS Governmental Affairs and Program Analysis,
229-3866
jbaker@calstrs.com