

**BILL NUMBER: SB 1352 (PE&R) as amended May 27, 2016**

**SUMMARY**

SB 1352 makes various technical, conforming or minor changes to the Teachers' Retirement Law to facilitate efficient administration of the State Teachers' Retirement Plan (Plan), which includes the Defined Benefit (DB) Program, the Defined Benefit Supplement (DBS) Program and the Cash Balance (CB) Benefit Program.

**BOARD POSITION**

**Sponsor.** This bill will make various technical, conforming or minor amendments necessary for continued effective administration of the California State Teachers' Retirement System.

**REASON FOR THE BILL**

SB 1352 will help ensure continued effective and efficient plan administration for CalSTRS internal and external customers.

**SUMMARY OF AMENDMENTS**

The May 27, 2016, amendments:

- Repeal definition of "break in service," and instead specify the periods of service used for determining final compensation within the definition of final compensation.
- Move language providing that periods of service in which an employer certifies that there was a reduction in school funds would not be used for final compensation to the definition of 36-month final compensation.
- Specify compensation eligible to be used for concurrent retirement final compensation and when additional months are required for final compensation.
- Specify the consistent final compensation calculation to be used for non-service-based benefits, regardless of whether a member is part time or full time.
- Add a definition of "school term."
- Update the method of crediting cash balance program contribution credits to ensure definitely determinable benefits.
- Delete references to previous versions of final compensation for non-service-credit based benefits from the supplemental benefit calculation for Disability Allowance to Service Retirement conversions.
- Make technical changes, including statutory reference corrections.

**PROGRAM BACKGROUND & ANALYSIS:**

Repeal Duplicate Defined Benefit Supplement Account Balance Definition

*Background*

There are two current versions of Education Code section 22101.5 defining "accumulated Defined Benefit Supplement account balance" as a result of simultaneous legislation chaptered in 2001. Although the second occurrence aligns more accurately

with the intention of the DBS Program by including additional earnings credits, additional clarification is needed to describe that the account balance means “the amount of” credits.

*Proposed*

This measure repeals the first occurrence of the DBS account balance definition under Education Code section 22101.5 and amends the second occurrence to clarify that the account balance means “the amount of” credits.

*Section affected: 22101.5*

Supplemental Benefit Calculation for DA to SR Conversions

*Background*

Education Code section 24415 provides benefit recipients whose monthly benefit has not kept pace with inflation a quarterly supplemental payment. Prior to January 1, 2014, Education Code section 24410 outlined the base date used for the purpose of determining postretirement allowance increases for members who convert to service retirement (SR) after the termination of their disability allowance (DA) without returning to employment, pursuant to Education Code section 24212 or 24213. Although these sections specifically require a comparison calculation for the benefit to ensure that the member will receive no more than the terminated disability allowance, the law was silent regarding the base allowance amount used to determine supplemental purchasing power payments.

In practice, the formula for calculating the supplemental base allowance for benefits paid pursuant to Education Code sections 24212 and 24213 uses the DA effective date and the lesser of the following two calculations modified by the option factor at retirement:

- (a) SR projected service credit X DA final compensation X SR age factor
- (b) Original DA allowance, excluding children’s portions

In most instances, if the DA allowance is continued as the lesser of the two calculations made pursuant to Education Code sections 24212 and 24213, the prior DA allowance is continued as the lesser of the two base allowance calculations under (a) above. However, in a very few cases, even when the DA allowance is continued as the lesser of the two calculations, the supplemental base allowance will be the SR allowance using DA final compensation under (b) and will result in lower supplemental payments at conversion. In an effort to clarify the law, Chapter 558, Statutes of 2013 (AB 1379–PER&SS), included language specifying that under all circumstances, the base allowance shall be the original DA allowance. However, during planning for implementation, this change was found to have serious unintended consequences by providing increased supplemental payments that offset any decreases resulting when the retirement calculation is determined using a lower service credit-based SR calculation.

Upon further research, the intent was and always has been to use the service credit-based SR calculation for the base allowance for those members whose SR amount is the lesser of the two calculations at retirement.

Despite the potential consequences, as of November 1, 2015, CalSTRS has not been required to provide increased supplemental payments pursuant to AB 1379. The SR allowances for all 11 members with SR allowances under sections 24212 and 24213 who were eligible to begin receiving supplemental payments on or after January 1, 2014, were determined to be the DA allowance that they were receiving at retirement.

*Proposed*

This measure clarifies that the base allowance used to calculate supplemental payments for members retiring under Education Code sections 24212 and 24213 should be directly related to the lesser of the two allowances determined at conversion and provides an accurate description of the calculation of that amount.

*Sections affected: 22106.1 and 24410*

Amendments to Definition of Credited Interest

*Background*

The current definition of “credited interest” has surplus commas that change the meaning of the provision to be nonsensical.

*Proposed*

This measure clarifies the meaning of Education Code section 22120 by deleting both unnecessary commas.

*Section affected: 22120*

Final Compensation Cleanup

*Background*

Generally, final compensation is calculated using 36 or 12 months that are consecutive except that periods of service separated by “breaks in service” may be aggregated. Because teachers are often employed from September through June, the definition of “break in service” specifically excludes “months not recognized as part of the school term” if a member begins teaching at the beginning of the school term. As a result, if the first day of the school term is in September and a member does not earn creditable compensation in July or August, July and August will be included in the calculation of final compensation. Although CalSTRS has interpreted this requirement to provide that months not recognized as part of the school term could additionally include months during winter intersession or June for school terms ending in May, there is no separate definition of school term in current law, and the specific mechanics of the calculation are similarly lacking.

In addition, the board may determine a different final compensation for certain types of non-service-based benefits. For example, under CalSTRS disability benefits, a typical benefit is based on a percentage of a member’s final compensation that is fixed in statute (e.g., 50 percent under Education Code sections 24006 and 24106), regardless of service credit. To determine final compensation for part-time service, the compensation earnable “shall be adjusted by the ratio that part-time service bears to full-time service.” This calculation is intended to provide a benefit that adequately replaces the income a member was receiving prior to a disability or death.

*Proposed*

This measure makes the following changes to final compensation, consistent with CalSTRS interpretation of existing statute:

- Repeals the current definition of “break in service,” including eliminating a superfluous provision for career substitute teachers.
- Defines “school term” consistent with current law and applicable school calendars.
- Specifies within the “final compensation” definitions that periods of service for determining final compensation include full pay periods in which members earn compensation, periods prior to the school term when members earn compensation during the first pay period, periods following the school term when members earn compensation during the last pay period and periods in the middle of the school term when members earn compensation during the immediately preceding and immediately following pay periods.
- Clarifies that the prohibition on using full pay periods beyond the benefit effective date does not apply with regards to the final pay period of the school term.
- Repeals the definition of “final compensation” that allows for 36 months of service to be used that are consecutive except for periods in which an employer certifies that there has been a reduction in school funds and moves that language to the definition of 36-month final compensation.
- Specifies that final compensation for concurrent retirement can use “compensation for services rendered on a full-time basis” under the other retirement system rather than the CalSTRS-defined “compensation earnable.”
- Conforms the definition of “final compensation” to the definition of “concurrent retirement” by stating that it is only available when a member retires “for service” from each system, rather than retires for disability.
- Clarifies that when additional months are needed to calculate final compensation, they come from the member’s first school year, rather than first position.
- Requires non-service-based benefits for all members to be calculated using the average annual creditable compensation earned by a member over 36 or 12 months, consistent with the current calculation for part-time members, eliminating the need to determine subjectively whether a member is working part time when calculating benefits intended to provide income replacement.

*Sections affected: 22109.5, 22115.2, 22134, 22134.5, 22136, 22168.5 and 22664.*

Retirement System Election and Permissive Membership Election Requirements*Background*

The Teachers’ Retirement Law provides for several different ways employees can elect DB Program membership. However, none of the laws concerning election specify that the election form must be submitted to CalSTRS within any specific time frame. Other sections of law require that forms be received by the system within 30 days of the specified qualifying event, including the election of disability and death benefit coverage, conditions for service retirement allowance and pre-retirement option election changes.

*Proposed*

This measure specifies that membership election forms must be received by CalSTRS within 30 days of the member’s signature.

*Sections affected: 22508, 22508.5, 22509 and 22515*

### Conforming Changes to 2014 Full Funding Plan

#### *Background*

Chapter 47, Statutes of 2014 (AB 1469–Bonta), made several changes to Education Code sections concerning member, employer and state contributions. These sections are referenced in numerous places throughout the Teachers' Retirement Law. Most of these references were updated in Chapter 123, Statutes of 2015 (AB 991–PER&SS).

#### *Proposed*

This measure makes one additional conforming change to ensure correct code references are cited in Education Code section 22703.

*Section affected: 22703*

### Unused Sick Leave

#### *Background*

The DB Program grants service credit for a member's unused sick leave when the member retires for service. The Education Code prescribes the calculation of service credit for employees of California public schools. However, it does not address the calculation for DB members who are employed by a state agency.

#### *Proposed*

This measure specifies how to convert unused sick leave to service credit for members retiring from a state agency. The proposed calculation to credit 0.004 years of service for each day of sick leave is identical to the method used to credit state employees for educational leave credit in Education Code section 22717.5 and to the method used to credit unused sick leave for CalPERS members under Government Code section 20963.

*Section affected: 22717*

### Conforming Changes to USERRA

#### *Background*

The federal Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) requires qualified pension plans to treat returning military service members as if they had not incurred a break in service. CalSTRS initially implemented USERRA's requirements with regards to benefits provided under the DB Program and the CB Benefit Program. However, no changes were made to codify USERRA's requirements as they relate to the DBS Program when it was established in 2001.

#### *Proposed*

This measure makes conforming changes to ensure that Teachers' Retirement Law correctly reflects the requirements of USERRA.

*Sections affected: 22850, 22851, 22852, 22853, 22853.5, 22854, 28000, 28001 and 28002*

### Fixed Crediting of CalSTRS Cash Balance Programs

#### *Background*

The CB Benefit Program benefits have been determined by the Internal Revenue Service to be “definitely determinable” because contributions are credited based on a specified percentage of earnings, and interest is credited at a pre-determined minimum interest rate. The DBS Program, as with all cash balance programs, is also a defined benefit pension designed to provide definitely determinable benefits.

However, as initially designed, CalSTRS cash balance programs credit contributions upon receipt by the system. As a result, two members earning the exact same amount could accumulate different benefits (via interest credits) because although one employer could remit contributions in a timely manner, another employer could remit the required contributions late.

#### *Proposed*

This measure ensures that DBS and CB Benefit program benefits accrue in a definitely determinable and predictable manner, regardless of whether employers remit timely contributions. To accomplish this, the measure provides that DBS and CB accounts are credited on a specific day following the period for which the contributions are earned. In order to ensure that CalSTRS can implement this change within the new member database system without additional costs, the measure makes the new crediting methods effective July 1, 2018.

*Sections affected: 22905, 26603 and 26604*

### Benefit Effective Date

#### *Background*

Education Code sections 24005, 24105, 24201.5 and 24204 require that retirement and disability benefits shall become effective at a date designated by the member provided that, among other conditions, that date is later than “the last day of creditable service.” Current law is insufficient because “creditable service,” as defined by Education Code section 22119.5, includes a list of specific activities, none of which are required to be performed while on leave. Strict application of existing law would allow members to begin receiving their benefit after performing their last day of creditable service but before exhausting paid vacation or other leave for which creditable compensation is earned.

#### *Proposed*

This measure clarifies that the benefit effective date is required to be later than the last day that creditable compensation was earned as opposed to the last day of creditable service.

*Sections affected: 24005, 24105, 24201.5 and 24204*

### Service Retirement During Evaluation of a Disability Application – Defined Benefit Supplement Distribution

#### *Background*

When members apply for benefits, they must also choose how to receive their DBS benefit. Members can elect a lump-sum payment, an annuity payable in monthly

installments or a combination of both a lump-sum payment and an annuity. Those who apply for and receive a service retirement benefit during evaluation of a disability application are permitted to elect different distributions for their DBS retirement benefit and disability benefit. These two different choices are allowed because, if a member is approved for a disability benefit, subdivision (e) of Education Code section 24201.5 essentially cancels the service retirement benefit and replaces it with the disability benefit, and a member may want to elect a lower-paying annuity because the disability benefit may be higher than the service retirement benefit.

Both sections of law regarding a lump-sum payment for a DBS retirement benefit or disability benefit, Education Code sections 25009 and 25016, recognize that once a lump sum is paid there is no additional money to pay another lump sum or an annuity, stating “upon distribution of the entire retirement benefit in a lump-sum payment, no other benefit shall be payable to the member ... .” However, when a service retirement benefit is replaced by a disability benefit, the law is not clear that a lump-sum payment of a DBS retirement benefit supersedes a different election for the DBS disability benefit given that there is no money left in the DBS account.

#### *Proposed*

This measure specifies that members who elect a lump-sum payment for their DBS retirement benefit are prohibited from electing a subsequent DBS disability benefit.

*Section affected: 24201.5*

### Unused Sick Leave and Multiple Retirements

#### *Background*

The Teachers’ Retirement Law includes several different retirement calculations for specific situations when a member retires after previously receiving a disability allowance, a disability retirement or a previous service retirement. These “multiple retirement” calculations provide for the total amount of service credit to be used toward one-year final compensation under Education Code section 22134.5, the career factor under Education Code section 24203.5, and the longevity bonus under Education Code section 24203.6. Consistent with the application for each of these enhancements for a typical retirement benefit, CalSTRS administers each of these by including up to two-tenths of one year of unused sick leave as is provided pursuant to subdivision (c) of Education Code section 22121. However, this application is not explicit in the multiple retirement provisions of the law.

#### *Proposed*

This measure clarifies that up to two-tenths of one year of unused sick leave qualify individuals retiring under the multiple retirement calculations for certain enhancements.

*Sections affected: 24209, 24209.3, 24211, 24212 and 24213*

### Option Cancellation Request

#### *Background*

Generally, retired and disabled members may cancel or change option benefit and beneficiary elections up to 30 days after the effective date of the member’s initial benefit payment, and the law requires such changes to be made on a form provided by the

system. However, Education Code section 24322 does not prescribe such a form, which allows for inconsistent application of the law because CalSTRS must honor the member's request, regardless of the written format.

*Proposed*

This measure clarifies that in the event of the dissolution of marriage, option cancellations are required to be made on a properly executed form provided by the system.

*Section affected: 24322*

Payments Returned in Less Than One Year

*Background*

Education Code section 22310 requires CalSTRS to add interest if a payment has not been made because, after a good faith effort, the member or beneficiary cannot be located. Education Code section 24606 clearly states that when a payment has been issued, but remains unclaimed, no interest shall accrue. However, that section only applies when a warrant is cancelled by the State Controller's Office after the warrant is unclaimed for one year pursuant to Government Code section 17070. As a result, the law is silent regarding the interest that may or may not accrue when a payment is returned to CalSTRS or the State Controller's Office within 12 months or when an electronic funds transfer is rejected.

*Proposed*

This measure clarifies that no additional interest shall accrue on payments that are returned, regardless of the timeframe.

*Section affected: 24606*

References to Actuarial Valuations

*Background*

Education Code sections 25001, 25006 and 26202 refer to the adoption of an actuarial valuation. However, Education Code sections 22311.5 and 26211 do not require the board to adopt an actuarial valuation. In addition, the reference in Education Code section 26202 is incorrect as the description of actuarial services for the CB Benefit Program is in Education Code section 26211.

*Proposed*

This measure clarifies that recommendations of the actuary shall be "based on the actuarial valuation" and corrects the statutory reference.

*Sections affected: 25001, 25006 and 26202*

Impact of Reinstatement on CB Annuity

*Background*

Education Code section 26810 provides that participants who are retired for service and employed to perform creditable service subject to coverage by the CB Benefit Program may voluntarily terminate the annuity and make contributions to the program provided they have attained normal retirement age and been receiving the annuity for at least



one year. Prior to January 1, 2012, Education Code section 26505 terminated a participant's annuity if the participant was under normal retirement age or had an annuity less than one year and he or she returned to employment. This was a mandatory termination of the annuity. In addition, that previous version of Education Code section 26505 allowed participants who had an annuity for more than a year and reached normal retirement age to contribute to the system and continue to receive their annuity.

With the passage of Chapter 703, Statutes of 2011 (SB 349–Negrete McLeod), Education Code section 26505 was repealed. SB 349 introduced separation-from-service changes for CB participants. Within these changes, participants who are receiving an annuity are not required to terminate their annuity to perform retired member activities. However, they are then subject to a separation-from-service requirement for the first 180 calendar days after retirement. By repealing Education Code section 26505, members are no longer allowed to receive an annuity and contribute to the system at the same time. However, conforming changes were not made to Education Code section 26810 to address participants receiving an annuity who have not reached normal retirement age or had an annuity for more than a year who would like to voluntarily terminate their annuity and restart contributions.

#### *Proposed*

This measure clarifies that all CB participants employed to perform creditable service subject to coverage by the CB Benefit Program who are receiving an annuity may terminate the annuity and make contributions to the plan. This will address all CB participants who would like to terminate their annuity no matter their age or the length of time they have received the annuity. In addition, this measure clarifies the effective date of the termination and that the participant initiates the termination of his or her annuity.

*Sections affected: 26808 and 26810*

## **LEGISLATIVE HISTORY**

AB 1469 (Bonta, Chapter 47, Statutes of 2014) increased member, employer and state contributions to fully fund the DB Program by 2046.

SB 349 (Negrete McLeod, Chapter 703, Statutes of 2011) made various technical, conforming and minor policy changes to the Teachers' Retirement Law, including conforming changes to reconcile differences between the DB Program and the CB Benefit Program postretirement employment provisions.

AB 1316 (Bass, Chapter 332, Statutes of 2007) allowed members who apply for disability to receive a service retirement allowance while their disability applications are being processed.

SB 102 (Burton, Chapter 911, Statutes of 2004) allowed 0.2 years of unused sick leave service credit to be used toward determining eligibility for benefit enhancements.

AB 1509 (Machado, Chapter 74, Statutes of 2000) established the DBS Program and required that 25 percent of member contributions to the DB Program be credited to the DBS Program for 10 years.

AB 2700 (Lempert, Chapter 1021, Statutes of 2000) made all compensation for creditable service creditable to CalSTRS and credited member and employer contributions for service in excess of one year in a school year to the DBS Program.

AB 3221 (Gallegos, Chapter 383, Statutes of 1996) required that members be excluded from membership in the DB Program after entering into other employment covered by a different public retirement system unless they elect within 60 days to remain in the DB Program.

SB 1877 (Rogers, Chapter 680, Statutes of 1996) enacted provisions necessary for CalSTRS compliance with the federal Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) requiring qualified pension plans to treat returning military service members as if they had not incurred a break in service.

AB 2042 (Hughes, Chapter 327, Statutes of 1987) required that the original disability allowance effective date be retained as the base date for determining any postretirement benefit increases on or after January 1, 1982.

SB 647 (Harmer, Chapter 89, Statutes of 1974) provided service credit for accumulated unused sick leave at retirement.

## **FISCAL IMPACT**

Program Cost – None.

Administrative Costs/Savings – Minor and absorbable.

## **SUPPORT**

CalSTRS (Sponsor)

## **OPPOSITION**

None known.

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