STATE TEACHERS' RETIREMENT SYSTEM

BILL NUMBER: Senate Bill 1465 (Soto) – As Amended 05/02/06

SUMMARY:

SB 1465 makes the following minor policy changes to the Teachers' Retirement Law (TRL):

- Allows the Teachers' Retirement Board (Board) to establish a threshold for payment and collection of benefit adjustments not to exceed $250, an amount established pursuant to Government Code Section 13943.2;
- Provides a monthly benefit to dependent children who become eligible on or after January 1, 2007, under the Coverage B Survivor Benefits Program when there is no surviving spouse or partner at the time of the active member's death;
- Eliminates the restriction on the purchase of out-of-state permissive service performed in a public school outside of California that was not credited to a public retirement system;
- Eliminates the requirement that CalSTRS submit its *Annual Audit of Financial Statements* report to the Legislature, information which is already contained in the legislatively-mandated CalSTRS *Comprehensive Annual Financial Report* (CAFR);
- Eliminates the *Estimate of CalSTRS Investments in California Real Estate* report which duplicates much of the information CalSTRS prepares and submits in its final report to the Legislature.

BOARD POSITION:

Sponsor. As part of its policy to develop benefits and products that meet customer needs, the Board has sponsored SB 1465 in order to simplify the administration of benefits and streamline administrative reporting requirements.

SUMMARY OF SUGGESTED AMENDMENTS:

The May 2, 2006 amendment added a $145,000 appropriation from the Teachers' Retirement Fund (TRF) to cover CalSTRS's costs to implement the proposed changes, and corrected a spelling error.

LEGISLATIVE HISTORY:

<u>Chapter 10, Statutes of 2003 (AB 67—Negrete-McCloud)</u> the California Public Employees Retirement System (CalPERS) Omnibus Bill. Among other things, allows CalPERS to establish an amount tolerance or threshold with regard to benefit adjustments, recalculations and collections to permit or refrain from collecting overpayments of $250 or less.

Chapter 859, Statutes of 2003 (SB 627—PE&R) among other things, eliminates the limit on the amount of out-of-state service that can be purchased by a member of the CalSTRS Defined Benefit (DB) Program.

Chapter 569, Statutes of 1997 (SB 1027—Schiff) allows CalSTRS members to purchase up to ten years of additional service credit for out-of-state public school employment credited to a public retirement system.

Chapter 1166, Statutes of 1992, (SB 1885—C. Green) establishes new survivor benefits and disability programs for all new members entering CalSTRS covered service on or after October 16, 1992. These changes brought CalSTRS into compliance with the federal Older Workers' Benefit Protection Act passed by Congress in 1990.

PROGRAM BACKGROUND:

Payment Tolerances for Benefit Adjustments

Existing law authorizes a state agency, upon authorization of the Franchise Tax Board (FTB), to forego the collection of taxes, licenses, fees, or money owing to the state for any reason if the amount to be collected is $250 or less. Several agencies have sought statutory authority to establish payment or collection thresholds for small dollar amounts dispensing with the collection of underpayment and return of overpayment. Such examples are:

- Board of Equalization is authorized by Government Code Section 16302.1 to dispose of overpayments of $10 or less;
- Franchise Tax Board is granted authorization under Government Code Section 13943.2 to refrain from the collection of amounts of $250 or less;
- CalPERS may, pursuant to Government Code Section 20161, dispense with the collection of an underpayment or return of accumulated contributions and recalculation of benefit payments and adjustments;

CalSTRS processes, prints and distributes payments and overpayment notices to members for benefit adjustments made during the benefit finalization process. Frequent changes to benefits take place that result in low-dollar adjustments, especially in the first three to six months of a newly retired member's benefit effective date. The CalSTRS' corporate database currently performs the same payment and collection process on both small and large benefit adjustments, which generally take place when new account information, such as member contributions, are reported by a former employer after CalSTRS begins paying benefits.

As employers submit their reports, an adjustment in the accounts of newly retired members is created for each event, sometimes for as little as a penny. The associated activities and resulting costs for creating payments and award letters include, but are not limited to: staff review, postage, state data center processing fees, and researching uncashed payments. These costs range from approximately $1.00 for the processing of a benefit adjustment, to approximately $50-$100 to redeposit a single uncashed payment back into the TRF. Paying or collecting amounts that are less than the processing costs results in members' confusion and frustration with CalSTRS.

Without specific legislative authorization, CalSTRS fiduciary duties require it to continue paying and collecting these small amounts.

Extending Ongoing Coverage B Survivor Benefits to Dependent Children

CalSTRS provides benefits to survivors of deceased members under either the Coverage A benefit program, or for those members who became a CalSTRS member after October 15, 1992, the Coverage B benefit programs. Under existing law, one of the major differences between the programs is that Coverage A provides an ongoing monthly allowance to eligible dependent children of deceased members who do not have a surviving spouse or domestic partner, whereas Coverage B dependent children do not.

Currently, if a Coverage B member has a spouse or registered domestic partner on the date of his or her death, the survivor may choose either a spousal monthly allowance of 40 percent of the members final compensation, plus an additional 10 percent of compensation for each eligible dependent child age 21 or less, up to a maximum total allowance of 90 percent, or the spouse or registered domestic partner may choose to receive a lump sum return of the contributions and interest in the member’s account. In addition, a $20,000 lump sum death payment is paid to the member’s designated beneficiary.

The Coverage B Program requires that there be a surviving spouse or registered domestic partner of a deceased member and that person elect to receive a survivor benefit allowance if the dependent child of a deceased member is also to receive a survivor benefit allowance. If the surviving spouse or registered domestic partner elects to receive the lump-sum of the deceased member’s contributions and interest, or if there is no surviving spouse or registered domestic partner to elect the survivor benefit allowance, then no allowance is paid to the surviving dependent child or children. This is inconsistent with the current provisions of Coverage A.

The requirement that there be a surviving spouse or registered domestic partner, and that they must elect to receive a survivor benefit allowance prevents eligible dependent children from receiving the on-going financial support otherwise due them as a result of their parent’s CalSTRS membership. This unfairly penalizes dependent children left without another parent and therefore, without an opportunity to receive a Survivor Benefit Allowance.

Out-of-State Permissive Service Credit

Existing law permits a DB member to purchase CalSTRS permissive service credit for service covering public education in another state or territory of the United States that was credited to a public retirement system. Out-of-state permissive service credit can be purchased for the performance of prior public educational service and counts towards qualifying for the various benefit enhancements paid to DB members with 25 or 30 or more years of service credit, such as highest single year final compensation, the career factor and the longevity bonus.

There exists many public educational institutions in the U.S. in which service is not creditable to a public retirement system, primarily because the employee did not meet certain minimum workload requirements or remain in the position long enough to qualify for membership. Furthermore, many part-time, temporary and substitute teachers are only able to participate in Social Security, which is not considered a public retirement system under the TRL.

Streamlining CalSTRS Reports

CalSTRS is required to submit various reports to the Governor, Legislature and/or other state departments. These reports are required by statute and through the annual budget act, and are known collectively as “state-mandated reports.”

The “Estimate of CalSTRS Investments in California Residential Realty” report is required by Education Code Section 22362 when the Board determines that investing the statutory requirement of 25 percent of the available funds in residential real estate is not prudent. Upon making that determination, the Board is authorized to substitute alternative investments. When alternative investments are substituted, CalSTRS is required to prepare and submit an estimate of the amount of funds that are invested in residential real estate, as well as describe the type, quantity and yield of the alternative investments that will serve as substitutes. A subsequent report detailing the final amount of funds available for investing in residential real estate is also prepared and submitted annually.

In 1972, legislation required the Board submit an annual audit report to the Governor and the Legislature, as required by Education Code Section 22217. In 1976, the Legislature added a separate Education Code Section 22324 that required CalSTRS to prepare a Comprehensive Annual Financial Report (CAFR). The CAFR contains financial information on CalSTRS programs, and must include a copy of the annual audit of the System’s financial statements.

ANALYSIS:

Payment Tolerances for Benefit Adjustments

SB 1465 authorizes the Board to establish a tolerance threshold that would eliminate inconsistencies between CalSTRS business areas related to various types of one-time benefit adjustments by discontinuing the release of low dollar payments and establishing receivables for collection. The maximum amount that the Board would be allowed to write-off would be an amount specified in the Government Code pertaining to write-offs by the Victims Compensation and Government Claims Board. Adjustments to monthly allowances and one-time benefits under DB, Defined Benefit Supplement (DBS), and Cash Balance (CB) Benefit Programs would be subject to the tolerance limit or limits established by the Board as a plan amendment, thus affecting all CalSTRS benefits.

In many instances, the cost to generate these payments and receivables is less than the amount of the benefit adjustment. For example, it is estimated a $1.00 tolerance would eliminate an average of 539 adjustments per month. Not only does this decrease postage, state data center processing and State Controller’s Office costs, it also eliminates staff time spent completing the necessary paperwork to revert uncashed small dollar payments and resolves discrepancies between what is actually paid and what CalSTRS recognizes was paid.

SB 1465 would eliminate staffing hours that were previously required in order to review and release small dollar underpayments, improve consistency between business units releasing payments and provide better customer service to CalSTRS members and beneficiaries.

Extending Ongoing Coverage B Survivor Benefits to Dependent Children

SB 1465 would change the benefit eligibility criteria for a dependent child under the Coverage B Survivor Benefit Program to conform to the benefit eligibility requirements for a dependent child under the Coverage A Family Allowance Program and provide Coverage B surviving dependent children some of the same rights and options available to Coverage A survivors. Under the bill, even if there is no surviving spouse or partner eligible to receive the Coverage B Survivor Benefit, an allowance of up to 10 percent of the deceased member's final compensation will be paid to each dependent child who is not older than 21 years of age, up to a maximum of 50 percent of final compensation for five or more children.

Currently, if there is no surviving spouse, only a lump-sum cash out of the contributions and interest in the member account may be made. In some instances, the deceased member's dependent children have been named the beneficiary who receives the lump-sum return of contributions and interest.

SB 1465 creates a hierarchy for the purposes of distributing Coverage B survivor benefits similar to the order used for paying the Coverage A Family Allowance. The bill also clarifies that the deceased member's beneficiary can only receive the refund of contributions and interest when there are no eligible survivors, or when all survivors have waived their rights to the benefit. It is not the intent of this legislation or the Board to equalize benefit levels only to provide Coverage B surviving dependent children some of the same rights and options available to Coverage A survivors.

Out-of-State Permissive Service Credit

SB 1465 removes the requirement that the purchase of out-of-state service performed in a public school outside of California must have been credited to another public retirement system. The member's former out-of-state employer would be required to certify the type of service performed by their former employee, and whether that service was covered by a retirement system. Additional administrative procedures may be developed within the verification process to guard against the possibility of providing duplicative benefits for the same educational service.

This change may encourage the recruitment and retention of highly-qualified teachers in California schools by allowing more out-of-state teachers to purchase CalSTRS service credit for their previous educational service that was never credited to a public retirement system, at the member's expense.

Streamlining CalSTRS Reports

SB 1465 eliminates two state-mandated reports to the Governor and Legislature that are redundant and are therefore unnecessary. The Board would like to eliminate the "Estimate of CalSTRS Investments in California Residential Realty" report because the information primarily contained in this report is duplicative and submitted in the CalSTRS' final report detailing the final amount of funds available for investing in residential real estate. The Board would also like to eliminate the annual audit report because the financial information on CalSTRS' programs as well as a copy of the annual audit of the System's financial statements are included in the CAFR.

FISCAL IMPACT:

Payment Tolerances for Benefit Adjustments - Establishing threshold amounts or tolerances for the creation of payables and receivables where the costs are greater to issue the payment and letter than the amount of the payment of receivable would involve minor and absorbable benefit program costs of between $0 and $9,850 annually. Administrative savings of approximately $40,000 annually to CalSTRS printing, payment processing and staff time spent researching and returning uncashed payments to the TRF. Approximately $100,000 in one-time costs would be incurred to make the necessary changes to the CalSTRS Corporate Database.

Extending Ongoing Coverage B Survivor Benefits to Dependent Children - According to the System Actuary, based on the information currently available, the present value of extending Coverage B Survivor Benefits to the future population of eligible children beginning January 1, 2007, is $525,000 over a 30-year period. This cost reflects an average benefit of $327 per month. The total estimated administrative cost to accommodate the change in dependent child eligibility is approximately $45,000. This includes costs for modifying the START automated database, preparing job aids, providing system training, modifying the Member Handbook and meeting technology costs.

Out-of-State Permissive Service Credit - Any costs from the additional purchase of out-of-state permissive service credit would be offset from increased member contributions. Administrative cost are minor and absorbable.

Streamlining CalSTRS Reports - Nominal savings from CalSTRS staff and other resources not being spent gathering information, preparing, submitting and tracking redundant and duplicative legislative reports.

Appropriation – $145,000 appropriation from the TRF to cover the cost of implementation.

SUPPORT/OPPOSITION

Support: Teachers' Retirement Board (Sponsor)

Opposition: None Known

ARGUMENTS:

- Conserves CalSTRS administrative resources and reduces member phone calls expressing dissatisfaction with CalSTRS Business Practices;
- Encourages equitable treatment among dependent children under Coverage A and Coverage B with only nominal increase in benefit costs and provides a stable income to dependent children who may otherwise be left with little or no financial security;
- Enhances teacher recruitment by allowing additional DB members to receive a retirement benefit for all their teaching service in public schools;
- Eliminates redundant and unnecessary state-mandate reporting requirements and allows CalSTRS to reallocate staff time and resources used in the preparation of legislatively mandated reports to more productive uses.