

STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

BILL NUMBER: Senate Bill 1465 (Soto) – Amended August 21, 2006

SUMMARY:

SB 1465 makes the following changes to the benefit programs of the Teachers' Retirement Plan:

- Authorizes the Teachers' Retirement Board (Board) to establish a threshold for the payment and collection of small dollar benefit adjustments, not to exceed ten dollars, and delay payment of collection until the cumulative amount associated with adjustments to a members' account exceeds the threshold amount;
- 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;
- Allows members to purchase up to two years permissive service for time spent teaching in the Peace Corps.
- Conforms provisions of the Defined Benefit (DB) Program related to the treatment of members that experience a break between terminating a disability allowance and receiving a service retirement allowance to members that go directly from receiving a disability allowance to receiving a service retirement allowance;
- Authorizes the Board to use a set of calculation factors and assumptions that establish base hours and pay rates, in the absence of actual employer-reported data, for purposes of calculating benefits paid to part-time community college members of the DB Program who were employed by a community college prior to July 1, 1996 and that employer changed its minimum standard for full time employment;
- 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 and maintain 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 RECENT AMENDMENTS:

- Eliminates the ability for the \$10 limit on the proposed tolerance amount to be raised automatically.
- Recasts the prohibition on a member's purchase of out-of-state service credit if he or she retains credit for the same service in the Cash Balance Program or another retirement system, and specifies the means by which purchases of service not credited to a public retirement system may be made.
- Conforms certain provisions in Section 23855 to those also contained in CalSTRS' Technical Housekeeping Bill, SB 1466 (PE&R) to avoid chaptering-out issues. These provisions clarify when a dependent child is no longer eligible to receive an ongoing Coverage B Survivor Benefits, and that eligibility for the Longevity Bonus and Career Factor applies only to survivors who receive ongoing benefits under a joint and survivor option election.

LEGISLATIVE HISTORY:

Chapter 442, Statutes of 2004 (AB 1586—PER&SS) permits the recalculation of benefits paid to part-time community college employees who were members of the Defined Benefit Program prior to July 1, 1996, to correct inadvertent reductions in benefits paid as a result of previous legislation.

Chapter 10, Statutes of 2003 (AB 67—Negrete-McCloud) the California Public Employees Retirement System (CalPERS) Omnibus Bill, which among other things, establishes tolerance or threshold amounts with regard to benefit adjustments, recalculations and collections and refrain from collecting or paying benefit overpayments and underpayments below the threshold amount.

Chapter 1026, Statutes of 2000 (SB 1505-Burton) extends eligibility for the Minimum Guaranteed Monthly Allowance (MGMA) paid to DB members, their option beneficiaries and surviving spouses that received a service retirement allowance, survivor or option beneficiary benefit before 1/1/00, to members who were disabled prior to retirement, but would have had at least 20 years had they worked to age 60, members who were inactive at the time of retirement but had at least 20 years of credited service, and members who did not qualify for other reasons.

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. The ten year limit was later removed by Chapter 859, Statutes of 2003 (SB 627—PE&R).

Chapter 653, Statutes of 1997 (AB 1547—Committee on Consumer Protection, Government Efficiency & Economic Development) among other things, deletes the State Board of Control's (SBC) involvement in underpayments and overpayments of taxes, licenses, fees, or other monies owed to the state and instead, authorizes the State Controller's Office (SCO) to discharge any state agency or employee from accountability for the collection of these revenues if the debt is uncollectible or the amount of the debt does not justify the cost of its collection. Stipulates that a state agency is not required to collect these funds if the amount is \$250 or less.

Chapter 390, Statutes of 1995 (AB 1122-Cannella) establishes appropriate minimum standards for full-time employment for all classifications of employees in K-12 and community colleges for crediting service in CalSTRS, while continuing to allow the districts the flexibility to establish specific standards for full-time employment.

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:

Tolerance Thresholds 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 underpayments and return of overpayments. 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 payment or collection or amounts up to \$50 resulting from various types of benefit payments and adjustments and amounts up to \$250 for payment and collection of benefits associated with certain type of closed accounts.

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 \$24,652 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 when the parents are no longer married or have a partner 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.

Peace Corps Service Credit

Existing law provides for the purchase of various types of permissive service credit by a member, including:

- Sabbatical leave
- Certain active military leave
- Prior service with the California State University, a publicly supported and administered college or university in California, or a California Community College
- A certificated position at a child care center
- Maternity/paternity leave (two years or less in duration)
- Approved leave to participate in a specified federal educational and cultural programs
- Family Care and Medical Leave Act (four months within any twelve month period)
- Certificated position at Indian school in California
- Certificated position with Job Corps (not to exceed two years)
- Teaching position at the School for the Blind or the School for the Deaf

The amount of service credit purchased in these categories is subject to limitations specified in law. For example, eligibility for any of the categories is limited to persons who have not received or are eligible to receive credit for the time under the Cash Balance (CB) Benefit Program or another retirement system. In addition, the member must complete payment of contributions prior to retirement.

Minimum Guaranteed Monthly Allowance

Chapter 632, Statutes of 1999 provided a minimum guaranteed monthly allowance (MGMA) to certain members of the DB Program, their option beneficiaries and surviving spouses. Under the MGMA program, the minimum allowance, including purchasing power payments, paid to members with 20 years of service is \$15,000 annually, and that minimum increases by \$500 per year for each additional year of service, to a maximum benefit of \$20,000 for members with 30 or more years of service. This minimum allowance amount is paid to career teachers who retired under old CalSTRS benefit formulas and before various benefit enhancements were enacted over the past decade. With the MGMA, these members now receive retirement incomes that are, and will continue to be, maintained above the poverty level—especially important since their classroom service was not coordinated with Social Security, and therefore, they will not receive any Social Security benefits for that service.

Chapter 1026, Statutes of 2000 (SB 1505—Burton) extended eligibility for the MGMA to include retired CalSTRS members who: 1) retired before age 55, 2) retired as an inactive member, 3) retired by 03/21/74 and had 19.5 years of service, 4) retired on or after 03/21/74 and has sufficient unused sick leave to have a total of 20 years of service, and 5) were disabled prior to retirement, but would have had at least 20 years of service had they worked to age 60 through the use of projected service.

Full-Time Equivalency

Existing law defines "creditable compensation" and "full time" for purposes of calculating retirement benefits paid to DB members. Chapter 442, Statutes of 2004 (AB 1586—PER&SS), requires CalSTRS to use the definition of "full-time" that was in place prior to July 1, 1996, for members employed by a community college district prior to July 1, 1996. The definition of "full-time" that existed prior to July 1, 1996, did not distinguish between employment on a full-time and part-time basis. Therefore, all employment was measured on the basis of performing a full-

time workload, or performing 1,050 hours of service in a school year, and service credit was based on the percentage of 1,050 hours of service that the DB member performed.

As of July 1, 1996, a separate, reduced Full-Time Equivalent (FTE) was established for community college employees who were employed on a basis less than full-time, i.e. employed part-time or as an adult education instructor. The reduced FTE was based on a minimum of 525 hours of service for a part-time community college instructor and 875 hours of service for an adult education community college instructor. Reduction of the minimum number of hours of service required to receive one year of service credit resulted in part-time and adult education community college instructors accruing service credit at a faster pace; however, it also caused a reduction of these employees' final compensation. The reduction in final compensation may have produced an impairment of benefits for some of these members.

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 California 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, to the Legislature. 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) and provide a copy to the Governor and Legislature as well. 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, not to exceed \$10, and allow it to suspend the payment and collection of small-dollar benefit adjustments until that threshold amount is reached. This change eliminates inconsistencies between CalSTRS business areas related to the payment and collection of various types of one-time benefit adjustments. The bill also specifies that money held or collections delayed until the threshold is reached will not be credited with interest.

In many instances, the cost to generate these small dollar payments and receivables is less than the amount of the benefit adjustment itself. For example, staff estimates a \$1.00 tolerance would eliminate processing an average of 539 adjustments per month and a \$10.00 tolerance would eliminate processing of approximately twice that amount. Not only does the proposed change

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 to members, and what CalSTRS recognizes was paid. It also reduces the staff hours previously required 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 duplicate retirement 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.

Peace Corps Service Credit

SB 1465 allows a member to elect to receive credit and pay all costs for time served, not to exceed two years, as a volunteer in the Peace Corps. With the exception of nonqualified service, the type of service authorized to be purchased by CalSTRS members for the Defined Benefit (DB) Program has some relationship to a teaching career. This relationship can be in terms of (1) providing teaching service elsewhere, (2) interrupting a teaching career to provide a specific

service, such as military service, or (3) taking a leave for a specific purpose, such as sabbatical or maternity/paternity leave. In contrast, the service that could be purchased under this bill does not have to be related to providing any teaching service, nor is it necessarily provided during a break from teaching in the California public schools.

Minimum Guaranteed Monthly Allowance:

At the time SB 1505 was implemented, CalSTRS staff included in the new population of those members eligible to use projected service to qualify for the MGMA (1) members who retired for service when their disability allowance terminated because the member reached age 60 (or older, in the case of members with eligible dependent children) and the member has not returned to work, (2) members who terminated a disability allowance and either returned to perform creditable service prior to applying for service retirement and (3) members who terminated a disability allowance and applied for service retirement prior to reaching age 60 without returning to perform creditable service.

There are currently 10 members who retired prior to 1/1/00 under these two circumstances that have at least 20 years of combined actual and projected service credit and receive the MGMA, although SB 1505 did not authorize the use of projected service for purpose of determining their eligibility. They currently receive the same MGMA benefit provided to 1,505 DB members who previously received a disability allowance and retired without a break in service. The average monthly improvement in their benefit because they receive the MGMA is less than \$200 per month, which represents a present value benefit cost of approximately \$250,000 amortized over 30 years. The omission of this small population of members appears to have been a drafting oversight in SB 1505 because at the time, the consulting actuary's analysis assumed that both active and inactive members at the time immediately prior to their retirement were able to use projected service in order to qualify for the MGMA. The amendments made by SB 1465 codify existing practice and does not affect any DB members who first received a service retirement allowance on or after 1/1/00, change the benefits paid to existing MGMA recipients, and does not have administrative costs or affect the valuation of the DB Program.

Full-Time Equivalency

SB 1465 authorizes the Board to establish calculation factors and assumptions to determine member benefits as specified in Chapter 442, Statutes of 2004 (AB 1586—PER&SS), which requires CalSTRS to recalculate the benefits of certain retired and disabled part-time and adult education instructors employed by community colleges prior to July 1, 1996 who currently receive a benefit that is based on a full-time number of base hours (1,050 hours) for the service they performed prior to July 1, 1996, and a part-time number of base hours (525 hours) for the service they performed on and after July 1, 1996. The recalculated benefit will use the pre-July 1, 1996, definition of "full-time" and be compared to the benefit the retired DB member is currently receiving. Whichever benefit is greater will be paid to the member. Unfortunately, the affected members are unable to receive the potentially higher benefits available through this comparison because CalSTRS currently has no adequate administrative practice or procedure for performing the calculations. In addition, an extensive manual review of employer data revealed that much of the necessary information reported by the employers is inaccurate, unreliable or does not exist.

This data includes:

- The base hours that the employer established as of 7/01/96, for its part-time and adult education instructors;
- Whether those base hours are different for lecture and lab assignments;
- Whether those base hours are specific to the type of course taught;
- Whether the employee performed multiple assignments for the employer.

Instead of performing a manual process whereby each employer is contacted and information (if the employer actually continues to maintain accurate member data over a decade old) on the individual employee is retrieved, CalSTRS staff have developed an automated process by which the CalSTRS corporate database will perform the benefit comparison calculations using various calculation factors and assumptions. This automated solution is substantially less expensive to perform than manual processing. In order to utilize these assumptions, the Board must be allowed to adopt various assumptions in implementing AB 1586 to protect CalSTRS against future legal challenges if members question the assumptions used in the absence of accurate employer data, or the right of CalSTRS to use those assumptions.

Streamlining CalSTRS Reports

SB 1465 eliminates two redundant state-mandated reports to the Governor and Legislature. The “Estimate of CalSTRS Investments in California Residential Realty” report should be eliminated because the information it contains is duplicative and submitted in the CalSTRS’ Final Report to the Legislature detailing the final amount of funds available for investing in residential real estate. In addition, the Annual Audit Report should be eliminated because the financial information on CalSTRS’ programs it contains, as well as a copy of the annual audit of the System’s financial statements are included in the CalSTRS Consolidated Annual Financial Report, which CalSTRS is required in statute to supply to the Legislature annually. These changes allow CalSTRS to reallocate staff time and resources used in the preparation of these redundant legislatively mandated reports to more productive uses.

FISCAL IMPACT:

Payment Tolerances for Benefit Adjustments

Minor and absorbable benefit program costs of between \$0 and \$10,000 annually. Administrative savings of approximately \$80,000 annually to CalSTRS printing, payment processing and staff time spent researching and returning uncashed payments to the TRF. Approximately \$232,000 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 for modifying the START automated database, preparing job aids, providing system training, and modifying the Member Handbook is approximately \$58,000.

Out-of-State Permissive Service Credit

Any costs associated with the purchase of out-of-state permissive service credit would be offset from increased member contributions. Administrative costs are minor and absorbable.

Peace Corps Service Credit

Any costs associated with the purchase of peace corps service would be offset from increased member contributions. Administrative costs are minor and absorbable.

Minimum Guaranteed Monthly Allowance

Benefit costs associated with conforming the TRL to existing practice are currently included in the regular valuation of the DB Program. There are no administrative costs associated with this provision.

Full-Time Equivalency

There are no new benefit program costs associated with authorizing the use of assumptions as the CalSTRS consulting actuary cited a program cost of between \$424,000 and \$847,000, for the increased benefits that would be payable upon the recalculation of member benefits pursuant to AB 1586. The cost to modify the CalSTRS corporate database in order to automate the benefit comparison process utilizing these assumptions is approximately \$600,000, which has been allocated from the CalSTRS project budget for FY 2006-07. This amount is in addition to the \$140,000 that was appropriated by AB 1586 and has been spent. This cost is substantially less than a manual approach, which is the only other feasible alternative.

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 – \$290,000 appropriation from the TRF to cover the costs of implementation.

SUPPORT/OPPOSITION

Support: Teachers' Retirement Board (Sponsor)

Opposition: None Known