Date of Hearing: May 4, 2022

ASSEMBLY COMMITTEE ON APPROPRIATIONS
Chris Holden, Chair
AB 1667 (Cooper) – As Amended March 24, 2022

Policy Committee: Public Employment and Retirement Vote: 6 - 0

Urgency: No State Mandated Local Program: No Reimbursable: No

SUMMARY:

This bill imposes various requirements on the California State Teachers' Retirement System (CalSTRS) and public agencies related to audits of public agencies and members as those audits relate to the determination of creditable compensation and correction of errors in the calculation of retirement allowances to retirees.

Specifically, this bill:

1) Establishes requirements related to the transparency of CalSTRS audits and interpretations related to the determination of creditable compensation.

2) Authorizes an employer or exclusive representative of public school employees to submit to CalSTRS for review any compensation item that is in included or proposed to be included in a memorandum of understanding or collective bargaining agreement in which the compensation forms the basis of a pension benefit calculation. Requires CalSTRS to provide written guidance regarding the submission within 30 days of receiving the information required for a review.

3) Provides that, if CalSTRS' guidance provided in response to a submission for review is, for any reason, later determined by CalSTRS to result in disallowed compensation, including the collection of overpayments, as specified, any disallowed compensation reported in accordance with CalSTRS' written guidance must be deemed an error by CalSTRS; thereby, rendering CalSTRS financially responsible for any assessments or payments owed to the retired member, as specified.

4) Prescribes various corrective actions to be taken if contributions to CalSTRS were made on the basis of disallowed compensation.

FISCAL EFFECT:

1) Loss of revenue to CalSTRS due to its inability to retrieve overpayments. CalSTRS reports it recaptured $74.4 million in overpayments in the 2020-21 fiscal year.

2) Significant ongoing costs to CalSTRS to increase staff to provide written guidance regarding a compensation item upon request of an employee or employer. CalSTRS estimates it would need 12 additional benefits program staff, seven additional legal staff, and three additional audit services staff at a cost of approximately $3.5 million annually. The actual need for

additional staff would depend on the number of requests for written guidance CalSTRS receives.

3) Potential tax impact on CalSTRS' defined benefit plan. CalSTRS reports this bill would "likely" result in a violation of IRS qualification requirements for defined benefit plans, causing such a plan to lose its tax-exempt status and have adverse tax consequences for plan members.

COMMENTS:

Purpose of the Bill. CalSTRS is a defined benefit retirement program for public school educators, primarily teachers and administrators, in California public schools. A retiree's pension is based, in part on that person's creditable compensation (such as salary) while employed.

There have been numerous instances in which CalSTRS has determined that the pension of a retiree was based partly on non-creditable compensation. Sometimes that determination has been made several years after retirement and is sometimes a reversal of a determination that CalSTRS made at the time of retirement. When such a determination is made, the retiree is required to repay the overpayment and the monthly pension is reduced.

This bill addresses that problem by, among other things, requiring CalSTRS to provide, upon request by a member or employee, written guidance regarding any compensation item that is proposed to be included in the calculation of creditable compensation. If the guidance is later determined by CalSTRS to result in disallowed compensation, this bill provides, according to the author, that "any disallowed compensation reported in accordance with the system's written guidance shall be deemed an error by the system and rendering the system financially responsible for any assessments or payments owed to the retired member."

CalSTRS Concerns. CalSTRS acknowledges that it recovered approximately $74.4 million in overpayments in 2020-21, but states that most were unrelated to errors, and instead were due to a lag in time between the death of a beneficiary and the time that death was reported to CalSTRS. CalSTRS is concerned that this bill would create an untended incentive for the survivors of beneficiaries to delay the reporting of a death, because the resulting overpayments would not be recoverable.

CalSTRS is also concerned this bill could violate IRS requirements for a defined benefit plan, which require benefits to be "definitely determinable." Payments that exceed what is "definitely determinable" must be recovered to avoid disqualification and loss of a plans tax-advantaged status. According to CalSTRS, "The plan trust would lose its tax-exempt status, requiring CalSTRS to pay income tax on all trust earnings and seriously jeopardizing the plan's ability to meet funding targets and potentially even pay benefits." In addition, the loss of tax-advantaged status would render member contributions taxable retroactive to the time they were made, and members would have to include the employer contribution in their gross income.

Finally, CalSTRS argues that this bill violates its constitutional fiduciary duty over the administration of the plan and its assets.

Analysis Prepared by: Richard Pratt / APPR. / (916) 319-2081