



Agenda Item 9

November 17, 2015

ITEM NAME: Implementation of the Interim Relief for Charter Schools Issued by the Internal Revenue Service and Treasury Department

PROGRAM: Employer Account Management Division

ITEM TYPE: Information

EXECUTIVE SUMMARY

The California Public Employees Retirement System (CalPERS) is a governmental pension plan under section 414(d) of the Internal Revenue Code (IRC). On January 23, 2015, the Internal Revenue Service (IRS) and Treasury Department issued Notice 2015-07 entitled "Relief for Certain Participants in § 414(d) Governmental Plans" (the "Charter School Notice"). The Charter School Notice permits certain public charter schools to immediately participate in a governmental plan, and describes the criteria the IRS and Treasury Department are considering for permitting ongoing participation of such charter schools. The Employer Account Management Division (EAMD) has implemented a new School Applicant Questionnaire and certification process for each charter school requesting to participate in the CalPERS plan to help determine its eligibility in accordance with the criteria contained in the Charter School Notice. CalPERS has been able to successfully admit eligible charter schools into CalPERS since the implementation. Today's informational agenda item will provide the Board an update on this process.

STRATEGIC PLAN

This informational item supports Strategic Plan Goal B to actively manage business risks and deliver superior, end-to-end customer service that is adaptive to customer needs. EAMD has developed and implemented a process intended to balance the needs of our school employers with a focus on mitigating risk to the System.

BACKGROUND

On December 19, 2011, the IRS and Treasury Department issued an advance notice of proposed rulemaking entitled "Determination of Governmental Plan Status" (the "Section 414(d) Notice"). The Section 414(d) Notice was issued to solicit feedback regarding proposed draft regulations that provide a comprehensive "facts and circumstances" test for a governmental plan to determine whether an entity is eligible to participate in the Proposed Draft Regulations.

In response to the Section 414(d) Notice, the IRS received over 2,000 comments from members of the charter school community. The comments expressed concern that the Proposed Draft Regulations under consideration did not take into account the

special and unique nature of charter schools. After the release of the Section 414(d) Notice, CalPERS aligned its contracting procedures with the criteria contained in the Proposed Draft Regulations. As a result, a majority of the charter schools reviewed by CalPERS were not allowed to participate in the CalPERS plan.

ANALYSIS

The Charter School Notice was issued to provide interim relief for public charter schools to participate in a governmental plan if certain conditions are satisfied. In this regard, the Charter School Notice contains five requirements that must be satisfied by the time final regulations under Section 414(d) are issued.

- The entity is a nonsectarian independent public school that serves a governmental purpose by providing tuition-free elementary or secondary education, or both.
- The entity is established and operated in accordance with a specific State statute authorizing the granting of charters to create independent public schools or authorizing the establishment of independent public schools.
- Participation in the State or local retirement system by the entity's employees is expressly required or permitted under applicable law.
- The entity satisfies either of the following:
 - The entity's governing board or body is controlled by a State, political subdivision of a State, or agency or instrumentality of a State or political subdivision of a State.
 - The primary source of the entity's funding is from a State, political subdivision of a State, or agency or instrumentality of a State or political subdivision of a State, and the rights of the entity's employees to their accrued benefits under the State or local retirement system are not dependent on whether the entity continues to participate in the system and, in the event the entity ceases participation, a governmental entity has the responsibility for the accrued benefit of the entity's employees, including the continued funding of the accrued benefits, to no lesser extent than a governmental entity has the responsibility for the continued funding of the accrued benefits of the employees of any other participating employer in the system in the event that other employer were to cease to be a participating employer. Also, the entity is part of a local educational agency and is subject to the significant regulatory control and oversight by a State, political subdivision of a State, or agency or instrumentality of a State or political subdivision of a State.
- All financial interests of ownership in the entity are held by a State, political subdivision of a State, or agency or instrumentality of a State or of a political subdivision of a State. A State, political subdivision of a State, or agency or instrumentality of a State or political subdivision of a State is not treated as holding all financial ownership interests in an entity unless, upon dissolution or final liquidation of the entity, the entity's governing documents require the

entity's net assets to be distributed to another public school that meets all of the requirements above.

In response to the Charter School Notice, CalPERS developed a separate process for eligibility determinations when evaluating charter schools. This separate process includes a School Applicant Questionnaire (Attachment 1). In the past, CalPERS had one Applicant Questionnaire for both Schools and Public Agencies. Schools now have a specific questionnaire, incorporating the criteria contained in the Charter School Notice. The School Applicant Questionnaire is available on the CalPERS website. Circular Letter 200-024-15 (Attachment 2) was distributed on May 22, 2015, informing school employers of this new process.

In addition to the new School Applicant Questionnaire, CalPERS has developed an IRC Section 414(d) Charter School Certification (the "Certification") that all charter schools are required to sign before completing the contracting process. The Certification (Attachment 3) affirms the charter schools will take the appropriate measures to meet the final Section 414(d) regulations and remain compliant with the law. The Certification also specifies that in the event that the charter school fails to comply with the final Section 414(d) regulations, CalPERS would cancel benefits and remove service credited accrued for all employees and retirees of the charter school.

Once the School Applicant Questionnaire and Certification are completed and reviewed by CalPERS staff, charter schools are provided access into the system and can enroll employees into CalPERS. EAMD has approved several charter schools since the implementation of this process and continues to work with the schools to aide in the finalization of the process.

BUDGET AND FISCAL IMPACTS

Not Applicable

BENEFITS/RISKS

With the development and implementation of the School Applicant Questionnaire and the Certification, CalPERS is able to coordinate the immediate offering of benefits with the school while still aligning with the Charter School notice provided by the IRS and Treasury Department, mitigating risk to our system. However, as mentioned earlier, the Certification specifies that in the event that the Charter School fails to comply with the final Section 414(d) regulations, CalPERS would cancel benefits and remove service credited accrued for all employees and retirees of the Charter School.

ATTACHMENTS

Attachment 1 – School Applicant Questionnaire
Attachment 2 – Circular Letter 200-024-15
Attachment 3 – Charter School Certification

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