Pension & Health Benefits Committee

California Public Employees' Retirement System

Agenda Item 5a

June 12, 2012

ITEM NAME: Assembly Bill 1819 (Ammiano) – Charter School Participation in CalPERS

As Amended May 2, 2012

PROGRAM: Legislation

ITEM TYPE: Action

RECOMMENDATION

Adopt a position of **Oppose, Unless Amended** to (1) ensure that CalPERS current and future tax-qualified and governmental plan status under federal law is protected; and (2), clarify the reporting relationship and process for enrolling eligible charter schools and their employees in the CalPERS Plan.

EXECUTIVE SUMMARY

Assembly Bill (AB) 1819 requires charter schools to provide retirement benefits to their eligible employees under the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS).

Adopting the staff recommendation will allow CalPERS to advocate for amendments necessary to ensure conformity with the Public Employees Retirement Law (PERL) and to protect CalPERS tax-qualified and governmental plan status under federal law.

BACKGROUND

1. Charter Schools in California

   The Legislature authorized the creation of charter schools in 1992 to allow alternative teaching and educational administrative models to be developed and tested outside the traditional public school system. In enacting this area of law, the Legislature established a charter approval process, a funding process that has been refined over the years, imposed several levels of reporting and accountability, and allowed a charter school to elect coverage under the CalSTRS Plan or the CalPERS Plan, or both. Section 47611 of the Education Code further provides that if a charter school chooses to elect such coverage, charter school employees are entitled to participate in the selected retirement plan. Similarly, section 20610(b) of the PERL allows charter schools to choose to participate in CalPERS.

2. Charter School Employees as Members of CalPERS
   As part of the CalPERS-sponsored omnibus bill in 2004, the PERL was amended to clarify that a charter school that elects to participate in CalPERS shall be treated in the same manner as if the charter school was a public school within the school district that granted the charter. Therefore, charter school employees have been treated like school district employees and typically enrolled in CalPERS through the County Office of Education. CalPERS currently enrolls almost 425,000 school members, which constitutes approximately 38.5 percent of CalPERS active and inactive membership. School members receive a service retirement benefit of two percent per year of service at 55 years of age, with a highest 12 month average final compensation calculation, and coordination with Social Security. Currently, employee contributions are fixed by statute at seven percent of salary, and the 2012-2013 employer contribution rate is 11.417 percent of salary.

3. Advanced Notice of Proposed IRS Rulemaking
   The Internal Revenue Service (IRS) and the Treasury Department recently issued an advance notice of proposed rulemaking (the “IRS Notice”) regarding the definition of a "governmental plan" for purposes of section 414(d) of the Internal Revenue Code (IRC). IRC section 414(d) generally defines the term “governmental plan” as a plan established and maintained for its employees by the government of the United States, the government of any State or political subdivision thereof, or by any of their agencies or instrumentalities. A pension plan that qualifies as a “governmental plan” under IRC section 414(d) is generally treated differently than a private sector pension plan under federal tax laws. CalPERS is a governmental pension plan within the meaning of IRC section 414(d). Therefore, CalPERS will be subject to any final regulations that the IRS adopts interpreting IRC section 414(d). Ultimately, what this means is that CalPERS will have to prohibit the participation of any entity in the CalPERS Plan that is not “an agency or instrumentality of the State or a political subdivision of a State” as defined in the final regulations.

   The IRS and Treasury Department have received hundreds of comments from the charter school community expressing concerns about whether it will be permissible to cover charter school employees in a governmental plan in the future.

ANALYSIS

1. Proposed Changes
   Specifically, AB 1819 amends the Education Code to:
   - Require all charter schools to offer CalPERS membership to their CalPERS-eligible employees, eliminating the charter school’s choice under current law;
   - Require all charter schools to offer CalSTRS membership to their CalSTRS-eligible employees, eliminating the charter school’s choice under current law;

- Eliminate the employee notice requirement related to retirement system options which is rendered unnecessary by the mandatory participation requirement in this bill; and,
- Provide that its provisions shall not apply to the extent it would cause CalPERS or CalSTRS or their respective members to incur adverse tax consequences under federal law.

2. Proponents and Opponents
   This bill is sponsored by the California Federation of Teachers (CFT), which argues that charter schools are funded by public dollars and serve public school children, so their employees should have retirement benefits consistent with other public school employees. The California Charter Schools Association (CCSA) opposes the bill, contending that it imposes "new costs on charter schools that already strive to maintain financial stability in the face of daunting challenges."

3. Protecting CalPERS Tax-Qualified and Governmental Plan Status
   The IRS Notice regarding the definition of "governmental plan" has alarmed many in the charter school community. Of particular concern to them and to CalPERS is whether charter schools operated by nonprofit organizations would be eligible to participate in a "governmental plan" given the initial IRS position in the IRS Notice. AB 1819 does not alter CalPERS' existing authority to deny participation by entities determined by the Board to adversely affect the System. Staff nevertheless recommends that the bill be amended to (1) ensure that CalPERS' current and future tax-qualified and governmental plan status under federal law is protected (e.g., provide that only charter schools that will qualify under applicable federal law may participate in CalPERS); and (2) clarify the reporting relationship and process for enrolling eligible charter schools and their employees in the CalPERS Plan.

4. Impacts of Change from Voluntary to a Mandatory Participation Scheme
   It is not clear to what extent mandating charter schools to participate in CalPERS will affect schools and their employees. AB 1819 would impose CalPERS' various reporting and funding requirements on charter schools that have not previously elected to participate in CalPERS. This could result in increased staff time to ensure compliance if these charter schools are unwilling or unable to comply with these requirements. In addition, this may require additional staff time to ensure compliance with anticipated changes in federal law.

   Also, the bill only amends charter school law in the Education Code, and it does not make any conforming changes the PERL. Currently, the PERL specifies that if a charter school chooses to participate in CalPERS, its employees are covered in the same manner as School employees. Therefore, staff recommends amending the bill to include the necessary conforming changes to the PERL and include language to expressly provide the Board authority to determine eligibility, clarifying the reporting relationship between CalPERS and the charter schools, and specifying the process for enrolling charter school members in the CalPERS Plan.

5. Costs

Benefit Costs
This bill would not likely have an impact on charter schools or their employees who are currently participating in the System. However, charter schools that are eligible, but that are not currently participating in the System, would be required to participate in CalPERS and make employer contributions to the school pool effective, which is currently 11.417 percent of payroll. In addition, charter school employees would be subject to the current mandatory member contribution rate of seven percent of their earnings.

Administrative Costs
To the extent mandatory charter school participation requires CalPERS to restructure its processes; the System could incur significant costs for a pre-enrollment agency review and ongoing administrative responsibilities. Preliminarily staff estimates at least $1 million in implementation costs, and additional annual personnel costs.

BENEFITS/RISKS

Benefits

- Adding new membership expands the Schools Plan risk pool.

Risks

- Charter schools forced to participate in CalPERS by this bill may not be motivated to comply fully with current employer disclosure, payroll and contribution reporting requirements, or to do so in a timely manner.

- Adding new membership to the System carries some level of actuarial risk, though no more than adding any other new school or public agency employer.

- Without the appropriate safeguards, a County Office of Education may process members into the System that are employed by a charter school that should not be allowed, under current law or potential changes to the law based on the IRS Notice, to participate in the CalPERS Plan, thus endangering CalPERS' tax-qualified and governmental plan status.

ATTACHMENTS
Attachment 1 – Legislative History

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