

TEACHERS' RETIREMENT BOARD

REGULAR MEETING

Item Number: **18**

SUBJECT: Charter School Project

CONSENT: ____

ATTACHMENT(S): 0

ACTION: ____

DATE OF MEETING: July 14, 2017

INFORMATION: X

PRESENTER(S): Jack Ehnes

PURPOSE

The purpose of this item is to provide information to the board regarding the topics and issues related to charter schools that staff intends to research and present to the board during fiscal year 2017-18. Staff request feedback from the board regarding the proposed timeline and topics.

BACKGROUND

Charter schools first appeared in California in 1993 following the passage of the California's Charter Schools Act which was signed in 1992 by then Governor Pete Wilson. The act became effective on January 1, 1993. The first California charter school was approved and created in February of that year. The number of charter schools has steadily increased over the last 25 years. Today, there are over 1,200 charter schools in California, of which close to 1,100 have elected to provide retirement benefits to their eligible employees through CalSTRS.

At the June board meetings, staff presented two separate items related to charter schools. One was presented during the Audits and Risk Management Committee and covered the results of charter school audits. The other item was presented during the regular board meeting which provided general information about California charter schools, including an overview of charter school law, the growth of charter schools over time, CalSTRS' retirement benefits at charter schools, charter school demographic data and responses to a survey of charter school administrators.

During these meetings, several questions and issues were raised regarding charter schools ranging from bankruptcy, how charter schools are created, the election process as well as financial and actuarial issues. At the June board meeting, staff stated they would come back to the board in fiscal year 2017-18 to provide additional information on the issues and questions raised during the meeting and further look into charter schools and their impact on the membership and the funding of the retirement benefits for our members. The purpose of this item is to provide further details on the topics staff intends to research and the proposed schedule as to when the various topics will be reported back to the board in fiscal year 2017-18. Staff request feedback from board members on the proposed timeline and topics.

SUMMARY

With the increasing number of charter schools in California, it is important as a system that we fully understand how charter schools are created, how the election process is performed and what information is provided to the impacted families and teachers during that process. We should continuously monitor the trend and growth in charter schools to ensure it will not impact the long term funding of the system or result in a shifting of cost to other schools. Since the retirement security of teachers in California is our mission as a system, we may need to be proactive in ensuring the proper information regarding CalSTRS retirement benefits is provided during the election process.

Over the next 12 months, staff will research in more detail some of these issues and report back to the board for discussions. Topics that will be analyzed and presented for discussion include the following:

- Actuarial and funding issues
- Financial and bankruptcy issues
- Audit issues
- Election, outreach and membership issues
- Legal issues

Below are additional details on some of the topics staff intends to research

Actuarial Funding Issues

Last November, CalSTRS actuarial staff presented the 2016 Review of Funding Levels and Risks report, the first ever such report. The main risks that were analyzed for the report last year were related to investment volatility.

For this year's report, staff intends to look at other risks such as longevity risk and risks related to the growth or even decline in the CalSTRS covered population. Contributions are currently collected each year based on contribution rates set as a percentage of payroll. Even though current law allows the board to adjust contribution rates for the state and, starting in 2021, for employers, this authority is limited. A significant increase in the number of charter schools electing not to provide retirement benefits through CalSTRS could lead to a decline in the CalSTRS covered population and make it difficult for the board to set contribution rates that would be sufficient for the Defined Benefit Program to reach full funding.

Staff has been investigating in depth for more than a year some of the financial/actuarial risks associated with charter schools, especially risks related to a potential growth in the number of charter schools not electing CalSTRS for retirement benefits. Staff will report back on this topic in November 2017 as part of the upcoming 2017 Review of Funding Levels and Risks report.

Financial and Bankruptcy Issues

To ensure the long term financial stability of the fund and ensure our members receive the benefits that were promised, we have to be able to collect contributions owed by every school. Uncertainties and financial risks exist each time a charter school faces financial stress. When a charter school ceases to exist, we face increasing risk that owed contributions remain unpaid. The consequences are also different if the charter school faces a potential bankruptcy. Some of the topics and issues staff intend to research and report back on include:

- How do we ensure that charter schools that have elected CalSTRS are in fact reporting payroll and contributions to CalSTRS?
- Should CalSTRS monitor financial stress of charter schools to proactively identify low revenue or near bankrupt charter schools?
- What are the repercussions if a charter school fails to submit contributions? What are the next steps? How do we ensure contributions are ultimately collected?
- Would bankruptcy increase these risks? Would CalSTRS be treated like any other creditor in the event of a bankruptcy?
- Would the closure of a charter school result in shifting of cost to existing agencies? Should a termination fee be assessed if a charter school ceases to exist?
- Do members face any financial risks in the event of a closure?

Audit Issues

As was reported in June as part of the item on charter schools audits, Audit Services is currently conducting a separate risk assessment for charter schools to identify high-risk charter schools to audit as part of the 2018 audit plan. The results of this risk assessment will be reported back to the board in November.

Election, Outreach and Membership Issues

As evidence from the June board discussion, including stakeholder comments, there are many uncertainties, issues and unanswered questions surrounding the creation of charter schools. It is unclear whether the teacher and the parent communities are fully aware of the consequences of the charter schools either electing or not electing CalSTRS to provide retirement benefits.

It is also important to realize that although the issue of CalSTRS coverage is equally important, the consequences of not electing CalSTRS may not be the same depending on the type of charter school being created. There are two types of charter schools, those created through conversion of an existing public school and those that are start-up charter schools. Each type has its own petition signature requirement. Conversions to charter schools could have the most impact to existing members if the decision is to discontinue providing retirement benefits through CalSTRS, as existing members would lose coverage.

Over the next few months, staff intends to research and provide additional information to the board on to the election process, outreach and education efforts and how charter schools impact

our membership and more specifically their retirement security. Research topics include:

- How can we improve outreach efforts to ensure all affected parties are fully aware of the retirement benefits that are provided by the charter school and the consequences of not providing benefits through CalSTRS?
- Should legislation be pursued to require all new charter schools provide retirement benefits through CalSTRS?
- What happens when a charter school renews its charter?
- Can a charter school cease to exist and re-open under a different entity to avoid providing CalSTRS benefits?
- What if a charter school elects to only provide Social Security? Are teachers aware of the potential implications to their retirement security such as being affected by the Windfall Elimination Provision (WEP)?
- What if a charter school elects to provide a defined contribution plan without Social Security? Are teachers protected in the event of a disability or death prior to retirement?

Legal Issues

By their nature, many of the topics and issues mentioned above have inherent legal components that need to be researched. Additional legal issues and topics that will be researched may include:

- Existing laws and regulations covering charter schools, including bankruptcy laws.
- Whether there could be vested rights issues when an existing public school converts to a charter school and does not elect CalSTRS to provide retirement benefits.
- Determine the entity legally liable in situations where a charter school is delinquent and ceases to exist.

Timeline

Due to the volume of information and topics being researched, staff intends to bring back charter school topics for discussion with the board on two occasions during fiscal year 2017-18.

In November 2017, staff intends to discuss risks and issues that are more actuarial, audit, financial and legal in nature. For the February 2018 item, staff intends to discuss issues and concerns around the election and renewal process, membership as well as outreach issues. Once again, the purpose of this item is to inform the board and obtain feedback on the proposed outline and topics to be researched in fiscal year 2017-18.