TEACHERS' RETIREMENT BOARD

REGULAR MEETING Item Number: 5

SUBJECT: Amendment to Penalties and Interest Regulations: Extra Late Penalty Rate

CONSENT: __ ATTACHMENT(S): 1

ACTION: X MEETING DATE: June 11, 2015 / *30 mins.*

INFORMATION: __ PRESENTER: Ed Derman

PURPOSE

The purpose of this item is to secure direction from the board to begin the formal rulemaking process, pursuant to the Administrative Procedure Act, to amend the existing regulation that specifies the penalty rate employers are subject to when contributions are remitted after March 1 in the year following the fiscal year in which they were due ("extra late contributions"). In November 2014, the board directed staff to proceed with amending the penalty rate set for extra-late contributions.

BACKGROUND

CalSTRS relies on the timely and correct remittance of information and contributions from county offices of education and district employers who are authorized to report directly to CalSTRS. Late and inaccurate reporting of data can result in inaccurate benefit payments to members and lost state contributions; late contributions result in lost investment opportunities.

The Education Code requires that penalties and interest be assessed on employers for late or inaccurate reporting of retirement data and payment of contributions. Effective July 1, 2012, regulations were adopted by the board to ensure consistent and transparent assessment of penalties and interest.

Pursuant to section 22955.5 of the Education Code, each October, CalSTRS calculates the total amount of creditable compensation for the fiscal year that ended on the preceding June 30 using information provided by employers. CalSTRS submits a report that includes this calculation to the Director of Finance, the Chairperson of the Joint Legislative Budget Committee and the Legislative Analyst. On or before April 15 (generally in early April), CalSTRS notifies the same parties of any revisions to the total amount of creditable compensation since the October calculation. This revised number forms the basis for the final amount of the next year's state appropriation, and there is no provision for subsequent correction. Therefore, CalSTRS does not receive any contributions from the state for creditable compensation that is not included in the April revised report.

Current regulations include a 5 percent penalty for extra-late contributions, in order to recoup an amount approximating the lost state contribution resulting from extra late reporting. The state contribution would have been credited to the Defined Benefit (DB) Program and the Supplemental Benefit Maintenance Account (SBMA), which funds the purchasing power protection of benefits paid under the DB Program. The problem these amendments seek to address is that the current penalty rate falls short in recovering actual lost state contributions, particularly given that the state contribution rate is increasing over the next few years pursuant to Chapter 47, Statutes of 2014 (AB 1469–Bonta).

DISCUSSION

This amendment is expected to result in (1) recouping from employers an amount that will more closely relate to the actual state rate and (2) retaining the existing incentive for employers to remit contributions and report in a timely fashion by establishing the existing 5 percent penalty rate as the minimum penalty rate.

At the time the Penalties and Interest regulations were written, the state contribution rate was lower than it is today. The state contribution rate increased effective July 1, 2014, and will be subject to adjustment by the board under AB 1469 beginning July 1, 2017, based on the findings of the actuarial valuation of the DB Program. The state contribution rate may be increased by no more than 0.5 percent per year or may be adjusted down to as low as 4.517 percent (2.017 for the state contribution to the DB Program, plus 2.5 percent for the SBMA).

These amendments to the regulation propose a penalty rate that is the same as the state rate that is in place each March 1, effectively setting the penalty rate to lag the state rate by eight months. The table below illustrates the months of a fiscal year in which a specific state contribution rate is applied to compensation and the months in which that same rate would be applied as a penalty rate for extra-late reporting.

<table>
<tr><td colspan="8"></td><td colspan="12">Penalty rate year corresponding to fiscal year</td></tr>
<tr><td colspan="12">Fiscal year</td><td colspan="8"></td></tr>
<tr><td>July</td><td>August</td><td>September</td><td>October</td><td>November</td><td>December</td><td>January</td><td>February</td><td>March</td><td>April</td><td>May</td><td>June</td><td>July</td><td>August</td><td>September</td><td>October</td><td>November</td><td>December</td><td>January</td><td>February</td></tr>
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The state rate can only be increased in increments of 0.5 percent, with no maximum annual decrease in the state rate. Because of the lag in the penalty rate, the potential for under-recovery as opposed to over-recovery of actual lost state contributions is fairly high. To mitigate this, staff recommends establishing a minimum penalty rate equal to the current 5 percent, which has adequately served as an incentive to employers to report timely.

These amendments are expected to result in costs to employers (including school districts, community college districts and county offices of education) who remit contributions late. They will result in corresponding savings to the fund and, thus, to the state and employers as a whole.

NEXT STEPS

With the board's approval, staff will initiate the rulemaking process. Publication in the California Regulatory Notice Register (coinciding with the beginning of the 45-day public comment period) can occur on July 10, with the comment period ending on August 24.

The board has discretion as to whether or not to conduct a public hearing, but CalSTRS will be required to hold one if it is requested by the public no later than 15 days before the close of the written comment period. The board may choose to preschedule a hearing or wait to see whether one is requested and schedule it at that point. No comments were received in regards to this particular penalty when it was initially set in 2012.

The board may elect to conduct a hearing in person to coincide with its September meeting, which takes place during the week following the end of the 45-day comment period. Alternatively, the board may delegate the hearing to the Chief Executive Officer, which would allow greater flexibility in the September board agenda.

Regardless, the final proposed regulations will be brought before the board for adoption before they are submitted to the Office of Administrative Law for approval. If there is no need for an additional comment period, the board can consider adoption of the regulations in November. These regulations will be submitted with a request for a March 1, 2016, effective date outside the default quarterly schedule (January 1, April 1, July 1, and October 1) provided by the APA. If an additional comment period is required, staff would return instead with a revised draft in November, and the effective date would be delayed.

RECOMMENDATION

Staff recommends that the board direct staff to initiate the rulemaking process and delegate authority to schedule and hold the related hearing to the Chief Executive Officer.

Title 5. Education. Division 3. Teachers' Retirement System.

Chapter 1. Teachers' Retirement System.
Article 15.5. Penalties and Interest for Late Remittances and Late and Unacceptable Reporting by Employers.

§ 27007. Assessment of Penalties and Interest for Late Contributions – Defined Benefit Program

(a) A late contribution shall be subject to a penalty ~~equal to 5% of the creditable compensation upon which the contribution was based~~ if that contribution is received after March 1~~st~~ of the state fiscal year that immediately follows the state fiscal year in which the contribution was due.

<u>(1) The penalty rate shall be assessed on the creditable compensation upon which the late contribution was based. For purposes of this subdivision, creditable compensation shall include only creditable compensation for which member contributions are credited under the Defined Benefit Program.</u>

<u>(2) The penalty rate shall be the greater of the following:</u>

<u>(A) The state appropriation rate, pursuant to Sections 22954, 22955 and 22955.1 of the Education Code, that is in effect on the first day of March immediately preceding the date the contribution was received.</u>

<u>(B) Five percent.</u>

(b) Interest on late contributions shall be imposed as follows:

(1) If less than 95 percent of contributions due have been received by the ~~6th~~ <u>sixth</u> working day, interest shall be charged on the balance of those contributions due and compounded daily based on the regular interest rate in effect that day.

(2) For contributions received more than 15 working days after the date those contributions are due, interest shall be charged on the balance of contributions due and compounded daily based on the regular interest rate in effect that day.

(c) The penalty and interest assessed on late contributions provided for in this section shall not apply to adjustments made to contributions for a month prior to the effective date of this article.

(d) Adjustments to contributions remitted in a prior month shall not be subject to the penalty and interest assessed on late contributions provided for in this section if all of the following are true:

(1) The adjustments are made for all members of a class of employees;

(2) The adjustments are made pursuant to a written employment agreement with an employer or with an exclusive representative entered into by an employer, pursuant to Chapter 10.7 (commencing with Section 3540) of Division 4 of Title 1 of the Government Code;

(3) The adjustments become effective contemporaneously with the effective date of the written employment agreement or the effective date of the provision in the agreement providing for future increases in compensation; and

(4) The adjustments are remitted to the system within 90 days of the effective date of the written employment agreement or the effective date of the provision in the agreement providing for future increases in compensation.
(e) For an employee employed as a substitute teacher, or on a part-time basis or a full-time basis with an additional part-time position, contributions for the substitute or part-time position that are otherwise late shall not be subject to the penalty and interest assessed on late contributions provided for in this section if all of the following are true:
(1) The date the substitute or part-time position is paid is based upon a published salary schedule;
(2) That date is no more than 31 calendar days following the last day of the month in which the compensation being reported was earned; and
(3) 95~~%~~ <u>percent</u> of the contributions due are received five working days immediately following the date the substitute or part-time position is paid, and the balance of contributions due are received no more than 15 working days following the date the employee is paid.
(f) Contributions that are otherwise late shall not be subject to the penalty and interest assessed on late contributions provided for in this section during the following periods of time:
(1) The period of time beginning on the date an application for workers' compensation is filed with the Workers' Compensation Appeals Board until the date compensation is awarded, if the awarded compensation increases the amount of contributions due for that period of time. 95~~%~~ <u>percent</u> of the contributions that are exempt under this subdivision shall be due five working days immediately following the month in which compensation is awarded and shall be late thereafter, and the balance of contributions are due 15 working days following the month in which compensation is awarded and shall be late thereafter.
(2) Any period of time that directly results from the operation of a state or federal statute or regulation which requires a retroactive change in the creditable compensation paid to a member for prior service, if that retroactive change results in a change in the amount of contributions due for that period of time. 95~~%~~ <u>percent</u> of the contributions that are exempt under this subdivision shall be due five working days immediately following the month in which the period of time expires and shall be late thereafter, and the balance of contributions shall be due 15 working days following the month in which the period of time expires and shall be late thereafter.

Note: Authority: California Constitution, Article XVI, Section 17; and Sections 22207, 22213, 22214, 22250 and 22305, Education Code. Reference: Sections 23002~~,~~ <u>and</u> 23003, Education Code.