



## Regular Meeting

### Item Number 5 – Open Session

**Subject:** Proposed Revisions to the Lump-Sum Death Benefit Board Policy

**Presenter(s):** Rick Reed / David Lamoureux

**Item Type:** Action

**Date & Time:** March 7, 2024 – 15 minutes

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**Attachment(s):**

Attachment 1 – Proposed policy revisions

Attachment 2 – Actuarial cost analysis prepared by Milliman

**PowerPoint(s):** Lump-Sum Death Benefit Board Policy

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**Item Purpose**

The purpose of this item is to adopt revisions to the existing board policy related to the lump-sum death benefit paid to the beneficiaries of Defined Benefit Program members who die before or after retirement.

**Recommendation**

It is recommended that the board adopts the proposed revisions to the lump-sum death benefit board policy. As per these revisions, the board would only consider an increase if the Defined Benefit Program is on or ahead of schedule to reach full funding by 2046. Increases would be tied to California inflation and capped at the long-term assumed inflation of 2.75%.

### **Executive Summary**

Since 1992, the board has had the authority to annually adjust the one-time lump sum death benefit payable upon the death of an active or retired Defined Benefit Program member based on changes in the “All Urban California Consumer Price Index”. The board has done so ten times since 1992. The current one-time, lump-sum death benefit paid on behalf of active Coverage A members and retired members is \$6,903. The current one-time, lump-sum death benefit paid on behalf of active Coverage B members is \$27,612. These amounts were set by the board in May 2022.

Although the board has a policy related to the lump-sum death benefit, the existing board policy does not provide guidance regarding the basis for when adjustments to the lump-sum death benefit should be considered. It requires that the lump-sum death benefit be reviewed annually and be based on the results of the most recent actuarial valuation and a recommendation from its consulting actuary.

In January 2023, staff presented to the Benefits and Services committee an [item](#) discussing the lump sum death benefit. At that meeting, the committee directed staff to bring to the full board proposed revisions to the existing policy stating that future increases should be based on the inflation in California in the previous calendar year and that the board should only consider increases when certain funding thresholds are met.

For this item, the board is being asked to adopt revisions to the existing policy. The recommendation is for the funding thresholds to be tied to the CalSTRS Funding Plan. Specifically, the proposed policy states that the board would consider increases in the lump-sum death benefit amounts only if the following funding thresholds are met at each annual review:

- The funded status for the Defined Benefit Program is projected to be 100% or greater on June 30, 2046.
- In the most recent actuarial valuation, the funded status of the Defined Benefit Program, reflecting the increase under consideration, is greater than the funded status that was projected when the funding plan was adopted.

Annual increases would be tied to California inflation and capped at the long-term assumed inflation of 2.75%. There would also be a catch-up provision. Attached to this item is an actuarial cost analysis prepared by CalSTRS’s external actuary, Milliman. It shows that increasing the lump-sum death benefit by 2.75% each year would increase the unfunded actuarial obligation by about \$615 million.

These increases would not be automatic. The proposed funding thresholds will be used to guide staff’s recommendation of whether an increase in the lump-sum death benefit amounts should be considered by the board. The board will continue to have the opportunity to review the results of the valuation and other relevant considerations to determine whether an increase should be granted each May. If adopted, the proposed policy changes will be effective immediately and used for the next review which is scheduled to take place at the May 2024 regular board meeting.

Any increases in the lump-sum death benefit amounts adopted by the board at the May 2024 meeting would become effective on July 1, 2024.

**Background**

A one-time lump sum death benefit payment is payable to the beneficiary upon the death of an active or retired Defined Benefit Program member under certain conditions specified in statute. When an active member dies prior to retirement, the amount of the lump sum benefit varies based on whether the member was under Coverage A or B.

Section 23801 of the Education Code provides for a death payment of \$5,000 to the beneficiary of an eligible deceased active member who had coverage under the Family Allowance Program (Coverage A) of the Defined Benefit Program. Education Code section 23880 also provides for a death payment of \$5,000 to the beneficiary of an eligible deceased retired member. Section 23851 of the Education Code provides for a death payment of \$20,000 to the beneficiary of an eligible deceased active member who had coverage under the Survivor Benefit Program (Coverage B) of the Defined Benefit Program.

Each of these three sections permits the board to “adjust the death payment amount following each actuarial valuation based on changes in the All-Urban California Consumer Price Index” (California CPI). Below is a table showing a history of the adjustments to the lump sum death benefit levels.

<b>Historical Adjustments to the Lump Sum Death Benefit</b>		
<b>Date of Death</b>	<b>Active Coverage A and Retired Member</b>	<b>Active Coverage B</b>
10/16/92 to 6/30/94	\$5,000	\$20,000
7/01/94 to 12/31/96	\$5,110	\$20,440
1/01/97 to 6/30/98	\$5,227	\$20,908
7/01/98 to 6/30/99	\$5,493	\$21,974
7/01/99 to 6/30/00	\$5,598	\$22,394
7/01/00 to 6/30/01	\$5,763	\$23,052
7/01/01 to 6/30/02	\$6,010	\$24,040
7/01/02 to 6/30/18	\$6,163	\$24,652
7/1/18 to 6/30/2021	\$6,372	\$25,488
7/1/2021 to 6/30/2022	\$6,480	\$25,920
7/1/2022 to present	\$6,903	\$27,612

Note that in any given year, more than 90% of the deaths of CalSTRS members are for retired members. As a result, the smaller one-time death benefit, paid to both retired members and active Coverage A members is the most common lump-sum death benefit paid by CalSTRS.

As shown in the table above, the last adjustment to the lump sum death benefit was adopted by the board in May 2022. At the time, the board increased the death benefit amounts to fully reflect the

increase in the California CPI between December 2020 and December 2021 to prevent the lump sum death benefit from being further eroded by inflation. The increase was about 6.5%.

When considering whether to increase the lump sum death benefit, the existing board policy does not provide guidance regarding the basis for when adjustments to the death benefit should be considered. The existing policy pertains only to the timing of the reviews. It requires that the lump sum death benefit be reviewed annually and be based on the results of the most recent actuarial valuation and a recommendation from its consulting actuary.

In January 2023, staff presented to the Benefits and Services committee an [item](#) discussing the lump sum death benefit. At that meeting, the committee directed staff to bring to the full board proposed revisions to the existing policy stating future increases should be based on the inflation in California in the previous calendar year and that the board should only consider increases when certain funding thresholds are met.

When determining funding thresholds, it is important to consider the CalSTRS Funding Plan. The CalSTRS Funding Plan was created through the enactment of Assembly Bill 1469 in 2014, which established a plan to fully fund the Defined Benefit program by June 30, 2046 through increased member, employer and state contributions.

Whether the Defined Benefit Program achieves full funding by 2046 will be dependent on the extent to which the actual demographic and economic experience differs from the actuarial assumptions adopted by the board. Of these assumptions, the 7% long-term assumed investment return assumption presents the biggest risk to CalSTRS ability to reach full funding.

Each time the board increases the lump-sum death benefit, it increases the actuarial obligations of the Defined Benefit Program, increases the unfunded actuarial obligation and decreases the funded status. These increases could adversely impact the Defined Benefit Program and prevent full funding by 2046.

As per the rules of the funding plan, increases in the lump sum death benefit are the responsibility of the state. Therefore, any increases in the lump sum death benefit will increase the state's share of the unfunded actuarial obligation and will need to be funded through higher state contributions.

In developing funding thresholds, three main factors were considered: the most recent funded status compared to the funded status that was estimated when the funding plan was created in 2014, the projected funded status on June 30, 2046, and contribution rates.

When the funding plan was enacted in 2014, staff projected the funded status of the Defined Benefit Program as of June 30 each year through 2046. This funding status schedule has been used since 2014 to determine if CalSTRS was behind or ahead of schedule in the goal of reaching full funding by 2046. As was reported last November in the 2023 [Review of Funding Levels and Risks report](#), the Defined Benefit Program is currently slightly ahead of schedule.

Staff is recommending the board policy be amended to state that the board would consider increases in the lump-sum death benefit amounts only if the Defined Benefit Program is ahead of schedule and projected to remain ahead of schedule for the duration of the funding plan.

Specifically, the board would consider an increase only if the current and projected funded status in the most recent actuarial valuation, after reflecting the increase under consideration, is greater than the projected funded status when the funding plan was adopted for all years until the end of the funding plan.

Since the funding plan set a target for the Defined Benefit Program to be 100% funded by June 30, 2046, it is also recommended that one of the funding thresholds be tied to the June 30, 2046 date. Specifically, staff is recommending the board policy be amended to state that the board would consider increases in the lump-sum death benefit amounts only if the funded status for the Defined Benefit Program is projected to be 100% or greater on June 30, 2046, after reflecting the impact of the increase in the lump-sum death benefit amounts.

Contribution rates should also be taken into consideration when deciding whether the lump-sum death benefit amounts should be increased. However, having a funding threshold based on whether the funding plan remains ahead of schedule will ensure contribution rates would not need to increase above existing levels following an increase in the lump-sum death benefit amounts. Therefore, staff is not recommending any explicit funding thresholds related to contribution rates.

It is important to remember that the funding thresholds being proposed will be used to guide staff's recommendation of whether an increase in the lump-sum death benefit amounts should be considered by the board. These increases would not be automatic. The board will always have the opportunity to review the estimated cost impact of an increase while also taking into account the most recent actuarial valuation, the current economic environment and the funding thresholds in order to consider whether an increase should be granted.

In addition to developing funding thresholds, staff also received direction from the Benefits and Services committee in January 2023 that future increases in the lump-sum death benefit amounts should be based on the inflation in California in the previous calendar year.

Note that the board has adopted a long term-inflation assumption of 2.75% that is used in the actuarial valuations to determine the funded status. Staff is recommending that this assumption be taken into account when determining the increases that would be considered by the board.

First, inflation would be measured by comparing the increase in the California CPI for the months of December. For example, inflation in California for calendar year 2023 will be determined by calculating the increase in the California CPI between December 2022 and December 2023. The calculated inflation would then be compared to the inflation assumption adopted by the board, currently 2.75%.

If the actual inflation exceeds 2.75%, the recommended increase in the death benefit amount will be capped at 2.75%. The board policy would include a “catch-up” provision to ensure that when such a situation occurs, any portion of the inflation above 2.75% would be carried forward to be used for future increases in years where inflation is below 2.75%. When the actual inflation is less than 2.75%, the recommended increase in the death benefit amount will be based on the actual inflation plus any additional increases calculated by the “catch-up” provision.

Capping increases to the long-term inflation assumption, with a “catch-up” provision, will ensure cumulative increases in the lump-sum death benefit are in-line with the actuarial assumption used to assess funding levels and determine whether the Defined Benefit Program remains on track to reach full funding by 2046.

As stated earlier, the Defined Benefit Program is currently slightly ahead of the schedule to reach full funding by 2046. To the extent it remains ahead of schedule through 2046, the board could be in the position to consider increasing the lump-sum death benefit amounts each year through 2046. Each time the board increases the lump-sum death benefit, it increases the actuarial obligations of the Defined Benefit Program and increases the unfunded actuarial obligation. To help illustrate the potential impact of increasing the lump-sum death benefit amounts each year by 2.75%, an actuarial cost analysis was prepared by Milliman. It shows that increasing the lump-sum death benefit by 2.75% each year would increase the existing unfunded actuarial obligation by about \$615 million. A copy of the actuarial cost analysis is attached to this item.

The actuarial cost analysis also includes the impact of increasing the death benefit amounts by 2% instead of 2.75%. Capping increases to 2% would increase the unfunded actuarial obligation by about \$403 million, assuming the benefit were to increase by 2% each year. Capping increases at 2% with a “catch up” provision is an alternative option which the board could consider.

Considering that existing statutes permit the board to “adjust the death payment amount following each actuarial valuation based on changes in the All-Urban California Consumer Price Index”, it would be reasonable for the board to base increases on the California inflation in the previous calendar year and capped at the long-term assumed inflation of 2.75%.

In summary, staff recommends the board adopts the proposed revisions to the existing policy related to lump-sum death benefit for active and retired members as outlined in attachment #1. The board would consider increases in the lump-sum death benefit amounts only if the following funding thresholds are met at each annual review:

- The funded status for the Defined Benefit Program is projected to be 100% or greater on June 30, 2046.
- In the most recent actuarial valuation, the funded status of the Defined Benefit Program, reflecting the increase under consideration, is greater than the funded status that was projected when the funding plan was adopted, and the funded status is projected to remain ahead of schedule for the remainder of the funding plan period.

Increases would be based on the inflation in California in the previous calendar year but capped at 2.75% and be subject to a “catch-up” provision.

If adopted the proposed policy changes will be effective immediately and be used for the next review which is scheduled to take place at the May 2024 regular board meeting. Any increases in the lump-sum death benefit amounts adopted by the board at the May 2024 meeting would become effective on July 1, 2024.

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**Strategic Plan Linkage:** Goal 1: Trusted stewards – Ensure a well-governed financially sound trust fund. (FY 2022-25 Strategic Plan).

**Board Policy Linkage:** Board Governance Manual: Section 7E - Benefits and Services Policy - Specified Interest and Contribution Rates and Lump Sum Death Benefit

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**Optional Reference Material:**

[January 2023 Benefit and Services Committee Item](#)