CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 2201	**Assembly Member Honda (As introduced 2/24/00)**
Position:	**Support, if amended (Staff recommendation)**
Proponents:	**ACSA, ART, CFT, CRTA, CTA, FACCC**
Opponents:	**None known**

SUMMARY

This bill:

- Bases retirement allowances on the highest annual compensation earnable during any 12-month period
- Requires the annual two percent benefit adjustment be compounded
- Increases the purchasing power protection level to 80 percent
- Provides a 2 percent at age 55 service retirement allowance
- Increases the cap on the age factor with the career bonus from 2.4 percent to 2.5 percent
- Makes a variety of changes to the composition and method of selection to the Teachers' Retirement Board (Board), including
  - increasing the number of members from 12 to 13
  - requiring the election of four board members by active members and two by retired members, from their respective memberships
  - removing the life insurance company officer and bank or savings and loan officer positions and, in their places, requiring the Governor to appoint, subject to Senate confirmation, two public members
  - allowing the Governor to fill vacancies on the Board
- Is effective January 1, 2003, with the exception of the COLA provisions, which are effective September 1, 2003

HISTORY

SB 1693 (Ortiz, 2000) also proposes increasing purchasing power payments from 75 percent of the original allowance to 80 percent.

AB 2839 (PER&SS, 2000) also provides a 2 percent at age 55 service retirement allowance for CalSTRS members.

AB 821 (PER&SS, 1999), currently with the Senate Appropriations Committee, proposes one-year final compensation for California State Teachers' Retirement System (CalSTRS) members. The Board adopted a support if amended position on AB 821, if the bill was amended to identify appropriate funding.

AB 311 (Honda, 1999) would have created an elected Board and increased membership from 12 to 15. The Governor vetoed the bill.

AB 684 (Honda, 1998) would have compounded the COLA. The Board voted to support this bill if it was amended to identify funding. That bill failed to pass the Assembly.

CURRENT PRACTICE

Final Compensation – The member's final compensation generally is the highest average annual compensation earnable by the member for creditable service performed during any period of three consecutive years. Service retirement allowances of classroom teachers are calculated based on the highest average annual compensation earnable by the member during any 12 consecutive month period, if agreed to in collective bargaining and paid for by the employing district.

COLAs – Benefits are annually increased by a simple 2 percent improvement factor. The COLA is applied September 1 of each year following the first anniversary of the effective date of the member's initial benefit.

Service Retirement Formula – The service retirement allowances of members and specified nonmember spouses are calculated based upon a 2 percent at age 60 retirement benefit formula. The service retirement allowance of a member who retires prior to age 60 receives a reduced retirement allowance. A career bonus is provided to a member who retires with 30 or more years of service and an increased age factor is provided to a member who works after the age of 60, effective January 1, 1999. The maximum a member can receive under both the career bonus and increased age factor is 2.4 percent at age 63.

Purchasing Power Protection – All members and beneficiaries of the Defined Benefit (DB) Program receive monthly allowances that are increased by two percent of the original allowance. In addition, when the purchasing power of the current allowance, including the two percent adjustment, is less than 75 percent of the purchasing power of the original allowance, the member or beneficiary receives a quarterly benefit increase to the purchasing power of their total benefit to the 75 percent level. These supplemental payments are paid from (1) funds appropriated from the General Fund in an amount equal to 2.5 percent of the prior calendar year CalSTRS' member payroll, and (2) payments from the sale or use of land granted to the state by the federal government to support schools.

Board Membership – CalSTRS is administered by a 12-member Teachers' Retirement Board. Three are members of the DB Program or participants in the Cash Balance (CB) Benefit Program (two of which are a K-12 teacher and one a community college instructor); one is a retired member or participant. One member of the Board is an appointed officer of a life insurance company and one an appointed officer of a bank or savings and loan. The Governor appoints the K-12 and community college members, from a list submitted by the Superintendent of Public Instruction and the Community College Board of Governors, respectively. Other Board appointments by the Governor are subject to Senate confirmation.

DISCUSSION

One-Year Final Compensation – Generally, final compensation means the highest average annual compensation earnable by a member during any period of three consecutive school years while an active member of the DB Program or time during which he or she was not a member but for which the member has received credit under the DB Program.

Final compensation currently may be based on one 12-month period for a classroom teacher member who retires, become disabled, or dies after June 30, 1990, if during the last ten years of employment with the same employer,

- The member provided 60 percent or more of their contract time in direct classroom instruction,
- The member is employed by an employer who has entered into a written agreement with an exclusive representative to make this provision applicable to all classroom teachers, and
- The written agreement includes a mechanism to pay the actuarial difference between the one-year final compensation and the three-year final compensation, plus CalSTRS' administrative costs.

Currently, 41 school districts provide this benefit to their teachers. Changing the definition of final compensation from a three-year average to the highest 12 consecutive months for all CalSTRS members would create a basis of determining final compensation consistent with the formula used for state and school workers covered by the California Public Employees' Retirement System (CalPERS).

Compounded COLA – Currently, retired members and beneficiaries receive a 2 percent simple benefit improvement factor to their allowance. Currently CalPERS pay for 2 percent compounded annual COLAs to state and school CalPERS members. AB 2201 changes the CalSTRS COLA to a compounded COLA, effective September 1, 2003. Purchasing power protection payments are made to members and beneficiaries whose current allowance is worth less than 75 percent of the purchasing power of the original allowance. Consequently, if a member or beneficiary is receiving purchasing power payments, any increase in the COLA from compounding would be offset by a reduction in purchasing power payments. As a result, only members or beneficiaries who are not receiving purchasing power payments would realize a net benefit from compounding the COLA.

2 Percent at Age 55 Service Retirement Formula – AB 2201 improves the retirement formula from the current 2 percent at age 60 to a 2 percent at age 55 formula, for members who retire on or after January 1, 2003. This percentage would increase for each quarter year of the member's age, to a

maximum retirement formula of 2.5 percent at age 63 or over. The cap on the age factor, with the career bonus, also would be increase to 2.5 percent. As a result of these proposed changes, the age at which a member subject to the career bonus would reach the maximum age factor, with the career bonus, would decline from age 61½ to 60.) The resulting age factor would be as follows:

Age	Current law*	AB 2201	Proposed increase
55	1.400%	2.000	0.600%
56	1.520%	2.048%	0.544%
57	1.640%	2.126%	0.486%
58	1.760%	2.188%	0.428%
59	1.880%	2.250%	0.370%
60	2.000%	2.314%	0.314%
61	2.133%	2.376%	0.243%
62	2.267%	2.438%	0.171%
63	2.500%	2.500%	0.001%

*Before application of a career bonus if the member has at least 30 years of credited service

This would make the CalSTRS age factors (prior to the application of the career bonus) consistent with those used to calculate retirement allowances paid to CalPERS state and school members. The bill, as currently drafted, temporarily eliminates the increased age factor that became effective in 1999 to members who retire after age 60. The bill should be amended to correct this error. In addition, because the increased age factor does not begin until age 55, there would be a significant increase in the age factor (from 1.340 to 2.000, an increase of 0.660) from age 54 to age 55.

<u>Purchasing Power Protection</u> – Currently, approximately 40,000 members and beneficiaries, whose benefit effective date was 1981 or earlier, receive the quarterly supplemental payment. AB 2201 increases the supplemental payments from 75 percent to 80 percent to restore the purchasing power of the initial monthly allowances received by CalSTRS members. This would increase the number of supplemental benefit recipients by 16,340 members and beneficiaries, and would include all members and beneficiaries whose benefit effective date was 1984 or earlier.

<u>Board Elections</u> – AB 2201 changes the number and distribution of board seats, as follows:

Board Position	***Current***	***Proposed***
K-12	2	0
Community College	1	0
Retired	1	2 (elected member or participant)
School Board	1	1 (appointed)
Life Insurance, Bank	2	0
Public	1	2 (appointed)
State Officers	4	4
Active Member or Participant	0	4 (elected)
<u>TOTAL</u>	**12**	**13**

Other provisions of AB 2201;

- Allow the Governor to fill vacancies in the member, school board, or public seats upon resignation or death of the board member
- Require the school district or community college district members to vacate their respective seats if the member ceases to be on their respective board
- Specify that elected board members serve four year terms
- Require board members to sit out for a year after serving two consecutive board terms (eight consecutive years)
- Require the Board to adopt regulations to conduct the elections
- Allow the Board to contract with a private firm to conduct the elections.

As drafted, it appears that the terms of all Board members elected by CalSTRS members and participants would begin on the same date.

FISCAL IMPACT

Final Compensation

Benefit Program Costs – According to preliminary estimates by the actuary, providing one year final compensation to all CalSTRS members would result in the following actuarial impact:

	Present value cost (in millions)	**Percent of pay to fund**
Normal cost increase of future service		0.775%
Actuarial obligation for prior service	$2,651	0.834%
Total costs during funding period	$5,114	1.609%

These estimates do not reflect potential changes in the rate of retirement, which may or may not occur as a result of the changes in the bill.

This actuarial impact would result in the following expenditures over the first three full fiscal years (in millions of dollars):

	2001-02	**2002-03**	**2003-04**
Total benefit payment increase	$7.6	$20.7	$35.8
Annual increase in contributions needed to fund benefit	$313	$327	$340

Administrative Costs – CalSTRS anticipates that it could absorb any increased effort necessary to implement this bill.

Compounded COLA

Benefit Program Costs – According to preliminary estimates by the actuary, compounding the COLA for all current and future retired CalSTRS members would result in the following actuarial impact:

	Present value cost (in millions)	**Percent of pay to fund**
Normal cost increase of future service		0.353%
Actuarial obligation for prior service	$2,268	0.910%
Total costs during funding period	$3,388	1.263%

These estimates do not reflect potential changes in the rate of retirement, which may or may not occur as a result of the changes in the bill. In addition, compounding the COLA would reduce the cost of purchasing power payments.

This actuarial impact would result in the following expenditures over the first three full fiscal years (in millions of dollars):

	2003-04	**2004-05**	**2005-06**
Total benefit payment increase	$9.5	$19.9	$31.0
Annual increase in contributions needed to fund benefit	$267	$279	$290

Administrative Costs – There would be an initial increase in workload in the first year the benefit is available as necessary system modifications are made. After any initial increase in workload, ongoing costs would be minor and absorbable.

2 Percent at Age 55 Service Retirement Formula

Benefit Program Costs – According to preliminary estimates by the actuary, providing a 2 percent at age 55 retirement benefit allowance results in the following actuarial impact:

	Present value cost (in millions)	**Percent of pay to fund**
Normal cost increase of future service		1.440%
Actuarial obligation for prior service	$4,372	1.376%
Total costs during funding period	$8,950	2.816%

These estimates do not reflect potential changes in the rate of retirement, which may or may not occur as a result of the changes in the bill.

This actuarial impact would result in the following expenditures over the first three full fiscal years (in millions of dollars):

	2001-02	**2002-03**	**2003-04**
Total benefit payment increase	$13.4	$36.6	$63.4
Annual increase in contributions needed to fund benefit	$548	$572	$596

Administrative Costs – There would be a one-time cost of about $25,000 for programming and a potential increase in workload in 2003, the first year this benefit will be available, if the number of service retirements increases in that first year. Depending on the extent of any increase in retirements, the increased cost to accommodate the increased workload could be up to $92,000. After any initial increase in retirements, ongoing costs would be minor and absorbable.

Purchasing Power Protection
Benefit Program Costs – According to preliminary estimates by the actuary, increasing the level of purchasing power protection from 75 percent to 80 percent would increase purchasing power payments as follows (in millions of dollars):

	2003-04	**2004-05**	**2005-06**
Total benefit payment increase	$76.2	$82.5	$88.0

Given current actuarial assumptions, the funds that are available only to pay such payments are sufficient to pay the increased cost for at least 30 years.

Administrative Costs – Minor and absorbable costs.

Board Elections
Benefit Program Costs – The bill would not impact the current benefit structure or programs.

Administrative Costs – The bill allows the Board to contract with a private firm to conduct the elections. Based on CalPERS costs for the elections they conduct for their board, total election costs would be approximately $208,000 for 2001-02 (the first election year) and every four years thereafter, or an average of $52,000 per year, over four years. Actual costs could be different depending on when elections for particular seats were held, which is not identified in the bill.

AB 2201 proposes an additional Board member, increasing the current board membership to 13 from 12. For the current 12-member board, annual operating expenses are $6,400 per teacher member, plus about $3,600 per diem. Total costs for the additional member would be approximately $10,000 per year.

RECOMMENDATION

Support the benefit enhancements, if amended to identify an additional funding source. Although the final cost of all the proposed benefit changes combined has not been estimated, given the cost of these individual proposed benefits, the combined cost is beyond the ability of existing resources to fund. Historically, the Board has not taken a position on legislation affecting the composition of the Board.