

STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 819

Assembly PER&SS (As Amended 6/3/99)

Position:

Sponsor

Proponents:

CalSTRS

Opponents:

None Known

SUMMARY

AB 819 establishes the Replacement Benefits Program (RBP) in compliance with federal law. It also rescinds the election the California State Teachers' Retirement System (CalSTRS) made exempting certain members from existing federal limitations on benefit payments. Finally, the bill requires CalSTRS to restore benefits to certain members previously limited by federal law.

HISTORY

Chapter 1004, Statutes of 1989 (AB 50, Elder) in compliance with Internal Revenue Code (IRC) Section 415, exempted existing members of CalSTRS from the Section 415 benefit limitations, but subjected future members to the limitations, and thus protected CalSTRS from losing its "tax-qualified plan" status and avoided adverse tax consequences for the system and its members.

Chapter 829, Statutes of 1995 (SB 791, Hughes) limited the amount of compensation upon which contributions and benefits would be based, in compliance with recently enacted limits mandated under IRC Section 401(a)(17).

SUMMARY OF LATEST AMENDMENTS

The amendments of 6/3/99 were technical in nature. The amendments corrected a reference to the Internal Revenue Code and deleted an inapplicable effective date of the law.

CURRENT PRACTICE

The federal income tax laws provide favorable tax treatment to qualified retirement plans to encourage employers to provide retirement benefits to their employees. This favorable treatment permits CalSTRS Defined Benefit (DB) Program members and Cash Balance (CB) Benefit Program participants to defer paying income tax on contributions to the

State Teachers' Retirement Plan (STRP), and on the benefits accrued under the STRP, until actually received. Taxes on the earnings of the Teachers' Retirement Fund (TRF) are deferred until paid to the member, participant or beneficiary as part of the STRP benefit.

As a condition of qualifying the STRP for the special tax treatment, Section 415 has imposed specific restrictions, which include:

Benefit Limit:

Section 415 limits the employer-provided benefit to 100% of the average compensation for the last three years. The 100% of compensation limit for governmental plans, such as the STRP, was repealed effective for the 1995-1996 plan year.

Dollar Limit:

The dollar limit is the maximum amount of employer-provided benefits that can be paid each year to a DB member or CB participant under the qualified trust. The Internal Revenue Service (IRS) sets the limit annually, based on changes in the cost of living. For 1997, the limit was \$125,000. The limit was raised to \$130,000 for 1998 and remained at \$130,000 for 1999. The dollar limit is actuarially reduced for retirement at less than the age at which full Social Security benefits would be paid, and actuarially increased for retirement above the Social Security retirement age. It is also adjusted for less than 10 years of participation under the plan.

Federal law permitted CalSTRS to exempt members who were members before 1989 from these limits as it applied to benefits of the Plan that existed on October 14, 1987 under a "grandfather" election.

DISCUSSION

The Small Business and Job Protection Act (SBJPA) of 1996 authorizes a governmental plan, such as CalSTRS, to establish a program to pay benefits in excess of the federal limit and to revoke the grandfather election under the Technical and Miscellaneous Revenue Act (TAMRA) which provided relief from the Section 415 limits to members of the system on December 31, 1989 for all benefits of the plan as they existed on October 14, 1987. AB 819 restores those benefits that have or would be restricted by Section 415 in two ways. First, it restores the benefits that had been restricted to a level equal to 100% of final compensation. The effect of this change would be to provide members the full benefits accrued under the CalSTRS benefit formula. In addition, the bill establishes a replacement benefits program to pay the full amount of benefits provided under statute when those benefits exceeds the dollar limits established under Section 415.

Funding

Although benefit payments would increase under the bill, there would be no actuarial impact to the TRF on making these payments. CalSTRS has been collecting employer and employee contributions to fund the benefit provided under the benefit formula adopted for the Plan, without regard to the dollar limit imposed by Section 415. That portion of the benefit not payable from the TRF due to the Section 415 dollar limit would, however, never be payable. Instead, it would remain within the benefit reserves. Payment of the benefits under the bill would be paid from the reserves.

Application of the Limits

Currently, there are up to three DB members receiving an allowance that exceeds the dollar limits. CalSTRS has identified an additional seven members who, if they retired now, would be eligible for benefits that exceed the current federal dollar limit.

FISCAL IMPACT

Benefit Program - Less than \$20,000 one-time cost to restore benefits that exceeded 100% of final compensation. No actuarial impact from the RBP, because CalSTRS has been collecting contributions at a level sufficient to pay benefits without regard to the federal limit. Consequently, the funding needed to pay the replacement benefits authorized in the bill is already available to CalSTRS.

Administration - Implementation of the RBP would result in ongoing absorbable costs of \$62,500 to collect and reconcile the amounts being paid by the employers.

Because of the number of members affected by this program, the process should be entirely manual and will not affect the State Teachers' Automation Redesign Team (START).

POSITION - Co-sponsor

The Board is a co-sponsor of AB 819. It permits members to receive the benefits due them under the CalSTRS retirement formula that had previously been limited under federal law.