California State Teachers' Retirement System

Bill Analysis

<u>**Assembly Bill 1933**</u> **Assembly Member Strom-Martin (As amended 6/15/00)**

<u>**Position:**</u> **Support, if amended (Staff recommendation)**

<u>**Proponents**</u>**:** **CTA (Sponsor), LAUSD, UTLA, ACSA, CFT**

<u>**Opponents**</u>**:** **None known**

SUMMARY

AB 1933 permits local districts to provide an increased retirement benefit, known as the "Rule of 85," to member-employees whose age and service credit add up to at least 85 if agreed to by an employer and employee representatives. The retirement benefit would equal 2.4 percent of final compensation for each year of credited service. This bill also increases the career bonus for members retiring on or after January 1, 2001 with 29 years or more of credited service, and raises the limit of the age factor, when combined with both the current and proposed career bonuses, to 2.5 percent. Finally, this bill requires the Teachers' Retirement Board (Board) to conduct a study on the feasibility of paying pensions to members with a minimum retirement age based on years of service and final compensation, with no age factor, and to report its findings to the Legislature on or before July 1, 2001.

HISTORY

<u>Rule of 85</u>
The Rule of 85 has been introduced on a number of occasions, including:

- AB 1213 (1999) and AB 12X (1999), which failed to pass the Assembly;
- AB 88 (1998), which was vetoed;
- AB 1463 (1995), which failed to pass the Assembly;
- AB 449 (1993), AB 276 (1991), AB 122 (1989), and AB 3271 (1988), which were all vetoed.

<u>Career Bonus</u>
<u>Chapter 1006, Statutes of 1998, (AB 1102 – Knox)</u> provided a career bonus of .2 percent of final compensation per year of credited service up to a combined age factor and career bonus of 2.4 percent for members with 30 or more years of credited service who retire on or after January 1, 1999.

<u>SB 39 (Baca)</u>, also would have increased the career bonus for members with 29 or more years of credited service. That bill failed to pass the Senate.

SUMMARY OF AMENDMENTS

The May 26, 2000 amendments specify that the Rule of 85 benefit shall not apply to a school district, community college district or county superintendent of schools nor its employees until it is agreed to in a written memorandum of understanding entered into by the employer and representatives of employees. The June 15, 2000 amendments extend the Rule of 85 to state educational agencies.

CURRENT PRACTICE

Currently, the CalSTRS retirement allowance is based on years of credited service, age at retirement, and final compensation. The normal retirement age under CalSTRS' Defined Benefit (DB) Program is age 60. At age 60, a member receives an allowance equal to 2 percent of final compensation for each year of credited service. The age factor increases .033 percent per additional year of age over 60, to a maximum of 2.4 percent at age 63. If a member retires earlier than age 60, the retirement allowance is reduced by one-half of one percent for each month the member is between age 55 and age 60. A member may retire as early as age 50 with 30 years of service credit. If a member retires earlier than age 55, the allowance is further reduced by one-quarter of one percent for each month the member is under age 55. A career bonus of .2 percent is added to the age factor, up to a combined age factor and career bonus of 2.4 percent, if the member has 30 years or more of credited service.

DISCUSSION

Rule of 85 – AB 1933 permits local school districts to provide an increased retirement benefit to member-employees whose age and service credit add up to at least 85 if agreed to by an employer and employee representatives. This retirement benefit to members could equal between 2 percent and 2.5 percent of final compensation for each year of credited service, depending on local collective bargaining negotiations. There are about 22,600 members who would qualify for this benefit. Under the existing CalSTRS formula, a member's potential retirement allowance increases each year primarily due to the increased age factor. Members who retire under this provision of AB 1933 would not receive an increased benefit from an increase in age. To the extent that increasing a retirement benefit at higher retirement ages encourages members to defer retirement, AB 1933 may encourage members to take an earlier retirement.

The Rule of 85 benefit would not apply to a school district, community college district or county superintendent of schools nor its employees until it is agreed to in a written memorandum of understanding. The cost of the increased benefit would be borne by the DB Program, rather than paid by the employer.

Career Bonus – AB 1933 also increases the career bonus for members retiring on or after January 1, 2001 by applying it to members with 29 years of credited service and increasing the bonus after 30 and 31 years of credited service. In addition, AB 1933 increases the maximum percent of the age factor from 2.4 percent to 2.5 percent, when combined both with the current and proposed career bonuses. This may offset some of the early retirement incentive of the proposed Rule of 85. On June 30, 1999, there were 26,992 members who would have qualified for this enhanced benefit. The chart below illustrates the changes this bill would make by applying the career bonus at 29 years of credited service:

Years of Service Credit	Career Bonus	Final Career Bonus Under AB 1933
29	0	.1 %
30	.2 %	.3 %
31 +	.2 %	.4 %

Under current law, some service credit, such as nonqualified service, cannot be used to qualify for the career bonus because the career bonus is intended to reward actual service. As currently drafted, the bill does not exclude nonqualified service from determining eligibility for the enhanced bonus, but should be amended to do so. Other technical amendments to conform the proposal to the existing law also are required.

Service-Based Retirement – The bill also requires the board to conduct a study and prepare a report on the feasibility of basing pensions for its members on years of service and final compensation with no age factor, except for minimum retirement age. Currently, most defined benefit programs include age as a consideration in the benefit formula because the older the member is at retirement, the fewer years the member will receive the benefit. Increasing the percentage of final compensation as age increases, thereby increasing the monthly allowance, reflects the fact that the member will get a certain fixed amount of money, equal to the present value of the benefit, over a shorter period of time. Nonetheless, there are systems, such as the teachers’ retirement systems in Alaska and in Louisiana that pay a benefit to members equal to a fixed percentage per year of service, once a member has performed a specified amount of service in the plan.

FISCAL IMPACT

Rule of 85

As noted above there are approximately 22,600 members who, according to age and years of service credit, would qualify for this benefit. However, for the benefit to take effect, this bill requires a written memorandum of understanding between employer and employee representatives. Therefore, the actual number of members would depend on the results of future negotiations. The estimates assume that all employers negotiate the benefit.

Benefit Program Costs – Making the Rule of 85 available to an electing employer would result in the following actuarial impact if all employers elected to provide the benefit:

	Present value cost (in millions)	**Percent of pay to fund**
Normal cost increase of future service	–	0.523%
Actuarial obligation for prior service	$2,328	0.732%
Total costs	$3,989	1.255%

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	$6.2	$16.9	$29.3
Annual increase in contributions (funding) needed to fund benefit	$244	$255	$266

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

Career Bonus
Benefit Program Costs – According to preliminary estimates by the actuary, enhancing the career bonus would result in the following actuarial impact:

	Present value cost (in millions)	**Percent of pay to fund**
Normal cost increase of future service		0.479%
Actuarial obligation for prior service	$2,524	0.794%
Total costs during funding period	$4,046	1.273%

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	$6.5	$17.7	$30.5
Annual increase in contributions (funding) needed to fund benefit	$248	$258	$269

Administrative Costs – CalSTRS anticipates that it could absorb any increased administrative costs, (estimated to be less than $50,000) to implement the benefit increases in this bill. According to the CalSTRS consulting actuary, costs to complete the proposed study would cost an additional $25,000.

RECOMMENDATION

Support, if amended to provide a funding source and to include technical amendments that are needed to conform the terms of the proposed career bonus enhancement to those applicable to the career bonus in existing law.