

## SUMMARY

AB 1480 authorizes the California State Teachers' Retirement System (CalSTRS) to offer a Roth Individual Retirement Account (Roth IRA) to members for the purposes of receiving assets converted from a Roth 403(b) account.

## PURPOSE OF THE BILL

Federal law requires holders of certain retirement savings accounts--including Roth 403(b) accounts--to accept an annual minimum distribution starting at age 70 ½. Any required minimum distributions that are not taken are taxed at 50%. Because a Roth IRA does not have a required minimum distribution, an account holder may be able to increase his or her retirement savings by converting a Roth 403(b) account to a Roth IRA.

## BOARD POSITION

Sponsor. As part of CalSTRS' mission to secure the financial future of California's educators, the Board seeks to provide financially sound primary and supplemental retirement plans and to expand and improve the benefits and services provided through the funds CalSTRS administers.

## SUMMARY OF AMENDMENTS

The amendment of January 14, 2008 is technical in nature. The amendment creates the Roth IRA Operating Fund within the Teachers' Deferred Compensation Fund for the purpose of receiving premium and fee revenues, which will be used to carry-out the provisions of this bill.

## LEGISLATIVE HISTORY

Chapter 780, Statutes of 2006 (AB 2462—Mullin) allows the Board to supply, or contract to supply, fiduciary, recordkeeping, and administrative services for employer-sponsored deferred compensation plans to school districts, community college districts and county office of education that elect to contract with CalSTRS to provide those services.

Public Law 107-16, 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001, enacts a number of changes to federal law to enhance the portability of funds among different types of retirement plans, including 401(k), 403(b), and 457 plans, IRAs and 401(a) retirement plans. This law also introduces Roth 401(k) and Roth 403(b) options effective January 2006. In addition, it increases the contribution limits to 403(b), 457 and 401(a) plans and increases the annual allowance limit for defined benefit plans.

Public Law 105-304, 1997, the Taxpayer Relief Act of 1997, enacts numerous changes to federal tax law affecting individuals and businesses. Section 302 of this law establishes the Roth IRA as a new type of individual retirement plan.

Chapter 291, Statutes of 1994 (AB 3064—Morrow) requires CalSTRS to offer employees of school districts, community college districts and county offices of education a 403(b) tax-deferred retirement plan.

Chapter 489, Statutes of 1994 (AB 3705—Asm. PER & SS Committee.) authorizes CalSTRS to develop deferred compensation plans under Internal Revenue Code Section 457 that school employers could offer their CalSTRS members. Provides the Board with exclusive investment

and administrative authority over the plan on behalf of the employer. Establishes the Teachers' Deferred Compensation Fund to serve as a repository of funds for the deferred compensation plan developed pursuant to this bill.

## **PROGRAM BACKGROUND**

The CalSTRS' Defined Benefit Program provides approximately 65 percent of a member's pre-retirement salary. As CalSTRS members do not pay Social Security payroll taxes in CalSTRS-covered employment, members must bridge the gap between this 65 percent replacement income and their retirement costs through other assets, including deferred compensation accounts such as 403(b) and 457 accounts.

To provide a low-cost means for CalSTRS members to supplement their retirement income, CalSTRS has offered a 403(b) plan to school employees since 1994 called Pension2 (prior to November 2007, this program was known as the Voluntary Investment Program, or VIP). In addition to its current 403(b) offerings, Pension2 has been expanded to include a 457 retirement savings plan and will include a Roth 403(b) savings plan by mid-2008. As of June 30, 2007, there were over 3,800 participants and \$168 million invested in CalSTRS 403(b) funds, administered under this program.

A common feature of many retirement savings vehicles, including 403(b) accounts, 457 accounts, and Roth 403(b) accounts is a required minimum distribution beginning at age 70 ½. If the owner of an account opts not to take this distribution, the owner is subject to a 50 percent penalty tax on the amount that should have been distributed but was not. One of the unique features of a Roth IRA is that it is not subject to a required minimum distribution at any age. As a result, a person can leave Roth IRA assets untouched and save a greater amount of money for use later during retirement or to bequeath to beneficiaries.

One way to avoid the required minimum distribution of a Roth 403(b) account is to convert this account into a Roth IRA. If a member opens a Pension2 Roth 403(b) account (available in mid-2008) and subsequently wishes to roll the funds into a Roth IRA, the member will need to seek a Roth IRA vendor outside the Pension2 program.

## **ANALYSIS:**

Historically, CalSTRS has focused on its traditional Defined Benefit Program and responded primarily to the needs of those about to retire. However, as CalSTRS has broadened its mission to "securing the financial future of California educators," CalSTRS must take a broader perspective on the financial products and services provided to members as well as the timeframe in which CalSTRS engages with its members. This broader perspective includes providing retirement savings vehicles that will supplement defined benefit program benefits once the member retires and that will help the member to maximize these supplemental savings throughout the course of his or her life.

### **Existing Law:**

CalSTRS is not currently authorized to offer a Roth IRA. As a result, members who save using a Pension2 Roth 403(b) savings account will be required to take a distribution from these accounts at age 70 ½ or to independently seek an outside vendor to covert their accounts into Roth IRA

accounts. If a member converts a Pension2 account to a Roth IRA administered by a different vendor, the member will lose features of the Pension2 program, such as its low cost (the products offered in Pension2 feature some of the lowest fees in the industry), flexible investment options, and free objective advice and planning services.

**This bill:**

This bill would add a Roth IRA to Pension2's investment options for the purpose of receiving assets converted from a Roth 403(b) account. This additional offering would enable members to more easily convert a Roth 403(b) account into a Roth IRA in a 'one-stop shopping' environment, and it would enable members making this conversion to retain the benefits provided to other Pension2 account holders.

**FISCAL IMPACT**

Benefit Program Cost – None.

Administrative Costs/Savings – No net costs. Cost of administering and advertising the Roth IRA program, including the production of new communications to educate members about the new products, would be offset by program fees.

**SUPPORT**

CalSTRS (sponsor).

**OPPOSITION**

None known.

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