Bill Number: AB 55 (Mullin) As amended March 9, 2005

SUMMARY

Assembly Bill 55 increases General Fund contributions to the Teachers' Retirement Fund (TRF) between July 1, 2008 and June 30, 2011 to offset reduced contributions to the California State Teachers' Retirement System (CalSTRS) Supplemental Benefit Maintenance Account (SBMA) in 2003-04. Also specifies an adjustment in the July 1, 2010 payment prior to September 1, 2010 to reflect actual earnings on CalSTRS investments from July 1, 2004 through July 1, 2010

PURPOSE OF THE BILL

Chapter 6, Statutes of 2003, First Extraordinary Session (SB 20X—Committee on Budget and Fiscal Review reduced the 2003-04 General Fund appropriation to the SBMA by $500 million. The Teachers' Retirement Board (Board) voted to oppose Chapter 6 because the reduction in General Fund contributions adversely affects the long-term funding of CalSTRS' purchasing power program and the CalSTRS retirees who depend on supplemental payments to maintain their purchasing power as inflation rises. The Board also filed legal action in the California Superior Court to overturn the provisions of Chapter 6. At present, CalSTRS has asked the judge to rule on its motion for summary judgment. In the motion, CalSTRS contends the law obligating the state to make the contribution is "clear and unambiguous." If the judge disagrees with CalSTRS, then the case will go to trial. The purpose of AB 55 is to provide certain repayment, plus interest, for the suspended contribution of the General Fund to the SBMA in 2003-04. If enacted, AB 55 would obviate the need to continue litigation.

BOARD POSITION

Co-Sponsor. AB 55 provides certain and full repayment of any General Fund contributions to the SBMA that were deferred in Chapter 6, Statues of 2003.

SUMMARY OF AMENDMENTS

The March 9, 2005 amendments postpone and adjust the crediting schedule of money from the TRF to the SBMA, as well as the amount and timing of the transfer of money to the TRF from the General Fund to provide certain repayment of the reduced transfer of $500 million to the SBMA pursuant to Chapter 6, Statutes of 2003.

ANALYSIS

Assembly Bill 55 repeals the provisions of Chapter 6, and provides an alternative means of restructuring SBMA contributions without a change in the 2003-04 contribution provided by Chapter 6, by specifically:

- Crediting the SBMA from the CalSTRS Defined Benefit (DB) Program for three years from July 1, 2008 through July 1, 2010 in an amount equal to .3671 percent of the total creditable compensation for the fiscal year ending in the immediately preceding calendar year. This was a drafting error that will be corrected in subsequent amendments. The crediting to the SBMA should commence on July 1, 2005.
- Appropriating additional General Fund contributions to the DB Program to finance the credit to the SBMA over three years from July 1, 2008 to July 1, 2010 in an amount equal to .9973 percent of the second prior fiscal year creditable compensation.
- Requiring an adjustment in the July 1, 2010 General Fund payment prior to September 1, 2010 to reflect actual earnings on CalSTRS investments from July 1, 2004 through July 1, 2010, as specified.

Prior to the passage of Chapter 6, the 2003-04 General Fund contribution to the TRF for transfer to the SBMA would have equaled 2.5 percent of the creditable compensation paid to members during 2001-02, or a total of $558.9 million. That appropriation and transfer of funds was reduced under Chapter 6 by $500 million, resulting in a 2003-04 General Fund contribution to the SBMA of $58.9 million.

The contribution rate paid by the General Fund to the SBMA would be temporarily increased to offset the reduction in contributions paid as a result of Chapter 6. In 2008-09 and 2009-10, the increased contribution rate would be 0.9973 percent. The 2010-11 contribution rate would also be increased by 0.9973 percent, but that increased rate would be adjusted based on the actual rate of return on CalSTRS' investments from 2003-04 through 2009-10, as follows:

Rate of Return from 2003-04 Through 2009-10	Increased Contribution Rate
If the average annual rate of return is less than 3.5%	-0.6988%
At least 3.5% but less than 5.0%	-0.4822%
At least 5.0% but less than 8.0%	-0.2496%
At least 6.5% but less than 8.0%	0.0000%
At least 8.0% but less than 9.5%	0.2675%
At least 9.5% but less than 11.0%	0.5540%
Equal to or greater than 11.0%	0.8606%

This increased contribution in 2010-11 would total between $501 million and $955 million, depending on the rate of return on CalSTRS' investments between 2003-04 and 2009-10. The estimated payments, based on projected statewide payroll totals, beginning in 2008-09 would be: $274,521,000; Year 2: $286,188,000; Year 3: $298,351,000.

Under existing law, the SBMA is credited with interest based on the actuarially assumed rate of investment of DB Program funds, which currently is 8 percent. In order to eliminate the actuarial impact of the reduced contribution to SBMA in 2003-04, the SBMA would be credited annually with an increased contribution rate of 0.3671 percent to offset the actuarial value of the reduced contribution made in 2003-04. The rate would be adjusted by the board to reflect any changes in the assumed rate of investment returns. That increased crediting should have begun in 2005-06 though 2010-11, but due to a drafting error, the current amended version reflects an initial crediting date of July 1, 2008.

LEGISLATIVE HISTORY

AB 265 (Mullin—2004) as amended July 22, 2003, would have changed the General Fund contribution to the CalSTRS SBMA between July 1, 2008 and June 30, 2011. Specifically, for the seven years from July 1, 2004 through July 1, 2010 the SBMA would have received a credit from the DB Program equal to a fixed amount of the total creditable compensation for the fiscal year ending in the immediately preceding calendar year. In addition, the State would have appropriated additional General Fund contributions to the DB Program to finance its credit to the SBMA over three years from July 1, 2008 to July 1, 2010 in an amount equal to .9973 percent of the second prior fiscal year creditable compensation. There would also have been an adjustment in the July 1, 2010 payment prior to September 1, 2010 to reflect actual earnings on CalSTRS investments from July 1, 2004 through July 1, 2010, as specified. AB 265 was held in the Senate Appropriations Committee.

Chapter 6, Statutes of 2003 (SB 20x, Committee on Budget and Fiscal Review) decreases by $500 million for the 2003-04 fiscal year, the General Fund contribution to the SBMA and requires the Board, beginning in 2006 to report to the Legislature and Director of Finance regarding the ability of the retirement system to pay purchasing power protection payments in each fiscal year until 2036.

Chapter 840, Statutes of 2001 (AB 135, Havice) increased purchasing power for member and beneficiaries from 75 to 80 percent of the original purchasing power.

Chapter 1006, Statutes of 1998 (AB 1102, Knox) guaranteed a funding stream for purchasing power protection payments and vested the purchasing power benefits to the extent funds are available in the SBMA.

Chapter 939, Statutes of 1997 (SB 1026, Schiff) increased purchasing power of up to 75 percent of the benefit recipient's original purchasing power and authorized the Board to decrease the benefit when the 2.5 percent annual General Fund contribution is insufficient to support 75 percent purchasing power.

Chapter 116, Statutes of 1989 (SB 1513, Campbell, et al) requires an annual distribution of the proceeds of the SBMA in non-vested quarterly payments to member and beneficiaries to restore purchasing power up to 68.2 percent of the original purchasing power.

Chapter 115, Statutes of 1989 (SB 1407 C. Green, et al) established the funding mechanism for the SBMA and by requiring an annual contribution from the General Fund to restore purchasing power for CalSTRS retirees. The amount transferred was to increase annually to a maximum of 2.5 percent of the statewide teacher payroll.

PROGRAM BACKGROUND

Under current law, when a CalSTRS retirement benefit currently being paid is less than 80 percent of the purchasing power of the initial benefit, CalSTRS pays a supplemental benefit on a quarterly basis to the member, to restore the total benefit paid by CalSTRS to 80 percent of the purchasing power of the initial benefit. For example, if a CalSTRS member received an initial \$6,000 benefit annually in 1970, CalSTRS would now be paying her \$9,960 per year as a result of the annual two percent benefit adjustments. She would, however, have to receive \$31,188 in 2004 to be fully compensated for the effects of inflation on the benefit. In order to receive a benefit equal in purchasing power to 80 percent of the initial purchasing power, she would have to receive a total of \$24,950 per year (80 percent of \$31,188). Consequently, CalSTRS would pay a supplemental benefit equal to the difference between the \$24,950 she would need to maintain 80 percent of the purchasing power of the initial benefit and the \$9,960 she is actually receiving, or \$14,490. This amount would be paid in four equal installments annually, or \$3,748 per quarter.

Supplemental payments are a vested benefit to the extent that funds are available in the SBMA to make such payments. This means that if the combined funding from both sources is not sufficient to bring purchasing power up to the 80 percent level the Board has the authority to:

- Subject to authorization in the Budget Act, increase the employer contribution by up to 0.25 percent annually and credit that increased contribution to the SBMA;
- Reduce the level of purchasing power protection to a level that could be funded with available SBMA funds;
- Use any actuarial assets in the DB Program in excess of the actuarial obligation of that program to maintain the full purchasing power benefit.

Funding for the supplemental benefit is derived primarily from the General Fund, School Lands Revenue and interest earned on the balance in the SBMA. Funds in the SBMA are credited with interest, based on the actuarially assumed rate of investment earnings of the DB Program. Based on current assumptions adopted by the Board in 2003, the SBMA is currently credited with eight percent annual interest. The General Fund contribution to the SBMA (an account within the TRF) is an amount equal to 2.5 percent of the CalSTRS'-covered member payroll in the fiscal year ending in the prior calendar year. This contribution is made annually "pursuant to a contractually enforceable promise to make annual contributions from the General Fund to the Supplemental Benefit Maintenance Account." (Section 22954 of the Education Code). Pursuant to Chapter 6, Statutes of 2003, this section was amended to withhold \$500 million of the annual contribution from the total amount due in the 2003-04 fiscal year.

Prior to the passage of Chapter 6, the 2003-04 General Fund contribution to the TRF to the SBMA would have equaled 2.5 percent of the creditable compensation paid to members during 2001-02, or a total of $558.9 million. That appropriation and transfer of funds was reduced under Chapter 6 by $500 million, resulting in a 2003-04 General Fund contribution to the SBMA of $58.9 million.

FISCAL IMPACT

Benefit Program Cost – The $500 million reduction in the 2003-04 SBMA contribution pursuant to Chapter 6 would be offset by contributions to the SBMA over a three-year period beginning July 1, 2008. This would enable the SBMA to maintain the benefits that were contractually obligated to CalSTRS members prior to the enactment of Chapter 6.

Administrative Costs/Savings – CalSTRS anticipates any increased administrative cost to be minor and absorbable.

SUPPORT

California State Teachers' Retirement System

California Teachers Association

California Retired Teachers' Association

Association of California School Administrators

California Seniors' Coalition

OPPOSITION

None

ARGUMENTS

Pro: Provides certain and full repayment of any General Fund contributions to the SBMA that were deferred in Chapter 6, Statues of 2003.

Con: None