

**Bill Number: AB 789 (Mullin) Supplemental Benefit Maintenance Account, as amended
6/14/07**

SUMMARY OF AMENDMENTS

The June 14, 2007 amendments adjust the specific contribution rates to reflect the sponsor's intent to have CalSTRS fully compensated for the reduced 2003-04 appropriation.

PURPOSE OF THE BILL

The purpose of this bill is to restore, over time, \$500 million the State withheld from its annual contribution to the SBMA in fiscal year 2003-04, plus interest, based on CalSTRS investment returns since 2003-04. This bill would establish the amount of the annual appropriation is based on specified percentages of total creditable compensation. The final payment is due on July 1, 2014, and also includes the actual investment rate of return that CalSTRS would have received on the \$500,000,000.

BOARD POSITION

Neutral.

LEGISLATIVE HISTORY

AB 55 (Mullin—2005), would have increased General Fund contributions to the TRF between July 1, 2008, and July 1, 2012, to offset reduced contributions to the CalSTRS SBMA in 2003-04. The measure would have also credited an adjustment in the July 1, 2012, payment prior to September 1, 2012 to reflect actual earnings on CalSTRS investments from July 1, 2004 through June 30, 2012. AB 55 was vetoed by the Governor.

Chapter 6, Statutes of 2003, First Extraordinary Session (SB 20X—Committee on Budget and Fiscal Review), decreased, by \$500 million for the 2003-04 fiscal year, the General Fund contribution to the SBMA and required the Board, beginning in 2006, to report to the Legislature and Director of Finance regarding the ability of CalSTRS to make purchasing power protection payments in each fiscal year until 2036.

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

Chapter 802, Statutes of 1979 (AB 604—Thurman), prescribes legislative intent recognizing that inflation erodes the purchasing power of benefits paid to retirees under the CalSTRS Defined Benefit (DB) Program and requires the Board to report to the Governor and Legislature no later than June 1 of each year on the extent to which inflation has eroded the purchasing power of benefits provided under the DB Program. Also requires the Board to indicate the amount of supplementary increases in retirement allowances required to preserve the purchasing power of DB benefits.

PROGRAM BACKGROUND

Supplemental benefits are paid as quarterly payments to all benefit recipients when the purchasing power of the current allowance falls below 80 percent of the purchasing power of the initial allowance. These payments are not cumulative, are not part of the base allowance and will be paid only as long as funds are available. The primary source of funding is an annual General Fund contribution to the SBMA equal to 2.5 percent of CalSTRS' member payroll for the prior fiscal year (ending in the immediately preceding calendar year) pursuant to a statutory obligation.

The 2003-04 General Fund appropriation to the SBMA was reduced by \$500 million pursuant to Chapter 6, Statutes of 2003, First Extraordinary Session. The Board opposed this measure because the reduction in General Fund contributions would have adversely affected 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. In October 2003, the Board filed suit in the Sacramento County Superior Court seeking to overturn the provisions of Chapter 6, arguing that it violates the vested rights of teachers and retirees to have the SBMA funded, while providing no assurance the withheld amount would be returned, and that this would jeopardize the ability of CalSTRS to make SBMA payments in the future. On May 4, 2005, the Superior Court found that the law obligating the State to make the contribution is "clear and unambiguous," and ruled in CalSTRS' favor on its motion for summary judgment. An appeal was taken, and the matter is currently pending at the appellate court level.

ANALYSIS

Specifically, AB 789:

- Provides that, on July 1, 2008, and each July 1 thereafter until July 1, 2011, an amount equal to 0.7631 percent of the total creditable compensation of the fiscal year ending in the immediately preceding calendar year shall be credited to the SBMA from the TRF. The amount would be adjusted by the Board to reflect any changes in the rate of interest credited to accumulated reserves.
- Makes additional continuous appropriations from the General Fund to the TRF on July 1, 2010, and each July 1 thereafter until July 1, 2014, in amount equal to 0.7467 percent of the total creditable compensation of the fiscal year ending in the immediately preceding calendar year. In the last fiscal year, 2014-15, the amount would be adjusted based on a calculation formula, which includes the percentage of the fiscal year 2013-14 total creditable compensation and the average annual rate of investment return, according to a specified schedule.
- Provides that if the 2014-15 appropriation is to represent a reduction in the appropriation, the excess amount (transferred from General Fund to TRF) shall be treated as a credit for the amount continuously appropriated to the TRF in 2014-15 for DB Program benefits.

- Repeals the requirement that the Board report, beginning with the valuation year 2006, and every four years thereafter, to the Legislature and the Department of Finance regarding the ability of the retirement system to pay purchasing power protection payments in each fiscal year until 2036.
- Includes a statement of legislative intent regarding purchasing power protection for retired educators, the legislature reserves the right to amend the section regarding the effect of the bill on the actuarial soundness of the TRF.

According to the sponsors, the California Retired Teachers Association, “AB 789 ensures funding for the SBMA that protects the pensions of the oldest retired teachers who have the lowest pensions. These teachers average 82 years of age or more and, without this protection, many would have pensions of less than \$1,000 per month. AB 789 secures the pensions of those retired teachers who have already lost 20 percent of their original pension value. AB 789 would assist in ensuring these retirees would not have a further erosion of their pension because of inflation.”

AB 789 temporarily increases the General Fund appropriation to the TRF from 2010-11 through 2014-15 by a specific percentage of CalSTRS compensation, which is intended to offset the loss associated with the reduced contribution in 2003-04. According to the Assembly Appropriations Committee, the annual General Fund cost would be about \$200 million in 2010-11 rising to about \$240 million in 2014-15. These payments, which total over \$900 million, would both restore the original \$500 million transfer and provide funds to cover the investment returns that CalSTRS would have made on the funds had the appropriation been made in 2003-04.

In 2005, the Board sponsored legislation (AB 55—Mullin, Vetoed), that would accomplish exactly what AB 789 intends to accomplish. Since that time, however, the Board’s litigation has advanced in the Court of Appeals, and a decision could be issued later this calendar year. If the Court of Appeals upholds the Superior Court decision, it could order an immediate payment of the \$500 million, and legislative action to appropriate the interest owed on the \$500 million could be enacted relatively quickly. Even if the appellate court’s decision is appealed to the Supreme Court, that latter court, based on prior decisions, could elect not to hear the case. Under that circumstance, there could be substantially more rapid payment of the money owed than is provided by AB 789.

FISCAL IMPACT

Benefit Program Cost – According to the CalSTRS Actuary, there will be no costs associated with AB 789. However, enactment of this measure would provide an estimated \$1.36 billion in increased contributions on July 1, 2014, at 8 percent interest from July 1, 2006, until July 1, 2014.

**Cumulative Comparison Between the Value of Contributions
from State Under (AB 789) and Court Awarded Payments**

| Application: | Total Payment: (in millions) | By Payment Date: | Interest Rate: |
|---------------------|---|-------------------------|-----------------------|
| Enactment of AB 789 | \$1,170 | July 1, 2014 | 8% (7/1/06-7/1/14) |
| If Lawsuit Prevails | \$678 | January 1, 2008 | 7% (to 5/1/05) |
| If Lawsuit Prevails | \$713 | January 1, 2008 | 10% (to 5/1/05) |

- If, due to the lawsuit, CalSTRS were to be paid on January 1, 2008, \$678 million (which is the original \$500 million plus 7 percent interest to May 1, 2005), then on July 1, 2014, the \$678 million would be worth \$1.2 billion at 8 percent interest from January 1, 2008, until July 1, 2014;
- If, due to the lawsuit, CalSTRS were to be paid on January 1, 2008, \$713 million (which is the original \$500 million plus 10 percent interest to May 1, 2005), then on July 1, 2014, the \$713 million would be worth \$1.2 billion at 8 percent interest from January 1, 2008, until July 1, 2014;

Administrative Costs/Savings – There will be an additional accounting workload associated with the new application of a new formula, new reporting requirements, new reconciliation procedures and monitoring the additional fund transfer for a number of years. At this time, CalSTRS is unable to quantify this workload.

SUPPORT

California Retired Teachers Association, (Sponsor)
Delta Kappa Gama – Chi State
Los Angeles College Faculty Guild, Local 521
San Jose – Evergreen Community College District

OPPOSITION

None known.

LEGISLATIVE CONTACT:

Mike Mello
CalSTRS Legislative Affairs
(916) 229-4681

Jennifer Baker
CalSTRS Legislative Affairs
(916) 229-3866