CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 1207	**Assembly Member Corbett (As amended 6/19/03)**
Position:	**Support**
Proponents:	**CFT, ACSA, SSDA, CTA (co-sponsors), CSBA, FACCC, Riverside Co. School Advocacy Assn.**
Opponents:	**None known**

SUMMARY

Assembly Bill 1207 reopens and makes permanent an existing retirement incentive program (often referred to as the "Golden Handshake" program) that provides an additional two years of service credit to members of the Defined Benefit (DB) Program employed by participating school districts able to demonstrate cost savings. It also establishes a new retirement incentive program through 2004 that allows school districts to add two years of service credit and two years of age to the age factor calculation in determining a member's retirement allowance.

HISTORY

Chapter 361, Statutes of 1984 (AB 2223—Hughes) established the California State Teachers' Retirement System (CalSTRS) retirement incentive program, permitting members to receive an additional two years of service credit, under specified conditions, if the employer, by formal action, makes specific determinations and transmits the actuarial equivalent amount of money and the System's related administrative costs to CalSTRS.

Chapter 293, Statutes of 1985 (SB 835—Marks) modified a provision included in Chapter 361 that required the Chancellor of the California Community Colleges certify that implementation of the legislation will result in no costs to CalSTRS, the community college district, or the County Superintendent of Schools, as specified. This bill required the community college district make the certification to the Chancellor, instead of the Chancellor making the certification.

Chapter 601, Statutes of 1987 (AB 960—Hughes) extended the retirement incentive provisions through 6/30/90. There was, however, a six-month period from 7/1/87 through 12/31/87 when the provisions of this bill were not operative.

Chapter 996, Statutes of 1990 (AB 2609—Hughes) reestablished until 12/31/93 the retirement incentive program.

SB 107 (Hughes—1993) vetoed by the Governor, would have removed the 1/1/94 sunset date of the Golden Handshake provisions, thereby continuing the program on a permanent basis.

Chapter 20, Statutes of 1994 (SB 858—PE&R) reestablished the CalSTRS retirement incentive program from 3/30/94 through 12/31/98.

AB 212 (Maze) reopens and makes permanent an existing retirement incentive program that provides an additional two years of service credit to DB members employed by participating school districts. It also establishes a new retirement incentive program to allow school districts to add four years if service credit to those DB Program members who retire prior to 5/16/07.

SUMMARY OF AMENDMENTS

The June 19 amendments re-establish savings certification procedures for the current and the new incentive program, specifically the county superintendent or chancellor would demonstrate and certify to the Teachers' Retirement Board (Board) that the incentive will result in net savings, and also the county superintendent would certify to the State Superintendent of Public Instruction that the net savings can be demonstrated. The county superintendent, chancellor's office and State Superintendent may request reimbursement from the reporting entity for its administrative costs.

CURRENT PRACTICE

The basic retirement formula under the DB Program is calculated by multiplying the member's years of credited service by his or her final compensation and an age factor based the member's age at the time of retirement (currently 2 percent at the normal retirement age of 60). The age factor ranges from 1.1 percent at age 50 to a maximum 2.4 percent at age 63. A member may retire starting at age 50 with 30 years credited service, or starting at age 55 with at least 5 years credited service.

Retirement Incentives in the DB Program
School districts may provide their credentialed employees an incentive for early retirement by adding two years of service credit in calculating the DB Program benefit. This additional service credit, like other forms of service credit not associated with actual educational service, does not count towards other CalSTRS benefit enhancements. In order to participate, a school district must have taken formal action by December 31, 1998 to offer the program, establish window periods in the formal action within which its eligible employees must retire, and demonstrate a cost savings or other benefit to the district. In order for employees to receive the benefit, they must meet the requirements for a service retirement, retire within the window period and file a retirement application with CalSTRS before the end of the month in which they retire. In addition, the district must submit the proper forms to CalSTRS, pay the actuarial cost of the benefit and an administrative fee to the System.

At various time since the incentive program was established in 1984, school districts have been able to elect to participate in the program and establish window periods of 60 to 120 days by formal board action, usually a resolution. The deadline for a board to approve these window periods is set in the Teachers' Retirement Law, and has alternately lapsed and later been extended through legislation. Employees who retire within the window period are granted two additional years of service credit. An employer may have multiple, but not overlapping, window periods in any year. In fact, a small number of school districts have multiple window periods extending many years into the future. The school district retains control of whether to open the window and encourage employees who are members of the DB Program to retire.

The employer must pay CalSTRS the actuarial cost of the benefit plus an administrative fee of $250 within 30 days of the effective retirement date. This payment is based on an estimate of the present value cost of the benefit, and when the exact billing is determined, the employer may receive a refund, if overpaid, or be notified that more money is due, if underpaid. Under a deferred payment plan established by the Teachers' Retirement Board (Board), the employer can pay the present value over a period of four years, with the first billing sent to the district one year after the participating employee's effective retirement date. The administrative cost under the deferred plan is $285, with the System charging its regular interest rate of 6 percent for the 2002-03 fiscal year on the balance–the same rate charged to DB Program members making payments on their own service credit purchases. The employee's retirement incentive benefit is not affected by the method of payment and CalSTRS does not wait for the present value payment before granting the additional years of credit. Approximately 70 percent of the individual retirement incentive benefits are paid by school districts on a deferred basis.

FISCAL YEAR	School Districts Offering Current CalSTRS Retirement Incentive	Retirees Receiving CalSTRS Retirement Incentive	Total Retirements
2001-2002	29	107	9,762
2000-2001	40	258	8,701
1999-2000	140	943	7,556
1998-999	420	1,792	7,248
1997-1998	400	1,450	7,332
1996-1997	300	1,441	6,011
1995-1996	407	1,402	6,985
1994-1995	342	789	7,140

Districts currently offer retirement incentives that do not affect DB Program benefits. These incentives use annuity programs offered by private vendors. Because such annuities generally are based on a lower rate of return than the DB Program is based upon, the cost to the employer of an incentive provided by these alternative providers are often higher than a comparable incentive provided through the DB Program. On the other hand, there may be more flexibility in the design of an incentive offered by a private vendor than is provided by one established in statute.

<u>Cost Savings Realized by Districts</u>
Participating districts are required to document their cost savings from providing the current retirement incentive. The State Controller's Office reviews the program and reports annually to the Legislature on the cost savings realized by these districts.

Participating districts must disclose the following supplementary information in their annual audit reports:

- The reason for granting the additional years of service;
- Number and type of positions vacated;
- Age, service credit, salary and benefits of the retirees receiving the additional service credit;
- Average and service credit for the retirees;
- Comparison of the salary and benefits of each retiree receiving the additional service credit with the salary and benefits of any replacement employee;
- Resulting retirement cost and post-retirement health care benefit costs incurred by the employer;
- Total additional costs and yearly payroll savings resulting from the program; and
- Number of years it will take for the yearly payroll savings to recover the additional costs generated by the Program.

From this data, the Controller's Office has previously reported to the Legislature the following:

Fiscal Year	Average Age of Retiree	Average Years of Service Credit	Average Number of Positions Vacated per School District	Total Annual Personnel Savings[1]	Total Additional One-Time Costs	Net Cost for the Initial Year[2]	Net Cost Recovery Period (years)
2001-02	59.88	26.34	7.16	$5,247,407	$7,165,233	$1,917,826	1.37
2000-01	60.12	28.20	6.70	$5,735,904	$6,255,150	$519,246	1.09
1999-00	59.71	27.21	6.02	$9,151,845	$12,862,544	$3,710,699	1.41
1998-99	60.57	26.61	5.29	$34,234,574	$47,626,410	$13,391,836	1.39
1997-98	60.20	26.85	5.08	$35,450,874	$49,297,379	$13,846,505	1.39
1996-97	60.38	26.28	4.18	$23,534,624	$31,586,545	$8,051,921	1.34
1995-96	60.19	26.17	4.61	$22,886,733	$30,904,049	$8,017,316	1.35
1994-95	59.88	26.90	4.26	$27,026,746	$32,789,588	$5,762,842	1.21
1993-94	60.13	26.06	4.43	$24,030,738	$26,141,637	$2,110,899	1.09

[1] *Current year savings only; cumulative total is not available because school district reports only reflect current year retiree costs and savings.*

[2] *Net cost for the initial year is the difference between the total annual personnel savings and total additional one-time costs.*

According to the Controller's Office report to the Legislature for the year ending June 30, 2002:

> "An analysis of the audits of local educational agencies indicates that the STRS Early Retirement Incentive Program resulted in a net cost of $1,917,826 during fiscal year 2002-01. The total program cost was $7,165,233 through June 30, 2002, and was calculated based on one-time retirement contributions by the school districts. The annual savings realized in fiscal year 2001-02 is estimated to be $5,247,407. Accordingly, the total program costs will be recovered in 1.37

> years. Based upon data presented in this report, the agencies will continue to achieve cost savings in future years."

As of June 30, 2002, there were approximately 80,000 active members of the DB Program with sufficient age and service credit to become eligible to retire. This represents the potential statewide pool of DB Program members currently able to qualify for the retirement incentive program proposed by this bill.

DISCUSSION

Specifically, Assembly Bill 1207:

- Reopens and makes permanent the existing provisions that grant two additional years of service credit to retiring members of the DB Program employed by participating school districts and community college districts. It makes additional changes to:

    - ➢ Eliminates districts' ability to participate by demonstrating a reduction in the number of certificated employees or the retention of employees credentialed in teacher shortage disciplines;

    - ➢ Increase to eight years the period of time whereby the employer pays CalSTRS the actuarial cost of the additional benefit;

    - ➢ Require members to forfeit the benefit if they return to work in a California public school within one year;

    - ➢ Require members to forfeit the benefit if they return to work in the school district that grants them the retirement incentive within five years.

- Creates a new "2+2" early retirement incentive program to provide an additional two years of service credit and two additional years of age, for purposes of the age factor used to calculate retirement benefits, to retiring members of the DB Program whose employers have elected to participate.

Among the features included in the new program:

- ➢ The employer pays the actuarial cost of the additional benefit over a period of up to eight years, in a manner specified by the System;

- ➢ District participation is subject to collective bargaining; however, it may be provided to non-represented employees upon formal action by the district's governing board;

- ➢ Authorizes CalSTRS to bill participating employers for its costs to implement and administer the program;

- ➢ Requires school and community college districts to demonstrate and certify to the county superintendent or chancellor's office, respectively, the net savings achieved;

- ➢ Requires the county superintendent or chancellor to certify to CalSTRS, the net savings achieved. In addition, it requires the county superintendent to demonstrate and certify to the State Superintendent of Public Instruction, who must then also certify to CalSTRS, the net savings achieved;

- ➢ Requires school districts to reimburse the county superintendent for administrative costs. Authorizes the Superintendent of Public Instruction and the chancellor to request reimbursement for administrative costs;

- ➢ Requires the State Controller to document the net savings realized by participating districts in its annual Cost Analysis Report;

- ➢ Requires members to forfeit the benefit if they return to work in a California public school within one year;

- ➢ Requires members to forfeit the benefit if they return to work in the school district that grants them the retirement incentive within five years;

- ➢ The additional service credit does not count towards receiving other benefit enhancements;

- ➢ The program begins 120 days after enactment of this measure;

- ➢ The program ends January 1, 2005;

- Expresses legislative intent that districts consider both public and private retirement incentive options, and the impact on their ability to meet state teacher credentialing requirements and highly qualified teacher requirements under federal law.

According to the sponsors, the state's budget problems have had a major impact on school districts already struggling with deficits and revenue losses. They say that throughout the state this March, school districts sent layoff notices to approximately 30,000 teachers, counselors, and administrators, primarily those with the least seniority. Supporters believe this bill will provide districts an additional tool to deal with their budget problems and avoid making as many layoffs as they currently anticipate. They state that: "by allowing teachers already planning to retire in two to five years to retire early, school districts will be able to retain other teachers who would be teaching for perhaps the next 20 years."

AB 1207 reauthorizes and makes permanent the existing retirement incentive program for members of the DB Program employed by school districts and community college districts. Eliminating the sunset date for CalSTRS' existing retirement incentive program that provides two years of service credit to school employees is consistent with the part of the program that applies to state employees who are members of the DB Program, which does not have a sunset date. Once AB 1207 becomes effective, a district will be able to take immediate action to provide this existing retirement incentive program to its eligible employees.

This measure also extends the amount of time districts are allowed to pay back the cost of providing this benefit to their employees from the current four years to eight years. It also specifies that members of the DB Program who receive the two additional years of service credit may not work in a California public school in any capacity for one year, or the district that provided the benefit for five years, after receiving the retirement incentive benefit, and will forfeit the ongoing benefit provided by the two years extra service credit for violating those terms.

Eligibility for the New Retirement Incentive Program

The remainder of this analysis focuses on the new early retirement incentive program to provide two years of service credit and two years of age (2+2) to members of the DB Program that retire from participating districts. A participating employer may provide the new retirement incentive benefit to its employees either as part of a memorandum of understanding with a representative employee organization, or, through formal action by its governing board to provide the benefit to all employees who are members of the DB Program and are eligible to retire.

Members who elect to receive the new early retirement incentive, and, at any point in the future, change their retired status to reinstate into active service would lose the additional service credit and age when they retire the second time. Members who receive the two additional years of service credit and two additional years of age may not work in a California public school in any capacity for one year, or the district that provided the benefit for five years, after receiving the retirement incentive benefit or would forfeit the additional benefit they receive from the two years of service credit and two years added to their age factor calculation. Members would also forfeit the benefit if they return to work in any capacity for the employer that provided the retirement incentive benefit within five years.

The one-year and five-year restrictions apply to any work performed by a participating retired member of the DB Program for a CalSTRS covered employer, whether in a credentialed position, such as a substitute teacher, counselor or trainer, or a classified position, such as a teacher's aide. Existing law requires CalSTRS covered employers to provide monthly reports to the System on the service performed by their employees in all positions requiring a credential, allowing CalSTRS to monitor violations by members of the DB Program who return to work in a credentialed position. However, employers do not report work performed by classified employees to the System, preventing CalSTRS from monitoring violations by participating members who return to work in these positions.

Administration and Implementation

Among other things, the CalSTRS corporate database uses the member's birthday to establish the age factor calculation and option factor calculation. AB 1207 requires changes to the database to allow the age factor to be calculated on an age that is 2 years more than the real age, but not affect the option factor. Staff estimates it will take approximately three months and $56,000 to analyze, design, develop and test these changes. AB 1207 makes the new retirement incentive program operative 120 days after the bill is signed by the Governor's to allow the System to update the corporate database and internal processes, design forms and brochures, train affected staff and inform districts of the new retirement incentive program.

AB 1207 also specifies that a district must pay the costs of the 2+2 early retirement incentive to the system within eight years. Under the existing program, districts may choose to be billed at the time their employee retires, or in four equal annual payments, including interest, with the first payment due a year after the employee's retirement.

This measure permits CalSTRS to recover its administrative costs to implement and maintain a new 2+2 early retirement incentive program. Under current law, CalSTRS charges participating school districts an administrative fee per member to calculate the value of their new benefit and process the required paperwork under the existing program. Currently, there is a $250 fee when the district agrees to pay the contribution immediately and a $285 fee when the district pays the contributions on a deferred basis. The administrative fee CalSTRS will charge employers participating in the new program will be slightly higher to cover the additional costs associated with processing a more complex retirement calculation and doubling the number of billings to districts opting for the deferred payment plan.

<u>Impact of the Additional Age is Limited for Older Members</u>
The CalSTRS benefit formula is 2 percent of final compensation for each year of credited service at age 60, increasing to 2.4 percent at age 63. However, the maximum benefit cannot exceed 2.4 percent, even for members with 30 or more years of credited service, who would otherwise receive the career factor bonus, which provides an additional 0.2 percent of final compensation per year of credited service. Any member receiving the 2+2 early retirement incentive that is age 63 and older, or is age 61.5 with 30 years credited service, will realize no benefit from the addition of two years of age to their age factor calculation. Members between the age of 61 and 63, or between age 59.5 and 61.5 will realize only a partial benefit.

From data on the average member participating in the existing CalSTRS retirement incentive program collected by the Controller's Office in its Cost Analysis Report, it appears that providing service credit as an incentive does not have a major effect on the age at which a member retires. The level of service credit a member has accrued at the time of retirement, however, is lower by approximately the amount of additional service credit they receive. On average, it appears that a retiring member's target age and goal for the amount of service credit they must accrue at the time they retire appears to remain stable. It is premature to speculate whether increasing the age of the member, for purposes of determining the age factor, would similarly reduce the average age of members retiring under the new incentive program. AB 1207 requires the Controller's Office to document the net savings realized by districts that choose to provide the new 2+2 early retirement incentive in its annual report to the Legislature on the existing CalSTRS retirement incentive program.

Value and Cost of a 2+2 Benefit

		Unmodified Allowance	Increase in Monthly Allowance	Percent of Final Compensation	Present Value Cost to District
The Average 2002 Retired Member	Current law	$3,432		60%	
61.1 years old; 28.3 years svc Earns $5,686/mo	2 years additional service	$3,675	$243	65%	$37,323
	2 years additional service and 2 years additional age	$4,135	$703	73%	$108,099
The Average Age 55 Retired Member:	Current law	$1,636		32%	
22.844 years svc Earns $5,116/mo	2 years additional service	$1,779	$143	35%	$24,542
	2 years additional service and 2 years additional age	$2,084	$448	41%	$76,804
The Average Age 60 Retired Member:	Current law	$3,384		59%	
29.543 years svc Earns $5,727/mo	2 years additional service	$3,613	$229	63%	$35,960
	2 years additional service and 2 years additional age	$4,095	$711	72%	$111,674
The Average Age 62 Retired Member:	Current law	$4,360		74%	
30.699 years svc Earns $5,917/mo	2 years additional service	$4,644	$284	78%	$42,796
	2 years additional service and 2 years additional age	$4,644	$284	78%	$42,796
The Average Age 65 Retired Member:	Current law	$3,409		62%	
25.975 years svc Earns $5,468/mo	2 years additional service	$3,671	$262	67%	$36,939
	2 years additional service and 2 years addl. age	$3,671	$262	67%	$36,939

<u>Potential Savings to School Districts and the General Fund</u>
The existing CalSTRS retirement incentive program that provides 2 years additional service credit to participating members has demonstrated personnel savings to school districts throughout its existence, with a relatively short payback period of between 1.09 and 1.41 years. While the additional cost to participating districts for a 2+2 early retirement incentive will be substantial and lengthen the time it takes districts to realize any savings, savings will eventually be realized. Districts who do not replace their participating employees will realize the greatest savings, however, the districts who do later replace participating employees will also be able to maximize their savings by stabilizing the cost of salary and benefits for the replacements into the future. In addition, due to the higher assumed rate of return of the DB program, compared to annuities offered by private vendors, it may cost districts less to offer an incentive under this bill than through available alternatives.

Existing law requires the state to make an annual contribution from the General Fund to the TRF beginning July 1, 2003, equal to 4.517 percent of payroll for members of the DB Program in the fiscal year two years preceding the fiscal year the contribution is made to pay the cost of DB program benefits and purchasing power benefits To the extent that a 2+2 retirement incentive program replaces highly paid teachers with lower paid teachers, or not at all, contributions the TRF and costs to the General Fund will grow smaller into the future.

FISCAL IMPACT

<u>Benefit Program Costs</u> – Any increased benefit costs will be offset by payments by employers. In addition, districts may realize reduced costs to offer an incentive provided under this bill relative to a comparable benefit provided by an alternative vendor.

<u>Administrative Costs</u> – Approximately $56,000 in one-time costs associated with the necessary changes to the CalSTRS corporate database for it to recognize the addition of 2 years to members' age factor calculation and additional costs to administer the program, depending upon the number of participating members. Administrative costs would be offset by the administrative fee charged to participating districts.

BOARD POSITION

Support. This bill is consistent with the Board's efforts to improve benefits for CalSTRS members.