CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 1207	**Assembly member Corbett (As amended 3/28/03)**
Position:	**Support, if Amended (Staff Recommendation)**
Proponents:	**ACSA, CFT, CTA, SSDA (co-sponsors)**
Opponents:	**None known**

SUMMARY

Assembly Bill 1207 reopens and makes permanent the existing Golden Handshake Program which 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, and establishes a new early retirement incentive program ending January 1, 2005 to allow school districts that pay the actuarial cost, to provide two years of service credit and two years of age to the factor calculation that determines a member's retirement allowance.

HISTORY

Chapter 20, Statutes of 1994 (SB 858—PE&R) Reestablished the California State Teachers' Retirement System (CalSTRS) Golden Handshake two years additional service credit program, operative 3/30/94 through 12/31/98.

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 996, Statutes of 1990 (AB 2609—Hughes), An urgency measure effective 9/18/90, reestablished until 12/31/93 the CalSTRS Golden Handshake Program which allows school employers to provide DB members with two additional years of service credit at retirement.

Chapter 601, Statutes of 1987 (AB 960—Hughes) Extended the CalSTRS Golden Handshake Program 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 293, Statutes of 1985 (SB 835—Marks) A provision included in Chapter 361, Statutes of 1984 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 361, Statutes of 1984 (AB 2223—Hughes) established the CalSTRS Golden Handshake 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.

CURRENT PRACTICE

The basic retirement formula under the DB Program is calculated by multiplying the member's years of credited service by their final compensation and an age factor based on their age at the time of retirement (currently 2 percent at the normal retirement age of 60). 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. The retired member's benefit calculation is viewed as follows:

Service Credit
x Age Factor (add .2% w/ 30 years service not to exceed 2.4%)
x Final Compensation (3-year or 1-year)

+ Longevity Bonus (w/ 30, 31 & 32+ years service)
= Unmodified Retirement Allowance

The age factor ranges from 1.1 percent at age 50 to a maximum 2.4 percent at age 63. Members with at least 30 years creditable service receive an additional .2 percent credit to their age factor, not to exceed 2.4 percent. Final compensation is calculated as either the average of the member's highest 36 consecutive months creditable compensation, or, if the member has at least 25 years creditable service, the average of their highest 12 consecutive months' creditable compensation. A longevity bonus is also added to the monthly unmodified retirement allowance of members who accumulate at least 30 years of service credit prior to January 1, 2011. The amount of the longevity bonus depends on their years of service credit at retirement. With 30 years of service credit, members receive a monthly increase of $200; with 31 years, an increase of $300; with 32 or more years, an increase of $400.

CalSTRS GOLDEN HANDSHAKE PROGRAM
The CalSTRS Golden Handshake Program allows participating school districts to provide their credentialed employees as an incentive for early retirement, two additional years of service credit in the CalSTRS DB Program. This additional service credit, like other forms of service credit not associated with actual educational service within California, does not count towards other CalSTRS benefit enhancements. In order to participate, a school district must take formal action to offer the program, establish window periods 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 program was established in 1984, school districts have been able to elect to participate in the program and establish window periods 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. The window period is an inclusive 60-day minimum to 120-day maximum period of time during which the employee may retire and receive the Golden Handshake benefit. 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 offer a golden handshake to encourage employees that 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 their 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% for the 2003-03 fiscal year on the balance–the same rate charged to DB members making payments on their own service credit purchases. The employee's Golden Handshake benefit is not affected by the method of payment and CalSTRS does not wait for the present value payment before processing the Golden Handshake. Approximately 70 percent of the individual golden handshake benefits are paid by school districts on a deferred basis.

FISCAL YEAR	School Districts Offering Golden Handshake	Retirees Receiving Golden Handshake	Total Retirements
2001 / 2002	29	107	9,762
2000 / 2001	40	258	8,701
1999 / 2000	140	943	7,556
1998 / 1999	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

COST SAVINGS REALIZED BY DISTRICTS

As part of changes to the CalSTRS Golden Handshake Program requested by Governor Wilson in his veto message for SB 107 (Hughes—1993), which would have removed the 1/1/94 sunset date of the Golden Handshake provisions, subsequent legislation, Chapter 20, Statutes of 1994 (SB 858—PE&R), which extended the sunset date to 1/1/99, requires participating districts to document their cost savings and the State Controller's office to review the Program and report 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 implementing the Program;
- 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	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.*

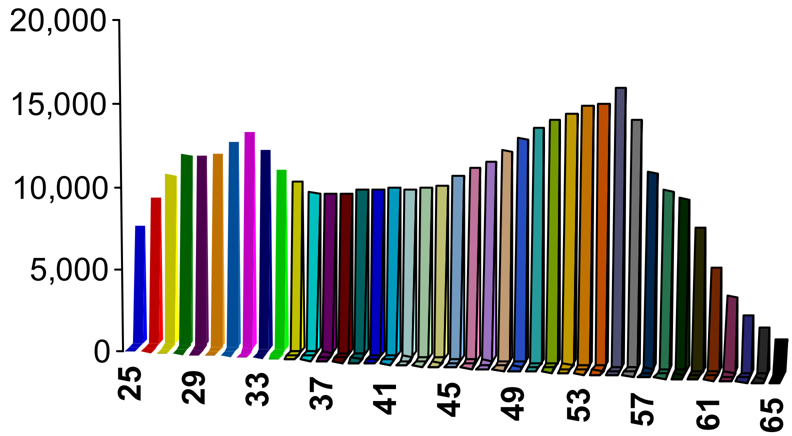
2 *Net cost for the initial year is the difference between the total annual personnel savings and total additional one-time costs.*

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."

CHARACTERISTICS OF DB MEMBERS

Active Members Classified By Age



As of June 30, 2002, there were approximately 96,000 members of the DB Program age 55 and older. While a small number of these members may not have accrued enough service credit to become eligible to retire, and some younger members with at least 30 years credited service are already eligible to retire, this figure approximates the potential statewide pool of DB members able to qualify for the Golden Handshake Program.

DISCUSSION

Specifically, Assembly Bill 1207:

- Reopens and makes permanent the existing, but inactive, Golden Handshake Program that provides two additional years of service credit to retiring members of the DB Program employed by participating school districts and community college districts.

- Creates a new 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.

  Features of the new program include:

  - The additional service credit counts towards 1-year final compensation, longevity and career factor bonuses.

  - The employer pays the actuarial cost of the additional benefit over a period of up to five years, in a manner acceptable to both the employer and the System.

  - District participation in the new program is subject to collective bargaining.

- Does not authorize CalSTRS to bill employers for the costs to implement and administer the program.

- Does not require participating districts to certify or prove there will be a cost savings.

- The program ends 1/1/2005, a duration of 21 months if signed by May 1, 2003.

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 40,000 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."

While AB 1207 will reauthorize and make permanent the existing Golden Handshake Program for members of the DB Program employed by school districts and community college districts to mirror the provisions that apply to state employees, 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 retiring members of the DB Program employed by participating districts.

THE PROPOSED BENEFIT AFFECTS MEMBERS'
<u>RETIREMENT CALCULATIONS UNEVENLY</u>

Unlike the existing Golden Handshake Program, members who receive the new 2+2 early retirement incentive have that additional service credit count towards other CalSTRS benefit enhancements such as one-year final compensation, the longevity bonus and career factor bonus. While DB members employed by a participating school district may share one or more of the characteristics that determine the CalSTRS retirement benefit calculation, the 2+2 incentive is more valuable to those who are on the verge of qualifying for the benefit enhancements than those members that have already qualified.

Furthermore, the additional cost to participating districts will be substantial and lengthen the time it takes to realize any savings. Staff recommends conforming the new 2+2 early retirement incentive to the existing Golden Handshake Program to provide that the additional years of credited service and years in age do not apply to other benefit enhancements.

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. It will be the responsibility of

CalSTRS and the participating districts to inform members of the effect this limit has on their retirement benefit.

Finally, Internal Revenue Code (IRC) Section 415(n) limits the amount of nonqualified service credit (service credit not associated with actual service, commonly referred to as “airtime”), that a member may purchase or accrue beginning or after December 31, 1997. The service credit granted under a Golden Handshake is considered nonqualified service. Therefore, a member that has already purchased or accrued five years of nonqualified service credit may not elect to receive two additional years service credit through a Golden Handshake. If a member has already purchased or accrued between three and five years of nonqualified service credit and then elects to receive two years service credit under a Golden Handshake, CalSTRS would limit the amount of service credit applied to their account to five years in order not to violate the IRC. It will be the responsibility of CalSTRS and the participating districts to inform members of this limit.

PARTICIPATING DISTRICTS’ PAYMENTS TO THE SYSTEM

AB 1207 specifies that a district must pay the costs of the 2+2 early retirement incentive to the system within five years. However, it would be done in a manner acceptable to both the employer and the Board. These provisions are not consistent with CalSTRS’ existing Golden Handshake Program, whereby districts have up to four years to pay for the costs of the benefit enhancement under terms and conditions set by the Board. 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.

Under AB 1207, a district could attempt to negotiate a one-time payment to the System at the end of the five-year period. However, since the new program would not require districts to document that granting a 2+2 early retirement incentive to their employees will result in a cost savings, CalSTRS would not be able to determine if the district had the ability to make such a delayed one-time payment.

With over 1,300 school districts as CalSTRS employers, allowing individual districts to negotiate the terms and conditions of their payments to the System under a new 2+2 early retirement incentive program places an administrative burden on CalSTRS that will increase the cost of providing this benefit and delay its introduction. Redirecting staff resources to negotiate payment terms and account for multiple payment schedules will also impair CalSTRS’ ability to serve other active and retired members. CalSTRS staff recommends an amendment to AB 1207 to allow the System to set uniform terms and conditions for districts’ payments of up to five years.

IMPLEMENTATION AND ADMINISTRATIVE COSTS

AB 1207 does not authorize CalSTRS to recover its administrative costs to implement and maintain a new 2+2 early retirement incentive program. In contrast, current law allows CalSTRS to charge participating school districts an administrative fee per member to calculate the value of their new benefit and process the required paperwork under the existing Golden Handshake Program. Currently, the System charges a $250 fee when the district agrees to pay the contribution immediately and $285 when the district pays the contributions on a deferred basis. If the System processes 2,000 requests during the period this new program is in effect, this activity represents a cost to the Teachers' Retirement Fund (TRF) of between $500,000 and $570,000.

Among other things, the CalSTRS corporate database uses the member's birthday to establish the age factor calculation and option factor calculation. Without 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 the option factor, the System will not be able to implement this program. Without changes to the database, the System will not be able to provide retirement benefit estimates to members considering participation in the new 2+2 early retirement incentive. Staff estimates it will take approximately three months and $56,000 to analyze, design, develop and test these changes. In addition, staff estimates several weeks to update internal processes, design forms and brochures, train affected staff and inform districts of the new 2+2 early retirement incentive program.

CalSTRS staff recommends an amendment to AB 1207 to allow the System to recover from participating employers the costs to implement and maintain this new program. Staff also recommends specifying the introduction of a new 2+2 early retirement incentive program begins 120 days after the effective date of the bill, if an urgency clause is added.

VALUE AND COST OF A 2+2 BENEFIT

From data on the average member participating in the existing CalSTRS Golden Handshake 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, however, the level of service credit a member has accrued at the time of retirement 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. Given this assumption, it is unclear to what extent the effect of adding two years to a member's age for purposes of the age factor calculation <u>and</u> allowing the additional service to count towards other CalSTRS benefit enhancements will expand the pool of eligible members that are willing to retire.

The chart on the following page demonstrates the value and the costs of various types of Golden Handshake benefits. It includes the calculation for the Career Factor Bonus (when applicable). Instances where the addition of the two years of age is affected by the age factor limit (2.4 percent maximum at age 63 or at age 61.5 with 30 years service) are denoted with an asterisk*. In addition, the Longevity Bonus is calculated separately at the bottom of the data for each age. Since the chart is based on an average retiree at a particular age and/or point in time, the effect and cost of the one year final compensation benefit cannot be included in these calculations.

The Average 2002 Retiree:	Benefit Enhancement	Value of Benefit to Retiree /mo	Retiree's New Unmodified Allowance /mo	Present Value Cost to District
			$3,432	
61.1 years old;	2 years additional svc	$587.14	$4,019	$90,338.56
28.3 years svc	4 years additional svc	$852.45	$4,285	$131,159.76
Earns $5,586/mo	2 years additional age*	$429.64	$3,862	$66,105.68
	2 yrs svc+2 yrs age*	**$702.57**	**$4,135**	**$108,099.20**
The Average Age 55 Retiree:				
		$0	$1,636	
22.844 years svc	2 years additional svc	$143.25	$1,779	$24,541.96
Earns $5,116/mo	4 years additional svc	$286.50	$1,923	$49,083.93
	2 years additional age	$280.49	$1,917	$48,054.57
	2 yrs svc+2 yrs age	**$448.29**	**$2,084**	**$76,803.72**
	longevity bonus-30 yrs	$200.00	+$200	+$34,265.00
	longevity bonus-31 yrs	$300.00	+$300	+$51,397.50
	longevity bonus-32+yrs	$400.00	+$400	+$68,530.00
The Average Age 60 Retiree:				
			$3,384	
29.543 years svc	2 years additional svc	$590.37	$3,974	$92,674.47
Earns $5,727/mo	4 years additional svc	$842.36	$4,226	$132,230.54
	2 years additional age	$451.74	$3,836	$70,913.07
	2 yrs svc+2 yrs age	**$951.67**	**$4,336**	**$149,388.89**
	longevity bonus-30 yrs	$200.00	+$200	+$31,395.20
	longevity bonus-31 yrs	$300.00	+$300	+$47,092.80
	longevity bonus-32+yrs	$400.00	+$400	+$62,790.40
The Average Age 62 Retiree:				
			$4,360	
30.699 years svc	2 years additional svc	$284.02	$4,644	$42,795.53
Earns $5,917/mo	4 years additional svc	$568.03	$4,928	$85,591.06
	2 years additional age*	None	$4,360	N/A
	2 yrs svc+2 yrs age*	**$284.02**	**$4,644**	**$42,795.53**
	longevity bonus-30 yrs	$200.00	+$200	+$30,136.00
	longevity bonus-31 yrs	$300.00	+$300	+$45,204.00
	longevity bonus-32+yrs	$400.00	+$400	+$60,272.00
The Average Age 65 Retiree:				
			$3,409	
25.975 years svc	2 years additional svc	$262.46	$3,671	$36,939.45
Earns $5,468/mo	4 years additional svc	$524.93	$3,934	$73,878.89
	2 years additional age*	None	$3,409	N/A
	2 yrs svc+2 yrs age*	**$262.46**	**$3,671**	**$36,939.45**
	longevity bonus-30 yrs	$200.00	+$200	+$28,148.20
	longevity bonus-31 yrs	$300.00	+$300	+$42,222.30
	longevity bonus-32+yrs	$400.00	+$400	+$56,296.40

POTENTIAL SAVINGS TO SCHOOL DISTRCTS AND THE GENERAL FUND

The existing CalSTRS Golden Handshake Program 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 that counts towards other CalSTRS benefit enhancements will be substantial and lengthen the time it takes districts to realize any savings, savings will eventually be realized. Districts will be able to maximize these savings by stablizing the cost of salary and benefits for the replacements of participating retirees into the future.

Existing law requires the state to make an annual contribution from the General Fund to the TRF equal to 2.017 percent of payroll for members of the DB Program in the fiscal year two years preceding the fiscal year the contribution is made. To the extent that a 2+2 early 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

Benefit Program Costs – None

Administrative Costs – Hundreds of thousands in lost administrative fees currently paid by school districts to cover CalSTRS' processing costs associated with Golden Handshake Program paperwork, and approximately $56,000 in 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.

RECOMMENDATION

Support, if amended to 1) remove the provision that the additional years of credited service and years in age apply to other benefit enhancements; 2) allow the System to set uniform terms and conditions for districts' payments and recover implementation and processing costs; and 3) specify that the introduction of the new program occurs 120 days after the effective date of the bill.