CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 212	**Assembly Member Maze (As amended 4/24/03)**
Position:	**Support, if Amended**
Proponents:	**Author (Sponsor), CTA, CFT**
Opponents:	**None known**

SUMMARY

Assembly Bill 212 establishes a new retirement incentive program to allow school districts to add four years of service credit to those Defined Benefit (DB) Program members who agree to retire prior to 2005.

HISTORY

Chapter 361, Statutes of 1984 (AB 2223—Hughes) established the current California State Teachers' Retirement System (CalSTRS) retirement incentive program (often referred to the "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.

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 1207 (Corbett) reopens and makes permanent the existing retirement incentive program which provides an additional two years of service credit to members of the DB Program employed by participating school districts able to demonstrate cost savings, and 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.

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 on the member's 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 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 of creditable service receive an additional 0.2 percent credit to their age factor, not to exceed 2.4 percent. Final compensation is the average of his or her highest 12 consecutive months' creditable compensation or, if the member has less than 25 years credited service, the average of the member's highest 36 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.

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 during the window period are granted the 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 golden handshake 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.

Cost Savings Realized by Districts

Participating districts are required to document their cost savings. 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

AB 212 creates a new early retirement incentive program to provide an additional four years of service credit 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 acceptable to <u>both</u> the employer and the System.
- The district is required to certify its participation will result cost savings, occurred as a result of declining enrollment, or will result in the retention of credential employees or employees qualified to teach in teacher shortage disciplines.
- 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.
- The program ends January 1, 2005.
- Is an urgency measure that becomes effective the day it is signed by the Governor.

According to the author, schools are struggling to find and implement costs savings measures to bridge their large budget deficits. He believes allowing districts to participate in a retirement incentive program will generate savings and avoid teacher layoffs, and is an appropriate cost savings measure for schools throughout the state.

AB 212 does not reauthorize the existing CalSTRS retirement incentive program, which provides two additional years of service credit to retiring members of the DB Program employed by school districts and community college districts. Because (1) the CalSTRS retirement incentive program has proven an effective cost savings measure and a benefit to both employers and members of the DB Program; and (2) the new retirement incentive program proposed in AB 212 would only be in effect for one year, staff recommends the bill be amended to also reopen and make permanent the existing program to mirror provisions that apply to state employees.

Unlike the existing retirement incentive program where the additional service credit does not count towards DB Program benefit enhancements, such as one-year final compensation, longevity and career factor bonuses, it is unclear whether DB Program members who receive four years of service credit under the new retirement incentive will have that service credit count towards the CalSTRS benefit enhancements. While DB Program members employed by a participating school district may share one or more of the characteristics that determine the CalSTRS retirement benefit calculation, an incentive that counts towards other benefit enhancements is more substantially more expensive to employers for those members who are on the verge of qualifying for the benefit enhancements. This will lengthen the time it takes to realize any savings. Staff recommends amendments that clarify that the service credit granted under the new early retirement incentive do not apply to the career-based benefit enhancements.

Participating Districts' Payments to the System

AB 212 specifies that a district must pay the costs of the four years additional service credit to the system within eight 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 incentive 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.

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 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 212 to allow the System to set uniform terms and conditions for districts' payments of up to eight years.

AB 212 does not authorize CalSTRS to recover its administrative costs to implement and maintain a new 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 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. CalSTRS staff recommends the bill be amended to allow the System to recover from participating employers the costs to implement and maintain this new program.

Value and Cost of Granting Four Years Additional Service Credit

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 remains stable.

The chart on the following page demonstrates the value and the costs of the existing and the proposed Golden Handshake benefit, assuming that the additional service does not count towards benefit enhancements.

		Unmodified Allowance	Increase in Monthly Allowance	Percent of Final Compensation	Present Value Cost to District
The Average 2002 Retired Member *61.1 years old; 28.3 years svc Earns $5,686/mo*	Current law	$3,432		60%	
	4 years additional service	$4,285	$852	75%	$131,160
The Average Age 55 Retired Member: *22.844 years svc Earns $5,116/mo*	Current law	$1,636		32%	
	4 years additional service	$1,923	$287	38%	$49,084
The Average Age 60 Retired Member: *29.543 years svc Earns $5,727/mo*	Current law	$3,384		59%	
	4 years additional service	$3,842	$458	67%	$71,920
The Average Age 62 Retired Member: *30.699 years svc Earns $5,917/mo*	Current law	$4,360		74%	
	4 years additional service	$4,928	$568	83%	$85,591
The Average Age 65 Retired Member: *25.975 years svc Earns $5,468/mo*	Current law	$3,409		62%	
	4 years additional service	$3,934	$525	72%	$73,879

Potential Savings to School Districts and the General Fund
The existing CalSTRS retirement incentive 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 early retirement incentive that provides four years of additional service credit 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 stabilizing the cost of salary and benefits for the replacements of participating retirees 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 early retirement incentive program that provides four years of additional service credit to DB members who agree to retire, 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 – 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.

Administrative Costs – Additional costs to administer the program, depending upon the number of participating members.

BOARD POSITION

Support, if amended to clarify that the additional years of credited service does not apply to other benefit enhancements, allow the System to set uniform terms and conditions for districts' payments, and recover processing costs.