CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 265 **Assembly Member Mullin (As amended 6/23/03)**

Position: **Sponsor (Staff recommendation)**

Proponents: **CTA , CRTA, CFT, FACCC**

Opponents: **None known**

SUMMARY

Assembly Bill 265 changes the General Fund contribution to the California State Teachers' Retirement System (CalSTRS) Supplemental Benefit Maintenance Account (SBMA) between 2003-04 and 2010-11. Specifically:

- The 2003-04 contribution, estimated to be $558.9 million, would be eliminated.
- There would be a small increase in the contribution rate between 2004-05 and 2009-10.
- There would be an increase in the contribution rate in 2010-2011 based on the actual rate of return CalSTRS earns on its investments from July 1, 2003 through July 1, 2010, as specified.

The bill contains an urgency measure and would become effective the day it is signed by the Governor.

HISTORY

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.

CURRENT PRACTICE

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 $9,840 per year as a result of the annual two percent benefit adjustments. She would, however, have to receive $29,430 in 2002 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 $23,544 per year (80 percent of $29,430). Consequently, CalSTRS would pay a supplemental benefit equal to the difference between the $23,544 she would need to maintain 80 percent of the purchasing power of the initial benefit and the $9,840 she is actually receiving, or $13,704. This amount would be paid in four equal installments annually, or $3,426 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 Defined Benefit (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 Teachers' Retirement Fund (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.

DISCUSSION

Prior to the passage of SB 20X (Chapter 6, Statutes of 2003), the 2003-04 General Fund contribution to the Teachers' Retirement Fund 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 approximately $59 million.

The Board voted to oppose Chapter 6 because the reduction in General Fund contributions will affect 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, will be adversely affected. The Board also directed staff to initiate litigation proceedings to overturn the provisions of Chapter 6. The purpose of AB 265 is to provide certain repayment, plus interest, for the suspended contribution of the General Fund to the SBMA in 2003-04.

This bill repeals the provisions of Chapter 6, and provides an alternative means of restructuring SBMA contributions. Specifically, the entire 2003-04 contribution would be deleted and contributions over the following seven years would be increased to provide an actuarially equivalent offset of the amount deleted in 2003-04.

The General Fund contribution rate would be increased as follows from 2003-04 through 2009-10:

Payment Date	Increased Contribution Rate
July 1, 2003	
July 1, 2004	.0998%
July 1, 2005	.0957%
July 1, 2006	.0918%
July 1, 2007	.0880%
July 1, 2008	.0845%
July 1, 2009	.0810%

In each year, this would increase the contribution from the General Fund to the SBMA by an estimated $22.3 million.

In 2010-11, the increased contribution rate would be based on the 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%	1.8499%
	At least 3.5 but less than 5%	2.0736%
	At least 5% but less than 6.5%	2.3184%
	At least 6.5% but less than 8%	2.5859%
	At least 8% but less than 9.5%	2.8779%
	At least 9.5% but less than 11%	3.1960%
	11% or greater	3.5421%

This increased contribution in 2010-11 would total between $553 million and $1.1 billion, depending on the rate of return on CalSTRS' investments between 2003-04 and 2009-10.

In addition, in order to offset the value of the eliminated 2003-04 General Fund contribution to the SBMA, on July 1, 2004 and each July 1 thereafter through July 1, 2010, an additional .4103 percent of the total statewide payroll would be credited to the SBMA from the TRF. The rate would be adjusted by the board to reflect any changes in the rate of interest credited to accumulated reserves.

Consulting Actuary

The consulting actuary has concluded that proposed funding alternative in AB 265 is actuarially sound for both the SBMA and the DB Program. According to the actuary "Even though the elimination of the 2003 appropriation diminishes the financial status of the SBMA temporarily, the added crediting form 2004 through 2010 is expected to adequately compensate for the missed appropriation as of July 1, 2003. The final adjustment scheduled prior to September 1, 2010, if necessary, will not have a material impact on the DB Program."

FISCAL IMPACT

Benefit Program Costs: The $500 million SBMA contribution deleted in 2003-04 pursuant to Chapter 6 would be offset by contributions to the SBMA over the following seven years, beginning July 1, 2004. 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 – CalSTRS anticipates any increased administrative cost to be minor and absorbable.

RECOMMENDATION

Sponsor. AB 265 provides certain and full repayment of any General Fund contributions to the SBMA that are deferred. The Board also recognizes the severe funding issues facing the State and would support legislative efforts to participate in a solution to the budget crisis, as long as its fiduciary responsibilities to our members are met and the long-term funding for supplemental payments remains stable and secure.