BILL NUMBER: ACA 15 (Brough) as introduced May 9, 2017

SUMMARY

ACA 15 prohibits a government employer from enhancing new government employee defined benefit pension plan benefits, enrolling a new government employee in a defined benefit pension plan or paying more than one-half of the total cost of retirement benefits for new government employees without approval by the voters of the applicable jurisdiction. This measure also prohibits retirement boards from imposing fees or other financial conditions on a government employer that proposes to close a defined benefit pension plan to new members without approval by the voters of the applicable jurisdiction or the sponsoring government employer.

BOARD POSITION

Oppose. The board's policy is to oppose legislation that makes changes to the structure of benefits provided through the funds administered by CalSTRS that would adversely affect the funding of CalSTRS benefits or that would be impracticable to administer.

REASON FOR THE BILL

According to the author, state and local governments face elimination or reduction of essential services because of costly, unsustainable retirement benefits granted to government employees.

ANALYSIS:

Existing Law:

Chapter 694, Statutes of 1913 (AB 1263), established the Public School Teachers' Retirement Salary Fund as a function of the State Board of Education, effective July 1, 1913. CalSTRS was created to provide California educators with a secure financial future during their retirement years and to provide an incentive for them to stay in the teaching profession during their entire careers. All certificated public school teachers and educational administrators automatically became members of the retirement system when it was established.

Membership in the Defined Benefit (DB) Program currently includes all full-time certificated and electing part-time employees in approximately 1,700 California public schools, county offices of education and the state, from prekindergarten through community college. With more than 914,000 members and benefit recipients, CalSTRS is the nation's largest public teachers' pension fund. Women make up 72 percent of the active member population. The State Teachers' Retirement Plan is a multiple-employer, cost-sharing defined benefit plan. Although CalSTRS is the administrator of the plan, the state is the plan sponsor and obligor of the trust.

The DB Program provides a defined benefit retirement, as well as disability and survivor benefits, for members and their families. The retirement benefit is modest, replacing on average just under 56 percent of a member's working salary. The disability program provided to members since October 16, 1992, delivers a lifetime disability benefit to those who remain disabled that is equal to 50 percent of final compensation, without regard to age or years of service. In order to qualify, a member must generally have five years of service and have a physical or mental impairment that will prevent the performance of his or her usual duties for 12 months or more.

Public educators do not receive Social Security benefits for their CalSTRS service. Moreover, due to the federal Government Pension Offset and Windfall Elimination Provision, retirees often have their Social Security benefits reduced when receiving a CalSTRS benefit. Most retired educators do not have employer-funded health insurance after age 65.

This Bill:

Specifically, ACA 15:

- Prohibits government employers, unless approved by voters of the jurisdiction, from:
    - Enhancing the defined benefit pension plan benefits of new government employees hired on or after January 1, 2021.
    - Allowing new government employees to enroll in a defined benefit pension plan.
    - Paying more than one-half of the total cost of retirement benefits for new government employees.
- Prohibits retirement boards from imposing termination fees on, accelerating payments on existing debt for, or imposing other financial conditions against a government employer that proposes to close a defined benefit pension plan to new members without approval of the voters in the applicable jurisdiction or the sponsoring government employer.
- Specifies that a challenge to government employer or retirement board action taken to comply with the requirements of the measure may only be brought in state and federal court.
- Specifies that the measure will not alter any provisions of an existing labor agreement but will apply to any successor labor agreement and any renewal or extension of an existing labor agreement.
- Specifies that the measure shall not modify or limit any disability or death benefits for government employees.
- Defines the terms "benefit enhancement," "defined benefit pension plan," "government employer," "new government employee," and "retirement benefit."

LEGISLATIVE HISTORY

AB 1469 (Bonta, Chapter 47, Statutes of 2014) increased member, employer and state contributions to fully fund the DB Program by 2046.

AB 340 (Furutani, Chapter 296, Statutes of 2012), also known as the Public Employees' Pension Reform Act, reduced retirement benefits and established a new benefit structure for educators who were first hired on or after January 1, 2013.

PROGRAM BACKGROUND

Impact to Members

Retirement Security

ACA 15 prevents new public employees from becoming members of any defined benefit pension plan, including the CalSTRS DB Program, unless the voters of the employer's jurisdiction approved such a plan. Defined benefit pension plans provide a predictable stream of income for life, allowing participants to plan for retirement and feel a sense of financial security. This measure is silent on whether employers could offer a defined contribution plan without voter approval, so presumably a defined contribution plan could be made available to new public employees under existing state and federal statutes. However, the retirement benefit from a defined contribution plan is based solely on the balance of contributions and investment earnings in the member's account and ceases when the funds in the account are fully paid out to the member. Therefore, a defined contribution plan does not provide the same level of predictability and financial security as a defined benefit plan.

The measure is not clear as to whether a plan such as the CalSTRS Cash Balance (CB) Benefit Program could be offered without voter approval—cash balance plans are, by definition, defined benefit plans. However, there are multiple distinctions between a cash balance plan and a traditional defined benefit plan. A cash balance plan can provide more security than a defined contribution plan because it offers professional management of funds, a guaranteed annual interest rate and a guaranteed benefit as either a lump sum or a lifetime annuity. However, because CalSTRS DB Program is ideally matched for the needs of a workforce that typically remains for an entire career, even if equivalent funding is provided, switching to either a defined contribution plan or a cash balance plan would sharply reduce the retirement income of California's public educators.

Mobility

By potentially allowing each school employer to have a distinct retirement benefit plan, there may be an effect on teacher mobility if the plans are not compatible from employer to employer, and a member's employment decisions would likely be affected by such issues. Under the measure, a new member beginning his or her career may be less likely than an existing member to accrue enough service credit as a career teacher to earn a retirement benefit. Future teachers would have to consider employment decisions with the understanding that they might either be tied to a single employer for the duration of their careers, if they wish to remain under the same retirement benefit plan, or risk forgoing retirement benefits in which they are not vested.

Social Security

Under this measure, a teacher who changes employers could become subject to coverage by Social Security, unless the defined contribution plan provided by the employer, or the defined benefit plan enacted by voters, provides a benefit that meets federal standards. A career that includes a mix of CalSTRS-covered service and Social Security-covered service ultimately leads to Social Security benefits that are subject to offsets, which are an important consideration for educators.

Effect on Disability Program

ACA 15 specifically does not modify or limit disability or survivor benefits. However, it does not specify a funding mechanism in order to maintain the existing disability and survivor benefits. Presumably, a separate contribution rate would need to be established specifically for those benefits, and employers and members would be subject to those rates in a similar manner to the way contributions to the DB Program are remitted today. The contribution rate would need to be enacted by separate legislation or ballot initiative.

<u>Impact to School Employers</u>

This measure could have a significant impact on employers' abilities to attract skilled and talented educators, especially for those employers that are not permitted to offer or that offer a less competitive defined benefit retirement plan. Under the existing structure in which CalSTRS provides a uniform statewide defined benefit plan, school and community college districts do not have to be concerned with whether their potential employees will be attracted by the retirement benefit plan they offer. Recruitment and retention strategies would inevitably change if retirement benefits plans vary from employer to employer, based on the types of retirement benefits that voters of a given jurisdiction authorize.

<u>Impact to CalSTRS</u>

Funding Impact

CalSTRS funding plan enacted by Chapter 47, Statutes of 2014 (AB 1469–Bonta), relies on future contributions to put CalSTRS on a trajectory toward eliminating the unfunded liability by 2046. This measure would likely have a detrimental impact on the funding of the DB Program by reducing the payroll on which contributions are received and, therefore, making the current scheduled contribution rates inadequate to fund the DB Program. The uncertain future of membership and the potential for varied benefits structures and funding mechanisms for new members after January 1, 2021, posed by this constitutional amendment are serious threats to success of the funding plan. Furthermore, CalSTRS unfunded liability could increase should local voters approve a retirement benefit increase without appropriating the additional contributions necessary to fund that increase.

Administrative Impact

ACA 15 could produce a fundamental shift in the purpose of CalSTRS, from a system that serves California educators with a statewide defined benefit plan to one that serves educators in individual districts where voters elect to provide benefits under the plan. If this measure provides voters in local jurisdictions with the flexibility to establish myriad funding approaches and benefit tiers, and if the intent is that these plans are to be administered by CalSTRS, it would require significant changes in the system's overall structure. Rather than a cost sharing plan for accounting purposes, CalSTRS would become an agent plan similar to CalPERS. CalPERS administers health and retirement benefits for the state and 1,580 public agencies, with varying rates for different classifications and benefit tiers within those entities. CalPERS programs are complex, and its operating budget and staffing are each approximately three times that of CalSTRS. In addition, by retaining the current structure for disability and survivor benefits with no mechanism to fund those benefits for educators excluded from the DB Program, ACA 15 would compound all of these additional complexities.

As a Government Employer
ACA 15 could have a significant impact on CalSTRS' ability to attract a skilled workforce. As a state agency, CalSTRS would not be able to provide membership in the defined benefit plan offered through CalPERS to new employees, unless the voters in the state authorize such a plan. If CalSTRS is unable to provide a defined benefit retirement plan, which is a significant component of total compensation, it would eliminate a competitive advantage in being able to attract employees from the private sector.

FISCAL IMPACT

Program Cost – Decreases revenue that is necessary to fund the DB Program without providing an alternative source of funding, eventually depleting assets.

Administrative Costs/Savings – Significant impact on the new pension administration system and possible impact on the existing member database system depending on potential implementation of this measure.

SUPPORT

None known.

OPPOSITION

CalSTRS

ARGUMENTS

Pro: None.

Con: Significantly affects retirement benefits for public employees hired on or after January 1, 2021, who work in jurisdictions in which voters do not approve a defined benefit plan.

Eliminates the security of a defined benefit plan for public employees.

Creates more obstacles for new employees saving for an adequate retirement benefit.

Potentially creates multiple benefit structures under the DB Program that would require greater resources to administer.

Affects a school employer's ability to competitively recruit employees if retirement benefits vary significantly as compared to other employers.

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