

# CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

## BILL ANALYSIS

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**Senate Bill 191**      **Senator Karnette (As amended 3/13/01)**

**Position:**              **Support, if amended**

**Proponents:**        **CRTA, Small School Districts Association, UTLA**

**Opponents:**        **None known**

### **SUMMARY**

Senate Bill 191 credits specified dollar amounts to a California State Teachers' Retirement System (CalSTRS) member's Defined Benefit Supplement (DBS) account based on his or her years of credited service. It also requires CalSTRS to pay the Medicare Part B premiums of currently active and retired Defined Benefit (DB) members who are at least 55 years of age on January 1, 2002. Finally, this bill requires CalSTRS to establish a nominal account for each member of the DB Program who retired before January 1, 2001, and credit the account with \$600 per year to pay the member's health care insurance premiums, including Medicare Part B.

### **HISTORY**

Chapter 74, Statutes of 2000 (AB 1509—Machado) establishes the DBS Program as a separate program for DB members, and for the next ten years, requires that 25 percent of a member's contributions to the DB Program be credited to their DBS account.

Chapter 1021, Statutes of 2000 (AB 2700—Lempert) makes all compensation for creditable service creditable to CalSTRS and credits member and employer contributions for service in excess of 1.000 years of service per school year to the DBS Program.

Chapter 1032, Statutes of 2000 (SB 1435—Johnston) requires CalSTRS to pay the Medicare Part A premiums for those eligible retired members of the DB Program effective July 1, 2001, including any penalties applicable to enrollment in Parts A or B by eligible members who enroll after age 65. It requires those premiums to be paid from the Teachers' Health Benefit Fund, created by the bill.

Chapter 874, Statutes of 2000 (AB 2383—Keeley), among other provisions, requires CalSTRS to report to the Legislature on a prescription drug program and a health benefits program for retired members, and authorizes the California Public Employees' Retirement System to submit a proposal to administer a health benefits program for CalSTRS retirees and their dependents.

## **CURRENT PRACTICE**

### **Defined Benefit Supplement Program**

The CalSTRS DBS Program was established by Chapter 74, Statutes of 2000 (AB 1509—Machado) to provide supplemental retirement benefits to all future and current active members of the DB Program. Chapter 74 also directs 25 percent of members' contributions (two percent of creditable compensation) from January 1, 2001 until January 1, 2011 that would otherwise go to the DB Program, into a separate nominal account in the DBS Program. In addition, as a result of Chapter 1021, Statutes of 2000 (AB 2700-Lempert) beginning (probably) July 1, 2002, any contributions to CalSTRS for service in excess of 1.000 years per school year, will be credited to a member's DBS account.

Members' DBS account balances are credited with interest at a guaranteed minimum rate. If actual earnings are higher, the Teachers' Retirement Board (Board) may declare an additional earnings credit to DBS accounts. In addition to receiving their normal DB allowance upon retirement, members receive the balance in their DBS account in either a lump sum or as the monthly actuarial equivalent. Members who accumulate a minimum of \$3,500 in their DBS account may choose an annuity option at retirement, at the time the disability application is approved, or, the beneficiary of a deceased member may elect the annuity option upon the member's death.

### **Health Care Benefits for Retired Teachers**

The availability of health care benefits for retired CalSTRS members varies among the membership and has historically been provided by school district employers on a district-by-district basis. Some districts provide full health care benefits, paying 100 percent of the premiums for medical, dental and vision insurance to retired teachers and their dependents, while other districts provide vested health insurance benefits to their retired employees, or offer benefits only until the age of 65. Still other districts do not provide any health care coverage to their retired employees. As a service to the retired member, CalSTRS deducts monthly health care premiums from retirement allowances at the member's request, and forwards the money to the appropriate provider.

An estimated 7,000 to 9,000 currently retired CalSTRS members over age 65 are not eligible for Medicare Part A either from their employment or through their spouse, while up to an additional 18,000 currently active members would not be eligible once they reach the age of 65.

Pursuant to Chapter 1032, Statutes of 2000 (SB 1435—Johnston), beginning July 1, 2001, CalSTRS will pay the Medicare Part A hospitalization premiums of DB Program members who retired prior to January 1, 2001, and are ineligible to receive premium-free coverage, provided they enroll in Medicare Parts A and B by the age of 65 or on July 1, 2001, whichever is later. As authorized under current law, the Board voted in May to extend the program to pay the Part A premiums of members who retire prior to January 1, 2006, provided they meet certain conditions specified in Chapter 1032.

Pursuant to Chapter 874, Statutes of 2000 (AB 2383—Keeley) CalSTRS conducted a review of potential benefit programs designed to extend health care coverage to all retired members. The resulting report evaluated six different health care options:

- Provide and fund a prescription drug plan
- Fund participation by retired members in local district medical plans
- Provide and fund a statewide health benefit program for all retired members
- Provide and/or fund local and statewide Medicare supplement plans
- Fund individual retired member health benefit premium payments
- Administer healthcare security accounts for active members' use upon retirement

The AB 2383 report recommended that the Legislature enact legislation, subject to the availability of resources to CalSTRS, to establish a catastrophic prescription drug plan to pay retired members' prescription drug costs above a specified level, and establish individual nominal health benefit accounts for retired members to pay Medicare Part B premiums or an equivalent subsidy.

**DISCUSSION**

SB 191:

- Annually credits funds to each member's DBS Account beginning January 1, 2002, based on his or her years of credited service, as specified in the chart below. A member's years of credited service is calculated from July 1 of the prior year, and any additional partial year of credited service greater than 75 percent must be rounded to the next highest year.

<b>Years of Credited Service</b>	<b>Amount of Credit to Member's Account</b>
5	\$5,000
10	\$5,000
15	\$5,000
20	\$500
21	\$1,000
22	\$1,500
23	\$2,000
24	\$2,500
25	\$5,000
26	\$3,000
27	\$3,500
28	\$4,000
29	\$4,500
30	\$10,000
31	\$5,000

32	\$6,000
33	\$7,000
34	\$8,000
35	\$20,000
36 or more	\$10,000

- Establishes the Teachers' Medicare Benefit Supplemental (TMBS) Program to pay the Medicare Part B premiums of all active and retired members of the DB program that are age 55 and older on January 1, 2002.
- Creates Supplemental Health Insurance Accounts (SHIA) as nominal accounts for each member of the DB Program who retired for service or disability before January 1, 2000. The Board would annually credit \$600 (or the cost of Medicare Part B premiums, whichever is higher) to each SHIA beginning July 1, 2002, with interest accruing on the account balance at a rate guaranteed by the Board. Eligible members could use the balance in their accounts to pay premiums for long-term care, health, vision and dental insurance, or Medicare Part B.

According to the bill's sponsor, by making annual credits to member's DBS accounts, with larger amounts awarded at various milestones in credited service, this measure provides teachers a strong incentive to stay in the classroom, and provides a benefit that does not discriminate based on salary. In addition, providing Medicare Part B coverage and establishing individual SHIA for retired teachers builds upon CalSTRS' MB Program and provides discrete funds to pay for a variety of health care benefits chosen by the member.

**Defined Benefit Supplement Payments**

This measure adds to the types of contributions that can be made to DBS accounts by requiring the Board to credit funds to member's accounts above and beyond the percentage of creditable compensation active members and employers contribute. CalSTRS staff is working with the author's office to amend this section of the bill to more closely reflect the sponsor's intent.

For example, the bill states that the payments to member DBS accounts will occur on an annual basis, however, the table indicating the payment amounts make it appear that prior to the 20<sup>th</sup> year there will only be three deposits made to member accounts at the 5, 10, and 15-year marks. The bill's language should be clarified to reflect the sponsor's intent that members' DBS accounts are credited for a particular level of service only once. CalSTRS staff also recommends that the date the System is required to calculate members' years of credited service should be changed from July 1 to June 30, to conform with current practice whereby service credit is accrued and calculated from the beginning to the end of each month. This will also coincide with the end of the school and fiscal years.

**Teachers' Medicare Benefit Supplemental Program**

Retired members ages 65 and older who receive Medicare Part A coverage have the option to purchase Medicare Part B coverage for their outpatient care and doctor visits for \$50 per month. The Teachers' Medicare Benefit Supplemental (TMBS) Program established by this bill would

fund the Medicare Part B premiums of approximately 246,000 active and retired members of the DB Program who will be age 55 or older at the time the program would become effective.

According to the AB 2383 report on potential health care benefit programs, nearly all retired CalSTRS members who participate in Medicare must purchase their own Part B coverage, regardless of whether they receive premium-free Part A coverage. Members have traditionally paid Part B premiums by sending quarterly payments directly to the federal Health Care Financing Administration (HCFA) which administers the Medicare Program, or having the premium amount deducted from any Social Security checks they may be receiving. Beginning in June 2001, CalSTRS will deduct \$50 from the monthly allowance checks of MB Program participants and those retired members receiving premium-free Part A coverage that elect to have CalSTRS forward their Part B payments to HCFA. As a result, much of the administrative effort to implement Medicare Part B payments through CalSTRS has been completed.

Under federal procedures, retired members who receive premium-free Part A coverage through previous employment have their Part B premiums deducted directly from their Social Security, Railroad Retirement, or federal Civil Service Retirement checks. If the Teachers' Medicare Benefit Supplemental Program is implemented, CalSTRS would be required to develop a process to directly reimburse members whose Part B premiums are paid from any federal retirement benefit checks they may be receiving.

As drafted, members already retired for service who are under age 55 on the program's effective date would be ineligible for the premium-free Part B benefit. In addition, members with district provided lifetime health care coverage and do not participate in Medicare would receive no benefit under the Teachers' Medicare Benefit Supplemental Program.

### **Supplemental Health Insurance Accounts**

Currently, CalSTRS is able to deduct the cost of health care premiums from a member's allowance and forward the money to the appropriate provider at their request. Under this provision, CalSTRS would be required to establish approximately 147,000 nominal accounts for members of the DB Program who retire before January 1, 2001, and credit each account with \$600 per year to pay insurance premiums, including Medicare Part B, on the member's behalf directly to the medical, dental, vision or long-term care insurer of their choice. The \$600 credit to members' Supplemental Health Insurance Accounts (SHIA) would increase with increases in the Part B premium.

According to the AB 2383 report on potential health care benefit programs, the value of this type of benefit lies in its ability to provide financial assistance to all eligible members, regardless of the insurance coverage they select. In addition, individual accounts do not affect the health care options that school districts may provide to their retired members.

As part of the report, the Board recommended that CalSTRS pay a member's Medicare Part B premiums or provide an equivalent subsidy. For those members whose Part B premiums are paid from other sources, the CalSTRS funds could be used to pay other health benefit payments.

CalSTRS would establish these accounts for current and future retired members, who would receive the benefit upon reaching age 65.

**FISCAL IMPACT**

Benefit Program Costs –According to the CalSTRS' consulting actuary, the total present value of costs resulting from this bill would be approximately \$6.556 billion.

	<b>Present value cost (in millions)</b>	<b>Increase in annual contributions needed as a percent of payroll</b>
Normal cost increase of future service	\$0	0.000%
Actuarial obligation for prior service <sup>1</sup>	\$6,556	2.316%
<b>Total costs</b>	<b>\$6,556</b>	<b>2.316%</b>

<sup>1</sup> Amortized over 30 years

This actuarial impact would result in the following expenditures over the first three full fiscal years (in millions of dollars):

	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>
Total benefit payment increase	\$634.1	\$807.6	\$795.0
Annual increase in contributions (funding) needed to fund benefit <sup>2</sup>	--	\$480.3	\$500.7

<sup>2</sup> Based on a payroll of \$20.7 billion in 2002-03, increasing by 4.25 percent annually

This total cost is allocated among the individual proposals, as follows:

**Defined Benefit Supplement Payments**

Crediting member's DBS accounts as specified in this bill over the next 10 years would have a total cost of \$3.679 billion.

	<b>Present value cost (in millions)</b>	<b>Increase in annual contributions needed as a percent of payroll</b>
Normal cost increase of future service	\$0	0.000%
Actuarial obligation for prior service <sup>1</sup>	\$3,679	1.087%
<b>Total costs</b>	<b>\$3,679</b>	<b>1.087%</b>

<sup>1</sup> Amortized over 30 years

This actuarial impact would result in the following expenditures over the first three full fiscal years (in millions of dollars):

	2002-03	2003-04	2004-05
Total benefit payment increase	\$587.8	\$561.6	\$540.0
Annual increase in contributions (funding) needed to fund benefit <sup>2</sup>	--	\$225.4	\$235.0

<sup>2</sup> Based on a payroll of \$20.7 billion in 2002-03, increasing by 4.25 percent annually

**Teachers' Medicare Benefit Supplemental Program**

Paying Medicare Part B premiums for all members who are at least age 55 by January 1, 2002 would result in an estimated present value total cost of \$1.984 billion, assuming that Part B premiums increased by five percent annually.

	Present value cost (in millions)	Increase in annual contributions needed as a percent of payroll
Normal cost increase of future service	\$0	0.000%
Actuarial obligation for prior service <sup>1</sup>	\$1,984	0.810%
Total costs	\$1,984	0.810%

<sup>1</sup> Amortized over 30 years

This actuarial impact would result in the following expenditures over the first three full fiscal years (in millions of dollars):

	2002-03	2003-04	2004-05
Total benefit payment increase	\$0.0	\$149.3	\$154.3
Annual increase in contributions (funding) needed to fund benefit <sup>2</sup>	--	\$168.0	\$175.1

<sup>2</sup> Based on a payroll of \$20.7 billion in 2002-03, increasing by 4.25 percent annually

**Supplemental Health Insurance Accounts**

Crediting \$600 per year, adjusted for increases in Part B premiums, to an account to pay member health care costs for all members who retired before January 1, 2001 would result in an estimated present value of total costs of \$893 million, assuming Part B premiums increased by five percent annually.

	<b>Present value cost (in millions)</b>	<b>Increase in annual contributions needed as a percent of payroll</b>
Normal cost increase of future service	\$0	0.000%
Actuarial obligation for prior service <sup>1</sup>	\$893	0.419%
<b>Total costs</b>	<b>\$893</b>	<b>0.419%</b>

<sup>1</sup> Amortized over 30 years

This actuarial impact would result in the following expenditures over the first three full fiscal years (in millions of dollars):

	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>
Total benefit payment increase	\$46.3	\$96.7	\$100.7
Annual increase in contributions (funding) needed to fund benefit <sup>2</sup>	--	\$86.9	\$90.6

<sup>2</sup> Based on a payroll of \$20.7 billion in 2002-03, increasing by 4.25 percent annually

Administrative Costs – Due to the multiple provisions and unresolved issues in this bill, the administrative costs cannot be determined at this time. However, the programming costs to implement the provisions of this measure are estimated to be over \$1 million.

## **BOARD POSITION**

Support, if amended to identify funding to finance the program costs, and consolidate the two health benefit proposals to reflect the Board's recommendation in the AB 2383 report to the Legislature on health care to establish a single program to pay retired members' Medicare Part B premiums or an equivalent subsidy for their health care expenses. In addition, technical amendments discussed earlier are needed to clarify provisions of the proposal to make credit specified dollar amounts to members' DBS accounts.