BILL NUMBER: SB 1031 (Moorlach) as introduced February 8, 2018

SUMMARY

SB 1031 prohibits public retirement systems from providing a cost-of-living adjustment (COLA) to benefits when the unfunded actuarial liability of the system is greater than 20 percent based upon the system's Comprehensive Annual Financial Report.

BOARD POSITION

Oppose. The board's policy is to oppose legislation that deprives members or participants of vested benefits. The board also opposes 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.

REASON FOR THE BILL

According to the author, "effecting freezes on cost-of-living adjustments will help to curb accruing further unfunded pension liabilities."

ANALYSIS

Existing Law:

Pursuant to Education Code sections 22140 and 22141, CalSTRS benefits include an improvement factor equal to 2 percent of the original benefit amount, which is not tied to inflation. This benefit was guaranteed for members retiring after January 1, 2014, in exchange for higher member contribution rates paid under the CalSTRS Funding Plan (AB 1469–Bonta). The Legislature has the authority to adjust the 2 percent improvement factor up or down as economic conditions dictate only for members who retired prior to January 1, 2014. For individuals who performed service on or after January 1, 2014, the 2 percent improvement actor is a "vested benefit pursuant to a contractually enforceable promise."

Pursuant to Chapter 29 of Part 13 of the Education Code, CalSTRS also provides quarterly supplemental payments to benefit recipients whose purchasing power has declined below 85 percent of the initial allowance. Since 2001, contributions from the state's General Fund to the Supplemental Benefit Maintenance Account (SBMA) to fund supplemental purchasing power payments have been a contractually enforceable obligation of the state. As set forth in Education Code section 22954, it was the intent of the Legislature in establishing a continuous appropriation to the SBMA to establish supplemental payments as vested benefits pursuant to a contractually enforceable promise. While the benefits and the continuous appropriation are vested, the level of benefits is not. If the board determines that the SBMA will not have sufficient funds, the board may reduce the level to 80 percent of purchasing power or, if the reserve is completely depleted, to the amount that can be funded by the annual appropriation. The monies held by the SBMA cannot be transferred to other program accounts in the

Teachers' Retirement Fund. In 2017-18, a beneficiary or member whose benefit effective date was in 1994 or earlier received a supplemental payment.

This Bill:

Specifically, SB 1031 prohibits public retirement systems from providing a COLA to benefits when the unfunded actuarial liability of the system is greater than 20 percent based upon the system's Comprehensive Annual Financial Report.

It is not clear how this provision would apply to CalSTRS. The 2 percent simple improvement factor cannot be reduced or eliminated for future retirees, so any savings to the DB Program would be restricted to pre-2014 retirees and would not be long term. Freezing the improvement factor for those retired prior to January 1, 2014, would result in improved funding for the DB Program, partially at the expense of the SBMA. After adjusting for inflation, the purchasing power of benefits for these members would decline following implementation of the bill but would ultimately stabilize at an amount equal to 85 percent of their original purchasing power once quarterly supplemental payments commence. This would correspondingly deplete the SBMA at an accelerated rate, which would likely lead the board to reduce the purchasing power level to 80 percent or less when it becomes necessary to fund the benefit on a pay-as-you go basis.

CalSTRS is making steady progress towards full funding of the plan as provided by the CalSTRS Funding Plan. Under current law and based on projections by CalSTRS actuaries, the fund is expected to reach an 80 percent funded ratio by approximately 2034. Since the improvement factor is provided through the Defined Benefit (DB) Program, a freeze of the improvement factor could improve program funding in the short term, and the DB Program may reach an 80 percent funded ratio at an earlier date than currently projected. At that point, the DB Program would be authorized to provide the improvement factor, and the funded ratio could oscillate above and below 80 percent until it ultimately stabilizes to more than 80 percent by approximately 2034.

LEGISLATIVE HISTORY

SB 32 (Moorlach, 2016) would have prohibited public retirement systems from making cost-of-living adjustments to benefits when the unfunded actuarial liability of either CalSTRS or CalPERS is greater than zero. This bill was held in the Senate Public Employment and Retirement Committee.

AB 1469 (Bonta, Chapter 47, Statutes of 2014) increased member, employer and state contributions for purposes of fully funding the DB Program by June 30, 2046. In addition to the scheduled member, employer and state contribution increases, the law allows the board to make limited adjustments, if necessary, to state contribution rates beginning July 1, 2017, and employer contribution rates beginning July 1, 2021.

AB 1381 (PER&SS, Chapter 559, Statutes of 2013) made various technical corrections and conforming changes that align the Teachers' Retirement Law with the provisions of the Public Employees' Pension Reform Act (PEPRA), as enacted in AB 340 (Furutani).

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

PROGRAM BACKGROUND

CalSTRS administers a hybrid retirement system, consisting of traditional defined benefit, cash balance and optional defined contribution plans. CalSTRS members receive a modest benefit that is based on a formula using a member's years of service credit, age and final compensation. The median CalSTRS retiree in 2016–17 was nearly 63 years old, retired with over 25 years of service credit and is receiving a benefit that replaces less than 60 percent of salary. CalSTRS members do not participate in or receive Social Security for their CalSTRS-covered service.

Inflation can deteriorate a person's ability to maintain a consistent standard of living after retirement. The purchasing power of CalSTRS benefits is supported in two ways: through a 2 percent simple improvement factor, which is not tied to inflation, and through supplemental payments. Currently, supplemental payments paid from the SBMA restore 85 percent of the original purchasing power of CalSTRS benefits, and sufficient funds are projected to maintain that benefit level through the 2089 funding period established by the board.

The funded status is the ratio between CalSTRS current assets and the obligations facing the system, which as of the June 30, 2016, actuarial valuation is 63.7 percent. The funded status by itself is less relevant in determining the long-term viability of a pension fund than the direction in which the funding level is headed. In response to the expected long-term depletion of the fund, in 2014, California enacted Chapter 47, Statutes of 2014 (AB 1469–Bonta), which implemented a funding plan for the DB Program through June 30, 2046, with shared contribution increases by the state, employers and members phased in over several years. The funding plan also gave the board limited rate-setting authority to adjust the state and employer contribution rates. Even with recent changes to economic and demographic assumptions, the funding plan's scheduled increases and limited board authority have put CalSTRS on a path towards full funding by 2046.

OTHER STATES' INFORMATION

In recent years, many other states have made changes to their state retirement systems' COLAs. According to the National Association of State Retirement Administrators, since 2009, 17 states changed COLAs affecting current retirees, seven states addressed current employees' benefits, and seven states changed the COLA structure for future employees only. The legality of these modifications has been challenged in court in several states.

FISCAL IMPACT

Program Cost – Potential short-term savings to the Defined Benefit Program, including the possibility of costs leading to the accelerated defunding of the SBMA.

Administrative Costs/Savings – Small technology impact as programming changes would be required for CalSTRS pension administration system. Resources would be needed to update publications, training and educational materials and to train staff.

SUPPORT

None known.

OPPOSITION

None known.

ARGUMENTS

Pro: Potentially creates short-term program cost savings.

Con: Challenges the vested rights of CalSTRS 2% at 60 and 2% at 62 members.

Introduces financial insecurity for new and existing member and retirees.

Creates the need for changes to CalSTRS current and new pension administration systems.

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