BILL NUMBER: SB 32 (Moorlach) as amended March 2, 2017

SUMMARY

Among the proposed reforms in SB 32, CalSTRS would be affected by the provisions that create the Citizens' Pension Oversight Committee to advise the CalSTRS and CalPERS boards; further define "normal monthly rate of pay or base pay" for CalSTRS 2% at 62 members; increase the final compensation period for new members on or after January 1, 2018, to at least 60 consecutive months; prohibit 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; and stipulate the applicable benefit structure for new members who leave employment with, and then are reemployed by, an employer participating in CalSTRS.

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 or that would be impracticable to administer.

REASON FOR THE BILL

According to the author, the California Public Employees' Pension Reform Act of 2013 (PEPRA) has several weaknesses and has had a negligible impact.

ANALYSIS

Existing Law:

Each year, as required by law, CalSTRS prepares a Comprehensive Annual Financial Report (CAFR), which is provided to the Governor and the Legislature and posted on the CalSTRS website. The CAFR is produced in accordance with Governmental Accounting Standards Board requirements. An independent audit of CalSTRS financial statements is performed each year and is distributed and posted online as part of the CAFR. In addition, the California Actuarial Advisory Panel provides independent and impartial information on pensions and related issues to the Legislature each year.

CalSTRS has two benefit structures, CalSTRS 2% at 60 and CalSTRS 2% at 62. Members under the 2% at 62 benefit structure are those first hired to perform creditable service activities on or after January 1, 2013. In addition to other provisions, PEPRA required final compensation for new members to be calculated using the highest 36 consecutive months of pensionable compensation, and restricted "pensionable compensation" for new members to compensation that is the "normal monthly rate of pay or base pay."

CalSTRS benefits include an annual benefit adjustment equal to 2 percent of the original benefit amount, which is not tied to inflation. This benefit was guaranteed in exchange for higher member contribution rates paid under the 2014 funding plan (AB 1469–Bonta). The Legislature has the authority to adjust the 2 percent annual benefit adjustment 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 annual benefit adjustment is a “vested benefit pursuant to a contractually enforceable promise.”

In addition, the Supplemental Benefit Maintenance Account (SBMA) provides annual supplemental payments to benefit recipients whose purchasing power has declined below a set level of the initial allowance, as long as funds are available. The board has broad administrative authority over funding policy and distribution of those funds. Since 2001, contributions from the General Fund to the SBMA have been a contractually enforceable obligation of the state. Pursuant to 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. The monies held by the SBMA cannot be transferred to other program accounts in the Teachers’ Retirement Fund.

This Bill:

SB 32 creates the Citizens' Pension Oversight Committee to advise the CalSTRS and CalPERS boards and to report to the public on actual pension costs and obligations. These provisions establish a committee to conduct a function already performed by the board, likely introducing inefficiency by adding a committee with a redundant role and by requiring the CalSTRS and CalPERS boards to jointly appoint the committee. The bill does not specify whether or how committee members are compensated, how the committee would be staffed or how the activities and reporting mandates of the committee would be funded.

SB 32 further defines “pensionable compensation” for members subject to PEPRA to exclude “incentive pay, educational pay, premium pay, special assignment pay or holiday pay.” It is not clear how this provision affects CalSTRS, as the terms are specific to CalPERS. However, certain types of pay that could potentially fall under the specified categories are currently accepted as creditable compensation for 2% at 62 members when otherwise payable to the entire class of employees and paid each pay period in which creditable service is performed, in accordance with Education Code section 22119.3. Since this provision is retroactive, and depending upon the extent to which it affects CalSTRS, it may present a significant administrative burden to CalSTRS and to employers who would be required to re-report compensation that has been accepted as creditable for more than four years. It also presents a potentially significant reduction in benefits for CalSTRS 2% at 62 members.

SB 32 bases final compensation for new members on a period of at least 60 consecutive months. This measure creates a new benefits tier for new members on or after January 1, 2018, increasing plan complexity and potentially improving long-term funding projections. Extending the period of time used to calculate final compensation would result in a lower normal cost and a reduced benefit for new members. Over the long term, it would reduce Defined Benefit (DB) Program liability and would minimize the impact of late career pay increases on a member's benefit. The following example describes the impact the bill would have on a 2% at 62 member earning $75,000 five years prior to retirement, with an assumption of 4.4 percent annual salary increases over the next five years, and retiring with 25 years of service credit:

	Monthly service retirement benefit
Calculation using 3-year final compensation	$ 3,558.11
Calculation using 5-year final compensation	$ 3,412.37
Difference	**$ 145.75**

SB 32 requires that new members who separate from employment for a different employer that does not participate in the public retirement system and return after more than one year receive the same benefits as a new member of the retirement system for service rendered after that date. This bill removes a key aspect of retirement security for new members on or after January 1, 2018: the ability to remain in a benefits tier after a departure from service of any duration upon returning to work. This increases plan complexity by allowing layers of formulas to comprise an individual's retirement. It also adds complexity to CalSTRS administration, creating a new need to verify employment, as well as type of employment, or non-employment, during breaks in service.

SB 32 prohibits 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. It is not clear how this provision would apply to CalSTRS. Freezing the annual benefit adjustment for those retired prior to January 1, 2014, would result in improved funding for the DB Program, partially at the expense of the SBMA. This would correspondingly deplete the SBMA at an accelerated rate, ultimately leaving it funded on a pay-as-you go basis. The 2 percent annual benefit adjustment cannot be reduced or eliminated for retirees going forward, so any savings to the DB Program would be restricted to pre-2014 retirees and would not be long-term. If it is the author's intent to freeze the SBMA, this constitutes a fundamental change in administration and management of the program, which is currently under the board's purview. Freezing supplemental benefits at their current levels would result in overfunding of the SBMA, with no benefit to DB Program funding. The individual impacts of freezing supplemental benefits, particularly for elderly members, would be substantial.

LEGISLATIVE HISTORY

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 (PERR&SS, Chapter 559, Statutes of 2013) made various technical corrections and conforming changes that align the Teachers' Retirement Law with the provisions of 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 a 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 2015–16 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.

CalSTRS has two benefit structures, CalSTRS 2% at 60 and CalSTRS 2% at 62. Members under the 2% at 62 benefit structure are those first hired under PEPRA to perform creditable service activities on or after January 1, 2013. Key changes for the 2% at 62 benefit structure include: normal retirement age is increased from age 60 to age 62, with the basic retirement formula consequently reduced; the final compensation period for members with more than 25 years of service is increased from 12 months to 36 months; the definition of "creditable compensation" is restricted to remuneration that is paid each pay period in which creditable service is performed; and creditable compensation is limited to an annually established cap (currently $139,320).

A member can maintain his or her status in a benefit structure after a departure from service of any duration upon returning to work. This provides the ability to take a break from employment or try a different career without compromising retirement security.

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 annual benefit adjustment and through supplemental benefits. Currently, supplemental benefits 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.

OTHER STATES' INFORMATION

Almost every state has enacted some form of pension reform over the past decade. However, each state's laws provide varying levels of protection to future benefit accruals.

FISCAL IMPACT

Program Cost – Expected savings to the Defined Benefit Program over the long term with the full impact of the proposal not being felt until most of the active population will be comprised of members subject to this bill. Depending upon the specific impact to CalSTRS' supplemental benefits, potential costs leading to the accelerated defunding of the Supplemental Benefits Maintenance Account.

Administrative Costs/Savings – Significant technological impact, with a large effort to upgrade the existing pension administration system and a very large change of additional unknown cost to the Pension Solution Project that is currently underway. Extensive resources would be needed to update publications, training and educational materials and train staff.

SUPPORT

None known.

OPPOSITION

CalSTRS

ARGUMENTS

Pro: Potentially creates program cost savings.

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

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

Introduces financial insecurity for new and existing members and retirees.

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