

**BILL NUMBER: [SB 868](#) (Cortese) as amended April 18, 2022**

**SUMMARY**

SB 868 provides additional Supplemental Benefit Maintenance Account (SBMA) benefits to members and beneficiaries of between 5% and 15% of their total benefit, effective July 1, 2023, to be paid quarterly. The percentage increase depends on the date that the member retired, became disabled or died.

**BOARD POSITION**

**Support.** The board's policy is to support legislation that expands and improves in a prudent manner the benefits and services provided through the funds administered by CalSTRS as appropriate for public retirement plans using available surplus assets of the SBMA.

**REASON FOR THE BILL**

CalSTRS members who retired before 1999 receive comparatively less in benefits than their peers who retired in the early 2000s and after, making it difficult for them to keep pace with rising inflation and California's complex economy. The SBMA, which provides up to 85% purchasing power protection to CalSTRS' oldest retirees, had projected excess resources of \$11.9 billion as of June 30, 2021. This means the current funds in the SBMA, along with future contributions from the state, exceed the amount needed to maintain the 85% purchasing power through 2089 by \$11.9 billion. SB 868 provides that a portion of these excess resources be used to ensure these retirees receive the fiscal support they need in today's economy.

**ANALYSIS**

**Existing Law:**

The SBMA is a special account in the Teachers' Retirement Fund that provides annual supplemental payments, in quarterly installments, to all benefit recipients whose purchasing power has fallen below 85% of the purchasing power of their initial allowance. It is an important part of the benefit package for California educators, providing needed inflation protection.

The SBMA is funded by an annual State General Fund transfer equal to 2.5% of total creditable compensation from the fiscal year ending in the prior calendar year, reduced by \$72 million each fiscal year. This contribution is in addition to the state's contribution to fund the Defined Benefit (DB) Program. The SBMA is also funded with revenues from the use of state school lands and lieu lands. The assets in the SBMA are credited each year at the rate of investment return assumed for the DB Program, currently 7%, regardless of the actual return on assets. Funding from the General Fund to the SBMA is a contractually enforceable obligation of the state, whereas the SBMA payments are only vested to the extent that there are funds in the account.

Current law authorizes the board to adjust purchasing power protection payments between no less than 80% and no more than 85% of the initial benefit based on actuarial projections through a period established by the board. If funding is not sufficient to bring purchasing power up to the 85% level, supplemental payments may have to be paid at a lower level.

For purposes of measuring the purchasing power level of allowances and inflation, CalSTRS uses the All-Urban California Consumer Price Index (CCPI). The current board-approved long-term assumed rate of inflation on which actuarial projections regarding the system's ability to continue providing purchasing power protection from the SBMA is 2.75%. According to board-adopted regulations, the actuarial analysis and projection is performed every two years, with June 30, 2089, established as the date through which purchasing power protection should be sustained.

Annual supplemental payments begin once a member's benefit qualifies and are issued from the SBMA quarterly on October 1, January 1, April 1 and July 1. Each year, CalSTRS calculates the inflation for the previous fiscal year and assesses the level of purchasing power for CalSTRS benefit recipients. Today, a member is deemed to be eligible to receive a benefit from the SBMA if the monthly benefit is below 85% of the fully indexed benefit.

It is important to remember that these payments are not guaranteed and will continue only as long as funds are available.

**This Bill:**

SB 868 provides additional SBMA benefits to members and beneficiaries through an increase that applies to the total benefit currently being paid, effective July 1, 2023. This increase is subject to a 2% annual benefit adjustment and any applicable purchasing power protection, both of which are funded from the SBMA. The increase is to be paid quarterly. The percentage increase is based on the year the member retired, became disabled or died and applies only to CalSTRS members and beneficiaries of members who began receiving a benefit prior to 1999 as follows:

<u>Period during which retirement, disability or death occurred:</u>	<u>Percentage increase:</u>
After December 31, 1998	0%
Between January 1, 1990, and December 31, 1998	5%
Between January 1, 1980, and December 31, 1989	10%
Prior to January 1, 1980	15%

The increase provided by SB 868 is not part of the base allowance and is payable only to the extent SBMA funds are available after providing all other purchasing power protection.

For illustrative purposes, the two tables below show the estimated impact to benefit recipients who were receiving a benefit as of June 30, 2021, assuming the proposed increase was applied to benefits paid in 2021-22. Based on the data as of June 30, 2021, a total of about 55,000 benefit recipients would receive a benefit increase from SB 868. Of these benefit recipients, about 39,000 are female, and about 16,500 are male.

Female

<u>Period during which retirement, disability or death occurred</u>	<u>Count</u>	<u>Current Average Total Monthly Benefit</u>	<u>Expected Increase in Monthly Benefit as a Result of SB 868</u>
Between January 1, 1990, and December 31, 1998	27,867	\$3,109	\$155
Between January 1, 1980, and December 31, 1989	9,592	\$2,570	\$257
Prior to January 1, 1980	1,413	\$2,092	\$314

Male

<u>Period during which retirement, disability or death occurred</u>	<u>Count</u>	<u>Current Average Total Monthly Benefit</u>	<u>Expected Increase in Monthly Benefit as a Result of SB 868</u>
Between January 1, 1990, and December 31, 1998	12,968	\$3,714	\$186
Between January 1, 1980, and December 31, 1989	3,292	\$3,142	\$314
Prior to January 1, 1980	292	\$2,049	\$307

**LEGISLATIVE HISTORY**

AB 1389 (Budget, Chapter 751, Statutes of 2008) provided the board with the authority to adjust purchasing power protection payments between no less than 80% and no more than 85% of the initial benefit based on actuarial projections. Changed the state contribution requirement to allow the state to reduce its annual contribution of 2.5% of payroll by \$72 million. Required the board to develop options for excess resources if funds are available beyond the amount needed to maintain 85% purchasing power through the specified period of time.

AB 135 (Havice, Chapter 840, Statutes of 2001) increased purchasing power for members and beneficiaries from 75% to 80% of their original purchasing power.

AB 1102 (Knox, Chapter 1006, Statutes of 1998) guaranteed a funding stream for purchasing power protection payments and vested the purchasing power benefits to the extent funds are available in the SBMA.

SB 1026 (Schiff, Chapter 939, Statutes of 1997) increased purchasing power protection from 68.2% to 75%. Specified the General Fund would continue to contribute 2.5% of prior year teacher payroll to the SBMA. Authorized the board to decrease the benefit when the 2.5% General Fund contribution is insufficient to support 75% purchasing power.

SB 1513 (Campbell, Chapter 116, Statutes of 1989) required an annual distribution from the SBMA in non-vested quarterly payments to member and beneficiaries to restore purchasing power up to 68.2% of their original purchasing power.

SB 1407 (Green, Chapter 115, Statutes of 1989) established the SBMA as a separate account, in the Teachers' Retirement Fund. Required an annual transfer from the General Fund of percentages, increasing annually, to a maximum of 2.5% of the total of prior year teacher payroll to the SBMA.

## **PROGRAM BACKGROUND**

The first level of inflation protection provided to CalSTRS members and beneficiaries is through an annual benefit adjustment of 2% of the initial benefit provided by the DB Program. This adjustment, also known as the improvement factor, is a simple adjustment; it is not indexed to inflation nor compounded. Because of these features, the purchasing power of a member's initial allowance can be depleted, and their ability to maintain a consistent standard of living after receiving a benefit can significantly deteriorate.

Prior to the establishment of any CalSTRS inflation protection programs, inflation protection was historically provided in the form of ad hoc increases. However, periods of high inflation in the late 1970s and early 1980s made it clear that using ad hoc increases was not a sustainable approach to providing inflation protection. In 1982, the Retirees' Purchasing Power Protection Account (RPPPA) was created, and since then, both the amount of the purchasing power protection and the funding levels for these programs have varied over time. The funding of these programs has always been the sole responsibility of the state. Beginning with fiscal year 1983-84, revenues from the use of state school lands and lieu lands were also used to fund these programs, in addition to the appropriations made by the state.

In 1989, the SBMA was established to provide inflation protection to replace the RPPPA. Since its establishment, the laws governing inflation protection and the SBMA have been changed on multiple occasions. From 1989 through 2001, as funding from the state increased and inflation decreased, the purchasing power level was increased incrementally from 68.2% to 80%.

In 1999, legislation established a minimum guaranteed benefit of \$15,000 to \$20,000, based on years of service, for members that had between 20 and 30 or more years of service. In 2000, legislation was passed authorizing an ad hoc increase, which provided benefit increases to CalSTRS benefit recipients of between 1% and 6%. The increase amount was based on the year the member retired, became disabled or died and was only provided to those who began receiving a benefit prior to 1998.

Chapter 751, Statutes of 2008 (AB 1389—Assembly Budget Committee), provided the board with the authority to adjust purchasing power protection payments between no less than 80% and no more than 85% of the initial benefit based on actuarial projections. This legislation also changed the state contribution requirement to allow the state to reduce its then annual contribution of 2.5% of payroll by \$72 million. Both the state contribution and the purchasing power benefit have remained at these levels since 2009.

The board is required to adopt regulations to outline and implement the process to adjust the purchasing power protection provided by the SBMA, including the timing and frequency of actuarial projections. The regulations adopted by the board in 2009 require an actuarial analysis to be performed at least every two years. The regulations also establish June 30, 2089, as the date through which the purchasing power should be sustained and require the board to re-evaluate that sustainability date sometime between 2019 and 2029.

Additionally, statute requires the board to develop options for the use of funds that are in excess of the amount needed to maintain 85% purchasing power protection through the term established. The options must be for the exclusive benefit of members and beneficiaries, and at least one of the options must be an increase in benefits paid to those members who began receiving a benefit before 1999 and their beneficiaries. A summary of the proposed options is required to be submitted to the Governor and specified legislative entities.

The most recent report was presented to the board May 4, 2022, and was based on the June 30, 2021, actuarial analysis, which projected that the current assets in the SBMA, along with expected future contributions from the state, exceeded the amount needed to maintain 85% purchasing power through June 30, 2089, by \$11.9 billion. The report included two options for the use of projected resources. The increase proposed by SB 868 reflects Option 1. The board reviewed the two options and supported Option 1. It is the option that will help CalSTRS retired members most in need of assistance while not compromising the financial integrity of the SBMA and its ability to provide inflation protection long term.

Because SBMA payments are not guaranteed and will continue only as long as funds are available, higher inflation could deplete the funds available much more quickly than expected if it continues to exceed the assumption over an extended period of time. The current board-approved long-term assumption for inflation used in the actuarial analysis is 2.75%. For the last four years, inflation has exceeded this assumption three times. Inflation was 3.9% in 2017-18, 3.1% in 2018-19, 1.4% in 2019-20 and 4.4% in 2020-21. So far in 2021-22, inflation is on pace to far exceed 2.75%.

## FISCAL IMPACT

Program Costs/Savings – A full cost analysis has been performed by Milliman, CalSTRS consulting actuary, which includes an in-depth discussion of risks and the sensitivity of the SBMA to future inflation. In summary, it is estimated that SB 868 will increase the present value of future benefits by \$592 million, reducing the projected excess resources as of June 30, 2021, from \$11.9 billion to \$11.3 billion. This amount reflects known inflation in California through December 31, 2021, and assumes inflation will be at the assumed level of 2.75% in the future. To the extent inflation is higher than 2.75% long term, the cost may be greater.

The likelihood that the funds in the SBMA will be sufficient to maintain inflation protection at the current level of 85% through June 30, 2089, would be reduced from 66% without the benefit increase proposed by SB 868 to 65% with the proposed increase, a reduction of 1%. This probability of sufficiency is based on modeling varying levels of inflation in the future but does not consider variation in other key assumptions such as mortality or future investment returns.

Administrative Costs/Savings – Costs are estimated to be approximately \$500,000 for changes to the existing pension administration system and minor additional costs for additional workload and staff resources. Costs for any necessary changes to the new pension administration system are unknown.

## SUPPORT

Association of California School Administrators (Co-Sponsor)  
California Federation of Teachers (Co-Sponsor)  
California Retired Teachers Association (Co-sponsor)

California Teachers Association (Co-Sponsor)  
Delta Kappa Gamma (Co-Sponsor)  
California School Employees Association  
CalSTRS  
Faculty Association of California Community Colleges

## **OPPOSITION**

None known.

## **ARGUMENTS**

**Pro:** Helps CalSTRS members most in need of assistance while not compromising the financial integrity of the SBMA and its ability to provide inflation protection long term.

Creates more equity among retirement and other benefits.

**Con:** While the SBMA has the projected resource to remain sound, increases benefits when there is an unfunded liability for the DB Program.

## **LEGISLATIVE STAFF CONTACT**

Mary Anne Ashley  
Manager,  
CalSTRS Governmental Relations,  
(916) 414-1981  
[maashley@calstrs.com](mailto:maashley@calstrs.com)

Joycelyn Martinez-Wade  
Director,  
CalSTRS Governmental Relations,  
(916) 414-1980  
[jmwade@calstrs.com](mailto:jmwade@calstrs.com)