



Benefits and Services Committee

Item Number 4 – Open Session

Subject: Lump Sum Death Benefit Analysis

Presenter(s): Tom Buffalo, David Lamoureux and Rick Reed

Item Type: Information

Date & Time: January 25, 2023 – 30 minutes

Attachment(s): Attachment 1 – Benefits Available to Survivors of Active and Retired Members compiled by the National Association of State Retirement Administrators, December 2022.

Attachment 2 – Section 7E-8 of the Board Governance Manual Benefits - Lump Sum Death Benefit for Active and Retired Members

PowerPoint(s): None

Item Purpose

To provide information to the Teachers' Retirement Board (board) on the CalSTRS one-time death benefit and to facilitate a discussion as to whether changes to the existing board policy should be considered regarding potential future adjustments in the death benefit amounts.

Executive Summary

For decades, CalSTRS has provided a one-time lump-sum death benefit for active and retired members. This amount has changed over time, most recently and most often through the board's statutory authority. The current one-time, lump-sum death benefit paid on behalf of active Coverage A members and retired members is \$6,903. The current one-time, lump-sum death benefit paid on behalf of active Coverage B members is \$27,612.

When the board last reviewed the lump-sum death benefit in May 2022, it requested an item be brought to this committee to provide additional information related to the lump sum death benefit. More specifically, the board requested information on the following:

- Purpose of the lump-sum death benefit
- Adequacy of existing benefit levels
- Comparison to other retirement systems

- Consideration for a policy to provide guidance regarding potential future adjustments

Historical records suggest a couple possible purposes for the one-time death benefit: to provide financial stability to the household of the member after their death, and to cover expenses related to the death of a member.

Regarding the adequacy of the existing benefit levels, if the purpose is to cover expenses related to the death of a member, research detailed in this item indicates that average costs associated with the death of a member can average anywhere from \$1,500 for a direct cremation service to \$7,000 for a traditional funeral with burial.

There is considerable variation among other state retirement systems regarding their offering and administration of one-time, lump-sum death benefits. Other systems either do not provide such a benefit, only provide a return of contributions and interest if no annuity is elected, pay a lump-sum benefit based on the member's salary, or pay a flat amount.

The existing board policy does not provide any guidance regarding the basis for adjusting the death benefit. It requires that the lump-sum death benefit be reviewed annually and be based on the results of the most recent actuarial valuation and a recommendation from its consulting actuary. If further guidance is desired by this committee, a discussion could be brought to a future meeting of the board to consider amending the policy to provide such guidance. Several options are discussed in this item including simplifying the options that are provided to the board each May when the one-time death benefit item is presented, specifying increases will always be based on the prior year's inflation numbers, and recommending increases if certain funding conditions are met.

Background

Origin, History, and Purpose of the Lump-Sum Death Benefit

Prior to 1972, upon the death of an active member, CalSTRS provided to the survivors one month's salary for each completed year of membership up to six—meaning the survivors could receive a maximum of six months of the active members salary after the member's death. Upon the death of a retired member, CalSTRS provided a lump-sum death benefit of \$500.

In 1972, the Teacher's Retirement Law was significantly revised under the E. Richard Barnes Act. Considerable changes were made to the retirement, disability and survivor benefits provided by CalSTRS. It established more substantial ongoing benefit payments for the family of an active member who dies before retirement. The lump-sum death benefit of six months' salary previously provided upon the death of an active member was deemed unnecessary and eliminated. It was replaced with a one-time, lump-sum death benefit of \$2,000. The lump-sum death benefit paid following the death of a retired member was increased from \$500 to \$2,000. The \$2,000 one-time lump-sum benefit remained in place until 1992.

A review of historical documents presented to the board did not provide clear evidence as to the intent of the \$2,000 lump-sum death benefit nor why this amount was selected. These documents indicated the \$2,000 was introduced to cover “expenses which arise on any death, whether the deceased teacher be active or retired.” Therefore, one possible purpose of the one-time death benefits could be to cover the additional expenses incurred at the loss of a loved one.

It is worth noting also that \$2,000 was the maximum amount allowed for a lump-sum death benefit to be paid tax-free by the IRS at the time and became a common death benefit amount among pension plans in the United States.

In 1992, further changes were made to the CalSTRS plan design that established Coverage A and Coverage B in compliance with the Older Workers’ Benefit Protection Act of 1990. This legislation also changed the amount of the one-time death benefit for retired and active members. Retired members and Coverage A active members were provided a base one-time death benefit amount of \$5,000 and Coverage B active members were provided a base one-time death benefit amount of \$20,000. Note that all new teachers are subject to Coverage B. Teachers who are subject to Coverage A are those who became CalSTRS members before October 16, 1992, and did not elect to be subject to Coverage B. As of June 30, 2022, about 430,000 active teachers were subject to Coverage B while about 20,000 active teachers were subject to Coverage A.

A review of historical documents presented to the board in 1992 did not provide any clear evidence as to the intent of the lump-sum death benefit nor why \$5,000 was selected when the amount was increased. The 1992 board item did however indicate the \$2,000 existing lump-sum death benefit had significantly decreased in value over the years, potentially implying the benefit was increased to address loss of purchasing power due to inflation.

It is worth noting that, at the time, \$5,000 was the new maximum amount allowed for a lump-sum death benefit to be paid tax-free by the IRS. It is believed this may have played a role in the selection of this exact amount. Note that IRS tax rules have since changed and these types of benefits are now fully taxable.

It is also important to point out why the one-time death benefit amount was increased to \$20,000 for Coverage B active members. When the 1992 changes were implemented to comply with the Older Workers’ Benefit Protection Act of 1990, it resulted in a benefit structure for Coverage B members that was less in value compared to the Coverage A benefit structure. This lesser value was caused by a less costly basic survivor benefit package now offered to Coverage B active members. To ensure these active members had a benefit package of equal value to Coverage A, other benefits were increased, including the one-time lump-sum death benefit for active members. It was increased to four times the Coverage A benefit—totaling \$20,000—to maintain the cost neutrality of both benefit packages. As the Coverage A benefit increases, the Coverage B benefit continues to be an amount equal to four times the Coverage A benefit.

When the 1992 changes were made, consideration was given to have the one-time lump-sum death benefit automatically increased each year based on California inflation. The proposal was

not pursued because of the cost associated with providing automatic increases. Instead, the law was changed to provide the board the authority to increase these amounts, after each actuarial valuation, based on the All Urban California Consumer Price Index.

As per its policy, the board reviews the lump-sum death benefit amount each year after the actuarial valuation has been completed. The board has exercised its authority and adjusted the lump-sum death benefit ten times since 1992. The last increase was provided in May 2022 and was effective July 1, 2022. Currently, upon the death of a retiree, or an active member under Coverage A, CalSTRS pays a one-time death benefit payment of \$6,903. Upon the death of an active member under Coverage B, the one-time death benefit payment amount is \$27,612. Below is a summary of changes in the one-time death benefit amount since 1972.

Table 1. One-time death benefit changes since 1972

Effective Dates	Active Coverage A and Retired Members	Active Coverage B Members	Reason for Change
7/1/1972 to 10/16/1992	\$2,000	Not applicable	Legislative plan design restructuring
10/16/1992 to 6/30/1994	\$5,000	\$20,000	Legislative plan design restructuring
7/1/1994 to 12/31/1996	\$5,110	\$20,440	Board authority
1/1/1997 to 6/30/1998	\$5,227	\$20,908	
7/1/1998 to 6/30/1999	\$5,493	\$21,974	
7/1/1999 to 6/30/2000	\$5,598	\$22,394	
7/1/2000 to 6/30/2001	\$5,763	\$23,052	
7/1/2001 to 6/30/2002	\$6,010	\$24,040	
7/1/2002 to 6/30/2018	\$6,163	\$24,652	
7/1/2018 to 6/30/2021	\$6,372	\$25,488	
7/1/2021 to 6/30/2022	\$6,480	\$25,920	
7/1/2022 to Present	\$6,903	\$27,612	

Note that in any given year, more than 90% of the deaths of CalSTRS members are for retired members. As a result, the smaller one-time death benefit, paid to both retired members and

active Coverage A members is the main lump-sum death benefit paid by CalSTRS. Also, considering how the Coverage B benefit was initially selected, any analysis of the appropriateness of the lump sum death benefit should focus primarily on the smaller post-retirement amount.

Adequacy of Existing Benefit Levels - Costs Associated with the Death of a Member

As suggested by historical records, one possible purpose of the one-time death benefits is to cover the additional expense incurred at the loss of a loved one. No comprehensive public database exists that tracks burial or funeral costs over time. There are, however, other sources of information on this topic.

The National Funeral Directors Association conducted a [survey](#) in July 2021 to gather price information from funeral homes throughout the United States. The NFDA provides cost data for various regions throughout the United States including the Pacific states—Alaska, California, Hawaii, Oregon, and Washington. The NFDA finds the median cost of an adult funeral with viewing and ceremony followed by burial for the Pacific states is \$7,225. The median cost of an adult funeral with viewing and cremation for those same states is \$6,028.

Another source of information is the consumer advocacy group [Funeralocity](#). On their website, they provide information on the cost of funeral services nationwide and at the state level based on their own surveying of funeral homes throughout the United States. They price the cost of four funeral service types. Below are the [costs for those services in California](#) according to Funeralocity.

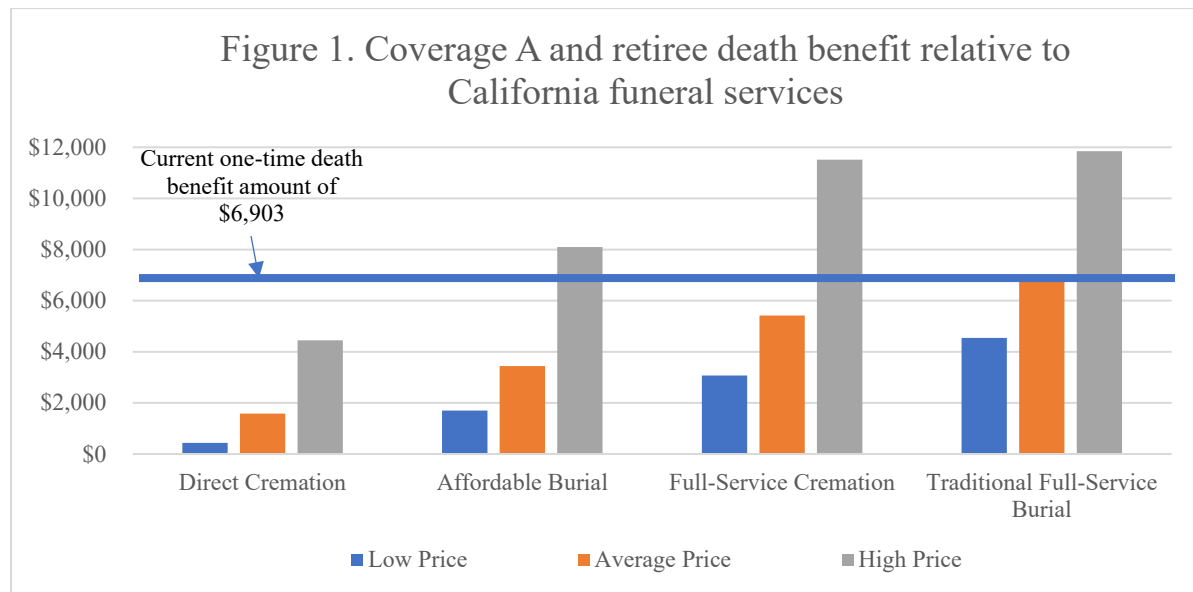
Table 2. Types and costs of funeral services in California according to Funeralocity

Service Type	Low Price	Average Price	High Price
Traditional Full-Service Burial	\$4,540	\$6,893	\$11,845
Full-Service Cremation	\$3,070	\$5,417	\$11,515
Affordable Burial	\$1,700	\$3,442	\$8,100
Direct Cremation	\$438	\$1,580	\$4,450

One notable finding when reviewing cost data for funeral services is the shift in preference from burial to cremation. The NFDA 2021 [Cremation and Burial Report](#) shows the overall cremation

rate in the United States is over 50%. They also project all states will have [cremation rates](#) above 50% by the year 2035. Both the NFDA and Funeralocity data show cremation is the less expensive option when compared to a traditional burial that includes other similar services.

As suggested by historical records, there is some indication the one-time death benefit is intended to cover the costs associated with the death of a member. Below is a visual representation of the one-time death benefit payment for retired members and Coverage A active members in relation to the various costs of funeral services in California according to Funeralocity.



If it was intended for the one-time death benefit for retired members to also cover additional end of life related expenses, based on the above data, only families not electing a traditional full-service burial would likely be able to use part of the death benefit amount to help cover such expenses.

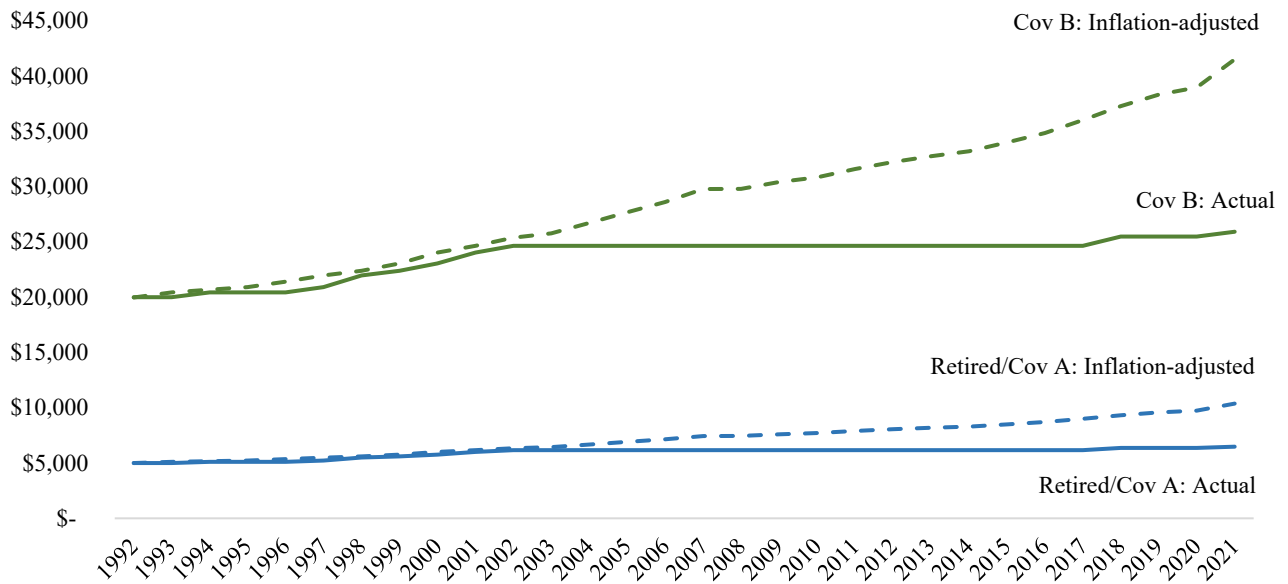
Since the Coverage B is currently at \$27,612, part of the one-time death benefit will be available for additional support to survivors beyond the cost of funeral services in California. It could be used for example to help cover potential loss of earnings in the year of death or even to help eliminate debt.

The Benefit Relative to an Inflation-Adjusted Value

One assessment of the benefit is how it compares to an inflation-adjusted value. The law regarding changes in alignment with inflation is permissive, not prescriptive. As such, the law specifies a minimum amount of the benefit—\$5,000 and \$20,000 respectively—and a maximum amount of the benefit—which represents the amount had the benefits been adjusted with inflation each year since 1992.

Since the board has been granted authority to adjust the benefit with inflation, decisions to increase the death benefit or not have been made by the board in the spring each year, reflecting known inflation as of the previous month of December. Note that the last four times the board increased the death benefit amount, the increase was based on the inflation in California in the previous calendar year. Below is a chart comparing the inflation adjusted benefit amounts for each one-time death benefit each year since 1992 to the actual death benefit amounts.

Figure 3. Actual and inflation-adjusted one-time death benefit amount



Comparison to Other Retirement Systems

The National Association of State Retirement Administrators provided a compilation of information from other state retirement systems in the United States regarding their death benefits. Most other state retirement systems provide the option to either receive a return of the contributions and interest of an active member’s account or an ongoing monthly benefit for survivors based on various eligibility criteria. For retired members, most state retirement systems only pay ongoing benefits in lieu of contributions and interest to the survivors if an election for the benefit is made before or at retirement.

Regarding other benefits payable at death, there is no consistent or unified method for providing additional benefits. Several retirement systems do not provide a one-time, lump-sum death benefit to their active or retired members aside from a return of contributions and interest of the account. For those retirement systems that provide one-time, lump-sum death benefits similar to those CalSTRS provides, a considerable number of those systems derive those benefits from the member’s salary. Several others provide a flat amount of the one-time, lump-sum death benefit. However, few retirement systems offer an ongoing, monthly survivor benefit with a one-time, lump-sum payment. The survivors typically are required to choose between a one-time amount and a monthly benefit. Survivors of CalSTRS members can receive both.

Consideration for a Policy to Provide Guidance Regarding Potential Future Adjustments

When the board last reviewed the lump-sum death benefit in May 2022, it requested this committee considers whether the existing board policy related to the lump-sum death benefit should be revised to provide guidance regarding potential future adjustments. A desire for consistency in how increases are granted was also expressed by some board members.

The existing board policy does not provide any guidance regarding the basis for adjusting the death benefit. The existing policy pertains only to the timing of the reviews. It requires that the lump-sum death benefit be reviewed annually and be based on the results of the most recent actuarial valuation and a recommendation from its consulting actuary. A copy of the existing board policy is provided as Attachment 2.

In 2015, the board considered amending its policy to automate annual increases to the lump-sum death benefit based on the inflation in California in the previous calendar year and to only provide such increase if the Defined Benefit Program funded status was ahead of the schedule anticipated when the CalSTRS Funding Plan was adopted in 2014. The board at the time decided it was more prudent to not have automatic increases and to instead review if increases were appropriate on an annual basis.

Since 2015, the board has increased the lump-sum death benefit four times. Each time, the increases were based on the inflation in California in the previous calendar year. One option this committee could consider recommending to the board is to include guidance in the policy that each year the board should only consider, for adoption, an increase based on the California inflation in the previous calendar year. Today several options are provided as per previous direction provided by the board. Always basing increases on the inflation in the previous calendar year would provide for consistency in the increases being considered by the board.

An additional option to consider would be for the board policy to provide guidelines as to when an increase should be recommended for adoption. For example, an option could be for an increase to be recommended only if the funded status of the Defined Benefit Program is ahead of schedule. The increase would not be automatic and would still require the board to act. The policy would only provide guidance to staff as to whether an increase should be recommended based on the most recent funded status of the Defined Benefit Program. If the funded status was ahead of schedule, i.e. higher than the projected funded status when the funding plan was passed, the recommendation would be for the board to adopt the increase. If behind schedule, the recommendation would be to not adopt an increase. The policy would only guide the recommendation. The board would continue to adopt the amount on an annual basis as it does today. This committee could also consider bringing back the idea of automatic increases that was considered in 2015.

Another option would be to include guidance in the policy on the purpose of the death benefit. For example, the policy could state the lump sum death benefit amount be based in part on costs associated with funeral costs in California. However, the fact no clear purpose was ever defined for this benefit and that it is possible the existing death benefit was meant to cover more than just funeral expenses, it might be more prudent not to attempt to define the purpose of the benefit in a policy.

Next Steps

If this committee wanted to pursue changes to the existing policy for considerations by the board, staff would also seek stakeholder inputs prior to bringing the proposed revisions to the board for adoption. Such revisions could include:

- Increases tied to inflation in the previous year
- Consideration of increases dependent on funding levels
- Base increases on costs associated with the death of a member

Strategic Plan Linkage: Goal 1: Trusted Stewards. Board culture of excellence in governance. Knowledgeable, engaged and participatory trustees.

Board Policy Linkage: Benefits and Service Policy – Lump Sum Death Benefit for Active and Retired Members

Optional Reference Material: None.