CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?

On September 12, 2012, Governor Brown approved Assembly Bill 340 (Furutani), enacted as Chapter 296, Statutes of 2012, an extensive revision to California public pension plans. Given the uniqueness of the benefit programs provided by CalSTRS, Chapter 296 will have different impacts on current and future CalSTRS members than on other public employees. This document is a summary of Chapter 296 and those impacts.

CURRENT CALSTRS BENEFITS

Currently, CalSTRS administers a hybrid retirement system consisting of the Defined Benefit (DB) Program (a traditional defined benefit plan), the Defined Benefit Supplement (DBS) Program (a cash balance plan) and Pension2 (a defined contribution 403(b)/457 program funded through voluntary employee contributions). CalSTRS members do not participate in Social Security for their public education service. As a result, the benefits paid by CalSTRS are the only ongoing source of retirement income that members receive for their public education service. In addition, CalSTRS has a very limited retiree health benefit focused on members who do not qualify for premium-free Medicare Part A coverage. The provision of health benefits is negotiated at the local level, and 62 percent of members retiring now do not receive financial support from their employer for their health benefits after they reach age 65.

Defined Benefit Program. The DB Program pays monthly service retirement benefits to eligible educators based on years of service, age at retirement and final compensation. Currently, members are retiring at an average age 62 years old, with over 25 years of service. Benefits are enhanced for career educators. (The DB Program also pays disability benefits and survivor benefits, which are largely unaffected by Chapter 296.) The average benefit paid to a member retiring in 2010-11 was approximately 56 percent of the member's final salary. Funding for the DB Program is derived from member, employer and state contributions, plus the earnings from investing those contributions. (The state makes an additional contribution to fund a separate program that maintains the purchasing power of DB Program benefits.)

Defined Benefit Supplement Program. The DBS Program supplements the benefits paid under the DB Program at the time that DB benefits are paid. The DBS benefit is equal to the member's account balance at the time of retirement, disability or death. Contributions that are credited to a member's DBS account are paid by the member and employer on compensation for service in excess of the full-time assignment, such as summer school or after-school activities; compensation paid for a limited number of times, such as compensation paid to those who agree to retire at the end of the school year; or certain compensation that CalSTRS determines is not creditable to the DB Program. Contributions are credited with a minimum amount of interest, based on 30-year Treasury bond rates (equal to 3.75 percent in 2012-13), but additional interest can be credited by the Teachers' Retirement Board if there are sufficient excess funds after meeting long-term DBS Program liabilities. Benefits can be paid either as a lump sum, a monthly annuity or a combination of both.

Pension2. Pension2 is a CalSTRS program that offers school employees an opportunity to further supplement their retirement with additional personal investments on a pre-tax basis, pursuant to either Section 403(b) or 457 of the Internal Revenue Code. Pension2 offers 22 different investment options in low-cost mutual funds or variable annuities, and sets up portfolios of these core selections that reflect different target retirement dates and risk profiles. Individual employers elect whether to offer Pension2 to their employees. Pension2 is not directly affected by Chapter 296.

THE PENSION LEGISLATION AND ITS IMPACT ON BENEFITS OF FUTURE MEMBERS

Chapter 296 makes a variety of changes to CalSTRS benefit programs that primarily affect those who are first hired on or after January 1, 2013, to perform service that could be creditable to CalSTRS. This would exclude those who were CalSTRS members before 2013, had terminated their membership, and returned to active membership on or after January 1, 2013. These latter members still will be subject to the current benefit program. The changes made in Chapter 296 include:

- Reducing the age factor for any specific age, and increasing both the minimum retirement age and the normal retirement age.
- Eliminating the career factor increase in the age factor.
- Requiring that final compensation be calculated based on the highest average annual salary rate over three consecutive school years, regardless of years of service.
- Reducing the limit on compensation that counts toward the retirement benefit paid by CalSTRS.
- Limiting the type of compensation that counts toward a CalSTRS retirement benefit.

- Prohibiting the payment of benefits in excess of the limitation imposed by the federal Internal Revenue Code.

Other provisions of the legislation apply to both current and future members. These include:

- Prohibiting the purchase of nonqualified service, or airtime, after December 31, 2012.
- Requiring that a conviction for a felony that is related to the member's official duties result in the forfeiture of CalSTRS benefits beginning from the date the felony was committed.
- Requiring that a DB member's benefit be reduced dollar for dollar, regardless of age, for the first 180 days after retirement if the member performs activities in the public schools that are creditable to CalSTRS, unless the governing body of the school district takes specified actions with respect to a member who is above normal retirement age.
- Extending a very limited exemption from the postretirement earnings limit through 2013-14, and prohibiting the granting of the exemption if the member received an incentive to retire in the previous six months.
- Prohibiting any enhancement to the DB benefit from applying to service performed prior to the effective date of the enhancement.

Finally, Chapter 296 makes changes in the financing of the DB Program by:

- Requiring the contribution rate for future members to equal at least 50 percent of the normal, ongoing cost of benefits or the current contribution rate, whichever is greater.
- Requiring the contribution rate for the public employer, as defined, to equal at least the normal cost rate, less the member's contribution.

The change enacted in Chapter 296 that will have the most significant impact will be the reduction in the age factor for future members. Any future member who retires before age 65 will receive a benefit based on a lower age factor than would that same member retiring under the current benefit formula. About 80 percent of those who retired in 2010-11 were under age 65. Assuming a continued average retirement age of 62 years, the reduction in benefits will average about 12 percent. Put another way, the average replacement ratio, the percentage of salary replaced by a benefit, will decline by about 6 percentage points, and the DB Program will end up replacing about 50 percent of the final salary for the average member. Alternatively, a member will have to work two years longer to receive the same benefit provided under the existing benefit plan.

In addition, future members with at least 25 years of service will realize an additional reduction in their DB benefit if they received salary increases in their final working years because final compensation will be based on the highest three consecutive years, rather than a single year. Substantially fewer members will realize additional reductions either in their DB or DBS benefits from the new limitation on creditable compensation and the expanded limitations on the type of compensation that will be creditable.

FISCAL EFFECT OF PENSION LEGISLATION

A preliminary analysis of the actuarial impact of Chapter 296 indicates that the normal cost of the new benefit plan will be 15.9 percent. This represents a 2.61 percent reduction from the 18.51 percent normal cost of the existing plan if the existing plan would have applied to future members. This reduction in benefit accrual is projected to save a total of $22.7 billion over 30 years, equivalent to $12.0 billion in 2013 dollars. As of June 30, 2011, the unfunded liabiity of the current benefit plan is about $65 billion. The reduction in benefits under the legislation will reduce the amount of additional contributions required to fully amortize the unfunded liability over 30 years by $4.9 billion, assuming the DB Program earns 7.5 percent over that time period. This is equivalent to a 0.754 percentage point reduction in the required increase in contributions to fully fund the benefit program.

In addition, the limitation in the amount and the type of compensation that will be creditable will result in the following savings to members, employers and the state over the next 30 years because contributions will be paid on lower compensation:

Reductions in Contributions Over 30 Years (in millions of dollars)

	Nominal dollars	2013 dollars
Members	$530	$280
School districts	$550	$290
State of California	$190	$100
TOTAL	$1,270	$670

The following table provides a side by side comparison of current law and the provisions of Chapter 296.

COMPARISON OF PENSION LEGISLATION AND CURRENT LAW

<table>
<tr><th colspan="4">Provisions Applicable to Future Members Only</th></tr>
<tr><th>Provision</th><th>Current Law</th><th>New Pension Legislation</th><th>Comments</th></tr>
<tr><td>Minimum Retirement Age</td><td>Age 55, with 5 years of service, or age 50, with 30 years of service</td><td>Age 55, with 5 years of service. Future members will not be permitted to retire before age 55.</td><td>28 of the 13,896 members who retired in 2010-11 were below age 55.</td></tr>
<tr><td>Normal Retirement Age</td><td>Age 60</td><td>Age 62</td><td></td></tr>
<tr><td>Age Factors</td><td>
<table>
<tr><th>Retirement Age</th><th>Current Member</th></tr>
<tr><td>55</td><td>1.40%</td></tr>
<tr><td>56</td><td>1.52%</td></tr>
<tr><td>57</td><td>1.64%</td></tr>
<tr><td>58</td><td>1.76%</td></tr>
<tr><td>59</td><td>1.88%</td></tr>
<tr><td>60</td><td>2.00%</td></tr>
<tr><td>61</td><td>2.13%</td></tr>
<tr><td>62</td><td>2.27%</td></tr>
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<tr><td>67</td><td>2.40%</td></tr>
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</td><td>
<table>
<tr><th>Retirement Age</th><th>Future Members</th></tr>
<tr><td>55</td><td>1.16%</td></tr>
<tr><td>56</td><td>1.28%</td></tr>
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</table>
</td><td>Generally, the age factors applicable to current members will apply two years later in age for future members

Future members retiring at age 65 or older will not experience a reduction in the age factor, compared to the current benefit formula. About 20 percent of members retiring in 2010-11 were age 65 or older.</td></tr>
<tr><td>Career Factor</td><td>Members retiring with 30 or more years of service may receive an increase of up to 0.2 percent in their age factor, known as the career factor, up to a maximum age factor of 2.4 percent.</td><td>The career factor will be eliminated for future members.</td><td>About 29 percent of the members who retired in 2010-11 received a benefit based in part on the career factor.</td></tr>
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Provisions Applicable to Future Members Only

Provision	Current Law	New Pension Legislation	Comments
Final Compensation	Members with at least 25 years of service credit have final compensation based on the highest salary rate over 12 consecutive months. Members with less than 25 years of service credit have final compensation based on the average salary rate over three consecutive school years. Classroom teachers with less than 25 years of service credit can retire with their highest single year final compensation, if the teacher meets statutory requirements and their employer elects to offer that benefit.	Final compensation will be based on the highest salary rate over three consecutive school years, regardless of years of service.	52 percent of the members who retired in 2010-11 had 25 years or more of service credit, thereby having their final compensation based on the highest 12 consecutive months.
Limits on Amount of Creditable Compensation	Federal law limits the compensation that counts toward the pension of a public employee first hired on or after July 1, 1996, to $250,000 in 2012. That limit is increased based on cost-of-living increases. No contributions are paid by the member, employer or the state on compensation in excess of the limit, and any excess compensation is excluded from determining final compensation.	Creditable compensation for future members will be limited to 120 percent of the 2013 limit upon which Social Security benefits are determined and Social Security payroll taxes are paid. In future years, the compensation limit will be adjusted for changes in the Consumer Price Index. Any excess compensation will be excluded from determining final compensation, and it appears that no contributions will be paid by the member, employer or the state on compensation in excess of the limit. Employers will not be permitted to offer a defined benefit plan for the compensation in excess of the limit, but can make contributions for such compensation to a defined contribution plan, as long as the contribution rate to such a DC plan does not exceed the employer contribution rate to the DB Program.	Based on the Social Security Administration's current estimate of the 2013 wage base, the compensation limit for future members will be $136,440. The actual 2013 limitation will be established when the Social Security Administration issues its final wage base figure in the next few months. About 3,400 active members earned creditable compensation in excess of $136,440 in 2010-11.

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Provision	Current Law	New Pension Legislation	Comments
Limits on Types of Creditable Compensation	Creditable compensation is based on different forms of compensation payable in cash, including salary, auto and housing allowances, performance bonuses and the payment of cash in-lieu of receiving fringe benefits. Compensation for creditable service that exceeds one year in a school year (overtime) or is paid a limited number of times is credited to the DBS Program and not counted toward final compensation. Other types of compensation, such as compensation for unused accumulated leave, are not creditable, and do not count toward any CalSTRS retirement benefit.	Only compensation that is regularly payable in cash pursuant to a publicly available pay schedule will be creditable for future members. Creditable compensation for service in excess of one year in a school year will continue to be credited to the DBS Program, but all other compensation, such as allowances, bonuses, cash in-lieu of fringe benefits, limited-period compensation or compensation determined to have been paid for the purposes of enhancing a benefit, will not be creditable to any CalSTRS benefit program.	57 percent of active members were credited with additional contributions to the DBS Program for service in excess of one year in a school year in 2010-11, and less than one percent of the active members were credited with contributions to DBS from other compensation.
Benefits in Excess of Federal Limit	Federal law generally limits the amount of benefits that can be paid by a qualified defined benefit plan, which is increased based on cost-of-living increases. Federal law, however, also allows public pension systems, such as CalSTRS, to pay benefits above that limit under a separate program, up to the amount payable under the pension plan's benefit formula.	Future members will not receive any benefits from CalSTRS in excess of the federal limit.[1]	In 2012, the federal limit applicable to a 65 year old CalSTRS member is $171,202. 317 CalSTRS members currently are receiving benefits under the existing Replacement Benefits Program.

Provisions Applicable to Current and Future Members

Provision	Current Law	New Pension Legislation	Comments
Nonqualified Service ("Airtime")	Vested CalSTRS members are permitted to purchase up to five years of nonqualified service. Members also may purchase additional service credit for time spent on approved leave or for prior service in another state. The member pays the entire cost of both types of service credit, based on the actuarial assumptions adopted by the Teachers' Retirement Board and an analysis of actual prior purchases. In addition, members who terminated their employment in the public schools and withdrew their CalSTRS contributions and interest can redeposit their DB contributions, with additional interest, and restore their service credit.	Purchases of nonqualified service by current and future members will be prohibited after 2012. In order to purchase nonqualified service, CalSTRS will have to receive the appropriate CalSTRS form prior to January 1, 2013. There is no impact on any other service credit purchases, including the ability to redeposit previously withdrawn contributions.	About 700 members purchase nonqualified service credit annually.

[1] Given the limitation on compensation that counts toward the final compensation of future members, as well as the reduction in the age factor for such members, it is unlikely that any future member would accrue a benefit in excess of the federal limit.

Provision	Current Law	New Pension Legislation	Comments
Forfeiture of Benefits Upon Felony Conviction	Any elected public officer who takes public office or is reelected to public office on or after January 1, 2006, and who is convicted of any specified felonies arising directly out of his or her official duties, forfeits all rights and benefits in any public pension system. Current law also enumerates which felony convictions would trigger forfeiture and provides a safe harbor provision that will void the forfeiture if the governing body of the public officer's employer authorized the officer to receive his retirement benefits.	Benefits will be forfeited by any current and future CalSTRS member who is convicted of committing a felony in the course of his or her official duties, including specifically if the felony involved a child with whom the member had contact as part of the member's official duties. Any benefits accrued after the commission of the felony will be forfeited, but not benefits accrued prior to the commission of the felony. Any contributions made by the member to CalSTRS after that date will be returned by CalSTRS, without interest, to an account of the member that conforms to Internal Revenue Code requirements. The convicted member and the prosecuting agency will be required to notify the member's employer within 60 days of the conviction, and the member and the public employer are required to notify CalSTRS within 90 days of the conviction. If the conviction is overturned, the member can either receive the forfeited benefits or redeposit the returned contributions, with interest.	Very few CalSTRS members are potentially affected by current law. They include the 52 County Superintendents of Schools elected to office by the county voters and a small number of elected school board trustees whose districts offer the Cash Balance Benefit Program. To date, there have been no CalSTRS members who have had to forfeit their retirement benefits. Under the legislation, however, all members will be subject to forfeiture if convicted of a work-related felony.

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Postretirement Employment	Retired DB Program members are subject to an annual limit on postretirement earnings for compensation earned from CalSTRS-covered service. Retired members who exceed the earnings limitation have their monthly benefits reduced for each dollar of compensation earned in excess of the limit. The limit is $0 for the first six months of retirement if the member is under age 60, and is 50 percent of the median final compensation for recently retired members, pursuant to the recently enacted Chapter 135, Statutes of 2012 (AB 178), for all other retired members. Neither employers nor members pay contributions on post-retirement earnings for the compensation earned from creditable service after retirement. Chapter 135 also established a very limited exemption to the annual earnings limit, for 2012-13 only, for retired members appointed by a county superintendent of schools, the Community College Board of Governors, the State Board of Education or State Superintendent of Public Instruction to perform specific duties with respect to schools that are experiencing specific academic or fiscal distress. Finally, Chapter 135 excluded certain employees of a third party from the earnings limit, if the member was, for a limited period of time, performing service not normally performed by a school employee.	The $0 earnings limit will be extended to all current and future retired members, regardless of age, for the first 180 days of the member's most recent retirement. For current members who are at least age 60, and future members who are at least age 62, that 180-day period in which no compensation could be earned does not apply if the governing body of the employer approves the appointment in a specified manner, the member did not receive any financial inducement to retire, and the member's termination of service was not the cause of the need to acquire the services of the member. The limited exemption for retired members appointed by a county superintendent of schools, the Community College Board of Governors, the State Board of Education or the State Superintendent of Public Instruction is extended through 2013-14, but the exemption will now not apply if the member received a financial inducement to retire within the previous six months.	The earning limitations apply regardless of whether the retired member is an employee of a CalSTRS employer, an employee of a third party performing service for a California public school or an independent contractor performing service for a California public school. The 2011-12 earnings limit is $40,011. Documentation substantiating the member's eligibility must be received by CalSTRS before the service begins. Time after retirement but before January 1, 2013, counts towards meeting 180-day period that the $0 earnings limit applies.

Provision	Current Law	New Pension Legislation	Comments
Retroactive Benefits	In the past, when CalSTRS pension benefits were improved, the improvement applied to service that was performed in the past, as well as future service. These improvements included: • One-year final compensation for those with 25 years or more of credited service. • Increased age factor for those who work past age 60. • Career factor for those with 30 years or more of credited service. • Longevity bonus for those with 30 years or more of credited service by December 31, 2010.	Future benefit enhancements will only apply to service performed on or after the operative date of the improvement.[2]	

Provisions Affecting Contribution Rates[3]

Provision	Current Law	New Pension Legislation	Comments
Member Contributions	The member contribution rate has been set in statute at 8 percent since 1972. The employer is legally permitted pay the member contribution if it is paid on behalf of everyone in the same class of employees.	Future members will pay the greater of either (1) at least 50 percent of the normal cost of their retirement plan, rounded to the nearest one-quarter percent, or (2) the contribution rate paid by current members. The member contribution rate could be increased from this level through collective bargaining. The contribution rate required to be paid by future members will be adjusted if the actuarial valuation of the DB Program indicates that the normal cost of the plan for future members has changed by at least one percent since the last adjustment in member contributions. The employer is not permitted to pay the member's contribution.	The current member contribution rate funds 44 percent of the normal cost of the current DB Program as of June 30, 2011. Based on preliminary analysis of the legislation, the contribution rate for future members will be 8 percent.

[2] As an example, when legislation was passed in 1998 that created the career factor, increasing the percentage of final compensation paid upon retirement for each year of service if the member retired with at least 30 years if service, the increased percentage of final compensation resulting from the legislation was applied to that earlier service credit. If this new provision had been in effect in 1998, any increase in the percentage of final compensation resulting from the career factor would only have applied to service credited after 1998.

[3] Under Chapter 296, employer and/or member contributions necessary to fund annual pension costs may not be suspended unless the plan is at least 120 percent funded and the system actuary determines that continuing to accrue excess earnings could result in federal tax disqualification of the plan.

Provision	Current Law	New Pension Legislation	Comments
Employer Contributions	The employer contribution rate has been set in statute at 8.25 percent since 1990. The state's contribution rate has declined, through a series of legislation, from 4.607 percent in 1998 to the current 2.541 percent. The state's contribution will increase by a quarter percent per year until the state's contribution rate to the DB Program is 3.522 percent in 2015-16.	Public employers will pay at least the normal cost rate, after subtracting the member's contribution.	Contributions, as currently structured, pay the ongoing costs of DB benefits, but since 2002, they have been insufficient to bridge the funding gap caused by two stock market collapses in the prior decade.