CalPERS

May 17, 2016

Item Name: Assembly Bill 1878 (Jones-Sawyer) – Retired School Member Death Benefits

As Amended March 28, 2016

Sponsor: California Federation of Teachers

Program: Legislation

Item Type: Action

Recommendation
Adopt a **Neutral, if Amended** position on Assembly Bill (AB) 1878 to include state miscellaneous plan members and identify an appropriate funding source.

Executive Summary
Current law requires a $2,000 death benefit be paid to the designated beneficiary of a retired school member, with the additional employer contributions required to fund this benefit to be computed as a level percentage of member compensation. This bill would increase that payment to not less than $5,000 for the designated beneficiary of a retired school member, and authorizes the California Public Employees' Retirement System (CalPERS) Board of Administration (Board) to adjust the death benefit amount based on changes in the All Urban California Consumer Price Index.

The CalPERS Legislative and Policy Engagement Guidelines suggest support for proposals that correct structural deficiencies in the Plan, and opposition to retirement benefit plan changes that would result in an unfunded liability without proper actuarial funding to address the liability. While the current CalPERS death benefit is insufficient to cover average funeral and burial expenses, AB 1878 has conflicting policy implications. Although the bill would increase the death benefit for CalPERS retired school members to more closely match those provided to retired members of the California State Teachers' Retirement System (CalSTRS), it creates another inequity because the death benefit for retired state miscellaneous members would remain at the lower level of $2,000. Furthermore, it does not specify an appropriate funding source.

Strategic Plan
This item supports CalPERS 2012-17 Strategic Plan Goal C to engage in state and national policy development to enhance the long-term sustainability and effectiveness of our programs.

Background
The California Public Employees' Retirement Law (PERL) provides varying levels of death benefits according to membership category and status, each providing a "lump-sum" of money to survivors at the time of the member's death. The original lump-sum death benefit of $300 for

all retired CalPERS members was enacted in 1945. However, over the years, the Legislature began to provide different benefit levels to different categories of members: state, school, local, Judges' Retirement Systems (JRS and JRS II), Legislators' Retirement System (LRS), active, and retired.

Currently, state and school members have a retiree death benefit of $2,000. School employers also have the ability to amend their individual contracts with CalPERS to provide enhanced retiree death benefits of $3,000, $4,000, or $5,000. Local members have a minimum benefit of $500, with an option to provide up to $5,000 through contract amendment. Members of JRS have no retiree burial benefit, while members of LRS receive $600.

In 1996, the federal income tax exclusion for death benefits up to $5,000 was repealed. A beneficiary who receives a lump-sum retired death benefit is permitted to roll-over the benefit into a qualified plan or an individual retirement account to defer taxes on the amount. Otherwise a mandatory 20 percent federal tax withholding is deducted from the payment.

Analysis

1. <u>Proposed Changes</u>
    Specifically, this bill:
    - Increases the death benefit paid to the beneficiary of a school member from $2,000 to no less than $5,000, and
    - Authorizes the CalPERS Board to adjust the death benefit amount based on changes in the All Urban California Consumer Price Index and adopt as a plan amendment any adjusted amount.

2. <u>Burial Costs</u>
    According to the latest information available from the National Funeral Directors Association, the median cost of a full-service funeral in 2014 was $7,181. This price did not include cemetery costs, grave space, or monuments. Combined with the current Social Security lump-sum death benefit of $255, the retiree lump-sum burial benefits currently provided are inadequate to pay for a basic funeral and burial.

3. <u>Other Retirement Systems</u>
    Comparable systems offer higher death benefits than CalPERS. CalSTRS provides $6,163; University of California Retirement System provides $7,500; and the 1937 Act County Systems provide a $1,000 base benefit with an option to provide up to $5,000.

4. <u>Benefit Inequality Among Retiree Groups</u>
    While AB 1878 would increase benefits for school retirees to match those provided to retired teachers, it should be noted that the death benefit for retired state members would remain at a lower level of $2,000, thus remedying one benefit inequity and creating another.

Budget and Fiscal Impacts

1. <u>Benefit Costs</u>
    Increasing the post retirement lump sum death benefit for school members to $5,000 would increase employer costs as follows:

Estimated Increase in Present Value of Benefits as of 6/30/2014	$334.8 Million
Estimated Increase in Accrued Liability as of 6/30/2014	$308.9 Million
Estimated Increase in Accrued Liability as of 6/30/2017	$398.1 Million

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The estimated increase in school employer contributions after 2018-19 will be approximately 0.303 percent higher for a 20 year period, and thereafter drop to a normal cost increase of 0.038 percent. In accordance with CalPERS policies on amortization methods, the estimated $398.1 million increase in liability as of June 30, 2017 will be amortized as a level percentage of payroll over a 20 year period. This will cause the rate on the unfunded liability to be approximately 0.265 percent higher for a 20 year period due to the increase in accrued liability. The first additional payment on the unfunded liability is expected to be in 2018-2019 in the estimated amount of $32.7 million. The last payment is expected to be in 2037-2038 in the estimated amount of $57.3 million.

AB 1878 states the CalPERS Board "may adjust the death benefit amount following each actuarial valuation based on changes in the All Urban California Consume Price Index and adopt as a plan amendment any adjusted amount." By adopting adjustments as a plan amendment, this provision would fall under future ad hoc adjustments in which CalPERS actuaries cannot predict with accuracy, the potential increase in the present value of benefits or the increase in accrued liability.

2. Administrative Costs
   Staff estimates a cost of $50,000 to modify the my|CalPERS system to comply with the requirements of this bill. In addition, the school member benefit publication and benefit information maintained on the CalPERS website would need to be updated. If out-of-cycle publication revisions are required or additional outside resources are needed to accomplish technology system modifications, administrative costs would increase significantly.

Benefits and Risks
   1. Benefits
      - According to the Author, "AB 1878 would better align the death benefit of classified school employees with the actual costs of funerals and with the death benefit received by other educators."

   2. Risks
      - According to the Department of Finance, "This bill adds hundreds of millions of dollars in unfunded pension liabilities to the school plan, which is 77.5 percent funded as of June 30, 2015. We also note that this bill creates retroactive benefit increases for school employees, which is strictly prohibited by the Public Employees' Pension Reform Act of 2013."
      - Historically, the amount of the Retired Death Benefit has been the same for families of deceased state retirees and school retirees. Therefore, if this bill is enacted to improve the death benefit for school retiree families, there is a potential risk that it could result in a similar proposal on behalf of deceased state retiree families.

Attachments
Attachment 1 – Legislative History
Attachment 2 – Support and Opposition

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