CalSTRS Funding: Understanding the Vested Rights Doctrine

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

Joint Informational Hearing Assembly Public Employees, Retirement and Social Security and Senate Public Employment and Retirement Committees

* Overview Vested Rights Doctrine

Under existing case law, the general principle is that "where the employee's contribution rate is a fixed element of the pension system, the rate may not be increased unless the employee receives comparable new advantages for the increased contributions," *Pasadena Police Officers Association v. City of Pasadena (1983) 147 Cal. App. 3d 695, 702-703.* Consistent with this decision, contributions paid by CalSTRS Defined Benefit Program members cannot be increased once they are hired to perform service subject to coverage in the program, unless the members receive a corresponding, offsetting advantage. The only means by which the contribution rate can be increased is to provide the member with an increased benefit of comparable value. Generally, the cost of the increased benefit would offset any revenue associated with the increased contribution, negating any value of the higher contribution in addressing the CalSTRS funding shortfall. CalSTRS most recent valuation, June 30, 2013, shows the unfunded liability is approximately $74 billion.

Member contribution rate of 8 percent set in statute, changes require comparable offset

Education Code section 22901 (a) provides, for CalSTRS 2% at 60 members, "Each member of the Defined Benefit Program shall contribute to the retirement fund an amount equivalent to 8 percent of the member's creditable compensation." The 8 percent employee contribution rate has not been changed since 1972.

2 percent Annual Benefit Adjustment may offer comparable offset

One instance in which the contribution paid by current members could be increased without requiring an offsetting increase in liabilities is in the benefit adjustment. The 2 percent Annual Benefit Adjustment, also known as the 2 percent improvement factor, is based upon Education Code section 22140, which provides for an annual benefit increase of 2 percent after retirement. Annual benefit adjustments are calculated at 2 percent of a member's initial benefit and are not compounded or tied to changes in the cost of living.

This benefit is not contractually guaranteed. The Legislature explicitly reserves the right to reduce or eliminate the Annual Benefit Adjustment, should economic conditions dictate. However, according to an independent legal analysis commissioned by CalSTRS, if legislation was enacted to eliminate that explicit legislative reservation, such that the 2 percent benefit adjustment was guaranteed as are other Defined Benefit Program benefits, there may be a legal basis to increase contributions paid by current members because they would receive a comparable advantage from the benefit guarantee. This would occur at no additional cost to the program because the cost of providing the benefit adjustment is already reflected in the financing of the Defined Benefit Program.

Value of the 2 percent Annual Benefit Adjustment

Based upon an actuarial analysis prepared by Milliman in April 2013, the projected actuarial cost of the benefit adjustment is 2.83 percent of payroll for CalSTRS 2% at 60 members and the cost for CalSTRS 2% at 62 members is 2.39 percent. Therefore, the cost associated with the guarantee the 2 percent Annual Benefit Adjustment could provide a legal basis to increase the contributions paid by current members who would receive a comparable advantage from the guarantee of the benefit, by an amount up to the actuarial cost.

4/9/2014