Testimony for the Conference Committee on Public Employee Pension
Examining the Impact of Increasing Normal Retirement Age

Ann Boynton
CalPERS
Deputy Executive Officer
Benefit Programs Policy and Planning
February 28, 2012

I'm Ann Boynton, Deputy Executive Officer for CalPERS Benefit Programs Policy and Planning. On behalf of CalPERS, our leadership team, Board and staff, we want to thank the committee for again including us in this discussion about pensions.

Joining me is our Chief Actuary Alan Milligan who has also appeared with me before this committee in the past.

We are pleased to continue providing fact-based analysis or information you find helpful as you finalize your recommendations.

Our comments today will address the impacts of increasing the normal retirement age.

Let me begin by providing a point of reference for our discussions about the current retirement ages set forth in law and the actual experience of our members.

Today, a general employee of the State of California can retire as early as age 50 with a minimum benefit. The benefit factor that is used in calculating their pension will reach a maximum amount at age 63.

In fiscal year 2010-11, the average State Miscellaneous employee retired at age 61 with 24 years of service and replaced about 51 percent of his or her pay, not including social security.

CalPERS recently provided, at the request of this committee, a cost-analysis of the Governor's hybrid pension plan proposal.

The Governor's proposed normal retirement ages were considered in our analysis.

There are three important points from our analysis that this committee may want to consider in its decisions about retirement age.

First, raising the normal retirement age reduces the overall pension cost for new hires.

For example, every three-year increment increase in normal retirement age may result in a 10 percent savings over about 35 years.

Additional savings would materialize based on how much increasing the retirement age actually changes behavior. Our actuaries have estimated that the Governor's proposal may result in a one-year increase to the overall average retirement age, probably to age 62 for a typical State Miscellaneous member.

This would mean a 3 percent savings in the normal cost that may be fully realized in approximately 35 years.

Second: While raising the retirement age may have the intended impact of lowering the pension cost, it could also result in providing benefits lower than the proposed target amount. This is because increasing the normal retirement age to 67 for miscellaneous employees and 57 for safety employees does not guarantee that public employees will wait that long to retire.

For example, if we use the nation's federal benefit program as a yardstick, we find that nearly three-quarters of all retirees draw Social Security before the full retirement age, which ranges from 65 to 67.

Referring to the charts we provided to illustrate this point, you will notice that the benefits replacement ratio reduces at a disproportionate level for each year below the normal retirement age.

This is due to the fact that the Defined Contribution component of the hybrid plan heavily relies on the compounding interest that occurs in the final years.

While difficult to quantify, the actual retirement age will also have an impact on health care premiums of the CalPERS pool. If raising the retirement age to 67 actually results in employees working past the age of 65, then premiums are likely to increase.

This is because the CalPERS basic health plan will continue to be the primary plan instead of Medicare. Conversely, an employer's OPEB liabilities would decrease as average retirement age increases.

Finally, increasing the retirement age to 57 and lowering benefit formulas for our safety employees could result in an increase in Industrial Disability retirements that will raise costs.

Under existing law, Industrial Disability replaces 50 percent of salary if the disability retirement occurs before normal retirement age. But if a member is eligible for Service Retirement, he or she can choose to receive the higher of the two benefit amounts. If the Industrial Disability law remains the unchanged, a lower benefit formula and higher retirement age may disincentivize safety employees to “work through” an injury—perhaps by taking a desk job. Ultimately, a safety employee will have the choice to work in a less demanding job until age 57 to receive a 50 percent salary replacement, or retire immediately to receive the same benefit amount. We know that before agencies changed their safety plans to a 3 percent at 50 formula, Industrial Disability retirements were significantly higher.

We cannot definitively what would happen, but our actuaries determined if Industrial Disabilities increase by 10 percent for POFF and Highway Patrol, it would increase costs to the State by 0.3 to 0.4 percent.

I’ll conclude my remarks there. Alan and I are happy to take any questions or expand on our analysis.