

PROPOSED “VOTER EMPOWERMENT ACT OF 2016”

FREQUENTLY ASKED QUESTIONS

Introduction

On June 5, 2015, proponents of a proposed voter initiative for the November, 2016 ballot submitted the measure to the Attorney General’s Office. The measure is currently referred to by its proponents as the “Voter Empowerment Act of 2016,” pending the Attorney General’s preparation and circulation of an official title and summary. Many CalSTRS’ stakeholders have asked about the impact, if any, that passage of the measure could have on CalSTRS. CalSTRS Staff has compiled these “Frequently Asked Questions” to help educate its stakeholders as to the content and likely impact of the measure on the retirement system should it become law. We will provide updated information as appropriate to address future developments.

The full text of the measure can be found at this [link](#). Section references below are to sections of the measure’s proposed new constitutional provisions.

Q. Would the measure impact CalSTRS’ administration?

- A.** Yes. The People of the State of California entrusted the Teachers Retirement Board with the sole and exclusive responsibility to administer CalSTRS in a manner that will assure prompt delivery of benefits and related services to its participants and their beneficiaries. To that end, the Board administers a unified, statewide defined benefit plan and related supplemental plans for educators who work for some 1700 school districts and other public education employers. Participation in the plan is mandatory for all full-time educators who perform creditable service throughout the State, and optional for all part-time educators. The Legislature designed the plan to have uniform eligibility requirements, vesting rules, benefit formulas, contribution rates, retirement ages, and beneficiary and survivorship allowances.

Assuming that individual school districts will be considered to be the “government employers” of their educators under the proposed initiative measure, the measure would instead confer on voters in each school district’s jurisdiction the right to determine, for their district alone, the amount of and manner in which retirement benefits are provided to educators in that district (Sec. 23.a). The measure could also require the Board to “fully and faithfully” (Sec. 23.e) administer multiple plans for multiple districts with potentially multiple and inconsistent eligibility requirements, vesting rules, benefit formulas, contribution rates, retirement ages, and beneficiary and survivorship allowances.

Under current state and federal law, the Board does not have the authority to administer any plan other than the one created by the Teachers Retirement Law, Educ. Code secs. 22000 *et seq.* By granting authority to voters in different districts to determine their own benefit plans for the educators working in those districts, and if those voters require the

Board to administer all of those different plans, the measure would pose a constitutional conflict for the Board that would have to be reconciled by the Legislature or the courts.

Q. Would the measure impact CalSTRS' funding?

- A. Yes. The Legislature passed AB 1469 in 2014, putting CalSTRS on a sound, actuarially funded course with projected full funding as of the year 2046. CalSTRS' funding is premised on receiving specified, mandatory contributions from the State, employers and members of the system, applied against future district payrolls, which in turn are to be invested with the plan's other assets over time in order to provide for the promised benefits. Contribution rates have been established based on actuarial assumptions about future employer payrolls, participant headcounts, projected mortality rates, capital markets, inflation rates and other fiscal and demographic data.

To the extent that any new employees (as defined in the measure) are not allowed to enroll in the current defined benefit plan (Sec. 23.c), the fiscal and demographic assumptions on which contribution rates were premised in AB 1469 will no longer be accurate. There will be reduced revenue available to pay down the unfunded actuarial obligation (UAO) of the system and the plan will no longer be projected to reach full funding by 2046. Additional contributions would be required from the State, employers and current employees.

An additional consequence is that CalSTRS' cash flow would become increasingly negative, impacting CalSTRS' investment decisions. To maintain liquidity, the Board will necessarily have to overweight shorter-term investments with lower expected returns. That, in turn, would require the Board to assume a lower expected rate of return on investments, causing contributions to increase. Typical of "closed plans," the system's UAO would increase dramatically over time, rather than decrease as currently projected. Under GASB 68's reporting requirements, the State and school districts will be required to report this increasing obligation on their financial statements, potentially affecting the cost of borrowing in the public markets.

Q. Would the measure impact the State's obligation to fund CalSTRS?

- A. Very likely. CalSTRS' members have a constitutionally-protected right to a financially sound retirement plan. The State is the ultimate guarantor of the obligations owed to California's educators. To the extent that CalSTRS is deprived funding from new educators (Sec. 23.a) and employer school districts are prohibited from contributing more than 50% of the cost of benefits for any new employees who are allowed to continue in the plan (Sec. 23.d), the State would be called upon to assure funding for any consequent shortfalls. The risk of higher State contributions also results from the measure's prohibition on the Board's ability to mitigate the heightened risk of default by school districts that terminate participation in the plan for new employees (Sec. 23.g), or whose voters do not approve of new employees' participation in the plan.

Q. Would the measure impact current CalSTRS' active members?

A. Yes. CalSTRS' members have the following vested rights protected by the Constitution:

- The right to earn the highest level of benefits promised at any time during their employment, not only for past service rendered but for future service as well, without any reduction unless accompanied by a comparable offsetting advantage
- The right to the contribution level established by law upon their employment and thereafter, without any increase unless accompanied by a comparable offsetting advantage
- The right to a financially sound retirement plan
- The right to specific appropriations to the plan by the Legislature

The measure would allow voters to impair these rights in multiple ways. For example, “notwithstanding any provision of the Constitution or any other law” (Sec. 23), voters could reduce benefits and advantages provided in the current defined benefit plan for current CalSTRS' members that they expect to earn for future work. The measure would allow voters in a school district to change all of the terms and conditions of member's benefits earned for future work, to increase their required contributions or to impose additional risks on the plan's ability to achieve full funding.

In addition, members of the plan who move between school districts maintain certain vested rights that are designed to assure “portability” of benefits and to avoid penalties for working for more than one school district during their careers. The measure's definition of “new employee” (Sec. 23.b) would deprive current members of these vested rights.

For new employees of school districts statewide, voters will not be obligated to enroll them in a defined benefit plan, a defined contribution plan, or any retirement plan at all. If no alternative qualified governmental retirement plan is provided to new employees, they will be required by federal law to participate in Social Security as their only assured source of retirement income. Required participation in Social Security could result in mandatory benefit reductions being imposed on any member who has previously earned retirement benefits from CalSTRS, CalPERS, or any other public employee retirement system in California.

Finally, while the measure appears on its face to be gender neutral, as applied to CalSTRS' membership the impact of the measure would fall most heavily on women. Nearly 70% of CalSTRS' members are women, many of whom interrupt their careers to raise families. Those who wish to do so likely would be deprived of their portable membership rights, since they will be treated as “new employees” who will not be allowed to continue to participate in CalSTRS unless voters in the jurisdiction of their school district affirmatively act to permit their participation.

Q. Would the measure impact CalSTRS' tax-exempt status?

- A. Very possibly. The breadth of the authority to be granted to voters to make changes to the terms of the plan on an ongoing basis (“[v]oters have the right to use the power of initiative or referendum...to determine the amount of and manner in which compensation and retirement benefits are provided...”, Sec. 23.a) could run afoul of the Internal Revenue Code’s requirements for state governmental retirement plans, which could jeopardize CalSTRS’ tax qualified status. That qualification allows income from investments to accrue tax-free, and for employees to make pre-tax contributions into the plan. Without the qualification, the system would effectively close and the State and school districts would have to assume principal funding of earned benefits for retired educators and their beneficiaries, and to pay the annual taxes due on the income from CalSTRS’ \$190 billion investment portfolio.

The key tax concern lies in the IRS’ “definitely determinable benefit” rule. The Internal Revenue Code (Sec. 401(a)(25) requires that the actuarial bases used for calculating benefits must be in the plan document, so that a “definitely determinable” plan is in place. The law is intended to protect against unfettered employer discretion in providing benefits. The measure would empower employers and/or voters in each school district to determine “the manner in which retirement benefits are provided” – who participates, the benefit amounts, contributions, eligibility requirements, funding, actuarial assumptions and the like. The breadth of this authority to make wholesale changes to the plan on an ongoing basis, creating a state of flux in which employers and voters are constantly changing the plan, could create ongoing uncertainty over the plan terms, which could run afoul of the “definitely determinable benefit” rule. This could put CalSTRS’ tax qualified status at risk.

There are other provisions of the measure that could raise tax qualification issues (such as the preservation of death and disability benefits (Sec. 23.i) in the absence of a predominant defined benefit retirement plan). Putting the plan’s tax qualified status in jeopardy is a risk that would fall heavily on the State, school districts and CalSTRS’ members.