TEACHERS’ RETIREMENT BOARD

BENEFITS AND SERVICES COMMITTEE Item Number: 7

SUBJECT: Policy on the Lump Sum Death Benefit *(First Reading)*

CONSENT: ___ ATTACHMENT(S): 0

ACTION: ___ DATE OF MEETING: September 3, 2015/*30 mins*

INFORMATION: X PRESENTER: Ed Derman

PURPOSE

The purpose of this item is to initiate the development of a policy to determine future adjustments to the lump-sum death benefit paid to the beneficiaries of Defined Benefit (DB) Program members who die before or after retirement.

BACKGROUND

A one-time lump sum death payment is payable to the beneficiary upon the death of an active or retired DB Program member under certain conditions specified in statute. Section 23801 of the Education Code provides for payment of a $5,000 death payment to the beneficiary of an eligible deceased member who had coverage under the Family Allowance program (Coverage A) of the DB Program. Members who are in Coverage A began their DB Program membership prior to October 11, 1992, and did not elect Coverage B. These members would be eligible for the disability and survivor benefit that was in effect in October 1992. Section 23851 provides for payment of a $20,000 death payment to the beneficiary of an eligible deceased member who had coverage under the Survivor Benefit program (Coverage B) of the DB Program. Certificated employees who became members on or after October 11, 1992, or who became members before that date and elected Coverage B when that opportunity was made available to them in 1992, are in Coverage B, which provides a different set of disability and survivor benefits than those under Coverage A, although the total cost of both coverage programs are comparable. Finally, section 23880 provides for payment of a $5,000 death payment to the beneficiary of an eligible deceased retired member.

Each of these three sections permits the board to “adjust the death payment amount following each actuarial valuation based on changes in the All Urban California Consumer Price Index” (California CPI). Because the statute authorizing the board to adjust the death benefit was enacted prior to the enactment of the provisions of the Public Employees’ Pension Reform Act of 2013 (PEPRA) prohibiting benefit enhancements applicable to prior service, subsequent adjustments to the death benefit pursuant to the current provision are not prohibited by PEPRA. The death benefit for active Coverage A members and retired members is $6,163 in fiscal year 2015-16, and the current death benefit for active Coverage B members is $24,652.

Both the $5,000 and $20,000 death benefit are vested benefits, as well as the mechanism by which the benefit can be adjusted, based on changes in the California CPI. As a result, the benefit can only be adjusted downward from an existing level if the California CPI has declined by an amount that would result in a death benefit amount that is less than the existing level, but in no case could the death benefit be less than the $5,000 and $20,000 specified in the statute.

During each of the last five years, CalSTRS has paid the following number and amounts in benefits to beneficiaries of the three groups of members.

Dollars in thousands

	Active Coverage A	Active Coverage B	Retired	Total	Number Paid
2010-11	$770	$5,152	$37,002	$42,924	6,062
2011-12	$789	$5,522	$35,460	$42,771	5,987
2012-13	$647	$4,831	$36,602	$42,081	5,956
2013-14	$604	$4,831	$37,046	$42,482	6,008
2014-15	$222	$3,624	$31,852	$35,697	5,043

Since 1992, the board has adjusted the lump-sum death benefit seven times, with the last increase being effective July 2002.

Date of Death	Active Coverage A, Disabled Member, Retired Member	Active Coverage B
Prior to 10/16/92	$2,000	(not applicable)
10/16/92 to 6/30/94	$5,000	$20,000
7/01/94 to 12/31/96	$5,110	$20,440
1/01/97 to 6/30/98	$5,227	$20,908
7/01/98 to 6/30/99	$5,493	$21,974
7/01/99 to 6/30/00	$5,598	$22,394
7/01/00 to 6/30/01	$5,763	$23,052
7/01/01 to 6/30/02	$6,010	$24,040
7/01/02 to present	$6,163	$24,652

In recent years, inflation in California has been below the board's assumed rate of inflation of 3 percent, and is currently projected to remain below assumed levels for at least the next few years. In fiscal years 2012-13 and 2013-14, the California CPI increased by 2.1 percent and 1.4 percent, respectively. The Department of Finance forecasts a California CPI increase of 1.97 percent in 2015-16 and 2.08 percent in 2016-17.

Existing law provides the board with discretion to adjust the death benefit payment, and provides guidelines to help inform the decision-making process. It is within the board's discretion to make no adjustment. However, should the board choose to adjust the amounts of the death payments, the board is required to consider the guidance of the California CPI and the most recent actuarial valuation. Existing law does not, however, require changes to mirror the California CPI, nor does it require that all changes be uniform. In other words, the board can elect to adjust the death benefit at a rate less than the full change in the California CPI, and it can adjust one death benefit at a different rate than another death benefit.

Increasing the death benefit payments to reflect changes in the California CPI between December 2001 and December 2014 would increase the death benefit by approximately 34.7 percent. The CalSTRS consulting actuary determined that based on the June 30, 2014 Actuarial Valuation, fully adjusting the current death benefit payment amounts to reflect inflation would increase the actuarial obligation by $238 million and the annual normal cost by 0.067 percent. The following table shows what the amounts would be if the current amounts were adjusted for inflation.

	Current	**Adjusted**
Retired or in Coverage A	$6,163	$8,299
Coverage B	$24,652	$33,196

The table below identifies the impact on costs and benefits of a full adjustment, and compares them to the impact of the following three alternatives:

- a one percent increase,
- an increase of the total CPI percentage change from 2013 to 2014 (1.4 percent), and
- an increase of half the total amount of CPI changes since the last increase in benefits (17.3 percent).

.	**Benefit Amounts**		**Increase in**	
	Coverage A or Retired ($6,163)	**Coverage B ($24,652)**	**Actuarial Obligation**	**Total 30-Year Cost**
Full increase	$8,299	$33,196	$238 million	0.067 %
1.0 percent increase	$6,225	$24,900	$6 million	0.002 %
1.4 percent increase	$6,247	$24,988	$9 million	0.003 %
17.3 percent increase	$7,231	$28,924	$119 million	0.033 %

COMPARISONS WITH OTHER PLANS

In order to compare current lump-sum death benefits offered by CalSTRS to those offered by other systems, staff examined 22 systems' offerings. In addition, staff collected responses to a series of questions regarding the purpose of the lump-sum death benefit and if the benefits have been adjusted over time and on what basis. The benchmarking results are attached.

Staff found that most systems provide some form of continuing income through options or other criteria selected upon retirement, similar to the benefits provided by CalSTRS under the DB Program, but fewer plans provided for ongoing benefits to beneficiaries of members who died while still working, such as is provided in the DB Program. In addition, only slightly more than half of the plans investigated provide a one-time lump-sum death benefit, other than the return of contributions and interest in the member's account, to survivors of members who die while in active service and less than half provide a similar benefit to members who die after retiring.

Several plans base their lump-sum death benefit on the member's salary and years of service. For example, New York State and Local Retirement System multiplies the member's final salary earned in the last 12 months of their career by years of service up to 3 years. Colorado on the other hand provides a 100 percent match of contributions if a retired or active member dies. For the most part; however, plans offer a specified dollar amount that ranges between $400, which is offered to inactive members with at least 10 years of service at Washington Teachers Retirement System and $5,000, which the Kentucky Teachers' Retirement System provides for retired members.

Intended Use of Benefits. Only Connecticut Teachers' Retirement, Ohio State Teachers' Retirement System, and Washington Teachers' Retirement System, indicated that their lump-sum death benefit was intended to help pay funeral or burial expenses. Ohio Public Employees' Retirement System indicated that when their benefit was initially established, it was based on funeral costs at the time. The structure of the plan, however, changed in 1989, and the death benefit is now tied to years of service.

ESTABLISHING A BASIS FOR ADJUSTING THE BENEFIT

Although the board has a policy pertaining to the timing within a year the one-time lump sum death benefit would be adjusted, the policy does not guide the basis for making adjustments to the death benefit. At the April 2015 committee meeting, the committee directed staff to propose a draft policy to provide a basis for future adjustments to the benefit. The committee has a few options for forming the basis of a policy. First, the policy could base future adjustments on increases in costs associated with the death of a member. Alternatively, the policy could base future adjustments on the impact of the increase in achieving full funding of the DB Program.

Adjustments Based on Costs

Two factors upon which to base adjustments to the benefit would be to consider the benefit to be a means to assist in paying the costs (1) of member's funeral (either a traditional casket burial or cremation) or (2) associated with the end of the member's life, particularly medical care during the final stages of life.

Funeral Costs. According to research by funeral industry trade associations, the average cost of a traditional burial would be approximately $10,000, which exceeds the $6,163 current death benefit paid to the 14 percent of active members under Coverage A and those who are retired, but is less than the $24,652 benefit paid to those under Coverage B. On the other hand, the average cost of a cremation is less than $4,000, and the percentage funerals by cremation has increased considerably, reaching 57 percent in 2011.

End-of-Life Medical Costs. A recent California Health Care Foundation report entitled, *Final Chapter: California's Attitudes and Experiences with Death and Dying,* indicates that the most important factor at the end of life for Californians is making sure their family is not burdened financially by the costs of care (67 percent said this is extremely important). Health care expenses near the end of an individual's life often deplete savings and jeopardize the financial security of surviving family members. However, the amount of end-of-life expenses that are accrued often depends heavily upon the cause of death and certain causes are more highly concentrated in certain age groups. Additionally, nearly 73 percent of all deaths in California occur at an age of 65 or older.

The vast majority of California educators will begin participating in Medicare at age 65, but the majority of retired members do not have employer-paid health insurance after age 65. Medicare covers hospitalization and most required medical treatments; however, it does not cover long-term care or home health care. Additionally, few CalSTRS members who have no health insurance other than Medicare will meet the income standard needed to qualify for Medi-Cal, so devoid of any other insurance, they will have to pay those expenses out of their own pockets. The National Bureau of Economic Research found that between the years of 1998-2006, the average out-of-pocket medical expense in the last year of life was $11,618. According to the 2015 CalSTRS Retirement Readiness Assessment, 53 percent of retired members have health insurance, other than Medicare, which is either paid at least partially by their former employer, or entirely by themselves.

Younger active members are more likely to die from causes in which the length of medical care would be relatively short. These sudden deaths generally result in lower health care costs than do fatal diseases. According to the CDC, the leading cause of death amongst those between the ages of 20 to 45 is accidents. Nearly every CalSTRS member working full-time receives some form of health insurance from their employer.

<u>Life Insurance as a Means of Covering Costs</u>. Individually purchased life insurance may also help ease the burden of a member's final expenses. Based on responses to the 2015 Retirement Readiness Survey conducted by CalSTRS, approximately 53 percent of active members have some form of life insurance coverage that they purchased on their own. This is a reduction from the 69 percent level reported in both the 2008 and the 2011 assessments and the 56 percent reported in 2013.

According to the American Council of Life Insurers, individual life insurance, as opposed to group life insurance, is the most widely used form of life insurance protection, accounting for 58 percent of all life insurance in force in the United States at the end of 2013. The average size of new individual life policies that are purchased in the U.S. has been decreasing since 2008 and was $165,000 in 2013. However, coverage tends to be higher in California, with the average coverage in 2015 being $227,000. Younger individuals can typically purchase this coverage at a lower cost than older individuals.

Adjustments Based on Funding Impact

AB 1469 (Bonta) was enacted last year as Chapter 47, and establishes a plan to fully fund the DB Program by June 30, 2046 through increased contributions from the member, employers and the state. Whether the program achieves full funding by that date is dependent on the extent to which actual economic and demographic experience corresponds to the assumptions adopted by the board. Future increases in the death benefit, although authorized in law, are not reflected in the actuarial valuation until the increases are adopted by the board. Consequently, any future increase in the death benefit would increase costs to the DB Program above those reflected in the valuation, and could affect the funded ratio of the program and whether the program is fully funded by 2046.

When the funding plan was enacted in AB 1469, staff projected the funded ratio of the DB Program as of June 30 of each year through 2046, when the program was projected to be 100 percent funded. The actual funded ratio of the program will differ each June 30 to the extent that actual experience, particularly investment returns, differs from board assumptions, or if board assumptions change in the future. If the funded ratio at the end of a fiscal year, as specified by the actuarial valuation submitted to the board at the time the death benefit is being adopted, is sufficiently greater than what was projected for that year in the funding plan, adjustments could be made to the death benefit, up to the amount authorized by current law, while maintaining projected full funding by 2046.

Any increase in the benefit, even one based on unexpected improvements in the funding of the DB Program, carries a risk to the funding plan if there is a sustained downturn in the financial markets. Because the board's authority to reduce the benefit amount, once adopted, is limited to decreases in the California CPI, if a benefit increase was followed by a few years of investment underperformance, money would be spent on the increased benefit that would otherwise be used to support the funding plan, and the board would have no ability to reduce the benefit in an effort to bring the funded ratio back in line with the funding plan.

RECOMMENDATION

Although basing the death benefit on costs associated with end of life, such as burial costs or end-of-life medical costs, could be reasonable, the magnitude of those costs are not consistently updated. For example, the cost of cremation was last surveyed in 2010. Consequently, it would be difficult to annually evaluate whether the benefit should be adjusted. In addition, the statistics on burial and cremation costs are derived from trade associations, and are not developed by public agencies. Consequently, the data may not be consistently developed.

On the other hand, a policy that bases future adjustments to the death benefit on the impact of such adjustments on fully funding the DB Program is easier to execute, and achieving full funding has consistently been a policy objective of the board. The annual valuation of the DB Program, combined with the analysis of adjusting the death benefit, could identify the extent, if any, the death benefit could be adjusted while maintaining projected full funding by 2046. Consequently, the board could make decisions on whether to adjust the benefit based on very current information on the status of funding the DB Program and the impact of making such adjustments on fully funding the program. As a result, staff recommends the board adopt a policy to adjust the lump-sum death benefit by an amount that still enables the DB Program to be projected to be fully funded by June 30, 2046, after reflecting the impact of the adjustment on the funded ratio of the DB Program.

In order to prevent an unusually good investment year, followed by an offsetting poor investment year, from resulting in an adjustment which might by excessive in the long run, the funded ratio should be measured based on the lesser of the market value of assets and the actuarial value of assets. In addition, the resulting benefit amount would not exceed the amount authorized under current law. The board would continue to have annual discretion on whether and how much the benefit should be adjusted, but the recommended policy would provide guidance to assist the board in deciding the magnitude of the adjustment. Suggested amendments to the board's current policy are attached.

System	Active Member*	Retired Member*	Taxable Benefit**	Misc. Details
CalSTRS (Coverage A)	$6,163	$6,163	Yes	N/A
CalSTRS (Coverage B)	$24,652	$6,163	Yes	N/A
Alabama RS	Previous year's salary, salary at time of death, or 100% match of contributions and interest (up to $5,000)	None	N/A	N/A
Arizona SRS	None	None	N/A	N/A
Canadian PSSA	2 x annual salary reduced by 10% annually starting at age 66. Will never go below 33% of annual salary or $10,000	2 x annual salary reduced by 10% annually starting at age 66. Minimum $10,000	N/A	N/A
Colorado PERA	100% match of contributions and interest with at least 1 year of service	100% match of contributions and interest	N/A	N/A
Connecticut TR	Up to $2,000, based on service credit, for burial expenses	None	Yes	System refers to the lump-sum as a burial expense and will pay it to a spouse or to the person who paid the member's funeral expenses.
Florida RS	None	None	N/A	N/A
Georgia TRS	None	None	N/A	N/A
Idaho PERS	None	None	N/A	N/A
Illinois TRS	Final annual salary or $1,000 with annuity to dependent	$3,000 or 1/6th of final salary or $1,000 with annuity to dependent	Yes	N/A
Kentucky TRS	$2,000 if employed in a full-time covered position	$5,000	No	Lump-sum benefit is considered a life insurance policy.
Louisiana TRS	None	None	N/A	N/A

System	Active Member	Retired Member	Taxable Benefit**	Misc. Details
Maine PERS (Teachers)	None	None	N/A	Offers a group life insurance plan that pays a sum equal to the member's annual salary rounded to the nearest $1,000 for both active and retired.
Maryland SRPS	Final salary if no dependents	None	N/A	N/A
Missouri PSRS	None	$5,000	N/A	N/A
Nevada PERS	None	None	N/A	N/A
New York SLRS	Final salary earned during last 12 months x years of service, not to exceed 3 years of salary.	50% of the active death benefit during first year in retirement, 25% in second, and 10% of benefit, payable at age 60 thereafter.	No, up to $50,000	N/A
New York STRS	1/12th of one year of salary x service to a max of 3 x earnings (Tier I) Between 1 and 3 years of salary (Tier 2-6). The benefit is reduced after age 60 by 4% per year up to max of 40% at age 70.	Between 1 and 3 years of salary when no monthly benefit payable.	No	N/A
Ohio STRS	Match of 50% of account balance	$1,000 and members can purchase an additional $1,000 or $2,000 of coverage.	Purchased coverage is taxable	Benefit is intended to help pay for funeral and other end of life expenses. Benefit was raised from $500 about 40 years ago.

System	Active Member	Retired Member	Taxable Benefit**	Misc. Details
Ohio PERS	Amount paid dependent on years of service.	Paid to survivor or person who paid funeral expenses based on the member's years of service. 5-9 years $500 10-14 years $1,000 15-19 years $1,500 20-24 years $2,000 25 or more years $2,500	No	Original benefit was determined based on funeral costs, but the structure of the plan changed in 1989 and the benefit is now tied to years of service.
Pennsylvania PSERS	None	None	N/A	N/A
Texas TRS	In lieu of contributions and interest, twice the annual salary (up to $80,000) or $2,500 (and a monthly annuity)	Depending on relationship to member, $10,000 with monthly annuity or $2,500 with monthly annuity	Yes	N/A
Washington TRS	Inactive w/ 10+ years of service receives $400 and actives receive $600.	None	N/A	Benefit was originally intended to cover funeral costs or end of life expenses and has never been increased.

*Lump-sum benefits described above exclude any return of contributions and interest.
**Lump-sum benefits paid as life insurance, or that represents a return of after-tax contributions, are not taxable

Draft Language to Add to the Teachers' Retirement Board Policy Manual—Section 800
E. Specified Interest and Contribution Rates and Lump-Sum Death Benefit

8. Lump Sum Death Benefit for Active and Retired Members

A one-time lump sum death payment is payable to the beneficiary upon the death of an active or retired DB Program member under certain conditions specified in statute. Sections 23801, 23851 and 23880 permit the board to "adjust the death payment amount following each actuarial valuation based on changes in the All Urban California Consumer Price Index". The board adopts the benefit amounts after the latest actuarial valuation and upon ~~recommendation~~ determination by ~~from~~ its consulting actuary of the projected impact of an adjustment on the funding of the Defined Benefit Program. It is the policy of the board that

a. The board ~~shall~~ adopt lump sum death benefit amounts for members of the DB Program annually with the goal of adopting the benefit amounts before July of the fiscal year in which the rate applies.
b. The board ~~shall~~ adopt separate death benefit amounts for active Coverage A members, all retired members, and active Coverage B members.
c. The board ~~shall~~ adopt the same benefit amount for Coverage B members under both the CalSTRS 2% at 60 and 2% at 62 benefit programs.
d. The adoption of the benefit amount ~~shall~~ be based on the latest actuarial valuation of the Defined Benefit Program and a determination by ~~recommendation~~ ~~from~~ ~~it's the~~ board's consulting actuary of the projected impact of an adjustment on the funding of the Defined Benefit Program.
e. The resulting projected funded ratio as of June 30 of the fiscal year in which the adjustment is effective not be less than the projected funded ratio of the Defined Benefit Program for that same date, as specified in the following schedule.
f. The projected funded ratio be based on the lesser of the market value of assets and the actuarial value of assets.
g. The total percentage increase in the benefit amount since 2002 not exceed the percentage change in the All Urban California Consumer Price Index since 2002.

As of June 30,	Funded Ratio
2015	64.8%
2016	64.4%
2017	64.4%
2018	64.6%
2019	65.1%
2020	65.8%
2021	66.6%
2022	67.5%
2023	68.3%
2024	69.2%
2025	70.2%
2026	71.1%

As of June 30,	Funded Ratio
2027	72.1%
2028	73.1%
2029	74.2%
2030	75.3%
2031	76.4%
2032	77.5%
2033	78.7%
2034	79.9%
2035	81.2%
2036	82.5%
2037	83.9%
2038	85.3%
2039	86.9%
2040	88.5%
2041	90.1%
2042	91.9%
2043	93.8%
2044	95.7%
2045	97.8%
2046	100.0%