Policy Brief

Creating a New Retirement Benefits Plan for Judges

Background

Due to the chronic failure of the state to adequately fund the obligations of the Judges' Retirement System, the system's unfunded liability has grown to $1.3 billion. Because revenues in the system's trust fund are inadequate to honor pension payments to current retirees of the system, the state's General Fund must make annual subsidies—$37.8 million in 1994-95 and growing.

After the Governor vetoed two bills passed in 1992 to reform judges' retirement, the Chief Justice appointed a select committee to develop recommendations to the Governor and the Legislature regarding changes in judges' retirement. The committee's report, released in May 1993, provides an important starting point for legislative efforts this year to reform judges' retirement.

Findings

The centerpiece of the select committee's report is a recommended new retirement plan for judges taking office after the effective date of necessary implementing legislation. The proposed plan should result in reduced state costs for judges' retirement in the long run, but is still expensive compared to other state retirement plans and also contains risks for higher future costs.

Recommendations

We recommend that the Legislature enact legislation to establish a new, actuarially sound, retirement program for judges taking office in the future in order to reduce long-run state costs for judges' retirement. The legislation should incorporate the retirement plan developed by the Select Committee on Judicial Retirement, with modifications to further reduce state costs, as detailed in this report.

BACKGROUND

The Judges' Retirement System (JRS) provides benefits for those justice, municipal, superior, appellate and supreme court judges, and their survivors, who are members of the JRS. This system is administered by the Public Employees' Retirement System (PERS). Members of the JRS earn retirement benefits equal to a percentage (up to 75 percent) of the *current* salary of the judicial office last held. The JRS will pay an estimated $68 million in benefits to 1,225 annuitants in 1994-95.

Funding Problems of the JRS

The contributions made by current members of the JRS and the statutory contributions by the state (equal to 8 percent of judges' salaries) go directly to pay benefits to current retirees, providing nothing for the eventual retirement of current judges. Moreover, these contributions are not adequate even to cover the benefit payments to current retirees, forcing the General Fund to make up the difference in the annual Budget Act. In order to honor 1994-95 benefit payments to current retirees, the Governor's Budget includes a subsidy of $37.8 million from the General Fund—$11.5 million above the current-year subsidy. Due to the chronic failure of the state to provide funds for the future retirement needs of current judges, the unfunded liability of the JRS has grown to *$1.3 billion,* based on the most recent actuarial valuation of the system (1992).

Recent Legislative Activity

In 1992, the Legislature enacted two bills that would have made fundamental changes to judges' retirement, but the bills were vetoed by the Governor. Assembly Bill 1031 (Bentley) would have increased member contributions from 8 percent of salary to 11 percent. Senate Bill 1563 (McCorquodale) would have created a new, less costly, retirement plan for judges appointed or elected after the effective date of the bill. The Governor indicated in his veto messages that, although reform of judges' retirement is necessary, neither bill received the full review through policy and fiscal committees warranted by the issues involved. The Governor also expressed concern about maintaining the state's ability to attract superior talent into the judiciary. He invited the respective authors to reintroduce legislation in the 1993-94 session.

In 1993, Senator McCorquodale introduced SB 65 to reform the JRS. At the time this analysis was prepared, SB 65 had been referred to a conference committee.

Select Committee on Judicial Retirement

After the Governor vetoed AB 1031 and SB 1563, the Chief Justice appointed a select committee to develop recommendations to the Governor and Legislature regarding changes in judges' retirement. The committee's report was released in May 1993. This report provides an important starting point for legislative efforts this year to reform the JRS.

Proposed "Judicial Retirement Program" for New Judges

The centerpiece of the select committee's report is a recommended new retirement plan for judges taking office after the effective date of necessary implementing legislation. This new plan has several features that, taken together, should result in reduced state costs for judges' retirement *in the long run.* Figure 1 compares the key features of the select committee's recommended plan with the existing JRS.

As shown in Figure 1, the recommended judicial retirement program would be less costly than the JRS. The lower projected cost of the new program is due mainly to two features—a higher minimum retirement age (63 instead of 60) and a less generous cost-of-living adjustment (a 3 percent annual cap instead of adjustments tied to increases in active judges' salaries).

The cost shown for the new judicial retirement program was estimated by a consulting actuary retained by the select committee. The estimate for the JRS was

Figure 1

Judges' Retirement System and Proposed Judicial Retirement Program Comparison of Features

Feature	Existing Judges' Retirement System	Proposed New "Judicial Retirement Program"
State cost[a]	25.7 percent of judges' salaries, subject to change based on future actuarial valuations.	21.4 percent of judges' salaries, subject to change based on future actuarial valuations.
Judges' cost	8 percent, subject to change by statute.	8 percent, fixed.
Retirement ages and basic benefits	With 20 years of service, may retire at age 60 and receive pension of 75 percent of salary. Between 10 and 20 years of service, may retire at age 66 and receive 65 percent of salary. Law includes disincentives for retiring after age 70.	With 20 years of service, may retire at age 63 and receive 75 percent of salary. Pension increases with increasing years of service and age to a potential maximum of 96.8 percent at a mandatory retirement age of 72. Between 5 and 20 years of service, and retiring before age 70, qualifies for a payment based on (1) contributions made and (2) investment performance of the retirement trust fund.
Service retirement options	None. Pension amount is defined by years of service and age at retirement—a "defined benefit" plan.	If at least age 63 with 20 years of service or age 70 with 5 years of service, option to choose (1) the "defined benefit" pension amount or (2) a "defined contribution" payment based on contributions made and investment performance of trust fund.
Cost-of-living adjustments	Pensions increase in step with active judges' salaries.	Up to 3 percent per year based on inflation.
Funding basis	De facto "pay as you go." Unfunded liability of $1.3 billion and growing.	Pre-funding of benefits, on actuarially sound basis, through contributions placed in retirement trust fund.

a State cost means the amounts, in terms of percentages of judges' salaries, that the state needs to contribute on an ongoing basis to pre-fund the state's retirement obligations as they accrue. With respect to the JRS, "cost" does not include amounts needed to address the system's large unfunded liability, which is due to past failures to pre-fund obligations as they accrued.

prepared by another actuary retained by the PERS, which administers the JRS. Two points should be noted. First, since the two actuaries used, in some cases, different assumptions, the estimates are not strictly comparable. Second, the estimates are just that—*estimates*, and are subject to change in the future.

Analysis and Recommendations

Our review of the select committee's proposal indicates that certain changes could be made to the plan which reduce the state's financial exposure, now and in the future. These are discussed in detail below.

State Faces Risk of Higher Contributions in Future

The inherent variability of actuarial valuations poses an important issue for the Legislature's consideration—how to apportion the risk of periodic changes in contributions that result from successive actuarial valuations. The select committee's proposal would place all of that risk on the state, because it would hold the judges' contribution rate at 8 percent regardless of changes in program cost.

We believe a sounder and more appropriate policy would apportion changes in contribution rates equally between the state and the judges who will benefit from the program. We therefore recommend that legislation establishing a new judicial retirement program provide for state and judges' contributions to move together (either upward or downward) in response to actuarial valuations, based on a fixed ratio between the *initial* contribution rates that the Legislature decides to set for each.

New Program Still Expensive Compared to Other Plans

The proposed judicial retirement program, while less expensive than the JRS, would still be more expensive (in terms of percent of affected salaries) than any state retirement plan in place for other public employees. Figure 2 compares cost and other features of the new judicial retirement program with the state's retirement plans for highway patrol officers, miscellaneous first tier members (most current state employees), and K-14 teachers.

The main reason for the higher expense of the judicial retirement program is the comparatively generous nature of its benefits. In the view of the select committee, this generosity is necessary in order to attract into judicial service attorneys from all areas of practice, private and public. A balance must be achieved, however, between the policy objective of attracting attorneys from private practice and the policy objective of minimizing necessary state costs. In achieving that balance, we believe the Legislature can and should modify the select committee's plan.

In this regard, we recommend the Legislature focus on two areas of potential savings that should not interfere with maintaining a high-quality bench: modest increases in the proposed (1) minimum

Figure 2

Proposed Judicial Retirement Program and Selected State Retirement Plans Comparison of Features

Feature	Proposed Judicial Retirement Program	Highway Patrol	State Miscellaneous, First Tier	State Teachers' Retirement System
Employer Cost (percent of salaries)	21.4 percent	16.9 percent	16.1 percent (includes 6.2 percent for Social Security).	14.9 percent[a]
Employee Cost (percent of salaries)	8 percent	8 percent of monthly salary over $863.	5 percent of monthly salary over $513, plus 6.2 percent of salary (below $60,000 per year) for Social Security.	8 percent
Benefit Formula	3.75 percent of final year's salary times 20 years of service (if at least 20 years earned). Past age 63 *and* 20 years service, additional years times 2.418 percent.	Formula peaks at 2.7 percent of highest salary earned times years of service, at age 55. Capped at 75 percent of highest salary earned.	Formula peaks at 2.418 percent of highest salary earned times years of service, at age 63. Plus, eligible for Social Security benefits.	Formula peaks at 2 percent of highest salary earned times years of service, at age 60. Highest salary is averaged over three years, or one year, depending on district.
Cost of Living Adjustments	Up to 3 percent (depending on inflation), compounded annually.	Up to 2 percent compounded annually. Some protection against sustained higher inflation available from earnings on employee accounts in trust fund.	Up to 2 percent compounded annually. Some protection against sustained higher inflation available from earnings on employee accounts in trust fund.	2 percent annually, uncompounded. Some protection against sustained higher inflation available from state contributions subject to annual appropriation.

a Consists of (1) 8.25 percent of salaries paid by school districts, (2) 4.16 percent paid by state, and (3) 2.5 percent from state, subject to annual appropriation by Legislature, for inflation protection.

retirement age and (2) judges' contribution rate.

Minimum Retirement Age

Under the existing JRS, the minimum retirement age for attaining full benefits is 60. The select committee's proposal would achieve significant savings by raising the minimum age for full benefits to 63. This fits in with another policy objective given to the committee by the Chief Justice—to find incentives for experienced judges to stay on the bench longer. Even without this policy objective, raising the minimum retirement age would make sense because of steadily increasing human longevity. Congress recognized this principle when it raised the full benefits retirement age for Social Security from 65 to 67 (for persons born in 1960 and later).

Based on information from the committee's actuarial consultant, the proposed plan's cost would drop by about 0.5 percent of salaries for each additional year by which the retirement age is raised. Thus, the Legislature could reduce the state's cost for the new retirement plan from an estimated 21.4 percent of salaries to 20.4 percent, simply by raising the minimum age for full retirement benefits to 65. We recommend that the Legislature make this adjustment, which not only would save state funds, but would further the policy objective of encouraging experienced judges to serve longer.

Judges' Contribution Rate

The contribution rate for current judges under the JRS is 8 percent of salary. The Legislature retains the right, under Government Code Section 75103.1, to increase this rate. The select committee's proposal would maintain the 8 percent contribution rate for new judges, but does not include any provision for the Legislature ever to increase the rate. Each percentage point increase in the judges' contribution translates into a percentage point reduction in the state's contribution.

We believe there is ample justification for a higher judges' rate than proposed by the select committee. As Figures 1 and 2 show, the proposal would give new judges a generous benefits package, particularly by comparison with the state's plans for other public employees. Yet the proposed contribution rate for judges is the same as for teachers, even though teachers earn far less than judges, and enjoy substantially less generous retirement benefits. Most state employees, who are members of miscellaneous first tier in the PERS, must make combined PERS and social security contributions of approximately 10.5 percent (varying somewhat based on salary level).

In view of the above, we recommend that the Legislature increase the proposed judges' contribution rate from 8 percent to 11 percent of salary. This is the same rate that the Legislature approved for judges in the JRS in AB 1031 (Bentley) of 1992 (vetoed), and is justified in comparison with contribution rates and benefits for other public employees.

We believe that an increase to 11 percent would also be justified for current judges in the JRS, as we recommended in the *Analysis of the 1993-94 Budget Bill* (page H-21). If legislation were enacted to take effect January 1, 1995, an increase in the JRS judges' rate would save the General Fund about $2.3 million in 1994-95, and about $4.7 million annually thereafter.

A Funding Plan for the New Judicial Retirement Program

The proposed judicial retirement program would lower the state's cost for judges' retirement in the long run. For the near-to-medium term, however, state expenditures would have to increase. Because the new program is to be pre-funded, like all the state's retirement plans other than the JRS, employer contributions would have to be made from its inception. And because the existing JRS long ago turned into a de-facto pay-as-you-go system, at least a decade will pass before substantial savings from closing off membership in the JRS will be realized.

In the interim, therefore, the state will have to spend the same amount it otherwise would spend for *current* retiree pensions, *plus* make contributions to the new judges' program. The contribution amounts for the new program would be modest at first but would grow as newly appointed judges entered the program. The Judicial Council estimates that the necessary state contribution (at the proposed 21.4 percent) would be $2.2 million in the first year of the program, rising to $10.3 million by the fourth year. (Adoption of our recommendations would cut these state costs to $1.8 million and $8.4 million, respectively.)

In order to avoid new demands on the General Fund at this time, the select committee endorsed an option discussed in our *Analysis of the 1993-94 Budget Bill* (page H-23) to increase that portion of civil court filing fees dedicated to judges' retirement (to account for inflation since 1971). This approach would generate enough revenue to avoid any General Fund expenditures for the new program for at least four years. In fact, the increased fee revenues (about $10 million annually) would exceed necessary state contributions to the program in its first year by about $8 million.

The select committee recommends that the residual fee revenues available in the initial years be applied to reduction of the JRS' unfunded liability. A more direct benefit, given the state's fiscal problems, would be to use the residual revenues to offset annual General Fund appropriations that have to be made to the JRS in the Budget Act. With this modification, we recommend that the Legislature increase civil court filing fees to fund the start-up of the judicial retirement program, as recommended by the select committee. If enabling legislation establishes the program and the fee increase by January 1, 1995, the General Fund could save approximately $4 million in 1994-95.

Summary of Our Recommendations

We recommend that the Legislature enact legislation to establish a new retirement program for judges taking office in the future, funded on an actuarially sound basis, in order to reduce long-run state costs for judges' retirement. The legislation should incorporate the retirement plan developed by the Select Committee on Judicial Retirement, with the following modifications to further reduce state costs:

- Raise the minimum age for full retirement benefits from 63 to 65. (Estimated General Fund saving of $50,000 in 1994-95, increasing steadily to $1.5 million annual savings within a decade.)

- Increase the contribution rate for new judges from 8 percent of salary to 11 percent. (Estimated General Fund saving of $150,000 in 1994-95, increasing steadily to $4.5 million annual savings within a decade.)

- Provide for the judges' contribution rate to rise or fall in concert with the state's rate in response to actuarial valuations, based on a fixed ratio between state contributions and judges' contributions of 17.4 to 11. This would fairly share the risks and the rewards of unforeseeable changes in program cost.

- Increase that portion of civil court filing fees dedicated to judges' retirement to provide start-up funding for the new judicial retirement program, as recommended by the select committee. However, use residual revenues to offset General Fund appropriations for the JRS (1994-95 savings of $4 million).
- Retain the Legislature's rights to reduce program benefits and increase contribution rates if future conditions warrant. (Restate Government Code Sections 75103.1 and 75103.2 in the new legislation.)

In addition, we recommend the following change to the *existing* JRS:

- Increase the contribution rate for current judges in the JRS from 8 percent to 11 percent. (General Fund savings of $2.3 million in 1994-95, and $4.7 million annually thereafter.)

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