

Addressing the CalSTRS Long-Term Funding Needs

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

Assembly Public Employees, Retirement and Social Security Committee

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* Background

The CalSTRS Defined Benefit Program faces a funding shortfall of \$71 billion. Absent any changes in contribution rates or liabilities, current calculations show the program will deplete its assets by as early as 2043. Last year CalSTRS submitted a report to the Legislature pursuant to Senate Concurrent Resolution 105 that provided a range of sustainable funding strategies built upon gradual, incremental contribution increases that could be adopted to close the funding gap and secure the long-term stability of the fund. CalSTRS' financial holdings sustained significant losses in the 2001 dot com bust and 2008 world economic turmoil. Since CalSTRS does not have authority to correct the situation by adjusting its contribution rates like other public pension funds, the long-term health of the fund has continued to weaken.

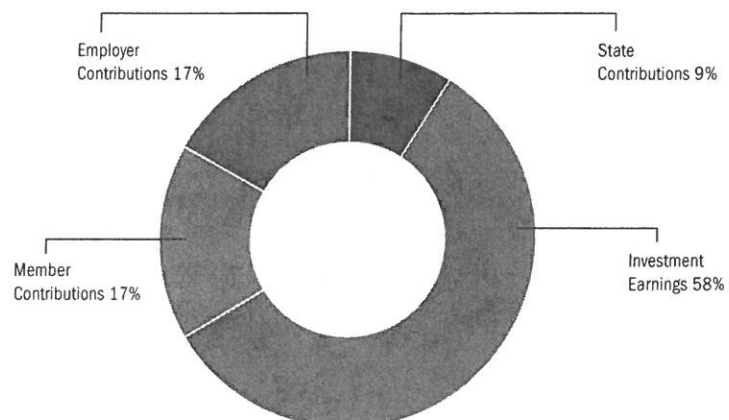
Defined Benefit Program Financial Status

CalSTRS June 30, 2012, actuarial valuation shows the Defined Benefit Program is 67 percent funded with an unfunded liability of \$71 billion. The CalSTRS portfolio was valued at \$181.1 billion as of December 31, 2013.



Benefit Funding Sources Since 1984-85

Benefits are paid by contributions from members, school employers, the State of California, and earnings from the investment of those contributions. In fiscal year 2012-13, \$11.4 billion was paid in benefits, which includes the Supplemental Benefit Maintenance Account.



Benefit funding sources are approximate representations.

Benefit Replacement Ratios

2% at 60 members - On average retired at age 62 after about 25 years of services with a pension that replaced about 54 percent of their highest salary for fiscal year 2013-14.

2% at 62 members - CalSTRS members hired on or after Jan. 1, 2013, subject to PEPRA legislation are estimated to retire with a pension that replaces about 47 percent of their highest three years' salary, assuming members retire at the same age and with the same service credit as recent retirees.

Comparative Contribution Rates

All CalSTRS contribution rates are set by statute. The state contribution amount of 5.541 percent includes the state contribution to the Defined Benefit Program and Supplemental Benefit Maintenance Account. The payroll rate for the Defined Benefit Program is equivalent to 3.041 percent for the 2013-14 fiscal year. The state contribution rate of 2.5 percent to the Supplemental Benefit Maintenance Account is also included in chart below.

| | Employee Defined Benefit | Employee Social Security | Employer Defined Benefit | Employer Social Security | State | Total |
|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|--------|--------|
| CalSTRS | 8.00% | N/A | 8.25% | N/A | 5.541% | 21.79% |
| CalPERS School | 7.00% | 6.20% | 11.44% | 6.20% | N/A | 30.84% |
| CalPERS State Misc (Tier I) | 8.00% | 6.20% | 21.12% | 6.20% | N/A | 41.52% |

Legal Considerations

- Contribution rate increases on current members must be accompanied by a corresponding, offsetting advantage.
- Proposition 98 legal issues should be resolved to understand impacts of contribution rate increases.

Unfunded Liability Values

Recently, several widely divergent figures have been used to describe the CalSTRS unfunded liability. Both the \$71 billion figure CalSTRS uses and the \$80.4 billion value cited in the Governor's 2014-15 Budget Proposal are derived from the CalSTRS June 30, 2012, actuarial valuation. Another figure, \$167 billion, is an estimation of the net pension liability required as part of the new Governmental Accounting and Standards Board requirements. All three of the values are associated with the CalSTRS \$71 billion unfunded liability. However only two of the values, \$71 billion and \$80.4 billion, could be used to estimate the required increase in contributions needed to address the funding shortfall, as both would result in the same required increase in contributions.

Impact of 2012-13 Investment Returns

A recent analysis by CalSTRS' outside actuarial firm Milliman indicates that the 13.8 percent investment return CalSTRS earned in fiscal year 2012-13, resulted in a positive impact on the long-term funding needs of the Defined Benefit Program. Specifically, to pay off the \$71 billion unfunded liability over a 30-year period beginning July 1, 2015, the calculated additional revenue needed would have been a 16.1 percent increase in payroll. However, because the actual return for CalSTRS significantly exceeded the assumed 7.5 percent return, CalSTRS' preliminary estimates show an increase of 14.2 percent of payroll to pay off the \$71 billion unfunded liability over a 30-year period beginning July 1, 2015, that translates into an additional \$4.2 billion in the first year, would still need to occur.

Legislative Considerations for a Funding Policy

- Define the financial objective.
- Determine the period of time to achieve the objective.
- Determine when contribution rate increases should begin.
- Establish the speed of contribution rate increases.
- Decide how contribution rate increases get allocated.
- Establish a date to re-evaluate the Defined Benefit Program funding changes.



CalSTRS report pursuant to SCR 105