CALSTRS

Regular Meeting

Item Number 9b – Open Session

Subject: Actuarial Valuation of the Defined Benefit Supplement Program and Consideration for the Adoption of an Additional Earnings Credit

Presenter(s): David Lamoureux and Rick Reed, CalSTRS / Nick Collier and Julie Smith, Milliman

Item Type: Action

Date & Time: May 2, 2024 – 5 minutes

Attachment(s):

Attachment 1 – June 30, 2023 Actuarial Valuation for the Defined Benefit Supplement Program

Attachment 2 – Proposed Resolution for the Adoption of an Additional Earnings Credit

PowerPoint(s):

Summary of Valuation Results for the Defined Benefit Supplement Program

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Item Purpose

The purpose of this item is to present the results of the June 30, 2023 actuarial valuation of the Defined Benefit Supplement Program and to consider the adoption of an additional earnings credit of 5.81%.

Recommendation

Staff recommends that an additional earnings credit of 5.81% of the June 30, 2023, account balance be awarded to members of the Defined Benefit Supplement Program who have not retired as of the day of the board's decision.

Executive Summary

The attached report is the annual actuarial valuation of the Defined Benefit Supplement Program required as per Section 22311.5 of the Education Code. The actuarial valuation provides a snapshot of the fund's assets and liabilities as of June 30, 2023, and reflects the updated actuarial assumptions that were adopted by the board in January 2024 as part of the 2024 Experience Analysis.

Funded Ratio

The funded ratio of a pension plan is defined as the ratio of a plan's assets to its actuarial obligation. The following table compares key information about the funded ratio of the Defined Benefit Supplement Program between June 30, 2023 and June 30, 2022 actuarial valuations.

Summary of Key Results for Defined Benefit Supplement Program

	June 30, 2023 Valuation	June 30, 2022 Valuation
Actuarial Obligation	$14.02 Billion	$13.22 Billion
Actuarial Value of Assets	$18.16 Billion	$17.17 Billion
Unfunded Actuarial Obligation / (Actuarial Surplus)	($4.14 Billion)	($3.95 Billion)
Proposed Additional Earnings Credit (Estimated Dollar Value / Percent of Account Balance Awarded)	$0.69 Billion[1] / 5.81%	$0.61 Billion[2] / 5.47%
Final Unfunded Actuarial Obligation / (Actuarial Surplus)	($3.46 Billion)	($3.34 Billion)
Funded Ratio		
- Before Additional Earnings Credit	129.6%	129.9%
- After Additional Earnings Credit	123.5%	124.1%

The funded status and the actuarial surplus have increased since the 2022 valuation. Note that the final funded status and actuarial surplus from the 2022 valuation are those which reflect the additional earnings credit awarded by the board. As shown above, the funded status increased by 5.5%, from 124.1% on June 30, 2022 (after the additional earnings credit) to 129.6% on June 30, 2023 (before the additional earnings credit). The actuarial surplus increased by about $0.8 billion.

These increases were primarily the result of the investment return for fiscal year 2022-23, which was less than the assumed investment return of 7.0% but greater than the minimum interest rate credited to the member's account of 2.09%. As shown on page 1 of the attached report, the investment return for the Defined Benefit Supplemental Program was calculated to be 6.5% for

[1] Subject to approval by the board at the May 2024 meeting.
[2] Approved by the board in May 2023.

fiscal year 2022-23. Additionally, there was a slight increase to the actuarial surplus due to the updated mortality assumptions adopted with the 2024 Experience Analysis. For additional details on the changes in the surplus, please refer to Table 4, *Actuarial Gains and Losses,* on page 12 of the attached report.

The funded ratio for the Defined Benefit Supplement Program is based on the market value of assets. This differs from the Defined Benefit Program which uses an actuarial value of assets which smooths the volatility in the investment markets by reflecting only one-third of the net accumulated investment gains and losses in a year. For the Defined Benefit Supplement Program the volatility of the investment market is managed by establishing a gain and loss reserve, which, if positive, includes investment earnings in excess of the amount needed to fund the program liabilities and, if negative, reflects an unfunded actuarial obligation of the program. If, in any year, investment earnings are less than necessary, any positive balance in the Gain and Loss Reserve is used to fund the minimum interest rate. If the balance in the gain and loss reserve is sufficient to properly protect the program against investment losses, any remaining actuarial surplus can be used to fund an additional earnings credit.

Additional Earnings Credit

Section 25006 of the Education Code allows the board to declare an additional earnings credit for members of the Defined Benefit Supplement Program. The board has adopted a policy stating that additional earnings credits may be awarded if the funded ratio of the program surpasses certain thresholds. The thresholds are determined using a two-step allocation process.

1. The first step in the process allocates the excess of the actuarial surplus over the standard deviation of the expected long-term rate of return on the investment portfolio, limited to the difference between the minimum interest rate from the previous valuation and the long-term assumed rate of earnings.
2. The second step in the process allocates 50% of the remaining actuarial surplus over two times the standard deviation of the expected long-term rate of return on the investment portfolio.

The additional earnings credit awarded would be the sum of the allocation from the two steps.

The standard deviation for the Defined Benefit Supplement Program was set at 11.3% when the board adopted the most recent experience study in January 2024. This means that the board is asked to consider an additional earnings credit only when the program has a funded status greater than 111.3%. For the second threshold, the funded ratio would have to exceed 122.6% following the first threshold allocation. As of June 30, 2023, the Defined Benefit Supplement Program had a funded ratio of 129.6%, which exceeds the first threshold. After the first allocation, the funded status is 124.4% which exceeds the second threshold.

Based on board policy, an additional earnings credit of 5.81% has been calculated as the sum of 4.91% under the first allocation step and 0.90% under the second allocation step. Awarding a

5.81% additional earnings credit will reduce the funded status of the program from 129.6% down to 123.5% and reduce the actuarial surplus by $688 million, from $4.14 billion down to about $3.46 billion. For more details on the calculation of the recommended additional earnings credit refer to Table 6, *Additional Earnings Credit Based on Board Policy,* on page 14 of the attached report.

If awarded, the additional earnings credit of 5.81% will be applied to the June 30, 2023, account balance for members who have not yet retired as of the day of the board's decision.

Strategic Plan Linkage: Goal 1: Trusted stewards – Ensure a well-governed financially sound trust fund.

Board Policy Linkage: Board Governance Manual: Section 7G - Benefits and Services Policy - Actuarial Valuations of the Defined Benefit Supplement Program and the Cash Balance Benefit Program.
