



CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

## FUNDING CALSTRS' BENEFITS

The primary retirement program administered by CalSTRS is the Defined Benefit Program. Members and beneficiaries in the DB Program have their benefits protected by the effects of inflation through a supplemental benefit program. Both the DB Program and the supplemental benefit program are at least partially funded by state contributions from the General Fund.

### State Funding of the DB Program

When CalSTRS was founded in 1913, contributions were made by the state from its inheritance tax, and many changes were made to the amount the state, members and employers paid between 1913 and the early-1970s. Because teachers received credit for service performed before 1913, the DB Program had been underfunded since its inception. Serious efforts were not made to address the adequacy of funding until the early-1970s. By 1970, it was clear a fluctuating employer contribution rate, a low employee contribution rate and an uncertain funding stream from the State's General Fund were insufficient and a secure funding mechanism was needed.

In 1972, the E. Richard Barnes Act was enacted, and member and employer contributions were statutorily fixed at 8 percent and the General Fund contribution was also locked-in at \$130 million per year for 30 years. (For a variety of

reasons, the General Fund contribution changed a number of times during the 1970s and 1980s. In addition, the employer's contribution was increased to 8.25 percent in 1980.)

By 1990, actuarial calculations indicated an amount equal to 4.2 percent of prior-year teacher payroll would satisfy the unfunded actuarial obligation within 45 years and prevent future unfunded obligations. Legislation was enacted in 1990 that based the General Fund's contribution as a percentage of the previous fiscal year's total teacher payroll, instead of basing the contribution on a dollar amount that increased with increases in the Consumer Price Index. The legislation providing this new funding mechanism provided for a suspension in the state's contribution for the 1990-91 fiscal year, in return for an annual state appropriation of 4.3 percent of prior-year payroll in future years.

The actuarial valuation of the DB Program conducted in 1998 indicated the unfunded liability would be eliminated if the investment returns met the Board's assumptions by the end of the 1999-2000 fiscal year. Therefore, in 1999, CalSTRS benefits were enhanced in a number of targeted ways in order to encourage teachers to remain in the classroom. (For example, benefits paid for retiring after age 60 or with at least 30 years of service were increased.) As part of that legislation, the state's contribution for benefits permanently changed in 1998 from 4.3 percent of prior-year teacher payroll to 3.102 percent.

Benefits were increased again in 2000, also primarily to encourage teachers to stay in the classroom, and that same legislation permanently reduced the General Fund contribution over a period of time to its current contribution rate of 2.017 percent of pay.

## **State Funding of Purchasing Power Benefits**

DB Program benefits are increased annually by two percent of the original benefit, and the Legislature has, on occasion, provided one-time increases in benefits to partially offset the effects of inflation. In 1982, a program was created to provide a more consistent means of protecting benefits from inflation, rather than continuing with periodic ad hoc increases. The Retirees' Purchasing Power

Protection Fund was established for the purpose of paying a benefit on a quarterly basis to supplement existing benefits when the purchasing power of the benefit currently being paid, including annual benefit adjustments, fell below a specified percentage of the value of the original benefit. The supplemental benefit was funded by a General Fund contribution equal to 5 percent of the average increase in teacher payroll from the three previous fiscal years. This contribution was subject to inclusion in and approval of the annual budget act.

The years following the establishment of the Retirees' Purchasing Power Protection Fund saw purchasing power improve slowly. The General Fund contribution to the purchasing power fund was graded-in beginning with the 1983-84 fiscal year and purchasing power protection increased each year:

- 1983 - General Fund contribution equaled \$20.5 million; improved purchasing power to 58.4 percent;
- 1984 - General Fund contribution equaled \$40.4 million; improved purchasing power to 61.0 percent;
- 1985 - General Fund contribution equaled \$72.7 million, improved purchasing power to 64.7 percent;
- 1986 - General Fund contribution equaled \$110.8 million, improved purchasing power to 67.7 percent;

In 1989, the Supplemental Benefits Maintenance Account (SBMA) was established to replace the annual dollar appropriation to the Retirees' Purchasing Power Protection Fund with an annual contribution from the General Fund equal to 2.5 percent of prior-year teacher payroll. This contribution would fund supplemental payments to maintain 68.2 percent purchasing power. The General Fund contributions were phased-in, beginning with 0.5 percent in 1989-90, and increasing by one-half percentage point each year until the full 2.5 percent contribution was reached.

Legislation was enacted in 1997 that increased purchasing power to 75 percent, in return for a one-time reduction of \$320 million in the state's contribution to SBMA. In 1998, as part of the legislation that enhanced DB Program benefits and

reduced the annual General Fund appropriation to the DB Program, the General Fund appropriation to SBMA became an explicit contractual obligation of the state, and the purchasing power benefits were vested to the extent that there were sufficient funds in the SBMA to make the payment. In 2001, the purchasing power benefit was increased to its current 80 percent level.

The 2003-2004 General Fund contribution to the SBMA was reduced by \$500 million in an attempt to reduce the State's budget deficit. CalSTRS pursued litigation, claiming that the State had a contractual obligation to make the contribution. CalSTRS has prevailed and received payment of the \$500 million on September 6, 2007. However, interest was also awarded by the court which as of January 1, 2008, had not yet been paid.