CALSTRS

Regular Meeting

Item Number 9a – Open Session

Subject: Actuarial Valuation of the Defined Benefit Program and Setting of Contribution Rates

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

Item Type: Action

Date & Time: May 2, 2024 – 20 minutes

Attachment(s):

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

Attachment 2 – Proposed Resolution for the State Supplemental Contribution Rate

Attachment 3 – Proposed Resolution for the Employer Supplemental Contribution Rate

Attachment 4 – Proposed Resolution for the Normal Cost Rate for CalSTRS 2% at 62 Members

PowerPoint(s): Summary of Valuation Results for the Defined Benefit 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 Program and to recommend the adoption of three rates for fiscal year 2024-25: the state supplemental contribution rate, the employer supplemental contribution rate, and the normal cost rate for CalSTRS 2% at 62 members.

Recommendation

Staff recommends the board keep the state and employer supplemental contribution rates at existing levels by adopting the following rates effective July 1, 2024:

	Recommended Rate for Fiscal Year 2024-25
State supplemental contribution rate	6.311%
Employer supplemental contribution rate	10.850%
Normal cost for 2% at 62 Members	18.393%

If adopted, these rates will result in a total contribution rate of 19.1% for employers and a total contribution rate of 10.828% for the state.

Executive Summary

CalSTRS continually monitors the CalSTRS Funding Plan and the financial health of the fund. Formal assessments of funding levels and risks are provided to the board twice a year. These formal assessments are presented in the spring through this annual actuarial valuation and in the fall through the Review of Funding Levels and Risks report. In addition to these two formal reports, CalSTRS provides updates to the board on the status of various funding-related risks as part of the semi-annual enterprise risk management report. These semi-annual reports are generally presented in March and September of each year.

At the January 2024 meeting, the board adopted new actuarial assumptions based on the results of the 2024 experience analysis. Periodically reviewing the actuarial assumptions is important to ensure they remain reasonable, reflect the actual experience of the system and are appropriate for assessing funding levels and determining the contribution levels needed to achieve full funding. The new actuarial assumptions were used for the June 30, 2023 actuarial valuation.

The CalSTRS Funding Plan provides the board with limited authority to adjust the contribution rates for both the state and employers. The purpose of the actuarial valuation is to provide an assessment of funding levels by taking a snapshot of the fund's assets and liabilities for the Defined Benefit Program as of June 30, 2023, and to determine whether adjustments are needed to contribution rates to keep the funding plan on track to reach full funding by 2046.

As shown in this item, funding levels have continued to improve since last year and the Defined Benefit Program remains slightly ahead of schedule to reach full funding by 2046. Current contribution rates continue to be sufficient to keep the CalSTRS Funding Plan on track.

Funded Ratio

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

Summary of Key Results for the Defined Benefit Program

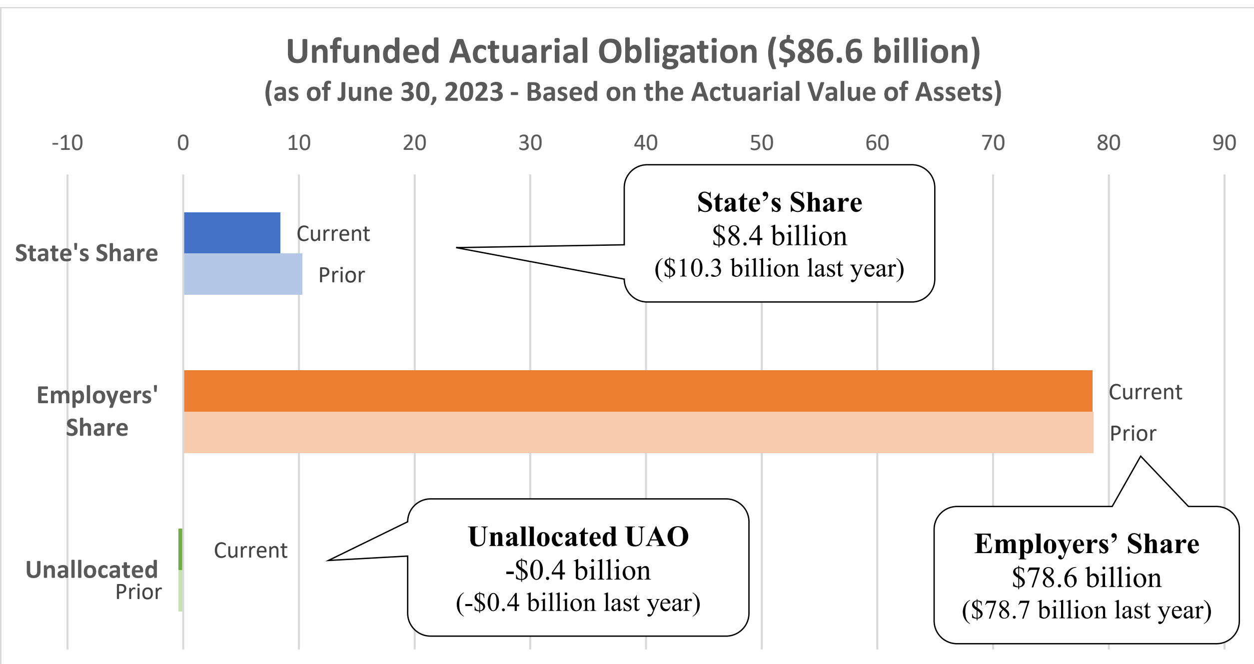
	June 30, 2023 Valuation	June 30, 2022 Valuation
Actuarial Obligation	$359.7 billion	$346.1 billion

Actuarial Value of Assets	$273.1 billion	$257.5 billion
Unfunded Actuarial Obligation	$86.6 billion	$88.6 billion
Funded Ratio	75.9%	74.4%

Both the funded ratio and the unfunded actuarial obligation slightly improved since the 2022 valuation. The funded ratio continued to increase due primarily to the contributions made by employers and the state to eliminate their share of the unfunded actuarial obligation by 2046 and to the implementation of the new actuarial assumptions. Please see page 5 of the attached report for further details on the reasons for the changes in the unfunded actuarial obligation.

As of June 30, 2023, the unfunded actuarial obligation was calculated to be $86.6 billion, down about $2 billion from $88.6 billion as of June 30, 2022. The unfunded actuarial obligation can be broken down between the state, the employers and the unallocated portion as per rules set forth in the CalSTRS Funding Plan. The unallocated portion of the unfunded actuarial obligation is the portion for which CalSTRS has no authority to adjust contribution rates up or down.

As the following chart illustrates, the breakdown of the unfunded actuarial obligation has changed slightly since the previous year. As of June 30, 2023, the employers are still responsible for most of the unfunded actuarial obligation. Employers are responsible for about 90% of the unfunded actuarial obligation while the state is responsible for about 10%.



Assuming all actuarial assumptions are met in the future, the unfunded actuarial obligation is projected to be fully eliminated by 2046. However, CalSTRS ability to reach full funding by 2046 could be impacted if CalSTRS were to go through a period of investment returns below its assumed 7%. Several of the risks that could prevent the Defined Benefit Program from reaching full funding by 2046 were explained in detail in the Review of Funding Levels and Risks report issued last November. The valuation report also includes a discussion of risk. Please see page 51 of the attached report for further details.

State Contribution Rate

The CalSTRS Funding Plan provides the board with the ability to increase the state contribution rate by up to 0.5% of payroll each year. The board's actuarial valuation policy also contains a limit of 0.5% of payroll each year on decreases to the state's contribution rate as long as the state has not eliminated its share of the unfunded actuarial obligation.

The state continues to be ahead of schedule to eliminate its share of the unfunded actuarial obligation by 2046. In fact, the state is currently on schedule to eliminate its $8.4 billion share of the unfunded actuarial obligation by 2029. As a result, the actuarial valuation has determined that the state's contribution rate could be decreased by 0.5% of payroll.

Although the valuation indicates the board can decrease the state's contribution rate by 0.5% of payroll, the board has the authority to make no change in the rate. This would be reasonable given the sensitivity of the state's contribution rate to investment volatility, the fact that investment markets remain volatile, and the Defined Benefit Program has a long way to go until reaching a 100% funded ratio. The board voted to keep the state supplemental contribution rate at existing levels for the last two years.

The following table compares the state contribution rate for this year and provides two options for the contribution rate for next fiscal year.

	Rate for Fiscal Year 24-25		
State Contribution Rate	**Option 1 (Recommended rate)**	**Option 2 (Calculated rate)**	**Current Rate for Fiscal Year 23-24**
Base (DB Program)	2.017%	2.017%	2.017%
Supplemental (DB Program)	6.311%[1]	5.811%	6.311%
Total to DB Program	**8.328%**	**7.828%**	**8.328%**
Contribution to SBMA[2]	2.500%	2.500%	2.500%
Total State Contribution to CalSTRS	**10.828%**	**10.328%**	**10.828%**

[1] Recommended for board adoption.

[2] The state contributes an additional 2.5% of payroll to fund the Supplemental Benefit Maintenance Account (SBMA) that is used to provide inflation protection to CalSTRS retirees and their beneficiaries. Pursuant to Education Code section 22954, the state contribution to the SBMA is reduced by $72 million each fiscal year.

Option 1 above would maintain the state's contribution rate at the current level. Option 2 would decrease the rate by 0.5% of payroll for next fiscal year. Considering the extreme sensitivity of the state's share of the unfunded liability to investment performance, it is recommended the board adopt option 1. Option 1 will provide a more stable rate, improve funding levels, and reduce risk in the event of future adverse investment outcomes. It is also worth noting that the Governor's proposed budget, released in January 2024, includes an amount for CalSTRS based on the expectation the total state contribution rate to CalSTRS will remain unchanged next fiscal year at 10.828%.

Employer Contribution Rate

Employers are required to contribute a base contribution rate of 8.25% of payroll to CalSTRS as well as a supplemental contribution rate to eliminate their share of the CalSTRS unfunded actuarial obligation by 2046. For fiscal year 2023-24, the employer supplemental contribution rate is 10.85% of payroll. This rate was adopted by the board at the May 2023 board meeting. The total employer contribution rate in fiscal year 2023-24 is 19.1% of payroll.

Fiscal year 2024-25 marks the fourth fiscal year for which the board has the authority to adjust the employer supplemental contribution rate pursuant to the CalSTRS Funding Plan. The board can now adjust annually the employer supplemental contribution rate up or down by a maximum of 1% of payroll in a single year. The total employer rate cannot exceed 20.25% of payroll.

Consistent with statute and the board valuation policy, the annual adjustments to the employer supplemental contribution rate are determined by calculating the employer contribution rate needed to eliminate the employers' share of the unfunded actuarial obligation by 2046.

Based on the results of the June 30, 2023 actuarial valuation, the employers are slightly ahead of schedule to eliminate their share of the unfunded actuarial obligation by 2046. In fact, the employers' share of the unfunded actuarial obligation is currently on schedule to be eliminated by 2044. As a result, an employer supplemental contribution rate of 9.850% was calculated to be sufficient in fiscal year 2024-25 for the employers to remain on schedule to eliminate their share of the unfunded actuarial obligation by 2046. This rate is 1% of payroll lower than the employer supplemental contribution rate in effect for fiscal year 2023-24.

Although the valuation indicates the board can decrease the employer supplemental contribution rate by 1% of payroll, the board has the authority to make no change in the rate. Since having the authority to set the employer supplemental contribution rate, the board has always voted to keep the employer supplemental contribution rate at 10.85% of payroll, for a total employer contribution of 19.1% of payroll. The board kept the employer contribution rate at the existing level, even if it could have been reduced, in order to maintain stability in the employer contribution rate, improve funding levels quicker and reduce the likelihood the board may have to raise the employer rate in the future.

The following table shows the breakdown of the total employer contribution rate under two options, maintaining the supplemental rate at its current level and decreasing the supplemental rate to the level calculated in the valuation.

Employer Contribution Rate	Fiscal year 2024-25		Fiscal Year 2023-24
	Option 1 (Recommended rate)	**Option 2 (Calculated rate)**	
Base	8.250%	8.250%	8.250%
Supplemental Rate	10.850%[3]	9.850%	10.850%
Total Employer Contribution Rate	**19.100%**	**18.100%**	**19.100%**

Option 1 would maintain the employer contribution rate at its current level. Option 2 would decrease the employer rate by 1%. Both options are consistent with the board valuation policy.

However, several risks could impact the employers' ability to eliminate their share of the unfunded actuarial obligation by 2046 and could require the board to increase the employer rate in the future. The main risk for employers is the uncertainty around K-12 enrollment levels and how it could impact the future size of the teacher payroll.

Over the last few years, California experienced a decline in enrollment in both K–12 public schools and community colleges. Total enrollment in K–12 public schools in California dropped by about 310,000, or a 5% reduction since 2019. At the same time, the number of students enrolled at community colleges dropped by 280,000 or 18%.

In October 2023, the State of California updated its projection of K–12 enrollment for California. The updated projection assumes the number of children enrolled in K–12 public schools will continue to decline for the next 20 years. The most recent projection anticipates a decline of about 15% over the next 20 years. Anticipated continued decreases in enrollment in K–12 public schools could lead to future declines in the size of the active membership, resulting in lower than anticipated payroll growth. This could negatively impact CalSTRS' ability to achieve full funding, requiring contribution rate increases for employers.

It is recommended that the board adopt option 1 and keep the employer rate at existing levels to maintain stability in the employer contribution rate, improve funding levels quicker and reduce the likelihood the board may have to raise the employer rate in the future.

Member Contribution Rate

Under the California Public Employees' Pension Reform Act of 2013 (PEPRA), 2% at age 62 members are required to pay at least one-half of the normal cost of their Defined Benefit Program benefit, rounded to the nearest quarter of one percent. The normal cost is the annual cost applied to each year of service that is necessary to adequately fund the benefits over time if all assumptions are met. The normal cost does not include costs associated with amortizing, or paying down, any unfunded liabilities.

[3] Recommended for board adoption.

Current law states that the contribution rate for PEPRA members should be adjusted if the normal cost changes by more than 1% since the last time the member contribution rate was adjusted. The last adjustment took place on July 1, 2018, when the contribution rate for 2% at age 62 members increased by 1%. The normal cost for 2% at 62 members at that time was 17.893%. 2% at age 62 members are currently paying 9% toward the normal cost. 2% at age 62 members also contribute an additional 1.205% as per the CalSTRS Funding Plan, for a total contribution rate of 10.205%.

As shown on page 8 of the attached report, the normal cost has increased by 0.5% since that time. It is now at 18.393%. This is a cumulative change of less than 1%. Therefore, no change in the 2% at 62 member contribution rate is necessary for next fiscal year. It is recommended the board adopt the normal cost for 2% at 62 members of 18.393%.

The contribution rate for 2% at 60 members is set in statute at 10.250%.

The following table compares the member contribution rates for this year and the next fiscal year.

Member's Contribution Rate	**June 30, 2023 Valuation (Rate for FY 24-25)**	**June 30, 2022 Valuation (Rate for FY 23-24)**
2% at 60 Members	10.250%	10.250%
2% at 62 Members	10.205%	10.205%

Note that the number of members subject to the 2% at age 62 formula continues to increase steadily. Generally, new teachers hired on or after January 1, 2013 are covered under the 2% at 62 formula. The number of 2% at 62 members has increased by almost 20,000 since the 2022 valuation. There were about 181,000 2% at 62 active members as of June 30, 2023. This represents about 39% of the roughly 459,000 total number of active members on June 30, 2023.

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

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