



Regular Meeting

Item Number 10 – Open Session

Subject: Inflation and Supplemental Benefit Maintenance Account Update

Presenter(s): Chairperson

Item Type: Consent Information

Date & Time: November 2, 2022 – 0 minutes

Attachment(s): None

PowerPoint(s): None

Item Purpose

The purpose of this item is to provide an update on how recent levels of inflation have impacted the Supplemental Benefit Maintenance Account (SBMA), CalSTRS' inflation protection program.

Recommendation

This is an information item only.

Executive Summary

The SBMA was created to provide inflation protection to CalSTRS retirees and their beneficiaries. The SBMA currently provides quarterly supplemental payments to maintain 85% of the purchasing power of a member's initial retirement allowance.

Over the last year, inflation in the United States has been at levels not seen for 40 years. California was no exception. California inflation was 8.3% for fiscal year 2021–22, the highest since 1981–82. Since the SBMA was designed to provide inflation protection, it should come as no surprise that both the payments made by the SBMA and the number of members receiving SBMA significantly increased this fiscal year.

In fiscal year 2021–22, SBMA quarterly payments were paid to members who retired in calendar year 2000 or earlier. In October 2021, CalSTRS paid SBMA payments to about 68,000 retirees and their beneficiaries, totaling about \$63 million dollars.

As a result of the recent high inflation, SBMA payments for fiscal year 2022–23 will now be made to members who retired in calendar year 2005 or earlier. Roughly 50,000 retired members and their beneficiaries will receive SBMA payments for the first time in October 2022, bringing the total number of recipients to almost 112,000. The SBMA payments that CalSTRS made in October 2022 almost doubled compared to October 2021. CalSTRS paid about \$124 million in quarterly SBMA payments in October 2022.

The high inflation in 2021–22 has also impacted the projected excess resources of the SBMA. When the June 30, 2021, actuarial projection for the SBMA was presented to the board in May 2022, it showed the value of the available resources (current assets plus projected future contributions on current member payroll) exceeded the projected value of future purchasing power benefits for current members by \$11.9 billion. Reflecting the 8.3% inflation in fiscal year 2021–22, it is estimated that the excess resources were reduced by \$4.4 billion. Excess resources have also been further reduced by about \$600 million as a result of Senate Bill 868. SB 868 was signed into law by Governor Newsom on September 30, 2022. SB 868 was supported by the board and will provide one-time permanent benefit increases, starting in fiscal year 2023-24, to CalSTRS members who retired prior to 1999. Staff will continue to monitor inflation levels and their impact on the SBMA. The next section provides additional information on the ability of the SBMA to maintain an 85% purchasing power protection level under various inflation levels.

Background

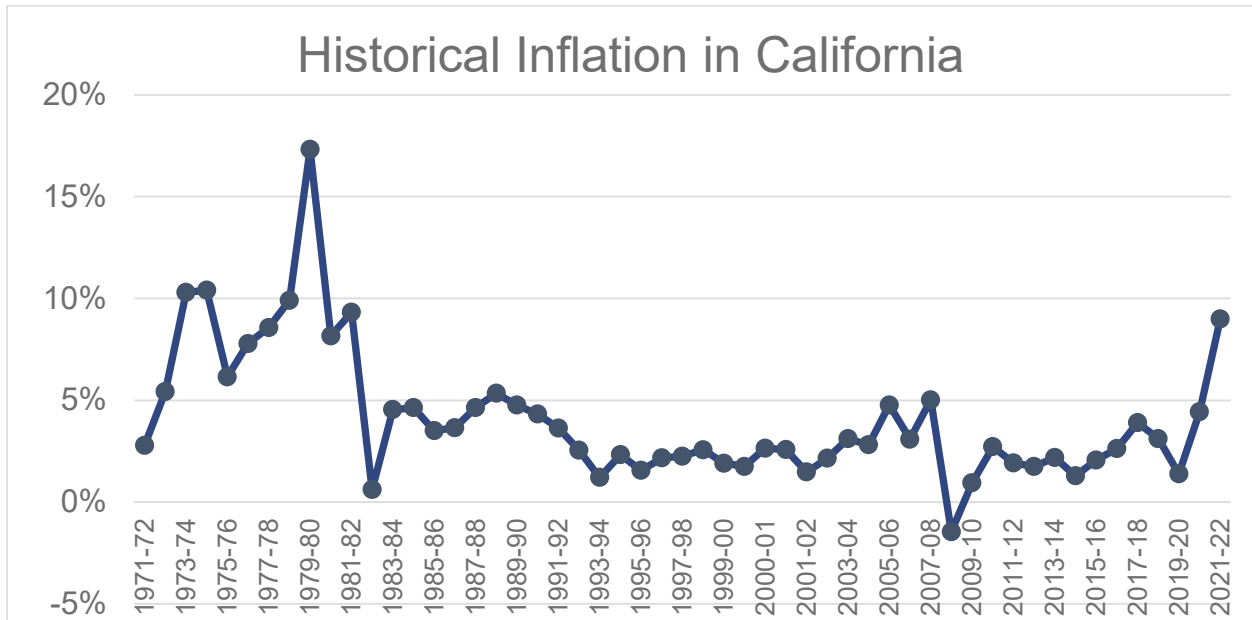
CalSTRS has two benefit provisions that protect members and their beneficiaries from the loss of purchasing power due to inflation. The first level of inflation protection is through the annual simple benefit adjustment, which provides a 2% increase to a member's monthly pension every September. This increase is based on the initial allowance, is not compounded as benefits increase and is granted each year regardless of the level of inflation.

The SBMA is the second level of protection and is the main defense against the loss of purchasing power when inflation is high. The benefit is directly tied to the level of inflation and was created specifically to provide inflation protection to CalSTRS retirees and their beneficiaries. The SBMA currently provides supplemental payments to maintain 85% of the purchasing power of a member's initial retirement allowance. SBMA eligibility is determined on a fiscal year basis. SBMA payments are made quarterly, with the first payment of each fiscal year made on October 1st. The other SBMA quarterly payments are made on the first of the months of January, April and July. SBMA payments are in addition to the simple benefit adjustment.

Since the SBMA is an inflation protection program, it is important to understand how inflation is measured each year for purposes of calculating purchasing power and determining the amount paid from the SBMA. For CalSTRS, the change in the All-Urban California Consumer Price Index, calculated by the Division of Labor Statistics and Research in the California Department of Industrial Relations, is used to determine the levels of inflation. As required by law, CalSTRS measures inflation for each fiscal year by comparing California CPI for the month of June in

successive years. Based on this index, the rate of inflation in California was 8.3% for the 2021–22 fiscal year.

As shown on the chart below, inflation over the last fiscal year was the highest seen in California since 1981–82.



The high inflation in the last year has significantly increased both the payments made by the SBMA and the number of members receiving SBMA. Below is a table comparing the number of members and their beneficiaries who received a payment from the SBMA in October in each of the last five years as well as the total quarterly amounts paid from the SBMA in October.

Month and Year	Number of Members and Beneficiaries who Received an SBMA Payment	Quarterly SBMA Payment
October 2018	72,216	\$50.4 million
October 2019	70,862	\$55.8 million
October 2020	65,705	\$50.1 million
October 2021	67,900	\$63.0 million
October 2022	111,680	\$123.9 million

Note that newly eligible members received a letter from CalSTRS confirming their eligibility. Their SBMA benefit was paid separate from the monthly benefit but issued in the same manner

as monthly benefits are received. This is an automated process, and members did not need to contact CalSTRS to enroll.

The timing as to when a retired member first starts receiving a benefit from the SBMA will always be directly related to levels of inflation. Currently, only those who retired in 2005 or earlier are receiving SBMA. This means those who retired in 2006 or later still have a purchasing power that exceeds 85%. If inflation continues to remain at high levels, the members eligible to receive SBMA could once again increase significantly. For example, if inflation were to be 5% in 2022–23, SBMA payments for next fiscal year would be paid to those who retired in 2010 or earlier. If inflation were to be 7.5%, members who retired in 2017 or earlier would become eligible for SBMA.

The ability for the SBMA to have enough funds to provide inflation protection for the long term is also directly related to future levels of inflation. In the most recent actuarial projection of the SBMA, it was determined that the value of the available resources (current assets plus projected future contributions on current member payroll) exceeded the projected value of future purchasing power benefits for current members by \$11.9 billion. This assumed inflation would remain at 2.75%, the long-term assumption adopted by the board. Reflecting the 8.3% inflation in fiscal year 2021–22, it is estimated that the excess resources are now \$7.5 billion, a reduction of \$4.4 billion.

Inflation since the start of fiscal 2022–23 remains high and is on pace to again exceed the long-term assumption of 2.75% per year. It is unclear when the efforts of the federal government to curb inflation will start to show in the inflation data. If California were to continue to experience high levels of inflation, it could adversely impact the ability of the SBMA to provide an 85% protection level long-term.

If impacted, the board may need to reduce the purchasing power protection level. Section 24415.5 of the Education Code authorizes the board to adjust the purchasing power protection level provided by the SBMA between 80% and 85% based on actuarial projections through a period established by the board. In 2009, the board adopted regulations to outline and implement the process to adjust the purchasing power protection provided by the SBMA, including the date through which purchasing power protection should be sustained. June 30, 2089, was the date set by the board through these regulations.

To evaluate the ability of the SBMA to provide purchasing power protection, the following table shows whether the SBMA would be able to continue to provide an 85% protection level through 2089 under various inflation scenarios. If unable, the table shows the year in which SBMA funds are expected to be depleted if the protection level is kept at 85%. The table also shows the highest protection the SBMA would be able to sustain through 2089 for each of the scenarios. Note that, as per existing statute, the board cannot set the protection level above 85%.

Inflation Scenario	Can SBMA Maintain an 85% Protection Level through 2089?	Depletion Year if Protection Level is Kept at 85%	Maximum Protection Level
2.75% each year	Yes	N/A	90%
5% for next 3 years 2.75% in years 4+	Yes	N/A	87%
6% for next 3 years 2.75% in years 4+	Yes	N/A	86%
7% for next 3 years 2.75% in years 4+	No	2088	84%
8% for next 3 years 2.75% in years 4+	No	2046	83%
9% for next 3 years 2.75% in years 4+	No	2038	82%

As shown above, the SBMA would be expected to have enough resources to sustain an 85% protection level if inflation remains below 7% for the next three years and reverts to an average of 2.75% per year afterward. If inflation were to remain at 7% or higher for the next three years, the board would be faced with the decision to potentially lower the protection level below 85% to ensure the SBMA funds are not depleted prior to 2089. As shown above, in instances where a protection level of 85% cannot be sustained, the SBMA would still be able to provide inflation protection through 2089 but at levels ranging between 82% and 84%. Staff will continue to monitor inflation levels and their impact on the SBMA and report back to the board as part of the SBMA sufficiency actuarial projection that is performed every two years. The next sufficiency projection is currently scheduled for May 2024.

Strategic Plan Linkage: Goal 1: Trusted steward – ensure a well-governed, financially trust fund.

Optional Reference Material: [Funding sufficiency projection for the SBMA](#)