

Why is CalSTRS’ ALM Study unique?

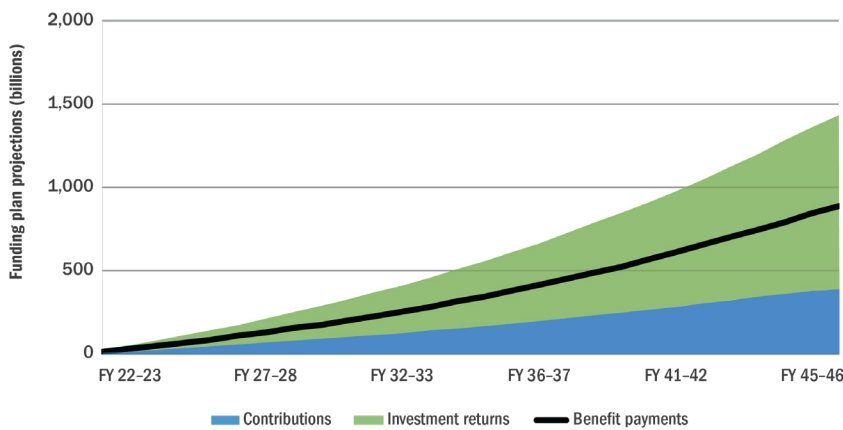
Conducting an ALM Study is a best practice for all pension funds, but the outcome of each study is unique to each plan. The data and results from our study are specific and applicable only to the Teachers’ Retirement Fund; any comparison with similar studies for other pension funds would be misleading. The singular focus of the CalSTRS ALM Study is to review CalSTRS’ liabilities (or pension benefits) owed to its members and its funding structure (CalSTRS Funding Plan) to determine how best to invest the assets to fund those pension benefits. CalSTRS members are unique regarding their years of service, pension benefit formula and demographics. The CalSTRS Funding Plan is also unique to CalSTRS and an important component of any asset allocation decisions. The funding plan, enacted in 2014, puts CalSTRS on the path toward full funding by 2046 through gradual contribution increases shared between CalSTRS members, employers and the state.

Figure 1: Sources of revenue to pay benefits for the last 30 years



Investment earnings are a critical component of the CalSTRS Funding Plan and the goal of reaching full funding by 2046. For the last 30 years, investment earnings have been the largest contributor to our ability to pay benefits (see Figure 1) and will continue to be. While benefit payments and contributions are predictable, short-term investment returns are more volatile due to normal market movements that can cause significant swings in portfolio return in any given year.

Figure 2: Projected investment returns, contributions and benefit payments



CalSTRS is a mature system, which means the system is approaching an active member-to-retiree ratio of one-to-one. This puts the system into what is called deficit funding, meaning annual benefits paid exceed contributions received each year (see Figure 2). It also makes the system more sensitive to investment volatility. Over the past 30 years academic research has shown that 90% of investment performance and volatility is directly linked to the system’s asset allocation. To mitigate risks, the ALM Study spends significant time modeling market volatility as a key risk to manage and take advantage of when it offers appropriate investment returns. As a result, the CalSTRS ALM Study puts it on the best path toward achieving full funding.

How does the CalSTRS ALM Study relate to the board’s Investment Beliefs?

The board has adopted a set of nine Investment Beliefs. These beliefs provide guidance to the board for investing in a manner that reflects CalSTRS’ view of the global investment markets and its vision for participating in these markets to accomplish its fiduciary goal. The board has identified four of these beliefs that relate directly to the ALM Study process.

- **Belief 1** – Diversification strengthens the fund.
- **Belief 5** – CalSTRS can potentially capture an illiquidity risk premium.
- **Belief 6** – Managing short-term drawdown risk can positively impact CalSTRS’ ability to meet its long-term financial obligations.
- **Belief 9** – Investment risks associated with climate change and the related economic transition—physical, policy and technology driven—materially impact the value of CalSTRS’ investment portfolio.

