Sustaining Retirement Security for Future Generations

Senate Concurrent Resolution 105 (Negrete McLeod)

SCR 105 encourages CalSTRS to work with affected stakeholders to develop at least three options to address the long-term funding needs of the Defined Benefit (DB) Program, and submit a report on those options by February 15, 2013. The report, “Sustaining Retirement Security for Future Generations: Funding the California State Teachers’ Retirement System,” was submitted on February 14, 2013.

CalSTRS Facts

- The Teachers’ Retirement Board has no authority to set contribution rates.
- As of 6-30-2011, the liabilities of the DB Program exceed program assets by $64 billion.
- Current calculations show the program will deplete its assets by 2046 if no changes occur.

Economic Downturn Drives Funding Shortfall

The primary cause of the $64 billion funding gap is the weak financial market since 2000. Annual investment returns from 2000 through 2012 averaged about 4 percent. The magnitude of the shortfall has increased throughout the decade because the amount contributed to the DB Program has been a decreasing percentage of the amount needed to maintain full funding.

AB 340 addressed weakest aspect of plan design

- The benefit formula under AB 340 (the California Public Employees’ Pension Reform Act of 2013) reduces the median benefit percentage of final compensation paid, known as the replacement ratio from the current 53 percent to 47 percent.
- Although changes enacted in AB 340 reduce accrued liabilities of service for future members, those benefit changes are insufficient to fully offset the funding shortfall.

CalSTRS identified six primary issues the Legislature and the Governor need to consider in developing a funding program as:

1. What is the financial objective?
2. Over what period of time should that objective be achieved?
3. When should contribution rates begin to increase?
4. How quickly should those contribution rates be increased?
5. How should those contribution rate increases be allocated among current and future members, employers and the state?
6. When should the Legislature and the Governor re-evaluate the DB Program funding changes being made?
Cost of Waiting Increases Risk

A delay in addressing the DB Program funding shortfall places the program at greater risk, particularly if there is another market downturn.

- If CalSTRS does run out of money, the state, as the plan sponsor, will be obligated to pay the difference between the benefits paid and the contributions received.
- Acting to increase contributions in 2014 in order to fully fund the program over the following 30 years would translate to an additional 15.1 percent* of payroll or a projected $4.5 billion in the first year.
- However, the cost will rise the later the contribution increase begins.

GASB Implications of Earlier Enactment

Recently adopted Governmental Accounting Standards Board (GASB) standards could ultimately require public employers to bear CalSTRS’ share of reporting unfunded liabilities on their financial statements, even if they don’t have the legal liability as the plan sponsor. If a funding solution is adopted in the 2013-14 legislative session, as intended in SCR 105, it may reduce the need to use an extremely low assumption rate in defining the unfunded liability on financial statements as required by GASB.

* Based upon the most recent, June 30, 2012, valuation, the additional percent of payroll needed is now 15.6 percent.

Stakeholder Organizations Support Increases

Since 2004, CalSTRS has worked to educate stakeholder groups on the need to increase contributions to address the funding shortfall. As a result, organizations representing CalSTRS members have expressed a willingness to increase the contribution rate imposed on all affected parties, including members.

Legal Considerations

- Proposition 98 legal issues should be resolved to understand impacts of contribution rate increases.
- Contribution rate increases on current members must be accompanied by a corresponding, offsetting advantage.

Reevaluation Recommended in 10-15 Years

Due to market volatility and its impact on investment returns, CalSTRS encourages the Legislature to reevaluate the need for additional changes within 10-15 years of enacting a funding plan.

Impact of Full Funding Alternatives

| Immediate Contribution Increases | 2014 When contribution increases begin + 30 Years Timeframe needed to achieve funded ratio = $121 billion Lower overall cost to meet target funded ratio |
| Delayed Contribution Increases | 2016 When contribution increases begin + 75 Years Timeframe needed to achieve funded ratio = $254 billion Higher overall cost to meet target funded ratio |

This is analogous to a home mortgage, where a larger payment over a shorter period of time ultimately means lower costs.

Link to the full report, Sustaining Retirement Security for Future Generations: Funding the California State Teachers’ Retirement System.