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Funding CalSTRS and CalPERS

In the late 1990s and early 2000s, both pension systems were fully funded and the pension benefits were increased at that time. Since then investment returns declined, creditable compensation increased more than predicted, and retirees have been living longer than anticipated. As the increasing pension contributions apply more pressure on local school agency budgets, we continue to receive questions as to why the employer contribution rates are more than doubling from 2013-14 through 2020-21.

Employer Contribution Rates

The California State Teachers' Retirement System (CalSTRS) employer contribution rate was 8.25% for many years—from 1990 through 2013-14. The funded status of the CalSTRS plan had been declining from being fully funded in 2000-01 to only 69% funded in 2010-11. As part of the enactment of the 2014-15 State Budget, the Legislature and Governor approved Assembly Bill (AB) 1469 (Chapter 47, 2014). AB 1469, billed as the "CalSTRS Funding Plan", implemented a schedule of increasing contribution rates for the state, employees, and employers. Employers bear the most significant portion of these increases, as follows:

2013-14 (Base Year)	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
8.25%	8.88%	10.73%	12.58%	14.43%	16.28%	18.13%	19.1%

Up until this time the CalSTRS Board did not have authority to change contribution rates—legislation had always been required. With the implementation of AB 1469 the CalSTRS Board has the authority to increase the employer contribution rate after 2020-21 by up to 1% per year to a maximum rate of 20.25%, which would be an additional 1.15% beyond the scheduled increases above (Education Code Section 22950.5).

The California Public Employees' Retirement System (CalPERS) Board has the authority to change the employer contribution rate and typically takes action in May of each year to set the rate for the next fiscal year. While there are no employer contribution rate increases scheduled in statute, as was done for the CalSTRS program, CalPERS provides estimated future rates to allow local school agencies to prepare multiyear financial plans. The actual employer contribution rates, along with the current estimated future rates for the same time frame as the above CalSTRS rates are as follows:

2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
11.442%	11.771%	11.847%	13.888%	15.531%	18.1%	20.8%	23.8%

The future estimated rates from CalPERS continue to increase beyond 2020-21 up to 27.3% for 2024-25.

Funding Sources

The funding sources for paying the pension benefits of both systems consist of the following:

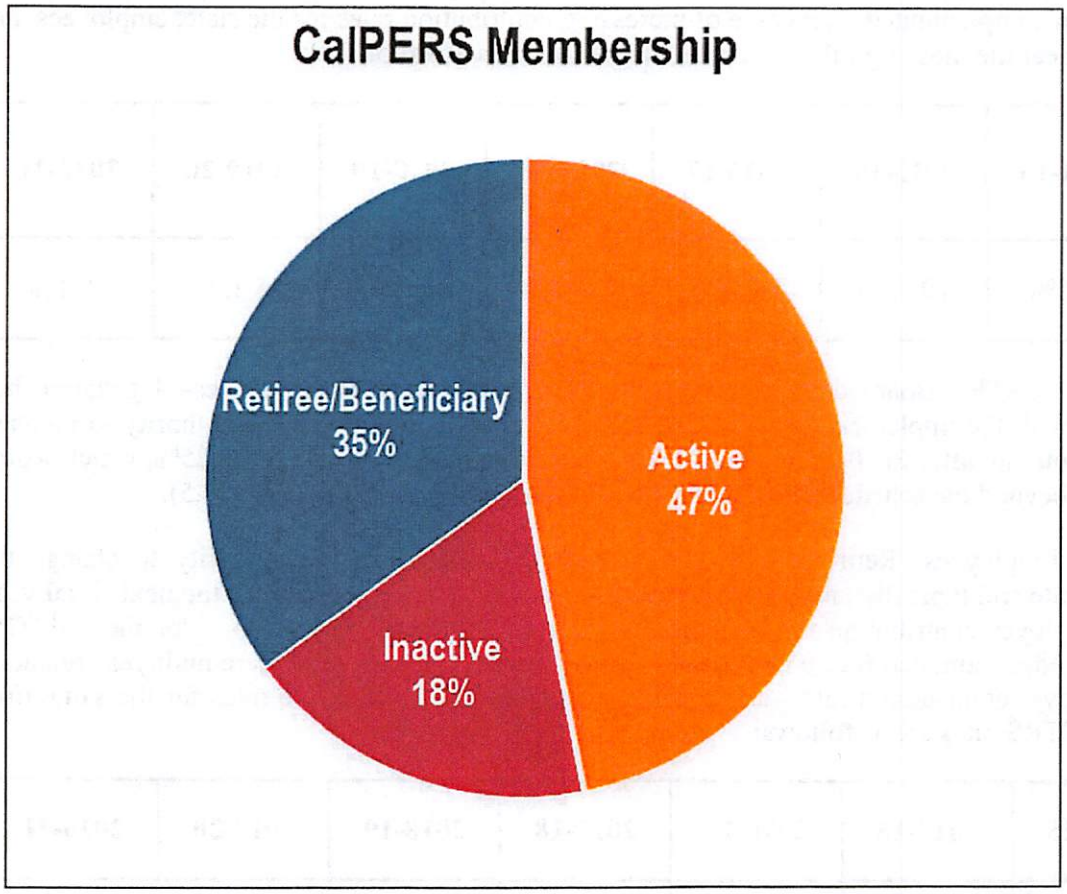
- Investment earnings
- Employer contributions
- Member contributions
- State contributions (CalSTRS only)

Most of the cost of pension benefits is funded by investment earnings—62% for CalPERS and 58% for CalSTRS—and the rest is funded by contributions. Therefore, the assumed rate of return on investments plays a big part in determining the funded status of the retirement plans—the higher the assumed rate, the higher the funded status and the inverse is true as well.

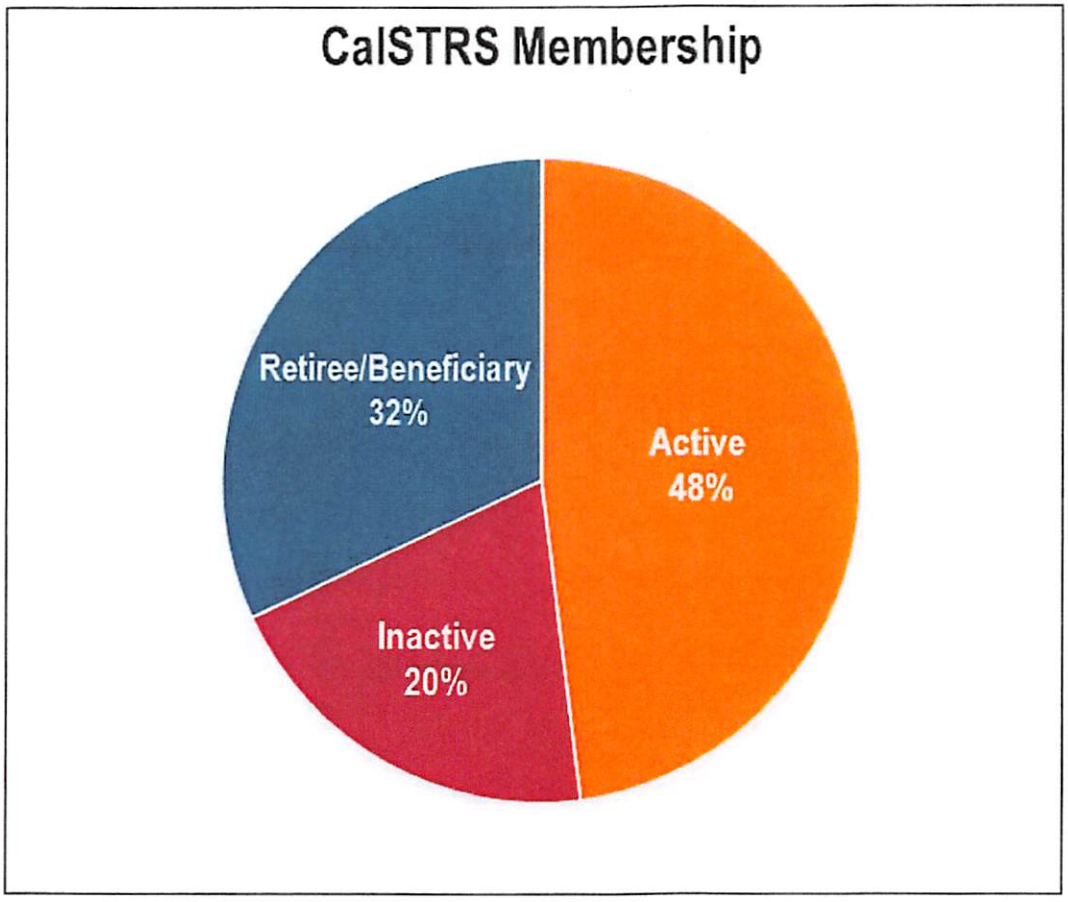
Both systems have recently reduced their assumed rate of return on investments from 7.5% to 7.0% over the course of two to three years, which will reduce the funded status of the plans. The CalPERS employer contribution rates estimated above reflect this investment return reduction, but the CalSTRS employer contribution rates currently in statute were enacted before the reduction in the assumed rate of return.

The net inflows and outflows for both pension systems are also driven by the makeup of the membership. The charts below illustrate the membership in each system:

CalPERS Membership



CalSTRS Membership



As can be seen above, the number of pension receivers (retirees and beneficiaries) is significantly less than the number of active members. For both systems, less than half of the members are paying contributions into the plans. This situation increases the reliance upon investment earnings as the major source of funding for retirement benefits.

Conclusion

While contributions to the systems are critical to the solvency of the basic retirement plans, the return on investments is key. Both pensions systems employ professional investment experts but they can be restrained in their investment choices by restrictions imposed by the Legislature or their own governing boards. As local school agencies plan for the increasing contributions we should keep our eyes on the CalSTRS and CalPERS investment returns and their impact on the funded status of the plans—these will drive the employer contribution rates of the future. Stay tuned . . .

—Charlene Quilao and Sheila Vickers

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