CALSTRS

Regular Meeting

Item Number 6 – Open Session

Subject: Actuarial Projection for the Supplemental Benefit Maintenance Account

Presenter(s): David Lamoureux and Rick Reed

Item Type: Action

Date & Time: May 4, 2022 – 10 minutes

Attachment(s):

Attachment 1 – Milliman's Projection of SBMA Funding Sufficiency

Attachment 2 – Proposed Resolution for the Adoption of the SBMA Purchasing Power Percentage

PowerPoint(s):

Projection of SBMA Funding Sufficiency

PURPOSE

The purpose of this item is to present the funding sufficiency projection for the Supplemental Benefit Maintenance Account (SBMA) and to recommend that the board maintain the purchasing power benefit at the current 85% level.

BACKGROUND AND SUMMARY

The SBMA is a special account in the Teachers' Retirement Fund that provides inflation protection to CalSTRS members. Section 24415.5 of the Education Code authorizes the Teachers' Retirement Board to adjust the purchasing power protection level provided by the SBMA between 80% and 85%, based on actuarial projections through a period of time 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 timing and frequency of actuarial projections. As per these regulations, an actuarial analysis is performed every two years and must use June 30, 2089, as the date through which the sufficiency of the SBMA is measured.

This item presents the results of the June 30, 2021, actuarial sufficiency projection for the SBMA. The last actuarial analysis was done two years ago. It was performed as of June 30, 2019, and presented to the board in September 2020. Based on the analysis presented at that time, the board voted to keep the purchasing power level at 85%, the maximum allowed by statute. The purchasing power level has been at 85% since 2008-09.

To fund the SBMA, the State General Fund provides an annual transfer equal to 2.5% of total creditable compensation from the fiscal year ending in the prior calendar year, reduced by $72 million each fiscal year. This contribution is in addition to the state contribution made to fund the Defined Benefit (DB) Program. The SBMA also receives revenues from the use of state school lands (land granted to California by the federal government to support schools) and lieu lands (properties purchased with the proceeds from the sale of school lands). In fiscal year 2020-21, the SBMA received $782 million in contributions, of which $775 million came from the State General Fund and about $7 million from school and lieu lands revenues. Benefits paid from the SBMA totaled $195 million in fiscal year 2020-21.

Note that pursuant to Education Code section 22216, the assets in the SBMA are credited each year at the rate of the investment return assumed for the DB Program. This is done regardless of the actual return on assets in the program. For fiscal year 2020-21, the SBMA assets were credited with a return of 7%, the assumed investment return for the DB Program.

For purposes of measuring inflation protection, Education Code section 24415 requires that CalSTRS measures inflation for each fiscal year using the California CPI-U index issued by Department of Finance for the month of June. The current board-approved long-term assumption for inflation is 2.75%. This assumption was last reviewed by the board as part of the 2020 CalSTRS Experience Study, which was presented to the board in January 2020. Since the completion of the last actuarial analysis, inflation in California has averaged close to the assumed 2.75%. Inflation in California was 1.4% in fiscal year 2019-20 and 4.4% in fiscal year 2020-21. Note that inflation this fiscal year is on pace to exceed 2.75%. At the time of writing this agenda item, fiscal year-to-date inflation in California was more than 7%.

Over the last two years, the number of members receiving SBMA has declined compared to the last time the actuarial analysis was performed in 2020. For fiscal year 2021-22, about 68,000 members are receiving a benefit from the SBMA at an average of $310 per month. Two years ago, about 71,000 members were receiving a benefit from the SBMA at an average of $261 per month. Considering the high level of inflation experienced so far this fiscal year, it is likely the number of members receiving SBMA will increase next fiscal year.

This fiscal year, SBMA payments are paid to all members and beneficiaries of members who retired in 2000 or earlier and to those who retired in 2001 and 2002 but on or after September 1 of those years. For members who retired in 2001 and 2002, only those who retired in the months of September, October, November and December have started to receive SBMA payments since they had to wait an extra year for their first 2% annual benefit adjustment. Due to terms set by law, members who retire prior to September 1st are eligible for their first annual adjustment the following calendar year. Those who retire on or after September 1st must wait an extra year. The additional one-year wait for those who retired in the September through December time period in 2001 and 2002 resulted in them falling just below 85% purchasing power for fiscal year 2021-22, triggering a benefit from the SBMA.

Below is a table comparing some of the key results from the June 30, 2021 SBMA actuarial projection to the 2019 projection.

Key Results

	June 30, 2021 actuarial projection	**June 30, 2019 actuarial projection**
Current assets	$21.0 billion	$17.4 billion
Present value of future contributions	$9.7 billion	$9.3 billion
Available resources	$30.7 billion	$26.7 billion
Present value of future SBMA payments for current members	$18.8 billion	$15.5 billion
Projected excess resources	**$11.9 billion**	**$11.2 billion**
Maximum purchasing power level	92%	92%
Probability of Sufficiency	66%	68%

As shown in the table, the value of the available resources (current assets plus projected future contributions on current member payroll) exceeds the projected value of future purchasing power benefits for current members by $11.9 billion as of June 30, 2021. This is an increase of about $700 million since 2019. This means that based on the current SBMA provisions, and the actuarial assumptions adopted by the board, it is expected that there will be sufficient funds to pay the SBMA benefits at the current 85% level through June 30, 2089.

The table above also shows that the current SBMA balance plus expected contributions would be sufficient to pay purchasing power benefits at a 92% level through 2089. This measure has remained the same since the last actuarial projection. It is important to realize these projections reflect the board assumption that inflation will remain stable at 2.75% each year into the future.

To measure the possible impact of fluctuations in future inflation, a stochastic model that varied inflation in the future was used to calculate a probability of sufficiency. Based on this stochastic analysis, it was determined that there was a 66% chance that the SBMA would be able to sustain an 85% level through 2089, a decrease of 2% since the last actuarial analysis. The attached actuarial analysis prepared by Milliman, CalSTRS consulting actuary, also contains a sensitivity analysis of how the SBMA would be able to continue to provide an 85% protection level under various short-term and long-term inflation scenarios. Please see pages 5 and 6 of the attached analysis for more details.

Based on the June 30, 2021, actuarial projection, it is recommended that the purchasing power level remain at 85%, the maximum benefit authorized under current law. This level of benefit would continue until the next actuarial analysis, which is scheduled to be the June 30, 2023, analysis.

Note that Education Code section 24415.5 requires the board—if it determines there are funds available beyond the amount needed to maintain 85% purchasing power protection through 2089—to develop options for the use of these excess resources. Options are being discussed in a separate agenda item.

The actuarial analysis prepared by Milliman, CalSTRS consulting actuary, is provided as an attachment to this item.

RECOMMENDATION

Staff recommends that the board maintain the purchasing power percentage at 85%.