



Regular Meeting

Item Number 13 – Open Session

Subject: Review of Funding Levels and Risks Report

Presenter(s): David Lamoureux and Rick Reed

Item Type: Information

Date & Time: November 2, 2023 – 30 minutes

Attachment(s): 2023 Review of Funding Levels and Risks Report

PowerPoint(s): Summary of Review of Funding Levels and Risks Report

Item Purpose

The purpose of this item is to present the 2023 Review of Funding Levels and Risks report. This report is intended to assist the board and CalSTRS stakeholders in assessing the soundness and sustainability of the system and to better understand how the CalSTRS Funding Plan is expected to accomplish its goal of achieving full funding by 2046.

Recommendation

This is an information item only.

Executive Summary

The Review of Funding Levels and Risks report provides the board and stakeholders the opportunity to take an in depth look at the CalSTRS Funding Plan and discusses a variety of risks associated with the funding of the Defined Benefit Program.

The attached report includes four main sections which focus on the following:

Path to full funding: Section detailing the significant changes in the past year and their impact on long-term funding levels and contribution rates under the current actuarial assumptions.

Key findings: Despite falling just short of its 7% assumed investment return in fiscal year 2022–23, CalSTRS remains slightly ahead of schedule in its goal to reach full funding. Both the state and the employer contribution rates are expected to remain the

same in fiscal year 2024–25 to eliminate their respective shares of the unfunded actuarial obligation by 2046.

The risk environment: Section exploring the risks that could prevent the Defined Benefit Program from reaching full funding by 2046, focusing specifically on the risk related to longevity, membership and payroll decline, and future investment returns.

Key findings: Although continued decreases in enrollment in K-12 public schools could put pressure on CalSTRS' ability to reach full funding long term if they result in decreases in the number of teachers, investment risk continues to be the most significant risk facing the CalSTRS Funding Plan. Because it has a funding plan in place, CalSTRS remains in a favorable position to withstand a recession in the next few years while keeping the funding plan on track.

Measures of plan maturity and volatility: Section detailing the continuing trend of maturation of the Defined Benefit Program, evidenced by the projected decline in the ratio of active to retired members and negative cash flows, and their impact on contribution rate volatility.

Key findings: The maturing of the Defined Benefit Program combined with the 2046 end date of the funding plan will make it harder for CalSTRS to react to an investment loss in the future.

Ability to reach full funding under different actuarial assumptions: Section investigating the ability of the funding plan to reach full funding by 2046 under more conservative economic actuarial assumptions. This section is of important relevance this year since actuarial assumptions are currently being reviewed for their appropriateness. The results of the review will be presented to the board in January 2024.

Key findings: CalSTRS would still be expected to reach full funding should the board elect to adopt more conservative economic actuarial assumptions in the funding of the system. However, contributions would have to increase for the state, for the employers and possibly for CalSTRS 2% at 62 members.

Background

CalSTRS continually monitors the funding plan and the financial health of the fund. Formal assessments of funding levels and risks are provided to the board twice a year. These formal assessments are presented in the spring through the annual actuarial valuation report and in the fall through the Review of Funding Levels and Risks report. In addition to these two formal reports, CalSTRS provides updates to the board on the status of various funding-related risks as part of the semi-annual enterprise risk management report. These semi-annual reports are generally presented in March and September of each year.

This year's Review of Funding Levels and Risks report is based on the results of the June 30, 2022, actuarial valuation that was presented to the board in May 2023 and reflects the events that

have taken place over the last fiscal year. Specifically, the report reflects the 6.3% investment return earned by CalSTRS in fiscal year 2022–23 and reflects the 6% increase in the payroll of active teacher in the last fiscal year, higher than the assumed 3.5% annual growth.

In January 2024, the board will be presented with the next experience study which will review and recommend updates to the economic and demographic actuarial assumptions. This review occurs every four years and helps ensure the actuarial assumptions remain reasonable and reflect the actual experience of the system. Regular reviews and adjustments to the assumptions are key to ensuring the plan stays on track to reach full funding. In May 2023, as part of the Asset Liability Management study, the board adopted a new asset allocation that has an expected return consistent with the existing 7% investment return assumption. As a result, it is anticipated that no changes will be recommended to the assumed investment return. However, as mentioned in the attached report, the experience study will take a close look and possibly recommend changes to the long-term payroll growth assumption.

CalSTRS is also required by statute to provide a progress report on the funding plan to the Legislature every five years. The first report was provided in June 2019. The next report is due this fiscal year, in June 2024. This report provides CalSTRS an opportunity to educate the Legislature about the funding plan, the health of the fund and the risks encountered in funding the Defined Benefit Program.

For the next progress report to the Legislature, the board will have the opportunity in March 2024 to discuss and consider whether the report should include for consideration potential improvements to further strengthen the funding plan and CalSTRS' ability to reach full funding. Making minor modifications to the funding plan, by addressing certain features, would help mitigate the impact of some of the risks identified in this report. These features include the end date of 2046, the inability to address the unallocated share of the unfunded actuarial obligation, the 0.5% limit on increases to the state contribution rate, and the requirement that the state contribution rate immediately drops to the base rate of 2.017% of payroll once the state has eliminated its share of the unfunded actuarial obligation.

Strategic Plan Linkage: Goal 1: Ensure a well-governed, financially sound trust fund.

Optional Reference Material:

[June 2019 Report to Legislature on the Progress of the CalSTRS Funding Plan](#)