

CalSTRS Unfunded Liability and State Contribution Rate Increase

Today, April 6, 2017, the California State Teachers' Retirement System (CalSTRS) Board adopted the latest actuarial valuation of the retirement system. Despite increases in contribution rates by members, employers, and the state, the funded ratio decreased from 68.5% to 63.7%, and the unfunded actuarial obligation (commonly called the unfunded liability) increased from \$76.2 billion to \$96.7 billion.

CalSTRS's actuarial firm cites three main factors for the increased unfunded liability:

1. The change in actuarial assumptions adopted by the Board, reducing the assumed rate of return from 7.5% to 7.25% in 2017, and changes in demographic assumptions resulted in an increase of \$13.2 billion in the unfunded actuarial obligation (UAO).
2. Recent investment returns have been below the assumed return, increasing the UAO by \$2.6 billion.
3. The UAO increased by \$4 billion because the contributions received over the 2015-16 fiscal year were not sufficient to cover the interest on the UAO.

Changes to the unfunded liability affect the three contributors in different ways.

State Contribution Rate

For the first time this year, the CalSTRS Board has the authority to adjust the state contribution rate necessary to pay off the state's portion of the UAO. The state contribution rate can be increased by up to 0.5% annually and the Board approved that rate increase, bringing the state contribution rate from 6.328% to 6.828% in 2017-18. Annual increases to the state rate of 0.5% annually is expected for "at least the next decade" according to Milliman.

Employer Contribution Rate

Because employer contribution rates are set in statute until 2020-21, there is no immediate effect on the employer contribution rate, which will increase from 12.58% to 14.43% in 2017-18.

Employee Contribution Rate

Under the Public Employees' Pension Reform Act of 2013 (PEPRA), post-PEPRA employees are required to pay at least one-half the normal cost of their benefits. Based on the valuation presented to the Board, the normal cost did not increase by 1%, the threshold for increasing the post-PEPRA employee contribution rate. Therefore, the contribution rate for post-PEPRA employees will remain unchanged at 9.205% of creditable compensation on July 1, 2017.

It is, however, very likely that these employees will experience a rate increase to 10.205% beginning in 2018. That determination will be made with next year's valuation.