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CalSTRS Likely to Lower Investment Expectations, Lead to Future Employer Rate Increases

At its February 1, 2017, meeting, the California State Teachers' Retirement System (CalSTRS) Board will entertain a recommendation from its actuarial firm to lower its assumed rate of investment return from 7.5% to 7.25%. In a move similar to the rate reduction recently made by the California Public Employees' Retirement Systems (CalPERS) Board (see "CalPERS Board Approves Reduction in Investment Return Assumption" in the December 22, 2017, edition of the *Fiscal Report* and *Community College Update*), this change would have a rippling effect down to the state, employer, and new member contribution rates to CalSTRS.

Milliman, CalSTRS's actuarial consultant, believes there is "a less than 50% probability that the current 7.5% return assumption for the DB [defined benefit] program will be achieved over the long term." Additionally, with retirees living longer, Milliman recommends changing demographic assumptions to reflect higher assumed life expectancies and notes that "the proposed changes to the demographic assumptions have a greater impact on funding and contribution levels than the proposed changes to the economic [investment return] assumptions."

What This Means for Employers

Under Assembly Bill (AB) 1469, the CalSTRS full-funding plan, both state and employer contribution rates can be increased by the CalSTRS Board in order to maintain the goal of reaching full funding of the retirement system by 2046. According to Milliman, "changes in actuarial assumptions are expected to increase the unfunded liability and will likely result in the need for higher contributions in the future."

For employers, current law increases contribution rates to 19.1% beginning July 1, 2020, and also gives the Board authority to increase rates to 20.1% beginning

July 1, 2021, and to 20.25% beginning July 1, 2022, if necessary. (Current law limits the employer contribution rate to 20.25%.)

What This Means for the State

Under AB 1469, the state contribution rate can also increase above its current 8.828% of payroll. The increases are limited to a 0.5% increase annually, but has no upper boundary similar to the employer rate contribution. According to Milliman, “assuming future returns are 7.25% each year, the State rate is expected to increase by 0.5% of payroll for each of the next 5 years.”

What This Means for Employees

Under the Public Employees’ Pension Reform Act, new CalSTRS members (hired after January 1, 2013) are required to pay at least half of the normal cost of the DB program. Based on the estimated normal cost provided by Milliman, these members’ contributions would increase by 0.5% effective July 1, 2017. About 20% of CalSTRS active members would be affected.

Next Steps

The CalSTRS Board will discuss this change at its February 1, 2017, meeting and we will report on that action when it occurs.

—Michelle McKay Underwood

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