Jack Ehnes
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CALSTRS
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February 23, 2011

Mr. Mac Taylor
Legislative Analyst
Legislative Analyst's Office
925 L Street, Ste. 1000
Sacramento, CA 95814

Dear Mr. Taylor:

I am writing in response to your webinar on public retirement benefits, which was presented on February 10, 2011. First of all, I appreciate your acknowledgment that encouraging retirement savings through deferral of compensation is good policy, as well as the value of a well-managed and properly funded retirement system.

Given the often heated rhetoric surrounding the pension debate, we do feel that it is time to be focused on solutions. Some of the economic pressures affecting our future are certainly not under our control nor completely predictable, such as the financial markets, while others like funding levels of the plan itself are manageable. We hope, as policy makers and stakeholders start to converge on specific actions, considerable care is taken to specifically understand the funding structure, plan design and liabilities of the individual pension systems.

Need to correct the record

The statistical facts cited in the presentation appear to be accurate, but sweeping generalizations simply do not hold true in all cases and misstate the causes of the problems facing CalSTRS. Ignoring the circumstances of the second largest public pension fund in the state and the nation in making your points does a serious disservice to policy makers who will accept your statements as true and your conclusions and recommendations as consistently valid.

No significant increase in State's contribution to CalSTRS

For example, you include a graph that displays the state costs of retirement beginning in 1990-91, without ever discussing the cause of the indicated increased costs or comparing the costs to the ability of the state to pay them. The costs related to CalSTRS have not increased because the state's contribution rate for retirement has increased - in fact, the state's contribution rate is now 2.6 percentage points less than what it was in the 1990's - but because the two factors upon which the state's contribution is based have: the number of CalSTRS members has increased by 47 percent since 1989-90 and the average salaries paid to public school educators has increased by 68 percent. Moreover, between 1989-90 and 2009-10, the percentage of General Fund revenue spent on the state's contributions to CalSTRS increased from 1.3 percent to 1.4 percent. This hardly suggests that the burden of CalSTRS benefits on the state has increased significantly.

CalSTRS contribution rates unchanged for decades
You also state that in the late 1990's, "pension systems cut employer contributions to near zero based on short-term investment gains, then increased them substantially." That again is a generalization that applies to other plans, but not CalSTRS. CalSTRS has no authority to set contribution rates; that is within the purview of the Legislature and the Governor. Although the Legislature, and not the pension system, did reduce the state's contribution rate to CalSTRS in the late 1990's and early 2000's, the state's contribution rate has not increased at all since then, although we do anticipate a relatively modest increase in the state's contribution rate beginning next fiscal year as a result of current law. Moreover, CalSTRS employer contributions have not changed since 1990 and employees' have not changed since 1972.

CalSTRS benefits middle of the road compared to other states
You state that "defined benefits are very [your emphasis] generous compared to those in other states and compared to the increasingly non-existent defined benefit systems in the private sector." The average percentage of final compensation paid to CalSTRS members retiring last fiscal year was under 60 percent (after almost 27 years of service and retirement at age 62), hardly an excessive amount. Because CalSTRS members do not participate in Social Security, their CalSTRS benefit represents the only source of a guaranteed monthly income for their public education service. Additionally, CalSTRS retired members generally do not receive employer-paid health care benefits after age 65.

Our analysis of other pension plans for public education employees who are not covered by Social Security, comparable to CalSTRS, indicates that, although some aspects of CalSTRS' pension program, such as the determination of final compensation, is more generous than the other plans, the percentage of final compensation paid to the average CalSTRS member is in the middle of what would be paid by those other plans. This does not support the contention that CalSTRS' plan is very generous compared to others.

In addition, the fact that defined benefit plans pay higher retirement benefits compared to those paid to private sector retirees speaks more to the inadequate retirement security provided to private sector retirees who are dependent on defined contribution. To conclude that public employees should receive retirement benefits that more closely reflect those paid to other Californians is understandable, but that goal should be achieved by increasing the financial security of those other Californians, not by reducing the security of public employees.

State's responsibility to CalSTRS members goes beyond contributions

Your suggestion that the retirement costs of future CalSTRS members be paid entirely by school employers and CalSTRS members, and not the state, is a policy decision the Legislature must make. However, it should be made clear that such a shift in financial responsibility does not eliminate the state's ultimate financial responsibility, as the plan sponsor and guarantor of the trust fund, to provide an actuarially funded retirement system. In the event that CalSTRS has inadequate resources to pay benefits, the state will still have the legal responsibility to pay the difference between assets and liabilities. Bear in mind, although the statutorily required payments to CalSTRS have been paid by the state over the past decade, the amounts being paid have been less than the amount required to fully fund the benefit program for the past eight years. The state's consistent inadequate contribution to CalSTRS and the devastating impact of the recession are key drivers of this financial dilemma.

Benefit structure should not be blamed for impact of financial downturn

Finally, the presentation appears to suggest that there is a flaw in the structure of benefits provided to public employees. While some public pension plans may have benefits that sometimes are greater than necessary to achieve financial security in retirement, the presentation does not give any consideration to the fact that the current funding problems facing public pension plans generally, and certainly CalSTRS in particular, is not the benefit structure, but the unprecedented financial turmoil the world has faced in the last ten years. If the markets had behaved even close to what had occurred historically, CalSTRS would not now be faced with the need for increased contributions.

The Teachers' Retirement Board agrees that improvements need to be made in the financing of the retirement plans offered by CalSTRS, and has evaluated dozens of financial options over the last several years to address the situation. We welcome the opportunity to work with stakeholders and legislators to address the funding situation in a manner that respects the budget situation facing the state and schools, while maintaining the financial security of educators in retirement which you acknowledged at the beginning of your presentation is appropriate. Such discussions, however, can only be successful if the facts are clear to everyone with respect to the specific retirement system being discussed, and not obscured by generalizations that do not apply to all plans.

We look forward to continuing to work with all affected parties in addressing the funding situation facing CalSTRS.

Sincerely,

Jack Ehnes

Jack Ehnes
Chief Executive Officer