California teachers’ pension fund faces $43 billion shortfall

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The California State Teachers’ Retirement System (CalSTRS), the second largest US pension fund estimated at $156 billion, is reporting a budget gap of $43 billion. As of the middle of last year, CalSTRS has said that it could only meet 77 percent of its future pension obligations.

CalSTRS provides retirement and disability benefits to 833,000 of California’s pre-kindergarten through community college teachers. The pension fund paid $7.9 billion in payments to its members and beneficiaries as of June 30, 2008, according to its website. In addition to being the largest teachers’ pension fund in the US, CalSTRS is also the seventh largest pension fund in the world.

CalSTRS lost a quarter of its value during the 2008-2009 fiscal year, witnessing a 43 percent decline in its real estate portfolio and a 27 percent decline in private equity. The unfunded liability of CalSTRS—the difference between assets and future costs—nearly doubled from $22 billion in June 2008 to $43 billion in 2009.

Jack Ehnes, the chief executive of CalSTRS, said that the pension fund could be broke in 35 years, which is the average length of a teacher’s career. In a report Ehnes presented to the CalSTRS board of directors he stated, “With some levels of loss, it is plausible that future investment returns could mitigate most or all (of the unfunded liability). Given the magnitude of these losses, that is not practical.”

In order to meet its pension obligations, the fund will have ask the state legislature to increase contributions from California’s 1,043 school districts by as much as 14 percent of what they already pay in employee retirement benefits.

However, California is currently confronting a $20 billion deficit and Governor Arnold Schwarzenegger has proposed a reduction in state spending that would include $2.4 billion in cuts to K-12 schools on top of the $13 billion in cuts made last year. Under these conditions, it is highly unlikely that the state will be able to squeeze additional money out of local government to fund CalSTRS’ budget gap.

Without a higher taxpayer subsidy, CalSTRS must make an average annual return on investments of 20 percent a year for the next five years to close the shortfall, far above the usual 8 percent predicted by investment standards and completely impossible in the current economic climate. In order to keep up with teacher retirements three decades from now, CalSTRS will have to raise either contributions from employers or employees by 22 percent, or both.

The solution being advanced by the political establishment in Sacramento to the pension crisis is not aimed at increasing funding, but rather undermining the living standards of employees and squeezing more work out of them over the course of their lifetime. In November, state voters may be asked to vote on three initiatives that would reduce the benefits paid to pensioners and postpone the retirement age for newly hired workers at state and local governments, schools, community colleges and the California State University.

Despite record losses in 2008, CalSTRS was able to pay huge bonuses to their management. According to an April 19, 2009, article in the *Sacramento Bee*, Christopher Ailman, chief investment officer for the fund, received an “incentive award” of $208,677 on top of his base pay of $330,000 for fiscal 2007-2008. In total CalSTRS paid $2.9 million in bonuses to 35 employees, including Ailman and CEO Ehnes, who received $205,000 in additional compensation as the pension fund’s finances were tanking.

CalSTRS officials have insisted that these bonuses were the only incentive they had to recruit “top talent.” CalSTRS spokesman Sherry Reser said in a statement, “Incentive pay is a valuable tool in attracting and keeping the best and the brightest.”

While thus far CalSTRS has yet to be implicated in the influence scandal engulfing the other major state pension fund in California, CalPERS, which serves public employees, there appear to be certain similarities between the way in which the two pension funds were run. Over the course of the past six months, there have been ongoing revelations about the existence of a revolving door between CalPERS and Wall Street firms; former members of the pension fund’s board of directors became so-called “placement agents” with major banks and used their insider knowledge and connections to lobby for multi-million dollar investments from CalPERS (See: “California pension funds paid millions to former insiders working as middlemen investors”).

Last month New York-based private equity firm Siguler Guff & Company announced it was adding Solomon Owayda to its management. Owayda is the former director of private equity for CalSTRS and was responsible for overseeing $2 billion in international and domestic funds, as well as managing the pension fund’s secondary and co-investment programs.

In short, while California’s teachers are facing the prospect of having their pensions dramatically reduced, if not eliminated, the financial managers who oversaw the investments that created this disaster are cashing in on their “experience” to advance their careers and further enrich themselves.