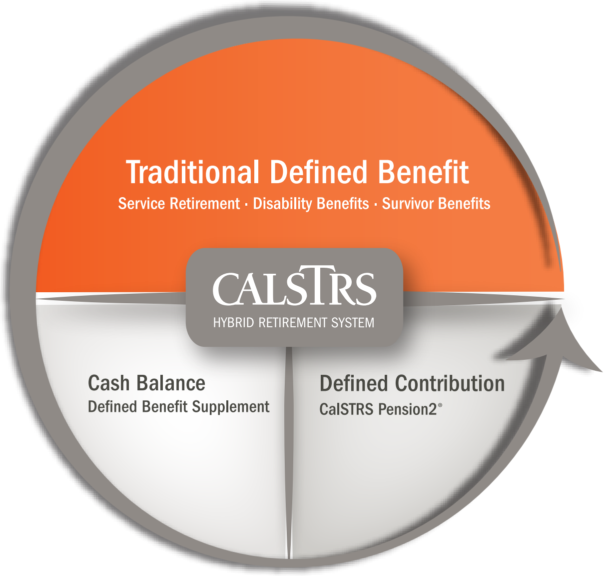
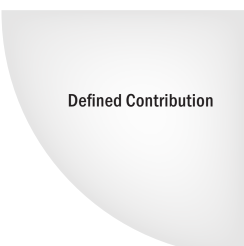
The Basics of a Cash Balance Plan



CalSTRS administers a comprehensive, hybrid retirement system that includes a traditional defined benefit plan, a cash balance plan and a defined contribution plan. Within the cash balance component of the plan are two programs: the Defined Benefit Supplement Program, available to full-time educators and the Cash Balance Benefit Program for part-time educators.

A cash balance plan acts like a hybrid, with 401(k) and defined benefit features.



Defined Contribution Features of a Cash Balance Plan

In a defined contribution plan, often a 401(k), the employee has an individual account in which contributions and any investment earnings are credited to the employee's account. At the time of retirement, disability, death or termination of employment, the employee receives a benefit equal to the balance in that account. In a cash balance plan, the employee also has a nominal account in which contributions and any investment earnings are credited to the employee's account. At the time of retirement, disability, death or termination of program membership, the employee also receives a benefit equal to the balance in that account as they would in a defined contribution.

Defined Benefit Features of a Cash Balance Plan

In a traditional defined benefit plan, the employee is guaranteed a benefit based on a formula, generally reflecting the employee's age, final compensation and years of service at retirement. In addition, CalSTRS invests the assets of the traditional defined benefit plan. In a cash balance plan, payment of a benefit is also guaranteed, but the nature of the guarantee is different than in a traditional defined benefit plan. Rather than basing the benefit on a formula, the payment of contributions previously made is guaranteed, as well as the earnings that were credited to the account. CalSTRS also invests the assets of the cash balance plan on the same basis that it invests traditional defined benefit plan assets. In contrast, in a defined contribution plan, the amount of money paid at the time of retirement could be less than the amount contributed if investment returns were negative. In addition, the individual employee is responsible for selecting how his or her account balance is invested.

How the Plan Works

Investment Earnings

Each year, the Teachers' Retirement Board establishes the guaranteed minimum interest rate. At CalSTRS, the guaranteed minimum interest rate is based on 30-year U.S. Treasury bonds for the period from March to February immediately prior to the plan year. The rate for plan year 2011–12 is 4.25 percent. Consequently, for 2011–12, CalSTRS is guaranteeing that accounts will be credited 4.25 percent, regardless of the actual earnings from investing the plan assets. Because a cash balance plan such as CalSTRS is invested in a diversified portfolio, it is very unlikely that the long term return on investments will be less than the guaranteed interest rate based on 30-year U.S. Treasury bonds.

Distribution Options

Benefits paid under CalSTRS cash balance plans can be distributed either as a lump sum or—if there is at least $3,500 in the account—a monthly annuity, either for the life of the employee and, if elected, a surviving beneficiary, or for a specific number of years. If a lump sum is chosen, funds may be rolled over to another qualified plan, such as a 401(k), 403(b) or 457 plan, or a traditional or Roth IRA.

Funding Guarantee

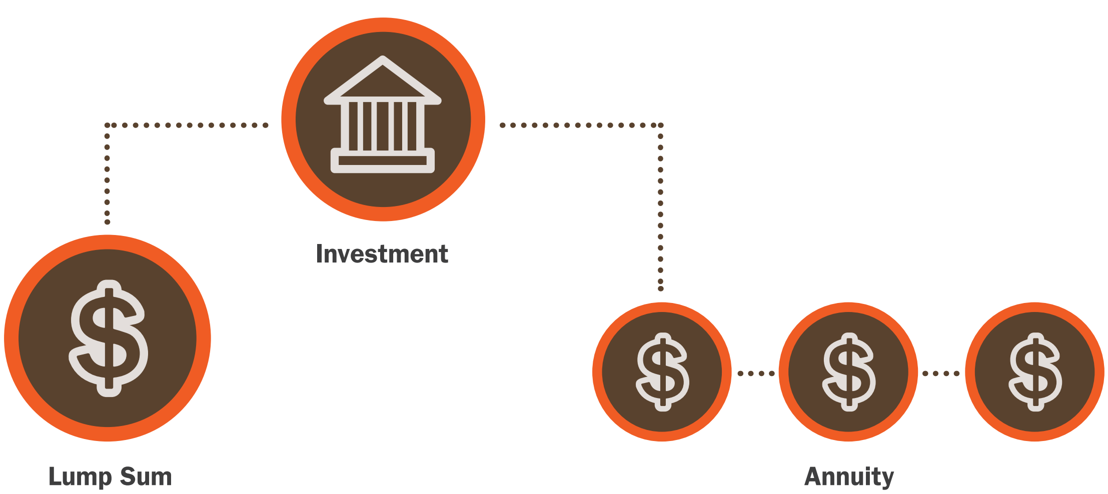
The earnings from investing cash balance plan assets are used to pay the guaranteed interest to member accounts. Any investment earnings in excess of the amount needed to pay the guaranteed interest is credited to a Gain and Loss Reserve maintained by CalSTRS. In years in which the rate of return on investments is less than the guaranteed interest rate, the difference is paid from the Gain and Loss Reserve.

After the end of the plan year, when the total investment earnings for the immediately preceding plan year are known, the plan may declare an additional earnings credit. Under Teachers' Retirement Board policy, no additional earnings credit is paid unless the ratio of program assets to program liabilities—the funded status—exceeds 100 percent by an amount equal to twice the guaranteed interest rate for the following year.

Member Vesting

CalSTRS members have an immediate vested right equal to any contributions made including any compounded interest earned.

Distribution Model



Contributions Risks and Benefits

Cash Balance Contributions

Contributions to the cash balance program component are made from employer and employee contributions on compensation from extra duty assignments, such as summer school, after-school activities or other extra-pay assignments and any other forms of compensation that may enhance a member's final compensation. The compensation credited to the cash balance program component is not included in the final compensation associated with the Defined Benefit Program.

Plan Risks

With any retirement plan there is always the risk that investment earnings are insufficient to pay either earned or guaranteed benefits. In a traditional defined benefit plan, the employer generally bears that risk, and employers would face increased contributions if long-term earnings are less than the assumed investment return. In a defined contribution plan, the employee bears the entire risk of lower investment returns. In a cash balance plan where interest rates vary, such as the CalSTRS plans, those risks are shared.

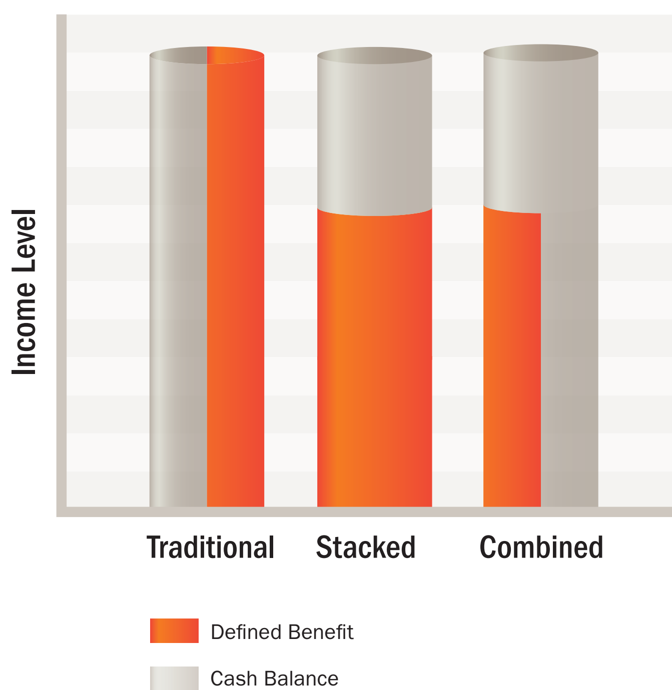
Longevity Risk

In order to maintain a secure retirement, a person should not be able to outlive the benefit provided under a primary retirement plan. In a traditional defined benefit plan, the benefit is paid in the form of a lifetime monthly annuity, which the employee cannot outlive. In a defined contribution plan, the benefit is typically paid out in a lump sum, which can be allocated over time. Once those assets are depleted, however, the employee would no longer have those funds available to pay living expenses. In a cash balance plan, an annuity is typically available, and could be mandated.

Prevention of Inappropriate Benefit Enhancement

The hybrid nature of the CalSTRS benefit program includes a built-in mechanism that credits extra compensation for summer school or other extra-pay assignments to a cash balance account, thus not allowing extra compensation to figure into final compensation, a factor in setting pension benefits. Additional bases for determining what compensation gets credited to a cash balance program are possible. For example, there could be a limit in the compensation that is credited to the traditional defined benefit program, which would affect what contributions are credited to the member's defined benefit account, as well as the determination of final compensation.

Benefit Models



Plan Comparison

	CalSTRS Defined Benefit Program	CalSTRS Defined Benefit Supplement Program/Cash Balance Benefit Program	Defined Contribution Plan
Amount of benefit	Formula based on age, service credit and final compensation	Account balance	Account balance
Form of benefit payment	Lifetime monthly annuity	Lump-sum and/or monthly lifetime annuity or period certain monthly annuity	Generally lump-sum
Nature of guarantee	Full guarantee that benefit based on formula is paid	Payment of contributions and minimum interest	None, other than payment of account balance, which could be less than amount contributed
Current guaranteed investment return	Implicitly 7.75 percent	Explicitly 4.25 percent	None
Potential additional benefits	None	Additional earnings credits from excess investment earnings	None
Participation	Mandatory levels of contributions	Mandatory levels of contributions	Could be either mandatory or voluntary levels of contributions
Assumed long-term rate of return	7.75 percent	7.75 percent (based on current asset allocation)	No assumed return, but actual long-term returns typically at least 1 percent less than in defined benefit plan
Vesting	Five years	Immediate	Varies, but can be immediate
Responsibility for investments	CalSTRS	CalSTRS	Individual
Risks borne	Employer bears risk that long-term investment return is less than assumed return	Employee bears risk that interest rates are low. Employer bears risk that long-term investment returns lower than interest rates.	Employee bears risk that long-term investment returns are less than needed to meet personal benefit target. Also bears risk of outliving assets.