



*Pension Reform  
CalPERS Risk Pooling Change  
OPEB*

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## Agenda

- Pension Reform
- CalPERS' New Risk Pooling Structure
- "On the Horizon"
- OPEB
- Impact of Recent Experience on Rates



# Pension Reform



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## New Limits for 2015

- California Actuarial Advisory Panel has calculated the limits for 2015
  - \$117,020 if in Social Security
  - \$140,424 if not in Social Security
- Letter is available at [http://www.sco.ca.gov/Files-ARD-Local/LocRep/PEPRA\\_Pension\\_Compensation\\_Limit\\_letter.pdf](http://www.sco.ca.gov/Files-ARD-Local/LocRep/PEPRA_Pension_Compensation_Limit_letter.pdf)



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## Above the Cap - What Are Employers Doing?

- GC § 7522.10(f): Can provide a defined contribution plan subject to certain limitations:
  - Contribution only on compensation above § 7522.10 limit
  - Subject to IRS limitations
  - Capped at % of pay for employees whose compensation does not exceed compensation limit

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## Above the Cap - What Are Employers Doing?

- Question: Is contribution limit based on:
  - All employees (*combined Miscellaneous & Safety contribution rate*);
  - All employees in the same classification (*Miscellaneous or Safety contribution rate*); or
  - All PEPRA employees in the same classification (*PEPRA employees contribution rate*)?

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## PEPRA Normal Cost

- PEPRA requires 50% cost sharing of normal cost for PEPRA members.
- Normal cost has to increase by 1% to trigger an increase in member contribution rate.
- Not enough data in the 2013 valuation to set new PEPRA normal cost
- 2014 valuations may be used to set new PEPRA normal cost

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## Excessive Compensation Increases

- PEPRA requires the CalPERS Board to:
  - Define a significant increase in actuarial liability due to increased compensation
    - Non-represented employee only
  - Ensure that the employer that causes the increase in liability to other employers bears the increased cost associated with that liability

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## Excessive Compensation Increases Next Steps

- CalPERS staff developing proposed rules
- CalPERS will reach-out to employer community to obtain feedback
- Goal at this time is to propose regulations in spring/summer 2015

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## Imposing Additional Member Contributions

- When
  - After January 1, 2018
  - After impasse
- How much
  - Lesser or 50% of normal cost or following:
    - 8% for miscellaneous members
    - 12% for police and firefighters
    - 11% for other safety members

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## Pensionable Compensation

- CalPERS approved a proposed regulation that clarifies the definition of pensionable compensation
  - Includes 99 categories of compensation all of which were pensionable prior to PEPRA
  - Currently with Department of Finance
  - League of Cities has concerns
- CalPERS is currently reviewing the list to see if some types of compensation are no longer used

## New Risk Pooling Structure

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## Risk Pooling Background

- Risk pooling is a type of insurance arrangement
  - Spreads demographic risks
  - Purpose is to avoid large liability losses
  - Serves to smooth the employer contribution rate
- Risk pooling was implemented with the 2003 actuarial valuations

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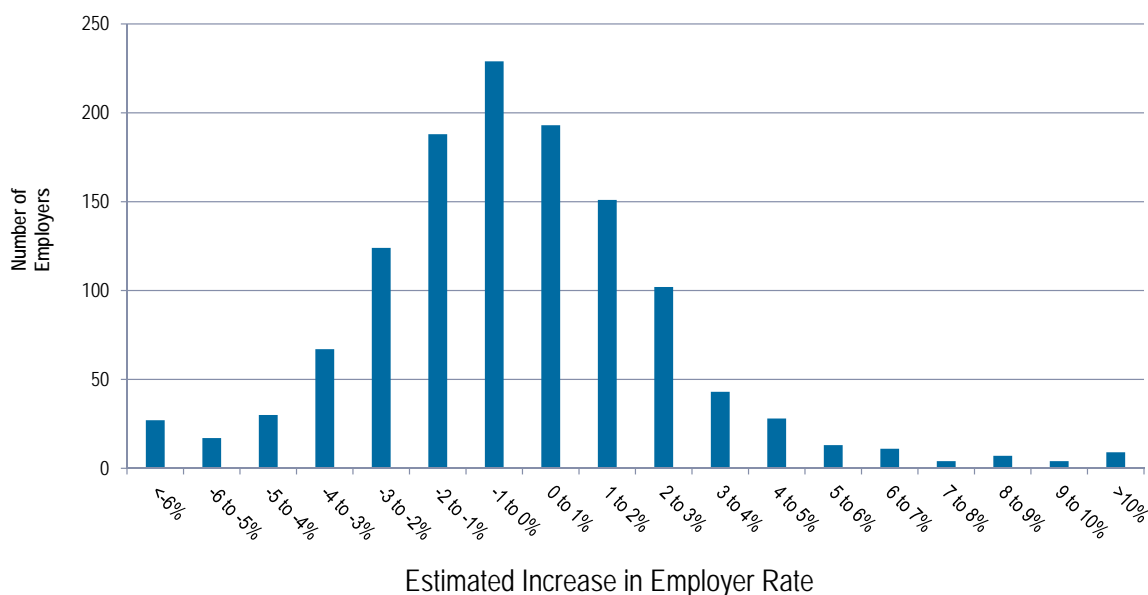
## Why Changes to Risk Pooling?

- Staff identified several issues while reviewing pooling
  - Funding issue
  - Equity issue
  - Employer contribution rate volatility issue
- Biggest contributor to these issues was PEPRA:
  - Closing of classic risk pools

## Changes to Risk Pooling

- Combining all pools into two (Miscellaneous and Safety)
- Allocating pool's unfunded liability to each plan based on total liability instead of payroll
- Collecting employer contributions toward unfunded liability and side fund as dollar amounts instead of a percentage of payroll
  - Contribution rate will continue to be available for information purposes through the valuation report

## Estimated Impact of Changes to Risk Pooling:





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## Benefits of Changes

- Retains benefits of risk pooling
- Does better job at addressing equity/fairness issue
- No overall contribution increases
- Permanent solution
- Provides ability for employers to pay down their share of pool's unfunded liability

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## Timing of Impact of New Risk Pool Structure on Rates

- Will impact employer contribution rates for the first time in FY 2015-16
- Impact specific to each pooled plan was included in the rate set by the June 30, 2013 valuation report

# On The Horizon



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## On the Horizon

- Board Workshop
- Asset allocation feasibility study
- GASB

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## Board Discussion about Risk

- November CalPERS Board meeting ( at the Finance and Administration Committee)
  - Discussion of funding levels and risks
  - Report is on-line at: <<link to be added later>>
- Key conclusions:
  - Risk levels have been reduced
  - But risk is still high

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## Possible Risk Mitigation Options

- Margins for adverse deviation
- Systematic lowering of risk
- Flexible lowering of risk
- Multiple asset allocations
- Additional voluntary employer contributions
- Risk sharing

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## Board Workshop on Risk Mitigation

- Planned for early 2015
- Focus on the options shown in previous slide
- Employer input is needed

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## Asset Allocation Feasibility Study

- CalPERS business plan includes a feasibility study on offering different asset allocations to employers in the PERF
- Study only, no timeframe on an actual implementation

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## GASB 68

- Pension accounting changes issued 6/25/12:
  - Effective for 2014/15 fiscal year
- Fundamental changes
  - Delinks contributions and accounting
  - Unfunded liability recognition drives expense

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## GASB 68

- Major issues:
  - Unfunded liability on balance sheet
  - Lower discount rate if projected assets do not cover projected benefit payments
    - Likely very rare in California
  - Significant additional disclosure

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## Will CalPERS Provide GASB 68 Information?

- CalPERS INTENDS on providing the information
- Updating systems to produce valuation reports
- Target to be ready by spring of 2015 and perform valuations between March and June
  - Have to produce over 3,000 separate reports!
- The draft report is similar to the illustrations in Statement 68 and Implementation Guide

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## Fee for GASB 68 Valuation

- CalPERS will have to charge employers
  - PERF qualified trust
- CalPERS Board gave approval to proceed and charge employer
  - Still reviewing mechanism to collect fee from employer
  - Fees expected to be known in early 2015
    - Agent / cost-sharing likely fee difference
- Circular Letter will be issued and provide details once available

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## Potential GASB 68 Implementation Issues

- Different fiscal year end date for employers
  - Most employers will need the information for June 30, 2015 CAFR
- For first few years, CalPERS may not be able to provide all necessary information
  - Employers will have to rely on outside actuarial firm if information provided by CalPERS is deemed not sufficient by auditor
- Example:
  - Cross-over calculation to determine discount rate

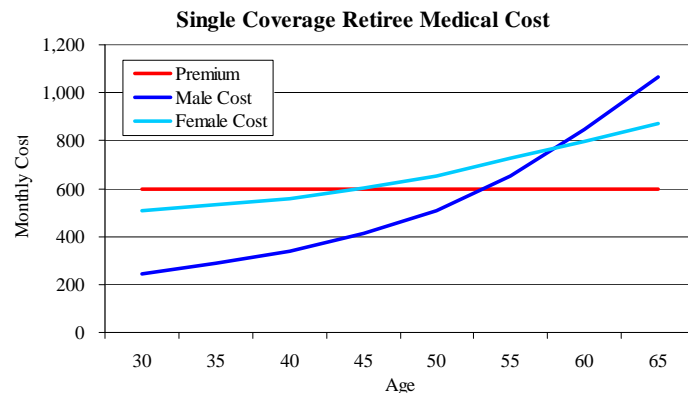


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## GASB 45 – Implicit Rate Subsidy

- Employer cost for allowing retirees to participate at active premium rates



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## GASB 45 – Implicit Rate Subsidy

- GASB 45 defers to Actuarial Standards of Practice (ASOP) for implicit rate subsidy
- Old ASOP says community-rated medical plans not required to value implicit rate subsidy
  - PEMHCA is, for most participating agencies, considered a community-rated plan







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## Anticipated New GASB OPEB Standard

- Fundamental changes
  - Delinks contributions and accounting
  - Unfunded liability recognition drives expense

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## Anticipated New GASB OPEB Standard

- Immediate recognition of:
  - Service & interest cost
  - Benefit changes
- Deferred recognition of:
  - Gains/losses & assumption changes, over future working lifetime (average of active and inactive employees) closed period
  - Asset gains/losses over 5 years
- Entry age normal cost method required

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## New OPEB Accounting Standard

<u>Entity</u>	<u>Year Beginning After</u>
■ Plans	December 15, 2015
■ Plan Sponsors	December 15, 2016

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## Issues GASB May Revisit

- Discount rate development
- Cost method
- How Implied Subsidy allocated to employers in pooled medical plan
- Other (primarily disclosure) issues

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## CERBT Alternative Investment Mixes – [Proposed]

- New capital market assumptions  $\Rightarrow$  Increased volatility with current target asset allocations
- Staff recommended more conservative asset allocations to reduce volatility to approximately current levels
- Investment Committee & Board adopted staff recommended alternative asset allocation strategies

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## CERBT Alternative Investment Mixes

- Discount rate is combination of:
  - Inflation                      2.75%              3.00%
  - Real Rate of Return        4.50%              4.50%
  - Total                              7.25%              7.50%

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## CERBT Alternative Investment Mixes

- CalPERS using lower inflation assumption
- Lower expected nominal and real net long-term returns
- Generally more conservative than recommended changes to pension asset allocation

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## CERBT Alternative Investment Mixes

- Bartel Associates will continue to use 3% inflation assumption
- Likely either:
  - Lower recommended discount rates or
  - Lower margin for adverse deviation

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## Movement towards Funding OPEB?

- Legislative Analyst's Office  
just published:



- Suggests that the State start funding OPEB benefits
- Part of implementing Proposition 2
- <http://www.lao.ca.gov/reports/2014/budget/fiscal-outlook/fiscal-outlook-111914.pdf>

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## From California's Fiscal Outlook

### LAO Suggested Approach for Proposition 2 Debt Payment Funds

#### Near-Term Plan

- Pay down large portion of eligible budgetary liabilities.
- Seriously consider addressing much or all of the Judges' Retirement System I unfunded liability over the next few years.

#### Longer-Term Plan

- Invite CalPERS, CalSTRS, UC, and others to respond with proposals for using Proposition 2 funds to address one or more of the state's large retirement-related debts over the next 15 years.
- Addressing persistent retiree health liabilities merits serious consideration. Setting up retiree health trust fund, however, would involve significant logistical planning that could take a few years.

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## From California's Fiscal Outlook

- "Other long-term Proposition 2 plans—such as addressing CalPERS, CalSTRS, or UC pension liabilities—may have merit, but we urge the Legislature to give strong consideration to using the funds earmarked by Proposition 2 to pay state, CSU, and/or UC retiree health liabilities beginning a few years from now."

# Impact of Recent Investment Experience on Employer Rates



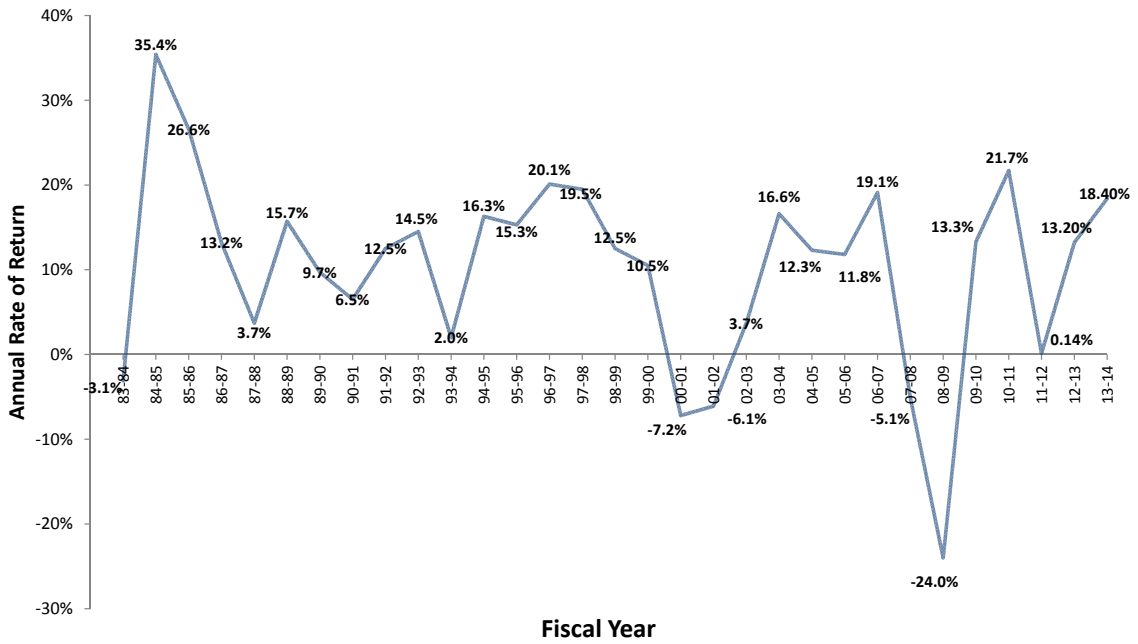
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## Impact of Investment Experience on Rates

- Investment experience is the primary cause of volatility
- Occurs when the actual investment return being different from the assumed discount rate
- Current assumption is 7.50 percent



**Historical Annual Rates Of Return for the California Public Employees Retirement Fund  
(Fiscal Year 1983-84 to 2013-14)**



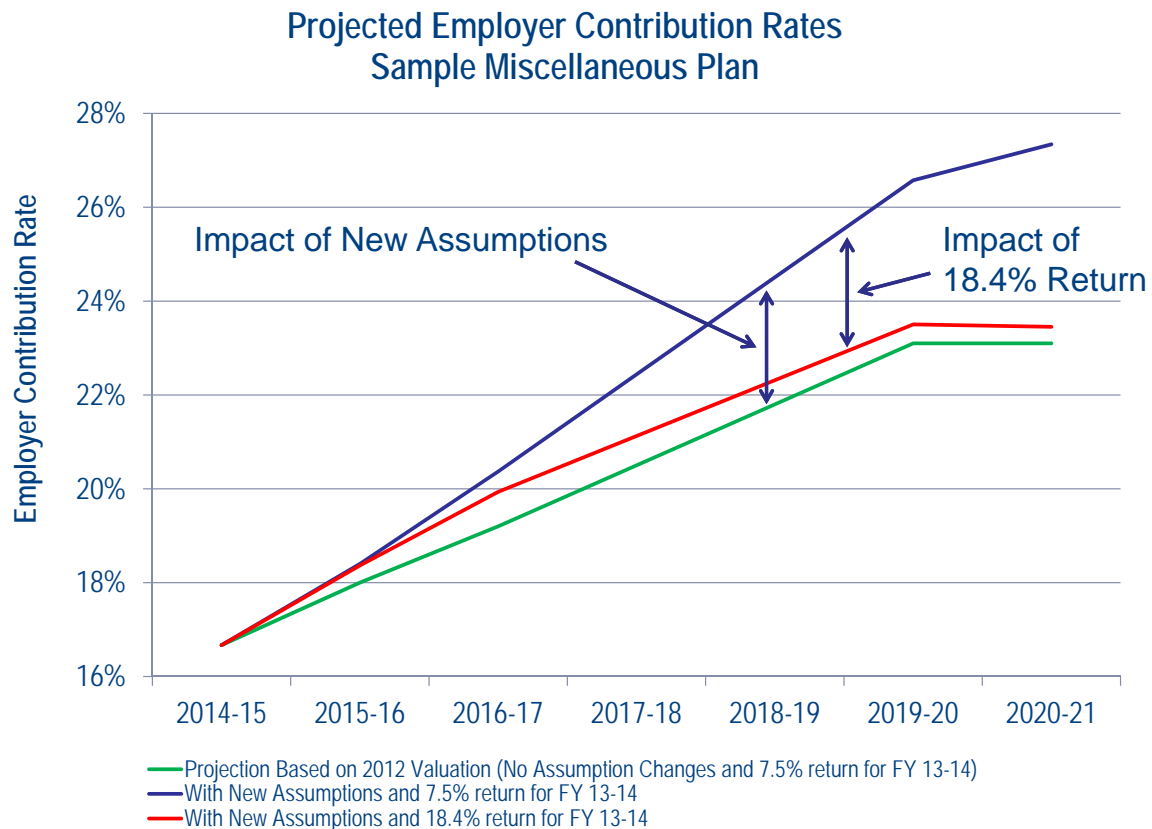
Data Source - CalPERS Comprehensive Annual Financial Reports

## Historic Returns Earned by CalPERS

1 year	5 year	10 year	20 year	30 year
18.4%	13.1%	7.2%	8.4%	10.1%

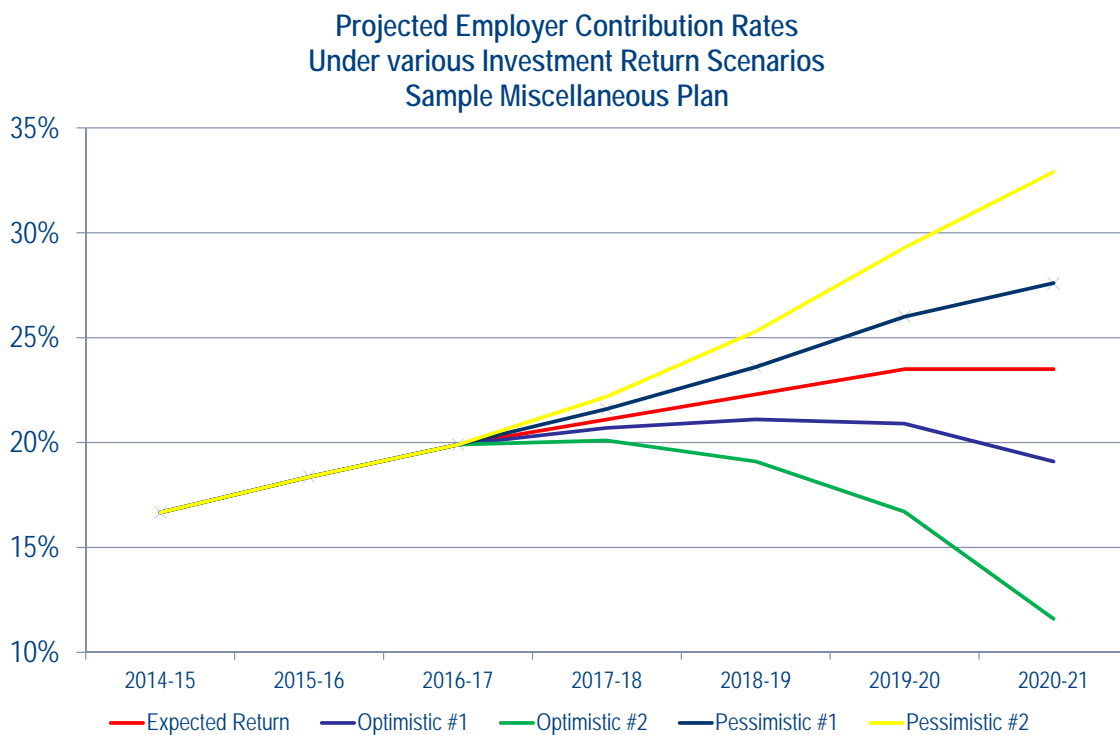
## Recap of Timeline

- FY 2015-16
  - New smoothing policy begins
  - New pooling structure begins
- FY 2016-17
  - New assumptions take effect



## Where can I see my future rates?

- Investment return sensitivity analysis
- Included in your annual actuarial report
- Estimated rates under five scenarios
  - Expected return  $\Rightarrow$  7.5 percent per year
  - Optimistic #1  $\Rightarrow$  12.0 percent per year
  - Optimistic #2  $\Rightarrow$  18.9 percent per year
  - Pessimistic #1  $\Rightarrow$  2.8 percent per year
  - Pessimistic #2  $\Rightarrow$  -3.8 percent per year



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# Questions & Comments