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

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

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

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*)?

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

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

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

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

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

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

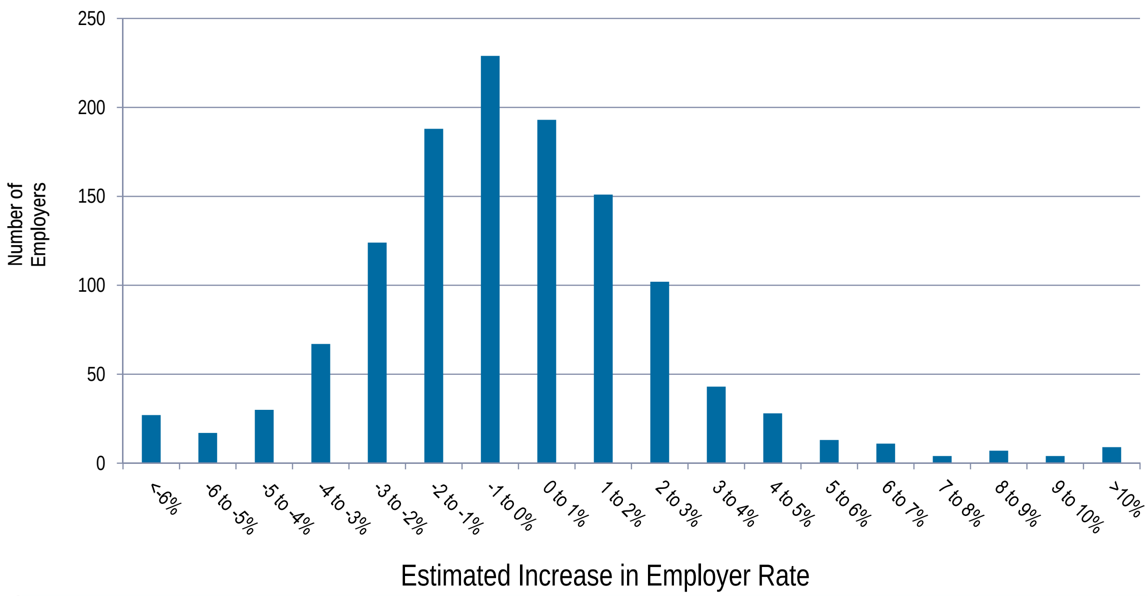
Why Changes to Risk Pooling?

- 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:



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

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 be included in the rate set by the June 30, 2013 valuation report

On The Horizon

On the Horizon

- Board Workshop
- Asset allocation feasibility study
- GASB

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

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

Board Workshop on Risk Mitigation

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

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

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

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

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

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

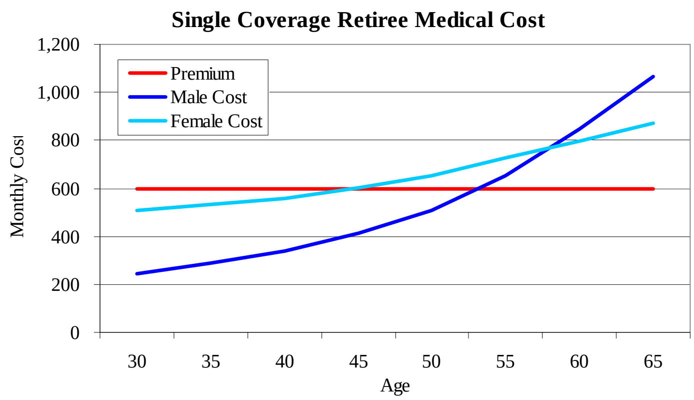
Potential GASB 68 Implementation Issues

- 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 <u>**if**</u> information provided by CalPERS is deemed not sufficient by auditor
- Example:
  - Cross-over calculation to determine discount rate

OPEB

GASB 45 – Implicit Rate Subsidy

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



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

GASB 45 – Implicit Rate Subsidy

- New ASOP requires
  - Implicit rate subsidy be valued for all plans
  - Based on medical plan's (not agency's) demographics
    - Cross-employer subsidy would be ignored
    - Some agencies will have liability that will not be defeased
    - Others will have liability that will be over defeased
- Actuaries must comply with valuation measurement after March 31, 2015

New OPEB Accounting Standard

- Similar to GASB 67 & 68
- Timing

- Exposure Draft	May 2014
- Comments	August 2014
- Hearing	September 2014
- Final	June 2015

Anticipated New GASB OPEB Standard

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

Anticipated New GASB OPEB Standard

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

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

New OPEB Accounting Standard

Entity	Year Beginning After
Plans	December 15, 2015
Plan Sponsors	December 15, 2016

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 ⇨ 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%

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

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

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

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.

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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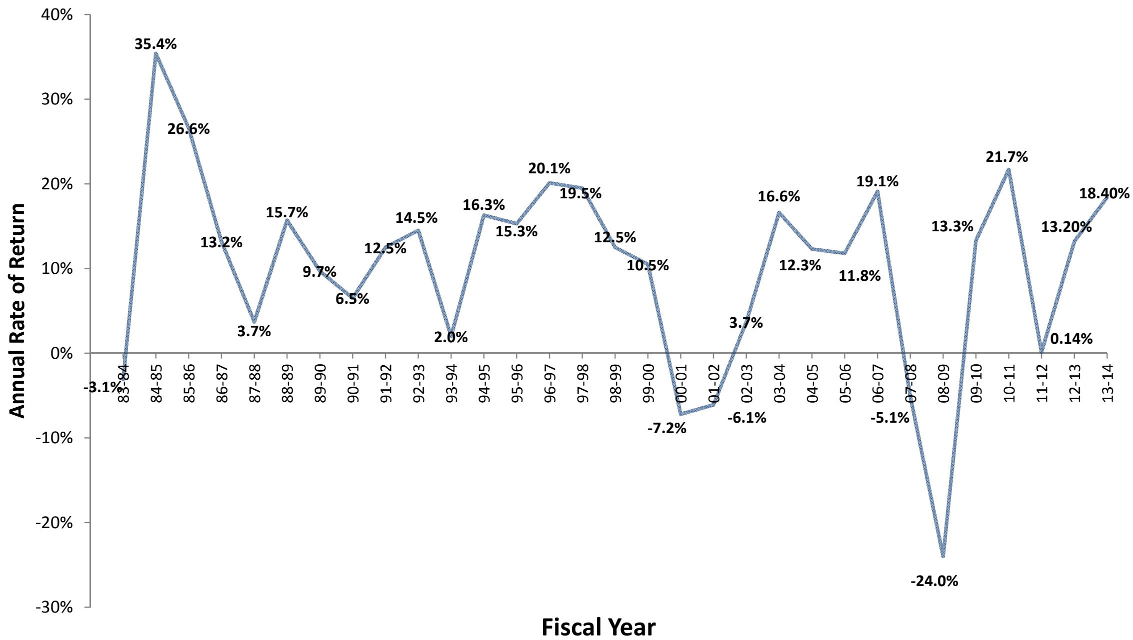
Impact of Investment Experience on Rates

- 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)



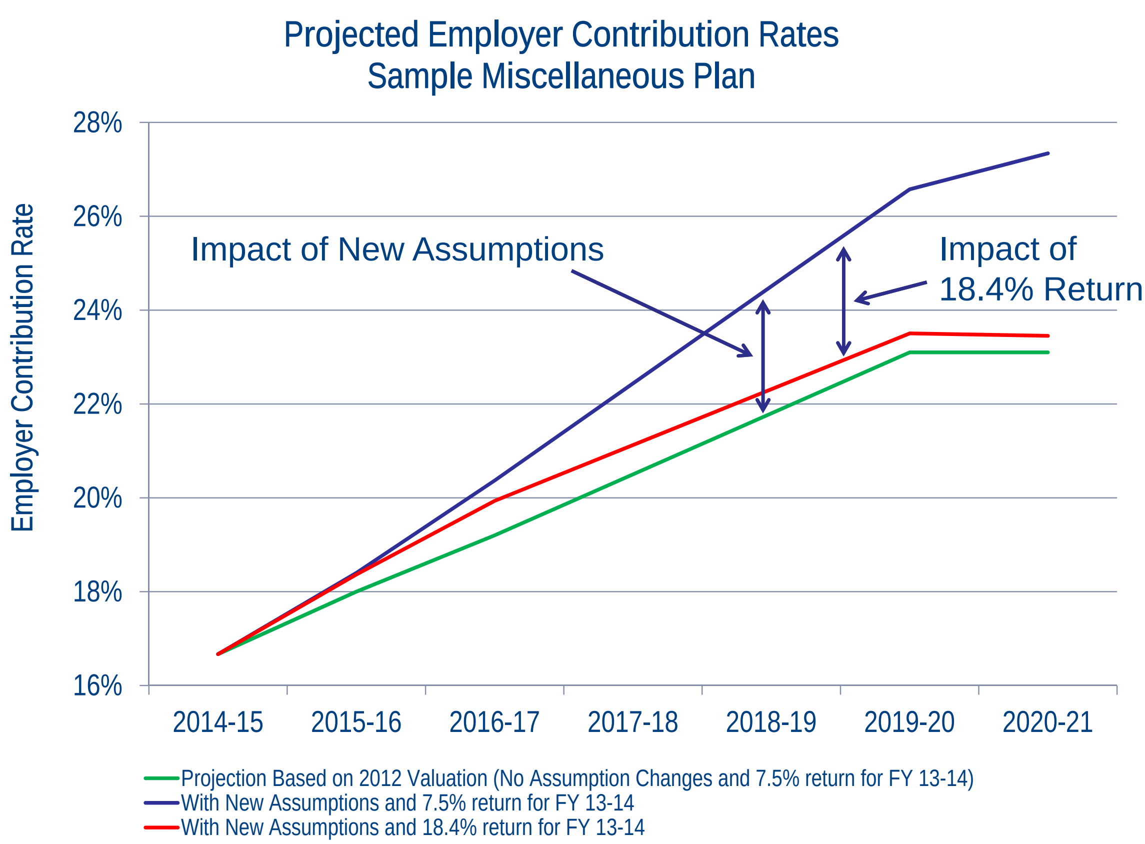
Data Source - CalPERS Comprehensive Annual Financial Reports

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%

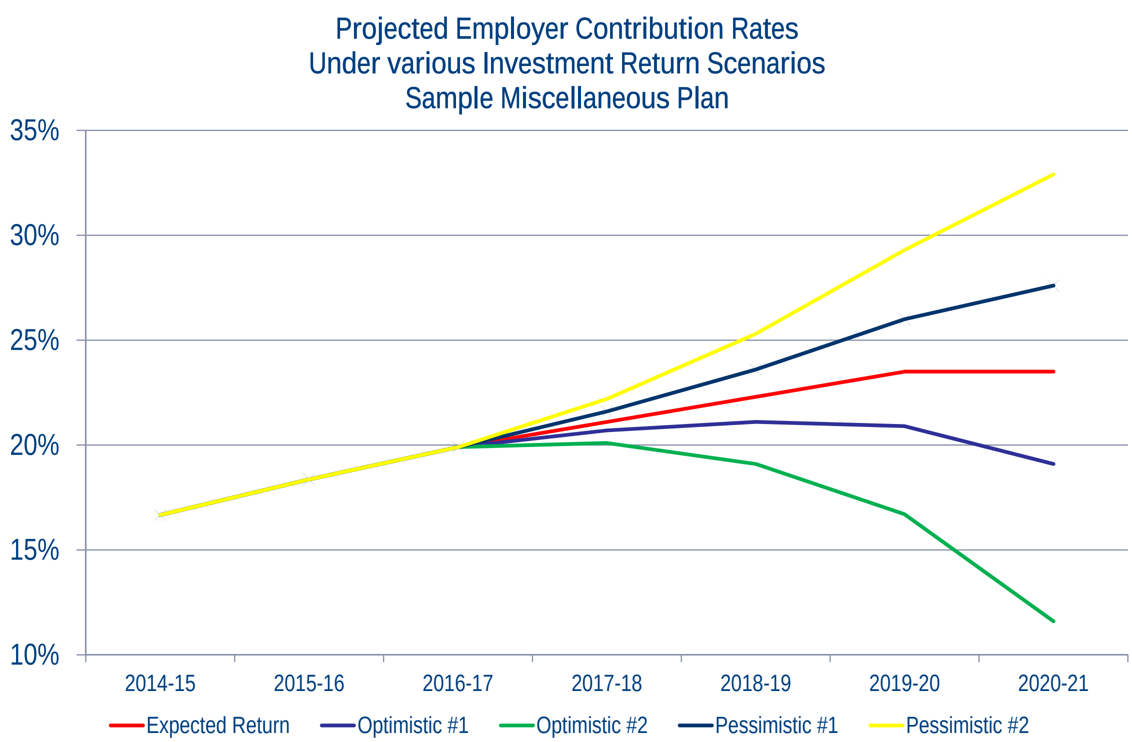
Recap of Timeline

- 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 ⇨ 7.5 percent per year
  - Optimistic #1 ⇨ 12.0 percent per year
  - Optimistic #2 ⇨ 18.9 percent per year
  - Pessimistic #1 ⇨ 2.8 percent per year
  - Pessimistic #2 ⇨ -3.8 percent per year



Questions & Comments