THE PUBLIC RETIREMENT
JOURNAL

CalPERS Contribution Rates, OPEB, GASB 68 (Pension Statement) and Other Fun Stuff

September 26, 2013

John E. Bartel
Bartel Associates, LLC

Agenda

GASB 68

New Pension Standard

GASB 27
What Was It?

- Recognize Net Pension Obligation (NPO) if Plan Sponsor did not contribute Annual Required Contribution (ARC)
- Pension Expense based on ARC, determined NPO
- Used as contribution out of bounds marker:
  - 30 year amortization

GASB 68
What Is It?

- Changes GASB 27 – Employer accounting
- Exposure Draft issued June 2011
- Final Standards Approved June 25th 2012
- Accounting only, **NOT** Contributions

GASB 68
What Is It?

- Everyone will recognize pension unfunded liability (asset) regardless of contributions
- Net Pension Liability drives Pension Expense
- Systems and plan sponsors will need to look elsewhere for contribution out of bounds markers
  - Actuaries?
  - Legislature?
  - Organizations?
  - Plan Sponsors?
  - Common sense?
- Additional note disclosures and RSI

GASB 68
Who Does It Apply To?

- Employers with DB &/or DC pension plans administered through trusts in which assets are:
  - Irrevocable
  - Dedicated and used only to provide pensions to plan members
  - Protected from creditors
- Agencies participating in CalPERS & other California retirement systems/plans

GASB 68
Effective Date

- Fiscal years beginning after June 15, 2014
  - Generally FYE 2015
- Earlier adoption encouraged

GASB 68
Three Categories of Plans

- Single Employer pension plan
  - Benefits only employees of one employer
- Agent multiple-employer pension plan
  - Assets pooled for investment purposes
  - Separate accounts maintained for each employer
  - Each employer's share of pooled assets is legally available only to pay pensions of its employees

Types of Plans (continued)

- Cost-sharing multiple-employer pension plan
  - Both assets and obligations to provide pensions are shared (pooled) by all employers
  - Plan assets can be used to pay employee pensions of any plan employer

Total Pension Liability

- Measure of benefits deemed earned to date ("past service")
- aka Actuarial Accrued Liability
- "Entry Age Normal" level percent of pay cost method
- Based on:
  - Benefit terms plus any legal agreements in force
  - Anticipated ad hoc COLAs and other changes to the extent considered substantively automatic
  - Reflect effects of significant changes between actuarial valuation date and measurement date

Assumptions

- Generally based on Actuarial Standards of Practice
- Discount rate – single equivalent rate based on:
  - Long term rate of return of plan investments
    - Net of investment but not administrative expenses
    - To the extent:
      - Projected plan assets expected to be available to pay benefits
      - Plan assets expected to be invested using long term strategy
  - 20-year high quality (AA/Aa or higher) tax exempt municipal bond rate:
    - benefit payments without (available projected) plan assets or
    - if plan assets not expected to be invested using long term strategy
    - Currently ≈4%

Total Pension Liability

- GASB 68 Measurement Date:
  - Within 12 months of employer fiscal year end
  - OK to roll forward from a prior date within 30 months of employer fiscal year end
  - For example:

Employer Fiscal Year End	Earliest Measurement Date	Earliest Valuation Date
6/30/15	6/30/14	12/31/12
12/31/15	12/31/14	6/30/13

  - Preference is for Measurement Date = FYE

Fiduciary Net Position - Assets

- At measurement date
- Dedicated to provide pension benefits
- Fair market value, no smoothing

Single and Agent Employers Recognize Net Pension Liability/Asset

- In financial statement
- Equal to:
  - Total Pension Liability

    net of
  - Fiduciary Net Position

Pension Expense

- Change in Total Pension Liability (AAL)

  minus
- Change in Fiduciary Net Position (MVA)

  less
- Deferred Outflows and Inflows for the period

  plus
- Portion of deferrals recognized in current period

Deferred Outflows and Inflows

- Deferred outflows and inflows of resources related to pensions
- Cumulative changes in Net Pension Liability which have not yet been recognized in pension expense
  - Unamortized portions of gains & losses and assumption changes.
- Contributions made after the Measurement Date

Change in Total Pension Liability Immediate Recognition

- Service Cost based on same method and assumptions as noted above
- Interest using blended single discount rate
- Benefit changes
- Other changes
  - Data adjustments/corrections
- Plan administration costs if paid from plan assets

Change in Total Pension Liability Deferred Recognition

- Active & inactive gains/losses
- Assumption changes
- Recognized over closed period based on average of active and inactive remaining future service
  - Likely ≈5-8 years
    - Shorter for plans with high ratio of retirees and
    - Longer for plans with high ratio of actives
  - May be level $ or level % of pay

Change in Fiduciary Net Position

- Immediate recognition for
  - Expected investment earnings
  - Contributions, benefit payments
- Deferred recognition for
  - Investment gains/losses on MVA
  - Over five year closed period

Cost Sharing Multiple-Employer Pensions

- For example, CalPERS Risk Pools
- Plan or Risk Pool's net pension liability calculated same as for single and agent employers
- Agency reports & recognizes proportionate share of Plan's or Risk Pool's net pension liability
  - Any reasonable method to determine proportion
  - Should be consistent with contribution determination

GASB 68 - Other Issues

- Special funding situations
  - Apply to entities other than employer that are legally required to contribute to the employer's plan
- Pension plans not funded through qualified trusts:
  - Will be addressed later and
  - Should continue to apply Statement Nos. 27/50

GASB 68 - Other Issues

- Defined Contribution Pensions, Recognize:
  - Expense for contributions for period as defined by plan's terms
  - Cash expenditures for amounts contributed
  - Liability for difference
- OPEB:
  - Will be addressed later and
  - Continue to apply Statement No. 45

CalPERS Upcoming Issues

What Is CalPERS Looking At?

- Contribution Policy
- Demographic Assumptions
- Discount Rate

Why Change Contribution Policy?

- GASB 68 encourages faster funding by requiring a lower discount rate for slower funding
- Asset corridor generates volatility when extreme events happen
- Slow progress towards increased funded status
- Current method needs improved transparency

What Changes Did CalPERS Make in Contribution Policy?

- No asset corridor in conjunction with shorter smoothing period and fixed (shorter) amortization periods
- Direct rate smoothing based on:
  - 5 year ramp up
  - No asset smoothing (target based on Market Value)
  - 25 year amortization period
  - No cap on rate increases each year

Timing For Funding Policy Changes?

- Approved by CalPERS Board in April
- Included in 6/30/13 valuation (15/16 rates)
- Estimated impact included in 6/30/12 valuation

Other Changes?

- Assumption study:
  - Will likely recommend generational mortality improvement
- Asset allocation study:
  - Likely recommend a .25% margin
  - Likely also recommend .25% reduction in real rate of return
    - need to wait for asset allocation study

Other Changes?

- Timing:
  - Default will be to include demographic & discount rate in 6/30/13 valuation (15/16 rates)
  - CalPERS Board may delay until 6/30/14 valuation

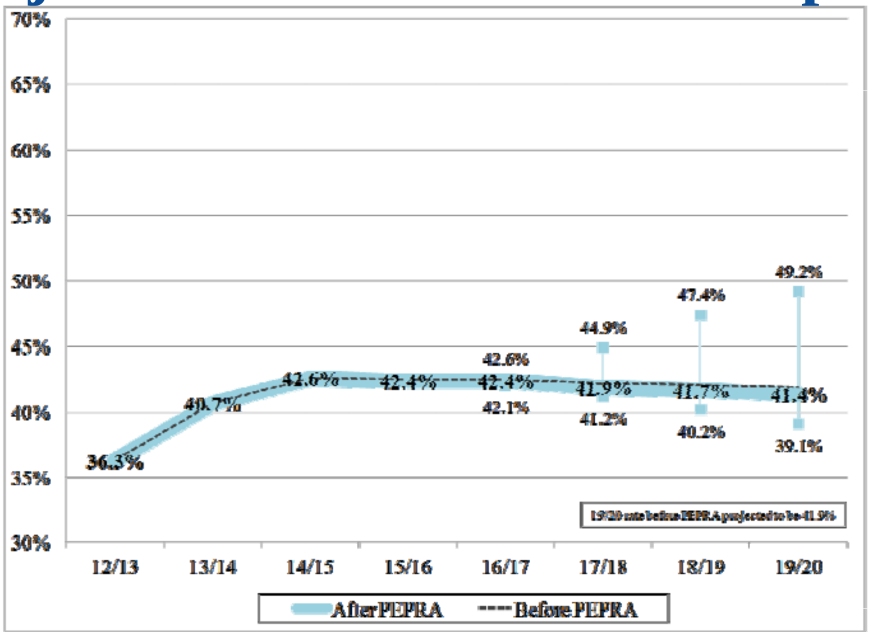
Safety Plan
Contribution Projection Assumptions
Market Value Investment Return

- June 30, 2012 0.1%
- June 30, 2013 13.9%
- June 30, 2013 - 2017
  - Poor Investment Return: ≈ 0.2% - 3.4%
  - Expected Investment Ret: ≈ 7.50%
  - Good Investment Return: ≈ 11.6% - 15.1%

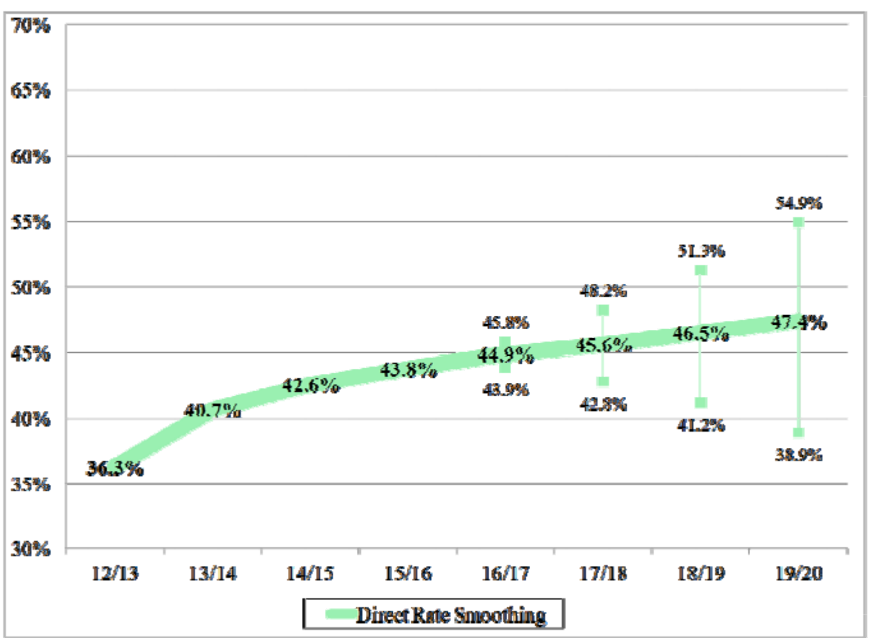
Contribution Projection Assumptions

- No Other: Gains/Losses, Method/Assumption Changes, Benefit Improvements
- Excludes Employer Paid Member Contributions (EPMC)
- New hire assumptions:
  - 50% of 2013 new hires will be Classic Members (Lateral) & 50% will be New Members.
  - Classic Member will decrease from 50% to 0% of new hires over 10 years.

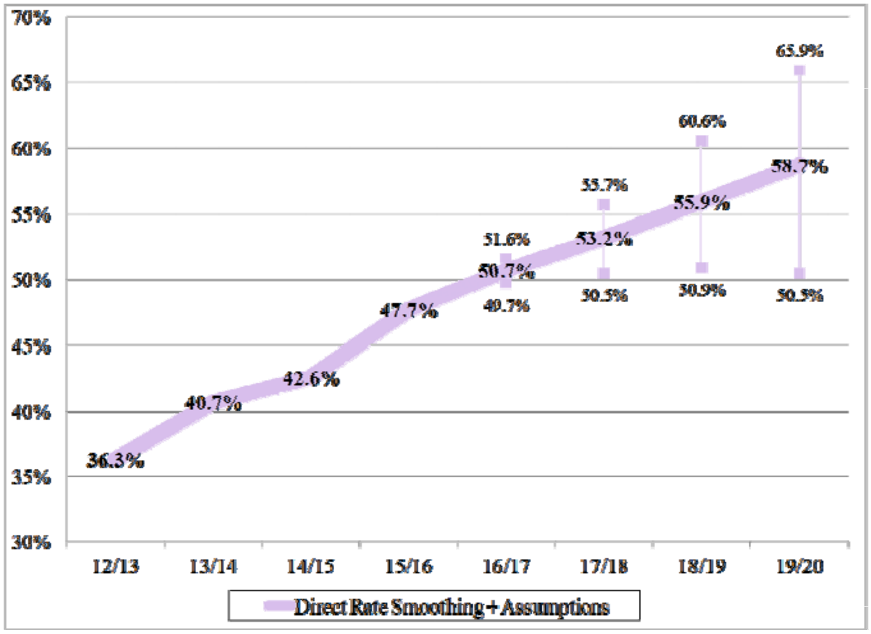
Current Contribution Policy Projections Include PEPRA Impact



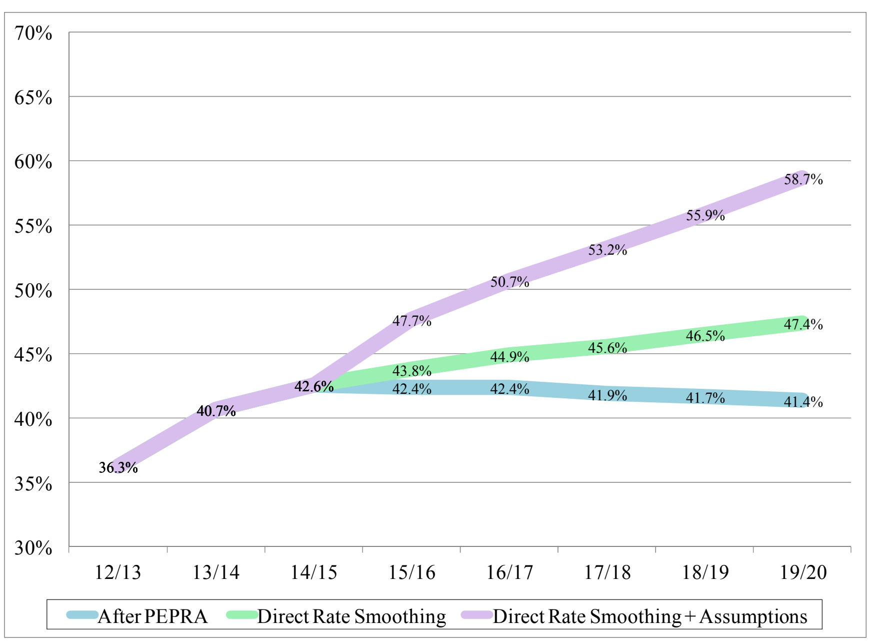
New Contribution Policy



New Contribution Policy
With Mort. & ¼% Discount Rate



Comparative Rates



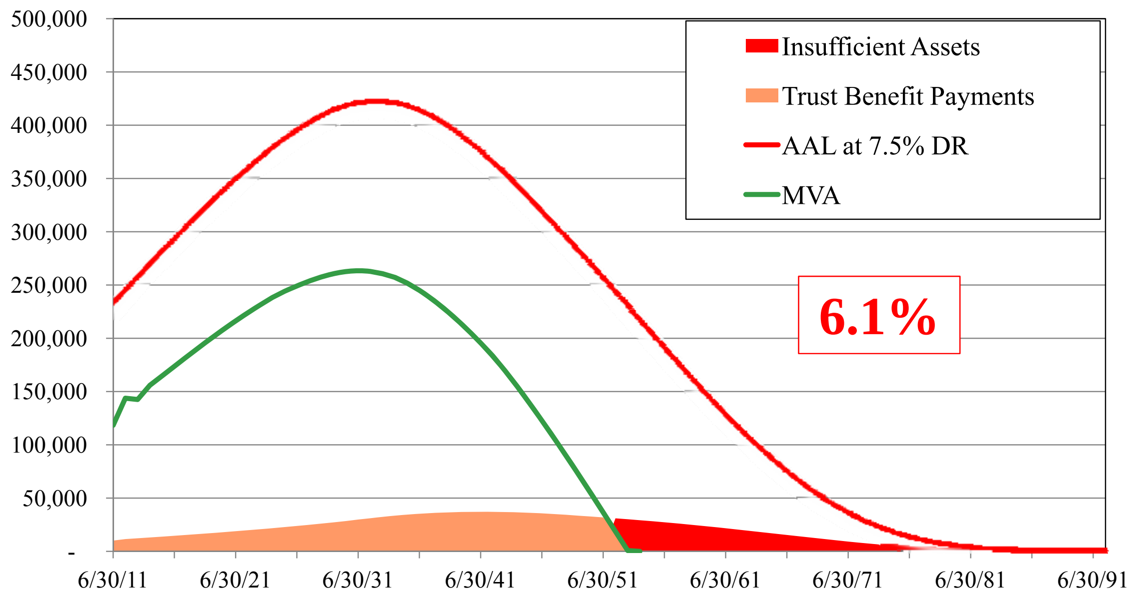
Sample CalPERS Safety Plan

(Aa 20 Year Municipal Bond Rate = 3%)

- 15 Year Rolling Asset Smoothing
- 30 Year Rolling Amortization of Gains/Losses

Sample CalPERS Safety Plan

(Aa 20 Year Municipal Bond Rate = 3%)



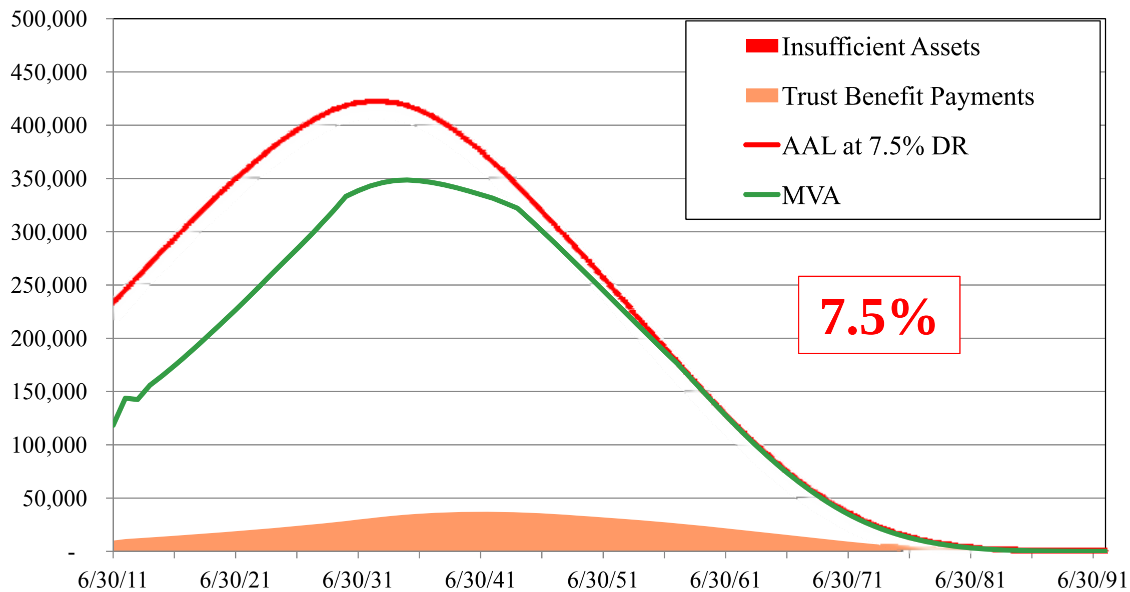
Sample CalPERS Safety Plan

(Aa 20 Year Municipal Bond Rate = 3%)

- New Contribution Policy

Sample CalPERS Safety Plan

(Aa 20 Year Municipal Bond Rate = 3%)



Background
CalPERS Contribution Rates

- PEPRA will, for some agencies, provide some long-term relief
- No Bright Line Test of What is Well or Poorly Funded Plan
  - Contribution Policy can have a big impact
  - What you are doing about Funded Status is more important than current Funded Status

CalPERS Side Fund Payoff

CalPERS Risk Pool
Side Fund

- Created when Risk Pools established in June 30, 2003 Valuation
- Pool treats side fund as contribution receivable
- Current policy:
  - Fixed 7½% interest rate
  - Payments:
    - Expected to increase by 3%
    - Actually made as:
      (contribution rate) x (actual PERSable wages)
  - Credit for expected payment not actual payment made

CalPERS Risk Pool
Side Fund

- Can likely borrow at much lower rate
- Can be significant & immediate savings, unless
  - Agency's payroll in Risk Pool declining rapidly
- Be careful if CalPERS keeps current policy:
  - 2nd Tier & PEPRA will result in lower costs without paying off Side Fund
- CalPERS will likely modify policy

CalPERS Side Fund Example

- June 30, 2013 Balance $10 million
- 7½% interest
- Level percent of pay: 3% payroll increases
- Actual amounts paid based on: percentage times actual payroll

CalPERS Side Fund 13 Year Amortization Example

- Contribution rate (15.4%) adjusted each year based on
  - Expected amortization payment and
  - CalPERS expected PERSable Wages

CalPERS Side Fund
13 Year Amortization Example

- Expected amortization payments:

Fiscal Year	w/o 2nd Tier & PEPRA	With 2nd Tier & PEPRA
2013/14	$ 1,017,800	$ 793,000
2014/15	1,048,300	874,400
↓	↓	↓
2025/26	1,451,100	1,052,700
2026/27	0	0

- Effective Interest Rate = **3.5%**

CalPERS Side Fund
5 Year Amortization Example

- Contribution rate (34.2%) adjusted each year based on
  - Expected amortization payment and
  - CalPERS expected PERSable Wages

CalPERS Side Fund
5 Year Amortization Example

- Expected amortization payments:

Fiscal Year	w/o 2nd Tier & PEPRA	With 2nd Tier & PEPRA
2013/14	$ 2,254,700	$ 1,756,800
2014/15	2,322,300	1,937,100
↓	↓	↓
2017/18	2,537,700	2,151,900
2018/19	0	0

- Effective Interest Rate = **0.4%**

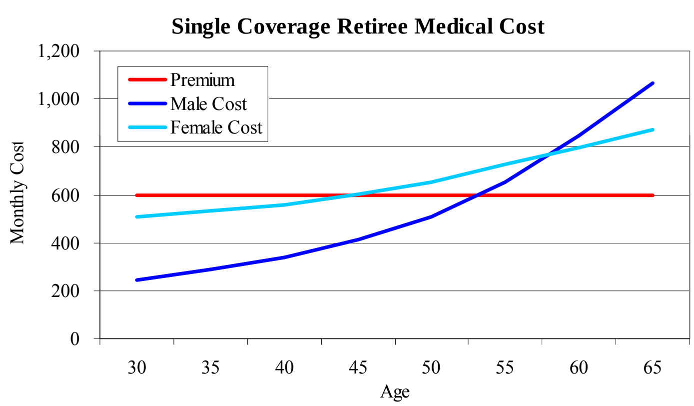
CalPERS Pooled Plan
Side Fund

- No longer a slam dunk to save money by paying Side Fund off
- Consider either
  - Waiting for CalPERS to decide if they will or will not change policy
  - Proceed cautiously based on your facts & circumstances

GASB 45
Implied Subsidy

GASB 45 – Implied Subsidy

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



GASB 45 – Implied Subsidy

- GASB 45 defers to Actuarial Standards of Practice (ASOP) for implied subsidy
- Current ASOP says community-rated medical plans not required to value implied subsidy
  - PEMHCA is, for most participating agencies, considered a community-rated plan
- Comment period for 2nd Exposure Draft just expired

GASB 45 – Implied Subsidy

- Exposure Draft would require
  - Implied 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
- Proposed final ASOP expected late 2013

Pension and OPEB Discount Rates

CERBT Alternative Investment Mixes

- Additional CERBT asset allocations
  - Agency selects one option on or after July 1, 2011
- Target asset allocations

Asset Classifications	Option 1	Option 2	Option 3
Global Equity	66.0%	50.1%	31.6%
US Nominal Bonds	18.0%	23.9%	42.4%
REIT's	8.0%	8.0%	8.0%
U.S. Inflation Linked Bonds	5.0%	15.0%	15.0%
Commodities	3.0%	3.0%	3.0%
Total	100.0%	100.0%	100.0%

CERBT Alternative Investment Mixes

- CalPERS expected returns (20 year period):

	Option 1	Option 2	Option 3
75% Confidence Limit[1]	5.80%	5.60%	5.25%
50% Confidence Limit	**7.61%**	**7.06%**	**6.39%**
25% Confidence Limit	9.43%	8.52%	7.47%
Standard Deviation	11.73%	9.46%	7.27%

- Agency selects discount rate, not CalPERS
- Requirement that discount rate cannot be greater than 50% confidence limit rate

CERBT Discount Rate Development

- 1st 10 years expected returns – based on asset advisors 10 year projections
- Higher returns assumed > 10 years
  - based on long term historical returns
  - implies investment losses in 1st 10 years
  - achievable?

CERBT Discount Rate Development

- Bartel Associates Recommendation:
  Select rate at 55% or 60% confidence limit

	Option 1	Option 2	Option 3
	55% Confidence Limit		
Discount Rate	**7.25%**	**6.75%**	**6.25%**
Maximum Discount Rate	7.61%	7.06%	6.39%
Margin for Adverse Deviation	(0.36%)	(0.31%)	(0.14%)
	60% Confidence Limit		
Discount Rate	**7.00%**	**6.50%**	**6.00%**
Maximum Discount Rate	7.61%	7.06%	6.39%
Margin for Adverse Deviation	(0.61%)	(0.56%)	(0.39%)

Pension & OPEB Discount Rates

- Discount rates are function of:
  - Real rates of return &
  - Inflation
- Outside (independent) investment advisors:
  - Significantly lower real rates of return
  - Bond returns in particular
- Do not be surprised if "***What is an appropriate discount rate?***" continues to be a major topic of discussion

Appendices

- Public Retirement Journal & PERS PAC Alert
- Bartel Associates www.Bartel-Associates.com:
  - GASB 68 Summary
  - PEPRA Summary
  - Other exciting stuff
- Anthony T. Oliveira, *The Local Challenges of Pension Reform*
  - http://www.tonytoliveira.com/Research.html