

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 Pension Statement | 1 |
| ■ CalPERS Upcoming Issues | 22 |
| ■ CalPERS Side Fund Payoff | 40 |
| ■ GASB 45 Implied Subsidy | 49 |
| ■ Pension & OPEB Discount Rates | 53 |

GASB 68

New Pension Standard

PRJ 9/26/13

1



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

PRJ 9/26/13

2



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?
 - Plan Sponsors?
 - Legislature?
 - Common sense?
 - Organizations?
- 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

PRJ 9/26/13

25



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

PRJ 9/26/13

26



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: \approx 0.2% - 3.4%
 - Expected Investment Ret: \approx 7.50%
 - Good Investment Return: \approx 11.6% - 15.1%

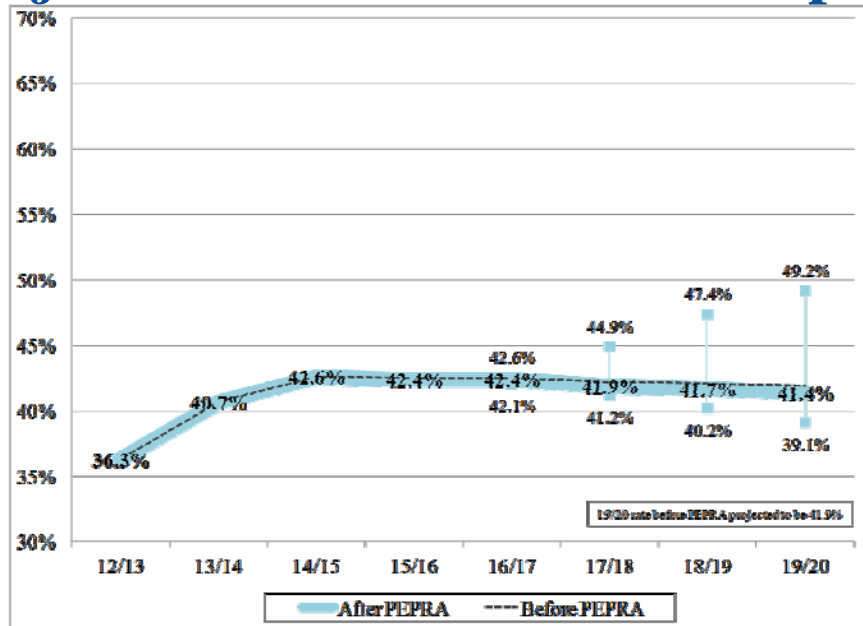


Contribution Projection Assumptions

- 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

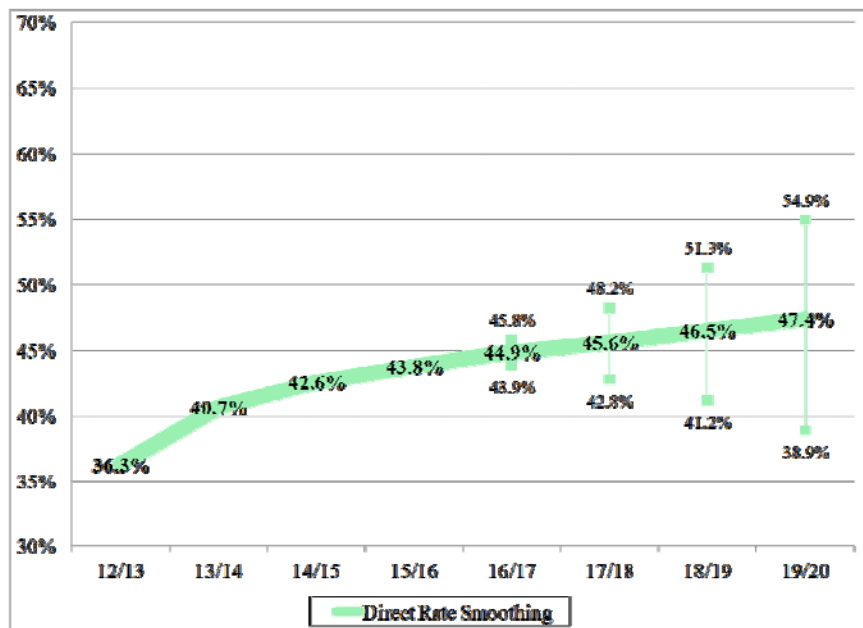


PRJ 9/26/13

31



New Contribution Policy

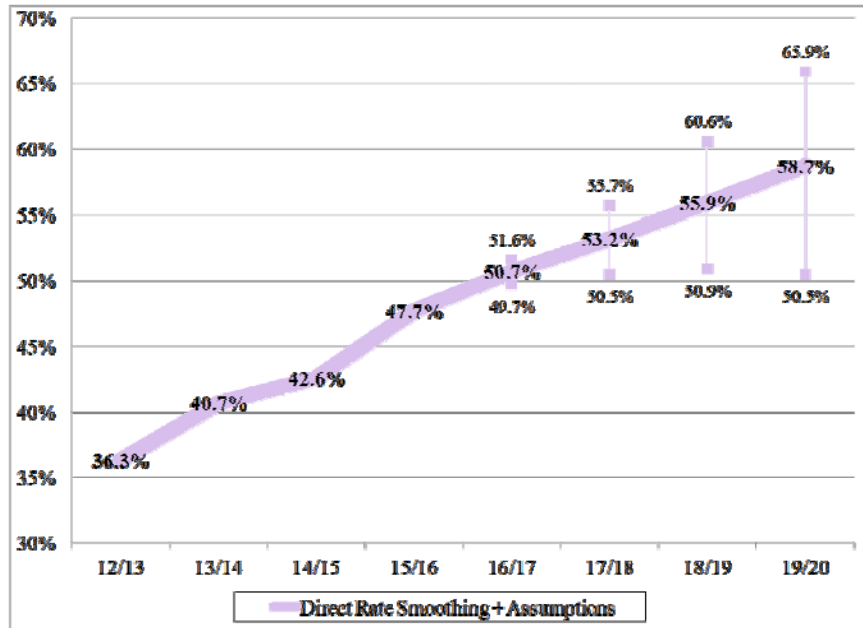


PRJ 9/26/13

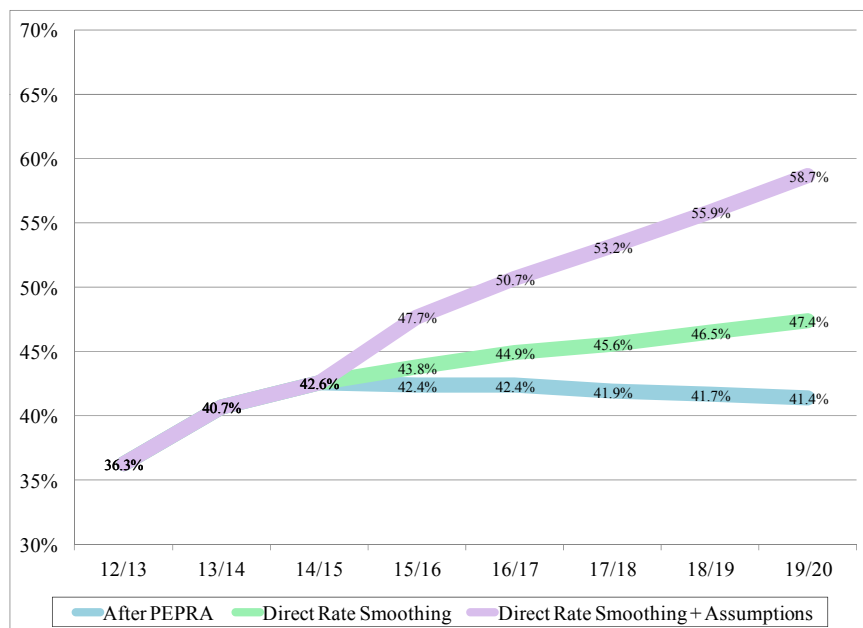
32



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

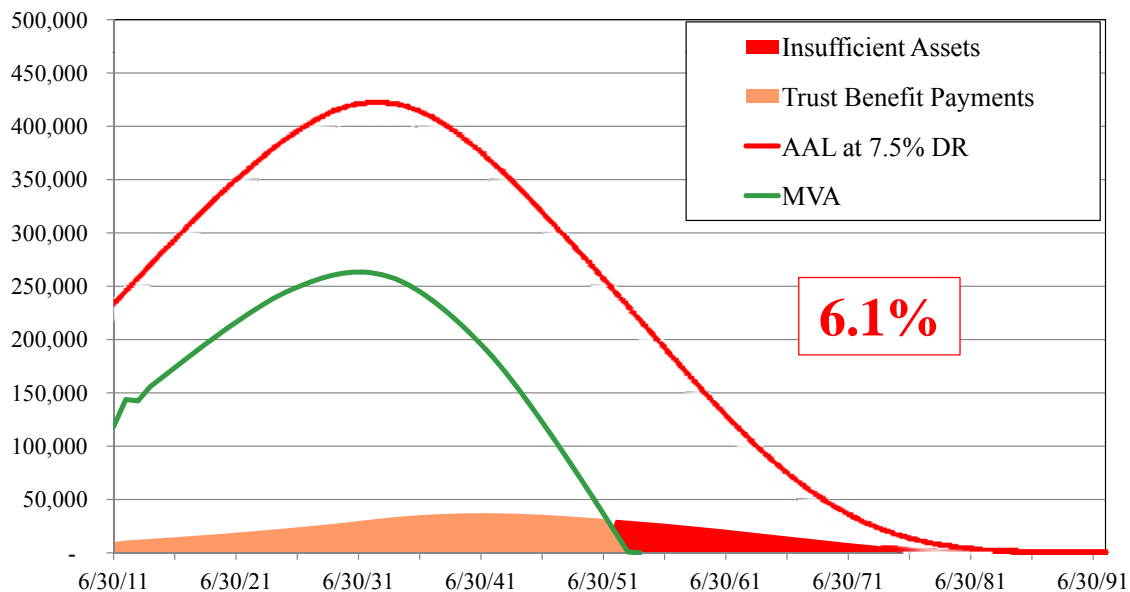
PRJ 9/26/13

35



Sample CalPERS Safety Plan

(Aa 20 Year Municipal Bond Rate = 3%)



PRJ 9/26/13

36



Sample CalPERS Safety Plan

(Aa 20 Year Municipal Bond Rate = 3%)

■ New Contribution Policy

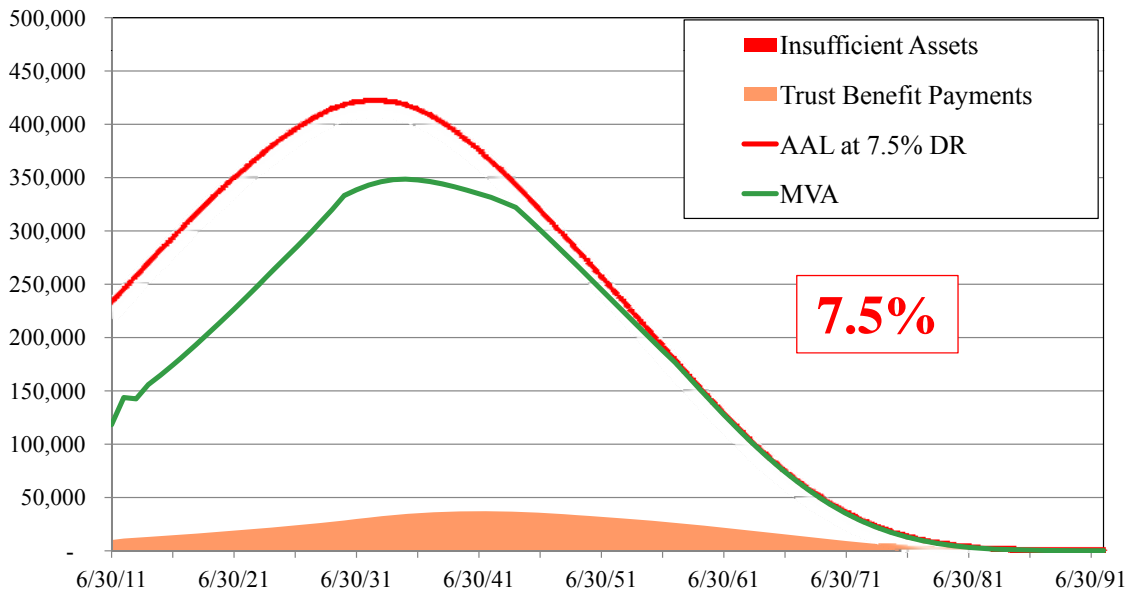
PRJ 9/26/13

37



Sample CalPERS Safety Plan

(Aa 20 Year Municipal Bond Rate = 3%)



PRJ 9/26/13

38



Background

CalPERS Contribution Rates

- PEPPRA 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 & PEPRAs 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 2 nd Tier & PEPRAs	With 2 nd Tier & PEPRAs
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%**

PRJ 9/26/13

45



CalPERS Side Fund 5 Year Amortization Example

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

PRJ 9/26/13

46



CalPERS Side Fund

5 Year Amortization Example

- Expected amortization payments:

Fiscal Year	w/o 2 nd Tier & PEPR	With 2 nd Tier & PEPR
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

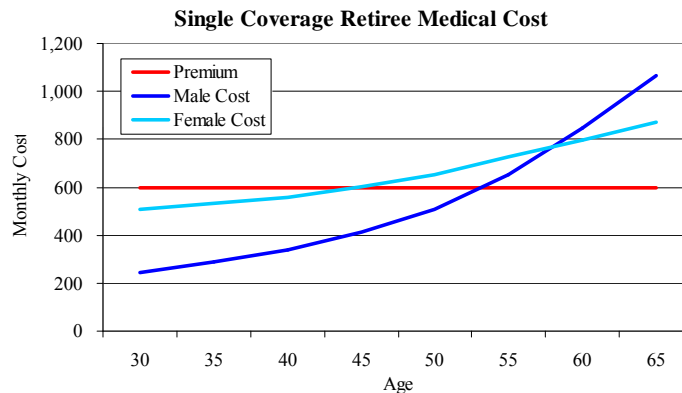
PRJ 9/26/13

49



GASB 45 – Implied Subsidy

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



PRJ 9/26/13

50



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

PRJ 9/26/13

53



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	<u>3.0%</u>	<u>3.0%</u>	<u>3.0%</u>
Total	100.0%	100.0%	100.0%

PRJ 9/26/13

54



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	<u>7.61%</u>	<u>7.06%</u>	<u>6.39%</u>
Margin for Adverse Deviation	(0.36%)	(0.31%)	(0.14%)
	60% Confidence Limit		
Discount Rate	7.00%	6.50%	6.00%
Maximum Discount Rate	<u>7.61%</u>	<u>7.06%</u>	<u>6.39%</u>
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
 - PEPRRA Summary
 - Other exciting stuff
- Anthony T. Oliveira, *The Local Challenges of Pension Reform*
 - <http://www.tonytoliveira.com/Research.html>

