Finance and Administration Committee

Agenda Item 6a

September 20, 2022

Item Name: Annual Actuarial Valuation for the Terminated Agency Pool

Program: Actuarial Office

Item Type: Information

Executive Summary

This agenda item presents the annual actuarial valuation report for the Terminated Agency Pool. As of June 30, 2021, the funded status of the Terminated Agency Pool is 199.0%.

The following table summarizes key results from the valuation:

Comparison of Current and Prior Year Results		
	June 30, 2020	**June 30, 2021**
Present Value of Benefits	$ 207,794,190	$196,452,685
Accrued Liability	$ 207,794,190	$196,452,685
Market Value of Assets	$ 366,127,374	$390,862,083
Funded Status	176.2%	199.0%

Strategic Plan

This item is presented as part of the regular ongoing workload of the Actuarial Office and supports the Pension Sustainability Goal of the CalPERS 2022-2027 Strategic Plan.

Background

The Terminated Agency Pool (TAP) Program exists to provide benefit payments to CalPERS members who are credited with service from terminated agencies. Agencies of the TAP Program do not pay regular contributions into the fund. Instead, each plan that terminates is required to have a funded status of 100% plus a contingency load of 5% for unforeseen negative experience to enter the pool.

Employers that have a funded status at termination that exceeds 105% are provided a refund for the difference. Those with a funded status below 105% are required to make up the difference at the time of termination.

On December 2012, the Board approved an asset allocation change for the TAP Program that splits the TAP asset portfolio into two segments: the "immunized" segment and the "non-immunized" segment. The immunized segment of the portfolio consists of long-term U.S. Treasury bonds, which are purchased to match liability cash flows and mitigate interest rate risk. The non-immunized segment is invested in the Public Employees' Retirement Fund (PERF) with an expected rate of return of 6.8%.

Analysis

As of June 30, 2021, the TAP Program is funded at 199.0%. This indicates that existing assets are roughly 99% greater than the amount expected to be necessary to pay all future benefits of the members of the TAP. The funded status improved since the last valuation due to favorable investment returns by the TAP assets during the previous year.

The discount rate used for the determination of the actuarial liabilities is 2.11%. This rate is the 30-year U.S. Treasury Separate Trading of Registered Interest and Principal of Securities (STRIPS) yield as of June 30, 2021. The discount rate used in the June 30, 2020 valuation was 1.48%.

Budget and Fiscal Impacts

This section is not applicable to this agenda item.

Benefits and Risks

Interest rate risk or investment volatility is typically the greatest risk that a pension plan faces for funding purposes. However, because a significant portion of the TAP is immunized, the pool is not subject to a large amount of interest rate risk. Therefore, the greatest risks to the pool are mortality risk and inflation risk, assuming no changes in current pool membership. A sensitivity analysis was performed on the TAP to evaluate the volatility of the funded status due to a change in mortality rates and inflation rates over the long-term. The following table summarizes the analysis:

Sensitivity of the Funded Status to a Change in Mortality Rates			
As of June 30, 2021	**Current Mortality Rates**	**-10% Mortality Rates**	**+10% Mortality Rates**
Funded Ratio	199.0%	191.9%	205.7%
Accrued Liability Impact		$7.2 million	($6.4) million

A 10% increase (decrease) to the assumed mortality rates over the long-term would result in approximately a 7% increase (decrease) to the funded ratio.

Sensitivity of the Funded Status to a Change in Inflation Rates			
As of June 30, 2021	**Current Inflation Rate 2.33%**	**1.33% Inflation Rate**	**3.33% Inflation Rate**
Funded Ratio	199.0%	219.7%	188.2%
Accrued Liability Impact		($18.5) million	$11.2 million

A decrease of 1% in the inflation rate assumption (2.33% to 1.33%) reduces the Accrued Liability by 9.4%. However, a 1% increase in the inflation rate (2.33% to 3.33%) increases the Accrued Liability by 5.7%. Unlike the mortality sensitivity analysis above, the impact of the inflation rate sensitivity is not symmetrical. The reason for this is most plans in the TAP have a 2% COLA provision, which limits annual increases to 2%.

Funded Ratio Dilution Risk

Over the last several years, the funded status of the TAP has varied between 250% to 175%. The current funded status is 199.0% The absolute dollar amount of the surplus has increased and is currently $194 million. This is primarily due to the good investment earnings of the TAP assets. The termination of a single large plan in the future could immediately reduce the funded status significantly. For example, as of June 30, 2021 at a funded status of 199.0%, a termination of a $50 million liability plan would decrease the funded status of the TAP by about 20 percentage points.

While the continued termination of plans in the future is expected to gradually reduce the funded status of the TAP, it is not expected to result in a funded status of less than 100%. However, a combination of the addition of future terminated plans and unfavorable experience such as longer life spans, could potentially reduce the funded status to less than 100%. This risk is mitigated by higher investment returns expected from the non-immunized segment of the TAP assets.

Inflation Risk

The U.S. Treasury securities purchased for the TAP portfolio are expected to cover projected benefit payments growing over a range of conservative inflation forecasts ranging from 2% to 6%. Even though current inflation rates are historically high, it is unlikely for this to persist in the future for an extended period.

Attachments

Attachment 1 – Terminated Agency Risk Pool Actuarial Valuation as of June 30, 2021

Attachment 2 – Terminated Agency Risk Pool PowerPoint Presentation

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