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Circular Letter

March 16, 2012

TO: **ALL PUBLIC AGENCY EMPLOYERS**

SUBJECT: **EMPLOYER RATE IMPACTS DUE TO DISCOUNT RATE CHANGE**

The purpose of this Circular Letter is to inform you of recent changes to the CalPERS discount rate assumption and the impact this will have on employer contribution rates.

At the March 14, 2012 meeting, the CalPERS Board of Administration (Board) approved a recommendation to lower the CalPERS discount rate assumption, or the rate of investment return the pension fund assumes, from 7.75 to 7.50 percent. This will increase public agency employer rates for fiscal year 2013-14.

CalPERS actuaries offered the Board two options to protect the soundness of the pension plan: a 7.25 percent discount rate that includes an adjustment to add an element of conservatism to further protect against lower returns, or a 7.50 percent discount rate without such an adjustment. The Board voted to lower the discount rate to 7.50 percent but directed staff to develop a plan to phase in the employer contribution rate increases over a period of two years.

Background

In March 2011, the Board voted to keep the current discount rate of 7.75 percent. That decision was partially made to help employers during these difficult economic times, but was also contingent upon a reassessment this year. CalPERS discount rate was last changed 10 years ago, when it was lowered to 7.75 percent from 8.25 percent.

Over the past year, the CalPERS Actuarial Office conducted its own study and hired an independent evaluator to assess economic assumptions. The discount rate assumption is calculated based on expected price inflation and real rate of return. Based upon information from both studies, CalPERS Actuaries recommended that the assumption for price inflation be reduced from 3.00 to 2.75 percent. When added to the current real return assumption of 4.75 percent, produces a discount rate assumption of 7.50 percent.

Results

The Board's decision to lower the discount rate assumption will have the following estimated impacts on public agency employers and employees:

- **Public agency employer contribution** rates are estimated to increase by approximately 1.0 to 2.0 percent of payroll for Miscellaneous plans and 2.0 to 3.0 percent of payroll for Safety plans. These increases are to be phased in over a period of two years beginning in fiscal year 2013-14. Details of the phase have yet to be developed. CalPERS will communicate via Circular Letter to employers when details are available.

- **Service credit purchase** requests postmarked, delivered, or faxed on or after March 15, 2012 will increase between 5.0 to 13.0 percent depending on the individual circumstances of members.

- **Retirement applications** with retirement dates on or after March 15, 2012 will be calculated from the new discount rate. Members who choose optional benefits – leaving some part of their benefit to a spouse or beneficiary after their death – will experience approximately a 2.0 percent increase in cost.

The measured impact of the change in the discount rate assumption will be known when the Actuarial Office completes the June 30, 2011 actuarial valuations in fall 2012. The June 30, 2011 valuations will set the employer rates that take effect on July 1, 2013.

If you have any questions, please call our CalPERS Customer Contact Center at **888 CalPERS** (or **888**-225-7377).

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