CalPERS

Finance and Administration Committee

Agenda Item 6d

April 18, 2022

Item Name: Schools Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Approve an employer contribution rate of 25.37% for the Schools Pool and a member contribution rate of 8.00% for schools' employees subject to the Public Employees' Pension Reform Act of 2013 (PEPRA). Rates are applicable for the period of July 1, 2022 to June 30, 2023.

Executive Summary

The employer contribution rate has increased since the prior fiscal year. It is lower than what was projected in our April 2021 agenda item and is in line with what was projected in the June 30, 2020 annual valuation report addendum.

The following table summarizes the key results of the June 30, 2021 valuation:

Key Valuation Results ($ in millions)

Funded Status	June 30, 2020	June 30, 2021
Market Value of Assets	$71,400	$86,519
Accrued Liability	$104,062	$110,507
Unfunded Accrued Liability	$32,662	$23,988
Funded Status	68.6%	78.3%

Contribution Rates	Fiscal Year 2021-22	Fiscal Year 2022-23
Employer Contribution Rate[1]	22.91%	25.37%
PEPRA Member Contribution Rate	7.00%	8.00%

[1] Fiscal year (FY) 2021-22 rate reflects reduction for the supplanting payment associated with the State's additional contribution in July 2019. See "State Supplanting Payments" below for more information.

Strategic Plan

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the fund sustainability goal of the strategic plan: strengthen the long-term sustainability of the pension fund.

Background

The Schools Pool provides retirement benefits to classified employees of school districts, community college districts, and county offices of education in California. It generally does not cover certificated school employees as they are covered by a separate retirement system, the California State Teachers' Retirement System (CalSTRS).

This actuarial valuation determines the funded status as of June 30, 2021 and sets forth the Schools employer and PEPRA employee contribution rates for FY July 1, 2022 through June 30, 2023.

Investment Return and Discount Rate

On July 12, 2021, CalPERS reported a preliminary 21.3% net return on investments for FY 2020-21. Since the preliminary return sufficiently exceeded the 7.00% discount rate, the Funding Risk Mitigation Policy triggered a 0.20% reduction in the discount rate, from 7.00% to 6.80%.

Under the Actuarial Amortization Policy, a portion of the investment gain was used to fully offset the increase in unfunded liability resulting from the decrease in discount rate. The remaining (net) investment gain was amortized over 20 years with a five-year ramp. This net investment gain reduced the required employer contribution rate in FY 2022-23 by 1.27% of pay. Due to the five-year ramp, this reduction will increase each year until it reaches an estimated 5.68% in FY 2026-27.

The reduction in discount rate increased the required employer contribution rate by 0.48% of pay. It was also the primary driver of an increase in the PEPRA member contribution rate from 7.00% to 8.00%, which served to reduce the employer rate by 0.42% of pay. See "PEPRA Member Contribution Rates" for more information on the member rate change.

Other Assumption Changes

On November 17, 2021, the board adopted new actuarial assumptions based on the recommendations in the November 2021 CalPERS Experience Study and Review of Actuarial Assumptions. This study assessed various assumptions including retirement rates, termination rates, mortality rates, rates of salary increase, and inflation. New assumptions stemming from the study are incorporated in this actuarial valuation and will affect required contributions for FY 2022-23. In addition, the board adopted a new strategic asset allocation as part of its Asset Liability Management process. The new asset allocation along with the new capital market assumptions and economic assumptions support retention of the 6.80% discount rate (previously triggered under the Funding Risk Mitigation Policy) and a reduction in the price inflation assumption from 2.50% to 2.30%.

The net impact of these assumption changes on the required employer contribution rate in FY 2022-23 is an increase of 0.54%, which accounts for the increase in normal cost and the increase in unfunded liability to be paid over 20 years.

State Supplanting Payments

In July 2019, the State made a contribution of $904 million from the General Fund to the Schools Pool to cover a portion of the required unfunded liability contribution on behalf of school employers. This contribution was spread among fiscal years 2019-20, 2020-21, and 2021-22 in the form of supplanting payments in accordance with Government Code section 20825.2. Due to the expiration of these supplanting payments, the required employer contribution rate for FY 2022-23 will increase by 2.16% relative to FY 2021-22.

Analysis

Schools Employer Contribution Rates for 2022-23

The Actuarial Office has completed the calculation of the employer contribution rate for the Schools Pool for FY 2022-23. The full actuarial report will be completed later this year and will be provided to the board and posted online when complete. The additional information provided in the full actuarial report will include details on assumptions, methods, and participant data.

The table below compares the FY 2022-23 employer contribution rates and corresponding dollar amounts to the current FY 2021-22.

Schools Pool Employer Contribution ($ in millions)

Employer Costs by Rate and Dollars	Fiscal Year 2021-22	Fiscal Year 2022-23
Employer Contribution Rate		
Employer Normal Cost	9.32%	9.82%
Unfunded Liability Rate[1]	13.59%	15.55%
Required Employer Rate	**22.91%**	**25.37%**
Projected Payroll[2]	$ 15,295	$ 15,181
Expected Employer Contribution Dollars		
Employer Normal Cost	$ 1,425	$ 1,491
Unfunded Liability Contribution	2,078	2,361
Expected Employer Contributions	**$ 3,503**	**$ 3,852**

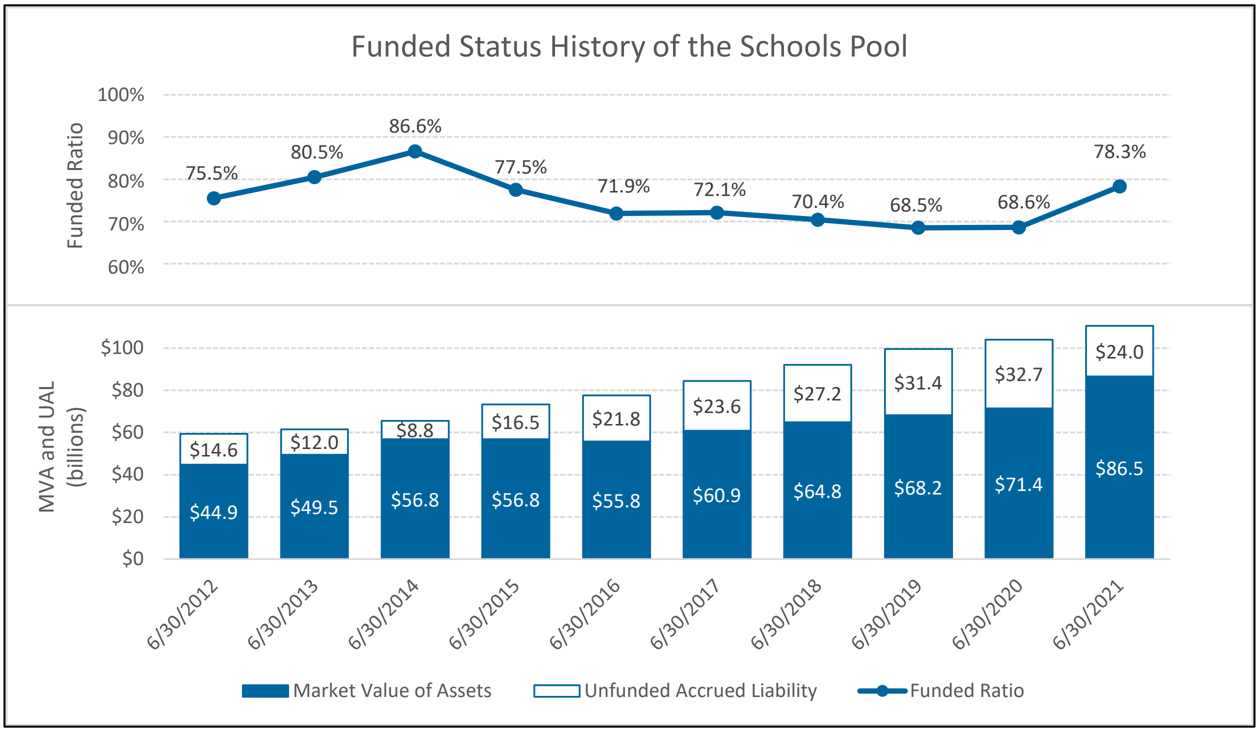
[1] For FY 2021-22, the $330 million supplanting payment associated with the State contribution under G.C. §20825.2 served to reduce the employer contribution by 2.16% of payroll.

[2] Projected payroll used to calculate the expected dollar contributions is payroll reported for the year prior to the valuation date, increased for two years of payroll growth at the prevailing payroll growth assumption (2.75% per year for the June 30, 2020 valuation, 2.80% per year for the June 30, 2021 valuation). To the extent that payroll in the contribution year is different than projected, the actual contribution amounts will be different than the expected contributions shown in the table above.

Funded Ratio

The funded ratio of a pension plan is defined as the ratio of assets to accrued liability. Plans with a lower funded ratio are, all other things equal, more costly and at higher risk of not being able to meet their future benefit obligations. From June 30, 2020 to June 30, 2021 the funded ratio of the Schools Pool increased by 9.7%. This increase is due primarily to higher than expected investment return in FY 2020-21, offset partially by the changes in assumptions, including the reduction in discount rate.

The graph below shows the funded ratio for the past ten years.



Reasons for Changes in the Contribution Rate

Overall, the required employer contribution rate for the Schools Pool increased by 2.46% of payroll from the prior year. The dollar amount of contributions expected to be generated in FY 2022-23 is approximately $349 million higher than in FY 2021-22.

The return on assets for the year ending June 30, 2021 exceeded the assumed return of 7.0%, leading to an investment experience gain (excess of actual return over assumed return) of approximately $11,101 million. As stated above, pursuant to the Funding Risk Mitigation and Actuarial Amortization policies, a portion of this investment gain was used to fully offset the impact of the discount rate reduction with the remainder established as a net investment gain amortized over 20 years with a five-year ramp.

The following table reconciles the required employer contribution from last year to this year.

Reconciliation of Required Employer Contribution

	Rate (% of Payroll)	Estimated Dollars (millions)
Employer Normal Cost		
2021-22 employer normal cost contribution	9.32%	$1,425
Change in payroll	0.00%	(10)
Demographic experience	(0.24%)	(36)
Discount rate change	0.75%	114
Other assumption changes	0.41%	62
Effect of change in member contribution rates	(0.42%)	(64)
2022-23 employer normal cost contribution	9.82%	$1,491
Unfunded Liability Contribution		
2021-22 unfunded liability contribution	13.59%	$2,078
Progression of amortization bases and change in payroll	1.80%	254
State supplanting payment expiration (G.C. §20825.2)	2.16%	330
Re-amortization of existing bases at 6.8% discount rate	(0.27%)	(41)
Net investment gain[1]	(1.27%)	(192)
Non-investment (gain)/loss	(0.59%)	(90)
Other assumption changes	0.13%	22
2022-23 unfunded liability contribution	15.55%	$2,361
Total Required Employer Contribution		
2021-22 total required employer contribution	22.91%	$3,503
Progression of amortization bases and change in payroll	1.80%	244
State supplanting payment expiration (G.C. §20825.2)	2.16%	330
Discount rate change	0.48%	73
Other assumption changes	0.54%	84
Experience (gains)/losses	(2.10%)	(318)
Effect of change in member contribution rates	(0.42%)	(64)
2022-23 total required employer contribution	25.37%	$3,852

[1] Pursuant to the Funding Risk Mitigation Policy and Actuarial Amortization Policy, a portion of the FY 2020-21 investment gain was used to fully offset the increase in unfunded accrued liability resulting from the reduction in discount rate from 7.0% to 6.8%. The remaining (net) investment gain was amortized over 20 years with a five-year ramp.

PEPRA Member Contribution Rates

Under PEPRA, new members hired on or after January 1, 2013 are required to contribute 50% of the total normal cost of their pension benefit as determined by the actuary. PEPRA school members currently contribute 7.00% of salary. The contribution rate for school members not subject to PEPRA (i.e., classic members) is set by statute and is currently 7.00% of salary.

Current law requires a change in the PEPRA member contribution rate when the total normal cost changes by more than 1% of payroll. When a change is triggered, the member contribution rate is adjusted to equal half the total normal cost, rounded to the nearest quarter of one percent.

The current PEPRA member contribution rate of 7.00% is based on a total normal cost for PEPRA members of 14.07% of payroll established in the June 30, 2017 actuarial valuation. Due primarily to the change in discount rate, the total normal cost for PEPRA members increased from 14.87% of payroll for FY 2021-22 to 15.91% for FY 2022-23. As the total normal cost changed by more than 1% relative to the basis of 14.07%, the PEPRA member contribution rate must be adjusted for FY 2022-23 to equal 50% of the new total normal cost, rounded to the nearest quarter percent. As a result, the member contribution rate will increase to 8.00% effective July 1, 2022.

The increase in PEPRA member rate will serve to reduce the school employer contribution rate by 0.42% in FY 2022-23.

As of June 30, 2021, there were 160,817 active PEPRA members in the Schools Pool, representing 51% of the total active population of the Schools Pool. The total payroll for active PEPRA members was $6,037 million, or 42% of the total payroll of the Schools Pool.

Expected Future Changes

The following table shows projected employer contribution rates. Projected rates assume all actuarial assumptions will be realized and no changes to assumptions, methods, or benefits will occur during the projection period. The projected rates further reflect that normal cost is expected to continue to decline gradually over time as new employees enter the PEPRA benefit tier.

Projected Schools Employer Contribution Rates (% of payroll)

Fiscal Year	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Employer Contribution	25.37%	25.2%	24.6%	23.7%	22.6%	22.6%

The actual investment return for FY 2021-22 was not known at the time this item was prepared. The projections above assume the investment return for that year will be 6.80%. ***If the actual investment return for FY 2021-22 differs from 6.80%, the actual contribution requirements for the projected years will differ from those shown above.***

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

Information about the risks associated with the funding of these plans will be included in the valuation report that is expected to be released later this year. This information includes investment return scenarios, discount rate sensitivity, volatility ratios, and other risk analyses.

Attachments

Attachment 1 – Schools Valuation Presentation

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