



# Finance and Administration Committee

## Agenda Item 5c

**April 17, 2023**

**Item Name:** State Valuation and Employer/Employee Contribution Rates

**Program:** Actuarial Office

**Item Type:** Action

### Recommendation

Adopt the actuarially determined employer contribution rates and approve the member contribution rates for the period July 1, 2023 to June 30, 2024 as set forth in the table on page 3 of this agenda item.

### Executive Summary

The recommended employer contribution rates for the State plans for fiscal year (FY) 2023-24 are higher than the rates adopted for FY 2022-23 except for POFF. The increase in employer contribution rates is primarily due to investment return in FY 2021-22 being less than expected.

Except for Safety and CHP, recommended employer contribution rates for FY 2023-24 are generally lower than the projected rates shown in the June 30, 2021 annual valuation report issued in September 2022. This is due to the application of the Supplemental Pension Payment (SPP) of \$2.925 billion made by the State in July 2022.

### Comparison of Current and Prior Year Results (in millions)

<b>Funded Status</b>	<b>June 30, 2021</b>	<b>June 30, 2022</b>
Accrued Liability	\$225,975	\$238,203
Market Value of Assets	\$182,354	\$167,420
Unfunded Accrued Liability	\$43,621	\$70,783
Funded Ratio	80.7%	70.3%
Expected Employer Contributions based on Actuarially Determined Contribution Rates	\$7,597 <sup>1</sup>	\$8,058 <sup>2</sup>
Expected Employer Contributions based on Anticipated Budget Act	\$7,980 <sup>3</sup>	\$8,471 <sup>3</sup>

<sup>1</sup> Reflects impact of Proposition 2 Supplemental Pension Payment made in July 2021 and CHP supplemental payments from August 2020 to August 2021.

<sup>2</sup> Reflects impact of Proposition 2 Supplemental Pension Payment made in July 2022 and CHP supplemental payments from August 2020 to May 2022.

<sup>3</sup> Reflects additional contributions under G.C. section 20683.2, the Bargaining Unit 5 agreement, and the State's contribution stabilization strategy.

## **Strategic Plan**

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the Pension Sustainability goal of the Strategic Plan: Strengthen the long-term sustainability of the pension fund.

## **Background**

The five plans included in this valuation provide retirement benefits to members employed by the State of California. This includes employees of the California State University system but generally does not include employees of the University of California system. It also does not cover school employees or employees of local governments that have elected to contract with CalPERS.

This actuarial valuation sets forth the employer and employee contribution rates for the State plans for fiscal year July 1, 2023 through June 30, 2024.

## **Investment Return and Discount Rate**

From the Basic Financial Statements issued on November 15, 2022, CalPERS reported a return on investments of -7.5% (before recognition of administrative expenses) for FY 2021-22 compared to an expected return of 6.8%. (Note, the time weighted return for FY 2021-22 of -6.1% reported prior to the issuance of the Financial Statements reflected information for private equity investments and real assets as of March 31, 2021.)

## **Assumption Changes**

There are no changes in assumptions in the June 30, 2022 valuation.

## Analysis

### Actuarially Determined State Employer Contribution Rates for FY 2023-24

The Actuarial Office is recommending that the board adopt the following actuarially determined employer contribution rates for the State plans for FY 2023-24. The contribution rates we anticipate will be included in the Budget Act are shown on page 8. The full actuarial report is expected to be completed later this year and will be provided online when completed. The additional information provided in the full actuarial report includes details on assumptions, valuation methods and participant census.

The table below compares the FY 2023-24 actuarially determined contribution rates and the associated estimated dollar amounts with rates and dollar amounts for FY 2022-23.

Fiscal Year	2022-23 Expected Employer Contribution (in millions)	2022-23 Employer Contribution Rate <sup>2</sup>	2023-24 Expected Employer Contribution (in millions)	2023-24 Employer Contribution Rate <sup>2</sup>
Valuation Date	June 30, 2021		June 30, 2022	
State Miscellaneous <sup>1</sup>	\$4,453	30.71%	\$4,750	30.87%
State Industrial	157	19.51%	165	19.54%
State Safety	537	21.13%	537	21.54%
State Peace Officers & Firefighters	1,851	47.21%	1,952	46.26%
California Highway Patrol	599	63.89%	654	67.69%
<b>Total State</b>	<b>\$7,597</b>		<b>\$8,058</b>	

<sup>1</sup> Includes both Tier 1 and Tier 2 benefit levels.

<sup>2</sup> Excludes additional contributions above the actuarially determined contribution rates. See page 7 of the agenda item for more information.

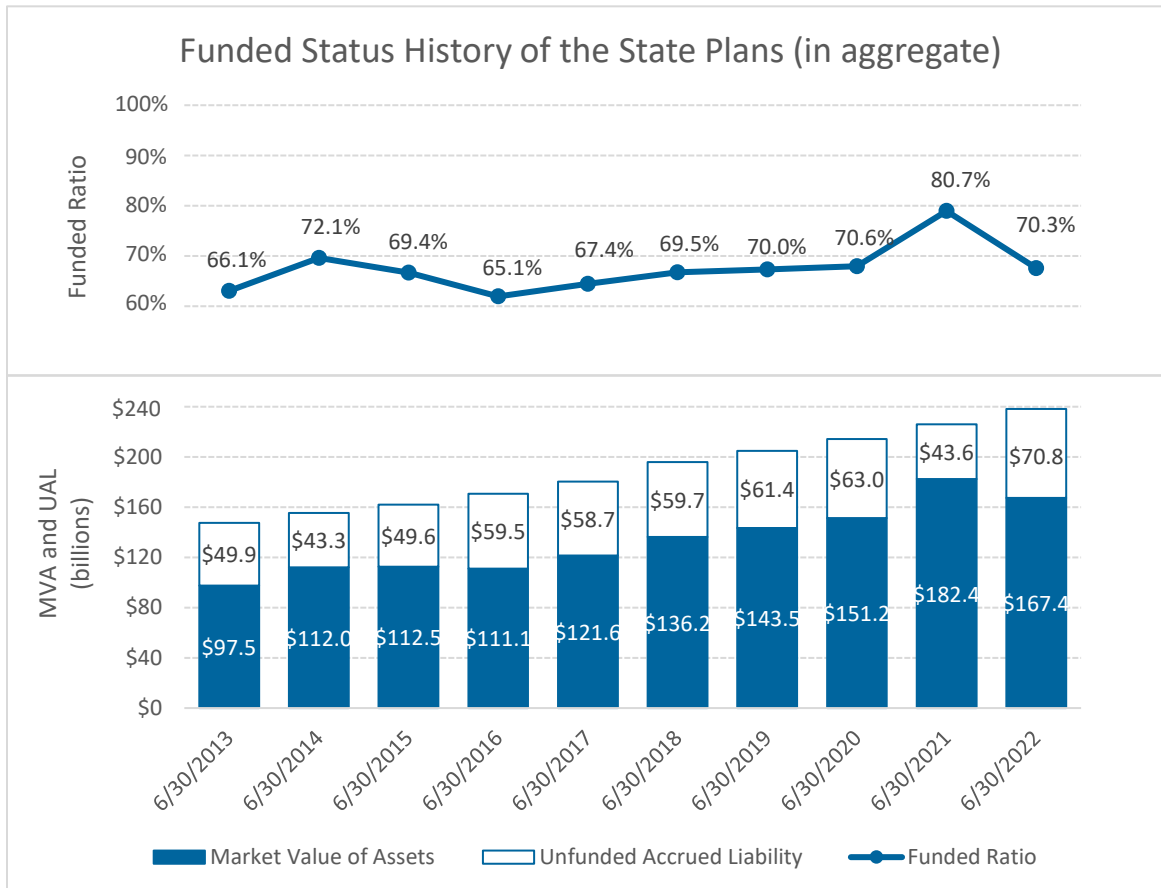
Please note that the payroll used to calculate the expected dollar contribution is the payroll used in the valuation, increased for two years of payroll growth at the prevailing payroll growth assumption (2.80% for FY 2022-23 and FY 2023-24). To the extent that actual payroll in the contribution year differs than expected, actual contribution amounts will be different than those provided above.

Please refer to Attachment 1 for the development of the employer rate for each state plan.

## Funded Ratio

The funded ratio of a pension plan is defined as the ratio of market value of assets to actuarial accrued liability. Plans with a lower funded ratio are, all else equal, more costly and at higher risk of not being able to meet future benefit obligations. From June 30, 2021 to June 30, 2022 the funded ratio of the State plans, in aggregate, decreased by 10.4% to 70.3% (80.7% as of June 30, 2021). The decrease in funded ratio was primarily driven by significantly lower than expected investment returns in FY 2021-22.

The chart below shows the funded ratio of the State plans in the aggregate for the past ten years.



Please refer to Attachment 2 for the funded ratio history of each plan as of June 30, 2022.

## Reasons for Changes in Employer Contributions for the State Plans

Overall, the actuarially determined contributions for the State plans increased by \$460.4 million from \$7,597.2 million in FY 2022-23 to \$8,057.6 million in FY 2023-24. This change is primarily driven by the factors listed below.

Reason for Change	Change in Required Contribution (in millions)
Required employer contribution in FY 2022-23	\$7,597.2
Change due to progression of existing amortization bases	(47.6)
Effect due to change in overall payroll	156.0
Decrease in Normal Cost due to new demographics	(60.7)
Decrease due to change member contributions rates	(49.0)
Decrease due to Supplemental Pension Payment	(481.3)
Changes due to experience:	
• Investment experience (reflects five-year ramp)	602.0
• Demographic experience	<u>341.0</u>
Total change in required contributions	460.4
Required employer contribution in FY 2023-24	\$8,057.6

During FY 2021-22, payroll across the State plans increased by 5.3%, compared to the payroll growth assumption of 2.80%, resulting in an expected increase of \$156.0 million in the required contribution for FY2023-24. The change in payroll for the year ranges from a decrease of 1.8% in State Safety to an increase of 7.6% in State Peace Officers and Firefighters.

The California Public Employees' Pension Reform Act of 2013 (PEPRA) requires lower benefits for new members as defined by PEPRA who are hired on or after January 1, 2013. The normal cost for all five of the state plans has decreased due to the enrollment of new hires into lower benefit levels. PEPRA membership ranges from a high of 53% of active members (48% of payroll) for State Safety to a low of 29% of active members (25% of payroll) for California Highway Patrol.

The return on plan assets for the year ending June 30, 2022 was approximately -7.5% before reduction for administrative expenses.

The employer contribution rates set forth by this valuation reflect statutory changes to member contribution rates effective July 1, 2023, to the extent they are known at this time. Please refer to "Member Contribution Rates" below for more information.

## Required State Contributions in Excess of the Actuarially Determined Contributions

Every year since FY 2013-14, the State employer contribution rates in the annual Budget Act have exceeded the actuarially determined contribution rates adopted by the board. Although the additional amounts arose at different times and through different processes, there is a common goal, which is to reduce the State's unfunded liability and create long-term savings.

**Additional Contributions under Government Code Section 20683.2**

Effective July 1, 2013 and July 1, 2014, the contribution rates of many State members were increased. The collective bargaining agreements and Section 20683.2 require that savings realized by the State due to these member rate increases be allocated to any unfunded liability. In order to facilitate this, the Actuarial Office calculates an additional rate to be added to the actuarially determined rate, which is then incorporated into the Budget Act. As in prior years, the additional employer contribution rates for FY 2023-24 remain unchanged as shown in the table below.

<b>Rate Plan</b>	<b>Additional Employer Contribution Rates Pursuant to Section 20683.2</b>
State Miscellaneous	0.10%
State Industrial	0.88%
State Safety	1.18%
State Peace Officers & Firefighters	1.65%
California Highway Patrol	1.32%

**Supplemental Pension Payments Pursuant to Proposition 2**

In 2014, California voters passed Proposition 2, which amended the State Constitution to require certain funds be appropriated to repay specific State debts, including unfunded liabilities for state-level pension plans. The July 29, 2022 Supplemental Pension Payments (SPP) shown below were the second payments made to these rate plans under Proposition 2.

<b>Plan</b>	<b>Supplemental Pension Payments Made on July 29, 2022 Pursuant to Proposition 2 (thousands)</b>
State Miscellaneous	\$1,333,958
State Industrial	81,612
State Safety	171,392
State Peace Officers & Firefighters	1,338,038
<b>Total</b>	<b>\$2,925,000</b>

The Constitution does not allow these payments to supplant funding that would have otherwise been used to pay for the unfunded liability in the fiscal year the payment was appropriated or the subsequent fiscal year. The supplemental payments, however, do reduce the actuarially required contribution rates in FY 2023-24 and later. The objective of the supplemental payments is to generate long-term savings rather than short-term savings, and to pay off the unfunded liability sooner than if the payments had not been made, which can be accomplished by budgeting and appropriating a contribution rate that is higher than the actuarially determined rates. The additional contribution rates shown here were selected by the State Department of Finance, with assistance from the Actuarial Office, and are intended to achieve long-term savings, shorten the time until the plans achieve a 100% funded ratio, and achieve a more stable and predictable contribution rate. This adjustment, referred to as the Contribution Stabilization adjustment, affords

the State some budget flexibility and allows the contribution rates in the Budget Act to closely align with the State's own budget projections.

The additional employer contribution rates for FY 2023-24 for Contribution Stabilization are shown in the table below and partially offset the immediate impact of the July 2022 SPP.

<b>Rate Plan</b>	<b>Additional Employer Contribution Rates for Contribution Stabilization</b>
State Miscellaneous	1.03%
State Industrial	0.58%
State Safety	0.03%
State Peace Officers & Firefighters	2.09%

**Supplemental Pension Payments Pursuant to Bargaining Unit 5 Agreement**

Under the 2019 agreement between the State and the California Association of Highway Patrolmen, the following SPPs have been made.

<b>California Highway Patrol Plan</b>	<b>Supplemental Pension Payments</b>
August 18, 2020	\$25,000,000
August 31, 2020	243,000,000
August 16, 2021	25,000,000
April 28, 2022	25,000,000
<b>Total</b>	<b>\$318,000,000</b>

Under the terms of the agreement, the supplemental payments may not decrease employer contributions during the term of the agreement, which expires on July 1, 2024. Since the payments reduced the unfunded liability, they also reduced the actuarially determined contribution rate. To comply with the agreement, the State must contribute the same amount for which supplemental payments decreased the actuarially determined contribution rate, 2.77% of payroll.

## Budgeted State Employer Contribution Rates for 2023-24

The table below shows the actuarially determined contribution rates along with adjustments needed to determine the budgeted contribution rates, which should be appropriated in the annual Budget Act.:

<b>Rate Plan</b>	<b>Actuarially Determined Employer Contribution Rates for 2023-24</b>	<b>Additional Employer Contribution Rates</b>	<b>Budget Act Contribution Rates for 2023-24</b>
State Miscellaneous	30.87%	1.13%	32.00%
State Industrial	19.54%	1.46%	21.00%
State Safety	21.54%	1.21%	22.75%
State Peace Officers & Firefighters	46.26%	3.74%	50.00%
California Highway Patrol	67.69%	4.09%	71.78%

The Additional Employer Contribution Rates shown above are the sum of Section 20683.2 adjustments, Contribution Stabilization adjustments, and Bargaining Unit 5 adjustments.

### Member Contribution Rates

PEPRA members employed by the Legislature, California State University (CSU), and the judicial branch are required to contribute at least 50% of the total normal cost of the defined benefit, in accordance with Government Code Section 7522.30. All such members in the State rate plans are in the State Miscellaneous, State Safety or State Peace Officers and Firefighters rate plans. Under this statute, when the total normal cost for the rate plan changes by more than 1% of payroll the member contribution rate must be adjusted and set equal to 50% of the total normal cost rounded to the nearest one quarter of one percent.

For fiscal year 2023-24, the total normal cost rates for PEPRA members in State Miscellaneous, State Safety or State Peace Officers and Firefighters plans changed by less than 1% of payroll from the base total normal cost rates. As a result, the member contribution rates for these PEPRA members will not change in fiscal year 2023-24.

Please refer to Attachment 3 for a summary of total normal cost by plan by benefit formula and Attachment 5 for details of the member contribution rates for certain PEPRA members. Attachment 4 contains the member contributions rates for all State members by Bargaining Unit.

Members represented by State Bargaining Units 2, 5, 16 and 18 are required to contribute 50% of the total annual normal cost of their pension benefit. While the overall concept is analogous to normal cost sharing above, the specific rules governing the change in member rates differ by Bargaining Unit. These cost sharing agreements do not result in any changes in member contribution rates for FY 2023-24. Please refer to Attachment 6 for more information.



## Projected Contribution Rates

The following table illustrates projected actuarially determined employer contribution rates for the next five fiscal years. Projected rates assume all actuarial assumptions will be realized, including the investment return of 6.80%, and no changes to assumptions, methods, or benefits will occur during the projection period. Projected rates further reflect member rate changes known to date and the estimated decrease in normal cost due to new hires entering lower cost benefit formulas.

Rates do not include the additional contributions pursuant to G.C. section 20683.2 or the State's Proposition 2 contribution stabilization strategy shown on page 7 of this agenda item. The Bargaining Unit 5 agreement to delay savings expires June 30, 2024 and is reflected in the rates for California Highway Patrol beginning in FY 2024-25.

Plan	Actuarially Determined Employer Contribution Rates (% of payroll)					
	Actual	Projected				
	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
State Miscellaneous	30.87%	31.7%	32.5%	32.9%	34.7%	34.5%
State Industrial	19.54%	20.2%	20.9%	21.2%	22.8%	22.5%
State Safety	21.54%	22.2%	22.8%	23.1%	24.7%	24.4%
Peace Officers & Firefighters	46.26%	47.5%	48.6%	49.1%	51.9%	51.3%
California Highway Patrol	67.69%	68.1%	69.5%	67.7%	70.6%	69.8%

Actual investment return for FY 2022-23 was not known at the time this agenda item was prepared. Projections above assume the investment return for fiscal year beginning FY 2022-23 would be 6.80%. ***If the actual investment returns for FY 2022-23 differ from 6.80%, actual contribution requirements for the projected years will differ from the rates shown above.***

An updated projection will be included in the actuarial valuation report that will incorporate the impact of the actual investment return in FY 2022-23. This report will be available later this year.

## 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, and volatility ratios.

**Attachments**

Attachment 1 – Employer Contribution Rates

Attachment 2 – Accrued and Unfunded Liabilities and Funded Ratio

Attachment 3 – Normal Cost Chart

Attachment 4 – State Member Contribution Rates by Bargaining Unit

Attachment 5 – PEPRAs Member Contribution Rates

Attachment 6 – Member Contribution Rates for State Bargaining Unit 2, 5, 16 and 18

Attachment 7 – PowerPoint Presentation

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