MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

FINANCE & ADMINISTRATION COMMITTEE

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

FECKNER AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

TUESDAY, NOVEMBER 14, 2023

1:45 P.M.

JAMES F. PETERS, CSR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

APPEARANCES

COMMITTEE MEMBERS:

Lisa Middleton, Chairperson

David Miller, Vice Chairperson

Fiona Ma, represented by Frank Ruffino

Jose Luis Pacheco

Ramón Rubalcava

Theresa Taylor

Yvonne Walker

BOARD MEMBERS:

Eraina Ortega

Kevin Palkki

Mullissa Willette

STAFF:

Marcie Frost, Chief Executive Officer

Doug Hoffner, Chief Operating Officer

Matthew Jacobs, General Counsel

Michele Nix, Acting Chief Financial Officer

Scott Terando, Chief Actuary

Randall Dziubek, Deputy Chief Actuary

Will Schaafsma, Chief, Financial Planning, Policy, and Budgeting Division

Emily Zhong, Supervising Health Actuary

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PROCEEDINGS

CHAIRPERSON MIDDLETON: Good afternoon. I'd like to call to order the November 14 Finance and Administration Committee.

First order of business is roll call.

BOARD CLERK TRAN: Lisa Middleton?

CHAIRPERSON MIDDLETON: Present.

BOARD CLERK TRAN: David Miller?

VICE CHAIRPERSON MILLER: Here.

BOARD CLERK TRAN: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Present.

BOARD CLERK ORTEGA: Jose Luis Pacheco?

BOARD CLERK TRAN: Present.

COMMITTEE MEMBER PACHECO: Present.

BOARD CLERK TRAN: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Present.

BOARD CLERK TRAN: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

BOARD CLERK TRAN: Yvonne Walker?

COMMITTEE MEMBER WALKER: Here.

CHAIRPERSON MIDDLETON: All right. Thank you.

Next order of business is the Executive Report.

Michele Nix.

ACTING CHIEF FINANCIAL OFFICER NIX: Good afternoon, Madam Chair and Committee members. Michele

Nix, CalPERS team member.

It was nice seeing many of you at the CalPERS Educational Forum last month. I'm happy to report that during the event our Pensions, Contracts, and Prefunding programs met with over 40 employers for contract consultations.

The agenda before you today has two action items for your consideration. We are seeking approval for the 2023-24 Mid-Year Budget Revisions and the 22-23 Basic Financial Statements.

In addition, we will have two information items. The Actuarial Office will present the Annual Review of Funding Levels and Risk Report, and the Semi-Annual Health Plan Financial Report.

The next Finance and Administration Committee Meeting is scheduled for February 2024 here in Sacramento. The agenda will include valuation reports for the Legislators' Retirement System and Judges' Retirement System I and 2.

Thank you, Madam Chair. This concludes my report. And I'll be pleased to take questions at this time.

CHAIRPERSON MIDDLETON: Thank you.

Are there any questions for Ms. Nix?

I've not received any requests to remove any of the action consent items. Could I get a motion to --

COMMITTEE MEMBER PACHECO: I'll motion.

CHAIRPERSON MIDDLETON: Motion to approve.

Second?

COMMITTEE MEMBER TAYLOR: Second.

CHAIRPERSON MIDDLETON: Second.

All in favor please say aye?

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

Items 3a through e are approved.

We have Information Consent Items. Is there requests from anyone on the Board to remove any of the information consent items?

Seeing none, information consent items are received and filed.

We will move on to Agenda Item 5a, the Mid-Year Budget Revisions. And with that, Ms. Nix and Mr. Schaafsma.

ACTING CHIEF FINANCIAL OFFICER NIX: Yes, I'd like to introduce Will Schaafsma. He's our budget chief that we hired in the last what, six months? Yeah.

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: Good afternoon, Madam Chair, members of the Committee. Will Schaafsma, CalPERS team member.

(Thereupon a slide presentation).

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: Today I'll be walking you through the 2023 proposed mid-year budget agenda item. This is an action item which will need your approval.

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FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: The total proposed increase to this year's budget is 15.7 million or 0.6 percent. This increase is primarily driven by employee compensation updates, bringing on additional Investment Office positions, and increased external management fees. These increases are partially offset by a decrease to third-party administrator fees.

Next slide, please.

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FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: A substantial portion of the overall mid-year budget increase is due to changes in operating costs. This budget line includes administrative operating costs, investment operating costs, and headquarters building account costs. The total increase for the operating cost budget is 31.4 million or 4.1

percent.

Next slide, please.

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FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: The main driver for the increase in the operating cost budget is administrative operating costs. Changes to salaries and benefits will increase this budget by 30.1 million or 6.6 percent.

Personal services changes are the result of collectively bargained salary increases, Board-approved salary and incentive compensation adjustments for Investment Office and executive positions, and Investment Office reorganization.

Operating expenses and equipment will increase by 1.1 million or 0.8 percent. This increase is attributable to additional executive search services for Investment Office positions, third-party administrator and pharmacy benefit managers, solicitation services, additional information security software, and consultant support for new compliance and risk programs. This increase was fully offset by salary savings from vacant positions and a funding schedule change for human capital management system migration.

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FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: The highlight of line on this slide includes investment external management fees and third-party administrative fees. As you can see, the total fee budget has an overall decrease of 15.7 million or 0.9 percent.

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FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: We estimate a 28.9 million or 2.2 percent increase in external management fees due to changes in base fees for global and private equity. These fee increases are a result of additional externally managed assets and commitments related to new partnerships -- new partnership agreements. Partially offsetting these estimated increases are reductions in the base fees for all other asset classes due to renegotiated fees and fewer than anticipated new partnerships. Performance fees for real assets reflects a minor increase due to better-than-expected performance in infrastructure.

For third-party administrator fees we estimate a decrease of 44.6 million or 13.5 percent. This adjustment is driven in large part by a change to the Blue Shield contractual agreement which no longer requires a third-party administrator fee. Our pharmacy benefit manager projection has been reduced by 1.3 million, reflecting an updated estimate of total claims.

This concludes my presentation on the proposed mid-year budget. I'll open it here for any questions.

CHAIRPERSON MIDDLETON: All right. Are there any questions for staff?

Seeing no questions.

Is there a motion to approve?

COMMITTEE MEMBER PACHECO: Move approval.

CHAIRPERSON MIDDLETON: Motion to approve.

COMMITTEE MEMBER TAYLOR: Second.

CHAIRPERSON MIDDLETON: Second by Ms. Taylor.

All those in favor please say aye.

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

Item 5a is approved.

We'll move on to Item 5b, which is Financial Statements.

Ms. Nix.

ACTING CHIEF FINANCIAL OFFICER NIX: If you'll please bring up the presentation for the basic financial statements.

(Thereupon a slide presentation).

ACTING CHIEF FINANCIAL OFFICER NIX: Okay.

Michele Nix, CalPERS team member.

I would like to present a few highlights from the basic financial statements for the fiscal year June 30th, 2023. The statements will be incorporated in the annual comprehensive financial report upon your approval.

Slide 2, please.

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ACTING CHIEF FINANCIAL OFFICER NIX: We ended the fiscal year with PERF total net assets at 464.6 billion. Annual money-weighted rate of return was 6.1 percent, resulting from strong performance results across all globally diversified asset classes. Drivers of the PERF investment return include gains in public equity and debt holdings, which were partially offset by losses in private market holdings.

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ACTING CHIEF FINANCIAL OFFICER NIX: The investment return is comparable between time weighted and money weighted. The time-weighted rate of return was 5.8 percent; and you'll recall that we announced this as a preliminary percentage in July. And the money-weighted rate of return was 6.1 percent as of June 30th, 2023. The 5.8 percent represents investment performance shown in accordance with investment industry standards. The measure represents investment returns that are available in June, which means the real assets and private equity includes returns from April 1st from last year through March 31st of this year, or commonly referred to as quarter lag reporting.

The 6.1 percent represents investment returns shown in accordance with GASB financial reporting standards. This measure represents investment returns that are available through September, which means that the market movement for the real assets and private assets does not include lagged -- means the market for real assets and private assets does not include lagged reporting and considers the last quarter of a fiscal year before the financial statements are finalized.

Slide 4, please.

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ACTING CHIEF FINANCIAL OFFICER NIX: This slide compares the differences between the time-weighted rate of return and the money-weighted rate of return. I'd like to include this because just as a reminder of the differences. So the time-weighted rate of return is basically weighted towards time and it measures the compounded growth rate over the period being measured while it eliminates the distorting effects of inflows and outflows of cash.

The time-weighted rate of return reporting is the standard for investment performance reporting. The money-weighted rate of return is the ACFR or the accounting rate of return and it expresses investment performance, net of investment expenses and administrative expenses adjusted for changing amounts that are invested as more cash comes in -- as the cash comes in they try to capture how long we've held the cash. So it doesn't assume that you have the cash for the entire time.

Money-weighted rate of return reporting is a GASB requirement.

Slide 5, please.

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ACTING CHIEF FINANCIAL OFFICER NIX: The PERF net position increased 25.2 billion or 5.7 percent from 439.4 billion as of June 30th, 2022, to 464.6 billion as of June 30th, 2023.

Over the 10-year period, June 30th, 2014, through June 30th, 2023, our net position increased 162.9 billion dollars or 54 percent.

Next slide, please.

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ACTING CHIEF FINANCIAL OFFICER NIX: Additions to the PERF net position include contributions from employers and members. Investment income is comprised of investment income, dividend income and net appreciation or depreciation of fair value of assets -- fair value of investment, which are assets. Gross investment gains including net securities income were 28.5 billion in fiscal year 22-23, compared to a loss of 34.8 billion in fiscal year 21-22. This was due to investment gains primarily in public market asset classes in the current fiscal year.

Employer contributions increased 1.5 billion dollars or 6.7 percent due to increases in employer contribution rates. Member contributions increased 512.8 million dollars or 9.9 percent. Deductions from the PERF are comprised of benefit payments, refunds of contributions to members and beneficiaries, and costs of administering the PERF. Benefit payments are the primary expense of our retirement system.

For fiscal year 22-23, retirement, death, and survivor benefit payments increased 2.0 billion dollars or 6.8 percent, primarily due to the cost of living increases in benefit payments and to an increase in the number of retirees and beneficiaries of 1.8 percent. These increased from 775,000 to 789,000 as of June 30th, 2023.

Next slide, please.

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ACTING CHIEF FINANCIAL OFFICER NIX: As I just mentioned in slide 6, investment income is made up of net appreciation or depreciation of investments, interest income and dividend income. As this chart shows, gains were in the public market holdings and losses were in the real estate -- real asset holdings.

Next slide, please.

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ACTING CHIEF FINANCIAL OFFICER NIX: This chart shows the unfunded liability and funded ratio through June 30th, 2022, since the valuations are always lagged in reporting. The unfunded actuarial liability, which is the excess of total actuarial accrued liability over the market value of assets was 179.9 billion at June 30th, '22. The increase in unfunded actuarial liability over the 10-year period is primarily due to changes in the actuarial assumptions such as discount rate, immortality assumptions. Additionally the unfunded actuarial liabil -- liability amortization payments were less than the interests on the UAL in many cases.

Next slide.

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ACTING CHIEF FINANCIAL OFFICER NIX: In fiscal year 22-23, 29.9 billion dollars was received in contributions while 31.1 billion dollars was paid in benefits. Contributions increased 7.3 percent from 2021 to 2022, primarily due to increases in employer contribution rates.

Next slide, please.

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ACTING CHIEF FINANCIAL OFFICER NIX: That ends the presentation. Although I would like to acknowledge that these financial statements as well as the annual comprehensive financial report are collaborative effort across the Finance Office and many others within CalPERS.

So that ends my presentation, and I'd be happy to take questions if you have them.

CHAIRPERSON MIDDLETON: All right. Are there questions?

Yes. We will start with Trustee Pacheco.

COMMITTEE MEMBER PACHECO: Yes, thank you. Thank you very much.

Thank you, Michele, for your comments here. I always definitely appreciate always the backwards look of where we are.

You mentioned regarding the pension payment -- payouts, our principle expense, I -- you said it was 31.4 billion. And it increased to -- from 29 -- from 29.1, I think, from last year.

ACTING CHIEF FINANCIAL OFFICER NIX: That sounds right, yeah.

29.9 billion was received in contributions while 31.1 billion was paid in benefits.

COMMITTEE MEMBER PACHECO: 31.4, right?

COMMITTEE MEMBER TAYLOR: 1.

COMMITTEE MEMBER PACHECO: Sorry. 0.1.

So of that, you mentioned it was -- what was it primarily due to again? I was -- I did not recall that.

ACTING CHIEF FINANCIAL OFFICER NIX: It was due to basically higher contributions from employers. And that's why the contributions increased. And the employer contribution rates we had a higher number of retirees.

COMMITTEE MEMBER PACHECO: You had a higher number of retirees. And that's -- okay. That's all I needed to verify.

Thank you very much.

ACTING CHIEF FINANCIAL OFFICER NIX: Okay. Thank you.

CHAIRPERSON MIDDLETON: All right. We have Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you, Chair.

I Just want to follow up a little bit on Trustee Pacheco's question.

So the fact that benefit payments are greater than contributions, many times it means it's for a mature plan, meaning there's more retirees than active. Is that -- I'm assuming that's the case in CalPERS. Correct?

ACTING CHIEF FINANCIAL OFFICER NIX: Yes.

COMMITTEE MEMBER RUBALCAVA: Thank you.

And so that's why we're so conscious -- so focused on the rate of -- on investment return.

The more I hear myself I realize I didn't have to ask that question.

So we haven't -- sorry. Thank you.

ACTING CHIEF FINANCIAL OFFICER NIX: No, you're fine. Thank you.

CHAIRPERSON MIDDLETON: Great.

Mr. Ruffino.

ACTING COMMITTEE MEMBER RUFFINO: Thank you, Madam Chair.

Two general questions. First of all, thank you, Ms. Nix, for your presentation.

The first question's got to do with GASB requirements. So are there any significant new GASB rules in the financial reporting that will affect next year's financial statements?

ACTING CHIEF FINANCIAL OFFICER NIX: Well, we'll have -- we have the leases that went into effect. But there was no material effect for us. So that really -- as Billy said earlier in the RAC, it didn't affect our financial statements.

I'm trying to the think if there's anything significant. There's probably not anything significant. We are working on the subscription base IT arrangements. But I don't think it -- our assets are so high, that it's hard to reach materiality with any of those statements really. So I would say no.

ACTING COMMITTEE MEMBER RUFFINO: Okay. And the second one is -- deals with the proposed ESG rules.

ACTING CHIEF FINANCIAL OFFICER NIX: Uh-huh.

ACTING COMMITTEE MEMBER RUFFINO: So, do you know -- they're proposed at this point -- but will the reporting requirements will affect CalPERS financial statements going forward?

ACTING CHIEF FINANCIAL OFFICER NIX: It's really unknown at this time. I believe that the GASB is aware of the ESG -- that's played out of course across the media. And they are -- it's on their technical agenda to look at it and to consider it. But no pronouncements have come out or any kind of rules that I'm aware of that we can respond to at this point. So I think they're looking at it, but I don't have any idea what's going to come out of that. You know, the process for GASB is quite a long deliberative process, and so they'll put exposure drafts out and allow everyone to respond to those. And so it -- as we go along we may know more when they put out that first draft to be able to -- I'll be able to tell you then, but for now I haven't seen anything.

ACTING COMMITTEE MEMBER RUFFINO: Okay. And finally, any issues with recruiting? What's your staffing level at this point?

ACTING CHIEF FINANCIAL OFFICER NIX: We're probably at about a 21 percent vacancy rate. I don't think that's that unusual. We have a lot of entry level positions in our area. So for that it's -- it turns over because they promote honestly.

I will say that the level of accountants that are available are less than there were tow years ago. So it does provide challenges in that respect.

ACTING COMMITTEE MEMBER RUFFINO: Okay. Great. Thank you so much.

Thank you, Madam Chair.

CHAIRPERSON MIDDLETON: Thank you.

President Taylor.

COMMITTEE MEMBER TAYLOR: Hi, Michele. Thanks very much for the -- both reports.

I was going to piggyback on what Mr. Rubalcava and Pacheco were talking about.

So the upswings in 2018 -- on - hold on - page 9 of 10, 2018 and 2020 where we actually did have more contributions than we had benefit payments, can you highlight what that was in regards to, how we pulled that one off?

ACTING CHIEF FINANCIAL OFFICER NIX: Okay. May be that -- that may be an actuarial question. And they're going to be ask -- so can we wait for that question --

COMMITTEE MEMBER TAYLOR: Sure.

ACTING CHIEF FINANCIAL OFFICER NIX: -- until the actuarial presentation?

COMMITTEE MEMBER TAYLOR: Sure. Not a problem.

Thank you very much.

CHAIRPERSON MIDDLETON: All right. Are there any other questions?

Ms. Nix, thank you. Very strong report. And we really appreciate all of the effort that goes into what you have given us today. So thank you.

ACTING CHIEF FINANCIAL OFFICER NIX: Thank you.

CHAIRPERSON MIDDLETON: With that, we will move on from -- that you already -- let's see. We need a motion to approve.

COMMITTEE MEMBER PACHECO: I'll motion it.

CHAIRPERSON MIDDLETON: And a second.

COMMITTEE MEMBER RUBALCAVA: Second.

CHAIRPERSON MIDDLETON: All those in favor please say aye.

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

5a -- or 5b is approved.

With this we will move on to information agenda items. And for that Mr. Terando and Randall, please.

(Thereupon a slide presentation).

CHIEF ACTUARY TERANDO: Good afternoon, Madam Chair, members of the Committee. Scott Terando with the Actuarial Office.

This is our annual review of the funding levels from risk report. It's an opportunity for the Actuarial Office to provide information for the system overall. We look at various funding levels, expected contributions over the next several years, and provide, you know, some of the risks faced by the system. You know, and it's -- we also look at, you know, some other information for the system overall. We look at PEPRA, what's happening with PEPRA membership and PEPRA contributions.

And as it's just discussed recently, some questions came up on, you know, benefits versus income on the cash flow side.

So I think we'll just jump into the review right now. And I'll pass it to Randy to go aver those details.

DEPUTY CHIEF ACTUARY DZIUBEK: It would help if I turned the right mic on.

Good afternoon, everyone. Madam Chair, Committee members. My name is Randy Dziubek. I'm in the CalPERS Actuarial Office. Very excited today to present this material to you. I hope you find it as interesting and engaging as the Actuarial Office does. Maybe not, but I guess there's hope.

I feel like the last two presentations were very efficient and moved nicely, which I'm going to take as I have a little bit more time to go through these slides. I hope you'll bear with me. I think there's a lot of interesting information here.

Before I jump into the slides I want to have some opening comments real quick. As you probably know, the Actuarial Office produces over 4,000 individual actuarial valuations every year. Each of these is for a specific plan within the CalPERS system. Each plan has its own funded status, has its own contribution requirements. And so in a lot of respects these plans are fairly independent and could just as easily be operated outside of CalPERS.

However, there are some areas where there is commonality between the plans, and that would be most notably they're all subject to the same investment policy that you select. They're all subject to the same investment performance; if the fund earns 8 percent in a particular year, every plan earns 8 percent.

They're also all subject to the same funding methods and policies and actuarial assumptions also that the Board selects. Now, for the funding levels in risk report, we take all 4,000 of those valuations and combine them together and provide results to you in total. Or average results, which are very interesting. They tell a story about the operation of a system that I think is interesting and helpful. And because of this commonality that I talked about, the results that are, you know, reflective of the whole system also pertain to each individual plan generally as well.

So with that, I'm going to move into the slides. Let's see if the clicker works.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. The key items we're going to about today are the current status of the system, both in terms of funded status, employer contributions. Then we're going to get into a 10-year lookback and 10-year lookforward of system results. And we're also going to talk about some impacts of PEPRA. This is a new item we've added to our report this year. We tend to get a lot of questions about the impact of PEPRA, and so we thought we would make it just part of our annual report.

Then we're going to talk about risk that the system faces and finally some of the factors that are used to mitigate or control some of these risks.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. Let's jump in and talk about the funded status. Funded status tends to be the factor that most folks identify with. If you know nothing else about the CalPERS system, you might know what the funded status is. Generally the funded status is considered by a lot of practitioners as the most important measure of the health of a system. Although the actuaries like to stress that it is only one measure. There are lots of other factors that go into determining how the system's working and how healthy it is.

If you look at the bars to the far right, you'll see the funded status for the system as a whole over the last three years. You'll see we had a fairly substantial decrease in the funded status from July 30, 2021, to July 30 -- sorry -- June 30, 2021, to June 30, 2022; and that was due to the minus 7-and-a-half percent investment return that we received for that year.

And then from that year to a year out, June 30, 2023, we see a slight improvement in the funded status from just under 71 percent to 72 percent. So one thing that tells us is that even though our return for that year was less than the assumed return of 6.8 - it was 6.1 as

Michele indicated in her presentation - we don't need to hit the 6.8 to see improvement in the funded status, although it helps clearly. We'd rather get the 6.8. But we can't still see improvement in the funded status without reaching our 6.8 assumption.

If you look at the bars towards the left, you'll just see the same results over that same three-year period for different areas of the system. You can see State results versus public agency results, miscellaneous versus safety results.

Next slide.

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DEPUTY CHIEF ACTUARY DZIUBEK: I'm not sure my clicker's working. So I'm just going to say next slide I think going forward.

Okay. So let's take a look at contribution rates. And these are employer contribution rates. The rates to far left of the chart show the current percent of pay contributions that our employers are making for the year that we're in. So the year starting July 1st, 2023, through June 30th, 2024.

Safety groups are towards the top of the chart. They have higher rates in general. They're in the purple colors.

The non-safety plans are towards the bottom.

They tend to have lower contribution rates. And that's basically due to the cost of the benefits that are provided for safety members versus non-safety members.

What you see as you go across the page is slight but steady increases in contribution rates are projected, primarily due to the last couple years of investment losses that the system received. These are relatively high contribution rates. As you probably know, the contribution that we require is made up of two pieces: The normal cost contribution piece, which is basically the annual amount that's required to prefund benefits for each of these plans; and then there's a second piece that goes towards funding and the unfunded liability that these plans have.

So the lower the funded status of a plan, generally the higher that required payment will be to close that gap and get that plan back to a hundred percent. In many cases, our plan's contributions more than half of it is due to those UAL payments. So if we could get the plans up to a hundred percent funded, which is the goal, these contribution rates will come way down.

Next slide.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. So let's take a look at the last 10 years, and also a projection of the next 10 years. And what we're showing here is a projection of the assets - not a projection - a history and a projection of the assets and the accrued liabilities; that the solid colored bars are the previous 10 years, the striped bars are the projected years going forward.

And a couple things that probably jump out. The gray bars, which are the asset values, tend to go up and down, and they're very much driven by the annual investment return in those particular years. And those results tend to drive the funded status of the system, which is the solid black line going across the chart. You can see there's a lot of ups and downs in that funded status result over the last 10 years.

The accrued liability bars tend to have more of a consistent upward pattern to them. They're not as volatile as the asset values. They are expected to increase. Although over this last 10 years, they increased significantly more than we would have predicted them to increase at the beginning of this 10-year period. And that was primarily due to changes in actuarial assumptions that were required during that 10-year period; most notably decreases in the discount rate, as well as changes in our mortality assumptions.

Now, as you look in the next 10-year period, now this is based on us receiving a 6.8 percent annual return, which is not likely. We're going to show you results under different scenarios. But should we get our 6.8 percent assumed return, and all other experience matches our assumptions, the one thing you'll notice I think is -- right away is that the projected improvement in the funded status is much greater than the change in the funded status over the previous 10 years.

You can see the previous 10 years, we had about a 2 percent improvement in the overall funded status, even though employers continued to make contributions. I already mentioned the changes in assumptions. That was one of the factors. A second factor in that lack of improvement in funded status was overall we had investment losses in that 10-year period. Even though the average return was 7.1 percent, the timing of the gains and losses during that period had a pretty significant impact on whether we saw overall gains or losses. We had a big loss just a couple years ago where our asset value was relatively high at that point. So that created a fairly sizable investment loss.

And, lastly, at the beginning of this 10-year period our amortization policies didn't require quite as high of a payment towards unfunded liability as it does now. A few years ago, the Board adopted changes to the amortization policy that generally require faster paydown of any unfunded liabilities. So the contributions in those early years would be much higher now -- not much higher, but would be materially higher under the new amortization policies.

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DEPUTY CHIEF ACTUARY DZIUBEK: So this looks a little bit like some of the information that Michele was talking about in her presentation. It's just a simple 10-year history, 10-year projection of contributions coming into the system versus benefit payments going out. Benefit payments are in the gray bars. We're showing them as negative because it's money coming out of the system. The pattern with those is pretty obvious. They tend to just be continuously increasing at a pretty consistent pace. They're not impacted by changes in actuarial assumptions. They're not impacted by investment gains or losses. They are expected to increase this way and will continue to increase this way into the future beyond this 10-year period.

Now, with regard to contributions, first of all the contributions are broken down between contributions that are required by CalPERS as a minimum contribution by our employers. That's the lighter blue portions of the bars. And then at the top of some of the bars you see a darker blue box. And those are what we call additional discretionary payments. Those are contributions that employers chose to make above and beyond the required minimums. Some of these are from public agencies; a lot of these are also from the State of California.

And you can see contributions have increased pretty consistently during this 10-year period, for the same reasons that the funded status didn't improve as much as we would have liked, the three things that we mentioned previously. But again, if we assume that those three issues will not be present to the same degree in the next 10 years, contributions should level off. They will increase a little bit over the next few years because of those recent investment losses, but then they should start coming down; and even beyond this 10-year period would come down significantly faster than what we're showing here, provided that again all experience matches our actuarial assumptions.

Now, the black line through the middle is just a difference between benefit payments and contributions expressed as a percentage of the assets. We sometimes call that negative cash flow if it's a negative number. It has been negative for a number of years. It was positive in a couple years, to Ms. Taylor's question. And you can see in those two years there were fairly significant additional discretionary payments, the dark blue portions of those bars. So really it was those payments that created the positive cash flow in those couple years.

We expect negative cash flow in a prefunded system like this. This is not a cause for concern. It's projected to grow more and more negative. Again, not a concern. It's a good thing for us to project and monitor and provide to our investment consultants, primarily for them to ensure that there's the appropriate amount of liquidity within our investments to be able to continue to pay benefit payouts.

But the fact that the benefit payments are larger than contributions is not a source of concern.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. Let's talk about PEPRA really quickly here. A couple slides here. The first slide is just showing us how our PEPRA population started and increased over the last 10 years and is projected to continue to increase over the next 10 years.

So the blue bars are PEPRA folks and the gray bars are our classic folks or non-PEPRA active members.

You can see when PEPRA was enacted in 2013, we started out with none essentially; and that number started to grow, and will continue to do so over the next 10 years. We're at about 60 percent now of our active members who are subject to PEPRA. We're projecting it looks like about 85 percent by the end of the next 10 years.

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DEPUTY CHIEF ACTUARY DZIUBEK: So the important aspect of PEPRA is of course the ability that it has to sort of bend the cost curve down a little bit to provide more affordable required contributions for our employers. Now because the rules applied only to people hired after the enactment of PEPRA, we had to wait for PEPRA members to join the system before we started seeing contribution decreases for our employers.

So each of these bars represents the estimated savings solely due to the enactment of PEPRA. And in the last 10 years we were able to save over 4 billion dollars, which is pretty good. But over the next 10, we're expecting to save five times that, or almost 25 billion dollars over the next 10 years. And in that final year there those savings will just continue beyond this 10-year period.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. I want to talk about some of the risks that the system faces. And most of these are investment related. There are other risks; they're talked about in the report to some extent. The big risk is not hitting our assumed 6.8 percent return.

This particular slide is showing you based on some stochastic modeling the likelihood that our plans might drop below 50 percent funded over the next 30 years. I think probably what we should focus on today is just the median results. And what we can see, we've got them broken down between safety plans and non-safety plans. So the median result here for miscellaneous plans was about a 23 percent chance that any one of these plans will fall below 50 percent funded over the next 30 years; and a little bit higher for the safety plans.

Now, the difficulty with a chart like this is that there's no particularly good result or desired result. It is what it is. And it's always a tradeoff between risk and reward typically to change these numbers.

So this will be probably more important for you when we get to the next ALM and you're choosing between alternate investment portfolios. Some portfolios will perhaps bring down this risk of falling below 50 percent, but will on the flip side likely cost the employers a little bit more.

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DEPUTY CHIEF ACTUARY DZIUBEK: Now, over the next 10 years, let's say, while we expect to earn 6.8 percent on our investments, the likelihood is that we'll earn something a little bit less or a little bit more. What we're modeling here is both a projection of funded status and employer contributions, using either a 5.8 or 7.8 percent return assumption as our brackets. And you can see -- first of all, as I said before, even with the 5 percent return we still do see improvements in the funded status each year on the left side of the chart, just not as fast as if we get the 6.8 or 7.8 would give us even faster improvement.

Contribution projections on the right show us that because of the way we smooth the impact of investment gains and losses, the impact on contribution starts out at a slower pace than the impact on the funded status. And that's just to, first of all, allow our employers to adjust to higher contributions, and also give some time for correction in the market; for example, if we have one year of really bad return, rather than charge the employers fully for the impact of that return, it gives a little bit of a period for there to be a correction in the market.

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DEPUTY CHIEF ACTUARY DZIUBEK: And if we move to the next slide, we see that even more significantly where -- now here we're modeling one-year worth of really good or really bad investment performance. Our range here, let's see, is 29.2 percent on the high end versus minus 15.6 percent on the low end.

And these are not likely returns for any particular year, but they're not impossible. In fact, in 2008 we saw something worse than this minus 15.6 percent.

So the theme of this chart is that we can see a pretty large swing in our funded status even in a single year. It does take longer for the contribution requirements to deviate based on that return because of the five-year smoothing. But if we don't get some correction within that five years, you can see that the range of contribution results even for that one year of either good or bad performance, we can end up five years later with substantially different employer contributions.

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DEPUTY CHIEF ACTUARY DZIUBEK: So in terms of factors that can mitigate risk that have been used, and we continue to use, we already mentioned additional contributions made by our employers. This is a chart that represents additional contributions by just our public agencies. So this does not include additional contributions made by the state. And you can see, there were a few years there where we received 3 billion or more of additional contributions, which was great. A lot of those were due to pension obligation bonds that were very popular during that time period due to low interest rates. We saw a big drop off in the last year. Of course pension obligation bonds are not nearly as attractive and I think to the extent employers had extra money over the last few years, they spent a lot of it in those preceding three years.

But we are constantly educating our employers of the benefits of making these additional payments.

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DEPUTY CHIEF ACTUARY DZIUBEK: So this is just a quick summary of some things we've already talked about that help to manage the risk of the system. The PEPRA changes. And I like to think of, you know, managing a large system like this. There's no silver bullet, no one thing that makes this easy or fine necessarily. It's more as if you need a quiver of multiple arrows that you use to attack this problem. And each one of these things listed here is an arrow that has had some benefit to the system; and, you know, if you shoot enough arrows, you start to look a lot better.

So PEPRA changes was one thing that reduced costs a little bit. The improvements in the amortization policy are requiring employers to close that funding gap a little bit faster. Lots of additional discretionary payments.

Also, in addition to those payments that are made directly to CalPERS, a lot of our employers are realizing that to put money aside in a Section 115 trust is also a good -- potentially for them based on their circumstances, a good strategy to creating a rainy day fund in the case of a year where the contribution requirement perhaps is outside of what they had budgeted for.

The CalPERS Actuarial Office as well as other folks around CalPERS try to get out and talk to our employers about these things. There are lots of forums where we speak. We do individual consults with employers; some of them are listed here. We also have some nice tools that I know you are all familiar with. The Pension Outlook Tool in particular.

We have a new item on our website. It's the last bullet here. And I'm not going to talk about it, but I would encourage you to -- there's a link to that site in the report, and it does show funded status results for all of the plans in the system, and you can choose which groups of plans you want to look at. And it will show you a dot for each one of those plans. It's nice to compare results of our individual plans.

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DEPUTY CHIEF ACTUARY DZIUBEK: And then finally on the last slide, just some things to continue to be aware of. I think -- you know, the item that we have some control over that potentially has the biggest impact on the system is this idea of balance between risk and reward. Of course we would like to get the highest returns possible. But generally to do that we have to take on a little bit more risk. And so the decision of where to draw that line, which is your decision, is a very difficult one. And there might be another portfolio introduced to you next March that was talked about yesterday. And beyond that, at the next ALM cycle you'll certainly have a grouping of portfolios to select from. And that's a very difficult decision.

We've got possible near-term economic turmoil. I know the Investment Office yesterday had kind of a rosy -- rosier picture of the future than maybe a few months ago when we put this slide together. I think there still are some warning signs that indicate that maybe the returns might not be 6.8 percent in the near term. It's just something for us to keep an eye on.

And then, finally, in terms of climate change. We added this mostly because we've seen the great work that our Investment Office is doing, modeling different scenarios related to climate risk. The actuaries are just starting to talk about various scenarios that might impact mortality or disability, things like that. But we're a little bit behind the Investment Office folks but -- and we'll just watch with you what they come up with as far as that kind of research.

So with that, we'll take any questions.

CHAIRPERSON MIDDLETON: All right. So we do have some questions. I want to start with Mr. Pacheco.

COMMITTEE MEMBER PACHECO: First of all, Randall, thank you for your presentation, I appreciate the thoroughness again on the PowerPoint.

My first question is regarding the -- more of a bigger picture, economic picture. You know, in your report you said if we had -- if we continue to have persistent inflation and near term economic decline, we may further -- have further increases in employer contribution.

What about geopolitical factors as well? Is that also an area of concern that we should be aware of?

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, I'm not sure it's as much of an actuarial question as just how individuals feel about geopolitical concerns. They're there. And to the extent they cause economic turmoil, of course it's something that we have to keep an eye on, and that will factor its way into the valuations as it occurs.

We don't have any particular crystal ball forecast of what those impacts could look like. But to mention -- or to respond to your point about inflation, there is some information in the report about cost of living adjustments that are likely to be a little bit higher this year. And we have to wait and see when inflation will drop back down, if ever, back to that 2 percent target that we saw for so long.

COMMITTEE MEMBER PACHECO: Right. And we're looking at -- we're monitoring that. I mean I think today, for instance, it was -- it came out with it was cooling down. The inflation rate cooled down today -- it was reported out today.

And the next question I have is regarding the Section 115, the trust, the prefunded trust. I know that at the educational forum there was a lot of -- it seemed to be a lot of interest in that. And I'm wondering how that -- what is the -- have been our communication process in terms of reach, outreach, getting out more -- getting more employers to understand our system and the benefits of it. And if you guys can -- you know, if someone could elaborate on the public agency side on that.

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, I'll start. I don't know if other people want to -- Michele probably wants to chime in.

Actually the Actuarial Office does not as much as other departments within CalPERS operate the CEPPT, which is our version of the 115 trust. I believe there was 175 million dollars in the CEPPT recently. So that's the amount of money that, you know, employers have given to us to invest in those accounts. But of course, our employers use other third-party providers, and we don't really know how much money is in those.

I know that the team under Michele does a lot of outreach to employers; and I'll turn it over to her for more comments.

Thank you, Michele.

ACTING CHIEF FINANCIAL OFFICER NIX: Thanks, Randy.

So our contracted prefunding trust teams go out to the employers. They participate in webinars. They participate in conferences, so they have set up booths to get the word out, as well as marketing materials. And they just meet with anyone and everyone that they can.

They respond to RFPs as they come on to the street. So they keep track of all of that and try to do the outreach.

COMMITTEE MEMBER PACHECO: Has it been successful over -- well, you know, since -- I think this started in 2019, right, or --

ACTING CHIEF FINANCIAL OFFICER NIX: Yes. Yes, it is growing.

COMMITTEE MEMBER PACHECO: It is growing. And from the -- I think you mentioned that -- how much has it grown since, let's say, from last year to this year? How many -- have we got additional employers?

ACTING CHIEF FINANCIAL OFFICER NIX: Oh, off the top of my head -- let me see if I know somebody that can tell me that. Hold on.

They don't know off the top of their head. We're happy to get back with that.

COMMITTEE MEMBER PACHECO: Al right. Fantastic.

Thank you very much.

CHAIRPERSON MIDDLETON: All right.

DEPUTY CHIEF ACTUARY DZIUBEK: The information that was provided to us for this report by Michele's team - and that information's a little bit in the past right now - but there were 94 employers with 175 million dollars of assets.

COMMITTEE MEMBER PACHECO: Oh, fantastic then.

So it is growing then. Thank you.

Thank you very much for that information.

CHAIRPERSON MIDDLETON: Ms. Taylor.

COMMITTEE MEMBER TAYLOR: Thank you very much.

I need -- oh, I'm on -- there you go.

So I have a couple of questions.

So as we were getting into the risks achieving the long-term return, and we talked about the 20-year amortization. So is there a possibility that we could look over our risk policy for the next time around?

DEPUTY CHIEF ACTUARY DZIUBEK: Looks like the chief actuary wants to take that question.

CHIEF ACTUARY TERANDO: Sure. I assume you're referring to the funding Risk Mitigation Policy?

COMMITTEE MEMBER TAYLOR: Correct, yeah.

CHIEF ACTUARY TERANDO: Thank you very much.

So I think that -- that's a fairly old policy. I think it was implemented I think close to the time you first joined the Board, Ms. Taylor.

COMMITTEE MEMBER TAYLOR: 2015.

CHIEF ACTUARY TERANDO: Yeah. And I think most of the current members aren't familiar with it. So I think we can go ahead and bring that policy back for review. It's probably somewhat outdated. And then we can make -- we can make some recommendations on how the Board wants to proceed with that policy and then we can go from there on that.

COMMITTEE MEMBER TAYLOR: Thank you, Mr. Terando. I appreciate it.

So I think that what I'm looking at particularly was the buydown, the -- so when we do very well, then we buy down -- take half of that --

CHIEF ACTUARY TERANDO: Yes.

COMMITTEE MEMBER TAYLOR: -- and buy that down. And I'm wondering, since we -- our employers already have to pay half the normal cost when we have a bad year, why should we -- you know, I know it's not as much, but they still have to contribute a little more even when we have a good year because we buy those rates down. So maybe --

CHIEF ACTUARY TERANDO: Yeah, I think it's what you said. We haven't brought that policy back in a number of years. I think it's definitely worth bringing it back, having a discussion, and seeing whether it's something we want to continue or what we want to do going forward with it -- policy. So that's not a problem.

COMMITTEE MEMBER TAYLOR: And then -- and I forgot to bring this up in the Investment Committee. So never mind.

I just had a question on, as we are -- I'm trying to find the slide. Hold on.

Here we go. So as we are going further into PEPRA, right, and we're seeing -- and we're going to cross that divide and we should be seeing a better funding status, how long -- and it looks like it's actually about seven or eight years before we start seeing a return that makes us sort of a hundred percent funded or close to. Is that something that is a projection, is that where we think that PEPRA's taking us for -- you know, for real, or are we -- as long as, you know, markets are winning?

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah. So the savings that the employers get from PEPRA results from the fact that the PEPRA benefit packages are a little bit less costly. Now, when they hire a PEPRA person, they immediately start pre-funding that person's benefits. So immediately the contributions they're giving to CalPERS are somewhat lower than if that was a classic member that they just hired.

So we have been getting that reduction in employer contributions from day 1. Although it started very small, as you can see on slide 6 -- I don't know if we want to put that slide up. Not slide 6. Sorry. Slide 8.

So these are real reductions in employer contributions that our employers have seen. It hasn't necessarily improved the funded status. It simply lowered the contributions.

Now, to the extent that freed up additional cash that they could then use for an additional discretionary payment, that could then boost the funded status.

So we're expecting every year for that offset to employer contributions to increase until the point where everybody's a PEPRA member, and then we'll sort of have this locked-in savings from that point forward.

COMMITTEE MEMBER TAYLOR: And we're at 60 percent you guys said, right?

DEPUTY CHIEF ACTUARY DZIUBEK: 60 percent right now, going to about 85 percent over the next 10 years, based on our actuarial assumptions.

COMMITTEE MEMBER TAYLOR: Okay. That is actually what's making this look better, not necessarily funding status but employer contribution rate?

DEPUTY CHIEF ACTUARY DZIUBEK: That's right.

COMMITTEE MEMBER TAYLOR: Okay.

All right. Thank you.

CHAIRPERSON MIDDLETON: Great.

Thank you. Outstanding report.

Couple of questions that I would like to follow-up. And let me pick up on the PEPRA issues that were presented. And this is more commentary than question.

But as we are in this 60 percent of members being PEPRA, there's certainly going to be an increase in tension between those who are classic employees and those who are PEPRA employees. And that is appearing in different wage negotiations that are taking place among public employers. And it's not so much your responsibility as actuaries, but we need to do a very good job of making clear to everyone what these savings are, where they're evident, and what the impacts of any changes to these -- to these PEPRA rules would mean for the system.

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah. And you're correct, we don't -- we don't drive changes up or down to benefit provisions. However, should anything be presented, we will likely present actuarial information to base decisions on.

CHAIRPERSON MIDDLETON: So as I was looking through these charts, one of the questions that emerged is what impact wage growth is going to have on these projections? We have certainly seen both in the private and the public sector that employees have been demanding more wage increases. And given inflationary rates, that's absolutely expected; and they are largely receiving significantly better wage contracts than existed in the last 10 years.

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah. You're correct, particularly due to the high inflation that we've seen over the last several years, we do expect there to be similar increases in wages. Maybe not occurring as quickly as the actual increases in inflation. We did in our last valuation, which was as of June 30, 2022, we saw that, in general, pays increase more than our actuarial assumptions, resulted in somewhere around a 1 percent increase in our accrued liabilities overall. So while we did see that wages increased higher than expected, it wasn't a really large change to our accrued liabilities.

Now, should that continue - and there's -- there is a good reason to think that it might for the next several years - we would get that information annually. As those higher wages are reported, they would come through as actuarial losses, which would have the same impact although not to the same degrees as an investment loss. They would somewhat reduce the funded status, somewhat increase contributions, probably not as much as a percentage of pay because the pay's going to be going up. But as a dollar amount, yeah, the dollar contributions would go up as a result of that.

CHAIRPERSON MIDDLETON: All right. So I would certainly like for us to be monitoring that as it's moving forward to see -- and, again, if I followed correctly, we're going to see that first in terms of employ -- funded status not improving at the rate that we were expecting it to improve, and resulting from that is an increase in employer contribution rates that could result.

DEPUTY CHIEF ACTUARY DZIUBEK: That's correct.

CHAIRPERSON MIDDLETON: All right. Thank you.

CHIEF ACTUARY TERANDO: Yeah. And if I could just say, I have a quick comment to that.

You know, we'll be doing the experience study in two years. So we will have two year of data to review. And if we continue to see trends in terms of salary -- continued salary increases over our expectation, you know, we'll take that into consideration in setting long-term assumptions. Right now, you know, we're seeing some losses on -- as Randy mentioned, losses on the salaries, you know, as increases our higher. The question is, is are these increases going to be continuing year after year after year or is it -- it'll be a one or two increase and then things start to level off going forward?

CHAIRPERSON MIDDLETON: Thank you. That helps.

Ms. Nix at the end of her report had a slide on benefit payments and contributions income. And I think there's -- if I follow correctly, a slide in yours that's picking up on essentially the same kind of data. And what it certain -- what both seem to be indicating is for the next decade you're projecting a pretty normalized rate of increase in terms of benefit payments that we are going to need to make. There's -- it's clearly going up each year, but I'm not seeing anything that looks like a dramatic increase in the rate of growth.

Is there anything out there that would cause you concern in terms of what that rate of growth and benefit payments are going to be?

DEPUTY CHIEF ACTUARY DZIUBEK: Generally no. And the rate of growth will be a little dampened by PEPRA as the new retirees are subject to the PEPRA benefits. But this is the nature of a defined benefit retirement system, this kind of -- particularly while the system's maturing. As I think someone mentioned previously, that as the system matured, we see larger increases in those annual benefit payments that tend to moderate as the system becomes fully mature. But even at that point, we would still expect moderate increases year by year. And it's the whole reason we prefund, because we know those payments are going to be very high in the future; we don't see any reason for concern on the size of those.

CHAIRPERSON MIDDLETON: Okay. So that goes to the question of the strength of our liquidity and the strength of our cash flow. And there are a few things that from my perspective are more critical than we remain strong in those areas.

Are there any actions at this point that you think we need to be taking that are different from what we have today in order to ensure that we are maintaining the liquidity that we need?

DEPUTY CHIEF ACTUARY DZIUBEK: I can start. It looks like Scott might want to chime in as well.

So the question gets a little bit outside of the actuary's knowledge base, which is why we work very closely with our Investment Office on these kinds of projections. This information -- and it's actually slide 6, if we want to put it up. This information gets provided to our investment professionals every year. They make it even fancier and maybe look at some of the investment income, some of the pieces that might be cash versus appreciation, whatever they do with it. And then they do the liquidity analysis, an assessment really without us. That's really mostly on them. I know that they do that and they talk to us about that. I'm not hearing any concerns they have about being able to make these benefit payments.

CHAIRPERSON MIDDLETON: All right. So I think that exhausts my questions.

But I want to thank you not only for the report, but for all of the outreach that we are doing to make certain that financial officers, municipal county officials are aware of the direction that we are going and really honing in on the impact that PEPRA is going to have over the next decade in terms of cost savings. I rarely encounter a fellow city council member who's quite understanding of the fact that there is actually improvement on the way.

DEPUTY CHIEF ACTUARY DZIUBEK: Thank you.

CHIEF ACTUARY TERANDO: Yeah, I was going to say, you just look at the graph Randy talked about, PEPRA savings. It took, you know, 10 years to get those savings. And, you know, it started as a trickle. And it's starting to grow. And, you know, we anticipate the increases to be, you know, a lot more substantial and noticeable going forward.

CHAIRPERSON MIDDLETON: We have Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you.

It's a very good report.

One thing -- sometimes people just look at one chart or one fact. And so I want to make sure that people understand how balance -- like, for example, on page 4 of 14, we project that employer contribution rates will go up for the next five years. But as reflected -- which is true. But as reflected also on chart on page 10 - it doesn't really lay out as much - but after those five years we can expect employer contributions to decrease because the funding -- because one increase of PEPRA population versus the classic members. But also because we're paying off the unfunded accrued liability. And that's another element of -- or the way we fund is that while there is going to be the market fluctuation, the employers sort of protected a little bit, because there's a smoothing the five year before you actually hit the whole impact of the investment return, either whether it's positive or negative. So I think that's another protection we have for the employer.

So I think the other takeaway is that, yes, there will be a little bit of a ramp-up. But in the long term, which is not that far away, we're going to see a better funded program and the employer contributions decreasing.

And just to follow-up on what the Chair mentioned is employers are very well -- one thing they're appreciative of is that they can budget, they can -- everything's not that -- not too many surprises. It can be projected more or less.

Or less.

Anyway, thank you.

CHAIRPERSON MIDDLETON: Thank you.

COMMITTEE MEMBER RUBALCAVA: And I want to say thank you, because it is a very good report. I would suggest in the future maybe we have another -- because it's in your report -- it's in the written report. But there isn't a chart, I don't think, that really lays out other than the -- how long-term contribution rates will increase. But it's more in the investment risk side. So the heading is sort of -- not alarmist, but it doesn't really speak to that issue about how long-term rates will decrease for the employer and the funding rate -- funding ratio will improve.

So thank you very much.

DEPUTY CHIEF ACTUARY DZIUBEK: Thank you. Appreciate the feedback.

CHAIRPERSON MIDDLETON: Ms. Ortega.

BOARD MEMBER ORTEGA: Yeah, I have a question, kind of related to Mr. Rubalcava's question or the slides he was looking at. On page 4, that graphic there, is it possible to get those lines without the PEPRA savings just to see what the percent of -- so I'm thinking about the savings as a dollar amount versus where the rates would be without PEPRA. I think that would be helpful for me to see.

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, I -- and I'm trying to think. We have some additional information in the report that's not in the slides. Maybe not exactly what you're asking for. But we have that information and we can put that together.

BOARD MEMBER ORTEGA: Okay. I think that would be helpful.

I mean I think the -- the savings is -- I mean it's extremely important, and I recognize everything that's been said about the employers having those savings. But at the same time when you look at the rate, the way I think about it is for like every one person we're paying this percentage of cost in addition just for the pension contribution. So when you look at the safety individuals, that's a pretty significant cost still to the employer. For every one safety person, you might be paying another 60 percent, almost another full cost of a person just for the pension liability.

So I think seeing the difference and what that would be and thinking about how that's going to get better over time in terms of being able to perhaps afford other staffing or just other compensation items.

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, I think we can put something together for you.

And by the way, if you're familiar with our tool pension outlook, you can do a 30-year projection on any plan or on the system, which does take into account the increase going forward of more and more PEPRA members coming into the system.

BOARD MEMBER ORTEGA: Thank you.

CHIEF ACTUARY TERANDO: Are you looking for State plans and specific or --

BOARD MEMBER ORTEGA: I'd like to see the whole chart, if possible, just -- it's helpful for the -- for a Board member perspective to see all of them.

CHIEF ACTUARY TERANDO: Sure. Okay.

CHAIRPERSON MIDDLETON: I'd like to second that. That will be a very helpful report.

CHIEF ACTUARY TERANDO: All right.

BOARD MEMBER ORTEGA: So thank you.

CHAIRPERSON MIDDLETON: Mr. Miller.

VICE CHAIRPERSON MILLER: Yeah. I also think that will be very helpful in terms of being able to understand the whole picture. And it also reminds me that all those cost savings to our employers, it's all money that comes straight out of the pockets of retirees. And that it's a tradeoff when you go to a diminished -- when we've got two tiers of retirees, aside from the generational differences in the workplace and at the bargaining table and everywhere else.

And in some sense, we hear lots and lots, almost every time we have a board meeting about, "Wow, we've got vacancies like crazy. Oh, it's so hard to hire the talent we need and hard to fill positions" like accounting and actuarial and IT. And, "Oh, it's tough because we've got to look now inflation and the employers are going to have to pay more to even --" But I would suggest that we may have done ourselves a disservice because in the bigger picture it's more cost effective to compete on the basis of benefits, of pensions, of accessible high quality health care, than it is on trying to compete for talent on a cash basis for public employees.

And so to some extent, you know, I think in the long run when we see this, I don't view it as all happy and roses, that it's our costs are going down on the benefit side for employers, unless we're not making it up on the employee side or on the retiree side.

And so I just want to bring a -- you know, a little bit of a different perspective on it. When we talk about reducing costs, you know, great if you're reducing costs by efficiencies, whether operational or economic or -- versus by reducing total compensation and benefits, that may not always be the rosy overall picture that we wanted in the grand scheme of things.

CHAIRPERSON MIDDLETON: Thank you.

Are there any other questions or comments from the Board?

Seeing none. Thank you. This was an information item.

We will now move on to 6b, which is the Semi-Annual Health Plan Financial Report from Ms. Zhong.

(Thereupon a slide presentation).

SUPERVISING HEALTH ACTUARY ZHONG: Good afternoon, Madam Chair and members of the Committee. Emily Zhong, CalPERS team member. This is Agenda Item 6b, Semi-annual Health Plan Financial Report. This is an information item.

This report is provided to the Committee twice a year as a part of the monitoring and reporting process for the Health Care Fund status. It included Health Plan account balances, actuarial reserve amount, and surpluses or deficits that are within the Health Plan subaccount.

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SUPERVISING HEALTH ACTUARY ZHONG: The Semi-annual Health Plan Financial Report provides the financial performance for the PPO and HMO plan as of the end of June 2023. HMO fully insured plans such as Kaiser and the Association plan are not in the scope of this report.

And as a reminder the Health Care Fund Reserve Policy provides a framework for maintaining the appropriate actuarial reserve level for the PPO and also for managing surpluses or deficits that accumulate in the PPO and HMO subaccount in June, as shared with the

Committee, the deficits in the Basic PPO subaccount as of the end of December 2022.

In the next couple slides I will give you an update for the basic PPO performance for the first half of 2023.

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SUPERVISING HEALTH ACTUARY ZHONG: This slide presented recent health care performance for the HMO Basic and PPO Medicare and Basic plans. Before going through the details, a reminder that the Health Care Fund subaccount are used for deposit and premiums and paying claims and other expenses. For our self-funded PPO plan, there require an actuarially important level of reserve that includes three components:

The first component is medical and pharmacy claim liability. This covers the fee-for-service claim that have occur but not yet reported.

And the second component is risk-based capital reserve, which based on an industry standard methodology to cover an expected claim due to major health event and natural disaster and other causes.

And the last piece of component is administrative reserve, which is to cover the wind-down costs should a health plan suddenly terminate.

So in this table, starting with the HMO Basic plans, the estimated fund balance at the end of June 2023 was 217 million.

The next column shows the HMO Basic estimated claim liability of 178 million.

With the last column showing the surplus of 39 million.

On the PPO side, starting with PPO Medicare, the estimated fund balance at the end of June 2023 was 75 million, with estimated liabilities and required actuarial reserve level of 137 million, for a deficit of 62 million. The PPO Medicare plan pattern is normally higher in the beginning of the year and decrease later in the year. This is because the plan covered the Medicare deductible for the members. As the deductible is satisfied, the medical costs decrease. This annual seasonality pattern combining with the higher-than-expected pharmacy costs are what's contribute to the current PPO Medicare deficit. But we anticipate this will improve later in the year, as medical costs decrease.

So for the PPO Basic plans, the estimated fund balance as of the end of June 2023 was 177 million. After including the estimated claim liability and required actuarial reserve of 533 million, the PPO Basic Plan has a deficit of 356 million. The overall basic PPO status improved by about 63 million from the end of 2022.

So just a reminder, all the figures for PPO deficits are compared to where we should be fully reserve, but not a cash deficit.

I'll go through some detail for the basic PPO performance in the next slide.

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SUPERVISING HEALTH ACTUARY ZHONG: Sorry.

Okay. Here we go.

In June, we reported the basic PPO with a reserve deficit of 437 million as of the end of 2022. As more claim has been processed and more data become available, now the updated deficits has become 419 million at the end of 2022, an 18 million improvement.

And for the first half of 2023, there was about 61 million increase in the fund balance due to medical cost seasonality patterns. For the basic PPO plan, they have an opposite seasonality pattern to the PPO Medicare plans. The PPO Basic members satisfied their annual deductible earlier in the year. So the medical costs are normally lower in the first half of the year and then increase in the second half of the year.

For pharmacy, while we have the best in the market pricing under our current Optum contract, but the high utilization and more use of the high-cost specialty drugs contribute to about 28 million loss for the first half of 2023.

And for our 2023 PPO Basic premium, as we know, we include a surcharge of 2 percent in platinum and 3 percent in gold for the purpose of replenishing the Health Care Fund reserve. We collected about 27 million in surcharge for the first six months of 2023. And there was also a small investment gain of 3 million dollars.

The overall basic PPO status improved by again about 63 million, bringing the total reserve deficits for the basic PPO to 356 million as of the end of June 2023.

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SUPERVISING HEALTH ACTUARY ZHONG: In summary, we still anticipate a PPO fund status will continue to improve, with a surcharge including in the basic PPO premium or it go to generate additional premium revenue to continue to replenishing the reserve deficits.

And we are also currently conducting solicitation for a new five-year contract for PPO from 2025 to 2029. We will be assessing border changes to the PPO including potential intervention to curb short-term and long-term costs.

That concludes my presentation. And we are happy to take any questions.

CHAIRPERSON MIDDLETON: All right. Are there any questions from the Board?

As you have projected it out over the next three to five years, at what point do you expect the deficit to be eliminated?

SUPERVISING HEALTH ACTUARY ZHONG: I believe as we share in the 2024 rate development. So even though now like a few months gone, we still expecting if we continue the similar surcharge level for the PPO Basic Plan is about four years.

CHAIRPERSON MIDDLETON: Four years. All right. Thank you.

CHIEF HEALTH DIRECTOR MOULDS: And if I could. I think what we're seeing in these -- in the first six months of this year is a marginal improvement over what was anticipated primarily on the medical side. You saw the challenging number on the pharmacy side. We're still factoring in the rebate piece of that. So as spending goes up, which as you see it has - rebates correspondingly go up - so that -- in all likelihood that will slim a little bit. Medical is looking a little bit better, so that puts us for this year marginally improved over anticipated but still similar trajectory.

CHAIRPERSON MIDDLETON: Are there areas that give you substantial concern about being able to make that four-year projection?

SUPERVISING HEALTH ACTUARY ZHONG: At this point we don't see any really significant sign that stop us from the four years. So that is also given in a new PPO five-year contract. We will continue with the self-funded model.

CHAIRPERSON MIDDLETON: All right. Thank you.

Seeing no questions from the Board.

Thank you for that report. And we will move on. Thank you.

So with that we are now to Summary of Committee Direction.

ACTING CHIEF FINANCIAL OFFICER NIX: Okay. Madam Chair, I'd like to address Jose's question about the last -- the growth in the CEPPT for the last year.

Before I do that. 72 -- we -- at the end of last year there were 72 employers, and this year we have 94. We had 85 million in assets under management, and we now have 174 million. So it's growing.

As far as committee direction goes, I took down two. The first one was to bring the funding Risk Mitigation Policy back and to actually make sure that we highlight the buydown provision within that.

And my second committee direction would be to provide a chart similar to one on page 4 of the actuarial presentation that lays out the contribution rates without the PEPRA savings, and project the long -- project it over time so that we can get a better idea of what the employer rates would be without it.

CHAIRPERSON MIDDLETON: All right. Thank you.

CHAIRPERSON MIDDLETON: Mr. Pacheco.

COMMITTEE MEMBER PACHECO: Yes. Ms. Nix, I just want to thank you for that information, and thank you for -- I want to also thank your team on this. I really believe that the Section 115 trust prefunding for the pension is an excellent tool to be utilized by the employers if -- you know, if they are able to do so. And to be able to mitigate risk in the entire system.

So thank you for that update, and keep up the good work.

Thank you.

ACTING CHIEF FINANCIAL OFFICER NIX: Thank you.

And if you have any employers out there that would like us to come talk to them, please pass that our way. We'll be happy to do so.

COMMITTEE MEMBER PACHECO: Thank you. Definitely thank you.

CHAIRPERSON MIDDLETON: I have not received any requests for public comment.

All right. Then we are adjourned. The next meeting on our calendar is the Governance Committee. We will take a 10-minute break. So back at 3:20 for the

Governance Committee.

Thank you all.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 3:09 p.m.)

CERTIFICATE OF REPORTER

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California;

That the said proceedings was taken before me, in shorthand writing, and was thereafter transcribed, under my direction, by computer-assisted transcription.

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 30th day of November, 2023.

James F. Peters

JAMES F. PETERS, CSR
Certified Shorthand Reporter
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