CalPERS

Finance and Administration Committee

# Agenda Item 6d

**September 20, 2022**

**Item Name**: How Investment Returns Impact Employer Contribution Rates

**Program**: Investment performance, Pension administration

**Item Type**: Information

## Executive Summary

This information item describes how employer contribution rates are impacted by the annual investment rate of return. Fundamentally, employer contribution rates increase and decrease based on changes to their asset values which are calculated at the end of the fiscal year and reported in the Annual Comprehensive Financial Report (ACFR). Employers are encouraged to use the Pension Outlook Tool to project their future pension costs.

## Strategic Plan

This item supports the 2022-27 CalPERS Strategic Plan goal of stakeholder engagement by promoting transparency.

## Background

Annually, CalPERS employers anticipate both the results of that fiscal year's investment performance rate of return, and the release of the prior year's actuarial valuation report showing their new contribution rate. Contribution rates are important to employers for budgeting and financial planning purposes. Yet, much confusion surrounds how contribution rates are impacted by the investment performance rate of return, primarily arising from the technical complexities and nuances of investment performance, financial accounting, and actuarial standards. This agenda item seeks to inform the board and stakeholders how the annual investment performance rate of return relates to and affects employer contribution rates.

Annual actuarial valuation reports are published 13 months after the end of the fiscal year. Effective dates for new contribution rates vary based on employer type. The state and schools pool rates take effect one year following the published valuation date. Public agency rates are effective two years following the published valuation date. Valuation reports rely on the current board-adopted actuarial assumptions and experience study, which are key components of the asset-liability management cycle that CalPERS undertakes every four years and recently completed in 2021. The valuation reports reflect any differences between actual and assumed estimates of investment returns, payroll growth, benefit structures, and member longevity. This agenda item focuses on investment returns because they are the most significant factor in year-to-year changes in contribution rates.

Following the end of the fiscal year, CalPERS makes a mid-July announcement of the preliminary total fund investment performance rate of return, with a final calculation of the rate announced in September. This rate of return is a time-based measurement of investment decisions. Notably, this rate uses private equity and real asset valuations as of March 31 because of a one-quarter delay in valuation data. Fortunately, the delayed valuation data is available and timely when the ACFR is finalized in November.

The ACFR is a financial report that follows Government Accounting Standards Board (GASB) requirements when reporting the investment performance rate of return and resulting asset values. It includes private equity and real asset valuations as of June 30, thus providing a view of the full fiscal year. The rate of return found in the ACFR is typically a slightly different rate than the total fund investment performance rate. A high-level comparison of the two methodologies is found in Attachment 1. Importantly, it is the asset values reported in the ACFR that are used by the actuaries to calculate contribution rates.

These differing rates of return have in the past resulted in confusion to stakeholders. The below table shows the rate differences for the last two fiscal years.

Table 1: Differing Investment Performance Rates of Return for the Last Two Fiscal Years

| | Investment* | | ACFR & Valuation Reports** | |
|---|---|---|---|---|
| Fiscal Year | Market Value of Assets | 1-Year Return | Market Value of Assets | 1-Year Return |
| 2021-22 | $440.2 billion | -6.1% | TBD | TBD |
| 2020-21 | $470.8 billion | +21.3% | $477.3 billion | +22.4% |
| | | | | |
| *Reflects private equity and real asset valuations as of March 31<br>**Reflects private equity and real asset valuations as of June 30 | | | | |

Fiscal Year 2020-21 had an approximate one percent difference between the rates. To connect the impact to employers, let’s apply this difference to a hypothetical scenario of a typical miscellaneous plan with $175 million in assets, a payroll of $25 million, and a funded ratio of 80%. Expressed as a percent of payroll, a negative one percent loss will increase the contribution rate by 0.2% to 0.8% in the first five years. This example is found in detail in Attachment 1.

The Pension Outlook Tool in myCalPERS allows employers to project future pension costs and inform decision-making. The tool’s modeling assumptions are found in Attachment 1. And an employer’s assigned actuary is always available to assist in using Pension Outlook and answer questions related to pension costs.

**Attachments**

Attachment 1 – How Investment Returns Impact Employer Contribution Rates PowerPoint Presentation.

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