CalPERS

Finance and Administration Committee

Agenda Item 6c

April 18, 2022

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, 2022 to June 30, 2023 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) 2022-23 are higher than the rates adopted for FY 2021-22. The increase in employer contribution rates is primarily due to the fact that the FY 2021-22 contribution rates reflected the remaining impact of the State's supplanting payment made in July 2019 under Government Code section 20825.1.

The recommended employer contribution rates for FY 2022-23 are generally lower than the projections shown in the June 30, 2020 annual valuation report addendum issued January 2022. This is due to the application of the Supplemental Pension Payment (SPP) of $1.881 billion made by the State in July 2021.

Comparison of Current and Prior Year Results (in millions)

Funded Status	June 30, 2020	June 30, 2021
Accrued Liability	$214,161	$225,975
Market Value of Assets	$151,209	$182,354
Unfunded Accrued Liability	$62,952	$43,621
Funded Ratio	70.6%	80.7%
Expected Employer Contributions based on Actuarially Determined Contribution Rates	$6,633[1]	$7,597[2]
Expected Employer Contributions based on Anticipated Budget Act	$6,765[3]	$7,980[4]

1 Reflects reduction in contributions associated with State's Supplanting Payment made in July 2019.
2 Reflects impact of Proposition 2 Supplemental Pension Payment made in July 2021 and CHP supplemental payments from August 2020 and August 2021.
3 Reflects additional contributions under G.C. section 20683.2.
4 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 fund 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, 2022 through June 30, 2023.

Investment Return and Discount Rate

In a news release issued on July 12, 2021, CalPERS reported a preliminary net return on investments of 21.3% for FY 2020-21. As reported, the Funding Risk Mitigation Policy triggered a 0.20% reduction in the discount rate, from 7.00% to 6.80%. Please refer to Attachment 1 for the impact of the reduction in discount rate for each state plan.

Other Assumption Changes

On November 17, 2021, the board adopted new demographic and economic assumptions based on the recommendations in the November 2021 CalPERS Experience Study and Review of Actuarial Assumptions. The new actuarial assumptions are incorporated with the June 30, 2021 actuarial valuation and will affect required contributions for FY 2022-23. Please refer to Attachment 1 for the impact of the change in actuarial assumptions for each state plan.

Analysis

Actuarially Determined State Employer Contribution Rates for FY 2022-23

The Actuarial Office is recommending the board adopt the following actuarially determined employer contribution rates for the State plans for FY 2022-23. 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 to the board and posted 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 FY 2022-23 actuarially determined contribution rates and the associated dollar amounts these rates are anticipated to generate with those of the current fiscal year.

Fiscal Year	2021-22 Expected Employer Contribution (in millions)	2021-22 Employer Contribution Rate[2, 3]	2022-23 Expected Employer Contribution (in millions)	2022-23 Employer Contribution Rate[3]
State Miscellaneous[1]	$4,160	29.12%	$4,453	30.71%
State Industrial	133	16.46%	157	19.51%
State Safety	476	18.29%	537	21.13%
State Peace Officers & Firefighters	1,263	31.19%	1,851	47.21%
California Highway Patrol	601	61.46%	599	63.89%
Total State	**$6,633**		**$7,597**	

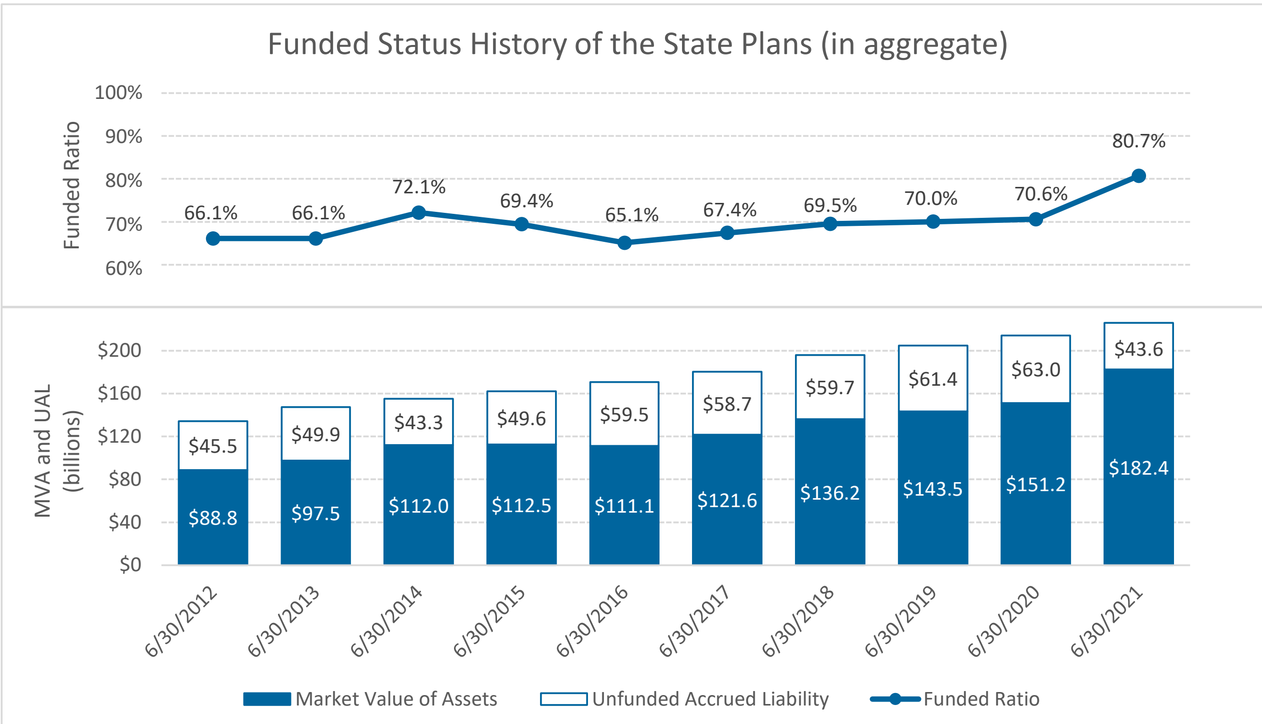
1 Includes both Tier 1 and Tier 2 benefit levels.
2 Reflects reduction for the supplanting payment associated with the State's additional contribution in July 2019.
3 Excludes additional contributions above the actuarially determined contribution rates. See page 7 of the agenda item for more information.

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 (2.75% for FY 2021-22 projected payroll and 2.80% for FY 2022-23 projected payroll). To the extent that actual payroll in the contribution year is different than expected, actual contribution amounts will be different than the expected contributions shown in the table 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, 2020 to June 30, 2021 the funded ratio of the State plans, in aggregate, increased by 10.1% to 80.7%. This increase is primarily due to investment returns higher than expected in FY 2020-21, offset partially by the changes in assumptions, including the reduction in discount rate.

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, 2021.

Reasons for Changes in Employer Contributions for the State Plans

Overall, the actuarially determined contributions for the State plans increased by $963.9 million from $6,633.3 million in FY 2021-22 to $7,597.2 million in FY 2022-23. This change is primarily driven by the factors listed below.

Reason for Change	Change in Required Contribution (in millions)
Required employer contribution in FY 2021-22	$6,633.3
Change due to progression of existing amortization bases	305.3
Expiration of supplanting payment (G.C. §20825.1)	1,404.5
Effect due to change in overall payroll	(17.9)
Decrease in Normal Cost due to new demographics	(60.9)
Decrease due to change member contributions rates	(14.2)
Increase in Normal Cost & amortization due to Risk Mitigation	130.6
Decrease due to Supplemental Pension Payment	(450.7)
Changes due to experience and actuarial assumptions:	
• Investment experience (reflects five-year ramp)	(417.9)
• Demographic experience	(168.5)
• Actuarial assumption change	253.6
Total change in required contributions	963.9
Required employer contribution in FY 2022-23	$7,597.2

During FY 2020-21, payroll across the State plans decreased by 0.2%, compared to the payroll growth assumption of 2.75%, resulting in a decrease of $17.9 million in the required contribution. The change in payroll for the year ranges from a 1.4% increase for State Miscellaneous to a 4.2% decrease for California Highway Patrol.

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 the plans is lower due to the enrollment of new hires into lower benefit levels. PEPRA membership ranges from a high of 50% of active members (44% of payroll) for State Safety to a low of 24% of active members (21% of payroll) for California Highway Patrol.

The return on plan assets for the year ending June 30, 2021 was approximately 21.3% before reduction for administrative expenses. This return resulted in a reduction to the discount rate from 7.00% to 6.80% as required by the Funding Risk Mitigation Policy. Pursuant to policy, a portion of this investment gain was used to fully offset the impact of the reduction in discount rate with the remaining investment gain being amortized over 20 years with a five-year ramp.

The employer contribution rates set by this valuation reflect statutory changes to member contribution rates effective July 1, 2022, 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. The additional employer contribution rates for FY 2022-23 are unchanged from the previous year and are shown in the table below.

Rate Plan	Additional Employer Contribution Rate under Section 20683.2
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 28, 2021 Supplemental Pension Payments (SPP) shown below were the first payments made to these rate plans under Proposition 2.

Plan	Supplemental Pension Payments Made on July 28, 2021 Pursuant to Proposition 2
State Miscellaneous	$865,017,000
State Industrial	50,499,000
State Safety	112,346,000
State Peace Officers & Firefighters	853,138,000
Total	**$1,881,000,000**

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 2022-23 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 rate. 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 2022-23 for Contribution Stabilization are shown in the table below and partially offset the immediate impact of the July 2021 SPP.

Rate Plan	Additional Employer Contribution Rate for Contribution Stabilization
State Miscellaneous	1.19%
State Industrial	0.61%
State Safety	0.44%
State Peace Officers & Firefighters	1.14%

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.

California Highway Patrol Plan	Supplemental Pension Payments
August 18, 2020	$25,000,000
August 31, 2020	243,000,000
August 16, 2021	25,000,000
Total	**$293,000,000**

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, 2023. Since the payments reduced the unfunded liability, they also reduced the actuarially determined contribution rate. To comply with the agreement, the State must contribute in excess of the actuarially determined contribution rate by the same amount the supplemental payments decreased the actuarially determined contribution rate, 2.33% of payroll.

Budgeted State Employer Contribution Rates for 2022-23

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.

Rate Plan	Actuarially Determined Employer Contribution Rate for 2022-23	Additional Employer Contribution Rate	Budget Act Contribution Rate for 2022-23
State Miscellaneous	30.71%	1.29%	32.00%
State Industrial	19.51%	1.49%	21.00%
State Safety	21.13%	1.62%	22.75%
State Peace Officers & Firefighters	47.21%	2.79%	50.00%
California Highway Patrol	63.89%	3.65%	67.54%

The Additional Employer Contribution Rate is the sum of Section 20683.2 adjustment, the Contribution Stabilization adjustment, and Bargaining Unit 5 adjustment.

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 plan are in either the State Miscellaneous or the State Peace Officers and Firefighters rate plan. 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 FY 2022-23, the total normal cost rates for PEPRA members in the State Miscellaneous and State Peace Officers and Firefighters plans changed by more than 1% of payroll from the base total normal cost rates. The change was due mainly to the change in actuarial assumptions, including the discount rate. As a result, the member contribution rates for these PEPRA members will increase in FY 2022-23.

Please refer to Attachment 3 for a summary of total normal cost by plan by benefit formula and Attachment 4 for details of the member contribution rates for certain PEPRA members.

Members represented by State Bargaining Units 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. Only Bargaining Unit 5 will require changes in member contribution rates for FY 2022-23.

Please refer to Attachment 5 for details of the member contribution rates for this Bargaining Unit.

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, 2023 and is reflected in the rates for California Highway Patrol beginning in FY 2023-24.

	Actuarially Determined Employer Contribution Rates (% of payroll)					
	Actual	Projected				
Plan	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
State Miscellaneous	30.71%	29.7%	28.5%	27.3%	25.8%	25.9%
State Industrial	19.51%	18.4%	17.3%	16.2%	14.9%	14.9%
State Safety	21.13%	19.4%	18.3%	17.2%	16.0%	15.9%
Peace Officers & Firefighters	47.21%	45.7%	43.6%	41.4%	38.8%	38.8%
California Highway Patrol	63.89%	61.4%	57.0%	53.9%	48.7%	48.4%

Actual investment return for FY 2021-22 was not known at the time this agenda item was prepared. Projections above assume the investment return for fiscal year beginning 2021-22 would be 6.80%. ***If the actual investment returns differ from 6.80%, actual contribution requirements for 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 2021-22. 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 – PEPRA Member Contribution Rates

Attachment 5 – Member Contribution Rates for State Bargaining Unit 5, 9, 16 and 18

Attachment 6 – PowerPoint Presentation

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