Finance and Administration Committee

Agenda Item 5d

April 17, 2023

Item Name: Schools Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Approve an employer contribution rate of 26.68% of payroll for the Schools Pool. This rate is applicable for the period of July 1, 2023 to June 30, 2024.

Executive Summary

The employer contribution rate has increased from the prior fiscal year, but it is slightly lower than what was projected in the June 30, 2021 annual valuation report.

The following table summarizes key results of the June 30, 2022 valuation.

Key Valuation Results ($ in millions)

Funded Status	June 30, 2021	June 30, 2022
Accrued Liability	$110,507	$116,982
Market Value of Assets	$86,519	$79,386
Unfunded Accrued Liability	$23,988	$37,596
Funded Ratio	78.3%	67.9%

Contribution Rates	Fiscal Year 2022-23	Fiscal Year 2023-24
Employer Contribution Rate	25.37%	26.68%
PEPRA Member Contribution Rate	8.00%	8.00%

Strategic Plan

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

Background

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

This actuarial valuation determines the funded status as of June 30, 2022 and sets forth the Schools employer and PEPRA employee contribution rates for FY July 1, 2023 through June 30, 2024.

Investment Return

From the Basic Financial Statements issued on November 15, 2022, CalPERS reported a return on investments of -7.5% (before recognition of administrative expenses) for FY 2021-22 compared to an expected return of 6.8%. (Note, the time weighted return for FY 2021-22 of -6.1% reported prior to the issuance of the Financial Statements reflected information for private equity investments and real assets as of March 31, 2021.) This return generated an actuarial investment loss of $12.4 billion. This loss will be amortized over 20 years with a five-year ramp (phase-in), increasing the employer contribution rate in FY 2023-24 by 1.69% of pay. Due to the five-year ramp, this impact will increase each year until it reaches an estimated 7.6% of pay in FY 2027-28.

Other Plan Experience

Non-investment experience during FY 2021-22, which includes both demographic experience and economic experience other than from investments, produced an actuarial loss of $1.6 billion. This loss will be amortized over 20 years, increasing the employer contribution rate by 0.80% in FY 2023-24. Combined with a 0.05% decrease in the employer normal cost rate, the net effect of non-investment experience is an increase of 0.75% in the employer rate.

The two most significant sources of non-investment experience were salary increases for active members and benefit increases for annuitants, both of which generated an actuarial experience loss. The average salary increase was 8.0% for members actively employed during the entire year ending June 30, 2022. The average benefit increase for annuitants was approximately 3.2%, driven by a May 2022 cost-of-living adjustment (COLA and PPPA) in excess of the assumed increases of 2% to 2.3%. COLAs were based on a 4.7% increase in the Consumer Price Index during 2021.

Total reported payroll in FY 2021-22 increased by 10.2% over the prior year, compared with 2.8% expected. This served to reduce the employer contribution rate for FY 2023-24 by 1.04% of pay as the dollar amount of the unfunded liability contribution is divided by a larger payroll.

Analysis

Schools Employer Contribution Rate for 2023-24

The Actuarial Office has completed the calculation of the employer contribution rate for the Schools Pool for FY 2023-24. The full actuarial report will be completed later this year and will be posted online when complete. The additional information provided in the report will include details on assumptions, methods, and participant data.

The following table compares the FY 2023-24 employer contribution rate and corresponding dollar amount estimated to be generated by the rate to amounts for the current FY 2022-23.

Schools Pool Employer Contribution ($ in millions)

Employer Costs by Rate and Dollars	Fiscal Year 2022-23	Fiscal Year 2023-24
Valuation Date	June 30, 2021	June 30, 2022
Employer Contribution Rate		
Employer Normal Cost	9.82%	9.77%
Unfunded Liability Contribution	15.55%	16.91%
Required Employer Rate	**25.37%**	**26.68%**
Projected Payroll[1]	$ 15,181	$ 16,731
Expected Employer Contribution Dollars		
Employer Normal Cost	$ 1,491	$ 1,635
Unfunded Liability Contribution	2,361	2,830
Expected Employer Contributions	**$ 3,852**	**$ 4,465**

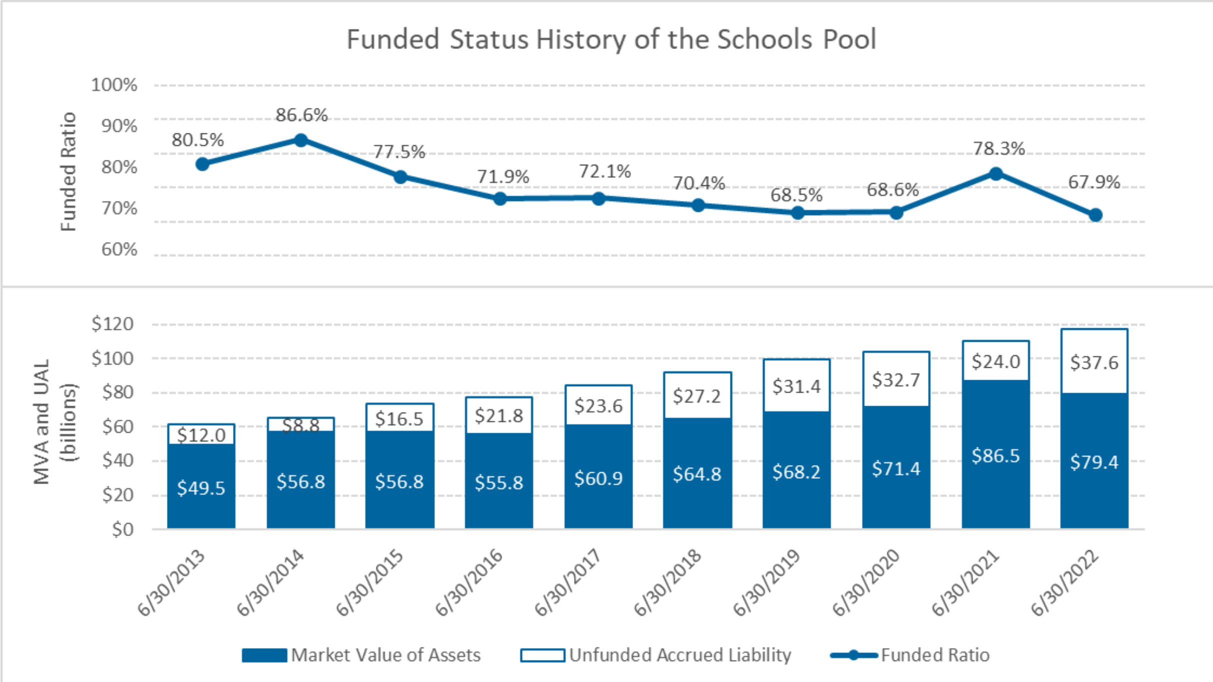
[1] Projected payroll used to calculate the expected dollar contributions is payroll reported for the year ending on the valuation date, increased for two years of growth at the prevailing payroll growth assumption (2.80% per year for the June 30, 2022 valuation). To the extent that payroll in the contribution year is different than projected, actual contribution amounts will differ from the expected contributions shown in the table above.

Funded Status

The chart below illustrates two different measures of funded status: funded ratio and Unfunded Accrued Liability (UAL). The funded ratio equals assets divided by accrued liability. It is a relative measure of funded status and allows for comparisons between plans of different sizes. Plans with a lower funded ratio are, all other things equal, more costly and at higher risk of not being able to meet their future benefit obligations. The UAL, a dollar amount, equals accrued liability minus assets and is an absolute measure of funded status.

From June 30, 2021 to June 30, 2022, the funded ratio of the Schools Pool decreased by 10.4% and the UAL increased by $13.6 billion. This deterioration in funded status was due primarily to lower-than-expected investment return in FY 2021-22.

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



Change in Required Employer Contribution

Overall, the required employer contribution rate for the Schools Pool increased by 1.31% of payroll from the prior year. The dollar amount of contributions expected to be generated in FY 2023-24 is approximately $613 million higher than in FY 2022-23. An explanation of the key sources of plan experience can be found on page 2.

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

Reconciliation of Required Employer Contribution

	Rate (% of Payroll)	Estimated Dollars (millions)
Employer Normal Cost		
2022-23 employer normal cost contribution	9.82%	$1,491
Change in payroll	0.00%	152
Demographic experience	(0.05%)	(8)
2023-24 employer normal cost contribution	9.77%	$1,635
Unfunded Liability Contribution		
2022-23 unfunded liability contribution	15.55%	$2,361
Progression of amortization bases and change in payroll	(1.13%)	51
Investment (gain)/loss	1.69%	284
Non-investment (gain)/loss	0.80%	134
2023-24 unfunded liability contribution	16.91%	$2,830
Total Required Employer Contribution		
2022-23 total required employer contribution	25.37%	$3,852
Progression of amortization bases and change in payroll	(1.13%)	203
Experience (gains)/losses	2.44%	410
2023-24 total required employer contribution	26.68%	$4,465

PEPRA Member Contribution Rate

Under PEPRA, new members hired on or after January 1, 2013 are required to contribute 50% of the total normal cost of their pension benefit as determined by the actuarial valuation. PEPRA school members currently contribute 8.00% of salary. The contribution rate for school members not subject to PEPRA (i.e., Classic members) is set by statute and is currently 7.00% of salary.

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

In this valuation, the total normal cost did not change by more than 1% relative to the basis currently in effect, therefore the PEPRA member contribution rate will remain 8.00% for FY 2023-24.

As of June 30, 2022, there were 190,858 active PEPRA members in the Schools Pool, representing 57% of the total active population of the Schools Pool. The total payroll for active PEPRA members was $7.69 billion, or 49% of the total Schools Pool payroll.

Expected Future Changes

The following table shows projected employer contribution rates for FY 2024-25 through FY 2028-29. Projected rates assume all actuarial assumptions will be realized and no changes to assumptions, methods, or benefits will occur during the projection period. The projected rates further reflect that normal cost is expected to continue to decline gradually over time as new employees enter the PEPRA benefit tier. Projected rates are estimates only; actual rates will be determined by future actuarial valuations.

Projected Schools Employer Contribution Rate (% of payroll)

Fiscal Year	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Employer Contribution	26.68%	27.7%	28.3%	28.7%	30.0%	29.8%

The actual investment return for FY 2022-23 was not known at the time this item was prepared. The projections above assume the investment return for that year will be 6.80%. ***If the actual investment return differs from 6.80%, the actual contribution requirements for the projected years will differ from those shown above.***

During the time period between the valuation date and the publication of this agenda item, inflation has been significantly higher than the expected rate of 2.3% per annum. Since inflation influences cost-of-living increases for retirees and beneficiaries and active member pay increases, higher inflation is likely to put at least some upward pressure on contribution requirements and downward pressure on the funded status in the June 30, 2023 valuation. The actual impact of higher inflation on future valuation results will depend on, among other things, how long higher inflation persists. The May 2023 cost-of-living adjustment (COLA and PPPA) will be based on an 8.0% increase in the Consumer Price Index during 2022. The projected rates above do not reflect any adjustment for the potential effects of higher inflation or other sources of plan experience beyond the valuation date.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

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

Attachments

Attachment 1 – Schools Valuation Presentation

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