Circular Letter

Date: December 5, 1996
Reference No:200-154

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Distribution: I, III, IV, VI, XII
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TO: **ALL STATE AGENCIES, SCHOOLS, AND CONTRACTING PUBLIC AGENCIES**

SUBJECT: **NEW POLICIES - AMORTIZATION OF UNFUNDED LIABILITIES AND EMPLOYER RATE CHANGES**

In order to help stabilize annual employer contribution rates, CalPERS will be implementing changes in the way unfunded liabilities are amortized. In addition, CalPERS will be changing the effective date of the increase in employer rates due to plan amendments. These changes are described below separately for State plans, the Schools Pool, and for Public Agencies.

State Plans:

All State plans have a funding horizon of 2029 (i.e. the unfunded liability of these plans is being fully amortized by June 30, 2029). Under current policy, all changes in unfunded liability, whether due to changes in benefits, changes in actuarial assumptions and methods, or gains/losses that occur annually due to differences between actuarial assumptions and actual experience are amortized over this same funding horizon. The new policy continues the current policy until there are twenty years remaining in the horizon. That is, the current policy will continue until 2009. Thereafter, the new policies described below will apply.

After 2009, changes in unfunded liability due to changes in plan provisions or changes in actuarial assumptions or methods will be amortized over the 20 year period commencing with the year of the change. For example, if benefits or actuarial assumptions were changed in 1998, the change in unfunded liability would be amortized between 1998 and 2029, while the change in unfunded liability due to a change in benefits or assumptions in 2025 would be amortized over the 20 year period from 2025 to 2045.

In addition, gains and losses that occur after 2009, will be amortized by including 10% of all unamortized gains and losses that occur after 2009 in the employer's rate. Since, gains and losses tend to offset each other with proper actuarial assumptions, this new approach will provide more stable employer rates.

The Schools Pool:

The School Pool has a funding horizon of 2011 (i.e. the unfunded liability of this plan is being fully amortized by June 30, 2011). Under current policy, all changes in unfunded liability, whether due to changes in benefits, changes in actuarial assumptions and methods, or gains/losses that occur annually due to differences between actuarial assumptions and actual experience are amortized over this same funding horizon.

Under the new policy, changes in unfunded liability due to changes in plan provisions or changes in actuarial assumptions or methods will be amortized over the 20 year period commencing with the year of the change. For example, if benefits or actuarial assumptions were changed in 1998, the change in unfunded liability would be amortized between 1998 and 2018, while the change in unfunded liability due to a change in benefits or assumptions in 2025 would be amortized from 2025 to 2045.

In addition, gains and losses that occur after July 1, 1996, will be amortized by including 10% of all unamortized gains and losses that occur after July 1,1996 in the employer's rate. Since, gains and losses tend to offset each other with proper actuarial assumptions, this new approach will provide more stable employer rates.

For Public Agencies:

Under current policy, prior service unfunded liability and current service unfunded liability are tracked separately and, in some instances, amortized over different funding periods. Changes in actuarial assumptions and methods, as well as gains and losses that occur annually due to differences between actuarial assumptions and actual experience, are all amortized over these same funding horizons. As the remaining amortization periods grew shorter, there were large rate fluctuations in some cases. When an employer requested an actuarial valuation to determine the impact of a proposed change in plan benefits, an estimated increase in the employer contribution rate would be provided based upon up to three different funding horizons. For example, an employer who requested an actuarial valuation to provide an improved benefit and whose unfunded liability, at that time, was being amortized to the year 2000 was provided valuations showing the estimated increase in the employer contribution rate due to the change in the plan provisions and:

1) continued amortization of the employer's total unfunded liability to the year 2000;
2) extended amortization of the employer's total unfunded liability to the year 2011; or
3) extended amortization of the employer's total unfunded liability to the year 2016.

In addition, increases in the employer contribution due to the amendment were not applied to the employer contribution rate for up to two years after the effective date of the change plan provisions. This delayed application of the rate change produces a greater potential for differences between estimated amendment cost and actual amendment cost

Under **new policy**, the prior service unfunded liability and the current service unfunded liability will be combined and amortized over a single new funding horizon. The single new funding horizon will be determined as that period which produces initial employer contribution rates as close as possible to the rates that would have been produced without making this change. For all current agencies , the combined unfunded liability on June 30, 1996 will be referred to as the initial unfunded liability and the single new funding horizon will be called the initial funding period. This change will produce only minor changes in rates. Gains and losses that occur after July 1, 1996, will be amortized by including 10% of all unamortized gains and losses that occur after July 1, 1996 in the employer's rate. Since, gains and losses tend to offset each other with proper actuarial assumptions, this new approach will provide more stable employer rates. This change will first effect employer rates in 1998-99. Further, changes in the unfunded liability due to changes in actuarial assumptions or methods or due to contract amendments will be amortized over 20 years from the year of the change. For example, the change in unfunded liability resulting from a change in actuarial assumptions or contract amendment in 1998 will be amortized between 1998 and 2018. If the same agency amends its contract in the year 2000, the change in unfunded liability for that contract amendment will be amortized between 2000 and 2020. The remaining balance on the initial unfunded liability and the initial amortization period will be unaffected by later contract amendments. Another important change is that **the increase in employer contribution rate due to a contract amendment will be effective as of the contract amendment effective date. This will apply to all contract amendments effective after June 30, 1997. The contract amendment effective date must also coincide with the first day of the contracting agency's payroll period.**

These policies continue CalPERS' commitment to its members and employers to provide benefit security and minimize employer rate fluctuations. If you have any questions or comments, please contact Actuarial and Employer Services Division at **888 CalPERS** (or **888**-225-7377).

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