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Circular Letter

TO: **ALL SCHOOL EMPLOYERS**

SUBJECT: **INVESTMENT RETURN IMPACT ON EMPLOYER RATES**

ATTENTION: **FINANCE DIRECTORS, HUMAN RESOURCE DIRECTORS, EMPLOYER DECISION MAKERS**

CalPERS is sending this Circular Letter as a result of our commitment to periodically provide information regarding the current financial market volatility impact to the CalPERS trust fund, to our employers and to our members. CalPERS continues to manage a well diversified portfolio and maintain a prudent, long term investment strategy in order to ensure the financial security for those we serve.

RECENT EMPLOYER OUTREACH

CalPERS issued Circular Letter 310-051-08 on October 8, 2008 in order to inform school employers of the CalPERS investment policy and strategy during the market decline. That Circular Letter also addressed the impact of financial market volatility on the security of retiree benefits. On October 21, 2008, CalPERS staff presented an agenda item to the Board of Administration that assessed the impact to the System's funding status and employer contribution rates under various 2008/2009 fiscal year investment return scenarios. In addition, CalPERS Board Members and Executive staff addressed these same issues extensively during the 2008 CalPERS Educational Forum that was held in southern California from October 27 through October 29.

This Circular Letter updates the information shared in October and includes the impact of a revision to the fiscal year 2007/2008 investment return and more recent asset return information during fiscal year 2008/2009, based on the latest data available to CalPERS.

FINAL 2007/2008 INVESTMENT RESULTS

In July 2008, CalPERS released preliminary investment returns for the 2007/2008 fiscal year of about negative 2.5 percent. Consistent with previous years, this announced return was labeled preliminary because the market value figures for the real estate and Alternate Investment Management (AIM) programs were as of the previous quarter ending March 31, 2008.

The one quarter lag is a result of the time involved in obtaining an appraisal of real estate as well as private market partners completing their financial reporting to CalPERS. This lag is consistent with industry reporting standards. CalPERS has now obtained final figures for these investments. The official 2007/2008 investment return net of expenses is negative 5.1 percent. More information about the official investment return is available on the CalPERS web site at www.calpers.ca.gov.

IMPACT ON 2009/2010 SCHOOL POOL CONTRIBUTION RATE

The School Pool contribution rate is affected by the investment return of a given fiscal year in the second year that follows. For example, CalPERS set the School Pool rate for fiscal year 2008/2009 based on the investment return of the fiscal year ending June 30, 2007. The negative 5.1 percent return for fiscal year 2007/2008 will first be reflected in the School Pool contribution rate applicable for the 2009/2010 fiscal year.

CalPERS achieved double digit gains in each of the four years leading up to the 2007/2008 fiscal year. Through CalPERS 15 year smoothing of investment returns, these previous positive returns will cushion the impact the 2007/2008 investment losses will have on the School Pool contribution rate in 2009/2010. In fact as of June 30, 2007, the asset smoothing method set aside about 14 percent of the CalPERS fund as a “rainy day” fund. The negative 5.1 percent return for fiscal year 2007/2008, about 12.9 percent less than the 7.75 percent expected rate of return, uses up most of the 14 percent of the “rainy day” fund. The good news is that the School Pool rate in 2009/2010 is not expected to increase as a result of the 2007/2008 negative 5.1 percent return. In fact, with the rate smoothing policies at CalPERS, the estimated impact of the negative 5.1 percent investment return is a decrease up to 0.1 percent of payroll in the expected 2009/2010 School Pool rate. This assumes that all other actuarial assumptions are realized in aggregate. **It is important to note that in recent years, the demographic experience of most plans translated to increases in employer rates.**

IMPACT ON 2010/2011 SCHOOL POOL CONTRIBUTION RATE

The investment return for fiscal year 2008/2009 will first impact the School Pool contribution rate in the 2010/2011 fiscal year. As a result of the rate stabilization method adopted by the Board, the impact on the School Pool rate will be greatly mitigated. However, the smoothing method adopted by CalPERS imposes a corridor of 80 percent to 120 percent of the market value of assets when determining the smoothed actuarial value of assets. Stated another way, the 15 year smoothing method stops when the actuarial value of assets hits 120 percent of the market value of assets or 80 percent of the market value assets.

The corridor limit will be hit if the 2008/2009 investment return reaches about negative 13 percent. Investment return lower than negative13 percent will produce a significantly greater impact on employer rates.

The table below shows the estimated impact of various 2008/2009 investment returns on the School Pool contribution rate for fiscal year 2010/2011.

ESTIMATED Change in the School Pool Contribution Rate in Fiscal Year 2010/2011

	Hypothetical Investment Return for 2008-2009						
	-20% Return	**-15% Return**	**-10% Return**	**0% Return**	**7.75% Return**	**10% Return**	**20% Return**
Range of Estimated Changes in Rates in Fiscal Year 2010-2011	Increase of about 2% to 3% of Payroll	Increase of about 1% of Payroll	Increase of about 0.2% to 0.3% of Payroll	Increase of about 0.1% of Payroll	Decrease of less than 0.1% of Payroll	Decrease of about 0.1% of Payroll	Decrease of about 0.2% to 0.3% of Payroll

If CalPERS does experience a negative return in 2008-2009 as illustrated above, and then returns to its anticipated 7.75 percent investment return, the School Pool rate would likely continue to rise slowly over time. Returns in excess of 7.75 percent in subsequent years would be necessary to prevent a steady rise in the School Pool rate.

For example, if the 2008/2009 fiscal year ends with an investment return of negative 20 percent, investment returns of 7.75 percent in the next few years would result in increases in the School Pool rate of about 0.2 percent to 0.3 percent of payroll each year.

IMPACT ON FUNDED STATUS

CalPERS determines a plan's funded status by comparing the market value of assets to the accrued liability. The table below displays the funded status of the CalPERS School Pool as of June 30, 2007. This table also shows the estimated funding status as of June 30, 2008 based on the negative 5.1 percent return during 2007/2008.

	Funded Status on a Market Value of Assets Basis as of June 30, 2007	**ESTIMATED Funded Status on a Market Value of Assets Basis as of June 30, 2008**
School Pool	108%	95%

The table below provides the estimated funded status for the CalPERS School Pool as of June 30, 2009 under various possible investment return scenarios.

ESTIMATED Funded Status on a Market Value of Assets Basis as of June 30, 2009 Based on Hypothetical Investment Returns

	Hypothetical Investment Return for 2008-2009						
	-20% Return	**-15% Return**	**-10% Return**	**0% Return**	**7.75% Return**	**10% Return**	**20% Return**
School Pool	71%	75%	79%	88%	95%	97%	106%

CalPERS cannot predict what the rest of the fiscal year will bring in the way of investment return; therefore, we are providing these scenarios to employers in order to build awareness of the potential impacts due to the global market downturn and to assist administrators with long term planning. CalPERS will continue to utilize our full range of resources and talents to protect our employer and member financial interests today and into the future.

If you have any questions, please contact the Employer Contact Center at **888 CalPERS** (or **888** 225 7377).

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