CalPERS

Finance and Administration Committee

Agenda Item 6c

April 19, 2021

Item Name: State Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Adopt the employer and member contribution rates for the period July 1, 2021 to June 30, 2022 as set forth in the table on page 4 of this agenda item.

Executive Summary

The recommended employer contribution rates for the State plans for fiscal year 2021-22 are generally lower than the rates adopted for fiscal year 2020-21 after the reduction via the enactment of Assembly Bill 84 (Government Code Section 20825.1). For some plans the rate is lower than what was estimated in the June 30, 2019 annual valuation report while for other plans the rate is higher.

Comparison of Current and Prior Year Results (in millions)

Valuation Date	June 30, 2019	June 30, 2020
Market Value of Assets	$143,466	$151,209
Accrued Liability	$204,836	$214,161
Unfunded Accrued Liability	$61,370	$62,952
Funded Ratio	70.0%	70.6%
Expected Employer Contributions based on Actuarially Determined Contribution Rates[1]	$6,491	$6,651
Expected Employer Contributions Including Additional Contributions Pursuant to G.C. Section 20683.2[1]	$6,617	$6,783

1 Reflects reduction for supplanting payments associated with State's additional contribution in July 2019. See "Additional State Contribution" for more information.

Strategic Plan

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the Strategic Plan Goal of Fund Sustainability.

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, 2021 through June 30, 2022.

Additional State Contribution

Senate Bill 90 (SB 90), approved by the Governor on June 27, 2019, directed the State to contribute additional funds to the State plans to pay down the Unfunded Accrued Liability. The payment to the State plans, totaling $2.5 billion, was received on July 29, 2019 and allocated among plans as follows:

Plan	Additional Contribution Made on July 29, 2019 Pursuant to SB 90
State Miscellaneous	$848,057,000
State Industrial	82,930,000
State Safety	184,427,000
State Peace Officers & Firefighters	1,384,586,000
California Highway Patrol	0
Total	**$2,500,000,000**

In April 2020, the board adopted the employer contribution rate for the State Plans for fiscal year 2020-21. Subsequently, due to budget challenges caused by the COVID-19 pandemic, the State modified the application of the $2.5 billion supplemental payment made by the State in July 2019 via the enactment of Assembly Bill 84 (Section 20825.1). In accordance with the statute, $95.5 million paid part of the 2019-20 required contribution, $1.0 billion paid part of the 2020-21 required employer contribution, and the remaining $1.4 billion pays part of the 2021-22 required employer contribution.

The revised allocations of the $2.5 billion among plans for fiscal year beginning 2019-20 through 2021-22 are as follows:

Plan	**Allocation of Supplement Payment Pursuant to AB 84**			**Total**
	2019-20	**2020-21**	**2021-22**	
State Miscellaneous	$32,384,208	$339,222,800	$476,449,992	$848,057,000
State Industrial	3,166,795	33,172,000	46,591,205	82,930,000
State Safety	7,042,595	73,770,800	103,613,605	184,427,000
State Peace Officers & Firefighters	52,872,296	553,834,400	777,879,304	1,384,586,000
California Highway Patrol	0	0	0	0
Total	**$95,465,894**	**$1,000,000,000**	**$1,404,534,106**	**$2,500,000,000**

For fiscal year 2021-22, the impact of the additional payment is directly reflected in the actuarially determined contribution because the additional payment was reflected in the funded status; hence the unfunded liability was reduced as of the June 30, 2020 actuarial valuation date. The $1.4 billion allocated to fiscal year 2021-22 served to reduce the required employer contribution rate by 6.18% of payroll.

Analysis

State Employer Contribution Rates for 2021-22

The Actuarial Office has completed the calculation of the employer contribution rates for the State plans for fiscal year 2021-22. The full actuarial report is expected to be completed later this year and will be provided to the board and posted online when complete. The additional information provided in the full actuarial report includes details on assumptions, methods and participant data.

The table below compares the next fiscal year 2021-22 actuarially determined required contribution rates and the dollar amounts these rates are anticipated to generate with the rates and contributions for the current fiscal year 2020-21.

Fiscal Year	2020-21 Expected Employer Contribution (in millions)	2020-21 Employer Contribution Rate[2,3]	2021-22 Expected Employer Contribution (in millions)	2021-22 Employer Contribution Rate[2,3]
State Miscellaneous	$3,986	29.27%	$4,169	29.18%
State Industrial	133	17.31%	133	16.46%
State Safety	479	18.77%	476	18.29%
State Peace Officers & Firefighters	1,318	34.45%	1,263	31.19%
California Highway Patrol	575	59.76%	610	62.39%
Total State	**$6,491**		**$6,651**	

Note that the payroll used to calculate the expected dollar contribution is the payroll used in the valuation incorporating two years of payroll growth using the annual payroll growth assumption of 2.75%. To the extent that actual payroll in the contribution year is different than projected, 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 plan. State Miscellaneous includes both Tier 1 and Tier 2 benefit levels.

Funded Status

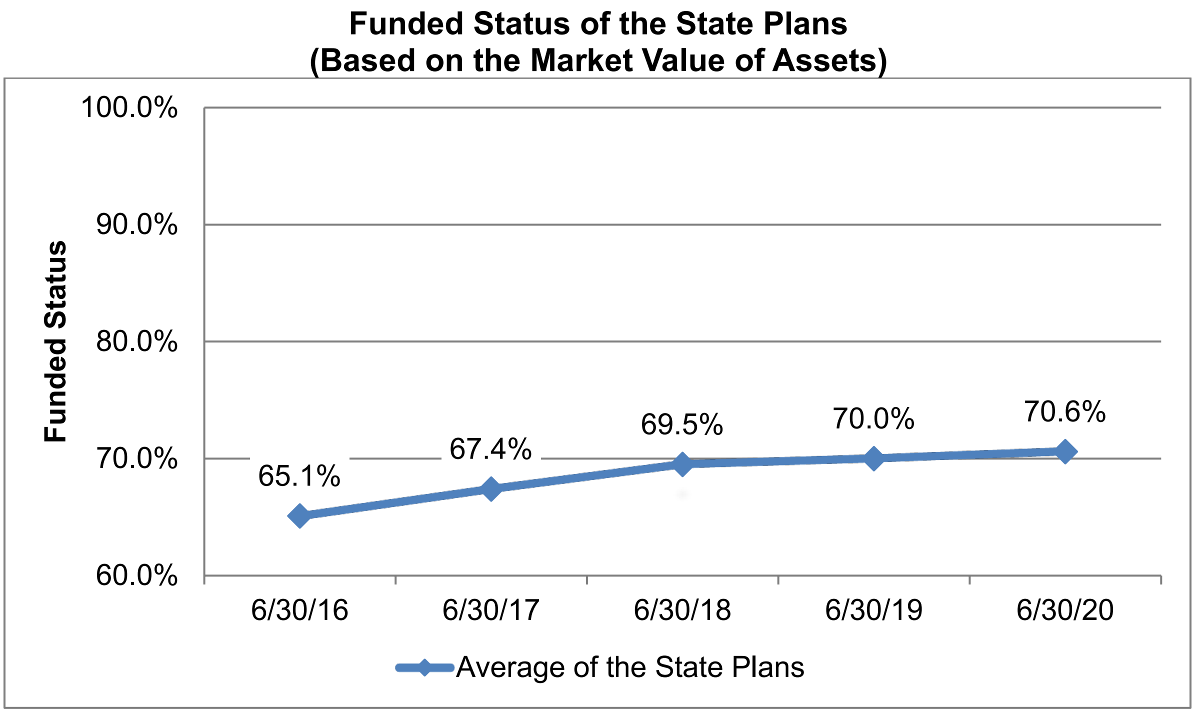
The funded status of a pension plan is defined as the ratio of assets to accrued liability. Plans with a lower funded ratio are, all other things equal, at greater risk of not being able to meet their future benefit obligations. From June 30, 2019 to June 30, 2020 the funded status of the State plans, in aggregate, increased slightly by 0.6% primarily due to the $2.5 billion additional contribution from the State offset by lower than expected investment return in fiscal year 2019-20.

Supplemental contributions to the State plans of $2.5 billion pursuant to Senate Bill 90 were received in July 2019 and therefore they have been reflected in the funded status as of June 30, 2020.

2 Reflects reduction for the supplanting payments associated with the State's additional contribution in July 2019. See "Additional State Contribution" for more information.

3 Excludes additional contributions pursuant to Government Code Section 20683.2. See page 7 of the agenda item for more information about that requirement.

The graph below shows the average funded status for the past five years for the State plans.



Please refer to attachment 2 for the funded status of each plan on June 30, 2020 as well as the preceding four years.

Reasons for Changes in Employer Contributions for the State Plans

Overall, the required contributions for the State plans increased by $160.0 million from $6,491.0 million in fiscal year 2020-21 to $6,651.0 million for fiscal year 2021-22. This change is driven by the factors listed below.

Reason for Change	Change in Required Contribution (in millions)
Required employer contribution in fiscal year 2020-21	$6,491.0
Change due to normal progression of existing amortization bases	333.6
Change due to increase in overall payroll	118.0
Decrease in Normal Cost due to new demographics	(52.1)
Decrease due to additional allocation of Section 20825.1 contributions	(404.5)
First installment of the 20-year amortization of the following sources of experience gains and losses:	
• Investment experience (reflects five-year ramp)	83.7
• Greater than expected contributions received due to higher than expected payroll	(36.1)
• Demographic experience	117.4
Total change in required contributions	160.0
Required employer contribution in fiscal year 2021-22	$6,651.0

Overall, payroll across the State plans increased by 4.6%, compared to the payroll growth assumption of 2.75% in fiscal year 2019-20. This led to an increase of $118.0 million in the required contribution. The payroll growth for the year ranges from 1.7% increase for California Highway Patrol to 5.8% increase for State Peace Officers & Firefighters.

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 47% of active members (41% by payroll) for State Safety to a low of 22% of active members (19% by payroll) for California Highway Patrol.

The return on plan assets for the year ending June 30, 2020 was approximately 4.7% before reduction for administrative expenses. Since the net return for the year is lower than the assumed return of 7.0%, an investment experience loss, amortized over 20 years with a five-year ramp up, was added to the amortization schedule.

The employer contribution rates set by this valuation reflect statutory changes to member contribution rates effective July 1, 2021. There are currently no proposed changes to member contribution rates for the 2021-22 fiscal year. See "Member Contribution Rates" below for more information. Notably, members in State Bargaining Unit 5 employed by the California Highway Patrol agreed to 50% of normal cost sharing effective July 1, 2020. However, this agreement was suspended due to the COVID-19 pandemic.

The plans in aggregate experienced a non-investment loss due to demographic sources offset by a gain due to actual contributions being greater than expected. The net effect was a non-investment experience loss that will be amortized over 20 years beginning in 2021-22.

Additional Contribution Pursuant to Government Code Section 20683.2

One of the provisions of pension reform added Government Code Section 20683.2, which changed the contribution rates of many State members effective July 1, 2013, July 1, 2014, or July 1, 2015. Government Code Section 20683.2 also stipulates that "savings realized by the state employer as a result of the employee contribution rate increases required by this section shall be allocated to any unfunded liability, subject to appropriation in the annual Budget Act." Under the California Constitution, the board has plenary authority over the actuarial function at CalPERS consistent with the fiduciary duties of a trustee. This includes authority to set employer contribution rates. By statute, the State may pay additional contributions in addition to the actuarially determined required contribution rates set by the board and CalPERS will generally accept these payments.

The table below shows the:

- Actuarially required contributions (the rates that the team is recommending the board set for the State plans),
- Additional contributions that the State is to make to offset the savings due to the increased member contributions, and
- Total contributions that the State is to make for each plan.

Plan	Actuarially Required Employer Contribution for 2021-22	Additional Statutory Contribution to Offset Increased Member Contributions	Total Contribution for 2021-22
State Miscellaneous	29.18%	0.10%	29.28%
State Industrial	16.46%	0.88%	17.34%
State Safety	18.29%	1.18%	19.47%
State Peace Officers & Firefighters	31.19%	1.65%	32.84%
California Highway Patrol	62.39%	1.32%	63.71%

In all cases, the savings are less than the actual increase in member contributions. This is because the additional member contributions increase the value of the benefit in some circumstances. One example is when a member terminates and takes a refund. Another example is Tier 2 members, who are assumed to elect to receive a Tier 1 benefit with an actuarial equivalent reduction to offset the missed Tier 1 contributions. Because the members will make additional contributions, a smaller reduction will apply in the future.

Please refer to Attachment 1 for the dollar contributions that the additional statutory contribution rates are expected to generate.

Member Contribution Rates

PEPRA members are required to contribute at least 50% of the total annual normal cost of their pension benefit. As per Government Code Section 7522.30, State employees are excluded from this requirement except for employees of the Legislature, California State University (CSU), and the judicial branch. A provision of PEPRA states that when the total normal cost changes by more than 1% of payroll the member contribution rate must be adjusted to ensure the member pays half the normal cost.

For fiscal year 2021-22, the total normal cost rates for PEPRA members in the State Miscellaneous and State Peace Officers & Firefighters plans changed by less than 1% of payroll from the base total normal cost rates. As a result, the member contribution rates for these PEPRA members will not change in fiscal year 2021-22. Note that, as there are currently no PEPRA members of State Industrial, State Safety, or the California Highway Patrol who pay 50% of normal cost, these calculations are not required for those plans.

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 Unit 16 are required to contribute 50% of the total annual normal cost of their pension benefit. While the overall concept is analogous to PEPRA normal cost sharing, the specific rules governing the change in member rates differ by Bargaining Unit. There is no change in member contribution rates for fiscal year 2021-22.

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

Expected Future Changes

The following table illustrates projected employer contribution rates. Projected rates assume all actuarial assumptions will be realized, including the investment return of 7.00% in fiscal year beginning 2020-21, and that no changes to assumptions, methods, or benefits will occur during the projection period. The projected rates further reflect known member rate changes in the future and the estimated decrease in normal cost due to new hires entering lower benefit formulas under PEPRA. Projected rates also reflect the contributions of $25 million and $243 million to the California Highway Patrol plan in August 2020.

Rates do not include the additional contributions pursuant to Government Code Section 20683.2 shown on page 7 of this agenda item.

		Projected Employer Contribution Rates				
Plan	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26**	**2026-27**
State Miscellaneous	29.18%	33.0%	33.7%	33.1%	33.2%	33.1%
State Industrial	16.46%	22.5%	22.7%	21.3%	21.2%	21.1%
State Safety	18.29%	22.5%	22.1%	22.1%	22.2%	21.9%
State Peace Officers & Firefighters	31.19%	50.9%	51.9%	50.8%	51.0%	50.6%
California Highway Patrol	62.39%	63.3%	62.4%	61.6%	61.9%	59.3%

Note that fiscal year 2021-22 is the final year in which the employer rate is reduced on account of the State’s additional payment under Section 20825.1. As a result, the rate for fiscal year 2022-23 will increase in relative terms.

The actual investment return for fiscal year 2020-21 was not known at the time this agenda item was prepared. The projections above assume the investment return for fiscal year beginning 2020-21 would be 7.00%. ***If the actual investment returns differ from 7.00%, the actual contribution requirements for the 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 fiscal year 2020-21. 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 Status

Attachment 3 – Normal Cost Chart

Attachment 4 – PEPRA Member Contribution Rates

Attachment 5 – Member Contribution Rates for State Bargaining Unit 16

Attachment 6 – PowerPoint Presentation

Nina Ramsey
Associate Pension Actuary

Shelly Chu
Senior Pension Actuary

Eddie W. Lee
Senior Pension Actuary

Scott Terando
Chief Actuary