MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

FINANCE & ADMINISTRATION COMMITTEE

CALPERS AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

TUESDAY, NOVEMBER 16, 2021

9:02 A.M.

JAMES F. PETERS, CSR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

APPEARANCES

COMMITTEE MEMBERS:

David Miller, Chairperson

Theresa Taylor, Vice Chairperson

Henry Jones

Fiona Ma, represented by Frank Ruffino

Lisa Middleton

Ramon Rubalcava

BOARD MEMBERS:

Margaret Brown

Rob Feckner

Eraina Ortega

Betty Yee, represented by Lynn Paquin

STAFF:

Marcie Frost, Chief Executive Officer

Michael Cohen, Chief Financial Officer

Matthew Jacobs, General Counsel

Don Moulds, Chief Health Director

Scott Terando, Chief Actuary

Randy Dziubek, Deputy Chief Actuary

Kelly Fox, Chief, Stakeholder Relations

Jennifer Harris, Chief, Financial Planning, Policy & Budgeting Division

Pam Hopper, Committee Secretary

APPEARANCES CONTINUED

STAFF:

Michele Nix, Controller

Emily Zhong, Supervising Health Actuary

ALSO PRESENT:

Brian Whitworth, Hilltop Securities

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PROCEEDINGS

CHAIRPERSON MILLER: Hello. Good morning, everybody. This will be the Finance and Administration Committee meeting. I'd like to call things to order. And just please be aware that this meeting is being transcribed by our court reporter who is remote. So they'll be doing it remotely today, but it will be transcribed.

So good to see everyone. And our first order of business is the call to order and roll call.

Ms. Hopper, please.

COMMITTEE SECRETARY HOPPER: David Miller?

CHAIRPERSON MILLER: Here.

COMMITTEE SECRETARY HOPPER: Henry Jones?

COMMITTEE MEMBER JONES: Here.

COMMITTEE SECRETARY HOPPER: Frank Ruffino for Fiona Ma?

ACTING COMMITTEE MEMBER RUFFINO: Present.

COMMITTEE SECRETARY HOPPER: Lisa Middleton?

COMMITTEE MEMBER MIDDLETON: Present

COMMITTEE SECRETARY HOPPER: Stacie Olivares?

CHAIRPERSON MILLER: She's excused.

COMMITTEE SECRETARY HOPPER: Ramon Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Present.

COMMITTEE SECRETARY HOPPER: Theresa Taylor?

VICE CHAIRPERSON TAYLOR: Here.

COMMITTEE SECRETARY HOPPER: Mr. Chair, Committee members are in attendance with the excused of Stacie Olivares.

CHAIRPERSON MILLER: Okay. Thank you, Ms. Hopper.

On to Item 2, approval of the November 16th, 2021 Finance and Administration Committee timed agenda. What's the pleasure of the Committee?

VICE CHAIRPERSON TAYLOR: Move approval.

CHAIRPERSON MILLER: Moved by Ms. Taylor.

COMMITTEE MEMBER JONES: Second

CHAIRPERSON MILLER: Seconded by President Jones.

Okay. I'll call for the question. Ms. Hopper, all in favor, do have to do this with electronic or can we just voice.

COMMITTEE SECRETARY HOPPER: Voice.

CHAIRPERSON MILLER: Okay. All in favor?

(Ayes.)

CHAIRPERSON MILLER: Any nays?

Hearing none.

Any abstentions?

Hearing none. The ayes have it.

Okay. We'll move on to the executive report.

CHIEF FINANCIAL OFFICER COHEN: Thank you, Mr.

Chair. Michael Cohen with the Financial Office. It's good to see everybody. This morning's Committee agenda has three substantive action items, the financial statements, the mid-year budget report, as well as the second reading of the Experience Study.

The Experience Study marks the end of the asset liability management decision-making process before we move into the implementation stages, based on yesterday's decision. As you heard from the public, we have been doing a large amount of stakeholder outreach. We will continue to do that. We've got one more webinar scheduled between now and the end of the month to sort of do a wrap-up in terms of the decisions you've made, as well as what the next steps are in terms of the timeline.

So with that, I will turn it back to you.

CHAIRPERSON MILLER: Okay. Thank you, Mr. Cohen.

At this point, we'll be taking public comments. And let me check in and see whether we have anyone queued up? Okay. It looks like we don't have anyone on the phone or in person for public comment.

So we'll move to action consent items. What's the pleasure?

VICE CHAIRPERSON TAYLOR: Move approval.

CHAIRPERSON MILLER: Moved by Ms. Taylor.

COMMITTEE MEMBER JONES: Second.

CHAIRPERSON MILLER: Second by President Jones.
Okay. I'll call for the question.
All in favor?
(Ayes.)
CHAIRPERSON MILLER: Any nays?
Any abstentions?
The ayes have it.
Going to our information consent items. I don't have any requests to pull anything.
BOARD MEMBER BROWN: Mr. Chair.
CHAIRPERSON MILLER: Oh, Ms. Brown.
BOARD MEMBER BROWN: I'd like to pull Item 6c.
CHAIRPERSON MILLER: Let me get your mic on here.
BOARD MEMBER BROWN: I'd like to pull item 6c, the semiannual health plan financial report.
CHAIRPERSON MILLER: Okay. I'm not seeing any others, so let's move to 6c, the semiannual health plan financial report.
Mr. Cohen.
CHIEF FINANCIAL OFFICER COHEN: Sure. Are there particular questions or did you want the actuarial team to make a presentation for you?
BOARD MEMBER BROWN: I'd like a presentation on it and I do have a specific question about health care subaccounts. And I don't want to get in trouble by

revealing anything that was discussed in closed sessions, but I did have a concern about what the financial restrictions are on those health care subaccounts that money cannot be moved from one subaccount to another. And I just want to get that on the record and clear and have the -- you tell us that that is true.

CHIEF FINANCIAL OFFICER COHEN: Sure. This is the report prepared jointly between our Actuarial Office and our Health Office. So let me see if -- Don you want to come up and...

And while they're coming up, this is a regular report that we provide to the Board that sort of provides the financial information on the PPOs as part of our system. So it's a subset of our health providers.

BOARD MEMBER BROWN: I'm using this as an opportunity to discuss a concern I raised in closed session. But since those negotiations have been -- and the prices have been set for health care, I thought it was appropriate. Unless Mr. Jacobs says it's inappropriate, I'd like just a discussion. And I think it's more on your side of the house, Mr. Cohen, as the CFO, to talk about what happens with those accounting in those subaccounts. I just want to be clear about what happens with those.

CHIEF HEALTH DIRECTOR MOULDS: So if there's a question in there, we're happy to answer it. It sounded like you had a particular concern so maybe we could start with that.

BOARD MEMBER BROWN: Sure. And I don't want to mention necessarily the plans, but initially when we were doing discussions, there was some -- one of the options was to move money between the subaccounts. And there was a question, not just mine, but a couple other people raised about whether or not you could move those funds. And my accounting background tells me that subaccounts they cannot -- money cannot be transferred between them. And I just want to get that on the record that that is true.

CHIEF HEALTH DIRECTOR MOULDS: So I will say as a general matter of policy, we tend not to -- we don't transfer money across subaccounts. The legal area, and Mr. Jacobs can jump in if he wants to, but is -- it's a complicated matter. I think there are a couple of different views about how the restrictions fall. It's a fairly technical matter related to PEMHCA, but we try to maintain the integrity of the subaccounts.

BOARD MEMBER BROWN: And the reason we have those subaccounts?

CHIEF HEALTH DIRECTOR MOULDS: Subaccounts, I can -- Emily, do want to go into detail, but subaccounts are there essentially -- so the primary reason for the subaccounts is that -- is that we flex fund most of our -- most of our health plan accounts, which means that we pre-negotiate overhead, and if there is overhead that comes back, because the plan has brought in more money and profit, or charged us more overhead, that money reverts back to CalPERS and CalPERS uses that to buy down the cost of future health premiums.

SUPERVISING HEALTH ACTUARY ZHONG: Hello. Good morning. I just want to make sure my mic is on.

Just a little bit more on Don, the subaccount's main purpose, it just basically is really general accounting practice, right. So we use the subaccount to collected premium on really high level. I know -- it's -- the things it's much more complicated than there. We have a CRS, we have ACF and basically just collect premium and hold in account to pay for capitation and fee for service. Just like what Don just mentioned, depend on -- depending on the plan, we have flex funded -- flex funding mechanism and we have fully ensured depending on the plan. So the arrangement depending from plan to plan, the way we collect, we pay out claim and do reconciliation based on the funding mechanisms.

And also as a part of Reserve Policy the Board approved in 2018, so depending how much we collect and how much we pay out. So for our PPO plans, any surplus or deficits, we do have a policy to use those funds, either bring down the premium or put a surcharge on the premium, if the fund go below a certain level.

BOARD MEMBER BROWN: Thank you. And my concern was there was a subaccount that had a huge surplus, but they were still getting charged a surcharge -- the members were being charged a surcharge, because of the risk adjustment thing that we were doing, right. So I'm just wondering how that money goes back to the members who paid it, because it was a lot of money and I don't remember which plan it was. One starts with a -- what is that?

SUPERVISING HEALTH ACTUARY ZHONG: Like risk adjustments that the premium increase or decrease based on risk adjustment is not too related to the subaccount, because from the subaccount perspective, the premium we put into the subaccount -- there are a lot of accounting exercise there. The money we donate to the subaccount, those are the unadjusted amount. So the money we pay out, the capitation and fee-for-service, those are the unadjusted amounts. So those are totally reflecting the risk of the population, the -- for the really, really high levels a long story short, the entire exercise of the risk adjustment, it says we change the way we collect premium.

BOARD MEMBER BROWN: Okay. Than you. I just want to make sure that we do full GAAP and that we keep the subaccounts whole and clean, because people who pay those premiums and pay in for the service should get, I believe, a reduction, if, in fact, the health care provider is saving money on costs. So I appreciate that.

And can tell me your name. You didn't tell me your name.

SUPERVISING HEALTH ACTUARY ZHONG: Oh, Emily Zhong. I'm the Supervising Health Actuary here in CalPERS.

BOARD MEMBER BROWN: All right. Thank you.

CHAIRPERSON MILLER: Yeah. Don, could -- let's, could you clarify and speak to the surplus versus the fees -- the risk adjustment the surplus fees. So I wasn't clear exactly what that -- the question was from Ms. Brown and how those relate to each other.

SUPERVISING HEALTH ACTUARY ZHONG: Just a little more detail and specific, for the subaccount, like it's all about money in and money out, right? So we do design a totally different funding mechanism to take care of the premium we collect, which is the risk-adjusted premium. We transfer to the unadjusted premium before we dump into the account. So we design transfer phase, like so all the money it just like a big pot. That's what we decide when we do the risk adjustments. So we make sure the money we collect and the claim we pay out are equivalent by projection. So --

CHIEF HEALTH DIRECTOR MOULDS: So in a nutshell, the money that comes in in premium does not go out in the same month always, because people need health care over the course of the year. So the subaccounts exist, so that we can accrue the premium dollars to use to pay out -- to pay out health benefits.

At the end of the year, we do a reconciliation, that because of flex funding, results in dollars coming back frequently to CalPERS, but it's not -- it's not -- the flow does not happen simultaneously, which is why the accounts exist.

CHAIRPERSON MILLER: Yeah, that's very helpful. It all gets reconciled, but not all at one time in the course of the year.

CHIEF HEALTH DIRECTOR MOULDS: Correct.

CHAIRPERSON MILLER: Great. Thank you.

Ms. Brown, was there anything else?

BOARD MEMBER BROWN: Okay. Thank you.

CHAIRPERSON MILLER: Mr. Rubalcava,

COMMITTEE MEMBER RUBALCAVA: Yeah. Thank you, Mr. Chair.

CHAIRPERSON MILLER: Yeah. Let me make sure the mic goes on.

COMMITTEE MEMBER RUBALCAVA: Thank you. I just want to follow up. In reviewing the semiannual plan financial report, I noticed the memo speaks to -- explains flex funding. And one thing that I think just took a little bit more detail to just clarify things, because it is flex funded, that means the health plan pays capitated portion and CalPERS pays the fee-for-service portion. So that's why mixing -- we have an incentive to make sure that carriers pay -- have more capitation than say fee-for-service contractors, providers. And so -- but one thing that I think should be explained is what also goes in -- while -- the reason we also have the reserves, the -- what do you recall it? The -- let me use my -- I took my notes last night. What it's called, the deficit -- or the actuary reserve, because sometimes isn't there like claims that haven't come in yet and have to be paid? And isn't that one of the big reasons we need the reserve also?

SUPERVISING HEALTH ACTUARY ZHONG: Yeah. Over here I want to do a little more clarification. The flex funded arrangement only for the HMO plans. And the reserve we are talking about is typically for the PPO plans. So our reserve include a different part. The big part -- so maybe 30, 40 percent, this is the IBNR, which is incurred but not paid claims reserve.

COMMITTEE MEMBER RUBALCAVA: That's it.

SUPERVISING HEALTH ACTUARY ZHONG: And we have about 50 percent of the reserve that's the RBC, which is the risk based capital. So this is -- again, this is for our self-funded PPO. For HMO, we don't have that part of the reserve.

COMMITTEE MEMBER RUBALCAVA: Got it.

SUPERVISING HEALTH ACTUARY ZHONG: We only have the IBNR for the fee-for-service unpaid claim.

COMMITTEE MEMBER RUBALCAVA: Thank you for the clarification. Thank you, Mr. Miller.

CHAIRPERSON MILLER: Thank you.

I think that covers it for Item 6.

So we'll go on to 7, our action agenda items. And the first one is 7a, our basic financial statements. I'll come back to Mr. Cohen.

CHIEF FINANCIAL OFFICER COHEN: Thank you, Mr. Chair. I'll turn it over to our Controller Michele Nix in second. But just a reminder, this is the annual financial statements. You'll hear from your independent auditor BDO this afternoon in the Risk and Audit Committee. But let me have Michele walk you through the presentation.

CONTROLLER NIX: Okay. Great. Good morning, Mr. Chair and members of the Committee. Can you hear me? Is it projecting? Just checking.

I'm Michele Nix, CalPERS Controller and team member. Today, I would like to present a few highlights from the basic financial statements for the year-ending June 30th, 2021. The statements will be incorporated into an annual comprehensive financial report upon your approval. The first group of highlights that I have for the basic financial statements are that the -- we ended the fiscal year with PERF having total net assets of 477.3 billion.

The annual money-weighted rate of return was 22.4 percent resulting from positive performance across most globally diversified asset classes. Drivers of the PERF's investment return include strong performances in both public and private equity.

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CONTROLLER NIX: Okay. The investment return is comparable, as you can see here, between the time-weighted and the money-weighted rate of return. The time-weighted rate of return was 21.3 percent, which is the one that you her about a lot. And then the money-weighted return -- weighted rate of return was 22.4 percent at June 30th, 2021. I want to remind you that the money-weighted rate of return is the accounting-weighted return.

Next slide, please

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CONTROLLER NIX: So a little more on that. This slide defines the way we measure those rates of return. It shows -- it talks about the differences between the money-weighted rate of return and the time-weighted rate of return. I think it's important to just bring this up, because it gets a little confusing. The time-weighted rate of return measures the compounded growth rate over period -- over the period being measured while eliminating the distorting effects of inflows and outflows of cash, which would -- we would consider when money was added or withdrawn from the fund.

Another way of saying this is the time-weighted rate of return is weighted heavier to time. So transactions that are older will matter more to performance than those transactions that are younger. Time-weighted rate of return is the reporting standard for investment performance.

The money-weighted rate of return, on the other hand, is adjusted for cash flows and changing amounts that come in on a daily basis. Another way of saying this is the money-weighted rate of return is heavier weighted to money. So those transactions that are larger in value will matter more to the performance than those transactions that are smaller in value. Money-weighted rate of return is the GASB reporting standard.

Next slide, please.

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CONTROLLER NIX: PERF net position. The net positioning increased by $84.9 billion, or 21.6 percent, from 392.5 billion as of June 30th, 2020 to 477.3 billion as of June 30th, 2021. Over the 10-year period, the net position increased $240.3 billion, or 101.4 percent.

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CONTROLLER NIX: Some of the reasons for this change in net position are additions to PERF's net position, which include net investment income, contributions -- and contributions from employers, and also from members. Investment income is comprised of interest income, dividend income, and net appreciation, or depreciation of the fair value of those investments.

Gross investment income, including securities -- net securities income was 89.2 billion in fiscal year 20-21 compared to 19.6 billion in fiscal year 20 -- 2019-20. This is due to significantly higher investment returns over the last current fiscal year.

Although employer contribution -- contributions increased between 0.1 and 4 percent on average, employer and non-employer contributions received at CalPERS decreased by $2.9 billion, or 12.7 percent. Member contributions decreased 0.1 billion, or 2.9 percent, as a result of the reduction of the member compensation that was due to -- that was due to the projected State revenue shortfalls as a result of COVID last year. So that -- the furlough pay cut affected it a little bit.

Deductions from PERF are comparable -- are comprised of benefit payments, refunds of contributions to members and beneficiaries, and costs of administering their PERF. Benefit payments are the primary expense of our retirement system.

For fiscal year 20-21, retirement, death, and survivor benefits increased $1.6 billion, or 6.3 percent, primarily due to cost of living increases in the benefit payments.

There was an increase in the number of retirees and beneficiaries as well. It went from 732,000 to approximately 750,000 at June 30th, 2020, so we're at 2.5 increase in membership.

Slide seven, please.

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CONTROLLER NIX: As mentioned in slide six, investment income is made up of net appreciation and depreciation of investments, as well as interest income and dividend income. As the chart shows, and I alluded to earlier, public equity and private equity had the largest gains for this fiscal year.

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CONTROLLER NIX: The unfunded actuarial liability, the excess of the total accrual of the liability of the market value of assets was -- accrued liability over the market value of assets was 163.3 billion at June 30th, 2020. And as you recall, the actuarial valuations are a year behind, so that's why we're reporting that here.

The increase in unfunded actuarial liability over the 10-year period is primarily due to changes in actuarial assumptions, such as the discount rate and the mortality assumptions. Additionally, the unfunded actuarial liability amortization payments were less than interest on the UAL, in many cases.

Slide nine, please.

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CONTROLLER NIX: This slide shows the benefit payments and the contributions. So in the last fiscal year, 24.8 billion was received in contributions, while 27.4 billion was paid in benefits. Contributions decreased 11 percent from last year, primarily due to pandemic responses of the salary reduction impacts to contributions.

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CONTROLLER NIX: Okay. I'm going to ask for questions, but I want to acknowledge that these financial statements, as well as the annual financial report, are a result of many hours of hard work from FRAS team members who prepared these reports within the normal deadlines, even though we had the challenges that COVID has posed. So I want to thank the team for that.

And that ends my presentation. Upon approval of these financial statements - this is an action item - they will be included in the annual comprehensive financial report at the end of this -- for this year. I'm happy to take questions, if you have them.

CHAIRPERSON MILLER: Great. Thank you for the presentation and for the fine work of the team. We really appreciate it. We know how challenging this year has been for everyone. So I do have a number of questions --

CONTROLLER NIX: Okay.

CHAIRPERSON MILLER: -- starting with Ms. Brown.

BOARD MEMBER BROWN: Do you want me to wait for the rest of the Committee to go first, members of the Committee or do you want me to go first?

CHAIRPERSON MILLER: Oh. Okay. Let's see.

BOARD MEMBER BROWN: I'll go. If you go back to page six on the presentation. I wanted to say I do appreciate information. Thank you very much. I know financials for an organization this size is challenging. And what I'm focused right now on administrative and investment expenses. And what I was wondering if -- you know, I'm looking at the year over year admin expenses have changed, either decreased or increased, as well as investment expenses. So are the employees who work in the Investment Office, are those charged to admin or are those charged to investment expense?

CONTROLLER NIX: They're charged at admin -- both.

BOARD MEMBER BROWN: They are both, yeah.

CONTROLLER NIX: The investment admin expenses.

BOARD MEMBER BROWN: So do you break them out separately.

CONTROLLER NIX: For this chart, we did not, but yes we have in the -- in the annual financial report they are broken out.

BOARD MEMBER BROWN: It would be helpful just to see how we are controlling costs. Yesterday, at the Investment Committee, we heard from a number of stakeholders who want us to control costs. And I think our admin costs went down last year. That's my recollection from previous conversations. But I think that would be a really good graph especially, if it's good news, right, that we -- that we plot that out. And then the other thing is investment expense, is that the money we pay to our consultants for fees, or is that -- is that --

CONTROLLER NIX: Investment expenses are all the investments expenses. So it could be fees for investments. It could be salary of the team. It could be consulting expenses. It's just everything that is related to investments.

CHIEF FINANCIAL OFFICER COHEN: But let me -- before you continue, if I could. Just sort of clearly the -- one of the large drivers of the cost reduction was the personal level program, the furloughs that our entire team experienced. So that was roughly a nine percent reduction in pay for the internal staff.

That being said, the Investment Office has been focused on reducing their overall costs, bringing things in house when they can -- you know, can do it more efficiently. But they've also been truing their team when they have a vacant position and feel that they no longer needed it. So you'll recall we had some longer customer service wait times than we desired about a year ago. The Investment Office was able to offer up a number of vacant positions to provide to our customer service center, and that's one of the ways that we've been reducing costs, in addition to focus on the external fees.

BOARD MEMBER BROWN: Great. Thank you for that.

And then I do have a question about the valuation of the assets overall that get us to our net position. And maybe this is more for Risk and Audit, but I'll ask it here and you can tell me if it needs to go Risk and Audit. And that is you talked about that all assets are valued as of June 30th. And so I want to make that -- is that the same for private equity or any real estate assets that lag or is that -- or are we using a March 30th valuation for those?

CONTROLLER NIX: It depends. So when we strike the -- create the balance sheet and income statement or the net position at the end of the year, we actually have the March numbers in there. But before we finalize it, we always consider the information through June 30th. So we would receive that in September, which we get those reports. And if they are significant, or if they've changed, or if they're significant enough of a change from those March numbers, then we will go ahead and put the interest through, which we did this year.

BOARD MEMBER BROWN: Right. So I want to make sure that there are notes in the financial statement that show that, because it feels like I don't know what four quarters you're using for private equity or for real assets, right? Are you using July 1 to June 30th, because you've adjusted it, because the number was significant or are you using -- so I want to make sure you're not counting five quarters versus four quarters, right?

So in this current report, which quarters are using for private equity and real assets? Did you have to make an adjustment? I think you said yes.

CONTROLLER NIX: Yes. We made the adjust, because it was -- I believe it was around $6 billion. It was significant. I know that I --

BOARD MEMBER BROWN: So you used July 1 to June 30?

CONTROLLER NIX: Yes.

BOARD MEMBER BROWN: Okay. And you would never use five quarters, is that correct?

CONTROLLER NIX: No, that's correct.

BOARD MEMBER BROWN: All right. So just so you know, it's a -- it's a little confusing which quarters you're using. And I would suggest that we -- that we always use July 1 to June 30 and make the adjustment, even if it's not significant, because that way you're using the same time period for all assets. That's a suggestion. I don't know what the auditors would say, but otherwise it's confusing whether or not -- what happens is I think last year's numbers, because you ended up putting the increase of five hundred and eighty something thousand dollars in the next year, I think it pumped up the return numbers, because it really belonged in the prior year. So it's -- it's -- I think it's problematic when it comes to incentives that our staff receives, if we're not basing it all on the same four quarters.

CHIEF FINANCIAL OFFICER COHEN: You'll recall that we did circulate a memo on this several months ago. And let me just state for the record that the investment incentives have absolutely no connection to this accounting adjustment, that the accounting adjustment comes after --

BOARD MEMBER BROWN: The incentives are paid.

CHIEF FINANCIAL OFFICER COHEN: -- the incentives are paid. So it -- the investment incentives are always paid on the same basis and there's no adjustment that affects them in the accounting world.

Also, the other point I would remind you of, and you're welcome to ask BDO about this in Risk and Audit is they sort of came to the Committee and said they were comfortable with our process. And certainly it's something that they pay attention to as you do each year, but they have stated publicly that they're comfortable with the process we use for these adjustments.

BOARD MEMBER BROWN: It is just confusing that sometimes we're using the assets valued as of March 31 and sometimes we're using the assets valued as of June 30th, depending upon how big the adjustment is, and that's problematic

CONTROLLER NIX: I also want to point out that for performance for the investment incentives, we use the time-weighted rate of return, not the money-weighted rate of return. So we would always cut that off with the March 31st information.

BOARD MEMBER BROWN: So it's March 31 for that.

CONTROLLER NIX: It's calculated before the financials are even completed.

BOARD MEMBER BROWN: I'm wondering, is there -- is there a reason why we don't wait until the financials are completed before we pay out the investment incentives?

CONTROLLER NIX: I think it's a matter timing, but that's just my guess, because it predates me.

CHIEF FINANCIAL OFFICER COHEN: Yeah. I mean, I think that's right that the incentive payments are for the prior fiscal year, so waiting till now to start calculating them to where the payments wouldn't come until six months after the financial -- the fiscal year is over, I think is -- it's somewhat problematic from an employment standpoint.

BOARD MEMBER BROWN: It would be a Holiday bonus. All right. Thank you.

CHAIRPERSON MILLER: Okay. Next, I have Mr. Jones.

COMMITTEE MEMBER JONES: Thank you, Mr. Chair. Yeah. Thank you for the report very concise. Just before I ask my question just going back to Ms. Brown's comment about always including the adjustment for the last quarter, those -- that information doesn't always come in at the same time, is that correct?

CONTROLLER NIX: That's correct. Well, it always comes in in September at some point, but we have to get it from various different managers, and reconcile it, and review it. So it takes a little bit of time and that's pretty close to the time that we're trying to finalize things.

COMMITTEE MEMBER JONES: Okay. Okay. Thank you.

When I speak to the public in -- at many conferences, I use this how much we pay out every year for our retirees. And I notice in here you have 27.7 billion. And then you went on to explain that about 1.6 billion of that was related to death. So what number on our website that I use, does it include the death or is it just the retirement benefits?

CONTROLLER NIX: It's broken out in the financial statements and I can -- I can provide that to you afterwards --

COMMITTEE MEMBER JONES: Okay.

CONTROLLER NIX: -- because I want to point where it's at in the annual financial report.

COMMITTEE MEMBER JONES: Yeah, because in our website, I use that number and I just want to know what I'm --

CONTROLLER NIX: Let me -- let me find the page numbers and you give you the line item --

COMMITTEE MEMBER JONES: Okay. Okay. Yeah.

CONTROLLER NIX: -- so that you have a specific on that.

COMMITTEE MEMBER JONES: Yeah, because that's a question that I normally get when I'm trying to update the public, so it would be helpful.

CONTROLLER NIX: Be happy to do that.

COMMITTEE MEMBER JONES: The other thing is that I notice you use the term annual financial report rather than comprehensive financial, would you just explain why the name change?

CONTROLLER NIX: Absolutely. It's actually officially now the annual comprehensive financial report. The term CAFR is considered a derogatory term in Africa and some of the international countries. And so the regulatory agencies, the GASB and the GFOA have determined that that is inappropriate to use that term. So we went ahead and early implemented it, so that we could, you know, support our inclusiveness and our diversity. The statement will actually come out for GASB this year for everyone to change that name, but we went ahead and did it early --

COMMITTEE MEMBER JONES: Thank you.

CONTROLLER NIX: -- because we thought it was appropriate.

COMMITTEE MEMBER JONES: Thank you

CHAIRPERSON MILLER: Okay. Thank you. Next, I have Ms. Middleton.

COMMITTEE MEMBER MIDDLETON: Okay. Thank you. One of the -- and thank you for all of the work that went into this. I have a good sense of just how hard this is and really appreciate you, the professionalism of the team. One of the numbers that you gave us is that in the course of the year, we went from approximately 730,000 retirees to about 750,000. That seems to be a fairly significant increase in the number of retirees in one year. What information do you have regarding the trend lines, and are they continuing to show that kind of increase in retire -- in number of retirees. And this may be a question for Scott, but at what point does it become actuarially significant that -- in terms of the rate of change of number of retirees.

CHIEF FINANCIAL OFFICER COHEN: Yeah, I definitely know Scott's been tracking this, so you want to pop up here and give the latest information. As it relates to the experience study as he gets settled, I will say that sort of lopped off -- so it will be -- any change will get captured in the next experience study four years from now, but I'm going to have Scott talk about the latest data he's seen.

CHIEF ACTUARY TERANDO: Yeah. So in terms of recent experience, if -- when we did our experience study, our experience study reflected data through 6/30/2019. So any of the recent experience going on in terms of additional retirements, and additional debts will be reflected in the next experience study. But as these changes occur for particular plans, if it results in a gain or loss throughout the year, we'll make adjustments in their current rates as -- whether they have additional retirements or not.

I do know there seems -- I think there's higher retirements on the school side. But on the State side, I think it might be possibly a little bit lower. I think if you look overall -- for PERS as a system overall, there's not that much difference from previous years, but I think depending on particular agencies or classifications, that they might be higher or lower on the retirement side.

COMMITTEE MEMBER MIDDLETON: Okay. It's an area that, at least anecdotally, is getting a lot of attention. There's also been some general media attention to increasing number of retirements. To the extent you're able to help supplement some of the stories with more in-depth study of where the increase in retirements are taking place, that could be helpful to those of us who are in the administrative side of issues.

One area that at least we believe we are seeing is in public safety employment, that there has been a significant and concerning increase in the number of retirements and the timing of those retirements.

CHIEF FINANCIAL OFFICER COHEN: We'd be happy to -- I think that's a great idea. We'd be happy to pull together and information --

COMMITTEE MEMBER MIDDLETON: Thank you.

CHIEF FINANCIAL OFFICER COHEN: -- summary of what we know and what we don't know.

COMMITTEE MEMBER MIDDLETON: All right.

CHAIRPERSON MILLER: Okay. Mr. Ruffino. Get your mic on here.

ACTING COMMITTEE MEMBER RUFFINO: Thank you, Mr. Chair. I don't have a question, but I'd like to make a comment regard -- regarding your recent professional award that your office received. This is a Certificate of Achievement for Excellence in Financial Reporting. And the Government Finance Officers Association of the United States and Canada awarded this Certificate of Excellence for Financial Reporting to CalPERS. And what is important to note is that this is your 25th year that CalPERS has achieved this prestigious aware. So a big congratulations not only to Controller Nix and the CFO Cohen, but to the entire financial team out there, who I am sure they've been working really, really hard, the present and past, to ensure that we achieve this level of excellence.

So the Treasurer, Ms. Ma, congratulates you, and your fine work, and your team.

Thank you, Mr. Chair.

CHAIRPERSON MILLER: Thank you. And, yes, a hearty congratulations. Quite an achievement over this sustained --

CHIEF FINANCIAL OFFICER COHEN: Thank you very much. We appreciate the recognition and it is a lot of hard work from Michelle and her team. So I do very little. It's Michele and her team that do all the work, so thank you though.

CHAIRPERSON MILLER: Okay. It doesn't look like I have any questions -- further questions from the

Committee and this is an action item. We will have some public comment before we do any voting, but I would entertain a motion to approve.

COMMITTEE MEMBER JONES: Move approval.

VICE CHAIRPERSON TAYLOR: Second.

CHAIRPERSON MILLER: Moved by President Jones, seconded by Theresa Taylor. And so I will call for the question -- do we have do a electronic vote on this?

VICE CHAIRPERSON TAYLOR: We have to see if we have comment on this.

CHAIRPERSON MILLER: Oh, yeah, that's right. I'm jumping ahead of myself already.

Okay. So any discussion by the Committee?

Anybody else?

And so we'll go to public comments. I have two people I'll call down Cathy Jeppson, and J.J. Jelincic. You can come down here to the two seats on the end.

CHAIRPERSON MILLER: Ms. Jeppson.

MS. JEPPSON: Thank you. Thank for the opportunity to speak this morning. I'd also like to take a point of personal privilege and say I've really missed you all. Those masks are scary, right, but --

(Laughter.)

MS. JEPPSON: -- it's really nice to be not only to see the Board, but also a lot of the staff are here.

And it's really nice to be able to say a few words.

The reason -- and this is something that has bothered me for a while. It's just not these financial statements this morning. But I think that lately CalPERS has been the recipient of a lot of bad publicity, the Board a lot of bad publicity. And I would hate for the Board to do anything that might further that. And what I'm talking about is that I think that you are about to approve draft financial statements that I don't believe you have seen the auditor's report, which is usually buried on the last page of the financial statements. I am CPA active in California.

And so I would be very reluctant to do anything that could come back at the Board. And for that reason, I would insist upon seeing the financial opinion of the auditors. Now this is not to imply that it's not going to come back and it's not going to be clean or unqualified, it's just that there are three other opinions, the qualified, the disclaimer, or worst yet, the adverse opinion. And I would just want to see that besides just the basic financial statements before I voted on them.

And it's great to see you all. Thank you very much.

CHAIRPERSON MILLER: Okay. Thank you.

Mr. Jelincic.

MR. JELINCIC: J.J. Jelincic.

The financial statements purport to be for the fiscal year July 1, '20 to June 30th, '21. The truth of the matter is not all assets are valued as of June 30th, 2021, yet the management which is responsible for the financial statements has chosen to hide that fact. Management chose not to include a footnote disclosing to the readers of the financial statement. It is disclosed in a footnote to a table in the unaudited investment section of the annual comprehensive financial report. But the users of the financial statements should not be required to go look at other documents to understand the financial position of the system.

It is unlikely that the statement of changes and fiduciary net position represents the income for the fiscal year-ended June 30th, if the private asset appreciation for the fourth quarter is not included or if it includes the income from the fourth quarter of the previous fiscal year.

The system can mix and match balance sheet dates and income statements in its financial reporting, but it's required to disclose these deviations from standard accounting. As Cathy pointed out, it's interesting that the Committee is being asked to accept and adopt the financial reports without seeing the auditor's opinion.

That should be troubling, but it is consistent with the mushroom -- the treatment that the Board readily accepts. Attached to this item, but not subject to your approval, is the draft annual comprehensive financial report. The report belongs to management and is actually never officially adopted by the Board. Historically, it has been called the comprehensive annual financial report, a CAFR, and staff has explained why they are changing the name.

But I would encourage you to request that staff index it under both names on the website for the simple reason that if people want to go searching for it or want to make historical comparisons, it would be very helpful if both -- if prior reports and this report all showed up together, either with the same name or at least by indexing.

Thank you.

CHAIRPERSON MILLER: Thank you for your comments.

I don't believe we have any other public comment on this item.

So a question. Mr. Jones.

COMMITTEE MEMBER JONES: Thank you, Mr. Chair. It's not a question. A comment. I just want to make a statement that the Board has received the auditor's report and we have had it a week ago to review it, and I could attest that when we do deal with it, it says, "In our opinion company the accompanying financial statements present fairly -- present fairly in all material respects the respective financial position of the fiduciary activities and the proprietary activities of the California Public Employees's System". So it's not like we are adopting this without that knowledge. So I just wanted to clarify that.

CHAIRPERSON MILLER: Yeah. Thank you for that clarification. Appreciate it.

So at this point, we have a motion on the floor to approve. And I will call for the question.

And is this an electronic vote, Ms. Hopper?

COMMITTEE SECRETARY HOPPER: No.

CHAIRPERSON MILLER: Okay. So all in favor?

(Ayes.)

CHAIRPERSON MILLER: Any nays?

Any abstentions?

The ayes have it. The motion passes.

So we'll move on to Action Item 7b, the 2021 to '22 mid-year budget revision.

Mr. Cohen.

(Thereupon an overhead presentation.)

CHIEF FINANCIAL OFFICER COHEN: Thank you, Mr. Chair. This is another action item. Jennifer Harris, our budget lead will walk you through the presentation. And she'll explain the primary change that's happening is related to collective bargaining costs that were negotiated after you adopted the initial budget in April, but let me turn it over to Jennifer.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Good morning, Mr. Chair and members of the committee. Jennifer Harris with CalPERS Financial Office. This item is an action item and your approval today will revise the funding level for the current 2021-22 fiscal year.

This morning, I'll walk you through the proposed adjustments and also give you a quick report on how we ended last fiscal year.

Next slide, please.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: In total, CalPERS proposes to increase the 2021-22 budget by 8.9 million or 0.5 percent. This includes a 10 million increase in operating costs, offset by a 1.1 million decrease in external fees. The mid-year adjustment is driven by increases in administrative operating costs, which I'll walk you through on the next couple of slides.

Total authorizes positions remain unchanged at

2,843. And this number, if you recall, represents the elimination of 32 vacant positions that we did this time last year.

Next slide, please.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Now, I want to point out that this slide does have an edit. The previous version cited total operating cost changes versus the administrative operating costs. Your Board materials have been updated. There's also updated copies in the back of the room, as well as online.

So administrative operating costs is an area that we made significant reductions in last year to limit the fiscal impacts of the pandemic. While the current year budge that you approved in April continued many of the ongoing reductions that we made, there are some unforeseen expenses that are driving increases at this time. There is a 19.2 million increase in administrative operating costs. And this includes 16.7 million for personal services and two and a half million for OE&E.

It is typical for CalPERS to adjust personal services expenses as mid-year to reflect collective bargaining changes. This year, the adjustment is 14.4 million. And this is for a general salary increase that was effective on July 1st. There is also a two and a half million increase -- or 2.3 million increase for various other personal service adjustments such as workers' comp and some temporary help class changes.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: The two and a half million increase for OE&E represents some unanticipated costs that we didn't know of when we were preparing the budget in April. This includes funds to do mandated weekly COVID tests for team members, to fund the unforeseen public agency Board election that will occur this spring, to contract with some external vendors to obtain additional death notification data to reduce overpayments, as well as funds to increase rates paid for external independent medical exams, to assist with executive searches, and for some anticipated insurance premium increases.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: As detailed on page five, of the mid-year budget, which is included as Attachment 1, you'll also see a number of various small decreases in OE&E line items. These are areas that we looked at to review to see where we could make additional changes in reductions to items that would not impact our core mission. And this helped offset some of those increases that we just talked about.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Two other operating cost areas are investment operating costs and headquarters building fund. These also have budget decreases. The 9.2 million decrease in investment operating costs is driven by technology expenses and the decision to not develop a single investment platform for public asset classes. Rather, CalPERS has decided it will continue to utilize its existing platform and continue to assess data analytics to support those systems.

The minor decrease in headquarters building costs represents a decrease in operating costs resulting from the continued telework environment and there were also some offsets for related building improvements to headquarters buildings, Lincoln Plaza, and less parking revenue. Details of headquarters building costs are on page 11 of the mid-year budget.

Next slide, please.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Overall, we have a 1.1 million reduction in external fees. This includes a 1.2 million in investment external management fees for revised assumptions and projections. Now these were for base fees. Performance fees are not estimated to change at this time.

And finally, the mid-year budget has a $35,000 increase in third-party administrator fees. And this is again an area we typically revise at mid-year. We update our health plan enrollment fees based on new data. And so we're seeing a small decrease there. That decrease is offset by an increase for the Long-Term Care Program for processing fees.

This is the end of the adjustments for the mid-year budget. I'd like to move on now to a quick report of how we ended last year fiscal year.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Next slide, please.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: As shown here and detailed in Attachment 2 of this agenda item, CalPERS ended fiscal year 2020-21 with 48.9 million in unexpended funds. We spent 97 million of the total 1.6 million authorized budget, and that budget did reflect 72.3 million in operating cost reductions that we made last year, the majority of which were in administrative operating costs.

The 48.9 million surplus represents 70. -- 75.7 million in unexpended funds and operating costs, as well as a 26.8 million overage for external fees. And those fees were driven by the deployment of capital in new private equity assets investments and higher than estimated global equity performance.

This is the end of the slide presentation.

Again, Item 7b is an action item requiring your approval to set the revised funding levels for the remaining months of this fiscal year. I welcome your questions on either the mid-year budget or the year-end expenditure report.

Thank you.

CHAIRPERSON MILLER: Yeah. Thank you for the presentation and all the fine work of the team that was -- went into it. I'm not seeing any questions and so I will entertain a move -- a motion to approve.

COMMITTEE MEMBER JONES: Move approval.

CHAIRPERSON MILLER: Move by President Jones.

VICE CHAIRPERSON TAYLOR: Second.

CHAIRPERSON MILLER: Seconded by Ms. Taylor.

So I will have no public comment on this item, so I'll call for the question.

All in favor?

(Ayes.)

CHAIRPERSON MILLER: Any opposed?

No abstentions.

The ayes have it. Motion is approved.

So we move on to action item Agenda Item 7c, the review of PERF actuarial assumptions.

Mr. Terando.

(Thereupon a slide presentation.)

CHIEF ACTUARY TERANDO: Good morning, Mr. Chair. Scott Terando with the Actuarial Office. Item 7c is an action item and seeks the approval of the adoption of the new actuarial assumptions. This material was brought to the Committee in September as an information item and continues our discussion of the ALM results started yesterday there in the Investment Committee.

At this time, I'll pass it to Randy Dziubek who will walk us through the presentation and the results of our experience study.

DEPUTY CHIEF ACTUARY DZIUBEK: Thank you, Scott. Good morning, Mr. Chair, Committee members. I am Randy Dziubek, CalPERS Actuarial team.

As Scott said, we're here to present to you the final recommendations for assumption changes for the PERF, excluding the discount rate assumption, which is generally considered the most important assumption and would normally be part of an experience study, such as this. But because of its importance, of course, we handle that separately. It was discussed at length yesterday in the Investment committee and the decision was made on that, so this discussion is about every other actuarial assumption outside of the discount rate.

What we'd like to do today is to focus on changes that we've made to these recommendations since the September meeting and also just highlight some of the main factors that we did talk about in September.

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DEPUTY CHIEF ACTUARY DZIUBEK: Most of the changes that we are recommending will have what we're calling a modest impact on required contributions. And we'll look at some more detail of those. Now keep in mind, as I said earlier, most of the numbers you'll see in the slide deck refer to the impact of the assumptions outside of the discount rate. The discount rate decision being separate and not part of this analysis was discussed yesterday. Also just for reference, I'll mention that in addition to the impacts that you'll see in this presentation, Attachment 2 of this item does provide additional impacts on employer contribution rates under alternate discount rates. Now, we show 6.8 and 6.5. Of course, 6.8 was selected yesterday.

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DEPUTY CHIEF ACTUARY DZIUBEK: So starting with -- yes, thank you. Starting with the changes since the September meeting, we made a very minor modification to our inflation assumptions since the September meeting. We were originally recommending 2.25 percent for price inflation. We have changed that to 2.3 percent, a very minor change. And that was mostly to be consistent with the long-term assumption that our Investment Office is using in their work with capital market assumptions and expected returns on our portfolios. So this change has minimal -- very minimal impact on required contributions.

In addition to that change, we also were able to make some minor modifications to some termination rates and mortality rates as a result of a comprehensive review done by a third-party actuarial firm that did a comprehensive review of all of our analysis and provided a very full and valuable report. That's also an attachment to this item.

Fortunately, throughout the process, we were in communication with them. And with regard to these two items mentioned here, these termination rates and mortality rates, they were able to give us some comments that we thought were important to work into these rates at this time. They didn't make a tremendous impact on the employer contributions that will come out of our assumption changes, but we -- nonetheless, we were happy to be able to work these into our financial recommendations.

This actuarial firm did have some other, what I would consider, minor recommendations for process improvements that are also in their report. I'm not planning to talk in any detail about those today. We will consider those for the next study. But again, none of those are expected to have a material impact on employer contributions.

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DEPUTY CHIEF ACTUARY DZIUBEK: So we had a question already about increased retirements potentially due to the pandemic. And it's clear that over the last couple years, this system has seen experience in more than one area that differed from our actuarial assumptions. The point we want to make hear today is that, as Scott mentioned, our analysis of recent experience that, for the most part, is the driver for us setting these future assumptions. Did not include data from the pandemic. And we didn't consider that a limitation of the study. In fact, as of right now, we're considering the impacts of the pandemic, while significant in some areas to be transitory. And we do not have evidence at this time to suggest that those impacts would continue on a long-term basis.

So remember every assumption in the actuarial valuation is a long-term assumption that's applied over decades as we project forward benefit values for our membership. So the bottom line is that we did not reflect any impacts of COVID into our future assumptions. However, it is something that needs to be monitored and watched carefully. Should these types of experiences differentials continue over the next year or two, certainly we would more strongly take that into account in setting assumptions at the next experience study.

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DEPUTY CHIEF ACTUARY DZIUBEK: I wanted to talk about inflation just a little bit. We discussed this in the September meeting. And the only change from September until now was changing from two and a quarter to now a recommendation of 0.3 for price inflation. But I think it's worth mentioning why we're recommending a decrease. Our current assumption is 2.5 percent and, of course, we're in the middle of a spike in inflation, as we all know.

And again, similar to my comments on the pandemic, we -- at this point, we do not believe that these types of inflation increases will persist on a long-term basis. And again, since our infla -- our assumption for inflation spans many decades, we continue to believe that it's appropriate to reduce the two and a half assumption to 2.3.

Actual price inflation over the last 10 to 15 years has been running under our two and a half percent assumption. Most economists, investment consultants, experts in this area continue to project long-term inflation at something a little bit lower than two and a half. It is interesting that we're making this decision at a really interesting time with inflation being so high today. And again, it is something that's a bit of a concern that will have to be monitored. But on a long term basis, we are still comfortable with our recommendation of 2.3 percent.

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DEPUTY CHIEF ACTUARY DZIUBEK: With regard to the long-term return on assets, this slide is here just again to mention that this drives our most important actuarial assumption which is the discount rate. It is a -- the topic of a separate discussion, which you had yesterday. It is not going to be talked about here, but it -- but it -- for us, it's just one other assumption that will be changed in addition to all of the others we're recommending today and will be reflected in our June 30, 2021 valuations for the first time.

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DEPUTY CHIEF ACTUARY DZIUBEK: So this slide and the following two slides attempt to show you visually the impact of all of the various proposed changes to our assumptions. We're starting with the State and schools plans on this particular slide. And I'm going to start on the far left and talk about post-retirement mortality. Again, we did talk about this in September. Nothing really has changed, but I'll just remind the Committee members that we made a couple structural changes to our mortality assumptions, the first of which is to employ something we refer to as generational mortality improvements.

And what that means is we are not only tabulating current mortality experience and setting base mortality rates, we then assume every year into the future there will be some incremental improvement to mortality going forward. Every time mortality is studied, of course, people are living longer, absent the perhaps transitory impact of the pandemic.

But this is an assumption that is more and more being used by retirement systems and it -- the benefit of this is not only do we think we get better liabilities, but it certainly limits the chance that we're going to see big changes from one experience study to the next when we look at mortality, because now we've already built in improvements, so by the time we get to the next study, the question will be did it improve faster or slower than our improvement? But if you look at a history of life expectancies from our experience studies, you'd see that since we've been building in these improvements, we haven't seen the big jump in the impact of mortality rate changes.

And let me just clarify, we have been building in improvements prior to this study. We did it in a less sophisticated manner. And now with a brand new actuarial system that's able to handle these generational improvements, we're just -- we're just incorporating the improvements in a more sophisticated manner.

Now, we if we go all the way to the right, we'll talk about inflation. And by the way, mortality and inflation are the two assumptions that pretty much apply the same way to all employee groups. Whereas the other assumptions we'll talk about tend to be group specific and vary from group to group. But the decrease in inflation present two and a half to 2.3 will put downward pressure on our expectation for future pay increases and future COLAs, and so it will reduce employer contributions slightly.

And then in the middle, we have sort of a mixed bag of some increases, some decreases in the employer contribution rate. I'll mention the sideways arrow does not indicate that we didn't make a change in the assumption nor does it indicate that the change was zero. It just indicates that it was relatively small compared to the other changes and assumptions.

And then if we go all the way to the right, we see the cumulative effect of all of these assumption changes on the employer contribution rate. Again, this does not reflect the impact of the discount rate going from 7 to 6.8. And when I say going from seven to 6.8, I'll clarify we all know that the Risk Mitigation Policy reduced the discount rate already to 6.8. That has never been used in any actuarial valuations up to this point. So we're measuring everything against the last valuations, which were at seven percent.

So as you can see, there's some mixed results here with the State and schools plans. The California

Highway Patrol in particular, the changes to the salary assumption and retirement rates are causing a little bit higher increases in expected contribution rates going forward.

Next slide.

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DEPUTY CHIEF ACTUARY DZIUBEK: And let me clarify also before I continue to the next slide, we have sometimes some confusion when we show percentages of increases, because it could either be a relative percentage increase. But in this case, what these percentages represent is a percentage of payroll increase to the employer contribution. So, for example, on this slide, if we're looking at the miscellaneous three percent at 60, you see the one percent impact. That means if the average contribution was 25 percent of payroll, it will now be 26 percent of payroll. So it's an additive percent of payroll change to the contributions.

Nothing too significant on this slide. This represents all of our miscellaneous groups. Each of these line items that refers to a particular formula has a number of plans within it, depending on what the employer selected for their benefit design. So the results are median results. They differ from plan to plan, but what we're showing to the far right is the median impact on the employer contribution rate. And obviously for miscellaneous plans, the increases are fairly modest, not exceeding even one percent of payroll.

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DEPUTY CHIEF ACTUARY DZIUBEK: We have a little bit more variation in results with the safety plans. That's not unexpected. The safety plans tend to be richer in nature. They have higher, what we call, volatility ratios, meaning changes to assumptions, changes in experience. Those things tend to impact the safety plans a little bit more than the miscellaneous plans.

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DEPUTY CHIEF ACTUARY DZIUBEK: All right. So let's talk about the PEPRA members. I want to break this again into two steps, because the discount rate again does impact PEPRA member contributions. But if we start with just the impact of all of the other changes first, which is what this study covers, the expectation is that about a quarter or so of our public agency plans will receive an increase to the member rate as a result of these changes, absent the discount rate change and the average increase for those that are expected to get an increase is about a half percent of pay. Now, these are estimates. We cannot know this for certain until we do the June 30, 2021 valuations, because any demographic experience from now until then -- well, that date has already passes, but we do the valuations, you know, in areas so to speak. But demographic experience that has't been tabulated in valuations yet will impact the PEPRA member contributions. So these are estimates.

But as I said, we would expect just these changes, absent the discount rate, to impact roughly 25 percent of our PEPRA member groups.

Now, if we factor in the discount rate change, we expect 80 to 90 percent or so of our PEPRA member groups will experience a rate increase. Those increases averaging about 0.8 percent.

I think that's generally the end of my prepared remarks. I would -- before I take questions, I would like to thank the Actuarial Office for their hard work on this study. In addition to this study, we also did a lot of hard work on the asset liability management process as well, so this was a long tough year for the Actuarial Office, but I want to thank them for their -- for their good work.

And with that, I can take any questions.

CHAIRPERSON MILLER: Yeah. Well, thank you for the presentation and a big thanks to the team. It has been quite a year and we appreciate the hard work and everyone pulling together and making it happen.

So I have a few questions starting with President Brown -- Henry -- oh, Henry Jones.

(Laughter.)

COMMITTEE MEMBER JONES: President Brown.

CHAIRPERSON MILLER: There you go.

COMMITTEE MEMBER JONES: Okay. Thank you, Mr. Chair. Yeah, my question goes to the inflation. And I've had some discussion regarding this, but I want a clarification. Because of the inflation rate being part of the discount rate, and I know you said this is outside of the discount rate discussion, but the first part of the question is the same inflation number used here is also part of that discount rate, is that correct?

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, that's correct.

COMMITTEE MEMBER JONES: So if we were to -- many times the economists are wrong about the future. So if we experience an inflation that goes on for three or four years at a higher rate, wouldn't you be considering making a change to that number at that time the inflation rate?

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah. Well, of course, the schedule would be that we would absolutely review that inflation assumption four years from now.

However, as the actuaries that sign all of the reports, with regard to any assumption, if at some point, we feel like an assumption that we're using is not appropriate, does not meet actuarial standards of practice, we would come to the Board and ask for a change. That doesn't happen very often. Normally, it takes a number of years of experience to make you start to think, oh, maybe we need to make a change.

And so typically we get through the four years without making a change. Although, a recent discount rate change, as you remember, did happen between the four-year reviews.

COMMITTEE MEMBER JONES: Um-hmm.

DEPUTY CHIEF ACTUARY DZIUBEK: So, yes, the answer is if the Actuarial Office, or the Chief Actuary in particular, believed that the current assumption was no longer appropriate, did not meet actuarial standards of practice, he would ask for a change.

COMMITTEE MEMBER JONES: Okay. And who owns that decision, is it the Actuarial Office or is it the asset liability management team?

CHIEF FINANCIAL OFFICER COHEN: Ultimately, it is the Chief Actuary, as Randy said. That being said, we do have the internal sort of asset liability management team that we would certainly discuss it, but, you know, it ultimately is an actuarial assumption, so it's in Scott's wheelhouse.

COMMITTEE MEMBER JONES: Okay. Thank you.

DEPUTY CHIEF ACTUARY DZIUBEK: I will add to that though that probably you are the owner. In fact, you adopt and approve all of these assumptions. Now, should the Chief Actuary recommend something and you choose something a little bit different, then the decision has to be made by the Chief Actuary what to say about that in the report. Can I use that assumption anyway?

There isn't only one correct assumption. There's always a minimal range. So I would say ultimately the Board owns the assumptions.

COMMITTEE MEMBER JONES: Thank you.

CHAIRPERSON MILLER: Next I have Ms. Taylor.

VICE CHAIRPERSON TAYLOR: Thank you, Mr. Miller. Thank you, guys, for the report. It was very in-depth and I appreciate all the work you guys have gone through. I know it's a lot this year.

So I had a couple of questions. One, you talked about the COVID-19 considerations that you didn't really put in, but if it happens may -- so we -- we're kind of living in an environment right now where I think everybody is accepting it, and we're just going to go about our business, right? So if we see -- I don't know -- and I know you talked about maybe if we see, you know, like a concurrent, you know, deaths, and then there's the -- what do they call it, the long-haul COVID, that that's going to have an impact on our assumptions, if we see that two years in the future or something like that.

So how -- so how would that impact it? Have you got kind of an idea? Does it reduce our mortality rate, increase our mortality rate? What do we -- how does it impact our -- this experience study, if in two years you have to make an adjustment for that?

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah. So first of all, the actual experience during the pandemic will ultimately factor into our actuarial valuations, not through an assumption change, but just through actual experience. We'll -- we expect to have about 10 percent more deaths than we expected for year two. That will lower plan liabilities and translate into a small, we think, decrease in employer contributions.

Now, if we snap out of that and go right back to where our assumption is, then it will have been a one-time gain, and basically go away. Now, if it continues that we see higher deaths than expected, then we would make the change to the actuarial assumption, which would also lower liabilities and lower employer contributions.

We have some, what we call, sensitivity analysis in our actuarial reports. We show all of the employers, the impact of a 10 percent higher or lower mortality experience for one year. I don't have any of those numbers in front of me, but we saw about a 10 percent increase in deaths. Scott, I don't know if you have any ballpark estimate of the change in liability. Probably not.

VICE CHAIRPERSON TAYLOR: Not yet, yeah.

DEPUTY CHIEF ACTUARY DZIUBEK: But -- you know, so there is that potential, but on the other side, you know, you read things about, you know, well new vaccine procedures being developed, and new treatments. And, you know, may that end up increasing life expectancies. So that's the reason that, even though we saw the increased deaths, we don't yet want to build them into our long-term assumptions.

VICE CHAIRPERSON TAYLOR: Okay. Thank you. I also wanted to know, so you did -- it looks like impact on PEPRA normal costs -- what is this page? Page 10. You did costs for most PEPRA groups based on the seven percent, and then based on the 6.8 percent. Now, this is -- I'm trying to figure out is this for the employer or the member?

DEPUTY CHIEF ACTUARY DZIUBEK: Sorry, I didn't do a very good job on this slide. Apparently, these are for the member.

VICE CHAIRPERSON TAYLOR: Okay.

DEPUTY CHIEF ACTUARY DZIUBEK: Well, I mean, these are the normal costs, the total normal cost increases, the range of increases, because every plan is a little bit different. Now, the way PEPRA works, of course, is that the member pays roughly half of the normal cost. So if the normal cost goes up two percent, a percent goes to the member and a percent goes to the employer.

VICE CHAIRPERSON TAYLOR: Okay. So this range -- let's go to the 6.8 percent. This range 0.7 to 2.6 percent, then that's halved between the employer --

DEPUTY CHIEF ACTUARY DZIUBEK: (Nods head.)

VICE CHAIRPERSON TAYLOR: Okay. That's where I was lost.

DEPUTY CHIEF ACTUARY DZIUBEK: That's right. And the --

VICE CHAIRPERSON TAYLOR: I was freaking out at the 2.6 percent. Okay.

(Laughter.)

DEPUTY CHIEF ACTUARY DZIUBEK: Well, I'm sure even half of that is not going to be great news to those members.

VICE CHAIRPERSON TAYLOR: No, it's not.

DEPUTY CHIEF ACTUARY DZIUBEK: But the average out of the range was 0.9. And that was actually on a slide that Scott presented yesterday.

VICE CHAIRPERSON TAYLOR: Okay. I don't know if this is the place. And I hesitate -- I think if 50 percent of our members now -- and this isn't great for the employers either, but if 50 percent of our members now are PEPRA employees, we really have to work at maintaining our discount rate and sustaining it at where we we've just determined it's going to be, because this -- a 1.3 percent increase to a member an employee is -- when we get, what was it, 2.2 percent of a raise and then health care goes up too, these are unsustainable, if we have to keep doing this. So I just want to speak on behalf of the members that I represent, but also all the members in the public agencies. This -- let's get this right for the employers and the members. This is -- this was a heavy lift yesterday. And as I -- I didn't comment on it for the members, but I -- and I appreciate all your hard work, but this is something that we have to really work on to maintain. And I do appreciate everybody's work in this.

CHAIRPERSON MILLER: Okay. Let's see, I think I had Ms. Brown. Oh, no, that's Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you, Mr. Chair.

My question is relative to inflation. I'm sorry, inflation relative to wage inflation. I noticed that the real wage inflation assumption is being reduced, while the real -- sorry, the price inflation is being reduced, while real wage inflation is being increased. Since one is a component of the other one, you usually see them moving together. So can you explain the contradictory -- the opposite -- why they're going in opposite directions, please?

DEPUTY CHIEF ACTUARY DZIUBEK: Sure. So wage inflation is different than price inflation. Wage inflation, typically when you measure it, is higher than price inflation. It includes productivity increases. We have had a larger gap between price inflation and wage inflation than the average retirement system out there. We felt that that was justified. But for this particular study, we wanted to reduce that gap somewhat. And that was also based on just looking at the history of wage inflation among our members. It's not -- it's not terribly easy to quantify the portion of a person's increase due to wage inflation versus merit and seniority, but we do attempt to do that and measure them separately, but that's the reason.

We believed we should lower price inflation, but the gap between price inflation and wage inflation, we chose to go in the other direction and be more consistent with other large systems, and again, based on -- based on the data, not just because of other systems --

COMMITTEE MEMBER RUBALCAVA: So it was based on the four-year experience study looking backwards.

DEPUTY CHIEF ACTUARY DZIUBEK: Yes.

COMMITTEE MEMBER RUBALCAVA: Okay. Thank you.

CHAIRPERSON MILLER: Okay. I have President Jones.

COMMITTEE MEMBER JONES: Yes. Thank, you Mr. Chair.

Yeah. Ms. Taylor's question triggered another question on that page 10 under the PEPRA normal costs, and you look at the range of 1.6 to 4.8 under a 6.5 discount rate. And my question is, so the 4.8 half of that would be the employer and half would be the employee, is that correct?

DEPUTY CHIEF ACTUARY DZIUBEK: That's correct.

COMMITTEE MEMBER JONES: So the question is is that half of the employer on top of what they would -- the experience is if we adopted a 6.5?

DEPUTY CHIEF ACTUARY DZIUBEK: I'm not sure I understand the question. I'll attempt to --

COMMITTEE MEMBER JONES: So if we --

DEPUTY CHIEF ACTUARY DZIUBEK: Go ahead.

COMMITTEE MEMBER JONES: -- drop the discount rate to 6.5, the contributions of the employer goes up?

DEPUTY CHIEF ACTUARY DZIUBEK: Yes.

COMMITTEE MEMBER JONES: So that number is in addition to this number, because they have a 2.4 hit here and then they have some kind -- I don't remember the numbers, but they have another hit on the discount rate being dropped. So those two, that's a significant hit on the employer, if we were to drop it to 6.5, right?

DEPUTY CHIEF ACTUARY DZIUBEK: Yes. Had we -- had we dropped to 6.5, the employer would have had their share of the increase in normal cost, which you're kind of see here, as well as increased unfunded liability payments.

COMMITTEE MEMBER JONES: Yeah.

DEPUTY CHIEF ACTUARY DZIUBEK: Now, the information that Scott presented yesterday in terms of looking at different contribution rates under different discount rates would have factored all of those things together.

COMMITTEE MEMBER JONES: Oh, so this part would have been part of the number yesterday?

DEPUTY CHIEF ACTUARY DZIUBEK: That's correct.

COMMITTEE MEMBER JONES: Oh, okay. That's what I was trying to understand, whether this is in addition to the number yesterday.

CHIEF ACTUARY TERANDO: No. No.

COMMITTEE MEMBER JONES: Okay.

CHIEF ACTUARY TERANDO: Yesterday's information contained everything.

COMMITTEE MEMBER JONES: Okay.

CHIEF ACTUARY TERANDO: Just so you -- so, you know, we wanted to make sure during this presentation, you would be able to see the impact of the demographic changes in isolation.

COMMITTEE MEMBER JONES: Okay.

CHIEF ACTUARY TERANDO: During the ALM process yesterday, we made sure everything was included.

COMMITTEE MEMBER JONES: Okay. Got it.

CHIEF ACTUARY TERANDO: So when you made a decision, there were no other changes that would change what -- the numbers you were seeing yesterday.

COMMITTEE MEMBER JONES: Okay. Thank you. That explains it, because I was interpreting it incorrectly.

CHIEF ACTUARY TERANDO: Yeah. Yeah. No. Yeah. We kind of made sure that there were no surprises where you had to add two sets of presentation numbers together to get the final number.

COMMITTEE MEMBER JONES: Okay. Thank you.

CHIEF ACTUARY TERANDO: Sure.

CHAIRPERSON MILLER: Okay. And Director Middleton, I believe.

COMMITTEE MEMBER MIDDLETON: All right. Thank you. Yesterday we did make the decision to go with the 6.8 percent target. And I know that's not reflected in what you have before you, but could you outline the next steps that you will be going through as you implement the 6.8 target?

DEPUTY CHIEF ACTUARY DZIUBEK: Sure. Well, the Actuarial Office will have just a small part of the implementation of this change. There will be lots of other CalPERS divisions that will join us in that. But we will very soon create a circular letter that will, as best we can, explain and illustrate the impacts on employer contributions due to all of these assumption changes taken together. Now, every plan comes out a little bit differently --

COMMITTEE MEMBER MIDDLETON: Right.

DEPUTY CHIEF ACTUARY DZIUBEK: -- so we'll probably show, you know, percentiles, or means, or ranges. We're not entirely sure what we'll show in that, but we'll make that as explanatory as we can.

We also have a tool called Pension Outlook. I'm not sure if --

COMMITTEE MEMBER MIDDLETON: Right.

DEPUTY CHIEF ACTUARY DZIUBEK: -- Board members are familiar with that. That tool can be used to estimate the impact of the discount rate change. It does not have loaded these new demographic assumptions, but we are exploring ways where we can do a -- maybe a mid-year update of that tool, so that on an individual basis, employers can get their correct updated numbers.

COMMITTEE MEMBER MIDDLETON: And at what point will you be coming back to us outlining what options we as a Board have, in terms of implementing what we expect to be additional costs for employers.

DEPUTY CHIEF ACTUARY DZIUBEK: There's -- there are policies in place that dictate precisely how all of these changes will factor into employer contributions. Those are policies that are adopted by the Board obviously. We are -- we have not anticipated that the Board will want to change any of those existing policies, but of course, those are your policies.

COMMITTEE MEMBER MIDDLETON: Right.

CHIEF FINANCIAL OFFICER COHEN: And if I could just add, it's probably worth noting the timeline of when employers and employees will see any rate increases. So for the State and schools, that happens July 1st of next year, but for public agencies, there's an additional year lag. So we're talking about, what, 18 months from now, they would start seeing the -- those changes. And all of this information we'll get into a little bit more detail in the webinar I mentioned at the top. And then obviously from there, we'll figure out where the key remaining questions are and can supplement information flow as needed.

COMMITTEE MEMBER MIDDLETON: I don't want to, Mr. Chairman, take and have us review every single policy that we already have, but I do think it would be wise for the Board and this Committee to be fully aware of what all of the policies are that are going to make a determination as to what additional contributions are going to be before they are implemented, so that we do have an opportunity, if we think any changes in policy are appropriate, to discuss those.

CHAIRPERSON MILLER: Yeah, I agree. And even if for nothing else than to really understand the implementation plan as it rolls out. So if we could have some sort of wrap-up or review of those provided to us before we get to that point, A summary.

CHIEF ACTUARY TERANDO: Yeah, we could bring something back to the Committee just kind of outlining the process involved and how the calculations work.

CHAIRPERSON MILLER: Yeah, a list of the governing policies and how they relate.

CHIEF ACTUARY TERANDO: Sure.

CHAIRPERSON MILLER: That would be great. Thank you.

And let's see, I'm seeing Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you. I did have a follow-up question -- thank you -- from Ms. Middleton.

CHAIRPERSON MILLER: Oh, sure.

COMMITTEE MEMBER RUBALCAVA: These changes in actuarial -- in actuarial val -- actuarial assumptions flowing from the experience study, they will be used in the actuarial valuations as of July 30 -- I'm sorry, June 30th, 2021. When do the participating agencies begin to get their new actuarial -- updated actuarial valuations that they can use to establish their employer contribution?

CHIEF ACTUARY TERANDO: Those -- our regular timing is for the public agencies that those valuations come out around July or August of next year. That's the timing. This year, the 2020 valuations came out just a few months ago. So we'd be looking around July, August time where the valuations would come out for public agencies.

COMMITTEE MEMBER RUBALCAVA: Thank you.

CHIEF ACTUARY TERANDO: Sure.

COMMITTEE MEMBER RUBALCAVA: Thank you, Mr. Chair.

CHAIRPERSON MILLER: Thank you.

Let me just check. I'm not seeing anymore questions from the Committee.

So at this point, I guess we'll entertain a motion.

VICE CHAIRPERSON TAYLOR: I'll make a motion.

CHAIRPERSON MILLER: Okay. Ms. Taylor --

COMMITTEE MEMBER JONES: Second.

CHAIRPERSON MILLER: Seconded by -President Jones. So I will call now for we have public comment on this item on the phone. Mr. Fox. I know there's a little bit of a delay. Tox fox yes Mr. Care man we have one caller so tar.

STAKEHOLDER RELATIONS CHIEF FOX: Yes, Mr. Chairman. We have one caller so far. We have a Mr. Brian Whitworth from Hilltop Securities.

MR. WHITWORTH: Hello. I would like --

CHAIRPERSON MILLER: Okay. Yeah, it was a little -- oh, go ahead, sir.

MR. WHITWORTH: Oh. Hello. I would like to speak regarding inflation. As Mr. Dziubek mentioned, at least in the short term, inflation has been rising, and staff looked at several indicators which you can find in

Attachment 1 for Item 7c starting on page 45. I'm concerned that inflation expectations are unusually volatile and has tended to rise since that data was collected in July of 2021. For example, one indicator was TIPS versus traditional treasuries, where the break-even rate at that time was 2.39 percent, and as of yesterday, the break-even rate had risen by 33 basis points to 2.72 percent.

The report also mentioned a May 2021 estimate from the Philadelphia Federal Reserve survey of the Society of Professional Forecasters who added 10-year average expectation of 2.3 percent at that time. And the updated November 15th number is 2.55 percent, which is a 25-basis point rise.

So I would like to suggest to the Committee that instead of the normal four-year review cycle, the Committee direct staff to report on updated inflation expectations at the April 2022 meeting and discuss any suggestions or changes in actuarial assumptions.

Thank you.

CHAIRPERSON MILLER: Thank you for your comments. And I don't believe we have any other public commenters in person or on the phone, is that correct, Mr. Fox?

STAKEHOLDER RELATIONS CHIEF FOX: That is correct, Mr. Chair.

CHAIRPERSON MILLER: Thank you, sir.

Okay. At this point, if there's no further discussion, I will call for the question.

All in favor?

(Ayes.)

CHAIRPERSON MILLER: Any nays?

No abstentions.

The ayes have it. The motion carries.

So that concludes the action agenda items. We've got an information agenda item, which is the summary of Committee direction. Mr. Cohen.

CHIEF FINANCIAL OFFICER COHEN: Thank you, Mr. Chair. I recorded three items, two from our financial statement conversation. The first one is a breakdown of the annual payout number, sort of reconciling the website to what was presented today. Second, providing data on what we know on retirement trends as of today. And then third from our preceding conversations, a report on the policies that would affect employer costs as well as an implementation timeline.

CHAIRPERSON MILLER: Thank you. That sounds right.

So, at this point, I think this Committee will be adjourned. And we will break. It's 10:33 now. And when do we start?

VICE CHAIRPERSON TAYLOR: Let's do 10:45 for Investment.

CHAIRPERSON MILLER: And 10:45 we'll come back to Investment Committee open session.

VICE CHAIRPERSON TAYLOR: 10:47.

CHAIRPERSON MILLER: 10:47.

VICE CHAIRPERSON TAYLOR: Sorry.

CHAIRPERSON MILLER: 10:47. There we go. Thank you. We're adjourned.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 10:34 p.m.)

CERTIFICATE OF REPORTER

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California;

That the said proceedings was taken before me, in shorthand writing, and was thereafter transcribed, under my direction, by computer-assisted transcription.

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 21st day of November, 2021.

James F. Peters

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