MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

FINANCE & ADMINISTRATION COMMITTEE

CALPERS AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

MONDAY, APRIL 18, 2022

1:41 P.M.

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

APPEARANCES

COMMITTEE MEMBERS:

Lisa Middleton, Chairperson

David Miller, Vice Chairperson

Rob Feckner

Fiona Ma, represented by Sertan Usanmaz

Jose Luis Pacheco

Ramon Rubalcava

Theresa Taylor

BOARD MEMBERS:

Eraina Ortega

STAFF:

Marcie Frost, Chief Executive Officer

Michael Cohen, Chief Financial Officer

Matthew Jacobs, General Counsel

Don Moulds, PhD, Chief Health Director

Scott Terando, Chief Actuary

Fritzie Archuleta, Deputy Chief Actuary

Matt Flynn, Investment Director

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

Pam Hopper, Committee Secretary

Nina Ramsey, Associate Pension Actuary

APPEARANCES CONTINUED

STAFF:

Paul Tschida, Senior Pension Actuary

Emil Zhong, Supervising Health Actuary

INDEX

INDEX CONTINUED

PROCEEDINGS

CHAIRPERSON MIDDLETON: Good afternoon. Call to order the Finance and Administration Committee meeting for April 18, 2022.

Could we get a roll call, please?

COMMITTEE SECRETARY HOPPER: Lisa Middleton?

CHAIRPERSON MIDDLETON: Present.

COMMITTEE SECRETARY HOPPER: Rob Feckner?

COMMITTEE MEMBER FECKNER: Good afternoon.

COMMITTEE SECRETARY HOPPER: Sertan Usanmaz for Fiona Ma?

ACTING COMMITTEE MEMBER USANMAZ: Present.

COMMITTEE SECRETARY HOPPER: David Miller?

VICE CHAIRPERSON MILLER: Here.

COMMITTEE SECRETARY HOPPER: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Present.

COMMITTEE SECRETARY HOPPER: Ramon Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Present.

COMMITTEE SECRETARY HOPPER: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

COMMITTEE SECRETARY HOPPER: Madam Chair, all is in attendance for the Finance and Administration Committee.

CHAIRPERSON MIDDLETON: All right. Thank you.

Can we get approval of the April 18, 2022 --

COMMITTEE MEMBER TAYLOR: Move approval.
CHAIRPERSON MIDDLETON: I'm sorry?
COMMITTEE MEMBER TAYLOR: Move approval.
CHAIRPERSON MIDDLETON: Move --
VICE CHAIRPERSON MILLER: Second.
CHAIRPERSON MIDDLETON: You guys are fast.
(Laughter.)
CHAIRPERSON MIDDLETON: All those in favor say aye?
(Ayes.)
CHAIRPERSON MIDDLETON: Opposed?
All right. Item number 3, Executive Report, Mr. Cohen.
CHIEF FINANCIAL OFFICER COHEN: Thank you, Chair, Committee members. Michael Cohen with the Financial Office, just to highlight a couple of our outreach activities that have gone on since the last time we had the chance to meet. I as well as a number of the actuaries were able to meet with the municipal finance officers in person at their conference, which was great to see everyone live. In contrast, we did do one final ALM webinar, particularly focused on our prefunding trust funds at the beginning of March, and that -- that went well and I think was very much appreciated. That will likely be our last of this ALM cycle, but we look forward

to bringing them back in four years when we start all again.

With that, I'll turn it back to you, Chair, to walk us through the agenda.

CHAIRPERSON MIDDLETON: All right. Thank you.

Next item is Item 4a through g, action consent items. Are there any consent items that anyone would like to pull?

COMMITTEE MEMBER RUBALCAVA: I'm voting abstain on the minutes. Sorry about that.

CHAIRPERSON MIDDLETON: We will note that.

Any other items to be pulled?

Okay. So we'll take the minutes separately.

Approval of the February 15, 2022 Finance and Administration Minutes.

All those in favor -- motion to approve?

COMMITTEE MEMBER PACHECO: (Raise hand).

VICE CHAIRPERSON MILLER: Second.

CHAIRPERSON MIDDLETON: All those in favor please say aye?

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

And abstentions.

COMMITTEE MEMBER RUBALCAVA: Abstain.

CHAIRPERSON MIDDLETON: All right.

Now, Items 5 -- 4b --

COMMITTEE MEMBER TAYLOR: Move approval -- move approval for 4b through 4g.

COMMITTEE MEMBER FECKNER: Second.

VICE CHAIRPERSON MILLER: Second.

CHAIRPERSON MIDDLETON: All right. Mrs. Taylor. Mr. Feckner beat you. And all those in favor please say aye?

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

All right. Five -- Item 5 is information consent items. We do not need to vote on that. Is there anyone who wants to pull any of that for a separate discussion?

Seeing none.

We will move on to action agenda items. Number 6a, Mr. Cohen and Ms. Harris, the 2022-23 annual budget proposal.

CHIEF FINANCIAL OFFICER COHEN: Thank you. I'm going to turn it over to Jennifer Harris our Budget Chief. But for those of you who have had a chance to review the materials, you'll know though that -- you'll notice that there was a large increase year-over-year budgetary-wise. That's almost exclusively oriented to what -- the way we forecast our investment fees as opposed to anything operational, but Jennifer will go into in more detail.

So let me turn it over to her.

(Thereupon a slide presentation.)

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Good afternoon, Madam Chair and members of the Committee. Jennifer Harris, CalPERS Financial Office.

It's nice to see all of you in person after these couple of years. I'll be walking you through the 22-23 proposed agenda item. This is a proposed budget and it is an action item. As is typical, I'll quickly update you on where we are with our current year spending.

Next slide, please.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: As of December 31st, CalPERS expended 856 million, or 45 percent, of the current year budget. Based on projections, we estimate that we'll end the fiscal year with nearly 39 million in savings.

Next slide, please.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Nearly all the projected savings is in operating cost categories. Within administrative operating costs, the driver is position vacancies, as well as less travel and external training resulting from the lingering effect of the pandemic, particularly this first half of the fiscal year.

Within an investment operating cost, we have less than anticipated expenses for consultant usage, legal reviews for private asset transactions, and data and analytic services.

The slight overage that we're estimating in headquarters building costs reflects an unanticipated plumbing repair to improve water quality issues in our campus buildings. While overall spending remains within budget, we continue to assess and monitor all expenses to make sure that they are appropriate. And as a reminder, all funds remain in the PERF until actual expenses are paid.

Moving on to the proposed budget. Next slide, please.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: For 2022-23, CalPERS proposes a total budget of two billion seven million dollars. This is a one 175.5 million increase over the current year budget.

Next slide, please.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Although I'll walk you through each of the budget categories, I've highlighted here that the primary driver -- oh, I'm sorry, one slide back. The -- one more back.

There we go.

The primary driver of the total budget increase is in investment external management fees. This is a projected amount and it reflects the increased deployment of capital following our new strategic asset allocation and strategies. We'll bring up page 19 of the proposed budget that you have as Attachment 1 to this item.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Shown here are the investment categories. And as you can see, the two biggest drivers are within real assets and private equity, again resulting from the increased deployment of capital. CalPERS estimates the expected fees for each of these categories, based on a variety of factors, one being the amount of capital that is deployed and another being the contract terms.

Matt Flynn from our Investment Office is going to come up and walk you through the details of our estimating process for these fees.

INVESTMENT DIRECTOR FLYNN: Good afternoon. Matted Flynn, CalPERS team member. Jennifer did a great job of summarizing the top line story here, which is if you look at page 19, certainly in dollar terms, you see the largest change and the largest increases are resulting from the private assets. If you recall part of the strategic asset allocation that this body -- or the full Board adopted has meaningful increases to allocations to private debt as a new allocation, to private equity, and to real assets.

When we go through an estimation process, even if it's not in an asset allocation year, one of the most important factors that we look at is, in fact, allocation, because those are things that we can control. The office -- and based on direction from the Committee, we can deploy assets up to and including our strategic asset allocation levels. And for the most part, the AUM in those particular assets -- assets under management. Sorry. Didn't want to use the alphabet soup here. Assets under management in the different asset classes is a direct result of the allocation process.

Fees for the most part in private assets are management fees. And whether that's private assets or public assets is typically derived from an AUM based approach. So that's, I would call, the fundamental approach to both why there's large numbers expressed here today for next fiscal year is the increase in the private assets. But it's also just a fundamental component of how we do forecasting on a year-over-year basis.

I would note on page 20 that if you take a look at the total management -- external management fees and basis points, you'll see that the focus the office has placed on negotiating more favorable terms has produced meaningful results. We've gone from somewhere in the 19 to 20 basis point range for the five years back -- look-back period to a period -- a point where we're now in the 15 basis point range. And that's ongoing year-over-year savings back to the -- to the Trust Fund as a result of those activities.

Happy to go into more detail on individual asset classes. Thought I'd pause at this point and see if there were specific questions or a desire to go into more detail.

CHAIRPERSON MIDDLETON: All right. Mr. Flynn, to the extent that we are able to bring more of the management in-house, what -- what degree of opportunity do we have to make significant savings?

INVESTMENT DIRECTOR FLYNN: In the private assets, I would have to say that that's an organizational construct that we don't have the ability to scale on an internal basis. Our general partner fund-based investing that we do along with co-invest that we do in private equity is typically that's -- typically reliant upon having a general partner manage the process for us. Same principally for real estate. Private debt is slightly different. We are building out a team internal to manage that allocation to five -- up to five percent allocation in this current SAA. And that's something that we're planning to do for the most part. We have two external managers, but for the rest of the allocation, we're trying to do that in-house.

Sadly, for real assets and for private equity, there's not really an opportunity to scale internal staff to do much of -- much improvement at all. So the focus there with those teams has been to negotiate more favorable economic terms, which that chart on page 20 shows that that's proven to be a successful strategy as well.

CHAIRPERSON MIDDLETON: Given the size of our organization, the assets under management, how much more of a savings can we anticipate as we continue to aggressively --

INVESTMENT DIRECTOR FLYNN: That's a crystal ball that I don't have a visual into. I can tell you that organizations that we partner with, for example, CEM, you're familiar with them in a number of different areas here. We participate in their work both on a global peer level, but also on U.S. based peer level. And CalPERS and the investment program continues to be considered a very low-cost provider. That's the best proxy that I can say that -- is 15 the right number? Is 14 the right number? Do we go back to 19? I don't know. But even over all those periods of time, we were still considered a low-cost provider.

CHAIRPERSON MIDDLETON: All right. What benchmarks would you recommend we use to be able to assess comparatively how we're doing in that area?

INVESTMENT DIRECTOR FLYNN: Comparatively meaning our peers?

CHAIRPERSON MIDDLETON: Yes.

INVESTMENT DIRECTOR FLYNN: I think CEM does a fine job. They -- we've been part -- we've been a part of their survey process for 20 some odd years on the investment side, and I think they have a very robust process.

CHIEF FINANCIAL OFFICER COHEN: And, Chair, just to add a little commentary, the executive team was just briefed by CEM on our comparison, and we do want to bring that information to a Board presentation. We're just working on when the best schedule for that would be, but we do think CEM is the best comparator, because it captures those big international pension funds as well as the national ones.

CHAIRPERSON MIDDLETON: All right. Good.

Questions?

Questions from -- from the dais?

No.

All right. Then please go on ahead.

INVESTMENT DIRECTOR FLYNN: Thank you very much.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Thank you, Matt.

Continuing with the proposed budget. Starting on page six, we'll begin with the operating costs. The first category that I'll discuss is administrative operating costs. And this is personal services, so the salaries and benefits that we pay to our team, as well as operations, equipment, and expenses, or OE&E that's commonly referred to.

In 2022-23, we propose a total of 561.6 million. This is over -- just over one percent increase over the current year. This increase is primarily driven by the redirection of vacancies to the Investment Office to stand up three new deal teams to implement these new strategic asset allocations and strategies. CalPERS continues to utilize its position pooling process, where we do redirect vacancies from one area to where they're most critically needed within the organization. So while our overall position count is remaining constant at 2,843, we are seeing a slight reduction. This -- or I'm sorry, a slight increase.

This increase is really driven by the fact that the vacant positions were lower level positions and it's the difference between those positions and the higher paying investment classifications, as well as an estimate for incentive comp that is paid to the investment team.

This personal services budget right now does not include any collectively bargained benefit increases that might come up for the next fiscal year. We will calculate the fiscal impact of those increases, based on the direction from the Department of Finance. That typically comes out in September. And we'll bring that forward to you in November with the mid-year budget.

Within administrative operating costs, there's also a 5.2 million increase for OE&E. This is a net effect of several adjustments across many of the line items that you see on pages 10 and 11. To highlight however some of the significant increases, we have funds to resume travel and our in-person Ed Forum and Women's Pathways Conference, to purchase software upgrades and to hold Board elections.

Next slide, please.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION

CHIEF HARRIS: The next operating cost category is investment operating costs. And these are the costs specifically incurred for investments. And the increase here that you're seeing is largely driven again by those new asset allocation strategies that we're implementing. It includes additional funds for consultants to assist the Board with its decisions, as well as consultants for technology to layer in the leverage and to the total assets -- in the Total Asset Data Strategy.

There's also an increase for appraisal fees. These will be needed for the new real asset deals that we are going to be investing in. And then the increase we're see for master custodian fees is for a new contract for improved accounting and analytic services.

Finally, the increase in technology is the actual costs for some redundant technology, as we transition our data and our analytics from one system to the next, as part of our ongoing data fund strategy.

Next slide, please.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Last administrative -- or our last operating cost category is headquarters building costs, 20.8 million shown here. The increases that we're seeing are primarily driven by a return to pre-pandemic operations. We have our teams on-site now. And we're also paying some contracted increases for our janitorial and our security teams. We're also having some funds earmarked for some building costs, such as improving security. We're replacing some fire alarm systems. And then continued maintenance to prevent water intrusion on our lower level garage area.

The dollar amount that you see here, the 20.8, this reflects the amount that's paid for by the PERF, but in the budget you'll see the total cost for headquarters is 25.5 million. The difference is 4.7 million. This is the amount that we built into the administrative budget, and it's the affiliates share of building costs.

Next slide, please.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: So this is our external fees budget. These are estimated amounts that are largely influenced by external factors. We've already discussed the major driver to the current -- or to the proposed budget, which is those external management fees.

So next slide, please.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Third-party administrator fees is our last category. Here, we're proposing 7.9 million increase. The large driver here is our Health Program. This is estimated based on expected enrollment, as well as migration of members between health plans. And we also have some contract escalation built into those terms.

The total is offset by a 1.2 million reduction in Long-Term Care Program fees based on continuing enrollment declines.

Next slide.

--o0o--

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Shown here again is the total 2022-23 budget. My colleagues and I are happy to answer any questions that you have to help inform your action to approve.

Thank you.

CHAIRPERSON MIDDLETON: Thank you.

Are there questions?

COMMITTEE MEMBER PACHECO: I have a question.

CHAIRPERSON MIDDLETON: All right. Mr. Pacheco.

COMMITTEE MEMBER PACHECO: Thank you. Regarding the headquarters --

COMMITTEE MEMBER TAYLOR: Hold on.

CHAIRPERSON MIDDLETON: Hold on.

COMMITTEE MEMBER TAYLOR: You have to push your button.

CHAIRPERSON MIDDLETON: There you go.

COMMITTEE MEMBER PACHECO: I did. I'm sorry.

CHAIRPERSON MIDDLETON: There you go.

COMMITTEE MEMBER PACHECO: Thank you. Thank you very much for that presentation. I have a question regarding the headquarters building costs. You mentioned that the total building cost was 25.5 million, but 4.7 came from the affiliate and the rest is coming from PERS[SIC], is that -- is that how it works?

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Sure. So the PERF, the Public Employees' Retirement Fund --

COMMITTEE MEMBER PACHECO: Yeah.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Yeah, so that's the budget that you see here. All funds -- or all expenses are traditionally paid for by the PERF, but through our cost allocation process, we try to match up the funds that get the benefit from the use of the building. And so we have to charge -- it's not really rent, but we charge a fair share through cost allocation to the Affiliate Funds.

COMMITTEE MEMBER PACHECO: Oh, I see. I see. And then the -- and the -- the major issues are you were -- you were mentioning some water intrusion issues that were happening in the -- in the -- at the basement level, that's why we're spending some additional funds for that?

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: There are some funds built in. We've, for the last few years, been doing some repairs on the lower level of the garage, where some water intrusion is coming in, so they're injecting a sealant into cracks to prevent the water intrusion to come in.

COMMITTEE MEMBER PACHECO: I see. Thank you very much for this. Thank you.

CHAIRPERSON MIDDLETON: All right. And Mr. Miller.

VICE CHAIRPERSON MILLER: Thank you for the presentation. It is good to see everybody in three dimensions here and this is -- it's peripherally related to the budget, but it's a -- it's -- as I've been in here during the pandemic, I always noticed we've got this army of people with gasoline powered noisy stinky blowers and all this stuff. And we may be able to save some money. Even just coming in today, my car is pelted with leaves blowing out into the road as the guy is like blowing leaves from one part of our property to another part of the property.

And I've had this discussion a little bit with do it Heidi Sanborn who some of you may know from Mow Better and some of the other groups that sits on the SMUD Board. And there may be some opportunities to work with our contractors to do some of this in a more efficient and environmentally friendly leeway to kind of demonstrate our values as well. So something to think about for the future when it comes to our building maintenance approach, especially our grounds keeping.

CHIEF FINANCIAL OFFICER COHEN: Thank you, Mr. Miller. And we share your desire to get our entire building to sort of a net zero place as quickly as possible. And certainly, I know Mr. Stone will take that note as a -- as a possible place to get a good start.

Thank you.

CHAIRPERSON MIDDLETON: Are there other questions for our staff?

So this is an action item. Is there a motion to approve?

COMMITTEE MEMBER TAYLOR: Motion to approve.

COMMITTEE MEMBER PACHECO: (Raised hand).

CHAIRPERSON MIDDLETON: Ms. Taylor. Second by Mr. Pacheco. And I believe this is an electronic vote.

COMMITTEE SECRETARY HOPPER: Not unless it's requested.

CHAIRPERSON MIDDLETON: Okay. All those in favor, please say aye?

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

Congratulations.

We will move on to Item 6b, Annual Review of Board Member Employer Reimbursements. Mr. Cohen and Ms. Nix.

CHIEF FINANCIAL OFFICER COHEN: Yes. Thank you. This is another action item, similar to the one you saw a couple of months ago. It adjusts the reimbursement rates as requested by Board members who are eligible for reimbursements. The percentages are laid out in the agenda, but again it is an action item for your approval.

CHAIRPERSON MIDDLETON: All right. Is there any discussion?

Seeing none.

Motion to approve.

COMMITTEE MEMBER TAYLOR: Move approval.

CHAIRPERSON MIDDLETON: Ms. Taylor.

Second?

COMMITTEE MEMBER FECKNER: Second.

CHAIRPERSON MIDDLETON: Second Mr. Feckner.

All those in favor please say aye?

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

6b is approved.

6c, State Valuation of Employer/Employee Contribution Rates, and that's Mr. Terando and Ms. Ramsey.

(Thereupon a slide presentation.)

CHIEF ACTUARY TERANDO: Good afternoon, Madam Chair, members of the Committee. Scott Terando, CalPERS Chief Actuary. This item is a action item and presents the State contributions for fiscal year 22-23. And I'll pass it along to Nina Ramsey who will step through the presentation.

CHAIRPERSON MIDDLETON: Welcome.

Welcome.

ASSOCIATE PENSION ACTUARY RAMSEY: Thank yo.

Thank you, Scott.

Good afternoon, Madam Chair, members of the Committee. Nina Ramsey, CalPERS actuarial team member.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: I am here today to present for our approval the results of the June 30th, 2021 annual valuation for the State plans. This annual valuation sets the employer and employee contribution rates for fiscal year 2022-23. The State plans consist of the five member subgroups listed on this slide, miscellaneous, industrial, safety, peace officers and firefighters, and CHP

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: There have been a few significant events since our last valuation. First, the PERF has an investment return of 21.3 percent as of June 30th, 2021. Our investment return triggered our funding Risk Mitigation Policy reducing our discount rate from 7 to 6.8 percent. We also have new demographic assumptions that are a result of our latest experience study, which was approved by the Board in November 2021.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: The State has made additional contributions towards their unfunded liability. In July of 2021, 1.9 billion was contributed and allocated to the miscellaneous, industrial, safety and peace officer and firefighter plans. The allocation of this payment is described on page six of the agenda item. This contribution reduced the coming year's required payment by about $429 million, which is approximately 1.97 percent of payroll for the four plans mentioned.

Twenty-five million dollars was contributed to the CHP plan in August of 2021 per CHP's M bargaining agreement the savings from this payment are going to be deferred until fiscal year 2023-24.

Both of these payments were made after our valuation date and therefore not included in our funded status as of June 30th, 2021. But will be included in next year's valuation.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: On this slide, we have some key results from the current year's valuation and for next year. We have an accrued liability as of June 30th, 2021 of approximately $226 billion, a market value of assets of $182 billion, leaving us with an unfunded accrued liability of $43.6 billion, and a financed ratio of 80.7 percent. Our expected contribution for fiscal year 2022-23 is $7.6 billion, which is $964 million greater than the current year.

The rates are increasing primarily due to the following reasons:

First, we have the end of the supplanting payments. In July 2019, in accordance with Assembly Bill 84, the State made an additional contribution towards their UAL to be allocated over three fiscal years. The last installment of that payment was applied to fiscal year 21-22, which was approximately $1.4 billion. So with the lack of supplanting payments moving forward, there would be an expected increase in the required contributions.

Secondly, we have the reduction to the discount rate, which increased liabilities. And lastly, we have the progression of existing amortization bases, mainly investment losses from 2019 and '20 that are being fully ramped in in this valuation.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: This slide shows a brief history of the State's aggregate funded status. You can see that we have increased from 70.6 to 80.7 percent as of June 30th, 2021. We have also including the aggregate market value of assets and unfunded accrued liability for the State plans. Individual figures for each of the five plans can be found on Attachment 2.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: Here, we have a comparison of the current year rates and next year's rates for each of the five plans. You can see that rates are increasing for all five plans. However, they are lower than what was projected in our addendum to our valuation report, which was released earlier this year.

As I mentioned, the reason for the increase is largely due to those supplanting payments. Most noticeably you'll see the peace officer firefighter plan increase from 31.19 percent this year to 47.21 percent for fiscal year 22-23.

POFF got the largest share of the supplanting payment last year, over $700 million. So that equated to about 19 percent of payroll for that plan. So with the lack of that supplanting payment, we are expecting that to pop right back up.

For the CHP plan, the increase in the rate is a little bit different. You can see that the expected dollar contribution is actually lower than the current career. CHP had a 4.2 percent reduction in payroll as of June 30th, '21 compared to June 30th of 2020. When we set the rates, we are dividing by an expected payroll. So when the payroll goes down, that rate goes up, even though the dollar amount is nearly the same.

In the center column, we have the listed estimated rates, which were included in our addendum report released earlier this year. All of the final rates for 22-23 are slightly lower. This is because our addendum report did not include the additional payments that I mentioned on Slide 4.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: So on this slide, we have the actuarially required employer contribution rates for fiscal year 22-23 listed on the left-hand side. We have also included for your information the additional statutory contribution per Government Code 20683.2 and the additional contribution rate established by the State for their rate stabilization -- that's not the right word -- Stable Contribution Rate Strategy.

They will be paying an additional amount on top of what is required of them to maintain stable contributions. These amounts are not something that we are asking the Board to approve. They are subject to the State's annual budget process.

As I mentioned on page -- slide 4 -- excuse me, slide 4, the Stable Contribution Strategy only applies to the first four plans. CHP is not part of that Stable Rate Contribution Strategy. They instead are choosing to defer the savings from that additional payment they made. So 2.3 pers -- 2.33 percent on this slide represents the savings from the additional payments, but because they are choosing to defer those savings, we are adding that 2.33 percent back to their rate.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: Moving on to member contributions. Most State employees are exempt from the rule that PEPRA members pay half of the normal cost. There are, however, a few exceptions. Those exceptions include the California Legislature, California

State University, and the judicial branch. PEPRA members for these groups will see an increase to their member contribution rate effective July 1st, 2022. For miscellaneous members, they will see an increase from 7.25 percent to 8 percent. And the peace officer, firefighter members will increase from 12 to 13.25 percent.

The reason for the increase is because the normal cost has increased by more than one percent since the last time the rates were adjusted.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: We also have a few select bargaining units who have collectively agreed that their classic and PEPRA members will contribution half of the normal cost. These bargaining units are Bargaining Units 5, 9, 16, and 18. Bargaining Units 9, their agreement to contribute half of the normal cost ends on June 30th of this year. So effective July 1st this year, members of those groups will return to contribution rates that existed prior to this agreement. So that means, their miscellaneous members will see a decrease from 8 and a half to 8 percent, and safety members will decrease from 11 and a half to 11 percent.

Bargaining Unit 5's members will see an increase effective July 1st of this year. Miscellaneous members will increase from 8 and a quarter to 8.75 percent. And

CHP members will increase from 12 and a half to 13 and a half percent. The CHP members will continue to see a 1 percent increase every year until they reach an ultimate member contribution rate of 16.5 percent in fiscal year 25-26, as 16.5 percent is currently half of the normal cost.

--o0o--

ASSOCIATE PENSION ACTUARY RAMSEY: Lastly, we have the projected required future contribution rates. We have the actual listed on the left-hand side. And you can see that the projected rates are scheduled to decrease over the next five years. This is due to ramping in of the investment gain from this year, the 21.3 percent. Rates beyond 26-27 are expected to remain stable.

CHP you may notice decreases a little bit more rapidly and that is due to the increase in the member contribution rates. When the members start paying more, the employer starts paying a little bit less. So that's why you can see a more drastic decrease for CHP.

We will have projections updated in our annual valuation report released later this year to include our final investment return for fiscal year 22-23. The projections you see on the slide assume an investment return of 6.8 percent annually with no other gains or losses. The report that will come out later this year will also include our assumptions, methods, and participant data. With that, that concludes my presentation, and I'd be happy to take any questions.

CHAIRPERSON MIDDLETON: Thank you for that very exhaustive presentation.

ASSOCIATE PENSION ACTUARY RAMSEY: A lot of numbers, yes.

CHAIRPERSON MIDDLETON: And any -- any presentation that includes moving our funded status from 70 to 80 percent is a good news story. So with that, are there questions from anyone on the dais?

Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you.

CHAIRPERSON MIDDLETON: Hold on a sec.

There you go.

COMMITTEE MEMBER RUBALCAVA: Thank you. Great presentation. And I echo the Chair's comment about increasing the funded ratio. I know when the experience study came in and all those demographics changes, I was a little concerned about that, but it paid off.

There was a bullet that most of our members of the State, State members, are not in PEPRA, but I'm assuming it's growing. Can you tell us what percentage it is compared to the last valuation study?

ASSOCIATE PENSION ACTUARY RAMSEY: I don't have the comparison to the last valuation study.

COMMITTEE MEMBER PACHECO: Oh. How much -- rough. Is it -- it's growing, I know that.

ASSOCIATE PENSION ACTUARY RAMSEY: Yes. It does range population from 20 to 45 percent for each of the five plans. CHP is the one that's around 19 or 20 percent of the population, so it is -- it is growing every year.

COMMITTEE MEMBER RUBALCAVA: Okay. Thank you. I was trying to get a sense, because I know with some '37 Act counties, it's actually going faster. And so it's --

ASSOCIATE PENSION ACTUARY RAMSEY: Yes.

COMMITTEE MEMBER RUBALCAVA: -- impacting the employer contribution rates, because, you know, it's better for them. But I was trying to understand the situation here. Thank you very much.

ASSOCIATE PENSION ACTUARY RAMSEY: Um-hmm.

CHAIRPERSON MIDDLETON: Any other questions for staff on this issue?

Again, this has been very good news. As you take out your crystal balls and look at what's occurred over the course of the last year, what do you see coming in the future?

ASSOCIATE PENSION ACTUARY RAMSEY: Well, I'm so sorry. I can't really comment on that. What the State is planning to do with additional contributions, I can't --

can't say anything about that. Assuming we have that 6.8 return every year, things are going to look like that --

(Laughter.)

ASSOCIATE PENSION ACTUARY RAMSEY: -- are the projections that we provided, so fingers crossed.

CHIEF ACTUARY TERANDO: Yeah. I'll add a little bit to that. I think the biggest volatility, you know, anticipated rates are going to come from the investment side, and how our investments fair compared to, you know, our assumptions of 6.8

CHAIRPERSON MIDDLETON: All right.

Ms. Taylor.

COMMITTEE MEMBER TAYLOR: Thank you, Madam Chair. I would like to -- this is an action item, so I would like to recommend that we -- or make a motion for -- to -- let me read this, determine employer contribution rates and approve the member contribution rates for July period 2022 to June 30th, 2023.

VICE CHAIRPERSON MILLER: Second.

CHAIRPERSON MIDDLETON: We've got a motion from Ms. Taylor, second by Mr. Miller. All those in favor please say aye?

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

Congratulations. We are approved.

We will move on to Item 6d, the Schools Valuation and Employer/Employee Contribution Rates.

Change a couple of seats here.

(Thereupon a slide presentation.)

CHIEF ACTUARY TERANDO: Thank you, Madam Chair. Scott Terando, Chief Actuary again.

Similar to the last item, this is an action item. In this case, we are looking at the schools pool valuation, the results, and the required rates for both the employer and employee -- PEPRA employees for fiscal year 22-23. With that, I'll hand it over to Paul who will walk us through the results.

SENIOR PENSION ACTUARY TSCHIDA: All right. Thank you, Scott. Good afternoon, Madam Chair, members of the Committee. Paul Tschida with the actuarial office here to present the results of the schools pool actuarial valuation.

--o0o--

SENIOR PENSION ACTUARY TSCHIDA: So a lot of the -- a lot of this will be similar to the State valuation that Nina presented in terms of things like the valuation date and the relevant fiscal year for the contributions. So again, the actuarial valuation date was June 30 of 2021. And the rates that we're setting here or that we're asking you to approve are for fiscal year 22-23. All participating school employers in the schools pool will pay the same contribution rate. It is in effect a risk pool.

--o0o--

SENIOR PENSION ACTUARY TSCHIDA: So significant events, since the prior valuation, break down roughly into four categories, most of which is -- is analogous to what Nina presented for the State. We'll run through it again here with a bit more brevity perhaps.

The first is the investment return of 21.3 percent that we saw in the fiscal year ending 2021. That triggered a risk mitigation event as we all know, which reduced the discount rate from 7 percent to 6.8 percent. That discount rate of 6.8 percent was later retained by the Board in the asset liability management process that concluded late last year.

So we have a pretty strong investment gain and then we have a reduction in the discount rate, which ate into that gain a bit, if you will.

--o0o--

SENIOR PENSION ACTUARY TSCHIDA: Two other significant events, one of -- is the change in the demographics assumptions and some of the other non-discount rate economic assumptions, such as inflation, and the wage growth assumption. This was the experience study that the Board approved late last year.

And the fourth item is the expiration of supplanting payments that the State made towards the schools pool on behalf of schools employers. So this is a contribution of over $900 million made in July of 2019. The effect of that, those supplanting payments, were spread over three fiscal years.

So schools employers saw a reduction in their rate compliments of the State's contribution, but the third and final year of the supplanting payments is for the fiscal year we're in now, so 21-22. So when those supplanting payments ending going into next year, that will increase the schools employer contribution rate by 2.1 percent -- 2.16 percent relative to the year we're in now.

--o0o--

SENIOR PENSION ACTUARY TSCHIDA: On slide 5, we have the key results of the valuation that we just completed compared with the prior valuation. And there are three things that I would like to highlight on this page. The first is the funded ratio. You see that it increased 68.6 to 78.3 percent. So almost a 10 percent increase in the funded status, which is, of course, wonderful news. And that is roughly in line with what we saw Nina present for the State.

The second item I would like to show here to highlight is the employer contribution rate. That is increasing from 22.91 percent to 25.37 percent. And we will touch on that a little bit more in the coming slides.

And the third item, I would like to highlight here is an increase in the PEPRA member contribution rate. PEPRA members and the schools pool will see an increase from 7 percent to 8 percent of their pay.

So next, let's look at the funded status here on the next slide.

--o0o--

SENIOR PENSION ACTUARY TSCHIDA: Again, we have 10 years of history, a similar chart that -- for what we showed for the State. And again, you can see a similar pattern where the last few years, the funded ratio was somewhat stable. But then in this most recent valuation, we see a nice bump of approximately 10 percent. The schools pool funded ratio now is 78.3 percent. And again, that's driven -- that increase over the prior year was driven by the strong investment return, the 21.3 percent, offset partially by the effect of reducing the discount rate from 7 percent to 6.8 percent.

Okay. Next, we'll view the employer contribution rate.

--o0o--

SENIOR PENSION ACTUARY TSCHIDA: So we have last year's rate compared with current year's rate, as well as in between we have an est -- we show what our estimate was for this current year just to give you an idea of how close we're coming to what we thought it might be. And again, you can see that the rate is increasing from 22.91 to 25.37 percent. Fortunately, that's in line with what we had projected in our most recent estimate, which was 25.4.

Now, several -- several factors contributed to this change as we talked about in the first few slides. There was a -- there's quite a bit of -- there's quite a few things going on this year, changes from the prior valuation. Some of them were positive, some of them were negative. There is a reconciliation in the agenda item itself on page five that quantifies each and every item that contributed to the increase in this rate or decrease for some factors.

But again, one of the bigger factors is that expiration of the supplanting payments that the State made in July of 2019. You can see that on the left side of this slide, where last year, the employer rate was reduced by 2.16 percent thanks to the supplanting payments. But now that -- that will be expiring in this coming year, so they do not -- the schools employers will not get that benefit, hence that relative increase in the rate.

Projected payroll is actually -- the projected payroll for the contribution year 22-23 is actually a little bit less than what it was last year. And that's due to some demographic disruptions, if you will, that we saw in the schools pool membership base, as a result of the pandemic. We actually saw a decrease in the active members of the pool for the first time in a while.

So that is also putting a little bit of upward pressure on the contribution rate, but it's not -- that's not a dramatic driver, I would say. So in terms of dollars we're expecting, roughly 300 million more dollars being contributed by employers this coming fiscal year over the current year we're in now.

Okay. Next we'll talk about member contributions --

--o0o--

SENIOR PENSION ACTUARY TSCHIDA: -- specifically PEPRA members, because unlike the State -- for the State plans that Nina talked about, PEPRA members in the schools pool are required to contribute 50 percent of their normal cost, similar to public agencies. Now, the member contribution rate for PEPRA members has been seven percent for the last few years, but this year we are seeing an increase to 8 percent. And that is driven by a combination of things, but some of the bigger drivers are the change in discount rate, of course. Anytime, you reduce the discount rate, you increase the normal cost. So that's putting pressure on the normal cost.

The other assumption changes, the demographic assumption changes also contributed a bit to this. And also just experience even prior to this valuation that we're doing. The total normal cost had already increased roughly 80 basis points prior to the basis. So not enough to trigger the -- you know, it was not over the 1 percent threshold, so it was not enough to trigger a member rate change. But now that we have triggered it with this valuation, all that past experience effectively plays into the new member rate. So again, just to summarize, we have -- we're seeing an increase of 1 percent in the PEPRA member contribution rate.

I'll just mention for the record that classic members in the schools pool, their contribution rate is set by statute. It's 7 percent and it will remain 7 percent. It's just an informational item. The payroll for PEPRA members in the schools pool is 42 percent of the pool total. If you look at membership just in terms of head counts, it's actually 51 percent. So this -- we talked about the -- you know, talked a little bit about the State and their PEPRA -- their share of PEPRA members in the active population. It's even higher in the schools pool. So roughly half of the schools pool active members are PEPRA.

And that is actually driving a reduction in the cost for the employers that we estimate at about 1.4 percent of payroll. So essentially if PEPRA never happened, we would expect employers -- schools employers would be paying 1 -- would contributing 1.4 percent more than they will be as a result of this actuarial valuation. So we can -- PEPRA is -- the benefits of PEPRA are emerging over time.

--o0o--

SENIOR PENSION ACTUARY TSCHIDA: Now, lastly, we'd like to give our best estimate at this time of where we think employer contribution rates will be in the future based on what we know today.

So you see that it's good news here, where the projection is that the rates will slowly decrease over the next few years. That is primarily a result of the strong investment gain that we saw in the fiscal year ending 2021 being ramped in over the five-year period. So each year we get to -- we get a little bit more of that investment gain benefit and that is helping to push down the rates a little bit each year.

Now, I want to note that this again assumes -- like for the State plans, this assumes that investment return for the fiscal year we're in now will be 6.8 percent. So to the extent that actual return comes in differently, then this cost curve we're showing here will be a little different. And the final actuarial valuation report that we publish later this year will reflect whatever the actual return for this fiscal year is.

That concludes my prepared remarks and I'm happy to take any questions.

CHAIRPERSON MIDDLETON: All right. Are there questions?

Ms. Taylor.

COMMITTEE MEMBER TAYLOR: Yes. Thank you, Madam Chair.

Just real quick, it appears that the school employees are more impacted by PEPRA. So are we going to have any communication plan for them, since their -- their rates are going to go up?

SENIOR PENSION ACTUARY TSCHIDA: Yes, we have -- we have stakeholder briefings in a sense. There's the school employer advisory committee. It's a joint CalPERS/CalSTRS committee that meets with schools employers on a quarterly basis to discuss all things related to, you know, pensions for schools. And I have been informing that group of employers that -- I've been giving them a heads up that we expect -- that we expected this change coming.

We -- the 8 -- the 8 percent rate that we are -- are releasing now, we didn't know that that exact rate would be what it is, but we knew that it -- the odds were extremely high that the PEPRA member it would go up. So there has been some groundwork laid in informing the stakeholder groups that this change was coming. And there will be other communications released through the Actuarial Office as there are for any PEPRA member rate changes that the member rate will be increasing for PEPRA members, yes.

COMMITTEE MEMBER TAYLOR: And you have stakeholder meetings with labor as well, right?

Yes.

CHIEF FINANCIAL OFFICER COHEN: That's correct. At least on a quarterly basis, if not more frequently.

COMMITTEE MEMBER TAYLOR: That's your most -- I would assume that would be your most -- your quickest way to get out to your -- to the members themselves.

CHIEF FINANCIAL OFFICER COHEN: Absolutely. And I would note that these numbers are very similar to those that were presented to you in the fall as we went through the ALM process. So I -- all of those folks that were engaged in the ALM deliberations including school labor are very well aware that this -- this will be happening but we certainly will remind them.

COMMITTEE MEMBER TAYLOR: All right. Thank you.

CHAIRPERSON MIDDLETON: Mr. Pacheco.

DEPUTY EXECUTIVE OFFICER PACHECO: Yes. Thank you -- thank you very much for the presentation.

COMMITTEE MEMBER PACHECO: I just wanted to understand the 7 percent was from a couple years back. When was the last time we had this et at the 7 percent to 8 percent.

SENIOR PENSION ACTUARY TSCHIDA: My recollection was that that was set in the June 30, 2017 actuarial valuation is when the current 7 percent rate was set. It was based -- the total normal cost at that time was 14.07 percent, so half of that was the 7 percent. And then in each subsequent actuarial valuation we measured the total normal cost.

COMMITTEE MEMBER PACHECO: Yes.

SENIOR PENSION ACTUARY TSCHIDA: And we see how it compares to the 14.07 basis. And if it has not changed by more than 1 percent, either above or below, then we keep the PEPRA member rate at 7 percent. That's just the way the law is written. It's a way to avoid the PEPRA member it being changed ever year by just a few basis points. And so it requires a large enough change in the total normal cost to trigger a subsequent change in the -- in the member rate.

So this actuarial valuation 2021, not four years later, is the first year when the total normal cost has differed from that 14.07 basis by more than 1 percent.

COMMITTEE MEMBER PACHECO: By more than 1 percent. And that's what triggered the 7 percent to the 8 percent?

SENIOR PENSION ACTUARY TSCHIDA: Correct.

COMMITTEE MEMBER PACHECO: Okay. I see. And you mentioned the population of the PEPRA members are in the school -- in the schools pool is about 42 percent, is that correct?

SENIOR PENSION ACTUARY TSCHIDA: Forty-two percent by payroll. So of the total payroll of the schools pool, 42 percent of it is attributed to PEPRA members, by head count it's more like 51 percent.

COMMITTEE MEMBER PACHECO: So you would say about the other half would be the classical -- classical members which are -- which are stabilized at by statue for the -- with the 7 percent, correct?

SENIOR PENSION ACTUARY TSCHIDA: Correct.

COMMITTEE MEMBER PACHECO: And you don't see that changing per the classical members or do you see that --

or the if statute does change?

SENIOR PENSION ACTUARY TSCHIDA: It would require and act of the Legislature. It would require a change to the statue itself. I'm not aware of any -- I'm not aware of any movement on that -- on that front.

COMMITTEE MEMBER PACHECO: Okay. I was just -- I was just curious how that was established.

SENIOR PENSION ACTUARY TSCHIDA: Yeah. It would require -- yeah, it would require the Legislature to sign that -- you know, to pass that and the Governor to sign it. And again, I'm not aware of any movement on that front.

COMMITTEE MEMBER PACHECO: Okay. Very good. Thank you very much.

CHAIRPERSON MIDDLETON: All right. The 51 percent that are PEPRA members by head count, do we know -- have any numbers as to what it would be for the State and for public agencies?

SENIOR PENSION ACTUARY TSCHIDA: I'll let Scott address that.

CHIEF ACTUARY TERANDO: We could look up that information and get back to you.

CHAIRPERSON MIDDLETON: I would be interested --

CHIEF ACTUARY TERANDO: Yeah.

CHAIRPERSON MIDDLETON: -- to have that

comparison and look a little more closely at what the implications of that are.

CHIEF ACTUARY TERANDO: Sure. Yes, ma'am.

SENIOR PENSION ACTUARY TSCHIDA: I think that -- just to add a bit that -- that was what Nina was speaking generally to when she said it ranges from 20 to I think 40 some percent for the different State plans. She just didn't have numbers the numbers at hand, but that's what -- that was that conver -- I believe that was the same conversation about PEPRA membership by headcount. But yeah, we will be happy to dig up those numbers for the State plans.

CHAIRPERSON MIDDLETON: All right. Thank you.

CHIEF ACTUARY TERANDO: Yeah. I was just informed that around 50 percent for the public agencies as well.

CHAIRPERSON MIDDLETON: Fifty.

CHIEF ACTUARY TERANDO: But we'll get the exact numbers for you on that.

CHAIRPERSON MIDDLETON: I would like to see that --

CHIEF ACTUARY TERANDO: Yes.

CHAIRPERSON MIDDLETON: -- as well as the number of retirees that we're dealing with that are a part of that membership numbers.

CHIEF ACTUARY TERANDO: Okay. So you want the number of PEPRA retirees as well.

CHAIRPERSON MIDDLETON: Yeah.

CHIEF ACTUARY TERANDO: Okay.

CHAIRPERSON MIDDLETON: Thank you.

Are there any other questions?

This is an action item. Do we have a motion to approve?

COMMITTEE MEMBER PACHECO: (Raised hand).

CHAIRPERSON MIDDLETON: Mr. Pacheco.

VICE CHAIRPERSON MILLER: Second.

CHAIRPERSON MIDDLETON: Second, Mr. Miller.

All in favor, please say aye?

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

Most is passed. And thank you both.

SENIOR PENSION ACTUARY TSCHIDA: Thank you.

CHAIRPERSON MIDDLETON: With that, we will move on to information agenda items and that's 7a, Long-Term Valuation Report. Ms. Archuleta.

(Thereupon a slide presentation.)

DEPUTY CHIEF ACTUARY ARCHULETA: Good afternoon, Madam Chair, members of the Committee. Fritzie Archuleta, part of the actuarial CalPERS team.

I'm here to -- oh, next slide, please.

--o0o--

DEPUTY CHIEF ACTUARY ARCHULETA: I'm here today to present the results of the June 30th, 2021 valuation for the Long-Term Care Program. All information in this presentation was developed based on the state of the program as of June 30th, 2021. This is annual information item, which highlights the key aspects of the Long-Term Care Valuation Report. For your convenience a full copy of the valuation report is also attached to this agenda stem.

Next slide, please.

--o0o--

DEPUTY CHIEF ACTUARY ARCHULETA: Okay. Cutting right to the chase, the margin for the program is 10.51 percent and the funded ratio of the program is 108 percent. This valuation does reflect the 52 percent across the board premium increase applied to -- applied to the premiums in November of 2021. And it also assumes a 25 percent increase to be applied in November of 2022.

As a reminder, the margin of the program is defined as the funding surplus divided by the present value of future premiums. The margin is an important measure, because it gives us a general indication of the possible premium adjustment needed if the program becomes underfunded. The funded ratio of the program is simply the ratio of the program assets to the program liabilities.

Every year, the Actuarial Office performs a reconciliation of the margin from one year to the next. The changes to the margin between last year's and this year's valuation can be broken into two categories, first, the actual experience sustained by the program during the 2021 fiscal year, and second, the changes to the actuarial assumptions implemented due to the findings from this year's experience study.

Next slide, please.

--o0o--

DEPUTY CHIEF ACTUARY ARCHULETA: So this table will numerically reconcile the margin from 2020 to 2021. Let me just take a step back and kind of walk you through it first. So on the top line, it has the final results from 6/30/2020, and it had a final margin of 1.34 percent with a funded status of 101 percent. And the way to read this table is you take the next line down and the blue column will be the change to the margin and you simply just add that to the margin from the line above and it will give you the resulting margin next to it. So just -- I'm a numbers person myself. I've got to do stuff in my head, but it was 1.34 in that first line. And then the first item happens, it increased the margin by 10.3. So we add 1.34 plus 10.3 and that's how we get to the 11.64. Okay. So that's how you would read the table.

So I'll go through the results. So like I said, the valuation final results for the margin was 1.34 and the funded status was 101 as of 6/30/2020. During the 2020-21 -- 20-21 fiscal year, we had, as you all know, a pretty good investment year. That caused the margin to increase by 10.3 percent. But on top of that, the program experienced higher mortality, fewer new claims, and less claim payments. And we think that these experiences were largely attributed to the COVID-19 pandemic. So that experience improved the margin by 3.44 percent. So overall, the experience for the program itself increased the margin to 15.08 percent and increased the funded status to 112 percent.

Next, we implemented our changes for the assumption -- the experience study that was conducted last year. This is a little bit of a different story, but there were two big assumptions -- big assumption adjustments that we made.

The first was the claims incidence assumption update. We noticed that policyholders 90 or above, the probability of them going on claim was a lot higher than what we were assuming. So after we adjusted that assumption, we -- the margin went down by 4.79 percent.

Secondly, we noticed that the morbidity improvement that we were assuming in the model was not really substantiated with any actual data. So we lowered that improvement assumption from 0.75 percent -- or 0.75 percent to 0.5 percent, and that lowered the margin by 3.08 percent. And then we made a couple of other small tweaks and that summed to about an increase of 3.3 percent. So overall, the experience study changed the margin to 10.51 percent and we landed also at a funded ratio of 108 percent. So kind of good news overall like the rest of the actuarial reports.

And so that concludes my presentation. I can now open it up to any questions.

CHAIRPERSON MIDDLETON: Are there any questions?

Well, I think you nailed it. This is a bit of a good news story and we appreciate it. This was an information item. So unless there is any further action required, we will take and file this report. Thank you so much.

DEPUTY CHIEF ACTUARY ARCHULETA: Thank you very much.

CHAIRPERSON MIDDLETON: All right. Next is 7B, which is the semiannual health plan financial report.

(Thereupon a slide presentation.)

SUPERVISING HEALTH ACTUARY ZHONG: Good afternoon, Madam Chair and members of the Committee. Emily Zhong, CalPERS team member.

We are bringing before you Item 7B the semi-annual health plan financial report. This is an information item.

This report is provided to the Committee twice a year. It's a part of the monitoring and reporting process for the Health Care Fund status, including how plan projected fund balances, actual reserve amount, and surplus or deficits for health plan subaccount.

--o0o--

SUPERVISING HEALTH ACTUARY ZHONG: Let me start with some background. The health plans submit annual report provided financial performance for the three PPO Basic plans, 3 PPO Medicare Supplemental plans, and 9 flex-funded HMO Basic plans as of December 31st, 2021. Kaiser and other full insured plans and the association plan are not included in the scope of this report.

The Health Care Fund Reserve Policy adopted in 2018 also provide a framework for maintaining the appropriate reserve level for the PPOs and for handling the surpluses or deficits that accumulate in the PPO and HMO subaccount and we've been using the Health Care Fund surpluses to buy down health benefit premium in recent years.

Next slide, please.

--o0o--

SUPERVISING HEALTH ACTUARY ZHONG: This slide shows the recent Health Care Fund performance for the HMO and PPO plans before going through the fund status. A reminder that the Health Care Fund subaccount are used for depositing premium and paying claim and other expenses.

Our self-funded PPO plan require an actuary prudent level of reserve that include three main components. The first one is medical and pharmacy claim liability. This is to cover the fee-for-service claim that have occurred, but not reported. The second piece is risk-based capital reserve, which is based on industry standard methodology to cover and expected claim due to major health event, natural disaster, and other causes. And the last piece is the other administrative reserve is to cover the wind-down cost should a plan suddenly terminate.

On our HMO side, which only require the claim liability reserve due to the flex-funded arrangement. When the projected fund balance exceed the actuarial reserve, the plan will have a surplus. Conversely, when the projected fund balance is less than the actuarial reserve, the plan will have a deficit.

The first two column on the table are the estimated surplus or deficits for the HMO and PPO as of end of December, 2020 and as of the end of June 2021. I want to draw your attention to the three column to the right, starting from the HMO plans on the top row of the table. The estimated fund balance at the end of 2021 was 170 million. The next column show HMO's estimated claim liability for 160 million, for a surplus of 10 million.

On the PPO side, starting with Medicare, the estimated fund balance at the end of 2021 was 154 million with a required actuarial reserve level of 110 million. We have a surplus of 44 million. The line below is for PPO Basic plans. The estimated fund balance as of the end of December 2021 was 284 million. I do want to mention that this amount is sufficient to cover the medical and pharmacy claim liability. But when we're comparing to the total required actuarial reserve, the PPO basic plan have a deficit of 290 million.

The reduction in the Basic PPO fund balance started from the first half of 2021, then reduced dramatically during the second half of the year. As you can see on the table, the deficits grew significantly from 45 million as of the end of June 2021 to 290 million as of the end of December.

In the next slide, I will walk through the factor that caused the decline in the PPO Basic plan and the potential option for addressing it.

Next slide, please.

--o0o--

SUPERVISING HEALTH ACTUARY ZHONG: 2021 was a very difficult year for the PPO Basic plan. There are five factors that contribute to this 290 million deficit.

First of all, the higher than expected medical and pharmacy costs contribute to about two-thirds, or 181 million, of the deficits in 2021. Those are the dark blue and the orange section of the doughnut.

As a reminder, 2021 premium were determined at the beginning of the pandemic. The actual 2021 COVID-19 related costs came in much higher than what we expected, and primarily hitting in the second half of the year due to the Delta surge during later summer and the Omicron surge started toward the end of the year in the Holiday Season. The total COVID-19 costs in 2021 were approximately 110 million for the Basic PPO plans, which was more than double the cost in 2020.

Also, after delaying and deferring care during the first year of the pandemic, a member to their provider more quickly than what we projected. The trend was very different from what we saw in 2020, as hospital and health care provider doing a better job of accommodating patients, the non-COVID-19 medical costs experienced an upward trend, even though during the surge in 2021. On the HMO side, we are protected from the higher cost because the flex-funded and the capitation arrangement with the plan.

Now for pharmacy. The higher-than-expected pharmacy costs continued to increase throughout the years of 2020 and 2021, mainly due to the increasing utilization for the high cost specialty drug. And we also experience an expected reduction in drug rebate collection due to the underperformance of the 2021 OptumRx PBM contract.

The next one is the 2021 premium buydown. This is the gray section on the doughnut, which contribute about 47 million to the deficit. We bought down 2021 premium for the basic PPO based on the assumed savings from 2020, but this saving did not eventually materialize. As fee-for-service claim came back to full utilization level in the last quarter of 2020 and the higher-than-expected pharmacy costs also offset some of the savings.

Now, regarding investments. This is the yellow section on the graph. Two factor contribute about 31 million to the deficit. First, interest earning from the Health Care Fund are projected into the premium during rate development. In 2021, the projected interest return did not materialize. And on top of that, the Health Care Fund, which is invested primarily in bond ended in 2021 calendar year with a negative 1.6 percent performance, because in general, as interest rate rise, bond's value goes down resulting in a negative performance.

And lastly, due to the higher-than-normal health care costs in 2021, the risk-based capital and other administrative reserves also increased higher than expectations. This contribute roughly 30 million to the deficit

Next slide, please.

--o0o--

SUPERVISING HEALTH ACTUARY ZHONG: We will be addressing options to restore the fund to a surplus condition with the Pension and Health Benefit Committee during the rate development process. Already underway is an improved contract with our PBM OptumRx. The new contract retained the acquisition-based model, but with much stronger pricing guarantee. We're also exploring other pharmaceutical purchasing strategy that will be discussed in the future Pension and Health Benefit Committee. We are also improving our modeling for predicting medical costs in our current rate development process for 2023. And as we head into our new five-year PPO contract solicitation, exploring innovative way to save costs in our PPO Basic plans.

That conclude my presentation and we are happy to take any questions.

CHAIRPERSON MIDDLETON: All right. Thank you.

So the $290 million deficit, I think Mr. Moulds touched on that earlier in the Pension and Health Benefits conversation, but that's a very concerning number. For some historical perspective, how does that number of $290 million deficit compare to what we have historically encountered?

CHIEF HEALTH DIRECTOR MOULDS: Do you want -- do you want to take it the historical question?

I mean, the short answer is we've never seen anything like this. The -- Emily laid out some of the reasons why. We had -- we had in -- two pandemic spikes, we've had a handful of other issues that happened at the course -- over the course of the same year. And the COVID projections, which were the same COVID projections. Emily, early on in COVID, engaged the National Actuary Association and other peers and consultants, and we were using what was the best projections for assuming both -- both likely COVID experience, but also the relation between COVID and non-COVID experience. And really the biggest surprise in addition to, you know, having two COVID spikes in a year after we -- many folks thought that we were seeing the end of the pandemic, was that unlike the first spike, the alpha spike, where there was a corresponding dramatic decrease in normal medical care, they both went up at the same time.

And that was a combination of hospitals getting much more sophisticated, as Emily alluded to, in being able to see normal patients, not having to reschedule surgeries, and so forth; people being much less reticent about going in and seeing a physician or going into a hospital for an elected surgery; and then the use of other mechanisms like telehealth.

CHAIRPERSON MIDDLETON: All right. This may be a question that's more appropriate for the Pension and Health Committee to -- to address. But given that this deficit is solely in the PPO Basic program, not in our HMO, not in our PPO Medicare, that does beg the question that there's something specific about the program that we put together for PPO Basic that is driving this deficit.

CHIEF HEALTH DIRECTOR MOULDS: That's exactly right. We are much less able to control -- to manage costs in the PPO. There are several reasons. You know, primarily it comes down to care management. And we -- the types of tools that we use in the HMO are not available in the PPO, because there aren't the same kinds of restrictions and going, for example, and seeing a specialist before you see a primary care physician.

We've been -- one of the changes that you all approved last November was the matching of the primary care physicians with -- with PPO members. We are hopeful that that will help. We do not know that that will -- well, we do -- we do know that that will not be enough to bring the experience on the PPO side to equivalent experience that we're seeing on the HMO side. But those are -- those are important conversations to have us -- to have with PHBC and the -- and the totality of the Board going forward.

CHAIRPERSON MIDDLETON: All right. Do you have a sense as to whether or not we are at the peak of the deficit or is this going to get worse before it begins to improve?

CHIEF HEALTH DIRECTOR MOULDS: Do you want me to take -- I can take that one too.

So that's -- that's exactly the right question to be asking. That was one of the first questions that we -- that we asked when we started to see this. And the short answer is that we have been monitoring 2022 PPO experience on a month-to-month basis. We have a little bit, but not too bad, of a claims lag. But what we've seen so far in 2022 is something that looks much more like a normal year than 2021. We are going to continue to monitor that on a month-to-month basis, so we will be back -- when we come back to you in -- I keep saying you -- when we come back to PHBC in June, we will update PHBC on the experience up to that point, but that also will bear on sort of how aggressively we -- or not aggressively we need to look at addressing the shortfall.

CHAIRPERSON MIDDLETON: All right. Thank you.

Mr. Rubalcava and then Mr. Pacheco.

COMMITTEE MEMBER RUBALCAVA: Thank you. This is very sobering news, of course, but appreciate the report. But I'm confident that we're going to -- you have an excellent staff and we're going to be able to work this through.

In the doughnut, about the -- what caused the deficit and what have you, I noticed that one thing that was not listed was the third-party administrator fees. During the budget presentation earlier today, that was one item that went up. And it was based on changes in enrollment. So because it's not in the doughnut, is -- does that -- does that mean the TPA fees, which is a projected expense, isn't a significant part of the -- of the deficit? Is that the way to read it?

SUPERVISING HEALTH ACTUARY ZHONG: No. The third-party administrative fee is not part of the cost for the 290, because the third-party administrator fee is already a pre-negotiated item through the five-year contract. So this is not a part of the loss in 2020.

COMMITTEE MEMBER RUBALCAVA: But it comes out of the Health Care Fund, doesn't it, the third-party administrative expenses?

SUPERVISING HEALTH ACTUARY ZHONG: Yeah. It does come out of the Health Care Fund, but the third-party administrator fee is already priced into the premium. It's a set amount as we pay for during the year 2021.

COMMITTEE MEMBER RUBALCAVA: I see. So the -- so there's -- okay. All right. So I will not follow up the questions I had. Thank you very much for clarifying that.

CHAIRPERSON MIDDLETON: Mr. Pacheco.

COMMITTEE MEMBER PACHECO: Thank you. Thank you for the presentation. So my question is about the -- how to address this deficit with respect to the plan to address. And you mentioned improved predictive models to -- for the medical utilization. I'm wondering if you -- if you're exploring like business intelligence, AI, machine learning to kind of explore the vast data repository that we have that can find -- because I believe that if we dig into those data, we could find some insightful information that perhaps could address this deficit and make us whole again. So I'm just wondering your thoughts on that, if you can elaborate further.

Thank you.

SUPERVISING HEALTH ACTUARY ZHONG: Yes, absolutely. We are always looking for a new tool and intelligent way to look -- different way to look at our data. But one of the challenge we currently experience is the new coding for identify the COVID cost. So because in our base projection, we do expectation or a projection how the non-COVID services were looking like for the year -- next year or the after and as well as the COVID projections.

So as we know, we are still doing a part of the pandemic in the coding and hard-to-identify the COVID costs. It's basically new every single month to us. So this is another -- another thing we do need to improve and we are continuing improve how we look at the COVID costs.

COMMITTEE MEMBER PACHECO: So just a follow-up. So that means you're mentioning the CD -- the CD -- is it the ICD -- ICD-9 --

SUPERVISING HEALTH ACTUARY ZHONG: ICD.

COMMITTEE MEMBER PACHECO: -- ICD-10 codes. So they're changing because of the COVID issue that you're mentioning. I mean, they're not -- they're not static right now or they're just, because of the -- you were mentioning that because of COVID, we have these new codes and that's where the problem may be or --

SUPERVISING HEALTH ACTUARY ZHONG: Yeah. So the new code identify different part of COVID. It just continue to -- adding to the new ICD-10 list.

COMMITTEE MEMBER PACHECO: Um-hmm.

SUPERVISING HEALTH ACTUARY ZHONG: Like for example, the new code for vaccine, and the article for treatment, and also with testing as well.

COMMITTEE MEMBER PACHECO: So because of the coding, it's difficult for us to kind of get together all this data and understand the -- so I'm just trying to -- I'm trying to elaborate on the -- my head on that.

SUPERVISING HEALTH ACTUARY ZHONG: Yeah, that's correct.

COMMITTEE MEMBER PACHECO: Okay.

SUPERVISING HEALTH ACTUARY ZHONG: This is something we're currently -- we've been successfully improve a whole lost from last year.

COMMITTEE MEMBER PACHECO: All right then.

CHIEF HEALTH DIRECTOR MOULDS: Yeah. I'll also add just because you mentioned our data repository and machine learning that we are currently in the middle of a procurement for our -- for our data warehouse and have included machine learning and some of the other tools that you alluded to as objectives as things that we are seeking to have as capabilities going forward. And one of the reasons is exactly this, that it gives us a better window into --

COMMITTEE MEMBER PACHECO: Yes.

CHIEF HEALTH DIRECTOR MOULDS: -- into -- into the future.

COMMITTEE MEMBER PACHECO: I totally agree with you. I think having more tools in our toolkit is definitely helpful. And I think -- and again, I think you would be able to find -- hopefully find some insight that will hopefully address this deficit that we're experiencing right now. Thank you very much.

CHAIRPERSON MIDDLETON: Are there other questions for staff?

All right. Well, this is an information item. It is, to borrow the word, sobering, and something that we would like to hear reports of as soon as possible to come back and answer that question of is this as bad as it's going to get, and what are the steps that we need to take moving forward. So thank you.

We now move to Item 7c, which is Summary of Committee Direction.

CHIEF FINANCIAL OFFICER COHEN: Thank you, Chair. We will get the Committee and the entire Board a summary of sort of the PEPRA membership by retirement group. And I think that will be very helpful to have in one place for everyone, so they can see the trends over time.

CHAIRPERSON MIDDLETON: Great. Thank you.

Do we have public comment?

None in the room and none on the telephone?

STAKEHOLDER STRATEGY MANAGER TEYKAERTS: Madam Chair, no public comments on the phone.

COMMITTEE MEMBER FECKNER: None.

CHAIRPERSON MIDDLETON: All right. Then we have reached the point at 3 p.m. that we will adjourn this day's meetings. Tomorrow, we will resume at 8:30 in the morning with the Performance, Compensation and Talent Management Committee. Thank you all for your attention during the course of today and please be safe out there.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 3:01 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 23rd day of April, 2022.

JAMES F. PETERS, CSR
Certified Shorthand Reporter
License No. 10063