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May 12, 2009

## **AGENDA ITEM 5**

**TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION  
COMMITTEE**

**I. SUBJECT:** State and Schools Employer Contribution Rates for  
the Fiscal Year July 1, 2009 through June 30, 2010

**II. PROGRAM:** Actuarial & Employer Services

**III. RECOMMENDATION:**

That the Committee recommend to the full Board the adoption of the employer contribution rates for the State and Schools for the period July 1, 2009 to June 30, 2010 as set forth in the table on the following page.

**IV. ANALYSIS:**

### **State and Schools Employer Contribution Rates for 2009-2010**

The Actuarial Office has completed the calculation of the employer contribution rates for the State and Schools for the fiscal year July 1, 2009 through June 30, 2010. A full actuarial report will be mailed under separate cover.

The table on the following page compares the fiscal year 2009-2010 contribution rates and the dollar amounts these rates are anticipated to generate with rates and contributions for the current fiscal year July 1, 2008 through June 30, 2009.

	2008-2009 Fiscal Year		2009-2010 Fiscal Year	
	Employer Contribution	Employer Rate	Employer Contribution	Employer Rate
State Miscellaneous Tier 1	\$1,507,108,202	16.574%	\$1,659,842,332	16.917%
State Miscellaneous Tier 2	71,899,425	16.470%	71,927,813	16.737%
State Industrial	75,904,718	17.236%	89,971,498	17.251%
State Safety	281,762,944	18.411%	346,351,430	18.099%
State Police Officers & Firefighters	891,422,825	26.064%	927,608,857	25.848%
California Highway Patrol	197,083,258	32.149%	191,870,528	28.438%
<b>Total State</b>	<b>\$3,025,181,372</b>		<b>\$3,287,572,458</b>	
Schools	966,316,743	9.428%	1,081,377,863	9.709%

Please refer to Attachment 1 for the development of the employer rate for each plan.

### Reasons for Changes in Employer Contributions

The contribution rates presented in this agenda item reflect the -5.1% return experienced by CalPERS in fiscal year 2007-2008. As a result of the rate smoothing methods adopted by the Board, the impact of this negative return is being greatly mitigated. Some rates are going up and some are going down. Contribution rates for all plans are changing by less than 0.4% of payroll with the exception of California Highway Patrol which is lower by almost 4% of payroll as a result of a reduction in benefit that was bargained for and adopted by the passage of AB 2936 (2005-2006 Legislative Session).

Overall, the required contributions for the State plans have increased by \$262.4 million between fiscal year 2008-2009 and fiscal year 2009-2010. The main reason for this increase is the growth in payroll for all State plans between the June 30, 2007 valuation and the June 30, 2008 valuation.

This growth in payroll was a combination of pay increases granted to existing employees as well as the growth in the number of active employees.

The plans with the largest growth in their active membership were the State Industrial and Safety plans. For these plans the active membership grew by 13% and 9.2% respectively. Overall, the total active population for the State grew by 3.5%.

Pay increases granted to existing employees are a normal part of every employee's career. The actuarial valuations performed by CalPERS actuaries

contain assumptions regarding salary increases. Actuarial losses occur when the salary increases granted to an individual are greater than anticipated by the actuarial assumptions. Similarly, actuarial gains occur when the salary increases are smaller than anticipated by the actuarial assumptions. For the State Plans our assumptions indicate an expected average salary increase between 4.2% and 5.5%.

The total payroll for all State plans increased by 9.1% over the prior year. This is substantially greater than the payroll growth assumption of 3.25% used in our actuarial valuation. The plan that saw the greatest increase in total payroll was the State Safety plan. The projected payroll for the State Safety plan for fiscal year 2009-2010 is 25% greater than the projected payroll for fiscal year 2008-2009.

Below are three tables indicating overall active membership growth by Plan, average salary increases by Plan and the resultant overall payroll growth of the State Plans.

**Active Membership Growth in FY 2007-2008**

	<b>Number of Active Members on June 30, 2007</b>	<b>Number of Active Members on June 30, 2008</b>	<b>Increase (%)</b>
State Miscellaneous	155,795	158,482	1.7%
State Industrial	8,859	10,010	13.0%
State Safety	22,852	24,961	9.2%
State Police Officers & Firefighters	44,864	47,140	5.1%
California Highway Patrol	6,926	7,027	1.5%
<b>Total State</b>	<b>239,296</b>	<b>247,620</b>	<b>3.5%</b>

**Average Salary Growth in FY 2007-2008  
 For Members Actively Employed on June 30, 2007 and 2008**

	<b>Average Salary on June 30, 2007</b>	<b>Actual Average Salary on June 30, 2008</b>	<b>Actual Salary Increase</b>
State Miscellaneous	\$58,078	\$62,286	7.2%
State Industrial	\$46,419	\$49,635	6.9%
State Safety	\$63,372	\$72,106	13.8%
State Police Officers & Firefighters	\$71,444	\$74,062	3.7%
California Highway Patrol	\$82,689	\$91,321	10.4%

### Growth in the Projected Payroll

	Projected Payroll for 2008-2009	Projected Payroll for 2009-2010	Increase (%)
State Miscellaneous	\$9,529,563,494	\$10,241,256,666	7.5%
State Industrial	\$440,392,201	\$521,553,130	18.4%
State Safety	\$1,530,400,086	\$1,913,633,845	25.0%
State Police Officers & Firefighters	\$3,420,181,521	\$3,588,760,580	4.9%
California Highway Patrol	\$613,031,231	\$674,693,670	10.1%
<b>Total State</b>	<b>\$15,533,568,534</b>	<b>\$16,939,897,891</b>	<b>9.1%</b>

Even though the main reason for the change in contribution was the growth in payroll, other events affected the overall contribution. The reasons for the changes in employer contributions for the State between fiscal year 2008-2009 and fiscal year 2009-2010 are as follows:

<b>Reason for Change</b>	<b>Change in Required Contribution (millions)</b>
Increase due to growth in payroll and normal progression of existing amortization bases	\$199.9
First installment of the 30 year amortization of the following actuarial gains and losses:	
<ul style="list-style-type: none"> <li>• Greater than expected payroll and salary increases in fiscal year 2007-2008</li> <li>• Greater than expected number of retirements in fiscal year 2007-2008</li> <li>• Greater than expected contributions received in fiscal year 2007-2008 (higher than expected payroll)</li> <li>• Combined impact of the -5.1% investment return in fiscal year 2007-2008 and previously unrecognized investment gains due to smoothing</li> <li>• Fewer deaths than expected on Retirees in fiscal year 2007-2008</li> <li>• AB 2936 Removal of EPMC for CHP</li> <li>• Other Gains and Losses</li> </ul>	<p>59.0</p> <p>44.8</p> <p>(23.5)</p> <p>(9.5)</p> <p>15.6</p> <p>(27.0)</p> <p>3.1</p>
<b>Total Change in Required Contributions</b>	<b>\$262.4</b>

The required contributions for the Schools pool are also increasing. Overall, the required contributions for the Schools pool have increased by \$115.1 million between fiscal year 2008-2009 and fiscal year 2009-2010. The reasons for the changes in employer contributions for the Schools pool between fiscal year 2007-2008 and fiscal year 2008-2009 are as follows:

### Schools Pool

<u>Reason for Change</u>	<u>Change in Required Contribution (millions)</u>
Increase due to growth in payroll and normal progression of existing amortization bases	\$71.9
First installment of the 30 year amortization of the following actuarial gains and losses:	
<ul style="list-style-type: none"> <li>• Greater than expected salary increases in fiscal year 2007-2008</li> </ul>	52.1
<ul style="list-style-type: none"> <li>• Combined impact of the -5.1% investment return in fiscal year 2007-2008 and previously unrecognized investment gains due to smoothing</li> </ul>	(4.5)
<ul style="list-style-type: none"> <li>• Greater than expected contributions received in fiscal year 2007-2008 (higher than expected payroll)</li> </ul>	(7.6)
<ul style="list-style-type: none"> <li>• Fewer deaths than expected on Retirees in fiscal year 2007-2008</li> </ul>	4.4
<ul style="list-style-type: none"> <li>• Other gains and losses</li> </ul>	(1.2)
<b>Total Change in required contributions</b>	<b>\$115.1</b>

Attachment 2 provides the total employer rate and contributions for each plan broken down into its major components as well as a reconciliation of the rate and contributions between the two fiscal years.

### Recent Pattern in New Retirements

In recent years, the number of retirements was much greater than anticipated by the actuarial assumptions. The trend started in fiscal year 2004-2005 when the actual number of retirements were almost 50% greater than those expected by the actuarial assumptions. That trend has been coming down. In 2005-2006, the actual number of retirements was 26% greater than expected and in 2006-2007 it

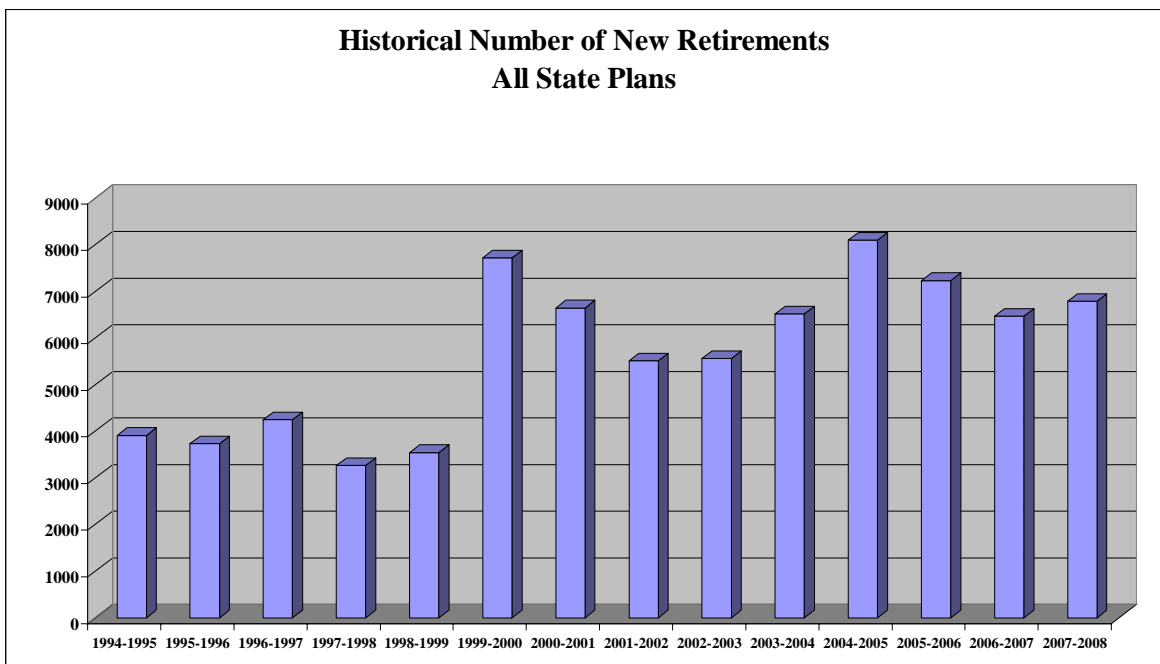
was 13% greater. In fiscal year 2007-2008, the number of State retirements increased by about 5% over the previous and was 3% greater than expected by the actuarial assumptions.

In 2007-2008, the number of retirements was below the assumed retirements for the State Miscellaneous, State Industrial and State Safety plans but was greater for the State Police Officers & Firefighters plan and the California Highway Patrol plan. We believe the reasons why these two plans had higher retirements was due to recent benefit changes.

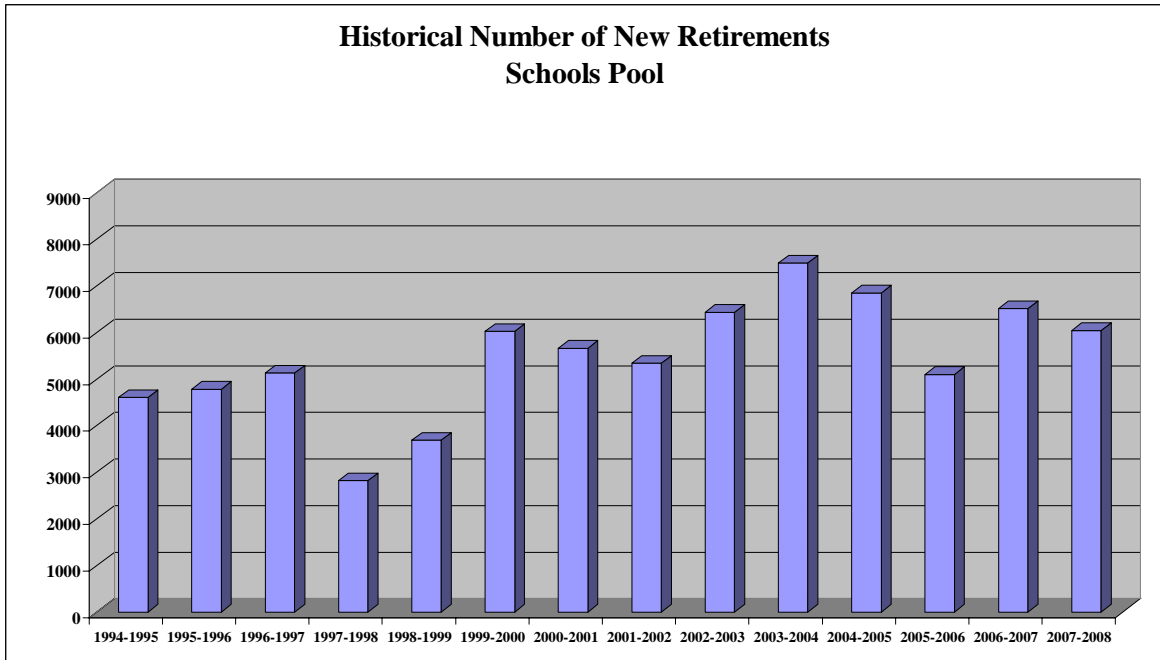
During the past year, the Actuarial Office has been working on an experience study and the results will be shared with the Board no later than the fall of 2009. In that study we are looking at demographic experience and will be deciding whether or not changes to existing actuarial assumptions are necessary and appropriate.

As can be seen from the recent trend in retirements, the main concern with reacting to sudden changes in behaviors and modifying assumptions is the fact that one would be changing actuarial assumptions and impacting employer rates each time a sudden change in behavior occurs, even if that change is temporary. Further information will be provided when the results of the demographic experience study will be presented to the Board.

The chart below shows the historical number of new retirements for the State Plans pool.



The chart below shows the historical number of new retirements for the Schools pool.



### History of the Expected Contribution Requirements

The following table shows the history the employer contributions set by CalPERS based on projected payroll for the State plans and the Schools pool going back to fiscal year 1996-1997.

Fiscal Year	Total State Contributions	Total School Contributions
1996-97	\$1,236,447,373	\$ 416,694,314
1997-98	1,223,327,746	317,571,853
1998-99	766,067,149	0
1999-00	159,460,097	0
2000-01	156,722,747	0
2001-02	677,244,769	0
2002-03	1,189,559,722	228,972,653
2003-04	2,212,518,481	869,501,830
2004-05	2,547,364,178	903,570,002
2005-06	2,428,720,628	826,672,339
2006-07	2,665,262,125	841,504,282
2007-08	2,746,929,250	919,528,538
2008-09	3,025,181,372	966,316,743
2009-2010	\$3,287,572,458	\$1,081,377,863

## Funded Status

We are monitoring the funded status of the State plans and Schools pool using the market value of assets to ensure that the new rate stabilization methods do not impair the security of benefits.

As a result of the -5.1% investment return experienced by CalPERS in fiscal year 2007-2008 versus the assumed 7.75%, the funded status has declined by close to 12% for all plans. The table below shows the funded status of the plans using the market value of assets.

<b>Funded Ratio of the Retirement Program (Based on the Market Value of Assets)</b>					
	<b>June 30, 2004</b>	<b>June 30, 2005</b>	<b>June 30, 2006</b>	<b>June 30, 2007</b>	<b>June 30, 2008</b>
State Miscellaneous	83.1%	86.2%	89.8%	98.6%	86.1%
State Industrial	88.3%	90.4%	95.0%	103.7%	91.0%
State Safety	81.3%	86.4%	89.2%	97.2%	84.8%
State Police Officers & Firefighters	83.0%	84.4%	86.0%	92.3%	82.2%
California Highway Patrol	78.7%	79.4%	81.5%	88.8%	79.3%
<b>Total State</b>	<b>82.9%</b>	<b>85.5%</b>	<b>88.6%</b>	<b>96.6%</b>	<b>84.9%</b>
Schools	91.4%	96.2%	98.7%	107.8%	93.8%

Refer to Attachment 3 for the development of the accrued and unfunded liabilities as well as the funded ratio for each plan based on the market value of assets. The actuarial value of assets is only used for setting employer rates and keeping them as stable as possible.

Please refer to Attachment 4 for the development of the actuarial value of assets for each plan.

## An Outlook for Fiscal Year 2009-2010

Back in October 2008, staff presented to the Board an agenda item discussing how the decline in investment markets since the beginning of fiscal year 2008-2009 could impact employer rates. The agenda item included a table showing potential rate increases under various investment return scenarios. Under the scenario of a -20% return for fiscal year 2008-2009, employer rates would be increasing between 2% and 5% of payroll. It would be premature to speculate further before the close of the fiscal year. Once the return for fiscal year 2008-2009 is available, staff will make an extensive communication effort to all employers.

Further, staff continues to look at alternatives regarding the impact of the investment return for fiscal year 2008-2009 on employer rates and will bring those alternatives to the Board shortly.

**V. STRATEGIC PLAN:**

This item is not a specific product of the Strategic or Annual Plans but is part of the regular and ongoing workload of the Actuarial Office.

**VI. RESULTS/COSTS:**

See attachments.

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