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February 17, 2010

AGENDA ITEM 7

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: Establishment of an Additional Contribution for Certain Plans with a Negative Cashflow

II. PROGRAM: Retirement

III. RECOMMENDATION:

That the Committee recommend that the Board approve that under the already adopted phase-in approach, additional contributions be required for any plan, State, Schools or local agencies with cash flows that hamper adequate funding progress by preventing the expected funded status on a market value of assets basis of the plan to either:

- Increase by at least 15% by June 30, 2042 for State and Schools and June 30, 2043 for local agencies; or
- Reach a level of 75% funded by June 30, 2042 for State and Schools and June 30, 2043 for local agencies

IV. ANALYSIS:

At the December 2009 meeting, the CalPERS Board directed staff to return in February, 2010 with a new agenda item which establishes a required additional minimum contribution for any plan, State, Schools or local agencies with cash flows that prohibit adequate funding progress under the already adopted phase-in approach.

The issue lies in the fact that for some plans, the net cash flows i.e. benefits being paid out of the fund versus employer and member contributions coming in are negative and represent in some cases 4% to 5% of the assets on hand.

Keep in mind that there is nothing wrong for a plan to have negative cash flows. It is expected that all plans will over time have negative cash flows. It is the normal cycle of a pension plan.

What exacerbated the issue is the fact that the assets of all plans have dropped dramatically in the last two years as a result of the -5.1% return in 2007-2008 fiscal year and the -24% return in 2008-2009 fiscal year. For plans with negative

cash flows, these negative cash flows now represent a much larger percentage of the assets.

As you know, the long term expected investment return on the CalPERS portfolio is 7.75% per year. For plans where cash flows are negative and represent 4% of the assets on hand, this means that each year, 4% of the expected return would have to be used to make up this negative cash flow, leaving only 3.75% to grow the assets.

Benefits paid reduce both assets and liabilities. However, when the plan is well below 100% funded, the funded status of such plans is very slow to progress toward 100% unless contributions are increased. If the contributions for such plans are not increased, only returns well in excess of 7.75% would increase the funded status of faster toward being 100% funded. We believe increasing contributions is the prudent and necessary step to take.

Staff is asking that the CalPERS Board approve that the contribution rate be increased for plans with cash flows that prohibit adequate funding progress. Plans needing additional contributions would be the ones where cash flows are preventing the expected funded status on a market value of assets basis to either:

- Increase by at least 15% by June 30, 2042 for State and Schools and June 30, 2043 for local agencies; or
- Reach a level of 75% funded by June 30, 2042 for State and Schools and June 30, 2043 for local agencies

The reason for the June 30, 2042 date for State and Schools and the June 30, 2043 date for local agencies is because the last payment employers will make toward the three year phase-in approach adopted by the Board will be in fiscal year 2041-2042 for State and Schools and fiscal year 2042-2043 for local agencies. The reason for such difference is due to the fact there is a one year lag between the valuation date and the contribution year for the State and Schools and a two year lag for local agencies.

Members of the Benefits and Program Administration Committee
February 17, 2010

The table below shows how the criteria for additional contributions would impact various plans including the State plans, the schools pool and six sample public agency plans. The table indicates whether or not an increase in contribution would be needed and if so how much as a percentage of pay the increase would have to be to meet these criteria.

Plan Name	Are Additional Contributions Needed?	Required Additional Contribution for the Next 30 Years as a Percentage of Payroll
State Miscellaneous	YES	1% of Payroll
State Industrial	NO	N/A
State Safety	NO	N/A
POFF	NO	N/A
CHP	YES	1% of Payroll
Schools	NO	N/A
Local Agency #1	YES	0.75% of Payroll
Local Agency #2	NO	N/A
Local Agency #3	NO	N/A
Local Agency #4	NO	N/A
Local Agency #5	NO	N/A
Local Agency #6	NO	N/A

The table below illustrates how the cash flows influence the progress of the funded status over time and how the additional contribution quoted above would impact the funded status over time.

Plan Name	Cash Flow as a Percentage of Assets	Expected Funded Status on June 30, 2009	Expected Funded Status At the End of the 33 Years *	
			Without Additional Contributions	With Additional Contributions
State Miscellaneous	-3.3%	60.8%	65.3%	75%
State Industrial	1.1%	64.7%	82.1%	N/A
State Safety	7.1%	61.4%	86.5%	N/A
POFF	1.7%	58.9%	79.1%	N/A
CHP	-1.8%	56.6%	69.3%	75%
Schools	-1.8%	66.2%	79.0%	N/A
Local Agency #1	-5.1%	69.0%	72.8%	76%
Local Agency #2	-5.5%	72.4%	76.8%	N/A
Local Agency #3	-5.2%	77.5%	80.3%	N/A
Local Agency #4	-3.9%	71.7%	77.7%	N/A
Local Agency #5	-4.1%	72.1%	79.0%	N/A
Local Agency #6	-3.5%	65.7%	76.4%	N/A

* This is the expected funded status as of June 30, 2042 for State and Schools and June 30, 2043 for local agencies.

At this time, it is estimated that the State Miscellaneous plan and the CHP plan would both have to receive additional contribution in the order about 1% of payroll to satisfy the criteria set by this agenda item.

As you recall, at the December Board meeting, the Board was provided with future estimated contribution rates and funded status under the three year phase-in approach as well as under a different method desired by the State. Attachment 1 contains a graph comparing the estimated contribution rates for State Miscellaneous under the phase-in approach, the State desired method as well as the estimated if the Board were to approve the additional contribution requirement. Attachment 2 contains a graph showing the estimated future funded status of the State Miscellaneous plan under the same three approaches.

It is important to remember that all the figures presented in this agenda item are estimates only. The Board is not approving any rates at this time. The final contribution rates for fiscal year 2010-2011 for the State plans and the Schools pool, including any additional contributions, will be approved by the Board at the May meeting. The final rates for local agencies will be established when the June 30, 2009 actuarial valuations are completed in the fall of 2010.

CalPERS administer over 2,000 local agency pension plans. Out of these 2,000 plans, we currently estimate that 30 to 40 plans might be affected by the additional minimum contribution requirements. The final number won't be known until the June 30, 2009 actuarial valuations are completed in the Fall of 2010.

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 & Employer Services Division.

VI. RESULTS/COSTS:

See Above.

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