MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

FINANCE & ADMINISTRATION COMMITTEE

CALPERS AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

TUESDAY, NOVEMBER 15, 2022

12:46 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 Frank Ruffino

Jose Luis Pacheco

Theresa Taylor

BOARD MEMBERS:

Mullissa Willette

Betty Yee, represented by Lynn Paquin

STAFF:

Marcie Frost, Chief Executive Officer

Matthew Jacobs, General Counsel

Don Moulds, PhD, Chief Health Director

Michele Nix, Acting Chief Financial Officer

Scott Terando, Chief Actuary

Randy Dziubek, Deputy Chief Actuary

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

Andy Nguyen, Assistant Chief, Pension Contract Management Services Division

Emily Zhong, Supervising Health Actuary

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PROCEEDINGS

CHAIRPERSON MIDDLETON: Good afternoon, everyone. I'd like to call to order the Finance and Administration Committee meeting.

First order of business is roll call.

COMMITTEE SECRETARY: Lisa Middleton?

CHAIRPERSON MIDDLETON: Present.

COMMITTEE SECRETARY: David Miller?

VICE CHAIRPERSON MILLER: Here.

COMMITTEE SECRETARY: Rob Feckner?

COMMITTEE MEMBER FECKNER: Good afternoon.

COMMITTEE SECRETARY: Frank Ruffino for Fiona Ma?

ACTING COMMITTEE MEMBER RUFFINO: Present.

COMMITTEE SECRETARY: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Present.

COMMITTEE SECRETARY: Ramon Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Present.

COMMITTEE SECRETARY: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

CHAIRPERSON MIDDLETON: All right. Next order of business is the Executive Report, Ms. Nix.

ACTING CHIEF FINANCIAL OFFICER NIX: Good afternoon, Madam Chair and Committee members. Michele Nix, CalPERS team member.

The agenda before you today has two action items for your consideration. We are seeking approval for the 22-23 mid-year budget revisions and the 21-22 basic financial statements. The market value of assets laid out in the basic financial statement presentation has gotten little media attention. I would to cover in more detail what that is during this presentation. However, I do want to stress that the market value rates of the PERF should be compared with their comparable snapshot from the prior year, in both instances either July for the investment return or November for the reporting return.

The two reporting periods reflect different methodologies for assessing performance and total funds. The actual -- Actuarial Office touched on these differing methodologies during the September presentation on how investment returns impact employer contribution rates.

In addition, we have two information items. The Actuarial Office will present the annual review of funding levels and risk report and the semiannual health plan financial report.

The next Finance and Administration Committee meeting is scheduled for February 2023 here in Sacramento. The agenda will include valuations, reports for Legislators' Retirement System and Judges' Retirement System number 1 and 2. And we will review the FAC del -- the Finance and Administration Committee delegation, and a report on the special retired member election results.

Thank you, Madam Chair, and this concludes my report I will be -- I am pleased to take questions at this time.

CHAIRPERSON MIDDLETON: All right. There are no questions at this time, so the next item is number 3, the action consent items, A through F. I've not received any request to pull any of those. Is there a motion to approve?

VICE CHAIRPERSON MILLER: Move approval.

CHAIRPERSON MIDDLETON: Mr. Miller approve.

COMMITTEE MEMBER RUBALCAVA: (Hand raised).

CHAIRPERSON MIDDLETON: Mr. Rubalcava second.

A voice vote. All in favor, please say aye?

(Ayes).

CHAIRPERSON MIDDLETON: Any opposed?

Any abstentions?

Number 3 is approved.

Next item is information consent items, A through D. We do have a request to pull Item C, so I will now ask for a motion to approve --

COMMITTEE MEMBER FECKNER: You don't need one.

CHAIRPERSON MIDDLETON: Hmm?

COMMITTEE MEMBER FECKNER: You don't need a motion for consent.

CHAIRPERSON MIDDLETON: Oh, it's consent. That's correct.

Then we will move on to Item 4c, and I'll recognize Ms. Taylor. Thank you.

COMMITTEE MEMBER TAYLOR: Thank you.

There we go. I just wanted to highlight this 4c, Pension Contract Management Program Report, specifically the Peninsula Community Service District, which was formerly known as Samoa Peninsula Fire Protection District. Could we go over that, because it seems like there's some outstanding stuff that we could maybe get them to pay and not have the terminated -- and plus go over how many employees are impacted, if you don't mind.

ACTING CHIEF FINANCIAL OFFICER NIX: No problem.

COMMITTEE MEMBER TAYLOR: Thank you.

ACTING CHIEF FINANCIAL OFFICER NIX: Let me call Andy up to the...

Introduce yourself and then talk a little bit about this.

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: Good afternoon. Andy Nguyen CalPERS team member. So today I will just give you just a brief background about the Samoa Peninsula Fire Protection District. Samoa Peninsula Fire Protection District contract with CalPERS for pension benefits since July 6th of 2000 -- of 1970.

Since 2001, the fire district has become a volunteer fire district and has stopped reporting active employees to CalPERS. Currently as a 6/30/2021, the District has five retirees and four beneficiaries. The District has been struggling financially for years due to the reduction in closure of business in the property tax. Back in 2020, the District has expressed their financial difficulty to continue with the pension obligation to CalPERS. They also asked us to give them some time, like temporary or permanent arrangements, because they are in the process of reorganizing this fire district into a community service district, which would allow them to have more authority to provide water and wastewaters for the District.

At that time, they provide us the financial plan for the future, where they also have a lot indication that they will be able to receive more tax funding to fund for these pension obligations. So we have agreed with that permanent arrangement, which we will see by January of 2023.

In October of 2022, the District has informed us that they -- the current plan is -- has a lot of delay. They're still in the development phase, so they inform us that they won't be able to pay the outstanding debt by

December of 2022, and we won't be able to continue for the monthly pension obligation for the next couple years. So that's where we are today. As of today, the outstanding balance is $298,000.

We have sent the first collection letter to the District and we also informed the nine members who are currently receiving retirement benefits from the District. We also reach out to the County for their assistance with no success. So we will continue to work with the District and the county to try to resolve these delinquencies. But if we are unable to resolve by January of 2023, we will have to bring this item back to this Committee potentially with a recommendation of involuntary terminations.

COMMITTEE MEMBER TAYLOR: So we have nine members who are currently receiving retirement benefits. Are there any more retiring or is that over with?

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: That's currently only nine members. There's no other inactive members awaiting to receive benefits.

COMMITTEE MEMBER TAYLOR: Okay. And how -- I hate to ask this question. How much will their benefit be reduced if they don't come up with the money.

ACTING CHIEF FINANCIAL OFFICER NIX: It could be up to 90 percent.

COMMITTEE MEMBER TAYLOR: Oof. And we just sent -- hold on. I'm -- you sent the first letter. You've engaged with the county. They said no thank you. And you have -- we have spoken to the members themselves?

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: Yeah, a handful of members had called us and we have talked to them.

COMMITTEE MEMBER TAYLOR: Is it out of our purview to encourage them to go to the -- or is this a defunct community service district and there's nobody to go to?

ACTING CHIEF FINANCIAL OFFICER NIX: I believe they could go to the county and we also sent them individual letters describing this, so they have --

COMMITTEE MEMBER TAYLOR: That they have some --

ACTING CHIEF FINANCIAL OFFICER NIX:

-- information to go there with.

COMMITTEE MEMBER TAYLOR: Okay. Was there -- so was it that they were going to reorg -- I thought there was a piece of property involved too?

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: They did reorg, so the Samoa Peninsula Fire Protection District now has -- now known as Peninsula Community Service District, which will give them more authority to provide water and wastewater service to the residents within that service area.

ACTING CHIEF FINANCIAL OFFICER NIX: Theresa to answer your question, I believe we've made agreements with them in the past. This is not the first one. There's been subsequent -- there's multiple agreements that we've made with them to get them caught up. And during one of the negotiations, they did say that they had some property that they thought they could sell. I don't think that ever came to fruition. And we've reviewed their balance sheet, and their income statements, and their financial statements, and it doesn't look like they have the funds to pay it as the District, so it would have to come a different way.

COMMITTEE MEMBER TAYLOR: And a payment arrangement was looked at and that's not feasible for the money -- for what they have?

ACTING CHIEF FINANCIAL OFFICER NIX: I do not believe, unless something comes up that isn't on the financial statements currently, that they will be able to pay the arrangement and the outstanding balance with what assets they have currently.

COMMITTEE MEMBER TAYLOR: Okay. And even with the reorg and bringing in some money, which I assume just pays for the services they're providing. But I was hoping that maybe that would bring in some money. Apparently not though.

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: Based on their financial plan, it will, but not now. It's may be done in the future.

COMMITTEE MEMBER TAYLOR: So they want you guys Back -- or want us, not you guys, they want us to take kind of a back seat and wait? Is that pretty much what they're asking us?

ACTING CHIEF FINANCIAL OFFICER NIX: I don't know that they've asked us that specifically, but I think there's been at least two payment plan arrangements, Andy.

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: Yeah.

ACTING CHIEF FINANCIAL OFFICER NIX: So has there been three or two?

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: Just two.

ACTING CHIEF FINANCIAL OFFICER NIX: Just two, so --

COMMITTEE MEMBER TAYLOR: That they've defaulted on or not made --

ACTING CHIEF FINANCIAL OFFICER NIX: Well, the arrangements were so low per month that it wouldn't catch them up. So we're basically going to accrue a higher balance as time goes on regardless, even if we gave them another arrangement.

COMMITTEE MEMBER TAYLOR: I gotcha. Okay. So we're kind of in a box at this point it sounds like. All right, I appreciate you highlighting that for us. I wanted to make sure that was out in the public, so thank you very much.

CHAIRPERSON MIDDLETON: Okay. Thank you, Ms. Taylor. What's the ages of the nine members?

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: So the average age for the nine members is about 75 years old, two out of those nine members, under the age of 70, but the rest of them are over 70 years old.

CHAIRPERSON MIDDLETON: Right. And their benefits that they're receiving right now, approximately how much of a pension are they receiving?

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: The average monthly pension for the whole nine members is about $1,500 a month.

CHAIRPERSON MIDDLETON: Fifteen hundred for each one of them?

PENSION CONTRACT MANAGEMENT SERVICES ASSISTANT DIVISION CHIEF NGUYEN: No, it's just an average, but it range from -- I think, one of them -- because we see like $30 associate to the Samoa plan up until -- they have another retiree that receive about like $3,300.

CHAIRPERSON MIDDLETON: Well, thank you. And as it's been brought up, anything that we can do to make known to the county and to the District the plight of these individuals I think is something that we should do.

Thank you.

There being no other questions, we will move on to Item 5a our action items. And the first is 5a, the 2022-23 mid-year budget revisions. Ms. Nix and Ms. Harris.

ACTING CHIEF FINANCIAL OFFICER NIX: I'll turn it over to Jennifer Harris for this.

(Thereupon a slide presentation).

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

The mid-year budget reflects adjustments to the budget that you approved this past April. This is an action item and your approval is required in order to adjust those funding levels to give us funding authority for the remainder of the 22-23 fiscal year.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Sorry. There we go.

As -- in total, we propose to increase the budget by 112 million, or 5.4 percent. There are two primary reasons for this increase, an updated projection for investment external management fees and statewide compensation and benefit adjustments.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Highlighted here is the line for investment external management fees. As we've talked about previously, the amount that we include in the budget for investment external management fees is a projection. It's based on total assets under management, or AUM, contract terms, and market conditions.

In April, our projection was 1 billion 44 million for investment management fees. And now our revised projection is 99.4 million more. And this is a result of increased assets in the infrastructure markets.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: The next increase or the remainder of the increase at mid-year is in our administrative operating cost budget, which is going up 15.7 million, or 2.8 percent. Administrative operating costs are salaries and wages for our team as well as operations and equipment expenses, or OE&E.

At mid-year, our personal services budget is going up 17.8 million. And this is a direct result of those statewide salaries, health benefits, and retirement contribution increases that we calculate based on direction from the Department of Finance. In contrast, there's a 2.1 million decrease in OE&E. The majority of this does reflect the cancellation of weekly on-site COVID testing and alignment with public health guidelines. We also have some other minor adjustments across the OE&E categories, based on our continued scrutiny of costs.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Investment operating costs, which are costs specific to our investment activity. So this is things like our trading and portfolio management systems, our appraisal fees, bank custodian fees, and investment and consultants for the Board. We are estimating these to go down $2 million at mid-year. The main driver here really is the deferral of some technology projects while Investment Office is -- Office focuses on implementing new investment strategies.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: The headquarters building budget line item that you see here reflects the amount of our headquarters costs that are funded by the PERF. Attachment 1 goes through the details of our headquarters building budget. And you'll see there that total costs are not expected to change.

However, our allocation and our calculation of costs that are funded by the PERF versus the affiliate funds has changed. It results in a $9,000 decrease to the PERF and the off setting increase is in the administrative operating budget, which is our mechanism and authority for charging the Affiliate Funds for their share of rent or the headquarters building costs.

And we already went over external investment management fees.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: So the last category is our third-party administrator fees. Similar to the investment external management fees, the amounts that we include in the budget are a projection and they are based on external factor. And specifically in this case, they're largely impacted by member enrollment changes. At mid-year, we are estimating a net 1.1 million decrease in total third-party administrator fees. This includes a $2 million decrease in health plan fees. Now, this is again resulting from member enrollment changes following open enrollment. Then we also have an 800,000 offsetting increase for long-term care fees. And this is driven by a contracted inflationary driven rate change in that contract that was specified.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: So in total, we are proposing 112 million at mid-year.

That's the end of my presentation for the mid-year changes. But before I close, I'll give you a brief update on how we ended last fiscal year.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: At June 30th, CalPERS ended the 2021-22 fiscal year with a net 52.4 million in savings. This included 78.5 million in unexpended funds in our operating costs, offset by a 26.2 million overage in projected external management fees. That's both investment external combined and netted out against third party.

As Attachment 2 goes into detail, we had savings in administrative costs resulting from position vacancies, as well as across various OE&E categories. Investment operating costs also came in lower than budget -- budgeted, largely due to the Investment Office focusing on those new investment strategies and implementing them.

We had a slight decrease in costs for headquarters building costs, particularly operating costs. Last year, we were still predominantly remote, and so operating costs came in lower than expected. We did have an increase in investment of external management fees from what we had projected this time last year. And those really were attributed to more capital deployed in both the infrastructure and the private equity markets. And then finally a slight under budget here for our third-party administrator fees, based on final actual enrollments for the health programs.

So that's the close of my presentation. I'm happy to answer any questions to help inform your decision to approve the mid-year budget.

CHAIRPERSON MIDDLETON: All right. Are there any questions for Ms. Harris?

COMMITTEE MEMBER TAYLOR: No, but I'll make a motion.

CHAIRPERSON MIDDLETON: All right. Go ahead ane make the motion.

COMMITTEE MEMBER TAYLOR: Hold on. There you go.

CHAIRPERSON MIDDLETON: Motion to approve.

COMMITTEE MEMBER FECKNER: You've got to click on her.

CHAIRPERSON MIDDLETON: There you go.

COMMITTEE MEMBER TAYLOR: I make a motion to approve the mid-year budget.

COMMITTEE MEMBER PACHECO: I'll second it.

CHAIRPERSON MIDDLETON: Second by Mr. Pacheco.

All in favor, please say aye?

(Ayes.)

CHAIRPERSON MIDDLETON: Any opposed?

Thank you.

So with that, we will move on to item number 6, which are our information agenda items. And we will begin with an annual review of funding levels and risk report from our actuaries.

ACTING CHIEF FINANCIAL OFFICER NIX: Madam Chair, would you like me to go over the basic financial statements?

CHAIRPERSON MIDDLETON: Oh, please. Thank you.

ACTING CHIEF FINANCIAL OFFICER NIX: Okay. Then we'll do that first.

CHAIRPERSON MIDDLETON: Yes.

(Thereupon an slide presentation).

ACTING CHIEF FINANCIAL OFFICER NIX: Okay. I would like to present a few highlights from the basic financial statements for the fiscal year June 30th, 2022. The statements will be incorporated into the annual comprehensive financial report upon your approval.

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ACTING CHIEF FINANCIAL OFFICER NIX: Okay. The PERF total net assets were 439.4 billion at the end of June 30th, 2022. The annual money weighted rate of return was negative 7.5 percent, resulting from mixed performance results from all globally diversified assets classes. Drivers of the PERF's investment return include losses in public equity and debt holdings, partially offset by gains in private market holdings.

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ACTING CHIEF FINANCIAL OFFICER NIX: Okay. So this is the PERF annual rates of return. The investment return is comparable between time weighted and money weighted. The time weighted rate of return is negative 6.1, which is the number that we presented back in, I believe, September for the June 30th investment return, and the money weighted return was negative 7.5, as of June 30th, 2022.

The negative 6.1 represents investment performance shown in accord -- in accordance with investment industry standards. This measure represents investment returns that are available in June, which means the real assets and private equity includes returns from April 1st of 2021 through March 30th of 2022, or more commonly referred to as a quarter lag reporting.

The negative 7.5 represents investment returns shown in accordance with GASB financial reporting standards. This measure represents investment returns that are available through September, which means the market movement for real assets and private assets does not -- does include lagged -- doesn't include lagged reporting, but it considers instead the last quarter of the fiscal year before the final -- financial statements are finalized.

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ACTING CHIEF FINANCIAL OFFICER NIX: Slide four defines the way we measure rates of return. This slide was used in the actuarial presentation at the September meeting. We updated the market value of assets to include the final numbers. So it had question marks in September, so we didn't know the number yet. This slide is a review of the differences between how the market value of assets changed compared to prior year for both investment reporting and financial reporting.

It is important to note, as I said earlier, that the market rate values of the Public Employees' Retirement Fund should be compared with their comparable snapshots from the prior fiscal year. The two reporting periods reflect different methodologies for assessing performance and total funds.

While this does not change the 2021-22 fiscal year-end investment numbers we reported in July, private asset performance through the end of June is factored in the annual report and will be incorporated in the employer contribution rates in the fiscal year of 22-23 and '23 and '24 evaluations.

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ACTING CHIEF FINANCIAL OFFICER NIX: The PERF net position decreased by 37.9 billion, or 7.9 percent, from 477.3 billion as of June 30th, 2021 to 439.4 billion as of June 30th, 2022. Over the 10-year period from June 30th, 2013 through June 30th, 2022, the net position increased 177.4 billion, or 67.7 percent.

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ACTING CHIEF FINANCIAL OFFICER NIX: Additions to the PERF's net position include contributions for employers and members. Investment income is comprised of investment -- of interest income, dividend income, and net appreciation or depreciation of the fair value of investments. Gross investment loss include net security lending income. And it was 34.8 billion in fiscal year 21-22 compared to the income of 88.1 billion in fiscal year 20-21. This was due to investment losses primarily in public market asset classes in the current fiscal year.

Employer contributions increased by 2.7 billion, or 13.3 percent, due in part to State furloughs resulting in salary reductions in the prior year, but not in the current fiscal year. Member contributions increased 402.7 million, or 8.5 percent, because of the reduction in the member compensation due to projected State revenue falls from COVID in the prior year, but no such projection in this current year. Deductions from the PERF are comprised of benefit payments, refunds of contribution to members and beneficiaries, and the costs of administering the PERF. Benefit payments are the primary expense of this retirement system.

For physical -- fiscal year 2021-22 retirement death and survivor benefit payments increased $1.7 billion, or 6.2 percent, primarily due to cost of living increases in benefit payment and to an -- to the increase in the number of retirees and beneficiaries of 3.3 percent. It was 750,618 of June 30th, '21, but it went to 775,285 as of June 30th, 2022.

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ACTING CHIEF FINANCIAL OFFICER NIX: As mentioned in slide six, investment income is made up of net appreciation or depreciation of investments, interest income and dividend income. As this chart shows, losses were in the public market holdings and gains were in the private market holdings.

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ACTING CHIEF FINANCIAL OFFICER NIX: This chart shows the unfunded liability and funded ratio through June 30th, 2021, since the valuations are always lagged in reporting. The unfunded actuarial liability, or the excess of total actuarial accrued liability over the market value of assets was 110.6 billion at June 30th, 2021.

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

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ACTING CHIEF FINANCIAL OFFICER NIX: In FY 21-22, 27.9 billion was received in contributions, while 21.9 billion was paid in benefits. Contributions increased 12.4 percent from FY 20-21, primarily due to the ending of the pandemic response salary reduction impacts to contributions due in the prior period.

That's all the slides I had for you. I'd like to acknowledge that these financial statements as well as the entire comprehensive financial report was, you know, the result of many hours of hard work from a lot of team members across CalPERS, and most definitely from the FRAS team members.

With that, I would be happy to take any questions that you might have.

CHAIRPERSON MIDDLETON: And we have a question from our President Taylor.

COMMITTEE MEMBER TAYLOR: Yes. Thank you, Chair Middleton. Ms. Nix, thank you very much for the very comprehensive report. I always with all look at our benefit payments and contribution graph, because I'm like how do we make that? But -- but, yeah, it looks like only a couple of times did contributions exceed our benefit payments, which is kind of not great. But is there any -- yeah. No, I know. It's -- so is there any way that we can do better on making sure that -- I know that we're a mature fund. I was just hoping for a little good news there.

Oh, you want the actuaries to cover it.

ACTING CHIEF FINANCIAL OFFICER NIX: I think the actuaries want to talk about that, so I don't want to steal their thunder.

(Laughter).

COMMITTEE MEMBER TAYLOR: I saw -- I saw Scott was like I want to talk about it.

CHIEF EXECUTIVE OFFICER FROST: I know. So, Ms. Taylor, it's your choice. So they can talk about it in the next agenda item, which is our --

COMMITTEE MEMBER TAYLOR: In Risk and Audit.

CHIEF EXECUTIVE OFFICER FROST: -- risk and funding report or they can come up to the table now.

COMMITTEE MEMBER TAYLOR: That's fine. I can wait.

CHIEF EXECUTIVE OFFICER FROST: Okay.

COMMITTEE MEMBER TAYLOR: It's always a little -- when I only see two times that we made more contributions than -- so I just wanted -- but otherwise I think your mid-year budget revision and the basic financials are excellent. We appreciate all the work that you guys put into it, and I would like to make a motion again to --

CHAIRPERSON MIDDLETON: We still have --

COMMITTEE MEMBER TAYLOR: Oh, we have more. Okay

CHAIRPERSON MIDDLETON: We have more, but we'll get to you.

All right. Mr. Pacheco.

COMMITTEE MEMBER PACHECO: Yes. Thank you. Thank you, Chairwoman Middleton and thank you Ms. Nix for your presentation. I really enjoyed reading this material. I just wanted a question on the understanding, because I just want to understand the GASB reporting of the 7.5 versus the actuarial of the 6.1.

ACTING CHIEF FINANCIAL OFFICER NIX: Um-hmm.

COMMITTEE MEMBER PACHECO: And just wanted to know, is that a normal process that we report out the actuarial losses before the GASB? I'm just trying to understand the timeline there.

ACTING CHIEF FINANCIAL OFFICER NIX: Yeah, let me clarify that the 6.1 is actually investment performance through June 30th.

COMMITTEE MEMBER PACHECO: Okay.

ACTING CHIEF FINANCIAL OFFICER NIX: Not actuarial, so I want to make sure that we clarify that.

COMMITTEE MEMBER PACHECO: Thank you.

ACTING CHIEF FINANCIAL OFFICER NIX: It is common in almost every pension fund across the United States that has private assets. They do lag reporting, because it's just not available at the time that year-end happens. So it's generally a lag reporting of a quarter and it's common across the industry to measure the investments as compared to Each other. So you want to make sure that we're reporting using the investment standards at June 30th for the 6.1, in the same way that say CalSTRS would or a retirement system in Missouri.

But the GASB reporting, that happened back in 2015. So we've been doing this for a little while now.

And that methodology is -- recognizes that cash flows happen. It's really technical. I won't go into that, but it does recognize cash flows in a different way, so it has a different methodology for computing, which is why you can't really compare the two, but we also have more time between the end of the year and the financial statements to make sure that we include all of the information that we have available, so that we have the most current and accurate financial statements.

COMMITTEE MEMBER PACHECO: Oh, I see. Now, I understand that.

And then the other question I have, now it's the unfunded liability and the funded ratio. I just -- I -- it's on page eight of 10. And I didn't -- I just noticed the trend, since -- so I guess since 2018, it appears that the unfunded AAL has -- it went from 150 to 158 and then 163, and then all of a sudden it dropped to 110. I just wanted to understand that trend there in the --

ACTING CHIEF FINANCIAL OFFICER NIX: Okay. I'll have Scott come up. I mean, I could answer it, but he's probably more prepared to answer it than I am.

CHIEF ACTUARY TERANDO: Sure.

COMMITTEE MEMBER PACHECO: Thank you.

CHIEF ACTUARY TERANDO: Good afternoon. Scott Terando, Chief Actuary. What happened in 2021, if you remember, we got the large increase in return. Our returns jumped up 20 percent. Funded status for most -- for the PERF went from 71 percent to 82 percent. You know, that's the reflection of that.

COMMITTEE MEMBER PACHECO: Oh, I see.

CHIEF ACTUARY TERANDO: So it was -- it was -- as you can see, you know, there's a Steady progression on the liabilities. But what happened is the -- there was a large jump in the assets that reduced the unfunded liability.

COMMITTEE MEMBER PACHECO: I see now. Thank you very much for that clarification.

CHIEF ACTUARY TERANDO: Sure.

CHAIRPERSON MIDDLETON: I don't see any other questions. The last two years have been a roller coaster to say the least. What is very pleasing in looking at these reports is we've consistently been in a position where there is no risk that we're not going to be making the benefits payments that we're responsible for making.

And we try to take a very long view. As I looked at some of those charts, if you separate out the incredible gains that we had in 20 -- in fiscal year 20-21, it's actually a fairly straightforward gain from one year to the next. So we obviously will be monitoring this year.

But I thank you and all of your team for the work that has gone into this and we look forward to what we hope will be a quieter year.

ACTING CHIEF FINANCIAL OFFICER NIX: Thank you.

CHAIRPERSON MIDDLETON: All right. With that, now we get to move on to Item 6 and Mr. Terando.

COMMITTEE MEMBER FECKNER: It's an action item.

CHAIRPERSON MIDDLETON: Oh, excuse me. Theresa, you want to make your motion now.

COMMITTEE MEMBER TAYLOR: We were discussing accounting over here. I make a motion to approve the basic -- 2021-22 basic financial statements. All right.

COMMITTEE MEMBER PACHECO: Second.

CHAIRPERSON MIDDLETON: And second by Mr. Pacheco.

All in favor please say aye?

(Ayes).

CHAIRPERSON MIDDLETON: All those opposed say no?

That is approved.

Scott, Randall, please begin.

(Thereupon a slide presentation).

CHIEF ACTUARY TERANDO: Thank you, Madam Chair, members of the Committee. Scott Terando, Chief Actuary.

Today, we have our review of the funding levels and risk report. This is an annual report that provides a comprehensive summary of current funding levels, near-term outlook of required contributions, and it gives us important information concerning the risk faced by the system.

By understanding these risks, you know, CalPERS and their agencies can consider if there are additional opportunities that can be taken to further reduce both the risks out there and increase the sustainability of the system.

I'm joined today by Randy Dziubek, who will walk us through this presentation and provide details of where we are in the system and some conclusions.

So, Randy.

DEPUTY CHIEF ACTUARY DZIUBEK: Thank you, Scott. Randy Dziubek, CalPERS actuarial team.

I want to start off by saying, I don't really have a slide that's going to address the question asked earlier about the relationship between benefit payments and contributions. I don't know if it's too much to put that back up and maybe we can answer that now, before I get into my slides or do people have it pictured in their heads sufficiently enough.

CHAIRPERSON MIDDLETON: Ms. Taylor, do you want to go back or we answered?

COMMITTEE MEMBER TAYLOR: I think we're good.

CHAIRPERSON MIDDLETON: I think so as well. So let's go ahead and proceed forward.

DEPUTY CHIEF ACTUARY DZIUBEK: Oh, sure. I'll wait for our slides to come up.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. So Scott has covered the important items that we're going talk about today. Let's jump into looking at one of the key measures of the system and that's the funded status.

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DEPUTY CHIEF ACTUARY DZIUBEK: We've already had a little bit of discussion of this in Michele's presentation. I'll try to add a little bit of context to that. So what we're looking at here is the funded status on three different measurement dates: June 30, 2020; June 30, 2021, and June 30, 2022, on an estimated basis. We know what the assets are as of June 30, 2022, but we do not have the valuations completed that actually set the actual funded status. So this is still an estimate at this point.

And we have the PERF numbers all the way to the right of the chart. And then to the left, we have different -- large groups of different kinds of employees within the system. And I think what you can see pretty clearly the trend in all of the employee groups is a pretty substantial increase from 2020 to 2021, and then a sizable decrease from 2021 to 2022. And not surprisingly, that's primarily the results of the investment returns for those two years. And Michele did a good job explaining the difference between minus 6.1 and minus 7.5. I'm really not going to get into that, but suffice it to say, everything you're going to see here today, every projected number that we're showing you is based on the most recent financial reports as of 6/30/2020.

So I think a couple important comments to take into account here. First of all, I think CalPERS is one of a small group of employers that actually uses the market value of assets to determine their funded status. Many systems around the country use a smoothed value of assets. They're smoothing in investment gains and losses. They are not as likely to see these larger ups and downs in the their funded status over period of years. CalPERS prefers to use market value, believes it's a more transparent measure, but we're going to see this type of volatility.

Now, to accomplish really the same thing that the others are trying accomplish, which is to not have employer contributions jumping impact up and down, we prefer to smooth the impact of the investment gains and losses directly into our employer contributions. So we're not dealing with high volatility in the contributions, because of this particular methodology.

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DEPUTY CHIEF ACTUARY DZIUBEK: Now, one of the measures that we look at every year, and we also look at it during the ALM study, is the probability of our plans falling below 50 percent funded. And for this purpose, 50 percent is sort of an arbitrary threshold that we've selected. Nothing in particular happens if you fall below 50 percent. You know, you're not in the death spiral that you can't work your way out of. However, I think we all understand that the lower the funded ratio gets, the harder it is to dig out of that whole. And so this is just a consistent measure that we look at it. And over the years, we can sort of judge the direction that the system is moving in by looking at this.

Now, the way we constructed this chart is first we took all of our non-pooled public agency plans - there's about 420 of those - we ran them all 5,000 times under simulated investment returns for the next 30 years. And for each of those 420 plans, we looked at the percentage probability that that plan would fall under 50 percent funded over the next 30 years. Then to construct the chart, we simply created five percentage bands and counted up the number of plans that fell within those bands.

So, for example, the highest bar in the chart the bluish-gray bar indicates that 87 of our miscellaneous plans had somewhere between a 25 and 30 percent chance of falling below 50 percent funded over the next 30 years And some plans have higher percentages, some lower. It's not show here, but the report does show that the State miscellaneous group, which is a very large group, came out at 23.4 percent. The schools pool was 24.9 percent. So these are -- these percentages are higher than they would have been last year, because we're starting from a lower funded status of 72 percent.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. Let's look at some actual contribution rates, employer contribution rates. What we have here are contribution rates determined as of June 30, 2020 and June 30, 2021. Again, even though June 30, 2022 was in the past, we have not computed -- completed those reports as of yet. Those will be done sometime next summer. So what we see here is the green bars represent results determined in the 2020 valuations, blue bars are results from the '21 valuations.

And in particular, if you look at the public agency results, we've got public agency miscellaneous plans, and public agency safety plans. What you'll see here is a rather small decrease from 2020 to 2021. And that's again primarily the results of the 21.3 percent investment return.

Now, the reason you don't see that in the other employee groups is that those are State and schools employee populations. And what happened with regard to the green bars is that the State came up with additional funding and used that as what we refer to as supplanting contribution payments. So they sort of bought down the employer contribution rate in that year. So the green bars for the State and schools groups are actually arbitrarily a little bit lower than they otherwise would be. And so when those supplanting payments went away the next year, the blue bar just popped up to sort of the normal expected contribution rate.

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DEPUTY CHIEF ACTUARY DZIUBEK: Now, the -- I want to mention that the decrease in the public agency rates is relatively modest and that's because of our smoothing of the impact of the investment gains and loss. If we didn't have that five year smoothing, there would have been a bigger decrease, but that works in our favor when we have to deal with losses obviously.

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DEPUTY CHIEF ACTUARY DZIUBEK: So now we look at projected contribution rates. And now for these, since we do know we had a return of minus 6.1 last year, we have factored that into our projected contribution rates. This is the same different employee groups that we saw in the previous slide. And what you generally see is fairly smooth, but modestly increasing contribution rates over the next five years. You don't tend to see large spikes, up or down, again because of the smoothing technique that deals with large investment gains and losses.

And I think I would say in talking with employers, and I'm sure you all speak with employers and hear the same thing, the level of contributions we're at right now is somewhat high for some of our employer agencies. It can be problematic for them in terms of their budgets. We don't have many, if any, significant issues of employers actually not making their contributions, aside from the one talked about earlier. But I think the point is that should we have future unfavorable experience that would raise these rates further, we would have some concerns that that would start to be more of a problem for some of our employers.

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DEPUTY CHIEF ACTUARY DZIUBEK: So the projections on the previous slide were all based on an assumption that we earn 6.8 percent, which are expected rate of return in the future, but it's also important to look at, well, what happens if we don't get our six percent -- our 6.8 percent expected return? And what we've illustrated here is if our returns are one percent lower and one percent higher than our expected 6.8, so 5.8 and 7.8.

The left-hand side of the chart illustrates the projection of the funded status for the entire PERF. The right side of the chart illustrates projected employer contribution rates for sample, miscellaneous, and safety plans. And I think the point of this chart that I'd like to make is that in any one year, if we get a return that's not of 6.8 but it's within one percent of 6.8, for one year, that's not really going to show up much in the valuation results. That's really going to be almost unnoticed. But if something like that continues over a prolonged period of time - 10 years we're illustrating here - you can see how, you know, the impact accumulates and can get to a fairly substantial deviation of results, if that were to continue over a long period of time.

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DEPUTY CHIEF ACTUARY DZIUBEK: Now, in any single year, of course, we can get a return that's significantly higher or significantly lower than our expected 6.8. And what we tried to illustrate here is what I'll call a shock return in the first year and then 6.8 in the years thereafter. The shock returns that we've modeled are one and two standard deviations above and below the 6.8 expected return. The solid green and pink lines are the one standard deviation lines and the dashed lines are two standard deviations.

And I think the important point here, which we've sort of seen already, is that our funded status can move substantially up or down, even in one year, with a really good or really bad return. Now, on the other side when you look at the contribution impact, you see it starts out much more gradually, because of the five-year phase-in. Now, if in that period, we don't have sort of correcting returns that go in the opposite direction, yes, after five years, when the full impact of those gains and losses are phased in, you see some large deviations. But the smoothing period allows us to have returns that balance each other out, which is exactly what we had in the last couple years.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. An item that we added this year into the report was the impact of high inflation. A very timely issue of course. Not that long ago, back in June I think it was, we hit a 40-year high in inflation of just over nine percent. Inflation impacts a number of things that then impact our funded status and our employer contributions, such as cost of living adjustments for retirees, pay increases for our members, and various regulatory caps on compensation that can be used to determine benefits or the benefits themselves. And Anthony did a nice discussion of limitations under section 415(b) earlier today.

Now, we don't know how long this higher inflation will last, so we've come up with a few different possible scenarios and performed some modeling on those to show you the possible impact of this high inflation on our valuation results.

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DEPUTY CHIEF ACTUARY DZIUBEK: So our three scenarios we've simply labeled fast, medium, and slow. And those terms just denote the speed at which we go from this high level of inflation back down to something closer to our expected long-term inflation assumption of 2.3 percent.

Now, the projection years, you see one through four and then five and beyond, that's a little confusing. Let me explain what we mean by that. They're labeled projection years, because the inflation in those years has not yet hit our actuarial valuations yet. We haven't done the '22 valuation yet as you know. And so actually, year one here is calendar year 2021. Okay. So that year has already occurred. We know inflation was roughly five percent for that year. That's why we've got five percent for year one in all of our scenarios.

Year two is the year that we're in now 2022. We're running about eight percent. Every time the report comes out, it seems to be around eight percent. We got some good news last month. I think it was down to 7.7, so some progress there. And it's not until next year that our scenarios start to deviate in terms of what inflation might be going forward.

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DEPUTY CHIEF ACTUARY DZIUBEK: So with those three scenarios, we again ran our non-pooled miscellaneous plans. Well, we ran miscellaneous and safety, but what this slide shows is just the results of the miscellaneous plans. Each line corresponds to one of those three inflation scenarios and what we're plotting here is the estimated increase to employer contribution rates solely as a result of this higher inflation.

Now, we're running a number of plans here and so we had to have some way of picking either the average or we decided to go with the median of our results. That -- that's what's represented in these lines. The median results of our miscellaneous plans. And what you can see is that under the slow recovery scenario, which is the one that would add the most cost to the plans, in the next five years or so, perhaps employer rates could go up by as much as eight percent or even more. Again, these are median, so some of the results are higher, some are lower.

Now, the two important comments I want to make about these two charts, including the next chart I'll show you, number one, we do believe over time that pay increases will keep pace with inflation. However, what typically happens is that pay increases are going to lag a little bit behind when high inflation actually hits. In other words, if inflation was five percent higher than we would expect, it doesn't mean in that very year everybody is getting a five percent higher pay increase. But over a relatively reasonable period of time, we do think pays will keep pace with inflation.

But what's -- so what we've assumed for simplicity is that these pay increase would occur exactly consistent with the higher inflation. I don't want to say it's a worst case scenario, but what's probably more likely is that that -- those increases will drag out a little bit longer, meaning you can sort of picture these lines with a little bit of a lower slope, still getting to the same ultimate results, eight percent, for example, for the slow recovery scenario, but probably taking a little bit more time to get to that point.

And I think the other important point I want to make is that, you know, we do expect, although we can't quantify it or even estimate it, but we do expect that high inflation would lead to some higher revenues for our employer agencies. And so, yes, their dollar contributions are expected to go up at these rates. However, if revenues are also increasing to some extent, that should give them a little bit better ability to meet those higher contributions.

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DEPUTY CHIEF ACTUARY DZIUBEK: And then quickly, just to show you the safety plans, the results have a similar look to them. But with regard to safety plans, these types of impacts usually have a bigger impact on the safety plans, given that they generally have more generous benefits than the miscellaneous plans.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. So I want to wrap up and just talk first about some risk-mitigating activities that I think we've all taken part of and our employers have taken part of that I think deserve some recognition. First of all, the Board adopted changes to our Amortization Policy a few years ago now, but the changes are at a prospective basis, so they're still working their way in, but they're capping the period of time over which employers payoff unfunded liability at 20 years now, rather than 30, which should definitely improve the likelihood that plans don't fall too dangerously low funding levels.

The next two items I think, you know, we give credit to our employers who have, over the last several years, given CalPERS more money than is required in the way of additional payments. And they've also made use of separate trusts, section 115 trusts. Sometimes with us we have a section 115 trust, sometimes with a third party. But in combination, those two things -- when an employer does those two things, they improve the funded status of their plan. They likely lower the long-term costs of their benefits by paying off costs earlier, and they deal with some of the volatility and the contribution rates. They've got a sort of a rainy day fund in this 115 trust. If the contribution rates spike, they've got a place to go to get extra money to help them with that in that year.

The Investment Policy, that was adopted by the Board just last year. It maintains a relatively high 6.8 percent expected return. And I'm sure everybody would have liked that to have been higher, including us. It's very difficult in this environment to construct a portfolio to earn even 6.8, let alone more than 6.8. And I think our Investment Office, in connection the Board, were able to come up with a policy that achieves that and used some creative techniques to keep the volatility at a reasonable level as well.

And then the Actuarial Office has done a couple things I think that are important. We've improved our techniques for assessing actuarial assumptions and recommending new assumptions to you for approval. We think that that will result in less deviation of experience from assumptions over time, which would limit volatility in our valuation results. And we have a couple modeling tools that we developed a few years ago that we continue to enhance. Pension Outlook is maybe one that you've -- you're familiar with. We have a lot of employers using that to forecast contributions in the future and help decide if they -- what's the impact of making additional contributions if they choose to do that.

We're always thinking about adding more functionality to that tool. Being able to model high inflation comes to mind right now. That might be the next improvement that we make. So we're going to continue with those efforts.

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DEPUTY CHIEF ACTUARY DZIUBEK: This is just a quick summary of the additional payments we have received just from public agencies. This does not include extra contributions from the State. The purplish sections of the bars are a result of pension obligation bonds. And it -- you may consider that more of a shifting of debt rather than an elimination of debt. But even beyond that, the green sections over the last two years, we've received more than a billion dollars of additional contributions, voluntary extra contributions from our employers, which I think has significantly improved the plans for those employers.

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DEPUTY CHIEF ACTUARY DZIUBEK: And finally, just a couple quick notes to think about going forward. Of course, we want to continue to improve our modeling tools. We also want to continue our efforts to engage with our stakeholders, our employers, and hear about their experience with making these contributions, how affecting their budgets. There's only so much that we as the team and you as the Board can do to moderate contribution levels, but there are -- there are things that can be done, choices that can be made, and getting the appropriate feedback is always the best way to go with regard to those decisions.

And lastly, the first bullet point here, probably one of the biggest, maybe the biggest decision that you make with regard to this pension program is the amount of investment risk that you are going to select with regard to the Investment Policy. In order to get those high returns that we would like to get, there has to be some level of investment risk. And that balance is a very difficult decision. We just went through that at the end of last year. We'll do a mid-year ALM review, and then four years from now a formal ALM review.

But just important for everybody to keep in mind also that we do have a funding Risk Mitigation Policy that is in force that could -- under the right circumstances, would require under that policy a change in investment volatility and likely the discount rate. So just something for all of us to keep in mind.

And with that, I'm going to end my prepared comments and we're happy to take any questions.

CHAIRPERSON MIDDLETON: All right. Great. Thank you very much for a wonder -- excellent report.

Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you, Ms. Chair. I also want to thank you for an excellent report. And I do want to -- I think it's very appropriate that CalPERS does these risk assessment kind of views. And I think it's also very good that the last slide ended -- or the last couple slides talked about some of the risk mitigation efforts that this Board has taken, and talked about the funding risk mitigation.

I remember one of my first actions when I came on this Board was voting to lower the amortization period from 30 years to 20 years. And that was to stabilize the system in the long run. Immediately -- I mean, the short term it did impact the employer contribution rates, but in the long term, it gets us closer to get to 100 percent funded and stabilizes the employer contribution rates.

You were -- I noticed you said that -- that that's one of our goals. Under the State Constitution, you know, the first priority of course is to beneficiaries, of course, but there's also like a secondary to sort of stabilize employer contributions and we have done that.

And so the reason I had a -- thank you -- I have a question here is on the -- on the slide inflation under the impacts. Page nine, you talked about the cost of living adjustments. And you mentioned it in your comments and also in your cover memo, and in the report itself under inflation, there's a statement that, you know, higher COLAs, of course, because they're in the plans, it's expected to somehow -- to result in somewhat higher employer contributions. That's to be expected.

But what I want you to speak to, there are some alarmist news articles there that just focus on one statement. You know, they don't see the whole report, which is basically these are projections and they actually have -- you know, how do we get to a better spot based on certain scenarios. They're focused on the, you know, the -- what up to eight percent or more increase in PERF contributions. So can you please speak to -- me, I'm the one that gets too excited.

(Laughter).

COMMITTEE MEMBER RUBALCAVA: Was it, in fact, an alarmist view out there taking just one sentence and projecting something to scare the employers? Maybe I'm just overreacting. Sorry about that, Chair, but please.

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, I'll start and I'll let staff --

CHAIRPERSON MIDDLETON: You don't scare easy.

(Laughter).

COMMITTEE MEMBER RUBALCAVA: Some employers do.

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, I am familiar with an article -- at least one article that I'm sure you're referring to. And I think, you know, of course, we keep our eyes on those and make sure there's nothing factually incorrect. And there didn't appear to be in this particular article, but I -- I would completely agree with you that they do see the whole report. They just don't really go into the reasons that we did here, some of the items that I mentioned that explain these results were completely absent from that article.

And so I -- I think an average reader might walk away with a more significant assessment of the impact that inflation was going to have than I think really exists.

Scott, you want to add to that?

CHIEF ACTUARY TERANDO: I think Randy covered it pretty well, in that, you know, we -- you know, the two examples and slides we have here on inflation, you know, they were just one particular example. And, you know, there were various ranges of it. And I think you're referring to an article where it picked the top range. And, you know -- you know, a lot of these are estimates. The goal -- the goal of these slides are to kind of provide a our stakeholders information on -- on the range of where things could go if, you know, a lot of things go wrong, you know, inflation remains high for several years.

And, yes, it could happen, but, you know -- you know, you've got to take into consideration, you know, what's happening with the returns during the time, what's happening with our assets. There are a lot of other things that are in play. And, you know, you can take one -- one or two numbers out of this report and kind of, you know, misrepresent how -- the bigger picture of where they are.

COMMITTEE MEMBER RUBALCAVA: Thank you. And I know that in one of the slides we had the projections for the actuarial valuation as of -- the funded ratio coming out of the 6/30/22 valuation. And you mentioned in your presentation that it will come out in the summer. So once those are -- they come out in a flowing schedule to the various employers, and that would basically show their new contribution rate, but that -- but in every plan, I mean, where there's an average of maybe 72 percent funded, every plan is slightly different. I mean, that's an average.

But also, there will be an annual one. And they'll -- the area one will change based on demographics, because we can -- I'm assuming that through the next experience study will show big changes in demographics because of the pandemic, and the mortality tables and things are changing and are being upgraded. So we can always expect changes in the funded ratio. We can always expect changes in the employer contribution rates because of the demographics and our economic assumptions, but is it correct to say that in the long term we're working to stable -- to full funded, stable employer contributions, and our members and beneficiaries benefits are guaranteed. Can we say that?

CHIEF ACTUARY TERANDO: Oh, yeah, definitely we can say that. You know, the goal is to be, you know, 100 percent funded for the system. And as we get closer to 100 percent funded, you will see the decrease in the contributions. You know, the unfunded is a -- you know, the normal cost is fairly stable for the employers. It's where we get that the variation is coming on the unfunded portion. And as that gets smaller, you know, contributions will come down for the employers and kind of ideally stabilize close to the normal cost, at that point.

COMMITTEE MEMBER RUBALCAVA: Thank you very much. Ms. Chair, I apolo -- thank you for allowing me my soap opera here -- soap stand here.

(Laughter).

CHAIRPERSON MIDDLETON: You do it very well. Thank you.

COMMITTEE MEMBER RUBALCAVA: That article just got to me and I had to respond. Thank you.

CHAIRPERSON MIDDLETON: All right. You're not along.

Mr. Pacheco.

COMMITTEE MEMBER PACHECO: Thank you. Thank you Chairman Miller -- Middleton. And thank you very much for your report. I really enjoyed reading it and so forth.

So my question is back to the -- again with what Mr. Rubalcava said about inflation. I'm also interested to know, since you mentioned -- I think you mentioned in your presentation that if -- with increasing inflation, these public agencies will also be exhibiting or experiencing increasing revenue. Am I correct on that?

CHIEF ACTUARY TERANDO: Well, that's my presumption. And I said I'd have a hard time really trying to quantify that or estimate it in any fashion. What I'm -- what I'm -- the point I'm trying to make with that is in a broad sense if the price of car goes up 10 percent because of inflation, but you as a consumer, your pay goes up 10 percent also because of inflation, you can just as equally afford that same car.

Now, what I'm showing here is just how much the cost of the car has increased.

COMMITTEE MEMBER PACHECO: Exactly.

DEPUTY CHIEF ACTUARY DZIUBEK: But I -- but I do think it's likely that employer's ability to meet those costs will be a little bit better, because I would assume that this high inflation would, in some cases, lead to higher revenues.

COMMITTEE MEMBER PACHECO: And if that -- if that's the case then and you mentioned -- you gave us several scenarios where there's one that's slow recovery, one that's fast recovery. And the one that's slow recovery, it's -- you know, the increase in the employer contribution is going to go up faster. I believe that's correct. And the faster one will go down -- will go -- won't go as fast basically.

And what I'm trying to understand is do you foresee, because of these scenarios, and the employers are planning these out -- hopefully they're planning these out, them utilizing the -- these -- I think it's called the -- it's called the 115 trust, as you mentioned earlier, like a piggy bank to foresee these -- this persistent level of inflation, at least in the short term?

DEPUTY CHIEF ACTUARY DZIUBEK: Yes. So a number of our employers already use section 115 trusts and are contributing to them and building up a certain amount of assets.

We have a CalPERS version of that, that some of our employers use. And there are third-party vendors that also create those trusts. So people have been using them for years, but I think they are understanding better the importance of utilizing them to some extent. It's -- I don't know that it can be a bad idea to have a little bit of money in such a trust, not that -- we don't make financial recommendations to employers, but to be able -- if you're an employer that has some concern that at some point in the future, contributions are going to spike and you're going to have a difficult time meeting those, certainly seems to me like a good strategy to have some money set aside that you can pull from in that situation.

COMMITTEE MEMBER PACHECO: Has -- because of the -- of the amount of inflation that's been going on recently in the economy, have you noticed an increase in up -- in public agencies utilizing the 115 trusts? Just your --

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah. It's a little hard for us to say. You know, our product is relatively new. It's been up and running for a couple years or so. And so, of course, it's -- it's growing relatively steadily from zero to as employers start to use it. And I -- honestly, I didn't come with any of those statistics of how much money has gone into our 115 trust.

As far as money going into a third-party 115 trust, we don't have any information on that. And all of our valuation results, by the way, completely exclude any of that money in those 115 trusts. That's just there for the employer to use when they need to or want to make their contributions to us. So we don't need to know what's in there, and in many cases, we don't.

COMMITTEE MEMBER PACHECO: Yeah, exactly. All right. Thank you very much.

CHAIRPERSON MIDDLETON: All right. Ms. Paquin.

ACTING BOARD MEMBER PAQUIN: Thank you, Madam Chair. Thank you for the report. Really appreciate all the information from this. And I had two questions. The first I think is that you noted on page nine of the report that the increased inquiries from some local employers about amortization waivers or payment options have been slightly increasing. Just curious if you're seeing larger employers making these types of inquiries or is it smaller employers or...

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, I would say -- I don't think there's been a significant number employ -- of employers who have come to us and formally pursued the financial necessity provisions that exist, if that's what you're referring to.

ACTING BOARD MEMBER PAQUIN: Um-hmm.

DEPUTY CHIEF ACTUARY DZIUBEK: We get calls where people are inquiring how does it work, what do I do. I don't really know how many -- well, I think they have to be approved by the Chief Actuary and I don't think you've approved any that I'm aware of.

So my comments were more anecdotal based on going to conferences, meeting with people, talking to them on the phone, you know, providing me with feedback -- very strong feedback that their contribution rates are high and isn't there something we can do about it. So -- and I'm guessing that you hear the same. But, you know, absent -- or aside from the case that was talked about earlier, there's not -- they're not -- we require our employers to make their full contribution, which is also a positive of our system relative to some other systems around the country, where the actuarial required contribution is not being made. And those systems are really falling behind in their funded status. And then for the most part, the vast, vast majority of our employers are fully making their contributions.

ACTING BOARD MEMBER PAQUIN: Okay. Great. Thank you. And then also curious about the pension obligation bonds. So as the interest rates are going up, do you expect to see the number of employers issuing the POBs declining?

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, I'm expecting a cliff basically of -- you know, we had a lot done in the last couple years, and I don't expect nearly as many going forward.

ACTING BOARD MEMBER PAQUIN: Sounds great. Thank you.

CHAIRPERSON MIDDLETON: All right. Thank you.

I don't see any other questions from the group. This was an excellent report. I would make note that the 115 trusts, the additional discretionary payments, we saw a fairly large spike in the last few years. I think for a number of our public agencies being able to see some data as it starts to develop as to what the impact of that has been on contribution rates and normalizing some of the growth of contribution rates for employers would be particularly helpful. We're not telling folks you should or shouldn't do this, but letting them know what -- what's happened for those agencies who have done it is something that strikes me as a very positive thing.

DEPUTY CHIEF ACTUARY DZIUBEK: Yeah, that's interesting, because at the Educational Forum, Scott, Fritzie, and I did have slide comparing agencies that had made ADPs in the last five years versus those that did not, looking at their funded status and level of contributions, so we do have that information.

CHAIRPERSON MIDDLETON: I did get to attend one of those sessions. It wasn't one that you taught, but it was very well received and a very good program.

So all right, if there are no other questions, this is an information item, so thank you.

And we will move on to Item 6b, which is the semi-annual health plan financial report. And that will be done by Ms. Zhong.

(Thereupon a slide presentation).

SUPERVISING HEALTH ACTUARY ZHONG: Good afternoon, Madam Chair and members of the Committee. Emily Zhong, CalPERS team member. Today we are bringing before you Item 6b, semi-annual health plan financial report. This is an information item. This report is provided to the Finance and Administration Committee twice a year as part of the monitoring and reporting process for the Health Care Fund status. It includes health plan account balances, actuarial reserve amount, and surpluses or deficits for the health plan subaccount.

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SUPERVISING HEALTH ACTUARY ZHONG: Thank you.

The health plan semi-annual report provides the financial performance for the two basic PPO plans, PERS Gold and PERS Platinum, the corresponding PPO Medicare supplemental plans, and 10 flex-funded HMO plans as of the end of June 2022. The HMO report includes the new UnitedHealthcare Harmony Plan which started in 2022.

Kaiser and other fully insured plans and the association plans are not in the scope of this report. The health plan -- the Health Care Fund's Reserve Policy adopted in 2018 provides a framework for maintaining the appropriate actuarial reserve level for the PPO and for managing surpluses or deficits that accumulate in the PPO and HMO subaccount.

In April, I shared with you the deficits in the basic PPO account as of the end of 2021. In the -- in the next couple of slides, I will give you an update on the basic PPO performance for the first six months of 2022.

Next slide, please.

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SUPERVISING HEALTH ACTUARY ZHONG: This slide present the recent Health Care Fund performance for the basic HMO and PPO Medicare and basic plans. Starting with the HMO basic plan, the overall fund status improved slightly from the end of 2021. The total fund balance as of the end of June was 178 million. The next column shows the HMO basic estimated claims liability of 151 million with the last column showing the surplus of 27 million. Note that the fund status for the HMO basic plan is protected by capitation and flex-funded arrangement of those plans.

On the PPO side, starting with PPO Medicare, the estimated fund balance at the end of June was 94 million, with a required actuarial reserve level of 121 million for a deficit of 27 million. We expect the fund status to improve in the second half of the year, seeing PPO Medicare plan cover the traditional Medicare deductible in the beginning of the year. Medical costs are normally higher in the first half of the year and lower in the second half of the years as deductibles are satisfied.

For the PPO basic plan, the estimated fund balance as of the end of June was 205 million. After including the required actuarial reserve of 538 million, the PPO basic plan has a deficit of 333 million. The overall basic PPO status worsened by about 41 million from the end of 2021.

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SUPERVISING HEALTH ACTUARY ZHONG: The decrease in the basic PPO fund balance in the first six months of 2021 was primarily driven by underperformance of the investment funds, as well as the higher than expected pharmacy costs. There was about 25 million gained based on the seasonality of medical spend. For PPO basic plan, medical claims pattern typically run on the schedule that is opposite to those for medical -- for PPO Medicare plans. Medical claims are lower in the beginning of the year as members satisfy their annual deductible.

We expect the medical claim to increase in the second half of the year. Pharmacy -- some pharmacy costs continue to run higher than expected due to the increasing cost of specialty drug. The pharmacy loss was 16 million for the first six months of 2022.

Regarding investment, two factors contribute about 50 million towards the deficits. First, interest earning from the Health Care Fund are projected into premium during rate development. In 2022, the projected interest return did not materialize. And on top of that, the Health Care Fund is invested primarily in bonds and ended the first six months of 2022 with a negative performance.

The overall basic PPO status worsened by an additional 41 million. Combining with the 292 million deficits carried forward from 2021, the total deficits for the basic PPO was 333 million as of the end of June 2022. We will continue to monitor and I will report back to you in April next year for the year-end 2022 results.

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SUPERVISING HEALTH ACTUARY ZHONG: Overall, we anticipate the PPO fund status will improve in 2023 with a surcharge included in the basic PPO premium. Our goal is to generate additional premium to start replenishing the reserve deficits. On the pharmacy side, the improved Optum contract will also be fully implemented for 2023, and we expect to see improvement on the pharmacy performance as well.

The very last, we're also working on the PPO strategic alignment project that the health team present in the HBC back in September and was discussed again this morning. The PPO alignment project was -- has several goals, including identifying potential intervention to curb near- and long-term costs.

That conclude my presentation. Don Moulds and I are happy for any questions.

CHAIRPERSON MIDDLETON: All right. Are there questions?

I don't see any.

Looking back at the deficit that we've run, what's your projections as we start to move out beyond this year as to -- for the PPO plans?

SUPERVISING HEALTH ACTUARY ZHONG: Yeah. Yeah, so for the projection, it really depending on the second half of the year how is the claim going to run. Of course, investment that is a very hot topic. It depends on how -- what was the performance for the second half of the year as well. So now looking at the first six months of 2022, yeah, as we mentioned, pharmacy is a little bit higher than what we expected, but medical is running compared to -- it's pretty much the same compared to what we expected. So for second half of the year, at this point, is really depending on the medical claim pattern and the investment performance.

CHIEF HEALTH DIRECTOR MOULDS: Yeah. And we'll -- as we've been, and we've told you this, we're monitoring this now on a monthly basis. The situation improves at the beginning of the year for a couple of different reasons. One is the surcharge.

CHAIRPERSON MIDDLETON: Right.

CHIEF HEALTH DIRECTOR MOULDS: The other is that we've zeroed out some of the investment assumptions, like interest income and so forth. So the -- you know, at this point, we're not anticipating anything dire. That could change. It's -- you know, it is less weird just in terms of claims patterns than it has been over the last couple years, but there's still high use of medical services and demand is very high. We just continue to monitor. And if things change, we will come back to you and talk about it.

CHAIRPERSON MIDDLETON: Okay. It's very difficult for this vantage point to anticipate that we will continue to have an increase in our deficit that -- those are not sustainable. I don't think it's time for us to be panicking at all, but it is -- we want to understand what the plan is going to be that will bring that deficit down.

CHIEF HEALTH DIRECTOR MOULDS: Yeah. The -- you know, the projection is that's a -- it's a three- to five-year protection with the surcharge.

CHAIRPERSON MIDDLETON: Right.

SUPERVISING HEALTH ACTUARY ZHONG: Yeah, it's a five-year projection. If we all remember from the July PHBC -- of July off-site when we approved the rates for 2023, we include three percent surcharge for the PPO Gold -- basic Gold product, and also two percent on the

Platinum. So hopefully in five years, we will slowly recoup or replenish in the reserve deficits.

CHAIRPERSON MIDDLETON: All right. Thank you.

Mr. Miller.

VICE CHAIRPERSON MILLER: Yeah. I think you partially answered Director Middleton's question kind of touched on what I was concerned about -- or not so much concerned about, but just interested in hearing that, you know, I guess as we tally up our experience with this latest open enrollment period and everything, kind of that -- that perennial kind of feedback loop of, you know, adverse selection, people migrating to and from the plans, and the impacts of things like the surcharges, and the costs with the PPOs, whether we'll see any kind of patterns that give us the ability to a little more confidently and concretely predict, you know, what will happen. But there's just so many variables, that it's kind of a -- it's a little bit of a -- a little bit of a crystal ball to try to look into.

CHIEF HEALTH DIRECTOR MOULDS: Yeah. And that's a -- that's a great observation. We're watching open enrollment right now. You know, one of the concerns that we shared with you early on was, you know, any dramatic changes in migration. We're not in a position today to talk about that. The numbers are still coming in. We're talking about that in March, but we're not seeing anything I think, at this point, that is -- that is overly concerning.

SUPERVISING HEALTH ACTUARY ZHONG: Yeah. And I also want to echo a little bit. So again, at this point, we still feel pretty good in our 2023 open enrollment or in our 2023 premiums. When we developed the rate of premium for 2023, we did anticipate and did reject -- project some sort of member movement between HMO and PPO and between Gold and Platinum. So those are assumptions in a lot of those and it will have a little premium impact as well. It's already factored into the 2023 premium build up.

VICE CHAIRPERSON MILLER: Yeah. Great. Thank you very much. Great report.

CHAIRPERSON MIDDLETON: All right. Thank you.

Seeing no other questions, this was an information item.

We will now move on to Item 6c, which is summary of Committee direction.

ACTING CHIEF FINANCIAL OFFICER NIX: Okay. Madam Chair, I only took one thing down and you asked for information on the impact of additional discretionary payments on employers. I don't know if you wanted us to just send you that or a report, however you want that delivered, but...

CHAIRPERSON MIDDLETON: I think I'll defer to Mr. Dziubek and Mr. Terando as to what's the most appropriate way to come back with that information.

ACTING CHIEF FINANCIAL OFFICER NIX: Sounds great. That's all I had.

CHAIRPERSON MIDDLETON: All right. With that, it is 2:08 and we will adjourn the Finance and Administration Committee meeting. We have the Risk and Audit Committee meeting that will begin -- let's begin that at 2:15 to allow people time to move around and we are adjourned.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 2:08 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 28th day of November, 2022.

James F. Peters

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