



## Agenda Item 10

May 15, 2012

**ITEM NAME:** Proposed Regulation to Permit Transfer of Assets in Severely Overfunded Situations

**PROGRAM:** Actuarial Office

**ITEM TYPE:** Action

### **RECOMMENDATION**

Staff recommends that the Pension and Health Benefits Committee accept and recommend to the Board that staff initiate the Rulemaking Process to adopt the proposed addition to Title 2 of the California Code of Regulations (CCR) permitting the transfer of assets between rate plans of a contracting agency in severely overfunded situations.

### **EXECUTIVE SUMMARY**

Staff recommends adopting the proposed addition to Title 2 of the CCR to permit the transfer of assets between rate plans of a contracting agency under specified overfunded circumstances. See Attachment 1 for a copy of the proposed regulation language. This transfer would help an employer lower their contributions toward one of their plans (which has an unfunded liability obligation) by using excess assets from another of their plans which is currently in a severely overfunded situation. The proposal, as written, limits transfers of assets from only the most overfunded circumstances and also provides for a safeguard against detrimental effects to the overfunded plan.

### **BACKGROUND**

Over a year ago, the Actuarial Office was contacted by a CalPERS contracting agency, Mammoth Lakes Fire District, regarding the ability to transfer assets from their severely overfunded Miscellaneous plan to their underfunded Safety plan to help pay off the current actuarial unfunded liability obligation of the Safety plan. Currently, there is no provision in statute or regulation that would permit such a transfer.

### **ANALYSIS**

The transfer of assets between plans is currently not permitted except in situations where service and liabilities are also transferred, e.g. a merger of plans or a reclassification of past service from a miscellaneous classification to a safety classification.

The only option for an employer with a severely overfunded plan to help an underfunded plan would be to terminate the overfunded plan. Upon termination of a plan, excess assets, determined based on the termination liabilities, are refunded to

the employer. Under existing statutes, the termination of the overfunded plan would be permitted only if the plan no longer had any active employees.

As of the most recent annual actuarial valuation, Mammoth Lakes Fire District's Miscellaneous plan has a funded status of 392 percent. Since this plan participates in a risk pool, the surplus is entirely in the side fund. As of June 30, 2011, the plan had a side fund balance of \$439,072. As per regulations governing side funds, the plan's side fund is credited annually with 7.5 percent interest and accrues over \$30,000 in investment income each year. For this plan, the side fund is used each year to pay the pool's rate. For the 2011-2012 fiscal year, the pool's contribution rate for this agency is 7.7 percent of payroll, resulting in a debit to this plan's side fund of roughly \$4,000. Consequently, the side fund is expected to be \$469,215 on June 30, 2012. As can be seen, the side fund is expected to continue to grow over time. The extent of the overfunding is such that the pool's rate must be over 65 percent of payroll in order for the side fund balance to start to deplete. The pool's rate has averaged 6.9 percent since the inception of pooling.

The Miscellaneous plan for Mammoth Lakes Fire District has one active member and no plans to increase staffing. The Safety plan, however, has reached a critical point in staffing and funding is crucial to maintain their current level of service. The agency would like to apply a portion of the Miscellaneous plan's excess assets toward their Safety plan to help pay off the current actuarial unfunded liability obligation. Currently, the agency cannot utilize the Miscellaneous plan's excess assets, even as the surplus in the side fund continues to grow. Plan termination is extremely undesirable, as the agency does not wish to lay off their one Miscellaneous employee.

To permit the transfer of assets in the situation of Mammoth Lakes Fire District and any other employer that may be in a similar situation in the future, staff is proposing a regulation change.

The proposed regulation would allow a contracting agency to request that the Board transfer excess assets from an overfunded rate plan. To protect existing active and inactive members against future market downturns, staff is proposing the following requirements be met:

- The actuarial value of assets exceeds 200 percent of the actuarial accrued liability.
- The market value of assets exceeds 150 percent of the termination accrued liability.

Upon such a request, if approved, the Board would transfer assets up to an amount such that the above requirements still hold. The transferred assets must be used solely for payment of the current unfunded accrued liability obligation for another rate plan in the contracting agency and will be amortized in accordance with Board

amortization policy. The proposed regulation will also require the employer to notify the employees of the overfunded plan that the employer has requested for a transfer of assets.

The proposed requirements help ensure the originating plan remains well funded after the transfer. However, this does not guarantee that the plan will not become underfunded at some point in the future due to market fluctuations, catastrophic occurrences, and other unforeseen events.

If the proposed regulation is adopted, such a transfer, based on the most recent annual actuarial valuation, would decrease the Mammoth Lakes Fire District's Safety plan's required employer contribution rate by up to five percent of payroll. The Miscellaneous Plan's required employer contribution rate would remain at zero percent of payroll.

#### **BENEFITS/RISKS**

Permitting the transfer of excess assets for rate plans meeting the severely overfunded plan requirements will allow agencies to redistribute excess assets to portions of their contract that are under the most financial stress. Such funding may help prevent layoffs, arrearage, and other consequences of financial hardships.

In adopting this proposal, the main risk would be the deterioration of the financial situation of the overfunded plan. Although the requirements provide for an overfunded plan to remain in extremely favorable condition following the transfer of assets, the transfer of assets will increase the chance, however small that probability may be, that the agency may have to resume contributions in the future for the currently overfunded plan.

#### **ATTACHMENTS**

Proposed Regulation to Permit Transfer of Assets in Severely Overfunded Situations

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