CalPERS

Pension & Health Benefits Committee

California Public Employees' Retirement System

Agenda Item 9

May 15, 2012

ITEM NAME: Judges' II Retirement System Actuarial Valuation and Employer Contribution Rate

PROGRAM: Actuarial Office

ITEM TYPE: Action

RECOMMENDATION

Staff recommends that the Pension and Health Benefits Committee accept and recommend to the Board of Administration (Board) the following:

1. Approve the June 30, 2011, Judges' II Retirement System Actuarial Valuation Report along with the change in assumptions as outlined in the report, and the transmittal letter to the Governor and Legislature.

2. Adopt the employer contribution rate of 22.837 percent for the period of July 1, 2012, through June 30, 2013, for the Judges' II Retirement System.

3. The use of a 7.00 percent discount rate assumption in all affected member calculations effective as follows:

    a. For service credit purchases under the "present value" method, the use of the new discount rate will apply to all applications postmarked on or after May 17, 2012.

    b. For retirement applications, any application with a retirement date on or after May 17, 2012, will be subject to the new discount rate.

EXECUTIVE SUMMARY

The employer contribution rate for the fiscal year 2012-2013 was determined to be 22.837 percent. This rate is 0.604 percent lower than last year's employer rate. There were two significant factors that contributed to this change. First, there was a larger than expected increase in the total payroll from June 30, 2010, to June 30, 2011, due to new entrants to the plan. Second, individuals already in the plan received no salary increases during the 2010-2011 fiscal year.

BACKGROUND

This is the seventeenth annual actuarial valuation of the Judges' II Retirement System. This system began on November 9, 1994, to provide retirement and ancillary benefits to judges elected or appointed on or after that date. The employer contribution rate from the inception of the plan until June 30, 1996, was set by State statute. Subsequently, the employer contribution rate was determined through an actuarial valuation process. This actuarial valuation sets forth the employer contribution rate for the plan for the fiscal year July 1, 2012, through June 30, 2013.

Economic Assumption Change

The CalPERS Actuarial Office conducted a study and hired an independent evaluator to assess current economic assumptions. Based on the information from both studies, the CalPERS Board has adopted updated economic assumptions to be used beginning with the June 30, 2011, valuation. In particular, the recommendation based on both studies was to lower the price inflation from 3.00 to 2.75 percent.

Lowering the price inflation also had a direct impact on the discount rate and the overall payroll growth assumptions. The discount rate assumption is calculated as the sum of the price inflation and the real rate of return. The assumed real rate of return is 4.50 percent. When added to the new price inflation of 2.75 percent, the resulting investment return is 7.25 percent. The 7.25 percent does not take into account the 0.25 percent reduction for administrative fees. After those fees are deducted the discount rate settles at 7.00 percent. The overall payroll growth is calculated as the sum of the price inflation and real wage inflation. The assumed real wage inflation is 0.25 percent. When added to the new price inflation of 2.75 percent, the resulting overall payroll growth is 3.00 percent.

The new assumptions are described in Appendix A of the valuation report. The effect of change in assumption on the unfunded liability is shown in the “(Gain)/Loss Analysis” and the effect on the employer contribution rate is included in the “Reconciliation of Required Employer Contributions.”

ANALYSIS

Valuation Results

The table below summarizes key results from the valuation:

	June 30, 2010	**June 30, 2011**
Present Value of Benefits	$ 1,060,742,176	$ 1,173,657,436
Accrued Liability	$ 520,687,470	$ 609,562,110
Market Value of Assets	$ 422,100,782	$ 575,978,052
Funded Status (Market Value Basis)	81.1%	94.5%
Recommended Employer Contribution Rate	23.441%	22.837%
Employee Contribution Rate	8.00%	8.00%

Reconciliation of Employer Contribution Rates
The reasons for the change in employer contribution for the Judges' II Retirement System between fiscal year 2011-2012 and fiscal year 2012-2013 are shown in the table below:

	Percentage of Projected Payroll	Estimated $ Based on Projected Payroll
1. 2011-2012 Employer Rate (from prior year annual report)	23.441%	53,144,136
2. Effect of changes since the prior annual valuation		
a) Effect of change in payroll	-	3,967,340
b) Effect of change in actuarial assumptions	0.017%	40,721
c) Effect of new actuarial methods	0.000%	0
d) Effect of unexpected changes in demographics	(0.621%)	(1,513,497)
e) Net effect of the changes above [Sum of a through d]	(0.604%)	2,494,564
4. 2012-2013 Estimated Employer Contribution	22.837%	55,638,700

The change to the employer rate due to the assumption change was immaterial. The full impact of the assumption change was recognized in this valuation without phase-in.

Projected rate for the 2013-2014 fiscal year
As of March 31, 2012, the fiscal year to date investment return was about 4.0 percent. This corresponds to a projected employer rate of 22.9 percent for the 2013-2014 fiscal year. This is a 0.1 percent increase from the year before.

The actuarial value of assets used in the June 30, 2011, report is 97.5 percent of the market value of assets. A large portion of the corridor can still be used for smoothing in the coming year. For this reason, the 2013-2014 employer rate is not sensitive to investment returns. For more information on employer rate projections, see Appendix D of the annual valuation.

BENEFITS/RISKS
This report is required to be filed with the Governor and the Legislature and CalPERS would not be in compliance with law if that is not done.

ATTACHMENTS
Transmittal letter to the Governor and Legislature
Judges' II Retirement System Actuarial Valuation Report as of June 30, 2011

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