Fiscal Year 2013-14
Mid-Year Budget Revisions

First Reading

November 19, 2013

CalPERS

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A. Total CalPERS Budget

Background

The Total CalPERS budget is composed of five main areas; the Administrative, Enterprise Projects, Headquarters Building Account, Investment Expenses, and Third Party Administrators. The "One Budget Initiative" consolidates all of these budgets to increase transparency and provide a holistic perspective.

The purpose of the Mid-Year Budget process is to address enterprise critical, unforeseen, and emergency resources not included in the FY 2013-14 Annual Budget process. Examples may include requests to address new legislative mandates, compliance with new laws or regulations, or new Board initiatives. All Formal Budget Requests submitted during the Mid-Year process were required to meet these criteria for consideration.

Summary

The FY 2013-14 Mid-Year Total Budget of $1.73 billion represents an overall increase of $15.1 million or 0.9 percent from the FY 2013-14 Annual Total Budget. More specifically, this is a $17.2 million increase to the Administrative Budget offset by a $2.1 million decrease to the Investment Expenses Budget.

Major highlights of the FY 2013-14 Mid-Year Budget of $1,728,300,000, including 11.0 positions, are as follows:

- Managing Flex-Funded health plans ($5.6 million and 6.0 positions)
- Increases in outside counsel related to municipal bankruptcy litigation and Long Term Care Litigation ($8.5 million)
- Board supported initiative on Public Agency Audit Reviews ($153,000 and 3.0 positions)
- Enterprise internal investigations within the Legal Office ($85,000 and 2.0 positions)

In addition, technical adjustments include $1.6 million for employee benefits and $1.3 million in investment administrative costs for travel, salaries and general expenses.

A. Total CalPERS Budget

FY 2013-14 Mid-Year Total Budget
(in millions)

	FY 2013-14 Annual Budget	FY 2013-14 Mid-Year FBRs & Technical Adjustments	FY 2013-14 Mid-Year Proposed Budget	% Change from Annual
Administrative	$408.0*	$17.2	$425.2	4.2%
Enterprise Project	33.3	0.0	33.3	0.0%
CalPERS Headquarters Building	40.7	0.0	40.7	0.0%
Total Administrative Budget	$481.9	$17.2	$499.2	3.6%
External Management Fees	1,030.0	0.0	1,030.0	0.0%
Operating Costs	86.5	(2.1)	84.4	(2.4%)
Investment Expenses	$1,116.4	($2.1)	$1,114.4	(0.2%)
Third Party Administrators	$114.8	$0.0	$114.8	0.0%
Total CalPERS Budget	$1,713.1	$15.1	$1,728.3	0.9%
Total Positions	2,685.0	11.0	2,696.0	0.4%

* The Contingency Reserve Fund Spring Finance Letter, approved in the 2013 Budget Act and adopted by the CalPERS Board of Administration on September 17, 2013, increased the FY 2013-14 Annual Administrative Budget by $2 million to $408 million.

B. FY 2013-14 Mid-Year Budget Revisions

The table below provides a breakdown of the FY 2013-14 Mid-Year Budget revisions.

FY 2013-14 Mid-Year Budget	Dollars (in thousands)	Dollars (in thousands)	Positions
Authorized Fiscal Year 2013-14 Budget		$1,713,142	2,685.0
Technical Additions to Budget:			
Salaries & Wages Benefit Adjustments (Retirement/Health/Dental)	$1,595		-
Investment Office - Due Diligence	1,277		
Total Technical Additions	$2,872	$1,716,014	-
Addition of Business Initiatives Recommended (FBRs) to Budget:			
[1] Outside Counsel	8,500		-
[2] Health Care Initiatives	5,616		6.0
[3] Public Agency Audit Review (PAAR)	153		3.0
[4] Internal Investigators	85		2.0
Addition of Initiatives (FBRs) to Budget	$14,354	$1,730,368	11.0
Reduction in Investment Expenses		-$2,089	
Total FY 2013-14 Mid-Year Budget		$1,728,279	2,696.0

The following pages provide detailed descriptions on each of the Mid-Year initiatives that are required to achieve efficiencies, identify and implement cost-saving measures, mitigate risks, deliver quality customer service, and maintain affordable health care programs for CalPERS to effectively deliver retirement and health security for the public workers of California.

1. Outside Counsel

	FY 2013-14		Annualized PY & Ongoing $
	$	Position	
1.1 - Outside Counsel - Bankruptcy Litigation	8,200,000	0.0	-
1.2 - Outside Counsel - Long Term Care Litigation	300,000	0.0	-
Total	8,500,000	0.0	-

Introduction

The existing annual outside counsel budget of $4.0 million pays for litigation that affects the enterprise on an ongoing basis, such as health program related work, independent contractor litigation, complicated tax issues, pension reform, and increased audits of public agencies. This funding is not available for outside counsel costs that accompany continued utilization of legal expertise for bankruptcy related cases and other critical CalPERS related legal matters, such as the unforeseen Long Term Care litigation.

1.1 Outside Counsel – Bankruptcy Litigation

The request of $8.2 million in one-time funding for outside counsel is due to increases in costs related to municipal bankruptcies. FY 2012-13 outside counsel expenses for municipal bankruptcy litigation was $6.6 million. FY 2013-14 outside counsel expenses for municipal bankruptcy litigation are projected to be $8.2 million. This is an increase of $1.6 million or 24.2 percent from the previous year.

1.2 Outside Counsel – Long Term Care Litigation

In October 2012, the CalPERS Board of Administration approved a plan to raise long-term care insurance premiums. As a result, long term care litigation has ensued and there is a request for one-time outside counsel funding of $300,000 to assist with this specific workload.

2. Health Care Initiatives

	FY 2013-14		Annualized PY & Ongoing $
	$	Position	
2.1.a - Health Plan Administration Division Flex Funded Services Unit	1,502,000	2.0	204,000
2.1.b - Legal Office	78,000	1.0	156,000
2.1.c - Fiscal Services Division	156,000	3.0	312,000
2.2 - Healthcare Decision Support System Consultant Funding	3,880,000	0.0	-
Total	5,616,000	6.0	672,000

Introduction

The Health Benefit Purchasing Initiative is $1.7 million of the $5.6 million requested. The initiative is a concept of hybrid funding arrangements for health plans and risk adjusting premiums. This requires a transfer of workload from the health plan operations to internal operations, related to claims processing, claims reserve management, account reconciliations, and health plan appeals processes. CalPERS expects approximately $40.0 million in reduced administrative fees per year from the providers by bringing this work in house. In addition, one-time funding of $3,880,000 is being requested for the enhanced Generation 3 data warehouse vendor contract to be implemented.

2.1.a Health Plan Administration Division Flex Funded Services Unit

The Health Plan Administration Division requests funding of $1.5 million. Of this amount, $1.4 million is for one-time consulting dollars related to project management, assisting with implementation efforts, and interagency consulting fees to the State Controller's Office. In addition, the request includes six-month funding of $102,000 for 1.0 manager and 1.0 analyst position (ongoing annual cost of $204,000) for a Flex Funding Services Unit. This unit will address administrative functions related to the flex-funded plans.

2.1.b Legal Office

The Legal Office requests six months' funding of $78,000 for 1.0 Attorney III position (ongoing annual costs of $156,000) to assist the Health Plan Administration Division manage the increased number of flex-funded health plans. The transfer of workload from the health plans includes support for managed health care compliance, working with the Department of Managed Health Care, contract compliance with health plans and pharmacy benefit managers, and interpretation of statutes and regulations in formulating proposed policy changes.

2.1.c Fiscal Services Division

The Fiscal Services Division requests six months' funding of $156,000 for 3.0 analyst positions (ongoing annual costs of $312,000) to address additional financial core workload functions related to the new flex-funded health plans being implemented January 1, 2014. With this transition and new workload, positions are needed in the Affiliate Accounting and Cashiering Units. They will serve as subject matter experts for

the financial management process associated with the capitation[1] account of payments for state active and annuitants, health plan capitation invoicing for contracting agencies, and Medicare Advantage plans' reimbursement reconciliation for five new health plans. They will also provide increased workload support in cash processing activities.

2.2 Healthcare Decision Support System Consultant Funding

The Healthcare Decision Support System is a data warehouse with over ten years of member eligibility data from CalPERS health plan partners, medical and prescription drug claims, patient visitation information, and disease management trends. The current five-year contract for the second generation Health Care Decision Support System expires on June 8, 2014.

One-time funding of $3,880,000 is to implement the enhanced Generation 3 data warehouse. This funding request was deferred from the FY 2013-14 Annual Budget process as it was not known at that time whether the funding would be required if a new vendor was selected and therefore met the criteria for Mid-Year funding. Consequently, a new vendor was chosen as part of the independent procurement process to manage the Healthcare Decision Support System for the next five years. It is necessary to also extend the current vendor's contract to allow for the parallel operation of both generations as data transfer occurs between the two vendors and the second generation vendor phases out.

[1]Payment arrangement based on cost per enrolled member.

3. Public Agency Audit Review Initiative

	FY 2013-14		Annualized PY & Ongoing $
	$	Position	
3.1 - Customer Account Services Division	94,500	2.0	189,000
3.2 - Legal Office	58,000	1.0	116,000
Total	152,500	3.0	305,000

Introduction

This request is to further support the August 2012 Board directive to increase the number of public agency audit reviews performed annually by the Office of Audit Services. The Office of Audit Services was approved for 9.0 new auditors in the FY 2012-13 Mid-Year and FY 2013-14 Annual Budget processes, impacting workload for support areas affected by the audits. The six-month funding request is for $152,500 for 3.0 positions (ongoing annual costs of $305,000) to support this initiative in the customer service and legal areas.

3.1 Customer Account Services Division

The Customer Account Services Division provides significant support to the Office of Audit Services in reviewing, researching, and resolving membership and compensation issues. The Customer Account Services Division is requesting 2.0 Retirement Program Specialist positions to continue to meet established effectiveness measures by closing audit findings within 12 months. In addition to an increase in total audits, the number of audit findings per audit has increased and each individual finding has proven to be more workload than anticipated.

3.2 Legal Office

Attorneys assist the Office of Audit Services staff with research, preparation of audit reports, Public Records Act requests, and managing determination letters and appeals. The Legal Office is requesting 1.0 additional Attorney I position to assist with this growing workload related to the public agency audit reviews.

4. Internal Investigations

	FY 2013-14		Annualized PY & Ongoing $
	$	Position	
4 - Internal Investigations	85,000	2.0	170,000
Total	85,000	2.0	170,000

Introduction

The Legal Office requests six months of funding of $85,000 (ongoing annual costs of $170,000) for 2.0 investigator positions due to new workload. Beginning FY 2013-14 internal investigations were centralized into the Legal Office. In recent years the Investigations Unit typically worked only a few internal investigations per year. In the first quarter of FY 2013-14, with investigations referred by the various CalPERS divisions, the Investigations Unit has already received and worked a significant amount of internal investigation cases.

The current investigators assigned to the Disability Validation Team have been responsible for conducting internal investigations in addition to their current caseload. This is impacting the disability cases investigations related to potential disability retirement fraud.

D. Position (PY) Support

The chart below details CalPERS authorized positions by branch. The 11.0 positions being recommended in the FY 2013-14 Mid-Year Budget increases the authorized positions from 2,685.0 to 2,696.0. Of the 11.0 positions, 6.0 are for the new Flex Funded Health Plan Initiative, 3.0 are for increased public agency audit reviews, and 2.0 positions are to support internal investigation workload. These 11.0 positions are for new workload as a result of new and growing program needs.

Branch	FY 2013-14 Annual Authority	Mid-Year Change in Positions	Proposed FY 2013-14 Mid-Year Authority	Percent Change
Actuarial Office	55.0	-	55.0	-
Benefit Program Policy and Planning 2.0 - Flex Funded Services Unit	131.0	2.0	133.0	1.5%
Customer Services and Support 2.0 - Public Agency Audit Review	888.5	2.0	890.5	0.2%
Office of External Affairs	63.0	-	63.0	-
Executive Office	19.0	-	19.0	-
Financial Office 3.0 - Flex Funded Financial Services Unit	206.0	3.0	209.0	1.5%
General Counsel 1.0 - Public Agency Audit Review 1.0 - Flex Funded Legal Support 2.0 - Special Investigators	123.0	4.0	127.0	3.3%
Investment Office	341.0	-	341.0	-
Operations and Technology	858.5	-	858.5	-
Total	2,685.0	11.0	2,696.0	0.4%

E. Investment Expenses

(in millions)

	FY 2012-13 Actuals	FY 2013-14 Annual Projection[1]	FY 2013-14 Mid-Year Projection
Global Equity	$111,083	$74,273	$74,273
Fixed Income	6,307	7,200	7,200
Real Assets	215,742	194,871	194,871
Absolute Return Strategy	-	68,000	68,000
Private Equity	516,852	494,167	494,167
External Mgmt - Base Fees	$849,984	$838,511	$838,511
Global Equity	$103,132	$57,941	$57,941
Fixed Income	4,300	4,500	4,500
Real Assets	135,622	65,017	65,017
Absolute Return Strategy	-	64,000	64,000
External Mgmt - Performance Fees	$243,054	$191,458	$191,458
Total External Mgmt Fees	$1,093,038	$1,029,969	$1,029,969
Master Custodian	7,528	5,847	5,867
Portfolio Mgmt. Services/Subscriptions	26,574	34,048	31,925
Appraisal Fees	6,627	5,200	5,200
Auditor Fees	776	200	392
Consultants	22,024	23,750	23,750
System Consultant Fees	3,399	4,320	3,900
Legal Fees	15,822	12,611	12,661
Tax Advisory Services	1,235	500	692
Total Operating Expenses	$83,985	$86,476	$84,387
Total External Mgmt & Operating Expenses	$1,177,023	$1,116,445	$1,114,356
Personal Expense	$53,087	$55,230	$55,505
Administrative Expense	2,558	2,754	3,756
Total Administrative Expenses	$55,645	$57,984	$59,261
Total Investment Management Costs[2]	$1,232,668	$1,174,429	$1,173,617

[1] Investment expenses per Fiscal Year 2013-14 Annual Budget Proposal - Second Reading (presented April 17, 2013)

[2] Transaction expenses (e.g. income tax expense, security lending charges, commissions and STFF expenses) incurred by the investment portfolio are not included

F. Administrative Budget by Fund Source

Fund	FY 2012-13 Actual Expenses	FY 2013-14 Revised Budget *	FY 2013-14 Mid-Year Proposed Budget	Percent Increase from 2013-14
Administrative Budget				
Public Employees' Retirement Fund (PERF)	$ 297,660,680	$ 341,533,000	$ 354,196,000	3.7%
Public Employees' Contingency Reserve Fund (CRF)*	26,229,576	28,813,000	28,947,000	0.5%
Public Employees' Health Care Fund (HCF)	16,881,823	22,313,000	28,351,000	27.1%
Long-Term Care Fund (LTCF)	2,011,082	5,625,000	5,012,000	-10.9%
Annuitants' Health Care Coverage Fund (AHCCF)	1,938,386	2,327,000	2,036,000	-12.5%
Deferred Compensation Fund (DCF)	1,423,057	1,798,000	2,189,000	21.7%
Judges' Retirement Fund (JRF)	1,329,092	1,440,000	1,113,000	-22.7%
Judges' Retirement Fund II (JRF II)	845,461	951,000	905,000	-4.8%
Legislators' Retirement Fund (LRF)	388,829	432,000	365,000	-15.5%
Replacement Benefit Custodial Fund (RBF)	7,877	9,000	9,000	0.0%
Subtotal	**$ 348,715,863**	**$ 405,241,000**	**$ 423,123,000**	**4.4%**
Reimbursements	2,960,817	2,742,000	2,086,000	-23.9%
Total CalPERS	**$ 351,676,680**	**$ 407,983,000**	**$ 425,209,000**	**4.2%**

* Includes the Contingency Reserve Fund Spring Finance Letter, approved in the 2013 Budget Act and adopted by the CalPERS Board of Administration on September 17, 2013, increased the FY 2013-14 Annual Administrative Budget by $2 million to $408 million.

G. Budget Detail by Branch

Total Budget	FY 2013-14 Annual Budget[1]	FY 2013-14 Mid-Year Requests	Total (in thousands)
Administrative Budget	$407,983	$17,226	$425,209
Actuarial Office	$7,102		7,102
Benefit Programs Policy and Planning	25,412	5,382	30,794
Customer Services and Support	101,280	95	101,375
Executive Office	5,913		5,913
Financial Office	25,100	156	25,256
General Counsel	18,967	8,721	27,688
Investment Office	57,984	1,277	59,261
Office of External Affairs	12,587		12,587
Operations and Technology	134,560		134,560
Other[2]	19,078	1,596	20,674
Enterprise Projects Budget	33,288		33,288
CalPERS Headquarters Building Account	40,676		40,676
Projected Investment Expenses	1,116,445	-2,089	1,114,356
Projected Third Party Administrator Expenses	114,750		114,750
Total FY 2013-14 Mid-Year Budget	$1,713,142	$15,137	$1,728,279

[1] Includes $2.0 million Spring Finance Letter included in the 2013 Budget Act and adopted by the Board of Administration on September 17, 2013

[2] Annual Central Administrative Series (Pro-Rata), and Mid-Year Salary & Wages Benefit adjustments - Retirement/Health/Dental