Agenda Item 5b

March 18, 2014

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

PROGRAM: Actuarial Office

ITEM TYPE: Action

RECOMMENDATION

Staff recommends that the Board take action on the following:

1. Approve the June 30, 2013 Judges' Retirement System II Actuarial Valuation Report along with the change in assumptions as outlined in the report, and the corresponding transmittal letter to the Governor and Legislature.

2. Adopt the employer contribution rate of 24.615 percent for the period of July 1, 2014 through June 30, 2015 for the Judges' Retirement System II.

3. Adopt the use of new mortality assumptions in all affected member calculations effective as follows:

    a. For service credit purchases under the "present value" method, the use of the new mortality assumptions will apply to all applications received on or after March 20, 2012.

    b. For retirement applications, any application with a retirement date on or after March 20, 2012 will be subject to the new mortality assumptions.

EXECUTIVE SUMMARY

Consistent with the decision made by the CalPERS Board of Administration for plans participating in the Public Employees' Retirement Fund (PERF), staff is recommending, as part of the adoption of the valuation report, the adoption of new mortality assumptions. The new mortality table used in this valuation was developed from the February 2014 experience study and includes 20 years of projected on-going mortality improvement using the Scale BB table published by the Society of Actuaries. The new assumptions have been incorporated in this valuation. The cost impact of this change has been spread over 20 years and phased in over 3 years, beginning with the contribution requirement for fiscal year 2014/2015.

The following table summarizes key results from the valuation:

Comparison of Current and Prior Year Results			
	June 30, 2012	**June 30, 2013**	
		Same Asssumptions as Prior Year	**New Mortality Assumptions**
Present Value of Benefits	$ 1,241,622,833	$ 1,327,946,693	$ 1,419,325,105
Accrued Liability	$ 702,732,271	$ 783,005,782	$ 837,197,578
Market Value of Assets	$ 655,383,900	$ 795,966,486	$ 795,966,486
Funded Status (Market Value Basis)	93.3%	101.7%	95.1%
Recommended Employer Contribution Rate	22.687%	22.042%	24.615%

On January 1, 2013, the Public Employees' Pension Reform Act of 2013 (PEPRA) took effect. PEPRA affects the rate for the first time in this valuation, which sets the 2014-15 contribution rates.

STRATEGIC PLAN

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the Strategic Plan Goal A: Improve long-term pension and health benefit stability.

BACKGROUND

The Judges' Retirement System II 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, 2014 through June 30, 2015.

ANALYSIS

Attachment 1 is the transmittal letter to the Governor and Legislature. Also attached (as Attachment 2) is the actuarial valuation report as of June 30, 2013 for the Judges' Retirement System (JRS). The results of the valuation are contained in the attached report and key results are included earlier in this agenda item.

Reconciliation of Employer Contribution Rates

As can be seen in our report, JRS II is reasonably well funded with a funded status of 95.1%. The contribution requirement and the funded status have not changed significantly since the prior valuation.

The actuarial office has set assumptions about the future experience of the plan. Each year, we assess the actual experience. To the extent the actual experience differs from what we assumed, a gain or a loss is created for the plan. This year the contribution amounts and investment returns, after smoothing methods were applied, had little impact on the employer rate. The plan experienced a large liability gain, due to the 0 percent salary increase given to the members during the 2012-2013 Fiscal Year. This would have resulted in a 0.5 percent drop in the required contribution rate if it had not been offset by other factors including the assumption change.

Other Considerations

With the enactment of the Public Employees' Pension Reform Act of 2013 (PEPRA), new PEPRA members are required to contribute at least 50 percent of the total annual normal cost of their pension benefit as determined by the actuary. Last year, staff determined the required contribution rate for PEPRA members based on the actuarial assumptions in place at the time. PEPRA contains a provision that states when the total normal cost has changed by more than 1% of payroll the member contribution rate must be adjusted. The new mortality assumptions have resulted in an increase of 2.028 percent to the total normal cost for new PEPRA members in this plan. Consequently, the PEPRA member contribution will be set to 15.25 percent effective July 1, 2014. This is 1 percent higher than the current 14.25 percent.

On April 17, 2013, the CalPERS Board of Administration approved a recommendation to change the CalPERS amortization and smoothing policies. Prior to this change, CalPERS employed an amortization and smoothing policy, which spread investment returns over a 15-year period while experience gains and losses were amortized over a rolling 30-year period. CalPERS will no longer use an actuarial value of assets and will employ an amortization and smoothing policy that will spread rate increases or decreases over a 5-year period, and will amortize all experience gains and losses over a fixed 30-year period.

The new amortization and smoothing policy will be used for the first time in the June 30, 2014 actuarial valuation. This valuation will be performed in early 2015 and will set employer contribution rates for the Fiscal Year 2015-16. The projections displayed in this valuation include the new amortization and smoothing policy. The new amortization and smoothing policy will have little impact on the Judges Retirement System II plan, primarily because the ratio of actuarial value of assets to market value of assets is almost 100 percent (97.9 percent)

Staff is not aware of any reason that the Board would want to consider setting a contribution rate other than the rate shown in our recommendation.

BENEFITS/RISKS
Volatility Ratios
The Actuarial Office presented the Annual Review of Funding Levels and Risks to the Board in March of 2013. One of the risks identified in that report was the Volatility Ratios (assets/payroll ratio, liability/payroll ratio).The asset /payroll volatility ratio for this plan is 3.3 and the liability/payroll ratio is 3.5. Both numbers are displayed in the Risk Analysis section of the valuation report. The volatility ratios indicate this plan has a lower risk of large changes to employer rates when it comes to investment earnings and changes in liability.

Future Investment Return Risk
The market return for the Fiscal Year 2013-14 has proven to be volatile. For example, the Judges Retirement II fund return at the end of January 2014 was about 8 percent. Reports before February 2014 month end indicates a fund return of over 12 percent. As part of this agenda item, an investment return sensitivity analysis for the 2013-14 Fiscal Year was performed to display the potential changes to the employer contribution rates.

Five different scenarios were selected to present a 95% confidence interval of the possible employer contribution rates for the Fiscal Year 2015-16. These scenarios represent a wide range of potential outcome based on the asset allocation strategy adopted by the Board of this system. For example, the 95th percentile return of 25% means there is a 5% chance that the fund will experience a return of 25% or better in any given year.

The table below shows the estimated 2015-16 contribution rate for the Judges' Retirement System II under the five different investment return scenarios. Note that the 2013-14 investment return would first be reflected in the June 30, 2014 actuarial valuation that will be used to set the 2015-16 employer contribution rates.

Estimated 2015-2016 Employer Rates Under Various Investment Return Scenario					
Percentile	5th	25th	50th	75th	95th
Estimated Return	-11.75%	-1.00%	7.00%	14.50%	25.00%
Estimated Contribution Rate	26.0%	25.5%	25.2%	23.5%	23.5%
Change from prior year	1.0%	0.2%	0.1%	0.1%	0.0%

As of January 31, 2014, the fiscal year to date investment return was about 8.0 percent. This return would correspond to a projected employer contribution rate of 25.1 percent for 2015-16.

The Actuarial Value of Assets used in the June 30, 2014 report is 97.9 percent of the Market Value of Assets. Because the actuarial value of assets is very close to the market value of assets, the rates are expected to remain stable despite the wide variety of investment returns. For more details on projected rates, see the Analysis of Future Investment Return Scenarios commencing on page 19 of the valuation report.

These projections are based on the new amortization and smoothing policy.

Funded Status

Another risk measured is the funded status of a plan. The funded status of a pension plan is defined as the ratio of assets to a plan's accrued liabilities. This measure when below a certain level along with other risk measures indicates whether a plan is at risk of not meeting future benefit obligations. The funded status of this plan on a MVA basis is 95.1% as of June 30, 2013. This plan is not above the ideal level of 100 percent. However, a funded status over 100 percent is not required. The actuarial process, will make sure the plan will meet its benefit obligations. By today's standards, the plan is well funded.

ATTACHMENTS

Attachment 1 - Transmittal letter to the Governor and Legislature
Attachment 2 - Judges' Retirement System II Actuarial Valuation Report as of June 30, 2013

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