Finance & Administration Committee

California Public Employees' Retirement System

Agenda Item 6a

February 18, 2015

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, 2014 Judges' Retirement System II Actuarial Valuation Report along with the changes to the amortization and smoothing policy outlined in the report, and the corresponding transmittal letter to the Governor and Legislature.
2. Adopt the employer contribution rate of 23.370 percent for the period of July 1, 2015 through June 30, 2016 for the Judges' Retirement System II.

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 the new amortization and smoothing policy for the Judges' Retirement System II. The new amortization and smoothing policy has been incorporated in this valuation and will impact the employer contribution rate for the first time in Fiscal year 2015-16.

The following table summarizes key results from the valuation:

Comparison of Current and Prior Year Results

	June 30, 2013	June 30, 2014
Present Value of Benefits	$ 1,419,325,105	$ 1,526,185,809
Accrued Liability	$ 837,197,578	$ 950,642,328
Market Value of Assets	$ 795,966,486	$ 1,013,839,948
Funded Status	95.1%	106.6%
Actuarially Determined Employer Contribution Rate	24.615%	21.866%
Minimum Employer Contribution Rate	24.615%	23.370%

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 (JRS 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 Fiscal Year July 1, 2015 through June 30, 2016.

ANALYSIS

As of June 30, 2014, JRS II is overfunded with a funded status of 106.6 percent. The funded status has improved significantly since the prior valuation. On June 30, 2013, the funded status was 95.1 percent. This improvement is due mostly to the gains the plan experienced during Fiscal Year 2013-14. Specifically, the fund earned 18 percent on the plan assets and the plan experienced salary increases lower than the assumed rate. These events created gains in excess of 115 million dollars.

The plan is now in surplus. Due to the provisions of PEPRA, the plan cannot use its surplus to offset its normal cost rate. Staff is recommending that the Board adopt a contribution rate of 23.370 percent for Fiscal Year 2015-16.

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.

The following table illustrates a history of the normal cost of the PEPRA group and the resulting employee contribution rate. In any given year, the employee normal cost for the PEPRA group will only change if there is more than a 1 percent change to the baseline normal cost rate.

Fiscal Year	Total PEPRA Normal Cost	Employee PEPRA Normal Cost
2013-14	28.674%	14.250%
2014-15	***30.702%****	***15.250%***
2015-16	30.652%	15.250%

*This is the current baseline normal cost rate

On April 17, 2013, the CalPERS Board of Administration approved a change to 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. Effective with this valuation, CalPERS no longer uses an actuarial value of assets and employs an amortization and smoothing policy that spreads rate increases or decreases over a 5-year period, and amortizes all experience gains and losses over a fixed 30-year period. A complete description of the actuarial methods used in the June 30, 2014 valuation may be found in Appendix A of this report.

The new amortization and smoothing policy was used for the first time in this actuarial valuation. The new amortization and smoothing policy had little impact on JRS II, primarily because the ratio of actuarial value of assets to market value of assets is almost 100 percent (97.9 percent).

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, 2014 for JRS II. The full results of the valuation are contained in the attached report.

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 returns for JRS II have proven to be volatile. As part of this agenda item, an investment return sensitivity analysis for Fiscal year 2014-15 was performed to display the potential changes to the employer contribution rates.

Five scenarios were selected to present a 95 percent confidence interval of the possible employer contribution rates for Fiscal Year 2016-17. These scenarios represent a wide range of potential outcomes based on the asset allocation strategy adopted by the Board of this system. For example, the 95th percentile return of 24.25 percent means there is a 5 percent chance that the fund will experience a return of 24.25 percent or better in any given year.

The table below shows the estimated 2016-17 contribution rate for the JRS II under the five different investment return scenarios. Note that the 2014-15 investment return would first be reflected in the June 30, 2015 actuarial valuation that will be used to set the 2016-17 employer contribution rates.

Estimated 2016-2017 Employer Rates Under Various Investment Return Scenario					
Percentile	5th	25th	50th	75th	95th
Estimated Return	-10.75%	-0.50%	7.00%	13.75%	24.25%
Estimated Contribution Rate	25.9%	23.5%	23.4%	23.4%	23.4%
Change from prior year	1.0%	0.2%	0.1%	0.1%	0.0%

As of December 31, 2014, the fiscal year to date investment return was about -1.5 percent. This return would correspond to a projected employer contribution rate of 23.8 percent for 2016-17.

Because the plan is in surplus, 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.

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. When below a certain level, this measure indicates whether a plan is at risk of meeting future benefit obligations. The funded status of this plan is 106.6 percent as of June 30, 2014. This plan is above the ideal level of 100 percent. 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, 2014

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