Finance & Administration Committee

California Public Employees' Retirement System

Agenda Item 8c

April 14, 2015

ITEM NAME: Schools Actuarial Valuation and Employer Contribution Rates

PROGRAM: Actuarial Office

ITEM TYPE: Action

RECOMMENDATION

Staff recommends that the Board adopt the employer contribution rate of 11.847 percent for the period of July 1, 2015 through June 30, 2016 for the Schools Pool.

EXECUTIVE SUMMARY

The recommended employer contribution rate for the Schools Pool is less than was projected in the June 30, 2013 annual valuation report, but will still increase from Fiscal Year 2014-15 to Fiscal Year 2015-16. The following table summarizes the results of the valuation:

Comparison of Current and Prior Year Results		
	June 30, 2013	June 30, 2014
Market Value of Assets	$ 49,481,899,610	$ 56,838,237,794
Accrued Liability	$ 61,487,179,133	$ 65,599,711,601
Unfunded Accrued Liability	$ 12,005,279,523	$ 8,761,473,807
Employer Contribution Rate		
Normal Cost	7.814%	7.621%
Unfunded Liability	3.957%	4.226%
Total Contribution	11.771%	11.847%

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 Schools Pool provides retirement benefits to members employed by school districts and community college districts in California. It generally does not cover teachers as they are covered by a separate retirement system – the California State Teachers' Retirement System, also known as CalSTRS.

Previously, the agenda item for the Schools Pool valuation has been combined with the agenda item for the State plan's valuations. Due to differences in the timing of actuarial assumption changes, a desire to simplify the reporting and in order to provide greater flexibility in the future, separate agenda items are now being provided.

As per the Board's decision in February of 2014, the new actuarial assumptions will be incorporated in the June 30, 2015 valuation for the Schools Pool and will not impact the Schools Pool contribution rate until Fiscal Year 2016-17. Analysis of this impact will be presented in the "Expected Future Changes" section.

This actuarial valuation sets forth the employer contribution rate for the plan for Fiscal Year July 1, 2015 through June 30, 2016.

ANALYSIS

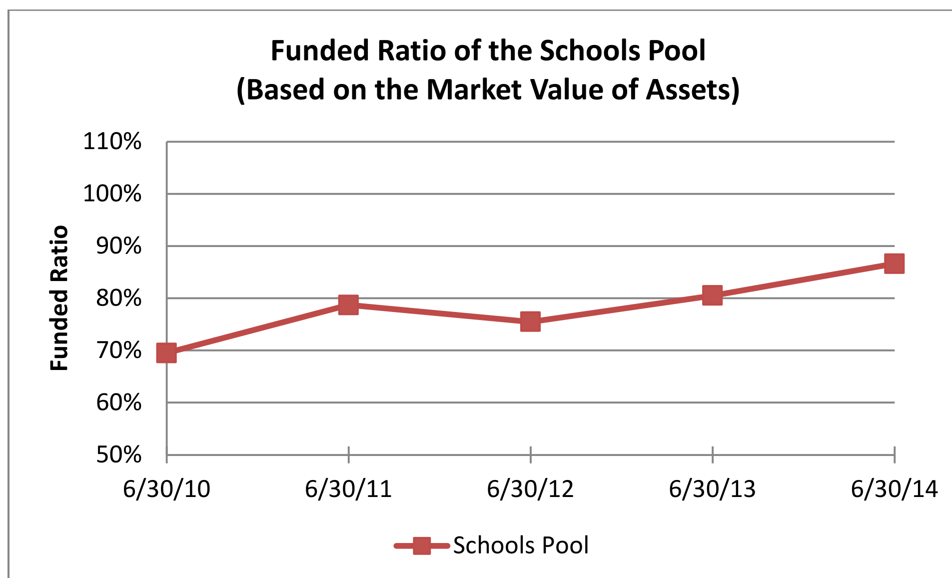
Schools Employer Contribution Rates for 2015-16
The Actuarial Office has completed the calculation of the employer contribution rates for the Schools Pool for the Fiscal Year 2015-16. The full actuarial report is expected to be completed this summer and will be provided to the Board and posted online when complete. The additional information provided in the full actuarial report includes details on assumptions, methods, and participant data. The Schools contribution rate has slightly increased between Fiscal Year 2014-15 and Fiscal Year 2015-16 from 11.771 percent to 11.847 percent.

Funded Status
The funded status of a pension plan is defined as the ratio of assets to a plan's accrued liabilities. Plans with a lower funded ratio are, all other things being equal, more at risk of not being able to meet their future benefit obligations. The following table displays the development of the Schools Pool's funded status:

Unfunded Liability and Funded Status Comparison

	June 30, 2013	June 30, 2014
1. Present Value of Benefits	$ 72,261,792,494	$ 76,932,325,687
2. Present Value of Future Normal Costs	$ 10,774,613,361	$ 11,332,614,086
3. Accrued Liability [(1) - (2)]	$ 61,487,179,133	$ 65,599,711,601
4. Market Value of Assets	$ 49,481,899,610	$ 56,838,237,794
5. Unfunded Liability/(Surplus) [(3) - (4)]	$ 12,005,279,523	$ 8,761,473,807
6. Funded Status [(4) / (3)]	80.5%	86.6%

The graph below shows the funded status of the Schools Pool for the past five years:



From June 30, 2013 to June 30, 2014 the funded status for the Schools Pool increased by 6.1 percent. This was mainly due to the investment return for Fiscal Year 2013-14 being greater than expected. Note that the increase in accrued liability due to the demographic assumption change will not be reflected until the June 30, 2015 valuation.

Reasons for Changes in Employer Contributions for the Schools Pool

Overall, the required contributions for the Schools Pool have increased by $111.0 million between Fiscal Year 2014-15 and Fiscal Year 2015-16, to approximately $1,338 million. Note that the payroll used to calculate the expected dollar contributions is the payroll used in the valuation incorporating two years of payroll growth using the payroll growth assumption of 3 percent. To the extent that payroll in the contribution year is different than the projected payroll, the actual contribution amounts will be different than the expected contributions stated here. The change in required contributions is mainly driven by the factors listed below.

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 will be shown in the valuation report that is expected to be released this summer. The increase in contributions caused by this change has been partially offset by strong investment returns during Fiscal Year 2013-14.

The Public Employees' Pension Reform Act of 2013 (PEPRA) requires new benefits for new members as defined by PEPRA, that are hired after January 1, 2013. The normal cost is lower than in the prior year due to the enrollment of new hires into the lower benefit level.

Payroll for Fiscal Year 2013-14 has increased by around 8 percent due to an increase in active counts and individual salary increases. As a result, required contributions are increasing by almost $70 million. This is the largest single factor towards the expected contribution increase.

There are other events that affected the overall change in contributions for the Schools Pool between Fiscal Year 2014-15 and 2015-16. The table below highlights all major contributors to the change in required contributions.

Reason for Change	**Change in Required Contribution (millions)**
Change due to normal progression of existing amortization bases	$12.4
Change due to increase in overall payroll	68.0
Decrease in normal cost due to new hires in lower benefit levels	(21.8)
First installment of the 5-year phased-in 30-year amortization of the following gains and losses:	
• Impact of investment experience and amortization and smoothing policy change	35.1
• Impact of greater than expected individual salary increases	10.3
• Impact of greater than expected retirements	6.2
• All other gains and losses	0.8
Total Change in Required Contributions	$111.0

PEPRA Member Contribution Rates

With the enactment of 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. PEPRA contains a provision that states when the total normal cost has changed by more than 1 percent of payroll the member contribution rate must be adjusted to ensure the member pays half the normal cost.

For Fiscal Year 2015-16, the total normal cost for Schools' PEPRA members is 12.00 percent and does not trigger a member rate change, leaving PEPRA employee contribution rates at 6 percent. Had the actuarial assumptions been implemented in the current valuation, the Schools' PEPRA normal cost would have been 12.68 percent. This also would not have triggered a member rate change.

Expected Future Changes

The amortization and smoothing policy approved by the Board on April 17, 2013 spreads rate increases or decreases over a 5-year period, and amortizes all experience gains and losses over a fixed 30-year period. This inherently builds in future rate changes due to the progression of the amortization schedule.

The new actuarial assumptions will first be reflected in the Schools Pool in the June 30, 2015 valuation. The increase in liability due to the new assumptions will be amortized over 20 years and phased in over 5 years, beginning with the contribution requirement for Fiscal Year 2016-17. The projected impact of the assumption change on the Schools Pool rate in year one is estimated to be 1.5 percent of payroll and in year five estimated to be 4.5 percent of payroll.

In total, the projected impact of all known amortization bases will result in an estimated rate increase of 1.2% in Fiscal Year 2016-17 and should peak at 5.6% in Fiscal Year 2020-21, where it is expected to no longer increase.

A more accurate projection will be included in the Schools valuation report which will include the expected impacts of the investment return for Fiscal Year 2014-15 as well as the anticipated decrease in normal cost due to new hires entering into lower benefit formulas due to PEPRA.

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 5.3 and the liability/payroll ratio is 6.2. Both numbers will be 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.

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