Finance & Administration Committee
California Public Employees' Retirement System

Agenda Item 5b

May 19, 2015

ITEM NAME: Amortization Policy – Rate Restructuring

PROGRAM: Actuarial Office

ITEM TYPE: Information

EXECUTIVE SUMMARY

The Board has delegated authority to staff to set public agency required contribution rates in accordance with the Board's actuarial policies, including the amortization and smoothing policy[1]. This item is to inform the Board how staff intends to use the existing provisions of that policy to provide rate restructuring to ease a situation affecting a small number of employers.

STRATEGIC PLAN

This agenda item supports the Strategic Objective under Strategic Plan Goal A – Improve long-term pension and health benefit sustainability that the system is funded through an integrated view of pension assets and liabilities.

BACKGROUND

Current Board policy permits a restructuring of the amortization bases (also known as a "fresh start") when the application of the amortization policy would not otherwise achieve the goals of the policy - to eliminate the unfunded liabilities in a manner that maintains benefit security while minimizing substantial variations in employer contribution rates.

Changes to the structure of risk pooling were adopted at the May Board meeting last year to avoid some inadvertent negative consequences that would have resulted from the adoption of the Public Employees' Pension Reform Act (PEPRA). While these changes were successful for most employers, a small number of employers will face a significant sudden increase in their required contributions.

ANALYSIS

Unfunded liabilities are subject to the Board's amortization and smoothing policy, ACT-96-05E. That policy permits[2] a restructuring of the amortization bases to better achieve the intent of the policy.

Last year in May, the Board approved changes to the risk pooling structure for pension plans to ensure the proper funding of these pools. As a result of the

[1] http://www.calpers.ca.gov/eip-docs/about/board/actuarial-policies/amortization-smoothing.pdf
[2] Under subparagraph (B)(9)(a)(5) of the policy

interaction of the change in the pooling structure with individual employer's circumstances and the amortization policy, some employers are facing significant, unexpected contribution increases. These employers may, at the same time, have future reductions in contribution as existing amortization bases are paid-off, resulting in a payment pattern that is not smooth. This situation was anticipated in the Board's amortization policy. The policy provides staff with discretion to adjust the schedules to better achieve the intent of the Board's policy.

It is imperative that any rate restructuring is consistent with the Board's fiduciary duty to the members of the system. To ensure that the restructuring will not exacerbate any underfunding and hence increase the risk to the members, staff will, at the request of a public agency, combine two or more existing amortization bases into a single base but only in situations that meet all of the following criteria:

1. The new base cannot result in a lower contribution amount in the first year than in the prior fiscal year.

2. The new base will result in a final payment no later than the final payment for the longest of the original bases.

3. The new base will have a duration that is less than the duration of the original bases and will result in less interest being paid than would have been the case if the original bases had not been combined into the new base.

The intent of the restructuring would be to reduce the volatility of employer contributions to better achieve the goals of the policy without increasing risk to the members.

To help illustrate how this rate restructuring will be applied, please refer to Attachments 1 and 2. Attachment 1 shows, for a sample plan, the impact of a fresh start on future employer contribution rates. Attachment 2 shows, for that same plan, the impact on the unfunded liability over time. As can be seen on the two charts, a fresh start would result in a smoother contribution pattern and would result long term in a better funded situation for that plan.

BUDGET AND FISCAL IMPACTS
Not Applicable.

BENEFITS/RISKS
The benefit of reducing substantial variations in employer contribution rates is helping that employer budget for their pension costs in an orderly manner which reduces stress on employers and helps them make the contributions necessary to ensure long term benefit security for members.

The risk in providing the rate restructuring is that initially, the employer will make lower contributions than they would have otherwise and hence the assets to support the benefits will be slightly less. However, because of the constraints listed above, this will turn around and the employer will subsequently make higher contributions resulting in a period where the assets are greater than would have been the case without the restructuring. This will mitigate the risks to the members.

ATTACHMENTS
Attachment 1 – Impact of Rate Restructuring on Employer Contribution Rates
Attachment 2 – Impact of Rate Restructuring on the Unfunded Liability

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