



Agenda Item 12

June 17, 2015

ITEM NAME: Funding Risk Mitigation Update

PROGRAM: Asset Liability Management

ITEM TYPE: Information

EXECUTIVE SUMMARY

In May, staff conducted a workshop for the CalPERS Board of Administration (Board) on risk mitigation strategies that could be implemented to help mitigate the risks faced in the funding of the Public Employees' Retirement System.

At the workshop, staff was asked to provide additional information on the impact of the two risk mitigations strategies under consideration on the risk measures previously provided in the Annual Report on Funding Levels and Risks. That information is included in this agenda item. Also included is an update on the stakeholder outreach currently underway to ensure feedback from stakeholders.

STRATEGIC PLAN

This agenda item supports Strategic Plan Goal A – to improve long-term pension and health benefit sustainability. It specifically addresses the objective to fund the system through an integrated view of pension assets and liabilities.

BACKGROUND

In February 2015, a workshop was conducted for the Board to provide an overview of the funding risks faced in the funding of the Public Employees' Retirement System, how these risks are changing, and introduced several concepts that could be applied to mitigate these risks.

In May 2015, a follow-up workshop was conducted to further expand on two risk mitigations strategies. At that session, Board members asked that additional information be provided to supplement information presented at the May workshop. Board members also requested that further outreach be performed to stakeholders before further direction is provided by the Board on a path forward.

ANALYSIS

Reducing the risk in the funding of the system will be difficult because it will involve tradeoffs between short and long-term considerations. Staff has presented two mitigation strategies that could be used to reduce risk which include:

- **Flexible glide path** – lowering the discount rate and expected investment volatility following a great investment return
- **Blended glide path** – similar to the flexible glide path but with check points over time that would trigger additional asset allocation changes and lowering of the discount rate if investment returns did not result in a sufficient reduction in volatility.

During the workshop, a request for information regarding the impact the two risk mitigations strategies under consideration would have on risk measures previously provided in the Annual Report on Funding Levels and Risks. The risk measures are:

- Probability of falling below 60%, 50% or 40% funded over the next 30 years
- Probability of employer contribution rates reaching 30%, 35% or 40% of payroll for that plan over the next 30 years
- Probability of the employer contribution rate increasing by more than 3%, 5% or 7% in a single year over the next 30 years

As requested, the risk measures provided in this agenda item (Attachment 1) are based on today's funding levels and look at the next 30 years under the two risk mitigation strategies and how they would impact the risk measures as risk mitigation progresses over the next 30 years.

While the information in Attachment 1 shows how the current risk measures would change if the Board were to adopt one of the risk mitigation strategies, it is not as helpful in assessing what the ultimate goal of risk mitigation should be. As has been stated before, our goal should not just be to be 100% funded but rather it should be to be 100% funded at an acceptable level of risk.

To assist the Board in its deliberations about the appropriate level of risk for the future, Attachment 2 compares the current risk measures with what they would be if the plan were fully funded both at the current level of investment volatility and at lower volatility levels.

Stakeholder Outreach Update

Risk mitigation is a topic we have been discussing with the CalPERS Board and our stakeholders for several months. In November of last year, staff presented the Funding Levels and Risk Report to the CalPERS Board and as a result, staff have briefed member and employer association leaders on the topic of risk at executive roundtables and stakeholder briefings in January, February, April and May.

Additionally, a presentation was made at the City Managers Conference hosted by the California League of Cities on January 28. In February of this year, a workshop on the topic was also given. Feedback from the CalPERS Board and stakeholder groups led to a refinement of the strategies and in May, a follow up workshop was held. In the May session, the Board expressed a strong interest in hearing the

feedback from our stakeholders about the two risk mitigation strategies under consideration.

Since the workshop, staff in External Affairs, in coordination with the Financial, Actuarial and Investment offices, have put together a comprehensive stakeholder outreach plan to educate stakeholders about the strategies as well as encouraging and soliciting feedback to help inform decisions on the future funding of the system.

On June 3 and 4, staff hosted two webinars led by CFO Cheryl Eason and Deputy Chief Actuary David Lamoureux to discuss the strategies and answer any questions from stakeholders. More than 250 participants were in attendance, largely from cities across the state as well as representatives from the California State Association of Counties and the California Association of Special Districts. We have also used the opportunity to discuss the risk strategies in recently held Employer Executive Visits with the City of Sacramento, Placer County, the City of Roseville, the County of Solano, including the cities of Fairfield, Vacaville, Vallejo and Benicia.

In late June and early July, we are planning Executive Roundtables with the leaders of our employer and member associations as well as future dates for additional webinars.

We will continue to work with the associations to facilitate their coordination in gathering input from their membership.

Our stakeholder outreach activities will culminate at the Board's August 19 meeting where we are planning to have various stakeholders, experts, employer and member association leaders provide direct feedback to the Board.

Following the August meeting, staff is scheduled to present a formal policy on a strategy based on direction from the Board and feedback from stakeholders.

BUDGET AND FISCAL IMPACTS

Not Applicable.

ATTACHMENTS

Attachment 1 – Comparison of Risk Measures for the Risk Mitigations Strategies

Attachment 2 – Comparison of Risk Measures in Possible Future States

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