



Special Session – Funding Risk & Mitigation August 18, 2015

ITEM NAME: Funding Risk and Mitigation Update

PROGRAM: Asset Liability Management

ITEM TYPE: Information; Direction being sought

EXECUTIVE SUMMARY

In June, staff provided additional information related to the two risk mitigation strategies under consideration. This included the impact the strategies would have based on CalPERS current funded status of approximately 77 percent and how the strategies would impact the risk measures provided in the Annual Report on Funding Level and Risks over the next 30 years.

Staff also included an update on the outreach and engagement activities that was being conducted to ensure feedback from stakeholders.

This agenda item provides a full report of stakeholder outreach to date and general commentary of the feedback received. Staff will also recap the strategies at the August 18 special session and Wilshire Associates will present additional risk mitigation considerations as context for the discussion. Staff is seeking direction from the Board on the risk mitigation strategy choice of either flexible or blended for the development of a policy that could be brought back to the Board in October.

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.

As discussed in previous workshops and meetings, maturity levels in the fund are at their highest levels and are expected to increase in the future. We are in a period of negative cash flow with a rapidly maturing public employee workforce. We expect employer contribution rate volatility to continue to increase over the next 20 to 30 years. Additionally, a poor investment return will impact contribution rates more in 20

years than it will if it happened today. As we have stated previously, we believe a mitigation strategy is imperative to address 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.

In June 2015, staff provided additional information requested and an update of stakeholder outreach.

ANALYSIS

Reducing the risk in the funding of the system involves tradeoffs between short and long-term considerations. Staff has presented two mitigation strategies that could be used to reduce risk:

- **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.

STAKEHOLDER OUTREACH

Risk mitigation is a topic that staff has been discussing with the CalPERS Board and stakeholders for several months. Below are the outreach and engagement activities conducted with stakeholders in the last 10 months where risk mitigation was a topic of discussion:

Employer and Member Organization Executive Roundtables

January 2014, February 2015, April 2015, May 2015, June 2015, July 2015

Stakeholder Engagement Briefings

February 2015, April 2015, May 2015, June 2015

Special Meetings

Meetings were conducted throughout the months of June and July with employer and member representatives listed below. Other groups were also invited to participate but not all chose or able to participate.

California League of Cities
California Special Districts Association
California State Association of Counties

Regional Council of Rural Counties
California School Employees Association
SEIU
AFSCME
California Professional Firefighters
Professional Engineers in California
California Department of Finance
RPEA

Educational Webinars

Five educational webinars were hosted to strengthen stakeholder understanding of the risk mitigation strategies under consideration to date. The archived webinar has also been viewed on the CalPERS web site by nearly 130 users.

Webinar Date	Attendance
June 3, 2015	152
June 4, 2015	129
July 9, 2015	57
July 10, 2015	49
July 30, 2015	71

Conferences & Events

Staff made presentations about the risk mitigation strategies at the League of California Cities City Managers Conference on January 28, before the California State Municipal Finance Officers Association on February 28, and at the League's Board of Directors Meeting on July 16. Risk mitigation was also a key panel discussion at CalPERS 2014 Educational Forum. Additionally, we discussed the risk mitigation strategies during our Employer Executive Visits to date.

Stakeholder Commentary

In general, employer and member stakeholders understand the need to reduce risk in the fund and the overall goals and objectives of the strategies.

Stakeholder feedback has ranged from support for the strategies to concern over the financial impacts in the future. It is clear that employers approach this topic with an individual perspective where some are in a strong financial position to absorb future costs, and may even want greater risk reduction, to other employers who express continued challenges with pension costs. The same can be said for member associations where the impacts to individual member groups (miscellaneous, safety, etc.) will be impacted with increased member contributions at different times in the future depending on the pace of risk reduction.

BENEFITS/RISKS

The benefits of a risk mitigation strategy include:

- Strengthens the long-term sustainability of the fund and security of future benefit payments
- Protects the fund from poor market conditions or changing demographics that could reduce CalPERS funded status
- Reduces the level of future risk in the investment portfolio
- Reduces the volatility in contribution rates for employers

The risks of a risk mitigation strategy include:

- Reducing CalPERS discount rate will increase employer contributions
- Increases member contributions over time, specifically those covered under PEPPRA

BUDGET AND FISCAL IMPACTS

Not Applicable.

ATTACHMENTS

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Chief Financial Officer

ALAN MILLIGAN
Chief Actuary

TED ELIOPOULOS
Chief Investment Officer

BRAD PACHECO
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ANNE STAUSBOLL
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