



**Consent**

**Agenda Item 4c**

February 17, 2016

**ITEM NAME:** Judges' Retirement System II Actuarial Valuation Report and Employer and Employee Contribution Rates

**PROGRAM:** Actuarial Office

**ITEM TYPE:** Action Consent

**RECOMMENDATION**

Staff recommends that the Board take action on the following:

1. Approve the June 30, 2015 Judges' Retirement System II Actuarial Valuation Report, and the corresponding transmittal letter to the Governor and Legislature.
2. Adopt the employer contribution rate of 23.185 percent for the period of July 1, 2016 through June 30, 2017 for the Judges' Retirement System II.

**EXECUTIVE SUMMARY**

The following table summarizes key results from the valuation:

<b><u>Comparison of Current and Prior Year Results</u></b>		
	<b><u>June 30, 2014</u></b>	<b><u>June 30, 2015</u></b>
Present Value of Benefits	\$ 1,526,185,809	\$ 1,709,083,961
Accrued Liability	\$ 950,642,328	\$ 1,081,824,423
Market Value of Assets	\$ 1,013,839,948	\$ 1,084,141,932
Unfunded Liability/(Surplus)	\$ (63,197,620)	\$ (2,317,510)
Funded Status	106.6%	100.2%
Actuarially Determined Employer Contribution	21.866%	23.142%
Minimum Employer Contribution Rate	23.370%	23.185%

**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, 2016 through June 30, 2017.

## ANALYSIS

As of June 30, 2015, JRS II is overfunded with a funded status of 100.2 percent. The funded status has declined since the prior valuation. On June 30, 2014, the funded status was 106.6 percent. This decline is due primarily to investment losses the plan experienced during Fiscal Year 2014-15. Specifically, the fund earned -0.3 percent on the plan assets which resulted in a loss of 75.9 million dollars.

The plan is still 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 23.185 percent for Fiscal Year 2016-17.

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 1 percent or more change from the Baseline Normal Cost Rate.

<b>Fiscal Year</b>	<b>Total PEPRA Normal Cost</b>	<b>Employee PEPRA Normal Cost</b>
2013-14	28.674%	14.250%
<b>2014-15</b>	<b>30.702%*</b>	<b>15.250%</b>
2015-16	30.652%	15.250%
2016-17	30.727%	15.250%

\*This is the current Baseline Normal Cost Rate

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, 2015 for JRS II. The full results of the valuation are contained in the attached report.

**BENEFITS/RISKS**

**Volatility Ratios**

The Actuarial Office presented the Annual Review of Funding Levels and Risks to the Board in November 17, 2015. 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 4.0 and the liability/payroll ratio is 4.0. 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 when compared to most plans in the PERF.

**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 2015-16 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 2017-18. 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 95<sup>th</sup> 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 2017-18 contribution rate for the JRS II under the five different investment return scenarios. Note that the 2015-16 investment return would first be reflected in the June 30, 2016 actuarial valuation that will be used to set the 2017-18 employer contribution rates.

<b>Estimated 2017-2018 Employer Rates Under Various Investment Return Scenario</b>					
Percentile	5 <sup>th</sup>	25 <sup>th</sup>	50 <sup>th</sup>	75 <sup>th</sup>	95 <sup>th</sup>
Estimated Return	-10.75%	-0.50%	7.00%	13.75%	24.25%
Estimated Contribution Rate	24.1%	23.5%	23.2%	23.2%	23.2%
Change from prior year	0.9%	0.2%	0.0%	0.0%	0.0%

As of December 31, 2015, the fiscal year to date investment return was about -3.4 percent. This return would correspond to a projected employer contribution rate of 23.7 percent for 2017-18.

Because the plan has a small 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 100.2 percent as of June 30, 2015. This plan is above the ideal level of 100 percent. By today's standards, the plan is well funded.

### **OTHER ISSUES**

#### **Subsequent Events**

In the case of Robert M. Mallano, et al. v. John Chiang, Controller of the State of California (SCO), the Judges' Retirement System (JRS), and the Judges' Retirement System II (JRS II), the judge issued a Statement of Decision which orders judicial salary increases to be given to the judges for the fiscal years 2008-09, 2009-10, 2010-11 and 2013-14 plus 10% interest per annum for each year that the judicial salaries were not increased within those fiscal years. The increases and amounts owed have not been calculated yet. We anticipate the impact of this lawsuit to be reflected in the June 30, 2016 valuation.

### **ATTACHMENTS**

Attachment 1 - Transmittal letter to the Governor and Legislature

Attachment 2 - Judges' Retirement System II Actuarial Valuation Report as of June 30, 2015

---

FRITZIE ARCHULETA  
Senior Pension Actuary

---

ALAN MILLIGAN  
Chief Actuary