Actuarial Cost Method Policy

Purpose

The Actuarial Cost Method Policy establishes the cost methodologies CalPERS will use to estimate pension costs.

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Background

This Policy uses a principled approach in the funding of benefits — that is, to fairly allocate the costs of public employee retirement benefits to the generation of taxpayers who benefit from the services of those public employees and to minimize cost volatility. One such method, the Entry Age Normal cost method, ensures that cost volatility is minimized and intergenerational equity is achieved.

This policy requires staff to generally use the Entry Age Normal cost method for pension benefit valuations and that any exception to use of the Entry Age Normal cost method requires Board approval.
In general, for fixed death benefits, cost volatility is minimized using the Term Insurance cost method and for all other benefits at CalPERS cost minimization is achieved using the Entry Age Normal cost method.

One exception is the non-indexed levels of the 1959 Survivor Benefit Program. In 1996 the CalPERS Board established a Task Force of employee representatives, employer representatives, and CalPERS actuarial and program staff, including the Board's Chief Actuary, to study the 1959 Survivor Benefit Program.

The Task Force assigned to study the Survivor Benefit Program submitted its report to the CalPERS Board and the Board accepted that report and its recommendations at its October 1996 meeting. These recommendations included the following with respect to the cost method for the Program:

- The Entry Age Normal cost method is not an appropriate cost method to apply to the benefit accrual pattern of the benefit levels within the 1959 Survivor Benefit Program specified in Government Code sections 21571, 21572, 21573, and 21574.

- The Term Insurance cost method, when modified to include the amortization of any unfunded liability or surplus assets in the program, is an appropriate method to apply to the benefit levels within the Survivor Benefit Program specified in Government Code sections 21571, 21572, 21573, and 21574.

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Background (continued)

On January 1st, 2001, a new benefit level was created in the 1959 Survivor Program, following the establishment of new requirements under Government Code section 21574.5(f). These new benefits are indexed to inflation and the Board adopted the Entry Age Normal Cost Method to determine costs consistent with the principle of minimizing cost volatility.

Finally, the State Group Term Life Insurance Program has benefits based on the life of active members similar to the 1959 Survivor non-Indexed Program. This program operates within each State's pension plans as a life insurance program for active members and uses the Term Insurance Cost Method to determine costs.

Strategic Objective

By providing for accurate projections of future costs, this policy establishes a sound basis for CalPERS to develop funding goals that support CalPERS ability to meet its benefit obligations, which will improve the long-term sustainability of CalPERS Pension Benefit Program.

Policy

Entry Age Normal Cost Method
CalPERS shall generally use the Entry Age Normal cost method in calculating actuarial costs, including the indexed level of the 1959 Survivor Benefit Program.

Term Insurance Cost Method
CalPERS shall use the Term Insurance cost method, modified to include the amortization of any unfunded liability or surplus assets in the program, to determine the liabilities and employer contribution rates for the benefit levels within the non-indexed 1959 Survivor Benefit Program and for the State Group Term Life Insurance Program.

Exceptions
Any exception to this policy requires Board approval. To obtain Board approval, staff must report to the Board those instances where an exception to this policy is appropriate and recommend an alternative cost method.

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Key Terms/ Definitions

Key Term	Definition
Entry Age Normal Cost Method	A method under which the actuarial present value of the projected benefits of each individual included in an actuarial valuation is allocated in a manner that produces a level annual cost over the earnings of the individual between entry age and assumed retirement age. The cost allocated to the current fiscal year is called the normal cost.
Term Insurance Cost Method	The method under which the actuarial present value of benefits of each individual included in an actuarial valuation is the expected benefit payments for the upcoming year. This is a funding method with no pre-funding of the survivor benefits payable on account of deaths expected to occur beyond those in the coming year.

Roles and Responsibilities

CalPERS Chief Actuary shall:

- Review the appropriateness of the actuarial cost methods from time to time or at any time for each of the benefit programs (including the affiliate programs) and make recommendations to the Board as appropriate.
- Direct and oversee the ongoing and effective implementation and maintenance of this policy.

All CalPERS actuaries shall comply with this policy in the execution of their duties.

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Compliance

All methodologies contained in this policy are subject to the auditing procedures of the CalPERS Office of Audit Services.

Authoritative Sources

CalPERS will administer this policy in compliance with the following legal, regulatory and policy requirements:

Source	**Description**
Government Code section 21574.5(f)	1959 Survivor Allowance – Indexed Level
Government Code sections 21571, 21572, 21573, and 21574	1959 Survivor Allowance – Levels One thru Four

Related Documents

Document	**Relevance**
Actuarial Standards of Practice (ASOP) No. 4 - Measuring Pension Obligations and Determining Pension Plan Costs or Contributions	Actuarial guidance for measuring pension obligations and determining pension plan contributions.

Revision History

The following revisions have been made to this policy:

Version	**Modification Date**	**Summary of Changes**
1.0	Final modification date TBD	Combined and reformatted existing resolutions; no material change This policy supersedes: • Resolution No. 95-05B *Funding Method* dated 5/17/95 • Resolution No. AESD-97-02 *Funding Method for Survivor Benefit Program* dated 11/19/97