



## Finance and Administration Committee Agenda Item 8c

April 19, 2016

**Item Name:** Review of the Actuarial Cost Methods Policy and Amortization Policy (Second Reading)

**Program:** Actuarial Office

**Item Type:** Action

### **Recommendation**

Approve the adoption of staff's consolidation of the Actuarial Cost Method and Actuarial Amortization policies (attachments 3 and 8).

### **Executive Summary**

This agenda item is the second reading of staff's consolidation of the Actuarial Cost Method and Actuarial Amortization policies. In addition to consolidating six actuarial policies into two (Actuarial Cost Method and Actuarial Amortization), staff performed a comprehensive review of the aforementioned actuarial policies. The consolidated policies keep the same content of the past policies with the additional flexibility to apply dollar billing for non-pooled plans and adding content in regards to the newly adopted Funding Risk Mitigation Policy.

### **Strategic Plan**

This agenda item supports the following strategic plan goals:

- Goal A – Actively manage and assess funding risk through an asset liability management framework to guide investment strategy and actuarial policy.
- Goal B – Cultivate a high-performing, risk-intelligent and innovative organization.

### **Background**

The purpose of this review is to consolidate similar policies and ensure consistency with actuarial and policy management best practices.

This review has followed a collaborative process, involving subject matter experts from across CalPERS, including actuarial, compliance, investment, strategy and performance, financial, and legal staff. Employer and employee organizations were also consulted regarding the changes and approach.

### **Analysis**

The changes generally fell into the follow categories:

- Consolidation of existing policies
- Deletion of transition provisions that are no longer applicable
- Adding or changing provisions to address needed changes or to provide some additional flexibility.

### **Consolidation**

Two current policies, the Funding Method (95-05B) policy and the Funding Method for Survivor Benefit Program (AESD-97-02) policy have been consolidated into the proposed Actuarial Cost Method Policy. These are included as Attachments 1, 2 and 3 respectively. Minor changes were made to incorporate existing Board approved exceptions with regard to the 1959 Survivor and the State Group Term Life Insurance Program.

The following four items were consolidated into the proposed Actuarial Amortization Policy:

Attachment 4 – Amortization and Smoothing Policy (ACT-96-05E Rev.): Current State

Attachment 5 – Smoothing Employer Contribution Rates policy (05-02-AESD Rev): Current State

Attachment 6 – 30 Year Amortization Extension Policy Guidelines: Current State

Attachment 7 – Funding Stability Directive: Current State

The proposed Amortization Policy is included as Attachment 8.

### **Deletion of Provisions No Longer Applicable**

The Amortization and Smoothing Policy (ACT-96-05E Rev.) contained a number of transition provisions that were no longer applicable as they only applied to certain years. These have been deleted.

### **Adding Provisions**

There were three substantive changes where provisions were added to address needed changes or add flexibility. These changes are:

1. Add a provision to coordinate the amortization of investment gains with the changes to the funding when a risk mitigation event occurs under the Funding Risk Mitigation Policy. This will ensure the treatment of a risk mitigation event is consistent with the intent of the Funding Risk Mitigation Policy.
2. Changes to permit the amortization of unfunded liabilities for non-pooled plans to be expressed as a dollar amount rather than as a percentage of pay. This change will cause the amortization of unfunded liabilities to be consistent with that of pooled plans. This change has been discussed with employers numerous times, including the last two Educational Forums and appears to be widely accepted by employers.
3. Add provisions to permit changes to amortization schedules if needed, provided the changes do not result in any additional deferral of contributions. This would permit, for example, staff to fresh start the amortization of an employer's unfunded liability as a level dollar amount rather than increasing as a percentage of payroll – something that would be appropriate if an employer was concerned that its payroll may not grow as quickly as our assumptions would predict. It would also permit small unfunded liabilities (which can occur, especially in newly created plans) to be amortized over shorter periods if it makes more sense.

### **Changes from the First Reading**

The Proposed Amortization Policy has changed from the first reading by including a provision on amortizing changes in plan provisions which was inadvertently left out of the version presented in the first reading.

## **Budget and Fiscal Impacts**

Not applicable

## **Benefits and Risks**

The proposed approach has the following benefits:

- Consolidating related requirements into a single document will streamline the administration and oversight of these requirements, while minimizing risk of error.
- Converting the out-of-date “resolution” format into a standardized policy template will streamline the policy revision process and improve readability, without affecting the Board’s oversight and approval of these policies.
- Aligning CalPERS policies and delegations will strengthen CalPERS governance framework, avoid potential confusion and ensure that authority and responsibilities are clearly defined.
- This policy is consistent with the intent of the Funding Risk Mitigation Policy.

## **Attachments**

Attachment 1 – Funding Method (95-05B): Current State

Attachment 2 – Funding Method for Survivor Benefit Program (AESD-97-02): Current State

Attachment 3 – Actuarial Cost Method Policy: Proposed Policy

Attachment 4 – Amortization and Smoothing Policy (ACT-96-05E Rev.): Current State

Attachment 5 – Smoothing Employer Contribution Rates policy (05-02-AESD Rev): Current State

Attachment 6 – 30 Year Amortization Extension Policy Guidelines: Current State

Attachment 7 – Funding Stability Directive: Current State

Attachment 8 – Actuarial Amortization Policy: Proposed Policy

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