California Public Employees' Retirement System

2016 Annual Review of Funding Levels and Risks

September 20, 2016

CalPERS

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Introduction

This report is intended to assist the CalPERS Board of Administration in assessing the soundness and sustainability of the Public Employees' Retirement System. It does not address the other systems (the Judges Retirement Systems, the Legislators Retirement System or the non-pension programs) administered by the Board of Administration.

The results presented in this report are based on the results of the June 30, 2015 annual valuations which have been projected forward to June 30, 2016 based on the known investment return for the 2015–16 Fiscal Year.

In this report, we focus on:

- Reporting the funded status for the system as a whole and for key components of the system
- Identifying and quantifying risks to the funding of the system
- Examining how risks are changing
- Outlining risk mitigations currently in effect and progress made in addressing the risks
- Assessing the effectiveness of the risk mitigations and whether changes are needed

In prior reports, there was a more extensive report on the results of the annual valuations. This year, we have broken those results out into a report that is being presented separately. This has permitted us to have a greater focus on the funding risks and the effect of the Board's Funding Risk Mitigation Policy in this report.

The report also reflects the pension and investment beliefs adopted by the Board that inform our work on risks and funding, including:

Pension Belief 5
Funding policies should be applied in a fair, consistent manner, accommodate investment return fluctuations and support rate stability.

Pension Belief 9
Sound understanding and deployment of enterprise-wide risk management is essential to the ongoing success of a retirement system.

Investment Belief 1
Liabilities must influence the asset structure.

Investment Belief 9
Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error.

Executive Summary

As a result of the relatively poor performance of the capital markets in the 2015–16 Fiscal Year, the funded status of the system has fallen to about 68%. The funded status varies significantly among the different plans, with the Schools pool in better shape than the average public agency plan, which in turn is in better shape than the State plans. Plans for miscellaneous members are generally in better shape than plans for safety members.

The decline in funded status has generally aggravated the risk that plans will fall to low funding levels, but this has been offset to some extent by the adoption of the Funding Risk Mitigation Policy. In fact, the risk of falling to the lowest funding levels has actually improved since the last report.

Employer contribution levels are climbing and this is putting stress on employers. When combined with some of the environmental changes discussed in the report, this is an area that needs to be monitored in the future.

At this point, sudden sharp increases in employer contribution rates do not seem to be as significant a concern as the overall level of the contributions.

Under the Funding Risk Mitigation Policy, no risk mitigation event was triggered as a result of the investment returns in the 2015–16 Fiscal Year. At this point, it is too early to assess the effectiveness of the risk mitigation policy. A longer baseline will be needed before the effectiveness of the policy can reasonably be assessed.

Maturation of plans and financial stress on some employers remain of concern. The termination policies and processes currently in place should mitigate risk to the system. However, if an employer is under severe financial stress, the termination policies cannot protect the benefits of members employed by such an employer. Ultimately, the members' benefits are only secure if the employer stands behind its promise of retirement benefits to its employees.

Recent economic conditions have increased the risk associated with achieving a 7.5% rate of return, at least over the medium term — the next 10 years or so. It is increasingly clear that some change to the expected rate of return should be considered by CalPERS. Fortunately, the next 18 months represents the culmination of the four-year Asset Liability Management (ALM) cycle where the appropriate asset allocation and expected return will be considered by the Board.

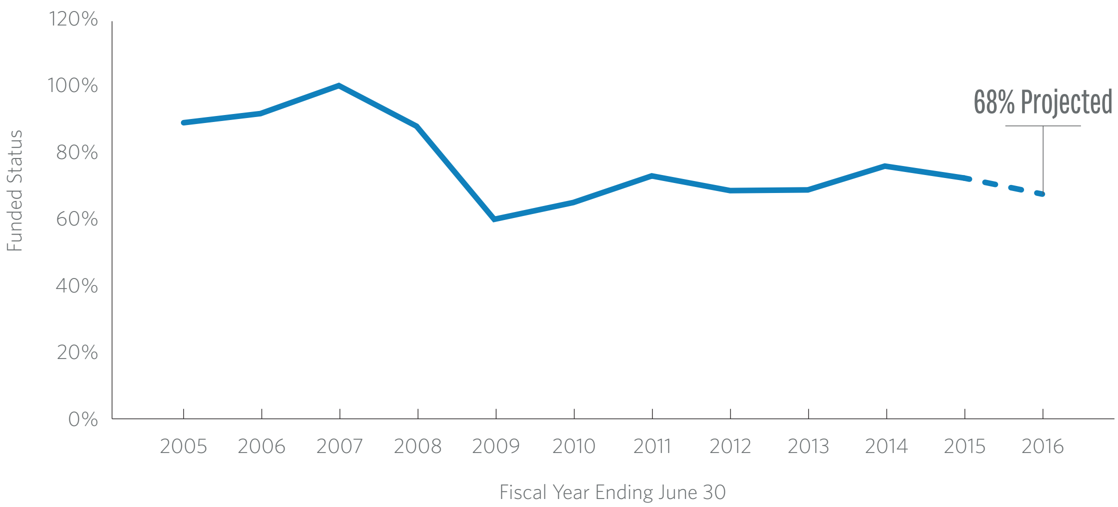
There is an emerging concern that there may be some degradation of the membership and revenue base of the Schools pool which would increase the risk to the funding of the pool.

Overall, this report shows that risks remain high. In the absence of explicit risk targets and tolerances, it is not clear whether the risk mitigations in place currently have brought risks to the levels that the Board considers acceptable. The Board may wish to take additional actions to address the level of funding risk.

Funding Levels

The overall level of funding of the system has declined as a result of the lower than expected investment return of the last two years. While we will not have definitive results until we complete the annual valuations, the estimated funded status is shown in the chart below.

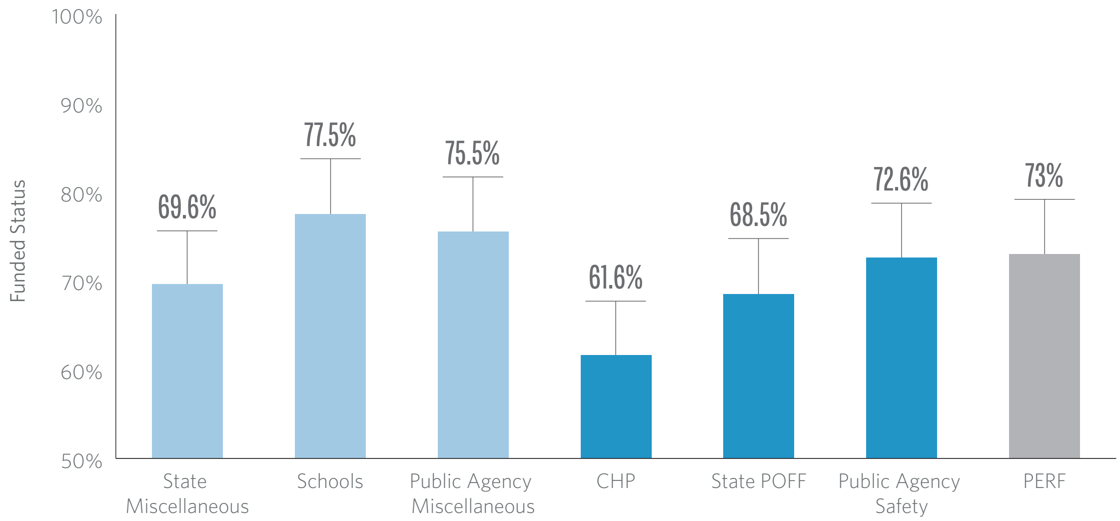
PERF Funded Status based on Market Value of Assets (June 30, 2005 to June 30, 2016)



Recent fluctuation in the funded status is within the expected variation due to the investment volatility inherent in the asset allocation last adopted by the Board. The overall funded status of the system remains a concern and the Board may wish to adopt stronger measures to improve the funded status of the system.

It should be noted that the System is a conglomeration of multiple plans and several risk sharing pools. Each of these pools and the non-pooled plans are funded separately. The charts on the next page show the funding levels of the various components of the Public Employees' Retirement System.

Funded Status Based on Market Value of Assets (as of June 30, 2015)



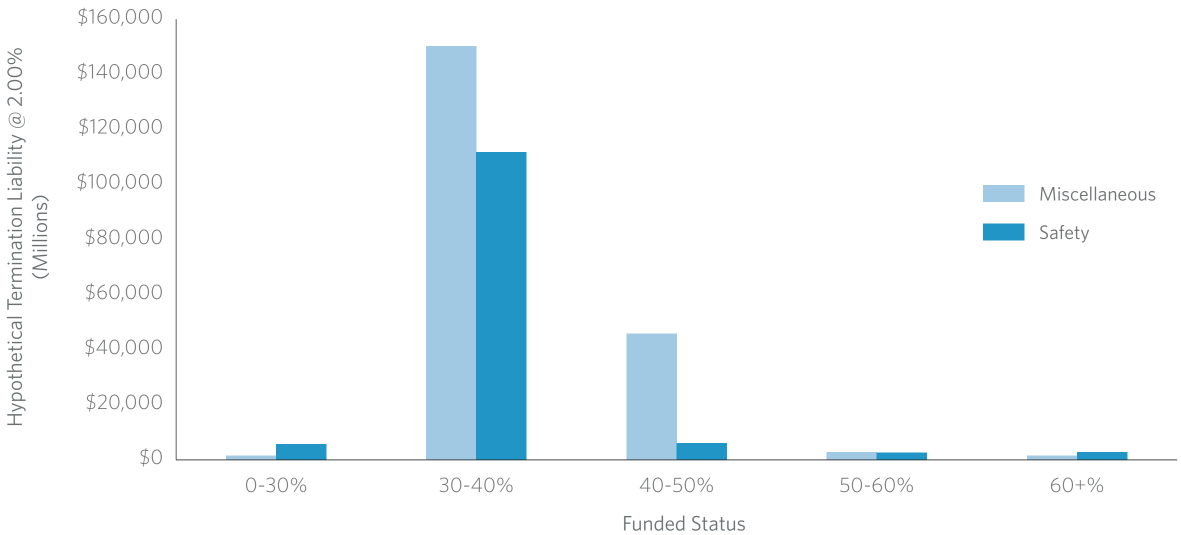
The chart shows that the average funded status of the Schools pool is higher than the funded status of the public agency plans, which is in turn higher than the funded status of the state plans.

Public agencies have the right, in law, to elect to terminate their plans. When this happens, the employer is required to make the contribution necessary to fully fund the plan on a wind-up basis. Because the employer will no longer be obligated to make up any shortfalls in investment return (or due to other economic or demographic events), CalPERS funds the terminated agency pool on a much more conservative basis to ensure that the affected members' benefits are secure.

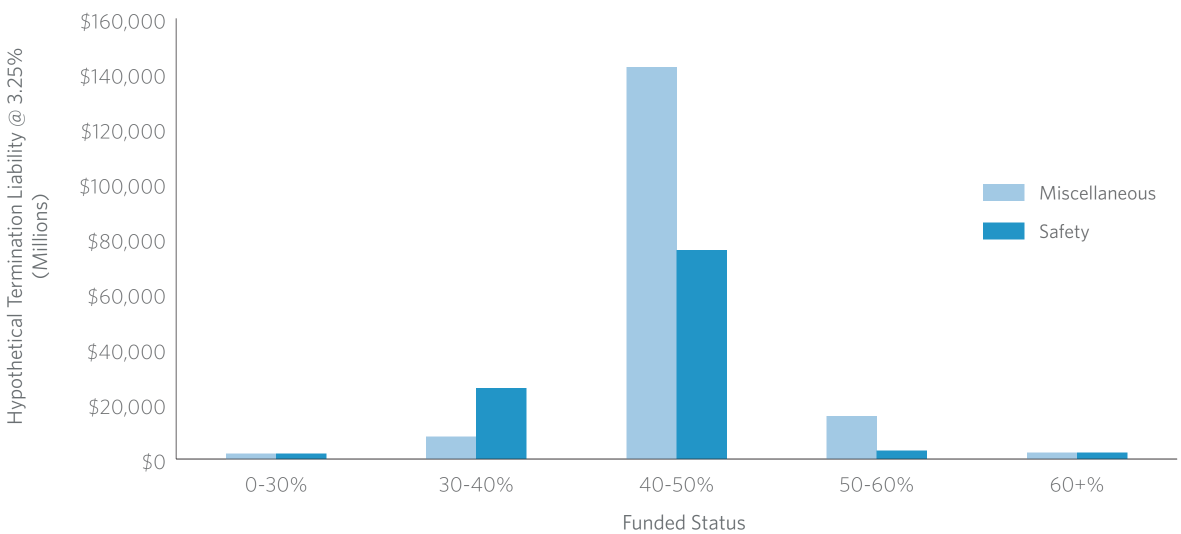
Because the funding of terminated plans is based on Treasury securities, the effective termination discount rate depends on actual market rates of return for such securities on the date of termination. In the charts on the next page, we have shown the average funded status of public agency plans discount rates near the lowest and highest interest rates observed during a 2-year period centered around the valuation date.

Comparing the tables below with the table on page 4 shows that the funded status on a hypothetical termination basis is significantly lower than on a going-concern basis. This indicates some additional risk to public agency members if their employer were to terminate their plan and be unable to make the required final contribution.

Public Agency Funded Status on a Hypothetical Termination Basis Using a 2.00% Discount Rate (as of June 30, 2015)



Public Agency Funded Status on a Hypothetical Termination Basis Using a 3.25% Discount Rate (as of June 30, 2015)



Identifying and Quantifying Risks

This section looks at the risk to the members and beneficiaries of the system by focusing on three key risk considerations:

1. The funded status and probability that it will fall to very low levels.
2. The employer contribution level and the probability that it will reach very high levels.
3. The possibility of high contribution increases in a single year.

Shared Risk

As fiduciaries of the System, we are concerned about the risks to the members and their benefits, and also the risks to the employers and their financial needs.

Of primary concern is the risk that a member's benefits will not be paid — in full and when due — as a result of the way the plan has been funded. It is also important, though, to consider the risks borne by the employer as this can impact their ability to make required contributions to fund the pensions. Investment and actuarial policies adopted by the CalPERS Board are always adopted with the purpose of maintaining benefit security for members while also considering the employers' ability to pay the contributions needed to fund the benefits. Helping employers plan for their contribution requirement reduces risks to both the employer and the members' benefits.

So long as the employer makes all of the contributions needed to fund the plan, along with the contributions from the members and the investment returns provided by CalPERS, the members' benefits will be paid. While there is a legal requirement for the employer to make the full contribution needed to fund the system, in extreme circumstances the employer may be unable to do so. In these situations, the employer's financial hardship can become a direct risk to the members and their benefits. By focusing on the risks to the soundness and sustainability to the overall system, CalPERS can better reduce the risks to both members and employers.

In the end, some of the greatest risks to the sound and sustainable funding of members' benefits are those things that put stress on the financial strength of their employer. We are reminded that, ultimately, members and employers are in this together.

Risk of Low Funding Levels

Low funding levels represent risk to the members in that it shows that the level of assets is not at the target level given the actuarial assumptions and methods being used to fund the benefits. As shown on page 4, current funding levels are significantly below the target level of 100%. A key metric associated with this is the probability of experiencing low funded status in the future.

Current State

Current funding levels were discussed in the previous section.

What is the Future?

The probability of falling to low funding levels in the future is shown in the table below:

Probability of Falling Below Given Funding Level (at any point in next 30 years)

Plan	40%		50%		60%	
	2015	2016	2015	2016	2015	2016
State Misc.	15%	12%	35%	36%	61%	67%
Schools	11%	9%	28%	28%	50%	55%
PA Misc.	13%	10%	29%	30%	52%	58%
CHP	14%	13%	39%	43%	73%	100%
State POFF	12%	10%	33%	34%	61%	67%
PA Safety	14%	12%	33%	35%	58%	66%

As shown in the table above, the probability of falling below 60% has increased in the last year. This is primarily due to the lower than expected investment return in the 2015–16 Fiscal Year. However, the probability of falling below 40% has actually decreased despite the investment return. This is due to the adoption of the Board's Funding Risk Mitigation Policy.

The probability of falling below any given level would be higher than shown in the table above if that policy were not in place, because the policy should result in lower levels of investment risk in the future when the plans become more sensitive to investment risk.

Given the Board's previous discomfort with the probability of low funded status, the current risk level may warrant further action to address this risk.

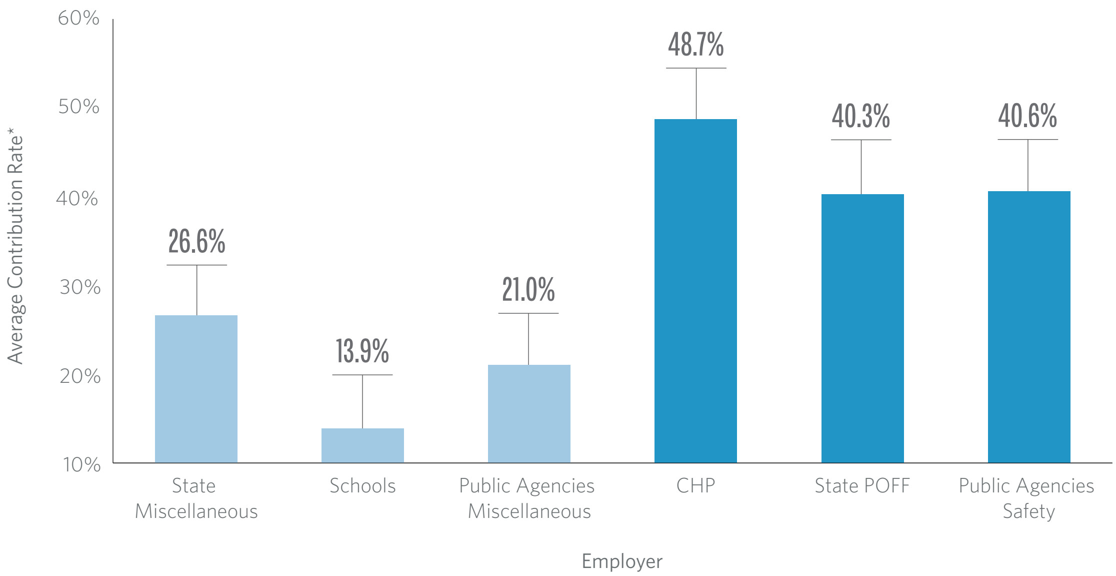
Risk of High Contribution Rates

High employer contribution rates impose significant financial stress and may increase the risk that employers will default and be unable to make their required contributions. Since future employer contributions are one of the funding sources for the benefit payments, a default by the employer would result in increased risk to the members' benefits. The level of financial stress associated with any particular level of contributions will differ significantly by employer.

Current State

Current contribution levels or average contribution levels are shown in the table below:

Employer Contribution Rates Set by June 30, 2015 Valuations*



*Fiscal Year 2016–17 Rates for the State and Schools
Fiscal Year 2017–18 Rates for Public Agencies

As shown above, employer contribution levels are high, especially for safety plans. These high employer contribution levels mean that it is very difficult to lower the overall risk in the funding of the system. Actions to reduce the probability of low funded status or contribution volatility generally result in increases in the contribution levels.

While it is difficult to assess just how much strain current contribution levels are putting on employers, anecdotal evidence — in the form of increased collections activities and in increased requests for information on plan termination procedures — indicates that at least some public agencies are under significant strain.

What is the Future?

Currently, we are anticipating an increase in employer contributions. This is due to current amortization schedules ramping up over the next few years. In addition, the impact of the Funding Risk Mitigation Policy is likely to result in somewhat higher contribution levels. It should be noted that the increase due to the policy is likely to be much less than the increases already scheduled.

The table below shows the probability of employer contribution levels exceeding certain thresholds at some point in the next 30 years.

Risk of Sharp Increases in Contribution Rates

Sharp increases in contributions can also impose financial strain on employers. And, similar to high contribution rates, that strain may increase the risk that employers will default and be unable to make their required contributions.

Probability of Employer Contribution Rates Exceeding Given Level (at any point in next 30 years)

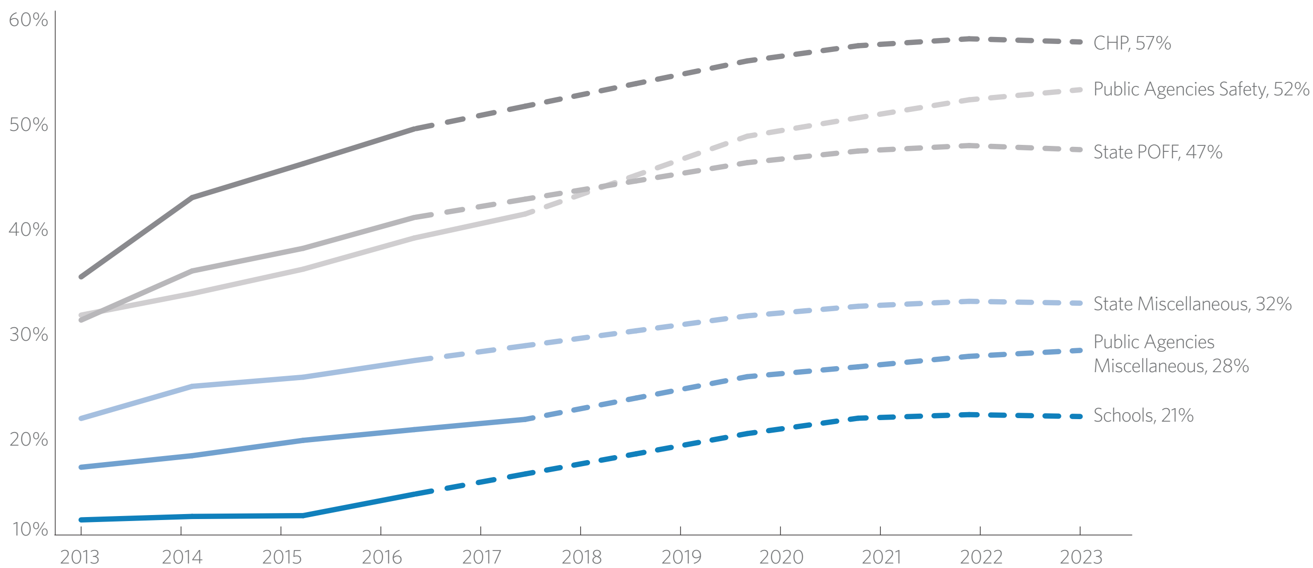
	30% of Payroll		35% of Payroll		40% of Payroll	
Plan	2015	2016	2015	2016	2015	2016
State Misc.	73%	88%	53%	63%	34%	42%
Schools	31%	39%	15%	18%	5%	5%
PA Misc.	43%	54%	25%	31%	12%	14%

	50% of Payroll		55% of Payroll		60% of Payroll	
Plan	2015	2016	2015	2016	2015	2016
CHP	89%	100%	70%	86%	56%	72%
State POFF	56%	70%	44%	57%	32%	43%
PA Safety	61%	74%	50%	61%	39%	50%

Current State

The Board's current actuarial policies do a good job of mitigating excessive single year rate increases. Based on conversations between staff actuaries and employers, it seems that this is currently less of a concern than the ultimate levels of the contributions.

Recent and Projected Employer Contribution Rates



What is the Future?

The table below shows the probability of employers seeing various levels of single year contribution increases over the next 30 years.

Probability of Employer Contribution Rates Increasing by More Than a Given Level (at any point in next 30 years)

Plan	3% of Payroll		5% of Payroll		7% of Payroll	
	2015	2016	2015	2016	2015	2016
State Misc.	54%	39%	10%	2%	1%	0%
Schools	45%	32%	4%	0%	0%	0%
PA Misc.	49%	39%	8%	3%	1%	1%

Plan	5% of Payroll		7% of Payroll		9% of Payroll	
	2015	2016	2015	2016	2015	2016
CHP	55%	41%	25%	9%	9%	1%
State POFF	46%	30%	18%	5%	6%	0%
PA Safety	58%	47%	24%	9%	9%	1%

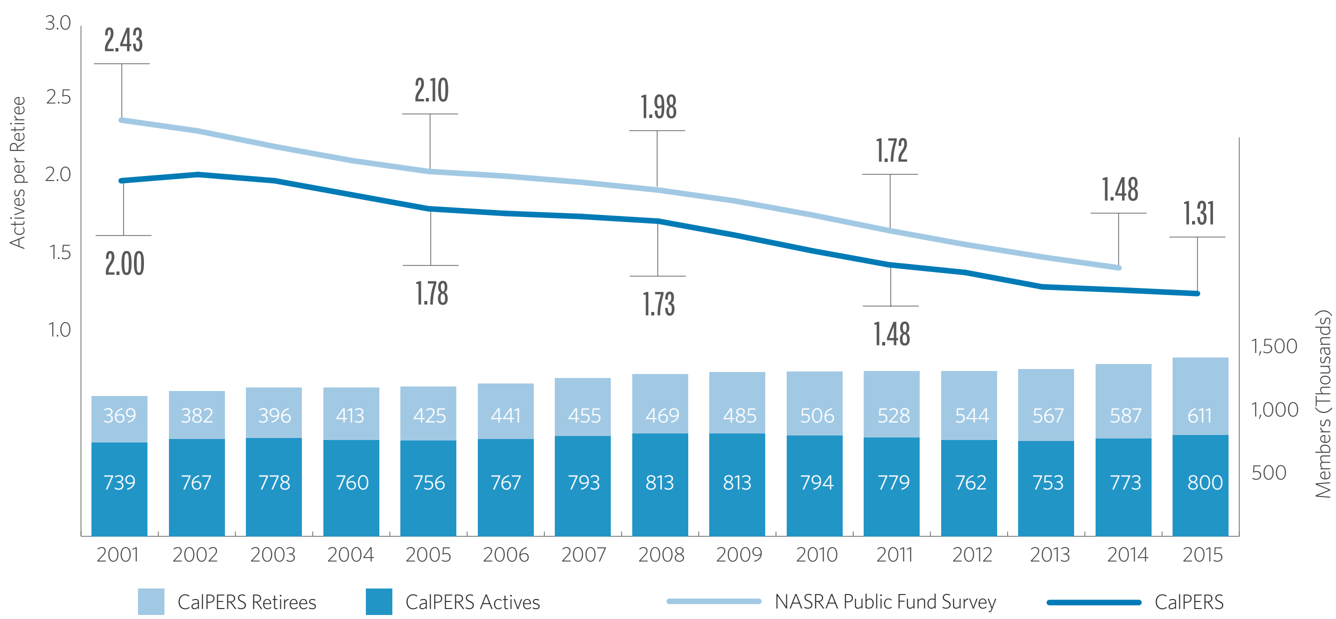
Environmental Factors: How Risks Are Changing

Plans Continue to Mature

The aging of the population and the retirement of the baby boomer generation are well known to everyone. Demographic shifts have long been predicted and taken into account in the funding of the system. The higher number of retirements we have seen the last few years was projected all along, and this trend is expected to continue as the baby boomer generation leaves the workforce to enter into its retirement years. Even though anticipated, this demographic shift is impacting risk measures identified in this report and has to be part of any discussion on funding levels and risks.

One way to look at the maturity level of CalPERS and its plans is to look at the ratio of actives to retirees. A pension plan in its infancy will have a very high ratio of active to retired members. As the plan matures, the ratio starts declining. A mature plan will often have a ratio near or below one. For both CalPERS and other retirement systems in the United States, these ratios have been steadily declining in recent years. Below is a chart comparing the ratio of active to retired members for CalPERS to other public retirement systems in the United States.

Ratio of Actives to Retirees



The ratio for CalPERS has dropped from just above 2 to just above 1.3 over the time period. Currently, we only have about one and one third active members' payrolls to spread the risk associated with each retiree's benefits instead of the two-to-one ratio of a decade ago.

Although these ratios appear to be leveling off the last two years, this is a result of significant increases in active membership of approximately 3 percent each year. Active membership counts are recovering from the recent recession and this rate of growth may not continue once employers are back up to pre-recession staffing levels. Accordingly, the ratio of actives to retirees is expected to continue dropping over the next few decades until reaching a floor somewhere between 0.6 and 0.8 depending on the plan.

As plans mature, they collect more assets, both in an absolute sense but also in relation to the plan sponsor. This means that when financial markets fail to deliver a strong return or even collapse like they did in 2008–2009, it can lead to very high contribution levels that could lead to employer insolvency or even bankruptcy that ultimately could impact the security of benefits for members.

Trend Towards Lower Expected Returns and Discount Rates

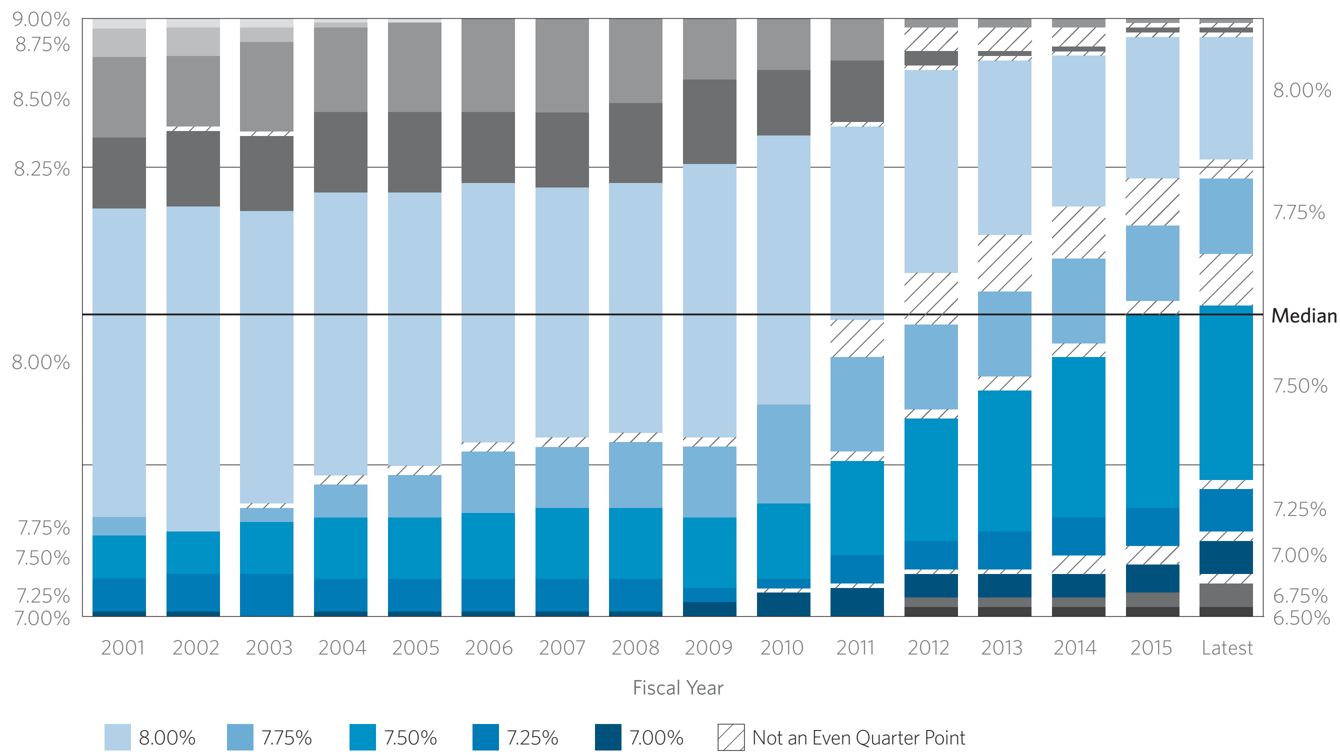
In addition to the demographic forces, there are increased concerns about lower returns over the near-term investment horizon. The trend nationally for public pension plans in recent years has been a reduction in the rate of return assumption.

Recent economic conditions have seen continuing declines in long-term government bond interest rates that serve as the foundation of capital market returns. This has resulted in a general lowering of the expected returns (at least over the medium term) from the various asset classes. This in turn means that plans must change their asset allocations to accept a higher level of investment risk (so as to achieve the same level of expected return) or to accept a lower expected return on investments.

CalPERS is not alone in facing the changed expectations of what can be achieved in the capital markets. The chart below shows the change in distribution of public pension investment return assumptions from the 2001 Fiscal Year through July 2016 as compiled by the National Association of State Retirement Administrators. Among the 127 plans measured in the Public Fund Survey, 59 have reduced their investment return assumption since Fiscal Year 2012.

The survey shows that the average investment return assumption is 7.58%, and the median is now 7.50%, down from 8.00% in 2011. Note that the number of plans with an investment return assumption below 7.50% has been steadily increasing since 2009.

Change in Distribution of Nominal Investment Return Assumptions



Public Fund Survey, NASRA July 2016

It is likely that the reductions in rate of return assumptions are the result of the same factors that have influenced changes at CalPERS, namely, a general lowering of expectations about future investment returns for a given level of risk and a concern about the level of risk being taken.

As part of the ALM cycle, the issue of the appropriate asset allocation and expected investment return will be addressed over the next 18 months, wrapping up in early 2018. This process is designed to address this issue in a measured, thoughtful way. It is increasingly clear that some change to the expected rate of return should be considered by CalPERS.

Changes to the capital market assumptions will result in a reassessment of the level of funding risk. All of the results in this report are based on the existing capital market assumptions. If the Board concurs with the general consensus and adopts capital market assumptions that provide for a lower expected return from the various asset classes and if there is no similar reduction to the expected investment volatility (which is not expected), then the risk levels as shown in this report will increase. Which of the risk measures will increase depends on whether the Board selects an asset allocation with a lower expected return or an asset allocation with a higher expected volatility, or a combination of the two.

Employers Taking Charge of their Future

A number of employers have elected to make additional contributions over and above the minimum required contributions to improve their funded status. This has been happening for many years but seems to be happening at an increasing rate since the implementation of GASB Statement 68. Anecdotal evidence — in the form of conversations with individual employers — indicates that employers desire to get to a fully funded status more quickly than would be the case if they made the minimum contributions per the actuarial valuation report. One benefit to employers is a reduction in pension expense, since interest on the unfunded liability is a large component of the expense under Statement 68.

A more recent development has been for employers to put more or less formal plans in place to make additional contributions on an ongoing rather than ad-hoc basis.

An example of this trend is the policy that the City of Irvine put in place in 2013:

> The City of Irvine will make “Annual Discretionary Payments” towards their unfunded accrued liability beyond the minimum required contributions outlined in their valuation reports. The city expects to make additional payments of $5 million per year for the following 10 years, but have the flexibility to modify these amounts based on the financial position and needs of the city. These annual payments are to come from existing City Reserves and the Reserves are to be re-paid based on the savings due to lower required Employer contributions in future years.
>
> So far, the city has made the additional contributions per the plan.
>
> More details concerning the city’s paydown plan are provided at the following link: http://www.governing.com/columns/public-finance/col-irvine-california-plans-prepay-pension-bill.html

Employers that make additional contributions beyond the minimum required contribution will lower their risk of low funded status and their risk of high contributions. This is true regardless of whether it is done on an ad-hoc basis or as part of a more formal plan.

More Transitory Employers

There appears to be an increase in the number of public agencies that are of a less permanent nature than has traditionally been the case at CalPERS. Staff have seen an increase in the number of Joint Powers Authorities (JPAs) and other employers where it is not clear if the revenue base is as stable as has been the case in the past.

In the case of a JPA, two or more governments cede some of their authority to a new entity which then takes on the role of providing services that would otherwise have to be provided by the parent entities. This authority can sometimes be revoked and the services returned to the parent entities. This means that JPAs may have a less stable revenue base than cities, counties, and other more traditional governmental entities.

The funding of the system is based on assumptions and methods that are appropriate to very long-term horizons and do not contemplate, and may not be appropriate for, entities which are more transitory in nature.

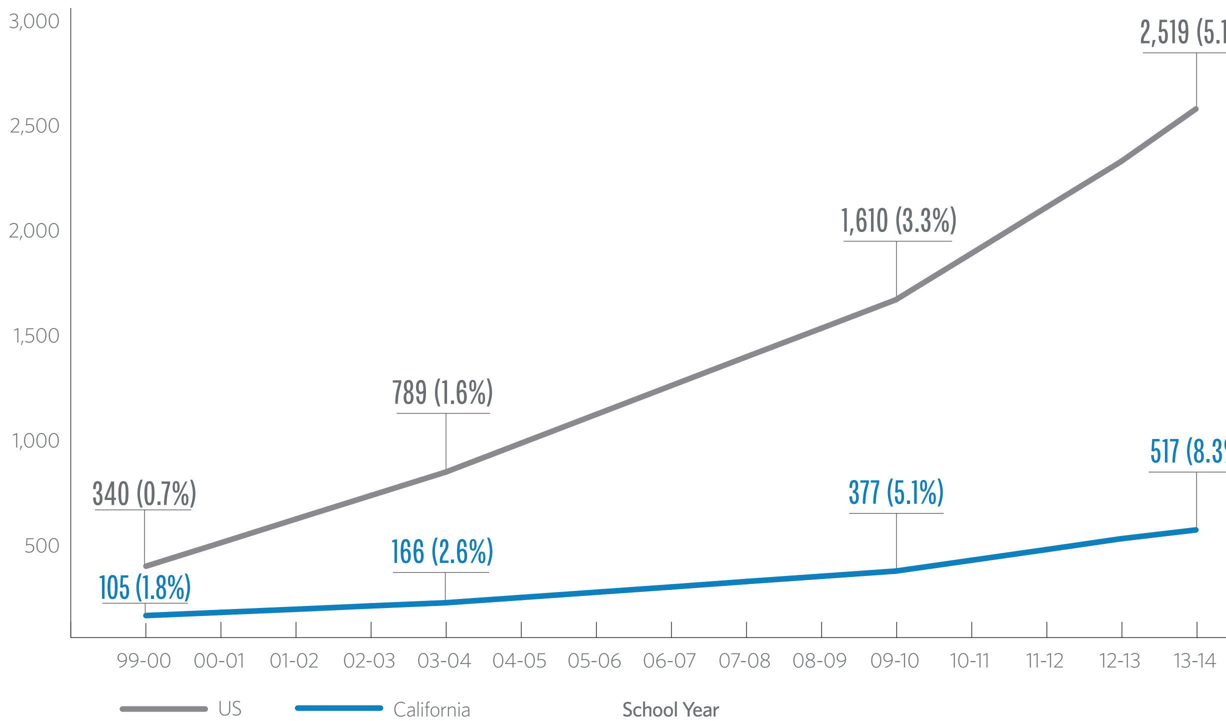
To address this concern, CalPERS has put in place procedures to more thoroughly vet the financial capacity and stability of prospective contracting agencies. It is important to maintain vigilance in this area and, ultimately, it may be necessary to adopt assumptions and methods that are less reliant on the long-term nature of participating employers.

Charter Schools Phenomenon

There is a concern that the growth of charter schools may eventually impact the financial stability of the Schools pool. This is because the movement to charter schools could erode the revenue base supporting the Schools pool.

Charter schools are growing. As shown in the chart on the next page, charter school enrollment as a percent of total public school enrollment in California grew from 1.8% in 1999–2000 to 8.3% in 2013–14. California currently has a higher level of charter school enrollment than most states but is significantly exceeded by Arizona (17.8% in 2013–14) and the District of Columbia (42.4%). Should the trend towards greater levels of charter school enrollment continue, it could lead to a significant erosion of the membership and, more crucially, the revenue base that supports the Schools pool.

Charter School Enrollment (in thousands)



The growth of charter schools does not automatically mean that employees are not covered by CalPERS. However, it is quite possible for this to occur:

- The charter school may not be structured as governmental entity. Instead, it may be structured as a for-profit institution. If it is not structured as a governmental entity, its employees would not be eligible to participate in CalPERS
- If the charter school is structured as a governmental entity, it has the option to join or not join CalPERS
- Finally, even if the charter school elects to join CalPERS, it may employ fewer classified employees than traditional schools

To the extent that the membership and revenue base deteriorates, the unfunded liability of the Schools pool will be supported by the lower revenue base. Eventually, the revenue base may not be large enough to make the contributions required to pay off the unfunded liability — which would put the members' benefits at risk.

At present levels, this does not seem to be a problem. However, the trend is towards more charter school enrollment. While it would take a considerable time for this to evolve into a significant concern, addressing a decline in the revenue base supporting the schools pool would require many years. In order to ensure the sustainability of the Schools pool, it may be necessary to adjust the funding even before the trend becomes clear.

Risk Mitigation

Current Policy

In November of 2015, the Board adopted the Funding Risk Mitigation Policy. This policy is currently in place and expected to result in a lowering of investment volatility (and hence lowering expected returns and the discount rate) over time. The goal of the policy is to reduce the risk to members' benefits that could result from investment volatility impacting funded status and required contribution rates.

The policy provides for a reduction in the investment risk by changing the asset allocation when investment performance significantly outperforms the discount rate. In order to achieve a lower level of investment volatility, the new asset allocation will have a higher allocation to less volatile asset classes — such as fixed income. This in turn means that the new asset allocation will have a lower expected investment return and require a consequent lowering of the discount rate.

The thresholds above which a risk mitigation event (the changing of the asset allocation and consequent reduction in the discount rate) are shown below:

Current Year Impact

During the 2015–16 Fiscal Year, the capital markets performed poorly and the resulting investment returns (0.61%) were insufficient to trigger a risk mitigation event under the policy. Less than half of the years are expected to generate investment returns that are sufficient to trigger a lowering of the investment risk.

Is the Policy Effective?

While the Funding Risk Mitigation Policy did not result in a risk mitigation event that changed the asset allocation this year, this is no reason to be concerned about the effectiveness of the policy. A single year is simply not sufficient time to judge the effectiveness of this policy. It would take a number of years to build a sufficient base of results to analyze the effectiveness of the policy.

How the Policy Works

Excess Investment Return If the actual investment returns exceed the discount rate by	Reduction in Discount Rate Then the discount rate will be reduced by	Reduction in Expected Investment Return And the expected investment return will be reduced by
4 percentage points	0.05%	0.05%
7 percentage points	0.10%	0.10%
10 percentage points	0.15%	0.15%
13 percentage points	0.20%	0.20%
17 percentage points	0.25%	0.25%

The policy provides that the reduced discount rate would be included in employer actuarial valuations effective as of June 30 in the fiscal year in which the funding risk mitigation event occurred. Member calculations (including service credit purchases) would not reflect the reduced discount rate until October 1st of the following fiscal year.

Next Steps

Over the course of the next 18 months, staff will be bringing the work of the current ALM cycle to the Board. This is expected to culminate in February 2018 with Board decisions on the economic and demographic assumption changes as well as the adoption of a new strategic asset allocation. Highlights of this process are shown below:

ALM Timeline

January 2017

CalPERS staff to present educational workshop for Policy Benchmark Review Findings and Asset Class Roles

June 2017

CalPERS IC to review for approval of Capital Market & Economic Assumptions for 2018-2028

CalPERS FAC to review draft Experience Study that looks at lifespan, workforce changes, and payroll trends

July/August 2017

Announcement of annual investment returns

CalPERS staff to present education workshop to review Key Risks for asset liability management

September 2017

Notification of Risk Mitigation Policy Thresholds to FAC

CalPERS staff to present the annual Pension Funding Level & Risk Report with performance measures to FAC

November 2017

CalPERS staff to present education workshop on asset liability management

Final Experience Study presented to FAC with discussion on new actuarial assumptions

February 2018

CalPERS Board to review for approval of PERF Asset Allocation and Actuarial Assumptions

In addition to the work shown above, CalPERS staff will be working with outside experts to develop a more detailed ALM model that better reflects the impact that some macro-economic factors have on both the asset and liability side of the system.

Also over the next few years, the model should be enhanced to make it possible to more easily model the diversity of public agency plans. Currently, the model is only able to handle two public agency plans, and this limits the insight it can give us into the risks facing public agency plans that differ from the most typical plans.

The goal of this additional work will be to have an enhanced model that will be better at forecasting the risks and the diversity of impacts that those risks have on the funding of the system.

Conclusion

Overall, this report shows that risks remain high. In the absence of explicit risk targets and tolerances, it is not clear whether the risk mitigations in place currently have brought risks to the levels that the Board considers acceptable. The Board may wish to take additional actions to address the level of funding risk.

At this point, it is too early to assess the effectiveness of the Funding Risk Mitigation Policy. The policy has been in place for a single year and no risk mitigation event was triggered due to the relatively poor investment climate in the 2015–16 Fiscal Year. The fact that a risk mitigation event was not triggered in the year should not cause concern about the effectiveness of the policy. A longer baseline is needed before the effectiveness of the policy can reasonably be assessed.

Maturation of plans and financial stress on some employers remain of concern. Termination policies should mitigate risk to the system, but the members employed by those employers under stress are at risk if the employer fails to stand behind its promise of retirement benefits to its employees.

Recent economic conditions have seen continuing declines in long-term government bond interest rates that serve as the foundation of capital market returns. This has increased the risk of achieving the current 7.5% expected rate of return, at least over the medium term. The remaining work of this ALM cycle, wrapping up in 2018, is designed to address this question in a measured, thoughtful way. It is increasingly clear that some change to the expected rate of return is going to need to be considered by CalPERS.

There is an emerging concern that there may be some degradation of the membership and revenue base of the Schools pool which would increase the risk to the funding of the pool. Services that have previously been provided by classified school employees (the members in the Schools pool) could be outsourced — possibly in association with the formation of charter schools. If this were to happen, the membership and revenue base of the Schools pool would decline or at least not grow as projected.

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