CalPERS

Finance and Administration Committee
Agenda Item 8d

September 20, 2016

Item Name: Notification of Risk Mitigation Policy

Program: Asset Liability Management

Item Type: Information

Executive Summary
The Funding Risk Mitigation Policy ("Policy") establishes a mechanism whereby CalPERS investment performance that significantly outperforms the discount rate triggers adjustments to the discount rate, expected investment return and strategic asset allocation targets.

The Policy calls for funding risk mitigation progress to be reported to the FAC in the Annual Funding Levels and Risks Report. In this report, presented as Agenda Item 8d above, the Chief Actuary reported that the risk mitigation policy was not triggered in the 2015-16 fiscal year as a result of the investment returns for the year.

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 November of 2015, The Finance & Administration Committee ("FAC") adopted the Funding Risk Mitigation Policy. The Policy applies to the Public Employees' Retirement Fund (PERF). The stated purpose of the Policy is to reduce CalPERS funding risk over time. The Policy further states that reducing the volatility of investment returns will increase the long-term sustainability of CalPERS pension benefits for members.

Analysis
Funding risk mitigation is to be triggered and implemented according to the following table contained in the Policy.

Table 1: Funding Risk Mitigation Event Thresholds and Impacts

Excess Investment Return	**Reduction in Discount Rate**	**Reduction in Expected Investment Return**
If the actual investment returns exceed the discount rate by:	*Then the discount rate will be reduced by:*	*And the expected investment return will be reduced by:*
4.00%	0.05%	0.05%
7.00%	0.10%	0.10%

10.00%	0.15%	0.15%
13.00%	0.20%	0.20%
17.00%	0.25%	0.25%

As reported to the CalPERS Board in July, the PERF earned a return of 0.61%. As a result, the Policy was not triggered for 2016.

Budget and Fiscal Impacts

There are no budget or fiscal impacts at this time.

Benefits and Risks

As stewards of the pension funding system, CalPERS must ensure that the pension fund is sustainable over multiple generations by taking steps to mitigate risks over the long-term through an integrated view of our assets and liabilities. As stated in the Agenda Item accompanying the approval of the Policy by the FAC, implementation of the Policy entails certain benefits and risks.

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 volatility of short-term investment returns or changing demographics that could reduce CalPERS long term funded status
- Reduces the level of future risk in the investment portfolio
- Reduces the volatility in contribution rates for employers

Risks associated with a risk mitigation strategy include:

- Reducing the CalPERS discount rate will increase the net present value of pension liabilities and increase employer contributions
- Increases to member contributions over time, specifically those covered under PEPRA.

Attachments
Attachment 1 – Funding Risk Mitigation Policy

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Alan Milligan
Chief Actuary

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Chief Investment Officer

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Cheryl Eason
Chief Financial Officer