

California Public Employees' Retirement System

Fiscal Year 2016-17 Mid-Year Budget

First Reading
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- A. Total CalPERS Budget..... 3
- B. FY 2016-17 Mid-Year Budget Revisions..... 5
- C. Budget Detail by Branch 9
- D. Administrative Budget by Fund Source 10

Background

The Total CalPERS Budget is composed of Administrative Operating Costs, Investment Operating Costs, Investment External Management Fees, Third Party Administrator Fees, Enterprise Project Costs, and Headquarters Building Costs.

The purpose of the Mid-Year Budget process is to address enterprise critical, unforeseen, and emergency resources not included in the Fiscal Year (FY) 2016-17 Annual Budget. Examples may include: requests to address new legislative mandates, compliance with new laws or regulations, or new Board initiatives. All Formal Budget Requests submitted were required to meet these criteria for consideration and inclusion in the Mid-Year Budget process.

The Mid-Year Budget process provides an opportunity to review current financial information and adjust the authorized budget based on a more accurate 2016-17 forecast for the remainder of the fiscal year.

Summary

The FY 2016-17 Mid-Year Total Budget of \$1,787.2 million represents an overall decrease of \$1.3 million (-0.07 percent) from the FY 2016-17 Annual Total Budget. More specifically, an increase is proposed in the Administrative Operating Costs of \$3.4 million, offset by decreases in Investment Operating Costs of \$1.0 million and Enterprise Project Costs of \$3.6 million. The authorized positions are proposed to increase by 14.0 positions from 2,872.0 to 2,886.0.

Fiscal Year 2016-17 Mid-Year CalPERS Total Budget

(in thousands)	FY 2016-17 Annual Budget	Mid-Year Adjustments	FY 2016-17 Proposed Mid-Year Budget	% Change From Annual
Administrative Operating Costs	\$455,771	\$3,380	\$459,151	0.7%
Investment Operating Costs ¹	90,538	(1,000)	89,538	(1.1%)
Investment External Management Fees ²	896,705		896,705	0.0%
Third Party Administrator Fees	272,809		272,809	0.0%
Subtotal: Operating Costs	\$1,715,823	\$2,380	\$1,718,203	0.1%
Enterprise Projects Costs	41,382	(3,646)	37,736	(8.8%)
Headquarters Building Costs	31,295		31,295	0.0%
CalPERS Total Budget	\$1,788,500	(\$1,266)	\$1,787,234	(0.07%)
Total Positions	2,872.0	14.0	2,886.0	0.5%

¹ Investment operating expenses are not part of CalPERS Administrative Operating Costs and therefore should not to be included in CalPERS pro-rata assessment.

² Investment External Management Fees consist of both Base Fees and Performance Fees.

Position Management

The CalPERS organization has made significant strides in reducing the number of vacancies where program areas have actively managed and repurposed positions through a strategic workforce planning effort. The CalPERS vacancy rate has significantly decreased by 4.0 percent over the past five years, from 10.6 percent to 6.6 percent. CalPERS has also made significant strides in reducing the number of temporary positions by over 50 percent in the last three years. The new CalPERS 2017-22 Strategic Plan will highlight the continued promotion of talent management and the managing of our internal resources and workforce in a strategic, effective, and resourceful manner. To add, the organization is looking at applying an enterprise position pooling concept that will be used to continue to assist CalPERS position management efforts. This concept will allow vacant positions to be redirected to the highest need in the organization where appropriate.

Major Highlights

The FY 2016-17 Mid-Year Budget of \$1,787.2 million include the following major highlights:

- Sixth formal budget process that the budget has been reduced.
- Increase of 8.0 new positions (\$1.1 million) in the Investment Office for the Global Equity and Sustainable Investment Realignment which were presented to the Board in August 2016.
- Increase of 6.0 new positions (\$0.4 million) in the Financial Office to perform increased financial risk assessments on public agencies seeking to contract with CalPERS for retirement benefits and to address unanticipated risks discovered related to existing employer contracts and contributions.
- Increase of \$0.4 million to begin implementing new internet and phone voting methods for Board Member Elections.
- Increase of \$10.5 million for technical statewide salary increases and employee benefits (retirement and dental).
- Decrease of \$8.0 million due to additional salary savings forecasted for the remainder of the year.
- Decrease of \$2.0 million in external legal costs.
- Decrease of \$3.6 million in Enterprise Project Costs.

The table below provides a breakdown of the proposed FY 2016-17 Mid-Year Budget revisions.

Mid-Year Budget Changes	Dollars (in thousands)	Positions
Approved FY 2016-17 Annual Budget	\$ 1,788,500	2,872.0
Additions to FY 2016-17 Annual Budget:		
Statewide Salary and Staff Benefit Increases	\$ 10,500	
Formal Budget Requests (FBRs):		
Investment Office: Global Equity Realignment	747	5.0
Investment Office: Sustainable Investment Realignment	379	3.0
Financial Office: Employer Contracts Management	361	6.0
Operations: Additional Voting Methods for Board Elections	393	0.0
Total FBRs	\$ 1,880	
Total Additions	12,380	14.0
SUBTOTAL	\$ 1,800,880	2,886.0
Reductions to FY 2016-17 Annual Budget:		
Salary Savings due to Vacancies	(\$8,000)	
Enterprise Projects Savings	(3,646)	
External Legal Costs	(2,000)	
Total Reductions	(13,646)	
Proposed FY 2016-17 Mid-Year Budget	\$ 1,787,234	2,886.0
Change from Annual Budget	(\$1,266)	14.0
Percent Change	(0.07%)	0.5%

The following provides further details on the proposed changes in the FY 2016-17 Mid-Year Budget:

Statewide Salary and Staff Benefit Increases (\$10.5 million increase)

Technical adjustments of \$10.5 million for statewide salary increases per collective bargaining agreements/Governor action and employee benefit rate increases for retirement and dental coverage. This increase is partially offset (\$8.0 million) due to excess salary savings (discussed on Page 7).

Formal Budget Requests for New Funding (\$1.9 million increase; 14.0 positions)

Additional resources are proposed for the following:

- 5.0 positions and \$0.7 million in 2016-17 (half year) for the Investment Office Global Equity Realignment. These resources will assist with the 5-year sustainable investment strategy of integrating environmental and social governance in specific areas of corporate engagement, proxy voting, and focus list programs. Of the current 57.0 authorized positions in the Global Equity unit, 8.0 are currently vacant (14.0 percent). The ongoing annual costs beginning in 2017-18 total \$1.2 million.

B. FY 2016-17 Mid-Year Budget Revisions

- 3.0 positions and \$0.4 million in 2016-17 (half year) for the Investment Office Sustainable Investment Realignment. These resources will be responsible for meeting key performance indicators including data and corporate reporting standards, engaging UN PRI Montreal Pledge Companies, and diversity and inclusion. There are no vacancies currently in this unit. The ongoing annual costs beginning in 2017-18 total \$0.7 million.
- 6.0 positions and \$0.4 million in 2016-17 (half year) for the Financial Office to perform financial risk assessments on public agencies seeking to contract with CalPERS for retirement benefits and to address unanticipated risks discovered related to existing employer contracts and contributions. These resources will support the employers in improved services as they relate to education, training, and outreach opportunities. These resources will specifically assist with contract performance management, financial negotiations, and underwriting. They will also deploy strategies to mitigate risks posed by contract initiations, amendments, and terminations. These additional functions are aimed at reducing delinquent payments and reduce the risk of agencies terminating due to outstanding amounts owed. This will assist the Financial Office in promoting financially sound contracts and enhance partnership relationships with employers to support meeting pension obligations. There are no vacancies currently in this unit. The total ongoing annual costs beginning in 2017-18 total \$0.7 million.
- Increase of \$0.4 million 2016-17 to begin implementing the new internet and phone voting methods for Board Member Elections. CalPERS received notification from the Secretary of State in March 2016 that they would continue to certify the CalPERS elections with internet, phone and mailed ballot options. To fully implement the new voting methods, an additional \$0.6 million will be requested in the 2017-18 Annual Budget process.

The table below details the 2,872.0 current positions and the 14.0 new proposed positions.

Positions by Branch	FY 2016-17 Annual Positions	Mid-Year Change in Positions	FY 2016-17 Proposed Mid-Year Positions	% Change From Annual
Actuarial Office	58.0		58.0	
Benefit Program Policy and Planning	160.0		160.0	
Customer Services and Support	965.5		965.5	
Communications and Stakeholder Relations	63.0		63.0	
Executive Office	18.0		18.0	
Financial Office	245.0	6.0	251.0	2.4%
6.0 - Employer Contracts Management				
General Counsel	136.0		136.0	
Investment Office	344.0	8.0	352.0	2.3%
5.0 - Global Equity Realignment				
3.0 - Sustainable Investment Realignment				
Operations and Technology	882.5		882.5	
Total	2,872.0	14.0	2,886.0	0.5%

Salary Savings due to Vacancies (\$8.0 million decrease)

To recognize the impact of vacancies on the cost of personnel services, an overall vacancy factor of 5.0 percent was applied during the annual budget process. This vacancy factor has been updated to 6.6 percent based on the year-to-date vacancy rate which is currently trending at this level and projected to remain there for the remainder of the fiscal year.

Enterprise Projects Savings (\$3.6 million decrease)

Project costs are anticipated to be \$37.7 million, a decrease of \$3.6 million from the current budget of \$41.4 million. Details follow.

- Tobacco Divestment Study and Outreach – decrease of \$250,000, from \$500,000 to \$250,000, due to lower than anticipated actual costs.
- Security Roadmap – decrease of \$936,000, from \$5.2 million to \$4.2 million, due to postponing the Security Information and Event Management (SIEM) effort to gather and analyze additional information and strategies.
- Treasury Management – decrease of \$300,000, from \$400,000 to \$100,000, due to lower than anticipated consultant and software costs.
- PeopleSoft HCM 9.2 Upgrade – decrease of \$160,000, from \$525,000 to \$365,000. The project is being repurposed based on information gathered during the project's "As-Is" discovery phase as well as industry best practices analysis with the Gartner advisors. A portion of the current year funding will be used to conduct a Business Capability Matrix for the enterprise to detail what services the Human Resources Division should and can provide, how to provide them (automation/manual), and at what service levels. Full implementation costs will be known after this effort is completed next Spring.
- Actuarial Valuation System Redesign – decrease of \$2.0 million, from \$4.8 million to \$2.8 million, due to lower than anticipated costs as the project moves from the conceptual phase to the design and implementation phases.

External Legal Costs (\$2.0 million decrease)

Savings of \$2.0 million in external legal costs are projected based on prior year trending and year-to-date case information. Costs are projected to decrease by \$1.0 million in the Administrative Operating Costs (from \$6.5 million to \$5.5 million), and by \$1.0 million in the Investment Operating Costs (from \$8.5 million to \$7.5 million).

Third Party Administrator Fees (no net change)

No change to the budget is proposed for the Third Party Administrator Fees. However, there are updated projections for the subcategories. The Self-Funded Health Program third party administrator fees are increasing by a net \$1.4 million, as follows:

- \$5.1 million decrease in the Self-Funded Health Plan costs due to the expected membership migration to lower cost health plans caused by the elimination of the Blue Shield Net Value plan, effective January 2017.
- \$120,000 increase in the State Controller's Office third party administrator contract (from \$780,000 to \$900,000) for the processing of State employees health contribution deductions from their pay warrants.

B. FY 2016-17 Mid-Year Budget Revisions

- \$6.3 million increase related to the new Pharmacy Benefit Manager, OptumRx, effective January 2017. The new contract includes customer service enhancements, such as smartphone apps to refill prescriptions, daily medication text message reminders, and the availability of more retailers to fill prescriptions. Further, administrative costs will remain static over the five-year contract term, and full transparency and disclosure of financial relationships between OptumRx and drug manufacturers is required.

The net increase described above is offset by lower third party administrator costs for the Long-Term Care Program due to membership trending downward. Costs are anticipated to decrease by \$1.4 million, from \$21.6 million to \$20.2 million.

Third Party Administrator Fees

(in thousands)	FY 2016-17 Annual Budget	Mid-Year Adjustments	FY 2016-17 Proposed Mid-Year Budget
Health Program	\$234,401	(\$5,091)	\$229,310
Health Program - State Controllers' Office	780	120	900
Subtotal, Health	235,181	(4,971)	230,210
Pharmacy Benefit Manager			
CVS/Caremark	12,158	(4,645)	7,513
OptumRx - PPO/HMO ¹	-	10,978	10,978
Subtotal, Pharmacy Benefit Manager	12,158	6,333	18,491
Long Term Care Program - LTCCG	21,572	(1,362)	20,210
Supplemental Income Plan - Voya	3,899	-	3,899
Total Third Party Administrator Fees	\$272,809	-	\$272,809

¹ Effective January 1, 2017, the CalPERS pharmacy benefit manager will change from CVS/Caremark to OptumRx.

Total Budget by Branch

(in thousands)	FY 2016-17 Annual Budget	Mid-Year Adjustments	FY 2016-17 Proposed Mid-Year Budget	% Incr/(Decr) From Annual
Administrative and Investment Operating Costs				
Actuarial Office	\$ 9,301	\$ 238	\$ 9,538	2.6%
Benefit Programs Policy and Planning	28,762	468	29,230	1.6%
Communications and Stakeholder Relations	10,560	(63)	10,498	(0.6%)
Customer Services and Support	109,434	(237)	109,197	(0.2%)
Executive Office	6,603	90	6,693	1.4%
Financial Office	29,978	879	30,856	2.9%
General Counsel	26,210	(477)	25,733	(1.8%)
Investment Office	161,796	(1,024)	160,772	(0.6%)
Operations and Technology	142,015	2,506	144,521	1.8%
Pro-Rata Assessment	21,651	-	21,651	0.0%
Subtotal	\$ 546,309	\$ 2,380	\$ 548,689	0.4%
Investment External Management Fees	896,705	-	896,705	0.0%
Third Party Administrator Fees	272,809	-	272,809	0.0%
Enterprise Projects Costs	41,382	(3,646)	37,736	(8.8%)
Headquarters Building Costs	31,295	-	31,295	0.0%
CalPERS Total Budget	\$ 1,788,500	(\$1,266)	\$ 1,787,234	(0.07%)

D. Administrative Budget by Fund Source

Administrative Operating Costs by Fund Source

(in thousands)	FY 2015-16 Actual Expenditures	FY 2016-17 Annual Budget	FY 2016-17 Proposed Mid-Year Budget	Change from Annual	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)
Administrative Operating Costs					
Public Employees' Retirement Fund (PERF)	\$ 349,390	\$ 369,798	\$ 372,860	\$ 3,062	0.8%
Public Employees' Contingency Reserve Fund (CRF) ¹	26,955	28,004	28,253	249	0.9%
Public Employees' Health Care Fund (HCF) ¹	32,792	40,518	40,980	462	1.1%
Long-Term Care Fund (LTCF)	3,564	5,738	5,788	50	0.9%
Annuitants' Health Care Coverage Fund (AHCCF)	2,541	4,054	3,761	(293)	(7.2%)
Deferred Compensation Fund (DCF)	1,667	1,848	1,720	(128)	(6.9%)
Judges' Retirement Fund (JRF)	1,257	1,765	1,746	(19)	(1.1%)
Judges' Retirement Fund II (JRF II)	1,389	1,983	1,976	(7)	(0.4%)
Legislators' Retirement Fund (LRF)	473	599	602	3	0.5%
Replacement Benefit Custodial Fund (RBF)	7	14	15	1	7.1%
Subtotal	\$ 420,034	\$ 454,321	\$ 457,701	\$ 3,380	0.7%
Reimbursements ²	1,500	1,450	1,450	-	-
Total CalPERS	\$ 421,534	\$ 455,771	\$ 459,151	\$ 3,380	0.7%

¹These Mid-Year amounts include estimates for statewide salary increases and will require Department of Finance approval of the funding levels.

²Amounts received by CalPERS for services rendered. These reimbursements are actuarial valuations prepared for public agencies that qualify for reimbursement, cost of photocopies/postage related to the Public Records Act requests, annual employer conferences, and administrative assessments for employers' delinquent payroll.