CalPERS

Finance and Administration Committee
Agenda Item 7a

November 15, 2016

Item Name: Securing CalPERS Future – Managing Funding Risks, Stakeholder Outreach and Engagement

Program: Financial Office, Office of Stakeholder Relations

Item Type: Information

Executive Summary
Based on direction from the CalPERS Finance and Administration Committee meeting in September 2016, staff has researched the current cost of the cost-of-living adjusment (COLA) rider as a portion of the total contribution and accrued liablitiy. In addition, staff has conducted stakeholder outreach and engagement with public agency employers and stakeholders to gauge their knowledge, preparation, priorities, and preferences related to a potential change of the discount rate

Strategic Plan
This item supports Strategic Plan Goal A "to improve long-term pension and health benefit sustainability."

Background
At the September 20, 2016 Finance and Administration Committee meeting, staff was directed to bring back in November 15, 2016 discussion on the following:

- Current cost of the cost-of-living adjusment (COLA) rider as a portion of the total contribution and explain what portion of the unfunded liability goes to covering the current cost of the COLA benefit.
- Survey agencies on prefunding their pension liabilities and explain additional options for consideration.

Analysis
<u>COLA</u>
The COLA accounts for approximately 14% to 18% of both the normal cost and the accrued liability, with miscellaneous plans falling towards the lower end of the range and safety plans near the upper end. Please note that we have provided the portion of the accrued liability instead of the unfunded liability, as this is more representative of the cost of the benefit.

<u>Stakeholder Outreach & Engagement</u>
Staff developed a set of questions to ask public agency employers that would provide useful data for the Committee's review and consideration. The questions were then organized and developed into a survey, to be distributed either in paper format, or online survey link, or through informal employer disucssions.

The surveys asked questions on the following topics:

- Awareness of the discount rate discussion and its connection to the challenging global investment environment
- Actions taken to plan for potential discount range changes, such as pre-funding pension obligations or budget forecasting
- The relative importance of risk mitigation, reducing investement volatility, and maximizing returns
- Ability to absorb increased contribution rates in the next 12 months
- Phased-in rate changes vs one-time reduction
- Professional level (elected official, executive, manager, etc.)

While the Committee directed staff to engage with employers on this issue, staff has also engaged member association leaders on the topic.

During the month of October and in early November, staff engaged with over 600 employers through a variety of outreach methods: in-person polling at two employer annual conferences, at the CalPERS Educational Forum, through online surveys, and via meetings with employer association senior leaders.

Surveys of employers indicate that most employers are aware of the discussions and issues around the discount rate, and have done at least some level of planning in anticipation of absorbing expected higher employer contribution rate increases in the near future. Actions employers have taken to plan for potential discount rate changes varied widely from budget forecasting out three and five years (61% of employers surveyed) to pre-funding pension benefits utilizing separate trusts (13%). The responses reflected a largely informed and proactive approach to absorbing likely future employer contribution rate increases. One exception to this was school employers; of 63 employers surveyed by the Association of California School Administrators (ACSA) 30 (47.6%) answered “no” when asked if they have been following discussions around the investment market and discount rate.

Employers were asked to rank three considerations in order of importance: maximizing returns, risk mitigation, and reducing volatility to employer contribution rates. Sixty-eight percent of employers said that the most important thing to their agency was “reducing volatility of employer contribution rates.” “Risk mitigation” was the second highest priority (21%) and “maximizing returns” was the lowest priority (11%).

On the key question of whether a phased-in approach to lowering the discount rate was preferable to a single rate reduction, 86% said they preferred a phased-in reduction over time and 14% preferred a single larger reduction all at once. When asked to rate the impact of lowering the discount rate in the next 12 months, most employers said it would be “high” (42%) or “some impact” (26%). Twenty-five percent selected the option “extremely high impact.” Less than one percent of employers indicated that it would have little or no impact.

The majority of those who took the survey identified themselves as managers or above.

In discussions with member associations, leaders expressed an interest in a unified path forward to be agreed upon by employers, member organizations, and the Board. Areas of concern expressed over changes to the discount rate included:

- Increased costs to employer and employees
- The inability of the recently approved Risk Mitigation policy to take effect
- CalPERS focus on a short-term market environment over the next 10 years
- Incremental approaches and revisiting of policies and assumptions instead of a long-term focused plan.

Budget and Fiscal Impacts
Not Applicable

Benefits and Risks
Not Applicable

Attachments
Attachment 1 – Stakeholder Outreach for Public Agencies
Attachment 2 – CalPERS Employer Contribution & Discount Rate Survey
Attachment 3 - Securing CalPERS Future – Managing Funding Risks, Stakeholder Outreach and Engagement PowerPoint

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