



Finance and Administration Committee  
**Agenda Item 3c**

April 18, 2017

**Item Name:** Judges' Retirement System Actuarial Valuation Report and Employer and Employee Contribution Rates

**Program:** Actuarial Office

**Item Type:** Action Consent

**Recommendation**

1. Approve the June 30, 2016 Judges' Retirement System Actuarial Valuation Report and the corresponding transmittal letter to the Governor and Legislature, including lowering the discount rate assumption from 4.25 percent to 3.25 percent and changes to other actuarial assumptions as outlined below and in the valuation report.
2. Adopt the use of a 6.50 percent (from 7 percent) discount rate assumption in all affected member calculations effective as follows:
  - a. For service credit purchases under the "present value" method, the use of the new discount rate will apply to all applications postmarked on or after April 20, 2017.
  - b. For retirement applications, any application with a retirement date on or after April 20, 2017 will be subject to the new discount rate.
3. Continue to encourage the Governor and Legislature to adopt an employer contribution schedule that includes advanced funding of the Judges' Retirement System.

**Executive Summary**

The funded status, as well as other key results of the valuation, is shown in the following table:

<b>Comparison of Current and Prior Year Results</b>		
	<b><u>June 30, 2015</u></b>	<b><u>June 30, 2016</u></b>
Present Value of Benefits	\$ 3,365,609,774	\$ 3,543,516,613
Accrued Liability	3,322,609,989	3,428,743,441
Market Value of Assets	41,177,519	39,793,891
Funded Status (Market Value Basis)	1.2%	1.2%
Estimated Pay-as-you-go Contribution	\$ 227,341,695	\$ 208,334,913

Over the last year, the State elected to continue funding the Judges' Retirement System on a pay-as-you-go basis. This means that there is no build-up of assets to secure the benefits for members, as shown by the funded status in the table above. Similarly, the lack of assets

means that this system is failing to take advantage of a substantial amount of expected investment income that would offset the cost of the benefits.

It is not within the Board's authority to require the State to fund this system. Accordingly, CalPERS cannot adopt a required contribution rate that will remedy the funding situation. As in the past, we recommend that the Board encourage the administration to institute proper funding of the plan.

### **Strategic Plan**

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the Strategic Plan Goal A: Improve long-term pension and health benefit sustainability

### **Background**

This report is presented in accordance with Section 75109.5 of the Judges' Retirement System Law. The information included provides information regarding retirement and ancillary benefits for judges elected or appointed prior to November 9, 1994.

### **Analysis**

Attachment 1 is the transmittal letter to the Governor and Legislature. Also attached (as Attachment 2) is the actuarial valuation report as of June 30, 2016 for the Judges' Retirement System (JRS). The results of the valuation are contained in the attached report and key results are included earlier in this agenda item.

There were changes to the actuarial methods and assumptions since the prior valuation. The first change was a revision to the assumed rates of retirement. Recent past experience indicated that active members have retired at lower rates than those previously assumed. These lower rates of retirement have persisted for a long enough period of time that we believe it is appropriate to reflect lower retirement rate expectations into our assumptions. The revised rates are believed to be a better predictor of future retirement patterns. In addition, we have also removed the assumed rates of termination and disability prior to retirement. We believe the future incidence of pre-retirement termination and disability will be sufficiently low such that removal of these rates is appropriate. The final change was a change to the discount rate from 4.25 percent to 3.25 percent. The new discount rate of 3.25 percent is the assumed rate of return for fixed income investments. For this purpose we have assumed that should the State begin a prefunding program that all assets will be invested in fixed income investments. A complete description of the actuarial assumptions used in the valuation may be found in Appendix A of the report.

As can be seen in the report, JRS continues to be unfunded due to the pay-as-you-go contribution basis followed by the State. Projections of expected statutory contributions and projected future benefit payouts are shown on page 13 of the valuation report.

The market value of assets for JRS as of June 30, 2016, is \$39.8 million. This is significantly less than the expected benefit payments in the year after the valuation date. If the only contributions to the system were those determined in accordance with statutory requirements, there would be insufficient assets to pay the benefits in the year after the valuation.

### **Benefits and Risks**

One risk measurement is the funded status of a plan. The funded status of a pension plan is defined as the ratio of assets to a plan's accrued liabilities. This measure, when below a certain level, indicates whether a plan is at risk of not meeting future benefit obligations. The funded status of this plan on a Market Value of Assets basis is 1.2 % and indicates that there are insufficient assets accumulated to pay future benefits.

Although it is unlikely the State would fail to pay ongoing benefit payments, as they are due, the lack of pre-funding means there is no benefit security for members of this plan. It also means the total cost is higher to the State since there is no accumulation of assets and, consequently, little to no investment earnings can be used to defray costs.

### **Other Issues**

In the case of Robert M. Mallano, et al. v. John Chiang, Controller of the State of California (SCO), the Judges' Retirement System (JRS), and the Judges' Retirement System II (JRS II), the judge issued a Statement of Decision, which orders judicial salary increases to be given to the judges for the fiscal years 2008-09, 2009-10, 2010-11 and 2013-14 plus 10% interest per annum for each year that the judicial salaries were not increased within those fiscal years. The increases and amounts owed have not been calculated yet. We anticipate the impact of this lawsuit to be reflected in the June 30, 2017 valuation.

### **Attachments**

Attachment 1 – Transmittal letter to the Governor and Legislature

Attachment 2 – Judges' Retirement System Actuarial Valuation Report as of June 30, 2016

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