

California Public Employees' Retirement System

Fiscal Year 2017-18 Mid-Year Budget

Second Reading
December 19, 2017



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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) 2017-18 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 2017-18 forecast for the remainder of the fiscal year.

Summary

The FY 2017-18 Mid-Year Total Budget of \$1.676 billion represents an overall decrease of \$552,000 (-0.03 percent) from the FY 2017-18 Annual Total Budget. More specifically, decreases are proposed in the Administrative Operating Costs of \$6.0 million and in the Enterprise Projects Costs of \$564,000, offset by an increase in the Third Party Administrator Fees of \$6.1 million. The authorized positions remain the same as 2,875.

Fiscal Year 2017-18 Mid-Year CalPERS Total Budget

(\$ in thousands)	FY 2017-18 Annual Budget	Mid-Year Adjustments	FY 2017-18 Proposed Mid-Year Budget	% Change From Annual
Administrative Operating Costs	\$474,441	(\$6,039)	\$468,402	(1.3%)
Investment Operating Costs ¹	91,236		91,236	0.0%
Investment External Management Fees ²	777,518		777,518	0.0%
Third Party Administrator Fees ³	282,860	6,051	288,911	2.1%
Subtotal: Operating Costs	\$1,626,055	\$12	\$1,626,067	0.0%
Enterprise Projects Costs	23,302	(564)	22,738	(2.4%)
Headquarters Building Costs	27,046		27,046	0.0%
CalPERS Total Budget	<u>\$1,676,403</u>	<u>(\$552)</u>	<u>\$1,675,851</u>	<u>(0.03%)</u>
Total Positions	2,875.0		2,875.0	0.0%

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

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

³ The State Controller's Office contract for FY 17/18 was negotiated for \$1.9 million, savings of \$5.0 million from the prior year contract of \$6.9 million, due to the reductions in printing costs. The item is shown as an increase to the budget, classified for the first time as an operating cost in the budget.

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 decreased by 5.0 percent over the past five years, from 10.8 percent to 5.8 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.

Major Highlights

The FY 2017-18 Mid-Year Budget of \$1.676 billion include the following major highlights:

- Increase of \$1.5 million for technical statewide salary increases and employee benefits (retirement, health, and dental).
- Increase of \$6.1 million in the Third Party Administrator Fees mainly for the Health Programs and the Long Term Care Program.
- Decrease of \$7.5 million due to additional salary savings forecasted for the remainder of the year.
- Decrease of \$0.6 million to the Enterprise Projects (Long Term Care Program third party administrator project).

The table below provides a breakdown of the proposed FY 2017-18 Mid-Year Budget revisions.

Mid-Year Budget Changes	Dollars (\$ in thousands)	Positions
Approved FY 2017-18 Annual Budget	\$1,676,403	2,875
Additions to FY 2017-18 Annual Budget:		
Statewide Salary and Staff Benefit Adjustments	\$1,461	
Third Party Administrator Fees		
Health Program	5,470	
Long Term Care Program	576	
CERBT	4	
Total Additions	7,512	
SUBTOTAL	\$1,683,915	
Reductions to FY 2017-18 Annual Budget:		
Salary Savings due to Vacancies	(\$7,500)	
Long Term Care Third Party Administrator Project	(564)	
Total Reductions	(8,064)	
Proposed FY 2017-18 Mid-Year Budget	\$1,675,851	2,875
Change from Annual Budget	(\$552)	
Percent Change	(0.03%)	

The following provides further details on the proposed changes in the FY 2017-18 Mid-Year Budget:

Statewide Salary and Staff Benefit Increases (\$1.5 million increase)

Technical adjustments of \$1.5 million for statewide salary increases per collective bargaining agreements/Governor action and employee benefit rate increases for retirement and dental coverage. During the annual budget process, the 2017-18 budget included an estimate for various collective bargaining salary increases. The \$1.5 increase million represents the difference between the initial estimated amount compared to the amount calculated based on recent budget letters issued by the Department of Finance.

Salary Savings due to Vacancies (\$7.5 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. As part of the Mid-Year process, additional salary savings have been estimated based on the current vacancy rate which is projected to remain there for the remainder of the fiscal year.

Also note, the 2017 Member-at-Large election concluded on October 2, 2017. No candidate for the Position B Board seat received a majority of the votes casted. The two candidates with the highest

number of votes will face each other in a runoff election. The estimated costs to conduct the runoff is approximately \$2.6 million and will be absorbed with existing funds resulting in no impact to the administrative budget.

Enterprise Projects Savings (\$563,500 decrease)

Project costs are anticipated to be \$22.7 million, a decrease of \$563,500 from the current budget of \$23.3 million. Savings were identified in the Long Term Care Third Party Administrator project.

Third Party Administrator Fees (\$6.1 million increase)

Third Party Administrator Fees are anticipated to increase by \$6.1 million, from \$282.8 million to \$288.9 million.

Health Program third party administrator fees are increasing by \$5.5 million as follows:

- \$1.7 million increase due to expected membership migration to plans with higher administrative service fees, including the newly offered Western Health Advantage plan, effective January 2018. The approved medical benefit changes for 2018 will increase the TPA costs for FY 2017-2018 but will produce savings on claims. Please refer to Pension and Health Benefits Committee Agenda Item 6 on June 20, 2017.
- \$1.1 million increase related to Silver Sneakers, a program encouraging older adults to participate in physical activities that will help them to maintain greater control of their health.
- \$0.4 million increase due to higher administrative service fees for CalPERS Preferred Provider Organization plans effective January 2018.
- \$0.4 million increase due to anticipated plan migration to plans that utilize OptumRx.
- \$1.9 million increase due to State Controller's contract for check writing, transaction auditing, and support services for the Self-Funded Health Program previously not reflected in the budget.

Long Term Care Program third party administrator fees are anticipated to increase by \$0.6 million, due to new contract terms, effective January 2018.

Third Party Administrator Fees

(\$ in thousands)	FY 2017-18 Annual Budget	Mid-Year Adjustments	FY 2017-18 Proposed Mid-Year Budget
Health Program	\$ 237,730	\$ 5,062	\$ 242,791
Pharmacy Benefit Manager	20,805	408	21,213
Total, Health	258,534	5,470	264,004
Long Term Care Program - LTCG	20,903	576	21,479
Supplemental Income Plan - Voya	3,326	-	3,326
California Employers' Retiree Benefit Trust (CERBT) - Northeast Retirement Services (NRS)	97	4	101
Total Third Party Administrator Fees	\$282,860	\$6,051	\$288,911

Total Budget by Branch

(\$ in thousands)	FY 2017-18 Annual Budget ¹	Mid-Year Adjustments	FY 2017-18 Proposed Mid-Year Budget	% Incr/(Decr) From Annual
Administrative and Investment Operating Costs				
Actuarial Office	\$ 10,241	\$ 33	\$ 10,275	0.3%
Communications and Stakeholder Relations	15,127	46	15,172	0.3%
Customer Services and Support	98,613	(1,325)	97,288	(1.3%)
Executive Office	6,691	21	6,712	0.3%
Financial Office	34,209	(101)	34,108	(0.3%)
General Counsel	27,761	(121)	27,641	(0.4%)
Health Policy and Benefits Branch	30,727	100	30,827	0.3%
Investment Office	164,969	(2,476)	162,492	(1.5%)
Operations and Technology	152,927	(2,216)	150,711	(1.4%)
Pro-Rata Assessment	24,411	-	24,411	0.0%
Subtotal	\$ 565,677	(\$6,039)	\$ 559,638	(1.1%)
Investment External Management Fees	777,518	-	777,518	0.0%
Third Party Administrator Fees	282,860	6,051	288,911	2.1%
Enterprise Projects Costs	23,302	(564)	22,738	(2.4%)
Headquarters Building Costs	27,046	-	27,046	0.0%
CalPERS Total Budget	\$ 1,676,403	(\$552)	\$ 1,675,851	(0.03%)

¹ During the first reading, the budget reflected partial reorganizational changes that became effective on July 1, 2017. The second reading has been adjusted to capture all reorganizational changes.

Administrative Operating Costs by Fund Source

(\$ in thousands)	FY 2016-17 Actual Expenditures	FY 2017-18 Approved Budget	FY 2017-18 Proposed Mid-Year Budget	Change from Annual	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)
Administrative Operating Costs					
Public Employees' Retirement Fund (PERF)	\$ 355,820	\$ 384,656	\$ 375,254	\$ (9,402)	(2.4%)
Public Employees' Contingency Reserve Fund (CRF)	27,325	28,102	30,832	2,730	9.7%
Public Employees' Health Care Fund (HCF)	38,849	43,012	44,337	1,325	3.1%
Long-Term Care Fund (LTCF)	5,230	6,324	5,706	(618)	(9.8%)
Annuitants' Health Care Coverage Fund (AHCCF)	3,369	3,902	3,846	(56)	(1.4%)
Deferred Compensation Fund (IRC 457)	1,522	1,630	1,651	21	1.3%
Supplemental Contributions Program Fund (SCP)	140	139	141	2	1.4%
Judges' Retirement Fund (JRF)	1,652	1,848	1,838	(10)	(0.5%)
Judges' Retirement Fund II (JRF II)	1,867	2,272	2,246	(26)	(1.1%)
Legislators' Retirement Fund (LRF)	570	606	601	(5)	(0.8%)
Replacement Benefit Custodial Fund (RBF)	15	450	450	-	0.0%
Reimbursements ¹	1,450	1,500	1,500	-	0.0%
Total Administrative Operating Costs	\$ 437,809	\$ 474,441	\$ 468,402	\$ (6,039)	(1.3%)
<i>Statewide Pro-Rata Assessment</i>	<i>\$ 24,709</i>	<i>\$ 24,411</i>	<i>\$ 24,411</i>	<i>\$ -</i>	<i>0.0%</i>
<i>CalPERS Administrative Costs</i>	<i>\$ 413,100</i>	<i>\$ 450,030</i>	<i>\$ 443,991</i>	<i>\$ (6,039)</i>	<i>(1.3%)</i>

¹ Amounts 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.