Finance and Administration Committee

Agenda Item 4b

February 13, 2018

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, 2017 Judges' Retirement System Actuarial Valuation Report and the corresponding transmittal letter to the Governor and Legislature, including lowering the discount rate assumption from 3.25 percent to 3.00 percent, lowering the inflation assumption from 2.75 percent to 2.50 percent and changes to other actuarial assumptions as outlined below and in the valuation report.

2. Adopt the use of new mortality and economic assumptions including inflation and salary growth in all affected member calculations. The discount rate for benefit calculations and service credit purchases is the same as that used for the Judges Retirement II System, namely, 6.50 percent. These changes are effective as follows:
   a. For service credit purchases under the "present value" method, the use of the new assumptions will apply to all applications postmarked on or after February 14, 2018.
   b. For retirement applications, any application with a retirement date on or after February 14, 2018 will be subject to the new assumptions.
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:

Comparison of Current and Prior Year Results		
	June 30, 2016	**June 30, 2017**
Present Value of Benefits	$ 3,543,516,613	$ 3,416,716,154
Accrued Liability	3,428,743,441	3,315,731,052
Market Value of Assets	39,793,891	48,274,516
Funded Status (Market Value Basis)	1.2%	1.5%
Annual Estimated Pay-as-you-go Contribution	$ 208,334,913	$ 207,313,847

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 any 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 Government Code 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, 2017 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. Consistent with the decision made by the CalPERS Board of Administration for plans participating in the Public Employees' Retirement Fund (PERF), staff is recommending, as part of the adoption of the valuation report, the adoption of new actuarial assumptions. The new mortality tables used in this valuation were developed from the December 2017 experience study and includes 15 years of projected on-going mortality improvement using 90 percent of Scale MP 2016 published by the Society of Actuaries. The inflation assumption is reduced from 2.75 percent to 2.50 percent. The individual salary and overall payroll increase assumptions are reduced from 3.00 percent to 2.75 percent.

In addition, the discount rate was lowered from 3.25 percent to 3.00 percent. The new discount rate of 3.00 percent is the assumed rate of return for fixed income investments consistent with capital market assumptions recently incorporated by the Board in its Asset Liability Management review. 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. The new assumptions have been incorporated in this valuation.

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, 2017, is $48.3 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 1.5 percent 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, when 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 valuation report following the decision.

Attachments

Attachment 1 – Transmittal letter to the Governor and Legislature
Attachment 2 – Judges' Retirement System Actuarial Valuation Report as of June 30, 2017

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