Finance and Administration Committee

Agenda Item 7b

April 17, 2018

Item Name: Schools Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Adopt an employer contribution rate of 18.062 percent for the Schools Pool and a member contribution rate of 7.00 percent for school's employees subject to the Public Employees' Pension Reform Act of 2013 (PEPRA) for the period of July 1, 2018 to June 30, 2019.

Executive Summary

We recommend that the Board adopt the employer contribution rate of 18.062 percent for the period of July 1, 2018 through June 30, 2019 for the Schools Pool. This employer contribution rate is higher than the previous fiscal year and higher than what was projected in the June 30, 2016 annual valuation report. The higher contribution rate is mainly due to the lowering of the discount rate to 7.375% from 7.50% and improvements regarding the valuing of part-time employees.

We also recommend that the Board adopt a member contribution rate of 7.00 percent for schools employees subject to PEPRA effective July 1, 2018. This is 0.50 percent higher than the current rate of 6.50 percent.

The recommended employer and employee contribution rates were generated based on the June 30, 2017 annual valuation using a discount rate of 7.375 percent, payroll growth of 3.00 percent and an inflation rate of 2.75 percent. Over the next two valuations, the discount rate, payroll growth and inflation assumptions will be lowered as shown in the table below:

Valuation Date	Discount Rate	Payroll Growth	Inflation Assumption
June 30, 2017	7.375%	3.00%	2.75%
June 30, 2018	7.25%	2.875%	2.625%
June 30, 2019	7.00%	2.75%	2.50%

The new demographic assumptions adopted by the CalPERS Board in December 2017 will be implemented in the June 30, 2018 valuation. Therefore, the first year that employer contributions will be impacted by the new demographic assumptions will be fiscal year 2019-20 which is consistent with Public Agency plans.

The following table summarizes the results of the June 30, 2017 valuation:

Comparison of Key Valuation Results (in millions)

	June 30, 2016	June 30, 2017
Market Value of Assets	$ 55,785	$ 60,865
Accrued Liability	$ 77,544	$ 84,416
Unfunded Accrued Liability	$ 21,759	$ 23,551
Funded Status	71.9%	72.1%
	Fiscal Year 2017-18	**Fiscal Year 2018-19**
Employer Contribution Rate	15.531%	18.062%
PEPRA Member Contribution Rate	6.50%	7.00%

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 stability.

Background
The Schools Pool provides retirement benefits to members employed by school districts and community college districts in California. It generally does not cover teachers as they are covered by a separate retirement system – the California State Teachers' Retirement System, also known as CalSTRS.

This actuarial valuation determines the funded status as of June 30, 2017 and sets forth the schools employer and employee contribution rates for the plan for fiscal year July 1, 2018 through June 30, 2019.

Analysis
Schools Employer Contribution Rates for 2018-19
The Actuarial Office has completed the calculation of the employer contribution rate for the Schools Pool for the fiscal year 2018-19. The full actuarial report is expected to be completed this summer and will be provided to the Board and posted online when complete. The additional information provided in the full actuarial report includes details on assumptions, methods, and participant data.

The table below compares the fiscal year 2018-19 actuarially required contribution rates and the dollar amounts these rates are anticipated to generate with the rates and contributions for the current fiscal year 2017-18.

Comparison of Schools Pool Employer Contribution (in millions)

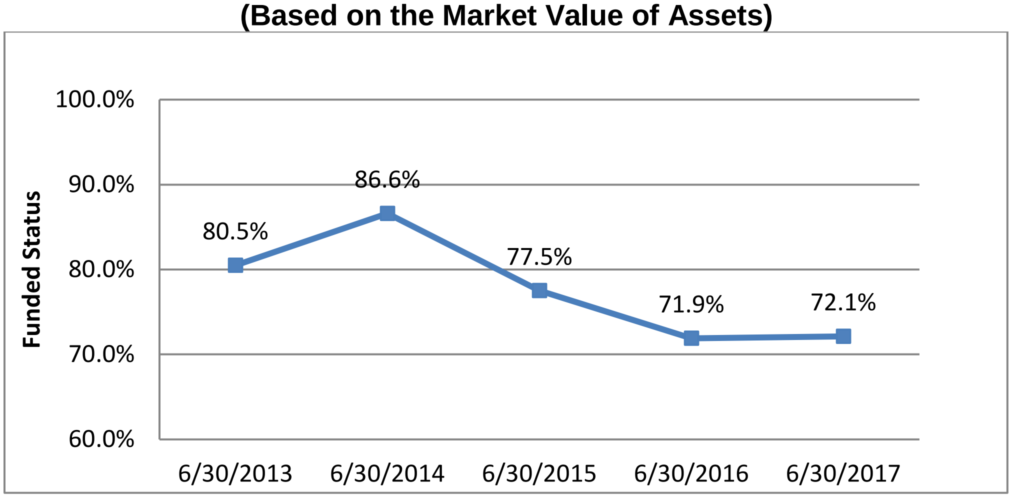
	Fiscal Year 2017-18	**Fiscal Year 2018-19**
Employer Contribution Rate		
Employer Normal Cost	8.103%	8.739%
Unfunded Liability Rate	7.428%	9.323%
Required Employer Rate	**15.531%**	**18.062%**
Expected Payroll	$13,022	$13,683
Expected Employer Contribution Dollars		
Employer Normal Cost	$ 1,055	$ 1,196
Unfunded Liability Payment	$ 967	$ 1,276
Required Employer Contribution	**$ 2,022**	**$ 2,472**

Note that the payroll used to calculate the expected dollar contributions is the payroll used in the valuation incorporating two years of payroll growth using the payroll growth assumption of 3 percent. To the extent that payroll in the contribution year is different than the projected payroll, the actual contribution amounts will be different than the expected contributions shown in the table above.

Funded Status

The funded status of a pension plan is defined as the ratio of assets to a plan's accrued liabilities. Plans with a lower funded ratio are, all other things being equal, more at risk of not being able to meet their future benefit obligations. From June 30, 2016 to June 30, 2017 the funded status for the Schools Pool increased by 0.2 percent. This was mainly due to the investment returns of 11.2% offset by the reduction in the discount rate. The graph below shows the funded status for the past five years for the Schools Pool.

Funded Status of the Schools Pool
(Based on the Market Value of Assets)



Reasons for Changes in the Schools Employer Contribution Rate
Overall, the required Employer contributions for the Schools Pool are expected to increase by $449.1 million between fiscal year 2017-18 and fiscal year 2018-19. The increase is driven mostly by the lowering of the discount rate and by the continued phase-in of previous experience losses since 2014 and the change in actuarial assumptions in the 2015 annual valuation.

The table below highlights the major contributors to the change in required contributions.

Reason for Change in Projected Schools Pool Employer Contributions (in millions)

Growth in overall payroll	$53.6
First installment of the 5-year phase in for:	
20-year amortization of lowering discount rate to 7.375 percent	88.1
30-year amortization of experience gain	(5.1)
Progression of previous ramped-in amortization bases for:	
Change in assumptions – 6/30/15 (3rd year)	92.6
Experience Loss – 6/30/16 (2nd year)	68.5
Experience Loss – 6/30/15 (3rd year)	56.6
Experience Loss – 6/30/14 (4th year)	59.3
Normal progression of existing non-ramped amortization bases	9.4
Demographics and Balance of Miscellaneous Items	26.0
Total Change in Required Contributions	$449.1

PEPRA Member Contribution Rates
With the enactment of PEPRA, new members hired on or after January 1, 2013 are subject to PEPRA and are required to contribute 50 percent of the total annual normal cost of their pension benefit as determined by the actuary. PEPRA schools members currently contribute 6.50 percent of salary. The contribution rate for schools members not subject to PEPRA, i.e. classic members, is set by statute and is currently 7.00 percent of salary.

Current law contains a provision that requires a change in the PEPRA member contribution rate when the total normal cost changes by more than 1 percent of payroll. When a change is triggered, the member contribution rate is adjusted once again to half the normal cost, rounded to the nearest quarter of one percent.

The current PEPRA member contribution rate of 6.50 percent is based on a total normal cost of 12.91 percent of payroll. The change of discount rate and plan demographics have increased the total normal cost for PEPRA members from 12.91 percent to 14.07 percent of payroll this year. The total normal cost for PEPRA members has now changed by more than one percent since the last time the member contribution rate was established. As a result, an adjustment to the PEPRA member contribution rate is necessary. The member contribution rate for the PEPRA members will be increased to 7.00 percent effective July 1, 2018. This is 0.50 percent higher than the current 6.50 percent.

Note that as of June 30, 2017, there are 105,565 active PEPRA members in the Schools Pool, which represents 33 percent of the total active population of the Schools Pool.

Expected Future Changes
The CalPERS Board approved a lowering of the CalPERS discount rate assumption at the December 21, 2016 meeting. For the Schools Pool, the discount rate is lowered to 7.375 percent in the June 30, 2017 actuarial valuation for the first time, impacting the Schools Pool employer contribution rates beginning in fiscal year 2018-19. The discount rate will be lowered further to 7.25 percent and then to 7.00 percent over the next two valuations. The Board also adopted new demographic assumptions that will be reflected in the June 30, 2018 valuation impacting employer contribution rates beginning in fiscal year 2019-20.

Lowering the discount rate means both the normal cost and the accrued liabilities will increase in the future. These increases will result in higher required employer contributions. Consistent with the existing board amortization and smoothing policy, the impact of each change in discount rate will be phased in over a five-year period. As a result, the full impact of the reduction in the discount rate will not be realized until fiscal year 2024-25.

The CalPERS Board also adopted a reduction of the inflation assumption which will be implemented in two steps in conjunction with the decreases in the discount rate. The long-term inflation rate will be lowered from 2.75 percent to 2.625 percent for the June 30, 2018 valuation and to 2.50 percent for the June 30, 2019 valuation. The reduction in the inflation assumption results in decreases in both the normal cost and the accrued liabilities in the future.

Below is a table showing projected schools employer contribution rates with the changes in discount rate, inflation, payroll growth and demographic assumptions reflected, along with the expected reductions in normal cost due to the continuing transition of active members from classic status to PEPRA status.

Projected Future Schools Employer Contribution Rates
(as a percentage of payroll)

Valuation Date	Fiscal Year Impact	Discount Rate	Projected Employer Contribution Rate
6/30/2018	2019-20	7.25%	20.8%
6/30/2019	2020-21	7.00%	23.5%
6/30/2020	2021-22	7.00%	24.6%
6/30/2021	2022-23	7.00%	25.3%
6/30/2022	2023-24	7.00%	25.8%
6/30/2023	2024-25	7.00%	26.0%
6/30/2024	2025-26	7.00%	25.7%

The CalPERS Board adopted a new amortization policy effective with the June 30, 2019 actuarial valuation. The new policy shortens the period over which actuarial gains and losses are amortized from 30 years to 20 years with the payments computed using a level dollar amount. In addition, the new policy removes the 5-year ramp-up and ramp-down on UAL bases attributable to assumption changes and non-investment gains/losses. Finally, the new policy removes the 5-year ramp-down on investment gains/losses. These changes will apply only to new UAL bases established on or after June 30, 2019. There is one exception to these rules for the Schools Pool valuation – the impact of the discount rate change from 7.25% to 7.0% in the June 30, 2019 valuation will be amortized under the old policy.

Budget and Fiscal Impacts
Not applicable.

Benefits and Risks
Information about the risks associated with the funding of these plans will be included in the valuation report that is expected to be released this summer. This information includes investment return scenarios, discount rate sensitivity, and volatility ratios.

Attachments
Attachment 1-Schools Valuation Presentation

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