



Finance and Administration Committee

Agenda Item 6d

April 16, 2019

Item Name: Schools Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Adopt an employer contribution rate of 20.733 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, 2019 to June 30, 2020.

Executive Summary

We recommend that the Board adopt the employer contribution rate of 20.733 percent for the period of July 1, 2019 through June 30, 2020 for the Schools Pool. This employer contribution has increased since the prior fiscal year and is consistent with what was projected in the June 30, 2017 annual valuation report. The increase is driven by the continued phase-in of previous assumption changes, experience losses since 2014, and the adoption of new assumptions, both demographic and economic.

We also recommend that the Board adopt a member contribution rate of 7.00 percent for school’s employees subject to PEPRA effective July 1, 2018. This is equal to the current rate.

The following table summarizes the results of the June 30, 2018 valuation:

Comparison of Key Valuation Results (\$ in millions)

	June 30, 2017	June 30, 2018
Accrued Liability	\$ 84,416	\$ 92,071
Market Value of Assets	<u>\$ 60,865</u>	<u>\$ 64,846</u>
Unfunded Accrued Liability	\$ 23,551	\$ 27,225
Funded Ratio	72.1%	70.4%

	Fiscal Year 2018-19	Fiscal Year 2019-20
Employer Contribution Rate	18.062%	20.733%
PEPRA Member Contribution Rate	7.00%	7.00%

The recommended employer and employee contribution rates were generated based on the June 30, 2018 annual valuation using a discount rate of 7.25 percent, payroll growth of 2.875 percent per year and an inflation rate of 2.625 percent per year. With the next valuation, the discount rate, annual payroll growth and annual inflation assumptions will be reduced to 7.00 percent, 2.75 percent and 2.50 percent, respectively.

The new demographic assumptions adopted by the CalPERS Board in December 2017 were implemented in this valuation. Therefore, 2019-2020 will be the first year that employer contributions are impacted by the new demographic assumptions, consistent with Public Agency plans.

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 (CalSTRS).

This actuarial valuation determines the funded status as of June 30, 2018 and sets forth the schools employer and employee contribution rates for the plan for fiscal year July 1, 2019 through June 30, 2020.

Analysis

Schools Employer Contribution Rates for 2019-20

The Actuarial Office has completed the calculation of the employer contribution rate for the Schools Pool for the fiscal year 2019-20. 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 2019-20 actuarially required contribution rates and the dollar amounts these rates are anticipated to generate with the rates and contributions for the current fiscal year 2018-19.

Comparison of Schools Pool Employer Contribution (in millions)

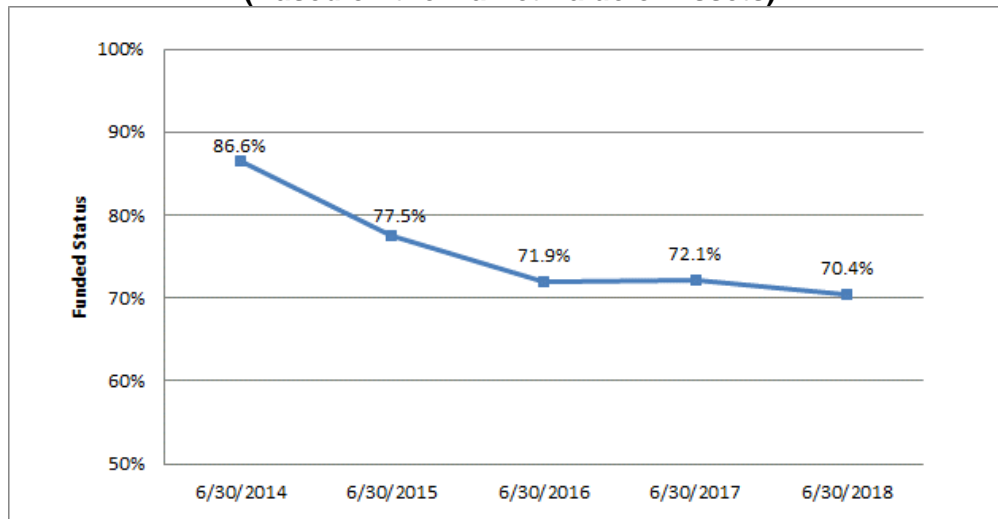
Employer Costs by Rate and Dollars	Fiscal Year 2018-19	Fiscal Year 2019-20
Employer Contribution Rate		
Employer Normal Cost	8.739%	8.992%
Unfunded Liability Rate	<u>9.323%</u>	<u>11.741%</u>
Required Employer Rate	18.062%	20.733%
Projected Payroll*	\$ 13,683	\$ 14,234
Expected Employer Contribution Dollars		
Employer Normal Cost	\$ 1,196	\$ 1,280
Unfunded Liability Payment	<u>\$ 1,276</u>	<u>\$ 1,671</u>
Required Employer Contribution	\$ 2,472	\$ 2,951

*Note that the projected 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 3.00 percent per year for the June 30, 2017 valuation and 2.875 percent per year for the June 30, 2018 valuation. 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 liability. 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, 2017 to June 30, 2018 the funded status for the Schools Pool decreased by 1.7 percent. This was mainly due to the reduction in the discount rate. The graph below shows the actual funded status for the past five years.

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



The decline in the funded status over the last five years is due to recent investment losses in excess of investment gains, the adoption of new assumptions, both demographic and economic, including lowering the discount rate, and negative amortization. Negative amortization results when the contribution towards unfunded liability is less than interest on the unfunded liability. Longer amortization periods (e.g., 30 years) combined with level-percent of pay amortization often result in negative amortization. The new amortization policy adopted by the Board, which will apply prospectively beginning with the June 30, 2019 actuarial valuation, will address negative amortization.

Reasons for Changes in the Schools Employer Contribution Rate

Overall, the required Employer contributions for the Schools Pool are expected to increase by \$479.7 million or 2.671 percent of payroll between fiscal year 2018-19 and fiscal year 2019-20.

CalPERS has implemented a new actuarial valuation software system for the June 30, 2018 valuation. With this new system we have refined and improved some of our calculation methodology. This change impacts both the normal cost rate and the unfunded accrued liability and is designated as a “method change”.

The table below reconciles the change in required contributions.

Reconciliation of Change in Projected Schools Pool Employer Contributions

Reconciliation of Changes	(millions)	% of Payroll
Prior Year Contributions		
Employer Normal Cost	\$ 1,195.8	8.74%
Unfunded Liability Contribution	<u>1,275.7</u>	<u>9.32%</u>
Total Required Contributions	\$ 2,471.5	18.06%
Change in Employer Normal Cost		
Assumption Change 6/30/2018	\$68.6	0.48%
Method Change 6/30/2018	(4.6)	(0.03%)
Experience	(28.0)	(0.20%)
Payroll Growth	<u>48.2</u>	<u>0.00%</u>
Total	\$ 84.2	0.25%
Change in Unfunded Liability Contribution		
Phase-in from Prior Years (5-year ramps)		
Experience Loss 6/30/2014 (5 th year)	\$ 56.6	0.41%
Experience Loss 6/30/2015 (4 th year)	54.9	0.40%
Experience Loss 6/30/2016 (3 rd year)	67.5	0.49%
Experience Gain 6/30/2017 (2 nd year)	(5.1)	(0.04%)
Assumption Change 6/30/2015 (4 th year)	89.1	0.65%
Assumption Change 6/30/2017 (2 nd year)	27.1	0.20%
3% Increase on Prior Years Bases	47.0	(0.10%)
Re-amortization of Prior Years Bases (7.25%/2.875%)	(2.2)	(0.02%)
New Amortization Bases		
Assumption Change 6/30/2018 (5-year ramp)	42.6	0.30%
Method Change 6/30/2018 (5-year ramp)	24.9	0.18%
Experience Gain 6/30/2018 (5-year ramp)	<u>(6.9)</u>	<u>(0.05%)</u>
Total	\$ 395.5	2.42%
Current Year Contributions		
Employer Normal Cost	\$ 1,280.0	8.99%
Unfunded Liability Contribution	<u>1,671.2</u>	<u>11.74%</u>
Total Required Contributions	\$ 2,951.2	20.73%

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 7.00 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 7.00 percent is based on a total normal cost of 14.07 percent of payroll. The change of discount rate and plan demographics have increased the total normal cost for PEPRA members from 14.07 percent to 14.28 percent of payroll this year. The total normal cost for PEPRA members has not changed by more than one percent since the last time the member contribution rate was established. As a result, no adjustment to the PEPRA member contribution rate is necessary. The member contribution rate for the PEPRA members will remain at 7.00 percent effective July 1, 2019.

As of June 30, 2018, there were 126,256 active PEPRA members in the Schools Pool, which represented 39 percent of the total active population of the Schools Pool. The total payroll for active PEPRA members was \$4,149 million which accounted for 31 percent of the total Schools Pool's payroll.

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 was being lowered to 7.25 percent in the June 30, 2018 actuarial valuation. The discount rate will be lowered further to 7.00 percent in the next valuation.

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 is being implemented in two steps in conjunction with the decreases in the discount rate. The annual inflation rate was reduced 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.

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
6/30/2019	2020-21	7.00%	23.6%
6/30/2020	2021-22	7.00%	24.9%
6/30/2021	2022-23	7.00%	25.7%
6/30/2022	2023-24	7.00%	26.4%
6/30/2023	2024-25	7.00%	26.6%
6/30/2024	2025-26	7.00%	26.5%

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

Kurt Schneider
Supervising Pension Actuary

May Shuang Yu
Senior Pension Actuary

Scott Terando
Chief Actuary