Finance and Administration Committee

Agenda Item 7a

November 19, 2019

Item Name: Annual Review of Funding Levels and Risks Report

Program: Actuarial Office

Item Type: Information

Executive Summary

Overall, this report shows that while the funding position and the risk of falling to low funding levels in the future have improved, risks remain in the system. Required employer contributions are projected to increase over the next few years and actual contribution increases could exceed expectations if future experience is unfavourable. Employers may struggle to continue to make future required contributions if they increase too significantly. In the absence of quantified risk targets and/or tolerances, it is not clear whether the risk mitigations in place currently have brought risks to the levels that the board considers acceptable. The board may wish to consider additional actions to address the level of funding risk.

Strategic Plan

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

Background

To assist the Finance and Administration Committee with its oversight of the financial soundness of the overall CalPERS system, the Annual Review of Funding Levels and Risks was developed. Included in this report are various system level actuarial results and risk measures that can be used to assess the effectiveness of funding policies, actuarial assumptions and methods.

The Board adopted the Funding Risk Mitigation Policy in November of 2015 in response to an increased awareness of risk. This policy is expected to result in a lowering of investment volatility. The goal of the policy is to reduce the risk to members' benefits that could result from investment volatility impacting funded status and required contribution rates.

CalPERS must ensure that the pension fund is sustainable over multiple generations. This is done by taking an integrated view of assets and liabilities and taking steps designed to mitigate risks over the long-term. The CalPERS asset allocation and actuarial assumptions are continually monitored and reviewed every four years in what is known as the Asset Liability Management (ALM) cycle. The Annual Review of Funding Levels and Risks report tracks the progress through this four-year cycle and highlights relevant risks in conjunction with emerging experience.

Analysis

Funded Status Improvement

Because of the relatively good performance of the capital markets over the previous few years, the funded status of the system has increased to approximately 71 percent as of June 30, 2019, despite the lowering of the discount rate to 7.0 percent. The funded status varies slightly among the different plans, with the average public agency plan having a higher funded status than the state plans. Plans for miscellaneous members generally have a higher funded status than plans for safety members.

Changing Pension Environment

Public pension plans, both at CalPERS and more generally across the United States, continue to mature. The report shows the ratio of retiree accrued liability to total accrued liability has increased and is expected to continue to increase in the future. In addition, asset volatility ratios continue to increase as well. This means that contribution volatility will continue to increase in the absence of offsetting changes.

In addition, concerns about the near-term investment horizon have increased. This is evidenced by a continuing trend towards lower expected returns and discount rates among other public pension systems.

System Risks

The improvement in funded status and recent modifications to the amortization policy have generally reduced the risk that plans will fall to low funding levels. However, employer contribution levels are climbing, and this is potentially increasing financial stress on some employers. When combined with some of the environmental changes discussed in the report, this is an area of concern for the future. In addition to the overall level of the contributions, sudden sharp increases in employer contribution rates remain a concern as well. The greatest risk continues to be the ability of employers to make their required contributions. However, with few exceptions, employers are currently up-to-date with their contribution requirements.

The termination policies and processes currently in place mitigate risks to the system. However, if an employer is under severe financial stress, the termination policies cannot fully protect the benefits of members that have served that employer. Ultimately, the members' benefits are only secure if the employer continues to make the required contributions.

Budget and Fiscal Impacts

There are no budget and fiscal impacts associated with this information item.

Benefits and Risks

This agenda item and the attached report should enhance the understanding of the risks inherent in the funding of the system. Such an understanding is necessary for effective management and mitigation of those risks.

Attachments

Attachment 1 - 2019 Funding Levels and Risks Report

Attachment 2 - Funding Levels and Risks Presentation

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