CalPERS

Finance and Administration Committee

Agenda Item 7d

April 21, 2020

Item Name: Schools Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Adopt an employer contribution rate of 22.68% for the Schools Pool. This contribution rate reflects an initial actuarially determined rate of 23.35% that has been reduced by 0.67% after reflecting part of the State contribution in accordance with Section 20825.2.

Adopt a member contribution rate of 7.00% for school's employees subject to the Public Employees' Pension Reform Act of 2013 (PEPRA) for the period of July 1, 2020 to June 30, 2021.

Executive Summary

This employer contribution has increased since the prior fiscal year and is consistent with what was projected based on our June 30, 2018 annual valuation report.

The following table summarizes the results of the June 30, 2019 valuation:

Comparison of Key Valuation Results ($ in millions)

Funded Status	**June 30, 2018**	**June 30, 2019**
Market Value of Assets	$64,846	$68,177
Accrued Liability	$92,071	$99,528
Unfunded Accrued Liability	$27,225	$31,351
Funded Ratio	70.4%	68.5%

Contribution Rates	**Fiscal Year 2019-20**	**Fiscal Year 2020-21**
Employer Contribution Rate	19.721%	22.68%
PEPRA Member Contribution Rate	7.00%	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 of Fund 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 non-classified employees 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, 2019 and sets forth the Schools employer and employee contribution rates for the plan for fiscal year July 1, 2020 through June 30, 2021.

Additional State Contributions to the Schools Pool

On June 27, 2019, the Governor approved Senate Bill 90, which added Section 20825.2 to the Government Code. This statute appropriated $904 million from the General Fund for payments relating to school employers' contributions and unfunded liabilities. The funds were received by CalPERS on July 29, 2019. In accordance with the statute, $144 million pays part of the 2019-20 required contribution on behalf of school employers, $100 million pays part of the 2020-21 required employer contribution, and $660 million is applied to the UAL for school employers.

Analysis

Schools Employer Contribution Rates for 2020-21

The Actuarial Office has completed the calculation of the employer contribution rate for the Schools Pool for the fiscal year 2020-21. The full actuarial report is expected to be completed later this year 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 2020-21 actuarially required contribution rates and the corresponding dollar amounts to the current fiscal year 2019-20.

Comparison of Schools Pool Employer Contribution (in millions)

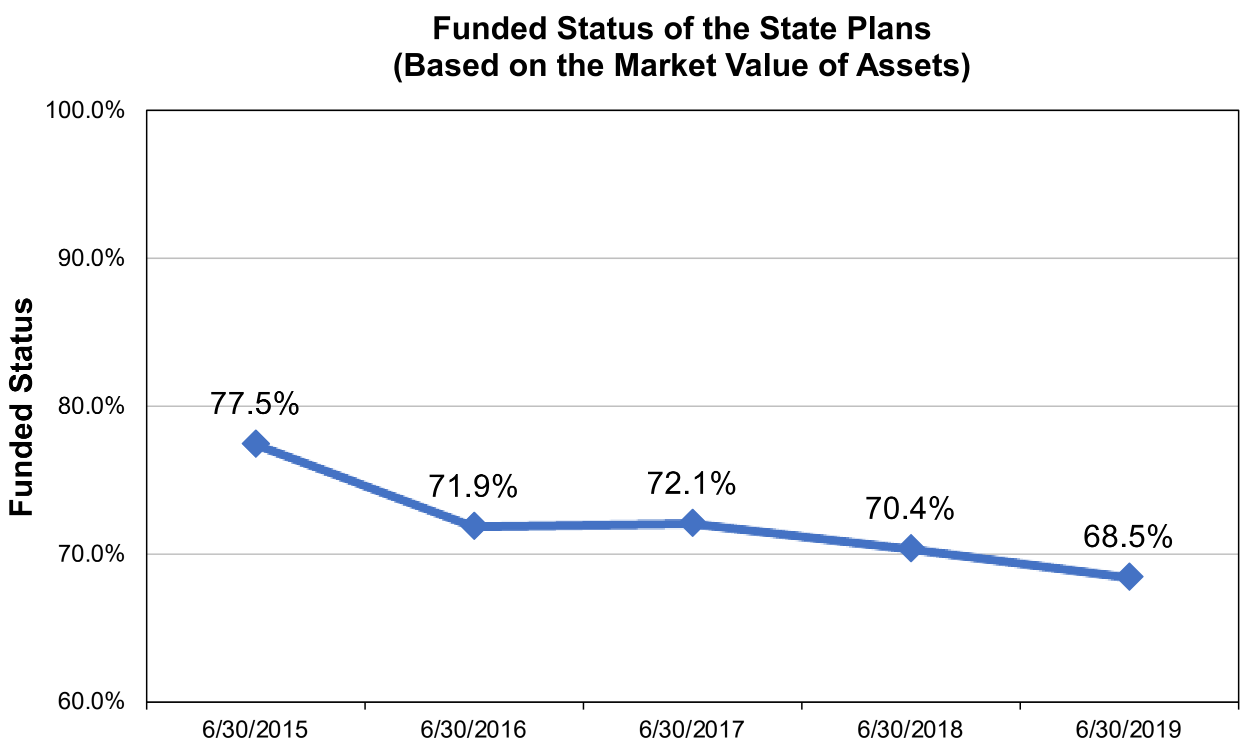
Employer Costs by Rate and Dollars	**Fiscal Year 2019-20**	**Fiscal Year 2020-21**
Employer Contribution Rate		
Employer Normal Cost	8.992%	9.47%
Unfunded Liability Rate	11.741%	13.88%
State Contribution (Section 20825.2)	(1.012%)	(0.67%)
Required Employer Rate	**19.721%**	**22.68%**
Projected Payroll*	$ 14,234	$ 14,844
Employer Contribution Dollars		
Employer Normal Cost	$1,280	$1,406
Unfunded Liability Rate	1,671	2,061
State Contribution (Section 20825.2)	(144)	(100)
Required Employer Rate	**$2,807**	**$3,367**

*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 2.875% per year for the June 30, 2018 valuation and 2.75% per year for the June 30, 2019 valuation respectively. 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 the 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, 2018 to June 30, 2019 the funded status for the Schools Pool decreased by 1.9%. This was mainly due to the reduction in the discount rate from 7.25% to 7.00% and investment return in 2018-19 being lower than expected.

The graph below shows the actual funded status for the past five years. The June 30, 2019 funded status does not reflect the State's additional UAL payment of $660 million that was made pursuant to Senate Bill 90, since CalPERS received the payment in July 2019.



The decline in the funded status over the last five years is due to recent investment losses in excess of investment gains, adoption of new assumptions, both demographic and economic, lowering of 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 applies prospectively beginning with the June 30, 2019 actuarial valuation, is expected to reduce the level and duration of any negative amortization in the future.

Reasons for Changes in the Schools Employer Contribution Rate

Overall, the required Employer contributions for the Schools Pool are expected to increase by $560 million or 2.96% of payroll between fiscal year 2019-20 and fiscal year 2020-21.

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	$ 1,280.0	8.99%
Unfunded Liability Contribution	1,671.3	11.74%
State Contribution (Section 20825.2)	(144.0)	(1.01%)
Total Required Contributions	$ 2,807.3	19.72%
Change in Employer Normal Cost		
Assumption Change 6/30/2019	$ 95.0	0.64%
Experience	(24.0)	(0.16%)
Payroll Growth	54.8	–
Total	$ 125.8	0.48%
Change in Unfunded Liability Contribution		
Phase-in from Prior Years (5-year ramps)	$ 300.8	2.11%
2.875% Increase on Prior Years Bases	56.7	–
State Contribution towards UAL (Section 20825.2)	(36.8)	(0.26%)
Re-amortization of Prior Years Bases (7.00%/2.75%)	(24.0)	(0.17%)
2019 Assumption Change (1st year of 5-year ramp)	53.7	0.38%
2019 Investment Loss (1st year of 5-year ramp)	12.4	0.09%
2019 Non-Investment Loss	27.0	0.19%
Payroll Growth 2018-19	–	(0.20%)
Total	389.8	2.14%
Current Year Contributions		
Employer Normal Cost	$ 1,405.8	9.47%
Unfunded Liability Contribution	2,061.1	13.88%
State Contribution (Section 20825.2)	(100.0)	(0.67%)
Total Required Contributions	$ 3,366.9	22.68%

On February 14, 2018, the Board adopted a new amortization policy effective with this actuarial valuation (first affecting Schools Pool plan employer contributions for fiscal year 2020-21). The new policy generally accelerates the recognition of new sources of Unfunded Accrued Liability by amortizing experience gains/losses over 20 years instead of 30 years, determining payments as a level dollar amount instead of a level percentage of payroll, and eliminating the five-year ramps (phase-in and phase-out) for all amortization bases except the ramp-up for investment gains/losses. The new policy applies only to amortization bases established on or after June 30, 2019; it does not alter the payments for amortization bases already in existence upon implementation. There is one exception to the new policy for the School Pool where the impact of the discount rate change from 7.25% to 7.00% in the June 30, 2019 valuation was amortized under the old policy.

The amortization policy in effect prior to this valuation spread rate increases or decreases over a five-year ramp period and amortized all experience gains and losses over a fixed 30-year period using a level percentage of payroll method. As such, only one-fifth of the total anticipated rate change caused by each gain or loss was recognized in the first year, culminating in the full increase in the fifth year. Amortization bases established prior to June 30, 2019 will continue to be amortized according to this policy, and amortization payments on bases still in the ramp-up period will exhibit relatively large increases each year during the ramp-up period.

A complete description of the actuarial methods used in the June 30, 2019 valuation will be shown in the valuation report that is expected to be released later this year.

The return on plan assets for the year ending June 30, 2019 was approximately 6.7% before reduction for administrative expenses. Since the net return for the year is lower than the assumed return of 7.0%, an investment experience loss, amortized over 20 years with a five-year ramp up, was added to the amortization schedule.

Overall, payroll across the Schools plan increased by 4.5%, compared with the payroll growth assumption of 2.875%. This led to an increase of $54.8 million in the required contribution.

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% of the total annual normal cost of their pension benefit as determined by the actuary. PEPRA school members currently contribute 7.00% of salary. The contribution rate for school members not subject to PEPRA, i.e. classic members, is set by statute and is currently 7.00% 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% 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% was calculated based on a total normal cost of 14.07% of payroll. The change of discount rate and plan demographics have increased the total normal cost for PEPRA members from 14.07% to 14.86% of payroll for 2020-21. Since, the total normal cost for PEPRA members has not changed by more than one percent, no adjustment to the PEPRA member contribution rate is necessary. The member contribution rate for the PEPRA members will remain at 7.00% for the 2020-21 fiscal year.

As of June 30, 2019, there were 145,891 active PEPRA members in the Schools Pool, which represented 44% of the total active population of the Schools Pool. The total payroll for active PEPRA members was $4,992 million which accounted for 36% of the total Schools Pool's payroll.

Expected Future Changes

The following table shows projected employer contribution rates. Projected rates assume all actuarial assumptions will be realized, including investment return of 7% in fiscal year 2019-20, and that no changes to assumptions, methods, or benefits will occur during the projection period. The projections reflect the supplemental payments pursuant to SB 90 received in July

2019. The projected rates further reflect the estimated decrease in normal cost due to new hires entering lower benefit formulas under PERPA.

Projected Future Schools Employer Contribution Rates (Discount Rate 7.00%)
(as a percentage of payroll)

Valuation Date	Fiscal Year Impact	Projected Employer Contribution Rate
6/30/2020	2021-22	24.6%
6/30/2021	2022-23	25.5%
6/30/2022	2023-24	26.2%
6/30/2023	2024-25	26.5%
6/30/2024	2025-26	26.4%
6/30/2025	2026-27	26.2%

A more comprehensive projection will be included in the actuarial valuation report that will include the estimated impact of the actual investment return in fiscal year 2019-20. As of the preparation date of this agenda item, the year to date return for the 2019-20 fiscal year was well below the 7% assumed return. Actual contribution rates during this projection period could be significantly higher than the projection shown above. An updated projection will be included in the actuarial valuation report that will include the impact of the actual investment return in fiscal year 2019-20. This report will be available later this year.

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 later this year. This information includes investment return scenarios, discount rate sensitivity, and volatility ratios.

Attachments

Attachment 1 – Schools Valuation Presentation

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