



California Public Employees' Retirement System

Parallel Valuation and Certification Report
Legislators' Retirement System Valuation

as of June 30, 2019

August 2020



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August 1, 2020

Board of Administration
California Public Employees' Retirement System (CalPERS)
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Members of the Board:

As provided in Contract 2015-8123, we have reviewed valuations prepared by the CalPERS professional actuarial staff in order to certify that such work satisfies applicable standards of the actuarial profession. In the following pages, we report the results of our review of the June 30, 2019 annual actuarial valuation prepared for the Legislators' Retirement System (LRS).

We reviewed the assumptions, methods and procedures used by CalPERS staff to perform the Legislators' Retirement System valuation we examined, and in our opinion, they conform to applicable Actuarial Standards of Practice.

In addition, we completed a parallel actuarial valuation for the Legislators' Retirement System using the same assumptions and census, asset and benefit provision data that were used by CalPERS staff to prepare their June 30, 2019 valuation of the System. We compared key results of our parallel valuation to those in the valuation report published by CalPERS.

Each actuarial organization has its own valuation model and applies actuarial assumptions and methods in its preferred way. There is rarely a single "right" answer when it comes to actuarial calculations. For a pension actuarial valuation, we consider one actuary's calculations to reasonably match another actuary's calculations when the present values (liabilities), normal cost contributions, and total employer contributions computed by the two actuaries are within 5% of each other.

For the Legislators' Retirement System, our computations of the contribution rates matched those prepared by CalPERS staff within 5%, which was the target tolerance level specified by CalPERS. Our analysis also included a comparison of present value of future benefits, accrued liabilities and normal costs, which also matched within the required 5% threshold. We view the differences between our calculations as immaterial.

Although not required by our contract, we also compared key valuation results for each individual participant (active members, transferred and terminated members, and retired members and beneficiaries) in the Legislators' Retirement System. This enhanced reconciliation process provides a deeper review of the calculations and may highlight differences in the handling of individual participants in the valuation process whose effects offset each other when results are aggregated at the level of the entire plan.

The Table of Contents, which immediately follows, outlines the material contained in the report.


Future actuarial measurements may differ significantly from current measurements due to plan experience differing from that anticipated by the economic and demographic assumptions, changes expected as part of the natural operation of the methodology used for these measurements, and changes in plan provisions, applicable law or regulations. An analysis of the potential range of such future differences is beyond the scope of this study.

This report was prepared for the Board and professional staff of CalPERS for their use in evaluating the preparation of actuarial valuations by the System. Use of this report for any other purpose or by other parties may not be appropriate and may result in mistaken conclusions because of failure to understand applicable assumptions, methods, or inapplicability of the report for other purposes. No one may make any representations or warranties based on any statements or conclusions contained in this report without the prior written consent of Buck.

This report was prepared under the supervision of David L. Driscoll, a Fellow of the Society of Actuaries, a Member of the American Academy of Actuaries and an Enrolled Actuary, and Peer Reviewed by Kelly L. Adams, an Associate of the Society of Actuaries, a Member of the American Academy of Actuaries and an Enrolled Actuary. We meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained in this report. This report has been prepared in accordance with all applicable Actuarial Standards of Practice, and we are available to answer questions about it.

Respectfully submitted,

Buck Global, LLC (Buck)



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Section I - Introduction

Under the California Constitution, the Board of Administration has plenary authority and fiduciary responsibility to provide for actuarial services. The CalPERS Chief Actuary advises the Board and directs the activities of the CalPERS professional actuarial staff. The Board also retains the services of an outside actuarial firm to review the work of the CalPERS professional actuarial staff and to certify that such work satisfies actuarial professional standards.

This report summarizes our review of the results of the valuation of the Legislators' Retirement System as of June 30, 2019. We did not audit or review the final valuation data provided to us by CalPERS for this parallel valuation, as review of the data is explicitly excluded from the scope of this assignment.

We first reviewed the actuarial assumptions and methods used for the June 30, 2019 Legislators' Retirement System valuation. Our review reflects the most recent changes in the Actuarial Standards of Practice (ASOP) applicable to the selection of economic assumptions (ASOP 27) and the selection of demographic assumptions (ASOP 35). The results of our review are discussed in Section II.

Next, we completed parallel actuarial valuations for the Legislators' Retirement System in order to compare our key valuation results with those published in the valuation report prepared for the plan. CalPERS requested that we reconcile any differences of more than 5% between the two sets of valuation results. Section III contains a summary of our parallel valuation methodology. The results of our analysis are summarized in Section IV.

We have also reviewed the report for the Legislators' Retirement System in light of the most recent guidance incorporated in ASOP 4, the standard of practice for measuring pension obligations and determining pension plan costs or contributions. ASOP 4 was significantly updated in late 2013 for valuations made on or after December 31, 2014.

Finally, we reviewed compliance with ASOP 51, which applies to funding calculations such as those presented in the June 30, 2019 Legislators' Retirement System valuation report and requires certain disclosures of potential risks. We found that the risks associated with this plan were thoroughly and appropriately addressed.

Section II - Review of Actuarial Assumptions and Methods

We have reviewed the actuarial assumptions and methods used in the Legislators' Retirement System valuation. The key valuation assumptions include the following:

- Expected rate of return on investments, net of expenses: 5.00%
- Salary increases: 2.75% per year
- Inflation: 2.50%
- Decrement assumptions including mortality, rates of termination and retirement: based on the most recent experience study adopted by the Board

Actuarial Standard of Practice (ASOP) 27 discusses the selection of economic assumptions for the measurement of pension liabilities. Similarly, ASOP 35 discusses the selection of demographic assumptions for the measurement of pension liabilities. In our opinion, the assumptions used in the LRS valuation are reasonable and the methodology used to select these assumptions is appropriate and consistent with the guidance provided in ASOP 27 and ASOP 35.

We have reviewed the assumed annual rate of return on plan assets of 5.00% using our own economic modeling tool and determined that it is a reasonable assumed long-term expected rate of return for the closed well-funded plan covered by this report.

Recommendations

1. Add information to the report to meet communication requirements.

We note the following items may be considered for inclusion in future reports in order to more completely fulfill the requirements of ASOP 27 and ASOP 35.

- a.) In accordance with ASOP 27 Section 4.1.1 and ASOP 35 Section 4.1.1, a statement that all assumptions represent an estimate of future experience. We note that the descriptions of the mortality and inflation assumptions specifically refer to a separate experience study. It may be inferred the requirement is met for these specific assumptions by the reference to the experience study. However, this is not the case for the other assumptions, for which the experience study is not referenced.
- b.) In accordance with ASOP 27 section 4.1.2, a disclosure of the rationale for the economic assumptions other than inflation. We note this may be done by referencing the experience study for all assumptions to which it is applicable and explicitly stating the rationale for any assumptions to which the experience study is not applicable.

Section III – Parallel Actuarial Valuation Methodology

The steps followed in our parallel actuarial valuation are described below.

We requested a copy of the final June 30, 2019 valuation report for the Legislators' Retirement System, and completed the following steps:

1. We requested:
 - a) The complete decrement tables used by CalPERS to prepare the valuation
 - b) The final participant data used in generating the valuation report
 - c) The key actuarial results presented in each valuation report (normal cost, actuarial accrued liability, present value of benefits, present value future salary, etc.) both in the aggregate and *on a per participant basis*.
2. Using the information provided in the valuation report and in 1(a) and 1(b) above, we produced a valuation for the plan using ProVal[®], a commercially available valuation system used worldwide by actuaries and investment professionals. We generated the key actuarial results for comparison to results published in the actuarial valuation report.
3. In the reconciliation process, using the data provided in 1(c) above and the output from ProVal[®], we compared the key results both on an aggregate basis and an individual basis. Reconciling results for individual participants as well as by plan may uncover multiple discrepancies that offset each other, producing aggregate results that fall within the 5% tolerance level. Valuation results that differ by less than 5% in total may camouflage systematic errors with respect to particular types of participants. Comparing results by participant helps us to identify the reasons for differences in aggregate result that exceed the 5% tolerance and to identify hidden material discrepancies for results that are within the tolerance as well. As part of this enhanced reconciliation process, we provide in Schedule C a frequency distribution of the percentage difference in key actuarial results by participant.
4. We have communicated preliminary results to CalPERS via email and telephone discussions.
5. In our Summary of Findings in the next section, we provide the following:
 - A recap of issues found in the actuarial review
 - A discussion of how issues were resolved
 - A description of any outstanding issues

Section IV - Summary of Findings

Schedule B summarizes the results for the Legislators' Retirement System.

In our parallel valuation and review, we compared present values of future pay, present values of future benefits, actuarial accrued liabilities, and total normal costs. We then used these key valuation results to compute and compare the total employer contribution rate. We are happy to report that our calculation of the employer contribution rates differed by less than 5% from the corresponding results reported by CalPERS.

Section V – Additional Comments and Recommendations

Our review has indicated that the actuarial process followed by CalPERS is thorough, complete, and complies with applicable Actuarial Standards of Practice. We have two recommendations:

1. Actuarial Standard of Practice 4 (ASOP 4) provides guidance for measuring pension obligations and determining pension plan costs or contributions. We believe that future reports would more completely fulfill the requirements of the current version of ASOP 4, in particular Section 4.1(m), if they contained a statement regarding the impact of the funding policy on future contributions and funded status; i.e., an explanation that the impact on funding associated with a current-year gain or loss will be increasing over the next five years before leveling out.
2. ASOPs 27 and 35 sections 4.1.1 state: “The actuary should describe each significant demographic assumption used in the measurement and whether the assumption represents an estimate of future experience, the actuary’s observation of the estimates inherent in market data, or a combination thereof.” The descriptions of the mortality and inflation assumptions explicitly cite the CalPERS Experience Study adopted by the CalPERS Board in December 2017. We recommend referring to this experience study more generally for all assumptions, or, alternatively, provide fuller descriptions of the bases for the selection of assumptions other than interest and mortality.

In our parallel valuations and review, we compared total present values of future benefits, actuarial accrued liabilities, and total normal costs. We then used these key valuation results to compute and compare the total employer contribution rates. We are happy to report that for all plans all of our calculations for these key results differed by less than 5% from the corresponding results reported by CalPERS.

The table in Schedule B summarizes the comparison for this plan. This schedule indicates that we were able to closely replicate the present value of future benefits, in most cases within 0.5% of CalPERS’ results. The attribution of this liability under the entry age method gave rise to a greater variance, particularly in the normal cost, which we consider a result of differences in valuation systems. No two valuation systems will produce identical results due to differing approaches to age- and service-rounding, adjustments for mid-year timing, consideration of monthly-vs.- annual payments, etc. These differences generally will not produce materially different results.

The following observations relate to evident differences in valuation system. These are not errors; they are simply differences of approach. These items do not have a material effect on overall liabilities but can give rise to significant percentage differences on an individual basis.

In the CalPERS valuation, the present value of a participant’s future benefits is based on his or her actual credited service amount as of the valuation date. However, the accrued liability and normal cost are determined using a theoretical service amount built by assumption from entry age. Generally, the theoretical service is at least as much as the actual, which tends to produce a lower accrued liability and a higher normal cost than if actual service were used.

This plan has two active participants, one of whom has actual service that is lower than his “Normal Cost Start Date” would imply. The following table compares the resulting liabilities for the two active participants under the two methods—to be clear, the “actual service” approach refers to valuing the entry age liabilities by projecting the actual service as of the valuation date back to entry age, rather than building a theoretical service amount:

	Buck Calculation Using the CalPERS Approach	Buck Calculation Using the Actual Service Approach
Present value of future benefits	\$1,485,396	\$1,485,396
Entry age normal accrued liability	\$1,140,365	\$1,171,337
Entry age normal cost	\$101,833	\$92,636
Required employer contribution	\$83,835	\$73,903

Section V – Additional Comments and Recommendations

The difference in approach has an insignificant effect on the plan's funded status, and though the percentage change in the entry age normal cost exceeds 5%, the dollar amount of the change is negligible relative to the \$115.8 million asset value as of June 30, 2019. We believe that CalPERS method, as a difference in system, is acceptable. In any case, changing this method would have no material effect on the plan's funding integrity. For the comparison results presented in this report, the Buck calculations using the CalPERS approach are used.

Schedule A – Comparison of Active Member Data

	CalPERS	Buck
Number of actives	2	2
Average age	68.3	68.3
Average service	10.3	10.3
Average pay	\$135,901	\$135,901

Schedule B – Comparison of Key Valuation Results

Liabilities as of June 30, 2019	CalPERS	Buck	% Difference
Present Value of Benefits			
1. Active members	\$ 1,494,694	\$ 1,485,396	-0.6%
2. Inactive members	3,061,831	3,085,873	0.8%
3. Members receiving benefits	<u>94,917,870</u>	<u>94,879,464</u>	-0.0%
4. Total	99,474,395	99,450,732	-0.0%
Accrued Actuarial Liability			
1. Active members	1,150,480	1,140,365	-0.9%
2. Inactive members	3,061,831	3,085,873	0.8%
3. Members receiving benefits	<u>94,917,870</u>	<u>94,879,464</u>	-0.0%
4. Total	99,130,181	99,105,702	-0.0%
Normal Cost (Employer + Employee)	101,609	101,833	0.2%

Contribution as a % of Payroll	CalPERS	Buck	% Difference
Total Normal Cost	37.38%	37.46%	0.2%
Employee Contribution	<u>(8.00%)</u>	<u>(8.00%)</u>	0.0%
Employer Normal Cost	29.38%	29.46%	0.3%
Unfunded Actuarial Liability Payment	<u>0.00%</u>	<u>0.00%</u>	N/A
Required Employer Contribution	29.38%	29.46%	0.3%

Schedule C – Comparison of Individual Participant Results

Present Value of Future Benefit Differences (Members Valued: 222)

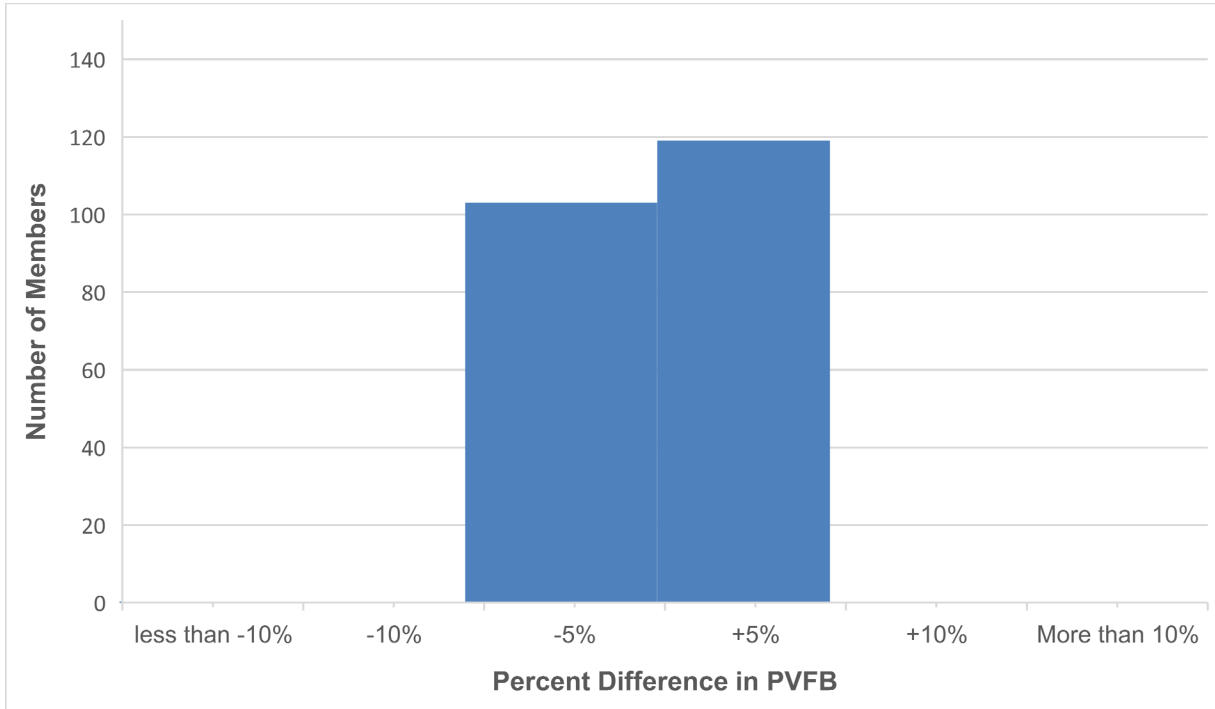


Chart Tabulation Method and Notation: The chart above reflects percent differences between Buck and CalPERS results, rounded to the nearest hundredth of a percent, where -5% reflects Buck results that were within the range from 0.00% to -4.99% compared to CalPERS results, where -10% reflects Buck results within -5.00% to -9.99% of CalPERS results, etc.

Schedule D – Previous Parallel Valuation and Certification Report Recommendations

- Our sole recommendation relates to fulfillment of the requirements of Actuarial Standard of Practice 4 (ASOP 4), which provides guidance for measuring pension obligations and determining pension plan costs or contributions. ASOP 4 was significantly revised in 2013 for measurements made as of dates on or after December 31, 2014. We believe that future reports would more completely fulfill the requirements of the current version of ASOP 4, in particular Section 4.1(m), if they contained a statement regarding the impact of the funding policy on future contributions and funded status; i.e., an explanation that the impact on funding associated with a current-year gain or loss will be increasing over the next five years before leveling out.

Comment: This does not appear to have been specifically addressed.