CalPERS

Finance and Administration Committee

Agenda Item 5c

September 19, 2023

Item Name: Investment Return Impact on Employer Contributions

Program: Actuarial Office

Item Type: Information

Executive Summary

This information item describes how required employer contributions are impacted by the annual investment rate of return. Fundamentally, employer contributions increase and decrease based on changes to their plan's asset values which are calculated at the end of the fiscal year and reported in the Annual Comprehensive Financial Report (ACFR). Employers are encouraged to use the Pension Outlook Tool to project their future pension costs.

Strategic Plan

This item supports the 2022-27 CalPERS Strategic Plan goal of Stakeholder Engagement by promoting transparency and stakeholder support.

Background

Annually, CalPERS employers anticipate both the results of that fiscal year's investment performance rate of return, and the release of the prior year's actuarial valuation report showing their new required contributions. CalPERS contributions are important to employers for budgeting and financial planning purposes. Yet, much confusion surrounds how contributions are impacted by the investment performance rate of return, primarily arising from the technical complexities and nuances of investment performance, financial accounting, and actuarial standards. This agenda item seeks to inform the board and stakeholders how the annual investment performance rate of return relates to and affects employer contributions.

Annual actuarial valuation reports are published 13 months after the end of the fiscal year. Effective dates for new contribution requirements vary based on employer type. The state and schools pool contribution rates take effect one year following the published valuation date. Public agency contribution requirements are effective two years following the published valuation date. Valuation reports rely on the current board-adopted actuarial assumptions and experience study, which are key components of the asset-liability management cycle that CalPERS undertakes every four years and recently completed in 2021. The valuation reports reflect any differences between actual and assumed estimates of investment returns, payroll growth, benefit structures, and member longevity. This agenda item focuses on investment returns because they are the most significant factor in year-to-year changes in required contributions.

Following the end of the fiscal year, CalPERS makes a mid-July announcement of the preliminary total fund investment performance rate of return, with a final calculation of the rate announced in September. This rate of return is a time-based measurement of investment decisions. Notably, this rate uses private equity and real asset valuations as of March 31 because of a one-quarter delay in valuation data. Fortunately, the delayed valuation data at June 30 is available and timely when the ACFR is finalized in November.

The ACFR is a financial report that follows Government Accounting Standards Board (GASB) requirements when reporting the investment performance rate of return and resulting asset values. It includes private equity and real asset valuations as of June 30, thus providing a view of the full fiscal year. The rate of return found in the ACFR is typically a slightly different rate than the total fund investment performance rate. A high-level comparison of the two methodologies is found in Attachment 1. Importantly, it is the asset values reported in the ACFR that are used by the actuaries to calculate required contributions.

These differing rates of return have in the past resulted in confusion to stakeholders. The below table shows the rate differences for the last three fiscal years.

Table 1: Differing Investment Performance Rates of Return for the Last Three Fiscal Years

Fiscal Year	Investment*		ACFR & Valuation Reports**	
	Market Value of Assets	1-Year Return	Market Value of Assets	1-Year Return
2022-23	$462.8 billion	5.8%	TBD	TBD
2021-22	$440.2 billion	-6.1%	$439.4 billion	-7.5%
2020-21	$470.8 billion	+21.3%	$477.3 billion	+22.4%

**Reflects private equity and real asset valuations as of March 31*

***Reflects private equity and real asset valuations as of June 30*

Fiscal Year 2022-23 had a one percent difference between the assumed return and the actual return. To connect the impact to employers, let's apply this difference to a hypothetical scenario of a plan with $100 million in assets. This one percent loss will increase the Unfunded Actuarial Liability (UAL) payments for this plan by the following amounts for the next five years. This example is found in detail in Attachment 1.

Table 2: Impact of 1% Investment Loss on UAL Payments for a Plan with $100M of Assets

Fiscal Year	Additional UAL Payments
2025-26	$24,517
2026-27	$49,035
2027-28	$73,552
2028-29	$98,069
2029-30+	$122,587

The Pension Outlook Tool on the CalPERS Website allows employers to project future pension costs and inform decision-making for their own plans. The tool's modeling assumptions are found in Attachment 1. An employer's assigned actuary is always available to assist in using Pension Outlook and answer questions related to pension costs.

Attachments

Attachment 1 – How Investment Returns Impact Employer Contributions PowerPoint Presentation.

____

Kerry Worgan
Supervising Pension Actuary
Actuarial Office

____

Scott Terando
Chief Actuary
Actuarial Office