Circular Letter

March 10, 2014

TO: SCHOOL DISTRICTS

SUBJECT: EMPLOYER RATE IMPACT DUE TO CHANGES IN ACTUARIAL ASSUMPTIONS

The purpose of this Circular Letter is to provide information regarding recent changes adopted by the CalPERS Board to the CalPERS strategic asset allocation and actuarial assumptions and the impact these changes are expected to have on employer contribution rates.

At the CalPERS Board of Administration meeting held in Sacramento on February 18, 2014, the Board adopted new actuarial assumptions based on a recently completed experience study. The Board also adopted an asset allocation mix that lowers the CalPERS investment risk but largely keeps its investment strategy unchanged, holding the fund’s long-term assumed rate of return at 7.5 percent.

To assist in preparing and planning for these changes, the Board adopted staff’s recommendation for school districts to first reflect the change in assumptions in the 2016-17 Fiscal Year with the cost spread over twenty years with the increases phased in over the first five years and ramped down over the last five years.

Background
The changes adopted by the Board represent the culmination of nearly two years of work on the asset liability management (ALM) process. ALM is an integral part of the CalPERS 2012-17 Strategic Objective to fund the System through an integrated view of pension assets and liabilities and to improve long-term pension and health benefit sustainability. This process was conducted as a joint effort by the Investment, Actuarial and Financial offices. Throughout the entire process, and particularly over the last two to three months, CalPERS staff has engaged extensively with stakeholders to educate them on the process and the recommendations, and to obtain their input. This process included an examination of the risk/return characteristics of possible asset allocations as well as modeling the impact these asset allocations would have on the funding of the system. It also included a review of the actuarial assumptions used in the actuarial valuations that sets the funding requirements through a process called an experience study.
Discussion
On February 18, 2014, the CalPERS Board made important decisions regarding the funding of pension benefits at CalPERS. Specifically, the Board adopted relatively modest changes to the current asset allocation that will reduce the expected volatility of investment returns while holding the fund’s long-term assumed rate of return at 7.5 percent. The Board also adopted more significant changes to the actuarial assumptions, most importantly, the inclusion of future mortality improvements in the actuarial assumptions. Finally, the Board approved a financing method which determines when and how quickly these changes will impact employer contributions. The actuarial assumptions adopted by the CalPERS Board of Administration are designed to ensure greater sustainability and soundness of the pension fund, and will be better at predicting future experience resulting in more secure retirement benefits in the decades to come. The current experience study was based on CalPERS member demographic data for the experience period from June 30, 1997 to June 30, 2011. The study focused on recent patterns of termination, death, disability, retirement and salary increases.

The major findings from the study showed that on average men are expected to live two years longer and women a year and a half longer. Other findings from the study for schools member show that no changes were necessary to the service retirement rates and that minor changes were needed to disability rates and to the salary increase assumption. Based on these findings, the new demographic assumptions will cause the Schools pension costs to increase.

The new assumptions will be implemented in the June 30, 2015 Schools actuarial valuation, setting employer contribution rates effective July 1, 2016. The 2014-15 and 2015-16 projected rates provided in the June 30, 2012 State and Schools report will not be impacted by the adoption of the new assumptions.

Below is a table showing the estimated impact the new actuarial assumptions will have on the schools employer contribution rates.

<table>
<thead>
<tr>
<th>Category</th>
<th>Total Estimated Change in Total Normal Cost (% of payroll)</th>
<th>Total Estimated Change in Employer Rate (% of payroll)</th>
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<tbody>
<tr>
<td></td>
<td>2016-17</td>
<td>2017-18</td>
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<tr>
<td>Schools</td>
<td>0.8%</td>
<td>1.4%</td>
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</tbody>
</table>

Below is a table showing the projected future employer contribution rates for Schools for the next six fiscal years. These rates are based on the 7.5 percent long-term assumed rate of return.

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</thead>
<tbody>
<tr>
<td>Schools</td>
<td>11.7%</td>
<td>12.6%</td>
<td>15.0%</td>
<td>16.6%</td>
<td>18.2%</td>
<td>19.9%</td>
<td>20.4%</td>
</tr>
</tbody>
</table>
To the extent future experience is different from what is assumed, the employer rates will vary in the future. Please refer to Page 62 of the June 30, 2012, State and Schools valuation report for a discussion of risk and the impact of various investment returns on rates.

In order to assist employers in preparing and planning, CalPERS staff will reflect the estimated impact of these changes in the projected rates that will be based on the 2013 Schools actuarial valuation and be made available in the summer of 2014. The actual impact of these changes will not be known until the 2015 valuation is performed in 2016.

The results of the study are described in detail in the 2014 experience study report which is located on CalPERS On-Line. If you have any questions, please call the CalPERS Customer Contact Center at 888 CalPERS (or 888-225-7377).

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