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Circular Letter

March 10, 2014

TO: **STATE EMPLOYERS**

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 approved new actuarial assumptions based on a recently completed experience study of CalPERS membership. 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.

The Board voted to approve implementing the increases for the State beginning in the 2014-15 Fiscal Year with the cost spread over 20 years and the increases phased in over three years. This was based in part on the Governor's stated ability that the State could pay earlier.

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 major findings included earlier retirement ages for CHP, POFF and higher than expected salary increases for active CHP and POFF members with long service. Other changes had minimal impact on rates. Based on these findings, State pension costs will increase.

The new assumptions will be implemented in the June 30, 2013 State actuarial valuation, setting employer contribution rates effective July 1, 2014.

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

Category	Total Estimated Change in Total Normal Cost (% of payroll)	Total Estimated Change in Employer Rate (% of payroll)		
		2014-15	2015-16	2016-17
State Miscellaneous Tier1	0.7%	2.0%	3.4%	4.7%
State Miscellaneous Tier2	0.7%	2.0%	3.4%	4.7%
State Industrial	0.4%	1.1%	1.9%	2.6%
State Safety	0.5%	1.2%	1.9%	2.6%
State POFF	2.3%	4.3%	6.3%	8.3%
State CHP	3.4%	6.3%	9.3%	12.3%

Below is a table showing the projected future employer contribution rates for State plans for the next six fiscal years. These rates are the sum of the projected employer rates found in the June 30, 2012 State and Schools valuation and costs due to new assumptions spread over twenty years with the increases phased in over the first three years and ramped down over the last three years of the twenty year amortization period.

	Projected Future Employer Contribution Rates					
Category	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
State Miscellaneous Tier1	23.3%	25.8%	28.2%	29.3%	30.5%	31.6%
State Miscellaneous Tier2	23.0%	25.7%	28.3%	29.6%	30.9%	32.2%
State Industrial	16.8%	18.2%	19.5%	20.1%	20.7%	21.3%
State Safety	17.8%	18.7%	19.6%	19.8%	20.0%	20.2%
State POFF	33.9%	37.2%	40.5%	41.8%	43.1%	44.4%
State CHP	41.4%	45.9%	50.4%	51.9%	53.4%	54.9%

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.

Note that the CalPERS Board is expected to adopt the actual 2014-15 State employer rates at its April 2014 meeting. That rate setting process will include additional information not available when this circular letter was prepared. Accordingly, the 2014-15 rates will be different from those shown above.

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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