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Actuarial

Circular Letter

April 26, 2018
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To: **School Employers**
Subject: **Actuarial Amortization Policy**

Purpose

The purpose of this Circular Letter is to inform you of changes to the CalPERS Actuarial Amortization Policy, effective with the June 30, 2019 Actuarial Valuation Report with contributions beginning fiscal year 2020-21.

Background

An amortization policy determines the systematic funding of a pension plan's Unfunded Accrued Liability (UAL). As part of the CalPERS Asset Liability Management Process, the actuarial office reviewed CalPERS' current policy and determined that changes were needed to address concerns of negative amortization, actuarial industry guidance, and intergenerational equity. The fiscal impact of the policy changes on annual employer contributions is expected to be minimal in the near term. The long-term impact will depend on future changes to unfunded liabilities resulting from, for example, investment gains or losses or changes to actuarial assumptions.

Current Policy

CalPERS' current policy amortizes different portions of the total UAL over different periods and has been in place since the June 30, 2013 annual actuarial valuation. Unfunded liability created through the June 30, 2018 actuarial valuation will continue to be amortized under the current policy.

The following table summarizes key features of the current policy.

Source of UAL

Driver	(Gain)/Loss Investment	(Gain)/Loss Non-investment	Assumption/ Method Change	Benefit Change	Golden Handshake
Amortization Period	30 Years	30 Years	20 Years	20 Years	5 Years
Escalation Rate*	Payroll (3%)	3%	3%	3%	3%
Ramp Up	5	5	5	0	0
Ramp Down	5	5	5	0	0

*Reducing to 2.875% for the 6/30/2018 valuation and 2.75% for the 6/30/2019 valuation.

Changes to Policy Effective as of June 30, 2019

CalPERS is making the following changes to the Amortization Policy, effective with the June 30, 2019 valuation and contributions beginning fiscal year 2020-21:

1. Reduced period over which actuarial gains and losses are amortized from 30 years to 20 years. This change applies only to new gains/losses established on or after June 30, 2019.
2. Level dollar amortization payments for all UAL bases throughout the amortization period. This change applies only to new UAL bases established on or after June 30, 2019.
3. Elimination of five-year ramp-up or ramp-down on UAL bases attributable to assumption changes and non-investment gains/losses established on or after June 30, 2019.
4. Elimination of five-year ramp-down on investment gains/losses established on or after June 30, 2019. The five-year ramp up from the current policy will continue.

New Amortization Policy Summary

The following table summarizes key features of the Policy for bases established on or after June 30, 2019 with contributions beginning fiscal year 2020-21.

Source

Driver	(Gain)/Loss Investment	(Gain)/Loss Non-investment	Assumption/ Method Change	Benefit Change	Golden Handshake
Amortization Period	20 Years	20 Years	20 Years	20 Years	5 Years
Escalation Rate	0%	0%	0%	0%	0%
Ramp Up	5	0	0	0	0
Ramp Down	0	0	0	0	0

The policy allows existing amortization bases to remain unchanged to minimize budgeting disruptions. The June 30, 2019 implementation date means that the first contribution year school employers will see any impact is fiscal year 2020-21. The amortization base established in the June 30, 2019 valuation when the discount rate is reduced from 7.25% to 7.00% will be amortized under the old policy (using a five-year ramp-up and ramp-down), because that assumption change was adopted by the board in December 2016 when the old policy was still in effect.

The exact first-year impact of the policy changes cannot be measured until the June 30, 2019 valuations are completed, but the impact is expected to be small. This is because the majority of the UAL payment will be from amortized bases established on or before June 30, 2018, which are not affected by the policy changes. Also, the largest source of gain or loss is typically due to investment experience. These bases will continue to use a five-year ramp up which will significantly reduce the first-year impact.

We believe that these changes will improve fund sustainability, benefit security, and intergenerational equity.

Amortization Policy Review and Outreach

The CalPERS team provided comprehensive review and outreach regarding the amortization policy, including the following activities:

- September 19, 2017 — The actuarial office presented policy change recommendations to the CalPERS Board of Administration’s Finance and Administration Committee.
- November 14, 2017— The actuarial office presented the first reading of the proposed policy changes to the Finance and Administration Committee.

- January 11, 2018 — The CalPERS team provided a webinar to CalPERS stakeholders regarding the need for policy changes and the possible impact of those changes.
- February 13, 2018 — The actuarial office presented the second reading of the proposed policy changes to the Finance and Administration Committee. The committee unanimously adopted the policy changes.
- February 14, 2018 — The CalPERS Board adopted the new Actuarial Amortization Policy including the recommendation to delay the effective date until the June 30, 2019 actuarial valuations.

All board materials are available on the CalPERS website at **www.calpers.ca.gov**. Board presentations and the amortization webinar can be viewed through the CalPERS Network YouTube channel at **www.youtube.com/calpersnetwork**.

If you have questions about the amortization policy, call CalPERS Customer Contact Center at **888 CalPERS** (or **888**-225-7377) and ask to have your actuary contact you.

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