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Date: February 27, 2004
Reference No.:
Circular Letter No.: 200-140-04
Distribution: I, VI, XII, XVI
Special:

Circular Letter

TO: PUBLIC AGENCIES, COUNTY SUPERINTENDENTS OF SCHOOLS AND INDIVIDUAL SCHOOL DISTRICTS

SUBJECT: IMPLEMENTATION OF RISK POOLS

The California Public Employees' Retirement System's (CalPERS) staff has been working toward implementing risk pools for the last few years. The implementation is fast approaching. CalPERS' staff has put together estimates of the costs associated with the risk pools. Attachment 1 contains estimates of the pools' normal costs, estimates of some of the surcharges for class 1 benefits and an example of how the phase out of the normal cost will be done.

Background Information

Risk pooling consists of pooling assets and liabilities across employers to produce large risk sharing pools that will dramatically reduce or eliminate the large fluctuations in the employer's contribution rate caused by unexpected demographic events.

In February 2002, the CalPERS' Board of Administration approved the conceptual details of pooling and sponsored legislation (Assembly Bill 1974) addressing the administration of risk pools and the mandated participation for smaller contracting agencies.

In October of 2002, Assembly Bill 1974 was chaptered, adding Sections 20840, 20841 and 20842 to the Government Code. These Sections give full authority to the CalPERS' Board to create risk pools for public agencies and mandate participation for all plans with less than 100 active members. Attachment 2 contains Government Code Sections 20840, 20841 and 20842.

In June of 2003, the CalPERS' Board gave the "go ahead" to add Article 7.5 to Title 2 of the California Code of Regulations to establish criteria for participation in risk pools, including mandated participation for rate plans with less than 100 active members.

CalPERS is continuing to work on the regulatory approval process and expects to have these regulations in place by June 30, 2004.

These regulations allow CalPERS to begin the process of creating risk pools that will be viable, fairly administered, will not take away any benefit flexibility from employers and will help reduce fluctuation in employer rates at CalPERS.

Summary of the Regulations

Attachment 3 contains a copy of the risk pooling regulations that were transmitted to the Office of Administrative Law. Here is a general overview of the regulations:

- Plans with less than 100 active members will be mandated in risk pools. Non-mandated plans will be allowed to join on a voluntary basis unless it would be harmful to the pool.

- Plans will be assigned to risk pools based on their service retirement formula. The following 9 risk pools will be created:
  1. Pool 1 - Miscellaneous 2% @ 60 pool
  2. Pool 2 - Miscellaneous 2% @ 55 pool
  3. Pool 3 - Miscellaneous 2.5% @ 55 pool
  4. Pool 4 - Miscellaneous 2.7% @ 55 pool
  5. Pool 5 - Miscellaneous 3% @ 60 pool
  6. Pool 6 - Safety 2% @ 55 pool (will also include plans with the ½ @ 55 safety formula)
  7. Pool 7 - Safety 2% @ 50 pool (will also include plans with the 2.5% @ 55 safety formula)
  8. Pool 8 - Safety 3% @ 55 pool
  9. Pool 9 - Safety 3% @ 50 pool

- School districts will be allowed to voluntarily leave the schools' pool and join a public agency risk pool if they amend for either the 2.5% @ 55, 2.7% @ 55 or the 3% @ 60 benefit formula. Cost information on the impact of voluntary participation will be available beginning November 2004.

- Employers that contract in the future for a higher service retirement formula for a member category will have these members transferred from their then current pool to the pool offering the new service retirement formula.

- Once a plan is in one of the risk pools, it will not be allowed to leave the risk pool structure and become a stand alone plan.

- All optional benefits will still be available to employers participating in risk pools. Each benefit will be assigned to one of three classifications based on the cost impact of the benefit. Attachment 4 contains the Board policy that establishes the criteria that will be used to assign each optional benefit to a classification. Attachment 5 contains the list of optional benefits and their anticipated classification. When new benefits become available as a result of legislation, the Chief Actuary will determine their classification in accordance with the criteria established in the Board policy.

- Optional benefits will be allowed to vary within the same pool but an employer contracting for a more expensive optional class 1 benefit will be required to pay a surcharge in addition to the pool's rate.

- A side fund will be established for each plan as it enters a pool. That side fund will take into account the level of assets and liabilities of the plan at the time of joining a risk pool. These side funds will be amortized over time and will add or subtract from that employer's contribution rate.

- Determination of the superfunded status for employers participating in risk pools will still be done on an employer basis rather than on a pool basis.

Implementation of Risk Pools

The implementation of risk pools will be done in a way that minimizes the impact on employer contribution rates. This will be accomplished through the amortization of the side fund and through a phase out of the differences between the pool's normal cost and the individual employer's plan's normal cost over a period of five years. The first year into risk pools, the employer contribution rates will be almost identical to what the rates would have been outside pools.

The yearly impact over the next 5 years of the 5-year phase-out of the difference in normal cost is estimated to be as follows:

Annual Change in Rate	% of Plans
More than +1%	0%
+0.5% to +1%	7%
-0.5% to +0.5%	81%
-1% to –0.5%	10%
More than –1%	2%

Attachment 1 contains <u>estimates</u> of each pool normal costs, estimates of some of the surcharges for class 1 benefits and an example of how the phase out of the normal cost will be done.

Government Code Section 20840(e) requires that each pool must contain certain benefits (see list below). CalPERS' actuaries estimate that the impact of mandating these benefits will be less than 1 percent of payroll. These mandated benefits will become effective on July 1, 2005.

The following benefits that were previously optional contract provisions will now be mandated for plans participating in risk pools:

- The pre-retirement optional settlement 2 death benefit – i.e., a death benefit payable to the spouse of an active member eligible to retire, equal to what the spouse would have received if the member retired, elected the 100 percent joint and survivor form of benefit and then died.
- The conversion of unused sick leave to retirement service credit.
- The ability for members to convert, at their own expense, prior military service and prior public service to CalPERS retirement service.
- The cancellation of any remaining payments owed by the member for the purchase of optional service credit upon the employment related disability of the member (i.e., upon industrial disability retirement or IDR as it is called). This benefit will only apply to local miscellaneous members if they are subject to Government Code Section 21151 (industrial disability retirement for local miscellaneous members)
- Local system service credit included in basic death benefit.

Mandated participation in risk pools will be based on the active membership of each rate plan as of June 30, 2003. These valuations will be prepared starting in summer of 2004 and are expected to be completed in October 2004. Benefit provisions as of June 30, 2004 (or thereafter) will be used to determine which pool a plan must enter. The June 30, 2003 valuations will be the first pooled valuations and the first pooled contribution rate will be effective on July 1, 2005. Demographic experience on or after July 1, 2003, will be considered part of the risk pools experience. Mandated benefits for employers participating in risk pools will be effective on the same date as the effective date of the first pooled contribution rates, July 1, 2005.

Even though pooling will help reduce fluctuation in employer contribution rates caused by unexpected demographic events, some employers have expressed concerns over participating in risk pools. As mentioned earlier, participation will be required for all rate plans with less than 100 active members. However, some employers currently have separate safety fire and safety police rate plans. Employers where the combined number of active fire and police safety members exceeds 100 members will be given the option of recombining their two rate plans into a single safety rate plan. If such an option is elected, participation in risk pools will not be mandated for those safety plans. However, these employers will be provided with a blended contribution rate instead of two separate contribution rates. Employers in this situation will be contacted in the near future with more information.

The list of plans participating in each of the pools will be available in summer of 2004 and will be included as part of the June 30, 2003 actuarial valuation report of each pool. These reports are expected to be mailed in October 2004.

School districts and public agencies with non-mandated rate plans will be able to contact CalPERS to begin the process to join the newly created risk pools beginning November 2004 following the completion of the June 30, 2003 valuations. Instructions on how to proceed will be forthcoming.

As established in the regulations, plans will be assigned to risk pools based on their service retirement formula. For some employers, assigning rate plans to pools based on benefit formula will result in the mandated split of their current rate plan into separate rate plans for each separate benefit formula. Currently, some employers receive a blended employer contribution rate for their fire and police members even thought the members are subject to different retirement formulas. Once pooling is implemented, the assets and liabilities of these rate plans will have to be split and put in two separate pools since the members are subject to different benefit formulas. As a result of the rate split, a separate employer contribution rate will be established in the future for each member category. All employers that will be affected by these rate plan splits will be contacted in the near future with more information.

Rate plans where members are also subject to different class 1 benefits, such as one year final compensation and post-retirement survivor allowance, will also be subject to a rate plan split. Once again, all employers that will be affected by these rate plan splits will be contacted in the near future with more information.

As indicated earlier, risk pooling consists of pooling assets and liabilities across employers. It is important to remember that this implies that all the assets of a pool, regardless of source, will be used to pay the benefits of all members participating in the pool.

As mentioned throughout this letter, various attachments are included with this letter. Here is a list of all five attachments and the topics they cover:

Attachment 1 - Estimates of Pools' Normal Cost and Surcharges for Class 1 Benefits

Attachment 2 - Government Code Sections 20840, 20841 & 20842
Attachment 3 - Risk Pooling Regulations
Attachment 4 - Board Policy Regarding Criteria to Establish the Classification of Optional Benefits Available in Risk Pools
Attachment 5 - Classification of Optional Benefits Available in Risk Pools

If you have any questions regarding the proposed regulations and the implementation of risk pools, please contact the Actuarial & Employer Services Division at
888 CalPERS (or **888**-225-7377) or visit the CalPERS' web site at:

www.calpers.ca.gov/employer/risk-pooling/

Ronald L. Seeling, Chief Actuary
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Attachments