Finance and Administration Committee

Agenda Item 7c

April 21, 2020

Item Name: State Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Adopt the employer and member contribution rates for the period July 1, 2020 to June 30, 2021 as set forth in the table on page 2 of this agenda item and in Attachments 4 and 5.

Executive Summary

The recommended employer contribution rates for some State plans for fiscal year 2020-21 are higher than the rates adopted for fiscal year 2019-20 while others are lower. The rate for each plan is equal to or less than what was estimated in the June 30, 2018 annual valuation report.

Comparison of Current and Prior Year Results (in millions)

Valuation Date	June 30, 2018	June 30, 2019
Market Value of Assets	$ 136,231	$ 143,466
Accrued Liability	$ 195,906	$ 204,836
Unfunded Accrued Liability	$ 59,675	$ 61,370
Funded Ratio	69.5%	70.0%
Expected Employer Contributions based on Actuarially Determined Contribution Rates[1]	$ 6,974	$ 7,348
Expected Employer Contributions Including Additional Contributions Pursuant to G.C. Section 20683.2[1]	$ 7,096	$ 7,475

Strategic Plan

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the Strategic Plan Goal of Fund Sustainability.

1 Expected employer contributions are calculated using the payroll as of the valuation date, incorporating two years of payroll growth at the assumption in effect on the valuation date (2.75%).

Background

The five plans included in this valuation provide retirement benefits to members employed by the State of California. This includes employees of the California State University system but generally does not include employees of the University of California system. It also does not cover school employees or employees of local governments that have elected to contract with CalPERS.

This actuarial valuation sets forth the employer and employee contribution rates for the State plans for fiscal year July 1, 2020 through June 30, 2021.

Analysis

State Employer Contribution Rates for 2020-21

The Actuarial Office has completed the calculation of the employer contribution rates for the State plans for fiscal year 2020-21. The full actuarial report is expected to be completed later this year and will be provided to the Board and posted online when complete. The additional information provided in the full actuarial report includes details on assumptions, methods, and participant data.

The table below compares the fiscal year 2020-21 actuarially required contribution rates and the dollar amounts these rates are anticipated to generate with the rates and contributions for the current fiscal year 2019-20.

Fiscal Year	**2019-20 Expected Employer Contribution (in millions)**	**2019-20 Employer Contribution Rate[2]**	**2020-21 Expected Employer Contribution (in millions)**	**2020-21 Employer Contribution Rate[2]**
State Miscellaneous	$ 4,007	30.977%	$ 4,279	31.43%
State Industrial	154	20.823%	162	21.04%
State Safety	526	21.526%	543	21.28%
State Peace Officers & Firefighters	1,755	47.198%	1,798	47.00%
California Highway Patrol	532	57.811%	566	58.84%
Total State	**$ 6,974**		**$ 7,348**	

Note that the payroll used to calculate the expected dollar contribution is the payroll used in the valuation incorporating two years of payroll growth using the annual payroll growth assumption of 2.75%. To the extent that actual payroll in the contribution year is different than projected, actual contribution amounts will be different than the expected contributions shown in the table above. Please refer to Attachment 1 for the development of the employer rate for each plan. State Miscellaneous includes both Tier 1 and Tier 2 benefit levels.

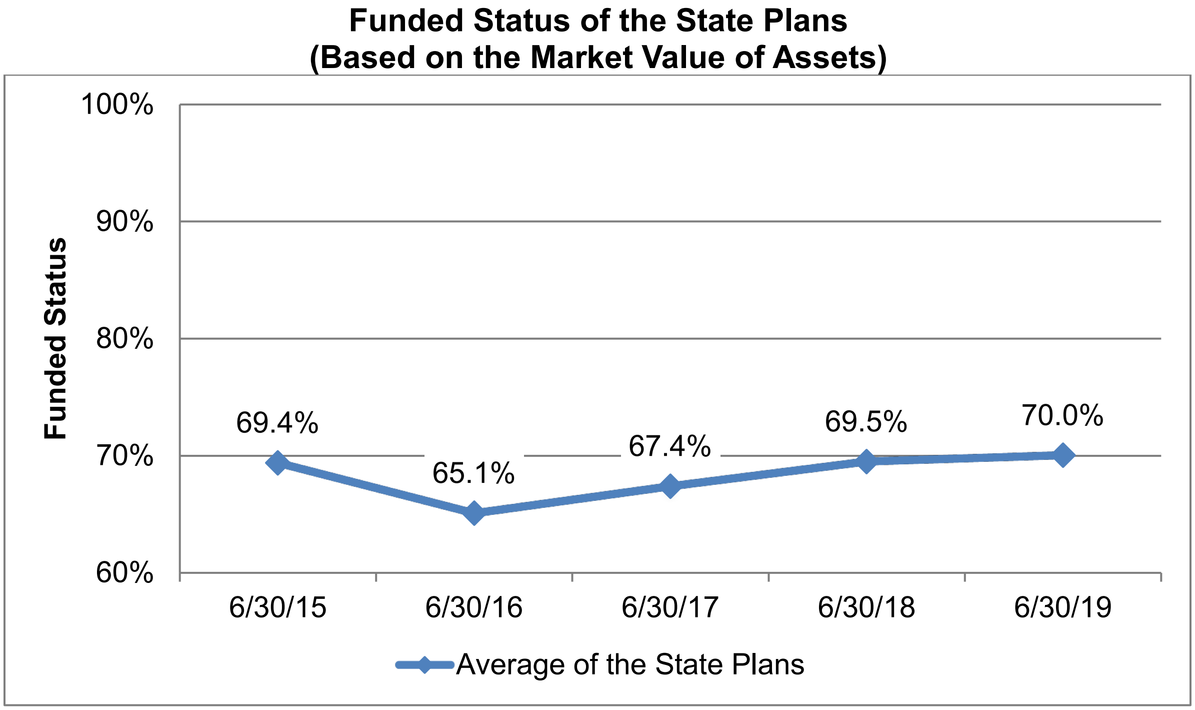
[2] Excludes additional contributions pursuant to Government Code Section 20683.2. See page 6 of the agenda item for more information about that requirement.

Funded Status

The funded status of a pension plan is defined as the ratio of assets to accrued liability. Plans with a lower funded ratio are, all other things equal, at greater risk of not being able to meet their future benefit obligations. From June 30, 2018 to June 30, 2019 the funded status of the State plans, in aggregate, increased by 0.5%.

Supplemental contributions to the State plans of $2.5 billion pursuant to Senate Bill 90 were made in July 2019, as explained below. As these contributions were made after the June 30, 2019 valuation date, they are not reflected in the funded status as of June 30, 2019.

The graph below shows the average funded status for the past five years for the State plans.



Attachment 2 shows the funded status of each plan on June 30, 2019 as well as the preceding four years.

Reasons for Changes in Employer Contributions for the State Plans

Overall, the required contributions for the State plans increased by $374 million from fiscal year 2019-20 to fiscal year 2020-21. This change is driven by the factors listed below.

Reason for Change	Change in Required Contribution (in millions)
Change due to normal progression of existing amortization bases	$391.3
Change due to increase in overall payroll	112.2
Decrease in normal cost due to new hires in lower benefit levels	(76.3)
Impact of change in member contribution rates	(0.7)
Decrease due to SB 90 additional contribution	(133.9)
First installment of the 20-year amortization of the following sources of experience gains and losses:	
• Investment experience (reflects five-year ramp)	18.7
• Greater than expected contributions received due to higher than expected payroll	(31.6)
• Demographic experience	94.3
Total change in required contributions	$374.0

On February 14, 2018, the Board adopted a new amortization policy effective with this actuarial valuation (first affecting State plan employer contributions for fiscal year 2020-21). The new policy generally accelerates the recognition of new sources of Unfunded Accrued Liability by amortizing experience gains/losses over 20 years instead of 30 years, determining payments as a level dollar amount instead of a level percentage of payroll, and eliminating the five-year ramps (phase-in and phase-out) for all amortization bases except the ramp-up for investment gains/losses. The new policy applies only to amortization bases established on or after June 30, 2019; it does not alter the payments for amortization bases already in existence upon implementation.

The amortization policy in effect prior to this valuation spread rate increases or decreases over a five-year ramp period and amortized all experience gains and losses over a fixed 30-year period using a level percentage of payroll method. As such, only one-fifth of the total anticipated rate change caused by each gain or loss was recognized in the first year, culminating in the full increase in the fifth year. Amortization bases established prior to June 30, 2019 will continue to be amortized according to this policy, and amortization payments on bases still in the ramp-up period will exhibit relatively large increases each year during the ramp-up period.

A complete description of the actuarial methods used in the June 30, 2019 valuation will be shown in the valuation report that is expected to be released later this year.

Overall, payroll across the State plans increased by 4.7%, compared with the payroll growth assumption of 2.75%. This led to an increase of $112.2 million in the required contribution. The payroll growth for the year ranges from a 2.9% increase for State Peace Officers & Firefighters to a 5.3% increase for State Miscellaneous.

The California Public Employees' Pension Reform Act of 2013 (PEPRA) requires lower benefits for new members as defined by PEPRA who are hired on or after January 1, 2013. The normal cost for all the plans is lower due to the enrollment of new hires into lower benefit levels. PEPRA membership ranges from a high of 42% of active members (38% by payroll) for State Safety to a low of 20% of active members (16% by payroll) for California Highway Patrol.

Senate Bill 90 (SB 90), approved by the Governor on June 27, 2019, directed the State to contribute additional funds to the State plans over multiple fiscal years to pay down the Unfunded Accrued Liability. The first payment to the State plans, totaling $2.5 billion, was received on July 29, 2019 and allocated among plans as follows:

Plan	Additional Contribution Made on July 29, 2019 Pursuant to SB 90
State Miscellaneous	$848,057,000
State Industrial	82,930,000
State Safety	184,427,000
State Peace Officers & Firefighters	1,384,586,000
California Highway Patrol	0
Total	**$2,500,000,000**

As directed by the Department of Finance, a portion of the contribution was treated as an advance payment toward the required contribution for fiscal year 2019-20 and the employer rate for the remainder of the fiscal year was reduced accordingly. The rest of the payment was treated as an additional paydown of Unfunded Accrued Liability. The additional payment served to reduce the required contribution for fiscal year 2020-21 by approximately $133.9 million. Note that while the additional payment is reflected in the calculation of the required contribution for fiscal year 2020-21, the fact that the payment was made after June 30, 2019 means it will not be recognized in the market value of assets or the funded status until the June 30, 2020 valuation.

Assembly Bill 118 (AB 118), approved by the Governor on October 13, 2019, altered the payments appropriated under SB 90 that are scheduled to be made in future fiscal years but did not affect the July 29, 2019 payments shown above.

The return on plan assets for the year ending June 30, 2019 was approximately 6.7% before reduction for administrative expenses. Since the net return for the year is lower than the assumed return of 7.0%, an investment experience loss, amortized over 20 years with a five-year ramp up, was added to the amortization schedule.

The employer contribution rates set by this valuation reflect statutory changes to member contribution rates effective July 1, 2020. See "Member Contribution Rates" below for more information. Notably, members in State Bargaining Unit 5 employed by the California Highway Patrol agreed to 50% of normal cost sharing effective July 1, 2020. The patrol member rate is anticipated to increase up to 1% each year until the member rate is half of the total normal cost. The first of these member rate increases, equaling 1%, is reflected in the California Highway Patrol employer rate for fiscal year 2020-21.

The plans in aggregate experienced a loss due to demographic sources and a gain due to actual contributions being greater than expected. The net effect was a non-investment experience loss that will be amortized over 20 years.

Additional Contribution Pursuant to Government Code Section 20683.2

One of the provisions of pension reform added Government Code Section 20683.2, which changed the contribution rates of many State members effective July 1, 2013, July 1, 2014, or July 1, 2015. Government Code Section 20683.2 also stipulates that “savings realized by the state employer as a result of the employee contribution rate increases required by this section shall be allocated to any unfunded liability, subject to appropriation in the annual Budget Act.” Under the California Constitution, the Board has plenary authority over the actuarial function at CalPERS consistent with the fiduciary duties of a trustee. This includes authority to set employer contribution rates. By statute, the State may pay additional contributions in addition to the actuarially required contribution rates set by the Board and CalPERS will generally accept these payments. The table below shows the:

- Actuarially required contributions (the rates that staff is recommending the Board set for the State plans),
- Additional contributions that the State is to make to offset the savings due to the increased member contributions, and
- Total contributions that the State is to make for each plan.

Plan	Actuarially Required Employer Contribution for 2020-21	Additional Statutory Contribution to Offset Increased Member Contributions	Total Contribution for 2020-21
State Miscellaneous	31.43%	0.10%	31.53%
State Industrial	21.04%	0.88%	21.92%
State Safety	21.28%	1.18%	22.46%
State Peace Officers & Firefighters	47.00%	1.65%	48.65%
California Highway Patrol	58.84%	1.32%	60.16%

In all cases, the savings are less than the actual increase in member contributions. This is because the additional member contributions increase the value of the benefit in some circumstances. One example is when a member terminates and takes a refund. Another example is Tier 2 members, who are assumed to elect to receive a Tier 1 benefit with an actuarial equivalent reduction to offset the missed Tier 1 contributions. Because the members will make additional contributions, a smaller reduction will apply in the future.

Please refer to Attachment 1 for the dollar contributions that the additional statutory contribution rates are expected to generate.

Member Contribution Rates

PEPRA members are required to contribute at least 50% of the total annual normal cost of their pension benefit. As per Government Code Section 7522.30, State employees are excluded from this requirement except for employees of the Legislature, California State University (CSU), and the judicial branch. A provision of PEPRA states that when the total normal cost changes by more than 1% of payroll the member contribution rate must be adjusted to ensure the member pays half the normal cost.

For fiscal year 2020-21, the total normal cost rates for PEPRA members in the State Miscellaneous and State Peace Officers & Firefighters plans changed by less than 1% of payroll from the base total normal cost rates. As a result, the member contribution rates for these PEPRA members will not change in fiscal year 2020-21. Note, as there are currently no PEPRA members of State Industrial, State Safety, or the California Highway Patrol who pay 50% of normal cost, these calculations are not required for those plans.

Please refer to Attachment 3 for a summary of total normal cost by plan by benefit formula and Attachment 4 for details of the member contribution rates for certain PEPRA members.

Members represented by State Bargaining Units 5, 9, 10, and 16 are required to contribute 50% of the total annual normal cost of their pension benefit. While the overall concept is analogous to PEPRA normal cost sharing, the specific rules governing the change in member rates differ by Bargaining Unit. Following are the changes effective for fiscal year 2020-21:

- Bargaining Unit 5 member rates
  - Miscellaneous: rate will be increased from 8.00% to 8.25%
  - Patrol: rate will be increased from 11.50% to 12.50%
- Bargaining Unit 9 member rates
  - Miscellaneous: rate will be decreased from 8.50% to 8.00%
  - Safety: rate will be decreased from 11.50% to 11.00%

The member rate decreases for Bargaining Unit 9 are due to the expiration of the 50% of normal cost sharing provisions effective June 30, 2020. All other member rates in Bargaining Units 5, 9, 10, and 16 will remain unchanged. Please refer to Attachment 5 for details of the member contribution rates for these Bargaining Units.

In addition to the changes based on 50% of normal cost sharing summarized above, the negotiated member rate for State Safety members in Bargaining Unit 2 will increase by 0.5%, from 11.0% to 11.5%, effective July 1, 2020.

Expected Future Changes

The following table shows projected employer contribution rates. Projected rates assume all actuarial assumptions will be realized, including investment return of 7% in fiscal year 2019-20, and that no changes to assumptions, methods, or benefits will occur during the projection period. The projections reflect the supplemental payments pursuant to SB 90 received in July 2019. The projected rates further reflect known member rate changes in the future and the estimated decrease in normal cost due to new hires entering lower benefit formulas under PEPRA, but do not include the additional contributions pursuant to Government Code Section 20683.2 shown on page 6 of this agenda item.

		Projected Employer Contribution Rates				
Plan	**2020-21**	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26**
State Miscellaneous	31.43%	32.0%	32.3%	32.7%	31.8%	31.6%
State Industrial	21.04%	21.4%	21.5%	21.5%	19.8%	19.5%
State Safety	21.28%	21.4%	21.4%	20.8%	20.5%	20.3%
State Peace Officers & Firefighters	47.00%	47.7%	48.1%	48.8%	47.4%	47.2%
California Highway Patrol	58.84%	59.0%	58.5%	59.1%	58.1%	58.1%

A more comprehensive projection will be included in the actuarial valuation report that will include the estimated impact of the actual investment return in fiscal year 2019-20. As of the preparation date of this agenda item, the year to date return for the 2019-20 fiscal year is well below the 7% assumed return. Actual contribution rates during this projection period could be significantly higher than the projections shown above. An updated projection will be included in the actuarial valuation report that will include the impact of the actual investment return in fiscal year 2019-20. This report will be available later this year.

Budget and Fiscal Impacts

Not applicable.

Benefits and Risks

Information about the risks associated with the funding of these plans will be included in the valuation report that is expected to be released later this year. This information includes investment return scenarios, discount rate sensitivity, and volatility ratios.

Attachments

Attachment 1 – Employer Contribution Rates

Attachment 2 – Liabilities and Funded Status

Attachment 3 – Normal Cost Chart

Attachment 4 – PEPRA Member Contribution Rates

Attachment 5 – Member Contribution Rates for State Bargaining Units 5, 9, 10, and 16

Attachment 6 – PowerPoint Presentation

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