



Finance and Administration Committee

Agenda Item 5e

April 15, 2024

Item Name: State Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Adopt the actuarially determined employer contribution rates and approve the member contribution rates for the period July 1, 2024 to June 30, 2025 as set forth in the table on page 3 of this agenda item.

Executive Summary

The recommended employer contribution rates for the State plans for fiscal year (FY) 2024-25 are higher than the rates adopted for FY 2023-24. This increase in employer contribution rates is primarily due to the non-investment loss for FY 2022-23 and the progression of existing amortization bases.

Contribution rates for all plans are within 0.50% of the projected rates from the June 30, 2022 valuation report, except for CHP. The increase in the CHP rate over the prior year is mainly due to non-investment losses related to salary and cost-of-living increases.

Comparison of Current and Prior Year Results (in millions)

Funded Status	June 30, 2022	June 30, 2023
Accrued Liability	\$238,203	\$248,129
Market Value of Assets	\$167,420	\$178,647
Unfunded Accrued Liability	\$70,783	\$69,483
Funded Ratio	70.3%	72.0%
Expected Employer Contributions based on Actuarially Determined Contribution Rates	\$8,058 ¹	\$8,616 ²
Expected Employer Contributions based on Anticipated Budget Act	\$8,471 ³	\$8,754 ⁴

¹ Reflects impact of Proposition 2 Supplemental Pension Payment made in July 2022 and CHP supplemental payments from August 2020 to August 2022.

² Reflects impact of CHP supplemental payments from August 2020 to April 2023.

³ Reflects additional contributions under G.C. section 20683.2, the Bargaining Unit 5 agreement, and the State's contribution stabilization strategy.

⁴ Reflects additional contributions under G.C. section 20683.2.

Strategic Plan

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the Pension Sustainability goal of the Strategic Plan: Strengthen the long-term sustainability of the pension fund.

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, 2024 through June 30, 2025.

Investment Return and Discount Rate

Based on final June 30, 2023 assets, the money-weighted investment return for FY 2022-23 was 6.1% compared to an expected return of 6.80%.

Assumption Changes

There are no changes in assumptions in the June 30, 2023 valuation.

Analysis

Actuarially Determined State Employer Contribution Rates for FY 2023-24

The Actuarial Office is recommending that the board adopt the following actuarially determined employer contribution rates for the State plans for FY 2024-25. The contribution rates we anticipate will be included in the Budget Act are shown on page 7. The full actuarial report is expected to be completed later this year and will be provided online when completed. The additional information provided in the full actuarial report includes details on assumptions, valuation methods and participant census.

The table below compares the FY 2024-25 actuarially determined contribution rates and the associated estimated dollar amounts with rates and dollar amounts for FY 2023-24.

Fiscal Year	2023-24 Expected Employer Contribution (in millions)	2023-24 Employer Contribution Rate ²	2024-25 Expected Employer Contribution (in millions)	2024-25 Employer Contribution Rate ²
Valuation Date	June 30, 2022		June 30, 2023	
State Miscellaneous ¹	\$4,750	30.87%	\$5,123	31.39%
State Industrial	165	19.54%	178	20.18%
State Safety	537	21.54%	565	22.03%
State Peace Officers & Firefighters	1,952	46.26%	2,064	48.09%
California Highway Patrol	<u>654</u>	67.69%	<u>686</u>	69.89%
Total State	\$8,058		\$8,616	

¹ Includes both Tier 1 and Tier 2 benefit levels.

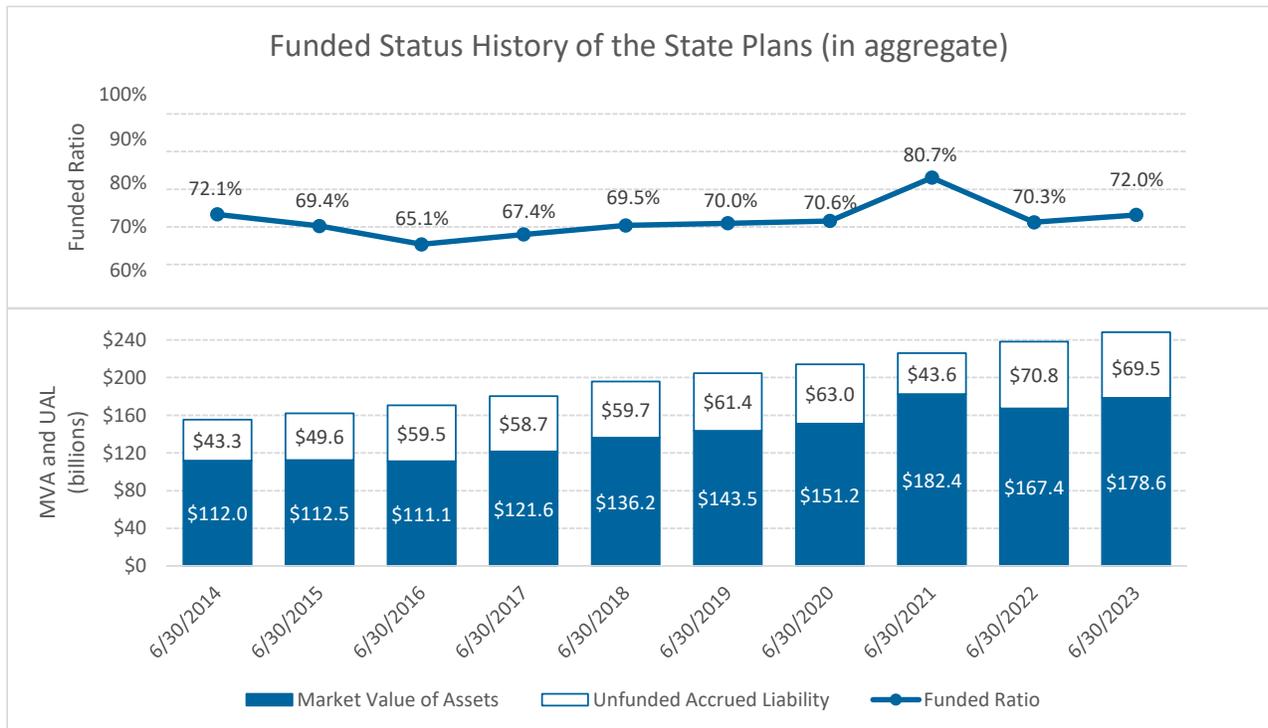
² Excludes additional contributions above the actuarially determined contribution rates. See page 7 of the agenda item for more information.

Please note that the payroll used to calculate the expected dollar contribution is the payroll used in the valuation, increased for two years of payroll growth at the prevailing payroll growth assumption of 2.80%. To the extent that actual payroll in the contribution year differs than expected, actual contribution amounts will be different than those provided above.

Please refer to Attachment 1 for the development of the employer rate for each state plan.

Funded Ratio

The funded ratio of a pension plan is defined as the ratio of market value of assets to actuarial accrued liability. Plans with a lower funded ratio are, all else equal, more costly and at higher risk of not being able to meet future benefit obligations. From June 30, 2022 to June 30, 2023 the funded ratio of the State plans, in aggregate, increased by 1.70% to 72.0% (70.3% as of June 30, 2022). The increase in funded ratio was primarily driven by the supplemental pension payment of \$2.925 billion on July 27, 2022 and offset by slightly lower than expected investment returns in FY 2022-23. The chart below shows the funded ratio of the State plans in the aggregate for the past ten years.



Please refer to Attachment 2 for the funded ratio history of each plan as of June 30, 2023.

Reasons for Changes in Employer Contributions for the State Plans

Overall, the actuarially determined contributions for the State plans increased by \$558.3 million from \$8,057.6 million in FY 2023-24 to \$8,615.9 million in FY 2024-25. This change is primarily driven by the factors listed below.

Reason for Change	Change in Required Contribution (in millions)
Required employer contribution in FY 2023-24	\$8,057.6
Change due to progression of existing amortization bases	404.8
Effect due to change in overall payroll	124.0
Decrease in Normal Cost due to new demographics	(38.6)
Decrease due to change member contributions rates	(5.2)
Decrease due to Budget Act Additional Contributions	(57.6)
Changes due to experience:	
• Investment experience (reflects five-year ramp)	28.9
• Demographic experience	103.9
Decrease due to Supplemental Payments made after January 1, 2023	<u>(2.0)</u>
Total change in required contributions	\$558.3
Required employer contribution in FY 2024-25	\$8,615.9

During FY 2022-23, payroll across the State plans increased by 4.7%, compared to the payroll growth assumption of 2.80%, resulting in an expected increase of \$124.0 million in the required contribution for FY 2024-25. The change in payroll for the year ranges from an increase of 1.7% in State Peace Officers and Firefighters to an increase of 6.1% in 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 five of the state plans has decreased due to the enrollment of new hires into lower benefit levels. PEPRA membership ranges from a high of 56% of active members (51% of payroll) for State Safety to a low of 34% of active members (30% of payroll) for California Highway Patrol.

The money-weighted return on plan assets for the year ending June 30, 2023 was approximately 6.1%.

The employer contribution rates set forth by this valuation reflect statutory changes to member contribution rates effective July 1, 2024, to the extent they are known at this time. Please refer to "Member Contribution Rates" below for more information.

Supplemental Pension Payments Pursuant to Proposition 2

In 2014, California voters passed Proposition 2, which amended the State Constitution to require certain funds be appropriated to repay specific State debts, including unfunded liabilities for state-level pension plans. The July 27, 2023 Supplemental Pension Payments (SPP) shown below were the third payments made to these rate plans under Proposition 2.

Plan	Supplemental Pension Payments Made on July 27, 2023 Pursuant to Proposition 2 (thousands)
State Miscellaneous	\$769,620
State Industrial	44,500
State Safety	99,924
State Peace Officers & Firefighters	742,956
Total	\$1,657,000

Supplemental Pension Payments Pursuant to Bargaining Unit 5 Agreement

Under the 2019 agreement between the State and the California Association of Highway Patrolmen, the following SPPs have been made.

California Highway Patrol Plan	Supplemental Pension Payments
August 18, 2020	\$25,000,000
August 31, 2020	243,000,000
August 16, 2021	25,000,000
April 28, 2022	25,000,000
April 21, 2023	25,000,000
Total	\$343,000,000

Required State Contributions in Excess of the Actuarially Determined Contributions

Every year since FY 2013-14, the State employer contribution rates in the annual Budget Act have exceeded the actuarially determined contribution rates adopted by the board. Although the additional amounts arose at different times and through different processes, there is a common goal, which is to reduce the State's unfunded liability and create long-term savings.

Additional Contributions under Government Code Section 20683.2

Effective July 1, 2013 and July 1, 2014, the contribution rates of many State members were increased. The collective bargaining agreements and Section 20683.2 require that savings realized by the State due to these member rate increases be allocated to any unfunded liability. In order to facilitate this, the Actuarial Office calculates an additional rate to be added to the actuarially determined rate, which is then incorporated into the Budget Act. As in prior years, the additional employer contribution rates for FY 2024-25 remain unchanged as shown in the table below.

Rate Plan	Additional Employer Contribution Rates Pursuant to Section 20683.2
State Miscellaneous	0.10%
State Industrial	0.88%
State Safety	1.18%
State Peace Officers & Firefighters	1.65%
California Highway Patrol	1.32%

Budgeted State Employer Contribution Rates for FY 2024-25

The table below shows the actuarially determined contribution rates along with adjustments needed to determine the budgeted contribution rates, which should be appropriated in the annual Budget Act.

Plan	Actuarially Determined Employer Contribution for 2024-25	Additional Employer Contribution Rates Pursuant to Section 20683.2	Total Employer Contribution Rates for 2024-25
State Miscellaneous	31.39%	0.10%	31.49%
State Industrial	20.18%	0.88%	21.06%
State Safety	22.03%	1.18%	23.21%
State Peace Officers & Firefighters	48.09%	1.65%	49.74%
California Highway Patrol	69.89%	1.32%	71.21%

Member Contribution Rates

PEPRA members employed by the Legislature, California State University (CSU), and the judicial branch are required to contribute at least 50% of the total normal cost of the defined benefit, in accordance with Government Code Section 7522.30. All such members in the State rate plans are in the State Miscellaneous, State Safety or State Peace Officers and Firefighters rate plans. Under this statute, when the total normal cost for the rate plan changes by more than 1% of payroll the member contribution rate must be adjusted and set equal to 50% of the total normal cost rounded to the nearest one quarter of one percent.

For FY 2024-25, the total normal cost rates for PEPRA members in State Miscellaneous, State Safety or State Peace Officers and 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 FY 2024-25.

Please refer to Attachment 3 for a summary of total normal cost by plan by benefit formula and Attachment 5 for details of the member contribution rates for certain PEPRA members.

Attachment 4 contains the member contributions rates for all State members by Bargaining Unit.

Members represented by State Bargaining Units 2, 5 and 18 are required to contribute 50% of the total annual normal cost of their pension benefit. While the overall concept is analogous to normal cost sharing above, the specific rules governing the change in member rates differ by Bargaining Unit. Please refer to Attachment 6 for details of the member contribution rates for these Bargaining Units.

Projected Contribution Rates

The following table illustrates projected actuarially determined employer contribution rates for the next five fiscal years. Projected rates assume all actuarial assumptions will be realized, including the investment return of 6.80% from June 30, 2024 and thereafter, and no changes to assumptions, methods, or benefits will occur during the projection period. Projected rates further reflect member rate changes known to date and the estimated decrease in normal cost due to new hires entering lower cost benefit formulas.

Rates do not include the additional contributions pursuant to G.C. Section 20683.2.

Plan	Actuarially Determined Employer Contribution Rates (% of payroll)					
	Actual	Projected				
	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
State Miscellaneous	31.39%	32.3%	32.9%	34.8%	34.7%	34.6%
State Industrial	20.18%	20.9%	21.4%	23.1%	23.0%	22.8%
State Safety	22.03%	22.8%	23.3%	25.0%	24.9%	24.7%
Peace Officers & Firefighters	48.09%	49.5%	50.4%	53.4%	53.1%	52.6%
California Highway Patrol	69.89%	69.9%	67.5%	70.8%	70.2%	71.9%

Actual investment return for FY 2023-24 was not known at the time this agenda item was prepared. Projections above assume the investment return for fiscal year beginning FY 2023-24 would be 6.80%. ***If the actual investment returns for FY 2023-24 differ from 6.80%, actual contribution requirements for the projected years will differ from the rates shown above.***

An updated projection that will incorporate the impact of the preliminary investment return for FY 2023-24 will be prepared following the announcement of the return. This projection will be available in August.

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 – Accrued and Unfunded Liabilities and Funded Ratio

Attachment 3 – Normal Cost Chart

Attachment 4 – State Member Contribution Rates by Bargaining Unit

Attachment 5 – PEPRA Member Contribution Rates

Attachment 6 – Member Contribution Rates for State Bargaining Units 2, 5 and 18

Attachment 7 – PowerPoint Presentation

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