CalPERS

Finance and Administration Committee

Agenda Item 5b

September 16, 2025

Item Name: Proposed Regulation Changes, Article 7.6. Participation in Risk Pools

Program: Actuarial Office

Item Type: Action

Recommendation

Approve recommendation to amend sections 588, 588.1, 588.2, 588.3, 588.4, 588.6, 588.7 and 588.8 and repeal sections 588.5, 588.9 and 588.10 of Article 7.6 of Subchapter 1 of Chapter 2 of Division 1 of Title 2 of the California Code of Regulations to clarify the California Public Employees' Retirement System's (CalPERS) operational procedures for maintaining risk pools and to refine criteria for rate plans to enter and cease participation in a risk pool, followed by submission of the final rulemaking package to the Office of Administrative Law (OAL) upon conclusion of the 45-day public comment period if no public comments are received.

Executive Summary

In accordance with the Public Employees' Retirement Law (PERL), CalPERS established risk pools in 2004. The purpose of risk pools is to spread risk among smaller contracting agencies. It allows CalPERS actuaries to first calculate the total actuarial results for the entire risk pool and then allocate unexpected experience evenly across the contracting agencies participating in the pool. Risk pooling has succeeded in mitigating demographic risk for smaller contracting agencies and reducing the likelihood of large changes in required contributions for smaller contracting agencies. Article 7.6 of the Employees' Retirement System Regulations currently contains regulations pertaining to the operation of the contracting agency risk pools administered by CalPERS. Proposed amendments are being introduced for these regulations to clarify operational procedures and modify criteria for plans to enter or cease participation in a risk pool.

Strategic Plan

The proposed regulatory amendments support the 2022-27 CalPERS Strategic Plan goal to strengthen the long-term sustainability of the pension fund.

Background

Before the introduction of risk pooling, contributions for contracting agencies were determined solely by the experience of their own members within their rate plans. This often resulted in significant fluctuations in contributions for smaller agencies. To address this, risk pooling was introduced to stabilize contributions and spread risk across multiple agencies. Currently, approximately 81% of CalPERS contracting agencies participate in risk pools, and pooled plans have an average active member count of approximately 34.

In 2009, the original risk pool regulations were updated. No further amendments have been made to the regulations.

Since then, procedural changes have occurred, necessitating conforming amendments to the current regulations. For example, procedural changes have occurred with respect to side funds.

Side funds were originally created to account for differences in the funded status between individual plans and the risk pool they joined. They were particularly useful when all contracting agencies contributed to the pool's Unfunded Accrued Liability as a percentage of payroll. However, since the consolidation of risk pools, no new side funds have been established. For some contracting agencies, existing side funds have not yet been fully amortized and are still reflected in their amortization schedules.

The California Public Employees' Pension Reform Act (PEPRA) of 2013 introduced one new service retirement formula for Miscellaneous members and three for Safety members. In 2014, CalPERS combined separate risk pools into two consolidated pools: the Miscellaneous Risk Pool and the Safety Risk Pool. This change aggregated shrinking classic benefit pools with their associated PEPRA pools preserving the ability to adequately distribute actuarial risk. These combinations were formalized by the CalPERS Board of Administration through resolution number 03-03-AESD.

This legislative change and subsequent process change have made some of the language and terms in the current regulations outdated, such as reference to a plan's superfunded status.

Superfunded is a term to describe when a plan's assets exceed the present value of benefits. Current regulations require the actuary to annually determine whether a pooled plan is superfunded. However, this practice is now outdated due to PEPRA.

In addition to the aforementioned and other minor changes related to risk pooling operational processes, the rules governing risk pool participation also present challenges.

Under current regulations, a non-pooled plan is required to join a risk pool if its active member count is less than 100 on any valuation date. Once a plan enters a pool, there is no provision for CalPERS to cease its participation in the pool and reinstate it as a non-pooled plan, even if its active member count later far exceeds 100. Some plans within risk pools have active member counts that have grown to several hundred. This is problematic because risk pools were not originally designed to accommodate plans of this size, which can affect the overall performance and outcomes of the pool.

The proposed regulatory amendments introduce new thresholds and criteria for determining risk pool participation based on the count of active members in a plan on a valuation date:

- Plans with active member counts of less than 100 will continue to be required to participate in a risk pool.
- Non-pooled plans with active member counts of 100 to 149 will have the option to enter a risk pool and may not cease participation in the pool unless their active member count is more than the threshold for mandatory removal, while pooled plans in this range must remain in the pool.

Both mandatory and optional participation will be subject to the actuary's determination that a contracting agency's participation in a risk pool will not be unfavorable to other agencies in the pool.

- Pooled plans with active member counts of 150 to 199 will have the option to cease participation in the pool, subject to the approval of the actuary, and may not return to a risk pool unless their active member count is less than the threshold for mandatory pooling, while non-pooled plans in this range must remain outside the pool.
- Plans with active member counts of 200 or more will be removed from the pool and re-instated as non-pooled plans.

Analysis

The previous changes made to the risk pool processes, which involved combining 12 risk pools into two and streamlining the actuarial reports into fewer documents, did not fundamentally change the impacts of pooling for CalPERS contracting agencies. However, these process changes have rendered some of the language of the existing regulations outdated. The proposed regulatory amendments address these process changes and will update the language to reflect current risk pool processes. Leaving the text of the existing regulations as-is could lead to unnecessary confusion for stakeholders.

Pooled plans with active member counts in the several hundred can create cross-subsidies between agencies that exceed desirable levels. While such actuarial experience could balance out in the long run, the preferred path is to remove such large plans from the risk pools given that their size makes risk sharing unnecessary. Plans required to cease participation in a risk pool may experience an increase or decrease in future contribution requirements. However, their future contribution requirements will be based on the actuarial experience of members within that plan. Additionally, plans of this size do not benefit from sharing actuarial gains and losses to the same extent as smaller plans, since their membership size is sufficient to spread risk internally. To address this, the proposed regulatory amendments would require plans with an active member count of 200 or more to cease participation in a risk pool.

Agencies periodically inquire about the ability to leave a risk pool for a variety of reasons. The proposed regulatory amendments would allow pooled plans with an active member count of 150 or more to cease participation in a risk pool. Subsequent to voluntarily ceasing participation in a risk pool, such plans will not be able to rejoin the risk pool unless the active member counts fall below 100. This is not expected to involve a significant number of risk pool plans, as most pooled plans maintain an active member count below 150.

The 200 or more active member threshold for mandatory removal from a risk pool was carefully determined. A rule based on a single count of active members, below which a plan must be pooled and above which a plan must be non-pooled, was deemed overly prescriptive and impractical. Having no buffer zone between mandatory pooling and mandatory removal would result in a large number of plans transitioning in and out of pools each year with some plans repeatedly shifting between pooled and non-pooled status. This level and frequency of movement would create unnecessary complexity for CalPERS and the impacted agencies, making the system less efficient and harder to manage.

To address these concerns, the 200 or more active member threshold was set high enough to ensure stability for plans transitioning into or out of the pool. The intent was to minimize frequent changes, allowing plans entering the pool to remain there for several years, if not permanently, and similarly ensuring that plans required to cease participation in the pool would not need to rejoin shortly thereafter. Historical data supports this approach, indicating that the proposed threshold is unlikely to result in more than two plans being required to cease participation in the pool in a single year, which is comparable to the number of terminated plans removed from risk pools annually.

Additionally, the analysis suggests that it is unlikely for a plan with active member counts of less than 100 to enter the pool, and later grow to or exceed 200 active members, let alone do so within a few short years. Similarly, there is no precedent for a plan growing to or exceeding 200 active members and later falling below a count of 100, which would necessitate rejoining the pool. The lack of such precedent suggests that the thresholds would result in stability for CalPERS and contracting agencies.

The thresholds were also carefully structured to avoid overlap, ensuring that two plans of identical size would not simultaneously be entering and ceasing participation in the pool, or that one plan could be entering when a slightly smaller plan was ceasing participation. Under the proposed framework, only smaller plans can enter the pool, while only larger plans can leave. This design prevents conflicting movements and maintains consistency in the administration of risk pools.

Finally, the data reveals that approximately one-third of contracting agency non-pooled plans have an active member count of less than 200. The plans required to cease participation in the pool under the proposed thresholds are larger than at least one-third of non-pooled plans, ensuring that the transition aligns with the size and demographic risk profile of these plans. This deliberate approach balances stability, simplicity, and fairness in the administration of risk pools.

The mandated removal would impact approximately 14 agencies, affecting only miscellaneous plans based on preliminary 2025 data. The implementation would not take effect until the June 30, 2026, valuation date. Contribution requirements would remain unaffected until the 2028-29 fiscal year, and financial reporting changes would not occur until the June 30, 2027, measurement date.

Budget and Fiscal Impacts

There are no budget or fiscal impact to CalPERS.

Benefits and Risks

The proposed amendments to sections 588, 588.1, 588.2, 588.3, 588.4, 588.6, 588.7 and 588.8 and repeal of sections 588.5, 588.9 and 588.10 of Article 7.6 of Subchapter 1 of Chapter 2 of Division 1 of Title 2 of the California Code of Regulations aim to update and clarify CalPERS procedures for managing risk pools. These changes explicitly define thresholds and criteria for plans to join or cease participation in a risk pool, align regulations with current practices and reduce potential confusion. The new criteria for exiting a risk pool are expected to better support the goals of risk pooling and offer agencies a more appealing option.

Not amending the risk pooling regulations could compromise the fairness, stability, and sustainability of the risk pool, while also limiting CalPERS' ability to effectively manage the program in alignment with its intended goals. Not amending existing regulations has the potential for several risks, including inequitable risk distribution, excessive cost subsidies and misalignment with risk pooling goals.

Attachments

Attachment 1 – Text of Proposed Regulations

Attachment 2 – Proposed Regulation Changes, Participation in Risk Pools PowerPoint Presentation

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