NCCIPMA-HR

BARTEL ASSOCIATES, LLC

CalPERS Issues

John E. Bartel
President

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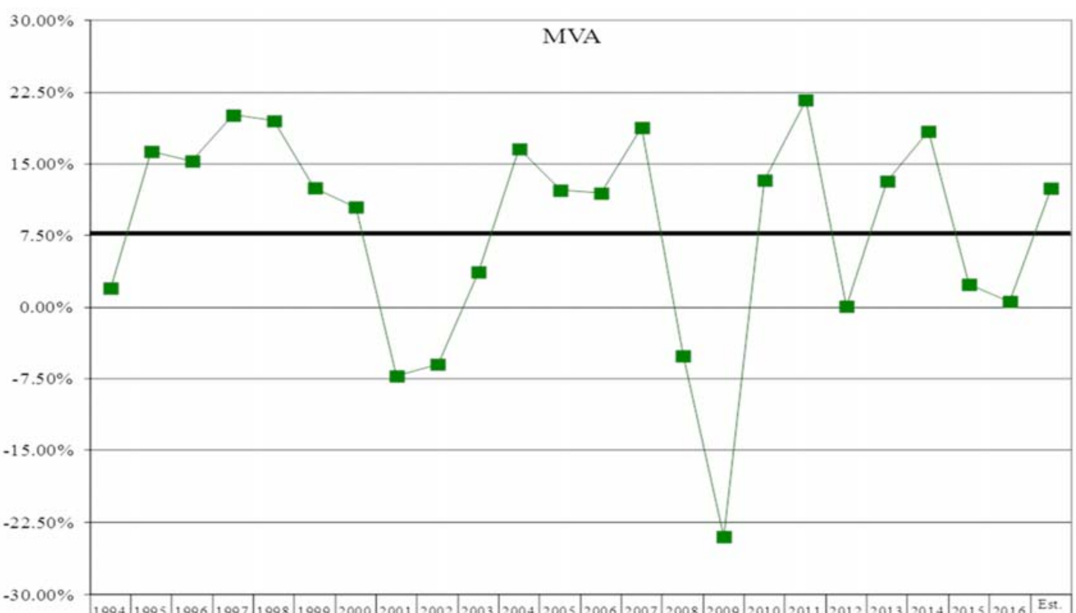
- Paying Down Unfunded Liability and Rate Stabilization 19

How Did We Get Here?

- Investment Losses
- Enhanced Benefits
- CalPERS Contribution Policy
- Demographics

Historical Investment Returns



	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Est. 2017
MVA	2.0%	16.3%	15.3%	20.1%	19.5%	12.5%	10.5%	-7.2%	-6.0%	3.7%	16.6%	12.3%	11.9%	18.8%	-5.1%	-24.0	13.3%	21.7%	0.1%	13.2%	18.4%	2.4%	0.6%	12.5%

Enhanced Benefits

- At CalPERS, enhanced benefits implemented using all (future & prior) service
- Typically not negotiated with cost sharing

CalPERS Old Policy

- Effective with 2003 valuations:
  - Slow (15 year) recognition of investment losses into funded status
  - Rolling 30 year amortization of all (primarily investment) losses
- Designed to:
  - First smooth rates
  - Second pay off UAL and
- Mitigated contribution volatility

Demographics

- Around the State
  - Large retiree liability compared to actives
  - Declining active population
- Common to have 60%-75% of liability for retirees

Recent CalPERS Changes

- Contribution Policy
- Assumptions
- Risk Mitigation Strategy
- Discount Rate
- Other

Contribution Policy Changes

- No asset smoothing
- 5-year ramp up
- All amortization bases have fixed amortization periods
  - No rolling amortization

Contribution Policy Changes

- June 30, 2013 Valuation (15/16 rates)
- Designed to:
  - First pay off UAL and
  - Second smooth rates
- Uses MVA so only one funded status/ratio
- If assumptions are met then:
  - Contributions go up in the short run but then come down
  - UAL will be paid off

Assumption Changes

- June 30, 2014 Valuation, 2016/17 rates
- No changes to economic assumptions
- Anticipate future mortality improvement
- Other, modest, changes to assumptions

Risk Mitigation Strategy

- Move to more conservative investments over time
  - Only when investment return is better than expected
- Lower discount rate in concert with investment allocation changes
- Essentially use ≈50% of investment gains to pay for cost increases
- Likely reduces discount rate 100 basis points over ≈20 years

Timing

	Valuation	First Impact	Full Impact
■ Contribution Policy	6/30/13	2015/16	2019/20
■ Assumptions	6/30/14	2016/17	2020/21
■ Risk Mitigation	Because based on investment gains timing is uncertain		

Ultimate Cost Increase

	Misc.	Safety
Next 15 Years		
■ Contribution Policy	≈ 7%	≈ 9%
■ Assumptions	≈ 4%	≈ 7%
■ Total	≈11%	≈16%
Next 25+ Years		
■ Risk Mitigation	≈ 8%	≈12%

Discount Rate

- Combination of

Expected Inflation	2.75%
Real Rate of Return (above inflation)	4.75
Margin for Adverse Deviation	0.00
Total	7.50%

- Based on:
  - 2010 Capital Market Assumption study (updated in 2014)
  - 2010 Asset Allocation

Discount Rate

- CalPERS Board was told at the end of last year:
  - 2017 Capital Market Assumption Study real rate of return will likely be 50 basis points lower
  - Delivered by:
    - Outside investment advisors
    - CFO
    - CIO
    - Actuarial staff
- Based on above, Board reached a compromise deal lowering the discount rate

Discount Rate

- Decrease discount rate from 7½% to 7% over next 3 valuations, for public agencies:

	Rate	Initial	Full
6/30/16 val.	7.375%	18/19	22/23
6/30/17 val.	7.25%	19/20	23/24
6/30/18 val.	7.00%	20/21	24/25

  - Risk mitigation suspended until after 6/30/18

Discount Rate

	Misc.	Safety
Normal Cost	2.0%	3.5%
UAL	5.5	9.5
Total	7.5%	13.0%
Standard Deviation	1%	2%

Ultimate Cost Increase

	Misc.	Safety
Next 10-15 Years		
■ Contribution Policy	≈ 7%	≈ 9%
■ Assumptions	≈ 4%	≈ 7%
■ Subtotal	≈11%	≈16%
■ Discount Rate	≈ 8%	≈13%
■ Total	≈19%	≈29%

Other Changes

- Collect payment on UAL as dollar amount for stand alone plans
  - Beginning with 2017/18 fiscal year
- Capital Market Assumptions Study
  - Beginning summer 2017, finish early 2018
  - Likely confirm 7.0% discount rate for current asset allocation

Paying Down Unfunded Liability
&
Rate Stabilization

Options

- Pension Obligation Bonds (POBs)
- Borrow from General Fund
- Amortization Period
- One time payments
- Internal Service Fund
- Irrevocable Supplemental (§115) Trust

POBs

- Usually thought of as interest arbitrage between **expected** earnings and rate paid on POB
- No guaranteed savings
  - Including paying off CalPERS Side Fund
- PEPRA prevents contributions from dropping below normal cost
  - Savings offset when investment return is good

Borrow from General Fund

- Pay GF back like a loan
- Payments should come from all funds

Request Shorter Amortization

- Higher short term payments
- Less interest and lower long term payments
- PEPRA prevents contributions from dropping below normal cost
  - Savings offset when investment return is good

One Time Payments

- Council/Board resolution to use a portion of one time money to reduce unfunded liability, e. g.
  - 1/3 to one time projects
  - 1/3 to replenish reserves and
  - 1/3 to pay down unfunded liability

Internal Service Fund

- Could be used for rate stabilization
- Restricted investments:
  - Likely low (0.5%-1.0%) investment returns
  - Short term/high quality
  - Designed for preservation of principal
- Assets could be used by Board/Council for other purposes
- Does not reduce GASB 68 Net Pension Liability

Irrevocable Suppl. Trust

- IRC §115
- Normally used for rate stabilization
- May not reduce GASB 68 Net Pension Liability
- Investments significantly less restricted:
  - Designed for long term returns
  - Likely much higher (4%-6%) investment returns than agency investment funds

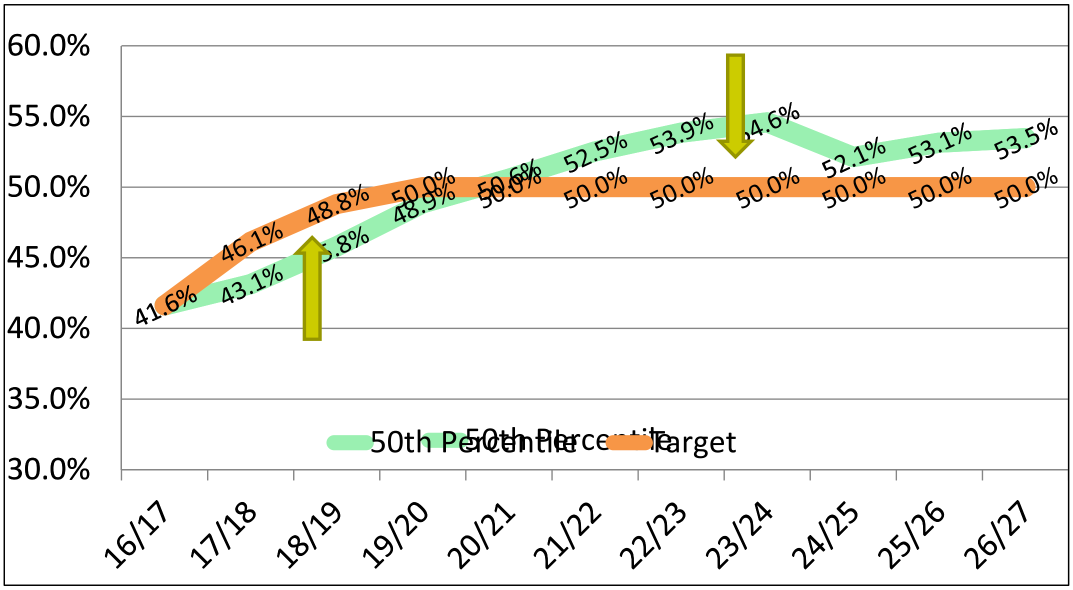
Irrevocable Suppl. Trust

- Can only be used to :
  - Reimburse for pension contributions
  - Make payments directly to pension system
- Assets could **not** be used for other purposes
- PARS, PFM & Keenan
- > 50 agencies

Irrevocable Suppl. Trust

- Can mitigate:
  - Investment volatility
  - Impact of plan becoming over funded
- Requires modest seed contribution to trust (≈10% of annual dollar contribution)

Irrevocable Supplemental Trust Contribution Rate Projections



Supplemental Trust Balance Projections