Finance and Administration Committee

Agenda Item 6d

April 19, 2021

Item Name: Schools Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Adopt an employer contribution rate of 22.91% for the Schools Pool and a member contribution rate of 7.00% for schools' employees subject to the Public Employees' Pension Reform Act of 2013 (PEPRA). Rates are applicable for the period of July 1, 2021 to June 30, 2022.

Executive Summary

The employer contribution rate has increased since the prior fiscal year but is slightly lower than what was projected in our June 30, 2019 annual valuation report.

The following table summarizes the key results of the June 30, 2020 valuation:

Key Valuation Results ($ in millions)

Funded Status	**June 30, 2019**	**June 30, 2020**
Market Value of Assets	$68,177	$71,400
Accrued Liability	$99,528	$104,062
Unfunded Accrued Liability	$31,351	$32,662
Funded Status	68.5%	68.6%

Contribution Rates	**Fiscal Year 2020-21**	**Fiscal Year 2021-22**
Employer Contribution Rate[1]	20.70%	22.91%
PEPRA Member Contribution Rate	7.00%	7.00%

[1] Reflects reduction for the supplanting payments associated with the State's additional contribution in July 2019. See "Additional State Contribution" below for more information.

Strategic Plan

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

Background

The Schools Pool provides retirement benefits to classified employees of school districts, community college districts, and county offices of education in California. It generally does not cover certificated school employees as they are covered by a separate retirement system, the California State Teachers' Retirement System (CalSTRS).

This actuarial valuation determines the funded status as of June 30, 2020 and sets forth the Schools employer and PEPRA employee contribution rates for fiscal year July 1, 2021 through June 30, 2022.

Additional State Contribution

In July 2019, the State made a contribution of $904 million from the General Fund to the Schools Pool to cover a portion of the required unfunded liability contribution on behalf of school employers. This $904 million was allocated among fiscal years in accordance with Government Code Section 20825.2. Specifically, $144 million paid part of the 2019-20 required employer contribution, $430 million paid part of the 2020-21 required employer contribution, and $330 million pays part of the 2021-22 required employer contribution.

For fiscal year 2020-21, the additional payment did not directly impact the actuarially determined contribution as it was not yet in the fund by the June 30, 2019 actuarial valuation date. The $430 million allocated to fiscal year 2020-21 was treated as an advance payment toward the unfunded liability contribution with the required employer contribution rate correspondingly reduced for the remainder of the fiscal year.

For fiscal year 2021-22, the impact of the additional payment is directly reflected in the actuarially determined contribution because the additional payment was in the fund — hence the unfunded liability reduced — as of the June 30, 2020 actuarial valuation date. The $330 million allocated to fiscal year 2021-22 served to reduce the required employer contribution rate by 2.16% of payroll.

Analysis

Schools Employer Contribution Rates for 2021-22

The Actuarial Office has completed the calculation of the employer contribution rate for the Schools Pool for fiscal year 2021-22. The full actuarial report will 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 will include details on assumptions, methods, and participant data.

The table below compares the fiscal year 2021-22 employer contribution rates and corresponding dollar amounts to the current fiscal year 2020-21.

Schools Pool Employer Contribution ($ in millions)

Employer Costs by Rate and Dollars	**Fiscal Year 2020-21**	**Fiscal Year 2021-22**
Employer Contribution Rate		
Employer Normal Cost	9.47%	9.32%
Unfunded Liability Rate[1]	14.13%	13.59%
Actuarially Determined Contribution	23.60%	22.91%
State Contribution (Section 20825.2)[1]	(2.90%)	–
Required Employer Rate	**20.70%**	**22.91%**
Projected Payroll[2]	$ 14,844	$ 15,295
Expected Employer Contribution Dollars		
Employer Normal Cost	$ 1,406	$ 1,425
Unfunded Liability Contribution	2,098	2,078
Actuarially Determined Contribution	$ 3,504	$ 3,503
State Contribution (Section 20825.2)	(430)	–
Expected Employer Contributions	**$ 3,074**	**$ 3,503**

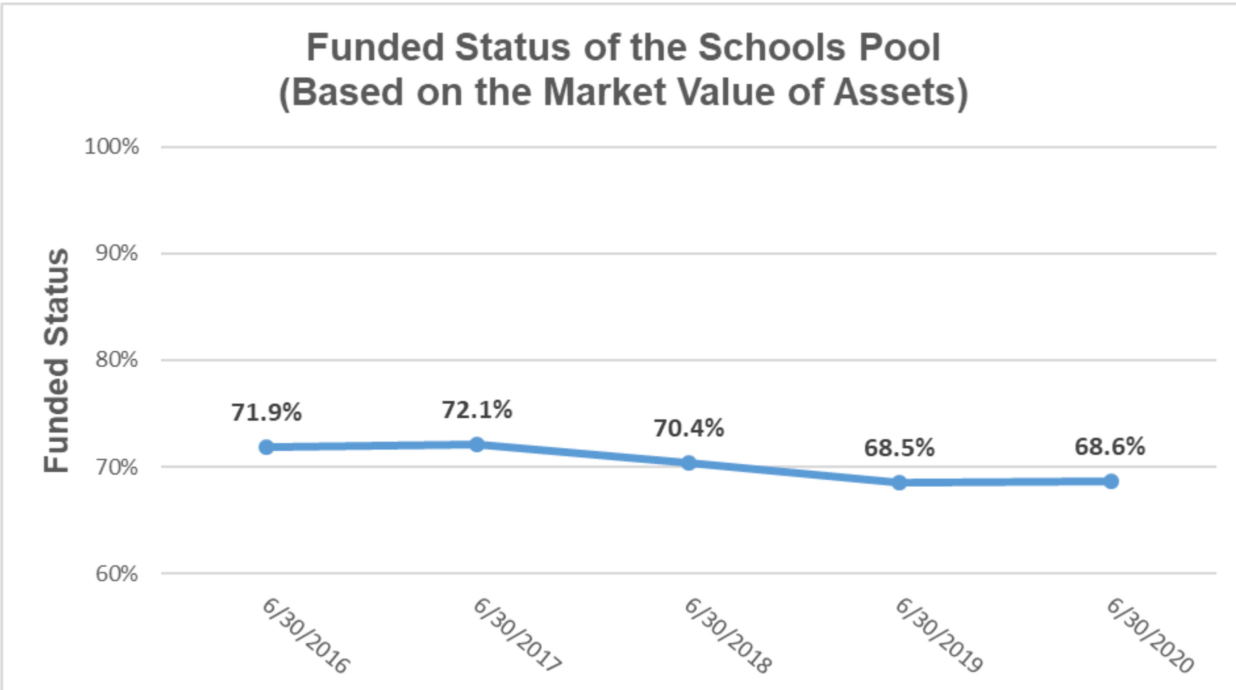
[1] For fiscal year 2021-22, the effect of the supplanting payment associated with the State Contribution under Section 20825.2 is incorporated in the Unfunded Liability Rate. It served to reduce the Actuarially Determined Contribution by $330 million, or 2.16% of payroll.

[2] Projected payroll used to calculate the expected dollar contributions is the payroll used in the valuation incorporating two years of payroll growth at the payroll growth assumption of 2.75% per year. To the extent that payroll in the contribution year is different than projected, the actual contribution amounts will be different than the expected contributions shown in the table above.

Funded Status

The funded status of a pension plan is defined as the ratio of assets to accrued liability. Plans with a lower funded status are, all other things being equal, more at risk of not being able to meet their future benefit obligations. From June 30, 2019 to June 30, 2020 the funded status of the Schools Pool increased by 0.1%. This increase is primarily due to the additional State contribution in July 2019 offset by the lower than expected investment return in fiscal year 2019-20.

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



The slight decline in funded status over the last five years is due to investment losses in excess of investment gains, adoption of new demographic and economic assumptions (particularly the lowering of the discount rate from 7.5% to 7.0%), and negative amortization. Negative amortization results when the contribution towards unfunded liability is less than interest on the unfunded liability. Longer amortization periods (e.g., 30 years) combined with level percent of pay amortization often result in negative amortization. The new amortization policy adopted by the board, which applied prospectively beginning with the June 30, 2019 actuarial valuation, serves to reduce or eliminate negative amortization.

Reasons for Changes in the Contribution Rate

Overall, the actuarially determined contribution rate for the Schools Pool decreased by 0.69% of payroll from the prior year. The dollar amount of contributions expected to be generated is approximately the same in both fiscal years.

The return on assets for the year ending June 30, 2020 was approximately 4.7% reduced for administrative expenses, lower than the assumed return of 7.0%, leading to an investment experience loss.

The table below reconciles the actuarially determined contribution from last year to this year.

Reconciliation of Actuarially Determined Contribution

	Rate (% of Payroll)	Dollars (millions)
Employer Normal Cost		
2020-21 Employer Normal Cost Contribution	9.47%	$1,406
Change in Payroll	0.00%	43
Demographic Experience	(0.15%)	(24)
Change in Member Contribution Rates	0.00%	0
2021-22 Employer Normal Cost Contribution	9.32%	$1,425
Unfunded Liability Contribution		
2020-21 Unfunded Liability Contribution	14.13%	$2,098
Progression of Amortization Bases & Change in Payroll	1.45%	283
Investment (Gain)/Loss	0.26%	40
Non-Investment (Gain)/Loss	(0.09%)	(13)
State Contribution (Section 20825.2)	(2.16%)	(330)
2021-22 Unfunded Liability Contribution	13.59%	$2,078
Total Actuarially Determined Contribution		
2020-21 Total Actuarially Determined Contribution	23.60%	$3,504
Progression of Amortization Bases & Change in Payroll	1.45%	326
Experience (Gain)/Loss	0.02%	3
Change in Member Contribution Rates	0.00%	0
State Contribution (Section 20825.2)	(2.16%)	(330)
2021-22 Total Actuarially Determined Contribution	22.91%	$3,503

For fiscal year 2020-21, the contribution rate ultimately paid by Schools employers was reduced for the $430 million supplanting payment associated with the State's contribution under Section 20825.2. This reduced the required employer contribution rate to 20.70% as shown on page 3.

The required employer contribution rate increased by 2.21% from fiscal year 2020-21 to fiscal year 2021-22. Following is a reconciliation of the employer contribution rate.

Reconciliation of Required Employer Contribution

	Rate (% of Payroll)	Dollars (millions)
2020-21 Required Employer Contribution	20.70%	$3,074
Progression of Amortization Bases & Change in Payroll	1.45%	326
Experience (Gain)/Loss	0.02%	3
Change in Member Contribution Rates	0.00%	0
Change in State Contribution (Section 20825.2)	0.74%	100
2021-22 Required Employer Contribution	22.91%	$3,503

PEPRA Member Contribution Rates

Under PEPRA, new members hired on or after January 1, 2013 are required to contribute 50% of the total annual normal cost of their pension benefit as determined by the actuary. PEPRA school members currently contribute 7.00% of salary. The contribution rate for school members not subject to PEPRA (i.e., classic members) is set by statute and is currently 7.00% of salary.

Current law contains a provision that requires a change in the PEPRA member contribution rate when the total normal cost changes by more than 1% of payroll. When a change is triggered, the member contribution rate is adjusted to equal half the total normal cost, rounded to the nearest quarter of one percent.

The current PEPRA member contribution rate of 7.00% is based on a previous total normal cost for PEPRA members of 14.07% of payroll. The change in plan demographics increased the current total normal cost for PEPRA members from 14.86% of payroll for fiscal year 2020-21 to 14.87% for fiscal year 2021-22. As the total normal cost has not changed by more than 1% relative to the basis of 14.07%, no adjustment to the PEPRA member contribution rate is necessary for fiscal year 2021-22. Therefore, the member contribution rate will remain at 7.00%.

As of June 30, 2020, there were 157,312 active PEPRA members in the Schools Pool, representing 48% of the total active population of the Schools Pool. The total payroll for active PEPRA members was $5,663 million, or 39% of the total payroll of the Schools Pool.

Expected Future Changes

The following table shows projected employer contribution rates. Projected rates assume all actuarial assumptions will be realized and no changes to assumptions, methods, or benefits will occur during the projection period. The projected rates further reflect that normal cost is expected to continue to decline over time as new employees enter the PEPRA benefit tier.

Projected Schools Employer Contribution Rates (% of payroll)

Fiscal Year	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Employer Contribution	22.91%	26.1%	27.1%	27.7%	27.8%	27.6%

Note that fiscal year 2021-22 is the final year in which the employer rate is reduced on account of the State's additional payment under Section 20825.2. As a result, the rate for fiscal year 2022-23 will increase in relative terms.

The actual investment return for fiscal year 2020-21 was not known at the time this item was prepared. The projections above assume the investment return for that year would be 7.00%. ***If the actual investment return for fiscal year 2020-21 differs from 7.00%, the actual contribution requirements for the projected years will differ from those shown above.***

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, volatility ratios, and other risk analyses.

Attachments

Attachment 1 – Schools Valuation Presentation

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