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Circular Letter

TO: PUBLIC AGENCIES

SUBJECT: ACTUARIAL EXPERIENCE STUDY

This circular letter is intended to provide you with information about recent changes in actuarial assumptions and the impact this will have on employer contribution rates.

Inflation Assumption

On April 21, 2004, the California Public Employees' Retirement System's (CalPERS) Board approved a change in the inflation assumption used in the actuarial valuations that set employer contribution rates. The inflation assumption was changed from 3.5 percent to 3 percent. The change impacted the inflation component of the annual investment return assumption, the long term payroll growth assumption and the individual salary increase assumptions as follows:

- The annual assumed investment return has decreased from 8.25 percent to 7.75 percent.
- The long term salary increase assumption has decreased from 3.75 percent to 3.25 percent.
- The inflation component of individual salary scales has decreased from 3.75 percent to 3.25 percent.

The change to the inflation assumption also impacted the cost of living adjustments and purchasing power protection allowances assumed in the actuarial valuations.

Other Assumptions

At its meeting on May 19, 2004, the CalPERS' Board adopted updated actuarial assumptions based on a recently completed experience study. An experience study is a review of actual experience and is used to determine future actuarial assumptions. This study focused on recent patterns of termination, death, disability, retirement, and salary increases. The current assumptions have become outdated since being developed in 1994. The new assumptions will be used to determine the public agency 2005-2006 employer contribution rates.

Based on the results of the experience study, the new assumptions predict the following:

- Longer post-retirement life expectancy for male retirees and beneficiaries
- Later retirement ages for safety members
- Lower salary increases
- Mixed results for other assumptions

Impact on Employer Contribution Rates

In an effort to provide you with some guidance regarding the impact of the updated assumptions, we examined a sample of 45 miscellaneous and 29 safety plans.

The combined impact of the updated demographic and inflation assumptions on public agency miscellaneous plan contribution rates ranged from a *decrease* of 0.4 percent of payroll to an *increase* of 4.0 percent with an average *increase* of 1.9 percent of payroll. The new mortality, retirement[1], and inflation assumptions produce increases in employer rates; while the revised salary scale cause decreases in employer rates.

The combined impact of the updated demographic and inflation assumptions on public agency safety plan contribution rates ranged from a *decrease* of 6.7 percent of payroll to an *increase* of 0.2 percent with an average *decrease* of 3 percent. The decline was primarily due to the removal of the assumption that all safety members will retire once their retirement allowance reaches the benefit cap. The new retirement and salary scale assumptions also caused safety rates to decrease; while the updated mortality, disability, and inflation assumptions caused the safety contribution rates to increase.

2005-2006 Annual Valuation Process

Please be advised that the 2005-2006 public agency valuations will incorporate several changes, for example, new demographic assumptions, a new inflation assumption, recognition of the Arnett case settlement in the valuation of industrial disability benefits, and the pooling of small agencies.

If you have any questions, please contact the Employer Contact Center at
888 CalPERS (or **888**-225-7377).

Kenneth W. Marzion, Chief
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[1] There were insufficient data to develop new retirement assumptions for the Miscellaneous 2.5 percent @ 55, 2.7 percent @ 55, and 3 percent @ 60 benefit formulas.