Proposed CalPERS Changes in Risk Pooling for Small Public Agencies

Webinar: April 30, 2014
Webinar Moderator

Chris McKenzie

- League of California Cities Executive Director since 1999
Agenda

- Introduction, Welcome and Webinar Goals
  - Chris McKenzie, Executive Director, League of California Cities

- CalPERS Presentation
  - Alan Milligan, Chief Actuary, CalPERS
  - David Lamoureux, Deputy Chief Actuary, CalPERS

- League Survey on Impact of Changes
  - Chris McKenzie

- Questions and Answers
Webinar Context

- In April, CalPERS staff presented recommendations to the CalPERS Finance and Administration Committee on whether to maintain multiple closed pools (9) for employers with classic employees or to collapse them down to a smaller number (2).
- League staff and members of the League’s CalPERS Working Group met with CalPERS actuaries to discuss recommendations.
Webinar Context

- Discussions suggested that additional time was needed to adequately brief the 350 cities that are in the current risk pools.
- CalPERS Chief Actuary Alan Milligan advised League staff that he would be recommending a one month delay in final action on staff risk pooling recommendations to solicit city input.
How to Ask a Question

• All phone lines have been muted.

• For **written** questions - use the Q&A window to the right side of your screen. Please enter your name, title and city.

• For **verbal** questions, raise your hand by clicking on the icon.
Webinar Speakers

Alan Milligan

- Chief Actuary, CalPERS
- Provides advice, recommendations and reports to CalPERS Board and Committees
- Collaborates with CalPERS Investment Office on comprehensive asset allocation strategy
- Former Chair and current member, California Actuarial Advisory Panel
Webinar Speakers

David Lamoureaux

- CalPERS Pension Actuary since 1999
- Responsible for overall operation of the Actuarial Office including actuarial and public policy matters and legislative issues.
Why Are We Here Today?

- Problems caused by the Public Employees’ Pension Reform Act (PEPRA) of 2013
  - Closing of classic risk pools
  - Accounting and actuarial standards
  - CalPERS implementation of risk pooling
- Applying existing Board policies would result in contribution increases
Estimated Impact of Changes to Risk Pooling
(If simply applying existing Board policies)
Background
What is Risk Pooling?

- A type of insurance arrangement
  - Spreads demographic risks
  - Purpose is to avoid large liability losses
  - Serves to smooth the employer contribution rate
Why is Risk Pooling Needed?

- To help small employers
- Actuarial assumptions do not work for small employers
  - A 5% probability for someone to retire does not work well with a 5 person agency
  - You need large numbers for assumptions to work
Why is Risk Pooling Needed?

- Small employers are more at risk of large employer rate increases caused by demographic events.
- Examples of demographic events:
  - Work related disability
  - Work related death
  - Service retirement
Brief History of Pooling

- Over 30 years ago, all local miscellaneous members were pooled.
- In 1989, Section 20815 of the Government Code discontinued the public agency miscellaneous pool.
Brief History of Pooling

• Between 1999 and 2002, Sections 20225.5, 20840, 20841 and 20842 of the Government Code were added to give statutory authority to the CalPERS Board to create pools and mandate them for smaller employers.

• Risk Pooling for local agencies was re-introduced effective with the June 30, 2003 Actuarial Valuations.
Growth in the Number of Plans in Risk Pool

- On June 30, 2012, there were 1,247 employers in risk pools.
- These employers had a total of 1,763 plans in one of the classic risk pools on June 30, 2012.
- As of June, 2013, the number of pooled plans, including those in one of the new PEPRA risk pools, exceeds 3,500.
The Issues
Review of Risk Pooling

- In a 2012 review of risk pooling, the risk pools were found to successfully protect small employers against large changes in employer contribution rates due to unexpected demographic events.
- The review also identified several issues and areas of concerns.
Risk Pooling Current Issues

- Current issues facing risk pooling can be categorized as follows:
  - Funding issue
  - Equity/Fairness issue
  - Employer contribution rate volatility issue
Funding Issue

- PEPRA effectively closed the risk pools for classic benefit formulas.
- Closed pools create issues with the assumed rate of employer payroll growth (payroll will grow less than expected).
- Payroll growing less than expected leads to underfunding of the system because plan contributions are based on a percentage of payroll.
Equity/Fairness Issue

- Employers in risk pool pay toward the pool unfunded liability as a percentage of payroll
- Employers with larger payroll pay more toward the unfunded liability
Equity/Fairness Issue

- As payroll starts declining in the closed risk pools, employers with larger payroll will unfairly pay more
- Employers with high retiree to active ratio currently pay less toward the unfunded liability than they would on their own
Employer Contribution Rate
Volatility Issue

- Employers in risk pool pay toward the pool unfunded liability as a percentage of payroll.
- As payroll declines, contribution rate volatility will increase making it harder for employer to budget.
The Recommendation
Risk Pooling Recommendation

- In December 2013, CalPERS staff presented the Board with an agenda item that included preliminary recommendations on how to address the issues facing risk pooling.

- [http://bit.ly/1mT8mnS](http://bit.ly/1mT8mnS)
Risk Pooling Recommendation

- In April 2014, CalPERS staff brought back the discussion and this time presented two alternatives to address the risk pooling issues. Staff recommended Alternative 2 as the preferred solution.


- Board deferred action to allow additional employer outreach.
Alternative 1

- Keep current pooling structure with 9 classic risk pools, 2 PEPRA risk pools and one pool for inactive plans.
- Amortize the unfunded liability as a level dollar amount rather than based on a payment stream assumed to grow at 3% per year (consistent with existing Board policies)
- Collect employer contributions toward unfunded liability and side fund as dollar amounts instead or a percentage of payroll
Alternative 2

- Combining all pools into two pools (Miscellaneous and Safety)
- Allocating the pool’s unfunded liability to each plan based on the plan’s total liability instead of payroll
- Collecting employer contributions toward unfunded liability and side fund as dollar amounts instead or a percentage of payroll
Impact of Alternative 1

- Not viable as a permanent solution
- Most employers will have to pay more if Alternative 1 is selected
  - 90% of miscellaneous plans in classic risk pools will see increase in rates ranging between 0% and 3% of payroll
  - 75% of safety plans in classic risk pools will see increase in rates ranging between 2% and 5% of payroll
Impact of Alternative 2

- About half of the pooled employers will see an increase in rate while the other half will see a decrease in rate.
Impact of Alternative 2

- In about 80% of the cases the change in employer contribution rate will be between a decrease of 3% and an increase of 3% of payroll
  - Employers with a high ratio of retirees to actives are expected to see an increase in cost
  - Employers with fewer retirees are expected to see a decrease in cost
Estimated Impact of Changes to Risk Pooling
Alternative 1 Vs Alternative 2

Number of Employers

Estimated Increase in Employer Rate

- Alternative 1
- Alternative 2
Estimated Impact of Changes to Risk Pooling
Difference Between Alternative 1 and Alternative 2

Number of Employers

Difference Between Alternative 1 and 2 as a Percentage of Payroll
Risk Pooling Recommendations

- Staff is recommending Alternative 2
  - Retains the benefits of risk pooling
  - Does a better job at addressing the equity/fairness issue
    - Employers offering more expensive benefits will continue to pay a higher normal cost and be responsible for their proper share of the pool’s unfunded liability
  - No overall contribution increases
  - Permanent solution
Risk Pooling Recommendations

- Alternative 2 provides what some employers have been requesting
  - Provides ability for employers to pay down their share of the pool’s unfunded liability
  - Pay unfunded liability payment as a dollar amount rather than a rate expressed as a percentage of payroll
    - Contribution rate will continue to be available for information purposes through the valuation report
Next Steps
Timeline

- May 2014 Finance and Administration Committee meeting (currently scheduled for Tuesday May 20th)
  - Staff will recommend Alternative 2
  - Board expected to take final action on May 21, 2014
- Changes to be implemented in the June 30, 2013 actuarial valuations setting the 2015-2016 contribution rates
  - Report will show the impact of the change for each plan
Valuation Report

- For the June 30, 2013 valuation, employers will continue to receive one report per “Tier,” per category even if all groups participate in the same pool.

- CalPERS staff is looking at ways to combine all groups into one report for the future. May not be in place next year either.
City Impact Survey
Estimated Impacts

- Spreadsheets were developed from CalPERS data supplied to the League to show the estimated impact the proposed changes to risk pools will likely have on employer contributions under the two alternative solutions.


**Notes**

- League Fiscal Policy Advisor Michael Coleman advises the city spreadsheets do not include plans for dependent agencies such as housing authorities or city utilities.

- CalPERS advises that the actual impact is expected to differ from the amounts estimated in this list. Also, the estimates were derived assuming the change had been implemented in the June 30, 2012 actuarial valuations and implemented for contribution rates in FY 2014-15. They are based on the 2012 unfunded liability derived using the market value of assets consistent with the smoothing changes that were adopted by the CalPERS Board in April 2013 that will be implemented in the upcoming 2013 actuarial valuations. The proposed changes will be incorporated for the first time in the June 30, 2013 actuarial valuations setting the contribution rates for FY 2015-16. The actual impact of the change will be provided to each employer in their annual actuarial valuation report. These reports are expected to be completed in late summer of 2014.
Estimated Impacts

- Spreadsheets show the percent and dollar impacts of the two alternatives as follows:
  - Impacts on cities by alphabetical order;
  - Impacts on cities ranked by Alt. 1 percentage change;
  - Impacts on cities ranked by Alt. 1 dollar change;
  - Impacts on cities ranked by Alt. 2 percentage change;
  - Impacts on cities ranked by Alt. 2 dollar change; and
  - Impacts on both Alt. 1 and Alt. 2 in alphabetical order.

(This is the original CalPERS spreadsheet from which the previous ones were derived)
League Member Survey

- The League needs city input about the proposed risk pool changes.
- Surveys must be submitted **electronically** by **5 p.m.** on **Friday, May 2**
- Survey is available online: [http://bit.ly/1iDZLVZ](http://bit.ly/1iDZLVZ)
League Member Survey

3 question survey:

1. Which proposed changes to risk pools do you prefer CalPERS adopt? (Alternative 1 or Alternative 2)
2. Do these proposed changes to risk pools present any unique issues or problems to your city that CalPERS should address or be made aware of other than a possible cost increase?
3. Do you need additional information about the risk pooling proposal?
Questions?
Thank you to our speakers and thank you for attending this webinar!

www.cacities.org

E-mail questions to: Leg@cacities.org