TEACHERS' RETIREMENT BOARD

REGULAR MEETING Item Number: 5

SUBJECT: Amendment to Actuarial Valuation Policy

CONSENT: ____ ATTACHMENT(S): 1

ACTION: X DATE OF MEETING: June 9, 2016 / *30 mins.*

INFORMATION: ____ PRESENTER(S): Chairperson

PURPOSE

The purpose of the item is to amend the board's actuarial valuation policy to reflect the intent to maintain the state's supplemental contribution of at least 4.311 percent to the Defined Benefit (DB) Program until its portion of the program's unfunded liability is fully amortized.

BACKGROUND

Under Assembly Bill 1469 (Bonta), enacted as Chapter 47, Statutes of 2014, the contribution rates applicable to the state and employers for the DB Program are increased to amortize specific portions of the unfunded liability associated with the DB Program. The board will have authority to adjust the state's contribution rate beginning in 2017-18, and the employer's contribution rate beginning in 2021-22. The state's contribution rate will then be based on the unfunded liability of the program attributable to the July 1, 1990 benefit and contribution structure. The employer rate will be based on the unfunded liability associated with the benefits enacted after July 1, 1990, for service credit accrued prior to July 1, 2014. In both cases, AB 1469 imposes limits on how much the board can change the contribution rate each year. The rate of increase in the state's contribution rate cannot exceed one-half percentage point per year, with no limit in the annual decrease in the state's supplemental contribution, and no limit in the total contribution rate paid by the state. The change in the employer's contribution rate cannot exceed one percentage point per year, and the total contribution rate by employers cannot exceed 20.25 percent. The increases in the state and employer contribution rate will sunset on July 1, 2046, and the contribution rates will then be based on the law as it existed prior to the enactment of AB 1469. AB 1469 also permanently increased member contribution rates to reflect the normal cost of the payment of a two percent annual increase in the member's original DB Program benefit, in return for guaranteeing the payment of that adjustment. Those additional member contributions also help amortize the unfunded liability of the program.

BOARD POLICY ON DB PROGRAM VALUATION

At the February 2015 and November 2015 regular meetings, the board adopted and subsequently amended a policy for completing actuarial valuations of the DB Program pursuant to AB 1469.

Under the policy, the state's contribution rate will be adjusted each year beginning in 2017-18 from 4.311 percent to amortize by June 30, 2046, the unfunded liability of the DB Program associated with the benefit and contribution structure in effect as of July 1, 1990. Under the policy, if the state contribution rate would fully amortize the state's responsibility for the unfunded liability before June 30, 2046, that portion of the unfunded liability would be "refinanced", and the state's contribution would be reduced to the rate necessary to fully amortize that unfunded liability by June 30, 2046.

In subsequent discussions with the Department of Finance, which advocated on behalf of the Governor for the state to continue to assume the financial responsibility for this share of the unfunded liability, the department indicated that it anticipated that the state's additional contribution rate would remain at a minimum of 4.311 percent until the unfunded liability associated with the benefit and contribution structure in effect as of July 1, 1990 was fully amortized. AB 1469 did not specify what the specific amortization date would be for the state's contribution rate; that date is specified only through the board's policy. Consequently, the board's policy could be amended to reflect the Governor's intent without being in conflict with the law. This would result in the state's contribution rate potentially being at a higher level in the near future than it would otherwise have been under the board's current policy, strengthening the funding of the DB Program. In addition, it's consistent with how the state contribution to retire the unfunded liability was determined before AB 1469, in which that contribution would be eliminated only after that portion of the unfunded liability was completely eliminated.

Based on the June 30, 2015 Actuarial Valuation of the DB Program, under the current policy and based on the current actuarial assumptions, the state's contribution rate imposed to amortize the unfunded liability is projected to be reduced from 4.311 percent to 1.566 percent in 2017-18, the first year the board has the authority to change the state contribution rate, but a supplemental state contribution rate would be imposed until 2046. If the proposed change was made in the board's policy, however, the supplemental state contribution rate would remain at 4.311 percent through 2025-26, at which time the unfunded liability associated with the benefit and contribution structure in effect as of July 1, 1990 would be projected to be fully amortized, and the state's supplemental rate would be eliminated.

In addition, with the higher state contributions under the proposed policy, the funded status of the overall DB Program would be higher than would occur under the current policy. For example, the funded ratio under the proposed policy would be projected to be 3.6 percentage points higher as of June 30, 2026, when the unfunded liability associated with the benefit and contribution structure in effect as of July 1, 1990 would be fully amortized. An analysis of alternative investment experience also indicates that regardless of the future rate of investment return, the funded status of the DB Program would be higher during the funding period under the proposed policy as compared to the current policy. These estimates are based on the DB Program valuation as of June 30, 2015. Actual results will vary, with the two biggest impacts likely to be the actual return for 2015-16 and any changes the board may adopt in the actuarial assumptions as a result of the upcoming experience study.

In addition, technical changes in the policy are needed to

- Delete the requirement that the board adopt the valuation, because the law does not provide for the board to adopt the valuation;
- Clarify that the board adjusts the member contribution rate for CalSTRS 2% at 62 members to reflect changes in the normal cost of that benefit structure, as provided in section 22901 of the Education Code; and
- Reword the provisions of the current policy with respect to adjustments to the state contribution rate to correct a syntax error.

RECOMMENDATION

Staff recommends the board adopt the attached revisions to the board's policy with respect to

- The state's contribution to amortize the unfunded liability of the DB Program and
- Clarifying technical adjustments.

Draft Revisions to the Teachers' Retirement Board Policy Manual—Section 800

F. ACTUARIAL VALUATIONS OF THE DEFINED BENEFIT PROGRAM

The board shall commission ~~and adopt~~ an actuarial valuation of the Defined Benefit (DB) Program annually, using the most recently adopted demographic and economic assumptions, including the period of time over which gains and losses that differ from assumed investment return are recognized and the actuarial cost method (different actuarial cost methods may be used depending on the purpose of the liability calculation). Such assumptions and methods shall be reviewed and adopted every four years, but assumptions and methods may be reevaluated more frequently if the board determines that events since the last adoption warrant an earlier review.

1. **Conducting Valuations**

   a. Actuarial valuations shall be undertaken to determine the current and long term fiscal status of the DB Program and establish state and employer contribution rates pursuant to Chapter 16 of Part 13 of Division 1 of the Education Code.
   b. The valuation shall be consistent with the Actuarial Standards of Practice and shall, among other indicators, identify the unfunded liability and the funded status of the DB Program.

2. **Determining State Contributions**

   a. Pursuant to Section 22955.1 of the Education Code, the state's contribution rate shall be subject to adjustment annually, commencing in 2017-18, in an amount necessary to fully amortize the unfunded liability by June 30, 2046, associated with the benefit and contribution structure in effect as of July 1, 1990<u>, except as provided in 2f</u>.
   b. The assets associated with this unfunded liability will reflect the additional contributions due to the increases in the state contribution rate designated to amortize this unfunded liability.
   c. The board shall reevaluate the target date for amortizing the unfunded liability in 2025.
   d. If an increase in the state's contribution rate is required, the increase shall not exceed 0.50 percent of the creditable compensation <u>upon which members' contributions to the DB Program are based during</u> ~~of~~ the fiscal year ending in the immediately preceding calendar year ~~upon which members' contributions to the DB Program are based~~, as reported pursuant to Section 22955.5 of the Education Code.
   e. The contribution rate for the 1990 Benefit Structure, when combined with the employer contribution rate imposed pursuant to Section 22950.5, shall not exceed the contribution rate needed to amortize the unfunded liability for the total DB Program.
   f. <u>Subject to the limitation in 2d, after July 1, 2017, the state's contribution rate pursuant to Section 22955.1 shall not be less than 4.311 percent of the creditable compensation upon which members' contributions to the DB Program are based if there is an unfunded liability associated with the benefit and contribution structure in effect as of July 1, 1990.</u>

3. Determining Employer Contributions

a. Pursuant to Section 22950.5 of the Education Code, the employer's contribution rate shall be subject to adjustment annually, commencing in 2021-22, in an amount necessary to fully amortize by June 30, 2046, the unfunded liability ~~by June 30, 2046, of the unfunded liability~~ associated with the changes made in the benefit and contribution structure on or after July 1, 1990, associated with the service credited to members as of June 30, 2014.
b. The assets associated with this unfunded liability will exclude future contributions equal to the Normal Cost for post-June 30, 2014 benefit accruals and will include a one-time adjustment equal to the difference between the June 30, 2014, actuarial obligation under the projected unit credit cost method and the actuarial obligation under the valuation cost method.
c. If an adjustment in the employer's contribution rate is required after determination of the state contribution rate, the adjustment shall not exceed 1.00 percent of the creditable compensation upon which members' contributions to the DB Program are based, unless the unfunded liability has been eliminated.
d. In no event shall the total contribution rate imposed pursuant to Section 22950.5 exceed 12.00 percent of the creditable compensation upon which members' contributions to the DB Program are based.
e. If there is a surplus (i.e., a negative unfunded liability) associated with the benefit and contribution structure in effect as of July 1, 1990 for service accrued prior to July 1, 2014, ~~pre-2014 service,~~ the employer contribution rate, when combined with the state contribution imposed pursuant to Section 22955.1, shall not exceed the contribution rate needed to amortize the unfunded liability attributable to service accrued prior to July 1, 2014, ~~pre-2014 service,~~ subject to the limitations described in 3c and 3d.
f. The employer contribution rate, when combined with the state contribution rate imposed pursuant to Section 22955.1, shall not be less than the contribution rate needed to amortize the unfunded liability attributable to service accrued prior to July 1, 2014, ~~pre-2014 service,~~ subject to the limitations described in 3c and 3d.

4. Determining Member Contributions

a. Member contributions shall be equal to the rates specified in Chapter 15 of Part 13 of Division 1 of the Education Code, and are not subject to adjustment by the board, except as provided in 4b.
b. For members subject to the California Public Employees' Pension Reform Act of 2013, the member contribution rate shall be adjusted if the normal cost rate increases or decreases by more than 1.00 percent of the creditable compensation upon which members' contributions to the DB Program are based above or below the normal cost rate in effect at the time the percentage is first established or, if later, the normal cost rate in effect at the time of the last adjustment.