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Date: **July 6, 2001**
Reference No:
Circular Letter No: **200-071-01**
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TO: **ALL PUBLIC AGENCIES**

SUBJECT: **NEW CALPERS' BOARD RESOLUTION CONCERNING VALUE OF ASSETS USED IN CALCULATION OF COST OF CONTRACT AMENDMENTS**

On June 20, 2001, the CalPERS' Board adopted a new resolution concerning the value of assets to be used in determining the employer contribution rate due to benefit increases for amendments to public agency contracts. This letter provides information about the new resolution and its potential impact upon public agencies' employer rates. The purpose of Resolution 01-03-BD is to provide a means to temporarily delay the full impact of the cost of benefit improvements on the employer's contribution rate. The delay is accomplished by using, in the determination of the employer's contribution rate, an actuarial value of assets chosen by the employer, rather than following the regular actuarial asset-smoothing method. As of the most recently completed actuarial valuation, for most plans the actuarial value of assets is less than market assets due to the delayed recognition of investment gains over the past several years.

This new resolution **does not apply** to any amendment cost analysis based on the June 30, 1999 annual valuation. Such amendments were covered by the prior Board resolution, which involved the use of an actuarial value of assets equal to 95% of market value. That prior resolution expired on June 30, 2001. If your agency notified CalPERS on or before June 30, 2001 that you intended to amend your contract based upon the June 30, 1999 valuation, the prior resolution utilizing the 95% of market value will be honored. If no such notification was provided by June 30, 2001, amendments based upon the June 30, 1999 valuation and effective after June 30, 2001, will have no adjustment made to the actuarial value of assets used in calculating the new employer contribution rate.

This new resolution **does apply** to all contract amendments based upon the June 30, 2000 annual actuarial valuation and for which a Resolution of Intent to amend is filed with CalPERS by June 30, 2002. It is anticipated that all June 30, 2000 annual valuations establishing employer rates for fiscal 2002-03 will be mailed by October 31, 2001. After those annual valuation results are completed, each amendment cost analysis provided will set forth all of the choices available to the employer with regard to asset values and corresponding employer contribution rates upon implementation of a contract amendment.

The full text of the resolution is included in Attachment A and will not be repeated here. Instead, what follows is a brief description of the choices made available by the resolution to employers implementing plan amendments.

The previous resolution, which expired on June 30, 2001, provided an actuarial value of assets equal to 95% of the market value of assets for any amendment increasing the present value of benefits, as determined by the Board. In some instances this produced a situation whereby a very small benefit increase resulted in a very large increase in the value of assets. The new resolution is designed to coordinate the size of the increase in assets recognized for rate setting with the size of the benefit increase produced by the amendment. Specifically, the increase in the actuarial value of assets to be used for rate setting is equal to twice the increase in the present value of benefits produced by the amendment. So, a small increase in benefits will at most produce a correspondingly small increase in assets, and a large increase in benefits will, at the option of the employer, produce a large increase in assets.

It should be emphatically stated that, under the new resolution, the employer has the option of taking no increase in the actuarial value of assets and allowing the regular asset smoothing method to operate as it normally would. In addition, the employer may limit the actuarial value of assets used for rate setting purposes to 100% of market value if normal application of the resolution would otherwise exceed this limit. Under no circumstances will an actuarial value of assets in excess of 110% of market value be utilized.

The table below demonstrates the rate choices upon implementation of a contract amendment. To understand the table, the reader should realize that the choices available to the employer are determined by the size of the actuarial value of assets after increasing them by twice the present value of benefits. Please refer to <u>Attachment B</u> for a glossary of actuarial terms used in this letter.

Actuarial Value of Assets increased by twice the increase in the Present Value of Benefits due to the amendment.	**Choices available to employer for how the employer contribution rate will be calculated**
Is less than 100% of market value	Either 1. No increase in asset value, or 2. Actuarial Value of Assets increased by twice the increase in the Present Value of Benefits due to the amendment
Is greater than 100% of market value, but less than 110% of market value	Either 1. No increase in asset value, or 2. 100% of market value, or 3. Actuarial Value of Assets increased by twice the increase in the Present Value of Benefits due to the amendment

Is greater than 110% of market value	Either 1. No increase in asset value, or 2. 100% of market value, or 3. 110% of market value

Subject only to the conditions previously stated, the available rate choices will be offered for all proposed amendments and apply to those amendments adopted by the agency during the window period. Further, the new resolution will apply to agencies whether or not they utilized the 95% asset value offered in the previous resolution.

The employer should carefully consider its choices in choosing its new rate under the options made available by the new resolution. For many plans at CalPERS, the financial soundness of the plan will not be jeopardized regardless of the choice made by the employer. However, it is possible that, for some plans, some choices under the resolution would represent poor financial decisions. While the choice will remain with the employer, you are strongly encouraged to have in-depth discussions with your CalPERS actuary about the consequences of each cost analysis disclosure you receive.

A word about asset smoothing and the impact of utilizing asset values other than those produced by the regular asset smoothing method is in order. The purpose of all asset-smoothing methods is to dampen the impact of market fluctuations on the employers' rates. During the bull market that ended in the year 2000, the smoothing method built up a cushion (the difference between market value and the actuarial value of assets) to protect against a substantial downturn in the markets. The utilization of that cushion to dampen the impact of benefit improvements will substantially reduce or completely eliminate the ability of the smoothing method to dampen the impact of the market downturn that has occurred during fiscal 2000-01.

For most CalPERS' public agency plans, the June 30, 2000 actuarial value of assets is expected to be around 93% to 94% of the market value of assets. While we do not have final investment returns for fiscal 2000-2001, there will be a negative return for the year. Under the usual actuarial asset smoothing technique, a –6% return for fiscal 2000-2001, would produce an actuarial asset value on June 30, 2001 of approximately 105% of market value of assets. Because the smoothed asset value will increase from 93% of market to 105% of market value, much of the market shortfall will be absorbed, and the amount of the market shortfall immediately passed into the employer rate is substantially dampened.

However, if the June 30, 2000 actuarial value of assets is moved to 100% of market value due to a contract amendment under the new resolution, the smoothing method will result in an actuarial value of assets on June 30, 2001 of 110% of market value. So, the smoothed asset value will increase from 100% of market to 110% of market and much more of the market shortfall will be passed immediately into the employer rate. If the June 30, 2000 smoothed assets are moved to as high as 110% of market value, then the June 30, 2001 smoothed value will also be 110% of market value. In this case, a substantial market shortfall will be passed immediately into the employer rate. In other words, accelerating recognition of past investment gains on June 30, 2000 will reduce the cushion that could be used to soften the effect of investment losses known to have occurred during fiscal 2000-01. Investment losses during this period affect the employers' fiscal 2003-04 rates.

Over the next several months, the CalPERS actuaries will be working on a new format for the year 2000 basis amendment cost disclosures. Our goal will be to provide a document that clearly expresses the cost impact upon the plan of the proposed contract amendment, and to provide a clear distinction between the choices provided by the new resolution. If you have any questions concerning the new resolution, please contact your plan actuary. A list of contact names and telephone numbers is available by checking the CalPERS website (go to the Employer Information tab), or you may refer to Attachment C.

Again, we strongly encourage you to engage in a discussion with your CalPERS actuary regarding each amendment cost disclosure you receive. Our actuaries are available by telephone to assist you in understanding the financial implications of amending your contract with CalPERS.

Kenneth W. Marzion, Chief
Actuarial and Employer Services Division

Attachments

Attachment A

RESOLUTION
By the Board of Administration of the
California Public Employees' Retirement System
To The Governor of the State of California
and The State Legislature

Subject:	Redress of Inequities Within Existing Retirement Programs for **Public Agency** Employees Covered by CalPERS	No. 01-03-BD

WHEREAS, the California Constitution provides that the Board of Administration (Board) of the California Public Employees' Retirement System (CalPERS) has the sole and exclusive authority for the administration of CalPERS, including the provision of all actuarial services.

WHEREAS, the California Constitution provides that the Board must discharge its duties with respect to CalPERS solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries; minimizing employer contributions to CalPERS; and defraying reasonable administrative expenses.

WHEREAS, the California Constitution provides that the Board's duty to CalPERS participants and beneficiaries shall take precedence over all other duties.

WHEREAS, the purpose of CalPERS, as articulated by the legislature when the System was created in 1932, is to effect economy and efficiency in the public service by assuring that public employees may, when they reach the age of retirement or become incapacitated, retire from the active workforce "without hardship or prejudice."

WHEREAS, the Board's Mission is to advance the financial and health security of all of those who participate in CalPERS.

WHEREAS, although the Board has the authority and duty to interpret and implement existing statutory provisions that establish retirement benefits, it does not have the authority to unilaterally create new benefits.

WHEREAS, during the five year period ended June 30, 2000, CalPERS earned a 15.6% return on its investments, well above the 8.25% assumed actuarial rate of return.

WHEREAS, these investment returns have been significantly higher than the actuarially assumed return rate of 8.5 percent, thus illustrating the sustained strength and growth of the Public Employees' Retirement Fund.

WHEREAS, in March 1998 and following an extensive deliberation of the issue, the Board adopted new economic assumptions, which are used for setting employer contributions rates; in so doing, the Board lowered the assumed investment return rate from 8.5 to 8.25 percent, the assumed inflation rate from 4.5 to 3.5 percent, and the long-term wage growth rate from 4.5 to 3.75 percent.

WHEREAS, there are approximately 1,800 different retirement plans currently being administered by CalPERS on behalf of the public agencies that have elected to contract with CalPERS for retirement system coverage for their employees (Public Agency Employers).

WHEREAS, as a result of CalPERS' continued high investment returns, lower inflation, and the March 1998 economic assumptions, the employer contributions due from Public Agency employers have generally decreased.

WHEREAS, the funded status of Public Agency plans has similarly improved, going from 98.8% aggregated funded as of the June 30, 1996 actuarial valuation, to 128.2% aggregated funding as of the June 30, 1999 valuation; while the funded ratios of each of the 1,800 different plans differ, about 2% of the plans are below 75% funded; approximately 6% of the plans are between 75% and 100% funded, and about 92 % are 100% funded or better.

WHEREAS, although employer contributions vary according to current economic assumptions and actuarial valuations, employee contributions are fixed by statute, and thus even when a plan may be significantly overfunded, employees must continue to contribute.

WHEREAS, the Board's Legislative Policy Standards (approved on June 19, 1996), provide that the Board will sponsor and support legislative action that redresses "inequitable, unfair or discriminatory benefits."

WHEREAS, the terms and conditions of employment for public agency employees who are covered by CalPERS are subject to the collective bargaining process set forth in the California Government Code, sections 3505 et seq.

WHEREAS, California Government Code section 20233 requires the Board to report to the Legislature on whether existing increases to retirement allowances are meeting the objective of preserving the purchasing power of benefits, and also to report on the amount of supplementary increases required to meet that objective.

WHEREAS, the Board has determined that, with a change in actuarial methodology (i.e., increasing assets used in the rate-setting process by twice the increase in the present value of benefits, rather than the current three-year smoothing method using 90-110% of market value) some improvements in benefits can be funded for a period exclusively from current surplus assets and thus not increase the employers' 2002-03 contributions.

NOW THEREFORE BE IT RESOLVED THAT:

The Board of Administration of the California Public Employees' Retirement System (CalPERS) has determined that each public agency plan that adopts an amendment (agency has, at a minimum, filed a Resolution of Intent with CalPERS by June 30, 2002) whose cost estimate is based upon the June 30, 2000 annual actuarial valuation shall, at the option of the employer, have their initial employer contribution rate due to implementation of the amendment determined using one of the following values for the actuarial value of assets:

1) their regular June 30, 2000 actuarial value of assets without further adjustment, or

2) their regular June 30, 2000 actuarial value of assets increased in dollars by twice the increase in the present value of benefits as of June 30, 2000 due to the contract amendment, but not greater than 110% of the market value of assets as of June 30, 2000, or

3) their regular June 30, 2000 actuarial value of assets increased in dollars by twice the increase in the present value of benefits as of June 30, 2000 due to the contract amendment, but not greater than 100% of the market value of assets as of June 30, 2000.

This resolution applies only to estimates based upon the June 30, 2000 annual actuarial valuation.

I hereby certify that on the **20th day of June 2001**, the Board of Administration of the California Public Employees' Retirement System, made and adopted the foregoing Resolution.

WILLIAM DALE CRIST
PRESIDENT
BOARD OF ADMINISTRATION

Attachment B

Glossary of Actuarial Terms

PRESENT VALUE OF BENEFITS

The total dollars needed today to fund all ***past*** and ***future*** benefits for ***current*** members of the plan.

ACCRUED LIABILITY

The desired total dollars needed today to fund all ***past*** benefits for ***current*** members of the plan.

NORMAL COST

The annual cost of providing benefits for the upcoming year. Should be viewed as the long-term employer contribution rate.

ACTUARIAL VALUE OF ASSETS

The actuarial value of assets used for funding purposes is obtained through an asset smoothing technique where investment gains and losses are not fully recognized in the year they are incurred.

This method helps avoiding large fluctuations in employer contribution rate.

UNFUNDED ACCRUED LIABILITY/EXCESS ASSETS

A plan with an actuarial value of assets below the accrued liability is said to have an unfunded accrued liability and must temporarily increase contributions to get back on schedule.

A plan with an actuarial value of assets in excess of the accrued liability is said to have excess assets and can temporarily reduce future contributions.

Attachment C

Actuarial Contacts

Actuary	Team No.	Phone Number
Alan Milligan	1	(916) 341-2113
David Clement	1	(916) 341-2472
Jason Ellement	1	(916) 341-2156
David DuBois	2	(916) 326-3427
Gale Patrick	2	(916) 326-3709
Kung-pei Hwang	3	(916) 326-3411
Barbara Ware	3	(916) 326-3426

County No.	County	Team No.	Actuary Assigned
1	ALAMEDA	2	David DuBois
2	ALPINE	1	David Clement
3	AMADOR	2	David DuBois
4	BUTTE	3	Barbara Ware
5	CALAVERAS	2	Gale Patrick
6	COLUSA	2	Gale Patrick
7	CONTRA COSTA	2	David DuBois
8	DEL NORTE	2	Gale Patrick
9	EL DORADO	2	Gale Patrick
10	FRESNO	1	David Clement
11	GLENN	2	Gale Patrick
12	HUMBOLDT	2	David DuBois
13	IMPERIAL	1	Alan Milligan
14	INYO	1	David Clement
15	KERN	3	Barbara Ware
16	KINGS	2	Gale Patrick

17	LAKE	2	David DuBois
18	LASSEN	1	Alan Milligan
19	LOS ANGELES	3	Kung-pei Hwang
20	MADERA	2	Gale Patrick
21	MARIN	3	Barbara Ware
22	MARIPOSA	2	Gale Patrick
23	MENDOCINO	2	David DuBois
24	MERCED	2	Gale Patrick
25	MODOC	1	Alan Milligan
26	MONO	1	Alan Milligan
27	MONTEREY	3	Barbara Ware
28	NAPA	3	Barbara Ware
29	NEVADA	1	David Clement
30	ORANGE	3	Kung-pei Hwang
31	PLACER	1	Alan Milligan
32	PLUMAS	1	David Clement
33	RIVERSIDE	2	David DuBois
34	SACRAMENTO	1	Jason Ellement
35	SAN BENITO	3	Barbara Ware
36	SAN BERNARDINO	2	Gale Patrick
37	SAN DIEGO	1	Jason Ellement
38	SAN FRANCISCO	2	David DuBois
39	SAN JOAQUIN	1	Alan Milligan
40	SAN LUIS OBISPO	3	Barbara Ware
41	SAN MATEO	2	David DuBois
42	SANTA BARBARA	1	Jason Ellement
43	SANTA CLARA	1	David Clement
44	SANTA CRUZ	1	David Clement
45	SHASTA	1	Alan Milligan
46	SIERRA	1	David Clement
47	SISKIYOU	1	David Clement
48	SOLANO	2	Gale Patrick
49	SONOMA	3	Barbara Ware
50	STANISLAUS	3	Barbara Ware
51	SUTTER	3	Barbara Ware
52	TEHAMA	2	Gale Patrick

53	TRINITY	1	David Clement
54	TULARE	2	Gale Patrick
55	TUOLUMNE	3	Barbara Ware
56	VENTURA	1	Alan Milligan
57	YOLO	1	Alan Milligan
58	YUBA	3	Barbara Ware