Finance and Administration Committee

Agenda Item 4e

April 18, 2022

Item Name: Judges' Retirement System II Actuarial Valuation Report and Employer and Employee Contribution Rates

Program: Actuarial Office

Item Type: Action Consent

Recommendation

- Approve the June 30, 2021 Judges' Retirement System II Actuarial Valuation Report and the corresponding transmittal letter to the governor and Legislature, including lowering the discount rate assumption from 6.50% to 6.00%, lowering the inflation assumption from 2.50% to 2.30% and changes to the assumed mortality and retirement rates as outlined below and in the valuation report.
- Adopt the employer contribution rate of 23.23% and a member contribution rate of 16% of salary for members subject to the Public Employees' Pension Reform Act of 2013 (PEPRA) for the period of July 1, 2022 through June 30, 2023 for the Judges' Retirement System II (JRS II).
- Adopt the use of the new demographic and economic assumptions including inflation and salary growth in all affected member calculations effective as follows:
  a. For service credit purchases under the "present value" method, the use of the new actuarial assumptions will apply to all applications received on or after April 21, 2022.
  b. For retirement applications, any application with a retirement date on or after April 21, 2022 will be subject to the new actuarial assumptions.

Executive Summary

Consistent with the decision made by the CalPERS Board of Administration for plans participating in the Public Employees' Retirement Fund (PERF), the actuarial office is recommending, as part of the adoption of the valuation report, the adoption of new actuarial assumptions. The new service retirement assumption used in this valuation was developed based on the actual retirement experience over the last four years. The new mortality table used in this valuation was developed from the 2021 experience study and was projected generationally for future years using 80% of the Society of Actuaries' Scale MP-2020. The inflation assumption was reduced from 2.5% to 2.3%. The individual salary and overall payroll increase assumptions were increased from 2.75% to 2.8%. In addition, the discount rate was lowered from 6.50% to 6.00% due to the changes in Capital Market Assumptions (CMAs) and updated asset allocation. The new assumptions have been incorporated in this valuation. The impact of this change will be reflected beginning with the contribution requirement for fiscal year (FY) 2022-23.

The following table summarizes key results from the valuation and shows a comparison of the prior year report.

Comparison of Current and Prior Year Results		
	June 30, 2020	**June 30, 2021**
Present Value of Benefits	$2,681,671,589	$2,902,440,109
Accrued Liability	1,913,087,688	1,964,843,572
Market Value of Assets	1,885,403,709	2,403,366,317
Unfunded Liability/(Surplus)	27,683,978	(438,522,745)
Funded Status	98.6%	122.3%
Required Employer Contribution Rate	24.24%	23.23%

Strategic Plan

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the strategic plan goal of fund sustainability.

Background

The Judges' Retirement System II (JRS II) began on November 9, 1994 to provide retirement and ancillary benefits to judges elected or appointed on or after that date. The employer contribution rate from the inception of the plan until June 30, 1996 was set by State statute. Subsequently, the employer contribution rate was determined through an actuarial valuation process. This actuarial valuation sets the employer contribution rate for fiscal year July 1, 2022 through June 30, 2023.

Analysis

As of June 30, 2021, JRS II has a funded status of 122.3%, having increased from 98.6% since the prior valuation. This increase was driven mostly by investment gains. In FY 2020-21 the fund earned approximately 24.1%.

The actuarial office recommends the board adopt a contribution rate of 23.23% for FY 2022-23. This rate is comprised of 23.23% for the employer normal cost and 0% for the amortization of the unfunded liability.

With the enactment of the Public Employees' Pension Reform Act of 2013 (PEPRA), PEPRA members are required to contribute at least 50% of the total annual normal cost as determined by the actuary.

The following table illustrates a history of the normal cost of the PEPRA group and the resulting employee contribution rate. The employee contribution for the PEPRA group will change if the total normal cost for PEPRA group changes by 1% or more from the Base Total Normal Cost

Rate. The Base Total Normal Cost Rate for PEPRA members is 32.10%. The new Total PEPRA Normal Cost is 32.43%. This results in no change to the PEPRA member contribution rate of 16% for FY 2022-23.

Fiscal Year	Total PEPRA Normal Cost	Employee PEPRA Normal Cost
2017-18	33.562%	16.75%
2018-19	32.104%*	16.00%
2019-20	32.760%	16.00%
2020-21	32.56%	16.00%
2021-22	32.62%	16.00%
2022-23	32.43%	16.00%

* Base Total Normal Cost Rate for members subject to the PEPRA, until the actual PEPRA Total Normal Cost Rate changes by 1% or more.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

One risk measurement is the Volatility Ratios (assets/payroll ratio, liability/payroll ratio). The Volatility Ratios for this plan are 6.8% and 5.6%, respectively. Both numbers are displayed in the Risk Analysis section of the valuation report. The volatility ratios indicate this plan has a lower risk of large changes to employer rates when it comes to investment earnings and changes in liability when compared to most CalPERS plans.

Another key risk measurement in the June 30, 2021 valuation report is the funded status of the plan. The funded status of a pension plan is defined as the ratio of assets to a plan's accrued liabilities. When below a certain level, this measure indicates whether a plan is at risk of meeting future benefit obligations. The funded status of this plan is 122.3% as of June 30, 2021. The target funded level is 100%.

Other Issues

In the case of Robert M. Mallano, et al. v. John Chiang, Controller of the State of California (SCO), the Judges' Retirement System (JRS), and the Judges' Retirement System II (JRS II), the judge issued a Statement of Decision which orders judicial salary increases to be given to the judges for the FY 2008-09, FY 2009-10, FY 2010-11, FY 2013-14, FY 2014-15 and FY 2015-16 plus 10 percent interest per year for each year that the judicial salaries were not increased. Based on the increased judicial salaries, adjustments to the defined benefit and lump sum payments have been calculated and paid. Any remaining payments will be reflected in future valuations as they are claimed and paid.

Attachments

Attachment 1 – Transmittal letter to the Governor and Legislature

Attachment 2 – Judges' Retirement System II Actuarial Valuation as of June 30, 2021

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David Clement
Senior Pension Actuary

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Scott Terando
Chief Actuary