CalPERS

Finance and Administration Committee

Agenda Item 6a

November 19, 2024

Item Name: Annual Review of Funding Levels and Risk Report

Program: Actuarial Office

Item Type: Information

Executive Summary

This annual report provides a comprehensive summary of the current funding levels of the system and the near-term outlook for required contributions. In addition, the report provides important information regarding the risks faced by the system in the near and long-term. By understanding these risks, CalPERS and its agencies can effectively consider whether additional measures can be taken to further reduce risk and increase sustainability of the system.

As discussed in this report, after 2 years of actuarial losses due to less than expected investment returns and higher than expected Cost of Living Adjustments (COLAs) and member pay increases through June 30, 2023, the PERF earned an investment return of 9.5% for the year ending June 30, 2024. This favorable return resulted in an increase to the estimated funded status of the PERF to 75% and will put downward pressure on required employer contributions beginning July 1, 2026.

Strategic Plan

This item is presented as part of the regular ongoing workload of the Actuarial Office and supports the Strategic Plan goal of Pension Sustainability.

Background

To assist the Finance and Administration Committee with its oversight of the financial soundness of the overall CalPERS system, the Annual Review of Funding Levels and Risks Report was developed. Included in this report are various system level actuarial results and risk measures that can be used to assess the effectiveness of funding policies, actuarial assumptions and methods.

CalPERS must ensure that the pension fund is sustainable over multiple generations. This is done by taking an integrated view of assets and liabilities and taking steps designed to mitigate risks over the long-term. The CalPERS asset allocation and actuarial assumptions are continually monitored and reviewed every four years during the Asset Liability Management (ALM) cycle. The most recent cycle was completed in late 2021 through early 2022. The current ALM cycle has begun with proposed changes to asset allocations or actuarial assumptions (if any), to be presented in September and November of 2025.

Analysis

Current Actuarial Results

The favourable investment returns during the year ending June 30, 2024, resulted in increases to the funded ratios for CalPERS plans. The total PERF funded status increased from 71.4% as of June 30, 2023, to an estimated 75% as of June 30, 2024. Each plan has its own funded ratio based on the assets and accrued liabilities of that plan. Some plans are better funded than the PERF average and others are not. Employer contribution rates (as a percentage of pay) are expected to be roughly level over the next several years for many plans. Although, each individual plan may see modest increases or decreases based on its particular circumstances.

COVID–19 Pandemic

The number of deaths among CalPERS retirees was higher during the pandemic resulting in actuarial gains. In addition, various aspects of the pandemic affected the behavior of many active members, in particular, with respect to retirement decisions. In general, recent experience shows a return to pre-pandemic results.

Other Risks

Over the next several years there is the potential for various factors to either further increase required contributions or add additional financial strain on employers and their ability to make required contributions. Two of these factors are inflation and near-term economic turmoil.

CalPERS and its members are potentially impacted by high inflation in several ways. Many retirees have received higher cost-of-living adjustments (COLAs) but likely still lost purchasing power. Higher COLAs result in higher contributions for employers. In addition, employee wages generally keep pace with inflation over the long-term. It is possible some members pay will increase faster than currently expected. The valuations for the year ending June 30, 2023, showed that between higher COLAs and higher than expected pay increases for the prior year, the PERF experienced actuarial losses of $7 billion. It remains to be seen if future inflation will continue to exceed our 2.3% assumption. If so, additional losses may be created, and the 2.3% assumption may need to be increased.

Despite positive signs with regard to the U.S. economy, there are other factors that may suggest the possibility of near-term economic turmoil. This could lead to potentially lower investment returns, increased investment volatility, and higher unemployment. Much of the discussion within this report is devoted to projecting funded ratios and contribution levels under various scenarios for future investment returns. If the system experiences lower than expected investment returns, the potential impact on required contributions, combined with the possible impacts of high inflation, could push contribution rates to levels that would prove challenging for some employers.

The inability to make required contributions puts a plan at risk for termination. The termination policies and processes currently in place mitigate risks to the system. However, if an employer is under severe financial stress, the termination policies cannot fully protect the benefits of members that have served that employer. Ultimately, the members' benefits are only secure if the employer continues to make the required contributions.

Budget and Fiscal Impacts

This section is not applicable to this agenda item.

Benefits and Risks

This agenda item and the attached report should enhance the understanding of the risks inherent in the funding of the system. Such an understanding is necessary for effective management and mitigation of those risks.

Attachments

Attachment 1 – 2024 Annual Review of Funding Levels and Risk Report

Attachment 2 – Annual Review of Funding Levels and Risks Presentation

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