Funding Risk Mitigation Policy

Purpose

The California Public Employees' Retirement System ("CalPERS" or the "System") Board of Administration ("Board") has established a key strategic goal of improving long-term pension benefit sustainability. This goal is to be pursued through funding the System with an integrated view of pension assets and liabilities and actively assessing and managing funding risk through an Asset Liability Management ("ALM") framework. This document sets forth the policy ("Policy") for funding risk mitigation, which is a significant component of the overall ALM framework.

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CalPERS

Background

The Funding Risk Mitigation Policy ("FRM") Policy seeks to reduce CalPERS funding risk over time. It establishes a mechanism whereby CalPERS investment performance that significantly outperforms the discount rate triggers a discussion around potential adjustments to the discount rate, expected investment return, and strategic asset allocation targets.

Staff Implementation of the Policy is overseen by the Asset Liability Management Advisory Committee ("ALMAC"), chaired by the Chief Financial Officer ("CFO") and made up of representatives from the financial office ("FINO"), investment office ("INVO"), actuarial office ("ACTO"), legal office ("LEGO") and communications and stakeholder relations ("CSR").

Strategic Objective

The strategic objective of the Policy is to reduce the volatility of investment returns, thereby increasing the long-term sustainability of CalPERS pension benefits for members.

Policy

If a Funding Risk Mitigation Event occurs, an item will be brought to the board for discussion on whether the discount rate and expected investment return shall be adjusted as set forth in Table 1 below, and the strategic asset allocation targets may be adjusted consistent with such new discount rate and expected investment return. The current CalPERS strategic asset allocation targets can be found in the CalPERS Total Fund Investment Policy, and are defined or approved during the periodic Asset Liability Management process undertaken by CalPERS, subject to adjustments per this Policy.

Table 1: Funding Risk Mitigation Event Thresholds and Impacts

Excess Investment Return	Reduction in Discount Rate	Reduction in Expected Investment Return
If the actual investment returns exceed the discount rate by:	*Then the discount rate will be reduced by:*	*And the expected investment return will be reduced by:*
2.00%	0.05%	0.05%
7.00%	0.10%	0.10%
10.00%	0.15%	0.15%
13.00%	0.20%	0.20%
17.00%	0.25%	0.25%

Upon the occurrence of a Funding Risk Mitigation Event, the Board shall be notified of the Event and a discussion seeking committee direction will occur.

1. Staff shall report the annual total fund time-weighted net investment return for the given fiscal year ending June 30th to the CalPERS Board of Administration.

2. When investment performance exceeds the discount rate by 2.0% or more, develop an agenda item that seeks board direction on potential adjustments to the discount rate, expected investment return, and or strategic asset allocation targets.
3. Implement changes as directed by the Board.

Policy Scope

This Policy applies to the Public Employees' Retirement Fund ("PERF").

Primary Responsibility

The Asset Liability Management Advisory Committee (ALMAC), under the direction of the CFO as chairperson, is responsible for this Policy. The Finance and Administration Committee ("FAC" or "Committee") is the Board committee responsible for overseeing staff's implementation of the Policy. The Committee intends for the Policy to be a dynamic document which will be reviewed and modified periodically to reflect the changing nature of CalPERS' assets and investment programs, benefit programs and economic conditions.

Key Terms / Definitions

For the purposes of this document, the following terms and definitions apply.

Key Term	**Definition**
Funding Risk Mitigation Event	The achievement of a time-weighted annual investment return net of investment expenses for a given fiscal year, as first publicly reported following the end of such fiscal year, that exceeds the CalPERS discount rate by 2.00% or more.
Event Year	The fiscal year in which the funding risk mitigation event occurred.
Threshold	The time-weighted annual investment return, net of investment expenses, in excess of the discount rate required for a funding risk mitigation event to occur.

Roles and Responsibilities

Staff's responsibilities with respect to the Policy shall include:

1. Reporting Funding Risk Mitigation Events to the FAC and implementing this Policy as these events occur.
2. Reviewing all funding risk mitigation actions taken with the FAC.
3. Reporting funding risk mitigation progress to the FAC in the Annual Funding Levels and Risks Report.

4. Reviewing the Policy with the Board as part of the cyclical Asset Liability Management (ALM) process.

The FAC's responsibilities with respect the Policy shall include:

1. Review Staff recommended action on Funding Risk Mitigation Events and take these recommendations for approval to the Board of Administration.
2. Overseeing senior management as they take steps to (1) manage, measure, monitor and control funding status and risks and (2) implement this policy.
3. Reviewing Staff recommendations for changes to the Policy and taking these recommendations for approval to the Board of Administration.

Authoritative Sources

CalPERS will administer this policy in compliance with the following legal, regulatory, and policy requirements:

Source	Description
Cal. Gov't. Code §20120	The CalPERS Board of Administration is vested with the management and control of the Public Employees' Retirement System (the "System").
California Constitution, ART. XVI, § 17	The Board has plenary authority and fiduciary responsibility for the investment of monies and administration of the System. The Constitution also vests the Board with the sole and exclusive power to provide for the actuarial services in order to assure the competency of the System.

Related Documents

For additional information, please refer to:

Document	Relevance
Asset Liability Management Policy	The Board has established a key strategic goal of improving long-term pension benefit sustainability. This goal is to be pursued through funding the System with an integrated view of pension assets and liabilities and actively assessing and managing funding risk through an Asset Liability Management ("ALM") framework. This policy

	establishes the overall ALM framework and serves as a guide for the Funding Risk Mitigation Policy.
Total Fund Investment Policy	Provides a framework for the management of CalPERS assets and outlines the objectives, benchmarks, restrictions and responsibilities of the investment program. Sets out the process for establishing asset class allocation policy targets and ranges and managing those asset class allocations within their policy ranges.

Revision History

The following revisions have been made to this policy:

Version	Modification Date	Summary of Changes
3.0	April 16, 2024	Removed the automatic change to the discount rate, added a triggered board discussion if annual assumed rate of return exceeds two percent, and updated procedural steps to align with removal of automatic mechanism. Updated to the new policy template and made minor grammatical edits.
2.0	February 14, 2017	Lowers the first threshold for the percentage by which actual investment return exceeds the discount rate in any fiscal year in order to trigger a discount rate reduction from 4.0% to 2.0%. Note: The Board has suspended implementation of this Policy until FY 2020-21.
1.0	November 15, 2015	This was the initial FRM Policy.