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Actuarial

Circular Letter

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To: **Public Agency Employers**
Subject: **Actuarial Amortization Policy**

Purpose

The purpose of this Circular Letter is to inform you of changes to the CalPERS Actuarial Amortization Policy, effective with the June 30, 2019 Actuarial Valuation Reports and contributions beginning fiscal year 2021-22.

Background

An amortization policy determines the systematic funding of a pension plan's Unfunded Accrued Liability (UAL). As part of the CalPERS Asset Liability Management Process, the actuarial office reviewed CalPERS' current policy and determined that changes were needed to address concerns of negative amortization, actuarial industry guidance, and intergenerational equity. The fiscal impact of the policy changes on annual employer contributions is expected to be minimal in the near term. The long-term impact will depend on future changes to unfunded liabilities resulting from, for example, investment gains or losses or changes to actuarial assumptions.

Current Policy

CalPERS' current policy amortizes different portions of the total UAL over different periods, and has been in place since the June 30, 2013 annual actuarial valuations. Unfunded liability created through the June 30, 2018 actuarial valuations will continue to be amortized under the current policy, except for inactive employers affected by item 5 below.

The following table summarizes key features of the current policy.

Source of UAL

Driver	(Gain)/Loss Investment	(Gain)/Loss Non-investment	Assumption/ Method Change	Benefit Change	Golden Handshake
Amortization Period	30 Years	30 Years	20 Years	20 Years	5 Years
Escalation Rate - Active Plans* - Inactive Plans	 Payroll (3%) 0%	 3% 0%	 3% 0%	 3% 0%	 3% 0%
Ramp Up	5	5	5	0	0
Ramp Down	5	5	5	0	0

* Reducing to 2.875% for the 6/30/2017 valuations and 2.75% for the 6/30/2018 valuations.

Changes to Policy Effective as of June 30, 2019

CalPERS is making the following changes to the Amortization Policy, effective with the June 30, 2019 valuations and contributions beginning fiscal year 2021-22:

1. Reduced period over which actuarial gains and losses are amortized, from 30 years to 20 years. This change applies only to new gains/losses established on or after June 30, 2019.
2. Level Dollar Amortization payments for all UAL bases throughout the amortization period. This change applies only to new UAL bases established on or after June 30, 2019.
3. Elimination of five-year ramp-up or ramp-down on UAL bases attributable to assumption changes and non-investment gains/losses established on or after June 30, 2019.
4. Elimination of five-year ramp-down on investment gains/losses established on or after June 30, 2019. The five-year ramp up from the current policy will continue.
5. Maximum amortization period of 15 years for the UAL of inactive employers (no active members in any CalPERS plan). This change will be effective for the June 30, 2017 actuarial valuations. The actuary will retain the ability to further shorten the period on any valuation date based on the life expectancy of plan members and projected cash flow needs of the plan.

New Amortization Policy Summary

The following table summarizes key features of the policy for bases established on or after June 30, 2019 with contributions beginning fiscal year 2021-22.

With the exception of inactive employers, the policy allows existing amortization bases to remain unchanged to minimize budgeting disruptions. The June 30, 2019 implementation date means that the first contribution year public agency employers will see any impact is fiscal year 2021-22.

Source

Driver	**(Gain)/Loss Investment**	**(Gain)/Loss Non-investment**	**Assumption/ Method Change**	**Benefit Change**	**Golden Handshake**
Amortization Period	20 Years	20 Years	20 Years	20 Years	5 Years
Escalation Rate	0%	0%	0%	0%	0%
Ramp Up	5	0	0	0	0
Ramp Down	0	0	0	0	0

The exact first-year impact of the policy changes cannot be measured until the June 30, 2019 valuations are completed, but the impact is expected to be small for most plans. This is because the majority of the UAL payment will be from amortized bases established on or before June 30, 2018 which are not affected by the policy changes. Also, the largest source of gain or loss is typically due to investment experience. These bases will continue to use a five-year ramp up which will significantly reduce the first-year impact.

We believe that these changes will improve fund sustainability, benefit security, and intergenerational equity.

Amortization Policy Review and Outreach

The CalPERS team provided comprehensive review and outreach regarding the amortization policy, including the following activities:

- September 19, 2017 — The actuarial office presented policy change recommendations to the CalPERS Board of Administration’s Finance and Administration Committee.
- November 14, 2017 — The actuarial office presented the first reading of the proposed policy changes to the Finance and Administration Committee.
- January 11, 2018 — The CalPERS team provided a webinar to CalPERS stakeholders regarding the need for policy changes and the possible impact of those changes.

- February 13, 2018 — The actuarial office presented the second reading of the proposed policy changes to the Finance and Administration Committee. The committee unanimously adopted the policy changes.
- February 14, 2018 — The CalPERS Board adopted the new Actuarial Amortization Policy including the recommendation to delay the effective date until the June 30, 2019 actuarial valuations.

All board materials are available on the CalPERS website at **www.calpers.ca.gov**. Board presentations and the amortization webinar can be viewed on the CalPERS Network YouTube channel at **www.youtube.com/calpersnetwork.**

Accelerated Funding Options

Implementation is not required until the June 30, 2019 actuarial valuations. However, public agencies may elect to adopt the new policy earlier. Public agencies currently have a number of options with regard to amortizing the UAL. At the agency's request, the CalPERS actuary may fresh start existing bases, shorten existing individual bases, and/or combine existing bases to achieve the public agency's goals, as long as the changes do not result in a deferral of funding. Also, the actuary may rebalance the amortization bases in order to smooth out funding requirements.

If you have questions about the amortization policy, call CalPERS Customer Contact Center at **888 CalPERS** (or **888**-225-7377) and ask to have your actuary contact you.

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Actuarial Office