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Segment: Downturn on Employer Contribution and Smoothing Changes
Operator: Not Introduced
Host: Patricia K. Macht, Director of External Affairs
Presenter: Alan Milligan, Deputy Chief Actuary

Audio Transcript

Operator:

Good morning Ladies and Gentlemen and welcome to the Downturn on Employer Contribution and Smoothing Changes conference call. At this time all participants are in a "listen only" mode. Later, we will conduct a question and answer session. Please note that this conference is being recorded. I will now turn the call over to Ms. Pat Macht. Ms. Macht may begin.

Host:

Thank you. Good morning. I want to welcome you to the second event of the California Retirement Dialogue. This is a series of web conferences and issue forums about retirement issues that is being hosted by CalPERS. The goal of the California Retirement Dialogue is to promote greater understanding of public retirement issues by engaging representatives of public employee groups, public employers and other interested stakeholders. This is a fact based dialogue about the future of retirement issues and the vital components that impact our benefits.

Today's Webinar features CalPERS Deputy Chief Actuary, Alan Milligan. Alan is going to share with us the impact of the economic downturn on the employer contributions and discuss the future of employer rates. He will also address some recent changes that we have made to our policies to help provide relief to our employers during what is a difficult financial environment. This bank recitation was shared recently with many of our employers at our Annual Educational Forum that was held in October. But it has been updated with current data and statistics.

Finally, I want to encourage you to register for two in-person issue forums that are scheduled for this month and next. On January 29th we'll be at the Sacramento Convention Center and on February 12th in Los Angeles at the LA Convention Center. You can register for both of these forums on our website by going to www.CalPERS.ca.gov. For those who may be interested in attending the Los Angeles event, you will want to know that the day before there will be a Public Retirement Journal Seminar held in the same location. So if you're interested in attending both of those in Los Angeles, it would be very convenient for you to do so.

Now, here are a few housekeeping items for today's webinar. First, if you want to speak to an operator just press star-zero (* + 0) on your phone. You can

submit questions by text after on the web via computer or by telephone. We expect this webinar to last about a half hour, followed by a Q & A session and will conclude in a total amount of an hour. A video of today's webinar will be available on our website on www.CalPERSresponds.com. Also, any questions we can't get to today on this webinar, we will be answering those on-line along with the video. So, on behalf of CalPERS I want to thank you for joining us today and now it is my pleasure to turn it over to Deputy Chief Actuary Alan Milligan.

Presenter:

Thank you Pat. These are the topics that I plan to address today. We all know that the current economic environment has put employers in very difficult financial positions. And, as we first reported to employers in the fall of 2008, we will have to increase pension contributions as a result of the turmoil in the investment market. This will add an additional burden to government at a time when they are already struggling. Everyone in California, including all of you, have an interest in these events as this will affect the state, schools and local agencies across the state. So whether you represent an employer, a collective bargaining agent, or a member of the public who pays taxes in the state, you have an interest in how the economic downturn is affecting government and in particular, how it impacts our pension contributions. I will be talking about both the causes of pension increases and about the timing and magnitude of the needed contribution increases. I will also be talking about a temporary policy modification that CalPERS has made in response to this unprecedented event.

There are a number of factors that have combined at the present time which result that the public sector is being battered by a perfect storm. Employer payrolls have increased, both because of an increase in the number of employees and increasing wages. Employer revenues have decreased. Healthcare costs are rising and now pension contributions must increase as well. Pension contributions are already higher than they have been since the 1980s and they will soon be increasing even higher. CalPERS can help a little bit, but we can only shift costs in time. We cannot make them go away. Real solutions to the current financial situation will need to be worked out between the parties at the bargaining table.

Let's get into some of the details. Unless we have again, a very impressive rebound in the market, contributions are going to have to increase. This is happening now primarily because of the active declines that happened in fall 2008 and early 2009. The way that the funding of this system was designed back when CalPERS was first created, is that there are three sources of funding: member contributions, which are fixed; investment earnings, which vary with the market; and the balancing item is the contributions from plan sponsors that is from the employers.

We are following the funding process the way that it was laid out when the plan was designed, but that does not mean that we need to increase employer

contribution rates. I would like to address the cost of benefit improvements. These costs have been included in the rates that employers are already paying. A very small number of plans may have some improvements that they have contracted for but that are not yet in effect. And these few employers will see an increase for that reason as well. However, for the vast majority of employers changes to their contribution rates will be due to investment and other experience, not benefit improvement. I don't want to mislead you. Benefit improvements have caused some of the increase in contributions over the last decade. They are just not a big factor now. Let's take a look at what has happened over the last decade.

While many reports indicate that the reason contributions have increased are because of benefit improvements. This can be misleading as it is only partially true. In fact, growth in government has a lot to do with the increases in contributions from employers. The cost of providing benefits is closely connected with the payroll of the sponsoring employer. When payroll grows faster than expected, whether due to increases in wages or due to new employees, CalPERS has to pay out more in benefits and will need to have more come in in contributions.

This slide shows the growth in the covered payroll for the state. Covered active employees have grown by 39% over the decade. Combine this with an increase in the average pay of 50% and you get an 84% increase in the covered payroll. This has resulted in a substantial increase in the dollars needed from the employer. Again, this was for state employees.

For school employees in CalPERS, which is pretty much all school employees other than teachers, the equivalent figures are a 39% increase in the covered active employees, a 49% increase in the average pay resulting in a 107% increase in the covered payroll.

For local government, with respect to their miscellaneous members--that is members who are not safety members, covered active employment has grown by 34%, the average pay has grown by 60% for growth in the total covered payroll of 114%. I should note here that some of this growth in covered active employees is a result of new agencies contracting for benefits. So for existing agencies, the growth in the number of employees and in the covered payroll would be less than shown here.

Finally, for local government with respect to their safety members, covered active employment has grown by 21%, average pay has grown by 69% for a growth in the total covered payroll of 104%. And again, some of the growth in employees in covered payroll is as a result of new agencies.

So what really caused the increase in contributions over the last decade or so? Well, it varies from employer to employer. Let's take a look at one particular

employer, the state. This fact shows a breakdown of the increase in state contributions over the period from the 97-98 fiscal year to the 2009-2010 fiscal year. The brown area on the right is the portion of the increase that is due to changes in payroll and represents 51% of the total, just over half. The blue area in the bottom left represents the increase due to SB400, that was a particular Bill that was introduced in 1999 which came into effect on January 1st, 2000 and increased pension benefits for state members and made new formulas available for public agencies. That increase represents 27% of the total change in the contributions over that period, just over a quarter of the change. The light brown/tan area is due to other benefit improvements, they represent 8% of the total change. Finally, the light blue area in the upper left is the effective gains and losses both because of investments and because of other factors, as well as changes in the methods and the functions. This is just 14% of the total. What this shows is that benefit improvements and SB400 in particular, represent a significant portion of the increased contributions but payroll growth is an even bigger slice of the pie.

Now let's take a step back. I said earlier that what is causing contribution increases now is what is happening in the investment markets. Let's look at that. This chart shows you the actual rates of return achieved by CalPERS over the last 20 years. While most of this period has been fairly good, the last two years, which are shown on the right, have been losses. Obviously last year was not good for any investor, CalPERS included. But also something that we should be noting is that these last two years have been the worst years in CalPERS investment history. This is a very unusual event that needs to be addressed separately from what we would normally expect to happen.

Well how do these returns for the last couple of years compare to our assumption about our earnings? Well, we currently assume that our investments will earn about 7.75% over the long term. And we really do mean the long term. We will be paying benefits for decades to come. There are members today who will be drawing benefits 80 years from now. One of the key points to understand is that we are not expecting to make the 7.75% every year. We expect investments to fluctuate over time. We don't want to overreact to each little blip in the market, but we don't want to under-react either. We will keep making changes to employer contributions to keep us heading in the right direction.

So how have these last two years affected our long term investment returns? Here is what our returns have been for the various periods ending on June 30th, 2009. Our short term and medium term returns have been below our assumed returns. This is to be expected. We are in the midst of or hopefully at the end of, the worst market since the great depression. It would be amazing if our short term or medium term returns were above our assumed rate of return at this point in time. What is encouraging is that our long term returns are close to what we are assuming. This is what we would hope to see given where we are in the market cycle and the severity of the current market cycle.

So from fiscal year 2003-2004 through fiscal year 2006-2007, the investment returns were in the double digits ranging from 11.8% to 19%. This resulted in a gradual improvement in the funded status. In fact, we ended this period close to 100% funded. At that point we had recovered from the dot.com crash at the beginning of the decade or maybe at the beginning of the last decade at this point. We then had a negative 5.1% return in 2007-2008. This reduced our funded status to 87% on a market value basis. And of course we had last year with a -24% return. This reduced our funded status to about 60%, or at least that's what we're expecting to see when we get our annual evaluations completed.

Here is a visual that shows the funded status of CalPERS over the period between 1992 and 2009. You can see the steady improvement in the funded status through the bull markets in the 1990s, a decline in the funded status from 2000 through 2003, primarily due to the dot.com bust but also due to benefit improvements, then there is the gradual improvement through 2007 that I mentioned in the previous slide; and finally, on the far right, you can see the impact on the last couple of years. And of course, the final ball on the right is in fact just an estimate, we have not completed those evaluations yet.

Well what about the current year? Well, this is a bit more encouraging. We are currently running at around a 12% rate of return. That is as of December 31st. It is too early for us to count on this. What will matter for setting employer rates is the rate of return as of the end of the fiscal year June 30th, but this is still encouraging. Let's hope that this holds up until the end of the fiscal year, but even if it does it will still not be enough. We need much more to offset the market losses of last year.

This chart summarizes what we saw when we started the 2010-2011 rates for public agencies. Over 80% of employers had relatively minimal changes. Their contribution rates changed by less than 1% either up or down. Another 6% actually had a reduction in their contribution rates of at least 1% of pay and the remaining 14% of plans had an increase in their contribution rates of at least 1% of pay. All of this is based on the -5.1% return in 2007-2008. The reason that there was so little change in the rates, even with a negative return is because of our smoothing methodology. We had built up a cushion as a result of the good investment experience in prior years and that offset any increases due to the -5.1% return. There were still some increases due to salary and retirement experience, and a small number of benefit improvements.

I'm going to talk a little bit about where the employer rates are going in the future. We are showing the change to employer contribution rates that would have been necessary as a result of the -24% return for 2008-2009 if we had not changed our policy. So this is what would have happened if our Board had not approved the temporary change to the smoothing methods. If we had not made any

changes, we would have expected most employers to see increases in their required contributions of between 3 and 8% of pay in the first year. These are pretty big increases and leads to the question are our smoothing methods working as well as they could.

Well, lets take a look at how smoothing has been working. This graph shows the average employer contribution rate for public agency miscellaneous plans at CalPERS over the years from 1980 to now and includes next year as well. The red bars represent the average contribution rate. The blue line is the normal cost-- that is the cost what we would be charging to employers if they were 100% funded at the time. Obviously they are less than 100% funded in recent years and that means that we are asking employers to contribute more, which is why the red bars are above the blue line in recent years.

I am going to concentrate on the red bars--the average employer contribution rate. This shows that the current contribution rates are similar to what they were in the 1980s, but it also shows how volatile the contributions were in the late 90s and early 2000s. You can see the dip in the rates which resulted from the bull markets in the 1990s and the sharp increases in employer contributions in the early 2000s. It was at this point in the early 2000s that we put in place the smoothing methods that we have been using for the last few years. And as you can see, for the last six years employer contributions have been quite stable.

Here is the same graph for public agency safety plans. As before you can see that the contribution rates recently are quite similar to what they were in the 1980s, they gradually reduced especially as a result of the boom during the 1990s. You see the same dip as you saw in the previous one, it just doesn't go quite as low, and you see the same sharp increase in the early 2000s. And finally, you see the stable contribution rates in the last two years just the same as you saw on the previous slide.

So as you can see, smoothing as worked well for the past six years but we have a much more serious test coming up--dealing with the market losses over the 2008-2009 fiscal year. This is a challenge that our old smoothing method would not have been able to handle without inflicting a lot of pain on our participating employers. We looked at the situation and decided that we should make some changes. So last year we went to our Board and recommended a temporary modification to the smoothing policy. They agreed with us and approved the new temporary smoothing method.

Here are the technical details of the new temporary smoothing method. We have a corridor around the market value of 80 to 120% of the market value. We are going to increase that corridor in the first year, reduce the amount that we increased it by half in the second year and go back to no increase, the regular corridor, in the third year. We are also going to isolate and amortize all gains and losses over the three year period over a fixed and declining 30 year period. So

for the June 30th, 2012 actuarial evaluations we will be back to our current smoothing methodology. Now that's why I've been describing it as a temporary smoothing method.

This graphic, I think, may help explain how the contribution increases are going to play out over time I think a little bit better than words would. The blue line on this graphic is the contribution rates that this employer would have had under the smoothing methodology in place before our Board took action. As you can see, right at the start contributions would have increased from 16% to about 21.5%. They would have gradually increased above that to getting above 23% and then falling off over time. The pink line is what will happen under the temporary methodology that has been approved by the Board. Those sharp increases in the first year are spread out over a three year period at which point the new methodology will actually cause the contribution rates to go even higher than they would have been if we had not made the change. This is because we are isolating those losses and paying for them over a fixed 30 year period. We are actually paying for those losses quicker under the new methodology even though we are giving employers a chance to sort of ramp up to the new contribution level. I do want to note with this that I guess you can see after about 30 years the contribution rate under the new methodology drops down below what we have under the old methodology. This is because at that point we have paid off most of the losses from 2008-2009 and whereas we would not have done under the old methodology. It should also point out that the graph on this scale has been designed to emphasize the difference between the two methodologies. And so if you are looking at this slide afterwards, please pay attention to the scale on the left.

There is an important concept that will help employers, and everyone for that matter, to understand the contribution volatility in a pension plan. This is what we call the volatility index. The volatility index is just the ratio of the market value of assets to the covered payroll of the employer. It is important because the higher planned volatility index, the more volatile that the employer's contribution will be. A plan with a volatility index of 8 will generally see twice the level of contribution volatility that a plan with an index of 4 will see.

There is a number of factors that impact a planned volatility index and I have listed some of them here. Currently, most miscellaneous plans have a volatility index of about 4 to 6 and safety plans have a volatility index of about 8. These vary between plans of course and there are some outliers so we encourage employers to be aware of the indices of their own plans. Having said that the volatility index is quite helpful in understanding what is coming in the way of contribution increases.

What we have here are the increases that we would expect to see in the first year that the 2008-2009 asset losses impact rates. That will be July 1st, 2010 for the state and schools plans and July 1st, 2011 for public agency plans. Most

miscellaneous plans are in the 4 to 6 range and will see increase of 0.3 to 0.8% of pay. A safety plan with a volatility index of 8 should expect to see an increase of about 0.8% of pay. For any employers out there, your volatility index is shown in your annual actuarial evaluation report as is a projection of the 2011-2012 contribution rate. I should warn you that we did not have the final returns for the year when we prepared the one year projection that we included in your annual evaluations. So we used a -28% return for that projection. This means that the estimate of the 2011-2012 employer contribution rate in your evaluation report may be slightly high.

These numbers are the increase in the first year only. What about the second and third years? Well here it is. For a plan with a volatility index of 4, this might be a 2% at 60 miscellaneous plan. Under the new method they would see an increase of 0.3% in the first year and an additional 1.3% in the second year and a further 2% increase in the third year with smaller increases after that.

Let's take a look at another. Well here is the plan with a volatility index of 6. This might be a 2% at 55 miscellaneous plan. The results are similar but with increases that are slightly greater than you saw in the previous slide. This table also shows another feature of the new method. In the third and fourth year, the contributions under the new method actually exceed those under the old method. Remember I said that the new method pays off the losses sooner. That cannot happen unless the contributions are greater under the new method at some point in time. You can see that happening here.

Finally, we show a plan with a volatility index of 8. This might be a 3% at 50 safety plan and again, you see larger increases because this time it has the higher volatility index and again, the contributions eventually climb higher under the new method than they were under the prior method.

I hope these last few slides have given you an understanding of what is coming in the way of contribution increases. I hope that this also helps you understand why some plans will have bigger or smaller contribution increases than other plans. And even help predict which ones will be affected in which way. Now I would like to move on to another topic.

Is CalPERS sustainable?

The answer is yes, it is sustainable. You may question me about this as the Chief Actuary for CalPERS Ron Seeling has been widely quoted as saying the benefits are unsustainable. I work closely with Ron and have heard him speak on this topic many times. Ron is concerned that many employers may find their future costs to be more than they can bear. He is not. And Ron is not questioning the sustainability of CalPERS. This is really just not an issue that we should be concerned about.

In this presentation I have talked about what the drivers of the higher costs of been over the last decade or so and what is driving contribution increases currently, primarily the recession and the associated market losses.

I would like to close by saying that we understand that employers--everybody really, are facing hard times and we are aware that increasing contributions in this financial environment is going to be very difficult on employers. And in fact, that pain is probably going to be shared. We cannot make this go away but we can help by giving employers a bit of breathing room, some time so that they can adjust as best they can. CalPERS actuaries are working with, and will continue to work with, both employers and collective bargaining agents to help manage this unique and difficult period.

Thank you. At this point in time I would like to answer any questions you might have. Operator, are you there?

Operator:

Yes, thank you. We will now begin the question and answer session. If you have a question, please press * then 1 on your touch tone phone. And if you wish to be removed from the queue, please press the # sign or the -. If you are using a speaker phone, you may pick up the handset first before pressing the numbers. So once again, if there are any questions, press * then 1 on your touchtone phone.

Presenter:

Okay. I think we are going to start with some questions that were submitted online.

First Question:

What is the optimal level of funding CalPERS is hoping for? 100%, 98%, or 90%.

Answer:

Well the answer on that is that we are trying to make progress towards 100% funding. No pension system is always at 100% funded because of fluctuations in the investment markets. We do not expect to remain at 100% funding. What we are trying to do is just make progress towards that goal. But that is our goal, we are trying to get to 100% funding.

Presenter:

Are there anymore questions? Have anymore questions been submitted online? Yes we have.

Question:

Okay, the next question is the estimated increases in employer rates are not the same lower--are not the same lower than the August 21st letter. Why?

Answer:

The August 21st letter was prepared based on an estimated -28% return for 2008-2009. The actual return was -24% and as a result the actual increases will be less than were shown in that letter.

Question:

Our third question is on the future employer contribution, what is the investment return assumption?

Answer:

The projected rates we presented today were developed assuming that CalPERS would earn 7 ³/₄% beginning on July 1st, 2009. So it is actually assuming a lower rate of return for the current fiscal year than we have already achieved.

Question:

The fourth question, how do you figure out the payroll ratio number?

Answer:

You can go to your annual actuarial evaluation report. That number is shown in the evaluation report itself. So we have actually explicitly included that in your annual actuarial evaluation report. You can just look it up there--and those reports are public documents, so if you're not an employer you can still get that number.

Question:

Next question, we seem to have quite a few. Have pension costs increased for the state by 2000% in the last 10 years?

Answer:

Well I think to answer that, I want to go back to a slide that we showed you earlier. Can we go back to that slide please? This is actually for local public agency miscellaneous plan, not the state, but the same sort of thing happened for both the state and local public agency miscellaneous plans. In the late 90s, early 2000s, our contribution rates were really low because we were at the end of quite frankly the longest bull market in history I believe, and we were--the contribution rates had fallen quite substantially. So yes, when you go from almost nothing to a more substantial contribution rate, you get a very high percentage increase. But I think it's very misleading to do so. In fact, if you take a look at what has happened here for public agencies--an again, the same sort of thing happened for the state, it would look very similar to this. You will see that while contribution rates have increased from you know, 1999-2000, they're really at the same level as they were back in the 1980s. So I think that that is quite a misleading statistic and it is certainly not one that I would want to use.

Presenter:

Okay. At the present time we are checking to see if we have anymore questions online.

Question:

How is the volatility index calculated? Is there a list of all agencies volatility indexed?

Answer:

We do not have such a list. We report each of the volatility indices to the employers in their annual actuarial evaluation reports. It is calculated by dividing the--is the ratio of the assets to the covered payroll of the employer. So a volatility index of 4 means the market value of assets here at CalPERS is 4 times the covered payroll of the group covered by that plan. So that's how we calculate it. Unfortunately there is no list of all agencies volatility indices. I am not sure what we can do with that.

Question:

So can our school district negotiate with the employee union so that part of the employers' rate is paid by the employees?

Answer:

Yes. But that would have to be done through collective bargaining and would have to be done outside of CalPERS. So I think there is a few issues with that and if that really is a question, I think you need to contact CalPERS and we will work with you on that one.

Presenter:

Still checking to see if there are more questions. Okay. Can we take a phone question while we are waiting for that question to come back?

Operator:

And thank you. Once again, if there are any questions, press *1. We do have a question from Thomas Williams. Please go ahead.

Question:

Okay. Yeah, my, my question is that we are a public agency and we do send in a prefunded amount for our retirees and my understanding is the reason that we started doing that is that that would guarantee the funds to be there in retirement. Can you explain why that's not working?

Answer:

I guess what I would say is that we do have the contributions that you contributed, but in order to fund these benefits, we are relying on investment income as well as the employer contributions. If we didn't invest in the markets,

we would have to be asking for much, much higher contributions. So because we are investing in the markets, there is a certain amount of market risk and contributions--and the markets go up and down. So we either have to stay out of the markets or we have to occasionally risk having some market losses in our portfolio. We think that we do very well and we think that this is still the right way to go. So I think that is where we are and that's where we intend to stay.

Presenter:

Do we have another question?

Operator:

Yes we do, we have Dena Haudrey, please go ahead. And Dena, your line is open. I'll take the next question. We have Alita Drake, please go ahead.

Question:

Yes, thank you. I am curious in working on our budget for this upcoming year do we utilize the information that was sent to us and then add on the average employer contribution in your historic bar graph there?

Answer:

If you look at your annual actuarial evaluation report, that's where we set the rate for 10-11. For 11-12, we also include in the annual actuarial evaluation report a projection of the rate for 11-12. Now that projection is based on the -28% return and may be slightly higher than that because we actually had a return of -24%. But that's probably your best source of information. You don't need to add anything to that number, it's already built into that number. If you want to really take a look at what the difference between the -28 and the -24 would do. You would need to contact your actuary. His phone number is on the cover letter to the actuarial evaluation report.

Ms. Drake:

Thank you.

Presenter:

You're welcome.

Operator:

And thank you. We have another question. We have Zane Johnson. Please go ahead.

Question:

Hi, I was wondering what if effect unpaid furloughs are having on your actuarial values. I am agencies continue to report salary without deduction for furlough to Pers but yet we only pay Pers on net pay which is net of unpaid furloughs. So is this creating and unfunded liability not addressed in your assumptions?

Answer:

To the extent that you are doing furloughs that will cause a reduction in the contributions that are being remitted to CalPERS. Depending on how much of a furlough you do, it may or may not impact the benefits. And if you're doing a relatively small furlough that's not too large, it will cause quite frankly very little change in benefits, but a reduction in the employer contributions to CalPERS. And so yes that will emerge as an experienced loss over the next few years. I think that we need to keep in mind that there may be a few other sources of experience over the next few years that will probably have a much more significant impact on the funded status. In particular I guess I would question whether or not we are going to see large salary increases over the next few years. I think there might be a few gains coming in that area. So it's a mixed bag, but the direct answer to your question is that yes, that will be causing an experienced loss that we will be recognizing in future years. Did that answer your question?

Mr. Johnson:

Yes, thank you.

Operator:

Would you like to take the audio question, the last one, or did you want to take one of your chat questions?

Presenter:

I was going to take a chat question and come back to you.

Operator:

Okay, thank you.

Question:

The next question I've got is has CalPERS done a sensitivity assessment to see what fees will need to be if the market stays in Japan two decade decline, I guess.

Answer:

We have done some sensitivity analysis but I don't think we have done any sensitivity analysis that was kind of modeled after the kind of recession that they saw in Japan over that period. So we have done some but not, not that particular sensitivity analysis.

Question:

We have another question. On the sustainability issue, what happens when an employee goes bankrupt or does not pay Pers, what is due to other employers-- what is due--do other employers make this up or do that agency, agency's retirees get less? I think, I think the question is what happens when an employer goes bankrupt.

Answer:

Other employers do not have to pay in the situation. By law, CalPERS has the right to terminate a contract and reduce benefits if an employer does not pay their required contributions. So if, if one employer failed to make their contributions that does not impact other employers in CalPERS.

Question:

Where can I find my particular volatility index? I have my current report but do not see the volatility index.

Answer:

It is in the report on Page 4, I think. So hopefully that will be the case. There may be a difference depending on whether you are a pooled or non-pooled agency, but I don't know. That's the best I can tell you at the present time.

Question:

Why are you anticipating at 7.75% return when your 20 year experience suggests less than 7.5%?

Answer:

Well I think you need to realize where we are at in the market in the present time. We are at the, hopefully, the end of the worst bear market since the depression. And I think that to assume that you know, I mean your ending point is such that you would expect your returns to be slightly less than your long term--than, your assumption. If we go back one year, so we look at the 20 year period ending not June 30th, 2009, but June 30th, 2008 what you'll see is a CalPERS rate of return is more like 9.4%. Well when we see a 20 year return of 9.4% we don't suddenly change our investment return assumption to 9.4%, we don't think that's appropriate. And similarly when we fall below the 7.75% I mean if we were near the top of a bull market or you know, it had been a good bull market and we were still below the long term assumption, then maybe we would need to take a look at that. But given where we are, this is exactly what we would expect to see and we think that 7.75% is still a very appropriate number to use.

Question:

Another question. If employees pay 2% additional more will this result in a 2% difference in your figures or is the offset different?

Answer:

Basically the offset will be 2%. It is not absolutely exact, but it's darn close. So yeah, the 2% increase in employee contribution would result in a 2% reduction in the employer contribution.

Presenter:

Can we take a phone call?

Operator:

Thank you. Our next question comes from Louise Ho. Please go ahead.

Question:

Thank you. I am reviewing one of our plans and looking at the volatility index and I am having to compare the variation for 2007 and the latest variation on 2008 and noticed that if the market value on 2007 is higher and the annual payroll is actually smaller, the index itself actually is higher. Does that make sense? That means that if you have more assets and smaller payroll you have more volatility?

Answer:

If you have more assets and a smaller payroll, yes you will have more volatility. That is exactly correct. Because the investment gains and losses are applying to the assets and so those bigger--you know when you have more assets, you're going to have bigger gains and losses. When you now try to amortize those over that smaller payroll, you very definitely get a more volatility. So yes, that's exactly correct.

Ms. Ho:

Why wouldn't that be misleading because when I did--when CalPERS first came out with their projection I want to say some time in the summer, I did the volatility calculation and was higher, now the volatility index based on 2008 is actually smaller. But that, that is actually going in the opposite direction because if you have less asset value and you have a bigger payroll, I guess that means that you have a bigger payroll to make up for your market value. But that doesn't make sense though, it should be the opposite because you are having--by looking at 2008 and we have such market loss--does the 2008 evaluation reflect the market loss, no right?

Presenter:

That's correct. It does not.

Ms. Ho:

It does not. So, so I see ...

Presenter:

Well let me clarify that.

Ms. Ho:

Okay.

Presenter:

It does not in the actuary liabilities and most of the numbers that we present in the report. However, in the report we do give you that one year forward projection of the rate that--the projection of the 2011-2012 rate. That's the only

place where the market loss, the 2008-2009 market loss is reflected in your report.

Ms. Ho:

Right. That's why I was listening to the conference today. My concern is if we were to use the 2008 volatility index, it is actually understating what your volatility index should be because like you just mentioned, the only place you show the market loss is on the projected rate for the following year. But if anyone is using the volatility index from the 2008 evaluation, they need to actually take a little bit higher because I'm looking at our savings plan. I am looking at the 2008 volatility index is 8.3, but looking at 2007, it is about 9.5. So, so even though using the 2008 number may not accurately reflect if you are doing a long range planning what your rate will be for the next couple of years. You need to take a little bit more conservative approach and actually increase your index a little bit more.

Presenter:

Well I think that if you're doing some long range planning and you are really trying to ask yourself what kind of volatility am I going to have, not in the next few years but many years out. Instead of using the volatility index, what you may want to do is divide your actuarial liabilities by your payroll. The reason for that is of course we are trying to get you to 100% funded. We are trying to get your assets up to 100% of the actuarial liabilities. So yes if you are trying to do some long term planning and you're trying to figure out what level of volatility and contribution volatility you're going to have, not in the immediate future but in the more distant future, then that's actually a good way to go.

Ms. Ho:

So you are saying to use the liability divide by you ...

Presenter:

Actuary liability divided by payroll. That's a much more stable number than the volatility index. The problem is it doesn't really reflect where you are right now and it may you know, in this case it would probably--it would overstate the volatility you expect to see in the next few years. But it is sort of what you would expect to see long term.

Ms. Ho:

But if you use the actuarial liability divided by payroll, what does that give you?

Presenter:

It gives you the equivalent of the volatility index but sort of for a longer term view.

Ms. Ho:

I see. And we are in a small employer pool, that we'll have to look at the entire pool's liability and payroll, right?

Presenter:
That's correct.

Ms. Ho:
Okay great, thank you.

Presenter:
You're welcome. Okay. We are now going to go back to some questions that were submitted online.

Question:
How has that make the impression that the 08-09 losses were a separate increment on top of the current contributions?

Answer:
The 08-09 losses are not included in the contribution rates that we sent you with your annual evaluations last October or last November. It was included in the one year projected rate that was included in that evaluation. So to the extent that you're saying that the 08-09 losses are an increment on top of the current contribution, you are correct and we have shown that in your annual evaluation when we did that one year projection of the rate. I hope that answers that question.

Question:
Another question that was submitted online. Can you explain how much of the total increase in contributions was due to benefit changes? Can you estimate how much of the rate increase was due to benefit improvements?

Answer:
I think for the state that was shown in my presentation. We broke the impact benefit improvements up into two pieces. One was the impact of SB400 and the other was the impact of sort of all other benefit changes. Both of those are shown in that pie chart that I have in my presentation. I hope that takes care of that.

Question:
Can we get these rates in a table like we got on the October 25th letter?

Answer:
We are going to check on that. I guess the thing is what we are really, you know I mean the projected rates that we included in the employer evaluation are much more meaningful because it reflects your particular plan than anything that we can do through this type of methodology. On the other hand if really what you're trying to do is something more general, something that you can apply to many employers, obviously looking up each and every employer separately is going to be very difficult and so we will see what we can do on that one.

Question:

Many state Pers systems are more conservative about their inflation adjustments for benefits. Might that be an appropriate fix for California?

Answer:

I think that the benefits that are provided for--we do provide--CalPERS has indexing of all of their benefits at the lesser of sort of a 2% increase or cost of living increases. Some employers do have the ability to contract for a higher level of indexing, but that's not that common. So the vast majority of members at CalPERS have you know, indexing equal to the lesser of 2% or the consumer price index. How that compares to other plans and whether that's an appropriate solution for CalPERS, I think its something that really needs to be dealt with in collective bargaining and I think that's the appropriate place to deal with it.

Last Question:

If employer contributions are made according to the letter sent in October 09, where is the additional monies paid by the employer going?

Answer:

I am not sure I fully understand this question. After the October 09 letter of course we sent out the annual actuarial evaluation reports and that's what we need you to make contributions on. So the right thing to do is to make contributions based on the annual evaluation report that we sent you. It is not appropriate to make the contributions based on the August 9th letter. So that is what I would say, make the contributions in accordance with your annual actuarial evaluation report. That will go into your plan or if you're a pooled agency, into the pool, which you are a part of and be available to provide those benefits for the members of your plan or the pool.

Presenter:

We have many more questions and will not be able to reach them all. But we will answer your questions online.

With that, we are out of time. On behalf of CalPERS I would like to thank you for participating in this webinar. I look forward to meeting you at future California Retirement Dialogue events.

Our next scheduled event is a forum to be held in the Sacramento Convention Center on January 29th. We also have a forum scheduled for February 12th at the Los Angeles Convention Centers. For those who may be interested in attending the Los Angeles forum, there will be a Public Retirement Journal seminar held in the same location one day earlier. Please visit our website at www.CalPERS.ca.gov for additional information about these events.

Thank you and have a happy New Year.

Operator:

And thank you Ladies and Gentlemen. This concludes today's conference.
Thank you for participating. You may now disconnect.