MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

FINANCE & ADMINISTRATION COMMITTEE

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

FECKNER AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

MONDAY, APRIL 15, 2024

10:15 A.M.

JAMES F. PETERS, CSR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

APPEARANCES

COMMITTEE MEMBERS:

Lisa Middleton, Chairperson

David Miller, Vice Chairperson

Fiona Ma, represented by Frank Ruffino

Jose Luis Pacheco

Ramón Rubalcava

Theresa Taylor

Yvonne Walker(Remote)

BOARD MEMBERS:

Malia Cohen, represented by Deborah Gallegos

Eraina Ortega

Kevin Palkki

Mullissa Willette

Gail Willis, PhD(Remote)

STAFF:

Marcie Frost, Chief Executive Officer

Doug Hoffner, Chief Operating Officer

Matthew Jacobs, General Counsel

Don Moulds, Chief Health Director

Michele Nix, Interim Chief Financial Officer

Scott Terando, Chief Actuary

APPEARANCES CONTINUED

STAFF:

Michelle Tucker, Chief, Human Resources Division

Fritzie Archuleta, Deputy Chief Actuary

Randy Dziubek, Deputy Chief Actuary

Nina Ramsey, Senior Actuary

Julian Robinson, Senior Pension Actuary

Will Schaafsma, Chief, Financial Planning, Policy, and Budgeting Division

Paul Tschida, Senior Actuary

Emily Zhong, Supervising Health Actuary

ALSO PRESENT:

Johnnie Pina, League of California Cities

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PROCEEDINGS

CHAIR MIDDLETON: Good morning. I'd like to call to order the Finance and Administration Committee. Our first order of business is roll call.

BOARD CLERK ANDERSON: Lisa Middleton?

CHAIR MIDDLETON: Present.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Here.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Present.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Present.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Present.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Here.

CHAIR MIDDLETON: All right. Good morning, Board members. Because we are not all present in the same room and Board members are participating from remote locations, that are not accessible to the public, Bagley-Keene requires that remote Board members to make certain disclosures about any other persons present with them during open session. Accordingly, the Board members participating remotely must attest either that, one, they are alone, or two, if there are one or more persons present with them who are at least 18 years old, the nature of the Board member's relationship to each person.

At this time, I would like to ask Ms. Walker to verbally attest accordingly.

COMMITTEE MEMBER WALKER: I so attest that I am alone and will remain alone for this meeting.

CHAIR MIDDLETON: All right. Thank you.

(Laughter).

CHAIR MIDDLETON: With that, I'd like to move on to the Executive Report to Ms. Nix.

INTERIM CHIEF FINANCIAL OFFICE NIX: Good morning, Madam Chair and members of the Committee. Michele Nix CalPERS team member. Yvonne added the humor for me today, so I'll just jump right into it. The action consent item today contains a delegation for the FAC and we recommend no changes to that. So just wanted to point that out.

The agenda before you today has seven action items for your consideration, the 2024-25 annual budget proposal, the annual review of the Board member employer reimbursements, Judges' Retirement and Judges' Retirement II actuarial valuation report, employer and employee contribution rates, State and schools valuation employer and employee contribution rates, and the Funding Risk Mitigation Policy.

In addition, we will review the long-term care valuation report and the semiannual health plan financial report.

The next Finance and Administration Committee meeting is schedule for September 2024 here in Sacramento. Thank you, Madam Chair. That concludes my report and I would be pleased to take questions at this time.

CHAIR MIDDLETON: Are there any questions at this time?

Seeing none, we'll move on to Item 3, which is action consent items. I've received a request to remove Item 3c for further discussion. Are there any other items that Board members would like removed from discussion?

Seeing none, if we could -- do we need to take a roll call vote on this?

COMMITTEE MEMBER TAYLOR: I'll move approval of all other items.

ACTING COMMITTEE MEMBER RUFFINO: Second.

CHAIR MIDDLETON: Okay. We've got an approval and a second. Roll call, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Sorry. Aye.

CHAIR MIDDLETON: All right. Thank you.

We'll move on to Item 3c and I would ask Ms. Nix and anyone else from staff to give a very short intro to this item and then we will move on to questions.

INTERIM CHIEF FINANCIAL OFFICE NIX: Sure. Item C3 is the semiannual contracting prospective report that do, obviously twice a year since it's semiannual. And it's reporting to the Board anything that exceeds a million dollar threshold. Do you want to ask questions at this time?

CHAIR MIDDLETON: Certainly. Mr. Pacheco, could you...

COMMITTEE MEMBER PACHECO: Yes. Thank you. And thank you, Ms. Nix. Yes, I would like to ask a question on the -- on actually page 6 of 12 of the item. I'd like to ask about the status of the recent benefit verification letters that were mailed out last month I believe to a certain population of retire -- re-population, and how that may be associated with the upcoming Socure contract moving forward. Thank you.

CHIEF EXECUTIVE OFFICER FROST: Okay. Thank you for the question, Mr. Pacheco. These are really unrelated. The death verification process is a process that we will continue even post the Socure contract. There is no perfect single data source for death information. Unfortunately, I wish we had access to that, but there 8,130 benefit eligibility letters sent out within the last two to three weeks. We have about 38.5 percent response rate with 37 deaths reported to date.

Kim Malm, who's our Deputy over our Customer Service areas will provide you a more fulsome update in her June report, but they are unrelated.

COMMITTEE MEMBER PACHECO: Thank you. Thank you for that clarification appreciate it very much.

CHAIR MIDDLETON: Great. Any other questions?

Can I get a motion to approve 3C?

COMMITTEE MEMBER PACHECO: I'll move.

COMMITTEE MEMBER TAYLOR: Second.

CHAIR MIDDLETON: Motion, second by Ms. Taylor.

Roll call, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye.

CHAIR MIDDLETON: Next item is information consent items. Is there a request to pull any of the information consent items?

Mr. Ruffino.

ACTING COMMITTEE MEMBER RUFFINO: Yes. It's on. Okay. Thank you, Madam Chair. Just a question, a clarification on 4C, please.

CHAIR MIDDLETON: Go ahead.

ACTING COMMITTEE MEMBER RUFFINO: Oh, okay. Sorry. Okay. Thank you. So, Ms. Nix, real quick, I'm just curious. You know, this is obviously represents the fiscal mid-year report to us. And as of December 2023, the net position of CalPERS Public Employee Retirement Fund increased by 10 percent since December 31st, 2022, if inter -- if I'm seeing this correctly primarily due to more favorable market conditions. So the question is how did changes in contribution rate impact the total contribution to the PERF as of mid-year 23-24 compared to mid-fiscal year 22-23, and what were the main drivers for these changes?

INTERIM CHIEF FINANCIAL OFFICE NIX: So the contributions for most went up a little bit, but -- and the question was how did it impact what, the drivers of the overall increase?

ACTING COMMITTEE MEMBER RUFFINO: Yeah. What were the main drivers that -- for these changes?

INTERIM CHIEF FINANCIAL OFFICE NIX: So the main drivers of the overall PERF were, as you said, the market experience. So we would have a higher market value at the end of December 31st, 2023. But the contributions also increased slightly, so that would obviously add to the insight of our overall assets.

ACTING COMMITTEE MEMBER RUFFINO: So good news --

INTERIM CHIEF FINANCIAL OFFICE NIX: Yeah.

ACTING COMMITTEE MEMBER RUFFINO: -- right?

INTERIM CHIEF FINANCIAL OFFICE NIX: Well, I mean, I guess if you're an employer or an employee maybe not. But overall, the -- for the PERF in general, yeah, it -- we are in a better position. Our contribution rate, I believe -- I mean, our funded ratio is increased slightly, which you'll hear in the actuarial presentation.

ACTING COMMITTEE MEMBER RUFFINO: Okay. Great. Thank you. Thank you, Madam Chair.

CHAIR MIDDLETON: Thank you. These are -- were information items and so no vote is necessary.

We'll move on to Item 5A on our action agenda item, and that is the 24-25 annual budget proposal. Ms. Nix and Mr. Schaafsma.

(Thereupon a slide presentation).

INTERIM CHIEF FINANCIAL OFFICER NIX: I'll go ahead and turn it into Will Schaafsma for a presentation on our budget.

BOARD CLERK ANDERSON: Before we start, Chair Middleton, we do have Dr. Gail Willis on the line so we will need to do the open attestation.

CHAIR MIDDLETON: All right. Go ahead.

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: Good morning, Madam Chair and members of the Committee. Will Schaafsma, CalPERS team member. Today, I will be walking you through the 2024-25 --

COMMITTEE MEMBER TAYLOR: We have to do the --

INTERIM CHIEF FINANCIAL OFFICE NIX: Did we have something? I'm sorry. I didn't catch that, but --

BOARD CLERK ANDERSON: The open attestation for Dr. Gail Willis.

CHAIR MIDDLETON: Ah. All right. So we need Ms. Walker to

COMMITTEE MEMBER TAYLOR: No, Ms. Willis.

CHAIR MIDDLETON: Oh, it's Willette. Okay. Because we are not all present and -- do I have to read this over again -- or just --

BOARD CLERK ANDERSON: (Nods head).

CHAIR MIDDLETON: All right. Thank you.

(Laughter).

CHAIR MIDDLETON: Because we are not all present in the same room and Board members are participating from remote locations that are not accessible to the public, Bagley-Keene requires that the remote Board members to make certain disclosures about any other persons present with them during open session. Accordingly, the Board members participating remotely must each attest that either, one, they are alone, or two, if there are one or more persons present with them who are at least 18 years old, the nature of the Board member's relationship to each person. At this time, I would like to ask Board Member Willette to --

COMMITTEE MEMBER TAYLOR: Willis.

CHAIR MIDDLETON: Willis to attest.

BOARD MEMBER WILLIS: Yes. This is Dr. Gail Willis I do attest to being alone.

CHAIR MIDDLETON: Thank you.

All right. We'll now on to Item 5A.

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: Thank you. So today, I'm going to walk you through the 2024-25 proposed budget agenda item, which is an action item. And I'll begin by updating you on our current year spending for fiscal year 2023-24.

Next slide, please.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: So as of December 31st, CalPERS has expended 982 million or roughly 40 percent of the current year budget. And based on our current projections, we estimate that we will end the fiscal year with a little bit more than 99 million in savings.

Next slide, please.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: So most of the projected savings fall within our operating cost categories within administrative operating costs. The savings driver here is position vacancies. Savings within investment operating costs are due to technology modernization project schedule changes and more cost efficient fee structures. Third-party administrator fees have a projected savings based on fall 2023 open enrollment, including health plan enrollment changes and migration to plans with lower TPA fees.

And while overall spending remains within budget, we continue to monitor and assess all expenses to make sure that they are appropriate. And as a reminder, all funds do remain in the PERF until actual expenses are paid.

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[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: So moving on to the proposed budget for 2024-25. We are proposing a budget of $2,470,000,000. This is a 26.6 million, or 1.1 percent, increase over the current year budget. And just for a point of reference, our annualized rate of growth from fiscal year 2020-21 through 2024-25 is 9.5 percent.

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[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: So I'll walk you through each of the budget categories, but the primary driver of this year's small increase is from external -- investment external management fees and headquarter building costs. These budget increases are attributable to the current strategic asset allocation, which assumes more active management and increased allocation to private asset classes as well as two building projects for Lincoln Plaza.

Can we get to slide 5, please.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: And next slide.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: So this is our operating cost category. The first Category I will discuss is administrative operating costs. This category includes personal services, which are the salaries and benefits we pay to our team, as well as operating expenses and equipment, which is also commonly referred to as OE&E.

In 24-25, we propose a total of $614.9 million in this category, which is 0.3 percent decrease over the current year. The decrease is primarily driven by planned reductions in software data and consulting services for non-investment related activities. And offsetting this decrease is an increase of 1.1 million for annualized salaries benefits and incentives for the 27 Investment

Office positions received in last year's budget to implement the new strategic asset allocation.

I would also note that within the administrative operating cost budget, there is a redirection of 4.1 million in projected salary savings to fund various business initiatives and Implement new projects. This includes 0.3 million for an actuarial experience study review, 1.6 million for Investment Office related recruitment services, 0.3 million for compliance and risk program consulting, 0.4 million for investment, contract, and procurement services, and 1.5 million for health program consultants.

And furthermore, the IT Services Branch will be leveraging some existing OE&E support a pilot program for artificial intelligence applications within the enterprise.

Next slide, please.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: So our next category is investment operating costs, which are costs specifically incurred for investments. The total proposed for investment operating costs in 24-25 is 146.7 million. This is a 3.9 million or 2.6 percent decrease compared to the 23-24 budget. The decrease is due to the expiration of the some one-time technology consultant services and related systems, infrastructure, and data funding. This is partially offset by an increase in appraisal fees resulting from greater volume and complexity of appraisals to support additional real estate investments.

Next slide, please.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: And our last operating cost category is for the headquarters building. We are proposing an $8.7 million increase to this category. This increase is driven by cost to continue updates to our audio and visual systems in the CalPERS auditorium and to replace fluorescent lighting with LED lighting throughout Lincoln Plaza. Just note on that, that California statute prohibits the sale of fluorescent lighting after Jan 1, 2025. And increases are also expected for utility rates and contracted service rates.

Next slide, please.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: And this is our external fees budget. These are estimated amounts that are largely influenced by external factors. While CalPERS estimates annual investment external management fees based on market assumptions and estimated deployment of capital, actual fees paid within a fiscal year are subject to market fluctuations. Current assumptions estimate total fees to be 1.4 billion in 2024-25, which is an increase of 4.4 percent over the 23-24 authorized budget.

As a result of the current strategic asset allocation, this increase corresponds to the expected change in the fees paid to external managers. Much of the increase in base fees is for private equity and private debt with additional but smaller in creases anticipated for global equity, fixed income, and real assets. A projected decrease in real assets performance fees reflects projected market conditions, which may lead to slower than anticipated returns.

Next slide, please.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: And this is our third-party administrator fees is our last category here. We are estimating a $36 million decrease in this category. The large driver here is our health program. Reduction is driven by primarily by Blue Shield changing from a flex-funded to a full insured program. And those fully insured programs do not include a TPA fee, as well as migration of members between health plans. We also project a reduction to Long-Term Care Program fees due to enrollment declines and continued suspension of new enrollments.

And next slide.

[SLIDE CHANGE]

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: So here again is our total 24-25 budget. My colleagues and I are happy to answer any questions you may have to inform your action.

Thank you.

CHAIR MIDDLETON: All right. Are there questions?

President Taylor.

COMMITTEE MEMBER TAYLOR: I actually didn't have a question.

THE COURT REPORTER: Microphone.

COMMITTEE MEMBER TAYLOR: Oh, it was. I did my part, man.

(Laughter).

COMMITTEE MEMBER TAYLOR: I didn't have an actual question. I just wanted to commend you all for working to -- even with our -- the increases in wages, and management fees, and everything working to bring that almost down to a wash. So I just wanted to congratulate you guys.

Thank you very much.

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: Thank you.

CHAIR MIDDLETON: Mr. Ruffino.

ACTING COMMITTEE MEMBER RUFFINO: Yeah. Thank you, Madam Chair. Echo those comments as well and the fact that we are not reducing any positions, so that's great.

I think I heard you saying that the 4.1 percent, or the 99.1 million, savings it was as a result of salary savings, so positions that they're vacant. And so I'm not sure exactly what your vacancy rate is, but I think the question is -- I think I know the answer, but I just want to make sure, because there's a lot of talks, as you know, with the budget deficit, that they want to eliminate any kind of open position. And I don't think that would affect us, would that?

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: (Shakes head).

ACTING COMMITTEE MEMBER RUFFINO: Okay. That's what I thought. I just wanted to understand that we were not subject to the -- you know, to that particular order, if, in fact, it gets executed or whatever.

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: You are correct. No position sweeps at CalPERS. So, the vacancy rate as of 3-31 for our enterprise is 14.3 percent. And again, the driver of the savings for the current fiscal year is position vacancies. We are actively trying to reduce that number to our fullest extent, so anticipating that number to go down in future fiscal years.

And then there is also, you know, some OE&E savings as try to, you know, look through our operating expenses and make sure what we're spending is truly needed for the enterprise.

ACTING COMMITTEE MEMBER RUFFINO: So 14.3 percent is your vacancy rate right now.

CHIEF EXECUTIVE OFFICER FROST: So, Frank, a large --

ACTING COMMITTEE MEMBER RUFFINO: Approximately. Approximately.

CHIEF EXECUTIVE OFFICER FROST: Yeah. A large number of those are the ones that we gave to the Investment Office. We gave those positions to them vacant. And it also correlates to the increase in outside search firm assistance to the Investment Office to be able to fill those positions. So they are making progress. It is slow. In particular, for Jean Hsu's team quite slow as she's trying to find, you know, competitive salaries when this is a very hot asset class right now. But we do believe that most of these vacancies will be filled in the next months.

ACTING COMMITTEE MEMBER RUFFINO: Great. Well, like I said, good job the Administrative Services Division and all of your team.

Thank you, Madam Chair.

CHAIR MIDDLETON: Thank you.

Mr. Pacheco.

COMMITTEE MEMBER PACHECO: Thank you, Madam Chair and thank you for your presentation. First of all, I also want to echo the same thing with my colleagues about this budget. It's very good and very robust. And Mr. Ruffino already answered my question about the vacancies, but I just want to veri -- want to just compliment on that. With respect to the recruitment, are we utilizing the rapid recruitment process to try to fill in these vacancies?

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: Yes. The rapid recruitment process is very much a part of our strategy to reduce vacancies and has been successful to this point. And we anticipate that lending some capacity to help us reduce the vacancy rate in the future.

COMMITTEE MEMBER PACHECO: And do you have any timeline when you feel it will happen?

CHIEF EXECUTIVE OFFICER FROST: Why don't we ask Ms. Tucker to come forward --

COMMITTEE MEMBER PACHECO: Sure.

CHIEF EXECUTIVE OFFICER FROST: -- and speak about it. We're not using rapid recruitment for the Investment Office vacancies, so these would be vacancies elsewhere in the enterprise, but we'll ask Ms. Tucker to talk more generally around recruitment and time tables, et cetera.

COMMITTEE MEMBER PACHECO: Sure.

HUMAN RESOURCES DIVISION CHIEF TUCKER: Thank you. Good morning. Michelle Tucker, CalPERS team member. Mr. Pacheco, in response to what Mr. Schaafsma mentioned, we are doing several mini rapid recruitments with specific occupational areas, for example our auditing classifications, I believe several specific areas in CSS have had many rapid recruitments, so that's kind of a more localized version of the rapid recruitment process that we adopted last year. And then the Investment team is, as Ms. Frost mentioned, actively working to fill those vacancies. So we have regular meetings with that team, the HR team, as well as the Investment team. They meet, I believe, once a week to kind of go over pending vacancies, where we are with various recruitments. So we are actively working on that.

COMMITTEE MEMBER PACHECO: Thank you. And I just want to -- I have one more question. It's corollary with respect to the recent announcement of our relationship with Stanford University and CalPERS investments. I just wanted to know that's also part of our strategy and our -- to recruit the next generations of folks.

CHIEF EXECUTIVE OFFICER FROST: Yeah, for certain. So that is also part of our pipeline development. You know, we hear a lot of reasons why we don't see more diversity in certain areas of the investment industry in particular. A lot of attribution to pipeline. So, you know, our thought is and belief is that we will develop our own pipeline to get there. So very important though as we bring these students in that we develop that long-lasting relationship so they look at us first when they're out looking for their next employment.

COMMITTEE MEMBER PACHECO: All right. Thank you. I look forward to this -- all these endeavors and our new budget. Thank you.

CHAIR MIDDLETON: Mr. Ruffino.

ACTING COMMITTEE MEMBER RUFFINO: Yeah. Thank you, Madam Chair just real quick a quick comment to trigger when we talked about rapid recruitment. And I'm not sure if it's something that it was granted to CalPERS or other agencies. But regardless, it doesn't matter, but I think it's worth thanking formally and officially, you know, CalHR for working with us and giving us that ability to do this rapid recruiting, and everyone that was involved in that process. So good work, CalHR.

CHAIR MIDDLETON: Any other questions?

I have one. The numbers for third-party administrator fees, that reduction is certainly very pleasing news to all of us. Is that a one-time major reduction, is this the new baseline for us moving forward, or is there any reason to believe that next -- over the course of the next year, we'll see any significant changes?

FINANCIAL PLANNING, POLICY, AND BUDGETING DIVISION CHIEF SCHAAFSMA: So that decrease is specific to Blue Shield moving to fully insured, which we would expect to continue at this point. So that budgetary impact would be ongoing and incorporated into future budgets.

CHAIR MIDDLETON: Very good. Thank you.

Well, I will add my compliments to those of my colleagues seeing a one percent budget change in 2024 is a pretty remarkable number and our compliments to everyone who was involved in this process. So thank you.

With that, we need to take a vote.

VICE CHAIR MILLER: Move approval.

CHAIR MIDDLETON: We have a move approval.

COMMITTEE MEMBER PACHECO: (Hand raised).

CHAIR MIDDLETON: We have a second.

Roll call, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye.

COMMITTEE MEMBER TAYLOR: Gail Willis?

BOARD CLERK ANDERSON: She's not on the Committee.

COMMITTEE MEMBER TAYLOR: Oh.

CHAIR MIDDLETON: All right. Motion is approved. We will move on to 5B, the annual review of Board member employer reimbursements. And again, Ms. Nix.

INTERIM CHIEF FINANCIAL OFFICE NIX: Thank you, Madam Chair. As you know, the Board's -- those Board members that are employed, their employers are reimbursed for salary and benefits paid as they spend time as elected Board members for the benefit of CalPERS. And the cost is primarily driven by the Committee assignments. So with that, I'll take -- I'll be -- I'm pleased to take questions. It's pretty much a standard item. So if you have any questions, I'd be happy to take those at this time.

CHAIR MIDDLETON: All right. Are there any questions?

Seeing none, is there a motion to approve?

COMMITTEE MEMBER PACHECO: I'll move to approve.

CHAIR MIDDLETON: And second?

VICE CHAIR MILLER: I'll second.

CHAIR MIDDLETON: We have a second by Mr. Miller. Roll call, please -- or roll call vote, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye. And I have a question after the vote is done. I didn't get my hand raised in time. Sorry.

CHAIR MIDDLETON: Sorry. Go ahead with your question.

COMMITTEE MEMBER WALKER: Okay. I just -- I just want to make sure that I'm understanding how this works, the employer reimbursement. I mean, my experience with that is, you know, we used to just get -- we'd get a bill from the employer and then we'd send it back out. So I just -- overall just want to know how it works.

INTERIM CHIEF FINANCIAL OFFICE NIX: I could certainly answer that. We actually have an MOU that we sign between the con -- between CalPERS and the employer agreeing on the reimbursement. And the employer bills CalPERS quarterly for the time spent at CalPERS and then we pay the employer directly.

COMMITTEE MEMBER WALKER: Okay. And does that account for also like when we -- when we go to -- (clears throat) -- sorry -- different meetings also?

INTERIM CHIEF FINANCIAL OFFICE NIX: Yes. There's a baseline that's something that we pay every time based on committee assignment. But then if there's any additional work that happens, that could be line itemed and also it is sent to us with -- the Board member actually reports it to their employer and then their employer puts it on the invoice.

COMMITTEE MEMBER WALKER: Okay.

INTERIM CHIEF FINANCIAL OFFICER NIX: Yeah.

COMMITTEE MEMBER WALKER: Thank you.

CHAIR MIDDLETON: All right. Thank you. And we did have a vote to approve, so this item is approved. We will move on to 5C, the Judges' Retirement System actuarial validation[sic] report and for that Scott and Tony.

(Thereupon a slide presentation).

CHIEF ACTUARY TERANDO: Thank you, Madam Chair. Scott Terando with the Actuarial Office. We have a number of actuarial valuations to review today. So I think we'll just jump right in. A quick little note Tony Cuny was unavailable today. So joining me today this morning is Randy Dziubek, who will present the Judges' valuation.

DEPUTY CHIEF ACTUARY DZIUBEK: Good morning, Madam Chair, Committee members. I am Randy Dziubek, Deputy Chief Actuary in the CalPERS Actuarial Office. As Scott said, this will be the first of four presentations of pension valuations as of June 30, 2023. CalPERS performs over 4,000 individual valuations each year.

You're only seeing four of them today, which I'm sure you're happy about. But together, they do represent about two-thirds of the system. The first two systems you'll hear about are relatively small, the Judges' plans and then you'll hear about the State and schools plans afterwards.

[SLIDE CHANGE]

DEPUTY CHIEF ACTUARY DZIUBEK: Now, the Judges' plan -- okay, let's see if I can advance these. I might need help. Okay.

The Judges' plan, as most of you probably know, has been closed since 1994, meaning new judges when they're brought into the CalPERS system go into the Judges' II plan, which Julian will talk about following my presentation. This is essentially a closed group of judges that's winding down. It will continue until the last judge passes.

The other unique thing about this plan is that unlike our other plans -- pension plans, this plan has not been prefunded. In other words, there has not been contributions over the years in excess of benefits paid that would result in the buildup of assets. This is essentially a pay-as-you-go system. The money that goes in every year is essentially what's needed to pay out benefits of the members in that following year.

Now, by statute, the members and the employer are both required to pay eight percent of payroll each year. That's important for the members, of course. That's the amount of money that actually comes out of their paycheck towards their retirement benefit. For purposes of the State, the eight percent is not very significant as it actually requires a lot more than that each year in order to contribute the amount of benefits that are going to be paid in the following year.

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DEPUTY CHIEF ACTUARY DZIUBEK: Okay. So if we look at the assets and liabilities of this plan. On the liability side, we have about $2.7 billion. And that's essentially the present value of future benefits expected to be paid from this plan. Assets of just over 50 million. Again, not a very significant amount compared to the size of the system, so it's 1.9 percent funded. And we expect that the employer will be required to pay about $200.4 million next year to meet the benefits that are expected to be paid.

Let's see if I can advance the slides.

Okay. Apparently, you need the Chief Actuary to advance the slides.

(Laughter).

[SLIDE CHANGE]

DEPUTY CHIEF ACTUARY DZIUBEK: Okay. So the math of the 200.4 million is pretty straightforward, as you can see on this slide. We project that the benefits paid next year will be $201.7 million. We'll get about $1.3 million from the 80 active members in the plan. And that will leave a difference of 200.4 million that the State will need to contribute next year.

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[SLIDE CHANGE]

DEPUTY CHIEF ACTUARY DZIUBEK: Looking at the demographics of this plan, we have 80 active judges remaining. They're about 75 years old on average with 35 years of service, just over 1,600 retirees in pay status, and about somewhere between 15 and 20 million dollars of annual payroll.

Next slide.

[SLIDE CHANGE]

DEPUTY CHIEF ACTUARY DZIUBEK: And then lastly, this is just a projection of benefit payouts over the remaining lifetime of this plan. Another unique thing about this plan is that they've essentially hit the top of their expected benefit payout stream. Our other plans are still generally increasing in terms of the amount of benefits being paid each year. This plan is already sort of at the top of that curve and is projected to decline going forward until again the last member has passed away.

So with that, I will take any questions.

CHAIR MIDDLETON: All right. Are there any questions on this plan?

Is there a motion To --

VICE CHAIR MILLER: Move approval.

CHAIR MIDDLETON: We have approval from Mr. Miller.

COMMITTEE MEMBER PACHECO: Second.

CHAIR MIDDLETON: Second by Mr. Pacheco.

Roll call, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye.

CHAIR MIDDLETON: All right. With that, we will now move on to Item 5D, which is the Judges' Retirement System II actuarial validation[sic]. And for that, we have Scott and Mr. Robinson.

(Thereupon a slide presentation).

SENIOR PENSION ACTUARY ROBINSON: Good morning, Committee. I'm Julian Robinson, Senior Actuary in the Actuarial Office. Happy to present the results of the Judges' Retirement System II this morning. Before I start, I'd like to thank my colleagues and the analysts in the office who have supported all of the work behind this valuation and the other valuations, which our office conducts.

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[SLIDE CHANGE]

SENIOR PENSION ACTUARY ROBINSON: We're going to cover briefly today, the actuarial valuation of June 30, 2023. This valuation is performed annually to determine the required contributions for the following fiscal year, so we're talking about fiscal year 2024-2025. And also, as part of the valuation process, we assess the PEPRA employee contribution rates necessary.

Next slide, please.

[SLIDE CHANGE]

SENIOR PENSION ACTUARY ROBINSON: A few brief comments about the experience of the plan in the previous fiscal year. The investment return of 20 -- during 2022-23 was 6.9 percent. The average salary increase was 3.4 percent. Benefits increased on average by three percent, and, the payroll -- total payroll increase of about 5.5 percent.

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[SLIDE CHANGE]

SENIOR PENSION ACTUARY ROBINSON: The key results for the system, similar to what Randy presented just earlier, but here are the corresponding results for the JRS II system. Unlike the JRS system, this is a funded plan and it's funded on an ongoing basis. The actuarial contribution is determined on annual basis. The accrued liability in the plan as of June 30, 2023 was approximately $2.4 billion. The market value of assets was $2.3 million. It's 98.8 percent funded, so it's almost a hundred percent funded, which is a great financial situation for this plan to be in. The discount rate used in this valuation is six percent.

Emerging from this valuation, the employer contribution rate for the next fiscal year will be 23.79 percent and the PEPRA contribution rate will be 16.75 percent.

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[SLIDE CHANGE]

SENIOR PENSION ACTUARY ROBINSON: Here's a few more details regarding the employer contribution rates. We have a employer normal cost rate which is the ongoing cost of benefits accruing in each fiscal year of 22.62 percent of salary, a unfunded liability contribution - it's relatively small, because the plan is in such good condition - of 1.17 percent to give us a total of 23.79 percent of salary. The projected payroll for the contribution year is 410 million. And therefore, we get an expected contribution for the plan of 97.6 million in the upcoming fiscal year.

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[SLIDE CHANGE]

SENIOR PENSION ACTUARY ROBINSON: Just a quick word about the PEPRA normal cost methodology. The total normal -- PEPRA normal cost is determined using the entire active population, that's the Classic and PEPRA members, based on the PEPRA benefit provisions until it has satisfied either of the two following thresholds. Either the number of PEPRA members exceeds 50 percent of the total members, in other words more than half of the population -- active population of PEPRA members or the other threshold is the PEPRA members exceed 25 percent, a quarter of the membership, and they -- there's more than a hundred PEPRA members.

So the PEPRA -- so as of this past valuation, the June 30, 2023 valuation, they -- the PEPRA thresholds have been met. More than 25 percent of the population of judge -- of active judges is now PEPRA and the -- therefore, the PEPRA normal cost determination has been done focusing on the PEPRA members alone. The average entry age of PEPRA members is 4.1 percent -- 4.1 years greater than the Classic members. And, in general, the higher the entry age leads to a higher normal cost.

The last slide --

[SLIDE CHANGE]

SENIOR PENSION ACTUARY ROBINSON: -- if we could just a quick review of the -- of the -- of the member contributions. The PEP -- we see the classic count as of June 30, 2023. There's 1,205 Classic members. The PEPRA count is 454. So that just put it's over 25 percent or actually 27.4 percent of the PEPRA population.

The Classic member total normal cost is 32.98 percent. Classic Judges pay an eight percent contribution rate. The PEPRA total normal cost rate is 33.35 percent and the PEPRA contri -- PEPRA member contribution rate is 16.75 percent.

With that, if any of the Committee has any questions, I'd be happy to answer. Thank you.

CHAIR MIDDLETON: Are there any questions?

I see none.

Is there a motion to approve?

VICE CHAIR MILLER: Move approval.

COMMITTEE MEMBER PACHECO: (Hand raised).

CHAIR MIDDLETON: Moved by Mr. Miller, second by Mr. Pacheco.

Roll call, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye.

CHAIR MIDDLETON: All right. The motion is approved.

SENIOR PENSION ACTUARY ROBINSON: Thank you.

CHAIR MIDDLETON: We will move on to Item 5E, the State valuation and employer/employee contribution rates. And for that, we will be joined by Ms. Ramsey. Thank you.

Welcome.

(Thereupon a slide presentation).

SENIOR ACTUARY RAMSEY: Good morning, Madam Chair, members of the Committee. Nina Ramsey, Actuarial team member. Today, I'm here to present to you for your approval the results of the June 30th, 2023 annual valuation for the State plans. This valuation sets forth the employer and employee contribution rates for fiscal year 24-25.

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[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: Thank you. And includes the five member subgroups listed on this slide. These include State miscellaneous, industrial, safety, peace officers and firefighters, and CHP. Before we get too far in, I need to mention that the attachments for this item were updated late last week on the CalPERS website to reflect a small change in the employer contributions for two plans. I believe these slides are updated, but I will make sure as we continue to go along.

Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: There have been a few significant changes since our last valuation. First, the PERF has received a 6.1 percent investment return as of

June 30th, 2023. Second, the State has made additional contributions towards their unfunded liability. In July 2023, the State contributed 1.7 billion, which was allocated to the miscellaneous industrial, safety, and POFF plans, according to their proportionate share of the State's general fund. This payment is described further or page six of the agenda item.

This payment was made after our valuation date and is therefore not included in the funded status as of June 30, 2023 nor is this payment included in the required contributions for fiscal year 24-25. Twenty-five million dollars was contributed to the CHP plan in April of 2023. Because this was ahead of our valuation date, it is included in the funded status and it has been applied to reduce the fiscal year 24-25 required contributions. This $25 million payment reduced the required contributions for CHP by about $2 million, which is equivalent to about 0.2 percent of expected payroll.

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[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: On this slide, we have some key results. For the June 30th, 2023 valuation, as well as from our previous valuation. As of June 30, 2023, we have an accrued liability of $248 billion, a market value of assets of $179 billion, leaving us with an unfunded accrued liability of about $69.5 billion and a funded ratio of 72 percent. We expect that the contributions for fiscal year 24-25 will be about $8.6 billion, which is 558 million greater than the current year. And just from this slide, I can see that these are the updated numbers.

The rates for 24-25 are increasing primarily due to the following reasons. We had a larger than expected non-investment loss as of June 30th, 2023. And we have the progression existing amortization bases, which is pushing up those contributions.

Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: This slide shows a brief history of the aggregate funded status for the State plans. You can see that we have increased from last year, 70.3 percent to 70.2 percent. This increase in the funded status attributable to the additional contributions made by the State during fiscal year 22-23 of $2.95 billion. We have also included the aggregate market value of assets and unfunded accrued liability that I mentioned from the previous slide. Individual figures for each of the five plans can be found in attachment 2.

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SENIOR ACTUARY RAMSEY: Here, we have a comparison of the current year rates and next year's rates. In the center column, we have the projected contribution rates, which were included in last year's annual valuation report. You can see that rates are increasing for all plans. Additionally, the expected contributions in the far right column are all higher than the current year.

Final rates do vary from what was projected in last year's valuation. For miscellaneous and industrial, the reason the rate is lower than projected is due to a larger-than-expected payroll increase. The UAL rate is determined by dividing the required contributions by the expected payroll. So when the payroll is larger than expected, you're dividing by a larger number, which results in a lower rate.

For safety, the reason the rate is lower is due to demographic changes within the plan. And for POFF and CHP, the rate is higher than projected due to large non-investment losses for each plan. This would include larger-than-expected salary and COLA increases, which were seen across all plans, but noticeably so for POFF and CHP.

Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: On this slide, we have the actuarially required contribute rates for fiscal year 24-25 listed on the left-hand side. We've also included, for your information, the additional contributions per Government Code 20683.2. These additional rates are for information purposes only and is something that is subject to the State's annual budget process.

Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: Moving on to member contributions. Separate member contribution rates for PEPRA members began January 1st, 2023 with PEPRA. PEPRA member contributions were initially set as half of the normal cost rounded to the nearest quarter percent. The normal cost is calculated annually. And when it is determined that the normal cost has changed by one percent or more since the last time the PEPRA member contribution rates were set, they will be recalculated. This is the policy we have in place for all of our public agencies.

The State employee contribution rates however do not adhere to this, as the rates for members are set through collective bargaining. In 2013, State Classic and PEPRA member contributions were scheduled to increase to reach half of the normal cost for bargaining groups where the employee contribution rate was less than half. For bargaining units where the member contributions were already greater than half the normal cost, those remained as they were.

Since 2013, the majority of member contribution rates have been determined through the collective bargaining process.

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[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: There are, however, a few exceptions where the State PEPRA member rates are calculated due -- according to the PEPRA rules that I mentioned. These exceptions include the PEPRA members of the Legislature, the California State University, and the Judicial Branch. These groups do adhere to those PEPRA rules. But as of June 30th, 2023, the normal cost has not changed by one percent or more since the last time those rates were sent -- set, so they will not be seeing any changes in fiscal year 24-25.

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[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: Additionally, we have a few bargaining units who have agreed that their Classic and PEPRA members will contribute half of the normal cost. These bargaining groups are 2, 5, and 18. Each of these groups has their own criteria for when those rates will change. But again, for these groups, the normal cost has not changed by one percent or more, so they will also not be seeing any changes in fiscal year 24-25.

Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY RAMSEY: Lastly, we have the project required rates for all five plans. You can see that rates are increasing through fiscal year 27-28. This is due to the ramping in of the June 30th, 2022 investment loss. You may notice a larger increase in fiscal year 27-28. And this is the last year of ramping in the '22 investment loss. The reason it is so noticeable in that year is because the year prior will have seen the full ramp-in of the June 30th, 2021 investment gain, which will no longer be offsetting the loss. You may also spot that CHP has a dip in fiscal year 26-27. And this is due to a large amortization base dropping off the year prior.

We will release updated projections later this year once our investment return, as of June 30th, 2024, is published. And we will also be publishing our full valuation report, which will include our assumptions, method, and our participant data. This concludes my presentation and I would be happy to take any questions.

CHAIR MIDDLETON: All right. Thank you.

Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you. Very good presentation. I did have just a clarifying question on this non-investment loss.

SENIOR ACTUARY RAMSEY: Yes.

COMMITTEE MEMBER RUBALCAVA: You know, because also when the Judges' II, we noticed that unfunded accrued liability decreased, which is generally a good thing, and the funded ratio improved, which is very good thing, and yet the employer contribution rates increased. And so, the explanation because it's mostly these non-investment losses. So that's more -- can you explain a little bit, you mentioned salary, you mentioned some demographics. So can you explain --

SENIOR ACTUARY RAMSEY: Sure. So we --

COMMITTEE MEMBER RUBALCAVA: -- what non-investment loss means. Thank you.

SENIOR ACTUARY RAMSEY: Yes. So every year when we perform the valuation, we have two categories that will always be added on. We have the investment loss, which is directly tied to the investment return that we earn. Whether it is below or above our discount rate of 6.8 percent, that will determine if it is a gain or loss.

For the non-investment gain or loss piece, that is just us reviewing the changes within the demographics of the plan, meaning all the members within the plan, whether they performed in accordance with our actuarial assumptions, meaning did they earn the exact payroll increase that we expected for them. Our general salary increase assumption is 2.8 percent. Most plans received greater than that in fiscal year 22-23. So when the salaries go up, that means the liabilities go up higher than we expected them to generating a loss.

The same can be said for COLA increases. With the current inflation situation that we have right now, many members are receiving greater than that two percent COLA benefit increase that we expected. So because those have increased further than we expected, that just means the liability has bumped up higher than we expected, generating a loss.

COMMITTEE MEMBER RUBALCAVA: So --

SENIOR ACTUARY RAMSEY: There are other assumptions within that, but those are two biggest contributors for this year.

COMMITTEE MEMBER RUBALCAVA: These actuarial assumptions they usually come out of the experience study.

SENIOR ACTUARY RAMSEY: That's right.

COMMITTEE MEMBER RUBALCAVA: So does that mean we can expect some significant changes in the -- when we look -- when we do the experience study and then the assumptions are approved for the next cycle?

CHIEF ACTUARY TERANDO: Yeah. During the next

ALM cycle, we look at the -- all our demographic assumptions. And, you know, what we need to -- you know, keep in mind is, you know, we want to take a long-term perspective on these assumptions. And we have to try and weed out, you know, short-term fluctuations and try and do our best estimate in terms of where we see inflation going, salary increases, and so forth.

But we do take into consideration, you know, what experience has happened over the last, you know, several years compared to what our expectations were and what -- you know, what are our expectations going forward. We bring those back to the Board. We have a full discussion about it. And, you know, we have the conversation and discussion to kind of let the Board know where we're going with -- where we see differences based on what we've currently assumed and any changes going forward.

COMMITTEE MEMBER RUBALCAVA: Because I know that there's been a lot of varied views about the -- about mortality tables, how they've been changing versus --

CHIEF ACTUARY TERANDO: Yeah. We --

COMMITTEE MEMBER RUBALCAVA: -- back and forth.

CHIEF ACTUARY TERANDO: Yeah.

COMMITTEE MEMBER RUBALCAVA: So looking forward to see how -- where we land on that.

CHIEF ACTUARY TERANDO: Our mortality has -- you know, we made some fairly significant adjustments several years ago. And that's a -- you know, a key driver in terms of assumptions. I think we're going to be keying on inflation, salary increases going forward. Those seem to be deviating the most currently. And, you know, we're going to try and make our best estimate in terms of where we see these changes going in the future, because, you know, when you think about it, you know, you can have a few years of salary increases really high, but are you really going to have 20 years of those increases year, after year, after year way -- at that level? So, you know, we need to make a reasonable assessment of where they are on a long-term basis.

COMMITTEE MEMBER RUBALCAVA: Thank you very much. Thank you, Madam Chair.

CHAIR MIDDLETON: Thank you.

Are there any other questions?

Any other comments?

Then motion to approve.

COMMITTEE MEMBER RUBALCAVA: I'll move approval.

COMMITTEE MEMBER TAYLOR: Second.

CHAIR MIDDLETON: Okay. We have a motion and a second. Roll call, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye.

CHAIR MIDDLETON: All right. Thank you.

And with that, we will now move on to Item 5F. And for that Mr. Tschida - I hope I did that correctly - will join us.

(Thereupon a slide presentation).

SENIOR ACTUARY TSCHIDA: Good morning, Madam Chair, members of the Committee. And yes, it's Paul Tschida. It was a very good job. Most people don't pronounce that anywhere even close to correct, so --

(Laughter).

SENIOR ACTUARY TSCHIDA: Senior Actuary in the CalPERS Actuarial Office. And you've heard a lot of actuarial valuation information today. And I'm here to discuss, last but not least, the schools pool, which is the largest component of CalPERS by membership, so by head count of membership. I will be presenting the results of the actuarial valuation and the recommended employer and employee contribution rates.

Let's see if I can master the clicker that others have struggled with.

Apparently not.

[SLIDE CHANGE]

SENIOR ACTUARY TSCHIDA: Thank you. So the valuation, like the other plans you've heard about, is June 30 of 2023. And that sets the recommended contributions that we are recommending to you for fiscal year 24-25, so the fiscal year that is coming up. And all participating school employers in the pool pay the same right, so it's essentially a risk pool.

Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY TSCHIDA: There are three Key elements of experience that I would like to touch on that were incorporated in this valuation. The first was the investment return of 6.1 percent that you've already heard about for the State. That's the PERF-wide number. Typically, the investment return is a fairly significant driver of our results, one way or the other. We thinks it's -- you know, whether it's a gain or a loss. This year, 6.1 percent is relatively close to the discount rate of 6.8 percent. So there is a small actuarial loss that came from it, but it's a pretty small player relative to some of the other factors that we saw in this valuation.

A much bigger factor was the salary increases. So for active members in the schools pool, the average increase was 9.8 percent in salary, which is quite sizable. And that's for the year ending June 30 of 2023. So that produced a more sizable actuarial loss. This would be an example of non-investment loss that Nina was talking about.

And another very important element of experience is the total pool payroll, which increased by 13.9 percent from the prior year. And that is quite a bit larger than our 2.8 percent assumption. And so we will -- we will see how that -- we'll see in a few slides how that affects the rate. But that is really a product of the prior item, the salary increases, combined with a fairly sizable growth in the -- just the total headcount of the active population of the schools pool.

Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY TSCHIDA: The key results are summarized here on this slide and I want to note -- I want to note three particular things. The first is just that you see the accrued liability and the market value of assets increased from last year to this year. And if you look at the unfunded accrued liability as a dollar amount, it did increase a bit over last year and the funded ratio ticked down a little bit from 67.9 to 67.5 percent. That deterioration in the funded status of the pool is due primarily to those salary increases, those sizable salary increases that we saw on the prior slide. The discount rate was unchanged.

In the contribution rates that we are recommending to the Board, both for the employers in the schools pool as well as the PEPRA employees are shown here. So the employer rate is increasing by 37 basis points from 26.68 percent to 27.05 percent, and the PEPRA member rate is not -- is not changing. It will -- it will remain eight percent.

Now, on the next slide, we'll see a more detailed look at the employer contribution rate from last year to this year. So if you could move to the next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY TSCHIDA: Thank you.

So a lot of number here, but a few things to notes. First is that increase in the employer contribution rate that we talked about from last year to this year, so the 26.68 percent moving to 27.05 percent actual rate for this upcoming fiscal year. So that's that 37 basis point increase we talked about.

The second item I'd like to note is that in the middle column, we show what we estimated the rate would be this year based on last year's valuation. And we thought it was -- we estimated it would be 27.8 percent. So it's really coming in 27.0, 27.1, so quite a bit lower than what we had projected.

And the culprit for that, the reason for that is the third item I'd like to point out, which is that projected payroll. So you see that last year -- in last year's valuation, the payroll that came into plat in the contributions was $16.7 billion. We estimated that this year that would increase to 17.2 billion approximately. Well, it's really coming in more like 19.0, 19.1, so quite a bit above what we projected. And again, that's driven by that 13.9 percent payroll increase that I spoke about a few slides ago.

Well, when you have a higher payroll, what happens to the employer contribution rate is that it serves to push it down a little bit. And that is because one of the components of the contribution rate is a payment towards the unfunded liability. That payment is determined as a fixed -- as a dollar amount. It's not determined as a -- determined as a dollar amount. And then to convert that to a rate that employers pay, you divide it by the payroll. So when the payroll goes up, you're increasing the denominator of that calculation and you end up -- you actually end up with a lower contribution rate.

So you can think of it as the same dollar amount is going to be -- we expect the same dollar amount to be coming in, but it's spread over a wider base, and therefore the rate itself goes down a little bit. So that helped to -- went a long ways towards mitigating a potential increase in that rate.

Okay. Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY TSCHIDA: Here is a 10-year history of the funded status, both the funded ratio on the top, as well as the unfunded liability as a dollar amount on the bottom, which is the white bars on the bottom. So this is just showing the same information you saw a couple slides ago, where the funded ratio ticked down from 67.9 to 67.5. Fairly steady. Just a very mild decrease there. And again though with a corresponding small increase in the unfunded accrued liability. Again, the largest driver is those salary increases we saw. I also want to note that there were -- you'll recall there were several discount rate changes over the course of this 10-year history.

At the beginning of this period, we were at seven and a half percent and now we're at 6.8 percent. And, of course, every time you lower the discount rate, you increase the unfunded liability a bit and you decrease the funded ratio. So that's part of what's behind some of the dropping that you're see on this slide.

Okay. Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY TSCHIDA: So again, PEPRA member contribution rate is something that we determine as part of the actuarial valuation. And the PEPRA members of the schools pool are subject to the requirement that they pay 50 percent of the normal cost. So we do the calculation every year and to see whether the total normal cost for the PEPRA members changed by more than one percent. And this year, it did not. Now, you may recall the last year it did change. A year or two ago, it was triggered by the decrease in the discount rate. It finally pushed it over the edge and the member rate increased to eight percent.

Well, this year, it is staying the same. The total normal cost has not changed by enough to trigger a change to the member rate. So they will still pay eight percent.

Now, what's noteworthy in the schools pool is that it's fairly sizable in terms of the PEPRA percentage of it. So 62 percent by a headcount of the schools pool are PEPRA members and by payroll is 54 percent, so well over half of the schools pool has already switched from classic to PEPRA.

Next slide, please.

[SLIDE CHANGE]

SENIOR ACTUARY TSCHIDA: Also, as part of the actuarial valuation, we refresh our analysis of where we think contribution rates might go in the future. So this is our best estimate based on what we know today, assuming all of our actuarial assumptions in the future are met, including the 6.8 percent investment return for this year and all -- and all subsequent years.

And you see we start at the 27.5 -- 27.05 percent for this coming fiscal year that we are recommending. And you see that there -- we expect the rate to increase for the next three fiscal years before then starting a slight decline after that.

And the reason for the increase in the next three years is exactly what Nina discussed for the State valuation, which is you still have that sizable investment loss from fiscal 21-22 that is still being ramped in and is really the main driver, the key driver behind that increase that you're seeing there. And then once that's fully phased in, then you have other -- then you have -- you're more in a steady state at that point and the slow changeover we've been seeking from Classic to PEPRA continues to take its effect, which serves to slowly drop the contribution rate over time. So hopefully, 27-28 we reach our peak and go down from there.

Okay. That is the end of my prepared remarks. I'm happy to take any questions the Committee has.

CHAIR MIDDLETON: Mr. Pacheco.

COMMITTEE MEMBER PACHECO: Thank you, sir. Thank you very much for your presentation. I actually want to go back to that last slide, which is the projected employer contribution rate. And you mentioned that if we -- you know, hypothetically, if we did -- if we did bring in our -- we had an increase in our return and exceeded our return, hopefully we could -- we could see a decrease in -- a projected decrease in the employer contribution. I just wanted to know your thoughts around that.

SENIOR ACTUARY TSCHIDA: Well, that is correct, that -- so this cont -- this projection, like I said, assumes that we get 6.8 percent return in the year we're currently in. And, of course, we're already at April.

COMMITTEE MEMBER PACHECO: Right.

SENIOR ACTUARY TSCHIDA: We're not going to, you know, surmise what the return might be. But yes, if the return for the fiscal year we're in now comes in above 6.8 percent --

COMMITTEE MEMBER PACHECO: Um-hmm.

SENIOR ACTUARY TSCHIDA: -- that's going to bend this curve down a little bit. The 27.05 beginning point is fixed. That's not going to change, but returns over 6.8 percent would help to push that down. And, of course, the amount by which it's pushed down would be -- would depend on how strong the investment return is. Bet yes, if we get over 6.8 percent, then hopefully -- then we should see this curve a little bit lower than what we're portraying here.

COMMITTEE MEMBER PACHECO: And I -- and I do recall from our March meeting during our trust review, we did see a -- for the first quarter, I think it was like 10.3 percent increase in our -- in our return. But, I mean, that is promising. There is many promise there absolutely.

Thank you.

SENIOR ACTUARY TSCHIDA: Yep.

CHAIR MIDDLETON: All right. Mr. Palkki.

BOARD MEMBER PALKKI: Thank you, Madam Chair. Thank you for the presentation.

Sort of tying into Mr. Pacheco's comments, looking at the long-term, the 10, 20 years down the road, do you see this trend of dropping even further or do you see it sort of stalling in the long term?

SENIOR ACTUARY TSCHIDA: In terms of the drop in the -- in the employer rate that we're --

BOARD MEMBER PALKKI: Yes.

SENIOR ACTUARY TSCHIDA: -- projecting here?

BOARD MEMBER PALKKI: Yeah.

SENIOR ACTUARY TSCHIDA: Yeah, so there's a few -- there's a few things. There's really two things going on that's underlying this projection. You know, we try not to think too far beyond five years, because, I mean, even five years is a bit of a stretch, because there's so much experience coming in every year that changes. And beyond five years, it's kind -- you lose more and more value as you go on time, kind of like a weather forecast.

But we're going to see two main forces happening here. We're -- we have the unfunded liability payment stream that is playing out. Now, we have -- we have amortization bases in existence for every past valuation and the investment and non-investment experience that came in. So those are going to continue to unwind themselves. And so it may not be a smooth -- you know, smooth drop, but a little bit of undulation in that, but we should see those over the long term trend down, assuming we don't add anything new in the future, right?

And the other aspect, the other thing this is changing is the normal cost rate. Now, the normal cost rate is that's the cost of benefits accruing in the coming future years. That rate is -- we expect that to continue. It has been and we expect it to continue to slowly decline over time. And that's because, as the membership -- the active membership changes from Classic to PEPRA, you have a lower benefit structure, less costly benefit structure, and the normal cost is correspondingly lower.

So we do see the normal cost -- the employer normal cost is slowly trending down over time and that's probably the -- that is the main driver of what you're seeing the last two years there of that chart is that gradual decline. And we do expect that to continue into the future until the population is wholly PEPRA.

BOARD MEMBER PALKKI: Thank you.

CHAIR MIDDLETON: All right. So if I heard correctly, you're projecting that we will peak in terms of employer contribution rate at 29 percent in fiscal year 27-28. And at least looking ahead for five years, that number should continue to go down, is that correct?

SENIOR ACTUARY TSCHIDA: I'm sorry. So continue to go down beyond this chart or --

CHAIR MIDDLETON: Yeah.

SENIOR ACTUARY TSCHIDA: Yeah. I don't have the numbers. I don't have the numbers. We are able to produce a longer projection. I don't have the numbers in front of me. I don't want to -- I don't want to say anything definitive at this particular meeting, but yes, the long-term trend after 27-28 is -- the long-term trend is a decline. There may be years in our projection that maybe it -- maybe there's a pop-up for some reason for the up because of the amortization basis playing out. But yeah, the long-term trend, I would say, a gradual decline.

CHAIR MIDDLETON: Okay. And this may be a question that Scott will have to jump in on, but is there reason to believe the schools, in terms of when they're going to peak at a employer contribution rate, are going to get to that peak sooner than public -- the State and other public agencies or is -- are the three systems going to be relatively consistent?

CHIEF ACTUARY TERANDO: I would think -- overall, they're going to be -- get there fairly consistently. I think you've got to take and look at individual plans as being a little bit different.

CHAIR MIDDLETON: Um-hmm.

CHIEF ACTUARY TERANDO: If you look at the State, you know, they're about two percent funded better than the schools are. And I think that's attributable to the additional contributions that the State puts in each year on behalf of the State plans. You know, those additional -- those additional billion dollars of contributions, you know, just move up the point at which the contributions will get lowered. I think your biggest drivers are going to be really what happens, you know, with the investment returns over the next few years. That's going to be the biggest drivers on where most of the plans go.

CHAIR MIDDLETON: Thank you. That makes sense.

Are we moving to a greater percentage of employees who are PEPRA at a rate that is relatively consistent with expectations or is that happening at a slightly increased rate?

SENIOR ACTUARY TSCHIDA: So speaking for the spools -- schools pool specifically, it's tracking fairly well I would say to what we would project. Other plans in the PERF, some of the public agency plans maybe have different experience. But schools pool in particular, yeah, it's tracking fairly closely.

CHAIR MIDDLETON: All right. Thank you.

Are there any other questions?

If I could get a motion to approve?

COMMITTEE MEMBER PACHECO: (Hand raised).

CHAIR MIDDLETON: Mr. Pacheco.

A second.

COMMITTEE MEMBER TAYLOR: (Hand raised).

CHAIR MIDDLETON: Ms. -- President Taylor.

Roll call vote, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye.

CHAIR MIDDLETON: And I want to thank all of the presenters on these issues for being so informed and so on top of the issues and the questions. We really appreciate it.

SENIOR ACTUARY TSCHIDA: Thank you.

CHAIR MIDDLETON: With that, we will move on to 5G, the Funding Risk Mitigation Policy. And for that, it's Ms. Nix and Scott.

(Thereupon a slide presentation).

INTERIM CHIEF FINANCIAL OFFICE NIX: Scott deserted me, so I'll just give you a little break from the valuation reports --

CHAIR MIDDLETON: Okay.

INTERIM CHIEF FINANCIAL OFFICER NIX: -- and we'll start the Funding Risk Mitigation Policy.

Okay. So at the February meeting -- oh, he came back. He undeserted me.

At the February meeting, staff was directed to come back in April with proposed changes to the CalPERS Funding Risk Mitigation Policy, and those include removing the automatic provision from the policy as well as adding a requirement to bring the proposed changes to the Board for discussion if the actual investment return exceeds the discounted rate by two percent.

Next slide.

[SLIDE CHANGE]

INTERIM CHIEF FINANCIAL OFFICE NIX: As you'll recall from our February information item, the purpose of the policy is to reduce CalPERS funding risk over time and thereby increase the long-term sustainability of the CalPERS pension benefits for our members.

Slide three, please.

[SLIDE CHANGE]

INTERIM CHIEF FINANCIAL OFFICE NIX: I presented this history in February, but a quick overview is that it was first adopted in 2015 and then we suspended the policy in 2017 through 2020, while the discount rate was lowered from 7.5 percent to 7 percent.

It was -- this policy was first triggered in 2021 due to the investment returns ex -- earning at 21 percent. And then it was brought to the Board as an information item in February 2024 as Committee direction.

Next slide, please.

[SLIDE CHANGE]

INTERIM CHIEF FINANCIAL OFFICE NIX: There are several mechanisms that I wanted to point out that are currently in place for lowering the discount rate. And those will not change with this -- with these proposed changes of the policy.

The first one is the Board can just decide at any time to change the discount rate. Secondly, the ALM process at both the midyear and at the ALM year will allow us to evaluate those discount rates and make sure that we're on track with our assumptions and you have an ability at that point in time to change the discount rate, and lastly, the Funding Risk Mitigation Policy when it is triggered.

Slide five.

[SLIDE CHANGE]

INTERIM CHIEF FINANCIAL OFFICE NIX: So the policy proposed before you today has the following changes. We removed the automatic mechanism to reduce the discount rate in a year where the excess returns exceed the discount rate. We added a requirement to bring a proposed discount rate change to the Board, if returns exceed at least two percent of the discount rate. We updated procedural steps that would have occurred if the automatic provision was in place. But since we removed it, we removed those provisions and we updated to the new template, made some minor grammatical edits, and removed the affiliate funds from the scope because the policy was really never intended to include those due to their more conservative approach to both the valuation and the funding.

So next slide, please.

[SLIDE CHANGE]

INTERIM CHIEF FINANCIAL OFFICE NIX: We are looking for a decision today to approve the proposal with the items changed as discussed in the previous slide.

And the last slide, if you'll change it to that.

[SLIDE CHANGE]

INTERIM CHIEF FINANCIAL OFFICE NIX: I'm pleased to take questions if anybody has any.

CHAIR MIDDLETON: Are there any questions?

President Taylor.

COMMITTEE MEMBER TAYLOR: Just a quick let's -- I really appreciate all of your report back and thank you for coming back with what we asked for. So I just want to make sure that if the -- if it comes up that we make two percent over 27 percent, 21 percent, whatever, and we -- and you bring it to us -- back to us and we vote -- what would be the vote, no? No, on it, right?

INTERIM CHIEF FINANCIAL OFFICE NIX: Well, if the -- if you accept the proposed changes in this policy, then what will happen is if we exceed -- if our investment returns exceed the discount rate by two percent or more, and there's a little chart in the actual policy --

COMMITTEE MEMBER TAYLOR: Right.

INTERIM CHIEF FINANCIAL OFFICER NIX: -- we'll bring that back to the Board as an action item. And then you'll have a discussion at that point to determine whether or not you want to reduce the discount rate as proposed when we bring it back, or to something different, or not.

COMMITTEE MEMBER TAYLOR: Not do it at all.

INTERIM CHIEF FINANCIAL OFFICE NIX: Yeah.

COMMITTEE MEMBER TAYLOR: Okay. Thank you. I just wanted clarify that.

CHAIR MIDDLETON: Thank you.

Any other questions?

So I want to thank you for bringing this back. And this is a change that for some of us we've wanted to see made for a long time. This retains discretion on the part of the Board to be able to make decisions based on the actual facts on the ground at a time that we exceed the projected rate of return. And most of us are always in favor of retaining that discretion where we can.

I don't see any other questions or comments, but before we go to a vote on this, we do have at least one public comment.

Mr. Pina.

JOHNNIE PINA: Good morning. Johnnie Pina with the League of California Cities here to testify in support of the recommended amendments to the Risk Mitigation Policy. And thanks again to staff for that excellent update and report.

While we certainly appreciate the original intent to help balance pension plan risk, funding, and costs, the reality is that any change to the discount rate can have a dramatic impact on employer costs. Retirement benefits are only as secure as an agency's ability to pay for them. And Cal Cities remains concerned about any prospective increase of employer contribution rates.

Given the significance of such a change, it is our belief that any adjustment to the discount rate merits a discussion of the Board and stakeholders should have the opportunity to weigh in on that decision.

Thank you for considering local government employer costs when making this decision. And thank you for the opportunity to speak.

CHAIR MIDDLETON: All right. Are there any other public comments?

BOARD CLERK ANDERSON: (Shakes head).

CHAIR MIDDLETON: All right. If I could get a motion to approve.

COMMITTEE MEMBER PACHECO: (Hand raised).

COMMITTEE MEMBER RUBALCAVA: (Hand raised).

CHAIR MIDDLETON: Second Mr. Rubalcava.

Roll call, please.

BOARD CLERK ANDERSON: David Miller?

VICE CHAIR MILLER: Aye.

BOARD CLERK ANDERSON: Frank Ruffino?

ACTING COMMITTEE MEMBER RUFFINO: Aye.

BOARD CLERK ANDERSON: Jose Luis Pacheco?

COMMITTEE MEMBER PACHECO: Aye.

BOARD CLERK ANDERSON: Ramón Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Aye.

BOARD CLERK ANDERSON: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK ANDERSON: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye.

CHAIR MIDDLETON: Item is approved.

We now move on to information agenda items, Long-term Care Valuation Report, Item 6A.

(Thereupon a slide presentation).

DEPUTY CHIEF ACTUARY ARCHULETA: Scott is trying to leave again.

(Laughter).

DEPUTY CHIEF ACTUARY ARCHULETA: Good morning, Madam Chair and the Committee. Fritzie Archuleta --

Vice Chair Miller: Microphone.

CHAIR MIDDLETON: Hold on.

There we go.

DEPUTY CHIEF ACTUARY ARCHULETA: Sorry.

Yeah, you can hear me.

Okay. Item 6A is a review of the Long-Term Care Valuation results, because we know you like your actuarial results on a Monday morning.

So next slide, please.

[SLIDE CHANGE]

DEPUTY CHIEF ACTUARY ARCHULETA: Okay. The background on this. This is an annual agenda item, which discloses the funded status of the Long-Term Care Program.

All information is as of June 30th, 2023. And this presentation highlights the key aspects of the report, but for your convenience the full report is attached to this agenda item.

Next slide.

[SLIDE CHANGE]

DEPUTY CHIEF ACTUARY ARCHULETA: Okay. So as of 6-30-2023, the margin for the program was negative 19.01 percent. And the funded ratio was 90 percent. Now, as a reminder, the margin is a measure of what percentage the premiums need to increase or decrease to make the plans whole. And the funded ratio is simply the assets on hand divided by the cost of the plan.

On the next page, we'll go over the reconciliation for what happened from last year to this year.

[SLIDE CHANGE]

DEPUTY CHIEF ACTUARY ARCHULETA: So last year, when I came here, I reported that the margin for 6-30-2022 was a negative 7.4 percent. And the funded ratio was 95 percent. Like the pension plans, we look at the experience of the Long-Term Care Program and we compare that to what we assumed was going to happen that year.

Now, the biggest driver for 22-23 was the investment return. We assume that we're going to get 4.75

percent on the portfolio. And this year, we actually lost 0.6 percent, so that caused a decrease in the margin of about a negative 8.54 percent and lowered the funded status to 91 percent.

So after that, each year, we also do an experience study and we make sure that our actuarial assumptions are still relevant for the future of the program. This year, we determined that we noticed that the claim termination period, which is the period that our policyholders are staying on claim, was a bit longer than what we anticipated. And so due to that change in that assumption, the margin went down by 3.13 percent. And that's how we ended up today at the margin of negative 19.01 percent and a funded ratio of 90 percent.

And next slide.

[SLIDE CHANGE]

DEPUTY CHIEF ACTUARY ARCHULETA: So this concludes the presentation, short and sweet. But if you have any questions, I'm happy to answer them.

CHAIR MIDDLETON: Are there any questions?

Seeing none, is there a motion to approve?

Oh, excuse me, this is an information item. My apology.

DEPUTY CHIEF ACTUARY ARCHULETA: Information, item, yes.

CHAIR MIDDLETON: Thank you.

We will move on then to Item 6B, the semi-annual health plan financial report.

(Thereupon a slide presentation).

SUPERVISING HEALTH ACTUARY ZHONG: Good morning, Madam Chair and members of the Committee. Emily Zhong, CalPERS team member.

This is Agenda Item 6B, semi-annual health plan financial report. It's an information item.

This report provided to the Committee twice a year as part of the monitoring and reporting process for the Health Care Fund status. It include health plan account balances, actuarial reserve amount, and surpluses or deficits for the health plan subaccount.

Next slide, please.

[SLIDE CHANGE]

SUPERVISING HEALTH ACTUARY ZHONG: The semi-annual health plan financial report provide the financial performance of the PPO and HMO plan as of the end of 2023. HMO fully insured plans, such as Kaiser and the association plan are not in the scope of this report. As a reminder, the Health Care Fund Reserve Policy provide a framework for maintaining the appropriate actuarial reserve level for the PPO and for managing surpluses or deficits that accumulate in the PPO and HMO subaccount.

The funding status -- the funding status figure I am reporting to you to today are related to fully funded reserve amount prescribed by that policy. In November, I shared with the Committee the fund status for the PPO subaccount as of the end of June 2023. In the next few slide, I will give you an update for the Basic and Medicare PPO performance for the second half of 2023.

Next slide, please.

[SLIDE CHANGE]

SUPERVISING HEALTH ACTUARY ZHONG: This slide present the recent Health Care Fund performance for the HMO Basic and PPO Medicare and Basic plans. In this table, starting with the HMO basic plan, the estimated fund balance at the end of 2023 was 251 million. The next column shows the HMO basic estimated claim liability of 182 million with the last column showing a surplus of 69 million.

On the PPO side, starting with Medicare, the estimated fund balance at the end of 2023 was 31 million. We estimated liability and required actuarial reserve level of 138 million for a fund status of 107 million below the recommended fully reserved level.

For the PPO Basic plans, the estimated fund balance as of the end of 2023 was 36 million after estimated claim liability and required actuarial reserve of 594 million. The fund status for PPO Basic plans was 558 million below the recommended fully reserved level. The overall Basic PPO status worsened by about 161 million from the end of June 2023. I'll go through some detail for the Basic and Medicare PPO performance in the next couple of slides.

Next slide, please.

[SLIDE CHANGE]

SUPERVISING HEALTH ACTUARY ZHONG: In November, we reported the basic PPO was 356 million below the recommended reserve level as of the end of June 2023. As more claim has been processed and more data become available, the updated -- the updated data worsened by 41 million is now 397 million below the fully reserved level.

For the second half of 2023, there was about 137 million decrease in the fund balance related to high medical experience. For the PPO Basic member, they normally satisfy the annual deductible early in the year, so medical costs are normally lower in the first half of the year and increase in the second half of the year. We also especially saw a rise in claim during the fourth quarter as a result of member altering the behavior to utilize care before the coinsurance and deductible are reset at the end of the year. And also on top of that, we assert more healthy members have moved from PPO to HMO plan due to the high premium increases.

This change in member mix contribute to the increased utilization in the Basic PPO. The overall medical cost in 2023 for PPO Basic plan increased by about 11 percent from 2022.

For pharmacy, while we have the best in market pricing under our current Optum contract, the high utilization and more use of high cost brand and speciality drugs contribute to about 54 million loss for the second half of 2023. The 2023 PPO Basic premium include a surcharge of two percent in Platinum and three percent in Gold to replenishing the PPO reserve. We collected about 27 million in the surcharge for the second half of 2023.

There was also a small investment gain of three million allocated to the Basic PPO plan. The overall Basic PPO fund status worsened by 161 million from the end of June bringing the total fund status below the fully reserve level by 558 million as of the end of 2023.

Next slide, please.

[SLIDE CHANGE]

SUPERVISING HEALTH ACTUARY ZHONG: Moving on to PPO Medicare, in November, we reported that the PPO Medicare was 62 million below fully reserved status as of the end of June 2023. The updated fund status worsened by 15 million and is now 77 million below the fully reserve level. So for the second half of 2023, there was about 10 million increase -- decrease in fund balance due to the higher-than-expected medical costs. While we know the Medicare fee schedule have been stable increase over the years, but we do see member tend to utilize more services after the pandemic. The overall medical cost in 2023 for PPO Medicare plan increased by around nine percent from 2022.

On the pharmacy side, the increase due to the high cost specialty drug contribute to about 21 million reduction in fund balance for the second half of 2023. There was also a very small investment gain of one million allocated to the Medicare plan. The overall PPO Medicare fund status worsened by 30 million in the second half of 2023, bringing the fund balance 107 million below the fully reserve level. But however, we do expect the Medicare status will improve as cash payment are expected to come in the form of pharmacy rebate and better subsidy from CMS attribute to the 2023 plan year. We will report back when the 2023 pharmacy rebate and subsidies are fully reconciled.

Next slide, please.

[SLIDE CHANGE]

SUPERVISING HEALTH ACTUARY ZHONG: As you know, the Board have approved two key rate actions to address the PPO funding status and the longer term viability of the PPO program. First, a two to three percent surcharge was included in the Basic PPO premium in 2023 and has increased to four to five percent to the 2024 premium. So our goal is to generate additional premium revenue to continue replenishing the reserve.

And second, the transition from the two risk pool to a single risk pool risk adjustment method to further stabilize premium for basic P -- HMO and PPO plans. This transaction is through a three-year phase-in process starting from 2024 and fully implement in 2026 for the purpose to reduce the member migration movement and stabilize the member mix going forward.

Additionally, we are exploring the other way to improve the PPO program through the solicitation for a new five year contract from 2025 to 2029. We are seeking a new performance guarantee in the contract to ensure the third-party administrator is financially responsible for keeping the cost at or below the agreed upon threshold. And to address the increase in pharmacy cost, we plan to explore pharmacy saving option in our next pharmacy benefit manager contract solicitation that is currently underway.

That conclude my pie presentation. We are happy to take any question.

CHAIR MIDDLETON: All right. Mr. Pacheco.

COMMITTEE MEMBER PACHECO: Yes. Thank you very much. Thank you, Chairman Middleton.

I'd like to ask -- first of all, excellent presentation. Thank you so much. I want to ask you a question about the drivers with respect to the Health Care Fund status in terms of the medical drivers. You also -- you mentioned that there were -- it's the utilization of individuals was increased uptake, but also, I just -- I'm just curious if medical inflation also had a contributing factor as well.

SUPERVISING HEALTH ACTUARY ZHONG: Yeah, that is correct. As I mentioned earlier from 2022 to 2023, we saw about 11 percent increase for the medical cost for the Basic plans. So that basically a very high level breakdown as everybody, the cost of services have increased quite a lot in the health care market. The increase in the labor, increase in the material for providing the cost. So of the 11 percent, we do expect about four to five percent is contributed to the cost of the services. And also, the member tend to use a little bit more utilization after the pandemic, so that's at about two to three percent.

So the very last factor is the member migration, right? So more healthy member have moved from PPO to HMO so the remaining program are generally a bit sicker, so that account for another two to three percent?

COMMITTEE MEMBER PACHECO: And you're still see -- are you still seeing the utilization of members still utilizing, you know, after -- post-COVID?

SUPERVISING HEALTH ACTUARY ZHONG: At this point, we still -- we don't see the trend declining at this point. But different people have a different view at this point. Some people they do expect will finally -- eventually will declining back to the pre-COVID level. Other people like -- are also explaining this type of utilization pattern it will keep remaining for the rest of -- for the next couple years as well.

CHIEF HEALTH DIRECTOR MOULDS: Yeah. And just to -- just to add a little bit of color to Emily's good answer, it really also varies when you look from modality to modality. So, you know, we've talked about this some in the past, but behavioral health utilization, for example, is staying -- you know, is staying very high, not coming down in areas where -- that have been -- that were particularly impacted where people were having a hard time getting appointments, for example, is still high. You know, a lot of that actuarial community, and Emily jump in if you want to expand upon this, are thinking that things are starting to normalize eyes somewhat, but there are these sticky areas that just remain high.

COMMITTEE MEMBER PACHECO: And just to clarify, just a follow-up on that, Don. So our long-term solutions is with respect to the 25-29 PPO contracting solicitation, that would hopefully address some of those issues.

CHIEF HEALTH DIRECTOR MOULDS: So we have -- you know, one of the things that we have -- that we have -- that I would include as sort of hallmark of the PPO solicitation is the request that proposals include, for lack of a better description, financial responsibility for higher than negotiated price trends. So if we see contracts coming back at a higher level than we're projected in the contract, a portion of those costs will be paid back to us by whoever we contract with. That's part of what we are seeking.

You know, the other -- the other piece, which is a longer term play, of course, are the Office of Health Care Affordability spending targets, which, you know, will set a rate at which, you know, trigger initially conversations between insurers, or provider groups, or others, and the -- and OHCA, and eventually transition into penalties.

COMMITTEE MEMBER PACHECO: Thank you very much, Don. I appreciate it very much.

CHAIR MIDDLETON: Don, when we see these reports, we tend to see a lot of churn between the PPO and the HMO, between this provider organization and that provider organization. And it becomes more difficult to get a handle on what's the overall total growth in terms of costs that are coming into the system and how concerned we should be in terms of that total number. And as I look at some of these numbers here, I start to get very concerned in terms of what this is going to mean in terms of overall system costs and preparing our members for some of the hard decisions that are going to have to be made in future years regarding those costs.

CHIEF HEALTH DIRECTOR MOULDS: I think that's a -- that's a point extremely well taken. The -- you know, we're also seeing, as you know, significant disparities in the costs we're seeing on the HMO side and the PPO side. Some of that will level as we go to a single risk pool. So some of what you're seeing is just risk shift from -- for the -- on the -- from the HMO to the PPO, meaning -- actually from the PPO to the HMO, we're seeing the low risk folks going from the PPO to the HMO.

You know, at some point, that will reduce when the surcharge is gone. Although, that's projected to be a number of years off. But no, it's a point extremely well taken. And I think some of the motivation behind the affordability -- the Affordability Board and the spending growth targets, because employers are -- and purchasers are feeling that across the state.

CHAIR MIDDLETON: All right. Well, I want to defer to Mr. Rubalcava and the Pension and Health Care Committee. But I think without getting into another master's thesis, we need to start looking at what are the projections moving forward for a few years in terms of total cost to the system, and how are we going to respond to that, and how are we going to communicate to our members what to expect?

CHAIR MIDDLETON: Okay. All right. Are there any other questions or comments?

Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you for raising -- speaking to this concern, Madam Chair, and -- but it is -- I think what we see this presentation reflects the real dynamics the -- how cost trends are increasing in health care and also how the delivery systems make a difference between PPO and HMO, where there's the role of managing the care, especially for chronic illness. But at the same time, I think this Board has made some very innovative moves, like the whole risk pool, where we'll see -- I mean, something -- you know, that should make a big difference. And the solicitation, I'm looking forward to it bringing some results. And I think we have some very good staff and very good thinkers. We're very fortunate, so I'm looking forward to us addressing the deficit.

I mean, one, is recognizing it. Two, is what do we do? And so I look forward to us continuing to work on this issue. It is a little scary, but I think we're up for, Ms. -- Madam Chair.

Thank you.

CHAIR MIDDLETON: All right. Thank you.

COMMITTEE MEMBER RUBALCAVA: Thank you for a great presentation.

CHAIR MIDDLETON: Are there any other questions or comments?

Seeing none, then this was again an information item. We will move on to Summary of Committee Direction.

I don't recall any.

INTERIM CHIEF FINANCIAL OFFICE NIX: No, Madam Chair. I took no Committee direction for the FAC.

CHAIR MIDDLETON: Okay. And do we have any public comments?

BOARD CLERK ANDERSON: (Shakes head).

CHAIR MIDDLETON: We do not, then we've reached the conclusion of this Committee meeting. It's the last meeting of the day, so we will be adjourned. And we will reconvene for the full Board of Administration meeting tomorrow morning at 9 a.m.

Thank you.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 11:54 a.m.)

CERTIFICATE OF REPORTER

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California;

That the said proceedings was taken before me, in shorthand writing, and was thereafter transcribed, under my direction, by computer-assisted transcription.

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 23rd day of April, 2024.

JAMES F. PETERS, CSR
Certified Shorthand Reporter
License No. 10063