Disclosure Reporting Standards for Pension Obligations

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Today's Focus

- Impact of New Standards on Employers
- Example of Blended Rate
- Practical Aspects of Implementation

About CalPERS

Who We Are Impact How We See These Changes

CalPERS

- Largest Pension Plan in North America
  - ~$240 billion in assets
  - ~1.5 million members and beneficiaries
- Three main components
  - State employees
  - Non-teaching school employees
  - Local public agency employees
    - For agencies that have contracted with us

CalPERS

- About 1500 Local Public Agencies
  - Counties
  - Cities
  - Special districts
- Two Main Categories of Workers
  - Safety and miscellaneous (or general)
- Over 2200 Separate Plans
  - Some employers have more than one plan

CalPERS

Agent Multiple Employer Plan
or
Cost Sharing Plan?

Both

Impact on Employers

Impact on Employers

1. Pension Expense Will Be More Volatile
2. Unfunded Liability on Balance Sheet
3. Additional Disclosures
4. More Cost to Comply

Pension Expense

- More Volatility Due to:
  - Shorter amortization periods for changes
  - Less asset smoothing (in some cases)
  - Blended discount rate sensitive to gains and losses

- Implication:
  - Pension funding and accounting will separate (the "Divorce")
  - Main drawback of changes (but is it really?)

Balance Sheet

- Statement of Net Position
  - Entire net pension liability reported
  - Deferred inflows or deferred outflows may be reported based on expense recognition
  - Investments measured at fair value

- More Consistency & Enhanced Visibility
  - Main improvement in reporting

Additional Disclosures

- From David’s Slides:
  - General information
  - Assumptions used in measurement
  - Details about changes in the net pension liability, pension expense, and deferred outflows of resources
- More Information
  - Better for detailed users of financial statements
  - Risk of too much information

More Cost to Comply

- There Will Be Additional Compliance Costs
  - Additional disclosures
  - More actuarial calculations
  - Staff time and expense

- Are the Improvements Worth It?
  - Costs are probably not excessive (example given later)
  - Additional consistency, visibility & transparency

The Divorce

- Currently Funding and Accounting are in Lock Step
  - Pension Expense = Required Contribution
  - For almost all plans in California
  - Not true in all states

- This Will Not Be True in the Future
  - Balance sheet focus vs. income statement focus
  - Pension expense will be too volatile to fund
  - Pension expense will be negative in some years

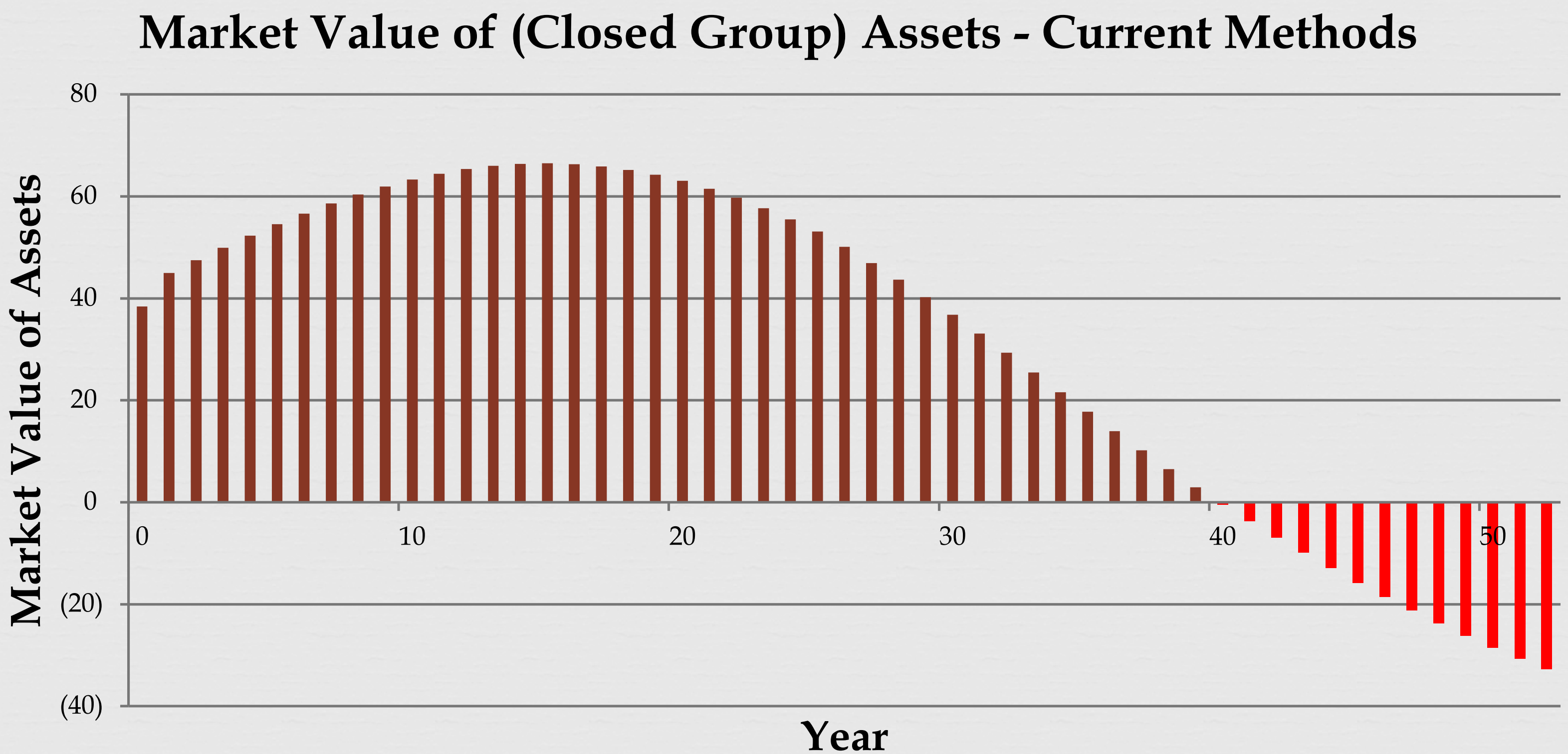
The Divorce

- Will this Divorce Have Any Practical Result?
  - Yes. Recent Phase in Decision by CalPERS Board

- Will it Have a Long Term Impact on Funding?
  - Not clear.
  - Depends on whether a new funding standard is developed
  - Model Funding Policies Are Being Developed by the California Actuarial Advisory Panel & others

Blended Rate Example

Closed Group Assets



Blended Discount Rate

- Crossover in 40 years
  - Due to open asset smoothing and amortization periods
- Liability Calculation
  - 7.5% for benefit payments in first 40 years
  - 4.0% for benefit payments after 40 years
    - Lower rate applies for all years, not just after year 40
- 10% Higher Actuarial Liability
- Blended Rate is ~ 0.7% lower than funding
  - 6.9% rather than 7.5%

Alternatives?

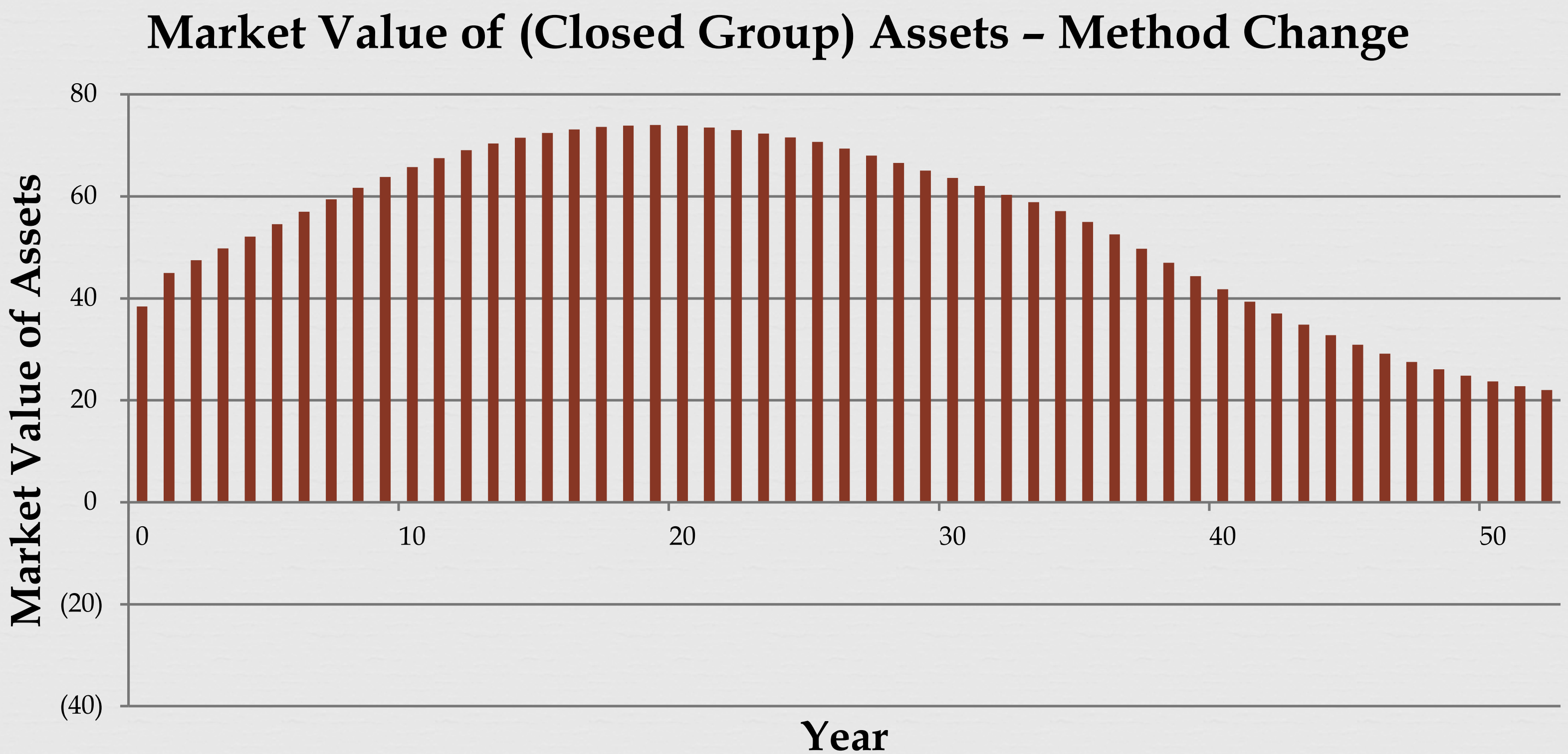
- This is a Lot of Work – Can We Do Something to Make it Easier?

- Method Changes Could Eliminate the Blended Rate Calculation

Possible Method Change

- Method Change Examined
  - 30 year closed amortization
    (versus 30 year open currently)
  - 5 year closed assset smoothing with no corridor
    (versus 15 year open with 20% corridor currently)

Asset Graph w/Changes



Impact of Change

- Impact of Method Change
  - Little difference in short term
  - Rates do not fall as quickly in the longer term
- Do Not Have to Do Blended Rate Calculation
- Report Same Liability for Funding and Accounting

Practical Aspects of Implementation

Current Accounting Disclosures

- Actuarial Valuations
  - Prepared by CalPERS annually
  - Accounting information included
  - 16 month delay
    - June 30, 2011 reports delivered in October 2012
    - Caused by reporting delays, antiquated systems & sheer volume

Problem #1

Who Does the Actuarial Work?

- Employer Accounting is ***Not*** a Trust Fund Expense
  - IRS rulings, legal opinions, etc.
- Breach of Fiduciary Duty
  - Cannot spend trust fund money on non-trust fund activities
- Cost and Expense of Hiring Consulting Actuary
  - Are there enough consulting actuaries?

Solution #1

Who Does the Actuarial Work?

- For Employers In CalPERS, Only One Reasonable Solution - CalPERS Actuarial Office
- But Funding Needed
  - Separate charge for employers
- Mandatory or Voluntary for Employers
  - Voluntary unless new law or regulation
  - Employers will have to take the lead

Solution #1

Who Does the Actuarial Work?

- How Much Will This Cost?
  - Ballpark estimate:
    - If mandatory
      - ~$2 million per year/2200 plans = ~$1,000 per plan
      - Estimate is probably high
    - If voluntary
      - Probably 2 to 3 times the cost if mandatory
  - Higher if Using a Consulting Actuary

Problems #2, 3 & 4

Timing, Timing & Timing

- Will CalPERS Have System Changes Ready?
  - Implementation timeline
- Will CalPERS Have the Valuations to Employers When they Need Them?
  - Year end differences & valuation delay
- Requirement to Have Employers Information as of Their Fiscal Year End

Solutions #2, 3 & 4

Timing, Timing & Timing

- GASB Has Been Listening!
  - Change from 24 to 30 months (plus a day)
  - One year deferral for initial implementation (we hope)
  - Employers can report as of plan fiscal year end

- Kudos and Expressions of Thanks!

Summary

- Change is Coming
- The Pension Expense Will Be More Volatile
- Pension Accounting and Funding Will Be Separated
- Better Information Will Be Provided
  - Consistent
  - Visible
  - Transparent
- Implementation Challenges Have Been Reduced
  - But Some Still Exist