PERS Reviewing Risk Mitigation Strategies for Pension Plans

PERS (California Public Employees' Retirement System) recently held a webinar to inform local agencies about risk mitigation strategies that are under review by the PERS Board that would lower the assumed rate of return on investments over time and increase employer and employee rates over decades to reduce the risk of big investment losses. While PERS has taken steps to reduce risk and increase the funding level of plans in recent years with new actuarial assumptions and smoothing policies, PERS still sees funding risks as the PERS system matures and the number of retirees grows and becomes more than the number of active workers. With more mature plans, contribution rate volatility will continue to increase over the next 20 to 30 years. This means a poor investment return will impact contribution rates more in 20 years than if it happened today.

To reduce the risk, the PERS Board is considering two risk reduction proposals, both of which would slowly lower the rate of return, or discount rate, from 7.5 percent a year to 7 percent or 6.5 percent over 20 to 30 years. The two proposals provide the option to make small cuts in the discount rate through a flexible glide path, with cuts occurring only in good investment years, or through a blended glide path with cuts occurring in good investment years or at scheduled intervals such as every four years.

The risk reduction proposals will result in higher contribution rates over the long term, with different impacts for different plans. PERS estimates miscellaneous plans will see employer contribution rates increase up to 12 percent over 50 years and rates for safety plans to increase up to 21 percent over 50 years. While these are modest increases when considered over a 50-year time frame, it is important to note that we have experienced 30 percent to 40 percent employer rate increases over the past five years and are scheduled to see rates climb another 30 percent over the next five years as the recent PERS changes for actuarial assumptions and smoothing policies are fully implemented. Additionally, the City, and all agencies, will continue to be exposed to rate volatility and the negative impact of big investment losses while any new policies are being put in place.

The PERS Board will discuss the risk reduction strategies further at their September 2015 meeting with possible action in October 2015.