Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 15

MEETING DATE: **March 17, 2021**

SUBJECT: **Interest Crediting and Unallocated Earnings Policy**

SUBMITTED FOR: ___ **Consent** _X_ **Deliberation and Action** ___ **Receive and File**

RECOMMENDATION

Staff recommends the Board approve amendments to the Interest Crediting and Unallocated Earnings Policy regarding pre-2006 allocations for member COLA contribution-rate offsets.

PURPOSE

This item supports the Strategic Management Plan goal to provide prudent and effective funding policies and practices that assist in producing low contribution rate volatility and plan sustainability.

BACKGROUND

In 1996, the Board approved an Interest Crediting and Excess Earnings Policy. The policy formalized the interest rates used to credit member and employer accounts, established reserve targets, and set parameters for applying "excess earnings" for non-vested benefits, such as retiree health and dental subsidies and reductions in member contribution rates. The concept of "excess earnings" is a unique feature of the County Employees' Retirement Law of 1937 (1937 Act) and refers to when the plan experiences higher than expected investment returns in a given year.

In 2006, the Board made a major revision to the policy, removing the "excess earnings" concept and renaming it the Interest Crediting and Unallocated Earnings Policy. The Board recognized that a one-year spike in investment returns above the assumed rate of return does not generate a "surplus" for ancillary benefits when the plan is paying down an unfunded liability on the core benefit structure. That policy remains in place today and requires—as first-priority goals—the funding of the vested retirement benefits and a contingency reserve equal to 3% of the plan's market value of assets before consideration of using "unallocated" earnings for non-vested, supplemental benefits.

Because SCERS has not achieved the policy goals of fully funded vested retirement benefits plus a 3% reserve, the Board has not approved any new allocations for additional retiree or member benefits in almost 20 years. In 2003, the Board discontinued its annual allocations for health and dental subsidies for retirees.

In addition to the health and dental subsidies, the Board also used to set aside “excess” earnings in the 1990s to provide modest reductions in member contribution rates. Specifically, funds were used to offset the COLA portion of contribution rates (members pay a basic rate and a COLA rate). However, instead of making an annual appropriation that would be reauthorized each year, the Board set aside funds in the 1990s and directed the actuary to establish an actuarial methodology to use those funds for contribution-rate offsets over the remaining working years of the active employees. Those funds were divided up between Miscellaneous and Safety members and by retirement tier. This COLA contribution-rate offset is noted in the annual actuarial valuation and is part of the rate-setting process approved the Board annually.

When the Public Employees’ Pension Reform Act of 2013 (PEPRA) was enacted—prohibiting “pick-ups” of member contribution rates—the Board did not extend the COLA contribute-rate offset to the PEPRA members, but continued it for all legacy members. That means the pre-2006 allocations for contribution-rate offsets is being spent down and allocated to a decreasing number of employees. In 2004, actuaries identified approximately $45 million in funds set aside for the contribution-rate offset. That amount was down to $14 million as of June 30, 2020. Depending on retirement tier, the offset has ranged from approximately 0.3% of pay for Miscellaneous members and up to 3.3% of pay for some Safety members.

DISCUSSION

Because the remaining allocation should be exhausted in about 10-15 years, it is appropriate for the Board to consider establishing parameters to provide a more fair and consistent approach for the final years of the benefit.

While most eligible members are receiving a very small benefit (about 0.3% of pay reduction in contributions), a “tail” dynamic emerges when the funds are allocated to only a few remaining members of a particular retirement tier, resulting in a larger rate reduction than was likely intended by the Board. For example, in the upcoming 2021-22 fiscal year, about 40 remaining Safety Tier 1 members will receive a relatively large allocation, resulting in a contribution reduction of 3.32%, jumping up from 1.95% in the current year. That value could grow even larger in future years if members in that tier retire at a faster pace, maxing out at the full amount of the COLA portion of the contribution rate. For Safety Tier 1 members, the full COLA portion of their contribution rate is about 7% of pay. COLA rates for other tiers represent about 2-4% of pay.

This benefit also results in County legacy employees not contributing equally to 50-50 normal-cost sharing, which was added to bargaining unit contracts and management policies after PEPRA’s implementation. (Technically, SCERS’ actuary first establishes 50-50 normal cost-sharing rates for the County and its employees, then subsequently applies the contribution-rate offset for members.)

Though the Board could consider discontinuing the COLA contribution-rate offset because it is not a vested benefit, Staff is instead proposing minor changes, given the relatively low value of the remaining funds that will be drawn down in the near term. Staff recommends adding language in the Interest Crediting and Unallocated Earnings Policy that would accomplish the following:

- Recognize the historic practice of providing offsets to COLA contribution-rates for legacy members, which was put in place before the Board's 2006 policy on limiting unallocated earnings for non-vested benefits.
- Affirm the continuation of that practice for remaining legacy members using the existing actuarial methodology, with the following changes:
    - Limit the maximum amount of offset for COLA contribution rates that a member can receive based on the June 30, 2020 levels. (Because the Board has already adopted contribution rates for 2021-22, this provision would take effect for the 2022-23 contribution rates.)
    - Revert any remaining balance to the employer reserve when the all members in the retirement tier have terminated their active SCERS membership; as described in the Interest Crediting and Unallocated Earnings Policy, funds in the employer reserve are transferred to the retiree reserve when members retire and are then used to pay for vested retirement benefits of all members and beneficiaries.

ATTACHMENTS

- Segal Memo – SCERS Use of Historical Unallocated Earnings to Offset Member COLA Contribution Rates
- Interest Crediting and Unallocated Earnings Policy – amended version
- Interest Crediting and Unallocated Earnings Policy – clean version

Prepared by:

/S/

____

Eric Stern
Chief Executive Officer

Segal

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Via Email

March 1, 2021

Mr. Eric Stern
Chief Executive Officer
Sacramento County Employees' Retirement System
980 9th Street, Suite 1900
Sacramento, CA 95814-2738

**Re: Sacramento County Employees' Retirement System (SCERS)
Use of Historical Unallocated Earnings to Offset Member Cost-Of-Living Contribution Rates**

Dear Eric:

We have been requested by your office to provide an overview of how historical "unallocated earnings" set aside by the Board have been utilized in the actuarial valuation process to offset the legacy members' cost-of-living (COL) contribution rates paid to the System. As part of this review, we also document how much the member's contribution rates have been reduced through the most recent valuation as of June 30, 2020 and how long the contribution rate reductions are expected to last.

Background

Article 5 of the County Employees Retirement Law of 1937 ("the CERL") provides the financial provisions that SCERS has to follow in tracking assets available to pay benefits to members of the System. Included in that Article are certain provisions available at the Board's discretion to pay non-vested benefits (such as retiree health subsidies, offsets to contribution rates to pay for cost-of-living benefits, additional purchasing power cost-of-living benefits, etc.). Such benefits can be paid if the Board allocates earnings at the end of an interest crediting period that are in excess of those required to credit interest to the various reserve accounts and to set up a 1% contingency reserve. Such allocated earnings are generally referred to as "unallocated earnings".

While the Board has not made any new allocation of unallocated earnings to pay such benefits during our tenure as actuary for the System since 2004, in the most recent valuation as of June 30, 2020 the System has a residual balance of $14,809,000 left from prior allocations. This amount is tracked by Segal in an Employer Reserve subaccount maintained for this purpose. In this letter, we outline the time period over which those prior unallocated earnings were transferred by the Board, how the current residual balance has been utilized in the June 30, 2020 valuation to offset part of the members' COL contribution rates, and how long those reductions may continue. (We note that before our tenure as actuary for the System, the Board used to provide a retiree health subsidy out of unallocated earnings but no such subsidy had been paid since at least 2004.)

Historical Transfers and Applications of Unallocated Earnings in the Valuation Process

Based on a review of the valuation reports prepared by the System's prior actuary and the minutes from some of the Board meetings when those valuations were adopted, we understand that unallocated earnings were allocated by the Board to pay non-vested benefits in each of the June 30, 1996 through 2000 valuations. We believe unallocated earnings were allocated prior to the June 30, 1996 valuation but there was not enough documentation in the prior valuation reports and minutes from Board meetings to definitively confirm the start of that practice at the System.

When we were appointed as the actuary for the System in 2004, there was a residual balance of $44,450,486 for COL offset left from prior allocations in the valuation as of June 30, 2004. Following a procedure used by the System's prior actuary, we took the residual balance that had been further broken down between the Miscellaneous and Safety membership groups and between the closed (i.e., Tier 1[1]) and the open (i.e., Tier 3 for Miscellaneous and Tier 2 for Safety back in the June 30, 2004 valuation) plans and determined the offsets to the COL contribution rates available over the expected future working lifetime of the active members in the June 30, 2004 valuation. The intent of spreading the $44,450,486 over the expected future working lifetime of those active members was to provide offsets to their COL contribution rates that would be expected to stay as level as possible during their entire active career if all the actuarial assumptions were to be met. However, in practice, the offsets to the COL contribution rates for members in the open plans would continue to drop as new members enter those plans (unless new transfers from unallocated earnings are made to make up for any changes in the COL contribution rate offsets).

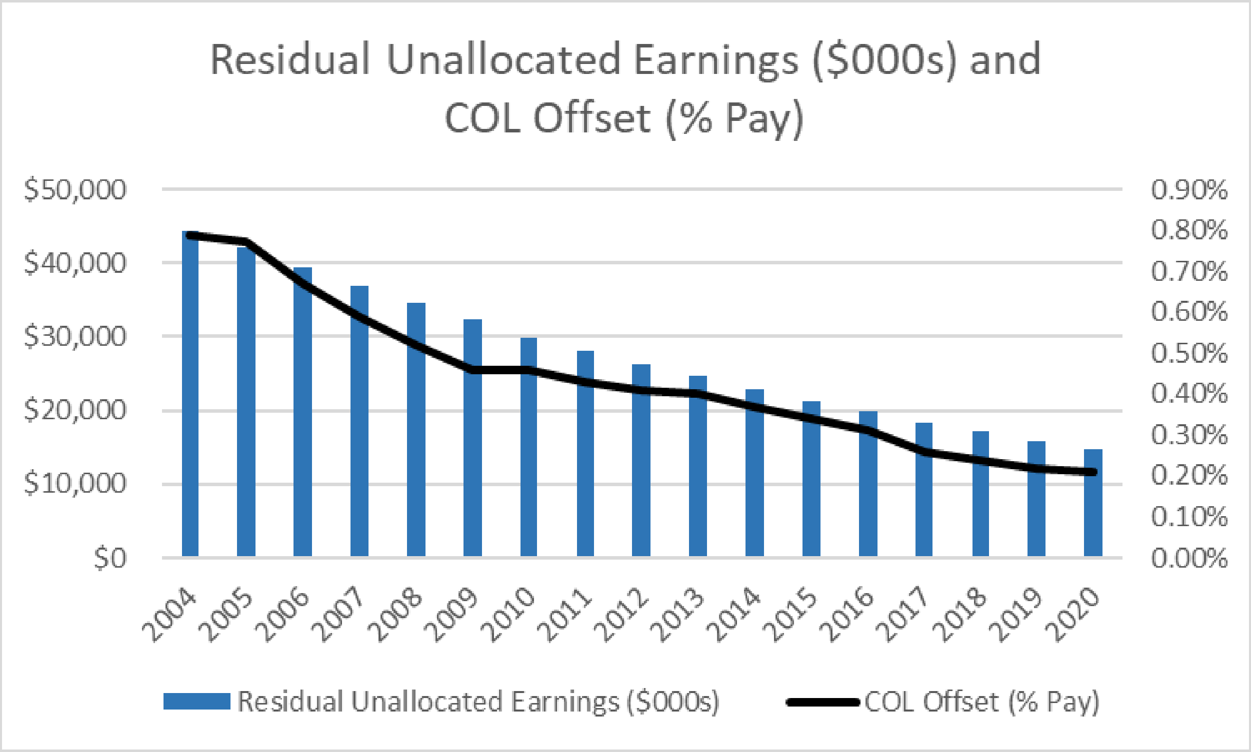
New members who entered the System had continued to receive offsets to their COL contribution rates until the passage of the California Public Employees' Pension Reform Act of 2013 (PEPRA). Based on our understanding of PEPRA, any new members who enter the System on or after January 1, 2013 would have to pay 50% of the total normal cost, including the COL normal cost contribution rates. Accordingly and after consulting with the System, we were directed to exclude any new members who enter the System on or after January 1, 2013 in calculating the offsets to the COL contribution rates as any such offsets would reduce the PEPRA member COL contribution rates to below 50% of the total normal cost. Excluding the PEPRA members from the calculation of the offsets to the COL contribution rates had the same impact as closing the then open plan calculations (which at that time included Miscellaneous Tiers 3 and 4 and Safety Tiers 2 and 3), and so has resulted in a more level amount of offset to their COL contribution rates.

[1] While Miscellaneous Tier 2 was a closed plan, it was not included in the above calculation because members in that plan were not eligible to receive any COL benefits and therefore did not pay COL contributions.

However, it should be pointed out that PEPRA also permits the employers and the employee bargaining groups to negotiate so that legacy members who entered the System prior to January 1, 2013 could also pay 50% of the total normal cost rates. Since the offsets to the COL contribution rates continue to be available in the valuation, those members covered by bargaining groups which have agreed to pay 50% of the total normal cost rates before considering the COL offset are actually paying less than the full 50% of normal cost after considering the COL offset to their COL contribution rates.

Residual Balance of Unallocated Earnings Available and Impact on COL Contribution Rates in the June 30, 2004 to June 30, 2020 Valuations

In the chart below, we show the change in the total residual balance of unallocated earnings from the $44,450,486 available for use in Segal's first valuation as of June 30, 2004 to the $14,809,000 available for use in Segal's most recent valuation as of June 30, 2020. It should be noted that the year by year reduction in the residual balance of unallocated earnings was equal to the expected draw down required to provide the COL contribution offset during the year, offset by the expected investment income during the year. We also include the offsets to the total COL contribution rates over the 17-year period.



A more detailed table that shows the amount of unallocated earnings allocated and the COL contribution rate offset available to each tier within the Miscellaneous and Safety membership groups is provided in Attachment A.

From Attachment A, we have extracted and included in the following table the residual balance available to provide offsets as well as the reduction in the COL contribution rates expressed as a percentage of pay over the members' expected working lifetime, as determined in the June 30, 2020 valuation. For example, for Miscellaneous Tier 1 members, using unallocated earnings of $10,000 available in the June 30, 2020 valuation, those members would receive a reduction in their employee COL contribution rate of 0.34% of pay over the 1.53 years they would be expected to work for their employers.

	Miscellaneous Tier 1	Miscellaneous Tiers 3 and 4	Safety Tier 1	Safety Tiers 2 and 3	Total
Residual Balance of Unallocated Earnings	$10,000	$10,873,000	$769,000	$3,157,000	$14,809,000
Offsets to COL Rate (% Pay)	0.34%	0.26%	3.32%	0.29%	0.21%
Expected Working Lifetime	1.53 years	9.05 years	2.42 years	7.33 years	8.69 years

In practice, the offsets to the COL contribution rates are adjusted in each valuation, based on the expected residual balances of unallocated earnings after adjusting for expected investment return (i.e., 7% as assumed in the June 30, 2019 valuation for the 2019/2020 plan year) and the actual usage of the offsets for the prior fiscal year. The offsets[2] would also be adjusted to reflect whether active members are leaving employment at the pace expected by the actuarial assumptions. This could mean that if members in the tiers that have been closed for a long time (such as Miscellaneous Tier 1 and Safety Tier 1) were to all leave employment in the near future and earlier than expected by our actuarial assumptions, there might be some residual balance of unallocated earnings left in the valuations for those tiers. When that happens, we would seek guidance from the Board on whether such residual balance should be used to reduce COL contribution rates for members in the other legacy tiers, reduce the Unfunded Actuarial Accrued Liability contribution rates for the employers, or some other purpose.

[2] It should be noted that the maximum offsets available would be to reduce the member COL contribution to 0% of payroll.

Please let us know if you have any questions and we look forward to discussing this with you and your Board.

Sincerely,

Paul Angelo, FSA, EA, MAAA, FCA Senior Vice President and Actuary	Andy Yeung, ASA, EA, MAAA, FCA Vice President and Actuary

ST/jl

cc: Debbie Chan, CPA
Enclosure

Attachment A – Residual Balance and Application of Unallocated Earnings in the June 30, 2004 to June 30, 2020 Valuations ($ in Thousands)

	Misc Tier 1	Misc Tiers 3 & 4	Saf Tier 1	Saf Tiers 2 & 3	Total
June 30, 2004 Valuation					
Residual Unalloc. Earnings	$4,627	$24,736	$8,917	$6,170	$44,450
Offsets to COL Rate (% Pay)	1.79%	0.55%	1.96%	0.65%	0.79%
Expected Working Lifetime	5.27	10.46	8.03	14.14	10.29
June 30, 2005 Valuation					
Residual Unalloc. Earnings	$3,908	$23,879	$8,205	$6,079	$42,071
Offsets to COL Rate (% Pay)	1.87%	0.54%	2.05%	0.60%	0.77%
Expected Working Lifetime	5.15	11.71	7.67	14.40	11.37
June 30, 2006 Valuation					
Residual Unalloc. Earnings	$3,229	$22,820	$7,415	$5,959	$39,423
Offsets to COL Rate (% Pay)	1.80%	0.47%	1.95%	0.53%	0.67%
Expected Working Lifetime	4.91	11.68	7.28	14.12	11.38
June 30, 2007 Valuation					
Residual Unalloc. Earnings	$2,638	$21,815	$6,643	$5,834	$36,930
Offsets to COL Rate (% Pay)	1.78%	0.42%	1.76%	0.49%	0.59%
Expected Working Lifetime	4.66	11.66	7.19	13.39	11.36
June 30, 2008 Valuation					
Residual Unalloc. Earnings	$2,110	$20,792	$5,963	$5,681	$34,546
Offsets to COL Rate (% Pay)	1.72%	0.36%	1.68%	0.43%	0.52%
Expected Working Lifetime	4.37	11.54	6.80	13.17	11.29
June 30, 2009 Valuation					
Residual Unalloc. Earnings	$1,635	$19,828	$5,312	$5,534	$32,309
Offsets to COL Rate (% Pay)	1.57%	0.32%	1.64%	0.40%	0.46%
Expected Working Lifetime	3.3	11.03	5.86	12.47	10.76
June 30, 2010 Valuation					
Residual Unalloc. Earnings	$1,254	$19,011	$4,407	$5,280	$29,952
Offsets to COL Rate (% Pay)	1.61%	0.33%	1.52%	0.44%	0.46%
Expected Working Lifetime	3.07	10.43	5.42	11.27	10.11
June 30, 2011 Valuation					
Residual Unalloc. Earnings	$923	$18,144	$3,856	$5,115	$28,038
Offsets to COL Rate (% Pay)	1.43%	0.31%	1.48%	0.44%	0.43%
Expected Working Lifetime	3.08	10.62	5.28	10.90	10.26

	Misc Tier 1	Misc Tiers 3 & 4	Saf Tier 1	Saf Tiers 2 & 3	Total
June 30, 2012 Valuation					
Residual Unalloc. Earnings	$681	$17,397	$3,355	$4,914	$26,347
Offsets to COL Rate (% Pay)	1.39%	0.31%	1.44%	0.40%	0.41%
Expected Working Lifetime	2.84	10.40	4.90	10.70	10.08
June 30, 2013 Valuation					
Residual Unalloc. Earnings	$490	$16,585	$2,874	$4,697	$24,646
Offsets to COL Rate (% Pay)	1.38%	0.31%	1.55%	0.37%	0.40%
Expected Working Lifetime	2.61	10.18	4.13	10.33	9.87
June 30, 2014 Valuation					
Residual Unalloc. Earnings	$338	$15,776	$2,369	$4,481	$22,964
Offsets to COL Rate (% Pay)	1.27%	0.32%	1.48%	0.35%	0.37%
Expected Working Lifetime	2.51	10.18	4.07	10.19	9.89
June 30, 2015 Valuation					
Residual Unalloc. Earnings	$233	$14,909	$1,976	$4,265	$21,383
Offsets to COL Rate (% Pay)	1.29%	0.32%	1.51%	0.33%	0.34%
Expected Working Lifetime	2.39	9.86	4.41	9.78	9.64
June 30, 2016 Valuation					
Residual Unalloc. Earnings	$152	$14,014	$1,647	$4,048	$19,861
Offsets to COL Rate (% Pay)	1.19%	0.31%	1.49%	0.32%	0.31%
Expected Working Lifetime	2.09	9.55	4.06	9.17	9.31
June 30, 2017 Valuation					
Residual Unalloc. Earnings	$88	$13,140	$1,374	$3,822	$18,424
Offsets to COL Rate (% Pay)	0.86%	0.28%	1.53%	0.29%	0.26%
Expected Working Lifetime	1.96	9.64	4.1	9.29	9.43
June 30, 2018 Valuation					
Residual Unalloc. Earnings	$52	$12,366	$1,150	$3,610	$17,178
Offsets to COL Rate (% Pay)	0.84%	0.28%	1.72%	0.29%	0.24%
Expected Working Lifetime	1.73	9.40	3.95	8.85	9.19
June 30, 2019 Valuation					
Residual Unalloc. Earnings	$26	$11,595	$946	$3,384	$15,951
Offsets to COL Rate (% Pay)	0.65%	0.27%	1.95%	0.28%	0.22%
Expected Working Lifetime	1.75	9.14	3.52	8.39	8.92

	Misc Tier 1	Misc Tiers 3 & 4	Saf Tier 1	Saf Tiers 2 & 3	Total
June 30, 2020 Valuation					
Residual Unalloc. Earnings	$10	$10,873	$769	$3,157	$14,809
Offsets to COL Rate (% Pay)	0.34%	0.26%	3.32%	0.29%	0.21%
Expected Working Lifetime	1.53	9.05	2.42	7.33	8.69

SCERS
SACRAMENTO COUNTY
EMPLOYEES' RETIREMENT SYSTEM

AMENDED

INTEREST CREDITING AND UNALLOCATED EARNINGS POLICY

I. PURPOSE

This policy establishes the parameters and methodology to credit semiannual interest to the reserves of the Sacramento County Employees' Retirement System (SCERS or the Plan) in accordance with the County Employees Retirement Law of 1937 (CERL).

II. OBJECTIVES

- To distribute Available Earnings to the reserves of SCERS.
- To maintain a Contingency Reserve not to exceed 3% of the Plan's Market Value of Assets against deficiencies in future earnings.
- To consider distribution of unallocated earnings if and when the Contingency Reserves reaches 3% of the Plan's Market Value of Assets and the Plan achieves 100% funded status.

III. DEFINITIONS

A. General Definitions

Actuarially Assumed Investment Rate of Return: The expected investment earnings rate of return used in the annual actuarial valuation of the Plan, recommended to the SCERS Board by the Plan third-party actuary in an experience study and set by the SCERS Board.

Actuarial Value of Assets: The Market Value of Assets less deferred investment gains or losses as calculated under the Plan's seven year actuarial asset smoothing method.

Available Earnings: Represent the actual earnings of the Plan as determined based on the smoothed Actuarial Value of Assets and funds previously set aside in the Contingency Reserve.

Market Value of Assets: An asset value where the full value of investment earnings is recognized in a fiscal year.

B. Reserve Definitions

Valuation Reserves: Reserves used by the Plan's actuary to develop the valuation value of assets. These include the Member Reserve, Employer Reserve, and Retiree Reserve.

Other Valuation Reserves: Includes Employer Reserve, and Retiree Reserve.

Member Reserve: Represents the balance of accumulated member contributions and interest for active, inactive, and deferred members of SCERS.

Employer Reserve: Represents the balance of accumulated employer contributions and interest for future retirement payments to current active members. When a member retires and begins receiving retirement allowance, funds in this reserve associated with the retiring member are moved to the Retiree Reserve.

Retiree Reserve: Represents the balance of transfers from Member Reserve, Employer Reserve, and interest earnings, less payments to retired members and beneficiaries.

Contingency Reserve: Reserve against deficiencies in future earnings not to exceed 3% of Plan's Market Value of Assets.

Market Stabilization Reserve: Represents the financial statement reserve account and is the difference between the Market Value of Assets and the smoothed Actuarial Value of Assets.

IV. INTEREST CREDITING

A. Upon determining Available Earnings for the interest crediting period, SCERS shall credit interest semiannually based on Actuarial Value of Assets on June 30 and December 31 to all funds that have been on deposit for the entire six months immediately prior to the interest crediting date at the interest crediting rates and dollar amounts set forth below:

1. Member Reserve: The semiannual interest crediting rate for Member Reserves is one-half of the United States 5-Year Treasury Note Rate in the Federal Reserve Statistical Release H.15 Selected Interest Rates on the last publishing date of the interest crediting period. The semiannual interest crediting rate for Member Reserve shall be the lesser of the United States 5-Year Treasury Note Rate or the interest crediting rate applied to the Other Valuation Reserves. In no event shall the member's interest crediting rate be less than zero.

2. Other Valuation Reserves: Semiannual interest will be credited to the Other Valuation Reserves to the extent there are available earnings. Semiannual interest crediting rate is one-half of the Actuarially Assumed Investment Rate of Return. The Other Valuation Reserves are also credited, on June 30 and December 31, with the dollar difference between one-half of the Actuarially Assumed Investment Rate of Return on the Member Reserve and one-half of the Member Reserve Interest Crediting Rate. If the Available Earnings are not sufficient to credit interest to Valuation Reserves at the Actuarially Assumed Investment Rate of Return, such interest shall be applied on a pro rata basis to each of the Other Valuation Reserve. In no event shall the Other Valuation Reserves' interest crediting rate be less than zero.

B. Contingency Reserve: When Available Earnings exceed the amount required to credit interest to the Valuation Reserves, the balance of the Available Earnings after interest crediting, shall be applied to the Contingency Reserve until that balance reaches 3% of the Plan's Market Value of Assets.

C. Unallocated Earnings:

1. Once the Contingency Reserve balance reaches 3% of the Plan's Market Value of Assets, then distribute unallocated earnings to Other Valuation Reserves until the Plan achieves 100% funded status.

2. When both goals are reached, the Board, in its discretion and consistent with its fiduciary duties, may consider establishing higher thresholds, or may distribute some or all of the unallocated funds toward other purposes as permitted by the ~~County Employees' Retirement Law of 1937 (~~CERL~~)~~.

V. APPLICATION

Staff shall apply the semiannual interest crediting to the Valuation Reserves in accordance with this policy. In the event there is unallocated earnings available after crediting interest at the Actuarially Assumed Investment Rate of Return, the Contingency Reserve reaches 3%, and the Plan achieves 100% funded status, staff will report to the Board and to determine the distribution of the funds toward other purposes.

The Board retains substantial discretion with respect to such matters under the CERL and Article XVI, Section 17 of the California Constitution and other provisions of state and federal law applicable to public retirement systems. This discretion includes the right to deviate from or alter a stated policy or procedure if the Board determines that such action is reasonable, appropriate, and prudent with respect to the Board's exercise of its fiduciary duties to secure the sound funding of the retirement system, and to act in the best interests of the system as a whole.

VI. PRE-2006 ALLOCATION FOR COST-OF-LIVING ADJUSTMENT (COLA) CONTRIBUTION-RATE OFFSET

While the Board has not provided additional, unallocated earnings for non-vested benefits since this policy's adoption in 2006, the Board has continued to provide an offset to COLA contribution rates for legacy members, using the balance available from pre-2006 allocations of unallocated earnings as reflected in the annual valuation, using a methodology determined by the System's actuary to provide the rate offset over the legacy members' expected future working lifetime. The balance available is tracked in an Employer Reserve subaccount maintained for this purpose by the actuary.

To minimize contribution-rate volatility and support the Board's duty of impartiality with respect to members, the Board determines that the residual balances from the pre-2006 allocations can continue to be used to offset COLA contribution rates as a percent of payroll for legacy members using the methodology previously established by the System's actuary, except that the offset to COLA contribution rates shall not exceed the percent of payroll provided for each membership group and tier as reflected in the June 30, 2020 valuation.

Furthermore, the Board determines that it is prudent, and in the best interest of all members and beneficiaries, that any residual balances remaining for a membership group shall revert to the Employer Reserves to reduce the Unfunded Actuarial Accrued Liability after all members in that plan and tier have terminated their active SCERS membership.

RESPONSIBILITIES

Executive Owner: Chief Executive Officer

POLICY HISTORY

Date	Description
03-17-2021	Board amended policy to add Section VI
06-19-2019	Board amended policy
02-21-2018	Board affirmed in revised policy format
06-15-2016	Board reviewed and affirmed policy with no revisions
09-21-2006	Board approved new policy

INTEREST CREDITING AND UNALLOCATED EARNINGS POLICY

I. PURPOSE

This policy establishes the parameters and methodology to credit semiannual interest to the reserves of the Sacramento County Employees' Retirement System (SCERS or the Plan) in accordance with the County Employees Retirement Law of 1937 (CERL).

II. OBJECTIVES

- To distribute Available Earnings to the reserves of SCERS.
- To maintain a Contingency Reserve not to exceed 3% of the Plan's Market Value of Assets against deficiencies in future earnings.
- To consider distribution of unallocated earnings if and when the Contingency Reserves reaches 3% of the Plan's Market Value of Assets and the Plan achieves 100% funded status.

III. DEFINITIONS

A. General Definitions

Actuarially Assumed Investment Rate of Return: The expected investment earnings rate of return used in the annual actuarial valuation of the Plan, recommended to the SCERS Board by the Plan third-party actuary in an experience study and set by the SCERS Board.

Actuarial Value of Assets: The Market Value of Assets less deferred investment gains or losses as calculated under the Plan's seven year actuarial asset smoothing method.

Available Earnings: Represent the actual earnings of the Plan as determined based on the smoothed Actuarial Value of Assets and funds previously set aside in the Contingency Reserve.

Market Value of Assets: An asset value where the full value of investment earnings is recognized in a fiscal year.

Reserve Definitions

Valuation Reserves: Reserves used by the Plan's actuary to develop the valuation value of assets. These include the Member Reserve, Employer Reserve, and Retiree Reserve.

Other Valuation Reserves: Includes Employer Reserve, and Retiree Reserve.

Member Reserve: Represents the balance of accumulated member contributions and interest for active, inactive, and deferred members of SCERS.

Employer Reserve: Represents the balance of accumulated employer contributions and interest for future retirement payments to current active members. When a member retires and begins receiving retirement allowance, funds in this reserve associated with the retiring member are moved to the Retiree Reserve.

Retiree Reserve: Represents the balance of transfers from Member Reserve, Employer Reserve, and interest earnings, less payments to retired members and beneficiaries.

Contingency Reserve: Reserve against deficiencies in future earnings not to exceed 3% of Plan's Market Value of Assets.

Market Stabilization Reserve: Represents the financial statement reserve account and is the difference between the Market Value of Assets and the smoothed Actuarial Value of Assets.

IV. INTEREST CREDITING

A. Upon determining Available Earnings for the interest crediting period, SCERS shall credit interest semiannually based on Actuarial Value of Assets on June 30 and December 31 to all funds that have been on deposit for the entire six months immediately prior to the interest crediting date at the interest crediting rates and dollar amounts set forth below:

1. Member Reserve: The semiannual interest crediting rate for Member Reserves is one-half of the United States 5-Year Treasury Note Rate in the Federal Reserve Statistical Release H.15 Selected Interest Rates on the last publishing date of the interest crediting period. The semiannual interest crediting rate for Member Reserve shall be the lesser of the United States 5-Year Treasury Note Rate or the interest crediting rate applied to the Other Valuation Reserves. In no event shall the member's interest crediting rate be less than zero.

2. Other Valuation Reserves: Semiannual interest will be credited to the Other Valuation Reserves to the extent there are available earnings. Semiannual interest crediting rate is one-half of the Actuarially Assumed Investment Rate of Return. The Other Valuation Reserves are also credited, on June 30 and December 31, with the dollar difference between one-half of the Actuarially Assumed Investment Rate of Return on the Member Reserve and one-half of the Member Reserve Interest Crediting Rate. If the Available Earnings are not sufficient to credit interest to Valuation Reserves at the Actuarially Assumed Investment Rate of Return, such interest shall be applied on a pro rata basis to each of the Other Valuation Reserve. In no event shall the Other Valuation Reserves' interest crediting rate be less than zero.

B. Contingency Reserve: When Available Earnings exceed the amount required to credit interest to the Valuation Reserves, the balance of the Available Earnings after interest crediting, shall be applied to the Contingency Reserve until that balance reaches 3% of the Plan's Market Value of Assets.

C. Unallocated Earnings:

1. Once the Contingency Reserve balance reaches 3% of the Plan's Market Value of Assets, then distribute unallocated earnings to Other Valuation Reserves until the Plan achieves 100% funded status.

2. When both goals are reached, the Board, in its discretion and consistent with its fiduciary duties, may consider establishing higher thresholds, or may distribute some or all of the unallocated funds toward other purposes as permitted by the CERL.

V. APPLICATION

Staff shall apply the semiannual interest crediting to the Valuation Reserves in accordance with this policy. In the event there is unallocated earnings available after crediting interest at the Actuarially Assumed Investment Rate of Return, the Contingency Reserve reaches 3%, and the Plan achieves 100% funded status, staff will report to the Board and to determine the distribution of the funds toward other purposes.

The Board retains substantial discretion with respect to such matters under the CERL and Article XVI, Section 17 of the California Constitution and other provisions of state and federal law applicable to public retirement systems. This discretion includes the right to deviate from or alter a stated policy or procedure if the Board determines that such action is reasonable, appropriate, and prudent with respect to the Board's exercise of its fiduciary duties to secure the sound funding of the retirement system, and to act in the best interests of the system as a whole.

VI. PRE-2006 ALLOCATION FOR COST-OF-LIVING ADJUSTMENT (COLA) CONTRIBUTION-RATE OFFSET

While the Board has not provided additional, unallocated earnings for non-vested benefits since this policy's adoption in 2006, the Board has continued to provide an offset to COLA contribution rates for legacy members, using the balance available from pre-2006 allocations of unallocated earnings as reflected in the annual valuation, using a methodology determined by the System's actuary to provide the rate offset over the legacy members' expected future working lifetime. The balance available is tracked in an Employer Reserve subaccount maintained for this purpose by the actuary.

To minimize contribution-rate volatility and support the Board's duty of impartiality with respect to members, the Board determines that the residual balances from the pre-2006 allocations can continue to be used to offset COLA contribution rates as a percent of payroll for legacy members using the methodology previously established by the System's actuary, except that the offset to COLA contribution rates shall not exceed the percent of payroll provided for each membership group and tier as reflected in the June 30, 2020 valuation.

Furthermore, the Board determines that it is prudent, and in the best interest of all members and beneficiaries, that any residual balances remaining for a membership group shall revert to the Employer Reserves to reduce the Unfunded Actuarial Accrued Liability after all members in that plan and tier have terminated their active SCERS membership.

RESPONSIBILITIES

Executive Owner: Chief Executive Officer

POLICY HISTORY

Date	Description
03-17-2021	Board amended policy to add Section VI
06-19-2019	Board amended policy to clarify interest crediting
02-21-2018	Board affirmed in revised policy format
06-15-2016	Board reviewed and affirmed policy with no revisions
09-21-2006	Board approved new policy