



# Board of Retirement Regular Meeting

## Sacramento County Employees' Retirement System

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### Agenda Item 14

**MEETING DATE:** June 19, 2019

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

**SUBMITTED FOR:** \_\_\_ Consent        X   **Deliberation and Action**      \_\_\_ **Receive and File**

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### RECOMMENDATION

Staff recommends the Board approve technical and clarifying revisions to the Interest Crediting and Unallocated Earnings Policy.

### PURPOSE

This item supports the 2018-19 Strategic Management Plan by maintaining transparent communications to stakeholders and demonstrating fiscal responsibility and stewardship.

### DISCUSSION

This Policy was last brought to the Board in February 2018 during which the Board affirmed the revised policy format. Since then Staff has reevaluated the Policy to ensure conformance to current practice. As a result, certain technical and clarifications have been made to the Policy as summarized below:

- Revises the Policy format and adds more definitions to the Policy.
- Combines Retiree Reserve and Retiree Death Benefit Reserve into one Retiree Reserve account.
- Clarifies that Member and Other Valuation Reserves shall not be less than zero.
- Clarifies current practice that establishes a maximum Contingency Reserve of 3% before considering the use of unallocated earnings.
- Clarifies that Board approval is not required related to the semiannual interest crediting to reserve accounts. Staff will report to the Board in the event there are Unallocated Earnings available.

The modifications to the Policy do not change the methods or approach in determining the semiannual interest crediting amounts.

**ATTACHMENT**

- Interest Crediting and Unallocated Earnings Policy – NEW POLICY
- Interest Crediting and Unallocated Earnings Policy – OLD POLICY

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Debbie Chan  
Senior Accounting Manager

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Eric Stern  
Chief Executive Officer



**NEW**

# **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.

## RESPONSIBILITIES

Executive Owner: Chief Executive Officer

## POLICY HISTORY

Date	Description
06-19-2019	Staff to recommend the Board approve the revised 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



**OLD**

# **INTEREST CREDITING AND UNALLOCATED EARNINGS POLICY**

## **PURPOSE**

This policy sets the goals, priorities, and methods for applying available earnings to the reserves of the Sacramento County Employees' Retirement System (SCERS), as determined by the SCERS Board of Retirement (Board).

## **POLICY OBJECTIVES**

- Maintain a sound funded status and pursue full funding of vested retirement benefits through the reasonable and prudent application of available earnings
- Establish a contingency reserve level equal to 3% of plan assets to help mitigate earnings shortfalls and unexpected expenses.
- Only consider application of unallocated earnings to other purposes if and when vested retirement benefits are more than 100% funded and contingency reserves equal at least 3% of plan assets.

The Board reserves the right to set funding and contingency reserve thresholds greater than the stated levels, or to otherwise decline to consider such alternative application of funds if the Board determines that such actions are reasonable and prudent for securing long-term stability of funding for the vested benefits of the retirement system.

## **POLICY**

### **A. Interest Crediting**

Pursuant to Government Code Section 31591, regular interest is credited semiannually on June 30<sup>th</sup> and December 31<sup>st</sup> to all contributions in the retirement fund that have been on deposit for six months immediately prior to the interest crediting date.

#### **1. Total Valuation Reserves**

Interest is credited in a manner designed to keep the Total Valuation Reserves on track with the investment return assumption for the plan as adopted by the Board. A lower interest crediting rate will be used for Member Contribution Reserves, and the difference between that lower crediting rate and the Target Crediting Rate will be applied to the Other Valuation Reserves so that the overall valuation reserves crediting rate is maintained at the Target Crediting Rate, subject to the provisions of this policy regarding available earnings.

## 2. Member Contribution Reserves

The semiannual interest crediting rate for Member Contribution Reserves is one-half of the United States 5-Year Treasury Note Rate for the last business day of the interest crediting period in the Federal Reserve Statistical Release H.15 Selected Interest Rates, with the following provisos:

- a. The Member Contribution Reserves interest crediting rate will not be greater than the Target Crediting Rate; and
- b. If the projected semiannual interest crediting rate for the Other Valuation Reserves is less than the Target Crediting Rate for the Total Valuation Reserves, the interest crediting rate for the Member Contribution Reserves will be the semiannual interest crediting rate applied to the Other Valuation Reserves or one-half of the Treasury Note Rate, whichever is lower.

## 3. Other Valuation Reserves

Semiannual Interest will be credited to the Other Valuation Reserves to the extent there are available earnings. Available earnings will be comprised of (a) the actual earnings of the retirement fund based on the smoothed actuarial value of assets; and (b) funds previously set aside in the Contingency Reserve. Crediting interest to Total Valuation Reserves at the Target Crediting Rate is the highest priority with respect to the use of available funds. If the funds available are not sufficient to credit interest to Total Valuation Reserves at the Target Crediting Rate, interest shall be applied on a pro rata basis to each valuation reserve, taking into account the lower crediting rate for Member Contribution Reserves.

### **B. Application of Unallocated Earnings**

Actual earnings of the retirement fund (based on the smoothed actuarial value of assets) that remain unallocated in a given interest crediting period after, but only after meeting the Target Crediting Rate for that period, will be applied equally toward:

- a. Addressing earnings deficiencies and other actuarial losses and assumption changes related to past periods by crediting Other Valuation Reserves; and
- b. Establishing target Contingency Reserve levels.

The equal application of such unallocated earnings will continue until such time as the retirement system has achieved a 100% funded status and established a Contingency Reserve equal to 3% of plan assets, respectively. When one goal is reached, the full amount of the unallocated earnings will be applied toward the second goal.

When both goals are reached, the Board, in its discretion and consistent with its fiduciary duties, may consider establishing higher thresholds, or the application of some or all of the funds toward other purposes as permitted by the County Employees' Retirement Law of 1937 (CERL). At any point, however, including prior to reaching stated target funding levels, if the Board determines that it is in the best interest of the retirement system to do so, the Board may use unallocated earnings to establish Contingency Reserves earmarked for an identified, anticipated, and extraordinary future expenditure.



## **APPLICATION**

Staff shall estimate semiannual Interest crediting for Total Valuation Reserves in accordance with this policy, including the use of amounts from the Contingency Reserve, if any, to credit interest at the Target Crediting Rate, for Board approval. If it is estimated there will be unallocated earnings available after crediting interest at the Target Crediting Rate, staff will include for Board approval an estimate of the amount of those earnings to be applied to the Other Valuation Reserves and the amount of those earnings to be applied to the Contingency Reserve.

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.

## **DEFINITIONS**

Member Contribution Reserves – A valuation reserve representing the balance of accumulated member contributions and interest for active, inactive, and deferred members of SCERS.

Contingency Reserve – A non-valuation reserve against deficiencies in future earnings and unexpected expenses established and maintained by SCERS pursuant to Government Code Section 31592.

Other Valuation Reserves – Includes Employer Reserves, Retiree Reserves, and Retiree Death Benefit Reserves.

Market Stabilization Reserve – A non-valuation reserve representing the unrecognized deferred gains and losses and is the difference between the smoothed actuarial value of assets and the market value of assets.

Target Crediting Rate – On an annual basis is equal to the investment return assumption for the plan; on a semiannual basis, is equal to one-half of the investment return assumption for the plan.

Total Valuation Reserves – Includes Member Contribution Reserves, Employer Reserves, Retiree Reserves, and Retiree Death Benefit Reserves.

## **BACKGROUND**

Prior to September 2006, SCERS target for crediting interest to Member Contribution Reserves was a rate equal to the investment return assumption for the plan. In 2006, the Board considered alternative target interest crediting rates for Member Contribution Reserves and adopted this policy setting a lower crediting rate for Member Contribution Reserves but maintaining an overall Target Crediting Rate on Total Valuation Reserves equal to the investment return assumption for the plan.

## RESPONSIBILITIES

Executive Owner: Chief Operations Officer

## POLICY HISTORY

<b>Date</b>	<b>Description</b>
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