MERCED COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
BOARD OF RETIREMENT POLICY
INTEREST CREDITING AND EXCESS EARNINGS POLICY

Purpose of this Policy:

The purpose of this policy is to establish a methodology for crediting interest to contributions and reserve accounts in the Merced County Employees' Retirement Association (Association) and to administer the remaining available earnings of the Association. This policy also addresses excess earnings when/if the Association has a funded status of 100% or above on a market value basis The Board of Retirement (Board) shall credit interest semiannually to establish reserves as provided by law and administer any remaining available earnings of the system in accordance with terms of this policy. This policy does not address how to fund the Association's plan(s) to get to a funded status of 100% on a market value basis.

Objectives:

- To maintain the consistency between the structure of the Association's reserve accounts and the actuarial funding policies.
- Assure that the reserve values are tracked to the market value of assets and the Association's actuarial accrued liability over the long term.
- Maintain stability in contribution rates and long term funding, establish/fund a contingency reserve and provide a framework for considering the disposition of excess reserves.

Governing Law:

The Association is governed by the provisions of the County Employees' Retirement Law of 1937 (CERL), California Public Employees' Pension Reform Act of 2013 (PEPRA), as well as federal and state laws relating to public employees retirement systems. The CERL generally governs the interest crediting and the use of available and/or excess earnings. Various reserves and designations are established and maintained by the Board under policies adopted pursuant to the CERL, specifically Government Code 31591 et seq.

Definitions:

- <u>Available Earnings</u> – the realized current period earnings of the fund calculated using the market value of assets, less current year expenses.
- <u>Excess Earnings</u> - defined as the market value of assets that is equal to or exceeds the actuarially determined liabilities. The Association's actuary determines the liabilities, annually.
- <u>Employer Advance Reserve</u> – This is a valuation reserve that includes the total accumulated contributions of employers which is held for benefit of the non-retired General and Safety members for service rendered as a member of the Association, plus semiannual interest credited to those contributions.
- <u>Retiree Member Reserve</u> – This is a valuation reserve that includes the total accumulated contributions of retired members and corresponding employer contributions for annuity

benefits plus semiannual interest credited to those contributions under this Policy, less the annuity payments made to members.

- Active Member Contribution Reserve – This is a valuation reserve that includes the total accumulated contributions of active members within an employer, plus semiannual interest credited to those contributions under this Policy.
- Interest Fluctuation Reserve – This is a valuation reserve that includes the realized gains or losses as well as investment income of the fund. This includes interest, dividends, and any gain or loss resulting from the sale of an asset.
- Contingency Reserve – This is a non-valuation reserve that represents excess earnings of the total interest credited to the valuation reserves, up to one percent (1%) of the market value of the Association's total assets maintained by each employer. The Contingency Reserve is treated as a non-valuation asset and is used as a reserve against deficiencies in years when the reserves have a deficit or in years with down investment markets, as provided by Government Code Sections 31592 and 31592.2.
- Actuarial Discount Rate – An estimated and expected rate used by the Association's actuary to discount liabilities and value expected investment earnings. This discount rate is made up of the Association's real return plus the Association's inflation assumption. For more information on the Association's actuarial discount rate, please refer to the following link: http://www.co.merced.ca.us/retirement/actuarialValuationReports.html

General Policies:

Interest Crediting Policy

1. Association will only credit interest to the extent that there is current fiscal year net investment revenue and/or any balance in the Interest Fluctuation Reserve that the Board, in its sole discretion, determines to be available for interest crediting.

2. The Active Member Contribution Reserve, Employer Advance Reserve and/or Retiree Member Reserve will have priority over the Contingency Reserve on funds available for interest crediting. The actual amount of semiannual interest credited to all reserve accounts will be determined by the Board within the guidelines and parameters of this Policy and the CERL.

3. The total semiannual interest that the Board may credit to the Active Member Contribution Reserve will fall within a range from zero percent to the Association's actuarial discount rate, at the high end. In determining the amount of interest to be credited to the Active Member Contribution Reserve, the Board may take into consideration and be guided by the Bank of America Merrill Lynch Six Month Treasury Bill index for the interest crediting period.

4. The Active Member Contribution Reserve will receive interest compounded semiannually, based on the account balance as of the prior December 31st or June 30th. The Board at its December and June meetings, or as soon thereafter, will determine the interest crediting rate for the Active Member Contribution Reserve. The total interest

credited for the period may not exceed the Association's actuarial discount rate except under the circumstances deemed relevant by the Board.

5. The Employer Advance Reserve and the Retired Member Reserve are included in the assets of the Association's actuarial valuation and shall be credited, if there are sufficient available funds, at the actuarial discount rate. If there are insufficient funds to fully credit the Employer Advance Reserve and Retired Member Reserve with interest at the actuarial discount rate, then the available funds shall be used to credit interest to the Employer Advance Reserve and the Retired Member Reserve on a pro rata basis.

Excess Earnings Policy

Excess earnings for the Association may only be declared in years in which the market value of assets is equal to or exceeds the actuarially determined liabilities. The timing of this declaration will depend on the actuary's determination of the liabilities. The Board in its sole discretion may determine that excess earnings may be used to pay for the following:

- Certain expenses such as but not limited to administrative, investment and actuarial expenses incurred by the fund,
- Creating or maintaining a one percent Contingency Reserve,
- Additional valuation reserve interest crediting.

If the fund is below 100% funded on a market value of assets basis;

- Any remaining earnings may be distributed on a pro rata basis between those reserves established for vested retirement benefits including the Active Member Reserve, Employer Advance Reserve, Retiree Member Reserve, pensions and cost of living adjustments with the following caveat; the percentage of earnings allocated to the Active Member Reserve shall be capped at the actuarial discount rate.

If the fund is greater than 100% funded (funded status ratio) on a market value of assets basis;

- If the funded status ratio is above 100%, the Board will have complete discretion on how the excess earnings will be allocated.

Discretionary Use of Excess Earnings

The Board may use its discretion in allocating discretionary excess earnings for <u>any or none of</u> the following uses (note that certain circumstances outlined in the CERL must be met prior to final action of the items below):

- Augment the Contingency Reserve. The Board may allocate discretionary excess earnings to increase the Contingency Reserve per Government Section Code 31592 of the CERL.

This reserve can be used in times of market down turns to offset the net annual losses from investments.

- Provide ad hoc benefits to retirees pursuant to Government Codes 31592.3 and 31874.3 or to other benefits authorized by the CERL and other applicable laws.
- Segregating excess earnings in a non-valuation reserve for future use to fund medical benefits per sections 31592.2 and 31592.4 of the CERL.

Prior to any action on the use of excess funds, the Board may revisit the investment risk of the Association's portfolio and determine whether further steps should be taken to reduce investment risk. The Board may obtain from the Association's actuary an analysis of impact on any action being considered by the Board. Such analysis may include but not be limited to, future liabilities, contribution rates and funding status of the plan(s). The Board may also obtain a legal opinion that any actions being considered are legal and in alignment with the CERL, PEPRA, federal and state laws.

The Board may always require that the normal employer contributions be made. If the retirement system is overfunded and the Association's actuary reduces the employer contributions to below the employer normal cost, the Board may not accept a contribution of below the employer normal cost for the year, per Government Code Section 7522.52 of PEPRA.

Board of Retirement of Merced County Employees' Retirement Association adopted this policy.

Darlene Ingersoll

Darlene Ingersoll, Board Chair

Alfonse Peterson, Secretary

Kristen Santos, Plan Administrator

Historical Notes
Adopted: 04/01/2003
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