FRESNO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION (FCERA)
INTEREST CREDITING AND UNDISTRIBUTED EARNINGS POLICY

I. PURPOSE OF POLICY:

The purposes of this policy are to establish a methodology to:

1. credit interest to valuation and non-valuation reserves of the retirement system; and

2. administer the “undistributed earnings” of the retirement system.

II. GOVERNING LAW:

FCERA is governed by provisions of the County Employees Retirement Law of 1937 (“CERL”), as well as other federal and State laws relating to public retirement systems. In addition, this policy provides guidelines that may be followed in administering the Settlement Agreement reached between FCERA, Fresno County and various employee organizations representing FCERA members in December of 2000.

CERL generally governs interest crediting and excess earnings. Under CERL, interest is credited every 6 months. Various reserves and designations are established and maintained by the Board under procedures adopted by the Board pursuant to CERL.

III. OBJECTIVES:

1. Maintain consistency between the reserving structure accounts and the actuarial funding policies of FCERA.

2. Assure that the reserve values track the market value of assets over the long term.

3. To the extent possible, maintain reasonable stability in the both interest crediting and contribution rates by avoiding charging short-term losses to reserves.

4. Assure that unfunded liabilities associated with the vested benefits granted by FCERA’s participating employers are funded before the Board funds any new discretionary non-vested benefits.

IV. GENERAL POLICIES:

1. Base “Available Earnings” on actual current period earnings of the fund calculated on the Actuarial Value of Assets as determined under the Board’s funding policy, plus the balance in the Undistributed Earnings and Contingency Reserves.

2. Credit interest on member accounts at a rate equal to one-half of the cost-of-living increase percentage provided to FCERA members who retired on or before April 1 of that calendar year. This is intended to approximate the return on a short-term savings account.

3. Credit interest at the assumed valuation interest rate on the valuation and non-valuation reserves (except for the Contingency and Undistributed Earnings Reserves).

4. Maintain a "Contra Tracking Account" to track any shortfalls of Available Earnings relative to earnings required to credit full interest to valuation reserves, and in subsequent interest crediting periods, use Available Earnings remaining after crediting such reserve interest to restore any prior shortfalls as tracked in the Contra Tracking Account.

5. Maintain a 1% Statutory Contingency Reserve. The Board may at its discretion maintain an additional Board Contingency Reserve of up to 2% based on current financial circumstances. One such circumstance to consider would be deferred market value actuarial losses not yet recognized in the Actuarial Value of Assets.

6. Any Available Earnings remaining after crediting full interest to valuation and non-valuation reserves and restoring the Contra Tracking Account and restoring the Contingency Reserves to their target levels constitute Undistributed Earnings. The balance in the Undistributed Earnings Reserve will be allocated in the following order of priority:

   A. Apply to the funding of current and/or additional benefits under the Settlement Agreement

   B. Allocated among the following discretionary uses of any remaining Undistributed Earnings

      1. Transfer to a reserve or designation to pay additional ancillary benefit such as Supplemental COLA and Additional Retiree Health Insurance as permitted by law.

      2. Transfer to a valuation reserve for reduction of UAAL for statutory benefits.

      3. Transfer to a reserve or designation for other uses as permitted by law.

      4. Retain in the Undistributed Earnings Reserve.

   Prior to implementing any of the above, the Board must obtain: (a) from FCERA's actuary, an analysis of the impact on such actions on future annual costs, on FCERA's contribution rates, Unfunded Actuarial Accrued Liability and Funding Ratio; and (b) the advice of legal counsel.

V. INTEREST CREDITING POLICY:

Step 1 - Determine "Available Earnings" for accounting period as the sum of:

A. Earnings of the retirement fund for the period based on Actuarial Value of Assets methodology, expressed in dollars. This could be a negative amount.

B. Balance in the Contingency Reserves.

C. Balance in the Undistributed Earnings Reserve.

Step 2 - Credit interest to the valuation reserves:

A. Credit Employee Reserve at "Member Crediting Rate." The employee account balance credited at this rate will be used to determine refunds available at termination.

B. Credit the difference between the Employee Reserve at the "Valuation Rate" and Member Crediting Rate temporarily to the other employer valuation reserves. This amount will be added back to the employee account balance calculated in (A) upon retirement.

The process used to credit member accounts with the difference between the full valuation crediting rate the member credit rate was original discussed back when the member crediting rate was introduced and is referred to as interest equalization. The process was not implemented at that time because the pension system in use at that time was not designed to have the capability to track and calculate the adjustment. The pension software was replaced in November 2014 and the Interest Equalization workflow was activated in October 2016. Interest Equalization does not alter the member's retirement allowance that is calculated based on salary, service and age dependent pension factor. The additional interest credit changes the ratio of how much of the member's allowance is considered funded by member contributions and interest, and how much is funded by the plan sponsor contributions.

1. The equalization process will apply to members who retire or who have signed declaration of retirement with an effective date that has passed.

2. Staff will retroactively process interest equalization calculations for all retirement calculations processed in Arrivos back to the "go-live" date in November 2014.
3. The Interest Equalization adjustment only affects residual lump sum payments to non-spouse beneficiaries for remaining member contributions under an unmodified or option 1 allowance.

C. Credit the other valuation reserves at the Valuation Rate.

D. Deduct the interest credited above from Available Earnings. If the amount of interest credited is more than the Available Earnings, charge the shortfall to the Contra Tracking Account. If Available Earnings is greater than amount of interest to be credited to reserves, then apply the excess Available Earnings to reduce the accumulated Contra Tracking Account balance (see Step 3 below).

Step 3 - Reduce the balance in the Contra Tracking Account

Transfer from any remaining Available Earnings an amount up to the balance in the Contra Tracking Account. Note that the Contra Tracking Account balance should be zero before any restoration of the 1% Statutory Contingency Reserve should occur.

Step 4 - Restore the Statutory Contingency Reserve to 1%

Transfer from any remaining Available Earnings into Statutory Contingency Reserve the amount required to maintain the Statutory Contingency Reserve balance at 1% of market value.

Step 5 - Credit interest to the Non-valuation Benefit Reserves:

Credit the Non-valuation Benefit Reserves with any remaining Available Earnings, up to the Valuation Rate.

Step 6 - Maintain a Board Contingency Reserve of up to 2%

Subject to the Board's discretion and based on review of current financial circumstances (such as deferred market value losses not yet recognized in Actuarial Value of Assets), transfer from any remaining Available Earnings into the Board Contingency Reserve the amount required to maintain a Board Contingency Reserve of up to 2% of market value.

VI. UNDISTRIBUTED EARNINGS POLICY:

Step 1 - Apply any remaining Available Earnings to the funding of current and/or additional benefits under the Settlement Agreement

A. Reduce Unfunded Actuarial Accrued Liabilities for any of the existing Sections 6, 8 and 9 benefits from the Settlement Agreement.

B. Grant additional Section 9 retiree health insurance benefit as described in the Settlement Agreement if there are at least $25 million in Available Earnings after A.

C. Reduce employer normal cost under Sections 6 and 9 and employee normal cost under Section 6 of the Settlement Agreement with Available Earnings after B.

Prior to implementing any of the above, the Board must obtain: (a) from FCERA's actuary, an analysis of the impact on such actions on future annual costs, on FCERA's contribution rates, Unfunded Actuarial Accrued Liability and Funding Ratio; and (b) the advice of legal counsel.

Step 2 - Negative Ancillary Reserve Balances

Restore any negative ancillary benefit reserve accounts to $0.

Step 3 - Consider other discretionary uses

The Board may, in its discretion, consider any or all of the following uses of any remaining Available Earnings.

A. Transfer to a reserve or designation to pay additional ancillary benefit such as supplemental COLA and additional retiree health benefits as permitted by law.

B. Transfer to a valuation reserve for reduction of UAAL for statutory benefits.

C. Transfer to a reserve or designation for other uses as permitted by law.

Prior to implementing any of the other discretionary uses, the Board must obtain: (a) from FCERA's actuary, an analysis of the impact on such actions on future annual costs, on FCERA's contribution rates, Unfunded Actuarial Accrued Liability and Funding Ratio; and (b) the advice of legal counsel.

Step 4 - Retain the Remainder in the Undistributed Earnings Reserve

VII. EFFECTIVE DATE AND PERIODIC REVIEW:

This policy was first reviewed and adopted on November 5, 2008 and updated on April 19, 2017 to include Interest Equalization processes. This policy will be reviewed and refined at least once every three years.
The Board of Retirement reviewed and modified this policy on April 19, 2017, February 19, 2020 and December 1, 2021.

I certify that this is a true reflection of an action taken and entered on the minutes of the Retirement Board on the date shown:

December 1, 2021
Date of Action:

Donald C. Kendig
By: Retirement Administrator

Glossary

Actuarial Terms and Definitions

The following list defines certain technical terms relevant to the Interest Crediting Procedures and Undistributed Earnings Policy for the convenience of the reader:

Investment Return:
The rate of earnings of the Plan from its investments, including interest, dividends and capital gain, and loss adjustments, computed as a percentage of the average value of the fund. For actuarial purposes, the investment return reflects a smoothing of market gains and losses to avoid significant swings in the value of assets from one year to the next.

Actuarial Value of Assets:
Market value of assets less unrecognized market value gains and losses from each of the last five years. Market value gains and losses are equal to the difference between the actual market return and the expected return on the market value, and are recognized over a five-year period. The actuarial value of assets is limited to no greater than 120% or less than 80% of the market value of assets.

Valuation Value of Assets:
The Actuarial Value of Assets reduced by the value of the Non-Valuation Reserves (Supplemental COLA Reserve, Additional Retiree Health Insurance Reserve, Contingency Reserves and Undistributed Earnings Reserve).

Member Crediting Rate:
The Employee Reserve is credited semi-annually at the Board-approved Member Crediting Rate that is one-half of the cost-of-living increase percentage provided to FCERA members who retired on or before April 1 of that calendar year.

Valuation Rate:
This is one-half of the interest rate adopted by the Board from the actuarial valuation that established the employer and employee contribution rates for that fiscal year.

Valuation Reserves

Employee Reserve:
This reserve represents the total accumulated contributions of members.
Employer Reserve:
This reserve includes the total accumulated contributions of the employer held for the benefit of non-retired General and Safety members on account of service rendered as a member of the retirement system.

Glossary (continued)

Retired Reserve:
The reserve represents total accumulated contributions of the employer held for the benefit of retired members on account of service rendered as a member of the retirement system, less the pension payments made to retired members.

Survivor Death Benefit Reserve:
The reserve represents the accumulated contributions of the employer to be used to pay death benefits of members.

Cost of Living Reserve:
The reserve represents the accumulated contributions of the employer to be used to pay cost of living payments.

Retired Annuity Reserve:
The reserve includes the total accumulated contributions of retired members less the annuity payments made to the members.

Non-Valuation Reserves

<u>Non-valuation Benefit Reserves</u>

Supplemental COLA Reserve:
The reserve represents the excess earnings allocated by the Board to pay supplemental COLA benefits to eligible retirees.

Additional Retiree Health Insurance Reserve:
The reserve represents excess earnings allocated by the Board to pay supplemental and taxable benefits to eligible retirees.

<u>Other Non-valuation Reserves</u>

Contingency Reserves:
Represent a 1% Statutory Reserve plus a Board Reserve of up to 2% accumulated from earnings in excess of the total interest credited to contribution of the employer and employee and are used as a reserve against deficiencies in Available Earnings in other years.

Undistributed Earnings Reserve:
Represents earnings in excess of the total interest credited to all other reserves that has not been allocated by the Board to other reserves or the Contra Tracking Account.

Glossary (continued)

Schedule of Section 9 Retiree Health Benefits:

The schedule of additional Section 9 benefit as contained in the Settlement Agreement is as follows:

Amount of Available Earnings	Increase in Monthly Retiree Health Insurance Benefit
\$25-\$50 million	\$0.50 per year of service
\$50-\$75 million	\$1.00 per year of service
\$75-\$100 million	\$1.50 per year of service
\$100 million and over	\$2.00 per year of service plus an additional \$0.50 per year of service for each full increment of \$25 million in Available Earnings above \$100 million, limited to the premium of the County plan with the highest premium