Statement of Reserve Policy

I. Purpose

A. The purpose of this Statement of Reserve Policy is to summarize the structure and operation of the reserves created and maintained by the San Joaquin County Employees' Retirement Association (SJCERA, the Plan, the Fund). This Statement is drafted to achieve the following goals:

1. Document the existing reserve structure and the accounting policies currently in place; and

2. Establish a base for considering future changes in reserve policies.

3. This Statement describes the SJCERA reserve structure and the mechanisms used to accumulate assets and disburse payments from each reserve. It is organized as follows:

   a. Description – The various reserves are categorized and their purposes and related liabilities are described.

   b. Cash Flows – The inflows and outflows, excluding interest, are enumerated for each reserve.

   c. Interest Credits – The computation and timing of the interest credited to each reserve are described.

   d. Reserve Transfers – The circumstances under which the Retirement Board (the Board) may elect to move balances from one reserve account to another are described.

   e. Reconciliation – The method and frequency by which the reserve accounts should be reconciled with the underlying liability is specified.

   f. This Statement is a working document that will be modified as the Board deems necessary.

II. Market Value and Actuarial Value

A. All reserves are held at market value. However, in computing the smoothed or actuarial value of assets required to compute the Plan's funded status and the employer contribution rates, a conversion to actuarial value is sometimes required. This will be noted in each case.

III. Reserve Descriptions

Fund reserves fall into one of two categories: Valuation Reserves and Special Reserves.

A. Valuation Reserves

1. Valuation Reserves include Member Reserves, Retired Member Reserves (excluding certain death benefit reserves), Employer Advance Reserves, the Market Stabilization Designation, and the Unappropriated Earnings Reserve. The total of the Valuation Reserves equals the market value of Fund assets, excluding amounts held in the Special Reserves, also at market value.
2. The total of the Valuation Reserves, excluding the Market Stabilization Designation and excluding the Special Reserves (adjusted to actuarial value), is the Actuarial Value of Fund Assets used to determine the funded ratio and the employer contributions to the Fund as part of the annual actuarial valuation performed each year. Any policy that affects the amount of funds assigned to Valuation Reserves has the potential to affect Plan costs.

   a) <u>Member Reserves</u>

      i. The Member Reserves contain the cumulative employee contributions with interest for active and deferred members. Active member contributions are held in separate reserves for General and Safety, while cumulative member contributions for terminated deferred members are also held in General and Safety reserves. Member contributions for COLAs are combined with all other member contributions in the Member Reserves.

      ii. The Plan liability matching this reserve is the sum of member contributions with interest for active and terminated deferred members.

   b) <u>Retired Member Reserves</u>

      i. The Retired Member Reserves contain the assets necessary to fund the benefits and COLAs in pay status for retired and disabled members and their beneficiaries.

      ii. The Plan liability matching this reserve is the actuarial present value of benefits for members in pay status – retired and disabled members and their beneficiaries. When reserves are reconciled with liabilities, the sum of the Retired Member Reserves should equal the liability held for retired and disabled members and their beneficiaries.

Consequently, the Plan's liability for members in pay status would be 100% funded.

iii. In actuarial valuations through January 1, 2012, Special Reserves were held for the $5,000 lump sum death benefit, the Purchasing Power Protection benefit, and the Pre-April 1, 1982 Settlement. Beginning with the January 1, 2013 valuation, these benefits will be included in the actuarial valuation performed for the Plan. Since these benefits are primarily payable on behalf of retired members, the reserve balances on December 31, 2012 will be included in Valuation Reserves (Retired Member Reserves).

c) Employer Advance Reserves

i. The Employer Advance Reserves contain the assets allocated to the employer portion of the liabilities for active and deferred members. The amount in this reserve is the actuarial value of total Fund assets, minus the Member Reserves, Retired Member Reserves, Unappropriated Earnings Reserve, and Special Reserves, all at actuarial value.

ii. The Plan liability matching this reserve is the actuarial accrued liability for active and deferred members.

d) Market Stabilization Designation

i. The Market Stabilization Designation consists of the difference between the market value of Plan assets and their actuarial value. It contains the total of unrecognized investment gains and losses from the current and prior three Plan (calendar) years.

ii. If the smoothed actuarial value of assets exceeds market value, the Market Stabilization Designation is negative; otherwise, it is zero or positive. The liability matching the Market Stabilization Designation is the sum of unrecognized investment gains and losses, as noted above.

iii. Since the actuarial and market values of Plan assets are determined for all assets in total, regardless of allocation to reserves, the calculation of the Market Stabilization Designation is independent of and must precede the apportionment of assets into reserves.

iv. The Market Stabilization Designation is the amount that must be added to the Actuarial Value of Fund assets to agree with the Market Value of Fund assets. It represents deferred gains (losses) if positive (negative). It therefore represents a reserve for those unrealized gains or losses that is excluded from the calculation of Plan funding status and employer contribution rates.

e) Unappropriated Earnings Reserve

i. The Unappropriated Earnings Reserve is reestablished yearly after all other requirements are met, in the following order: Full actuarial interest on Valuation Reserves and all other reserves, an amount necessary to bring the overall actuarial funded ratio of the Fund to 90% in accordance with the Board's Statement of Funding Policy, and an amount necessary to bring the Contingency Reserve to the 1% minimum.

ii. The amount in the Unappropriated Earnings Reserve can then be transferred to other reserves, subject to the limitations contained in the Board's Statement of Funding Policy and in other applicable legal obligations and settlements.

iii. The liability associated with this reserve is the excess of the Plan's actuarial accrued liability over the total of the Member, Retired Member, and Employer Advance Reserves.

B. **Special Reserves**

1. Special Reserves consist of funds excluded from the annual actuarial valuation and therefore not used in the calculation of the Plan's funded ratio and employer contribution. The amounts set aside can be for designated purposes or for market fluctuation.

a. Post-Retirement Death Benefit Reserve

i. Effective January 1, 2013, the liability for the $5,000 lump sum death benefit for retirees (Government Code Section 31789.3) was included in the actuarial valuation and in Valuation Reserves.

b. Employment Healthcare Agency Fund

i. In 2011, following the IRS' approval of SJCERA VCP application it was determined that the proper presentation of what was formerly known as the Health Insurance Reserve should instead be the Post-Employment Healthcare Agency. The fund is used for cash flows in from employers to fund sick leave bank benefits for their eligible retired employees on a pay as you go basis, and for cash flows out for payment of sick leave bank benefits.

c. Purchasing Power Cost of Living Reserve

    i. After January 1, 2013, the liability for the Purchasing Power Protection benefit for retirees (Government Code Section 31874.3) is included in the actuarial valuation and in Valuation Reserves, and is part of Retired Member Reserves. It is no longer be separately accounted for.

d. Pre-April 1, 1982 Settlement Reserve

    i. After January 1, 2013, the liability for the Pre-April 1, 1982 Settlement benefit for retirees established as part of the 2001 DSA Settlement is included in the actuarial valuation and in Valuation Reserves, and is part of the Retired Member Reserves. It is no longer be separately accounted for.

e. Post-April 1, 1982 Settlement Reserve

    i. The Post-April 1, 1982 Settlement Reserve was established in 2001 as part of the DSA Settlement for members who retired after April 1, 1982 and before January 1, 2001. The benefit payable from the reserve is $10 per month per year of service, with a maximum monthly benefit of $300, prorated for beneficiaries receiving less than 100% of the member's benefit. An initial amount of $19.1 million was transferred from the Special Litigation Reserve; at the time of the Settlement, the Fund actuaries estimated that it would take $36.9 million to fully fund this benefit.

    ii. Under the Settlement Agreement, benefits are paid from the Reserve until the Reserve is exhausted. At that time, benefits are stopped until additional funds are added to the Reserve. The Settlement stipulates that full funding of post-1982 benefits is a requirement after transfers required by law to make up for prior years' interest crediting shortfalls and after any true-up costs occurring in the three years following the establishment of this Reserve.

    iii. Benefits stopped in May 2006, when this reserve was depleted. In October 2007, the Board of Retirement elected to make a one-time transfer from funds in excess of 1% in the Contingency Reserve. After the transfer of $2.5 million from the Contingency Reserve, benefits recommenced December 1, 2007. In August 2008, the Board of Retirement approved a transfer of approximately $4.6

million from the Unappropriated Earnings Reserve to continue funding of this benefit. In October 2008, the Board of Retirement approved a transfer of $18.4 million from the Unappropriated Earnings Reserve to continue the Post-1982 Settlement Benefit as long as sufficient funds remain.

iv. The liability matching this reserve is the actuarial present value of the benefits provided under this part of the DSA Settlement.

f. Contingency Reserve

i. The Contingency Reserve (formerly the Interest Fluctuation Reserve) is required by law to have a balance of at least 1% of all Fund assets before the Board is allowed to make any discretionary reserve allocations. Retirement Board policy historically was to maintain the Reserve at 3%, but, for reasons and under the conditions set forth in its Resolution 2017-06-02 the Board exercised its discretion in June 2017 to set the level at 1%.

ii. Assigning funds to the Contingency Reserve keeps them outside of the valuation assets, thus increasing employer contributions to the Plan in a given year. Using the Contingency Reserve during years when full interest cannot otherwise be credited serves to decrease Plan costs in those years.

iii. No liability is associated with this reserve.

g. County Additional UAL Contribution Reserve

i. The County Additional UAL Contribution Reserve receives additional contributions paid by San Joaquin County toward its share of the unfunded actuarial liability (UAL) beginning in calendar year 2017. On March 29, 2016, the Board of Supervisors approved an additional annual County contribution ranging from 0% to 5% of payroll for the next 10 years effective January 1, 2017 for this purpose.

ii. These additional UAL contributions are not to be taken into consideration in the annual retirement contribution rate setting process, unless and until the County advises when it wants the plan actuary to credit this new reserve against the County's share of UAL as valuation assets.

iii. For the annual GASB 67/68 report, the County's additional UAL contributions are included in the Plan Net Position (and thus will reduce the total Net Pension Liability). However, these assets directly offset only the County's portion of the Net Pension Liability (NPL).

IV. Relationship of Reserve Balances

Table 1 below shows the relationships among the reserve balances at the end of each Plan fiscal year, both at actuarial value and at market value. The numbers below show the order in which the various reserves are computed.

Table 1: Relationships Among Reserve Balances			
Reserve	**Actuarial Value**	**Market Stabilization Designation**	**Market Value**
Total Fund	2. Total Fund balance at Actuarial Value as computed by the actuary at the end of the Fund fiscal year	3. Market Value of the Fund minus Actuarial Value at the end of the Fund fiscal year	1. Total Fund balance at Market Value as contained in the Financial Statements of the Fund at the end of the Fund fiscal year
Special Reserves	6. The Actuarial Value of the Special Reserves, obtained by subtracting the Market Stabilization Designation for Special Reserves from the Market Value of Special Reserves	5. The portion of the Market Stabilization Designation attributable to Special Reserves, derived by applying the ratio of the Market Value of Special Reserves to the total Fund Market Value	4. Market Value of the Fund Special Reserves, as reported in the Fund Financial Statements at the end of the Fund fiscal year
Unappropriated Earnings Reserve	7. The Board sets aside a portion of assets in the Unappropriated Earnings Reserve, based on Board Funding Policy.	9. Market Value of the Unappropriated Earnings Reserve minus Actuarial Value of the Unappropriated Earnings Reserve at the end of the Fund fiscal year.	8. The Market Value of the Unappropriated Earnings Reserve, computed by applying the ratio of the Market Value of the total Fund to the Total Fund balance at Actuarial Value and applying that to the Unappropriated Earnings Reserve at Actuarial Value.
Valuation Assets	10. The Actuarial Value of Assets for use in computing Employer Contributions in the annual Actuarial Valuation, obtained by subtracting the Actuarial Value of the Special Reserves from the Actuarial Value of all Fund Assets. Valuation Assets includes all Valuation Reserves: The Member Reserves, Retired Member Reserves, Employer Advance Reserve, and the Unappropriated Earnings Reserve.	11. The portion of the Market Stabilization Designation attributable to Valuation Assets, computed by subtracting the Market Stabilization Designations for the Special Reserves and the Unappropriated Earnings Reserve from the Market Stabilization Designation of all Fund Assets.	12. The Market Value of Valuation Assets, computed by subtracting the Market Value of the Special Reserves from the Market Value of all Fund Assets. Note this can also be obtained by adding the Actuarial Value of Valuation Assets to the Market Stabilization Designation for Valuation Assets.

V. Reserve Cash Flows

Shown below are the additions and subtractions to each reserve, excluding interest credits. Interest credits are described in Section VI.

A. Valuation Reserves

1. Member Reserves

   i. For active members, employee contributions are added to the reserves, while the entire accumulated balance for members who take a contribution refund or enter pay status through retirement, disability, or death is subtracted.

   ii. For deferred members, there are no employee contributions to add, but the entire accumulated balance for members who take a contribution refund or enter pay status through retirement, disability, or death is subtracted.

   iii. Addition and subtraction of member contributions occurs on a biweekly and monthly basis.

2. Retired Member Reserves

   i. The Retired Member Reserve increases with reserves transferred from the Member Reserve and the Employer Advance Reserve when members retire, become disabled, or die leaving beneficiaries; it decreases as members or their beneficiaries receive benefit payments.

3. Employer Advance Reserves

   i. The Employer Advance Reserves is increased by employer contributions each year, and is decreased by the liability for members who enter benefit status each year through retirement, disability, or death.

4. Market Stabilization Designation

   i. The Market Stabilization Designation is recomputed in each annual actuarial valuation as the total of unrecognized investment gains and losses from the current and prior three Plan (calendar) years. Therefore, any increases or decreases to this reserve do not result from additions or deletions. See Table 1 above.

5. **Unappropriated Earnings Reserve**

   i. The Unappropriated Earnings Reserve is reestablished yearly in accordance with the Board’s Statement of Funding Policy and other applicable legal obligations and settlements. This process is described in Section III, A.5 above.

B. Special Reserves

1. Post-Employment Healthcare Agency Fund

   i. The Post-Employment Healthcare Agency Fund is increased with employer contributions and decreased when retirees' health premiums are paid from their sick leave banks or accumulated sick leave at retirement is converted to additional retirement service credit on a pay as you go basis.

2. Post-April 1, 1982 Settlement Reserve

   i. The Post-April 1, 1982 Settlement Reserve is decreased with payments made and is increased with interest credits and any amounts transferred by the Board from other reserves.

3. Contingency Reserve

   i. The annual additions to and withdrawals from the Contingency Reserve are determined by the Board and sufficiency of earnings on assets to credit full interest to all accounts.

4. County Additional UAL Contribution Reserve

   i. The County Additional UAL Contribution Reserve is increased with additional contributions paid by the County.

VI. Reserve Interest Credits

A. At the end of each year, each reserve account is adjusted based on contributions and disbursements during the year, as described above. Reserves are then credited interest using the following priority order:

1. Member Reserves: The first priority is to credit all Member Reserves at the actuarial assumed rate, regardless of Fund performance. For both active and deferred Member Reserves, interest is credited semiannually at a rate which, when compounded, produces the annual actuarial assumed rate of investment return.

2. Determination of Market Stabilization Designation (MSD): Before any other reserve accounts are allocated, the amount of the market stabilization reserve needs to be determined by the Plan's actuary. This amount can be positive or negative, and serves as an offset to the market value of assets in determining available interest credits. This means that the amount of available earnings at the end of each

year is roughly equal to the return on the actuarial value of assets from the prior valuation date.

3. Employer, Retiree, and certain special reserves: After the Member Reserves and MSD are allocated, a target total interest credit is calculated for all other reserve accounts, excluding the Contingency Reserve. This target amount is based on interest credits at the full actuarial rate to the end-of-year reserve balances. To the extent that the remaining available assets cover the target interest credits, all accounts are credited annually.

4. Currently all of these additional reserves receive equal priority, so if the available interest credits only cover a portion of the full target amount at the actuarial rate, these accounts will all receive the same percentage interest credit. For example, if the total end-of-year balance for all of these reserves equals $1 billion, and $70 million is available to allocate at this point, then all accounts will receive 7.0% interest credits. Interest crediting for these reserves is deferred until the close of the calendar year, when the full impact of investment earnings is known.

5. County Additional UAL Contributions: This reserve is credited with the actual annual rate of return (including negative returns) on the market value of assets for the plan as a whole, rather than the "smoothed" rate of return credited to other reserves included in valuation assets. This will ensure that no other reserves will be affected by the performance of the assets in this separate reserve. Also, the plan contribution rate will not be impacted by this separate reserve until the County instructs this reserve to be included in valuation assets for the determination of the County's retirement contribution rates. Interest crediting for these reserves is deferred until the close of calendar year, when the full impact of investment earnings is known.

6. Contingency Reserve: If full interest crediting as described in Step 3 above is not possible, then the Contingency Reserve will be set to $0. If full interest crediting is possible, then any remaining available earnings are allocated to the Contingency Reserve up to the policy level (1% of the Total Fund). Other Special Reserves: Following the year-end close and subsequent valuation, the Board of Retirement makes determinations of crediting any remaining available funds to special accounts in accordance with any applicable legal obligations and settlements. Interest crediting for these reserves is deferred until the close of calendar year, when the full impact of investment earnings is known.

7. Unappropriated Earnings Reserve (UER): If all accounts have been fully credited as described in Steps 1 through 4 above, and additional funds still remain, they are allocated to the UER.

8. Consistency with Statement of Funding Policy: The Board's Statement of Funding Policy will govern any reserve transfers; in particular, amounts will be transferred from the UER to other reserves only if the Plan Funded Ratio as defined in the Funding Policy is 90% or above.

VII. Periodic Reconciliation of Valuation Reserve Accounts

A. Over time, reserve balances and the related Fund liabilities will tend to drift apart. This occurs because the reserve accounting procedure discussed above does not allow for actuarial gains or losses in Plan assets and liabilities. As a result, the reserves may not always represent an accurate estimate of the amount needed to pay for the intended benefits. Consequently, the amounts in each Valuation Reserve should be reconciled periodically with the actuarial valuation to account for Plan experience or changes in benefits and assumptions.

B. Reconciliation of the Valuation Reserve Accounts will result in transferring amounts from one Valuation Reserve to another. Any adjustment(s) must be authorized by the Board. It should take place when the actuarial assumptions are reviewed as a result of an actuarial experience study but no less often than every three years. For consistency with the actuarial valuation, the actuarial value of Fund assets should first be allocated to Member Reserves, then to Retired Member Reserves, then to the Employer Advance Reserves, with any remainder allocated to the Unappropriated Earnings Reserve.

C. To the extent that it is only a rearrangement of assets within the Valuation Reserves, this reconciliation of the reserve accounts will not impact the Plan's overall contribution rate, but it could affect the calculated contribution rates for Safety and General members since funds could be transferred from one to the other. If assets are transferred from or to Special Reserves, such as the Contingency Reserve or the Post April 1, 1982 Settlement Reserve, employer contributions will be affected.

VIII. Policy Review

A. Staff shall review this Policy at least once every three years to ensure that it remains relevant, appropriate, and in compliance. Any revisions or amendments to this policy must be approved by the Board of Retirement in accordance with the bylaws.

IX. History

Date	Summary of Board Action
02/10/2012	Adopted
12/16/2016	Added County additional UAL reserve
06/09/2017	Deleted 3% reference for UER; deleted Health Insurance Reserve; set Contingency Reserve at 1%
07/06/2018	Staff updated format; corrected inadvertent numbering error in Table 1.
04/12/2019	Policy Review section amended to at least once every three years

Certification of Board Adoption

04/12/2019

Clerk of the Board Date