SamCERA's Funding Policy

Adopted 8/23/2022

The funding policy describes the overall funding goal and objectives that the San Mateo County Employees' Retirement Association (SamCERA) strives to achieve, and it is designed to ensure pension benefits are adequately funded. The policy includes detailed discussion of the methods, assumptions, and metrics employed by SamCERA to assess funding progress and requirements, which will help the Board shape policies and make decisions to attain the desired outcomes.

OVERVIEW

The California Constitution gives retirement boards plenary authority and fiduciary responsibility for the investment of moneys and administration of their retirement systems. Retirement boards have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries.

SamCERA provides pension benefits for the employees of three employers: The County of San Mateo, the San Mateo County Superior Court, and the San Mateo County Mosquito and Vector Control District.

Pension benefits provided to SamCERA's members come from three sources: 1) Employee Contributions- Money employees pay for future benefits, 2) Employer Contributions- Money employers pay for members' future benefits, and 3) Net Investment Earnings- Earnings from stocks, bonds, alternative investments, and other investments, minus fees.

FUNDING GOAL

SamCERA's funding goal is to achieve and maintain a funded ratio of 100%, ensuring assets are sufficient to pay promised benefits.

OBJECTIVES

Funding objectives are the four fundamental convictions that are pivotal to meet the Board's long-term funding goal:

1. **Benefit Security** – This objective is achieved by adopting policies that involve greater funding upfront with a comparatively shorter amortization period, use of the Entry Age actuarial cost method, and using a discount rate that is more likely to be achieved. The guidelines to consider in reaching this objective are:

    - Funding policy decisions should be made in accordance with California State law under which the Board's duty to its participants and beneficiaries takes precedent over any other duty.

- Actuarial assumptions and methodologies should be reviewed periodically to ensure expected results are reasonably consistent with actual results and anticipated future long-term experience.

- Funding targets must be set to ensure a high level of benefit security.

- Unfunded Actuarial Accrued Liability (UAAL) amortization methods should avoid increasing the UAAL through negative amortization.

- Analysis should be performed periodically to evaluate how changes in market conditions could potentially affect future funding.

2. **Stable and Predictable Costs** - This objective is achieved through asset smoothing and periodic adjustments to amortization periods to minimize contribution volatility, including additional layering of previous balances. Contributions should be managed and controlled, consistent with other funding objectives and policies, so that costs remain relatively stable and predictable over time for both cash-flow and investing purposes. The guidelines to consider in reaching this objective are:

   - Contributions from employers and employees should be predictable to the extent possible.

   - Amortizing the UAAL in a systematic manner to create a stable and predictable payment plan for the employers.

   - UAAL amortization periods that create untenable contribution volatility should be avoided.

   - The use of asset or contribution rate smoothing is a valuable tool to reduce the impact of annual investment volatility on contributions.

3. **Intergenerational Equity** - The employee's pension should be funded by the generation of taxpayers that receives the employee's services. The guidelines to consider in reaching this objective are:

   - The plan's UAAL amortization period should approximate the active members' average years of service until retirement.

   - The normal cost requirement, as part of the annual contribution, is a core element leading to intergenerational equity.

4. **Cost Sustainability** - An effective funding model should provide employers the

ability to pay their actuarially determined contributions through various economic cycles. This objective is achieved by reducing the volatility of plan sponsor contributions, especially during challenging economic periods. Longer amortization periods help stabilize plan sponsor contributions but may also conflict with other objectives. The guidelines to consider in reaching this objective are:

- Economic and non-economic assumptions should be evaluated periodically, with a view toward long-term trends based upon actual historical experience and estimated future experience while avoiding a bias to current conditions.
- Actuarial assumptions and methods should be based on the premise that the Plan and the Plan Sponsors will continue to exist and fund their plans.
- Analysis should be done to evaluate the Plan's ability to withstand volatile economic conditions by scrutinizing key economic assumptions about the future under different economic scenarios.
- Prepayment of required contributions from employers should be encouraged.
- Supplemental contributions from employers should be encouraged and can be used to offset future contributions.

METHODS AND ASSUMPTIONS

The core elements listed below should be employed to meet the funding goal and objectives:

1. Economic Assumptions – include discount rate (investment return), Consumer Price Inflation (CPI), Cost of Living Adjustment (COLA), general wage increase rate, merit salary increase rates, payroll increase rate, Social Security Wage Base increase rate, and Public Employees' Pension Reform Act (PEPRA) compensation increase rate. These assumptions are reviewed annually prior to the actuary conducting the valuation.

2. Demographic Assumptions – include probabilities at which members terminate employment, become disabled, die, or retire. These assumptions are reviewed every three years in conjunction with the Triennial Investigation of Experience (Experience Study) and before that year's valuation.

3. Actuarial Cost Method – is an attribution method upon which liabilities are determined based on the present value of future benefits to past, current, and future periods of time. SamCERA uses the Entry Age actuarial cost method.

4. Asset Valuation Method – is a valuation tool used to assess the plan assets over time. SamCERA employs the "Asset Smoothing" method to dampen asset value volatility from market fluctuations by spreading the full gain/loss in the

year (in relation to the expected return), after offsetting against prior years' gain/loss, over a five-year horizon (or ten six-month periods).

5. Amortization Method – is aimed at mitigating contribution rate volatility while ensuring the unfunded liabilities are paid off in a reasonable time-period. SamCERA uses a 15-year layered approach to amortize the UAAL.

RISK MANAGEMENT

1. Investment risks can be managed with diversification of asset classes. Asset smoothing can be used to dampen the short-term effects of investment volatility.
2. Demographic and economic risks can be measured and managed by adopting reasonable assumptions based on recommendations from the Board's actuary responsible for the annual valuation and the Triennial Experience Study.
3. Periodic review of the retained actuary's work by an independent actuarial firm through an actuarial audit helps assure the accuracy of the valuation calculations and the reasonableness of the assumptions the valuation is based upon.
4. Governance risks can be managed with clear policies and controls over major administrative practices of the retirement system including audits of the actuarial processes.

METRICS/BENCHMARKS

Standardized metrics and benchmarks can be used to measure SamCERA's progress towards meeting its funding goals and objectives. The most typical ones are listed below. Other metrics can be considered when their utility become evident:

1. Funded Ratio: Actuarial Value of Assets (AVA)/Actuarial Accrued Liabilities (AAL) and Market Value of Assets (MVA)/AAL. Comparing the past and projected future progress of the funded ratio can indicate the financial health of the plan. Comparing the AVA to the MVA shows the impact of yet-to-be-realized deferred gains and/or losses in future valuations. Note that for valuation purposes certain non-valuation reserves are excluded from the Actuarial Value of Assets in the calculation of the funded ratio.

2. Employer Statutory Contribution Rate: composed of two portions, Employer Normal Cost Rate and the Unfunded Actuarial Accrued Liability (UAAL) amortization rate. Tracking the changes in employer contribution rates can help determine if the funding policy is producing relatively stable contribution rates.

3. Actuarily Determined Employer Contributions (ADEC): The actuarially

determined level of employer contribution that would be required on a sustained, ongoing basis to systematically fund the normal cost and to amortize the Unfunded Actuarial Accrued Liability (UAAL) attributed to past service over a pre-determined period. Comparing the ADEC with the actual contributions made can assess whether the contributions are being met (or exceeded).

GOVERNANCE POLICY/PROCESS

Below is a list of specific actuarial and funding-related studies where the frequency is determined by the Board:

1. Actuarial Valuation (performed annually) – The Board is responsible for the review of SamCERA's annual actuarial valuation report, which provides the annual funded ratio and the calculation of the employer and employee contribution rates.

2. Experience Study (performed triennially) –The Board is responsible for reviewing the results of the experience study and approving the actuarial assumptions and methodologies to be used for all actuarial valuations relating to the defined benefit pension plan.

3. Actuarial Audit (performed triennially and concurrently with the Experience Study and Valuation) – The Board is responsible for reviewing the audit report from a separate actuarial consulting firm regarding the reasonableness of the actuarial methods and assumptions in use and the resulting actuarially computed liabilities and contribution rates.

4. Asset/Liability Study – The Board is responsible for conducting Asset/Liability Modeling studies in accordance with the Investment Policy.

5. Funding Policy Review – The Board is responsible for the periodic review of this policy. The review is best performed prior to the time the actuary is making recommendations on what economic and demographic assumptions are to be used for the upcoming valuation.

GLOSSARY OF FUNDING POLICY TERMS

Actuarial Accrued Liability (AAL): The AAL is the value at a particular point in time of all past normal costs. This is the amount of assets the plan would have today if the current plan provisions, actuarial assumptions, and participant data had always been in effect, contributions equal to the normal cost had been made, and all actuarial assumptions had been met.

Actuarial Cost Method: The actuarial cost method allocates a portion of the total cost (present value of benefits) to each year of service, both past service and future service.

Actuarial Determined Employer Contribution (ADEC): The amount actuarially calculated each year that is required to be contributed by an employer to a pension plan's

pool of assets in order to ensure there will be enough funds to pay promised pension benefits. For SamCERA, this is equal to pensionable compensation multiplied by the Employer Statutory Contribution Rate.

Asset Values:

Actuarial Value of Assets (AVA): The AVA is the market value of assets less the deferred investment gains or losses not yet recognized by the asset smoothing method.

Market Value of Assets (MVA): The MVA is the fair value of assets of the plan as reported in the plan's audited financial statements.

Entry Age Actuarial Cost Method: The Entry Age actuarial cost method is a funding method that calculates the normal cost as a level percentage of pay or level dollar amount over the working lifetime of the plan's members.

Funded Ratio: The funded ratio is the ratio of the plan assets to the plan's actuarial accrued liabilities. Actuarial Value Funded Ratio is the ratio of the AVA- (net of certain non-valuation reserves) to the AAL.

Normal Cost: The normal cost is the cost allocated under the actuarial cost method to each year of active member service.

Present Value of Benefits (PVB) or total cost: The PVB is the value at a particular point in time of all projected future benefit payments for current plan members. The future benefit payments and the value of those payments are determined using actuarial assumptions regarding future events. Examples of these assumptions are estimates of retirement and termination patterns, salary increases, investment returns, etc.

Unfunded Actuarial Accrued Liability (UAAL): The UAAL is the portion of the AAL that is not currently covered by the AVA. It is the positive difference between the AAL and the AVA.

Valuation Assets: Assets used in the calculation of the actuarial valuation.

Valuation Date: The valuation date is the annual date upon which an actuarial valuation is performed; meaning that the trust assets and liabilities of the plan are valued as of that date. SamCERA's annual valuation date is June 30.