Richard A. White, Jr.
Retirement Administrator

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**MENDOCINO COUNTY**
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: June 19, 2013
To: Board of Retirement
From: Richard White, Retirement Administrator
Subject: ACTUARIAL FUNDING POLICY

**Summary:**

The Board of Retirement reviewed current funding practices and deliberated possible modifications to the actuarial funding policy of MCERA at your March and April meetings and approved changes which are incorporated into the ACTUARIAL FUNDING POLICY to be adopted at this meeting. The major policies to be adopted include:

- Actuarial Cost Method. Continued use of the Entry Age actuarial cost method.

- Asset smoothing method. Investment gains or losses of each valuation period shall be recognized in level amount over 5 years. Deferred investment gains or losses cannot exceed 25% of the Market Value of Assets.

- Amortization policy.
  - Current Unfunded Actuarial Accrued Liability (UAAL) will be continued to be amortized over its declining 30-year schedule.
  - New UAAL as a result of gains and losses will be amortized over a period of 18 years.
  - New UAAL as a result of actuarial assumptions or methods will be amortized over a period of 18 years.
  - New UAAL as a result of new plan amendments will be amortized over a period of 15 years.
  - New UAAL resulting from temporary retirement incentive programs will be amortized over a period of 5 years.
  - UAAL shall be amortized over closed amortization periods.
  - UAAL shall be amortized as a level percentage of payroll.
  - The final UAAL payment by each employer shall be equal to the UAAL contribution rate times the covered payroll (as estimated in the actuarial valuation) or the UAAL contribution rate times the actual covered payroll, whichever is greater.
  - Actuarial surplus will be amortized over an open amortization period of 30 years.

**Staff Recommendation:**

Adopt actuarial funding policy.

**Background:**

The Segal Company provides actuarial services to the Retirement Association including the annual actuarial valuation and the triennial actuarial experience study. Segal has been requested to provide a review of the funding policy elements utilized by MCERA which they have also been performed for other California public pension plan clients

The actuarial funding policy takes into consideration the recently adopted standards by the Governmental Accounting Standards Board (GASB) and the California Actuarial Advisory Panel and the policy will be a readily accessible document to MCERA in meeting the new GASB requirements in Statements 67 and 68 which require governmental plans to identify actuarially determined employer contributions determined using the funding policy adopted by the governing body.

The funding policy will be used to set employer contribution rates beginning with the June 30, 2013 actuarial valuation, as well as to meet the new GASB reporting requirements which become effective for the Retirement Association for plan year 2013/2014 and fiscal year 2014/2015 for the employer.

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Attachments

SEGAL

THE SEGAL COMPANY
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T 415.263.8200 F 415.263.8290 www.segalco.com

VIA E-MAIL and USPS

May 30, 2013

Mr. Richard A. White
Retirement Administrator
Mendocino County Employees' Retirement Association
625-B Kings Court
Ukiah, CA 95482

**Re: Mendocino County Employees' Retirement Association**
**Statement of Actuarial Funding Policy – Discussion Draft**

Dear Rich:

As you requested, we have updated the sample actuarial funding policy statement that was attached to our letter dated March 7, 2013 to reflect the final policy element choices approved by the Board at its meeting on April 17. The updated statement is provided in Attachment A.

We look forward to discussing the statement with the Board on June 19.

Sincerely,

Paul Angelo, FSA, MAAA, FCA, EA
Senior Vice President and Actuary

Andy Yeung, ASA, MAAA, FCA, EA
Vice President and Associate Actuary

/bqb
Enclosure

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**Attachment A**

**Mendocino County Employees' Retirement Association**

**Statement of Actuarial Funding Policy – Discussion Draft**

## Introduction

The purpose of this Statement of Actuarial Funding Policy is to record the funding objectives and policies set by the Board of Retirement (Board) for the Mendocino County Employees' Retirement Association (MCERA). The Board establishes this Statement of Actuarial Funding Policy to help ensure future benefit payments for members of MCERA. In addition, this document records certain policy guidelines established by the Board to assist in administering MCERA in a consistent and efficient manner.

This Statement of Actuarial Funding Policy supersedes any previous statements. It is a working document and may be modified as the Board deems necessary.

## Goals of Actuarial Funding Policy

1. To achieve long-term full funding of the cost of benefits provided by MCERA;

2. To seek reasonable and equitable allocation of the cost of benefits over time; and,

3. To minimize volatility of the plan sponsor's contribution to the extent reasonably possible, consistent with other policy goals.

## Funding Requirement and Policy Components

MCERA's annual funding requirement is comprised of a payment of the Normal Cost and a payment on the Unfunded Actuarial Accrued Liability (UAAL). The Normal Cost and the amount of payment on UAAL are determined by the following three components of this funding policy:

I. Actuarial Cost Method: the techniques to allocate the cost/liability of retirement benefit to a given period;

II. Asset Smoothing Method: the techniques that spread the recognition of investment gains or losses over a period of time for the purposes of determining the Actuarial Value of Assets used in the actuarial valuation process; and

III. Amortization Policy: the decisions on how, in terms of duration and pattern, to reduce the difference between the Actuarial Accrued Liability and the Valuation Value of Assets in a systematic manner.

## I. Actuarial Cost Method:

The Entry Age[1] actuarial cost method shall be applied to the projected retirement benefits in determining the Normal Cost and the Actuarial Accrued Liability.

## II. Asset Smoothing Method:

The investment gains or losses of each valuation period, as a result of comparing the actual market return and the expected return on Valuation Value of Assets, shall be recognized in level amount over 5 years in calculating the Actuarial Value of Assets. Deferred investment gains or losses cannot exceed 25% of the Market Value of Assets.

The Board acknowledges the occasional need for and reserves the right to consider future ad-hoc adjustments to the asset smoothing method to achieve a more level pattern of recognition of the net deferred investment gains or losses after a period of significant market change followed by a period of market correction, upon receiving the necessary analysis from its actuary.

## III. Amortization Policy:

- The UAAL, (i.e., the difference between the Actuarial Accrued Liability and the Valuation Value of Assets), as of June 30, 2012 shall continue to be amortized over its declining 30-year schedule (with 27 years remaining as of June 30, 2012);
- Any new UAAL as a result of actuarial gains or losses identified in the actuarial valuation as of June 30, 2013 or later will be amortized over a period of 18 years;
- Any new UAAL as a result of change in actuarial assumptions or methods, effective with the actuarial valuation as of June 2013 or later will be amortized over a period of 18 years;
- Unless an alternative amortization period is recommended by the Actuary and accepted by the Board based on the results of an actuarial analysis:
    a. with the exception noted in b. below, the increase in UAAL as a result of any plan amendments will be amortized over a period of 15 years;
    b. the increase in UAAL resulting from a temporary retirement incentive will be funded over 5 years;
- UAAL shall be amortized over "closed" amortization periods so that the amortization period for each layer decreases by one year with each actuarial valuation;
- UAAL shall be amortized as a level percentage of payroll so that the amortization amount in each year during the amortization period shall be expected to be a level percentage of estimated covered payroll, based on the current actuarial assumption for general payroll increase;

[1] This method has also been referred to as the Entry Age Normal method but following recent guidance from both GASB and the California Actuarial Advisory Panel, it is referred to as the Entry Age actuarial cost method in this policy.

- In addition to the UAAL contribution rate, an amortization amount equal to the UAAL contribution rate times the covered payroll (as estimated in the actuarial valuation that establishes such UAAL contribution rate) shall be calculated for each employer. The final UAAL payment by each employer shall be equal to the UAAL contribution rate times the actual covered payroll or the above amortization amount, if greater; and
- If an overfunding exists (i.e., the total of all UAAL becomes negative so that there is a surplus and the amount of such surplus is in excess of 20% of the AAL per Section 7522.52 of CalPEPRA), such actuarial surplus and any subsequent surpluses will be amortized over an "open" amortization period of 30 years. Any prior UAAL amortization layers will be considered fully amortized, and any subsequent UAAL will be amortized as the first of a new series of amortization layers, using the above amortization periods.

**Other Policy Considerations**

**A. Lag between Date of Actuarial Valuation and Date of Contribution Rate Implementation**

In order to allow the employer to more accurately budget for pension contributions and other practical considerations, the contribution rates determined in each valuation (as of June 30) will apply to the fiscal year beginning 12 months after the valuation date. Any shortfall or excess contributions as a result of the implementation lag will be amortized as part of MCERA's UAAL in the following valuation.

Any change in contribution rate requirement that results from plan amendment is generally implemented as of the effective date of the plan amendment or as soon as administratively feasible.

**B. Actuarial Assumptions Guidelines**

The actuarial assumptions directly affect only the timing of contributions; the ultimate contribution level is determined by the benefits and the expenses actually paid offset by actual investment returns. To the extent that actual experience deviates from the assumptions, experience gains and losses will occur. These gains (or losses) then serve to reduce (or increase) the future contribution requirements.

Actuarial assumptions are generally grouped into two major categories:

- Demographic assumptions – including rates of withdrawal, service retirement, disability retirement, mortality, etc.
- Economic assumptions – including price inflation, wage inflation, investment return, salary increase, etc.

The actuarial assumptions represent the Board's reasonable estimate of anticipated experience under MCERA and are intended to be long term in nature. Therefore, in developing the actuarial assumptions, the Board considers not only past experience but also trends, external forces and future expectations.

## C. Glossary of Terms

Actuarial Funding Method – A technique to allocate present value of projected benefits among past and future periods of service.

Actuarial Accrued Liability – The portion of the present value of projected benefits that is attributed to past service by the actuarial funding method.

Normal Cost – The portion of the present value of projected benefits that is attributed to current service by the actuarial funding method.

Entry Age Actuarial Cost Method – A funding method that calculates MCERA's Normal Cost as a level percentage of pay over the working lifetime of the plan's members.

Actuarial Value of Assets – The market value of assets less the deferred investment gains or losses not yet recognized by the asset smoothing method.

Valuation Value of Assets – The value of assets used in the actuarial valuation to determine contribution rate requirements. It is equal to the Actuarial Value of Assets reduced by the value of any non-valuation reserves.

Unfunded Actuarial Accrued Liability – The portion of the Actuarial Accrued Liability that is not currently covered by plan assets. It is calculated by subtracting the Actuarial Accrued Liability from the Valuation Value of Assets.

Valuation Date – June 30 of every year.

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EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: June 19, 2013
To: Board of Retirement
From: Richard White, Retirement Administrator
Subject: Actuarial Triennial Study

**Summary**:

The Government Code Section requires that a Board of Retirement conduct an actuarial study at least every three years. In practice, systems do an actuarial valuation annually and a detailed review of all the assumptions (i.e., an "experience study") every three years.

The most recent triennial experience study was conducted by The Segal Company based on the demographic experience for the period of July 1, 2008 through June 30, 2011 and the target asset allocation as of June 30, 2011. That study was approved by the Board of Retirement on November 9, 2011. The cost of this experience study was $30,000.

The normal three-year cycle for the next study would cover the demographic experience for the period of July 1, 2011 through June 30, 2014 and the target asset allocation as of June 30, 2014 and would be done in the later part of calendar year 2014.

Board member Stephens has asked that the Board of Retirement discuss the timing of the experience and demographic study, especially the economic assumptions that include the investment return (discount) rate.

**Staff Recommendation**: Direction to staff.

**Background:**

Government Code Section 31611 requires that a retirement system conduct, at intervals not to exceed three years, an actuarial valuation that reviews the mortality, service and compensation experience of members and beneficiaries, and shall evaluate the assets and liabilities of the retirement fund.

Commonly referred to as a review of the economic and demographic actuarial assumptions, the study includes a comparison of the actual experience with that expected under the current assumptions during the three year period under review.

The importance of this study is to review the actuarial assumptions and ensure that they are realistic and reasonable in the long term. It is important to note that the actuarial assumptions used do not determine the "actual cost" of the plan. The actual cost is ultimately determined by the benefits and administrative expenses paid out, offset by investment income received.

However, it is desirable to estimate as closely as possible what the actual cost will be so as to permit an orderly method for setting aside contributions today to provide benefits in the future, and to maintain equity among generations of participants and taxpayers.

**Discussion.**

The Board of Retirement recently authorized its investment consultant, Callan Associates, to conduct an Asset/Liability Study for the Retirement Association. The purpose of this study, which is conducted every three years, is to model the Association's liabilities and to model alternative asset projections in order to determine the best asset allocation mix for the trust fund, based on the Board's risk/return objectives and our cash flow needs.

The timing and order of the Asset/Liability Study and the Actuarial Experience Study is important for the Board to consider. The study to determine the optimal allocation of the trust fund assets drives the Association's investment policy and ultimately the expected earnings from these investments.

Investment earnings affect how much of future benefit payments can be funded by investment income rather than by contributions and the asset allocation is one of the key components used by the Actuary in preparing their recommended economic actuarial assumptions. Thus, it is important for the Board to have the asset/liability study completed prior to the actuary's review of the economic assumptions to ensure that the investment policy is the most current and the one which will be implemented going forward.

Also, the Board of Retirement may want to consider the period of time which has elapsed since the last experience and demographic study. As mentioned, the cycle as provided for under the Government Code allows the actuary to have three years of actual experience to review. A shorter period of time means that the assumptions will be based upon less actual experience and information about the plan and its members unless the Board wants to limit the scope of the study to include a review of just the economic assumptions. Even that approach would leave the question of whether there is enough new capital market information to justify an out-of-cycle review using the current asset allocation.

The Board of Retirement is being asked to provide direction to staff and our actuary on the timing for the review of economic and demographic changes (experience study).

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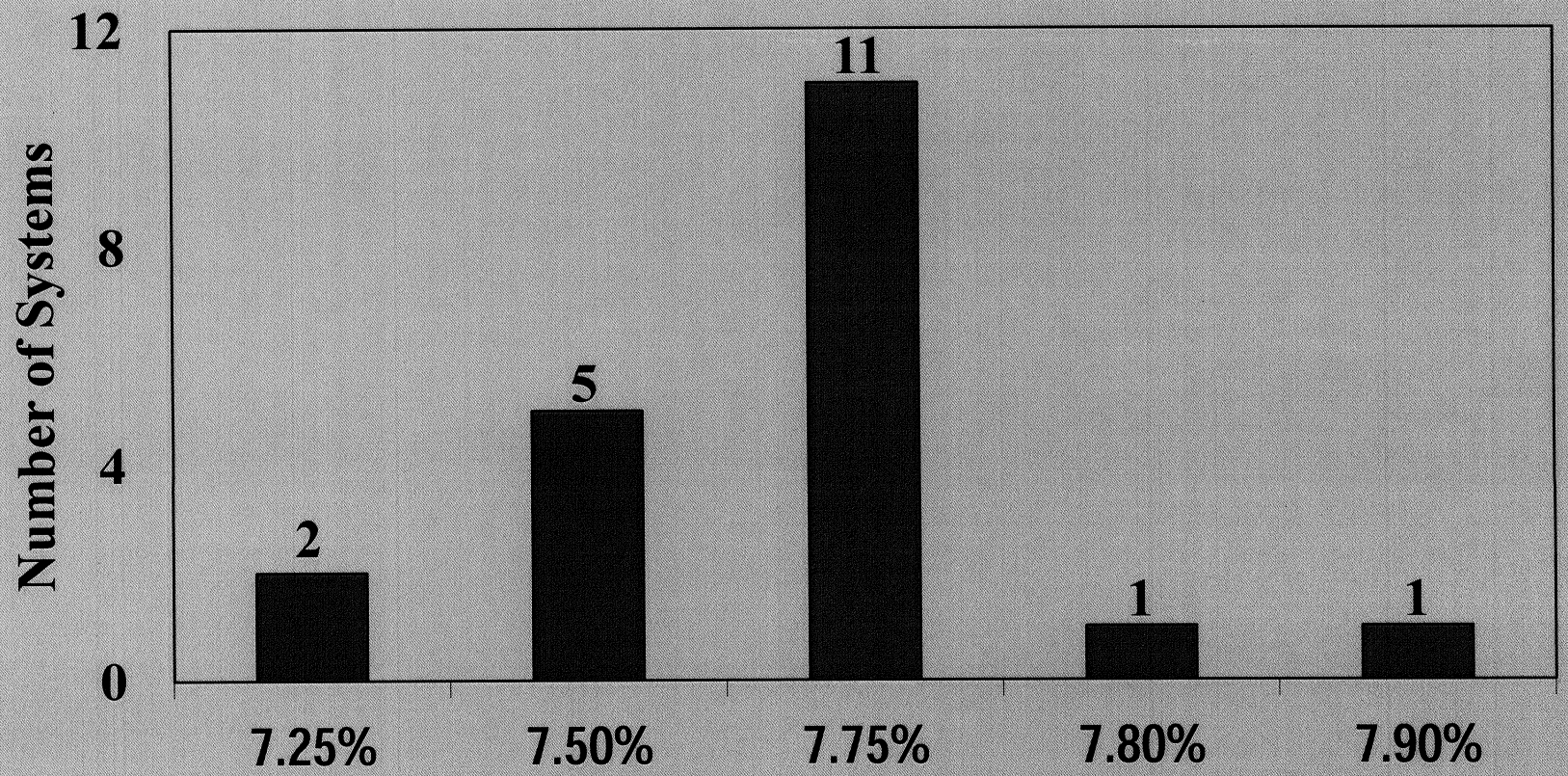
Attachment

# Investment Return Assumptions