Los Angeles County Employees' Retirement Association

Retirement Benefit Funding Policy

Amended by the Board of Investments
February 13, 2013

I. Funding Goal

The Funding Goal establishes the funding status the Board of Investments would like LACERA to achieve. The main goal is to provide benefit security for its members as well as to achieve and maintain stable employer contributions that are as low as possible.

Under the Entry Age Actuarial Cost Method, the cost of financing benefits is allocated over a member's working lifetime, with the goal that sufficient assets are accumulated to fund benefits by the time the benefits first become payable. LACERA allocates the cost of paying for the promised benefits evenly over time expressed as a percentage of payroll. Determining the cost as a percentage of payroll rather than level dollars provides intergenerational equity between taxpayers that reflects changes in inflation over time. The allocation of benefit financing to prior and future years is based on the cost method, with prior years' allocation equal to the Actuarial Accrued Liability (AAL) and the future years' allocation equal to Present Value of Future Normal Costs. Note that the actuarial cost method is an allocation of when to fund the benefits, not when they are being earned.

The Funded Ratio is the measurement of the Valuation Reserves to the AAL. When the assets available for funding (Valuation Reserves) equal the AAL, then LACERA is considered fully funded with a Funded Ratio of 100%. Assets in excess of those needed to reach 100% funding are considered excess funds for funding purposes. A Funded Ratio equal to 100% is the **Funding Goal.**

II. What Does the Funding Goal Mean for Setting Contribution Rates?

1. Funding Policy

The assets and the liabilities for both prior and future accrued benefits will be constantly changing based on experience, benefit changes, assumption changes, and other outside factors impacting LACERA benefits. Therefore, the Funding Policy will guide the Board as to what actions are expected to be taken in determining contribution rates to achieve the Funding Goal.

This policy is intended to provide guidance as to when adjustments to LACERA's contributions and funding for discretionary benefits should be considered by the Board of Investments. The Funding Policy is meant to assist in establishing a contribution rate which is relatively stable over the long term while LACERA provides its members superior retirement benefit security and minimizes both the size and volatility of the employer contributions.

When the Ratio of the Valuation Reserves to the Actuarial Accrued Liabilities is:

A. **Less than 100%** - the Funding Policy requires a contribution rate equal to:

   1) The Normal Cost Rate for the year, plus

   2) A minimum 30 year amortization payment on the increase in UAAL due to the current year's experience and changes (current Yearly UAAL layer) plus

   3) The sum of the amortization payments for each remaining Yearly UAAL layer created in years prior to the valuation date, expressed as a percentage of pay.

   4) In no case shall the total amount contributed by the employer be less than the Normal Cost Rate for the year, plus a 30-year amortization of the total UAAL.

B. **Greater than 100% and less than 120%** - the contribution rate is the Normal Cost Rate. This conforms with California Government Code Section 7522.52 of the California Public Employees' Pension Reform act of 2013.

C. **Greater than 120%** - the contribution rate is the Normal Cost Rate reduced by an amount equal to the amortization of the surplus, where the surplus is defined as the Valuation Reserves in excess of the Actuarial Accrued Liability on the valuation date. The surplus amount is amortized using a 30 year amortization period provided all conditions in California Government Code Section 7522.52(b) are met.

2. Guidelines and Terminology

A. The Funded Ratio is calculated by dividing the Valuation Reserves by the AAL. It may be determined separately between the Active and Inactive members by first allocating Valuation Reserves to the Inactive AAL and then all remaining Valuation Reserves to the Active AAL.

B. The Yearly UAAL layer is the difference between the expected increase in the UAAL due to the passage of time and the actual change in the UAAL due to the experience since the last annual actuarial valuation. The expectation is that each year's UAAL will be amortized and funded separately so that its ultimate payment is visible in the funding decisions.

C. Once LACERA's Funded Ratio reaches 100% or more, then all prior Yearly UAAL layer amounts will be considered fully amortized and will no longer be considered in the determination of contribution rates.

D. If, at some time after LACERA's Funded Ratio reaches 100%, but then the Funded Ratio, once again, drops below 100%, a new UAAL layer amount will be established in the first year equal to the new UAAL amount.

E. Valuation Reserves are the actuarial value of the fund. The following three reserves are not part of the Valuation Reserves:

   1) Contingency Reserve - The '37 Act requires the Contingency Reserve be set at a minimum of 1.0% of assets for future earnings deficiencies.

   2) County Contribution Credit Reserve - Funds set aside to be used by the County for current and future County contributions.

   3) Advanced Employer Contribution Reserve – Employer contributions paid in advance by the County.

F. The market value of total assets is used in calculating the actuarial value of the fund. Under the actuarial asset method, the market value returns are smoothed over a 5 year period to reduce contribution rate volatility.

III. Annual Implementation

1. Interest Crediting Policy for Reserves

In accordance with Section 31591 of the CERL, LACERA maintains various Reserve accounts for purposes of allocating the realized income and disbursements of the trust fund assets. As such, the balances are accounting balances and may not equal the Actuarial Value of Assets. For Reserve Accounting purposes, interest credits are allocated in the same priorities as listed for the allocation of actuarial assets but are based only on Realized Earnings for the period. Realized Earnings includes the net realized income plus any prior balance in the Contingency Reserve. The allocation of Realized Earnings is performed twice a year as of June 30 and December 31.

2. Allocation of Actuarial Assets

For funding purposes and for setting contributions rates, Recognized Earnings for a Plan Year is the recognized investment income as determined by the Actuarial Asset Method and includes both unrealized income and net realized income together with the prior balance in the Contingency Reserve. The allocation of Recognized Earnings is only performed once a year as of the Valuation Date in the following order of priority:

Priority 1: Allocate to the Member Reserve so the Actuarial Asset allocation to that Reserve equals the accounting value for that Reserve on the Valuation Date.

Priority 2: Allocate to the Advanced Employer Contributions Reserve so the Actuarial Asset allocation to that Reserve equals the accounting value for that Reserve on the Valuation Date.

Priority 3: Allocate to the Employer Reserve so the Actuarial Asset allocation to that reserve equals the accounting value for that Reserve on the Valuation Date.

Priority 4: Allocate to the County Contribution Credit Reserve so the Actuarial Asset allocation to that reserve equals the accounting value for that Reserve on the Valuation Date. Note: This Reserve is not a Valuation Reserve.

Priority 5: Allocate to the Employer Reserve so the total amounts allocated equal one year's interest at the assumed interest rate used in the actuarial valuation as of the preceding Valuation Date to the extent there are positive Recognized Earnings to allocate.

Priority 6: Allocate to the Contingency Reserve an amount equal to 1% of the Market Value of Assets as of the Valuation Date to the extent there are positive Recognized Earnings to allocate.

Priority 7: Allocate to the Employer Reserve an amount, if necessary, when combined with other Valuation Reserves, to provide 100% funding of the AAL as of the Valuation Date to reach the Funding Goal. In the event there are negative Recognized Earnings, allocate the entire amount.

Priority 8: The Board may consider additional actions as permitted under the County Employee Retirement Law (CERL) using funds in excess of the amount needed to meet the Funding Goal for funding discretionary benefits. "Excess Earnings" as defined in the County Employees Retirement Law (CERL) may be appropriated upon reaching the Funding Goal, however, the Board may consider adjustment to the employer's contributions only upon satisfying California Government Code Section 7522.52(b).

Increases to the Employer Reserve and the Advanced Employer Contributions Reserve amounts will be allocated first to cover the expected Normal Cost payment for the valuation year and then proportionally to each Yearly UAAL amount. All UAAL layers are assumed to be fully amortized once the plan equals or exceeds a 100% Funded Ratio.

If the Funding Goal has been met and previously unallocated Excess Earning are used for discretionary benefits under Priority 6, the actuarial assumed earnings rate will need to be assessed as part of the next scheduled investigation study regarding the projected net earnings available to fund future benefits.

3. Valuation Cycle

Annually, LACERA shall engage the services of an actuary to conduct a valuation of plan liabilities and assets to measure the funding progress of the plan. Every third year the actuary shall conduct an investigation of experience to measure the effectiveness of the plan assumptions and valuation methodology and make recommendations to the Board as needed. While the plan document provides for the valuations to be conducted not less than every three years, the funding policy will require an annual valuation and a recommendation of employer rates on an annual basis. Employee rates will be recommended as required due to changes in the underlying assumptions and methodology used to calculate the employee rates.

Notes:

2009: For the purposes of conducting the June, 30, 2009 actuarial valuation, the Board determined the STAR Reserve, as referenced in policy section II.2.(e), shall be a Valuation Reserve. As such, the actuary will include the STAR Reserve as part of the actuarial assets available for funding retirement benefits. Excerpt from Board of Investment minutes, December 9, 2009:

> A motion was made by Mr. Saladino, seconded by Chair Pryor to adopt the funding policy actuarial valuation effective June 30, 2009 as proposed in the Proposed Policy dated November 18, 2009, except to (i) include the STAR COLA Reserve in the valuation assets for the fiscal year ending June 30, 2009, and (ii) reevaluate the STAR COLA Reserve issue for the fiscal year ending June 30, 2010. The motion carried with Messrs. Hudson, Saladino, Scheider, Unger and Chair Pryor voting yes and Ms. Sandoval and Messrs. Barger and Russin voting no. Absent: Santos.

2010: For the purposes of conducting the June, 30, 2010 actuarial valuation, the Board determined the STAR Reserve, as referenced in policy section II.2.(e), shall be a Valuation Reserve. As such, the actuary will include the STAR Reserve as part of the actuarial assets available for funding retirement benefits. Excerpt from Board of Investment minutes, November 10, 2010:

> A motion was made by Mr. Saladino, seconded by Chair Santos that the non-vested portion of the STAR COLA Reserve be included as a valuation asset for one year and that the Board of Investments revisit the issue prior to next year's asset valuation. The motion carried with Messrs. Pryor, Russin, Saladino, Valenzuela, and Chair Santos voting yes and Ms. Sandoval and Messrs. Barger and Schneider voting no. Absent: Unger.

2011: For the purposes of conducting the June 30, 2011 actuarial valuation, the Board determined the STAR Reserve, as referenced in policy section II.2(e), shall be a

Valuation Reserve. As such the actuary will include the STAR Reserve as part of the actuarial assets available for funding retirement benefits. Excerpt from Board of Investment minutes, October 12, 2011:

> A motion was made by Mr. Pryor, seconded by Mr. Santos to include the STAR COLA Reserve as a valuation asset for fiscal year 2011 and direct staff to provide information at the next Board meeting, on modifying the Funding Policy with respect to the STAR COLA Reserve and on securing an indemnification from the County with respect to that Reserve for fiscal year 2012 and beyond, to allow the Reserve to be included as a valuation asset. The motion carried with Messrs. Valenzuela, Pryor, Kelly, Santos and Unger voting yes and Messrs, Schneider, Russin, Ms. Sandoval and Chair Barger voting no.

2012: The Board amended the Funding Policy to (a) bring the Policy in compliance with the California Public Employees' Pension Reform Act of 2013 standard on employer rate relief and (2) add the STAR Reserve as a valuation asset by removing the STAR Reserve reference in Policy section II.2(e). As such the actuary will include the STAR Reserve as part of the actuarial assets available for funding retirement benefits. Excerpt from Board of Investment minutes, February 13, 2013:

> A motion was made by
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> The motion carried with Ms. Widner, Messrs. Green, Pryor, Saladino, Unger, and Chair Santos voting yes and Ms. Sandoval and Messrs. Barger and Schneider voting no.