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## ACTUARIAL PRACTICES AND FUNDING POLICY

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### I. PURPOSE AND BACKGROUND

The purpose of this Actuarial Practices and Funding Policy is to record the funding objectives and policies and other actuarial practices set by the Board of Retirement (Board) for the Mendocino County Employees Retirement Association (MCERA). The Board establishes this Actuarial Practices and 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 in accordance with current best practices in defined benefit pension administration.

This Actuarial Practices and Funding Policy is a working document and may be modified as the Board deems necessary. The Funding goals and elements are outlined in Section II and the Actuarial Practices are outlined in Section III.

### II. ACTUARIAL FUNDING POLICY GUIDELINES

#### A. 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.

#### B. Funding Requirement and Actuarial Funding 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 following three components of this funding policy:

1. Actuarial Cost Method: the techniques to allocate the cost/liability of retirement benefit to a given period;
2. 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
3. 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.

The Board adopts the following regarding its actuarial funding policy.

### C. Actuarial Cost Method

The Entry Age<sup>1</sup> actuarial cost method shall be applied to the projected retirement benefits in determining the Normal Cost and the Actuarial Liability.

### D. 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.

### E. Amortization Policy

1. 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 ~~27-22~~ years remaining as of June 30, ~~2012~~2017);
2. Any new UAAL as a result of actuarial gains or losses identified in the actuarial valuations as of June 20, 2013 or later will be amortized over a period of 18 years;
3. Any new UAAL as a result of change in the actuarial assumptions or methods, effective with the actuarial valuation as of June 2013 or later will be amortized over a period of 18 years;
4. 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;
5. UAAL shall be amortized over “closed” amortization periods so that the amortization period for each layer decreases by one year with each actuarial valuation;

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<sup>1</sup> This method had historically also been referred to as the Entry Age Normal method but following guidance from both GASB and the California Actuarial Advisory Panel, it is currently referred to as the Entry Age actuarial cost method in this policy.

6. 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;
7. 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,
8. 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.

## F. Other Policy Considerations

### 1. 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 for 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. However, the UAAL contribution rates in the current actuarial valuation are adjusted to account for the delay in implementing any changes in contribution rates during this 12-month period.

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.

### 2. 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 the 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:

- a. Demographic assumptions – including rates of withdrawal, service retirement, disability retirement, mortality, etc.
- b. 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.

### 3. Glossary of Terms

- a. **Actuarial Funding Method** – A technique to allocate present value of projected benefits among past and future periods of service.
- b. **Actuarial Accrued Liability** – The portion of the present value of projected benefits that is attributed to past service by the actuarial funding method.
- c. **Normal Cost** – The portion of the present value of projected benefits that is attributed to current service by the actuarial funding method.
- d. **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.
- e. **Actuarial Value of Assets** – The market value of assets ~~less or~~ plus the deferred investment gains or losses not yet recognized by the asset smoothing method.
- f. **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.
- g. **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.
- h. **Valuation Date** – June 30 of every year.

## III. ACTUARIAL PRACTICES

The Board adopts the following actuarial practices:

### A. Actuarial Valuation

The actuarial valuation report is an important document as it is the basic source document for information regarding actuarially determined contributions and the funded status of pension plans. The actuarial valuation report, prepared in accordance with Actuarial Standards of Practice (ASOP), is even more critical with the implementation of GASB Statement No. 68, Accounting and Financial Reporting for Pensions, because funding information for pensions is no longer automatically ~~be~~ provided in financial reports prepared by the employer. That is, the actuarial valuation report is the sole source of information for many financial decision makers desiring to make informed decisions about the funding of pension benefits.

The Board will direct the consulting actuary to produce an actuarial valuation report on an annual basis after the end of the plan's fiscal year on June 30 annually. The actuarial valuation report shall be based upon the membership and position of the plan as of the end of the fiscal year.

When a new consulting actuary is engaged by the Board, the new consulting actuary shall perform a full replication of the previous actuarial valuation to establish a comparative baseline.

## **B. Experience Study**

An actuarial experience study reviews the differences between the assumed and actual experience over multiple years with the goal of examining the trends related to actual experience and recommending changes to assumptions, if needed.

The reliability of an actuarial valuation depends on the use of reasonable methods and assumptions. Actuarial experience studies can help to ensure the assumptions are in line with the plan's demographic and economic experience, or can be used as a guide to make necessary changes.

The Board will direct the consulting actuary to conduct an actuarial experience study at least once every three years.

## **C. Actuarial Audit**

Due diligence requires that pension plan fiduciaries and plan sponsors exercise prudence in selecting service providers such as actuaries, and monitor the quality of their work. An actuarial audit is a valuable tool for monitoring the quality of actuarial services performed on behalf of the pension plan. An actuarial audit involves engaging the services of an outside actuary (reviewing actuary) to scrutinize the work of the plan's consulting actuary.

The Board will provide for an actuarial audit at least once every six years. The frequency is utilized so that an actuarial audit is conducted after the completion of the triennial experience study. This cycle provides a better basis for auditing and evaluating the work of the consulting actuary.

## **IV. POLICY REVIEW**

This Policy is subject to change in the exercise of the Board's judgment. The Board shall review this Policy at least once every five years to ensure that it remains relevant and appropriate and consistent with state and federal laws and regulations. In the event of legislative changes to the pertinent sections addressed in the Policy, the Board will review the Policy as appropriate.

## **V. POLICY HISTORY**

This policy supersedes the "Statement of Actuarial Funding Policy" adopted by the Board on July 17, 2013.

The Board adopted this policy on April 19, 2017.

The Board amended this policy on February 21, 2018