SAN DIEGO COUNTY EMPLOYEES RETIREMENT ASSOCIATION
INTEREST CREDITING AND EXCESS EARNINGS POLICY

I. PURPOSE

The purpose of this policy is to establish the process to be used by the San Diego County Employees Retirement Association ("SDCERA") to credit semi-annual interest to reserves. This policy shall include, but may not be limited to, the following:

A. defining the reserves maintained by SDCERA,

B. determining the rates of interest at which reserves are to be credited,

C. determining the priorities and sequence by which interest will be credited to the reserves.

II. CURRENT RESERVES

A. SDCERA maintains the following reserves:

1. **Valuation Reserves:**

a) <u>Member Contribution Reserve</u> – The reserves to which member contributions are credited, including those contributions made by the employer on behalf of the member pursuant to Government Code section 31581.2 ("pick-ups"). Contributions may be refunded to the member upon separation from service or left on deposit by the member upon separation from service (deferred retirement). Upon the retirement of a member the reserves will be transferred to the Retirement Allowances Reserve.

b) <u>County Contribution Reserve</u> – The reserves to which employer contributions are credited, including those contributions made by the employer on behalf of the member pursuant to Government Code section 31581.1 ("offset"). Contributions are not refunded to the member at the time of separation. Upon the retirement of a member a transfer is made to the Retirement Allowances Reserve.

c) <u>Retirement Allowances Reserve</u> – The reserve to which transfers are made from Member Contribution and County Contribution Reserves at the time of a member's retirement. The amount of transfer should equal the present value of the total benefit due to the new retiree and eligible beneficiaries.

d) <u>The Smoothed Market Value Transition Reserve</u> – This reserve represents the accumulated difference between the Actuarial Value of assets and the book or cost value of assets at June 30, 2005. This was a one-time adjustment to align the reserve balances with the Actuarial Value of Assets.

2. **Non-valuation Reserves:**

   a) Statutory Contingency Reserve – This reserve is maintained in an amount equal to 1.0% of the total market value of assets to provide for future deficiencies in interest earnings and losses on investments.

   b) Undistributed Excess Earnings Reserve – The amount of earnings on actuarial assets that is the source of funds for crediting interest to reserves semi-annually and for other uses at Board discretion, as permitted by statute and subject to the Excess Earnings Policy.

   c) Market Stabilization Account – represents the balance of deferred earnings created by a five-year smoothing of actual gains and losses compared to gains at the targeted return.

3. **Supplemental Benefit Reserves:**

   a) Supplemental Targeted Adjustment for Retirees Cost-of-Living (STAR COLA) Reserve – This reserve was established in 1998 for the payment of a supplemental cost-of-living benefit pursuant to the provisions of Government Code section 31874.3(b) to those retirees whose cost-of-living accumulations (banks) equal or exceed 20.0%. At the discretion of the Board and subject to the Excess Earnings Policy this reserve may be replenished annually with an additional transfer from Undistributed Excess Earnings.

   b) Supplemental Pension Benefit Reserve – This reserve was established in 2007 for the advance funding of a pension supplement for General Tier A and Safety covered by the 3% at 50 benefit formula. This reserve was funded by a transfer from the Health Benefits Reserve. At the discretion of the Board and subject to the Excess Earnings Policy this reserve may be replenished annually with an additional transfer from Undistributed Excess Earnings.

   c) Tier A Disability Supplemental Pension Benefit Reserve – This reserve was established in 2007 for the advance funding of a pension supplement for disabled General Tier A and Safety covered by the 3% at 50 benefit formula. This reserve was funded by a transfer from Undistributed Excess Earnings. At the discretion of the Board and subject to the Excess Earnings Policy this reserve may be replenished annually with an additional transfer from Undistributed Excess Earnings.

   d) Health Benefits 401(h) Account - This account was established in 1999 to provide for the tax free payment of the monthly health benefits subsidy, effective July 1, 2007 this account will provide for the tax free payment of the monthly health benefit subsidy to Tier I and II retirees only. The account is funded with direct contributions from the County, not to exceed 25% of the employee and employer normal cost contributions to the retirement fund. The 401(h) Account earns a proportionate share of the earnings of the total fund based on the average assets in the account as a percentage of the total fund.

III. RATES OF INTEREST AT WHICH RESERVES ARE CREDITED

A. Regular Interest Rate – This is the target rate to be credited to all valuation reserves including the Member Deposit Reserve. By statute, this rate means interest at 2 ½ percent a year until otherwise determined by the Board compounded semiannually on June 30th and December 31st to all contributions in the retirement fund which have been on deposit for six months immediately prior to that date (Government Code section 31591). With respect to the rates of interest to be credited to members and to the County or District, the Board may, in its sound discretion recommend a rate that is higher or lower than the actuarial interest rate assumption. Board policy is to set the semiannual regular interest rate equal to actual earnings of the fund for that semiannual period or one half of the current actuarial interest assumption rate adopted by the Board whichever is lower, but with a minimum interest crediting rate of zero. The current actuarial interest assumption rate is defined as the rate adopted by the board for use in determining member and employee contribution rates during that period.

B. Member Crediting Rate – Member accounts shall be credited each June 30 and December 31 in an amount equal to the actual earnings rate of the fund for that semiannual period or one half the Regular Interest Rate; whichever is lower, with a minimum interest crediting rate of zero.

C. Timing of Rate Determination – The actuarial interest rate used for crediting interest to valuation reserves on December 31 and June 30 shall be the rate that corresponds to the actuarial interest rate used to calculate the current employer and employee contribution rates. Actual earnings will be based on the total fund return reported by SDCERA's custodian for the each six month period ending June 30 and December 31.

D. Service Purchases – a lump sum payment amount will be equal to the total cost of the purchase amount plus interest; this is the lump sum payment amount. If the member chooses to repay the lump sum payment amount over time the payment period will be charged interest at the current actuarial interest assumption rate.

IV. CREDITING OF INTEREST

A. Effective with the crediting of interest on June 30, 2009, reserves shall be credited semiannually as follows:

1. **Step 1 - Determine "Available Earnings" for accounting period as the sum of:**
   a) Actuarial Earnings for the period, defined as the difference between the Actuarial Value of Assets at the end of the period and the Actuarial Value of Assets at the beginning of the period less non-investment cash flow (contributions less benefits). This could be a negative amount.
   b) The balance in the Statutory Contingency Reserve
   c) The balance in Undistributed Excess Earnings Reserve
2. **Step 2 – Negative Earnings**
   a) If the sum of Available Earnings plus Contingency Reserve plus Undistributed Excess Earnings Reserve is less than zero, no interest will be posted. The balance in the Undistributed Excess Earnings Reserve will be transferred first to the Smoothed Market Value Transition Reserve until exhausted and then to the County Reserve. If the sum of Available Earnings plus Contingency Reserve plus Undistributed Excess Earnings Reserve is positive then go to step 3.
3. **Step 3 - Credit Interest to the Member Deposit Reserve at the Member Crediting Rate**
   a) Deduct this interest amount from Available Earnings. If this amount of interest is more than Available Earnings, credit the amount of Available Earnings.
4. **Step 4 – Credit Interest to Valuation Reserves at the Regular Interest Rate**
   a) If Available Earnings are not sufficient, credit the amount of Available Earnings first to the Retirement Allowances Reserve, then to the County Contribution Reserve and lastly the Smoothed Market Value Transition Reserve.
5. **Step 5 – Restore the Statutory Contingency Reserve to Target Levels**
   a) Transfer from Available Earnings (if available) into Statutory Contingency Reserve the amount required to maintain the Statutory Contingency Reserve balance at 1% of market value.
6. **Step 6 - Retain any remaining Available Earnings in the Undistributed Excess Earnings Reserve**
   a) Undistributed Earnings shall be available for semiannual interest crediting and for other uses as directed by the Board of Retirement, as permitted by statute, to the extent that excess earnings are available for allocation subject to the Excess Earnings Policy. Lawful purposes permitted by statute include; transfers to the County Contribution Reserve (Section 31592.2) to reduce any Unfunded

Actuarial Accrued Liability, transfers to existing supplemental benefit reserves (Section 31691 and 31874.3) (Optional), and funding of new supplemental benefits (Section 31691.1).

V. EXCESS EARNINGS POLICY

A. After crediting the mandatory reserves with the assumed rate of interest, undistributed earnings (excess earnings) will be used to fund the pension liability.

B. In the event the amortization of the unfunded liability is a credit, the Board of Retirement will require the County to contribute the full service cost for that year.

REVIEW

This policy shall be reviewed by the Board annually and may be amended at any time.

HISTORY

November 1, 2007	Adopted, effective July 1, 2007
May 7, 2009	Revised, effective immediately
December 14, 2017	Revised, effective immediately