SCERA Retirement Board Meeting

COLA and Reserve Policy Discussion

August 24, 2023

SCERA COLA and Reserve Policy Discussion

- Where we’ve been
  - With an ever-growing Negative Contingency Reserve, the SCERA Board began having policy discussions about the future of the ad hoc COLA program in 2022
  - August 2022
    - Segal (Plan actuary) presented informational session for the Board on Negative Contingency Reserve
    - Ad Hoc COLA Committee formed to work through COLA and reserve policy issues and engage with County representatives to discuss the future of the COLA program
    - Committee members – Trustees Baker, Balzarini, Coursey and Williamson

SCERA COLA and Reserve Policy Discussion

- Where we've been
  - December 2022
    - Board discussed COLA history and outlined SCERA's objective
      - Create shared understanding of past actions including various forms of COLAs granted and related funding approaches
      - Engage County representatives regarding future COLA program
      - Next steps will then be determined
  - February 2023
    - Board received a summary of past actions on COLA
    - CEO virtually met with the County Administrator and other County representatives
      - Identified 3 COLA cost studies to request from Segal
      - Asked to wait for collective bargaining to conclude before meeting with County representatives

SCERA COLA and Reserve Policy Discussion

- Where we've been
  - March 2023
    - Board received a Purchasing Power COLA cost and reserve status presentation – no COLA recommendation
    - Information sent to County Administrator and SCARE President
  - April 2023
    - Board received an Ad Hoc COLA Committee update outlining next steps
      - Future presentation on COLA Policy and Negative Contingency Reserve – goal of creating a common understanding among all Trustees
      - Set a date for Ad Hoc COLA Committee to meet with County representatives
      - Set a date for the Ad Hoc COLA Committee to meet in advance of the meeting with County representatives

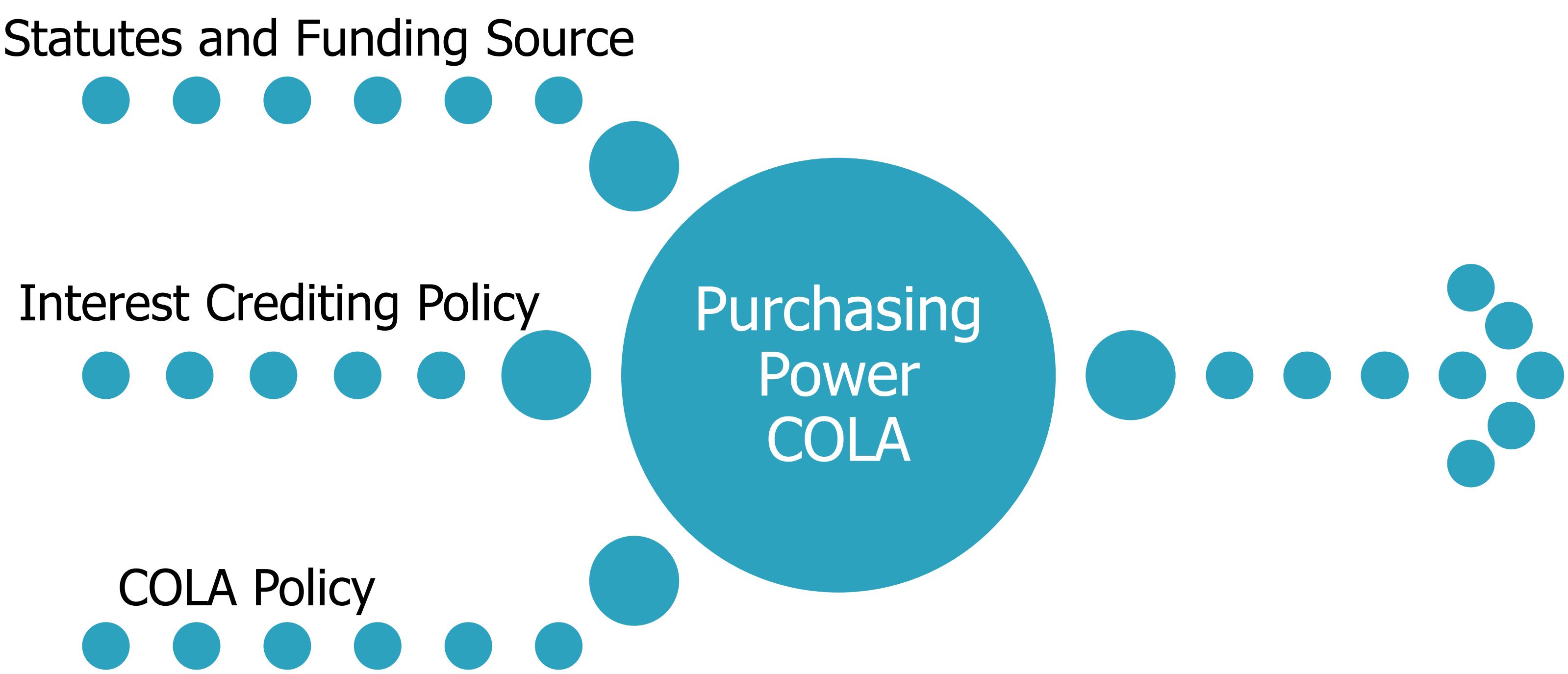
SCERA COLA and Reserve Policy Discussion

- Where we've been
  - July 2023
    - Board received a presentation on COLA Policy and Negative Contingency Reserve
    - Next step – COLA and Reserve policy options to be outlined at August 24th Board meeting
    - Goal is that future policy focus is determined

SCERA COLA and Reserve Policy Discussion

- Intersecting Statutes, Policies and Policy Decisions
  - SCERA's COLA Policy is tied to statute and SCERA's Interest Crediting and Reserve Policy
    - SCERA's COLA statute (Government Code §31874.6)
      - Purchasing Power COLA funded with excess earnings
    - Excess earnings defined by statute (GC §31592) as "earnings of the retirement fund during any year in excess of the total interest credited to contributions and reserves during such year…"
    - But before excess earnings can be used to fund COLA benefits they must meet both statutory and policy hurdles

SCERA COLA and Reserve Policy Discussion



SCERA COLA and Reserve Policy Discussion

- Statutory Hurdles
  - Excess Earnings **that can be used to fund a benefit** defined by statute (§31592.2) as surplus excess earnings “when such surplus exceeds 1 percent of the total assets of the retirement system…”
  - Remember: The ad hoc Purchasing Power COLA is to be funded with Excess Earnings (§31874.6)
  - Potential policy decision – Consider other funding sources
    - Legal analysis – what is possible
    - Policy analysis – what is desired and who owns the funding decision (SCERA or the County and other Participating Employers)

SCERA COLA and Reserve Policy Discussion

- Policy Hurdles and Decisions
  - SCERA's Interest Crediting and Reserve Policy
    - Establishes SCERA's Interest Crediting rate
      - Statute says interest shall be credited semi-annually at 2 ½ percent per annum "until otherwise determined by the Board."
      - SCERA Board determined that the member contribution reserve will get interest credited at the current yield on the 10 Year Treasury Note
      - Employer contributions, Annuitant and COLA reserves are credited with the Plan's actuarially assumed investment earnings rate of 6.75%
      - Difference between the member contribution interest crediting rate and 6.75% is credited to the Employer contribution reserve

SCERA COLA and Reserve Policy Discussion

- Policy Hurdles and Decisions
  - SCERA's Interest Crediting and Reserve Policy (con't)
    - Calls Excess Earnings "Unapportioned Earnings"
    - Established an "Interest Fluctuation Reserve" where Unapportioned Earnings are tracked for future interest crediting shortfalls and 1 percent of total assets requirement
    - The flip side of the Interest Fluctuation Reserve is the Negative Contingency Reserve where shortfalls in interest crediting are tracked
    - Potential policy decision – Decide whether to maintain the Negative Contingency Reserve

SCERA COLA and Reserve Policy Discussion

- Policy Hurdles and Decisions
  - Potential policy decision – Decide whether to maintain the Negative Contingency Reserve
    - Keep it, set it to zero and restart tracking, or get rid of it
      - If set to zero or abolished completely, need to "write down" other reserves so total reserves still match smoothed assets; no immediate impact on contribution rates
    - If abolished completely cannot credit more than amount earned on smoothed basis
    - If abolished completely need to consider whether to track future excess earnings annually or cumulatively
      - Can consider cumulative tracking when smoothed return is more or less than assumed, but outside of reserving process
      - Then can also decide how to track and manage cumulative amount, including whether amount will be adjusted with interest

SCERA COLA and Reserve Policy Discussion

- As a reminder:
  - Why was the Negative Contingency Reserve created in 2002
    - Policy shift in public defined benefit plan community regarding true “excess” earnings
    - The Plan was experiencing its third straight year of investment losses
    - Concern that available reserve balances were strained and had been significantly
    - Earnings forecasts were low
    - COLA – Future Reserve, which was a reserve funded with Unapportioned Earnings up to this point, was in danger of being entirely depleted
    - Fear of potential shortfalls in future Available Earnings to credit interest

SCERA COLA and Reserve Policy Discussion

- Policy Hurdles and Decisions
  - COLA Policy
    - Describes process for determining if earnings remain after interest crediting and designating a 3% of assets reserve
    - Establishes thresholds for COLA recommendation
    - Increased 1 % of plan assets statutory requirement to 3% before surplus excess earnings can be spent to fund a COLA

SCERA COLA and Reserve Policy Discussion

- Policy considerations – What thresholds should be in place before COLA recommended
  - Per statute COLA has to be fully funded from surplus excess earnings
  - Surplus excess earnings don't exist until 3% of plan assets are set aside after interest crediting and restoring the Negative Contingency Reserve
  - Is 3% still desired
  - If not, revert back to 1% or some different number
  - Does the Board want to consider whether there are other factors that should be added or subtracted from the thresholds

SCERA COLA and Reserve Policy Discussion

- Further Discussions
  - Depends on Board's policy direction
    - Potential future Board meeting discussions
  - November 2nd meeting with County representatives and Ad Hoc COLA Committee
  - Meeting of Ad Hoc COLA Committee to be scheduled to prepare for County meeting prior to November