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San Bernardino County Employees'  
Retirement Association

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Area Actuary and  
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Applicability SBCERA  
systemwide

## Interest Crediting Procedures and Undesignated Excess Earnings Allocation

POLICY NO. 002

### PURPOSE STATEMENT

The procedures and policies outlined by this document are intended to set forth the parameters and methodology of distributing earnings to valuation and non-valuation reserves, and to illustrate excess earning priorities.

### GOVERNING LAW

SBCERA is governed by provisions of the County Employees' Retirement Law of 1937, as well as other federal, and State laws relating to public retirement systems.

Article 5 of the County Employees' Retirement Law of 1937 governs excess earnings.

### GENERAL OBJECTIVES

1. Distribute Available Earnings to valuation assets. Valuation assets must initially be credited with all interest from investment proceeds up to the Board adopted interest rate.
2. Distribute Available Earnings in excess of those credited to Valuation Reserves to valuation asset shortfalls incurred in previous years as measured by the Contra Account.
3. Set aside 3% of the market value of assets as contingency reserves for future losses.
4. Distribute Undesignated Excess Earnings to Employer Current Service Reserve (County Advance Reserve), maintain as an Additional Contingency Reserve, or hold as Undesignated

Excess Earnings.

# **INTEREST CREDITING PROCEDURES**

## **STEP 1**

Determine Available Earnings (AE) for each fiscal year as the sum of:

1. Actual earnings of the retirement fund based on the actuarial value of assets, expressed in dollars. This could be a negative amount.
2. Prior year's ending balance in the Restricted Balance Reserved for Deficiencies (RBRD).
3. Prior year's ending balance in the Additional Contingency Reserve (ACR).

## **STEP 2**

Credit interest to Member Deposit Reserve (MDR):

1. Apply Member Crediting Rate (MCR) to prior MDR, and credit MDR with this MDR Interest amount.
2. Deduct MDR Interest from AE. If AE is not sufficient, increase the Contra Account by the amount of the shortfall. The Contra Account applies to the Employer Current Service Reserve.

## **STEP 3**

Credit interest on other Valuation Reserves (i.e. other than MDR):

1. Valuation Reserves may include a Contra Account when historical earnings have been below the Actuarial Assumed Investment Rate of Return (AAIRR). Apply interest to Valuation Reserves at the AAIRR based on the net total actual reserves including the Contra Account (which applies as an offset against the Employer Current Service Reserve).
2. If AE are insufficient for #1 above, increase the Contra Account by the amount of the shortfall.

## **STEP 4**

Make-up Credit for Annuity Reserve:

The Make-up Credit is the excess of the Valuation Rate over the Member Crediting Rate, times the prior MDR.

1. Transfer the Make-up Credit, if any, from AE to the Annuity Reserve. If AE is not sufficient, increase the Contra Account by the amount of the shortfall.

## **STEP 5**

Restore Contra Account:

1. If AE exist after Step 4 above, credit the Contra Account with remaining AE until Contra Account balance is zero.

## STEP 6

Restore RBRD and ACR:

If AE exist after Step 5 above, restore both the RBRD and the Additional Contingency Reserve (ACR) to target levels:

1. Transfer from AE into the RBRD an amount to bring the RBRD to 1% of Market Value, but not more than the Available Earnings remaining from Step 5.
2. Transfer from AE into the ACR an amount to bring the ACR to 2% of Market Value, but not more than the Available Earnings remaining from #1 above.
3. If the transfers in #1 and #2 above do not bring the RBRD to 1% of Market Value and the ACR to 2% of Market Value, but there is a balance in Undesignated Excess Earnings, then transfer from Undesignated Excess Earnings an amount sufficient first to bring the RBRD up to the 1% of Market Value target and then to bring the ACR up to the 2% of Market Value target.

## UNDESIGNATED EXCESS EARNINGS ALLOCATION POLICY

The dollar value remaining after Step 6 is considered Undesignated Excess Earnings. The following options are established by the Board. All allocations of Undesignated Excess Earnings require Board action.

## STEP 7

Allocate remaining AE to Undesignated Excess Earnings:

The following options represent possible uses of Undesignated Excess Earnings with no pre-assigned priority:

1. **Distribute Undesignated Excess Earnings to the ACR.**  
This action would increase the ACR above the 2% Market Value target. Such an action might be taken if losses are foreseeable in the future.
2. **Improve the funded status of the current statutory benefit.**  
If available, transfer from Undesignated Excess Earnings to Valuation Reserves all or a portion of an amount equal to any Unfunded Actuarial Accrued Liability. This would commit excess earnings to the full funding of statutory benefits.

## GLOSSARY

### Actuarial Terms and Definitions

The following list defines certain technical terms relevant to the Interest Crediting Procedures and Excess Earnings Policy for the convenience of the reader:

## Investment Return:

The rate of earnings of the Plan from its investments, including interest, dividends and capital gain, and loss adjustments, computed as a percentage of the average value of the fund. For actuarial purposes, the investment return reflects a smoothing of market gains and losses to avoid significant swings in the value of assets from one year to the next.

## Actuarial Assumed Investment Rate of Return:

The rate of investment yield that the Plan is assumed to earn over the long-term future.

## Actuarial Value of Assets:

Market value of assets less unrecognized market value gains and losses from each of the last five years. Market value gains and losses are equal to the difference between the actual market return and the expected return on the market value, and are recognized over a five-year period.

## Valuation Value of Assets:

The Actuarial Value of Assets reduced by the value of the Non-Valuation Reserves (Burial Allowance reserve, Undistributed Excess Earnings reserve and both the RBRD and ACR).

## Member Crediting Rate:

The Member Deposit Reserve is credited semi-annually at the Member Crediting Rate which is the lesser of the assumed investment earnings rate or the six month T-bill rate at the last public auction. In the event the six month T-bill rate at the last public auction is less than zero, the Member Crediting Rate will be zero. The Member Crediting Rate was approved by the Board of Retirement on 4/21/2003.

## Contra Account:

An account to track historical earning shortfalls on Valuation Reserves and applies to the Employer Current Service Reserve.

Pension Reserves (Valuation and Non-Valuation).

## Valuation Reserves

### 1. Member Deposit Reserve (Step 2):

The reserve represents the total accumulated contributions of members.

### 2. Employer Current Service Reserve (Step 3):

The reserve includes the total accumulated contributions of the employer held for the benefit of non-retired general and safety members on account of service rendered as a member of the retirement system. Also known as County Advance Reserve.

### 3. **Annuity Reserve (Step 4):**

The reserve includes the total accumulated contributions of retired members less the annuity payments made to the members.

### 4. **Pension Reserve (Step 3):**

The reserve represents total accumulated contributions of the employer held for the benefit of retired members on account of service rendered as a member of the retirement system, less the pension payments made to retired members.

### 5. **Death Benefit Reserve (Step 3):**

The reserve represents the accumulated contributions of the employer to be used to pay active death benefits of members.

### 6. **Cost of Living Reserve (Step 3):**

The reserve represents the accumulated contributions of the employer to be used to pay cost of living payments.

### 7. **Supplemental Disability Reserve (Step 3):**

The reserve represents the accumulated contributions of the employer to pay supplemental disability payments.

### 8. **Survivor Benefit Reserve (Step 3):**

The reserve represents the accumulated contributions of the employer and employees to be used to pay retirees' survivor benefit allowances.

## **Non-Valuation Reserves**

### 1. **Burial Allowance Reserve (Step 7):**

The reserve represents the excess earnings allocated by the Board to pay a portion of the retirees' burial allowance<sup>1</sup>. In 1985 the Board of Retirement adopted Government Code section **31789.13**, which provides an additional \$250 burial allowance to retired SBCERA members. This is a *discretionary benefit* provided from excess earnings pursuant to section 31592.2.

### 2. **Restricted Balance Reserved for Deficiencies (RBRD) (Step 6):**

Represents earnings in excess of the total interest credited to Valuation Reserves, equal to 1% of market value of assets (Government Code Section 31592.2) and are used as a reserve against deficiencies in interest earnings in other years, losses on investments and other contingencies. If the Board approves an excess earnings benefit to be paid (or sets aside reserves to pay excess earnings benefits into the future) this reserve must be created in the year when the Board votes to provide the excess earnings benefit. Excess earnings benefits created from a previous Board vote that set aside a reserve to pay such benefits over time do not require the maintenance of the restricted balance, as the requirements to provide the excess earnings benefit were satisfied at the time the Board voted to create the excess

earnings benefit.

### 3. Additional Contingency Reserve (Step 6):

Represents earnings in excess of the total interest credited to the Valuation Reserves, equal to 2% of total market value of assets and are used as a reserve against deficiencies in interest earnings in other years, losses on investments and other contingencies. This reserve was first established by the Board in 2005.

### 4. Undesignated Excess Earnings (Step 7):

Represents earnings in excess of the total interest credited to all other reserves that has not been allocated by the Board to other reserves.

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<sup>1</sup> In 1963 the Board of Supervisors adopted Government Code section **31789**, which provides a \$750 death benefit, hereinafter referred to as the "burial allowance," to retired SBCERA members. This is an actuarially-funded, *vested-benefit* provided through employer contributions.

## Approval Signatures

### Step Description

### Approver

### Date

Chief Counsel Review

Barbara Hannah: Chief Counsel

Pending

Amy McNerny: Chief Financial  
Officer

7/9/2024

## Applicability

SBCERA, SBCERA Internal