

## Purpose and Background

1. The purpose of this policy is to document the existing reserve structure created and maintained by OCERS and the distribution of available earnings and interest-crediting to the reserve accounts consistent with Government Code §§31592 and 31592.2.

## Policy Objectives

2. The objectives of this policy are to:
  - a. Identify all the reserves maintained by OCERS, and how funds are distributed to and from the relevant reserve.
  - b. In the event of excess earnings in any fiscal year, provide guidance to OCERS' staff to ensure appropriate application of excess earnings (Undistributed Earnings) to reserve accounts.

## Definitions

The System's reserves are book-keeping accounts and do not represent an actual separation of funds; the sum of all reserves equals the net position restricted for pension and other post-employment benefits and fall into these categories: Valuation, Non-Valuation and Health Care.

3. **Valuation Reserves** consist of the reserves used by the actuary in calculating the valuation value of assets, including the Employer Contribution Reserve, Employee Contribution Reserve, Pension Reserve, , Annuity Reserve, UAAL Contribution Reserve, STAR COLA Reserve, ERI Contribution Reserve, Contra Account and the Contingency Reserve. The total of the Valuation Reserves equals the market value of the system's assets used by the actuary in determining current funding levels.
  - a. **Employer Contribution Reserve**—represents the cumulative employer contributions for active and deferred members plus interest for future retirement benefits. Additions include employer contributions for active members, and interest credited semi-annually. Deductions include transfers to the Pension Reserve to fund retirement benefits, disability benefits and death benefits.
  - b. **Employee Contribution Reserve**—represents the cumulative employee contributions for active and deferred members plus interest for future retirement benefits. Additions include member contributions and interest credited semi-annually. Deductions include member refunds and transfer of funds to the Annuity Reserve for retirement benefits of newly retired members.
  - c. **Pension Reserve**—represents funding set aside from employer contributions for retirement and disability benefit payments. Additions include transfers from the Employer Contribution Reserve as current active members retire and interest credited. Deductions include benefit payments to retired and disabled members, and their beneficiaries.
  - d. **Annuity Reserve**—represents funding set aside from employee contributions for retirement and disability benefit payments. Additions include transfers from the Employee Contribution Reserve as current active members retire and interest credited. Deductions include benefit payments to retired and disabled members, and their beneficiaries.

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- e. **UAAL Contribution Reserve**—represents the cumulative additional employer contributions made for their unfunded actuarial accrued liability in excess of the required contribution. This reserve is included as part of the Employer Contribution Reserve in the financial statements of the System. Additions include employer contributions to their UAAL, and interest credited semi-annually.
  - f. **STAR COLA Reserve (Supplemental Targeted Adjustment for Retirees Cost-of-living Adjustment)**—represents employer contributions for retirees whose retirement benefit has lost more than 20 percent of its purchasing power since retirement. Additions to this reserve include bi-weekly contributions from the employer. Deductions include monthly benefit payments made to eligible retired members and transfers to the Pension Reserve for any differences between amounts contributed and benefits paid.
  - g. **ERI Contribution Reserve**—represents the cumulative employer contributions for future retirement payments to active employees who were offered an incentive for early retirement by their employer. This reserve is included as part of the Employer Contribution Reserve in the financial statements of the System. Additions include annual employer contributions to be paid over a 15 year period through 2017 and interest credited semi-annually. Deductions include transfers to the Pension Reserve to fund the early retirement benefits for eligible members.
  - h. **Contra Account**—represents the accumulation of the interest crediting to the valuation reserves accounts which cannot be funded from available earnings.
  - i. **Contingency Reserve**—provides a buffer against deficiencies for payment of retirement benefits due to interest and earnings fluctuations, changes in assumptions or some other unforeseen contingency. The County Employees Retirement Law provides that when the Contingency Reserve exceeds one percent of total assets, the retirement board may transfer all or any part of the surplus as specified in Government Code § 31592.2. Additions to this reserve are transfers from the Undistributed Earnings. Deductions are transfers to other reserve funds as required by this policy. If no Undistributed Earnings are available, this reserve may be unfunded.
4. **Non-Valuation Reserves** include the County Investment Reserve, Medicare/Medical Insurance Reserve, EPA Reserve, the OCSD UAAL Deferred Reserve, as well as the Actuarial Deferred Returns. These reserves are special purpose reserves for specific employers and retirees and are not used by the actuary in determining current funding levels.
- a. **County Investment Reserve**—represents the remaining proceeds from the County of Orange’s 1994 Pension Obligation Bond issuance. The remaining proceeds are utilized, in accordance with a long standing agreement between OCERS and the County of Orange, to offset a portion of the annual actuarially-determined contribution rates for the County of Orange. Additions to this reserve include interest credited as stated in the agreement. Deductions represent transfers to the Employer Contribution Reserve as provided in the aforementioned agreement.
  - b. **Medicare/Medical Insurance Reserve**—represents funds received from the County to subsidize Medicare benefits for a small group of retirees in settlement of a retiree healthcare lawsuit back in the 1970’s. There are no additions to this reserve. Deductions to this reserve represent payments to the few remaining retirees who are entitled to this benefit. Once there are no

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longer any retirees entitled to this benefit, any remaining funds will be transferred to the Pension Reserve. For financial statement reporting purposes only, this reserve is currently included with the Pension Reserve.

- c. **EPA (Employee Purchased Annuity) Reserve**—represents additional after-tax contributions made by employees pursuant to Government Code §31627 for the purpose of providing additional benefits. Under this plan, active employees were given the choice of receiving a lump sum benefit upon retirement, or a monthly distribution for 60 to 120 months, then a lifetime additional retirement benefit. The plan was closed as of December 31, 2002 and only a few retirees are receiving this additional benefit. Interest had been credited at the assumed rate of return minus 0.5%, but the balance in this reserve has been exhausted. Activity in this reserve is limited to deductions for the monthly additional benefit for the remaining retirees. For financial reporting purposes, the negative balance in this reserve is offset against the Pension Reserve.
  - d. **OCSD UAAL Deferred Reserve**—represents the payment by the Orange County Sanitation District (OCSD) of its deferred unfunded actuarial accrued liability (UAAL). This non-valuation reserve was established by a memorandum of understanding (MOU) adopted on January 17, 2017 to track the deferred losses of OCSD's UAAL. Commencing December 31, 2016 and annually thereafter until there is no remaining balance of funds in this reserve, OCERS will transfer the amount necessary to satisfy the actual UAAL attributed to OCSD into OCERS' Employer Reserve Account. Additions to this reserve include interest credited annually at the actual rate of return per the terms of the MOU.
  - e. **Actuarial Deferred Returns**—represents the amount of deferred earnings created by a five-year smoothing of actual gains and losses compared to the assumed investment rate of return. A positive balance represents accumulated earnings above the assumed investment rate of return. A negative balance represents accumulated earnings below the assumed investment rate of return. Changes to this amount are determined based on the actuarial valuation completed at the end of the year. This amount may also be referred to as "Net Unrecognized Gains/ (Losses)" or "Reserve for Market Stabilization."
5. **Health Care Reserves** include funds held for the special purpose to pay medical benefits for eligible recipients.
- a. **Health Care Reserve—County**—represents assets held to pay medical benefits for eligible retirees of the County 401(h) health care plans. Additions include employer contributions and investment earnings. Deductions include medical payments and administrative expenses.
  - b. **Health Care Reserve—OCFA**—represents assets held to pay medical benefits for eligible retirees of the OCFA 401(h) health care plans. Additions include employer contributions and investment earnings. Deductions include medical payments and administrative expenses.
6. **Other Related Terms**
- a. **Undistributed Earnings** are the most recent annual earnings of the fund.
  - b. **Available Earnings** are Undistributed Earnings, as defined above, plus any balance in the Unallocated Fund Balance and Contingency Reserves.

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- c. **Unallocated Fund Balance** is the amount remaining after all the required reserves have been funded and interest has been credited to those reserves. An Unallocated Fund Balance will only occur when earnings have more than exceeded expectations and the required Contingency Reserve has been funded.

### Policy Guidelines

7. Available Earnings of OCERS will be allocated in the following order:
  - a. Payment of administrative and investment expenses
  - b. Credit of regular interest compounded semi-annually on June 30 and December 31 to all contributions in the retirement fund which have been on deposit for six months prior to that date as specified in Government Code § 31591:
    1. Employee (EE) Contribution Reserve at an annual rate of 5%
    2. Employer (ER) Contribution Reserve at the annual assumed rate of return plus the excess between the annual assumed rate of return and 5% credited for employee interest
    3. Annuity Reserve at the annual assumed rate of return
    4. Pension Reserve at the annual assumed rate of return
    5. Early Retirement Incentive (ERI) Reserve at the annual assumed rate of return
    6. UAAL Contribution Reserve at the annual assumed rate of return
  - c. Credit of interest per terms of applicable agreement to the following non-valuation reserves:
    - a. County Investment Reserve
    - b. OCSD UAAL Deferred Reserve
  - d. Credit the balance to Undistributed Earnings
8. The Board adopts the allocation of Undistributed Earnings in the following order:
  - a. Replenish the Contra Account
  - b. Replenishing the Contingency Reserves to 1% of assets
  - c. Credit to Employer (ER) Contribution and Pension Reserves so as to reduce the unfunded accrued actuarial liability (UAAL) of the System
  - d. Credit the balance to the Unallocated Fund Balance

### Policy Review

9. This Policy is subject to change in the exercise of the Board's judgment. The Board will review this policy at least every three years to ensure that it remains relevant and appropriate. In the event of legislative changes to the pertinent sections addressed in this policy, the Board will review the policy as appropriate.

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**Policy History**

10. The Board adopted the Undistributed Earnings policy on November 23, 2009.
11. The Undistributed Earnings Policy was last reviewed on January 21, 2014.
12. This Reserves and Interest-Crediting Policy supersedes the prior Undistributed Earnings Policy.

**Secretary's Certificate**

I, the undersigned, the duly appointed Secretary of the Orange County Employees Retirement System, hereby certify the adoption of this policy.



12/18/17

Steve Delaney  
Secretary of the Board

Date