



Board Agenda Item 5

DATE: February 20, 2024

TO: Board of Supervisors

SUBMITTED BY: Donald C. Kendig, CPA, Retirement Administrator

SUBJECT: June 30, 2023 Annual Actuarial Report and FY 2024-25 Retirement Contribution Rates

RECOMMENDED ACTION(S):

- 1. Receive and file the Fresno County Employees' Retirement Association Actuarial Valuation and Review report (the Actuarial Valuation and Review report) as of June 30, 2023 by The Segal Group, Inc. (Segal), relating to the Fresno County Employees' Retirement Association (FCERA); and**
- 2. Approve and adopt the Board of Retirement's recommended rate of interest, and employer and FCERA member contribution rates, for FY 2024-25 as provided for in the FCERA member contribution rates in Section 4, Exhibit 3 entitled "Member Contribution Rates," the employer contribution rates in Section 2, Subsection F entitled "Recommended Contribution" and the Administrative Expense Load percentage of Payroll rates in Section 4, Exhibit 1 of the Actuarial Valuation and Review report as of June 30, 2023, in accordance with Government Code sections 31453 and 31454.**

Generally, under Government Code section 31453, upon the basis of the investigation, valuation, and recommendation of FCERA's actuary, the Board of Retirement, at least 45 days prior to the beginning of a fiscal year (here, FY 2024-25), recommends to your Board the changes in the rates of interest, in the rates of contributions of FCERA members, and in County and district appropriations (*i.e.*, employer contributions) as are necessary. Accordingly, Government Code section 31454 generally requires your Board, no later than 90 days following the commencement of the fiscal year (here, FY 2024-25), to adjust the rates of interest, the rates of contributions of FCERA members, and County and district appropriations (*i.e.*, employer contributions) in accordance with the recommendations of the Board of Retirement.

The Fresno County Employees' Retirement Association's (FCERA) delivery, on behalf of the Board of Retirement, of the accompanying Actuarial Valuation and Review report by FCERA's actuary, Segal, to your Board along with this item enables your Board to timely adopt and implement these necessary employer and FCERA member contribution rates for FY 2024-25 that would satisfy your Board's statutory requirement for that fiscal year.

The recommended employer contribution rates and FCERA member contribution rates, as well as Valuation Highlights and Summary of Key Valuation Results, and the bar graphs of the projection of the unfunded actuarial accrued liability (UAAL) balances and payments, and the recommended rate of interest set forth in the Actuarial Valuation and Review report, are attached to this item.

ALTERNATIVE ACTION(S):

Your Board may defer implementation of the recommended rates up to 90 days after the end of current FY 2023-24; however, that would delay the timing of the assumed funding of FCERA, as recommended by Segal, and result in an adjustment by way of a subsequent Actuarial Valuation and Review report, and related likely increased employer and FCERA member contribution rates, as such deferred contributions would be provided as a percentage of annual assumed payroll in a shorter time period than presently assumed by Segal over the entire fiscal year (i.e., the recommended rates are assumed to be effective and implemented starting July 1, 2024). The Board of Supervisors also has the option of timely pre-funding contributions based on the new rates, which would lower future rates on a relative basis.

FISCAL IMPACT:

The following are based on a review of the Actuarial Valuation and Review report, and as applicable, are rounded to the nearest thousand, shown as changes from FY 2023-24 to FY 2024-25, or, where stated as a percentage of payroll, are based on a projected covered payroll of approximately \$529.8 million as of FYE June 30, 2023:

Pgs. 12 or 34 - The average member contribution rate will increase 0.13%, from 9.45% to 9.58% of payroll, primarily attributed to changes in economic assumptions, minor actuarial refinements, and active member demographic changes.

Pgs. 12 or 33 - The overall average employer contribution rate will increase by 3.33%, from 45.93% to 49.26% of payroll (a reversal/offset of the current fiscal year decrease of 4.86%). This increase is primarily due to the effect of the investment return being less than the 6.50% assumed rate, after "smoothing" (2.25%), the effect of COLA increases greater than expected with the COLA banked (2.17%), the changes in economic assumptions or (2.25%), offset by the effect of the end of the 2008 UAAL amortization layer (-2.31%), among others. Note that the UAAL contributions are expected to continue to decline in the next few valuations as other layers are fully amortized, as shown in the graphical projection found in Section 3, Exhibit I on page 79.

Pgs. 12 or 33 - The increase in the total employer contributions in FY 2024-25 are estimated at \$17.6 million, from an estimated \$243.4 million to \$261.0 million assuming no change in plan sponsors' projected payroll.

Pg. 84 - The administrative expense load will remain the same as current fiscal year at 1.30% of payroll.

Pg. 26 - FCERA's investment portfolio gained 9.61% in Market Value during the fiscal year 2022-23. The return was 3.11% higher than the assumed rate of return of 6.5% on the Market Value of Assets. Investment gains and losses are smoothed over a rolling five-year period, and the substantial loss of the previous fiscal year was offsetting. The most recent five-year and 10-year average returns, on a Market Value basis, was 5.85% and 6.23%, respectively.

Pg. 25 or 26 - The return on the Valuation Value of Assets was 4.24% for the fiscal year 2022-23 after considering the gradual recognition of current and prior years' investment gains and losses. This resulted in an actuarial loss when measured against the assumed rate of return of 6.50%. This actuarial investment loss increased the average employer contribution rate by 2.25% of payroll. The most recent five-year and 10-year average returns, on a Valuation Value basis, was 6.17% and 6.49%, respectively.

Pgs. 9 or 24 - The actuarial loss of \$305.4 million, or 4.1% of the Actuarial Accrued Liability, is due to an investment loss of \$138.0 million, a contribution gain of \$14.6 million, and a net experience loss from sources other than investments and contributions of \$182.0, prior to the reflection of COLA assumption change. This loss was primarily due to COLA increases greater than expected for retirees and beneficiaries with a 3% maximum COLA.

Pg. 22 - The total unrecognized net investment loss as of June 30, 2023 is about \$232.1 million as compared to an unrecognized net investment loss of \$510.7 million in the previous valuation. This deferred investment loss of about \$232.1 million will be recognized in the determination of the Actuarial Value of Assets for funding purposes in the next few years as shown in Section 2, Subsection B of the Actuarial Valuation and Review report. Deferred losses as of June 30, 2023 recognized in each of the next five years (i.e., "smoothing") is expected as follows:

(a) Amount recognized on June 30, 2024	\$(22,358,718)
(b) Amount recognized on June 30, 2025	(23,622,574)
(c) Amount recognized on June 30, 2026	(150,536,138)
(d) Amount recognized on June 30, 2027	(65,951,110)
(e) Amount recognized on June 30, 2028	<u>30,382,228</u>
Total	<u>\$(232,086,311)</u>

The net deferred loss of \$232.1 million represents about 3.8% of the Market Value of Assets. Unless offset by future investment gains or other favorable experience, the recognition of the \$232.1 million market loss is expected to have a negative impact on FCERA's future funded ratio and contribution rate requirements, with the largest negative effect in the June 30, 2026 actuarial valuation.

Segal's Actuarial Valuation and Review report sets the rates recommended for FY 2024-25, by member types (general and safety) and retirement tier as provided in the member contribution rates in Section 4, Exhibit 3, entitled "Member Contribution Rates" (pages 105-121), the employer contribution rates in Section 2, Subsection F entitled "Recommended Contribution" (pages 31-39), and the Administrative Expense load as a percentage of payroll in Section 4, Exhibit 1 (page 84).

DISCUSSION:

In accordance with Government Code Section 31453 and 31454, the Board of Retirement for FCERA reviews and approves the retirement contribution rates as set forth in the Fresno County Employees' Retirement Association Actuarial Valuation and Review report (the Actuarial Valuation and Review report), and then, at least 45 days prior to the beginning of the next fiscal year (here, FY 2024-25), recommends those rates to the Fresno County Board of Supervisors for its adoption and implementation. The Board of Supervisors then implements those adopted rates no later than 90 days after the beginning of the succeeding fiscal year (here, FY 2024-25). However, as stated above, the recommended rates in the Actuarial Valuation and Review report are assumed to be effective and implemented starting July 1, 2024. In summary, the Board of Retirement reviews, approves, and recommends the retirement rates for the adoption and implementation by the Board of Supervisors.

Pursuant to the Actuarial Valuation and Review report, the Board of Retirement adopted the average employer contribution rate and member contribution rates for all retirement tiers as presented by Segal in the Actuarial Valuation and Review report at the Board of Retirement's regular meeting held on December 20, 2023.

The Actuarial Valuation and Review report reflects changes in the demographic and economic assumptions. These changes are documented in Segal's Analysis of Actuarial Experience (pages 24-28) and are outlined in Section 4, Exhibit 1 of the Actuarial Valuation and Review report (pages 84-96). These assumption changes resulted in an increase of \$124.9 million of the total \$327.0 million net increase in the Unfunded Actuarial Accrued Liability (UAAL) (see page 30, and below, regarding page 13), an increase in the average employer contribution rate of 2.25% of the total 3.33% net increase of payroll (see page 33), and the entire increase in the average member contribution rate of 0.13% of payroll (see page 34).

In addition to the fiscal impact information, above, key findings of the Actuarial Valuation and Review report are as follows (dollar amounts are stated in approximate thousands).

Pgs. 13, 25 or 84 - The Board of Retirement’s recommended rates of interest (i.e., FCERA’s assumed net investment rate of return) is 6.50% for FY 2022-23.

Pgs. 14 or 17 - FCERA’s membership totals 21,211 and is comprised of: 8,374 retired members and beneficiaries receiving benefits; 5,187 terminated members entitled to, but not yet receiving benefits (also known as inactive vested members) or entitled to a return of their member contributions (also known as inactive nonvested members) (collectively, “Inactive Members”), and 7,650 active members.

Pg. 17 - For each active member, there are 1.77 inactive members (i.e., inactive vested and nonvested members, and retired members and beneficiaries).

Pg. 71 - The Contra Tracking Account increased \$249.3 million, from \$1,473.5 million at June 30, 2022, to \$1,722.8 million at June 30, 2023.

Pg. 13 - On a Valuation Value of Assets basis (smoothed), the UAAL increased \$327.0 million, from \$784.7 million at June 30, 2022 to \$1,111.7 million at June 30, 2023. On a Market Value of Assets basis, the UAAL increased \$48.3 million from \$1,295.5 million at June 30, 2022 to \$1,343.8 million at June 30, 2023.

Pg. 13 - The funded ratio, on a Valuation Value of Asset basis, decreased from 88.66% at June 30, 2022 to 85.06% at June 30, 2023, while on a Market Value of Asset basis, the funded ratio increased from 81.28% at June 30, 2022 to 81.94% at June 30, 2023.

Pg. 84 - The Administrative Expense load remained the same as the current fiscal year at 1.30% of payroll. The allocation of the expense between Employer Basic Normal Cost, Employer Basic UAAL, and the Member Basic rates are adjusted annually, and are shown below with historical rates.

Expense Load Category	<u>6/30/23</u>	<u>6/30/22</u>	<u>6/30/21</u>	<u>6/30/20</u>
Employer Basic Normal Cost Rate	0.21%	0.22%	0.20%	0.17%
Employer Basic UAAL Rate	0.88%	0.86%	0.90%	0.86%
Member Basic Rate	<u>0.21%</u>	<u>0.22%</u>	<u>0.20%</u>	<u>0.17%</u>
Total	<u>1.30%</u>	<u>1.30%</u>	<u>1.30%</u>	<u>1.20%</u>

The increase in the average employer contribution rate (from 45.93% of payroll at June 30, 2022 to 49.26% of payroll at June 30, 2023) is primarily due to the effect of the investment return being less than the 6.50% assumed rate (after “smoothing”), the effect of COLA increases greater than expected, the changes in economic assumptions, offset by the effect of the end of the 2008 UAAL amortization, among others. A complete reconciliation of FCERA’s average employer contribution rate is provided in Section 2, Subsection F, on page 33.

Continued in the Actuarial Valuation and Review report is a Risk Assessment beginning on page 44 in Section 2, Subsection J, required by Actuarial Standards of Practice No. 51 (“ASOP 51”). The Risk Assessment is a concise discussion of some of the primary risks that may affect the plan’s future financial condition. As a mature pension plan, determined by the ratio of members in pay status to active participants, the cash needed to fulfill benefit obligations will increase over time. Therefore, the plan’s asset allocation needs to evolve to meet emerging pension liabilities.

Retirement plans are subject to volatility in the level of required contributions. A further discussion of plan maturity measures and how they relate to changes in assets and liabilities is included in Section 2, Subsection I, Volatility Ratios on page 43. The Asset Volatility Ratio (AVR) equals the Market Value of Assets divided by total payroll and is currently about 11.5, which means that a 1% asset gain or loss (relative to the assumed investment return of 6.5%) translates to about 11.5% of one year’s payroll. Since these gains and losses are amortized over 15 years, there would be an approximate 1.0% of payroll decrease/ (increase) in the required contribution for each 1% asset gain/(loss). The Liability Volatility Ratio (LVR)

equals the Actuarial Accrued Liability divided by payroll, and provides an indication of the longer-term potential for contribution volatility for any given level of investment volatility. The current total plan LVR is about 14.0, but is 13.3 for General compared to 17.8 for Safety. Please refer to page 43 of the Actuarial Valuation and Review report for a chart of the AVR and LVR from fiscal years ended 2014 through 2023.

REFERENCE MATERIAL:

BAI #36, March 28, 2023 - Actuarial Valuation and Review Report

BAI #12, March 22, 2022 - Actuarial Valuation and Review Report

ATTACHMENTS INCLUDED AND/OR ON FILE:

Excerpts of June 30, 2023 Actuarial Valuation and Review report:

Section 1, Actuarial Valuation Summary, Valuation Highlights (pages 8-11), and Summary of

Key Valuation Results (for June 30, 2023 and June 30, 2022) (pages 12-14)

Section 3, Exhibit I - Projection of UAAL Balances and Payments (pages 78-79)

Section 2, Subsection F - entitled "Recommended Contribution" - Recommended Employer Contribution Rate (pages 35-36)

Section 4, Exhibit 3 - entitled "Member Contribution Rates" - Recommended Member Contribution Rates (pages 105-121)

On file with Clerk - June 30, 2023 Actuarial Valuation and Review report

CAO ANALYST:

Paige Benavides