Board Agenda Item 25

DATE: February 25, 2025

TO: Board of Supervisors

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

SUBJECT: June 30, 2024 Annual Actuarial Report and FY 2025-26 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, 2024 by The Segal Group, Inc. (Segal), relating to the Fresno County Employees' Retirement Association (FCERA);**

2. **Approve and adopt the Board of Retirement's recommended rate of interest, and employer and FCERA member contribution rates, for FY 2025-26 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, 2024, in accordance with Government Code sections 31453 and 31454; and**

3. **Direct the County Administrative Officer to discuss with FCERA Staff the potential for FCERA's smoothing of the unfunded actuarial accrued liability (UAAL) and associated employer contributions, in the upcoming Actuarial Valuation and Review report as of June 30, 2025, but not changing or impacting the Actuarial Valuation and Review report as of June 30, 2024 by Segal.**

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 2025-26), 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 2025-26), 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.

Under the first and second recommended actions, 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 2025-26 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 lability (UAAL) balances and payments, and the recommended rate of interest set forth in the Actuarial Valuation and Review report, are attached to this item. Under the Actuarial Valuation and Review report, Segal's assumed rate of return on FCERA's assets is 6.50%.

The third recommended action is based on the Board of Retirement's December 18, 2024 direction to FCERA's staff to discuss the following with Plan Sponsors, including the County. Segal states the following in page 8 of the Actuarial Valuation and Review report:

> As noted on page 85, the UAAL contributions in the next five to ten years would continue to fluctuate. If all the actuarial assumptions were to be met, the UAAL contributions as determined in the June 30, 2024 valuation of $171 million would drop to $129 million in the June 30, 2025 valuation. Then, in the valuations between June 30, 2026 and 2032, the annual UAAL contributions would be expected to fluctuate in the range of $113 million to $144 million.

There is an opportunity to smooth contributions to ensure a steady decline and prevent interim increases as we get back to normal cost.

The actuary felt that this was something to be discussed with plan sponsors before possibly implementing. This change would have no impact on the current June 30, 2024 valuation results as the total amount of the UAAL as of June 30, 2024 remains unchanged.

ALTERNATIVE ACTION(S):

Your Board may defer implementation of the recommended rates up to 90 days after the end of current FY 2024-25; however, that would delay the timing of the assumed funding of FCERA, as recommended by Segal in the Actuarial Valuation and Review, 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. The reason is that 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, 2025). 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 2024-25 to FY 2025-26, or, where stated as a percentage of payroll, are based on a projected covered payroll of approximately $581.1 million as of FYE June 30, 2024:

Pgs. 13 or 34 - The average FCERA member contribution rate will decrease 0.01%, from 9.49% to 9.48% of payroll, primarily attributed to member demographic changes on normal costs (these costs decreased), offset by a relatively smaller change in explicit administrative expense load (these expenses increased).

Pgs. 12 or 33 - The overall average employer contribution rate will decrease by 4.74%, from 48.76% to 44.02%, attributable to several factors, the greatest of which was a 4.25% decrease attributable to the 2009 UAAL amortization layers being fully amortized.

Pgs. 12, 36, or 87 - The decrease in the total employer contributions in FY 2025-26 are estimated at $27.6 million, from an estimated $283.4 million to $255.8 million, based on total estimated payroll of $581.1 million.

Pg. 86 - The administrative expense load will remain the same as current fiscal year at 1.30% of payroll.

Pg. 25 or 27 - FCERA's investment portfolio gained 10.30% in Market Value during the fiscal year 2023-24. The return was 3.80% 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. The most recent five-year and ten-year average returns, on a Market Value basis, was 6.81% and 5.64%, respectively.

Pg. 5, 25, 27, & 33 - The return on the Valuation Value of Assets was 6.38% for the fiscal year 2023-24 after recognizing a portion of this year's investment gain and a portion of 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 (after asset smoothing)
increased the average employer contribution rate by 0.11% of payroll. The most recent five-year and 10-year average returns, on a Valuation Value basis, was 6.66% and 6.23%, respectively.

Pg. 9 or 23 - The total unrecognized net investment loss as of June 30, 2024 for the five-year period of FYE June 30, 2025 through FYE June 30, 2029 is about $9.2 million as compared to an unrecognized net investment loss of $232.1 million in the previous valuation for the five-year period of FYE June 30, 2024 through FYE June 30, 2028. This deferred investment loss of about $9.2 million will be recognized in the determination of the Actuarial Value of Assets for funding purposes in the next five years as shown in Section 2, Subsection B of the Actuarial Valuation and Review report. Deferred losses as of June 30, 2024 recognized in each of the next five years (*i.e.*, "smoothing") is expected as follows:

(a) Amount recognized on June 30, 2025	$21,167,992
(b) Amount recognized on June 30, 2026	(105,745,572)
(c) Amount recognized on June 30, 2027	(21,160,544)
(d) Amount recognized on June 30, 2028	75,172,793
(e) Amount recognized on June 30, 2029*	21,405,388
Total	$(9,159,944)

Note: * The Actuarial Valuation and Review report inadvertently showed this date as June 30, 2028.

For the upcoming Actuarial Valuation and Review report for June 30, 2025, the Board of Retirement directed Segal to combine the net deferred loss of $9.2, stated above, into a single, four and a half year, further smoothing "layer" (in addition to such five-year smoothing) and thereby recognizing the net deferred loss of $9.2 million evenly over the next four and a half years in nine level amounts of approximately $1 million each semi-annual period, instead of the large positives and negatives stated above. This would reduce the volatility associated with the current pattern of the deferred gain/loss recognition and thereby result in more stable funded ratios on an actuarial value basis and more level employer contribution rates. Segal noted in the Actuarial Valuation and Review report that this change would have no impact on the current June 30, 2024 valuation results as the total amount of the net deferred loss as of June 30, 2024 remains unchanged.

The net deferred loss of $9.2 million represents about 0.1% of the Market Value of Assets. Unless offset by future investment gains or other favorable experience, the recognition of the $9.2 million market loss is expected to have a negative impact on FCERA's future funded ratio and contribution rate requirements.

Segal's Actuarial Valuation and Review report sets the rates recommended for FY 2025-26, 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 112-128), 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 86-87).

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 2025-26), 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 2025-26). However, as stated above, the recommended rates in the Actuarial Valuation and Review report are assumed to be effective and implemented starting July 1, 2025.

Under the Actuarial Valuation and Review report, Segal's assumed rate of return on FCERA's assets is 6.50%.

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 18, 2024.

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. 14, 27 or 86 - The Board of Retirement's recommended rates of interest (*i.e.*, FCERA's assumed net investment rate of return) is 6.50% for FY 2024-25.

Pgs. 15 or 18 - FCERA's membership totals 21,804 and is comprised of: 8,490 retired members, disabled members, and beneficiaries receiving benefits; 5,404 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 7,910 active members.

Pg. 18 - For each active member, there are 1.76 non-active members (*i.e.*, inactive vested and nonvested members, and retired members and beneficiaries).

Pg. 72 - The Contra Tracking Account increased $136.1 million, from $1,722.8 million at June 30, 2023, to $1,858.9 million at June 30, 2024.

Pg. 14 - On a Valuation Value of Assets basis (smoothed), the UAAL decreased $21.8 million, from $1,111.7 million at June 30, 2023 to $1,089.8 million at June 30, 2024. On a Market Value of Assets basis, the UAAL decreased $244.9 million from $1,343.8 million at June 30, 2023 to $1,098.9 million at June 30, 2024.

Pg. 14 - The funded ratio, on a Valuation Value of Asset basis, increased from 85.06% at June 30, 2023 to 85.94% at June 30, 2024, while on a Market Value of Asset basis, the funded ratio increased from 81.94% at June 30, 2023 to 85.82% at June 30, 2024.

Pg. 87 - 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	6/30/24	6/30/23	6/30/22	6/30/21
Employer Basic Normal Cost Rate	0.23%	0.21%	0.22%	0.20%
Employer Basic UAAL Rate	0.84%	0.88%	0.86%	0.90%
Member Basic Rate	0.23%	0.21%	0.22%	0.20%
Total	1.30%	1.30%	1.30%	1.30%

Pg. 8 - The decrease in the average employer contribution rate (from 48.76% of payroll at June 30, 2023 to 44.02% of payroll at June 30, 2024) is primarily due to the effect of a decrease in the UAAL rate from a greater than expected increase in total payroll and 2009 UAAL amortization layers being fully amortized, offset somewhat by the investment return on the valuation value (*i.e*., after asset smoothing) less than the assumed rate of 6.50% used in the June 30, 2023 valuation, individual salary increases greater than expected, and actual contributions less than expected. 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 pages 43-44, 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 starting on page 47.

- The Asset Volatility Ratio (AVR) equals the Market Value of Assets divided by total payroll and is currently about 11.4, which means that a 1% asset gain or loss (relative to the assumed investment return of 6.5%) translates to about 11.4% 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 13.3, but is 12.5 for General members compared to 17.3 for Safety members.

Please refer to page 48 of the Actuarial Valuation and Review report for a chart of the AVR and LVR from fiscal years ended 2015 through 2024).

REFERENCE MATERIAL:

BAI #5, February 20, 2024 - Actuarial Valuation and Review Report
BAI #36, March 28, 2023 - Actuarial Valuation and Review Report

ATTACHMENTS INCLUDED AND/OR ON FILE:

Excerpts of June 30, 2024 Actuarial Valuation and Review report:
  Section 1, Actuarial Valuation Summary, Valuation Highlights and Summary of
  Key Valuation Results (for June 30, 2024 and June 30, 2023) (pages 7-15)
  Section 3, Exhibit I - Projection of UAAL Balances and Payments (pages 84-85)
  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 112-128)

On file with Clerk - June 30, 2024 Actuarial Valuation and Review report

CAO ANALYST:

Paige Benavides