ACERA Board - August 15, 2024

Funding and Contribution Volatility Management

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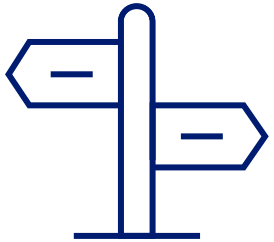
Segal

Significance of Funded Ratio

Which plan would you prefer?

	Funded Ratio	
Valuation Date	Plan A	Plan B
2024	73%	82%



Significance of Funded Ratio

Which plan would you prefer?

	Funded Ratio	
Valuation Date	Plan A	Plan B
2024	73%	82%
2023	61%	89%
2022	57%	93%
2021	46%	102%
2020	38%	118%
2019	24%	132%

Beyond Funded Ratios:

Principles for sound pension funding

Healthy governance

- Structure and culture where politics take a back seat for the ultimate goal
- Supports intergenerational equity as much as possible

Realistic assessment of liability

- Transparent, unbiased, prudent assumptions

Effective required contributions

- Amortization that identifies, tracks, and eliminates unfunded liability
- Contributions are consistently met in full

Contribution Volatility Management

Two primary considerations

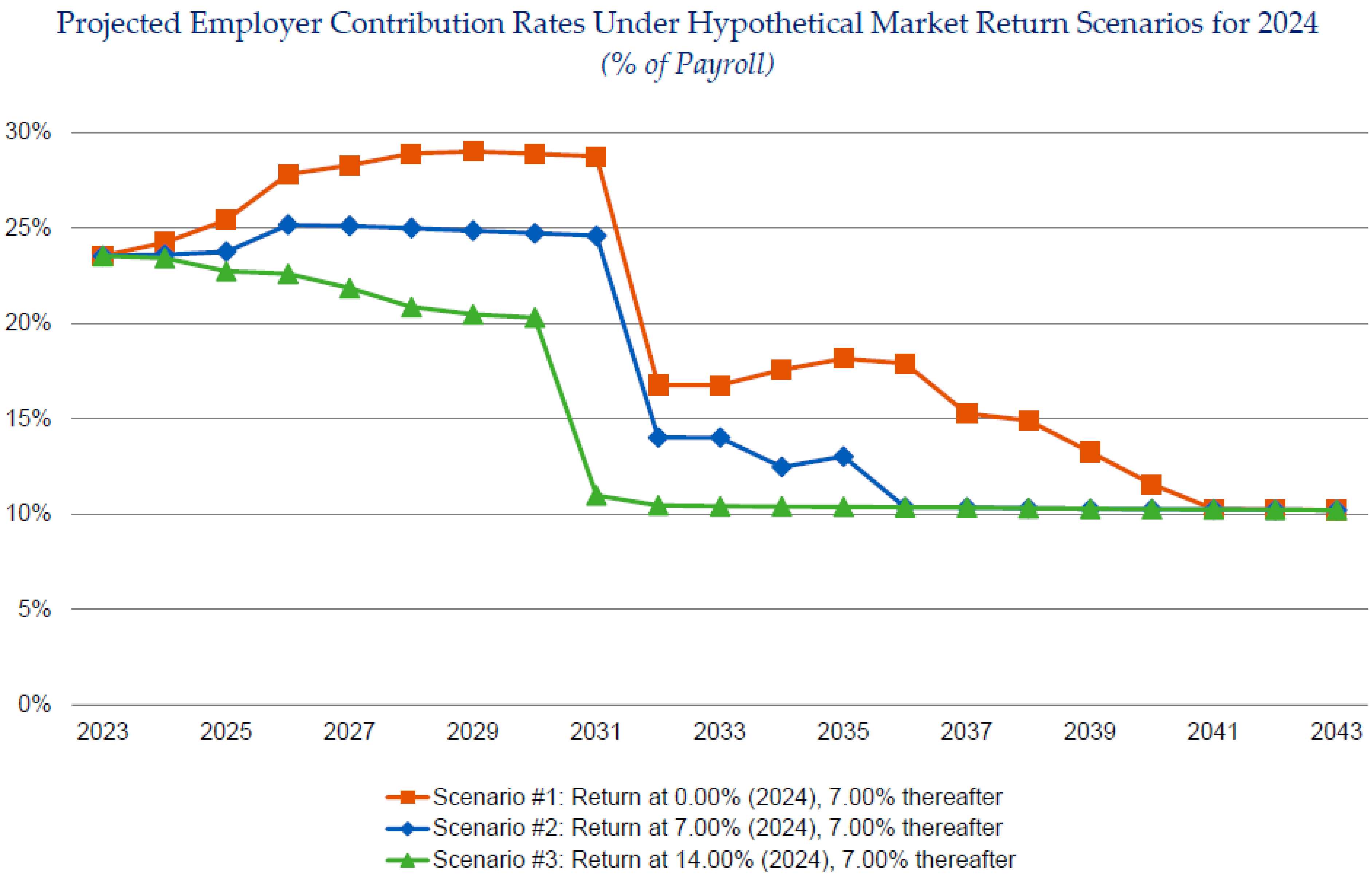
“Tail volatility” from UAAL amortization layers

- Layered amortization systematic pays off all UAAL by source
- As layers are eliminated, contribution rates will move up or down
- Occasionally, this movement can be significant and need management

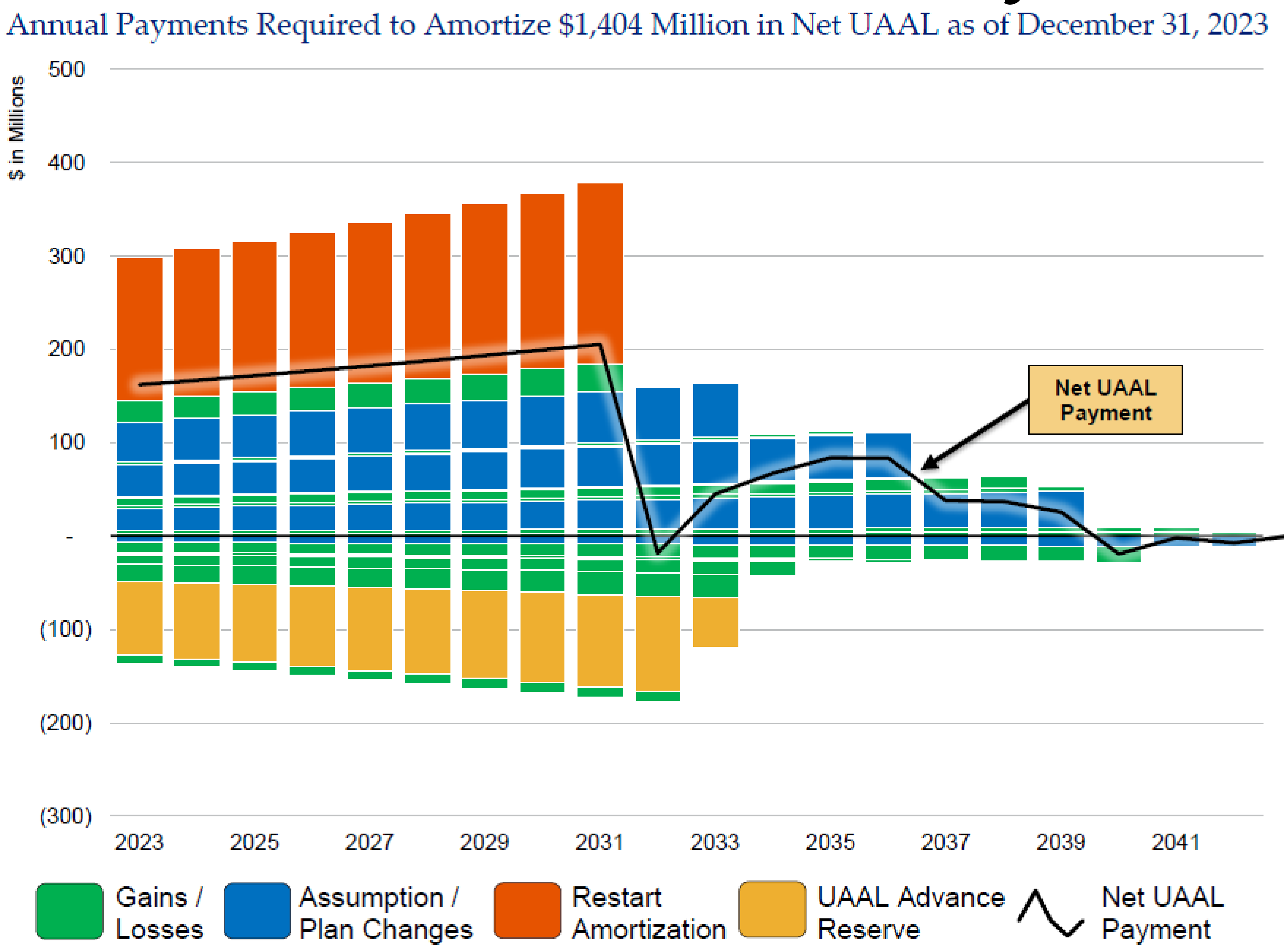
Contribution cliff when reaching surplus

- When a plan reaches surplus, <u>all</u> existing UAAL layers are wiped out
- This can also create sudden swings in contribution rates

Upcoming ACERA Contribution Cliff



ACERA's Schedule of UAAL Payments



Note: As UAAL contributions would be expected to be non-level starting with the 2032 valuation, Segal would bring back some proposals to levelize these amounts for the Board to consider.

Managing Tail Volatility

ACERA is anticipating volatility starting in 2032

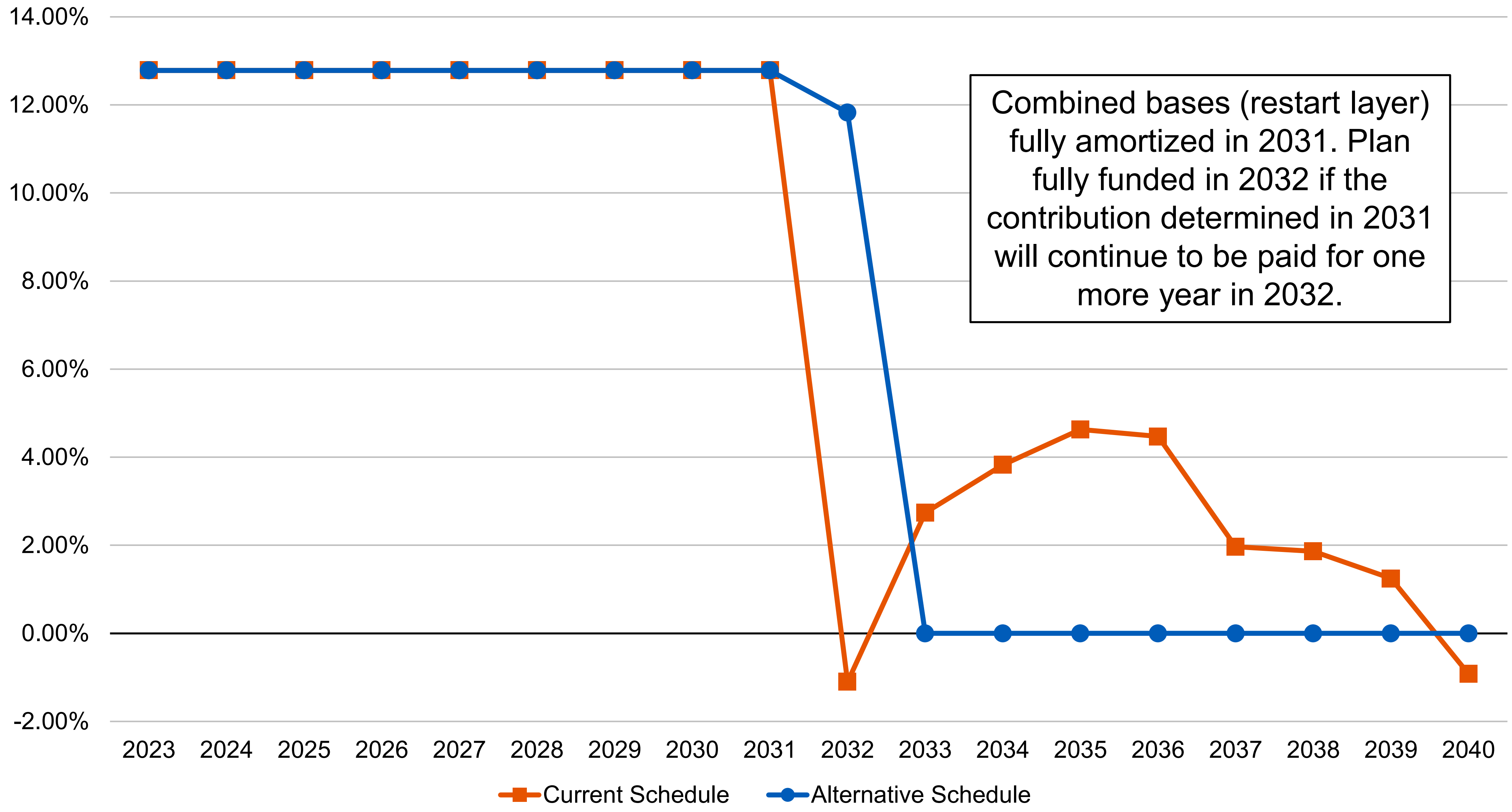
- Steep drop in contributions
- Followed by four years of increasing $ contributions

Active management of amortization periods

- Mitigating action ahead of time reduces impact on employer contributions
- Consider synchronizing payment periods for affected UAAL layers
- Generally, the goal is volatility management, not changing the funding period
  - In ACERA's case, keeping a stable contribution rate for one more year in 2032 could result in full funding in 2033

Tail Volatility Example for ACERA

Projection of UAAL Contribution Rates (% of Payroll)



Surplus Management

Considerations to enhance ACERA's Funding Policy

Best practices

- Establish a formal Surplus Management Policy within the Funding Policy
- Mitigate future contribution rate volatility
  - Avoid large drops followed by increases, where possible
- Prepare the plan to be stable in a strong funding position

Resources published in the last year

- GFOA's Core Elements of a funding policy
  - Includes specific considerations for a Surplus Management Funding Policy
- American Academy of Actuaries' Surplus Considerations for Public Plans

ACERA's Surplus Management

Already part way there

ACERA already:

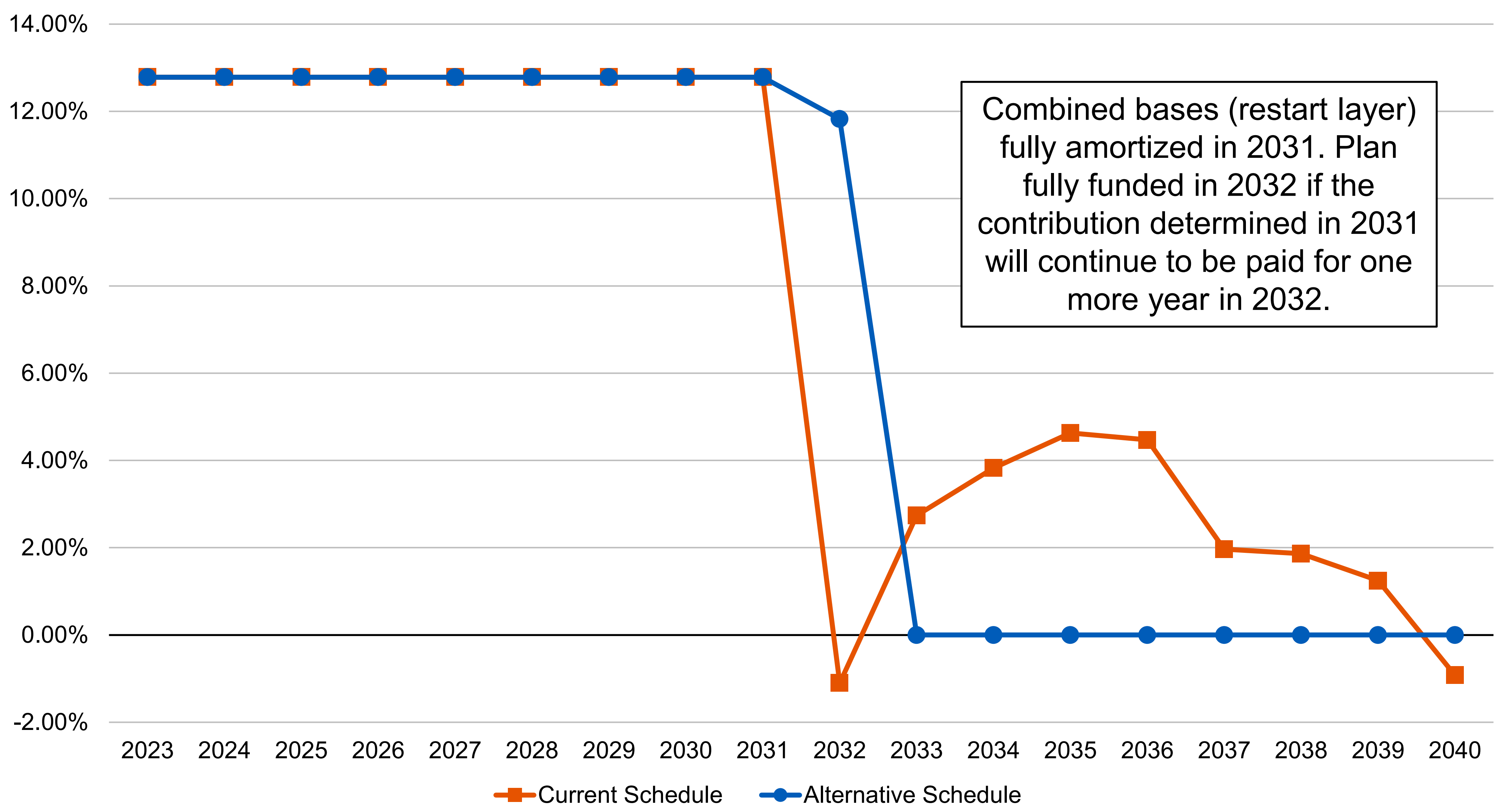
- Uses a buffer of 120% before amortizing any surplus as a credit (from PEPRA)
- Any surplus that can be amortized is done over a long "open" 30-year amortization

However, when reaching surplus, the plan is exposed to volatility

- When the UAAL rate is eliminated, contribution rates could drop significantly
  - But any following losses could immediately put the plan back in unfunded territory
- It may be desirable to reduce the UAAL rate gradually over time
  - Creating a buffer against future losses and stabilizing contribution rates

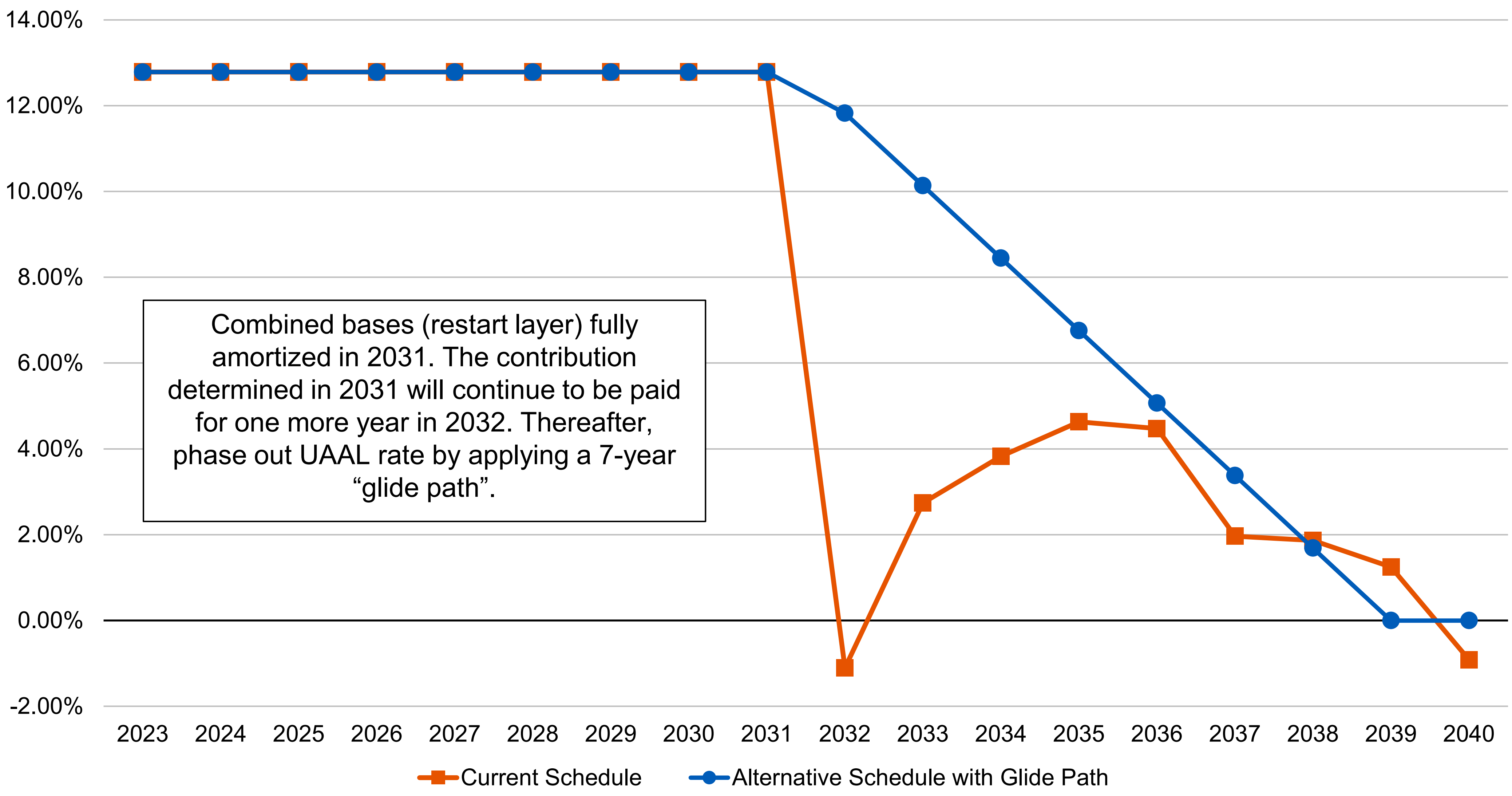
Tail Volatility Example for ACERA

Projection of UAAL Contribution Rates (% of Payroll)



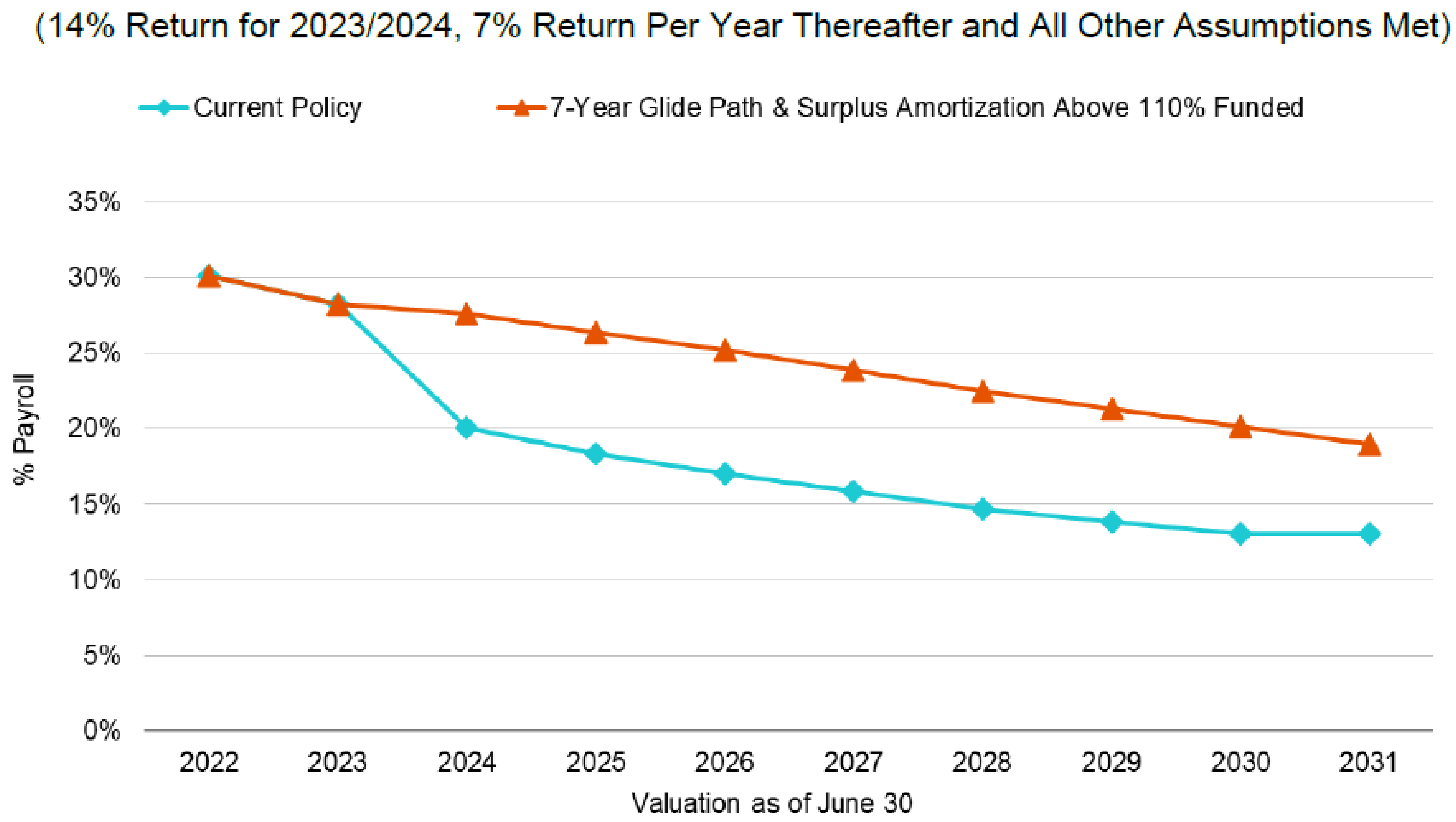
Tail Volatility Example for ACERA

Projection of UAAL Contribution Rates with Glide Path



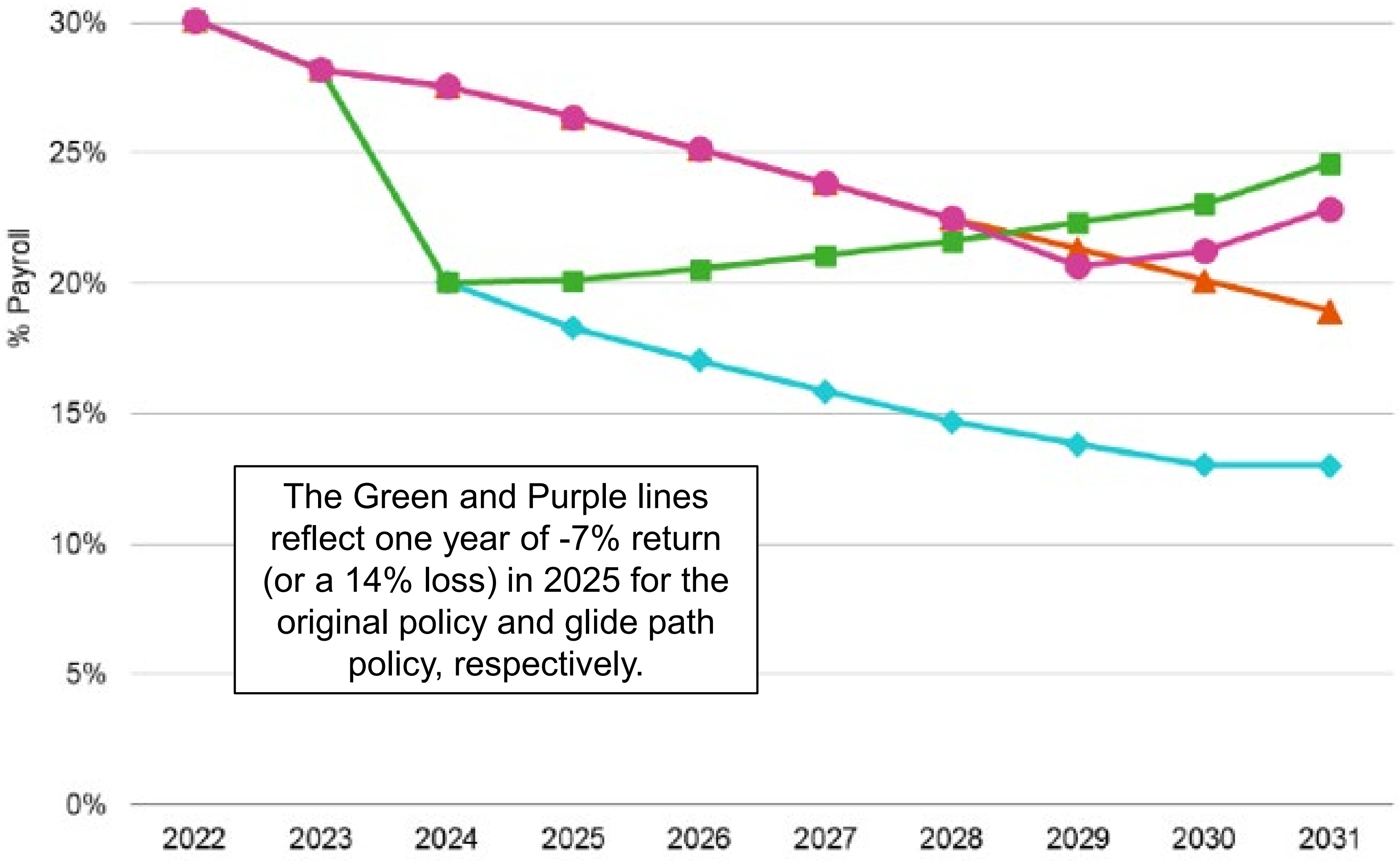
Surplus Management Case Study Example

A City Plan's 7-year linear "glide path" to phase out UAAL rate

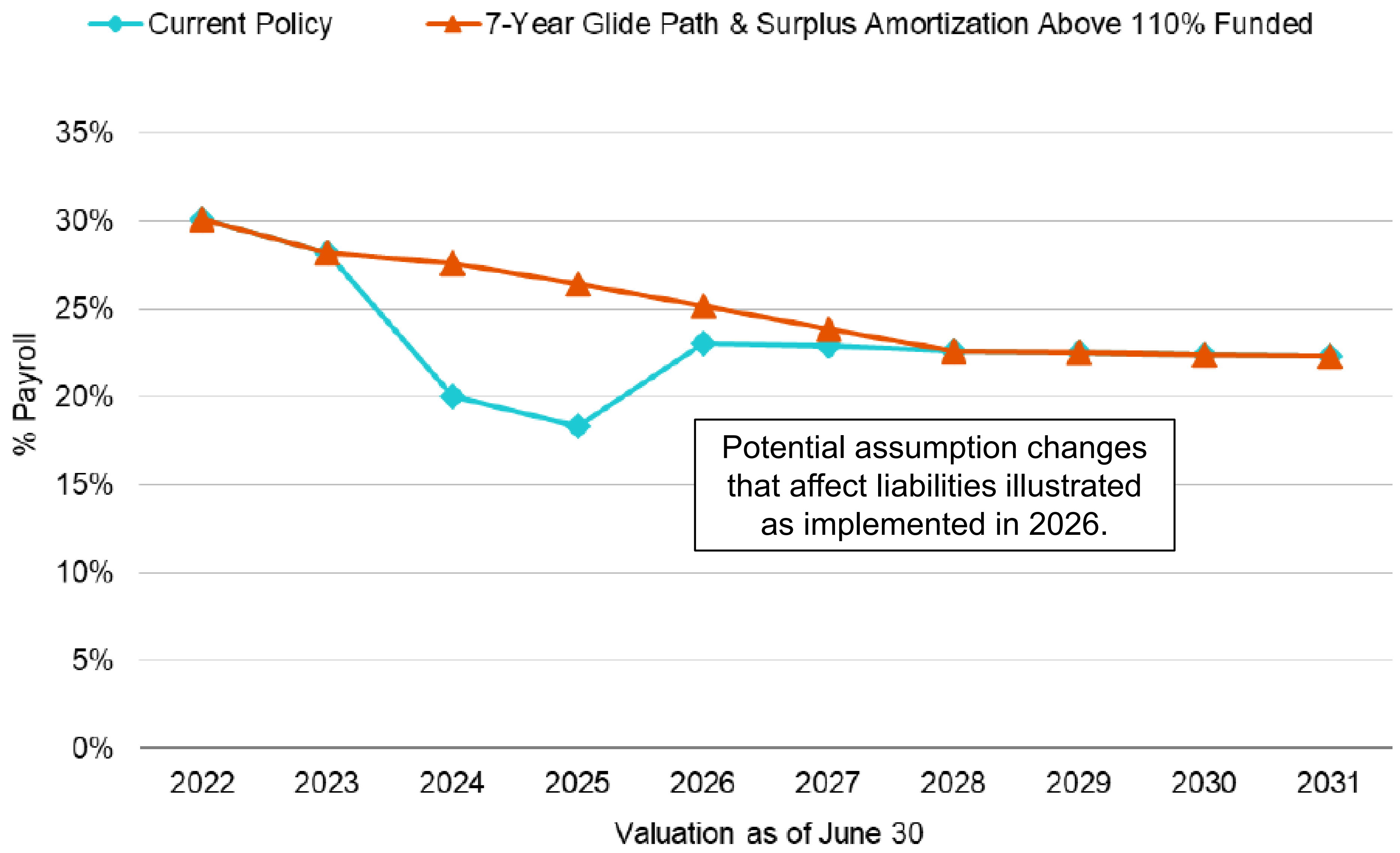


Surplus Study – Managing Asset Volatility

One year of asset shock



Surplus Study – Managing Liability Changes



In Conclusion

ACERA could consider two ways to improve contribution volatility

Mitigate “Tail volatility” from UAAL amortization layers

- By actively managing layers before big movements occur

Proactively prepare for a future surplus position

- By building a Surplus Management Policy (SMP) into the Board’s Funding Policy
- And utilizing contribution volatility mitigation strategies
  - Considering a SMP ahead of time helps support an objective process

Thank You

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