Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 14

MEETING DATE: **January 15, 2020**

SUBJECT: **UC-Davis Medical Center Pension Liabilities**

SUBMITTED FOR: ___ **Consent** _X_ **Deliberation and Action** __ **Receive and File**

RECOMMENDATION

Staff recommends the Board (1) determine that a "triggering event" has occurred regarding outstanding University of California-Davis Medical Center (UCD) pension liabilities owed to SCERS; (2) receive and file the actuarial analysis from Segal Consulting; and, (3) discuss next steps regarding collection of approximately $264,000 from UCD.

PURPOSE

This item supports the 2019-20 Strategic Management Plan to ensure funding integrity and sustainability of the plan by maintaining effective funding policies.

DISCUSSION

At the June 2019 Board Meeting, the Board approved two new policies that establish a uniform approach to ensure the equitable and adequate funding of liabilities in situations involving employers that are withdrawing or have withdrawn membership from SCERS. The policies—the Declining Employer Payroll Policy and the Terminating Employer Policy—establish procedures for identifying employers who should be subject to the policies, and establish a methodology for determining liabilities and a payment schedule needed to fund any outstanding liabilities.

While 11 participating employers now constitute the SCERS membership, the number of employers has fluctuated over time, as special districts that participate in SCERS merge with each other, consolidate with an agency covered under the California Public Employees' Retirement System (CalPERS) or other retirement system, or dissolve.

The County Employees' Retirement Law of 1937 (CERL) provides the statutory authority for district employers to both enter and exit a retirement system, while the Retirement Board retains the constitutional authority to maintain an actuarially sound system and ensure that member benefits will be paid out, even if the participating employer has withdrawn membership.

SCERS had treated these situations in the past on an ad hoc basis. For example, in 2015, residual pension liabilities for former Sacramento County Library and Air Quality employees—now special districts under CalPERS-covered agencies—were amortized and incorporated into the Sacramento County annual pension payment. In 2018, SCERS entered into a 20-year funding agreement with the Sacramento Metropolitan Fire District to pay down the remaining liabilities on behalf of the former Florin Fire Protection District, which was consolidated into the larger regional fire district that provides retirement benefits through CalPERS.

Staff has recently worked with SCERS' outside actuary, Segal Consulting, to determine if another former employer, UCD, has remaining pension obligations to SCERS.

In 1973, UC Davis took over the County's hospital system, transferring hundreds of County employees to the university. As part of the transition, County hospital employees were given the option of (1) remaining at SCERS as an active member to continue earning future service credit in SCERS while working for UCD, or (2) establishing reciprocity with SCERS and earning future service credit through the university's retirement system.

Approximately 60 hospital employees chose to remain as active SCERS members, and UCD and the employees continued to make payroll-based pension contributions to SCERS until the last active SCERS member retired in 2013. However, there are a total of seven (7) retired UCD members and beneficiaries still receiving pension payments from SCERS.

Because unfunded liabilities are traditionally built into payroll contribution rates, it becomes necessary to establish a separate payment schedule for an employer that has a declining or no payroll. Even if there are no longer active employees making payroll contributions, the employer's obligation remains ongoing until the last beneficiary dies.

Based on the Declining Employer Payroll Policy, the Chief Executive Officer recommends the Board determine that a triggering event occurred at UCD due to the employer no longer having an active employee payroll while benefits continue to be paid to retirees and beneficiaries.

The next step is to determine what assets and liabilities are attributable to the employer. The Declining Employer Payroll Policy provides a fair and transparent methodology to calculate assets and liabilities based on a point-in-time when the triggering even occurs. The UCD situation is unique in that the true triggering event occurred in 1973 with the hospital transfer; however, it would be administratively difficult to recreate the UCD contribution and benefit stream since 1973.

In consultation with Segal, Staff instead considers the triggering event to have occurred following the adopting of the Declining Employer Payroll Policy in June 2019. Using this approach, UCD will be allocated a prorated share of SCERS' unfunded actuarial accrued liability as of June 30, 2019. Segal has determined that the actuarial accrued liability was approximately $1.6 million for the seven remaining UCD retirees and beneficiaries currently receiving benefits, leaving a $264,000 unfunded liability that is owed to SCERS, based on the policy methodology.

Following this Board meeting, Staff plans to begin discussions with UCD regarding a payment plan. The policy allows up to a 20-year amortization period; however, it is more appropriate to seek a shorter repayment period, given the average age of the retired UCD members and beneficiaries is 86.2 years.

In October 2015, the Orange County Employees' Retirement System (OCERS) faced a similar situation with the legacy pension liabilities of the former Orange County Medical Center, which was purchased by UC Irvine in the 1970s. OCERS has successfully negotiated a payment schedule with UC Irvine.

BACKGROUND

A 2019 appellate court ruling found that retirement boards retain significant authority to enforce payment of contributions from employers that have deferred or retired employees currently receiving benefits from the County retirement system, even if the employer no longer has active employees in the retirement system (*Mijares v. Orange County Employees Retirement System*, 32 Cal.App. 5th 316).

The *Mijares* court also found that the unfunded liability payment is not required to be deducted from active employee payroll and recognized the system's right to recommend changes in county and district contributions as necessary.

Attachments

- Segal Consulting actuarial analysis of UCD liabilities
- Declining Employer Payroll Policy

Prepared by:

/S/

Eric Stern
Chief Executive Officer

Segal Consulting

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January 2, 2020

Mr. Eric Stern
Chief Executive Officer
Sacramento County Employees' Retirement System
980 9th Street, Suite 1900
Sacramento, CA 95814-2738

Re: Sacramento County Employees' Retirement System (SCERS)
University of California-Davis Unfunded Actuarial Accrued Liability as of June 30, 2019

Dear Eric:

As requested, we have determined SCERS' Unfunded Actuarial Accrued Liability (UAAL) that would be allocated to the University of California-Davis (UCD) members as of June 30, 2019 using the methodology as described in SCERS' Declining Employer Payroll Policy (Policy) adopted at the June 2019 Board meeting. We have determined the Actuarial Accrued Liability (AAL) and resulting UAAL that have been allocated to UCD as of June 30, 2019 based on the Policy.

In determining the UAAL, we have used the long-term actuarial assumptions (such as the 7.00% investment return assumption) assuming that there will be an annual update to the UAAL to reflect the actual experience and to reflect any new actuarial assumptions that may be adopted by the Board after June 30, 2019. This annual update is provided for in the Policy.

Also included in the Policy is the Board discretion to allow UCD to settle the UAAL through level, fixed-dollar installments over a period not to exceed 20 years. We would be glad to work with SCERS and UCD to provide payment schedules to eliminate the UAAL determined in this study that take into account characteristics of the 7 retired members[1] included in this study, if we are requested to do so.

SUMMARY OF RESULTS

After applying the Policy, we have determined UCD's UAAL to be $264,000 as of June 30, 2019.

[1] For instance, this may include considering the average age of 86.2 for the 7 retired members.

Background

UCD took over the County hospital in 1973. The then active County hospital employees were given the option of remaining at SCERS as (1) active members and to continue to earn future service credit in SCERS while working for UCD or (2) deferred reciprocal members and to earn future service credit with the University of California Retirement System (UCRS) while working for UCD.

Since all new active employers who were subsequently hired by UCD to work at the hospital have been enrolled in UCRS, UCD's remaining payroll for the SCERS members who elected the option described in (1) above has declined since 1973 and has been $0 since the last active SCERS member retired in 2013.

For the purpose of this study, we have assumed a triggering event occurred during 2019/2020 following the adoption of the Policy in June 2019. This is after consultation with SCERS and their direction not to apply the Policy retroactively in assessing UCD for a share of their UAAL for the members electing option (1) above, and to apply the Policy only with respect to service and associated benefit earned at UCD after 1973.

Allocation of UAAL under Declining Employer Payroll Policy

Based on the methodology described in the Policy, UCD would be allocated a pro-rata share of the total UAAL for their participation in the Miscellaneous membership group. That pro-rata share would be allocated based on UCD's AAL including retirees and beneficiaries as compared to the AAL for all the employers within the Miscellaneous membership group. This method explicitly assumes that liabilities for all employers in the Miscellaneous membership group are funded to the same degree (i.e., same funded ratio). The detailed calculations of the UAAL for UCD based on applying the Policy are shown in Exhibit A

Assumptions used in Calculations

Unless otherwise noted, all of the above calculations are based on the June 30, 2019 actuarial valuation results including the participant data and actuarial assumptions on which that valuation was based. That valuation and these calculations were completed under the supervision of Andy Yeung, ASA, MAAA, Enrolled Actuary.

The undersigned are Members of the American Academy of Actuaries and meet the qualification requirements to render the actuarial opinion contained herein.

Please let us know if you have any questions.

Sincerely,

Paul Angelo, FSA, EA, MAAA, FCA
Senior Vice President and Actuary

Andy Yeung, ASA, EA, MAAA, FCA
Vice President and Associate Actuary

MYM/bbf
Enclosure

Exhibit A

UNIVERSITY OF CALIFORNIA-DAVIS ALLOCATED INITIAL UAAL AFTER TRIGGERING EVENT

UCD's former employees are currently included in SCERS' Miscellaneous membership group. Also included in that membership group are members from the County and other Districts. As of June 30, 2019, there were 5 service retirees, 1 disabled retiree and 1 beneficiary with UCD who rendered service at UCD while participating as active members in SCERS on or after July 1, 1973.

Based on the methodology described in the Policy, UCD would be allocated a pro-rata share of the total UAAL in the Miscellaneous membership group. That pro-rata share would be allocated based on UCD's AAL including retirees and beneficiaries as compared to the AAL for all the employers within the same membership group.

Here are the specific steps involved in the determination of the UAAL for UCD:

Step 1: Determine the AAL for UCD as of June 30, 2019

The June 30, 2019 AAL of UCD was calculated using the membership data for UCD as of the same date. However, it is our understanding that any AAL attributable to service earned prior to July 1, 1973 should not be allocated to UCD but rather to the County. We calculated the total service for the UCD members using the total service hours provided in the data for the June 30, 2019 actuarial valuation. We allocated the portion of that total service to the County based on the elapsed time from the date of hire to July 1, 1973. The remaining service was allocated to UCD. We then allocated a pro-rata share of the AAL for each member of UCD based on the service allocated to UCD.

The AAL allocated to UCD as of June 30, 2019 was $1,601,000.

Step 2: Determine the UAAL for UCD as of June 30, 2019

We have allocated a pro-rata share of the UAAL to UCD. That pro-rata share was calculated by dividing the AAL for UCD by the AAL for all the employers within the Miscellaneous membership group. This method explicitly assumes that liabilities for all employers in the membership group are funded to the same degree (i.e., same funded ratio).

Under that method, UCD's portion of the UAAL as of June 30, 2019 would be determined in the proportion that the June 30, 2019 AAL for UCD bears to the AAL of all employers in the Miscellanous membership group. The total UAAL for the Miscellaneous membership group as of June 30, 2019 was $1,192,698,000. We have divided that amount into two pieces: (i) a UAAL of $1,101,860,000 for actuarial experience that occurred prior to July 1, 2017 that is allocated to all employers in the membership group excluding Rio Linda Elverta Recreation and Parks District and (ii) the remainder of the $1,192,698,000 which is $90,838,000 for actuarial experience that occurred on or after July 1, 2017 that is allocated to all employers in the membership group including Rio Linda Elverta Recreation and Parks District. The amount in (i) is further adjusted by (a) subtracting the $2,915,000 outstanding balance of the withdrawn employers amortization layer that is allocated to the County only and (b) adding the $31,044,897 outstanding balance of the additional UAAL due to the fact that the districts did not participate in the issuance of Pension Obligation Bonds (POBs) by the County.

The June 30, 2019 AAL for UCD was $1,601,000 while the AAL for all employers in the Miscellaneous membership group was $7,406,510,000.[2]

Based on these values, the total UAAL for UCD's members as of June 30, 2019 was $264,000.[3] This is determined by:

- multiplying the total UAAL for actuarial experience that occurred prior to July 1, 2017 that is allocated to all employers in the Miscellaneous membership group excluding Rio Linda Elverta Recreation and Parks District of $1,129,989,897[4] by the ratio of the June 30, 2019 AAL for UCD of $1,601,000 to the AAL for all employers in the Miscellaneous membership group excluding Rio Linda Elverta Recreation and Parks District of $7,406,360,000

PLUS

- multiplying the total UAAL for actuarial experience that occurred on or after July 1, 2017 that is allocated to all employers in the Miscellaneous membership group including Rio Linda Elverta Recreation and Parks District of $90,838,000 by the ratio of the June 30, 2019 AAL for UCD of $1,601,000 to the AAL for all employers in the Miscellaneous membership group including Rio Linda Elverta Recreation and Parks District of $7,406,510,000.

Accordingly, the UAAL for UCD as determined under the Declining Employer Payroll Policy as of June 30, 2019 is equal to:

$1,129,989,897 × ($1,601,000 / $7,406,360,000)

PLUS

$90,838,000 × ($1,601,000 / $7,406,510,000)

= $264,000[3]

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[2] This is the AAL for the Miscellaneous membership group including the AAL for Rio Linda Elverta Recreation and Parks District. The AAL excluding Rio Linda Elverta Recreation and Parks District is $7,406,360,000.

[3] This has been rounded to the nearest $1,000.

[4] This is equal to $1,101,860,000 minus $2,915,000 for withdrawn employers plus $31,044,897 for the POBs.

DECLINING EMPLOYER PAYROLL POLICY

PURPOSE

A participating employer of SCERS may experience an actual or anticipated material decline in the payroll attributable to its SCERS active members (SCERS-covered payroll). The Declining Employer Payroll Policy is intended to establish guidelines by which SCERS ensures that such employer will continue to satisfy its obligation to timely pay all unfunded actuarial accrued liability (UAAL) attributable to the prior and future service of active, retired, and deferred SCERS members who are or were the participating employer's employees, and their beneficiaries.

POLICY

A participating employer remains liable, and must make the required appropriations and transfers to SCERS for the participating employer's share of liabilities attributable to its members who are and may be entitled to receive retirement, disability, and related benefits from SCERS. It is the Board of Retirement's intent to allow an employer covered by this Policy to satisfy its funding obligation in a manner which provides the employer reasonable flexibility; however, primary consideration will be given to ensuring the adequacy of the assets attributable to the employer to satisfy the employer's funding obligations.

APPLICATION

Absent exigent circumstances or unless otherwise expressly approved by the Board of Retirement (the Board) at a duly-noticed public meeting, the procedures and guidelines for implementing this Policy are set forth below.

Commencement of Coverage – Triggering Events

This Policy covers only those employers for whom the Board determines, based on a recommendation from SCERS' Chief Executive Officer (CEO), that a triggering event as described in this section has occurred and who are not excluded from coverage under this Policy as described in the "Exclusions from Coverage; Terminations of Coverage" section below. The fact that a triggering event may have occurred in the past does not prevent SCERS from applying this policy to that employer. The Board hereby directs the CEO to work with SCERS' staff and SCERS' actuary to obtain the information (e.g., SCERS-covered payroll history) needed for the Board to make determinations regarding triggering events.

Triggering event resulting from ceasing to enroll new hires: Some SCERS participating employers cease to enroll new hires with SCERS but, for a period of time, continue to have at least some previously-enrolled employees maintaining their status as active SCERS members. These employers' SCERS-covered payroll will eventually diminish to zero as their active employees retire or otherwise terminate employment. Examples of employers in this category may include an employer that is acquired by another entity that is not a SCERS participating employer, or a SCERS employer that covers some of its employees through another pension system such as CalPERS or a 401(k) plan. There may be other examples as well.

Triggering event resulting from a material and permanent reduction in SCERS-covered payroll: Some employers may experience a material reduction in their SCERS-covered payroll, but nevertheless continue to enroll their new hires with SCERS. The reduction may be sudden (e.g., due to a discrete event such as a partial loss of funding, or partial outsourcing), or it may be more gradual, over a period of years, and might not be tied to a discrete event. Generally, the Board would determine that this type of triggering event has occurred only if the Board expects that the reduction in an employer's SCERS-covered payroll is expected to be permanent or for an indefinite period of time with no reasonably foreseeable end. Generally, by its nature, the determination whether this type of triggering event has occurred is more subjective than that described in the paragraph immediately above.

Exclusions from Coverage; Terminations of Coverage

This Policy also covers only those employers which are a) financially-viable entities when a triggering event occurs, and b) which SCERS expects to continue indefinitely thereafter to be financially-viable entities. This Policy does not cover any other situation, including, without limitation, an employer going out of business by reason of dissolution, loss of funding, consolidation or merger (unless there is a surviving financially-viable entity that is acceptable to the Board that will make the ongoing payments under the Policy). This Policy also does not cover a "terminating employer" that ceases to provide SCERS membership for all of the employer's active SCERS members (i.e., as of a date certain, withdraws both new hires and existing actives from membership with SCERS).

The Board of Retirement also recognizes that participating employers covered by this Policy will have UAAL funding obligations for several years. Therefore, if concerns arise during that period of time regarding the employer's ongoing existence as a financially-viable entity, the Board may remove the employer from coverage under this Policy and/or take any other measures that may be available to ensure the actuarial soundness of the Plan including, without limitation, assessing the entire amount of the employer's projected UAAL (as recommended by the fund's actuary and approved by the Board) using a risk-free interest rate assumption and payable in a single sum immediately due.

Procedures

1. The CEO will (i) work with SCERS' staff and actuary, and SCERS' participating employers to obtain the information (e.g., SCERS-covered payroll history, financial reports) needed for the Board to make determinations regarding triggering events

and exclusions from, or terminations of, coverage and (ii) report to the Board, as necessary, regarding these activities.

2. Upon a recommendation from the CEO and notice to the affected participating employer, the Board will make a determination at a duly-noticed public meeting regarding (i) whether a triggering event has occurred for the employer, (ii) whether the employer should be excluded from coverage under this Policy, and (iii) for those employers that the Board has previously determined to be covered under the Policy, whether their coverage should be terminated under the “Exclusions from Coverage; Terminations of Coverage” section above. Employers may be required to provide SCERS with updated employee census and payroll data and financial reports. (See Government Code 31543.)

3. If the Board determines that a triggering event has occurred and the employer is not excluded from coverage under the Policy, then, solely for purposes of determining the covered employer’s UAAL contribution obligation, SCERS will segregate all assets and liabilities attributable to the employer based upon the recommendation of SCERS’ actuary, and shall maintain such separate accounting for the employer until all of the participating employer’s obligations to SCERS have been fully satisfied.

4. SCERS’ actuary will determine, and certify to the Board of Retirement, the covered employer’s funding obligation for its initial UAAL, which obligation shall not be pro-rata based on payroll, but rather based on the employer’s actuarial accrued liability (AAL) including inactive members, when determinable. Otherwise, the Board may use other methodologies to determine the liability as recommended by SCERS’ actuary, including but not limited to the pro-rata share based on payroll. The Board may determine to require the employer’s contributions to be paid in level, fixed-dollar amounts over a period not to exceed twenty (20) years, beginning on July 1 of the plan year immediately after the plan year in which the triggering event occurs. The Board of Retirement has the sole authority to modify the installment period if:

    - The employer demonstrates to the Board of Retirement’s satisfaction that the payment schedule causes undue hardship; or

    - The Board of Retirement determines, at any time before the end of the installment period, that the installment period is insufficient to ensure adequate funding of the employer’s obligation.

5. The actuary will use the actuarial valuation performed for SCERS as of the end of the plan year immediately prior to the plan year in which the triggering event occurs (and based on all of SCERS’ then current actuarial assumptions and methodologies) to determine the initial valuation value of assets (VVA), a smoothed value, allocated to the covered employer. That initial VVA will be a pro-rata allocation based on the employer’s AAL (i.e., based on the employer’s initial UAAL allocation as described in 4. above). Later values of the VVA (i.e., those used in the future valuations described below) shall be determined by rolling forward the initial VVA, adding contributions, deducting benefit payments, and crediting earnings at the actual smoothed (VVA) earnings rate on total SCERS assets.

6. Annually, after the determination of the covered employer's initial funding obligation, as part of the regular annual actuarial valuation of the plan, SCERS' actuary will measure any change in the UAAL of the participating employer due to actuarial experience or changes in actuarial assumptions. In addition to the amortized payments for the covered employer's initial UAAL determined as of the initial valuation, the employer will be liable for, and must contribute to SCERS, any such new UAAL determined as of subsequent valuations, based upon an amortization schedule recommended by the actuary and adopted by the Board of Retirement. If a negative UAAL (Surplus) exists, SCERS will hold the Surplus to be applied against any future UAAL of the covered employer.

7. If any Surplus remains after the covered employer has satisfied all of its UAAL obligations (Final Surplus), SCERS will distribute the Final Surplus in accordance with the terms of applicable law.

Notwithstanding anything to the contrary herein, the SCERS Board of Retirement hereby reserves the right to pursue any other remedies under applicable law that, depending on the circumstances, may be available to "ensure the actuarial soundness of the retirement system" (See Government Code 31564.2(d)).

BACKGROUND

Pursuant to Gov. Code 7522.52, 31453.5, 31581, 31582, 31584, 31585, 31586, 31611, and other applicable provisions of law, a participating employer remains liable, and must make the required appropriations and transfers to SCERS for the participating employer's share of liabilities attributable to its officers and employees who are and may be entitled to receive retirement, disability, and related benefits from SCERS.

SCERS retains significant authority to enforce payment of contributions from employers that have deferred or retired employees currently receiving benefits from the County retirement system, even if the employer no longer has active employees in the retirement system (*Mijares v. Orange County Employees Retirement System*, 32 Cal.App. 5th 316).

The *Mijares* court also found that the unfunded liability payment is not required to be deducted from active employee payroll and recognized the system's right to recommend changes in county and district contributions as necessary.

RESPONSIBILITIES

Executive Owner: Chief Executive Officer

POLICY HISTORY

Date	Description
06-19-2019	Board approved policy