



# CASH MANAGEMENT POLICY

## PURPOSE

This Policy identifies processes and tools to assist the Sacramento County Employees' Retirement System (SCERS, the Plan, or the System) in the management of cash, monitoring of liquidity, and the management of liquidity risk.

The objectives of the cash management policy are to:

- Ensure that member benefit payment and funding obligations are met without interruption regardless of financial market conditions.
- Provide a process for the oversight and management of cash.
- Oversee liquidity risk and maintain appropriate liquidity profiles within the SCERS Plan.

## POLICY

SCERS' assets are broken into different liquidity categories, measured by the expected time it takes to convert an asset into cash. They are shown below from most liquid, including cash, to least liquid. The ability to convert an asset into cash within the non-cash categories is impacted by whether financial markets are in a "normal" or "stressed" liquidity environment. A stressed liquidity environment occurs during a broad disruption within financial markets that could have unfavorable effects on the Plan's ability to meet liquidity needs. A stressed liquidity environment is often triggered by a severe, unanticipated market or non-market event.

### Dedicated Cash Allocation

- A dedicated cash allocation is included in SCERS' strategic asset allocation and serves as a key liquidity tool.
- The cash allocation is intended to close the gap between annual benefit payments and total contributions in an environment where investment earnings fall short of the targeted assumed rate of return and will be used prior to other Plan assets during a stressed liquidity environment.

### Other Cash

- Cash excluded as part of the dedicated cash allocation is reserved for other uses. This cash includes:
  - Prepayment of employer annual contributions.
  - Cash held to fund alternative assets commitments.
  - Distributions from illiquid assets and investment income.
- Other Cash is reserved for:
  - Monthly benefit payments.
  - Funding of private market capital calls.
  - Other plan expenses.
- Cash not included as part of the dedicated cash allocation is invested by SCERS' Overlay Program in a manner which replicates SCERS' policy target strategic asset allocation and is exposed to market risks.
- This 'Other Cash' can be used to supplement cash needs over interim time periods; however, it is reserved for future uses as described above.

### Liquid Financial Assets

- Assets that typically have the ability to convert to cash within 1 to 7 days in a "normal" liquidity environment, and 7 to 10 days in a "stressed" liquidity environment.
- Includes: Public Equities (both domestic and international) and Fixed Income (U.S. Treasuries; core/core plus fixed income).
  - U.S. Treasuries represent SCERS' most liquid asset outside of cash, typically offering 1-day liquidity regardless of liquidity environment.
    - Often trade at a higher value in a stressed market environment.
    - U.S. Treasuries are a favored liquidity source outside of cash.
  - Core plus fixed income typically provides liquidity in approximately 3 to 7 days depending on the liquidity environment and is also considered a favored liquidity source.
    - Typically lose less value than "risky" assets such as public equities during a stressed market environment, and can sometimes trade at a higher value.
  - U.S. equities are typically more liquid (3-7 days) than non-U.S. equities (7-10 days).
    - U.S. and non-U.S. public equities typically experience meaningful losses during a broad market downturn, and are considered an

unfavorable source of liquidity, as liquidity taken during a market downturn will typically result in selling assets at discounted prices.

### Semi-Liquid Assets

- Assets that are invested within open-end commingled funds with monthly and quarterly liquidity in a “normal” liquidity environment.
- Includes: Absolute Return, Core Real Estate, and parts of Real Assets (Infrastructure).
- Liquidity can move from monthly/quarterly in a ‘normal’ liquidity environment to one year or greater in a “stressed” liquidity environment.

### Illiquid Financial Assets

- Assets that are invested within closed-end multi-year fund structures.
- Includes: Private Equity, Private Credit, Real Assets, and Non-Core Real Estate.
- For liquidity purposes, these assets are defined as having the ability to convert to cash in one year or greater, whether in a “normal” or “stressed” liquidity environment.
  - These are typically 5-15 year fund structures, and are generally held until maturity.
  - Liquidity can be gained through the secondary markets; however, this can result in realizing a discounted price to fair market value.
- Liquidity becomes more limited in a “stressed” liquidity environment.

## **APPLICATION**

### Liquidity Measurement

SCERS shall keep track of the liquidity profile of the overall Plan. SCERS’ investment consultants and actuarial consultant will assist in forecasting cash flows, and SCERS’ general investment consultant will perform a liquidity analysis. SCERS’ liquidity will be measured in the form of a liquidity coverage ratio that compares the Plan’s liquid assets and cash inflows to the Plan’s cash outflows and expenses, including:

Liquid assets and cash inflows:

- Liquid financial assets
- Total employer and employee contributions
- Distributions from illiquid assets (i.e., private equity; private credit; real assets; real estate)
- Investment Income

Cash outflows and expenses:

- Member benefit payments
- Plan expenses
- Capital calls for illiquid assets

The objective is for the aggregate of liquid financial assets and total cash inflows to be greater than total cash outflows and expenses. A liquidity coverage ratio provides a gauge whether SCERS has sufficient liquidity coverage with Cash and Liquid Financial Assets to cover cash outflows over a designated time period after a major market dislocation (i.e., 5 years), and not be in a position where it needs to sell Illiquid Financial Assets to meet plan obligations. It provides an indication of the level of illiquid financial assets exposure the Plan can maintain, with the higher the liquidity coverage ratio the higher the potential exposure to illiquid assets.

To error on the side of prudence, a more conservative liquidity coverage ratio will also be measured, which will measure only the liquidity of Liquid Financial Assets that the Plan would be more comfortable using and/or selling in a stressed market environment in which broad markets are likely down in value. These include cash, U.S. Treasuries, and core/core plus fixed income, rather than public equities, which as referenced above tend to experience meaningful losses during a broad market downturn, and would not be favorable to sell for liquidity purposes.

#### Measurement Period

SCERS' Staff (Staff) and SCERS' general investment consultant will evaluate and monitor SCERS' liquidity profile on an ongoing basis and will report to SCERS' Board of Retirement (Board) any identified liquidity issues. At a minimum, Staff and SCERS' general investment consultant will update the Board on SCERS' liquidity profile annually. A meaningful imbalance between the level of the Plan's liquid assets and cash inflows and the Plan's cash outflows and expenses will trigger a discussion with the Board to identify a course of action to address the potential liquidity shortfall.

#### Cash Flow Forecasting

Cash flow forecasts will be prepared for all areas of the Plan where business activity can result in a material impact to the liquidity coverage of the System.

SCERS' actuarial consultant will provide forecasts of member benefit payments, and employer and employee contributions that are used as inputs into the calculation of the liquidity coverage ratio.

For the purpose of creating annual investment plans for private market asset classes, and as an input to the calculation of a liquidity coverage ratio, SCERS' alternative assets and real estate consultants will provide private market cash flow forecasting on an annual basis, or more frequently as needed. This data will be primarily focused on Private Equity,

Private Credit, Real Assets, and Real Estate asset classes. The private market cash flow forecasting typically covers new commitment pacing, fair value as a percentage of plan assets estimates, and net cash flow forecasts over a 10-year period.

### Rebalancing

SCERS employs an Overlay Program to rebalance the asset allocation to policy targets and minimize the risk that SCERS falls short of achieving its targeted return due to the asset allocation straying from policy target ranges. The Overlay Program also invests all available cash outside of the dedicated cash allocation, including: (1) unallocated cash; (2) cash balances in manager portfolios; and (3) cash held for previously committed to, but un-invested private market investments, in a manner which replicates SCERS' policy target strategic asset allocation.

As an alternative to overlay rebalancing, SCERS also employs physical rebalancing: (1) when there is low correlation between the overlay proxies designed to replicate the underlying asset classes and managers, as is the case with many alternative assets; and (2) when there is a persistently large difference between physical assets and the target allocation.

Physical rebalancing will serve as an additional tool to managing cash flows by reducing exposure to asset classes that are overweight to their respective target allocations, and adding exposure to asset classes that are underweight their respective target allocations, including the dedicated cash allocation.

### County Pooled Investment Fund

SCERS will maintain an adequate cash balance within the Sacramento County Pooled Investment Fund (PIF) to meet SCERS' cash flow needs and payment obligations. Below are characteristics of the cash balance held in the PIF:

- Includes bi-monthly employer and employee contributions, and other cash inflows;
- The amount of cash will vary on a monthly basis depending on the timing of cash inflows and outflows;
- SCERS will not maintain an excessive balance, and any excessive cash will be transferred to SCERS' custodial cash account; and,
- Cash held in the PIF will be accounted for within SCERS' total portfolio in combination with the aggregate cash levels held at SCERS' custodian.

Annual prepayments of employer contributions will not be held in the PIF:

- The annual prepayment will be transferred to the custodian and invested through SCERS' overlay program according to SCERS' strategic asset allocation, to earn

a return in line with the discount that is embedded into the annual employer prepayment.

- The annual prepayment incurs a wider variety of markets risks including equity, credit, and duration risk, and therefore necessitates longer holding periods as these funds are drawn down over the following year.

## **BACKGROUND**

The Board has the sole and exclusive responsibility to administer SCERS in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The Board may delegate certain responsibilities to SCERS' Staff for purposes of implementation, administrative efficiency, and expertise. Among these responsibilities are the management of cash, monitoring of liquidity, and the management of liquidity risk in order to assist the Board with its fiduciary duties.

SCERS' strategic asset allocation emphasizes diversification across market segments to reduce volatility and portfolio downside risk, reduce the range of outcomes that the portfolio is subjected to, and generate increasing levels of cash flows. However, in a stressed market environment, SCERS' assets can experience negative returns, which will make earning the actuarial rate of return challenging. Falling short of the actuarial rate of return over an extended period could put pressure on SCERS' ability to meet benefit payment and funding obligations, which emphasizes the need for maintaining sufficient liquidity within the investment portfolio. The cash management policy will assist in ensuring that SCERS is in a sufficient liquidity position across economic and market cycles.

## **RESPONSIBILITIES**

Executive Owner: Chief Investment Officer

## **POLICY HISTORY**

<b>Date</b>	<b>Description</b>
05-15-2024	Board amended policy
09-21-2022	Board re-affirmed policy with minor corrections
08-21-2019	Board approved Cash Management Policy