Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 5

MEETING DATE: **December 20, 2017**

SUBJECT: **Interest Crediting Rate on Member Contribution Accounts for December 31, 2017**

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

RECOMMENDATION

Staff recommends the Board authorize staff to credit interest to member contribution (employee reserve) accounts for the six-month period ending December 31, 2017, at a rate that is equal to one-half of the 5-year Treasury Note rate in effect on December 31, 2017 (approximately 1.055%) or equal to one-half of the interest rate applied to the other valuation reserves (approximately 1.874%), whichever is lower.

The Board's approval of this request prior to the effective interest crediting date will enable staff to more efficiently serve our members, since the interest crediting process will commence in early January 2018. This will enable more expedient processing of retirement applications, contribution withdrawals, and public service credit purchases.

PURPOSE

To comply with the requirements of County Employees' Retirement Law of 1937, Article XVI, Section 17 of the California Constitution, and other provisions of state and federal law applicable to public retirement systems requiring SCERS to apply available earnings to the active member contribution reserves.

DISCUSSION

In accordance with the law and the Board's Interest Crediting and Unallocated Earnings Policy, interest is credited to member contribution accounts semi-annually on June 30th and December 31st**. Staff estimates that SCERS will have sufficient funds to credit the member contribution accounts at one-half of the 5-year Treasury Note rate** to be published for December 31, 2017 and to credit all valuation reserves at the overall 3.50% interest crediting rate for the six-month period ending December 31, 2017 or 7.00% annually.

Staff's interest crediting estimate is based on the estimated financial data for the six-month period ending December 31, 2017, most significantly impacted by SCERS' investment performance and the portion of net deferred losses to be recognized in valuation assets for the six-month period ending December 31, 2017.

Estimate of Funds Available for Interest Crediting

The following findings were applied in estimating the funds available for interest crediting:

	June 30, 2017	**November 30, 2017**	**Increase**
Market Value of Assets (in Millions)	$8,584.2	$8,920.8	$336.6

SCERS' actual gain on the market value of assets as of November 2017 approximated $413.5 million (or 4.8%). This increase in market value exceeds the expected market return of $301.8 million for the first six months by $111.7 million, which will be recognized in valuation assets over the seven-year actuarial smoothing period.

	July 1 to December 31, 2017 (in Millions)
Average Market Value of Assets	$8,621.8
Expected Return (7.0%)	$301.8
Estimated Year-to-Date Return as of November 30, 2017	$413.5
Return in Excess of Expected Return	$111.7

Half of one-seventh of the $111.7 million gain or $8.0 million will be recognized in valuation assets for the first six months of fiscal year 2017-2018. When combined with the $4.7 million of net deferred losses that will also be recognized during this period, the net gain to be recognized in the first six months of fiscal year 2017-2018 is $3.3 million.

	(Amounts stated in Millions)		
	Amount	**FY 2016-2017 Gains/(Losses) Recognized**	**Deferred Gain/(Loss)**
Net Deferred Loss as of June 30, 2017	($81.0)	($4.7)	($76.3)
Return in Excess of Expected Return for the First Six Months of Fiscal Year 2017-2018	$111.7	$8.0	$103.7
Net Deferred Gain as of December 31, 2017		**$3.3**	**$27.4**

The estimated amount available for interest crediting during the six-month period ending December 31, 2017 is as follows:

	Amount (in Millions)
Expected Return for the First Six Months of FY 2017-2018	$301.8
Gain Recognized for the First Six Months of FY 2017-2018	$3.3
Amount Available for Interest Crediting in December 2017	**$305.1**

The assumed annual increase in asset market value is based on the estimated average market value of net assets. However, the actual interest crediting obligation as of December 31, 2017 will be based on (1) the actuarially smoothed value of valuation reserves, rather than the market value of net assets; and (2) the adjusted balance of the valuation reserves as of the December 31, 2017 actuarial valuation.

Estimated Interest Crediting

The estimated amount required to credit all valuation reserves at the assumed earnings rate of 7.00% annually or 3.50% semi-annually and the estimated amount available for interest crediting for the six-month period ending December 31, 2017 are shown below:

	Employee Reserves		**All Other Reserves**		**Total**	
	Amount (in Millions)	**Percentage**	**Amount** (in Millions)	**Percentage**	**Amount** (in Millions)	**Percentage**
Available for Interest Crediting					$305.1	
Required to Credit All Valuation Reserves at the Assumed Earnings Rate	$8.1	1.055%	$285.3	3.747%	$293.4	3.500%
Earnings in Excess of Amount Required to Credit Interest					**$11.7**	

Valuation reserves were estimated based on actual contributions and benefit payments experience through November 30, 2017 and a projection of consistent experience for the month of December 2017.

Variability of Estimated Interest Crediting for December 31, 2017

The 5-Year Treasury Note rate will be used in determining the interest crediting rate for member contribution accounts as of December 31, 2017. As of December 6, 2017, the 5-Year Treasury Note rate was 2.11%. If that is the rate in effect on December 31st, member contribution accounts for the six-month period ending December 31st would be credited with 1.055% interest.

While the rate could increase between now and December 31st, under the Interest Crediting and Unallocated Earnings Policy, the employee reserve crediting rate would be capped at one half of the amount applied to other valuation reserves (i.e. one half of 3.747% or 1.873%).

This estimate may change if investment returns in December are substantially lower, if the Treasury Note rate changes, or if the ratio of employee reserves to total valuation reserves varies from staff estimates. However, an increase in the Treasury Note rate will not affect the amount needed to credit all reserves.

BACKGROUND

The Interest Crediting and Unallocated Earnings Policy provides guidance pertaining to member contribution accounts:

> Interest will be credited to the active employee contribution reserves semi-annually. The interest crediting rate will be one-half of the United States 5-Year Treasury Note Rate for the last business day of the interest crediting period in the Federal Reserve Statistical Release H.15 Selected Interest Rates, with the following provisos: (a) the active member contribution reserves interest crediting rate will be no greater than one-half of the actuarial assumed earnings rate (currently 7.00%); and (b) if the projected interest crediting rate for the other valuation reserves is less than one-half of the overall target crediting rate for the valuation reserves (i.e., 3.50% or one-half of 7.00%), the interest crediting rate for the active member contribution reserves will be one-half of the interest rate applied to the other valuation reserves or one-half of the Treasury Note Rate, whichever is lower.

ATTACHMENTS - None

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