Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 7

MEETING DATE: **December 19, 2018**

SUBJECT: **Interest Crediting Rate on Member Contribution Accounts for December 31, 2018**

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

RECOMMENDATION

Staff recommends that the Board authorize interest crediting to member contribution (employee reserve) accounts for the six-month period ending December 31, 2018, at a rate that is equal to one-half of the 5-year Treasury Note rate in effect on December 31, 2018 or equal to one-half of the interest rate applied to the other valuation reserves, 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. This will enable more expedient processing of retirement applications, contribution withdrawals, and public service credit purchases.

PURPOSE

This item supports the FY 2018-19 Strategic Management Plan to maintain prudent and effective funding policies and practices that assist in producing low contribution rate volatility and plan sustainability.

DISCUSSION

Interest is credited to member contribution accounts semi-annually on June 30th and December 31st in accordance with legal requirements and SCERS' Interest Crediting and Unallocated Earnings Policy**. 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, 2018, and to credit all other valuation reserves based on the assumed rate of return at 3.5% (7.0% annual percentage rate) for the six-month period ending December 31, 2018.

Staff's interest crediting amount was based on estimated financial data for the six-month period ending December 31, 2018, which reflects SCERS' estimated investment performance, and the portion of net deferred losses to be recognized in the valuation assets for the six-month period ending December 31, 2018.

Estimate of Funds Available for Interest Crediting

Estimated interested crediting was based on the following amounts:

	June 30, 2018	*November 30, 2018*	*Decrease*
Market Value of Assets (in Millions)	$9,251.9	$9,180.1	$71.8

SCERS' loss for the six-month period ending December 31, 2018 is estimated to be $9.8 million (-0.1%), and the average market value of assets during this period is estimated to be $9.3 billion. The expected return of $326.0 million exceeds the estimated loss of $9.8 million for the six months ending December 31, 2018, which results in an actuarial loss of $335.8 million.

	July 1 to December 31, 2018 (in Millions)
Average Market Value of Assets	$9,313.6
Expected YTD Return as of December 31, 2018 (3.5% for six months)	$326.0
Estimated YTD Loss as of December 31, 2018	($9.8)
Loss in Excess of Expected Return	($335.8)

Half of one-seventh of the $335.8 million actuarial loss (or $24.0 million) will be recognized in valuation assets for the six months ending December 31, 2018. When combined with the $12.1 million of net deferred gains that will also be recognized during this period, the net loss to be recognized in the six-month period ending December 31, 2018 is ($11.9) million.

	(Amounts Expressed in Millions)		
	Amount	**Gains/(Losses) Recognized**	**Deferred Gain/(Loss)**
Net Deferred Gain as of June 30, 2018	$128.9	$12.1	$116.8
Loss in Excess of Expected Return for the Six Months Ending December 31, 2018	($335.8)	($24.0)	($311.8)
Estimated Net Deferred Loss as of December 31, 2018		**($11.9)**	**($195.0)**

The estimated amount available for interest crediting during the six-month period ending December 31, 2018 is as follows:

	Amount (in Millions)
Expected Return for the first six months of FY 2018-19	$326.0
Net Loss Recognized for the first six months of FY 2018-19	($11.9)
Amount Available for Interest Crediting in December 2018	**$314.1**

The actual interest crediting obligation as of December 31, 2018, 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 December 31, 2018.

Estimated Interest Crediting

The estimated amount required to credit all valuation reserves at the assumed rate of return of 3.5% semi-annually (7.00% annually) and the estimated amount available for interest crediting for the six-month period ending December 31, 2018 are shown below:

	Employee Reserves		All Other Reserves		Total	
	Dollar Amounts Expressed in Millions					
	Amount	Percentage	Amount	Percentage	Amount	Percentage
Available for Interest Crediting					$314.1	
Required to Credit All Valuation Reserves at the Assumed Interest Rate	$11.0	1.350%	$296.7	3.719%	$307.7	3.500%
Assumed Earnings in Excess of Amount Required to Credit Interest					**$6.4**	

Valuation reserves were estimated based on actual contributions and benefit payments through November 30, 2018 and a projection of consistent contributions and benefit payments for the month of December 2018.

Variability of Estimated Interest Crediting for December 31, 2018

The 5-Year Treasury Note rate will be used in determining the interest crediting rate for member contribution accounts as of December 31, 2018. As of December 7, 2018, the 5-Year Treasury Note rate was 2.700%. If that is the rate on December 31st, member contribution accounts for the six-month period ending December 31st would be credited with 1.350% 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 3.719% or 1.860%).

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’s 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:

> The semi-annual interest crediting rate for Member Contribution Reserves is 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 Member Contribution Reserves' interest crediting rate will not be greater than the Target Crediting Rate; and
>
> b. If the projected semi-annual interest crediting rate for the Other Valuation Reserves is less than the Target Crediting Rate for the Total Valuation Reserves, the interest crediting rate for the Member Contribution Reserves will be the semi-annual interest crediting rate applied to the Other Valuation Reserves or one-half of the Treasury Note Rate, whichever is lower.

Prepared by:

/S/

____
Debbie Chan
Senior Accounting Manager

Reviewed by:

/S/

____
Kathryn T. Regalia
Chief Operations Officer

Concur:

/S/

____
Eric Stern
Chief Executive Officer