

AGENDA ITEM DETAILS

Subject: Consideration of Annual Gain Sharing Interest Adjustment for Group 4 Members and Annuitants

Background:

In 2021, the 87th Texas Legislature enacted Senate Bill 321 in an effort to return the ERS Pension Trust to long-term financial solvency and to initiate structural changes to mitigate future financial liability risk. The legislation established an annual legacy payment to retire the Trust's unfunded liabilities by 2054, coupled with a new cash balance benefit for employees. The cash balance benefit, known as Group 4, applies to employees who begin state service on or after September 1, 2022, who do not already have a retirement account with ERS.

Like members of ERS Retirement Groups 1, 2 and 3, the Group 4 cash balance members contribute a percentage of their salary toward retirement and receive a guaranteed rate of interest on their account balance. The State also provides a matching contribution for members of all Groups at retirement, and each retiree is guaranteed a lifetime payment. One provision, however, that is unique to Group 4 members and annuitants is the gain-sharing feature.

As part of the plan design for the cash balance benefit structure, the Legislature included a gain-sharing provision for Group 4 members and annuitants to share in the investment returns generated by the ERS Trust. A gain-sharing adjustment is made to Group 4 member account balances and annuity payments when the average annual net return of Trust fund investments over the preceding five-year matched performance period ending August 31 exceeds 4%. The five-year matched performance figure is calculated using the Global Investment Performance Standards methodology, net of all internal and external investment expenses.

Group 4 members are guaranteed 4% annual growth on their account balance. The gain-sharing adjustment to Group 4 members and annuitants is determined solely by the five-year matched performance for the period ending each August 31. Per statute, the ERS Trust and Group 4 population split the returns in excess of 4%. If the five-year matched performance number exceeds 10%, then the gain sharing adjustment to the Group 4 population is capped at 3%. If the five-year matched performance figure is equal to or below 4%, then no gain sharing adjustment is made. For context, the five-year matched performance figure has exceeded 4% in 18 of the last 25 years, and it has exceeded 10% in 5 of the last 25 years.

The five-year matched performance number for the period ending August 31, 2023 is 7.53%. This results in a Gain Sharing Interest Rate (GSIR) of 1.77%, rounded to the nearest basis point, to be applied to Group 4 member accounts and annuity payments.

| GSIR Calculation |
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| $GSIR = (5\text{-year matched performance} - 4\%) \div 2$ |
| $GSIR = (7.53\% - 4\%) \div 2$ |
| $GSIR = 3.53\% \div 2$ |
| $GSIR = 1.765\%$ rounded up to the nearest basis point \rightarrow 1.77% |

The gain sharing adjustments will be applied in December 2023. For Group 4 members, the gain sharing adjustment will be applied to their account balance as of August 31. For Group 4 annuitants, the gain

sharing adjustment will be applied to their monthly payment amount beginning with their December 29, 2023 payment.

There are approximately 24,000 contributing and 5,000 non-contributing members in Group 4 who will receive the account adjustment and 10 retirees who will receive the annuity increase.

This agenda item is informational only and requires no action by the Board.

ATTACHMENTS:

1 Slides - Adoption of Annual Gain Share for Group 4 Members and Annuitants