

Public Agenda Item #9

Consideration of Annual Gain Sharing Interest Adjustments for Group 4 Members and Annuitants

December 5, 2023

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Group 4 Gain Sharing



New Legislation in 2021

- The Texas Legislature passed legislation that shifted the ERS pension plan from a path toward depletion to being 100% funded by 2054
 - Established an annual Legacy Payment to retire the Trust's unfunded liabilities
 - Created a new cash balance benefit for employees beginning state service on or after September 1, 2022 who do not already have a retirement account with ERS (aka Group 4)
 - Includes a gain sharing feature

Group 4 Gain Sharing



What is Gain Sharing?

- Statutory provision that allows Group 4 members and annuitants to share in the investment returns generated by the ERS Trust
- Gain sharing is distributed when the average return on investments over a 5-year matched performance period ending August 31 exceeds 4%

Group 4 Gain Sharing



How Does Gain Sharing Work?

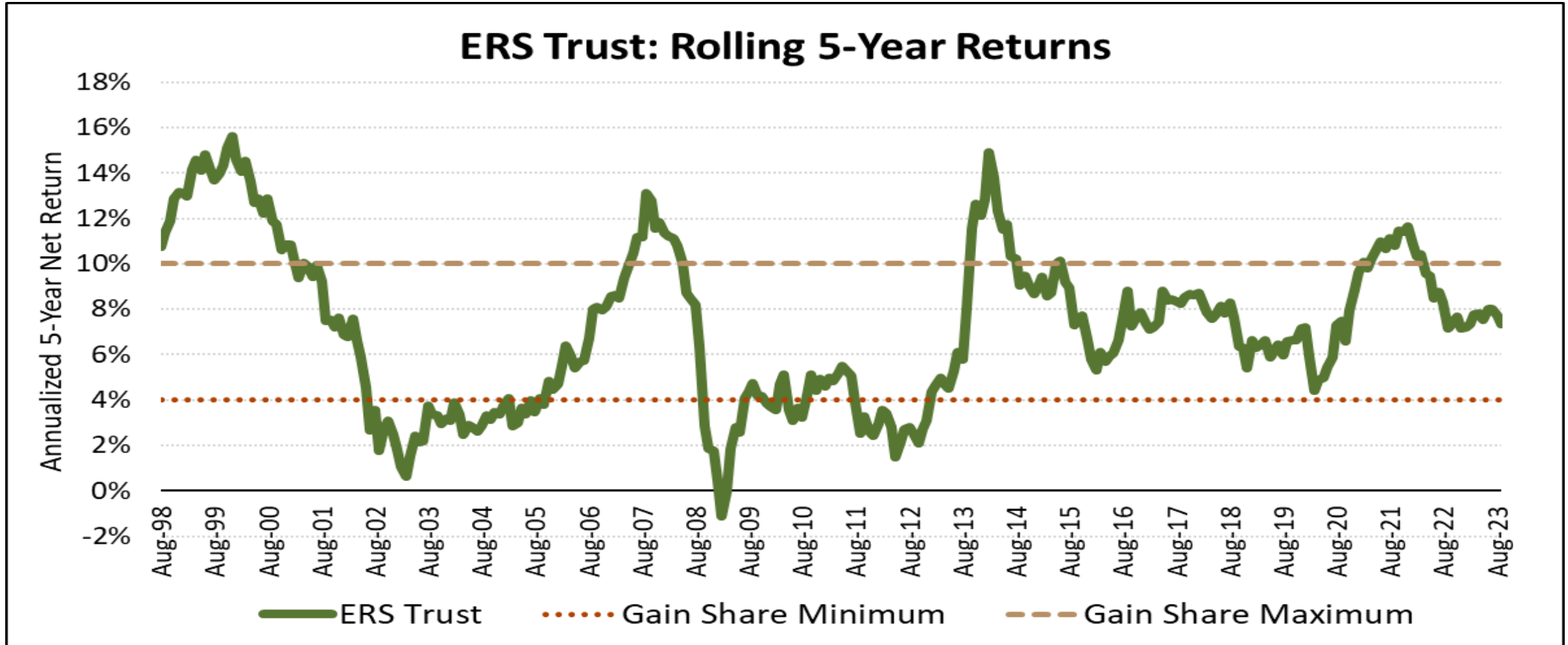
- The ERS Trust and Group 4 members and annuitants equally split the excess returns when the average return on investments over a 5-year matched performance period ending August 31 exceeds 4%
 - No gain sharing adjustment is applied if the 5-year matched performance $\leq 4\%$
 - The max gain sharing adjustment in a given year for Group 4 members and annuitants is capped at 3% per statute

Group 4 Gain Sharing

Rolling 5-Year Returns for ERS Trust Since 1998



ERS Trust: Rolling 5-Year Returns



Group 4 Gain Sharing



How is Gain Sharing Calculated?

- Based on the average return on the ERS Trust over a 5-year matched performance period as of August 31 of each fiscal year
 - Public market assets are valued daily (valuations as of August 31)
 - Private market assets are valued quarterly (the books remain open through the end of September to include most of the June 30 valuations)
 - 5-year matched performance for period ending August 31, 2023 is **7.53%**
- Global Investment Performance Standards (GIPS) methodology is used
 - Best practices for performance reporting and disclosure
 - Reported performance is net of all internal and external investment expenses

Group 4 Gain Sharing



How is Gain Sharing Calculated? (cont'd)

- Formula to compute gain sharing interest rate (GSIR)

$$\text{(5-year matched performance – 4\% threshold)} \div 2$$

- The 5-year matched performance through August 31, 2023 is 7.53%
- The resulting GSIR is 1.77%
 - $\text{GSIR} = (7.53\% - 4\%) \div 2$
 - $\text{GSIR} = 3.53\% \div 2$
 - $\text{GSIR} = 1.765\% \rightarrow 1.77\%$ rounded up to the nearest basis point

Group 4 Gain Sharing



How is Gain Sharing Calculated? (cont'd)

- **Hypothetical examples**

- **Example 1:** 5-year matched performance is 3.48%

- $GSIR = (3.48\% - 4\%) \div 2$
- $GSIR = -0.26\%$ → cannot be negative
- *No gain sharing is applied when matched performance $\leq 4\%$*

- **Example 2:** 5-year matched performance is 11.12%

- $GSIR = (11.12\% - 4\%) \div 2$
- $GSIR = 3.56\%$ → cannot exceed 3% per statute
- *GSIR is capped at 3% when matched performance $> 10\%$*

Group 4 Gain Sharing



How and When is Gain Sharing Applied?

- If gain sharing > 0%, then the GSIR adjustment is applied to Group 4 accounts and annuities in December
 - Members
 - Adjustment is applied to the August 31 balance
 - Posts to accounts in ERS Online by December 31
 - As of August 2023 = ~24,000 contributing and ~5,000 non-contributing
 - Annuitants
 - Adjustment is applied to the gross monthly payment amount beginning with the December 31 payment
 - Fewer than 10 annuitants as of November 2023

Group 4 Gain Sharing



How and When is Gain Sharing Applied? (cont'd)

- **Hypothetical examples**

- **Member**

- August 31 balance x GSIR = GSIR adjustment
- $\$88,223 \times 1.77\% = \$1,561.55$

- August 31 balance + GSIR adjustment = Adjusted account balance
- $\$88,223 + \$1,561.55 = \$89,784.55$

- **Annuitant**

- November 30 payment x GSIR = GSIR adjustment
- $\$2,624 \times 1.77\% = \46.44

- November 30 payment + GSIR adjustment = December 31 payment
- $\$2,624 + \$46.44 = \$2,670.44$

Group 4 Gain Sharing



Timeline of Key Milestones, September 2022 – September 2023

Enrollment
of Group 4
members
begins

1

Sep 2022

Group 4 member's
account balance as
of August 31 is
used for gain
sharing purposes

2

Aug 2023

ERS factors in all
investment-related
expenses for
annual financial
reporting purposes

3

Sep 2023

Group 4 Gain Sharing



Timeline of Key Events, October 2023 – December 2023

ERS' custodian bank provides matched performance results

ERS reports matched performance and gain sharing interest rate to the Board and in the Annual Comprehensive Financial Report

ERS calculates resulting gain sharing interest rate based on 5-year matched performance

ERS applies gain sharing adjustment to Group 4 member accounts and annuities by December 31

4

Oct 2023

5

Oct 2023

6

Dec 2023

7

Dec 2023

Discussion