



## MEMO NO. 2021-02B

TO: MEMBERS OF THE BOARD OF TRUSTEES  
FROM: TRAVIS ALMOND, EXECUTIVE DIRECTOR  
SUBJECT: SUPPLEMENTAL PENSION BENEFIT  
FY 2022 INTEREST RATE ASSUMPTION  
DATE: MARCH 22, 2021

The interest rate assumption on Supplemental Pension Benefits is defined in SDCL 3-12C-1502 as follows:

*3-12C-1502. Interest rate assumption--Suspension of new supplemental pension contracts--No right to particular price. On an annual basis, at minimum, the board shall establish an interest rate assumption upon which the provisions of subsequent supplemental pension contracts shall be based. The board shall establish the assumption on the basis of the recommendations of the system's actuary and the state investment officer. The interest rate assumption may not be greater than the actuarial assumed rate of return for the fund, nor may the interest rate assumption be less than the effective rate of interest. Any other provision of law notwithstanding, the board may suspend issuance of new supplemental pension contracts at any time. Any suspension of new supplemental pension contracts shall be prospective in operation and may not affect supplemental pension contracts already in effect.*

*The administration of the supplemental pension benefit requires that supplemental pension benefit purchase costs vary from one time period to the next. Consequently, participants who accept the option of a supplemental pension benefit have no expectation or fundamental right to any particular supplemental pension benefit purchase price.*

After review of appropriate annuity rates and fixed income/return instruments available in the marketplace, the external actuary has recommended a SPB interest rate assumption of between 1.75% and 2.75% and the state investment officer has recommended an interest rate assumption of between 3.0% and 3.5%. Based on this information and a process similar to what was used in the past, staff recommends the use of a 2.875% interest rate for FY 2022. The fiscal year 2021 interest rate assumption approved by the board was 2.875%.

The historical recommendations for the Supplemental Pension Benefit interest rate assumption are as follows:

	External Actuary	State Investment Officer	Staff Recommended/ Implemented Rate
FY 2009			5.5%
FY 2010	5.25%	4.65-5.15%	5.0%
FY 2011	4.0%	4.5-5.0%	4.5%
FY 2012	4.25-4.75%	4.5%	4.5%
FY 2013	3.5-4.0%	4.0-4.5%	4.0%

FY 2014	3.0-3.5%	4.0-4.5%	3.75%
FY 2015	3.5-4.5%	3.75-4.25%	4.0%
FY 2016	2.5-3.5%	3.5-4.0%	3.5%
FY 2017	2.8-3.8%	3.5-4.0%	3.5%
FY 2018	2.8-3.8%	3.25-3.75%	3.5%
FY 2019	2.8-3.8%	3.28-3.78%	3.5%
FY 2020	3.0-4.0%	3.38-3.89%	3.5%
FY 2021	2.0-3.0%	2.75-3.5%	2.875%
FY 2022	1.75-2.75%	3.0-3.5%	2.875%

If and when these contracts become more prevalent, we may want to update the process used to establish the interest rate. The procedure established in 2009 for determining the interest rate assumption is below.

Please bring your copy of this memo to the April board meeting, as this will be an agenda item. Please contact us if you have any questions.

### **Procedure for Determining the Supplemental Pension Benefit Annual Interest Rate Assumption**

The Board of Trustees shall at least annually establish the Supplemental Pension Benefit interest rate assumption. The interest rate assumption may not be greater than the actuarial assumed rate of return for SDRS, nor may the interest rate assumption be less than the effective rate of interest described in South Dakota Codified Law in subdivision 3-12C-108.

The Board shall establish the interest rate assumption based on the recommendation of the system's external actuary and the state investment officer. These recommendations shall be based on current capital market rates including fixed income investments and expected returns available at or near the time that the rate is defined.

The recommendations for the interest rate assumption may consider:

- US government/agency and corporate bond rates with or without the addition of an equity factor.
- Annuity rates defined by insurance/ investment firms and public information, including, but not limited to, the Pension Benefit Guarantee Corporation annuitization values.
- The expected return of the South Dakota Retirement System trust fund and the likelihood that the assumption will be achieved with these funds.

A range of interest rate assumptions will be provided to the Board of Trustees based on these factors and the input of the external actuary and state investment officer. A specific recommendation for the rate should be provided by the Executive Director. The external actuary and state investment officer may also provide a specific recommendation.