Pennsylvania Municipal Retirement Board Policy Statement 05-2	Excess Interest Award Process

Purpose: To document how the Pennsylvania Municipal Retirement Board determines whether and the extent to which Excess Interest is available to be distributed to the member plans.

Authority: The Pennsylvania Municipal Retirement Law, Act 15 of 1974 (referred to as "the Act"), Sections 104 (General Powers of the Board) and 110 (Management and Investment of Fund; Interest Credits).

Background: The Pennsylvania Municipal Retirement Board is required to determine annually the amount of investment earnings on the System assets in excess of that required for allocation to regular interest and expenses. This "excess" is defined in the law as "Excess Interest." The Board adopted a procedure to determine the excess interest in 1984. This Policy Statement is intended to memorialize the process and make it available to the public. The Board is adding one new stipulation to the process – the establishment of a minimum award threshold. This additional provision is to limit the administrative burden associated with the allocation process in years when the award would be considered "de minimis."

Policy: The Board requires the following calculations to be made as part of the excess interest determination process.

1. At the close of the year, staff with the confirmation of the independent auditing firm under contract to the Board, shall make all required allocations of regular interest to the System's accounts.
2. Staff and consulting actuary shall then determine the expected administrative expense for the following year that is not expected to be met from the $20 per plan member administrative charge.
3. Staff with the confirmation of the independent auditing firm shall determine the *Market value* of the System's investment portfolio as of year end along with the audited balances of the *System's Reserve accounts* (Member, Municipal, Retired, Disability).
4. These numbers (See Steps 1, 2 & 3) will be provided to the consulting actuary who will be responsible for performing the next set of calculations.
5. The consulting actuary will add to the *System's Reserve accounts* the projected expenses from Step 2. This total will become the *Preliminary value*.

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(Con't.)

6. The consulting actuary will then subtract from the *Market value* of the System's investment portfolio the *Preliminary value*. This result will be the *Available surplus*.
7. The consulting actuary will then determine the *New surplus* by subtracting from the *Available surplus* last year's *Final surplus*. New surplus is limited to be no greater than Available surplus
8. Next the consulting actuary will calculate the ratio "m" of *Available surplus* (See Step 6) to *Market value*.
9. Next the consulting actuary will calculate the ratio "n" of *New surplus* (See Step 7) to *Market value*.
10. The percentage of *New surplus* to be used for the *Excess interest* (e) is derived from the following formula:

$$e = \frac{0.10 + 8m}{1.0 + 8n}$$

11. The consulting actuary then determines the *Trial excess interest allocation* by multiplying (e) (See Step 10) times *New surplus* (See Step 7).
12. The consulting actuary will also determine *Trial surplus* by subtracting *Trial excess interest allocation* (See Step 11) from *Available surplus* (See Step 6).
13. The consulting actuary will determine *Trial margin* by dividing *Trial surplus* (See Step 12) from *Market value* (See Step 3).
14. If *Trial margin* (See Step 13) is less than ten percent (10%), then trial figures become final figures and the *Actuarial value* is set as *Market value* less *Final surplus* (See Step 12).
15. If *Trial margin* (See Step 13) is equal to or greater than ten percent (10%), the *Final excess interest allocation* is *Available surplus* (See Step 6) less ten percent (10%) of *Market value* (See Step 3), *Final surplus* is ten percent (10%) of *Market value*, and *Actuarial value* is ninety percent (90%) of *Market value*.

Once the *Final excess interest allocation* is determined, the *Excess interest percentage* is calculated by the consulting actuary. This is derived by first adding the Member Reserve balance, the Municipal Reserve balance and the actuarially determined Present value of the Retired Reserve balance to determine *eligible reserves*. The Excess interest percentage is the *Final excess interest allocation* divided by the *eligible reserves*.

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If the *Excess interest percentage* is less than five tenths of one percent (0.5%), there shall be NO *Excess interest* awarded, the *Actuarial value* shall be set to the *Preliminary value* and the *Final surplus* shall be set to the *Available surplus*. If the *Excess interest percentage* is five tenths of one percent (0.5%) or greater, the resulting *Excess interest percentage* shall be awarded and the plans notified as to their proportion of the total *Final excess interest allocation*.

The actual allocation of the year's *Excess interest* will be posted to the plans' accounts as of December 31 of the following year. To be eligible to receive a portion of the excess interest awarded for any year, a municipality's plan must have been in PMRS on December 31 of the year for which the allocation was made.

Effective Date: This policy is to be implemented effective immediately.

Adoption Date: Adopted at the July 21, 2005 meeting of the Pennsylvania Municipal Retirement Board.

James B. Allen, Secretary