

TO: Investment Committee for the
Federated City Employees' Retirement System

FROM: Prabhu Palani

SUBJECT: Annual Pre-funding Contributions by the City

DATE: February 25, 2025

RECOMMENDATION

Discussion and action on the City's prefunding option for fiscal year 2025-26:

Staff recommends reducing the pre-funding discount rate offered to the sponsor by 15% to 5.63125%

ANALYSIS

The attached memorandum from the Plans' legal counsel entitled, "Board Discretion Regarding the Discount Rate Used for Determining Actuarial Equivalence of the City's Pre-Funding Option", dated April 20th, 2015, states that the Municipal Code reserves the exclusive right for the City to elect to pre-fund its contributions. However, the Boards do have the discretion to determine the "actuarial equivalence" when calculating the pre-funding amount.

In 2014, staff began utilizing an incremental reduction approach to determining "actuarial equivalence" predicated on the average duration of business expansions and the absolute returns of broad indices (please see detailed Board approved methodology in the attached memo, "Prefunding Risk Mitigation Process Recommendation," dated September 15th, 2014). At the February 22, 2022 Investment Committee meeting for each Plan, Staff recommended (and the ICs approved) modifying the existing methodology by adding equity valuations as an additional triggering metric for incrementally reducing the pre-funding discount rate ("Staff Recommendation to update Prefunding Discount Rate Calculation," February 22, 2022).

One of the triggers for reducing the discount rate has been activated for FY 2025-26 – the equity valuations trigger (CAPE ratio more than two standard deviations above the long-term mean) implies that the pre-funding discount rate should be incrementally reduced by 15%. The full discount rate is 6.625%. A 15% reduction would result in a proposed pre-funding discount rate of 5.63125%.

If any of the three indicators is similarly triggered next year, an additional 15% reduction would be recommended; alternatively, the absence of any trigger would result in a recommendation of extending the full discount rate to the sponsor.

CONCLUSION

Staff recommends reducing the pre-funding discount rate offered to the sponsor by 15% to 5.63125%



Prabhu Palani
Chief Investment Officer

APPENDIX

FY Year (start)	Analysis Date	Business Cycle		Business Cycle Trigger (>58)	S&P 500			Returns	S&P 500 Trigger (>130%)	CAPE Ratio		CAPE Ratio Trigger (>2SD)	Discount Rates		Recommended Framework		
		Most Recent Prior Business Cycle Trough	Months of Expansion		Most Recent S&P 500 Trough (30% from all time high)	S&P 500 Trough Level	S&P 500 on Analysis Date			CAPE Ratio	Average +2 Std Dev		Fed (%)	P&F (%)	Trigger	Fed Prefunding Discount	PF Prefunding Discount
2025	9/01/24	4/30/2020	53	No	3/31/2020	2584.59	5,528.93	114%	No	35.7	32.2	Yes	6.625	6.625	Yes	5.63125	5.63125