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July 16, 2020

TO: All DROP Account Members

RE: St Lucie County Fire District Firefighters Pension Trust Fund
Change in Actuarial Assumed Rate

Dear DROP Account Members:

The Board of Trustees recently lowered the assumed actuarial rate of return on the most recent actuarial valuation. We want to explain both the reason for this decision and the impact to your DROP Account.

The Pension Trust Fund previously assumed an 8% return on assets, net of investment expenses. With average investment expenses of about 40 basis points (40/100 of 1%), this means the assets must consistently deliver a gross return of about 8.4% before expenses. Only about 2% of public pension plans still use an 8% net assumption rate[1], with the average now about 7.18%. Accordingly, the actuary for the Pension Fund expressed real concern that the Division of Retirement would not continue to accept the 8% net return assumption. Current capital market projections do not support an 8% net return on investments for longer periods. And finally, the historical results for this plan also do not support an 8% net investment return assumption. The plan assets generated an actuarial return on assets (adjusted for smoothing) of 6.5% over the past 5 years with an average real market return of 5.2%. The plan had an average actuarial return of 4.1% for the past 10 years and 5.1% average over the past 15 years. FRS, by comparison, lowered the net investment return assumption from 7.4% to 7.2% for the state retirement system in 2019.

Based on the advice of both the actuary and the investment consultant retained by the Board, the Trustees passed a motion at a June 10, 2020 Special Meeting to lower the investment return assumption from 8.0% to 7.6% for 2019, with a plan to reduce the assumption rate by an additional 0.1% each year until the assumption reaches 7.0%. With other assumption changes, the Fire District contribution increased from $14,102,186 or 41.35% of covered payroll for fiscal year 2020 to $15,582,134 or 46.55% of covered payroll for fiscal year 2021. The lower assumption rate alone increases the required Fire District contribution by $1.85 million for the next year.

The Plan Document states that DROP Accounts shall be credited with earnings at the actuarial rate of return as provided for in the most recent actuarial valuation. An additional Resolution effective October 1, 2016, allows a member to choose an earnings credit equal to the actuarial rate less one percent (1%) to allow the surviving spouse or minor child until age 18 to retain the DROP Account following the death of the member. Other than the additional choice given to members in 2016, the plan language for the credit of DROP earnings has not changed since the inception of the DROP in 2008; moreover, the Articles of Agreement for Local 1377 incorporate the same language. This means that your DROP Account will receive a net earnings credit of 7.6% for the quarter beginning July 1, 2020 and ending September 30, 2020. The 7.6% annual rate equates to a quarterly equivalent of 1.85% determined as follows:

$$\text{Quarterly Rate} = (1 + \text{Annual Rate})^{(1/\text{Periods})} - 1 = (1 + 7.6\%)^{1/4} - 1 = 1.85\%$$

And in a similar fashion, 1.85% compounded quarterly equals an annual credit rate of 7.6%. If you elected to provide for a continuation of your DROP Account to a spouse or minor child, your account will continue to receive 1% less than the assumed actuarial rate, or 6.6% annually and 1.61% as the quarterly equivalent.

Your Trustees are aware that the change in the actuarial assumed rate also affects each of you individually. Your actual DROP benefit does not change, however, since the plan language that describes the credit of earnings to your account has never changed. Enclosed you will find your DROP Statements through June 30, 2020, which do not yet reflect the new earnings credit rate. The Board implemented this change only prospectively to begin with the current quarter starting July 1 and ending September 30, rather than making the change effective as of the October 1, 2019 Valuation date. The Trustees wanted to allow each of you time to make any adjustments to your accounts and investments that you feel appropriate under the circumstances.

We want you to know that we appreciate the opportunity to work for you; we never take what we do for granted. And please take care during these times.

Sincerely,

J. Scott Baur, Administrator
Managing Partner, Resource Centers LLC

Enclosures