South Dakota Retirement System

The South Dakota Perspective

For Presentation to the
Minnesota Legislative Commission on Pensions and Retirement

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SDRS Structure

SDRS is a hybrid, defined benefit plan covering essentially all South Dakota public employees

- SDRS operates within the resources provided by **fixed, statutory member and employer contributions**
- Recent plan changes have added significant **variable features** that adjust benefits to changing market conditions and plan experience
- South Dakota statutes provide **funding thresholds** that if crossed require the SDRS Board of Trustees to recommend corrective actions (benefit reductions)

As a result, SDRS has a fixed budget for retirement benefits, automatically adjusting benefit features, and specific funding measures that dictate when corrective action must be taken

SDRS was 100% funded in 2017 and in 27 of last 32 years

Our Perspective on Benefits

- A **defined benefit** plan is preferred because it is the most efficient and advantageous design for SDRS members, employers, and taxpayers
- **Hybrid features** that combine the advantages of both defined benefit and defined contribution plans are essential for an equitable distribution of benefits to both career and non-career members
- **Variable benefits** based on affordability measures are essential for sustainability and the COLA is the most logical benefit feature to vary
- Benefits should meet **specific income replacement objectives**; excessive benefits must be avoided
- Provisions and practices that result in higher than intended and/or **artificially inflated benefits** must be avoided and corrected to protect scarce resources and to reinforce adherence to our goals

Our Perspective on Plan Management and Funding Policy

- The **SDRS Board of Trustees** must have the expertise, knowledge, and resources and act as fiduciaries, recommend benefit and funding policies, and actively lead SDRS
- **Fixed contributions** are a prudent financial decision, and SDRS **benefits must be managed** accordingly since:
  - Variable contributions may require significant and unpredictable higher costs
  - Contribution increases alone may not be adequate to solve funding issues
- The SDRS funding policy must specify **minimum funding standards** to dictate when changes are required or should be considered
- Contribution rates with a **50% chance of funding** actuarial liabilities are not acceptable unless accompanied with flexible benefits
- Additional **risk measures** must be developed and communicated to provide transparent disclosure of the likelihood of meeting the funding policies and benefit goals of SDRS

Recent Plan Changes

Recent initiatives have added automatic benefit features that adjust with changing economic environments

- Legislation in 2016 redesigned the benefit structure for new hires after June 30, 2017 (Generational Design):
  - Increased normal retirement ages by two years and increased benefit multiplier
  - Eliminated subsidies (early retirement incentives, subsidized spousal benefits, compensation loopholes)
  - Added a new variable benefit within the defined benefit plan
- Legislation in 2017 changed the COLA to vary with CPI and affordability to maintain 100% funding in all but the most extreme conditions
  - COLA equals CPI-W with minimum rate of .5% and maximum rate of 3.5%
  - COLA maximum may be restricted based on resources available

Appendix

Board of Trustees' Funding and System Management Policies

Managing SDRS based on Fixed, Statutory Contributions

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<tr><th>FUNDING OBJECTIVES</th><th>CONSIDERATION OF BENEFIT IMPROVEMENTS</th><th>REQUIRED CORRECTIVE ACTION RECOMMENDATIONS</th></tr>
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A Fair Value Funded Ratio of over 120 percent is required before considering benefit improvement recommendations
The cost to fully fund the recommended benefit improvement is also limited to the net accumulated actuarial investment gains and losses, with gains recognized over a five-year period and losses recognized immediately
After fully funding the cost of the benefit improvement, the Fair Value Funded Ratio must be at least 120 percent and all funding objectives must continue to be met
Proposed benefit improvement must be consistent with both the Board's long-term benefit goals and sound public policy with regard to retirement practices

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The annual report to Governor and Retirement Laws Committee (RLC) will include corrective action recommendations if SDRS does not meet both of the following conditions:

Fixed, statutory contributions sufficient to meet the actuarial requirement
Fair Value Funded Ratio of 100 percent or more

The report shall include recommendations for the circumstances and timing for any benefit changes, contribution changes or any other corrective action, or any combinations of actions to improve the funding conditions

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Generational Benefit Objectives

Primary Objectives for Benefit Restructuring

- Increase likelihood of sustainability
- No additional contributions or costs
- Meet income replacement goals
- Maintain equity with current members
- Maintain hybrid defined benefit structure
- Limit or eliminate subsidies
- Add benefit features that do not create a fixed liability but vary with plan experience
- Align benefits to better recognize employer’s workforce needs

Generational Benefit Structure

Retirement Benefit Eligibility (Class A):

- Normal Retirement Age: 67
- Early Retirement Age: 57 (5% per year reduction) – No Special Early Retirement
- Vesting: 3 years of service

Benefit Formulas and Features:

- 1.80% times Final Average Compensation (FAC) times years of service
- Five year FAC with 5% per year increase limit
- Variable Retirement Account – allocate 1.5% of compensation to a member account and credit net trust fund investment performance

Termination Benefits:

- Refund of accumulated contributions - employee contributions plus 85% of employer contributions and interest (50% for non-vested)
- Deferred vested benefits – indexed with COLA from termination to retirement

COLA:

- Varies directly and automatically with inflation, experience, and affordability
- CPI-W with minimum rate of .5% and maximum rate of 3.5%
- Maximum may be restricted based on resources available

Variable COLA Process

Step 1: Determine Baseline
Fair Value Funded Ratio (FVFR)
(Using Baseline COLA assumption of 2.25%)

If 100% or More

COLA = CPI-W Increase
Minimum = 0.5%
Maximum = 3.5%

If Less than 100%

Step 2: Determine
Restricted Maximum COLA
Resulting in FVFR of 100%

COLA = CPI-W Increase
Minimum = 0.5%
Maximum = Restricted Maximum

2018 COLA Calculation

Step 1:
June 30, 2017
Baseline FVFR = 96.4%

If 100% or More

COLA = CPI-W Increase
Minimum = 0.5%
Maximum = 3.5%

If Less than 100%

Step 2: Restricted
Maximum COLA = 1.89%
Resulting in FVFR of 100%

COLA = CPI-W Increase (1.96%)
Minimum = 0.5%
Maximum = 1.89%
2018 SDRS COLA = 1.89%

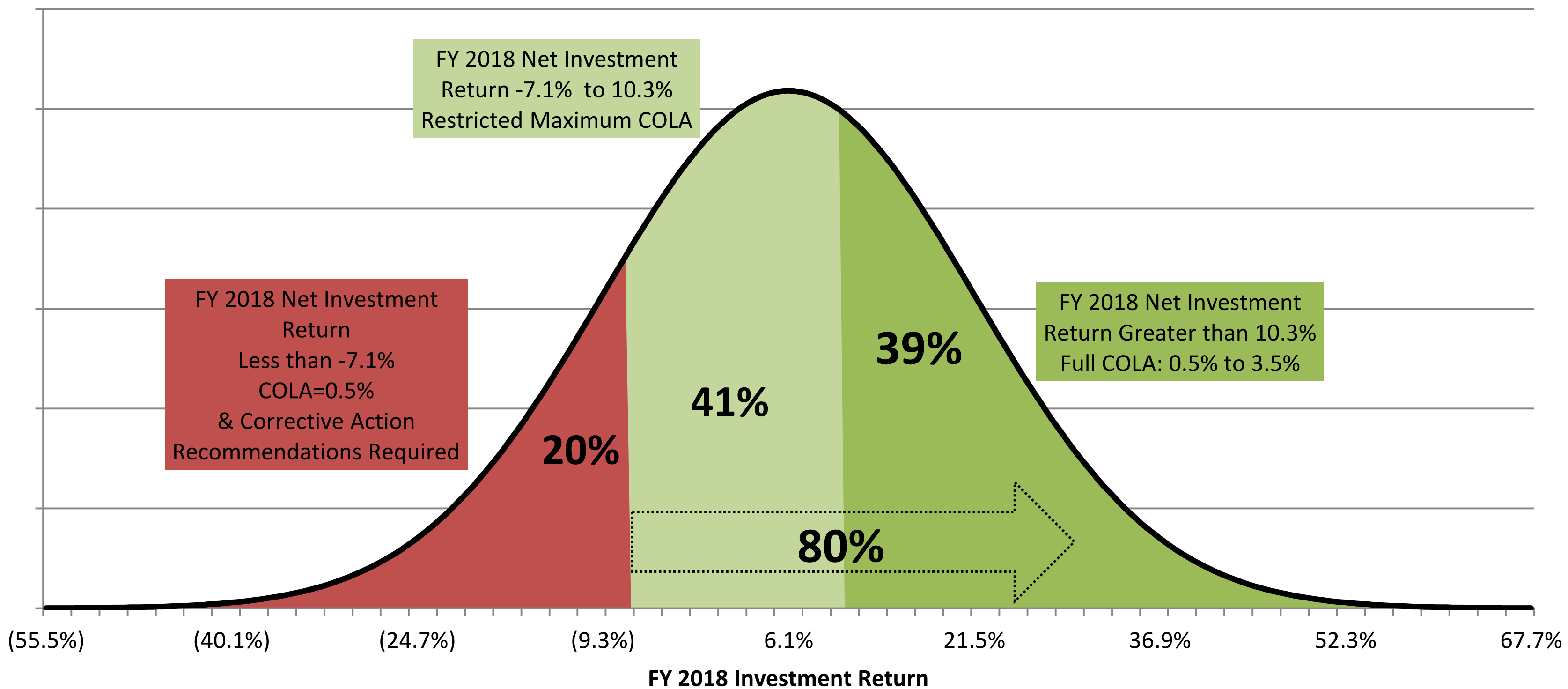
2018 SDRS COLA = 1.89%

Projected Funded Status as of June 30, 2018 and 2019 Maximum COLA*

If Net Investment Return for FYE June 30, 2018 is:		Step 1: Determine Baseline FVFR (Using Baseline COLA assumption of 2.25%)	Step 2: Determine Restricted Maximum COLA (Resulting in FVFR of 100%)	Step 3: Determine FVFR (Using Baseline COLA or Restricted Maximum COLA, if applicable)
(-7.1%)	Minimum Return to Avoid Corrective Actions	84%	0.50%	100%
6.5%	Assumed Return	97%	1.90%	100%
0.0% 2.5% 5.0% 7.5%	Return Examples	91% 93% 95% 97%	1.25% 1.45% 1.75% 2.00%	100% 100% 100% 100%
10.3%	Minimum Return for 100% FVFR with Baseline COLA	100%	Unrestricted: 3.5%	100%

* Before consideration of liability gains/losses for year ending June 30, 2018. June 30, 2017 Baseline FVFR was 96.4%.

Projected Future COLA Ranges: 2019 SDRS COLA*



- Ignoring FY18 returns to date, the likelihoods for 2019 COLA ranges, which are primarily driven by FY18 investment returns, are:
  - 39% likelihood that the baseline COLA will be payable (CPI-W between 0.5% and 3.5%)
  - 41% likelihood that the COLA will have a restricted maximum (CPI-W between 0.5% and the restricted maximum)
  - 20% likelihood that a 0.5% COLA will be payable and additional Corrective Action recommendations will be required

* Before consideration of liability gains/losses. Likelihoods based on SDIC 2017 investment portfolio statistics. Assumes 2.25% annual inflation.