Annual Report of the Funded Status of the South Dakota Retirement System to the Governor and Legislature of the State of South Dakota

JANUARY 2021

South Dakota Retirement System

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SDRS Fiscal Year 2020 Key Takeaways

- **SDRS exists to provide adequate and equitable lifetime retirement benefits for public employees in South Dakota**

- **SDRS is sustainably managed within the resources provided by fixed, shared member and employer contributions that are much less than the national average**

- **SDRS' funding has greatly benefited from the superior long-term investment results generated by the South Dakota Investment Council**

- **SDRS remains 100% funded at June 30, 2020 and is expected to remain 100% funded under most economic conditions**

- **The SDRS Cost of Living Adjustment varies with inflation and affordability and the July 2021 COLA will equal inflation for the prior year of 1.28 percent**

- **The State of South Dakota and other SDRS participating employers remain unburdened by the increasing retirement plan contribution requirements and balance sheet debt impacting many employers participating in public sector retirement systems**

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January 12, 2021

To the Governor and the Legislature of the State of South Dakota:

We are pleased to present the Annual Report of the Funded Status of the South Dakota Retirement System (SDRS) for the fiscal year ended June 30, 2020.

As of June 30, 2020, SDRS is 100 percent funded and all the Board's funding objectives have been met. This marks the twenty-fifth time out of the last thirty actuarial valuations that SDRS has been at least 100 percent funded on a Fair Value of Assets basis. A fully funded status is rare among statewide retirement plans but is the expected result of SDRS' design that manages benefits and liabilities within the resources provided by fixed member and employer contributions.

The success of SDRS has been achieved through the disciplined management of the Board of Trustees, the outstanding long-term success of the South Dakota Investment Council, and the ongoing support of all stakeholders, including the Executive and Legislative branches of state government and SDRS members. SDRS continues to be one of the most financially sound public employee retirement systems in the nation and is well-positioned to confront the challenges of the future.

SDRS strives to provide appropriate and equitable lifetime benefits funded by fixed, statutory member and employer contributions. SDRS' variable benefit features automatically adjust benefits based on the resources available and will result in SDRS remaining fully funded in most economic conditions. In addition, SDCL 3-12C-228 requires recommendations to the Legislature for corrective actions if economic conditions exhaust the automatic adjustments provided by the variable benefit features and acceptable funding conditions are not met. These two mechanisms are designed to work together to sustainably and efficiently provide the maximum benefits that can be prudently afforded within the fixed contribution budget.

The SDRS Board of Trustees will continue to analyze risks and evaluate SDRS sustainability under all economic conditions. SDRS remains fully committed to the SDRS hybrid defined benefit plan model with variable benefits that is fiscally responsible, efficient, and provides appropriate retirement income to our members within our resources.

We welcome your comments and questions after your review of this report.

Sincerely,

Travis W. Almond
Executive Director

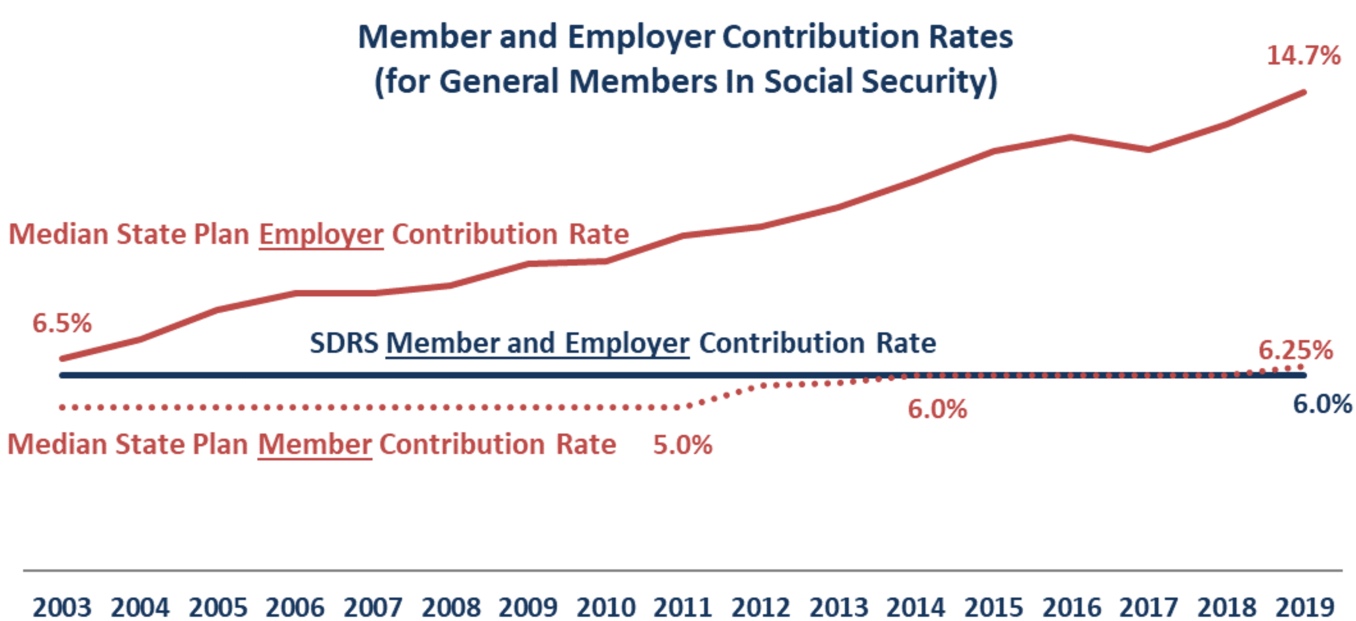
THE SDRS MODEL

SDRS is a defined benefit pension system – a system that pays lifetime benefits at retirement based on a members' compensation and service. The expected costs to provide the benefits are determined using assumptions about future events including life expectancies, retirement ages, and the investment returns system assets will earn. To meet those expected costs, defined benefit plans are funded by member and employer contributions throughout members' careers.

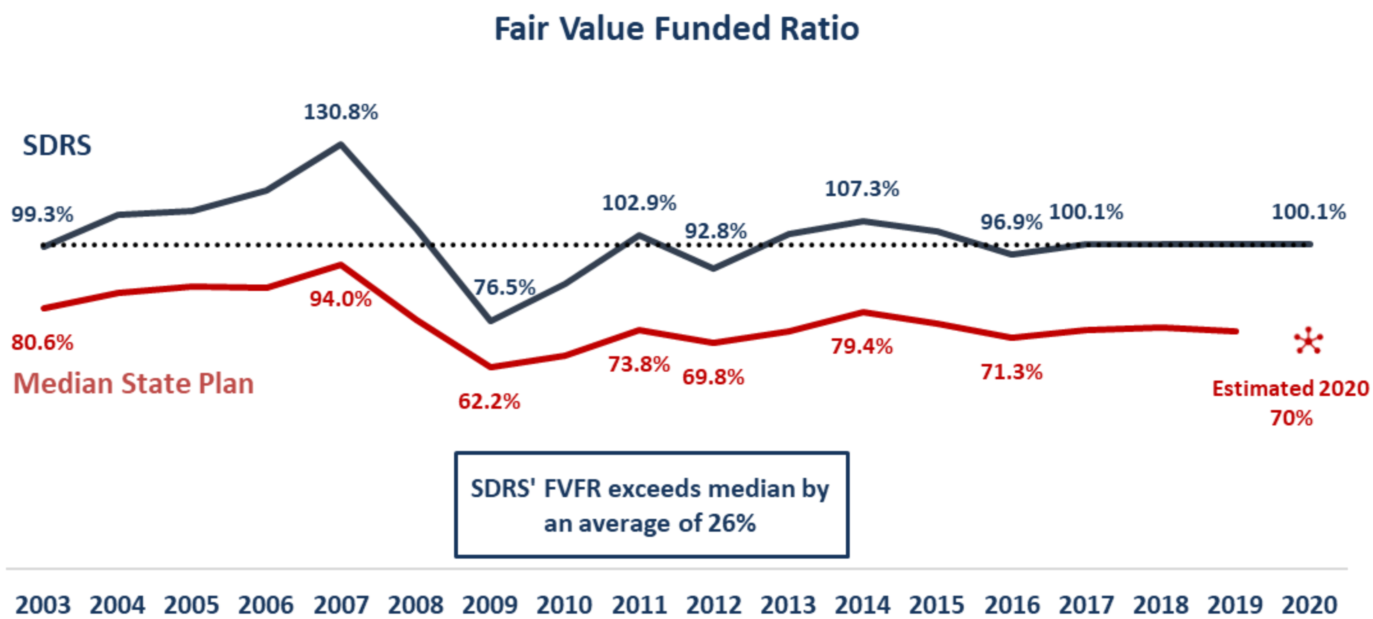
Most state retirement systems have fixed benefits and vary employer contributions when experience inevitably departs from the assumptions. Conversely, SDRS has operated with fixed contributions since 1974 and when experience departs from assumptions, SDRS benefits vary automatically. If experience is significantly worse than expectations, SDRS has explicit statutory funding thresholds that require corrections when not met.

Two following charts illustrate the effectiveness of the two approaches.

The first chart shows historical median member and employer contribution rates for large, public sector pension plans and for SDRS. This considers only plans covering general employees (not public safety or judicial) who are also covered by Social Security. Since 2003, the **median member contribution rate** has increased from 5 percent to 6.25 percent of pay. The **median employer contribution rate**, however, has more than doubled from 6.5 percent in 2003 to almost 15 percent of pay in 2019. During that same time, SDRS **member and employer contributions** have remained at 6 percent of pay.



While median public sector contribution rates have escalated, it has not translated to improved funding. The second chart shows the Fair Value Funded Ratio for SDRS has exceed the ratio for the median public sector plan by an average of 26 percent over the same time period. The Fair Value Funded Ratio is one measure of the soundness of a retirement system and is calculated as the ratio of the Fair Value of Assets to the Actuarial Accrued Liability.



Frequent media reports detail the struggles many public sector retirement plans face in addressing pension funding issues. Many plans have no pre-determined maximum level of required employer contribution or minimum funded ratios that would serve as a call for reform. In some states, stakeholders must determine each year if the situation is dire enough to begin what is often a painful public fight over pension reform. In many instances, delay in making reforms has resulted in continuing deterioration of the plan's funded status and a need for even greater reforms.

Without question, the outstanding long-term investment performance of the South Dakota Investment Council has been the primary factor in the funding success of SDRS. In addition, the fundamental SDRS approach of fixed contributions, variable benefits, and defined funding thresholds requiring corrective action recommendations has imposed an important funding discipline on SDRS and kept SDRS on sound financial footing.

SDRS FUNDED STATUS AS OF JUNE 30, 2020

FUNDING POLICY OBJECTIVES

The SDRS Board has adopted a Funding Policy that includes the following funding objectives:

- Fair Value Funded Ratio of 100 percent or greater.
- A fully funded System with no Unfunded Liabilities.
- Actuarially determined benefits that are variable and can be supported by fixed, statutory contributions that are equal to or greater than the minimum actuarial requirement to support benefits.

MEETING THE BOARD'S FUNDING OBJECTIVES

The 2020 actuarial valuation of SDRS confirms that all three of the Board's funding objectives have been met based on the current restricted maximum COLA.

2020 LEGISLATIVE CHANGES REFLECTED IN 2020 FUNDING RESULTS

Legislation enacted in 2020 brought the assets and the liabilities of the South Dakota Department of Labor and Regulation Plan into SDRS effective July 1, 2020. The funding results presented in this report include the assets and liabilities of that plan.

Legislation enacted in 2020 also established a Qualified Benefit Preservation Arrangement (QBPA) under Section 415(m) of the Internal Revenue Code (IRC). The QBPA was effective July 1, 2020 and pays a portion of SDRS benefits that are restricted by IRC Section 415(b). The total benefits paid from SDRS and the QBPA will be limited to the applicable 415(b) annual limit, unreduced for early commencement if members retire prior to age 62 and actuarially increased for late retirement up to age 70 if members retire after age 65. The funding results in this report consider benefits payable from both SDRS and the QBPA.

No other substantive benefit changes were included in the June 30, 2020 actuarial valuation.

SDRS COLA

SDRS provides an annual COLA that increases benefits for retirees. The Board's objective is to provide a COLA that protects retirees from a loss of purchasing power due to inflation during periods of low to moderate inflation.

Legislation enacted in 2017 tied the COLA directly to the annual inflation rate and the available resources to pay for it.

The COLA will be less than inflation only when it is not affordable, or inflation is extraordinarily high. However, it is anticipated that the SDRS COLA will meet the Board's objective and approximate the rate of inflation over time.

Based on the result of the June 30, 2019 actuarial valuation, the restricted maximum COLA for the July 2020 increase was 1.88 percent. Inflation for the prior year was 1.56 percent, less than the restricted maximum, resulting in a **July 2020 SDRS COLA of 1.56 percent.**

Based on the result of the June 30, 2020 actuarial valuation, the restricted maximum COLA for the July 2021 increase is 1.41 percent. Inflation for the prior year was 1.28 percent, less than the restricted maximum COLA, resulting in **a July 2021 SDRS COLA of 1.28 percent.**

The SDRS COLA has met the Board's objective of matching inflation for the last two years.

SDRS CONTINGENCY PLANNING

Beginning in December 2019 and continuing through 2020, the SDRS Board of Trustees engaged in a contingency planning exercise. The Board focused on planning for future periods of economic uncertainty. As a result, the Board has adopted **A System Guide to Planning for the Unexpected** which is expected to be used as a starting point for discussions if economic conditions prevent SDRS from reaching its Funding Policy Objectives and statutory funding requirements. Two initiatives were identified in the planning guide.

The first initiative is a recommendation to **lower the minimum COLA from 0.5% to 0%**. This recommendation will be submitted for consideration during the 2021 Legislation Session. Lowering the minimum COLA to 0% will allow SDRS to better withstand periods of very low inflation and will expand the economic conditions during which SDRS can remain fully funded without additional corrective actions. It will result in a COLA as low as 0% when SDRS cannot afford a higher COLA on a sustainable basis.

The second initiative is to **consider allowing a small Unfunded Actuarial Accrued Liability in limited circumstances** after the COLA has been reduced to 0% and economic conditions prevent SDRS from remaining fully funded. When the COLA has been reduced to 0%, the fixed, statutory member and employer contributions will exceed the annual normal cost – the cost of funding each year's benefit accrual. The margin between the fixed contributions and reduced normal cost could be used to eliminate an Unfunded Actuarial Accrued Liability up to approximately five percent of the Actuarial Accrued Liability; that is, with a Funded Ratio as low as approximately ninety-five percent. The contribution margin would be expected to eliminate the Unfunded Actuarial Accrued Liability in approximately 10 to 12 years.

One of the key funding objectives of the SDRS Board of Trustees is to maintain a fully funded System. Historically, SDRS had been well funded, but less than fully funded on an Actuarial Value basis, until June 30, 2013, when the Unfunded Actuarial Accrued Liability was eliminated by a transfer from the excess of the Fair Value of Assets over the Actuarial Value of Assets. Permitting a small Unfunded Actuarial Accrued Liability would utilize all available resources, including the contribution margin for current contributing members, as an alternative to further reductions in member benefits. The second initiative would only be considered during a severe downturn or prolonged period of low investment returns and the SDRS Board is committed to seeking input from all stakeholders before the second initiative will be pursued. Adoption of this initiative would require approval of the Legislature and Governor.

A System Guide to Planning for the Unexpected can be found on the SDRS website at:

https://sdrs.sd.gov/docs/SDRSplanningboarddocument.pdf

SDRS 2021 PROPOSED LEGISLATION

The SDRS Board of Trustees will submit the following bills for consideration during the 2021 Legislative Session:

- **HB 1030:** An Act to revise and clarify certain provisions regarding the required minimum distribution methods of the South Dakota Retirement System.
- **HB 1031:** An Act to revise certain provisions relating to the South Dakota Retirement System.
- **HB 1032:** An Act to revise the minimum cost of living adjustment and revise terminology of the South Dakota Retirement System.
- **HB 1033:** An Act to update certain provisions relating to the South Dakota Retirement System, to revise certain provisions relating to reemployment after retirement with the South Dakota Retirement System, and to declare an emergency.

Details and descriptions of the proposed legislation can be found in the 2021 legislative summary on the SDRS website at:

https://sdrs.sd.gov/docs/2021ProposedSDRSLegislation.pdf

LINKS TO ADDITIONAL INFORMATION

More complete data on SDRS can be found on the SDRS website.

The **June 30, 2020 actuarial valuation report** with additional detail on the funded status of the system and fiscal year 2020 experience:

https://sdrs.sd.gov/docs/2020SDRSActuarialValuation.pdf

The **June 30, 2020 Comprehensive Annual Financial Report** with complete financial data on the system, fiscal year 2020 experience, and historical trend information:

https://sdrs.sd.gov/docs/CAFR2020.pdf

Material from the **December 3, 2020 SDRS Board of Trustees Meeting**, including presentations on the June 30, 2020 actuarial valuation results, demographic trends, and the fiscal year 2020 financial statements:

https://sdrs.sd.gov/docs/December3Materials-File1.pdf

https://sdrs.sd.gov/docs/December3Materials-File2.pdf

Material from the **December 10, 2020 SDRS Board of Trustees Meeting**, including presentations on SDRS' projected funded status at the end of fiscal year 2021 and A System Guide to Planning for the Unexpected, a summary of the conclusions of the Board's 2020 contingency planning exercises:

https://sdrs.sd.gov/docs/December10Materials.pdf

Appendix A: Fiscal Year 2020 Highlights

Total System Membership	**92,325**
Active Contributing Members	**41,327**
Inactive Non-Contributing Members	**20,656**
Benefit Recipients	**30,342**
Fair Value of Assets	**$12.4 Billion**
Actuarial Accrued Liability	**$12.3 Billion**
Assumed Future COLAs	**1.41%**
Fair Value Funded Ratio	**100.1%**
Member and Employer Contributions	**$263.2 Million**
Benefit Payments and Refunds	**$625.8 Million**
Administrative Expenses	**$5.1 Million**
Net Investment Income	**$192.2 Million**
Minimum Statutory COLA	**0.50%**
Restricted Maximum COLA	**1.41%**
Prior Year Inflation	**1.28%**
July 2021 COLA	**1.28%**

Appendix B: SDRS Benefits Payable by County

The following exhibit presents a schedule of the annualized benefits payable as of July 1, 2020, by SDRS on a county-by-county basis.

County	Benefit Recipients	Annual Benefits	County	Benefit Recipients	Annual Benefits	County	Benefit Recipients	Annual Benefits
Aurora	132	$2,101,827	Fall River	324	$4,648,427	McPherson	75	$1,086,874
Beadle	526	$10,075,394	Faulk	117	$1,690,125	Meade	682	$13,003,453
Bennett	49	$825,030	Grant	206	$3,676,219	Mellette	55	$680,542
Bon Homme	325	$5,194,870	Gregory	163	$2,588,362	Miner	79	$1,594,392
Brookings	1,552	$39,663,531	Haakon	62	$948,092	Minnehaha	4,066	$95,873,700
Brown	1,248	$26,403,454	Hamlin	198	$3,364,090	Moody	202	$3,192,669
Brule	142	$2,862,980	Hand	102	$1,549,087	Oglala Lakota	18	$326,646
Buffalo	3	$51,493	Hanson	52	$951,955	Pennington	3,408	$76,978,495
Butte	339	$5,463,554	Harding	36	$495,688	Perkins	85	$1,269,638
Campbell	69	$1,038,456	Hughes	1,454	$38,498,354	Potter	109	$1,832,793
Charles Mix	244	$4,585,903	Hutchinson	259	$4,543,652	Roberts	290	$4,913,600
Clark	129	$1,927,039	Hyde	65	$821,060	Sanborn	86	$1,480,678
Clay	668	$17,498,548	Jackson	54	$921,771	Spink	439	$6,949,735
Codington	827	$18,923,589	Jerauld	73	$1,124,718	Stanley	234	$5,807,042
Corson	53	$832,365	Jones	40	$854,352	Sully	59	$864,281
Custer	392	$6,967,480	Kingsbury	221	$3,794,453	Todd	59	$1,103,317
Davison	565	$12,547,864	Lake	461	$9,658,901	Tripp	201	$3,336,666
Day	225	$3,751,597	Lawrence	980	$21,050,560	Turner	253	$3,873,668
Deuel	136	$2,254,933	Lincoln	417	$7,207,417	Union	344	$6,534,489
Dewey	99	$1,709,589	Lyman	92	$1,557,349	Walworth	236	$4,248,256
Douglas	90	$1,553,632	Marshall	187	$3,152,801	Yankton	900	$18,098,683
Edmunds	112	$1,931,904	McCook	156	$2,852,030	Ziebach	24	$405,640

Total SDRS Benefits Payable in South Dakota	**$ 537,569,752**
Total SDRS Benefits Payable Outside of South Dakota	**$ 74,966,004**
Total SDRS Benefits Payable	**$ 612,535,756**
Total Cement Plant Benefits Payable in South Dakota	**$ 4,103,528**
Total Cement Plant Benefits Payable Outside of South Dakota	**$ 389,568**
Total Cement Plant Benefits Payable	**$ 4,496,066**
Total SDRS and Cement Plant Benefits Payable	**$ 617,031,822**
Benefits Payable to Former Department of Labor and Regulation Plan Members	**$ 4,485,333**
Total Benefits Payable	**$ 621,517,155**

SDRS MISSION STATEMENT

To plan, implement, manage, and efficiently administer financially sustainable retirement income programs within the fixed resources available in accordance with fiduciary responsibilities and sound public policies.

SDRS VISION

Provide members and their families the opportunity to achieve financial security at retirement, death, or disability by delivering appropriate and equitable lifetime benefits, and promote, encourage, and facilitate additional member savings for retirement.

SDRS LONG-TERM INCOME REPLACEMENT GOALS

Provide lifetime retirement income replacement of at least 55 percent of final average compensation for career employees with a cost of living adjustment during retirement that provides partial inflation protection.

Encourage members to establish an individualized lifetime retirement income goal that will enable them to maintain their standard of living in retirement. This will typically require lifetime income replacement of at least 85 percent of final average compensation (with at least partial inflation protection during retirement), including income from SDRS, Social Security, and personal retirement savings of at least one year's compensation at retirement.

SDRS
SOUTH DAKOTA
RETIREMENT SYSTEM

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