SDRS
SOUTH DAKOTA RETIREMENT SYSTEM

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February 8, 2022

Mr. Travis W. Almond
Executive Director
South Dakota Retirement System
P.O. Box 1098
222 East Capitol Ave., Suite 8
Pierre, South Dakota 57501-1098

Re: South Dakota 2022 Legislative Session – House Bill 1261

Dear Travis:

House Bill 1261 modifies SDRS provisions regarding reemployment after retirement.

Summary of Fiscal Impact of HB 1261 to SDRS

HB 1261 will cause **increases in SDRS actuarial liabilities or reductions in assets that will range from approximately $12 million to $44 million**, depending on the number of retired members who are reemployed, or active members who retire and are reemployed prior to the sunset date in HB 1261. **If the sunset date is extended, the costs will increase.**

Note that while SDRS costs will increase, the combined employer salary and SDRS contribution costs will decrease by 21 percent of pre-retirement pay while each member is reemployed under HB 1261.

Background and details of the analysis follow.

Current SDRS Provisions

SDRS currently requires a three-month separation of service at retirement. Benefits of members who retire and are reemployed are reduced by 15 percent and the COLA is suspended during reemployment. The benefit reduction and COLA suspension do not apply to Class B Public Safety retirees who are rehired into a Class A position or to members who are rehired to work less than 1,250 hours provided the reemployment either follows a three-month separation of service or the member was at least age 59 ½ at retirement.

Member contributions are required during reemployment and are deposited in the member's Supplemental Retirement Plan account. Employer contributions are also required during reemployment and, along with the benefit reduction and COLA suspension, offset the cost of the earlier payment of benefits.

Summary of HB 1261

The bill revises the following SDRS provisions for retirees returning to work for an employer at a salary that is 75 percent or less than the member's salary prior to termination and the employer certifies it has not been successful in filling the position:

- The required separation of service period is reduced to 30 days.
- No benefit reduction or COLA suspension is applied during reemployment.
- The employer contributes 12 percent of the reduced salary to SDRS and the member makes no contributions.

Under HB 1261 as drafted, these revised provisions would be repealed on June 30, 2025.

<u>Note that the proposed return-to-work provisions provide more generous and costly benefits to rehired retirees than were provided before the provisions were revised to limit SDRS losses in 2010.</u>

Fiscal Impact Considerations

SDRS is funded by fixed, statutory contribution rates including employer contribution rates that are 40 percent of the national median. SDRS contribution rates do not change based on actuarial experience. SDRS is also subject to minimum statutory funding requirements detailed in SDCL 3-12C-228. As a result, experience that deviates from assumptions, or changes in actuarial assumptions driven by demographic trends or economic conditions, first impact the affordable COLA paid to retired members and beneficiaries.

Two main determinants of the cost of a pension plan are the amount of retirement benefits and when those benefits are paid. If members have reached eligibility for unreduced retirement benefits, the sooner benefits are paid, the more valuable and costly they are.

The current return to work provisions were carefully designed to comply with IRS requirements, provide SDRS employers with flexibility to rehire retired members, and avoid a significant financial benefit to the member or employer that would encourage earlier retirement and thereby increase SDRS actuarial liabilities. This last point is critical because of the SDRS structure discussed above. If generous return-to-work provisions encourage earlier retirements that are not offset by benefit adjustments, SDRS will experience actuarial losses that will impair the ability to sustainably pay retirees COLAs.

The fiscal impact of HB 1261 is directly related to whether the revised provisions encourage retired members to return to employment or encourage active members to retire and begin receiving benefits earlier than they would absent the provisions. The impact will vary based on members' eligibility for unreduced retirement benefits, ages, SDRS service and pay. We have focused on the impact of HB 1261 on Class A Foundation members under age 62 (because reemployment is more likely prior to age 62 and the availability of Social Security benefits beginning at age 62 makes the reemployment decision more complicated). The estimated impact on differently situated members follows.

Retired Members with an Unreduced SDRS Retirement Benefit

The employers of members who are already retired, or who would have retired absent the provisions of HB 1261, and are reemployed contribute 12 percent of the member's reduced salary to SDRS. Under current provisions, no contributions are made to SDRS for retired members. The increase in contributions would decrease SDRS costs, or rather, increase SDRS assets for each retired member who is incented to return to employment.

Active Members Not Yet Eligible for Unreduced SDRS Retirement Benefits

When members are not yet eligible for unreduced SDRS retirement benefit, the increase in the SDRS benefit for working another year is more significant because it includes an additional year of service in the benefit formula and one less year of early retirement reduction. As such, we have assumed that HB 1261 would not provide a large enough financial incentive for these members to retire, and no members will be incented to retire prior to unreduced retirement eligibility. HB 1261 would not materially impact the actuarial liabilities, annual costs, or actuarial gains or losses of SDRS for these members.

Active Members Eligible for Unreduced SDRS Retirement Benefits

Class A Foundation members reach eligibility for unreduced SDRS retirement benefits at age 65, or when age and service total at least 85.

For an active member eligible for an unreduced SDRS benefit, the HB 1261 provisions provide an opportunity for the member to retire and return to work and increase the member's total compensation (salary and SDRS benefits) from 10 to almost 30 percent of the member's pre-retirement compensation, depending on the member's service at retirement. The net impact of a front-loaded cashflow pattern with higher immediate total compensation is likely to incent members to retire if able to be reemployed under HB 1261.

SDRS Cost Increase Estimates

HB 1261 will change members' decisions about retirement. In fiscal year 2021, 14 percent of SDRS Class A members eligible for an unreduced benefit and under age 62 retired; the remaining 86 percent continued to work.

We have assumed SDRS retirees who are reemployed remain reemployed for four years, following historical SDRS reemployment data.

HB 1261 will incent some retired members to return to work and SDRS will receive 12 percent employer contributions on those members' reduced salary. For each retired member who returns to work under HB 1261, SDRS costs decrease by 9 percent of the member's pre-retirement pay for each year that the member remains reemployed. The average SDRS cost savings for each reemployment would be approximately $21,300.

HB 1261 will also incent some of the 86 percent of members who are eligible for unreduced SDRS benefits and under age 62 who currently choose to remain active to retire and return to work under the HB 1261 provisions. For each member who receives benefits under HB 1261, SDRS costs increase by approximately 18 to 19 percent of the member's pre-retirement pay for each year that the member remains reemployed. The average SDRS losses from the accelerated benefit payments and reduced contributions would be approximately $52,500.

Based on historical reemployment rates of reemployed retirees we expect a minimum of 5 percent and an upper estimate of 20 percent of retired members under age 62 to be reemployed under the provisions of HB 1261. We have also assumed the same 5 to 20 percent of eligible members under age 62 will be incented to retire and return to employment. As a result:

- The additional cost to SDRS would range from $13-$47 million because of additional members will be incented to retire

- The additional cost savings to SDRS would range from $1-$3 million due to members who would have retired but will change their mind and return to work

- The net additional cost to SDRS would range from $12-$44 million

Employer Cost Savings Estimates

Employer costs are reduced by approximately 21 percent of the member's pre-retirement pay for each year the member is reemployed due to the 25 percent reduction in salary only partially offset by the higher SDRS contribution rate on a reduced salary.

This assumes there is not an offsetting increase in non-salary remuneration to compensate the member for the reduction of the salary to 75 percent of the pre-retirement amount. If there will be an offsetting increase that is not addressed in HB 1261, the incentive for members to retire and be reemployed would be strengthened, the number of members retiring and becoming reemployed would increase, and the fiscal impact of HB 1261 would be greater than the noted estimate.

Effectively, SDRS funds which are designated for the exclusive benefit of SDRS retirees and beneficiaries would be used to subsidize the employer compensation costs of members who return to work.

Summary

In summary, HB 1261 will cause increases in SDRS actuarial liabilities that will range from approximately $12 million to $44 million. Costs will be higher if the sunset date is extended or if more than 20 percent of eligible members elect to retire and be reemployed.

At the same time, HB 1261 will result in reduced employer costs of approximately 21 percent of each member's pre-retirement pay for each year the member is reemployed.

We again note that any increase in SDRS actuarial liabilities and costs may impair SDRS' ability to sustainably pay retirees COLAs.

Sincerely,

Douglas J. Fiddler, A.S.A., E.A., M.A.A.A., F.C.A.
Senior Actuary

c: Ms. Jacquelyn Storm, SDRS
Ms. Michelle Mikkelsen, SDRS