



South Dakota Retirement System

SDRS Update for Executive Board of Legislative Research Council

August 23, 2022

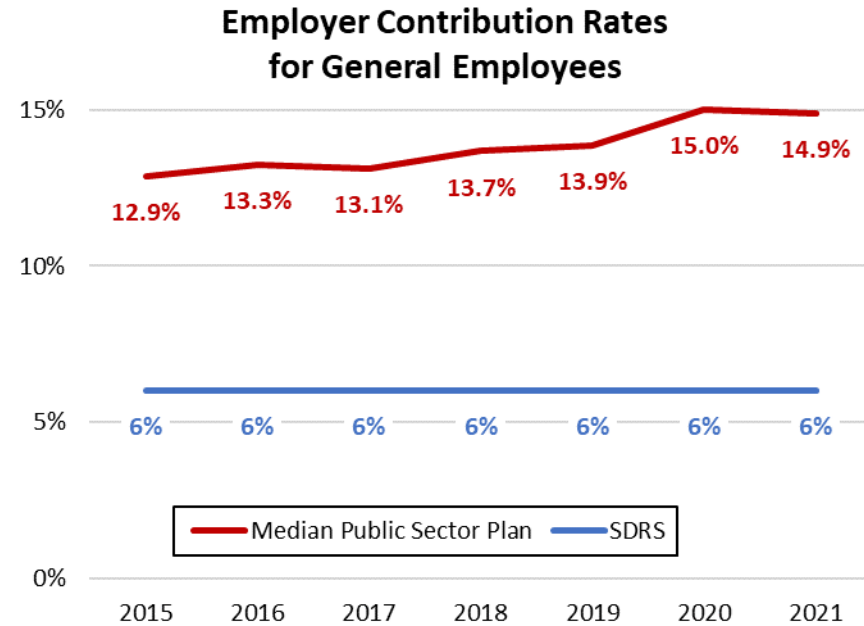
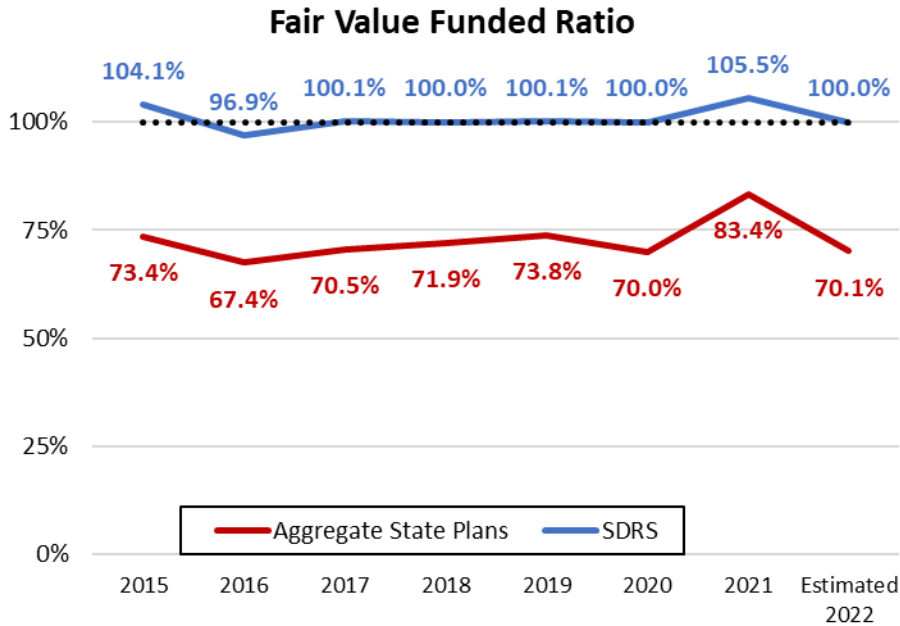


Unique Funding Structure

- SDRS is managed within the resources provided by **fixed contributions**
- SDRS benefits, primarily the COLA, vary as necessary to remain fully funded:
 - In other states, experience worse than assumed causes employer contribution increases and funded ratio decreases
 - At SDRS, experience worse than assumed impacts the COLA SDRS can afford
- Under most economic conditions, SDRS variable benefits will result in full funding, but a severe or prolonged downturn could require corrective action recommendations
- Diversion of SDRS resources for purposes other than providing income in retirement will diminish the ability to provide retirement security for all members



SDRS Funded Status and Contribution Rates Compared to Other State Plans



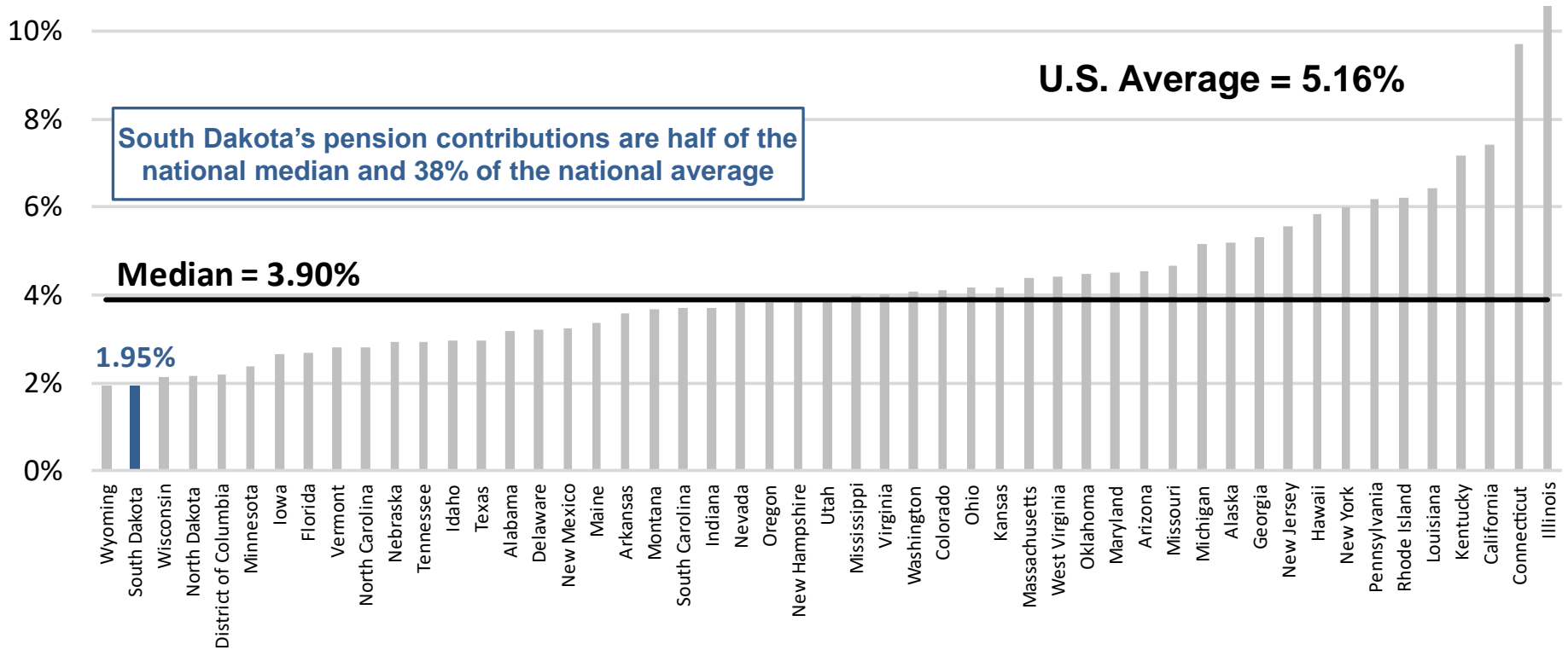
The median investment return assumed by statewide plans has dropped to 7.00%. SDRS assumes 6.5% investment return.

State plan funded ratios are from 2021 Wilshire Consulting Report on State Retirement Systems: Funding Levels and Asset Allocation. 2021 and estimated 2022 state plan figures are from 2022 Wilshire estimate released July 8, 2022. Employer contribution rates from NASRA Public Fund Survey, November 2021.



Government Spending on Pensions

Government Contributions to Pensions as a Percent of All Direct Government Spending, FY 2019 (most recently available)



Data from NASRA Issue Brief: State and Local Government Spending on Public Employee Retirement Systems.



Funding Structure Impacts

- Fixed employer contribution requirement provides budgetary certainty
- Variable benefit structure, primarily the COLA, provides as much benefit as affordable within fixed resources
- Statutory funding thresholds ensure state and other participating employers are not required to recognize pension debt on balance sheets
- Structure is positive factor in keeping state's AAA credit rating, in turn, lowering borrowing costs
- However, the ability to pay adequate and appropriate benefits is subject to affordability based on fixed resources



SDRS COLA

- The July 2022 COLA was 3.5%, the statutory maximum:
 - Full COLA range was affordable for the first time on the current COLA structure
 - COLA was highest in SDRS history; however, inflation was 5.92%
- SDRS goal is to pay a COLA equal to inflation, but goal is subject to funding constraints:
 - COLAs vary based on affordability while remaining fully funded based on fixed member and employer contribution rates
- Through the July 2022 COLA, approximately 35% of SDRS benefit recipients have received cumulative COLAs less than inflation since their benefits started:
 - July 2023 COLA will likely again trail inflation by a substantial amount
 - Through July 2023 COLA, rough estimate is 65% of benefit recipients will have received cumulative COLA increases since retirement that trail inflation by approximately 6%
- Providing adequate and appropriate benefits funded by fixed contributions is increasingly difficult as retirees live longer and market returns diminish



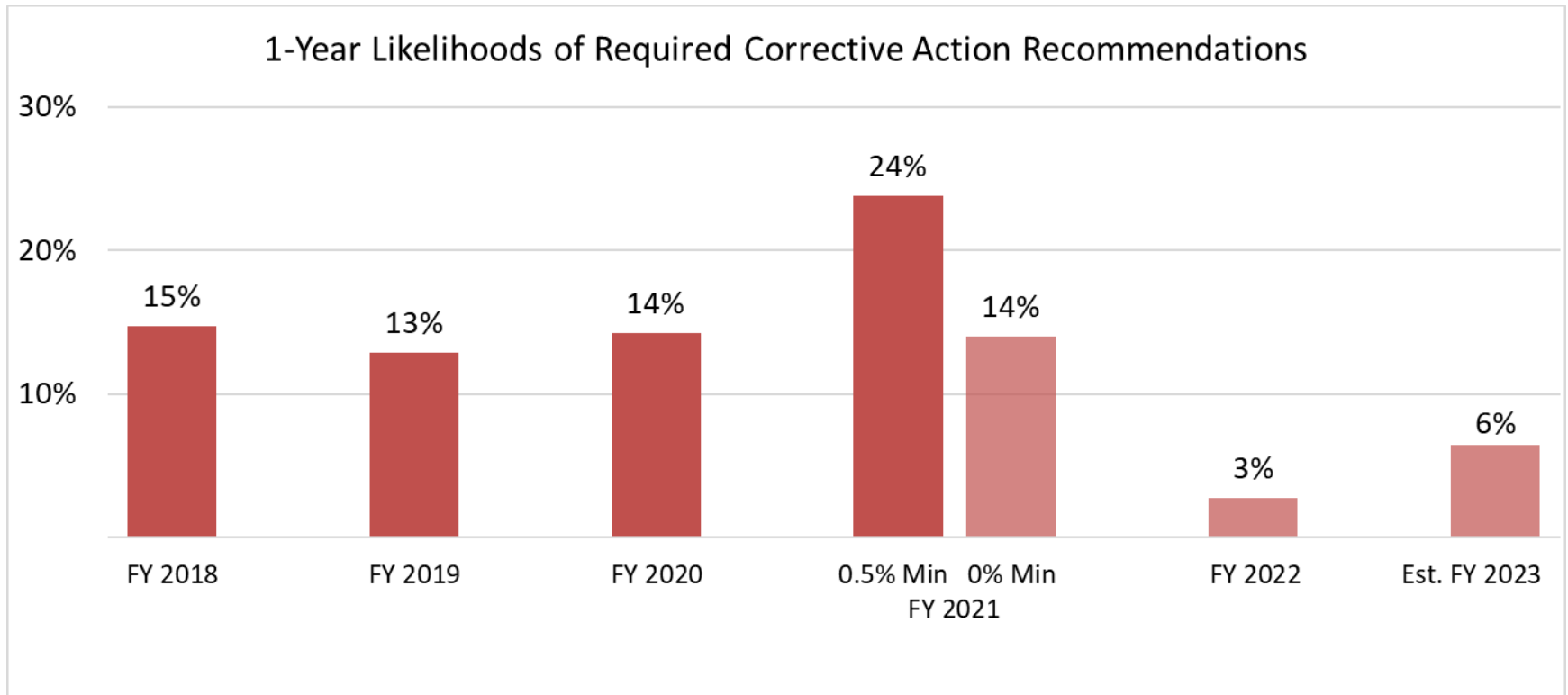
June 30, 2022 Projected Funding Results and July 2023 COLA Estimate

- When affordable, the SDRS COLA is equal to inflation with a 3.5% maximum:
 - Affordability requires a Baseline Fair Value Funded Ratio (FVFR) of 100% or more
 - Projected June 30, 2022 Baseline FVFR is 98%
 - As a result, COLA range must be limited
- Fair value of assets support an ongoing COLA of 2% (preliminary estimate):
 - July 2023 COLA will be inflation with a maximum of approximately 2%
 - CPI-W increase will exceed 2%
 - **July 2023 COLA will be approximately 2%**
- Financial statements of SDRS and employers will reflect **100% funded status**
- The 2022 SDRS valuation will likely be the 27th of the last 32 with a FVFR of 100% or greater



Corrective Action Risk Assessment

SDRS regularly measures the likelihood of required recommendations for corrective actions at the current fiscal year



Before consideration of liability gains/losses. Likelihoods based on SDIC **current** asset allocation investment portfolio statistics (FY 2023: mean = 5.66%, standard deviation = 12.2%).



Demographic Trends

- The baby boom generation (born from 1946 to 1964) has a significant impact on SDRS demographics:
 - Boomers now 36% of membership
 - 68% of boomers now retired
 - SDRS now has over three retirees for every four active members
- The number of retirements is at an all time high:
 - FY 2022 retirements were again at an all time high, but only 1% more than FY 2021
 - The median Class A retirement age had increased to 64.3 in FY 2021, FY 2022 TBD
 - Fewer members are retiring at earlier ages
- Negative cash flow (benefits paid in excess of contributions) is expected and stable
- **All SDRS employers will need to replace a significant portion of employees in upcoming years**



Summary

- SDRS is managed within the resources provided by **fixed contributions**
- SDRS paid a **COLA of 3.5% in 2022**, the highest in our history but will likely only be able to afford a **COLA of approximately 2% in 2023**
- The **funded status as of June 30, 2022 will be 100%**, meeting funding goals, but based on restricted maximum COLA of approximately 2%
- Under most economic conditions, SDRS variable benefits will result in full funding, but a severe or prolonged downturn could require Corrective Action recommendations
- Long-term investment performance and commitment to managing liabilities result in a **funded status of 100%** – significantly better than most state retirement systems (estimated 70.1% in aggregate)
- Members continue to retire later; however, all employers will need to replace a significant portion of employees in upcoming years