SDRS
SOUTH DAKOTA
RETIREMENT SYSTEM

222 East Capitol Avenue, Suite 8 ● PO Box 1098 ● Pierre, SD 57501
Toll-Free (888) 605-SDRS ● Phone (605) 773-3731
Fax (605) 773-3949 ● sdrs.sd.gov

February 7, 2023

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 2023 Legislative Session – House Bill 1177

Dear Travis:

House Bill 1177 modifies SDRS provisions regarding reemployment after retirement.

Summary of Fiscal Impact of HB 1177 to SDRS

HB 1177 will cause **increases in SDRS actuarial liabilities or reductions in assets that will range up to approximately $83 million**, depending on the number of active members who retire and are reemployed prior to the sunset date in HB 1177. **If the sunset date is extended or the eligible group expanded, the costs will be greater.**

Note that because SDRS is funded with fixed contributions and SDRS COLAs vary based on affordability, the increase in cost will result in reduced future COLAs for SDRS benefit recipients, reducing the monthly benefits paid to retirees and beneficiaries for the rest of their lives.

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 1177

We note that the Sections 1 and 2 of bill as introduced appear to be in conflict and we have based this analysis on what we believe is the intended provisions. We believe the intent of the bill is to remove the 15 percent benefit reduction and COLA suspension for teachers returning to work if the teacher has a twelve-month consecutive separation from service and the school district certifies it has not been successful in filling the position.

Under HB 1177 as drafted, these revised provisions would be repealed on June 30, 2026.

Note that the proposed return-to-work provisions provide more generous and costly benefits to rehired teachers than were provided before the provisions were revised in 2010 to eliminate the additional costs to SDRS due to the existing return-to-work provisions.

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, changes in actuarial assumptions driven by demographic trends or economic conditions, or legislation modifying SDRS provisions 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 earlier 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 costs. 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 reduce retirees COLAs and increase the likelihood of future corrective actions.

The fiscal impact of HB 1177 is directly related to whether the revised provisions encourage active members to retire and begin receiving benefits earlier than they would absent the provisions.

Teachers who are Class A Foundation members, those entering SDRS prior to July 1, 2017, reach eligibility for unreduced SDRS retirement benefits at age 65, or when age and service total at least 85, no earlier than age 55.

There are currently over 1,100 active teachers who are eligible or will be eligible for unreduced SDRS benefits by July 1, 2023. On average, these members have 31 years of service and their accrued SDRS benefit is slightly greater than 50 percent of Final Average Compensation (FAC). HB 1177 provides these teachers the opportunity to retire and return to work after twelve months and receive their full salary and their full SDRS benefit. After the twelve-month break, the take home pay of rehired teachers could increase by more than 50 percent under HB 1177.

The required twelve-month break is not an effective barrier to counteract the financial incentive to retire and return to work. After considering the pre-retirement SDRS member contributions and SDRS retirement benefit, the retired teacher would only have to replace 44 percent of pre-retirement pay to remain whole. Accrued leave payouts and any interim employment could replace this income without significant hardship. In addition, according to the most recent audit reports on the Department of Legislative Audit website, most of the largest school districts are still paying early retirement incentives of up to 80 percent of pay to active teachers who retire early.

In most circumstances, HB 1177 would provide an opportunity for a year break from the classroom and the potential for a significant financial windfall when rehired. We have not estimated how many eligible teachers would decide to immediately retire but have estimated an upper limit to the SDRS cost impact if all eligible teachers do so.

Because of the financial windfall available to eligible teachers, an unintended consequence of HB 1177 may very well be a devastating teacher shortage in fiscal year 2024, much worse than the current shortage.

HB 1177 will change active teachers' decisions about retirement. In fiscal year 2022, 14 percent of teachers eligible for an unreduced benefit and under age 60 retired; the remaining 86 percent continued to work.

HB 1177 may incent some retired members to return to work and SDRS will receive six percent employer contributions on those members' reduced salary. Any currently retired member who returns to work but would not have without the removal of the benefit adjustments, decreases the cost of HB 1177.

However, HB 1177 will also create a privileged class of rehired retirees who get beneficial treatment compared to those rehired into non-teaching positions, those previously rehired, those rehired after the sunset date, and those who did not have a twelve-month separation from service. We would expect future efforts to broaden the preferential treatment to each of these groups.

Summary

In summary, HB 1177 will cause increases in SDRS actuarial liabilities that will range up to $83 million. Costs will be higher if the sunset date is extended or if the eligibility is extended to groups other than teachers. This potential cost increase would reduce SDRS COLAs paid to retirees and beneficiaries, permanently reducing their monthly benefits.

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

Future actuarial results may differ significantly due to plan experience different than assumed or other unanticipated changes. An actuarial model was used for this analysis that in my professional judgement, is sufficient for assessing the impact of this legislation. The signee meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.