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

JANUARY 2024

South Dakota Retirement System
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SDRS Fundamental Principles

- **SDRS is funded by fixed, modest, statutory contribution rates – South Dakota spends the lowest percentage of total spending on pensions in the nation, less than 40% of the national average**

- **SDRS is sustainably managed by the SDRS Board of Trustees within the limited resources provided by the fixed contribution rates:**
    - **The SDRS Cost of Living Adjustment (COLA) is annually limited to the affordable and sustainable percentage**
    - **Corrective action recommendations are required if statutory funding thresholds are not met**

- **SDRS exists to provide adequate and equitable lifetime retirement benefits for public employees in South Dakota to help them achieve financial security in retirement**

SDRS Fiscal Year 2023 Key Takeaways

- **SDRS is 100.1% funded at June 30, 2023 and is expected to remain 100% funded in most economic conditions due to the variable SDRS COLA**

- **The July 2024 COLA will be 1.91 percent, lower than recent inflation, but the maximum affordable on a sustainable, long-term basis considering current resources**

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

- **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 9, 2024

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, 2023.

As of June 30, 2023, SDRS is 100.1 percent funded and all the Board of Trustees' funding objectives have been met. This marks the twenty-eighth time out of the last thirty-three 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 – and is particularly noteworthy given that the SDRS fixed member and employer contributions are much less than the national average. This has been achieved while providing benefits that generally meet the Board's adequacy goals; however, recent SDRS cost-of-living adjustments (COLAs) have not kept pace with the recent historically high levels of inflation.

The success of SDRS has been achieved through the disciplined management of the System by 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 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 that meet the Board's goals and can be funded by our 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. The July 2024 SDRS COLA will be 1.91 percent, the maximum affordable COLA while remaining fully funded. 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 metrics 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

Eric Stroeder
Chair, SDRS Board of Trustees

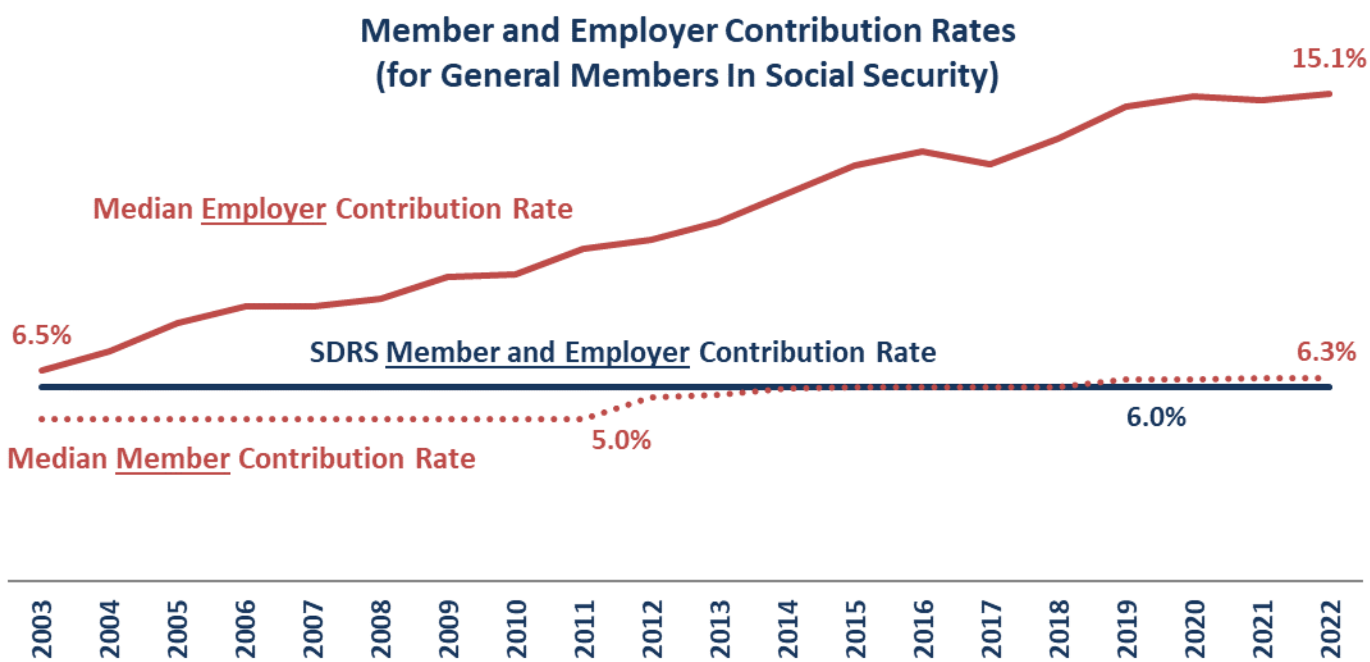
THE SDRS MODEL

Defined benefit pension plans pay lifetime benefits at retirement based on a member's 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 on system assets. 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 corrective action recommendations when not met.

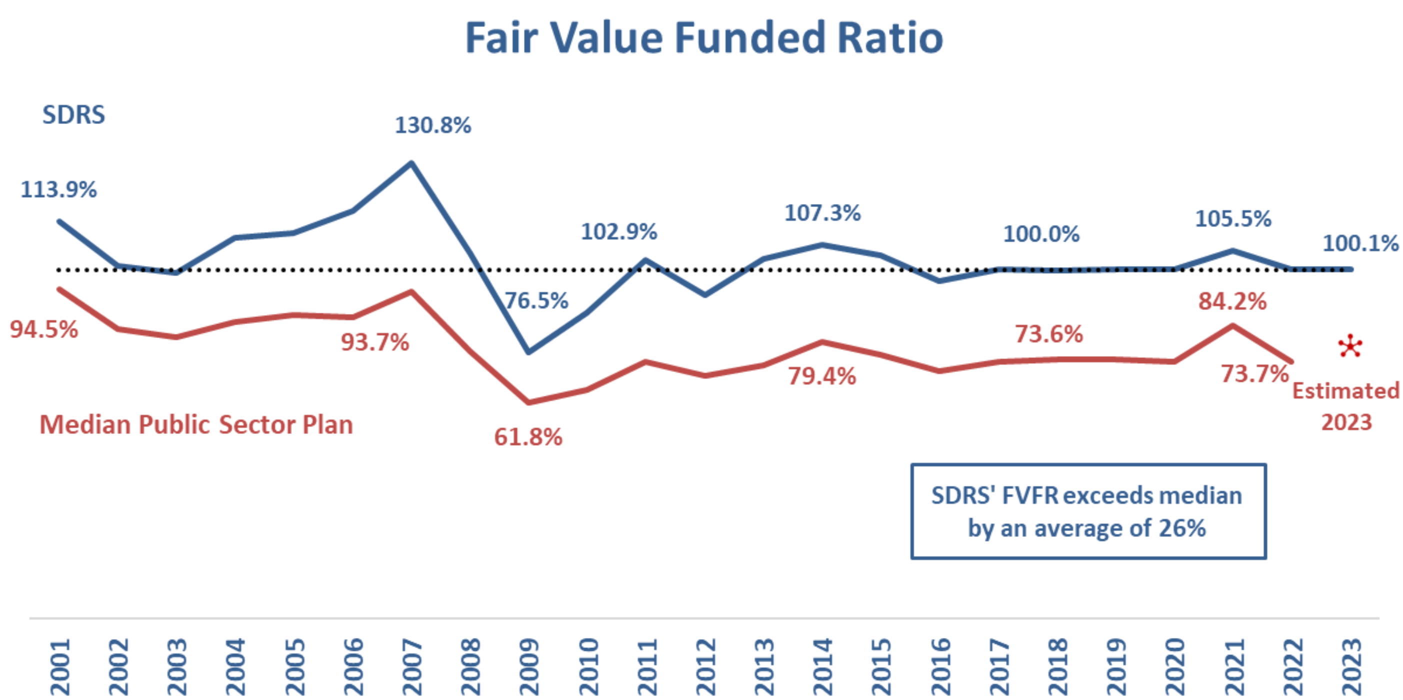
The two following charts compare the effectiveness of the two approaches.

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 6.3 percent of pay. The **median employer contribution rate**, however, has more than doubled from 6.5 percent in 2003 to 15.1 percent of pay in 2022. During that same time, SDRS **member and employer contributions** have remained at 6 percent of pay. SDRS employer contributions are 40 percent of the median rate.



Median public sector plan contribution rates from NASRA Public Fund Survey, November 2023

While median public sector contribution rates have escalated significantly, the median funded status has remained well below SDRS' full funded status. The second chart shows the Fair Value Funded Ratio for SDRS has exceeded 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 a key 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. These results would be even more striking if the median funded ratios were based on the SDRS investment return assumption, which is currently 6.5 percent compared to a median rate of 7 percent for state plans.



Median public funded ratios from Public Plans Database.

Frequent media reports detail the struggles many public sector retirement plans face in addressing pension funding issues. The funded status for most of the plans improved during fiscal year 2021 due to investment returns significantly above long-term assumptions and subsequently deteriorated during fiscal year 2022. Early estimates for the median Fair Value Funded Ratio for fiscal year 2023 are approximately 78%.

The outstanding long-term investment performance of the South Dakota Investment Council has been the primary factor in the funded status 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 discipline on SDRS and kept SDRS on sound financial footing.

SDRS FUNDED STATUS AS OF JUNE 30, 2023

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 2023 actuarial valuation of SDRS confirms that all three of the Board's funding objectives have been met based on the restricted maximum COLA of 1.91 percent.

2023 LEGISLATIVE CHANGES

During the 2023 Legislative Session, no substantive changes to SDRS provisions were enacted. Emergency medical service personnel were designated as Class B Public Safety Members on a prospective basis.

Of note, SDRS representatives again opposed Legislation that would have significantly increased benefits paid to SDRS retirees reemployed in full-time, SDRS-covered positions. Because SDRS is funded by fixed contributions and SDRS COLAs are reduced, if necessary, to remain fully funded, any unfunded increase in benefits for some members necessarily results in reduced future COLAs for all retirees and beneficiaries. Although the Legislation might have convinced a few retired members to return to the public workforce, it also would have provided wide-spread opportunities for active members at or near retirement eligibility to reap substantial windfalls, and employers to reduce compensation costs, all at the expense of SDRS retirees. In addition, significant flexibility to rehire SDRS retirees on a part-time basis without impacting SDRS benefits currently exists. SDRS urges Legislators to resist future efforts to divert SDRS resources for purposes that are not consistent with our primary objective of providing adequate and equitable retirement income for all public employees.

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.

Legislation enacted in 2017 tied the COLA directly to the annual inflation rate and the available resources to pay for it. Legislation enacted in 2021 reduced the minimum SDRS COLA to 0 percent.

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 results of the June 30, 2021 actuarial valuation, the full COLA range of 0 to 3.5 percent was affordable. However, inflation for the prior year was the highest in recent history at 5.92 percent. As a result, while **the July 2022 SDRS COLA of 3.50 percent was the highest SDRS has ever paid,** it was significantly less than inflation for the prior year for the first time in many years.

Based on the results of the June 30, 2022 actuarial valuation, the full COLA range was not affordable, and a restricted maximum COLA of 2.10 percent was effective for the July 2023 increase. Inflation for the prior year was at an even higher level of 8.75 percent, resulting in a **July 2023 SDRS COLA of 2.10 percent,** substantially less than inflation for the year.

Based on the results of the June 30, 2023 actuarial valuation, the full COLA range is again not affordable, and a restricted maximum COLA of 1.91 percent will be effective for the July 2024 increase. Inflation for the prior year was at 3.20 percent, resulting in a **July 2024 SDRS COLA of 1.91 percent,** again less than inflation for the year.

As of July 2023, cumulative COLAs since retirement will equal or exceed cumulative inflation for approximately 30 percent of SDRS retirees and beneficiaries but will be less than inflation and fall short of the Board's objective for the other 70 percent. This is primarily a result of recent, extraordinarily high inflation rates. Nevertheless, 70 percent of retirees are receiving a benefit that is at least 95 percent of the benefit they would be receiving if the SDRS COLA had matched inflation. Approximately 93 percent of retirees are receiving a benefit that is at least 90 percent of the benefit they would be receiving if the SDRS COLA had matched inflation. The Board will continue to closely monitor the COLA compared to inflation and, as part of its contingency planning discussed below, has placed a high priority on addressing any COLA shortfall if, and when, possible.

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 was developed to be used as a starting point for discussions if economic conditions prevent SDRS from reaching its Funding Policy Objectives and statutory funding requirements. The threat of a recession necessitates a re-evaluation of the guide which was begun by the Board in 2023 and is expected to be completed during 2024.

In addition, the planning guide identifies potential benefit improvement recommendations for consideration if the criteria in the Board's policy on benefit improvements is met.

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

Contingency Planning Document

LOW-DEFAULT-RISK OBLIGATION MEASURE

In compliance with the updated Actuarial Standards of Practice Statement No. 4 (ASOP 4), the June 30, 2023 actuarial valuation report includes a disclosure of a new liability measurement called a Low-Default-Risk Obligation Measure, or LDROM. The LDROM is a recalculation of the actuarial accrued liability using a discount rate derived from low-default-risk fixed income securities, which will typically be a lower discount rate than the assumed investment return, resulting in a higher liability figure. While the LDROM does not impact SDRS funding or accounting measurements, we expect organizations opposed to governmental defined benefit plans will use the LDROM to escalate criticisms of public pension plans. Importantly for SDRS, revised ASOP 4 directs actuaries to consider the impact investing in low-default-risk fixed income securities would have on variable benefits, such as the SDRS COLA. As a result, the LDROM for SDRS is very similar to SDRS' funding measurements but based on a lower affordable COLA. For more details, please see the SDRS June 30, 2023 actuarial valuation report.

SDRS 2024 PROPOSED LEGISLATION

The SDRS Board of Trustees has submitted the following bills for consideration during the 2024 Legislative Session:

- **SB 68:** An Act to amend certain provisions pertaining to the South Dakota Retirement System to comply with federal law.
- **SB 69:** An Act to amend certain provisions pertaining to the South Dakota Retirement System.

Details and descriptions of the proposed legislation can be found in the 2024 legislative summary on the SDRS website at:

SDRS 2024 Legislative Session Page

ADDITIONAL INFORMATION

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

The **June 30, 2023 actuarial valuation report** with additional detail on the funded status of the system and fiscal year 2023 experience and the **June 30, 2023 Annual Comprehensive Financial Report** with complete financial data on the system, fiscal year 2023 experience, and historical trend information can be found under the "Annual Reports" heading on the SDRS publications page at:

SDRS Publications

Material from the **December 2, 2023 SDRS Board of Trustees Meeting**, including presentations on the June 30, 2023 actuarial valuation results, demographic trends, and the fiscal year 2023 financial statements:

December 2023 SDRS Board Meeting Material

Appendix A: Fiscal Year 2023 Highlights

Total System Membership	**100,828**
Active Contributing Members	**42,504**
Inactive Non-Contributing Members	**25,043**
Benefit Recipients	**33,281**
Fair Value of Assets	**$14.5 Billion**
Actuarial Accrued Liability	**$14.5 Billion**
Assumed Future COLAs	**1.91%**
Fair Value Funded Ratio	**100.1%**
Member and Employer Contributions	**$308.6 Million**
Benefit Payments and Refunds	**$735.1 Million**
Administrative Expenses	**$5.2 Million**
Net Investment Income	**$806.1 Million**
Minimum Statutory COLA	**0.00%**
Maximum Statutory COLA	**1.91%**
Prior Year Inflation	**3.20%**
July 2024 COLA	**1.91%**

Appendix B: SDRS Benefits Payable by County

The following exhibit presents a schedule of the annualized benefits payable as of July 1, 2023, by SDRS on a county-by-county basis.

County	Benefit Recipients	Annual Benefits	County	Benefit Recipients	Annual Benefits	County	Benefit Recipients	Annual Benefits
Aurora	130	$2,203,811	Fall River	343	$5,478,813	McPherson	77	$1,263,252
Beadle	550	$11,375,916	Faulk	134	$1,947,263	Meade	809	$16,417,994
Bennett	56	$939,755	Grant	211	$4,138,065	Mellette	60	$830,643
Bon Homme	340	$5,924,667	Gregory	180	$3,137,087	Miner	82	$1,732,293
Brookings	1,691	$46,616,277	Haakon	67	$1,135,265	Minnehaha	4,612	$113,275,652
Brown	1,392	$31,286,822	Hamlin	220	$3,863,705	Moody	214	$3,551,256
Brule	162	$3,543,452	Hand	121	$2,042,750	Oglala Lakota	21	$384,596
Buffalo	3	$55,111	Hanson	63	$1,111,687	Pennington	3,814	$89,703,620
Butte	352	$6,128,878	Harding	42	$624,650	Perkins	94	$1,403,767
Campbell	63	$958,334	Hughes	1,579	$44,631,984	Potter	114	$2,137,410
Charles Mix	249	$5,119,222	Hutchinson	272	$5,139,507	Roberts	291	$5,210,969
Clark	141	$2,194,023	Hyde	62	$773,250	Sanborn	94	$1,624,116
Clay	709	$19,557,306	Jackson	55	$994,390	Spink	456	$8,124,945
Codington	924	$22,549,103	Jerauld	85	$1,465,752	Stanley	258	$6,455,288
Corson	54	$1,012,256	Jones	38	$893,877	Sully	66	$1,037,915
Custer	418	$7,827,633	Kingsbury	247	$4,714,374	Todd	70	$1,352,860
Davison	638	$14,994,925	Lake	483	$10,991,889	Tripp	211	$3,704,171
Day	232	$4,244,531	Lawrence	1,110	$25,292,693	Turner	273	$4,854,786
Deuel	139	$2,330,583	Lincoln	521	$9,846,483	Union	361	$7,276,781
Dewey	115	$1,978,554	Lyman	110	$1,950,625	Walworth	235	$4,418,360
Douglas	97	$1,742,720	Marshall	208	$3,755,966	Yankton	999	$21,421,257
Edmunds	118	$2,156,842	McCook	174	$3,582,083	Ziebach	28	$581,741

Total SDRS Benefits Payable in South Dakota	**$ 629,016,551**
Total SDRS Benefits Payable Outside of South Dakota	**$ 92,837,999**
Total SDRS Benefits Payable	**$ 721,854,550**

SDRS MISSION STATEMENT

To responsibly manage a financially sustainable system within fixed resources and prepare our members for retirement.

SDRS VISION

To be a model retirement system that is fully funded, delivers benefits that meet our long-term benefit goals, and provides members the foundation to achieve financial security during retirement.

SDRS LONG-TERM INCOME REPLACEMENT GOALS

Retirement Income from SDRS

Lifetime income from SDRS of at least 50 percent of Final Average Compensation (FAC) at normal retirement for career members with credited service of at least 30 years for Class A members, 25 years for Class B Public Safety members, and 20 years for Class B Judicial members.

Proportionate lifetime income from SDRS for members who participate in SDRS for less than a career.

Additional Member Savings

SDRS will educate members of the need for additional savings and will encourage members to accumulate personal savings of at least 100 percent of annual pay at retirement to provide retirement benefits in addition to those provided by SDRS and Social Security.

Total Retirement Income

Educate, advise, and encourage members to plan for retirement by establishing a total retirement income goal based on their unique circumstances and considering benefits available from SDRS, Social Security, and personal savings.

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