REGULAR MEETING

SOUTH DAKOTA RETIREMENT SYSTEM

December 3, 2015

The Board of Trustees of the South Dakota Retirement System held its regular meeting on December 3, 2015, in the downstairs conference room, View 34, Pierre, South Dakota.

BOARD MEMBERS IN ATTENDANCE:

Elmer Brinkman, Chair
Karl Alberts
Steve Caron
Jason Dilges
Jilena Faith
Laurie Gill
Laurie Gustafson
James Hansen
James Johns
Louise Loban
Bonnie Mehlbrech
Dave Merrill
Lt. Governor Matt Michels
K.J. Peterson
Eric Stroeder
Justice Steven Zinter
Matt Clark, Ex Officio

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OTHERS IN ATTENDANCE:

Deene Dayton
Hank Kosters, PARTA
Bob Mercer, Media
Eric Ollila, SDSEO
Aaron Olson, LRC
Paul Schrader, Consultant
Sandra Waltman, SDEA
Rob Wylie
Travis Almond
Jane Beer
Susan Jahraus

Doug Fiddler
Michelle Mikkelsen
Jessica Reitzel
Dawn Smith
Jacque Storm

For continuity, these minutes are not necessarily in chronological order.

AGENDA ITEM 1
APPROVAL OF SEPTEMBER 2, 2015, MINUTES

Board Action
IT WAS MOVED BY MR. STROEDER, SECONDED BY MS. GUSTAFSON, TO APPROVE THE MINUTES OF THE SEPTEMBER 2, 2015, BOARD OF TRUSTEES MEETING. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 2
SDRS FINANCIAL STATEMENTS
FOR THE PERIOD ENDING JUNE 30, 2015

Summary of Presentation
Mr. Rob Wylie, SDRS Executive Director/Administrator, and Ms. Jane Beer, SDRS Chief Financial Officer, presented the SDRS Financial Statements for the period ending June 30, 2015. Ms. Beer stated that there was $219.7 million in total contributions and over $482 million in total benefits and refunds paid. As of June 30, 2015, stated Ms. Beer, SDRS had over $10.7 billion in assets.

SDRS fully implemented GASB 67 in its Financial Statement for the fiscal year ending 2014. Changes within the Statement include new Notes as required by GASB 67. Note 4 goes into detail regarding the net pension asset of the System. Required Supplementary Information (RSI) was also changed significantly with the implementation of GASB 67.

Board Action
No action was necessary.

AGENDA ITEM 3
SDRS FINANCIAL AUDIT
FOR PERIOD ENDING JUNE 30, 2015

Summary of Presentation
Ms. Beer presented the external financial audit of SDRS, the SDRS Supplemental Retirement Plan (SRP), and the Special Pay Plan (SPP), as prepared by Eide Bailly, for the fiscal year ending June 30, 2015.

Ms. Beer stated that the Eide Bailly report found no material weaknesses in the review of SDRS' financial statements and internal accounting controls.

Board Action

IT WAS MOVED BY MS. PETERSON, SECONDED BY JUSTICE ZINTER, TO ACCEPT THE FINANCIAL AUDIT REPORT FOR FISCAL YEAR 2015 AS PREPARED BY REPRESENTATIVES OF EIDE BAILLY. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 4
SDRS ACTUARIAL VALUATION
FOR THE PERIOD ENDING JUNE 30, 2015

Summary of Presentation

Mr. Doug Fiddler, SDRS Senior Actuary, presented the SDRS Actuarial Valuation for the period ending June 30, 2015.

Mr. Fiddler explained the purpose and uses of the actuarial report. He stated that it can be used for the detection of changes from the prior year and as an early warning system for potential funding problems.

Mr. Fiddler stated that there was an increase in the present value of all benefits to $11.8 billion. The actuarial accrued liability increased to $10.3 billion, the actuarial value of assets increased to $10.3 billion, and the unfunded actuarial accrued liability remained at zero. The normal cost decreased to 10.7 percent and the funding period also remained at zero. The actuarial accrued liability funded ratio remained at 100 percent and the fair value funded ratio decreased to 104.1 percent.

The conclusions of the 2015 Actuarial Valuation, advised Mr. Fiddler, are as follows:

- System investment experience was less than assumed for the year and generated actuarial asset losses of $271 million;
- Liability experience was slightly unfavorable for the year and generated net losses of $54 million;
- The actuarial value funded ratio of 100 percent and the fair value funded ratio of 104.1 percent meet the Board's funding policy;
- Fixed, statutory member and employer contributions exceed the actuarially determined contributions by 1.747 percent of pay, resulting in a risk management contribution that was $29 million for FY 2015 and is expected to be $31 million for FY 2016;
- The cushion at June 30, 2015, is $424 million, and will increase annually with the risk management contribution;
- Due to the cushion and the risk management contribution, if future experience matches the actuarial assumptions, the actuarial value funded ratio is expected

to remain at 100 percent and the fair value funded ratio is expected to increase from the current 104.1 percent;

- The reserve for funding of long-term benefit goals is negative $588 million as of June 30, 2015, but $927 million in cumulative net gains will be added in the next four years;
- As of June 30, 2015, SDRS has a net pension asset. The cumulative impact of the net pension asset and deferred inflows/outflows results in an asset on the balance sheets of SDRS participating employers; and
- SDRS remains a well-funded retirement system, significantly better funded than the vast majority of statewide retirement systems and all SDRS funding objectives are met as of June 30, 2015.

Board Action
No action was necessary.

AGENDA ITEM 5
SDRS LIMITED SCOPE ACTUARIAL REVIEW

Summary of Discussion
Mr. Fiddler stated that the conclusions of the limited scope review of the SDRS valuation as prepared by Buck Consultants found no notable issues with respect to compliance with current or pending actuarial standards of practice, regulatory issues, or Buck standard practices that would affect future actuarial valuations.

Board Action
IT WAS MOVED BY MS. MEHLBRECH, SECONDED BY MR. MERRILL, TO ACCEPT THE LIMITED SCOPE ACTUARIAL REVIEW FOR FISCAL YEAR 2015 AS PREPARED BY REPRESENTATIVES OF BUCK CONSULTANTS. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 6
FY2016 INVESTMENT UPDATE

Summary of Discussion
Mr. Matt Clark, State Investment Officer, informed the Board that as of November 30, 2015, the SDRS Trust Fund was down 2.5 percent.

Board Action
No action was necessary.

AGENDA ITEM 7
PROJECTED FUNDED STATUS AS OF JUNE 30, 2016

Summary of Discussion

Mr. Fiddler stated that as of June 30, 2015, the SDRS fair value funded ratio was at 104 percent and the actuarial value funded ratio was at 100 percent.

If the investment return for the fiscal year ending June 30, 2016, remains at negative 2.5 percent, advised Mr. Fiddler, the fair value funded ratio would decrease to 95 percent and the actuarial value funded ratio would remain at 100 percent.

The SDRS projected GASB net balance sheet liability/asset at June 30, 2016, if the investment return remains a negative 2.5 percent, will be a $310 million asset.

With a negative 2.5 percent return, stated Mr. Fiddler, the minimum annual investment return required to utilize the existing cushion and risk management contribution over the next five, 10, 20, and 30 years would be 8.5 percent, 7.9 percent, 7.6 percent, and 7.6 percent, respectively.

Mr. Fiddler stated that the nominal investment return assumption is 7.25 percent through 2017 and 7.5 percent in 2018 and after. Returns equal to the nominal assumption will grow the cushion and fair value funded ratio. When adjusting for the risk management contribution, the assumption rate effectively decreases to 7 percent and 7.25 percent for the two periods. These returns maintain the fair value funded ratio and slowly grow the cushion. If SDRS were to utilize the cushion, each rate would decrease to 6.94 percent. Annual returns of 6.94 percent will exhaust the cushion and decrease the fair value funded ratio to 100 percent over 10 years.

Board Action

No action was necessary.

AGENDA ITEM 8
AN UPDATED BENEIFT DESIGN FOR THE NEXT GENERATION OF SDRS MEMBERS

Summary of Discussion

Mr. Wylie stated that some of the objectives for the updated benefit design for new members include increasing the likelihood of sustainability and avoidance of corrective actions in the future. Eliminating or decreasing subsidies, inequities, and unanticipated costs will allow a restructure of benefits without requiring additional contributions and add more variable benefits utilizing the savings. These objectives recognize increasing life expectancy, meet income replacement goals for career employees, enhance hybrid features of SDRS, maintain equity with current members, align benefits to better recognize employers' workforce issues, and consider national practices and materiality.

Members first joining SDRS prior to July 1, 2017, advised Mr. Wylie, will be called foundation members. Members who join after June 30, 2017, will be called generational members.

Mr. Paul Schrader, SDRS Consultant, stated that SDRS remains one consolidated plan with key differences in benefits and features for foundation and generational members and the changes will only apply to generational members. The benefits are being restructured, no cutting of benefits or costs. Generational members will not be subsidizing foundation members. In the design for generational members, subsidies are reduced or eliminated and variable hybrid benefits are added all while recognizing longer life expectancies.

Some key administration details, advised Mr. Schrader, are that the member is a foundation member if contributions were made to SDRS and not withdrawn before July 1, 2017. A member would be a generational member if SDRS receives the first contributions after June 30, 2017. The election of post-retirement survivor benefits for generational members results in a reduction to the member's monthly benefit and requires both the member's and spouse's signature.

The variable retirement account (VRA) is provided only if the member does not refund accumulated contributions, noted Mr. Schrader. It will be credited with actual annual South Dakota Investment Council investment return to the month before the benefit commences. The minimum VRA is equal to the variable retirement contributions made to the account. The VRA will be paid when SDRS monthly benefits begin and the payment options include lump-sum or rollover to the SDRS supplemental retirement plan or another eligible account.

Explaining a chart, Mr. Schrader stated that the generational members would have a higher benefit at normal retirement than the foundation members. However, if they leave before normal retirement age their benefit would be less than the foundation members.

Moving to the benefit election examples, Mr. Schrader stated that a generational member who retires at age 67 and has a spouse of the same age, and has a life only benefit of $3,000 would receive $2,712 for life if the member chose the 60 percent joint and survivor benefit and $2,550 for life if the member chose the 100 percent joint and survivor benefit. The surviving spouse would receive no benefit if the member chose the life only benefit, $1,627 if the member chose the 60 percent joint and survivor benefit, and $2,550 if the member chose the 100 percent joint and survivor benefit.

The second example shows the same benefits, but uses a spouse who was age 62. Under this scenario, the member would receive $3,000, $2,625, and $2,424, respectively. The spouse would receive $0, $1,575, and $2,424 respectively.

All benefits will be increased annually by the generational COLA. The minimum of accumulated contributions (less any VRA distributions at retirement), will be paid regardless of benefit option elected at retirement.

Mr. Schrader stated that the COLA for generational members was similar to the foundation members in that it was based on the funded ratios of SDRS, however the generational COLA has a minimum of 1 percent and a maximum of 3.1 percent and was driven by the consumer price index (CPI). Mr. Schrader explained a chart that showed recent COLAs for foundation members and what the COLA would have been had the generational design been in place.

The variable retirement account (VRA) will be funded by variable retirement contributions (VRC) made annually to generational members. The contribution is anticipated to be 1.5 percent of pay initially. The investment return will be credited annually on June 30 based on the actual net investment return for SDRS for the fiscal year. Investment return will be credited to the end of the month preceding commencement of retirement or disability benefits, or the death of the member, for distributions during the fiscal year. Contributions during the year will receive one-half year's investment return credit.

The VRA will be paid only at retirement, disability, or death. The distribution can be made as a lump sum payment, rolled over to the SDRS SRP or another eligible plan, or used to purchase a supplemental pension benefit, however this option is only available at the time of retirement. Generational members who withdraw their accumulated contributions forfeit the VRA.

Mr. Schrader gave an example of a VRA accumulation based on a Class A member hired at age 35 with a starting salary of $40,000 and increases as assumed in the valuation. The VRA average annual investment returns were assumed to range from 4 percent to 11 percent. Based on the above criteria, if the member retired at age 57 the VRA accumulation range was between 40 and 70 percent of the member's final average compensation. If the member retired at age 67, that range increased to 50 to 160 percent of final average compensation.

Mr. Schrader stated that the added variable benefit feature will take a very long time to fully implement. The feature will delay or avoid the need for corrective actions, or if required, will reduce the magnitude of corrective actions. These features will also allow quicker funding of any new unfunded liabilities.

For example, noted Mr. Schrader, after the membership is fully transitioned to generational members and with the system starting from a fair value funded ratio of 100 percent, SDRS will be able to sustain marginally worse investment losses before crossing the corrective action thresholds, about 2 percent worse in a one-year downturn to about 3 percent worse in a three-year downturn. Likewise, the corrective actions required

following a one-year, 20 percent investment loss would be reduced by approximately 40 percent. The variable retirement contributions could also be suspended and redirected to amortize any unfunded liabilities that develop; however, the balance between foundation and generational members should be considered in any corrective action recommendations.

In summary, stated Mr. Schrader, subsidies have been significantly reduced or eliminated for generational members resulting in greater benefits at normal retirement, enhanced equity for all members, and better alignment with employer workforce needs. The addition of flexible benefits will allow members to share directly in SDIC success, enhance SDRS's sustainability, and help avoid corrective actions. Additionally, redesigning the benefits while SDRS is well-funded allows benefits to be restructured with the same overall cost and avoids the issues of "haves" and "have-nots".

Board Action
No action was necessary.

AGENDA ITEM 9
PROPOSED 2016 LEGISLATION

Summary of Discussion
Ms. Jacque Storm, SDRS General Counsel, noted that the legislation was discussed in great detail during the conference call board meeting and therefore would not be discussed to that level again unless there were questions. However, she noted, one point that requires further explanation is the determination on which design a member is in – foundation or generational.

Any current member and any member who starts contributing service prior to July 1, 2017, is and will continue to be a foundation member. The only way a foundation member would no longer be a foundation member is if that member withdrew his or her accumulated contributions from SDRS.

A foundation member may become inactive, but as long as the member keeps his or her accumulated contributions in the system, the member remains a foundation member. If a foundation member terminates employment but does not withdraw and then some months or years later is again employed by a participating employer, that member remains a foundation member and therefore is governed by the laws applicable to foundation members.

Also, if a foundation member never became re-employed by a participating employer but instead started a retirement benefit (even after 2017) that benefit would be determined by the laws governing foundation members.

The only way a foundation member would become a generational member is if that member terminated employment, withdrew all his or her accumulated contributions, and then returned to covered employment after June 30, 2017.

Ms. Storm highlighted the provisions of the new member plan design for new members. She noted that the definition of accumulated contributions is streamlined and that redeposits will no longer be permitted for generational members. The definition of credited service is also simplified as there is no need to reference prior service, and the computation for final average compensation is revised from three years to five years.

The COLA, or improvement factor, will now match the CPI but with a minimum of 1 percent and a maximum of 3.1 percent, with ranges based on the system's fair value funded ratio.

The normal retirement age increases to age 67 for Class A and Class B judicial members and age 57 for Class B public safety members with the reference that retirement ages may be increased in the future based on System experience. Ms. Storm noted that in discussions with the consultant counsel, they suggested that the law also specifically include who is authorized to increase the retirement age, so the bill was changed to specify that it would take legislative action to change the retirement ages.

The Class A multiplier is set at 1.8 percent with the multipliers remaining the same for Class B public safety and judicial members.

Ms. Storm stated that the generational members will make an election upon retirement, choosing from among three benefit options: single life with nothing payable upon the death of the member; 60 percent joint and survivor benefit that provides a reduced monthly benefit to the member and upon the member's death, provides 60 percent of the reduced benefit to the surviving spouse; and 100 percent joint and survivor benefit that provides a reduced monthly benefit to the member and upon the member's death provides the same monthly amount to the surviving spouse. Benefits payable pursuant to a joint and survivor benefit are based on the ages of the member and spouse and are actuarially equivalent to a single life benefit. The member's monthly amount is reduced to pay for the surviving spouse benefit. The benefit election is irrevocable although there is a one-month exception. The surviving spouse benefit is only payable to the spouse who was the spouse at the time of election and at the time of death, and only if the spouse survives the member. The retirement application must be signed and either notarized or witnessed by a representative of SDRS.

The law relating to the commencement of a retirement benefit and retroactive payments was clarified. This change also occurs for foundation members.

For a generational member receiving disability, the disability benefit will terminate at normal retirement age. The generational member must submit an application for a

retirement benefit and elect a benefit option. The single life benefit amount is the same amount as the disability benefit, but as with any generational member, the 60 percent and 100 percent joint and survivor benefit is also available.

A generational member may start a retirement benefit up to 10 years prior to normal retirement age; however, the benefit will be reduced five percent for each full year before normal retirement age.

The surviving spouse benefit depends on the age of the member at death, advised Ms. Storm. If the member dies after retirement, the spouse receives the benefit elected by the member and signed by the spouse at retirement. If the member dies after normal retirement age but before starting a benefit, the surviving spouse shall receive a benefit based on the calculation that considers the member retired on the date of death and elected the 60 percent joint and survivor benefit. The surviving spouse benefit is equal to 60 percent of the actuarially reduced amount the member would have received. The surviving spouse benefit for the active member who dies before normal retirement age or retirement (and also for a member who dies while receiving disability) is calculated the same way for generational members as foundation members but is available at the spouse's age 67 rather than 65. A surviving spouse may start a benefit up to 10 years prior to reaching age 67, but the benefit is reduced by five percent for each full year before 67.

Ms. Storm noted that the retire and return to employment provisions remain the same.

The generational members will have a variable retirement account (VRA) made up of variable retirement contributions (VRC) and credited investment return on those contributions. The VRA is payable upon retirement, disability, or death of the member, whichever occurs first. The VRA is not payable to a member who withdraws his or her accumulated contributions from SDRS. The VRC will be established by the Board each year and will begin at 1.5 percent of the member's compensation for the fiscal year beginning July 1, 2017. The VRC could be as high as 1.5 percent or in a critical situation there may be no VRC. The VRA is payable in a variety of ways, advised Ms. Storm. It can be paid in a lump sum, rolled over to the South Dakota Supplemental Retirement Plan, rolled into another eligible account, or used to purchase a supplemental pension benefit. However, a member may only get an SPB at the member's retirement.

Ms. Storm discussed changes that apply to both current and new members. These changes include a number of definitions that had to be revised, including the addition of a new definition for noncontributory service that covers both foundation and generational members. In addition to the definitions that were reviewed during the conference call, advised Ms. Storm, definitions for the terms, member and retiree were added. The legislation adds foundation or generational to several definitions so when the terms, member and retiree are not modified by either foundation or generational it is clear that the provision applies to both member groups.

The minimum benefit section was amended to include the member's variable retirement account. This section applies after all potential benefits are paid and refers to what a member's beneficiary or estate may receive.

The supplemental pension benefit (SPB) provisions are amended to provide that a member may use the variable retirement account to fund an SPB and also provides that a member may have one SPB funded by the supplemental retirement plan and special pay plan and a separate SPB funded by a VRA. The SPB provisions are amended to provide three types of benefits for both foundation and generational members to choose from. In addition to the benefits currently offered, which are life only and joint and survivor with 60 percent paid to the spouse upon the member's death, a third option is added, which is joint and survivor with 100 percent paid to the spouse upon the member's death.

Ms. Storm noted that there are no substantive changes to the benefit design of foundation members. However, a number of provisions are amended to provide that they are applicable only to foundation members. Two items of note are the level income, as that is not a feature of the new design, and the surviving spouse benefit after a disability retirement, as the benefit is currently considered a retirement benefit at age 65 and this legislation would change that to normal retirement age. The change would provide that a Class B member's benefit is considered a retirement benefit at age 55, making a spouse potentially eligible for a benefit years earlier without a reduction. This provision is the same for new members.

Moving to the clean-up legislation, Ms. Storm stated that this legislation revises and updates definitions, clarifies the vote required for a decision of the Board, and removes old language that ties the SDRS budget with the Department of Labor and Regulation. Since the latter ties into the use of the term, administrator, this bill is appropriate for making the changes from administrator to executive director so the clean-up provisions and the provisions changing the title will be in one legislative bill. This legislation will also clarify the use of assumed rate of return for deposits required when joining the system, correct citations in provisions relating to death or disability while on military leave, remove specific reporting requirements for the quadrennial independent report, revise provisions relating to the report of the conditions of the system, and repeal several outdated sections.

The final piece of legislation, advised Ms. Storm, would provide that the administrator/executive director of SDRS be a permanent member of the South Dakota Investment Council. As a result, the Board would not be required to make an annual appointment.

Board Action

IT WAS MOVED BY MR. JOHNS, SECONDED BY MS. LOBAN, TO ADOPT THE PROPOSED LEGISLATION FOR INTRODUCTION IN THE 2016 LEGISLATIVE

SESSION AND TO AUTHORIZE STAFF TO MAKE NONMATERIAL CHANGES AS NECESSARY IN THE DRAFTING PROCESS, FOR FORM AND STYLE AND TO ENHANCE CLARITY OF THE PROVISIONS AND COMPLIANCE WITH IRS REGULATIONS. THE MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE WITH 15 AYES, 0 NAYS AND ONE ABSENT AND NOT VOTING.
THOSE VOTING AYE: ALBERTS; BRINKMAN; CARON; DILGES; FAITH; GILL; GUSTAFSON; HANSEN; JOHNS; LOBAN; MEHLBRECH; MERRILL; MICHELS; PETERSON; STROEDER.
THOSE ABSENT AND NOT VOTING: ZINTER

AGENDA ITEM 10
FY2017 GOVERNOR'S RECOMMENDED BUDGET

Summary of Discussion
Ms. Beer reported on the Governor's Recommended Budget for SDRS. She advised that the Governor did not recommend the increase for salary and associated benefits for a new Actuarial/Operations Analyst position, but instead said it should be found within the current budget. The Governor did recommend the requested $45,000 for contractual services.

The Governor's recommendation also included expenditure authority for a salary package and bureau billing increases due to the budget recommendations.

Board Action
No action was necessary.

AGENDA ITEM 11
CONFERENCE ATTENDANCE REQUEST

Summary of Discussion
Chair Brinkman requested permission to attend the Mountain States Investor Forum in Denver, CO, in March.

Board Action
IT WAS MOVED BY MS. GUSTAFSON, SECONDED BY MS. PETERSON, TO APPROVE THE CONFERENCE ATTENDANCE REQUEST BY CHAIR BRINKMAN. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 15
OLD/NEW BUSINESS

Summary of Discussion

2016 Legislative Session

Mr. Wylie stated that the Legislation Session starts on January 12th and runs through March 29th.

Next Meeting Date

Mr. Wylie stated that the meeting dates for the upcoming meetings were on the agenda.

Board Action

No action was necessary.

ADJOURNMENT

IT WAS MOVED BY LT. GOV. MICHELS, SECONDED BY MR. MERRILL, THAT THERE BEING NO FURTHER BUSINESS, THE MEETING BE ADJOURNED. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

Respectfully submitted,

Robert A. Wylie
Executive Director/Administrator