# BOARD MEETING

# SOUTH DAKOTA RETIREMENT SYSTEM

# April 3, 2014

The Board of Trustees of the South Dakota Retirement System held its regular Board meeting on April 3, 2014. The meeting began at 9:00 a.m. on April 3rd in the Downstairs Conference Room at the View 34 Restaurant in Pierre.

**BOARD MEMBERS IN ATTENDANCE:**

Elmer Brinkman, Chair
Karl Alberts
Steven Caron
Jason Dilges
Jilena Faith
Laurie Gill
Laurie Gustafson
James Hansen
Louise Loban
Bonnie Mehlbrech
Dave Merrill
Matt Michels
Steve Zinter
Matt Clark – Ex Officio

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Board members James Johns, KJ Peterson, and Eric Stroeder were absent.

**OTHERS IN ATTENDANCE:**

Deene Dayton
Doug Fiddler, Buck Consultants
Hank Kosters, PARTA
Bob Mercer, Newspaper
Aaron Olson, LRC
Tammy Otten, SDIO
Paul Schrader

Scott Schroeder, BIT Development
Dave Slishinsky, Buck Consultants
Gail Swenson
Sandra Waltman, SDEA
Don Zeller
Rob Wylie
Travis Almond
Susan Jahraus
Michelle Mikkelsen
Jess Reitzel
Jane Roberts
Dawn Smith
Jacque Storm

## AGENDA ITEM 1
## APPROVAL OF MEETING MINUTES

**Summary of Discussion**
Justice Zinter noted that Sandra Zinter was not present at the meetings and the minutes were so corrected.

**Board Action**
IT WAS MOVED BY DR. HANSEN, SECONDED BY MS. GUSTAFSON, TO APPROVE THE MINUTES OF THE DECEMBER 4, 2013, AND JANUARY 7, 2014, BOARD MEETINGS AS CORRECTED. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

## AGENDA ITEM 2
## 2014 LEGISLATIVE REPORT

**Summary of Discussion**
Ms. Jacque Storm, SDRS General Counsel, discussed the 2014 Legislative Session. She explained that all of the SDRS bills passed through both bodies of the Legislature without a dissenting vote and were signed by the Governor.

Mr. Rob Wylie, SDRS Executive Director/Administrator stated that there were several other bills SDRS was watching during the Legislative Session. These bills included the bills that appropriated $5.6 million to the Cement Plant Retirement Fund to fully fund the plan and consolidate it with SDRS.

**Board Action**
No action was required.

**AGENDA ITEM 3**
**FY2015 BUDGET REPORT**

**Summary of Discussion**
Ms. Jane Roberts, SDRS Chief Financial Officer, stated that the budget went very well this year. She noted that SDRS asked for an increase of $189,351 in the budget and that increase was approved.

**Board Action**
No action was required.

**AGENDA ITEM 4**
**RULES HEARING**

**Summary of Discussion**
Ms. Jacque Storm, reviewed the proposed administrative rules. Copies of the transcript and minutes of the administrative rules hearing are on file in the SDRS offices.

**Board Action**
IT WAS MOVED BY MR. ALBERTS, SECONDED BY MR. MERRILL, TO ADOPT THE RULES AS PRESENTED. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

**AGENDA ITEM 5**
**CEM REPORT**

**Summary of Discussion**
Mr. Wylie explained that since the first CEM Benchmarking report was completed for SDRS in 2005, there have been many improvements made in the customer service areas of SDRS.

Mr. Wylie stated that SDRS was by far one of the smallest state plans that CEM had in their study and was the smallest system in the peer group used for comparison of SDRS.

Mr. Wylie noted that SDRS' total pension administration cost per active member and annuitant was $50. This did not change between 2010 and 2013. The peer group's costs were $70, which represented a cost decrease of 2.3 percent per year during that same period.

Some of the reasons why SDRS' total cost was below the peer average included the lower transactions per members, higher transactions per FTE, lower costs per FTE for salaries and benefits, lower third-party and other costs in front–office activities, and paying less for back-office activities.

The total service score for SDRS, advised Mr. Wylie, was 83 out of 100. This was above the peer median of 81. CEM defines service from the member's perspective as faster turnaround times, more availability, more choice, and higher quality.

The key takeaways from this year's CEM report, stated Mr. Wylie, were:

- SDRS' cost of $50 per member and annuitant was the lowest of our peer group and amongst the lowest in CEM's universe.
  - The primary reasons why:
    - Lower costs per FTE
    - Higher transaction volumes per FTE
- SDRS service score was 83 – above the peer median score of 81.
- SDRS has maintained or increased its service levels in all activities.
- SDRS's activity service scores were higher than or equal to the peer median for 14 of the 15 service activities, however, SDRS lags the universe in website capability.

**Board Action**
No action was necessary.

## AGENDA ITEM 6
## EFFECTIVE RATE OF INTEREST FOR FY2015

**Summary of Discussion**
Ms. Jane Roberts, SDRS Chief Financial Officer, said that SDCL 3-12-47(27) states that SDRS's annual effective rate of interest shall be no greater than 90 percent of the average 91-day United States Treasury bill rate for the immediately-preceding calendar year.

Advising that the United States 91-day Treasury bill rate was 0.06 percent for 2013, Ms. Roberts stated that the rate for Fiscal Year 2015 could be set at 0.05 percent. She noted that this interest rate would be credited on July 1, 2015, for the period of July 1, 2014, through June 30, 2015.

**Board Action**
IT WAS MOVED BY MS. GUSTAFSON, SECONDED BY MS. LOBAN, TO SET THE EFFECTIVE RATE OF INTEREST FOR FY 2015 AT .05 PERCENT. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

## AGENDA ITEM 7
## SET FY2015 SUPPLEMENTAL PENSION BENEFIT
## INTEREST RATE ASSUMPTION

### Summary of Presentation

Mr. Wylie stated that the Board needed to establish the periodic Supplemental Pension Benefit interest rate assumption. He added that the interest rate assumption could not be greater than the actuarial assumed rate of return for SDRS, nor could it be less than the SDRS effective rate of interest.

He advised that the interest rate assumption is established based on the recommendations of both the System's actuary and the State Investment Officer with the input of the Executive Director/Administrator. The actuary recommended between 3.5 and 4.5 percent and the state investment officer recommended between 3.75 and 4.25 percent.

Based on all of the information, stated Mr. Wylie, it was his recommendation that the Board set the Supplemental Pension Benefit interest rate assumption at 4.0 percent, effective July 1, 2014.

### Board Action

IT WAS MOVED BY MS. MEHLBRECH, SECONDED BY MS. FAITH, TO SET THE INTEREST RATE FOR THE SUPPLEMENTAL PENSION BENEFIT AT 4.0 PERCENT, EFFECTIVE JULY 1, 2014. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

## AGENDA ITEM 8
## DATA PROCESSING UPDATE

### Summary of Discussion

Ms. Susan Jahraus, SDRS Operations and Compliance Director, updated the Board on the Legacy Code Transformation (LCT) project. She reminded the Board that during a teleconference call in January the Board authorized the SDRS Executive Director/Administrator to finalize negotiations and enter into a contract with Metex.

In March, separate SDRS and BFM contracts were negotiated and signed with the effective dates of March 12, 2014. Ms. Jahraus noted that the delay in signing the contracts was due to the need for additional contract clauses and precautions necessary to ensure security of SDRS, BFM, and State of South Dakota assets.

Subsequent to the signing of the contracts, advised Ms. Jahraus, separate SDRS and BFM Statements of Work (SOW) have been negotiated and these statements of work specify in greater detail how the re-engineering of FoxPro will proceed. The estimated timeframe for SDRS is 52 weeks and BFM is 36 weeks. The current project start-up tasks include providing Metex documentation on the architecture design and system configurations of the current FoxPro systems. This will be worked on in the next month.

**Board Action**
No action was necessary.

## AGENDA ITEM 9
## FY2014 INVESTMENT UPDATE

**Summary of Discussion**
Mr. Matt Clark, State Investment Officer, stated that through March 31, the estimated return for SDRS was 13.6 percent. The estimated return for the Cement Plant Retirement Fund was 13 percent.

**Board Action**
No action was necessary.

## AGENDA ITEM 10
## REVIEW OF PROJECTED FUNDED STATUS

**Summary of Discussion**
Mr. Doug Fiddler, Consulting Actuary, Buck Consultants, stated that as of June 30, 2013, the SDRS market value funded ratio was 103 percent and the actuarial value funded ratio was 100 percent.

If the investment return for the fiscal year ending June 30, 2014, would be 12.5 percent, advised Mr. Fiddler, the market value funded ratio would increase to 109 percent and the actuarial value funded ratio would remain at 100 percent.

With a 12.5 percent return, stated Mr. Fiddler, the minimum annual investment return required to utilize the "cushion" over the next five, 10, and 20 years would be 5.3 percent, 6.2 percent, and 6.6 percent, respectively. He noted that the required net investment returns consider the risk management contribution made until the cushion is exhausted at the end of each period. At that point, investment returns (less the effect of the risk management contribution) must equal or exceed the assumed investment return to avoid creating a deficit. Future risk management contributions will reduce the net investment income required by approximately 0.39 percent below the assumed investment return.

Mr. Fiddler stated the minimum annual net investment return required to avoid corrective actions over the next five, 10, and 20 years with a 12.5 percent return would be .9 percent, 4.1 percent, and 5.8 percent respectively. Lower returns will result in crossing the SDCL 3-12-122 thresholds for corrective action.

**Board Action**
No action was necessary.

## AGENDA ITEM 11
## STATE OF THE SYSTEM

**Summary of Discussion**
Mr. Paul Schrader, Consultant, gave a brief overview of where the System was as of July 1, 2013. He stated that with a 19 percent investment return for the year, the System was able to eliminate the unfunded liabilities by a transfer of $634 million from the cushion leaving $282 million or 3 percent of the actuarial asset value in the cushion. The market value funded ratio was 103 percent and the actuarial asset funded ratio was 100 percent. The funding policy objectives were strengthened to be 100 percent or greater on both market and actuarial value. The normal cost including expenses is 10.1 percent of pay while the total contributions coming into the System is 12.5 percent of pay with the difference growing the cushion. Mr. Schrader added that SDRS is truly a mature retirement system with 52 percent of the cost of future benefits due to retired/inactive members.

Mr. Schrader stated that the changes made to the actuarial assumptions effective July 1, 2012, as a result of the experience analysis should provide a better estimate of long-term costs and should generally add additional conservatism to the projections. The change in the investment return expectation added significant conservatism. However, the mortality changes did not add significant margin for future improvements and will likely need further adjustments. All the added costs due to the assumption changes were absorbed from the Cushion.

Mr. Schrader stated that the GASB changes will be implemented at the end of fiscal year 2014 for SDRS and the end of fiscal 2015 for employers. SDRS is expected to have no unfunded liabilities and therefore, employers are expected to have no balance sheet liability recognition.

He added that other recent developments included the SDRS disability and survivor benefits being simplified, de-linked from Social Security, and streamlined to meet the long-term benefit goals; the Cement Plant Retirement System being fully funded and consolidated into SDRS; and the favorable opinion on the retiree lawsuit and changes to SDCL 3-12-122 which strengthens the ability to make corrective actions, if needed.

Moving to the long-term goals, Mr. Schrader advised that they were updated in 2012 and are currently generally met, however, the SDRS income replacement target has not been adjusted to reflect the improved life expectancy and is not currently met for Class A employees nor will it likely be met in the near term. Alternatively, normal retirement eligibility has not increased to reflect improved life expectancy and the early retirement incentives may be in conflict with the work force issues.

Mr. Schrader noted that the Board should formally establish and adopt a future corrective action plan in case it becomes necessary and a or benefit improvement plan in case the guidelines are met.

Mr. Fiddler stated that Buck’s survey of regional state retirement systems found that SDRS had the lowest contribution rate in the survey with 6 percent for both employers and employees. For the regional average the member rate was 7 percent and the employer actual rate was 9 percent. When additional contributions that are coming into those plans was factored in the average employer and state actual rate was 9.6 percent. When additional contributions that should be coming in to make the full funding requirement were factored in it increased to 10.6 percent.

Taking into account the changes to the disability and survivor benefits, advised Mr. Fiddler, the SDRS normal costs and expenses is 10.118 percent of pay leaving 2.36 percent of pay available for the risk management contribution.

Mr. Fiddler observed that the SDRS employer/member contributions are significantly below average and fully meet the actuarial requirements. The COLA is above average, impacts all benefits, and increases costs by 33 percent. Benefits that exceed common practices include post-retirement survivor benefits – 4 percent of total costs; PRO – 1 percent of total costs; and vesting – 6 percent of total costs. The SDRS benefit formula multiplier is below average due to the costs of the COLA, special early and early retirement subsidies, and other above average benefits. Mr. Fiddler added that after funding all unfunded liabilities, current statutory fixed employer and member contributions will exceed normal costs by 2.4 percent of pay, which will contribute to the cushion each year.

In conclusion, advised Mr. Schrader, the System is fully funded, which is a significant and rare accomplishment. It is sound, in balance, and meets the funding goals with conservative actuarial assumptions. The System has strong overall benefit practices, with the exception of the Class A benefit formula multiplier, but the early retirement subsidies and above average practices are very significant.

The System has below average employer and member costs with fixed statutory contributions that meet actuarial requirement with a margin that will increase the cushion each year. The Board also has a precedent of using corrective actions when required.

**Board Action**
No action was necessary.

## AGENDA ITEM 12
## RISK MANAGEMENT AND SUSTAINABILITY DISCUSSION

**Summary of Discussion**
Mr. Schrader stated that paying off the unfunded liabilities improved the SDRS risk management model because it shows responsible management and increases the equity between current and future members. Further, it eliminates the need to allocate a portion of the current contributions to fund benefits for prior service and reserves that portion of the current contributions (risk management contributions) to grow the cushion or to fund any new unfunded liabilities. It also results in two sources to grow the cushion in the future, contribution based and experience based (investment returns and liability growth), all while strengthening SDRS as a best practice system.

Historically, advised Mr. Schrader, most state retirement systems have aspired to fund the annual required contribution (ARC) including amortization of unfunded liabilities over a period not to exceed 30 years – many have not succeeded. SDRS has consistently met its funding objectives with statutorily fixed contributions that meet or exceed the ARC and funded ratios that exceed 95 percent.

Meanwhile, the recent Society of Actuaries' Blue Ribbon Committee Report recommends trustees "strive to fund 100 percent of the obligation for benefits using assumptions that are consistent with median expectations about future economic conditions." SDRS recently strengthened its funding objectives to include funded ratios that meet or exceed 100 percent and has currently accomplished this objective.

The report also states "programs should be funded at levels that will enable them to respond to changing conditions and maintain a high degree of resilience in order to cope with uncertain future conditions." Mr. Schrader noted that the SDRS cushion and risk management contribution provide the resources to meet this objective and improve the sustainability likelihood.

Mr. Schrader stated that maintaining a fully funded plan eliminates the need to allocate a portion of the current contributions to pay for unfunded liabilities. This amount (2.36 percent of pay) is referred to as a risk management contribution. The current risk management contribution is 19 percent of the fixed contributions. An objective of maintaining a risk management contribution of 20 percent of fixed contributions would result in available significant risk management resources each year, build the cushion each year, raise the likelihood of earning sufficient return to maintain the funded status by 3 to 4 percent and provide a resource that could amortize up to $564 million of unfunded liabilities over 20 years if necessary. Mr. Schrader stated that over the past years, the Board has taken the initiative to correct things that needed correcting or were needed to improve the sustainability of the plan. Some of the initiatives include:

- Final average compensation limits;
- Removal of termination pay from compensation;
- Elimination of optional spouse benefit;
- Return to work benefit changes;
- Elimination of pro-rata COLA;
- Indexing of COLA with funded status and inflation;
- Added employer contribution to pay for alternative formula;
- Restructured disability and pre-retirement survivor benefits;
- Changed purchase service rates to actuarial cost; and
- Limited interest on accumulated contributions to 90 percent of the 91 day T-Bill rate.

All of these past initiatives have significantly lowered SDRS' risk profile and increased sustainability.

Mr. Schrader noted that the Board had some current risk management issues. They include, the increasing life expectancy effectively increasing the value of benefits in the past and will likely continue to do so in the future, the likelihood of earning the assumed investment return over long periods, and the subsidies in the current benefit structure.

Mr. Schrader stated that the cushion is projected to be $790 million at July 1, 2014, based on a 12.5 percent investment return for FY14. The normal cost is projected to be 10.1 percent of pay with statutory fixed contributions to remain at 12.5 percent of pay. That leaves a risk management contribution of 2.4 percent of pay to grow the cushion or amortize any future unfunded liabilities.

Mr. Fiddler quantified the impact of the risk management contribution on the likelihood of achieving the annual investment return assumption based on the Investment Council's 2013 outlook.

Mr. Fiddler stated that in 1974 a 62 year old female had a life expectancy of 81.7 years. In 2010 a 62 year old female had a life expectancy of 85 years. With the increase in the life expectancy, the effective benefit multiplier for the female who retired in 2010 would be 1.69 percent compared to 1.55 percent for a 62 year old back in 1974.

In conclusion, Mr. Schrader stated that the next steps would be to agree on an appropriate risk management contribution percentage and sustainability likelihood measures and incorporate those into the goals, develop a plan to deal with improved life expectancy including consideration of retirement eligibility, evaluate the current subsidy/equity benefit issues, develop a future corrective action contingency plan, develop a future benefit improvement contingency plan, and continue Board discussion during 2014.

**Board Action**
No action was necessary.

## AGENDA ITEM 13
## REVIEW OF ACTUARIAL SERVICES CONTRACT

**Summary of Discussion**
The Board went into Executive Session to discuss the actuarial services contract.

**Board Action**
IT WAS MOVED BY DR. HANSEN, SECONDED BY MR. ALBERTS, TO GO INTO EXECUTIVE SESSION PURSUANT TO SDCL 1-25-2 TO PREPARE FOR CONTRACT NEGOTIATIONS. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

## AGENDA ITEM 14
## EXECUTIVE DIRECTOR/ADMINISTRATOR'S EVALUATION

**Summary of Discussion**
Mr. Elmer Brinkman, SDRS Board Chair, informed the Board that he had received and tallied the results of the Executive Director/Administrator's evaluation.

**Board Action**
IT WAS MOVED BY DR. HANSEN, SECONDED BY MR. ALBERTS, TO GO INTO EXECUTIVE SESSION PURSUANT TO SDCL 1-25-2 FOR PERSONNEL MATTERS. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

IT WAS MOVED BY LT. GOV. MICHELS, SECONDED BY MS. MEHLBRECH TO AUTHORIZE THE SAME ACROSS-THE-BOARD SALARY ADJUSTMENT FOR THE EXECUTIVE DIRECTOR/ADMINISTRATOR AS

THE GOVERNOR APPPROVED FOR ALL OTHER STATE GOVERNMENT EMPLOYEES. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

## AGENDA ITEM 15
## OLD/NEW BUSINESS

**Summary of Discussion**

**American Academy of Actuaries – Retirement for the AGES**
Mr. Wylie stated that he was invited to participate in the American Academy of Actuaries – Retirement for the AGES workshop that was going to be held in Washington, DC, the end of April.

**SDRS Year-End Survey Results**
Mr. Wylie went over the year-end survey results.

**Cement Plan Consolidation**
Mr. Wylie stated that the Cement Plant consolidation was in process. So far everything was moving smoothly.

**Board of Trustee Election Update**
Ms. Dawn Smith, SDRS Executive/Board Assistant, advised the Board that there would be an election in one of the three open positions.

**Upcoming Meetings**
The Board discussed the upcoming meeting schedule. Mr. Wylie was going to check with the Chairs of the Retirement Laws Committees and see when a Joint Retirement Laws Committee meeting would work for them.

**Board Action**
No action was necessary.

## ADJOURNMENT

IT WAS MOVED BY MS. GUSTAFSON, SECONDED BY MS. GILL, THAT THERE BEING NO FURTHER BUSINESS, THE MEETING BE DECLARED ADJOURNED. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

Respectfully submitted,

Robert A. Wylie
Executive Director/Administrator