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

JANUARY 2023

South Dakota Retirement System
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SDRS Fundamental Principles

- **SDRS is funded by fixed, modest, statutory contribution rates – South Dakota spends 40% of the national average on public pensions**

- **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 2022 Key Takeaways

- **SDRS is 100.1% funded at June 30, 2022 and is expected to remain 100% funded in most economic conditions due to the variable SDRS COLA**

- **The July 2023 COLA will be 2.10 percent, significantly 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 10, 2023

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, 2022.

As of June 30, 2022, SDRS is 100.1 percent funded and all the Board of Trustees' funding objectives have been met. This marks the twenty-seventh time out of the last thirty-two 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 2023 SDRS COLA will be 2.10 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

James Johns
Chair, SDRS Board of Trustees

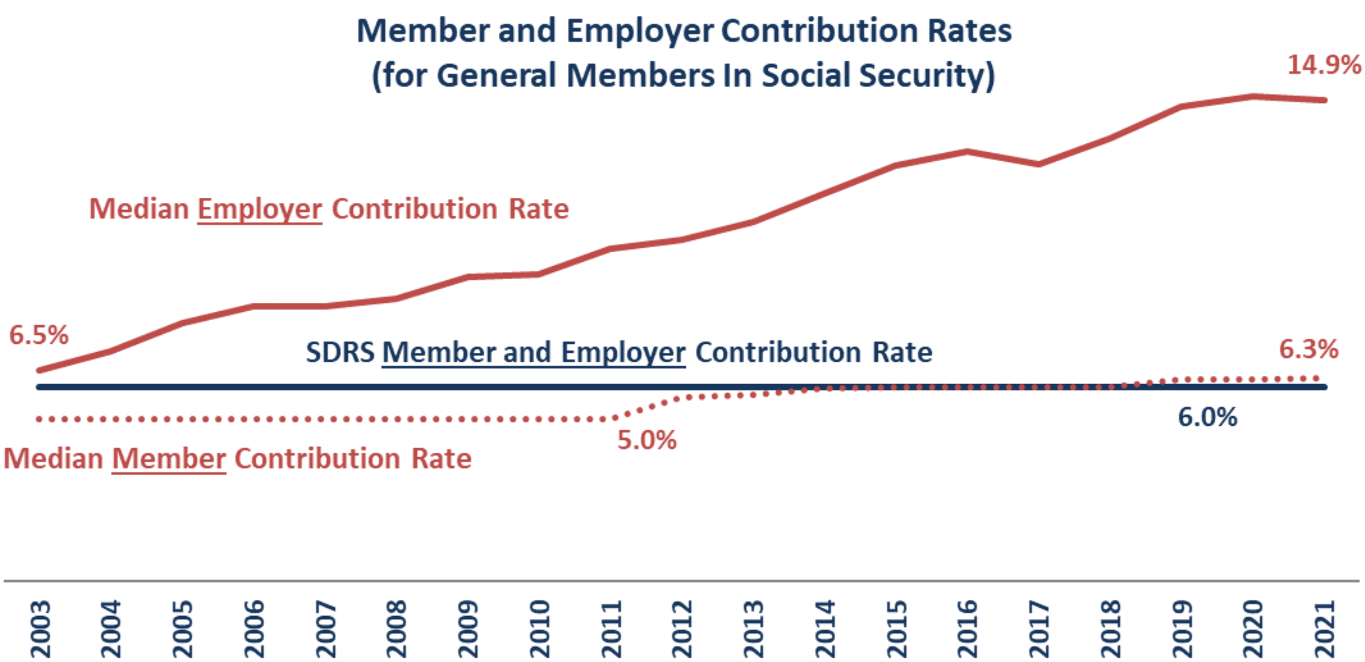
THE SDRS MODEL

SDRS' defined benefit pension model pays 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 corrections when not met.

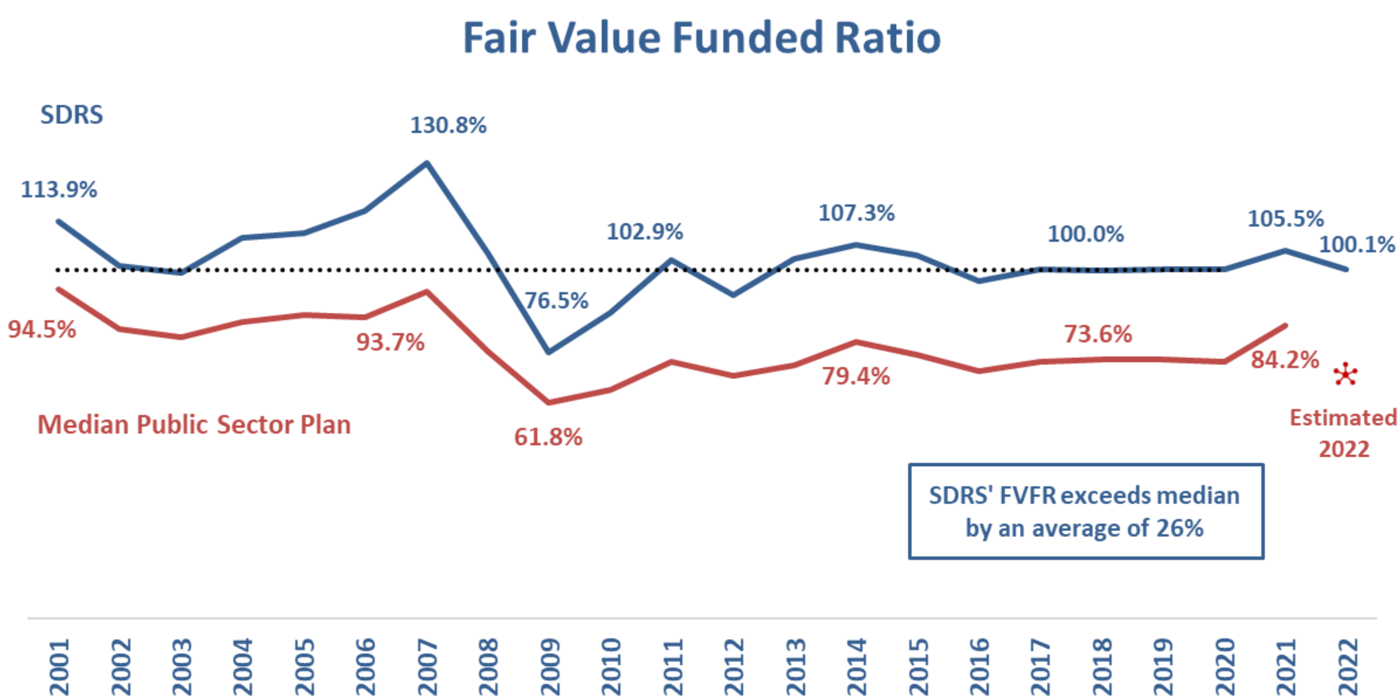
The two following charts compare the effectiveness of the two approaches.

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 14.9 percent of pay in 2021. 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, October 2022

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 the majority of the plans improved during fiscal year 2021 due to 2021 investment returns significantly above long-term assumptions. However, when fiscal year 2022 reporting is finalized for all plans, the median Fair Value Funded Ratio will likely have decreased from fiscal year 2020.

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, 2022

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 2022 actuarial valuation of SDRS confirms that all three of the Board's funding objectives have been met based on the restricted maximum COLA of 2.10 percent.

2022 LEGISLATIVE CHANGES

During the 2022 Legislative Session, no substantive changes to SDRS provisions were enacted. Gaming enforcement agents were designated as Class B Public Safety Members on a prospective basis.

Of note, SDRS representatives opposed Legislation that would have significantly increased benefits paid to retired and reemployed members. 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 enticed 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. 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 is not affordable, and a restricted maximum COLA of 2.10 percent will be 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.

As of July 2022, cumulative COLAs since retirement will equal or exceed cumulative inflation for approximately 50 percent of SDRS retirees and beneficiaries but will be less than inflation and fall short of the Board's objective for the other 50 percent. This is primarily a result of recent, extraordinarily high inflation rates. Nevertheless, 73 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. Virtually all 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 2020 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 by the Board in 2023.

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

SDRS 2023 PROPOSED LEGISLATION

The SDRS Board of Trustees will submit the following bills for consideration during the 2023 Legislative Session:

- **HB 1008:** An Act to revise provisions relating to actuarial terminology of the South Dakota Retirement System.
- **HB 1007:** An Act to add emergency medical services personnel to Class B membership of the South Dakota Retirement System.
- **HB 1009:** An Act to revise certain provisions relating to the South Dakota Retirement System.

Details and descriptions of the proposed legislation can be found in the 2023 legislative summary on the SDRS website at:

SDRS Proposed Legislation

LINKS TO ADDITIONAL INFORMATION

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

The **June 30, 2022 actuarial valuation report** with additional detail on the funded status of the system and fiscal year 2022 experience:

SDRS 2022 Actuarial Valuation

The **June 30, 2022 Annual Comprehensive Financial Report** with complete financial data on the system, fiscal year 2022 experience, and historical trend information:

SDRS 2022 ACFR

Material from the **December 2, 2022 SDRS Board of Trustees Meeting**, including presentations on the June 30, 2022 actuarial valuation results, demographic trends, and the fiscal year 2022 financial statements:

December 2022 SDRS Board Meeting Material

Appendix A: Fiscal Year 2022 Highlights

Total System Membership	**97,830**
Active Contributing Members	**41,878**
Inactive Non-Contributing Members	**23,604**
Benefit Recipients	**32,348**
Fair Value of Assets	**$14.1 Billion**
Actuarial Accrued Liability	**$14.1 Billion**
Assumed Future COLAs	**2.10%**
Fair Value Funded Ratio	**100.1%**
Member and Employer Contributions	**$286.3 Million**
Benefit Payments and Refunds	**$696.0 Million**
Administrative Expenses	**$4.9 Million**
Net Investment Income	**($91.5 Million)**
Minimum Statutory COLA	**0.00%**
Maximum Statutory COLA	**2.10%**
Prior Year Inflation	**8.75%**
July 2023 COLA	**2.10%**

Appendix B: SDRS Benefits Payable by County

The following exhibit presents a schedule of the annualized benefits payable as of July 1, 2022, by SDRS on a county-by-county basis.

County	Benefit Recipients	Annual Benefits	County	Benefit Recipients	Annual Benefits	County	Benefit Recipients	Annual Benefits
Aurora	132	$2,171,107	Fall River	332	$5,197,178	McPherson	80	$1,289,488
Beadle	538	$10,906,993	Faulk	127	$1,840,191	Meade	775	$15,570,647
Bennett	53	$893,538	Grant	199	$3,686,554	Mellette	56	$730,944
Bon Homme	339	$5,836,333	Gregory	175	$3,047,360	Miner	84	$1,778,742
Brookings	1,660	$44,632,502	Haakon	68	$1,117,023	Minnehaha	4,450	$108,247,098
Brown	1,374	$30,548,442	Hamlin	211	$3,621,970	Moody	209	$3,458,318
Brule	153	$3,303,726	Hand	120	$2,011,907	Oglala Lakota	18	$345,892
Buffalo	3	$53,977	Hanson	59	$1,063,053	Pennington	3,728	$86,772,710
Butte	351	$5,934,111	Harding	41	$609,433	Perkins	92	$1,371,265
Campbell	63	$1,014,120	Hughes	1,551	$43,015,544	Potter	112	$1,974,232
Charles Mix	244	$5,006,731	Hutchinson	263	$4,867,993	Roberts	278	$4,912,896
Clark	136	$2,113,724	Hyde	64	$825,490	Sanborn	91	$1,564,592
Clay	696	$18,918,889	Jackson	51	$987,782	Spink	444	$7,782,007
Codington	886	$21,471,822	Jerauld	80	$1,340,702	Stanley	252	$6,262,828
Corson	52	$930,870	Jones	38	$875,683	Sully	64	$982,281
Custer	406	$7,542,571	Kingsbury	247	$4,539,426	Todd	64	$1,231,271
Davison	616	$14,454,724	Lake	474	$10,488,587	Tripp	209	$3,677,016
Day	226	$4,032,379	Lawrence	1,065	$23,765,982	Turner	263	$4,528,571
Deuel	130	$2,172,846	Lincoln	493	$9,230,070	Union	353	$7,094,801
Dewey	110	$1,849,825	Lyman	107	$1,886,023	Walworth	233	$4,364,908
Douglas	93	$1,700,071	Marshall	207	$3,637,999	Yankton	969	$20,572,428
Edmunds	114	$2,041,564	McCook	168	$3,353,839	Ziebach	24	$467,219

Total SDRS Benefits Payable in South Dakota	**$ 603,520,808**
Total SDRS Benefits Payable Outside of South Dakota	**$ 87,328,013**
Total SDRS Benefits Payable	**$ 690,848,821**

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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