BOARD MEETING

SOUTH DAKOTA RETIREMENT SYSTEM

June 1, 2022

The Board of Trustees of the South Dakota Retirement System held its regular Board meeting on June 1, 2022. The meeting began at 8:30 a.m. in the board room at the South Dakota Investment office, Sioux Falls, SD.

BOARD MEMBERS IN ATTENDANCE:

James Johns, Chair
Eric Stroeder, Vice Chair
Karl Alberts
James Appl
Mark Barnett
Annette Brant
Penny Brunken
Kathy Greeneway
Myron Johnson
Jill Lenards
Kevin Merrill
Justice Mark Salter
Darin Seeley
Glen Vilhauer
Doug Wermedal
Matt Clark, Ex Officio

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OTHERS IN ATTENDANCE:

Bob Hoffmann, SDEA Retired
Diana Miller, Large Schools Group
Rob Monson, School Administrators of SD
Philip Nord, SDEA Retired
Eric Ollila, SDSEO
Tammy Otten, SDIC
Travis Almond
Doug Fiddler
Michelle Humann
Sam Koldenhoven
Michelle Mikkelsen
Dawn Smith
Jacque Storm

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

AGENDA ITEM 1
BOARD MEMBER CONFLICTS DISCLOSURE

Summary of Presentation
No board member had any conflict to disclose.

Board Action
No action was necessary.

AGENDA ITEM 2
APPROVAL OF APRIL 5, 2022, MEETING MINUTES

Board Action
IT WAS MOVED BY MR. BARNETT, SECONDED BY MR. WERMEDAL, TO APPROVE THE MINUTES OF THE APRIL 5, 2022, BOARD OF TRUSTEES MEETING. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 3
ELECTION RESULTS

Summary of Presentation
Ms. Dawn Smith, SDRS Executive Assistant, stated that there were three positions up for election this year. James Johns (Class B Public Safety) and Kevin Merrill (Classified Employees) won their elections and will begin their four-year term July 1, 2022. She noted that Penny Brunken (Teachers) ran unopposed and will also begin her four-year term July 1, 2022.

Board Action
IT WAS MOVED BY MS. GREENEWAY, SECONDED BY MR. STROEDER, TO ACCEPT THE ELECTION REPORT AND DECLARE JAMES JOHNS (CLASS B PUBLIC SAFETY), KEVIN MERRILL (CLASSIFIED EMPLOYEES), AND PENNY BRUNKEN (TEACHERS), AS THE WINNERS OF THE 2022 SDRS BOARD OF TRUSTEES ELECTION. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 4
FY 2024 BUDGET REQUEST

Summary of Presentation
Ms. Michelle Mikkelsen, SDRS Chief Financial Officer, stated that SDRS is requesting no changes be made from the FY 2023 budget, so the request for FY 2024 remains the same.

Board Action:
IT WAS MOVED BY MR. ALBERTS, SECONDED BY MS. BRANT, TO APPROVE THE FY 2024 BUDGET REQUEST AS DISCUSSED. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 5
APPOINTMENT OF AUDIT COMMITTEE

Summary of Presentation
Chair Johns stated that he has appointed an audit committee to consist of Karl Alberts, Kathy Greeneway, and Glen Vilhauer.

Board Action
No action was necessary.

AGENDA ITEM 6
UPDATE OF FY 2022 INVESTMENT PERFORMANCE

Summary of Presentation
Mr. Matt Clark, South Dakota State Investment Officer, informed the Board that as of May 31, the SDRS trust fund had a fiscal year-to-date return rate of approximately 1.75 to 2 percent.

Board Action
No action was necessary.

AGENDA ITEM 7
REVIEW OF SDRS PROJECTED FUNDED STATUS

Summary of Presentation:
Mr. Doug Fiddler, SDRS Senior Actuary, noted that the SDRS contribution rates are fixed in statute and that the statutes require a recommendation for corrective actions if SDRS falls below 100 percent funded. The SDRS COLA will vary with both inflation and long-term affordability and is critical to managing the system on fixed contributions.

Employer contribution rates of 6 percent for Class A members are 40 percent of the national median of 15 percent. At the same time, advised, Mr. Fiddler, SDRS' fair value funded ratio of 105.5 percent exceeds the median FVFR of 85.7 percent. In addition, as a percent of government spending, South Dakota spends the least in the nation on pensions at 1.95 percent compared to the median of 3.87 percent and 5.01 percent aggregate.

Delivering adequate benefits and remaining fully funded through all economic conditions while funded with contributions that are less than half of the median is a very high standard. These are very challenging objectives and become even more difficult to meet as retirees live longer and the consensus view of future investment returns is lower. The efforts of SDRS management to meet these objectives have included enacting the variable COLA process, transitioning foundation members to a 5-year final average compensation and pay increase caps, the generational design, retire-rehire reform, and various other initiatives to avoid or lessen subsidies.

Mr. Fiddler noted that since 2010, the average SDRS COLA of 2.4 percent was higher than the average inflation for the same period; however, on a cumulative basis since retirement, SDRS COLAs have lagged inflation for about 35 percent of SDRS benefit recipients.

Mr. Fiddler stated that based on a FY22 net investment return of 1.6 percent the baseline FVFR is expected to be 100 percent at June 30, 2022. As a result, the preliminary estimated 2023 COLA would be equal to inflation within the full COLA range (0-3.5 percent). Recent investment experience had reduced the affordable COLA payable, but FY 2021 investment returns permitted the full COLA range to be payable in 2022. Investment returns for FY 2022 less than about 1.6 percent will again reduce the maximum 2023 COLA payable.

Mr. Fiddler noted that the most significant immediate risk to SDRS is investment risk. The investment returns will first impact the variable SDRS COLA. Less than assumed returns will reduce the restricted maximum COLA while greater than assumed returns will increase the maximum or enable the full COLA range. However, the variable COLA will not be sufficient to maintain 100 percent FVFR in all conditions and additional corrective actions may be required. Likewise, if investment returns significantly exceed assumptions, the FVFR may reach the Board's criteria for consideration of benefit improvements.

Mr. Fiddler stated that lowering the minimum COLA to 0%, and favorable investment experience in FY 2021 reversed the recent trend of an increased likelihood of required corrective action recommendations.

In summary, advised Mr. Fiddler, FY 2022 returns below approximately negative 18 percent would require a corrective action recommendation while returns greater than approximately 1.6 percent would result in the full 0 percent to 3.5 percent COLA range applying for the July 2023 COLA. He noted that the actuarial assumptions will be revised for the June 30, 2022, valuation based on the experience analysis.

Board Action
No action was necessary.

AGENDA ITEM 8
RETIREMENT AND REEMPLOYMENT PROVISIONS

Summary of Presentation

Mr. Fiddler reviewed the guiding principles of the SDRS Mission and Vision Statements as well as the plan funding basics of SDRS' fixed contributions, statutory funding thresholds, and necessity of a reduced COLA maximum.

Mr. Fiddler noted that the Class A foundation normal retirement age is 65, with the earliest retirement age of 55. At consolidation, the early retirement reduction was 6 percent per year, approximately actuarially equivalent. In the subsequent years, there were several benefit improvements which included changing the early retirement reduction to 3 percent in 1978 and adding the rule of 85. In 1986 the minimum age for the rule of 85 was 60, that decreased to age 58 in 1991, and age 55 in 1993. This unreduced benefit at age 55 is twice as valuable/expensive as the same benefit deferred to age 65.

The emphasis on improving early retirement opportunities in the past was a response to both employer and member requests and was intended to provide career members whose productivity had declined or had "burned-out" an opportunity to retire before normal retirement age with full benefits. It was also helpful to employers to be able to replace highly paid employees with less expensive ones and to provide opportunities for advancement. The intent was to provide a better benefit before age 65 for those career members who chose to retire early, not to provide an SDRS benefit before actual retirement. Early retirement subsidies create costs to SDRS, but these costs are anticipated based on actual retirement experience. Each year, 13 percent of members eligible for unreduced benefits and younger than age 62 choose to retire. However, early retirement subsidies are not affordable if all members start SDRS benefits as soon as eligible.

This is a different time, advised Mr. Fiddler, and early retirement subsidies are counter-productive during a workforce shortage because they incent members to retire early creating additional workforce shortages, encourage members to take advantage of them even when they are not ready to retire, and make retire-rehire more lucrative which encourages sham retirements. Subsidized early retirement is not included in the Generational design to avoid benefiting those who retire early at the expense of those who don't. Eliminating the subsidy allows a greater Class A benefit for all members.

Mr. Fiddler stated that early retirement incentives only exacerbate workforce issues. He noted that policies should encourage continued employment rather than early retirement if workforce shortage is the concern. SDRS member communications emphasize advantages of continued employment over the availability of subsidized early retirement. The SDRS lifetime benefit for a member who is age 58 with 32 years of service increases substantially with delayed retirement. If members worked until age 62 their benefit would go up by 27 percent, if they worked until age 65 the benefit would increase by 51 percent, and if they worked until age 67 the benefit would increase by 69 percent. Similarly, Social Security benefits are not available until age 62 and increase with delayed retirement. In addition, Medicare is not available until age 65.

Mr. Fiddler reviewed the retire-rehire provision history. He noted that prior to July 1, 2004, SDRS benefits and COLA continued unadjusted, member and employer contributions continued, and the member's benefit was recalculated including all service at second retirement. July 1, 2004, through March 31, 2010, the COLA was suspended during reemployment, the member and employer contributions continued and the member earned a second benefit for the reemployment service. After April 1, 2010, the COLA was suspended and the benefit reduced by 15 percent during reemployment. The member and employer contributions continued, but the member contributions go to their supplemental retirement account (SRP). The COLA suspension (post-2004) and the 15 percent benefit reduction (post-2010) do not apply to public safety retirees reemployed in a Class A position. The retirement benefits that were reduced for early retirement were suspended upon reemployment until July 1, 2021. There were also provisions for part-time reemployment (less than 1250 hours) added effective July 1, 2021.

Prior to the 2010 retire-rehire reforms, the number of retire-rehires was escalating. Mr. Fiddler noted that 35 percent of Class A retirements at ages 55 and 56 (the most expensive retirees) returned to work. Of those, 75 percent of reemployed retirees returned to the same employer and 73 percent of reemployed retirees returned within three months of retirement with an average 13-day gap between retirement and reemployment. Clearly, most rehires had a plan in place at the time of retirement to return to work and decided to take advantage of the SDRS retirement benefits while continuing to work, often at the same job with the same employer.

Mr. Fiddler explained that when an eligible member retires is a primary driver of SDRS costs. SDRS costs are not calculated assuming 100 percent retire at first eligibility, but assume a data driven percentage of eligible members retire at each age. SDRS' primary concern is not the cost impact of a reemployed retiree who did not, at retirement, have the potential or future expectation to return to covered employment and receive a financial windfall. However, questioned Mr. Fiddler, should a rehired retiree receive beneficial treatment compared to a similarly situated active member continuing to work? For an active member, the expected availability of reemployment with a significant income boost unquestionably incentivizes earlier retirement. Earlier retirements increase SDRS costs. In addition, with fixed contributions, statutory funding thresholds, and variable COLAs, earlier retirements result in lower future COLAs for all retirees.

Under the current retire-rehire provisions, advised Mr. Fiddler, if a member returns to full-time employment a three consecutive month break is required with no employment relationship, the benefit is reduced 15 percent and the COLA suspended during reemployment, member contributions go to the SRP, and employer contributions remain with SDRS. If the member returns to part-time employment (less than 1,250 hours per fiscal year) and the member is age 59 ½ at retirement or has a three consecutive month break in service, there is no impact to the benefit or COLA during reemployment, and no member or employer contributions are required.

Mr. Fiddler stated that the SDRS retire-rehire provision objectives provide employers and members flexibility to meet workforce needs, comply with IRS requirements, and avoid windfalls to members, or savings to employers, that incent members to “retire” before the end of their careers and increase SDRS costs. The 2004 and 2010 reforms and subsequent adjustments have targeted these objectives and any proposals for additional changes should be evaluated on the same criteria.

In conclusion, noted Mr. Fiddler, it is essential to retain provisions that result in an SDRS cost-neutral and member benefit-neutral outcome. Any additional factors that encourage earlier retirement increases SDRS costs without these or similar provisions and will eventually result in lower COLAs for all retirees. The current retire-rehire provisions allow reemployment, but prevent windfalls compared to continued employment. The flexibility to return at less than 1,250 hours without benefit and COLA adjustments promotes phased retirements to assist employers and members in meeting workforce needs. The current retire-rehire provisions meet the SDRS objectives.

Board Action
No action was necessary.

AGENDA ITEM 9
RETIREMENT AND REEMPLOYMENT

Summary of Presentation
Mr. Rob Monson, Executive Director for the School Administrators of South Dakota, and Ms. Dianna Miller, representing the Large Schools Group, talked to the Board about the workforce shortage and changes to the current retirement and reemployment provisions.

The Board asked Mr. Monson and Ms. Miller a number of questions. Mr. Monson and Ms. Miller stated they would follow-up with the Board. Chair Johns stated that this would be an item on the September agenda and asked for responses prior to the meeting.

The Board thanked Mr. Monson and Ms. Miller for coming and explained that they felt the current retirement and reemployment provisions provided flexibility for both the employer and employee. They noted that they had a fiduciary responsibility to ensure the sustainability of the System and cannot support any additional costs at the expense of the retirees and their COLA.

Board Action
No action was necessary.

AGENDA ITEM 10
FOLLOW-UP TO CLASS B PUBLIC SAFETY CRITERIA, PROCEDURE, AND COMMITTEE REVIEW

Summary of Presentation

Ms. Samantha Koldenhoven, SDRS Associate General Counsel, noted that this review of the Class B Public Safety criteria is to clarify and, if determined appropriate, to revise the criteria. The discussion should be based on the appropriate criteria without regard to any specific group. She stated that any applicant who received the current criteria and is in the process of applying for Class B Public Safety membership will be recommended to the Board for membership if the applicant meets either the current criteria or the revised criteria, if adopted.

The Class B Public Safety benefit provisions at consolidation closely followed the terms of the then existing Law Enforcement Plan. Members of that plan at consolidation included enforcement officers of the Highway Patrol, enforcement agents of the Division of Criminal Investigation, and municipal police and fire. The consolidation study noted "earlier retirement is usually permitted, most commonly at age 55, usually when extra risk or high physical requirements exist as for law enforcement and fire prevention employees." The jailers' application for Class B membership in the late 1970s initiated a discussion to create specific criteria for future applications to limit membership to jobs similar to those initially included. The criteria was finalized in the early 1980s after a lengthy review process and has not changed since.

Ms. Koldenhoven stated that the current criteria has six points. They are that the primary duty must be to preserve the safety of the general public and protection of human life and both private and public property; age reduces the capacity to perform at an acceptable level; the appointing authority must agree – justification to taxpayers; duties must be hazardous, stressful, and physically demanding; must be a full-time responsibility; and statutory duties may define the responsibility for the safety of individuals and their property. Each item in the current criteria and the alternative criteria must be met.

Ms. Koldenhoven stated that staff had three alternatives to streamline and consolidate the current criteria into three items and relegate two items to the procedure. Alternative A provides clarification of what constitutes hazardous duties. Alternative B makes minimal changes by eliminating the word "stressful", and Alternative C makes substantive changes broadening the criteria.

The majority of the Board stated that the word "stressful" should be removed from the criteria. The majority also preferred Alternative B and stated concerns with broadening the criteria.

Ms. Koldenhoven noted there were also potential revisions to the Class B Public Safety membership procedure. The first is whether to revise the current group as a whole requirement, which requires each SDRS employer with the position to agree to the change to be Class B Public Safety. The alternative would be to allow each employer to decide, on a case by case basis, if the position should be included as Class B Public Safety. The Board, by consensus decided to retain the group as a whole requirement. The second potential revision is to move the appointing authority and statutory description from the criteria to the procedure and the Board agreed by consensus to this change. The final consideration is adding Board members to the internal Class B Public Safety Committee, specifically the Class B Public Safety representative as well as one other at-large Board member appointed by the Chair.

Board Action

IT WAS MOVED BY MR. BARNETT, SECONDED BY JUSTICE SALTER TO ADOPT ALTERNATIVE B AS PROVIDED IN THE CLASS B PUBLIC SAFETY CRITERIA PRESENTATION.

IT WAS MOVED BY MR. APPL, SECONDED BY MR. MERRILL, TO ADD TWO BOARD MEMBERS TO THE INTERNAL CLASS B PUBLIC SAFETY COMMITTEE, THE CLASS B REPRESENTATIVE AND ONE OTHER MEMBER APPOINTED BY THE CHAIR. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 11
ASSET ALLOCATION

Summary of Presentation

Mr. Matt Clark, State Investment Officer, SDIO, discussed the asset allocation process, importance, and application to SDRS. He discussed the recommended benchmark allocation and ranges, expected return and standard deviations, asset category valuation, and the movement of category allocations within ranges based on valuation.

Mr. Clark discussed the recommended benchmark level of equity-like and bond-like risk to balance long-term potential returns with drawdown risk in difficult markets. He indicated this was for the benchmark which should represent what could be adhered to through thick and thin. He showed charts of historic returns noting the dominance of equity returns over the very long term and the diversification benefit during market downturns of mixing in some bonds. He discussed the recommended range for equity-like risk and bond-like risk. He said the goal is to enter market downturns with below benchmark risk and increase toward maximum during the downturn to benefit from an eventual rebound. He added that after getting to minimums and maximums, markets will typically move further, which can be very painful. It is essential to be patient for at least another three to five years.

Mr. Clark discussed equity-like and bond-like risk mapping for all asset categories. He discussed specific asset categories to be included in the benchmark which are those that are significant and passively implementable. He discussed other niche or skill-based categories which are not in the benchmark but that have a permitted range. He presented the SDRS capital market benchmark allocations and minimum/maximum ranges for each asset category.

Mr. Clark showed SDRS historical levels of equity-like allocation. He reviewed the asset allocation risk/return analysis. The first portion focused on long-term mean expected returns, expected standard deviations, and asset correlations provided by JP Morgan Asset Management as a proxy for conventional expectations. The incremental return and standard deviation impact of each asset class was shown. The analysis was shown again using internal asset category expected returns and internal adjusted risk measures.

Mr. Clark discussed additional risk measures and risk control. He reiterated that the focus is on equity-like risk and bond-like risk which includes embedded equity and bond risk for all categories. He said statistical measures of risk such as standard deviation and correlation are adjusted to reflect higher real-world frequency and magnitude of adverse outlier events. He said that behavior of some assets in a crisis can vary depending on whether the crisis is rooted in inflation or deflation concerns. Clark discussed how risk is managed by broad diversification and by reducing amounts invested in expensive assets. He said adequate liquidity is maintained to avoid liquidations of depressed assets in a crisis and to allow rebalancing. He stated that participation in the economic system is necessary to get the highest long-term rewards and that short-term ebbs and flows must be endured. He added that strength and determination is important to be able to handle tough markets, which is helped by strong funding built up in good markets and a flexible benefit design.

Mr. Clark then discussed asset category valuation. Equity category valuation is based on estimated future cash flows based on normal earnings and growth rates and a risk impacted discount rate. He said the model is similar to the model used to value individual companies. He discussed adjustments to fair value based on monetary conditions and corporate earnings strength.

Board Action
No action was necessary.

AGENDA ITEM 12
EXPERIENCE ANALYSIS: ECONOMIC ASSUMPTIONS

Summary of Presentation
Mr. Fiddler stated that actuarial assumptions are used to project the timing and amount of future benefits and estimate the costs of funding those benefits. Assumptions must be individually and aggregately reasonable and must adhere to the Actuarial Standards of Practice. The goal is to provide realistic estimates of future experience by the selection of appropriate assumptions. The Board is required by SDCL 3-12C-227 to adopt actuarial assumptions based on an actuarial experience analysis, the recommendations of the actuary, and the certification by the actuary that the changes are reasonable. The experience analysis reviews the recent experience to better forecast future events. The

last comprehensive experience analysis was completed after the 2016 valuation with assumption changes effective for the 2017 valuation. Changes in assumptions are recommended if sufficient data shows material difference between expected future experience and current assumptions.

Mr. Fiddler stated that April's board meeting focused on the demographic assumptions, about events in members' lives. Today's focus will be on the economic assumptions, which generally have a more significant impact on the liabilities, as well as the impact of any recommendations on the funding requirements. He noted that the Board would need to approve the assumption changes at this meeting or at the latest, the September meeting.

Recommended demographic assumptions are primarily based on SDRS recent experience and trends. Economic assumptions are impacted more by external forces and this analysis and recommendations more heavily focus on current market conditions and forecasts, but also consider relevant historical data.

Mr. Fiddler reviewed all the economic assumptions with the Board. He recommended the following assumption changes: increase the price inflation from 2.25 percent to 2.50 percent; increase the wage inflation from 3.00 percent to 3.15 percent; maintain the 6.50 percent nominal investment return but reduce the real investment return to 4.00 percent; reflect recent salary experience, considering impact of 2017 teacher salary increase and increased wage inflation assumption for salary increases; maintain 2.25 percent baseline COLA; reduce credited rate of interest from 2.50 percent to 2.25 percent; and propose legislation to modify SDCL 3-12C-109 to include immediate recognition of any surplus in calculation of minimum actuarial requirement to support benefits.

Board Action

IT WAS MOVED BY MR. SEELEY, SECONDED BY MS. BRANT, TO ADOPT CHANGES TO THE FOLLOWING ECONOMIC ASSUMPTIONS AS DETAILED IN THE EXPERIENCE ANALYSIS ECONOMIC ASSUMPTIONS PRESENTATION:

1. PRICE INFLATION
2. WAGE INFLATION
3. INVESTMENT RETURN
4. SALARY INCREASES
5. BASELINE COLA
6. CREDITED RATE OF INTEREST

THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 13
ECONOMIC EXPERIENCE ANALYSIS AUDIT

Summary of Presentation

Mr. Larry Langer, Principal and Consulting Actuary, Cavanaugh Macdonald Consulting (CavMac), stated that CavMac has reviewed the development of the economic assumptions and find it to be complete and supportive of the use of the recommended set of economic assumptions. Therefore, CavMac believes the recommended economic assumptions to be reasonable.

Board Action
IT WAS MOVED BY MS. BRANT, SECONDED BY MR. VILHAUER, TO ACCEPT THE AUDIT OF THE ECONOMIC EXPERIENCE ANALYSIS AS PRESENTED BY CAVANAUGH MACDONALD CONSULTING. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 14
PUBLIC COMMENT

Summary of Presentation
Mr. Bob Hoffman, SDEA – Retired. Mr. Hoffman provided public comment, seeking a mechanism to provide a larger COLA to retirees.

Board Action
No action was necessary.

AGENDA ITEM 15
OLD/NEW BUSINESS

Summary of Presentation
Conference Attendance
Mr. Jim Appl requested permission to attend the National Council on Teacher Retirement (NCTR) conference in Tucson, AZ from October 9-12, 2022.

Mr. Darin Seeley requested permission to attend the International Foundation of Employee Benefit Plans (IFEBP) conference in Las Vegas, NV from October 23-26, 2022.

Upcoming Board Meeting Dates
Ms. Smith discussed the upcoming SDRS Board meeting dates.

Board Action
Conference Attendance
IT WAS MOVED BY MR. STROEDER, SECONDED BY JUSTICE SALTER, TO APPROVE THE TRAVEL REQUEST OF JIM APPL TO THE NCTR CONFERENCE AND DARIN SEELEY TO THE IFEBP CONFERENCE IN OCTOBER. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

ADJOURNMENT

Board Action

IT WAS MOVED BY MR. JOHNSON, SECONDED BY JUSTICE SALTER, THAT THERE BEING NO FURTHER BUSINESS, THE MEETING BE DECLARED ADJOURNED. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

Respectfully Submitted,

Travis Almond
Executive Director