

MEMORANDUM

Subject: Disclosure of Pension Information
June 30, 2016 Measurement Date

The Governmental Accounting Standards Board (GASB) issued Statement No. 68 entitled *Accounting and Financial Reporting for Pension Plans* in June 2012. The disclosure requirements applicable to employers participating in the South Carolina Retirement System or the Police Officers Retirement System are prescribed in paragraphs 48 through 82 of GASB 68.

The following information is provided in order to assist employers in meeting current disclosure requirements. Additional materials to assist employers in complying with GASB requirements, including an [audit report](#) on the Schedules of Employer Allocations, Schedules of Pension Amounts by Employer, and Related Notes to the Schedules are available online at <http://www.peba.sc.gov/rgasb.html>.

Description of the Entity

The South Carolina Public Employee Benefit Authority (PEBA), which was created July 1, 2012, administers the various retirement systems and retirement programs managed by its Retirement Division. PEBA has an 11-member Board of Directors, appointed by the Governor and General Assembly leadership, which serves as co-trustee and co-fiduciary of the systems and the trust funds. By law, the State Fiscal Accountability Authority (SFAA), which consists of five elected officials, also reviews certain PEBA Board decisions regarding the funding of the South Carolina Retirement Systems (Systems) and serves as a co-trustee of the Systems in conducting that review.

For purposes of measuring the net pension liability, deferred outflows and inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Systems and additions to/deductions from the Systems fiduciary net position have been determined on the accrual basis of accounting as they are reported by the Systems in accordance with generally accepted accounting principles (GAAP). For this purpose, revenues are recognized when earned and expenses are recognized when incurred. Benefit and refund expenses are recognized when due and payable in accordance with the terms of the plan. Investments are reported at fair value.

PEBA issues a Comprehensive Annual Financial Report (CAFR) containing financial statements and required supplementary information for the Systems' Pension Trust Funds. The [CAFR](#) is publicly available through the Retirement Benefits' link on PEBA's website at www.peba.sc.gov, or a copy may be obtained by submitting a request to PEBA, 202 Arbor Lake Drive, Columbia, SC 29223. PEBA is considered a division of the primary government of the state of South Carolina and therefore, retirement trust fund financial information is also included in the comprehensive annual financial report of the state.

Plan Description

The South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan, was established effective July 1, 1945, pursuant to the provisions of Section 9-1-20 of the South Carolina Code of Laws for the purpose of providing retirement allowances and other benefits for employees of the state, its public school districts, and political subdivisions.

The State Optional Retirement Program (State ORP) is a defined contribution plan that is offered as an alternative to SCRS to certain newly hired state, public school, and higher education employees. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers.

The South Carolina Police Officers Retirement System (PORS), a cost-sharing multiple-employer defined benefit pension plan, was established effective July 1, 1962, pursuant to the provisions of Section 9-11-20 of the South Carolina Code of Laws for the purpose of providing retirement allowances and other benefits for police officers and firemen of the state and its political subdivisions.

Membership

Membership requirements are prescribed in Title 9 of the South Carolina Code of Laws. A brief summary of the requirements under each system is presented below.

- SCRS - Generally, all employees of covered employers are required to participate in and contribute to the system as a condition of employment. This plan covers general employees and teachers and individuals newly elected to the South Carolina General Assembly beginning with the November 2012 general election. An employee member of the system with an effective date of membership prior to July 1, 2012, is a Class Two member. An employee member of the system with an effective date of membership on or after July 1, 2012, is a Class Three member.
- State ORP - As an alternative to membership in SCRS, newly hired state, public school, and higher education employees and individuals newly elected to the S.C. General Assembly beginning with the November 2012 general election have the option to participate in the State Optional Retirement Program (State ORP), which is a defined contribution plan. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers. PEBA assumes no liability for State ORP benefits. Rather, the benefits are the liability of the investment providers. For this reason, State ORP programs are not part of the retirement systems' trust funds for financial statement purposes. Employee and Employer contributions to the State ORP are at the same rates as SCRS. A direct remittance is required from the employers to the member's account with investment providers for the employee contribution and a portion of the employer contribution (5 percent). A direct remittance is also required to SCRS for the remaining portion of the employer contribution and an incidental death benefit contribution, if applicable, which is retained by SCRS.
- PORS - To be eligible for PORS membership, an employee must be required by the terms of his employment, by election or appointment, to preserve public order, protect life and property, and detect crimes in the state; to prevent and control property destruction by fire; or to serve as a peace officer employed by the Department of Corrections, the Department of Juvenile Justice, or the Department of Mental Health. Probate judges and coroners may elect membership in PORS. Magistrates are required to participate in PORS for service as a magistrate. PORS members, other than magistrates and probate judges, must also earn at least \$2,000 per year and devote at least 1,600 hours per year to this work, unless exempted by statute. An employee member of the system with an effective date of membership prior to July 1, 2012, is a Class Two member. An employee member of the system with an effective date of membership on or after July 1, 2012, is a Class Three member.

Benefits

Benefit terms are prescribed in Title 9 of the South Carolina Code of Laws. PEBA does not have the authority to establish or amend benefit terms without a legislative change in the code of laws. Key elements of the benefit calculation include the benefit multiplier, years of service, and average final compensation. A brief summary of the benefit terms for each system is presented below.

- SCRS - A Class Two member who has separated from service with at least five or more years of earned service is eligible for a monthly pension at age 65 or with 28 years credited service regardless of age. A member may elect early retirement with reduced pension benefits payable at age 55 with 25 years of service credit. A Class Three member who has separated from service with at least eight or more years of earned service is eligible for a monthly pension upon satisfying the Rule of 90 requirement that the total of the member's age and the member's creditable service equals at least 90 years. Both Class Two and Class Three members are eligible to receive a reduced deferred annuity at age 60 if they satisfy the five- or eight-year earned service requirement, respectively. An incidental death benefit is also available to beneficiaries of active and retired members of employers who participate in the death benefit program.

The annual retirement allowance of eligible retirees or their surviving annuitants is increased by the lesser of one percent or five hundred dollars every July 1. Only those annuitants in receipt of a benefit on July 1 of the preceding year are eligible to receive the increase. Members who retire under the early retirement provisions at age 55 with 25 years of service are not eligible for the benefit adjustment until the second July 1 after reaching age 60 or the second July 1 after the date they would have had 28 years of service credit had they not retired.

- PORS - A Class Two member who has separated from service with at least five or more years of earned service is eligible for a monthly pension at age 55 or with 25 years of service regardless of age. A Class Three member who has separated from service with at least eight or more years of earned service is eligible for a monthly pension at age 55 or with 27 years of service regardless of age. Both Class Two and Class Three members are eligible to receive a deferred annuity at age 55 with five or eight years of earned service, respectively. An incidental death benefit is also available to beneficiaries of active and retired members of employers who participate in the death benefit program. Accidental death benefits are also provided upon the death of an active member working for a covered employer whose death was a natural and proximate result of an injury incurred while in the performance of duty.

The retirement allowance of eligible retirees or their surviving annuitants is increased by the lesser of one percent or five hundred dollars every July 1. Only those annuitants in receipt of a benefit on July 1 of the preceding year are eligible to receive the increase.

Contributions

Contributions are prescribed in Title 9 of the South Carolina Code of Laws. Upon recommendation by the actuary in the annual actuarial valuation, the PEBA Board may adopt and present to the SFAA for approval an increase in the SCRS and PORS employer and employee contribution rates, but any such increase may not result in a differential between the employee and total employer contribution rate that exceeds 2.9 percent of earnable compensation for SCRS and 5 percent for PORS. An increase in the contribution rates adopted by the Board may not provide for an increase of more than one-half of one percent in any one year. If the scheduled employee and employer contributions provided in statute or the rates last adopted by the Board are insufficient to maintain a thirty year amortization schedule of the unfunded liabilities of the plans, the Board shall increase the contribution rates in equal percentage amounts for the employer and employee as necessary to maintain the thirty-year amortization period; and, this increase is not limited to one-half of one percent per year.

Required employee contribution rates¹ are as follows:

	<u>Fiscal Year 2017</u>	<u>Fiscal Year 2016</u>
SCRS		
Employee Class Two	8.66%	8.16%
Employee Class Three	8.66%	8.16%
State ORP		
Employee	8.66%	8.16%
PORS		
Employee Class Two	9.24%	8.74%
Employee Class Three	9.24%	8.74%

Required employer contribution rates¹ are as follows:

	<u>Fiscal Year 2017</u>	<u>Fiscal Year 2016</u>
SCRS		
Employer Class Two	11.41%	10.91%
Employer Class Three	11.41%	10.91%
Employer Incidental Death Benefit	0.15%	0.15%
State ORP		
Employer Contribution ²	11.41%	10.91%
Employer Incidental Death Benefit	0.15%	0.15%
PORS		
Employer Class Two	13.84%	13.34%
Employer Class Three	13.84%	13.34%
Employer Incidental Death Benefit	0.20%	0.20%
Employer Accidental Death Program	0.20%	0.20%

¹ Calculated on earnable compensation as defined in Title 9 of the South Carolina Code of Laws.

² Of this employer contribution, 5% of earnable compensation must be remitted by the employer directly to the ORP vendor to be allocated to the member's account with the remainder of the employer contribution remitted to the SCRS.

Actuarial Assumptions and Methods

Actuarial valuations involve estimates of the reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and future salary increases. Actuarial assumptions and methods used during the annual valuation process are subject to periodic revision, typically with an experience study, as actual results over an extended period of time are compared with past expectations and new estimates are made about the future.

South Carolina state statute requires that an actuarial experience study be completed at least once in each five-year period. An experience report on the Systems was most recently issued as of July 1, 2015. The June 30, 2016, total pension liability, net pension liability, and sensitivity information were determined by the Systems consulting actuary, Gabriel, Roeder, Smith and Company (GRS) and are based on the July 1, 2015, actuarial valuations, as adopted by the PEBA Board and SFAA which utilized membership data as of July 1, 2015. The total pension liability was rolled-forward from the valuation date to the Systems' fiscal year ended June 30, 2016, using generally accepted actuarial principles. Information included in the following schedules is based on the certification provided by GRS.

The following provides a summary of the actuarial assumptions and methods used in the July 1, 2015, valuations for SCRS and PORS.

	SCRS	PORS
Actuarial cost method	Entry age normal	Entry age normal
Investment rate of return ¹	7.5%	7.5%
Projected salary increases	3.5% to 12.5% (varies by service) ¹	4.0% to 10.0% (varies by service) ¹
Benefit adjustments	lesser of 1% or \$500 annually	lesser of 1% or \$500 annually
¹ Includes inflation at 2.75%		

The post-retiree mortality assumption is dependent upon the member's job category and gender. This assumption includes base rates which are automatically adjusted for future improvement in mortality using published Scale AA projected from the year 2000. Assumptions used in the July 1, 2015, valuations for SCRS and PORS are as follows.

Former Job Class	Males	Females
Educators	RP-2000 Males (with White Collar adjustment) multiplied by 110%	RP-2000 Females (with White Collar adjustment) multiplied by 95%
General Employees and Members of the General Assembly	RP-2000 Males multiplied by 100%	RP-2000 Females multiplied by 90%
Public Safety and Firefighters	RP-2000 Males (with Blue Collar adjustment) multiplied by 115%	RP-2000 Females (with Blue Collar adjustment) multiplied by 115%

Net Pension Liability

The net pension liability (NPL) is calculated separately for each system and represents that particular system's total pension liability determined in accordance with GASB No. 67 less that System's fiduciary net position. NPL totals, as of June 30, 2016, for SCRS and PORS are presented below.

System	Total Pension Liability	Plan Fiduciary Net Position	Employers' Net Pension Liability (Asset)	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
SCRS	\$ 45,356,214,752	\$ 23,996,362,354	\$ 21,359,852,398	52.9%
PORS	6,412,510,458	3,876,035,732	2,536,474,726	60.4%

The total pension liability is calculated by the Systems' actuary, and each plan's fiduciary net position is reported in the [Systems' financial statements](#). The net pension liability is disclosed in accordance with the requirements of GASB 67 in the Systems' notes to the financial statements and required supplementary information. Liability calculations performed by the Systems' actuary for the purpose of satisfying the requirements of GASB Nos. 67 and 68 are not applicable for other purposes, such as determining the plans' funding requirements.

Long-term Expected Rate of Return

The long-term expected rate of return on pension plan investments, as used in the July 1, 2015, actuarial valuations, was based upon the 30 year capital markets outlook at the end of third quarter 2015. The long-term expected rate of returns represent assumptions developed using an arithmetic building block approach primarily based on consensus expectations and market based inputs. Expected returns are net of investment fees.

The expected returns, along with the expected inflation rate, form the basis for the revised target asset allocation adopted beginning January 1, 2016. The long-term expected rate of return is produced by weighting the expected future real rates of return by the target allocation percentage and adding expected inflation and is summarized in the table below. For actuarial purposes, the 7.50 percent assumed annual investment rate of return used in the calculation of the total pension liability includes a 4.75 percent real rate of return and a 2.75 percent inflation component.

<u>Asset Class</u>	<u>Target Asset Allocation</u>	<u>Expected Arithmetic Real Rate of Return</u>	<u>Long Term Expected Portfolio Real Rate of Return</u>
Global Equity	43.0%		
Global Public Equity	34.0%	6.52%	2.22%
Private Equity	9.0%	9.30%	0.84%
Real Assets	8.0%		
Real Estate	5.0%	4.32%	0.22%
Commodities	3.0%	4.53%	0.13%
Opportunistic	20.0%		
GTAA/Risk Parity	10.0%	3.90%	0.39%
HF (Low Beta)	10.0%	3.87%	0.39%
Diversified Credit	17.0%		
Mixed Credit	5.0%	3.52%	0.17%
Emerging Markets Debt	5.0%	4.91%	0.25%
Private Debt	7.0%	4.47%	0.31%
Conservative Fixed Income	12.0%		
Core Fixed Income	10.0%	1.72%	0.17%
Cash and Short Duration (Net)	2.0%	0.71%	0.01%
Total Expected Real Return	100%		5.10%
Inflation for Actuarial Purposes			2.75%
Total Expected Nominal Return			7.85%

Discount Rate

The discount rate used to measure the total pension liability was 7.50 percent. The projection of cash flows used to determine the discount rate assumed that the funding policy specified in the South Carolina State Code of Laws will remain unchanged in future years. Based on those assumptions, each System's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity Analysis

The following table presents the collective net pension liability of the participating employers calculated using the discount rate of 7.50 percent, as well as what the employers' net pension liability would be if it were calculated using a discount rate that is 1.00 percent lower (6.50 percent) or 1.00 percent higher (8.50 percent) than the current rate.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate			
System	1.00% Decrease (6.50%)	Current Discount Rate (7.50%)	1.00% Increase (8.50%)
SCRS	\$ 26,645,830,988	\$ 21,359,852,398	\$ 16,959,474,388
PORS	3,324,267,374	2,536,474,726	1,828,495,252

Additional Financial and Actuarial Information

Detailed information regarding the fiduciary net position of the plans administered by PEBA is available in the Systems' [audited financial statements for the fiscal year ended June 30, 2016](#) (including the unmodified audit opinion on the financial statements). Additional actuarial information is available in the [accounting and financial reporting actuarial valuation as of June 30, 2016](#).