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S.C. retirement systems funding status update

September 6, 2016

Recent news reports have centered on the funding status of the retirement plans for South Carolina's public workforce. These reports come in the wake of the first meeting of a legislative committee formed to study the retirement systems and proffer solutions for long term sustainability. As executive director of the South Carolina Public Employee Benefit Authority (PEBA), I appreciate the opportunity to provide you with an explanation of the current status of the retirement systems and to let you know that you will be hearing more in the coming months.

I appreciate your concerns about the funding of our retirement systems, as well as the future benefits to be paid to retirees. PEBA serves as the administrator for the state's five public workforce retirement systems, and we look to the South Carolina General Assembly for direction on the governance of the plans, because they set out the benefits and funding structure for the retirement systems in statute.

Before I get into the background of the current circumstances, I want to let you know that the General Assembly is aware of these ongoing challenges, and most recently established a Joint Committee on Pension Systems Review to study what steps may need to be taken now. My staff and I are working to provide this body of lawmakers the information they will need in this effort, as are the staff of our actuary firm and the South Carolina Retirement System Investment Commission, which is responsible for investing and managing the pension trust funds. The group met for the first time August 30, and the initial reports and video of the meeting are available on the Committee's page on the South Carolina Legislature's website.

Now, I would like to provide you with background on the current state of the systems' funding, as well as the steps which have been taken recently in its management and the steps which are being taken now. Included with this response are summaries of both the funding history for the South Carolina Retirement System, (SCRS), the largest of state's public pension plans, and the 2012 retirement reforms enacted by the General Assembly.

Security of future benefit payments

The systems' trust funds have the money to pay benefits that are due now and there is a statutory and constitutional mandate to ensure that funding will be in place to pay future benefits as well.

State law additionally requires that actuaries study the plans every year to determine funding needs and to ensure that the plans are financially accountable. Every five years, a more in-depth study by outside actuaries is also conducted to ensure that the assumptions used in the actuarial calculations remain reasonable. The studies of the plans that we undertake every year, or actuarial valuations, consider many variables that will affect the plans in the future, such as how much employees are expected to contribute, how much investment income is expected, as well as when employees will retire and how

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much they are expected to be paid in benefits after they do. The most recent of these studies, as of June 30, 2015, indicated that the actuarial value of the unfunded liability of SCRS is $16.75 billion.

The unfunded liability represents the relationship between the eventual payments that the plan will need to make to retirees and the current value of the funds to pay these obligations.

How the systems are funded

The retirement plans have three sources of revenue: contributions from employees, contributions from employers and income from the investment of the funds. If any of these three sources of income does not meet expectations (actuarial assumptions), the other sources must increase to make up the difference. For example, the funding of the system currently assumes investment returns will be 7.50 percent each fiscal year. However, over the 10 year period ended June 30, 2015, the 10-year annualized return was 5.06 percent. As a result, employee and employer contributions have to make up the difference. As well, in the latest experience study, the actuaries recommended that the assumptions for life expectancy be increased. Increasing life expectancy will result in higher benefit costs as retirement benefits are paid for a longer period of time. And therefore, employee and employer contributions must increase to pay for the increase in life expectancy.

According to current statute, when contribution rates must rise, the difference between the employee contribution rate and the employer contribution rate must remain at 2.9 percent.

2012 Legislative reform

The 2012 General Assembly reforms included a number of steps to provide for the long-term stability of the pension funds. A summary of these steps is on Page 4 of this document.

Public policy discussion has begun

As I mentioned earlier, the General Assembly remains aware of these ongoing challenges, and the Joint Committee on Pension System Review's first public meeting was August 30, 2016. We will actively be providing information to the Committee and its staff to ensure they have what they need to make informed decisions about the plans going forward.

Our responsibility, and the responsibility of many other governmental organizations to the more than 558,000 members of our retirement systems is a tremendous one. We are aware and focused on the issues which impact the systems' future, and will continue to serve as diligent fiduciary stewards of your pension funds.

Sincerely,

Peggy G. Boykin

Peggy G. Boykin, CPA
Executive Director

Funding history: South Carolina Retirement System (SCRS)

Historical information

- Value of the SCRS unfunded liability as of June 30, 2015:

  Market value - $18.99 billion

  - COLAs - $3.31 billion
  - Investment losses - $5.96 billion
  - Deferred investment losses - $2.23 billion
  - Liability experience - $2.59 billion
  - Assumption changes - $2.09 billion
  - Interest on the UAAL - $2.74 billion
  - Non-COLA benefit changes - $63 million

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Unfunded liability on a market value basis for SCRS at June 30, 2016, will be more than $21 billion.

2012 retirement reform summary

- Legislature met from March 2011 through June 2012
- Created PEBA
- No decrease in contribution rates may be made until the System is at least 90 percent funded
- Increased employer and employee contribution rate and required future increases to maintain a 2.90 percent difference
- Budget and Control Board decreased assumed rate of return from 8 percent to 7.50 percent prior to reform in 2012. Reform put 7.50 percent assumed rate of return in statute.
- Created Class Three tier of membership in SCRS
    - Newly hired employees with membership dates on or after July 1, 2012
    - Employees must be age 60 or satisfy the Rule of 90 requirement (age and years of service credit must add up to 90) to retire with full benefits
        - For example, an employee who is 55 years old can retire if he has 35 years of service
    - Increased vesting period from five years to eight years
    - Increased average final compensation calculations from 12 quarters to 20 quarters of highest earnable compensation
    - Removed unused leave at retirement from benefit calculations
- Changes affecting all members
    - Closed TERI program effective June 30, 2018
    - Changed cost of service purchase to be actuarially neutral
    - Removed overtime pay from earnable compensation if not mandated by employer
- Changes affecting SCRS retirees
    - Limited annual benefit adjustment, formally referred to as cost-of-living adjustment (COLA), to 1.00 percent up to a maximum of $500
    - Previously, a 2.00 percent COLA was guaranteed (since FY 2008)
- Changed provisions for SCRS disability retirement
- Closed GARS to legislators first elected to serve in the General Assembly at or after the general election of 2012
    - New members may join SCRS or State ORP
- Added $10,000 earnings limit for certain SCRS return-to-work employees who retired on or after January 2, 2013 (some exemptions apply)
- Eliminated interest on inactive accounts