South Dakota Retirement System

Tying it all Together: A Plan Design for New Members

Revisited II: With More Information

September 2, 2015

June Board Actions

- General agreement with new member plan design objectives and details of recommended plan design presented in June
- Requested draft legislation
- Requested information on practices of other statewide plans for new members
- Requested following examples:
  - Maintain a Special Early Retirement (Rule of) Benefit with eligibility modifications
    - Rule of 90 with minimum age 57 (80 at 47 for PS, 85 at 57 for Judicial)
    - Rule of 90 with minimum age 62 (80 at 52 for PS, 85 at 62 for Judicial)
  - Increase vesting requirement from three years to five years of service

Objectives: New Plan Design for New Members

- Increase likelihood of sustainability and avoidance of corrective actions in the future
- Eliminate or decrease subsidies, inequities, and unanticipated costs
- Restructure benefits without requiring additional contributions
- Add more variable benefits utilizing the savings
- Recognize increasing life expectancy
- Meet income replacement goals for career employees
- Enhance hybrid features of SDRS
- Maintain equity with current members
- Align benefits to better recognize employers’ workforce issues
- Consider national practices and materiality

Recommended New Member Plan Design

Current Plan Terms

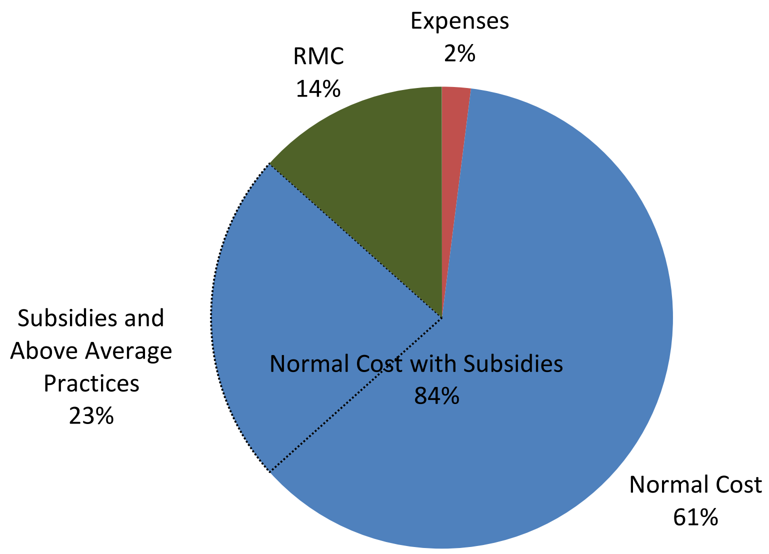
- Retirement Benefits:
  - Normal Retirement Age: 65/55 (A and Judicial / PS)
  - Early Retirement Age: 55/45, 3% per year reduction
  - Special Early Retirement (Rule of 85/75/80)
  - Class A Alternate Formula
- Base Benefits:
  - 1.55% for Class A
  - 2% and 3.3%/2% for Class B
  - No VBA
- Three-Year Final Average Comp
- Three-Year Vesting
- 60% Post-Retirement Survivor Benefit
- COLA indexed to funded status and CPI (minimum of 2.1%, maximum of 3.1%)
- PRO: Refund of member contributions plus 85% of employer contributions (50% if not vested)

New Plan Terms

- Retirement Benefits:
  - Normal Retirement Age: 67/57 (A and Judicial / PS)
  - Early Retirement Age: 57/47, 5% per year reduction
  - No Special Early Retirement
  - No Alternate Formula
- Base Benefits:
  - Increased to 1.8% for Class A
  - No change for Class B
  - VBA to supplement base benefits at retirement
- Five-Year Final Average Comp
- Three-Year Vesting
- Survivor Benefit available at member cost
- COLA indexed to funded status and CPI (minimum of 1.0%, maximum of 3.1%)
- PRO: Refund of member contributions plus 85% of employer contributions including VBA (50% if not vested)

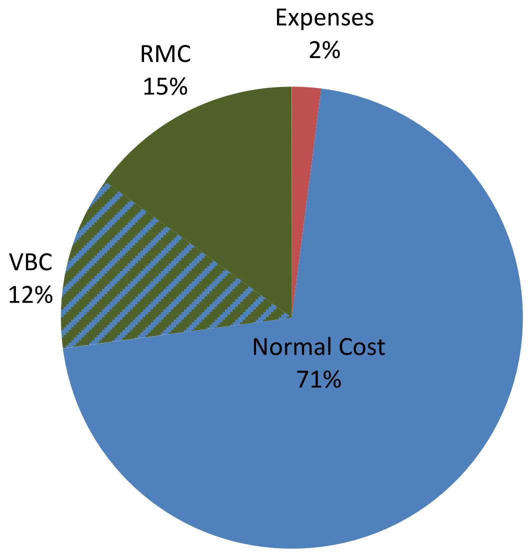
Plan Design Cost Comparison

Current Plan



	Percent of Pay
Total contributions	12.482%
Subsidies/above average practices	2.900%
Contributions available to amortize unfunded liability (RMC)	1.671%

New Member Plan Design



	Percent of Pay
Total contributions	12.338%
Subsidies/above average practices	0.000%
Contributions available to amortize unfunded liability (RMC and VBC)	3.346%

Similarity of Recommended New Member Benefits with Provisions in Other States

- The specific combination of benefits in the recommended plan design meets the stated objectives and is unique to SDRS
- However, each of the specific benefit changes is very similar or identical to provisions for new members in a number of statewide systems
  - **Hybrid DB Plans with variable member accounts**
    - A feature of statewide systems in GA, IN, OH, OR, RI, TN, UT, VA, WA
  - **Final Average Compensation**
    - The most common period is 5 years
    - Systems in 14 states use a period of 3 years or less
    - Systems in 2 states use 8 year periods
    - Defined contribution or cash balance systems in 5 states are effectively career average plans

Similarity of Recommended New Member Benefits with Provisions in Other States

- **Early Retirement or Special Early Retirement Subsidies**
  - Statewide systems in 10 states provide unreduced retirement benefits only after reaching a Normal Retirement Age of 65-67
    - ID, IL, MA, ME, MN, MT, NH, NJ, RI, WA
  - Statewide systems in 5 states are defined contribution or cash balance and therefore provide no Early/Special Early Retirement subsidies
    - AK, KS, KY, MI, NE
  - The most common Early Retirement reductions are 5% per year or exact actuarial reduction
    - Only a handful of systems provide a 3% reduction to new members
- **COLA**
  - 22 statewide systems have no automatic annual COLA
  - Another 21 are based on CPI, with a minimum of 1.5% or less

New Member Tiers in Other States

- Most statewide systems have made benefit changes in the wake of the Great Recession and/or significant budgetary pressure
- A common result is new member tiers with reduced benefits or delayed benefit eligibility while:
  - Still requiring the same level of contributions, and
  - Frequently subsidizing benefits for existing members
- Without reserves or adequate contributions, subsequent unfavorable experience can require additional changes, leading to multiple tiers (29 statewide systems have 3 to 7 tiers of benefits)

Aligning New Plan Design Provisions with Objectives: Special Early Retirement

- The recommended new member plan design meets all the objectives
- Preserving Early or Special Early Retirement subsidies will dilute some or all of the objectives highlighted below, depending on how benefits are then restructured
  - **Increase likelihood of sustainability and avoidance of corrective actions in the future**
  - **Eliminate or decrease subsidies, inequities, and unanticipated costs**
  - Restructure benefits without requiring additional contributions
  - **Add more variable benefits with savings**
  - Recognize increasing life expectancy
  - **Meet income replacement goals for career employees**
  - **Enhance hybrid features of SDRS**
  - **Maintain equity with current members**
  - **Align benefits to better recognize employers' workforce needs**
  - Consider national practices and materiality

Aligning New Plan Design Provisions with Objectives: Special Early Retirement

- Approximately one-third of fiscal 2014 retirements were subsidized Special Early Retirements
- Staff and consultant opinions – Eliminating all Early and Special Early Retirement subsidies:
  – Avoids making value judgments about the priority of retirement subsidies over other subsidies and over new plan design objectives
  – Avoids subsidizing members who have not met Normal Retirement Age requirements
  – Avoids interfering with employer workforce issues
  – Avoids dilution of new plan design objectives
  – Provides resources (Variable Benefit Contributions) that members may use to finance their own early retirement, if desired

Request A: Retain Special Early Retirement - Minimum Age 57/47

- Specifics:
  - Class A: Rule of 90
    - Minimum age of 57
    - 5% reduction per year prior to earlier of age 67 or Rule of 90
  - Public Safety: Rule of 80
    - Minimum age of 47
    - 5% reduction per year prior to earlier of 57 or Rule of 80
  - Judicial: Rule of 85
    - Minimum age of 57
    - 5% reduction per year prior to earlier of 67 or Rule of 85
- Results: Increases SDRS Normal Cost from 8.99% to 9.67% of pay
- Members who retire upon reaching “Rule of” requirements at age 57/47 receive benefits with a value 50% greater than benefits at Normal Retirement Age

Request A: Retain Special Early Retirement - Minimum Age 57/47

- Request A provisions result in a higher cost that would require:
  - Reduced sustainability features (RMC or VBC), or
  - Reduced benefits for all members to subsidize some members
- Consequences of addressing increased costs of Request A provisions while maintaining the balance between Class A and Class B would be:
  - Reduce the RMC only
  - Reduce the VBC only
  - Reduce the benefit multipliers only, or
  - Reduce some combination of the above

Request A: Retain Special Early Retirement - Minimum Age 57/47

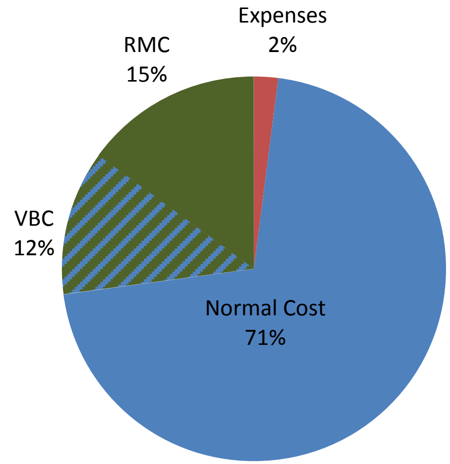
June Illustration	Multipliers	VBC	RMC	VBC + RMC Could Amortize Unfunded of:
	A: 1.80% PS: 2.00% Jud: 3.333% (15)/2.00%	1.50%	1.85% of pay $31M 0.30% of FVA	$800M

Cost Consequences *	Multipliers	VBC	RMC	VBC + RMC Could Amortize Unfunded of:	Comments
Reduce RMC only	Same as June	Same as June	1.17% of pay $20M 0.19% of FVA	$640M	Sustainability impact of RMC and VBC reduced by 20%
Or					
Reduce VBC only	Same as June	0.82%	Same as June	$640M	Sustainability impact of RMC and VBC reduced by 20%
Or					
Reduce multipliers only	A: 1.65% PS: 1.83% Jud: 3.07% (15)/1.83%	Same as June	Same as June	$800M	Benefits reduced by 8%

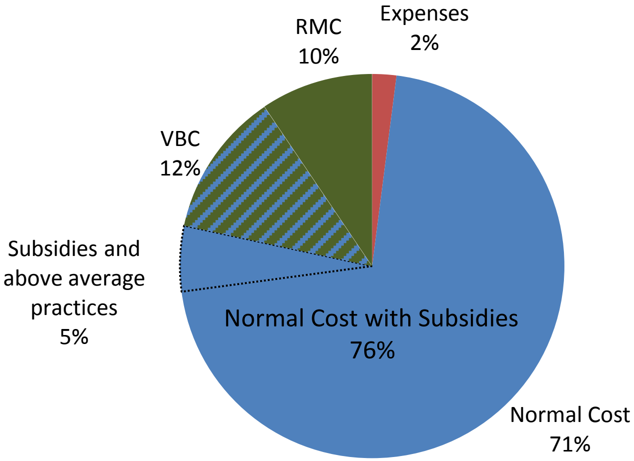
* Reducing the RMC or the VBC diminishes the sustainability of the System and dilutes other objectives.
Reducing the multipliers prevents reaching income replacement goals and lowers the Class B multipliers below the current level.

Request A Cost Comparison

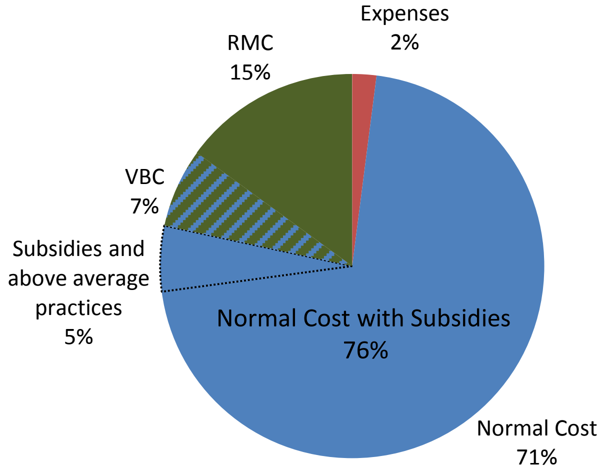
New Member Plan Design



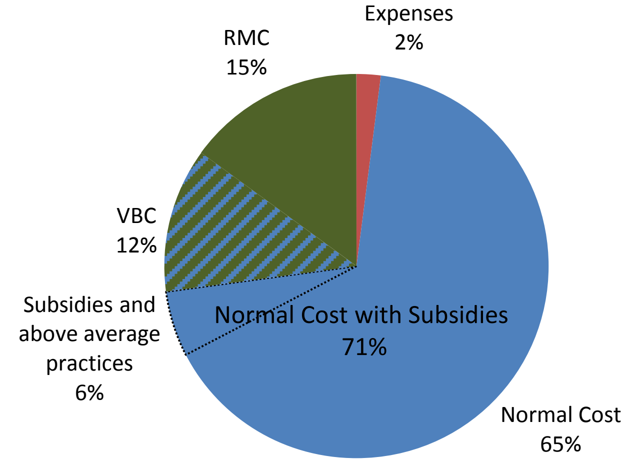
Request A: Reduce RMC



Reduce VBC



Reduce Multipliers



Request B: Retain Special Early Retirement - Minimum Age 62/52

- Specifics:
  - Class A: Rule of 90
    - Minimum age of 62 for unreduced benefits, 57 for reduced benefits
    - 5% reduction per year prior to earlier of age 67 or Rule of 90/age 62
  - Public Safety: Rule of 80
    - Minimum age of 52 for unreduced benefits, 47 for reduced benefits
    - 5% reduction per year prior to earlier of 57 or Rule of 80/age 52
  - Judicial: Rule of 85
    - Minimum age of 62 for unreduced benefits, 57 for reduced benefits
    - 5% reduction per year prior to earlier of 67 or Rule of 85/age 62
- Results: Increases SDRS Normal Cost from 8.99% to 9.53% of pay
- Members who retire upon reaching "Rule of" requirements at age 62/52 receive benefits with a value 25% greater than benefits at Normal Retirement Age

Request B: Retain Special Early Retirement - Minimum Age 62/52

- Request B provisions result in a higher cost that would require:
  - Reduced sustainability features (RMC or VBC), or
  - Reduced benefits for all members to subsidize one group of members
- Consequences of addressing increased costs of Request B provisions while maintaining the balance between Class A and Class B would be:
  - Reduce the RMC only
  - Reduce the VBC only
  - Reduce the benefit multipliers only, or
  - Reduce some combination of the above

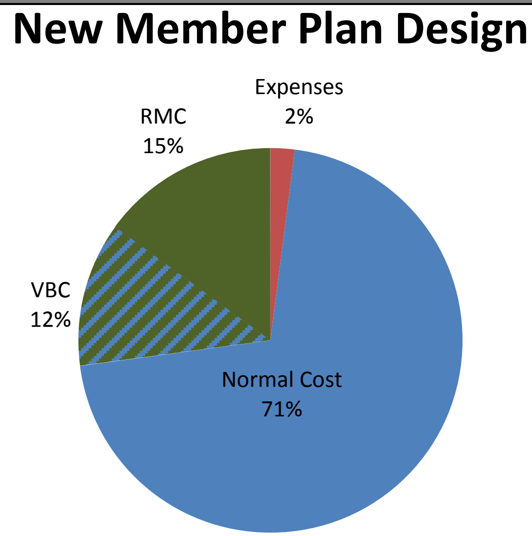
Request B: Retain Special Early Retirement - Minimum Age 62/52

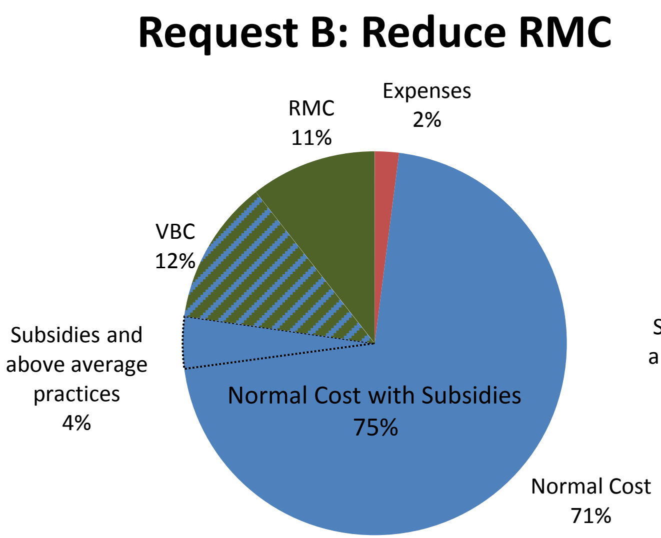
June Illustration	Multipliers	VBC	RMC	VBC + RMC Could Amortize Unfunded of:
	A: 1.80% PS: 2.00% Jud: 3.333% (15)/2.00%	1.50%	1.85% of pay $31M 0.30% of FVA	$800M

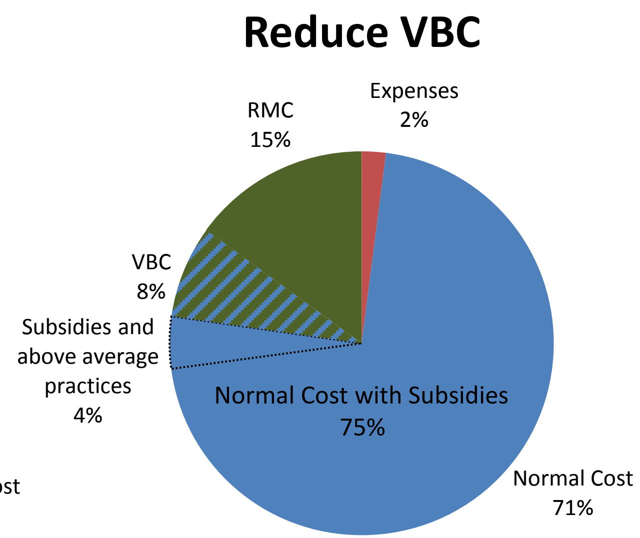
Cost Consequences*	Multipliers	VBC	RMC	VBC + RMC Could Amortize Unfunded of:	Comments
Reduce RMC only	Same as June	Same as June	1.31% of pay $22M 0.21% of FVA	$670M	Sustainability impact of RMC and VBC reduced by 16%
Or					
Reduce VBC only	Same as June	0.96%	Same as June	$670M	Sustainability impact of RMC and VBC reduced by 16%
Or					
Reduce multipliers only	A: 1.68% PS: 1.87% Jud: 3.11% (15)/1.87%	Same as June	Same as June	$800M	Benefits reduced by 7%

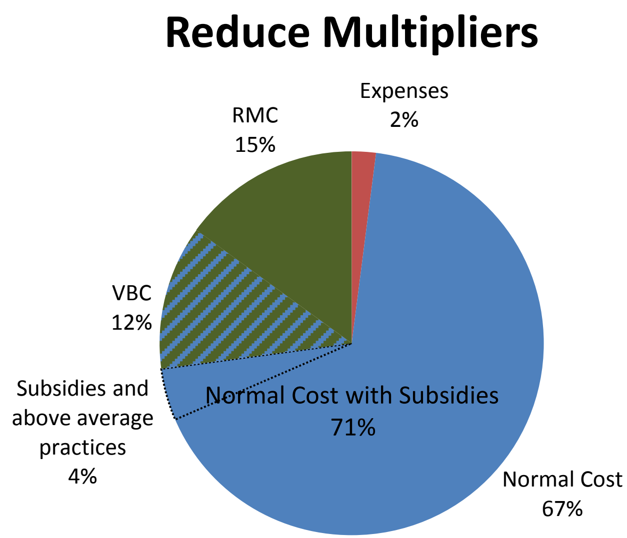
* Reducing the RMC or the VBC diminishes the sustainability of the System and dilutes other objectives.
Reducing the multipliers prevents reaching income replacement goals and lowers the Class B multipliers below the current level.

Request B Cost Comparison









Aligning New Plan Design Provisions with Objectives: Vesting

- Systems in 3 neighboring states have vesting requirements of 3 years:
  - MN, ND, NE
- Staff and consultant opinions – 3-year vesting, PRO, and indexing of deferred vested benefits in combination added key hybrid features that:
  - Maintain an appropriate balance between benefits for short-term members and benefits for long-term members and meet:
    - The balance objective of the SDRS Plan Design White Paper, and
    - The new member plan design objective to expand the hybrid features of SDRS
  - Are unique positive features of SDRS that counter criticisms that most public defined benefit plans do not deliver meaningful benefits to shorter service members

Request C: Increase Vesting Requirement to 5 Years

- Results: Decreases SDRS Normal Cost from 8.99% to 8.85% of pay
- Small increases in benefit multipliers, RMC or VBC could be implemented and modestly enhance the sustainability or income replacement objectives:
  - RMC could be increased by 0.14% of pay (sustainability impact of RMC and VBC increased by 4%)
  - VBC could be increased by 0.14% of pay (sustainability impact of RMC and VBC increased by 4%)
  - Benefit multipliers could be increased very slightly (0.03%)

Summary

- Recommended new member plan design as detailed on pages 2 and 3 meets all objectives
- Specific benefit provisions recommended are similar to benefit feature in new member tiers in many other statewide plans
- Eliminating all subsidies avoids making value judgments about the priority of a specific subsidy over other subsidies, and over new plan design objectives
- Maintaining identified subsidies comes at a cost to all other members and requires corresponding reductions in benefits and/or sustainability features
- Increasing vesting requirements to 5 years produces small cost savings, but impacts the balance of benefits for short-term and long-term members and dilutes the hybrid features of SDRS