ANNUAL REPORT OF THE FUNDED STATUS OF THE SOUTH DAKOTA RETIREMENT SYSTEM FOR FISCAL YEAR 2008 PRESENTED TO THE GOVERNOR AND LEGISLATURE OF THE STATE OF SOUTH DAKOTA

JANUARY 2009

South Dakota Retirement System
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South Dakota Retirement System

January 8, 2009

To the Governor and the Legislature of the State of South Dakota

Re: Annual Report of the Funded Status of the South Dakota Retirement System

Despite the asset losses experienced during fiscal year (FY) 2008, we are pleased to report that the funded status of the South Dakota Retirement System (SDRS) as of the latest actuarial valuation date of June 30, 2008, remains strong.

The outstanding investment returns of 2004-2007 left SDRS much better prepared for the 2008 economic downturn than virtually all of its peers. This performance:

- Resulted in a System Funded Ratio of 105% based on the market value of assets and 97% based on the actuarial value of assets, even after experiencing significant asset losses during FY 2008,
- Left a "Cushion" (market value of assets over actuarial value of assets) of $528M, even after the FY 2008 asset losses.

The SDRS measures of actuarial soundness remain substantially above industry standards and also substantially above virtually all other similar systems.

Unlike most statewide public systems, SDRS sets aside funds to pre-fund benefit improvements and protect the System in the event of a market downturn. As a result, as of June 30, 2008, SDRS has not incurred losses that must be recovered through favorable experience, higher contributions or benefit reductions. The Cushion of $2,114M as of June 30, 2007, has served to significantly lessen the impact of the current economic downturn and SDRS continues to be one of the best funded statewide public systems in the country.

SDCL § 3-12-122 contains specific conditions that mandate immediate reporting to the Governor and the Retirement Laws Committee and recommended corrective action if the conditions exist for three consecutive years. As of the latest actuarial valuation date of June 30, 2008, these conditions did not exist. However, without improvements in the current investment markets, these conditions may exist in the near future. If and when this occurs, the appropriate reports and recommendations will be delivered.

During the 2008 South Dakota Legislative Session, benefit improvements with a total projected cost of $355 million were made to SDRS. This legislation included a provision that these improvements could be reduced or eliminated if the SDCL §3-12-122 conditions exist.

The enclosed information provides a more in-depth summary of the current funded status of SDRS, the most recent year's experience, comparative data, and the SDCL §3-12-122 requirements.

Sincerely,

Robert A. Wylie	Elmer P. Brinkman
Executive Director/Administrator	Chair of the Board of Trustees

SDRS FUNDED STATUS REPORT

JUNE 30, 2008, MEASURES OF ACTUARIAL SOUNDNESS

The most important measures of actuarial soundness for a retirement system are the Funding Period and the Funded Ratio.

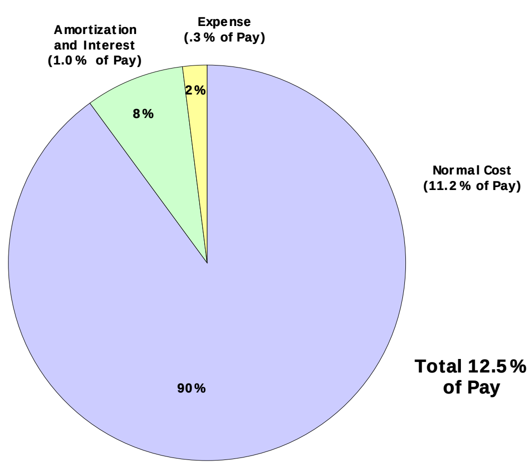
The Funding Period is a measure of the adequacy of fixed contributions to provide fixed benefits. If adequate, the fixed contributions will pay the Normal Costs of the System (the cost of benefits earned each year) and pay down the current Unfunded Actuarial Accrued Liability over a reasonable period. As of June 30, 2008, the SDRS Funding Period was 20 years.

The Funded Ratio is a measure of the progress of funding the plan benefits to date. It compares the Actuarial Value of Assets to the Actuarial Accrued Liability. The Actuarial Value of Assets is a “smoothed” value that assumes the assets earn the long-term expected annual rate of investment return each year. The Actuarial Accrued Liability is a measure of the present value of all benefits earned to date, including those that will be payable due to future salary increases. The Funded Ratio is equal to the SDRS assets at the Actuarial Value, divided by the Actuarial Accrued Liability. As of June 30, 2008, the SDRS Funded Ratio was 97%.

The Funded Ratio has increased from 40% in 1973 to over 90% each year since 1988 and over 95% on a consistent basis since 1997.

DISTRIBUTION OF FUNDING REQUIREMENTS

SDRS has only a minimal Unfunded Actuarial Accrued Liability of $193 million, or 2.8% of the total accrued liabilities of the System. As a result, only a small portion of the annual contributions is needed to fund the Unfunded Actuarial Accrued Liability. The following chart illustrates that 92% of the contributions pay for the cost of the current annual benefits (including System expenses) and only 8% of the contributions are required to amortize the Unfunded Actuarial Accrued Liability over 20 years.



This is in sharp contrast to the percentage of contributions that was required to amortize the Unfunded Actuarial Accrued Liability of SDRS in its first ten years, and the length of the Funding Period at various times in its history.

FISCAL YEAR 2008 SDRS EXPERIENCE

The SDRS investment loss of 8.65% in fiscal year 2008 was significantly less than the assumed annual rate of return of 7.75%, which resulted in an actuarial investment loss of $1,187M.

Actual Investment Return	$(723)M
Less Expected Return	(464)M
Actuarial Investment Gain/(Loss)	$(1,187)M

All SDRS investment gains and liability gains and losses are allocated to the Reserve for Funding of Long-Term Benefit Goals over five years. All actuarial investment losses are allocated to the Reserve immediately.

RESERVE FOR FUNDING OF LONG-TERM BENEFIT GOALS

The Reserve was initiated in 1995 as a means of setting aside gains from favorable experience to completely fund any proposed benefit improvements and to protect the System against future unfavorable experience. The Reserve functioned as intended and provided an important source of funds to offset the economic downturn that lasted from 2000 to 2003.

Reserve at June 30, 2007		$865M
Less Present Value of Benefits Enacted into Law, funded from the Reserve	-	355M
Less Current Year Allocations	-	793M
Reserve at June 30, 2008		$(283)M

During fiscal year 2008, benefit improvements of $355M were funded from the Reserve. In addition, the investment losses suffered during the year were immediately allocated to the Reserve. As a result, the Reserve has a negative balance of $(283)M as of June 30, 2008.

Since 1995, $872M has been allocated to the Reserve and $1,155M in benefit improvements were fully funded from the Reserve, leaving a negative balance of $(283)M. Credits of $726M will be allocated to the Reserve over the next four years.

FUNDED STATUS COMPARISONS

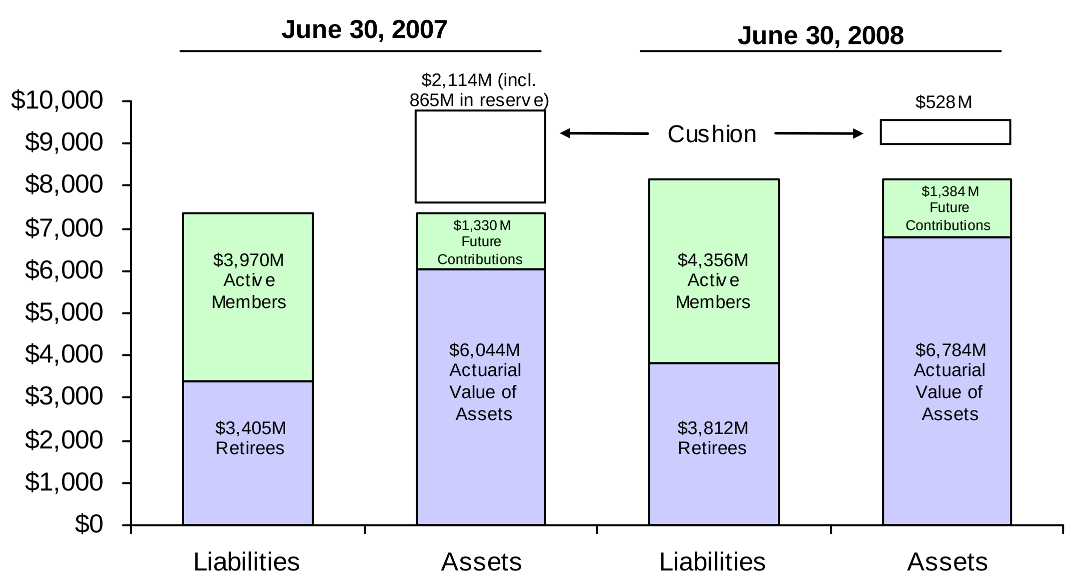
The long-term experience of SDRS has been very favorable, resulting in a Funded Status that exceeds virtually all other statewide public retirement systems.

	June 30, 2007		June 30, 2008	
	SDRS	Average*	SDRS	Average*
Funded Ratio (Actuarial Value of Assets)	97%	84%	97%	85%
Funded Ratio (Market Value of Assets)	131%	97%	105%	77%

* Wilshire Associates State Retirement Plan Funding Report for statewide public systems. 2008 averages estimated by Buck Consultants.

SDRS LIABILITIES AND RESOURCES

Current SDRS members are projected to receive future benefits from SDRS that have a present value of $8.2B. Of that amount, 47% is due to current retirees and 53% is due to current active members. SDRS has existing assets of $6.8B at Actuarial Value and $7.3B at Market Value as of June 30, 2008, to offset those future costs.



FUNDED STATUS SUMMARY

Although SDRS suffered substantial asset losses during fiscal year 2008, SDRS remains financially strong and very well-funded with over $7.3B in assets. In addition:

- The SDRS measures of actuarial soundness substantially exceed its standards and also exceed those of virtually all similar systems.
- SDRS assets at Market Value exceed the Actuarial Value of Assets by $528M as of June 30, 2008, resulting in a significant Cushion.
- The net annual cash flow out of the System (benefit payments and administrative expenses less contributions) is a relatively low 1.7% of the Market Value of Assets.

Appendix A

PLANNING FOR THE FUTURE OF SDRS

During 2007, the Board of Trustees developed a Strategic Plan for the future of SDRS. As a result of this process, the Board adopted the following strategies to focus its future efforts on successfully carrying out the mission of SDRS.

SDRS Mission

To plan, implement and administer income replacement programs, and to encourage additional savings for retirement, all of which offer SDRS members and their families the resources and opportunity to achieve financial security at retirement, death or disability by providing an outstanding, appropriate and equitable level of benefits.

The Board of Trustees believes this mission is achievable with the resources available in a progressive working environment, by sound and efficient management, through superior investment performance and by exercising the fiduciary responsibility associated with the proper stewardship of member assets.

Summary of Strategies

SDRS Strategy 1 — **Strengthening Our Partnerships**
SDRS will develop and maintain a strong partnership with the Legislature, the Executive Branch of South Dakota Government, and our participating employers to ensure their support of the mission and goals of SDRS.

SDRS Strategy 2 — **Governance and Management**
SDRS will be governed and managed professionally and efficiently and will be held to the highest standards of fiduciary responsibility.

SDRS Strategy 3 — **Sustaining a Model Retirement System**
SDRS is, and will continue to be, a model consolidated statewide retirement system, setting a national example of best practices.

SDRS Strategy 4 — **Sound Financial Management**
SDRS will consistently be an appropriately funded public retirement system and will be successfully and responsibly managed within the fixed member and employer contribution rates.

SDRS Strategy 5 — **Communications, Disclosure, and Education**
SDRS will enhance its communications, disclosure, and education efforts to prepare our members for a successful retirement and to inform all our stakeholders and the public of the value of SDRS.

SDRS Strategy 6 — **Member Services**
SDRS will continue to provide comprehensive services to our members so they are informed of the eligibility for, and amount of, their current and projected SDRS benefits and do so in a timely, efficient, and technologically advanced manner.

Appendix B

SDRS IMPACT ON ECONOMY

The following exhibit presents an estimate of the economic impact of SDRS to the State on a county-by-county basis. These estimates are the results of an economic impact study prepared by Stuefen Research, LLC in partnership with the University of South Dakota Business Research Bureau on behalf of SDRS. The exhibit illustrates the estimated total economic activity created by SDRS benefit payments as of March, 2007, and the number of permanent full- and part-time jobs supported by this economic impact. The estimated total economic impact to South Dakota is $287M, supporting 2,126 jobs.

County	Total Economic Activity	Permanent Full- and Part-Time Jobs	County	Total Economic Activity	Permanent Full- and Part-Time Jobs
Aurora	$909,401	3.3	Hyde	$371,237	1.4
Beadle	5,955,436	40.3	Jackson	520,414	2.1
Bennett	341,245	1.4	Jerauld	500,992	2.0
Bon Home	2,480,539	11.4	Jones	341,403	1.3
Brookings	15,089,049	90.1	Kingsbury	1,300,718	5.5
Brown	14,470,508	112.0	Lake	4,897,306	30.5
Brule	1,482,722	10.6	Lawrence	9,071,628	58.0
Buffalo	32,484	0.1	Lincoln	2,872,594	14.7
Butte	2,212,521	13.0	Lyman	669,266	3.2
Campbell	397,586	1.8	Marshall	1,552,331	6.6
Charles Mix	2,092,616	12.2	McCook	1,146,732	5.3
Clark	864,341	3.0	McPherson	660,117	2.6
Clay	7,630,419	51.7	Meade	5,593,290	34.8
Codington	8,183,047	58.1	Mellette	330,811	0.9
Corson	457,491	0.9	Miner	592,240	2.3
Custer	2,641,366	12.2	Minnehaha	33,399,039	241.2
Davison	6,459,896	44.5	Moody	1,232,590	4.0
Day	1,904,537	9.9	Pennington	33,392,526	227.2
Deuel	688,530	2.5	Perkins	735,032	3.7
Dewey	700,816	2.3	Potter	847,728	4.1
Douglas	600,196	2.3	Roberts	2,149,120	10.2
Edmunds	938,969	3.1	Sanborn	631,804	1.8
Fall River	1,973,860	11.6	Shannon	100,455	0.2
Faulk	1,036,843	3.9	Spink	3,463,279	11.7
Grant	1,707,433	10.3	Stanley	1,645,498	7.2
Gregory	1,212,852	7.1	Sully	281,022	1.2
Haakon	472,850	2.8	Todd	532,133	1.1
Hamlin	1,309,906	4.1	Tripp	1,673,164	11.8
Hand	1,005,043	5.4	Turner	2,029,111	8.1
Hanson	437,507	0.9	Union	2,393,624	10.5
Harding	252,291	1.1	Walworth	2,182,969	14.7
Hughes	18,703,190	134.2	Yankton	7,943,701	52.7
Hutchinson	2,176,644	10.2	Ziebach	126,896	0.3

Appendix C

STATUTORY CONDITIONS THAT REQUIRE CORRECTIVE ACTION

SDCL **§ 3-12-122. System funding review—Report required upon existence of specified conditions—Recommended changes**

The board shall review the funding of the system and shall make a report to the Governor and the Retirement Laws Committee if any of the following exists as of the latest annual actuarial valuation of the system:

(1) The contributions do not equal the actuarial requirement for funding;
(2) The funded ratio is less than eighty percent, or a ratio based on the market value of assets is less than eighty percent; or
(3) The market value of assets is less than ninety percent of the actuarial value of assets.

The report shall include an analysis of the conditions required for an improvement of the funded status of the system and recommendations for the circumstances and timing for any future benefit changes, contribution changes, or changes in actuarial assumptions. If any of the conditions set out by this section exist for a period of three consecutive annual actuarial valuations, benefit reductions, contribution changes, or both, shall be recommended by the board to the Governor and the Retirement Laws Committee, effective as soon as possible, to improve the funded status of the system.

MEASUREMENT OF CONDITIONS AT JUNE 30, 2007, AND JUNE 30, 2008

	June 30, 2007	June 30, 2008
Contributions	Meet Actuarial Requirement	Meet Actuarial Requirement
Funded Ratios	AVA 97% MVA 131%	AVA 97% MVA 105%
MVA/AVA Ratio	135%	108%

As of June 30, 2008, the conditions that require corrective action as defined in SDCL 3-1-2-122 have not been met. No statutory corrective action is required or is pending in the 2009 Legislative Session. However, the SDRS Board of Trustees has begun consideration of corrective actions that may be advisable if the conditions outlined in SDCL 3-12-122 are initially met on June 30, 2009.