BOARD MEETING

SOUTH DAKOTA RETIREMENT SYSTEM

April 1, 2021

The Board of Trustees of the South Dakota Retirement System held its regular Board meeting on April 1, 2021. The meeting began at 9:00 a.m. via Teams Conference Call.

BOARD MEMBERS IN ATTENDANCE:

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James Johns, Chair
Eric Stroeder, Vice Chair
Karl Alberts
James Appl
Penny Brunken
Kathy Greeneway
Laurie Gustafson
Dr. James Hansen
Myron Johnson
Kevin Merrill
Justice Mark Salter
Darin Seeley
Glen Vilhauer
Doug Wermedal
Matt Clark, Ex Officio

Board member Liza Clark was absent.

OTHERS IN ATTENDANCE:

Larry Langer, CavMac
Paul Schrader
Brittnie Adamson
Travis Almond
Jane Beer
Doug Fiddler
Michelle Humann

Sam Koldenhoven
Michelle Mikkelsen
Dawn Smith
Jacque Storm

AGENDA ITEM 1
CHAIR'S PRELIMINARY REMARKS AND BOARD CONFLICT DISCLOSURE

Summary of Discussion:
No board member had any conflict to disclose.

Board Action:
No action was necessary.

AGENDA ITEM 2
APPROVAL OF MEETING MINUTES

Board Action
IT WAS MOVED BY DR. HANSEN, SECONDED BY MR. JOHNSON, TO APPROVE THE MINUTES OF THE DECEMBER 3, AND DECEMBER 10, 2020, BOARD MEETINGS. THE MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.
THOSE VOTING AYE: ALBERTS, APPL, BRANT, BRUNKEN, GREENEWAY, GUSTAFSON, HANSEN, JOHNS, JOHNSON, MERRILL, SALTER, SEELEY, STROEDER, VILHAUER, WERMEDAL.
THOSE ABSENT AND NOT VOTING: CLARK(LIZA)

AGENDA ITEM 3
BOARD MEMBER ELECTION UPDATE

Summary of Discussion
Ms. Dawn Smith, SDRS Executive/Board Assistant, informed the Board of the current election candidates. She stated that there would be two elections as there were multiple candidates for the State Employee representative and Retiree positions. The candidate for the Teacher representative was unopposed.

Board Action
No action was required.

AGENDA ITEM 4
2021 LEGISLATIVE AND BUDGET REPORT

Summary of Discussion
Ms. Jacque Storm, SDRS Deputy Director/General Counsel, discussed the 2021 Legislative Session. She explained that all the SDRS bills received unanimous support from the Retirement Laws Committees of both houses and the House floor, however the COLA bill received two votes against it on the Senate floor. They were all signed by the Governor.

She noted that there were several other bills SDRS was watching during the Legislative Session. These included bills that modify the composition of the Retirement Laws Committee and a bill that impacts how board members vote in a teleconference meeting.

There were also several bills SDRS was watching that did not get enacted. These included bills that would have removed the requirement that each teleconference meeting provide a place for the public to participate, required posting all the materials of a public meeting at the principal office of a political subdivision, and required that any website or platform used by a public body to livestream a meeting meet certain requirements.

Ms. Jane Beer, SDRS Chief Financial Officer, stated SDRS requested a decrease of $47,000 in expenditure authority and a shift of $87,021 in other fund expenditure authority from operating expenses to personal services for the 2022 SDRS budget and the Legislature approved the SDRS budget as requested.

Board Action
No action was necessary.

AGENDA ITEM 5
INVESTMENT PERFORMANCE UPDATE

Summary of Discussion
Mr. Matt Clark, State Investment Officer, stated that through March 31, 2021, the estimated return for SDRS was approximately 16.5 percent.

Board Action
No action was necessary.

AGENDA ITEM 6
SDRS PROJECTED FUNDED STATUS

Summary of Discussion

Mr. Doug Fiddler, SDRS Senior Actuary, noted that the SDRS COLA will vary with both inflation and long-term affordability. As a result, under most circumstances, SDRS's fair value funded ratio (FVFR) is expected to remain at 100 percent.

Mr. Fiddler noted that since 2010, the average SDRS COLA of 2.3 percent was almost 1 percent higher than the average inflation for the same time period.

Mr. Fiddler stated that based on a FY21 net investment return of 16.5 percent the baseline FVFR is expected to be 101 percent at June 30, 2021. As a result, the preliminary estimated 2022 COLA would be equal to inflation within the full COLA range (0-3.5 percent).

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 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.

Mr. Fiddler stated at June 30, 2020, the estimated one-year likelihood of required corrective action recommendations using the current asset allocation statistics was 24 percent. Legislation enacted in 2021 reduced the minimum COLA to 0%, which when considered at June 30, 2020, reduced the estimated one-year likelihood of required corrective action recommendations to 14 percent.

Mr. Fiddler advised that if FY 2021 net investment returns are 10 percent, the estimated likelihood of required corrective action recommendations at the end of FY 2022 would reduce to 9 percent.

In summary, advised Mr. Fiddler, the recent investment experience less than the 6.5 percent assumption reduced the maximum COLA and increased the likelihood of required corrective action recommendations. However, reducing the minimum COLA to 0 percent allows SDRS to weather more severe downturns without required corrective action recommendations and is a significant change. If FY 2021 net investment returns are below approximately negative 7 percent, a corrective action recommendation would be required. Returns near 10 percent would increase the maximum COLA range and the required corrective action likelihood would decrease. If the return exceeds approximately 15 percent, the full COLA range may be affordable.

ADMINISTRATIVE RULES HEARING

Summary of Discussion
A copy of the minutes from the administrative rules hearing is in the office of the Executive Director.

Board Action
IT WAS MOVED BY DR. HANSEN, SECONDED BY MR. WEREMEDAL TO ADOPT THE ADMINISTRATIVE RULES AS PRESENTED. THE MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.
THOSE VOTING AYE: ALBERTS, APPL, BRANT, BRUNKEN, GREENEWAY, GUSTAFSON, HANSEN, JOHNS, JOHNSON, MERRILL, SALTER, SEELEY, STROEDER, VILHAUER, WERMEDAL.
THOSE ABSENT AND NOT VOTING: CLARK(LIZA)

AGENDA ITEM 7
WHAT'S HAPPENING WITH OTHER CAVANAUGH MACDONALD CONSULTING CLIENTS

Summary of Discussion
Mr. Larry Langer, Principal and Consulting Actuary, Cavanaugh Macdonald Consulting (CavMac) shared CavMac's recent experiences with other public sector clients. He noted that plans' fiscal year 2020 returns generally exceeded return assumptions and COVID is having mixed demographic impacts with some reporting lower retirements and terminations, which contradicts expectations. Systems will likely experience more deaths in 2020/2021 with experience varying based on members covered and geography. In addition, public sector workers may not have the same experience as the general public.

Mr. Langer stated that, while it is still early, no funding cuts were anticipated. There is some concern about salary/contribution leakage due to fewer active employees as well as the impact of the phase-in of contributions due to reductions in investment return. Actuaries' focus on reducing the funding periods below 25 years to avoid negative amortization is not gaining much traction and the funding of OPEB is almost nonexistent.

Mr. Langer noted that there were no real "major" legislative initiatives as the focus was currently elsewhere. COVID is driving some legislation as a presumption for disability benefits and temporary return to work legislation to fill high need positions. Revenues may not be an issue for many states as they are above expectations. In addition, advised Mr. Langer, some states are reviewing their COLA practices while others are continuing their focus on DC/Hybrid plans and lower benefits tiers to lower the sponsors risk.

Mr. Langer stated that some states are adopting the PUB2010 Public Sector mortality table and are continuing to shift to generational mortality to reflect a gradually improving mortality. There is hesitancy to reflect the impact of COVID on future mortality until it occurs because there is no way to know which way mortality will trend. There is also a continued movement towards a more realistic investment return assumption as well as lowering inflation while maintaining real returns which drives lower return assumptions.

Board Action

No action was necessary.

AGENDA ITEM 8
REVIEW SDRS LONG TERM BENEFIT GOALS AND OBJECTIVES

Summary of Discussion

Mr. Travis Almond, SDRS Executive Director, stated that the Board establishing and assessing goals, including specific goals for both funding/sustainability metrics as well as benefit adequacy, has been a significant contributor to the success of SDRS. He noted that SDRS operates within a fixed contribution budget and current SDRS funding neither requires benefit reductions, nor supports benefits improvements.

Mr. Paul Schrader, SDRS Retirement Consultant, stated that for years, SDRS has set long-term benefit goals based on member needs and compared SDRS' benefits with those of similar systems. The objective for this presentation, advised Mr. Schrader, is to review the current goals, assess progress in meeting those goals, consider updated information needed to judge adequacy of the goals, and identify potential changes to the goals.

Mr. Schrader stated that SDRS' Income Replacement Goal is at least 55 percent of final average compensation for career members (Class A – 30 years; Public Safety – 25 years; and Judicial – 20 years). Under the current provisions, the benefit formulas are higher for service before 2008 and different by member class and Foundation/Generational status. Currently, advised Mr. Schrader, this goal is not being achieved for all members.

Mr. Schrader questioned whether the career service criteria was appropriate for the income replacement goal considering the typical working career of a member. He noted that the achievement of the goal for Foundation members varied based on members' service before or after 2008, and there is a significant shortfall for Foundation members other than judicial. The goal could be achieved for Foundation members if Class A members worked an additional six years and Public Safety members worked an additional three years. For the Generational members, the goal is achieved for Class A and Judicial members and 94 percent achieved for Public Safety members when the variable retirement account (VRA) is included.

Moving to the total income replacement/savings goal, Mr. Shrader stated that the goal was to promote an income replacement of 85 percent of FAC including SDRS, Social Security, and savings of at least 100 percent of pay at retirement. There are multiple savings opportunities offered through SDRS and education and promotion of those opportunities is ongoing.

The 85 percent income replacement goal is likely achieved currently for the average Class A member with 30 years of service if the member retires at age 65 or later.

Mr. Schrader noted that a 70 to 80 percent total income replacement was historically touted as adequate, with more needed for the lowest income employee and less for higher income employees. The 85 percent SDRS goal was developed years ago based on pre- and post-retirement expenses and tax considerations. The question now, advised Mr. Schrader, is 85 percent the right message? Should the goal vary based on income? How is the cost of health care considered? Is the savings goal of at least 100 percent of pay at retirement adequate? And should the 85 percent goal be met before normal retirement age with 30 years of service considering SDRS, Social Security and the savings goal? Mr. Schrader recommended an updated analysis of the income replacement needed at retirement for a fresh look and to address these questions.

The normal retirement age goals have been achieved. For the Foundation members SDRS provides an unreduced benefit at appropriate age considering demands of public safety jobs, while the Generational normal retirement ages reflect higher life expectancies. Mr. Schrader advised that the goals should be periodically reevaluated to consider changes to the Social Security normal retirement age, improved life expectancy, and changes to Medicare eligibility.

Mr. Schrader stated that the early retirement income goal for Foundation members was to provide unreduced benefits 10 years prior to normal retirement age for long-service members and subsidized reduced benefits for others. For Generational members the goal is to provide non-subsidized reduced benefits 10 years prior to normal retirement age. These goals are currently being achieved. Under the current provisions, Class A Foundation members have the Rule of 85 benefit based on age and service, and a 3 percent annual early retirement reduction. Generational members have no "Rule of benefit" and their early retirement reduction is 5 percent annually.

Mr. Schrader noted that SDRS members are working longer and early retirement is not a reality for most members without substantial savings or work after retirement. Health care costs, particularly before Medicare eligibility, are a significant factor. SDRS education efforts may be influencing delayed retirements as well. The return to work rules appear to be effective in assuring termination of employment and avoiding subsidies. The Generational benefits trade a later normal retirement age and elimination of early retirement subsidies for higher benefit formulas and a variable retirement account (VRA). It is likely that younger members will need to work to an older age because of SDRS and Social Security normal retirement age changes and continuing high health care costs.

The COLA goal of providing limited inflation protection after retirement and after termination of employment based on affordability and the CPI-W has been achieved. The COLA has met or exceeded inflation, except for the minimal shortfall in 2018-2019. Mr. Schrader questioned if the goal should be to provide inflation protection without the qualifier and if the CPI-W was the best measure of inflation. He noted that during high inflation, the COLA is limited to 3.5 percent. The COLA is also limited to less than inflation when not affordable. Past COLA adequacy has been identified as a priority consideration when improvements are affordable under the SDRS Board planning guide.

Mr. Schrader stated that the disability income, family benefits, surviving spouse benefits, minimum death benefit, and enhanced portability goals have all been achieved. The disability and survivor benefits for death before retirement were greatly simplified and improved several years ago. The combination of SDRS and Social Security benefits provide benefit adequacy for the average member. For example, the average member will receive disability income of 67 percent of FAC including Social Security and temporary family income replacement of nearly 100 percent of FAC including Social Security in the event of the pre-retirement death of a spouse with two children. Having post-retirement surviving spouse benefits at no cost for the Foundation members is uncommon for plans covering Class A members. The post-retirement surviving spouse benefit changes for Generational members were part of the trade-off for higher benefit formulas and the VRA, which results in equal treatment for married and non-married members.

The goals to maintain and enhance the likelihood of sustainability to preserve the current benefit structure and preserving the tax-qualified status of SDRS to continue favorable tax treatment to members have both been achieved as well. Both of these efforts are on-going.

In summary, stated Mr. Schrader, most of the goals have been achieved. The income replacement goals are not met based on career service criteria and are the weakest link. The next steps are to revisit the income replacement needs, compare SDRS practices with peer plans in the region, identify new initiatives, and update the goals based on the findings.

Board Action
No action was necessary.

AGENDA ITEM 9
EFFECTIVE RATE OF INTEREST FOR FY22

Summary of Discussion
Ms. Jane Beer noted that SDCL 3-12C-108 states that SDRS's annual effective rate of interest shall be no greater than 90 percent of the average 91-day United States Treasury bill rate for the immediately preceding calendar year.

Advising that the 91-day United States Treasury bill rate was .35 percent for 2020, Ms. Beer stated that 90 percent of the rate is .32 percent. She noted that this interest rate would be credited on July 1, 2022, for the period of July 1, 2021, through June 30, 2022.

Board Action
IT WAS MOVED BY MR. APPL, SECONDED BY MR. VILHAUER, TO SET THE EFFECTIVE RATE OF INTEREST TO BE CREDITED FROM JULY 1, 2021, TO JUNE 30, 2022, AT .32 PERCENT. THE MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.
THOSE VOTING AYE: ALBERTS, APPL, BRANT, BRUNKEN, GREENEWAY, GUSTAFSON, HANSEN, JOHNS, JOHNSON, MERRILL, SALTER, SEELEY, STROEDER, VILHAUER, WERMEDAL.
THOSE ABSENT AND NOT VOTING: CLARK(LIZA)

AGENDA ITEM 10
SET FY22 SUPPLEMENTAL PENSION BENEFIT INTEREST RATE ASSUMPTION

Summary of Discussion
Mr. Almond stated that the Board needed to establish the periodic Supplemental Pension Benefit interest rate assumption. He added that the interest rate assumption could not be greater than the actuarial assumed rate of return for SDRS, nor could it be less than the SDRS effective rate of interest.

He advised that the interest rate assumption is established based on the recommendations of both the system's external actuary and the State Investment Officer with the input of the Executive Director. The external actuary recommended between 1.75 and 2.75 percent and the State Investment Officer recommended between 3.0 and 3.5 percent.

Based on all the information and the process established by the Board, Mr. Almond stated it was his recommendation that the Board set the Supplemental Pension Benefit interest rate assumption at 2.875 percent, effective July 1, 2021.

Board Action

IT WAS MOVED BY MR. ALBERTS, SECONDED BY MS. GUSTAFSON, TO ESTABLISH THE INTEREST RATE FOR THE SUPPLEMENTAL PENSION BENEFIT AT 2.875 PERCENT, EFFECTIVE JULY 1, 2021. THE MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.
THOSE VOTING AYE: ALBERTS, APPL, BRANT, BRUNKEN, GREENEWAY, GUSTAFSON, HANSEN, JOHNS, JOHNSON, MERRILL, SALTER, SEELEY, STROEDER, VILHAUER, WERMEDAL.
THOSE ABSENT AND NOT VOTING: CLARK(LIZA)

AGENDA ITEM 11
PUBLIC COMMENT

Summary of Discussion

There was no public comment.

AGENDA ITEM 12
OLD/NEW BUSINESS

Summary of Discussion

Staff Retirement

Mr. Almond stated that Jane Beer, SDRS Chief Financial Officer, would be retiring April 23rd.

Upcoming Meetings

The Board discussed the upcoming meeting schedule.

Board Action

No action was necessary.

AGENDA ITEM 13
EXECUTIVE DIRECTOR'S PERFORMANCE EVALUATION

Summary of Discussion
This item was deferred to the June meeting.

ADJOURNMENT

IT WAS MOVED BY MR. JOHNSON, SECONDED BY MS. GREENEWAY, THAT THERE BEING NO FURTHER BUSINESS, THE MEETING BE DECLARED ADJOURNED. THE MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.
THOSE VOTING AYE: ALBERTS, APPL, BRANT, BRUNKEN, GREENEWAY, GUSTAFSON, HANSEN, JOHNS, JOHNSON, MERRILL, SALTER, SEELEY, STROEDER, VILHAUER, WERMEDAL.
THOSE ABSENT AND NOT VOTING: CLARK(LIZA)

Respectfully submitted,

Travis Almond
Executive Director