



South Dakota Retirement System

Review of Long-Term Benefit Goals

April 2021



Funding and Long-Term Benefit Goals

- Establishing and **assessing goals** has been a significant contributor to the success of SDRS, including specific goals for both **funding/sustainability metrics** and **benefit adequacy**
- SDRS operates within a **fixed contribution budget** and current SDRS funding neither requires benefit reductions, nor supports benefit improvements
 - Such a time is ideal for assessing the adequacy of SDRS benefits
- **Big picture discussion today**—no changes contemplated



Long-Term Benefit Goals

- SDRS has for years set long-term benefit goals based on member needs and compared SDRS benefits with those of similar systems:
 - Provides a benchmark for adequacy and benefit improvement decisions
 - Periodically updated based on new information
- Objectives today:
 - Review the current goals
 - Assess progress in meeting goals
 - Consider updated information needed to judge adequacy of goals
 - Identify potential changes to goals



Income Replacement at Retirement

- **Goal:**

- **At least 55%** of final average compensation (FAC) for career members
 - Class A 30-year career
 - Public Safety 25-year career
 - Judicial 20-year career

- **Current Provisions:**

- Benefit formulas higher for service before 2008 and different by member class and Foundation/Generational status

- **Assessment: Less than 100% Percent of Goal Achieved**

	Foundation	Generational
• Class A	85-93%	98% + VRA*
• Public Safety	91-100%	91% + VRA
• Judicial	100%	100% + VRA

*Variable Retirement Account



Observations/Issues

- Is career service criteria appropriate?
- Achievement of goal for Foundation members varies based on service before or after 2008
 - Class A example
 - $1.55\% \text{ times } 15 + 1.7\% \text{ times } 15 = 48.75\%$
 - $48.75\%/55\% = 89\%$ of goal
- **Significant shortfall** for Foundation members other than Judicial
 - Benefit increase for service after 2008 identified in planning guide
- Goal for Foundation members could be achieved with more service
 - Up to six years for Class A and up to three years for Public Safety
- When VRA for Generational members included:
 - **Goal achieved** for Class A and Judicial
 - 94% of goal achieved for Public Safety



Total Income Replacement/Savings

- **Goal:**

- Promote an income replacement goal of **85% of FAC** including SDRS, Social Security, and savings of at least **100% of pay at retirement**

- **Assessment:**

- **Promotion goal achieved**—education and promotion ongoing
- Multiple savings opportunities offered (SRP, SPB, and SPP)
- 85% income replacement goal likely achieved for average Class A member with 30 years of service only if **retiring age 65 or later**

- Class A Foundation member example retiring at age 65

– SDRS	49%
– Social Security	30%
– Savings	<u>6%</u>
– Total	85%



Observations/Issues

- 70-80% replacement income historically touted as adequate, with more needed for lowest income and less for higher income
- 85% FAC SDRS goal developed years ago based on pre- and post-retirement expenses and tax considerations
- Is 85% 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% of pay at retirement adequate?
- Should the 85% goal be met before normal retirement age with 30 years of service considering SDRS, Social Security and the savings goal?

Recommend an updated analysis of income replacement needed at retirement for a fresh look and to address questions



Normal Retirement Age

- **Goals:**
 - Foundation: Provide unreduced benefit at appropriate age considering demands of public safety jobs
 - Generational: Reflect higher life expectancies
- **Current Provisions:**
 - Foundation Members
 - Class A/Judicial Age 65
 - Public Safety Age 55
 - Generational Members
 - Class A/Judicial Age 67
 - Public Safety Age 57
- **Assessment:**
 - **Goals achieved**



Observations/Issues

- Goals should be periodically reevaluated to consider
 - Changes to Social Security normal retirement age
 - Improved life expectancy
 - Changes to Medicare eligibility



Early Retirement Income

- **Goals:**
 - Foundation: Provide unreduced benefits 10 years prior to normal retirement age for long-service members/subsidized reduced benefits for others
 - Generational: Provide non-subsidized reduced benefits 10 years prior to normal retirement age
- **Current provisions:**
 - Rules of age and service and 3% early retirement reduction for Foundation members
 - 5% early retirement reduction for Generational members
- **Assessment:**
 - **Goals achieved**



Observations/Issues

- **Early retirement is not a reality** for most members without substantial savings or work after retirement
- Health care costs (particularly before Medicare eligibility) are deterrent to early retirement
- SDRS education efforts may be influencing delayed retirements
- Return to work rules appear to be effective in assuring termination of employment and avoiding subsidies
- Generational benefits trade later normal retirement and elimination of early retirement subsidies for higher benefit formulas and VRA
- 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



COLA

- **Goal:**
 - Provide limited inflation protection after retirement and after termination of employment based on affordability and CPI-W
- **Current Provisions:**
 - COLA is equal to inflation between 0.0% and 3.5% when affordable
- **Assessment:**
 - **Goal achieved**
 - COLA has met or exceeded inflation, except for minimal shortfall in 2018-2019



Observations/Issues

- Should goal be to provide **inflation protection** without qualifier?
 - Limited inflation protection message is imprecise and dilutes intent
 - Goal should represent ideal, but may not always be fulfilled
- During high inflation, COLA is limited to 3.5%
- COLA also limited to less than inflation when not affordable
- Past COLA adequacy has been identified as a priority consideration when improvements affordable under planning guide
- Is CPI-W the best measure of inflation?
- COLA is **key variable benefit and members have adequacy risk**
 - Communication of the rationale for the COLA advisable to get the facts out and manage expectations



Disability Income

- **Goal:**
 - Provide lifetime income of greater of 25% of FAC or the earned benefit
- **Current provisions:**
 - Same
- **Assessment:**
 - **Goal achieved**



Family Benefit

Death Before Retirement

- **Goals:**
 - Provide temporary income of greater of 25% of FAC or the earned benefit to eligible children
 - Provide retirement income to spouse equal to 60% of the greater of 25% of FAC or the earned benefit
- **Current provisions:**
 - Same
- **Assessment:**
 - **Goals achieved**



Surviving Spouse Benefit

Death After Retirement

- **Goals:**
 - Foundation: Provide 60% of member's benefit to surviving spouse for life at no cost
 - Generational: Provide 60% or 100% of member's benefit to surviving spouse if member elects, funded by a reduction in the member's benefit
- **Current provisions:**
 - Same
- **Assessment:**
 - **Goals achieved**



Minimum Death Benefit

- **Goal:**
 - Benefit paid upon death to beneficiary if prior payments have not equaled 100% of member's contributions and 85% of employer contributions, plus credited interest
- **Current provisions:**
 - Same
- **Assessment:**
 - **Goal achieved**
 - **Unusual and superior** provision



Observations/Issues

- Disability and survivor benefits for death before retirement greatly simplified and improved several years ago
- **Benefit adequacy** for average member:
 - Disability income of **67% of FAC** including Social Security (if eligible)
 - **Temporary** family income of **nearly 100%** of FAC including Social Security at pre-retirement death for spouse with two children
- Post-retirement surviving spouse benefit at no cost for Foundation members uncommon for plans covering Class A members
- Post-retirement surviving spouse benefit change for Generational members part of trade-off for higher benefit formulas/VRA, results in equal treatment for married and non-married members
- VRA balance also paid upon death or disability for Generational



Enhanced Portability

- **Goal:**
 - Provide equitable benefits for short-service members
- **Current Provisions:**
 - Early vesting with COLA paid on deferred benefit
 - Vested and non-vested members who terminate can opt to receive portion of employer contributions plus 100% of their contributions
 - VRA for Generational members paid at retirement
- **Assessment:**
 - **Goal achieved**
 - SDRS practices **unusual and superior**



Sustainability

- **Goal:**
 - Maintain and enhance likelihood of sustainability to preserve current benefit structure
- **Current Provisions:**
 - Numerous inequities, subsidies, and provisions that result in higher than anticipated costs addressed
 - Variable benefit features adopted and expanded
 - Initiatives identified in 2020 planning process and return to work provisions are examples of most recent efforts
 - Risk analysis continuously expanded and improved
- **Assessment:**
 - **Goal achieved**
 - Effort is on-going



Tax Qualified Status

- **Goal:**
 - Preserve tax-qualified status of SDRS to continue favorable tax treatment to members
- **Current Provisions:**
 - SDRS has received a favorable determination letter from the IRS confirming qualified status
 - Recent initiatives to meet IRS requirements include:
 - Termination of employment rules
 - Maximum benefit limits
 - Required minimum distribution issues
- **Assessment:**
 - **Goal achieved**
 - Effort is on-going as new regulations issued
 - Outside expert legal counsel retained



Member Issues

- **Goal:**
 - Identify and formalize additional initiatives to meet goals, modify goals, or add new goals
- **Current Provisions:**
 - Expansion of VRA as a potential benefit improvement when affordable only current initiative
- **Assessment:**
 - No new initiatives in recent years



Observations/Issues

- A benefit that pays a portion of **retiree health care** costs has been discussed in past as a potential initiative:
 - Health care costs are huge issues for retirees—particularly pre-Medicare
 - Some systems provide a separate retiree health care benefit, but many have struggled to fund
 - Unlikely to be affordable and not part of current plan
- Consider other benefit initiatives when identified



Summary and Next Steps

- Most goals have been **achieved**
- Income replacement goals **not met** based on career service criteria and **weakest link**
- Next steps:
 - Revisit income replacement needs
 - Comparison of SDRS practices with peer plans in region
 - Identify new initiatives
 - Update goals based on findings