



# South Dakota Retirement System

## **Follow-Up to Long-Term Benefit Goals Review**

**June 2021**



# Long-Term Benefit Goals

- Goals reviewed and assessed in April
- Findings:
  - **Most goals met or exceeded**
  - SDRS **income replacement goals not met** for all
- Objectives today:
  - Determine retirement income needed to maintain pre-retirement spendable income
  - Assess benefit adequacy using spendable income analysis
- Conduct retiree survey and present results at September meeting
- Consider any recommended changes to goals in September



# How Much Retirement Income Is Needed?

- 70-85% of Final Average Compensation (FAC) is general **benchmark**
- However, each member has a **unique target** considering:
  - Cessation of contributions to SDRS, Social Security, savings, and work-related expenses
  - Spendable income and spending patterns before and after retirement
  - Health
  - Lifestyle in retirement
  - Debt
  - Financial obligations to children, parents, grandchildren
  - Home ownership



# Spendable Income Analysis Approach

- Determine **spendable income before retirement**
- Determine gross **retirement income needed** after retirement to match spendable income before retirement
- Meeting this objective will **maintain standard of living** assuming:
  - Spendable income reflects actual expenses before retirement
  - No significant increase in total expenses after and during retirement
  - Inflation protection provided after retirement
- Spendable income is determined by considering:
  - Contributions to SDRS, Social Security, and retirement savings before retirement
  - Federal income taxes before and after retirement
- Spendable income approach avoids **common planning mistake** of comparing gross income after retirement to net income before retirement



# Example: Spendable Income Before Retirement

- Average spendable income during FAC period:

	<b>No Personal <u>Savings</u></b>	<b>With Personal <u>Savings</u></b>
- Final Average Compensation	\$65,000	\$65,000
- Less SDRS contributions	-3,900	-3,900
- Less Social Security/Medicare Taxes	-4,973	-4,973
- Less retirement savings	<u>N/A</u>	<u>-1,300</u>
- Net income	\$56,127	\$54,827
- Less Federal income taxes	<u>-6,429</u>	<u>-6,143</u>
- Spendable income	<b>\$49,698</b>	<b>\$48,684</b>

- Member needs \$49,698 (no savings) or \$48,684 (with savings) of spendable income after retirement to equal spendable income before retirement



# Example: Spendable Income After Retirement for 2021 Retiree

- Spendable income calculation (Class A Foundation member, \$65,000 FAC, 30-years' service, age 65):

	<b>No Personal Savings</b>	<b>With Personal Savings</b>
– SDRS Benefit	\$31,883	\$31,883
– Social Security Benefit	18,804	18,804
– Benefit from savings	<u>N/A</u>	<u>4,220</u>
– Total Retirement income	\$50,687	\$54,907
– % of FAC	78.0%	84.5%
– Less Federal income taxes	<u>-3,835</u>	<u>-4,341</u>
– Spendable income	<b>\$46,852</b>	<b>\$50,566</b>
– <b>% change in spendable income</b>	<b>-5.7%</b>	<b>3.9%</b>

- Spendable income after retirement will vary with FAC:
  - \$25,000 FAC: 13.3% increase (no savings), 23.9% increase (with savings)
  - \$150,000 FAC: 11.4% decrease (no savings), 2.2% decrease (with savings)



# Spendable Income Analysis Findings

- The average paid 2021 SDRS retiree with 30 years of service retiring at age 65 with additional savings of 100% of pay at retirement will **more than replace** spendable income before retirement
  - Lowest paid members will replace spendable income by an **even greater margin**
  - Highest paid members will **fall slightly short** of replacing spendable income
- Most SDRS members will need **additional savings** to replace spendable income before retirement
- For most SDRS members, **total retirement income of 80-85% of FAC** will result in the same spendable income after retirement



# Benefit Adequacy

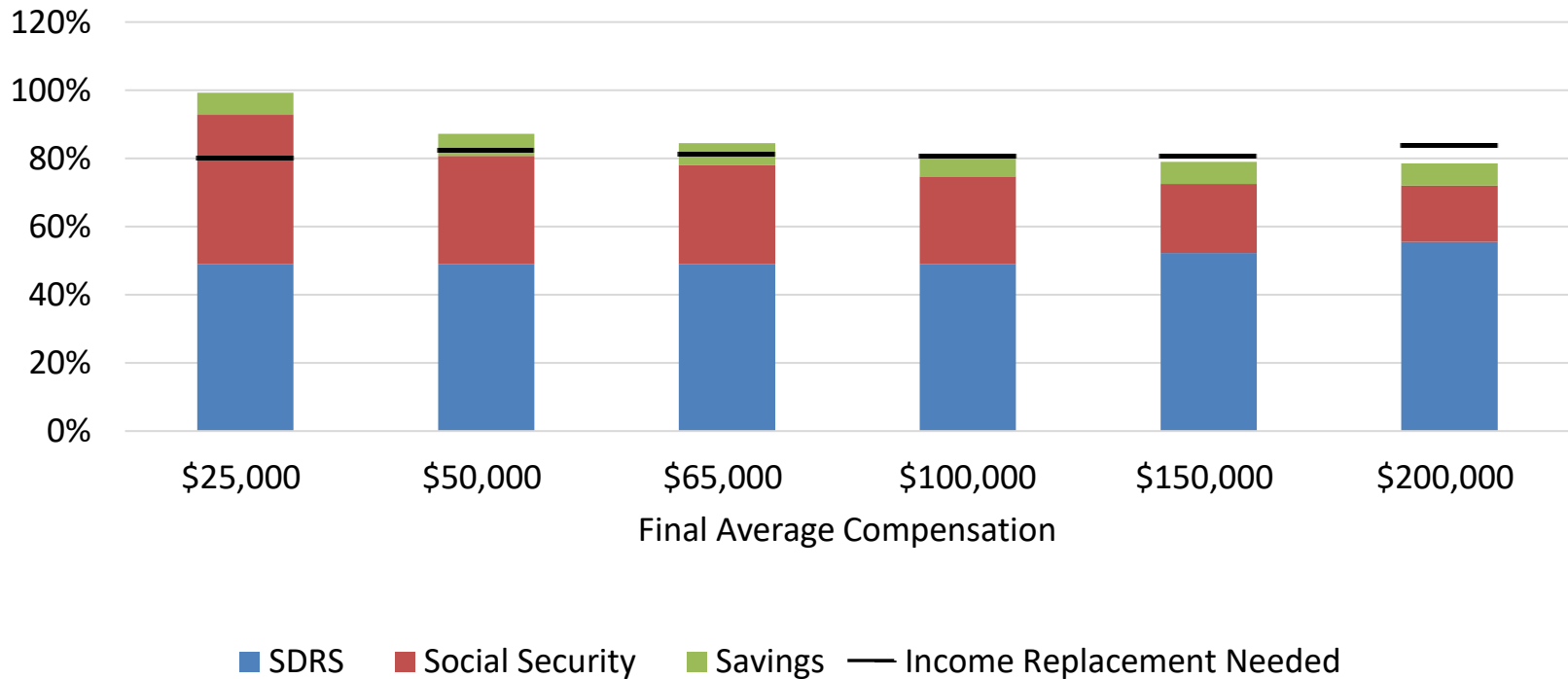
- SDRS benefits **represent only one source** of retirement income
- **Adequacy** based on spendable income replacement approach is **80-85% of FAC**
- **Adequacy assessment** should include benefits available from SDRS, Social Security, and personal savings
- Following charts show benefit adequacy assuming members:
  - Meet career service criteria
  - Retire at SDRS normal retirement age in 2021 for Foundation members and at normal retirement age for Generational members
  - Achieve savings goal of 100% of pay at retirement
  - Commence Social Security benefits at retirement (except for Public Safety members)





# Class A Foundation Member

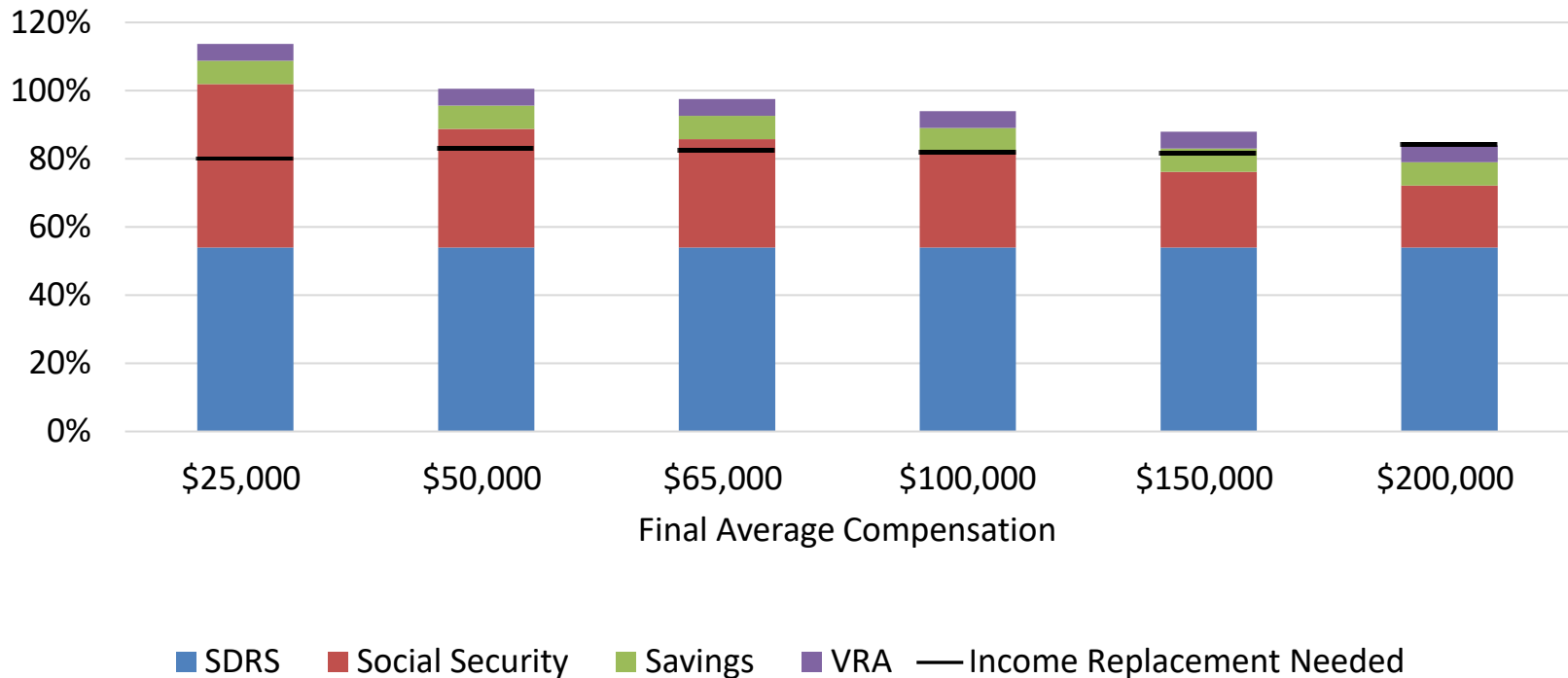
## Normal Retirement Income Replacement Rates Class A Career Foundation Members





# Class A Generational Member

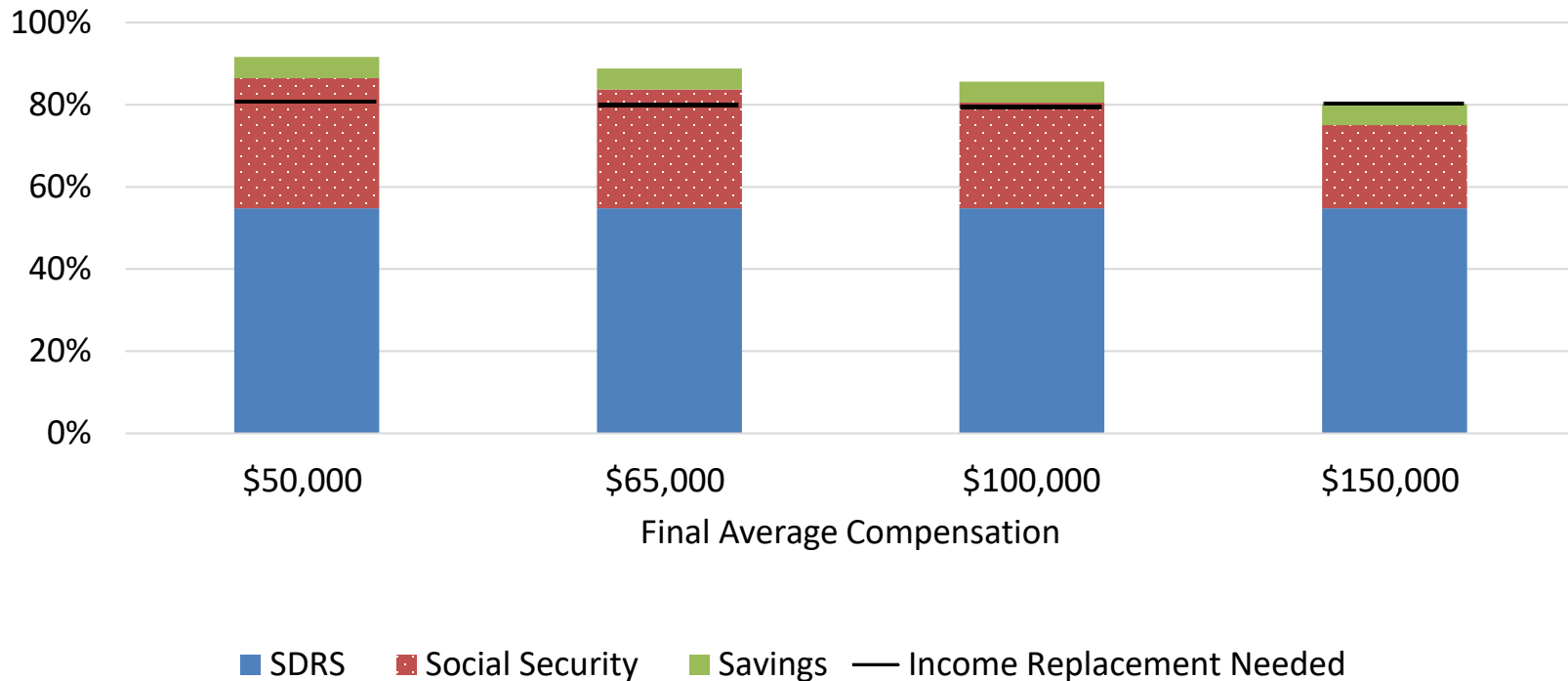
## Normal Retirement Income Replacement Rates Class A Career Generational Members





# Public Safety Foundation Member

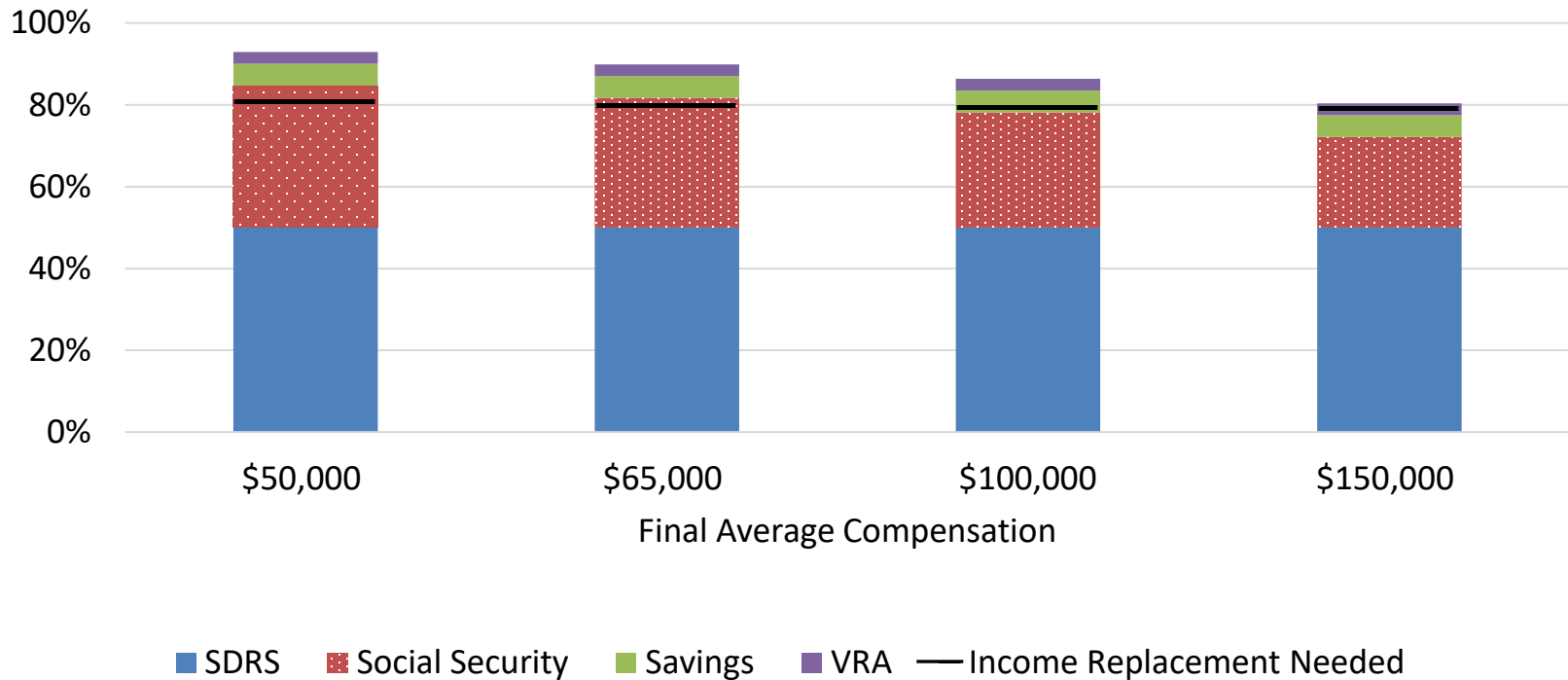
## Normal Retirement Income Replacement Rates Public Safety Career Foundation Members





# Public Safety Generational Member

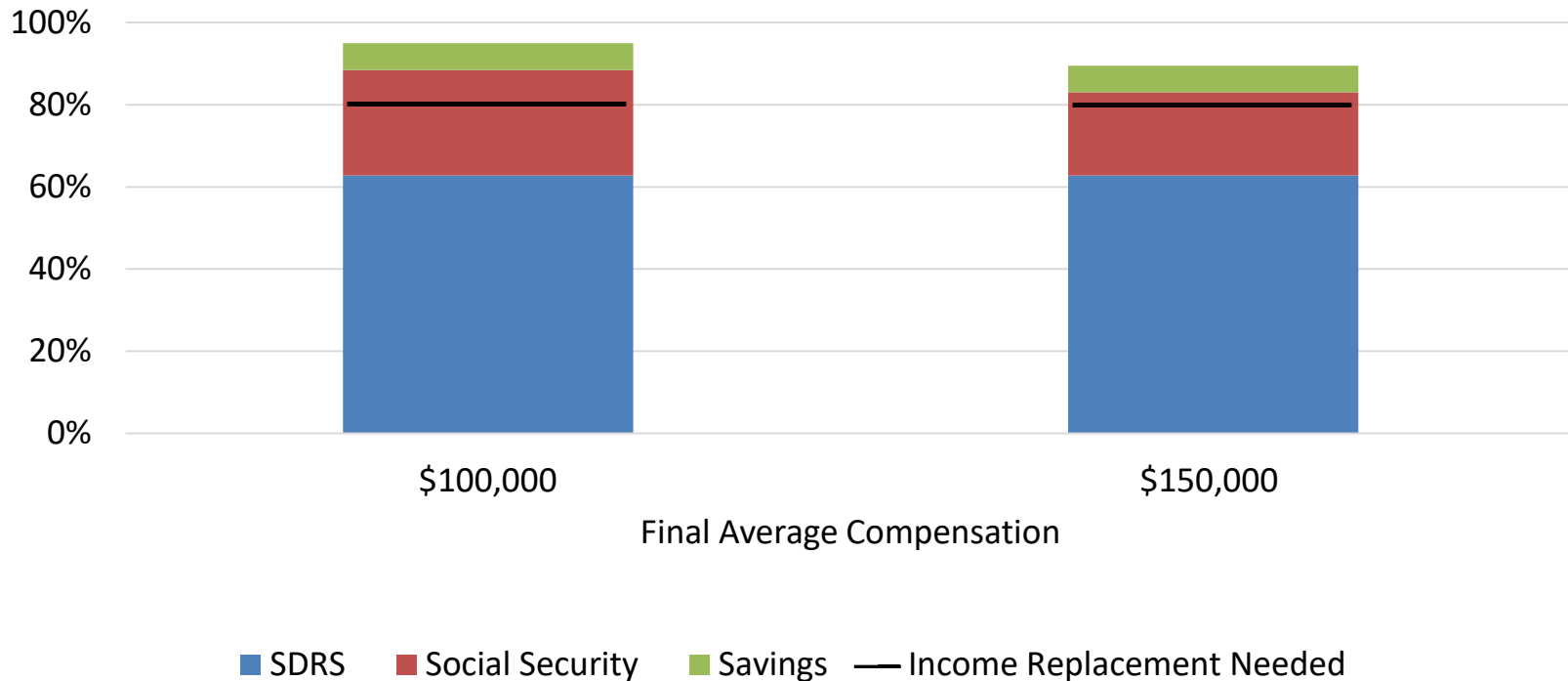
## Normal Retirement Income Replacement Rates Public Safety Career Generational Members





# Judicial Foundation Member

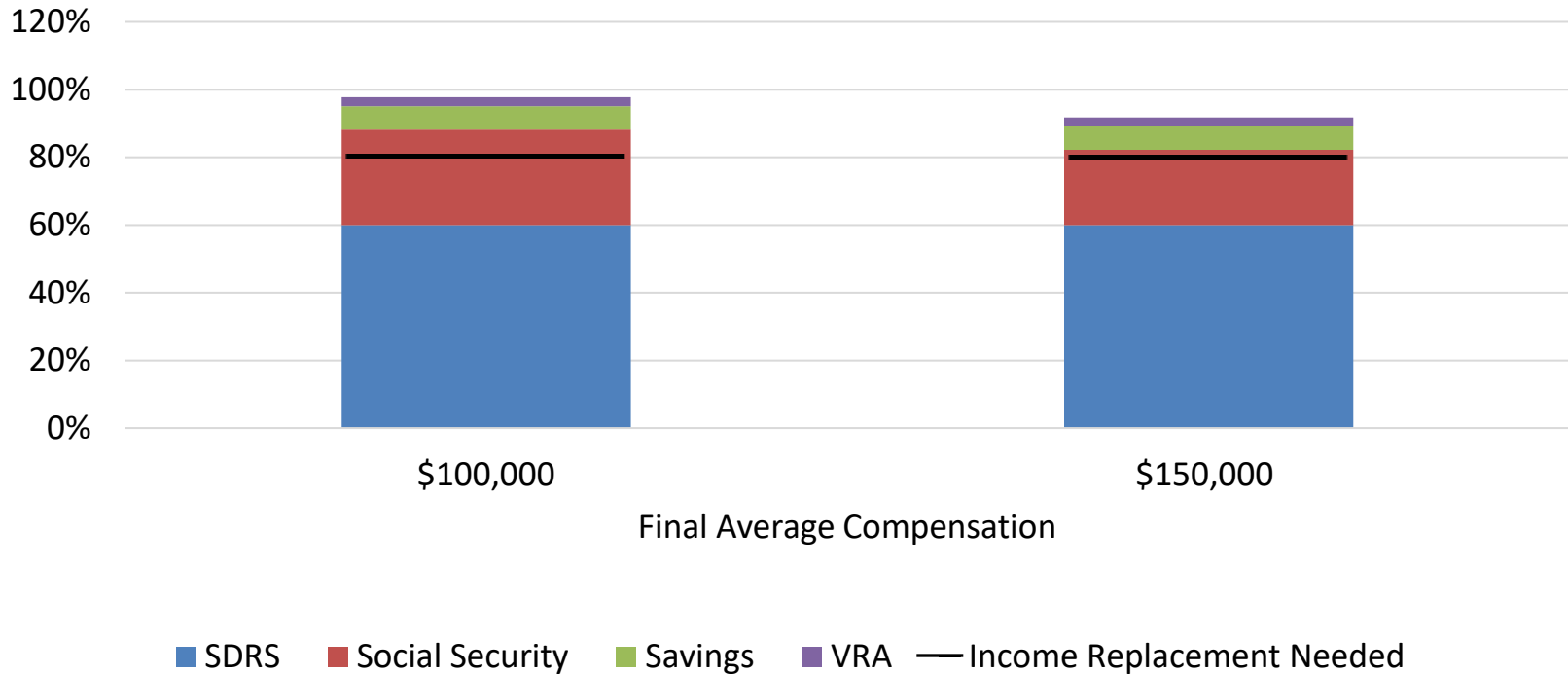
## Normal Retirement Income Replacement Rates Judicial Career Foundation Members





# Judicial Generational Member

## Normal Retirement Income Replacement Rates Judicial Career Generational Members





# Benefit Adequacy Conclusions

- **Most SDRS career retirees will currently match or exceed spendable income** before retirement based on retirement at normal retirement age and meeting savings goal
- The **SDRS COLA** is key to maintaining standard of living
- Income replaced by SDRS benefits for future Foundation retirees **will decline slightly and gradually** due to unimproved benefits since 2008
  - full decline will be 2.5% of FAC in 17 years for Class A Foundation
- Public Safety members who retire at normal retirement age of 55/57 and other members who retire early will not have Social Security benefits available until age 62
- Similarly, SDRS adequacy goals are based on members retiring at 65/67—**earlier retirement** (particularly before Social Security eligibility at age 62) **is not a reality** for most members without substantial savings or work after retirement



# Other Thoughts

- Spendable income analysis provides **objective starting point**
- **One size doesn't fit all**—SDRS should continue to encourage each member to establish individual goals based on their unique circumstances
- Logically expenses will change after retirement but will vary for each member. For example:
  - Medicare provides significant health care benefits at age 65 and effectively limits charges—even so health care costs after retirement can be substantial and generally **increase with age**
  - Surveys of retirement spending indicate that **total spending** in retirement **tends to decrease** with age until at least age 80 at a rate of 1-2% per year
  - Retirement spending **may be higher** in initial years of retirement due to travel and lifestyle decisions, and at older ages due to health care costs





# Next Steps

- Survey retirees and present results in September
- Consider any changes to goals based on spendable income analysis and retiree feedback in September