PRESENTATION
OF THE STATE RETIREES ASSOCIATION
ON THE STATE RETIREMENT PLANS

by
J. Samuel Griswold, Ph.D
President Emeritus
State Retirees Association of SC

Mr. Chairman, Members of the Subcommittee, we appreciate the opportunity to be here and to be heard on our concerns regarding the State Retirement Systems. It seems we have been working on these issues for many years. I was convinced we had reached a credible long term solution with the legislation that passed in 2008 as a result of the work of the Treasurer's Task Force on which I sat as did several others in this room. I actually still believe that. If we had not encountered the economic recession of 2008/2009 and the serious losses to the Retirement Fund, I don't think we would be here today. Fortunately we have made up those losses with stellar returns on investment the last two years but it put the fund in the position of losing income from investments which should have been there for three years: the year we lost it and the two years it took to bring it back. All the talk you have heard about unfunded COLAs and TERI were addressed to a great extent in 2008. We are here not because of those things but because of the losses we incurred during the recession of 2008/2009.

As I hope you have found over the past decade of working on this issue, the State Retirees Association does not want to be an obstacle in looking for adjustments that may need to be made. And we know that adjustments must be made to maintain the viable system we all want. We have always tried to be part of the solution, not the problem. We pledge to continue working in that mode.

That being said, we do act as a representative and advocate for retired employees. We have an obligation to bring their concerns, fears and priorities to the table. In doing that, I think you will find that we have never lobbied for more and better benefits. **All we want is what was promised us and what was implicit in the assumptions we made when we retired.**

We have been working closely with the SC Education Association, the SC State Employees Association and the SC Law Enforcement Officers Association over the past number of weeks. All of these representative organizations acknowledge and understand that we must make changes to the current retirement systems so that we can retain those things of greatest value to us and adjust those things that can keep the systems viable. We are prepared to join with you to do that.

WHAT WE HOLD DEAR AND HOPE TO RETAIN

First, the issue of most concern among retirees and those who aspire to be retirees--**their highest priority**--is the maintenance of cost of living adjustments (COLAs) at least at the current level. Further, we would strongly recommend that the rules regarding COLAs be the same for the SCRS and the PORS systems.

The current level for COLAs reflects the increase in the Consumer Price Index up to a maximum of 2%. Keep in mind, in 2008, as part of the negotiations associated with the Treasurer's Task Force and subsequent changes in retirement law, retirees accepted an upper limit of a 2% COLA . This was half the upper limit of 4% that existed at the time. Retirees have done their part in addressing shortfalls. In many years, 2% does not meet the CPI rate of inflation which has averaged 4% since World War II. So even if a 2% COLA were given each year, inflation would still take its ravaging toll as one ages.

A deep-seated fear among many retirees is that inflation or a major illness will so deplete their resources that they will be driven into desperate circumstances. The COLA and their health insurance helps guard against that. But keep in mind, the average retirement benefit is $19,000 (from the 2010 Comprehensive Financial Report). This, supplemented with a little social security benefit, is what many retirees are living on. This is hardly a huge buffer against the fear that they will not be able to live out their final years with some dignity and pride.

Second, while it is a moot issue for those already retired, active employees place a high priority on maintaining the ability to retire with 28 years of service for teachers and regular employees and 25 years for law enforcement. This really devolves into a burn-out and a recruitment issue. Neither teachers, state employees or law enforcement officers are particularly well paid in our state. These two employee benefits are invaluable in recruiting and retaining quality people into those ranks.

We also believe that we and this Subcommittee have more than just a fiscal problem at stake here. We believe that what is also at stake is the quality and competence of the government you provide to the citizens of South Carolina. Many government employees, myself included, came to work for government first and foremost out of a kind of idealism: we thought we could help build a better life for people in our state. You, as elected officials, I am sure, understand that feeling. We knew you could not get rich working for government--that is just not in the cards, at least for employees. But you could earn a living wage, you had a decent health insurance, and the retirement system was fair and, most importantly, sure.

For many of us, that is what happened. I use myself as an example. From Deputy Director and Chief Operating Officer of the Budget and Control Board, I went on to head two of our largest state agencies and was in the cabinet of two governors, one a Republican and one a Democrat. I felt like I made a positive difference in the lives of thousands of South Carolinians. I didn't care what political party the governor was. I earned enough to live and put my children through school but certainly did not get rich off my government salary. I had opportunities and offers to leave. But I believed in what I was doing, I could survive on my salary, and I was vested in the Retirement System. I stayed. There are thousands more like me in police work, in class rooms, in mental health, in social services, in our colleges and universities. They make life better for South Carolinians in many different ways. They need to be the best we can buy.

I have lots of friends still in government. Based on what I hear and see, you are in danger of not being able to attract the best and brightest any more. They haven't had a raise in a number of years, they must endure the slings and arrows of various anti-government ideologues, they see more and more top level appointees--who know little about their jobs--earning six figure salaries. They are doing their job and part of their laid off fellow employee's job, and now, NOW, even their modest (compared to many states) benefit package appears under threat. I ask you, given all this, would you recommend to a bright young person right out of college to start a career in our government service?

Yes, retirees have a degree of self interest in what happens here. But they also, perhaps more than most, have a concern that the state maintain a quality work force which can help our state move forward competitively into the future.

WHAT WE ARE DOING TO HELP

To that end, as mentioned earlier, we have not been standing still waiting to see what happens. The Retirees Association has been working diligently with the Law Enforcement Officers Association, the State Employees Association and the Education Association. We have pooled resources and brains and are devising a responsible plan of benefit and financial changes which, if enacted, we believe will provide a long-term "fix" to this issue at hand while still preserving those things we hold most dear. The plan is in a first draft status and we still need to get final figures and verifications. In addition, we need to hear what our constituents are saying during the public hearing process and learning from our own polls of our members so that any additional common concerns can be addressed. But our plan, at first brush, appears to deal effectively with all the issues at hand, is not outlandish in price, and promises to be as close to a long term fix as we might get. We will be pleased to share this with you when it is in final form.

ASSUMED RATE OF RETURN ON INVESTMENTS

Lots of worrying has occurred over whether we should lower the presumed rate of return on investment of the Retirement Fund from 8% to, say, a slightly lower rate of 7.5%. Somehow, this half a percent has been given inordinate importance. Since this would mean projecting earnings at a lesser rate, this change would significantly **increase** the unfunded liability. We think this issue is the equivalent of the proverbial "straw man." First, as we believe from first indications of implementation of our draft plan, the system will easily be within actuarially safe territory regardless of whether this rate is changed by half a percent. Second future returns will be what they actually turn out to be regardless of what presumptive rate is set and, if necessary, adjustments can be made later when the economy recovers.

This rate is an actuarial assumption that is appropriately thought of as one that should be realistic for a long-run horizon such as 30 years--not the next five to seven years. Investment returns have always been variable from year to year with multiple years of low returns followed by years of high returns. It is too early in the short life of our Investment Commission to declare that an 8% return is unachievable at a reasonable level of risk in a globally diversified portfolio with their 15 asset classes.

At the current time, we find ourselves in a period of depressed global economic activity that leads even many investment professionals to think pessimistically about the future. This old psychological phenomenon of overemphasizing the present environment in economic and investment forecasts should not be driving policy decisions in the current environment. Some even think that the US has seen its best days and will have difficulty maintaining a leadership position in the global economy going forward. Even if such a prognostication materializes in the US, sophisticated investors will maintain high average long run returns by allocating more assets to investments in areas of the world economy that are experiencing relatively high economic growth. At the present time, even US Standard & Poors 500 firms obtain at least 50% of their revenues from international sources, including emerging economies.

There is no scientific formula for calculating assumed rates of investment returns. Actuaries are generally not investment specialists or economists. They are mathematicians. Consequently, they cannot and will not do it. **This rate is a policy decision**. Of course, it cannot be set outlandishly high or it would so distort reality that both employer and employee contributions could, at least theoretically, be eliminated. That would be a poor policy decision. And if we set it abnormally low, we would have to increase dramatically employer and employee contributions. That, too, would be a poor policy decision. And we can never set it "just right" because that would be setting it to the amount actually to be earned which is beyond our capability to predict. That leaves us with a reasonable middle range of perhaps 6% to 9% within which to work.

We pay very dearly for staff at the Retirement Investment Commission to invest the Retirement Fund. With bonuses, top level staff there can earn up to $700,000-$800,000 per year if they meet or exceed returns on relevant benchmarks subject to certain controls on risk. From their perspective, the lower the assumed rate of investment return, the less is the amount of risk they have to manage--their job is easier and their bonuses more secure. However, their job is not to tell us what rate of return they are comfortable with. For Investment Commission personnel to recommend a lower rate of return represents a highly self-serving conflict of interest on their part.

Their job is to structure an investment portfolio that will deliver a return on investments as determined by State policy makers. That is why we pay them the big bucks. As fiduciaries of retirement plan assets, they are charged to work solely in the best interests of plan participants and beneficiaries. Indirectly, their degree of success impacts on taxpayers by influencing how much employers (state and local governments) must contribute to the Retirement Fund. Policy makers should, therefore, set targets for them.

As long as that presumed return is reasonable--that is, somewhere within the previously mentioned range--these professionals should be able to deliver. If not, we need a new bunch. I am no investment genius but I own shares in a generally available mutual fund which has managed an average annual return in excess of 8% for many years. I never earned $700,000 per year but if I can do it personally, I think they might as well.

I suggest we tell these guys we want a return of 8%, that this is not an unreasonable demand, and they need to develop a portfolio to achieve it over the long run. Even in a world with an economy like the one we have, the average return for public pension funds similar to ours across the United States was 21% for FY 2011. Our return was 18.4%: **LESS** than the average. Yes, in 2008/2009 we lost money during a (hopefully) once in a lifetime economic event. Yes, the economy is certainly weak right now in some respects. But the money does not just disappear, it goes somewhere--banks and big companies are stockpiling it and this can be expected to lead to corporate investments with enhanced profits when they decide the economic climate is right. And returns for public pension funds are doing pretty well. They are stockpiling some of this money as well. We need to demand performance from our investment team but not be unreasonable about it. An 8% long-run assumption does that.

Thank you for the opportunity to express our concerns and our willingness to help find a solution. We look forward to working with you in the future.

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