PEBA[SM]
SC Retirement Systems
and State Health Plan

Serving those who serve South Carolina

# Retirement Systems review

House Ways & Means Constitutional Subcommittee

January 22, 2020

# Roles in managing the Systems

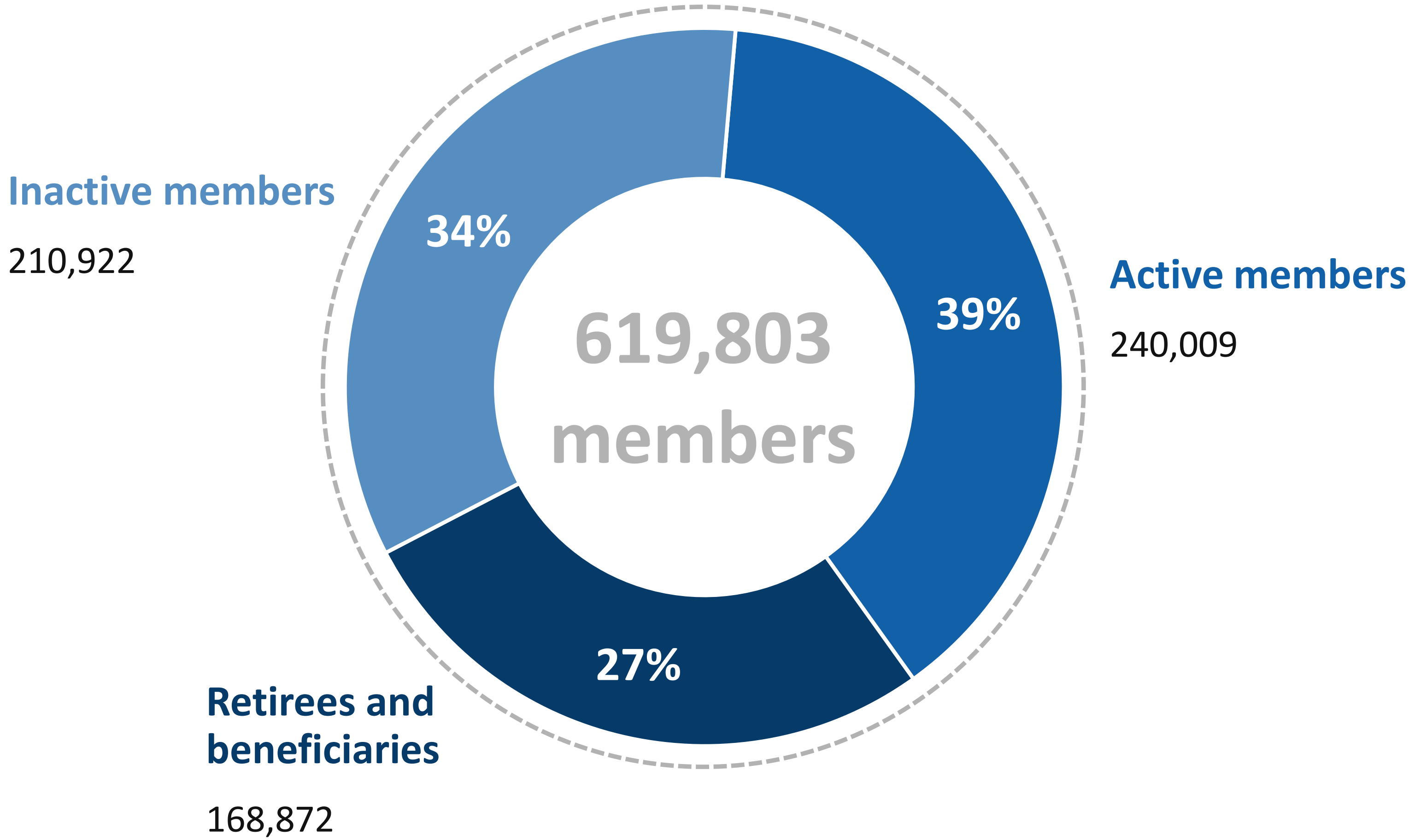
- PEBA operates and administers the state's retirement programs, which were created and are defined by state statute.
- The S.C. General Assembly has authority to make changes to the laws that govern these retirement plans.
  - South Carolina Retirement Systems.
  - State Optional Retirement Program.
  - South Carolina Deferred Compensation Program.

# PEBA's retirement plans

- Defined benefit plans:
  - South Carolina Retirement System (SCRS).
  - Police Officers Retirement System (PORS).
  - General Assembly Retirement System (GARS).
  - Judges and Solicitors Retirement System (JSRS).
  - South Carolina National Guard Supplemental Retirement Plan (SCNG).
- Defined contribution plan:
  - State Optional Retirement Program (State ORP).
- Voluntary, supplemental retirement savings plan:
  - South Carolina Deferred Compensation Program.

# Membership as of July 1, 2019

*Includes SCRS, PORS, GARS, JSRS and SCNG*



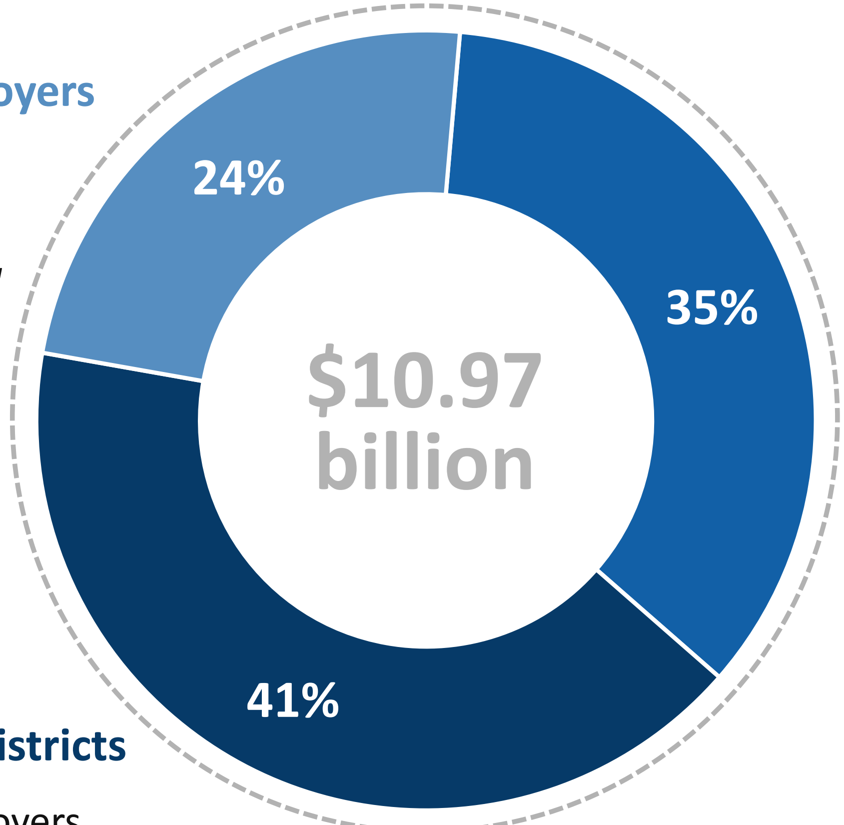
# FY 2019 total annual compensation by employer type for SCRS

*Amounts expressed in thousands*

**Optional employers**

578 employers
$2,591,130

*Includes cities, counties and other local subdivisions of government.*




**State agencies and higher education institutions**

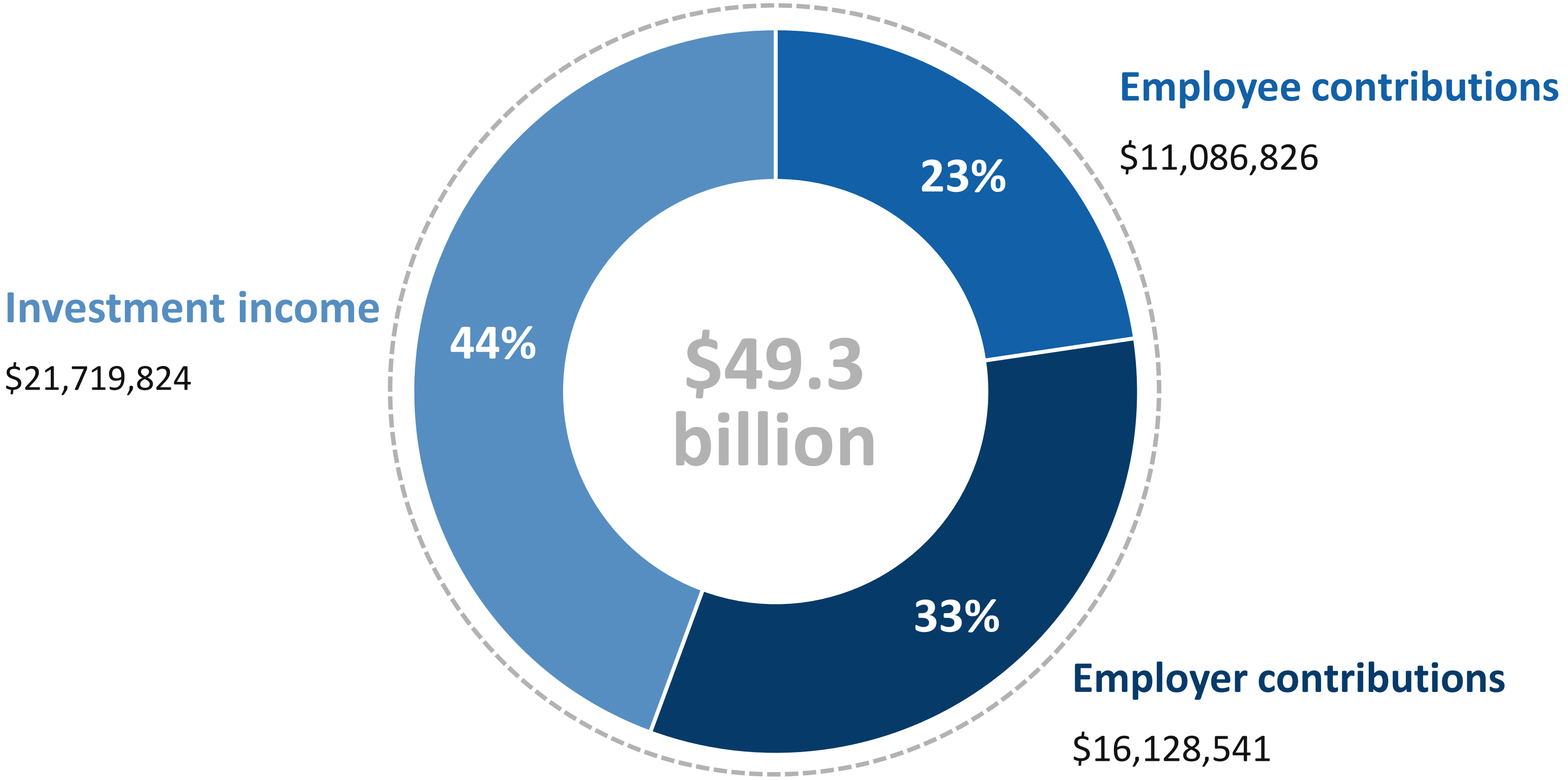
118 employers
$3,846,606

**School districts**

118 employers
$4,536,509

# Additions to pension trust funds | 2005-2019

**Includes SCRS, PORS, GARS, JSRS and SCNG**
*Amounts expressed in thousands*



# SCRS unfunded liability as of June 30, 2019

| | Market value<br>$23.200 billion | Actuarial value<br>$22.995 billion |
|---|---|---|
| **Investment experience** | $9.775 billion | $9.775 billion |
| **Deferred investment losses** | $205 million | Not applicable |
| **Interest on the unfunded actuarial accrued liability (UAAL)** | $3.729 billion | $3.729 billion |
| **COLAs** | $3.312 billion | $3.312 billion |
| **Non-COLA benefit changes** | $63 million | $63 million |
| **Liability experience** | $2.250 billion | $2.250 billion |
| **Assumption changes** | $3.866 billion | $3.866 billion |

# Past pension reform

- Benefit reform was done in 2012.
- Funding reform was done in 2017.

# Act 278 of 2012

- Created Class Three tier of membership in SCRS and PORS for newly hired employees with membership dates on or after July 1, 2012.
  - Increased service requirements for retirement with full benefits
    - Rule of 90 for SCRS; 27 years of service for PORS.
    - Age-based retirement requirements were unchanged.
  - Increased vesting period from five years to eight years.
  - Changed average final compensation calculations from 12 quarters of highest earnable compensation to 20 quarters.
  - Removed credit for unused annual and sick leave at retirement from benefit calculations.

# Act 278 of 2012

- Changes affecting Class Two and Three members:
  - Closed TERI program effective June 30, 2018.
  - Changed cost of service purchase to be actuarially neutral.
  - Excluded pay for non-mandatory overtime from SCRS earnable compensation.
  - Changed eligibility for SCRS disability retirement.
  - Eliminated interest on inactive accounts.

# Act 278 of 2012

- Changes affecting retirees:
  - Limited annual benefit adjustment, formally referred to as a COLA, to 1 percent up to a maximum of $500 annually.
  - Added $10,000 earnings limit for members who retired after January 1, 2013, and return to work for a covered employer, unless the member was over age 62 (SCRS) or age 57 (PORS) at retirement.
    - Other exceptions to the earnings limitation include compensation from certain elected and appointed offices and for certain critical needs positions in public schools.
- Closed GARS to newly elected officials after the general election of 2012; new members may join SCRS or State ORP.

# Retirement System Funding and Administration Act of 2017

- Legislation did not change the benefits provided to members of the Retirement Systems.
- Goal of the legislation was to pay down the unfunded liability faster by:
  - Reducing the funding period;
  - Increasing contribution rates; and
  - Decreasing the negative amortization.
- Decreased the assumed rate of return from 7.5 percent to 7.25 percent effective July 1, 2017.
  - Rate will remain in effect through July 1, 2021, at which time a new rate will be set by the General Assembly.
  - PEBA provides a proposed rate based upon a recommendation from the systems actuary and in consultation with RSIC.

# Retirement System Funding and Administration Act of 2017

- Changed employee and employer contribution rates effective July 1, 2017.
  - SCRS employee rate was increased to and capped at 9 percent.
  - PORS employee rate was increased to and capped at 9.75 percent.
  - Employer rates for SCRS and PORS increased by 2 percent. A schedule of rates includes additional 1 percent increases annually through July 1, 2022.
  - The General Assembly provided funding in fiscal years 2018, 2019 and 2020 for credits towards employer contributions for most employers participating in SCRS and PORS.

# Retirement System Funding and Administration Act of 2017

- Gradually reduced the maximum funding period from 30 years to 20 years by July 1, 2027.
  - Schedule reflects a one year reduction in the funding period for each of the next 10 years, but also allows for future unforeseen investment losses.
- The legislation took several important steps to increase funding to the Retirement Systems, which improves the financial condition of the plans more quickly and incorporates a cushion for possible future adverse investment experience.

# Contribution schedules set by Retirement System Funding and Administration Act of 2017

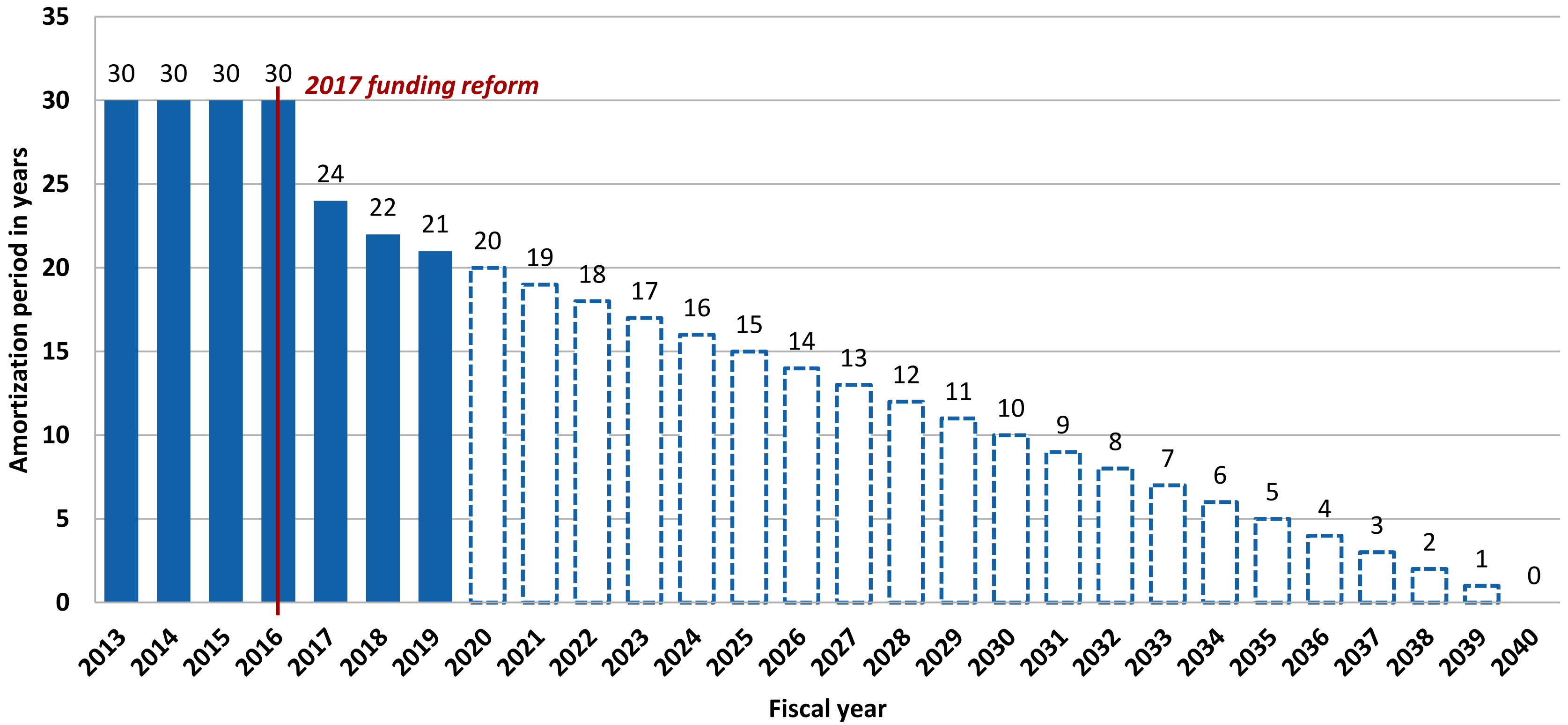
| SCRS | | |
|---|---|---|
| Fiscal year | Employer contribution | Employee contribution |
| **2017** | 11.56% | 8.66% |
| **2018** | 13.56% | 9.00% |
| **2019** | 14.56% | 9.00% |
| **2020** | 15.56% | 9.00% |
| **2021** | 16.56% | 9.00% |
| **2022** | 17.56% | 9.00% |
| **2023** | 18.56% | 9.00% |

| PORS | | |
|---|---|---|
| Fiscal year | Employer contribution | Employee contribution |
| **2017** | 14.24% | 9.24% |
| **2018** | 16.24% | 9.75% |
| **2019** | 17.24% | 9.75% |
| **2020** | 18.24% | 9.75% |
| **2021** | 19.24% | 9.75% |
| **2022** | 20.24% | 9.75% |
| **2023** | 21.24% | 9.75% |

Rates include incidental death benefit and Accidental Death Program contributions when applicable.

# Effects of 2017 legislation on SCRS

While the UAAL has continued to rise, the additional contributions required by the 2017 legislation have reduced the funding period. If actuarial assumptions are met, the funding period is expected to shorten over time. The actual reduction in the amortization period will depend upon emerging experience, including investment experience.



# SCRS “tread water” payment

- Pension plan is projected to attain the “tread water” contribution in FY 2021 (reported in the state’s FY 2022 financials).
- Actual year the “tread water” contribution effort attained will depend on emerging experience.

| SCRS (plan year reporting with $ in billions) | | | | |
|---|---|---|---|---|
| **Measurement date/ fiscal year ending** | **Plan reported NPL (unadjusted)** | **“Tread water” contribution** | **Actual contribution** | **Excess/ (deficiency)** |
| 6/30/2016 (Actual) | $21.360 | $1.405 | $1.073 | ($0.332) |
| 6/30/2017 (Actual) | $22.512 | $1.549 | $1.169 | ($0.380) |
| ↓ **Post 2017 funding reform** ↓ | | | | |
| 6/30/2018 (Actual) | $22.407 | $1.640 | $1.405 | ($0.235) |
| 6/30/2019 (Actual) | $22.834 | $1.675 | $1.539 | ($0.136) |
| 6/30/2020 (Projected) | $23.238 | $1.690 | $1.699 | $0.009 |
| 6/30/2021 (Projected) | $23.138 | $1.703 | $1.853 | $0.150 |
| 6/30/2022 (Projected) | $22.856 | $1.697 | $2.025 | $0.328 |
| 6/30/2023 (Projected) | $22.369 | $1.675 | $2.207 | $0.532 |

Table is for the plan financials. There is a one-year delay in the reporting in the state’s financial information. The state’s portion of the unfunded liability and contribution effort is approximately 55 percent to 60 percent of the total plan. Projected years is based on a 7.25 percent investment return assumption.

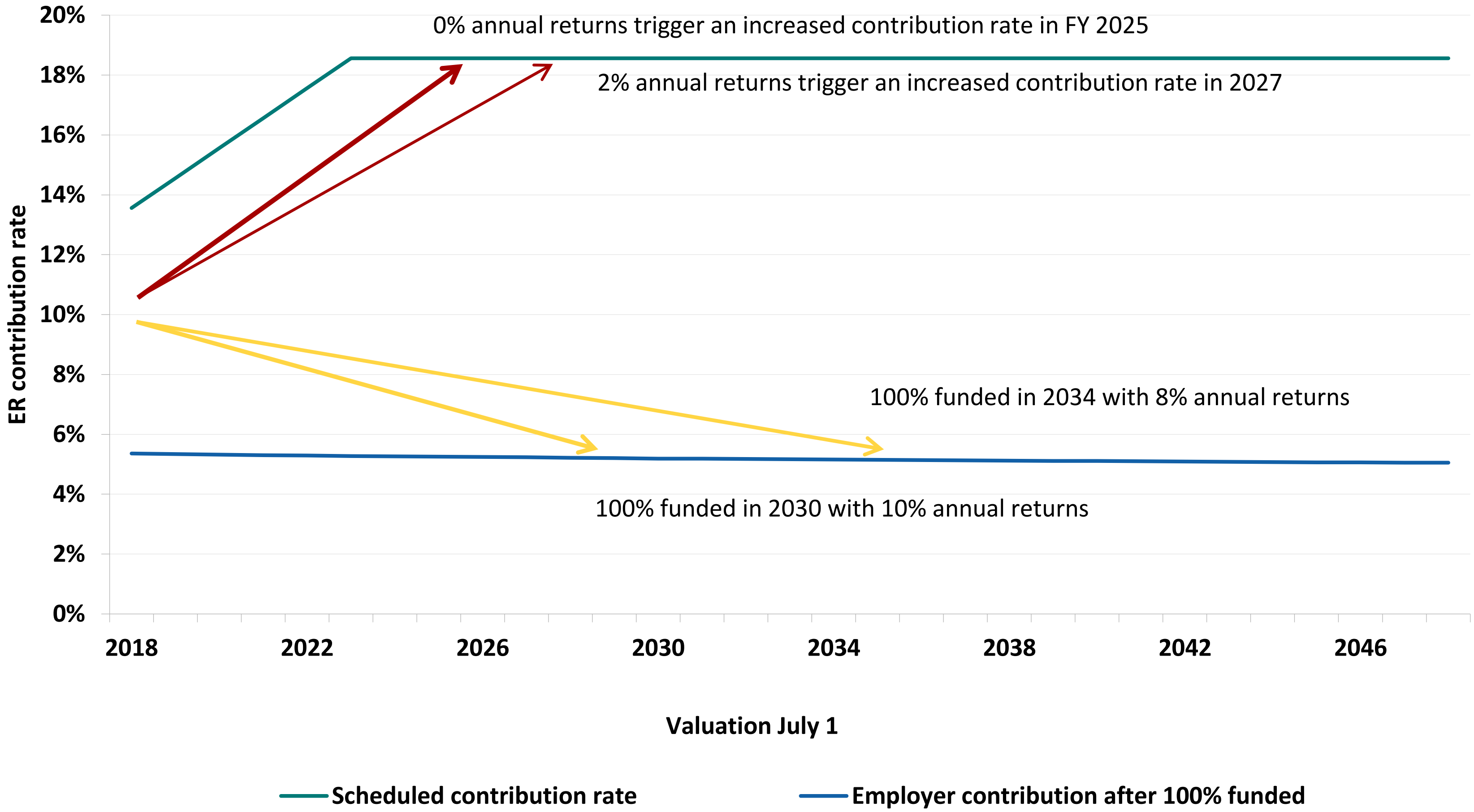
# PORS “tread water” payment

- Pension plan attained the “tread water” contribution in FY 2019 (reported in the state’s FY 2020 financials).
- Future “tread water” contribution effort attained will depend on emerging experience.

| PORS (plan year reporting with $ in billions) | | | | |
|---|---|---|---|---|
| Measurement date/ fiscal year ending | Plan reported NPL (unadjusted) | “Tread water” contribution | Actual contribution | Excess/ (deficiency) |
| 6/30/2016 (Actual) | $2.536 | $0.202 | $0.175 | ($0.027) |
| 6/30/2017 (Actual) | $2.740 | $0.226 | $0.192 | ($0.034) |
| ↓ Post 2017 funding reform ↓ | | | | |
| 6/30/2018 (Actual) | $2.834 | $0.240 | $0.225 | ($0.015) |
| 6/30/2019 (Actual) | $2.866 | $0.245 | $0.250 | $0.005 |
| 6/30/2020 (Projected) | $2.904 | $0.249 | $0.273 | $0.024 |
| 6/30/2021 (Projected) | $2.868 | $0.251 | $0.293 | $0.042 |
| 6/30/2022 (Projected) | $2.827 | $0.245 | $0.313 | $0.068 |
| 6/30/2023 (Projected) | $2.747 | $0.244 | $0.337 | $0.093 |

Table is for the plan financials. There is a one-year delay in the reporting in the state’s financial information. The state’s portion of the unfunded liability and contribution effort is approximately 55 percent to 60 percent of the total plan. Projected years is based on a 7.25 percent investment return assumption.

# Test comparing multiple outcomes over different time horizons




Slide content from GRS, the Retirement Systems' actuary.

# Contributions effective July 1, 2019

## Defined benefit participant (SCRS)

| | Normal cost | | Unfunded liability | | Total |
|---|---|---|---|---|---|
| Member | 9.00% | + | - | = | 9.00% |
| Employer | 1.66% | + | 13.90% | = | 15.56% |
| Total | 10.66% | + | 13.90% | = | 24.56% |

## Defined contribution participant (State ORP)

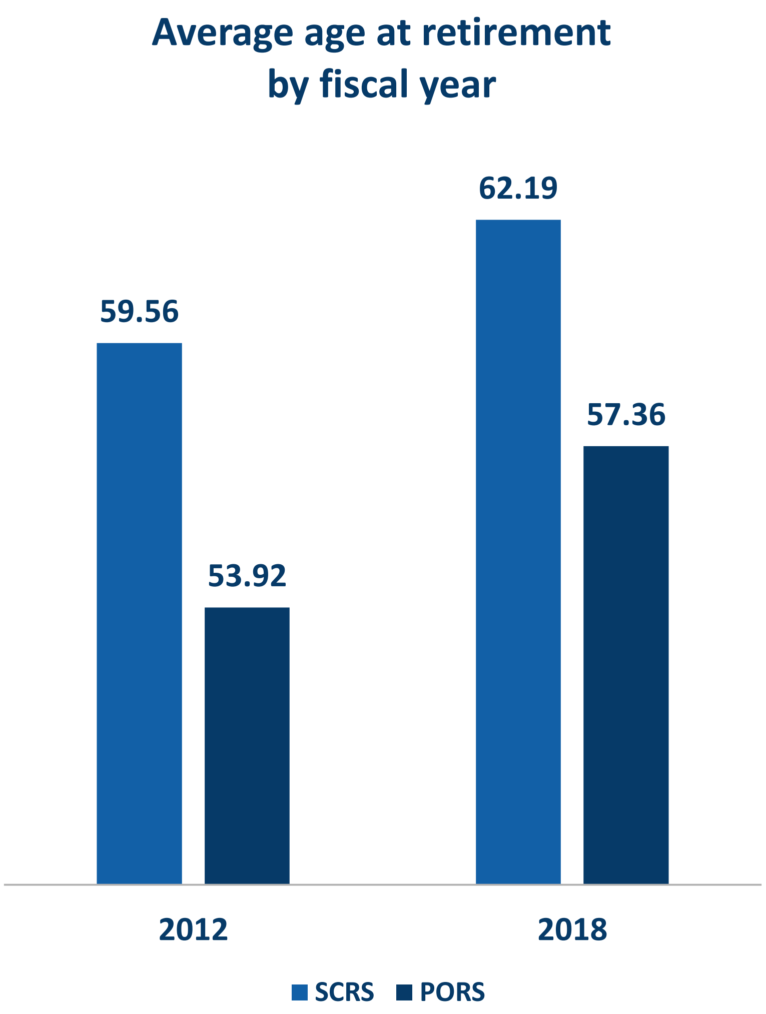
| | Member account | | Unfunded liability | | Total |
|---|---|---|---|---|---|
| Member | 9.00% | + | - | = | 9.00% |
| Employer | 5.00% | + | 10.56% | = | 15.56% |
| Total | 14.00% | + | 10.56% | = | 24.56% |

# What is the earnings limitation?

- Provisions do not actually limit the ability of a retiree to return to covered employment or restrict the amount of compensation a retiree may receive; provisions are limitations on the receipt of benefits.
- Once a member earns more than $10,000 in a calendar year from covered employment, his retirement benefit is suspended for the remainder of the year. His retirement benefit payments will be reinstated the next January.
  - Benefit will be reinstated before the next January if he terminates covered employment before the end of the year.

# What is the earnings limitation?

- Earnings limitation was put into place to encourage members to delay the start of their monthly retirement benefit.
- The TERI program and generous return-to-work provisions encouraged members to retire earlier than expected, resulting in additional costs to the plan.



# Earnings limitation

- Contribution and benefit structures are designed to provide a retirement benefit that replaces a portion of a member's income after retirement.
- Ability to return to covered employment after retirement without affecting benefits incentivizes members to retire earlier than they would have without the availability of unlimited post-retirement employment.
- Acceleration of members' retirement dates has a cost to the systems because it results in the systems paying benefits earlier and longer than would otherwise be expected.
  - Earnings limitation is intended to remove incentives.

# To whom does the earnings limitation apply?

- Members who retire on or after January 2, 2013, and are younger than age 62 (SCRS) or age 57 (PORS) on the date of retirement, unless they meet an exception:
  - Retired before January 2, 2013, regardless of age at retirement.
  - Retirement after age 62 (SCRS) or age 57 (PORS).
  - Compensation from certain public offices.
  - Compensation from certain critical needs positions in the school system.

# Other return-to-work considerations

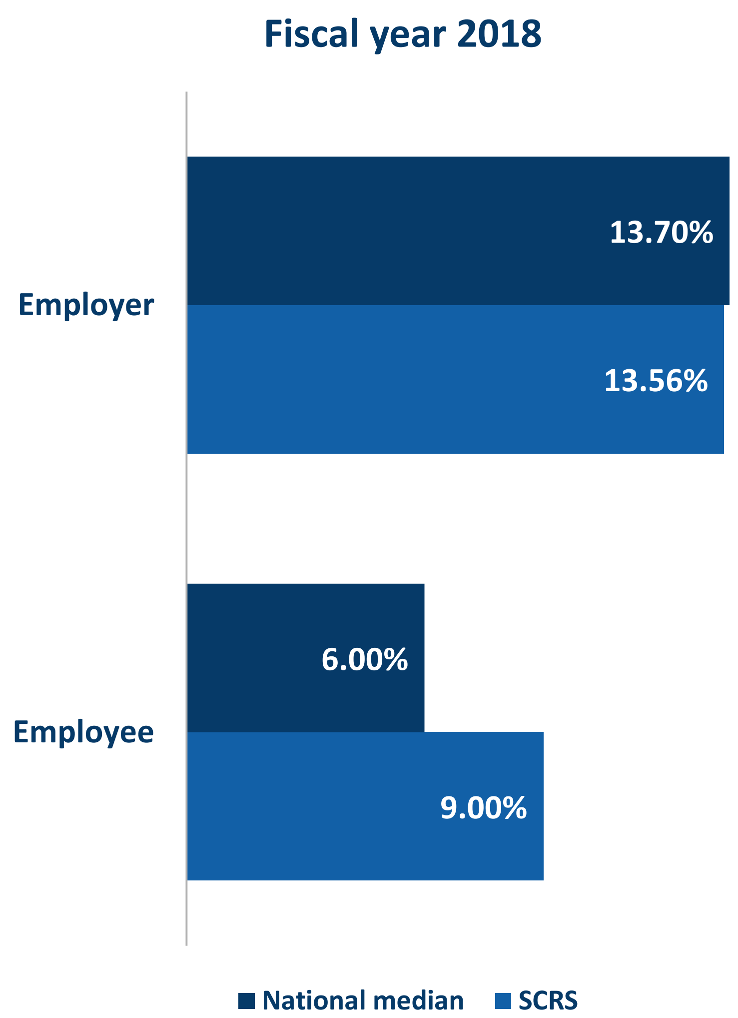
- Member must have a complete, bona fide termination from all covered employment to retire and begin receiving a monthly benefit.
- If member returns to covered employment sooner than 30 consecutive calendar days after retirement, he is not eligible to receive his benefit until the separation requirements are satisfied.
- If an employer fails to notify PEBA when it hires a retired member, the employer may be responsible for reimbursing the retirement systems for any benefits wrongly paid to the retired member.

# Pension reform in other states

- Since 2009, nearly every state has passed reform to one or more of its pension plans.
- Most common types of pension reform:
  - Employees are required to pay more.
  - Benefits are reduced.
  - Cost-of-living adjustments are reduced.
  - Employees are required to work longer.
  - Decision to retain traditional pension plan.

# Contribution rate comparison for general employee plans

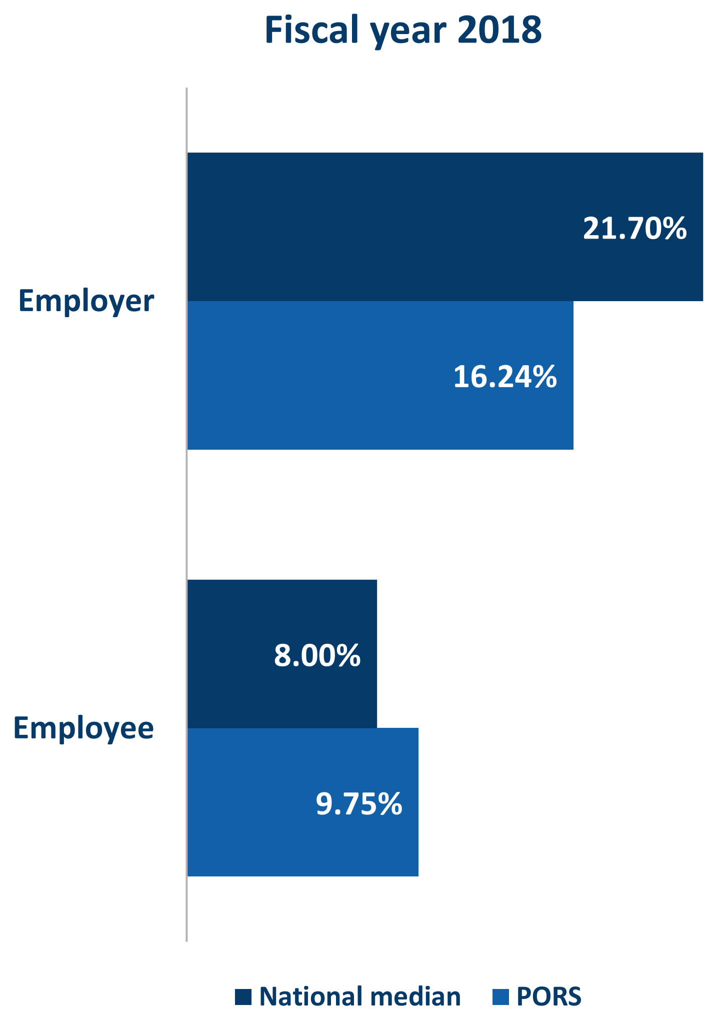
According to the National Association of State Retirement Administrators (NASRA), the median employer contribution rate was 13.7% of pay and the median employee contribution rate was 6% of pay for fiscal year 2018 for general employee and teacher plans that are also covered by Social Security.




National median employee contribution rate for fiscal year 2018 from NASRA, December 2019. National median employee contribution rate for fiscal year 2018 from NASRA Issue Brief, September 2019.

# Contribution rate comparison for public safety plans

According to the National Association of State Retirement Administrators (NASRA), the median employer contribution rate was 21.7% of pay and the median employee contribution rate was 8% of pay for fiscal year 2018 for public safety plans that are also covered by Social Security.




National median employee contribution rate for fiscal year 2018 from NASRA, December 2019. National median employee contribution rate for fiscal year 2018 from NASRA Issue Brief, September 2019.

# Actuarial assumptions

- The external consulting actuaries make assumptions about future experience regarding member experience and investment experience. These assumptions are reevaluated every four years during an experience study and are presented to the PEBA Board of Directors for review and adoption.
- The next experience study will be completed in spring 2020. Completing an experience study ensures assumptions stay reasonable according to the professional standards of the actuaries.
- The plans assume they will earn 7.25% each year. The plans actually earned 5.84% in fiscal year 2019; therefore, the plans experienced an actuarial loss of 1.41% in fiscal year 2019.
- This does not mean the plans actually lost 1.41% in the stock market; it means that the plans didn't earn as much as we expected it to earn.
- Because the plans are invested in financial markets, volatility of returns (variance in returns) is expected. However, the ups and downs are expected to even out over time.
- For example, in fiscal year 2018, the plans earned 7.82%, compared to the 7.25% assumption, which was an actuarial gain.
- The actuarial valuations recognize both gains and losses over time to account for the expected volatility. This process is called "smoothing."

# Disclaimer

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