Bill Number:	S. 394 Introduced on February 9, 2017
Author:	Sheheen
Subject:	Retirement System Funding and Administration
Requestor:	Senate Finance
RFA Analyst(s):	Shuford
Impact Date:	February 21, 2017

Estimate of Fiscal Impact

	FY 2017-18	FY 2018-19	FY 2022-23 Totals
State Expenditure			
General Fund	$73,600,000	$110,400,000	$257,600,000
Other and Federal	$95,400,000	$144,550,000	$335,450,000
Full-Time Equivalent Position(s)	0.00	0.00	0.00
State Revenue			
General Fund	$0	$0	$0
Other and Federal	$137,800,000	$354,600,000	$869,800,000
Local Expenditure	$67,400,000	$101,100,000	$235,800,000
Local Revenue	$0	$0	$0

Fiscal Impact Summary

This bill would increase General Fund employer contributions by $73,600,000 in FY 2017-18 and by an additional $36,800,000 each year in FY 2018-19 through FY 2022-23, for a total of $257,600,000 for the six fiscal years. Federal Funds and Other Funds employer contribution expenditures would increase by $95,400,000 in FY 2017-18 and by an additional $47,700,000 each year in FY 2018-19 through FY 2022-23 for a total of $334,000,000 for the six fiscal years. Local government employer contributions would increase by $67,400,000 in FY 2017-18 and by an additional $33,700,000 each year in FY 2018-19 through FY 2022-23 for a total of $235,800,000 for the six fiscal years. These amounts are reported also in the enclosed Table 1, which provides a further breakout of these amounts between the two retirement systems.

These General Fund, Federal Funds, and Other Funds employer contributions expenditures are also a corresponding $827,400,000 increase in Other Fund revenue for the SCRS and PORS retirement funds by FY 2022-23. In addition, member contributions would increase by $42,400,000 in FY 2017-18 resulting in a total $869,800,000 in Other Fund revenue for the SCRS and PORS retirement systems in the next six fiscal years through FY 2022-23.

Other Funds expenditures in FY 2018-19 for the South Carolina Public Employee Benefit Authority and the Retirement System Investment Commission fiduciary audits will increase by $1,450,000 as administrative costs of these boards must be paid from the earnings of the retirement system.

Explanation of Fiscal Impact

Introduced on February 9, 2017
State Expenditure
This bill modifies many aspects of the South Carolina Retirement System. This fiscal impact statement analyzes the following sections that may affect state and local expenditures and revenue.

Section 1. This section increases the employer and employee contribution rates for the South Carolina Retirement System (SCRS) beginning in FY 2017-18. Employer contributions for SCRS will increase by 2 percent in FY 2017-18 from the current 11.56 percent. The rate will increase further by 1 percent per year in FY 2018-19 for five years until it reaches 18.56 percent in FY 2022-23. The member contribution rate will increase by thirty-four basis points in FY 2017-18 from the current 8.66 percent to 9 percent. The member contribution rate is capped at 9 percent and the 2.9 percent statutorily prescribed differential between the employer and member contribution rates is eliminated.

Beginning with FY 2027-28, the Board of Directors of the South Carolina Public Employee Benefit Authority (PEBA) may increase the employer contribution rate based on actuarial valuation. If the annual actuarial valuation of the system reports a funded ratio (ratio of the actuarial valuation of the assets to the actuarial accrued liability) of 85 percent or higher, then PEBA may decrease employer and employee contribution rates. Conversely, if the funded ratio is less than 85 percent, then PEBA may increase the contribution rates in amounts not to exceed one-half of one percent per year, and the member rate may not exceed 9 percent. The SCRS funded ratio is presently 60 percent and is expected to be 67 percent by FY 2027-28 with the changes prescribed in this bill. The bill requires amortization of the unfunded actuarial accrued liability over a thirty-year period in FY 2017-18, decreasing to a twenty-year period by FY 2027-28. If these funding periods are not met, PEBA may increase the employer contribution rate.

Section 2. This section similarly increases the employer and member contribution rates for the Police Officers Retirement System (PORS). Employer contributions for PORS will increase by 2 percent in FY 2017-18 from the current 14.24 percent. The rate will increase further by 1 percent per year in FY 2018-19 for five years until it reaches 21.24 percent in FY 2022-23. The member contribution rate will increase by fifty-one basis points in FY 2017-18 from the current 9.24 percent to 9.75 percent. The member contribution rate is capped at 9.75 percent, and the 5.0 percent statutorily prescribed differential between the employer and member contribution rates is eliminated.

Beginning with FY 2027-28, PEBA may increase the employer contribution rate based on actuarial valuation. If the annual actuarial valuation of the system reports a funded ratio (ratio of the actuarial valuation of the assets to the actuarial accrued liability) of 85 percent or higher, then PEBA may decrease employer and employee contribution rates. Conversely, if the funded ratio is less than 85 percent, then PEBA may increase the contribution rates in amounts not to exceed one-half of one percent per year and the member rate may not exceed 9.75 percent. The PORS funded ratio is presently 66 percent and is expected to be 76 percent by FY 2027-28 with the changes prescribed in this bill. The bill requires amortization of the unfunded actuarial accrued liability over a thirty-year period in FY 2017-18, decreasing to a twenty-year period by FY 2027-28. If these funding periods are not met, PEBA may increase the employer contribution rate.

The combined expenditure impact from the increased employer contributions in Sections 1 and 2 for SCRS and PORS is based on personal service expenditures by funding source provided by the Revenue and Fiscal Affairs Office and actuarial valuation reports of the retirement system by PEBA consultants and actuaries. The enclosed Table 1 reports the additional expenditures by funding source and retirement system for FY 2017-18 through FY 2022-23. The increased employer contributions expense to the General Fund, Federal Funds, Other Funds, and local governments would increase by $236,400,000 in FY 2017-18. The increased General Fund expenditure estimate of $73,600,000 includes school district employees funded through Education Improvement Act (EIA) allocations.

Beginning in FY 2018-19, additional employer contributions from the proposed annual rate changes would increase total expenditures by an additional $118,200,000 from all funding sources. General Fund expenditures would increase by $36,800,000, Federal Funds and Other Funds would increase by $47,700,000, and local government expenditures would increase by $33,700,000.

The member contribution rate increase in FY 2017-18 to 9 percent for SCRS and 9.75 percent for PORS would increase employee contributions by a total of $42,400,000. General Fund employees' contributions would increase by $13,000,000. Federal Funds and Other Funds employees' contributions would increase by $16,400,000, and local government employee's contributions would increase by $13,000,000. Table 1 reports the additional employee contributions by funding source and retirement system. Member contributions will not affect General Fund, Federal Funds, or Other Funds expenditures.

Section 5. This section requires a completed fiduciary audit of PEBA every four years beginning January 15, 2019, by a private audit firm chosen by the State Auditor. This section deletes the requirement that the General Assembly appropriate sufficient funds to the Office of the State Inspector General for this annual audit. In past years, earnings of the retirement system funded this audit, which cost $700,000 when last performed in 2015. The audit requirement has been suspended by temporary budget provisos through FY 2017-18. Given the suspension in temporary provisos, this section would have no General Fund, Federal Funds, or Other Funds expenditure impact until FY 2018-19 when the audit is required. In FY 2018-19, Other Fund expenditures would increase by $700,000 as administrative costs of PEBA must be paid from the earnings of the retirement system.

Section 8. This section increases the number of Retirement System Investment Commission (RISC) board members from seven to eight. In addition, the section requires the State Treasurer appoint a RSIC member rather than serve on the board himself. RISC indicates that the two additional paid board members would increase Other Fund expenditures by $52,880 in FY 2017-18. These expenditures include $20,000 in salary, federal FICA taxes of $1,240, and travel expenses of $5,200 per board member. The RSIC indicates that these additional expenditures would be managed within current allocations to the board. Therefore, this section would not have an expenditure impact on the General Fund, Federal Funds, or Other Funds. Administrative costs of the RSIC are paid from the earnings of the retirement system.

Section 10. This section requires a completed fiduciary audit every four years beginning January 15, 2019, on the RSIC by a private audit firm chosen by the State Auditor. This section deletes the requirement that the General Assembly appropriate sufficient funds to the Office of the State Inspector General for this annual audit. In past years, earnings of the retirement system funded this audit, which cost $750,000 when last performed in 2014. The audit requirement has been suspended by temporary budget provisos through FY 2017-18. Given the suspension in temporary provisos, this section would have no General Fund, Federal Funds, or Other Funds expenditure impact until FY 2018-19 when the audit is required. In FY 2018-19, Other Fund expenditures would increase by $750,000 as administrative costs of the RSIC must be paid from the earnings of the retirement system.

Sections 13 and 15. These two sections shift the responsibility of custodian of all retirement system funds or assets from the State Treasurer to the PEBA board. The RSIC is assigned the exclusive authority to select the custodial bank provided that PEBA is a third-party beneficiary of the contract with the custodial bank with full information rights. The bill does not mandate a change in the custodial bank.

As current custodian of the funds, the State Treasurer and the Bank of New York Mellon have negotiated a ten-year custody and securities lending agreement for the $40 billion in assets held by the five defined benefit pension systems and other public funds of the state. The State Treasurer indicates that approximately $68,000,000 in securities lending deficits exist under these accounts, which primarily result from the financial crisis beginning in 2007. While the State Treasurer has stated concerns that this deficit is noted in the state financial reports and changing the current custodial contract would have an immediate financial impact, PEBA and RSIC indicate that this issue is unclear and unsettled and would be addressed in any negotiations to amend or terminate the current contract. The Treasurer also expressed concern about the impact on the custody and securities lending contracts for other public funds. If separate custody agreements were negotiated, the Treasurer suggests that service fees on public funds may be affected.

Given the permissive aspect of this bill in regards to selection of the custodial bank and the unknown outcome of future negotiations, the expenditure impact on the General Fund, Federal Funds, or Other Funds from sections 13 and 15 is undetermined and will depend on how the custodial agreement may be modified.

State Revenue

The General Fund, Federal Funds, Other Funds, and local government employer contribution expenditures are also a corresponding increase in Other Fund revenue for the SCRS and PORS retirement funds. In addition, member contributions would increase by $42,400,000 in FY 2017-18, resulting in a total $869,800,000 in Other Fund revenue for the SCRS and PORS retirement systems in the next six fiscal years through FY 2022-23.

Local Expenditure
Local government employer contributions to the two retirement funds would increase by $67,400,000 in FY 2017-18 and by an additional $33,700,000 each year in FY 2018-19 through FY 2022-23 for a total of $235,800,000 for the six fiscal years.

Local Revenue
N/A

Table 1.
Annual Impact of Retirement Contribution Increases
(Millions of Dollars)

Employer Impact

			General Fund			Local Government			Federal/Other Funds			
July 1,	SCRS Employer Rate Increase	PORS Employer Rate Increase	SCRS	PORS	Total	SCRS	PORS	Total	SCRS	PORS	Total	Total All Funding Sources
2017	2.00%	2.00%	$66.8	$6.8	$73.6	$49.2	$18.2	$67.4	$94.0	$1.4	$95.4	$236.4
2018	1.00%	1.00%	33.4	3.4	36.8	24.6	9.1	33.7	47.0	0.7	$47.7	$118.2
2019	1.00%	1.00%	33.4	3.4	36.8	24.6	9.1	33.7	47.0	0.7	$47.7	$118.2
2020	1.00%	1.00%	33.4	3.4	36.8	24.6	9.1	33.7	47.0	0.7	$47.7	$118.2
2021	1.00%	1.00%	33.4	3.4	36.8	24.6	9.1	33.7	47.0	0.7	$47.7	$118.2
2022	1.00%	1.00%	33.4	3.4	36.8	24.6	9.1	33.7	47.0	0.7	$47.7	$118.2
Total			$233.8	$23.8	$257.6	$172.2	$63.6	$235.8	$329.0	$5.0	$334.0	$827.4

Employee Impact

			General Fund Employees			Local Government Employees			Federal/Other Funds Employees			
July 1,	SCRS Employee Rate Increase	PORS Employee Rate Increase	SCRS	PORS	Total	SCRS	PORS	Total	SCRS	PORS	Total	Total All Funding Sources
2017	0.34%	0.51%	$11.3	$1.7	$13.0	$8.4	$4.6	$13.0	$16.0	$0.4	$16.4	$42.4

Based on SCRS and PORS Scenarios 5b Alt 1 prepared by GRS on January 19, 2017

Funding source impact based on RFA analysis in January 2017

Frank A. Rainwater, Executive Director