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# **Retirement for the AGES Assessment**

## **Forward Thinking Task Force**

### **Proposal: South Dakota Retirement System**

#### **Grade: B+**

This assessment is of the contributory defined benefit program of the South Dakota Retirement System (SDRS) that requires all new state employees to participate. There is a separate defined contribution plan available for employees who wish to defer pay. There are separate provisions for different classes of employees (most employees are Class A Standard, and only those provisions are summarized here). The base defined benefit formula is 1.55% of final three-year average pay for service after 2002. Normal retirement age is 65 with three years of service. Early retirement age is 55 with three years of service with unreduced benefits upon attaining Rule of 85 (age plus service equals or exceeds 85). Early retirement reduction with less than 20 years of service is 3% per year. Mandatory employee and employer contributions equal 6% of pay for each. Interest on mandatory contributions is no greater than 90% of the 91-day T-bill rate with a maximum of the actuarially assumed rate of investment return. Distributions from the plan are guaranteed monthly lifetime benefit payments. Vesting is three years of service. Employees can make supplemental pre-tax contributions to the defined contribution plan. They can also withdraw those funds and use them to purchase a higher defined benefit – the cost is based on the age at purchase. Cost-of-living increases based on CPI are provided to both retired and terminated vested participants and guaranteed to be at least 2.1% regardless of the funded status (it can be as high as 3.1% if the plan is at least 100% funded). Disability and death benefits are provided. Return of contributions is guaranteed. Normal form of benefits for married participants is unreduced joint and 60% survivor annuity.

The SDRS board's long-term goal of replacing 55% of pay for full career members is a primary goal. Employers are expected to make additional contributions on compensation above the Social Security taxable wage base to attain this goal for all Class A career members.

The board considers the actuarial soundness of SDRS a primary responsibility and has specific funding objectives that they evaluate and update as needed.

Employer and employee contributions are fixed as a percentage of salary in the statutes. The board's funding policy provides that if certain conditions are not met for three consecutive years, the board will recommend to the governor and retirement legislative committee that benefits be reduced, contributions increased, or a combination of the two.

## Source Material

- South Dakota Retirement System website, August 2014. Available at <http://www.sdrs.sd.gov/about/>.
- *Independent Auditor's Report*, South Dakota Retirement System, June 2013. Available at <http://www.sdrs.sd.gov/publications/documents/AuditReport.pdf>.
- *Income for Your Retirement: Information about Your SDRS Retirement Benefits*. South Dakota Retirement System, July 2013. Available at <http://www.sdrs.sd.gov/publications/documents/ClassA-Jul2013.pdf>.

# South Dakota Retirement System

## Alignment

### A

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#### Description

- Aligns each stakeholder's role with their skills.
- Redefines employer's role by placing responsibility for important roles with those appropriate entities.
- Helps individuals by structuring their choices to be well-defined and enhance good decision-making.
- Develops systemic ways to enhance financial security through appropriate levels of laws and regulations.

#### Application of Principles

- + Mandatory contributions for employees and employers to professionally managed fund.
- + Provides a base defined benefit with opportunity for employees to supplement it through their own contributions.
- + Provides lifetime benefits (and allows employee deferral balances to be converted to an annuity).

#### Legend

(+) feature meets principles

(-) feature does not meet principles

(\*) feature where there is not enough information to determine impact or actual impact may depend on stakeholder actions

# South Dakota Retirement System

## Efficiency

**A-**

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### Description

- Allows smaller plans to group together, with standard and transparent fees to lower plan costs.
- Provides consistent opportunities to accumulate assets during working lifetime to enhance participation and coverage.
- Minimizes leakage for non-retirement benefits during accumulation and payout phases.
- Encourages pooling and effective risk sharing so funds can provide lifetime income.
- Incentivizes narrowing the variability of benefits by fostering risk hedging and allowing for pricing benefits and guarantees.

### Application of Principles

- + Smaller employers benefit from the pooling amongst employers participating in the SDRS.
- + Participants have portability within the system.
- + Expenses are kept low relative to both benefits and assets.
- + Provides benefit increases for retired and terminated vested employees.
- + Three-year vesting for lifetime benefits.
- + 50% vesting for employer contributions plus interest if terminate before three years. Can be withdrawn as lump sum or left in system, and will accrue interest for up to 10 years.
- + Mandatory participation eliminates anti-selection and allows more predictable funding.
- Terminated employees can withdraw portion of contributions. However, cost-of-living adjustments for terminated participants may incentivize participants to leave money in fund.

#### Legend

(+) feature meets principles

(-) feature does not meet principles

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# South Dakota Retirement System

## Governance

**B+**

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### Description

- Clearly defines roles and responsibilities, and acts in accordance with them.
- Reduces real and potential conflicts of interest.
- Recognizes and manages competing needs.
- Staffs boards with financial and other professionals who possess relevant expertise.

### Application of Principles

- + There is stakeholder representation on the board.
- + Investments are professionally managed.
- + Involves employer and employees in decision processes.
- + Clearly communicates rationale for changes.
- + Trust fund used exclusively for benefit of members.
- + Board makes recommendations in changes to benefit levels and provisions to maintain funded status, including benefit decreases if the funded ratio falls below 80%.
- + Board's policy is not to recommend increases in benefits that would result in a funded ratio of less than 120%.
- + Administration and investment handled separately. Investment committee staffed with financial experts appointed by the legislature who are independent of the system.
- Large majority of board members are beneficiaries of the system. Board of trustees is elected by members to four-year terms.
- Board must rely on action from legislature and governor to effect recommendations. Currently, the legislative committees with oversight responsibility will not act on any legislation related to SDRS without input from board.

### Legend

(+) feature meets principles

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# South Dakota Retirement System

## Sustainability

### B

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#### Description

- Promotes intergenerational equity.
- Allocates cost properly among stakeholders.
- Withstands market shocks.
- Maintains balance between sustainability and adequacy.

#### Application of Principles

+ Board makes recommendations in changes to benefit levels and provisions to maintain funded status, including benefit decreases if the funded ratio falls below 80%.

+ Board's policy is not to recommend increases in benefits that would result in a funded ratio of less than 120%.

+ Cost-of-living increase could vary between 2.1% and 3.1% based on funded status of the plan.

+ Benefit increases granted in 2008 apply to prior service only (this is also true of increases granted in 1998, 1999, and 2000).

- Early retirement eligibility (age 55 and three years of service) and early payment reductions are very generous compared to actuarial equivalence. Can also qualify for unreduced benefits with additional service (e.g., age 55 and 30 years of service).

- Under the current law, cost-of-living increases cannot be less than 2.1% regardless of the funded status.

- Cost-of-living increases for terminated vested employees is uncommon and increases cost.

\* The current administrative pricing process to purchase additional defined benefits is intended to reflect the market. However, this process is subject to change and may not fully incorporate annuity market movements.

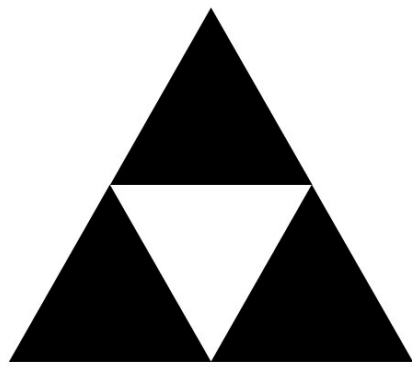
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