MEETING

SOUTH DAKOTA RETIREMENT SYSTEM

June 5, 2014

The Board of Trustees of the South Dakota Retirement System held its regular meeting on June 5, 2014. The meeting began at 9:00 a.m. in the Downstairs Conference Room, View 34, Pierre, South Dakota.

BOARD MEMBERS IN ATTENDANCE:

Elmer Brinkman, Chair
Karl Alberts
Steven Caron
Jason Dilges
Jilena Faith
Laurie Gill
Laurie Gustafson
James Hansen
James Johns
Louise Loban
Bonnie Mehlbrech
Eric Stroeder
Matt Clark, Ex Officio

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Board members David Merrill, Matt Michels, KJ Peterson and Steve Zinter were absent.

OTHERS IN ATTENDANCE:

Deene Dayton
Joel Ebert, Capital Journal
Laura Haug, SDEA
Hank Kosters, SD Retired Teachers
Doug Fiddler, Buck Consultants
Eric Ollila, SDSEO
Paul Schrader, Consultant
Dave Slishinsky, Buck Consultants
Ryan Sutton, DOT Intern
Rob Wylie
Travis Almond
Susan Jahraus

Michelle Mikkelsen
Jessica Reitzel
Jane Roberts
Dawn Smith
Jacque Storm

For continuity, these minutes are not necessarily in chronological order.

AGENDA ITEM 1
APPROVAL OF APRIL 3, 2014, MEETING MINUTES

Board Action
IT WAS MOVED BY MS. LOBAN, SECONDED BY MS. GUSTAFSON, TO APPROVE THE MINUTES OF THE APRIL 3, 2014, BOARD OF TRUSTEES MEETING. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 2
ELECTION RESULTS

Summary of Presentation
Ms. Dawn Smith, SDRS Executive Assistant, stated that there were three positions up for election this year. Jilena Faith (Classified Employees) won her election. Bonnie Mehlbrech (Teachers) and James Johns (Class B Public Safety) were unopposed.

Board Action
IT WAS MOVED BY MR. ALBERTS, SECONDED BY MR. STROEDER, TO ACCEPT THE CANVASSARS' REPORT AND DECLARE JILENA FAITH (CLASSIFIED EMPLOYEES), BONNIE MEHLBRECH (TEACHERS), AND JAMES JOHNS (CLASS B PUBLIC SAFETY) AS THE WINNERS OF THE 2014 SDRS BOARD OF TRUSTEES ELECTION. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 3
UPDATE OF SDRS FY2014 INVESTMENT PERFORMANCE

Summary of Presentation
Mr. Matt Clark, State Investment Officer, informed the Board that as of May 31, the SDRS trust fund was up 16.2 percent.

Board Action
No action was required.

AGENDA ITEM 4
REVIEW OF SDRS FY 2014 PROJECTED FUNDED STATUS

Summary of Presentation:

Mr. Douglas Fiddler, Senior Consultant, Actuary, Buck Consultants, stated that if the investment return for SDRS for the fiscal year ending June 30, 2014, remains at 15 percent, the actuarial value funded ratio for that time period will be 100 percent and the market value funded ratio would increase to 111 percent.

With a 15 percent investment return for FY2014, advised Mr. Fiddler, the minimum annual investment return required to utilize the existing cushion over 5, 10, 20, and 30 years is 4.7, 5.9, 6.4 and 6.5 percent, respectively.

The minimum annual net investment return required to avoid corrective actions over the same time period with the 15 percent investment return would be 0.4, 3.8, 5.6 and 6.3 percent respectively.

Board Action

No action was necessary.

AGENDA ITEM 5
UPDATED MORTALITY INFORMATION

Summary of Presentation:

Mr. Dave Slishinsky, Principal and Consulting Actuary, Buck Consultants, stated that a couple years ago, Buck did an experience analysis of SDRS. The experience of mortality for SDRS showed that people were living longer and when they live longer their benefits are paid longer, therefore increasing the liability and the costs to the System.

Mr. Slishinsky stated that in 1900 infants under the age of one accounted for the greatest number of deaths. The life expectancy at birth for someone born in 1900 was 48. At age 40 the expected age at death was 68 and at age 65 the expected age at death was 77.

Mr. Slishinsky explained the life expectancies for every 10-year period up to 2010. By 2010, advised Mr. Slishinsky, the life expectancy at birth had increased to 76 years of age, at age 45 it had increased to 78 years old, and at age 65, life expectancy had increased to age 83.

Mr. Slishinsky stated that life expectancy continually increased over the stated period. There were dramatic increases at birth, especially pre-1950. At middle age there were slower, steadier increases. Most forecasts currently in use for pension plans assume slower life expectancy increases in the future, including at older ages. However, undervaluing future mortality improvement understates the pension liabilities.

Mr. Fiddler noted that SDRS' experience showed that over the last eight valuations, the average age at death for females was 86.2 years old and the average age at death for males was 82 years old. Both increased by approximately one year over the period.

Various factors influence mortality, advised Mr. Slishinsky. Factors include gender, genetics, marital status, education, lifestyle, medical technology and many more.

Mr. Slishinsky stated that there was a new mortality improvement scale for pension plans. Although it is not yet finalized, Scale MP-2014 is designed to replace scales AA and BB. This scale has just come out, there is a comment period, and there's likely to be more discussion about these tables; therefore, Buck is not recommending adoption of the new table at this time.

Mr. Fiddler explained that a mortality assumption can be static (not projected, or projected to a specific point in time) or generational (reflecting decreases in mortality rates throughout each member's lifetime). Both projected static assumptions and generational assumptions use a base mortality table and a mortality projection scale (typically Scale AA or Scale BB). SDRS's current (static) mortality assumption was set after the 2012 experience study with a small margin for future improvement and was acknowledged as a first step. The Actuarial Standards of Practice require "consideration of future mortality improvement" and the Buck recommended practice is a fully generational projection. Based on a limited sample of public retirement system assumptions, the majority of systems use a static table often with a projection to a future date; however, an increasing number of systems are adopting a generational table, typically using Scale AA, with a limited number of systems adopting Scale BB.

Board Action
No action was necessary.

AGENDA ITEM 6
SDRS RISK MANAGEMENT AND SUSTAINABILITY

Summary of Presentation
Mr. Wylie stated that the objectives for this meeting were to primarily deal with mortality improvement considerations and then to begin the discussion of the possibility of additional sustainability initiatives for new members.

Mr. Wylie advised that the next steps would be to agree on a degree of future mortality improvement, agree on appropriate use and amount of the risk management contribution, develop a plan to deal with improved life expectancy and the impact on the actuarial accrued liability and the normal cost, discuss the timing of a mortality improvement and any benefit provision changes, and consider additional equity/subsidy/unanticipated cost concerns for new members.

Mr. Paul Schrader, consultant, stated that maintaining a fully funded System eliminates the need to allocate a portion of the current contributions to pay for the unfunded liabilities. This amount, 2.36 percent of pay or $40 million expected for FY 2015, is referred to as a risk management contribution.

Mr. Schrader gave a recap of the System's status. He noted that at June 30, 2013, the actuarial value funded ratio was 100 percent, the market value funded ratio was 103 percent, the cushion was $282 million, and total contributions were 12.5 percent of pay with 2.3 percent of that (18 percent of statutory contributions) going to fund the risk management contribution.

At June 30, 2014, with an estimated net return of 15 percent, the actuarial value funded ratio is projected to be 100 percent, the market value funded ratio is projected to be 111 percent, the cushion is expected to be $1,023 million, the risk management contribution is expected to be 19 percent of the statutory contributions, and the System has no unfunded liabilities.

Mr. Schrader stated that together, the projected market value funded ratio, the cushion, and the risk management contributions provide protection if the assumed investment return is not earned. Based on a 15 percent investment return for FY 2014, maintaining a market value funded ratio of 100 percent at the end of the period would require aggregate annual net investment returns of 6.2 percent over 10 years (60 percent likelihood) or 6.6 percent over 20 years (58 percent likelihood). A market value funded ratio of 90 percent would require 5.2 percent over 10 years (68 percent likelihood) and 6.2 percent over 20 years (62 percent likelihood). Likewise an 80 percent market value funded ratio would require 4.1 percent over 10 years (75 percent likelihood) and 5.8 percent over 20 years (66 percent likelihood). All of the likelihoods, noted Mr. Schrader, are based on the FY14 South Dakota Investment Council outlook with an inflation adjustment.

Mr. Schrader stated that increasing life expectancy has effectively increased the value of benefits in the past and will likely continue to do so in the future, resulting in unanticipated costs. The current benefit features directly impacted by longer life expectancies, and in some cases by equity and subsidy concerns as well, include the normal retirement age, early retirement, special early retirement, and the pre-retirement surviving spouse benefit.

Additional equity/subsidy/unanticipated cost concerns, advised Mr. Schrader, include the final average compensation manipulation, Class A/Class B, alternate formula, COLA in excess of inflation, and the post-retirement surviving spouse benefit.

Mr. Schrader stated that some policy and sustainability issues that the Board should deal with include:

- When should the System recognize the cost associated with increasing life expectancy, and how can such unanticipated costs be financed?

- Are there initiatives that should be considered related to longer life expectancies that will improve the System's chances for sustainability?
- Are there specific changes to the SDRS benefit structure that should be considered to offset the increasing costs of benefits caused by the increasing life expectancy?
- Are there additional changes to the SDRS benefit structure that should be considered because of reasons of unanticipated costs, subsidies, equity, or above average practices?

Mr. Fiddler noted that the increasing life expectancy has been well documented over recent decades and that actuarial standards of practice require consideration of future mortality improvement. Mortality improvement can be assumed by using a generational table that projects annual improvements in each future year, or a static table with improvement projected to a fixed point in time.

Mr. Fiddler stated that at the current mortality assumption, the June 30, 2013, actuarial accrued liability (AAL) is $8,795 million and the normal cost rate is 10.118 percent. If SDRS moved to the RP-2000 Generational with scale BB, advised Mr. Fiddler, the AAL would increase to $9,349 million and the normal cost would increase to 10.904 percent. Mr. Fiddler stated that the RP-2000 Generational with scale BB is the best estimate today of SDRS' total liability.

There are three options for dealing with the costs of mortality improvement, advised Mr. Fiddler. Option A would finance the mortality improvements totally with current resources. Option B would finance them partially with current resources and partially with benefit changes applicable to future service only, and Option C would finance the mortality improvements totally with benefit changes. Of note, Option C would require reducing accrued benefits for existing members and is not a recommended option unless necessary due to SDCL 3-12-122 thresholds.

Assuming the Fiscal Year 2014 return remains at approximately 16 percent, a generational mortality assumption with scale BB (Option A) adopted June 30, 2014, without benefit structure changes, and funding the AAL increase from the cushion, Mr. Fiddler stated that the actuarial value funded ratio would be projected to remain at 100 percent, the market value funded ratio would decrease from 112 percent to 106 percent, the projected cushion would decrease from $1.1 billion down to $550 million, and the expected risk management contributions would decrease from 19 percent to 13 percent of the statutory contributions. SDRS would have approximately a 50 percent likelihood of maintaining 100 percent funded status for 20 years, which is an envious position, but by using some of the current resources there would be less protection for the future.

Moving to Option B, Mr. Fiddler explained the normal costs by benefit and feature. Alternatives for the effective date of benefit changes applicable only to future service include:

- Method 1 – Apply changes only to new members – This creates a separate tier of benefits, an approach that has been avoided to date and does not reduce the Normal Cost immediately, but only very gradually.
- Method 2 – Phase-in the changes over a number of years – This would reduce the Normal Cost more quickly, but the total impact would still be phased-in.
- Method 3 – Apply the changes for all benefits accrued after the change – This would reduce the Normal Cost immediately and affect members' benefits more in proportion to the increase in costs caused by mortality improvement.

One potential scenario for benefit provision changes, advised Mr. Fiddler, would be to increase the normal retirement age to 67 (57 for Class B public safety), increase early retirement age to 57 (47 for Class B PS), increase the early retirement reduction to 5 percent per year, increase the special early retirement eligibility to Rule of 89 and minimum age of 57 (Rule of 84 and age 57 for Class B Judicial and Rule of 79 and age 47 for Class B PS) and increase the pre-retirement surviving spouse benefit age to 67. He noted that all benefit provision changes apply only to benefits earned for future service. Benefits based on past service will not change.

With the aforementioned assumptions regarding the investment return and mortality, including the above benefit structure changes, and paying off the increase in the AAL from the cushion, Mr. Fiddler stated that the actuarial funded ratio, market value funded ratio, and cushion remain the same as with option A; however, the expected risk management contributions increase from 19 percent to 23 percent of the statutory contributions.

Mr. Schrader stated that some of the policy issues that the Board needs to think about are:

- Recognizing the lengthening life expectancy, which will increase both the actuarial accrued liability and the normal cost;
- Offsetting some of the cost of the longer life expectancy with changes to the benefit structure, and if changes are made, the preferred effective date of any benefit changes;
- Addressing the increase in the AAL
  - Funded from the cushion,
  - Funded from the establishment of a new unfunded actuarial accrued liability (this would not meet the Board's funding objectives and would use some or all of the risk management contribution), or
  - Modify the benefit structure for benefits already accrued (not recommended unless SDCL 3-12-122 thresholds met); and
- Enhancing the SDRS risk management features with a new benefit design for new members only.

Mr. Schrader stated that the objectives for a sustainable plan design for new members are to increase the likelihood of sustainability; eliminate or decrease subsidies, inequities, and unanticipated costs; recognize increasing life expectancy; reconsider income replacement objective and career service criteria; maintain fixed benefits and enhance hybrid features of SDRS; minimize inequity with current members; and limit the lifetime benefits for more highly compensated members and enhance hybrid benefits within SDRS.

Some options for a new member plan design, advised Mr. Schrader, include:

- Age 67 normal retirement;
- Age 57 early retirement;
- 5 percent per year reduction for early retirement benefits;
- Age 62 and Rule of 95 for special early retirement;
- 5-year final average compensation and vesting;
- Tighter final average compensation limits;
- No post-retirement survivor benefit provided (available at member cost);
- COLA limited to rate of inflation;
- Alternate formula eliminated;
- Compensation limited to Social Security wage base (currently $117,000) for SDRS defined benefit structure. Current employer and member contributions above that amount fund the hybrid benefit;
- Reconsider benefit formula targets;
- Actuarially increased benefits for Class A members working past normal retirement age with comparable changes for Class B members; and
- Immediate funding of hybrid account within SDRS equal to difference in normal cost rate for new members compared to existing members.

Mr. Schrader added that if any Board members had any other ideas or suggestions for a new member plan design to get them to Mr. Wylie and they would be incorporated into the September meeting presentations.

Board Action

No action was necessary.

AGENDA ITEM 7
ACTUARIAL SERVICES

Summary of Presentation:

Mr. Wylie stated that the amended contract with Buck Consultants for actuarial services has been signed. He noted that Doug Fiddler will begin his actuarial duties as an employee of SDRS beginning July 1, 2014.

Board Action

No action was necessary.

AGENDA ITEM 8
FY2016 BUDGET REQUEST

Summary of Presentation
Ms. Jane Roberts, SDRS Chief Financial Officer, stated that the majority of the financial impact related to the staff's recommended expenditure authority changes for the FY 2016 budget is in capital assets.

Ms. Roberts noted that the recommended line-item expenditure authority changes included:

- $5,000 to cover the additional travel costs relating to education of membership and staff;
- $3,000 to cover expenses related to SDRS being a defendant in an action as a result of selling Tribune Stock in connection with a leveraged buyout of the Tribune Company in 2007;
- $3,000 for the increase in dues, subscriptions, and registrations; and
- $20,000 is requested to cover the cost of purchasing software for Actuarial Services Pension Administration.

Board Action

IT WAS MOVED BY DR. HANSEN, SECONDED BY MR. JOHNS, TO APPROVE THE INCREASE IN THE FY2016 BUDGET REQUEST AS PRESENTED BY STAFF AND SUBMIT IT TO THE GOVERNOR'S OFFICE. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 9
CONFIRM STRATEGIC PLAN

Summary of Presentation
Mr. Wylie reviewed the SDRS strategic plan with the Board. He noted that the strategic plan is designed to provide focus on the key elements needed to maintain a successful public employee retirement system. It also defines the most important strategic initiatives for the Board of Trustees, administration, and staff for the next five years.

Board Action
No action was necessary.

AGENDA ITEM 10
OVERVIEW OF RULES REVIEW COMMITTEE MEETING

Summary of Presentation
Ms. Jacque Storm, General Counsel, stated that the rules that were approved by the Board at the April meeting were presented to and approved by the Rules Review Committee on May 6th and were effective May 27, 2014.

Board Action
No action was necessary.

AGENDA ITEM 11
SELECTION OF BOARD REPRESENTATIVE TO SERVE ON THE INVESTMENT COUNCIL

Summary of Presentation
The Board members discussed the appointment of the Board representative to the Investment Council.

Board Action
IT WAS MOVED BY DR. HANSEN, SECONDED BY MR. JOHNS, TO APPOINT ROB WYLIE AS THE BOARD REPRESENTATIVE TO SERVE ON THE INVESTMENT COUNCIL. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

It was a Board consensus to direct staff to prepare legislation that would make the appointment of the Administrator to the Investment Council a permanent appointment.

AGENDA ITEM 12
CONFERENCE ATTENDANCE REQUEST

Summary of Presentation
Mr. James Johns requested Board approval to attend the IFEBP conference in Boston, MA, October 12-15, 2014.

Board Action
IT WAS MOVED BY MS. GUSTAFSON, SECONDED BY MS. LOBAN, TO APPROVE THE CONFERENCE ATTENDANCE REQUEST OF JAMES JOHNS TO THE IFEBP CONFERENCE OCTOBER 12-15, 2014. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

AGENDA ITEM 12
CONFERENCE ATTENDANCE REPORT

Summary of Presentation
Mr. Eric Stroeder and Ms. Laurie Gustafson gave a brief presentation on the NCPERS conference that they attended in Chicago, IL, April 27, 2014 through May 1, 2014.

Board Action
No action was necessary.

AGENDA ITEM 17
OLD/NEW BUSINESS

Summary of Presentation
Metex Update
Ms. Susan Jahraus, Operations/Compliance Director, updated the Board on how the process was going with Metex regarding the new data processing software.

Consolidation of Cement Plant Retirement Plan
Mr. Wylie informed the Board that the information for the consolidation of the Cement Plant Retirement Plan would not be finalized until the September meeting.

40-Year Anniversary
Mr. Wylie stated that the Board was scheduled to meet with the Governor at the Capitol for the proclamation regarding SDRS' 40-year anniversary.

Upcoming Meeting Dates
Mr. Wylie noted the upcoming meeting dates.

Board Action
No action was necessary.

ADJOURNMENT

Board Action
IT WAS MOVED BY MR. JOHNS, SECONDED BY MS. LOBAN, THAT THERE BEING NO FURTHER BUSINESS, THE MEETING BE DECLARED ADJOURNED. THE MOTION PASSED UNANIMOUSLY ON A VOICE VOTE.

Respectfully Submitted,

Robert A. Wylie
Executive Director/Administrator