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Briefing paper on state law related to the funding of the state's public pension plans

A recent opinion issued by the South Carolina Attorney General's Office has been misused to suggest that the state's public pension plans are not being administered in accordance with state law and actuarially sound practices. In response to the misuse of that opinion, the South Carolina Public Employee Benefit Authority (PEBA) has issued this briefing paper to reassure stakeholders and other interested parties that the state's public pension plans have been, and will continue to be, administered and funded in full compliance with all applicable state laws and professional actuarial standards of practice.

Misuse of the South Carolina Attorney General's opinion issued January 10, 2017

The Attorney General's January 10, 2017, opinion has been mischaracterized in recent media releases as finding that the methods used to fund the state's public pension plans are illegal and unconstitutional. However, as explained below, the opinion makes no such finding.

The Attorney General's opinion does not make findings of fact

The recent opinion issued by the Attorney General's Office makes no finding that PEBA or any other entity has administered the state's public pension plans in a manner that violates the state constitution, state statutes or actuarial standards of practice. The Attorney General's Office has long stated that, in issuing its advisory legal opinions, the office does not have the necessary fact-finding authority and resources to investigate or decide factual questions. Accordingly, in responding to the question posed by the South Carolina State Treasurer, the Attorney General's Office did not communicate with PEBA or the plans' actuaries to investigate or determine any facts related to how the state's public pension plans are funded, but rather, issued an opinion based only upon the factual assertions made in the Treasurer's request for an opinion.

The assertions in the opinion request do not reflect actual practice

The factual assertions that were provided in the opinion request, and that the Attorney General's Office relied upon in issuing its opinion, do not reflect the actual practices used to administer the state's public pension plans. In particular, the opinion addresses two hypothetical funding practices: (1) the use of an open amortization method under which contribution rates would be continually reset every year at the minimum rate necessary to stay at a 30-year funding period to pay off the unfunded liabilities of the pension plan, and (2) a method of setting the required contribution rates for the plan that would not set current contribution rates at a level sufficient to pay off the plans' unfunded actuarial liabilities within the required funding period, but that would rely upon future contribution rate increases to satisfy the required funding levels. Neither of these methods is used in the administration of the state's public pension plans.

Amortization method

The state does not continually reset contribution rates for its public pension plans every year at the minimum rate to stay at a 30-year funding period to pay off the unfunded liabilities of the plans. Rather, since 2012, state law has prohibited contribution rates from being decreased until the plans are at least 90 percent funded. Therefore, once the contribution rates have been set to pay off the unfunded actuarial liabilities on a schedule that does not exceed 30 years, those rates cannot be reduced to later reset the 30-year funding period, unless the plan were over 90 percent funded. Under the current amortization method, the only way that the funding period could regress is if the plan has negative fiscal experience, such as underperforming investment returns that do not meet expectations, which, unfortunately, has occurred in recent years. If those deferred investment losses are not offset by future gains, contribution rates will be increased as necessary so that the funding period does not exceed 30 years at any time, as required by state law.

Future contribution increases

The state sets contribution rates for its public pension plans at a level sufficient to pay off the plans' unfunded actuarial liabilities within the required funding period without relying upon future contribution rate increases. As certified by the plans' actuaries, contribution rates set based upon the annual actuarial valuations of the plans are the full rates required to pay off the unfunded actuarial accrued liabilities of the plans within the funding period required by law, without any future increases. However, it is important to recognize that these rates are based upon the actuarial condition of the plan on the date of the actuaries' valuation. If there is an expectation of negative fiscal experience after the valuation date, such as the recognition of deferred investment underperformance, the actuaries have also produced comparative projections that illustrate what increases in contribution rates might be required if that negative experience is realized. These projections are not actuarial valuations of the plans' assets and liabilities on those future dates, and do not set the required contribution rates, but are simply educational information for the plans' stakeholders and decision makers on what sort of funding requirements may be necessary if the plans experience negative fiscal circumstances.

The Attorney General does not investigate or determine factual questions in rendering an advisory opinion on a question presented. In this instance, the factual assertions in the question presented to the Attorney General's Office do not reflect the actual funding methods for the state's public pension plans. Accordingly, it is a misuse of that opinion to assert that the opinion finds that the funding methods for the state's pension plans are illegal, unconstitutional or actuarially unsound.

The state funds its public pension plans in full compliance with state law and actuarial standards of practice

As stated at the outset, the state's public pension plans have been funded in full compliance with the requirements of state law and actuarial standards of practice. All contribution rates for the plans have been set based upon the certified annual actuarial valuations of the plans performed by the plans' actuaries and have only taken effect upon approval by the PEBA Board of Directors and the plans' cotrustees at the State Fiscal Accountability Authority (or its predecessor, the State Budget and Control Board). The plans' current actuaries, Gabriel Roeder Smith (GRS), were selected through a competitive bidding process in 2011 by a panel with representatives from each of the five members of the former State Budget and Control Board, and the basic actuarial methodologies used by the actuaries for determining the funding requirements for the plans, including the current amortization method, are the methodologies that were adopted by the Budget and Control Board in November 2011 upon retaining the current actuaries. Many of these methodologies, including the amortization method, were also used by the prior actuaries for the plans, and the actuarial methodologies adopted or reaffirmed in 2011 are the same methodologies that were incorporated in the fiscal projections used by the General Assembly when it enacted the retirement reform legislation in Act 278 of 2012.

Under that reform legislation, prior to June 30, 2015, PEBA only had the authority to approve an increase in the contribution rates for the plans if such an increase was necessary to maintain a funding period for the plans that did not exceed 30 years. Since July 1, 2015, PEBA has been authorized to increase the employer and member contribution rates for the plans beyond the minimum requirements, up to 0.5 percent each year, in order to improve the funded status of the plans. Pursuant to that authorization, PEBA has adopted, and the State Fiscal Accountability Authority has approved, the maximum 0.5 percent increase in employer and member contribution rates for the past two years in an effort to improve the funding of the plans to the full extent of their authorization.

PEBA is working with the Joint Committee on Pension Systems Review to address the funding of the state's public pension plans

Although the state's public pension plans have been funded to the maximum extent authorized under current law, PEBA recognizes, and has testified to such before the General Assembly's Joint Committee on Pension Systems Review, that additional funding for the pension plans will be necessary if the plans are to absorb the magnitude of existing deferred investment losses and continue to make expected progress toward paying off the plans' existing liabilities. PEBA considers securing the necessary funding for the state's public pension plans to be its highest priority, and is actively working with the Joint Committee as it addresses these funding challenges. For more information on the Joint Committee and its review of these funding issues, visit the Committee's website.