SCRS Pension Explainer: Why South Carolina Needs a New Retirement Plan for Future Hires

1. Proposed Pension System Changes Will Only Slow the Growth of Unfunded Liabilities, Pension Debt Will Continue Increasing

❖ The Joint Committee on Pension Systems Review has proposed funding policy changes that would lower the assumed rate of return to 7.25% and possibly eventually down to 7%. This change, along with other adjustments, will mean increasing contributions into SCRS — which is a good policy choice for the defined benefit plan that has failed to fully account for the cost of providing retirement benefits for over a decade. However, <u>the changes are not enough to put the plan on a path to solvency</u>:

- Average actual investment performance for SCRS is well below even 7% returns.
  10-year average: 4.4% | 15-year average: 5%
- PEBA's estimates for the change in contribution rates under pension reform options have consistently assumed that the actual returns until FY2021 will be just 4%.
- Many market forecasts suggest average returns for pension plans similar to SCRS are likely to be around 6% (or less) in the coming decades.

2. Lowering the Assumed Rate of Return to a Realistic Rate Today Would Crowd Out Other Budgetary Goals

❖ A more realistic and reasonable long-term investment return assumption for SCRS would be between 4% and 6%.[1] However, this more accurate accounting recognition of the costs of providing retirement benefits will mean increasing the contributions today, leaving less room in the budget for other public goods and services.

❖ South Carolina can phase in the budgetary costs of improving accounting methods for pension benefits to avoid overwhelming today's budget, but it should be clear that unfunded liabilities would still grow.

3. Creating a New Retirement Plan for Future Hires Would Stop the Digging of an Even Deeper Unfunded Liability Hole

❖ Every new person hired into SCRS means increasing the amount of promised pension benefits that are exposed to the imperfect funding methods and assumptions used by the plan. Thus, the next step for pension reform should be to stop adding employees to the existing plan that isn't properly accounting for the costs of benefits.

❖ If the proposed funding policies are adopted it is likely that unfunded liabilities will grow to around $35 billion by 2040 — less than without changes, but still more than today's $18.6 billion.[2] However, if a new plan is created for future hires that is fully funded from inception, then unfunded liabilities will only grow to about $32 billion by 2040.[3]

Questions about pension reform? Want to see the sources for the numbers quote here?
Check out www.reason.org/SCRS

[1] The 10-year and 15-year historic averages are 4.4% and 5%, respectively. However, RSIC has recently adopted a new investment strategy and re-allocated assets. There is a limit to how much historic average can tell us about future returns. However, most market forecasts are suggesting returns for institutional investors like SCRS and PORS are likely to get at best 6% to 6.5% returns over the next few decades, and likely significantly less in the short-term. PEBA estimates that that actual return produced by RSIC between now and 2021 will be 4%. Collectively, the market forecasts plus recent historic averages suggest South Carolina should expect returns between 4% and 6% in the long-run.

[2] "Likely" scenario modeled here includes adopting the funding policy changes proposed by the Joint Committee and assuming that investment returns continue on their recent historic average of 5%.

[3] "Fully funded" scenario modeled here includes adopting the funding policy changes proposed by the Joint Committee, adopting a defined contribution plan for new hires, and then assuming that investment returns continue on their recent historic average of 5%. Results would have been similar for adopting a defined benefit plan with a 5% assumed rate of return.