



HENRY McMASTER
GOVERNOR

April 25, 2017

The Honorable James H. "Jay" Lucas
South Carolina House of Representatives
State House, Second Floor
Columbia, South Carolina 29201

Dear Mr. Speaker and Members of the House:

I have signed into law H.3726, which addresses South Carolina's \$22 billion unfunded pension liability.

Working together for over two years, members of the General Assembly and the Joint Committee on Pension Systems Review have wisely recognized the need to address the State's unfunded pension liability crisis. However, H. 3726 is just the first step of many which are needed to secure the future fiscal health and sustainability of the pension systems.

Today, active, inactive and retired members of the South Carolina Retirement System (SCRS) and Police Officers Retirement System (PORS) make up 11.5% of the State's population. The state's commitment to them for their retirement must not only be honored but protected into the future.

This unfunded liability in our pension system is the result of a combination of factors created, occurring and neglected for over fifteen years: the twenty-eight year retirement eligibility; the Teacher and Employee Retirement Retention Incentive (TERI) program; continued cost of living adjustments (COLAs); and lower than expected rates of return on investments.

Unfortunately, the only means available today to immediately begin reducing the State's unfunded liability is to increase employee and employer contributions for the SCRS and PORS. These increases are expected to annually produce \$827 million in additional pension funding by 2023.

This will allow a statutorily-set reduction in the assumed rate of return on investments through 2021, and the reduction in the amortization period from thirty to twenty years, both of which are critical to ensuring that the retirement systems are sufficiently funded to address the liability.

Disappointingly, H. 3726 does not address the single most important measure which would ensure the long term financial stability and viability of the State's retirement systems: a date certain transition from the state's defined benefit pension plans to a defined contribution retirement plan for new state employees.

Defined benefit pension plans are now virtually extinct in corporate America. This is because they are unsustainable, expensive and require constant infusions of capital to remain afloat. Recently, fifteen states have transitioned away from defined benefit plans and have adopted defined contribution plans for their employees. Additional states are preparing to do so and we should, too.

A defined contribution plan for South Carolina must be structured in such a way to maintain state government's competitiveness in the job marketplace against private sector jobs which are free to offer more flexibility, compensation or other benefits or advantages. One idea is to provide "enhanced" contributions by state employers as awards for an employee's years of service, promotions, or other merit based criteria. There are many other ideas.

I ask the General Assembly to assess the viability of restricting any defined contribution system we adopt to new state agency employees only. Counties, municipalities and school districts may find more suitable defined contribution plans through the free marketplace and competition.

Finally, I am aware of the disagreements over this bill's structured changes concerning the Retirement System Investment Commission (RSIC) and the Public Employee Benefit Authority (PEBA). I believe the removal of the State Fiscal Accountability Authority (SFAA) and the State Treasurer from oversight and approval roles was unnecessary, therefore, I ask the General Assembly to review the effectiveness of these structural changes in 2021.

Please know that I do not consider H. 3726 the resolution to our State pension system's unfunded liability crisis – only the first step. The steps ahead are much steeper.

Yours very truly,



Henry McMaster