

# INTRODUCTORY SECTION





**A** boatwright is a person who builds boats and ships. As any boatwright knows, you have to have a plan before you begin your work. This plan helps him build the most airtight, buoyant and efficient boat needed to complete the tasks ahead. He begins by first identifying the purpose of this vessel and then goes to work creating blueprints to guide his work.

Just as the boatwright bases his blueprints on the goals and purpose of his ship, the South Carolina Retirement Systems utilizes all of its resources to administer its five defined benefit plans to provide retirement benefits for the state's public school teachers, police officers, fire fighters, judges, solicitors, National Guard, General Assembly members and state workers.

# Introductory Section

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**Nikki R. Haley, Chair**  
Governor  
**Curtis M. Loftis, Jr.**  
State Treasurer  
**Richard Eckstrom**  
Comptroller General

## **SC Budget and Control Board** **South Carolina Retirement Systems**

**1-803-737-6800**      **William M. Blume, Jr., CPA**      **1-800-868-9002**  
Director

**Hugh K. Leatherman, Sr.**  
Chairman,  
Senate Finance Committee  
**W. Brian White**  
Chairman,  
Ways and Means Committee  
**Marcia S. Adams**  
Executive Director

### **LETTER OF TRANSMITTAL**

November 23, 2011

The Honorable Nikki Haley, Governor  
and  
SC Budget and Control Board  
State of South Carolina

Dear Members of the Budget and Control Board:

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the South Carolina Retirement Systems for the fiscal year ended June 30, 2011. The South Carolina Retirement Systems is required by Section 9-1-300 of the South Carolina Code of Laws to publish annually a report of the fiscal transactions of the Systems, and this CAFR fulfills that statutory requirement. Since the Retirement Systems is a part of the primary government of the state of South Carolina, the Systems' financial information is also included in the CAFR of the state. Responsibility for both the accuracy of the data, and the completeness and reliability of the presentation, including all disclosures, rests with the management of the Systems. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of the Systems.

The CAFR was prepared to conform to the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board (GASB). GASB is an organization established under the Financial Accounting Foundation which establishes and improves governmental standards. GASB is recognized as the official source of generally accepted accounting principles (GAAP) for state and local governments.

Transactions of the Systems are reported on the accrual basis of accounting. Sufficient internal accounting controls exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements and supporting schedules; however, the cost of internal control should not exceed anticipated benefits. The financial statements presented in this CAFR have been independently audited by Clifton Gunderson, LLP, under the direction of the State Auditor's Office. Clifton Gunderson issued an unqualified opinion, which means that based upon the audit, they concluded that the financial statements were fairly presented in all material respects and are free from material misstatement, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Governmental Auditing Standards, as part of obtaining reasonable assurance about whether the Systems' financial statements are free of material misstatement, Clifton Gunderson also considered internal

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controls over financial reporting and compliance with certain provisions of laws, regulations, contracts, and other matters. Although independent auditors cannot guarantee the accuracy of the statements, they do have a reasonable basis for the opinion they render. The independent auditor's report is presented as the first component of the financial section of this report. Management's Discussion and Analysis (MD&A), which can also be found in the financial section starting on Page 27, provides a narrative introduction to and analysis of the financial statements. This letter of transmittal is meant to complement the MD&A and should be read in conjunction with it.

### Profile of the Systems

The South Carolina Retirement Systems administers five defined benefit pension plans. A defined benefit plan is a retirement plan in which contributions are made to fund a level of retirement income at a future retirement date. Specified monthly service retirement benefits, as well as disability benefits and death benefits are provided to eligible members and/or their surviving beneficiaries. The plans' terms specify the amount of pension benefits to be provided at a future date or after a certain period of time. The benefit amount specified is a function of a formula based on years of service, compensation, and age. Our administrative and reporting structure is outlined in the introductory section of this report.

This report contains information on the following defined benefit pension trust funds:

- The South Carolina Retirement System (SCRS) was established July 1, 1945, to provide retirement and other benefits for teachers and employees of the state and its political subdivisions. SCRS covers employees of state agencies, public school districts, higher education institutions, and other participating local subdivisions of government.
- The Police Officers Retirement System (PORS) was established July 1, 1962, to provide retirement and other benefits to police officers and firefighters. PORS also covers peace officers, coroners, probate judges and magistrates.
- The Retirement System for Members of the General Assembly of the State of South Carolina (GARS) was established January 1, 1966, to provide retirement and other benefits to members of the General Assembly.
- The Retirement System for Judges and Solicitors of the State of South Carolina (JSRS) was established July 1, 1979, to provide retirement and other benefits to state judges and solicitors. JSRS also covers circuit public defenders.
- The National Guard Retirement System (NGRS) was established July 1, 1975, to provide supplemental retirement benefits to members who served in the South Carolina National Guard.

### Fiscal Year 2011 Highlights

No legislative changes were enacted during fiscal year 2011; however, the South Carolina Retirement Systems continue to experience many of the same challenges and opportunities that other public pension plans encounter. One of the most basic challenges facing defined benefit plans relates to establishing adequate funding mechanisms to ensure long-term sustainability of providing benefits under the plan, while also providing stakeholders with customer service at a best practices level coupled with reduced administrative costs.

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### Administrative Activities

In fiscal year 2011, the Retirement Systems conducted an online customer satisfaction survey which allowed the division to gauge satisfaction with our service among all of our stakeholder groups. In addition to covered employers and retired members, both with satisfaction ratings exceeding 96 percent, satisfaction ratings were obtained from active employees and other members. Other members include retirees, beneficiaries, inactive members, and those survey participants who chose not to identify their category. Ratings for active employees and other members were more than 95 percent and 98 percent, respectively.

Retirement Systems' staff continued efforts to improve efficiencies and implement process improvements in all operational areas while limiting expenditures. During fiscal year 2011, administrative functions were consolidated by creating a Defined Contributions unit that is responsible for management oversight of both the South Carolina Deferred Compensation Program (SCDCP) and the State Optional Retirement Plan (State ORP). This achieved staffing efficiencies by cross-training staff members to perform duties for both programs. Changes were also made to the division's organizational structure in efforts to improve operational efficiencies.

### Public Policy Activities

Prompted by the recent recession and compounded by other economic and demographic factors, public pension funds across the country are financially stressed. Many have experienced growth in their plans' unfunded liabilities, and public policymakers are faced with challenges of devising well-reasoned actions to restore the retirement plans' funding and providing adequate retirement benefits in cost efficient and equitable manners.

In February 2011, the S.C. Senate Retirement and Employee Benefits Subcommittee was established to review the five defined benefit plans administered by the Retirement Systems. Committee members were charged with developing long term solutions that would achieve financial sustainability for the plans while being fair to all stakeholders. A subsequent S.C. House Retirement Ad Hoc Study Committee was also established to perform similar reviews and offer solutions.

### Operational System Improvements

During fiscal year 2011, significant improvements were implemented in the Retirement Systems' web-based Electronic Employer Services (EES) system which included expanding features and functionality for receiving and updating employer provided data. We also began front-end imaging of incoming enrollment documents to improve the workflow processing and eliminate duplicate handling of paper forms.

## Summary of Financial Condition

### Actuarial Results

A funding objective of the pension trust funds is to meet future benefit obligations of retirees and beneficiaries through employee and employer contributions and investment earnings. Each year, the external consulting actuaries determine the actuarial soundness of the plans based on long term obligations and the sufficiency of current contribution levels to fund the liabilities of each plan over a reasonable time frame. The most recent valuations dated July 1, 2010, concluded that all systems are operating on an actuarially sound basis. All five systems are considered to be adequately funded within the Governmental Accounting Standards Board's (GASB'S) standards and the SC Budget and Control Board's policy that requires actuarial liabilities be funded over a period not to exceed 30 years.

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The current funded ratios of the five plans range from a low of 35.9 percent for NGRS to a high of 74.5 percent for PORS. The funded ratio for SCRS, which represents the largest membership of the five plans, decreased slightly from 67.8 percent to 65.5 percent. The unfunded actuarial liability for SCRS increased from \$11.97 billion to \$13.4 billion. Accordingly, the period for amortizing SCRS' unfunded actuarial accrued liability grew; however, in order to satisfy the 30 year amortization period requirement, the increase was offset through the Budget and Control Board's approval of an employer contribution increase of 0.92 percent effective July 1, 2012. The unfunded actuarial liability for PORS increased from \$1.08 billion to \$1.24 billion. Similarly, an employer contribution increase of .305 percent was approved for PORS effective July 1, 2012. The NGRS has a very low funded ratio because at one time, the plan was not funded on an actuarial sound basis. In 2006, the General Assembly made a commitment to ensure the NGRS plan would be sufficiently funded prospectively and transferred administrative responsibility from the Adjutant General's Office to the South Carolina Retirement Systems. Now recurring funds are set aside each year in the state's annual budget to fund NGRS over an amortization period that does not exceed 30 years, so continued future improvement in the funded ratio is expected.

Because the fiscal year 2010 actuarial valuation highlighted substantial funding requirements for the plans' future sustainability, the Systems' governing board, the SC Budget and Control Board, requested a second opinion. A second actuarial firm was engaged and a parallel valuation was completed with the purpose of obtaining an independent assessment of the plans' assumptions and actuarial soundness, along with other analyses and tools to support the legislative efforts to improve funding and ensure future retirement security. Due to the Board's funding policy, considerable effort was made to match the calculated amortization period based on current contribution rates as well as the contribution necessary to attain a 30 year amortization period. The parallel valuation confirmed the previously calculated actuarial accrued liabilities.

Although the plans experienced an actuarial gain on plan assets for the 2010 fiscal year, which resulted from actual investment returns being greater than the assumed rate of investment return, only a portion of investment gains and losses are recognized each year because actuarial smoothing techniques are utilized to mitigate volatility. Under the smoothing techniques used, the Systems recognized a net actuarial loss on investment returns for the valuation year. Under SCRS, the smoothing methodology resulted in a net amount of \$5.7 billion in excess investment losses being deferred as of the July 1, 2010 valuation. Other non-investment related experience activity such as mortality, salary experience, payroll growth and turnover, which are considered normal within the course of plan experience, contributed to other actuarial gains and losses, as actual experience cannot be precisely predicted and will never exactly match the estimated assumptions. In accordance with Act 311 of the South Carolina Code of Laws and the actuary assumptions that were in effect at that time, up to a 2 percent automatic annual Cost of Living Allowance (COLA) was provided to eligible SCRS and PORS annuitants when certain conditions were satisfied. The Consumer Price Index for Wage Earners and Clerical Workers (CPI-W) for the calendar year ended December 31, 2009, increased from the prior year, resulting in a 2 percent COLA for annuitant payees effective July 1, 2010.

For additional financial information, refer to management's discussion and analysis, financial statements and schedules included in the financial section and the actuarial section of this report.

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### Investment Performance

The South Carolina Retirement System Investment Commission (RSIC) faced another challenging year of investing and managing the assets of the retirement trust funds. Uncertainties such as government intervention by the Federal Reserve to stimulate the economy due to fears of a “double dip” recession, the focus of Congress on the U.S. debt ceiling, and concern over the health of the European financial system and potential for a default of their sovereign debt contributed to the RSIC’s challenges.

As of June 30, 2011, the Retirement Systems’ total assets in the investment portfolio were valued at \$26.2 billion, an increase over the \$22.9 billion of assets one year prior. In addition to this portfolio growth, from a cash flow perspective, a net amount of \$897 million, in excess of incoming contributions, was paid out of the plan for retiree benefit obligations. The portfolio’s overall investment performance for the fiscal year ending June 30, 2011, was 18.59 percent. This performance significantly exceeded its benchmarks as well as the 8 percent actuarial assumed rate of investment return.

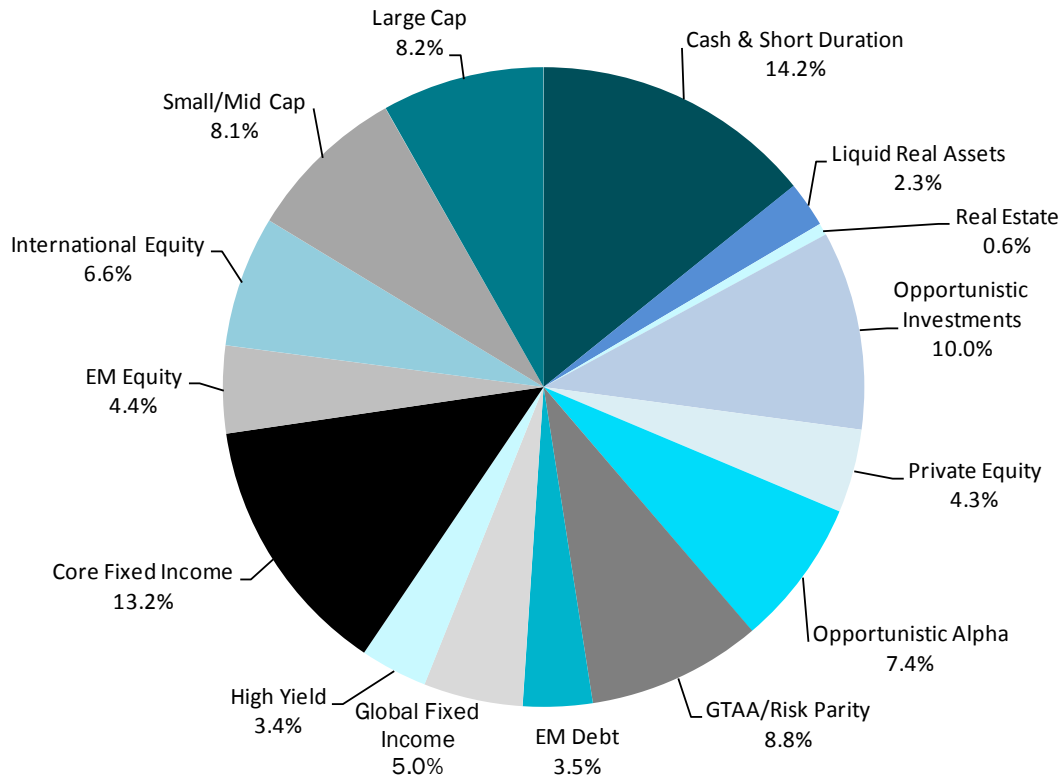
The plan assets are invested by the Commission in a manner consistent with a long-term investment time horizon. While the financial markets continue to experience significant volatility, the assets of the Retirement Systems are invested in a broadly diversified manner in an effort to mitigate risk. Although member benefits accrued and payable under the Retirement Systems’ defined benefit plans are not dependent on individual member account balances, investment returns are a critical overall funding component.

An optimally diversified investment portfolio is designed to generate long-term returns sufficient to ensure the program’s financial stability. While the Systems’ investment performance was historically limited by state constitution and state statute, the Commission has implemented a diversified asset allocation policy including a wide variety of alternative investments. With the help of the retained investment consultant (NEPC), the RSIC manages investments across a progressive asset allocation designed to generate attractive long-term risk-adjusted returns.

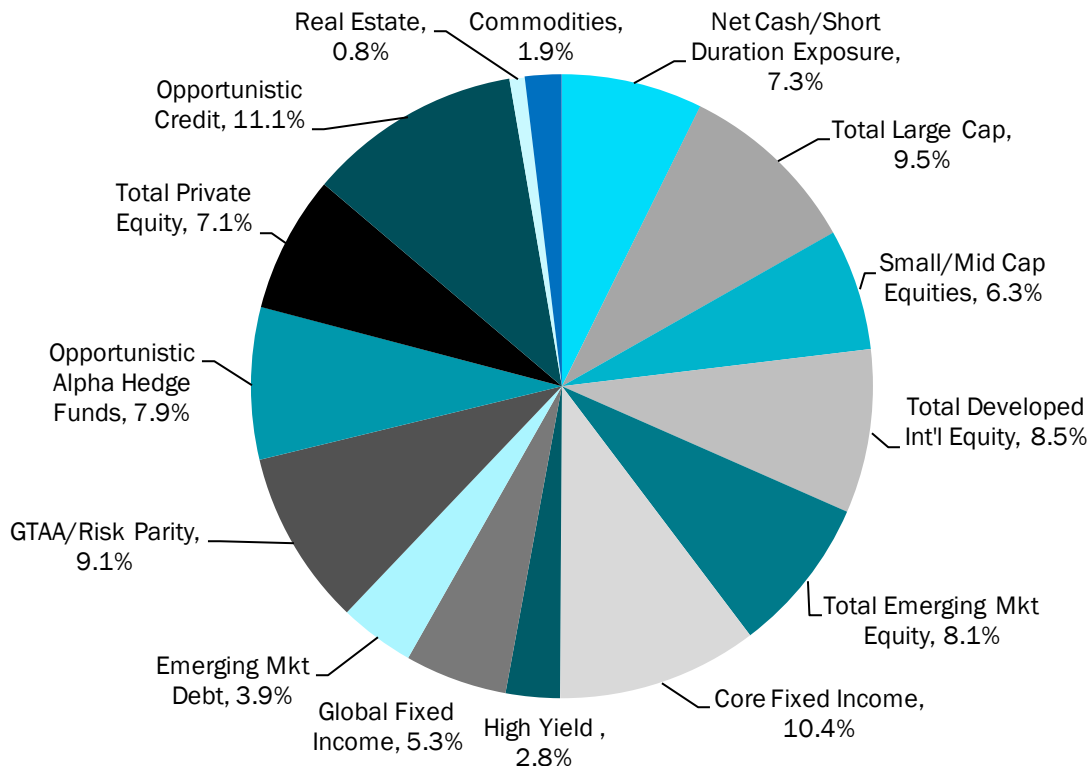
The following charts summarize the diversification progress of the Retirement Systems’ trust funds from the prior fiscal year and the target allocation in effect as of fiscal year ended June 30, 2011.

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## Actual Asset Allocation as of June 30, 2010

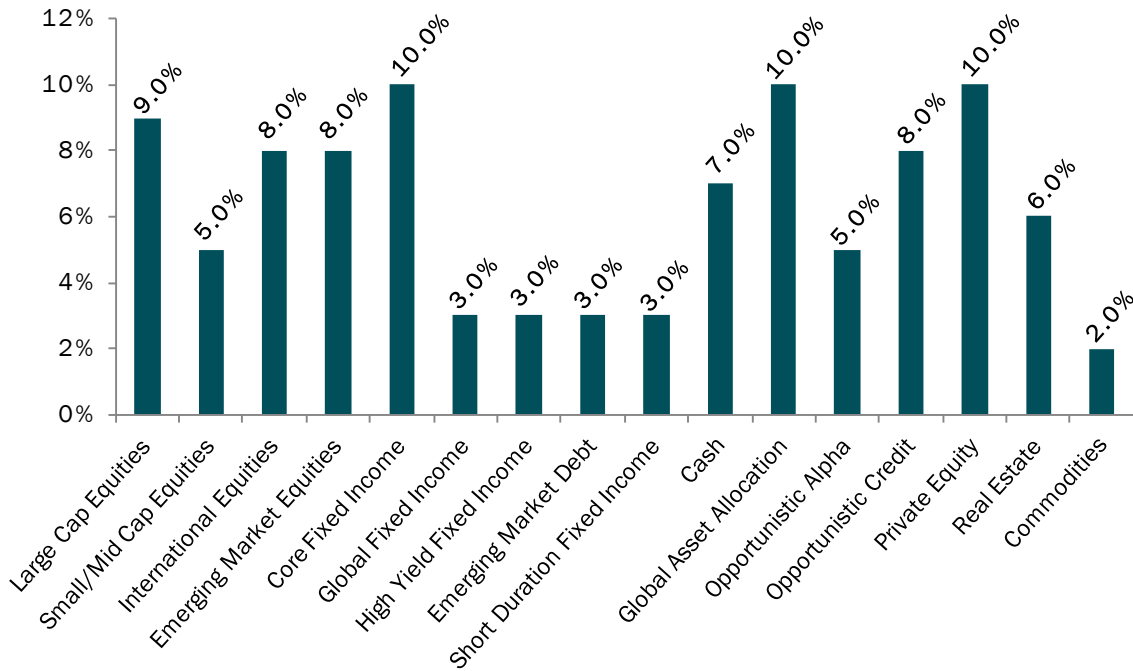


## Actual Asset Allocation as of June 30, 2011



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### Target Asset Allocation



**Note: Target Asset Allocation in effect at fiscal year end 2011 and adopted by Commission on November 18, 2010.**

Investment performance, in comparison to the actuarial assumed rate of investment return, is one of the most significant factors in the actuarial valuations. As previously mentioned, the actuarial asset valuation method utilized dampens year-to-year fluctuations, smoothes the effect of volatility in the market and helps provide a consistent estimate for the actuarial value of assets. Detailed investment results for fiscal year 2011 can be found within both the financial and investment sections of this report.

### Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the South Carolina Retirement Systems for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2010. This was the 24th consecutive year that the Retirement Systems has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

## Introductory Section

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### Public Pension Standards Award

The South Carolina Retirement Systems received the Public Pension Coordinating Council's Public Pension Standards Award in 2011 for the eighth consecutive year in recognition of meeting professional plan design and administration standards. The Public Pension Coordinating Council is a confederation of the National Association of State Retirement Administrators, the National Conference on Public Employee Retirement Systems, and the National Council on Teacher Retirement.

### Acknowledgments

The compilation of this report reflects the combined efforts of the staff of the South Carolina Retirement Systems functioning under your leadership. The report is intended to provide comprehensive and reliable information about the Retirement Systems, to demonstrate compliance with legal provisions, and to allow for the evaluation of responsible stewardship of the trust funds of the Retirement Systems.

We express our gratitude to the members of the Board, the General Assembly, the RSIC, the staff, the consultants, and the many people who have worked so diligently to assure the continued successful operation of the Retirement Systems for the members we serve.

Respectfully submitted,



William M. Blume, Jr., CPA  
Director



Tammy B. Nichols, CPA  
Deputy Director of Operations



Certificate of  
Achievement  
for Excellence  
in Financial  
Reporting

Presented to

South Carolina Retirement  
Systems

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2010

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



*Linda C. Danison*

President

*Jeffrey R. Emer*

Executive Director



Public Pension Coordinating Council

***Public Pension Standards Award  
For Funding and Administration  
2011***

Presented to

***South Carolina Retirement Systems***

In recognition of meeting professional standards for  
plan funding and administration as  
set forth in the Public Pension Standards.

*Presented by the Public Pension Coordinating Council, a confederation of*

National Association of State Retirement Administrators (NASRA)  
National Conference on Public Employee Retirement Systems (NCPERS)  
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script that reads "Alan H. Winkle".

Alan H. Winkle  
Program Administrator

## Introductory Section

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### Governing Board and Administration

#### Governing Board - SC State Budget and Control Board

|                         |  |
|-------------------------|--|
| Nikki R. Haley, Chair   | Governor                                 |
| Curtis M. Loftis, Jr.   | State Treasurer                          |
| Richard Eckstrom        | Comptroller General                      |
| Hugh K. Leatherman, Sr. | Chairman, Senate Finance Committee       |
| W. Brian White          | Chairman, House Ways and Means Committee |
| Marcia S. Adams         | Executive Director                       |

#### Retirement System Investment Commission<sup>1</sup>

|                         |  |
|-------------------------|--|
| Allen R. Gillespie, CFA | Chairman   |
| Reynolds Williams       | Vice Chairman, Chairman Emeritus                   |
| Edward N. Giobbe        |  |
| James R. Powers         |  |
| Curtis M. Loftis, Jr.   | State Treasurer                                    |
| Travis Pritchett        |  |
| Robert L. Borden, CFA   | Chief Executive Officer & Chief Investment Officer |

#### Investment Consultant

New England Pension Consultants

#### Consulting Actuaries

Cavanaugh Macdonald Consulting, LLC

#### Retirement Systems Executive Management

|                            |   |
|----------------------------|---|
| William M. Blume, Jr., CPA | Director                                    |
| Dianne Poston              | Chief of Staff                              |
| Tammy B. Nichols, CPA      | Deputy Director of Operations               |
| Travis Turner, CPA         | Deputy Director of Operations               |
| Sharon Graham, CPA         | Assistant Director – Customer Claims        |
| Lisa Phipps                | Assistant Director – Information Technology |
| Jamella Williams           | Assistant Director – Customer Services      |
| David Avant                | General Counsel – Retirement Systems        |
| Gwen Bynoe                 | Governmental Affairs                        |
| Megan B. Lightle           | Manager, Communication                      |
| John E. Page, CIA, CISA    | Internal Audit Manager                      |

#### Retirement Systems Staff Responsible for Compilation of CAFR

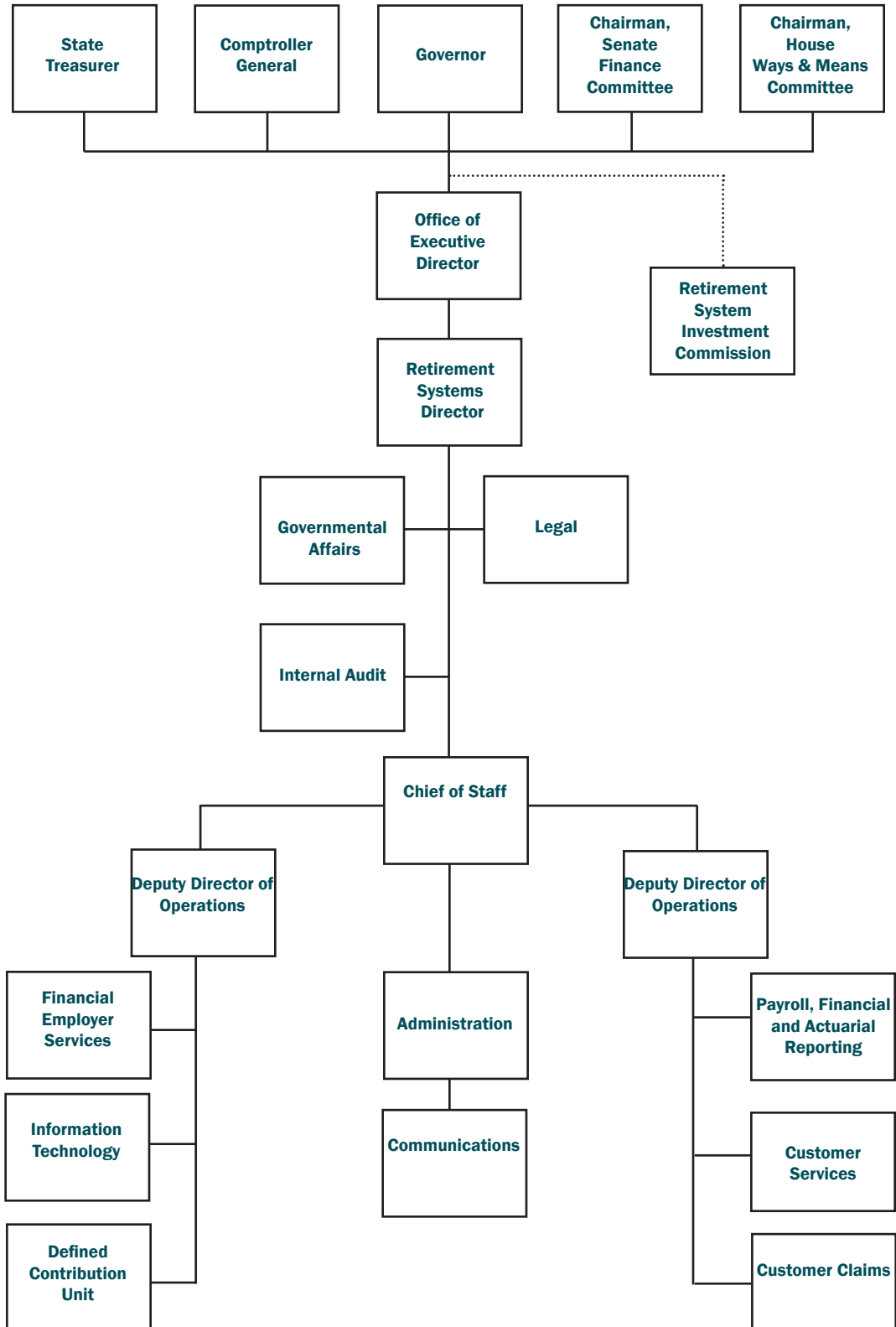
|                              |  |
|------------------------------|--|
| Tammy B. Nichols, CPA        | Deputy Director of Operations              |
| Danielle M. Quattlebaum, CPA | Payroll, Financial and Actuarial Reporting |
| Faith Wright                 | Payroll, Financial and Actuarial Reporting |
| Angie Warren                 | Public Information Coordinator             |
| Megan Bagwell                | Public Information Coordinator             |

<sup>1</sup>Refer to pages 84-87 for a complete list of investment managers.

# Introductory Section

## Organizational Chart

### South Carolina Budget and Control Board



## Introductory Section

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### Organizational Description

The structural organization of the Systems is depicted in the organizational chart on Page 20. A brief description of the primary functions performed by each department follows:

#### Administration

Responsible for managerial, budgetary, and administrative oversight of all division operations; physical plant issues, operations, and maintenance; procurement; human resources activities; communications and public information; accounts payable; postal center operations; and courier services.

#### Payroll, Financial and Actuarial Reporting

Functioning as chief financial office for the Retirement Systems, responsibilities encompass maintaining comprehensive financial accounting systems, including actuary, investments and disbursements of benefit payments, for the five statutorily defined benefit retirement plans. This department is responsible for preparation of the *Comprehensive Annual Financial Report* and *Popular Annual Financial Report* as well as staffing accounting roles for disbursing funds and reporting of financial data; tax reporting; managing daily financial operations; establishing financial policies and procedures; and communication related to actuarial valuations, legal issues and fiscal impact of proposed legislative changes. Benefit payments are disbursed in the form of monthly annuities, TERI distributions, refunds to terminated members, and death payments to beneficiaries.

#### Customer Claims

Responsible for the processing of customer claims relating to annuities, refunds, or death claims; the computation of the cost for purchases of prior service for all members of the Retirement Systems; and the auditing of service credit for our membership.

#### Information Technology

Responsible for the design, implementation and control of all automated applications within the Systems; and the maintenance of complete historical records of each member via digital imaging.

#### Financial Employer Services

Responsible for determining the average final compensation to be used in calculating a member's annuity benefit at retirement; collecting and allocating member and employer contributions; maintaining membership enrollment and beneficiary information; and the State Optional Retirement Program.

#### Customer Services

Responsible for member consultations (in person, by telephone, or on-line via the Internet) in all phases of retirement operations. Also responsible for training employers in all aspects of the Retirement Systems' member benefits, reporting procedures, and the Internet-accessed employer information system; meeting with employees as requested to present benefit overviews and pre-retirement education programs; and coordinating and conducting retirement seminars designed to better prepare members whose retirement is imminent.

#### Defined Contribution Unit

Responsible for the general oversight of the administration of the State Optional Retirement Program and the South Carolina Deferred Compensation Program.

#### Legal

Responsible for representing the South Carolina Retirement Systems in matters before circuit and appellate courts and administrative bodies, and for providing program support to the management of the South Carolina Retirement Systems.

#### Internal Audit

Responsible for providing an independent appraisal function to examine and evaluate processes and policies, and for providing assurance to management regarding the internal control structure of the division.