

Annual Actuarial Valuation of the South Carolina Tuition Prepayment Program Fund

June 30, 2015

Prepared by
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September 14, 2015

The Honorable Curtis M. Loftis, Jr.
Treasurer, State of South Carolina
118 Wade Hampton Building
Columbia, SC 29201

Dear Treasurer Loftis:

We have completed our actuarial analysis of the Fund ("the Fund") for the South Carolina Tuition Prepayment Program ("SCTPP" or "the Program") as of June 30, 2015. This report presents our findings with respect to the Fund's expected cash flows and the surplus/deficit position of the Fund. The analyses have been prepared in accordance with generally accepted actuarial principles and practices commonly applicable to similar types of arrangements.

Currently the expected value of liabilities is \$150,351,666 and the value of assets is \$94,441,663, for a difference of \$55,910,003. The funded ratio is 62.8% of liabilities. For comparison purposes, in 2014 the deficit was \$57,379,163 and the funded ratio was 65.4%. You should note that **the Fund is projected to run out of assets in the Fiscal Year beginning on July 1, 2019** unless remedial actions are taken.

SCTPP was created by the 1997 South Carolina General Assembly, and enrollment into the Program began in 1998. Since, 2001 the Fund has been operating with an actuarial deficit.

In making our projections, we have included the effects of the statutory limitation on benefits to Program participants to a maximum of seven percent annual increase. You should also note that we have not assumed any further sales of prepaid tuition contracts.

The results above are based on assumptions approved by SCTPP personnel after consultation with us.

We appreciate the opportunity to serve the State of South Carolina. Any questions about the report should be directed to me at (770) 752-5656.

Very truly yours,

A handwritten signature in black ink, appearing to read "John Condo". The signature is fluid and cursive, with the first name "John" and last name "Condo" clearly distinguishable.

John T. Condo, FSA, MAAA, Ph.D.
Vice President
Actuarial Resources Corporation

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I. EXECUTIVE SUMMARY

The following are the key findings of our analysis.

Adequacy of the Fund

The Fund's liabilities exceed its assets by \$55,910,003. The key results are shown below.

Value as of June 30, 2015	Assets and Liabilities
Assets	
Investments	\$91,668,006
Future Contract Payments	<u>2,773,657</u>
Total Assets	<u>\$94,441,663</u>
Liabilities and Surplus	
Future Contract Benefits	\$150,282,732
Other Liabilities	<u>68,934</u>
Total Liabilities	<u>\$150,351,666</u>
Surplus	<u>(\$55,910,003)</u>
Total Liabilities and Surplus	<u>\$94,441,663</u>
Funded Ratio	62.8%

Note: The above assets and liabilities are based on unaudited financial information. Audited balances are contained in the Fund's Annual Report.

From Last Year to This Year

The table below summarizes the change in the deficit from June 30, 2014 to June 30, 2015.

Progression of Surplus/(Deficit)	
Surplus at June 30, 2014	(\$ 57,379,163)
Projected Change to June 30, 2015	(1,658,800)
Loss From Unfavorable Investment Experience	(1,359,683)
Gain Due to Favorable Tuition Inflation	5,358,662
Loss Due to Change in Inv. Return Assumption	(1,095,651)
All Other Experience Items	224,632
Surplus at June 30, 2015	(\$ 55,910,003)

Implications of the Deficit

SCTPP was created by the 1997 South Carolina General Assembly, and enrollment into the Program began in 1998. Since, 2001 the Fund has been operating with an actuarial deficit. SCTPP has not accepted new entrants into the program since 2006. The South Carolina General Assembly indefinitely closed the Program to new enrollment in 2008 due to the Fund’s actuarial deficit.

The existing deficit is an indicator that existing assets combined with future cash flows are insufficient to pay all contract owners their benefits. We project that assets will be depleted in the Fiscal Year beginning on July 1, 2019. Unless remedial action is taken, the Program will be unable to pay benefits.

Remedial actions may include, but are not limited to the following:

1. Shut down the Program. This will require the refund of unused contributions accumulated at 4%. As of June 30, 2015 this liability was \$92.6 million. If the Program is shut down at June 30, 2016, we project that the liability will be \$91.4 million. We project assets to be \$69.7 million, so that we are projecting that the State would need to refund \$21.7 million from the General Fund.
2. Shut down the Program on February 28, 2020 when the Program is projected to run out of assets. This would require the refund of unused contributions accumulated at

4%, which we project to be \$29.2 million. This would require that the entire amount be paid from the General Fund.

3. Provide additional appropriations annually beginning at the time of asset depletion to pay the contractual benefit. The estimated total cost to pay these benefits is \$7.5 million annually beginning in February, 2020 (immediately before asset depletion) continuing until all benefits are projected to be paid. Total additional appropriations would be \$67,500,000.
4. Scenario 3, immediately above, allows for assets to be depleted at interim dates since cash out-flows are greater than \$7.5 million dollars in the early years. A similar scenario that provides non-level appropriations such that assets are projected never to be depleted is shown immediately below. The total appropriations for this scenario are \$64,030,000.
 - February 2020: \$20.33 million
 - February 2021: \$13.23 million
 - February 2022: \$10.78 million
 - February 2023: \$ 8.80 million
 - February 2024: \$ 6.34 million
 - February 2025: \$ 3.27 million
 - February 2026: \$ 1.22 million
 - February 2027 \$ 0.03 million
 - February 2028 \$ 0.03 million
5. Provide an additional appropriation now to offset the deficit. We are projecting that a lump-sum appropriation of \$56.4 million in December, 2015 would offset the deficit, if all actuarial assumptions are realized.
6. Provide an additional appropriation at the time of asset depletion to offset the deficit. We are projecting that a lump-sum appropriation of \$61.7 million in February, 2020 would offset the deficit if all actuarial assumptions are realized.
7. Provide a series of annual appropriations until asset depletion. We project that annual appropriations of \$11.71 million beginning September, 2015 and ending September 2019 would offset the deficit if all actuarial assumptions are realized. This is a total appropriation of \$58,550,000.
8. Provide a series of annual appropriations until all liabilities are mature in February 2029. (As in Scenario 3, assets may be depleted at interim dates.) We project that these amounts would be:
 - \$4.62 million, if begun at December, 2015 for a total of \$64,680,000;
 - \$5.04 million, if begun at December 2016 for a total of \$65,520,000;
 - \$5.52 million, if begun at December 2017 for a total of \$66,240,000

Investment Strategy

During this fiscal year, the investment strategy of SCTPP migrated to 100% duration matched fixed income assets. The State Treasurer's Office, with the assistance of the Program advisors, has adopted this strategy to better match the fund's assets and liabilities in order to manage the Fund's long-standing actuarial deficit in an effort to preserve existing assets. The portfolio was revised in part to lower risk by eliminating

equity holdings and investing in high quality fixed income assets which provide cash flows which better match liability payments. The strategy is based on the recommendation of Columbia Management Investment Advisers, LLC which assumed investment management of the Fund assets on October 2012 and the approval of Pension Consulting Alliance.

Actuarial Resources Corporation of Georgia has not reviewed the strategy nor are we expressing an opinion on the strategy.

Key economic assumptions are listed below. The assumption for future investment returns is based on the recommendation of Columbia Management Investment Advisers, LLC and Pension Consulting Alliance after considering the likely returns of the SCTPP Portfolio and reviewing with the Actuarial Resources Corporation of Georgia and the State Treasurer’s Office.

Key Assumptions	
Return on Investments (net of expenses)	
All future years	2.20%
Asset Allocation	
Fixed Income	100.00%
Tuition Inflation	
For those attending SC public universities	7.0%
All others	8.0%
Bias Load	
All years	3.0%

II. RELIANCES & ACTUARIAL STANDARDS

In making the projections on which this report is based, we relied on the following information supplied to us as indicated below.

- Tuition and fee amounts at South Carolina public institutions of post-secondary education, supplied by the Office of the State Treasurer;
- Headcount at South Carolina public institutions of post-secondary education, supplied by the Office of the State Treasurer;
- Market value of assets of the Program's trust fund, supplied by the Office of the State Treasurer;
- Inventory of Program contracts, supplied by InTuition Solutions, Inc., the Program's records administrator; and
- Assumptions regarding future investment returns on the Program's trust fund, supplied by the Office of the State Treasurer and Columbia Management Investment Advisers, LLC.

There are no actuarial standards of practice that apply specifically to prepaid tuition plans. However, there are two general standards that we believe apply:

- Actuarial Standard of Practice #23 "Data Quality". This standard sets guidelines on review of data supplied by a third party. We have performed reasonableness and consistency checks on the data supplied to us by personnel of the Program and by the records administrator, and are in compliance with this standard. Our review of the data was not an audit of the data.
- Actuarial Standard of Practice #41 "Actuarial Communications". This standard sets general guidelines for actuarial communications. This report is in compliance with this standard.

III. DESCRIPTION OF THE PROGRAM

The Program was created in 1997 by the South Carolina Legislature to "...assist the citizens of South Carolina with the expense of college by providing an advanced payment program for tuition at a fixed and guaranteed level for public colleges and universities." The Office of the South Carolina State Treasurer administers the Program.

Since, 2001 the Fund has been operating with an actuarial deficit. SCTPP has not accepted new entrants since 2006. The South Carolina General Assembly indefinitely closed the Program to new enrollment in 2008 due to the Fund's actuarial deficit.

The Program is summarized below. This summary is provided for explanation purposes only, and the Program will be governed by the provisions of the enabling legislation and State Treasurer's Office procedures. The General Assembly passed the legislation below which was effective July 1, 2008.

S.75 (Rat #0296, Act #0246 of 2008)

Section 59-4-110

(A) Notwithstanding another provision of law, the South Carolina Tuition Prepayment Program may not accept new participants until the General Assembly authorizes the program to accept new participants by joint resolution.

(B) This section does not affect the existing participants in the program, and the South Carolina Tuition Prepayment Program remains in full operation for this purpose.

Section 59-4-120

Types of Contracts

Existing contracts are comprised of two types. Both types provide for tuition and mandatory fees imposed by public higher education institutions in the State of South Carolina.

The four-year college/university contract provides for up to eight semesters of tuition and fees at any accredited senior higher education institution. The benefits provided for under this contract may also be used to provide for junior college tuition and fees or a combination of junior and senior college tuition and fees.

The two-year college/university contract provides for up to four semesters of tuition and fees at any accredited senior higher education institution. The benefits provided

for under this contract may also be used to provide for junior college tuition and fees or a combination of junior and senior college tuition and fees.

Types of Contract Payment Options

There are three payment options for existing contracts:

- Lump-sum payments;
- 48 monthly installment payments; and
- Extended payments, which are monthly installment payments that run until the year of anticipated matriculation of the beneficiary.

Refunds

If the beneficiary dies or becomes disabled, monies paid for the purchase of a tuition prepayment contract shall be returned to the contributor in lump sum to include the lesser of the total of contract contributions plus the compounded rate of return earned by the Fund or the current Weighted Average. Applicable interest is determined by the State Treasurer's Office on a year-to-year basis.

If the beneficiary is awarded a scholarship, monies paid for the purchase of a tuition prepayment contract shall be returned on a pro-rata basis to the contributor in semester installments coinciding with the matriculation by the beneficiary in amounts equal to the lesser of the original purchase price plus the compounded rate or return earned by the Fund or the current Weighted Average Tuition.

Rollovers to the South Carolina Future Scholar 529 College Savings Plan receive a refund equal to contract payments accumulated at 2% interest per year.

Voluntary terminations receive a refund equal to contract payments accumulated at 2% interest per year, less a deduction of the lesser of \$150 or 50% of the sum of all payments, not including administrative fees, minus any amounts paid as benefits by the Fund.

Involuntary terminations receive a refund equal to contract payments accumulated at 2% interest per year, less a deduction of the lesser of \$150 or 50% of the sum of all payments, not including administrative fees, minus any amounts paid as benefits by the Fund.

Change of Beneficiary

Generally, a contract owner can change the beneficiary at any time provided that the new beneficiary is the same age or younger than the original beneficiary, and is a member of the current beneficiary's immediate family.

Age Limit on Benefits

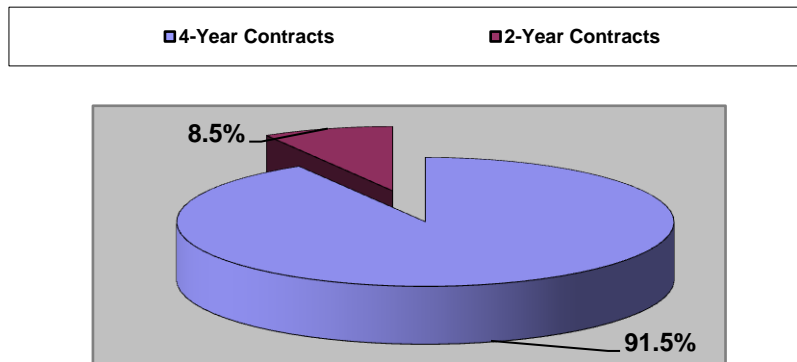
Benefits are available until the beneficiary is age 30. This limit may be extended to age 34 if the beneficiary has military service.

IV. SUMMARY OF CONTRACT DATA AND CURRENT ASSETS

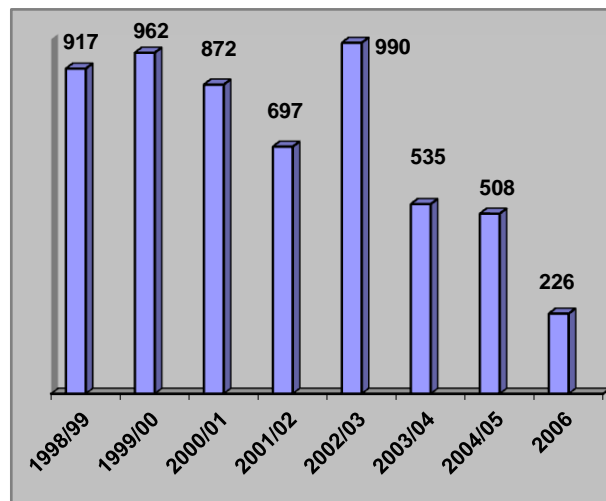
Contract Data

Data on the number of outstanding contracts and contributions were provided by InTuition, Inc., the Program’s records administrator. The graphs below summarize the data provided concerning these contracts.

Distribution of Contracts by Contract Type

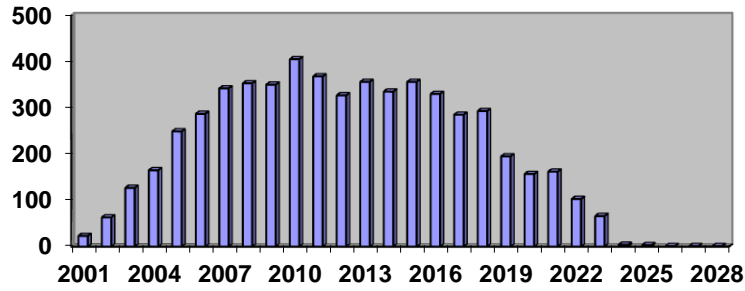


Distribution of Contracts by Enrollment Year

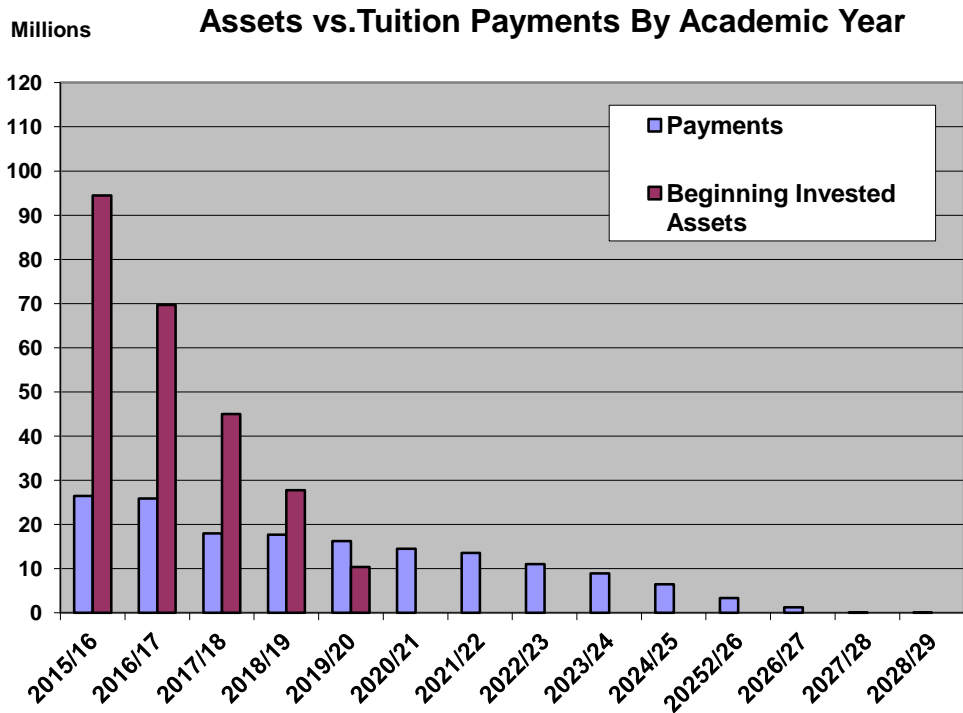


Note: The Program has not accepted new entrants since 2006. In 2008, the General Assembly closed the program to new entrants indefinitely as a result of the actuarial deficit.

Number of Contracts By Year of Matriculation



The benefit payments for tuition generated by these contracts are shown in the chart and table immediately following.



Assets vs. Tuition Payments By Academic Year		
Amounts in \$ millions		
Year	Assets	Payments
2015/16	94.4	25.9
2016/17	69.7	25.5
2017/18	45.0	17.6
2018/19	27.7	17.4
2019/20	10.4	16.1
2020/21		14.4
2021/22		13.5
2022/23		11.0
2023/24		8.9
2024/25		6.5
2025/26		3.3
2026/27		1.2

Current Assets

As of June 30, 2015 the Program's assets were deployed 100% in duration matched fixed income assets.

Fund Investments

The market value of Program assets is shown in the table below.

Market value of assets held as of June 30, 2015		
	<u>Amount</u>	<u>% Of Total</u>
Fixed Income	91,668,006	100.00%

V. ACTUARIAL METHODS AND ASSUMPTIONS

Methods

The actuarial method for the determination of the adequacy of the Fund consists of projecting future tuition rates based on the average anticipated number of contracts and future utilization of contracts. Future benefits are discounted using the assumed investment yield as the interest discount rate. The assumed discount rate is based on the current and anticipated mix of assets of the Fund.

For the projection of future benefits, the analysis proceeds as follows:

- Project future tuition rates for all years under consideration. Future tuition is based on the assumptions for tuition inflation.
- Determine the nominal cost of future benefit payments.
- Determine the nominal value of future contract payments.
- Determine the present value of future contract benefits, future expenses and future revenue based on the investment yield assumptions.
- Perform projections for all of the Program's beneficiaries to determine if the Fund is adequate in the aggregate.
- In making our projections of the surplus, we assume that the Program will not sell any more contracts. This is a conservative limitation that provides a static “snapshot view” of the Program as of June 30, 2015.

Assumptions

Actuarial assumptions used to determine financial soundness of programs are of two general types: economic and demographic. Demographic assumptions determine the expected exposure to financial claims and generally answer the question "How and when will people use their contractual benefits?" Economic assumptions are concerned with the expected level of benefit usage and answer the question "What is the expected value of benefit usage?" The assumptions that we used were those that were approved by the South Carolina Treasurer's Office, after consultation with us.

Economic Assumptions

Economic assumptions are used to estimate the annual tuition rates at two- and four-year colleges, increases in Fund expenses, and Fund earnings on assets invested. Because inflation is a major component of the rate of increase in tuition rates and of investment returns, we considered these rates together. We believe that the difference in these rates is more important than the absolute level of the rates. The following paragraphs describe the economic assumptions used in this study.

Income Tax

We assumed that Fund earnings are exempt from Federal and State Income Tax.

Annual Tuition Rates and Bias Load

Our assumptions were guided by our observations of historic tuition increases, trends in post secondary enrollment in South Carolina and the level of legislative appropriations for post secondary schools in South Carolina.

The Bias Load assumption accounts for Program enrollment at institutions that are more expensive than the Weighted Average Tuition. The choice of this assumption was based on a review of Program experience and what we have seen in other prepaid tuition programs.

The assumptions for tuition inflation and bias load are shown in the table immediately below.

Tuition Inflation	
For those attending SC public universities	7.0%
All others	8.0%
Bias Load - applicable for those attending SC public universities	
All Years	3.0%

The tuition inflation assumption for those attending public universities in South Carolina is based on the statutory limit on benefit increases for Program beneficiaries. The inflation assumption for all others is based on an assumed average increase in the Weighted Average Tuition of 9% (same assumption as last year), applicable to 50% of those who attend either private college or out-of-state college, and an increase in private tuition of 7% applicable to the other 50% of those who attend either private college or out-of-state college. These assumptions were based on experience of the Program through June 2008.

Fund Earnings Rate

In setting our assumptions for the yield on assets, we relied on input from the State Treasurer's Office personnel and their investment advisor Pension Consulting Alliance, and Columbia Management Investment Advisers, LLC.

Our investment yield assumption (net of investment expenses) is:

2.20% for all future years.

The assumption for yield on future investment returns is based on the recommendation of Columbia Management Investment Advisers, LLC and Pension Consulting Alliance after considering the likely returns of the SCTPP Portfolio and reviewing with Actuarial Resources Corporation of Georgia and the State Treasurer's Office.

The State Treasurer annually informs the State Legislature of the Program's funded status by letter. A letter was sent to the State Legislature in December 2014 with a copy of the 2014 SCTPP Actuarial Report and an update on the unfunded liability.

In conjunction with Columbia Management Investment Advisers, LLC, Pension Consulting Alliance and Actuarial Resources Corporation of Georgia, the State Treasurer's Office reviews the investment return assumption annually. Although we do not expect the Fund to realize this exact rate in any year, we believe it represents a reasonable earnings rate over the time horizon of this report. In some years the Fund will have yields in excess of the assumed rate, while in other years the Fund will earn less than this rate.

Demographic Assumptions

The demographic assumptions used in this report are based on our experience with similar types of liabilities. Our choice of assumptions is based on recent experience and our best estimates as to future events. These assumptions are as follows:

Mortality and Disability

We assumed that there would be no terminations due to death or disability.

At-Will Termination of Contract

Our projections include assumptions regarding voluntary termination of contracts prior to matriculation. These assumptions vary by payment type and by number of years from contract purchase. These assumptions are shown in the following table.

	Lump Sum	48 Monthly Payments	Extended Payments
Year of purchase	2.0%	5.0%	8.0%
Year of purchase+1	2.0%	4.0%	7.0%
Year of purchase+2	2.0%	3.0%	6.0%
Year of purchase+3	1.5%	2.0%	5.0%
Year of purchase+4	1.5%	1.0%	4.0%
Year of purchase+5	1.5%	1.0%	3.0%
Year of purchase+6	1.5%	1.0%	2.0%
Year of purchase+7	1.0%	1.0%	2.0%
Year of purchase+8	1.0%	1.0%	2.0%
Thereafter	1.0%	1.0%	1.0%

Matriculation Percent

All beneficiaries are assumed to matriculate at the matriculation date specified in the application, except for those who are projected to terminate.

Utilization of Benefits

Four-year contract beneficiaries are assumed to use their benefits ratably over four years, while two-year contract beneficiaries are assumed to use their benefits ratably over two years. However, for contracts which are past their anticipated matriculation date, but have not used any benefits, all benefits are projected to be used completely over the next two years.

We believe that this is a conservative assumption since experience at other prepaid tuition programs, and universities in general, indicates that the average student takes somewhat longer than four years to complete a four-year degree.

Dropout Rate

All beneficiaries are assumed to use 100% of their contractual benefits once they have enrolled in college.

Frequency of Beneficiary Replacement

Since all surviving beneficiaries are expected to matriculate and are expected to use their benefits until completion, the assumption is made that no replacement of beneficiaries will occur.

VI. ADEQUACY OF THE FUND AS OF JUNE 30, 2015

In determining the adequacy of the Fund, we estimated the future disbursements for higher education expenses of beneficiaries, expenses and refunds for terminated contracts. We also projected the future assets based on current assets and expected earnings on assets. We believe these estimates are reasonable based on the information available and our past experience and judgment.

The estimates of the prospective assets and liabilities of the Fund are summarized in the table on the following page and demonstrate the financial position of the Fund. The value of all assets is \$94,441,663 while the expected value of all liabilities is \$150,351,666. The expected present value of the excess of liabilities over assets is \$55,910,003. This compares to the prior year's deficit of \$57,379,163.

The deficit will change from year to year due to positive and negative cash flows and due to the change in the present value of future benefit usage and expense payments because of the passage of time. The deficit will also change due to the variance of experience from the assumptions. These variances include tuition increases, investment income and expenses.

The deficit will also change due to the updating of the assumptions to reflect the Program's emerging experience. The changes for the year ending June 30, 2015 are summarized in the table below.

Progression of Surplus/(Deficit)	
Surplus at June 30, 2014	(\$ 57,379,163)
Projected Change to June 30, 2015	(1,658,800)
Loss From Unfavorable Investment Experience	(1,359,683)
Gain Due to Favorable Tuition Inflation	5,358,662
Loss Due to Change in Inv. Return Assumption	(1,095,651)
All Other Experience Items	224,632
Surplus at June 30, 2015	(\$ 55,910,003)

In the following chart we show the value of expected future benefit usage, expected future payments, current assets and expected surplus as of the end of each future year for contracts in place as of June 30, 2015. Note that existing assets are projected to be sufficient to meet future liabilities through 2019.

PRESENT VALUE OF ASSETS AND LIABILITIES

Fiscal Year Ending	Value of Assets	Present Value of Future Benefits	Surplus/ (Deficit)
2015	94,441,663	150,351,666	(55,910,003)
2016	69,708,986	127,008,675	(57,299,689)
2017	44,985,329	103,497,952	(58,512,623)
2018	27,747,153	87,513,968	(59,766,815)
2019	10,391,483	71,440,557	(61,049,075)
2020	(5,886,023)	56,476,171	(62,362,194)
2021	(20,754,467)	42,952,942	(63,707,409)
2022	(34,990,602)	30,093,360	(65,083,961)
2023	(46,951,018)	19,544,478	(66,495,496)
2024	(57,061,085)	10,880,836	(67,941,921)
2025	(64,860,882)	4,563,883	(69,424,765)
2026	(69,655,822)	1,290,175	(70,945,996)
2027	(72,453,286)	51,226	(72,504,512)
2028	(74,072,788)	26,777	(74,099,565)
2029	(75,729,706)	0	(75,729,706)

VII. CHANGES IN ACTUARIAL ASSUMPTIONS

The only assumption change this year is a reduction in the expected net investment return from 2.40% to 2.20%.

Change in Investment Return

The investment return assumption was changed 6/30/2015. Assets were shifted to 100% fixed income securities and 0% risk assets as of February, 2015 to remove the potential impact from a decline in the market value of risk assets should the stock market decline. This caused a decrease in the investment return assumption.

Current Assumption	Prior Assumption
2.20%	2.40%

Dollar Effect of Change in Assumptions

If assumptions had been the same as last year, the Plan's deficit would have been

(\$54,814,352)

The change in expected net investment return increased the deficit by \$1,095,651.

VIII. EXPECTED USE OF FUNDS

The Fund is expected to pay benefits and expenses in the following proportions:

- Tuition payments - 98.7%
- Payments of refunds to contract owners - 1.3%

These results are shown graphically below.

Expected Use of SCTPP Funds

