

State Teachers Retirement System Report October 2010

The STRS Board of Directors met Oct. 14 -15.

STRS Receives Actuarial Study:

The STRS actuary, PriceWaterhouseCoopers, presented the July 1 results of the STRS pension study. The report was significant as it underscored the need for the Ohio legislature to pass legislation to provide for financial solvency of the STRS pension. STRS sent its original plan for solvency to the Ohio General Assembly in September of 2009. However the legislature is not expected to act until after the November elections, or until the next biennium.

The actuarial study concluded that STRS is not collecting enough money to cover the interest on its pension debt or unfunded liability. The current cost of the STRS pension is at \$94.7 billion. This means that if STRS paid all active and retired members what they are owed, it would cost \$94.7 billion. The fund holds \$63 billion in assets, \$31 billion short of the amount needed to pay off everyone in the system today. That \$31 billion is called the accrued unfunded liability. The pension is therefore 60 percent funded with its \$63 billion in asset holdings. This type of scenario means that the fund could run out of money. That is why steps are needed now to strengthen the fund and preserve the defined benefit plan.

Compare this situation to your personal home mortgage on a home purchased for \$94,000. Consider that over the years you have paid \$63,000 toward the pay-off of the original loan amount of which you still owe \$31,000. The loan of \$31,000 requires that you make monthly payments based on 8 percent interest which delays the final pay-off of the debt. Furthermore, on a 30-year amortization of the loan, you will likely pay almost twice the original amount. In short, it costs a great deal more money to pay off a large debt over a long period of time.

An additional financial situation can develop if revenues fall short of the amount you need to pay the monthly mortgage. STRS is no exception. The pension relies on its revenue through active teacher contributions, employer contributions, and returns on investment assets to fund STRS. According to PriceWaterhouseCoopers, the current 23 percent contribution from active teacher and employer contributions does not adequately fund its part of the pension which should be neared to 40 percent. That, coupled with the actuarial projected return of 5 percent (the federal GASB rate) or 8 percent (the actuarial rate based on past performance) on investment assets will not compensate for the underage of the current fund. PriceWaterhouseCoopers warned, however, that a movement to a defined-contribution pension design will not solve this issue.

Board Votes to Support HPA Plan Changes to Long-Term Fiduciary and Planning Proposal:

The STRS Board passed a motion to support changes as a legislative amendment to the STRS Long-Term Fiduciary and Financial Planning proposal. These changes concern the original proposal for pension solvency sent to the Ohio Retirement Study Council (ORSC) in September of 2009. The original proposal was in response to a directive from ORSC to the five state pensions. Each pension system was required to submit a plan to provide for its own financial solvency.

Months after the STRS proposal was submitted, a group representing teacher, retiree, and employer groups known as the Health Care and Pension Advocates (HPA), offered its recommendations for STRS consideration. The plan includes changes that meet the fiduciary need of the system with the least impact on active teachers and retirees. This plan is supported by the largest teacher organizations in Ohio, thus providing for a stronger base support of the legislation. Both summaries of the Board Approved Plan and the recently approved HPA Plan are included in this report:

The following changes recommended by HPA were approved Oct. 15.

1. Retirement Eligibility:

-- Unreduced Benefit

30 Years of service until 8/1/2015;
31 Years of service 8/1/2015 through 7/31/2017
32 Years of service 8/1/2017 through 7/31/2019
33 Years of service 8/1/2019 through 7/31/2021
34 Years of service 8/1/2021 through 7/31/2023
35 Years of service 8/1/2023 and after

(In the original STRS plan, after August 1, 2015, a member could retire at age 60 with 30 years of service, or at age 65 with 5 years of service. The revision provides for a member to retire with 30 years of service under age 60, or at age 60 with 5 years of service, with an actuarially reduced pension benefit beginning August 1, 2015.)

--Actuarially Reduced Benefit

30 years of service under age 60

2. COLA (Cost of Living Adjustment)

Members retiring after 7/1/2011, receive percent COLA deferred for 36 months
(The original STRS plan awarded 1.5 percent COLA to those retiring after 7/1/2015.)

3. FAS (Final Average Salary)

Calculation of the final average salary (FAS) will be phased in on the basis of three, four, or five years.

(The original plan called for the final average salary based on 5 years of earnings.)

(There were no changes made to the Contribution Component, or to the Benefit Formula Component described in the original Board plan which calls for a 5 percent increase in contributions, 2.5 percent from employees and 2.5 percent from employers.)

The above changes are indicated from the original Long-Term Fiduciary and Financial Planning proposal approved by the Board in September, 2009:

Original Plan, September, 2009:

- **Contribution Component:** Increase member and employer contributions by a total of 5 percent by 7/1/2020. Ultimately, members would contribute 12.5 percent; employers would contribute 16.5 percent *(Currently, employees pay 10 percent and employers pay 14 percent.)*
- **FAS Component:** Base final average salary (FAS) on five years of earnings beginning 8/1/2015. *(Currently, the FAS is based on the highest 3 years of earnings.)*
- **Retirement Eligibility Component:** Beginning 8/1/2015, members may retire and receive an unreduced benefit at any age with 35 years; age 60 with 30 years; or age 65 with 5 years. Members may retire earlier with an actuarially reduced benefit at: age 55 with 30 years, or age 60 with 5 years. Members who meet age and service eligibility for service retirement as of 7/1/2015 under the current rule retain their eligibility.
- **Benefit Formula Component:** Benefit formula is 2.2 percent per year for the first 30 years; 2.5 percent per year thereafter, beginning 8/1/2015; The 35 year enhanced benefit is no longer needed to encourage teachers to work longer and is eliminated. Those who have 30 years of service; who are age 55 with 25 years of service; or who are age 60 with 5 years of service as on 7/1/2015, receive the greater of:
 - a) The benefit as on 7/1/2015, under the current formula; OR
 - b) The benefit upon retirement under the new formula.
- **COLA Component:** Beginning 7/1/2011, current retirees receive an annual 2 percent COLA. Members retiring after 7/1/2011 or later receive a 1.5 percent COLA each year.

In the final analysis, the HPA plan is expected to cost \$600 million more than the original STRS plan from 2009, but it saves \$8.4 billion from the current base. The HPA plan would bring the unfunded liability, now at \$38.88 billion down to \$30.47 billion, and the funding period would be brought from infinity to 35.1 years. The original Board Plan would bring the unfunded liability to \$29.89 billion with a funding period of 33.4 years.

The Board will embark on a campaign to lobby the legislature in support of the original Board plan with the HPA amendments

Health Care Session Provides Information on Future Changes:

During the September Board meeting, it was announced that staff would provide education sessions to update the Board on the state of STRS healthcare, as well as any future changes due to the National Healthcare Reform Act.

Brent Greenwood, vice president of Actuarial Consulting for Ingenix Consulting, provided a presentation directed at changes in national health care, a result of national health care reform. Highlights of the presentation include:

- There is a decline in the number of public and private organizations offering retiree health care.
- When compared to other organizations, STRS is offering a good value, quality insurance product to its retired members as it employs current premium subsidies and deductibles.
- New health care reforms are mandating the elimination of pre-existing condition exclusions, and new controls of underwriting,
- States will be offering healthcare exchanges
- The marketplace will change as it offers more options to retiree health care, including lower premiums and healthcare for those under age 65.
- Medicare Advantage may have higher premiums due to future reduced subsidies.
- New 10 Medicare supplemental plans should present more options.

The Board will continue education sessions over the next months as it studies the circumstances affecting STRS health care for the future. The Board is expected to vote on changes during the early part of 2011.

STRS Investments Show High Returns for September:

Steve Mitchell, Deputy Director of Investments for STRS, said that STRS investment assets were at \$60.9 billion at the end of September. Since June 30th, the fund has risen by \$4 billion, an 8.8 percent return. In addition, all asset classes have exceeded the benchmark.

An 8.8 percent return is considered good for a one-year return. As a first-quarter return this is exceptional.

Although it registered concern last month, the STRS economic report concluded that the economy is not expected to experience a double-dip recession. Instead, a projection for moderate growth including low interest rates rising late in the fiscal year, low inflation, and above average returns for equities, are on the forecast.

The November STRS Board meeting will be held Nov 18-19.