

## **The STRS Ohio Plan to Strengthen the Financial Condition of the Retirement System**

### **The Issue**

Before the market downturn, STRS Ohio had a funding period for its pension fund of 41.2 years, exceeding state statute's 30-year maximum funding period. Economic and demographic factors, such as members living longer, were causing a reduction in available funds to pay off accrued liabilities over time. The unprecedented decline in the global markets and the accompanying recession, along with the projected gradual economic recovery, significantly accelerated the need for STRS Ohio to make changes. In just one year, from July 2008 to July 2009, STRS Ohio's unfunded liability has nearly doubled to \$36.6 billion and the funding period is at infinity.

STRS Ohio has the cash flow needed to pay current pension benefits when they are due. In fact, the value of preserving the security of the Defined Benefit Plan to our members has never been more apparent. However, looking long term, there is a shortfall in the funding of STRS Ohio benefits. If no changes are made, STRS Ohio will eventually be unable to pay future benefits.

### **The Planning Process**

In March 2009, the State Teachers Retirement Board took the prudent and proactive step to begin a long-term contingency planning process to address the funding challenge. Its objective was to:

- Preserve the Defined Benefit Plan, and
- Ensure the continuation of the STRS Ohio Health Care Program.

The board pledged that the process would be detailed, thorough and deliberative. It further noted that no actions would be taken lightly as all actions impact STRS Ohio members and employers. The board received input from individual members, employers and constituency groups as it went through its many months of discussion.

### **The Plan**

The current expected long-term actuarial rate of return of 8% for STRS Ohio's investment assets cannot be raised; STRS Ohio cannot count on higher investment returns as a solution. In addition, while it is absolutely imperative that STRS Ohio watches every dollar that it spends, reducing operating expenditures cannot solve the long-term issue of funding pensions for future generations of teachers and a viable health care program. As a result, the board unanimously approved a multifaceted plan on Sept. 1, 2009, to strengthen the financial condition of the retirement system that includes these components:

#### **Increase in Contributions**

- Increase member contributions by 0.5% per year beginning July 1, 2011, to a total of 2.5% on July 1, 2015.
- Increase employer contributions by 0.5% per year beginning July 1, 2016, to a total of 2.5% on July 1, 2020.

Currently, STRS Ohio members pay 10% of their salary to STRS Ohio and employers pay 14% of total teacher payroll in lieu of paying into Social Security. This plan component increases member and employer contributions by a total of 5% by July 1, 2020. The member increase would be phased in at 0.5% per year, beginning July 1, 2011, until 2.5% is reached on July 1, 2015. The employer increase would be delayed for five years, when it would be phased in at 0.5% per year, beginning July 1, 2016, until 2.5% is reached on July 1, 2020. Ultimately, STRS Ohio members would contribute 12.5% and employers would contribute 16.5%. This phased approach allows time for the economy to improve and also helps employers with budgeting.

#### **Increase in Final Average Salary (FAS) Years**

- FAS calculation to be based on five highest years of earnings beginning Aug. 1, 2015.

Pension benefits are determined by a member's age, years of service and FAS. With this change, the FAS would be based on the five highest years of earnings versus the current three years, beginning Aug. 1, 2015.

#### **Change in Eligibility for Retirement**

- Increase years of service required for retirement, beginning Aug. 1, 2015.

This change increases the number of years required to be eligible for retirement. Beginning Aug. 1, 2015, members can retire at any age with 35 years of service; at age 60 with 30 years of service; or at age 65 with five years of service. (Members may retire earlier with an actuarially reduced benefit at age 55 with 30 years or at age 60 with five years.) Members who meet age and service eligibility for service retirement as of July 1, 2015, under the existing rule retain their eligibility.

*(continued)*

## Change in Benefit Formula

— *New formula would be 2.2% per year for the first 30 years of service; 2.5% per year thereafter, beginning Aug. 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 five years of service as of July 1, 2015, receive the greater of:

- (a) The benefit as of July 1, 2015, under the current formula; or
- (b) The benefit upon retirement under the new formula.

In short, members who are eligible for service retirement will receive no less of a base pension benefit than they could have received on July 1, 2015. Under the new formula, at the end of a 35-year career, teachers would receive 78.5% of their final average salary; teachers who retire at age 60 with 38 years would receive 86% of final average salary.

## Reduction in Cost-of-Living Adjustment (COLA)

— *Beginning July 1, 2011, current retirees would receive an annual 2% COLA; members retiring after July 1, 2011, would receive a 1.5% COLA each year.*

Currently, the COLA is 3%. Without a change in the COLA, a viable Defined Benefit Plan cannot be sustained.

**STRS Ohio staff projects that these changes would save almost \$9 billion in accrued liabilities and would bring the pension fund to a 33.4-year funding period from its current status of infinity. Further, the current 1% employer contribution to the health care fund continues.**

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## Next Steps

In addition to STRS Ohio, low investment returns, demographic factors and the economic outlook have impacted the other four Ohio public pension plans. As a result, the Ohio Retirement Study Council (ORSC), which is the legislative oversight body for the five systems, directed each system to present a board-approved plan at the ORSC's Sept. 9, 2009, meeting for either maintaining or returning to a 30-year funding period.

There was wide divergence among the plans that were presented due to the variations in each system's funding situation, demographics and plan design. In the coming weeks, ORSC staff will be working with the systems and discussions will continue at the monthly ORSC meetings. It is anticipated that eventually legislation will be drafted and introduced and then the normal legislative process will begin. **All of the changes contained in STRS Ohio's proposed plan require legislative action by the Ohio General Assembly and the governor, as all the plan components require changes in existing statute.**

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## Looking to the Future

The Retirement Board will continue to annually review the actuarial valuations of the pension fund and the health care fund to monitor both funds' progress over time. The board will also continue working with its many constituents — including the Healthcare and Pension Advocates (HCA) for STRS — as discussions continue with the other Ohio systems, the ORSC and other members of the Legislature.

The STRS Ohio plan:

- Preserves the Defined Benefit Plan for Ohio's public educators. STRS Ohio members do not have to worry about outliving their benefits. These pension benefits can continue to support local economies (more than \$3.6 billion in benefits are paid to Ohio residents alone); the taxes paid on these benefits can also continue to support local, state and federal governments. A viable Defined Benefit Plan also reduces the likelihood that STRS Ohio members will have to turn to public assistance, Medicaid or social services in retirement, thus relieving taxpayers of future obligations.
- Continues to offer a retirement plan that will help Ohio's public schools, colleges and universities recruit and retain quality educators.
- Allows for current and future active members, retirees and employers to collectively contribute to a solution.
- Provides a transition period for those teachers who are close to retirement, while recognizing that those further out from retirement have more time to plan for their future financial security.
- Allows members to continue to control their retirement decisions and not be "forced" out. This mitigates a potential "stampede" of members who want to retire before changes go into effect, thus preserving retirement patterns for STRS Ohio and protecting employers from veteran teachers leaving all at once.
- Preserves all past cost-of-living adjustments (COLAs) and ad hoc increases for current retirees.
- Allows retirees' pensions to continue to grow in the future, but at a slower rate.

**Most importantly, the Retirement Board and staff, as fiduciaries of the system, have developed a plan that helps ensure the long-term solvency of STRS Ohio for future generations of teachers.**

At STRS Ohio, we know there are no easy solutions to the challenges we face — and we know some decisions will not make all members happy. We pledge to continue to use our newsletters, Web site, e-mail news service and face-to-face meetings to do what we can to make sure members know the progress of the legislation and any changes going forward.

