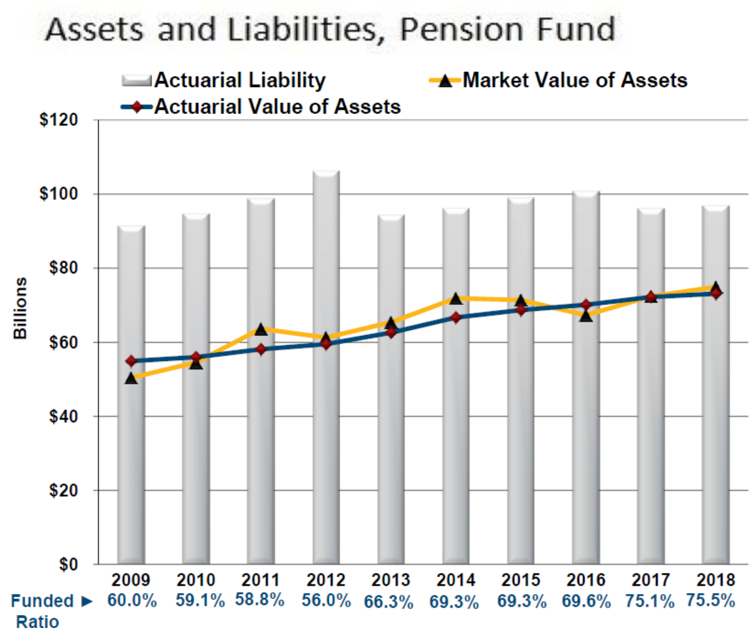
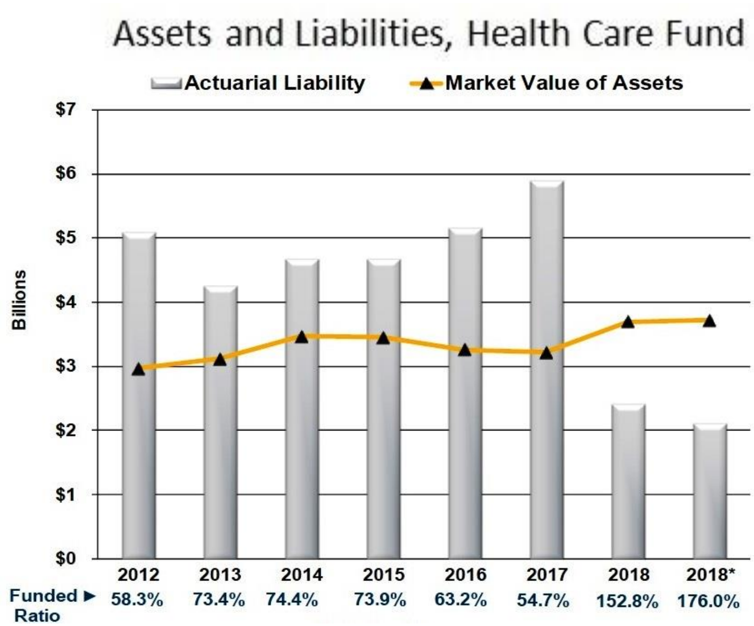
STRS report for OSURA, December 2018. G. Newsom

The long-awaited Frontline program on public pension plans focused only on Kentucky. Like some other public pension systems, problems arose when governments did not make their required payments into the pension system or, as in Kentucky, they borrowed money from the system to cover operating costs. These problems don't seem to have affected Ohio.



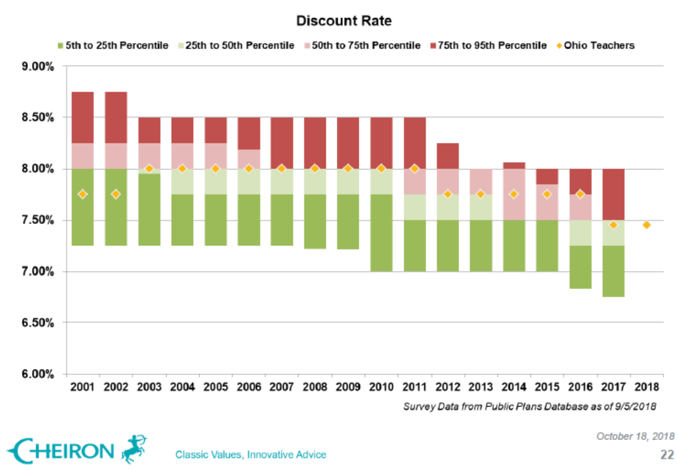
The graph at right shows assets and liabilities for the pension fund, with a sharp drop in liabilities after the revised pension formula in 2012 and a smaller drop in liabilities with the loss of COLAs in 2017, improving the Funded Ratio (actuarial liability divided by actuarial value of assets) in FY 2017 and 2018.

Retirees at the "public comment" section Board meetings continue to protest the loss of COLAs, while staff and consultants worry that the chances of future downturn in investment returns would require bigger cuts in pensions. These pressures on the Board push in opposite directions.



The next graph shows the status of the health care fund; the remarkable ratio of assets to liabilities of 153% at the end of December 2017 grew to 176% by the end of June 2018. Non-Medicare participants in the health-care plan receive a much higher subsidy from STRS than Medicare recipients do, so non-Medicare enrollments have a major effect on plan finances. This has been dropping rapidly in recent years. Much of the drop comes from under 65 retirees going on to a spouse's medical insurance. However, many of these other employers are planning to end health insurance for spouses who have access to such insurance elsewhere, so this trend could easily reverse very suddenly as younger retirees flood back to STRS. But it's hard to predict.

The graph on the next page shows the Discount Rate (the assumed rate of return on investments) from the database maintained by the consultants (Cheiron), with the range of discount rates that different public pension plans have assumed so far this century. The colored bars show the distribution by percentile (from lowest 5% to highest 95%), with the yellow diamonds for STRS. STRS rarely strayed far from the median



until other plans started reducing their discount rates in 2012. STRS' decrease to 7.45% brought them back into the middle of the pack but forced a suspension of COLAs.

A couple years ago OPERS reduced its assumed rate of return for its pension fund from 8.0% to 7.5%, and they just reduced it again to 7.2%. I haven't heard any noises in STRS about reducing their assumption of 7.45%; doing so would be pretty disruptive and there's a reasonably good chance that the 7.45% will hold up for the next 10 years. It seems surprising that, after the recent strong investment returns, OPERS would lower its projected future returns, but maybe the stronger finances thanks to last year's return is what made it easier to lower expected returns.

Last fiscal year, the STRS Board held its annual retreat in November. It's a good review for all members but especially for those newly-elected. Led by Ed Gaydos, the Board discussed its duties and operations. There was a consensus that the Board is operating well, with more collegiality and trust between Board members and between the Board and STRS staff, and this wasn't always the case in the past. Long-time observers not employed by STRS echoed this, commenting for example that the senior staff had some remarkably talented and effective people.

It looks unlikely that STRS will reintroduce a COLA before at least the five-year review comes up in a few years. But I can envision the situation when the time comes when funding ratio and funding period both improve significantly.

1) Current retirees expect the top priority will be to reinstate their COLA (or possibly a "COLA-lite"; a COLA might be reinstated only up to some maximum pension amount, or a one-time COLA might be declared instead of the annual increases we used to get)

2) Current teachers expect the top priority will be to cut their contribution rate from its current 14% of salary

3) State legislators and school boards expect the top priority will be to cut the employer contribution from its current 14%; after all, that would free up more funds for the schools with no additional taxes or appropriations from the legislature

4) Managers of the health-care fund hope the 1% of salary that employees used to put towards the health-care fund and has been diverted to the pension fund in recent years will be restored

5) And staff managing the pension fund would instead like to see the assumed rate of return reduced (which makes the funding ratio and funding period look worse), to cut down the chances that a downturn would put the fund in jeopardy again.

They can't all get their wish.