MEMORANDUM

DATE: February 13, 2020

TO: Ohio Retirement Study Council

FROM: Karen Carraher, Executive Director

RE: **Report of Recent Board Activity and Actions**

Executive Summary

For the past two years, OPERS has been communicating about a comprehensive plan to address two significant issues – 1) reducing the unfunded actuarily accrued liability (UAAL) and 2) extending the solvency of its Health Care Fund. In January 2020, the OPERS Board approved the second portion of this plan.

Problem Definition

For more than three years, OPERS has been seeking changes that will reduce the UAAL through a change to the Cost of Living Adjustment (COLA). The 2012 changes (Senate Bill 343) reduced approximately $4 billion of the UAAL associated with the active members (OPERS 2012 legislation did not impact any retirees). The bulk of remaining liability is associated with retirees.

OPERS is funded by member contributions, employer contributions and investment earnings. *Member* contributions can only be used to fund pensions and are always 100% refundable with interest back to members. The *employer* contribution must be used to fund pension and only if pensions are adequately funded can the employer contribution be used to fund health care. OPERS currently is using all 14% to fund pensions and no portion of the employer contribution is funding health care.

Upon receipt of funds, the contributions are invested into the appropriate trust which have different investment allocation policies. Interest earned on each of the trusts are added to the trust.

OPERS pays out over $6.7 billion annually ($558 million per month) in pension payments and an additional $1 billion in health care payments. Approximately 89% of our members remain Ohio residents.

OPERS 2019 UAAL is approximately $24 billion and the expected amortization period is 27 years. Calendar year 2019 was an outstanding year for investment returns with

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preliminary pension returns of 17%. While this strong return is expected to improve the amortization period from 27 years down to 24 years, it does not solve the issue with the UAAL.

With the employer contribution rate allocated to strengthen the pension funding, the discretionary health care program is not receiving any additional funding. The only source of funding for the health care trust fund is the interest earned. Again, while 2019 was a strong investment return year with the preliminary health care return estimated to be 19%, this does not provide a consistent source of funding for health care payments. The health care trust fund was expected to provide funding for health care for 11 years prior to the 2020 Board approved changes and projections indicated that funding to this trust fund could not resume until somewhere in excess of 15 years – beyond the expected depletion date of the health care trust fund. Thus, the goal was to reduce health care expenditures to allow the trust fund solvency to be extended until funding could resume.

Reduce UAAL (COLA Changes)

For more than three years, OPERS has been communicating the need for cost-of-living-adjustments (COLA). OPERS' unfunded liability is $24 billion, the highest it has ever been. After its initial proposal in 2017 (HB 413 (132nd General Assembly)) failed to move forward. Unlike most of the other Ohio statewide retirement systems, OPERS does not have the unilateral authority to change its COLA based on its financial condition. OPERS must seek changes to its COLA through the Ohio General Assembly. After an extensive education campaign, staff recommended to the Board an alternative legislative proposal. In September 2019, the Board approved the proposal, which includes the following components:

- Retirees would receive no COLA in 2022 and 2023, and resume receiving a COLA in 2024, consistent with what they received in 2021. Those receiving a three-percent COLA in 2021 would receive a three percent COLA beginning again in 2024. Those receiving a COLA that is tied to the CPI would receive a CPI-based COLA in 2024.
- Extends the time to receive the initial COLA to 24 months, from 12 months, for future retirees beginning in 2022.
- Restores 85 percent purchasing power for some members who retired prior to 1995.

This proposal, which has been formally endorsed by the largest OPERS retiree association, would reduce OPERS' unfunded liability by $3.44 billion and reduce its amortization period by an estimated six years.

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Health Care Changes

In January the Board voted to approve changes to the health care program. OPERS has been working with the Board on this initiative for approximately two years. The goal was to preserve the health care fund by reducing health care program costs. The current health care trust fund was only projected to last 11 years. Projections also indicated that we could not begin funding health care again for at least 15 years. By extending the solvency period of the trust fund through reduced expenditures, the health care trust fund could last until we are able to fund it again. In the end, the health care preservation initiative increased the solvency of the health care fund from 11 years to nearly 19 years and when we add in the positive investment returns in 2019, the solvency is extended to between 22 and 23 years.

The health care changes, which were also endorsed by the largest retiree organization, will be effective Jan. 1, 2022. Feedback received from both member/retiree surveys and Health Care Funding education sessions indicated that members, after being presented with the facts, were willing to accept changes in the interest of preserving access to health care coverage during retirement.

The changes approved by the Board are as follows:

- All retirees currently receiving health care will continue to receive health care.
- Eligibility for Medicare age will continue to be 20 years of service at age 65 (When health care was first introduced in 1974, the requirement was five years of service, which was later increased to 10 years, followed by 20 years. Each change grandfathered in existing retirees).
- Eligibility for those retiring prior to age 65 (pre-Medicare) will require a minimum of 30 years of service.
- Medicare group will continue to be provided as it is now, with the monthly base allowance reducing from $450/month to $350/month (continues to cover cost of most expensive medical and drug plan).
- Pre-Medicare retirees will no longer be provided a group plan sponsored by OPERS; instead, OPERS will provide a monthly allowance to purchase a plan on the open market. The base allowance will initially be $1,200/month (retirees receive a percentage between 51% and 90%). OPERS is also planning to front-load this group's HRA accounts with $1,200.
- Grandfathered retirees were previously protected with a minimum allowance percentage of 75%. In the future, their allowance will be adjusted to align with the allowance chart.

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- The disability eligibility conditions remain unchanged, but disability recipients will be subject to the same changes to allowance levels. Our preliminary analysis indicates many disability recipients may receive greater subsidy support through the federal government.
- OPERS will provide a vendor, similar to the Medicare connector, to assist with the pre-Medicare group.
- These changes will take effect beginning in 2022.

A more comprehensive account of the OPERS organization and the recent Board activities is attached.

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Full ORSC Board Activity Update

02/13/2020

Ohio Public Employees Retirement System (OPERS) - Pension System Overview

Asset size - OPERS is the 12th largest public retirement system with assets of approximately $100 billion. OPERS is the largest public retirement system in Ohio followed by STRS ($79.2B), Ohio Police and Fire ($15.9 billion), Ohio School Employees Retirement System ($14.6B) and Ohio Highway Patrol Retirement System ($700M).

Board Composition - OPERS 11-member Board is the governing body and is comprised of seven individuals elected by the specific stakeholder groups each represents (college/university employees, state employees, county employees, municipal employees and miscellaneous employees). Two Board members are elected from the retiree members and three individuals with investment expertise are appointed by the Governor, Treasurer and jointly by the Ohio Legislature. The final Board member is the Director of the Ohio Department of Administrative Services who serves by virtue of office.

OPERS Membership Base – OPERS serves approximately 1.1 million members consisting of:

- 304,000 active members
- 213,000 retirees and beneficiaries
- 628,000 inactive members with funds still in the system
- Works with over 3,700 employers
- Membership includes all public employees not covered by another pension system
- Diverse mix including state, local, county, municipal, public safety, law enforcement, elected officials

Funding - (*See **Appendix 1***). OPERS is funded by member contributions, employer contributions and investment earnings. Members contribute 10% of pay (law enforcement and public safety contribute 13% and 12%, respectively) and their employers contribute an additional 14% of pay (law enforcement and public safety employers contribute 18.1% of pay). *Member* contributions can only be used to fund pensions and are always 100% refundable with interest back to members. The *employer* contribution must be used to fund pension and only if pensions are adequately funded can the employer contribution be used to fund health care. OPERS currently is using all 14% to fund pensions and has no contribution funding health care.

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Upon receipt of funds, the contributions are invested into the appropriate trust which have different investment allocation policies. Interest earned on each of the trusts are added to the trust.

OPERS pays out over $6.7 billion annually ($558 million per month) in pension payments and an additional $1 billion in health care payments. Approximately 89% of our members remain Ohio residents.

Pension Funding – OPERS assumes a long-term investment earnings of 7.2% for pension funding. This rate is reviewed by the Ohio Retirement Study Council's independent actuary and is the rate used by most pension systems around the country. (See ***Appendix 3*** for a historical summary of OPERS returns) OPERS has been responsible in regularly assessing the appropriateness of this assumption. Long-term assumption returns that are too high eventually requires significant changes to benefits. Conversely, assuming long-term investment returns that are too low place too much burden on the current members. Unlike many other states, Ohio has a fixed contribution rate. Other states increase or decrease the employer contribution rate based on funding needs on an annual basis. Ohio's pension systems address long-term funding needs through legislatively-approved benefit changes.

The 2008 market downturn resulted in a $24.9 billion loss for OPERS. If amortized over a 20-year period, this would have required an employer contribution rate increase of approximately 14% of payroll. While it took more than six years to recover to the 2007 levels, which does not include expected earnings on those assets. During this time, OPERS continued to meet the monthly benefit payment outflow requirement. Actuarial analyses indicate that if the 2008 loss had not occurred, OPERS would have $41.8 billion in additional assets. The OPERS portfolio is a diversified portfolio designed to earn a long-term investment return of 7.2%.

As of December 31, 2018, the date of the most recent actuarial valuation, OPERS is 78% funded ($0.78 accumulated for every $1.00 of pension liability expected to be paid out). The amortization period (the number of years to accumulate the remaining unfunded portion) is 27 years, which is within the statutorily-required 30 years. The 2019 preliminary investment return of 17 percent is expected to increase the funded ratio to 79% and reduce the amortization period to 24 years.

OPERS is a mature system with a declining membership and an active to retiree ratio of approximately 1.3 active members to each retiree down from a high of 6.7 to 1.

Health Care Funding – The Ohio pension systems were established to provide pensions. In 1974, OPERS added health care as a discretionary program. Through the years as the costs of health care increased, OPERS has made the necessary

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modifications to the health care program. Given that health care is a discretionary program, legislation is not required to modify health care.

In 2013, annual health care expenditures were $1.8 billion, and the unfunded liability was approximately $19B, the same level as the pension unfunded liability. OPERS implemented changes which ultimately reduced the unfunded liability by $12 billion and reduced the annual health care expenditures to approximately $1 billion. One of the features of these changes was to discontinue our Medicare group plan and provide an allowance to purchase a Medicare supplement plan on the open market. Medicare provides primary coverage and we provide a vendor to assist them in selecting a Medicare Supplemental plan as their secondary insurance plan. Eligible members are provided an allowance through a health reimbursement account (HRA) which ranges from 51% to 90% of a base amount depending on their years of service and age at which they began receiving health care from OPERS. (See *Appendix 4*). The base level was established at $450/month. More than 70% of our retirees receive a 75% allowance, providing them $337 per month. The base allowance was established using market factors. The most expensive medical and drug plan cost was $232 per month; therefore, members were afforded $100 or more per month to use for other qualified medical expenses. The Medicare transition has been very successful, with the members' average HRA balance of $3,700.

At that time there was not a strong open market for the pre-Medicare retiree group, so OPERS maintained the group plan with the understanding that once the market developed, the pre-Medicare retirees would move to a similar model. Since 2013, the number of pre-Medicare retirees has decreased from approximately 80,000 to less than 30,000 retirees. This population is considered high risk. Nearly 75 percent have more than one chronic illness.

Proposed Changes – OPERS has historically announced pension and health care simultaneously to allow members to adequately plan for retirement changes.

Pension: In 2012, following three years of effort to seek legislative changes, the General Assembly approved S.B. 343. These changes impacted active members only, and in varying degrees, based on how close members were to retirement. These changes reduced the unfunded liability by approximately $4 billion. No retirees were impacted by these changes. These pension changes eliminated subsidization of benefits and required members to work longer in response to increased life expectancy.

In 2017, OPERS sought legislative changes that would have reduced all Cost-of-Living-Adjustments (COLA) to CPI not to exceed 2.5 percent. This would impact active members and retirees and reduced the unfunded liability by approximately $3.0 billion. OPERS was unsuccessful in this effort largely because 2017 was a strong investment

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return year (16.7%) and a lack of stakeholder support. The following year, the investment return was a loss of 3.38%.

Throughout 2018 and 2019 OPERS worked with retiree groups and stakeholders to gain support of a two-year COLA freeze. Following the freeze, members would return to current conditions (some members receive a flat 3% and others receive CPI not to exceed 3%). The two-year COLA freeze would reduce the unfunded liability by approximately $3.4 billion and would impact both active and retirees.

Unlike most of the other Ohio statewide retirement systems, OPERS does not have the unilateral authority to change its COLA based on its financial condition. OPERS must seek changes to its COLA through the Ohio General Assembly.

The other statewide retirement systems (STRS, SERS, OHPS) have utilized their board authority to adjust their COLA's since 2013.

Additionally, national data shows that other states are also experiencing pension reform. Over 40 states have made pension benefit changes and over 30 states have made changes to the COLA benefits.

OPERS has communicated its plan to address pension and health care funding issues extensively across its membership. Based on in-person feedback, as well as data received from surveys, the COLA and health care packages adopted by the Board of Trustees were the preferred options. The largest OPERS retiree association has endorsed OPERS'-approved legislative proposal and Labor has assured OPERS that they will remain neutral.

Health care:

The changes approved by the Board are as follows:

- All retirees currently receiving health care will continue to receive health care.
- Eligibility for Medicare age will continue to be 20 years of service at age 65 (When health care was first introduced in 1974, the requirement was five years of service, which was later increased to 10 years, followed by 20 years. Each change grandfathered in existing retirees).
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percentage between 51% and 90%). OPERS is also planning to front-load this group's HRA accounts with $1,200.

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- OPERS will provide a vendor, similar to the Medicare connector, to assist with the pre-Medicare group.
- These changes will take effect beginning in 2022.

The health care changes are expected to reduce the unfunded liability and extend the health care trust fund solvency until funding can be resumed at a later date. The timing of funding health care is dependent on a strong pension fund.

Other changes – In addition to COLA and health care changes, OPERS has shared a proposal for a new retiree group, referred to as Group D. Group D, as contemplated, would not affect any current OPERS members. Upon implementation, only new members would be classified in this group. Group D is designed to address portability issues; it provides the member an opportunity to have more control over a portion of their contributions; it introduces an investment-sharing component when certain financial conditions are met; and it provides flexibility to the System to grow and contract with financial market volatility.

Group D is still under discussion and OPERS will spend much of 2020 working with stakeholders to discuss the changes. OPERS will periodically report feedback to the Board and would not begin seeking legislative approval until 2021.

Summary - We believe these changes are pro-active and fiscally prudent. OPERS has spent more than a year discussing the reasons for the changes and the proposals with members. OPERS is committed to ensuring we have a strong defined benefit plan and to maintaining a health care program.

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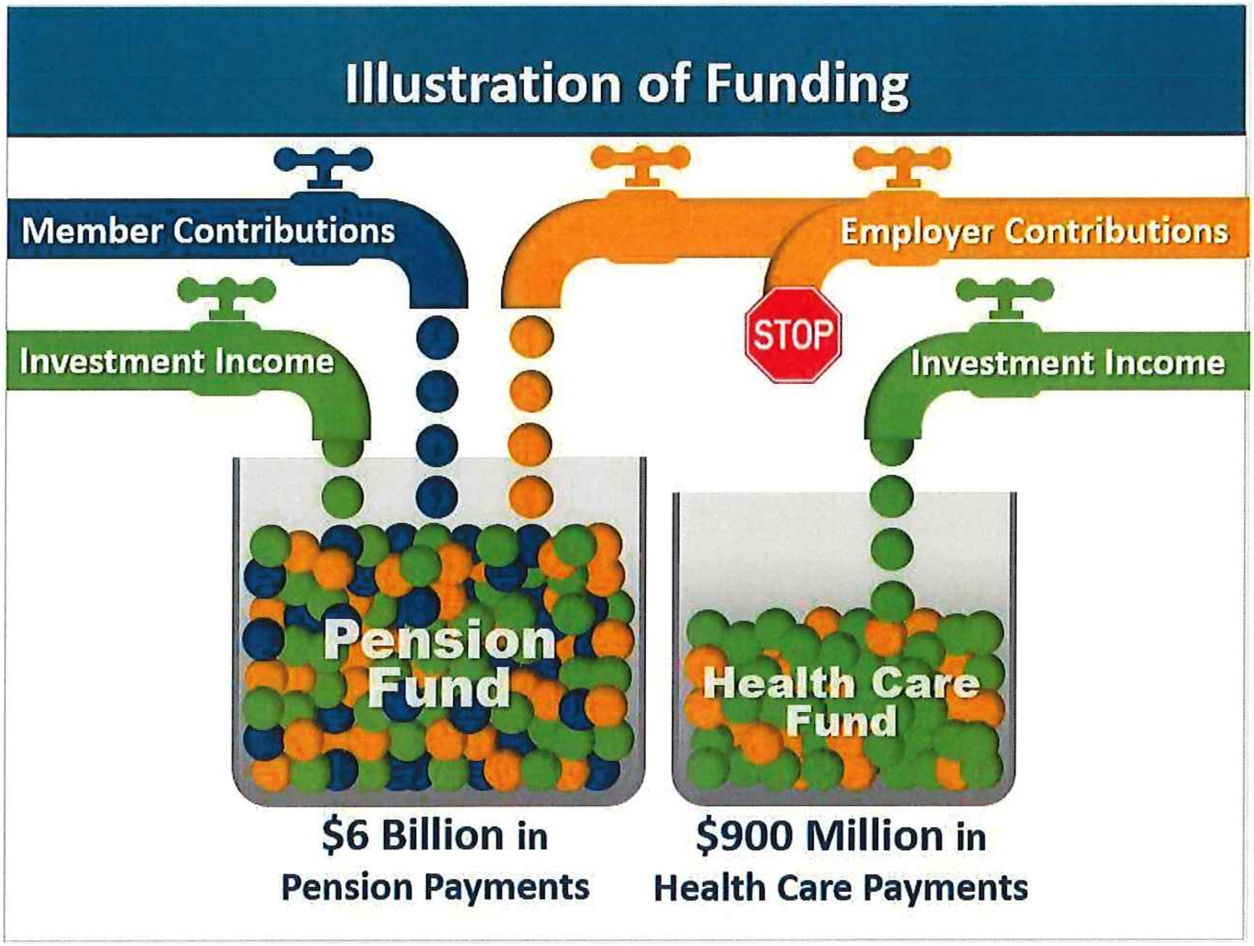
Appendix 1. – Funding Illustration



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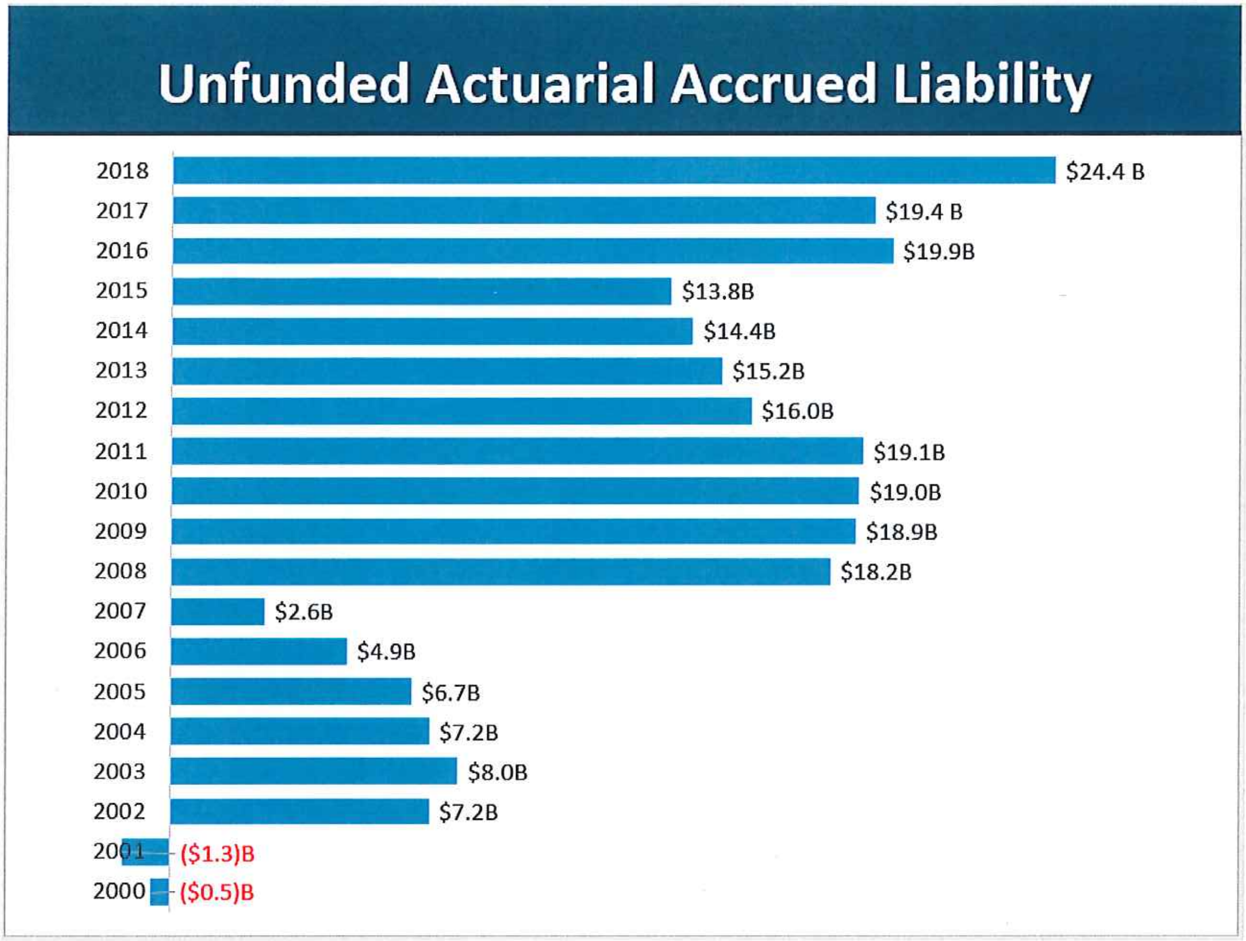
Appendix 2. – Historical chart of Unfunded Actuarial Accrued Liability (UAAL)



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Appendix 3. – 2018 CAFR Historical Investment Returns

Historical Investment Returns

Year	Total Portfolio Return	Total Defined Benefit Return[1]	Total 401(h) Health Care Trust Return[1]	Total 115 Health Care Trust Return (Health Care Portfolio)	Total Defined Contribution Return[2]
2018	(3.38%)	(2.99%)		(5.76%)	(6.65%)
2017	16.62	16.82		15.25	17.39
2016	8.23	8.31[a]	4.73%[a]	5.11[a]	9.51
2015	(0.03)	0.33	(2.18)	(3.23)	(1.71)
2014	6.70	6.96	5.28	(0.03)[b]	4.83
2013	14.00	14.38	11.36		20.45
2012	14.40	14.54	13.72		13.37
2011	0.20	0.36	(0.38)		(2.59)
2010	13.90	13.98	13.93		13.74
2009	20.06	19.09	24.80		26.44
2008	(26.92)	(27.15)	(25.77)		(28.00)
2007	8.52	8.89	6.87		5.80
2006	14.66	15.05	12.78		12.96
2005	9.03	9.25	8.00		6.88
2004	12.49	12.50			9.73
2003	25.39	25.39			
2002	(10.73)	(10.73)			
2001	(4.58)	(4.58)			
2000	(0.71)	(0.71)			
1999	12.10	12.10			
1998	14.45	14.45			
1997	13.37	13.37			
1996	7.85	7.85			
1995	20.47	20.47			
1994	(0.02)	(0.02)			
1993	9.72	9.72			
1992	5.66	5.66			
1991	15.68	15.68			
1990	6.30	6.30			
1989	18.38	18.38			

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Appendix 4. – HRA Allowance Chart

Health Care Allowance Percentage Chart

Years of Service / Age	60	61	62	63	64	65+
20	51%	54%	57%	60%	63%	66%
21	53%	56%	59%	62%	65%	68%
22	55%	58%	61%	64%	67%	70%
23	57%	60%	63%	66%	69%	72%
24	59%	62%	65%	68%	71%	74%
25	61%	64%	67%	70%	73%	76%
26	63%	66%	69%	72%	75%	78%
27	65%	68%	71%	74%	77%	80%
28	67%	70%	73%	76%	79%	82%
29	69%	72%	75%	78%	81%	84%
30	71%	74%	77%	80%	83%	86%
31	73%	76%	79%	82%	85%	88%
32	75%	78%	81%	84%	87%	90%

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Appendix 5. – HRA Allowance Chart in dollars

Monthly Allowance		
Health Care Allowance Percentage	Medicare ($350 base allowance)	Pre-Medicare ($1,200 base allowance)
51%	$178.50	$612.00
53%	$185.50	$636.00
54%	$189.00	$648.00
55%	$192.50	$660.00
56%	$196.00	$672.00
57%	$199.50	$684.00
58%	$203.00	$696.00
59%	$206.50	$708.00
60%	$210.00	$720.00
61%	$213.50	$732.00
62%	$217.00	$744.00
63%	$220.50	$756.00
64%	$224.00	$768.00
65%	$227.50	$780.00
66%	$231.00	$792.00
67%	$234.50	$804.00
68%	$238.00	$816.00
69%	$241.50	$828.00
70%	$245.00	$840.00
71%	$248.50	$852.00
72%	$252.00	$864.00
73%	$255.50	$876.00
74%	$259.00	$888.00
75%	$262.50	$900.00
76%	$266.00	$912.00
77%	$269.50	$924.00
78%	$273.00	$936.00
79%	$276.50	$948.00
80%	$280.00	$960.00
81%	$283.50	$972.00
82%	$287.00	$984.00
83%	$290.50	$996.00
84%	$294.00	$1,008.00
85%	$297.50	$1,020.00
86%	$301.00	$1,032.00
87%	$304.50	$1,044.00
88%	$308.00	$1,056.00
89%	$311.50	$1,068.00
90%	$315.00	$1,080.00