



**STATE TEACHERS
RETIREMENT SYSTEM
OF OHIO**

**A Report to the
Ohio Retirement
Study Council**

March 2007

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Prepared by the State Teachers Retirement System of Ohio Executive Summary

For several years, the State Teachers Retirement System of Ohio (STRS Ohio) has been conducting annual telephone surveys of randomly selected active and retired STRS Ohio members. While the individuals polled have changed each year, much of the results have remained the same. *STRS Ohio active and retired members continue to place pension fund solvency and affordable health care coverage as their priorities for their retirement system.*

In response, the State Teachers Retirement Board continues to implement policies and pursue initiatives that will bring the pension fund to a 30-year funding period in a reasonable amount of time, plus shore up the health care fund.

The STRS Ohio pension fund is on a steady course to achieve a 30-year funding period within two-to-three years. (See Appendix A.) For fiscal year 2006, the actuarial valuation showed that the funding period improved for the pension fund, as predicted in last year's report to the Ohio Retirement Study Council. The funding period, which reflects the number of years required to pay off the unfunded actuarial accrued liability (UAAL) of the system, dropped to 47.2 years from 55.5 years as shown in Appendix B. (As a point of reference, we predicted it would improve to 49.6 years.) Further, STRS Ohio has more than \$4.3 billion of additional investment gains that have been "deferred" to future years due to asset "smoothing" for actuarial purposes.

The Retirement Board Has Taken Many Steps to Strengthen the Solvency of the Pension Fund While Preserving Health Care

The State Teachers Retirement Board has taken numerous steps during the past four years to reduce its UAAL while preserving health care coverage for its current and future retirees. These steps include making changes to actuarial assumptions to more accurately reflect experience, quick implementation of the components of Amended Substitute House Bill 449, and lowering the interest rate paid on member withdrawals. Many changes were also made to the STRS Ohio Health Care Program to increase the solvency of the Health Care Stabilization Fund, which supports this program for more than 113,000 retirees and their dependents.

Further, during the Retirement Board's annual planning retreat in February 2006, the board members reached consensus that they would consider pension benefit improvements *only* when the funding period is less than 30 years *and* the funding level exceeds 85%, thus controlling future liabilities.

To shore up the health care fund, STRS Ohio, with the support of the Health Care Advocates for STRS (HCA)*, is pursuing a legislative initiative to increase member and employer contributions over a five-year period.

STRS Ohio Is on Track to Achieve a 30-Year Funding Period for Its Pension Fund

STRS Ohio is on track to return to a 30-year funding period for its pension fund within two-to-three years, assuming there are no net actuarial losses. Assumptions for individual items, such as payroll growth, may not be met; on the other hand, investment returns have been exceeding the actuarial rate of return and result in unrealized gains, as noted above. All assumptions will be reviewed in 2008.

In addition, if the contribution increase being sought through the health care legislation can be obtained, the current 1% of employer contributions going toward health care can start flowing back into the pension fund, further accelerating the speed at which the UAAL is reduced.

*The HCA is a coalition of major management, professional and retiree organizations that represent more than 200,000 active and retired public educators in Ohio's K-12 classrooms and public colleges and universities.

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For several years, the State Teachers Retirement System of Ohio (STRS Ohio) has been conducting annual telephone surveys of randomly selected active and retired STRS Ohio members. While the individuals polled have changed each year, much of the results have remained the same. *STRS Ohio active and retired members continue to place pension fund solvency and affordable health care coverage as their priorities for their retirement system.*

This report is provided to the Ohio Retirement Study Council (ORSC) in compliance with Section 3307.512, Revised Code. This section requires Ohio's public pension plans to provide the ORSC with a report in any year that the funding period for the unfunded actuarial accrued liability (UAAL) of the pension fund exceeds 30 years and indicate how the board will reduce the amortization period to 30 years or less.

The STRS Ohio pension fund is on a steady course to achieve a 30-year funding period within two-to-three years. (See Appendix A.) For fiscal year 2006, the actuarial valuation showed that the funding period improved for the pension fund, as predicted in last year's report to the ORSC. The funding period, which reflects the number of years required to pay off the UAAL, dropped to 47.2 years from 55.5 years as shown in Appendix B. (As a point of reference, we predicted it would improve to 49.6 years.) Further, STRS Ohio has more than \$4.3 billion of additional investment gains that have been "deferred" to future years due to asset "smoothing" for actuarial purposes.

This report has two goals:

- (1) Briefly review the significant actions STRS Ohio has taken since 2003 to affect the system's pension funding period and reduce future liabilities, while also providing retirees and their dependents with health care coverage; and
- (2) Share the progress we have made to strengthen pension solvency and shore up health care in the future to achieve a 30-year funding period for both the pension fund and the health care fund.

Background

Since 1920, the State Teachers Retirement Board has provided pension, survivor and disability benefits to the public teachers of Ohio. Further, STRS Ohio has provided subsidized health care coverage for more than 30 years — one of only a few states to offer health care through a retirement system. Most states provide health care through the employer or state.

Ohio law (R.C. Chapter 3307) requires most teachers in the public schools and institutions of higher education to contribute to STRS Ohio while employed in service to its citizens. It also requires the teachers' employers to contribute, based on the salaries paid. The current contribution rates are capped in statute at 10% of gross earnings for employees and 14% from employers.

The same laws that create and govern STRS Ohio also create an "obligation" to these educators as a result of their participation in STRS Ohio. Financial benefits result if and when a teacher attains eligibility.

STRS Ohio is required to pay the following when eligibility is demonstrated:

- Age/service benefits for defined benefit plan participants (R.C. 3307.58, 3307.59 and 3307.60)
- Annuities to reemployed retirees who are already receiving pensions (R.C. 3307.352)
- Disability benefits (R.C. 3307.62–3307.64)
- Survivor benefits (R.C. 3307.562 and 3307.66)
- Defined contribution plan benefits under terms specified by the plan document (R.C. 3307.81)

Other guaranteed payments/programs are:

- Annual 3% COLA (cost-of-living adjustment) for recipients of defined benefits (R.C. 3307.67)
- Partial reimbursement of Medicare Part B premiums paid by Defined Benefit Plan recipients (R.C. 3307.39)
- \$1,000 lump-sum benefit upon death of a benefit recipient (R.C. 3307.661)
- Refunds in lieu of any other benefit upon withdrawal by members who leave teaching in Ohio and request a refund (R.C. 3307.56 and 3307.563)

Ohio law *does not currently guarantee nor require* the following to be provided by STRS Ohio. However, it instead allows STRS Ohio to offer its participants access to other benefits and act, as it is able, to help members by paying all or part of the following:

- Cost of health coverage for Defined Benefit Plan recipients (R.C. 3307.39)
- Supplemental benefit (R.C. 3307.671)
- Additional retiree-funded lump-sum benefit upon the death of a recipient of an age/service or disability benefit (R.C. 3307.392)
- Excess benefit plan to pay guaranteed benefit excluded by IRC section 415 (R.C. 3307.461)

The Retirement Board Has Taken Many Steps to Strengthen the Solvency of the Pension Fund While Preserving Health Care

During the past four years, the State Teachers Retirement Board has taken a number of steps to control its UAAL while preserving health care coverage for its current and future retirees.

- (1) **The Retirement Board increased the required member contribution to the maximum allowed under Ohio law — 10% — beginning July 1, 2003, and has been collecting the maximum 14% of payroll from employers since 1984.**
- (2) **The Retirement Board reduced the employer payroll contribution going into the Health Care Stabilization Fund to 1% from 4.5%, beginning July 1, 2003.** This is the *lowest* allocation to health care of any Ohio retirement system. If this 1% contribution toward retiree health care was discontinued, the pension funding period would now be at 37 years versus the current 47.2 years. However, taking this annual allocation of about \$94 million from the Health Care Stabilization Fund reduces its solvency period by three to five years.
- (3) **In October 2003, the Retirement Board made adjustments to the actuarial assumptions based on the five-year actuarial experience review.** Changes were made to assumptions regarding life expectancy, retirement, disability and teacher salary increases to reflect actual experience. With the advice of the board's investment and actuarial consultants, the annual actuarial investment return assumption was raised to 8% from 7.75%. The net effect of the assumption changes was to reduce the amortization period by 10 years. Currently, STRS Ohio, OPERS, SERS and the Highway Patrol Retirement System have an actuarial investment return assumption of 8%; only the Ohio Police & Fire Pension Fund has an assumption of 8.25%.

Looking at annualized investment returns for the 10-year period from July 1, 1996, to June 30, 2006, STRS Ohio had a total fund return of 8.28%, exceeding the actuarial assumption and the total fund objective of 8% by 28 basis points. This time span included the difficult period from fiscal year 2001 through fiscal year 2003, when the three-year annual compounded return was -4.2% per year.

The next actuarial experience review will occur in 2008. Two areas we are monitoring closely are mortality experience and the payroll growth assumption. Factors such as the growth in charter schools, the number of children who are home-schooled in this state, and a possible increase in

participation in the private school voucher program are being monitored. Data from STRS Ohio's own experience, plus information from the Ohio Department of Education and KidsOhio.org, will be part of the analysis.

- (4) **The Retirement Board made the very difficult decision to change the eligibility qualifications for both access and subsidies for health care coverage, effective Jan. 1, 2004.** A 30-year career teacher receives a subsidy of 75% toward the health care premium, down from 87%. In addition, eligibility requirements for the health care program call for 15 years of service versus the former five years, and premium subsidies for spouses and dependents were eliminated.
- (5) **In February 2005, the Retirement Board reduced the match from the Employer Trust Fund that can be included in a reemployed retiree's lump-sum payment or monthly annuity benefit to 50% from 100%, based on the 10% employee contribution rate.** This change, which went into effect on July 1, 2005, means that the same percentage of employer contributions is being applied toward the unfunded liability for reemployed retirees as for active members. On an annual basis, this provides an additional \$12–\$14 million to help reduce the unfunded liability. The Retirement Board was given the authority to make this change through the passage of Amended Substitute House Bill 449.
- (6) **In October 2005, the Retirement Board endorsed House Bill 272, sponsored by Rep. Michelle Schneider. This bill had included a component that required reemployed retirees of STRS Ohio, OPERS and SERS to obtain health care benefits from their employer — whether the employer is public or private — provided health care was offered to employees in comparable positions.** Because these provisions were removed from the bill before its passage, the State Teachers Retirement Board subsequently instructed staff in August 2006 to draft an administrative rule that will allow STRS Ohio to provide only secondary coverage to service retirees, as well as survivor and disability benefit recipients, who are reemployed in a public or private position.
- (7) **In November 2005, the Retirement Board completed an Asset/Liability Study.** The study showed that only an investment policy with much higher levels of risk than are appropriate for a pension system (e.g., all stocks), could *significantly* improve the funded status of either the pension fund or the Health Care Stabilization Fund. However, the Retirement Board did move more of the system's investment assets to real estate and international equities to improve returns. In addition, the allocation to alternative investments was increased slightly.

In concert with the Asset/Liability Study, the board made compensation adjustments necessary to recruit, retain and motivate Investment associates. This enables a continued internal active investment strategy to be pursued with the objective of achieving a net added value of at least 40 basis points (\$300 million annually) while continuing to save approximately \$90 million per year through internal management versus external management. For fiscal year 2006, the net value added was 137 basis points, or about \$750 million.

- (8) **In December 2005, the Retirement Board lowered the annual interest rate paid on member withdrawals to 2% for members with less than three years of service credit and to 3% for members with three or more years of service credit, effective Jan. 1, 2006.** Previous interest rates had been 4% and 5%, respectively. This resulted in an actuarial gain of \$127 million in fiscal year 2006.
- (9) **During the Retirement Board's annual planning retreat in February 2006, the board members reached consensus that they would consider pension benefit improvements *only* when the funding period is less than 30 years *and* the funding level exceeds 85%.** While this has been the board's practice, by adopting this as an additional guiding principle for its decision-making, the board sent a loud and clear message to its members that past supplemental benefits, such as the "13th check" are off the table, as well as items such as compound cost-of-living adjustments or enhanced pension benefit formulas.

The extended significant market downturn experienced from 2000–2002 had a profound effect on all public and private pension plans in this country, including STRS Ohio. However, as noted earlier in this report and in the December 2006 Evaluation Associates report presented to the ORSC, STRS Ohio has 10-year returns that are above its actuarial interest rate assumptions. The most recent actuarial valuation of STRS Ohio by its actuary, Buck Consultants, still reflects the last year of losses incurred in fiscal year 2003 due to four-year smoothing. Investment gains generated in fiscal years 2004, 2005, 2006 and 2007 will have a more positive effect going forward. *As a point of reference, STRS Ohio had more than \$4.3 billion in unrecognized market gains as of July 1, 2006.* (Market value of assets of \$65.8 billion versus market-related [smoothed] value of assets of \$61.5 billion.)

“The Great GASB” Impact on STRS Ohio Has Not Been Overlooked

Governmental Accounting Standards Board (GASB) Statement 43 is already generating discussion in state legislatures across the country and in the national media. GASB 43 mandates that public pension plans, as well as local governments, must start reporting their estimated financial liability associated with providing retiree health care coverage in their financial statements, just like they currently do for pension benefits. In other words, STRS Ohio will report what percentage of teacher payroll is needed to fully fund health care for current and future retirees on a full-reserve basis — that is, a 30-year funding period.

Fortunately, the State Teachers Retirement Board has been assessing these liabilities for more than 10 years through annual valuation reports and sharing these results with STRS Ohio’s membership. Data from these reports has shown that the funded status of the health care program is considerably higher than most other public pension plans in the United States, due to more than \$5.4 billion in past allocations made to the health care fund by the Retirement Board and changes in plan design and eligibility, as noted earlier in this report. As recently noted by the system’s actuary, Buck Consultants, at a January 2007 meeting with the board, *“STRS Ohio has been significantly more proactive than other public sector entities in addressing the health care program funding issues. Most public sector health care plans are 0% funded.”*

Currently, there are more than 113,000 individuals enrolled in the STRS Ohio Health Care Program. Health care costs for this program are paid out of the Health Care Stabilization Fund. Currently, monies for this fund come from premiums charged to program enrollees; 1% of payroll from employer contributions, as noted earlier in this report; and investment earnings on the fund. During fiscal year 2006, STRS Ohio also began to receive Medicare Part D reimbursements from the federal government.

Unfortunately, even with STRS Ohio retirees paying 48% of their health care costs and 1% of employer contribution going into the Health Care Stabilization Fund, the fund cannot sustain the STRS Ohio Health Care Program indefinitely. As a result, the Retirement Board, working with the Health Care Advocates for STRS (HCA)*, are working on a legislative initiative to create an ongoing, dedicated revenue stream that would put the health care fund on a full-reserve basis (i.e., a 30-year funding period), based on current actuarial assumptions.

STRS Ohio Is on Track to Achieve a 30-Year Funding Period for Its Pension Fund

STRS Ohio is on track to return to a 30-year funding period for its pension fund within two-to-three years, assuming there are no net actuarial losses. Assumptions for individual items, such as payroll growth, may not be met; on the other hand, investment returns have been exceeding the actuarial rate of return and result in unrealized gains, as noted above. All assumptions will be reviewed in 2008.

In addition, if the contribution increase being sought through the health care legislation can be obtained, the current 1% of employer contributions going toward health care can start flowing back into the pension fund, further accelerating the speed at which the UAAL is reduced.

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APPENDIX A**STRS Ohio Projected Funding Status**

ASSUMING no change in assumptions, pension benefits or plan design, and continuation of 1% employer contribution to the Health Care Stabilization Fund.

Year Ended June 30	Actuarial Assets	Unfunded Liability	Funding Period	Funded Ratio
2007	\$ 66,674,643,000	\$ 17,734,802,000	35.7 years	79.0%
2008	71,075,414,000	16,825,314,000	30.0	80.9%
2009	75,081,448,000	16,260,462,000	26.4	82.2%
2010	78,281,197,000	16,418,350,000	25.0	82.7%
2011	81,305,544,000	16,629,485,000	23.8	83.0%
2012	84,145,930,000	16,858,028,000	22.8	83.3%
2013	86,776,422,000	17,079,039,000	21.7	83.6%
2014	89,159,169,000	17,272,262,000	20.7	83.8%
2015	91,235,274,000	17,430,421,000	19.7	84.0%
2016	92,936,088,000	17,546,992,000	18.7	84.1%
2017	94,182,761,000	17,615,630,000	17.7	84.2%
2018	94,885,511,000	17,629,772,000	16.7	84.3%
2019	94,942,713,000	17,582,297,000	15.7	84.4%

APPENDIX B

STRS Ohio Historical Funding Status

Year Ended June 30	Actuarial Assets	Unfunded Liability	Funding Period	Funded Ratio
1967	\$ 1,204,360,000	\$ 704,671,000	15.6 years	63%
1968	1,360,942,000	936,188,000	15.6	59%
1969	1,523,805,000	970,657,000	14.1	61%
1970	1,710,084,000	1,390,892,000	23.0	55%
1971	1,959,093,000	1,375,086,000	21.6	59%
1972	2,235,741,000	1,445,769,000	22.1	61%
1973	2,526,917,000	1,513,090,000	22.7	63%
1974	2,785,350,000	1,794,728,000	24.7	61%
1975	3,000,635,000	1,939,647,000	24.8	61%
1976	3,240,277,000	2,367,446,000	33.8	58%
1977	3,590,432,000	2,618,608,000	37.1	58%
1978	3,991,494,000	2,947,834,000	44.9	58%
1979	4,474,515,000	3,364,770,000	44.4	57%
1980	4,978,714,000	4,855,683,000	59.7	51%
1981	5,634,905,000	4,669,818,000	50.0	55%
1982	6,344,385,000	5,124,609,000	59.0	55%
1983	7,210,677,000	5,301,141,000	44.0	58%
1984	8,326,788,000	5,772,218,000	41.0	59%
1985	9,469,194,000	6,222,881,000	39.0	60%
1986	10,895,158,000	6,414,042,000	39.5	63%
1987	12,911,072,000	6,380,720,000	35.0	67%
1988	14,613,182,000	6,759,786,000	35.0	68%
1989	16,407,002,000	7,211,686,000	34.5	70%
1990	18,242,453,000	7,640,885,000	34.0	71%
1991	20,094,849,000	8,014,512,000	33.5	72%
1992	22,536,343,000	8,263,895,000	32.5	73%
1993	26,259,447,000	8,229,529,000	31.5	76%
1994	28,543,410,000	8,328,399,000	30.5	77%
1995	31,416,677,000	8,570,498,000	29.3	79%
1996	34,569,651,000	8,197,261,000	28.4	81%
1997	38,743,272,000	7,820,498,000	26.9	83%
1998	43,865,907,000	7,262,181,000	24.2	86%
1999	49,124,802,000	5,638,538,000	16.3	90%
2000	54,712,921,000	4,480,237,000	23.1	92%
2001	57,450,612,000	5,230,628,000	27.5	92%
2002	51,969,345,000	14,256,819,000	39.0	79%
2003	51,697,000,000	17,037,000,000	42.3	75%
2004	55,340,714,000	17,613,627,000	42.2	76%
2005	57,048,493,000	20,051,544,000	55.5	74%
2006	61,533,635,000	19,362,974,000	47.2	76%