State Teachers Retirement System (STRS) Cost-of-Living Adjustments (COLA): Design, Costs, and Intergenerational Equity

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- Inflation and Purchasing Power
- COLA Design and Growth (no claw-back) of Benefit
- Expense of COLA (Scale)
- STRS Sustainable Benefit Enhancement Plan (SBEP-"The Plan")
- Investments and COLA
- Intergenerational Equity

1: Inflation and Purchasing Power

The exclusive purpose of a COLA is to reduce the effect of inflation on a retirement benefit. ORSC staff cannot find any example of a COLA from any state retirement plan in the United States whose purpose or intent is to completely offset the decline in purchasing power.

Inflation rate	Purchasing power at 5 years	Purchasing power at 10 years	Purchasing power at 20 years	Purchasing power at 30 years
2%	$91 (-9%)	$82 (-18%)	$67 (-33%)	$55 (-45%)
3%	$86 (-14%)	$74 (-26%)	$55 (-45%)	$41 (-59%)
4%	$82 (-18%)	$68 (-32%)	$46 (-54%)	$31 (-69%)

ORSC Issue Brief: COLA and Ohio Retirement Systems: 1998-2022 ORSC Staff Report on the Historical Experience of the Five Ohio Retirement Systems Since 1998 ("History Report").

2: COLA Design and Growth (no claw-back) of Benefit

Ohio's Variable Design:
- Ad hoc, fixed, CPI-based, and suspended

Ohio's Consistent Design:
- Non-compounding
- Determined Annually
- No claw-backs (aka Wisconsin Retirement System or other "shared risk" plans)
- Never intended to fully offset inflation
- Intermittent and variable

ORSC Issue Brief: COLA and ORSC "History Report."

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Base Benefit	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100
3% COLA	-	$3	$3	$3	$3	$3	$3	$3	$3	$3
3% COLA	-	-	$3	$3	$3	$3	$3	$3	$3	$3
3% COLA	-	-	-	$3	$3	$3	$3	$3	$3	$3
3% COLA	-	-	-	-	$3	$3	$3	$3	$3	$3
3% COLA	-	-	-	-	-	$3	$3	$3	$3	$3
3% COLA	-	-	-	-	-	-	$3	$3	$3	$3
3% COLA	-	-	-	-	-	-	-	$3	$3	$3
3% COLA	-	-	-	-	-	-	-	-	$3	$3
3% COLA	-	-	-	-	-	-	-	-	-	$3
Total Benefit	$100	$103	$106	$109	$112	$115	$118	$121	$124	$127
2004 Purchasing Power	$100	$100	$99	$100	$98	$101	$101	$102	$101	$102

Purchasing power calculated by using Bureau of Labor Statistics CPI inflation change calculator (calculator available online at: https://data.bls.gov/cgi-bin/cpicalc.pl).

STRS	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Base Benefit	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100
COLA wait period	-	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
COLA wait period	-	-	$0	$0	$0	$0	$0	$0	$0	$0	$0
COLA wait period	-	-	-	$0	$0	$0	$0	$0	$0	$0	$0
COLA wait period	-	-	-	-	$0	$0	$0	$0	$0	$0	$0
No new COLA	-	-	-	-	-	$0	$0	$0	$0	$0	$0
No new COLA	-	-	-	-	-	-	$0	$0	$0	$0	$0
No new COLA	-	-	-	-	-	-	-	$0	$0	$0	$0
No new COLA	-	-	-	-	-	-	-	-	$0	$0	$0
3% COLA	-	-	-	-	-	-	-	-	-	$3	$3
1% COLA	-	-	-	-	-	-	-	-	-	-	$1
Total Benefit	$100	$100	$100	$100	$100	$100	$100	$100	$100	$103	$104
2014 Purchasing Power	$100	$100	$99	$96	$94	$93	$91	$89	$83	$81	$81

Theoretical Average 3% COLA, 2024 (PERS and OP&F figure is for 2023)						
	PERS	**STRS**	OP&F	SERS	HPRS	**Social Security (2024 3.2% COLA)**
Average Annual Increase	$708	**$1,179**	$1,213	$418	$1,092	**$708**

General Assembly's Findings and Intent for STRS Pension Reform

"The General Assembly finds that certain changes to the STRS defined benefit plan, including changes to member contribution rates, retirement eligibility, benefit formulas, the number of years used to calculate final average salary, and future cost-of-living adjustments, are reasonable and necessary to further these legitimate and important state interests."

"In amending section 3307.67 of the Revised Code, it is the intent of the General Assembly to do all of the following:

To recognize that no member has a legitimate expectation of any particular future cost-of-living adjustment, or payment of future cost-of-living adjustments at any particular time, under Ohio law;

To declare that the modification to future cost-of-living adjustments under section 3307.67 of the Revised Code are reasonable;

To recognize that the funding crisis exacerbated by the historic decline in the global investment markets and accompanying recession was unforeseen;

To recognize that cost-of-living adjustments under the STRS defined benefit plan were never intended to undermine the solvency of the STRS defined benefit plan, or to put at risk the monthly pensions of current and future retirees under the plan"

Section 7 of Sub. S.B. 342 of the 129th General Assembly.

Support for S.B. 342

- Ohio Education Association (OEA)
- Ohio Retired Teachers Association (ORTA)
- Ohio Federation of Teachers (OFT)
- Ohio Association of School Business Officials (OASBO)
- Inter-University Council of Ohio (IUC)
- Buckeye Association of School Administrators (BASA)
- Ohio Association of Elementary School Administrators (OAESA)
- Ohio Association of Secondary School Administrators (OASSA)

3: Expense of COLA (Scale)

FY2023 Actuarial Liability is $107 Billion
FY2023 Actuarial Value of assets is $87 Billion
FY2023 Unfunded Actuarial Liability is $20 Billion

If I gave STRS $10,000 a day, in 100 days that's $1,000,000. It would take 2 million days or 5,479 years to get to $20,000,000,000.
1 million seconds is about 12 days. 20 billion seconds is well over 600 years.
In the 2022-2023 school year, OSU awarded 17,537degrees. It would take 1,140,445 years for OSU to issue 20 billion degrees at this rate.

Liability of all previously granted COLAs to be paid into the future is $13.2 Billion (no claw-back)
Liability of new, permanent and repeating 3% COLAs is $21 Billion

STRS is 81% funded/11 years amortization ***assuming no further benefit enhancements.***

ORSC Issue Brief: COLA; State Teachers Retirement System of Ohio Actuarial Valuation as of June 30, 2023; and STRS Board Meeting on March 21, 2024, Discussion on Sustainable Benefit Enhancement Plan.

4: STRS Sustainable Benefit Enhancement Plan (SBEP "The Plan")

From 2012 to 2021, the STRS funding ratio improved from 56% to 80%.
Net Assets increased from $64 billion to $97 billion. Unfunded liability decreased from $47 billion to $21 billion.
Funding period decreased from 40 to 14 years.

"It is only with increased contributions by active members, decreased future benefits, and suspension of future COLA increases combined with remarkable long-term investment returns that STRS has avoided the possibility of having insufficient funds for existing benefits." History Report, page 7.

<u>This plan was working.</u>

The STRS Board and their actuary developed the Sustained Benefit Enhancement Plan (SBEP). Under that plan, a 3% COLA was provided. Over the following two years, the Board approved enhancements *outside of this plan* using a "de minimis" *1% of total plan assets* for which the board had to vote to waive its funding policy to grant.

ORSC "History Report."

2022: 3% 1-time permanent COLA: Cost $2.3 billion in increased liability

2023: 1% 1-time permanent COLA (approximately $460 million) and temporary years of service reduction (approximately $425 million) *waived board funding policy*

2024: Reduction of years of service to 34 (approximately $850 million) *waived board funding policy*

The STRS Board has indicated an interest for a one-time supplemental benefit ("13th Check"; R.C. 3307.671) to retirees to be provided in December of this year. ORSC staff do not know the amount of this benefit. The ORSC has advocated for a repeal of this authority since as early as 1996.

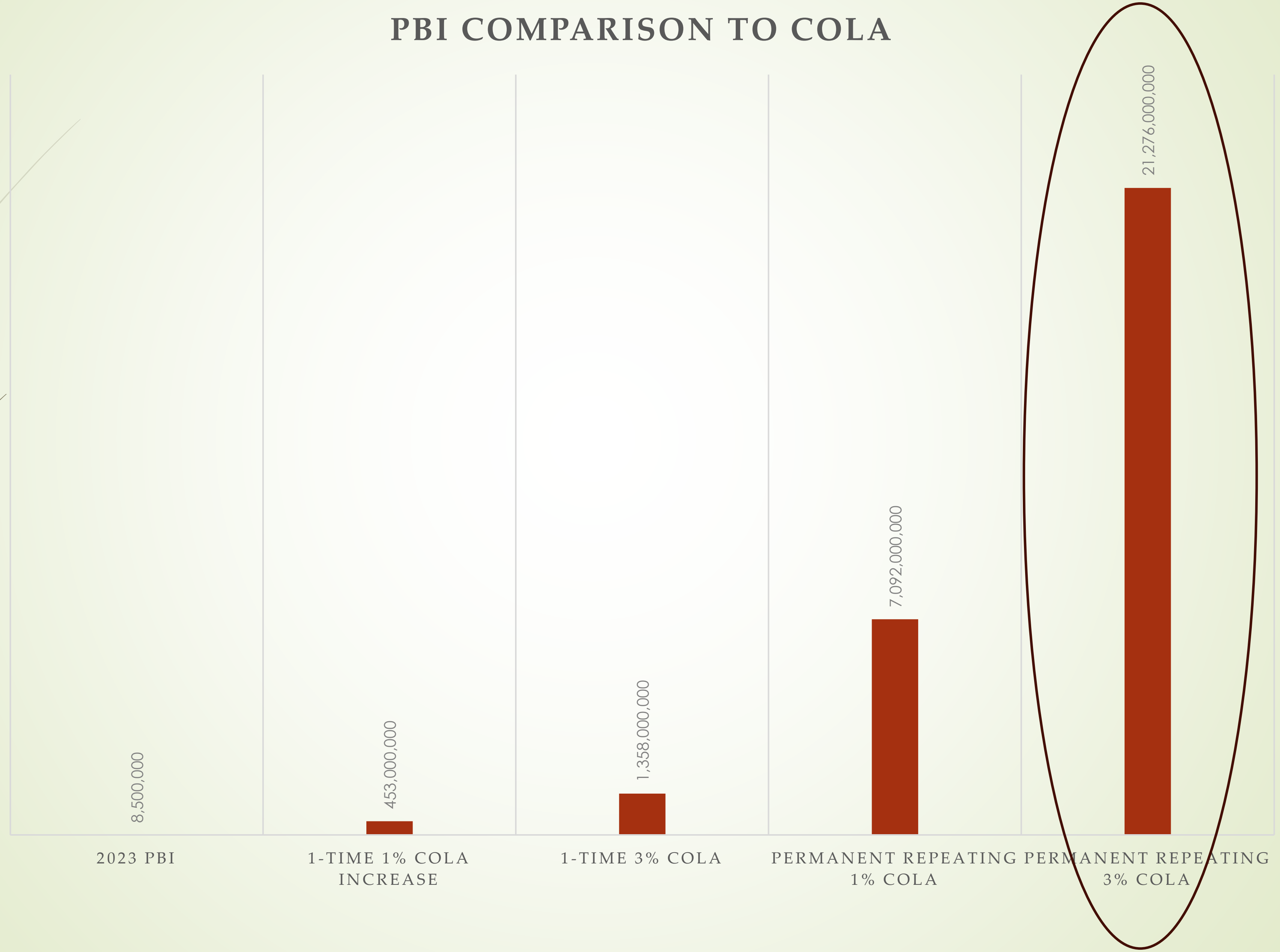
This totals $4 billion in new additional unfunded liabilities since 2022.

State Teachers Retirement System of Ohio, Actuarial Valuation Report as of June 30, 2023, and State Teachers Retirement System of Ohio, Actuarial Valuation Report as of June 30, 2024; Sustainable Benefit Enhancement Plan presentation to the STRS Board, March 21, 2024, and "May Board News" posted May 17, 2024 (https://www.strsoh.org/resources/newsroom/2024/may-board-news.html).

5: Investment Returns and PBI Compensation

	PERS	STRS	SERS	OP&F	HPRS		60/40 Portfolio
Annualized 1999-2023	6.34%	7.03%	6.65%	6.85%	6.18%		5.35%
Annualized 2009-2023	8.68%	9.59%	9.16%	9.26%	8.82%		8.29%

PBI COMPARISON TO COLA



6: Intergenerational Equity: COLAs under a Negative Normal Cost

"There should be equal treatment in the burden of pension financing between generations of taxpayers"—*D.3 of the Principles Governing Pensions.*

Fiduciary Principle: Impartiality requires attention to intergenerational equity. Randy Miller and Tiffany Reeves (ORSC Presentation, June 13, 2024).

"Unfortunately, a negative normal cost is necessary, as STRS has and is providing benefits to retirees that were not adequately funded by those retirees."

"The COLA suspension is, therefore, necessary to avoid ever further increases in unfunded liabilities that will have to be paid for by the current generation of workers. In fact, according to the Principles Governing Pensions, the current situation would suggest that improvements in STRS funding first be realized in reducing contributions to be closer to the [normal cost] than to grant additional unfunded COLA increases for current retirees."—Jeffery A. Bernard, "Intergenerational Equity and STRS" (June 10, 2021).

STRS FY2023 Normal Cost of 10.93% vs. a contribution amount of 14%. In FY2023, the dollar amount difference of this spread was $375,155,300.

Key Takeaways

1) There have been no claw-backs of COLAs. A granted COLA has been granted and will continue until death.
2) COLA does not equal PBI.
3) STRS has $20 billion in unfunded liabilities, and this liability cannot be filled with new unfunded benefits. There are also additional risks related to negative cash flow, investment returns, and the ratio of actives to retirees that are exacerbated by the size of this unfunded liability.
4) ORSC staff have significant concerns regarding intergenerational equity and the recent enhancement of benefits and discussions of further enhancements.