Pension Funding of Member Benefits

Policy Updates

Sept. 19, 2024

Recall Summary from August

- Adding Sustainable Benefits Plan (SBP) ☑
- Proposing a framework for how SBP spending is prioritized ☑
- Scorecard language removed and replaced with SBP
- Changes to Funding Objectives
- Going forward, a new amortization method

Funding Objectives

Current (**removed**)

Funding objectives shall include:

- 100% funding
  - At **85% or greater**, the Board may consider plan changes that in the determination of the Board's actuary do not materially impair the fiscal integrity of the system.

Proposed (**added**)

Specific objectives

Funding objectives are taken as a whole, and individual objectives are considered to the extent consistent with other objectives.

Funding objectives shall include:

- **At least** 100% funding **over the long term**
  - At **any level**, the Board may consider plan changes that in the determination of the board's actuary do not materially impair the fiscal integrity of the system.

Funding Level

Reasons for 100%+	Reasons for less than 100%
1. Financial stability and responsibility	1. Conservative assumptions make 100% funding unnecessary
2. Attracting and retaining quality educators	2. Trade-offs with other public priorities
3. Avoiding future taxpayer burden	3. Pensions can be funded on a pay-as-you-go basis

Funding Objectives (continued)

Current (removed)

- Manage the risk of unanticipated benefit changes
- Intergenerational equity, to the extent consistent with other funding objectives
- Transparency and accountability

Proposed (added)

- Optimizing asset return volatility
- Managing the risk of unanticipated benefit reductions
- Intergenerational equity
- Transparency and accountability

Asset Return Volatility

Implications for lower	Illustration

✓ Lowers the risk of not meeting expected investment returns in any given year

x Potentially lower returns

✓ Helps to pass SBP Test #2 as the shock is lowered. see illustration

Illustration

- SBP Test #2 assumes a shock return of two standard deviations below expected
- Assume a 7% return and 12% standard deviation

$$7\% - 2 \times 12\% = -17\%$$

x It takes ~10 years to recover

- If the standard deviation were lowered from 12% to 11%

$$7\% - 2 \times 11\% = -15\%$$

✓ Recovery is three years earlier

Actuarial Elements

Current (no changes)

Elements of a funding policy shall include:

- Actuarial Cost Method: entry age normal
- Asset Smoothing Method: four-year smoothing of gains/losses in excess of assumed earnings, with an actuarial value corridor of 91% to 109% of market value

Proposed

Actuarial Elements

No change to the text, adding a heading to make it easier to read.

Actuarial Elements *(continued)*

Current (removed)

- **Funding Period Policy:** a closed funding period, starting from 30 years as of 7/1/2015, with a level percentage of payroll amortization of all UAAL.

Proposed (added)

- **Initial UAAL: the UAAL established over** a closed funding period, starting from 30 years as of 7/1/2015, with a level percentage of payroll amortization of all UAAL.
- **New Incremental UAAL: each subsequent valuation will produce a New Incremental UAAL consisting of all benefit changes, assumption and methodology changes and experience gains and/or losses that have occurred since the previous valuation and shall be amortized over a closed 20-year period.**

Funding Type

Open

Resets each year to match the period set in the amortization policy

✓ Reduces contribution rate volatility

x Higher total cost

x Losing popularity

Single Layer Closed

Unfunded liability is eliminated within a specified timeframe that declines annually by one year

x Contribution rate volatility, particularly toward the end of the period

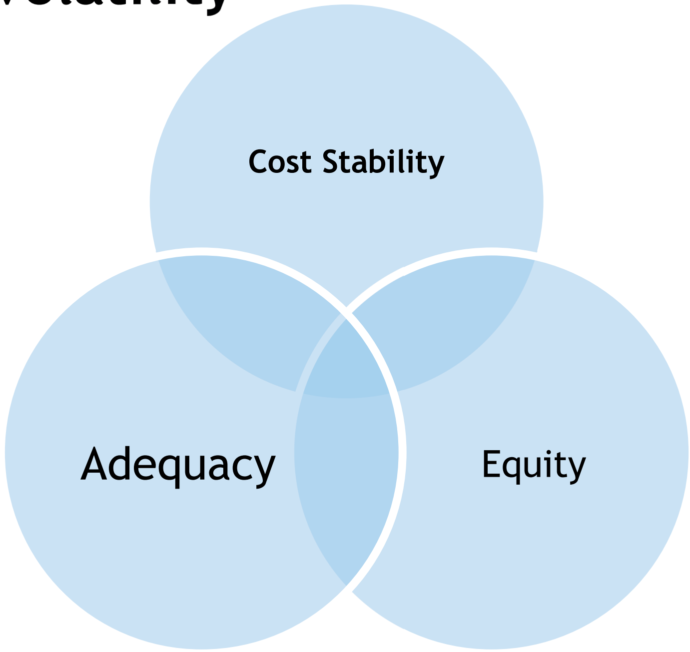
✓ Lower total cost

Closed Multi Layer

A new amortization schedule is created for each year's actuarial experience

Amortization Period

Shorter	Longer
✓ Lowers overall cost as liability is paid off quickly	x Higher overall cost
✓ Good intergenerational equity	x Poor intergenerational equity matching
x Increases contribution rate volatility	✓ Low contribution rate volatility



Amortization Period — Recommendations

ORSC: It would be valuable for the General Assembly to consider reducing the maximum amortization funding period to something at or below 20-years[1]

SOA: Amortization of gains/losses should be completed over a period of no more than 15 to 20 years[2]

CCA PPC: For gains and losses, balancing demographic matching and volatility control leads to an ideal amortization period range of 15 to 20 years[3]

Intergenerational Equity and Amortization Period

28 (average career yrs) − **13.5** (current actives yos) = **14.5** (yrs remain)

[1] *ORSC Staff Report on the Historical Experience of the Five Ohio Retirement Systems Since 1998, April 2024*
[2] *Report of the Blue Ribbon Panel on Public Pension Plan Funding, February 2014*
[3] *Actuarial Funding Policies and Practices for Public Pension Plans, October 2014*

Actuarial Elements *(continued)*

Current (removed)

- **Funding Period Policy:** a closed funding period, starting from 30 years as of 7/1/2015, with a level percentage of payroll amortization of all UAAL.

Proposed (added)

- **Initial UAAL: the UAAL established over** a closed funding period, starting from 30 years as of 7/1/2015, with a level percentage of payroll amortization of all UAAL.
- **New Incremental UAAL: each subsequent valuation will produce a New Incremental UAAL consisting of all benefit changes, assumption and methodology changes and experience gains and/or losses that have occurred since the previous valuation and shall be amortized over a closed 20-year period.**

Removing Scorecard and Simplifying

- **Scorecard language was put in place before the SBP**
  - The SBP has replaced the way plan design changes are made, making the scorecard duplicative
- **Removing this language aligns the policy closer to practice**
  - Eliminating statutory language and including links

Annual Valuation

Current (removed)

On an annual basis, an actuarial valuation of the pension assets, projected liabilities and projected funding requirements of the Retirement System will be prepared by an actuary. Such valuation study shall meet all requirements of Section 3307.51(A) of the Revised Code.

Proposed (added)

Actuarial Valuation and Studies

All actuarial valuations, studies, and/or other analyses shall be prepared by an actuary pursuant to applicable Ohio law, and specifically in accordance with Section 3307.51 — R.C. and Section 3307.84 — R.C., as may be amended from time to time.

In addition, an actuarial review shall be conducted of the economic assumptions, including discount rate, inflation and wage growth on an annual basis.

Annual Valuation *(continued)*

Current (removed)

On an annual basis following the completion of the actuarial valuation, staff, working with an actuary, will update the funding scorecard according to the criteria set forth in the Metrics to Guide Funding Policy. Staff will update the Board of the resulting score. Should the overall score, or any of the individual metrics, fall outside the range of advisory levels established by the Metrics to Guide Funding Policy, the Board will either initiate action to mitigate this risk or approve a written statement explaining why mitigation is not considered necessary, possible or desirable at that time.

Proposed

This material is being removed.

Annual Valuation *(continued)*

Current (removed)

On an annual basis, to assist the Board's interpretation of scorecard results and to facilitate consideration of actions that may be necessary to meet funding objectives, STRS Ohio staff and an actuary will prepare a sensitivity analysis detailing the projected impact of a range of possible plan design changes.

Proposed

This material is being removed.

Demographic Assumptions

Current (removed)

At least once in every quinquennial period, an actuarial review shall be prepared by or under the supervision of an actuary to update the actuarial assumptions used in the annual actuarial valuation study. Such review shall comply with the requirements set forth in Section 3307.51(B) of the Revised Code. The review will include demographic factors, such as the mortality, service and other experience of the members, retirees and beneficiaries, as well as the economic experience of the Retirement System.

Proposed

This material is being replaced by the language above.

Actuarial Studies

Current (removed)

At intervals determined by the Board, an actuarial study shall be prepared to assess the negative financial impact, if any, on the defined benefit plan resulting from participation of members in the defined contribution plan. Such review shall comply with the requirements of Section 3307.84 of the Revised Code.

Proposed

This material is being replaced by the language above.

Actuarial Studies *(continued)*

STRS OHIO

Current (removed)

As necessary, an analysis shall be prepared under the supervision of an actuary of any introduced legislation expected to have a measurable financial impact on the Retirement System. Such review shall comply with the requirements of Section 3307.51(D) of the Revised Code.

Proposed

This material is being replaced by the language above.

Appendix

Current

This is new material.

Proposed (**added**)

Appendix

Sustainable Benefits Plan

The following describes the Sustainable Benefits Plan fiscal integrity tests developed by Cheiron in 2023. It is included here for reference only and is subject to change at any time by Cheiron.

Appendix *(continued)*

Current

This is new material.

Proposed (added)

The SBP consists of three fiscal integrity tests to evaluate whether a change may materially impair the fiscal integrity of the System. The tests currently are:

1. Do contributions exceed treadwater by a 20% margin?
2. Will contributions exceed treadwater within 5 years after a shock investment return?
3. Is there an 80% probability that contributions will exceed treadwater in 10 years?

Questions?

Governance Consultant Review

Sept. 19, 2024

Background

- In May 2024, an RFP was issued for a new board governance consultant to assist with recommendations related to Board Policies, strategic planning, education and enterprise risk management
- In June 2024, proposals were received from six potential consultants
- Last month, the Governance Committee heard presentations from three potential consultants: Segal, Hackett Group and Global Governance Advisors

Current Status/Next Steps

- **Per the board's guidance, staff contacted consultant provided-references and the Ohio Retirement Study Council, researched potential conflicts of interest and clarified proposal costs**
  - Summary of references
  - ORSC feedback
  - Cost clarifications
  - Potential conflicts of interest/relevant information
- **Discussion/Next steps**

Questions?

November Board Education & Planning Meeting

Sept. 19, 2024

Background

- Each year the board holds a Board Education & Planning Meeting in November in place of a regular board meeting
- While there may be some board business to address, the primary goal is to schedule educational topics of interest to the board
- Per the updated Governance Committee Charter, the committee is now in charge of coordination of ongoing board education

Current Topics

- Annual fiduciary training
- Ethics training (will be online again this year)
- Strategic planning
- Board self-evaluation
- Stakeholder Engagement Task Force
- Cheiron – SBP, Pension Funding Policy
- Other topics of interest?

Questions?

This material is intended for use by the board of the State Teachers Retirement System of Ohio (STRS Ohio) and not by any other party. STRS Ohio makes no representations, guarantees, or warranties as to the accuracy, completeness, currency, or suitability of the information provided in this material. Nothing included herein is either a legal reference or a complete statement of the laws or administrative rules of STRS Ohio. In any conflict between the information provided herein and any applicable laws or administrative rules, the laws and administrative rules shall prevail. This material is not intended to provide tax, legal or investment advice. STRS Ohio disclaims any liability for any claims or damages that may result from reliance on this material or the information it contains, including any information obtained from third parties.