

SERS Board Retreat July 17, 2019

The annual Board Retreat was held at the School Employees Retirement System on July 17, 2019. The meeting convened in open session at 9:01 a.m. The roll call was as follows: Chairperson Catherine Moss, Hugh Garside, James Haller, Barbra Phillips, Daniel Wilson and Hugh Garside. Ms. Moss excused the absence of Jeffrey DeLeone. Also in attendance was Mary Therese Bridge, representative of the Attorney General, and various members of the SERS staff.

Welcome/Overview – Richard Stensrud, SERS Executive Director

Executive Director Richard Stensrud welcomed everyone to the retreat and provided an overview of the day's sessions which were built around the theme of sustainability. Mr. Stensrud then introduced Michael Perri and Michele Berry from Lincoln Crow Strategies to facilitate the pension sustainability discussion.

Pension Sustainability

Mr. Perri and Ms. Berry facilitated discussions by and among the Board regarding how to move forward on and achieve pension fund sustainability.

The Board expressed its desire to engage in a series of discussions of the considerations necessary to make sure the SERS' pension fund is in position to withstand changes in member demographics, investment experience, and other financial pressures. The Board noted while the pension fund is currently reasonably healthy, the Board wants to identify measures to strengthen the system before there are any financial or legal imperatives to act.

Board members reviewed each other's expectations and visions of the sustainability initiative, prioritized plan elements that require further investigation, and began the iterative process of establishing a common definition of "sustainability" that will aid in planning efforts.

The Board acknowledged that in certain respects the sustainability initiative would require them to work together differently from the normal Board Meeting and decision making process. To that end, Mr. Perri and Ms. Berry conducted several exercises to help Board members foster creative thinking, and strengthen their ability to work together and analyze complex issues.

Board members noted that the sustainability discussions will be difficult because any proposed changes will directly affect people's lives. The Board further noted, however, that each Board Member is fully committed to acting in the best interest of the pension fund. They committed to thinking outside the box, being open to new and different ideas, to respecting differences of opinion, and working together to tackle tough questions. They also committed to being transparent and include stakeholder participation and input in the process.

The Board members discussed in small groups, as well as in a larger group setting, what they believe "sustainability" means. Board members' definitions of sustainability included being able to provide pensions earned through years of contributing service, and exploring long-term funding beyond the state-mandated 30-year funding window. They said the sustainability initiative has to look beyond the 30 year actuarial assumptions to make sure there is some retirement security for those who earn it.

Finally, Mr. Perri and Ms. Berry assisted the Board members in prioritizing topics for investigation during the next phases of the initiative, which will take place in the fall. Potential topics for exploration included:

- What is the current state of SERS, and what does it that mean for a sustainable future?

- How do the many forms of risk involved in providing retirement benefits impact sustainability?
- How do current actuarial assumptions impact our vision of the future?
- What will be the impact of changes in Ohio demographics on our educational system?
- How does pension system cash flow impact the ability to provide sustainable benefits?
- What type of plan changes have other systems made or are proposing to make themselves more sustainable?
- What possible new pension plan designs have other systems made or are exploring to make themselves more sustainable?
- What is SERS' primary purpose?

Concluding, Board members agreed that actuarial assumptions, SERS' purpose, and changing demographics are the most important topics to explore during the next phase, and that a discussion surrounding the purpose of SERS as a pension system needs to take place before addressing the other elements.

Mr. Perri and Ms. Berry will work Board Chair Cathie Moss, Vice Chair Hugh Garside and Executive Director Richard Stensrud to develop a proposal concerning how to move forward on the sustainability initiative, and present it during the September Board meeting. The Board thanked Mr. Perri and Ms. Berry for their presentation and the facilitation of sustainability discussions.

Following the presentation, the Board took a break 10:34 a.m. and reconvened at 11:01 a.m.

Next, Mr. Stensrud asked Chief Investment Officer Farouki Majeed to discuss investment outlook.

Investment Outlook – Growth, Valuation, and Trade Wars

Mr. Majeed introduced David Lebovitz of J.P. Morgan for a presentation on market outlook. He reviewed the factors of global growth, which entailed the length and strength of expansions, long-term drivers and inflation. Mr. Lebovitz stated that the country is currently in the longest economic expansion in U.S. history, but the cumulative growth has been the lowest compared to prior cycles. Globally, there has been a step down in economic growth. Inflation is benign across all the major economies. The U.S. dollar is expected to weaken due to deficits and the expected cut in Fed rates. Mr. Lebovitz stated that this may favor Non-US equities. China's growth is 6.2%, which is the slowest growth since the early 90's, and countries are now looking into shifting their supply chains from China to other countries on account of the U.S. tariffs.

Following Mr. Lebovitz's presentation, Mr. Majeed provided a presentation on China's market growth. China is the second largest equity market and the third largest bond market. China's growth is slowing, but is still at a rate faster than the developed countries. SERS has not taken a country specific approach to investment in China, but will look into this. Concluding questions and comments, the Board thanked Mr. Lebovitz and Mr. Majeed for their presentations.

The Board recessed at 12:11p.m., and reconvened at 1:00p.m.

Mr. Stensrud asked Health Care Services Director Christi Pepe to introduce the next speakers. Ms. Pepe introduced Michael Madalena and Emily Madalena of Madalena Consulting, LLC, an independent health care consultant, along with members of SERS Health Care Services Staff, to present the sustainability review.

Health Care Sustainability

The presentation examined SERS financial status over a 10-year period in relation to health care expenses and actuarial projections. Mr. Madalena noted for the Board that the Health Care program's

financial status is stable, and it is positive that long-term strategies can be considered thoughtfully, without the pressure of a fiscal emergency.

Discussion ensued regarding different measures of financial solvency, which included an entity's ability to pay for a percentage of its future expenses, SERS' current funding policy, and actuarial valuation of future solvency. A timeline of historical health care changes, subsidization, enrollment, eligibility, and other landmarks also was reviewed.

One of the topics examined was the fact that if SERS were to make changes to the health care program to extend plan longevity, not all changes would have equal effect. Specifically, the premium subsidy was identified as the most significant and impactful area of change available to decision makers. Subsidy changes which "grandfather" or protect current retirees have less effect than those which apply to all current enrollees. The SERS Board has made changes in subsidy which have been both prospective and retrospective at different times in the program's history.

Further analysis of the premium subsidy and its history showed that SERS' health care subsidy is worth \$95 million per year to members. While 48% of subsidy dollars were in the Medicare population, 52% were in the non-Medicare population, even though the non-Medicare population only accounts for 12% of all enrollees. This is partially due to the fact that the base premium for non-Medicare is over six times more expensive than Medicare. Of the non-Medicare enrollees, 99% are receiving a subsidy.

Staff observed that service retirees accounted for 86% of subsidy dollars while health care enrollees with more than 20 years of service accounted for 92% of subsidy dollars. The current subsidy structure, in place since 2011, provides the most benefit to disability benefit recipients and retirees with higher years of service.

The presentation also made note of SERS' unique demographics. Compared to its sister systems, SERS' membership was older, mainly female, had fewer years of service, and had markedly lower salaries. The Medicare and non-Medicare Program plans also were compared and examined by expenses, claims, and enrollment.

Based on the analytics gathered to create the presentation, it became clear that subsidization drives enrollment, which drives demographics, which drive expense distribution.

The program's expenses were reviewed, also noting that the current level of reimbursements from Medicare for both medical and prescription drugs substantially offset expenses and the Medicare program, if measured independently, would be solvent indefinitely.

Another issue of consideration is the need for SERS to review the existing Guiding Principles document as part of future health care sustainability discussions. Further discussions related to health care sustainability will take place during the September Board meeting.

The Board thanked Madalena Consulting and SERS Staff for their presentation.

Adjournment

Chairperson Catherine Moss moved to adjourn the meeting at 2:56 p.m.

Catherine Moss, Board Chair

Richard Stensrud, Secretary