Pension Fund Sustainability

Equity and Cash Flow

August 20, 2020

Following the June Sustainability Meeting, SERS' staff and actuary, Cavanaugh Macdonald, began gathering data to support discussions exploring the impact of providing an annual cost-of-living adjustment (COLA), the definition of a career member, raising the age to be eligible for an unreduced benefit, changing the final average salary (FAS), changing the minimum number of days required to earn a year of service credit, and comparing disability benefits with service retirement benefits.

Based on the data provided, August's discussions examined all of these topics.

The August discussions began with the topic of SERS' COLA.

After a three-year suspension of COLAs for new and existing retirees in 2018, 2019, and 2020, the Board expressed its desire to provide an increase in 2021.

If a COLA is provided in 2021, the amount needs to be finalized soon to allow enough time for staff to properly code the benefit payment data into the member benefit computer system.

Although SERS' current COLA statute states that the amount of the COLA increase will be based on the June 30 year-over-year CPI-W calculation performed by the Bureau of Labor Statistics, the Board has the authority to approve a higher or lower amount based on the actuary's assessment of the financial stability of the system.

To aid the Board in making a determination as to the size of the 2021 COLA, SERS' actuary was tasked with gathering information about the effect that different levels of a 2021 COLA would have on SERS' cash flow.

Cash flow is the difference between the amount of employer and employee contributions coming into the fund compared to the amount of benefits being paid during a year. Like virtually all mature retirement systems, SERS is in a negative cash flow position, meaning that benefit payments exceed contributions, but SERS is able to cover the difference with income generated by the investment portfolio.

The Board also voiced support for looking at an approach for determining the appropriate COLA tied more closely to both the SERS' investment performance and the system's cash flow status. SERS' actuary provided information about how such an approach has been utilized at systems in other states, and in September, SERS' staff and actuary will present a proposed plan and modeling examples of how such a plan might work at SERS.

Additionally, Board members expressed that decisions concerning future COLAs should take into account funding for health care and preserve the ability to pay down the System's unfunded liabilities.

Staff provided the Board with extensive data on current active member demographics. The Board reviewed two possible ways to incentivize active members to work longer: A laddered plan that increases the service credit rate accruals at certain steps as service time increases; and a proposal to move to a "rule of 90" where the earliest age eligibility to retire moves from the current age 57 to age 60 with 30 years of service.

The Board will review these proposals in more depth in September.

Next, the Board discussed the impact of changing the Final Average Salary (FAS) from a three-year calculation to a five-year calculation. Currently, the FAS is an average of a member's three highest years. SERS' actuary concluded that changing this calculation to an average of a member's five highest years would have a minimal impact on SERS' funded status.

Additionally, Board members discussed the impact of changing the FAS to the member's three highest *consecutive* years. In an example provided in the data packet, a member's salary that would have produced a FAS of $37,356 under the current calculation would be $33,633 under the consecutive-year calculation.

This led into a Board discussion regarding pension spiking.

Pension spiking is defined as an increase in pension benefits by substantially increasing the FAS beyond what is expected from normal salary increases. Two specific approaches that have been implemented by other Ohio public pensions systems include limiting the percentage of pensionable compensation growth in FAS years, and using a Contribution Based Benefit Cap (CBBC) to cap pension benefits. The CBBC is calculated by multiplying a single-life annuity based on the member's accumulated contributions and age by a CBBC factor, which would be set by the Board, in consultation with SERS' actuary. This formula is designed to impact only members whose formula benefit is out of proportion with their career contributions, and would impact a small percentage of members. Following discussion, the Board asked for anti-spiking examples from systems similar to SERS in other states.

The next topic discussed was regarding how one year of service credit is determined, and if the current calculation is still equitable to career employees.

Presently, SERS grants one year of service credit upon completion of 120 or more days of paid school service in a fiscal year. If members work less than 120 days, their service credit is prorated based on 180 days. Any portion of a day constitutes a full day.

Board members discussed the impact of moving a full year of service credit up from 120 days closer to 180 days, which is the length of a typical school year. If this change were to be implemented, it would affect nearly 10% of members who have between 120 and 179 days of service credit. Board members also proposed researching how many days a full-time school employee typically works in a school year, and possibly adjusting this proposal based on the findings.

Finally, in an effort to ensure that disability benefits continue to meet both the goals of the program and the needs of membership, and that disability and service retirements are calculated equitably, the Board examined disability benefits as compared to service retirement benefits.

Disability benefit recipients comprise only 6% of SERS' benefit recipients. Based on when a member began contributing to SERS, the member can qualify for one of two disability plans: The Old Disability Plan and the New Disability Plan.

Disability benefits are considered income replacement until those members reach the end of the benefit period (at age 65 or later based upon their age at disability), at which time, under the New Disability Plan, their benefits will be converted into retirement benefits.

Complete disability benefit eligibility requirements are available on our website.

SERS implemented a process of re-examination of new disability recipients known as the Any Occupation standard. This new process changed how SERS re-examines members after they receive disability benefits for three years (or five years if on a continued leave of absence), evaluating their ability to work in any occupation. Prior to this change, members were re-examined only on their ability to perform their last-assigned position with the schools.

The Board also received information on a disability model that provides different vesting standards and different benefits depending on whether the disabling condition is caused by the person's work or if the condition is not service-connected.

The Board will continue its sustainability discussions in September. No Board decisions have been made on any of these topics to date.