Pension Fund Sustainability: Finalizing Plan Design Elements and Subgroups

At the February Board Retreat held at SERS' headquarters in Columbus, Ohio, Board members used the morning session to continue sustainability discussions.

Board Vice-Chair Hugh Garside reiterated the Board’s goal of making substantial progress on the sustainability analysis by the end of the fiscal year so that engagement with SERS’ advocacy groups and stakeholders on possible sustainability measures can accelerate in the new fiscal year.

At the meeting, the Board identified the following plan design elements that will be discussed at future meetings: level of benefits, employee eligibility, vesting requirements, retirement formula, other benefits (health care, disability, survivors, etc.), and forms of benefit payments. All of these design elements will be discussed as they pertain to the following membership subgroups: disability recipients, inactive members, career members (30+ years of service), and non-career members.

To begin the session, the Board reviewed all of the demographic data that was gathered since the sustainability discussions began. The following data was identified as important to consider in upcoming sustainability discussions:

1. The significant jump in the number of retirees over age 90 in the last 40 years
2. The average service time of retirees is only 26 years which means more people could live in retirement longer than they contributed to the SERS
3. The concept of SERS replacing 60-66% of final average salary compared to Social Security, which replaces less than 40%, may need to be examined
4. A review of disability benefits compared to service retirement payments. If disability benefits are higher, explore the rationale.
5. The reasons why the vesting period is 10 years

Board members also expressed interest in the following courses of action:

1. Investigate further when employee/employer contributions are exhausted and look at ways to incentivize/enhance refunds
2. Make sure SERS retains the ability to revise plan design elements as economic conditions change
3. Gather data as to when retirees begin receiving more in pension benefits than their final average salary
4. Compare SERS’ plan design with other similar pension systems
5. Investigate how changes to school employment (i.e., the recent implementation of two-hour jobs) affect SERS
6. Look at changes to plan design on a blank sheet of paper rather than in comparison to where the System is today

Finally, the Board agreed to focus on reviewing plan design elements for career members at the March meeting.
Board Education Session: Board Governance Affects Financial Stability of Pension Plans

The afternoon training session of the Board’s annual retreat focused on the importance of good Board governance for a financially successful defined benefit pension plan. Brad Kelly and Peter Landers, partners with Global Governance Advisors (GGA), focused on best practices that lead to good governance.

Citing recent research conducted by the Center for Retirement Research at Boston College (CRR), good Board governance can add 24 basis points of additional investment returns over a 10-year period. SERS’ Board composition closely matches the composition CRR recommends for optimal performance: SERS’ Board provides investment and operational oversight; it contains 9 members which is within the 6-10 member recommendation; it has three ex-officio members and is slightly above the 20-70% active/retired member ratio; the Board has more than two financial experts; and the group average of 8+ years of Board service is within the 8-10 years of tenure recommendation.

GGA also stressed the importance of Board self-assessment. While the SERS Board has not performed self-assessments regularly in the past, they were open to learning more about the different types of assessments and how they should be conducted.

GGA also addressed misinformation being circulated that public pensions are unsustainable and should be converted to defined contribution plans. Using the experience of Canada’s public pension plans, they described the roadmap those pensions used to improve their funded statuses from 60% to fully funded in a short time period.

Some steps they took included:

1. Moving control of the pension funds from government entities to the Boards
2. Restructuring the Boards to include a majority of active and retired workers
3. Aligning investment and executive compensation to match similar jobs in the private sector rather than basing pay on similar public sector jobs
4. Diversifying the asset allocation of the funds to include more than just Canadian equities and fixed income
5. Moving the management of some investments to internal managers to save on investment fees and setting up offices overseas to be closer to the investments they manage
6. Refraining from investing in hedge funds due to higher fees

Other recommendations included investing in alternative assets such as utilities, toll roads, airports, buildings, lotteries, and infrastructure; and pooling assets with other public pensions to get lower investment fees.

The presenters acknowledged that SERS is already following many of these recommendations. The System has lowered investment fees of the Total Fund by nearly 20% since 2012; has increased its exposure to infrastructure to 2.8% of the Total Fund; and restructured its investment approvals to allow SERS’ staff to move quickly to invest in time-sensitive opportunities.

Some recommendations such as moving investments from external managers to in-house staff and setting up investment offices in markets around the world must wait until SERS’ assets grow substantially.