Pension Fund Sustainability

Examining a Year of Service and Benefit Inflation

April 16, 2021

The April 2021 sustainability session began with an overview of the materials created by staff at the request of the Board. Topics included: the standard for earning a year of service credit; ways to prevent pension benefit inflation; formula factors and their impact on members and SERS; eligibility to draw a pension; and risks to sustainability.

Board Members were reminded by Board Chair Hugh Garside that as a group, the Board had collectively agreed to address one subject at a time and reach consensus on a decision for that topic before moving to another topic.

John Garret, principal consulting actuary with Cavanaugh Macdonald, SERS' independent actuary, was available to answer questions.

Topic One: Year of Service
The first topic was defining what constitutes a year of service.

Standard for Earning a Year of Service Credit
Currently, SERS grants a full year of service credit to any member who works 120 or more days during a school year.

The Board engaged in a discussion regarding the appropriateness of granting a year of service credit to members who work 120 or more days during a school year. Some Board Members viewed 120 days as being too low of a floor when a full school year was 180 days, equating that the length of service was closer to part-time work than full-time. Others Board Members countered that several factors limited the number of days school employees can work during a year including:

1. In Ohio, school districts have different calendars, so some have a school year that is longer than 180 days while others are below that level
2. Some districts pay employees for calamity days and others do not
3. Some employees are limited early in their careers to jobs that only offer 120-170 days of work per year

In response to Board questions, SERS' actuary said that the discussion on what constitutes a year of service was relevant as a fairness issue and matter of policy, but that increasing the number of days to earn a full year of service credit would not significantly improve SERS' financial situation. He reminded the Board that the proactive actions they took regarding increasing age and service to qualify for retirement and changes to the COLA were important decisions that will help keep the System on solid financial ground.

When asked how SERS could remain sustainable as the gap grows between contribution collections and the amount paid out in benefits, Garret said that SERS' cash flow as a percentage of fund value is less than 4%, which is sustainable, and that actuarial projections indicate the gap will moderate in the future. He also reiterated that the current contribution structure is sufficient to keep SERS financially stable 100 years into the future, even if investment returns only realize 25% of the expected rate of return over that time.

While the Board acknowledged the importance of part-time workers to school districts, they discussed the impact of long-term, part-time workers on SERS.

They questioned the actuary whether members who worked four hours a day for more than 30 years negatively impacted SERS' financial status when they retire. The actuary said that situations like this do not negatively impact the financial stability of the System because SERS pro-rated service time for those who worked less than 120 days, and lower part-time salary ultimately limited Final Average Salary (FAS) and pension amounts.

Although not an official vote, the Board agreed to keep 120 days as the level at which a year of service is earned.

Topic Two: Retirement Benefit Inflation

Garret said that a situation involving part-time workers that does affect sustainability of the System is when someone receives a huge salary inflation near the end of his or her career, most notably a move from part-time work to full-time work. This benefit inflation created a situation where career earnings were not enough to cover a higher FAS. He categorized benefit inflation as “leakage” that SERS should control as much as possible.

Benefit inflation is defined as an increase in pension benefits due to a substantial increase in the FAS beyond what is expected from normal salary increases. When a person’s contributions do not support their benefit, the pension system subsidizes the pension of this person.

Three ways to prevent pension benefit inflation were examined:

1. Increase the number of years used to calculate the FAS
2. Limit types of remuneration included in pensionable compensation
3. Limit the percentage of “pensionable compensation” growth in FAS years

Because SERS already limits the types of income that can be included as pensionable compensation and the Board remains comfortable with a FAS based on the highest three years of a member’s compensation, the discussion focused on limiting compensation growth in FAS years.

Staff summarized the methods used by other Ohio pension systems to control benefit inflation and recommended the implementation of a Contribution Based Benefit Cap (CBBC) system similar to the one used by the Ohio Public Employees Retirement System.

This type of anti-benefit inflation tool has three advantages for SERS:

1. It is fair and aligns with the basic premise that a member’s contributions plus earnings over time should fund the member’s pension
2. The General Assembly is familiar with the CBBC and therefore would be more likely to support legislation necessary to implement it
3. More types of one-time payments could count as pensionable compensation, because the CBBC would cap the pension of a member who experienced a large jump in FAS

The CBBC involves the actuary calculating an annuity amount for members based on their age at retirement and total lifetime contributions with interest. This annuity amount is then multiplied by a formula factor, approved by the Board, that is used to calculate a maximum cap to a member’s benefit amount. A member’s pension is the lower of the traditional pension calculation or the CBBC maximum cap.

Staff conducted a CBBC calculation on just under 2000 recent retirements. It found that approximately 18 members would have been flagged for possible benefit inflation using a factor of 6, and 42 members flagged using a factor of 5. This exercise also alerted staff to the fact that certain scenarios like conversion retirement members, old disability members, and members who have purchased service credit will need to be addressed when crafting the CBBC legislation.

The Board members were supportive of the CBBC concept but wanted to make sure the implementation would not negatively affect members who steadily progressed into higher paying positions during their careers or who received pay increases upon the completion of continuing education and the attainment of certifications. Board members agreed that they wanted to make sure implementation of the CBBC would not be detrimental to members in these scenarios.

Board Chair Garside said that he would send staff examples of common wage progressions to determine how CBBC calculations would affect them.

The results of the calculations will be discussed at the May sustainability meeting.