School Employees Retirement System of Ohio
Board Meeting Highlights
November 2022

Actuary Presents Pension and Health Care Valuations
SERS' actuary, Cavanaugh Macdonald Consulting, LLC, presented the results of the FY2022 pension and health care actuarial valuations to the Board.

In FY2022, SERS’ funded status for Basic Benefits (Pension, Death Benefit, and Medicare B Funds) increased from 74.46% to 75.48%, and the amortization period (the amount of time it takes to pay off all pension liabilities) of the unfunded actuarial accrued liability decreased from 23 years to 22 years.

Although investment performance in FY2022 was below the assumed rate of return of 7.0%, the actuarial value of the assets increased due to the four-year smoothing method SERS uses for investment gains and losses. Under the smoothing process, gains and losses were divided into four equal amounts and recognized over a four-year period. Because the unrecognized gains from the previous three years were greater than this year’s one-fourth loss, SERS’ actuarial value increased.

The remaining three-fourths of the investment losses from FY2022 will be phased into the actuarial value of assets over the next three years.

Although health care is not funded on an actuarial basis, an annual valuation is performed to fulfill the requirements of GASB 74 and 75. The valuation reports that health care experienced a slight decrease in the funded ratio from 46.56% to 45.36%, mainly due to negative investment experience and no income from the 14% of employer contributions in FY2022. However, the Health Care Fund is projected to remain solvent for 38 years, until 2060.

The System’s funding policy allows the Board to allocate up to 0.50% of the 14% employer contribution toward health care if the funded ratio of the pension fund is greater than 70% but less than 80%.

At the September Board meeting, the Board voted to allocate 0% of the employer contribution toward health care in FY2023, preferring instead to enhance the funding level for Basic Benefits.

At the recommendation of SERS' actuary, the Board allocated the 14% employer contribution for FY2023 with 13.28% to the Pension Fund, 0.05% to the Death Benefit Fund, 0.67% to the Medicare B Fund, and 0.00% to the Health Care Fund.

Also upon the advice of SERS’ actuary, the Board set the minimum compensation amount of $25,000 for determination of the FY2024 health care surcharge.

Fixed Income Annual Portfolio Review
Staff presented a review of the fixed income portfolio's structure and performance, as well as FY2023 expectations.

Currently, SERS’ fixed income portfolio has a market value of $2.1 billion and is 6.4% below its 19% target. Staff has strategically underweighted fixed income due to the Federal Reserve’s aggressive increase in interest rates to combat historically high inflation.

This portfolio contains investments in three sectors: 49% in core (Treasuries, corporate bonds, and mortgages); 40% in core plus (core securities plus high yield and non-US debt); and 11% in tactical and diversifying (emerging market debt, high yield, dislocation strategies, and fixed income relative value). Sector exposure includes 26.2% in government bonds, 24.2% in investment grade corporate, 23% in mortgages, 6.4% in emerging market debt, and 5.5% in high-yield bonds, with the remaining 14.7% allocated to asset-backed securities, commercial mortgage-backed securities, non-US developed, and other/cash.

Despite a -14.2% loss over the last 12 months, this portfolio has outperformed the Bloomberg U.S. Aggregate Bond Index benchmark over 1 year by 0.36%, 3 years by 1.38%, 5 years by 0.88%, and 10 years by 0.86%.

Looking ahead, most of the conditions that caused fixed income investments to drop should ease in the coming year. The Federal Reserve is expected to slow or stop the interest rate increases in 2023, and interest payments should provide higher fixed income returns going forward. Staff expects fixed income returns to be closer to the current portfolio yield of 5.05% over the long term.

Investments Quarterly Report
David Lindberg of Wilshire Associates provided the Board with an update of current global market conditions, as well as SERS' FY2023 first quarter (July-September) investment results.

During the quarter, Lindberg noted that the U.S. stock market experienced a drop of 4.4%, now down 24.4% for the 2022 calendar year. Small cap stocks outperformed large cap by 100 basis points, and growth stocks outperformed value stocks. Most sectors experienced negative returns, with the communication services, real estate, and materials sectors performing the worst.

Inflation remains high and U.S. interest rates continue to increase.

At the Federal Reserve's annual Jackson Hole Economic Symposium in August, Federal Reserve chairman Jerome Powell warned that stabilizing prices and reducing inflation by way of higher interest rates will bring "some pain" to households and businesses. Shortly after the conference, market returns plunged.

With further tightening of federal policy, the federal funds rate increased by 0.75% in both July and September, targeting a range of 3.00% to 3.25%.

As inflation persists, the odds of a "soft landing," or a gradual slowdown in economic growth or spending that would avoid recession, are diminishing. As the Federal Reserve is pressured to decrease inflation aggressively, Lindberg noted that the result may be somewhere between a hard and a soft landing.

Diversification continues to be key to adding value to the total fund.

The SERS portfolio is currently underweight in global equity and fixed income and overweight in real assets and opportunistic, which has helped with overall returns.

For SERS' first quarter, the portfolio was underweight in global fixed income by 6.4% on average, which added 10 basis points of value, and in global equity by 3.9% on average, which added another 10 basis points of value.

SERS' portfolio was overweight in real assets by 4%, which added 30 basis points of value, and in opportunistic by 4.6%, which was flat to the benchmark.

Due in great part to this asset allocation, the total fund outperformed the benchmark by 3.3% net of fees for the one-year period.

When compared to nearly 300 other U.S. pension funds, SERS' total fund gross of fees investment performance ranked near the top across all time periods. During the quarter, the -2.57% return ranked 7th; the 1-year return of

-4.35% ranked 4th; the 3-year return of 8.39% ranked 3rd; the 5-year return of 7.84% ranked 3rd; and the 10-year return of 8.99% ranked 1st.

For the quarter, the median fund returned -4.41%; for the 1-year, the median fund returned --14.09%; over 3 years, the median fund returned 3.90%; over 5 years, the median fund returned 4.78%; and over 10 years, the median fund returned 6.78%. SERS was more than 2% ahead of median funds for the 10-year period.

Investment Committee Approves Two Investments
The SERS Staff Investment Committee approved a $50 million commitment to PanAgora, a small cap core strategy within the US equity portfolio, and a $15 million commitment to Digital Bridge Partners II GD Towers Co-Investment, an infrastructure strategy within the real assets portfolio.

These investments will be funded from cash reserves.

Total Fund Update

TOTAL FUND BALANCE		
August 31	**September 30**	**Difference**
$17.32 billion	$16.53 billion	▼$790 million
TOTAL FUND RETURN (net of fees)		
Fiscal Year	**Calendar Year**	**3-Year**
▼2.79%	▼9.65%	▲7.72%
TOTAL FUND RETURN vs. BENCHMARK		
Fiscal Year	**Calendar Year**	**3-Year**
▲0.86%	▲2.48%	▲1.95%

Board Approves Final Filing of Amended Administrative Rule
The Board approved the final filing of an amended administrative rule concerning the determination of a statutory beneficiary that was reviewed by the Joint Committee on Agency Rule Review (JCARR).

Currently, SERS' statutory order of succession does not take into account if a beneficiary died simultaneously or within hours of the member's death.

The administrative rule is being updated to reflect that if any designated or statutory beneficiary dies within 120 hours, or five days, of the member or retiree, SERS will move on to the next beneficiary in the line of succession rather than pay benefits to the deceased beneficiary's estate.

This amendment will bring SERS in line with Ohio's current survivorship law. In addition, it will allow SERS to pay benefits sooner by reducing administrative burdens for the beneficiary.

Executive Director's Update

State Legislative Activity
The Ohio General Assembly is beginning a "lame duck" session, which occurs following the general election before a successor's term begins. SERS is working to get its Contribution Based Benefit Cap (CBBC) legislation approved before the session ends.

In the meantime, SERS staff continues to engage with stakeholders to ensure they remain current on the status of the CBBC legislation, as well as the sustainability discussions taking place at SERS.

SERS' First Lunch Break Webinar a Success
SERS' Member Services and Employer Services departments continue to host educational opportunities to help members prepare for retirement and employers better understand their role at SERS.

Earlier this month, Member Services hosted a Lunch Break webinar, a half hour educational session which covered various topics such as the fundamentals of SERS, the value of a defined benefit plan, and the importance of saving for retirement. Twenty-five members attended the November webinar.

This will become a regular webinar series aimed at active members ages 45-55 with at least 10 years of service; however, any SERS member is welcome to attend.

Also earlier this month, Member Services hosted a retirement conference for members who were generally within two years of retirement. The conference was successful with 134 people in attendance.

A full list of upcoming webinar and conference dates is available on SERS' website.

Majority of SERS Retirees are Career Employees
Following presentation of the actuarial valuation, Executive Director Richard Stensrud offered additional remarks and observations regarding the demographics of SERS retirees and members.

Stensrud noted that the total number of retirees increased for the first time in four years. For FY2022, nearly 91% of retirees were aged 65 or older; nearly 30% were aged 80 or older; nearly 15% were aged 85 or older; nearly 6% were aged 90 or older; and nine benefit recipients are 105 or older.

As far as active members are concerned, 72% of current active members have less than 10 years of service credit. As the years of service increase, that percentage goes down, indicating that many people start with SERS but ultimately choose a different career path.

However, the numbers demonstrated that SERS is a retirement system that is fundamentally serving career employees. Of all of the new service retirees in FY2022, 87% had more than 20 years of service credit.

Investment Staff Compensation
Executive Director Stensrud also shared observations regarding investment staff compensation.

While members contribute 10% of their paycheck and employers contribute 14% of an employee's compensation, more than two-thirds of pension funding comes from investment returns. Typically, a retiree exhausts their employee contributions and the employer contributions made on the retiree's behalf in just four to six years of retirement. The remainder is covered by investment returns. As such, it is important to attract and retain the best investment talent possible.

Performance-based investment staff compensation is a way to incentivize and reward members of the investment staff for out-performance. This plan is annually reviewed and approved by the SERS Board. In addition, any compensation earned is not determined by the investment staff themselves. The compensation is calculated by an independent third party and reviewed by SERS' Internal Audit Officer, who reports directly to the Board.

Good investment returns are not guaranteed. It requires expertise in assembling and maintaining a diversified portfolio, and choosing and overseeing good investment managers.

When comparing the performance-based compensation paid to the assets under management, the total investment compensation paid equates to 0.0049% of total assets under management.

For FY2022, SERS outperformed the benchmark by 3.11%. This represents $575 million of value added that would not be in the fund but for the expertise and decision making by the investment team. This is 69 times the total investment staff compensation paid and equates to a 687% return on investment.

Considering these factors, the value added to SERS as a public pension system is considerably greater than the cost of being able to secure qualified investment experts. The investment decisions made by the investment staff enhances the sustainability of the pension and health care trusts, benefiting all SERS members, retirees, and employers.

Monthly Retirement and Survivor Benefit Transactions
For November, the SERS Board approved 558 active members for service retirements, and 11 survivor benefits for spouses and/or dependents.

December Meeting Dates
The next Board meeting will take place Thursday, December 15, and Friday, December 16, at 8:30 a.m.