Ohio
Retirement
Study
Council

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To: ORSC Members
From: Jeffery A. Bernard, Senior Research Associate JAB
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Subject: Proposed OPERS COLA Changes

At the Ohio Public Employees Retirement System's (OPERS) October 18th, 2017, meeting, the OPERS Board passed a proposal that would reduce future cost-of-living adjustments (COLAs) to retirees. Generally, the plan would reduce COLAs for all existing retirees from a fixed 3% to a CPI-W (inflation based) COLA, with a cap of 2.25%. It would also suspend the COLA under certain deleterious funding conditions that would act as automatic triggers.

OPERS is currently within the required 30-year statutorily required funding period, and is therefore not strictly *required* to contemplate benefit reductions. There is limited guidance for ORSC staff on evaluating legislative initiatives that would reduce statutory benefits when a retirement system is within the 30-year funding period.

The purpose of this memo is to review existing guidelines applying to ORSC staff and to seek guidance from the ORSC on the evaluation of legislative initiatives such as the OPERS proposal. The OPERS COLA proposal will establish a precedent that ORSC staff will use in the future.

ORSC Guidelines in Order of Priority

ORSC staff follow a number of ORSC guidelines when evaluating legislative initiatives. The ORSC guidelines that pertain to funding goals and COLAs are detailed below:

1. Systems ***must*** submit a plan if funding exceeds 30-years (i.e. 30-years is a statutory red line; cannot cross);
2. Intergenerational equity should be maintained;
3. 1978 ORSC Principles Governing Pensions explicitly state that retirement benefits should be "adequately maintained" during retirement (i.e., COLA). Those principles also specify that there should

be a plan for pre-funding those benefits. The principles do not define what "adequately maintained" means in any concrete sense;

4. ORSC has officially endorsed systems proactively trying to improve funding status beyond the 30-year requirement;
5. ORSC approved the 2012 PTA/KMS report "Analyzing 30 Year Plans and Pension Reform." This was an actuary's report of pension reform and recommended the adoption of a declining funding period (perhaps 15-20 years). However, the report has never been adopted as an official position of ORSC; therefore, while staff is aware of the recommendation, staff does not necessarily utilize it in its evaluations.
6. ORSC has shown an interest in maintaining health care coverage within the pension systems, but the focus has been on strengthening the funding of the pension side of benefits to allow that health care funding.

Establishing a Precedent for Funding Improvements

ORSC staff are looking for direction from the Council concerning proposals that seek to aggressively improve the funding status of the systems beyond the statutory 30-year requirement. The OPERS proposal intersects with many ORSC guidelines, but prioritizes those guidelines differently. Does the ORSC support attempts to achieve more solid funding of benefits beyond the 30-year requirement? Because there is little existing precedent on which ORSC staff can evaluate the OPERS proposal, the ultimate recommendation from the ORSC on this matter will have a significant impact on staff evaluations of benefit adjustments and funding improvements in the future.

OPERS COLA Proposal in Detail

The OPERS Board proposed the following changes to COLA:

1. **Tie COLA to the Consumer Price Index (CPI) -** Beginning in 2019, all future COLAs will be based on the CPI, with a cap of 2.25%;
2. **Delay Disbursement of COLA** - For OPERS members who retired from 2010 through 2012, the new COLA will be delayed two years. For future retirees, the first COLA will be delayed until their second pension anniversary;
3. **Restore Purchasing Power -** OPERS will provide a one-time pension adjustment to restore 85 percent purchasing power for those retirees whose purchasing power is less than 85% of their original benefit; and
4. **Include Funding Triggers** - Should OPERS' required time to pay off unfunded liabilities top 30 years, there will be no COLA for the next calendar year. In the event inflation exceeds three percent for an extended period of time, the Board could increase the COLA to three percent if OPERS' funding is strong.

ORSC Staff Considerations and Comments

The OPERS proposal raises a number of questions regarding the application of ORSC guidelines addressed above.

Funding of the Systems

- The 30-year requirement has certainly enforced discipline on the systems. But, as expressed by the ORSC actuary, "the standard itself is not onerous, particularly with no current requirement for a declining 30-year funding standard." It is an absolute minimum, not an ideal.[1] Not fully funded, the systems are highly susceptible to market volatility, perhaps necessitating further benefit or contribution changes.
- For the purpose of providing greater stability, does the ORSC wish to establish a new amortization horizon? If so, what is a reasonable target balancing intergenerational equity, commitment to planned benefits, and more secure funded levels?
- The OPERS proposal provides for a COLA cap of 2.25%, but OPERS economic assumptions anticipate a 2.50% annual inflation. The proposal therefore knowingly sets a COLA cap that is lower than OPERS assumes for inflation. Given PERS funded level, how do ORSC staff prioritize improving funded levels with a proposal that knowingly will impede "adequate maintenance" of retirement benefits? Even if no new horizon is established, is ORSC staff to evaluate proposals that improve the funding status of the systems positively, even if they undercut other ORSC guidelines?

The 1978 Principles Governing Pensions

- The 1978 Governing Principles called for the "adequate maintenance" of retirement benefits. Due to COLAs broadly being reduced, what is the range that the ORSC wishes to maintain? 85%? 80%?
- The 1978 Governing Principles provide that the adequate maintenance of retirement benefits must be pre-funded. Staff has taken this to mean that those benefits should not be provided if the systems are beyond or in danger of passing the 30-year funding period—this was the basis for approval of the SERS COLA modification and lack of opposition to the STRS COLA suspension. We would then recommend that the downside trigger envisioned by OPERS be applied to all systems.
- COLA adjustments are often made with implicit or explicit statements that savings will be applied to Health Care. How are ORSC staff to evaluate the

[1] PTA/KMS, "Analyzing 30 Year Plans and Pension Reform" (2012), 36.

reduction of a benefit endorsed by the 1978 Governing Principles and protected by statute (COLA) for a non-guaranteed benefit that has no statutory protection at all (health care)?

- As the governing principles are nearly 40-years old, the ORSC may amend the principles as necessary.

Deference to System Boards

- Should staff consider Board policy regarding funding objectives? STRS and SERS have adopted a closed funding period objective. Should staff consider these objectives, even if they are more stringent that ORSC goals, when evaluating legislation? This question has increased significance with the increased authority provided to the systems by the General Assembly over the objections of the ORSC.

COLA Vesting Statutes

- Consideration of R.C. 145.561 regarding vesting of COLA benefits. During 2012 pension reform, the PERS vesting statutes were modified to provide that those vesting statutes do not apply to a COLA increase for those benefits beginning on or after January 2013. ORSC staff and OPERS staff will need to discuss a potential different reading of this statutory change, and whether OPERS legal staff interprets the change to allow a modification of future COLA adjustments post 2013 or if it interprets the change more broadly to permit a clawback of already granted COLAs to those benefits beginning 2013.

Select Information on COLAs and Retirement Systems

Actuarial Inflation Assumptions				
PERS	STRS	SERS	OP&F	SHPRS
2.5%	2.5%	3.00%	2.75%	2.5%

Funding Period (% Ratio) *At time of COLA modification proposal				
PERS*	STRS*	SERS*	OP&F	SHPRS
19 (80.1%)	50.4 (66.6%)	28 (67.0%)	28 (71.3%)	29 (67.7%)

Funding Period (% Funded) Post-2017 COLA modification (*proposal)				
PERS*	STRS	SERS	OP&F	SHPRS[2]
Pending	18.4(75%)	28 (71%)	N/A	N/A

COLA 2017 Modification (*Proposal)	
PERS*	Restore purchasing power to 85% 2-year delay on first COLA (from 1-year) CPI-W capped at 2.25% Upward and downward triggers, funding contingent
STRS	Suspended COLA, with periodic review
SERS	Suspended 2018, 2019, and 2020 CPI-W (from flat 3%) with a 2.5% cap

Liability Removed During 2012 Pension Reform (% of which active member liability)				
PERS	STRS	SERS	OP&F	SHPRS
$4.1 Billion (100%)	$15.7 Billion (majority of liability reduction paid for by actives)	$222.5 million (100%)	$3.2 Billion (primarily active and new hires)	$117.5 million[3]

Liability Removed by 2017 COLA Modification (*Proposal)				
PERS*	STRS	SERS	OP&F	SHPRS
$4 Billion	$12.4 Billion	$1.2 Billion	N/A	N/A

[2] SHPRS modifies COLAs on an annual basis.

[3] Pension reform provided the HPRS Board discretion on both annual employee contribution rates and annual COLAs. Because of this variability, a precise distribution of active/retiree liability is not possible. However, HPRS has increased active employee rates and decreased annual COLAs and actuarial reports suggest the distribution has been equitable.