**Ohio Retirement Study Council**
**30 East Broad Street, 2nd Floor**
**Columbus, Ohio 43215**

**Minutes**
**October 14, 2021**

The meeting was called to order by Chairman Carfagna at approximately 10:04 a.m. in Room 017, the Statehouse, Columbus, Ohio.

The following members attended the meeting:

**Voting members**

Rick Carfagna, Chair
Hearcel Craig
Brigid Kelly
Lora Miller
Dr. Anthony Podojil
Kirk Schuring, Vice-Chair

**Non-voting members**

Karen Carraher, PERS
Mary Beth Foley, OP&F
William Neville, STRS
Carl Roark, HPRS
Richard Stensrud, SERS

**Absent**

Jay Hottinger, Excused
James Patterson, AG, Excused
Phil Plummer, Excused

**Staff**

Jeff Bernard
Bethany Rhodes

With a quorum present, the meeting was called to order at 10:04 a.m.

Chairman Carfagna asked that the minutes of the previous meeting be approved. The minutes were approved without objection.

Chairman Carfagna deviated from the agenda to move to new and old business. He asked Jeff Bernard to address new business. Mr. Bernard notified the ORSC that a new version of an RVK presentation had been added to the folders and to discard any copies that had been printed off the website earlier in the week.

He also notified the ORSC that all four of the fiduciary and actuarial audit contracts had been finalized and the kick-off calls had taken place for both the STRS and OP&F fiduciary audits. He also explained that since the selection of the vendors for the fiduciary audits, Funston had decided to conduct the optional self-assessment surveys free of charge, as Funston deemed it would improve the audits. STRS indicated that they did not have concerns with adding the survey at no additional cost. Mr. Bernard notified the ORSC that OP&F had raised concerns relative to time commitments and that staff was bringing forward the survey to ensure that the ORSC would be comfortable with the inclusion of the free of charge self-assessment survey. Chairman Carfagna asked Mr. Bernard to explain the self-assessment.

Mr. Bernard said that not doing the self-assessment would neither impact nor impair the ability of the ORSC to complete the audit; however, Funston stated that it would improve the interview process, an essential component of the audit, by informing Funston of concerns or areas of interest from the senior leadership and board members taking the self-assessment survey. Funston has stated the survey takes 15 minutes more or less. Chairman Carfagna asked if the survey was usually completed in the past. Mr. Bernard said he couldn't recall but it did not seem unusual as part of the audit process. Vice-Chairman Schuring clarified that it would not cost any extra money but would improve the interview process. Mr. Bernard said yes that is how he understood it as well.

*Ms. Miller left at 10:08 a.m.*

*Representative Kelly arrived at 10:09 a.m.*

*Ms. Miller returned at 10:10 a.m.*

Chairman Carfagna noted that the ORSC originally had not included the survey as OP&F indicated they already did a board survey and, by not doing so, could shave some cost off the audit; however, now that it would be done without cost, it would be prudent to expand the scope to include the self-assessment. Vice-Chairman Schuring asked Director Foley if she was comfortable with the assessment. Director Foley indicated that after looking at what the survey would encompass and after discussions with Director Rhodes, she was comfortable. Chairman Carfagna clarified with Mr. Bernard that the assessment was only for the Board members and senior staff, not a survey for all active members or retirees. Mr. Bernard said yes, it was a survey only for senior staff and the Board.

Vice-Chair Schuring made a motion to expand the scope of the audit to include the self-assessment survey as part of the audit for both STRS and OP&F. Chair Carfagna seconded the motion.

The motion was approved 6-0.

Chairman Carfagna moved to the investment performance review for the period ending June 30, 2021, and asked Jim Voytko to present the report.

Mr. Voytko indicated that he would be presenting the semi-annual report and then deviating from the report to take a deep dive into a discussion of returns. He began with a discussion of the very positive returns and favorable market environment and ability of the funds to capture those returns in the first half of 2021. He remarked that there are five ways that are worth thinking about when evaluating the performance of the pension funds: 1) How are the funds doing relative to their actuarial assumptions; 2) how are the funds doing against the board expectations expressed in the custom policy benchmarks; 3) how are the funds doing compared to other funds as seen in the peer rankings; 4) how are the funds doing relative to the risks they are taking; and 5) how are they doing versus the fees and costs of the investment programs, which is best expressed in the net of fees returns.

He continued the summary with the diversification of fund investments, the single most important investment decision a board makes. He stated that the diversification of the funds reflects good practice. He noted some of the name changes in the HPRS fund, noting that the investment name change was less important than what it reflected about investment changes. He noted that funds earn money either as an owner of a company (through equity or real estate) or as a lender (through bonds). He noted that the net effect of the HPRS change was to be slightly more exposed to equity.

*Director Foley left at 10:26 a.m.*

Mr. Voytko continued with a review of the quilt chart, showing the varying asset class performance across time.

*Director Foley returned at 10:30 a.m.*

He noted that across the country funds are lowering their expected returns, noting that the current OP&F target expectation is significantly higher than funds across the country and in Ohio. Mr. Voytko then turned to the presentation entitled "Public Fund Board Member Considerations and Economic Overview." He discussed the differences between the actuarial rate of return with the assumed rate of return in the market, noting that they are related but not the same thing.

Mr. Voytko provided examples of boards across the country lowering assumed rates of return, noting the role of both lower fixed income yields and greater risk taking in pushing down those expected returns. He noted that in general, the higher the Shiller PE ratio, the lower the expected returns in the next 10 years. Alternatively, the lower the Shiller PE Ratio, the higher the expected returns in the next 10 years. Today, we are very high on the Shiller PE Ratio. He noted that this is combined with very low bond yields, which also indicate that there will be low fixed income returns moving forward. He said that this will not last forever but it is the situation at the moment.

*Director Foley left at 10:54 a m.*

In discussing the gap between expected returns and current actuarial rates, he asked how concerned the boards should be. He said that if the gap exists for a short period of time, it is concerning and should be a focus of concern. However, if the gap exists for an extended period, it is more worrisome, as it means that whatever is supposed to flex, whether it is contribution increases or benefit decreases, in your system is not flexing in time. "What this essentially means is that you are digging a hole for yourself." This creates an unfunded liability, which once created, tends to compound on itself, noting the similarity to a credit card interest. This hole has to be filled at some point, creating issues of intergenerational equity and angst.

*Director Foley returned at 11:02 a.m.*

Mr. Voytko discussed his preference for viewing assets market to market, rather than a smoothing, though he noted the use of it in moderating wild fluctuations in funding policy. He optimistically reviewed a historical chart that showed that there have been very few 10-year periods where there have been a 0-5% market return. He finished with a recommendation that the boards should be constantly talking with their actuaries and that the funds, with one exception, have been reducing their expected returns. He also thought it was prudent to do asset liability studies and recommended against taking undue risk at the moment and noted that now would not be the time increase benefits.

Mr. Voytko returned to the executive summary report.

*Director Foley left at 11:16 a.m.*

*Director Foley returned at 11:19 a.m.*

*Director Foley left at 11:20 a.m.*

Mr. Voytko discussed the Sharpe Ratio and how much return does an investor receive for the additional volatility they are taking. He noted that as that applies to the retirement systems, HPRS has the lowest Sharpe Ratio (meaning higher volatility risk) and SERS has the highest (meaning lower volatility risk). He emphasized that this is neither good nor bad, but is something that has to be kept in mind when reviewing returns to consider the amount of risk that is being taken. He noted that since RVK had provided its initial report, many of the Ohio funds had incrementally reduced risk. Mr. Voytko finished his presentation.

Chairman Carfagna asked where the best place to be was on the chart on page 7 (the Sharpe Ratio scattergram); he assumed it was above the red line, but is it better to be to the left or right of the vertical line. Mr. Voytko said absolutely you want to be above the red line. He noted that if you are taking less risk and getting more return, you would definitely want to be more to the left. But it depends on how far out on the risk you are comfortable with in considering the horizontal placement as high returns are great but you want to consider how much risk you are taking on.

*Director Foley returned at 11:24 a.m.*

Representative Kelly asked if there is a simple and quick explanation as to what is going on. She asked if we are taking advantage of opportunities as they come available. She noted that everyone brings good news with a side of doom and gloom and that is frustrating for members. She noted that the plans are exceeding their assumed rates, but we still have challenges on the horizon and is having difficulty keeping all these different views in line. Mr. Voytko noted that the pension systems have been able to capture the opportunities that the market has offered in the past. The question was if the market was going to offer those opportunities to the funds in the magnitude that they have in the past 7-10 years, which seems unlikely. That was not a doomsday scenario but that RVK is required to provide honest advice to their clients. He noted that, unfortunately, in the institutional investor world, there just isn't a good simple and quick explanation to provide.

Representative Kelly noted that constituents will contact them and ask if they can count on their benefits, should I be concerned? He noted that there is no way that anyone with any credibility can say "don't worry everything will be fine," because he knows that things can happen. But, he noted that there is no evidence in the performance of the funds that he sees that should scare people. He noted that the funds are consistently professionally run and benefits have been paid. Representative Kelly asked about fee disclosure in alternative investments and whether funds that have required disclosure have had different returns or fewer options to invest. Mr. Voytko noted that from their experience, they have not seen material differences between funds that do and do not have disclosure requirements. He noted that RVK focuses on net returns. He noted that even in California, which has disclosure requirements, there are still investment facts that cannot be disclosed. He discussed the issue of carried interest and that if you are reporting net of fees you are capturing all those fees and expenses.

Senator Craig had a question about smoothing but wanted to express to those listening in the audience that the funds have a duty and obligation to provide those benefits. Mr. Voytko discussed the use and costs of smoothing from the perspective of a funder of a plan and a participant of a plan.

Vice-Chairman Schuring asked that some of the things discussed in the presentation be put in writing in the future. He wanted to remind people listening that benefits are statutory and that it would take an act of the General Assembly to change benefits, with the exception of some COLA authorization and the non-statutory health care benefits.

Dr. Podojil asked if there is a way to model the effect of additional benefits on the stress to the system and if it were to affect the expected return of a system. Mr. Voytko said that yes, this is a complicated question, but there is a scenario in which a system that is under severe stress can no longer have access to certain investment options, and an actuary would take note of that in determining an actuarial rate of return. There was nothing that RVK has seen that would suggest that the systems are remotely close to that type of situation. He said that you can model it, but it would only exist in the extremes and he did not see that currently in the systems.

Chairman Carfagna noted that Mr. Voytko early in his presentation discussed the issue of intergenerational equity. He didn't want that issue to be lost and wanted to note that STRS has the negative normal cost with members and employers contributing to fund the current retiree's benefit. He knows that STRS retirees have not had a COLA for some time but that this was existing in a negative normal cost system. Mr. Voytko noted that this is a deep question and well above his pay grade of an investment consultant. He noted that intergenerational equity is an issue that comes up frequently in boards' discussions as the funds exists for today's generation and for future generations and some sovereign wealth funds try to maintain the per capita value for the population. He noted that retirement plans have flexing as a designed feature as a way to address these types of concerns. He noted this could go both ways, both with under-saving and over-saving. He noted that if you do not save enough, it is not that those costs go away, they just shift the cost to a future group. He noted that these questions of intergenerational equity are often ones that cannot even be addressed at the board level, but ultimately lie on the sponsor of the plans themselves, which is the State itself.

Chairman Carfagna asked if it ever made sense to have a goal of lower than 100% funding and was it prudent or not prudent? Mr. Voytko noted that 80% may be close yes, but what is the goal? He said from a market to market perspective, the goal of 100% is a very, very good goal to pursue and having less than that seems to be saying that the fund is perpetually not funded and that is ok and that has the result of pushing those cost into the future. His perspective was one to have the goal of 100%.

Chairman Carfagna noted that PERS had recently lowered their expected returns but that the investment report had PERS with returns over those figures. He wanted to point out that Mr. Voytko's presentation provided information that this decision was not made in a vacuum, was not unusual compared to other systems across the country, and that it helps explain why that decision to lower the assumed rate was made.

*Ms. Miller left at 12:02 p.m.*

Chairman Carfagna asked about the asset liability studies. He asked the systems how often those studies are done. The systems responded that they are done either with a significant market shift or at a minimum of 3-5 years. He asked if that is the norm? Mr. Voytko said yes, and circumstances in the market or benefit structure can cause it to be done more frequently.

*Ms. Miller returned at 12:08 p.m.*

Chairman Carfagna moved to rules. Mr. Bernard reviewed the rules, noting that they are consistent with the Revised Code and that he had no further comments.

The Chairman said that the next meeting is scheduled for November 11, 2021, which is Veteran's Day, or at the call of the Chair. The Chair noted that the ORSC sometimes does not meet as the agenda items may be quite small.

The meeting adjourned at approximately 12:12 p.m.

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| Date Approved | Rick Carfagna, Chair |
| Bethany Rhodes, Secretary | Kirk Schuring, Vice Chair |