STRS OHIO

State Teachers Retirement System of Ohio

A Report to the Ohio Retirement Study Council

March 2006

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Prepared by the State Teachers Retirement System of Ohio

Executive Summary

The members of the State Teachers Retirement System of Ohio — Ohio's current and retired Ohio educators — have been sending a very loud and clear message to the Retirement Board, the associates of STRS Ohio and the General Assembly for several years now. And that message is: ***Continue to keep our pension fund solvent while doing everything possible to provide us with affordable health care coverage in retirement***. This is a charge that we take seriously. It has served as the foundation for many of the policies, practices and proposals the board and staff have initiated since 2003 as they collectively work to meet members' expectations. Further, it has driven some of the initiatives that we have sought or will seek support for from the Ohio Retirement Study Council (ORSC) and the General Assembly.

Our actuarial valuation for the year ended June 30, 2005, shows that the funding period — the number of years required to pay off the pension fund's unfunded actuarial accrued liability (UAAL) — now stands at 55.5 years. (As a point of reference, STRS Ohio had $2.6 billion in unrecognized market gains as of July 1, 2005.) This 55.5 years represents the peak, and the funding period is now projected to return to 30 years by 2015. (See Appendix B.) However, *this 30-year mandate could be achieved in as little as three to five years*. This will be accomplished through a plan that:

- **Strengthens pension solvency and shores up health care in the future to achieve a 30-year funding period for both the pension fund and the health care fund;**
- **Meets the expectations of more than 430,000 active, inactive and retired Ohio public educators; and**
- **Lessens the risk of additional liabilities being placed on the Ohio Legislature and/or Ohio taxpayers.**

The Retirement Board Has Taken Many Steps to Strengthen the Solvency of the Pension Fund While Preserving Health Care

The State Teachers Retirement Board has taken numerous steps during the past three years to control its UAAL while preserving health care coverage for its current and future retirees. These steps range from making adjustments to a number of actuarial assumptions to more accurately reflect experience, to the quick implementation of components of Amended Substitute House Bill 449 that now provide an additional $12–$14 million on an annual basis to help reduce the unfunded liability. Many changes were also made to the STRS Ohio Health Care Program to increase the solvency of the Health Care Stabilization Fund, which supports this program for more than 111,000 retirees and their dependents.

STRS Ohio's Plan for Returning to a 30-Year Funding Period

The State Teachers Retirement Board understands that as a fiduciary, its first and foremost priority and legal obligation is to protect the system's ability to honor the pension and other benefit promises in state law. The board also recognizes the importance of providing affordable health care coverage to its retirees and dependents. Currently, monies for the Health Care Stabilization Fund come from premiums charged to program enrollees, 1% of payroll from employer contributions and investment earnings on this fund.

The health care actuarial valuation report received by the Retirement Board in February 2006 showed that the Health Care Stabilization Fund balance of $3.465 billion is projected to last until 2021, based on current actuarial assumptions. The report also showed that the funded status of the plan is 36.7%. This latter figure will become increasingly important next year when public retiree health care plans, including the five Ohio public pension plans, are required to show the amount of employer contribution needed to fund their health care plans on a full-reserve basis (i.e., a 30-year funding period) in their annual financial reports.

STRS Ohio faces two actuarial funding challenges. STRS Ohio is addressing both challenges by aggressively seeking support for a legislative proposal that would allow the system to increase members' contributions to STRS Ohio by 2.5% and their employers' contributions by 2.5% of teacher payroll to create an ongoing and dedicated revenue stream for the STRS Ohio Health Care Program. These increases would be phased in over a five-year period, in .5% increments.

The health care actuarial valuation report showed that an annual contribution of 4.58% is needed this year and each following year to fund the STRS Ohio Health Care Program on a 30-year basis, based on current actuarial assumptions. This percentage is in line with STRS Ohio's legislative proposal.

Further, if this contribution increase can be obtained, the current 1% of payroll from employer contributions going toward health care can start flowing back into the pension fund — an influx of approximately $94 million per year that has a significant impact on the speed at which the UAAL can be reduced. (See Appendix C.)

Our Proposed Contribution Increase Has Majority Support of the Members

In October and November 2005, the Retirement Board joined with the Health Care Advocates for STRS (HCA)* to share this proposal for a dedicated revenue stream for health care with STRS Ohio active members. Both the Retirement Board and the HCA wanted to be sure there was support for this proposal before seeking a legislative initiative.

During this brief period, more than 10,000 STRS Ohio members were actively engaged in the campaign. *Member feedback indicated there is majority support across the membership for increasing member and employer contributions — even among educators who are 15 years or more away from retirement*.

Based on the results of this campaign, STRS Ohio is working on draft legislation and seeking a sponsor. But much more work needs to be done to make this proposal a reality. Many more of our members need to be engaged in conversation with the HCA and us to ensure they understand the full impact of the proposal. STRS Ohio and the HCA also need to engage school boards in this discussion.

The school funding issues they face cannot be ignored. However, there is also a cost to school districts if the retiree health care issue is not addressed. If the STRS Ohio Health Care Program ends, efforts at the bargaining table to increase teachers' salaries significantly will undoubtedly intensify because these educators will know they will be responsible for 100% of their health care costs in retirement.

The impact of removing health care benefits from educators' retirement package goes beyond individual employers. It also has an impact on the financial well-being of this state, as it will exacerbate the inability of school districts and higher education to recruit and retain teachers. Most significant, though, is the fact that without a dedicated revenue stream, the Health Care Program will effectively end in just a few short years due to the inability to offer affordable premiums. This will shift costs and create an immediate liability for thousands of suddenly uninsured retirees, plus future liabilities. In short, another class of uninsured Ohioans will be created. Ultimately, this will have an adverse impact on the State of Ohio and its taxpayers.

STRS Ohio Is Addressing Two Actuarial Funding Challenges With Its Plan

The Retirement Board, in concert with the HCA, have developed a proposal that, if successful, strengthens pension solvency and shores up health care in the future to achieve a 30-year funding period for both the pension fund and the health care fund; meets the expectations of current and retired Ohio public educators; and lessens the risk of additional liabilities being placed on the Ohio Legislature and/or Ohio taxpayers. Also contributing to pension solvency will be the unrealized market gains that we currently have, plus future investment returns.

STRS Ohio members — both active and retired — have told the Retirement Board to do what it can to ensure the solvency of the pension fund *and* affordable health care coverage for current and future retirees. We owe it to our members to fully pursue this 5% contribution increase before making any significant changes to pension benefits.

*The HCA is a coalition of management, professional and retiree organizations that represent nearly 200,000 Ohio public educators.

A Report to the Ohio Retirement Study Council

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Prepared by the State Teachers Retirement System of Ohio

The members of the State Teachers Retirement System of Ohio — current and retired Ohio educators — have been sending a very loud and clear message to the Retirement Board, the associates of STRS Ohio and the General Assembly for several years now. And that message is: ***Continue to keep our pension fund solvent while doing everything possible to provide us with affordable health care coverage in retirement***. This is a charge that we take seriously. It has served as the foundation for many of the policies, practices and proposals the board and staff have initiated since 2003 as we collectively work to meet members' expectations. Further, it has driven some of the initiatives that we have sought or will seek support for from the Ohio Retirement Study Council (ORSC) and the General Assembly.

During the past three years, we have shared many of these initiatives with the ORSC through the report we are required to present to you in compliance with Section 3307.512, Revised Code. This section of the Revised Code requires Ohio's public pension plans to provide the ORSC with a report in any year that the funding period for the unfunded actuarial accrued liability (UAAL) of the pension fund exceeds 30 years. The report must also indicate how the board will reduce the amortization period to 30 years or less.

We also take this charge seriously. Our actuarial valuation for the year ended June 30, 2005, shows that the funding period — the number of years required to pay off the pension fund's unfunded accrued liability — now stands at 55.5 years. The system's funded ratio — the market-related value of assets compared to liabilities — is 74%. These numbers are very close to what was projected in last year's report to the ORSC. We anticipated a funding period of 52 years and a funded ratio of 74%. At that time, we also projected a return to a 30-year funding period by 2020. As we will explain in this report, this 55.5 years represents the peak, and the funding period is now projected to return to 30 years by 2015. (See Appendix B.) However, *this mandate could be achieved in as little as three to five years*.

This report has two goals:

1) Briefly review the significant actions STRS Ohio has systematically and deliberately taken since 2003 to affect the system's pension funding period and reduce future liabilities, while providing retirees and their dependents with health care coverage; and
2) Share our plan for strengthening pension solvency and shoring up health care in the future to achieve a 30-year funding period for both the pension fund and the health care fund; meet the expectations of more than 430,000 active, inactive and retired Ohio public educators; and lessen the risk of additional liabilities being placed on the Ohio Legislature and/or Ohio taxpayers.

Background

Since 1920, the State Teachers Retirement Board has provided pension, survivor and disability benefits to the public teachers of Ohio. Further, STRS Ohio has provided subsidized health care coverage for more than 30 years — one of only seven teacher retirement systems in the non-Social Security states to offer health care coverage to retirees.

Ohio law (R.C. Chapter 3307) requires most teachers in the public schools and institutions of higher education to contribute to STRS Ohio while employed in service to its citizens. It also requires the teachers' employers to contribute, based on the salaries paid. The current contribution rates are capped in statute at 10% of gross earnings for employees and 14% from employers.

The same laws that create and govern STRS Ohio also create an "obligation" to these educators as a result of their participation in STRS Ohio. Financial benefits result if and when a teacher attains eligibility.

STRS Ohio is required to pay the following when eligibility is demonstrated:

- Age/service benefits for defined benefit plan participants (R.C. 3307.58, 3307.59 and 3307.60)
- Annuities to reemployed retirees who are already receiving pensions (R.C. 3307.352)
- Disability benefits (R.C. 3307.62–3307.64)
- Survivor benefits (R.C. 3307.562 and 3307.66)
- Defined contribution plan benefits under terms specified by the plan document (R.C. 3307.81)

Other guaranteed payments/programs are:

- Annual 3% COLA (cost-of-living adjustment) for recipients of defined benefits (R.C. 3307.67)
- Partial reimbursement of Medicare Part B premiums paid by Defined Benefit Plan recipients (R.C. 3307.39)
- $1,000 lump-sum benefit upon death of a benefit recipient (R.C. 3307.661)
- Refunds in lieu of any other benefit upon withdrawal by members who leave teaching in Ohio and request a refund (R.C. 3307.56 and 3307.563)

Ohio law ***does not currently guarantee nor require*** the following to be provided by STRS Ohio. However, it instead allows STRS Ohio to offer its participants access to other benefits and act, as it is able, to help members by paying all or part of the following:

- Cost of health coverage for defined benefit plan recipients (R.C. 3307.39)
- Supplemental benefit (R.C. 3307.671)
- Additional retiree-funded lump-sum benefit upon the death of a recipient of an age/service or disability benefit (R.C. 3307.392)
- Excess benefit plan to pay guaranteed benefit excluded by IRC section 415 (R.C. 3307.461)

The Retirement Board Has Taken Many Steps to Strengthen the Solvency of the Pension Fund While Preserving Health Care

During the past three years, the State Teachers Retirement Board has taken a number of steps to control its UAAL while preserving health care coverage for its current and future retirees.

(1) **The Retirement Board increased the required member contribution to the maximum allowed under Ohio law — 10% — beginning July 1, 2003, and has been collecting the maximum 14% of payroll from employers since 1984.**

(2) **The Retirement Board reduced the employer payroll contribution going into the Health Care Stabilization Fund to 1% from 4.5%, beginning July 1, 2003.** This is the *lowest* allocation to health care of any Ohio retirement system. If this 1% contribution toward retiree health care was discontinued, STRS Ohio would likely reach a 30-year funding period *within three to five years*. (See Appendix C.) However, taking this annual allocation of about $94 million from the Health Care Stabilization Fund reduces the solvency period for the fund by four years — from 2021 to 2017.

(3) **In October 2003, the Retirement Board made adjustments to the actuarial assumptions based on the five-year actuarial experience review.** Changes were made to assumptions regarding life expectancy, retirement, disability and teacher salary increases to reflect actual expe-

rience. With the advice of the board's investment and actuarial consultants, the annual actuarial investment return assumption was raised to 8% from 7.75%. The net effect of the assumption changes was to reduce the amortization period by 10 years.

Currently, STRS Ohio, along with Highway Patrol Retirement System and Ohio Public Employees Retirement System (OPERS), have a more conservative actuarial investment return assumption of 8%, while Ohio Police & Fire and School Employees Retirement System (SERS) have an assumption of 8.25%. *Were STRS Ohio to adopt an 8.25% actuarial investment return assumption, the funding period would be 37.6 years instead of 55.5 years.*

The next actuarial experience review will occur in 2008. Two areas we are monitoring closely are mortality experience and the payroll growth assumption.

STRS Ohio is pleased that members are living longer; however, this trend has an impact on the accrued liabilities of the system as members receive pensions longer than expected.

Payroll growth is also being closely watched. As shown in the chart below, while the total payroll growth assumption of 4.5% has served STRS Ohio well in the past, there has been a recent reversal in the trend that bears watching. Last year alone (fiscal year 2005), employer payrolls increased only 2.19% over the previous fiscal year. In short, this means less employee and employer contributions than expected were received by STRS Ohio and the system experienced a $470 million actuarial loss.

We project a similar loss may be incurred in fiscal year 2006. The rapid growth in charter schools is helping to fuel this change, as salaries, overall, for teachers in these schools are lower than those found in public schools. For example, in fiscal year 2004 the average public school classroom teacher salary was $49,333; the charter school average was $20,000–$30,000. The upcoming voucher program in Ohio could also mean an outflow of students from public schools to private schools. Enrollment drops could force public schools to cut back staffing accordingly;

Payroll Growth History

	Payroll *(in billions)*	**Actual Increase**	**Assumption**
July 1, 1994	$ 5.986		5.0%
July 1, 1995	$ 6.327	5.70%	5.0%
July 1, 1996	$ 6.554	3.58%	4.5%
July 1, 1997	$ 6.806	3.85%	4.5%
July 1, 1998	$ 7.112	4.50%	4.5%
July 1, 1999	$ 7.444	4.67%	4.5%
July 1, 2000	$ 7.845	5.38%	4.5%
July 1, 2001	$ 8.257	5.25%	4.5%
July 1, 2002	$ 8.747	5.94%	4.5%
July 1, 2003	$ 9.206	5.25%	4.5%
July 1, 2004	$ 9.566	3.91%	4.5%
July 1, 2005	$ 9.775	2.19%	4.5%

Payroll growth reflects changes in total payroll versus individual salary increases.

private school teachers do not contribute to STRS Ohio. Finally, home schooling may be having an effect. Currently, there are approximately 56,000–60,000 students being home schooled in Ohio. What is unknown at this time is whether this number is increasing or if it has held steady over the years.

(4) **The Retirement Board made the very difficult decision to change the eligibility qualifications for both access and subsidies for health care coverage, effective Jan. 1, 2004.** A 30-year career teacher receives a subsidy of 75% toward the health care premium, down from 87%. In addition, eligibility requirements for the health care program call for 15 years of service versus the former five years, and premium subsidies for spouses and dependents were eliminated.

(5) **In February 2005, the Retirement Board reduced the match from the Employer Trust Fund that can be included in a reemployed retiree's lump-sum payment or monthly annuity benefit to 50% from 100%, based on the 10% employee contribution rate.** This change, which went into effect on July 1, 2005, means that the same percentage of employer contributions is being applied toward the unfunded liability for reemployed retirees as for active members. On an annual basis, this provides an additional $12–$14 million to help reduce the unfunded liability.

The Retirement Board was given the authority to make this change through the passage of Amended Substitute House Bill 449. This bill also enables STRS Ohio to retain the 14% employer contribution and accompanying interest for reemployed retirees who elect to withdraw before age 65.

(6) **In October 2005, the Retirement Board endorsed House Bill 272, sponsored by Rep. Michelle Schneider.** This bill includes a component that requires reemployed retirees of STRS Ohio, OPERS and SERS to obtain health care benefits from their employer — whether the employer is public or private — provided health care is offered to employees in comparable positions.

(7) **In November 2005, the Retirement Board completed an Asset/Liability Study.** Unfortunately, the study showed that only an investment policy with much higher levels of risk than are appropriate for a pension system (e.g., all stocks), could *significantly* improve the funded status of either the pension fund or the Health Care Stabilization Fund. However, the board did decide to move more of the system's investment assets to real estate and international equities to improve returns. In addition, the allocation to alternative investments was increased slightly. These changes are currently under way.

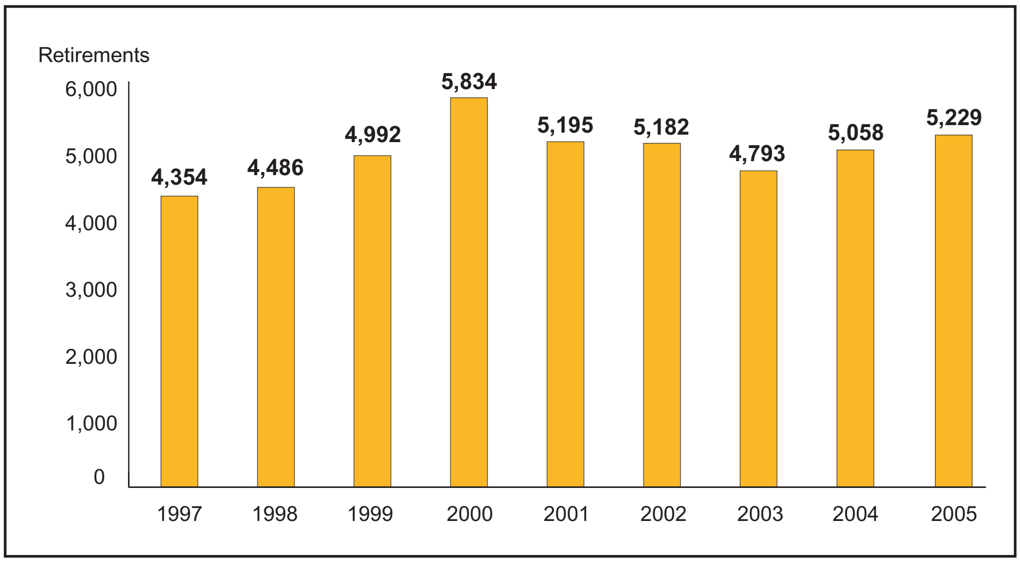
In concert with the Asset/Liability Study, the board has made compensation adjustments necessary to recruit, retain and motivate Investment associates. This will allow a continued internal active investment strategy to be pursued with the objective of achieving a net added value of at least 40 basis points ($300 million annually) while continuing to save approximately $70 million per year through internal management versus external management. As a point of reference, STRS Ohio has $625 million of net value added over its total fund benchmarks for fiscal year 2006, as of Feb. 28, 2006.

(8) **In December 2005, the Retirement Board lowered the annual interest rate paid on member withdrawals to 2% for members with less than three years of service credit and to 3% for members with three or more years of service credit, effective Jan. 1, 2006.** Previous interest rates had been 4% and 5%, respectively.

(9) **During the Retirement Board's annual planning retreat in February 2006, the board members reached consensus that it would consider pension benefit improvements *only* when the**

funding period is less than 30 years and the funding level exceeds 85%. While this has been the board's practice, by adopting this as an additional guiding principle for its decision-making, the board is sending a loud and clear message to its members that past supplemental benefits, such as the "13th check" are off the table, as well as items such as compound cost-of-living adjustments or enhanced pension benefit formulas.

(10) **The Retirement Board continues to monitor retirement trends**. As the chart below illustrates, until fiscal year 2004 STRS Ohio experienced an annual decline in retirements for three consecutive years — in spite of the fact that baby boomers are reaching retirement age. In fact, our research tells us that one out of two active educators plan on teaching longer — primarily because of health care costs and/or they want to increase their benefit through additional years of service. Those planning to teach longer are particularly clustered around the 45–54 age group. Also, the average age of our retireees is now 58 years. The increase in the number of retirements we've experienced in the past two fiscal years can be attributed to the large number of buyout plans that school districts across the state are offering more experienced teachers to balance their budgets in light of education financing challenges.



The extended significant market downturn experienced from 2000–2002 had a profound effect on all public and private pension plans in this country, including STRS Ohio. However, as noted in the December 2005 Evaluation Associates (Milliman) report presented to the ORSC, STRS Ohio has 10-year returns that are above its actuarial interest rate assumptions. The most recent actuarial valuation of STRS Ohio by its actuary, Buck Consultants, still reflects, in part, the investment losses incurred during that market downturn due to four-year smoothing. Investment gains generated in fiscal years 2004, 2005 and 2006 will have a more positive effect going forward. *As a point of reference, STRS Ohio had $2.6 billion in unrecognized market gains as of July 1, 2005.**

STRS Ohio's Plan for Returning to a 30-Year Funding Period

The State Teachers Retirement Board understands that as a fiduciary, its first and foremost priority and legal obligation is to protect the system's ability to honor the pension and other benefit promises in state law. The board also recognizes the importance of providing affordable health care coverage to its retirees and dependents. Currently, there are more than 111,000 individuals enrolled in the STRS Ohio

*Market value of assets of $59.6 billion versus market-related (smoothed) value of assets of $57 billion.

Health Care Program. Health care costs for this program are paid out of the Health Care Stabilization Fund. Currently, monies for the fund come from premiums charged to program enrollees; 1% of payroll from employer contributions, as noted earlier in this report; and investment earnings on this fund. Also, this year STRS Ohio expects to receive about $33 million in Medicare Part D reimbursements from the federal government.

The health care actuarial valuation report received by the Retirement Board in February 2006 showed that the Health Care Stabilization Fund balance of $3.465 billion is projected to last until 2021, based on current actuarial assumptions. The report also showed that the funded status of the plan is 36.7%. This latter figure will become increasingly important next year when public retiree health care plans, including the five Ohio public pension plans, are required to show the amount of employer contribution needed to fund their health care plans on a full-reserve basis (i.e., a 30-year funding period) in their annual financial reports.

STRS Ohio faces two actuarial funding challenges. STRS Ohio is addressing both challenges by aggressively seeking support for a legislative proposal that would allow the system to increase members' contributions to STRS Ohio by 2.5% and their employers' contributions by 2.5% of teacher payroll to create an ongoing and dedicated revenue stream for the STRS Ohio Health Care Program. These increases would be phased in over a five-year period, in .5% increments.

The health care actuarial valuation report showed that an annual contribution of 4.58% is needed this year and each following year to fund the STRS Ohio Health Care Program on a 30-year basis, based on current actuarial assumptions. This percentage is in line with STRS Ohio's legislative proposal.

Further, if this contribution increase can be obtained, the current 1% of employer contribution going toward health care can start flowing back into the pension fund. As noted earlier, this influx of approximately $94 million per year has a significant impact on the speed at which the UAAL can be reduced. (See Appendix C.)

Our Proposed Contribution Increase Has Majority Support of the Members

No one wants to have more money taken out of his or her paycheck for anything that doesn't yield an immediate return. That's why the Retirement Board joined with the Health Care Advocates for STRS (HCA)* to share this proposal for a dedicated revenue stream for health care last fall with STRS Ohio active members. Both the Retirement Board and the HCA wanted to be sure there was support for this proposal before seeking a legislative initiative.

The Health Care Member Education and Engagement Campaign held primarily in October and November 2005 included an informational mailing to all active members, meetings throughout the state, and a posting on the STRS Ohio Web site that included an online version of the presentation made at the meetings. During this brief period, more than 10,000 STRS Ohio members were actively engaged in the campaign. A significant amount of data was collected and analyzed from the 7,100 postcard surveys, 595 online surveys and 713 meeting surveys returned to STRS Ohio. In addition, another 1,052 active members were randomly selected to participate in telephone surveys. *Feedback indicated there is majority support across the membership for increasing member and employer contributions — even among educators who are 15 years or more away from retirement.*

Based on the results of this campaign, STRS Ohio is working on draft legislation and seeking a sponsor for this initiative. But much more work needs to be done to make this proposal a reality. Many more of

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our members need to be engaged in conversation with the HCA and us to ensure they understand the full impact of the proposal. Those we have already talked to realize that in effect, they will be absorbing the full 5% increase through not only additional deductions from their paychecks, but less money at the bargaining table. They also recognize there is no "guarantee" with this proposal. Health care is not just an STRS Ohio issue or a public pension plan issue … it's a national public policy issue. These contribution increases will enable STRS Ohio to better provide affordable health care coverage to its current and future retirees until the health care system in this country receives a major overhaul.

STRS Ohio and the HCA also need to engage school boards in this discussion. The school funding issues they face cannot be ignored. However, the employer contribution rate has been 14% since 1984. While the actual dollar amount increases each year with inflation and/or salary increases, the cost of health care is rising much faster.

There is a cost to school districts if the retiree health care issue is not addressed. If the STRS Ohio Health Care Program ends, efforts at the bargaining table to increase teachers' salaries significantly will undoubtedly intensify because these educators will know they will be responsible for 100% of their health care costs in retirement.

The impact of removing health care benefits from educators' retirement package goes beyond individual employers. It also has an impact on the financial well-being of this state, as it will exacerbate the inability of school districts and higher education to recruit and retain teachers. Most significant, though, is the fact that without a dedicated revenue stream, the STRS Ohio Health Care Program will effectively end in just a few short years due to the inability to offer affordable premiums. This will shift costs and create an immediate liability for thousands of suddenly uninsured retirees. In short, another class of uninsured Ohioans will be created. Ultimately, this will have an adverse impact on the State of Ohio and its taxpayers.

STRS Ohio Is Addressing Two Actuarial Funding Challenges With Its Plan

The Retirement Board and STRS Ohio members are united in recognizing that they do not want to sacrifice the guaranteed pension benefits for any non-guaranteed benefits. The legislative initiative STRS Ohio is proposing may not succeed. However, STRS Ohio members — both active and retired — have told the Retirement Board to do what it can to ensure the solvency of the pension fund *and* affordable health care coverage for current and future retirees. Our retirees are paying more in health care premiums and other out-of-pocket costs; our active members are willing to pay more out of their paycheck for health care coverage when they retire. **We owe it to our members to fully pursue this 5% contribution increase before making any significant changes to pension benefits.** And as shown earlier in this report, our research tells us that one out of two active members already plan on teaching longer. Supporting this finding is data that shows we have more than 12,000 active members who could retire immediately with unreduced pension benefits, but are continuing to work. This is a 2% increase over last year.

While putting its efforts toward accomplishing this legislative initiative, the Retirement Board is also mindful of the need to begin evaluating options that could serve as a mechanism for reducing the pension funding period and/or limiting future liabilities. During the board's retreat in February 2006, it discussed some possible options. One is **resetting early retirement reductions in Section 3307.58, R.C. to actuarially cost-neutral reductions**. This could potentially affect about 1,000 new retirees per year, and could reduce the funding period by as much as *eight years* (assuming all other assumptions are met). The following is an example of how the change would affect members:

> Member retires at age 55 with 25 years of service and a $60,000 final average salary.
>
> Current statutory calculation: 25 years x 2.2% x 75% early retirement x $60,000 = $24,750 annual pension benefit
>
> Actuarially neutral calcuation: 25 years x 2.2% x 61% early retirement x $60,000 = $20,130 annual pension benefit.
>
> There is a difference of $4,620 per year or $385 per month.

Legislation would be required to implement this change.

Another option is **increasing requirements for a full year of service credit.** Pension benefits are underfunded when part-time members earn a full-year of credit for part-time work and part-time pay, then move to a full-time position with full-time pay late in their careers. Currently, about 6,000 members are working in part-time positions for which they are earning a full year of service credit. While it could reduce the funding period by only about *one year* (assuming all other assumptions are met), legislation is not required to implement this change.

There has also been discussion at the ORSC with all five public pension plans regarding the actuarial impact of purchased service credit. While increasing the cost of all purchasable service to 100% of liability would not affect the funding period of any of the systems, it would reduce yearly actuarial losses for each system going forward. Future discussion on this topic would undoubtedly have to take into consideration the impact such a change would have on the "portability" of these systems' defined benefit plans. Also, since most members delay purchasing service credit until relatively close to retirement, an announced pending change in the cost for this service will greatly accelerate purchases, perhaps negating any short-term positive impact on the systems' liabilities.

Finally, if the legislative initiative that supports health care funding and strengthens pension solvency is not successful, significant steps for changing the current plan design and cost-sharing structure of the Health Care Program will have to be implemented. In addition, possible changes to age and/or service requirements for full retirement will need to be examined. The Retirement Board is prepared to evaluate these things if necessary, but first, we believe it is imperative that we follow the will of our membership.

As explained in this report, STRS Ohio faces two actuarial funding challenges. The Retirement Board, in concert with the HCA, have developed a proposal that, if successful, strengthens pension solvency and shores up health care in the future to achieve a 30-year funding period for both the pension fund and the health care fund; meets the expectations of current and retired Ohio public educators; and lessens the risk of additional liabilities being placed on the Ohio Legislature and/or Ohio taxpayers. Also contributing to pension solvency will be the unrealized market gains that we currently have, plus future investment returns.

For almost three years, the Retirement Board and STRS Ohio associates have worked hard to restore the trust and confidence of our members. We have made significant changes to operations, staffing and policies that have resulted in lower operating budgets, as detailed in reports to the ORSC. Management and spending decisions are focused on making STRS Ohio operations in all areas as "lean" as possible, without jeopardizing delivery of pension benefits and services and health care coverage to members; adversely impacting investment operations; or failing to meet fiduciary responsibilities or legal requirements. Our research shows that our efforts have been successful. Going forward, we need to continue to demonstrate to our members — both active and retired — that we are making every effort to ensure the solvency of their pension as well as affordable health care coverage in the future.

APPENDIX A

STRS Ohio Historical Funding Status

Year Ended June 30	Actuarial Assets	Unfunded Liability	Funding Period	Funded Ratio
1967	$ 1,204,360,000	$ 704,671,000	15.6 years	63%
1968	1,360,942,000	936,188,000	15.6	59%
1969	1,523,805,000	970,657,000	14.1	61%
1970	1,710,084,000	1,390,892,000	23.0	55%
1971	1,959,093,000	1,375,086,000	21.6	59%
1972	2,235,741,000	1,445,769,000	22.1	61%
1973	2,526,917,000	1,513,090,000	22.7	63%
1974	2,785,350,000	1,794,728,000	24.7	61%
1975	3,000,635,000	1,939,647,000	24.8	61%
1976	3,240,277,000	2,367,446,000	33.8	58%
1977	3,590,432,000	2,618,608,000	37.1	58%
1978	3,991,494,000	2,947,834,000	44.9	58%
1979	4,474,515,000	3,364,770,000	44.4	57%
1980	4,978,714,000	3,924,712,000	59.7	51%
1981	5,634,905,000	4,669,818,000	50.0	55%
1982	6,344,385,000	5,124,609,000	59.0	55%
1983	7,210,677,000	5,301,141,000	44.0	58%
1984	8,326,788,000	5,772,218,000	41.0	59%
1985	9,469,194,000	6,222,881,000	39.0	60%
1986	10,895,158,000	6,414,042,000	39.5	63%
1987	12,911,072,000	6,380,720,000	35.0	67%
1988	14,613,182,000	6,759,786,000	35.0	68%
1989	16,407,002,000	7,211,686,000	34.5	70%
1990	18,242,453,000	7,640,885,000	34.0	71%
1991	20,094,849,000	8,014,512,000	33.5	72%
1992	22,536,343,000	8,263,895,000	32.5	73%
1993	26,259,447,000	8,229,529,000	31.5	76%
1994	28,543,410,000	8,328,399,000	30.5	77%
1995	31,416,677,000	8,570,498,000	29.3	79%
1996	34,569,651,000	8,197,261,000	28.4	81%
1997	38,743,272,000	7,820,498,000	26.9	83%
1998	43,865,907,000	7,262,181,000	24.2	86%
1999	49,124,802,000	5,638,538,000	16.3	90%
2000	54,712,921,000	4,480,237,000	23.1	92%
2001	57,450,612,000	5,230,628,000	27.5	92%
2002	51,969,345,000	14,256,819,000	39.0	79%
2003	51,697,000,000	17,037,000,000	42.3	75%
2004	55,340,714,000	17,613,627,000	42.2	76%
2005	57,048,493,000	20,051,544,000	55.5	74%

APPENDIX B

STRS Ohio Projected Funding Status

ASSUMING no change in assumptions, pension benefits or plan design, and continuation of 1% employer contribution to the Health Care Stabilization Fund.

Year Ended June 30	Actuarial Assets	Unfunded Liability	Funding Period	Funded Ratio
2006	$ 60,595,639,000	$ 20,090,358,000	49.6 years	75.1%
2007	64,978,887,000	19,311,380,000	40.9	77.1%
2008	68,531,483,000	19,355,451,000	37.6	78.0%
2009	71,610,141,000	19,838,855,000	36.2	78.3%
2010	74,576,805,000	20,367,913,000	35.0	78.5%
2011	77,402,398,000	20,934,973,000	33.9	78.7%
2012	80,070,165,000	21,514,453,000	32.9	78.8%
2013	82,543,135,000	22,094,722,000	31.9	78.9%
2014	84,769,715,000	22,671,758,000	30.9	78.9%
2015	86,690,098,000	23,241,929,000	29.9	78.9%
2016	88,235,420,000	23,801,927,000	28.9	78.8%
2017	89,327,214,000	24,348,318,000	27.9	78.6%
2018	89,876,500,000	24,877,347,000	26.9	78.3%
2019	89,782,650,000	25,384,856,000	25.9	78.0%

APPENDIX C

STRS Ohio Projected Funding Status

ASSUMING current 1% employer contribution returns to the pension fund beginning July 1, 2008, and no change in assumptions, pension benefits or plan design.

Year Ended June 30	Actuarial Assets	Unfunded Liability	Funding Period	Funded Ratio
2006	$ 60,595,639,000	$ 20,090,358,000	49.6 years	75.1%
2007	64,978,887,000	19,311,380,000	40.9	77.1%
2008	68,531,483,000	19,355,451,000	30.5	78.0%
2009	71,610,140,000	19,723,417,000	29.2	78.4%
2010	74,576,803,000	20,122,607,000	28.0	78.8%
2011	77,402,395,000	20,543,982,000	27.0	79.0%
2012	80,070,163,000	20,960,447,000	26.0	79.3%
2013	82,543,132,000	21,358,734,000	25.0	79.4%
2014	84,769,713,000	21,733,033,000	24.0	79.6%
2015	86,690,096,000	22,077,774,000	23.0	79.7%
2016	88,235,418,000	22,387,543,000	22.0	79.8%
2017	89,327,212,000	22,656,618,000	21.0	79.8%
2018	89,876,498,000	22,878,759,000	20.0	79.7%
2019	89,782,649,000	23,047,107,000	19.0	79.6%