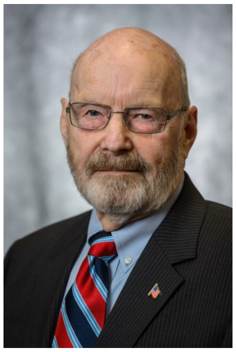
# Protect Ohio Pensions

## 1st Quarter 2019

***Retirees & Current Employees Working Together to Preserve Ohio's Public Pensions***

## Insight From the Administrator

**By William I Winegarner**



**Pensions 101**

One of our members, Michael, wrote wanting to gain a greater understanding of why or how the public Employee Pension Transparency Act (PEPTA) legislation would be harmful to a pension system's ability to continue providing current pensions and benefits. He suggested that a novice's version of a pension-system operation might be helpful to all members' understanding.

When I first wrote back to Michael, I told him that pension funding and operations were too complex to attempt to print an adequate explanation in a newsletter. I said these complexities are why pension systems have to have boards, executive and assistant directors, experienced internal and external investment personnel, I.T. (computer systems) professionals, internal and external accountants, attorneys, actuaries, and experienced government relations officers in order to help them operate efficiently, effectively and legally.

Pension systems have hundreds, if not thousands, of pages of legislation and rules under which they must operate. All of their activities come under the oversight and scrutiny of the state's Attorney General, Treasurer, Director of Administrative services, General Assembly and dozens of stakeholder groups.

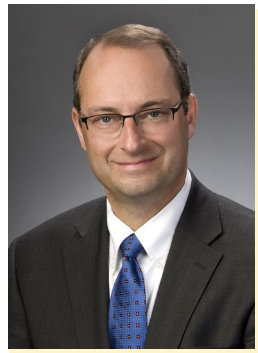
I agreed that it would be of great benefit for all of our members, and also the members of the Ohio General Assembly, to fully understand these complexities. Without experiential knowledge, it is more difficult to identify the approaches and fallacies behind the arguments to eliminate Ohio's traditional (defined-benefit) pension plans.

Michael also asked, "Are any of the pension systems underfunded?" I responded, "When considering that question, one needs to also consider the counter question

**Continued on page 2**

## The Legislative Report

**By Steve Buehrer, Esq.**



**Ringing in the New!**

At the Ohio Statehouse, as well as in capitol buildings across the country, new leaders with new ideas and diverse backgrounds are raising their hands to begin new terms in office. In Ohio we have seated a new governor as well as a full slate of statewide elected officials to lead our state over the next four years. The Ohio General Assembly has reconvened for its 133$^{rd}$ session and will begin organizing itself to consider the state budget and all of the issues that will come before it.

Although many new faces fill the seats in Columbus, many of the issues at the forefront of past consideration remain. Even though public pension change and reform has not been mentioned as a high priority this year, the necessity to maintain a strong and stable pension system remains. As detailed in the Executive Director's article this month, changes in the fundamental rules or assumptions that are the current foundation of the pension systems could have a dramatic effect on the sustainability of these critical systems going forward. Not only do pension system leaders have an obligation to balance the needs of today with the priorities of the future in a responsible way, all of us must remain vigilant in ensuring that all players in our pension system understand the pluses and minuses of any proposed change. We also must ensure that political leaders do not get swept up in hasty uninformed-decision making, especially when these calls for change are driven by the forces that seek to profit off the system rather than preserve it. **Continued on page 3**

## Retirees & Workers  Standing Together



**Insight (Cont'd from page 1)**

which is: Are the pension amounts and benefits over promised?" The answer to both questions is yes, and no.

In an attempt to explain, let us review a very basic and very simplified situation: A worker retires at the age of 62 with 30 years of service. Over his working career, the employee has contributed $8.52 plus $0.68 in earned interest to his pension fund. At the time of retirement, the retiree's account has $9.20 in it. The legislature has established a formula that sets the employee-retirement benefit at $2.71 per year. Based on a retiree-projected life span of 23 years (age 85) the pension system will be obligated to pay out approximately $82.78 to this retiree.

Is the pension system underfunded, or is the employee over promised? The pension system is underfunded because it is being asked to pay $82.78 to an individual who only has only put $9.20 in his account. The individual is over promised because he is expecting $82.78 in pension payments from a deposit of $9.20.

***If you multiply the figures in the example by 10,000: $9.20=$92,000; $2.71=$27,100; $82.78=$827,800 it will be closer to basic figures for a $41,000 final average salary (FAS).***

What pension boards attempt to accomplish is to invest the $9.20 in such a way that it doesn't lose any of its value, but rather earns enough on investments, coupled with a portion of the employer contributions, to cover the $82.78.

Over the past 30 years, Ohio's pension systems have earned an average of 8% per year which when added to the contributions, still leaves a pension fund $47.75 short in covering the $82.78 promised.

The next topic we have to consider is the cost of side benefits such as health care and cost of living allowances. Where do those funds come from?

Originally, side benefits arose when the stock market and other investment returns skyrocketed in the late 70s and early 80s. Back then, bowing to pressure from their stakeholders, retirement boards began to draw on their future reserves to provide these additional and unfunded benefits to their members. Today's reality is that as time has passed the investment-earning reserve has dwindled and the pension systems are now faced with the probability of having to substantially reduce the COLAs and health care benefits or to fund a major portion of these benefits with current earnings.

From a financial point of view, funding from current earnings is a dangerous practice and Ohio's legislature has set up a check-point monitor to avoid it. The monitor is referred to as a pension system's 30-year funding requirement. Simply stated, Ohio's pension systems have to have the real, or projected, assets to amortize (pay off) all of their obligations for the next 30 years.

> Let me help to clarify with an analogy of a home mortgage. We buy a home worth $100,000 and pay the first $20,000 in cash as our down payment. We sign a 30-year mortgage-note for the balance of $80,000 at 4.25% interest. We have created a liability of $141,678.69 ($80,000 plus interest over a 30-year period). If we don't have the cash or other assets to pay the total debt, this liability is a real-unfunded liability.
>
> Even though we owe more than we have cash on hand, we do have mitigating assets because of our earning potential. We have a secure job that projects enough future income to cover $113,343 of the obligation. With our job taken into consideration, we would be able to estimate that we are currently 80% funded in relationship to our mortgage debt.
>
> Are we on solid ground financially? 100% funded is always better, but 80% is fairly secure because we could get raises or promotions to improve our projections or possibly refinance the mortgage at some point and reduce the interest rate and term.

The mortgage-funding example is similar to one a pension system has. They have the challenge of paying out $827,769 (23 years) in pension payments. The employee has contributed $92,000 and their employer $128,870 for a comparative down payment of $220,919. When this employee retires, the system has an immediate-unfunded pension liability of $477,478.80.

**Continued on page 3**

## Insight (Cont'd from page 2)

| | Pension Amortization | | | | |
|---|---|---|---|---|---|
| Year | Deposits | Earnin gs | Results | Payment | Remainder |
| 1 | 220,919.68 | 8.00% | 238,593.25 | 27,060.11 | 211,533.15 |
| 2 | 211,533.15 | 8.00% | 228,455.80 | 27,871.91 | 200,583.89 |
| 3 | 200,583.89 | 8.00% | 216,630.60 | 28,683.71 | 187,946.89 |
| 4 | 187,946.89 | 8.00% | 202,982.64 | 29,495.52 | 173,487.12 |
| 5 | 173,487.12 | 8.00% | 187,366.09 | 30,307.32 | 157,058.77 |
| 6 | 157,058.77 | 8.00% | 169,623.47 | 31,119.12 | 138,504.35 |
| 7 | 138,504.35 | 8.00% | 149,584.69 | 31,930.93 | 117,653.77 |
| 8 | 117,653.77 | 8.00% | 127,066.07 | 32,742.73 | 94,323.34 |
| 9 | 94,323.34 | 8.00% | 101,869.21 | 33,554.53 | 68,314.67 |
| 10 | 68,314.67 | 8.00% | 73,779.85 | 34,366.34 | 39,413.51 |
| 11 | 39,413.51 | 8.00% | 42,566.59 | 35,178.14 | 7,388.45 |
| 12 | 7,388.45 | 8.00% | 7,979.53 | 35,989.94 | (28,010.41) |
| 13 | (28,010.41) | 0.00% | (28,010.41) | 36,801.75 | (64,812.16) |
| 14 | (64,812.16) | 0.00% | (64,812.16) | 37,613.55 | (102,425.71) |
| 15 | (102,425.71) | 0.00% | (102,425.71) | 38,425.35 | (140,851.06) |
| 16 | (140,851.06) | 0.00% | (140,851.06) | 39,237.16 | (180,088.22) |
| 17 | (180,088.22) | 0.00% | (180,088.22) | 40,048.96 | (220,137.18) |
| 18 | (220,137.18) | 0.00% | (220,137.18) | 40,860.76 | (260,997.94) |
| 19 | (260,997.94) | 0.00% | (260,997.94) | 41,672.57 | (302,670.50) |
| 20 | (302,670.50) | 0.00% | (302,670.50) | 42,484.37 | (345,154.87) |
| 21 | (345,154.87) | 0.00% | (345,154.87) | 43,296.17 | (388,451.04) |
| 22 | (388,451.04) | 0.00% | (388,451.04) | 44,107.97 | (432,559.02) |
| 23 | (432,559.02) | 0.00% | (432,559.02) | 44,919.78 | (477,478.80) |
| | PENSION INCLUDING 3% COLA | | | 827,768.68 | |

Since pension systems have no other source of income, their only direct-mitigating asset is investment income. Unlike a homeowner's employment, which is reasonably reliable, investment income is speculative and very unreliable. Mortality rates are another estimable factor for long-range pension valuations. Mortality rates help predict how long and how much a pension system may be obligated to pay a pension.

Every five years or so, the pension board's outside-consultant actuaries (professional predictors) review the history, markets, trends and mortality rates with the boards and present their recommendations as to what the potential earning and survival rates might be over the next five-year period. The boards select a projected rate of return based on their actuaries' findings and recommendations. The actuarial-permitted rate a pension system selects to project their future assets will determine if they are adequately funded or not. Currently, OPERS is at 7.2%, STRS 7.45%, SERS 7.5%.

Now let's return to our main topic, "How would the Public Employee Pension Transparency Act (PEPTA) legislation be harmful to us and our pension systems' ability to continue providing current pensions and benefits. If a pension system were required to use the PEPTA mandated 2.7% US Bond rate of return to establish their future status, it would be approximately 4.8% lower than a board's more realistically established rate. The PEPTA-mandated rate would make each system appear to be a bad credit risk for investments and would also project that they have exceeded their statutory funding requirements.

Under a PEPTA projection return, current retiree benefits (health care / COLA) would have to be greatly reduced and possibly even pension amounts to bring a pension system under its statutory funding requirements. The idea behind PEPTA, and similar initiatives, is to convince members of the legislature to eliminate defined-benefit pensions and to force current workers into defined-contribution plans (individual 401K type). If that should occur, using our example from above, a defined-contribution worker would retire with \$92,050 + \$73,640 (8% of the employer contribution), or \$165,690 in a 401k type account. From there, they would have to be their own investment expert and provide their own pension amounts and COLAs.

How would a change in current-worker retirement plans impact current retirees? The change would be totally devastating to those currently retired under Ohio's traditional pension plans. Defined-benefit pensions require the continuing flow of new deposits to sustain them and the benefits they provide. Even though we may be faced with the reduction of some benefits under current financial conditions, there would be no question about it under PEPTA or similar reporting-requirement attacks.

Being aware of this type of legislation before it can be enacted, is why it is so vitally important for all retirees and workers to join together as members of Protect Ohio Pensions (POP5). The purpose of this organization is to help our members understand and to have the proper legislative resources and contacts to do everything it can to preserve Ohio's traditional pensions and in doing so, help preserve everyone's pension and benefits.

## Legislative (Cont'd from page 1)

As 2019 dawns, our highest priority as your Legislative Counsel is to build relationships with new government officials especially in the legislature. We are undertaking meetings now to acquaint ourselves with new members, hear their priorities and offer ourselves as resources as they consider pension related legislation. These initial contacts as well as reengaging with veteran members we already know is critical to the relationship building that is central to how the legislature operates and good advocacy is done.

**Continued on page 4**

**Legislative (Cont'd from page 3)**

We also continue to encourage you to take opportunities to get to know your local legislators. Being able to call on someone in the middle of a breaking issue with whom you have already built a relationship is a far easier task than reaching out for the first time when a vote is on the line.

I am sure when legislative proposals begin to surface in the next few weeks, ideas will be brought forward that impact Ohio pension systems. Our hope is that these proposals will be well vetted and will be compatible with good stewardship of the pension systems.

We will follow closely the activities of the Ohio Retirement Study Council as they fulfill their duty to review pension proposals. We will also continue to enhance our relationships with the pension systems so that we, to the extent it is possible, will be able to harmonize our message around the things that matter most to the efficiency of operating the systems. In the perfect world, all participants in the governance system would fulfill their roles in preserving Ohio's defined-benefits system. However, despite our high aspirations for a new year, undoubtable some things will happen that are not as planned.

That is when our team at POP-5, that includes you, will step forward and work to ensure that maintaining Ohio's pension systems and their responsible management prevails. We look forward to that challenge as well as all things that the New Year holds.

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