The Truth about the Ohio Public Employees’ Retirement System

Working with 3,700 public employers, the Ohio Public Employees Retirement System (OPERS) covers more than 365,000 active members and 416,000 inactive members (those who are eligible to receive benefits in the future but are no longer plan participants). Participants work at the state, county and municipal levels and perform jobs ranging from architect to zookeeper. For the 350,000 active members of the traditional plan, the average annual salary is $35,849, (OPERS FY 2009 Financial Report, page 113). Employees must pay 10 percent of every paycheck toward their retirement.

There have been some recent claims that retirement systems like OPERS are facing a financial crisis. These claims are rarely true, and they are not true of OPERS. As of December 31, 2009, OPERS held net assets with an actuarial value of $69.5 billion. This includes more than $11 billion for post-employment benefits other than pensions (OPEBs), such as retiree health care. Ohio is one of just nine states to be rated as a “solid performer” by the Pew Center on the States regarding the handling of its OPEB obligation. Pew also includes Ohio as one of 16 solid performers regarding its pension plans (Trillion Dollar Gap, Pew Center on the States, February 2010).

OPERS Provides Reasonable Pension Benefits to Career Employees

OPERS currently provides retirement benefits to more than 170,000 retirees and their beneficiaries. The average annual benefit for retired members of all plans was $19,524 in 2008, (FY 2009 Financial Report, page 112). As part of the formula used in calculating pension benefits, plans like OPERS use a service credit multiplier. For most employees, OPERS uses a multiplier of 2.2 percent. Nationally, the typical large public sector plan that is not coordinated with Social Security uses a multiplier of about 2.3 percent, and some use a multiplier as high as 3 percent. To illustrate, the benefit for a hypothetical 25-year OPERS participant with a final average salary of $40,000 would be calculated in the following manner:

$$40,000 \times 25 \text{ years of service} \times \text{service credit multiplier of 2.2 percent} = \$22,000$$
For the vast majority of those individuals this will be their primary source of income in retirement, as only 2.6 percent of public employees in Ohio are covered by Social Security.

Because participating employers can calculate each employee’s benefit, employers can efficiently manage the workforce. On the other hand, 401(k) plan participants may invest too little, or their investments may provide insufficient returns, thus preventing employees from retiring. A recent calculation done by the Center for Retirement Research for Retirement USA shows that the real retirement crisis in our country is the $6.6 trillion gap between current savings and what Americans should have today to maintain their standards of living in retirement (The Retirement Income Deficit, Retirement USA, October 2010). As a result, millions of U.S. workers have already delayed, or are likely to delay, their retirement dates. This can complicate the employer’s role, forcing decisions with unpleasant consequences for everyone. Even for those employees who have accrued what they believe may be sufficient savings, there is often little incentive to retire.

An OPERS participant becomes “vested,” or has the right, after satisfying a minimum service requirement, to ultimately receive a defined benefit regardless of whether the employee remains a member of the pension plan, after five years. In other words, even though benefits may not be “portable,” an employee with five years of creditable service will be eligible for a modest benefit upon reaching retirement age. According to the Wisconsin Legislative Council’s 2008 Comprehensive Study of Major Public Employee Retirement Systems, nearly three-quarters of the public plans surveyed require five or fewer years of service to vest. Private sector plans also provide vesting after five years.

Employees covered by OPERS are eligible for a pension calculated under the plan’s formula at age 65 with at least five years service, or after 30 years of service, whichever is earlier. This requirement is in line with other public sector plans. In fact, because many public sector jobs are physically or emotionally demanding and employees who hold those positions are directly responsible for public safety and health, many plans provide that employees can retire once the sum of their age and service equals 80.
OPERS is Financially Sound

It should come as no surprise that the 2008 market downturn adversely impacted all investors. What is surprising is that some individuals fail to account for the fact that defined benefit plan funding is structured to be carried out indefinitely; they are designed for the long haul and do not have an investment horizon like defined contribution plans that cover individual employees. OPERS makes investments following a long-term investment allocation strategy in order to minimize risk in the market and to provide the returns needed to support the benefit structure.

As of December 31, 2009 OPERS had an asset base of $69.5 billion, with about $57 billion in assets for the traditional defined benefit pension plan. Based on the actuarial value of those assets, at that time OPERS had a funded ratio of about 75 percent. This is in line with other large public sector plans; according to a recent survey by the Center for State and Local Government Excellence the national average for large public sector plans was 78 percent as of June 30, 2009. A plan’s funding ratio is simply a comparison of assets to accrued pension obligations. A retirement system’s liabilities are amortized over time – similar to paying off a mortgage. In other words, a plan’s funding status is a snapshot that captures a government’s ongoing effort at one point in time to fund its future pension liability. If a plan sponsor is consistently making its annual required contribution, its pension plan can have a funded ratio below 100 percent yet still be on track toward full actuarial funding.

It is also important to point out that in 2001, OPERS instituted a “market value corridor” policy that prohibits the actuarial funding value from varying by more than 12 percent from the market value of assets. Without this policy, which many systems do not use, OPERS’ funding ratio would have been close to 90 percent but due to the conservative corridor policy, the funding ratio is about 75 percent.

Defined benefit plans have access to professional investment managers who are trained in developing ongoing, long-term investment strategies that include an optimum mix of growth potential and risk. Participants, employers and taxpayers benefit from the favorable investment performance of pooled pension fund assets, as well as fees and expenses that are significantly lower than those of defined contribution savings plans. The wide range of investment options
open to large pension plans, such as foreign and domestic stocks and bonds and venture capital, also improve investment returns. Furthermore, OPERS investments are not affected by the retirement timing of a particular employee, so the investment horizon never has to be shortened.

Current funding of DB plans actually reduces long-term costs over time through the compounding of contributions and interest earnings. To a large extent, investment returns dictate the level of contributions needed to keep pension plans funded at healthy levels because those returns provide about two-thirds of plan revenues. Actuarial projections assume that over the long-term, OPERS will earn an average of eight percent each year on its investments. In some years returns will be below that rate and in others returns will exceed it. Over the past 30 years, the cumulative long-term investment return has exceeded the projected eight percent rate.

For example, while 2008 investment results were poor for all investors, OPERS' 2009 investment return was positive, with returns of 19 percent for the defined benefit portfolio and 24 percent for the health care portfolio. OPERS recently announced that, for the year ending December 31, 2010, the Fund achieved a 13.9 percent investment return. When returns are strong and above the actuarial assumed rate, the employer's level of contributions will generally be lower than when investment returns lag the actuarially assumed rate. When returns are less than projected, those actuarial losses are amortized through increased employer contributions, which is one reason why contributions needed from the employer will increase over the levels needed earlier in the decade. State and local government employer pension costs for all public pension plans in Ohio amounted to less than three percent of all state and local government spending in 2008 (Issue Brief: State and Local Government Spending on Public Employee Retirement Systems, National Association of State Retirement Administrators, January 2011).

Plan investments not only help keep costs down for plan sponsors, but are also a critical part of the economic fabric of the state. According to the National Institute on Retirement Security, each dollar in taxpayer contributions to Ohio's state and local pension plans supports $5.73 in long-term economic activity in the state. Retiree expenditures stemming from state and local pension plan benefits support nearly 79,000 jobs in Ohio. These figures reflect the fact that taxpayer contributions are, in the long run, a highly efficient source of financing for retirement benefits that ultimately provide income and jobs for others (Pensionomics: Measuring the
Economic Impact of State and Local Pension Plans, National Institute on Retirement Security, February 2009).

Other Post-Employment Benefits

For many years employers have been contributing substantially toward OPERS’ retiree health care program. As a result, OPERS now holds about $11 billion for retiree health care benefits. This is extremely important, as most public employers in the United States have set aside little, if any, money to “pre-fund” retiree health care programs. The vast majority continue pay retiree health care costs on a pay-as-you-go basis – paying medical costs or premiums as they are incurred. Employers providing retiree health care benefits can cut their long-term costs substantially by pre-funding those obligations because those contributions can be invested like assets in a pension plan and investment returns then provide the bulk of revenues used to pay insurance premiums and other costs. As the following chart shows, OPERS is in dramatically better shape than plans in most other jurisdictions:

<table>
<thead>
<tr>
<th>State</th>
<th>OPEB Funded Ratio</th>
</tr>
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<tbody>
<tr>
<td>Ohio/OPERS</td>
<td>38.2</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>24.0</td>
</tr>
<tr>
<td>Kentucky</td>
<td>10.4</td>
</tr>
<tr>
<td>West Virginia</td>
<td>4.0</td>
</tr>
<tr>
<td>Michigan</td>
<td>1.9</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>&lt;1</td>
</tr>
<tr>
<td>Indiana</td>
<td>0</td>
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<tr>
<td>Minnesota</td>
<td>0</td>
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For years health care costs have spiraled upward, and Ohio has tightened eligibility standards to receive those benefits. While retirees with at least 10 years of service accumulated prior to or on January 1, 2007 receive a 100 percent premium subsidy, subsequent groups of retirees will receive much lesser benefits and must generally work for 30 years in order for their premiums to be fully paid. In other words, stakeholders have already taken steps to ensure the long term soundness of the retiree health care program.

AFSCME believes in a society of opportunity where all workers not only earn a living wage, but can afford to see a doctor when they are sick. AFSCME believes we all should have the
opportunity to reach our full potential in our chosen careers and to retire with dignity when our work is done. For decades, OPERS has provided workers and their beneficiaries with secure retirement benefits. There is no reason to believe it will not continue to be able to do so.