Oklahoma Teachers Retirement System

UCO Faculty & Staff Presentation
April 6, 2016

Tom Spencer, Executive Director
History and Overview

- Created in 1943 by an act of the Oklahoma Legislature.
- Official operations began July 1, 1943.
- First retirement checks disbursed Jan. 1, 1947.
- Employees of more than 600 local school districts, career technology schools, public colleges and universities are enrolled as members of OTRS.
Appointing Authority & Qualification

Name

- Governor, 4 Coterminous (Public or private funds management, banking, law or accounting experience) - William L. “Bill” Peacher, Chairman
- Governor (Higher Education Rep.) - Dr. Gary Trennepohl
- Governor (Nonclassified Personnel) - Roger Gaddis
- Governor (Nonclassified Personnel) - Kevin Moore
- Governor (Nonclassified Personnel) - Dr. Myron Pope
- Senate Pro Tempore (Active Classroom Teacher) - Judy Harris, Board Secretary
- Senate Pro Tempore (Retired Member) - Dr. Phillip V. Lewis
- Senate Pro Tempore (Retired Member) - Vernon Florence, Vice Chairman
- House Speaker (Active Classroom Teacher) - (vacant)
- House Speaker (Retired Member) - Christa Hughes
- Ex Officio - State Superintendent or designee - Lance Nelson, Designee
- Ex Officio - OMES Director or designee - Jill Geiger, Designee
- Ex Officio - Career-Tech Director or designee - Dr. Greg Winters, Designee
- Nonvoting - statewide organization representing retired educators - Bill Bentley
OTRS Membership

- Available to all public school employees working half-time or more.
- Teachers and administrators are required to be members.
- Support staff may join voluntarily.
- As of June 30, 2015, TRS had 169,704 total clients:
  - 90,388 Active Clients
  - 58,929 Retired Clients (incl. beneficiaries)
  - 10,457 Inactive Vested Clients
  - 9,930 Inactive Non-vested Clients
Client Overview

- Average Active Client
  - $46,819 Salary
  - 45.8 Years of Age
  - 11.0 Years of Service

- Average Retired Client
  - $20,242 Annual Benefit (regular ret’ees)
  - $19,798 (reg. & disab. ret’ees, benefic. & spouses)
Actuarial Statistics

- 2015 Funded Ratio
  - 66.6% on actuarial basis (63.2% in FY 2014)
  - 69.6% on a market value basis (72.7% in FY 2014)

- Funding Period
  - 16 Years (11 years in FY 2014)

- Actuarial Determined Contribution Rate (Employer)
  - 17.2% of payroll (13.1% in FY 2014)
Actuarial & Financial Statistics

- 2015 Unfunded Liability
  - $6.921 Billion ($7.207 Billion in FY 2014)

- Actuarial Determined Contribution (was “ARC”)
  - $551 Million (Employers)
  - $728 Million actually collected

- Benefit payouts to service retirees, disability & beneficiaries in FY 2015
  - $1.2 Billion
Assets vs. Liabilities

- Funding Ratio

- 1996 to 2015
- $0 to $25,000
- 0% to 70%

- Assets (Left)
- Liabilities (Left)
- Funded Ratio (Right)
# OTRS Investment Performance

## Annual Market Rate of Return (Fiscal Year)

<table>
<thead>
<tr>
<th>Year</th>
<th>Return</th>
</tr>
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<tbody>
<tr>
<td>2015</td>
<td>3.5%</td>
</tr>
<tr>
<td>2014</td>
<td>22.4%</td>
</tr>
<tr>
<td>2013</td>
<td>17.8%</td>
</tr>
<tr>
<td>2012</td>
<td>1.80%</td>
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<tr>
<td>2011</td>
<td>23.5%</td>
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<tr>
<td>2010</td>
<td>16.6%</td>
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<tr>
<td>2009</td>
<td>(15.25)%</td>
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<tr>
<td>2008</td>
<td>(7.50)%</td>
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<tr>
<td>2007</td>
<td>18.00%</td>
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<tr>
<td>2006</td>
<td>9.40%</td>
</tr>
<tr>
<td>2005</td>
<td>10.00%</td>
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<tr>
<td>2004</td>
<td>20.2%</td>
</tr>
<tr>
<td>2003</td>
<td>4.80%</td>
</tr>
<tr>
<td>2002</td>
<td>(5.40)%</td>
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<tr>
<td>2001</td>
<td>(2.30)%</td>
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<tr>
<td>2000</td>
<td>10.5%</td>
</tr>
<tr>
<td>1999</td>
<td>11.9%</td>
</tr>
<tr>
<td>1998</td>
<td>21.4%</td>
</tr>
</tbody>
</table>

## Compound annualized rate of returns (end of fiscal years):

- 10 yr. 8.3%
- 5 yr. 13.4%
- 3 yr. 14.3%
Investment Returns – Historical

Investment Returns by Fiscal Year
Financial Overview

- **Summary**
  - System underfunded status continues but is improving
  - Funding period down to 16 years from infinity
  - Recent and long-term financial performance is very good
  - Contributions & Revenue exceed Actuarially Determined Contributions
The Plan Overview

- Defined Benefit Plan
- Retirees receive a lifetime annuity
- Benefit calculated by average salary $X$ years of service $X \times 2\%$.
- Employee and employer pay contributions
- Vesting is 5 years
- COLAs – Not statutory; all “ad hoc.”
The Plan Overview

*Defined Benefit vs Defined Contribution*

- Defined Benefit Plan – Pros
  - Retirement benefit is guaranteed for your *lifetime*; possibly the lifetime of your joint annuitant
  - Retirement benefit you receive based on a formula
  - Benefit is independent of contributions and investment returns
  - Plan Sponsor bears all risks associated with a DB plan – longevity, inflation, investment, etc.
The Plan Overview

Defined Benefit vs Defined Contribution

- Defined Benefit Plan – Cons
  - Retirement benefit you receive is based on a formula that you do not control
  - Retirement benefits are unlikely to increase once you retire
  - Cannot “borrow” against retirement funds
  - Portability or withdrawal is limited to your contributions with minimal interest accrual
Plan Overview

Defined Benefit vs Defined Contribution

- Defined Contribution Plan – Pros
  - Voluntary Contributions
  - Employee chooses investments (usually)
  - Retirement benefits are controlled by you
  - DC Account is easily portable (contributions + all accrued earnings after vesting)
  - Tax advantages (may reduce overall tax liability)
  - Borrowing Provisions
Defined Contribution Plan

What You Need to Know

- Defined Contribution Plan – Cons
  - Voluntary Contributions
  - Discipline: must make contributions consistently over a long period of time
  - Retirement income uncertain: based solely on amount contributed and investment returns
  - Employee chooses investments and assumes risk
  - Employee bears longevity and inflation risk
“A Better Bang for the Buck”
(Nat’l Institute on Retirement Security)

- Academic Study by NIRS published in 2008
- Co-authored by Beth Almeida and William B. Fornia

Study of how Defined Benefit (pension) plans are actually more cost-effective than Defined Contribution (401 k – type) plans.

See:
“A Better Bang for the Buck”

DB Plans are less expensive and more financially efficient because:

- DB plans are better at managing “longevity risk.”
- DB plans get higher returns since they don’t have to change asset allocation. Pension plans aren’t based on one participant’s lifetime.
- DB plans get lower fees since they invest larger blocks of assets.
"A Better Bang for the Buck"

DB Plans manage “longevity risk” better

- Individuals must assume they will reach their maximum life expectancy. Don’t outlive your funds. DB plans use average life expectancy. Collectively don’t put in as much.
- Advisors encourage individual investors to save as much as possible. Might be saving too much.
- Many DB plans have survivor annuity benefits like TRS
“A Better Bang for the Buck”

DB plans get higher returns since they don’t have to change asset allocation.

- Individuals lower their risk when they reach the age for payouts. Advisors tell individuals to take as much of their investment risk off the table when they near or reach retirement age. More is invested in bonds.
- DB plans can keep a balanced portfolio perpetually. These plans keep more assets in equities and other higher risk investments. DB plans can also ride out periodic down markets much more easily.
- With higher allocations in equities and other investments, DB plan returns are higher.
“A Better Bang for the Buck”

DB plans get lower fees since they invest larger blocks of assets.

- Large pension plans invest large sums of money. They can command the lowest fees available.
- DB plans can afford more professional investment management and achieve higher returns.
- Most DC investors pay higher retail fees on mutual funds.
Legislative Issues – 2016 Session

• Reduce Dedicated tax and other revenue to TRS
  • TRS receives 5% of state and corporate income tax
  • TRS receives 5% of state sales and use taxes
  • TRS receives some lottery revenue and some tobacco taxes
  • This dedicated revenue brought in $312 million in FY 2015 (30.2%)

• Salary caps for TRS retirees & “COLAs”
  • HB 2247 – Raises RRTW cap to $18 K for those under 62
  • HB 3156 / SB 1187 – “Empowerment” school districts. Reduce state regulation. Senate would make TRS optional
Questions and Answers

1. Would OTRS be affected if a large number of people chose to leave the system, choose to switch to a 401 program? If new employees choose an alternative plan over OTRS, does that affect the future funds for the employees that currently are in OTRS and choose to stay in OTRS?

State law controls what type of retirement benefits are provided for public school teachers and employees of educational entities like UCO. For almost all such entities, membership in TRS is mandatory for instructors and administration. Only support staff can opt in or out.

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#1 continued
If the Oklahoma Legislature changed the retirement benefit to a savings plan for all new employees (like OPERS legislation), there would be a fiscal impact to TRS. The reason is that TRS has pension liabilities that must be paid on all retirees. If fewer people are available to pay those outstanding liabilities, the State or TRS will come up short.

When new state employees were put into a DC savings plan in 2015, the Legislature acknowledged that cost. Employers still must pay in a certain contribution on these new employees that goes to the OPERS pension plan.
Questions and Answers

2. What would happen if 10% if the faculty decided to pull out of OTRS to do a defined contribution system? An actuary would have to analyze that.

3. Why are OU and OSU not in OTRS? OU and OSU still participate in OTRS. But for most employees it’s not mandatory. Those employees have the option to be in OTRS or to participate in an “Alternate Retirement Plan” controlled by OU for their employee and OSU for theirs.
Questions and Answers

4. I heard someone from the Social Security Administration the other day talking about how Social Security was not intended to be someone’s only income in retirement, that we were to have a three-legged stool: Social Security, personal savings and a pension plan. How does OTRS fit into that?

It is true that Social Security was never intended to be U.S. citizens only retirement plan. The 3-legged stool concept is one personal financial advisors talk about. Soc. Secur. is the foundation & first leg. If you have a 2\textsuperscript{nd} form of guaranteed retirement like a DB pension that’s the 2\textsuperscript{nd} leg. That would be TRS. Finally, personal savings is the 3\textsuperscript{rd} leg. It’s good to have liquid assets in addition to guaranteed income.
Questions and Answers

5. Some have complained that putting money into OTRS does not allow people to provide for a spouse or children if they die. Can you address that? (Are there options?)

TRS has “joint annuitant” options to take care of a significant other. The benefit amount of the client’s pension and that of his or her joint annuitant are actuarially based and depend on the ages of both. TRS clients can provide a pension to a spouse that takes effect upon the death of the client. With a child there is generally such a gap in ages that the reduction to the pension for the client may be too great.
6. Why are there people who are opposed to pension funds? Many in the private sector that don’t have a pension are opposed to public employees having them. It’s called “pension envy.” In some jurisdictions that have more lavish pension benefits, the costs to the government and taxpayer have been too high.

7. Since we have a revenue failure, does this not create incentives for the legislature to try to justify why OTRS should not be supplemented by the state budget? It’s not a matter of getting a supplement. It’s protecting what we already get in the way of dedicated revenue.
8. The retirement system’s viability for future retirees has prompted legislative maneuvering in recent years. In 2010, OTRS staff told *The Oklahoman* newspaper there were only three options to shore up the system. Those three things were putting more money into the system, increase investment returns, or doing something about benefits. Which is likely of the three to happen?

We know how this story ended. In 2011, future retirement benefits were trimmed by making the default retirement age 65 or Rule of 90 w/age 60. We had great investment returns from 2010 to 2014. Contribution rates and dedicated revenue largely remained the same.
Questions and Answers

9. Oklahoma’s teachers’ retirement program has long been one of the most underfunded of its kind in the U.S. Employer contributions did not begin until 1986, a fact that has largely contributed to its $10.4 billion unfunded liability as of May 2011. Will there be anything done to rectify this liability?

Again, we’ve seen how this story has changed over the last several years. Here is a quote from my column in the last newsletter:

“In 1996, OTRS had a 39.6% funded ratio. The System had a $5.5 billion unfunded liability and assets of $2.28 billion. After the close of the last fiscal year on June 30, 2015, OTRS got to its highest funded ratio in history at 66.6%! Unfunded liability was down to $6.9 billion after being as high as $12.5 billion as a result of the fiscal meltdown of 2008-09. Assets of OTRS had grown to $13.77 billion. Over the last 20 years the OTRS funded ratio has improved by 68%. Assets have grown by a little more than 600%!”
Questions and Answers

10. If the legislature decided to create a new requirement for all new employees to exclusively sign up with a D.C. plan on Aug. 1, 2017, what legal options do we as investors of OTRS have to keep from diminishing returns when we retire?

This very thing happened with the OPERS Plan. Two OPERS members filed an action challenging the law that put most new state employees into a DC plan. The District Court ruled against them. The case is on appeal.
Questions and Answers

11. As a former budget guy from “up North”, I know that the contractual rights of pension fund members constrain the diligent efforts of budget hawks working to reduce public funding for such systems. Can you talk about these rights in Oklahoma and the extent to which they protect the retirement future of public higher education workers?

b. A public employee’s right to a pension is controlled by the terms of the statute. *Baker*.
c. Public employees whose retirement rights are vested have contract rights. *Taylor v. State and Education Group Insurance Program*, 1995 OK 51, 897 P.2d 275 (Okla.1995). The Taylor case dealt with diverting $40 million from TRS to the State & Education Employees Group Insurance Plan. The court held that the contract rights of members of TRS were not harmed as the Legislature provided equal funding to TRS at the same time.

See also, 1996 OK AG 21, 1995 OK AG 45
Tom Spencer,
Executive Director

Oklahoma Teachers
Retirement System

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• www.ok.gov/trs