

## FACULTY ASSOCIATION FOR ALTERNATIVE RETIREMENT PLAN PARTICIPANTS

### FAARPP

#### FINANCIAL ANALYSIS

##### 1. *Effect on individual retirement accounts*

Some newer faculty who were already in STRS in 1997 were given the opportunity to switch from STRS (the only option prior to 1997) to the ARP. There was a huge catch, however: such individuals could only recoup their own contributions to date and STRS retained the University match. Thus STRS benefited from those faculty who migrated to the ARP, because it retained the University contributions that had been made on their behalf. In 2001, STRS started their own defined-contribution programs, and these have also had the mitigating rate applied to them<sup>1</sup>. Across all public universities in Ohio, STRS retained \$209M, which today would be worth about \$344M. In addition to losing the university contribution to their retirement, the faculty who switched were then also hit with the mitigating rate (see Fact Sheet #1 for a full explanation).

Ever since, the mitigating rate has redirected a portion of the university match for all ARP participants to STRS. The net loss to faculty (e.g. TIAA-CREF or Fidelity accounts) depends on the individual's salary and length of service.

**Example:** Consider a faculty member who was hired in 2005 at an annual salary of \$75,000 and who received 3% increments every year thereafter. For this individual, the total amount sent to STRS over the last 10 years, instead of to the faculty member's ARP, is \$36,557.06 (close to half the starting salary). If that amount had been invested in a vehicle that achieved a market return of 7% per year (the average return on the Standard and Poors 500 Index over that time period), it would have netted over \$140,000 in additional retirement savings today and over \$700,000 in additional retirement savings after 35 years of work.

A rough estimate is that your current ARP account<sup>1</sup> would be 20% larger had the mitigating rate not been in force.

Between 20% and 30% of all OSU faculty are in the ARP, and we do not have good information on how they are distributed across units or ranks.

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<sup>1</sup> To avoid confusion, we use "ARP" to include all defined-contribution plans. Thus the private vendor plans offered by OSU, as well as the STRS defined-contribution and combined plans, all are subsumed within the ARP for our purposes. Herein we use STRS to denote the defined-benefit plan offered by the State Teachers Retirement System.

## **2. Aggregate contributions to STRS from faculty in the ARP**

We cannot yet estimate the losses OSU faculty in the ARP have sustained as a result of the mitigating rate; that calculation would require data on the numbers in the ARP, and their aggregate salaries. STRS, however, does report the aggregate salary of all eligible state employees at all public universities in Ohio who are enrolled in ARP. Reviewing those annual reports since 1999, we can see that ARP enrollment has grown steadily, from an aggregate state-wide salary of \$106 million in 1999 to \$591 million in 2014. This represents about 6% of the total pool of state-wide salaries of individuals eligible for membership in STRS<sup>2</sup>.

Between 1999 and the beginning of 2015, STRS has mitigated a total of \$208 million from all state-employed faculty in the ARP. If these funds had been invested in stocks yielding the actual market return over that time period, they would be worth \$343 million today.

## **3. STRS Unfunded Liability**

The State Teachers Retirement System is required by law to maintain sufficient funds to discharge their anticipated pension liabilities to a 30-year horizon. Many state pension systems have found they are underfunded (e.g. Illinois) and STRS in Ohio is also in that position. As of the end of 2014, STRS was underfunded by \$29.5 billion.

This shortfall is called an unfunded liability, referring to the amount of money STRS owes retirees versus the amount of money they actually have on hand with assets. The unfunded liability increased from the late 1990s to the present, although it improved slightly in 2014 relative to 2013. The other major pension system for Ohio State staff, OPERS, has far less unfunded liability; indeed for several of the past 15 years, the mitigating rate for staff has been 0%, and it now stands at 0.77%.

## **4. The effect of ARP participation on STRS budgets**

Like most pension plans, STRS relies on contributions from working teachers and faculty to pay for pensions of retirees. They have repeatedly argued that the ARP contributes to their unfunded liability. That argument led to the institution of a mitigating rate in the 1997 legislation. Initially and still 18 years later, however, that argument is invalid. While it is true that ARP participants do not contribute to STRS, it is equally true that ARP participants do not draw a pension from STRS when they retire. That is, ARP employees do not create a future liability for STRS.

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<sup>2</sup> Keep in mind that STRS also serves public school teachers, whose numbers are far greater than those in higher education. We do not have good data on what percent of *faculty* aggregate salaries are in ARP versus STRS.

Over the next 30 years, STRS estimates it will require \$96 billion to meet its obligations; of that, the unfunded liability is \$29.5 billion (i.e. they are 30% underfunded). As of the end of 2014, the total contribution that ARP members have shifted away from STRS and into ARP over the lifetime of ARP (not including the mitigation which of course went into STRS) was \$1.2 billion *and they generated no future liability*.

The aggregate of annual salaries of ARP members in 2014 was \$590 million, while that for STRS members was \$9,572 million. Thus ARP is 6% of the total payroll, which includes K-12 teachers in public schools. Elementary and high-school teachers enter STRS at ages roughly 10 years younger than do higher education faculty, allowing them to retire at earlier ages as well. Thus the STRS liability reflects pension payouts to K-12 teachers for more years of retirement than for faculty. The unfunded liability in STRS therefore may derive most strongly from anticipated retirements of public school teachers.

### ***5. What is the difference in retirement outcomes between STRS and ARP?***

Comparisons of the benefits from STRS versus the ARP requires setting some parameters.

Consider a faculty member who started employment in 2005 with a \$75,000 annual salary as an assistant professor and then moved appropriately through the ranks to full professor; this individual will retire in the mid-sixties and then live another 25 years. The benefits paid by STRS under the current formula are equivalent to what would be generated by a retirement account of \$4.7 million.

This same person contributing to the ARP would have only \$3.5 million saved (assuming they achieved 7% annual returns). If the mitigating rate is removed, the person would have \$4.3 million.

These straightforward calculations illustrate the fundamental problems with mitigation and with STRS. First, mitigation is extremely harmful to individuals in ARP, reducing retirement benefits by 20% compared to what they should have if they could invest the full university contribution. Mitigation also puts ARP members at a disadvantage relative to STRS. The typical ARP retiree will have around 30% fewer resources at retirement than the typical STRS retiree.

Faculty retiring from the ARP incur additional disadvantages relative to those retiring from STRS. First, individual investors contributing to the ARP bear their own risk and thus may see their retirement funds decline with market losses. Secondly, ARP members do not receive any health benefits as STRS members do. Finally, there are no automatic cost of living adjustments from ARP investments.

## 6. *The mitigating rate and STRS*

Mitigation implies that removing some salaries from the STRS salary pool harms STRS by reducing the contributions they rely upon to meet their obligations. Is that in fact true?

In 2014, STRS obtained \$2,702 million in contributions from all members. They disbursed \$6,786 million, meaning that they had a shortfall of \$4,083 million, which they had to take from their market earnings. The total “diverted” to the ARP (individual contributions plus the university match) was \$127 million. Thus contributions to the ARP represented 4.7% of all retirement contributions to STRS, 1.9% of the STRS disbursements, and 3.1% of the shortfall.

Since 2005, the annual shortfall has more than tripled, from \$1291 million to \$4083 million. At the same time, the contributions to ARP have increased from \$67 million to \$127 million, or an 89% increase. The STRS shortfall is rising much faster than ARP contributions.

The calculations above concern how contributions to the ARP reduce the STRS income, but they neglect the lack of payouts to ARP participants had they been in STRS all along and now retire. *The discussion to date has only focused on what has been diverted from the STRS intake without consideration of how the outflow has been reduced as well.* An assistant professor starting at \$75,000 per year and choosing the ARP, effectively reduces STRS’ unfunded future liability by \$37,000 in the first year alone. Thus individuals choosing the ARP provide a benefit to STRS.

The net effect of a faculty member opting to participate in the ARP (lost income plus reduced future liability) is *positive* for STRS, nullifying the premise for a mitigating rate.

## 7. **If the ARP is not the problem for STRS, why do we still pay the mitigation rate?**

The Ohio Retirement Council in their latest report (December 8, 2014) states that the ARP harms STRS. Our calculations call that conclusion into question, and a fundamental goal of the FAARPP is to show that the ARP should not be linked to the STRS’ unfunded liability. Until we can convince lawmakers of our position, it is unlikely they will abolish the mitigation rate. In short, the mitigation rate will continue to erode our retirement accounts until we organize and become our own advocates to the legislature.

## Summary

- The FAARPP position is that STRS and the ARP are completely independent financial entities, and linking the two via a mitigation rate is fundamentally unfair.

- When one considers both the reduced contributions from APR participants *and* the lack of future payouts to those individuals, it is clear that STRS benefits from faculty choosing the ARP.
- Faculty in the ARP have far less generous retirement benefits than those in STRS. The mitigating rate should not only be discontinued, but faculty should recoup the amounts sent to STRS since they enrolled in the ARP.