Good afternoon, Chairman Arndt, Vice Chair Pelanda, Ranking Member Howse, and members of the House Aging and Long Term Care Committee. My name is Karen Carraher and I'm the Executive Director of the Ohio Public Employees Retirement System. Thank you for allowing me the opportunity to speak with you again about House Bill 413.

First, I want to thank Representative Scherer for his sponsorship of this legislation and for Mr. Speaker Pro Tempore Schuring, not only for his support in facilitating the introduction of HB 413, but also for his support of public pensions. As Chairman of the Ohio Retirement Study Council, his support of our initiatives is critical to our success. Representative Scherer and Representative Schuring understand the importance of taking actions timely to avoid making more drastic changes later. This type of leadership is what makes Ohio's public retirement systems so strong.

As you know, HB 413 proposes to modify the annual cost-of-living adjustment for current and future OPERS retirees to be equal to the lesser of CPI or 2.5%, beginning in 2019. This bill does not eliminate or freeze the COLA as many other systems including many in Ohio have had to do. This action is prudent at this time. We are taking a moderate step now rather than waiting for a crisis and asking for a much more drastic step later. Seventy-two percent of our own members told us through their responses to a survey they would prefer a lower cap to a freeze on the COLA.

You have read and heard that OPERS is strong and we are. We are 80% funded. That means we have accumulated 80% of what is estimated we will need to pay off the liabilities as measured at this time. While 80% is still in the "good" range for financial funding, it is at the low end of the range. A major reason that we are in this shape is because our System has the foresight to make hard decisions proactively to ensure we are able to weather the future negative events. This approach allows us to make moderate changes rather than drastic ones and allows us to phase in changes over time or announce them with plenty of advance notice and communication. As an example, we were the only system that was not outside the 30-year amortization period when we proposed our

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2012 pension changes. Because of this, we were able to phase in the changes in a manner that impacted those closest to retirement the least while the greater impact was to those farther away from retirement.

As we plan for the future, we have several underlying issues to address. First, our current funding plan is predicated on the premise that we will no longer fund health care into the future until our pension funding improves substantially. While health care coverage is discretionary, the important point is there are limited tools available to pension plans to modify course in the event of a downturn. One of the only tools available, reducing heath care funding, is no longer available.

Investment markets have been strong this year and were up last year. Last year we earned 8.33% return and assuming the markets hold this year we will have another strong year. But even with these strong returns, all contributions will go to pension funding with none going to health care. Again, with all the contribution rate being used to support pension, OPERS has no ability to make corrections to improve pension funding other than to reduce benefits in reaction to a future down market.

OPERS consults with independent investment professionals and actuaries to analyze past trends and model future projections. Our investment experts and actuarial consultants are expecting an additional reduction in our assumed rate of return on our investment portfolio during the next experience study. In the last experience study OPERS reduced our assumed rate of return based actuaries' advice. The assumed rate of return decreased from 8.0% to 7.5%. That 0.5% reduction added $6 billion to the unfunded liability and increased our amortization period by 29 years. At that time, we were able to eliminate the 1% funding to health care which allowed us to recoup 28 years. The actuaries have indicated we will likely need to reduce our assumed rate of return by an additional 0.25% to 0.5% in the next study. The impact of an additional 0.25% to 0.50% decrease in the assumed rate of return would add additional years to the amortization period with no offsetting levers. This advice mirrors that of the

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independent actuary hired by the Ohio Retirement Study Council who recommended the Ohio systems evaluate their investment earnings assumption.

OPERS first granted a COLA in 1970, at a rate of 1.5%, at a time when inflation was 6.0%. The original intent of the OPERS COLA was not to keep pace with inflation but rather to mitigate inflation. The COLA has exceeded inflation 60% of the time in the past 30 years. We understand and acknowledge that our retirees don't like the current COLA because it is a simple COLA, not a compounded COLA and since it is a percentage of the original benefit, it will diminish over time. Unfortunately compounding COLAs are cost prohibitive and neither our COLA nor any Ohio retirement system COLA was ever intended to be compounding. The fact is the COLA has always been a simple COLA and was never intended to fully offset inflation. To put it in perspective, moving to a compounding COLA would add $25 billion to our unfunded liability.

I'd like to address some of the comments you may hear from opponents of this legislation. First, some will dispute the fact that we have an imminent financial need and will suggest we don't need to make these changes now. They will tell you we should wait for a financial crisis or until we see what the financial markets yield in the next few years. I would dispute this with several responses.

OPERS has always been good financial stewards of the funds. We have not embarked on making a change without careful consideration of all options and we have never overcorrected. The Legislature has entrusted us to review our plan for subsidizations and find ways to correct them. We use reliable information to plan ahead, avoiding the urge to manage by crisis, though oftentimes that is the easier route. We did not achieve our current strong financial position by waiting for a crisis or gambling on future investment returns to improve our position.

The bottom line is the fundamental equation for pensions is contributions plus investment earnings must be able to support pension benefits. What has

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happened over time is that the investment earnings portion of the equation has shrunk and therefore the benefits portion of the equation must also be reduced. We would love to be back in the times when bonds were earning 8.0%, but that is not our current reality. To put this in perspective, bonds were earning 5.05% in 2001 when the OPERS COLA was changed to a flat 3%.Today, bonds are earning 2.40%.

Keeping in mind the system serves all members, both active workers and retirees. Another argument in opposition to HB 413 is that retirees should held harmless and any changes should be made to the current active members. As many of you know, the pension reform changes made in Substitute Senate Bill 343 impacted only active members. To be clear, we did follow those adjustments with significant changes to our health care plan, which impacted both our retirees and active members. The changes in SB 343 resulted in more than $4 billion in savings. The projected savings in HB 413 amount to about $3.1 billion (approximately $1 billion actives, $2.1 retiree).

These changes, along with others, require active members to contribute more and work longer. Most active members are contributing 1.5% more than the majority of our current retirees contributed during their working career. Active members have to work longer, than their predecessors, and if they retire early, the reduction is much greater than the previous reduction factors used which, were based on life expectancies in the 1950s. Active members also have to earn more than double the amount of minimum earnable salary a retiree had to earn, and must count their five highest years of salary toward their final average salary rather than three years. As you can see, active member benefits have been significantly impacted and we have held off impacting retirees until we were out of significant levers. The COLA is a very expensive benefit and the last significant lever to reduce unfunded liabilities that would not constitute total benefit redesign. OPERS pays out $5.3 billion per year in pension payments and the COLA accounts for $1.3 billion of that amount.

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We have a fiduciary responsibility to make decisions in the best interest of all one million members. We have a responsibility to be prudent stewards and to look forward and prepare for the challenges we see, not wait for them to occur. There is no business in the world that would operate that way if they plan to survive, so why would anyone want their pension system to adopt that approach?

Finally, there are those who expect us to not make any changes or who expect the changes we made in 2012 to suffice forever. As we all know, the world we live in changes and we must adapt accordingly. Benefit changes have occurred over time and while they are difficult to make, at the time, they are prudent and later judged as good decisions.

I do want to point out that initially the retiree advocacy group, PERI, supported the 2.5% cap as they indicated in an October 11th letter to me, but have subsequently modified their position.

The most important thing I can close with is that OPERS has never proposed changes without careful evaluation. We have remained responsible stewards and have always taken the financially responsible path, even when it's not necessarily the easy one.

As we have shared with our members during our presentations, I thought it would be fitting to close by sharing our five overarching goals that guide us now and in the future.

1. Provide a stable pension for all OPERS retirees
2. Continue to provide a meaningful retiree health care plan
3. Minimize drastic plan design changes
4. Be financially positioned to react to market volatility
5. Maintain intergenerational equity

Thank you, again, Chairman Arndt and members of the House Aging and Long Term Care Committee, for consideration of this important piece of legislation.

I'm happy to answer any questions.