REPORT AND PROPOSALS ON OKLAHOMA'S RETIRMENT SYSTEMS

Funded levels of Oklahoma's Pension Systems have reached crisis levels with the total unfunded liability in Oklahoma's pensions now exceeding $16.5 billion, over twice the amount of the entire state budget. Actual contribution levels are hundreds of millions less than required contribution levels and assumed investment rates of return exceed even the most optimistic projections for the future. Oklahoma can no longer afford to ignore this problem. The pension systems cannot earn their way out of the hole that has been dug over decades. As each year passes with no meaningful action being taken to address the problem, the cost to remedy the situation only grows. If decisive action is not taken to address the underfunded situation, the financial health of the systems may rapidly deteriorate to the point of severe problems.

The primary culprit for the current financial situation in the systems is lack of discipline. For decades, benefit increases have been granted to the members of the retirement systems without those benefits being funded by the legislature. The result has been that each benefit increase has served to only make the unfunded liability "hole" grow until now the funded status of Oklahoma's pension systems has reached crisis levels with the unfunded liability exceeding twice the amount of the entire state budget and the additional amount required to adequately fund the systems on an annual basis being $736,227,339 or 11% of the state budget.

Teachers' Retirement System (OTRS)

- $10.4 billion unfunded liability
- 47.9% funded ratio
- Infinite funding period
- Actual contributions $121,734,951 per year less than actuarial required contributions
- Benefit payments exceed contributions into system
- Actuarial numbers based upon an 8% assumed rate of return
- Normalized numbers indicate an unfunded liability of $11 billion, a 46% funded ratio, and required additional contributions of $520,820,992 per year

Oklahoma Public Employees Retirement System (OPERS)

- $3.27 billion unfunded liability
- 66% funded ratio
- Actual contributions $141,038,576 per year less than actuarial required contributions
- Normalized numbers indicate an unfunded liability of $3.3 billion, a 65.7% funded ratio, and required additional contributions of $70,284,197 per year

Oklahoma Firefighters Pension and Retirement System

- $1.47 billion unfunded liability
- 53.4% funded ratio
- Actual contributions $110,326,205 per year less than actuarial required contributions
- Normalized numbers indicate an unfunded liability of $1.41 billion, a 54.4% funded ratio, and required additional contributions of $92,916,470 per year

Oklahoma Police Pension and Retirement System

- $587 million unfunded liability
- 74.9% funded ratio
- Actual contributions $91,600,443 per year less than actuarial required contributions
- Normalized numbers indicate an unfunded liability of $627 million, a 73.7% funded ratio, and required additional contributions of $46,755,041 per year

Oklahoma Law Enforcement Retirement System

- $239 million unfunded liability
- 73.4% funded ratio
- Actual contributions $27,168,199 per year less than actuarial required contributions
- Normalized numbers indicate an unfunded liability of $163 million, an 80.3% funded ratio, and required additional contributions of $5,450,639 per year

Proposed Responses:

1. Revise current law to provide that a COLA may not be granted by the legislature or the board of any retirement system unless accompanied by funding at an actuarial determined level to fully fund the COLA on a current and future basis.
2. Revise the definition of "compensation" on which benefits are paid so that the definition for OTRS is consistent with that of OPERS.
3. For OPERS and OTRS, adopt a uniform 8 year vesting period and a retirement age of 65.
4. Calculate benefits in the OTRS and OPERS systems based upon the average compensation earned during the five years immediately preceding retirement.
5. Amend the OPERS law to eliminate the provision that allows up to 120 days of unused sick leave to be exchanged for an extra year of employment for purposes of calculating retirement benefits.

6. Change the OTRS post retirement employment rules to be consistent with those of OPERS (one year before a retired employee can be rehired by another employer in the retirement system).

Benefit of COLA Change: By eliminating the assumption of a 2% per year unfunded COLA, the plans should all reach 80% funded in 25 years. This is the single most significant reform that can be made to the system.

Change to a New Plan Design: It is periodically suggested that the funded problems in Oklahoma's pensions could simply be solved by closing the old defined benefit plans and starting new defined contribution plans for new hires. In 2003, the state contracted with Milliman USA to study the feasibility of closing the OPERS and OTRS defined benefit plan and adopting new defined contributions plans for all newly hired employees of the two systems with "savings" arising from the reduced contributions to the retirement plans of the new hires being used to pay off the unfunded liability of the old defined benefit plans. Milliman concluded that the liabilities could not be paid without a significant increase in state contributions. Since that time, the funded status and required state funding for both systems has worsened significantly which would only serve to make a similar analysis today indicate an even greater level of state funding required to retire the liabilities.

Closing a plan with unfunded liabilities causes two problems. First, the payroll on which future contributions will be made shrinks as new hires enter the new system. Second, the unfunded liability which with an open plan can be repaid over an open ended period of time must be paid over a finite period which requires greater annual contributions to pay off the liability over a shorter time frame. Finally, with a shrinking state employment and hiring freeze in place, there will be very few new hires from which contributions can be "saved" to help fund the liability in the old system.

Once reforms are made to the existing defined benefit plans to ensure their long term financial viability it makes sense to study different plan designs going forward to ensure the plans are affordable to the state and that they are helping to attract and retain the desired workforce or whether some other design might be more effective. Any such analysis, however, must factor in the cost of retiring the unfunded liabilities in the existing defined benefit plans.