DEFAULT SETTINGS

How Ohio can nudge teachers toward a more secure retirement

Chad Aldeman ◆ November 2020

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Foreword

by Aaron Churchill

The fiscal woes of state pension systems are regularly in the news. Earlier this year, in the midst of economic turmoil, the *New York Times* and other outlets covered Illinois' plea for a federal bailout of its historically underfunded pensions. Closer to home, local media have covered debates on addressing the unfunded liabilities—the difference between promised retirement benefits and the monies set aside to pay them—of Ohio's pension systems.[1]

Given the attention paid to pensions, it may surprise you to learn that Ohio doesn't actually require public school teachers to enroll in the state pension plan. Starting in 2001, the state has offered teachers a choice in retirement plans. They may enroll in a 401(k)-style defined-contribution (DC) plan, a traditional pension, or a hybrid that combines features of both. However, by state law, new teachers are automatically enrolled in the pension plan if they make no affirmative decision within 180 days of starting their jobs. In practice, the vast majority of Ohio teachers take no action and thus land—permanently—in the pension system.

This default policy would make logical sense if the pension plan delivered more generous benefits than the other retirement options. But does it?

Authored by Chad Aldeman, a seasoned pensions analyst at Bellwether Education Partners, this policy brief shows that today's automatic default, innocuous as it may seem, costs Ohio teachers tens of thousands in retirement benefits. His analysis shows that new educators—even those who expect to teach into their fifties and sixties—would be better off financially in either the DC or hybrid plan.

The numbers are staggering. Consider a brand-new teacher right out of college. Under the standard state pension, she would accrue retirement benefits worth about $100,000 if she decided to leave the Ohio school system at age forty. Should she stay until sixty, her pension would be worth approximately $800,000. Not too shabby, right? Yet the DC option performs even better: At age forty, Aldeman calculates retirement benefits worth about $300,000—roughly three times the pension. And at age sixty, she'll have saved around $1.2 million for retirement (as might be expected, the hybrid yields benefits that fall between the DC and pension plans). These results assume investment returns of 7.45 and 6.45 percent, respectively, for the pension and DC plans—rates that, while unlikely to be met in the near term due to the economic downturn, are in line with historical returns on equities.

For those who choose—or are defaulted into—the pension plan, this is real money left on the table. The differences in benefits could mean staying in the comforts of the family home well into retirement, rather than needing to downsize. The extra savings could pay for the trip of a lifetime after years of serving students. Or maybe the money represents the chance to help finance a grandchild's college education. Of course, some teachers may believe the peace of mind commonly associated with a pension is worth these costs. But the opportunity for a more fulfilling retirement may slide by just because a youthful, first-year teacher does not fully comprehend the implications of her choice in retirement plans.

Why the discrepancies? The required contribution rates are the same across the three retirement options: 28 percent of a teacher's salary, combining the employer and employee contribution. The difference, however, turns on how these contributions benefit teachers. Under the DC plan, the bulk of a teacher's contributions, 23.5 percent, goes directly toward her own savings; under the hybrid plan, the figure is 16 percent. Yet when she selects or defaults into the pension plan, state actuaries calculate that just 10.8 percent of the required contribution supports her own retirement. Instead, most of it helps the pension system pay down tens of billions in existing unfunded liabilities ($23.4 billion as of 2019) to current teachers and retirees.

Based on this analysis, we conclude that state policymakers should switch the default from the pension to either the DC or hybrid plan. Viewed strictly in terms of financial benefits, the 401(k)-style DC plan would be the superior default, as it outperforms the hybrid. Yet the hybrid plan, because it contains a pension component, does promise a basic level of lifetime income, something that a DC plan can't guarantee (and Ohio teachers don't participate in social security). The hybrid also currently offers retiree healthcare benefits for which DC participants are ineligible. Overall, state policymakers should thoughtfully weigh the tradeoffs of these two options—a solid discussion appears in Aldeman's paper—and consider altering the default policy.

This policy brief challenges the conventional wisdom that traditional pensions remain the best option for retirees. That may have been true for previous generations, especially those who taught before the rise of individual retirement accounts. But Ohio's unfunded pension liabilities mean that teachers hired today are at risk of receiving skimpier benefits when they retire. This, in fact, has already happened once within the past decade: the state, acknowledging the need to address unfunded liabilities, passed legislation in 2012 that reduced benefits for future retirees.

With the traditional teacher pension plan under financial pressure and projected to deliver lesser benefits than other options, it's time for policymakers to reconsider whether it remains the best way to support the next generation of Ohio educators. Whether it's a career in the classroom or just a few years of service, teachers deserve the retirement benefits they've worked so hard to earn.

Acknowledgments

We offer our deepest thanks to Chad Aldeman of Bellwether Education Partners for furnishing his expertise on teacher retirement policies to author this fine policy brief. On the Fordham team, we wish to thank Michael Petrilli and Chester E. Finn, Jr. for their thoughtful feedback during the drafting process. Here in the Columbus office, we thank our Fordham colleague Jeff Murray, who assisted in report dissemination. Last, special thanks to Pamela Tatz, who copyedited the report, and Dan Lee, who designed the layout.

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Background

For the last two decades, Ohio has given its new public school teachers[2] choices among retirement plans. Early in their employment, they are handed a form that allows them to opt for a traditional pension plan, a 401(k)-style defined-contribution (DC) plan, or a plan that combines elements of each.

If they make no affirmative decision at all—that is, if they don't return the form with a choice clearly indicated within their first 180 days—state law dictates that they be automatically enrolled in the first option, the defined-benefit (DB) plan. As might be expected, many new Ohio teachers—about three-quarters of them in recent years—take no action and thus end up in the DB plan.[3] After all, they're being asked to make a decision about future retirement benefits at the same time that they're starting a new job, preparing to teach, dealing with children in classrooms, and facing the typical deluge of new-employee HR paperwork on a multitude of benefits and workplace policies.

Ohio deserves credit for giving its teachers choices on their retirement plan, but the stakes for teachers to make the right decision are high. If they enroll in the DB plan—or default into it—educators cannot reverse their decision. And because the Buckeye State is one of fifteen states that do not cover teachers under social security,[4] the plan that workers choose will provide their only retirement benefits while working in Ohio public schools.

This brief explains the three choices available to teachers and models out how workers would earn retirement benefits under each plan. That analysis shows that Ohio educators would be better off under one of the alternatives than under the DB plan. If state policymakers intend to provide the greatest retirement benefits to the most workers, they should be open to changing the default option.

How Ohio's defined-benefit plan works

Ohio's DB plan operates like other traditional pension plans but is unusual in several respects. As is typical, employers and employees share responsibility for making contributions into the plans, and benefits are based upon a formula tied to the worker's salaries and years of experience. However, what a worker ultimately receives is not directly tied to his or her own contributions. Over time, that disconnect has grown larger and larger, such that employees today are paying more into the plan than they'll ever get back. Employer contributions, meanwhile, are not going toward benefits at all but are instead entirely consumed by the plan's unfunded liabilities.

In Ohio, the benefit formula consists of a multiplier (2.2 percent) times the worker's final average salary (the average of their five highest-salaried years) and their years of service. For example, a member with ten years of service qualifies for a pension worth 22 percent of their salary (that is, 2.2 percent times ten years of years), payable upon reaching the state's normal retirement age. Meanwhile, a teacher with thirty years of service would receive 66 percent of her final average salary. Workers retiring after 2026 can begin to collect their benefits upon reaching age sixty-five if they have five or more years of service or at age sixty if they have thirty-five or more years of service.

Due to financial pressures, Ohio legislators have begun changing these rules over the last few years and are phasing in more changes over time (see table 1). Today's teachers are paying higher contributions into the system than their predecessors (which means less take-home pay). Additionally, the DB plan used to include an annual cost-of-living adjustment to help retirees combat inflation, but that was eliminated in 2017. Ohio has also been reducing benefits for long-serving veterans. Those cuts have been phased in depending on the worker's retirement date. In 2015, Ohio reduced the benefit multiplier for workers with more than thirty years of service. The state is also gradually increasing the retirement date for those workers—the phase-in period extends from 2015 through 2026—which effectively forces long-serving veterans to wait longer to collect their retirement benefits.

Table 1: The evolution of Ohio's defined-benefit plan

	DB (pre-2015 retirees)	DB (post-2026 retirees)	End result
Employee contributions[5]	10 percent	14 percent	Reduces employee take-home pay
Formula multiplier	Greater of the following: 2.2 percent per year, plus an extra 0.1 percent for every year from 30–39 years of service; 2.5 percent once member has 35 years of service; or $86 times years of service	2.2 percent	Veteran employees receive lower pensions
Final average salary	Highest 3 years	Highest 5 years	Reduces average salary figure
Normal retirement age	Age 65 with 5 years of service; any age with 30 years of service	Age 65 with 5 years of service; age 60 with 35 years of service	Employees must stay longer to collect a full benefit
Early retirement	Age 55 with 25 years of service; age 60 with 5 years of service	Any age with 30 years of service; age 60 with 5 years of service	Employees must stay longer to collect an early benefit
COLA	2 percent	0 percent	Cuts the real value of benefits over time

Note: Throughout this period, Ohio has allowed workers to retire at age sixty-five with five years of experience. That has not changed and is not scheduled to change. However, Ohio also offers an additional retirement option for long-serving veterans, and it is slowly increasing that option. Prior to July 2015, workers with thirty years of experience could retire at any age. The state is increasing the years of service requirement for those workers in a stair-step fashion, such that workers who retired between August 2015 and July 2017 needed thirty-one years of experience and so on, until retirees between August 2023 and July 2026 will need thirty-five years of service. Starting in August 2026, retirees will need thirty-five years of service and be at least sixty years old.

Just like employees, every participating employer in the Ohio State Teachers Retirement System (STRS) must contribute 14 percent of each member's salary. But because the plan has $23.4 billion in unfunded liabilities, the entire employer contribution goes toward paying down these liabilities, which means that none goes toward building up benefits for current workers. Table 2, below, shows how these figures have changed over time, as member contribution rates have climbed from 10 to 14 percent of salary.

Table 2: Ohio's defined-benefit plan contribution rates

Year	Member contribution rate	Member contributions toward benefits	Member contributions toward unfunded liabilities	Employer contribution rate*	Employer contributions toward benefits
2010	10.00%	10.00%	0%	14.00%	4.30%
2011	10.00%	10.00%	0%	14.00%	3.98%
2012	10.00%	10.00%	0%	14.00%	5.94%
2013	11.00%	11.00%	0%	14.00%	1.03%
2014	12.00%	11.83%	0.17%	14.00%	0%
2015	13.00%	11.46%	1.54%	14.00%	0%
2016	14.00%	10.95%	3.05%	14.00%	0%
2017	14.00%	10.84%	3.16%	14.00%	0%
2018	14.00%	10.91%	3.09%	14.00%	0%
2019	14.00%	10.83%	3.17%	14.00%	0%

Note: Employer rate includes a 1 percent healthcare contribution prior to 2014.
Source: Page 75 of STRS's 2019 Comprehensive Annual Financial Report: https://www.strsoh.org/_pdfs/annual-reports/50-143-19.pdf.

Employer contribution rates have stayed at the same 14 percent over the last decade, but what's changed is where that money is going. Actuaries divide the cost of pension plans into two parts. The first is called the plan's "normal cost," which measures how much the benefits are worth, calculated as an average across all members in the plan. Ohio's STRS actuaries currently estimate that the DB plan has a normal cost of 10.83 percent of salary.

That is, STRS members are contributing more into the DB plan than the plan's actuaries say the benefits are worth. Even as STRS members are individually contributing 14 percent, the benefits they receive are worth only 10.83 percent of their salary. The difference between these two figures can be explained by the second element of pension costs: the paying down of accrued unfunded liabilities.

If a pension plan is fully funded—that is, if its expected assets fully match its expected liabilities—then it doesn't have any unfunded liabilities to pay down. Ohio's DB plan, however, has not been fully funded at any point in at least the last two decades.[6] As of 2019, it had made $97.8 billion in promises to teachers and retirees, but the actuarial value of its assets—meaning the amount of money it had on hand at the time plus its expectation for how that money would grow over time—totaled only $74.4 billion. To make up that difference would require 17.17 percent of every active participant's salary, according to STRS estimates.

In other words, all of the contributions that employers are making into STRS are being eaten up by the cost of the plan's unfunded liabilities. On top of that, members are contributing 3.17 percent of their own salaries toward the accumulated liabilities.

As the table above shows, this relationship made a dramatic flip between 2012 and 2014. The change had four primary causes. One, the plan failed to hit its investment targets in the wake of the Great Recession, reducing its pool of assets. Two, the plan lowered its assumed rate of return from 8 percent in 2011 down to 7.45 percent. That meant the plan reduced its expectation for future growth of its assets, which in turn required higher contribution rates in the present. Three, the state raised employee contribution rates, requiring them to take on a larger share of the costs. And fourth, STRS lowered its amortization period from infinity to a thirty-year fixed period. Prior to 2015, the plan rolled over its balance year to year like a credit card debtor who never pays down their principal; now the plan must gradually pay down its liabilities, just like a traditional mortgage forces homeowners to pay off their full balance over time.

Collectively, these changes were financially responsible. But they also revealed the disconnect between the true cost to operate the DB plan and the benefits it delivers to current workers. As these figures help illustrate, employees and their employers are contributing 28 percent of their salary toward the plan, while workers today are only getting benefits worth 10.83 percent of salary in return. In other words, today's teachers, districts, and charter schools are paying to support generous benefits for today's retirees that today's teachers will never receive themselves. As the next sections describe, many workers would likely be better off in the state's two other retirement options.

Ohio’s retirement-plan choices

As mentioned before, Ohio legislators in 2001 created two optional retirement plans. Newly hired teachers can pick the one they prefer or default into the long-standing DB plan. The options include a 401(k)-style DC plan and a combined plan that features both a pension and a DC element.

How Ohio’s defined-contribution plan works

Under Ohio’s DC plan, employees contribute 14 percent of their salary, just like DB plan members. Unlike the DB plan, however, the full 14 percent contribution goes directly into their own accounts, plus any gains from investment earnings. Employers also contribute the same 14 percent, but only 9.53 percent goes into member accounts; the remaining 4.47 percent goes toward the DB plan’s unfunded liabilities. Still, that means employees receive total contributions of 23.53 percent into their DC accounts.

Employees “vest,” or qualify for the employer’s contributions, on a graduated basis. Employees qualify for 20 percent of the employer contribution after one year, 40 percent after year two, and so on, until they qualify for the full employer contribution after five years (their own contributions vest immediately).

In the DC plan, the value of any individual’s benefits is directly tied to the contributions made into their accounts plus any earnings made on their investments. There are no guarantees, and employees bear the full brunt of any investment gains or losses. That’s a risk for teachers, especially when—as in Ohio—they don’t have social security to fall back on.

DC plan participants suffer from another disadvantage. Members who accrue twenty years of service in either the DB or the combined plans have access to healthcare benefits in retirement for themselves as well as for their spouses and any eligible dependents. These benefits confer a considerable advantage to those who collect them, but according to the state’s actuarial assumptions, less than one-third of Ohio educators will stay long enough to become eligible.

Yet the DC plan offers some other advantages. Because benefits are directly tied to contributions, it will never accrue unfunded liabilities that must be paid off by future generations. DC plans are also well suited for individuals who may change jobs. If individuals stop teaching, transition to the private sector, or move out of state, their retirement accounts are theirs to take with them.

This feature is especially advantageous for short termers, career switchers, and other geographically mobile workers, and it stands in stark contrast to the DB plan. The DB plan offers disproportionately large benefits to workers who stay in the plan for their entire careers, but it penalizes anyone who moves out of state or changes jobs. For example, a teacher who stays for thirty years in the Ohio DB plan will have 74 percent more pension wealth, or the equivalent of $500,000 more in lifetime income, than a teacher who spends fifteen years in Ohio and fifteen years in a state with an identical pension plan.[7] Teachers who move more frequently face even larger penalties. That issue doesn't exist in Ohio's DC plan.

Ohio's DC plan also addresses many of the problems of private-sector 401(k) plans. Rather than outsourcing investments to a private financial-services company, members can choose from nine different low-fee mutual funds, ranging from money-market accounts and bonds to domestic and international stock funds. STRS also operates so-called "lifecycle funds" that adjust the member's investment allocations automatically based on their age and expected date of retirement. These funds can significantly improve worker investment decisions: One recent study estimated that low-cost lifecycle funds could boost retirement savings over a thirty-year career by as much as 50 percent.[8]

The state's DC plan is also unique in that it helps members spend down their assets. Under most 401(k) plans, when workers are ready to retire, they must decide on their own how to responsibly spend down their account balance over time. The STRS DC plan is different. Unless retirees choose otherwise, STRS automatically converts employee account balances into a state-run annuity, which mirrors the automatic monthly payments that are part of the

STRS DB plan. Retirees get the same predictability regardless of which plan they choose; the only difference is how workers accrue the benefits in the first place. Even mobile workers who are no longer actively contributing to the STRS DC plan will receive these benefits, as long as they leave their investments with STRS rather than cashing out or rolling them over.

How Ohio's combined plan works

In addition to the stand-alone DB and DC plans, Ohio teachers may choose to participate in the combined plan that features elements of each. The employee and employer contribution rates are the same as under the other two options (14 percent for each), but the differences come from where those contributions go. The full employer contribution goes toward the pension component, but for the 14 percent employee contribution, 12 percent goes toward the DC component and 2 percent goes toward the pension element.

The pension-plan component of the combined plan has two main differences. As compared to the 2.2 percent multiplier in the stand-alone DB plan, the pension component of the combined plan features a multiplier of just 1 percent. For example, a combined-plan member with ten years of service qualifies for a pension worth 10 percent of their final average salary (that is, 1 percent times ten years), payable upon reaching the plan's normal retirement age. Meanwhile, a teacher with thirty years of service would receive 30 percent of her final average salary. The combined plan does have an earlier normal retirement age, though, of sixty years for anyone with five years of experience, as opposed to sixty-five under the DB plan. With these benefit provisions, STRS actuaries estimate the normal cost of the pension-plan component in the combined plan to be worth 3.99 percent of salary.[9]

Recall that both combined-plan members and their employers are contributing 14 percent of salary. Where is all that money going? From the employer side, almost all of that money is going toward unfunded liabilities. Of the 14 percent employer contribution, 12.01 percent is going toward unfunded liabilities, with just 1.99 percent toward benefits. Employers make no contribution toward the DC component. These accounts are run by STRS with the same investment options and annuities, just like under the stand-alone DC plan.

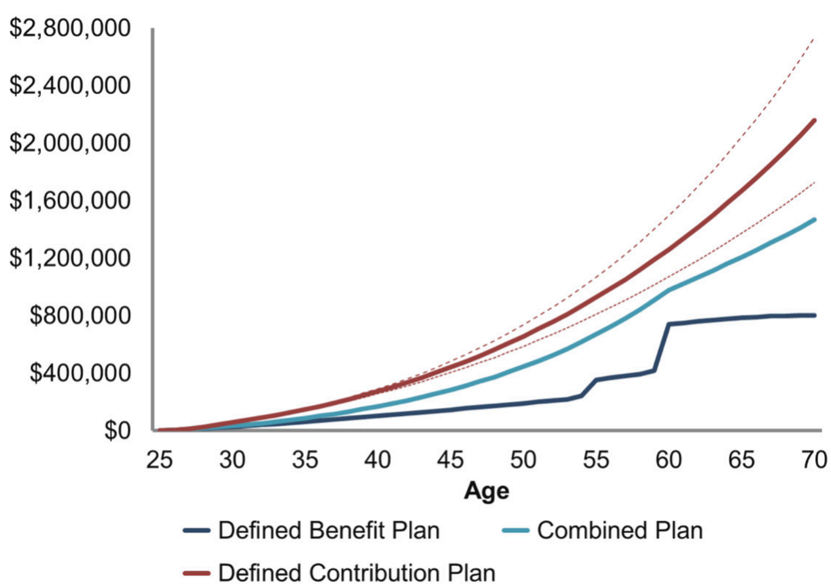
A hybrid plan like Ohio's combined plan attempts to balance the pros and cons of traditional pension plans and DC accounts. With the combined plan, participants get both the guarantee of predictability with a DB pension plan and the portability of a DC plan. This hybrid is meant to strike a middle ground and appeal to all types of workers, especially ones who are uncertain of how long they might stay in the profession.

How the plans translate into retirement benefits for workers

As described above, the three plans are cost neutral in the sense that teachers and their employers contribute the same 14 percent of salary under each plan. That does not, however, mean the benefits for workers are equivalent. Both the DC and combined plans have higher proportions of their contribution rates going toward actual retirement benefits. The DB plan invests just 10.83 percent toward worker benefits, compared to 15.99 percent under the combined plan and 23.53 percent in the DC plan (for the full provisions of each plan, see appendix table 1).

As figure 1 shows, these differences manifest in very different retirement savings amounts under the three plans. The graph compares how total retirement benefits, including employee contributions, accrue under each plan for someone who starts their career at age twenty-five. For all plans, the chart assumes the same starting salary and uses STRS's official salary growth rate and termination assumptions.[10] About two-thirds of Ohio teachers began their careers before age twenty-five, so this graph is representative of the majority of Ohio's teacher workforce.[11]

Figure 1: Comparing Ohio STRS's retirement-plan options, twenty-five-year-old entrants



The dark blue DB-plan line represents the total lifetime value of the teacher's expected pension amount. It offers minimal benefits to short- and medium-term workers but has significant spikes at age fifty-five, when workers first become eligible for early retirement, and again at age sixty, when long-serving veteran teachers become eligible for full retirement. The combined plan, represented by the light-blue line in the graph, falls roughly in the middle. The small guaranteed-pension component contributes to the slight upward trend at age sixty in the graph, and its investment-account component allows it to beat the DB plan at every age.

The combined plan, represented by the light-blue line in the graph, falls roughly in the middle. The small guaranteed-pension component contributes to the slight upward trend at age sixty in the graph, and its investment-account component allows it to beat the DB plan at every age.

As the graph makes clear, all teachers would be better off in either the combined or the DC plans, regardless of how long they served, but the red lines representing the DC plan perform the best of all. The solid red line is meant to reflect an average expected return for workers participating in the DC plan.[12] Because individual workers would ultimately see higher or lower values depending on timing and market volatility, the dotted red lines are meant to show some uncertainty if returns were 1 percent higher or lower than expected. Some readers, mindful of market fluctuations and risks, may recall that Ohio teachers do not participate in social security and still prefer the guarantee in the DB plan over the uncertainty in the DC and combined-plan options. However, the contributions toward actual retirement benefits under the DC plan are so much higher than the DB plan that teachers could earn investment returns equal to inflation and still have more retirement assets than members in the DB plan.

One more factor not captured by this figure is healthcare for retirees and their spouses; as mentioned above, that is included in the DB and combined plans but not the DC one. So that's another reason that some workers might not choose the DC plan. However, there's no ironclad guarantee that healthcare retiree benefits will remain in any of these plans in the future; they are not considered contractual guarantees in the same way that pension benefits are. Therefore, new teachers can't be sure that these benefits will be there for them thirty years from now.

“Nudging“ Ohio teachers to make smart decisions

Ohio deserves credit for offering its teachers a choice among retirement plans. It is one of only five states to do so.[13] Unlike in the private sector, where participation in retirement plans is voluntary for workers, Ohio makes teachers participate in some retirement plan. Those policies are a good first step toward ensuring that Ohio teachers are on a path to a secure retirement.

However, Ohio automatically defaults all new workers who don’t make an affirmative decision within 180 days of their hire date into the STRS Pension Plan.[14] As a result, 78 percent of new teachers default into the traditional pension plan without making any decision at all.[15]

Research from the private sector has found that employee defaults like the one employed by Ohio STRS can be powerful mechanisms. Workers, especially new ones, have a lot to figure out, and when given an option to join an employer-provided retirement plan, many new employees fail to make decisions. When employers switch the default option to assume automatic participation, enrollment rates jump 25 to 35 percent. Similar research has found that employees are likely to follow default options on contribution rates and investment decisions.[16] None of these choices are mandatory, but this body of research suggests there are ways to “nudge” workers into making smart decisions.

Ohio should learn from this research. The state already requires new teachers to enroll in a retirement plan, so policymakers should set the default plan as the one that does the best job of ensuring all Ohio teachers are on a path to a secure retirement. That would require two main changes.

First, lawmakers should change the default option to either the DC or the combined plan. Given that both of those options would provide better benefits to nearly all Ohio teachers, it makes sense to automatically enroll all new workers who don’t make an affirmative decision on their own into a plan that is more likely to provide the best fit to the most workers.

Deciding among these two options requires a trade-off. In purely numerical terms, the DC plan outperforms the combined plan for all types of workers, even if workers earned essentially no real return on their investments. As described above, the differences in the amount of contributions going into each plan means that the DC plan will almost always deliver better benefits. Moreover, the DC plan will never accrue any unfunded liabilities, whereas the combined plan is at risk of being cut if its assumptions prove incorrect.

For these reasons, I recommend that Ohio shift its default to the DC plan. State legislators could also consider creating a new, smaller DC plan paired with social security coverage. Absent such a change, the combined plan may be the second-best option, especially because Ohio does not yet provide social security coverage to its teachers. Policymakers may see the combined plan as a "just-right" compromise between the flexibility offered by the DC plan and the guarantees offered in the standalone DB plan.

Ohio's statutory language on selecting a retirement plan

To revise the default option, the state legislature would need to amend the paragraph in state code section 3309.251 that applies to teacher decisions (and a similar one for nonteachers). In particular, legislators would need to update the sentence in bold below:

(A) Except as provided in division (D) of this section, an individual who becomes a member of the school employees retirement system on or after the date on which the school employees retirement board establishes a plan under section 3309.81 of the Revised Code shall make an election under this section. Not later than one hundred eighty days after the date on which employment begins, the individual shall elect to participate either in the plan described in sections 3309.18 to 3309.70 of the Revised Code or one of the plans established under section 3309.81 of the Revised Code. **If a form evidencing an election under this section is not on file with the employer at the end of the one-hundred-eighty-day period, the individual is deemed to have elected to participate in the plan described in sections 3309.18 to 3309.70 of the Revised Code.**

To be clear, shifting the default to either the DC or the combined plan would not take away any option for Ohio teachers. If someone knew they were going to remain in STRS for their entire career and preferred the guaranteed benefit provided by the DB plan, they would still have that option available. But it no longer makes sense to assume the DB plan is the best plan for all workers.

With regards to retiree health benefits, legislators should treat all STRS members equally. There are strong arguments for ending the state retiree healthcare plan entirely. Retirees already qualify for Medicare at age sixty-five, and those under the age of sixty-five may be eligible for subsidies under the federal Affordable Care Act. A two-member household earning less than $65,840, or 400 percent of the federal poverty level, would qualify for federal subsidies to cover at least some costs of a healthcare plan. Most STRS retirees are collecting pensions under that amount and would be eligible for the federal subsidies. Short of taking this step, Ohio legislators should at least extend the same retiree health benefits to all STRS members, regardless of the retirement plan they choose.

If legislators agree to shift the default in this way, they should also look to STRS itself to improve the DC plan. On the plus side, the legislature has already established adequate, mandatory contribution levels. Its five-year graduated vesting period is also a standard practice to ensure workers begin building a retirement nest egg in their early years of work. On the back end, STRS automatically converts employee account balances into a state-run annuity plan, which mirrors the automatic monthly payments that are part of the STRS Pension Plan.

However, one flaw in Ohio's STRS DC plan is the absence of a default investment option. Workers are left on their own to decide how to allocate their investments and decide among the full suite of fund options. As noted above, STRS offers "lifecycle" funds that allow workers to select their age and allow STRS experts to handle all investment allocation decisions. But STRS should be more assertive about "nudging" workers into the age-appropriate lifecycle fund. Members could still choose their own investments if they preferred, but STRS should make it as easy as possible for workers who aren't inclined to decide among the various funds on their own. Setting lifecycle funds as the default would nudge workers to take on risks that are appropriate to their age. Making this change would not require legislative action but would require STRS to update its internal policies and notify workers through its “Retirement Plan Selection” form for new members.[17]

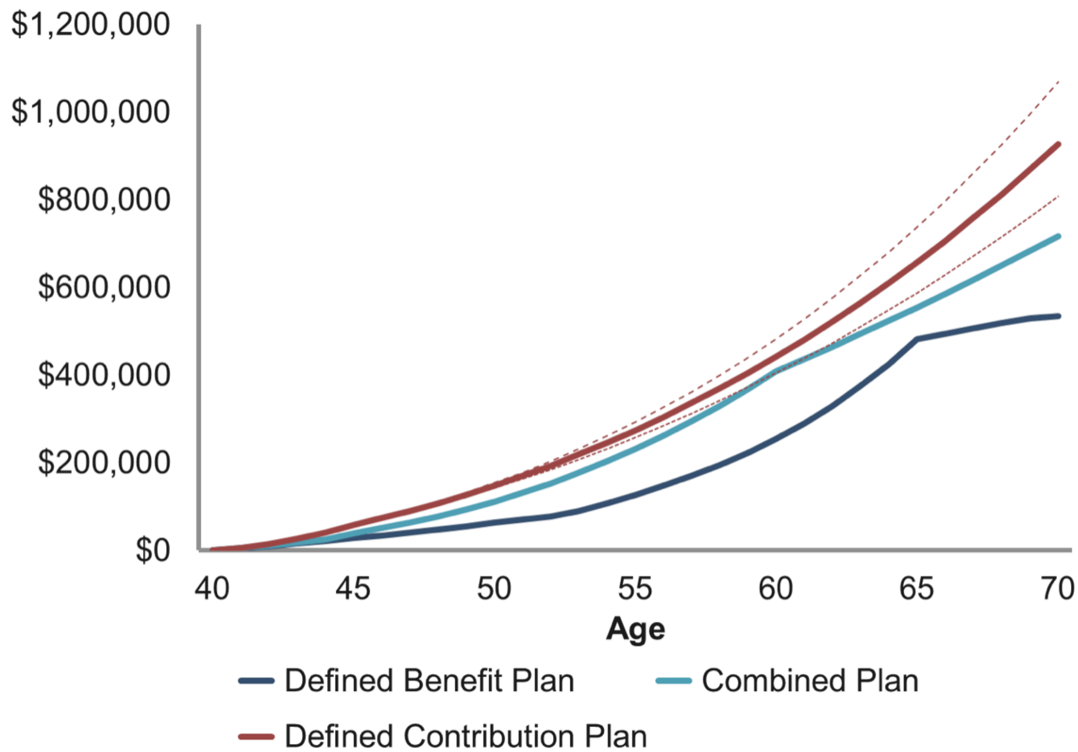
Ohio policymakers have already adopted a number of policies that help put educators on a path to a secure retirement. With these additional changes, Ohio could dramatically improve the retirement security of its teacher workforce.

Appendix

Appendix table 1: Ohio's retirement-plan options

	DB plan[18]	Combined plan	DC plan
Employee contributions for benefits	10.83 percent	14 percent (12 percent into DC, 2 percent toward DB)	14 percent
Employee contributions for unfunded liabilities	3.17 percent	0 percent	0 percent
Employer contributions for benefits	0 percent	1.99 percent	9.53 percent
Employer contributions for unfunded liabilities	14 percent	12.01 percent	4.47 percent
Investment return assumption	7.45 percent	7.45 percent on DB component; 6.45 percent on DC component	6.45 percent[19]
Inflation assumption	2.5 percent	2.5 percent	2.5 percent
Vesting period	5 years	5 years	5 years graduated (20 percent per year)
Formula multiplier	2.2 percent	1 percent	N/A
Final average salary	Highest 5 years	Highest 5 years	N/A
Interest credit on withdrawals	2 percent if less than 3 years of service; 3 percent in years 3–5; 3 percent plus a 50 percent employer match if over 5 years of service	2 percent if less than 3 years of service; 3 percent if 3–5 years of service; 3 percent plus a 50 percent employer match if over 5 years of service	N/A
Normal retirement age	Age 65 with 5 years of service; age 60 with 35 years of service[20]	Age 60 with 5 years of service	Any age after 50
Early retirement	Any age with 30 years of service; age 60 with 5 years of service	Only if member elects for a lump-sum distribution	N/A
COLA	0 percent	0 percent	N/A
Social security	N	N	N

Appendix figure 1: Comparing Ohio STRS's retirement-plan options, forty-year-old entrants



Endnotes

1 Mary Williams Walsh, "Illinois seeks a bailout from Congress for pensions and cities," *New York Times*, April 17, 2020; Anna Staver, "State pension system asks legislators to freeze cost-of-living raises for retirees," *Columbus Dispatch*, January 14, 2020; and Ben Deeter, "Retired teachers file class action lawsuit over state benefits cut," *Columbus Dispatch*, May 24, 2019.

2 Although it's called the "State Teacher Retirement System of Ohio," STRS covers workers employed by Ohio school districts, community colleges, state universities, and other educational institutions. This brief uses the terms "teachers," "members," or "employees" interchangeably, but they are meant to apply to all STRS participants.

3 Out of all new teachers, 10 percent chose the pension plan, 8 percent chose the DC plan, and 4 percent chose the combined plan. Jennifer Erin Brown and Matt Larrabee, Decisions, *Decisions: An Update on Retirement Plan Choices for Public Employees and Employers* (Washington, D.C.: National Institute on Retirement Security, August 2017), https://www.nirsonline.org/wp-content/uploads/2017/11/final_decisions_2017_report.pdf.

4 For more on the history of why Ohio does not provide social security coverage to its teachers, see Leslie Kan and Chad Aldeman, *Uncovered: Social Security, Retirement Uncertainty, and 1 Million Teachers* (Washington, D.C.: Bellwether Education Partners, 2014), http://www.teacherpensions.org/sites/default/files/UncoveredReportFinal.pdf.

5 Employee contributions rose from 10 percent to 11 percent in 2013, 12 percent in 2014, 13 percent in 2015, and 14 percent in 2016. Although employee-contribution rates do not affect benefits, they do affect the employee's benefit net of their own contributions. That is, employees are paying more into the plan but getting less back in return.

6 "Plan Data: Ohio Teachers," Public Plans Data, accessed May 18, 2020, https://publicplansdata.org/quick-facts/by-pension-plan/plan/?ppd_id=88.

7 Robert M. Costrell and Michael Podgursky, "Golden Handcuffs," *Education Next* 10, no.1 (2010), https://www.educationnext.org/golden-handcuffs.

8 Olivia S. Mitchell and Stephen Utkus, "Target Date Funds and Portfolio Choice in 401(k) Plans," NBER Working Paper No. 26684 (January 2020), https://www.nber.org/papers/w26684.

9 Cheiron, "State Teachers Retirement System of Ohio: Actuarial Valuation Report as of June 30, 2019," State Teachers Retirement System of Ohio, October 2019: p.2, https://www.strsoh.org/_pdfs/annual-reports/Actuarial_Valuation_2019.pdf.

10 For starting salary, see "2017–2018 Average Starting Teacher Salaries by State," National Education Association, accessed May 28, 2020, http://www.nea.org/home/2017-2018-average-starting-teacher-salary.html, and Cheiron, "State Teachers Retirement System of Ohio: Actuarial Valuation Report."

11 "Public Teachers Data File 2011–12," U.S. Department of Education, National Center for Education Statistics, Schools and Staffing Survey (SASS). To see how the picture would change for later-career entrants, see appendix figure 1. For forty-year-old entrants, the ranking of the three plans stays the same, although the magnitude of the difference shrinks. That's mainly due to workers being closer to qualifying for normal retirement under the DB plans. In fact, the only workers who do better under the DB plan than the DC plan are those who enter the system at exactly age sixty and stay exactly five years.

12 There's an ongoing academic debate about whether asset returns are higher in DB or DC plans. Mindful of that debate, here we assume the Ohio DC plan participants earn 6.45 percent, or 1 percentage point, less than STRS assumes its DB plan will earn. For more background, see Josh B. McGee, *Defined-Contribution Pensions Are Cost-Effective* (New York, NY: Manhattan Institute, August 12, 2015), https://www.manhattan-institute.org/html/defined-contribution-pensions-are-cost-effective-6361.html, and Alicia H. Munnell, Jean-Pierre Aubry, and Caroline V. Crawford, "Investment Returns: Defined Benefit vs. Defined Contribution Plans," Center for Retirement Research at Boston College, December 2015, http://crr.bc.edu/briefs/investment-returns-defined-benefit-vs-defined-contribution-plans.

13 Florida, Michigan, South Carolina, and Utah are the other ones. See Kathryn M. Doherty, Sandi Jacobs, and Martin F. Lueken, *Doing the Math on Teacher Pensions: How to Protect Teachers and Taxpayers* (Washington, D.C.: National Council on Teacher Quality, January 2015), https://www.nctq.org/dmsView/Doing_the_Math.

14 Workers who choose the DC or the combined plan can switch to the DB plan within their first five years, but no such option exists for DB-plan participants. See "K–12 Educators," State Teachers Retirement System of Ohio, accessed May 18, 2020, https://www.strsoh.org/actives/new-members/k-12.

15 Brown and Larrabee, *Decisions, Decisions.*

16 "The Effect of Default Options on Retirement Savings," National Bureau of Economic Research, accessed May 18, 2020, https://www.nber.org/aginghealth/summer06/w12009.html.

17 The current version is available online at https://www.strsoh.org/_pdfs/forms/20-600a.pdf.

18 As discussed above, Ohio is phasing in a series of changes to its DB plan. This chart reflects the plan provisions in place for retirees after the year 2026.

19 The DC plan modeled here assumes a constant rate of return of 6.45 percent, which is 1 percentage point lower than STRS's assumed rate of return. Although there's some debate over whether DC-plan investors earn lower returns, the 1 percentage point is meant as a concession to that argument and the fact that the DC plan is subject to more volatility.

20 Ohio is phasing in new retirement ages from 2015 to 2026. In 2015, workers could retire at age sixty-five with five years of experience or at any age after reaching thirty years of experience.