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Analysis

H.B. 152 – Rep. Widener *(As Introduced)*

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ORSC Position

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The bill would require each school board to offer public school teachers and employees the alternative retirement plan (ARP) in lieu of the State Teachers Retirement System (STRS) or the School Employees Retirement System (SERS).¹ Current law requires public school teachers and employees to participate in STRS and SERS, respectively. The ARP is a defined contribution (DC) plan administered by private vendors, and is limited to full-time employees of public institutions of higher education under current law.²

Public school teachers and employees whose employment commences on or after the effective date of the bill *or* who have less than five years of service credit on the day immediately preceding the effective date of the bill may elect the ARP in lieu of STRS or SERS.³ The election shall be made no later than 120 days after employment commences for new hires and no later than 120 days after the ARP is adopted for current employees with less than five years of service. Failure to make an election shall be deemed to be an election to participate in STRS or SERS, as applicable.

Public school teachers and employees electing the ARP shall contribute the same percentage of compensation as currently required under either STRS (10%) or SERS (10%), as applicable. Each school board shall contribute the same percentage of payroll on behalf of such teachers and employees as currently required under either STRS (14%) or SERS (14%), as applicable. The bill would require that a percentage of the employer contribution rate be made to the otherwise applicable retirement system to mitigate any negative financial impact of the ARP on such retirement system. The initial percentage would be six percent, as modified every three years based upon an actuarial study

¹ “School board” means the board of education of a city, local, exempted village, or joint vocational school district, the governing board of an educational service center, or the governing board of a community school.

² In a defined contribution plan, the employer only promises to allocate a specified contribution, generally a percentage of the employee’s annual salary, to the employee’s individual account. The employer does not promise the employee any specific benefit amount at retirement; rather, the employee receives a benefit in an amount determined by his or her account balance, the interest rate expected to be earned on the funds in the account and the anticipated length of time the benefit is to be paid. Under this type of plan, the employer’s liability is limited to each year’s required contribution; the employee bears all investment risk.

In a defined benefit plan, the employer agrees to provide the employee a benefit amount at a stipulated retirement age based upon a specified formula. The formula is typically based on years of service and earnings. Under this type of plan, the employer is responsible for ensuring that contributions made by the member and the employer are sufficient, when combined with earnings on pension assets, to fulfill the benefit promises. The investment risk is borne by the employer.

³ The bill would exclude educational employees of the Department of Education otherwise subject to STRS membership as well as any person, not a faculty member, employed in any school, college or other institution wholly controlled and managed by the state or any political subdivision thereof otherwise subject to SERS membership.

prepared by the ORSC actuary, *except* that such percentage shall *not* exceed the percentage adopted by the retirement system to mitigate any negative financial impact of its own DC plan upon such retirement system (An amendment to a biennial budget bill provided for this exception (H.B. 94 – eff. 9/5/01).

Background – The ARP was established in H.B. 586 (eff. 3/31/97) for full-time academic and chief administrative employees of public institutions of higher education electing the DC plan in lieu of the defined benefit (DB) plans of PERS, STRS or SERS. An amendment to an omnibus retirement bill (S.B. 133 – eff. 8/1/05)) extended eligibility for the ARP to all full-time employees of public institutions of higher education.

One of the recommendations made in the final report of the Joint Legislative Committee to Study Ohio’s Public Retirement Plans (December 11, 1996) was as follows:

“That an alternative defined contribution plan be established, in conjunction with the existing defined benefit plan, in the three non-uniformed employee retirement systems [PERS, STRS, SERS] to provide greater portability and options for employees.”

Pursuant to that specific recommendation, S.B. 82 (eff. 3/7/97) required each board to develop for legislative consideration an alternative benefit program to provide greater pension portability and options for their members. Subsequent legislation was then enacted requiring each board to establish an alternative defined contribution plan, in conjunction with the existing defined benefit plan, in PERS (H.B. 628 – eff. 9/21/00), STRS (S.B. 190 – eff. 7/13/00) and SERS (S.B. 270 – eff. 4/9/01). STRS established an alternative DC plan as well as a combined plan with a DC benefit funded by employee contributions and a DB benefit funded by employer contributions in 2001. Similarly, PERS established an alternative DC plan as well a combined plan in 2003 as required by statute. SERS conducted a member survey in 2002 that generally concluded there was no interest in a pure DC plan among its members, although there appeared to be considerable interest in a plan that combined features of a DB and DC plan. No DC plan or combined plan has been established in SERS.

The issue of greater portability of benefits for short-term, mobile employees under the STRS DB Plan and the PERS DB plan was also addressed in H.B. 586 (eff. 3/31/97) and S.B. 144 (eff. 12/13/00), respectively. These two legislative enactments required STRS and PERS to pay interest upon a refund of the member’s accumulated contributions and, for members with at least five years of service, a portion of the employer contributions. No similar requirements were enacted in SERS, which currently provides for only a refund of the member’s accumulated contributions without interest upon termination of employment prior to service retirement.

Staff Comments – H.B. 152 raises several public policy issues that merit serious legislative consideration and discussion.

Rationale of ARP for Higher Education Employees

The ARP was established for higher education employees in 1997, and received the favorable recommendation of the ORSC for the following reasons:

- Public institutions of higher education in Ohio successfully demonstrated a compelling need for an ARP (i.e., a defined contribution plan) to enable them to compete in the national market for faculty and top administrators.
- The ARP was very common for higher education employees throughout the nation; forty-seven (47) states had an ARP for higher education employees. The Teachers' Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) is the best-known, oldest and largest defined contribution plan for higher education employees. TIAA-CREF was originally created in 1918 to provide retirement income for private and public university and college professors and administrators.
- None of the non-uniformed employee retirement systems (PERS, STRS, SERS) offered a comparable defined contribution plan for higher education employees. Each retirement board had just initiated a feasibility study of establishing such alternative benefit plans for their members as required under S.B. 82 (eff. 3/7/97).

The above reasons would seemingly argue against the proposed expansion of the ARP to K-12 public school teachers and employees. First, school boards have *not* demonstrated a compelling need to enter the national market to recruit public school administrators, teachers and other employees in Ohio. In fact, they have offered opposition testimony to the bill on behalf of the Ohio Association of School Business Officials (OASBO), the Ohio School Boards Association (OSBA), and the Buckeye Association of School Administrators (BASA), citing the creation of a new and unnecessary administrative and financial burden on school districts, the lack of demand from STRS and SERS members, and the shift of fiduciary duty in administering the plan from the retirement boards to the school boards among other reasons.

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Secondly, DC plans, as a primary rather than a supplemental retirement plan, are very rare for K-12 public school teachers and employees; the overwhelming majority of elementary and secondary public school teachers and employees are covered under defined benefit (DB) plans throughout the nation. To date, only two (2) states (Alaska, West Virginia) have established mandatory DC plans for K-12 employees, *though West Virginia has recently passed a bill to convert it back to DB plan due to the inadequacy of plan benefits and increased costs under the DC plan created in 1991*. Only three (3) states (Florida, Ohio, South Carolina) have established optional DC plans for K-12 employees, in conjunction with their existing statewide DB plans. And only four (4) states (Indiana, Ohio, Oregon, and Washington) have established hybrid plans for educational employees that combine features of both DC and DB plans whereby the employer-funded portion of the plan is a defined benefit while the employee-funded

⁴ The DC plan was recently created in Alaska for new hires on or after July 1, 2006; the DC plan was created in West Virginia for new hires on or after July 1, 1991, but is to be converted back to a DB plan for new hires on or after July 1, 2006.

portion is a defined contribution. The most common method for addressing the interstate portability needs of mobile educational employees under DB plans throughout the nation is the purchase of service credit; 47 states allow K-12 public school teachers and employees to purchase out-of-state service credit, including Ohio. Moreover, several states, including Ohio, have made it easier for members to purchase such credit by allowing for installment payments through payroll deduction plans and trustee-to-trustee transfers from 457(b) governmental deferred compensation plans (e.g., Ohio Public Employees Deferred Compensation Plan), 403(b) tax-sheltered annuity plans (e.g., TIAA-CREF) and other 401(a) qualified pension plans (e.g., state retirement systems) – all on a tax-deferred basis.

Thirdly, since the establishment of the ARP for higher education employees in 1997, the General Assembly has refrained from expanding the ARP beyond public institutions of higher education. In 1999, the Ohio General Assembly took no action on H.B. 199 (123rd General Assembly), which would have expanded the ARP to all members of the state retirement systems, including the Ohio Police and Fire Pension Fund and the Highway Patrol Retirement System. It also took no action on H.B. 623 (123rd General Assembly), which would have expanded the ARP to elected officials and non-classified state employees. In lieu of these bills, the 123rd General Assembly enacted legislation consistent with the recommendation made in the final report of the Joint Legislative Committee to Study Ohio’s Public Retirement Plans requiring the establishment of a DC plan, in conjunction with the existing DB plan, in PERS (H.B. 628 – eff. 9/21/00), STRS (S.B. 190 – eff. 7/13/00) and SERS (S.B. 270 – eff. 4/9/01) – all of which were favorably recommended by the ORSC.

Since July 1, 2001 STRS has offered members in lieu of its DB plan an optional DC plan as well as an optional hybrid plan that combines features of both DB and DC plans. The STRS DC plan is comparable to the ARP, yet provides greater flexibility by allowing members to make a plan reselection in the fifth year of employment. In addition to the optional DC plan and hybrid plan, portability is also provided to K-12 teachers under STRS in a number of other ways, including the following:

- Statewide multiple-employer retirement plan covering all public school districts in Ohio;
- Coordinated retirement provisions with PERS and SERS allowing members to combine contributions and service credit between retirement plans;
- Purchase or transfer of uniformed employee retirement system (OP&F, HPRS) credit;
- Purchase of prior service credit authorizations, including teaching service in a public or private school of this or another state;
- Enhanced refund provisions requiring payment of interest upon a refund of member contributions and, for members with at least five years of service, a portion of employer contributions;
- Trustee-to-trustee transfers from 457(b) governmental deferred compensation plans, 403(b) tax-sheltered annuity plans and other 401(a) qualified pension plans.

As noted above, SERS conducted a member survey in 2002 that generally concluded there was no interest in a pure DC plan among its members, although there appeared to be considerable interest in a hybrid plan that combined features of a DB and DC plan (46% of respondents). Unlike the other two non-uniformed employee retirement systems (PERS, STRS), SERS has *not* established an optional DC plan (*or hybrid plan*) as required by current statute, though no time deadline has been imposed by the legislature. Moreover, the legislature has not enacted comparable provisions in SERS for an enhanced refund requiring payment of interest on the member contributions and, for members with at least five years of service, a portion of employer contributions. As such, SERS currently offers less portability and options for its members than PERS and STRS; at a minimum, the legislature should require the establishment of a hybrid plan in SERS by a date certain.

STRS and SERS as Multiple-Employer Plans v. Individual Employer Plans

Since their creation in 1920 and 1937, respectively, STRS and SERS were established as statewide multiple-employer retirement systems, with each retirement board vested with the responsibility for the administration and management of the retirement system. This is in direct contrast to the 454 separate local police and fire pension funds that existed in Ohio prior to their consolidation into the statewide multiple-employer OP&F in 1967 due to the inability of many individual employers to effectively administer and manage their pension funds for police and firefighters – many of which were on the brink of financial insolvency. This is also in direct contrast to the nearly 1,000 school boards in Ohio that, under H.B. 152, would become a plan sponsor and a fiduciary of the ARP for their teachers and educational employees and assume responsibility for the administration and management of the ARP, including, but not limited to, the following:⁵

- Negotiate and enter into a contract with each private vendor designated by the Department of Insurance that is willing to provide investment options under the individual employer's ARP;
- Notify in writing STRS or SERS, as applicable, within ten days of each employee's election;
- Allow each employee to change vendors at least once per year and at any time the vendor ceases to be designated;
- Transmit the required contributions to the vendor selected by each employee as well as the supplemental contributions to the state retirement system that would have otherwise covered such employee;
- Perform such other necessary functions for the proper administration of the ARP.

Each ARP established by the nearly 1,000 school boards in Ohio would **not** be subject to the jurisdiction of the ORSC which, since 1968, has provided legislative oversight of the five statewide retirement systems in Ohio. Each ARP would also **not** be subject to the numerous legislative reporting requirements applicable to the five retirement systems, such as fiduciary audits, semi-annual investment reviews, use of Ohio-based brokers,

⁵ Currently, the ARP is limited to only 37 state universities and colleges.

investment managers, and minority enterprises, etc. In short, there would be less accountability and oversight under the ARP than under the five state retirement systems, contrary to the numerous pension reforms recently enacted in S.B. 133 (eff. 9/15/04) to improve accountability, oversight and fiduciary standards with respect to the governance and operation of the public pension plans for governmental employees in Ohio.

Other advantages to statewide multiple-employer retirement systems as opposed to individual employer-sponsored retirement plans include the following:

- Statewide multiple-employer retirement systems provide uniformity of benefits well as portability of benefits for all school districts in Ohio; H.B. 152 provides that each school board shall contract with each private vendor designated by the Department of Insurance only to the extent that vendor is willing to provide investment options to employees of that school board, potentially creating differences among school boards should a private vendor choose to provide investment options to employees of select school districts only.
- Statewide multiple-employer retirement systems provide more efficient and effective administration by eliminating unnecessary duplication of function and achieving economies of scale in order to reduce overall administrative and investment-related expenses.

Other Jurisdictions

As noted above, DC plans, as a primary rather than a supplemental retirement plan, are very rare for K-12 public school teachers and employees; the overwhelming majority of elementary and secondary public school teachers and employees are covered under defined benefit (DB) plans throughout the nation. It is important to note that unlike Ohio the few states that have established DC plans as a primary retirement plan also provide Social Security coverage. Social Security is generally a defined benefit plan that provides safety net benefits, including retirement, disability, survivor and death benefits. It is also important to note that the DC plans established by the other states are part of a statewide multiple-employer retirement system rather than a single employer-sponsored retirement plan as proposed under H.B. 152. Therefore, it is unlikely that the proposed ARP under the bill would improve recruitment efforts or portability of benefits in any meaningful way for K-12 public school teachers and employees entering or leaving Ohio.

Exclusion of PERS

H.B. 152 would only apply to school boards currently covered under STRS and SERS. The bill would **not** apply to the state, counties, municipal corporations, townships and all other employers covered under PERS which, like STRS, has established an alternative DC plan as well as a combined plan for its members. The rationale for the different treatment of the three non-uniformed employee retirement plans is unclear as a matter of public policy.

Fiscal Impact – In general, the proposed ARP would have a negative fiscal impact upon STRS and SERS for three reasons. The first reason is that the existing unfunded liabilities of STRS and SERS must be amortized. The retirement systems rely on contributions for the next 30 or so years from all employees presently covered by the retirement systems (current and future hires) to amortize these liabilities. To the extent that the ARP decreases the number of employees joining the retirement systems in the future or allows current members to opt out of the retirement systems, the financing base is eroded.

The second reason is that the decrease in the amount of forfeited contributions available to pay the retirement systems’ unfunded liabilities that results from the transfer of some members to the ARP outweighs any corresponding decrease in the retirement systems’ liabilities that may occur as a result of such transfer. That is, to the extent that employees make decisions based on their best financial interests (and consequently, the systems’ worst financial interests), the retirement systems’ costs will increase.

A third reason is that members electing to join an ARP receive compensation generally higher than the compensation provided to other members. Employer contributions allocated to fund discretionary health insurance benefits for retired members are expressed as a percentage of pay. But the cost of health insurance does not vary in proportion to earnings. Thus, if the employees with higher than average earnings transfer to an ARP, contributions to finance health insurance will decrease disproportionately to the decrease in the long term cost of providing health insurance to retirees.

According to the STRS actuary Buck Consultants, the fiscal impact of the expanded ARP on the STRS funding period and funded ratio depends on both the amount of the supplemental employer contribution rate to finance the unfunded liability of the DB plan and the percentage of new hires that elect to participate in the ARP. The following table shows the projected impact on the funding period and funded ratio as of July 1, 2025 for various combinations of member participation rates and supplemental employer contribution rates to the DB plan:

Participation Rate for New Hires	Supplemental Employer Contribution to DB Plan	Projected Funding Period in 2025	Projected Funded Ratio in 2025
0% (Baseline)	N/A	11.2 years	91%
10%	0.0%	13.7 years	90%
10	3.5%	12.6 years	90%
10	8.0%	11.3 years	91%
40%	0.0%	26.2 years	86%
40%	3.5%	17.8 years	88%
40%	8.0%	11.4 years	90%
75%	0.0%	Infinite	82%
75%	3.5%	28.2 years	85%
75%	8.0%	11.6 years	89%

Similarly, the SERS actuary Buck Consultants estimated the fiscal impact of the expanded ARP on the SERS funded ratio as follows:⁶

Participation Rate For Eligible Members	Supplemental Employer Contribution to DB Plan	Projected Funded Ratio in 2025
0% (Baseline)	N/A	90%
1%	0.0%	90%
1%	6.0%	90%
10%	0.0%	89%
10%	6.0%	89%
40%	0.0%	85%
40%	6.0%	85%
75%	0.0%	80%
75%	6.0%	81%

In addition, Buck Consultants notes the negative fiscal impact of the expanded ARP on the SERS health care fund. Under each scenario listed in the table above, the actuary estimates that the amount of employer contribution necessary to fund pension benefits guaranteed by statute within a 30-year funding period would increase, thereby lowering the amount of employer contribution currently allocated to discretionary retiree health care benefits. Since employer health care contributions are calculated as a percent of active member payroll, fewer active employees with a lesser payroll and a higher pension contribution requirement would result in a decrease in the overall level of employer contributions that will be made to the SERS health care fund and in a shortening of the expected solvency period of the SERS health care fund. Moreover, transferring employees from SERS to the ARP would lower the overall active member payroll, thus lowering the employer health care surcharge contributions to the SERS health care fund, which currently generate the maximum 1.5% of payroll permitted by statute. The level of negative fiscal impact upon the SERS health care fund would ultimately depend upon the number of eligible employees who elect to transfer to the ARP and their compensation levels.

ORSC Position – At the September 12, 2007 meeting of the Ohio Retirement Study Council, the Council voted to recommend that the Ohio General Assembly disapprove H.B. 152 for the reasons cited above.

⁶ All scenarios included in the table assume a 30-year funding period for amortizing SERS’ unfunded liabilities.