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The Ohio Retirement Study Council
88 E. Broad St., Suite 1175
Columbus, Ohio 43215
(614)228-1346 Phone
(614)228-0118 Fax
www.orsc.org Website

Analysis

Sub. H.B. 157 - Rep. Schuring
(As Enacted)

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ORSC Position

Glenn Kacic - Contact Person
(614)228-1346

Sub. H.B. 157 - Rep. Schuring

Sub. H.B. 157 would change the current determination of the annual cost-of-living allowance (COLA) under the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Ohio Police & Fire Pension Fund (OP&F), and the Highway Patrol Retirement System (HPRS).

Current law requires the retirement boards of all five state retirement systems to determine annually the average percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Whenever the CPI-W increases, the retirement boards are required to pay a cost-of-living allowance (COLA) to eligible recipients receiving a benefit for at least 12 months equal to the actual percentage increase or such increase plus any prior accumulations in the benefit recipient's COLA bank, up to a maximum of three percent (3%).[1] The COLA is calculated on the original benefit amount (unless the legislature establishes a new base). Any percentage increase in the CPI-W in excess of the maximum 3% is accumulated in the benefit recipient's COLA bank and combined with the percentage increase in the CPI-W in succeeding years.[2] Pursuant to the Attorney General's Opinion 87-044, benefit recipients begin accumulating any excess percentages in their respective COLA banks upon first becoming eligible for a COLA.

The bill would eliminate the COLA bank and require the retirement boards to pay an annual 3% simple COLA to all eligible benefit recipients, regardless of the actual percent change in the CPI-W. In the case of OP&F, the monthly benefit would increase to $566.50, plus $16.50 each year thereafter, for surviving spouses; $163.50, plus $4.50 each year thereafter, for surviving children; and $109.00, plus $3.00 each year thereafter, for each dependent parent ($218.00, plus $6.00 each year thereafter, for a sole dependent parent. These amounts are the equivalent of a 3% increase on the original base amounts recently established under H.B. 194 (eff. 7/1/99) and H.B. 275 (eff. 3/17/00) for OP&F surviving beneficiaries.

As amended by the Senate Ways and Means Committee, the bill would also make the following changes:

- Permit a township to establish an early retirement incentive (ERI) plan for a designated department of the township under PERS. Current PERS law permits a township to establish an ERI plan for the township as a whole. This change is consistent with existing PERS law that permits a municipal corporation to establish an ERI plan for a particular agency of the municipal corporation.

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[1]Members of the Ohio Police & Fire Pension Fund who retired prior to July 24, 1986 are eligible for an annual COLA equal to the actual percentage increase multiplied by $12,000 or such increase plus any prior accumulations in the member's COLA bank multiplied by $12,000, up to a maximum of $360 per year.

The State Highway Patrol Retirement System provides the same COLA to eligible recipients who not only have received a benefit for at least 12 months but also have attained age 53; surviving beneficiaries are eligible for the same COLA upon receiving a benefit for twelve months (60 months for disabled retirees), regardless of age.

[2]For example, the CPI-W increased by 3.5% for calendar year 2000. Individuals whose effective date of retirement is on or after July 1, 2000 but before June 30, 2001 will receive the maximum 3% COLA and the excess 0.5% will be accumulated in their individual COLA bank that may be drawn upon in future years in which the CPI-W increases by less than 3%. Therefore, assume the CPI-W increases by only 2.5% for calendar year 2001. These individuals will once again receive the maximum 3% COLA (2.5% actual CPI-W increase + 0.5% accumulation in COLA bank = maximum 3% COLA), leaving their individual COLA bank with a zero balance.

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- Make surviving spouses of members of or contributors to a former local police and firemen's relief and pension fund whose benefits were terminated or never paid due to remarriage eligible for survivor benefits under the statewide OP&F which became operational in 1967, replacing the 454 local police and firemen's relief and pension funds in Ohio. The bill would also make them eligible for benefits under the Ohio Public Safety Officers Death Benefit Fund, provided the member was "killed in the line of duty." Such benefits shall commence upon the first day of the month following receipt by OP&F of an application and sufficient evidence indicating that the spouse's benefits were terminated or never granted due to remarriage or that the deceased member was killed in the line of duty, as the case may be.

Staff Comments

The following methods of retirement income protection are provided by the state retirement systems: (1) Annual Cost-of-Living Allowances (COLA); (2) Comprehensive Retiree Health Care Plans; and (3) Ad Hoc Legislative Post-Retirement Increases.

The annual COLA is generally payable upon receiving a benefit for at least 12 months, calculated upon the original benefit amount (unless the legislature establishes a new base), and limited to a maximum of three percent.

The retiree health care plans are perhaps the most valuable in terms of retirement income protection. They provide comprehensive hospital, medical and prescription drug coverage. They also provide for full or partial reimbursement of the cost of Medicare Part B monthly premiums. Unlike other forms of retirement income protection, retiree health care benefits are neither taxable nor subject to the Social Security government offset provisions.

In addition, the legislature has granted various ad hoc post-retirement increases from time to time in an effort to offset in part the loss in the original purchasing value of retirement benefits during periods of high inflation. These ad hoc increases are generally included in the benefit recipient's base for purposes of calculating future COLAs.

The proposed change in the current COLA provisions raises a number of public policy issues. Moving to a fixed 3% annual COLA would increase benefit payments under each of the five retirement systems relative to current law. The fact that the retirement systems' actuaries assume that a 3% COLA will be paid each year does not mean that the proposed change will have no cost. To the extent that future benefit payments under a fixed 3% COLA exceed current payments under existing law, the provision will increase long-term costs. For eight of the last nine years, the average percentage change in the CPI-W has been below 3%, thus resulting in actuarial gains (savings) to the retirement systems. These gains are available to offset actuarial losses resulting from adverse experience in other areas, such as continual improvements in life expectancy that increase long-term benefit costs, *or* to accelerate the amortization of any unfunded liabilities.

The following table prepared by Milliman & Robertson shows the estimated magnitude and growth in these gains over the last nine years:

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(Amounts in Millions)

FY Ending	**PERS**	**OP&F**	**STRS**	**SERS**
1993	$22.4	$4.9	$31.1	$4.2
1994	$20.9	$4.7	$36.4	$5.0
1995	$20.7	$5.3	$41.9	$5.3
1996	$0.9	$0.3	$1.6	$0.2
1997	$1.8	$0.5	$3.9	$0.4
1998	$23.1	$6.0	$45.4	$5.3
1999	$80.1	$20.7	$126.3	$18.1
2000	$63.3	$15.6	$223.8	$14.2
2001	$0.00	$0.00	$0.00	$0.00
Total	**$233.2**	**$58.0**	**$510.4**	**$52.7**

The gains shown in the above table reflect the savings over the remaining lifetime of the retirees and beneficiaries. These actuarial gains (savings) total $854.3 million for the nine-year period.

The proposed change would also benefit recent retirees whose benefits have been eroded by inflation the least more than older retirees whose benefits have been eroded by inflation the most, thus creating an issue of equity. Under existing law, older retirees are in effect guaranteed a 3% COLA for life due to significant accumulations in their COLA banks from prior years of inflation over and above 3%, whereas recent retirees who retired on or after July 1, 1990 have accumulated only one-half of one percent (0.5%) in their COLA banks due to very low inflation over the past decade. To provide a COLA that exceeds the effect of inflation on an individual's benefit seems inequitable to individuals who have been retired longer and provided less than a full adjustment to their benefits.

The attached COLA report prepared by Milliman & Robertson describes various alternative approaches toward providing retirement income protection. In contrast to the proposed change in the COLA provisions under the bill, both S.B. 190 and H.B. 628 which were recently enacted by the legislature for STRS and PERS, respectively, would restore the purchasing value of their retirees' benefits to 85% of the original benefit as adjusted for the cumulative percentage change in the CPI-W. This legislative approach is intended to help those older retirees whose benefits have been eroded by inflation the most.

In its *Report on the Solvency of the Health Care Stabilization Fund* dated November 1, 2000, the OP&F actuary indicates that the OP&F health care fund will be exhausted in 2015 despite increases in the employer contributions allocated to the fund and increases in retiree health care premiums payable to the fund effective 7/1/01. This is a significant change from financial projections made in the previous year's report. The OP&F actuary largely attributes the declining financial condition of the OP&F health care fund to escalating prescription drug costs. Recognizing the importance of retiree health care benefits to the overall financial security of OP&F members in retirement, Milliman & Robertson concludes that OP&F could not afford to have future actuarial gains under the present COLA provisions eliminated under H.B. 157 for the very same reasons that OP&F could not afford to have its state subsidies eliminated under H.B. 94.[3] (The state subsidies were eliminated for the other four state retirement systems under H.B. 94.) Milliman & Robertson also concludes that the other four state retirement systems could afford the proposed COLA changes included in H.B. 157. However, this raises an issue of whether the COLA provisions for all five state retirement systems should remain uniform in operation. Changing the COLA provisions in four of the five state retirement systems may create pressure to make a similar change in OP&F, regardless of its negative financial impact upon the ability of OP&F to continue providing retiree health care benefits in the future.

Fiscal Impact
See the attached actuarial analysis prepared by Milliman & Robertson.

ORSC Position
At its meeting of June 13, 2001 the Ohio Retirement Study Council voted to recommend that the 124th Ohio General Assembly approve H.B. 157.

Effective Date
February 1, 2002

[3]The present value of actuarial gains (savings) under the present COLA provisions is estimated to be $58.0 million for OP&F over the last nine years; the present value of state subsidies payable to OP&F was estimated to be $20.0 million.)