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Director/General Counsel

Bethany Rhodes

30 East Broad Street, 2nd Floor
Columbus, Ohio 43215
PHONE: 614-228-1346
FAX: 614-228-0118

To: Governor Mike DeWine
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LSC Director Mark Flanders

From: Bethany Rhodes, Director/General Counsel

Date: March 19, 2019

Subject: 2018 ORSC Annual Report

Since 1968, and pursuant to Revised Code 171.04, the Ohio Retirement Study Council has submitted an annual report to the Governor and the General Assembly covering its evaluation and recommendations regarding the five state retirement systems. ORSC staff is pleased to submit this year's report on the Evaluation and Recommendations Regarding the Operations of the State retirement Systems. The staff report includes information on the systems' investment performance, status of health care funds, actuarial reviews of the systems, fiduciary reports, progress on achieving 30-year funding, reports on enacted pension legislation, pending pension-related issues, a subject index of pension bills introduced, and a status sheet for pension legislation as of December 31, 2018.



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30 East Broad Street, 2nd Floor
Columbus, Ohio 43215
PHONE: 614-228-1346
FAX: 614-228-0118

Annual Report *2018*

Evaluations and Recommendations Regarding the Operations of the State Retirement Systems

**132nd General Assembly
January 1, 2018 – December 31, 2018**

Issued March 19, 2019

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ANNUAL REPORT
THE 132nd GENERAL ASSEMBLY
JANUARY 1, 2018 - DECEMBER 31, 2018

TABLE OF CONTENTS

| | <u>Page</u> |
|--|-------------|
| Introduction | i |
| Systems' Investment Performance | 1 |
| 30-Year Funding Plans | 3 |
| Status of Health Care Funds | 4 |
| Reports on Enacted Pension Legislation | 6 |
| Pending Pension-Related Issues & Recommendations | 9 |
| Documents Statutorily Required of the Retirement Systems | 15 |
| Documents Statutorily Required of the ORSC | 17 |
| Status of Pension Legislation | 18 |

Introduction

The Ohio Retirement Study Council (ORSC) staff is pleased to submit this report on the five public state retirement systems and the fund for volunteer firefighters for the period beginning January 1, 2018, and ending December 31, 2018. This report is submitted pursuant to section 171.04(B) of the Ohio Revised Code, which requires the ORSC to “make an annual report to the Governor and the General Assembly covering its evaluation and recommendations with respect to the operations of the state retirement systems and their funds.”

As of January 1, 2018, the five systems have combined assets of approximately \$197 billion with approximately 700,000 active contributing members, 1,000,000 inactive members, and 475,000 beneficiaries and recipients. The State of Ohio has a long tradition of providing retirement benefits to public employees. These benefits are held in trust and managed by the five systems and funded through employer and employee contributions and investment earnings on those contributions.

Ohio’s five public state retirement systems are the State Teachers Retirement System (STRS), created in 1920 for teachers in public schools, colleges, and universities; the Public Employees Retirement System (PERS), created in 1935 for state employees and expanded in 1938 to cover local government employees; the School Employees Retirement System (SERS), created in 1937 for non-teaching school employees; the State Highway Patrol Retirement System (HPRS), created in 1944 by the withdrawal of all state troopers from PERS; and the Ohio Police and Fire Pension Fund (OP&F), created in 1967 after the abolition of 454 local police and fire relief and pension funds, many of which were on the verge of financial insolvency because of a routine disregard of the financial consequence of benefit increases.

As a direct result of the collapse of local police and fire pension funds, the ORSC was created in 1968 to assist the state legislature, governor, and other public officials in the formation of sound public pension policy and is one of the oldest public oversight councils in the country. The general purpose of the Council is to advise and inform the state legislature on all matters relating to the benefits, funding, investment, and administration of the five public retirement systems in Ohio.

Legislators are accustomed to dealing in two-year budgetary cycles, whereas decisions about public pension plans typically involve significant long-term costs such as 30-year pension obligations. If not made prudently and with foresight, such decisions can threaten the stability of state and local government budgets years after those obligations are made and result in serious inter-generational inequity through reduced benefits or higher taxes.

The Council is required to make an impartial review of the laws governing the administration and financing of Ohio’s five public retirement systems and to recommend to the General Assembly any changes it may find desirable with respect to the allowances and benefits, the sound financing of the cost of benefits, the prudent investments of funds, and the improvement of the language, structure, and organization of the laws.¹ It must report to the Governor and the General Assembly concerning its evaluation and recommendations with

¹ R.C. 171.04.

respect to the operations of the systems. The Council is required to study all statutory changes in the retirement laws proposed to the General Assembly and report to the General Assembly on their probable cost, actuarial implications, and desirability as a matter of public policy.

The Council evaluates the operations of the systems on a continuing basis. During the past year, the Council reviewed the retirement systems' operating budgets and administrative rules. In addition, the ORSC staff has continued a digitization project to preserve records in the Council's possession, monitored legislation introduced in the General Assembly that would affect the state retirement systems, continued a multi-year project to standardize the reports provided by the systems to the General Assembly and Council, and began a fiduciary audit of PERS.

This report is a compilation of the evaluations and recommendations the Council made throughout 2018. It provides a summary of the ORSC reports and staff activities completed during 2018, pending public retirement issues, and staff recommendations. In addition, it provides a historical record of legislative action taken during the 132st Ohio General Assembly on bills affecting PERS, STRS, SERS, OP&F, HPRS and the Volunteer Fire Fighters' Dependents Fund (VFFDF).

Further detail on any topic listed in this report is available in the ORSC office or online at ORSC.org.

SYSTEMS' INVESTMENT PERFORMANCE

July 1, 2017 – June 30, 2018

The ORSC is required to conduct a semiannual review of the policies, objectives, and criteria of the systems' investment programs.² RVK is the Council's investment performance consultant. While there is a wealth of information in the analyses, this report details only the rolling 1-, 5-, and 10-year performance experiences, and comments from RVK.

Investment Performance Summary (July 1, 2017 - December 31, 2017)

The following summarizes the report received by the ORSC staff and reflects the investment performance for all six funds³ for the period ending December 31, 2017. The findings of this report are briefly summarized as follows:

- All of the retirement system portfolios had positive results for the one-year period ending December 31, 2017; net of fees, all of the funds outperformed their policy benchmarks in that same period.
- Over the trailing five-year period, all of the retirement system funds have exceeded their actuarial interest rate (the actuarial rate is the investment return target used by the systems' actuaries to determine its capacity to fully fund future benefits). Net of fees, PERS returned 9.20% (vs. 7.50% actuarial rate), STRS 10.10% (vs. 7.45%), OP&F 9.31% (vs. 8.00%), SERS 9.59% (vs. 7.50%), and HPRS 9.10% (vs. 7.75%).
- Over the trailing ten-year period, no funds have achieved their actuarial interest rate. Net of fees, PERS returned 5.85% (vs. 7.50% actuarial rate), STRS 5.91% (vs. 7.45%), OP&F 6.22% (vs. 8.00%), SERS 5.11% (vs. 7.50%), and HPRS 5.13% (vs. 7.75%). During the same period, PERS and OP&F exceeded their fund benchmarks. STRS, SERS, and HPRS trailed their fund benchmarks.

To summarize RVK comments:

1) Currently, all the funds are diversified across multiple asset classes and exhibit characteristics of prudent investment diversification. RVK further noted that the determination of a fund's asset allocation is the single most important investment decision and is a major determinant of long-term return and the volatility risk of asset values. However, RVK advised the ORSC to not assume that all the funds should have the same asset allocation. Differences in their liabilities, funding status, the risk tolerance of their fiduciaries and other factors will likely produce legitimate differences in asset allocation. They advised the Council and retirement system boards to monitor changes in asset allocation over time.

² R.C. 171.04.

³ The PERS health care portfolio (designated "PERS HC" by RVK) is tracked separately from the PERS pension benefit funds (designated as "PERS DB" or "PERS").

2) While the report focuses on recent information in return and risk taken at each of the funds, RVK strongly encouraged the Council to focus on the 3- and 5- year risk and return results to better gauge the stewardship of pension assets.

Investment Performance Summary (January 1, 2018 – June 30, 2018)

The following summarizes the report received by the ORSC staff and reflects the investment performance for all six funds⁴ for the period ending June 30, 2018. The findings of this report are briefly summarized as follows:

- All of the retirement system portfolios had positive results for the one-year period ending June 30, 2018. All of the system portfolios outperformed their policy benchmarks for the same period.
- Over the trailing five-year period, all funds have exceeded their actuarial interest rate (the actuarial rate is the investment return target used by the systems' actuaries to determine its capacity to fully fund future benefits. Net of fees, PERS returned 8.37% (vs. 7.50% actuarial rate), PERS-HC 6.65% (vs. 6.50%), STRS 9.12% (vs. 7.45%), OP&F 8.69% (vs. 8.00%), SERS 8.82% (vs. 7.50%), and HPRS 7.94% (vs. 7.75%).
- Over the trailing ten-year period, no fund has achieved their actuarial interest rate. Net of fees, PERS returned 6.65% (vs. 7.50% actuarial rate), PERS-HC 5.93% (vs. 6.50%), STRS 6.91% (vs. 7.45%), OP&F 7.08% (vs. 8.00%), SERS 6.00% (vs. 7.50%), and HPRS 6.04% (vs. 7.75%). During the same period, PERS, PERS-HC and OP&F exceeded their fund benchmarks. STRS, SERS, and HPRS trailed their fund benchmarks.

RVK made the same summary comments as during the previous performance analysis:

1) Currently all the funds are diversified across multiple asset classes and exhibit characteristics of prudent investment diversification. RVK further noted that the determination of a fund's asset allocation is the single most important investment decision and is a major determinant of long-term return and the volatility risk of asset values. However, RVK advised the ORSC to not assume that all the funds should have the same asset allocation. Differences in their liabilities, funding status, the risk tolerance of their fiduciaries and other factors will likely produce legitimate differences in asset allocation. They advised the Council and system boards to monitor changes in asset allocation over time.

2) While the report focuses on recent information in return and risk taken at each of the funds, RVK strongly encouraged the Council to focus on the 3- and 5- year risk and return results to better gauge the stewardship of pension assets.

⁴ The PERS health care portfolio (designated "PERS HC" by RVK) is tracked separately from the PERS pension benefit funds (designated as "PERS DB" or "PERS").

30-YEAR FUNDING PLANS
 THE 132nd GENERAL ASSEMBLY
 JANUARY 1, 2018 – DECEMBER 31, 2018

Each retirement system whose funding period exceeds 30 years in any given year is required to submit to the ORSC and the standing committees of the Ohio House and Senate, with primary responsibility for pension legislation, a plan approved by the retirement board that reduces the funding period to no more than 30 years, along with any progress made by the board in meeting the 30-year funding period.⁵ This 30-year amortization refers to the amount of time the respective system would need to pay off all currently accrued but unfunded benefits. This standard was modeled after the national standard adopted by the Governmental Accounting Standards Board for all governmental pension plans. The change was intended to maintain inter-generational equity among taxpayers and system members by limiting the ability to fund current benefit costs by extending the funding period beyond 30 years. **Actuarial reports issued in 2018 indicate that all systems remain within the 30-year time frame for the fourth year in a row.** The actuarial reports are as of December 31, 2017, for PERS, OP&F, and HPRS and June 30, 2018, for STRS and SERS.

Ohio is unique in requiring its state retirement systems to pay off all unfunded liabilities over a 30-year period. Lacking such a requirement, many other retirement systems across the country tend to focus on funded ratio. While the funded ratio is an important component in understanding the financial health of a retirement system, the ratio is a reflection of a system’s funding at a *particular moment in time*, given certain actuarial assumptions. A funded ratio is less able to express the trajectory of a system through time, if all current conditions and actuarial assumptions remain stable. The funded ratio and the years of unfunded liabilities, therefore, are top-line numbers that express different things:

- 1) The **funded ratio** provides the current ratio of the systems assets versus their existing liabilities under current actuarial assumptions; and
- 2) The **years of unfunded liabilities** estimates the amount of time, given the retirement system’s current plan design and actuarial assumptions, to reach a 100% funded ratio.

The following table summarizes the funding period and funded ratio of each retirement system as reported in its last actuarial valuation:

| | Years of Unfunded Liabilities | Funded Ratio |
|------|-------------------------------|--------------|
| PERS | 18 | 81.1% |
| OP&F | 28 | 69.9% |
| STRS | 17.8 | 75.5% |
| SERS | 26 | 70.07% |
| HPRS | 27 | 67.2% |

⁵ R.C. 145.221, 742.16, 3307.512, 3309.211, and 5505.121.

STATUS OF HEALTH CARE FUNDS
THE 132nd GENERAL ASSEMBLY
JANUARY 1, 2018 - DECEMBER 31, 2018

In 1974, the five public retirement boards were given broad discretionary authority to provide health care coverage to retirees and their dependents. Unlike pension benefits, which are vested on retirement, health care benefits are not a vested right under Ohio's public pension laws. Therefore, the courts have determined that the boards are authorized to change the premiums, eligibility, and level of health care benefits at any time. A 2004 ruling by the Tenth District Court of Appeals⁶ upheld the discretionary nature of health care benefits in a lawsuit that had attempted to prevent the SERS Board from making changes to its health care plan. The Ohio Supreme Court let this decision stand in May 2005 when it declined to review the case.

Since 1974, each system has provided some level of comprehensive hospital, medical, and prescription drug coverage. In 1977, the systems were required by law to reimburse benefit recipients for Medicare Part B premiums (medical). Additionally, retirees who do not qualify for Medicare Part A (hospital) are provided equivalent coverage under the systems' health care plans or are provided access through a Medicare Connector. All employees hired on or after April 1, 1986, are required by federal law to contribute to Medicare and will therefore not require this equivalent coverage. Employees hired before that date were not required to contribute to Medicare.

Beginning in 2006, Medicare began offering a prescription drug benefit known as Medicare Part D. Low income retirees who qualify for a government subsidy for their Medicare prescription drug benefit may fare better under Medicare Part D than the systems' plans. These low income retirees will need to determine which prescription drug plan is better for them.

Controlling health care costs has been and continues to be a major concern for Ohio's retirement systems. In calendar year 2017, the total cost of providing retiree health care was approximately \$1.8 billion. As employee contributions are used solely to fund pension benefits under federal and state law, any discretionary health care costs borne by the retirement systems must be financed by excess employer contributions only; the systems are not permitted to use any employee contributions for health care.⁷

The retirement systems' actuaries annually review the amount of contributions required to fund vested pension benefits. Employer contributions in excess of what is needed to support those benefits can be allocated to health care. Each year the retirement systems review their health care plans and make adjustments as needed. The following chart indicates the percentage of employer contributions each system allocated to health care during 2018 and the projected solvency period for each system's health care fund.

⁶ Ohio Association of Public School Employees, et al. v. School Employees Retirement System Board, et al. (2004).

⁷ R.C. 145.47, 26 U.S.C. 401(a), and 26 U.S.C. 401(h).

| Ohio Retirement System | Percentage of Employer Contribution Allocated to Health Care in 2018 | Projected Solvency Period for Health Care Funds (as of 2017) |
|-------------------------------|---|---|
| PERS | 0.00% | 2030 |
| STRS | 0.00% | Indefinite** |
| SERS | 0.50%* | 2033 |
| OP&F | 0.50% | 2033 |
| HPRS | 3.50% | 2029 |

*Does not include employer health care surcharge of up to 1.5% state average of total active member payroll.

**"Indefinite" means that funding will last beyond 100 years if all assumptions are met.

REPORTS ON ENACTED PENSION LEGISLATION
THE 132nd GENERAL ASSEMBLY
JANUARY 1, 2017 - DECEMBER 31, 2018

Am. Sub. H.B. 49 (Biennial Budget Bill)

The biennial budget bill included provisions permitting the SERS Board to modify the annual Cost-of-Living Adjustment (COLA) provided to SERS retirees. It also included some changes to HPRS law. This summary is limited to those provisions of the bill that pertain to SERS and HPRS. The Act:

- Beginning January 1, 2018, permits, rather than requires, the SERS Board to grant an annual COLA and, if the board grants a COLA, changes the amount to the percentage increase in the Consumer Price Index (CPI), if any, but not exceeding 2.5%.
- Authorizes the SERS Board, before granting an increase, to adjust the COLA percentage if the board's actuary determines, in its annual actuarial valuation or in other evaluations, that an adjustment does not materially impair the retirement system's fiscal integrity or is necessary to preserve its fiscal integrity.
- Eliminates a requirement that limited eligibility for HPRS retirement to active HPRS members, therefore allowing former HPRS members who have left their contributions with the system to retire under HPRS.
- Allows a former HPRS member who has left contributions with HPRS to designate an individual or a trust as beneficiary for payment of accumulated contributions should the former member die and no pension become payable.

ORSC Position – While the ORSC did not take a position specifically on Am. Sub. H.B. 49, it did approve, in part, the elimination of the automatic COLA in its analysis of S.B. 151 and H.B. 242. The ORSC disapproved of permitting the SERS Board to raise the COLA beyond CPI in its analysis of H.B. 242.

Effective Date – June 29, 2017.

Am. Sub. S.B. 8

Am. Sub. S.B. 8 generally established the School Facilities Option Program, but also included SERS COLA provisions. This summary is limited to those provisions of the bill pertaining to SERS. The Act:

- Requires the SERS Board determine how long retirees and benefit recipients whose allowances or benefits begin on or after January 1, 2018, must wait before first receiving annual cost-of-living adjustments (instead of waiting 12 months).

ORSC Position – While the ORSC did not take a position on Am. Sub. S.B. 8, it did recommend approval of a provision providing for a delay of initial COLAs in SERS in its analysis of S.B. 151 and H.B. 242.

Effective Date – March 23, 2018.

Am. H.B. 362

Am. H.B. 362 modifies the law governing HPRS. The Act:

- For individuals who become HPRS members on or after January 1, 2020, the bill increases the minimum age at which a member is eligible to retire with an unreduced pension to 52 (from 48).
- Reduces the minimum pension for off-duty HPRS disability retirement on or after the bill's effective date by basing the pension on at least 12 years of service instead of at least 20 years as under current law.
- Revises the monthly survivor pension for the surviving spouse of a deceased HPRS member who dies on or after the bill's effective date or the surviving spouse of an HPRS retirant who retires on or after that date.
- To be eligible for a surviving spouse pension, requires the surviving spouse of a deceased HPRS member or retirant who dies or retires on or after the bill's effective date to have been married to the deceased member or retirant while the member or retirant was in the active service of the State Highway Patrol.

ORSC Position – The ORSC approved H.B. 362 with suggested amendments at the October 12, 2017, meeting. The recommended amendments were added to the bill.

Effective Date – May 11, 2018.

S.B. 144

Sub. S.B. 144 largely addressed the Opportunities for Ohioans with Disabilities Council but included a provision to re-stagger the term of the employee firefighter board member of the Ohio Police & Fire Pension Fund.

ORSC Position – The ORSC did not take a position on the bill, but staggering of terms is periodically necessary and was most recently done in S.B. 42 of the 130th General Assembly.

Effective Date – May 30, 2018.

Sub. S.B. 296

Am. H.B. 362 modifies the law governing the Ohio Public Safety Officers Death Benefit Fund. The Act also included pay raises for certain elected officials. The Act:

- Extends payment of the initial death benefit to the date of the officer's maximum age and service pension eligibility for the officer's position, instead of limiting the payment to the date the officer would have first been eligible for retirement;
- Increases the transitional benefit paid after the officer's maximum retirement eligibility date from 50% to 75% of the officer's salary at the time of death, including salary increases;
- Eliminate a requirement that the DBF amount be reduced/offset by any survivor benefits payable by the officer's respective retirement system.

ORSC Position – The ORSC recommended that the 132nd General Assembly approved S.B. 296 with the addition of language limiting an initial retirement and survivor benefit to 100% of the deceased member’s salary (plus salary increases as under current law) to maintain the general cap effectively placed on all retirement income throughout the systems.

Effective Date – December 27, 2018.

The 132nd General Assembly passed SB 296 as an emergency measure without additional language recommended by ORSC. SB 296 was vetoed by the Governor and subsequently both the House and Senate passed SB 296 notwithstanding the objections of the Governor.

Sub. H.B. 572 (Retirement Omnibus)

Sub. H.B. 572 permitted County Department of Developmental Disabilities working in a school setting and school schedule to receive a full year of credit in PERS. The Act also included a largely non-substantive retirement omnibus amendment addressing several administrative changes to the state retirement systems.

ORSC Position – The ORSC approved H.B. 572 at the September 20, 2018, meeting. Separately, the ORSC approved the omnibus amendment addition at its December 4, 2018, meeting.

Effective Date – March 22, 2019

PENDING PENSION-RELATED ISSUES AND RECOMMENDATIONS
THE 132nd GENERAL ASSEMBLY
JANUARY 1, 2017 - DECEMBER 31, 2018

The ORSC staff keeps legislators aware of relevant public retirement issues and of prior recommendations that have been made but not acted upon by the legislature. There remain a number of issues and recommendations that continue to warrant legislative consideration. At its September 2014 meeting, the ORSC asked its staff to update these recommendations that have not been acted on. The list was presented and accepted at its November 2014 meeting. What follows is a brief summary of each issue and of action taken by the legislature or the ORSC, if any, in the 132nd General Assembly.

Community School Employees in STRS and SERS

Amendments to Am. Sub. H.B. 2 and Sub. H.B. 340 provided that certain community school employees would contribute to Social Security rather than STRS or SERS, and certain existing community school employees already contributing to both STRS and SERS would continue to dually contribute. ORSC staff issued a memo on November 2, 2015, discussing the issue and noted that determination of these individuals is a matter unresolved by the IRS and that Ohio's Section 218 Agreement does not permit dual contribution to Social Security and a state retirement system. ORSC staff remarked that, depending on IRS eventual determination, additional changes to Am. Sub. H.B. 2 and Sub. H.B. 340 in the future may be required.

Triennially Reporting of Valuations

Pension reform during the 129th General Assembly included a modification of the timing of certain reports issued by OP&F. One modification required triennial valuations by OP&F, rather than annual.⁸ The ORSC recommended during pension reform that this provision remain annual, an opinion concurred upon by independent consultants and again supported by the Council during the 130th General Assembly. No action has been taken by the General Assembly to revert the requirement to an annual valuation report. However, because of concern expressed by Council members, at the September 12, 2013, ORSC meeting, OP&F Director John Gallagher indicated that OP&F would continue to supply annual valuation reports to the Council. The ORSC staff continue to support a statutory change to require such reporting.

Board Authority

A component of pension reform in the 129th General Assembly was the authority of OP&F, SERS, STRS, and HPRS to independently adjust the plan design features of their respective retirement system. Pension reform required the ORSC to review that authority. At the April 9, 2013, ORSC meeting, the ORSC recommended that the board authority provisions be modified in the following ways: 1) Any plan design change receive actuarial

⁸ R.C. 742.14(A).

review; 2) Any plan design change receive review and prior-approval by the ORSC; 3) The board authority provisions be standardized and consistent among the systems; and 4) That objective, measurable standards be established to determine when a board is authorized to make or propose plan design adjustments.

There has been no further action on this recommendation. Subsequent to pension reform, further authority has been granted to SERS to adjust COLA in Am. Sub. H.B. 49 of the 132nd General Assembly. The ORSC disapproved of permitting the SERS Board to provide a COLA above CPI.

Ad Hoc Report on Disability Experience of Law Enforcement/Report Standardization Project

In November of 2012, Representative Schuring requested that ORSC staff provide an accounting of the disability experience of the law enforcement divisions, with recommendations to improve its functionality. ORSC staff issued a report in November 2014. The ORSC took no action on the report, but did ask staff to suggest a process to standardize all reports provided by the retirement systems to the Council. At its December 11, 2014, meeting, the ORSC modified then accepted a staff plan to standardize a number of reports. ORSC staff have completed the standardization of four reports (the Iran/Sudan Divestiture Report, Internal Audit Report, Budget Report, and Annual Health Care Report) and are continuing the standardization project. The final report to be standardized is the Annual Disability Report.

Actuarial Funding of Pension Benefits

There are generally three sources of revenue for the public retirement systems to fund, on an actuarial basis, their defined benefit plans: (1) employee contributions; (2) employer contributions; and (3) investment earnings. Investment earnings are typically the largest source of revenue for the five public retirement systems, funding up to 75% of the benefits paid. Therefore, the experience of a retirement system meeting its actuarial interest rate is essential to funding promised benefits. The actuarial interest rate is the rate of return the retirement system uses in anticipating sufficient funding levels in the future. Two points of data reviewed by ORSC staff are the experience of the systems in meeting their rate over a 10-year period and the statutorily required analysis of the adequacy of contribution rates for OP&F.

10-year actuarial interest rates The most recent semi-annual investment review required by law as of June 30, 2018, indicated that over the trailing ten-year period, no fund has achieved their actuarial interest rate. Net of fees, PERS returned 6.65% (vs. 7.50% actuarial rate), PERS-HC 5.93% (vs. 6.50%), STRS 6.91% (vs. 7.45%), OP&F 7.08% (vs. 8.00%), SERS 6.00% (vs. 7.50%), and HPRS 6.04% (vs. 7.75%). During the same period, PERS and OP&F exceeded their fund benchmarks. STRS, SERS, and HPRS trailed their fund benchmarks.

It is important to note that while no system has met their actuarial rate, they are able to pay off all accrued benefits over a 30-year period, or less, as required by law. The success of a system in meeting its long term actuarial interest rate is one of the most closely monitored data points by the Council, but it is not the sole determining factor of adequate pension funding. Even so, the failure to meet the actuarial rate is of concern and was

analyzed by PERS, HPRS, and SERS during their 5-year experience review study occurring in 2016 and STRS and OP&F in their 2017 5-year review. As a result of this statutorily required review, all systems reduced their assumed actuarial rate of return. PERS reduced their rate to 7.50%, and further reduced it to 7.20% in 2018 (from 8.00%), SERS reduced to 7.50% (from 7.75%), STRS reduced to 7.45% (from 7.75%), OP&F reduced to 8.00% (from 8.25%), and HPRS reduced their rate to 7.75% (from 8.00%).

Adequacy of OP&F contribution rates The ORSC is required to conduct an annual study on the adequacy of contribution rates of OP&F.⁹ The 2015 study was reviewed at the October 12, 2017, ORSC meeting. In that report, PTA/KMS concurred that OP&F was within the statutory 30-year period. The report did note that this was in part possible as very little funding is being made for any health care expenses, potentially jeopardizing the solvency of the health care fund. They also noted that, with future actuarial changes and negative 2015 returns being included, the 30-year period may not be met in the future and that further modifications may be necessary.

Cost and Funding of Retiree Health Care Benefits

All of the retirement systems face significant challenges controlling health care costs while maintaining meaningful coverage. The significant investment losses experienced from March 2000 to March 2003 as well as during the recession of 2008-2009 have exacerbated the health care funding problem since the retirement systems must first fund guaranteed pension benefits, which has required a reduction in the amount allocated to discretionary retiree health care benefits. The early retirement ages for many public employees create an additional challenge for each retirement system's health care program.

Restructured OP&F Health Care Plan

In the spring of 2017, the OP&F Board decided to restructure the retiree health care plan, ending their group-sponsored model. A new model was implemented in January 2019 and provides a fixed monthly stipend to pay for health care. OP&F has stated that this change will extend the solvency of the health care plan from 10 years to 15 years.

Remove 13th Check Authority in STRS

R.C. 3307.671 permits the STRS Board to provide a supplemental benefit to retirees. This has often been referred to as the "13th check." The repeal of this section was initially advocated in 1996 under the "Joint Legislative Committee to Study Ohio's Public Retirement Plans"¹⁰ and ORSC staff continue to support its immediate removal from the Ohio Revised Code.

STRS does not currently provide this supplemental benefit.

⁹ R.C. 742.311.

¹⁰ 1996 Joint Legislative Committee to Study Ohio's Public Retirement Plans, chaired by Sen. Cooper Snyder and Rep. Dale Van Vyven.

Update Past Studies Relative to Disparity of Employer Rates in OP&F

Employer contribution rates for police and fire fighters are established in statute. Police employers are required to contribute an amount equal to 19.50% of salary, while fire fighter employers are required to contribute 24%. In its annual study on the adequacy of contribution rates, ORSC's previous actuary, Milliman, recommended a blending and equalizing of those rates at a weighted average of 21.5%.¹¹ Their position was that without equalizing the rates fire fighters are in part subsidizing the benefits of police officers. Previous funding plans proposed by OP&F have also proposed equalizing the rates. At its September 2012 meeting, Rep. Schuring requested that the ORSC provide an update on this policy issue.

PTA/KMS reviewed the allocation rates in its 2015 annual adequacy report and concurred that it could be argued that firefighter employers are paying a larger share of the unfunded liability than are police employers. PTA/KMS did not propose a blended rate.

Reemployment Provisions

There continues to be legislative interest in the re-employment provisions of the five public retirement systems that allow members who have been retired to return to public employment while continuing to receive their pension. Recommendations have varied depending on if the re-employment resulted from a "*retired-rehired*" process, in which the member retired and then was rehired in the exact same position, versus so-called "*double-dipping*," where the member retires and returns to employment in a new capacity (for instance, a teacher retiring to become a state legislator). In the past, the Council has recommended that the re-employment provisions be standardized and more robust penalties be issued for "*retired-rehired*" situations, rather than establishing a uniform prohibition of re-employment.

Mandatory Social Security

The State of Ohio has a long and successful record of opposing mandatory Social Security coverage for its public employees. This issue continues to resurface in the context of various Social Security reform proposals as a means of generating additional revenues for Social Security. The General Assembly has consistently opposed efforts to require Social Security participation.

Purchase of Service Credit

Pursuant to the ORSC's request, Milliman completed a report on the cost of purchasing service credit in 2007. The report noted that with regard to health care benefits, if they are reduced in the future, some of the additional health liabilities could be eliminated. Additionally, if service purchases did not count toward eligibility or amount of health care benefits, then the additional health care liabilities would be eliminated. The report revealed that the retirement systems subsidized the purchase of credit in nearly every case in 2005.

¹¹ Milliman USA letter to ORSC dated June 6, 2002.

Pension reform has largely eliminated this subsidization. Any additional purchases requiring subsidization that were inadvertently excluded should be reviewed to determine if they should likewise be modified.

Independent Legal Counsel

The ORSC contracted with Independent Fiduciary Services to complete fiduciary audits of STRS and OP&F. These reports were completed in 2006. One of the recommendations was that Ohio law should be amended to authorize the retirement systems' boards to retain independent outside legal counsel without the prior approval of the State Attorney General. This recommendation has not been acted upon but was reaffirmed by the ORSC at its November 2014 meeting.

Custodian

Another recommendation from the 2006 fiduciary audits of STRS and OP&F that has not been acted upon was that the applicable Ohio statutes should be amended to grant authority to select, contract with, manage, and terminate the financial institution(s) that will provide master custody services to the retirement systems, which are subject to the oversight jurisdiction of the ORSC. ORSC reaffirmed this position at its November 2014 meeting.

Subsequent to the reaffirmation of this position, an additional consultant, Funston, in its 2017 fiduciary audit of SERS, found that the model used in Ohio results in higher costs and complexity for SERS custodial services and recommended that SERS be provided authority to contract directly with a single global custodial bank.

Review of Policy Framework for Pensions

During its 2012 review, PTA/KMS stated that "a well-defined public policy acts as a standard against which any proposal can be fairly analyzed." They found that the current ORSC policy statement appeared to be dated, incomplete, and on occasion inconsistent with current practices and provisions. From existing files, it appears the ORSC "Principles Governing Pensions" has not been amended since its adoption in 1978.

PTA/KMS recommended that the ORSC consider updating this policy framework. This recommendation has not been acted upon but was reaffirmed by the ORSC at its November 2014 meeting.

Implement a Declining 30-year Funding Policy

PTA/KMS recommended in its 2012 review that the 30-year funding policy be modified to provide that it is an absolute funding limit rather than a minimum standard. They recommended a removal of the 30-year funding period as an objective in favor of the establishment of a declining 30-year period that aims for a funding period of 15-20 years.¹²

At its February 2015 meeting, the STRS Board adopted a closed 30-year funding period beginning July 1, 2015 (meaning that in 30 years, STRS liabilities would be fully

¹² Forna, Bournival, and Schrader, 36.

funded). The SERS funding policy has advocated for a closed 30-year funding period since 1998. PERS, OP&F, and HPRS do not have a closed 30-year funding policy.

DOCUMENTS STATUTORILY REQUIRED OF THE RETIREMENT SYSTEMS
THE 132nd GENERAL ASSEMBLY
JANUARY 1, 2018 - DECEMBER 31, 2018

The retirement systems are required by statute to submit various documents to the ORSC to assist the Council in its evaluation of the systems. The following is a listing of each report the retirement systems are required to submit to the ORSC along with a very brief summary of the contents of the report. Copies of completed reports can be obtained at the ORSC office and the ORSC website (orsc.org).

Annual Actuarial Valuation (R.C. 145.22(A), 742.14(A), 3307.51(A), 3309.21(A), 5505.12(A))

This annual report is an actuarial valuation of the pension assets, liabilities, and funding requirements of the retirement systems. With the exception of OP&F which requires triennial valuations, the actuarial valuation must be submitted annually to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued.

Annual Report on Health Care (R.C. 145.22(E), 742.14(E), 3307.51(E), 3309.21(E), 5505.12(E))

This report provides a full accounting of the revenues and costs relating to health care benefits. The report on health care must be submitted annually to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued.

Quinquennial Evaluation (R.C. 145.22(B), 742.14(C), 3307.51(B), 3309.21(B), 5505.12(B))

This report must be completed at least once every five years. It is an actuarial investigation of the mortality, service, and other experience of the members, retirees, contributors, and beneficiaries of the system to update the actuarial assumptions used in the actuarial valuation. The quinquennial evaluation must be submitted to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation.

No reviews were required in 2018.

Annual Report on Disability Experience (R.C. 145.351, 742.381, 3307.513, 3309.391, 5505.181)

The report details the preceding fiscal year of the disability retirement experience of each employer. The report must specify the total number of disability applications submitted, the status of each application as of the last day of the fiscal year, total applications granted or denied, and the percentage of disability benefit recipients to the total number of the employer's employees who are members of the respective retirement system. The report on the disability experience must be submitted to the Governor, the ORSC, and the chairpersons of the standing committees and subcommittees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued.

30-Year Funding Period (R.C. 145.221, 742.16, 3307.512, 3309.211, 5505.121)

This report is required if the system's funding period exceeds 30 years. The report must include a plan approved by the board that indicates how the board will reduce the amortization period of unfunded actuarial accrued liability to not more than 30 years. The report on the 30-year funding period must be submitted to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation not later than 90 days after the retirement system board receives the actuarial valuation in which the funding period exceeds 30 years. No 30-year plans were required in 2018.

Actuarial Analysis of Legislation (R.C. 145.22(D), 742.14(D), 3307.51(D), 3309.21(D), 5505.12(D))

These reports are required when any introduced legislation is expected to have a measurable financial impact on the retirement system. The actuarial analysis must be submitted to the ORSC, the Legislative Service Commission, and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation within sixty days from the date of introduction of the legislation. Actuarial analyses were completed for H.B. 362 (making changes to HPRS law) and for the general COLA changes in SERS (H.B. 242, S.B. 151, and H.B. 49)

Budgets (R.C. 145.092, 742.102, 3307.041, 3309.041, 5505.062)

Each retirement system is required to submit to the ORSC its proposed operating budget, along with the administrative budget for the board, for the next immediate fiscal year at least 60 days before adoption of the budget. The budgets were timely submitted.

Audit Committee Report (R.C. 145.095, 742.105, 3307.044, 3309.044, 5505.111)

Each retirement system is required annually to submit to the ORSC a report of the actions taken by its Audit Committee. These reports were timely issued.

Rules

The systems are required to submit to the ORSC a copy of the full text, rule summary, and fiscal analysis of each rule they file with the Joint Committee on Agency Rule Review pursuant to R.C. 111.15. The systems rules were reviewed in 2018 and any concerns were resolved through ORSC meetings.

Divestment of Assets in Iran and Sudan

Section 707.20 of H.B. 562 of the 127th General Assembly required OP&F to establish a policy for the identification of businesses in which the fund has direct or indirect holdings that are engaged in scrutinized activities in Iran or Sudan and a policy to divest those holdings. OP&F has continued to report on those efforts and, as of January 2018, had reduced the market value of those holdings by 99.68%. The other retirement systems have also developed a policy of divestiture of holdings of companies conducting business in Iran and Sudan and have continued to decrease those holdings.

DOCUMENTS STATUTORILY REQUIRED OF THE ORSC
THE 132nd GENERAL ASSEMBLY
JANUARY 1, 2018 - DECEMBER 31, 2018

The ORSC is required by statute to issue various reports. The following is a listing of each report that ORSC is required to complete along with a very brief summary of the contents of the report. Copies of completed reports can be obtained at the ORSC office or the ORSC website (orsc.org).

Investment Performance (R.C. 171.04(D))

The ORSC is required to semiannually review the policies, objectives, and criteria of the retirement systems' investment programs, including a review of asset allocation targets and ranges, risk factors, asset class benchmarks, time horizons, total return objectives, relative volatility, and performance evaluation guidelines. **ORSC's consultant provided these reviews to ORSC staff.**

10-Year Actuarial Review (R.C. 171.04(E))

The ORSC is required, at least once every 10 years, to complete an actuarial review of the actuarial valuation and quinquennial actuarial investigation of the retirement systems, including a review of the actuarial assumptions and methods, the data underlying the valuations and investigations, and the adequacy of each system's employee and employer contribution rates to amortize its unfunded liability.

No actuarial reports were due in 2018.

10-Year Fiduciary Performance Audit (R.C. 171.04(F))

The ORSC is required, at least once every 10 years, to complete a fiduciary performance audit of each retirement system. **The 10-year fiduciary audit of PERS was begun in 2018.**

Annual Review of OP&F Contribution Rates (R.C. 742.311)

The ORSC is required, annually, to review the adequacy of employer and employee contribution rates under OP&F and make recommendations on the proper financing of the benefits of the Fund. **The 2017 report is pending ORSC review.**

ORSC Annual Budget (R.C. 171.05)

The ORSC is required, annually, to submit a budget of its expenses. **The ORSC budget was submitted and approved in June of 2018.**

ORSC Annual Report (R.C. 171.04)

The ORSC is required, annually, to submit a report on its evaluation and recommendations regarding the state retirement systems. **The 2017 report was submitted in March 2018.**

STATUS OF PENSION LEGISLATION
THE 132nd GENERAL ASSEMBLY
JANUARY 1, 2017 - DECEMBER 31, 2018

HOUSE BILLS

| <u>H. Bill</u> | <u>H. Int.</u> | <u>Actuarial Received</u> | <u>Subject, Sponsor, and System</u> | <u>ORSC Pos.</u> | <u>H. Cmt</u> | <u>Reported Out - Floor Vote</u> | <u>Sen. Int.</u> | <u>Sen. Cmt</u> | <u>Reported Out - Floor Vote</u> | <u>Conf Cmt</u> | <u>Con.</u> | <u>Eff Date</u> |
|----------------|----------------|---------------------------|--|------------------|---------------|----------------------------------|------------------|-----------------|----------------------------------|-----------------|-------------|-----------------|
| HB 49 | 2/8/17 | | Operating Budget | | FIN | 5/2/17 | 5/3/17 | FIN | 6/21/17 | 6/21/17 | 6/28/17 | 6/29/17 |
| HB 161 | 3/28/17 | | Make safety service workers with PTSD eligible for workers' comp | | INS | | | | | | | |
| HB 242 | 5/25/17 | X | Permit SERS to grant reduced cost-of-living adjustments | AA | ALTC | X | X | X | X | X | X | X |
| HB 362 | 9/26/17 | | Revise State Highway Patrol Retirement System Law | AA | ALTC | 12/5/17 | 12/11/17 | INS | 1/30/18 | | | 5/11/18 |
| HB 413 | 11/9/2017 | | Regards PERS cost-of-living adjustments and service credit | | ALTC | | | | | | | |

SENATE BILLS

| <u>S. Bill</u> | <u>S. Int.</u> | <u>Actuarial Received</u> | <u>Subject, Sponsor, and System</u> | <u>ORSC Pos</u> | <u>S. Cmt</u> | <u>Reported Out – Floor Vote</u> | <u>H. Int.</u> | <u>H. Cmt</u> | <u>Reported Out – Floor Vote</u> | <u>Con. Cmt.</u> | <u>Con</u> | <u>Eff Date</u> |
|----------------|----------------|---------------------------|--|-----------------|---------------|----------------------------------|----------------|---------------|----------------------------------|------------------|------------|-----------------|
| SB 8 | 1/31/17 | | To revise eligibility for School Employees Retirement System pension and benefit recipients' annual cost-of-living adjustments | | ED | 5/17/17 | 5/18/17 | ECR | 7/6/17 | 9/26/17 | 11/29/17 | 3/23/18 |
| SB 118 | 3/23/17 | | Make safety service workers with PTSD eligible for workers' comp | | INS | | | | | | | |
| SB 144 | 5/3/17 | | To restore staggered terms of office for the employee members | | GOV | 9/27/17 | 10/2/17 | SL | 2/14/18 | 2/20/18 | 2/20/18 | 5/30/18 |

| HOUSE COMMITTEES | SENATE COMMITTEES | LEGISLATIVE ACTION |
|------------------|--|----------------------------|
| ALTC | Aging & Long Term Care | A Amended |
| ARD | Agriculture & Rural Development | S Substitute |
| AVH | Armed Services, Vet Affairs, & Homeland Security | P Postponed Indefinitely |
| CIJ | Civil Justice | R Rereferred |
| EDCL | Economic Development, Commerce, & Labor | V Vetoed |
| CFA | Community & Family Advancement | E Emergency |
| CRJ | Criminal Justice | CR Concurrence Refused |
| ECR | Education & Career Readiness | |
| ENR | Energy & Natural Resources | |
| FIR | Federalism & Interstate Relations | |
| FIHU | Financial Institutions, Housing, & Urban Development | |
| D | Finance | |
| FIN | Government Accountability & Oversight | |
| GAO | Health | |
| HEA | Higher Ed & Workforce | A Approved |
| HEW | Development | D Disapproved |
| D | Insurance | AA Approved with Amendment |
| INS | Public Utilities | AD Action Deferred |
| PU | Rules & Reference | N/A No Action Required |
| RR | State & Local | |
| SL | Transportation & Public Safety | |
| TPS | Ways & Means | |
| WM | | |