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Analysis

Sub. S.B. 134 - Sen. Blessing
(As Enacted)

July 23, 2002

ORSC Position

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Sub. S.B. 134 provides for the establishment of a deferred retirement option plan (DROP) under the Ohio Police and Fire Pension Fund (OP&F).[1] Details of the DROP follow.

The act requires the OP&F board to establish and administer a DROP and, in establishing and administering the DROP, to meet all of the federal tax qualification requirements applicable to governmental plans. The board shall adopt rules to implement the DROP, and shall specify the initial implementation date of the DROP. The rules may also specify a period during which members may rescind their election to participate in the DROP.

Participation in the DROP is limited to members who meet the minimum age 48 and twenty-five years of service requirement for normal service retirement under existing law. These members may elect to participate in the DROP by completing and submitting a form provided by OP&F. The election shall be irrevocable from the date the form is received by OP&F to the date employment is terminated, unless rescinded as permitted by board rule. The election shall become effective on the first day of the employer's first payroll period immediately following receipt of the form by OP&F. At the time of election, the member shall **not** be required to specify the number of years the member will participate in the DROP, **but** must agree to terminate employment and begin receiving the member's normal service retirement benefit not later than eight years after the effective date of the election or be subject to forfeiture of the member's DROP account.

While participating in the DROP, the member shall **not** accrue any additional service credit in OP&F or be eligible for health insurance coverage provided by OP&F. The member shall continue to make the same contributions as under existing law (10.00%); the employer shall continue to make the same contributions as under existing law (19.50% - police, 24.00% -fire). The member's DROP account shall accrue the following amounts:

- The member's monthly retirement allowance calculated on the member's service credit and average annual salary (excluding terminal pay) prior to the effective date of the member's election to participate in the DROP;

- Annual cost-of-living allowances (COLAs) granted by OP&F;

- 50% of the employee contributions made during the first two years of participation in the DROP; 75% of the employee contributions made during the third year; and 100% of the employee contributions made during the fourth and succeeding years; and

- Annual compound interest on the above amounts at a rate determined by board rule.

(The balance of the employee contributions made, but not accrued, to the member's DROP account during the first three years shall be credited to the Police Officers' Contribution Fund or Firefighters' Contribution Fund, as appropriate; all employer contributions made on behalf of DROP participants shall be credited to the Police Officer Employers' Contribution Fund or Firefighter Employers' Contribution Fund, as appropriate.)

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[1]Generally, participation in a DROP is limited to members who are otherwise eligible for normal service retirement. The member continues to be employed for some defined period during which the member's monthly service retirement benefit is credited to the member's DROP account, along with annual compound interest at some specified rate. Upon termination of employment, the member receives a lump sum distribution of the member's DROP account or some alternative distribution thereof, and begins receiving a monthly service retirement benefit based on the member's final average salary and service credit calculated at the time the member elects participation in the DROP.

The member's participation in the DROP shall terminate upon the earliest of the following occurrences:

- Termination of employment;
- Last day of the eight-year period;
- Acceptance of a disability award; or
- Death.

If the member terminates employment on or after the first day of the fourth year after the effective date of the member's election, the member shall be entitled to the entire accrued benefit in the member's DROP account, including annual compound interest. If the member terminates employment prior to the first day of the fourth year after the effective date of the member's election, the member shall be entitled to the accrued benefit in the member's DROP account, excluding annual compound interest. The member shall select one of the following methods of distribution:

- Single lump sum payment; or
- Periodic payments as determined by board rule. (The act allows members who select periodic payments to change their selection at least once during each calendar year.)

Distributions of the accrued benefit in the member's DROP account shall not commence prior to the first day of the fourth year after the effective date of the member's election.

The member's retirement allowance based on his or her years of service and average annual salary prior to participation in the DROP shall commence on the first day of the second month after the member ceases to participate in the DROP. (The member shall also select a plan of payment at that time, unless the member selected a payment plan at the time of the member's DROP election.)

Should the member fail to terminate employment at the end of the eighth year after the effective date of the member's election to participate in the DROP, the member shall forfeit the accrued benefit in the member's DROP account, be granted service credit for the period the member was participating in the DROP, and have the retirement allowance calculated as though the member had never made the election.

Should the member accept a disability award while participating in the DROP, the member shall forfeit the accrued benefit in the member's DROP account, be granted service credit for the period the member was participating in the DROP, and have the disability award calculated as though the member had never made the election.

Should the member die while participating in the DROP, the accrued benefit in the member's DROP account shall be paid to the surviving spouse or, if none, the member's designated beneficiary or, if none, the member's estate. The surviving spouse or designated beneficiary may choose either a single lump sum payment or periodic payments as described above. Any amounts payable to the member's estate shall be made in a lump sum payment. The surviving spouse is eligible for the 50% Joint and Survivor Annuity and the flat monthly survivor benefit payable under existing OP&F law. If eligible, the surviving child(ren) or dependent parent(s) may receive the flat monthly survivor benefits payable under existing OP&F law. (If the member dies in the line of duty, the surviving spouse, children and dependent parents of the deceased member qualify for monthly survivor benefits payable under the Ohio Public Safety Officers Death Benefit Fund.) The effective date of the survivor benefits described above shall be the first day of the month after the member's death.

The act requires an actuarial investigation of the DROP at least once every five years to determine whether the DROP, as established or modified, has a negative financial impact upon OP&F and, if so, make recommendations to eliminate any negative financial impact. If the actuarial investigation indicates that the DROP has a negative financial impact, the OP&F board may modify the DROP or cease to allow future members from electing to participate in the DROP. The rights and obligation of members who elected to participate in the DROP shall not be altered by any board action. As amended by the Senate Ways & Means Committee, the police and fire employer contribution rates shall not be increased as a result of any negative fiscal impact resulting from the DROP upon OP&F. The actuarial investigation required under the act may be included as part of the quinquennial experience study of OP&F required under existing law. If not so included, the actuarial investigation shall be submitted separately to the Ohio Retirement Study Council and the standing committees of house and senate with primary responsibility for retirement legislation not later than the first day of November following the last fiscal year in which the investigation covers.

Staff Comments

DROPs have recently gained widespread recognition in the public sector. DROPs were introduced in Louisiana in the early 1980s and spread rapidly throughout the South among municipal police and firefighter pension funds. In recent years, DROPs have become popular in all parts of the country and among all branches of government service. Four statewide pension funds include DROPs, including the teacher and general employee retirement systems in Louisiana and Texas, and others are considering them.

As part of the report of the Joint Legislative Committee to Study Ohio's Public Retirement Plans dated December 11, 1996, one of the recommendations included therein, but not acted upon by the legislature, was to increase the normal retirement age in both the uniform and non-uniform retirement systems. This recommendation was made in response to the continual improvements in life expectancies experienced among the memberships of all five retirement systems in Ohio which directly increase each retirement system's benefit costs, including post-retirement health care costs. Since then, the legislature has enacted S.B. 190 (eff. 7/13/00) upon the favorable recommendation of the ORSC which, among other things, provides a financial incentive for teachers to work beyond normal service retirement (30 years at any age); that is, STRS members who remain teaching for 35 years receive an annual retirement allowance of 88.5% of their final average salary as opposed to 66% after 30 years. This incentive is designed to help retain experienced teachers during the current and near future teacher shortage and to help control rising health care costs in STRS.

The DROP proposed under S.B. 134 would provide a similar financial incentive for police officers and firefighters to work beyond normal service retirement (25 years at age 48) by offering them the opportunity to receive a lump sum distribution not otherwise available upon retirement. Similarly, the DROP could help not only employers smooth the transition of experienced employees and their replacements but also OP&F save on post-retirement health care costs. The concept of the DROP is generally consistent with the objective of the above-referenced recommendation to get members to work beyond the current normal service retirement requirements.

The act grants only the OP&F board the authority to establish a DROP. This necessarily raises a public policy issue of whether the other four retirement systems should be granted similar authority to adopt DROPs for their respective memberships. Based upon the experience in other states that have established DROPs for their police officers and firefighters, there will likely be considerable interest from other groups of public employees to have the opportunity to participate in a DROP.

Fiscal Impact

The ORSC actuary, Milliman USA, reviewed the bill and found that S.B. 134 would be affordable in the sense that it would satisfy the 30-year funding requirements of S.B. 82 based on the actuarial assumptions utilized by Watson Wyatt if 0.25% to 0.50% of the employer contribution rate were allocated from health care to pensions. If actual experience is favorable, offering a DPOP could assist OP&F in managing the health care program within current contribution limitations. Additionally, if actual experience is unfavorable, the Board will have the flexibility to modify or cease offering the DROP.

ORSC Position
At its meeting of October 10, 2001 the Ohio Retirement Study Council voted to recommend that the 124th Ohio General Assembly approve S.B. 134 upon the adoption of the following amendments:

- That the actuarial investigation of the DROP be submitted to the ORSC not later than the first day of November following the last year of the period covered by the investigation;

- That the surviving spouse receive the greater of the 50% joint survivor annuity or the plan of payment elected by the member at the time the member elects to participate in the DROP should the member die while participating in the DROP;

- That the words “the effective date of” be inserted in line 711 after the first “to”.

All of the above amendments have been incorporated in the act.

Effective Date
July 23, 2002