THE GENERAL ASSEMBLY OF
THE STATE OF OHIO

JOINT LEGISLATIVE COMMITTEE TO STUDY OHIO'S PUBLIC RETIREMENT PLANS

Final Report: Findings, Staff Recommendations and JLC Action

December 11, 1996

STATE HOUSE COLUMBUS, OHIO 43215

TABLE OF CONTENTS

Joint Legislative Committee to Study Ohio's Public Retirement Plans

I. Introduction - On April 13, 1995, the Joint Legislative Committee to Study Ohio's Public Retirement Plans (JLC) was created by Ohio Senate President Stanley J. Aronoff and House Speaker Jo Ann Davidson to review the operations of Ohio's five statewide retirement systems.

The following members were appointed to serve on the committee:

Senators
- Cooper Snyder, Co-Chair (Resigned 3/31/96)
- Doug White, Co-chair (Appointed 4/30/96)
- Grace Drake
- Leigh Herington
- Jan Michael Long
- Richard Schafrath
- Gary Suhadolnik

Representatives
- Dale Van Vyven, Co-chair
- William Batchelder
- William Ogg
- Lynn Olman
- Frank Sawyer, Secretary
- Ray Sines

The Ohio Retirement Study Commission (ORSC) staff, along with designated members of the Legislative Service Commission and the offices of the co-chairmen, provided the necessary support for the JLC to carry out this review.

The information in this report is based on the testimony provided to the JLC in 1995.

II. General Scope of Review - The purpose of the JLC is to review the laws and operations of the five state retirement systems and to determine whether any changes would be appropriate or desirable as a matter of public policy. The state retirement systems have combined assets of over $66 billion and provide retirement, disability and survivor coverage to nearly 1.2 million members, retirees and their beneficiaries. Comprehensive hospital, medical and prescription drug coverage is also provided by all five systems pursuant to their discretionary authority to make such coverage available to retirees and their dependents.

Each system is a creature of statute, and is therefore governed by the laws enacted by the state legislature. It follows that the legislature bears direct responsibility for the financial security and well-being of Ohio's public pension funds, and should regularly review its policies. The legislature represents not only the various employee benefit groups but also the taxpayers who are the ultimate guarantors of the retirement benefits promised by the legislature.

The JLC recognizes that the day-to-day administration and management of the systems are vested in the individual retirement boards, a majority of whose members are elected by the plan participants. In addition, each board includes designated statutory members such as the Auditor of State and Attorney General. The JLC also recognizes that each board's authority comes directly from the state legislature. Therefore, the JLC has a responsibility to both the plan participants and the taxpayers of Ohio to ensure that the level of benefits is equitable, the level of funding is adequate and the investment of funds is prudent. The fact that the state retirement systems are in place of Social Security makes this responsibility all the more important.

In recent reports prepared for the state legislature, the Ohio Retirement Study Commission (ORSC) has raised some specific concerns and made some specific recommendations relative to the state retirement systems. In 1991, the ORSC warned of the growing imbalance between the systems' health care costs and health care revenues which, if left unchecked, could jeopardize the actuarial funding of basic pension benefits. The ORSC recommended, among other things, that the systems negotiate on a collective basis with providers to establish managed care programs, and that the systems segregate pension reserves from health care funds. Recently, managed care programs have been established in all five systems as an integral part of their overall cost containment efforts in the health care area.

In 1992, the ORSC's consulting actuary raised concerns regarding the adequacy of the police and fire contribution rates to support the benefits provided by the pension fund. Of particular concern was the pay-as-you-go financing of retiree health care benefits. Among the two key recommendations made by the ORSC were that no future legislation creating additional liabilities to the fund be enacted and that retiree health care costs be limited to 6.5% of payroll. The legislature has followed this advise, and has refrained from enacting any benefit improvements for police and fire in the last two legislative sessions. The fund has also instituted several cost containment initiatives in an effort to keep health insurance costs under 6.5% of payroll.

In 1993, the ORSC focused attention on the important role that investment earnings play in the overall funding of benefit costs in each system. The ORSC favorably recommended passage of legislation which expanded the investment authority of all five systems. The legislation, which authorized the systems to invest up to 50% of their assets in domestic equities and up to 10% in foreign stocks and bonds, marked the first major revisions in the systems' investment authority in more than a decade.

In 1994, the ORSC's actuary continued to raise concerns regarding the adequacy of the police and fire contribution rates. The actuary based such concerns on the fact that more members were retiring at age 48 than assumed; more members were going out on disability retirement than assumed; and both healthy and disabled retirees were living longer than assumed. The actuary also cited the fact that demographic pressures alone would make it difficult to contain retiree health care costs as an additional basis for concern. The ORSC recommended, above all else, that a study into the causes of the high rates of disability among both police and firefighters be made to determine if any changes in the statutory provisions and/or administrative procedures would be appropriate.

Based on the above-mentioned concerns and as a matter of good public policy, the JLC was created to conduct a comprehensive review of the laws and operations of all five systems not only for the financial security of Ohio's public employees but also for the financial interests of Ohio's taxpayers. In this regard, the JLC focused its review of each system on the following major areas:

- disability statutes, procedures and experience;
- cost and funding of retiree health care benefits;
- retirement eligibility and benefit provisions, including early retirement;
- investment authority and performance, including derivatives;
- level of contributions in relation to level of benefits provided.

III. <u>Sub-Committee to Select a Disability Consultant</u> - At the JLC meeting of May 11, 1995 Co-chair Dale Van Vyven appointed the following members to the Sub-Committee to Select a Disability Consultant: Senator Richard Schafrath, Chair; Representative William Batchelder; and Representative Frank Sawyer.

The Sub-Committee met on May 23, 1995 and, after reviewing three written proposals, recommended unanimously that the JLC select William M. Mercer, Inc., to do a study into the causes of the high rates of disability among police and firefighters. The JLC accepted this recommendation at its meeting of June 1, 1995.

The disability study was strongly recommended by the ORSC in its legislative report of December 1994 relative to the adequacy of the police and fire contribution rates. That report found that during the period 1987-91, disabilities comprised 41% of all police retirements and 35% of all firefighter retirements, compared to 35% and 25%, respectively, during the preceding five-year period 1982-86. Though lower than the 1987-91 disability experience, the number of disabilities for police and firefighters in 1992 and 1993 remained higher than the number assumed by the PFDPF actuary.

The disability study was intended to cover the following major items:

- Review the current *structure* of the PFDPF disability program, including statutes, rules, plan design features, and other sources of benefits such as Workers' Compensation;

- Review the current *procedures* for evaluating and monitoring disability claims, including application process, medical review requirements, benefit levels, approval rates, appeal process, case management, etc.

• Collect and analyze data to identify *cost factors*, including disability incidence rates, permanent and total versus partial disability experience, police versus firefighter disability experience, service versus disability retirement experience, demographic data, provider data, diagnosis information, presumptive heart, cardiovascular and respiratory disabilities, tax treatment of disability and service retirement benefits, etc.

• Compare PFDPF with *other public plans*, including disability standards, procedures and policies, claim experience, benefit levels, earnings limits, benefit offsets, etc.

• Audit a *random sample* of individual claim files to test for compliance with the statutory and administrative rules governing disability retirement;

• Prepare a concise, comprehensible *written report* of findings and recommendations, together with an oral presentation of such report to the JLC and ORSC.

A temporary law was enacted in H.B. 308 as an emergency measure on March 6, 1996, which enabled the JLC and its authorized agent, the William M. Mercer, Inc., to obtain otherwise confidential information to complete its review of the PFDPF disability retirement program. Specific language was included to protect the confidentiality of the information as well as the privacy of individuals by requiring names and addresses be deleted prior to release of such information and by exempting such information from public inspection. The Attorney General, as the legal advisor for the fund, indicated a need for this temporary law in order to protect the interests of the JLC, the plan participants, the plan administrators and the disability consultant.

The William M. Mercer, Inc. presented the disability study to the JLC on November 14, 1996. The executive summary of the major findings and recommendations of the study is provided in Section IX of this report.

At the request of the JLC, the PFDPF prepared a written response to the disability study which was presented on November 21, 1996. The PFDPF response is also provided in Section X of this report.

<u>IV. Brief Overview of Ohio's Public Pension Plans</u> - Ohio has five statewide retirement systems for public employees: the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Police and Firemen's Disability and Pension Fund (PFDPF) and the Highway Patrol Retirement System (HPRS). The Cincinnati Retirement System is the only municipal retirement system in Ohio, and falls outside the legislative oversight jurisdiction of the ORSC. These public pension plans are in lieu of Social Security coverage.

Over 651,000 active employees are covered by the five statewide retirement systems, plus 283,000 inactive members who are not currently contributing but have not withdrawn their contributions. In addition to the active and inactive members of the retirement systems, over 263,000 individuals receive benefits for age and service retirement, disability or survivorship. Comprehensive health care coverage is also provided by the systems for retirees and their dependents. Altogether the five systems provide coverage to nearly 1.2 million active, inactive and retired members.

System	Active Members	Inactive Members	Beneficiaries
PERS	358,149	110,745	114,342
STRS	167,770	115,742	77,405
SERS	99, 918	56,819	51,479
PFDPF	24, 191	90	19,061
HPRS	1,465	12	777
Total	527,507	283,408	263,064

The assets of the five retirement funds exceed $66 billion. The annual income of these funds totals nearly $6.7 billion. Benefits and other expenses payable annually exceeds $3.7 billion.

Dollars in Millions			
System	Assets	Annual Income	Annual Expenses
SERS	$30,325.9	$1,611.3	$1,462.7
STRS	$27,267.8	$3,730.9	$1,460.8
SERS	$3,575.9	$647.1	$365.8
PFDPF	$4,830.3	$610.3	$407.8
HPRS	$364.8	$84.1	$15.7
Total	$66,364.7	$6,683.7	$3,712.8

• *Creation* - The oldest of these funds is STRS which was created in 1920 for teachers in the public schools, colleges and universities. PERS was created in 1935 for state employees, with local government employees added in 1938. SERS was created in 1937 for non-teaching employees of the various local school boards. HPRS was created in 1941 by the withdrawal of all state troopers from PERS. PFDPF was created in 1967 after the abolition of 454 local police and fire relief and pension funds. A special retirement program administered by PERS, and hereinafter referred to as the PERS-LE program, was created in 1975 for certain law enforcement officers, including sheriffs, deputy sheriffs, township police officers and various others.

• *Governing Boards* - Each retirement system is governed by an independent board composed of seven to nine members.

The PERS board has nine members, as follows: the Auditor of State; the Attorney General; the Director of Administrative Services; one retired member elected by the service and disability retirees; and five members elected by the active employees from various areas of government, including one state employee, one municipal employee, one county employee, one non-teaching higher education employee, and one miscellaneous employee not otherwise represented.

STRS also has a nine-member board: the Auditor of State; the Attorney General; the Superintendent of Public Instruction; one retired member elected by the service retirees; and five members elected by the active membership, including disability retirees.

The SERS board consists of seven members: the Auditor of State; the Attorney General; one retired member elected by the service and disability retirees; and four members elected by the active membership.

The PFDPF board has nine members, as follows: the Auditor of State; the Attorney General; a municipal finance officer appointed by the Governor; five members elected by the active membership, including two police officers, two firefighters and one member which alternates between a police officer and a firefighter; and one alternating retired member elected to represent retirees and their survivors.

The HPRS board consists of seven members: the Auditor of State; the Superintendent of the State Highway Patrol; four members elected by the active membership; and one retired member elected by the service and disability retirees.

• *Service Retirement - Vesting* - A member's benefit in one of the non-uniformed employee retirement systems (PERS, STRS, SERS) is vested after five years of service. The normal retirement age at which there is no reduction in benefits is 65, or any age after 30 years of service. A member may retire on a reduced pension upon attaining age 60 with at least five years of service, or age 55 with 25 years of service.

A member's benefit in the uniformed employee retirement systems (PFDPF, HPRS) is vested after 15 years of service. A member with 15 years of service, who voluntarily resigns or is discharged for any reason other than dishonesty, cowardice, intemperate habits or conviction of a felony, may retire on a pension based on a lower benefit formula at age 48 in PFDPF, or age 55 in HPRS. Normal retirement is age 48 with 25 years of service or age 62 with 15 years of service in PFDPF, and age 48 with 25 years of service or age 52 with 20 years of service in HPRS. A member may also qualify for a reduced pension upon attaining age 48 with 20 years of service in HPRS.

• ***Age and Service Benefits*** - The formula for determining age and service benefits is generally 2.1% of final average salary times years of service in the non-uniformed employee systems, except that members with more than 30 years of contributing service receive 2.5% for each year over 30 in PERS and STRS. For example, members with 25 years of service receive 52.5% of their final average salary at age 65. The maximum benefit is 100% of final average salary in PERS and STRS, and 90% in SERS. The minimum benefit is $86 per year of service in all three non-uniformed employee systems. In lieu of the benefit based on the 2.1% formula, a member may receive a benefit based upon the money purchase value of the member's and employer's contribution, with interest. The member receives the benefit which provides the greater amount.

In the uniformed employee systems, the normal age and service benefit formula is 2.5% of final average salary for the first 20 years of service, plus 2% for the next five years of service, plus 1.5% for all service in excess of 25 years, up to a maximum of 72% of final average salary. For example, members with 25 years of service receive 60% of their final average salary at age 48. The benefit formula for members with 15 years of service, who voluntarily resign or are discharged, is 1.5% of final average salary times years of service. Neither of the uniformed employee systems offers a money purchase alternative.

Final average salary is based upon the average of the three highest years of compensation in all five systems.

• *Disability Benefits* - Members of the three non-uniformed employee systems are eligible for a disability pension after five years of service. Members of PFDPF become eligible for on-duty disability benefits immediately upon employment and off-duty disability benefits after five years of employment. Members of HPRS become eligible for both on-duty and off-duty disability benefits immediately upon being employed as a state trooper.

Members of the non-uniformed employee systems are covered under one of two disability programs, the original plan or the revised plan. Employees who were members on or before July 29, 1992 were given a one-time opportunity to select coverage under either one of these programs. Employees hired after July 29, 1992 are automatically covered under the revised plan. The revised plan was adopted in 1992 to comply with the federal Older Workers Benefit Protection Act which generally prohibits age discrimination in employee benefits.

Under the original plan, application for disability must be filed before age 60. The benefit is generally payable for life, and is based on the same formula as an age and service pension except that service is projected from the member's age at the time of application to age 60 and is added to the member's earned service credit. The minimum benefit is 30% of final average salary; the maximum, 75%.

Under the revised plan, application for disability may be filed at any age. The benefit is payable for a defined period of time depending upon the member's age at the effective date of the benefit. The benefit is the greater of 45% of final average salary, or the accrued benefit under the 2.1% age and service formula, up to a maximum of 60% of final average salary. When the disability benefit ends under the revised plan, the member may apply for a service retirement benefit. The benefit amount would be the greater of the following: 2.1% of final average salary times years of service, including years of service for the period of disability, up to a maximum of 45%; or the member's accrued benefit under the normal age and service formula, not including years of service for the period of disability.

In the uniformed employee systems, there are no age limits on applicants for a disability pension. In PFDPF, the permanent and total disability benefit equals 72% of the last year of earnings. Partial disability benefits are fixed by the retirement board, with a maximum of 60% of final average salary for members with less than 25 years of service. Members with at least 25 years of service receive a benefit based on the normal age and service formula, up to a maximum of 72% of final average salary.

In HPRS, members whose disability is incurred in the line of duty receive a pension of not less than 60% or more than 72% of final average salary. If the disability is not incurred in the line of duty, the benefit ranges from a minimum of 50% to a maximum of 72% of final average salary.

In 1994 the ORSC reported that during the 1987-91 quinquennial period, disabilities comprised 41% of all police retirements and 35% of all firefighter retirements in PFDPF. The ORSC recommended in its December, 1994 report to the General Assembly, Adequacy of Contribution Rates for the Police and Firemen's Disability and Pension Fund, that a study into the causes of the high rates of disability in PFDPF be undertaken to determine if changes in the statutory provisions and/or administrative procedures would be appropriate. The National Conference of State Legislatures (NCSL) also recommends in its revised report, Public Pensions: A Legislator's Guide, that state legislatures undertake a thorough evaluation of the effectiveness of disability programs for public employees.

• *Survivor Benefits* - The dependents of active members who die before retirement are eligible for monthly survivor benefits if the member had attained 18 months of service under PERS, STRS or SERS. Such coverage continues for 27 months after leaving employment, provided contributions are not withdrawn. Survivor benefits are payable to the dependents of police and firefighters and state troopers immediately upon membership in PFDPF and HPRS.

Under the non-uniformed employee systems, the allowance for the survivors of a member *not eligible to retire* is either a fixed dollar amount per dependent or a percent of the deceased member's final average salary, whichever is greater. Benefits to the surviving spouse of an active member terminate upon remarriage unless the surviving spouse remarries after attaining age 62. If the remarriage ends within two years due to death or divorce, the terminated benefit resumes.

The surviving spouse of an active member who was eligible to retire but continued to work receives an allowance computed as a monthly joint and survivor annuity, providing the actuarial equivalent of the member's single life annuity had the member actually retired prior to death.

However, the surviving spouse of a retired member does not automatically receive a benefit under the non-uniformed employee systems. The spouse receives a monthly benefit only if the retiree elects to receive an actuarially-reduced pension in order to provide for such spouse under one of several joint and survivor annuity options. The law has been recently changed to require a signed statement from the spouse acknowledging the retiree's election of any option that provides less than one-half of the retiree's pension to the spouse. Also, once a joint and survivor annuity option is elected, the law allows the retiree to change such option upon divorce only with the written consent of the spouse or pursuant to a court order.

The surviving beneficiary or estate of a retired member also receives a $500 death benefit in SERS, a $1,000 death benefit in STRS, and a death benefit ranging from $500 to $2,500 in PERS based on the amount of service credit at retirement. STRS members may buy an additional $1,000/$2,000 coverage.

Under the uniformed employee systems, the allowance for the survivors of a member *not eligible to retire* is a flat dollar amount per dependent. Benefits to the surviving spouse of an active member terminate upon remarriage regardless of age. However, if the remarriage ends within two years due to death or divorce, the terminated benefit resumes.

In PFDPF, the survivors of retired members receive the flat dollar amounts payable to the survivors of active members but, in addition, are eligible for any amount designated by the retiree under one of several joint and survivor annuity options. In HPRS, the surviving spouse of a retired member is eligible for either the flat dollar benefit payable to the spouse of an active member or 50 percent of the retiree's pension, whichever is greater. In addition, a recent change in the law allows retirees to elect one of several joint and survivor annuity options.

The surviving spouse or estate of all retired members in PFDPF or HPRS receives a $1,000 lump sum death benefit.

• ***Health Care Benefits*** - In 1974 the five state retirement boards were given broad discretionary authority to provide health care benefits to retirees and their dependents. Health care benefits are not a vested right and are subject to change at any time upon board action, including the level of coverage as well as the amount paid by those covered.

Since 1974 the five systems have provided a comprehensive hospital, medical and prescription drug plan. In 1977 the systems were required to reimburse benefit recipients for Medicare Part B (medical portion) premiums. Retirees not qualifying for Medicare Part A (hospital portion) are provided equivalent coverage under the systems' health care plans.

Controlling health care costs has been and continues to be a primary concern of each system. In 1991 the ORSC issued a report, The Costs and Funding of Health Care Benefits Provided by the Ohio Retirement Systems. Among the various concerns raised in that report is the risk of escalating retiree health care expenditures jeopardizing the actuarial funding of basic pension benefits as pension reserves become used to pay for health care benefits. By law, any costs borne by the systems are required to be financed out of the employer contribution rate. The report documents that higher employer contribution rates are required to finance health care costs, and that the systems have little or no flexibility to increase the employer rates because they are either fixed by statute or at or near the statutory maximum.

In response to this concern, the systems have implemented a variety of cost-containment measures, including a preferred retail pharmacy network; a managed care network for retirees and dependents without Medicare; case management; mail-order drug plan; premium charges for retirees and/or dependents; increased deductibles and co-pays; hospital admission charges; formularies; etc. Also, the Ohio General Assembly has enacted legislation capping the Medicare Part B reimbursement in SERS at $24.80 (1988), STRS at $29.90 (1991) and HPRS at $41.10 (1994); changing the requirement to qualify for health insurance from five years to ten years of service in PERS and SERS (1981); and authorizing the SERS employer surcharge on the salaries of members who earn less than an actuarially-determined amount to fund health care benefits.

The following table shows each system's annual health care expenses, health care reserves, employer health care rate, Medicare Part B reimbursement rate and retiree premium contribution. As the table indicates, the retirement systems differ in their retiree premium charges, Medicare Part B reimbursement rates, health care funding levels, health care reserves and annual health care expenses.

System	Health Care Expenses	Health Care Reserves	Employer Rates	Medicare Rate	Retiree Premium[2]
PERS	$327,578,426	$6,295,394,811	4.29% (State) 5.11% (Local) 5.89% (Law)	$46.10/mo.	$0.00/mo.
STRS [3]	$157,276,000	$829,600,000	2.00%	$29.90/mo.	$38-$50/mo. $48-$63/mo. $57-$75/mo. $67-$88/mo. $77-101/mo.
SERS[4]	$85,496,108	$141,000,000	6.01%	$24.80/mo.	$0.00/mo. $89.50/mo. $179.00/mo. $268.50/mo.
PFDPF[5]	$63,698,537	$184,565,586	6.5%	$46.10/mo.	$10.00/mo.
HPRS	$1,704,066	$58,680,971	5.5%	$41.10/mo.	$0.00/mo.

• *Post-Retirement Increases* - Benefits in all five systems are increased from time to time to supplement the value of the original benefit. In 1970 an annual cost-of-living allowance (COLA) was adopted for the retired members of the three non-uniformed employee systems. It now provides for an annual 3% increase to all benefit recipients on the rolls for at least one year, provided the average change in the Consumer Price Index (CPI) is at least 3% in the preceding year.

An annual COLA for retired members of HPRS was first adopted in 1981. Similar to the COLA provided by the non-uniformed employee systems, it provides for an annual 3% increase, provided the CPI increases by that amount. However, service and disability retirees must wait until age 57 to receive their first COLA, except that disability retirees may qualify after five years of retirement, regardless of age.

In 1986 an annual COLA was adopted for members of PFDPF retiring after July 24, 1986 and electing not to have any future pension calculated on the basis of terminal pay. Identical to the COLA for the non-uniformed employee systems, it provides for an annual 3% increase, provided the CPI increases by that amount.

In 1988 an annual COLA was adopted for members of PFDPF who retired before July 24, 1986 with an annual pension below a certain amount. The initial "cap" was $18,000 per year; this cap increases by $500 per year. In 1995, the cap is $21,500 per year. The annual COLA increase is a flat $360 under a single life annuity with proportional reductions for the various joint and survivor annuity options, provided the CPI increases by at least 3% in the preceding year.

PFDPF spouses and dependent children receiving statutory survivor benefits are the only beneficiaries among the five systems who are not eligible for an annual COLA.

Ad hoc post-retirement increases are also granted by the legislature from time to time in all five systems in an effort to offset at least partially the loss in the purchasing value of benefits during periods of high inflation.

The STRS board also has discretionary authority to grant an annual lump-sum supplemental benefit check (13th check) in December to those who have received benefits for the preceding 12 months. Funds are derived from prior-year investment earnings that exceed the actuarial funding requirements of the system.

• ***Early Retirement Incentive Plans*** - Early retirement incentive (ERI) plans are available to the employers covered under the three non-uniformed employee systems. The plans for STRS and SERS were authorized in 1983; the PERS plan was authorized in 1986. The ERI plans for all three systems are very similar. The plans are established at the option of the employer and participation is voluntary on the part of the employee. (PERS law, however, provides for the mandatory establishment of ERI plans in the case of certain closings and mass layoffs at state institutions.) The employer pays the total actuarial liability associated with the purchase of service credit. The employer may purchase up to five years of service credit or one-fifth of the employee's total service credit, whichever is less. The plans are designed to be non-discriminatory since the employer must offer the plan to at least five percent of the employees based on seniority.

Traditionally, public employers have adopted ERI plans to cut payroll costs and reduce work force as an alternative to layoffs during difficult budgetary and economic times. Apart from financial reasons, some employers have also used such plans to provide greater managerial flexibility in restructuring operations, making promotions and maintaining a balance in the age and composition of the work force (something that might not occur in seniority-based layoffs).

The ORSC concluded in its November 1994 report, Early Retirement Incentive Plans: "ERI plans vary from state to state. The law authorizing ERI plans in Ohio is a permanent part of the retirement statutes of PERS, STRS and SERS. The law maximizes "local control," allowing individual employers to offer such plans at their discretion and providing them some flexibility in the design of such plans to achieve their objectives. Most importantly from the perspective of the ORSC, the law protects the actuarial soundness of the state retirement systems by requiring the individual employer to pay the additional liability resulting from the incentive plan as determined by each system's actuary. In other words, the law precludes employers from shifting costs to the retirement systems."

• *Social Security* - Public employees in Ohio are not covered by Social Security, with very few exceptions. Generally, membership in one of the state retirement systems is mandatory for both full-time and part-time public employees, and is in place of Social Security coverage. Individuals receiving benefits from the state retirement systems may be subject to a partial or total offset of their Social Security pension which they have earned through other employment or which they qualify for through a spouse's employment.

• *Actuarial Funding* - Each of the five state retirement systems is funded on an actuarial reserve basis. This method requires the systems to accumulate funds during the active working years of their members which, at retirement, are sufficient to pay all retirement benefits, less interest accumulated during retirement. The law requires each retirement board to have a complete actuarial evaluation of all funds at least every five years, showing the value of present and future assets and liabilities, including any recommendations for the proper operations of the systems. More frequent valuations may be made at the discretion of the boards, and are presently done on an annual basis by all five systems.

The difference between the present value of all benefits credited to current participants and retired members and the value of the present assets is the unfunded accrued liability of a pension fund. Unfunded accrued liabilities are amortized over varying periods of time, as determined by the respective boards on the basis of the actuary's recommendation. Forty years is generally recommended as the maximum amortization period for the prudent management of a fund. The Government Accounting Standards Boards (GASB) has recently issued GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans," which, among other things, sets the target amortization period at 40 years with a ten-year transition to 30 years as the maximum acceptable period.

The following table shows each system's amortization period for unfunded pension liabilities as of the end of fiscal year 1994 (fiscal year 1995 for STRS and SERS):

Retirement System	Amortization Period
PERS	
State	21.0 Years
Local	28.0 Years
Law	13.0 Years
STRS	29.5 Years
SERS	35.0 Years
PFDPF	40.0 Years
HPRS	12.0 Years

Employee and employer contribution rates are certified annually by each actuary as sufficient to pay off the unfunded accrued liabilities and establish a sufficient reserve to cover the anticipated pensions of current active and inactive members who are vested.

Generally, the five state retirement systems have three sources of revenue to fund the level of benefits guaranteed by statute: member contributions, employer contributions, and investment earnings. Also, a very small portion of the financing comes from state general revenue fund appropriations for ad hoc post-retirement increases enacted by previous legislatures, which decreases each year as the closed population of benefit recipients continues to decline due to mortality.

Investment income has become the largest source of revenue for all five systems. Twenty years ago, approximately 25% of the systems' total revenues came from investment earnings; today, up to 65% of their total revenues come from investments.

The following table shows for each system the current employee contribution rate, the current statutory maximum for employee contributions, the current employer contribution rate and the current statutory maximum for employer contributions.

Retirement System	Current Employee Rate	Current Statutory Maximum	Current Employer Rate	Current Statutory Maximum
PERS				
• State	8.5%	10.0%	13.31%	14.00%
• Local	8.5%	10.0%	13.55%	14.00%
• Law	9.0%	No Maximum	16.70%	No Maximum
STRS	9.3%	10.0%	14.00%	14.00%
SERS[6]	9.0%	10.0%	14.00%	14.00%
PFDPF[7]				
• Police	10.0%	10.0%	19.50%	19.50%
• Fire	10.0%	10.0%	24.00%	24.00%
HPRS[8]	10.5%	10.5%	24.53%	31.50%

• ***Investment Authority*** - By law, the boards of the five state retirement systems are vested with the authority and fiduciary responsibility to invest the funds held in trust for the payment of retirement benefits to their members.

The law provides that with respect to the investment of such funds the boards shall discharge their duties solely in the interest of the participants and beneficiaries; for the exclusive purpose of providing benefits to the participants and beneficiaries and defraying reasonable expenses of administering the system; with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; and by diversifying the investments of the system so as to eliminate the risk of large losses, unless under the circumstances it is not prudent to do so. This standard, often referred to as the "prudent expert" rule because it calls for a special capacity beyond ordinary diligence, is similar to the standard set forth in the Employee Retirement Income Security Act (ERISA) which is applicable to most private pension plans.

In addition to the prudent expert standard, the law provides a "legal list" which further restricts the types and amounts of investments the boards may make. If an investment vehicle is not specifically authorized in the legal list, the systems are prohibited from investing in it, regardless of whether the investment would otherwise be prudent.

Legal lists are in need of constant revision in order to keep current with changing market opportunities. A growing number of states have abolished the legal lists and restricted their pension fund investments to prudent person investment authority.

The Treasurer of State is the custodian of all funds and credits the income earned on investments to the respective pension funds.

The investment authority of the five systems was last updated in 1993. Such authority was expanded to increase the systems' maximum equity exposure from 35 to 50% of total assets; allow the systems to invest up to 10% of total assets in foreign stocks and bonds; add American depositary receipts, commingled stock investment funds, real estate investment trusts and derivatives to the systems' legal lists; and modify certain restrictions relative to the systems' investments in corporate stocks, corporate and government bonds, commercial paper and real estate.

The following table shows the restrictions on asset allocation under the current legal lists.

Asset Class	Maximum Percent Limitation
US Stock	50% of Total Assets
Real Estate	25% of Total Assets
Canadian Bonds	15% of Total Assets
Venture Capital	5% of Total Assets
Foreign Securities	10% of Total Assets

V. Defined Benefit Plans v. Defined Contribution Plans - Defined benefit plans remain the predominant primary retirement plans among public employers. In 1990, defined benefit plans covered 90% of full-time state and local government employees.

Ohio is no exception. Ohio sponsors five statewide retirement systems, which are defined benefit plans. Ohio's public employees are not covered by Social Security.

There is, however, a growing interest in defined contribution plans among public employers. In 1990, 9% of full-time state and local government employees participated in a defined contribution plan compared with 5% in 1987. Generally, defined contribution plans in the public sector are supplemental rather than primary retirement plans, with the notable exception of teachers in colleges and universities who are typically covered under a defined contribution plan such as TIAA-CREF. There are only two states where the primary statewide retirement system is a defined contribution plan: the Nebraska State and County Employees' Retirement Systems and the recent West Virginia Teachers' Defined Contribution Retirement Plan created in 1991.

Defined contribution plans are not new in Ohio. Originally, each of the three non-uniformed systems provided an allowance based on a "money purchase plan." Basically, such plan provided that the retired employee receive a monthly annuity in an amount that the aggregate contributions of the employee and the employer, plus interest, would buy at the time of retirement based upon the life expectancy of the individual. There was no guaranteed benefit amount.

During the 1950's, the Ohio General Assembly established a defined benefit plan in each of these systems, but retained the defined contribution feature of the "money purchase plan." Each system provided the retired employee with the greater of a defined benefit based on a percentage of the employee's final average earnings multiplied by years of service *or* a money purchase benefit based on the sum of the employee's contributions and the employer's matching contribution, both of which are credited with interest. About 98% of the employees now retire under the defined benefit plan; greater benefits are generally provided under the money purchase plan for those employees who separate from public service several years prior to retirement.

Two other types of defined contribution plans are offered on a supplemental, voluntary basis to Ohio's public employees. Members of all five retirement systems may defer income on a pre-tax basis under a Section 457 State and Local Government Deferred Compensation Plan. Public educational employees may also defer income under a Section 403(b) Tax-Sheltered Annuity Plan.

• *General Description of DB and DC Plans* - A defined benefit plan defines the amount of each employee's benefit. This promised benefit is usually based on the employee's earnings, length of service or both, and is independent of investment performance. For example, the School Employees Retirement System provides an annual benefit equal to 2.1% of the member's final average salary for each year of service.

In a defined benefit plan, there are generally no individual accounts; all assets set aside to fund the benefits for all members are usually combined to provide the benefits payable under the plan. The employer contributes to the plan such amounts which are estimated to be sufficient to pay the plan benefits. These estimates are based on assumptions on future rates of interest, salary increases, mortality, withdrawals from the plan and other factors. If the plan experience differs from these estimates, for example, earning more or less investment return than assumed, this will increase or decrease the amount of employer contributions needed in future years.

In contrast, a defined contribution plan defines the amount of the employer contribution for each employee. The contribution is usually determined as a percentage of each employee's earnings, such as 10% of pay. The benefit payable at retirement is based on money accumulated in each employee's individual account. Such accumulated money includes employer contributions, employee contributions (if any) and investment gains or losses. It may also include account balances forfeited by employees who leave before they become vested to the extent such forfeitures are reallocated to the accounts of employees who remain. The benefit is generally paid as a lump sum, a series of installments over a period of years or a monthly annuity for life. The amount of benefit is largely dependent on the investment performance of each employee's individual account.

In short, a defined contribution plan defines the amount of contribution paid into the plan, while a defined benefit plan defines the amount of benefit paid out of the plan. Under a defined contribution plan, the amount of contributions is known but the amount of future benefits is not known. Under a defined benefit plan, the amount of benefit is known, at least as a percentage of earnings per year of service, but the amount of contributions that will be needed to fund future benefits is less certain.

• ***Major Differences Between DB and DC Plans*** - Both defined benefit plans and defined contribution plans have their relative merits and drawbacks in terms of their use. The following key factors are identified to provide further understanding of the differences between the two types of plans.

• ***Retirement Income*** - In a defined benefit plan, retirement income is based on a benefit formula that is typically tied to an employee's earnings and years of service, and does not rely on investment performance. This not only provides employers with the ability to design plans that attempt to satisfy stated retirement income objectives, but also provides employees with a predictable retirement benefit.

In contrast, defined contribution plans provide retirement income based on the investment performance of the employee's individual account and the level of contributions. Simply put, the greater the real rate of return, the greater the benefit to the employee; the lower the return, the lower the benefit amount. Accordingly, there is no way of knowing in advance the amount of assets that will be in the employee's account at retirement as defined contribution plans are not specifically designed to provide stated retirement benefit levels. Though employers may structure contribution schedules to meet target levels of retirement income, the actual benefits payable at retirement can be far below or far above the target, depending on the investment experience.

• ***Plan Costs*** - In a defined benefit plan, the employer bears the rewards and risks of favorable or unfavorable experience under the plan, and thereby accepts an uncertain cost commitment. Numerous factors affect the cost of benefits under a defined benefit plan, including the rates of return on investments, future salary increases, mortality, separation from employment, and other economic and non-economic conditions. This uncertain cost is minimized by the use of actuarial projections relative to all these factors with the objective of establishing a reasonably level funding pattern. The ultimate cost of the plan, however, is fixed by statute, Under a defined benefit plan, favorable or unfavorable experience with respect to investments, salary levels, mortality and other factors will decrease or increase the employer's cost, but will not affect the amount of promised benefits payable to employees.

In contrast, the employer cost under a defined contribution plan is known each year as the employer is only committed to allocate a specified contribution amount to each employee's individual account. The employer does not promise the employee a specified benefit amount at retirement. Under a defined contribution plan, there are no unfunded liabilities.

• ***Investment and Inflation Risk*** - In a defined benefit plan, employers assume an obligation to pay a specified future benefit, and accept the investment risk in meeting such obligation. Unfavorable investment experience might require the employer to make additional contributions to the plan. Favorable investment experience might result in either a reduction in the contribution amount from employers or a demand for greater benefits from employees.

In a defined contribution plan, however, the employee bears the investment risk. Favorable investment results will increase benefits; unfavorable results will decrease benefits.

Defined benefit plans may also provide better protection against inflation during employment, especially those plans which provide a benefit based on a percentage of the employee's final pay. However, employees who cease employment prior to retirement generally receive no inflation protection under a defined benefit plan. Upon retirement, 50% of state and local government employees covered under defined benefit plans receive an annual cost-of-living adjustment; other plans often provide ad hoc post-retirement increases.

Defined contribution plans may also provide protection against inflation during employment through investment returns, although at a higher risk to the employee. A conservative investor who selects a fixed-income portfolio may not receive sufficient protection against inflation. Upon retirement, defined contribution plans do not typically provide for an annual cost-of-living allowance, though some plans allow employees to convert their account balances to either a level annuity or one that increases by a fixed percentage each year. The initial benefit under the increasing annuity is obviously lower than the amount under the level annuity.

• ***Recruitment and Retention of Employees*** - Defined benefit plans tend to favor older, long-tenure employees and employees making permanent job changes relatively late in their careers. Since the benefit is typically tied to the employee's earnings and length of service, benefits in a defined benefit plan accrue at a slower rate during the initial years of service and accrue at a faster rate for employees near retirement. Mobile employees generally suffer large benefit losses under a defined benefit plan, because each time a change in employment occurs a fixed dollar benefit is determined ... a benefit that no longer increases with salary increases and years of service.

In contrast, defined contribution plans tend to favor younger, more mobile employees. Employees who change jobs several times do not typically incur large benefit losses because defined contribution plans often provide for vesting with less service, which enables more employees to take advantage of the accumulated benefits than under a defined benefit plan. Assuming they do not spend the defined contribution benefit after leaving the job, investment income may continue to accrue in a tax-deferred vehicle until retirement.

In short, the defined benefit plan is designed in part to retain workers for full careers, while the defined contribution plan is more likely to attract younger, more mobile employees.

• ***Portability*** - Defined contribution plans typically provide greater portability of benefits than defined benefit plans, primarily due to shorter vesting requirements. This allows employees who move from job to job to continue accumulating benefits throughout their entire working career.

In contrast, most employees in defined benefit plans do not work a full career with the same employer, or even with a related group of employers. This often results in short-tenure employees earning different or sometimes no retirement benefits in each position. Vested benefits accrued for earlier service are generally not as large as vested benefits accrued for the same length of later service because such earlier benefits are usually based on the salary at the time employment terminates rather than upon the employee's final average salary.

Many states have recognized this problem for short-tenure employees by reducing the vesting requirements and/or providing for complete portability of service among various units of state and local government. Ohio has achieved complete portability of service among the five statewide retirement systems, and also provides for the purchase of various types of other public service, including federal, out-of-state and military service. Nevertheless, there is still a significant portability issue between public and private employment as well as between the various states.

<u>VI. Medicare</u> - The federal government provides two major health care programs: (1) the Medicare program for the elderly and disabled, and (2) the Medicaid program for the poor. The two programs differ greatly. Medicare is the health insurance component of Social Security, while Medicaid is a tax-funded aid program for the poor that varies significantly from state to state.

Medicare is a federal health insurance program primarily designed for individuals entitled to Social Security who are age 65 or older (although younger individuals can also qualify, for example, those receiving Social Security disability benefits). Effective April 1, 1986 mandatory Medicare coverage was extended to all newly hired state and local government employees. Therefore, these individuals and their employers must pay 1.45% of payroll, respectively.

Medicare consists of two parts: (1) Medicare Part A which covers inpatient hospital services and services provided by other institutional health care providers such as skilled nursing facilities, home health agencies and hospices, and (2) Medicare Part B which covers the services of doctors, suppliers of medical items and services, and various types of outpatient services.

There are certain items and services that are excluded from coverage under both parts of the Medicare program. Perhaps the two most significant exclusions include custodial care and prescription drugs.

Medicare Part A coverage is automatically provided for persons entitled to Medicare. Medicare Part B is optional and must be paid for separately by beneficiaries through monthly premium payments. Persons not automatically entitled to Medicare can voluntarily enroll in the program if they pay the monthly Part A premium and also enroll in Part B. In 1995, the Part A premium is $183/month for those with at least 30 quarters of Social Security coverage and $261/month for those with under 30 quarters of coverage. The Part B premium is $46.10/month in 1995.

The inpatient hospital deductible under Medicare Part A increased to $716 in 1995. Once a Medicare beneficiary has met the deductible, Medicare pays the remaining costs of covered hospital services for the first 60 days per hospital benefit period. The beneficiary pays a daily co-insurance amount from the 61st through the 90th day in a hospital period - $179 in 1995 (one-fourth of the inpatient hospital deductible). Each beneficiary also has a "lifetime reserve" of 60 additional days that can be used when the covered days within a hospital benefit period have been exhausted. The co-insurance amount for "reserve" days is one-half of the inpatient hospital deductible - $358 in 1995.

Qualifying care in a skilled-nursing facility is covered for up to 100 days per benefit period with a co-insurance rate applicable to days 21 through 100. The daily co-insurance rate is fixed at one-eighth of the inpatient hospital deductible - $89.50 in 1995.

The annual deductible under Medicare Part B remains $100 in 1995. Once the deductible is met, Medicare generally pays 80% of all covered expenses; the beneficiary, 20%.

Medicare Part A is financed by a payroll tax of 1.45% of earnings. This tax is paid by *both* the employee and the employer.

By law, Medicare beneficiaries pay 25% of the cost of the Medicare Part B program through monthly premiums. The remaining costs are paid by the federal government through general revenue funds. In 1990, Congress set the monthly premiums for 1991 through 1995, estimating beneficiaries' 25% share of Medicare Part B costs. Because Medicare costs roses at a slower pace than anticipated, beneficiaries are paying 31.5% of the cost in 1995 ($46.10/month). Therefore, 1996 premiums will be reduced to reflect the beneficiary's 25% share of the costs ($42.50/month), assuming no change in the law is made by Congress.

The five state retirement systems' health care plans are secondary to Medicare (both Parts A & B) for those individuals covered by Medicare and, therefore, serve basically as Medicare supplemental plans. Conversely, the systems' plans are the primary payers of health care services for those individuals not eligible for Medicare.

VII. Employer Surcharge - The employer surcharge was enacted in SERS in 1988 to help fund retiree health insurance. The surcharge is paid by employers on the salaries of lower-paid members, and is in addition to the regular employer contribution rate (14% of payroll).

In 1994 the surcharge generated additional revenues of 1.26% of payroll. The surcharge varies from school district to school district depending on the number of employees earning less than a minimum compensation amount within the particular school district; that is, those districts with more low-salary employees pay a higher surcharge than those districts with fewer low-salary employees.

Upon the advice of its actuary, the SERS board determines annually a minimum compensation amount. In 1994 the minimum compensation amount was $11,200. For each member whose salary for the prior year is less than that amount, the board assesses a surcharge to the member's employer.

The surcharge is determined by subtracting the member's salary for the prior year from the minimum compensation amount. The difference is multiplied by the employer contribution rate in effect, and prorated according to the service credit earned.

For example:

STEP 1	Minimum Compensation	MINUS	Employee's Salary	EQUALS	Surcharge Base
	$11,200		$10,200		$1,000
STEP 2	Surcharge Base	TIMES	Employer Rate	EQUALS	Gross Surcharge
	$1,000		14%		$140
STEP 3	Gross Surcharge	TIMES	Service Credit	EQUALS	Total Surcharge
	$140		1 year		$140
	-OR-				
	$140	TIMES	½ year	EQUALS	$70

The fundamental problem in SERS is the disproportionate number of low-salary employees in the non-certificated ranks. On average, SERS members earn half as much as PERS members and one-third as much as STRS members. Therefore, the employer contribution received by SERS to support health care benefits is substantially less and places an obvious burden on SERS' ability to fund health care benefits. Providing a flat benefit which has no relation to salary (i.e., health care), yet funding it on the basis of salaries (i.e., payroll) poses a real difficulty for actuarial purposes.

The employer surcharge alleviates the need to increase the overall employer contribution rate, which is currently at the statutory maximum of 14% of payroll. However, because of the surcharge, there is no effective cap on the amount of employer contributions to SERS.

VIII. Summary of Findings, Staff Recommendations and JLC Action - The following is a summary of the findings, staff recommendations and action taken by The JLC.

• ***Disability Statutes, Procedures & Experience***

i. Findings

• All five state retirement systems provide *for total* disability retirement; PFDPF is the only retirement system that also provides for *partial* disability retirement.

• The authority to grant or deny disability retirement is vested in each retirement board.

• Disability benefits are based upon the average of the member's highest three-year earnings in all five systems, *except* that PFDPF statutes provide for the calculation of on-duty total disability benefits on the basis of the member's last twelve-month earnings.

• Disability benefit levels are fixed by statute in all five systems, *except* that PFDPF statutes authorize the board to fix the benefit amount for members who are granted partial disability benefits with less than 25 years of service.

• The five state retirement boards have no authority to adjust disability benefits, *except* that the PFDPF board may increase or decrease partial disability with less than 25 years of service and off-duty disability benefits if there is a change in the member's earning capacity warranting such an increase or decrease.

• Employee misconduct does *not* affect eligibility for disability or normal service retirement in any of the five systems. Therefore, none of the systems inquire into such matters upon application for disability or service retirement.

The "bad boy" clause, included in the uniformed employee systems' laws (PFDPF, HPRS, PERS-LE), applies only in cases where members are *dismissed* for reasons of dishonesty, cowardice, intemperate habits or a felony conviction before qualifying for normal service retirement and, as a consequence, are eligible for a refund of their contributions, without interest; however, if the member *voluntarily resigns* for any of these reasons, the member may qualify for a reduced pension based on a 1.5% benefit formula, with a minimum of 15 years of service, payable at age 48 in PFDPF provided 25 years have elapsed since initial employment (age 52 in PERS-LE and age 55 in HPRS).

• The disability programs of the non-uniformed employee systems (PERS, STRS, SERS) make no distinction between on-duty or off-duty disabilities. Though the disability programs of the uniformed employee systems (PFDPF, HPRS) provide for both on-duty and off-duty disabilities, eligibility requirements and/or benefit amounts may differ based on the type of disability. Also, heart and cardiovascular diseases are presumed under the uniformed employee systems' laws to have been incurred in the line of duty, and may have the effect of qualifying surviving beneficiaries for benefits under the state's Death Benefit Fund. PFDPF law also presumes respiratory diseases to be duty-related.

• Disability standards vary among the five systems, and are generally less stringent than the standard established under Social Security.

Under PERS and STRS, the member must be mentally or physically incapacitated for the performance of duty by a disabling condition either permanent or presumed to be permanent. Under SERS, the member must be mentally or physically incapacitated for the performance of the member's *last primary duty as an employee* by a disabling condition either permanent or presumed to be permanent. Total and permanent disability under PFDPF is defined as the inability to perform duties of any gainful occupation for which the member is reasonably fitted by training, experience and accomplishments and for which there is no present indication of recovery. Partial disability is defined as a disability that prevents the performance of the member's official duties and impairs the member's earning capacity. Under HPRS, the member must be permanently and totally incapacitated for duty in the employ of the state highway patrol.

In contrast, disability is defined under Social Security as "the inability to engage in *any substantial gainful activity* by reason of any medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months."

The standard used to define disability may have a significant effect on the administration and management of a disability benefit program. Defining disability as the inability to perform current duties may result in individuals legally holding jobs and simultaneously receiving disability benefits. Defining disability as the inability to perform the duties of any and all positions for which the individual is reasonably suited would make benefits less broadly available.

• No outside earnings limit applies to members on disability retirement in any of the five systems. Annual earnings statements are required in all five systems to determine whether the type of employment is similar to the employment from which the member was found to be physically or mentally incapable of performing to warrant a medical re-examination by the board physician(s).

• Disability benefits automatically terminate upon employment covered by the system paying the benefit; however, members may engage in *other* public or private employment while on disability retirement, *provided it is not determined that the member is physically and mentally capable of performing service similar to that from which the member was separated.*

• Members of the non-uniformed employee systems receiving disability benefits are considered on leave of absence for five years; PFDPF members, a three-year leave of absence; and HPRS members, an indefinite leave of absence. Members who are determined to be physically or mentally capable of resuming service during the leave of absence shall be restored to their previous position and salary.

• The disability statutes of all five systems authorize the boards to require each disability benefit recipient to file an annual statement of earnings and current medical information and submit to periodic medical re-examinations. PERS and STRS administrative rules also provide for additional medical treatment as a condition for disability retirement.

• The disability statutes of all five systems provide *no* offset for Workers' Compensation benefits; therefore, members may be eligible for benefits provided by both the retirement system and Workers' Compensation in the case of work-related injuries.

• The disability statutes of all the systems, *except* PFDPF, authorize the employer to make application for disability retirement on behalf of the member.

• In response to the federal Older Workers' Benefit Protection Act of 1990, a revised disability plan was created in the non-uniformed employee systems (PERS, STRS, SERS. Members who joined the systems after July 29, 1992 are covered under the revised plan. Members who joined the systems before July 29, 1992 are covered under the original plan *unless* they elected coverage under the revised plan during an open window period.

The original plan prohibits application for disability retirement upon attainment of age 60, and provides a benefit payable for life. The revised plan allows members to apply for disability retirement at any age, though the benefit is payable for a limited time period after which the member must apply for a service-related benefit. The service benefit may be less than the disability allowance. This conversion from disability to service retirement is intended to have a cost-neutral effect on the systems.

Under the uniformed employee systems (PFDPF, HPRS), disability benefits are generally payable for life. No provision is made to convert the member from disability to service retirement upon the attainment of normal retirement age.

• Four of the five systems (PERS, STRS, PFDPF, HPRS) approve over 90% of disability applications; SERS' approval rate is the lowest at just over 75%.

• Among the uniformed employee systems, PFDPF has the highest percent of retirements due to disability, averaging nearly 40% of all police retirements and nearly one-third of all firefighter retirements over the last ten years. HPRS has the lowest percentage, averaging only 4% during this same time period. The PFDPF actuary indicates that there has been a major shift from total disabilities to partial disabilities over the last ten years, and that the significant increase in disability retirements that occurred in the late 80's and early 90's appears to have abated and that a trend toward fewer disability retirements appears to have begun.

• Among the non-uniformed employee systems, PERS has the highest percent of retirements due to disability, averaging nearly 15% over the last ten years, followed by SERS at 12.9%, and STRS at 9.5%. The PERS disability program provides the same coverage for general employees as well as approximately 6,300 law enforcement officers, except that law enforcement officers qualify for duty-related benefits immediately upon employment. Each system has experienced an increase in the relative percentage of disability retirements since 1992 as result of the establishment of the revised disability plan which allows members to apply for disability benefits at any age. The original plan prohibited members from applying for disability retirement upon their attainment of age 60, thereby making them eligible for service retirement only.

• Several factors have had an impact on disability retirements: court decisions and legal opinions providing a liberal construction to the disability statutes; favorable tax treatment; economic conditions; Americans with Disabilities Act (ADA); Age Discrimination in Employment Act (ADEA); improvements in medical technology and rehabilitation; benefit structures; health and physical maintenance programs; early intervention and return-to-work programs; training programs; prevention programs; presumptive disabilities (heart, cardiovascular, respiratory); etc.

• Employment practices may have a significant impact on the cost of employee benefit programs. Whether these practices are the result of unilateral action on the part of employers, bilateral agreements between employers and employee organizations, legal requirements or court decisions, they all have a potential cost impact on the disability programs of each system. The systems have *no* authority in these matters which fall within the jurisdiction of the employer(s).

• There are few, if any, incentives for employers to adopt early intervention and return-to-work programs in order to shift employees from disability status to employment status. There is, also, little employer involvement in the disability retirement process.

ii. Staff Recommendations

• That William M. Mercer, Inc., the consultant for the JLC, include as part of its review the following items, including specific recommendations:

(1) current disability standards in all five systems;

(2) coordination of disability benefits with Workers' Compensation, Social Security and other benefit sources in all five systems;

(3) conversion from disability to service-related benefit upon attainment of normal service retirement age in the uniformed employee systems;

(4) financial incentives for employers to establish health and physical maintenance programs, training programs, prevention programs and early intervention and transitional return-to-work programs;

(5) effective use of rehabilitation.

• That an annual medical re-examination be required for *all* disability retirees in the five systems with board authority to waive this requirement based on the recommendation of the board physician for individual retirees on a case-by-case basis.

• That the five systems provide an annual report with sufficient data to permit a thorough evaluation of the effectiveness of the disability plan to the appropriate standing committees of both houses of the Ohio General Assembly with responsibility for retirement and insurance legislation and ORSC.

iii. Action Taken: Disability Statutes, Procedures and Experience

• H.B. 226 - Effective August 25, 1995

The bill was enacted as an emergency measure in response to testimony provided by the PFDPF to the JLC which indicated a need for additional statutory authority and clarification relative to the disability retirement program based in large part on an Attorney General Opinion and certain adverse judicial decisions. The act makes the following changes which are intended to address the most critical needs of the disability program:

- requires disability retirees to undergo a medical reexamination at such times as the board considers necessary and file annual statements of earnings and current health status.

- grants members a three-year leave of absence while on disability retirement and requires employers to restore them to their previous employment if the board physician determines that they are physically or mentally capable of resuming employment prior to the expiration of the leave of absence.

- prohibits application for disability retirement benefits if made more than 12 months after the member's dismissal, resignation or leave of absence.

- prohibits members who are receiving disability or service retirement benefits from applying for a refund of employee contributions.

- permits members to request light-duty employment in lieu of receiving partial disability retirement benefits and employers to accommodate the request.

• The JLC hired the services of the William M. Mercer, Inc. to conduct a study into the high rates of disability among police and firefighters, as recommended by the ORSC in its legislative report on the adequacy of the PFDPF contribution rates (1994). The disability study was presented to the JLC on November 14, 1996, and included several public policy issues and recommendations for the consideration of the legislature and the pension fund relative to the following major areas: disability standards; disability benefit structure; performance of duties basis; on-duty versus off-duty; workers' compensation offset; disability determination process; early intervention programs; monitoring and reexamination of disability retirees; and employer involvement and accountability. (See Section IX for an executive summary of the study's findings and recommendations)

Though the focus of the study was limited to the PFDPF, the William M. Mercer, Inc. considered "best industry practices" and "current trends" in both the private and public sectors to formulate its recommendations regarding effective disability management, a common interest of all five systems. It also raised several public policy issues which equally have a bearing on the disability programs of the other systems, such as the workers' compensation offset. Therefore, the study may serve as a legislative guide to determine whether changes in the statutory provisions and/or administrative procedures of the other systems' disability programs would also be appropriate or desirable as a matter of public policy.

Due to the end of this legislative session, the JLC was unable to draft legislation to give effect to the recommendations included in the study. It is anticipated, however, that a bill will be introduced next session for the legislature's consideration.

• S.B. 82 - Effective March 6, 1997

The act requires annual medical reexaminations for all disability retirees in the five systems, with board authority to waive this requirement based on the recommendation of the board physician on a case-by-case basis. This requirement is designed to provide for an effective monitoring procedure to determine eligibility of disability retirees for continuing benefits.

The act also requires the five systems to submit the following information to the ORSC and the standing committees of the House and Senate with primary responsibility for retirement legislation:

- the annual actuarial valuation of the system's pension assets, liabilities and funding requirements;

- the five-year actuarial investigation of the mortality, service and other experience of the system's participants.

• *Cost and Funding of Retiree Health Care Benefits*

i. Findings

• The five state retirement systems' primary duty is to provide pension benefits earned during the working careers of public employees. These pension benefits are mandated by statute and become vested upon retirement. The systems are also charged with the responsibility of accumulating and maintaining the necessary reserves to pay for these benefits when they become due. Therefore, funding for pension benefits takes legal precedence over funding for health care benefits.

• In 1974 the Ohio General Assembly granted the five systems broad discretionary authority to provide retiree health care benefits. Health care benefits are not a vested right under any of the five systems' laws and, therefore, are subject to change at any time upon board action, including the level of coverage as well as the amount paid by those covered.

Since 1974 the five systems have provided comprehensive hospital, medical and prescription drug coverage within the constraints of available resources. (The systems' health care plans cover only *eligible retirees, benefit recipients and their dependents*; public employers are responsible for any health care coverage provided to *active employees and their families*.)

• In 1977 the Ohio General Assembly mandated that each system reimburse benefit recipients for monthly Medicare Part B premiums (medical portion). This monthly reimbursement was subsequently capped by the legislature in SERS at $24.80 (1988), STRS at $29.90 (1991) and HPRS at $41.10 (1994) as one measure to contain these systems' health care costs; the Medicare Part B reimbursements are not capped in PERS and PFDPF ($46.10).

Retirees not qualifying for Medicare Part A (hospital portion) are provided equivalent coverage under each system's health care plan.

State and local government employees hired on and after April 1, 1986, along with their employers, are respectively required to pay 1.45% of compensation into Medicare; government employees hired before then continue to be exempt from mandatory Medicare coverage.

• In 1993 the Ohio General Assembly mandated that each system offer long-term health insurance coverage to both active members and retired members, including their family members. This insurance provides cash benefits to individuals unable to perform activities of normal daily living, and is paid entirely by the member electing coverage.

• Effective August 1, 1995 two of the five systems - PERS and HPRS - offered dental and vision care to retirees and their dependents. The premium is paid entirely by the retiree electing coverage.

• The five systems' health care plans are secondary to Medicare, which generally provides coverage to eligible individuals who are age 65 (although younger individuals may also qualify, for example, those receiving Social Security disability benefits); conversely, the systems' plans provide primary coverage for those retirees without Medicare.

Approximately one-third of the benefit recipients *not* covered by Medicare generate nearly two-thirds of the hospital/medical claim payments in the five systems. The normal retirement age of 48 exposes the uniformed employee systems' plans to significant medical costs for up to 17 years before Medicare becomes the primary insurer.

• Proposed Medicare cutbacks to help balance the federal budget by the year 2002 will likely have a negative fiscal impact on the systems' health care plans by shifting cost from Medicare to the systems.

• The cost of prescription drugs, which are not covered by Medicare, ranges from one-fourth to nearly one-third of the systems' total health care costs.

• Four of the five systems (PERS, STRS, PFDPF, HPRS) established a dual managed care network for retirees and their dependents without Medicare Part A (hospital portion) in 1993; one administered by Aetna Health Plans (Aetna), and the other by Blue Cross Blue Shield of Ohio (BCBSO). A single managed care network administered by Aetna was established in SERS.

In 1993-94 the five systems achieved an actual reduction in total health care costs primarily due to significant savings under the managed care network established for benefit recipients without Medicare, industry-wide reductions in health care costs, and other cost-containment initiatives.

• The five systems' health care plans generally provide similar coverage, though deductibles, co-payments, out-of-pocket maximums, premium charges, medicare reimbursement rates, eligibility requirements, funding levels and health care fund balances are all areas of key differences between the systems. These differences between the systems are likely to increase as a direct result of significant differences in the current funding structure of each system. (See Appendix)

• Various cost-containment measures have been implemented by the systems, including a mail-order drug plan; a retail pharmacy network; a managed care network for retirees and dependents without Medicare Part A (hospital portion); health maintenance organizations; individual case management; increased co-pays, deductibles and out-of-pocket maximums; increased service eligibility requirements; hospital admission charges; premium charges; pre-certification; managed second opinions; second surgical opinions; fraud investigations; hospital billing audits; usual, customary and reasonable fees; subrogation procedures; formularies; etc.

• STRS is the only system that charges *all* retirees part of the premium cost for health care coverage. PERS and HPRS are the only two systems with *no retiree* premium charges for single coverage. Premiums in both STRS and SERS are adjusted annually at the same rate as plan costs.

• The laws of all five systems require that any health care costs incurred by the systems be paid from employer contributions. (By law, the employee contribution rate is totally dedicated to fund pension benefits.) Each board has, however, the discretionary authority to determine the amount paid by the system as well as the amount paid by the benefit recipient for health care benefits.

Each system must constantly monitor health care costs and take necessary action to balance cost with revenues. Tools available to effect this balance include the ability to change benefit program;, increase deductibles, co-payments and out-of-pocket maximums; charge premiums; limit eligibility requirements; and increase contributions rates (not available to STRS or PFDPF whose contribution rates are presently at the statutory maximum).

In addition, SERS is the only system with authority to assess an employer health care surcharge on the salaries of members earning less than a minimum annual salary, as determined by the board each year based on the recommendation of its actuary, for the exclusive purpose of funding health care costs. The surcharge is in addition to the regular employer contribution rate (14% of payroll), and generates additional revenues of approximately 1.25% of payroll, or $20 million. The employer surcharge amount varies by school district depending on the number of individuals earning less than the minimum annual salary. Because of the surcharge, there is, in effect, no cap on employer contributions in SERS.

The fundamental problem in SERS is the high percentage of low-salary employees in the non-certificated ranks. On average, SERS members earn approximately one-third as much as members of the other four systems. Therefore, the employer contributions received by SERS to fund health benefits are substantially less, which places a financial burden on SERS' ability to maintain existing health care benefits. Providing a flat benefit which has no relation to salary (i.e., health care), yet funding it based upon salaries (i.e., payroll) poses a real difficulty for actuarial purposes.

• Funding alternatives for post-retirement health care benefits range from pay-as-you-go financing to full actuarial funding (pre-funding) similar to the method used by each system to fund pension benefits. Unlike pension benefits, however, health care benefits are not generally payable in equal installments over a given time period, but rather sporadically and in large increments. Also, health care benefits are not earnings-based, but rather driven by individual circumstances and usage. The medical inflation rate has greater fluctuation than the general inflation rate. All of these factors make health care benefits a less predictable expense and, therefore, more difficult to fund than pension benefits.

Pay-as-you-go financing requires the minimum amount of revenue to cover current expenditures. However, it places a financial burden on future generations and is highly volatile.

Full actuarial funding provides for greater equity between generations and for a relatively stable rate of contributions from year to year. Earnings from invested assets aid in paying future liabilities. However, it is practically impossible today to pay current health care expenses and also prefund post-retirement health care benefits, starting off with little or no reserves. For example, even assuming medical inflation equal to general inflation, SERS would require nearly $1.8 *billion* in assets to prefund its current health care plan, compared to current assets of approximately $140 *million*.

Each system has set aside assets in a health care fund, with balances ranging from 1.65 times annual claims and expenses in SERS to over 32 times annual claims and expenses in HPRS. HPRS' health care costs are subject to greater volatility than the other systems' due to the small number of covered individuals.

The SERS board has recently established an alternative funding method to pay-as-you-go financing in order to protect its health care fund from insolvency and smooth out the annual rate of change in the contribution level by adopting a minimum reserve balance of 125% of annual claims and expenses for its health care fund.

The STRS board has periodically authorized major infusions into its health care fund when employer contributions exceed the amount needed to actuarially fund pension benefits due to favorable actuarial experience.

The PFDPF board has recently established a health care fund with an initial allocation of $150 million, and adopted an objective of limiting the fund's net costs to 6.5% of payroll as recommended by the ORSC.

The PERS and HPRS boards have funded health care benefits on an actuarial basis since 1974 and 1991, respectively, with separate valuation and disclosure of actuarial accrued liabilities for post-retirement health care benefits.

ii. Staff Recommendations

• That a health care fund be created by statute in all five systems and that assets reserved for pension benefits be segregated from assets available for post-retirement health care benefits.

• That a minimum reserve balance of two times annual health care claims and expenses be established by each system and that mandatory reductions in benefits or increases in premiums or suspension of benefits be instituted by the board upon failure to maintain the minimum reserve balance.

• That the five systems provide an annual disclosure of health care expenditures, contributions, and minimum reserve balances to the standing committees of both houses with primary responsibility for retirement and health care legislation and ORSC.

• That managed care be extended to benefit recipients covered by Medicare.

• That the actuarial accrued liability for post-retirement health care benefits be calculated and reported separately in the annual actuarial valuations for STRS and PFDPF.

• That Medicare Part B premium reimbursements be capped in PERS and PFDPF.

• That the employer health care surcharge be limited to no more than 1.75% of payroll in SERS.

• That the five systems have prepared a study to determine the feasibility of pooling active members and retirees for purposes of health care coverage and submit their findings and recommendations to the standing committees of both houses of the Ohio General Assembly with primary responsibility for retirement and health care legislation and ORSC no later than December 31, 1996.

• That each board adopt a rule establishing eligibility guidelines and coordination of benefits among the five state retirement systems' health care plans.

iii. Action Taken: Cost and Funding of Retirement Health Care Benefits

• <u>S.B. 82 - Effective March 6, 1997</u>

The act requires the five systems to report separately their annual pension assets/liabilities and health care assets/costs to the ORSC and the standing committees of the House and Senate with primary responsibility for retirement legislation. This requirement is consistent with recent statements issued by the Governmental Accounting Standards Board (GASB

Statement No. 25 - Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans; GASB Statement No. 26 - Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans) requiring separate accounting of pension and health care assets and liabilities by public pension funds, and achieves the overriding objective of segregating assets reserved for pension benefits from assets available for Post-employment health care benefits. Under GASB Statement No. 26, governmental pension plans are *not* required to provide actuarial information on their health care plans.

These new accounting and reporting standards promulgated by GASB have largely resolved the issue of creating a separate health care fund in each system and requiring actuarial information on each system's health care plan. Under the act, the retirement boards retain discretionary authority to modify health care coverage and the cost paid by covered individuals.

The act also requires each retirement board to adopt rules for the coordination of health care coverage provided by the system with similar coverage provided by any of the other four systems. This requirement is intended to prevent certain individuals who qualify for health care coverage under more than one plan from abusing the system.

• The retirement boards have begun to make Medicare HMO's available for some benefit recipients residing in certain geographic areas in Ohio. These plans are intended to offer the retirement system and the retiree a "win-win" alternative to the traditional fee-for-service Medicare program and indemnity plan. Advantages for the retirement system include savings on retiree health care costs, increased value of the system's health care dollars, and improved predictability of the system's health care expenses. Retiree advantages include low or no monthly premiums, additional benefits, reduced out-of-pocket expenses and no claim forms.

iv. No Action Taken: Cost and Funding of Retiree Health Care Benefits

• Medicare Part B reimbursement cap in PERS and PFDPF. (Currently, SERS, STRS and HPRS are capped)

• Employer health care surcharge limit of 1.75% of payroll in SERS. (Currently no limit)

• Feasibility study on pooling active members and retirees for purposes of health care coverage.

• *Retirement Eligibility and Benefit Provisions, Including Early Retirement*

i. Findings

• The retirement eligibility and benefit provisions among the three non-uniformed employee systems (PERS, STRS, SERS) are generally the same, with the following *key* exceptions:

- The salary-related benefit formula is 2.1% of FAS for *all* years of service under SERS; the multiplier is 2.5% for years of service over 30 under PERS and STRS.

- The maximum benefit payable is 90% of FAS under SERS, compared to 100% under PERS and STRS.

- The death benefit is a $500 lump sum under SERS, compared to $1,000 under STRS and a range of $500 to $2,500 based on years of service under PERS.

- The money purchase interest rate is determined by the retirement board under STRS and SERS, but is fixed by statute under PERS. The current rates are 6.0% in STRS, 4.5% in SERS and 4.0% in PERS.

- The STRS board is authorized to grant an annual lump-sum supplemental benefit check (13th check) to all benefit recipients on the rolls for at least twelve months when prior-year investment earnings exceed the actuarial funding requirements of the system; the PERS and SERS boards have no such authority.

- The STRS survivor benefit program provides a service-related benefit option when the member has 20 or more years of service; this option is not available under PERS and SERS.

- Generally, public retirees may be employed in any position covered by the five systems after *two* months without forfeiting their retirement allowance, *except* that PERS retirees must wait *six* months to be employed in a PERS-covered position and STRS retirees must wait *eighteen* months to be employed full-time in a STRS-covered position.

- Disproportionate salary increases just prior to retirement may be limited in STRS to a specified percentage for purposes of FAS unless such increase results from employment with another employer or promotion to a position previously held by another employee; PERS and SERS have no such limitation.

- Service credit is calculated on the basis of earnings in PERS (earnings of $250 or more per month during a calendar year produce one-year service credit; if less than $250, service credit is prorated on the basis of $250 per month). STRS and SERS calculate service credit on the basis of days employed (one-year service credit is granted for at least 120 days of paid employment during the fiscal year; if less than 120 days, service credit is prorated on the basis of 180-day school year).

• The uniformed employee systems (PFDPF, HPRS, PERS-LE) generally provide for earlier retirement eligibility and higher benefit formulas than the non-uniformed employee systems.

Though similar in many respects, the uniformed employee systems include the following *key* differences:

- Normal service retirement is age *48* with *25* years of service in PFDPF and HPRS, or age 52 with 20 years of service in HPRS; normal service retirement is age *52* with *25* years of service in PERS-LE, though members may apply for reduced benefits at age 48 with 25 years of service. Reduced benefits are also available at age 48 with less than 25 years of service in HPRS.

- PFDPF members may use non-law enforcement service covered under PERS, STRS or SERS to meet the eligibility requirements for service retirement; HPRS and PERS-LE allow only the use of law enforcement service, including military service, to qualify for service retirement. Non-law enforcement service may be used for additional benefits once eligibility requirements are otherwise met in HPRS and PERS-LE.

- The salary-related benefit formula is 2.5% of FAS for the first 20 years of service, plus 2.0% for the next five years of service, plus 1.5% for years of service over 25 in PFDPF and HPRS; the multiplier is 2.1% of FAS for *all* years of service over 20 in PERS-LE.

- The maximum benefit payable is 72% of FAS in PFDPF and HPRS, compared to 90% in PERS-LE.

- The PFDPF survivor benefit program provides $410/month for the spouse and $118/month for each dependent child in the case of an active member who dies prior to retirement eligibility; surviving spouses and dependent children are eligible for $600/month and $100/month, respectively, in HPRS; survivor benefit protection is the same for law enforcement officers as for other PERS members, providing a benefit ranging from 25% to 60% of FAS based on the number of dependents.

- The death benefit is a $1,000 lump sum in PFDPF and HPRS, compared to a variable death benefit of $500 to $2,500 based on years of service under PERS-LE.

• Survivors of law enforcement officers who die as a result of duty-related causes may qualify for additional benefits under the state's Death Benefit Fund, which is administered by PFDPF but financed by the State of Ohio.

• State university police officers are the only group of law enforcement officers who are required under Ohio law to complete satisfactorily the Ohio Peace Officers Training Academy, but are excluded from participation in PERS-LE. Consequently, they are eligible for the same benefits as general employees covered under PERS.

• Generally, employee misconduct does *not* affect eligibility for retirement in any of the five systems. The "bad boy" clause, included in the uniformed employee systems' laws (PFDPF, HPRS, PERS-LE), applies only in cases where members are *dismissed* for reasons of dishonesty, cowardice, intemperate habits or a felony conviction before qualifying for normal service retirement and, as a consequence, are eligible for a refund of their contributions, without interest; however, if the member *voluntarily resigns* for any of these reasons, the member may qualify for a reduced pension based on a 1.5% benefit formula, with a minimum of 15 years of service. This reduced pension is payable at age 48 in PFDPF, provided 25 years have elapsed since initial employment (age 52 in PERS-LE and age 55 in HPRS).

Also, benefits payable from any of the five systems are subject to court withholding orders requiring restitution for the criminal offense of theft-in public office.

• Generally, the five systems provide an annual 3% COLA to *all* benefit recipients on the rolls for at least 12 months whenever the average change in the CPI-W increases at least 3%, with the following *exceptions*:

- PFDPF spouses and dependent children receiving monthly survivor benefits, other than a joint and survivor annuity selected by the retired member;

- HPRS service and disability retirees under age 57, or HPRS disability retirees receiving benefits for less than five years; and

- PFDPF members who retired on or after July 24, 1986 and elected the "Non-COLA" option in order to include "terminal pay" in the benefit calculation. (PFDPF members who retired prior to July 24, 1986 qualify for an annual $360 COLA, or its actuarial equivalent, whenever the average change in the CPI increases at least 3%).

If the CPI increase is greater than 3%, the difference between the actual CPI and the authorized payment is put into "banks" to help determine future adjustments. When the CPI increase is less than 3%, an eligible benefit recipient receives a COLA payment if the recipient's "bank" is sufficient to make up the difference between the actual CPI increase and 3%.

The actuaries of all five systems assume that the 3% COLA payment will be made each year in determining actuarial contribution requirements. Each system, therefore, experiences an actuarial gain to the extent that COLA payments are not made to benefit recipients with insufficient "banks."

• Surviving spouse benefits, other than a joint and survivor annuity, terminate upon remarriage in all five systems, *except* if the spouse remarries after age 62 under PERS, STRS and SERS.

• Upon application for a refund from any of the five systems, a member is entitled to his or her accumulated employee contributions, *with no interest*. Employer contributions made on behalf of the member are *not* refunded, but are factored into the actuarial funding requirements of the system.

• Portability has become a national retirement issue. It has also become an issue in Ohio in terms of the recruitment of higher education employees and is likely to become an increasing issue for other groups of public employees, such as part-time, short-service and mobile employees, who are required to participate in retirement systems which are designed to benefit older, long-tenure employees and employees making permanent job changes relatively late in their careers.

• Benefits payable from any of the five systems are neither assignable nor subject to garnishment, attachment, bankruptcy or other legal process, *except* in the following two cases: (1) court withholding orders for spousal and child support in domestic relations proceedings, and (2) court withholding orders for restitution in criminal theft-in public office proceedings.

Also, benefits are exempt from qualified domestic relations orders (QDRO's) issued under federal law.

• Upon retirement, spousal acknowledgment is required in all five systems *if* the retiree selects a plan of payment providing less than one-half of the retiree's pension to the spouse upon death. Once selected, a joint and survivor annuity may be changed upon divorce with the written consent of the spouse or by court order.

• Federal law may reduce or eliminate the Social Security benefits for those entitled to both a state retirement benefit and Social Security. One limitation, "the Social Security Offset," affects retirees who plan to collect a Social Security benefit based on their spouse's work record. Social Security will reduce the spouse benefit by two-thirds of the monthly amount of the state retirement benefit. The other limitation, "the Social Security Windfall," affects retirees who are eligible for Social Security based on their own work record and also a state retirement benefit. The Social Security benefit formula will be reduced unless the retiree has at least 30 years of coverage under Social Security.

ii. Staff Recommendations

• That the normal retirement age be increased in the uniformed employee systems from 48 to 52 with a four-year phase-in and that benefits be reduced prior to normal retirement age.

• That non-law enforcement service credit be excluded for purposes of determining eligibility for service retirement under PFDPF.

• That the normal retirement age of 65 in the non-uniformed employee systems be increased in tandem with Social Security and that the 30-year service requirement be increased at the same rate and that benefits be reduced prior to normal retirement age *or* service.

• That the statutory reduction rates for early retirement be repealed and that reduction rates for early retirement be determined on an actuarial basis in all five systems.

• That an alternative defined contribution plan be established, in conjunction with the existing defined benefit plan, in the three non-uniformed employee systems to provide greater portability and options for employees.

• That each board be authorized to pay up to a three-percent COLA to eligible benefit recipients *if* the average change in the CPI is less than 3%; that the eligibility age for the COLA be reduced from age 57 to 53 for HPRS service and disability retirees; and that PFDPF spouses and dependent children receiving statutory survivor benefits, other than a joint and survivor annuity, be made eligible for an annual cost-of-living adjustment upon the availability of funds.

• That disproportionate increases in salary prior to retirement be limited to a maximum percentage for purposes of determining final average salary in PERS, SERS, PFDPF and HPRS *unless* such increase results from employment with another employer or promotion to a position previously held by another employee.

• That the statutory authority to grant an annual lump-sum supplemental benefit check (13th check) be repealed in STRS and that ad hoc post-retirement increases be enacted on an as-needed basis by the legislature.

• That the forfeiture of surviving spouse benefits upon remarriage be repealed in all five systems.

• That state university police officers be eligible to participate in the PERS-LE program.

iii. Action Taken: Retirement Eligibility and Benefit Provisions, Including Early Retirement

• S.B. 82 - Effective March 6, 1997

The act requires the three non-uniformed employee retirement systems (PERS, STRS, SERS) to prepare a report that proposes an alternative benefit program, in conjunction with their existing defined benefit program, and submit it, no later than one year after the effective date of the act, to the ORSC and the standing committees of the House and Senate with primary responsibility for retirement legislation. This requirement is intended to address the issue of pension portability, which has become perhaps the single most important national retirement issue today.

• H.B. 123 - Effective June 5, 1996

The act lowers the age at which surviving spouses may remarry without forfeiting their statutory monthly survivor benefits from 62 to 55 under PERS, STRS and SERS. Though the act does *not* totally eliminate the remarriage penalty due to cost considerations, it does remove it for a significant group of surviving spouses.

• H.B. 365 - Effective September 27, 1996

The act authorizes each retirement board to pay a cost-of-living allowance (COLA) equal to the actual change in the Consumer Price Index (CPI) or such change plus any prior accumulations, up to a maximum of 3%, whenever the average change in the CPI falls below three percent. (For PFDPF members who retired prior to July 24, 1986 this percentage change is multiplied by $12,000 to determine the COLA payment.)

The act also allows surviving spouses in the PFDPF to remarry after age 55 without forfeiting the statutory monthly survivor benefits. Prior law required forfeiture of survivor benefits upon remarriage at any age. Though this change does *not* totally eliminate the remarriage penalty due to cost considerations, it does remove it for a significant group of surviving spouses.

- H.B. 308 - Effective June 6, 1996

The act lowers the eligibility age for the cost-of-living allowance (COLA) from 57 to 53 for HPRS service and disability retirees who have received a pension for twelve months, except that disability retirees are still eligible for a COLA after five years of retirement, regardless of age. This change is intended to lessen the erosion of the member's pension due to inflation.

The act totally eliminates the remarriage penalty for HPRS surviving spouses, thereby allowing them to remarry at any age without forfeiting their monthly survivor benefits. The act also makes surviving spouses whose benefits were terminated due to remarriage eligible once again for survivor benefits on the first day of the month following the effective date of the act.

- H.B. 379 - Effective November 6, 1996

The act generally makes state university law enforcement officers eligible for the PERS-LE program. As defined by the act, "state university law enforcement officer" means any person who has received a peace officer training certificate and who is employed as a law enforcement officer by a state university, the Medical College of Ohio at Toledo, Northeastern Ohio Universities College of Medicine, a technical college or a community college.

As enacted, however, the bill does not address the law enforcement officers of the University of Akron and the various technical and community colleges who contribute to SERS rather than PERS. There are approximately 20 University of Akron law enforcement officers and 65 technical or community college law enforcement personnel who are SERS members and who are ineligible for the PERS-LE program.

- H.B. 586 - Effective March 31, 1997

The act establishes an alternative defined contribution plan(s) for the full-time academic and chief administrative employees of public institutions of higher education electing the plan in lieu of participation in PERS, STRS or SERS.

The act also requires STRS to pay interest upon the withdrawal of the member's accumulated contributions due to death or separation from employment, along with a 50% match from employer contributions for members who had at least five years of service. No interest or employer contributions would be paid upon the withdrawal of the member's accumulated contributions under PERS and SERS.

These legislative changes are intended to address the issue of pension portability.

iv. No Action Taken: Retirement Eligibility . . .

• Increase in normal retirement age from 48 to 52, with four-year phase in, for PFDPF and HPRS.

• Increase in normal retirement age in tandem with Social Security for PERS, STRS and SERS.

• Exclusion of non-law enforcement service for retirement eligibility purposes in PFDPF.

• Determination of reduction rates for early retirement on actuarial basis in all five systems.

• Maximum percentage limit on "final average salary" in PERS, SERS, PFDPF and HPRS.

• Ad hoc post-retirement increases on as-needed basis in lieu of 13th check in STRS.

• Annual cost-of-living allowance for PFDPF surviving spouses and dependent children.

• *Investment Authority and Performance, Including Derivatives*

i. Findings

• The five state retirement boards are vested by statute with the authority and fiduciary responsibility to invest the funds held in trust for the payment of retirement benefits to their members.

The investment statutes of all five systems provide that with respect to the investment of funds each board shall discharge its duties *solely* in the interest of the participants and beneficiaries; for the *exclusive* purpose of proving benefits to the participants and beneficiaries and defraying reasonable expenses of administering the system; with the care, skill, prudence, and diligence under the circumstances then prevailing that a *prudent* person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; and by *diversifying* the investments of the system so as to eliminate the risk of large losses, unless under the circumstances it is not prudent to do so. This standard, often referred to as the *"prudent expert rule,"* because it calls for a special capacity beyond ordinary diligence, is similar to the standard set forth in the Employees Retirement Income Security Act (ERISA) which is applicable to most private pension plans.

In addition to the prudent expert rule, the statutes of all five systems provide a *"legal list"* which further restricts the types and amounts of investments that each board may make. If an investment vehicle is not specifically authorized in the legal list, the board is prohibited from investing in it regardless of whether the investment would otherwise qualify under the prudent expert rule.

• The investment statutes of all five systems require each board to adopt, *no less than annually*, written policies, objectives and criteria for the operation of its investment program. Also, each board must give equal consideration to investments that enhance the general welfare of the state and that involve minority-owned and controlled firms and firms owned and controlled by women where such investments offer quality return and safety comparable to other investments currently available to it. Equal consideration must also be given to qualified minority and female-owned and controlled firms relative to the selection of agents with whom the board may contract for the administration of the fund.

• The statutory investment authority of each board is totally permissive and virtually identical. This authority was expanded in 1993 to increase the systems' maximum domestic equity exposure from 35 to 50% of total assets; allow the systems to invest up to 10% of total assets in foreign stocks and bonds; add American depositary receipts, commingled stock investment funds, real estate investment trusts and derivatives to the systems' legal lists; and modify certain restrictions relative to the systems' investments in corporate stocks, corporate and government bonds, commercial paper and real estate. These changes marked the first major revisions to the systems' investment authority in over a decade.

The following table shows the restrictions on asset allocation under the current legal lists.

Asset Class	Maximum Percent Limitation
US Stock	50% of Total Assets
Real Estate	25% of Total Assets
Canadian Bonds	15% of Total Assets
Venture Capital	5% of Total Assets
Foreign Securities	10% of Total Assets

• Today, the majority of state retirement systems are authorized to manage their investment portfolios exclusively under the prudent person rule, or some variant thereof; the minority of state retirement systems (approximately 25%), including Ohio's, are restricted to legal lists.

• Asset allocation decisions concerning how much to invest in the various asset classes (fixed-income, equities, real estate, international, cash-equivalents, etc.) have a significantly greater impact upon the investment portfolio's long-term rate of return than decisions concerning which specific securities to buy or sell within each asset class. Investment consultants estimate that asset allocation decisions account for approximately 75 to 80% of the overall rate of return on assets.

The following table shows the current asset allocation of each system:

System	Fixed-Income	Equities	Real Estate	International	Cash Equivalents
PERS	65.5%	19.5%	7.4%	0.7%	6.9%
STRS	39.0%	46.0%	7.0%	5.0%	3.0%
SERS	32.0%	46.7%	5.0%	8.5%	7.0%
PFDPF	38.9%	39.9%	6.2%	4.8%	9.5%
HPRS	39.5%	48.3%	4.5%	3.0%	4.7%

• A widely used actuarial rule of thumb indicates that a 1% increase in the long-term investment return will finance benefit improvements in the range of 10 to 15%, or will allow a similar reduction in contributions or actuarial debt.

The following table shows the annualized rates of return for each system:

System	One Year	Three Year	Five Year	Ten Year
PERS	14.0%	8.9%	9.3%	10.5%
STRS	17.3%	10.1%	10.5%	11.1%
SERS	16.6%	8.8%	9.4%	10.4%
PFDPF	16.9%	10.1%	10.7%	11.1%
HPRS	15.5%	7.9%	9.8%	11.6%

• The five systems have three sources of revenue to fund the level of benefits guaranteed by statute: (1) member contributions; (2) employer contributions; and (3) investment income. Investment income is the largest source of revenue for all five systems, financing up to 65% of benefit costs today. Twenty years ago approximately 25% of benefit costs were financed by investment earnings.

The more revenue that is generated by investments, the less contributions that are required from employees and/or employers, and taxpayers as the ultimate guarantors of promised benefits. If investments do not generate enough money to pay for promised benefits, then contributions must be raised to provide the necessary funding.

• As the five state retirement systems mature, the number of active members eligible for retirement will increase from current levels. The effect will be that the ratio of retirees to active members will increase, and that benefit payments will exceed retirement contributions. It is important to understand that this characteristic is to be expected for maturing pension plans, such as Ohio's, and that investments are thus to be relied upon to meet these pension obligations as they become due. The use of investments to pay benefit obligations is part of the intended design of an actuarially-funded pension plan upon reaching maturity.

• Four of the five systems - PERS, STRS, SERS, PFDPF - manage investments internally to varying degrees , with the use of external managers by each system for specific aspects of their portfolios (e.g., venture capital, real estate, international). HPRS is the only system whose total investment portfolio is managed externally.

• Derivatives are neither good nor bad investment instruments per se.

Derivatives can be used to implement trading and hedging strategies. For example, future contracts enable investors to establish or change a market position more quickly and efficiently, meaning lower transaction costs. Future contracts can also be used as hedging tools to reduce portfolio risk.

On the other hand, investors can use derivatives to speculate in the market and thereby increase portfolio risk. The large derivative losses experienced by Orange County and others were the result of leveraging.

None of the five systems engages in leveraging. In other words, no more risk is assumed when using derivatives than would be experienced by investing in the underlying cash market of that particular security.

ii. Staff Recommendations

• That the "legal lists" be repealed in all five systems and that the systems' investment authority be subject to the "prudent expert" standard, together with the written objectives, policies and criteria adopted by each board, as provided under present law.

• Alternatively, that the "legal lists" be expanded in all five systems to increase the maximum limits from 50 to 60% in U.S. equities and from 10 to 20% in international investments.

iii. Action Taken: Investment Authority and Performance, Including Derivatives

• S.B. 82 - Effective March 6, 1997

The act expands the investment authority of the five systems by repealing the "legal lists" and adopting the "prudent person" standard. Under the prudent person standard, the retirement boards are required to discharge their duties with respect to the investment of funds *with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.* The boards are also required to diversify investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. This standard, sometimes referred to as the "prudent investor" rule because it calls for a special capacity beyond ordinary diligence, is modeled after the standard set forth under the Employees Retirement Income Security Act (ERISA) which is applicable to most private pension plans.

The act also requires each board to adopt annually definitive, written investment guidelines in the following major areas: asset allocation targets and ranges; risk factors; asset class benchmarks; time horizons; total retum objectives; and performance evaluation measures. Each board is also required to comply with the performance presentation standards established by the Association for Investment Management and Research (AIMR) when reporting on its investment performance.

• *Level of Contributions in Relation to Level of Benefits Provided*

i. Findings

• Four of the five systems - PERS, STRS, SERS, HPRS - use the entry age normal actuarial cost method; the initial frozen liability actuarial cost method is used by PFDPF due to the manner in which the fund was initially created, whereby the assets and liabilities of each municipality were calculated separately with the implication that no unfunded liabilities were to be created in the future.

• The five systems have prepared an actuarial valuation each year. Three of the five systems - PERS, SERS, HPRS - measure and report separately the actuarial accrued liabilities for pension benefits and post-retirement health care benefits. The actuarial valuations of STRS and PFDPF measure and report only the actuarial accrued liabilities for pension benefits, and *not* post-retirement health care benefits.

• The laws of all five systems provide that each board, upon the advise of its actuary, shall establish the actuarial assumptions.

The following table shows the key economic assumptions of each system:

System	Interest Assumption	Inflation Assumption
PERS	7.75%	5.25%
STRS	7.50%	5.00%
SERS	7.75%	4.75%
PFDPF	8.25%	4.00%
HPRS	7.75%	5.00%

• The laws of all five systems require an actuarial investigation every five years, which compares each system's assumed experience against actual experience to anticipate future trends and to determine the appropriateness and reasonableness of the current actuarial assumptions.

• The laws of the non-uniformed employee systems authorize each board to fix the employee contribution rate, up to a maximum of 10%, and the employer contribution rate, up to a maximum of 14%. The PERS board is also authorized to determine *separately* the employer and employee contribution rates for the PERS-LE program without regard to the above statutory limits. (See Appendix)

The employer contribution rates of two systems - STRS, SERS - are currently at the statutory maximum. However, SERS is authorized to assess an employer surcharge on members earning below a minimum compensation amount, as determined by the board each year based on the recommendation of its actuary, to fund health care benefits. The surcharge is in addition to the employer contribution rate. Because of this surcharge, there is no effective cap on employer contributions to the system.

• The employee contribution rates are fixed by statute in the uniformed employee systems. In addition, the employer contribution rates for police and firefighters were frozen by statute in 1986. Prior to 1986, the PFDPF board was authorized to determine annually the employer contribution rate based upon the recommendation of its actuary. (See Appendix)

The HPRS board is authorized to determine the employer contribution rate, up to a maximum of three times the employee contribution rate.

• Valuation assets are determined on a market-related basis in all five systems.

• The Government Accounting Standards Board (GASB) has issued GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans," which, among other things, sets the target amortization period at 40 years with a ten-year transition to 30 years as the maximum acceptable period. It also requires that assets accumulated for pension benefits and for post-retirement health care benefits be stated separately.

The following table shows the amortization periods and funded status of each system:

SYSTEM	FUNDED STATUS	AMORTIZATION PERIOD (pension benefits)	AMORTIZATION PERIOD (health care benefits)
PERS	87.0%	-------	--------
◆State	--------	21.0 years	23.0 years
◆Local	--------	28.0 years	31.0 years
◆Law	--------	13.0 years	24.0 years
STRS	78.0%	29.5 years	N/A
SERS	73.0%	35.0 years	N/A
PFDPF	59.5%	40.0 years	N/A
HPRS	88.4%	12.0 years	11.0 years

The average funded status for public pension plans is approximately 85%.

i. Recommendations

• That a 30-year maximum amortization period be adopted by the legislature for the five state retirement systems, with a ten-year transition period.

• That actuarial calculations based on the entry age normal actuarial cost method be prepared and submitted by PFDPF to ORSC for purposes of reviewing the adequacy of the statutory contribution rates for police and firefighters.

• That an actuarial analysis be required by statute to be attached to all proposed legislation changing the actuarial accrued liabilities of any of the five state retirement systems.

iii. Action Taken: Level of Contributions in Relation to Level of Benefits Provided

• S.B. 82 - Effective March 6, 1997

The act establishes a maximum 30-year funding period, with a ten-year transition, for each system to amortize its unfunded actuarial accrued pension liabilities. This standard is modeled after the national standard recently adopted by the Governmental Accounting Standards Board (GASB Statement No. 25) for all governmental pension plans. Each board is required to prepare a report in any year in which the system's funding period exceeds 30, and submit it to the ORSC and the standing committees of the House and Senate with primary responsibility for retirement legislation.

This change is intended to maintain inter-generational equity among taxpayers by limiting the ability to fund benefit costs by simply extending the funding period beyond 30 years and thereby shifting costs to future generations of taxpayers. It further ensures that all five systems meet the national standards for governmental pension plans.

The act requires the PFDPF actuary to prepare for the ORSC an annual actuarial valuation of the fund based on the entry age normal actuarial cost method for purposes of its review of the adequacy of the PFDPF statutory contribution rates pursuant to R.C. §742.311. This actuarial method is traditionally used to evaluate the adequacy of fixed contribution rates, such as under PFDPF, and is used by the other four systems.

The act requires each system to have prepared an actuarial analysis of any introduced legislation having a measurable financial impact on the system and to submit it, no later than 60 days from the date of introduction, to the ORSC and the standing committees of the House and Senate with primary responsibility for retirement legislation.

This change recognizes that there is often either inadequate information, uncertain understanding, or both, when decisions about public pension plans are made. These decisions often involve significant long-term costs. A single, ill-conceived retirement bill could have serious fiscal consequences which are not fully recognized for many years later. If not made carefully and with foresight, these decisions can threaten the budgetary stability of state and local governments years later when the pension obligations become due. Therefore, the requirement that an actuarial analysis be attached to all introduced retirement legislation is intended to provide immediate recognition of the long-term cost implications of retirement decisions made today.

• ***STRS Money Purchase Interest Reduction***

i. Findings

• Generally, the STRS money purchase calculation was affected by *four* key factors: (1) the interest rate credited to member's accumulated contributions from October 1, 1994 to the time of retirement was reduced from 7.75% to 6.00%; (2) the annuitization factors used to convert the member's accumulated contributions into an annuity were changed to reflect the cost of the 3% annual COLA after retirement; (3) the annuitization factors were also changed to reflect expected investment returns of 6.00% as opposed to 7.50% on money purchase reserves; and (4) the annuitization factors were further changed to reflect the cost of improved life expectancies.

• The STRS board acted within its statutory authority to adjust the interest credit and annuitization factors.

• The Milliman & Robertson's actuarial review indicated that "it is not reasonable to expect (1) that two times the member's contributions plus interest at the actual rate of investment returns could be devoted solely to providing the money purchase benefit without the COLA and (2) that the remaining employer contributions could fully support all of the other benefits (COLA, health insurance, long-term disability coverage, survivor coverage, 13th check, etc.)." It also indicated that the new money purchase factors would affect both active members and inactive members, though the financial impact on inactive members would be much greater primarily due to their frozen salaries upon leaving employment.

• Buck Consultants' actuarial review indicated that the old money purchase factors would destabilize the actuarial soundness of STRS. Under the old factors, the costs of benefits could not be sustained unless (1) other benefits were reduced; (2) the funding period was extended; and/or (3) employer contributions were increased. If no changes were made, the employer contribution rate would have to increase gradually by 3.85% to maintain the long-term financing of the STRS retirement program.

• Former teachers relied on estimates given by STRS staff of expected benefits which turned out to be grossly overstated in many cases to the detriment of those involved. Projecting current interest rates to retirement is probably not sound practice in providing estimates of future benefits.

• Two alternatives were presented by Milliman & Robertson to mitigate the effect of the new money purchase factors on the benefits of both active and former teachers: (1) the interest rate and investment return assumption for annuitization purposes could be based on the investment return assumption used for the annual actuarial valuation (7.5%); or the interest rate and investment return assumption for annuitization purposes could be based on the three or five-year average yield on long-term government bonds, with provision for a narrow corridor of plus or minus 1% of that rate (five-year average through 1994 - 7.75%). Under either alternative, the annuitization factors would reflect the cost of the 3% COLA as well as the new mortality rates. Milliman & Robertson also suggested that a special grandfather or transition rule would be appropriate and justified for former teachers who relied on overstated estimates given by STRS to their detriment.

• Buck Consultants estimated the cost of alternative #1 to be $1.4 billion, requiring either an increase in the employer contribution rate of 1.4% or an increase in the funding period by 11.5 years. The cost of alternative #2 was estimated to be $1.7 billion, requiring either an increase in the employer contribution rate of 2.17% or an increase in the funding period by 21.5 years.

Buck Consultants also estimated the cost to grandfather both active and inactive teachers under the old money purchase factors for a one to five-year period. The results are shown below:

GROUP	Jan 1, 1996	Jan 1, 1997	Jan 1, 1998	Jan 1, 1999	Jan 1, 2000
Inactives	... $49.3	... $68.9	... $93.0	.. $117.6	... $140.6
Actives	... $37.1	... $54.0	... $72.5	.. $103.4	... $139.8
Total	... $86.4	.. $122.9	.. $165.5	.. $221.0	... $280.4

For example, inactive members could retire under the old money purchase factors on or before January 1, 2000 at a cost of $140 million. The cost for both active and inactive members retiring under the old factors would be $280 million. Individuals retiring after January 1, 2000 would have their money purchase benefit calculated under the new factors.

• In response to the cost estimates prepared by Buck Consultants, Milliman & Robertson concluded that the cost associated with alternative #1 seems reasonable, but the cost associated with alternative #2 seems overstated. Milliman & Robertson's rough estimate of the cost of alternative #2 is either an increase in the employer contribution rate of 0.5% as opposed to 2.17% or an increase in the funding period of a few years as opposed to 21.5 years.

Buck Consultants' cost estimate was based on the assumption that the yield on long-term government bonds would average 7.75% in the future while the return on all investments made by STRS would average only 7.5%. Milliman & Robertson found that this assumption is unreasonable and inconsistent with STRS's Investment Objective and Policy Statement included in its comprehensive annual financial report.

Milliman & Robertson also concluded that the cost estimates associated with the grandfather provision of a one to five-year window seem reasonable, and suggested that perhaps some transition rule which would provide a gradual phase-in from the old factors to the new factors over a ten year period might be considered.

• Buck Consultants estimated that the ten-year transition for former teachers would cost approximately $200 million. If active teachers were also included, an additional $100 million would be required to fund the cost.

• Assuming that member and employer contributions rates are not to increase, the costs associated with increasing the money purchase interest credit will have to be covered by one or more of the following: (1) reductions in other discretionary benefits; (2) the use of any existing actuarial "surplus;" (3) future investment returns in excess of the 7.5% actuarial assumption (or other favorable actuarial experience); or (4) an extension of the funding period.

• The employer contribution rate is at the statutory maximum of 14%; the STRS actuarial evaluation as of July 1, 1994 indicates that the funding period for pension benefits is 30.5 years and that special reserves established by the STRS board as a result of more favorable actuarial experience than assumed totaled $306 million.

• Since STRS was granted authority in 1980 to pay a "13th check," the sixteenth annual supplemental benefit was approved in 1995 at a cost to STRS of approximately $42 million. The sixteen supplemental benefit payments have totaled more than $479 million.

• The following proposed resolution is premised on the conditions that the contribution rates should not be increased (presently, statutory maximum of 14%); the funding period should not be extended (presently, 29.5 years); and that the long-term actuarial soundness of STRS should be maintained.

- That a gradual transition from the old factors to the new factors over a ten-year period be provided for former vested teachers only, as described in Milliman & Robertson's October 12 letter.

- That the cost be funded by reducing discretionary benefits such as the 13th check and using part of the $306 million in special reserves which have been established by the board as of July 1, 1994.

- That estimates not be based simply by projecting current interest rates to retirement, but rather by providing a range of possible interest rates and showing the impact on future benefit amounts.

i. Recommendations

• That estimates of the money purchase benefit not be based simply by projecting the current interest rate to retirement, but rather by providing a range of possible interest rates and showing the impact on future benefit amounts.

• That any proposed legislative action be deferred because of the pending litigation regarding this issue.

iii. Action Taken: STRS Money Purchase Interest Reduction

• Estimates of the money purchase benefit provided by the STRS include a disclaimer to the effect that the factors used in calculating this benefit are subject to change without notice and that the actual amount payable may be substantially less than the amount shown.

• The legislature has deferred action because of the pending litigation regarding this issue.

• ***Blue Cross & Blue Shield of Ohio***

i. Findings

• Effective April 1, 1993 four of the five state retirement systems (PERS, STRS, PFDPF, HPRS) established a dual managed care network for retirees and their dependents without Medicare Part A (hospital portion); one administered by Aetna Health Plans (Aetna), and the other by Blue Cross BlueShield of Ohio (BCBSO). A single managed care network administered by Aetna was established in SERS.

• A managed care network consists of a group of doctors, hospitals and other health care providers that agree to provide services at specially negotiated rates under contract with the health care administrator.

• Under the dual managed care network, retirees without Medicare Part A are given a choice between Aetna and BCBSO. The two networks generally provide the same coverage. Under either network, retirees may choose to use network providers or non-network providers; however, they receive greater coverage with the use of network providers. Retirees may change networks during an annual open enrollment period.

• As part of its review, the JLC found that the calculation of the retiree co-insurance amount relative to non-network hospital services and certain in-network hospital outpatient services differs under Aetna than under BCBSO. Under Aetna, the retiree co-insurance amount is calculated on the negotiated discount rate; therefore, the individual retiree shares proportionately with the retirement systems in any provider discounts. Under BCBSO, the retiree co-insurance amount is calculated on allowed charges (the amount before any provider discount) with the effect of increasing the retiree's out-of-pocket expenses; all provider discounts are passed directly to the four state retirement systems involved, not the individual retiree.

• The JLC found that no disclosure of the negotiated discount rate is made to the retiree under BCBSO.

• The difference between the two co-insurance calculation methods is estimated to be about $246 thousand in additional retiree out-of-pocket costs under BCBSO, broken down by system as follows:

SYSTEM	RETIREE COST
PERS	$110,075
STRS	$ 85,600
PFDPF	$ 50,000
HPRS	$ 287
TOTAL	$245,962

ii. Staff Recommendations and Action Taken: Blue Cross & Blue Shield Of Ohio

• BCBSO has agreed to use the same methodology as Aetna, effective January 1, 1996, so that retirees will share proportionately with the four state retirement systems in any provider discounts. The systems have also agreed to provide proper disclosure to retirees of this change.

Endnotes

[1]Statistical data on the five public pension plans in Ohio are as of 12/3194 for PERS, PFDPF and HPRS and 6/30/94 for STRS and SERS, unless noted otherwise.
[2]The 1995 rates for service retirees without Medicare.
[3]The retiree premiums vary according to the retiree's years of service and the retiree's choice of insurance carrier. The lowest rates are for members retiring with 25 or more years of service, followed by those retiring with 20 but less than 25 years, followed by those retiring with 15 but less than 20 years, followed by those retiring with 10 but less than 15 years, and finally followed by those with less than 10 years of service paying the highest rates. The rates on the left-hand side of the column are for Blue Cross and Blue Shield of Ohio; the right-hand side, Aetna.
[4]The retiree premiums vary according to the retiree's years of service. Members retiring with 25 or more years of service pay no premiums; those retiring with 20 but less than 25 years of service pay 25% of the premium, followed by those retiring with 15 but less than 20 years paying 50% of the premium, and finally followed by those retiring with 10 but less than 15 years paying 75% of the premium.
[5]Service retirees with annual pensions of less than $10,000 pay no premiums.
[6]In addition to the employer contribution rate of 14.0%, the SERS board is authorized to impose an employer surcharge on the salaries of lower-paid members in order to fund health care benefits. The surcharge generates an additional 1.14% of payroll.
[7]In addition to the employer contribution rate for police and firefighters, each employer having an unfunded accrued liability when PFDPF was established in 1967 pays annually an amount equal to five percent of that liability. Under this schedule, the liability should be paid off in the year 2035.
[8] HPRS law provides that the employer contribution rate shall not exceed three times the employee contribution rate.

IX. William M. Mercer Executive Summary: Major Findings and Recommendations of Disability Study - In this section, we present an overview of our major findings and recommendations. Supporting details are provided in the subsequent sections of the report.

Background

The disability retirement benefits for the Ohio Police and Firemen's Disability and Pension Fund (PFDPF) are established by statute. All PFDPF disability retirement benefits are based on "permanent" disability. A permanent disability is one in which the PFDPF Board finds there is "no present indication of recovery." Disabilities which are temporary in nature are handled by the local employers and may be covered by programs such as sick leave, injury leave, salary continuance, short term disability and workers' compensation.

The statutes (which are detailed in Section III) provide for three types of disability retirement benefits, as outlined in the following table:

OHIO PFDPF DISABILITY RETIREMENT BENEFITS

	On-Duty Permanent and Total	On-Duty Partial	Off-Duty
Disability Standard	Any Occupation	Own Occupation and Impaired Earning Capacity	Own Occupation and Impaired Earning Capacity
Service Requirement	None	None	Five Years
Caused or Induced by Performance of Duties	Yes	Yes	No
Benefit Formula	72%	$\le$ 25 years: Percentage awarded by Board (60% maximum) $\ge$ 25 years: Use normal service formula (up to 72% at 33 years of service)	Percentage awarded by Board, up to lessor of: a) 60%, or b) normal service formula
Salary Basis	Last 12 Months	Highest three years of earnings	Highest three years of earnings

The PFDPF disability retirement benefits contain a blend of features common to other types of public and private disability programs. For example:

1) Group Disability Plans -- Private employers typically offer sick leave, salary continuance or short term disability benefits for short duration disabilities or for the beginning of a prolonged or permanent disability when the employee is unable to perform his/her own job. After a period of time (usually 3 to 9 months), long term disability (LTD) benefits apply. During the LTD benefit period, the standard for continuing benefits usually changes from inability to do one's "own occupation" to inability to perform "any gainful occupation". For disabilities deemed to be permanent, some employers convert disabled employees to disability retirement status. Typically, disability benefit amounts are offset by benefits received from Social Security or workers' compensation.

2) Workers' Compensation -- Disabilities which are caused or induced by the performance of job duties are subject to workers' compensation benefits. Benefits for "temporary" disabilities are payable if the disabled claimant cannot perform his/her own job duties or the duties of a temporary alternate assignment. For "permanent" disabilities, there are separate benefit categories for those who cannot perform their "own occupation" (permanent partial benefits) versus those who cannot perform "any occupation" (permanent and total benefits).

3) Social Security – Social Security disability benefits are payable only for permanent disabilities (those expected to last at least 12 months or result in earlier death). Benefits are payable after a five-month waiting period and are subject to a very strict disability standard – unable to perform "any substantial gainful activity".

The following table compares the major features of these programs:

	Temporary Disability	Permanent Disabilities	On-Duty versus Off-Duty	Disability Standard
Ohio PFDPF	Local employer responsibility	Disability retirement through PFDPF	Both covered; separate benefit categories	Separate benefits for "own occ" and "any occ"
Group Disability Plans	Sick leave, salary continuance, short term disability, LTD	LTD or disability retirement	Usually no on/off-duty distinction (Workers' Comp. offset)	"Own occ" at beginning; move to "any occ" after 12-24 months
Workers' Compensation	Benefits provided; usually "own occ"	Benefits provided for partial or total disabilities	On-duty only	Separate benefits for "own occ" and "any occ"
Social Security	Not covered by Social Security	Covered after five month waiting period	No distinction (Workers' Comp. offset)	"Any substantial gainful activity"

Structure of the PFDPF Plan

Our major findings regarding the structure of the PFDPF disability retirement plan are as follows:

1) Definition of permanent and total disability -- The statutes state that a permanent and total disability must be one in which there is no present indication of recovery and the member is "unable to perform the duties of any gainful occupation for which the member is reasonably fitted by training, experience, and accomplishments, provided that absolute helplessness is not a prerequisite of total disability." This language is comparable to the "any gainful occupation" standard typically applied in the private sector.

   In reviewing actual disability claim files, it appears that the criteria being used for classifying members as being permanently and totally disabled are most commonly based on the ability of the member to perform police or firefighter job duties, rather than the duties of "*any* gainful occupation" (emphasis added). There are no formal efforts by the Fund to assess the member's potential for re-employment in a different occupation. This raises questions about whether the current administration of the "any gainful occupation" standard is consistent with the intent of the law.

   Other sources providing insight into the interpretation and administration of the disability standard are as follows:

   a) Per A.G. Opinion 93-072: "If, at the time an application for a disability award is considered, there is evidence that the claimant has re-employment potential, that evidence may provide a basis for a finding that the claimant does not meet the criteria for permanent total disability."

   b) In *Kinsey v. Board of Trustees (1990)*, the court ruled that determining an applicant is qualified to do some kind of work, such as sedentary or nonstressful work, does not necessarily mean that he is not totally disabled for purposes of PFDPF. Instead, there must be "some evidence" that the gainful occupation he can now engage in, is an occupation for which he is reasonably fitted by way of training, experience and accomplishments. Per A.G. Opinion 93-072, the Board determines if the member's disability meets the definition of permanent and total disability *at that time*. The statutes do not directly address the possibility that a member may subsequently obtain additional training for a different type of job.

   c) House Bill 226, enacted in 1995, allows the Fund to monitor the ongoing disability status of retirees. This law applies to all disability benefit recipients, regardless of retirement date or type of disability (total, partial and off-duty). The language in this law refers to evaluating retirees from the standpoint of whether they are capable of "resuming employment similar to that from which the recipient was found disabled." It appears that in administering this law, the Fund is focusing on employment similar to police or firefighter work.

2) Definition of On-Duty Partial and Off-Duty Disability -- To qualify for on-duty partial and off-duty disability benefits, the law states that the disability must be one that prevents the member from performing his official duties ("own occupation") and impairs his earning capacity. The Board may increase or decrease the disability benefit when there is a change in earning capacity.

The statutes do not explicitly define what is meant by earning capacity and how the Board is to determine the extent to which earning capacity is impaired. There are at least two ways to interpret "impaired earning capacity":

a) Decreased physical and/or mental capacity for police or firefighter duties,

b) Decreased capacity to earn wages comparable to those of a police officer or firefighter in any type of job.

The first definition would be consistent with the Fund's interpretation of the language in House Bill 226 ("own occupation"). However, A.G. Opinion 93-072 and court cases seem to support the second definition. Per *Brunson v. Bedner* (1971), "...earning capacity is not limited solely to earning capacity as a police or firefighter but relates to capacity to earn compensation in other positions...".

One could argue that the second definition transforms the "own occupation" criterion into an "any occupation" definition of disability, because it relates to the ability to earn wages in any occupation. If the second definition applies, it is not consistent with the "own occupation" language included in the statute for on-duty partial and off-duty benefits. It also blurs the distinction between the on-duty total and on-duty partial disability standards.

3) Determination of Benefit Level - The statute requires the Board to determine the benefit percentage for on-duty partial disabilities (for members with less than 25 years of service) and for off-duty disabilities, based on impaired earning capacity. The lack of guidance regarding the definition of impaired earning capacity, combined with the fact that no formal procedures or objective criteria are used to evaluate level of impairment, leads to potential inconsistencies in how the benefit percentages are determined.

4) Basis for "performance of duties" – On-duty partial and off-duty disability definitions are based on the ability to perform official duties. The statutes do not specify what is meant by official duties. In practice, the basis for PFDPF appears to be the full

range of duties for a police officer or firefighter, as opposed to duties of the last job held or light-duty or restricted assignments that might be available.

5) On-Duty versus Off-Duty -- The statute provides for more generous benefit levels for disabilities caused in the line of duty compared to off-duty disabilities. In addition, there is a tax advantage for on-duty benefits (discussed below). Under current law, certain conditions (heart disease, cardiovascular and respiratory disease) are presumed to be incurred in the line of duty, unless the contrary is shown by competent evidence. Beyond that, there is no formal guidance in the law for determination of whether a disability was caused by the performance of duties.

   Based on our review of claim files, it appears that the on-duty/off-duty determination has been administered so that low probability relationships between current or past job duties and the disabling condition results in an on-duty benefit award. Less than 3% of the disabilities awarded from 1985 through 1995 were classified as off-duty.

6) Tax Status of Disability Benefits -- A recent private letter ruling from the IRS confirms that there is a clear tax advantage associated with PFDPF disability retirement benefits (as compared to service retirement benefits), specifically for disabilities awarded on-duty status. (See Section III for a full explanation). While the tax treatment of these benefits is not within the control of the Legislature or the PFDPF, the tax advantages are likely to affect the disability experience. In cases where the member is also eligible for a normal service retirement, there is an incentive to apply for a disability retirement because of the tax advantages.

7) Workers' Compensation Offset -- The PFDPF plan does not offset workers' compensation benefits from the disability benefits paid by PFDPF. Because many of the members who receive duty-related disability retirement benefits from PFDPF may also be eligible for workers' compensation benefits, it is possible for these retirees to achieve income levels that far exceed their pre-retirement or pre-disability income, conceivably as much as two times former pay, considering the non-taxable nature of both benefits. This encourages more people to apply for disability benefits.

   Most private and other public plans include some sort of benefit offset for workers' compensation benefits, as the receipt of both would generally be considered excessive compensation. These offsets reduce the plans' costs because the benefits paid by the plan are reduced, either totally or partially, by benefits received for workers' compensation. Although the other Ohio retirement systems also do not have workers' compensation benefit offsets, it is likely that those systems do not have as many job-related disabilities which would be subject to workers' compensation.

Process and Procedures for Evaluating Disabilities

Our evaluation of the process and procedures used to evaluate disabilities consisted of: 1) a review of written policies and procedures, 2) interviews with people involved in the processing and evaluation of claims, and 3) a detailed audit of a sample of disability claim files.

The processes used by PFDPF for disability retirement application and determination are outlined in Section III. Our detailed analysis of the processes, based on our audit of the disability claim files, is provided in Section V. Major findings are as follows:

1) The Fund is timely and consistent in the processing of member disability claims. Existing written policies and procedures are followed.

2) Based on the files we reviewed, it appeared there were no major changes in the policies and procedures used to evaluate disabilities over the time period we reviewed (1985-1995).

3) The ultimate authority to grant or deny disability benefits rests with the Board of the PFDPF. Key criteria that the Board considers in determining disability status are as follows:

    a) Nature of disability -- If the disability is not "permanent" in nature, the member is not eligible for PFDPF disability benefits.

    b) Cause of disability -- A determination must be made as to whether the disability is a result of the performance of official duties.

    c) Disability rating -- For on-duty disabilities, the Board must determine whether the member meets the disability standard for total disability (any gainful occupation) or partial disability (own occupation and impaired earning capacity).

    d) Benefit Percentage -- For partial disability claims of members with less than 25 years of service and off-duty disabilities, the Board must also determine the amount of payment based on level of earning capacity impairment.

4) Consistent with statute, the Board has developed a benefit determination process based fundamentally on the opinions of community physicians:

    a) Physicians (both attending and Fund-appointed) who examine the claimants are asked to provide information on the claimant's condition and prognoses, and to opine as to whether or not a member is temporarily or permanently "incapacitated for the performance of duties." Physicians are also asked to determine if a member is unable "to perform the duties of any gainful occupation for which the applicant is reasonably fitted by training, experience, and accomplishments."

b) The Board reviews the physicians' statements and, with the advice of its medical advisor, makes a decision on disability status.

5) Regarding the determination of whether the disability was incurred in the line of duty:

a) It appears that low probability relationships between current or past job duties and the disabling condition results in an on-duty benefit award. Often, minor or apparently resolved on-the-job injuries from many years ago or multiple injuries sustained over an entire career are determined to be the cause of disabling conditions. These same conditions occur in the general population and worsen over time, such as back disorders, osteoarthritis, and degenerative joint disease.

b) The statements completed by attending and Fund-appointed physicians do not ask about the relationship of the disability to the member's job duties. However, some physicians' written summaries provide an opinion on job-relatedness.

c) For conditions presumed to be work-related (by law), pre-employment physical records (used to determine the existence of a disease prior to employment) were sometimes not available. When physical records were not available, the Fund assumed the condition was not present at the time of employment. There was no evidence in the files that the Fund searches for "other competent evidence" that the disease is not work-related, as is allowed by law.

6) Regarding the determination as to whether the member can perform his official duties ("own occupation" determination):

a) Job descriptions (including physical demand analyses) were not found to be a part of the disability determination process. Physicians opine on capacity for performance of duties without specific knowledge of functional job requirements.

b) In comparing a member's current capacities with physical job demands, it appeared that comparison was always made with the heavy physical demands required of a regular, full duty police or fire position. The files indicated that some members had been working for months or years at jobs with significantly less physical demand than the original full duty, regular position for which they were hired. Whether the change to less physically demanding work was necessary due to the member's medical condition was not documented, nor was it usually clear what change occurred in a member's condition when the decision to file for disability was made.

7) Regarding the determination as to whether the member can perform "any gainful occupation":

a) Physicians involved in reviewing disability applicants are not asked to specify a member's remaining work capacities and non-work functional status. Instead, they are asked for a single summary statement as to a members' inability to perform work.

b) Physicians are asked about the member's ability to perform the duties of any gainful occupation without being provided professional assessment of employability, which would include, for example, an analysis of the member's transferable skills and labor market potential.

c) The Fund itself does not search for evidence of employability (though to do so would seem consistent with the statute). Vocational assessments were performed only on members who appealed the Board's decision after October, 1994.

8) With respect to the physician evaluations:

a) A formal credentialing process is not in place for the selection of Fund-appointed physicians.

b) While the physicians appointed by the Fund to examine disability applicants appeared to be appropriately specialty-matched to the member's condition, many of the Fund-appointed physicians' reports lacked completeness and/or objectivity. Medical histories, descriptions of physical and mental capacities and current treatment were often fragmentary. Opinions of attending physicians were often repeated apparently without critical review.

c) Generally, information contained on "Attending Physician Reports" is not adequate for a clinical reviewer to make an independent determination of disability status.

d) There were frequent discrepancies between the disability status box checked on the reports filled out by physicians (attending and Fund-appointed) and the physicians' narrative text, creating confusion over physicians' true opinion.

9) The assessments and recommendations of the Fund's medical advisor were absent from files. Because the Board relies on the guidance of its medical advisor, the absence of this documentation makes it difficult to fully understand the rationale behind some Board decisions.

10) No objective clinical rationale or vocational criteria were apparent in the Fund's assignment of partial disability benefit award percentages.

11) Employer accommodations of varying time lengths were apparent in some clinical histories. No return-to-work initiatives were noted on the part of the Fund. However, when a workers' compensation claim is simultaneously active, there may be return-to-work advocacy by the workers' compensation claim administrator.

12) Vocational rehabilitation, even on a voluntary basis, does not appear to be offered. The lack of vocational rehabilitation may result in a loss of: a) potential quality of life for members who could continue to be productive in a different line of work and b) Fund resources.

13) Other findings of an administrative nature include:

    a) Benefit calculations are performed manually, and evidence of calculation audit activity was present in every file. No benefit calculation errors were detected.

    b) While disability files contained the basic required documentation, important types of summary file data have not been maintained in an information system (i.e., diagnoses and physician information).

Disability Retirement Experience

Our analysis of the detailed claim experience data is provided in Section IV. We collected data for approved disability claims for the 11-year time period from 1985 through 1995. The PFDPF staff provided us with a computer data file with information on all of the members who retired on disability during that time period. Information that was not available on PFDPF's computer system was obtained manually by Mercer from disability claim files examined on-site at PFDPF. Data was collected on 2,896 claims.

Many of the findings from the analysis of 1985-1995 experience data support our conclusions regarding the structure of the plan and the process for evaluating disabilities. When appropriate, we have outlined possible explanations for specific experience results. Some experience data, such as experience variances by employer, cannot be explained without further investigation. In some areas, there is no obvious reason for certain experience trends. As mentioned previously, there were no major changes in the process for evaluating disabilities during this time period. The make-up of the PFDPF Board changes over time. It is possible that, as the Board changes, the decisions on disability determinations are affected.

Key findings from the experience data analysis are as follows:

1) The most common type of disability benefit awarded is on-duty partial, which accounted for 65.2% of all disability retirements granted from 1985-1995. Over this

time period, there has been a notable trend towards more on-duty partial awards. Partial disabilities accounted for 54.7% of all disabilities from 1985-1987, compared to 77.8% in 1994-1995.

2) Only 2.3% of the disabilities from 1985-1995 were classified as off-duty. In the most recent years, the percentage has increased (to 6.3% in 1995). Under current law, certain commonly occurring conditions (cardiovascular/heart disease, respiratory disease of a chronic nature) are "presumed" to be incurred in the line of duty, which is part of the reason that many disabilities are classified as on-duty. However, as noted previously, it appears that any possible connection between job duties and the disabling condition results in an on-duty award. About 94% of cancer claims have been classified as on-duty, although cancer is not a presumptive condition under current law.

3) Over 1985-1995, 38.4% of disabilities were classified as "presumptive" on-duty, based on coding in the PFDPF information system. Firefighters have a higher prevalence of presumptive conditions than police. There was a notable decrease in the presumptive percentage over the time period, from 42.0% in 1985-1987 to 31.0% in 1994-1995. The data does not reveal specific reasons for this decrease. About 26% of the claims classified as presumptive by the PFDPF had a diagnosis category which was not one of the presumptive conditions, suggesting that there was either an error in how claims are being coded on the computer system or some disabilities are being classified as presumptive when they should not be.

4) The average annual number of disability retirements was highest in the middle (1988-1993) of the time period we reviewed (1985-1995). Experience has improved in the past two years, with both the number and the rates of disabilities showing decreases.

5) For on-duty partial disability benefits for members with less than 25 years of service, the Board has the authority to set the benefit percentage (up to a maximum of 60%), based on impaired earning capacity. Available data indicated that over two-thirds of members in this category receive the maximum award.

6) The top three diagnosis categories for police and fire disability retirements are cardiovascular/heart disease, degenerative joint disease (which includes disk disease and degenerative changes of the spine) and other musculoskeletal conditions (which includes muscle or tendon strains and sprains, back strains without disk involvement, tendinitis, bursitis, and carpel tunnel syndrome).

7) Disabilities due to degenerative joint disease, musculoskeletal conditions and arthritis accounted for nearly 40 percent of all disability retirements during 1985-1995. The high prevalence of these types of disabilities is important to note for several reasons:

   a) For these types of conditions in particular, it is not possible to make an accurate assessment of disability status without knowledge of functional job requirements, including physical demand analyses (which are not currently a formal part of the disability evaluation process for PFDPF).

   b) These conditions tend to develop over a long period of time. It is often difficult to determine at what point the condition has reached a level such that the police/firefighter can no longer adequately perform the duties of his/her job.

   c) Over 75% of the members with disabilities based on these conditions were awarded on-duty partial benefits; therefore, the Board must determine the extent of the disability in assigning the benefit award percentage. Without objective criteria for evaluating the level of impairment, inconsistency in benefit awards is likely.

8) The fourth highest category of disabilities are those due to psychiatric conditions. Psychiatric conditions account for a significantly higher percentage of police disabilities than they do for firefighters.

9) Our analysis indicated that there are notable differences in disability experience by employer. Further investigation would be required to reach conclusive explanations for the disability experience of individual employers. However, we offer possible reasons for experience variations in Section IV, along with an analysis of experience by employer. Some overall findings are:

   a) For police, large employers generally had higher disability rates than small employers.

   b) For fire, mid-size employers tended to have higher disability rates than the very small or very large employers.

   c) A detailed analysis of large employers (100 or more members, which includes 10 police and 10 fire employers) shows a wide variation in experience. For police, the four employers with the highest rates of disability were the cities of Youngstown, Cleveland, Dayton and Springfield. For fire, the four employers with the highest rates were Youngstown, Akron, Cleveland and Canton.

Statistics for individual employers are provided in Section IV and Appendix III.

10) Attending physicians and Fund-appointed physicians involved in the disability application process are asked to draw conclusions about the disability status of claimants. The data we reviewed showed that recommendations made by physicians are often not consistent with the benefit actually awarded by the Board. In addition, it was quite common for the various physicians involved in reviewing a case to make different recommendations.

11) Over the 1985-1995 time period, the PFDPF appointed over 150 physicians to evaluate disability claims. A relatively small number of these physicians were used frequently -- 19 of these 150 physicians were involved in 93% of the disability claims. About 37% of the claimants from 1985-1995 were reviewed by more than one Fund-appointed physician.

12) Approximately 40% of initial Board decisions on disability are appealed. Of those cases appealed in the past six years, the initial decision was changed in 59% of the cases.

13) Nearly 20% of members applying for disability retirement are still serving in a "regular duty" employment status at the time of application for disability. In that the law requires members to be totally or partially disabled, the high percentage on regular duty status appears unusual.

14) Although our review indicated that a large percentage of disability retirees (about 67%) have filed a workers' compensation claim, data was not available from the Fund on the percentage of retirees who actually receive workers' compensation benefits in addition to a PFDPF disability pension benefit. Currently, there is no provision in the law to require PFDPF's disability benefits to be offset by workers' compensation benefits.

Comparison of Ohio PFDPF to Other Retirement Systems

In order to compare Ohio PFDPF's disability plan and procedures to other similar retirement systems, we conducted a survey of other police and/or firefighter retirement plans. We contacted 27 plans, of which 15 responded to the survey. An analysis of the survey results is provided in Section VI. Detailed documentation on the survey responses (for each survey question, by retirement system) is provided in Appendix I.

Our purpose in conducting the survey was two-fold:

1) To compare Ohio's plan and procedures to other systems, in order to determine if Ohio's practices are similar to those of other systems and to identify any areas in which Ohio differs significantly.

2) To identify "best practices" in disability programs for police and/or fire retirement systems.

In comparing plans, it is important to keep in mind the different circumstances for each system that may affect their experience or how they handle disability retirements (e.g., single-employer versus multi-employer systems, urban versus rural, separate police and/or fire plans versus plans combined with other state employees, etc.). The data collected through this survey was not intended to be sufficient to relate each systems' plan features to their actual experience.

With the exceptions described below, we found that Ohio PFDPF's disability program is not unusual compared to the programs of other systems we surveyed. No single system that responded to the survey stood out as being significantly different from other systems in its approach to managing disability retirements.

Major findings from the survey are as follows:

3) Disability Standard -- All but one of the systems surveyed have an "own occupation" criterion determination. Five systems (including Ohio) out of 16 have a separate category for "total" disability, requiring the member to be unable to perform the duties of any gainful occupation. (Note: Ohio's on-duty partial and off-duty benefit categories are based on an "own occupation" standard and the on-duty total category is based on an "any gainful occupation" standard.)

4) On-Duty Versus Off-Duty --

   a) Ohio's plan is not unusual in that it provides separate benefits for disabilities incurred in the line of duty versus off-duty disabilities All but one system surveyed provide separate on-duty and off-duty benefits.

   b) For the 15 systems (including Ohio) with on-duty disability categories, nine have presumptive disease categories, including heart, lung and cancer diseases. Most systems attempt to determine if the condition existed prior to employment through pre-employment physicals or other evidence. The Houston firefighters require an employee to have been employed for six years before presumptive conditions apply.

   c) Performance of Duties Basis -- To determine the ability to perform job duties, five systems (including Ohio) out of the 15 consider the full range of duties for a police officer or firefighter. Five systems consider the job for a specific rank, classification or department; and four systems base their determination on the last position held (sometimes including light-duty positions). One system (City of Los Angeles) matches the member's remaining work capacities to available jobs, including light or restricted duty. Many systems use job descriptions of some sort or rely on employer information on job duties.

5) Workers' Compensation -- Unlike Ohio, most systems include benefit offsets for workers' compensation benefits. Only one other system (out of 13 who responded to the question) does not offset for workers' compensation. These offsets reduce the benefit paid by the retirement systems by some or all of the amount received by workers' compensation. Most of the offsets are dollar for dollar, but a few systems apply offsets when the combined benefits (disability pension plus workers' compensation) exceed 100% of final compensation.

6) Outside Earnings Limits – Limits on outside earnings (once a person is receiving disability benefits) vary among systems. Five systems out of 16 have no limits. Most of the remaining systems limit earnings so that the sum of earnings and disability benefits do not exceed a specified amount. A few systems do not have specific earnings limitations, but refer to changes in earning capacity or taking jobs that exceed the physical restrictions identified when the disability was granted. When applicable, most systems collect earnings information on an annual basis, through tax returns, W-2 statements, standard forms or questionnaires. Ohio PFDPF has no specific limits on outside earnings.

7) Tax Status -- Tax treatment of disability benefits varies at the state level. Most stated that, at least to some extent, disability benefits are exempt from taxation. Of those that responded to the federal taxation question, most seemed consistent with the conclusions that Ohio received in its private letter ruling: on-duty benefits not based on years of service are tax-exempt.

8) Disability Application Process –

a) Ohio's disability application process is generally not unusual compared to other systems. The major exception is that Ohio does not allow employers to file for disability retirements on behalf of its employees, while most other systems do. (In addition, the other four Ohio retirement systems do allow employers to file on behalf of employees).

b) In some other systems, employers are also more involved in the process than they are in Ohio (for example, by providing employment history or documentation and information on specific job duties, testifying as to the availability of light-duty or restricted positions, providing opinions on an applicant's disability).

c) Like Ohio, most systems do not allow for disability applications to be filed after service retirement. In Colorado, members cannot apply for a disability once they are eligible for service retirement.

d) Like Ohio, most systems do not have any maximum allowable time between an accident and filing of a disability claim resulting from that accident. (Often, disability claims are filed many years after an accident).

9) Physical Fitness Requirements – The pension systems generally do not use physical fitness requirements in the disability determination process, mainly because such fitness requirements are usually the responsibility of local employers or departments, and tend to vary.

10) Light/Restricted Duty – If offered, light duty jobs are generally at the discretion of the local employer. They are usually intended to be temporary or to provide accommodations at the beginning of a disability. An exception is the City of Los Angeles, where a disability application will be denied if the member is capable of performing a light/restricted duty and a position is available.

11) Return-To-Work, Early Intervention and Rehabilitation programs are generally the responsibility of the local employer, not the retirement system.

12) Reexamination of Disabled Retirees --

a) Most systems allow for reexamination of disability retirees. Some have specific guidelines for the timing and frequency of reexaminations and some specify when the exams will no longer be required (e.g., when the member is within three years of normal retirement, at age 55, or until determination is made that the retiree cannot ever return to work).

b) If it is found, through the reexamination process, that a member is no longer disabled, some systems terminate or reduce the disability benefit, while others only terminate the benefits when a position is available. In Ohio, employers must restore employees to their previous (or similar) employment if they are deemed no longer disabled within the first three years (per House Bill 226). No other responding systems had provisions exactly like this, although a few required employers to return employees back to work if a position was available.

13) Criminal Activity – Termination or denial of pension benefits due to criminal activity is rare among survey respondents. Exceptions include Michigan State Police and New Jersey Police and Firemen.

Conclusions and Recommendations

Based on the findings from our analysis of the statutes, disability claim experience, and processes used to evaluate disabilities, we have developed conclusions and recommendations for the consideration of the Legislature and the Fund. When appropriate, we have considered best industry practices and current trends in effective disability management to formulate our recommendations. In some instances, we have outlined areas that the Legislature may wish to consider from a public policy standpoint. In other areas, we have outlined suggestions for changes in policies or procedures that, in our opinion, would improve the management of disability retirements for PFDPF.

Our conclusions and recommendations cover the following major areas:

1) Disability Standard

2) Disability Benefit Structure

3) Performance of Duties Basis

4) On-Duty Versus Off-Duty

5) Workers' Compensation Offset

6) Disability Determination Process

7) Early Intervention Programs

8) Monitoring and Reexamination of Disability Retirees

9) Employer Involvement and Accountability

Explanations and rationale supporting each of these items is provided below.

Disability Standard

Current Situation

1) On-Duty Total -- The statutory language reflects an "any occupation" disability standard. In practice, this standard is not administered rigorously, which means that members receiving this benefit may be able to perform some other type of work.

2) On-Duty Partial and Off-Duty -- The standard is "own occupation" plus "impaired earning capacity". The statute does not clearly define earning capacity which leads to confusion about what standard the Legislature intended to be used in awarding benefits.

Other Plans

1) The other Ohio retirement systems use an "own occupation" standard.

2) Social Security disability benefits are based on "any substantial gainful activity".

3) Workers' Compensation includes both definitions, with separate benefits.

4) Of the 15 other uniformed systems we surveyed, nine have an "own occupation" definition only, four systems use both standards, and one system use an "any occupation" standard only.

5) Private disability plans usually switch from "own occupation" to "any occupation" at 12 to 24 months.

Public Policy Alternatives

We recommend that the Legislature review and clarify the intent of the law with respect to the disability standard for PFDPF. Alternatives to consider are:

1) Keep both standards (own occupation and any occupation) in the statute, with separate benefits. If so, then:

   a) The administration of the "any occupation" standard for on-duty total benefits should be modified to include objective criteria for determining the ability to perform other types of work. A common industry standard for determining ability to perform "any occupation" is employability at 60% of previous wages, based on considerations such as physical and cognitive capacities, transferable skills and labor market potential.

   b) For on-duty partial and off-duty benefits, the Legislature should clarify or remove "impaired earning capacity" from the disability standard. (Additional comments are provided later regarding the benefit award percentage for "own occupation").

2) Move to an "own occupation" standard only.

   a) In practice, on-duty total benefits have not been strictly based on an "any occupation" standard. If this current practice reflects the intent of the Legislature, then the distinction between on-duty total and on-duty partial benefits is confusing and unnecessary.

   b) If "own occupation" is the only standard, the law could still allow for different benefit levels based on level of impairment or earning capacity.

Disability Benefit Structure

Current Situation

The current benefit structure requires the PFDPF Board to set the benefit percentage for on-duty partial disabilities for members with less than 25 years of service and for members with off-duty disabilities, based on level of earning capacity impairment. The statute lacks guidance on the definition of earning capacity, and the Fund has not established objective criteria for determining level of earning capacity.

Public Policy Issues

A previous recommendation suggested that the Legislature clarify the definition of earning capacity. Additional consideration should be given to the benefit structure (the amount of payment) for the benefit categories subject to the language relating to impaired earning capacity. For these categories, which are subject to an "own occupation" disability standard, there are philosophical issues which the Legislature might consider regarding the structure of the benefit payment:

1) To what extent should the ability to do other types of work affect the disability pension amount?

2) For on-duty disabilities, should there be a "permanent" award or pension to compensate for job-related impairments, regardless of ability to do other work?

3) Should benefits be structured to encourage members to become gainfully employed in another occupation?

Depending on the answers to these questions, there are several alternatives which could be considered in determining the benefit amount for disabilities which are not "total" in nature:

1) All recipients in these categories could receive the same benefit, or be subject to the same formula, so that the benefit amount would not be related to level of impairment or earning capacity.

2) The benefit amount could be based on the member's earning capacity for other types of work.

3) The benefit could be structured so that there is a reward or compensation for physical or mental impairments preventing the performance of police/fire duties. This could be applicable only to on-duty disabilities.

4) The benefit could be structured so that a "vocational rehabilitation benefit" category is added for claimants expected to be trainable in a different occupation, based on skills, training, experience and accomplishments. This benefit would be coordinated with new employment earnings for two years, to encourage members to become gainfully employed again. A vocational rehabilitation assessment could be used to identify candidates for this benefit.

5) The benefit structure could be structured to include a combination of these approaches.

In any of these situations, consideration should be given to preventing a "take away" of retirement benefits already earned based on years of service. The current benefit for on-duty partial disabilities converts to the service retirement formula at 25 years of service. Prior to that time, the Board assigns the payment amount, so it has the ability to, at least on an informal basis, award benefits that are not less than what would be awarded using the service retirement formula.

Benefit Structure Example

The following is an example of how the benefit amounts could be determined using a combination of the above approaches. This structure would apply only to those disabilities which do not meet the criteria for "total" disability, based on ability to perform any gainful occupation. The claimants in this category are not able to perform their own occupation, but are able to do other types of work.

The benefit amount could be based on the *greater* of the following:

1) Earning Capacity Benefit -- This amount would be based on the ability to earn wages in other jobs. Benefits could vary based on an earning capacity "rating" determined through objective vocational assessments.

2) Physical/Mental Impairment Benefit -- This would be based on a "rating" of the member's physical or mental impairment. The intent would be to provide compensation for impairments incurred in the line of duty.

3) Minimum Benefit Based on Service -- To avoid a take away of service-based retirement benefits.

For example, a person who has a permanent physical impairment which was incurred in the line of duty may still be found to be capable of earning as much or more wages in other types of jobs. Although he would not be eligible for a benefit under item a) above, he could still be eligible for a benefit under item b), based on the physical impairment.

On the other hand, there are situations where the benefit under item a) could exceed the benefit under b). For example, members who, by reasons of age, education, experience, training, etc., are not judged to have significant employment potential in other jobs.

Performance of Duties Basis

Current Situation

For on-duty partial and off-duty disabilities, the disability standard is based on the ability to perform official duties. The statutes do not define official duties. In practice, PFDPF considers the full range of duties for a police officer or firefighter when the ability to perform job duties is evaluated. No consideration is given to regular jobs with less physical demands or modified duty jobs that might be available or that the member may have held prior to application for disability retirement.

Other Plans

1) Ohio State Highway Patrol -- The statute for HPRS requires that members be "incapacitated for duty in the employ of the state highway patrol" in order to qualify for disability retirement. According to Attorney General Opinion No. 90-002, the state highway patrol must base determination of disability "on the specific job duties and responsibilities of each individual applicant rather than on the functions of the highway patrol in general." (Note that Ohio PFDPF has not asked for an opinion from the Attorney General on this issue).

2) For the 14 other police/fire systems surveyed (who have an "own occupation" disability standard), the basis for four systems is full range of duties; four systems use last job held (one specifies last non-light-duty job held); five systems use job duties for the rank, classification or department; one system (City of Los Angeles) matches remaining work capacities to available jobs, including light or restricted duty.

Public Policy Issue

We recommend that the Legislature clarify the definition of job duties used to determine if a member is able to perform his official duties. Alternatives to consider:

1) The full range of police or firefighter job duties

2) Job duties for a specific rank or classification

3) The last job held by the member, if it is still available

4) Other jobs that may be available

The criteria used to evaluate disability retirements on a statewide basis must consider variations by employer. Policies and practices regarding job classifications, specific job requirements, and light-duty or restricted jobs differ for each employer. In addition, collective bargaining agreements and requirements relating to the Americans with Disabilities Act (ADA) may affect how employers handle light-duty or restricted job classifications.

Administrative Considerations

Once the definition of official duties is clarified, the administrative processes should be modified as follows:

1) Job analyses (which include physical demands, mental demands, stress factors, environmental characteristics and hazards) for the job which is the basis for the disability determination should be provided to physicians and medical reviewers.

2) Depending on how the definition of duties is defined, the Fund should consider requiring employer input on specific job requirements, or moving to statewide standards.

On-Duty Versus Off-Duty

Current Situation

1) PFDPF benefits for disabilities classified as off-duty are less generous than on-duty benefits. In addition, there is a five-year service requirement for off-duty benefits and none for on-duty benefits.

2) There is a distinct tax advantage for on-duty benefits.

3) By statute, certain conditions (heart, cardiovascular and respiratory disease) are presumed to be incurred in the line of duty.

4) In practice, very few disabilities are classified as off-duty.

Other Plans

1) Ohio retirement systems: only PFDPF and the Highway Patrol Retirement System have the on-duty/off-duty distinction.

2) Of 15 systems surveyed, 14 have separate benefits for on-duty and off-duty disabilities. Four of these use an "accidental" on-duty definition, meaning that the disability must be a direct result of an accident or traumatic event.

3) Social Security makes no distinction between on-duty/off-duty.

4) Workers' compensation benefits are for on-duty disabilities only.

Public Policy Considerations

Three alternatives for the Legislature to consider are:

1) Keep the on-duty/off-duty distinction. This is common practice among uniformed systems and reflects a public policy desire to make members disabled in the line of duty "whole", by providing greater retirement benefits. However, as currently

designed and administered, the PFDPF plan provides a significant tax advantage for on-duty disabilities.

2) Revise the on-duty/off-duty definition. This could mean a stricter definition of on-duty disabilities (e.g., "accidental" as with some other uniformed systems). Alternatively, the current statutory language could stay in place, but with stricter interpretation or administration (see suggestions below).

3) Remove the on-duty/off-duty distinction. This would be very unusual compared to other uniformed systems. However, Ohio's plans replace Social Security, which does not distinguish between on-duty/off-duty. Workers' compensation benefits are available to address on-duty disabilities. With this alternative, the current five-year eligibility requirement for off-duty disabilities would have to be addressed. This change may also affect the tax status of benefits.

Administrative Considerations

There are ways that the administration and determination of on-duty status could be modified to potentially reduce the number of disabilities awarded on-duty status:

1) Administration of the law relating to presumptive conditions:

   a) Steps could be taken to require that pre-employment physicals be maintained on file at the Fund (for the purpose of identifying the presence of presumptive conditions prior to employment).

   b) Statewide standards for pre-employment physicals could be considered, with specific references to presumptive conditions and other conditions which may be related to job duties.

   c) The laws relating to presumptive conditions could be tightened to require that, in order for members with presumptive conditions to qualify for an on-duty disability, the member must prove that he/she was subject to "injurious exposure" to heat, smoke, toxic gases, chemical substances, etc. This is similar to workers compensation's handling of these conditions.

2) During the disability evaluation and determination process, procedures to more objectively assess the duty-relatedness of disabilities should be implemented:

   a) Evaluating physicians should be asked to make a medical determination on cause of disability.

   b) The time lapsed from the date of injuries to the date of disability and their severity should be considered.

   c) To the extent applicable, lifestyle factors and predispositions relating to the disabling condition should also be considered.

Workers' Compensation Offset

Current Situation

The PFDPF disability benefit is not offset by benefits received from any other sources, including workers' compensation. It is possible to receive both benefits, in some cases on a non-taxable basis, and achieve income levels that far exceed pre-retirement income.

Other Plans

1) Ohio retirement systems: None have a workers' compensation offset.

2) 15 other uniformed systems surveyed: Twelve systems have workers' compensation offsets, one system has no offsets, and two systems did not respond to the question.

3) Private sector: Most plans have offsets for Social Security and workers' compensation.

Public Policy Considerations

The Legislature may wish to consider adding a provision to the statute that would offset the PFDPF benefit by any periodic workers' compensation benefit. This offset can be structured so that the PFDPF cost-of-living adjustment is preserved.

Disability Determination Process

To ensure consistency in decisions, increase administrative efficiency and minimize the potential for disability awards for people who are fit for some duty or work, we have developed recommendations to enhance the process used by the Fund and its Board to evaluate disability retirement applications. These recommendations are based on best industry practices for disability management and will help the Board make more effective decisions. Our recommendations are as follows:

1) For disability application processing, from an administrative perspective:

   a) Automate the collection of data and calculation of benefits.

   b) Develop a file structure which chronologically organizes pertinent information in separate sections.

c) Expand the information included on the PFDPF data base of disability claim information to include items such as diagnosis information, physicians information (attending and Fund-appointed), benefit calculation data, and the earnings and medical information that will be used for ongoing monitoring under House Bill 226.

d) Take steps to ensure that the data entered on the computer system is coded consistently and periodically quality-checked for accuracy.

2) Formally credential Fund-appointed physicians, striving for 100% Medical Board certification. Systematically evaluate the quality of reports submitted by physicians and establish a process by which the panel of Fund-appointed physicians is continually monitored, making appropriate changes to the panel when necessary. Encourage the appointed physicians to obtain certification by the American Board of Independent Medical Examiners (ABIME).

3) Take steps to improve the quality of the evaluations provided by Fund-appointed and attending physicians. For example:

a) Provide additional guidance to examining physicians about their role in the disability evaluation process, including a revision of the Attending Physician's Report and Fund-Appointed Physician's Report to more clearly define the questions for the physicians and structure their responses.

b) Require that copies of member's treatment records be submitted from attending physicians. Lack of adequate information ought to delay a disability determination.

c) Require that Fund-appointed physicians review all medical records.

4) Consider changing the role of evaluating physicians, as follows:

a) Change the responsibility of physicians (attending and Fund-appointed) from that of focusing on whether the claimant cannot do a police or firefighter job, to focusing on residual work capacities (what the claimant is capable of doing). This can be promoted through adding a checklist of physical and cognitive capabilities to the form that the physicians are required to be complete on behalf of the claimant. Also, require physicians to state their opinion on the degree of medical impairment resulting from the disabling condition.

b) Consider using an outside evaluator to determine the degree of disability and earning capacity, based on the evaluating physicians' assessment of the employee's remaining physical and cognitive capabilities and the job requirements under consideration.

5) For all disability applicants who are able to participate in a disability examination, initiate common evaluation procedures, such as:

   a) Functional capacity evaluations – An assessment of an individual's ability and willingness to perform a full-range of activities, primarily as related to a job (i.e., the extent to which the person can lift, stand, bend, climb, or do find-hand motions). These evaluations are typically conducted by an occupational or physical therapist.

   b) Educational and vocational histories – To evaluate training, knowledge, experience and abilities that an employee has demonstrated in the past that might meet the requirements for other jobs.

   c) Professional vocational assessments – The process of determining a disabled employee's potential to return to work with the previous employer or for outplacement to a new employer.

6) Require the medical advisor to complete a written analysis and recommendation for the Board, which remains an integral part of the record and is available for the appeal process.

Early Intervention Programs

<u>Current Situation</u>

Currently, early intervention activities are the responsibility of the local employers. The Fund is not involved until the member applies for disability retirement, when the disability has reached a potentially "permanent" status.

<u>Best Practices</u>

Early intervention programs involve the initiation of a variety of case management and stay-at-work or return-to-work efforts as soon as possible after an actual or potentially disabling event occurs. These programs typically involve communication among employees, physicians, employers, claims administrators, and rehabilitation specialists. Early intervention programs can include the following types of initiatives:

1) Rehabilitation

2) Transitional work (modified work or alternate duty)

3) Job restructuring

4) Job conditioning (progressive physical/psychological activity, often simulating job duties, oriented toward helping an employee return to work)

5) Vocational assessments, counseling, rehabilitation

6) Transferable skills analysis

7) Job seeking skills training

Public Policy Considerations

Because PFDPF is not the "employer" of its members, administration of early intervention programs has been viewed as being someone else's responsibility. However, there is much documented evidence that early intervention programs can be effective in helping disabled employees return to full functionality and productive work, which would most definitely effect the disability retirement experience for PFDPF. Therefore, it is important for the Legislature and the Fund to consider potential methods for increasing the prevalence and effectiveness of early intervention programs. Issues to consider:

1) Who should bear the responsibility for the administration and funding of early intervention initiatives?

   a) Local employers (current situation).

   b) The Fund – Consider earlier involvement in "managing" disability claims prior to retirement application.

   c) Shared responsibility between local employers and the Fund.

2) Can guidelines or minimum standards for early intervention activities be established?

Legislation was recently passed in Massachusetts which requires the implementation of an Early Intervention Program (EIP) for disability retirements. Under this program, if a member is absent from work for 30 days, an evaluation is made as to whether the member is a candidate for early intervention. An early intervention team is assembled to determine the best approach to rehabilitation. Costs for the EIP are to be paid out of retirement system investment earnings.

Monitoring and Reexamination of Disability Retirees

Current Situation

House Bill 226, enacted in 1995, gave the Fund new powers to monitor the eligibility of disability retirees for continuing benefits. Regardless of when a member retired, the Board may now order the member to be re-evaluated by a Fund-appointed physician. If the physician finds that the member is capable of resuming employment similar to that from which he was found disabled, then the Board can terminate the disability pension. The law also granted disability retirees a three-year leave of absence while on disability retirement and requires employers to restore them to their previous employment (or a similar position) if the Board finds they are capable of resuming employment.

To administer the provisions of this law, the Fund is now requiring disability retirees to file an annual statement of earnings and an attending physician's statement. For 1996, these statements were due by September 1. Over 4,200 disability benefit recipients were sent notices and all but about 200 responded by the deadline. According to staff at the Fund, about 60 to 70 of those that responded were identified as being subject to further review because they appeared to be performing work similar to police/firefighter type of work.

Public Policy Issue

The language in the bill states that benefits may be terminated if the member is "capable of resuming employment similar to that from which they were disabled". It appears the Fund is interpreting this language as meaning police/fire work. However, a direct interpretation could be that the ongoing monitoring should reflect the disability standard applicable to the benefit award for each recipient:

1) On-Duty Total – If the standard is "any occupation", then these retirees should be monitored based on the ability to perform any type of occupation, not just police/fire work.

2) On-Duty Partial and Off-Duty – This will depend on the clarification of "impaired earning capacity". If it relates to earnings in other occupations, then ability perform other occupations should be monitored.

Guidelines for Monitoring and Reexamination

The Fund should establish criteria for determining which members should be reexamined and develop specific guidelines for decisions regarding termination or reduction of disability benefits. Some suggestions:

1) On-Duty Total – If it is determined (by evaluating physicians or the Board's medical advisor) that there is little likelihood for improvement in the condition, then the reporting requirements should be waived. For others, specific reporting guidelines should be established (i.e., annual reporting plus medical advisor review after two years).

2) On-Duty Partial and Off-Duty – Reporting of earnings and attending physician's statement should be required every year. The physician's report form should be changed to focus on remaining work capacities (which could be specifically listed on the form).

3) The Fund should develop an approach to screening the information reported each year, to determine which retirees should be subject to further review and/or a Fund-

appointed physician evaluation. The approach should reflect the disability standard that applies to the recipient. For example, if the disability considers earning capacity in any job, the screening approach could be based on a percentage of earnings test.

Employer Involvement and Accountability

Current Situation

Currently, there is little employer involvement in the disability application and determination process. Employers cannot file for PFDPF disability retirement application on behalf of employees. The other Ohio retirements are allowed to file applications on behalf of employees.

Individual employers are not accountable for their disability retirement experience, in that the contribution rates (as a percentage of pay) to the Fund are the same for all employers.

Employer Involvement

The Legislature and/or Fund should consider employer involvement, as follows:

1) Consider allowing the employer to file for disability on behalf of an employee (other Ohio systems already have this provision).

2) Consider possible additional involvement by employers in the disability application process, such as:

   a) Providing information on job duties and physical demands

   b) Identifying the availability of light-duty or restricted jobs

   c) Testifying or documenting past job injuries

   d) Providing opinions on the applicant's ability to do assigned or other duties.

Employer Accountability

The Legislature may consider methods to hold employers more accountable for their own experience, such as:

1) Penalties for non-compliance with early intervention and rehabilitation programs.

2) Rewards or encouragement for workplace accommodations (light-duty or alternative jobs).

3) Publishing of disability retirement experience by employer annually.

4) Incorporation of experience rating into the determination of Fund contribution rates (by basing the contribution, to some degree, on disability retirement experience).

X. PFDPF's Response to Disability Study

TESTIMONY OF THOMAS A. BENNETT BEFORE THE JOINT LEGISLATIVE COMMITTEE TO STUDY OHIO'S PUBLIC RETIREMENT PLANS

NOVEMBER 21, 1996

Co-chairmen White and Van Vyven, members of the Joint Committee, I am Tom Bennett, a Dayton police officer and chairman of the Board of Trustees of the Police and Firemen's Disability and Pension Fund, and to my left is William J. Estabrook, Executive Director. We are here to give you the initial response of the Board to the Mercer report which was released a week ago at this Committee's last meeting. At that time, Co-chairman Van Vyven asked that the fund be prepared to respond at today's meeting. In accordance with that request, the Board held an emergency meeting this past Monday to consider the report and to hear the same presentation that was made to this Committee by the Mercer Company. I might add that Melanie Hoffman was gracious enough to schedule this time on very short notice.

We would like to begin by thanking the Committee for the opportunity to appear before you and commending you for drawing the requirements of your charge to Mercer in such a way as to insure a comprehensive report. We offer our compliments to the Mercer Company, as well, for the methodology they employed in preparing the report which we believe was objective and complete. They simply set out the facts as they found them to be and made no effort to speculate as to causes. We sincerely hope that others who read the report will draw their conclusions only after sober thought and fair consideration.

The Board has taken the report very seriously and is giving it our closest consideration. We hope to be able to add our perspective and expertise to the dialogue that will surely follow. While we may question some findings, we are not here, today, to argue with the report. Concerns about the findings or questions about the recommendations should be left to later discussions.

The general thrust of the report is to lay out issues and questions related to our disability program that resulted from the study. In a number of these items the report goes on to make recommendations that the legislature may want to consider. However, they are handled, the report suggests that these matters should be addressed. We agree. Resolution of these problems will not be achieved in one tidy package. We concur with Mercer that in many cases there is a need for statutory clarification. In addition, judicial decisions have added to these problems. Therefore, the solution must necessarily be the result of a collective effort of the legislature, interested parties including employees and municipalities, the fund and others. Our pledge to you is that we are willing to do our part.

The findings and recommendations of the report fall into two categories; first, those relating to the processes we employ to carry out our obligations under the disability statutes and second, those dealing with public policy. While it is impossible for the fund to formulate a definitive response to each of the issues identified in the report in such a short time frame, I can say without fear of contradiction that it is the Board's intention to work with the legislature and all other parties to tackle these issues head on. At the same time, we will maintain our commitment to fairness and equity in the application and administration of our disability program. Clearly, many of the questions raised in the report are so fundamental that they go to the very nature of our disability program. These public policy issues will bear heavily on our fund and Ohio's other public pension funds and will require no less than the power of the General Assembly to resolve. We want to have a seat at the table and to add our voice to the discussion.

Furthermore, while there will be legislative attention focused on these more weighty questions, the other category of issues identified in the report focuses on process oriented matters. It lies within the province of the Board to affect these operations by the adoption of a rule or the amendment of a policy or procedure. For this reason, I am pleased to be able to tell you that the Board has already adopted initiatives in connection with a number of these issues and has taken certain measures that will resolve many of the shortcomings set out in the report. Bill Estabrook will cover some of these programs in a few minutes.

We believe that the results of these internal revisions are beginning to be felt and are showing up in many of the statistics included in the Mercer report. For example, the trend in the average annual rate of disability is very clearly headed downward. We think also that there is a

rebalancing of the proportion of permanent and total disabilities to partial disabilities. We think these are good things for the fund but we also understand that there is more work to be done.

As I mentioned a moment ago, the issues set out in the report fall into two categories. We have already begun to take on many of these issues in both areas. In that regard, I would now ask our executive director, Bill Estabrook, to tell you of some of the initiatives that we have already begun that change our disability procedures. He will also relate to you some of the discussions currently underway around our Board table that deal with the more substantive questions contained in the report.

Thank you again, Co-chairmen Van Vyven and White and members of the Committee.

TESTIMONY OF WILLIAM J. ESTABROOK
BEFORE THE JOINT LEGISLATIVE COMMITTEE
TO STUDY OHIO'S PUBLIC RETIREMENT PLANS

NOVEMBER 21, 1996

Thank you Chairman Bennett and good morning Co-chairmen and members of the Committee. I am Bill Estabrook, executive director of the Police and Firemen's Disability and Pension Fund. I also appreciate the opportunity to appear before you today. I would like to follow up on a few of the things Mr. Bennett alluded to in his testimony. First, I would like to tell you that, as you know, I arrived at the fund only last September. One of the first things I became aware of was the sense that things are changing at the fund. This feeling comes not only from my discussions with Board members and staff and what I have been involved in but also from conversations I have had with our members and retirees. I am well aware of the recent news reports concerning the fund and I am familiar with the many long hours put in by the Committee. I can assure you that things are moving in the right direction.

The release of the Mercer report comes at the end of a legislative session that saw a significant amount of pension related legislation and just prior to one which promises to continue the trend. By the same token, the past several months have witnessed important activity at the fund in the way of changes to some of our policies and procedures and, perhaps more importantly, the launching of discussions about some of the most basic policy questions raised in the report. The Board realizes that it cannot do all that is required by itself and that it will take the collective effort of a number of different groups, each with its own specific desires, to find the resolutions. However, where it can act, the board has begun to do so.

A number of the findings and recommendations in the report relate to the disability determination process. The Board has already instituted several of these suggestions. For example, the recommendation of the fund's medical advisor is now included in the file of a disability applicant. In addition, the fund is considering the revision of the information required from examining physicians to give a fuller basis for making these decisions. Virtually every recommendation in the report dealing with the automation of data collection and benefit calculation, as well as other advances not in the report, will be accomplished through the MIS restructuring program currently underway at the fund. This effort will completely reengineer the fund's information systems. We anticipate the new MIS system will be available on or about August 1, 1997.

In another important area the fund has worked with this Committee during the General Assembly to fashion legislation that give the fund the tools it needed to be able to monitor disability recipients on an ongoing basis. House Bill 226 gives the fund the ability to require earnings statements and medical reports from disability recipients. Just recently, this law was amended in Senate Bill 82 to allow the fund discretion in removing the burden of an annual physical examination from those recipients certified by a fund physician to have an ongoing disability. Perhaps the most important fact to give you in this regard is that, as of today, after reviewing this information the fund has withdrawn the disability benefits from several recipients. I hasten to add that the Board is presently involved in reviewing the mountain of information received this Fall pursuant to House Bill 226.

There are a number of public policy issues within the report that go to the fundamental structure of the disability program at the fund and the statutes that govern it.. The recommendations are a starting point for discussion of these issues but no more. They carry a broad sweep that will affect many interested parties, all of whom should have a voice in the debate. For its part, the Board has already begun this discussion and is grappling with these difficult matters. Perhaps it would be informative for me to mention, briefly, some of the items that were on the agenda for a recent policy committee meeting. The issue of mandatory and standardized preemployment physical examinations was discussed from the standpoint of how this could help the fund in administering its disability program and how it may afford more security to the citizens of Ohio and the security officers themselves. Although it is not within the control of the fund, there was discussion about the effect the federal tax law on our disability experience and how we should deal with it. In addition, the board continues to grapple with the questions surrounding the use of an occupational standard for disabilities as well as the meaning of the statutory phrase "earnings capacity" both of which are discussed in the report.

I could go on with this list but the purpose of our appearance is to give you our initial response to the report. As Chairman Bennett said earlier, there was no time to prepare a detailed, item-by-item response nor do I think that's what the Co-chairmen were looking for. We hope we have complied with your request by giving you a brief statement of how we regard the report, what we expect to do about these issues going forward and, finally, to give you a quick glimpse of some of the things we've already started that address many of these issues.

Thank you, Co-chairmen Van Vyven and White and members of the Committee for your kind attention. We would be happy to entertain any questions you may have.

Tables and Information Schedules

Managed Care Network

Benefit Coverage	PERS In-Net	PERS Out-of-Net	STRS In-Net	STRS Out-of-Net	SERS In-Net	SERS Out-of-Net	PFDPF In-Net	PFDPF Out-of-Net	HPRS In-Net	HPRS Out-of-Net
Annual Deductible	$100/$200	$150/$300	$200 per person*	$200 per person*	$275/$550	$550/$1100	$100/$200	$250/$500	$200 per person	$400 per person
Annual OPM	$500/$750	$750/$1125	$800/$1200	$1600/$2400	$750/$1500	$2000/$4000	$500/$750	$1500/$2250	$750/$1500	$1500/$3000
Lifetime Maximum	$1,000,000	$1,000,000	$1,250,000	$1,250,000	$1,250,000	$1,250,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Hospital Services										
• Admission	• No Charge	• $100	• $162	• $212	• $100	• $250	• No charge	• $100	• No charge	• $100
• Inpatient	• 100%	• 70%	• 100%	• 80%	• 100%	• 65%	• 100%	• 70%	• 100%	• 70%
• Outpatient	• 100% for preadmission testing and surgery; 80% for all other	• 70%	• 100% for preadmission testing and surgery; 80% for all other	• 80% for preadmission testing and surgery; 70% for all other	• 100% for preadmission testing and surgery; 80% for all other	• 65%	• 100% for preadmission testing and surgery; 80% for all other	• 70%	• 100% for preadmission testing and surgery; 80% for all other	• 70%
Physician Services										
• Office	• $10 co-pay	• 70% UCR	• $10 co-pay	• 70% UCR	• $20 co-pay	• 65% UCR	• $10 co-pay	• 70% UCR	• $10 co-pay	• 70% UCR
• All Other	• 80%	• 70% UCR	• 80%	• 70% UCR	• 80%	• 65% UCR	• 80%	• 70% UCR	• 80%	• 70% UCR
Emergency Room										
• Hospital	• 100% after $45 co-pay		• 100% after $50 co-pay		• 100%; 50% if non-emergency		• 100% after $50 co-pay		• 100% after $50 co-pay	
• Medical	• 80%		• 80%		• 80%		• 80%		• 80%	
Precertification Penalty										
• Inpatient	• None	• 50% up to $300 per admission	• None	• 50% up to $200 per admission	• None	• 50% up to $200 per admission	• None	• 50% up to $200 per admission	• None	• 50% up to $300 per admission
• Outpatient	• None	• $100 per procedure	• None	• $100 per procedure	• None	• $100 per procedure	• None	• $100 per procedure	• None	• $100 per procedure
• Managed 2d Opinion	• None	• $100 per procedure	• None	• $100 per procedure	• None	• $100 per procedure	• None	• $100 per procedure	• None	• $100 per procedure

* Certain benefit recipients whose benefits began prior to January 1, 1992 subject to variable annual deductible of $75-$200.

Benefit Coverage	PERS In-Net	PERS Out-of-Net	STRS In-Net	STRS Out-of-Net	SERS In-Net	SERS Out-of-Net	PFDPF In-Net	PFDPF Out-of-Net	HPRS In-Net	HPRS Out-of-Net
Mental Health										
• Inpatient	• 100%	• 70%	• 100%	• 80%	• 100%	• 65%	• 100%	• 70%	• 100%	• 70%
• Outpatient	• 80% with annual max of $550 for alcoholism	• 70% with annual max of $550 for alcoholism	• 80% with annual max of $550 for alcoholism	• 70% with annual max of $550 for alcoholism	• 90% up to $3000 per year	• 50% up to $1500 per year	• 80% with annual max of $550 for alcoholism	• 70% with annual max of $550 for alcoholism	• 80% with annual max of $550 for alcoholism	• 70% with annual max of $550 for alcoholism
Preventive Care										
• Routine Physicals, Well Baby/ Child Care	• Not Covered	• Not Covered	• $10 co-pay for physician services; 80% for lab services up to $150 per year	• 70% UCR for physician and lab services up to $150 per year	• Not Covered	• Not Covered	• Not Covered	• Not Covered	• Not Covered	• Not Covered
• Routine PSA, PAP Smears, Mammographies	• $10 co-pay for physican services; 80% for lab services up to one per year	• 70% UCR for physician and lab services up to one per year	• $10 co-pay for physician services; 80% for lab services up to one per year	• 70% UCR for physician and lab services up to one per year	• 100% up to $100 per year; 90% thereafter	• 65%	• $10 co-pay for physician services; 80% for lab services up to $85 per year	• 70% UCR for physician and lab services up to $85 per year	• $10 co-pay for physician services; 80% for lab services up to $100 per year	• 70% UCR for physician and lab services up to $100 per year
Other Expenses										
• Hospice	• 100% up to 30 days for inpatient; 80% up to $3000 for outpatient	• 90% up to 30 days for inpatient; 70% up to $3000 for outpatient	• 100% up to 60 days for inpatient; 80% up to $7,500 for outpatient	• 80% up to 60 days for inpatient; 70% up to $7,500 for outpatient	• 100% up to 30 days for inpatient; 80% up to $5000 for outpatient	• 100% up to 30 days for inpatient; 80% up to $5000 for outpatient	• 100% up to 30 days for inpatient; 80% up to $3000 for outpatient	• 80% up to 30 days for inpatient; 70% up to $2000 for outpatient	• 100% up to 30 days for inpatient; 80% up to $7500 for outpatient	• 80% up to 30 days for inpatient; 70% up to $5000 for outpatient
• Skilled Nursing Facility	• 100% up to 365 days	• 90% up to 365 days	• 100% up to 365 days	• 80% up to 365 days	• 100% up to 365 days	• 100% up to 365 days	• 100% up to 365 days	• 70% up to 365 days	• 100% up to 365 days	• 90% up to 365 days
• Home Health Care	• 100% for 100 visits per year; 80% thereafter	• 90% for 100 visits per year; 70% thereafter	• 100% for 100 visits per year; 80% thereafter	• 80% for 100 visits per year; 70% thereafter	• 100% for 100 visits per year; 80% thereafter	• 100% for 100 visits per year; 80% thereafter	• 80%; private duty nurse limited to 120 8-hour shifts per year	• 70%; private duty nurse limited to 120 8-hour shifts per year	• 100% for 100 visits per year; 80% thereafter	• 90% for 100 visits per year; 70% thereafter
Prescription Drugs										
• Retail	• Network $4.50 - generic; $9 - brand • Non- Network 80% after deductible		• Network $4.50 - generic; $9 - brand •Non-Network 60% after deductible		• 20% or minimum of $2.50 for generic and $5 for brand.		• Network $5 - generic; $10 - brand • Non-Network $7.50 - generic; $15 - brand		• Network $4.50 - generic; $9 - brand • Non-Network 60% after deductible	
• Mail Order	• National Rx $0 - generic; $2 - brand if no generic; $8 - brand if generic		• National Rx $2 - generic; $10 - brand		• National Rx $0 - generic; $10 - brand		• National Rx $1 - generic; $5 - brand		• National Rx $0 - generic; $10 - brand	
Medicare Part B										
• Monthly Reimbursement	Full premium of $46.10		Legislative cap of $29.90		Legislative cap of $24.80		Full premium of $46.10		Legislative cap of $41.10	

Covered Individual	PERS Monthly Premium Charge	STRS* Service Credit	STRS* Monthly Premium Charge	SERS** Service Credit	SERS** Monthly Premium Charge	PFDPF*** Benefit Amount	PFDPF*** Monthly Premium Charge	HPRS Monthly Premium Charge
Retiree with Medicare A (or age 65 & over in STRS and PFDPF)	$0.00	25 or > 20 - 24 15 - 19 10 - 14 5 - 9	Aetna/Blue Cross $16.00 $20.00 $23.00 $27.00 $31.00	25 or > 20 - 24 15 - 19 10 - 14	$0.00 $15.08 $30.17 $45.25	$10,000 or > < $10,000	$5.00 $0.00	$0.00
Retiree without Medicare A	$0.00	25 or > 20 - 24 15 - 19 10 - 14 5 - 9	Aetna: $50.00 / Blue Cross: $38.00 Aetna: $63.00 / Blue Cross: $48.00 Aetna: $75.00 / Blue Cross: $57.00 Aetna: $88.00 / Blue Cross: $67.00 Aetna: $101.00 / Blue Cross: $77.00	25 or > 20 - 24 15 - 19 10 - 14	$0.00 $89.50 $179.00 $268.50	$10,000 or > < $10,000	$10.00 $5.00	$0.00
Spouse with Medicare A (or age 65 & over in PFDPF and HPRS)	$20.00	25 or > 20 - 24 15 - 19 10 - 14 5 - 9	Aetna/Blue Cross $26.00 $33.00 $39.00 $46.00 $52.00		$41.00		$0.00	$0.00
Spouse without Medicare A (and under age 65 in STRS)	$60.00	25 or > 20 - 24 15 - 19 10 - 14 5 - 10	Aetna: $76.00 / Blue Cross: $59.00 Aetna: $96.00 / Blue Cross: $74.00 Aetna: $115.00 / Blue Cross: $88.00 Aetna: $134.00 / Blue Cross: $103.00 Aetna: $153.00 / Blue Cross: $118.00		$138.00		$40.00	$50.00
Dependent Child	$20.00	25 or > 20 - 24 15 - 19 10 - 14 5 - 9	Aetna/Blue Cross $27.00 $34.00 $41.00 $48.00 $54.00		$39.00		$0.00 under age 18; $50.00 ages 18 - 22	$25.00

* A flat $15 monthly premium charge for survivors who are receiving monthly benefits due to the death of an active teacher who was *not* eligible to retire.

** No premium charge for SERS recipients of disability or survivor benefits.

*** A flat $5 monthly premium charge for PFDPF recipients of partial or off-duty disability benefits who are age 65 and over and receiving less than $10,000 per year. Also, a flat $40 monthly premium charge for recipients of partial or off-duty disability or survivor benefits who are under age 65, regardless of annual benefit amount.

HEALTH CARE EXPENDITURES & RESERVES

Retirement System	Health Care Expenditures 1994	Health Care Reserves 1994	Ratio Reserves/Expenditures
PERS	$327,578,426	$6,295,394,811	19.22
STRS	$157,276,000	$829,600,000	5.27
SERS	$85,496,108	$140,865,000	1.65
PFDPF	$64,624,163	$184,565,585	2.86
HPRS	$1,700,751	$55,000,000	32.34

HEALTH CARE CONTRIBUTION RATE

Retirement System	Percent of Employer Rate Allocated to Health Care	Total Employer Contribution Rate
PERS		
• State	4.29%	13.31%
• Local	5.11%	13.55%
• Law Enforcement	5.89%	16.70%
STRS	2.00%	14.00%
SERS	6.15%	15.26%*
PFDPF		
• Police	6.5%	19.50%
• Fire	6.5%	24.00%
HPRS	5.50%	24.53%

*Includes employer surcharge of 1.26% of payroll to fund post-retirement health care benefits.

ALLOCATION OF EMPLOYER AND EMPLOYEE CONTRIBUTION RATE: PENSION AND HEALTH CARE BENEFITS

Retirement System	Allocation of Employer Contribution *		Allocation of Employee Contribution		Allocation of Total Contribution	
	Pension	Health Care	Pension	Health Care	Pension	Health Care
[illegible]						
State	9.02%	4.29%	8.50%	0.00%	17.52%	4.29%
Local	8.44%	5.11%	8.50%	0.00%	16.94%	5.11%
Law	10.81%	5.89%	9.00%	0.00%	19.81%	5.89%
STRS	12.00%	2.00%	9.30%	0.00%	21.30%	2.00%
SERS	9.45%	5.81% (including 1.26% surcharge)	9.00%	0.00%	18.45%	5.81%
PFDPF						
Police	18.28%	6.50%	10.00%	0.00%	28.28%	6.50%
Fire	16.12%	6.50%	10.00%	0.00%	26.12%	6.50%
HPRS	19.03%	5.50%	10.50%	0.00%	29.53%	5.50%

* The law requires that any health care costs borne by the retirement systems shall be included in the employer contribution rate. The law also requires that payment toward any unfunded pension liabilities shall be included in the employer contribution rate.

Number of Covered Individuals & Health Care Costs*

Retirement System	Individuals Covered (1994)	Health Care Costs (1994)	Average Cost Per Covered Individual
PERS	146,289	$327,578,426	$2,239
STRS	96,917	$157,276,000	$1,623
SERS	60,056	$85,496,108	$1,424
PFDPF	29,942	$63,698,537	$2,127
HPRS	1,138	$1,700,751	$1,495

*The law authorizes each retirement board not only to offer retiree health care benefits, but also to determine the level of benefits provided and the amount of retirement resources allocated toward the cost of those benefits. Given the current provision of retiree health care coverage in all five state retirement systems, each board may choose to pay none of the cost, part of the cost or all of the cost of such coverage.

The law also provides that any cost borne by the retirement system shall be included in the *employer contribution rate*. Therefore, the health care costs shown in the above table are each system's net costs, not gross costs; that is, such costs reflect the amount of retirement resources that are allocated toward the cost of retiree health care benefits and, therefore, are paid solely from employer contributions. It follows that the variance in the average cost per covered individual shown in the above table is largely attributable to greater participation in costs by retirees through premiums, co-pays and deductibles in some systems than in others.

RETIREE PER CAPITA HEALTH CARE COST BY VENDOR:

COMPARATIVE TABLE

Vendor	PERS	STRS	SERS	PFDPF	HPRS
Aetna Health Plans (Hospital/Medical Cost)	$1,639 $1,357	$1,353 $1,022	$1,267 $891	$1,307 $1,199	$1,097 $943
Blue Cross Blue Shield (Hospital/Medical Cost)	$2,427 $2,031	$1,840 $1,260	Not Applicable	$1,279 $1,116	$1,298 $1,212
Kaiser Permanente (Cost per Participant)	$2,087 $1,489	$1,980 $1,482	$1,704 $1,361	$1,961 $1,935	Not Applicable
Health First	$1,571 $1,132	$2,100 $1,700	$1,455 $1,171	Not Applicable	Not Applicable
Health Ohio	$1,248 $1,024	Not Applicable	Not Applicable	Not Applicable	Not Applicable
Aetna Retail Pharmacy	$184 $137	$229 $172	Not Applicable	Not Applicable	$117 $93
Paid Retail Pharmacy	Not Applicable	Not Applicable	$207 $163		Not Applicable
National RX Mail Order	$471 $446	$395 $355	$425 $398	$412 (retail/mail order) $381	$307 $281

The top number in each cell is the gross cost per covered individual; the bottom number, the net cost to the retirement system and ultimately the taxpayers. The level of deductibles, co-payments, out-of-pocket maximums, premium charges and medicare reimbursement rates are all factors having a direct impact on net costs.

The mix of Medicare and Non-Medicare enrollees has a direct impact on a health plan's per capita costs. When Medicare is the primary payor, the retirement systems pick up only a fraction of the retiree's health care costs as the secdondary payor. For example, Aetna's health care costs on a per capita basis are lower than the other plans' under STRS because Aetna's covered population has a higher percentage of Medicare enrollees than any other plan.

CURRENT AND MAXIMUM EMPLOYEE AND EMPLOYER CONTRIBUTION LEVELS

Retirement System	Current Employee Contribution Rate	Statutory Maximum Employee Contribution	Current Employer Contribution Rate	Statutory Maximum Employer Contribution	Total Current Contribution Rate
[illegible]	8.50%	10.00%	13.31%	14.00%	21.81%
[illegible]	8.50%	10.00%	13.55%	14.00%	22.05%
[illegible]	9.00%	Not Applicable	16.70%	Not Applicable	25.70%
STRS	9.30%	10.00%	14.00%	14.00%	23.30%
SERS*	9.00%	10.00%	14.00%	14.00%	23.00%
PFDPF					
Police	10.00%	10.00%	19.50%	19.50%	29.50%
Fire	10.00%	10.00%	24.00%	24.00%	34.00%
HPRS	10.50%	10.50%	24.53%	31.50%	35.03%

*In addition to the employer contribution rate of 14.00%, SERS law authorizes the board to assess an employer surcharge on the salaries of lower-paid members. The SERS actuarial valuation as of June 30, 1994 indicates that the employer surcharge generated an additional 1.26% of payroll to help fund retiree health insurance.

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

February, 1995 Number 2-95

AUTOMATIC COST OF LIVING INCREASES FOR OHIO RETIRANTS

In April of each year, the boards of the three-non-uniformed employee retirement systems and the Police and Firemen's Disability and Pension Fund (PFDPF) are required to determine the average percentage change in the Consumer Price Index [U.S. City Average for Urban Wage Earners and Clerical Workers (CPI-W)] for the preceding calendar year over the next preceding calendar year. The Highway Patrol Retirement System (HPRS) board makes the same determination in September of each year.

Whenever the average change in the CPI is at least three percent, the boards of the non-uniformed employee systems and PFDPF provide a three percent cost-of-living allowance (COLA) to all eligible benefit recipients who, during the period of July 1 through June 30, have received a benefit for twelve months. The HPRS board provides a three percent COLA to all eligible benefit recipients who, during the period of December 1 through November 30, not only have received a benefit for twelve months but also have attained age 57; all surviving beneficiaries are eligible for the three percent COLA upon receiving a benefit for twelve months (60 months for disabled retirees), regardless of age.

Any percentage change in the CPI in excess of three percent is accumulated and combined with the percentage change in the CPI in succeeding years. Pursuant to the Attorney General's Opinion 87-044, benefit recipients begin accumulating any excess percentages upon first becoming eligible for the three percent COLA. The first COLA in the non-uniformed employee retirement systems was authorized for the period of July 1, 1971 through June 30, 1972; in PFDPF, July 1, 1988 through June 30, 1989. The first acumulation of excess percentages in HPRS was authorized for the period of December 1, 1988 through November 30, 1989.

Whenever the average change in the CPI is less than three percent, no three percent COLA shall be paid except for benefit recipients who have accumulated sufficient excess percentage points in their respective COLA banks to make up the difference between the actual percentage change in the CPI and the minimum three percent change required by law.

First Payout Year (July 1 - June 30)	Percent Change In CPI*	Percent Paid Out	Excess Percent	Accumulation Percent Before Payout	Accumulation Percent After Payout
1971-72	70/69: 6.0	1.5	4.5	78.8	78.3
1972-73	71/70: 4.2	1.5	2.7	74.3	73.8
1973-74	72/71: 3.3	1.5	1.8	71.6	71.1
1974-75	73/72: 6.2	1.5	4.7	69.8	69.3
1975-76	74/73: 11.1	1.5	9.6	65.1	64.6
1976-77	75/74: 9.1	1.5	7.6	55.5	55.0
1977-78	76/75: 5.8	2.0	3.8	47.9	47.4
1978-79	77/76: 6.5	2.0	4.5	44.1	43.6
1979-80	78/77: 7.6	3.0	4.6	39.6	39.1
1980-81	79/78: 11.5	3.0	8.5	35.0	34.5
1981-82	80/79: 13.5	3.0	10.5	26.5	26.0
1982-83	81/80: 10.2	3.0	7.2	16.0	15.5
1983-84	82/81: 6.0	3.0	3.0	8.8	8.3
1984-85	83/82: 3.0	3.0	0.0	8.8	8.3
1985-86	84/83: 3.4	3.0	0.4	8.8	8.3
1986-87	85/84: 3.5	3.0	0.5	8.4	7.9
1987-88	86/85: 1.5	0.0	1.5	7.9	7.4
1988-89	87/86: 3.6	3.0	0.6	6.4	5.9
1989-90	88/87: 4.0	3.0	1.0	5.8	5.3
1990-91	89/88: 4.8	3.0	1.8	4.8	4.3
1991-92	90/89: 5.2	3.0	2.2	3.0	2.5
1992-93	91/90: 4.1	3.0	1.1	0.8	0.3
1993-94	92/91: 2.9	0.0	2.9	2.7	2.2
1994-95	93/92: 2.8	0.0	2.8	2.8	2.3
1995-96	94/93: 2.5	0.0	2.5	-	2.5

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

February, 1995 Number 3-95

THE CONSUMER PRICE INDEX (1982-84 = 100 Unadjusted) (CPI-W)
PERCENTEAGE CHANGES IN THE INDEX AND THE VALUE OF THE DOLLAR 1944-1994

Year	Annual AverageIndex	Annual Average % Change	% Increase In CPI Since Year Sown	Dollar Value Measured By CPI
1944	17.7	-	722.6	5.650
1945	18.1	2.3	704.4	5.525
1946	19.6	8.3	642.9	5.102
1947	22.5	14.8	547.1	4.444
1948	24.2	7.6	501.7	4.132
1949	24.0	-0.8	506.7	4.167
1950	24.2	0.8	501.7	4.132
1951	26.1	7.9	457.9	3.831
1952	26.7	2.3	445.3	3.745
1953	26.9	0.7	441.3	3.717
1954	27.0	0.4	439.3	3.704
1955	26.9	-0.4	441.3	3.717
1956	27.3	1.5	433.3	3.663
1957	28.3	3.7	414.5	3.534
1958	29.1	2.8	400.3	3.436
1959	29.3	0.7	396.9	3.413
1960	29.8	1.7	388.6	3.356
1961	30.1	1.0	383.7	3.322
1962	30.4	1.0	378.9	3.289
1963	30.8	1.3	372.7	3.247
1964	31.2	1.3	366.7	3.205
1965	31.7	1.6	359.3	3.155
1966	32.6	2.8	346.6	3.067
1967	33.6	3.1	333.3	2.976
1968	35.0	4.2	316.0	2.857
1969	36.9	5.4	294.6	2.710
1970	39.0	5.7	273.3	2.564
1971	40.7	4.4	257.7	2.457
1972	42.1	3.4	245.8	2.375
1973	44.7	6.2	225.7	2.237
1974	49.6	11.0	193.5	2.016
1975	54.1	9.1	169.1	1.848
1976	57.2	5.7	154.5	1.748
1977	60.9	6.5	139.1	1.642
1978	65.6	7.7	122.0	1.524
1979	73.1	11.4	99.2	1.368
1980	82.9	13.4	75.6	1.206
1981	91.4	10.3	59.3	1.094
1982	96.9	6.0	50.3	1.032
1983	99.8	3.0	45.9	1.002
1984	103.3	3.5	40.9	.968
1985	106.9	3.5	36.2	.935
1986	108.6	1.6	34.1	.921
1987	112.5	3.6	29.4	.889
1988	117.0	4.0	24.4	.855
1989	122.6	4.8	18.8	.816
1990	129.0	5.2	12.9	.775
1991	134.3	4.1	8.4	.745
1992	138.2	2.9	5.4	.724
1993	142.1	2.8	2.5	.704
1994	145.6	2.5	0.0	.687

The average CPI for each year is shown in the second column. In 1944 the CPI averaged 17.7. The third column shows the change in the CPI from the previous year. In 1945 the CPI increased 2.3% over 1944. The fourth column shows the percentage increases in the CPI since the years in the first column. For example, since 1944 the CPI has risen 722.6%; since 1984 it rose 40.9%. The fifth column shows the value of the dollar on a 1982-84=100 base in the respective years. In 1994 the dollar was worth 68.7 cents.

The average percentage increase over the fifty year period was 4.38%, while the average annual increase over the last ten years was 3.50%.

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

August 1994 Number 4-94

CHANGES IN EMPLOYEE CONTRIBUTION RATES
(AS PER CENT OF SALARY)

NON-UNIFORMED EMPLOYEE SYSTEMS

Calendar Year Change Occurred	PERS State	PERS Non-State	STRS	SERS	MODIFICATION
1920			4.00		$2,000 earnings limit
1935	4.00				$2,000 earnings limit
1937				4.00	$2,000 earnings limit
1938		4.00			$2,000 earnings limit
1945	5.00	5.00	5.00	5.00	$3,000 earnings limit
1951	6.00	6.00	6.00	6.00	Based on total salary
1959			7.00	7.00	Optional on salary over $18,000[1]
1960	7.00	7.00			Optional on salaev over $18,000[1]
1965	7.00	7.00	7.00	7.00	Optional on salary over $25,000
1968	7.70	7.70	7.80	7.90	Based on total salary
1974	8.00	8.00	8.00	8.00	
1977	8.50	8.50	8.50	8.00	
1983			8.75		
1984				8.75	
1988			8.77		
1989				9.00	
1990			9.25		
1994			9.30		

[1] Until 1959-60 members were charged an operational expense fee, initially set by law at one dollar, then $1.50 and finally $3.00. In 1959-60 the systems discontinued the fee charges and charged all expenses to earnings on investments.

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

August 1994 Number 5-94

CHANGES IN EMPLOYER CONTRIBUTION RATES
(As Percent of Payroll)

NON-UNIFORMED EMPLOYEE SYSTEMS

Calendar Year Change Occurred	PERS State	PERS Non-State	STRS	SERS
1920			5.57	
1923			4.70	
1924			3.70	
1926			3.60	
1927			3.57	
1930			3.45	
1935	4.80			
1937				5.57
1938			3.82	
1939		4.80	4.44	5.50
1941			4.00	
1942		4.30		5.00
1943	4.30			
1945			5.00	5.50
1946		5.40	4.75	
1947	5.40		5.75	6.50
1948		5.70	7.50	7.00
1949	6.05		7.25	
1950		5.90		
1951	6.95		8.50	8.00
1952		7.00	8.00	7.75
1953	7.10			7.50
1955			9.25	8.00
1956		7.25		
1957	7.35			
1958			9.33	
1959	7.41	7.31	10.41	
1960		8.51		9.22
1961	8.61			
1963	7.91	7.27		
1964		7.37	11.00	
1965	8.03		11.27	10.00
1966	9.00		11.50	
1967		8.00		
1969	10.00	9.00	12.90	11.40
1973	10.40	9.40		
1974			12.55	12.50
1975	12.00	11.20		
1976		11.90		
1977	13.71	13.95	13.50	
1963				14.00
1964			14.00	
1991	13.31	13.55		

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

February, 1991 Number 8-91

AGE AND SERVICE BENEFITS[1]

Non-Uniformed Public Employee Retirement Systems

	PERS	STRS	SERS
Normal Retirement Eligibility	5 YOS at age 65 or 30 YOS at any age	Same as PERS	Same as PERS
	145.32, 145.33	3307.38	3309.34, 3309.36
Normal Retirement Benefits	2.1% x FAS x first 30 YOS; 2.5% x FAS x YOS over 30	2.1% x FAS x YOS; 2.5% x FAS x YOS over 30 that are earned Ohio service	2.1% x FAS x YOS
	145.33	3307.38	3309.36
Early Retirement Eligibility	5 YOS at age 60 or 25 YOS at age 55	Same as PERS	Same as PERS
	145.32, 145.33	3307.38	3309.34, 3309.36
Early Retirement Benefits	Normal retirement benefit reduced by 25 to 3% from ages 55 to 64	Same as PERS	Same as PERS
	145.33	3307.38	3309.36
Maximum Benefit[2]	100% of FAS	Same as PERS	90% of FAS
	145.33	3307.38	3309.36
Minimum Benefit	$86 x YOS	Same as PERS	Same as PERS
	145.33	3307.38	3309.36

[1] Key to abbreviations: YOS - years of service FAS - final average salary

[2] No age and service benefit shall exceed the limitations established under Section 415 of the Internal Revenue Code. Section 415 limits the annual benefit to the lesser of $90,000, as indexed, or 100% of the member's average W-2 income for his high three consecutive years (145.33, 145.34, 3307.38, 3309.34, 3309.36, 3309.38).

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

June, 1995 9a-95

DISABILITY BENEFITS

Non-Uniformed Public Employee Retirement Systems

	PERS	STRS	SERS
Definition	• Mentally or physically incapacitated for performance of present or similar duty • Permanent or presumed to be permanent	• Mentally or physically incapacitated for performance of duty • Permanent or presumed to be permanent	• Mentally or physically incapacitated for performance of last assigned primary duty • Permanent or presumed to be permanent
	§145.35	§3307.42	§3309.39
Eligibility[1]	• 5 YOS[2] • Not receiving disability benefit under another Ohio state or municipal retirement system • Not receiving age and service benefit under PERS or combined benefit with STRS or SERS, or having withdrawn contributions	• 5 YOS • Not receiving age and service benefit under STRS or having withdrawn contributions	• 5 YOS • Not receiving age and service benefit under SERS or having withdrawn contributions
	§145.35	§3307.42	§3309.39

(cont'd on back)

[1]Benefits apply to both on-duty and off-duty injury or illness
[2]Years of Service

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

June 1995 9b-95

DISABILITY BENEFITS

Uniformed Public Employee Retirement Systems

	PFDPF	HPRS	PERS-LE[1]
Definition	<u>Total</u>: • Unable to perform duties of any gainful occupation for which member is fitted by training, experience, or accomplishment •No present indication of recovery <u>Partial</u>: • Unable to perform official duties and impairs earning capacity	• Totally incapacitated for duty in State Highway Patrol • Permanent or will probably be permanent	• Mentally or physically incapacitated for performance of present or similar duty • Permanent or presumed to be permanent
	§742.01, 742.37	§5505.18	§145.35
Eligibility[2]	<u>On-duty</u>: • Immediate coverage <u>Off-duty</u>: •5 YOS[3]	<u>On-duty/off-duty</u>: • Immediate coverage	<u>On-duty</u>: •Immediate coverage <u>Off-duty</u>: • 5 YOS
	§742.37	§5505.18	§145.35

(cont'd on back)

[1]Each member as of 7/29/92 had a choice of coverage under the original plan §145.36 or the revised plan §145.361 (choice expired 4/7/93.) Members after 7/29/92 are automatically covered under §145.361. See Pension Profile no. 9a, *Disability Benefits for Non-Uniformed Public Employees Retirement Systems*, for a description of the revised plan §145.361.

[2]Age and service retirants and persons who withdraw contributions are ineligible.

[3]Years of service.

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

June, 1995 12-95

BENEFITS FOR SURVIVORS OF ACTIVE MEMBERS[1]
PERS - STRS[2] - SERS[3]

Number of Qualified Dependents[4]	Minimum Monthly Benefit	Final Average Salary Related Benefit
1	$96[5]	25%
2	186	40
3	236	50
4	236	55
5 or more	236	60

1Members are eligible for survivor income protection after establishing one and one-half years of Ohio service with at least one-quarter year of Ohio contributing service within the two and one-half years prior to death. In lieu of the benefits listed above, the surviving spouse or other sole dependent beneficiary of a member who was eligible for service retirement may elect to receive a monthly benefit equal to the actuarially reduced pension the member would have received had he retired and selected the 100% joint and survivor plan of payment.

2Qualified spouse or dependent beneficiary (STRS only) must select either the above method or the following method of calculating benefits which will remain in effect without regard to any change in the number of qualified dependents:

Years Of Service	Annual Benefit As A Per Cent Of Member's Final Average Salary
20	29%
21	33
22	37
23	41
24	45
25	48
26	51
27	54
28	57
29	60

If the benefit is calculated using the second option the benefit will be equally apportioned, except if there is a surviving spouse the portion allocated to the spouse will be as follows:

Number of Dependents	Spouse's Share of Total Benefit
2	62.5%
3	50.0
4	45.45
5 or more	41.67

3The statutory citations are R.C. 145.45 for PERS, R.C. 3307.49 for STRS and R.C. 3309.45 for SERS.

4Qualified dependents include the following persons: 1) spouse age 62 or age 50 if member had ten or more years of service, or any age if spouse is physically or mentally incompetent, or any age if spouse is caring for dependent children (or any age if member had ten or more years of service - STRS only); 2) unmarried child under age 18 or under age 22 if child is full-time student or any age if child is physically or mentally incompetent; and 3) dependent parent age 65 (or any age if parent is physically or mentally incompetent - PERS only).

5Spouse shall receive at least $106 per month if member had ten or more years of service.

(cont'd on back)

THE OHIO RETIREMENT STUDY COMMISSION

88 E. Broad Street • Columbus, Ohio 43215 • 614/228-1346

June, 1995 13-95

BENEFITS FOR SURVIVORS OF RETIRED MEMBERS[1]

PERS Plan of Payment	STRS Plan of Payment	SERS Plan of Payment	PFDPF Plan of Payment	HPRS Plan of Payment
Plan A - 1/2 of the retirant's allowance paid to the spouse	Option 1 - Full amount of retirant's allowance paid to sole designated beneficiary	Plan A - 1/2 of the retirant's allowance paid to the spouse	Option 1 - Full amount of retirant's allowance paid to sole designated beneficiary	Option 1 - Full amount of retirant's allowance paid to sole designated beneficiary
Plan C - 1/2 or some other portion of the retirant's allowance paid to sole designated beneficiary	Option 2 - 1/2 or some other portion of the retirant's allowance paid to sole designated beneficiary	Plan C - 1/2 or some other portion of the retirant's allowance paid to sole designated beneficiary	Option 2 - 1/2 or some other portion of the retirant's allowance paid to sole designated beneficiary	Option 2 - 1/2 or some other portion of the retirant's allowance paid to sole designated beneficiary
Plan D - Full amount of retirant's allowance paid to sole designated beneficiary	Option 3 - Benefit offered under Option 1 or 2, except in case of death or divorce from beneficiary, retirant may return to straight life annuity	Plan D - Full amount of retirant's allowance paid to sole designated beneficiary	Option 3 - Full amount of retirant's allowance paid to designated beneficiary for remainder of a certain guaranteed period	Option 3 - Full amount of retirant's allowance paid to designated beneficiary for the remainder of a certain period
Plan E - Full amount of retirant's allowance paid to designated beneficiary for remainder of a certain guaranteed period selected by retirant	Option 4 - Full amount of retirant's allowance paid to designated beneficiary for remainder of a certain guaranteed period selected by retirant	Plan E - Full amount of retirant's allowance paid to designated beneficiary for remainder of a certain guaranteed period selected by retirant		
	Option 5 - Plan of payment combining any of the features of Option 1, 2 or 4			
R.C. 145.46	R.C. 3307.50	R.C. 3309.46	R.C. 742.3711	R.C. 5505.162

1Under each system the retirant may choose among several plans of payment. Each plan of payment provides a monthly benefit to the retirant but in differing amounts. The Single Life Annuity is the maximum benefit payable for the life of the retirant. The plans of payment listed above provide a lesser benefit payable for the life of the retirant and continuing to a designated beneficiary after the retirant's death.

Effective July 24, 1990, the surviving spouse shall receive at least one-half of the retirant's benefit unless the spouse acknowledges in writing that the retirant selected a plan of payment that provides less than one-half or the retirement board waives the spousal acknowledgment due to the absence or incapacity of the spouse (PERS, STRS, SERS, PFDPF.) Upon divorce, the retirant may cancel a joint and survivor plan of payment only with the written consent of the spouse or pursuant to a court order.