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# *Analysis*

## S.B. 206 – Sen. Coughlin
***As Introduced***

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## ORSC Position

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The bill provides for the establishment of a deferred retirement option plan (DROP) under the Highway Patrol Retirement System (HPRS), similar to the current DROP established under the Ohio Police and Fire Pension Fund (OP&F) pursuant to S.B. 134 (eff. 7/23/02).[1] Details of the proposed DROP follow.

The bill would require the HPRS board to establish and administer a DROP. In establishing and administering the DROP, the board may do all things necessary to meet the federal tax qualification requirements applicable to governmental plans under section 401(a) of the Internal Revenue Code. The board shall adopt rules to implement the DROP, and shall specify the initial implementation date of the DROP. The rules may also specify a period during which members may rescind their election to participate in the DROP.

Participation in the DROP would be limited to members who are eligible for normal service retirement (i.e., age 48 with 25 years of service or age 52 with 20 years of service) and who are younger than age 58. These members may elect to participate in the DROP by completing and submitting an election form provided by HPRS. The member's election shall become effective on the day the member files the form with HPRS. At the time of making such election, the member shall also select a plan of payment for monthly retirement benefits under existing law (i.e., single life annuity, joint and survivor annuity, guaranteed period annuity) which, except as otherwise provided under existing law, shall be irrevocable upon receipt by HPRS.

Under the bill, a member electing to participate in the DROP must agree to terminate employment not later than the earlier of the member's sixtieth (60$^{th}$) birthday (the mandatory retirement age under existing law) or the date that is eight years after the effective date of the member's election. If the member refuses or neglects to terminate employment in accordance with this agreement, the HPRS board shall deem the member's employment terminated.

While participating in the DROP, the member shall not earn any additional service credit in HPRS, shall not be eligible to purchase any service credit under HPRS, and shall not be eligible for any health care benefits under HPRS (including the member's spouse and dependents). For purposes of board elections, the member shall be eligible to vote for the retirant member of the HPRS board. The member shall continue to make the same contributions as under existing law (10%); the state shall continue to make the same contribution under existing law (25.5%). The member's DROP account shall accrue the following amounts:

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

- The member's monthly retirement benefit calculated on the member's service credit and final average salary as of the last day of the employer's payroll period immediately prior to the effective date of the member's election to participate in the DROP and in accordance with the member's plan of payment selection;

- Any annual three percent (3%) cost-of-living allowances (COLAs) granted by HPRS under existing law;

- The member's contributions made while participating in the DROP;

- Annual compound interest on the above amounts at a rate set by the HPRS board.

(All employer contributions made on behalf of DROP participants shall be retained by HPRS and credited to the employers' accumulation fund as part of the overall funding of the retirement system.)

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

- Termination of employment;

- Last day of the eight-year period;

- The member's sixtieth (60th) birthday (current mandatory retirement age in HPRS);

- Acceptance of a disability retirement benefit;

- Death.

The bill requires that a DROP participant who terminates employment shall notify HPRS of the termination on a form provided by the retirement system, and shall not be eligible to make another election to participate in the DROP. With respect to a member who was younger than age 52 on the effective date of the DROP election, if the member terminates employment on or after the first day of the fourth year, the member shall be entitled to the entire accrued benefit in the member's DROP account, including annual compound interest. If the member terminates employment prior to the first day of the fourth year after the effective date of the DROP election, the member shall forfeit all interest on the accrued benefit in the member's DROP account. With respect to a member who was age 52 or older on the effective date of the DROP election, if the member terminates employment on or after the first day of the third year, the member shall be entitled to the entire accrued benefit in the member's DROP account, including annual compound interest. If the member terminates employment prior to the first day of the third year, the member shall forfeit all interest on the accrued benefit in the member's DROP account..

Distributions of the accrued benefit in the member's DROP account shall not commence prior to the first day of the fourth year after the effective date of the DROP election for members who were younger than age 52 when they elected to participate in the DROP; for members who were age 52 or older when they elected to participate in the DROP, the accrued benefit in the member's DROP account shall not commence prior to the first day of the third year after the effective date of the DROP election. The member shall select one of the distribution options provided under section 401(a) of the Internal Revenue Code applicable to governmental plans.

The member's monthly retirement benefit calculated on years of service and final average salary prior to participation in the DROP and in accordance with the plan of payment selected by the member shall commence on the first day following the member's last day of employment.

Under the bill, should the DROP participant qualify for an on-duty disability retirement benefit, the member shall elect to receive one of the following:

- the on-duty disability retirement benefit provided under existing HPRS law. (Acceptance of this benefit results in the forfeiture of the member's accrued benefit in the DROP account, the granting of service credit for the period of DROP participation, and the calculation of the member's disability retirement benefit as though the member had not participated in the DROP); or

- the member's accrued benefit in the DROP account, plus a service retirement benefit calculated on the member's years of service and final average salary prior to the member's DROP election and in accordance with the member's plan of payment selection.

Should the DROP participant qualify for an off-duty disability retirement benefit, the member shall be entitled to the member's accrued benefit in the DROP account, plus a service retirement benefit calculated on the member's years of service and final average salary prior to the member's DROP election and in accordance with the member's plan of payment selection.

Should the member die while participating in the DROP, the accrued benefit in the member's DROP account shall be paid in a lump sum to the surviving spouse, or if none, the member's designated beneficiary, or if none, the member's estate. In addition, the surviving spouse, dependent children and dependent parents (if not surviving spouse or dependent children) shall remain eligible for monthly survivor benefits under existing HPRS law, except that the pension amount used to calculate the surviving spouse's benefit shall be based upon the deceased member's years of service and final average salary prior to the DROP election. The $5,000 lump sum death benefit under existing law would also remain payable upon the death of a DROP participant. Should the member die in the line of duty, the surviving spouse, dependent children and dependent parents of the deceased member shall qualify for monthly survivor benefits payable under the Ohio Public Safety Officers Death Benefit Fund.

The bill would require an actuarial investigation of the DROP at least once every five years to determine whether the DROP, as established or modified, has a negative financial impact upon HPRS and, if so, make recommendations to eliminate any negative financial impact. If the actuarial investigation indicates that the DROP has a negative financial impact, the HPRS board shall modify the plan. The rights and obligations of members who have already elected to participate in the DROP shall not be altered by any board action. Also, the employer contributions to HPRS shall not be increased to offset any negative financial impact of the DROP upon HPRS. The actuarial investigation of the DROP may be included as part of the five-year actuarial investigation of the retirement system required under existing law. If not included, the actuarial investigation of the DROP shall be submitted to the ORSC and the standing committees of the house of representatives and senate with primary responsibility for retirement legislation not later than the first day of November following the last fiscal year of the period the investigation covers.

The bill would amend the disability statutes of HPRS to make them consistent with the current mandatory retirement age of 60 in HPRS (formerly age 55). Under the bill, members on disability retirement who have not attained age 60 rather than 55 under the current statutes would be subject to the annual medical reexamination and annual statement of earnings requirements, unless waived by the board.

**Staff Comments** – DROPs have gained widespread recognition in the public sector. DROPs were first introduced in Louisiana in the early 1980's and spread rapidly throughout the South among municipal police and firefighter pension funds. In more recent years, DROPs have become popular in all parts of the country and among all branches of government service.

As part of the report of the Joint Legislative Committee to Study Ohio's Public Retirement Plans dated December 11, 1996, one of the recommendations included therein, but not acted upon by the legislature, was to increase the normal retirement age in both the uniform and non-uniform employee retirement systems. This recommendation was made in response to continual improvements in life expectancies experienced among the memberships of all five retirement systems in Ohio which directly increase each retirement system's benefit costs, including post-retirement health care costs. Since then, the legislature has enacted S.B. 190 (eff. 7/13/00) upon the favorable recommendation of the ORSC which, among other things, provides a financial incentive for teachers to work beyond normal service retirement (30 years at any age); i.e., STRS members who remain teaching for 35 years receive an annual retirement allowance of 88.5% of their final average salary as opposed to 66% after 30 years. The legislature has also enacted S.B. 134 (eff. 7/23/02) upon the favorable recommendation of the ORSC which offered a similar financial incentive for police and firefighters to work beyond normal service retirement (age 48 with 25 years of service) by providing them an opportunity to receive a lump sum distribution not otherwise available upon retirement through the establishment of a DROP. These incentives are designed to help not only employers retain experienced workers and smooth the transition of such workers and their replacements, but also the retirement systems save on post-retirement health care costs.

The DROP proposed under S.B. 206 for state troopers is generally consistent with that established under S.B. 134 for police and firefighters. The concept of a DROP is also generally consistent with the objective of the above-referenced recommendation included in the final report of the Joint Legislative Committee to get members to work beyond current normal service retirement eligibility.

One of the public policy issues raised by S.B. 206 is whether the PERS, STRS and SERS boards, like the OP&F and HPRS boards, should be granted similar authority to establish DROPs for their respective memberships. Based upon the experience in other states, there will likely be considerable interest from other groups of public employees, for example, PERS law enforcement officers whose benefit structure is comparable to OP&F and HRPS in terms of early retirement ages, to have the opportunity to participate in a DROP. The legislature should consider whether the PERS, STRS and SERS boards and their respective memberships would be similarly well-served by encouraging members to work beyond normal retirement through the establishment of a DROP.

Throughout the bill, DROP participants are generally treated the same as retirants. For example, for purposes of board elections, they are eligible to vote for the retirant member of the board. Like all other retirants, they are ineligible to purchase service credit. In line 664 of the bill, the term "benefit recipient" which is neither defined under existing law nor used in any other section of HPRS law is used to categorize DROP participants for purposes of rules adopted by the HPRS board. *It is recommended that the term "benefit recipient" be deleted and the term "retirant" be inserted in lieu thereof.*

**Fiscal Impact** – According to the HPRS actuary, S.B. 206 establishing a DROP is designed to be actuarially cost neutral to HPRS. The bill further provides a safeguard by requiring a separate actuarial investigation of the DROP to be conducted at least once every five years to determine whether the DROP has any negative financial impact upon HPRS and requiring the HPRS board to make any necessary modifications to the DROP, including termination, to eliminate any negative financial impact.

**ORSC Position** – At the November 16, 2005 meeting of the Ohio Retirement Study Council, the Council voted to recommend that the 126th Ohio General Assembly approve S.B. 206 upon the adoption of the following amendment:

- That the term "benefit recipient" in line 664 which is neither defined under existing law nor used in any other section of HPRS law be deleted and the term "retirant" which is defined under existing law be inserted in lieu thereof.