Ohio Retirement Study Council

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

Voting Members

Representatives
Kirk Schuring, *Chairman*
Rick Carfagna
Dan Ramos

Senators
Steve Wilson, *Vice-Chair*
Edna Brown
Jay Hottinger

Governor's Appointees
Lora Miller
Dr. Thomas Pascarella
Vacant

Non-Voting Members
Mark Atkeson, *HPRS*
Karen Carraher, *PERS*
John Gallagher, *OP&F*
Mike Nehf, *STRS*
Richard Stensrud, *SERS*

Director/General Counsel
Bethany Rhodes

S.B. 151 of the 132nd General Assembly

June 8, 2017

ORSC Recommendation

Staff Contact
Jeffery A. Bernard
(614) 228-5644

Summary of S.B. 151

S.B. 151 would remove the requirement that the Board of the School Employees Retirement System (SERS) annually increase retiree and disability recipient cost-of-living-adjustments (COLA) by 3%. Instead, the Board would be *permitted* to provide a COLA, and if the Board choose to do so the COLA would be restricted to the increase of CPI-W, not to exceed 2.5%.

S.B. 151 is an updated version of a draft bill (LSC 132 0362-2) reviewed by the ORSC at its April 2017 meeting. S.B. 151 maintains the provisions that received approval from the ORSC and excludes the items that the ORSC recommended be amended out of the bill draft.

Background

COLAs have experienced significant alteration in Ohio law. Immediately prior to 2002, COLAs were based on CPI-W, plus any additional amounts accrued in what was known as the "COLA bank," capped at 3%. The COLA bank was fairly complicated but allowed members to store increases in the CPI-W that were beyond 3% and use them in years that CPI-W was less than 3%. This system enabled those whose benefits had been eroded during high inflation years (such as the late 70s or 80s) to receive larger COLA increases during moderate inflation periods. This was frequently combined with other ad hoc COLA increases to provide retirement income protection.

Effective February 1, 2002, H.B. 157 modified COLAs to be a flat 3%, regardless of any CPI-W changes.[1] Since enactment, only four of sixteen years have seen CPI-W increases of greater than 3%, with six of those years achieving inflation of less than 2%. The following chart below details CPI-W since 2002.

Year	Annual Average % of Change	Year	Annual Average % of Change
2002	1.4	2010	2.1
2003	2.2	2011	3.6
2004	2.6	2012	2.1
2005	3.5	2013	1.4
2006	3.2	2014	1.5
2007	2.9	2015	-0.4
2008	4.1	2016	1
2009	-0.7		

[1] ORSC staff had recommended disapproval of the bill and to instead allocate additional funding to discretionary retiree health care (H.B. 157 Staff Recommendation, June 1, 2001).

Under pension reform, and as approved by the ORSC, four of the five systems altered COLA formulas again. As seen below, SERS is now an outlier among the systems in maintaining a 3% fixed COLA.

System	COLA Benefit
PERS	Until January 2019, 3%. Thereafter, for recipients of benefits beginning not later than January 7, 2013, 3%. For recipients of benefits beginning after January 7, 2013, any increase in the CPI-W, not to exceed 3%.
STRS	Beginning July 1, 2017: 0% For those receiving an allowance or benefit on or after August 1, 2013, five years must pass before the first COLA is applied to an allowance or benefit, unless retirement is immediately preceded by a disability benefit. STRS Board may adjust the COLA if the Board's actuary determines that an adjustment does not materially impair the fiscal integrity of the retirement system or is necessary to preserve the fiscal integrity of the system.
SERS	Flat 3%, irrespective of CPI-W changes.
OP&F	(1) Annual COLA of 3% for those who have at least 15 years of service credit on or before July 1, 2013. (2) Annual COLA of the lesser of 3% or the increase in CPI-W, if any, for all others. COLA is provided only to recipients who have attained age 55 and have received the pension or benefit for one year, except that disability recipients who are permanently and totally disabled do not have to attain age 55.
SHPRS	Authorizes the Board to grant a COLA of no more than 3%, except that the Board is to grant a COLA of 3% to a recipient age 65 whose benefit is less than 185% of the federal poverty limit for a family of two. (2017 COLA is 1.25%) A recipient of a retirement, disability, or survivor pension whose pension effective date is on or after January 7, 2013, will not be eligible for a COLA until age 60.

Ohio law has frequently adjusted post-retirement COLAs. More recent precedent is that, though the five systems have diverged in how and when COLAs are to be calculated, a fixed COLA of 3% is being phased out. S.B. 151 would be in line with this precedent.

ORSC comments

<u>COLA, proactive funding measures, and intergenerational equity</u>

According to SERS, S.B. 151 is being taken as a proactive measure to strengthen the SERS funding position and enable a portion of employer contributions to be set aside for retiree health care.[2] According to the most recent actuarial valuation, SERS is within the statutory 30-year funding period[3] and is therefore not statutorily required to submit a funding plan to ORSC.[4] Even so, both the ORSC and the ORSC actuary have advocated and encouraged the systems to be proactive on funding levels and seek to reduce the funding period.[5]

The bill improves the SERS funding position by reducing COLA expenses. According to the SERS actuary, a similar draft bill would reduce SERS unfunded liabilities by approximately $1.2 billion and increase the funded status to 71% (from 66%). COLA benefits are a significant cost to the retirement systems but the main source of retirement income protection provided to Ohio's state retirees (state employees in Ohio are not eligible for Social Security for their state employment). This is particularly true for SERS beneficiaries, whose average 2016 benefit of $14,206 is the least among the five systems. This makes SERS beneficiaries particularly susceptible to inflation. S.B. 151 seeks to moderate the loss of retiree purchasing power by permitting the SERS Board to match future COLAs with CPI-W. Since this amount is capped at 2.5%, it is possible that the purchasing power of retirees will decrease if inflation exceeds 2.5% or if the Board elects to use its authority to not provide a COLA in future years.

It is important to note that the 2012 pension reform affected only active SERS members and that 60% of SERS current unfunded liability lies with retirees,[6] suggesting that further benefit adjustments must include retirees in order to maintain intergenerational equity. Because S.B. 151 reduces COLAs, it would appear to be directed solely at retirees, but this would be incorrect. In fact, according to the ORSC actuary, a similar bill's cap on COLA would actually reduce current active members' benefit more than that of current retirees. This is because active members will have a full retirement of reduced COLA, while those now retired have about half of their retirement (on average) with higher COLAs. However, S.B. 151 would affect both active and retired members, and therefore be in line with ORSC recommendations regarding proactive stabilization of funding and intergenerational equity standards.

The COLA provisions of the five state retirement systems have diverged since pension reform. However, with the exception of SERS, all are moving away from a fixed 3% COLA. S.B. 151 has precedent with previous bills approved by the ORSC to eliminate a fixed COLA in favor of a COLA indexed to CPI-W. The bill has an added measure to protect SERS funding by providing that the SERS Board may elect to

---

[2] SERS, "COLA Changes—What You Need to Know" (January 2017). Available online at: https://www.ohsers.org/Document/Get/16495

[3] The period to pay down unfunded liabilities in SERS is 28 years.

[4] Cavanaugh Macdonald Consulting, "SERS: Report on the Annual Basic Benefits Valuation of the School Employees Retirement System of Ohio, Prepared as of June 30, 2016."

[5] ORSC Minutes, November 3, 2014 and William B. Fornia, Linda L. Bournival, and R. Paul Schrader, "Analyzing Retirement Systems' 30-Year Plans and Alternative Pension Reform Solutions," July 2012, pg. 36.

[6] SERS, "COLA Changes."

provide no COLA, presumably to be used should funding conditions necessitate such an action.

S.B. 151's likely impact on SERS health care funding

In accordance with SERS funding policy, if S.B. 151 results in SERS funding status increasing above 70%, SERS will redirect 0.50% of employer contributions to SERS post-retirement health care coverage.[7] With the exception of the SERS surcharge,[8] SERS currently allocates 0% of employer contributions to post-retirement health care benefits. The current solvency period of the fund is 2024. Health care benefits are a discretionary benefit and not guaranteed under Ohio law. Therefore, a portion of potential savings achieved by S.B. 151 would be diverted to the health care fund rather than to reducing the funding period of SERS.

Effect on employer normal cost

According to the SERS actuary, the employer normal cost (that is, the contribution amount needed from the employer to fund active member's benefit that is in addition to employee contributions) resulting from a similar bill would be 0.11% (decreased from 0.73%) and therefore would remain positive, if only by a small amount.[9] ORSC does not have a strict policy on maintaining a positive employer normal cost, but with recent changes it is attracting greater attention and concern from the ORSC. Normal cost is affected by a large number of actuarial assumptions and may fluctuate up or down in the future.

Expansion of board authority

Under S.B. 151, SERS is provided with the authority to suspend a COLA as necessary. While the ORSC finds that the ability to suspend COLA to be prudent should funding conditions deteriorate, the ORSC prefers that any plan design changes made by the systems be subject to prior ORSC review in order to maintain ORSC oversight of the state retirement systems. Therefore, this provision, while consistent with existing *law*, is inconsistent with prior ORSC *recommendations*.[10]

Actuarial Impact

ORSC's actuary reviewed the analysis performed by the SERS actuary on a similar bill. Although they were not able to replicate the calculations, and would have

[7] "SERS Funding Policy" June 2015, IV(C).

[8] Ohio law permits SERS to impose a surcharge on employers of up to a statewide average of 1.5% of employee payroll for health care coverage of retirees.

[9] The employer normal cost provides an approximation of the benefit an active employee receives in retirement beyond the employee's own contributions. A 0% employer normal cost would imply that the benefit of an employee is entirely self-funded; that is, any employer amounts are redirected for other purposes, such as paying down unfunded liabilities. A positive employer normal cost indicates that an employees' benefit is funded in part by employer contributions rather than purely self-funded. A negative employer cost indicates that a current employee is actually contributing *more* to the system than they can anticipate in future benefits. For comparative purposes, the employer normal cost for the five retirement systems according to the most recent actuarial valuations is as follows: PERS 3.22%, OP&F 5.31%, STRS (-3.05%), and SHPRS 7.2%.

[10] "Report on Board Authority Provisions of S.B. 340, 341, 342, and 345 of the 129th General Assembly," (April 9, 2013).

come up with a slightly different analysis, they agree with the conclusion that costs and liabilities would decrease materially, and the funded percentage would rise to be above 70%. The ORSC actuary noted that the major contributor to the cost savings was a suspension of the COLA until 2021. Therefore the savings from S.B. 151 may depend on the SERS Board using its authority to suspend the COLA in future years.

ORSC recommendation

In line with its April 13, 2017 recommendation to approve LSC 132-0362-2, the recommends that the General Assembly approve S.B. 151 for the following reasons:

1) S.B. 151's removal of a fixed 3% COLA and use of CPI-W has previous precedent;
2) The COLA modification will proactively improve SERS funding status in line with previous recommendations from the ORSC and ORSC actuary;
3) S.B.151 will more accurately reflect actual inflation figures but also provide retirement income protection; and
4) By applying to both retirees and active members, S.B. 151 provides intergenerational equity.

In accordance with ORSC oversight responsibilities and previous recommendations, the ORSC recommends that S.B. 151 be amended to require ORSC to review instances when a retirement system uses its authority to suspend COLA.

The ORSC also recommends non-substantive amendments to reflect the schedule of COLA calculations in SERS.