

**OR
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The Ohio Retirement Study Council
88 E. Broad St., Suite 1175
Columbus, Ohio 43215
(614)228-1346 Phone
(614)228-0118 Fax
www.orsc.org Website

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Annual Report 2003

Evaluations and Recommendations Regarding the Operations of the State Retirement Systems and Their Funds

**First Half of the 125th General Assembly
January 1, 2003 - December 31, 2003**

March, 2004

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ANNUAL REPORT

FIRST HALF OF THE 125TH GENERAL ASSEMBLY

JANUARY 1, 2003 - DECEMBER 31, 2003

March, 2004

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Introduction

The Ohio Retirement Study Council (ORSC) is pleased to submit this report on the five state retirement systems and the fund for volunteer firefighters for the period beginning January 1, 2003 and ending December 31, 2003. This report is submitted pursuant to section 171.04(B) of the Revised Code, which requires the ORSC to “*make an annual report to the governor and the general assembly covering its evaluation and recommendations with respect to the operations of the state retirement systems and their funds*”.

The State of Ohio has a long and successful track record regarding its five statewide retirement systems. The oldest of these retirement systems is the State Teachers Retirement System (STRS), which was created in 1920 for teachers in the public schools, colleges, and universities. The Public Employees Retirement System (PERS) was created in 1935 for state employees, with local government employees added in 1938. The School Employees Retirement System (SERS) was created in 1937 for non-teaching employees of the various local school boards. The Highway Patrol Retirement System (HPRS) was created in 1941 by the withdrawal of all state troopers from PERS. The Ohio Police and Fire Pension Fund (OP&F) was created in 1967 after the abolition of 454 local police and fire relief and pension funds, many of which predated the Social Security System created in 1935 and many of which were on the verge of financial insolvency. A special retirement program administered by PERS was subsequently created in 1975 for certain law enforcement officers, including sheriffs, deputy sheriffs, township police and various others. Today the five systems have combined assets of just over \$129 billion; approximately 730,743 active contributing members, 464,469 inactive members, and 328,960 beneficiaries and recipients. The January 26, 2004 issue of Pensions and Investments included a list of the top 200 public and private pension funds in the nation. Four of Ohio’s five public retirement systems are listed in the top 200. PERS ranked 16th out of all public and private funds and 10th out of all public pension funds. STRS ranked 18th out of all public and private funds and 12th out of all public pension funds. OP&F ranked 119th, while SERS ranked 123rd among all public and private pension funds.

Created in 1968, ORSC was one of the first permanent pension oversight commissions in the nation. The Council was designed to develop legislative leadership in the area of retirement pensions for public employees. It is empowered to make an impartial review of the laws governing the administration and financing of Ohio’s five public retirement systems and to recommend to the General Assembly any changes it may find desirable with respect to the allowances and benefits, the sound financing of the cost of benefits, the prudent investments of funds, and the improvement of the language, structure and organization of the laws. It must report to the Governor and the General Assembly concerning its evaluation and recommendations with respect to the operations of the systems. The Council is required to study all statutory changes in the retirement laws proposed to the General Assembly and report to the General Assembly on their probable cost, actuarial implications, and desirability as a matter of public policy.

The Council evaluates the operations of the systems on a continuing basis. Throughout the summer of 2003, a number of concerns regarding the administration and operations of the retirement systems were raised at the ORSC meetings. This led to the introduction of pension reform bills in both the House and the Senate (H.B. 227 and S.B. 133). During the past year the Council also reviewed the retirement systems' governance, investment performance, actuarial condition, and the health care funding status. In addition, staff presented to the Council analyses of legislation and updates on administrative rules filed by the systems. The analyses of legislation always contain staff recommendations. For example, one of the staff recommendations, which is included in both

S.B. 133 and H.B. 227, is that fiduciary audits be conducted on all five retirement systems. The Council is currently in the process of accepting proposals to conduct audits of STRS and OP&F.

This report is a compilation of the evaluations and recommendations the Council made throughout the year. It provides a summary of the ORSC reports completed during 2003, pending public retirement issues, and staff recommendations. In addition, it provides a historical record of legislative action taken by the 125th Ohio General Assembly on bills affecting PERS, STRS, SERS, OP&F, HPRS and the Volunteer Fire Fighters' Dependents Fund (VFFDF).

The report is divided into eight sections: Systems' Investment Performance; Status of Health Care Funds; Actuarial Reviews; Reports on Pending Pension Legislation; Reports on Enacted Pension Legislation; Pending Pension-Related Issues; Subject Index of Pension Bills Introduced; and Status of Pension Legislation.

The Systems' Investment Performance section provides a summary of the investment performance reviews completed by Milliman USA, during 2003. The full reports can be obtained from the ORSC office or on the ORSC website: www.orsc.org.

The Status of the Health Care Funds provides a summary of the major changes made to the systems' health care benefits for 2004 as well as a summary of a recent court decision regarding the discretionary nature of these benefits. The summaries of health care plan changes include an overview of changes the systems made relative to prescription drugs, benefits, premiums, eligibility, and plan design. In addition, it provides information regarding the amount of employer contributions allocated to healthcare during 2004.

The Actuarial Reviews section provides a summary of the actuarial review completed by the ORSC actuary, Milliman USA during 2003. We have included several reports Milliman completed in early 2004 because they provide additional information regarding the actuarial review completed in 2003 and information requested by the Council relative to that report.

The Reports on Pending Pension Legislation section provides a detailed examination of each pension bill the ORSC has taken a position on during the first half of the 125th Ohio General Assembly, including the name of the principal sponsor, a description of its contents, its fiscal impact, and the ORSC position. These reports are intended to give the reader an awareness and understanding of all substantive changes made to the state retirement plans; they are not intended to serve as a substitute for the statutory laws governing these plans.

The Reports on Enacted Pension Legislation section provides a detailed examination of each pension bill enacted into law during the first half of the 125th Ohio General Assembly, including the name of the principal sponsor, a description of its contents, its fiscal impact, the ORSC position and its effective date. These reports are intended to give the reader an awareness and understanding of all substantive changes made to the state retirement plans; they are not intended to serve as a substitute for the statutory laws governing these plans.

The Pending Pension-Related Issues section provides a summary of relevant public retirement issues and prior recommendations that have been made, but not acted upon by the legislature.

The Subject Index of Pension Bills Introduced provides a listing of legislation under subject headings and a key word description within the subject heading. Bills that covers more than one subject area are listed under all appropriate headings. All subject headings are listed at the

beginning of the index for quick reference.

The Status of Pension Legislation provides a record of the legislative action taken on pension bills at each step of the legislative process from the date of introduction to the date of enactment, including the committee assignments in each house of the Ohio General Assembly, the date reported by the committees, the date passed by each house and the date reported by a conference committee and/or concurred in by the other house. Also provided are a brief description of the subject of the pension bill and the ORSC position on the bill. A key to all abbreviations used in the Status of Pension Legislation is found on the last page.

SYSTEMS' INVESTMENT PERFORMANCE

Section 171.04(D) of the Revised Code requires the ORSC to conduct a semiannual review of the policies, objectives, and criteria of the systems' investment programs. These reports are submitted to the Governor and General Assembly. The following is a summary of the investment reviews completed during 2003:

Investment Performance Review (Fourth Quarter 2002), April 9, 2003 -

This report, which was presented at the April 9, 2003 ORSC meeting, reflected the investment performance for all five retirement systems over the nine-year period beginning January 1, 1994 and ending December 31, 2002. The findings of this report are summarized as follows:

- The year ending 12-31-02 was a difficult and volatile period for all of the funds. All experienced negative results, ranging from -8.42 (HPRS) to -11.58 (SERS and STRS). All of the funds ranked below the median public retirement system in a broad universe of such funds. The highest ranking fund for the year was HPRS, with a 55th percentile rank. The other funds ranged from 73rd percentile (OP&F) to 88th percentile (SERS and STRS).
- Longer term, the impact of three years of negative returns has been meaningful. All of the funds now have nine-year annualized returns that are below their actuarial interest-rate assumptions. While the funding implications of lowering assumptions may be severe, one must question if it is realistic to maintain assumed rates of return that are, in general, significantly higher than actual experience over what is now nearly a decade. On the other hand, when they performed their analysis for the period ending December 1999, all of the funds had six-year returns that were significantly in excess of their actuarial assumptions. Using the returns of the recent past to forecast the future is not a prudent practice.
- Also longer term, only OP&F had results that were ahead of its own benchmark for the nine-year measurement period (1-1-94 to 12-31-02). HPRS had the worst nine-year results relative to benchmark, underperforming by 2.67%.
- SERS had the best absolute results over the full measurement period, achieving an average return of 7.31%.
- HPRS, which has experienced the lowest return over the entire measurement period, has shown dramatic signs of improvement over the past year. The fund's -8.42% return over the past twelve months not only represents the smallest loss experienced by any of the systems for the year, but compares favorably to its -11.58% benchmark return for the twelve months ending 12-31-02.
- Milliman compared the Ohio funds' results to three "peer" universes. First, they compared them to a broad Total Fund universe, which includes roughly 1,100 private and public plans, both large and small. Second, they compared them to a Public Fund universe, which includes 158 plans with an average size of over \$2 billion. Finally, they compared them to a Large Plan universe, which includes 67 plans with an average size of \$6.8 billion. For the last five-year cumulative period, all of the funds are in the bottom half of every one of those universes. While it is true that this comparison is less relevant than a comparison to individual benchmark returns, these poor relative results are troubling none the less.

Investment Performance Review (Second Quarter 2003), November 6, 2003 -

This report, which was presented at the November 6, 2003 ORSC meeting, reflected the investment performance for all five retirement systems over the nine and one-half-year period

beginning January 1, 1994 and ending June 30, 2003. The findings of this report are summarized as follows:

- The six-months ending 6-30-03, the period since Milliman’s last report, was extremely positive for the systems. All experienced positive results, ranging from 9.96% (HPRS) to 9.06% (SERS). All of the funds except OP&F outperformed their target policies for the period, with excess results ranging from 0.52% (HPRS) to 0.15% (PERS). All of the funds also ranked well above the median public retirement system in a broad universe of such funds. The highest ranking fund for the six months was HPRS (15th percentile). The other funds ranged from the 16th percentile (PERS) to the 34th percentile (SERS).
- Longer term, only SERS and OP&F have outperformed their respective policy benchmarks for the past five years. The other three funds experienced results that lagged behind their benchmarks in annualized amounts ranging from 0.32% (STRS) to 1.77% (HPRS).
- The impact of the three years of negative returns from 2000 to 2002 has not been erased by this year’s good results. All of the funds still have long-term (nine and one-half year) annualized returns that are below their actuarial interest-rate assumptions.
- HPRS, which experienced the lowest return over the entire measurement period, continues to show signs of improvement. The fund’s 9.96% return over the past six months compares favorably to the 9.44% return for its policy benchmark. It is now also ahead of its benchmark for trailing one and three year periods.

Preliminary Year-End 2003 Assets - The next investment performance review is scheduled to be completed in April, 2004 and will evaluate investment results from the second half of 2003. Preliminary data from the retirement systems indicate that each system’s assets continued to grow during the last half of 2003. The systems ended the year with combined assets of approximately \$129 billion. The following table delineates each system’s assets:

System	Assets as of 12-31-02	Assets as of 12-31-03	Rate of Return for 2003
PERS	\$47.5 billion	\$58.7 billion	24.8%
STRS	\$43.8 billion	\$52.9 billion	24.1%
SERS	\$6.7 billion	\$8 billion	22.8%
OP&F	\$7.4 billion	\$8.8 billion	22.7%
HPRS	\$513 million	\$625 million	24.8%
TOTAL	\$105.913 billion	\$129.025 billion	-----

These asset totals make Ohio’s public pension funds among the largest pension funds in the nation. The January 26, 2004 issue of Pensions and Investments included a list of the top 200 public and private pension funds in the nation. Two of Ohio’s five public retirement systems made it into the

top 20. PERS ranked 16th out of all public and private funds and 10th out of all public pension funds. STRS ranked 18th out of all public and private funds and 12th out of all public pension funds. OP&F ranked 119th, while SERS ranked 123rd among all public and private pension funds.

STATUS OF HEALTH CARE FUNDS

In 1974 the five state retirement boards were given broad discretionary authority to provide health care coverage to retirees and their dependents. Unlike pension benefits, which become vested upon retirement, health care benefits are not a vested right under Ohio's public pension laws. Therefore, the boards are authorized to change the premiums, eligibility, and level of health care benefits at any time. A recent ruling by the Franklin County Common Pleas Court (Ohio Association of Public School Employees, et al. v. School Employees Retirement system Board, et al.) upheld the discretionary nature of the health care benefits when the Court dismissed a lawsuit that had attempted to prevent the SERS board from making changes to its health care plan.

Since 1974 each system has provided some level of comprehensive hospital, medical, and prescription drug coverage. In 1977 the systems were required to reimburse benefit recipients for Medicare Part B premiums (medical). Retirees who do not qualify for Medicare Part A (hospital) 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 2002, the total retiree health care costs paid by the retirement systems were over \$1.6 billion; prescription drug costs constituted 42 percent of these costs. By law, any health care costs borne by the retirement systems must be financed by employer contributions only. The retirement systems' actuaries review annually the amount of contributions required to fund vested pension benefits. Contributions in excess of what is needed to support those benefits can be allocated to health care. The following chart indicates the percentage of the employer contribution each system will allocate to health care during 2004.

System	Percentage of Employer Contribution Allocated to Health Care in 2004
PERS	4.00%
STRS	1.00%
SERS*	4.91%
OP&F	7.75%
HPRS	3.50%

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

The last three years have been an extremely trying period for Ohio's public retirement systems, in terms of poor investment returns and rapidly escalating medical and health care costs. These factors have necessitated that the pension funds reexamine how they can best continue to provide discretionary health benefits to their members. While each of the five retirement systems' boards made changes to their health care benefits in 2004, some of the changes were more significant than others. It is worth noting that the systems' statutory pension component remains healthy and that the systems remain determined to preserve a meaningful health care benefit for their members, as they have since the inception of discretionary health care in 1974. Below is a description of the changes to each system's health care plan that went into effect on January 1, 2004.

PERS

On January 1, 2004, the Public Employees Retirement System continued a series of changes to its health care plan. The PERS Board had voted in December 2001 to adopt the Choices Plan, which is an alternative health care plan designed to affect only PERS members hired after January 1, 2003. The Choices Plan introduced the concepts of a *graded monthly allocation* - a fixed dollar amount, based on length of service at time of retirement, allocated to benefit recipients to be used for the purchase of health care products and services; and a *cafeteria plan* - allowing a benefit recipient to create a package of services that meet his or her individual needs. Even after the introduction of the Choices Health Care Plan, it was estimated that, if no other changes were made, the PERS health care fund would last until 2018. At that point, the plan would have to resort to operating on a "pay as you go" basis resulting in sudden, large cuts in health care benefits and little to no reserves to fall back on. PERS opted to take action now and go ahead with a series of modest changes to its health plan that will keep the health fund viable for many years to come. These changes will be phased in over time. For 2004, the PERS Board reduced the percentage of employer contributions it was allocating to discretionary health care benefits from 5% to 4%.

PREMIUMS:

Under PERS' traditional health plan (Medical Mutual of Ohio, and Aetna PPOs), benefit recipients will see very little change in the premium structure, though premiums for spouses and children will increase. However, premiums for coverage under one of PERS' alternative health care plans/HMOs (AultCare, Kaiser, Paramount Elite, Paramount Health Care, and United Health Care) will change more dramatically. PERS will continue to reimburse the full Medicare Part B premium, which, in 2004, is \$66.60 per month, as required under PERS law.

ELIGIBILITY:

PERS made no changes to the health care eligibility requirements.

BENEFITS:

One of the most significant changes that PERS has implemented for 2004 concerns formulary medicines. Beginning January 1, 2004, formulary medicines will be less expensive for PERS Health Plan participants than medications that are not on the formulary of Medco, PERS' Pharmacy Benefit Manager. A formulary is an extensive list of generic and brand name medicines that are preferred by PERS' Health Plan. The formulary medicine list was created by Medco's Pharmacy and Therapeutics Committee, which is made up of health care professionals, including pharmacists and doctors from various medical specialties. The formulary list is updated every few months as new medicines become available. In 2004, benefit recipients will have to pay higher co-payments for medicines not on the formulary list. PERS has implemented other changes to its prescription coverage to discourage the use of brand name drugs when a generic is available (if a benefit recipient chooses to use a brand name drug when a generic is available, they will be required to pay the difference between the cost of the generic and the brand name drug up to \$100.)

PERS also made changes to major medical coverage that include modest increases in deductibles, out-of-pocket maximums, and co-payments for office and emergency room visits.

For further information on PERS' 2004 health care plan, please visit the system's website at www.opers.org.

STRS

The State Teachers Retirement System implemented a series of comprehensive changes to its health care plan in 2004, with the intent to extend the solvency of the health care fund to 2014. Without these changes, it was estimated that the STRS Health Care Fund would have been depleted by 2008. For 2004, the STRS Board decided to continue to allocate 1% of employer contributions to discretionary health care benefits.

PREMIUMS:

The most significant changes were made to STRS' premium subsidy structure. Beginning January 1, 2004, all retirees with less than 15 years of service credit, all spouses, and dependents of benefit recipients now pay 100% of health care premiums. Also beginning January 1, 2004, all service retirement and benefit recipients with 15 or more years of service credit will receive a 2.5% subsidy based on years of service, up to a maximum of 75%. On January 1, 2004, STRS began offering a Health Care Assistance Program to eligible benefit recipients. This assistance program provides a 30% reduction in the monthly premium amount for benefit recipients who have 25 or more years of service as a service retiree or are currently receiving disability benefits, and whose total annual income falls at or below \$13,000 (approximately 150% of the 2003 federal poverty level) for the benefit recipient, or if married, at or below \$18,000 (approximately 150% of the 2003 federal poverty level) for the benefit recipient, spouse and any dependent children. Also, liquid assets or funds readily available to the recipient (e.g. cash, savings, money market and checking accounts, trust funds, publicly traded securities and other investment vehicles) must not exceed \$10,000 for the benefit recipient, or if married, \$20,000 for the benefit recipient and his or her spouse to be eligible for the program. For 2004, STRS has frozen its reimbursement for Medicare Part B premiums using the 2003 Medicare Part B monthly premium of \$58.70. Members are reimbursed for their Medicare Part B monthly premiums based on a sliding scale. The reimbursements range from a minimum of \$29.90 to a maximum of \$52.83 per month, depending on the member's years of services.

Two new health plan options are available in 2004, the Plus Plan and the Catastrophic Plan. These plans replaced the former plans administered by Aetna and Medical Mutual in 2003 and offer two different levels of benefits. The Plus Plan has a higher monthly premium, but less out-of-pocket expenses for medical care and prescription drugs than the Catastrophic Plan. Conversely, the Catastrophic Plan has a lower monthly premium, but higher out-of-pocket expenses.

ELIGIBILITY:

Members retiring on or after January 1, 2004 need 15 years of service credit to be eligible for health care coverage through STRS Ohio (prior to January 1, 2004, only five years of service credit were needed to qualify for health care coverage). Members with less than 15 years of service credit who were retired as of December 31, 2003, have access to health care coverage, but they must pay 100% of their health care premium.

BENEFITS:

Effective January 1, 2004, benefit recipients who chose the Plus Plan or the Catastrophic Plan administered by Aetna or Medical Mutual, or Paramount HMO, now pay flat copayments for prescription drugs. Once members who have enrolled in the Plus Plan have paid a total of \$2,500 in retail and mail-service copayments, the enrollee pays nothing for the remainder of the calendar

year. Members enrolled in the Catastrophic Plan pay a copay for prescription drugs just like enrollees of the Plus plan. However, once STRS has paid a total of \$1,500 in retail and mail-service prescription drug costs on their behalf, the member is then responsible for paying 100% of prescription drug costs for the remainder of the calendar year.

For further information on STRS' 2004 health care plan, please visit the system's website at www.strsoh.org.

SERS

The School Employees Retirement System enacted a series of reforms to its health care program in 2004, as the SERS Health Care Fund was projected to become depleted in 2006. With the changes made to its health plan, SERS expects to extend the solvency of the health care fund until 2008. Effective July 1 2003, the SERS allocation to discretionary health care benefits decreased from 5.83% to 4.91% of employer contributions.

PREMIUMS:

SERS' 2004 Health Plan includes a graduated premium schedule for all retirees. All current retirees now pay at least 15% of the monthly premium. Members with over 25 years of service (YOS), survivor benefit recipients, and disability retirees are also subject to this 15% premium. As an example, an SERS member enrolled in the Aetna or Medical Mutual PPO/Indemnity plan pays 100% of the actual monthly premium if they have 10-14.999 YOS, 50% of the premium if they have 15-19.999 YOS, and 25% of the premium if they have 20-24.999 YOS. Under the Aetna and Medical Mutual of Ohio (MMO) PPO plans, the eligible spouses of SERS retirees pay premiums of \$74 per month if they have Medicare coverage and \$274 per month if they do not have Medicare Part A. Monthly payments for SERS members who formerly paid a premium for health care coverage have also increased in 2004. SERS has approved a safety net plan to reduce premiums by 50% for retirees with a total household income below the federal poverty level. In 2003, the federal poverty level was \$8,980 for a single person and \$12,120 for a family of two. In 2004, the federal poverty level is \$9,310 for a single person and \$12,490 for a family of two. The amount that SERS reimburses for Medicare Part B premiums is set in statute at \$45.50 per month.

ELIGIBILITY:

SERS made no changes to the health care eligibility requirements.

BENEFITS:

Deductibles under the Aetna or Medical Mutual of Ohio plans, annual out-of-pocket limits, and doctor's office visit co-pays have all increased in 2004. For those retirees with Medicare, SERS' Health Care Plan will reimburse only the normal plan benefits (e.g. if Medicare pays 80% of a health care cost, and the Aetna or MMO benefit payment would have been 80%, there will be no payment.) SERS' HMO plans no longer offer dental, vision or hearing aid coverage. As of January 1, 2004, open enrollment periods will occur every two years, instead of every year. The only changes made to the prescription drug plan are increases in the co-pays for drugs ordered through the mail. There is no change in the number of days' supply (90), nor any change in the short-term retail prescription drug plan.

For further information on SERS' 2004 health care plan, please visit the system's website at www.strsoh.org

OP&F

The Ohio Police & Fire Pension Fund implemented a new health care plan on January 1, 2004 that was designed to preserve some level of health care funding for the next 10 years and beyond. The OP&F Board will review the funding status of the plan each year and make additional adjustments as necessary. The new plan incorporates significant changes to plan design, eligibility and contributions and allows OP&F benefit recipients to choose the options that best meet their health care needs. For 2004, the OP&F Board decided to continue their allocation of 7.75% of employer contributions to discretionary health care benefits.

PREMIUMS:

In order to minimize the impact of increased health costs for current retirees, OP&F has adopted a plan that distinguishes between those members with a retirement date prior to January 1, 2004 and those who retire on or after that date. For those members who retired prior to January 1, 2004, OP&F will pay 75% of overall health care costs, and 50% for their spouse and eligible dependents (OP&F currently pays 88% of the overall health care costs for members and their enrolled dependents.) For members who retire on or after January 1, 2004, OP&F will compute their monthly health care premiums based on (1) the year they retire; (2) their age at retirement; and (3) their years of service at retirement (for example, if a member retires in 2004 and their age at retirement plus their years of service at retirement equals at least 73, but not more than 77, the retiree will be responsible for paying 62.5% of the full health care premium for their own coverage and 75% of the full premium for their spouses and children; the subsidy level changes will be phased in over a 5-year period.) The plan is designed so that all benefit recipients will gradually move through higher subsidy levels with the effect that the percentage of the full health care premium they pay will decrease. OP&F currently offers a Contribution Discount Program that provides a 30% discount on monthly health care premiums to members who have certain low income levels (to be eligible for the discount in 2004, benefit recipients must have total "household income" in 2002 equal to or less than 150% of the poverty level established annually by the U.S. Department of Health and Human Services. In 2003, the federal poverty level was \$8,980 for a single person and \$12,120 for a family of two. In 2004, the federal poverty level is \$9,310 for a single person and \$12,490 for a family of two.) OP&F will continue to offer optional dental and vision plans, but will not subsidize those benefits. As required under OP&F law, OP&F will continue to reimburse the full Medicare Part B premium, which is \$66.60 in 2004.

ELIGIBILITY:

Beginning January 1, 2004, re-employed retirants who are eligible for health care benefits through their employer will be eligible to participate in OP&F's Health Care Plan, but OP&F will not subsidize any of their monthly health care costs. Also effective January 1, 2004, members will have very limited opportunities to enroll or re-enroll in OP&F's major medical and prescription drug coverage if they terminate or waive their coverage. Members and their eligible dependents will have limited opportunities to enroll under the following circumstances: 1) at the time of their retirement; 2) three years after their retirement; 3) with proof of change in family status; 4) with proof of loss of group medical coverage; or 5) at the time of Medicare eligibility.

For further information on OP&F's 2004 health care plan, please visit the system's website at www.op-f.org.

HPRS

The Highway Patrol Retirement System made several changes to its health plan for 2004. In March 2003, the HPRS board reduced the allocation to funding discretionary health care benefits from 5.75% to 5.50%. The board further reduced the allocation to health care to 3.5% of employer contributions to discretionary health care benefits beginning July 1, 2003.

PREMIUMS:

On January 1, the premium charged to retirees' spouses who are under 65 years of age rose from \$60 to \$70 monthly. HPRS will continue to reimburse the retiree for the full Medicare Part B premium, which, in 2004, is \$66.60 per month.

ELIGIBILITY:

As of the beginning of 2004, a re-employed retiree of the Highway Patrol Retirement System who is eligible for medical coverage through his or her current employer must assume that coverage as primary insurance (i.e. HPRS' health insurance becomes secondary). It was already HPRS' policy that anytime a covered spouse became employed he or she had to obtain their primary medical coverage through their employer, if available.

BENEFITS:

HPRS is the only system that continues to subsidize the entire monthly premium for its retirees' dental insurance. HPRS retirees, however, are responsible for paying the entire premium for their spouses' or other eligible dependents' dental and vision insurance. In 2004, the dental premiums an HPRS retiree must pay on their spouse's or other eligible dependent's behalf rose slightly. The monthly premium for spouses is now \$14.61 (as opposed to \$14.23 in 2003). The monthly premium for coverage of a spouse and children rose to \$30.78 (from \$30.57), and the cost of covering children only increased to \$11.80 (from \$11.65) a month. There were no increases in the monthly premium for vision insurance.

For further information on HPRS' 2004 health care plan, please visit the system's website at www.ohprs.org.

ACTUARIAL REVIEWS

Ohio law establishes a maximum 30-year funding period for amortizing each system's unfunded actuarial accrued pension liabilities. This requirement 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. As of the most recent actuarial valuations (June 30, 2003 for STRS and SERS; December 31, 2002 for PERS, OP&F, HPRS), the systems had the following funding periods and funded ratios:

System	Funding Period	Funded Ratio
PERS	29	86.00%
STRS	42.3	74.20%
SERS	30	82.50%
OP&F	Infinite	82.63%
HPRS	32	79.6%

Section 742.311 of the Revised Code requires the ORSC to conduct an annual review of the police and fire contribution rates and make recommendations to the legislature that it finds necessary for the proper financing of OP&F benefits. In addition to the statutorily required review of the adequacy of the police and fire contribution rates, the Council voted to have Milliman review the adequacy of the the contribution rates for the State Teachers Retirement System, the School Employees Retirement System, the Public Employees Retirement System, and the Highway Patrol Retirement System. Milliman's first report on OP&F, SERS, and STRS was completed in late 2003. The report on the contribution rates for HPRS and PERS was completed in early 2004 along with an addendum that provided an update to the original report on OP&F, SERS, and STRS. Also as part of their review, Milliman was asked by the Council to review the contribution rates that would be necessary to actuarially fund post-retirement health care benefits.

Review of the Adequacy of the Contribution Rates to OP&F, SERS, and STRS, November 5, 2003 - Milliman presented these findings at the November 5, 2003 ORSC meeting.

The major findings and recommendations from this report are as follows:

- As of July 1, 2003, none of the systems satisfied the 30-year funding period required by law (in the case of OP&F, this means being on track to satisfy that requirement at the end of 2006). (SERS later reduced its allocation to health care in order to satisfy the 30-year funding requirement. See Addendum to the Review of the Adequacy of the Contribution Rates to OP&F, SERS, and STRS.)
- The funding period calculation required by law should be based on the actuarial costs of all benefits mandated by statute - the pension benefits and the Medicare Part B premium reimbursements. SERS is the only system that includes the statutorily mandated Medicare Part B premium reimbursements in the development of its funding period. We recommend that both OP&F and STRS include these statutorily mandated benefits when determining their funding periods in future actuarial valuations.
- Significant "excess" investment returns will be needed over the near term by each of the

systems to “catch-up” with the actuarial value of assets that is used by each of the systems to determine its funding period. For example, OP&F would need to earn annualized investment returns of approximately 11.7% over the next 5 years to “catch-up”. The comparable figures for SERS and STRS are 12.5% and 9.6%, respectively.

- The Capital Market Assumptions used by the systems for investment planning purposes anticipate that actual returns will fall short of the long-term actuarial investment return assumption over the next 10 years. (The actuarial investment return assumption is 8.25% for OP&F and SERS and 7.75% for STRS. As of June 30, 2003, STRS increased its actuarial investment return assumption to 8.0%; See Addendum to the Review of the Adequacy of the Contribution Rates to OP&F, SERS, and STRS.) Thus based on those Capital Market Assumptions, there is less than a 50% chance that the systems will even meet the long-term actuarial investment return assumption over the next 10 years, let alone earn “excess” returns to “catch-up” with the actuarial value of assets used for purposes of determining compliance with the 30-year limit required by law.
- If neither contributions nor benefits are modified, based on the average Capital Market Assumptions used by these systems for investment planning purposes, there is only a 17% probability that OP&F will be in compliance with the 30-year limit on the funding period even 10 years from now, in 2014. Based on the same assumptions, there is only about a 19% probability that SERS and a 28% probability that STRS would comply with the 30-year limit in 2014.
- If actual investment returns over the next 5 years are somewhat favorable so that they meet the long-term actuarial investment return assumption of the Boards (but do not produce “excess” returns to “catch-up” to the actuarial value of assets),
 - SERS could bring itself into compliance with the 30-year funding period limit by reducing its allocation to discretionary healthcare benefits from 5.83% to 1.0% and redirecting those contributions to mandated benefits. This would require a reduction in the discretionary healthcare benefits of roughly 65% (assuming that SERS continued to assess the employer healthcare surcharge);
 - Neither OP&F nor STRS could comply with the 30-year limit even if all contributions were allocated to mandated benefits. This would mean that no contributions would remain available to be allocated to discretionary healthcare benefits; and
 - If little or no contributions were allocated to discretionary healthcare benefits, those benefits would have to be significantly reduced immediately and eliminated when the healthcare fund is exhausted. (As of the most recent actuarial valuations, the healthcare fund in OP&F was adequate to pay healthcare benefits for 1.3 years. The comparable figures for SERS and STRS are 1.8 years and 6.9 years, respectively.) Alternatively, healthcare benefits could be offered to retirees with the retiree required to pay the full cost. This latter alternative would at least allow retirees to retain their current coverage if they choose to pay for it.
- If investment returns over the near term are quite favorable so that they meet the long term investment return assumptions of the boards and produce “excess” returns sufficient to “catch-up” with the actuarial value,

- Both OP&F and SERS could bring themselves into compliance with the 30-year limit on the funding period by reducing the contributions allocated to discretionary healthcare benefits and redirecting them to mandated benefits. In the case of OP&F, this would reduce the allocation to discretionary healthcare benefits from 7.75% to roughly 1.4% of payroll. Such a reduction in the contributions allocated to discretionary healthcare benefits would require a reduction in discretionary healthcare benefits of roughly 80%. The comparable figures for SERS are a reduction in the discretionary healthcare contribution rate from 5.83% to 4.8%, and a reduction in benefits of roughly 15% (assuming that SERS continued to assess the employer healthcare surcharge); and,
- STRS could not bring themselves into compliance with the 30-year limit on the funding period even if they completely eliminate the allocation to discretionary benefits and redirect all contributions to mandated benefits. Eliminating the allocation to discretionary healthcare benefits would force the elimination of these discretionary benefits as soon as the healthcare fund is exhausted.
- If the systems continue to allocate to discretionary healthcare benefits the portions of the employer contributions indicated in their most recent actuarial valuations, one or more of the following steps will need to occur.
 - The statutory employer and/or member contribution rate limitations will need to be increased.
 - State subsidies will need to be provided to the systems.
 - The benefits mandated by statute will need to be reduced.
 - The 30-year limit on the funding period required by law will need to be extended.
- If infinite funding periods were allowed to persist, the systems would be gradually defunded.

Review of the Adequacy of the Contribution Rates to HPRS and PERS, February 11, 2004 - Milliman presented these findings at the February 11, 2004 ORSC meeting.

The major findings and recommendations from this report are as follows:

- Investment returns achieved by HPRS and PERS in 2003 were far in excess of their long-term actuarial assumed rate of return. However, due to the smoothing of investment losses from prior years and investment gains from 2003, Milliman estimates that, as of December 31, 2003 only PERS Local Division satisfied the 30-year funding period required by law. (Technically, the 30-year funding period limitation applies to PERS on an aggregate basis, including all Divisions. Throughout this report, they discuss the 30-year limitation as if it applied to each Division separately.)
- The funding period calculation required by law should be based on the actuarial costs of all benefits mandated by statute - the pension benefits and the Medicare Part B premium reimbursement benefits. Milliman recommends that both HPRS and PERS include these statutorily mandated Medicare Part B premium reimbursement benefits when determining

their funding periods in future actuarial valuations. (SERS is the only Ohio retirement system that has included these mandated Medicare Part B premium reimbursement benefits in its actuarial valuation. Milliman previously recommended that OP&F and STRS include them in future valuations also.)

- The Capital Market Assumptions used by the systems for investment planning purposes anticipate that the annualized returns will be approximately 7.2% in the case of HPRS and 7.3% in the case of PERS over the next 10 years based on their current asset allocation policies. These returns fall short of the long-term actuarial investment return assumption of 8.00% used by both systems.
- If neither contributions nor benefits are modified, based on the average Capital Market Assumptions used by the five Ohio Retirement Systems for investment planning purposes there is a 43% probability that HPRS will be in compliance with the 30-year limit on the funding period 10 years from now, in 2014. Based on these assumptions, the probabilities of PERS State, PERS Local and PERS Law being in compliance with the 30-year limit in 2014 are 49%, 53%, and 54% respectively.
- The current contribution rates to HPRS and PERS are less than the statutory maximum rates. As a result, HPRS and PERS-State and PERS-Local could each comply with the 30-year funding period limit by increasing the current contribution rates without reducing the portion of the employer contribution rates allocated to discretionary healthcare benefits and still remain within the maximum contribution rate limitations provided by statute.
- If investment returns over the near term are favorable so that the PERS actuarial value of assets grows to “catch-up” with the market value, PERS-LE and PERS-Public Safety could also bring themselves into compliance with the 30-year funding period limit by increasing member and/or employer contributions and still remain within the maximum contribution rate limitations provided by statute.
- If investment returns over the near term meet the actuarial investment return assumption but provide no “excess” returns, PERS-LE and PERS-Public Safety could bring themselves into compliance with the 30-year funding period limit by both (a) increasing member and/or employer contributions to the statutory maximum limitation and (b) slightly reducing the current allocation to discretionary healthcare benefits.

Addendum to the Review of the Adequacy of the Contribution Rates to OP&F, SERS, and STRS, February 11, 2004 - This addendum to the Milliman report presented November 5, 2003 was in response to a request by the ORSC for some additional information. Milliman presented these findings at the February 11, 2004 ORSC meeting.

- **Summary Update on OP&F:**

- As a result of reduced resources to fund healthcare benefits as well as the rapid rate of increase in healthcare costs, OP&F has decreased the discretionary healthcare benefits it provides to retirees effective 2004 and increased the portion of healthcare costs retirees must pay.
- As a result of a rebound in the equity markets through the last six months of 2003, Milliman estimates that OP&F’s UAL decreased from \$1.8 billion as of June 30, 2003 to \$1.7 billion as of December 31, 2003 and that the funding period remains

infinite.

- Based on the updated investment returns through December 31, 2003, if neither contributions nor benefits are modified, the model estimates there is a 26% probability that OP&F will be in compliance with the 30-year limit on the funding period 10 years from now, in 2014. The corresponding figure from the November 5, 2003 report was 17%.

- **Summary Update on SERS:**

- In order to satisfy the 30-year funding period limitation, the allocation to discretionary healthcare benefits was decreased from 5.83% as of July 1, 2002 to 4.91% as of July 1, 2003.
- As a result of reduced resources to fund healthcare benefits as well as the rapid rate of increase in healthcare costs, SERS has decreased the discretionary healthcare benefits it provides to retirees effective 2004.
- Based on the updated investment returns through December 31, 2003, if neither contributions nor benefits are modified, the model estimates there is a 30% probability that SERS will be in compliance with the 30-year limit on the funding period 10 years from now, in 2014. The corresponding figure from the November 5, 2003 report was 19%.

- **Summary Update on STRS:**

- As a result of reduced resources to fund healthcare benefits as well as the rapid rate of increase in healthcare costs, STRS has decreased the discretionary healthcare benefits it provides to retirees effective 2004.
- Based on the favorable investment returns through December 31, 2003 and updated projections based on the new actuarial assumptions in use as of the July 1, 2003 actuarial valuation, the UAL was lowered from \$18.4 billion to \$17.0 billion as of July 1, 2003.
- Based on the updated investment returns through December 31, 2003, if neither contributions nor benefits are modified, the model estimates there is a 40% probability that STRS will be in compliance with the 30-year limit on the funding period 10 years from now, in 2014. The corresponding figure from the November 5, 2003 report was 28%.

Review of Contribution Rates Necessary to Actuarially Fund Post-Retirement Healthcare Benefits for HPRS, OP&F, PERS, SERS, and STRS - This report was prepared in response to a request made by the ORSC at the November 5, 2003 Council meeting. Milliman presented these findings at the February 11, 2004 ORSC meeting.

The major findings and recommendations from this review are as follows:

- Healthcare fund balances have generally been declining in recent years due to a combination of investment losses and negative cash flow (e.g. - contributions allocated to healthcare

benefits were less than benefits and administrative expenses).

- Current contribution rates allocated to discretionary healthcare benefits are on the order of 1/10 to 1/3 of the contribution rates needed to actuarially fund the plans so that the portion of the total cost of healthcare subsidized by the systems could be maintained.
- If the current healthcare contribution rates persist, or if the contribution rates allocated to healthcare are further decreased to shift funding back to mandated benefits, discretionary healthcare benefits would have to be significantly reduced.
- At a minimum, discretionary healthcare benefits could be offered to retirees with the retiree required to pay the full cost. This latter alternative would at least allow retirees to retain their coverage if they choose to pay for it.
- Medicare Part D reimbursements from the federal government beginning in 2006 will help defray the overall cost of prescription drugs somewhat, but are estimated to have a minimal effect on helping the systems move toward actuarial funding of post-retirement healthcare benefits. Alternatively, some, or all, of those reimbursements could be applied to reduce the portion of the premiums paid by retirees.
- Changes to post-retirement healthcare plan designs in response to increasing healthcare costs may reduce enrollments, and may also affect retirement patterns. Milliman did not attempt to estimate the potential effect of shifts in enrollment patterns or retirement patterns in preparing this report. To the extent that fewer/(more) retirees enroll for healthcare benefits than assumed or delay/(accelerate) retirement from the assumed ages, the contribution rates shown in this report would decrease/(increase).

REPORTS ON PENDING PENSION LEGISLATION
FIRST HALF OF THE 125TH GENERAL ASSEMBLY
JANUARY 1, 2003 - DECEMBER 31, 2003

H.B. 98 - Rep. Willamowski

H.B. 98 would amend the existing laws governing the division of retirement benefits upon termination of marriage under the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS) and the School Employees Retirement System (SERS) with respect to the following two issues: (1) the annual 3% cost-of-living allowance (COLA); and (2) the establishment of a mechanism to provide continuing benefits to an alternate payee after the member's death pursuant to a division of benefits order (DOBO).

The bill would also create a new joint and survivor annuity plan under PERS, STRS and SERS.

The Ohio Police and Fire Pension Fund (OP&F) and Highway Patrol Retirement System (HPRS) are excluded from the changes proposed under the bill.

Details of the bill follow.

Annual 3% COLA - The bill would provide that the annual 3% COLA payable under PERS, STRS and SERS shall be apportioned between the alternate payee (i.e., former spouse) and the benefit recipient in the same proportion that the alternate payee's benefit amount bears to the recipient's benefit amount. Under existing law, the COLA is payable only to the benefit recipient, in its entirety.

Continuing Benefits to Former Spouse under Court Order - The bill would provide an exception to the automatic 50% joint and survivor annuity for married members under PERS, STRS and SERS, which provides for the actuarial equivalent of the member's retirement allowance in a lesser amount payable for the life of the member and 50% of such allowance continuing after death to the member's spouse. Under the bill, the automatic 50% joint and survivor annuity would be waived *if* a plan of payment providing a specified amount continuing after death to the member's former spouse is required by a court order issued prior to the member's effective date of retirement.

Under existing law, the automatic 50% joint and survivor annuity may be waived only with the consent of the member's spouse.¹ Moreover, benefits payable to a former spouse pursuant to a DOBO currently terminate upon the member's death.

New Joint and Survivor Annuity Plan - The bill would provide for a new joint and survivor annuity plan under PERS, STRS, and SERS, which shall consist of the actuarial equivalent of the member's retirement allowance in a lesser amount payable for the life of the member and continuing after death to two or more surviving beneficiaries designated at retirement in such amount as designated at retirement. Under existing law, monthly benefits may *not* be paid to more than one beneficiary under the various plans of payment provided by PERS, STRS and SERS. Therefore, the new joint and survivor annuity plan would enable the continuing payment of the member's retirement allowance in a lesser amount after death to the member's former spouse, for example, along with the member's current spouse or other designated beneficiary.

Background - Prior to Sub. H.B. 535 (eff. 1/1/02), the laws of all five retirement systems generally provided that retirement benefits, including lump sum payments, shall not be subject to

¹Spousal consent may be waived due to the absence or incapacity of the member's spouse or any other cause specified by the board.

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execution, garnishment, attachment, the operation of bankruptcy or insolvency laws, or other process of law whatsoever, and shall not be assignable except as follows:²

- Alimony and child support pursuant to a withholding order; and
- Restitution for theft in public office or certain sex offenses committed within the context of the offender's employment pursuant to a withholding order.

Ohio domestic relations law provides that "marital property" shall include retirement benefits that are acquired by either or both of the spouses during the marriage (R.C. §3105.171). Accordingly, Sub. H.B. 535 was enacted to address the conflict between Ohio's domestic relations law that recognizes retirement benefits acquired during the marriage as marital property subject to equitable division upon termination of the marriage and Ohio's public pension laws that recognize only the member's right to retirement benefits, including lump sum payments, with the limited exceptions noted above.³

Effective January 1, 2002, Sub. H.B. 535 required the five state retirement systems to comply with a division of benefits order (DOB0) issued by a court upon termination of marriage that meets all of the following requirements:

- The order must be on a form created jointly by the state retirement systems, the Ohio State Bar Association and the Ohio Domestic Relations Judges Association;
- The order must set forth the name and address of each retirement system made subject to the order;
- The order must set forth the names, social security numbers, and current addresses of the member and alternate payee;
- The order must specify the amount to be paid to the alternate payee as both a monthly dollar amount and as a percentage amount with the numerator being the number of years in which the member was both a member of the retirement system(s) and married to the alternate payee and the denominator being the member's total years of service at the time the member elects to receive a benefit or lump sum payment;
- The order must specify the amount to be paid to the alternate payee from each benefit or

²The specific language of OP&F law differs from that of the other four retirement systems relative to the non-alienation of benefits.

³For a married member covered by any of the five state retirement systems, the automatic plan of payment upon service retirement is a 50% joint and survivor annuity that provides an actuarially-reduced pension for the member's life and one-half of such pension continuing for the spouse's life. The written consent of the member's spouse is required should the member elect an optional plan of payment providing for less than the 50% joint and survivor annuity. Moreover, once elected, the member may cancel a joint and survivor annuity upon termination of marriage **only** upon the written consent of the former spouse or a court order.

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lump sum payment if the member is eligible for more than one benefit or lump sum payment;

- The order must require the member or alternate payee to notify the retirement system in writing of any change in address;
- The order must notify the alternate payee of the following:
 - The alternate payee's right to payment under the order is conditional upon the member's right to a benefit or lump sum payment;
 - The possible reduction in the amount paid to the alternate payee if the member's benefit or lump sum payment is or becomes subject to more than one DOBO and/or spousal or child support order. (In the case of more than one DOBO and/or spousal or child support order, spousal or child support orders have priority over all other orders. All other orders have priority in order of earliest retention by the retirement system);
 - The possible termination of the alternative payee's rights to payment upon the earlier of the member's death, the alternate payee's death or termination of the member's benefit.
- The order must apply to payments made by the retirement systems after retention of the order;
- The benefit amount used to determine the amount to be paid to the alternate payee shall be the monthly benefit amount the member is receiving at the time the decree for divorce or dissolution becomes final or, if the member has not applied for a benefit, the monthly benefit amount calculated at the time the member elects to receive it;
- Payments to an alternate payee shall commence as soon as practicable if the member is receiving a benefit or has applied for, but not yet received a lump sum payment or upon application for a benefit or lump sum payment if the member has not yet applied for a benefit or lump sum payment;
- The order shall not require the retirement system to take any action or provide any benefit not authorized by the law governing the retirement system;
- The order shall authorize the retirement system to determine an amount necessary to defray the cost of administering the order and divide such charge equally between the member and the alternate payee;
- The total of the amounts to be paid to an alternate payee(s) shall not exceed 50% of the member's benefit or lump sum payment.

In an interesting development that occurred between the legislative enactment and the effective date of Sub. H.B. 535, the Ohio Supreme Court ruled in Erb v. Erb; Ohio Police & Fire Pension Fund (Erb II) (May 30, 2001) that OP&F must comply with the terms of a domestic relations order

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requiring it to pay directly to the member's former spouse that portion of the member's benefit that represents the former spouse's property interest pursuant to a division of marital property. According to this ruling, the anti-alienation provisions of OP&F law do not prohibit direct payments to a member's former spouse (i.e., non-member of the fund) who has been awarded a property interest in the pension fund pursuant to a division of marital property. The anti-alienation provisions are intended to protect member benefits from the creditors of persons to whom benefits are due; a member's former spouse who has been awarded a property interest in the member's benefit is not a creditor, but has an outright property interest in the benefit itself. Moreover, the changes enacted in Sub. H.B. 535 relative to the division of public pensions upon termination of marriage reflect the legislature's dissatisfaction with numerous courts' incorrect interpretations of the anti-alienation provisions which prohibited OP&F from making direct payments to a former spouse pursuant to a domestic relations order and simply clarify the law as it exists today. A subsequent motion for reconsideration of the Supreme Court's ruling was denied.

As previously noted in footnote #2, the specific language of the anti-alienation provisions under OP&F law differs from that of the other four retirement systems. In Patterson v. Patterson, (February 18, 2003), the Ohio Court of Appeals for the Twelfth Appellate District recognized the difference in specific language and overturned the trial court's application of the Erb II decision to PERS on that basis.

Pursuant to Section 11 of Sub. H.B. 535, the Ohio Retirement Study Council was required to have prepared a report that examines all of the following issues relative to the division of benefits provided by the five state retirement systems upon termination of marriage:

- Provision of benefits to a former spouse of a member or retirant of the retirement systems;
- Cost and feasibility of offering an optional plan of payment that provides for continuing benefits after the death of a retirant to more than one beneficiary;
- Cost and feasibility of providing a cost-of-living allowance or other post-retirement benefit adjustment to an alternate payee; and
- Any other issues related to the division of retirement benefits upon termination of marriage.

The report was presented by Milliman USA to the ORSC on January 9, 2002.

Staff Comments - Pensions are often the largest marital asset. In many cases, the courts find that other marital assets are insufficient to offset the non-member's equitable share in the pension or that installment payments to offset the non-member's equitable share in the pension create an undue financial burden on the member. Other available division methods often require the courts to retain continuing jurisdiction in order to ensure that both parties receive their interests in the funds, thereby frustrating the court's objective to disentangle the parties' economic relationship so as to create a conclusion and finality to the marriage.

Sub. H.B. 535 (eff. 1/1/02) established a uniform method among the five state retirement systems, authorizing the retirement systems to comply with DOBO's issued by the courts upon termination of marriage, provided they meet all of the requirements listed above. Sub. H.B. 98 would address certain outstanding issues that were not addressed by the legislature in Sub. H.B. 535; namely, the allocation of the annual 3% COLA between the alternate payee and the benefit recipient and the

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establishment of a mechanism to provide continuing benefits to an alternate payee after the member's death under a joint and survivor annuity option.

Sub. H.B. 98 would apply to only PERS, STRS and SERS, thereby creating greater benefit rights for non-member former spouses in these retirement systems than those in OP&F and HPRS. As a matter of public policy, the legislature should maintain the same uniformity among members and non-member former spouses in all five state retirement systems as previously established under Sub. H.B. 535 and, therefore, should extend the proposed changes to OP&F and HPRS as well.

It should be noted that the federal Employee Retirement Income Security Act (ERISA) governing most private pension plans provides stronger protections for non-member former spouses under private pension plans than currently provided for non-member former spouses under Ohio's five public pension plans. For example, Sub. H.B. 535 does not provide for survivorship benefits to former spouses. Therefore, instead of the current two-tier system in Ohio - one for non-member former spouses covered under ERISA and one for non-member former spouses covered under Ohio's public pension laws - the legislature would be creating yet a third tier - one for non-member former spouses covered under OP&F and HPRS - if these two retirement systems were to remain excluded from the substitute bill.

As was done under Sub. H.B. 535 (eff. 1/1/02), Sub. H.B. 98 should provide for a delayed effective date so that the retirement systems have adequate time to implement the proposed changes under the bill, including computer programming and actuarial software needs. An effective date of July 1, 2004 is suggested, assuming the bill is enacted before the end of this year.

Fiscal Impact - H.B. 98 is intended to have an actuarial cost-neutral impact upon PERS, STRS and SERS since the member's retirement allowance would be reduced on an actuarial basis in order to provide for continuing benefits to more than one beneficiary. Also, the allocation of the annual 3% COLA between the alternate payee and the benefit recipients would have no actuarial impact upon PERS, STRS or SERS.

ORSC Position - At the May 14, 2003 meeting of the Ohio Retirement Study Council, the ORSC voted to recommend that the 125th Ohio General Assembly approve H.B. 98 upon the adoption of the following amendments:

- That the proposed changes be made to the Ohio Police and Fire Pension Fund and the Highway Patrol Retirement System in order to maintain the existing uniform and equal treatment of Ohio's public employees relative to the division of benefits upon termination of marriage (**Not** included in Sub. H.B. 98);
- That the effective date of the bill be delayed to July 1, 2004, assuming the bill is enacted before the end of this year, in order to provide the retirement systems adequate time to implement the proposed changes under the bill (**Not** included in Sub. H.B. 98);
- That certain technical corrections identified by ORSC staff be made (Included in Sub. H.B. 98).

H.B. 98 was voted out of the House on June 25, 2003 and is currently pending in the Seneate

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Health, Human Services and Aging Committee.

Am. Sub. H.B. 227 - Rep. Schneider

Am. Sub. H.B. 227 is an omnibus pension reform bill that generally seeks to improve accountability, oversight and ethical standards with respect to the governance of the five state retirement systems in Ohio: the Public Employees Retirement System (PERS); the State Teachers Retirement System (STRS); the School Employees Retirement System (SERS); the Ohio Police & Fire Pension Fund (OP&F); and the Highway Patrol Retirement System (HPRS). The bill also makes significant changes in the investment authority of the five retirement systems and the authority of the retirement boards with respect to the executive director of each retirement system.

As introduced, H.B. 227 would have replaced one active teacher member position with an additional retired teacher member position to the STRS board.

A description of the numerous changes follows:

Financial Disclosure Statements Filed with Ohio Ethics Commission

- Requires the board members and employees of the five state retirement systems whose positions involve substantial and material exercise of discretion in the investment of retirement funds to file a financial disclosure statement with the Ohio Ethics Commission. The financial disclosure statements would be considered public records because they are required to be filed pursuant to statute rather than administrative rule. (R.C. §102.02)

Currently, the chief executive officer of each system is required by statute to file a financial disclosure statement; board members of each system are required by administrative rule to file financial disclosure statements with the Ohio Ethics Commission and, therefore, such statements are considered confidential under current law.

(S.B. 105, S.B. 133, H.B. 242 and H.B. 283 include a similar requirement.)

Campaign Financial Disclosure Statements Filed with Secretary of State

- Requires each candidate or campaign committee that receives contributions or in-kind contributions totaling \$1,000 or more or makes expenditures totaling \$1,000 or more in connection with the candidate's efforts to be nominated for election or elected to the retirement boards of the state retirement systems to file with the Secretary of State two complete, accurate and itemized statements setting forth in detail the contributions, in-kind contributions and expenditures relative to the board nomination or election. The Secretary of State is required to prescribe the form for the campaign financial disclosure statements and to accept such forms from candidates filing them. The first statement shall be filed no later than twelve days before election day, and shall reflect contributions and in-kind contributions received and expenditures made to the close of business on the twentieth day before the election. The second statement shall be filed no sooner than eight days after the election and no later than 38 days after the election, and shall reflect contributions and in-kind contributions received and expenditures made during the period beginning on the nineteenth day before the election and ending on the close of business on the seventh day after the election. (R.C. §§111.30, 145.052, 742.042, 3307.072, 3309.071, 5505.041)

“Contribution” is defined to mean a loan, gift, deposit, forgiveness of indebtedness, donation, advance, payment, transfer of funds, or transfer of anything of value, including

Am. Sub. H.B. 227 - Rep. Schneider

the transfer of funds from an inter vivos or testamentary trust or decedent's estate, and the payment by any person other than the person to whom the services are rendered for personal services to another person, which contribution is made, received or used for the purpose of getting an individual nominated for election to a retirement board or influencing the results of a board election. "Contribution" does not include services provided without compensation by individuals volunteering a portion or all of their time on behalf of a person; ordinary home hospitality; and the personal expenses of a volunteer paid for by that volunteer campaign worker.

"In-kind Contribution" is defined to mean anything of value other than money that is used to get an individual nominated for election to a retirement board or influence the results of a board election or is transferred to or used in support of or in opposition to a candidate and that is made with the consent of, in coordination, cooperation or consultation with, or at the request or suggestion of the benefitted candidate. The financing of the dissemination, distribution, or republication, in whole or in part, of any broadcast or of any written, graphic or other form of campaign materials prepared by the candidate, the candidate's campaign committee, or their authorized agents is an in-kind contribution.

"Expenditure" is defined to mean the disbursement or use of a contribution for the purpose of getting an individual nominated for election to a retirement board or influencing the results of a board election.

- No person shall knowingly fail to file a complete and accurate campaign financial disclosure statement. Whoever violates this provision shall be subject to a fine of not more than \$100 per each day of the violation. Any fines imposed shall be paid into the Ohio Ethics Commission fund. (R.C. §§145.053, 145.99, 742.043, 742.99, 3307.073, 3307.99, 3309.072, 3309.99, 5505.042, 5505.99)
- Authorizes the Secretary of State or any person with personal knowledge and subject to the penalties of perjury to file a complaint with the Ohio Elections Commission alleging a violation of the campaign financial disclosure requirements. Upon receipt of the complaint, the Ohio Elections Commission shall hold a public hearing to determine whether the alleged violation has occurred. The Commission may administer oaths and issue subpoenas to any person in the state compelling the attendance of witnesses and the production of documents. Upon refusal to obey a subpoena or to be sworn and answer as a witness, the Commission may apply to the court of common pleas of Franklin County to obtain compliance. The Commission shall provide the person accused of the violation at least seven days prior notice of the time, date and place of the hearing. The accused may be represented by an attorney and shall have an opportunity to present evidence, call witnesses and cross-examine witnesses. If the Commission determines that a violation has occurred, the Commission shall either impose a fine as authorized above or enter a finding that good cause has been shown not to impose the fine. (R.C. §§145.054, 742.044, 3307.074, 3309.073, 5505.043)

(S.B. 133 includes a similar requirement.)

Retirement Board Composition

- Changes the composition of each retirement board as follows:

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In the case of the PERS Board, the bill would eliminate the Attorney General, the Auditor of State and the Director of Administrative Services as statutory board members and replace them with the Treasurer of State, a gubernatorial appointee with no less than five years of experience in the management, analysis, supervision or investment of assets, and another retired member. The current PERS Board consists of the Attorney General, the Auditor of State, the Director of Administrative Services, five employee members elected by their respective members (one representing state employees, one representing county employees, one representing municipal employees, one representing college and university employees, and one representing all other miscellaneous employees) and *one* retired member elected by service and disability benefit recipients. Under the bill, the Governor shall request the Director of Administrative Services, with the organizations representing county commissioners, municipal corporations and townships, to submit the names and qualifications of three nominees, and the Governor shall appoint to the PERS Board one of the persons so nominated. (R.C. §145.04)

In the case of the OP&F Board, the bill would eliminate the Attorney General and the Auditor of State as statutory members and replace them with the Treasurer of State and a gubernatorial appointee with no less than five years of experience in the management, analysis, supervision or investment of assets. The current OP&F Board consists of the Attorney General, the Auditor of State, the fiscal officer of a municipal corporation appointed by the Governor, four employee members elected by their respective members (two representing police officers and two representing firefighters), and two retired members elected by their respective counterparts (one representing retired and disabled police officers and their survivors, and one representing retired and disabled firefighters and their survivors). Under the bill, the Governor shall request the Director of Administrative Services, with the organizations representing county commissioners, municipal corporations and townships, to submit the names and qualifications of three nominees, and the Governor shall appoint to the OP&F Board one of the persons so nominated. (R.C. §742.03)

In the case of the STRS Board, the bill would eliminate the Attorney General and the Auditor of State as statutory members and replace them with the Treasurer of State and another retired teacher member. At the option of the Governor, either the Superintendent of Public Instruction or an individual appointed by the Governor with no less than five years of experience in the management, analysis, supervision or investment of assets would serve as a statutory member. With respect to the proposed gubernatorial appointee, the Governor shall request that the organization representing school boards submit the name and qualifications of three nominees, and the Governor shall appoint one of the persons so nominated. The current STRS Board consists of the Attorney General, the Auditor of State, the Superintendent of Public Instruction, five teacher members elected by active, inactive and disabled teachers, and one retired teacher member elected by service benefit recipients. (R.C. §3307.05)

In the case of the SERS Board, the bill would eliminate the Attorney General and the Auditor of State as statutory members and replace them with the Treasurer of State and another retired member. The current SERS Board consists of the Attorney General, the Auditor of State, four employee members elected by active and inactive members, and one retired member elected by service and disability benefit recipients. (R.C. §3309.05)

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In the case of the HPRS Board, the bill would eliminate the Auditor of State and Superintendent of the State Highway Patrol as statutory members and replace them with the Treasurer of State and another retired member. The current HPRS Board consists of the Auditor of State, the Superintendent of the State Highway Patrol, four employee members elected by contributing members, one retired member elected by service and disability benefit recipients. (R.C. §5505.04)

The attached pension profile provides the current composition of each retirement board.

(S.B. 133 also makes changes to the composition of the retirement boards; H.B. 283 (125th G.A.) would remove the Attorney General and the Auditor of State from the retirement boards.)

- Provides that the initial election of the additional retired member to the PERS, STRS, SERS and HPRS boards shall be held at the first election that occurs later than 90 days after the effective date of the bill, and every four years thereafter.

The initial gubernatorial appointment to the PERS, OP&F, and STRS boards shall be made within 90 days after the effective date of the bill. The term of office for such appointee shall be four years commencing on the first day of January (fourth day of June in OP&F; first day of September in STRS) following appointment or, if the Governor makes the appointment after the first day of January (first day of September in STRS), the term shall commence on the day of appointment. The member shall continue in office subsequent to the expiration date of the member's term until the member's successor takes office or until a period of 60 days has elapsed, whichever comes first. A member appointed by the Governor to fill a vacancy occurring prior to the expiration of the predecessor's term shall hold office for the remainder of that term.

In the case of the PERS Board, the Auditor of State and Director of Administrative Services shall remain members of the board until the new member has been appointed by the Governor and the additional retired member has been elected. In the case of the OP&F Board, the Auditor of State shall remain on the board until the new member has been appointed by the Governor. In the case of the STRS Board, the Auditor of State shall remain on the board until the additional retired member has been elected, and the Superintendent of Public Instruction shall remain on the board until the new member has been appointed by the Governor should the Governor opt to replace the Superintendent. In the case of the SERS Board, the Auditor of State and the Attorney General shall remain on the board until the additional retired member has been elected. In the case of the HPRS Board, the Superintendent of the State Highway Patrol shall remain on the board until the additional retired member has been elected. (R.C. §§145.05, 742.03, 3307.06, 3309.06, 5505.04)

- Makes a member of the retirement systems who has been convicted of or pleaded guilty to a felony in this state or any other jurisdiction ineligible for election to the retirement boards. The bill also provides that the office of a member of the retirement boards who is convicted of or pleads guilty to a felony shall be deemed vacant. (R.C. §§145.05, 145.055, 742.03, 742.045, 3307.061, 3307.07, 3309.062, 3309.07, 5505.04, 5505.044)

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(S.B. 133 includes a similar prohibition.)

Travel Policy

- Requires each retirement board to adopt rules establishing a policy for the reimbursement of travel expenses incurred by employees of the retirement system. Currently, this statutory requirement is limited to the reimbursement of travel expenses incurred by members of the retirement boards.

(S.B. 133 includes a similar requirement.)

The bill further prohibits board members and employees of the retirement systems from accepting payment or reimbursement for meals and other food and beverages provided from any source other than the retirement system's expense fund. Currently, meals and other food and beverages provided are exempted from this prohibition. (R.C. §§145.08, 742.08, 3307.10, 3309.10, 5505.05)

Ethics Policy

- Requires each retirement board to adopt rules establishing an ethics policy to govern members of the board and employees of the retirement system in the performance of their duties. (R.C. §§145.09, 742.102, 3307.041, 3309.041, 5505.051)

Board Training Program

- Requires each retirement board to provide periodic training to members of the board and employees of the retirement system, including the requirements and prohibitions under the Ohio's ethics laws, the board's ethics policy, the board's travel policy, the board's policy on employee compensation and bonuses, and any other training the board deems to be appropriate. (R.C. §§145.093, 742.103, 3307.042, 3309.042, 5505.052)

(S.B. 133 includes a similar requirement.)

Internal Audit Committee

- Requires each retirement board to appoint a committee to oversee the selection of an internal auditor and to employ such person(s) selected. The committee shall consist of the following board members: one retired member, one employee member, and one ex officio member. The committee shall annually prepare a report of its actions during the preceding year and submit it to the ORSC. (R.C. §§145.094, 742.104, 3007.032, 3309.032, 5505.111)

(In testimony before the Joint Legislative Committee to Study Ohio's Public Retirement Plans in 1996, the Auditor of State recommended that the legislature require the five retirement systems to adopt an internal control structure, including the employment of an internal auditor, and file an annual internal control audit report with the ORSC and the standing committees of both houses with primary responsibility for retirement issues. All of the retirement systems, except HPRS, has employed an internal auditor since then.)

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Treasurer of State

- Grants the Treasurer of State sole authority to appoint the executive director of each retirement system upon the advice and consent of the other board members. The board shall advise and consent regarding the appointment no later than 60 days following the appointment. The executive director shall serve at the pleasure of the Treasurer of State.

The bill provides that the initial executive directors appointed by the Treasurer of State shall commence service immediately upon appointment. Each board shall advise and consent providing the appointment not later than 60 days after it is made. (R.C. §§ 145.09, 742.10, 3307.11, 3309.11, 5505.07)

Currently, the executive director of each retirement system is appointed by the entire board.

- Requires the Treasurer of State to deposit all domestic assets of the retirement systems with a bank that is eligible to become a public depository and is subject to corporate franchise tax in this state. “Domestic asset” is defined to mean United States government securities, securities issues by a federal agency, corporate bonds and notes of companies incorporated in the United States, domestic equities, and any other asset considered a domestic asset by the Treasurer of State. (R.C. §113.052)

Investment Operations

- Requires each retirement board to execute not less than 70% of all equity and fixed-income trades in any given year through approved agents (i.e., licensed dealers) designated by the board and, *as a board goal*, not less than an additional 10% of all equity and fixed income trades through approved agents that are minority business enterprises (i.e., owned and controlled by Ohio residents who are Black, American Indian, Hispanic, or Oriental). The board shall designate an agent as an approved agent if the following requirements are met:
 - the agent submits to the board all required information concerning the agent’s history, personnel with substantial responsibilities regarding equity investments, support personnel, clients, fees, and any other related matter specified by the board;
 - the agent has practiced, or each of its principals has practiced, as an agent in Ohio for at least three years prior to designation;
 - the agent is subject to Ohio taxation;
 - the agent employs at least five Ohio residents;
 - the agent has demonstrated professional and administrative ability; and
 - the agent has no outstanding legal judgments or past judgments that reflect negatively on the agent or the retirement system.

The percentage of equity trades shall be measured by the dollar value of commissions paid; the percentage of fixed-income trades shall be measured by the face value of the securities traded. The board shall annually compile and make available upon request a list of

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approved agents. (R.C. §§145.11, 145.114, 742.11, 742.114, 3307.15, 3307.152, 3309.15, 3309.157, 5505.06, 5505.062)

- Requires each retirement system to disclose annually to the Division of Securities of the Department of Commerce and the Ohio Ethics Commission the following information:
 - any money received by the retirement system from an agent and any money spent by an agent for any expense of the system; and
 - the name of any employee of the retirement system with authority over the investment of funds or any board member of the system who deals with such agent.

The bill also requires each agent who receives a commission from a retirement system to disclose to the Division of Securities of the Department of Commerce and the Ohio Ethics Commission the following information:

- any money paid by the agent to the retirement system and any money spent by an agent for any expense of the system; and
- the name of any employee of the retirement system with authority over the investment of funds or any board member of the system who deals with such agent.

The disclosures shall be made semiannually, not later than the thirtieth day of June and the thirty-first day of December of each year. (R.C. §§145.115, 742.115, 1707.49, 3307.153, 3309.158, 5505.063)

- Requires each retirement system that contracts with external investment managers to award not less than 50% of the assets externally managed to investment managers that meet the following criteria and, *as a board goal*, not less than an additional 10% of such assets to minority business enterprises:
 - the investment manager must have at least one significant contract as determined by the board with another state or federal governmental entity; and
 - the investment manager must have its headquarters in Ohio *or* have at least three operating locations in Ohio and employ at least 15 individuals at each location *or* employ at least 500 individuals in Ohio.

The bill would also require each retirement system, *as a board goal*, to award an additional 3% of its assets to one or more emerging investment managers. Each board shall adopt a policy not later than six months after the effective date of the bill that does both of the following:

- establish criteria that an investment manager must meet to be designated an emerging investment manager which shall include at least the following two requirements: (1) manage not more than \$500 million worth of investments; and (2) have at least one contract deemed significant by the board with another state or federal level government entity.

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- provide preferential treatment to emerging investment managers that meet all of the following requirements: (1) has its corporate headquarters in Ohio; (2) employs at least five individuals in Ohio; and (3) has other investment operations within Ohio that utilize agents determined to be significant by the board.

All external investment managers shall meet all of the following requirements:

- shall be a bank, an insurance company, an investment company, or an investment adviser;
 - provide to the board the manager's investment strategies and objectives and satisfactory evidence of successful employment of such strategies and objectives;
 - demonstrate to the board's satisfaction that the investment management has achieved performance measures calculated on a time-weighted basis and based on a composite of fully discretionary accounts with a similar investment style and has net and gross fees that are comparable to other investment managers with similar investment strategies and objectives;
 - provide to the board an investment performance evaluation prepared by an objective third party that illustrates the investment manager's risk and return profile relative to other investment managers with similar investment strategies and objectives;
 - provide all information required by the board concerning the investment manager's history, personnel with substantial responsibilities regarding investment strategies and objectives, support personnel, clients, fees, and any other related matters; and
 - shall not have any judgments that may, in the board's opinion, reflect negatively on the investment manager or the retirement system. (R.C. §§145.11, 145.116, 742.11, 742.116, 3307.15, 3307.154, 3309.15, 3309.159, 5505.06, 5505.064)
- Requires external investment managers to do all of the following:
 - comply with the board's investment policies and objectives and the laws governing the investment of retirement funds;
 - at the board's direction, vote by proxy for the board in a manner consistent with the long-term interests of the retirement system and the board's investment policies and objectives;
 - keep detailed records of any votes by proxy;
 - on at least a quarterly basis, report to the board on the status of the retirement system's investments under management, including the gains and losses on such investments for the reporting period; and
 - meet with officers and employees of the retirement system at least twice per year to report the economic outlook of the retirement system's investments under management and compliance with the board's investment policies and objectives.

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(R.C. §§145.117, 742.117, 3307.155, 3309.1510, 5505.065)

- Requires each retirement board to supervise and control the execution of the equity and fixed-income trades made by external investment managers to ensure compliance with the mandated percentages described above for Ohio-based licensed dealers and minority business enterprises. (R.C. §§145.118, 742.118, 3307.156, 3309.1511, 5505.066)
- Requires each retirement board to submit a quarterly report to the ORSC, including all of the following information:
 - the name of each approved agent designated by the board;
 - the percent of equity and fixed-income trades executed by approved agents;
 - the percent of equity and fixed-income trades executed by minority business enterprises;
 - the name of each investment manager contracted with by the board;
 - the percent of assets managed by each investment manager and the status of those assets;
 - the percent of assets managed by minority business enterprises and the status of those assets;
 - the percent of assets managed by emerging investment managers and the status of those assets;
 - a summary of the investment managers' compliance with the legislative mandates relative to trade execution. (R.C. §§145.119, 742.119, 3307.157, 3309.1512, 5505.067)

Fiduciary Performance Audits

- Requires the ORSC to have conducted an independent fiduciary performance audit of each retirement system at least once every ten years. The cost of such audit shall be paid by the retirement system audited. (R.C. §171.04)

(S.B. 133 includes a similar requirement as well as H.B. 283.)

Removal of Elected Board Members

- Provides that any elective board member of the retirement systems who willfully and flagrantly exercises authority or power not authorized by law, refuses or willfully neglects to enforce the law or to perform any duty imposed by law, or is guilty of gross neglect of duty, gross immorality, drunkenness, misfeasance, malfeasance, or nonfeasance is guilty of misconduct in office. Upon a complaint and hearing as provided below, the board member shall have judgment of forfeiture of the office, creating a vacancy in the office to be filled as provided by existing law.

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Proceedings for the removal of such board member shall be commenced by filing with the court of appeals of the district in which the board member resides a written complaint specifically setting forth the charge. The complaint shall be accepted if signed by the Governor or signed by eligible members or retirees constituting at least 10 percent of the number of votes cast in the election for such board member position with at least 20 signatures in at least five different counties (or if no election, the most recent election held for such board member position). The clerk of court shall submit the signatures to the board, which shall verify the validity of the signatures and report its finding to the court.

The clerk of court shall cause a copy of the complaint to be served on the board member at least ten days before the hearing. The court shall hold a public hearing not later than 30 days after the filing of the complaint. The court may subpoena witnesses and compel their attendance in the same manner as in civil cases. Process shall be served by the sheriff of the county in which the witness resides. Witness fees and other fees in connection with the proceedings shall be the same as in civil cases. The court may suspend the board member pending the hearing.

If the court finds that one or more of the charges in the complaint are true, it shall make a finding for removal of the board member. The court's finding shall include a full detailed statement of the reasons for the removal, and shall be filed with the clerk of court and be made a matter of public record. The board member has the right of review or appeal to the supreme court on leave first obtained. The supreme court shall hear the case in not more than 30 court days after granting leave. In all other respects, the hearing shall follow the regular procedure in appealable cases that originate in the court of appeals. No person who has been removed from the board pursuant to the above procedure shall be eligible for future board membership. (R.C. §§171.50, 171.51, 171.52)

This provision is modeled after existing law governing the removal of public officers under R.C. §3.07, et al.

Staff Comments - In this section of our analysis, we will focus on those provisions of the bill that raise significant public policy issues or depart from well-established legislative principles and past precedents that have guided the operations of the retirement systems over the years.

- **Retirement Board Provisions**

One of the most significant public policy issues raised by the bill is the actual composition of the retirement boards. A survey of other state retirement boards throughout the 50 states indicates that board composition varies widely. (See attachment) Some boards are primarily made up of governmental officials, while others are made up of more pension plan participants than representatives of the public. Some boards provide for the election of members by the plan participants, while others provide for the appointment of such members by the governor or some other governing authority. Some require representation of citizens who are not members of the retirement system and individuals with experience in special fields, such as actuarial science, banking, insurance, and investments; others require no such representation. Some boards include legislators, while others do not. Some boards require retiree representation; others have no such representation. Some have

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as few as one trustee, while other have as many as 18 trustees, with an average of 9 trustees.

In Ohio the composition of the state retirement boards share the following characteristics:

- The majority of the board members are elected by the members of the system, including contributing members and non-contributing members with accounts on deposit with the system;
- Each board includes at least one elected retired member (two retired members in OP&F);
- Each board has an odd number of trustees to prevent voting deadlocks; and
- Each board includes statutory members to represent the general public, such as the Auditor of State, the Attorney General or other public officials.

Generally, the bill would provide *less* public representation on the retirement boards at a time when *more* public accountability for board decision-making is sought. The number of statewide public office holders on four of the five retirement boards (PERS, STRS, SERS, and OP&F) would be reduced from two (the Attorney General and Auditor of State) to one (the Treasurer of State). Also, the number of overall public representatives on four of the five retirement boards would be reduced from three (the Attorney General, Auditor of State and the Director of Administrative Services) to two (the Treasurer of State and a gubernatorial appointee with investment experience) in PERS; in STRS, from three (the Attorney General, Auditor of State and the Superintendent of Public Instruction) to two (the Treasurer of State and *either* the Superintendent of Public Instruction *or* a gubernatorial appointee with investment experience at the option of the Governor); from two (the Attorney General and Auditor of State) to one (the Treasurer of State) in SERS; and in HPRS, from two (Auditor of State and Superintendent of State Highway Patrol) to one (the Treasurer of State).

Since the creation of the retirement systems beginning in 1919, the Attorney General as well as the Auditor of State have served as statutory members of the retirement boards, with the exception of the HPRS board on which only the Auditor of State has served. Both the Attorney General and the Auditor of State are statewide public office holders directly accountable to the citizens of all 88 counties in Ohio. The proposed replacement of at least one of these statewide public officers with a gubernatorial appointee in PERS and OP&F, a local school board member in STRS, and no one in SERS and HPRS would seem to provide more limited accountability and representation to the general public, particularly given the statewide nature of these retirement systems. *Therefore, we would recommend that at least two statewide public office holders remain statutory members of the PERS, STRS, SERS and OP&F retirement boards and that an additional statewide public office holder be added to the HPRS board to provide consistency with the other four retirement boards as well as greater public accountability. This could be accomplished within the current framework of the bill by retaining the Auditor of State on all five retirement boards.*

The proposed addition of a gubernatorial appointee with experience in investments to the PERS, OP&F and STRS Boards has considerable merit, and is very common among other

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retirement boards throughout the country. Given the importance of investments in the actuarial funding of the retirement systems (funding up to 75% of benefit costs), such individual could provide invaluable knowledge and experience to perhaps the single most important responsibility of the board - managing the assets of the fund. Therefore, it is questionable why the bill, as currently drafted, would provide for the appointment of such individual to only three of the five retirement boards (PERS, OP&F, STRS), and *not* SERS and HPRS as well. It should also be noted that SERS is the only retirement board without a public representative under the authority of the Governor; with the proposed removal of the Superintendent of the State Highway Patrol, HPRS would become the second retirement board without a public representative under the authority of the Governor. Currently, PERS, OP&F, STRS and HPRS boards include the Director of Administrative Services, a fiscal officer of a municipal corporation appointed by the Governor, the Superintendent of Public Instruction, and the Superintendent of the State Highway Patrol, respectively. In the case of the STRS board, the bill would provide, at the option of the Governor, for *either* the Superintendent of Public Instruction remaining on the board *or* being replaced by an individual with experience in investments. *Accordingly, we would recommend that the Governor be given the same option either to retain his current public representative on the PERS, OP&F and HPRS boards or appoint an individual with investment experience in place thereof. We would further recommend that the SERS board include, at the option of the Governor, either a school board member or an individual with investment experience appointed by the Governor to provide the same level of public representation and accountability as the other four retirement boards.*

The bill had provided for a public employer representative on the STRS and SERS Boards, namely, a school board member, *prior to* a standing committee amendment which removed the proposed school board member from the STRS and SERS Boards in order to retain the current number of employee representatives on those boards. This type of representation has considerable merit given the significant contributions made by public employers to the retirement systems, and is rather common among other state retirement boards. *Therefore, we would recommend that consideration be given to adding a public employer representative to the PERS Board as well, such as a county commissioner or the chief executive officer of a municipal corporation, and restoring the proposed school board member to the STRS and SERS Boards.* These recommended changes, along with the other recommended changes described above, would deny absolute voting control of the board decision-making process to any single group of board members, thereby ensuring that all voices are heard and considered.

The bill would apparently change the manner in which current “teacher members” to the STRS board are elected by limiting voting to “contributing members”, though that term is *not* defined under the bill or under existing STRS law. Therefore, it is not clear, for example, whether “reemployed retirants” who are receiving a service retirement allowance from the system while contributing to the system would be eligible to vote for such “contributing member,” though they are not otherwise deemed to be “members” pursuant to existing STRS law. Similarly, it is not clear whether disability benefit recipients, who are *not* contributing to the system but are otherwise considered “members” under existing STRS law, would become disenfranchised under the proposed change. “Teacher members” are currently elected by the members of STRS, which includes *not only* members who are currently contributing to the retirement system *but also* members who are not currently contributing but who have accounts on deposit with the retirement system which may

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include teachers on temporary professional, maternity, disability or military leave. In addition, disability benefit recipients are considered “members” and, therefore, are eligible to vote for the “teacher member.” The proposed change would seem to limit voting rights to only members who are currently contributing to STRS which is inconsistent with the laws governing the other two non-uniformed employee retirement systems, PERS and SERS. The proposed change would seem to disenfranchise large segments of the current STRS membership who continue to have vested, financial interests in the proper management and operation of their retirement system. *Therefore, we would recommend that this proposed change be removed from the bill so that members of PERS, STRS and SERS continue to be treated fairly and consistently with respect to their voting rights. We would further recommend that STRS law be amended to conform with the laws of the other four retirement systems which provide that the retired board member shall be elected by both the service and disability benefit recipients. STRS is the only retirement system in which disability benefit recipients vote for the “employee board member” as opposed to the “retired board member.”*

The attached table shows the composition of each retirement board if the recommendations described above were adopted.

- **Investment Provisions**

The proposed changes to the five state retirement systems’ investment authority mark a significant departure from well-established legislative principles and past precedents that have guided the investment operations of the retirement systems over the decades. The proposed mandates on the retirement systems’ use of Ohio-based brokerage firms, investment managers, minority business enterprises and emerging investment managers generally are contrary to the principles underlying the adoption of the “prudent person” standard established by the legislature in 1997 as the sole criteria to be used in managing the retirement systems’ investments. The proposed mandates also run counter to the legislature’s consistent and steadfast opposition to various and sundry proposed mandates over the years on the retirement boards’ exercise of their investment authority and fiduciary responsibilities with respect to the management of the system’s assets. Moreover, the proposed mandates could jeopardize the qualified plan status of the retirement systems under Section 401(a) of the Internal Revenue Code which, in addition to state statutes, applies to governmental plans, and thus adversely impact the favorable tax treatment currently accorded to the plan participants. The retirement boards could also become subject to various causes of action filed by the plan participants for breach of fiduciary duty as a result of the proposed mandates.

By way of background, the legislature has long recognized the significant role investments play in the overall funding of benefit costs in each retirement system. Of the three sources of revenue - employee contributions, employer contributions, investment earnings - the largest source of revenue for all five state retirement systems is investment earnings, funding up to 75% of their benefit costs. Thus, investment yields are very important to determining the contributions required from employees, employers and ultimately taxpayers to fund current and future benefit obligations.

Governed by outdated “legal lists” that severely restricted both the types and amounts of investments that could be made by the five state retirement systems, the ORSC

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recommended that the legislature revamp the retirement systems' investment authority to enable them to respond to changing financial markets and a changing economy.⁴ As part of a comprehensive review of the laws governing the state retirement systems, the ORSC recommended that the "legal lists" be abolished and that the retirement systems' investment authority be made subject solely to the "prudent person" standard.⁵ This recommendation was adopted by the legislature in S.B. 82 (eff. 3/7/97), which was later amended to provide similar investment authority for the Bureau of Workers' Compensation (BWC).

Under the "prudent person" standard, the state retirement boards "shall discharge their duties with respect to the funds *solely in the interest of the participants and beneficiaries; for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the public employees retirement 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 these 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 minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so." (Emphasis added) The guiding principles underlying the "prudent person" standard adopted by the legislature recognize the need for the state retirement systems to respond to changes in the economy and investment markets in a timely manner and to rely upon professional investment managers and economic advisors to guide their investment decisions, including trade execution, asset allocation, and the selection of investment managers. The proposed mandates under the bill undermine these guiding principles by reverting back to inflexible, arbitrary percentages and standards that do not allow the boards to respond to changing conditions or to rely solely on professional investment judgment to guide their decisions.

During the past two decades, the legislature has established a firm precedent of opposing any proposed mandates on the investment authority of the retirement systems. Since the early 80's, the legislature has rejected all attempts to require the systems to divest in companies with connections to South Africa, Northern Ireland, nations sponsoring acts of terrorism, tobacco and other social issues. The proposed mandates under the bill would mark a departure from this legislative precedent, and could set a precedent for future mandates that would further erode the boards' investment authority and fiduciary responsibility to manage the systems' assets "solely in the interest of the participants and beneficiaries."

The proposed mandates under the bill are reportedly modeled after the current BWC investment policy. It should be noted, however, that at least two significant differences can

⁴A "legal list" generally spells out in varying degrees of detail the types and amounts of investments that can be made. If an investment is not specifically authorized under the legal list, then the retirement systems can not make the investment, regardless of whether it would otherwise be prudent to do so. Legal lists are in need of constant revision in order to keep current with changing financial markets and a changing economy.

⁵*Final Report: Findings, Staff Recommendations and JLC Action*, Joint Legislative Committee to Study Ohio's Public Retirement Plans (December 11, 1996).

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be found. First, the statutory authority governing the BWC investments includes no similar mandates. The use of Ohio-based brokers, investment managers and minority business enterprises by BWC is done pursuant to its investment policy, which can be changed at any given time under its current statute. Therefore, the BWC retains discretionary authority under its current statutes to modify its policy as it deems appropriate and “prudent.” The proposed mandates under the bill would be amended into each retirement system’s investment statute, thereby providing no board discretion or flexibility with respect to the enumerated percentages or standards and requiring legislative action to change them - one of the very reasons the “legal lists” were abolished and the “prudent person” standard was adopted for both the state retirement systems and the BWC as the sole criteria for guiding investment decisions under S.B. 82.

Secondly, the BWC is a state insurance fund *not* subject to the qualification requirements under section 401(a) of the Internal Revenue Code; as qualified plans, the state retirement systems must satisfy the exclusive benefit rule of section 401(a)(2) of the Internal Revenue Code in order for the current favorable tax treatment to be accorded to their plan participants. The exclusive benefit rule provides that a trust forming part of a qualified plan must be established and maintained by an employer *for the exclusive benefit of that employer’s employees and beneficiaries*. The proposed mandates under the bill could jeopardize the status of the retirement systems as qualified plans since the investment statutes, as amended by the bill, would make it possible for the assets of the retirement system to be diverted for a purpose other than the exclusive benefit of the plan participants, *should strict compliance with such mandates not otherwise be deemed prudent*. It is for this reason that the current investment statutes of all five retirement systems provide, for example, that it shall be the intent of the board to give consideration to investments that enhance the general welfare of the state and its citizens *where the investments offer quality, return, and safety comparable to other investments currently available to the board* rather than strictly mandating a specified percentage of such investments, regardless of whether all things are otherwise equal. The same type of statutory provisions apply to investments that involve minority owned and controlled firms and firms owned and controlled by women.

One of the basic principles of public pension policy adopted by the National Conference of State Legislatures in its publication Public Pensions: A Legislator’s Guide, July 1995 is that pension investments should be governed by the “prudent person” rule. It further cautions against “any attempt to invest pension fund assets in ways designed primarily to perpetuate public services or to improve the business climate or tax base.” The proposed mandates under the bill would seem to warrant such caution.

Therefore, we would recommend that the proposed mandates on the retirement boards’ investment authority and fiduciary responsibility to manage the retirement systems’ assets be removed from the bill for the various reasons cited above.

- **Treasurer of State**

The proposed changes with respect to the employment of the executive directors of the five state retirement systems also mark a significant departure from well-established legislative policy. Since the creation of the state retirement systems beginning in 1919, the board has appointed the executive director who has served at the pleasure of the board. Under the

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bill, the Treasurer of State would have sole authority to appoint the executive director, with the advise and consent of the board, and the executive director would serve at the pleasure of the Treasurer of State.

Under the governing statutes of the retirement systems, it is the board as a collective whole, not as individual board members, that is granted statutory authority with respect to the management and administration of these retirement systems, including the investment of retirement funds. The law also provides that the board as a whole may sue and be sued, plead and be impleaded, contract and be contracted with, employ and fix the compensation of employees, and adopt rules for the proper administration and management of the fund. In exercising such authority, fiduciary responsibility and potential liability apply equally to all individual board members, which suggests that each board member should have equal authority to fulfill such responsibilities. Investing the sole authority to hire and fire the executive directors in the Treasurer of State would create an untenable situation where the remaining board members remain responsible as fiduciaries, yet are denied the authority to take appropriate and necessary action as circumstances warrant, such as the removal of an executive director against the wishes of the Treasurer. It could also place the executive directors in a compromising position with respect to their duty of undivided loyalty to the board when the Board majority and Treasurer take conflicting positions on various issues and board policies, especially given the sole authority of the Treasurer to fire the director at will. In essence, the bill creates the potential for requiring the executive directors to serve two masters in these situations.

Therefore, we would recommend that the proposed changes with respect to the employment of the executive directors of the five state retirement systems be removed from the bill.

Fiscal Impact - We are not in position at this point to determine the fiscal impact of the bill on the retirement systems, particularly with respect to the investment changes proposed under the bill. This measure could have an actuarial impact upon the retirement systems to the extent that their investment costs increased and thus their investment returns decreased. Further information and analysis is required.

ORSC Position - At its meeting of November 13, 2003, the Ohio Retirement Study Council voted to recommend that the 125th Ohio General Assembly approve Sub. H.B. 227 upon the adoption of the following amendments:

- *that at least two statewide public office holders remain statutory members of the PERS, STRS, SERS and OP&F retirement boards and that an additional statewide public office holder be added to the HPRS board to provide consistency with the other four retirement boards as well as greater public accountability. This could be accomplished within the current framework of the bill by retaining the Auditor of State on all five retirement boards.*
- *that the Governor be given the same option either to retain his current public representative on the PERS, OP&F and HPRS boards or appoint an individual with investment experience in place thereof. In addition, we recommend that the SERS board include, at the option of the Governor, either a school board member or an individual with investment experience appointed by the Governor to provide the same level of public representation*

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and accountability as the other four retirement boards.

- *that consideration be given to adding a public employer representative to the PERS Board as well, such as a county commissioner or the chief executive officer of a municipal corporation, and restoring the proposed school board member to the STRS and SERS Boards..*
- *that the proposed change that “contributing” members rather than “teacher” members be removed from the bill so that members of PERS, STRS and SERS continue to be treated fairly and consistently with respect to their voting rights. We would further recommend that STRS law be amended to conform with the laws of the other four retirement systems which provide that the retired board member shall be elected by both the service and disability benefit recipients. STRS is the only retirement system in which disability benefit recipients vote for the “employee board member” as opposed to the “retired board member.”*
- *that the proposed mandates on the retirement boards’ investment authority and fiduciary responsibility to manage the retirement systems’ assets be removed from the bill for the various reasons cited in the staff comments.*
- *that AM4733-125, which was adopted by the House Banking, Pension, and Securities Committee yesterday and expands eligibility in the alternative retirement plans (ARP) offered by PERS, STRS, and SERS, to any full-time employee of a public institution of higher education with less than five years of service be removed until an actuarial analysis can be completed, as required by statute. (This recommendation was adopted on the House floor)*
- *that AM4709-125, which provides for the transition of the new board members, be harmonized with language added by AM 4731-125, which removes the school board member from the SERS and STRS boards (This recommendation was adopted on the House floor)*
- *that AM4729, which provides that the retirement systems shall have as a goal that one or more emerging investment managers manage not less than 3% of the assets of the retirement system, be clarified to mean not less than 3% of the assets of the retirement system that are managed externally to reflect the intent of the bill, which retains the retirement boards’ existing discretionary authority to decide the appropriate use of internal versus external management of their assets. In addition, the goal of having 10% of the investment managers be minority business enterprises should also be clarified to mean not less than 10% of the assets of the retirement system that are managed externally for the same reason. (This recommendation was adopted on the House floor)*
- *that 125HB227-4748/BGE, which provides that the Treasurer of State shall appoint to*

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each board, with the advice and consent of the board, an executive director who serves at the pleasure of the Treasurer of State and requires the board to advise and consent within sixty days following the appointment, be removed from the bill.

H.B. 227 was voted out of the House on November 13, 2003 and is currently pending in the Senate Health, Human Services and Aging Committee.

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S.B. 133 is an omnibus pension reform bill that is intended to improve accountability, oversight and ethical standards with respect to the governance of the five state retirement systems in Ohio: the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Ohio Police & Fire Pension Fund (OP&F) and the Highway Patrol Retirement System (HPRS).

A description of the numerous changes follows:

Financial Disclosure Statements Filed with Ohio Ethics Commission

- Requires the board members, investment officers and employees of the five state retirement systems whose positions involve substantial and material exercise of discretion in the formulation of policy or the expenditure or investment of retirement funds to file a financial disclosure statement with the Ohio Ethics Commission. In addition, the bill requires members of the Ohio Retirement Study Council (ORSC) who are appointed by the Governor or jointly appointed by the majority and minority leaders of the House and Senate and ORSC employees other than employees who perform purely administrative and clerical duties to file financial disclosure statements. The financial disclosure statements would be considered public records because they are required to be filed pursuant to statute rather than administrative rule. (R.C. §102.02)

Currently, the chief executive officer of each system is required by statute to file a financial disclosure statement; board members of each system are required by administrative rule to file financial disclosure statements with the Ohio Ethics Commission and, therefore, such statements are considered confidential under current law.

The bill prohibits board members, investment officers and employees of the retirement systems whose position involves substantial and material exercise of discretion in the investment of retirement funds to accept or solicit payment of actual travel expenses, including lodging, meals, food and beverages. (R.C. §103.03)

Civil Actions Filed by Attorney General for Breach of Fiduciary Duty

- Authorizes the Attorney General to file a civil action against a board member of the five state retirement systems for breach of fiduciary duty. The Attorney General may recover damages or be granted injunctive relief, which shall include the enjoinder of specified activities and the removal of the member from the board. Any damages awarded shall be paid to the retirement system. The bill specifies that this authority is in addition to any other authority granted to the Attorney General under any other provision of the Revised Code. (R.C. §§109.98, 145.114, 742.114, 3307.152, 3309.157, 5505.065)

The Attorney General currently serves as the legal adviser for each retirement system.

Board Elections

- Requires the Secretary of State to adopt rules governing the election of board members to the five state retirement systems, including rules governing the nominating petitions for elections; to oversee the administration of board member elections; to certify the validity of nominating petitions for the elections; to certify the results of the elections; to prescribe

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forms for campaign finance disclosure statements to be filed by board members and persons making independent expenditures with the Secretary of State; to oversee elections held to fill vacancies on the retirement boards; and to certify the results of such elections. (R.C. §111.30)

Currently, all elections of board members are conducted under the supervision of the retirement boards.

- Provides that a successor employee or retiree board member who is elected to fill a vacancy shall hold office until the next board election that occurs not less than 90 days after the successor's election to the board. (R.C. §§145.06, 742.05, 3307.06, 3309.06, 5505.042)

Under existing law, the successor employee or retiree board member holds office for the remainder of the predecessor's term.

Reporting to ORSC

- Requires the Ohio Ethics Commission to report its findings, in addition to the appropriate prosecuting authority and the appointing or employing authority of the accused under existing law, to the Ohio Retirement Study Council (ORSC) with respect to any violation of the ethics laws committed by a board member of the five state retirement systems under R.C. Chapter 102 of the Revised Code, including having an unlawful interest in a public contract under R.C. §2921.42 and soliciting or receiving improper compensation under R.C. §2921.43. (R.C. §102.06)
- Requires the Auditor of State to report to the ORSC on the results of an audit, including any special audit, of the five state retirement systems. (R.C. §117.10)

Board Composition

- Replaces the Attorney General as a statutory member of the PERS, STRS, SERS and OP&F boards (the Attorney General is not a statutory member of the HPRS board) with the Treasurer of State. The bill also adds the Treasurer of State to the HPRS board. (R.C. §§145.04, 742.03, 3307.05, 3309.05, 5505.04)

In the case of the PERS board, the bill would add the following two board members: (1) a county commissioner, auditor, sheriff, treasurer, recorder, engineer, *or* coroner appointed by the Governor for a term of four years; and (2) an investment expert appointed by the Governor for a term of four years. The investment expert shall be a resident of Ohio; within three years immediately preceding appointment, shall not have been employed by the retirement system or by an person, partnership or corporation that has provided financial or investment services to the retirement system; and shall have direct experience in the management, analysis, supervision or investment of assets. The initial investment expert shall be appointed and take office not less than ninety days after the effective date of the bill. Any investment expert appointed to fill a vacancy shall hold office until the end of the predecessor's term. The investment expert shall continue in office subsequent to the expiration of the member's term until a successor takes office or a period of 60 days has elapsed, whichever occurs first. The bill provides no similar provisions with respect to the initial appointment of the elected county officer to the PERS board. (R.C. § 145.04)

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In the case of the OP&F Board, the bill would add two investment experts appointed by the Governor for terms of four years. (R.C. §742.03)

The bill would also provide that if a vacancy of an employee or retirant member of the OP&F board occurs, all of the remaining members of the board shall elect a successor employee or retirant member. Current law provides that such election shall be made by only the remaining employee or retirant members of the board. (R.C. §742.05)

In the case of the STRS Board, the bill would add the following two board members: (1) another retired teacher member; and (2) a school board member appointed by the Governor. The bill would also allow the Superintendent of Public Instruction to designate an investment expert to serve on the STRS Board in place of the Superintendent. (R.C. §3307.05)

In the case of the SERS Board, the bill would add the following two board members: (1) a school board member appointed by the Governor; and (2) an investment expert appointed by the Governor. (R.C. §3309.05)

In the case of the HPRS Board, the bill would add the following board members: the Director of Public Safety as a statutory member; and two investment experts appointed by the Governor. (R.C. §5505.04)

The attached pension profile provides the current composition of each retirement board.

- Adds two former legislative members who have served at least one term on the ORSC or on the standing committee/subcommittee of either house with primary responsibility for retirement and health legislation as voting members of the ORSC. The bill provides that one member shall be jointly appointed by the Speaker of the House and the leader of the Senate of the same political party and the other member shall be jointly appointed by the legislative leaders of the House and Senate of the opposite political party. The members shall serve until their successors are appointed and qualified, notwithstanding the adjournment of the general assembly or the expiration of their terms as members of the ORSC. The two new members shall be appointed at the same time the House members of the ORSC are appointed, and shall serve until the thirty-first day of December of the following year. The bill also requires at least one of the three current gubernatorial appointees to the ORSC to be a person with investment expertise. (R.C. §171.01)

Currently, the ORSC is composed of 14 members as follows: three Senators appointed by the President of the Senate, no more than two of whom may be of the same political party; three Representatives appointed by the Speaker of the House, no more than two of whom may be of the same political party; three members appointed by the Governor, with the advice and consent of the Senate, one representing the state and its employees, one representing non-state governments and their employees and one representing educational employers and their employees, no more than two of whom may be of the same political party; and the five executive directors of the retirement systems as non-voting members.

- Specifies that the Attorney General is the legal adviser of the ORSC. (R.C. §171.06)

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The Attorney General has served as the legal adviser for the ORSC since its creation in 1968.

Orientation and Continuing Education Program

- Requires the boards of the five state retirement systems to jointly develop an orientation and continuing education program for board members and submit it to the ORSC. The education program shall cover the following topics: board member duties; member benefits and health care management; ethics and governance processes; actuarial soundness; investments; and any other subject matter reasonably related to the duties of board members. The boards shall jointly pay the costs associated with establishing and conducting the education programs which shall be held in Ohio. (R.C. §171.50)
- Requires each newly-elected board member to complete the orientation program established by the retirement boards no later than 90 days after commencing service as a board member. The bill also requires board members who have served one or more years to attend continuing education programs established by the retirement boards not less than twice each year. (R.C. §§145.041, 742.031, 3307.051, 3309.051, 5505.064)

Travel Expenses of Board Members

- Provides that a person who has served as an elected or appointed member of the retirement boards during any part or all of fiscal years 2000, 2001 and 2002 shall be ineligible for reelection or reappointment to the board if the person accepted reimbursements for travel and travel-related expenses that average more than \$10,000 for those fiscal years. (R.C. §§145.042, 742.032, 3307.052, 3309.052, 5505.49)

Campaign Financial Disclosure

- Requires each candidate or campaign committee that receives contributions or in-kind contributions or makes expenditures in connection with the candidate's election to the boards of the five state retirement systems to file with the Secretary of State two complete, accurate and itemized statements setting forth in detail the contributions, in-kind contributions and expenditures relative to the board election. The first statement shall be filed no later than twelve days before election day, and shall reflect contributions and in-kind contributions received and expenditures made to the close of business on the twentieth day before the election. The second statement shall be filed no sooner than eight days after the election and no later than 38 days after the election, and shall reflect contributions and in-kind contributions received and expenditures made during the period beginning on the nineteenth day before the election and ending on the close of business on the seventh day after the election. Every expenditure shall be vouched for by a receipted bill stating the purpose of the expenditure; a canceled check with a notation of the purpose of the expenditure shall be deemed a receipted bill.

The bill also requires each individual, partnership, or other entity that makes an independent expenditure in connection with the candidate's efforts to be elected to a retirement board to file such statements with the Secretary of State detailing the expenditures.

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“Contribution” is defined to mean a loan, gift, deposit, forgiveness of indebtedness, denotation, advance, payment, transfer of funds, or transfer of anything of value, including the transfer of funds from an inter vivos or testamentary trust or decedent’s estate, and the payment by any person other than the person to whom the services are rendered for personal services to another person, which contribution is made, received or used for the purpose of influencing the results of a board election. “Contribution” does not include services provided without compensation by individuals volunteering a portion or all of their time on behalf of a person; ordinary home hospitality; and the personal expenses of a volunteer paid for by that volunteer campaign worker.

“In-kind Contribution” is defined to mean anything of value other than money that is used to influence the results of a board election or is transferred to or used in support of or in opposition to a candidate and that is made with the consent of, in coordination, cooperation or consultation with, or at the request or suggestion of the benefitted candidate. The financing of the dissemination, distribution, or republication, in whole or in part, of any broadcast or of any written, graphic or other form of campaign materials prepared by the candidate, the candidate’s campaign committee, or their authorized agents is an in-kind contribution.

“Expenditure” is defined to mean the disbursement or use of a contribution for the purpose of influencing the results of a board election or the results of an election to fill a vacancy on the board.

“Independent expenditure” is defined to mean an expenditure by an individual, partnership, or other entity advocating the election or defeat of a candidate(s) that is not made with the consent of, in coordination, cooperation or consultation with, or at the request or suggestion of any candidate. An independent expenditure shall not be construed as being a contribution. (R.C. §§145.053, 742.042, 3307.072, 3309.072, 5505.044)

- No person shall knowingly fail to file a complete and accurate campaign financial disclosure statement. Whoever violates this provision shall be subject to a fine of not more than \$100 per each day of the violation. Any fines imposed shall be paid into the Ohio Ethics Commission fund. (R.C. §§145.054, 145.99, 742.043, 742.99, 3307.073, 3307.99, 3309.073, 3309.99, 5505.045, 5505.99)
- No person, during the course of a person seeking nomination for or during the campaign for election to the retirement board, shall knowingly and with intent to affect the nomination or outcome of the campaign do any of the following by means of campaign materials, an advertisement on radio or television or in a newspaper or periodical, a public speech, press release or otherwise:
 - with regard to a candidate, identify the candidate in a manner that implies that the candidate is a member of the board or use the term “re-elect” when the candidate is not currently a member of the board;
 - make a false statement concerning the formal schooling or training completed or attempted by a candidate; a degree, diploma, certificate, scholarship, grant, award, prize, or honor received, earned or held by a candidate; or the period of time during which a candidate attended any school, college, community technical school, or

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institution;

- make a false statement concerning the professional, occupational, or vocational licenses held by a candidate or concerning any position held by the candidate for which salary or wages were received;
- make a false statement that a candidate or public official has been indicted or convicted of a theft offense, extortion, or other crime involving financial corruption or moral turpitude;
- make a statement that a candidate has been indicted for any crime or has been the subject of a finding by the Ohio Elections Commission without disclosing the outcome of any legal proceedings resulting from the indictment or finding;
- make a false statement that a candidate or official has a record of treatment or confinement for mental disorder;
- make a false statement that a candidate or official has been subjected to military discipline for criminal misconduct or dishonorably discharged from the armed services;
- falsely identify the source of a statement, issue statements under the name of another person without authorization, or falsely state the endorsement of or opposition to a candidate by a person or publication;
- make a false statement concerning the voting record of a candidate or public official;
- post, publish, circulate, distribute, or otherwise disseminate a false statement concerning a candidate, either knowing the same to be false or with reckless disregard of whether it is false, if the statement is designed to promote the election, nomination or defeat of a candidate.

Whoever violates these provisions shall be imprisoned for not more than six months or fined not more than \$5,000, or both. (R.C. §§145.054, 145.99, 742.043, 742.99, 3307.073, 3307.99, 3309.073, 3309.99, 5505.045, 5505.99)

- Authorizes the Secretary of State or any person with personal knowledge and subject to the penalties of perjury to file a complaint with the Ohio Elections Commission alleging a violation of the campaign financial disclosure requirements. Upon receipt of the complaint, the Ohio Elections Commission shall hold a public hearing to determine whether the alleged violation has occurred. The Commission may administer oaths and issue subpoenas to any person in the state compelling the attendance of witnesses and the production of documents. Upon refusal to obey a subpoena or to be sworn and answer as a witness, the Commission may apply to the court of common pleas of Franklin County to obtain compliance. The Commission shall provide the person accused of the violation at least seven days prior notice of the time, date and place of the hearing. The accused may be represented by an attorney and shall have an opportunity to present evidence, call witnesses and cross-examine witnesses. If the Commission determines that a violation has occurred, the Commission shall either impose a fine as authorized above, refer the matter to the

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appropriate prosecutor, or enter a finding that good cause has been shown not to impose the fine or refer the matter to the appropriate prosecutor. (R.C. §§145.055, 742.044, 3307.074, 3309.074, 5505.046)

Felony Charges and Other Criminal or Ethical Violations; Suspension & Removal

- Provides that any board member who is charged with committing a felony, a theft offense, a violation of the ethics laws and offenses against justice and public administration shall be suspended from participation on the board during the period the charges are pending.⁶ If the charges are dismissed or the member is found not guilty or the charges are otherwise resolved in a manner not resulting in the member being convicted or pleading guilty to an offense of that nature, the suspension shall end. If the board member pleads guilty or is convicted of the offense, the board member's position shall be deemed vacated. A person who has pleaded guilty to or been convicted of the above offenses is ineligible for election to the retirement boards. (R.C. §§145.057, 742.046, 3307.061, 3309.061, 5505.048)

Investment Officers

- Requires each retirement board to designate a person who is a licensed state retirement investment officer to be the chief investment officer for the retirement fund. Each board shall notify the Division of Securities in writing of its designation and of any change thereto within 10 calendar days of the designation or change.

The chief investment officer shall reasonably supervise licensed state retirement system investment officers and other persons employed by the retirement fund with a view toward preventing violations of federal and state securities laws, and the rules and regulations

⁶Theft offenses include aggravated robbery; robbery; aggravated burglary; burglary; breaking and entering; safecracking; tampering with coin machines; theft; unauthorized use of a vehicle; unauthorized use of property, computer, cable or telecommunications property or service; possession or sale of unauthorized cable television device; telecommunications fraud; unlawful use of telecommunications device; passing bad checks; misuse of credit cards; forgery and identification card offenses; criminal simulation; making or using slugs; trademark counterfeiting; medicaid fraud; tampering with records; securing writing by deception; impersonating an officer; defrauding creditors; insurance fraud; workers' compensation fraud; receiving stolen property; cheating; theft in office; any offense under an existing or former municipal ordinance or law of this or another state or of the United States involving robbery, burglary, breaking and entering, theft, embezzlement, wrongful conversion, forgery, counterfeiting, deceit or fraud; and a conspiracy or attempt to commit, or complicity in committing any of the offenses listed above.

Offenses against justice and public administration include bribery; perjury; falsification; obstructing official business; having an unlawful interest in public contract; soliciting or receiving improper compensation; and dereliction of duty.

Ethical violations include duty to file financial disclosure statement with ethics commission; restrictions on present and former public officials and employees; compensation or services received other than from agency with which person employed; and confidentiality of information in disclosure statements.

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thereunder. The duty of reasonable supervision shall include the adoption, implementation, and enforcement of written policies and procedures reasonably designed to prevent such persons from misusing material, nonpublic information in violation of these laws, rules and regulations.

No chief investment officer shall be considered to have failed to satisfy the duty of reasonable supervision if the officer has done all of the following:

- Adopted and implemented written procedures and a system of applying the procedures that would reasonably be expected to prevent and detect, insofar as practicable, any violation;
- Reasonably discharged the duties and obligations incumbent upon the chief investment officer by reason of the established procedures and system for applying the procedures when the officer has no reasonable cause to believe that there was a failure to comply with the procedures and systems;
- Reviewed, at least annually, the adequacy of the policies and procedures established and the effectiveness of their implementation;

The chief investment officer shall ensure that securities transactions are executed in such a manner that the retirement system's total costs or proceeds in each transaction are the most favorable under the circumstances. No chief investment officer shall be considered to have failed to satisfy the duty of best execution if the officer has done both of the following:

- Adopted and implemented a written policy that outlines the criteria used to select broker-dealers that execute securities transactions on behalf of the retirement system which criteria shall include all of the following: commissions charged by the broker-dealer, both in the aggregate and on a per share basis; the execution speed and trade settlement capabilities of the broker-dealer; the responsiveness, reliability, and integrity of the broker-dealer; the nature and value of research provided by the broker-dealer; and any special capabilities of the broker-dealer.
- Reviewed, at least annually, the performance of broker-dealers that execute securities transactions on behalf of the retirement system. (R.C. §§145.094, 742.104, 3307.043, 3309.043, 5505.065)
- Prohibits each retirement board from employing an investment officer who does not hold a valid state retirement system investment officer license issued by the Division of Securities in the Department of Commerce, effective 90 days after the effective date of the bill. (R.C. §§145.09, 742.10, 3307.11, 3309.14, 5505.07)
- Defines "state retirement investment officer" to mean an individual employed by a state retirement system as a chief investment officer, assistant investment officer, or the person in charge of a class of assets. (R.C. §1707.01)
- Prohibits any person from acting as a state retirement investment officers unless the person is licensed as a state retirement investment officer by the Division of Securities. The bill also prohibits a state retirement investment officer from acting as a dealer, salesperson,

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investment advisor or investment advisor representative. (R.C. §1707.162)

- Requires applicants for a state retirement system investment officer license to file with the Division of Securities the information, materials and forms specified in rules adopted by the Division. The bill provides that the Division may investigate any applicant and require any additional information it considers necessary to determine the applicant's business repute and qualifications to act as an investment officer. If the application requires the Division to investigate outside of this state, the applicant may be required to advance sufficient funds to pay any of the actual expenses of the investigation.
- Provides that the Division of Securities shall by rule require an applicant to pass an examination designated by the Division or achieve a specified professional designation unless the applicant meets both of the following requirements:
 - (1) acts a state retirement system investment officer on the effective date of the amendment;
 - (2) has experience or equivalent education acceptable to the Division.

If the Division finds that the applicant is of good business repute, appears to be qualified to act as a state retirement system investment officer, and has complied with Chapter 1707 and the rules adopted thereunder, the Division shall issue a license upon payment of the applicable fee. (R.C. §1707.163)

- The license fee shall be \$50.00. The license of every state retirement system investment officer shall expire on the thirty-first day of June of each year. The license may be renewed on the filing with the Division of Securities of an application for renewal and the payment of the \$50.00 fee. The Division shall give notice, without unreasonable delay, of its action on any application for renewal. (R.C. §1707.17)
- The license of a state retirement system investment officer may be refused, suspended or revoked if the Division of Securities determines that the investment officer:
 - (1) is not of good business repute;
 - (2) is conducting an illegitimate or fraudulent business;
 - (3) is, in the case of a dealer or investment adviser, insolvent;
 - (4) has knowingly violated any provision of Chapter 1707 of the Revised Code, or any regulation or order made thereunder;
 - (5) has knowingly made a false statement of a material fact or an omission of a material fact in an application for a license or in any statement made to the Division;
 - (6) has refused to comply with any lawful order or requirement of the Division;
 - (7) has been guilty of any fraudulent act in connection with the sale of any securities or in connection with acting as a state retirement system investment officer;
 - (8) conducts business in purchasing or selling securities at such variations from the

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existing market as in the light of all the circumstances are unconscionable;

(9) conducts business in violation of such rules and regulations as the Division prescribes for the protection of investors, clients, prospective clients, or state retirement systems; and

(10) has failed to furnish to the Division any information with respect to acting as a state retirement system investment officer. (R.C. §1707.19)

- If a court of Common Pleas grants an injunction against any state retirement system investment officer for violation of Ohio's securities laws, the Director of Commerce may request that the court order the state retirement system investment officer to make restitution. (R.C. §1707.261)
- No state retirement system investment officer shall do any of the following:
 - (1) employ any device, scheme or artifice to defraud any state retirement system;
 - (2) engage in any action, practice or course of business that operates or would operate as a fraud or deceit on any state retirement system;
 - (3) engage in any act, practice or course of business that is fraudulent, deceptive or manipulative; (The Division of Securities may adopt rules reasonably designed to prevent such acts, practices, or courses of business as are fraudulent, deceptive, or manipulative.)
 - (4) knowingly fail to comply with any policy adopted by the retirement systems regarding state retirement investment officers.

Travel & Compensation Policies; Operating Budget & Communication Plan

- Requires each retirement board to review, in consultation with the Ohio Ethics Commission, its existing policies regarding travel of board members and employees as well as compensation/bonuses to employees and to adopt rules establishing a new or revised policy. The boards shall submit the rules to the ORSC.
- Requires each retirement board to submit to the ORSC its proposed operating budget, along with the administrative budget for the board, and to adopt such budget no earlier than 60 days after submission to the ORSC.
- Requires each retirement board to submit to the ORSC a plan describing how the board will improve the dissemination of public information pertaining to the board. (R.C. §§145.092, 742.102, 3307.041, 3309.041, 5505.062)

Ethics Training & Policy

- Requires each retirement board to provide ethics training to board members and employees regarding the requirements and prohibitions under the ethics provisions under Chapter 102 of the Revised Code, along with sections 2921.42 (having an unlawful interest in a public contract) and 2921.43 (soliciting or receiving improper compensation) of the Revised

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Code. The bill also requires the board to adopt a procedure to ensure that each employee is informed of the procedure to file a complaint with the Ohio Ethics Commission or appropriate prosecuting attorney)

- Requires each retirement board, in consultation with the Ohio Ethics Commission, to develop an ethics policy and submit it to the ORSC for approval. The ORSC shall review the policy and, if the ORSC determines, upon the advise of the Ethics Commission, that it is adequate, approve the policy. If the ORSC determines that the policy is inadequate, it shall specify the revisions to be made and the board shall submit a revised policy. If the ORSC approves the revised policy, the board shall adopt it. If not, the board shall make any further revisions required by the ORSC and adopt the policy. (R.C. §§145.093, 742.103, 3307.042, 3309.042, 5505.063)

Public Records

- Provides that upon the written request of any person, each retirement board shall make available all documents regarding the filling of a vacancy of an elected board member. The person making the request shall pay the cost of compiling, copying and mailing the documents. Such documents shall be deemed to be a public record. (R.C. §§145.27, 742.41, 3307.20, 3309.22, 5505.04)

The bill also provides that the board shall furnish the Secretary of State with the personal history records of plan participants for purposes of certifying board elections. The Secretary of State shall maintain the confidentiality of such records.

ORSC Authority

- Authorizes the ORSC to establish a uniform reporting format for the five state retirement systems. (R.C. §171.03) The bill also requires each retirement board to submit any required reports to the ORSC in that format. (R.C. §§145.09, 742.10, 3307.03, 3309.03, 5505.122)

This was one of the recommendations made by the Auditor of State to the Joint Legislative Committee to Study Ohio's Public Retirement Plans in 1997. The purpose is to allow legislators, board members and the public to make meaningful comparisons of the retirement systems, since many public policy issues involve all five retirement systems.

- Authorizes the ORSC to request the Auditor of State to perform or contract for the performance of a financial or special audit of a retirement system; (R.C. §171.03)

(S.B. 126 (125th G.A.) would authorize the ORSC to request the Inspector General to investigate the management and operation of the state retirement systems. Also, S.B. 104 (125th G.A.) would authorize the Inspector General to investigate the ORSC and the five retirement systems.)

- Requires the ORSC to have conducted an independent fiduciary performance audit of each retirement system at least once every five years to be paid by the retirement system audited; (R.C. §171.04)

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(H.B. 283 (125th G.A.) includes a similar provision.)

- Requires the ORSC to review all proposed retirement rules and submit any recommendations to the Joint Committee on Agency Rule Review. (R.C. §171.04)

This requirement was recommended in an earlier draft of H.B. 648 (eff. 9/16/98), but was substantially modified to require only that the retirement boards submit a copy of any proposed rules to the ORSC when they file them with JCARR. The purpose of this requirement is to provide a public review process of such rules, similar to the current review process for proposed legislation, given the fact that the legislature has granted the retirement boards broad rule-making authority in various substantive areas of the current retirement laws, including the disability determination process, defined contribution plans and post-retirement health care benefits.

OP&F Disability Applications

- Requires the OP&F retirement board to notify, in addition to the employer under existing law, the chief of a police department or the chief of a fire department, as applicable, of the filing of a disability application. The notice shall state the name of the member filing the disability application, in addition to the member's position or rank as provided under existing law. The notice and the fact that the application has been filed shall be confidential. (R.C. §742.38)

Staff Comments - In this section of our analysis, we will focus on those provisions of the bill that raise significant public policy issues or potential problems.

Perhaps one of the most significant public policy issues raised by the bill is the actual composition of the retirement boards. A survey of other state retirement boards throughout the fifty states indicates that board composition varies significantly. (See attachment) Some boards are primarily made up of governmental officials, while others are made up of more pension plan participants than representatives of the public. Some boards provide for the election of members by the plan participants, while others provide for the appointment of such members by the governor or some other governing authority. Some require representation of citizens who are not members of the retirement system and individuals with experience in special fields, such as actuarial science, banking, insurance, and investments; others require no such representation. Some boards include legislators, while others do not. Some boards require retiree representation; others have no such representation. Some have as few as one trustee, while other have as many as 18 trustees, with an average of 9 trustees.

In Ohio the composition of the state retirement boards share the following characteristics:

- The majority of the board members are elected by the members of the system, including contributing members and non-contributing members with accounts on deposit with the system;
- Each board includes at least one elected retired member (two retired members in OP&F);

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- Each board has an odd number of trustees to prevent voting deadlocks; and
- Each board includes statutory members to represent the general public, such as the Auditor of State, the Attorney General or other public officials.

Since the creation of the state retirement systems beginning in 1919, the Attorney General as well as the Auditor of State have served as statutory members of the state retirement boards, with the exception of HPRS in which only the Auditor of State has served on the board. Both the Attorney General and the Auditor of State are statewide public office holders directly accountable to the citizens of all 88 counties in Ohio; these statutory board positions are intended to provide needed public representation and accountability to the boards of the statewide retirement systems in Ohio. The bill would still retain two statewide public officer holders on the PERS, STRS, SERS and OP&F boards by replacing the Attorney General with the Treasurer of State. The bill would also provide the HPRS board with two statewide public officer holders by adding the Treasurer of State as a statutory member, thereby making it consistent with the other four retirement boards in this regard. According to the attached survey, the Treasurer of State is the single most statewide public office holder that serves as a statutory member of other state retirement boards, serving in more than one-half of the states.

The proposed addition of an investment expert(s) to each retirement board has considerable merit, and is very common among other state retirement boards throughout the country. Given the importance of investments in the actuarial funding of the retirement systems (funding up to 75% of benefit costs), such individual could provide invaluable knowledge and experience to perhaps the single most important responsibility of the board - managing the assets of the fund.

The bill also provides for a public employer representative on the PERS, STRS and SERS boards, namely, an elected county official in PERS and a school board member in STRS and SERS. (The Superintendent of the State Highway Patrol also serves as a statutory member to the HPRS board.) This type of representation also has considerable merit given the significant contributions made by public employers to the retirement systems and, again, is a rather common provision among other state retirement boards.

The proposed increase in the size of all five retirement boards would necessarily encourage coalition-building of the board decision-making process. Currently, the employee members of each retirement board constitute a majority. Employee members would still have the greatest number of board positions, though just shy of constituting a board majority.

The bill also provides for two additional members to the ORSC to ensure that acquired knowledge and experience on retirement and health care issues continues to be made available for the performance of the duties of the ORSC: two former legislators who have either served on the ORSC or on a standing committee of either house with primary responsibility for retirement and health care legislation. This is a particularly important provision due to the loss of knowledge, experience and perspective relative to the operation of the state retirement systems resulting from legislative term limits.

Perhaps one of the most significant problems raised by the bill is the provision authorizing the Attorney General to file a civil action against a board member of the five state retirement systems for breach of fiduciary duty. Under existing law, the Attorney General serves as the legal adviser to all five retirement boards. This provision of the bill creates an inherent conflict-of-interest

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whereby the Attorney General is given authority to file civil actions against board members while concurrently serving as the legal adviser to such members who are the potential subject of such actions. This provision raises a whole host of legal issues, including attorney-client privilege and the code of professional responsibility to name a few. This provision also fails to recognize that the retirement boards are legally structured to act as a whole, not as individual members of the board, with respect to the exercise of their fiduciary duties and, therefore, any civil action for breach of fiduciary duty would most likely involve the entire board. *We would recommend that the retirement boards be given independent statutory authority to engage the services of outside legal counsel in those situations where the Attorney General is both legal adviser to the board as well as a plaintiff filing a civil action against the board.*

Another potential problem is the provision prohibiting elected or appointed board members whose travel expenses for fiscal years 2000, 2001 and 2002 averaged more than \$10,000 from being reelected or reappointed to the retirement boards. This provision raises a constitutional issue relative to the retroactive application of laws enacted by the General Assembly in violation of Article II, Section 28, of the Ohio Constitution. As drafted, the provision would apply only to travel expenses incurred by board members during the past three years, and would have no prospective application whatsoever. Moreover, the provision is extremely vague as to what constitutes "reimbursement for travel or travel-related expenses..." It would appear to encompass any reimbursement for travel related to attendance at board meetings and legislative hearings; performance of due diligence with respect to on-site visits to investment managers, other professional advisors, and investment holdings; communication outreach efforts to member, retiree and employer organizations throughout the state; attendance at orientation and continuing education programs either in-state or out-of-state; and the like. *We would recommend that the provision denying the right of reelection or reappointment to the retirement boards for elected or appointed board members whose travel expenses averaged more than \$10,000 for fiscal years 2000, 2001 and 2002 be removed from the bill because of the general constitutional prohibition against the retroactive application of laws enacted by the General Assembly.*

Fiscal Impact - We are not in position at this point to determine the fiscal impact of the bill on the retirement systems. We do know that the fiduciary performance audits of the retirement systems may range from \$300,000 to \$400,000 per retirement system (cost borne by each system), though there may also be the potential for future savings in the millions resulting from the findings and recommendations of such audits. There could also be some additional administrative costs relative to board elections as a result of the addition of another elected retiree member to the STRS Board as well as the supervision of such elections by the Secretary of State. For example, the average cost of STRS board elections is \$100,000. As a point of reference, out of 299,988 ballots sent, 41,810 active, inactive and disabled members of STRS cast ballots for the active teacher member; out of 80,366 ballots sent, 47,263 service retirees cast ballots for the retired teacher member. Board members receive no compensation, but are reimbursed for actual and necessary expenses incurred in the performance of their duties. There could also be some additional administrative costs incurred by the retirement systems in establishing and conducting board education programs, though there may also be the potential for savings as a result of any commensurate reductions in out-of-state travel as well as more restrictive travel allowances. There is also the potential for savings for each retirement system resulting from further restrictions on employee bonuses and compensation packages in general.

ORSC Position - At its meeting of November 13, 2003, the Ohio Retirement Study Council voted to recommend that the 125th Ohio General Assembly approve S.B. 133 upon the adoption of

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the following amendments:

- *that the retirement boards be given independent statutory authority to engage the services of outside legal counsel in those situations where the Attorney General is both legal adviser to the board as well as a plaintiff filing a civil action against the board; and*
- *that the provision denying the right of reelection or reappointment to the retirement boards for elected or appointed board members whose travel expenses averaged more than \$10,000 for fiscal years 2000, 2001 and 2002 be removed from the bill because of the general constitutional prohibition against the retroactive application of laws enacted by the General Assembly (Article II, Section 28, of the Constitution of Ohio)*

S.B. 133 was voted out of the Senate on November 13, 2003 and is currently pending in the House Banking, Pensions and Securities Committee.

REPORTS ON PENSION LEGISLATION ENACTED
FIRST HALF OF THE 125TH GENERAL ASSEMBLY
JANUARY 1, 2003 - DECEMBER 31, 2003

Am. Sub. H.B. 95 - Rep. Calvert

Am. Sub. H.B. 95 generally makes appropriations for the operation of the state and education for the biennium beginning July 1, 2003 and ending June 30, 2005. This analysis describes only those provisions of the bill that relate to the Ohio public retirement systems. Listed below are appropriations included in the act for state subsidies to the Ohio Police & Fire Pension Fund and to the Ohio Public Safety Officers Death Benefit Fund:

Appropriation Item	Fiscal Year 2004	Fiscal Year 2005
090-524 Police and Fire Disability Pension	\$35,000	\$30,000
090-534 Police & Fire Ad Hoc Cost of Living	\$225,000	\$230,000
090-544 Police and Fire State Contribution	\$1,200,000	\$1,200,000
090-554 Police and Fire Survivor Benefits	\$1,320,000	\$1,260,000
090-575 Police and Fire Death Benefits	\$24,000,000	\$25,000,000

The bill also makes changes to the reemployment provisions of PERS, STRS, and SERS. If a member of PERS, STRS, or SERS retires from a position that is customarily filled by a vote of members of a board or commission or, for a PERS retiree, by the legislative authority of a county, municipal corporation, or township, the bill requires the board, commission, or legislative authority to take certain actions before the retiree can be rehired to the same position. The bill requires the board, commission, or legislative authority to (1) give public notice at least 60 days before the reemployment is scheduled to commence that the retiree is or will be retired and is seeking employment with the board, commission, or legislative authority and (2) hold a meeting on the issue of the reemployment between 15 and 30 days before the employment is to begin. The PERS, STRS, and SERS Boards are required to adopt rules to implement this provision.

Additionally, the act changes the deadline for an elected official who intends to retire and run for reelection to the same office to notify the county board of elections that the member intends to retire before the end of the current term. Prior law required the elected official to provide notice at least 90 days before the election. The act changes the deadline to at least 90 days before the primary election or, if no primary is scheduled, 90 days before the date on which a primary would have been held. Failure to notify the board of elections by the deadline results in forfeiture of the pension portion of the retirement allowance and suspension of the annuity portion if the retiree is elected to the same office for the term immediately following.

Am. Sub. H.B. 311 - Rep. Hagan

ORSC Position - The ORSC took no action on this bill.

Effective Date - June 26, 2003 (Emergency)

Am. Sub. H.B. 311 - Rep. Hagan

Am. Sub. H.B. 311 would generally create the Ohio's Best Rx Program under which eligible residents of Ohio would receive discounted prices on covered prescription drugs. This analysis is limited to those provisions of the bill that relate to the five state retirement systems in Ohio: the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Ohio Police and Fire Pension Fund (OP&F), and the Highway Patrol Retirement System (HPRS).

The bill would require each retirement system to submit the following information to the Ohio Department of Job and Family Services (ODJFS):

- The name of each health care plan offered by the retirement system;
- The number of individuals eligible for benefits under each health care plan;
- The formula used to determine the per unit price for each drug covered by the plan and dispensed through means other than a mail order system, the per unit price for each drug, or both the formula and per unit price for each drug, if available;
- The per unit rebate for each drug covered by the plan and dispensed through a mail order system or other means.

In submitting the above information about drugs covered by the plan(s), the retirement systems would be required to do all of the following:

- Compute and submit information separately for each covered drug according to its national drug code number;
- Submit the formula, per unit price, or both the formula and per unit price, if available, for each covered drug after each change to the formula or per unit price *not less than weekly* should the formula or per unit price change more than once a week;
- Provide for the formula or per unit price information to reflect the formula or per unit price as most recently changed;
- Submit the information regarding per unit rebates once a year, including the per unit rebates for the previous calendar year.

(ODJFS would be required to use the above information, along with identical information submitted by the Department of Administrative Services, to compute weighted average prices and rebates and use those weighted averages in determining the discounted price for drugs covered under the Ohio's Best Rx Program and the amount paid thereunder to participating pharmacies.)

If a pharmaceutical manufacturer has not entered into a rebate agreement under the program with respect to a drug for which the retirement systems receive a rebate, ODJFS shall ask each retirement system to determine whether the drug should be placed for the following plan year on a prior authorization list.

Staff Comments - Since 1974, the legislature has granted the state retirement systems

Am. Sub. H.B. 311 - Rep. Hagan

discretionary authority to offer retiree health care plans to the extent that resources not otherwise required to fund the pension plans are available. This authority recognizes that post-retirement health care benefits (which are **not** guaranteed by statute) are secondary to pension benefits (which are guaranteed by statute upon the granting thereof) by allowing the individual retirement boards to change the level of coverage and the costs paid by benefit recipients at any time and to terminate such coverage, if necessary.

The retirement systems currently spend nearly \$670 million on prescription drugs costs alone, and have experienced double-digit increases in such costs over the last several years. These costs are summarized in the following table:

Retirement System	Prescription Drug Costs
PERS	\$314,213,257
STRS	\$200,000,000 (approx.)
SERS	\$99,249,656
OP&F	\$53,762,570
HPRS	\$2,650,000 (annualized)
Total	\$669,875,483

To give some perspective on the significance of the retirement systems' prescription drug costs, the total retiree health care costs paid by the retirement systems were over \$1.6 billion last year; prescription drug costs constituted 42 percent of these costs.

Under the proposed bill, the state retirement systems would be required to submit their negotiated prescription drug discounts and rebates from pharmaceutical manufacturers and distributors to the Ohio Department of Job and Family Services (ODJFS) which, in turn, would use this information as the basis for determining the discounted price for drugs covered under Ohio's Best Rx Program and the amount paid thereunder to participating distributors. This requirement would likely cause prescription drug costs to increase for the retirement systems by hampering their ability to negotiate for such discounts and rebates in the future, since manufacturers and distributors wishing to participate in the Ohio Best Rx Program would be required to offer the same terms to individuals enrolled in that Program as well. It is likely that fewer manufacturers and distributors will be willing or able to offer the same level of discounts or rebates previously achieved by the retirement systems. The likely effect will mean smaller discounts and rebates spread over a larger population and, thus, greater costs for the retirement systems and their participants.

A recent actuarial report prepared by Milliman USA on the adequacy of the contribution rates under OP&F, STRS and SERS generally shows that significant reductions in retiree health care benefits, including perhaps elimination thereof, will be necessary to place the retirement systems in compliance with the maximum 30-year funding period required by law *unless* contribution rates are increased, pension benefits are reduced and/or the funding periods are extended well beyond 30 years. A similar review of PERS and HPRS is under way. Potentially increasing the cost of retiree health care benefits at this critical juncture will only exacerbate the existing challenges facing the retirement boards as well as the legislature. It should be noted that to the extent that the

Am. Sub. H.B. 311 - Rep. Hagan

retirement systems pay for retiree health care benefits, the law provides that such costs shall be included as part of the employer contribution rate.

The proposed bill could also add significant administrative costs to the retirement systems by requiring them to provide ODJFS with detailed, up-to-date reports on the cost of each drug covered under each plan offered by the systems, not less than weekly each time a drug cost changes. This raises a significant legal issue of whether the use of retirement system funds for purposes of enabling the ODJFS to administer the Best Rx Program is a breach of the retirement boards' fiduciary duty to discharge their duties with respect to the funds "solely in the interest of the participants and beneficiaries; for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the retirement system ...". Under the bill, each retirement system would be an integral part of the on-going administration of the Ohio Best Rx Program by serving as the pricing mechanism, along with DAS, for the discounts and rebates offered under the Program.

The proposed bill further provides that if a manufacturer has not entered into a rebate agreement with respect to a drug covered by a retirement system's health care plan that receives a rebate from that manufacturer, ODJFS shall ask the retirement system to determine whether the drug should be placed for the following plan year on a prior authorization list. As indicated above, each retirement board's discretionary authority to offer retiree health care plans and determine the type of coverage offered, if any, dates back some 30 years. As a matter of public policy, the legislature should be cautious about any implications that may be drawn by involving the retirement systems with any state-sponsored health care plans so as not to jeopardize the ability of the retirement systems to change or terminate their retiree health care plans, if necessary, and inadvertently cause the legislature to assume future responsibility for such plans. In this regard, it should be noted that unlike the authority of DAS which mandates the provision of health care coverage for all eligible state employees and elected officials as evidenced by the use of the word "shall" under R.C. §124.81, the authority of the retirement systems to provide health care coverage for their beneficiaries is generally permissive as evidenced by the use of the word "may" under R.C. §§145.58, 742.45, 3307.39, 3300.69 and 5505.28.⁷

Fiscal Impact - This bill would have no impact on the actuarial funding of the retirement systems because health care benefits are discretionary and could be discontinued if the systems no longer could afford to offer them in the future. However, there would be administrative costs incurred by the retirement systems and it is likely that prescription drug costs could increase for the systems and their participants.

Staff Recommendation - That the Ohio Retirement Study Council recommend that the 125th Ohio General Assembly remove the state retirement systems from the provisions of H.B. 311 for the following reasons:

- the retirement systems could see above normal price increases for prescription drugs as a result of this legislation which already constitute 42% of their total health care costs. Also, a recent actuarial report prepared by Milliman USA generally shows that significant reductions in retiree health care benefits, including perhaps elimination thereof, will be

⁷The only mandate relates to reimbursements for Medicare Part B premiums under these sections (eff. 8/20/76).

Am. Sub. H.B. 311 - Rep. Hagan

necessary to place the retirement systems in compliance with the 30-year funding period required under existing law *unless* contribution rates are increased, pension benefits are reduced and/or the funding periods are extended well beyond 30 years.

- the bill raises a significant legal issue of whether the use of retirement system funds (administrative costs incurred by the retirement systems) for purposes of enabling the ODJFS to administer the Best Rx Program is a breach of the retirement boards' fiduciary duty to discharge their duties with respect to their funds "*solely in the interest of the participants and beneficiaries; for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the retirement system ...*"
- As a matter of public policy, the legislature should be very cautious about any implications that may be drawn by involving the retirement systems with any state-sponsored health care plans so as not to jeopardize the system's ability to change or terminate their retiree health care plans, if necessary, and inadvertently cause the legislature to assume future responsibility for such plans. In this regard, it should be noted that unlike the authority of DAS which mandates the provision of health care coverage for all eligible state employees as evidenced by the use of the word "shall" under R.C. §124.82, the authority of the retirement systems to offer health care coverage to their beneficiaries is generally permissive as evidenced by the use of the word "may" under R.C. §§145.58, 742.45, 3307.39, 3309.69 and 5505.28.

ORSC Position - The ORSC took no action on this bill.

Effective Date - December 18, 2003 (Emergency)

PENDING PENSION-RELATED ISSUES

The ORSC staff keeps legislators abreast of relevant public retirement issues and of prior recommendations that have been made but not acted upon by the legislature. There continues to be a number of such issues and recommendations that warrant legislative consideration. What follows is a brief summary and description of each, with further background and detail being available through the ORSC web site www.orsc.org.

Actuarial Funding of Pension Benefits - There are generally three sources of revenue for the Ohio retirement systems to fund, on an actuarial basis, their defined benefit pension benefits: (1) employee contributions; (2) employer contributions; and (3) investment earnings. The legislature guarantees the defined benefit pension benefits that are paid to participants and determines the maximum contribution rates. Investment earnings are typically the largest source of revenue for the Ohio retirement systems, funding up to 75 percent of the benefits paid.

The last semi-annual investment review required by law and presented at the ORSC meeting on November 6, 2003 indicates that the impact of three years of negative returns upon the Ohio retirement systems has been meaningful. All of the systems have nine and one-half years annualized returns that are below their actuarial interest rate assumptions.

For funding purposes, the Ohio retirement systems smooth asset values and investment returns generally over four years in order to keep contribution rates and funded ratios relatively stable. The losses experienced during the recent market downturn will have an adverse impact over the next several years, having a dampening effect on any future gains that might occur, since these losses have not been fully recognized in the systems' actuarial value of assets and funded ratios. Moreover, the losses are likely to put upward pressure on the systems' contribution rates and/or funding periods for paying off unfunded liabilities.

Current law establishes a maximum 30-year funding period for each system to amortize its unfunded liabilities in order to maintain inter-generational equity among taxpayers. Should the retirement systems exceed the maximum 30-year funding period in any year, the retirement boards are required to report to the ORSC and the standing committees of both houses with primary responsibility for retirement legislation on how they plan to reduce their funding period to 30 years.

Recent actuarial reviews conducted by Milliman USA of all five retirement systems generally indicate that a 30-year funding period for amortizing unfunded accrued pension liabilities can be achieved by all five retirement systems within their current contribution rate structure by reducing or eliminating the amount currently allocated towards discretionary retiree health care benefits. Absent such a reduction in or elimination of discretionary health care funding, the actuarial reviews generally indicate that contribution rates must be increased and/or pension benefits must be reduced in order to achieve a 30-year funding period as required by existing law.

Cost and Funding of Retiree Health Care Benefits - Faced with double-digit increases for the foreseeable future, particularly in the area of prescription drugs, all of the retirement systems face significant challenges of controlling costs while maintaining meaningful coverage. Contributing factors to the double-digit increases include: the advent of "baby boomer" retirements, improved life expectancy of retirees, higher drug utilization, advances in medical technology, direct consumer advertising, and the general declining ratio of active members to retirees. The significant investment losses experienced from March 2000 to March 2003 by all investors have also exacerbated the health care funding problem since the retirement systems must first fund

guaranteed pension benefits, which will likely require a reduction in or elimination of the amount currently allocated to discretionary retiree health care benefits, given the current caps on contribution rates. The early retirement ages for many public employees create a significant cost for each retirement system's health care program.

Joint Legislative Committee to Study Ohio's Public Retirement Plans - In 1995, the Joint Legislative Committee to Study Ohio's Public Retirement Plans (JLC) was created to complete a comprehensive review of the laws and operations of all five retirement systems. It consisted of six senators and six representatives (including members of the ORSC), and was supported by the ORSC staff. The JLC reviewed each system, concentrating on the following major areas: disability statutes, procedures, and experience; cost and funding of retiree health care benefits; retirement eligibility and benefit provisions; investment authority and performance; and the level of contributions in relation to the level of benefits provided. In 1996, JLC issued a report in which ORSC staff made a number of recommendations. Many, but not all, of the recommendations have been acted upon by the legislature. The following recommendations were made by staff as part of the report, but have not been implemented:

- “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 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 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.” (H.B. 180 (eff. 10-29-91) established a percentage limit in STRS.)
- “That the statutory authority to grant an annual lump sum supplemental benefit check (i.e., 13th check) be repealed in STRS and that ad hoc post-retirement increases be enacted on an as-needed basis by the legislature.”
- “That non-law enforcement service credit be excluded for purposes of determining eligibility for service retirement under PFDPF.” (H.B. 648 (eff. 9-16-98) requires members who establish membership in OP&F on or after 9-16-98 to pay the difference between both the employee and employer contributions that were made and the employee and employer contributions that would have been made had the member rendered the service in OP&F, plus annual compound interest thereon. Members who do not pay the difference receive pro-rated credit for their non-law enforcement service.)
- “That Medicare Part B reimbursements be capped in PERS, PFDPF (OP&F) and HPRS.” (H.B. 648 (eff. 9-16-98) established a minimum reimbursement rate of \$29.90 per month as well as a maximum monthly reimbursement rate as determined by the STRS board, not to exceed 90% of the Medicare Part B monthly premium in STRS; S.B. 270 (eff. 4-9-01)

established the monthly reimbursement rate at \$45.50 in SERS. The Medicare Part B premium for 2004 is \$66.60 per month.)

- “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.”

Also, in testimony before the JLC in 1996, the Auditor of State recommended “that the legislature should require uniform reporting from all five systems. The Ohio Retirement Study Commission should prescribe the report format.” The rationale is to enable legislators, board members and the public to make meaningful comparisons of the systems since many public policy issues involve all five systems. S.B. 133 (125th General Assembly) includes a provision that would require the ORSC to establish a uniform reporting format for the five systems; as part of the fiduciary audits recently authorized for STRS and OP&F, one of the requirements is for the consulting firm to identify items critical for the ORSC to review on a regular basis as part of its oversight duties and to develop a reporting format for those items so that meaningful comparison of all five systems can be made.

Division of Benefit Orders (DOBOs) - H.B. 535 (eff. 1-1-02) amended the laws of all five retirement systems to permit the division of retirement benefits upon termination of marriage. There were a number of unresolved issues between the legal community and the retirement systems relative to the bill, including the recognition of a “separate property interest” in the member’s former spouse, the creation of an optional payment plan that provides for continuing benefits to the member’s former spouse after the death of the member, and the provision of cost-of-living increases to the member’s former spouse.

H.B. 98 (125th General Assembly) generally amends the existing laws governing the division of retirement benefits upon termination of marriage in PERS, STRS, and SERS with respect to the following two issues: the creation of an optional payment plan that provides for continuing benefits to the members’ former spouse after the death of the member and the provision of cost-of-living increases to the member’s former spouse. At its meeting of May 14, 2003 the ORSC voted to recommend that the 125th General Assembly approve the bill upon the adoption of an amendment which would extend its provisions to OP&F and HPRS in order to maintain the existing uniform and equal treatment of Ohio’s public employees relative to the division of benefits upon termination of marriage. As passed by the House, the bill *only* applies to PERS, STRS and SERS. The bill is currently in the Senate Health, Human Services and Aging Committee.

Defined Contribution Plan for SERS Members - Another staff recommendation included in the JLC final report was “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.” (Alternative defined contribution (DC) plans have been established in STRS pursuant to S.B. 190 (eff. 7-13-00) and in PERS pursuant to H.B. 628 (eff. 9-21-00). No alternative DC plan has been established in SERS, though S.B. 270 (eff. 4-9-01) requires the SERS board to establish such plan.)

According to SERS staff, the SERS board commissioned The Segal Company to statistically verify member interest and identify the costs of implementing a defined contribution plan in 2002. Segal

surveyed 10,000 SERS members who had less than five years of service and would be eligible for the DC plan. They found that 1% of new SERS members were interested in a DC option based solely on their own investments and 89% of new members preferred a guaranteed retirement. Segal found that the least expensive method of developing and implementing a DC option would be to completely outsource the development and maintenance of the option. According to Segal this would require about \$1 million in start-up costs and \$1.3 million annually to operate. In February 2003, the SERS board decided that it was not in the best interest of its members to develop a DC option; however, the board requested that staff revisit the studies at a later time, and in the interim, request a language change making the current statute permissive rather than mandatory.

Contributing Service Credit in PERS - H.B. 232 (eff. 2-16-84) increased the minimum amount of earnable salary required per month from \$150 to \$250 to receive one month's credit in PERS. A PERS member who earns \$250 per month for twelve consecutive months (\$3,000) is granted one year of service credit. This raises the public policy issue of whether the minimum monthly salary amount used to determine service credit in PERS should be increased and indexed to annual wage inflation.

Surviving Spouses of PERS-LE Members - Another issue is certain disparities in the law concerning surviving spouses of active members in PERS-LE, OP&F, and HPRS. Under existing law, active members of OP&F and HPRS are eligible for survivor coverage immediately upon employment, whereas active members of PERS-LE become eligible for survivor coverage upon completion of 18 months of contributing service. Moreover, surviving spouses of active members of OP&F and HPRS are eligible for survivor coverage at any age, whereas surviving spouses of active members of PERS-LE are not eligible to receive benefits until they are 62 years old unless they have dependent children, the member had ten years of service, or the spouse is adjudged mentally or physically incompetent. A change in the law to correct these disparities should be considered.

Election of New Optional Plan upon Remarriage - H.B. 648 (eff. 9-16-98) amended OP&F law regarding the election and effective date of a joint and survivor annuity option upon remarriage. Under the bill, OP&F retirees who remarry may elect a new optional plan of payment, *provided they make such election no later than one year following remarriage*. Moreover, the new plan shall become effective upon the date the election is made. In contrast, the comparable laws of the other state retirement systems allow retirees to elect a new optional plan of payment at any time following remarriage; the effective date of the new plan is the first day of the month following the date the election is made. The objectives of the changes made under H.B. 648 were two-fold: (1) To limit adverse selection against the retirement system; and (2) To give effect to the retiree's intention should the retiree die subsequent to having made an election but prior to the first day of the month following such election. Similar changes should be considered in the other four retirement systems.

Deferred Retirement Option Plans (DROP) - Popular throughout the country, these plans are intended to encourage members to continue working beyond normal retirement and are often designed to be cost-neutral to the retirement system. Generally, participation in DROP plans is limited to members who are eligible for normal service retirement. The member continues to be employed for some defined period, such as three to eight years, during which period the member's monthly service retirement benefit is credited to the member's DROP account, along with annual compound interest at some specified rate. Upon termination of employment, the member receives a lump sum distribution of the member's DROP account or some alternative distribution thereof,

and begins receiving a monthly service retirement benefit based on the member's final average salary and service credit calculated at the time the member elects participation in the DROP plan. S.B. 134 (eff. 7-23-02) granted the OP&F board the authority to establish a DROP for its members. In its analysis of the bill, the ORSC staff raised the public policy issue of whether the other four retirement boards should be granted similar authority to establish DROP plans for their respective memberships.

Medical Savings Accounts - S.B. 247 (eff. 10-1-02) authorizes the PERS board to establish medical savings accounts or a similar type of program for the purpose of providing funds to the member for payment of health insurance expenses. This raises a public policy issue of whether the other four retirement boards should be granted similar authority to establish such accounts or programs for their members for the payment of health insurance expenses.

“Bad Boy” Provisions - Currently, Ohio public pension laws permit the withholding of retirement benefits as restitution to the governmental unit for theft in public office and to the victim of certain sex offenses committed in the context of public employment. There continues to be legislative interest to expand these “bad boy” provisions to include other offenses.

University of Akron Non-Teaching Employees - With the single exception of the University of Akron, all non-teaching employees of Ohio's state universities are members of PERS. Employees of the University of Akron are currently members of SERS. In the interest of maintaining parity in retirement benefits, there continues to be some legislative interest to transfer these employees from SERS to PERS. The ORSC actuary provided several options to address the actuarial impact upon both retirement systems of such a transfer in its report Transfer of University of Akron Active Members from SERS to PERS dated March 11, 2002. Based upon that report, the ORSC staff recommended “the transfer of the University of Akron non-teaching employees from SERS to the PERS state division in order to provide uniform benefits and representation for all non-teaching employees at state universities, provided:

(1) PERS receives from SERS an amount equal to the member's actuarial accrued liability to the extent funded by SERS under the third option described above which would minimize any actuarial loss to PERS and have no actuarial gain or loss to SERS;

(2) PERS serves as a pass-through or conduit for health care contributions received from the University of Akron (A PERS employer after enactment) to pay SERS for the net cost of providing health care benefits to University of Akron retirees still remaining in SERS until the last University of Akron retiree ceases to be covered under the SERS health care plan. This is consistent with the current pay-as-you-go financing of retiree health care benefits in all five retirement systems, and would hold SERS harmless as well as avoid any windfall to PERS on account of the proposed transfer; and

(3) The current differential in the contribution rates under SERS and PERS, including the employer health care surcharge, remains payable by the University of Akron and its non-teaching employees for 25 years (the current funding period under SERS), with the excess in contributions used to provide a supplemental contribution to SERS. This is consistent with the supplemental contribution currently payable by state universities on behalf of employees who elect the alternative defined contribution plan, and would mitigate any adverse impact upon the SERS health care plan and would eliminate any perceived financial incentive for potential groups of employers and employees to “shop” among the state retirement systems for benefits. In the

alternative, the University of Akron makes a lump sum payment to SERS that is the actuarial equivalent of the above supplemental contribution payable over 25 years as determined by the SERS actuary and reviewed by the ORSC.”

The ORSC did not take any action upon the staff recommendation. This session H.B. 32 has been introduced, which would transfer non-teaching employees of the University of Akron from SERS to PERS.

Reemployment Provisions - There continues to be legislative interest in the reemployment provisions of the Ohio retirement systems that allow members who have been retired for at least two months to return to public employment while continuing to receive their pension. H.B. 84 (eff. 7-31-01) requires elected officials who retire and are reelected or appointed to the same office from which they retired to notify the board of elections or appointing authority of their retirement in order to continue receiving their pension. H.B. 63 (125th General Assembly) would prohibit elected officials who are reelected to the same office from which they retired from receiving a pension. H.B. 95 (eff. 6-30-03) includes language that requires a hearing before certain retirees can be reemployed and changes the deadline for elected officials to file notice of intent to retire and run for reelection to the same office.

Health Care for Reemployed Retirees - H.B. 151 (eff. 2-9-94) requires PERS reemployed retirees to receive primary health insurance coverage through the retiree's **public** employer if the employer provides coverage to other employees performing comparable work. PERS health care coverage becomes secondary. Effective January 1, 2004 both the OP&F and HPRS amended their health care policies relative to reemployed retirees. In OP&F, reemployed retirees who are eligible for health care coverage through their employer must pay the full premium cost should they choose to enroll in the OP&F health care plan. In HPRS, reemployed retirees who are not eligible for Medicare must receive their primary health care coverage through their employer, if available; the HPRS health care coverage becomes secondary. This raises a public policy issue of whether similar requirements should be adopted in the other state retirement systems with respect to reemployed retirees. Moreover, it raises a public policy issue of whether such requirements should include reemployment with a private employer that provides health insurance coverage as well.

Annual 3% COLA - In its analysis of H.B. 157 (eff. 2-1-02) which provides for an annual 3% COLA in all five retirement systems, regardless of the actual percentage change in the CPI-W, the ORSC staff recommended against the COLA changes under the bill and suggested that “any additional resources of these retirement systems be allocated to the provision of discretionary retiree health care benefits that are neither taxable nor subject to the Social Security offset and/or the provision of ad hoc increases, such as a “purchasing parity” adjustment of some target ratio of either 75% or 85%, to retirees whose benefits have been eroded the most by inflation over the years.” The ORSC rejected the staff recommendation and recommended instead that the legislature approve H.B. 157. The CPI-W has increased by less than 3% in 11 of the last 12 years.

Workers' Compensation Offset - In its Analysis of Police and Firemen's Disability and Pension Fund Disability Plan, Procedures and Experience, November 8, 1996, William M. Mercer recommended that the legislature “consider offsetting the disability retirement benefit by any periodic benefit being received by the disabled member through workers' compensation.” A subsequent study prepared by the ORSC actuary Milliman & Robertson per a legislative mandate concluded that “Based on the data collected in this study, M&R believes it is feasible for the State of Ohio to coordinate public retirement systems disability benefits and workers' compensation

benefits. We clearly recognize that the decision to do so rests with the Ohio General Assembly. If such a decision is made, we recommend that the benefit coordination be structured as follows:

- a. Offsets should affect the following benefits:
 - (1) Periodic Wage Replacement Benefits;
 - (2) Lump Sum payments to close workers' compensation cases;
 - (3) Cost of living adjustments.
- b. Offset should not affect lump sum scheduled benefits.
- c. Maximum income from combined disability and workers' compensation benefits should be set at 100% of final average salary.
- d. If offsets are introduced in Ohio, they should be made applicable to all 5 public retirement systems at the same time."

(Report to the Ohio Retirement Study Council: Feasibility Study on Disability and Workers' Compensation Coordination, Milliman & Robertson, November 23, 1999)

Board Governance/Fiduciary Audits - During the summer of 2003, a number of concerns regarding the administration and operations of the retirement systems were raised at the ORSC meetings. In response to these concerns, the House and Senate each introduced omnibus pension reforms bills that generally seek to improve accountability, oversight and professional standards with respect to the governance of the five retirement systems. (See H.B. 227 and S.B. 133 under section entitled Pending Pension Legislation). The ORSC also voted to have fiduciary performance audits of STRS and OP&F completed in 2004. The audits will cover the following areas, which include a review of all administrative costs:

- A. Investment Issues
 - 1. Current Investment Policies
 - 2. Portfolio Risk
 - 3. Investment Performance
 - 4. Investment Management Structure and Costs
 - 5. Use of External Consultants
 - 6. Asset Allocation
 - 7. Brokerage Practices
 - 8. Due Diligence Procedures/Selection of Investment Service Providers
 - 9. Statutory Provisions and Administrative Rules
 - 10. Conflicts of Interest
 - 11. Custodial Structure
 - 12. Internal Controls and Risk Management
 - 13. Investment Accounting
- B. Management Issues
 - 1. Board Governance, Policies, and Oversight
 - 2. Efficiency and Effectiveness of Organizational Structure and Resources

3. Ability to Attract and Retain Employees
4. Monitoring of Investments and Reporting
5. Reporting to the ORSC

The ORSC is currently in the process of awarding this contract. Once the contract is awarded, the audits will be conducted simultaneously and are expected to be completed within six months. Findings and recommendations of the audits for legislative consideration, some of which may be applicable to the other retirement systems, are expected in late 2004 and will be reported in the next annual report.

Review of Adequacy of the Contribution Rates - Current law requires the ORSC to conduct an annual review of the police and fire contribution rates and make recommendations to the legislature that it finds necessary for the proper financing of OP&F benefits. In 2003 the Council voted to have Milliman USA review the adequacy of the the contribution rates for PERS, STRS, SERS, and HPRS. The legislature should consider requiring ORSC to conduct similar actuarial reviews of the adequacy of the contribution rates for the other four retirement systems as well.

Mandatory Social Security - The State of Ohio has a long and successful record of opposing mandatory Social Security coverage for its public employees. This issue continues to resurface in the context of various Social Security reform proposals as a means of generating additional revenues which are estimated to extend the solvency of Social Security by a mere two years.

SUBJECT INDEX OF PENSION BILLS INTRODUCED
FIRST HALF OF THE 125TH GENERAL ASSEMBLY
JANUARY 1, 2003 - DECEMBER 31, 2003

The Subject Index of Pension Bills Introduced provides a listing of pension bills under subject heading and a key word description within the main heading. Bills that cover more than one subject are listed under all appropriate headings.

The pension systems affected by the bill are also indicated. "All systems" means the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Ohio Police and Fire Pension Fund (OP&F), and the Highway Patrol Retirement System (HPRS). "VFFDF" and "DBF" respectively refer to the Volunteer Fire Fighters' Dependents Fund and the Ohio Public Safety Officers Death Benefit Fund

The main subject headings are listed at the beginning of the index for quick reference. The bills that became law are indicated by an asterisk.

Subject Headings

Alternative Retirement Plan	Cost-of-Living Disability	Membership Ohio's Best Rx Policies
Appropriations	Ethics Commission	Reemployment
Benefit Options	Fiduciary Performance Audits	Salary
Boards	Financial Disclosure	Taxation
Civil Actions	Inspector General	Uniform Reporting
Contributions	Investments	

Alternative Retirement Plan

Eligibility Extended - PERS, STRS, SERS - HB 337

Appropriations

Biennial Appropriations - OP&F - HB 95*

Benefit Options

Continue Benefits to Former Spouse - PERS, STRS, SERS - HB 98

Boards

Budget Submitted to ORSC - ALL SYSTEMS - SB 133
Campaign Financial Disclosure - ALL SYSTEMS - HB 227, SB 133
Composition of - ALL SYSTEMS - HB 227, HB 283, SB 133
Dissemination of Public Information ALL SYSTEMS - AB 133
Elections - SB 133
Ethics Training - SB 133
Internal Audit Committee - ALL SYSTEMS - HB 227
Orientation - ALL SYSTEMS - SB 133
Filling of Vacancy Public Records - ALL SYSTEMS - SB 133
Removal of - ALL SYSTEMS - HB 227, SB 133
Training Programs - ALL SYSTEMS - HB 227, SB 133
Travel Expenses - ALL SYSTEMS - SB 133
Treasurer of State - ALL SYSTEMS - HB 227

Civil Actions

Attorney General Authorized to File - SB 133

Cost-of-Living

Increase - OPF - HB 187
Member's Former Spouse - PERS, STRS, SERS - HB 98

Disability

Cancer Included as On-Duty Presumption - OP&F - HB 140
Employer Notification - OP&F - SB 133

Ethics Commission

Consultation on Travel, Compensation, and Ethics Policies - ALL SYSTEMS - SB 133
Reporting to ORSC - SB 133

Fiduciary Audit

ORSC Required to Conduct - ALL SYSTEMS - HB 227, HB 283,

Financial Disclosure

Board Members - ALL SYSTEMS - HB 227, HB 242, HB 283, SB 105, SB 133
Certain System Employees - ALL SYSTEMS - HB 227, HB 242, SB 105, SB 133
ORSC Employees - SB 133
ORSC Members - SB 133

Inspector General

Investigative Authority - ALL SYSTEMS, ORSC - SB 104
ORSC Authority to Contract With - ALL SYSTEMS - SB 126

Investments

Licensure of Investment Personnel - SB 133
Ohio Brokers/Managers, Use of - HB 227

Membership

Corrections Officers - PERS - HB 198
County Agricultural Society Employees - PERS - HB 69
Metropolitan Housing Authority Police Officers - PERS-LE - HB 211
Municipal Park Rangers - PERS-LE - HB 101
Nonteaching University of Akron Employees - SERS, PERS - HB 32
Public Safty Officials - PERS - HB 198
Township Police Cadets - PERS-LE - HB 101

Ohio's Best Rx

Reporting to ODJFS - ALL SYSTEMS - HB 311*, SB 138

Policies

Ethics - ALL SYSTEMS - HB 227
Travel - ALL SYSTEMS - HB 227, SB 133
Compensation - ALL SYSTEMS - SB 133

Reemployment

Elected officials - PERS - HB 63; HB 95*; HB 176
Public Hearing - PERS, STRS, SERS - HB 95*

Salary

Limit on Certain Executives - ALL SYSTEMS - HB 271

Taxation

Exempt up to \$10,000 retirement benefits - HB 22

Uniform Reporting
ORSC Establish Format - ALL SYSTEMS - SB 133

STATUS OF PENSION LEGISLATION
FIRST HALF OF THE 125TH GENERAL ASSEMBLY
JANUARY 1, 2003 - DECEMBER 31, 2003

The Status of Pension Legislation provides a record of legislative action taken on pension bills at each step of the legislative process from the date of introduction, assignments in each House of the General Assembly, testimony, the date reported by the committees, the date passed by each House, the date reported by a conference committee and/or concurred in by the other House, to the effective date of the bill. Also provided are a brief description of the subject of the pension bill and the ORSC position on the bill. An index of abbreviations used in the status report is on the final page.

HOUSE BILLS

HSE BILL	INTRO	Actuarial Received	Subject, Sponsor, and System	Cont Pers	ORSC Pos	Hse Cmte	Testimony - Reported Out - Floor Vote	INTRO SEN	Sen Cmte	Testimony - Reported Out - Floor Vote	Conf Cmte	Concurrence	Eff Date
32	02-03-03	04-11-03	Moves nonteaching employees of University of Akron from SERS to PERS Williams - PERS	GK		BPS Blasdel 02-04-03	02-27-03---03-20-03---06-05-03---						
40	02-05-03		Budget corrections Calvert	BI	N	FA Calvert 02-10-03	02-06-03---02-11-03---02-12-03 Amend; FIVo:Y=68 N=31	2-13-03	FFI Harris 02-14-03	02-11-03---02-12-03---02-13-03--- 02-14-03---02-18-03---02-19-03 Sub; Amend; FI Vo: Y=18 N=15		02-25-2003	03-03-2003
63	02-13-03	05-13-03	Employment restrictions on certain reemployed elected officials Olman - PERS	TN		BPS Blasdel 02-25-03	03-20-03---05-22-03---06-12-03---						
69	02-18-03	05-13-03	Includes county and independent agricultural society employees in PERS Faber - PERS	TN		BPS Blasdel 02-25-03	03-13-03---06-05-03 Sub---06-12-03---						
95	02-27-03		Budget Bill Calvert	BI	N	FA Calvert 03-04-03	04-04-03---04-05-03---04-06-03--- 04-07-03 Amend---04-08-03 Sub--- 04-09-03 Amend FI Vo: Y=53 N=46	4-10-03	FFI Harris 04-29-03	04-29-03---04-30-03---05-01-03--- 05-06-03---05-07-03---05-08-03--- 05-13-03---05-14-03---05-20-03--- 05-21-03---05-22-03---05-27-03--- 05-28-03 Sub---05-29-03---05-30-03--- 06-03-03 Amend---06-05-03 Amend FI Vo: Y=24 N=9	06-19-03	06-19-03	06-26-2003
98	03-04-03	STRS:05-05-03 SERS:05-09-03 PERS:05-13-03	Creates optional payment plan to continue benefits to member's former spouse after death of member and provides a COLA to member's former spouse Willamowski - PERS, STRS, SERS	GK	AA 05-14-02	BPS Blasdel 03-04-03	03-13-03---03-20-03---05-08-03--- 05-22-03 Sub---05-29-03 Amend--- 06-25-03 FI Vo Y=92 N=0		HHA Wachtmann 09-17-03				
101	03-04-03	PERS:9-10-03	Includes municipal park rangers and township police cadets in PERS-LE Willamowski - PERS-LE	AE		BPS Blasdel 03-04-03	03-13-03---03-20-03---05-08-03---						
140	03-25-03		Changes on-duty disability presumptions Sykes - OP&F			HLT Jolivet 03-25-03							
176	05-07-03		Employment restriction on certain reemployed elected officials. Hoops - PERS *Amended into HB95			SG Carmichael 05-14-03	05-20-03---06-03-03---06-10-03---						
187	05-14-03		Increases COLA for certain OP&F members T. Patton - OP&F			BPS Blasdel 05-20-03	05-29-03---10-02-03---						
198	05-21-03		Creates special provisions for public safety officials Willamowski - PERS-LE	AE		HSA Schneider 05-28-03	06-04-03---06-11-03---						

HOUSE BILLS

HSE BILL	INTRO	Actuarial Received	Subject, Sponsor, and System	Cont Pers	ORSC Pos	Hse Cmte	Testimony - Reported Out - Floor Vote	INTRO SEN	Sen Cmte	Testimony - Reported Out - Floor Vote	Conf Cmte	Concurrence	Eff Date
211	06-04-03	PERS:9-10-03	Includes metropolitan housing authority police officers in PERS-LE Trakas - PERS-LE	AE		BPS Blasdel 06-10-03	10-02-03---03-18-04---						
213	06-04-03		Exempts up to \$10,000 in state, federal, military retirement benefits from income tax Willamowski	BI		WM	01-22-04----01-29-04----						
227	06-19-03		Makes changes to the governance of the retirement systems Schneider - All Systems	GK	AA 10-13-03	BPS Blasdel 09-16-03	10-02-03---10-23-03 Sub----10-29-03----10-30-03----11-05-03----11-10-03 Sub----11-12-03 Amend----11-13-03 Amend; FI Vo: Y=81 N=13	11-18-03	HHA Wachtmann 12-02-03				
242	07-03-03		Requires financial disclosure statements to be filed by certain retirement system employees Taylor - All Systems			BPS Blasdel 09-16-03	10-02-03----						
271	09-09-03		Limits salary and benefits to certain executives McGregor - All Systems			FA Calvert 09-16-03							
283	09-18-03		Requires board members to file with Ethics Commission and changes composition of boards J. Stewart - All Systems										
311	10-23-03		Ohio's Best Rx Hagan - All Systems	GK		FA Calvert	10-27-03----10-28-03----11-05-03----11-18-03----11-19-03----12-02-03---12-02-03 Sub---12-09-03 Sub; Amend; FI Vo: Y=92 N=1		FFI Harris	12-10-03 Amend; FI Vo: Y=32 N=1		12-10-03	12-18-2003 (E)
337	11-20-03	PERS:1-30-04 STRS: 02-06-04 SERS: 01-29-04	Expands eligibility to participate in alternative retirement plans Blasdel - PERS, STRS, SERS	AE	AA 03-10-04	BPS Blasdel 12-02-03	12-09-03----03-18-04----						
395	02-03-04		Prohibits investment employees from making political contributions Redfern - All Systems			SG Carmichael 02-05-04							

SENATE BILLS

SEN BILL	INTRO	Actuarial Received	Subject, Sponsor, and System	Cont Pers	ORSC Pos	Sen Cmte	Testimony - Reported Out - Floor Vote	INTRO HSE	Hse Cmte	Testimony - Reported Out - Floor Vote	Conf Cmte	Concurrence	Eff Date
22	01-30-03		Exempts \$10,000 in state, federal, military retirement benefits from income tax Coughlin	BI	N	WM Amstutz 02-04-03							
104	07-03-03		Authorizes Inspector General to investigate retirement systems and ORSC Fedor - All Systems			HHA Wachtmann 09-17-03							
105	07-03-03		Requires financial disclosure statements to be filed by certain retirement system employees Schuring - All Systems			HHA Wachtmann 09-17-03							
126	09-11-03		Allows ORSC to contract with Inspector General to investigate retirement systems Schuring - All Systems			HHA Wachtmann 09-17-03							
133	10-02-03		Makes changes to the governance of the retirement systems Wachtmann - All Systems	GK	AA 10-13-03	HHA Wachtmann 10-14-03	10-07-03---10-08-03---10-14-03---10-21-03---11-05-03 Sub---11-06-03---11-12-03 Amend---11-13-03 FI Vo: Y=22 N=11	11-13-03	BPS Blasdel 12-02-03	12-09-03---			
138	10-23-03		Ohio's Best Rx Spada - All Systems	GK		FFI Harris	10-29-03---11-06-12---11-12-03---12-02-03---12-03-03 Sub---12-09-03 Sub; Amend---						

HOUSE COMMITTEES

ANR Agriculture & Natural Resources
PNR Parks and Natural Resources Subcommittee
BPS Banking, Pensions & Securities
CCL Civil & Commercial Law
CL Commerce & Labor
CTG County & Township Government
VA Veterans Affairs Subcommittee
CJ Criminal Justice
EDT Economic Development & Technology
EDU Education
FGR Federal Grant Review & Education Oversight
Subcommittee
EE Energy & Environment
RR Regulatory Reform Subcommittee
FA Finance & Appropriations
AG Agriculture Subcommittee
HE Higher Education Subcommittee
HS Human Services Subcommittee
PSE Primary & Secondary Education
Subcommittee
TRA Transportation Subcommittee
HLT Health
CHF Children's Health Care & Family Services
Subcommittee
HEA Homeland Security, Engineering &
Architectural Design
HSA Human Services & Aging
INS Insurance
JUD Judiciary
JFL Juvenile & Family Law
MGU Municipal Government & Urban
Revitalization
PU Public Utilities
RR Rules & Reference
SG State Government
EE Election & Ethics Subcommittee
TPS Transportation & Public Safety
WM Ways & Means

SENATE COMMITTEES

AGR Agriculture
EDU Education
ENE Energy, Natural Resources & Environment
FFI Finance & Financial Institutions
FI Financial Institutions Subcommittee
HHA Health, Human Services, & Aging
HSA Human Services & Aging Subcommittee
HT Highways & Transportation
ICL Insurance, Commerce & Labor
JCV Judiciary - Civil Justice
JCR Judiciary - Criminal Justice
PU Public Utilities
REF Reference
RUL Rules
SLV State & Local Government & Veterans
Affairs
WME Ways & Means & Economic Development

LEGISLATIVE ACTION

A Amended
S Substitute
P Postponed Indefinitely
R Rereferred
V Vetoed
E Emergency
CR Concurrence Refused

ORSC POSITION

A Approved
D Disapproved
AA Approved with Amendment
AD Action Deferred
P Pending
N No Action Necessary

ORSC CONTACT PERSON

GK Glenn Kacic
AE Anne Erkman
TN Tony Nichols
BI Bill of Interest