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# *Analysis*

## **Sub. S.B. 190 - Sen. Blessing** *As Enacted by the 123<sup>rd</sup> Ohio General Assembly*

April 27, 2000

ORSC Position

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The bill would make the following changes to the State Teachers Retirement System (STRS):

- Increases the defined benefit formula for calculating a service retirement benefit or a disability allowance under the post-1992 disability plan for STRS active members who retire or are disabled on or after the effective date of the bill;
- Provides for a recalculation, based on the current STRS defined benefit formula, for retirees receiving a service retirement benefit on July 1, 1999 and a benefit increase for those retirees whose benefit is less than the recalculated amount;
- Increases the amount of any benefit payable on July 1, 1999 that is less than 85% of the original benefit amount, as adjusted for inflation;
- Requires the STRS board to make a one-time, lump sum payment to persons eligible for an increase under the bill's provisions had the bill gone into effect on July 1, 1999;
- Requires the STRS board to establish one or more alternative defined contribution plans, in conjunction with the current defined benefit plan;
- Requires the STRS board to submit its annual actuarial valuation to the appropriate standing committees of the House and Senate and the Ohio Retirement Study Council (ORSC) no later than the first day of January (currently May) following the end of the fiscal year covered by the valuation;
- Authorizes the five state retirement systems to establish qualified governmental excess benefit arrangements for members who exceed the limits established under Section 415 of the Internal Revenue Code;
- Reorganizes Chapter 3307. of the Revised Code to accommodate the above changes, with corresponding amendments to the other state retirement systems' laws that reference Chapter 3307.

The bill would also make the following changes to the ORSC:

- Requires the ORSC to review semiannually the investment programs of the five state retirement systems, including their investment objectives and policies, asset allocations, risk factors, time horizons, benchmarks and performance, and submit such review to the Governor and the General Assembly;
- Requires the ORSC to have prepared by an independent actuary at least once every ten years an actuarial audit of the five state retirement systems and submit such audit to the Governor and the General Assembly.

**Defined Benefit Formula Increased** - The bill would increase the defined benefit formula for active members who retire or are disabled on or after the effective date of the bill for purposes of calculating a service retirement benefit or a disability allowance under the post-1992 disability plan.

Under current STRS law, the defined benefit formula for age and service retirement is 2.1% for each year of service, *except that years of service in excess of 30 that are STRS contributing service and/or purchased service for leaves-of-absence are calculated according to the following schedule:*

<b>Year of Service</b>	<b>Per Cent for Year</b>
31	2.5%
32	2.6%
33	2.7%
34	2.8%
35	2.9%
36	3.0%
37	3.1%
38	3.2%
39	3.3%

The bill would increase the defined benefit formula from 2.1% to 2.2% for each year of service, with the following two exceptions:<sup>1</sup>

- Years of service in excess of 30 that are STRS contributing service, STRS purchased service for leaves-of-absence, STRS service earned after July 1, 1978 for which no deductions were made, military service purchased or otherwise granted under STRS law, PERS or SERS service used in calculating a coordinated benefit, and/or PFPF or HPRS contributing or restored service shall be calculated according to the above schedule under current law;<sup>2</sup>
- 2.5% for each of the first 30 years of service for members who have at least 35 years of STRS contributing service, STRS purchased service for leaves-of-absence, STRS service earned after July 1, 1978 for which no deductions were made, military service purchased or otherwise granted

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<sup>1</sup>The maximum age and service retirement benefit would remain at the lesser of 100% of final average salary or the annual dollar limit established under section 415 of the Internal Revenue Code.

<sup>2</sup>Military service purchased or otherwise granted under STRS law has been included under the substitute bill for purposes of placing STRS law in compliance with federal law.

under STRS law, PERS or SERS service used in calculating a coordinated benefit, and/or PFPF or HPRS contributing or restored service.

For example, under current STRS law, a teacher with 30 years of contributing service receives 63% of final average salary (2.1% x 30 = 63%). Under S.B. 190, the teacher would receive 66% (2.2% x 30 = 66%). Under current law, a teacher with 35 years of contributing service receives 76.5% (2.1% x 30 = 63% + 2.5% + 2.6% + 2.7% + 2.8% + 2.9% = 76.5%). The teacher would receive 88.5% (2.5% x 30 = 75% + 2.5% + 2.6% + 2.7% + 2.8% + 2.9% = 88.5%) under the bill.

Under current STRS law, members qualify for coverage under one of two disability benefit plans: the pre-1992 disability plan or the post-1992 disability plan.<sup>3</sup> The defined benefit formula under the pre-1992 plan would remain at 2% for each year of service, plus projected years of service until age 60, up to a maximum of 75% of final average salary.<sup>4</sup> The defined benefit formula under the post-1992 plan would increase from 2.1% to 2.2% for each year of service, up to a maximum of 60%.<sup>5</sup>

Under current STRS law, the disability allowance under the post-1992 plan terminates upon the member's attainment of age 65 or the expiration of the following benefit period for members who are disabled on or after age 60:

<b>Attained Age at Date of Disability</b>	<b>Benefit Period</b>
60 or 61	60 months
62 or 63	48 months
64 or 65	36 months
66, 67 or 68	24 months
69 or older	12 months

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<sup>3</sup>Teachers who were members of STRS on July 29, 1992 were given an opportunity to make a one-time, irrevocable election between disability coverage under the pre-1992 plan and the post-1992 plan. Teachers who became members after July 29, 1992 were automatically covered under the post-1992 disability plan.

<sup>4</sup>The minimum benefit under the pre-1992 plan would remain 30% of final average salary.

<sup>5</sup>The minimum benefit under the post-1992 plan would remain 45% of final average salary.

On termination of the disability allowance, the member may apply for a service retirement benefit. Under current STRS law, the service retirement benefit is the greater of the following amounts:<sup>6</sup>

- 2.1% for each year of service, *including* service credit for the period the member was receiving a disability allowance, up to a maximum of 45% of final average salary; or
- an allowance calculated under the defined benefit formula for age and service retirement, *excluding* service credit for the period the member was receiving a disability allowance.

The bill would increase the defined benefit formula for calculating the service retirement benefit to 2.2% for each year of service, *including* service credit for the period the member was receiving a disability allowance, up to a maximum of 45% of final average salary as under current law. The defined benefit formula for age and service retirement, as modified under the bill, would also be used for determining the service retirement benefit for each year of service, *excluding* service credit for the period the member was receiving a disability allowance. The member would continue to receive the greater of the two amounts as under current law.

**Recalculation of Benefits Based on Service Retirement** - The bill would require the STRS board to recalculate, no later than 180 days after the effective date of the bill, all benefits payable on July 1, 1999 that are based on service retirement, including benefits paid under one of the joint and survivor annuity options. The board shall determine the single life benefit amount, excluding any annual cost-of-living adjustments (COLA's) granted by the board, using the current 2.1% defined benefit formula, as adjusted by any statutory reduction factors on account of the member's age or years of service that were in effect at the time of retirement. If the recalculated amount is greater than the annual single life benefit amount granted to the benefit recipient at retirement, the board shall increase the benefit to the greater amount or its actuarial equivalent. The board shall include such increase in the benefit recipient's base for purposes of determining future annual COLA's. The board may adopt rules to implement this provision of the bill.

**Benefits Increased to 85% of Original Purchasing Value** - Except as provided in italics below, the bill would require the STRS board to determine, no later than 180 days after the effective date of the bill, for each recipient receiving a service, joint and survivor, disability or survivor benefit on July 1, 1999 an amount equal to the sum of the following:

- 85% of the original benefit amount, except that if the recipient is not the individual to whom the original benefit was granted, 85% of the product obtained by multiplying the original benefit amount by the percentage of the original benefit amount being paid to the recipient; plus

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<sup>6</sup>Added to these amounts would be any additional cost-of-living adjustments the member would have received had the member retired as of the effective date of the disability allowance.

- an amount equal to the product obtained by multiplying the amount determined above by the cumulative percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from December 31 of the year immediately preceding the effective date of the original benefit to December 31 of the year immediately preceding the effective date of the bill.

*Under the substitute bill, the board shall determine an amount equal to the following for individuals who are receiving survivor benefits by reason of the death of a disability benefit recipient:*

- *85% of the deceased member's final average salary as adjusted by the cumulative percentage change in the CPI-W, which shall be used as the member's final average salary for purposes of calculating the individual's survivor benefit under existing STRS law.*

If the amount determined by the board is greater than the annual benefit being paid to the recipient, the board shall increase the benefit to the greater amount.<sup>7</sup> The board shall include such increase in the benefit recipient's base for purposes of determining future annual COLA's. The board may adopt rules to implement this provision of the bill.

**Lump Sum Payment to Eligible Recipients** - The bill would require the STRS board to make a one-time lump sum payment to all benefit recipients who are eligible for an increase under the above provisions of the bill. The board shall pay an amount equal to the difference between the actual benefits being paid to the eligible recipient between July 1, 1999 and the date of payment and the increased benefits that would have been paid to the recipient had the provisions of the bill become effective on July 1, 1999.

**Defined Contribution Plan Established** - The bill would require the STRS board to establish one or more plans consisting of benefit options that provide for an individual account for each participating member. Benefits shall be based solely on the amounts accumulated in the participant's account. The plan may include life insurance, annuities, variable annuities, regulated investment trusts, pooled investment funds and other forms of investment. The plan may also include options which provide definitely determinable benefits to the participant. The board may administer the plan and/or contract with other entities to administer it.

Each benefit option offered under the DC plan shall satisfy the minimum retirement benefit requirements under the Internal Revenue Code to qualify as a retirement system maintained by a state or local government entity. A plan generally satisfies these federal requirements if allocations to the participant's account are at least 7.5% of the participant's compensation, regardless of whether such allocations are made by the participant, employer, or some combination of the two. Failure of the plan to satisfy these requirements would cause the participant and employer to contribute to the Social Security System under existing federal law.

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<sup>7</sup>The board shall use the recalculated benefit based on the current defined benefit formula, as described above, in lieu of the annual benefit being paid to the recipient for making such determination under this provision of the bill.

Under the bill, the STRS board shall adopt rules to establish the DC plan. The board may also do all things necessary to avoid the payment of federal or state income taxes on plan contributions and earnings and, to the extent permitted under federal or state law, allow the plan participants to make tax deferred contributions for periods of interrupted or prior service.

The bill would require each individual who becomes a member on or after the date the STRS board establishes the DC plan to elect, not later than 180 days after employment, either the DC plan or the current defined benefit (DB) plan. Current members who have less than five years of service credit as of June 30 immediately preceding the date the DC plan is established may also make an election, not later than 180 days after the establishment of the plan, to participate in the DC plan.<sup>8</sup> If no election is made within the applicable 180-day period, the member shall be deemed to have elected the DB plan.

All elections shall be made in writing on a form provided by STRS and filed with STRS.<sup>9</sup> *Upon receipt of notice from the employer of the employment of a new teacher, STRS shall inform the new member of the right to elect the DB or a DC plan and of the provision that upon the first day of July following the fourth anniversary of membership, the member shall begin participating in the DB plan unless the member elects to remain in the DC plan.*<sup>10</sup> The election shall be irrevocable upon receipt of the employer for new members (STRS for current members), except that new members shall begin participating in the DB plan as provided above unless they make another election to remain in the DC plan. The following individuals are ineligible to make an election:

- Former teachers receiving service retirement benefits from the STRS DB plan or a coordinated service retirement benefit from PERS, SERS or STRS at the time of employment;
- Former teachers receiving benefits from the DC plan at the time of employment;
- Members or contributors participating in the STRS DB plan at the time of employment;

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<sup>8</sup>With respect to current members who elect the DC plan, STRS shall do the following: (1) credit to the member's account in the defined contribution fund established under the bill the accumulated contributions standing to the member's credit in the Teachers' Savings Fund, plus any additional amounts provided for under current law, such as annual compound interest; and (2) cancel all service credit and eligibility for any payment, benefit or right under the DB plan.

<sup>9</sup>Individuals who become members on or after the establishment of the DC plan shall file the election with the employer's personnel officer. Not later than 10 days after receiving the election, the employer shall transmit to STRS a copy that includes a statement certifying that it is a true and accurate copy of the original.

<sup>10</sup>Teachers who are participating in the DC plan may elect to remain in the DC plan. An election shall be made in writing on a form provided by the STRS board and filed with the board not later than 30 days prior to the date the teacher would have five years of service credit had the teacher elected the DB plan upon employment. STRS shall notify the teacher, not later than 180 days prior to the beginning of the 30-day period described above, of the opportunity to elect continued participation in the DC plan.

- Eligible employees of public institutions of higher education in Ohio who elected the alternative defined contribution plan established under Chapter 3305. of the Revised Code.

STRS members who elect a DC plan shall be ineligible for any benefits under the DB plan, including the annual COLA and the variable supplemental benefit (13th check). They shall also be forever barred from claiming or purchasing credit with STRS or any other state retirement system for service covered by the election. The right of such members to a retirement, disability, or survivor benefit, to health insurance coverage, or to a withdrawal of contributions under a DC plan shall be governed strictly by the plan selected by the member. *Under the substitute bill, benefits payable to a married member under a DC plan shall be paid in the form of a 50% joint and survivor annuity, unless the spouse consents to the selection of a different form of payment or the designation of a different beneficiary. The DC plan shall include the same requirements for consent as required under Section 417 of the Internal Revenue Code. Each plan may waive consent if the spouse cannot be located or for any other reason permitted under the Internal Revenue Code. Consent or waiver shall only be effective with respect to the spouse who is the subject of the consent or waiver.*

The bill would create the “Defined Contribution Fund” in STRS, the fund in which contributions deducted from the compensation of teachers participating in a DC plan shall be accumulated, along with any earnings and employer contributions credited thereon. Under the bill, DC members would contribute the same percentage as DB members which is currently 9.3% of compensation. Contributions from DC members would be credited to the Defined Contribution Fund; contributions from DB members are credited to the Teachers’ Savings Fund under current law. Employers may “pick-up” these contributions on a pre-tax basis pursuant to Section 414(h) of the Internal Revenue Code. *Under the substitute bill, contributions shall not exceed the limits established under Section 415 of the Internal Revenue Code.*

Employers of DC members would contribute the same percentage as employers of DB members which is currently 14%. Contributions from DC employers would be credited to the Defined Contribution Fund, *less an amount transferred to the Employers’ Trust Fund equal to the percentage of compensation determined annually by the STRS actuary to be necessary to mitigate any negative financial impact on the STRS DB plan resulting from participation of members in the DC plan*; contributions from DB employers are credited to the Employers’ Trust Fund under current law. *Under the substitute bill, STRS shall make the above transfers to the Employers’ Trust Fund until the unfunded actuarial accrued liability, excluding health care benefits and any benefit increases provided to members and former members participating in the DB plan after the effective date of the bill, is fully amortized, as determined by the annual actuarial valuation prepared by the STRS actuary.*

*Under the substitute bill, STRS members other than eligible current members who elect a DC plan shall, on the first day of July following their fourth anniversary of membership, begin participation in the DB plan unless they elect to remain in the DC plan prior to that date. The election shall be made in writing on a form provided by the STRS board and filed with the board no later than the thirtieth day of June following the fourth anniversary of membership. STRS shall notify DC members, not later than 180 days prior to such thirtieth day of June, of the opportunity to elect continued participation in the DC plan. DC members who fail to make the election shall begin participation in the DB plan and shall have*

the same rights and privileges as all other members under the DB plan. Upon such participation, STRS shall do all of the following:

- Transfer from the Defined Contribution Fund to the Teachers' Savings Fund an amount equal to the member's contributions required under STRS law, any voluntary supplemental contributions made by the member, and any earnings on those supplemental contributions;
- Transfer from the Defined Contribution Fund to the Employers' Trust Fund an amount equal to the employer contributions required under STRS law and any remaining amounts in the member's account in the Defined Contribution Fund;
- *Grant service credit in accordance with rules adopted by the board which shall be based on the member's length of participation in and contributions to the DC plan.*

*Under the substitute bill, if the amount in the member's account in the Defined Contribution Fund is less than the amount the member would have had in the Teachers' Savings Fund if the member had elected the DB plan, STRS shall transfer from the Guarantee Fund to the Teachers' Savings Fund the necessary amount to make the required transfer above.*

The bill would authorize the STRS board to offer DB members the opportunity to also participate in one or more of the benefit options available under the DC plan, as a supplement to the DB plan. Contributions made by the member would be credited to an individual account established in the Defined Contribution Fund.

The bill would also authorize the STRS board to contract for health insurance coverage for DC benefit recipients if the DC plan selected includes health, medical, hospital or surgical benefits. The cost of such coverage shall be paid by the recipient. The STRS board may offer plans that provide for different levels of coverage or the prepayment of the cost of coverage. *Under the substitute bill, DC benefit recipients would be ineligible for any reimbursement of Medicare Part B premiums paid by STRS unless such reimbursements are funded through a DC plan selected by the member.*

The bill would also authorize the STRS board to offer the current retiree-funded death benefit plan to DC benefit recipients. The retiree-funded death benefit is optional, paid for entirely by the benefit recipient, and provides a benefit of \$1,000 or \$2,000. This differs from the STRS-funded death benefit which is part of the DB plan and paid to the beneficiary of a service or disability retiree.

The bill would require the STRS board to offer the current long-term health insurance program to DC members and benefit recipients. Long-term health insurance is optional, paid for entirely by the enrollee, and provides coverage for custodial care expenses in the home or nursing home. Long-term care coverage provides daily cash benefits when an enrollee is no longer independent in activities of daily living, such as feeding, dressing, bathing and walking.

Under the bill, STRS may require DC members and their employers to furnish information and contributions at more frequent intervals than required for DB members and their employers. STRS shall have no duty to accept contributions by or on behalf of a DC member if such information is not furnished at such intervals.

**Annual Actuarial Valuation** - *The substitute bill would require the STRS board to submit its annual actuarial valuation to the appropriate standing committees of the House and Senate and the ORSC no later than the first day of January following the end of the fiscal year covered by the valuation. Under current law, the STRS board shall submit it no later than the first day of May following the end of the fiscal year.*

**Excess Governmental Benefit Arrangements Authorized** - *The substitute bill would authorize the five state retirement systems to establish and maintain a qualified governmental excess benefit arrangement that meets the requirements of Section 415 (m) of the Internal Revenue Code, as amended, and any regulations adopted thereunder. If established, the excess benefit plan shall be maintained solely for the purpose of providing that portion of the member's annual benefit otherwise payable under the terms of the state retirement systems that exceeds the limits established under Section 415 of the Internal Revenue Code as applicable to governmental pension plans. Members shall not be permitted to elect to defer compensation under such excess benefit plan. Also, excess benefits shall not be paid from a trust forming part of the state retirement systems unless such trust is maintained solely for the purpose of providing such benefits. The boards of the state retirement systems may adopt rules to administer such excess benefit plans so established.*

**Semiannual Investment Review** - *The substitute bill would require the ORSC to review semiannually the investment programs of the five state retirement systems, including their investment policies and objectives, asset allocation targets and ranges, risk factors, asset class benchmarks, time horizons, relative volatility, and performance. No later than 30 days after completing such review, the ORSC would be required to submit it to the Governor and the Ohio General Assembly.*

**Actuarial Audits** - *The substitute bill would require the ORSC to have prepared by an independent actuary at least once every ten years an actuarial audit of the five state retirement systems, including a review of their actuarial assumptions and methods, the data upon which their annual actuarial valuations and quinquennial investigations are based, and the adequacy of the employee and employer contribution rates to amortize any unfunded liabilities and support the payment of benefits authorized by statute. The ORSC shall submit such audit to the Governor and the Ohio General Assembly.*

**Staff Comments** -

***Defined Benefit Formula*** - The current defined benefit formula for service retirement in STRS is 2.1% for each year of service, except that each year of earned service over 30 years is credited at 2.5% for the 31st year, 2.6% for the 32nd year, 2.7% for the 33rd year, and so forth, up to 3.7% for the 43rd year. The maximum STRS service retirement benefit is 100% of FAS. The current defined benefit formulas for service retirement in PERS and SERS are very similar, providing 2.1% for the first 30 years of service and a constant 2.5% for each year of service in excess of 30 years. The maximum service retirement benefit is 100% in PERS and 90% in SERS.

The following table provides a history of the changes in the defined benefit formula in STRS since 1968:

Bill	Old Formula	New Formula
H.B. 959 (eff. 6/10/68)	1.65% x FAS x YOS, up to a maximum of 75% of FAS.	1.9% x FAS x YOS, up to a maximum of 80% of FAS.
H.B. 100 (eff. 12/31/71)	1.9% x FAS x YOS, up to a maximum of 80% of FAS.	2.0% x FAS x YOS, up to a maximum of 80% of FAS.
H.B. 430 (eff. 11/20/73)	Maximum: 80% of FAS.	Maximum: 90% of FAS.
H.B. 293 (eff. 9/15/89)	2.0% x FAS x YOS, up to a maximum of 90% of FAS.	2.1% x FAS x YOS, plus 2.5% x FAS x earned YOS over 30, up to a maximum of 100% of FAS.
H.B. 339 (eff. 8/6/97)	2.1% x FAS x YOS, plus 2.5% x FAS x earned YOS over 30, up to a maximum of 100% of FAS.	2.1% x FAS x YOS, plus 2.5% for 31st year, 2.6% for 32nd year, 2.7% for 33rd year, 2.8% for 34th year, 2.9% for 35th year, 3.0% for 36th year, 3.1% for 37th year, 3.2% for 38th year, 3.3% for 39th year, 3.4% for 40th year, 3.5% for 41st year, 3.6% for 42nd year, and 3.7% for 43rd year of earned service, up to a maximum of 100% of FAS.

S.B. 190 would generally increase the defined benefit formula to 2.2% x FAS x YOS, with the same escalating multipliers as under current law for earned years of service over 30.<sup>11</sup> Therefore, a member who retires with 30 years of service at any age would receive **66%** (2.2% x 30 = 66%) of FAS under the bill rather than **63%** (2.1% x 30 = 63%) of FAS under current law.

The following table provides a comparison of the normal service retirement benefit formulas for other non-Social Security statewide teacher retirement systems:

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<sup>11</sup>The formula for members with at least 35 years of earned service would be 2.5% for the first 30 years of service, with the same escalating multipliers for years of earned service over 30.

<b>State</b>	<b>Defined Benefit Formula for Normal Service Retirement</b>	<b>Percent of FAS Based upon 30 YOS</b>
Alaska	2.0% x first 20 YOS, plus 2.5% x YOS in excess of 20	65% of FAS
California	2.2% x YOS payable at age 60 2.3% x YOS at age 60 3/4 2.4% x YOS at age 61 1/2	66% of FAS 69% of FAS 72% of FAS
Colorado	2.5% x YOS	75% of FAS
Connecticut	2.0% x YOS	60% of FAS
Illinois	1.67% x first 10 YOS, plus 1.9% x second 10 YOS, plus 2.1% x third 10 YOS, plus 2.3% x YOS over 30  2.2% x YOS after 6/30/98 (Non-retired members may upgrade service prior to 6/30/98 to the 2.2% formula)	56.7% of FAS  66% of FAS
Kentucky	2.0% x YOS prior to 7/1/83, plus 2.5% x YOS after 7/1/83	68% of FAS
Louisiana	2.0% x YOS for teachers who joined prior to 7/1/99 2.5% x YOS for teachers who joined after 7/1/99	60% of FAS 75% of FAS
Maine	2.0% x YOS	60% of FAS
Massachusetts	1.0% x YOS payable at age 50 1.5% x YOS at age 55 2.0% x YOS at age 60 2.5% x YOS at age 65	30% of FAS 45% of FAS 60% of FAS 75% of FAS
Missouri	2.5% x YOS	75% of FAS
Nevada	2.5% x YOS	75% of FAS
Ohio	2.1% x YOS, plus 2.5% x 31st year of earned service, 2.6% x 32nd year, and so on.	63% of FAS
Texas	2.2% x FAS	66% of FAS

As shown in the above table, the current service retirement benefit formula in STRS is higher than a few, but lower than most non-Social Security statewide teacher retirement systems. Many states have recently increased their benefit formulas, including California, Illinois, Louisiana, and Texas. The proposed increase in the STRS service retirement formula seems well within reason in comparison to the other non-Social Security states' current service retirement formulas.

One of the principles adopted by the Ohio Retirement Study Council in its review and recommendations of retirement bills is that "there should be equal pension treatment among the various groups of non-uniformed public employees and as nearly as practicable retirement benefits should be uniform." (March 1978) As indicated above, the service retirement benefit formulas for PERS, STRS and SERS are currently very similar, as are the disability and survivor provisions of the three non-uniformed retirement systems. The current coordination-of-benefit provisions providing for joint service and disability retirement and the portability of service credit provisions are largely predicated upon maintaining similar benefit structures in these retirement systems. However, an overriding principle adopted by the ORSC is that "no proposed increase in pension benefits be seriously considered or granted until there is established adequate funding to cover its cost ." (March 1978)

The proposed change in the STRS benefit formula would create a small deviation among the three retirement systems, though both the PERS and SERS boards have announced an intention to have separate legislation introduced this session which, among other things, would increase their benefit formulas to 2.2% as well, thereby largely maintaining uniform retirement benefits. The PERS board also intends to reduce the employer contribution rate in conjunction with the benefit improvements, as was done by the HPRS board relative to the enactment of the last several benefit improvements for active and retired state troopers. In this regard, Milliman & Robertson recommends that the legislature begin developing policies to address the recently improved funded status of the retirement systems due to very favorable investment returns - whether to improve benefits, reduce contributions, or some combination thereof. (The attached supplemental actuarial analysis dated January 19, 2000 and prepared by M&R shows the employer contribution reduction which could be made by the STRS board pursuant to its existing authority if the funding period were extended with and without the enactment of S.B. 190.)

The bill would provide a significant financial incentive for members to work beyond 30 years (normal service retirement). Under the bill, members who have 35 years of earned service would receive **2.5%** rather than **2.2%** for each of the first 30 years of earned service, plus 2.5% for the 31st year, 2.6% for the 32nd year, 2.7% for the 33rd year, 2.8% for the 34th year and 2.9% for the 35th year, for a total benefit of 88.5% of FAS. Members who have 30 years of earned service would receive 66% under the bill. The incentive is intended to respond to changing demographics. The number of service retirements is expected to double in STRS within the next ten years, creating a growing need for experienced teachers. Moreover, members are expected to live longer in the future, creating an increase in both retirement and health care costs. The stated purpose of the incentive is to retain experienced teachers who otherwise qualify for normal service retirement by encouraging them to defer their actual retirement by at least five years.

There are, of course, other alternatives for addressing these changing demographics. Changes in the normal age and service requirements could be adopted to retain experienced teachers and mitigate the

increased benefit costs resulting from continuing improvements in life expectancy. Prior to 1973, STRS law required **35** years of service to qualify for normal retirement at any age. The STRS normal retirement requirements were lowered to **32** years of service at any age in 1973 and the current **30** years of service in 1976. The U.S. Congress has adopted this approach for the Social Security System through the phase-in of incremental increases in the normal retirement age from 65 to 67. Also, one of the ORSC staff recommendations made as part of the final report to the Joint Legislative Committee to Study Ohio's Public Retirement Plans (December 11, 1996), but not acted upon by the Ohio General Assembly, was to increase the normal age and service requirements in the non-uniformed employee retirement systems, with an appropriate reduction in benefits prior to normal age and service retirement.

Changes in the reemployment restrictions applicable to STRS service retirees could also be adopted to attract experienced teachers. Under current law, STRS retirees must wait a minimum 18 months after the effective date of service retirement in order to be employed full-time in a STRS-covered position. STRS retirees forfeit their monthly retirement allowance for each month they are employed full-time prior to the expiration of the 18-month waiting period. STRS retirees may be employed up to 85 school days in any school year without forfeiting their monthly allowance, provided they wait a minimum two months. PERS retirees are required to wait a minimum six months to be employed full-time in a PERS-covered position; SERS retirees, two months.

Other states have established financial incentives for teachers to defer normal service retirement until older ages by providing a variable formula for calculating benefits based upon the teacher's age at retirement. For example, California recently changed its benefit formula for teachers retiring on or after January 1, 1999 from 2.0% x YOS to the following schedule:

<u>Attained Age at Retirement</u>	<u>Benefit Formula</u>
60	2.0% x YOS
60 1/4	2.033% x YOS
60 1/2	2.067% x YOS
60 3/4	2.1% x YOS
61	2.133% x YOS
61 1/4	2.167% x YOS
61 1/2	2.2% x YOS
61 3/4	2.233% x YOS
62	2.267% x YOS
62 1/4	2.3% x YOS
62 1/2	2.333% x YOS
62 3/4	2.367% x YOS

63 and over	2.4% x YOS
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The above benefit multipliers are increased by 0.2% for California teachers with 30 or more YOS, not to exceed 2.4% x YOS. Therefore, a teacher having 30 or more years of service receives 2.2% x YOS at age 60; 2.3% at age 60 3/4; and 2.4% at age 61 1/2 or older.

Deferred Retirement Option Plans (DROP) offered by some states also provide a financial incentive for members to remain working beyond normal service retirement. Under a DROP plan, members who are eligible for normal service retirement continue to be employed for some defined period, such as two to five 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.

It should be noted that the financial incentives provided under the bill for members to remain working beyond normal service retirement are at cross-purposes with the financial incentives provided under early retirement incentive plans (ERI) established by employers. Under current STRS law, employers may establish an ERI plan for the purchase of additional service credit. Employees who are at least age 50, who qualify or will qualify for service retirement with the purchased credit, and who agree to retire within 90 days after the purchase are eligible to participate in the plan. The amount of service purchased by the employer may not exceed five years or 20% of the employee’s total service credit. The employer may limit participation in the plan, provided the plan is offered to at least 5% of the employees. If participation is limited, employees with greater service have priority over employees with lesser service. As indicated in the ORSC study, Early Retirement Incentive Plans (November 16, 1994), ERI plans were most popular among universities, followed by city school districts and community colleges, and least popular among technical colleges and joint vocational schools according to a survey conducted by STRS in 1987. Employers cited “cutting expenses” and “replacing staff” as their top two objectives in implementing ERI plans, followed by “rewarding staff” and “reducing staff.”

**Post-Retirement Increases** - Current STRS law provides for the following methods of retirement income protection: (1) Annual Cost-of-Living Allowances (COLA); (2) Variable Supplemental Benefits (13th Check); (3) Comprehensive Retiree Health Care Program; and (4) Ad Hoc Legislative Post-Retirement Increases.

The annual COLA is generally payable upon receiving a benefit for at least 12 months, calculated upon the original benefit amount (unless the legislature establishes a new base), and limited to a maximum of three percent. The annual COLA became effective on July 1, 1971.

Unlike the annual COLA, the variable supplemental benefit is discretionary. When STRS investment earnings exceed STRS funding requirements in any given year, the STRS board may allocate up to 25% of the excess investment earnings to pay the benefit. The variable supplemental benefit is payable to persons receiving a benefit for at least 12 months, calculated by multiplying the unit value (as determined by the board) by the combined years of service at retirement and the number of years on

retirement, and paid as a lump sum in December.<sup>12</sup> For example, the most recent variable supplemental benefit was paid in December 1999 based upon a unit value of \$14. Therefore, a teacher who had 30 years of service at retirement and had retired ten years ago would have received a lump sum payment of \$560 [(30 + 10) x \$14 = \$560]. The total amount allocated for the variable supplemental benefit was \$49 million in 1999. The variable supplemental benefit became effective in December 1980, and has been granted by the STRS board for 20 consecutive years.

The STRS retiree health care program is perhaps the most valuable in terms of retirement income protection. It provides comprehensive hospital, medical and prescription drug coverage. It also provides for reimbursement of up to 90% of the cost of Medicare Part B monthly premiums. STRS was first authorized to pay the cost of retiree health insurance coverage on January 1, 1974.

The legislature has enacted various ad hoc post-retirement increases from time to time in an effort to offset in part the loss in the purchasing value of benefits during periods of high inflation. The last STRS ad hoc increase was granted in H.B. 339 (eff. August 6, 1997), and increased the minimum annual benefit from \$6,000 to \$9,600 for teachers who retired with 30 or more YOS. It also restored the purchasing value to a minimum of 70% of the retiree's original benefit amount, as adjusted for the cumulative change in the cost-of-living since retirement. These ad hoc increases were included in the benefit recipient's base for purposes of calculating the annual COLA.

S.B. 190 would provide similar ad hoc post-retirement increases. The bill would recalculate the benefits of service retirees under the current benefit formula assuming the formula had been in effect at the time of their retirement. The current benefit formula became effective for teachers retiring on or after July 1, 1997. The bill would also restore the purchasing value to a minimum of 85% of the benefit recipient's original benefit amount, as adjusted for the cumulative percentage change in the cost-of-living since the effective date of retirement.

***Defined Contribution Plan*** - One of the ORSC staff recommendations made in the final report to the Joint Legislative Committee to Study Ohio's Public Retirement Plans (December 11, 1996) 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." S.B. 190 would implement this recommendation for STRS members.

By way of background, the Ohio General Assembly enacted H.B. 586 (eff. March 31, 1997) which established an alternative defined contribution plan administered by outside providers for full-time academic and chief administrative employees of public institutions of higher education electing such plan in lieu of participation in the defined benefit plans of PERS, STRS or SERS. The bill also required STRS to pay interest upon the withdrawal of the member's contributions due to death or separation of employment, along with a 50% match from employer contributions for members who had at least five years of service. These legislative changes were favorably recommended by the ORSC and intended to

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<sup>12</sup>The variable supplemental benefit is excluded from the member's base for purposes of calculating the annual COLA.

address the issue of pension portability.

S.B. 144 was introduced this session which would require the PERS board to credit interest on the member's contributions, along with a 33% match of employer contributions for members with five but less than 10 years of service and a 67% match for members with ten or more years of service. The bill has been favorably recommended by the ORSC, passed by the Senate, and referred to the House Health, Retirement & Aging Committee. In addition, the PERS board intends to create an alternative defined contribution plan, in conjunction with the existing defined benefit plan, as part of benefit improvement legislation to be introduced this session. Moreover, recent discussions relative to H.B. 199 indicate an interest in establishing an alternative defined contribution plan administered by outside providers for elected officials and non-classified state employees. All of these legislative measures seek to address the need for greater pension portability and options for Ohio's public employees, especially short-service, mobile employees, and are generally consistent with prior ORSC recommendations and positions concerning this issue.

S.B. 190 would require a supplemental employer contribution to be made on behalf of members electing the STRS defined contribution plan and paid to the STRS defined benefit plan in order to mitigate any negative financial impact upon the defined benefit plan. The amount of the supplemental employer contribution would be determined annually by the STRS actuary and would remain payable until the STRS unfunded actuarial liabilities, excluding health care benefits and benefit increases provided to members and former members participating in the defined benefit plan after the effective date of the bill, are fully amortized.

***Annual Actuarial Valuation*** - The substitute bill would require the STRS board to submit its annual actuarial valuation no later than the first day of January following the end of the fiscal year covered by the valuation. Under current law, STRS is required to submit it no later than the first day of May. The STRS fiscal year begins on July 1 and ends June 30. Therefore, the Ohio General Assembly and the ORSC would receive the valuation within six months under the bill rather than 10 months under current law.

One of the major principles adopted by the ORSC in its review and recommendations of public employee retirement bills is that "no proposed increase in pension benefits be seriously considered or granted until there is established adequate funding to cover its cost." Timely and the most current actuarial information from the retirement systems is required for the ORSC to formulate its recommendations to the legislature and avoid any unnecessary delay in the legislative process. A similar change was adopted this legislative session for HPRS in S.B. 189.

***Excess Benefit Plans*** - The substitute bill would authorize the five state retirement systems to establish and maintain qualified governmental excess benefit arrangements. Through the passage of the Small Business Job Protection Act of 1996, Congress permitted state and local retirement plans to establish these "excess benefit arrangements" under Section 415(m) of the Internal Revenue Code in order to pay plan benefits otherwise lost due to the Section 415 limits. An excess benefit plan may be established within the framework of a governmental pension plan. The qualified portion of the governmental plan can provide a benefit up to the Section 415 limit, while the amount above that limit can be provided by the excess benefit plan. In establishing an excess benefit plan, the governmental pension plan must

adhere to the following constraints associated with such plans:

- The excess plan can only provide benefits that are not payable from the qualified governmental defined benefit plan due to the Section 415 limits.
- Operationally, benefits from the excess plan can not be paid from the qualified governmental defined benefit plan's trust. Benefits can be paid on a pay-as-you-go basis or through a separate trust established for the sole purpose of providing excess benefits.
- The excess plan can not allow members to elect to defer additional compensation through the plan.

The substitute bill permits each retirement board in its sole discretion to establish an excess plan within the parameters of the Internal Revenue Code and regulations thereunder.

***Semiannual Review of Investment Programs*** - The substitute bill would require the ORSC to conduct a semiannual review of the investment programs of the five state retirement systems, and submit it to the Governor and the Ohio General Assembly. Such review was recommended in a 1998 ORSC study of the Ohio public retirement systems. Given the recent expansion of the investment authority of all five state retirement systems under the prudent person rule, the Ohio General Assembly has a responsibility to monitor the systems' exercise of this broad authority on a regular, objective and comparative basis.

***Actuarial Audits*** - The substitute bill would require the ORSC to have prepared by an independent actuary at least once every ten years an actuarial audit of the five state retirement systems. Currently, the retirement systems are required by law to have prepared by their actuary an annual actuarial valuation and, at least once every five years, an actuarial investigation of the economic and demographic experience of the system. The purpose of a ten-year actuarial audit is to provide an independent critique of the reasonableness of the actuarial assumptions and methods in use and the accuracy of the data and resulting actuarially-computed contributions and liabilities of the systems. The Government Finance Officers Association (GFOA) recommends independent actuarial audits at least once every ten years as one of its standards for all governmental pension plans. The Auditor of State supports the independent performance of such audits by the ORSC for the benefit of the plan participants, the legislature and the taxpayers alike.

**Fiscal Impact** - (See the attached actuarial analysis prepared by Milliman & Robertson.)

**ORSC Position** - At its meeting of February 9, 2000 the Ohio Retirement Study Council voted to recommend that the 123rd Ohio General Assembly approve Sub. S.B. 190 upon the adoption of the following amendments:

- Require the ORSC to conduct a semi-annual, comparative review of the systems' investments, including asset allocation, investment performance, and investment objectives and policies, and submit such review to the legislature, as recommended by Milliman & Robertson as part of its 1998 study of the Ohio public retirement systems;

- Require the ORSC to conduct an independent actuarial review of the retirement systems at least once every ten years, as recommended by the Government Finance Officers Association as one of its standards for all public employee retirement systems; and
- Require STRS to submit its annual actuarial valuation no later than six months after the fiscal year end (currently ten months) to the ORSC and legislative standing committees.

(The substitute bill incorporates all of the above amendments.)

**Effective Date** - July 13, 2000