



The Ohio Retirement Study Council
88 East Broad Street, Suite 1175
Columbus, OH 43215-3506
Phone: (614) 228-1346
Fax: (614) 228-0118
Website: www.orsc.org

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**Recommendations in Response
to the Report Regarding Service
Purchases Experience of the
Five Ohio Retirement Systems
During FY Ending 2005**

September 12, 2007

ORSC Position

Background

The ORSC requested Milliman, Inc. to complete a report on the cost of purchasing service credit. The report, entitled *Report Regarding Service Purchases Experience of the Five Ohio Retirement Systems During FY Ending 2005* was presented at the March 14, 2007 ORSC meeting. The goal of the report was to tabulate and compare the effect of the purchase of service credit on each system. In order to do so, each system calculated the additional actuarial liabilities attributable to the service purchases based on their actuarial assumptions and methods for their regular annual actuarial valuation. PERS, HPRS, and OP&F used calendar year 2005, while STRS and SERS used fiscal year July 2004 through June 2005.

The additional pension liabilities shown in the report reflect statutorily mandated benefits. The health care liabilities reflect discretionary benefits, except to the extent that Medicare Part B premium reimbursements are included. The report noted that with regard to health care benefits, if they are reduced in the future, some of the additional health liabilities could be eliminated. Additionally, if service purchases did not count toward eligibility for or the amount of health care benefits, then the additional health care liabilities would be eliminated.

The full report is attached, however, the following table summarizes Milliman's findings.

	Total Increase in Actuarial Accrued Liabilities	Total Amount Paid	Total Increase in Unfunded Actuarial Accrued Liabilities	Total Percent of Increase in UAAL Covered by Amount Paid
PERS	\$272,191,566	\$54,942,240	\$217,249,326	20.2%
STRS	\$212,261,987	\$48,914,164	\$163,347,823	23.0%
SERS	\$28,820,268	\$7,927,910	\$20,892,358	27.5%
OP&F	\$28,478,297	\$9,440,096	\$19,038,201	33.1%
HPRS	\$1,612,409	\$546,834	\$1,065,575	33.9%

Staff Comments

The report revealed that the retirement systems subsidized the purchase of credit in nearly every case in 2005. This was true even for service credit for which the member was required to pay the full actuarial cost. The actuarial cost of service is dependent upon the member's final average salary, years of service, and age at retirement. None of these factors are known until a member retires. Therefore, the true actuarial cost of purchasing service can be known only at retirement. This raises the public policy issue of whether a member's purchase of service credit should be subsidized by the retirement system. When a member pays less than the full cost of the additional liability created by the purchase, an unfunded liability is created. This unfunded liability must be paid for out of employer contributions.

The purchase of credit creates two types of additional liabilities: pension and health care. Although pension benefits are set by statute and become vested once a member retires, health care is discretionary and, therefore, the additional health care liability will change as changes are made to the health care plan. As Milliman noted in the report, health care liabilities created by the purchase of service could be eliminated if the purchased service did not count toward eligibility for or the amount of health care benefits. Currently, members of PERS and SERS are statutorily prohibited from using purchased out-of-state, federal, non-interrupted military, exempt, and early retirement incentive service credit from being used to qualify for health care eligibility.

Since 1989 the General Assembly has consistently been requiring members to pay more of the actuarial liability created by their purchase of service credit. In 1989, the law was amended to require STRS members to pay at least 50% of the additional actuarial liability created by the purchase (H.B. 293, eff. 9/15/89). This change applied to (1) any person establishing STRS membership for the first time on or after July 1, 1989 regardless of when the service to be purchased occurred and (2) any service that commences on or after July 1, 1989 regardless of when membership is established.

In 1991, members of PERS, STRS, and SERS were first permitted to purchase credit for school board service provided they paid the entire additional liability resulting from the purchase. They also had to agree to retire within 90 days after receiving notice from the retirement board of the additional liability resulting from the purchase (H.B. 382, eff. 6/30/91). In 1992, the law was amended to require members of OP&F who purchase credit for time they were laid off to pay the full cost of the additional liability created by the purchase (H.B. 394, eff. 9/3/92). Beginning in 1994, OP&F members who purchase out-of-state or federal service are required to pay the entire additional liability created by the purchase and they must also retire within 90 days of the purchase (H.B. 197, eff. 10/11/94).

The law was changed in 2000 to require members of PERS to pay at least 50% of the actuarial cost for military service that does not interrupt public employment (H.B. 186, eff. 3/17/00). The most recent change that required members to pay more of the additional liability for purchases occurred last session in H.B. 71 (eff. 3/3/07). That bill allowed members of PERS, STRS, SERS, and HPRS to purchase service credit for active duty in the Ohio National Guard or armed forces reserves that consists of assembly for drill and instruction; training at encampments, maneuvers, outdoor target practice, or other exercises; and any training or duty in this state ordered by the governor if the member pays **100%** of the resulting additional actuarial liability. Because these types of service do not interrupt public employment, they are not covered by the federal Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA). USERRA requires a member whose public employment is interrupted by military service to be treated as though his or her public service was not interrupted, which means the system may require the member to pay the employee contributions that would have been made during that time period.

Recommendations

1. **Recommendation:** The purchase price for all types of service should be the full actuarial liability resulting from the purchase of service credit, except as prohibited by federal law, and members should be required to retire within 90 days of purchasing service.

Rationale: This change would end the current practice whereby all members of the system subsidize a member's purchase of service credit. It is also consistent with recent legislative changes that have required members to pay more of the additional actuarial liability resulting from the purchase of service credit.

2. **Recommendation:** Purchased credit should be prohibited from being counted for purposes of health care eligibility or subsidy.

Rationale: As noted in the Milliman report, this would eliminate the additional health care liabilities created by the purchase of credit. This could be done by legislation or administrative rule.

ORSC Position

At its meeting of September 12, 2007, the Ohio Retirement Study Council voted to approve staff's recommendations regarding the purchase of service credit.