Fiscal Note & Local Impact Statement

123 rd General Assembly of Ohio

BILL: **H.B. 275** DATE: **September 21, 1999**

STATUS: **As Introduced** SPONSOR: **Rep. Vesper**

LOCAL IMPACT STATEMENT REQUIRED: **No — No local cost**

CONTENTS: **Increases benefits paid to surviving spouses of members of PFDPF, eliminates the eligibility limits for COLAs that apply to certain PFDPF members, and declares an emergency**

State Fiscal Highlights

STATE FUND	FY 2000	FY 2001	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	Potential decrease in expenditures from Death Benefit Fund	Potential decrease in expenditures from Death Benefit Fund	Potential decrease in expenditures from Death Benefit Fund
Police and Firemen's Disability and Pension Fund (PFDPF)			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	Increase due to one-time lump sum payment for certain eligible surviving spouses plus increased retirement benefits	Increase due to increased benefits	Increase due to increased benefits; estimated increase in UAAL of $189,632,000

Note: The state fiscal year is July 1 through June 30. For example, FY 2000 is July 1, 1999 – June 30, 2000. PFDPF's fiscal year is the calendar year.

- The proposed increase in benefits would result in an $189,632,000 increase in actuarial accrued liability and an increase of $3,834,000 in normal costs. According to PFDPF's 30-year amortization plan submitted on February 24, 1999, these increased benefits could be financed without any increase in contribution rates and within the statutory limitations set by S.B. 82 in the 121st General Assembly.

- Although monthly survivor benefits paid by PFDPF to spouses who are also receiving benefits under the Death Benefit Fund would increase, an offsetting decrease in death benefits would occur. Since death benefits are non-taxable and regular survivor benefits paid by PFDPF are generally taxable, this provision may result in a benefit reduction for such spouses. A reduction in General Revenue Fund expenditures would also occur, since the Death Benefit Fund is a GRF subsidy line held by the Treasurer of State.

- The bill would also provide one-time-only payments to increase certain pensions as if the bill had taken effect on January 1, 1998

Local Fiscal Highlights

- No direct fiscal effect on political subdivisions from the benefit increases, since the increase in UAAL can be covered without an increase in the contribution rate. However, this action, if combined with other factors affecting financial viability, could increase pressure on future contribution rates.

Detailed Fiscal Analysis

Background

Amended Substitute House Bill 194 of the 122nd General Assembly provided various benefit enhancements for surviving spouses, surviving children and dependent parents of Police and Fire Disability and Pension Fund (PFDPF) members. It increased pensions for certain current retirees to a minimum of $550 per month, provided an annual cost of living adjustment (COLA) up to a maximum of 3%, and authorized one time payments for certain eligible individuals. House Bill 275 extends these enhanced benefits to additional groups of individuals by providing $550 per month to **all** current and future survivors and a COLA benefit to all pre-1986 retirees.

Increase in Monthly Survivor Pensions

House Bill 275 would increase the monthly survivor pension from $410 to $550 for:

- spouses of members who retire on or after September 16, 1998 and who die after July 1, 1999;[1]
- spouses of active members who, on or after September 16, 1998, are eligible for service retirement at the time of death and who die after July 1, 1999;
- spouses of members who retired prior to September 16, 1998 but whose death occurs after December 21, 1999 or spouses of members who qualify for the deceased member's full monthly salary under the Firemen and Policemen's Death Benefit Fund.[2]

These benefit increases are identical to those provided under Am. Sub. H.B. 194 but are simply extended to an additional group of survivors.

It is important to note, however that although monthly survivor benefits paid by PFDPF to spouses who are also receiving benefits under the Death Benefit Fund would increase, an offsetting decrease in Death Benefits would occur. Since death benefits are non-taxable and regular survivor benefits paid by PFDPF are generally taxable, this provision may result in a benefit reduction for such spouses. A reduction in General Revenue Fund expenditures would also occur, since the Death Benefit Fund is a GRF subsidy line held by the Treasurer of State.

Cost of Living Adjustments (COLAs)

These benefit increases would also be subject to a COLA indexed to the average percentage change in the CPI-W for the preceding calendar year, up to a maximum of three percent. Effective July 1, 2000, the COLA would be calculated using the base amount of $550; each subsequent calculation would be accomplished on the first of July in each following year thereafter.

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[1] September 16, 1998 was the effective date of H.B. 648, which guaranteed a 50% joint and survivor annuity unless the spouse gives informed written consent to waive the annuity.

[2] December 21, 1999 marks the expiration of the one-year window provided under Am. Sub. H.B. 194 for retired members to elect a joint and survivor annuity for their spouses.

One-Time Payments

In addition, the bill would provide a one-time payment to spouses who become survivors after the effective date of Am. Sub. H.B. 194 and who are eligible for the benefit increase on July 1, 1999. These spouses would receive a lump sum payment equal to $140 (the difference between the new benefit amount of $550 and the current benefit of $410) for each month they are eligible to receive a monthly pension from the effective date of Am. Sub. H.B. 194 and June 30, 1999. A lump sum payment would also be made to the spouses who were excluded from the Am. Sub. H.B. 194 benefit increase (i.e., those spouses outlined above). These spouses would receive a lump sum payment equal to $140 for each month they are eligible to receive a monthly pension benefit for the period January 1, 1998 through the effective date of H.B. 275. In either case, the PFDPF board must make the lump sum payments no later than the first day of the second month after the effective date of H.B. 275.

Miscellaneous Provisions

Amended Substitute House Bill 194 of the 122nd General Assembly permitted members who retired prior to September 16, 1998 to elect a joint/survivor annuity no later than December 21, 1999. House Bill 275 limits this joint/survivor annuity election to only those members who are married to the same spouse they were married to at the time of retirement. The bill also stipulates that the election form must be mailed to the pension fund's principal place of business as opposed to the pension board itself.

The bill also eliminates the annual pension cap for those members who retired prior to July 24, 1986. These retirees were permitted to include various types of terminal pay (e.g., sick leave) in the calculation of their average annual salary, effectively boosting or "spiking" their annual pensions. As a means of equalizing pension benefits among different groups of retirees, pre-1986 retirees whose annual pensions exceeded a certain amount were not permitted to receive yearly COLAs.[3] Removal of this annual pension cap would make all pre-1986 retirees eligible for annual COLAs of up to $360, regardless of current annual pension amount levels. A pension cap would still exist, however, for those individuals who were active members with at least fifteen years of service as of January 1, 1989 and had elected the terminal pay option.

Actuarial Funding of H.B. 275 Benefit Enhancements

Senate Bill 82 of the 121st General Assembly mandates that all five public retirement systems attain a 30-year funding period for amortizing unfunded actuarial accrued liability (UAAL) by January 2007. Unfunded actuarial accrued liabilities are the difference between the actuarial accrued liabilities and the valuation of assets. The actuarial accrued liabilities, which are the portion of the actuarial present value of pension plan benefits and expenses not provided for by total employer and employee contributions, can be mitigated by increased asset valuation thereby reducing UAAL.

According to PFDPF's 1998 actuarial valuation report and prior to consideration of Am. Sub. H.B. 194, the system could fund UAAL within 56.71 years; including the costs of Am. Sub. H.B. 194 would increase the amortization period to 85.06 years. A recent actuarial cost analysis

[3] The capped amount in 1999 is $23,500; any pre-1986 retiree whose annual pension amount was $23,500 or more in 1999 would not receive a COLA. The annual pension cap increases by $500 each year thereafter.

conducted for a Senate bill (S.B. 118) with PFDPF benefit enhancements that are identical to those found in H.B. 275, indicates that the increase in UAAL of $189,632,000 would increase the amortization period from 85.06 years to an infinite period.

In spite of the funding scenario confronting PFDPF both now and in the future, the system believes that it will be in compliance with the mandates of S.B. 82. The system's 30-year Amortization Plan, which was submitted to the Legislature on February 24, 1999 incorporates the added liabilities incurred by passage of H.B. 648 and H.B. 194 (both of the 122nd General Assembly) as well as those of H.B. 275 and still attains an amortization period of 30 years by 2007. The main thrust of this plan is the expectation for strong investment returns and the "front-loading" of asset targets, which protects the system against weak investment markets in the future.[4] Given the investment returns realized in the past, (average returns over the past 5 years have been 13.3% each year, which is well above the 9% needed under the system's Amortization Plan), PFDPF believes that the asset targets they have established will compensate for any weak market performance in the future and will bring them well within a 30 year funding period by 2007.

Due to the innate uncertainty of forecasting future returns, PFDPF has formulated several contingency plans to maintain compliance with S.B. 82. Among these plans is the recognition of previously unrecognized gain on stocks, as well as the shifting of a larger percentage of payroll contributions from healthcare to the UAAL. Two possible actions for which the fund has no reasonable contingency, however, are the possible expansion of Social Security by Congress and the possible enactment of H.B. 199, the alternative retirement plan for public employees. It is estimated that mandatory Social Security coverage would reduce payroll contributions by PFDPF members by 12.4 percentage points; H.B. 199 would eliminate healthcare contributions from active members, causing the system to shift a higher percentage of contributions to meet current healthcare obligations and away from reducing UAAL.

While the probability of either the enactment of mandatory Social Security for public employees or passage of H.B. 199 (as well as future legislation increasing benefits or mandating refunds to PFDPF members) is not known, the occurrence of either would affect the financial viability of the system and increase pressure on future contribution rates. Barring the occurrence of either action and given the strong performance of investment markets as well as contingency plans formulated by the system, however, it would appear that PFDPF can fund the cost of the benefit enhancements in H.B. 275 and still attain a 30-year funding period by 2007.

❑ *LBO staff: Sharon Hanrahan, Budget/Policy Analyst*

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[4] The "front-loading" used by the system is based on the use of a fixed annual investment income target of $636 million per year.