Ohio Legislative Service Commission

Ruhaiza Ridzwan

Fiscal Note & Local Impact Statement

Bill: Sub. S.B. 340 of the 129th G.A.

Date: May 16, 2012

Status: As Reported by Senate Insurance, Commerce & Labor

Sponsor: Sens. Niehaus and Kearney

Local Impact Statement Procedure Required: Yes

Contents: To make changes to the law governing the Ohio Police and Fire Pension Fund

State Fiscal Highlights

- The provision that increases employee contribution rates for members participating in the Ohio Police and Fire Pension Fund (OP&F) would reduce personal income tax (PIT) receipts beginning in FY 2014. An employee's contributions that are withheld from the employee's paycheck and paid to the system are not taxable currently. Thus, the provision would reduce PIT receipts for several years, by an amount increasing over three years as the rate increases are phased in, to approximately $1.6 million per year starting in FY 2016. The state GRF would bear $1.5 million of such revenue loss while the Local Government Fund (LGF) and Public Library Fund (PLF) (combined) would bear $0.1 million annually.[1]
- Most provisions would decrease OP&F's future pension benefit expenditures, thereby generating savings for the system. Few if any state employees are members of OP&F. If any state employees are members the resulting decrease in liabilities is likely to decrease future state spending to provide retirement benefits to those employees, contingent on an actuary's determination that the savings are sufficient to reduce contribution rates. Due to this contingency, LSC staff consider any such fiscal effects to be indirect.
- Under existing law, the board of each of the retirement systems is required to prepare an actuarial analysis of any introduced legislation expected to have a

[1] Under current law, beginning in FY 2014 transfers to the LGF and PLF will be based on a fixed percentage as determined by the Tax Commissioner not later than July 5, 2013. The percentage will be based on the amount transferred to each fund in FY 2013 as a percentage of total GRF tax revenues in FY 2013. In FY 2014, total distribution to the LGF and the PLF is estimated to be about 3.3% of total GRF tax revenue.

measurable financial impact on the system by not later than 60 days from the date of introduction of the legislation.[2]

Local Fiscal Highlights

- The provision that increases employee contribution rates for members participating in the Ohio Police and Fire Pension Fund (OP&F) would reduce PIT receipts beginning in FY 2014. The Local Government Fund (LGF) and Public Library Fund (PLF) (combined) would bear a loss of $0.1 million annually.
- The provision that increases employee contribution rates would also decrease school district income taxes, for those school districts that impose them and in which members of the OP&F reside. This occurs for the same reason as the reduction in the state personal income tax.
- The provision that increases the frequency for remitting employer contributions to the OP&F to monthly rather than quarterly may minimally increase administrative costs for local government employers affected by the provision.
- All local government employees are either a member of the Public Employee Retirement System (PERS) or OP&F.
- Most provisions would decrease future OP&F pension benefit expenditures, thereby generating savings for the system. The resulting decrease in liabilities is likely to decrease local governments' future spending to provide retirement benefits to employees, contingent on an actuary's determination that the savings are sufficient to reduce contribution rates. Due to this contingency, LSC staff consider any such fiscal effects to be indirect.

[2] A copy of the actuarial analysis must be submitted to the Legislative Service Commission (LSC), the Ohio Retirement Study Council (ORSC), and the standing committees of the House of Representatives and the Senate with primary responsibility for retirement legislation.

Detailed Fiscal Analysis

The bill makes various changes to law governing the Ohio Police and Fire Pension Fund (OP&F). Most of the provisions have no significant direct fiscal effect on the state and local governments. However, the provision that increases employee contribution rates for members participating in OP&F would reduce receipts from the state personal income tax and from school district income taxes, as described in more detail below.

At a given point in time, state and local contributions to the retirement systems are based on the size of their respective payrolls, which are multiplied by a contribution rate determined by an actuary; for example, the employer contribution rate under OP&F is currently 19.5% for each police officer and 24.0% for each firefighter, and is unchanged by the bill. The bill's provisions generally create savings for the OP&F, and it is likely that those savings will reduce future required contribution rates, but any such reduction is contingent on an actuary's determination. Because of the contingent nature of the savings to the state and to political subdivisions, LSC staff consider such fiscal effects to be indirect.

The LSC bill analysis provides a detailed description of this bill. The following are provisions that have a fiscal effect on the state or on political subdivisions, or a major fiscal effect on the retirement system.

- Increases police officer and firefighter contributions by increments from 10% to 12.25% of salary beginning with the payroll period starting July 2, 2013. Allows the OP&F Board to increase member contribution rates after July 2, 2015, if the Board's actuary determines that an increase is necessary to meet the Board's funding requirements.
- Modifies age and service retirement benefit eligibility criteria for OP&F members hired on or after July 2, 2013. Increases the age requirement for an unreduced retirement benefit with 25 years of service to age 52, rather than 48. Establishes an early (reduced) retirement benefit for members with 25 years of service credit and age 48.
- Authorizes the Board to increase age and service requirements for all members if the Board's actuary determines that an increase is necessary to meet the Board's funding requirements.
- Provides that, in calculating average annual salary (AAS), five years (rather than three) is to be used for members who have less than 15 years of active service on July 2, 2013.
- Allows the Board to determine what constitutes salary and terminal pay in determining contributions and AAS.
- Delays eligibility for a cost-of-living adjustment (COLA) for a retirement pension or disability benefit recipient.

- Requires that members electing on or after July 2, 2013, to participate in the deferred retirement option plan (DROP) to participate in the plan for five years (rather than three).
- Revises disability benefits coverage and eligibility.
- Requires certain Board reports to be completed triennially (rather than annually).
- Increases the frequency for remitting employer contributions to OP&F to monthly rather than quarterly. The new remittance schedule is effective for payrolls paid on or after the 91st day after the bill's effective date.
- Allows the OP&F Board to ask the director of Office of Budget and Management (OBM) to withhold any funds under the director's control that are payable or due to a public employer, who is delinquent on its liability, and pay the amount withheld to the OP&F.

Fiscal impact

State and local governments

The provisions that increase employee contribution rates for members participating in OP&F would reduce receipts from the state PIT and from school district income taxes, if the local employer treats such contributions as a salary reduction employer pick-up plan (as the state does under PERS, for example). Table 1 shows proposed member contribution rates and the amount of member contributions. Employees' contributions that are withheld from such employees' paychecks and paid to the retirement system are treated as tax deferred, and thus not taxable income currently. Any increase in employee contribution rates would correspondingly increase total amounts of payroll that are not taxed currently, thereby decreasing income tax receipts.

Using member contributions in Table 1, the estimated amount of payroll that would effectively shift from taxable to nontaxable, at the 12.25% member contribution rate, would be up to $13.2 million in the first year, increasing each year to up to $39.6 million per year starting in the third year. Assuming a marginal tax rate of 4.109%,[3] state PIT revenue would decrease by up to $1.6 million per year after three years. The state GRF would bear up to $1.5 million of such revenue loss while the LGF and the PLF (combined) would bear about $0.1 million. Any revenue loss to the LGF and PLF would subsequently reduce the allocations to various local government entities (counties, municipalities, and townships). The provision would also decrease school districts' income tax receipts for those school districts that impose them due to the reduction in Ohio taxable income (which is the tax base of the school district tax).

[3] According to data from the most recent OP&F report, the average member's salary is $66,525 annually.

Table 1: Proposed Employee Contribution Rates[4]			
System	**Current Member Contribution Rate**	**Member Contributions ($ in millions)**	**Proposed Contribution Rates**
OP&F	10.0%	$175.5	12.25% (increases phased in by 0.75% per year, over three years, beginning on July 1, 2013)

Table 2: Estimated Revenue Loss, by Fiscal Year			
	FY 2014 ($ in millions)	**FY 2015 ($ in millions)**	**FY 2016 ($ in millions)**
PIT revenue loss	$0.54	$1.08	$1.62
GRF revenue loss	$0.52	$1.04	$1.56
LGF and PLF revenue loss	$0.02	$0.04	$0.06

Most of the provisions would have no direct fiscal impact on the state, local governments, and school districts because the bill does not make any changes to employers' contribution rates. Thus, the bill would not directly affect the state's, local governments', and school districts' retirement costs. Retirement benefits for a public employee are funded by a combination of employees' and employers' contributions and investment earnings on those contributions. Employee and employer contribution rates are based on a set percentage of employees' payroll. The rates are determined by an actuary as the percentage necessary to fully fund benefit amounts over time, but limited to the maximum rates specified in the Revised Code.[5]

Many of the bill's provisions would decrease OP&F liabilities. By doing so, those provisions would likely permit an actuary to determine, at some point, that employer contribution rates could be reduced, thereby decreasing future costs for the state and political subdivisions. LSC does not employ an actuary, and does not have access to employee-level data with which to estimate the likely magnitude and timing of any such reduction in contribution rates. Also, due to the fact that such reductions are contingent on an actuary's analysis and determination, LSC would consider such reductions to be indirect fiscal effects.

The provision that increases the frequency for remitting employer contributions to OP&F to monthly, rather than quarterly, will decrease local governments' monthly cash flow that may be used for investment or other purposes before the employer contributions are remitted to OP&F. However, the estimated amount of forgone revenue from earnings on investment will depend on several factors, including the amount of funds available for investment and interest rates on the investment. The

[4] Amounts for OP&F are as of December 31, 2010.

[5] Currently, a portion of an employer's contributions is used to fund retirees' optional health benefits provided by the systems.

provisions may also increase local governments' expenditures if they fail to pay the contributions on time, due to penalties that OP&F is required to assess for late payments. The provision would have no fiscal impact on the state because state employees and employers do not contribute to OP&F.

Retirement systems

The majority of the bill's provisions, when they begin to take effect, would decrease future OP&F pension benefit expenditures. This in turn would decrease OP&F pension liabilities and the number of years to amortize its unfunded actuarial accrued liabilities (UAAL). A UAAL occurs when the value of the actuarial accrued liabilities exceeds the value of assets. UAAL is calculated by an actuary based on various economic and actuarial assumptions. The bill would require OP&F to increase employee contributions. Thus, the bill would improve the long-term funding status of OP&F. The magnitude of the impacts on OP&F liabilities and UAAL would need to be determined by an actuary, and is undetermined at this time.

Under current law, OP&F is required to amortize its UAAL over a period not to exceed 30 years.[6] Table 3 presents OP&F financial data as of January 1, 2011, the most recent actuarial valuation available.[7] The bill may also increase OP&F's administrative costs, however, any potential cost due to the bill would be offset by savings realized by the system.

Table 3: OP&F Financial Data

System	UAAL ($ in millions)	Funded Ratio[8]	Funding Period for Pension
OP&F (as of 1/1/2011)	$4,703.4	69.4%	Infinite

In the future, if OP&F maintained a 30-year amortization and its funding status remained stable, it would lessen the chances of further increase in contribution rates or reductions in benefits.[9] Thus, the bill may indirectly affect employer (state, local governments, and school districts) and employee contributions in the future, as described above.

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[6] The Revised Code specifies that in any year a system's funding period exceeds the 30-year requirement, the system is required to submit a report to the Ohio Retirement Study Council outlining its plans to comply with the 30-year funding requirement.

[7] Funding period is the number of years needed to fully amortize pension liabilities.

[8] A funded ratio represents ratio of assets to actuarial accrued liabilities, and is an indicator of the fiscal strength of a retirement system, i.e., its ability to pay benefits when due.

[9] In general, investment earnings account for about two-thirds of total revenues to pay for retirement benefits. Thus, investment returns have a significant and direct impact on future contribution rates.