Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: Sub. S.B. 343 of the 129th G.A.

Date: September 12, 2012

Status: As Passed by the House

Sponsor: Sens. Niehaus and Kearney

Local Impact Statement Procedure Required: No

Contents: To make changes to the law governing the Public Employees Retirement System

State Fiscal Highlights

- The provisions requiring public employers that contribute to the Public Employees Retirement System (PERS) to comply with certain administrative requirements may minimally increase the state's administrative costs.
- Approximately 96% of state employees are members of PERS (2.5% are members in the Highway Patrol Retirement System, and the remaining 1.5% are in the State Teachers Retirement System).
- Most provisions would decrease future PERS pension benefit expenditures, thereby generating savings for the system. The resulting decrease in liabilities is likely to decrease future state 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.
- Under existing law, the PERS Board is required to prepare an actuarial analysis of any introduced legislation expected to have a measurable financial impact on the system by not later than 60 days from the date of introduction of the legislation.[1]

Local Fiscal Highlights

- The provisions requiring public employers that contribute to PERS to comply with certain administrative requirements may minimally increase local government employers' administrative costs.
- The provision that requires any legal action commenced against PERS be filed in Franklin County may increase minimally Franklin County court costs.

[1] 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.

- Most provisions would decrease future PERS pension benefit expenditures, thereby generating savings for the system. The resulting decrease in liabilities is likely to decrease future local governments' 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.

Detailed Fiscal Analysis

The bill makes numerous changes to the law governing the Public Employees Retirement System (PERS). Most of the provisions of the bill have no significant direct fiscal effect on the state and local governments. 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; see Table 1 (on page 5) for PERS employer contribution rates, by division.

The bill's provisions generally create future savings for the PERS, and it is likely that those savings will reduce future required contribution rates relative to what the rates would have been under current law,[2] 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. However, some provisions requiring public employers to comply with certain administrative requirements may minimally increase the state and local governments' administrative costs.

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

- Classifies PERS members into three groups: "Group A" are PERS members who, using current criteria, are eligible to retire no later than five years after the effective date of the bill. Members in "Group B" are PERS members who, using existing criteria, have 20 years of service credit or will be eligible to retire not later than ten years after the bill's effective date. Members in "Group C" are PERS members who do not meet the criteria for either of the above groups or become PERS members after the bill's effective date.
- Modifies age and service retirement benefit eligibility criteria only for members in Groups B and C. Under the new criteria, members in Groups B and C are generally required to attain certain additional years of service

[2] This statement does not necessarily imply an actual decrease in contribution rates. It would also describe, for example, a scenario in which an actuary determined that the contribution rate needed to be increased by one-half percentage point under the bill's provisions, when it would have needed to be increased by a full percentage point under current law.

credit or attain a higher age to be eligible to retire with full benefits (or to be eligible for early retirement with reduced benefits).

- Permits the PERS Board to treat service as a public safety officer as service as a law enforcement officer if certain conditions are met. In general, public safety officers will have the same retirement eligibility requirements as law enforcement officers.
- Allows the PERS Board to establish a "contributions based benefit cap" (CBBC). In general, the cap would limit the amount of retirement allowance a member may receive to a designated multiple of such member's lifetime contributions into the system.
- Specifies that the reduction caused by the CBBC may not exceed 5% of any Group A member's single-life annuity before application of the CBBC unless during any full month of service the member's earnable salary was less than $1,000. Provides that the $1,000 restriction applies only to service earned after January 1, 1987.
- Eliminates two optional benefit formulas that are alternatives to receiving a benefit determined by a percentage of final average salary (FAS) multiplied by years of service.
- Changes the FAS used to calculate a member's benefit, for all members in Group C, from the average of the three highest calendar years' salary to the average of the five highest calendar years of earnable salary. Provides that FAS will be calculated using the member's highest calendar years of service or the last continuous months of service.
- Changes an annual cost-of-living adjustment (COLA) for benefits granted five years after the bill's effective date. The new COLA equals any increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for the immediately preceding year, not exceeding 3% annually, instead of the automatic 3% under existing law.
- Increases the amount a PERS member must earn in a month to receive full credit for that month from $250 to $600 effective January 1, 2014. Provides for future increases in this threshold based on increases in compensation of township trustees.
- Revises a member's eligibility and increases the cost to purchase certain service credit. A member or former member who purchases such credit would be required to pay an amount equal to 100% of the additional liability to PERS resulting from the additional credit.
- Revises disability benefits coverage and eligibility, generally restricting eligibility for such benefits.
- Provides that the Board must establish a reimbursement amount for Medicare Part B premiums. Under existing law, the Board is required to make a

payment of not less than $96.40 per month for Medicare Part B premium. In 2012, the Medicare Part B premium for most Medicare participants is $99.90 per month.

- Allows the PERS Board to establish rules related to health care coverage eligibility requirements. Current law authorizes, but does not require, the PERS Board to provide health care coverage for retired members and their spouses and dependents.
- Specifies that the rate of interest credited to the accounts of certain re-employed retirants is a rate determined by the PERS Board, rather than PERS's actuarial assumption rate of interest.
- Permits, rather than requires, the PERS to transfer the "mitigating rate" to the PERS Traditional Pension Plan, a defined benefit (DB) plan. Under existing law, a percentage of employer contributions made on behalf of PERS defined contribution plan participants, known as the mitigating rate, will be redirected to the Traditional Pension Plan to compensate for any negative financial impact due to such members' participation under the defined contribution plans.
- Authorizes the PERS Board to allow employees of the Ohio Public Employees Deferred Compensation Board to participate in any health care coverage PERS offers its own employees.
- Specifies that any legal action commenced against PERS be filed in Franklin County.
- Requires each public employer who is a member of PERS, to prepare a report containing a list of individuals providing personal services who at any time during the preceding year received compensation for which contributions were not made to PERS. The report must be submitted to PERS by not later than the last day of January of each year.
- Specifies that provisions in the bill generally will take effect on January 7, 2013.

Fiscal impact

State and local governments

Most of the provisions would have no direct fiscal impact on the state, local governments, or 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.[3] Employee and employer contribution

[3] 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.

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.[4] Table 1 (below) shows PERS employees' and employers' contribution rates in 2012, by division.

Table 1: Contribution Rates in 2012			
System	Division	Employee Contribution Rate	Employer Contribution Rate
PERS	State	10.0%	14.0%
	Local	10.0%	14.0%
	PERS Public Safety	11.5%	18.1%
	PERS Law Enforcement	12.1%	18.1%

Many of the bill's provisions would decrease future liabilities of the PERS. 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.

One provision of the bill would require each public employer who is a member of PERS to prepare a report containing a list of individuals providing personal services who at any time during the preceding year received compensation for which contributions were not made to PERS. This provision would likely increase administrative costs for the state and for political subdivisions. LSC economists think that, due to the widespread use of accounting software to generate financial reports, any such increase is likely to be minimal.

The provision that requires any legal action commenced against PERS be filed in Franklin County may have a minimal fiscal impact on Franklin County court costs.

PERS liabilities

The majority of the bill's provisions, when they begin to take effect, would decrease future PERS pension benefit expenditures. This in turn would decrease PERS 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. Thus, the bill would improve the long-term funding status of PERS.

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

Based on the PERS actuarial valuation as of December 31, 2010, the actuarial value of net assets set aside to pay the Traditional Pension Plan (a defined benefit, or DB, plan) benefits (excluding health care assets) was $60.6 billion. PERS' UAAL for its DB plan was $19.0 billion, which corresponded to a 76.1% funded ratio. A funded ratio represents ratio of assets to actuarial accrued liabilities, which is an indicator of the fiscal strength of a retirement system, i.e., its ability to meet its future obligations. The PERS DB plan had a funding period of 30 years, which is the number of years needed to fully amortize its UAAL. Under current law, PERS is required to amortize its UAAL over a period not to exceed 30 years.[5]

The bill may also increase PERS administrative costs, however, any potential cost due to the bill would be offset by savings realized by the system.

According to an actuarial analysis prepared by a PERS actuary, Gabriel, Roeder, Smith & Company, dated June 18, 2012, the proposed changes under the bill would reduce the system's total employer contribution rate by 4.38 percentage points (reductions of 2.54 percentage points to total normal cost and 1.84 percentage points to UAAL). The estimated decrease in actuarial accrued liabilities and in UAAL would be about $4 billion. The analysis indicated that PERS would amortize its UAAL in 24 years, which is within the 30-year funding requirement. The estimates are calculated based on December 31, 2010 actuarial valuation data, with some modifications to actuarial assumptions.

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[5] 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.