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From: Bethany Rhodes, Director/General Counsel 

Date: March 27, 2017

Subject: 2016 ORSC Annual Report

Since 1968, and pursuant to Revised Code 171.04, the Ohio Retirement Study Council has submitted an annual report to the Governor and the General Assembly covering its evaluation and recommendations regarding the five state retirement systems. ORSC staff is pleased to submit this year's report on the Evaluation and Recommendations Regarding the Operations of the State Retirement Systems. The staff report includes information on the systems' investment performance, status of health care funds, actuarial reviews of the systems, fiduciary reports, progress on achieving 30-year funding, reports on enacted pension legislation, pending pension-related issues, a subject index of pension bills introduced, and a status sheet for pension legislation as of December 31, 2016.



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Annual Report *2016*

Evaluations and Recommendations Regarding the Operations of the State Retirement Systems

131st General Assembly
January 1, 2016 – December 31, 2016

Issued March 27, 2017

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Mike Nehf, State Teachers Retirement System

DIRECTOR

Bethany Rhodes

ANNUAL REPORT
THE 131st GENERAL ASSEMBLY
JANUARY 1, 2016 - DECEMBER 31, 2016

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Introduction

The Ohio Retirement Study Council (ORSC) staff is pleased to submit this report on the five public state retirement systems and the fund for volunteer firefighters for the period beginning January 1, 2016, and ending December 31, 2016. This report is submitted pursuant to section 171.04(B) of the Ohio Revised Code, which requires the ORSC to “make an annual report to the Governor and the General Assembly covering its evaluation and recommendations with respect to the operations of the state retirement systems and their funds.”

As of January 1, 2016, the five systems have combined assets of approximately \$190 billion with approximately 671,000 active contributing members, 769,000 inactive members, and 468,000 beneficiaries and recipients. The State of Ohio has a long tradition of providing retirement benefits to public employees. These benefits are held in trust and managed by the five systems and funded through employer and employee contributions and earnings on those contributions.

Ohio’s five public state retirement systems are the State Teachers Retirement System (STRS), created in 1920 for teachers in public schools, colleges, and universities; the Public Employees Retirement System (PERS), created in 1935 for state employees and expanded in 1938 to cover local government employees; the School Employees Retirement System (SERS), created in 1937 for non-teaching school employees; the State Highway Patrol Retirement System (SHPRS), created in 1944 by the withdrawal of all state troopers from PERS; and the Ohio Police and Fire Pension Fund (OP&F), created in 1967 after the abolition of 454 local police and fire relief and pension funds, many of which were on the verge of financial insolvency because of a routine disregard of the financial consequence of benefit increases.

As a direct result of the collapse of local police and fire pension funds, the ORSC was created in 1968 to assist the state legislature, governor, and other public officials in the formation of sound public pension policy and is one of the oldest public oversight councils in the country. The general purpose of the Council is to advise and inform the state legislature on all matters relating to the benefits, funding, investment, and administration of the five public retirement systems in Ohio.

Legislators are accustomed to dealing in two-year budgetary cycles, whereas decisions about public pension plans typically involve significant long-term costs such as 30-year pension obligations. If not made prudently and with foresight, such decisions can threaten the stability of state and local government budgets years after those obligations are made and result in serious inter-generational inequity through reduced benefits or higher taxes.

The Council is required to make an impartial review of the laws governing the administration and financing of Ohio’s five public retirement systems and to recommend to the General Assembly any changes it may find desirable with respect to the allowances and benefits, the sound financing of the cost of benefits, the prudent investments of funds, and the improvement of the language, structure, and organization of the laws.¹ It must report to the Governor and the General Assembly concerning its evaluation and recommendations with

¹ R.C. 171.04.

respect to the operations of the systems. The Council is required to study all statutory changes in the retirement laws proposed to the General Assembly and report to the General Assembly on their probable cost, actuarial implications, and desirability as a matter of public policy.

The Council evaluates the operations of the systems on a continuing basis. During the past year, the Council reviewed the retirement systems' investment performances, operating budgets, and administrative rules. In addition, the ORSC staff has continued a digitization project to preserve records in the Council's possession, monitored legislation introduced in the General Assembly that would affect the state retirement systems, continued a multi-year project to standardize the reports provided by the systems to the General Assembly and Council, and began its first ever fiduciary audit of SERS.

This report is a compilation of the evaluations and recommendations the Council made throughout 2016. It provides a summary of the ORSC reports and staff activities completed during 2016, pending public retirement issues, and staff recommendations. In addition, it provides a historical record of legislative action taken during the 131st Ohio General Assembly on bills affecting PERS, STRS, SERS, OP&F, SHPRS and the Volunteer Fire Fighters' Dependents Fund (VFFDF).

Further detail on any topic listed in this report is available in the ORSC office or online at ORSC.org.

SYSTEMS' INVESTMENT PERFORMANCE

July 1, 2015 – December 31, 2016

The ORSC is required to conduct a semiannual review of the policies, objectives, and criteria of the systems' investment programs.² RVK is the Council's investment performance consultant. While there is a wealth of information in the analyses, this report details only the rolling 1-, 5-, and 10-year performance experience, and comments from RVK.

Investment Performance Summary (July 1, 2015 - December 31, 2015)

The following summarizes the report received by the ORSC at its May 12, 2016, meeting and reflects the investment performance for all six funds³ for the period ending December 31, 2015. The findings of this report are briefly summarized as follows:

- Four of the six retirement system portfolios had positive results for the one-year period ending December 31, 2015; four of the funds (PERS, STRS, OP&F and SERS) outperformed their policy benchmarks in that same period.
- Over the trailing five-year period, two of the retirement system funds have exceeded their actuarial interest rate (the actuarial rate is the investment return target used by the systems' actuaries to determine its capacity to fully fund future benefits). Net of fees, PERS returned 7.13% (vs. 8.00% actuarial rate), PERS-HC 5.37% (vs. 5.00%), STRS 8.28% (vs. 7.75%), OP&F 7.77% (vs. 8.25%), SERS 7.31% (vs. 7.75%), and SHPRS 6.32% (vs. 8.00%).
- Over the trailing ten-year period, one fund (PERS-HC) has achieved its actuarial interest rate. Net of fees, PERS returned 5.74% (vs. 8.00% actuarial rate), PERS-HC 5.15% (vs. 5.0%), STRS 6.17% (vs. 7.75%), OP&F 6.35% (vs. 8.25%), SERS 5.13% (vs. 7.75%), and HPRS 5.17% (vs. 8.00%). During the same period, PERS and OP&F exceeded their fund benchmark. PERS-HC, STRS, SERS, and SHPRS trailed their fund benchmarks.

To summarize RVK comments:

1) Currently, all the funds are diversified across multiple asset classes and exhibit characteristics of prudent investment diversification. RVK further noted that the determination of a fund's asset allocation is the single most important investment decision and is a major determinant of long-term return and the volatility risk of asset values. However, RVK advised the ORSC to not assume that all the funds should have the same asset allocation. Differences in their liabilities, funding status, the risk tolerance of their fiduciaries

² R.C. 171.04.

³ The PERS health care portfolio (designated "PERS HC" by RVK) is tracked separately from the PERS pension benefit funds (designated as "PERS DB" or "PERS").

and other factors will likely produce legitimate differences in asset allocation. They advised the Council and retirement system boards to monitor changes in asset allocation over time.

2) RVK advised that, while the report focuses on recent information in return and risk taken at each of the funds, they strongly encouraged the Council to focus on the 3- and 5- year risk and return results to better gauge the stewardship of pension assets.

Investment Performance Review (January 1, 2016 – June 30, 2016)

The following summarizes the report received by the ORSC at its October 13, 2016, meeting and reflects the investment performance for all six funds⁴ for the period ending June 30, 2016. The findings of this report are briefly summarized as follows:

- Five of the six retirement system portfolios had positive results for the one-year period ending June 30, 2016 (HPRS had a negative return). STRS and SERS outperformed their policy benchmarks, with the remaining funds underperforming their benchmarks.
- Over the trailing five-year period, no fund has exceeded their actuarial interest rate (the actuarial rate is the investment return target used by the systems' actuaries to determine its capacity to fully fund future benefits; note that SERS and SHPRS reduced their actuarial rate during this period). Net of fees, PERS returned 6.87% (vs. 8.00% actuarial rate), PERS-HC 5.30% (vs. 6.50%), STRS 7.53% (vs. 7.75%), OP&F 7.30% (vs. 8.25%), SERS 6.90% (vs. 7.50%), and SHPRS 5.94% (vs. 7.75%).
- Over the trailing ten-year period, no fund has achieved their actuarial interest rate. Net of fees, PERS returned 5.77% (vs. 8.00% actuarial rate), PERS-HC 5.27% (vs. 6.50%), STRS 5.93% (vs. 7.75%), OP&F 6.26% (vs. 8.25%), SERS 4.96% (vs. 7.50%), and SHPRS 4.92% (vs. 7.75%). During the same period, PERS and OP&F exceeded their fund benchmark. The other funds trailed their fund benchmarks.⁵

RVK made the same summary comments as during the previous performance analysis:

1) Currently all the funds are diversified across multiple asset classes and exhibit characteristics of prudent investment diversification. RVK further noted that the determination of a fund's asset allocation is the single most important investment decision and is a major determinant of long-term return and the volatility risk of asset values. However, RVK advised the ORSC to not assume that all the funds should have the same asset allocation. Differences in their liabilities, funding status, the risk tolerance of their fiduciaries and other factors will likely produce legitimate differences in asset allocation. They advised the Council and system boards to monitor changes in asset allocation over time.

⁴ The PERS health care portfolio (designated "PERS HC" by RVK) is tracked separately from the PERS pension benefit funds (designated as "PERS DB" or "PERS").

⁵ Note that the PERS actuarial assumed rate was reduced to 7.50% after the RVK report was issued.

2) RVK advised that, while the report focuses on recent information in return and risk taken at each of the funds, they strongly encouraged the Council to focus on the 3- and 5- year risk and return results to better gauge the stewardship of pension assets.

30-YEAR FUNDING PLANS
THE 131st GENERAL ASSEMBLY
JANUARY 1, 2016 – DECEMBER 31, 2016

Each retirement system whose funding period exceeds 30 years in any given year is required to submit to the ORSC and the standing committees of the house and senate with primary responsibility for pension legislation a plan approved by the retirement board that reduces the funding period to no more than 30 years, along with any progress made by the board in meeting the 30-year funding period.⁶ This 30-year amortization refers to the amount of time the respective system would need to pay off all currently accrued but unfunded benefits. This standard was modeled after the national standard adopted by the Governmental Accounting Standards Board for all governmental pension plans. The change was intended to maintain inter-generational equity among taxpayers and system members by limiting the ability to fund current benefit costs by extending the funding period beyond 30 years. **Actuarial reports issued in 2016 indicate that all systems remain within the 30-year time frame for the second year in a row.** The actuarial reports are as of December 31, 2015, for PERS, OP&F, and SHPRS and June 30, 2016, for STRS and SERS.

Ohio is unique in requiring its state retirement systems to pay off all unfunded liabilities over a 30-year period. Lacking such a requirement, many other retirement systems across the country tend to focus on funded ratio. While the funded ratio is an important component in understanding the financial health of a retirement system, the ratio is a reflection of a system's funding at a *particular moment in time*, given certain actuarial assumptions. A funded ratio is less able to express the trajectory of a system through time, if all current conditions and actuarial assumptions remain stable. The funded ratio and the years of unfunded liabilities, therefore, are top-line numbers that express different things:

- 1) The **funded ratio** provides the current ratio of the systems assets versus their existing liabilities under current actuarial assumptions; and
- 2) The **years of unfunded liabilities** estimates the amount of time, given the retirement system's current plan design and actuarial assumptions, to reach a 100% funded ratio.

The following table summarizes the funding period and funded ratio of each retirement system as reported in its last actuarial valuation:

	Years of Unfunded Liabilities	Funded Ratio
PERS	19	85.0%
OP&F	29	71.3%
STRS	26.6	69.6%
SERS	28	67.3%
SHPRS	30	68.6%

⁶ R.C. 145.221, 742.16, 3307.512, 3309.211, and 5505.121.

STATUS OF HEALTH CARE FUNDS
THE 131st GENERAL ASSEMBLY
JANUARY 1, 2016 - DECEMBER 31, 2016

In 1974, the five public retirement boards were given broad discretionary authority to provide health care coverage to retirees and their dependents. Unlike pension benefits, which are vested on retirement, health care benefits are not a vested right under Ohio's public pension laws. Therefore, the courts have determined that the boards are authorized to change the premiums, eligibility, and level of health care benefits at any time. A 2004 ruling by the Tenth District Court of Appeals⁷ upheld the discretionary nature of health care benefits in a lawsuit that had attempted to prevent the SERS Board from making changes to its health care plan. The Ohio Supreme Court let this decision stand in May 2005 when it declined to review the case.

Since 1974, each system has provided some level of comprehensive hospital, medical, and prescription drug coverage. In 1977, the systems were required by law to reimburse benefit recipients for Medicare Part B premiums (medical). Additionally, retirees who do not qualify for Medicare Part A (hospital) are provided equivalent coverage under the systems' health care plans or are provided access through a Medicare Connector. All employees hired on or after April 1, 1986, are required by federal law to contribute to Medicare and will therefore not require this equivalent coverage. Employees hired before that date were not required to contribute to Medicare.

Beginning in 2006, Medicare began offering a prescription drug benefit known as Medicare Part D. Low income retirees who qualify for a government subsidy for their Medicare prescription drug benefit may fare better under Medicare D than the systems' plans. These low income retirees will need to determine which prescription drug plan is better for them.

Controlling health care costs has been and continues to be a major concern for Ohio's retirement systems. In calendar year 2015, the total cost of providing retiree health care was approximately \$2.92 billion. As employee contributions are used solely to fund pension benefits under federal and state law, any discretionary health care costs borne by the retirement systems must be financed by excess employer contributions only; the systems are not permitted to use any employee contributions for health care.⁸

The retirement systems' actuaries annually review the amount of contributions required to fund vested pension benefits. Employer contributions in excess of what is needed to support those benefits can be allocated to health care. Each year the retirement systems review their health care plans and make adjustments as needed. The following chart indicates the percentage of employer contributions each system allocated to health care during 2016 and the projected solvency period for each system's health care fund.

⁷ Ohio Association of Public School Employees, et al. v. School Employees Retirement System Board, et al. (2004).

⁸ R.C. 145.47, 26 U.S.C. 401(a), and 26 U.S.C. 401(h).

Ohio Retirement System	Percentage of Employer Contribution Allocated to Health Care in 2016	Projected Solvency Period for Health Care Funds (as of 2015)
PERS	2.00%	Indefinite ⁹
STRS	0.00%	2031
SERS	0.00%*	2024
OP&F	0.50%	2025
SHPRS	4.00%	2026

*Does not include employer health care surcharge of up to 1.5% state average of total active member payroll.

⁹ "Indefinite" means that the PERS actuary has projected that the PERS health care plan will remain solvent for over 100 years.

REPORTS ON ENACTED PENSION LEGISLATION
THE 131st GENERAL ASSEMBLY
JANUARY 1, 2015 - DECEMBER 31, 2016

Am. Sub. H.B. 2

Am. Sub. H.B. 2 generally makes changes to the states' charter school operations. This summary is limited to those provisions of the bill that pertain to the five public retirement systems. The Act:

- Excludes from STRS or SERS membership certain persons who are employed by community school operators and are subject to Social Security (R.C. 3307.01(B)(2)(b), 3309.011, 3309.013, and 3314.10.)

ORSC Position - The ORSC took no action on this bill.

Effective Date - February 1, 2016

Am. Sub. H.B. 64 (Biennial Budget bill)

Am. Sub. H.B. 64 made numerous changes to state law and established the biennial budget. This summary is limited to those provisions of the bill that pertain to the five public retirement systems. The Act:

- Freezes at current rates the percentage of an alternative retirement program (ARP) participant's compensation that must be paid by a public institution of higher education to the Public Employees Retirement System (PERS) (0.77%), State Teachers Retirement System (STRS) (4.5%), or School Employees Retirement System (SERS) (6%), to mitigate any financial impact of the ARP on the retirement system (R.C. 3305.052 and 3305.062).
- If the STRS Board increases the mitigating rate for ARPs between July 1, 2015, and September 29, 2015, then the Board is required to repay each public institution the difference between the Board's rate and 4.5% and reimburse each institution for expenses related to increasing the rate and caps the rate at 4% until the difference is repaid (Section 733.40 of Am. Sub. H.B. 64).
- Eliminates provisions requiring each state public retirement system board to annually submit to the Ohio Retirement Study Council two reports related to securities transactions and asset management: one on Ohio-qualified agents and minority business enterprises and one on Ohio-qualified investment managers (R.C. 145.114, 145.116, 742.114, 742.116, 3307.152, 3307.154, 3309.157, 3309.159, 5505.068, and 5505.0610).

ORSC Position - The ORSC took no action on this bill.

Effective Date - June 30, 2015

Am. Sub. H.B. 305

Am. Sub. H.B. 305 includes new non-teaching employees of the University of Akron as members of PERS rather than SERS (R.C. 145.011).

ORSC Position – The ORSC approved H.B. 305 with suggested amendments at the November 12, 2015 meeting.

Effective Date – September 28, 2016

Sub. H.B. 340 (Biennial Budget correction bill)

Sub. H.B. 340 makes numerous changes to state law and the biennial budget. This summary is limited to those provisions of the bill that pertain to the five public retirement systems.

The Act:

- Modifies Am. Sub. H.B. 2, provisions addressing STRS and SERS charter school membership to provide that, for the STRS and SERS exclusion to apply, the operator must have been paying Social Security taxes on or before February 1, 2016 (R.C. 3307.01 and 3309.013).
- Under Am. Sub. H.B. 2 a teacher employed by a community school operator that withholds and pays Social Security taxes is included in STRS membership only if the teacher has contributing service in a community school in Ohio within one year preceding the later of July 1, 2016, or the date on which the operator for the first time withholds and pays Social Security taxes for the teacher. The bill changes the July 1, 2016, date to February 1, 2016, the effective date of Am. Sub. H.B. 2 (R.C. 3307.01 and 3309.013).

ORSC Position - The ORSC took no action on this bill.

Effective Date – December 22, 2015

Am. Sub. H.B. 520 (Omnibus retirement bill)

Am. Sub. H.B. 520 makes administrative and clarifying changes to the laws governing the five state retirement systems. It modifies the calculation used to determine the mitigating rate applying to alternative retirement plan (ARP) participants. The Act:

- Makes a significant number of administrative changes to all retirement systems.
- Eliminates a freeze on the ARP mitigating rate and establishes a new formula (R.C. 145.222, 3307.514, and 3309.212).
- Expands PERS-LE positions (R.C. 145.01).

ORSC Position - The ORSC approved H.B. 520 with suggested amendments at its October 13, 2016 meeting.

Effective Date – April 6, 2017

Sub. S.B. 27

Sub. S.B. 27 provides a statutory presumption that a firefighter who is disabled as a result of certain cancers incurred the cancer while performing his or her official duties. The Act:

- Specifies that exposure to all carcinogens in group 1 or 2A, as classified by the International Agency for Research on Cancer, are covered by the act (R.C. 745.38).
- Provides for a rebuttable presumption under certain conditions (R.C. 745.38).
- Requires the firefighter to have been assigned to at least six years of hazardous duty (R.C. 748.38).

ORSC Position - The ORSC approved S.B. 27 with suggested amendments at the June 9, 2016 meeting.

Effective Date – April 6, 2017

PENDING PENSION-RELATED ISSUES AND RECOMMENDATIONS
THE 131st GENERAL ASSEMBLY
JANUARY 1, 2016 - DECEMBER 31, 2016

The ORSC staff keeps legislators aware of relevant public retirement issues and of prior recommendations that have been made but not acted upon by the legislature. There remain a number of issues and recommendations that continue to warrant legislative consideration. At its September 2014, meeting, the ORSC asked its staff to update these recommendations that have not been acted on. The list was presented and accepted at its November 2014 meeting. What follows is a brief summary of each issue and of action taken by the legislature or the ORSC, if any, in the 131st General Assembly.

Community School Employees in STRS and SERS

Amendments to Am. Sub. H.B. 2 and Sub. H.B. 340 provided that certain community school employees would contribute to Social Security rather than STRS or SERS, and certain existing community school employees already contributing to both STRS and SERS would continue to dually contribute. ORSC staff issued a memo on November 2, 2015, discussing the issue and noted that determination of these individuals is a matter unresolved by the IRS and that Ohio's Section 218 Agreement does not permit dual contribution to Social Security and a state retirement system. ORSC staff remarked that, depending on IRS eventual determination, additional changes to Am. Sub. H.B. 2 and Sub. H.B. 340 in the future may be required.

Increase of mitigating rate by STRS

Certain members of STRS may participate in the alternative retirement plan (ARP) rather than the STRS defined benefit plan. If they do so, a portion of the employer contribution is diverted to the defined benefit plan rather than accruing to the benefit of the member; this is referred to as the *mitigating rate*.

In 2000, this rate was set at 6%. That rate was later adjusted to 5.76% according to an actuarial study. In 2001, STRS established its own defined contribution plan (STRS DC) and set the mitigating rate for that plan at 3.5%. In response, the General Assembly took two actions that affirmatively reduced the mitigating rate and placed it under increased control of the General Assembly. First, H.B. 535 of the 123rd General Assembly removed a requirement that an actuarial study automatically increase or decrease the mitigating rate and instead provided that the ORSC was to conduct an analysis triennially and *permitted* to adjust the rate as reflected in the analysis.¹⁰ Second, H.B. 94 of the 124th General Assembly provided that the ARP rate could not, under any circumstances, exceed the STRS DC rate. By operation of law under H.B. 94, the ARP rate decreased to 3.5%, where it remained until

¹⁰ The last report was completed in 2005 and suggested a rate of 8.64%. ORSC took no action on receiving this report. No analysis was completed in either 2008 or 2011. According to the triennial schedule, the next analysis was due 2014, but under motion of the ORSC, H.B. 483 delayed that study to 2015, by which time the freeze on rates by H.B. 64 was in effect.

June of 2013. At that time, STRS raised its DC rate to 4.5% and required employers to raise the ARP rate to 4.5% as well.

In response to these actions, the ORSC requested that the Attorney General issue an opinion specifying whether it is the ORSC or STRS that has the authority to raise the ARP mitigating rate. The Attorney General issued Opinion 2013-024 in July of 2013. This opinion indicated that STRS does not have the authority to independently modify the ARP mitigating rate and that the authority to do so, with restrictions, rested with the ORSC. At the time, the ORSC had not altered the mitigating rate, and therefore it appeared the rate should remain at 3.5% by operation of H.B. 94 of the 124th General Assembly. However, STRS continued to require employers of ARP participants to remit 4.5% rather than 3.5%.

H.B. 483 of the 130th General Assembly provided that the rate could not exceed 4.5% and required the ORSC to issue a report on the rate. The ORSC staff report noted that the mitigating rate analyses have been inconsistent and made a number of recommendations to improve the mitigating rate process. At its December 11, 2014, meeting, the ORSC accepted the report and asked staff to work with the ORSC consulting actuary to recommend a new rate and process for determining that rate.

Subsequent to that meeting, Am. Sub. H.B. 64 of the 131st General Assembly froze the ARP contribution rates as follows:

PERS 0.77%
STRS 4.50%
SERS 6.00%

In 2016, H.B. 520 removed these frozen rates and established a statutory formula to be reset each 5-year period. According to actuarial analysis completed pursuant to H.B. 520, the rates for the next five years are as follows:

PERS 2.44%
STRS 4.47%
SERS 3.48%

With a statutory formula in place, the mitigating rate is no longer subject to review by the ORSC.

Triennially reporting of valuations

Pension reform during the 129th General Assembly included a modification of the timing of certain reports issued by OP&F. One modification required triennial valuations by OP&F, rather than annual.¹¹ The ORSC recommended during pension reform that this provision remain annual, an opinion concurred upon by independent consultants and again supported by the Council during the 130th General Assembly. No action has been taken by the General Assembly to revert the requirement to an annual valuation report. However, because of concern expressed by Council members, at the September 12, 2013, ORSC meeting, OP&F Director John Gallagher indicated that OP&F would continue to supply annual valuation reports to the Council. The ORSC staff continue to support a statutory change to require such reporting.

¹¹ R.C. 742.14(A).

Board Authority

A component of pension reform in the 129th General Assembly was the authority of OP&F, SERS, STRS, and SHPRS to independently adjust the plan design features of their respective retirement system. Pension reform required the ORSC to review that authority. At the April 9, 2013, ORSC meeting, the ORSC recommended that the board authority provisions be modified in the following ways: 1) Any plan design change must receive actuarial review; 2) Any plan design change receive review and prior-approval by the ORSC; 3) The board authority provisions be standardized and consistent among the systems; and 4) That objective, measurable standards be established to determine when a board is authorized to make or propose plan design adjustments.

There has been no further action on this recommendation.

Ad hoc report on disability experience of law enforcement/Report standardization project

In November of 2012, Representative Schuring requested that ORSC staff provide an accounting of the disability experience of the law enforcement divisions, with recommendations to improve its functionality. ORSC staff issued a report in November 2014. The ORSC took no action on the report, but did ask staff to suggest a process to standardize all reports provided by the retirement systems to the Council. At its December 11, 2014, meeting, the ORSC modified then accepted a staff plan to standardize a number of reports. ORSC staff have completed the standardization of three reports (the Iran/Sudan Divestiture Report, Internal Audit Report, and Budget Report) and are continuing the standardization project in 2017. Additional reports to be standardized are the Annual Health Care Report and the Annual Disability Report.

Actuarial Funding of Pension Benefits

There are generally three sources of revenue for the public retirement systems to fund, on an actuarial basis, their defined benefit plans: (1) employee contributions; (2) employer contributions; and (3) investment earnings. Investment earnings are typically the largest source of revenue for the five public retirement systems, funding up to 75% of the benefits paid. Therefore, the experience of a retirement system meeting its actuarial interest rate is essential to funding promised benefits. The actuarial interest rate is the rate of return the retirement system uses in anticipating sufficient funding levels in the future. Two points of data reviewed by ORSC staff are the experience of the systems in meeting their rate over a 10-year period and the statutorily required analysis of the adequacy of contribution rates for OP&F.

10-year actuarial interest rates The most recent semi-annual investment review required by law as of June 30, 2016, indicated that over the trailing 10-year period, no fund has achieved their actuarial interest rate, even after three of the systems lowered their assumed rates. Net of fees, PERS returned 5.77% (vs. 7.50% actuarial rate), PERS-HC 5.27% (vs. 6.50%), STRS 5.93% (vs. 7.75%), OP&F 6.26% (vs. 8.25%), SERS 4.96% (vs. 7.50%), and SHPRS 4.92% (vs. 7.75%).

It is important to note that while no system has met their actuarial rate, they are able to pay off all accrued benefits over a 30-year period as required by law. The success of a system in meeting its long term actuarial interest rate is one of the most closely monitored

data points by the Council, but it is not the sole determining factor of adequate pension funding. Even so, the failure to meet the actuarial rate is of concern and was analyzed by PERS, SHPRS, and SERS during their 5-year experience review study occurring in 2016. As a result of this statutorily required review, all three systems reduced their assumed actuarial review. PERS reduced their rate to 7.50% (from 8.00%), SERS reduced to 7.50% (from 7.75%), and SHPRS reduced their rate to 7.75% (from 8.00%). STRS and OP&F will conduct their 5-year review in 2017.

Adequacy of OP&F contribution rates The ORSC is required to conduct an annual study on the adequacy of contribution rates of OP&F.¹² The PTA/KMS 2015 report is pending review.

Cost and funding of retiree health care benefits

All of the retirement systems face significant challenges controlling health care costs while maintaining meaningful coverage. The significant investment losses experienced from March 2000 to March 2003 as well as during the recession of 2008-2009 have exacerbated the health care funding problem since the retirement systems must first fund guaranteed pension benefits, which has required a reduction in the amount allocated to discretionary retiree health care benefits. The early retirement ages for many public employees create an additional challenge for each retirement system's health care program.

Remove 13th check authority in STRS

R.C. 3307.671 permits the STRS Board to provide a supplemental benefit to retirees. This has often been referred to as the "13th check." The repeal of this section was initially advocated in 1996 under the "Joint Legislative Committee to Study Ohio's Public Retirement Plans"¹³ and ORSC staff continue to support its immediate removal from the Ohio Revised Code.

Update past studies relative to disparity of employer rates in OP&F

Employer contribution rates for police and fire fighters are established in statute. Police employers are required to contribute an amount equal to 19.50% of salary, while fire fighter employers are required to contribute 24%. In its annual study on the adequacy of contribution rates, ORSC's previous actuary, Milliman, recommended a blending and equalizing of those rates at a weighted average of 21.5%.¹⁴ Their position was that without equalizing the rates fire fighters are in part subsidizing the benefits of police officers. Previous funding plans proposed by OP&F have also proposed equalizing the rates. At its September 2012 meeting, Rep. Schuring requested that the ORSC provide an update on this policy issue. PTA/KMS will provide an update on this policy issue in its 2015 annual adequacy report.

¹² R.C. 742.311.

¹³ 1996 Joint Legislative Committee to Study Ohio's Public Retirement Plans, chaired by Sen. Cooper Snyder and Rep. Dale Van Vyven.

¹⁴ Milliman USA letter to ORSC dated June 6, 2002.

Reemployment Provisions

There continues to be legislative interest in the reemployment provisions of the five public retirement systems that allow members who have been retired to return to public employment while continuing to receive their pension. Recommendations have varied depending on if the re-employment resulted from a “*retired-rehired*” process, in which the member retired and then was rehired in the exact same position, versus so-called “*double-dipping*,” where the member retires and returns to employment in a new capacity (for instance, a teacher retiring to become a state legislator). In the past, the Council has recommended that the reemployment provisions be standardized and more robust penalties be issued for “retired-rehired” situations, rather than establishing a uniform prohibition of re-employment.

Annual 3% COLA

In its analysis of H.B. 157 (eff. 2-1-02), which provided for an annual 3% COLA in all five public retirement systems, regardless of the actual percentage change in the CPI-W (Consumer Price Index-Urban Wage Earners and Clerical Workers), the ORSC staff recommended against the COLA changes under the bill and suggested that “any additional resources of these retirement systems be allocated to the provision of discretionary retiree health care benefits that are neither taxable nor subject to the Social Security offset and/or the provision of ad hoc increases, such as a ‘purchasing parity’ adjustment of some target ratio of either 75% or 85%, to retirees whose benefits have been eroded the most by inflation over the years.” The ORSC rejected the staff recommendation and recommended instead that the legislature approve H.B. 157. Since enactment, only four of fifteen years have seen an increase of greater than 3% in CPI-W and six of those years experienced inflation of less than 2%.

Under pension reform, COLA has been modified. For OP&F, COLA for certain members is reduced to the lesser of 3% or CPI, for SHPRS the Board is authorized to provide a COLA of up to 3%, for STRS 2% and a suspension of COLA for certain members, and for PERS the lesser of 3% or CPI for certain members. SERS continues to provide a 3% benefit, but is in discussion with interested parties to reduce the COLA in 2017.

Mandatory Social Security

The State of Ohio has a long and successful record of opposing mandatory Social Security coverage for its public employees. This issue continues to resurface in the context of various Social Security reform proposals as a means of generating additional revenues for Social Security. The General Assembly has consistently opposed efforts to require Social Security participation.

Purchase of Service Credit

Pursuant to the ORSC’s request, Milliman completed a report on the cost of purchasing service credit in 2007. 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 or amount of

health care benefits, then the additional health care liabilities would be eliminated. The report revealed that the retirement systems subsidized the purchase of credit in nearly every case in 2005.

Pension reform has largely eliminated this subsidization. Any additional purchases requiring subsidization that were inadvertently excluded should be reviewed to determine if they should likewise be modified.

Independent Legal Counsel

The ORSC contracted with Independent Fiduciary Services to complete fiduciary audits of STRS and OP&F. These reports were completed in 2006. One of the recommendations was that Ohio law should be amended to authorize the retirement systems' boards to retain independent outside legal counsel without the prior approval of the State Attorney General. This recommendation has not been acted upon but was reaffirmed by the ORSC at its November 2014 meeting.

Custodian

Another recommendation from the 2006 fiduciary audits of STRS and OP&F that has not been acted upon was that the applicable Ohio statutes should be amended to grant authority to select, contract with, manage, and terminate the financial institution(s) that will provide master custody services to the retirement systems, which are subject to the oversight jurisdiction of the ORSC. ORSC reaffirmed this position at its November 2014 meeting.

Review of policy framework for pensions

During its 2012 review, PTA/KMS stated that "a well-defined public policy acts as a standard against which any proposal can be fairly analyzed." They found that the current ORSC policy statement appeared to be dated, incomplete, and on occasion inconsistent with current practices and provisions. From existing files, it appears the ORSC "Principles Governing Pensions" has not been amended since its adoption in 1978.

PTA/KMS recommended that the ORSC consider updating this policy framework. ORSC indicated its support in a November 2014 motion.

Implement a declining 30-year funding policy

PTA/KMS recommended that the 30-year funding policy be modified to provide that it is an absolute funding limit rather than a minimum standard. They recommended a removal of the 30-year funding period as an objective in favor of the establishment of a declining 30-year period that aims for a funding period of 15-20 years.¹⁵

At its February 2015 meeting, the STRS Board adopted a closed 30-year funding period beginning July 1, 2015 (meaning that in 30 years, STRS liabilities would be fully funded). The SERS funding policy has advocated for a closed 30-year funding period since 1998.

¹⁵ Forna, Bournival, and Schrader, 36.

DOCUMENTS STATUTORILY REQUIRED OF THE RETIREMENT SYSTEMS
THE 131st GENERAL ASSEMBLY
JANUARY 1, 2016 - DECEMBER 31, 2016

The retirement systems are required by statute to submit various documents to the ORSC to assist the Council in its evaluation of the systems. The following is a listing of each report the retirement systems are required to submit to the ORSC along with a very brief summary of the contents of the report. Copies of completed reports can be obtained at the ORSC office and the ORSC website (orsc.org).

Annual Actuarial Valuation (R.C. 145.22(A), 742.14(A), 3307.51(A), 3309.21(A), 5505.12(A))

This annual report is an actuarial valuation of the pension assets, liabilities, and funding requirements of the retirement systems. With the exception of OP&F which requires triennial valuations, the actuarial valuation must be submitted annually to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued.

Annual Report on Health Care (R.C. 145.22(E), 742.14(E), 3307.51(E), 3309.21(E), 5505.12(E))

This report provides a full accounting of the revenues and costs relating to health care benefits. The report on health care must be submitted annually to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued.

Quinquennial Evaluation (R.C. 145.22(B), 742.14(C), 3307.51(B), 3309.21(B), 5505.12(B))

This report must be completed at least once every five years. It is an actuarial investigation of the mortality, service, and other experience of the members, retirees, contributors, and beneficiaries of the system to update the actuarial assumptions used in the actuarial valuation. The quinquennial evaluation must be submitted to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation. In 2016, PERS, SERS, and SHPRS completed their review. The STRS and OP&F reviews are due in 2017.

Annual Report on Disability Experience (R.C. 145.351, 742.381, 3307.513, 3309.391, 5505.181)

The report details the preceding fiscal year of the disability retirement experience of each employer. The report must specify the total number of disability applications submitted, the status of each application as of the last day of the fiscal year, total applications granted or denied, and the percentage of disability benefit recipients to the total number of the employer's employees who are members of the respective retirement system. The report on the disability experience must be submitted to the Governor, the ORSC, and the chairpersons of the standing committees and subcommittees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued.

30-Year Funding Period (R.C. 145.221, 742.16, 3307.512, 3309.211, 5505.121)

This report is required if the system's funding period exceeds 30 years. The report must include a plan approved by the board that indicates how the board will reduce the amortization period of unfunded actuarial accrued liability to not more than 30 years. The report on the 30-year funding period must be submitted to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation not later than 90 days after the retirement system board receives the actuarial valuation in which the funding period exceeds 30 years. No 30-year plans were required in 2016.

Actuarial Analysis of Legislation (R.C. 145.22(D), 742.14(D), 3307.51(D), 3309.21(D), 5505.12(D))

These reports are required when any introduced legislation is expected to have a measurable financial impact on the retirement system. The actuarial analysis must be submitted to the ORSC, the Legislative Service Commission, and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation within sixty days from the date of introduction of the legislation. Actuarial analyses were completed for H.B. 520 and for the companion bills of H.B. 292/S.B. 27.

Budgets (R.C. 145.092, 742.102, 3307.041, 3309.041, 5505.062)

Each retirement system is required to submit to the ORSC its proposed operating budget, along with the administrative budget for the board, for the next immediate fiscal year at least 60 days before adoption of the budget. The budgets were timely submitted.

Audit Committee Report (R.C. 145.095, 742.105, 3307.044, 3309.044, 5505.111)

Each retirement system is required annually to submit to the ORSC a report of the actions taken by its Audit Committee. These reports were timely issued.

Rules

The systems are required to submit to the ORSC a copy of the full text, rule summary, and fiscal analysis of each rule they file with the Joint Committee on Agency Rule Review pursuant to R.C. 111.15. The systems rules were reviewed in 2016 and any concerns were resolved through ORSC meetings.

Divestment of Assets in Iran and Sudan

Section 707.20 of H.B. 562 of the 127th General Assembly required OP&F to establish a policy for the identification of businesses in which the fund has direct or indirect holdings that are engaged in scrutinized activities in Iran or Sudan and a policy to divest those holdings. OP&F has continued to report on those efforts and, as of January 2017, had reduced the market value of those holdings by 99.68%. The other retirement systems have also developed a policy of divestiture of holdings of companies conducting business in Iran and Sudan and have continued to decrease those holdings.

DOCUMENTS STATUTORILY REQUIRED OF THE ORSC
THE 131st GENERAL ASSEMBLY
JANUARY 1, 2016 - DECEMBER 31, 2016

The ORSC is required by statute to issue various reports. The following is a listing of each report that ORSC is required to complete along with a very brief summary of the contents of the report. Copies of completed reports can be obtained at the ORSC office or the ORSC website (orsc.org).

Investment Performance (R.C. 171.04(D))

The ORSC is required to semiannually review the policies, objectives, and criteria of the retirement systems' investment programs, including a review of asset allocation targets and ranges, risk factors, asset class benchmarks, time horizons, total return objectives, relative volatility, and performance evaluation guidelines. **ORSC's consultant provided these reviews at the May and October ORSC meetings.**

10-Year Actuarial Review (R.C. 171.04(E))

The ORSC is required, at least once every 10 years, to complete an actuarial review of the actuarial valuation and quinquennial actuarial investigation of the retirement systems, including a review of the actuarial assumptions and methods, the data underlying the valuations and investigations, and the adequacy of each system's employee and employer contribution rates to amortize its unfunded liability.

A 10-year report of PERS was issued in 2015. That report was issued by PTA/KMS and found that the actuarial valuation and quinquennial investigations for PERS were "reasonable, consistent and accurate. [PTA/KMS does] not believe that any methods, assumptions, or calculations are erroneous to the level of necessary recalculations." *Once PTA/KMS presents the report to the PERS board, the 10-year actuarial review for PERS will be complete.*

PTA/KMS is currently completing the 10-year actuarial review of OP&F for submission in the first half of 2017.

10-Year Fiduciary Performance Audit (R.C. 171.04(F))

The ORSC is required, at least once every 10 years, to complete a fiduciary performance audit of each retirement system. **The 10-year fiduciary audit of SERS began in 2016 and ORSC staff anticipate issuing the report in the first half of 2017.**

Annual Review of OP&F Contribution Rates (R.C. 742.311)

The ORSC is required, annually, to review the adequacy of employer and employee contribution rates under OP&F and make recommendations on the proper financing of the benefits of the Fund. **This report was completed in 2016 and ORSC staff anticipates issuing the report in the in the first half of 2017** (See *Pending Pension Related Issues*, above).

ORSC Annual Budget (R.C. 171.05)

The ORSC is required, annually, to submit a budget of its expenses. **The ORSC budget was submitted in June of 2016.**

ORSC Annual Report (R.C. 171.04)

The ORSC is required, annually, to submit a report on its evaluation and recommendations regarding the state retirement systems. **The 2015 report was submitted in March 2016.**

STATUS OF PENSION LEGISLATION
THE 131th GENERAL ASSEMBLY
JANUARY 1, 2015 - DECEMBER 31, 2016

HOUSE BILLS

House Bill	H. introduction	Actuarial Received	Subject, Sponsor, and System	ORSC Pos	H Cmte	Reported Out – Floor Vote	Sen introduction	S Cmte	Reported Out – Floor Vote	Conf Cmte	Concurrence	Eff Date
2	1/28/15	-	Charter school participation STRS and SERS-Dovilla	-	EDU	3/25/15-3/26/15	3/31/15	EDU	6/25/15-6/25/15	Yes	H 10/07/15 S 10/07/15	2/01/16
11	1/28/15	N/A	PERS judge healthcare-Bremner	N/A	JUD	3/4/15-3/17/15	3/18/15	CVJ	6/11/15-9/23/15		9/30/15	10/19/15
64	2/11/15	N/A	Teaching permits, ARP rates, and ORSC Manager report-Smith	N/A	FIN	4/21/15-4/22/15	4/27/15	FIN	6/17/2015-6/18/2015	Yes	S 6/25/2015 H 6/26/2015	Various
257	6/10/15		Re-employed retirees-Becker	-	FIN							
284	7/7/15	N/A	Forfeiture of benefits-Dovilla and Antelski	AA	JUD	1/27/16						
292	7/22/15	Yes	Cancer presumption-Hagan	AA	INS							
305	8/25/15	Yes	Akron employees-Schuring	AA	HG/RR	12/9/15 (2/2/16-2/7/16)- 2/23/16	2/24/16	SGO	5/10/2016-5/17/2016			9/28/2016
311	8/31/15		STRS ARP rate-Schuring	-	HG							
340	9/28/15	N/A	Charter school participation STRS and SERS-Amstutz	N/A	SG	10/19/15-10/27/15	10/29/15	FIN	12/9/15-12/9/15		12/9/15	12/22/15
503	3/30/16	N/A	Agency rule review-Duffley	AA	GOV							
520	4/13/16	Yes	Retirement Ornitibus-Schuring and Ramos	AA	HA	11/15/2016-11/17/2016	11/22/2016	SLG	12/7/2016-12/8/2016		12/8/2016	4/6/2017
H.J.R. 6	2/2/16	N/A	Retirement system investments-Johnson	D	GOV							

SENATE BILLS

Sen Bill	S. introduction	Actuarial Received	Subject, Sponsor, and System	ORSC Pos	Sen Cmte	Reported Out – Floor Vote	H introduction	H Cmte	Reported Out – Floor Vote	Conf Cmte	Concurrence	Eff Date
3	2/2/15	-	High Performing School Districts-Sen. Hite and Faber	N/A	ED	3/23/2015-3/25/2015	3/26/2015	ED	12/7/2016-12/8/2016		12/8/2016	3/16/2017
11	2/2/15	N/A	Volunteer Firefighter Dependents Fund-Sen. Eklund	N/A	INS	10/13/2015-10/14/2015	10/19/2015	INS	11/19/15-12/8/15		12/8/2015	3/23/2016
27	2/9/15	N/A	Firefighter cancer presumption-Sen. Patton		FI	4/13/2016-4/13/2016	4/14/2016	INS	12/6/2016-12/7/2016		12/7/2016	4/6/2017
38	2/9/15	-	State contracts-Seitz	N/A	GOV	3/11/2015-3/18/2015	3/19/2015	GOV	4/29/2015-4/29/2015		4/29/2015	8/12/2015
303	3/30/16	N/A	Agency rule review-Decker	AA	GOV							

HOUSE COMMITTEES

ARD Agriculture & Rural Development
 ASV Armed Services, Veterans Affairs, and Public Safety
 COM Commerce and Labor
 CFA Community and Family Advancement
 EWD Economic and Workforce Development
 ED Education
 ENR Energy and Natural Resources
 FIN Finance
 FHD Financial Institutions, Housing, & Urban Development
 GOV Government Accountability and Oversight
 HG Health & Aging
 INS Insurance
 JUD Judiciary
 LOC Local Government
 PU Public Utilities
 RR Rules & Reference
 SG State Government
 TI Transportation and Infrastructure
 WM Ways & Means

SENATE COMMITTEES

AG Agriculture
 CVJ Civil Justice
 CL Commerce and Labor
 CRJ Criminal Justice
 ED Education
 ENR Energy and Natural Resources
 FIN Finance
 FI Financial Institutions
 GOV Government Oversight and Reform
 HHS Health and Human Services
 INS Insurance
 MED Medicaid
 PU Public Utilities
 RR Rules and Reference
 SLG State and Local Government
 TR Transportation, Commerce, and Labor
 WM Ways & Means

LEGISLATIVE ACTION

A Amended
 S Substitute
 P Postponed Indefinitely
 R Rereferred
 V Vetoed
 E Emergency
 CR Concurrence Refused

ORSC POSITION

A Approved
 D Disapproved
 AA Approved with Amendment
 AD Action Deferred
 N/A No Action Required