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Annual Report 2007

Evaluations and Recommendations Regarding the Operations of the State Retirement Systems and Their Funds

First Half of the 127th General Assembly
January 1, 2007 – December 31, 2007

January 2008

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ANNUAL REPORT

FIRST HALF OF THE 127TH GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

January 2008

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Introduction

The Ohio Retirement Study Council (ORSC) is pleased to submit this report on the five state retirement systems and the fund for volunteer firefighters for the period beginning January 1, 2007 and ending December 31, 2007. This report is submitted pursuant to section 171.04(B) of the 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"*.

The State of Ohio has a long and successful track record regarding its five statewide retirement systems. The oldest of these retirement systems is the State Teachers Retirement System (STRS), which was created in 1920 for teachers in the public schools, colleges, and universities. The Public Employees Retirement System (PERS) was created in 1935 for state employees, with local government employees added in 1938. The School Employees Retirement System (SERS) was created in 1937 for non-teaching employees of the various local school boards. The Highway Patrol Retirement System (HPRS) was created in 1941 by the withdrawal of all state troopers from PERS. The Ohio Police and Fire Pension Fund (OP&F) was created in 1967 after the abolition of 454 local police and fire relief and pension funds, many of which predated the Social Security System created in 1935 and many of which were on the verge of financial insolvency. A special retirement program administered by PERS was subsequently created in 1975 for certain law enforcement officers, including sheriffs, deputy sheriffs, township police and various others. Today the five systems have combined assets of over $174 billion (as of January 1, 2007) and approximately 715,000 active contributing members, 584,000 inactive members, and 365,000 beneficiaries and recipients. The January 22, 2007 issue of <u>Pensions and Investments</u> included a list of the top 200 public and private pension funds in the nation. Four of Ohio's five public retirement systems are listed in the top 200. PERS ranked 14th out of all public and private; STRS ranked 18th out of all public and private funds; OP&F ranked 111th; while SERS ranked 116th among all public and private pension funds.

Created in 1968, ORSC was one of the first permanent pension oversight commissions in the nation. The Council was designed to develop legislative leadership in the area of retirement pensions for public employees. It is empowered 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. It must report to the Governor and the General Assembly concerning its evaluation and recommendations with 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 also reviewed the retirement systems' investment performance, operating

budgets, and compliance with various provisions of S.B. 133 (eff. 9-15-04). In addition, ORSC staff presented to the Council analyses of legislation and updates on administrative rules filed by the systems. The analyses of legislation always contain staff recommendations and staff makes recommendations regarding changes in proposed administrative rules as needed.

All of the Council's reports and legislative analyses can be found on the Council's website at www.orsc.org. In addition, the website contains links to all five retirement systems, their laws, and various pension-related organizations. Staff recently archived all legislative changes to the laws affecting the ORSC and each retirement system. These archived laws are now available on our website.

This report is a compilation of the evaluations and recommendations the Council made throughout the year. It provides a summary of the ORSC reports completed during 2007, pending public retirement issues, and staff recommendations. In addition, it provides a historical record of legislative action taken by the 127th Ohio General Assembly on bills affecting PERS, STRS, SERS, OP&F, HPRS and the Volunteer Fire Fighters' Dependents Fund (VFFDF).

The report is divided into nine sections: Systems' Investment Performance; Status of Health Care Funds; Actuarial Reviews; Reports on Pending Pension Legislation; Reports on Enacted Pension Legislation; Pending Pension-Related Issues; Documents Submitted by the Retirement Systems; Subject Index of Pension Bills Introduced; and Status of Pension Legislation.

The Systems' Investment Performance section provides a summary of the investment performance reviews completed by Evaluation Associates, LLC (a subsidiary of Milliman), during 2007. The full reports can be obtained from the ORSC office or on the ORSC website: www.orsc.org.

The Status of the Health Care Funds provides a summary of the major changes made to the systems' health care benefits for 2008. The summaries of health care plan changes include an overview of changes the systems made relative to prescription drugs, benefits, premiums, eligibility, and plan design. In addition, it provides information regarding the amount of employer contributions that will be allocated to healthcare during 2008.

The Actuarial Reviews section provides a summary of the actuarial reviews completed by the ORSC actuary, Milliman, during 2007. The full reports can be obtained from the ORSC office or on the ORSC website.

The Reports on Pending Pension Legislation section provides a detailed examination of each pension bill the ORSC has taken a position on during the first half of the 127th Ohio General Assembly, including the name of the principal sponsor, a description of its contents, its fiscal impact, and the ORSC position. These reports are intended to give the reader an awareness and understanding of all substantive changes made to the state retirement plans; they are not intended to serve as a substitute for the statutory laws governing these plans.

The Reports on Enacted Pension Legislation section provides a detailed examination of each pension bill enacted into law during the first half of the 127th Ohio General Assembly, including the name of the principal sponsor, a description of its contents, its fiscal impact, the ORSC position and its effective date. Like the Reports on Pending-Pension Legislation, the reports are intended to give the reader an awareness and understanding of all substantive changes made to the state retirement plans; they are not intended to serve as a substitute for the statutory laws governing these plans.

The Pending Pension-Related Issues section provides a summary of relevant public retirement issues and prior staff recommendations that have been made, but not acted upon by the legislature. It includes a brief summary of the issues and whether any legislation has been introduced this session that addresses the issue.

The Documents Statutorily Required of the Retirement Systems section provides information on all reports that the retirement systems are required by law to submit to the ORSC.

The Subject Index of Pension Bills Introduced provides a listing of legislation under subject headings and a key word description within the subject heading. Bills that cover more than one subject area are listed under all appropriate headings. All subject headings are listed at the beginning of the index for quick reference.

The Status of Pension Legislation provides a record of the legislative action taken on pension bills at each step of the legislative process from the date of introduction to the date of enactment, including the committee assignments in each house of the Ohio General Assembly, the date reported by the committees, the date passed by each house and the date reported by a conference committee and/or concurred in by the other house. Also provided are a brief description of the subject of the pension bill and the ORSC position on the bill. A key to all abbreviations used in the Status of Pension Legislation is found on the last page.

SYSTEMS' INVESTMENT PERFORMANCE

FIRST HALF OF THE 127TH GENERAL ASSEMBLY

JANUARY 1, 2007 – DECEMBER 31, 2007

Section 171.04(D) of the Revised Code requires the ORSC to conduct a semiannual review of the policies, objectives, and criteria of the systems' investment programs. The ORSC has hired Evaluation Associates, LLC to conduct the reviews. These reports are submitted to the Governor and General Assembly. The following is a summary of the investment reviews completed during 2007:

<u>Investment Performance Review (Fourth Quarter 2006), June 13, 2007</u> -
This report, which was presented at the June 20, 2007 ORSC meeting, reflects the investment performance for all five retirement systems over the ten-year period beginning January 1, 1996 and ending December 31, 2006. The findings of this report are summarized as follows:

- In the six months ending December 31, 2006, the systems experienced solid performance results, due primarily to strong equity market returns. The range of returns for the six months goes from a low of 8.89% (PERS HC) to a high of 12.06% (STRS). Given the PERS HC appropriately higher allocation to fixed income, it is expected that these results would trail the others in a rising equity market. The five retirement plans' returns ranged from 9.83% (HPRS) to 12.06% (STRS).

- Three of the systems lagged their respective policies for the six-month period, one matched the policy return and two outperformed. The two outperformers were STRS and PERS DB. These two outperformed by 88 and 11 basis points respectively. PERS HC matched their benchmark. OP&F had the largest lag of 32 basis points, HPRS trailed 20 basis points behind their index and SERS lagged by 8 basis points. On a calendar year basis, four of the systems outperformed their benchmarks, with STRS generating the largest outperformance at 104 basis points. The two laggards were HPRS (32 basis points behind) and PERS DB (trailing by 29 basis points).

- From a universe comparison perspective, all systems with the exception of HPRS ranked above the median public retirement system in a broad universe of such funds (the Mellon All Public Fund Universe) for six months ending December 31, 2006. The top-performing fund for the six months was STRS (top percentile). The other funds ranged from the 12th percentile (PERS DB) to the 56th percentile (HPRS).

- For the calendar year 2006, all of the systems with the exception of HPRS were above median versus the Mellon All Public Fund Total Fund Universe. HPRS ranked just below median at the 52nd percentile; STRS was the leader ranking in the 4th percentile.

- Over the trailing three-year period, only HPRS has underperformed its policy benchmark, by 27 basis points: 11.27% vs. 11.54%. STRS has the strongest annualized three-year return of 14.05%, ahead of their benchmarks by 127 basis points. It is worth noting that STRS has the highest equity allocation in their benchmark (67.0%), which included the highest allocation to international equities (25.0%). Their policy allocation to fixed income is also the lowest of the group at 20.5%. The strong performance of equities, and especially international equities has been beneficial to the plan. For the three-year period PERS DB, (+12.23%), SERS

(+12.59%), and OP&F (+12.74%) have returns that are tightly clustered; all three have outperformed their benchmark for the period.

- Relative to the Mellon All Public Fund Universe, four of the five systems are above median for three years with HPRS the exception (63rd percentile). STRS has the best relative performance (6th percentile), followed by OP&F (23rd), SERS (26th), and PERS DB (41st).

- For the trailing five-year period, all systems have outperformed their respective policy benchmarks. STRS (+10.24%) and OP&F (+10.04%) ranked in the second quartile, while PERS DB (+9.61%) performed at the median of the Mellon All Public Total Fund Universe. HPRS (+9.53%, third quartile) and SERS (9.18%, third quartile) had the weakest relative returns. The fact that all systems beat their benchmark is noteworthy.

- Over the trailing ten-year period, OP&F, PERS DB, SERS, and STRS are exceeding their actuarial interest rate. HPRS has lagged their actuarial rate. In comparison to the systems' respective policy benchmarks over the past ten years, SERS and STRS outperformed, OP&F effectively matched their benchmark, while HPRS and PERS DB trailed for the period.

- During the seven years EAI has been reviewing the results of the systems on behalf of the Council, the asset allocation targets have tended to converge. Current targets are very close to each other. The obvious exception is PERS HC. It is important to note that they have a lower actuarial interest rate target than the others, at 6.5%. The retirement plans all have actuarial return assumptions of 8.00% to 8.25%. As a result, PERS HC has a lower equity and higher fixed income allocation than the retirement plans. This similarity in policy makes comparing one system's results to the other a more meaningful exercise over the more recent time periods. There were still some important differences in target allocations in the 1990's, which impact the longer-term return series.

- The following observations grow out of EAI's review of the systems' asset allocation:

    1. The systems' actual and target allocation to domestic equity rank above the total public fund median plan's allocation to domestic equity (39.91%) in the Mellon Total Public Fund Universe. The same is true of the public funds over $1 billion universe. It is noteworthy that the median universe allocation to domestic equities has dropped by almost 1% over the past six months.

    2. The systems' actual and target asset allocation to fixed income fall below the total public fund median plan's exposure to fixed income (26.21%). This median is down by almost 1.5% in the six months since the last report.

    3. There is a 20.30% allocation to international equity amongst the total public fund universe. HPRS is below that both in actual (11.36%) and target (15.00%) allocation. All other systems have an actual allocation higher than

the median. SERS and HPRS were two exceptions, as they set their international equity target allocations to 16.00% and 15.00%, respectively.

4. All five of the retirement systems' asset allocation targets to real estate rank above the median plan's allocation to real estate (6.02%), and four of the five have an actual allocation above median. OP&F is the exception, with an actual allocation of 4.44% versus a target of 8.00%. SERS has the largest actual real estate allocation at 9.93% and the largest target allocation of 10.00%.

5. There is a 5.44% allocation to alternative investments amongst the total public fund universe. HPRS has the largest actual (9.16%) and target (10.00%) allocation. All other systems have actual allocations ranging between 1.97% and 2.98%.

Investment Performance Review (Second Quarter 2007), November 14, 2007 –
This report, which was presented at the November 14, 2007 ORSC meeting, reflects the investment performance for all five retirement systems over the ten-year period beginning July 1, 1997 and ending June 30, 2007. The findings of this report are summarized as follows:

- The systems benefited from strong equity markets, both domestically and abroad, during the six months ending June 30, 2007, producing very favorable single digit returns. The range of returns for the six-month period was from a high of +8.48% (OP&F) to a low of +4.75% (PERS HC).

- All five systems outpaced their respective policy indexes for the six-month period. OP&F led its policy index by the largest amount, 123 basis points, and was followed by SERS, which led its target by 121 basis points. STRS' policy index return was the top performer for the six- month period (+7.46%) largely due to a higher overall equity allocation and a higher alternatives policy target return. The PERS HC policy index had the lowest return for the six-month period, due to its higher allocation to fixed income. Fixed income produced only low single digit returns for the six-month period.

- In comparison to a broad universe of other public retirement systems (the Mellon All Public Total Fund Universe), all plans ranked above median for the period ending June 30, 2007. OP&F ranked in the first quartile (13th percentile), while the other systems ranged from the 25th percentile (SERS) to the 43rd percentile (PERS DB).

- For the one-year period ending June 30, 2007, all of the systems except HPRS led their respective policy index returns and outpaced the median of the Mellon All Public Total Fund Universe, producing rankings in the 5th, 10th, 19th, 29th, and 47th percentiles (STRS, OP&F, SERS, PERS DB, and HPRS, respectively.

- On a three-year basis, only HPRS has lagged its policy index, trailing by 33 basis points. Over the same time period, SERS has led is policy benchmark by the largest

amount (121 basis points) followed by STRS (118 basis points), PERS DB (56 basis points) and OP&F (57 basis points).

- Comparing the three-year returns of the systems to the Mellon All Public Total Fund Universe, STRS ranked in the 8th percentile followed by OP&F, SERS, and PERS DB, which ranked in the 19th, 22nd, and 36th percentiles, respectively. HPRS ranked in the 59th percentile, which is slightly below median.

- For the five-year period, all systems have outpaced their respective policy benchmarks with STRS producing the largest level of outperformance at 101 basis points. In comparison to the Mellon All Public Total Fund Universe, STRS (+13.17%) and OP&F (+12.80%) ranked in the first quartile, PERS DB (+12.27%), and SERS (+12.09%) ranked in the second quartile, and HPRS (+11.76%) ranked just below median in the third quartile.

- Over the longer-term, ten-year period, HPRS is the only system trailing its actuarial interest rate. When compared to each system's respective policy benchmark over the last ten years, STRS, SERS, and OP&F exceed the return of their policy benchmark while PERS DB and HPRS trailed for the same period.

- During the eight years that EAI has been reviewing the results of the systems on behalf of the Council, the asset allocation targets have become more similar and reasonably close to each other. The obvious exception is PERS HC. It is important to note that they have a lower actuarial interest rate target than the others, at 6.5%. The retirement plans all have actuarial returns assumptions of 8.00% to 8.25%. As a result, PERS HC has a lower equity and higher fixed income allocation than the retirement plans. This similarity in policy makes comparing one system's results to the other a more meaningful exercise over the more recent time periods. Recent changes to asset allocation policy by HPRS, and more recently SERS, will likely cause some comparison differences in the near future as SERS has significantly lowered it domestic equity allocation, adding to international equity and alternatives, while HPRS has lowered fixed income and added to alternatives. Additionally, longer-term comparisons are more problematic as there were still some important differences in target allocations in the 1990's, which impact the longer term return series. In the end, while peer comparisons can be a useful exercise, comparisons to the plans' policy index should be the primary comparison tool.

- With a full ten years of data now available since the formal adoption of the "prudent person rule," it is a useful exercise to examine the relative performance of the systems versus the peer group of public fund plans over that period. Tracking relative performance for the ten-year period, where all of the plans ranked below the median of the peer universe, to more recent 1,2,3,4, and 5 year periods, where the majority of the systems are consistently ranking in the first or second quartile of the peer universe, should give validity to the concept that a larger investment opportunity set and increased portfolio diversification are favorable for performance.

- The following observations are based on a review of the systems' asset allocation in comparison to two public fund universes: the total universe of public funds and the universe of public funds in excess of $1 billion.

  1. The actual and target asset allocation of PERS DB, STRS, OP&F, and HPRS to domestic equity rank above the median plan's allocation to domestic equity (40.58%) in the Mellon All Public Total Fund Universe. The actual (30.43%) and target (29.00%) allocation of SERS to domestic equity is below that of the median plan. The same holds true when the systems are compared to the median (38.73%) of the Mellon Billion Dollar Public Total Fund Universe.

  2. The systems' actual and target asset allocation to fixed income are below the median plan (26.52%) of the Mellon All Public Total Fund Universe.

  3. There are some differences in the target allocations of the systems to international equity. The median plan allocation of the Mellon All Public Total Fund Universe as of June 30, 2007 was 21.09%. The target allocations of STRS and SERS are higher at 25% and 29%, respectively. The target allocations of PERS DB and OIP&F approximate the median at 20% and the HPRS target allocation is below at 15%. It is worth noting that each of the plans is maintaining an allocation to international equity that is marginally higher than stated targets. This allocation has been beneficial, as these markets have produced double-digit returns over the past six months.

  4. The universe median allocation to real estate was 5.40%. While the target allocation of each of the systems is above the median allocation, all plans except PERS DB and HPRS are maintaining a current allocation below their respective targets.

  5. SERS and HPRS both have current target allocations to alternatives that are above the peer median of 6.30%. The remaining plans have lower target allocations to alternative assets.

STATUS OF HEALTH CARE FUNDS

FIRST HALF OF THE 127th GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

In 1974, the five state retirement boards were given broad discretionary authority to provide health care coverage to retirees and their dependents. Unlike pension benefits, which become vested upon retirement, health care benefits are not a vested right under Ohio's public pension laws. Therefore, 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 Appeals (Ohio Association of Public School Employees, et al. v. School Employees Retirement System Board, et al.) 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 statutorily to reimburse benefit recipients for Medicare Part B premiums (medical). Retirees who do not qualify for Medicare Part A (hospital) are provided equivalent coverage under the systems' health care plans. All employees hired on or after April 1, 1986 are required by federal law to contribute to Medicare.

Beginning in 2006, Medicare began offering a prescription drug benefit known as Medicare D. For most retirees, the prescription drug benefit provided by the systems is superior to the benefit offered by Medicare. However, low income retirees who qualify for a government subsidy for their Medicare prescription drug benefit may fare better under Medicare D so they will need to determine which 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 2006, the total retiree health care costs paid by the retirement systems were over $2.1 billion. By law, any health care costs borne by the retirement systems must be financed by employer contributions only. The retirement systems' actuaries review annually the amount of contributions required to fund vested pension benefits. Contributions in excess of what is needed to support those benefits can be allocated to health care. The following charts indicate the percentage of employer contribution each system intends to allocate to health care during 2008 and the projected solvency period for each system's health care fund as of November 2007.

Ohio Retirement System	Percentage of Employer Contribution Allocated to Health Care in 2008
PERS	7.00%
STRS	1.00%
SERS	4.18%*
OP&F	6.75%
HPRS	4.50%

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

Projected Solvency Period for Health Care Funds (As of November 2007)	
PERS	2034
STRS	2021
SERS	2021
OP&F	2026
HPRS	2024

Each year the retirement systems review their health care plans and make adjustments as needed. Below is a description of the changes to each system's health care plan effective January 1, 2008.

PERS

PREMIUMS

Premiums for Kaiser HMO and AultCare PPO plans have increased 3% and 2.7% respectively and also feature increases in the amount of deductibles, out-of-pocket maximums and/or coinsurance.

PERS will continue to reimburse the basic Medicare Part B monthly premium, which is $96.40 in 2008.

ELIGIBILITY

PERS made no changes to its health care eligibility requirements for 2008.

BENEFITS

PERS will offer Aetna Medicare Open Plan to Medicare-eligible retirees and their covered, Medicare-eligible spouses in 2008. It is a private-fee-for-service Medicare Advantage plan. Retirees who are Medicare-eligible and currently participating in the Aetna Enhanced plan will automatically be enrolled in the Aetna Medicare Open Plan for 2008.

The co-payment generic prescription drugs under the Enhanced Plan will decrease from $5 to $3 for a 30-day supply while the co-payment for formulary brand drugs will increase from $10 to $15 for a 30-day supply. Prices for a 90-day supply will remain at 3 times the 30-day supply price.

Express Scripts will replace Medco as the pharmacy benefits manager effective April 1, 2008.

For more information on the PERS health plan in general, please visit the system's website at www.opers.org.

STRS

PREMIUMS

For 2008, the STRS board continued its policy of providing a premium subsidy of 2.5% per year of service, up to 75% for benefit recipients and providing access to spouses and dependents at 100% of the rate.

Additionally, STRS will continue to reimburse Medicare Part B premiums on a sliding scale from $29.90 to $52.83 based on the member's years of service at retirement.

ELIGIBILITY

STRS made no changes to its health care eligibility requirements for 2008.

BENEFITS

Enrollees in the Aetna and Medical Mutual Plus and Basic Plans and the Paramount health care plans will be able to buy over-the-counter Prilosec at retail for a $5 co-payment with a doctor's prescription in 2008. Further, co-payments for all other tiers of proton pump inhibitors will be increased in 2008 to $25/$50/$75 at retail and $65/$125/$190 through mail order. These plans will also begin offering a voluntary pill-splitting program for certain generic drugs. This program allows a doctor to prescribe half the number of pills for a double-strength medication and the enrollee splits the pill. Enrollees will be charged only half of the normal co-payment. Additionally, Express Scripts will now be the pharmacy benefits manager for Aetna, Medical Mutual, and Paramount health care plans in lieu of Caremark.

The STRS board enhanced the Basic Plan offered by Aetna and Medical Mutual by increasing the prescription drug maximum annual benefit from $5,000 to $10,000 for 2008.

For more information on the STRS health plan, please visit the system's website at www.strsoh.org.

SERS

PREMIUMS

The board adopted several changes to the premiums for new service and disability retirees who retire on or after January 1, 2008. These changes are intended to extend the life of the health care fund. There are three major changes:

1. Years of service for premium purposes will be based on the number of years a member was paid for at least 740 hours.
2. To receive any premium subsidy, a retiree must have been eligible for insurance from their school employer at the time they retire.
3. The percentage of premium paid by the retiree is based on qualified years of service, and will increase for retiring members with less than 35 years.

The premium rates for SERS retirees with Medicare A and B will decrease in 2008, whereas the premiums for retirees without Medicare, with the exception of AultCare health plan, will increase in 2008. The rates for spouses will increase and they will be based upon the retiree's years of qualified service.

The amount that SERS reimburses for Medicare Part B premiums remains set in statute at $45.50 per month.

ELIGIBILITY

SERS made no changes to its health care eligibility requirements for 2008.

BENEFITS

The board adopted Medicare Advantage plans for those with Medicare A for 2008. These plans replace traditional Medicare. SERS will pay the insurance companies a monthly premium for each Medicare retiree and spouse.

Express Scripts will replace Medco as the pharmacy benefits manager.

For more information on the SERS health plan, please visit the system's website at www.ohsers.org.

OP&F

PREMIUMS

OP&F will continue to subsidize 75% of the health care premium for retirees who retired on or before July 24, 1986 and 50% for their dependents. If benefits began being paid on or after July 25, 1986, OP&F will subsidize 75% of the retiree's premium and 25% for dependents.

OP&F will continue to reimburse the basic Medicare Part B monthly premium, which is $96.40 in 2008.

ELIGIBILITY

Healthcare coverage through OP&F for members and their dependents who are age 65 or older and enrolled in both Medicare Part A and Part B will terminate December 31, 2007. However, these retirees have the option of enrolling in the AARP Health Care Options Medicare Supplement Plan and will continue to be covered by the OP&F-sponsored pharmacy plan.

BENEFITS

Effective in 2008, UnitedHealthcare will administer all health care, pharmacy, dental, and vision benefits.

Under the new UnitedHealthcare Pharmacy plan, prescription medications will no longer be categorized by generic, preferred, and nonpreferred. Instead, they will be categorized by three tiers depending on the co-payment level.

For more information on the OP&F health care plan, please visit the system's website at www.pfdpf.org.

HPRS

PREMIUMS

Monthly premiums for dental coverage will increase for spouse and child(ren) from $42.18 to $43.02 and child(ren) only from $18.51 to $18.88 effective January 1, 2008. The premium for spouse only remains $17.51. HPRS will continue to pay the full premium to cover retirees. HPRS will continue to reimburse the basic Medicare Part B monthly premium, which is $96.40 for 2008.

ELIGIBILITY

Effective January 1, 2008, surviving spouses who are not eligible for Medicare and who are working and have medical coverage available through their employers will be required to obtain their primary medical coverage through that employer.

BENEFITS

HPRS made no benefit changes to its health care plan for 2008.

For more information on the HPRS health care plan, please visit the system's website at www.ohprs.org.

ACTUARIAL REVIEWS

FIRST HALF OF THE 127th GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

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

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

The following table summarizes Milliman's findings:

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

Staff made the following recommendations in response to the report:

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

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

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

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

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

REPORTS ON PENDING PENSION LEGISLATION

FIRST HALF OF THE 127th GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

Sub. H.B. 8 – Rep. R. Hagan

Sub. H.B. 8 would require any member of the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Ohio Police and Fire Pension Fund (OP&F), the Highway Patrol Retirement System (HPRS), or the Cincinnati Retirement System (CRS), or a participant in an Alternative Retirement Plan for higher education employees (ARP) who pleads guilty to or is convicted of a designated offense while the member was engaged in the performance of duties related to public employment to forfeit the right to receive a disability benefit or the pension portion of a retirement allowance.

Under current law, a public employee's retirement or disability benefit cannot be forfeited for employee misconduct.

Staff Comments – Under the bill, a member of PERS, STRS, SERS, OP&F, HPRS or CRS, or a participant in an ARP who pleads guilty to or is convicted of any designated offenses committed while engaged in the performance of duties related to public employment forfeits the right to receive a disability benefit or the pension portion of a retirement allowance.

"Designated offense" is defined as a felony violation of the following:

- Extortion (R.C. §2905.11);
- Bribery (R.C. §2921.02);
- Perjury (R.C. §2921.11);
- Obstructing justice (R.C. §2921.32);
- Theft in office (R.C. §2921.41);
- Unlawful interest in a public contract (R.C. §2921.42);
- Engaging in a pattern of corrupt activity (R.C. §2923.32); and
- Conspiracy or attempt to commit one of the above-listed offenses.

The forfeiture is limited to the extent that, on the date the member pleads guilty or is convicted of the offense, the benefit or allowance has not vested pursuant to Ohio law, the plan document for a defined contribution plan, or federal law. The forfeited amount is retained by the retirement system of which the person is a member or the ARP in which the person is participating.

When a court sentences an offender for a designated offense committed on or after the effective date of the bill, the court is required to determine whether the offender committed the designated offense while engaged in the performance of duties related to public employment and whether the offender is a member of a public retirement system or a participant in an alternative retirement plan. If the court determines both of those criteria are met, the court is required to order the forfeiture to the public retirement system or alternative retirement plan of the offender's right to a disability benefit or the pension portion of a retirement allowance, to the extent that, on the date the member pleads guilty or is convicted of the offense, the benefit or allowance has not vested. The court must then send a copy of the journal entry imposing the sentence on the offender to the public retirement system or alternative retirement plan in which the offender is a member or participant. "Pension" is defined as the portion of a retirement allowance that is derived from contributions made to a

public retirement system or alternative retirement plan by an employer and earnings on those contributions.

The bill would allow the offender to request a hearing prior to sentencing to determine whether there is good cause for the forfeiture order not to be issued. If the court finds there is good cause for the forfeiture order not to be issued, the court shall not issue the forfeiture order.

The system would be required to comply with a forfeiture order at the following appropriate times:

- If the offender has applied for, but is not yet receiving a retirement allowance or disability benefit, as soon as practicable;
- If the offender has applied for, but has not yet received a payment of accumulated contributions, as soon as practicable;
- If the offender has not applied for a retirement allowance, disability benefit, or payment of accumulated contributions, on application by the offender for a retirement allowance, disability benefit, or payment of accumulated contributions.

Under the bill, the forfeiture would not affect a member's right to a refund of the member's accumulated contributions; any portion of a retirement allowance or payment of accumulated contributions that is subject to withholding due to an order for restitution for theft in office, certain sexual offenses, or a division of marital property order; the eligibility of a member or the member's spouse or qualified dependents to receive health care coverage or long-term care insurance from a state retirement system; or payment of a survivor benefit to a member's spouse, beneficiaries, or qualified dependents. This would give beneficiaries of members who are subject to a forfeiture order greater protection than all other beneficiaries because it would guarantee benefits to individuals who otherwise might not be eligible for them. Under current law, if a member takes a refund of contributions, the member and the member's spouse/dependents are no longer eligible for health care or survivor benefits. This bill, however, would require the systems to provide health care and survivor benefits to the individuals affected by a forfeiture order.

By law, any health care costs borne by the retirement systems must be financed by employer contributions only. It is inconsistent to require members to forfeit employer –funded pension benefits (that are otherwise guaranteed by statute) but allow them to receive employer funded health care benefits (that are provided purely at the discretion of the retirement system). Furthermore, current law does not guarantee health care benefits for any retiree or beneficiary. Since 1974, the five state retirement boards have had broad discretionary authority to provide health care coverage to retirees and their dependents. The boards are authorized to change the premiums and eligibility requirements, as well as whether to continue to provide health care benefits at all. This discretionary nature has been upheld in court. (Ohio Association of Public School Employees, et al. v. School Employees Retirement System Board, et al.) This bill calls into question whether health care benefits are truly discretionary. Guaranteeing these benefits for a small set of beneficiaries would set a costly

precedent for future retirees and beneficiaries. *We recommend that the bill be amended to remove the language that guarantees health care coverage and survivor benefits.*

"Accumulated contributions" is defined in the bill by referencing the definition currently in each system's law and generally refers to the employee's contributions plus interest, any amounts the employee paid to purchase service credit, and any additional voluntary contributions the employee has made to the retirement system. However, the definition under HPRS' law has been omitted from the bill. *We recommend that the bill be amended to define accumulated contributions for HPRS as having the same meaning as in R.C. §5505.01.*

Sub. H.B. 8 raises a significant public policy issue: should employee misconduct affect the receipt of public retirement benefits. Current law generally provides that public retirement benefits are assignable or subject to attachment or other legal process only in the following cases:

- Restitution for theft in public office pursuant to a court withholding order;
- Restitution for certain sex offenses committed in the context of the offender's public employment;
- Payment of spousal support and child support pursuant to a court withholding order; and
- Payment to a former spouse pursuant to a division of property order.

This anti-assignment/alienation requirement has been recognized not only in Ohio's public retirement laws, but also under the Employee Retirement Income Security Act (ERISA) as applied to private pension plans. Therefore, Ohio law currently affords public sector employees the same protection as the federal law gives private sector employees with respect to retirement benefits.

The principal reason behind the statutory provisions exempting retirement benefits from legal process except in a limited number of circumstances is that society has an interest in ensuring that an adequate source of income exists for the support of members who are unable to earn income due to age or disability and that a source of income exists for the support of their dependents. This societal interest in securing these sources of income has historically outweighed other competing interests. It is important to note that public employees do not contribute to Social Security and, therefore, rely solely on the benefit provided by the public retirement system for retirement income. If the benefit is forfeited, the member and spouse could be in a position where they would have no source of retirement income.

This bill limits the list of offenses to egregious breaches of the public trust. Like the restitution provisions, the offenses for which a benefit may be forfeited must be committed in the context of the offender's public employment. Sub. S.B. 3, which the Council approved at the May 22, 2007 ORSC meeting, is similar to Sub. H.B. 8 but limits the list of offenses to bribery, engaging in a pattern of corrupt activity, theft in office, a violation of any similar city, state, or federal law, or conspiracy or attempt to commit any of those offenses. Although the list of designated offenses in this bill includes several more offenses than Sub. S.B. 3, it is still consistent with Sub. S.B. 3.

Sub. H.B. 8 – Rep. R. Hagan

Sub. H.B. 8 would limit the forfeiture to the pension portion of a retirement allowance, which is made up of employer contributions, plus earnings on those contributions. In addition, the bill does not require a member to apply for a refund of contributions. Therefore, a member subject to a forfeiture order could apply for an allowance based solely on the member's accumulated contributions if the member meets the age and service requirements instead of electing to take a refund of the accumulated contributions. However, current law does not provide for the receipt of this type of benefit and the bill does not indicate how this benefit would be calculated. It does not appear that this provision is consistent with the sponsor's intent of forfeiting an ongoing benefit from the retirement system. *We recommend that the bill be amended to require a member who is convicted of or pleads guilty to any of the designated offenses to forfeit the right to receive any payment under a pension, annuity, allowance, or other type of benefit under this chapter, other than a payment of the accumulated contributions standing to the person's credit under this chapter.* This is consistent with Sub. S.B. 3.

Fiscal Impact – The actuarial analysis submitted by each system is based on the as introduced version of the bill. The introduced version of the bill did not require the systems to provide health care benefits or survivor benefits to members subject to forfeiture. This change could have an impact on the actuarial analysis; however, the systems' actuaries have not reviewed the substitute bill.

According to the PERS actuary, Gabriel Roeder Smith & Company, there was no data available upon which to make a detailed actuarial analysis. However, it is their opinion that the bill as introduced would have no measurable financial impact on the system.

The SERS actuary, Buck Consultants, reviewed the as introduced version of the bill and found that the number of affected members would be a very small percentage of the total membership, thus having almost no measurable impact on valuation results, given the magnitude of SERS' overall liabilities.

According to the STRS actuary, Buck Consultants, the introduced version of the legislation would affect too few members for there to be a measurable impact on the actuarial liabilities. Their conclusion is that the funded ratio and funding period would not change.

According to the OP&F actuary, Buck Consultants, the introduced version of the legislation would affect too few members for there to be a measurable impact on the actuarial liabilities. Their conclusion is that the funded ratio and funding period would not change.

According to HPRS, it is their actuary's opinion, Gabriel Roeder Smith & Company, that any actuarial impact that might occur would be negligible due to the limited application of the bill as introduced.

ORSC Position – At the June 13, 2007 meeting of the Ohio Retirement Study Council, the Council voted to recommend that the 127th Ohio General Assembly approve Sub. H.B. 8 upon the adoption of the following amendments:

Sub. H.B. 8 – Rep. R. Hagan

- *An amendment to remove the language that guarantees health care coverage and survivor benefits;*

- *An amendment to define accumulated contributions for HPRS as having the same meaning as in R.C. §5505.01;*

- *An amendment to require a member who is convicted of or pleads guilty to any of the designated offenses to forfeit the right to receive any payment under a pension, annuity, allowance, or other type of benefit under this chapter, other than a payment of the accumulated contributions standing to the person's credit under this chapter.*

The bill is pending in the Senate Judiciary – Criminal Justice Committee.

Am. Sub. H.B. 151 – Reps. Mandel, Jones

Am. Sub. H.B. 151 would generally prohibit the treasurer of state, the state board of deposit, the bureau of workers' compensation and the five state retirement systems from investing in the stocks and bonds of publicly traded companies with "scrutinized business operations" in Iran or Sudan, and would require them to divest any existing investments in such companies. This analysis is limited to the provisions of the bill that relate to the five state retirement systems: the Public Employees Retirement System (PERS), the Ohio Police and Fire Pension Fund (OP&F), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS) and the State Highway Patrol Retirement System (HPRS).

Within 90 days after the effective date of the bill, each state retirement system would be required to make its best efforts to identify all companies having "scrutinized business operations" in Iran or Sudan.[1]

"Scrutinized business operations" is defined as a company that meets any of the following criteria:

1. The company has business operations that involve contracts with or provision of supplies or services to the government of Sudan, companies in which the government of Sudan has any direct or indirect equity interest, consortiums or projects commissioned by the government of Sudan, or companies involved in consortiums or projects commissioned by the government of Sudan, **and** one of the following apply:
    a. More than 10% of the company's revenues or assets linked to Sudan involve oil-related activities or mineral-extraction activities; less than 75% of the company's revenues or assets linked to Sudan involve contracts with or provision of oil-related or mineral-extracting products or services to the regional government of southern Sudan or a project or consortium created exclusively by that regional government; and the company has failed to take substantial action specific to Sudan; **or**
    b. More than 10% of the company's revenues or assets linked to Sudan involve power-production activities; less than 75% of the company's power-production activities include projects whose intent is to provide power or electricity to the marginalized populations of Sudan; and the company has failed to take substantial action specific to Sudan.[2]

[1] "Best efforts" shall include reviewing and relying on publicly available information regarding companies having business operations in Iran or Sudan, including information provided by nonprofit organizations, research firms, international organizations, and government entities; contacting asset managers that invest in companies having business operations in Iran or Sudan; contacting other institutional investors that have divested or engaged with companies that have business operations in Iran or Sudan; and reviewing the laws of the United States regarding the levels of business activity that would cause application of sanctions for companies conducting business or investing in countries that are designated state sponsors of terror.

[2] "Substantial action specific to Sudan" means adopting, publicizing and implementing a formal plan to cease scrutinized business operations within one year and refrain from any

2. The company is complicit in the Darfur genocide.[3]
3. The company supplies military equipment within Sudan unless it clearly shows that the military equipment cannot be used to facilitate offensive military actions in Sudan or it implements rigorous and verifiable safeguards to prevent use of that equipment by forces actively participating in armed conflict.
4. The company has business operations that involve contracts with or provision of supplies or services to the government of Iran, companies in which the government of Iran has any direct or indirect equity interest, consortiums or projects commissioned by the government of Iran, or companies involved in consortiums or projects commissioned by the government of Iran, **and** one of the following apply:[4]
   a. More than 10% of the company's revenues or assets linked to Iran involve oil-related activities, mineral-extraction activities, or petroleum resources;
   b. The company has, with actual knowledge, on or after August 5, 1996, made an investment of $20 million or more, or any combination of investment of at least $10 million each, which in the aggregate equals or exceeds $20 million in any twelve-month period, and which directly or significantly contributes to the enhancement of Iran's ability to develop petroleum resources in Iran; **or**
   c. The company is engaged in business with an Iranian organization labeled as a terrorist organization by the United States government.

Within 90 days after the effective date of the bill, each retirement system would be required to create a list of "scrutinized companies," make it available to the public and update it annually. The retirement system would be required to provide written notice to any company on the list with inactive business operations in Iran or Sudan to encourage it to continue refraining from initiating active business operations in Iran or Sudan. Each retirement system would be required to continue such notice semiannually.

For any company on the list that has active business operations in Iran or Sudan, each retirement system would be required to send written notice informing the company of its status as a "scrutinized company," the opportunity to clarify its Iran-related or Sudan-related business activities and the requirement to cease active business operations or convert such

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new business operations; undertaking humanitarian efforts in conjunction with an international organization, the government of Sudan, the regional government of southern Sudan, or a nonprofit entity evaluated and certified by an independent third party to be substantially in a relationship to the company's Sudan-related business and of benefit to one or more marginalized populations of Sudan; or, through engagement with the government of Sudan, materially improving conditions for the genocidal victimized population in Darfur.

[3] A "social development company" that provides humanitarian goods or services to the people of Sudan and is not complicit in the Darfur genocide is excluded.

[4] Any company that takes substantial action specific to Iran with respect to 4(a) or (b) shall not be deemed as a "scrutinized company." "Substantial action specific to Iran" means adopting, publicizing and implementing a formal plan to cease scrutinized business operations within one year and refrain from any new business operations.

operations to inactive business operations within 90 days in order to avoid becoming subject to divestment by the retirement system.

Each retirement system would also be required to submit letters to the managers of actively managed investment funds containing indirect holdings in companies that have scrutinized active business operations requesting them to consider removing such companies from the fund or create a similar actively managed fund having indirect holdings devoid of such companies.[5] If the manager creates a similar fund, each retirement system would be required to replace all applicable investments with investments in the similar fund in an expedited timeframe consistent with prudent investment standards. For the purposes of this provision, a private equity fund is deemed to be an actively managed investment fund.

If any company on the list fails to take action within 90 days, the retirement system would be required to divest all direct holdings in the publicly traded company (i.e., stocks and bonds) within 12 months.[6] The retirement system would also be prohibited from acquiring any direct holdings in publicly traded companies on the list with active business operations in Iran or Sudan. The bill would provide an exception for any "private holdings" of a public investor. A limited exception is also provided under the divestment mandate and investment prohibition for any company that is headquartered in the United States and complies with all relevant United States foreign trade controls relating to Iran or Sudan.

Am. Sub. H.B. 151 would provide that the retirement systems may cease divestment and reinvest in scrutinized companies if clear and convincing evidence shows that the value of all assets under management becomes equals to or less than 99.50%, or at least 50 basis points, of the hypothetical value of all assets under management assuming no divestment for any company had occurred. In advance of any reinvestment, each retirement system would be required to provide a written report to the President of the Senate and the Speaker of the House, setting forth the reasons and justification for the retirement system's decision to cease divestment or begin reinvestment in otherwise scrutinized companies.

If any company resumes active business operations in Iran or Sudan, each retirement system shall reinstate the company on the list and shall send written notice to the company, as described above.

Within 30 days after creating and updating the list, each retirement system would be required to file a report with the President of the Senate, the Speaker of the House, the Minority

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[5] "Indirect holdings" means all stocks and bonds of a company that are not direct holdings and are held in an account or fund in which the public sector owns shares or interests together with other investors not subject to the provisions of this act, as well as any private equity fund, private equity fund-of-funds, venture capital fund, hedge fund, hedge fund-of-funds, real estate fund, or other investment vehicle that is not publicly traded, mutual funds, and pooled or securitized investment vehicles.

[6] "Direct holdings" means all stocks or bonds of a company held directly by a public investor or held in an account or fund of which the public investor owns all of the shares or interests.

Leader of the House, the Minority Leader of the Senate, the ORSC and the Workers' Compensation Council that includes the list of scrutinized companies and make it available to the public. Annually, each retirement system would also be required to send a report to the President of the Senate, the Speaker of the House, the Minority Leader of the Senate, the Minority Leader of the House, the ORSC, the Workers' Compensation Council and the United States presidential special envoys to Iran and Sudan. Such report shall also be made available to the public. The report shall include the following information:

1. A summary of correspondence with companies provided written notice by the state retirement systems;
2. All investments divested under the provisions of the bill;
3. All prohibited investments under the provisions of the bill;
4. Any progress made with managers of actively managed investment funds containing indirect holdings in companies having scrutinized business operations;
5. A list of all publicly traded securities held directly the state retirement systems.

The bill would provide that the board of a state retirement system is not liable for breach of fiduciary duty if the board complies in good faith with the requirements of the bill and that the board is not liable for slander or libel if the board makes determinations in good faith regarding the status of a company as required under the bill. Also, the bill would provide that all members, officers, employees and agents of the board shall be indemnified for all claims, demands, suits, actions, damages, judgments, costs, charges and expenses, including court costs and attorney's fees, and against all liability, losses and damages of any nature that may be incurred by reason of any decision to restrict, reduce or eliminate investments in scrutinized companies. A member, officer, employee or agent of the board shall be indemnified by the retirement system in which they serve.

Am. Sub. H.B. l51 would also provide that the provisions of the bill prevail over any conflicting provisions with the state retirement systems' governing investment statutes. The Attorney General shall enforce the provisions of the bill and may bring an action in court to enforce such provisions. Should the Attorney General bring an action against the retirement boards, the retirement boards may obtain outside legal counsel.

Am. Sub. H.B. 151 would permit, ***but not require***, the Ohio Public Employees Deferred Compensation Program, the alternative retirement program sponsored by public
institutions of higher education in Ohio, and the Ohio Tuition Trust Authority to offer participants a "terror-free investment option."[7] None of these public entities would be subject to the divestment mandates or prohibited investments proposed under the bill. The Ohio Public Employees Deferred Compensation Board and the Ohio Tuition Trust Authority would be required to prepare and submit an annual report to the President of the Senate and the Speaker of the House regarding their efforts to identify and provide a "terror-free

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[7] "Terror-free investment option" means an account or fund that excludes from its portfolio any company that has scrutinized business operations in Iran or Sudan.

investment option." Public institutions of higher education in Ohio, as the plan sponsors of the alternative retirement plans, are exempted from this requirement.

The provisions of the bill would expire with respect to Sudan upon the occurrence of any of the following:

1. Congress or the President determines that the government of Sudan has sufficiently halted the genocide in the Darfur region for at least 12 months;
2. The federal government revokes all sanctions against the government of Sudan;
3. Congress or the President, through legislation or executive order, declares that mandatory divestment of the type provided under the bill interferes with United States foreign policy;
4. Congress or the President declares that the government of Sudan has honored its commitments to cease attacks on civilians, demobilize and demilitarize the Janjaweed and associated militias, grant free and unfettered access for deliveries of humanitarian assistance, and allow for the safe and voluntary return of refugees and internally displaced persons.

The provisions of the bill would expire with respect to Iran upon the occurrence of any of the following:

1. Congress or the President determines that the government of Iran has ceased to acquire weapons of mass destruction and support terrorism;
2. The federal government revokes all sanctions against the government of Iran;
3. Congress or the President declares that mandatory divestment of the type provided under the bill interferes with United States foreign policy;

Staff Comments – Am. Sub. H.B. 151 is modeled after Florida legislation (S.B. 2142) recently passed by the Florida legislature and signed by the Governor, and still raises a number of significant financial, legal and public policy issues that merit serious consideration. While the substitute bill limits the scope of scrutinized companies to those involved in oil-related, military supply, mineral-extraction and power production activities, the substitute bill expands the number of countries to include Iran as well as Sudan.

Investment Mandates

Historically, the Ohio General Assembly has rejected any type of investment mandates upon the retirement boards' "full power to invest the funds," including several proposed divestiture bills in the early 1980's relative to South Africa and in the early 1990's relative to Northern Ireland. Most recently, the Ohio General Assembly reaffirmed its longstanding policy of rejecting proposed legislative mandates in S.B. 133 (eff. 9-15-04) by eliminating language

that would have required the retirement boards to use a specified percentage of Ohio-based asset managers and brokers for their investment transactions.

The Ohio General Assembly has considered such legislative investment mandates to be inconsistent not only with the fiduciary duties of the retirement boards to act "… solely in the interest of the participants and beneficiaries …" but also with the legal status of the retirement systems as trust funds. Once contributions are transferred to the state retirement systems, they belong solely to the members as required under federal tax law to remain a "qualified plan" and to receive favorable tax treatment on the contributions and earnings thereon. While individuals are free to manage their own assets as they see fit, attempting to achieve foreign policy or other social objectives with other people's money violates basic trust law principles and intercedes in the fiduciary responsibilities of the retirement boards who are vested under current state law with plenary power to invest the funds solely in the interest of and for the exclusive purpose of providing benefits to participants and their beneficiaries.[8]

Prudent Person Investment Authority

S.B. 82 (eff. 3-7-97) abolished the "legal lists" and adopted the "prudent person rule." The former "legal lists" placed significant restrictions on the retirement boards' investment authority and impeded the boards' ability to respond to changes in the economy and financial markets and to rely upon professional investment managers and economic advisors to guide their investment decisions. The current "prudent person rule" is modeled after the standard established in the Employees Retirement Income Security Act (ERISA) that governs most private pension plans, and provides for greater flexibility in asset allocation and selection of investment vehicles so as to achieve further growth in investment earnings and diversification of plan assets.

In adopting the "prudent person rule," the Ohio General Assembly recognized the critical role investments play in the funding of benefit costs. Investment earnings constitute the largest source of revenue for all five state retirement systems, funding up to 80 percent of benefit costs. Simply put, the less revenue generated by investments, the more contributions required from employers and employees, and ultimately Ohio taxpayers.

Sub. H.B. 151 would mark the first set of restrictions placed upon the retirement systems' investment authority since the adoption of the "prudent person rule," and could set a dangerous and costly precedence for further restrictions upon the retirement systems' investment authority. This bill is a prime example. While the bill, as introduced, would have prohibited investments in certain companies doing business in Iran only, the substitute bill would extend a similar prohibition to certain companies doing business in Sudan. Other

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[8] Public accountability for board actions is ensured by each board having one investment expert appointed by the Governor, one investment expert appointed by the State Treasurer, and one investment expert jointly appointed by the Ohio General Assembly.

divestiture initiatives throughout the country include, but are not limited to, companies doing business in other terrorist states (e.g., Cuba, North Korea, Syria), companies operating in other conflict zones (e.g., Burma, Israel), and companies engaged in certain industries (e.g., alcohol, firearms, gambling, tobacco, weapons manufacturing). There simply is no logical end to such restrictions once they are established as precedence.

In order to achieve the best risk-adjusted returns available, the state retirement systems must include foreign companies in their investment portfolios to take advantage of the diversification and risk reduction benefits offered through global investment. It should be noted that international equity has been one of the largest contributors to the state retirement systems' double-digit total fund returns over the last three years that have outperformed the domestic equity and fixed income markets. The semi-annual performance evaluation prepared by Evaluation Associates for the period ending December 31, 2006 indicates that the rates of return for *international equities* for the five state retirement systems ranged from 24.90% to 28.23% for the past year and from 18.60% to 23.75% for the past three-year period. For comparative purposes, the rates of return for *fixed income* for the five state retirement systems ranged from 5.28% to 5.78% for the past year and from 4.38% to 5.45% for the past three-year period. The rates of return for *domestic equity* ranged from 14.54% to 16.21% for the past year and from 11% to 12.19% for the past three-year period.

Foreign Companies in Ohio

The Ohio Department of Development maintains 11 offices around the world not only to promote exports of Ohio goods and services abroad but also to promote new or expanded foreign investment in Ohio. Foreign companies in Ohio employ over 200,000 Ohioans, and provide the livelihood for more than four percent of Ohio's private sector workforce. These foreign companies support 95,000 manufacturing jobs in Ohio, and tend to have a strong "multiplier" effect on the economy by stimulating a substantial amount of activity and jobs in other sectors through their demand for inputs from other suppliers. Over 45% of the jobs at these foreign companies are in manufacturing industries and pay significantly higher than average compensation.

China has significant business ties with both Iran and Sudan. Ohio's Department of Development addressed the Forum on Chinese Trade and Investment hosted by the Council of Great Lakes Governors in May, lauding Ohio's nearly 30-year business ties with China and encouraging more. GE Aviation and Chinese airline companies signed agreements for the purchase of Ohio-made jet engines. Moreover, the Department of Development International Trade Division signed a memorandum of understanding with the Chinese Ministry of Commerce, urging strong business ties between Ohio and China. China is Ohio's fourth largest export market. The substitute bill could work at cross-purposes with these efforts to encourage Chinese firms to invest in Ohio by prohibiting Ohio's state pension funds from investing in these Chinese firms.

Attached is a list of 22 companies investing in Iran's energy sector that was initially given to us. As shown, most, if not all, of these companies involve "oil-related activities" in Iran.

Am. Sub. H.B. 151 – Reps. Mandel, Jones

However, Am. Sub. H.B. 151 is limited neither to Iran nor to companies in the oil and gas industry. It includes under the divestment mandate and prohibited investment section of the bill companies with ties to Sudan as well as companies involved in military supply, mineral extraction and power production activities. Based upon this analysis, a subsequent list of 52 companies investing in Iran and Sudan was provided to us; this list apparently identifies prohibited companies under Am. Sub. H.B. 151 (See attached).

Independent Shareholder Services (ISS), an independent research provider, was asked by SERS to screen their Iran and Sudan universes according to the criteria established under Am. Sub. H.B. 151. ISS came up with 75 foreign companies under the Iran screen and an additional 30 foreign companies under the Sudan screen for a total of 105 companies that would be illegal investments under Am. Sub. H.B. 151 (See attached). ISS is doing some or all of the screening for Florida, California and Colorado.

Missouri Plan and S.B. 133

The Missouri State Employees' Retirement System (MOSERS) anti-terrorist policy and screening process, which has received considerable attention in Ohio and throughout the nation, is fundamentally different from what is being proposed under Am. Sub. H.B. 151. It is **not** a legislative investment mandate, but rather a policy adopted by the retirement board that retains the board's broad discretion to make the ultimate investment decision as to whether to divest consistent with its fiduciary duties.[9] Under that policy, the retirement staff identifies the universe of investment securities that will be subject to screening. The staff then compares the universe of investment securities to be screened with a list of companies identified by two independent research providers. Where there are matches, the staff will further investigate by asking the portfolio manager for any information known about the company and the reason for owning the security. After receiving any requested reports from the portfolio manager on specific companies, the staff will prepare a report for the board indicating whether the staff believes the security should be held or should be sold. The board retains discretionary authority to agree or disagree with the staff recommendation to hold or sell the security. If the board votes to sell, the portfolio manager will be directed to sell the holding. If the board does not vote to sell, the company will remain in the portfolio and will be subject to routine monitoring.

This anti-terrorist policy and screening process clearly recognizes the fiduciary duties of the retirement board by allowing the board to conduct its due diligence and retaining the board's discretionary authority to decide whether to hold or sell the security. This anti-terrorist policy and screening policy is significantly different from the legislative investment mandate proposed under Am. Sub. H.B. 151.

The Ohio General Assembly has consistently recognized the fiduciary duties of the retirement board as being paramount to other policy objectives. The General Assembly has

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[9] A *non-binding resolution* was recently introduced in the Missouri legislature that would call on all Missouri public retirement plans to divest funds in any terrorist-sponsoring state.

enacted legislation encouraging the retirement boards to give consideration to investments that enhance the general welfare of the state, that involve minority owned and controlled firms and that involve firms owned and controlled by women, *provided such investments offer quality, return and safety comparable to other investments available to the board.* Similarly, the General Assembly enacted S.B. 133 (9-15-04) which required each retirement board to adopt a policy with the goal of increasing utilization of Ohio-based asset managers and brokers, including minority business enterprises, *provided such asset managers, brokers and enterprises offer quality, services, and safety comparable to other managers, brokers and enterprises available to the board.* S.B. 133 and prior legislation strikes the appropriate balance by recognizing the retirement boards' fiduciary duties in pursuing certain policy objectives established by the legislature, and holding the retirement boards accountable to the legislature through annual reporting to the ORSC and legislative committees on their progress in implementing these legislative policies.

Attached is a proposed amendment (127 HB151-3262/KB) modeled after S.B. 133. It would require each retirement board to adopt and implement a written policy, within 90 days after the effective date of the bill, to address investments in scrutinized companies with certain ties to Iran or Sudan. The policy shall address each of the following:

- A screening process by which one or more independent research providers shall identify scrutinized companies;
- A review process by which scrutinized companies may challenge or appeal the determination made by the independent research provider;
- A process by which the retirement board determines whether divestment or prohibition of direct holdings in forbidden entities is consistent with the board's fiduciary duty, subject to replacement holdings that offer quality, return and safety comparable to other holdings otherwise available to the board. The board's determination shall be final;
- A requirement that the initial screening be completed within 90 days after the policy is adopted.

The proposed amendment modeled after S.B. 133 would further require each board to submit an annual report to the governor, president of the senate, speaker of the house, and the ORSC containing the following information:

- The name of the independent research provider selected;
- The list of scrutinized companies identified;
- The result of written notice process to scrutinized companies;
- The list of forbidden entities from which the board divested;
- Any other information requested by the ORSC regarding the board's implementation of its policy.

It should be noted that both Congress and other states have recognized the inherent conflict between the fiduciary duty of retirement boards established under federal and state law and the mandatory divestment provisions applicable to such boards, such as under Am. Sub. H.B.

Am. Sub. H.B. 151 – Reps. Mandel, Jones

151. Last month federal legislation entitled Iran Sanctions Enabling Act of 2007 (H.R. 2347 and S. 1430) was introduced **permitting, but not mandating**, public and private fund managers to divest in companies that support Iran's oil and gas industry. Moreover, Sudan divestment legislation recently enacted in California and pending Iran divestment legislation recently passed by the House specifically provides that the California Public Employees' and State Teachers' Retirement System shall not be required to divest unless the board determines, in good faith, that such divestment is consistent with the fiduciary duties of the board.

Foreign Policy

The United States Constitution provides that the federal government has authority over foreign affairs and commerce with foreign countries. The federal government has the power to decide whether U.S. companies can do business in other countries based on national security interests. State and local retirement systems are neither positioned nor equipped to make foreign policy judgment calls as to which multi-national companies (foreign and domestic) are operating for or against the national security interests of the United States. The federal government should provide guidance to ensure that any divestment efforts to influence foreign policy are uniform throughout the nation and consistent with the objectives of the United States. Last month federal legislation was introduced to require the U.S. Treasury, in consultation with other federal agencies, to create a list of companies investing over $20 million in the Iranian energy sector, and update it every six months. The federal legislation would **permit, but not require**, both public and private fund managers to divest in such companies listed.

Governmental Defined Contribution Plans and Other Institutional Investors

Am. Sub. H.B. 151 creates an unfair bias against governmental defined benefit plans, such as the five state retirement systems, and in favor of governmental defined contribution plans, such as the alternative retirement plan sponsored by public institutions of higher education in Ohio, by requiring the state retirement systems to divest in scrutinized companies but allowing governmental defined contribution plans sponsored by public entities to continue investing in such companies. Other public entities **excluded** from the proposed divestment mandates include, but are not limited to, the following:

- The alternative retirement plans of public institutions of higher education as the plan sponsor (e.g., TIAA-CREF, AIG/VALIC);
- The endowments of public institutions of higher education;
- The Ohio Public Employees Deferred Compensation Plan (administered by the PERS Board, plus two legislators appointed by leadership);
- The Ohio Tuition Trust Authority; and
- The 403(b) tax-sheltered annuity plans and other supplemental retirement plans sponsored by school districts and other political subdivisions in Ohio.

<u>Am. Sub. H.B. 151 – Reps. Mandel, Jones</u>

Am. Sub. H.B. 151 would **permit, but not require**, the alternative retirement plans of public institutions of higher education in Ohio, the Ohio Public Employees Deferred Compensation Plan and the Ohio Tuition Trust Authority to offer a "terror-free investment option." Moreover, the bill would exclude alternative retirement plans sponsored by public institutions of higher education from reporting to the legislature on their efforts to identify and provide "terror-free investment options" to their participants. At a minimum, the same reporting requirements should apply to alternative retirement plans as are applicable to the Ohio Public Employees Deferred Compensation Plan and Ohio Tuition Trust Authority under the amended substitute bill.

Mandating the state retirement systems to divest securities that these other public entities can then buy is not only a contradictory state policy but also likely to be an ineffective state policy in achieving its purported purpose. For example, mandating defined benefit managers, such as STRS, to divest securities that defined contribution managers, such as TIAA-CREF, can buy on behalf of public employees of state universities makes absolutely no sense as a matter of public policy.

The bill would also **not** apply to private pension plans, other institutional investors and just about everyone with a 401(k) pension plan or mutual fund in Ohio.

Cost to the State Retirement Systems

As indicated above, an initial list of 22 companies investing in Iran's energy sector was given to us. A subsequent list of 52 companies with certain ties to Iran and Sudan was provided last week. ISS, an independent research provider, has identified for SERS 105 foreign companies that would be prohibited investments under the current criteria established under Am. Sub. H.B. 151. ISS is currently doing some or all of the screening for Florida, California and Colorado.

Requiring the state retirement systems to divest of the securities in these companies will impose at least trading costs as they sell the securities and buy replacements. Further, there will likely be market impact cost as traders, knowing that the retirement systems must sell these holdings within 18 months after the effective date of the bill, drive down the prices of the securities being sold. Moreover, the retirement systems will be required to contract with one or more independent research providers to prepare accurate lists of prohibited investments and monitor them on a continuous basis as foreign companies cease or commence business ties with Iran or Sudan. Also, divestiture will reduce the opportunity set of investments, which has an implicit cost in terms of lower returns and higher risk. It should be noted that any investment losses incurred by any of the five state retirement systems would further reduce the limited resources available for discretionary retiree health care benefits as each retirement system has a statutory obligation to fund mandated pension benefits within a 30-year funding period.

While it is certain that Am. Sub. H.B. 151 would impose additional costs to the retirement systems as described above, the amount of those costs are uncertain because the lists of

scrutinized companies differs significantly, ranging anywhere from 52 to 105 foreign companies, and the future opportunity costs of a limited international investment universe is unknowable. Based on the list of 52 scrutinized foreign companies, the estimated direct holdings of the state retirement systems are as follows:

- STRS - $771 million representing about 22 foreign companies;
- PERS - $267 million representing about 30 foreign companies;
- OP&F - $131 million representing about 8 foreign companies;
- SERS - $120 to $130 million representing about 18 companies.

Indemnification

As noted above, any investment losses incurred by the five state retirement systems as a result of Am. Sub. H.B. 151 would further reduce the limited resources available for discretionary retiree health care benefits as each retirement system has a statutory obligation to fund mandated pension benefits within a maximum 30-year funding period. While the bill provides that members, employees and agents of the retirement board shall be indemnified for any losses incurred as a result of the investment restrictions proposed under the bill, the bill provides no indemnification for the retirement systems themselves, meaning the members, retirees and their beneficiaries shall bear the financial burden for any losses. Legislation in California provides that the State of California shall provide indemnification to the state retirement systems for any losses incurred as a result of a similar investment mandate. Consideration should be given to do the same for the five state retirement systems in Ohio.

Fiscal Impact – See Cost to the State Retirement Systems.

Staff Recommendation – That the Ohio Retirement Study Council recommend that the 127th Ohio General Assembly disapprove Am. Sub. H.B. 151 for the reasons cited above and that the General Assembly consider the attached amendment that would require the retirement boards to adopt and implement a written policy, within 90 days after the effective date of the bill, to address investments in scrutinized companies doing business in Iran and Sudan and report annually to the Governor, President of the Senate, Speaker of the House, and the ORSC on their progress in implementing such policy. The amendment is modeled after S.B. 133 (eff. 9/15/04), and would allow the boards to make any divestment decisions consistent with their fiduciary duties.

ORSC Position - At is meeting of May 22, 2007 the Ohio Retirement Study Council recommended by a vote of 9 to 0 that the 127th Ohio General Assembly disapprove Sub. H.B. 151 (LSC 127 0911-7) for the reasons cited above and that the General Assembly consider the attached amendment that would require the retirement boards to adopt a policy to address investments in scrutinized companies doing business in Iran and report annually to the ORSC on their progress in implementing such policy. The amendment is modeled after S.B. 133 (eff. 9/15/04), and would allow the retirement board to make any divestment decisions consistent with their fiduciary duties.

Am. Sub. H.B. 151 – Reps. Mandel, Jones

The ORSC has not yet reviewed Am. Sub. H.B. 151 as reported by the House Financial Institutions, Real Estate and Securities Committee, but the mandate to divest remains a part of the bill. Additionally, the systems' actuaries have not yet had an opportunity to review this version of the bill.

The bill is pending in the House Rules and Reference Committee.

H.B. 152 – Rep. Widener

H.B. 152 would require each school board to offer public school teachers and employees the alternative retirement plan (ARP) in lieu of the State Teachers Retirement System (STRS) or the School Employees Retirement System (SERS).[10] Current law requires public school teachers and employees to participate in STRS and SERS, respectively. The ARP is a defined contribution (DC) plan administered by private vendors, and is limited to full-time employees of public institutions of higher education under current law.[11]

Public school teachers and employees whose employment commences on or after the effective date of the bill *or* who have less than five years of service credit on the day immediately preceding the effective date of the bill may elect the ARP in lieu of STRS or SERS.[12] The election shall be made no later than 120 days after employment commences for new hires and no later than 120 days after the ARP is adopted for current employees with less than five years of service. Failure to make an election shall be deemed to be an election to participate in STRS or SERS, as applicable.

Public school teachers and employees electing the ARP shall contribute the same percentage of compensation as currently required under either STRS (10%) or SERS (10%), as applicable. Each school board shall contribute the same percentage of payroll on behalf of such teachers and employees as currently required under either STRS (14%) or SERS (14%), as applicable. The bill would require that a percentage of the employer contribution rate be made to the otherwise applicable retirement system to mitigate any negative financial impact of the ARP on such retirement system. The initial percentage would be six percent, as modified every three years based upon an actuarial study prepared by the ORSC actuary,

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[10] "School board" means the board of education of a city, local, exempted village, or joint vocational school district, the governing board of an educational service center, or the governing board of a community school.

[11] In a defined contribution plan, the employer only promises to allocate a specified contribution, generally a percentage of the employee's annual salary, to the employee's individual account. The employer does not promise the employee any specific benefit amount at retirement; rather, the employee receives a benefit in an amount determined by his or her account balance, the interest rate expected to be earned on the funds in the account and the anticipated length of time the benefit is to be paid. Under this type of plan, the employer's liability is limited to each year's required contribution; the employee bears all investment risk.
In a defined benefit plan, the employer agrees to provide the employee a benefit amount at a stipulated retirement age based upon a specified formula. The formula is typically based on years of service and earnings. Under this type of plan, the employer is responsible for ensuring that contributions made by the member and the employer are sufficient, when combined with earnings on pension assets, to fulfill the benefit promises. The investment risk is borne by the employer.

[12] The bill would exclude educational employees of the Department of Education otherwise subject to STRS membership as well as any person, not a faculty member, employed in any school, college or other institution wholly controlled and managed by the state or any political subdivision thereof otherwise subject to SERS membership.

except that such percentage shall *not* exceed the percentage adopted by the retirement system to mitigate any negative financial impact of its own DC plan upon such retirement system (An amendment to a biennial budget bill provided for this exception (H.B. 94 – eff. 9/5/01).

Background – The ARP was established in H.B. 586 (eff. 3/31/97) for full-time academic and chief administrative employees of public institutions of higher education electing the DC plan in lieu of the defined benefit (DB) plans of PERS, STRS or SERS. An amendment to an omnibus retirement bill (S.B. 133 – eff. 8/1/05)) extended eligibility for the ARP to all full-time employees of public institutions of higher education.

One of the recommendations made in the final report of the Joint Legislative Committee to Study Ohio's Public Retirement Plans (December 11, 1996) was as follows:

> *"That an alternative defined contribution plan be established, in conjunction with the existing defined benefit plan, in the three non-uniformed employee retirement systems [PERS, STRS, SERS] to provide greater portability and options for employees."*

Pursuant to that specific recommendation, S.B. 82 (eff. 3/7/97) required each board to develop for legislative consideration an alternative benefit program to provide greater pension portability and options for their members. Subsequent legislation was then enacted requiring each board to establish an alternative defined contribution plan, in conjunction with the existing defined benefit plan, in PERS (H.B. 628 – eff. 9/21/00), STRS (S.B. 190 – eff. 7/13/00) and SERS (S.B. 270 – eff. 4/9/01). STRS established an alternative DC plan as well as a combined plan with a DC benefit funded by employee contributions and a DB benefit funded by employer contributions in 2001. Similarly, PERS established an alternative DC plan as well a combined plan in 2003 as required by statute. SERS conducted a member survey in 2002 that generally concluded there was no interest in a pure DC plan among its members, although there appeared to be considerable interest in a plan that combined features of a DB and DC plan. No DC plan or combined plan has been established in SERS.

The issue of greater portability of benefits for short-term, mobile employees under the STRS DB Plan and the PERS DB plan was also addressed in H.B. 586 (eff. 3/31/97) and S.B. 144 (eff. 12/13/00), respectively. These two legislative enactments required STRS and PERS to pay interest upon a refund of the member's accumulated contributions and, for members with at least five years of service, a portion of the employer contributions. No similar requirements were enacted in SERS, which currently provides for only a refund of the member's accumulated contributions without interest upon termination of employment prior to service retirement.

Staff Comments – H.B. 152 raises several public policy issues that merit serious legislative consideration and discussion.

Rationale of ARP for Higher Education Employees

The ARP was established for higher education employees in 1997, and received the favorable recommendation of the ORSC for the following reasons:

H.B. 152 – Rep. Widener

- Public institutions of higher education in Ohio successfully demonstrated a compelling need for an ARP (i.e., a defined contribution plan) to enable them to compete in the national market for faculty and top administrators.
- The ARP was very common for higher education employees throughout the nation; forty-seven (47) states had an ARP for higher education employees. The Teachers' Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) is the best-known, oldest and largest defined contribution plan for higher education employees. TIAA-CREF was originally created in 1918 to provide retirement income for private and public university and college professors and administrators.
- None of the non-uniformed employee retirement systems (PERS, STRS, SERS) offered a comparable defined contribution plan for higher education employees. Each retirement board had just initiated a feasibility study of establishing such alternative benefit plans for their members as required under S.B. 82 (eff. 3/7/97).

The above reasons would seemingly argue against the proposed expansion of the ARP to K-12 public school teachers and employees. First, school boards have *not* demonstrated a compelling need to enter the national market to recruit public school administrators, teachers and other employees in Ohio. In fact, they have offered opposition testimony to the bill on behalf of the Ohio Association of School Business Officials (OASBO), the Ohio School Boards Association (OSBA), and the Buckeye Association of School Administrators (BASA), citing the creation of a new and unnecessary administrative and financial burden on school districts, the lack of demand from STRS and SERS members, and the shift of fiduciary duty in administering the plan from the retirement boards to the school boards among other reasons.[13]

Secondly, DC plans, as a primary rather than a supplemental retirement plan, are very rare for K-12 public school teachers and employees; the overwhelming majority of elementary and secondary public school teachers and employees are covered under defined benefit (DB) plans throughout the nation. To date, only two (2) states (Alaska, West Virginia) have established mandatory DC plans for K-12 employees, *though West Virginia has recently passed a bill to convert it back to DB plan due to the inadequacy of plan benefits and increased costs under the DC plan created in 1991.* Only three (3) states (Florida, Ohio, South Carolina) have established optional DC plans for K-12 employees, in conjunction with their existing statewide DB plans. And only four (4) states (Indiana, Ohio, Oregon, and Washington) have established hybrid plans for educational employees that combine features of both DC and DB plans whereby the employer-funded portion of the plan is a defined benefit while the employee-funded portion is a defined contribution. The most common method for addressing the interstate portability needs of mobile educational employees under DB plans throughout the nation is the purchase of service credit; 47 states allow K-12 public school teachers and employees to purchase out-of-state service credit, including Ohio. Moreover, several states, including Ohio, have made it easier for members to purchase such

[13] The DC plan was recently created in Alaska for new hires on or after July 1, 2006; the DC plan was created in West Virginia for new hires on or after July 1, 1991, but is to be converted back to a DB plan for new hires on or after July 1, 2006.

credit by allowing for installment payments through payroll deduction plans and trustee-to-trustee transfers from 457(b) governmental deferred compensation plans (e.g., Ohio Public Employees Deferred Compensation Plan), 403(b) tax-sheltered annuity plans (e.g., TIAA-CREF) and other 401(a) qualified pension plans (e.g., state retirement systems) – all on a tax-deferred basis.

Thirdly, since the establishment of the ARP for higher education employees in 1997, the General Assembly has refrained from expanding the ARP beyond public institutions of higher education. In 1999, the Ohio General Assembly took no action on H.B. 199 (123rd General Assembly), which would have expanded the ARP to all members of the state retirement systems, including the Ohio Police and Fire Pension Fund and the Highway Patrol Retirement System. It also took no action on H.B. 623 (123rd General Assembly), which would have expanded the ARP to elected officials and non-classified state employees. In lieu of these bills, the 123rd General Assembly enacted legislation consistent with the recommendation made in the final report of the Joint Legislative Committee to Study Ohio's Public Retirement Plans requiring the establishment of a DC plan, in conjunction with the existing DB plan, in PERS (H.B. 628 – eff. 9/21/00), STRS (S.B. 190 – eff. 7/13/00) and SERS (S.B. 270 – eff. 4/9/01) – all of which were favorably recommended by the ORSC.

Since July 1, 2001 STRS has offered members in lieu of its DB plan an optional DC plan as well as an optional hybrid plan that combines features of both DB and DC plans. The STRS DC plan is comparable to the ARP, yet provides greater flexibility by allowing members to make a plan reselection in the fifth year of employment. In addition to the optional DC plan and hybrid plan, portability is also provided to K-12 teachers under STRS in a number of other ways, including the following:

- Statewide multiple-employer retirement plan covering all public school districts in Ohio;
- Coordinated retirement provisions with PERS and SERS allowing members to combine contributions and service credit between retirement plans;
- Purchase or transfer of uniformed employee retirement system (OP&F, HPRS) credit;
- Purchase of prior service credit authorizations, including teaching service in a public or private school of this or another state;
- Enhanced refund provisions requiring payment of interest upon a refund of member contributions and, for members with at least five years of service, a portion of employer contributions;
- Trustee-to-trustee transfers from 457(b) governmental deferred compensation plans, 403(b) tax-sheltered annuity plans and other 401(a) qualified pension plans.

As noted above, SERS conducted a member survey in 2002 that generally concluded there was no interest in a pure DC plan among its members, although there appeared to be considerable interest in a hybrid plan that combined features of a DB and DC plan (46% of respondents). Unlike the other two non-uniformed employee retirement systems (PERS, STRS), SERS has *not* established an optional DC plan (*or hybrid plan*) as required by current statute, though no time deadline has been imposed by the legislature. Moreover, the

legislature has not enacted comparable provisions in SERS for an enhanced refund requiring payment of interest on the member contributions and, for members with at least five years of service, a portion of employer contributions. As such, SERS currently offers less portability and options for its members than PERS and STRS;
at a minimum, the legislature should require the establishment of a hybrid plan in SERS by a date certain.

STRS and SERS as Multiple-Employer Plans v. Individual Employer Plans

Since their creation in 1920 and 1937, respectively, STRS and SERS were established as statewide multiple-employer retirement systems, with each retirement board vested with the responsibility for the administration and management of the retirement system. This is in direct contrast to the 454 separate local police and fire pension funds that existed in Ohio prior to their consolidation into the statewide multiple-employer OP&F in 1967 due to the inability of many individual employers to effectively administer and manage their pension funds for police and firefighters – many of which were on the brink of financial insolvency. This is also in direct contrast to the nearly 1,000 school boards in Ohio that, under H.B. 152, would become a plan sponsor and a fiduciary of the ARP for their teachers and educational employees and assume responsibility for the administration and management of the ARP, including, but not limited to, the following:[14]

- Negotiate and enter into a contract with each private vendor designated by the Department of Insurance that is willing to provide investment options under the individual employer's ARP;
- Notify in writing STRS or SERS, as applicable, within ten days of each employee's election;
- Allow each employee to change vendors at least once per year and at any time the vendor ceases to be designated;
- Transmit the required contributions to the vendor selected by each employee as well as the supplemental contributions to the state retirement system that would have otherwise covered such employee;
- Perform such other necessary functions for the proper administration of the ARP.

Each ARP established by the nearly 1,000 school boards in Ohio would **not** be subject to the jurisdiction of the ORSC which, since 1968, has provided legislative oversight of the five statewide retirement systems in Ohio. Each ARP would also **not** be subject to the numerous legislative reporting requirements applicable to the five retirement systems, such as fiduciary audits, semi-annual investment reviews, use of Ohio-based brokers, investment managers, and minority enterprises, etc. In short, there would be less accountability and oversight under the ARP than under the five state retirement systems, contrary to the numerous pension reforms recently enacted in S.B. 133 (eff. 9/15/04) to improve accountability, oversight and fiduciary standards with respect to the governance and operation of the public pension plans for governmental employees in Ohio.

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[14] Currently, the ARP is limited to only 37 state universities and colleges.

<u>H.B. 152 – Rep. Widener</u>

Other advantages to statewide multiple-employer retirement systems as opposed to individual employer-sponsored retirement plans include the following:

- Statewide multiple-employer retirement systems provide uniformity of benefits as well as portability of benefits for all school districts in Ohio; H.B. 152 provides that each school board shall contract with each private vendor designated by the Department of Insurance only to the extent that vendor is willing to provide investment options to employees of that school board, potentially creating differences among school boards should a private vendor choose to provide investment options to employees of select school districts only.
- Statewide multiple-employer retirement systems provide more efficient and effective administration by eliminating unnecessary duplication of function and achieving economies of scale in order to reduce overall administrative and investment-related expenses.

Other Jurisdictions

As noted above, DC plans, as a primary rather than a supplemental retirement plan, are very rare for K-12 public school teachers and employees; the overwhelming majority of elementary and secondary public school teachers and employees are covered under defined benefit (DB) plans throughout the nation. It is important to note that unlike Ohio the few states that have established DC plans as a primary retirement plan also provide Social Security coverage. Social Security is generally a defined benefit plan that provides safety net benefits, including retirement, disability, survivor and death benefits. It is also important to note that the DC plans established by the other states are part of a statewide multiple-employer retirement system rather than a single employer-sponsored retirement plan as proposed under H.B. 152. Therefore, it is unlikely that the proposed ARP under the bill would improve recruitment efforts or portability of benefits in any meaningful way for K-12 public school teachers and employees entering or leaving Ohio.

Exclusion of PERS

H.B. 152 would only apply to school boards currently covered under STRS and SERS. The bill would **not** apply to the state, counties, municipal corporations, townships and all other employers covered under PERS which, like STRS, has established an alternative DC plan as well as a combined plan for its members. The rationale for the different treatment of the three non-uniformed employee retirement plans is unclear as a matter of public policy.

<u>Fiscal Impact</u> – In general, the proposed ARP would have a negative fiscal impact upon STRS and SERS for three reasons. The first reason is that the existing unfunded liabilities of STRS and SERS must be amortized. The retirement systems rely on contributions for the next 30 or so years from all employees presently covered by the retirement systems (current and future hires) to amortize these liabilities. To the extent that the ARP decreases the

number of employees joining the retirement systems in the future or allows current members to opt out of the retirement systems, the financing base is eroded.

The second reason is that the decrease in the amount of forfeited contributions available to pay the retirement systems' unfunded liabilities that results from the transfer of some members to the ARP outweighs any corresponding decrease in the retirement systems' liabilities that may occur as a result of such transfer. That is, to the extent that employees make decisions based on their best financial interests (and consequently, the systems' worst financial interests), the retirement systems' costs will increase.

A third reason is that members electing to join an ARP receive compensation generally higher than the compensation provided to other members. Employer contributions allocated to fund discretionary health insurance benefits for retired members are expressed as a percentage of pay. But the cost of health insurance does not vary in proportion to earnings. Thus, if the employees with higher than average earnings transfer to an ARP, contributions to finance health insurance will decrease disproportionately to the decrease in the long term cost of providing health insurance to retirees.

According to the STRS actuary Buck Consultants, the fiscal impact of the expanded ARP on the STRS funding period and funded ratio depends on both the amount of the supplemental employer contribution rate to finance the unfunded liability of the DB plan and the percentage of new hires that elect to participate in the ARP. The following table shows the projected impact on the funding period and funded ratio as of July 1, 2025 for various combinations of member participation rates and supplemental employer contribution rates to the DB plan:

Participation Rate for New Hires	Supplemental Employer Contribution to DB Plan	Projected Funding Period in 2025	Projected Funded Ratio in 2025
0% (Baseline)	N/A	11.2 years	91%
10%	0.0%	13.7 years	90%
10	3.5%	12.6 years	90%
10	8.0%	11.3 years	91%
40%	0.0%	26.2 years	86%
40%	3.5%	17.8 years	88%
40%	8.0%	11.4 years	90%
75%	0.0%	Infinite	82%
75%	3.5%	28.2 years	85%
75%	8.0%	11.6 years	89%

Similarly, the SERS actuary Buck Consultants estimated the fiscal impact of the expanded ARP on the SERS funded ratio as follows:[15]

[15] All scenarios included in the table assume a 30-year funding period for amortizing SERS' unfunded liabilities.

H.B. 152 – Rep. Widener

Participation Rate For Eligible Members	Supplemental Employer Contribution to DB Plan	Projected Funded Ratio in 2025
0% (Baseline)	N/A	90%
1% 1%	0.0% 6.0%	90% 90%
10% 10%	0.0% 6.0%	89% 89%
40% 40%	0.0% 6.0%	85% 85%
75% 75%	0.0% 6.0%	80% 81%

In addition, Buck Consultants notes the negative fiscal impact of the expanded ARP on the SERS health care fund. Under each scenario listed in the table above, the actuary estimates that the amount of employer contribution necessary to fund pension benefits guaranteed by statute within a 30-year funding period would increase, thereby lowering the amount of employer contribution currently allocated to discretionary retiree health care benefits. Since employer health care contributions are calculated as a percent of active member payroll, fewer active employees with a lesser payroll and a higher pension contribution requirement would result in a decrease in the overall level of employer contributions that will be made to the SERS health care fund and in a shortening of the expected solvency period of the SERS health care fund. Moreover, transferring employees from SERS to the ARP would lower the overall active member payroll, thus lowering the employer health care surcharge contributions to the SERS health care fund, which currently generate the maximum 1.5% of payroll permitted by statute. The level of negative fiscal impact upon the SERS health care fund would ultimately depend upon the number of eligible employees who elect to transfer to the ARP and their compensation levels.

ORSC Position – At the September 12, 2007 meeting of the Ohio Retirement Study Council, the Council voted to recommend that the Ohio General Assembly disapprove H.B. 152 for the reasons cited above.

The bill is pending in the House Financial Institutions, Real Estate and Securities Committee.

H.B. 240 – Rep. Goodwin

H.B. 240 would limit the ability of a public employer covered by the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), or the Ohio Police and Fire Pension Fund (OP&F) to rehire a retired administrative employee to the same position held at the time of retirement.[16]

In order to rehire an administrative employee to the same position, the following criteria must be met:

> 1. The employer must submit, on a form provided by the retirement board, a written request that the retirement board authorize the employment;
>
> 2. The retirement board must authorize the employment by notifying the employer of the amount that equals 60% of the retirant's final average salary; and
>
> 3. The annual salary of the reemployed retirant cannot exceed 60% of the retirant's final average salary.

The bill provides that the employment cannot exceed one year beginning on the date of reemployment. Additionally, employment would automatically terminate in one year unless the employer renews employment by (1) notifying the retirant of the date employment terminates; (2) conducting a review of the retirant's employment to determine whether to continue employment; and (3) notifying the retirant of the results of the review.

A retirant who is reemployed under the provisions of this bill is also prohibited from receiving nonmonetary compensation for the employment other than health care coverage, if the employer provides coverage to other employees who perform similar work.

A PERS administrative employee is defined as (1) the head of any department appointed by the Governor or by and with the Governor's consent or by the chief appoint authority of any entity of local government; (2) a deputy or assistant of any state agency or local government agency authorized to act for and on behalf of the agency, or holding a fiduciary or administrative relation to that agency; (3) a deputy or assistant of any officer or principal executive officer of an entity of state or local government who is authorized to act for and in the place of the officer or performs administrative functions or has managerial responsibilities and duties, including an executive director or assistant executive director. It does not include a person elected or appointed to an elective state or local government office.

An OP&F administrative employee is defined as (1) a member of a police department employed as a chief of police or in another position with managerial responsibilities and duties and (2) a member of a fire department employed as a fire chief or in another position with managerial responsibilities and duties.

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[16] The Highway Patrol Retirement System is not included in the bill because persons age 35 or older are ineligible to become state troopers.

H.B. 240 – Rep. Goodwin

The bill defines an STRS administrative employee as (1) a person employed as superintendent, principal, assistant principal, or any other position with managerial responsibilities and duties and (2) a person employed as a president, business manager, administrative officer, dean, or assistant dean of an institution of higher education or any other position with managerial responsibilities and duties. Whereas an SERS administrative employee means a person employed in a position with managerial responsibilities and duties, but does not include a school board member or a governing board member.

Current law limits reemployment of retirees in several different ways. First, reemployed retirees are required to wait two months before becoming reemployed with a public employer regardless of whether the retiree is reemployed in the same position. If a retiree returns to employment before the expiration of the two-month waiting period, the retirement allowance is forfeited for any month in which the retirant is reemployed prior to the expiration of the two-month period. Reemployed retirees are not considered members of the retirement system and do not earn an additional defined benefit, but they and their employers still must contribute to the retirement system toward a "money purchase benefit." The calculation of the money purchase benefit is the amount of the retiree's accumulated contributions, excluding contributions made during the two-month waiting period, plus an amount determined by the board (an equal amount in the case of OP&F), plus interest at a rate determined by the board.

Another limitation to reemployment concerns elected officials who retire and are re-elected or appointed to the same office for the remainder of their term or the term immediately following. They are prohibited from receiving their retirement allowance while drawing a salary for that office unless they file notice of an intent to retire at least 90 days prior to the primary election. If notice is filed, the official is treated the same as all other PERS members. A reelected official who does not file notice becomes a new member of PERS and receives a refund of accumulated contributions, plus interest or a supplemental retirement allowance based on the reemployment period.

Finally, if a member of PERS, STRS, or SERS retires from a position that is customarily filled by a vote of members of a board or commission or, for a PERS retirant, by the legislative authority of a county, municipal corporation, or township, the board, commission, or legislative authority must give public notice and hold a meeting on the issue of reemployment before the employment is to begin.

From an actuarial funding perspective, the state retirement systems are designed so that the employee and employer contributions made to the system over the working life of the member, together with investment earnings thereon, are sufficient to fund in full the retirement allowance payable to the member upon retirement. Therefore, the fact that the retired member may be employed subsequent to retirement by a public employer rather than a private employer has no actuarial cost impact upon the retirement system's funding of the retirement allowance earned by the member.

H.B. 240 – Rep. Goodwin

Background – Prior to 1991, reemployed retirees did not contribute to any of the public retirement systems. That changed in response to a federal mandate that would have otherwise required certain reemployed retirees to contribute to the Social Security System on or after July 1, 1991. Because Ohio has consistently opposed mandatory Social Security coverage for public employees, the legislature enacted H.B. 382 (eff. 6/30/91), which required retirees who become reemployed in the public sector to contribute to a public retirement system in lieu of Social Security. Under the federal law, public employees not contributing to a state or local retirement system are generally required to contribute to Social Security.

Accordingly, the prior reemployment restrictions were amended in 1991 to require contributions from all reemployed retirees toward a money purchase benefit equal to the member's accumulated contributions during reemployment, with interest, along with a matching amount from employer contributions. Reemployed retirees continued to receive their original retirement allowance during the period of reemployment, provided they waited at least two months after retirement before returning to employment (18 months after retirement in STRS before returning to full-time teaching). The money purchase benefit was payable as a lump sum payment or monthly annuity upon the later of the first day of the month following termination of employment, attainment of age 65 (age 60 in OP&F) or 12 months after the effective date of their last money purchase benefit.

Unlike any of the other state retirement systems, PERS retirees who were reemployed in a position covered by PERS were given the option to forego their original retirement allowance during the period of reemployment and become members of PERS, with all the rights and obligations of membership, except survivor coverage. They were eligible for a supplemental formula benefit based upon their years of service and final average salary earned during the period of reemployment or a refund of their accumulated contributions during the period of reemployment.

Since the enactment of H.B. 382, the reemployment statutes have been amended in an ad hoc manner. H.B. 151 (eff. 2/9/94) increased the waiting period from two to six months for PERS retirees who were reemployed in positions covered by PERS; the two-month waiting period, however, still applied to PERS retirees who were reemployed in positions covered by another state retirement system. Also, H.B. 151 prohibited an elected official from retiring from PERS during the period beginning 31 days prior to the election date through 31 days after the commencement of the new term of office. S.B. 82 (eff. 12/6/96) further changed the restrictions applicable to elected officials who retired from PERS and were elected or appointed to the same office by requiring them to forego their retirement allowance during the period of reemployment and become once again members of PERS under the special option described above.

As shown above, prior to 2000 various reemployment restrictions applied to different groups of retired public employees. This raised the public policy issue of whether the reemployment restrictions among the Ohio retirement systems should be made more uniform, where practicable. The legislature enacted S.B. 144 (eff. 9/14/00), which modified the reemployment statutes of the state retirement systems. *The purpose of these modifications*

was to provide a single, uniform set of rules applicable to all retired public employees, including elected officials, who were reemployed in a position covered by any of the five state retirement systems in Ohio. Another purpose was to alleviate shortages in experienced personnel in some critical areas (teachers, township trustees). The prior reemployment statutes often served as a disincentive or obstacle for retired public employees to fill such vacancies. In this regard, S.B. 144 made three major changes to the reemployment statutes.

First, S.B. 144 amended the reemployment provisions of PERS and STRS with respect to the minimum waiting period. The bill reduced the minimum waiting period in PERS and STRS from six and eighteen months, respectively, to two months, which is consistent with the reemployment statutes of the other state retirement systems.

Second, S.B. 144 permitted members of PERS, STRS or SERS who have concurrent service covered under PERS, STRS or SERS to retire from the position having the higher salary and continue contributing on the other position(s) toward a money purchase benefit. Under prior law, such members were prohibited from retiring prior to termination of all employment covered by PERS, STRS or SERS. Under S.B. 144, the determination of eligibility for retirement and the amount of the retirement allowance on the higher-salaried position is based on the member's total service credit and contributions in PERS, STRS and/or SERS **prior to** the effective date of retirement, except that no more than one year of service credit shall be granted for any twelve-month period. The retiree continues to contribute to PERS, STRS or SERS on the position(s) having the lower salary. Upon termination of employment in the lower-paid position, the retiree is eligible for a money purchase benefit equal to the member's accumulated contributions **on or after** the effective date of retirement, with interest, along with an amount from employer contributions.

Third, S.B. 144 amended the PERS reemployment statute to eliminate the previous option provided to PERS retirees who were employed in PERS-covered positions to forego their retirement allowance during the period of reemployment, reestablish membership in PERS with all the rights and obligations thereof, except survivor coverage, and accrue additional service credit toward a supplemental retirement allowance based on such service. None of the other state retirement systems provided for this option. S.B. 144 grandfathered in all PERS retirees who chose this option prior to the effective date of the bill in recognition of the prospective application of new laws in Ohio. S.B. 144 also permitted those elected officials who were required by statute to choose the option to revoke it.

Less than one year after the enactment of S.B. 144, the reemployment restrictions for elected officials that existed prior to S.B. 144 were reinstated by H.B. 84 (eff. 7/31/01). However, elected officials who provided written notice of their intent to retire 90 days prior to the election were exempted from the provisions. The notice requirement was subsequently changed in H.B. 95 to 90 days prior to the *primary* election (H.B. 95; eff. 6/26/03).

H.B. 95 also enacted the current provision that a member of PERS, STRS, or SERS who retires from a position that is customarily filled by a vote of members of a board or commission or, for a PERS retirant, by the legislative authority of a county, municipal

corporation, or township, the board, commission, or legislative authority must give public notice and hold a meeting on the issue of reemployment before the employment is to begin.

Staff Comments – This bill raises the public policy issue of whether public employers should be limited in their hiring of employees based on the retirement status of the employee. The current requirement that retirants must forfeit their allowance during the two-month waiting period is intended to deter public employees from retiring and immediately resuming public employment. However, it does not prevent a public employer from hiring a retirant, nor does it prevent a retirant from resuming public employment. Based on the numerous bills over the years that have attempted to limit reemployment, allowing a public employee to receive a retirement benefit and immediately become reemployed in the same public position without a break in service has been a central issue. One way to deter this would be to increase the time period for the benefit forfeiture. Rather than limiting the forfeiture of the allowance to just the two-month waiting period, the legislature could consider extending the forfeiture period to the entire reemployment period if the retiree returns to the same position before the expiration of the two-month waiting period.

Another option would be to allow members of all systems to enroll in a deferred retirement option plan (DROP) similar to those offered by OP&F and HPRS. Generally, participation in a DROP is limited to members who are otherwise eligible for normal service retirement. The member continues to be employed for some defined period during which the member's monthly service retirement benefit is credited to the member's DROP account, along with annual compound interest at some specified rate. Upon termination of employment, the member receives a lump sum distribution of the member's DROP account or some alternative distribution thereof, and begins receiving a monthly service retirement benefit based upon the member's final average salary and service credit calculated at the time the member elects participation in the DROP. DROPs are intended to be cost neutral to the retirement systems.

According to a survey conducted by Watson Wyatt, phased retirement arrangements, such as DROPs, are becoming increasingly popular in both the private and public sectors. The reasons for this include longer life spans and improved health at older ages, employers' need to retain skilled and valued workers, and individuals' need to supplement retirement income. Recently, Congress eliminated the Social Security earnings test for workers who reach full retirement age, which had penalized older workers by reducing their Social Security benefits. Additionally, the Pension Protection Act of 2006 allows in-service distributions to employees who have reached age 62.

The concept of a DROP is generally consistent with the objective of one of the recommendations included in the final report of the Joint Legislative Committee dated December 11, 1996. Staff recommended that the normal retirement age in both the uniform and non-uniform employee retirement systems be increased. Allowing members to select participation in a DROP rather than retiring and then applying for the same position would encourage public employees to continue working longer than they otherwise would have without receiving a retirement benefit. As an active member in a DROP, the public employee

receives health care benefits from his or her employer rather than from the retirement system. A DROP also prevents the public employee from receiving both a salary and a pension benefit simultaneously.

Fiscal Impact – According to the PERS actuary, Gabriel Roeder Smith & Company, the bill makes return to work less attractive, and is likely to result in a greater number of regular, contributing members than would otherwise be the case. Therefore, more contributions would be available to fund the unfunded liability than would otherwise be the case. This effect, while favorable for PERS, is likely to be too small to measure reliably.

According to the STRS actuary, Buck Consultants, they expect the bill will impact a sufficiently small number of members so that the financial impact on the system will be negligible.

According to the SERS actuary, Buck Consultants, it is expected that the number of potential employees affected by the bill would be minimal. Therefore, the actuary believes the overall impact on SERS would be negligible given the magnitude of SERS' overall liabilities.

According to the OP&F actuary, Buck Consultants, the bill will impact a sufficiently small number of members so they expect the financial impact on the fund to be negligible.

ORSC Position – At its October 10, 2007 meeting the Ohio Retirement Study Council voted to recommend that the 127th Ohio General Assembly disapprove H.B. 240 and instead consider (1) discouraging public employees from returning to the same position from which they retired without a break in service by requiring them to forfeit their allowance during the entire period of reemployment rather than just during the two-month waiting period if the retirant returns to the same public position prior to the two-month waiting period and (2) allowing members of PERS, STRS, and SERS to participate in a deferred retirement option plan.

The bill is pending in the House Financial Institutions, Real Estate and Securities Committee.

Sub. H.B. 270 – Rep. Schneider

As introduced, H.B. 270 would require a retirant of the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), or the Ohio Police and Fire Pension Fund (OP&F) to forfeit the pension portion of their retirement benefit if they return to the same position or a position that is substantially equivalent to their prior position with the same public employer less than 180 days after their retirement benefit commences.[17] The forfeiture would begin on the day reemployment begins and would end on the first day of the month following the month in which the employment ends. The annuity portion would be suspended and paid to the reemployed retirant in a lump sum following termination of employment.

The pension portion of a retirement benefit is the portion that is derived from contributions made by the employer and is paid in monthly or less frequent installments. The annuity portion of a retirement benefit is the portion of the benefit that is derived from contributions made by the former member and is paid in monthly or less frequent installments.

The bill provides that if there is any doubt as to whether the duties of the position are the same or substantially equivalent, the retirement board shall make the determination. Its decision is final. However, the employer is better suited to determine whether the duties are the same or substantially equivalent because the employer would be familiar with the job. *Therefore, we recommend that the bill be amended to require the employer rather than the retirement board to determine whether the duties of the position are the same or substantially equivalent.*

Current law limits reemployment of retirees in several different ways. First, reemployed retirees are required to wait two months before becoming reemployed with a public employer regardless of whether the retiree is reemployed in the same position. If a retiree returns to employment before the expiration of the two-month waiting period, the retirement allowance is forfeited for any month in which the retirant is reemployed prior to the expiration of the two-month period. Reemployed retirees are not considered members of the retirement system and do not earn an additional defined benefit, but they and their employers still must contribute to the retirement system toward a "money purchase benefit." The calculation of the money purchase benefit is the amount of the retiree's accumulated contributions, excluding contributions made during the two-month waiting period, plus an amount determined by the board (an equal amount in the case of OP&F), plus interest at a rate determined by the board.

Another limitation to reemployment concerns elected officials who retire and are re-elected or appointed to the same office for the remainder of their term or the term immediately following. They are prohibited from receiving their retirement allowance while drawing a salary for that office unless they file notice of an intent to retire at least 90 days prior to the primary election. If notice is filed, the official is treated the same as all other PERS members. A reelected official who does not file notice becomes a new member of PERS and receives a

[17] The Highway Patrol Retirement System is not included in the bill because persons age 35 or older are ineligible to become state troopers.

refund of accumulated contributions, plus interest or a supplemental retirement allowance based on the reemployment period. H.B. 270 would eliminate this provision and apply the 180-day waiting period to all retirees who are reemployed in the same or substantially same position with the same employer.

Finally, if a member of PERS, STRS, or SERS retires from a position that is customarily filled by a vote of members of a board or commission or, for a PERS retirant, by the legislative authority of a county, municipal corporation, or township, the board, commission, or legislative authority must give public notice and hold a meeting on the issue of reemployment before the employment is to begin.

From an actuarial funding perspective, the state retirement systems are designed so that the employee and employer contributions made to the system over the working life of the member, together with investment earnings thereon, are sufficient to fund in full the retirement allowance payable to the member upon retirement. Therefore, the fact that the retired member may be employed subsequent to retirement by a public employer rather than a private employer has no actuarial cost impact upon the retirement system's funding of the retirement allowance earned by the member.

Background – Prior to 1991, reemployed retirees did not contribute to any of the public retirement systems. That changed in response to a federal mandate that would have otherwise required certain reemployed retirees to contribute to the Social Security System on or after July 1, 1991. Because Ohio has consistently opposed mandatory Social Security coverage for public employees, the legislature enacted H.B. 382 (eff. 6/30/91), which required retirees who become reemployed in the public sector to contribute to a public retirement system in lieu of Social Security. Under the federal law, public employees not contributing to a state or local retirement system are generally required to contribute to Social Security.

Accordingly, the prior reemployment restrictions were amended in 1991 to require contributions from all reemployed retirees toward a money purchase benefit equal to the member's accumulated contributions during reemployment, with interest, along with a matching amount from employer contributions. Reemployed retirees continued to receive their original retirement allowance during the period of reemployment, provided they waited at least two months after retirement before returning to employment (18 months after retirement in STRS before returning to full-time teaching). The money purchase benefit was payable as a lump sum payment or monthly annuity upon the later of the first day of the month following termination of employment, attainment of age 65 (age 60 in OP&F) or 12 months after the effective date of their last money purchase benefit.

Unlike any of the other state retirement systems, PERS retirees who were reemployed in a position covered by PERS were given the option to forego their original retirement allowance during the period of reemployment and become members of PERS, with all the rights and obligations of membership, except survivor coverage. They were eligible for a supplemental formula benefit based upon their years of service and final average salary earned during the

period of reemployment or a refund of their accumulated contributions during the period of reemployment.

Since the enactment of H.B. 382, the reemployment statutes have been amended in an ad hoc manner. H.B. 151 (eff. 2/9/94) increased the waiting period from two to six months for PERS retirees who were reemployed in positions covered by PERS; the two-month waiting period, however, still applied to PERS retirees who were reemployed in positions covered by another state retirement system. Also, H.B. 151 prohibited an elected official from retiring from PERS during the period beginning 31 days prior to the election date through 31 days after the commencement of the new term of office. S.B. 82 (eff. 12/6/96) further changed the restrictions applicable to elected officials who retired from PERS and were elected or appointed to the same office by requiring them to forego their retirement allowance during the period of reemployment and become once again members of PERS under the special option described above.

As shown above, prior to 2000 various reemployment restrictions applied to different groups of retired public employees. This raised the public policy issue of whether the reemployment restrictions among the Ohio retirement systems should be made more uniform, where practicable. The legislature enacted S.B. 144 (eff. 9/14/00), which modified the reemployment statutes of the state retirement systems. *The purpose of these modifications was to provide a single, uniform set of rules applicable to all retired public employees, including elected officials, who were reemployed in a position covered by any of the five state retirement systems in Ohio. Another purpose was to alleviate shortages in experienced personnel in some critical areas (teachers, township trustees). The prior reemployment statutes often served as a disincentive or obstacle for retired public employees to fill such vacancies. In this regard, S.B. 144 made three major changes to the reemployment statutes.*

First, S.B. 144 amended the reemployment provisions of PERS and STRS with respect to the minimum waiting period. The bill reduced the minimum waiting period in PERS and STRS from six and eighteen months, respectively, to two months, which is consistent with the reemployment statutes of the other state retirement systems.

Second, S.B. 144 permitted members of PERS, STRS or SERS who have concurrent service covered under PERS, STRS or SERS to retire from the position having the higher salary and continue contributing on the other position(s) toward a money purchase benefit. Under prior law, such members were prohibited from retiring prior to termination of all employment covered by PERS, STRS or SERS. Under S.B. 144, the determination of eligibility for retirement and the amount of the retirement allowance on the higher-salaried position is based on the member's total service credit and contributions in PERS, STRS and/or SERS **prior to** the effective date of retirement, except that no more than one year of service credit shall be granted for any twelve-month period. The retiree continues to contribute to PERS, STRS or SERS on the position(s) having the lower salary. Upon termination of employment in the lower-paid position, the retiree is eligible for a money purchase benefit equal to the member's accumulated contributions **on or after** the effective date of retirement, with interest, along with an amount from employer contributions.

Sub. H.B. 270 – Rep. Schneider

Third, S.B. 144 amended the PERS reemployment statute to eliminate the previous option provided to PERS retirees who were employed in PERS-covered positions to forego their retirement allowance during the period of reemployment, reestablish membership in PERS with all the rights and obligations thereof, except survivor coverage, and accrue additional service credit toward a supplemental retirement allowance based on such service. None of the other state retirement systems provided for this option. S.B. 144 grandfathered in all PERS retirees who chose this option prior to the effective date of the bill in recognition of the prospective application of new laws in Ohio. S.B. 144 also permitted those elected officials who were required by statute to choose the option to revoke it.

Less than one year after the enactment of S.B. 144, the reemployment restrictions for elected officials that existed prior to S.B. 144 were reinstated by H.B. 84 (eff. 7/31/01). However, elected officials who provided written notice of their intent to retire 90 days prior to the election were exempted from the provisions. The notice requirement was subsequently changed in H.B. 95 to 90 days prior to the *primary* election (H.B. 95; eff. 6/26/03).

H.B. 95 also enacted the current provision that a member of PERS, STRS, or SERS who retires from a position that is customarily filled by a vote of members of a board or commission or, for a PERS retirant, by the legislative authority of a county, municipal corporation, or township, the board, commission, or legislative authority must give public notice and hold a meeting on the issue of reemployment before the employment is to begin.

Staff Comments –The current requirement that retirants must forfeit their allowance during the two-month waiting period is intended to deter public employees from retiring and immediately resuming public employment. However, it does not prevent a public employer from hiring a retirant, nor does it prevent a retirant from resuming public employment. Based on the numerous bills over the years that have attempted to limit reemployment, allowing a public employee to receive a retirement benefit and immediately become reemployed in the same public position without a break in service has been a central issue. One way to deter this would be to increase the time period for the benefit forfeiture similar to what H.B. 270 does. However, H.B. 270 requires only the pension portion of the benefit to be forfeited not the entire benefit if the retiree returns to the same position before the expiration of the waiting period. *We recommend that the bill be amended to require retirants who return to the same or substantially same position from which they retired without a break in service to forfeit the full benefit during the entire period of reemployment. We further recommend that the bill be amended to reduce the waiting period from 180 days to 2 months in order to be consistent with the current reemployment provisions.*

Another option would be to allow members of all systems to enroll in a deferred retirement option plan (DROP) similar to those offered by OP&F and HPRS. Generally, participation in a DROP is limited to members who are otherwise eligible for normal service retirement. The member continues to be employed for some defined period during which the member's monthly service retirement benefit is credited to the member's DROP account, along with annual compound interest at some specified rate. Upon termination of employment, the member receives a lump sum distribution of the member's DROP account or some

alternative distribution thereof, and begins receiving a monthly service retirement benefit based upon the member's final average salary and service credit calculated at the time the member elects participation in the DROP. DROPs are intended to be cost neutral to the retirement systems.

According to a survey conducted by Watson Wyatt, phased retirement arrangements, such as DROPs, are becoming increasingly popular in both the private and public sectors. The reasons for this include longer life spans and improved health at older ages, employers' need to retain skilled and valued workers, and individuals' need to supplement retirement income. Recently, Congress eliminated the Social Security earnings test for workers who reach full retirement age, which had penalized older workers by reducing their Social Security benefits. Additionally, the Pension Protection Act of 2006 allows in-service distributions to employees who have reached age 62.

The concept of a DROP is generally consistent with the objective of one of the recommendations included in the final report of the Joint Legislative Committee dated December 11, 1996. Staff recommended that the normal retirement age in both the uniform and non-uniform employee retirement systems be increased. Allowing members to select participation in a DROP rather than retiring and then applying for the same position would encourage public employees to continue working longer than they otherwise would have without receiving a retirement benefit. As an active member in a DROP, the public employee receives health care benefits from his or her employer rather than from the retirement system. A DROP also prevents the public employee from receiving both a salary and a pension benefit simultaneously. *Therefore, we recommend that the bill be amended to allow members of PERS, STRS, and SERS to participate in a deferred retirement option plan.*

Finally, we note that current law allows PERS retirees who return to public employment in certain positions to have their retirement benefit recalculated based on the retiree's original service **and** the retiree's service as a reemployed retiree (R.C. §145.382). The positions that currently can be used to recalculate a benefit are:

> (1) any position authorized by R.C. §§101.31 (Senate clerk, chief administrative officer, House clerk, sergeant-at-arms), 121.03 (administrative department heads), or 121.04 (certain positions created in administrative departments, e.g., commissioner of securities in the Department of Commerce, deputy superintendent of insurance in the Department of Insurance);
> (2) a position to which appointment is made by the Governor with the advice and consent of the Senate;
> (3) the head of a division of a state department.

These are the only groups who are eligible to have their benefit recalculated based on reemployment. In 2000 as part of S.B. 144, the legislature repealed a similar provision. That provision had allowed an elected official of the state or a political subdivision who had retired independently from STRS or SERS to have his retirement benefit recalculated to include the elected service when he retired under PERS. *We recommend that the bill be*

amended to repeal R.C. §145.382, which allows certain reemployed PERS retirees to have their retirement benefit recalculated upon termination of reemployment.

Fiscal Impact – According to the PERS actuary, Gabriel Roeder Smith & Company, it can be expected that very few, if any, people will forfeit their pension amounts because they would either delay retirement or retire and return to work in a different position. Therefore, the bill is likely to result in a small cost savings to PERS with respect to both pension and retiree health to the extent that people delay retirement. However, the savings is likely to be too small to measure reliably. The actuary noted that there would be an unspecified, but probably small administrative cost to the system as the board would have to determine whether a position is the same or substantially equivalent to the pre-retirement position.

According to the STRS actuary, Buck Consultants, the financial impact of H.B. 270 would depend on how STRS members react. However, it would have no immediate impact on the unfunded liabilities or funded status of STRS because the bill impacts only future retirees and the actuarial valuation does not anticipate future reemployment savings or costs. Over time, the unfunded liabilities and funded status would be impacted by the gains or losses associated with H.B. 270.

According to the SERS actuary, Buck Consultants, if H.B. 270 were enacted it would be expected to be favorable to the system. The overall impact on the system would ultimately depend on the number of the affected reemployed retirants, their level of compensation upon reemployment, and the length of their reemployment period. The actuary believes the overall impact on SERS would be negligible given the magnitude of SERS' overall liabilities.

According to the OP&F actuary, Buck Consultants, they believe the impact of H.B. 270 would be favorable, but given the insignificant number of retirees who would be affected compared to the magnitude of the OP&F liabilities in general, the financial impact would be negligible. The enactment of H.B. 270 would have no significant impact on either the unfunded accrued liability or the funding period.

ORSC Position – At its October 10, 2007 meeting, the Ohio Retirement Study Council voted to recommend that the 127th Ohio General Assembly approve H.B. 270 upon the adoption of the following amendments:

- *An amendment that would require retirants who return to the same or substantially same position from which they retired without a break in service to forfeit the full benefit during the entire period of reemployment.*
- *An amendment to reduce the waiting period from 180 days to 2 months in order to be consistent with the current reemployment provisions.*
- *An amendment to require the employer rather than the retirement board to determine whether the duties of the position are the same or substantially equivalent.*
- *An amendment to allow members of PERS, STRS, and SERS to participate in a deferred retirement option plan.*

Sub. H.B. 270 – Rep. Schneider

- *An amendment to repeal R.C. §145.382, which allows certain reemployed PERS retirees to have their retirement benefit recalculated upon termination of reemployment.*

These amendments were adopted at the 10-25-07 meeting of the House Financial Institutions, Real Estate and Securities Committee. Additionally, the following amendments were also adopted at that meeting:

- Allow members who retire from one PERS position while still employed in another PERS-covered position to participate in the additional annuity program, allow all members who participate in the additional annuity program to select any of the plans of payment currently available for retirement benefits, adds to circumstances under which a participant in the additional annuity program may be paid a refund rather than an annuity, and adds additional options for the date payments begin. Change a reference in PERS law to "guaranteed interest" to "earnings" to conform to additional annuity program provisions. *(This was approved at the November 14, 2007 ORSC meeting.)*

- Authorize PERS to recover health care overpayments. *(This was approved at the November 14, 2007 ORSC meeting.)*

- Provide that certain unclaimed funds are to remain in the Employees' Savings Fund or may be transferred to the Income Fund instead of a requirement that the funds be transferred to the Income Fund. *(This was approved at the November 14, 2007 ORSC meeting.)*

- Provide that a change in the plan of payment of a retirement benefit or additional annuity from a plan with survivor benefits to a single life annuity due to the death of the beneficiary is effective the first day of the month following the date of death instead of the first day of the month after the board receives notice of death. *(This was approved at the November 14, 2007 ORSC meeting.)*

- Clarify the effective date of the provision in Am. H.B. 10 (124th G.A.) that limits to one year the period during which a retirant may change a plan of payment after marriage or remarriage for STRS, SERS, and HPRS. *(This change for PERS was already included in the bill.)*

The bill is pending in the House Financial Institutions, Real Estate and Securities Committee.

Sub. S.B. 3 – Sen. Faber

Sub. S.B. 3 would make the following changes:

- Require a member of the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Ohio Police and Fire Pension Fund (OP&F), the Highway Patrol Retirement System (HPRS), or the Cincinnati Retirement System (CRS), or a participant in an Alternative Retirement Plan for higher education employees (ARP) who pleads guilty to or is convicted of a specified offense committed while serving in a position of honor, trust, or profit to forfeit the right to any benefit other than the member's accumulated contributions.[18]

  Under current law, a public employee's retirement or disability benefit cannot be forfeited for employee misconduct.

- Prohibit a person from serving as a retirement system lobbyist if the person is convicted of or pleads guilty to committing any of the following felony offenses after the effective date of the bill:
  - bribery, intimidation, retaliation, theft in office, having an unlawful interest in a public contract, engaging in a pattern of corrupt activity;
  - any of the following if the person committed the violation while the person was serving in a public office and the violation was related to the duties of the person's public office or to the person's actions as a public official: tampering with records, intimidation of attorney, victim, or witness in a criminal case, perjury, tampering with evidence, obstructing official business, obstructing justice;
  - a violation of an existing or former municipal ordnance or law of this or any other state or the United States that is substantially equivalent to any of the above listed violations;
  - a conspiracy to commit any of the above listed violations.

Staff Comments – Under the bill, a member of PERS, STRS, SERS, OP&F, HPRS, or CRS or a participant in an ARP who pleads guilty to or is convicted of a specified felony while serving in a position of honor, trust, or profit would forfeit the right to a pension, annuity, allowance, or any other benefit other than the member's accumulated contributions. If the convicted person is a reemployed retiree, the retiree would be eligible only for a refund of the person's contributions. These provisions apply when the crime was committed on or after the effective date of the bill.

The offenses specified in the bill are the following:

- Bribery (R.C. §2921.02);

[18] The bill also contains provisions regarding the restoration of rights and privileges of persons convicted of certain criminal offenses. This analysis covers only those provisions relating to the public retirement systems.

- Engaging in a pattern of corrupt activity (R.C. §2923.32);
- Theft in office - third degree felony (R.C. §2921.41);
- A violation of an existing or former municipal ordinance or law of this or any other state or the United States that is substantially equivalent to any violation listed above; and
- A conspiracy to commit, attempt to commit, or complicity in committing any violation listed above.

"Accumulated contributions" generally refers to the employee's contributions plus interest, any amounts the employee paid to purchase service credit, and any additional voluntary contributions the employee has made to the retirement system.

"Position of honor, trust, or profit" is defined as the following:

- An elective office of the state or any political subdivision of the state;
- A position on any board or commission of the state that is appointed by the governor or the attorney general;
- A position as a public official or employee, as defined in R.C. §102.01 who is required to file a disclosure statement under R.C. §102.02;
- A position as a prosecutor, as defined in R.C. §2935.01;
- A position as a peace officer, as defined in R.C. §2935.01, or as the superintendent or a trooper of the state highway patrol.

When charges are filed alleging that a person committed an offense specified in the bill while serving in a position of honor, trust, or profit, the prosecutor who has been assigned the case must provide written notice to the retirement system of which the person is a member or the alternative retirement plan in which the person is a participant, whichever is applicable.

Once the system receives notice that the member has been charged with any of the specified offenses, the system is prohibited from (1) making any payment of the member's accumulated contributions prior to the day the system receives a court copy of the journal entry of the member's sentence if the member is convicted of or pleads guilty to the charge and forfeiture is ordered or the day the system receives final disposition of the charge if the charge is dismissed, the person is found not guilty or not guilty by reason of insanity and (2) processing any application for a refund prior to the final disposition of the charge.

If a member is sentenced for an offense specified in the bill while serving in a position of honor, trust, or profit, the court is required to order the forfeiture to the public retirement system or alternative retirement plan in which the offender was a member or participant of the right to a retirement allowance, pension, disability benefit, or other right or benefit, other than payment of the offender's accumulated contributions. The court is required to send a copy of the journal entry imposing sentence to the appropriate retirement system or alternative retirement plan in which the offender was a member or participant.

The bill would allow the offender to request a hearing prior to sentencing to determine whether there is good cause for the forfeiture order not to be issued. If the court finds there is

good cause for the forfeiture order not to be issued, the court shall not issue the forfeiture order.

The retirement system or alternative retirement plan in which the offender was a member or participant must comply with the order at the time the member or contributor applies for payment of his or her accumulated contributions. If a person who is ordered to forfeit his or her pension receives a refund of contributions, the person is barred from restoring the refunded service credit.

Sub. S.B. 3 raises a significant public policy issue: should employee misconduct affect the receipt of public retirement benefits. Current law generally provides that public retirement benefits are assignable or subject to attachment or other legal process only in the following cases:

- Restitution for theft in public office pursuant to a court withholding order;
- Restitution for certain sex offenses committed in the context of the offender's public employment;
- Payment of spousal support and child support pursuant to a court withholding order; and
- Payment to a former spouse pursuant to a division of property order.

This anti-assignment/alienation requirement has been recognized not only in Ohio's public retirement laws, but also under the Employee Retirement Income Security Act (ERISA) as applied to private pension plans. Therefore, Ohio law currently affords public sector employees the same protection as the federal law gives private sector employees with respect to retirement benefits.

The principal reason behind the statutory provisions exempting retirement benefits from legal process except in a limited number of circumstances is that society has an interest in ensuring that an adequate source of income exists for the support of members who are unable to earn income due to age or disability and that a source of income exists for the support of their dependents. This societal interest in securing these sources of income has historically outweighed other competing interests. It is important to note that public employees do not contribute to Social Security and, therefore, rely solely on the benefit provided by the public retirement system for retirement income. If the benefit is forfeited, the member and spouse could be in a position where they would have no source of retirement income.

This bill limits the list of offenses to egregious breaches of the public trust. Like the restitution provisions, the offenses for which a benefit may be forfeited must be committed in the context of the offender's public employment.

Under the provisions of the bill, the forfeiture is triggered when the member withdraws his or her contributions. Therefore, if a member who otherwise would have been eligible to receive a benefit dies prior to applying for a refund, the member's spouse and dependents would still be eligible for survivor benefits. Current law provides that a member who is married at the time the member applies for a refund and is eligible for age and service retirement must

obtain the written consent of his or her spouse before receiving a refund. Because a member subject to forfeiture would not be eligible for a benefit, this provision would not apply. *We recommend that the bill be amended to require written consent from the spouse of a married offender who would have been eligible for age and service retirement but for the forfeiture order.* This would provide additional protection to an innocent spouse and dependents.

We note there is a typo in line 1270, which would require a technical amendment. The code section should be "3307.372" not "3307.732."

Fiscal Impact – According to the PERS actuary, Gabriel Roeder Smith & Company, there was no data available upon which to make a detailed actuarial analysis. However, it is their opinion that the bill would have no measurable financial impact on the system.

According to the SERS actuary, Buck Consultants, the number of affected members would be a very small percentage of the total membership, thus having almost no measurable impact on valuation results, given the magnitude of SERS' overall liabilities.

According to the STRS actuary, Buck Consultants, the proposed legislation would affect too few members for there to be a measurable impact on the actuarial liabilities. Their conclusion is that the funded ratio and funding period would not change.

According to the OP&F actuary, Buck Consultants, the proposed legislation would affect too few members for there to be a measurable impact on the actuarial liabilities. Their conclusion is that the funded ratio and funding period would not change.

According to HPRS, it is their actuary's opinion, Gabriel Roeder Smith & Company, that any actuarial impact that might occur would be negligible due to the limited application of the bill.

ORSC Position – At its meeting of May 22, 2007, the Ohio Retirement Study Council voted to recommend that the 127th Ohio General Assembly approve Sub. S.B. 3 upon the adoption of the following amendments:

- An amendment to require written consent from the spouse of a married offender who would have been eligible for age and service retirement but for the forfeiture order.

- A technical amendment to correct the code section reference in line 1270.

The bill is pending in the House State Government and Elections Committee.

Sub. S.B. 148 – Sen. Faber

Sub. S.B. 148 would make the following changes to the laws governing the School Employees Retirement System (SERS):

- Change the eligibility requirements for retirement.
- Require new members to attain age 55 in order to participate in an early retirement incentive plan.
- Change the money purchase benefit calculation.
- Change the early retirement reduction factors.

Staff Comments - Sub. S.B. 148 would apply only to members who establish membership on or after the effective date of the bill; current members would continue to be subject to the current retirement provisions.

The bill would increase the retirement age and the minimum number of years of service new members need to be eligible for retirement. Under the bill, new members would be eligible for normal age and service retirement with no reduction in benefit if the member is age 55 with 30 years of service or age 65 with 10 years of service. The member would be eligible for early retirement with reduced benefits at age 62 with 10 years of service or at age 60 with 25 years of service.

Members who established membership before the effective date of the bill would be subject to current law, which provides that members are eligible for normal retirement if they are age 65 with 5 years of service or at any age with 30 years of service. Members are eligible for early retirement with a reduced benefit if they are age 60 with 5 years of service or age 55 with 25 years of service. Any member with less than five years of service is eligible only for a refund of contributions upon separation from employment.[19]

The bill would also require the SERS actuary to review the retirement eligibility requirements at least once every 10 years.

	Current Law	Sub. S.B. 148
Normal Retirement (no reduction)	Age 65 with 5 or more years of service Any age with 30 or more years of service	Age 65 with 10 or more years of service Age 55 with 30 or more years of service
Early Retirement (normal benefit reduced)	Age 60 with 5 or more years of service Age 55 with 25 or more years of service	Age 62 with 10 years of service Age 60 with 25 years of service

[19] SERS is the only non-uniformed retirement system that does not provide interest upon the refund of a member's contributions.

Sub. S.B. 148 – Sen. Faber

The bill would also increase the minimum age required to participate in an early retirement incentive plan. In order to be eligible to participate in an early retirement incentive plan, the bill would require new members to be at least 55 years old. Current law, which would apply to members who established membership before the effective date of the bill, allows members to participate in an early retirement incentive plan offered by their employers upon attaining age 50. This change is consistent with the additional requirement in the bill that a member must be at least 55 years old to retire.

The bill would also change the way a benefit is calculated. The Revised Code provides three ways to calculate a retirement benefit: (1) final average salary related; (2) flat dollar related; and (3) money purchase benefit. The member receives the greater of these. In most cases, the member receives the final average salary related benefit because it provides the greatest benefit.

The final average salary related benefit is calculated by multiplying the member's final average salary[20] by the member's years of service by 2.2% for the first 30 years of service, plus 2.5% for each year of service over 30. The flat dollar related benefit is calculated by multiplying the member's years of service by $86. The money purchase benefit is calculated by adding the member's accumulated contribution, plus a matching amount of employer contributions, plus $40 for each year of prior service credit[21], plus $180 for members with 10 or more years of service accumulated prior to October 1, 1956. Sub. S.B. 148 would change the way the money purchase benefit is calculated for members whose membership is established on or after the effective date of the bill. The new money purchase benefit would be calculated by adding the member's accumulated contributions plus a matching amount of employer contributions.

Sub. S.B. 148 would change the reduction for new members opting for early retirement with a reduced benefit. These factors have not been changed for any of the non-uniformed retirement systems since 1976. Currently, there is no correlation between the reduction factors and the actuarial impact of early retirement. If a member retires early, the normal benefit is reduced based on the following statutory schedule:

Attained Age	or	Years of Ohio Service Credit	Percent of Base Amount
58		25	75%
59		26	80%
60		27	85%
61			88%
		28	90%
62			91%
63			94%

[20] "Final Average Salary" is the average of the member's three highest years of compensation.
[21] "Prior Service" means service rendered prior to September 1, 1937.

Sub. S.B. 148 – Sen. Faber

Attained Age	or	Years of Ohio Service Credit	Percent of Base Amount
		29	95%
64			97%
65		30 or more	100%

The bill would provide that the normal benefit for new members who retire prior to normal age and service retirement eligibility would be reduced to the actuarial equivalent of the member's normal age and service retirement allowance, as determined by the board's actuary. However, the bill provides some protection for members with at least 25 years of service. If the member has between 25 and 29 years of service, the benefit would not be actuarially reduced below the following percentages:

Years of Service Credit	Percent of Base Amount
25	75%
26	80%
27	85%
28	90%
29	95%

The bill would also require the SERS board to have its actuary evaluate the actuarial equivalents at least once every 10 years to determine their appropriateness and adjust them based on the actuary's recommendation.

As part of the report of the Joint Legislative Committee to Study Ohio's Public Retirement Plans (JLC) dated December 11, 1996, three of the recommendations included therein, but not acted upon by the legislature, were (1) that the normal retirement age of 65 should be increased in tandem with Social Security for PERS, STRS, and SERS, the 30-year service requirement should be increased at the same rate, and benefits prior to normal retirement age or service should be reduced; (2) the normal retirement age in the uniformed employee systems should be increased from 48 to 52 with a four-year phase-in and benefits prior to normal retirement age should be reduced; and (3) the statutory reduction rates for early retirement should be repealed and reduction rates for early retirement should be determined on an actuarial basis in all five systems. These recommendations were made in response to the continual improvements in life expectancies experienced among the memberships of all five retirement systems in Ohio, which directly increase each retirement system's benefit costs, including post-retirement health care costs. The provisions of Sub. S.B. 148 are generally consistent with these recommendations.

Although this bill affects only SERS, it raises a public policy issue of whether similar changes should be made to the retirement eligibility and early retirement reduction rate provisions of the other four retirement systems. This is particularly true for the retirement

eligibility provisions for PERS, STRS, and SERS, which currently are the same and, when changes have been made, have been amended simultaneously for at least the past 48 years.

Fiscal Impact – According to the SERS actuary, Buck Consultants, the bill would reduce the system's unfunded liabilities. The actuary estimates that the unfunded actuarial accrued liability will be reduced by $3 million after the first year of implementation. After all active participants have been replaced with new hires, the actuary estimates SERS will have a $513 million decrease in its unfunded actuarial accrued liability.

ORSC Position - At its meeting of May 22, 2007, the Ohio Retirement Study Council voted to recommend that the 127th General Assembly approve Sub. S.B. 148.

This bill is pending in the House Financial Institutions, Real Estate and Securities Committee.

REPORTS ON ENACTED PENSION LEGISLATION

FIRST HALF OF THE 127th GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

Am. Sub. H.B. 119 – Rep. Dolan

Am. Sub. H.B. 119 generally makes operating appropriations for the biennium beginning July 1, 2007 and ending June 30, 2009 and provides authorization and conditions for the operation of state programs. This analysis is limited to those provisions of the bill that pertain to the Ohio retirement systems.

The bill would make the following appropriations to Ohio Police & Fire Pension Fund (OP&F):

Appropriation Item	Fiscal Year 08	Fiscal Year 09
GRF 090-524 Police and Fire Disability Pension Fund	$14,000	$12,000

This state subsidy is authorized by R.C. §742.374 and funds the ad hoc increase enacted in H.B. 284 (109th General Assembly - 1971). Persons who were receiving a pension prior to July 1, 1968 were eligible for an additional monthly payment of two dollars for each year between their effective date of retirement and December 31, 1971.

Appropriation Item	Fiscal Year 08	Fiscal Year 09
GRF 090-534 Police and Fire Ad Hoc Cost of Living	$140,000	$130,000

This state subsidy is authorized by R.C. §742.3712 and funds the ad hoc increase first granted in H.B. 204 (113th General Assembly - 1979) and later codified in H.B. 638 (114th General Assembly - 1981). Persons who were receiving an age and service or disability pension prior to July 1, 1974 were eligible for a supplemental payment of five percent of the first 5,000 dollars of their annual pension. Persons receiving a survivor benefit prior to July 1, 1981 were also eligible for a supplemental payment of five percent of the first 5,000 dollars of their annual benefit.

Appropriation Item	Fiscal Year 08	Fiscal Year 09
GRF 090-554 Police and Fire Survivor Benefits	$910,000	$865,000

This state subsidy is authorized by R.C. §742.361 and funds the survivor benefit increases enacted in H.B. 215 (108th General Assembly - 1970), S.B. 48 (110th General Assembly - 1974) and H.B. 268 (111th General Assembly - 1976). This state subsidy was limited by H.B. 694 (114th General Assembly - 1981) to persons who first received survivor benefits

prior to July 1, 1981. For survivors first receiving benefits on or after July 1, 1981, OP&F is required to make payment from its own resources.

Appropriation Item	Fiscal Year 08	Fiscal Year 09
090-575 Police and Fire Death Benefits	$20,000,000	$20,000,000

This state subsidy is authorized by R.C. §742.62 and funds benefits payable under the Ohio Public Safety Officers Death Benefit Fund to the surviving spouses and dependent children of law enforcement officers and fire fighters who die in the line of duty or from injuries sustained in the line of duty. OP&F administers the Death Benefit Fund; the State of Ohio funds the benefits payable thereunder.

Additionally, the bill adds science, technology, engineering, and mathematics schools established under Revised Code Chapter 3326. to the definition of "employer" for the State Teachers Retirement System (STRS) and the School Employees Retirement System (SERS). Further, the bill states that payments made to STRS and SERS shall be deducted from the amount allocated under R.C. §3326.33. Am. Sub. H.B. 119 provided for the establishment and operations of independent public science, technology, engineering, and mathematics schools.

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

Effective Date - June 30, 2007 (Emergency); the sections pertaining to STRS and SERS are effective September 29, 2007.

PENDING PENSION-RELATED ISSUES

THE FIRST HALF OF THE 127th GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

The ORSC staff keeps legislators abreast 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. What follows is a brief summary of each issue and of action taken by the legislature, if any, in 2007. Further background and detail is available through the ORSC website www.orsc.org.

Actuarial Funding of Pension Benefits - There are generally three sources of revenue for the Ohio retirement systems to fund, on an actuarial basis, their defined benefit pension benefits: (1) employee contributions; (2) employer contributions; and (3) investment earnings. The legislature guarantees the defined benefit pension benefits that are paid to participants and determines the maximum contribution rates. Investment earnings are typically the largest source of revenue for the Ohio retirement systems, funding up to 75 percent of the benefits paid.

The last semi-annual investment review required by law and presented at the ORSC meeting on November 14, 2007 indicates that four of the five systems (PERS, STRS, SERS, and OP&F) have ten-year returns that are above their current actuarial interest rate assumptions, while one of the systems (HPRS) did not exceed its interest rate assumption.

Pursuant to S.B. 82 (eff. 12-6-1996), 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. The following table summarizes the funding period and funded ratio of each retirement system as reported in its last actuarial valuation[22]:

Retirement System	Funding Period	Funded Ratio
PERS	26	92.6%
STRS	26.1	83.0%
SERS	29	80.0%
OP&F	**Infinity**	**78.2%**
HPRS	28	80.9%

Milliman prepared actuarial reports on all five retirement systems for the ORSC in 2003 and updated in 2004. These reports generally concluded that in the case of OP&F and STRS one or more of the following actions would need to occur to achieve compliance with the 30-year funding requirement: contribution limits increased; mandated pension benefits reduced; state subsidies provided; and/or contributions reallocated from discretionary health care benefits to mandated pension benefits. Since then, subsequent actuarial valuations for OP&F, including the latest, indicate that no progress has been made in meeting the 30-year funding period. The most recent valuation for STRS, on the other hand, shows that STRS has reduced its

[22] The most recent actuarial valuations for PERS, OP&F, and HPRS are as of 12/31/06; STRS and SERS as of 6/30/07.

funding period from 47.2 years as of 6/30/06 to 26.1 years as of 6/30/07. The long-term funding of retiree health care benefits remains problematic, however.

In the case of OP&F, the actuarial valuation report as of 1/1/07 indicates that, based upon the current allocation of statutory contribution rates between mandated pension benefits and discretionary health insurance benefits, the unfunded actuarial accrued liability has an infinite funding period as previously reported in each of the four prior valuation reports; that is, the unfunded actuarial accrued liability for mandated pension benefits is expected to grow indefinitely into the future, gradually disfunding the retirement system. The unfunded actuarial accrued liability in OP&F grew from $2.64 billion to $2.83 billion while the funded ratio dropped from 78.3% to 78.2%.

At the time Milliman reviewed the adequacy of the contribution rates in OP&F, they concluded that the current rates were not adequate to support **both** the mandated pension benefits within the maximum 30-year funding period and the discretionary health insurance benefits provided by OP&F to retirees, beneficiaries and their dependents. One or more of the following actions will need to occur: statutory contribution rates must be increased between 5 and 5.5% of payroll; state subsidies must be provided to OP&F; mandated pension benefits must be reduced; and/or discretionary health care benefits must be reduced significantly or eliminated. Milliman further found that an infinite funding period in OP&F should be deemed to be an unacceptable situation and that the cost of bringing the funding period into compliance with the maximum 30-year funding limit will continue to grow the longer corrective action is delayed.

Numerous options have been presented or come up in discussion with respect to the actuarial reports prepared by Milliman as well as the 30-year funding reports prepared by STRS and OP&F for the ORSC on reducing the funding period to no more than 30 years. Included among these options are the following: increasing the retirement age and/or service requirements; increasing the employee contribution limits; increasing the employer contribution limits; requiring members to pay 100% of the actuarial liability created by some or all service credit purchases; limiting the COLA to the lesser of 3% or the actual percentage change in the CPI-W; capping the reimbursement for Medicare Part B premiums; making the retirement systems' health care coverage secondary for reemployed retirants; and reducing/discontinuing the employer contribution allocation to discretionary health care benefits. The following table shows the 2008 contribution rates for each retirement system and the maximum rates permitted by current statute:

Retirement System	Current Contribution Rate	Maximum Rate by Statute
PERS		
state - employee	10%	10%
state - employer	14%	14%
local - employee	10%	10%
local - employer	14%	14%
law enforcement - employee	10.10%	10.10%
law enforcement - employer	17.40%	18.10%

Retirement System	Current Contribution Rate	Maximum Rate by Statute
public safety - employee **public safety - employer**	10% 17.17%	10% 18.10%
STRS **employee** **employer**	 10% 14%	 10% 14%
SERS **employee** **employer**	 10% 14%	 10% 14%
OP&F **police - employee** **police - employer** **fire - employee** **fire - employer**	 10% 19.50% 10% 24%	 10% 19.50% 10% 24%
HPRS **employee** **employer**	 10% 25.50%	 10% 30%

These options would require legislation or a change in board policy. Failure to implement a viable plan that will reduce the funding period to no more than 30 years, as certified by the retirement system's actuary, could be potentially very costly in the long run with the gradual disfunding of these retirement systems.

Cost and Funding of Retiree Health Care Benefits - Faced with double-digit increases for the foreseeable future, particularly in the area of prescription drugs, all of the retirement systems face significant challenges of controlling costs while maintaining meaningful coverage. Contributing factors to the double-digit increases include: the advent of "baby boomer" retirements, improved life expectancy of retirees, higher drug utilization, advances in medical technology, direct consumer advertising, and the general declining ratio of active members to retirees. The significant investment losses experienced from March 2000 to March 2003 by all investors have also exacerbated the health care funding problem since the retirement systems must first fund guaranteed pension benefits, which will likely require a reduction in or elimination of the amount currently allocated to discretionary retiree health care benefits, given the current caps on contribution rates. The early retirement ages for many public employees create a significant cost for each retirement system's health care program. S.B. 148, introduced this session, raises establishes a minimum retirement age of 55 with 30 years of service, increases the minimum number of years of service needed to retire to 10, as well as increasing the age at which a member is eligible for early retirement to 62 with 10 years of service or 60 with 25 years of service. H.B. 315, which also was introduced this session, would establish a dedicated stream of funding for health care benefits for STRS. These bills are pending in the House Financial Institutions Real Estate and Securities Committee.

Joint Legislative Committee to Study Ohio's Public Retirement Plans - In 1995, the Joint Legislative Committee to Study Ohio's Public Retirement Plans (JLC) was created to

complete a comprehensive review of the laws and operations of all five retirement systems. It consisted of six senators and six representatives (including members of the ORSC), and was supported by the ORSC staff. The JLC reviewed each system, concentrating on the following major areas: disability statutes, procedures, and experience; cost and funding of retiree health care benefits; retirement eligibility and benefit provisions; investment authority and performance; and the level of contributions in relation to the level of benefits provided. In 1996, JLC issued a report in which ORSC staff made a number of recommendations. Many, but not all, of the recommendations have been acted upon by the legislature over the years. The following recommendations were made by staff as part of the report, but have not been implemented:

- "That the normal retirement age be increased in the uniformed employee systems from 48 to 52 with a four-year phase-in and that benefits be reduced prior to normal retirement age."

- "That the normal retirement age of 65 in the non-uniformed employee systems be increased in tandem with Social Security and that the 30-year service requirement be increased at the same rate and that benefits be reduced prior to normal retirement age or service."

  S.B. 148, introduced this session, would increase the retirement age and the minimum number of years of service new members of SERS would need to be eligible for retirement. The bill is pending in the House Financial Institutions, Real Estate and Securities Committee.

- "That the statutory reduction rates for early retirement be repealed and that reduction rates for early retirement be determined on an actuarial basis in all five systems."

  S.B. 148 would also change the reduction factors for new members opting for early retirement. The reduced benefit would be based on actuarial factors under this bill. The bill is pending in the House Financial Institutions, Real Estate and Securities Committee.

- "That disproportionate increases in salary prior to retirement be limited to a maximum percentage for purposes of determining final average salary in PERS, SERS, PFDPF and HPRS unless such increase results from employment with another employer or promotion to a position previously held by another employee." (H.B. 180 (eff. 10-29-91) established a percentage limit in STRS.)

- "That the statutory authority to grant an annual lump sum supplemental benefit check (i.e., 13th check) be repealed in STRS and that ad hoc post-retirement increases be enacted on an as-needed basis by the legislature."

- "That non-law enforcement service credit be excluded for purposes of determining eligibility for service retirement under PFDPF." (H.B. 648 (eff. 9-16-98) requires members who establish membership in OP&F on or after 9-16-98 to pay the difference between both the employee and employer contributions that were made and the employee and employer contributions that would have been made had the member rendered the service in OP&F,

plus annual compound interest thereon. Members who do not pay the difference receive pro-rated credit for their non-law enforcement service.)

- "That Medicare Part B reimbursements be capped in PERS, PFDPF (OP&F) and HPRS." H.B. 648 (eff. 9-16-98) established a minimum reimbursement rate of $29.90 per month as well as a maximum monthly reimbursement rate as determined by the STRS board, not to exceed 90% of the Medicare Part B monthly premium in STRS; S.B. 270 (eff. 4-9-01) established the monthly reimbursement rate at $45.50 in SERS. The Medicare Part B premium for 2008 is $96.40 per month.)

- "That the five systems have prepared a study to determine the feasibility of pooling active members and retirees for purposes of health care coverage and submit their findings and recommendations to the standing committees of both houses of the Ohio General Assembly with primary responsibility for retirement and health care legislation and ORSC no later than December 31, 1996."

Defined Contribution Plan for SERS Members - Another staff recommendation included in the JLC final report was "that an alternative defined contribution plan be established, in conjunction with the existing defined benefit plan, in the three non-uniformed employee systems to provide greater portability and options for employees." Alternative defined contribution (DC) plans have been established in STRS pursuant to S.B. 190 (eff. 7-13-00) and in PERS pursuant to H.B. 628 (eff. 9-21-00). No alternative DC plan has been established in SERS, though S.B. 270 (eff. 4-9 01) requires the SERS board to establish such plan.

According to SERS staff, the SERS board commissioned The Segal Company to statistically verify member interest and identify the costs of implementing a defined contribution plan in 2002. Segal surveyed 10,000 SERS members who had less than five years of service and would be eligible for the DC plan. They found that 1% of new SERS members were interested in a DC option based solely on their own investments and 89% of new members preferred a guaranteed retirement. However, there appeared to be considerable interest in a hybrid plan that combined features of a DB and DC plan (46%). Segal completely outsourced the development and maintenance of the option. According to Segal this would require about $1 million in start-up costs and $1.3 million annually to operate. In February 2003, the SERS board decided that it was not in the best interest of its members to develop a DC option; however, the board requested that staff revisit the studies at a later time, and in the interim, request a language change making the current statute permissive rather than mandatory. However, there has been no such request this session.

Contributing Service Credit in PERS - H.B. 232 (eff. 2-16-84) increased the minimum amount of earnable salary required per month from $150 to $250 to receive one month's credit in PERS. A PERS member who earns $250 per month for twelve consecutive months ($3,000) is granted one year of service credit. This raises the public policy issue of whether the minimum monthly salary amount used to determine service credit in PERS should be increased and indexed to annual wage inflation.

<u>Deferred Retirement Option Plans (DROP)</u> - Popular throughout the country, these plans are intended to encourage members to continue working beyond normal retirement and are often designed to be cost-neutral to the retirement system. Generally, participation in a DROP is limited to members who are eligible for normal service retirement. The member continues to be employed for some defined period, such as three to eight years, during which period the member's monthly service retirement benefit is credited to the member's DROP account, along with annual compound interest at some specified rate. Upon termination of employment, the member receives a lump sum distribution of the member's DROP account or some alternative distribution thereof, and begins receiving a monthly service retirement benefit based on the member's final average salary and service credit calculated at the time the member elects participation in the DROP. S.B. 134 (eff. 7-23-02) granted the OP&F board the authority to establish a DROP for its members. A recent review of OP&F's DROP revealed that 85% of members who do not retire when first eligible for retirement elect to participate in the DROP. In the analysis of S.B. 134, the ORSC staff raised the public policy issue of whether the other four retirement boards should be granted similar authority to establish DROPs for their respective memberships. S.B. 206 (eff. 6/15/06) established a DROP for members of HPRS last year. Sub. H.B. 270, introduced this session, would require PERS, STRS, and SERS to establish a DROP. This bill is pending in the House Financial Institutions, Real Estate and Securities Committee.

<u>"Bad Boy" Provisions</u> - Currently, Ohio public pension laws permit the withholding of retirement benefits as restitution to the governmental unit for theft in public office and to the victim of certain sex offenses committed in the context of public employment. There continues to be legislative interest to expand these "bad boy" provisions to include other offenses. S.B. 3 and H.B. 8 were introduced this session and both would affect a member's ability to receive a benefit upon conviction of certain specified crimes. S.B. 3 is pending in the House State Government and Elections Committee. H.B. 8 is pending in the Senate Judiciary – Criminal Justice Committee.

<u>University of Akron Non-Teaching Employees</u> - With the single exception of the University of Akron, all non-teaching employees of Ohio's state universities are members of PERS. Employees of the University of Akron are currently members of SERS. In the interest of maintaining parity in retirement benefits, there continues to be some legislative interest to transfer these employees from SERS to PERS. The ORSC actuary provided several options to address the actuarial impact upon both retirement systems of such a transfer in its report <u>Transfer of University of Akron Active Members from SERS to PERS</u> dated March 11, 2002. Based upon that report, the ORSC staff recommended "the transfer of the University of Akron non-teaching employees from SERS to the PERS state division in order to provide uniform benefits and representation for all non-teaching employees at state universities, provided:

1. PERS receives from SERS an amount equal to the member's actuarial accrued liability to the extent funded by SERS under the third option described above which would minimize any actuarial loss to PERS and have no actuarial gain or loss to SERS;

2. PERS serves as a pass-through or conduit for health care contributions received from the University of Akron (A PERS employer after enactment) to pay SERS for the net cost of providing health care benefits to University of Akron retirees still remaining in SERS until the last University of Akron retiree ceases to be covered under the SERS health care plan. This is consistent with the current pay-as-you-go financing of retiree health care benefits in all five retirement systems, and would hold SERS harmless as well as avoid any windfall to PERS on account of the proposed transfer; and

3. The current differential in the contribution rates under SERS and PERS, including the employer health care surcharge, remains payable by the University of Akron and its non teaching employees for 25 years (the current funding period under SERS), with the excess in contributions used to provide a supplemental contribution to SERS. This is consistent employees who elect the alternative defined contribution plan, and would mitigate any adverse impact upon the SERS health care plan and would eliminate any perceived financial incentive for potential groups of employers and employees to "shop" among the state retirement systems for benefits. In the alternative, the University of Akron makes a lump sum payment to SERS that is the actuarial equivalent of the above supplemental contribution payable over 25 years as determined by the SERS actuary and reviewed by the ORSC."

The ORSC did not take any action upon the staff recommendation.

Reemployment Provisions - There continues to be legislative interest in the reemployment provisions of the Ohio retirement systems that allow members who have been retired for at least two months to return to public employment while continuing to receive their pension. H.B. 84 (eff. 7 31-01) requires elected officials who retire and are reelected or appointed to the same office from which they retired to notify the board of elections or appointing authority of their retirement in order to continue receiving their pension. H.B. 95 (eff. 6-30-03) included language that requires a hearing before certain retirants can be reemployed and changes the deadline for elected officials to file notice of intent to retire and run for reelection to the same office. H.B. 240, introduced this session, would limit public employers' ability to hire certain administrative employees to work at the same position from which they retired. Sub. H.B. 270, also introduced this session, would require retirees to forfeit their entire benefit during reemployment if they return to work before the end of the two-month waiting period. Both bills are pending in the House Financial Institutions, Real Estate and Securities Committee.

Health Care for Reemployed Retirees - H.B. 151 (eff. 2-9-94) required PERS reemployed retirants to receive primary health insurance coverage through the retirant's public employer if the employer provides coverage to other employees performing comparable work. PERS health care coverage becomes secondary. It is important to note that health care coverage is a discretionary retiree benefit. Effective January 1, 2004 both the OP&F and HPRS boards amended their health care policies relative to reemployed retirees. In OP&F, reemployed retirees who are eligible for health care coverage through their employer must pay the full premium cost should they choose to enroll in the OP&F health care plan. In HPRS, reemployed retirees who are not eligible for Medicare must receive their primary health care coverage through their employer, if available; the HPRS health care coverage becomes secondary. This raises a public policy issue of whether similar requirements should be

adopted in the other state retirement systems with respect to reemployed retirants. Moreover, it raises a public policy issue of whether such requirements should include reemployment with a private employer that provides health insurance coverage as well. The STRS board recently adopted a rule, which becomes effective January 2009, that requires reemployed retirees to receive health care coverage from their public or private employer if the employer offers health care.

Annual 3% COLA - In its analysis of H.B. 157 (eff. 2-1-02), which provides for an annual 3% COLA in all five retirement systems, regardless of the actual percentage change in the CPI-W, 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. Between 1992 and 2006, the CPI-W has increased by less than 3% in 12 of those years.

Workers' Compensation Offset - In its Analysis of Police and Firemen's Disability and Pension Fund Disability Plan, Procedures and Experience, November 8, 1996, William M. Mercer recommended that the legislature "consider offsetting the disability retirement benefit by any periodic benefit being received by the disabled member through workers' compensation." A subsequent study prepared by the ORSC actuary Milliman & Robertson pursuant to a legislative mandate concluded that "Based on the data collected in this study, M&R believes it is feasible for the State of Ohio to coordinate public retirement systems disability benefits and workers' compensation benefits. We clearly recognize that the decision to do so rests with the Ohio General Assembly. If such a decision is made, we recommend that the benefit coordination be structured as follows:

1. Offsets should affect the following benefits:

    a. Periodic Wage Replacement Benefits;

    b. Lump Sum payments to close workers' compensation cases;

    c. Cost of living adjustments.

2. Offset should not affect lump sum scheduled benefits.

3. Maximum income from combined disability and workers' compensation benefits should be set at 100% of final average salary.

4. If offsets are introduced in Ohio, they should be made applicable to all 5 public retirement systems at the same time."

(Report to the Ohio Retirement Study Council: Feasibility Study on Disability and Workers' Compensation Coordination, Milliman & Robertson, November 23, 1999)

Review of Adequacy of the Contribution Rates - Current law requires the ORSC to conduct an annual review of the police and fire contribution rates and make recommendations to the legislature that it finds necessary for the proper financing of OP&F benefits. In 2003 the Council voted to have Milliman review the adequacy of the contribution rates for PERS, STRS, SERS, and HPRS. The legislature should consider amending the law to require the ORSC to conduct similar actuarial reviews of the adequacy of the contribution rates for the other four retirement systems as well.

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 which are estimated to extend the solvency of Social Security by a mere two years.

Submission of Annual Actuarial Valuation - Each system is required to submit annually an actuarial valuation to the ORSC and the standing committee of the House of Representatives and Senate with primary responsibility for retirement legislation. The due date for each system is different: PERS must submit theirs by September 1, OP&F must submit theirs by November 1, STRS must submit theirs by January 1, SERS must submit theirs by May 1, and HPRS must submit theirs by July 1 following the year for which the valuation was made. This raises the issue of whether the due date should be the same for PERS, OP&F, and HPRS, all of whom operate on the calendar year and whether the due date should be the same for STRS and SERS, both of whom are on fiscal years beginning July 1 and ending June 30.

Purchase of Service Credit – Pursuant to the ORSC's request, Milliman, Inc. completed a report on the cost of purchasing service credit this year. The report noted that with regard to health care benefits, if they are reduced in the future, some of the additional health liabilities could be eliminated. Additionally, if service purchases did not count toward eligibility for or the amount of health care benefits, then the additional health care liabilities would be eliminated. The report revealed that the retirement systems subsidized the purchase of credit in nearly every case in 2005. This was true even for service credit for which the member was required to pay the full actuarial cost. This report raised the public policy issue of whether a member's purchase of service credit should be subsidized by the retirement system. ORSC staff made the following recommendations, which the Council approved: (1) The purchase price for all types of service should be the full actuarial liability resulting from the purchase of service credit, except as prohibited by federal law, and members should be required to retire within 90 days of purchasing service and (2) purchased credit should be prohibited from being counted for purposes of health care eligibility or subsidy.

DOCUMENTS STATUTORILY REQUIRED OF THE RETIREMENT SYSTEMS

FIRST HALF OF THE 127th GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

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 brief summary of the contents of the report. Copies of the reports can be obtained at the ORSC office.

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. The report must include (1) a summary of the benefit provisions evaluated; (2) a summary of the census data and financial information used in the valuation; (3) a description of the actuarial assumptions, actuarial cost method, and asset valuation method used in the valuation, including a statement of the assumed rate of payroll growth and assumed rate of growth or decline in the number of members contributing to the retirement system; (4) a summary of findings that includes a statement of the actuarial accrued pension liabilities and unfunded actuarial accrued pension liabilities; a schedule showing the effect of any changes in the benefit provisions, actuarial assumptions, or cost methods since the last annual actuarial valuation; and (6) a statement of whether contributions to the retirement system are expected to be sufficient to satisfy the funding objectives established by the board.

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. PERS must submit theirs by September 1, OP&F must submit theirs by November 1, STRS must submit theirs by January 1, SERS must submit theirs by May 1, and HPRS must submit theirs by July 1 following the year for which the valuation was made.

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 must include (1) a description of the statutory authority for the benefits provided; (2) a summary of the benefits; (3) a summary of the eligibility requirements for the benefits; (4) a statement of the number of participants eligible for the benefits; (5) a description of the accounting, asset valuation, and funding method used to provide the benefits; (6) a statement of the net assets available for the provision of the benefits as of the last day of the fiscal year; (7) a statement of any changes in the net assets available for the provision of benefits, including participant and employer contributions, net investment income, administrative expenses, and benefits provided to participants, as of the last day of the fiscal year; (8) for the last six consecutive fiscal years, a schedule of the net assets available for the benefits, the annual cost of benefits, administrative expenses incurred, and annual employer contributions allocated for the provision of benefits; (9) a description of any significant changes that affect the comparability of the report required under this division; and (10) a statement of the amount paid for Medicare Part B reimbursement.

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. PERS, OP&F, and HPRS must submit theirs by June 30, whereas STRS and SERS must submit theirs by December 31, following the year for which the report was made.

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, retirants, contributors, and beneficiaries of the system to update the actuarial assumptions used in the actuarial valuation. The report must include (1) a summary of relevant decrement and economic assumption experience observed over the period of the investigation; (2) recommended changes in actuarial assumptions to be used in subsequent actuarial valuations; (3) a measurement of the financial effect of the recommended changes in actuarial assumptions.

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. PERS, OP&F and HPRS must submit theirs by November 1, STRS and SERS must submit theirs by May 1 following the last fiscal year of the period the report covers.

OP&F submitted its quinquennial evaluation covering the years 2002-2006 in December 2007.

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 public employees 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 Senate and House of Representatives with primary responsibility for retirement legislation.

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 thirty years. The report must include the number of years needed to amortize the unfunded actuarial accrued pension liability as determined by the annual actuarial valuation and 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 thirty years. The report submitted by OP&F must also include whether the board has made any progress toward meeting the 30-year amortization period.

The report on the thirty-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 ninety days after the retirement system board receives the actuarial valuation in which the funding period exceeds thirty years.

In 2007, the funding period at STRS and OP&F exceeded the statutory maximum of thirty years. STRS submitted its report to the Council at the April 18, 2007 ORSC meeting. OP&F presented its report to the Council at the May 9, 2007 ORSC meeting.

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 include (1) a summary of the statutory changes that are being evaluated; (2) a description of or reference to the actuarial assumptions and actuarial cost method used in the report; (3) a description of the participant group or groups included in the report; (4) a statement of the financial impact of the legislation, including the resulting increase, if any, in the employer normal cost percentage; the increase, if any, in actuarial accrued liabilities; and the per cent of payroll that would be required to amortize the increase in actuarial accrued liabilities as a level per cent of covered payroll for all active members over a period not to exceed thirty years; (5) a statement of whether the scheduled contributions to the system after the proposed change is enacted are expected to be sufficient to satisfy the funding objectives established by the board.

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.

Investment Managers and Brokers - (R.C. §§145.114(E), 145.116(C), 742.114(E), 742.116(C), 3307.152(E), 3307.154(C), 3309.157(E), 3309.159(C), 5505.068(E), 5505.0610(C)) Each system is required to submit an annual report to the ORSC containing the following information: (1) the name of each agent designated as an Ohio-qualified agent; (2) the name of each agent that executes securities transactions on behalf of the board; (3) the amount of equity and fixed-income trades that are executed by Ohio-qualified agents, expressed as a percentage of all equity and fixed-income trades executed by agents; (4) the compensation paid to Ohio-qualified agents, expressed as a percentage of total compensation paid to all agents that execute securities transactions; (5) the amount of equity and fixed-income trades that are executed by agents that are minority business enterprises (i.e., owned and controlled by Ohio residents who are Black, American Indian, Hispanic, or Oriental), expressed as a percentage of all equity and fixed-income trades executed by all agents; and (6) any other information requested by the ORSC regarding the board's use of agents.

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 sixty days before adoption of the budget.

STRS and SERS operate on fiscal years beginning July 1 and ending June 30. They presented their proposed operating budgets for fiscal year 2008 at the May 9, 2007 ORSC meeting. PERS, OP&F, and HPRS submitted their budgets for calendar year 2008 at the November 14, 2007 ORSC meeting.

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.

SUBJECT INDEX OF PENSION BILLS INTRODUCED

FIRST HALF OF THE 127TH GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

The Subject Index of Pension Bills Introduced provides a listing of pension bills under subject heading and a key word description within the main heading. Bills that cover more than one subject are listed under all appropriate headings.

The pension systems affected by the bill are also indicated. “All systems” means the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Ohio Police and Fire Pension Fund (OP&F), and the Highway Patrol Retirement System (HPRS). “VFFDF” and “DBF” respectively refer to the Volunteer Fire Fighters’ Dependents Fund and the Ohio Public Safety Officers Death Benefit Fund.

The main subject headings are listed at the beginning of the index for quick reference. The bills that were enacted are marked with an asterisk.

Subject Headings

Additional Annuity Program
Age and Service
Alternative Retirement Plan
Appropriations
Benefit Options
Benefits
Contributions
Deferred Retirement Option Plan (DROP)
Early Retirement Incentives
Funds
Health Care
Investments
Membership
Reemployment
Salary
Taxation

Additional Annuity Program
Date of payment – PERS – H.B. 270
Refund of deposits – PERS – HB 270
Retirement from one position – PERS – HB 270

Age and Service
Age 55 with 30 YOS – SERS – SB 148
Increase minimum YOS – SERS - SB 148
Early retirement eligibility – SERS - SB 148

Alternative Retirement Plan
Public school employees – SERS – HB 152
Public school teachers – STRS – HB 152

Appropriations
Subsidies – OP&F – HB 119*

Benefit Options
Additional Annuity – PERS – HB 270
Change due to death, effective date – PERS – HB 270

Benefits
Forfeiture of upon conviction or guilty plea – ALL SYSTEMS – SB 3, HB 8
Forfeiture of upon reemployment – PERS, STRS, SERS, OP&F – HB 270
Recalculation prohibited – PERS – HB 270

Contributions
Employee rate – STRS – HB 315; PERS-LE – S.B. 267
Employer rate – STRS – HB 315

Deferred Retirement Option Plan (DROP)
Authorized – PERS, STRS, SERS – HB 270

Early Retirement Incentives
Judges – PERS – HB 173

*Enacted

Funds
Employees' Savings Fund, unclaimed – PERS – HB 270

Health Care
Health Care Fund established – STRS – HB 315
Recover overpayments – PERS – HB 270

Investments
Divestment from Iran – ALL SYSTEMS – HB 151
Divestment from Sudan – ALL SYSTEMS – HB 151, SB 161

Membership
Public safety officer – S.B. 267
Science, technology, engineering, and mathematic school employees – SERS, SERS – HB 119*

Reemployment
Administrative employee – PERS, STRS, SERS, OP&F – HB 240
Same position – PERS, STRS, SERS, OP&F – HB 240, HB 270

Salary
Limited for certain reemployment – PERS, STRS, SERS, OP&F – HB 240

Taxation
Exempt from personal income tax – SB 191

*Enacted

STATUS OF PENSION LEGISLATION

FIRST HALF OF THE 127th GENERAL ASSEMBLY

JANUARY 1, 2007 - DECEMBER 31, 2007

OHIO RETIREMENT STUDY COUNCIL

STATUS OF PENSION LEGISLATION

127TH GENERAL ASSEMBLY

JANUARY 1, 2007 – DECEMBER 31, 2008

HOUSE BILLS

HSE BILL	INTRO	Actuarial Received	Subject, Sponsor, and System	Cont Pers	ORSC Pos	Hse Cmte	Testimony – Reported Out – Floor Vote	INTRO SEN	Sen Cmte	Testimony – Reported Out – Floor Vote	Conf Cmte	Concur-rence	Eff Date
8	02-20-07	PERS:03-19-07 SERS:04-10-07 STRS:04-11-07 OP&F:04-12-07 HPRS:05-17-07	Forfeiture of retirement benefit based on felony conviction R. Hagan – ALL SYSTEMS	AE	AA 06-13-07	SGE Daniels 02-21-07	03-01-07----03-15-07----03-22-07----05-24-07----05-30-07----06-07-07 Sub----06-14-07 Fl Vo: Y=93 N=3	06-19-07	JRC Grendel l 06-20-07				
119	02-20-07		Biennial Budget Dolan – OP&F	BI	N	FA Dolan 03-21-07	03-28-07----03-29-07----04-03-07----04-04-07----04-05-07----04-10-07----04-11-07----04-12-07----04-13-07----04-17-07----04-18-07----04-19-07----04-27-07----04-29-07----05-01-07 Amend; Fl Vo: Y=97 N=0	05-01-07	FFI Carey 05-02-07	05-02-07----05-08-07----05-09-07----05-10-07----05-11-07----05-15-07----05-16-07----05-17-07----05-18-07----05-22-07----05-23-07----05-24-07----05-29-07----05-30-07----05-31-07----06-01-07----06-05-07----06-06-07----06-07-07----06-08-07----06-12-07 Amend----06-13-07 Amend; Fl Vo: Y=33 N=0	06-20-07	06-27-07	
151	04-12-07		Prohibit public investors from investing in companies that do business with Iran and Sudan and require divestiture Mandel, Jones – ALL SYSTEMS	GK	AD 05-09-07 D 05-22-07	FRS Widener 04-17-07 RR Husted 06-13-07	04-19-07----04-25-07----05-03-07----05-10-07----05-17-07----05-24-07----05-30-07 Amend----06-05-07 Informally passed----06-07-07----06-13-07 Re-referred----						
152	04-17-07	SERS:06-15-07	Require school boards to establish alternative retirement plans Widener – STRS, SERS	GK	D 09-12-07	FRS Widener 04-25-07	05-17-07----06-14-07----06-21-07----06-27-07----						
173	04-24-07	06-18-07	Requires ERI plan to be offered to certain judges whose positions are abolished Seitz - PERS			JUD 04-25-07 Blessing	05-31-07----06-06-07----06-13-07----06-21-07----						
240	05-29-07	PERS:08-10-07 STRS:08-03-07 SERS:07-17-07 OP&F:08-10-07	Reemployment of an administrative employee Goodwin – PERS, STRS, SERS, OP&F	AE	D 10-10-07	FRS Widener 06-12-07	06-21-07----06-27-07----10-30-07----						
270	06-19-07	PERS:09-10-07 STRS:09-27-07 SERS:08-13-07 OP&F:08-21-07	Reemployment of a retiree in same position Schneider – PERS, STRS, SERS, OP&F	AE	AA 10-10-07	FRS Widener 06-21-07	10-30-07----12-05-07 Sub----						
315	09-18-07		Creates Health Care Fund Oelslager - STRS	GK		FRS Widener 09-27-07							
372	10-30-07		Exempts military pensions from Ohio income tax R. McGregor	BI	N	IHV Reinhard 11-01-07	10-31-07----11-07-07 Amend; Fl Vo: Y=96 N=1	11-08-07					

SENATE BILLS

SEN BILL	INTRO	Actuarial Received	Subject, Sponsor, and System	Cont Pers	ORSC Pos	Sen Cmte	Testimony – Reported Out – Floor Vote	INTRO HSE	Hse Cmte	Testimony – Reported Out – Floor Vote	Conf Cmte	Concur-rence	Eff Date
3	02-20-07	PERS:03-19-07 SERS:04-10-07 STRS:04-11-07 OP&F:04-12-07 HPRS:05-17-07	Forfeiture of retirement benefit based on felony conviction. Faber – ALL SYSTEMS	AE	AA 05-22-07	JCR Grendell 02-27-07	02-28-07----03-21-07----03-28-07----05-16-07 Sub; Fl Vo: Y=32 N=0	05-17-07	SGE Daniels 05-23-07	06-07-07----06-14-07----			
19	2-20-07		Exempts military pensions from Ohio income tax Cates	BI	N	WME Amstutz 02-27-07	03-07-07----06-20-07----11-14-07----						
148	04-19-07	SERS:04-30-07	Revise retirement eligibility requirements. Faber - SERS	AE	A 05-22-07	HHA Coughlin 04-24-07	05-02-07----05-09-07 Sub----05-16-07----05-30-07 Amend---10-24-07 Fl Vo: Y= 31 N=2	10-25-07	FRS Widener 11-01-07	12-05-07----12-12-07----01-16-08----			
161	05-03-07	PERS:07-05-07 SERS:07-11-07	Prohibit public investors from investing in companies that do business with Sudan and require divestiture Jacobson – ALL SYSTEMS	GK		FFI Carey 05-08-07							
191	06-26-07		Exempt local, state, and federal employee and military retirement benefits from personal income tax Coughlin	BI	N	WME Amstutz 06-27-07							
194	06-27-07		Create Department of Health Care Administration R. Miller – ALL SYSTEMS	BI	N	FFI Carey 10-02-07							
267	12-18-07		Creates public safety officers; Faber - PERS	GK									

HOUSE COMMITTEES

ANR	Agriculture & Natural Resources
AE	Alternative Energy
CC	Civil & Commercial Law
CL	Commerce & Labor
CRJ	Criminal Justice
EDE	Economic Development & Environment
ED	Education
FA	Finance & Appropriations
AD	Agriculture & Development Subcommittee
HE	Higher Education Subcommittee
HS	Human Services Subcommittee
PSE	Primary & Secondary Education Subcommittee
TJ	Transportation & Justice Subcommittee
FRS	Financial Institutions, Real Estate & Securities
HLT	Health
HAA	Healthcare Access and Affordability
IHV	Infrastructure, Homeland Security & Veterans Affairs
INS	Insurance
JUD	Judiciary
JFL	Juvenile & Family Law
LGR	Local & Municipal Government & Urban Revitalization
PU	Public Utilities
RR	Rules & Reference
SGE	State Government & Elections
WM	Ways & Means

SENATE COMMITTEES

AG	Agriculture
ED	Education
ENE	Energy & Public Utilities
ENR	Environment & Natural Resources
FFI	Finance & Financial Institutions
HHA	Health, Human Services & Aging
HT	Highways & Transportation
ICL	Insurance, Commerce & Labor
JCV	Judiciary - Civil Justice
JCR	Judiciary - Criminal Justice
REF	Reference
RUL	Rules
SLV	State & Local Government & Veterans Affairs
WME	Ways & Means & Economic Development

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	No Action Necessary

ORSC CONTACT PERSON

GK	Glenn Kacic
AE	Anne Erkman
BI	Bill of Interest