



**Ohio
Retirement
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Mike Nehf, *STRS*

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To: Governor John R. Kasich
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Senate Minority Leader Joe Schiavoni
House Minority Leader Tracy Maxwell Heard
Members of the Ohio Retirement Study Council
LSC Director Mark Flanders

From: Bethany Rhodes, Director/General Counsel 

Date: March 21, 2014

RE: 2013 ORSC Annual Report

Since 1968, and pursuant to Revised Code 171.04, the Ohio Retirement Study Council has submitted an annual report to the Governor and the General Assembly covering its evaluation and recommendations regarding the five state retirement systems. ORSC staff is pleased to submit this year's report on the Evaluations and Recommendations Regarding the Operations of the State Retirement Systems. The staff report includes information on the systems' investment performance, status of health care funds, actuarial reviews of the systems, fiduciary reports, progress on achieving 30-year funding, reports on enacted pension legislation, pending pension-related issues, a subject index of pension bills introduced, and a status sheet for pension legislation as of December 31, 2013.



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Annual Report *2013*

Evaluations and Recommendations Regarding the Operations of the State Retirement Systems

130th General Assembly
January 1, 2013 – December 31, 2013

Issued March 2014

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DIRECTOR

Bethany Rhodes

ANNUAL REPORT
THE 130TH GENERAL ASSEMBLY
JANUARY 1, 2013 - DECEMBER 31, 2013

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Introduction

The Ohio Retirement Study Council (ORSC) staff is pleased to submit this report on the five public state retirement systems and the fund for volunteer firefighters for the period beginning January 1, 2013 and ending December 31, 2013. 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.”

As of January 1, 2014, the five systems have combined assets of approximately \$187 billion with approximately 680,000 active contributing members, 746,000 inactive members, and 432,000 beneficiaries and recipients. The State of Ohio has a long tradition of providing retirement benefits to public employees. These benefits are managed by the five systems and funded through employer and employee contributions and earnings on those contributions.

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

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

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

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

¹ R.C. 171.04.

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

The Council evaluates the operations of the systems on a continuing basis. During the past year the Council reviewed the retirement systems' investment performance, operating budgets, and administrative rules. In addition, the ORSC staff has begun a digitization project to preserve records in the Council's possession, completed an ad hoc analysis of Board authority granted to certain boards under pension reform, and analyses of legislation introduced in the General Assembly that would affect the state retirement systems.

This report is a compilation of the evaluations and recommendations the Council made throughout 2013. It provides a summary of the ORSC reports and staff activities completed during 2013, pending public retirement issues, and staff recommendations. In addition, it provides a historical record of legislative action taken in the first half of the 130th Ohio General Assembly on bills affecting PERS, STRS, SERS, OP&F, HPRS and the Volunteer Fire Fighters' Dependents Fund (VFFDF).

Further detail on any topic listed in this report is available in the ORSC office.

SYSTEMS' INVESTMENT PERFORMANCE

July 1, 2012 – June 30, 2013

The ORSC is required to conduct a semiannual review of the policies, objectives, and criteria of the systems' investment programs.² The ORSC contracts with Milliman to conduct these investment reviews and the reports are submitted to the Governor and General Assembly. While there is a wealth of information in the analyses, this report details only the two 6-month experiences, rolling 10-year experience, 1-year experience as of the first half of the year, and allocation comments from Milliman.

Investment Performance Summary (June 30, 2012 - December 31, 2012) -

The following summarizes the report received by the ORSC at its April 9, 2013 meeting and reflects the investment performance for all six funds³ over the six-month period ending December 31, 2012. The findings of this report are briefly summarized as follows:

- All six retirement system portfolios had positive results for the six months ending December 31, 2012, with all but one of the Systems outperforming their policy benchmarks.⁴
- Over the trailing ten-year period, PERS, OP&F, and STRS have exceeded their actuarial interest rate (the return target used by the systems' actuaries to determine its capacity to fully fund future benefits). SERS was close to its actuarial rate with a return of 7.6% compared to 7.75%, and HPRS trailed their actuarial rate, 7.3% compared to 8.0%.⁵ Over this period all funds except HPRS exceeded their respective policy benchmarks.
- Milliman provided the following observations on a review of the systems' asset allocation in comparison to the InvestorForce⁶ All Public Defined Benefit Universe:
 1. The actual (39.0%) and target (35.0%) domestic equity allocation of HPRS was above the median plan's allocation to domestic equity (34.3%) in the InvestorForce All Public Defined Benefit Universe. This was also true for STRS' actual (34.5%) and target (38.0%) allocation to domestic equities. For OP&F, the target allocation to domestic equities (31.6%) was below the median, as was the actual allocation (27.8%). The actual (23.9%) and target (22.5%) allocation of SERS, the actual (22.5%) and target (23.6%) allocation of PERS, as well as the

² R.C. 171.04.

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

⁴ STRS matched its benchmark during this period.

⁵ The system's 2013 return targets are: PERS 8.0%, OP&F 8.25%, STRS 7.75%, SERS 7.75%, HPRS 8.0%.

⁶ InvestorForce provides monitoring, analysis, and reporting on institutional assets.

actual (22.6%) and target (24.6%) allocation of PERS Health Care domestic equity were all below that of the median plan.

2. Five of the six funds' actual asset allocations to fixed income were well below the median plan (34.4%) of the InvestorForce All Public Defined Benefit Universe. PERS Health Care has a target (34.8%) above the median, but an actual allocation (34.0%) slightly below the median.
3. The median plan allocation of the InvestorForce All Public Defined Benefit Universe to non-U.S. equity as of December 31, 2012 was 14.0%. The target allocations for all plans were significantly above the median, with the actual allocations following suit.
4. The universe median allocation to real estate in the InvestorForce All Public Defined Benefit Universe was 9.3% as of December 31, 2012. The target allocation of each of the systems, with the exception of HPRS (5.0%) and PERS Health Care (6.0%), is above the median allocation. The actual allocations for PERS Health Care (5.9%) and HPRS (4.7%) were below the median.
5. The universe median allocation to alternatives in the InvestorForce All Public Defined Benefit Universe was 9.3% as of December 31, 2012. The target allocation of each of the systems, with the exception of OP&F (5.3%) and PERS Health Care (6.4%), is above the median allocation. The actual allocations for OP&F (4.6%) and PERS Health Care (5.6%) were below the median.

Investment Performance Review (January 1, 2013 – June 30, 2013) -

The following summarizes the report received by ORSC at its October 10, 2013 meeting and reflects the investment performance for all six funds over the six-month period ending June 30, 2013. The findings of this report are briefly summarized as follows:

- All six of the funds had positive results for the six months ending June 30, 2013, with three of the systems outperforming their respective policy benchmarks (PERS, PERS Health Care, and HPRS), two matching those benchmarks (OP&F and SERS), and one underperforming its benchmark (STRS).
- For the one-year period ending June 30, 2013, SERS (+13.7%) outperformed its benchmark by 160 basis points. HPRS (+13.2%) outperformed its benchmark by 90 basis points. PERS (+12.7%) outperformed its benchmark by 100 basis points, PERS Health Care (+10.6%) outperformed its benchmark by 90 basis points, and OP&F (+13.0%) outperformed its benchmark by 60 basis points. STRS (+13.9%) underperformed its benchmark by 30 basis points.
- Over the trailing ten-year period, two funds have met their actuarial interest rates. STRS had a 10-year return of 8.2% compared to an actuarial rate of 7.75%, and OP&F

returned 8.4% compared to 8.25%. PERS returned 7.7% compared to 8.0%. SERS had a return of 7.2% compared to 7.75%. PERS Health Care had a 7-year return of 5.2% compared to 6.7% for their actuarial rate. HPRS had a return of 7.0% compared to 8.0%. During the same period, OP&F, STRS, PERS, and SERS exceeded their respective benchmark. HPRS trailed its benchmark by 80 basis points.

- Milliman provided the following observations on a review of the systems' asset allocation in comparison to the InvestorForce All Public Defined Benefit Universe:
 1. The actual (38.2%) and target (35.0%) domestic equity allocation of HPRS was above the median plan's allocation to domestic equity (35.4%) in the InvestorForce All Public Defined Benefit Universe. For OP&F, the target allocation to domestic equities (31.6%) was below the median, as was the actual allocation (28.5%). STRS actual (33.7%) was below the median, but its target (36.0%) is above the median allocation to domestic equities. The actual (24.8%) and target (22.5%) allocation of SERS, the actual (21.0%) and target (21.8%) allocation of PERS, as well as the actual (22.4%) and target (23.2%) allocation of PERS Health Care domestic equity were all below that of the median plan.
 2. Five of the six funds' actual asset allocations to fixed income were well below the median plan (29.2%). PERS Health Care has a target (33.5%) and actual allocation (31.4%) above the median.
 3. The median plan allocation for non-U.S. equity as of June 30, 2013 was 13.6%. The target allocations for all plans were significantly above the median, with the actual allocations following suit.
 4. The universe median allocation to real estate in the InvestorForce All Public Defined Benefit Universe was 9.7% as of June 30, 2013. The target allocation of each of the systems, with the exception of HPRS (5.0%) and PERS Health Care (6.0%), is above the median allocation.
 5. The universe median allocation to alternatives in the InvestorForce All Public Defined Benefit Universe was 9.4% as of June 30, 2013. The target allocation of each of the systems, with the exception of OP&F (5.3%) and PERS Health Care (8.1%), is above the median allocation.
 6. PERS and PERS Health Care added two new asset classes Risk Parity and Cambria Global Tactical ETF (GTAA) during the first half of 2013. The actual allocations for PERS (1.8%) Risk Parity and (1.9%) GTAA. PERS Health Care actual allocations (1.8%) Risk Parity and (1.8%) GTAA. The target allocation is 2.0% for each asset class.

7. OP&F added a new asset class Master Limited Partnerships (MLPs) during the first half of 2013. The target allocation is 5.0%.

**30-YEAR FUNDING PLANS
THE 130TH GENERAL ASSEMBLY
JANUARY 1, 2013 – DECEMBER 31, 2013**

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.⁷ This 30-year amortization refers to the amount of time the respective system would need to pay off all currently accrued benefits. This standard was modeled after the national standard adopted by the Governmental Accounting Standards Board for all governmental pension plans. The change was intended to maintain inter-generational equity among taxpayers and system members by limiting the ability to fund current benefit costs by extending the funding period beyond 30 years. **Actuarial reports issued in 2013 indicate that OP&F and STRS are beyond this 30-year standard. OP&F and STRS are required to submit their 30-year funding plans on or before January 20, 2014 and February 24, 2014 respectively.**

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

	Years of Unfunded Liabilities	Funded Ratio
PERS	26	80.9%
OP&F	47 ⁸	64.2%
STRS	40.2 ⁹	66.3%
SERS	29	65.3%
SHPRS	30	68.1%

⁷ R.C. 145.221, 742.16, 3307.512, 3309.211, and 5505.121.

⁸ OP&F Board action taken January 1, 2014, reduced this period to 38 years by reducing the amount of employer contribution dedicated to health care to .5% (from 2.85%).

⁹ The 2013 STRS actuarial evaluation indicated a period of 36.1 years to fund liabilities. However, the actuary STRS had a contract with, The Segal Company, indicated that due to a Segal error, the actual period was 40.2. Segal's error did not affect the funded ration of STRS.

STATUS OF HEALTH CARE FUNDS
THE 130th GENERAL ASSEMBLY
JANUARY 1, 2013 - DECEMBER 31, 2013

In 1974, the five public retirement boards were given broad discretionary authority to provide health care coverage to retirees and their dependents. Unlike pension benefits, which are vested on retirement, health care benefits are not a vested right under Ohio's public pension laws. Therefore, the courts have determined that the boards are authorized to change the premiums, eligibility, and level of health care benefits at any time. A 2004 ruling by the Tenth District Court of 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 by law to reimburse benefit recipients for Medicare Part B premiums (medical). Additionally, retirees who do not qualify for Medicare Part A (hospital) are provided equivalent coverage under the systems' health care plans. All employees hired on or after April 1, 1986, are required by federal law to contribute to Medicare and will therefore not require this equivalent coverage. Employees hired before that date were not required to contribute to Medicare.

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

Controlling health care costs has been and continues to be a major concern for Ohio's retirement systems. In calendar year 2012, the total cost of providing retiree health care was approximately \$2.6 billion. By law, any health care costs borne by the retirement systems must be financed by employer contributions only; the systems are not permitted to use any employee contributions for health care.

The retirement systems' actuaries annually review 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. Each year the retirement systems review their health care plans and make adjustments as needed. The following chart indicates the percentage of employer contribution each system allocated to health care during 2013 and the projected solvency period for each system's health care fund.

Ohio Retirement System	Percentage of Employer Contribution Allocated to Health Care in 2013	Projected Solvency Period for Health Care Funds
PERS	1.00%	Indefinite
STRS	1.00%	2060
SERS	.16%*	2020
OP&F	2.85% ¹⁰	2029
HPRS	3.65%	2024

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

¹⁰ As of January 1, 2014, the contribution to health care was reduced to .5% by the OP&F Board to assist with pension funding.

REPORTS ON ENACTED PENSION LEGISLATION
THE 130th GENERAL ASSEMBLY
JANUARY 1, 2013 - DECEMBER 31, 2013

Am. Sub. H.B. 59 (Biennial Budget Bill)

Am. Sub. H.B. 59 generally makes operating appropriations for the biennium beginning July 1, 2012, and ending June 30, 2014, 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 five public retirement systems. The Act:

- Requires each system to pay its proportionate share to ORSC by electronic transfer or other method of electronic payment (R.C. 171.05).
- Includes as entities that may offer investment options under an alternative retirement plan (ARP) maintained by a public institution of higher education entities that have provided investment options for at least ten years under ARPs at Ohio public institutions of higher education (R.C. 3305.03).

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

Effective Date - September 9, 2013

H.B. 67

The Act:

- Delays until September 7, 2013, a requirement that certain public employers notify individuals who have provided personal services of their right to seek determinations of membership in PERS.
- Delays until August 7, 2014, the date by which an individual must submit a request for PERS to determine whether the individual should have been classified as a public employee for purposes of PERS membership.

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

Effective Date - March 16, 2013

H.C.R. 19

The enacted Resolution urges Congress to oppose any legislation that requires Social Security coverage for members of any of the five public retirement systems.

ORSC Position – The ORSC recommended that the General Assembly approve H.C.R 19 at its November 14, 2013, meeting.

Concurrence - November 13, 2013

PENDING PENSION-RELATED ISSUES AND RECOMMENDATIONS
THE 130th GENERAL ASSEMBLY
JANUARY 1, 2013 - DECEMBER 31, 2013

The ORSC staff keeps legislators aware of relevant public retirement issues and of prior recommendations that have been made but not acted upon by the legislature. There remain a number of issues and recommendations that continue to warrant legislative consideration. What follows is a brief summary of each issue and of action taken by the legislature or the ORSC, if any, in 2013.

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

In 2000, this rate was set at 6%. That rate was later adjusted to 5.76% according to an actuarial study. In 2001, STRS established its own defined contribution plan (STRS DC) and set the mitigating rate for that plan at 3.5%. In response, the General Assembly took two actions that affirmatively reduced the mitigating rate and placed it under increased control of the General Assembly. First, H.B. 535 of the 123rd General Assembly removed a requirement that an actuarial study automatically increase or decrease the mitigating rate and instead provided that the ORSC was to conduct an analysis triennially and *permitted* to adjust the rate as reflected in the analysis.¹¹ Second, H.B. 94 of the 124th General Assembly provided that the ARP rate could not, under any circumstances, exceed the STRS DC rate. By operation of law under H.B. 94, the ARP rate to decrease to 3.5%, where it remained until June of 2013. At that time STRS raised its DC rate to 4.5% and required employers to raise the ARP rate to 4.5% as well.

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

The matter could be resolved by reviewing R.C. 3305.06 and R.C. 171.07 to clarify the intent of the General Assembly. ORSC staff would recommend that STRS maintain a rate of 3.5% until such time that the matter is resolved, as the AG opinion did not indicate that STRS has the authority to independently raise the ARP rate.

¹¹ The last report was completed in 2005 and suggested a rate of 8.64%. ORSC took no action on receiving this report. No analysis was completed in either 2008 or 2011. According to the triennial schedule, the next analysis is due 2014.

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

Market smoothing – Market smoothing provides that market gains or losses are incurred over a period of time (typically 3-5 years) rather than immediately as they occur. This effectively reduces “noise” from wild swings in the market (positive or negative) that could result in knee-jerk reactions resulting in benefit modifications that are not supported by long-term trends. A smoothing method is more consistent with pension actuarial analysis and funding, and it has historically been used by the five public retirement systems. At the September 12, 2013, ORSC meeting, the use of a smoothing method in reports provided to the Council was formalized by an 8-0 vote. The Council did not specify the duration of the smoothing and did not prohibit the inclusion of market value (i.e., non-smoothed accounting of assets) for information purposes.

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

There has been no further action on this recommendation.

Ad hoc report on disability experience of law enforcement – In November of 2012, Representative Schuring requested that ORSC staff provide an accounting of the disability experience of the law enforcement divisions, with recommendations to improve its functionality. ORSC staff began the project in the summer of 2013 and anticipates completion in 2014.

Actuarial Funding of Pension Benefits - There are generally three sources of revenue for the public retirement systems to fund, on an actuarial basis, their defined benefit plans: (1) employee contributions; (2) employer contributions; and (3) investment

¹² R.C. 742.14(A).

earnings. Investment earnings are typically the largest source of revenue for the five public retirement systems, funding up to 75 percent of the benefits paid. Therefore, the experience of a retirement system meeting its actuarial interest rate is essential to funding promised benefits. The actuarial interest rate is the rate of return the retirement system uses in anticipating sufficient funding levels in the future. Two points of data reviewed by ORSC staff are the experience of the systems in meeting its rate over a 10-year period and the statutorily required analysis of the adequacy of contribution rates for OP&F.

10-year actuarial interest rates

The last semi-annual investment review required by law on October 10, 2013, indicated that over the trailing ten-year period only two funds have met their actuarial interest rate. STRS had a 10-year return of 8.2% compared to a 7.75% actuarial rate, and OP&F returned 8.4% compared to 8.25%. The remaining systems have not met their actuarial rates over the same period. PERS returned 7.7% compared to 8.0%. SERS had a return of 7.2% compared to 7.75%. HPRS returned 7.0% compared to 8.0%.

It is important to note, however, that while STRS and OP&F have exceeded their actuarial rates, their funding period remains beyond the statutorily required 30-year period. PERS, SERS, and HPRS have not met their rates but are able to pay off all accrued benefits over a 30-year period as required by law. The success of a system meeting its long term actuarial interest rate is one of the most closely monitored data points by the Council, but it is not the sole determining factor of pension funding.

Adequacy of OP&F contribution rates

ORSC is required to conduct an annual study on the adequacy of contribution rates in OP&F.¹³ The last study was completed by Milliman in 2006. A current study is in process, again through Milliman. The 2006 study concluded that the rates at the time 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. This report is now almost a decade old and does not include the market losses and gains of the previous years, recent actions by the OP&F Board to stabilize funding, and, more importantly, the dramatic effect on existing liabilities resulting from the pension reform of the 129th General Assembly.

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

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

¹³ R.C. 742.311.

complete a comprehensive review of the laws and operations of all five public 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 129th General Assembly further implemented these recommendations. The following details recommendations that were acted upon in either the 129th or 130th General Assemblies. The following also specify those recommendations that have not yet been addressed.

- “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.” Pension reform implemented this recommendation for all uniformed members except highway patrol.

S.B. 340 of the 129th G.A. (eff. 1-7-13) raised the normal unreduced retirement age for OP&F members hired after July 1, 2013.

S.B. 343 of the 129th G.A. (eff. 1-7-13) raised the normal unreduced retirement age for PERS members in Group B to 50 and Group C to 52.

- “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. 341, 342, and 343 (eff. 1-7-13) increased both the years of service and age requirements necessary for a normal retirement in PERS, STRS, and SERS. They remain untied to Social Security.

- “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.” Pension reform implemented this recommendation for OP&F, STRS, and PERS (this recommendation was previously implemented in SERS). HPRS continues to have statutory percentage reduction of benefits, and ORSC staff maintains its recommendation that reductions be actuarially determined.

S.B. 340, 342, and 343 (eff. 1-7-13).

- “That disproportionate increases in salary prior to retirement be limited to a maximum percentage for purposes of determining final average salary in PERS, SERS, [OP&F] and HPRS unless such increase results from employment with another employer or promotion to a position previously held by another employee.”

The legislature has continued to implement strategies to reduce or eliminate “salary spiking” by members. Pension reform continued this process in OP&F and PERS.

However, ORSC staff recommends that continued vigilance be practiced in preventing disproportionate increases in final salary resulting in unjustifiable and subsidized retirement benefits.

- “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.”

The section in the Revised Code permitting this “supplemental benefit” (R.C. 3307.671) continues to be operative and ORSC staff continues to recommend its immediate removal.

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) required SERS to establish such a plan. Pension reform (S.B. 3309.81) removed the requirement that SERS establish a defined contribution fund, and made the establishment permissive.

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 outsourced the development and maintenance of the option in its analysis. 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. ORSC staff considers the JLC recommendation resolved by the more recent action of the General Assembly and the findings of the SERS survey and withdraws its recommendation that SERS be *required* to establish a DC plan. However, ORSC staff continues to recommend that SERS have the authority to do so should future members desire such an option.

University of Akron Non-Teaching Employees - 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. Consideration of a transfer of these employees from SERS to PERS should be made in the interest of developing consistent membership standards. The ORSC actuary provided several options to address the actuarial impact upon both retirement systems of such a transfer in its March 11, 2002, report Transfer of University of Akron Active Members from SERS to PERS. Based on that report, the ORSC staff recommended a transfer of the

University of Akron non-teaching employees from SERS to PERS for the purpose of providing 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 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; and¹⁴

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 funding period under SERS at the time), with the excess in contributions used to provide a supplemental contribution to SERS. This is consistent with 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 has not taken any action on the recommendation. The staff position is now over a decade old. ORSC staff continues to support consistent and clear membership standards; however, the conditions of the transfer may need further review in response to pension reform.

Reemployment Provisions - There continues to be legislative interest in the reemployment provisions of the five public retirement systems that allow members who have been retired to return to public employment while continuing to receive their pension. In the past, the Council has recommended that the reemployment provisions be standardized and more robust penalties be issued for those employees who retire and return to the exact same employment as a re-employed retiree, rather than establishing a uniform prohibition of re-employment.

¹⁴ With the implementation of the PERS Health Care Preservation Plan, this recommendation may no longer apply.

Health Care for Reemployed Retirees - H.B. 151 (eff. 2-9-94) required PERS reemployed retirees to receive primary health insurance coverage through the retiree'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 the OP&F board amended its health care policy 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. The STRS board adopted a rule, which became effective January 2009, that requires reemployed retirees to receive health care coverage from their public or private employer if the employer offers health care. HPRS also has a policy, which became effective January 1, 2008, that requires surviving spouses who are not eligible for Medicare and who are working and have medical coverage available through their employers to obtain their primary medical coverage through that employer. While SERS does not include a similar requirement, it is only with pension reform that they were authorized to do so. They have not required their reemployed retirees to receive health care through their employer at this time.

Annual 3% COLA - In its analysis of H.B. 157 (eff. 2-1-02), which provides for an annual 3% COLA in all five public 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. Since enactment, only three of twelve years have seen an increase of greater than 3% in CPI-W and five of those years experiencing inflation of less than 2%.

Under pension reform, COLA has been modified. For OP&F, COLA for certain members is reduced to the lesser of 3% or CPI, for HPRS the Board is authorized to provide a COLA of up to 3%, for STRS 2% and a suspension of COLA for certain members, and for PERS the lesser of 3% or CPI for certain members. SERS continues to provide a 3% benefit.

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 [five] 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)

The report is approaching two decades old. There has been no action to support or consider an offset by the General Assembly.

Review of Adequacy of the Contribution Rates - Current law requires the ORSC to conduct an annual review of contribution rates to OP&F and make recommendations to the legislature that it finds necessary for the proper financing of those benefits. In 2003, the Council voted to have Milliman review the adequacy of the contribution rates for PERS, STRS, SERS, and HPRS. The legislature has not indicated if they wish this procedure to be periodic or intended it as a one-time request.

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. The General Assembly has consistently opposed efforts to require Social Security participation.

Purchase of Service Credit - Pursuant to the ORSC's request, Milliman completed a report on the cost of purchasing service credit in 2007. The report noted that with regard to health care benefits, if they are reduced in the future, some of the additional health liabilities could be eliminated. Additionally, if service purchases did not count toward eligibility 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.

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

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

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

DOCUMENTS STATUTORILY REQUIRED OF THE RETIREMENT SYSTEMS
THE 130th GENERAL ASSEMBLY
JANUARY 1, 2013 - DECEMBER 31, 2013

The retirement systems are required by statute to submit various documents to the ORSC to assist the Council in its evaluation of the systems. The following is a listing of each report the retirement systems are required to submit to the ORSC along with a very brief summary of the contents of the report. Copies of 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. With the exception of OP&F which requires triennial valuations, the actuarial valuation must be submitted annually to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued and are available at the ORSC office.

Annual Report on Health Care - (R.C. 145.22(E), 742.14(E), 3307.51(E), 3309.21(E), 5505.12(E)) This report provides a full accounting of the revenues and costs relating to health care benefits. The report on health care must be submitted annually to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued and are available at the ORSC office.

Quinquennial Evaluation - (R.C. 145.22(B), 742.14(C), 3307.51(B), 3309.21(B), 5505.12(B)) This report must be completed at least once every five years. It is an actuarial investigation of the mortality, service, and other experience of the members, retirees, contributors, and beneficiaries of the system to update the actuarial assumptions used in the actuarial valuation. The quinquennial evaluation must be submitted to the ORSC and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation. No quinquennial evaluations were required during 2013.

Annual Report on Disability Experience - (R.C. 145.351, 742.381, 3307.513, 3309.391, 5505.181) The report details the preceding fiscal year of the disability retirement experience of each employer. The report must specify the total number of disability applications submitted, the status of each application as of the last day of the fiscal year, total applications granted or denied, and the percentage of disability benefit recipients to the total number of the employer's employees who are members of the respective retirement system. The report on the disability experience must be submitted to the Governor, the ORSC, and the chairpersons of the standing committees and subcommittees of the House of Representatives and Senate with primary responsibility for retirement legislation. These reports were timely issued and are available at the ORSC office.

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 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 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. No plans were received in 2013. Both STRS and OP&F are required to submit plans in the first quarter of 2014.

Actuarial Analysis of Legislation - (R.C. 145.22(D), 742.14(D), 3307.51(D), 3309.21(D), 5505.12(D)) These reports are required when any introduced legislation is expected to have a measurable financial impact on the retirement system. The actuarial analysis must be submitted to the ORSC, the Legislative Service Commission, and the standing committees of the House of Representatives and Senate with primary responsibility for retirement legislation within sixty days from the date of introduction of the legislation. No actuarial analyses were required during 2013.

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 information on the use of Ohio-qualified agents and minority business enterprises. These reports were timely issued and are available at the ORSC office.

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. The budgets were timely submitted and reviewed by ORSC and are available at the ORSC office.

Audit Committee Report – (R.C. 145.095, 742.105, 3307.044, 3309.044, 5505.111) Each retirement system is required annually to submit to the ORSC a report of the actions taken by its Audit Committee. These reports were timely issued and are available at the ORSC office.

Rules - The systems are required to submit to the ORSC a copy of the full text, rule summary, and fiscal analysis of each rule they file with the Joint Committee on Agency Rule Review pursuant to R.C. 111.15. The systems rules were reviewed in 2013 and any concerns were resolved through ORSC meetings.

Divestment of assets in Iran and Sudan – Section 707.20 of H.B. 562 of the 127th General Assembly required OP&F to establish a policy for the identification of businesses in which the fund has direct or indirect holdings that are engaged in scrutinized activities in Iran or Sudan and to divest those holdings. OP&F has continued to report on those efforts and, as

of October 2013, had reduced the market value of those holdings by 94.25%. The other retirement systems have also developed a policy of divestiture of holdings of companies conducting business in Iran and Sudan and have continued to decrease those holdings.

STATUS OF PENSION LEGISLATION
THE 130th GENERAL ASSEMBLY
JANUARY 1, 2013 - DECEMBER 31, 2013

HOUSE COMMITTEES

SENATE COMMITTEES

ANR	Agriculture & Natural Resources	AG	Agriculture
CLT	Commerce, Labor, & Technology	CVJ	Civil Justice
DRR	Economic Development & Regulatory Reform	CL	Commerce and Labor
ED	Education	CRJ	Criminal Justice
FA	Finance & Appropriations	ED	Education
FHD	Financial Institutions, Housing, & Urban Development	ENR	Energy and Natural Resources
HG	Health & Aging	FIN	Finance
INS	Insurance	IFI	Insurance and Financial Institutions
JUD	Judiciary	MHS	Medicaid, Health, and Human Services
MWD	Manufacturing and Workforce Development	PLV	Public Safety, Local Government, and Veterans Affairs
MVA	Military & Veterans Affairs	PU	Public Utilities
PO	Policy & Legislative Oversight	RU	Rules
PU	Public Utilities	SGO	State Government Oversight and Reform
RR	Rules & Reference	TR	Transportation
SLG	State & Local Government	WM	Ways & Means
TPS	Transportation, Public Safety, & Homeland Security	WED	Workforce and Economic Development
WM	Ways & Means		

LEGISLATIVE ACTION

ORSC POSITION

A	Amended	A	Approved
S	Substitute	D	Disapproved
P	Postponed Indefinitely	AA	Approved with Amendment
R	Referred	AD	Action Deferred
V	Vetoed	N/A	No Action Required
E	Emergency		
CR	Concurrence Refused		