



The Ohio Retirement Study Council

88 East Broad Street, Suite 1175

Columbus, OH 43215

(614) 228-1346 Phone

(614) 228-0118 Fax

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Analysis

H.B. 64 - Rep. Fox

(As Introduced)

Glenn Kacic - Contact Person
(614) 228-1346

The bill would make the following changes relative to the purchase of military service credit under the Public Employees Retirement System (PERS):¹

- Allows PERS members to purchase the total amount of military service credit for which they are eligible after completing one year of Ohio service (up to a maximum of five years), except that the PERS board shall not credit any amount of purchased military service that exceeds the member's total accumulated Ohio service until such time as the number of years purchased equals the member's total accumulated years of Ohio service.

Current law prohibits members from purchasing military service in excess of the member's total accumulated years of Ohio service. They may purchase part of their military service in any one payment or defer the purchase until they have accumulated years of Ohio service equal to or greater than the number of years of military service to be purchased.

- Lowers the purchase cost for military service by either eliminating annual compound interest altogether or reducing the time period upon which it is calculated. For each year of service purchased, the member shall pay an amount equal to the contribution rate in effect on the date the member was hired by a public employer multiplied by the member's first-year salary for full-time public employment. To this amount shall be added annual compound interest from the date the member began public employment to the date of payment, except that **no** interest shall be charged if the member purchases the military service no later than 90 days after the member's first year of public employment.²

Current law provides that for each year of service the member shall pay an amount equal to the contribution rate in effect at the time the military service began multiplied by the member's first-year salary for full-time public employment. To this amount shall be added annual compound interest from the date military service terminated to the date of payment.

- Allows members to use purchased military service to satisfy the ten-year service requirement for retiree health care coverage provided by PERS.

Under current law, members may not use purchased military service credit, early retirement incentive credit, out-of-state service credit, or exempted service credit to qualify for retiree health care coverage.

¹PERS law grants up to ten years of military service at no cost to the member, provided: (1) the member has at least one year of payroll deductions before entering active duty and maintains membership in PERS; (2) the member returns to employment covered by one of the five state retirement systems or the Cincinnati Retirement System within two years after an honorable discharge; and (3) the member completes at least one year of service thereafter. Members who do not satisfy these provisions may purchase up to five years of military service (an additional five years of concurrent prisoner-of-war service).

²Under Am. Sub. H.B. 450 (eff. 10-29-96), PERS members who are reemployed by the *same* public employer that employed them prior to their service in the armed forces may purchase up to five years of military service credit by paying an amount equal to the contributions they would have paid had they not been out of active service as public employees by reason of their service in the military. Annual compound interest is charged from the date of reemployment to the date of payment *only if* the member pays all or any portion of the required contributions later than the lesser of five years of a period that is three times the member's military service.

- Expands the types of military service which can be purchased to include **inactive duty** in the reserve components of the armed forces.

Current law limits the purchase of military service to **active duty** in the reserve components of the armed forces.

Staff Comments

The five state retirement systems in Ohio have some of the most liberal service credit provisions in the nation. Not only can public employees acquire service credit while contributing during their working years, but also they can purchase numerous types of service to increase retirement benefits or accelerate retirement eligibility, including federal service, out-of-state service, military service, restored service, prior service, exempted service, service while on leave-of-absence, service while on state temporary disability leave program, and various others. The establishment of payroll deduction plans has facilitated the purchase of credit for many members. Certain types of service are also granted by the systems at no cost to the member (e.g., military service which interrupts public employment).

In 1987 an actuarial study of the State Teachers Retirement System (STRS) service credit provisions indicated that the system's actuarial liabilities resulting from the purchase of service far exceed the cost paid by the member. That study determined that the member pays, on average, 15% of the actuarial cost. The member cost for military service credit in STRS, which is identical to that in the other four state retirement systems, represents, on average, only 7.5% of the full actuarial cost.

This study has raised the issue of whether the Ohio public retirement plans are well served by a policy which allows **some** public employees to accelerate retirement eligibility and/or increase retirement benefits through the purchase of an extensive variety of service at a fraction of the full actuarial cost and which requires **all** public employers to absorb the lion's share of the remaining cost. Based on the 1987 study, the STRS service credit provisions have been amended to require members to pay at least 50% of the actuarial cost for future purchases of service, including military service (H.B. 293 - 119th G.A.). Also, recent legislative sessions have marked an end to any further liberalization of the laws governing the purchase of service credit. Legislation enacted relative to the purchase of additional credit generally requires the member to pay the full actuarial liability resulting from the purchase or a greater portion of such liability (H.B. 383 - 119th G.A. - PERS, STRS, SERS - exempted service; H.B. 394 - 119th G.A. - PFDPF - service during lay-off period; H.B. 197 - 120th G.A. - PFDPF - federal and out-of-state service).

H.B. 64 would contravene these recent legislative enactments and the underlying public policy relative to the purchase of service credit by reducing the member cost for purchasing military service, which presently is a mere fraction of the full actuarial liability. Under the bill, the member would not be required to pay annual compound interest if the member were to purchase the military service no later than 90 days after the member's first-year anniversary in public employment. Also, in the event the member were to purchase the service after the 90-day window, the member would pay compound interest from the date the member was hired rather than the date the military service terminated, which could be many years later in certain situations. The effect would be to increase the funding requirements to cover the unfunded liabilities resulting from these purchases, which thereby would become the obligation of all employers covered by the system. Simply put, the bill would shift an even greater portion of the cost from the individual member who directly benefits from the purchase to all employers who assume the unfunded liability obligation for that purchase.

The bill would also defeat the legislative purpose of raising the service requirement from five years to ten years to be eligible for retiree health care benefits provided by PERS (H.B. 126 - 114th G.A.). Under the bill, a member could purchase five years of military service and actually contribute to PERS for only five years, and still be eligible for health care benefits which are presently provided at no cost to the retired member. The limited contributions made during this five-year period would likely be grossly inadequate to fund the costs of the health care benefits provided, which is the very reason the minimum service requirement was increased from five years to ten years of service in PERS, exclusive of purchased military service credit, early retirement incentive credit, federal and out-of-state service credit, and exempted service credit.

The bill would further create an inconsistency between the purchase military service credit provisions of PERS and the other four state retirement systems, which are presently uniform in terms of the member cost for purchasing such credit. As drafted, the bill would apply only to PERS members who purchase military service credit.

Fiscal Impact

According to the PERS actuary, Gabriel, Roeder, Smith & Company, H.B. 64 would create additional pension and health care liabilities. Data upon which to make detailed actuarial calculations is not available since the retirement systems has no way of knowing how many current or future members would be eligible to purchase military service and how many would actually choose to purchase it. Payments received for the purchased military service would generally be smaller and would *not* offset the full actuarial liability of the purchased credit. Although a precise measurement cannot be made, the PERS actuary indicates that the cost of the bill would be several million dollars per year.

Assuming that eligibility for post-retirement health care benefits would be advanced by two months, the PERS actuary indicates that the effect on contribution rates or funding periods (if the cost is absorbed within the current contribution rate structure) would be as follows:

Estimated Increase in Employer Contribution Rate to Fund Additional Health Care Liability			
	State	Local	Law Enforcement
Current Employer Rate	13.31%	13.55%	16.70%
Estimated Increase	00.06%	00.10%	00.07%
Total Employer Rate	13.37%	13.65%	16.77%

Estimated Increase in Amortization Period to Fund Additional Health Care Liability			
	State	Local	Law Enforcement
Current Funding Period	24 years	34 years	19 years
Estimated Increase	3 years	10 years	2 years
Total Funding Period	27 years	44 years	21 years

As an additional frame of reference, the PERS actuary indicates that the lump sum present value of

health care benefits for a married member retiring at age 60 is over \$70,000 in 1997. This is roughly equal to the present value of the pension benefit for an average salaried member retiring at the same age with 10 years of service. Therefore, allowing the use of purchased military service to meet the health care eligibility requirements could double PERS' present actuarial liability for members who retire and would not otherwise be eligible for health care benefits.

As indicated above, the bill would also increase pension liabilities by eliminating interest in certain situations or reducing interest in others. Presently, the member cost for purchasing military service is far less than the full actuarial cost resulting from the purchase. A 1987 actuarial study made in STRS indicates that the member pays, on average, only 7.5% of the full actuarial cost. A further reduction in the member cost of purchasing military service would have the effect of raising the funding requirements for PERS to cover these additional pension liabilities. The amount of these additional pension liabilities is not known since it is dependent on the number of years purchased as well as the age, final average salary and years of service of the member purchasing the credit. The trend in recent retirement legislation has been to charge the full actuarial liability to the member for the credit being purchased.

ORSC Position

At its meeting of April 24, 1997 the Ohio Retirement Study Council voted to recommend that the 122nd Ohio General Assembly disapprove H.B. 64 because under the existing military service credit provisions members pay only a small fraction of the actuarial liability resulting from such purchases and within the last few years the legislature has refrained from any further liberalization of service credit provisions due to cost considerations by requiring members to pay the full actuarial liability for the purchase of any new types of service credit.