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Analysis

H.B. 601 - Rep. Hartley

(As Introduced)

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(ORSC Position)

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H.B. 601

The bill would explicitly permit a member of the Police and Firemen's Disability and Pension Fund (PFDPF) who is receiving either an on-duty or off-duty partial disability benefit to apply far an on-duty total disability benefit at any time subsequent to the initial disability award. [R.C. §742.37(C)(8)]

Also, the bill would implicitly permit PFDPF members who are receiving service retirement benefits to subsequently apply for either partial or total disability benefits as a result of the proposed elimination of existing language which was enacted in H.B. 721 (effective 7/24/86) in response to the Ohio Supreme Court's decision in Manders/O'Neill v. Board of Trustees of the Police and Firemen's Disability Pension Fund (decided 11/25/81).

Current law provides that no person receiving a service or disability benefit from PFDPF on or after July 24, 1986 may apply for any new, changed or different benefit, except as follows:

- persons receiving an on-duty or off-duty partial disability benefit from PFDPF may have the partial disability award increased or decreased by the retirement board whenever the impairment of the member's earning capacity warrants such increase or decrease, up to a maximum of 60% of the member's average annual salary;

- persons receiving a service retirement benefit from PFDPF who are re-employed in a position covered under PFDPF may apply for a money purchase annuity based strictly on the amount of employee contributions, with interest, plus a matching amount of employer contributions, for the period of reemployment.

Background - In 1981, the Ohio Supreme Court rendered its decision in Manders/O'Neill, a consolidated case involving two PFDPF members who were receiving partial disability benefits and who subsequently applied for total disability benefits. The retirement board refused to consider their application, contending that it had no statutory authority to change a partial disability award to a total disability award. The Supreme Court rejected the board's contention on the grounds that PFDPF law defined "member of the fund" to include retirees and since a "member of the fund" could apply for total disability benefits, then retirees, as members of the fund, could also reapply for total disability benefits.

In 1986, the Ohio General Assembly enacted H.B. 721 which, among other things, overturned the Ohio Supreme Court's decision in Manders/O'Neill by specifically providing that no person receiving a pension or other benefit from PFDPF shall be entitled to any new, changed or different benefit from the fund, except that persons receiving partial disability awards may have such award increased or decreased whenever the impairment of the member's earning capacity warrants such increase or decrease. This specific provision restored the original legislative intent of PFDPF law that once a member retired under one of the service or disability provisions, the retiree could not later reapply for retirement or disability benefits under a different provision.

Current PFDPF law provides that a member who is unable to perform the duties of any gainful occupation for which the member is reasonably fitted by training, experience and accomplishments is eligible for total disability benefits. The total disability benefit is equal to 72% of the member's annual salary for the last year of active service, and is tax-free.[1]

A member whose disability prevents the member from performing the duties of a police or firefighter and impairs the member's earning capacity is eligible for partial disability benefits. For member's with less than 25 years of service, the on-duty partial disability award is fixed by the retirement board as a percentage of the member's average annual salary (average of the member's highest salary in any three years), up to a maximum of 60%. For members with 25 or more years of service, the on-duty partial disability award is determined under the following normal service retirement benefit formula: 2.5% times the first 20 years of service, plus 2% times the next five years of service, plus 1.5% for each year of service over 25, up to a maximum of 72% of the member's average annual salary. On-duty partial disability awards are tax-free, up to 60% of the member's average annual salary.

Off-duty partial disability awards are also fixed by the board, with a maximum benefit based on the member's actual years of service under the normal service retirement benefit formula described above.[2] Off-duty disability awards are taxable.

Staff Comments - The bill would reverse a longstanding public policy established since the initial operation of the fund in 1967 and reaffirmed by the state legislature in 1986 that PFDPF members who are receiving a partial disability award can not later apply far a total disability award. The rationale underlying this public policy is the fact that routine aging will inevitably cause most persons to attain a physical or mental state of total disability at some point preceding death, including those persons who retire on normal service retirement benefits. This is especially true since heart, cardiovascular and respiratory diseases are presumed under PFDPF law to be service-related

The bill would provide a built-in economic incentive for many retired members, whether they are receiving partial disability or service retirement benefits, to apply for total disability benefits. The total disability award is based on the member's annual salary for the last year of service, which is assumed by the retirement fund's actuary to be the member's highest salary. In contrast, partial disability and service retirement awards are calculated on the member's average annual salary (the average of the member's highest salary over three years). The total disability award is 72% of the member's annual salary for the last year, the highest percentage amount awarded under PFDPF. In contrast, the maximum on-duty partial disability award for members with less than 25 years of service is 60% of the member's average annual salary and the maximum service retirement award for members with 33 or more years of service is 72% of the member's average annual salary. Members who go out under regular service retirement with the minimum 25 years of service receive 60%. Perhaps more importantly, the total disability award of 72% is tax-free. In contrast, service retirement and off-duty partial disability awards are taxable; on-duty partial disability awards are tax-free only up to 60%.

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[1] Sub. H.B. 648, as passed by the House, would change the total disability benefit from 72% of the member's annual for the last year of active service to 72% of the member's average annual salary.

[2] Sub. H.B. 648 wouldauthorize the PFDPF board to fix the amount of an off-duty disability benefit as a percentage if the member's average annual salary, up to a maximum of 60%, based on the degree of medical impairment.

H.B. 601

The Ohio Retirement Study Council (ORSC) recommended in its 1994 legislative report regarding the adequacy of the police and fire contribution rates that a study into the causes of the high rates of disability among police and firefighters be made to determine whether any changes in the statutory and/or administrative procedures would be appropriate or desirable as a matter of public policy. The ORSC report found that during 1987 through 1991 disabilities comprised 41% of all police retirements and 35% of all firefighter retirements, compared to 35% and 25%, respectively, during the preceding five-year period. The disability study was completed by the William M. Mercer company at the very tail end of last session, and provides the basis for the various disability reforms included in H.B. 648 this session. Due to the concerted efforts of the ORSC, the Joint Legislative Committee to Study Ohio's Public Retirement Plans, and the PFDPF board over the last few years, disabilities among police and firefighters have declined significantly from their record highs during 1987 through 1991, especially the percentage of total disability awards according to the fund's actuary in testimony before the Joint Committee on H.B. 648. Enactment of H.B. 601 would likely undermine the success of the various disability reforms which have been made by the PFDPF board and which are proposed under H.B. 648 by once again creating a statutory incentive that encourages retired members to switch from partial disability or regular service retirement to total disability prior to death.

The present funding period for amortizing the unfunded actuarial accrued pension liabilities in PFDPF is 63.5 years as a result of changes to the actuarial assumptions recommended by the fund's actuary in the most recent five-year study (1992-96) of the fund's actual experience compared to its assumed experience. S.B. 82 (effective March 6, 1997) establishes a maximum 30-year funding period for all five statewide retirement systems in Ohio, with a ten-year transition. The PFDPF board has prepared a plan to reduce its funding period over the next ten years to comply with the funding requirements of S.B. 82. A key component of the board's plan is a moratorium on any retirement legislation that creates any additional liabilities without providing additional funding. As drafted, H.B. 601 provides no additional funding for the additional liabilities created by the bill, as determined by the fund's actuary. (See Fiscal Impact)

H.B. 601 provides that persons receiving off-duty partial disability benefits may apply for total disability benefits. In order to qualify for total disability benefits, PFDPF law provides that the member must be totally disabled as a result of the performance of the member's official duties as a police or firefighter. Therefore, it is unclear under the bill how an off-duty disability can be reclassified as service-related for purposes of satisfying the eligibility requirements for a total disability benefit

Fiscal Impact - According to the PFDPF actuary, Watson Wyatt, reclassifying a member from a partial disability to a total disability would create additional liabilities to the retirement fund for two reasons: (1) earnings used in the total disability benefit calculation become based on the member's annual salary for the last year rather than the member's average annual salary for a three-year period; (2) the percentage for the total disability benefit increases to 72% as opposed to the assumed 60% for partial disability benefits. Assuming that the reclassification occurs, on average, five years from the valuation date (l/1/97) for current partials and five years from the disability award for future partials, the actuary estimates a 16% increase in the total present value of benefits (as opposed to a 27.2% increase if the reclassification were to occur immediately).

Estimated in the actuarial accrued liability depend on the percentage of part that will be reclassified as totals. The actuary estimates that the actuarial accrued liability would increase by approximately $20 million for each 10% increment in reclassifications. Normal cost would increase by about $1 million for each 10% increment.

The actuary estimates that for each 10% increment in reclassification under H.B. 601, the required increase in the employer contribution rate to fund these additional liabilities would be about 0.19%. For example, assuming 50% reclassifications of partials to totals, the actuary estimates that the required increase in the employer contribution rate to be 0.95%. It should be noted that the employer contribution rates in PFDPF are fixed by statute at 19.5% for police and 24.0% for firefighters and that H.B. 601 provides for no increase in these statutory contribution rates.

Assuming that the statutory contribution rates remain at their present levels, the actuary estimates that the effect H.B. 601 on the 1997 funding period of 43.5 years for PFDPF would be an increase of 3.3 years with 10% reclassifications (46.8 years) and an increase of 27.6 years with 50% reclassifications (71.1 years). If the percentage of reclassifications were 75% or more, there would be no period sufficient to amortize the unfunded actuarial accrued liabilities resulting from the bill under the present statutory contribution rates. It should be noted that the present funding period has recently increased from 43.5 to 63.5 years due to changes in the actuarial assumptions which were made based on the most recent actuarial quinquennial study (1992-96).

The actuary indicates that the present amortization period for PFDPF already exceeds the 30-year maximum prior to any benefit improvements. "Hence, the Fund must focus on controlling costs in order to lower the amortization period. Any additional unfunded liability or normal cost imposed by the legislature could jeopardize the Fund's ability to satisfy 30-year amortization by 2007."

It should be noted that the actuarial cost estimates provided above consider only the reclassification of partial to totals. No consideration was given to the potential reclassification of service retirees who may apply for total disability benefits under the bill due to the elimination of existing language which prohibits them from applying for any new, changed or different benefit. Therefore, the actuarial impact upon the fund could be considerably greater than that shown above.

ORSC Position - At its meeting of February 11, 1998 the Ohio Retirement Study Council voted to recommend that the Ohio General Assembly disapprove H.B. 601.[3]

[3] Allen J. Proctor, Executive Director of PFDPF, stated that the PFDPF would be interested in legislation that limits the number of partial disability benefit recipients who may apply for total disability benefits to those recipients reapplying based on disease codes that are closely related to the disease codes which were the basis for the partial disability award and by creating a window during which the member could reapply. Mr. Proctor stated he would discuss the possibility of a substitute bill with Rep. Hartley. The ORSC would consider a substitute version of H.B. 601 with the appropriate actuarial valuation at a later time.