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Analysis

Sub. H.B. 623 - Rep. Cates

May 25, 2000

Staff Recommendation

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Sub. H.B. 623 would establish an alternative defined contribution (DC) plan for elected officials of the state or a political subdivision of the state and unclassified employees of the state or an instrumentality of the state that are exempt from collective bargaining (other than law enforcement officers) who elect to participate in the DC plan in lieu of the Public Employees Retirement System (PERS).¹ Sub. H.B. 623 would also make certain changes to the current alternative DC plan for academic and administrative employees of public institutions of higher education.

Current law requires unclassified, exempt employees of the state or an instrumentality of the state to become members of and contribute to PERS upon employment. PERS membership is optional for elected officials of the state or any political subdivision thereof. Elected officials who choose **not** to become members of and contribute to PERS on or after July 1, 1991 are required to contribute to Social Security pursuant to a federal mandate included in the Omnibus Budget Reconciliation Act of 1990.

Sub. H.B. 623 would, thus, provide elected officials and unclassified, exempt state employees another retirement option. Under the bill, unclassified, exempt state employees could choose to participate in the defined benefit (DB) plan provided under PERS or the DC plan established under the bill.² Elected officials of the state and any political subdivision thereof could choose to participate in the DB plan provided under PERS or the DC plan. Elected officials who choose neither of the above alternatives would be required to contribute to Social Security pursuant to current federal law.

Further details of the bill follow.

Establishment of Alternative DC Plan - The bill would require the Department of Administrative Services (DAS) to establish an alternative DC plan for elected officials and unclassified, exempt state employees who elect such plan in lieu of participation in PERS. Under the bill, DAS shall serve as the plan sponsor of the DC plan, and may perform such functions and provide as necessary for the administration of the plan. DAS may adopt any necessary rules to

¹An unclassified, exempt employee of the state or an instrumentality of the state shall include an individual who serves at the pleasure of the appointing authority or is employed under a written contract between the individual and the employer in the case of an employer that does not classify its employees. In cases of doubt whether an individual is an employee for purposes of the bill, the employer shall make the determination and its decision shall be final. In cases of doubt whether an employer is an instrumentality of the state for purposes of the bill, DAS shall make the determination and its decision shall be final.

²In a defined benefit (DB) plan, the employer generally promises to provide the employee a benefit amount at a stipulated retirement age based on a specified formula. The formula is typically based on years of service and earnings. Under a DB plan, the employer is responsible for ensuring that the 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.

In a defined contribution (DC) plan, the employer generally promises to allocate to the employee's individual account a specified contribution amount, typically some percentage of the employee's annual salary. The employer does *not* promise any specific benefit amount at retirement; rather, the employee receives a benefit based solely on the amounts accumulated in the employee's individual account. The employee bears all investment risk.

perform its duties under the bill.

The alternative DC plan shall consist of investment options to be offered to electing employees pursuant to individual or groups contracts, and certificates issued under group contracts, and may include life insurance, annuities, variable annuities, regulated investment trusts, pooled investment funds, or other forms of investment.

The alternative DC plan shall meet the tax qualification requirements under Section 401(a) of the Internal Revenue Code in order to avoid payment of federal income tax on contributions or the amounts earned thereon prior to the employee's receipt of a benefit. The plan shall also satisfy the minimum retirement benefit requirements under the Internal Revenue Code to qualify as a retirement system maintained by a state or local government entity. A plan generally satisfies these federal requirements if allocations to the employee's account are at least 7.5% of the employee's compensation, regardless of whether such allocations are made by the employee, employer, or some combination of the two.³

Designation of Entities - The bill would require the Department of Insurance to designate three or more entities to provide investment options under the alternative DC plan; such designations shall not be subject to competitive bidding. Each entity would be required to meet the following two conditions: (1) It must be authorized to conduct business in Ohio with regard to the investment options to be offered under the plan; and (2) It must provide the same or similar investment options in at least 10 other states.

In designating an entity, the Department of Insurance would be required to consider all of the following factors: (1) The experience of the entity in providing the investment option(s) in other states; (2) The potential effectiveness of the entity in the recruitment and retention of employees; (3) The nature and extent of the rights and benefits to be provided under the investment option(s); (4) The relationship between the rights and benefits provided under the investment option(s) and the amount of contributions made under the option(s); (5) The suitability of the rights and benefits provided under the investment option(s) to meet the needs and interests of electing employees; (6) The capability of the entity to provide the rights and benefit provided under the investment option(s); and (7) Any other relevant matters. The Department of Insurance would also be required to review periodically each designated entity, and rescind any designation if the Department finds that the entity is **not** in compliance with the requirements and conditions enumerated above.

Contracts - The bill would require DAS, as the plan sponsor, to enter into a contract with each designated entity that is willing to provide investment options under the alternative DC plan. Each contract shall provide for termination upon cessation of the entity's designation by the Department of Insurance.

Eligible Employees - The bill would permit an elected official of the state or a political subdivision thereof or an exempt, unclassified employee of the state or an instrumentality thereof (other than a law enforcement officer) whose employment commences after the establishment of the DC plan to make an election to participate in the DC plan, provided they are not receiving benefits from PERS. Within 10 days of employment, the employer shall notify DAS and PERS of the employee's name and address. The election shall be made not later than 120 days after the commencement of employment, and shall become effective as of the starting date of employment.

³Failure of the plan to satisfy these minimum retirement benefit requirements would cause the employee and employer to contribute to the Social Security System under current federal law.

If no election is made within this 120-day period, the employee shall be considered a member of PERS (unless the employee is an elected official who has not applied for PERS membership).

The bill would also permit a PERS member who is an elected official of the state or a political subdivision thereof or an exempt, unclassified employee of the state or an instrumentality thereof and who has less than five years of service credit as of the last day of the month prior to the establishment of the DC plan to make an election to participate in the DC plan, provided they are not receiving benefits from PERS.⁴ The election shall be made not later than 120 days after the establishment of the DC plan, and shall become effective as of the last day of the month prior to the establishment of the DC plan. If no election is made within this 120-day period, the member shall continue as a member of PERS.

All eligible employees shall make the election on a form provided by the employer and shall submit it to the employer. Once made, the election is irrevocable while the employee is employed by the same employer.⁵ Not later than 10 days after the election is submitted by the employee, the employer shall file a certified copy of the election with DAS and PERS. An employee who makes an election to participate in the alternative DC plan is forever barred from claiming or purchasing service credit in any state retirement system for the period during which the election is in effect.

The bill would require DAS to permit electing employees to do all of the following:

- Select a provider;
- Contract with only one provider in any plan year;
- Change providers once during the first payroll in any plan year or at any time upon the cessation of the provider's designation.

The bill would require the provider to transfer the employee's account balance to the new provider if the electing employee changes providers.

Transfer of Contributions to DC Plan - The bill would require PERS, not later than 30 days after receipt of the employee's election, to pay to the selected provider any contributions made by or on behalf of the employee for the period beginning on the employee's starting date (or the last day of the month prior to the establishment of the alternative DC plan) and ending on the day prior to the commencement of contributions to the alternative DC plan, less any amounts required to be paid to PERS as supplemental contributions.

The bill would also require PERS, *upon application of the member*, to pay to the selected provider the member's accumulated contributions, including any payments for the purchase of service credit under PERS, that are otherwise on deposit with PERS. Such payment shall cancel the member's service credit in PERS, and shall forever bar the member from claiming or purchasing credit in PERS for the period of employment attributable to those contributions.

⁴An elected official who is not a PERS member may make an election if the elected official has been in such position for less than five years on the last day of the month prior to the establishment of the DC plan.

⁵An eligible employee who terminates employment with one employer and is subsequently employed by another employer may make another election.

Required Contributions to DC Plan - The bill would require electing employees to contribute the same percent of earnable salary to the DC plan as they would have otherwise been required to contribute to PERS, except that the percentage shall not be less than 3%. The current employee contribution rate is 8.5% under the state division of PERS. Employee contributions may be made on a pre-tax basis pursuant to Section 414(h) of the Internal Revenue Code which permits governmental employers to “pick-up” such contributions.

The bill would require the employer to contribute to the DC plan an amount determined by DAS. Under the bill, DAS shall collect the employee and employer contributions made by and on behalf of the electing employee and distribute the same to the appropriate providers for application to the electing employee’s option.

In addition, each employer would be required to contribute 6% of the electing employee’s salary to PERS as a supplemental contribution to mitigate any negative financial impact of the DC plan on PERS, *except* that such percentage may be adjusted by the ORSC based on its actuarial study.⁶ Any adjustment in the supplemental contribution shall become effective on the first day of the second month following the submission of the ORSC actuarial study to DAS. The supplemental contribution shall continue until the unfunded actuarial accrued liabilities of PERS, excluding health care and any benefit increases provided after the effective date of the bill, are fully amortized as determined by the annual actuarial valuation of PERS.

Rights of Electing Employees under the DC Plan - The bill would provide that neither the State of Ohio, DAS nor any employer shall be a party to any contract purchased in whole or in part with contributions made to the alternative DC plan. The bill would also provide that no retirement, death or other benefits shall be payable by the State of Ohio, DAS or any employer under the DC plan. Benefits shall be paid to the electing employee or such employee’s beneficiaries in accordance with the DC plan established under the bill. Benefits shall not be paid under the DC plan prior to the electing employee’s death, termination of employment or, if provided under the plan, upon disability.

Spousal Consent - The bill would require each designated provider under the DC plan to obtain, prior to making any payment, the consent of the employee’s spouse to the form of payment selected by the employee. The provider shall establish the same requirements for consent as required under Section 417 of the Internal Revenue Code. Consent may be waived if the spouse cannot be located or for any other reason permitted under the Internal Revenue Code and regulations adopted thereunder. Consent or waiver shall only be effective with respect to the spouse who is the subject to the consent or waiver.

Non-Assignment/Exemptions - The bill would generally provide that benefits, contributions, investments and income thereon under the alternative DC plan shall be neither assignable nor subject to attachment, garnishment, the operation of bankruptcy or insolvency laws or other legal process. The bill would provide the following exceptions to this general rule: (1) withholding orders as restitution for theft in office and certain sex offenses committed in the context of employment; and (2) withholding orders for alimony or child support. The bill would also exempt

⁶The bill would require the ORSC to have an actuarial study completed and submitted to DAS within one year after the establishment of the alternative DC plan and each year thereafter. The study shall determine any necessary adjustment in the supplemental contributions to PERS to reflect any changes in the level of negative financial impact of the DC plan on PERS.

benefits, contributions, investments and income thereon under the alternative DC plan from any state tax, except the state income tax, and any county, municipal or local tax, except any school district income tax. Currently, benefits, contributions, investments and income thereon under the five state retirement systems are subject to the same legal provisions.

Ohio Public Employees Deferred Compensation Program - The bill would permit both elected officials and unclassified, exempt state employees electing an alternative DC plan and higher education employees electing an alternative DC plan to defer additional income in the Ohio Public Employees Deferred Compensation Program. This program is established in accordance with Section 457 of the Internal Revenue Code which allows state and local government employees to defer income up to a specified maximum. Participants in the program pay federal and state income taxes on the deferred income when the income is received rather than earned. Current law permits members of the five state retirement systems to participate in the program.

Changes to Alternative DC Plan for Higher Education Employees - Sub. H.B. 623 would make several changes to the current alternative DC plan for academic and administrative employees of public institutions of higher education.

Current law provides that an administrative employee who is serving in a position in the unclassified civil service pursuant to R.C. §124.11 may elect the alternative DC plan. The bill would provide that if R.C. §124.11 does not apply to the public institution of higher education, then an administrative employee who is serving in a position comparable to a position in the unclassified civil service may make such election.

Current law provides that the alternative DC plan shall provide retirement and death benefits through the purchase of annuity contracts or certificates, fixed or variable in nature. The bill would provide that such benefits shall be provided through group or individual contracts, and may include life insurance, annuities, variable annuities, regulated investment trusts, pooled investment funds, and other forms of investment.

Current law provides that each public institution of higher education shall enter into a contract with each designated provider. The bill would clarify this provision to require the public institution to contract with each designated provider that is willing to offer an alternative DC plan to eligible employees at that institution.

Current law provides that academic and administrative employees who are employed on or after the establishment of an alternative DC plan may make an election to participate in such plan not later than 90 days after the commencement of such employment. The bill would extend the election period to 120 days. It would also clarify that the election shall be irrevocable while the electing employee is employed by the same public institution of higher education.

Current law provides that an election shall only apply to the electing employee's employment in positions for which an alternative DC plan is available. Employment of the electing employee in any other position shall be subject to coverage under the applicable state retirement system. The bill would provide an exception for employees who are participating in an alternative DC plan and who change to a position for which an alternative DC plan is not available at the same public institution of higher education. Under the bill, such employees would be required to continue participation in the alternative DC plan.

Current law requires the public institution of higher education to permit an electing employee to change the alternative DC plan in which the employee is participating if the provider of such plan

ceases to be a designated provider. The bill would require the public institution to permit electing employees to do the following: (1) select from among the designated providers that have entered into a contract with the public institution; (2) contract with only one designated provider in any plan year ; (3) change the provider selected once during the first payroll period in any plan year or at any time in which the provider selected ceases to be a designated provider. The bill would also require the provider to transfer the employee's individual account balance to the new provider when the employee changes providers.

Current law requires the applicable state retirement system to return to the public institution any contributions made by or on behalf of the electing employee during the election period, less any supplemental contributions required to be paid by the institution to the state retirement system. The bill would require the applicable state retirement system to pay such contributions directly to the provider selected by the employee not later than 30 days after the certified copy of the election is filed with the state retirement system.

Current law provides that any adjustment in the supplemental contribution payable to the applicable state retirement system shall become effective on the first day of July in the year in which the actuarial study is completed by the ORSC. The bill would make any adjustment in the supplemental contribution effective on the first day of the second month following submission of such actuarial study to the Board of Regents.

Current law provides that the supplemental contribution shall continue until the unfunded actuarial accrued liabilities of the state retirement system, excluding health care, are fully amortized. The bill would also exclude from such unfunded actuarial accrued liabilities any benefit increases provided under PERS after the effective date of the bill.

The bill would eliminate the current statutory provision which allows electing employees to make additional contributions on a voluntary basis to the alternative DC plan. The bill would also provide that a benefit shall not be paid under an alternative DC plan prior to the electing employee's death, termination of employment or, if provided under the plan, upon disability.

The bill would make benefits payable under the alternative DC plan for higher education employees subject to withholding orders as restitution for certain sex offenses committed in the context of employment. This provision is consistent with the laws governing the five state retirement systems.

The bill would require each designated provider under the alternative DC plan for higher education to obtain, prior to making any payment, the consent of the employee's spouse to the form of payment selected by the employee. The provider shall establish the same requirements for consent as required under Section 417 of the Internal Revenue Code. Consent may be waived if the spouse cannot be located or for any other reason permitted under the Internal Revenue Code and regulations adopted thereunder. Consent or waiver shall only be effective with respect to the spouse who is the subject to the consent or waiver. This provision is consistent with the laws governing the five state retirement systems.

Staff Comments - One of the findings included in the final report of the Joint Legislative Committee to Study Ohio's Public Retirement Systems (**December 11, 1996**) is as follows:

"Portability has become a national retirement issue. It has also become an issue in Ohio in terms of the recruitment of higher education employees and is likely to become an increasing issue for other groups of public employees, such as part-time, short-service and mobile employees, who are required to participate in retirement systems which are designed to benefit older, long-tenure

employees and employees making permanent job changes relatively late in their career.”

One of the recommendations included in the final report is as follows:

“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.”

Since then, the Ohio General Assembly has enacted and/or proposed several pieces of legislation to address this issue.

By way of background, the General Assembly enacted H.B. 586 (eff. 3/31/97) which established an alternative DC plan administered by outside providers for full-time academic and chief administrative employees of public institutions of higher education electing such plan in lieu of participation in the DB plans of PERS, STRS or SERS. The bill also required STRS to pay interest upon the withdrawal of the member’s contributions due to death or separation from employment, along with a 50% match from employer contributions for members who had at least five years of service.

This session, the General Assembly enacted S.B. 190 (eff. 7/13/00) which, among other things, requires the STRS board to establish an alternative DC plan. Similarly, H.B. 628 and S.B. 270 have been introduced which, among other things, would require the PERS board and SERS board to establish alternative DC plans for their respective memberships. Also, S.B. 144, which has passed the Senate and is pending before the House, would require the PERS board to credit interest on the member’s contributions, along with a 33% match of employer contributions for members with five but less than 10 years of service and a 67% match for members with ten or more years of service upon the withdrawal of contributions.

All of these legislative measures seek to address the need for greater pension portability and options for Ohio’s public employees and have received the favorable recommendation of the ORSC.

Sub. H.B. 623 is modeled after H.B. 586 which established the alternative DC plan for Ohio’s higher education employees. Like H.B. 586, the bill seeks to address specific recruitment needs and portability needs of certain public employers and employees, respectively. The bill is limited to elected officials and unclassified, exempt state employees in recognition of the effect of impending term limits and typical job mobility between the private and public sectors as well as between different states on the longevity of service for such officials and employees who often serve at the pleasure of the electorate and/or appointing authority. Accordingly, these groups of public employees, along with their employers, may benefit from the flexibility of an alternative DC plan to meet the portability needs of such employees and the recruitment needs of such employers.

Like higher education employees who are eligible for the alternative DC plan, the STRS DB plan, and the options to be offered under the STRS alternative retirement plan under Sub. S.B. 190, elected officials and unclassified, exempt state employees would become eligible for the alternative DC plan established under the bill, the PERS DB plan and the options to be offered under the PERS alternative retirement plan under H.B. 628. Elected officials who choose none of the above alternative retirement coverages would be covered under the Social Security System.

Though the alternative DC plan for higher education employees is designed as a single-employer plan, whereas the proposed alternative DC plan for elected officials and unclassified, exempt state employees is designed as a multi-employer plan, this difference is relatively minor in nature and

largely justified on the grounds that small employers, such as villages, are ill-equipped to administer such plans for their public officials. Therefore, DAS on behalf of the individual employers would perform the same statutory functions as each board of trustees under the current alternative DC plan for higher education employees relative to the role of plan sponsor. DAS would collect contributions made by and on behalf of electing employees and distribute such contributions to the appropriate provider selected by the employee.

Like H.B. 586, the bill is intended to hold PERS harmless by requiring supplemental contributions to be paid to PERS to mitigate any negative financial impact resulting from the establishment of the alternative DC plan on the DB plan established under PERS. The initial supplemental contribution provided under the bill is 6% of the electing employee's earnable salary, and may be adjusted within one year of the bill's effective date and each year thereafter based on the actuarial studies to be completed by the ORSC. Currently, PERS has no unfunded actuarial accrued liabilities as of December 31, 1998 and, therefore, receives no supplemental contributions under the current alternative DC plan for higher education employees. The supplemental contributions were recently reduced from 6% to 5.76% in STRS and to 3.10% in SERS based on a recent actuarial study completed by the ORSC.

In order to determine the supplemental contribution necessary to mitigate any negative fiscal impact upon PERS, the ORSC actuary must have direct access to information on employees electing the alternative DC plan, such as social security number, date of birth, contributions, compensation, gender, etc. *Because of the greater number of employers covered under the alternative DC plan established under the bill than covered under H.B. 586, it is recommended that each provider be required to maintain and submit such information to the ORSC as a condition of being designated by the Department of Insurance. It is also recommended that after completion of the actuarial study within one year of the effective date of the bill, the ORSC be required to conduct such studies every three years thereafter, which is consistent with the law governing the alternative DC plan for higher education employees. It is further recommended that provision be made for the resumption of the supplemental contribution should adverse experience generate actuarial losses to the retirement system that recreate an unfunded actuarial accrued liability.*

Fiscal Impact - The ORSC staff has received the actuarial analysis of H.B. 623 from the PERS actuary, which is pending review by the ORSC actuary, Milliman & Robertson.

Staff Recommendation - That the Ohio Retirement Study Council recommend that the 123rd Ohio General Assembly approve Sub. H.B. 623 (LSC 123 1513-4) upon the adoption of the following amendments:

- That each provider be required to maintain and submit information to the ORSC on employees electing the alternative DC plan established under the bill as a condition of being designated by the Department of Insurance;
- That after the completion of the actuarial study to determine any necessary adjustments to the supplemental contribution rate within one year after the establishment of the alternative DC plan under the bill, the ORSC be required to conduct such studies every three years thereafter;
- That provision be made to reinstate supplemental contributions under both the alternative DC plan established under the bill and under H.B. 586 should adverse experience generate actuarial losses to the retirement system that recreate an unfunded actuarial accrued liability.