OPERSource

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OPERS PENSION LEGISLATION (SB343) INCLUDES ANTI-SPIKING PROVISION

Throughout the years, much attention has been paid to the practice commonly-referred to as “spiking.” The term “spiking” describes the practice of a small number of members who attempt to increase their pension benefits by dramatically increasing their final average salaries over a relatively short period of their career. An example is the member who works at a low salary for 27 years, and then moves to a much higher-paying job for 3 years (the final average salary calculation period under current law). This member’s pension would be based on the higher compensation level even though the contributions made over the member’s career were inadequate to fund this higher benefit. This practice results in subsidization – when a member’s contributions are not sufficient to fund his or her pension benefit, the System and all of its members are required to make up the difference. There is nothing in the law now to address these situations, but as you can see, it creates disparate final pension benefits for our members. As a result, it has been a concern for OPERS and the Ohio General Assembly for many years.

Now however, the OPERS Board of Trustees has proposed a unique and innovative approach to limit the practice of “spiking.” In February 2012, the Board recommended that pending pension legislation be amended to include this new approach.

This new approach is called the Contribution-Based Benefit Cap (CBBC), and it works like this: A member’s formula pension benefit (2.2% x Final Average Salary x Years of Service) is compared to the amount the member contributed to OPERS throughout his or her career (annuitized and multiplied by a factor selected by the OPERS Board). If the member’s formula benefit exceeds the annuitized contribution amount, the formula benefit will be capped. The Board wanted to address spiking in a way that created a measured response to the spiking issue and would not negatively affect members that provide adequate contributions over time to help fund pension payments. Using a factor of six for the benefit cap would have affected just 2 percent of age and service retirees from 2006-2010.

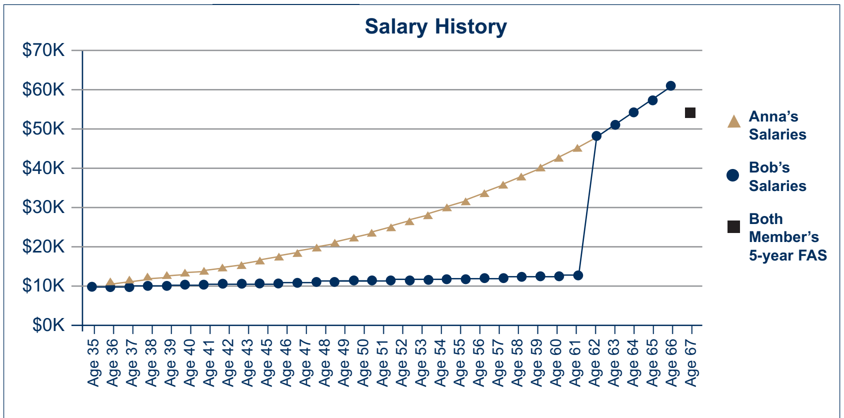
Stated another way, the CBBC does not focus solely on final average salary calculations but also on the member’s accumulated contributions over time. It is meant to cap the pension benefits of only those members who have a formula benefit out of proportion with their contributions. As proposed, the cap would more than likely only impact less than 2% of our population. The proposed cap is not designed to impact members who receive typical salary increases and promotions throughout their careers. It also is important to note that this anti-spiking measure *would not be applied retroactively. It would apply only to members who retire after pension legislation becomes law.*

“We believe the proposal has merit as a potential blueprint for other public pension funds that wish to limit spiking.”

The Contribution Based Benefit Cap (CBBC) formula was included in Senate Bill 343, and we hope to secure its passage into law this year. This proposal aligns with our goal to eliminate unfair subsidization of one member’s benefits by other members. We believe the proposal has merit as a potential blueprint for other public pension funds that wish to limit spiking.

In summary, the OPERS-proposed CBBC is a new approach to address spiking because it focuses not solely on final average salary calculations but on accumulated contributions by the member. It is meant to impact only those members who have a formula benefit out of proportion with their contributions.

In order to reduce confusion and anxiety regarding the implementation of the CBBC, OPERS has developed a “CBBC calculator” so that members can determine whether they will be impacted by the cap. To use the calculator, members can visit our website, www.opers.org, and scroll down to the “Special Coverage” section then look for the column entitled, “Additional Information.” Please note, to use the calculator, a member must know his or her contribution history.



	Anna	Bob
5-Year FAS	$54,000	$54,000
Service Credit	32	32
Retirement Age	67	67
Accumulated Contributions (assuming 1% interest)	$102,000	$64,000
Formula Benefit	$38,000	$38,000

EXAMPLE OF HOW "SPIKING" HAPPENS

Let's consider two 67-year-old public servants who retire with 32 years of service credit. "Anna" has had steady salary increases to achieve a final average salary of $54,000 at retirement. "Bob," who was paid at a very low salary for 27 years, then moved to a much higher-paying job for the final five years of his career, also achieved a FAS of $54,000.

In each case under the statutory benefit formula, Anna and Bob would receive a pension benefit of $38,000. However, while Anna has contributed (with interest) $102,000 to her pension over the course of her working career, Bob has contributed only $64,000. (OPERS members pay at least 10 percent of their salary toward their retirement.)

The OPERS anti-spiking proposal would reduce Bob's annual benefit by using the following formula, which reflects his lower lifetime pension contributions: Accumulated contributions x Annuity factor x Contribution-based benefit cap (CBBC) factor = Annual benefit.

Here are the formula definitions:

Accumulated contributions: The amount that the member contributed to the retirement system, plus interest.

Annuity factor: An age-based figure developed by our actuaries that converts the accumulated contributions to an annuity payable over the retiree's expected remaining life. In these examples, the annuity factor for a 67-year-old is .08664.

CBBC factor: A number that reflects the ratio between the formula benefit and the annuitized accumulated contributions. The benefit cap factor that the Board selected is six, which means the benefit would be capped if it is six or more times the annuitized accumulated contributions.

Annual benefit: The amount the member receives yearly.

APPLYING THE ANTI-SPIKING FORMULA YIELDS THE FOLLOWING RESULTS:

Anna's annuitized accumulated contribution:
$102,000 x .08664 = $8,837.

Because Anna's formula benefit of $38,000 is less than six times her annuitized accumulated contribution benefit of $8,837, she would receive the formula benefit of $38,000.

Bob's annuitized accumulated contribution:
$64,000 x .08664 = $5,545.

Because Bob's formula benefit of $38,000 is more than six times his annuitized accumulated contribution benefit of $5,545, his benefit would be capped using the formula mentioned above: $64,000 x .08664 x 6 = $33,270

Bob would receive an annual benefit of $33,270 rather than $38,000.

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OPERS

The Ohio Public Employees Retirement System (OPERS) is the largest public pension fund in Ohio and the 11th largest public pension fund in the U.S. In operation since 1935, OPERS serves nearly 954,000 members, including more than 176,000 retirees and beneficiaries.