PTA

William B. Fornia, FSA | President

April 11, 2024

Ms. Bethany Rhodes
Executive Director
Ohio Retirement Study Council

Subject: Response to Ohio Police and Fire Funding Period Adequacy Studies

Dear Bethany:

Section 742.311 of the Ohio Revised Code (ORC) requires that we review the adequacy of the current statutory contribution rates relative to the benefits provided under the Ohio Police and Fire Pension Fund (OP&F). As we reported in our last two reports, we are concerned with the methodology and assumptions used by Cavanaugh MacDonald Consulting, LLC (CMC), actuary for OP&F.

In particular, the level of future OP&F administrative expenses assumed by CMC is not realistic and not an appropriate consideration for this determination of funding period. CMC has responded to our concern in a letter on March 22, 2024.

In this letter, CMC proposed to modify its assumption in a manner which satisfies our concerns. And fortunately, CMC calculated that using this refined assumption, the OP&F funding period remains below 30 years as of both January 1, 2022 and 2023.

We have replaced the current expense assumption used by CMC with the refined assumption and confirm that the funding period remains below 30 years as of January 1, 2023.

However, we would encourage CMC to use an administrative expense assumption other than that currently proposed. Specifically, CMC proposes to project expenses for 30 years based on the current year expenses paid, which could be distorted by a special one-time expense. For example, the 'other' administrative expenses increased by 16% from 2020 to 2021 and decreased by 2% from 2017 to 2018. There are several other more refined approaches to setting the administrative expense assumption like the other Ohio systems do.

As mentioned in our reports, we do not believe that the funding period was calculated using realistic assumptions of future OP&F administrative expenses. Specifically, the CMC methodology assumed that a 2021 $9 million credit from OPERS to OP&F recognizing the cost of OPERS benefits for OP&F staff would recur year-after-year for 30 years. This will not occur. We found two problems with this approach. First was that rather than assuming a cost to provide OPERS benefits to the OP&F staff, the methodology assumed a credit or negative cost. Second was that the figure was purely a financial accounting number on the financial statements and not actual cash which could be used to pay pension benefits. CMC solves this twofold problem by substituting actual cash contributions from OP&F to OPERS for the volatile and occasionally negative accounting figure. CMC, with OP&F's assistance, was able to identify the actual cash contributions for the past seven years. The table below from CMC's letter presents this information.

Development of Proposed Administrative Expense Assumption				
Calendar Year	(a) Administrative Expense From ACFR	(b) OPERS GASB Expense	(c) OPERS Contributions Actually Made per OP&F Staff	Proposed Administrative Expense (a) - (b) + (c)
2016	$ 19,517,891	$ 3,672,521	$ 1,356,608	$ 17,201,978
2017	20,218,704	4,426,337	1,403,108	17,195,475
2018	16,780,220	1,340,383	1,472,029	16,911,866
2019	21,612,071	5,207,345	1,523,056	17,927,782
2020	19,218,035	3,123,667	1,543,347	17,637,715
2021	9,780,703	(8,921,262)	1,559,294	20,261,259
2022	12,810,009	(6,492,288)	1,557,189	20,859,486

The key is comparing columns (b) and (c). The previous CMC method used the current year's column (b) and assumed it would continue (adjusted for inflation) for the thirty-year funding period. It was actually column (a) which was provided in the annual reports, which for years up to and including 2020 did not seem to be of concern. Also note that CMC has a similar observation to ours that "The expense assumption is normally inconsequential." But in 2021 when this figure decreased from $19,218,035 to $9,780,703, we made a more thorough review and identified column (b). Our estimates in our two letters reverted to the CMC 2020 assumption of $19,218,035 increasing with inflation for 30 years.

CMC identified the actual cash OPERS contributions (column (c)) and saw that their previous approach of using financial statement figures (column (b)) was not only invalid in the two years that we identified but was also inappropriate – and too high – in most of the prior years. When they corrected their assumption, they determined that the thirty-year period would have been met in both 2021 and 2022.

Although CMC has modified their approach to no longer consider non-cash negative amounts in their long-term administration expense assumption, we encourage them to use a method which does not rely only on the most recent years' experience. For example, the 2018 expenses (column (d)) decreased from the prior year by 2% and the 2021 expense increased by 15%, The other four Ohio systems use methods which do not have such significant swings. Typically, they develop an assumption in their experience study based on several years of experience and do not modify it each year.

Conclusion

CMC has modified their assumption for administrative expenses in a manner which fully satisfies our concerns with its inappropriateness. We have reviewed their revised funding period calculations and confirm that using their proposed approach, the funding period remains below 30 years as of January 1, 2023. Actuarial calculations were performed under the direction of William Fornia, FSA and Linda Bournival, FSA. We are Members of the American Academy of Actuaries and qualified to render this actuarial opinion. We are available to discuss these findings and recommendations in more detail.

Sincerely,

WB Fornia　　　　Linda Bournival

William B. Fornia, FSA　　　　Linda L. Bournival, FSA

Cc: Tom Vicente, Bolton Partners