Ohio Police & Fire Pension Fund
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November 5, 2003

Mr. Aristotle Hutras
Ohio Retirement Study Council
88 East Board Street, Suite 1175
Columbus, OH 43215

Dear ~~Mr. Hutras~~: Aris

The enclosed summary represents the 30-year funding solvency discussion that is currently being reviewed by the Ohio Retirement Study Council. OP&F is proud to reiterate our solvency and that in fact stronger than when measured in 1997.

As you review this summary and then analysis ORSC report please, as usual, contact either this office or our Legislative Agent Darryl Dever (614-221-6566).

Thank you.

Sincerely,

Bill

William J. Estabrook
Executive Director

Key Points Concerning OP&F Actuarial Evaluation

- Actuaries found, as they did for virtually every pension fund in the country, that substantial slippage occurred in terms of the time required for the Ohio Police & Fire Pension Fund (OP&F) to be considered fully funded. This change is attributable virtually entirely to stock market conditions, which affect the value of pension fund portfolios at any given point in time.

- This conclusion is supported by OP&F's actuary, John J. Garrett, ASA, MAAA, Vice President of The Segal Company, who said "absent the deepest and longest bear market in the post-depression era, the Fund would otherwise be well positioned to satisfy a 30-year funding period as of January 1, 2003" as required by Ohio law. It is also supported by William A. Reimert of Milliman USA who stated in a June 2002 letter that "OP&F will have a funding period of slightly more than 30 years as of January 2007," noting however that "there is no margin for benefit increases or adverse actuarial or investment experience between now and that date."

- It is important to note that the 30-year funding requirement in state law is not an absolute, but rather it is a trigger point. When the funding period for any one of Ohio's five state retirement systems exceeds the 30-year requirement, the fund is required by law to put in place a plan to bring it to the 30 year requirement.

- The increasing trend in health care costs compounded by the general stock market decline that has caused the funding period to rise is also what is behind the need faced by Ohio pension funds this year to alter their health care plans in order to reduce the cost of these plans to the funds.

- OP&F has been extremely well managed over the years and continues to be well managed. In the 2002 annual valuation, OP&F had a funding period of 28 years, a full two years lower than the 30 years required by statute.

- The change in funding period does not effect OP&F's solvency, or its ability to meets its current obligations, as evidenced by Garrett's, November 2003 letter to OP&F. Garrett concludes that "the investment losses attributable to the general market decline from March 2000 to March 2003 has had a significant impact on the valuation assets, however the plan is in a more solvent position than measured in 1997."

- "Due to the size of the problem, it is not possible to satisfy the requirements of ORC Section 742.16 (in the short term) through adjustments which can be mandated by the Board of Trustees," Garrett said. One solution for OP&F to meet statutory requirements would be a substantial raise in rates to Ohio's public employers. Garrett noted, however, that raising rates takes an act of the legislature and is not an action OP&F's Board of Trustees is authorized to make.

- Actuaries have quoted analysts and others as observing that the market downturn has created these conditions is short-term. Garrett noted that "The shear size of the investment loss will take significant future gains to offset, and additional contributions **may** be required to re-establish an acceptable period of funding in the long-term."

- However, the extent of the contributions required will depend on how the market rebounds, which is a process that has already begun. Therefore, raising rates would create serious long-term pressures on local governments in response to a short-term problem. Because the deficiency comes from extraordinarily poor market conditions, a major increase in rates would be overkill.

- Garrett explains, "The valuation assets to date show that the Fund is currently experiencing very positive investment gains. In the current fiscal year, through September 30, 2003, the investment performance of the Fund has produced an excess return, above the assumed investment return, of over $400 million dollars."

- Garrett noted that "Historically, the five-years following each of the eight bear markets since 1930, the S&P 500 averaged a cumulative return just over 100%. These historical returns, while not guaranteed but if realized, will have a dramatic effect on the funding status of OP&F as well as mitigate the severity of any plan put in place today."

- Accordingly, it is the recommendation for the time being of OP&F's actuary to keep a close watch on the fund over the next several years to determine how market conditions impact the situation. "The extent of the financial market's recovery over the next three to five years will be a key factor in determining the long-term financial condition of the Fund," Garrett said.

Ohio Police & Fire Pension Fund - Retiree Profile

On average, both Police and Fire Retirees receive the value of their own member contributions after 2.5 years of retirement (1.9 years if retiree health care is included).

Retirement Statistics for Average Retiree

Police: Service	Police: Disability		Fire: Service	Fire: Disability
64.6 yrs.	58.0 yrs.	**Current Age**	66.8 yrs.	60.5 yrs.
52.8 yrs.	45.7 yrs.	**Age at Retirement:**	53.8 yrs.	48.1 yrs.
26.4%		*Younger than age 50*	*17.8%*	
54.1%		*Age 50 to 55*	*56.5%*	
19.5%		*Older than age 55*	*25.7%*	
28.3 yrs.	21.4 yrs.	**Years of Service**	28.5 yrs.	22.6 yrs.
$30,396	$26,124	**Annual Retirement Benefit:**	$29,304	$27,276
	32.4%	*Permanent and Total Disability*		*35.7%*
	63.7%	*Partial Disability*		*61.0%*
	3.9%	*Non-Service Related Disability*		*3.3%*
		Life Expectancy After Retirement:		
18.2 yrs.	*19.4 yrs.*	*Current Retirees*	*16.5 yrs.*	*18.3 yrs.*
26.8 yrs.	*27.4 yrs.*	*Future Retirees*	*26.0 yrs.*	*25.3 yrs.*
$867,000	$894,000	**Expected Remaining Benefit for Current Retirees and their Survivors**	$809,000	$872,000
$1,993,000		**Lifetime Benefits for Future Retirees and their Survivors**	$1,918,000	

Health Care Statistics for Average Retiree

Expected Future Lifetime Health Care Costs for Retirees, Including Their Survivors:

Police		*Fire*
$372,000	*Current Retiree*	*$338,000*
$1,548,000	*New Retiree*	*$1,493,000*

	Total Annual Cost
Medical before age 65	**$7,926**
Prescriptions before age 65	**$2,865**
Medical after age 65	**$1,854**
Prescriptions after age 65	**$3,810**
2003 Medicare Part B Cost	**$704**

Based on 2002 data unless otherwise indicated.

Ohio Police & Fire Pension Fund

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Plan for 30-Year Funding

Meeting of the Ohio Retirement Study Council

February 11, 2004

Ohio Revised Code Section 742.16

If the annual actuarial valuation of the Fund results in a funding period in excess of 30 years, the Board of Trustees is required to prepare and submit to the ORSC a plan that will re-establish a 30-year funding period.

Comparison of Valuation Results

	January 1, 2003	January 1, 2002
1. Actuarial Accrued Liability	$10,508,367,000	$9,785,766,000
2. Actuarial Value of Assets	8,682,704,000	9,076,469,000
3. Unfunded Actuarial Accrued Liability (1. – 2.)	1,825,663,000	709,297,000
4. Funding Period	Infinite	28 years

Background

- OP&F was established by enactment of legislation on July 19, 1965. The bill mandated the transfer of local government pension funds assets and liabilities as of January 1, 1967. OP&F was less than 10% funded as of January 1, 1967.
- Section 742.16 of the ORC became effective in March 7, 1997. The January 1, 1997 valuation of OP&F resulted in a 44-year funding period. OP&F submitted a plan to satisfy 30-year funding to the ORSC in November of 1997.
- The January 1, 2000 valuation resulted in a 27-year funding period and remained below 30 years until the January 1, 2003 valuation.

What is the Cause of Infinite Funding?

- Equity investment losses from March 2000 to March 2003.
  - The longest and deepest bear market since the great depression

- If the Fund had experienced the actuarial assumed rate of return of 8.25% per year for each of the past five years:
  - UAAL = $396 million ($1,430 million less than 1/1/2003 valuation)
  - Funded Ratio = 96.2% vs. 82.6% in valuation
  - Funding Period = 15 years vs. infinite in valuation

Historical Total Fund Returns

Period Ending December 31	Annual Return	5-Year Average Return	10-Year Average Return	**15-Year Average Return**
2002	(9.90)%	2.1%	**7.3%**	**9.0%**
2001	(3.88)%	7.6%	9.2%	9.8%
2000	(1.10)%	11.2%	11.9%	11.1%
1999	13.82%	16.6%	12.5%	12.6%
1998	13.75%	13.2%	12.9%	
1997	17.15%	12.7%	12.6%	
1996	13.56%	10.9%	10.9%	
1995	25.10%	12.5%	11.1%	
1994	(1.75)%	8.6%	**10.7%**	
1993	11.30%	12.5%		

Why is the OP&F Plan Reasonable?

- Historically, over the five years following each of the eight bear markets since 1930, the S&P 500 averaged a cumulative return just over 100% and ranged from 65% to 170%.
- The Fund has shown historically that it has attained or exceeded the actuarial assumed rate of return of 8.25% over 15-year rolling periods
- The Plan concept is to re-establish a 30-year funding period as of January 1, 2018 by impacting contributions and benefits only as necessary to offset a less than full market recovery

Initialization of the Plan

Upper Boundary – Full Market Recovery

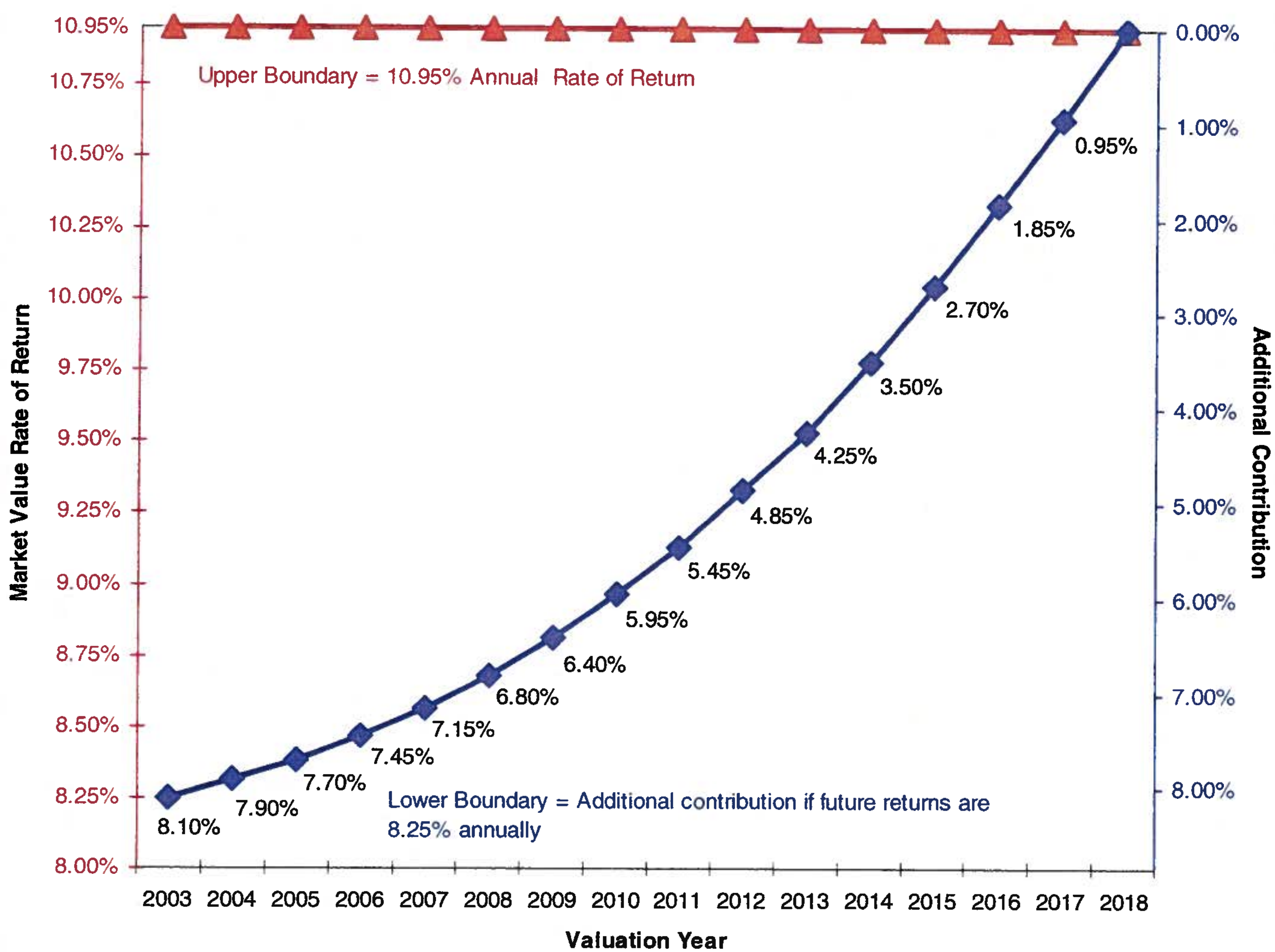
- The Fund must average a 10.95% annual net rate of return in order to attain the goal of 30-year funding as of January 1, 2018 on an actuarial value basis.
- Results in no increase in contributions or pension benefit reductions to the current plan to attain goal.

Initialization of the Plan

Lower Boundary – No Market Recovery

- From January 1, 2003, if the Fund averages an 8.25% annual net rate of return, an 8.10% of payroll increase to contributions or equivalent pension benefit reductions would be necessary to achieve the goal of 30-year funding as of January 1, 2018.
- Lower Boundary in each year of the plan is the percent of payroll necessary to achieve the goal assuming past returns equal 10.95% and future returns equal 8.25%.
- Any changes would require legislation.

Concept of Plan



Future Plan Updates

- Plan projections will be updated with annual valuation results and the lower boundary will be tested by determining the necessary contribution increase to achieve the goal assuming all future annual returns equal 8.25%.
- A decision point is reached if the lower boundary for that year is exceeded.
- The amount of contribution increase or equivalent pension benefit reduction equals the difference between the lower boundary test result and the scheduled lower boundary pertaining to that year.
  - Differences of less than 0.50% can be deferred.
  - The smallest annual adjustments recommended is 1.00% of payroll.

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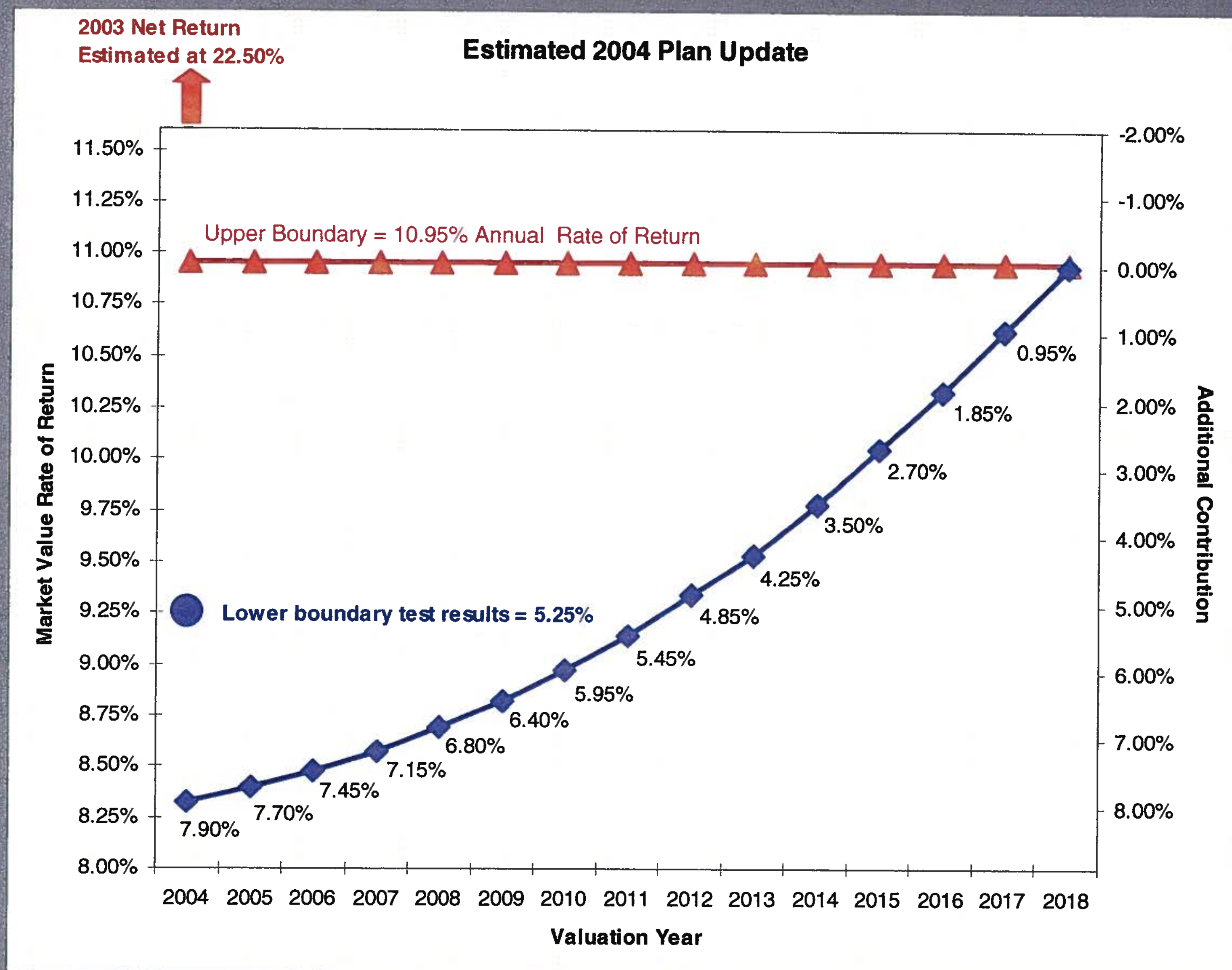
2003 Net Return
Estimated at 22.50%
Estimated 2004 Plan Update
Upper Boundary = 10.95% Annual Rate of Return
Lower boundary test results = 5.25%
Market Value Rate of Return
11.50% 11.25% 11.00% 10.75% 10.50% 10.25% 10.00% 9.75% 9.50% 9.25% 9.00% 8.75% 8.50% 8.25% 8.00%
Additional Contribution
-2.00% -1.00% 0.00% 1.00% 2.00% 3.00% 4.00% 5.00% 6.00% 7.00% 8.00%
7.90% 7.70% 7.45% 7.15% 6.80% 6.40% 5.95% 5.45% 4.85% 4.25% 3.50% 2.70% 1.85% 0.95%
2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018
Valuation Year

Estimated Impact of 2003 Market Return

- The investment performance by OP&F for 2003 results in approximately $1 billion more in assets at market value than the market value would have been assuming the actuarial return of 8.25%.
- In the future, the Fund can average 10.00% annual net returns to achieve goal without contribution increases or benefit reductions. Due to the strength of the 2003 return, the 2004 return can be as little 60 basis points to maintain the plan.
- Results in an estimated 2.65% of payroll positive margin below lower boundary for 2004.

Maintenance of the Plan

- Optimistically, the goal may be achieved through a full market recovery.
- Realistically, in some future year, a decision point may occur.
- To be effective, the Board and perhaps ORSC will have to react quickly to affect changes to the contribution rates and/or plan benefits.
- The contribution increase or benefit reduction would be only the amount necessary to offset the lag or lack in the market's recovery to date.
- We recommend no benefit improvements or increases in the allocation to the Health Care Stabilization Fund be considered until the 30-year funding period goal is achieved.

Other Factors

- Changes to the plan design and member contributions for health care coupled with DROP may have a significant impact on future retirement behavior.
- Non-investment experience will be reflected in the plan updates. Favorable non-investment experience from such sources as rates of retirement, salary increases, etc., will have a positive impact on the updates.
- ORSC has discussed equalizing the contributions of Police and Fire employers in the past. Even phasing-in the increase to the Police Officer employers will have a very positive impact on the plan.

Conclusion

- An infinite funding period for a multiple-employer cost-sharing plan has no implication to the financial reporting of employers.
- The plan must disclose that less than the annual required contribution, calculated in accordance with GASB parameters, was received in aggregate.
- The plan, as recommended by Segal, has been adopted by the Board of Trustees. The plan is reasonable, achievable and in compliance with the governing statutory provisions.