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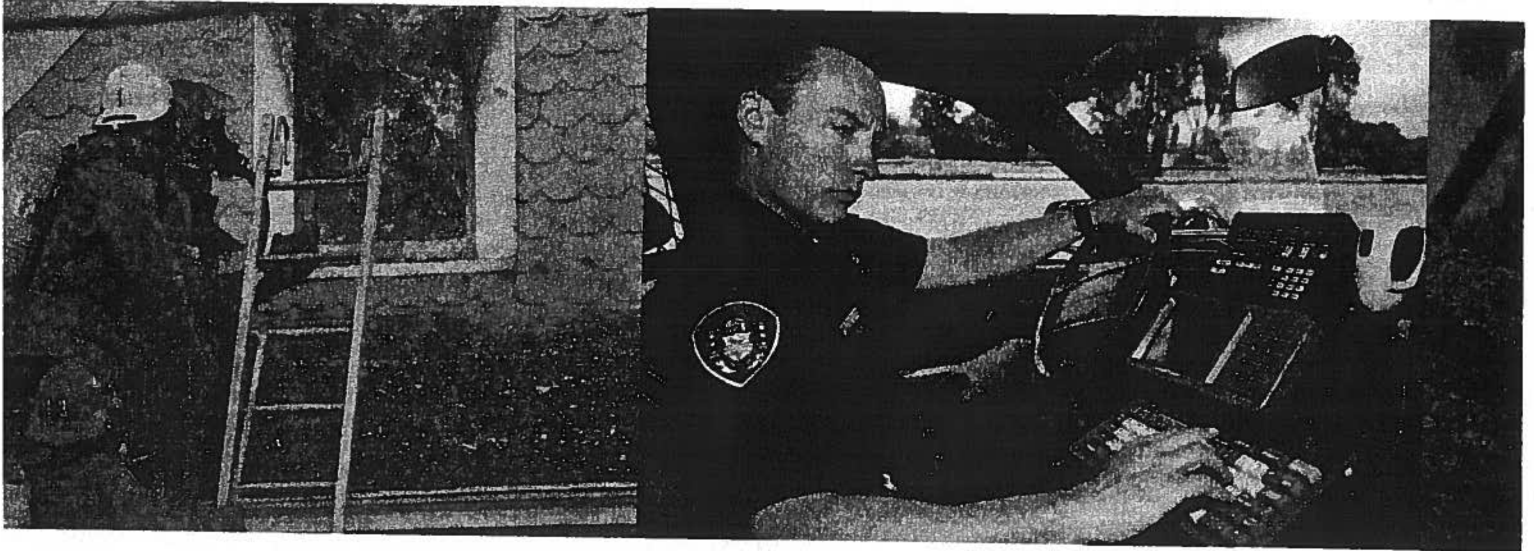

OHIO RETIREMENT STUDY COUNCIL
Ohio Police & Fire Pension Fund

November 17, 2004

Human Resources & Investor Solutions

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Plan for 30-Year Funding

The Ohio Revised Code Section 742.16 requires that 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 would re-establish the funding period. On November 26, 2003, the Board of Trustees submitted a plan to re-establish the funding period in accordance with the parameters established by Section 742-9-13 of the Ohio Administrative Code. The January 1, 2004 valuation has not yet been completed. Once the valuation has been completed, Mellon will re-evaluate the plan and report on any recommendations or changes that we feel are appropriate. The last completed valuation is as of January 1, 2003. Mellon performed a comparative January 1, 2003 valuation. The results of Mellon's January 1, 2003 valuation and the January 1, 2002 valuation results are as follows:

Table 1

Item	January 1, 2003	January 1, 2002
1. Actuarial Accrued Liability	$ 10,268,543,000	$ 9,787,766,000
2. Market Value of Assets	7,235,586,000	8,251,336,000
3. Actuarial Value of Assets	8,682,704,000	9,076,469,000
4. Unfunded Actuarial Accrued Liability (1) – (3)	1,561,428,000	709,297,000
5. Funding Period	Infinite	28 years
6. Funding Ratio	84.6%	92.8%
7. Deferred Asset Losses (2) – (3)	(1,447,117,000)	(825,103,000)

An infinite funding period means that the contribution toward the unfunded accrued liability is not large enough to pay off a portion of the principal. The unfunded liability continues to grow.

Asset Losses

The infinite funding period is a direct result of the asset losses that occurred during the 2000, 2001 and 2002 calendar years. For calendar year 2002, the market value of assets experienced negative 10.2% rate of return. The actuarial value of assets spreads investment gains and losses over a period of five years. This smoothing method is designed to avoid wide fluctuations in the

actuarial value of assets due to market conditions. The smoothing method is a commonly used technique and complies with the Actuarial Standards of Practice. The actuarial assets are determined by recognizing 20% (i.e., 1/5th) of asset gains and losses that are in excess of or less than the valuation interest rate for each of the next five years. This means that the 2000 asset loss will be reflected in the January 1, 2004 and January 1, 2005 actuarial assets. The 2001 asset loss will be reflected in the January 1, 2004, January 1, 2005 and January 1, 2006 assets. The 2002 asset loss will be reflected in the January 1, 2004, January 1, 2005, January 1, 2006 and January 1, 2007 actuarial assets.

As shown in item 7 (Table 1), as of January 1, 2003 there were deferred asset losses totaling $1,447,117,000 that will be recognized in future valuations.

2003 Asset Gain

The unaudited market value of assets as of January 1, 2004 is $8,691,562,000. The return on the market value assets was 24.96%. The unaudited actuarial value of assets as of January 1, 2004 is $9,337,103,000. The asset gain during 2003 has reduced the deferred asset losses as of January 1, 2004 to $645,541,000. As a result, we believe significant progress has been made toward reaching the 30-year funding requirement.

As described above, the asset losses that occurred during the 2000, 2001 and 2002 fiscal years will continue to be reflected in the actuarial assets until January 1, 2007. However, the asset gain that occurred during the 2003 fiscal year has offset those losses and will continue to offset losses through January 1, 2007.

Table 2 shows the actual deferred asset losses as of January 1, 2002 through January 1, 2004. Also shown is a projection of deferred asset losses and gains through January 1, 2007. The projection is based on the assumption that assets will earn 8.25% during the 2004, 2005 and 2006 calendar years.

Table 2

Deferred Asset Losses and Gains
Actual for January 1, 2002 through January 1, 2004
Projected for January 1, 2005 through January 1, 2007

Valuations of January 1	Deferred Asset (Losses)/Gains
2002	$ (825,103,000)
2003	(1,447,117,000)
2004	(645,541,000)
2005	(158,450,000)
2006	148,121,000
2007	224,832,000

Historical Total Investment Returns

Table 3 shows a 10-year history of investment returns on the market value of assets. With the exception of the 2002 fiscal year, the 10-year average return on assets exceeded the actuarial interest rate assumption of 8.25%.

Table 3

Historical Total Fund Returns

Period ended December 31	Annual Return	5-Year Average Return	10-Year Average Return
2003	24.96%	4.0%	8.5%
2002	-9.90%	2.1%	7.3%
2001	-3.88%	7.6%	9.2%
2000	-1.10%	11.2%	11.9%
1999	13.82%	16.6%	12.5%
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%

Historical Funding Ratio

Table 4 shows a 26-year history of the funding ratio. The funding ratio is the ratio of actuarial assets to the actuarial accrued liability. The funding ratio is a measurement of the progress made toward funding liabilities. The higher the funding ratio, the better the progress toward funding the actuarial accrued liability. In 1978, OP&F had a funding ratio of 33% while the funding ratio for the 2004 valuation is expected to be 85%. A higher funding ratio is an indicator that the pension fund is in a better position to meet its pension obligations.

Table 4

Historical Funding Ratio

Period Ending December 31	Actuarial Value of Assets	Actuarial Accrued Liability	Funding Ratio
2004	$9,337,100,000	$10,950,000,000*	85%
2003	8,682,704,000	10,268,543,000	85
2002	8,682,703,560	10,268,543,000	85
2001	9,076,469,000	9,785,766,000	93
2000	8,498,069,000	9,506,283,000	89
1999	7,988,578,000	8,995,564,000	89
1998	7,306,804,000	8,452,622,000	86
1997	6,231,419,000	7,697,677,000	81
1996	5,554,114,000	7,024,555,000	79
1995	4,950,200,000	8,245,400,000	60
1994	4,625,500,000	7,757,400,000	60
1993	4,357,800,000	7,316,100,000	60
1992	4,027,467,000	6,826,200,000	59
1991	3,678,500,000	6,375,700,000	58
1990	3,170,200,000	5,943,300,000	53
1989	2,961,500,000	5,573,600,000	53
1988	2,659,100,000	5,175,500,000	51
1987	2,436,100,000	4,808,100,000	51
1986	2,231,200,000	4,408,500,000	51
1985	1,900,000,000	3,836,800,000	50
1984	1,641,200,000	3,680,600,000	45
1983	1,454,700,000	3,428,700,000	42
1982	1,207,200,000	3,224,100,000	37
1981	1,035,800,000	3,006,600,000	34
1980	912,100,000	2,688,400,000	34
1979	805,600,000	2,413,900,000	33
1978	718,300,000	2,171,100,000	33

* Estimated

Plan Changes

Effective January 1, 2003, a Deferred Retirement Option Plan (DROP) was introduced. Upon attainment of age 48 with 25 years of service, members can elect the DROP for a minimum period of three years and a maximum period of eight years. When the member enters the DROP, the member's retirement benefit is determined. While in the DROP, the member's monthly benefits are deposited into the member's DROP account, accumulating interest. At actual retirement, the member receives a lump sum equal to the amount in the member's DROP account and the member's monthly pension commences. As of January 1, 2004, there are 1,662 members in the DROP. We expect that the DROP will have a favorable impact on the Fund, as members will stay in the workforce longer, resulting in retirements being deferred to a later date.

Retiree Health Care Changes

While retiree health care is not a guaranteed benefit like the pension benefit is, the Board would like to continue to offer subsidized health care to the OP&F retirees. As such, 7.75% of the employer contribution rate is currently allocated to the Health Care Stabilization Fund. The Board made major changes in the amount of health care premium subsidy effective in January 2004 and adopted a strategy that the Health Care Stabilization Fund will have a 10-year solvency period, each year in the future. This means that on an annual basis, the solvency period is determined and the Board will make the changes necessary in order to maintain the 10-year solvency period. The changes in subsidy that the Board adopted in 2004 require current retired members and future retired members to pay a higher portion of the cost of retiree health care. We expect that active members will continue to remain in the workforce longer since the cost of health care will have a significantly adverse financial impact on the retirement decisions of active members.

However, because the Health Care Stabilization Fund has a current solvency period of 10 years, we believe that the current allocation of the employer contribution toward health care should be retained.

Contribution Rates

Employers contribute 19.5% for police officers and 24% for firefighters. Members contribute 10%. The contributions are the maximum allowed under the Ohio Revised Code. Mellon supports the recommendation made by Segal as a part of the 30-year funding plan which was submitted to ORSC in November 2003. Segal recommended that the Board of Trustees pursue an increase in the contribution rates for participating police officer employers to equal the 24% rate contributed by firefighter employers. We understand that the Board of Trustees has not yet made a decision with respect to this recommendation and that legislation would be required. We believe that if the employer rate for police were increased to the employer rate for fire, significant progress would be made toward achieving the 30-year funding requirement.

OP&F Plan

In conclusion, we again want to state our belief that significant progress has been made toward reaching the 30-year funding requirement. The plan remains on track to attain 30-year funding in accordance with the parameters established by Section 742-9-13 of the Ohio Administrative Code. We recommend no changes be made to benefits or member contribution rates at this time. OP&F's plan to achieve the 30-year funding requirement relies on a market recovery. The 24.96% investment return earned during 2003 has significantly improved the plan's funding position. The benchmark return established by the plan for calendar year 2003 was 10.95%. In addition, the deferred asset losses are projected to be eliminated with the January 1, 2006 valuation. Finally, the DROP and health care changes are expected to delay retirement dates, which will also result in improving the plan's funding position. For these reasons, we recommend no changes be made to benefits or member contribution rates at this time. We do recommend that OP&F and ORSC continue to consider increasing the employer contribution rate made on behalf of police to the same employer rate of 24% made on behalf of fire.

Respectfully Submitted,

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