MILLIMAN & ROBERTSON, INC.
Actuaries & Consultants
Internationally WOODROW MILLIMAN

Suite 300, 259 N. Radnor-Chester Road, Radnor, Pennsylvania 19087-5260
Telephone: 610/687-5644
Fax: 610/687-4236

July 1, 1999

Mr. Aristotle L. Hutras
Director
Ohio Retirement Study Council
88 East Broad Street, Suite 1175
Columbus, OH 43215-3580

Re: House Bill No. 586, 121st General Assembly

Dear Aris:

As you requested, we have prepared an actuarial study as mandated by H.B. 586 to determine whether any adjustments to the employer supplemental contribution rate required under Section 3305.06.(E) are necessary. This section requires employers of members electing coverage in an Alternative Retirement Plan, "ARP", for academic and administrative employees of public institutions of higher education to pay 6% of the electing employees' compensation to the Ohio Retirement System in which they would have been a member absent their election to join the ARP. The Ohio Retirement Systems affected by this bill are the Public Employees Retirement System, "PERS", the School Employees Retirement System, "SERS", and the State Teachers Retirement System, "STRS". This study is to be completed by July 1, 1999 and every third year thereafter.

Purpose of Study

The purpose of this study is to determine whether any adjustments are necessary to the 6% employer supplemental contribution rate. This contribution rate, as adjusted, will continue until the unfunded actuarial accrued pension liability of the retirement system is fully amortized, as determined by the annual actuarial valuation performed by the system's actuary.

Determination of Rate

For purposes of this report, it was necessary to determine the basis for measuring the rate necessary "to mitigate any negative financial impact of the Alternative Retirement Program on the State Retirement System". We have adopted the methods we utilized to estimate the magnitude of this supplemental contribution rate during 1994 through 1996 while H.B. 586 was under consideration by the legislature. (The final estimates were set forth in our letter to you of March 22, 1996. See attached copy.)

As we indicated at that time, there are three primary reasons why a supplemental contribution to the Ohio Retirement Systems is needed. The first reason is that the existing unfunded actuarial liabilities of the systems must be amortized. Each system relies on contributions on behalf of all employees (covering both current employees and future hires) in the groups currently covered by the Retirement Systems to amortize these obligations. To the extent that an ARP decreases the number of employees joining the Retirement System in the future or allows current members to transfer out, the financing base for amortizing these unfunded actuarial liabilities will be eroded.

The second reason is that employees who are most likely to join the ARP are those who expect to receive benefits from the Ohio Retirement Systems with a lower value than the benefits provided by the ARP. Those members of the Retirement System who expect the ARP will provide benefits with a value lower than the Retirement System will more likely choose to stay in the Retirement System. To the extent that this occurs, this also will serve to increase system costs.

A third reason is that University and College employees eligible to join an ARP receive compensation higher than the compensation provided to other members of the Retirement Systems. Employer contributions allocated to fund health insurance benefits for retired members are expressed as a percentage of pay in each of the three Retirement Systems. But the cost of health insurance does not vary in proportion to earnings. Thus, if the employees with higher than average earnings transfer to an ARP, contributions to finance health insurance will decrease by more than the cost of providing health insurance to retirees.

While H.B. 586 was under consideration, the work we did to estimate the supplemental contribution required by the Retirement Systems related to eligible members who were covered by STRS only. Based on that analysis, we estimated that the supplemental employer contribution rate would have to be between 5.6% and 7.4% assuming that health insurance was not offered to employees electing coverage under the ARP. H.B. 586 as enacted reflected a 6% supplemental contribution rate. These rates were developed based on estimates regarding which eligible members would elect to join the ARP. The portion of the supplemental contribution rate attributable to pension benefits was estimated as the excess of the total contributions which would have been made by the member and employer over the employee's entire career into the Retirement System over the portion of those future contributions which would be provided in the form of retirement, death, disability, etc. benefits to the member in the future. The portion of the supplemental contribution rate attributable to health insurance costs was calculated based on the extent to which employees electing to join the ARP had compensation in excess of the average pay of all system members.

Covered Institutions

For purposes of this report, we attempted to obtain data with respect to the six Ohio Universities who established ARPs for which the election period expired on or prior to May 1, 1999. The following six Universities met this criteria:

Cleveland State University
Miami University
NE Ohio University College of Medicine
Ohio University
University of Cincinnati
Youngstown State University

Data

We received data from both PERS and STRS regarding members (1) who had elected to transfer or were eligible to transfer to an ARP during the first 120 days after the University first established the ARP or (2) who were hired after the date the ARP was first established. The data from STRS included information with respect to all six Universities. PERS was only able to provide data with respect to three of the Universities: Miami University, Ohio University and the University of Cincinnati. Only members of the State Division of PERS were reported as eligible for an ARP at these universities.

We also requested data from the six Universities. Since the election periods have expired so recently, only two of them have been able to respond to our request to date. Therefore we have not been able to reflect data from the Universities in these calculations.

We did not receive any data from SERS since none of their members are employees of any of the six universities listed above. Hence, we have not been able to do any analysis regarding the appropriateness of the 6% supplemental contribution rate for SERS.

Attached to this letter is a summary of the data sources and the limitations of the data provided.

Results

The results of our calculations to determine the required supplemental contribution rate based on this initial data has been summarized in the table below for both PERS-State and STRS. In reviewing these figures, it is important to remember that these figures reflect only the initial elections at the Universities for which PERS and STRS were able to provide us with data. Our understanding is that a total of fifteen 4-year institutions and twenty-two 2-year institutions have implemented ARPs and most of them will have their initial enrollment period end by July 31, 1999 (see attached). Thus, it is possible that a calculation reflecting the actual elections at all of these institutions could significantly differ from the supplemental contribution rate shown below. Approximately 25% of the total number of eligible employees in all of the institutions instituting ARPs are included among the six Universities we were able to include in our analysis because their initial enrollment periods ended by May 1st. The other 75% of the eligible employees work at institutions for whom the election period closes during May, June or July, 1999.

	PERS-State	STRS
Calculated Supplemental Contribution Rate for:		
Pensions	0.59%	5.77%
Health Insurance	0.64	0.25
Total	1.23%	6.02%
Statutory Supplemental Contribution Rate under H.B. 586	6.00%	6.00%

The statute calls for an automatic adjustment of the Statutory Supplemental Contribution Rate based on this report.

The actuarial assumptions used for these calculations are the PERS assumptions used for the December 31, 1997 Actuarial Valuation and the STRS assumptions used for the July 1, 1998 Actuarial Valuation. These calculations assume that the number and age/earnings characteristics of the future hires who will elect to join the ARP will mirror the number and age/earnings characteristics of recent hires (less than one year of service) who joined the ARP, except that starting salaries were assumed to grow at the payroll growth assumption adopted by each system.

Amortization Period

The supplemental contribution is to be continued until the unfunded actuarial accrued liability of the Retirement System is fully amortized, as determined by the annual actuarial valuation performed by the system's actuary. For STRS, this period was reported to be 24.2 years in the July 1, 1998 Actuarial Valuation.

PERS prepares two actuarial valuations each year. One is for retired lives and the other is for active and inactive members. We believe that it would be most appropriate to interpret the requirements of H.B. 586 with respect to PERS based on a single amortization period which would be a composite reflecting the total assets and liabilities associated with that division of PERS. Therefore we have developed a composite amortization period for the PERS State division (this is the division of PERS in which all of the members who elected to join the ARP were covered) reflecting the total assets and liabilities of the State division as reported in the actuarial valuation of active and inactive members and the actuarial valuation of retired lives as of December 31, 1997. That composite funding period for the State division is 3.3 years. This compares to the funding period reported in the valuation for the active and inactive members of 3 years.

It is not clear what the legislative intent was with respect to this provision in the event that legislation is enacted which improves benefits. Thus it may be desirable for the ORSC to consider the appropriate interpretation of this provision before any benefit improvements are enacted.

Conclusions

Based on the above, it appears that the initial election patterns among STRS members eligible to join an ARP support the statutorily required supplemental contribution rate of 6%.

But the initial enrollment results at the three Universities for which we were able to receive data from PERS (these 3 Universities include roughly 20% of the employees eligible to join an ARP) suggests that the 6% supplemental contribution rate is excessive. The initial enrollments suggest that a supplemental contribution rate of approximately 1.25% would be appropriate. As a result of this significant difference between the statutorily required supplemental contribution rate of 6% and the supplemental contribution rate of 1.25% indicated based on the initial election data provided to us, it seems desirable to delay establishing the supplemental employer contribution rate for PERS for the period commencing July 1, 1999 until data is available with respect to all of the institutions of higher education which have ARP enrollment periods currently underway and are scheduled to expire by the end of July. If such a delayed recalculation reflecting more enrollment data is possible, we would have more confidence in recommending an adjustment to this rate.

We could complete such a recalculation within four weeks of receipt of all the data. The law provides that the adjusted rate will become effective July 1, 1999. If affected Universities continue to pay PERS at the 6% rate until an adjusted rate is finalized, PERS would rebate any excess payments at that time.

Please do not hesitate to call if you have any questions.

Sincerely,

Katherine A Dill

Katherine A. Dill

William A. Reimert

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Enclosure