PRINT

March 11, 2002

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

Re: Transfer of University of Akron Active Members from SERS to PERS

Dear Aris:

As requested, we have completed an actuarial study of transferring currently active University of Akron, "U of Akron", non-teaching members from the School Employees Retirement System, "SERS", to the State division of the Public Employees Retirement System, "PERS-State". (Professors and instructors at U of Akron are members of the State Teachers Retirement System and U of Akron law enforcement officers transferred from SERS to the PERS-Law Enforcement Division effective September 16, 1998.)

Cost Sharing Nature of the Ohio Retirement Systems

All of Ohio's public pension plans were created and structured by the Legislature as cost sharing multiple employer pension plans. Accordingly, there is a pooling of resources and a cross-subsidization among all employers covered under a given plan; that is, contribution rates to fund the plans' accrued liabilities are the same for each employer based upon a blending of experience of all members covered under the plan. In other words, the plan's accrued liability is *not* assigned to individual employers, but shared by all employers covered under the plan.

For example, members who purchase service credit typically pay less than the full liability resulting from such purchases; the unfunded liabilities thus created from these purchases become the obligation of all employers covered under the plan. Another example involves disability retirements. In its disability study of the Ohio Police & Fire Pension Fund, William M. Mercer found that "individual employers are not accountable for their disability retirement experience, in that contribution rates (as a percentage of pay) to the Fund are the same for all employers." Mercer suggested that the Legislature may wish to consider methods to hold employers more accountable for their own experience, including incorporation of experience rating into the fund's determination of contribution rates by basing the contribution for individual employers, to some degree, on the individual employer's disability experience. The Legislature rejected this suggestion as contrary to the underlying nature of Ohio's public pension plans as cost sharing multiple employer plans.

For purposes of this actuarial study, we have been asked to determine the liability resulting from the transfer of U of Akron active members from SERS to PERS-State based upon U of Akron active member data provided to us by SERS. The determination and assignment of such liability to an individual employer differs from our previous actuarial analyses of similar transfers of members from one retirement plan to another. In previous transfers, only some employees of an employer would be transferring from one retirement plan to another. In this case, all employees of an employer would be transferring from one retirement plan to another. Therefore, the makeup of the employers comprising the cost sharing arrangement in each retirement plan would change as a result of this transfer.

Summary of Impact

The major effects of transferring U of Akron non-teaching employees to PERS-State are summarized below.

- SERS would no longer receive the member and employer contributions on behalf of U of Akron members.
- The U of Akron and its employees would pay less to PERS than they currently pay to SERS since PERS-State's member and employer contribution rates are lower than SERS' rates.
- The U of Akron transfer would not adversely impact the funding of the pension and Medicare Part B reimbursement benefits provided by SERS.
- The U of Akron transfer would adversely impact the funding of the healthcare benefits provided by SERS in two ways, unless either the U of Akron or PERS provided SERS with contributions to fund these benefits.
  - The first adverse impact on SERS is caused because the funding source for the healthcare benefits for current retirees – contributions on behalf of active members – would be eliminated. Our recommendation is that PERS reimburse SERS for the cost of providing healthcare benefits to U of Akron retirees in SERS. An alternative is that U of Akron reimburse SERS for this cost. This would, however, result in U of Akron effectively paying twice for the same benefits – once to SERS and again to PERS. This would also result in a windfall to PERS as PERS will be receiving contributions for U of Akron members, but will not be paying healthcare benefits to U of Akron retirees for a while.
  - The second adverse impact on SERS is caused because U of Akron members have compensation that is, on average, higher than other SERS members. Therefore, U of Akron members currently subsidize the rest of SERS with respect to healthcare benefits. One suggestion is that U of Akron pay a Supplemental Contribution to SERS. (This issue was previously addressed by the Legislature when higher education employees were given the opportunity to transfer from PERS, SERS and STRS to an ARP, such as TIAA-CREF.)

Summary of Key Issues

Pension Benefits

With respect to pension benefits, the key issue that needs to be addressed is how and when to transfer future benefit rights and accumulated assets from SERS to PERS (or vice-versa, as is currently provided under the existing coordination of benefits provision). The following three options are discussed in this letter:

1. Apply the existing coordination of benefits provision that applies whenever a member has service in more than one non-uniformed Ohio Retirement System and applies for an annuity benefit.
2. Have SERS transfer the accumulated member and employer contributions to PERS at the time the members transfer, including amounts paid by members to purchase service credit. This method was specified in Substitute House Bill 648 (effective September 16, 1998) when U of Akron law enforcement officers transferred from SERS to PERS-Law Enforcement division.
3. Have SERS transfer to PERS at the time the members transfer assets equal to the actuarial accrued liabilities in SERS for the transferring active members, to the extent they are funded.

We estimate that Options 1 and 2 would have a positive impact on SERS, while Option 3 would not affect the actuarial status of SERS pension and Medicare Part B reimbursement benefits.

Healthcare Benefits

Unlike pension benefits that are funded on an actuarial basis over the working lifetime of members, post-retirement healthcare benefits are funded on a pay-as-you-go basis, meaning that a portion of the employer contributions made on behalf of current active members is used to pay the cost of providing healthcare benefits to current retirees. Therefore, should the U of Akron current active members transfer from SERS to PERS, a portion of the employer contributions made by the U of Akron to PERS (now as a PERS employer) on behalf of these active members is, in fact, intended to pay the cost of healthcare benefits to current U of Akron retirees remaining in SERS, and would amount to a "windfall" to PERS to the extent that such portion were retained by PERS. To avoid a "windfall" to PERS and to hold SERS harmless under the current pay-as-you-go financing of post-retirement healthcare benefits, PERS could simply serve as a "pass-through or conduit" for that portion of employer contributions made by the U of Akron to PERS on behalf of U of Akron current active members to pay the cost of healthcare benefits to current U of Akron retirees remaining in SERS by reimbursing SERS for these costs. Over time, this reimbursement will be reduced until eliminated as the U of Akron retirees in SERS cease being covered, such as upon death.

Another, and less critical, healthcare issue is the negative impact on SERS healthcare due to the removal of the active U of Akron employees. While healthcare benefits cost the same for each member, the active U of Akron employees have higher salaries, on average, than other SERS members. Consequently, SERS receives greater contributions per member to provide healthcare benefits from U of Akron employees than it receives from other SERS members. Thus effectively, U of Akron provides a subsidy to SERS that helps to finance healthcare benefits for retirees of other participating employers. The negative impact of eliminating these subsidies could be mitigated by having the U of Akron pay a supplemental contribution to SERS. The supplemental contribution would keep the average contribution rate per active SERS member, including the employer surcharge, that is allocated to healthcare benefits the same after the transfer as before.

Background

As indicated in the Ohio Legislative Service Commission note (LSC 124 1524), the pension benefits provided to PERS-State members are the same or better than the benefits provided to SERS members. In particular, the benefits payable on termination of employment prior to retirement are better and the required member contributions are lower in PERS-State than in SERS. Moreover, the healthcare benefits provided to PERS retirees are better than the healthcare benefits provided to SERS retirees.

As a result, we believe that it is reasonable to anticipate that all U of Akron eligible members will elect to transfer from SERS to PERS-State. Moreover, all future non-teaching hires at U of Akron would automatically be covered by PERS-State. (The U of Akron is currently the only four-year state university in Ohio whose non-teaching employees are covered by SERS rather than PERS.)

Transfer of assets and obligations

Two different precedents exist in Ohio statutes that could be applied for purposes of transferring the assets and benefit obligations attributable to U of Akron members who elect to transfer from SERS to PERS. The first of these is the coordination of benefits method currently used whenever a member in more than one of the non-uniformed Ohio Retirement Systems retires with a monthly annuity. Under this first method, the asset and benefit obligation transfers take place when a member commences a monthly annuity. The second was developed for the transfer of U of Akron law enforcement officers from SERS to PERS-LE as a result of Substitute House Bill 648 (effective September 16, 1998). Under this second method, all assets and benefit obligations are transferred at the time that the active members transfer from SERS to PERS. A possible third alternative that would involve transferring assets and benefit obligations at the time that the active members transfer is also discussed below.

Coordination of Benefits precedent

In general, when a member in more than one non-uniformed Ohio Retirement System retires with a monthly annuity, the member's total benefit is paid by the system under which the largest amount of service was earned. This practice is referred to as Coordination of Benefits, "COB". The systems, other than the one responsible for paying the annuity benefit, transfer, at the time of the member's retirement, twice the accumulated member contributions without interest to the system paying the annuity benefit. The retiree would also be eligible for healthcare benefits from the system paying the monthly retirement benefit, provided the retiree meets the system's eligibility requirements for healthcare benefits based on his total service with all of the non-uniformed systems. If such annuity benefits are not payable to the member, each non-uniformed system pays benefits (e.g., refund of contributions) directly to the member.

Substitute House Bill 648 precedent

Substitute House Bill 648 (effective September 16, 1998) provided that any person who was employed full-time as a U of Akron law enforcement officer on or after September 16, 1998 would become eligible for benefits under the PERS Law Enforcement Division, "PERS-LE". Full-time U of Akron law enforcement officers on that date were permitted to make a one-time irrevocable election to transfer from SERS to PERS-LE within 90 days. Upon such election, SERS transferred to PERS-LE the following amounts:

1. the member's accumulated contributions,
2. the employer contributions made on behalf of the member, and
3. any amount paid by the member or employer for the purchase of service credit.

These amounts were transferred without interest.

One question, that would need to be addressed if the method applied for members who transferred under Sub HB 648 were adopted for the transfer of non-teaching U of Akron members, is whether the employer contributions made on behalf of the member include amounts payable under the employer surcharge provision. The employer surcharge helps fund the cost of retiree healthcare benefits in SERS. Since only a few full-time members were eligible to transfer under Sub HB 648, this question was probably moot for the law enforcement officers since full-time members most likely earned more than the minimum compensation amount for the employer surcharge. Some of the current U of Akron non-teaching members earn less than the minimum compensation amount. Therefore, if this was not resolved for the Sub HB 648 transfers, it would have to be for this bill.

Third alternative

If non-teaching U of Akron employees transferred immediately to PERS, there is a third method that could be adopted to determine the assets to be transferred. This third approach would be to transfer assets equal to the actuarial accrued liabilities for members who transfer, to the extent they have been funded. This could be based on the assumption that SERS assets would first be allocated to cover actuarial accrued liabilities for retired and inactive members of SERS with the residual amount allocated to actuarial accrued liabilities for active members. The assets transferred would be equal to the funded percentage of the actuarial accrued liabilities for the transferring active members.

Actuarial Effect of Transfer on Pension Benefits

If the Coordination of Benefits method is used

We have estimated the impact on SERS and PERS-State if the coordination of benefits method of transferring assets is used, assuming that all non-teaching active U of Akron members transfer to PERS.

The existing COB provision applies when an individual member applies for a monthly retirement, disability, or survivor annuity. For example:

1. Employee A has 20 years of service with SERS at the time of transfer to PERS. Employee A subsequently works an additional 5 years and then retires. In this instance, at the time of retirement, SERS begins paying the member an annuity based on a total of 25 years of service, and PERS transfers to SERS assets equal to twice the member contributions (without interest) that were paid into PERS during the 5 year post-transfer period.
2. Employee B has 10 years of service with SERS at the time of transfer to PERS. Employee B subsequently works an additional 15 years and then retires. In this instance, at the time of retirement, PERS begins paying the member an annuity based on a total of 25 years of service, and SERS transfers to PERS assets equal to twice the member contributions (without interest) that were paid into SERS during the 10 year pre-transfer period.

The estimated effects of using the existing COB approach for U of Akron non-teaching members are summarized in the following tables, separately for SERS and PERS-State. The assets and benefit obligations included in these tables are only for benefits that are actuarially funded – pension benefits for PERS and pension benefits and the Medicare Part B reimbursement for SERS.

Estimated Impact of COB on SERS
($ Amounts are in millions)

	Estimated SERS' liabilities under current law	Estimated Effect of bill if COB is used	Estimated SERS' liabilities after enactment of bill
Present Value of all future Benefit Obligations (pension and Medicare Part B)	$131.8	($49.9)	$81.9
Present Value of future 9.00% member contributions	(29.2)	29.2	0.0
Present Value of future 5.46% employer contributions for pensions and Medicare Part B	(17.7)	17.7	0.0
Present Value of amounts to be transferred to PERS from SERS under COB provision	0.0	3.1	3.1
Present Value of amounts to be transferred from PERS to SERS under COB provision	0.0	(10.8)	(10.8)
Actuarial Accrued Liability of SERS	84.9	(10.7)	74.2

Explanation of Above Table:

- After the transfer of the currently active U of Akron non-teaching members from SERS to PERS-State, SERS' liability for pension and Medicare Part B benefits will decrease as some employees (i.e. – Employee B in the previous example) will receive these benefits from PERS.
- At the same time, future contributions to SERS will decrease as SERS will no longer receive the 14.46% of salary contributions (9.00% member plus 5.46% employer) that SERS currently receives and allocates to actuarially funding pension and Medicare Part B benefits.
- Finally, due to the existing COB provision, assets will be transferred between SERS and PERS when members apply for annuity benefits. In the initial period after the transfer, assets will flow from PERS to SERS, as members will receive benefits through SERS. Over time, assets will begin to flow from SERS to PERS, as members gradually accrue more post-transfer service at PERS than their pre-transfer service at SERS. The present value of the assets to be transferred from SERS to PERS is much lower, as the amounts transferred will reflect the lower salaries in the past, and the transfers will take place in the more distant future. Thus they are more heavily discounted to the present time.

- In total, we estimate that SERS would realize an actuarial gain of $10.7 million as a result of the enactment of the bill if COB were applied.
- Note that this is not an estimate of the impact on the next actuarial valuation or the funding period, rather it is the expected impact to SERS over time, based on the demographic and economic actuarial assumptions currently used by SERS.

Estimated Impact of COB on PERS-State
($ Amounts are in millions)

	Estimated PERS-State's liabilities under current law	Estimated Effect of bill if COB is used	Estimated PERS-State's liabilities after enactment of bill
Present Value of all future Benefit Obligations	$0.0	$50.5	$50.5
Present Value of future 8.50% member contributions	0.0	(27.6)	(27.6)
Present Value of future 9.01% employer contributions for pensions	0.0	(29.3)	(29.3)
Present Value of amounts to be transferred to PERS from SERS under COB provision	0.0	(3.1)	(3.1)
Present Value of amounts to be transferred from PERS to SERS under COB provision	0.0	10.8	10.8
Actuarial Accrued Liability of PERS-State	0.0	1.3	1.3

Explanation of Above Table:

- After the transfer of the currently active U of Akron non-teaching members from SERS to PERS-State, PERS will have an obligation to pay pension benefits, as some employees (i.e. – Employee B in the above example) will receive these benefits from PERS.
- At the same time, PERS will receive all future contributions of 17.51% of salary contributions (8.50% member plus 9.01% employer) that PERS currently allocates to actuarially funding pension benefits.
- Finally, as in the previous table, due to the existing COB provision, assets will be transferred between SERS and PERS when members apply for annuity benefits. In the initial period after the transfer, assets will flow from PERS to SERS, as members receive their annuity benefits through SERS. Over time, assets will begin to flow from SERS to PERS, as

members gradually accrue more post-transfer service at PERS than their pre-transfer service at SERS. The present value of the assets to be transferred from PERS to SERS is much higher, as the amounts are based on the higher future PERS salaries, and the transfers take place relatively soon. Thus they are discounted relatively less to the present time.

- In total, we estimate that PERS would incur a $1.3 million actuarial loss due to the enactment of this bill if COB were applied. Since PERS-State has an accrued liability of $18.8 billion as shown in the December 31, 2000 valuation, the use of the COB provision would have a small impact on PERS-State.
- Note that this is not an estimate of the impact on the next actuarial valuation or the funding period, rather it is the expected impact to PERS over time, based on the demographic and economic actuarial assumptions currently used by SERS.

<u>If the Substitute House Bill 648 method is used</u>

We have estimated the impact on the results of the most recent actuarial valuations of SERS and PERS-State assuming that all U of Akron non-teaching members transferred from SERS to PERS-State and that assets transferred immediately from SERS to PERS-State using the method that was applied under Sub HB 648.

The assets that would be transferred under the Sub HB 648 method were estimated to be $66.7 million. This amount is the estimated total accumulated member contributions for active U of Akron members as of June 30, 2001 multiplied by 23/9 to reflect the total employer contributions of 14% of pay. (The 14% employer contribution rate has been in effect since 1983. Lower rates were in effect prior to 1983.) We do not have any information regarding service purchase amounts.

We have not estimated payments under the employer surcharge for healthcare benefits in the above figure. The healthcare surcharge paid by U of Akron in FY 2001 was $96,923. (The total healthcare surcharge paid in FY 2001 by all participating SERS employers was $24,593,508.) Thus it seems probable that the accumulated surcharge paid by U of Akron on account of current SERS members would not materially increase the $66.7 million estimate shown above. If it were decided to transfer the accumulated surcharge payments to PERS also, we believe that including them would not materially affect the estimated results shown below for either system.

The following tables summarize the estimated results following the Sub HB 648 approach.

Estimated Impact on SERS June 30, 2001 Actuarial Valuation
($ Amounts are in millions)

	Before Transfer	Estimated Effect of Transfer	Estimated After Transfer
Accrued Liability	$8,852.0	(90.4)	$8,761.6
Actuarial Value of Assets	8,790.9	(66.7)	8,724.2
Unfunded Accrued Liability	61.1	(23.7)	37.4
Total Normal Cost Rate	14.27%	0.00%	14.27%
Member contribution rate	9.00	0.00	9.00
Employer contribution rate	14.00	0.00	14.00
Employer rate allocated to pension benefits	5.46	(0.07)	5.39
Employer rate allocated to healthcare benefits	8.54	0.07	8.61
Funding Period (in years)	25.0	n/a	25.0

Explanation of Above Table:

- As the estimated assets to be transferred are less than the expected decrease in the accrued liability, SERS would realize a gain in that its unfunded actuarial accrued liability would decrease.
- As the unfunded accrued liability decreases, SERS would be able to slightly decrease the amount of the employer contribution rate that is allocated to pension benefits by 0.07% from 5.46% to 5.39%, thus increasing the amount allocated to healthcare benefits, while still maintaining the funding period of 25 years.
- Note that in preparing the above estimates, neither the employer contribution rate nor the employer rate allocated to healthcare benefits reflect contributions attributable to the employer surcharge for healthcare benefits.
- The estimated liabilities in the above table reflect the plan provisions and actuarial assumptions used in the June 30, 2001 Actuarial Valuation of SERS.

Estimated Impact on PERS-State December 31, 2000 Actuarial Valuation,
($ Amounts in millions)

	Before Transfer	Estimated Effect of Transfer	Estimated After Transfer
Accrued Liability	$18,792.6	$101.4	$18,894.0
Actuarial Value of Assets	19,077.4	66.7	19,144.1
Unfunded Accrued Liability	(284.8)	34.7	(250.1)
Total Normal Cost Rate	16.19%	0.00%	16.19%
Member contribution rate	8.50	0.00	8.50
Employer contribution rate	13.31	0.00	13.31
Employer rate allocated to pension benefits	9.01	0.00	9.01
Employer rate allocated to healthcare benefits [1]	4.30	0.00	4.30
Funding Period (in years)	(5.1)	0.6	(4.5)

Explanation of Above Table:

- As the estimated assets to be transferred are less than the expected increase in the accrued liability, PERS will experience an actuarial loss, since its surplus will decrease.
- We have assumed that PERS would not reallocate the employer contribution between pension and healthcare benefits due to this transfer. Thus, the net effect would be an increase in the funding period of 0.6 years. But since PERS-State is currently fully funded and would remain so after the transfer, this increase in the funding period does not have any particular significance beyond indicating that this transfer would generate a loss in PERS-State.
- The estimated liabilities in the above table assumed that SERS service would be counted as PERS service in determining eligibility for PERS' benefits, including the enhanced refund benefit.
- The estimated liabilities in the above table reflect the plan provisions and actuarial assumptions used in the December 31, 2000 Actuarial Valuation of PERS.

<u>Possible use of the "third" option discussed above</u>

If the alternative "third" method described above were used to determine the assets transferred to PERS-State, we have estimated that assets equal to 98.7% of the actuarial accrued liability under SERS, $89.2 million, would be transferred from SERS to PERS-State. If this were to occur, the SERS employer contribution rate allocated to pension benefits would remain 5.46% to maintain a 25-year funding period and the funding period for PERS-State would increase by only 0.3

years (because the actuarial loss to PERS-State would be less than if the Sub HB 648 method were adopted). Again, PERS-State would remain fully funded under this approach.

Senate Bill 82

Each of the three options for transferring assets and benefit obligations above are estimated to be affordable within the 30-year funding period constraint of Senate Bill 82.

Healthcare Benefits

Current Retirees

The situation with healthcare benefits is complicated by the fact that the healthcare benefits, with the exception of SERS Medicare Part B reimbursements, are financed on a pay-as-you-go basis. If all of the active U of Akron members transfer from SERS to PERS, SERS would no longer receive contributions from U of Akron to finance the healthcare benefits that SERS provides to U of Akron's retirees from current contributions. Thus there would be a negative impact on SERS, as its overall healthcare benefit obligations to U of Akron retirees would remain the same while the funding source would be significantly diminished, if not eliminated.

We estimate that, if the transfer occurred, SERS would not receive $3.4 million during FY 2002 on behalf of U of Akron members that would be allocated to provide healthcare benefits. This estimate is based on increasing FY 2000 payroll to FY 2002 using the SERS' payroll growth assumption, a healthcare contribution rate of 8.54%, and estimated employer surcharge of $0.1 million for U of Akron.

To deal with this situation, PERS could reimburse SERS each year for the net cost of providing healthcare benefits (other than Medicare Part B reimbursements) to U of Akron retirees. Since PERS would be receiving the employer contributions from U of Akron that were intended to finance healthcare benefits for U of Akron retirees, having PERS reimburse SERS for the cost of healthcare benefits provided to U of Akron retirees who remain in SERS would serve to properly align the contributions intended to support healthcare benefits with the cost of those benefits.

If U of Akron were to reimburse SERS for the cost of healthcare benefits provided to its retirees who remain in SERS, U of Akron would be paying twice for healthcare coverage for its retirees since U of Akron would also be paying the employer contribution rate to PERS, a portion of which is allocated to pay for healthcare benefits to retirees. PERS would also be receiving a windfall initially as PERS would be receiving contributions for healthcare benefits, but would not be providing healthcare benefits to U of Akron retirees for a while.

It should be relatively straightforward to determine the premium cost of providing U of Akron retirees with coverage each year and to have SERS bill PERS the net cost (total premium minus the retiree paid portion of the premium), excluding the Medicare Part B reimbursement. As SERS has been actuarially funding Medicare Part B reimbursements as a component of the SERS pension valuation, SERS could retain the obligation to provide Medicare Part B reimbursements to all U of Akron retirees who receive pension benefits from SERS. Over time, this reimbursement would decline until eliminated as the U of Akron retirees in SERS cease coverage.

Under the current coordination of benefits provision, members who have service under more than one non-uniformed Ohio Retirement System are eligible for healthcare benefits from the system under which the largest amount of service was earned, provided the member meets that system's eligibility requirements for healthcare benefits. For example, Employee A in the earlier example, who has 20 years of service in SERS followed by 5 years in PERS, would receive pension and healthcare benefits from SERS. Employee B, who has 10 years of service in SERS followed by 15 years in PERS, would receive pension and healthcare benefits from PERS. The transfer of twice the accumulated member contributions without interest to the system paying the annuity benefit is the only reimbursement that the paying system receives from the other systems to cover the costs of both the pension and healthcare benefits. In the normal course of events, one could expect that the transfers even out among the non-uniformed retirement systems over time.

The U of Akron transfer would create a relatively large number of employees that are transferring from SERS to PERS. Therefore, if the coordination of benefits provision was selected for determining which system pays the pension benefit, the cost of healthcare benefits (excluding the Medicare Part B reimbursement) provided in the future by SERS to current U of Akron members who ultimately receive monthly annuities from SERS should also be reimbursed by PERS (i.e. – Employee A in the earlier example).

<u>Supplemental Contribution</u>

An additional issue relating to financing healthcare benefits could be a desire of the Legislature to mitigate the negative financial effect on SERS due to the fact that healthcare contributions provided on behalf of U of Akron members are higher than the average contributions toward healthcare for the other SERS members; thus higher paid SERS members, such as U of Akron members, subsidize the cost of healthcare benefits provided to lower paid SERS members. This intra-system subsidy is inherent in the funding of healthcare benefits for all of the Ohio retirement systems since healthcare premiums are the same for high and low paid retirees while the contributions allocated to finance healthcare benefits are based on a percentage of salary (with the exception of the healthcare surcharge for SERS). This is analogous to the problem created for PERS, SERS, and STRS when higher education employees were given the opportunity to join an ARP.

A reasonable way to deal with this issue would be to require U of Akron to pay SERS a Supplemental Contribution in order to mitigate the negative financial effect on the SERS healthcare program of their transfer to PERS similar to the Supplemental Contribution calculation prepared for higher education employees who join an ARP. The same issues regarding how long this Supplemental Contribution should be paid by U of Akron would also pertain in this situation, as it did for PERS, SERS, or STRS employees who joined an ARP. (Note that the Supplemental Contribution would not cover the pension benefits nor the Medicare Part B reimbursement.) House Bill 586, 121st General Assembly (effective March 31, 1997), implemented the Supplemental Contribution for higher education employees who elect coverage in an ARP.

In the event a Supplemental Contribution is developed, some thought should be given to how the Supplemental Contribution would be affected by:

- a possible subsequent merger of SERS into either PERS or STRS, or,
- the possibility that additional employers would approach the Legislature and request the right to transfer their members out of SERS.

Based on the differences in the average contributions allocable to healthcare from current U of Akron members compared to the entire SERS membership, such a supplemental contribution is estimated to be approximately 2.1% of payroll. This reflects a healthcare contribution rate of 8.54% and the employer surcharge for FY 2001.

The portion of the total employer contribution allocated to healthcare benefits has increased significantly over the past five fiscal years, as shown in the following table. The average of the healthcare contribution rate paid for the last 5 fiscal years was 7.61%. If 7.61% were used instead of the current 8.54% healthcare contribution rate, the supplemental contribution estimate would be reduced to 1.8% of payroll.

Fiscal Year	Employer Contribution Rate allocated to pension benefits (including Medicare Part B reimbursement)	Employer Contribution rate allocated to healthcare benefits
2002	5.46%	8.54%
2001	4.20	9.80
2000	5.55	8.45
1999	7.70	6.30
1998	9.02	4.98

Senate Bill 270 (effective April 9, 2001) limited the maximum employer surcharge amount to no more than 2% of an individual employer's payroll for employees covered under SERS and limited the aggregate amount collected through the employer surcharge to no more than 1.5% of the total SERS active member payroll.

In determining if and how long a Supplemental Contribution should be paid to SERS by the U of Akron, the Legislature may wish to consider that the U of Akron has contributed to the current balance in the Healthcare Fund. Since the U of Akron's payroll is approximately 1.9% of total SERS payroll, we estimate that the U of Akron's "share" is 1.9% of the June 30, 2001 balance of $315.7 million, or $6.0 million. This amount is roughly equivalent to the present value of a Supplemental Contribution of 2.1% of payroll payable by the U of Akron for the next 9 years.

Based on the relatively low percentage of active members who would be eligible to transfer (1,470 out of 113,811 total SERS active members as of June 30, 2000, or roughly 1.3%), we have not prepared any projections of the impact on the pay-as-you-go costs of healthcare benefits for U of Akron retirees. Assuming that PERS would reimburse SERS for any healthcare benefits paid to U of Akron retirees, excluding Medicare Part B reimbursements, SERS should not suffer any loss attributable to healthcare benefits as a result of enactment of this bill, other than the possible loss of the subsidy provided by the U of Akron as discussed above. Moreover, PERS would be receiving the U of Akron healthcare contributions, so it would have the ability to pay those costs without incurring a loss.

Current Draft of the Bill

A proposed bill (LSC 124 1524) has been drafted that would transfer all non-teaching employees of the U of Akron that are members of SERS to PERS, where non-teaching employees at all other four-year state universities are covered. All new non-teaching employees hired by the U of Akron would become members of PERS. Since the bill is silent on the amount of assets to be transferred, the coordination of benefits provision would seem to apply. The bill also does not provide for any supplemental contribution to be paid to SERS nor for any reimbursement for healthcare benefits from PERS to SERS.

Basis for Analysis

This analysis was based on U of Akron active member data as of June 30, 2000 provided to us by SERS. The total FY 2000 reported payroll was $35,620,299 for 1,470 members. Please note that of the 1,470 active U of Akron members, 154 members had FY 2000 reported earnings of $0 and an additional 219 members had FY 2000 reported earnings of less than $10,000. Their average age and service are 42.0 and 8.5 years, respectively, as of June 30, 2000.

In determining the estimated impact of the COB method, the present values as of June 30, 2000 for both SERS and PERS were determined using the assumptions in the June 30, 2001 actuarial valuation of SERS.

In determining the estimated impact of the Sub HB 648 method, the liabilities as of June 30, 2000 for U of Akron members were increased by the SERS' payroll growth assumption of 4.25% to estimate liabilities as of June 30, 2001.

This analysis was also based on the June 30, 2001 Actuarial Valuation for SERS and the December 31, 2000 Actuarial Valuation for PERS, including the plan provisions and the actuarial assumptions contained therein.

The supplemental contribution estimate was based on the June 30, 2000 payroll of SERS of $1,866,283,000 and the FY 2001 employer surcharge of $24,593,508 of which U of Akron paid $96,923.

In preparing this analysis, we have relied on the data and other information provided by SERS, ORSC, and Gabriel, Roeder, Smith & Company. We have not audited or verified this data and other information. If the underlying data or other information are inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

We performed a limited review of the data used directly in our analysis for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or for relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

Differences between our projections and actual amounts depend on the extent to which future experience conforms to the assumptions made for this analysis. It is certain that actual experience will not conform exactly to the assumptions used in this analysis. Actual amounts will differ from projected amounts to the extent that actual experience deviates from expected experience.

Please call if you have any questions.

Sincerely,

Glenn D. Bowen

William A. Reimert

Katherine A. Warren

GDB:WAR:KAW:kaw\ORC71
g:\corr02\orc\ltr03_akron.doc