

May 11, 2023

Ms. Bethany Rhodes  
Executive Director  
Ohio Retirement Study Council

Subject: Ohio Retirement Systems' Administrative Expense Assumptions

Dear Bethany:

As requested, we have reviewed the administrative expense assumptions for the five Ohio retirement systems. Our study focused on how the recognition of administrative expenses could significantly distort contribution rates and funding period developed in the annual actuarial valuations, as they did in the case of the Ohio Police and Fire Pension Fund. As we reported in our recent adequacy study for OP&F, their method of anticipating administrative expenses in their calculation of a funding period seriously distorted their solvency measure as of January 1, 2022. This is because administrative expenses in the prior year were extraordinarily low for an extraordinary reason which is not expected to recur.

Our findings for the other four retirement systems follow:

#### Ohio Public Employees Retirement System

The OPERS administrative expense assumption as of December 31, 2022 is that the cost for expenses is recognized as a load to the normal cost of approximately 0.40% of Traditional Plan payroll and 1.00% of Combined Plan payroll. The actuary presumably reviews the 0.40% and 1.00% assumption periodically. Based on this methodology, extraordinary deviations in actual administrative costs do not impact the normal cost load and resulting contribution rates.

#### School Employees Retirement System of Ohio

The SERS employer contributions as of June 30, 2021 consist of normal contributions, accrued liability contributions and contributions for administrative expenses although no disclosure of an administrative expense assumption was provided in the valuation report.

Noted in the 2021 ACFR was a significant decrease in administrative expenses from 2020 resulting from SERS recognizing their portion of OPERS pension income and OPEB income, \$3.3 million and \$10.1 million respectively.

SERS' experience study through 2020 shows a reduction of 22 basis points to the interest rate assumption calculation due to administrative expenses. However, SERS' investment return assumption does not reflect an adjustment due to the significant decrease in administrative expenses from 2020 to 2021. Because SERS sets their administrative expense assumption only every five years, we do not find that there is distortion in contribution rates and funding period as a result of extraordinary deviations in OPEB costs as there is with OP&F.

State Teachers Retirement System of Ohio

STRS' Investment Return Rate assumption is 7.00% per annum as of June 30, 2022, compounded annually and net of all expenses.

From the 2021 and 2022 ACFRs, no significant reduction in administrative expenses were realized from the prior year. Further, investment return assumption is net of all expenses and was reduced in 2021 from 7.45% to 7.00%.

Because STRS sets this assumption only every five years, we do not find that there is distortion in contribution rates and funding period as a result of extraordinary deviations in OPEB costs as there is with OP&F.

Ohio Highway Patrol Retirement System

The December 31, 2021 HPRS Administrative Expense assumption is based on the average of actual expenses incurred in the prior two fiscal years and then increases based on 2.5% inflation rate annually.

From the 2021 CAFR, deductions from fiduciary net position increased 8.3% over the prior year. Of this amount, pension benefits increased by 9.3%, health care expenses increased by 2.9% and **administrative expenses decreased by 35.8%**.

The 2021 and 2020 valuations show administrative expenses of \$1.28 million, or 1.11% of payroll and \$1.64 million, or 1.34% of payroll.

As the expense assumption is based on the prior two fiscal years, the upcoming 2022 valuation may be a concern as the annual contribution will likely be impacted by the sharp 2021 reduction in administrative expenses. This may result in a distortion as with OP&F. But since it is based on a two-year average, the distortion would only be half as significant as it was for OP&F, but would continue for two years.

In conclusion, the annual contribution rates developed by OPERS, STRS and SERS are not influenced by the administrative expense assumption. However, HPRS' contributions are directly impacted by the administrative expense assumption, particularly for 2022 which will incorporate the 35.8% reduction in 2021 administrative expenses.

We are happy to discuss this further with ORSC staff, the Council, and retirement systems as appropriate.

Sincerely,



William B. Fornia, FSA

Cc: Linda Bournival, KMS Actuaries