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May 6, 2002

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

Re: House Bill 373 – HPRS benefit improvements

Dear Aris:

As you requested, we have reviewed the Supplemental Actuarial Valuation as of December 31, 2000 of the Highway Patrol Retirement System, "HPRS", dated March 4, 2002 prepared by Gabriel, Roeder, Smith & Company, "GRS", that estimated the effect of proposed benefit changes for active, retired and deferred members of HPRS on its actuarial status. We understand that the proposed benefit changes addressed in that Supplemental Actuarial Valuation have been introduced as House Bill 373. In addition, you provided us with a copy of a letter dated April 17, 2002 addressing the effect of a potential 1% contribution rate increase on the results of that Supplemental Actuarial Valuation. In addition, Brian Murphy, the consulting actuary to HPRS, provided us with some additional analysis relating to the Supplemental Actuarial Valuation.

The Supplemental Actuarial Valuation indicates that the proposed benefit changes would increase the funding period of HPRS to exactly 30 years. On this basis, the proposed benefit changes would be affordable within the 30 year funding period limitation of Senate Bill 82.

But Brian Murphy's letter of April 17 cautions that "We have used the phrase "estimated amortization period" because the 2001 valuation is not complete, and we cannot know for certain what the period will be until the valuation is, in fact, complete. It could be more than 30 years, or less." Moreover, he closes that letter with the request that "If possible, we would like to redo our estimates based upon the 2001 results, prior to adoption of any benefit changes."

We recommend that consideration of these proposed benefit changes be delayed until updated estimates are available based on the 2001 results. There are several reasons for us making this recommendation beyond the fact that HPRS's actuary believes that this would be desirable. They are discussed below.

1. The Supplemental Actuarial Valuation estimates that the funding period for the current benefits will increase to roughly 26 years as of December 31, 2001 solely as a result of the $45.3 million of investment losses that are scheduled for recognition as of that date. Before recognition of those losses, HPRS's funding period was 8 years (as reported in the December 31, 2000 Actuarial Valuation).

   In addition to the $45.3 million of investment losses scheduled for recognition in the December 31, 2001 Actuarial Valuation, there are an additional $95.5 million of investment losses deferred to future years. (The market value of assets as of December 31, 2001 was $571.9 million while the funding value of those assets is estimated to be $667.4 million.) $38.2 million of the deferred losses are scheduled for recognition during 2002.

   As a result, even if HPRS earns an 8% investment return during 2002, the scheduled recognition of $38.2 million of the deferred losses will significantly depress the funding value as of December 31, 2002. Thus it seems reasonable to anticipate that, absent a significant rebound in investment returns in the remaining 8 months of 2002, HPRS is likely to see its funding period increase well beyond the 30 year limit in SB 82 by the end of this year even if no benefit increases are enacted.

2. The December 31, 2000 Actuarial Valuation recommended that the HPRS "Board and Staff monitor the post retirement health care program throughout the year and consider a rate reallocation from retirement, survivor and disability allowances to post retirement health care in conjunction with the December 31, 2001 actuarial valuation". The report offered an example of such a reallocation that would shift 1.75% of payroll from funding retirement, survivor and disability allowances to health care. Under that scenario, the allocation to health care would have increased to 6.5% of payroll, which would be close to, but still slightly less than, the current payout rate of 6.8% of payroll to provide health care benefits. Any increase in the allocation to the post retirement health care program will reduce the allocation to pensions. This would also increase the funding period for pension benefits beyond 30 years.

In light of the above and the request of HPRS's actuary that they be allowed to redo their estimates of the effect of HB 373 based on the results of the 2001 Actuarial Valuation, we believe that deferring consideration of this proposal is appropriate.

One of the proposed improvements under HB 373 is the adoption of a Partial Lump Sum Option Program, "PLUS". This program would allow members to withdraw a lump sum at retirement and to have their monthly pension actuarially reduced to reflect that withdrawal. So long as the actuarial factor used to determine the benefit reduction is actuarially equivalent to the lump sum

paid to the retiree, this provision would be cost neutral to HPRS. (Our understanding is that the initial actuarial factor of a $6.25 reduction for each $1,000 withdrawn would be updated periodically at the time of future experience studies. Such a procedure would allow the Board to ensure that the PLUS Program remains cost neutral.) Thus this one portion of HB 373 could be enacted without increasing the funding period of HPRS.

In preparing this analysis, we have relied on the reports and other information provided by GRS. We have not audited or verified these reports and other information. If those reports or 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.

GRS's conclusions seem reasonable to us. But there is some uncertainty associated with them. Differences between their projections and actual costs will depend on the extent to which future experience conforms to the assumptions. It is certain that actual experience will not conform exactly to the assumptions used. Actual costs will differ from projected amounts to the extent that actual experience deviates from the assumptions.

Please let us know if you have any questions.

Sincerely,

William A. Reimert

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