



The Ohio Retirement Study Council

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Aristotle L. Hutras

To : ORSC Members

From : Aristotle L. Hutras

Date : July 5, 2005

Re : Supplemental Contribution Rate for Members Who Elect to Participate in an Alternative Retirement Plan

Attached for your review is the actuarial study on the supplemental contribution rate required for members who elect coverage in an Alternative Retirement Plan (ARP) for academic and administrative employees of public institutions of higher education that was completed pursuant to R.C. §171.07.

As Milliman states in the report, the study covers only the State Teachers Retirement System because the ARP supplemental contribution rates for the Public Employees Retirement System (PERS) and the School Employees Retirement System (SERS) were both reduced to 0.0% because the unfunded actuarial accrued liability at both of those funds had been fully amortized. However, the study notes that the ARP supplemental contribution rate will resume for SERS beginning August 1, 2005 and for PERS beginning January 1, 2006. In our analysis of H.B. 337 (125th G.A.), staff pointed out that the current statutory language is unclear as to whether the supplemental contribution rate to the ARP resumes if the systems go from being fully funded to having an unfunded liability. Therefore, staff recommended that the current statutory language should be clarified to state that the supplemental contribution will resume if unfunded actuarial liabilities reemerge due to actuarial losses and that it would be payable over a time period set as the funding period reported in the most recent annual actuarial valuation of the retirement system minus an adjustment to decrease that period to reflect benefit increases subsequent to March 31, 1997. This recommendation was not adopted and, therefore, the current statutory language remains unclear.



Milliman

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June 28, 2005

Mr. Aristotle L. Hutras
Director
Ohio Retirement Study Council
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Re: Supplemental Contributions from Higher Education Employers

Dear Aris:

As requested, we have prepared the actuarial study required under Section 171.07 of the Revised Code to determine whether any adjustments to the employer Supplemental Contribution Rate required under Sections 3305.06(D) and 3305.061 are necessary. Section 3305.06(D) 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 a percentage 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 potentially affected by this section are the Public Employees Retirement System, "PERS", the School Employees Retirement System, "SERS", and the State Teachers Retirement System, "STRS". Such a study is to be completed by July 1 every third year starting in 2002.

Purpose of Study

The purpose of this study is to determine whether adjustments are necessary to the 3.5% employer Supplemental Contribution Rate currently made to STRS. This Supplemental Contribution Rate, as adjusted, is to continue until the unfunded actuarial accrued pension liability of each retirement system, excluding benefit increases provided after March 31, 1997, is fully amortized, as determined by the annual actuarial valuation performed by the system's actuary.

Applicability to PERS and SERS

The ARP Supplemental Contribution Rate payable to PERS was reduced to 0.0% as of January 1, 1999 since the December 31, 1998 Valuations for Active and Inactive Members and for Retired Lives for PERS indicated that the Unfunded Actuarial Accrued Liability was fully amortized as of that date. As a result, PERS is excluded from this study.

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The ARP Supplemental Contribution Rate payable to SERS was reduced to 0.0% as of July 1, 2000 since the June 30, 2000 Annual Basic Benefits Actuarial Valuation for SERS indicated that the Unfunded Actuarial Accrued Liability was fully amortized as of that date. As a result, SERS is excluded from this study.

Effect of Senate Bill 133

Effective August 1, 2005, generally all full-time employees of public institutions of higher education will become eligible for the ARP due to Senate Bill 133.

The ARP Supplemental Contribution Rate will resume in SERS at 6.0% (the rate established under amended R. C. Section 3305.06) beginning August 1, 2005 and may be adjusted to reflect the determinations made in subsequent actuarial studies prepared by the ORSC (the next actuarial study shall be completed by July 1, 2008 pursuant to R.C. Section 171.07).

The ARP Supplemental Contribution Rate will not resume in PERS at 6.0% beginning August 1, 2005 since existing law (R.C. Section 3305.061) provides that the ARP Supplemental Contribution Rate shall not exceed the rate transferred under the PERS defined contribution plan which presently is 0.0%; however, a study prepared by the PERS actuary is underway to determine the rate to be transferred under the PERS defined contribution plan beginning January 1, 2006 and, therefore, the ARP Supplemental Contribution Rate will resume in PERS at the lesser of 6.0% (the rate established under R.C. Section 3305.06 which may be adjusted in subsequent studies prepared by the ORSC) or the rate determined by the PERS actuary for the PERS defined contribution plan beginning January 1, 2006.

Determination of Rate

Section 3305.06(D) of the Revised Code mandates that the Supplemental Contribution Rate "mitigate any negative financial impact of the Alternative Retirement Program on the State Retirement System". In preparing this report, we have continued using the methods we utilized to estimate the magnitude of this Supplemental Contribution Rate during 1994 through 1996 while H.B. 586 (the legislation that established the ARP) was under consideration by the legislature modified to reflect the demographics of the employees who have elected to join an ARP.

Subsequent to the enactment of section 3305.06(D) of the Revised Code, Section 3305.061 was added. It provides that "the percentage of an electing employee's compensation contributed by a public institution of higher education under division (D)

of section 3305.06 of the Revised Code shall not exceed the percentage of compensation transferred under section 145.87, 3307.84, or 3309.88 of the Revised Code, as appropriate, by the state retirement system that otherwise applies to the electing employee's position."

Why Supplemental Contribution Rate is needed

As we indicated in the previous studies, there are three primary reasons why a Supplemental Contribution to the Ohio Retirement Systems is needed. The first reason is that the unfunded actuarial liabilities of the systems that existed when the ARPs were first adopted must be amortized. Each system relies on contributions on behalf of all employees (covering both current employees and future hires) in the groups covered by the Retirement Systems to amortize these obligations. To the extent that an ARP decreases the number of employees joining the Retirement System, the financing base for amortizing these unfunded actuarial liabilities is eroded.

The second reason is that employees who are most likely to join the ARP are those who expect to receive lower benefits from the Ohio Retirement Systems than the benefits provided by the ARP. Those members of the Retirement System who expect the ARP will provide lower benefits than the Retirement System will more likely choose to stay in or join 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 generally 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. 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 disproportionately to the decrease in the long term cost of providing health insurance to retirees.

Data

We received data from STRS regarding 4,539 ARP members with contributions forwarded to STRS by their employers during 2003-2004. These ARP members include those (1) who had elected to transfer during the first 120 days after the institution of higher education first established the ARP and (2) who were hired after the date the ARP was first established.

Results

The results of our calculations to determine the required Supplemental Contribution Rate based on this data have been summarized in the table below for STRS.

Calculated Supplemental Contribution Rate for:	
Pension Benefits	8.48%
Health Insurance	0.16
Total	8.64
Current Supplemental Contribution Rate as limited by 3305.061	3.50

The Supplemental Contribution Rate calculated before applying the limit under section 3305.061 is significantly higher than the rate calculated in the last study. This increase is primarily attributable to:

1. a 3.5% of payroll increase in the portion of the employer contribution rate to STRS allocated to pension benefits;
2. a 0.7% of payroll increase in the member contribution rate that is allocated to pension benefits;
3. revised actuarial assumptions adopted by STRS for the July 1, 2003 Actuarial Valuation; and,
4. changes in the demographics of the ARP members.

As of the prior report in 2002, there were 3,017 eligible employees who joined an ARP. Over the past three years, 598 of them terminated and 2,120 new employees joined an ARP. For this study we reflected the 4,539 ARP members reported to us. Roughly 47% of them joined an ARP since the prior study.

Period Supplemental Contribution is Payable

The Supplemental Contribution Rate will be payable until the STRS unfunded actuarial accrued liability for all benefits, except health care benefits and benefit increases provided after March 31, 1997, is fully amortized as determined by the annual actuarial valuation.

Conclusions

Based on the STRS members who elected to join an ARP, a Supplemental Contribution Rate of 3.50% is appropriate based on the provisions of Sections 3305.06(D) and 3305.061 of the Revised Code.

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The statute calls for an automatic adjustment of the Statutory Supplemental Contribution Rate based on this report "effective on the first day of the second month following submission of the actuarial study to the board of regents under Section 171.07 of the Revised Code."

Basis for Analysis

This analysis is based on the data supplied by STRS. We have not audited or verified this data but have relied on it as submitted. If the underlying data is inaccurate or incomplete, the results of our analysis will 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 to search for values that are questionable or for relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

The actuarial assumptions and plan provisions used for these calculations are the STRS assumptions used for the July 1, 2004 Actuarial Valuation. These calculations assume that the number and age/earnings characteristics of the future hires who will elect to join the ARP in the future will mirror the number and age/earnings characteristics of recent hires who joined the ARP, except that average starting salaries of future hires were assumed to grow each year at the payroll growth assumption adopted by STRS.


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.

We are members of the American Academy of Actuaries and meet its Qualification Standards to render this actuarial opinion.

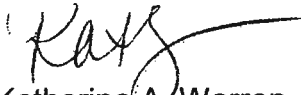
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Please let us know if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "W. Reimert", with a long horizontal flourish extending to the right.

William A. Reimert

A handwritten signature in black ink, appearing to read "K. Warren", with a long horizontal flourish extending to the right.

Katherine A. Warren

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