

OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM
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MEMORANDUM

DATE: March 4, 2004

TO: OPERS Retirement Board Members

FROM: Karen Carraher, Director of Finance
Dan Drake, Director of Benefits

RE: **V. Discussion Items:**
A. Contribution Rate Increase Options

Purpose

The purpose of this memo is to continue to present and discuss contribution rate increase alternatives. This document will provide alternatives and considerations. This document will include a summary of examples from the pension and health care calculators. We will have both of these calculators available at the March Board meeting to review other options the Board may wish to see.

Background

Last month, we began a discussion with the Board regarding contribution rate increases. The Board requested staff to:

- bring back calculator results of the proposed examples and identify more gradual phased in alternatives;
- conduct a comprehensive survey of employers and employees;
- include examples of the impact of proposed alternatives on both employees and employers;
- identify implementation issues;
- illustrate examples of more gradual health care funding phase-in;
- discuss the potential impact on pick-up plans; and
- include this discussion in the context of the other proposed health care changes that are under discussion (plan design change and asset allocation change).

Under Sections 145.47 and 145.48 of the Ohio Revised Code, the General Assembly has given the OPERS Board the authority to set employee and employer contribution rates within certain limitations. These sections establish a cap on employee contributions at 10% and on employer contributions at 14%.

Under current law, the employee contribution must be used to fund an individual's pension. The employer contribution may be used to fund pensions, pay off unfunded pension liabilities, or fund retiree health care. Prior to 2004, OPERS used 5% of the employer contribution to fund the health care liability. Due to increased pension funding needs, this funding was reduced to 4% in 2004. To the extent that OPERS can increase its contribution rate, the Board would have the option to restore the health care funding back to 5% level.

The table below provides a summary of the current employer and employee contribution rates for each of the local, state and law enforcement divisions. The table also shows the portion of each of the respective contributions that is currently being used to fund pension and health care. The table shows the total contribution (both pension and employer) and the statutory max for employer and employee contributions for each division. The final column in the table calculates the allowable increase in each rate for each division from the current level up to the statutory max. Essentially, this final column is the amount of increase that can be phased in (partially or wholly) in any alternative we present.

Current Employer and Employee Contribution Rates

	Current Pension	Current Healthcare	Current Total	Statutory Max	Amount Under Max
Employer:					
Local	9.51%	4.00%	13.55%	14.00%	0.45%
State	9.55%	4.00%	13.31%	14.00%	0.69%
Law Enforcement	12.70%	4.00%	16.70%	18.10%	1.40%
Employee:					
Local	8.50%	0.00%	8.50%	10.00%	1.50%
State	8.50%	0.00%	8.50%	10.00%	1.50%
Law Enforcement	10.10%	0.00%	10.10%	10.10%	0.00%
Public Safety	9.00%	0.00%	9.00%	N/A	N/A
Total:					
Local	18.01%	4.00%	22.05%	24.00%	1.95%
State	18.05%	4.00%	21.81%	24.00%	2.19%
Law Enforcement	22.80%	4.00%	26.80%	28.20%	1.40%
Public Safety	21.70%	4.00%	25.70%	N/A	N/A

One item to note is that in last month's Board discussion, staff presented the historical rationale of the different rate levels for the state and local divisions. That rationale revolved around differing population characteristics that previously existed. As noted in that discussion, these population characteristic differences no longer exist, and as such staff will be recommending that these two rates be established at equivalent levels in the future.

Alternatives

OPERS is presenting two options for consideration. These options are different from the two presented last month in that these options utilize a more gradual phase-in of both the contribution rate increases and the corresponding health care funding increases.

Alternative 1 – This option phases in the employer and employee contribution rate increases at a rate of **0.25%** increase per year up to the statutory maximum for each division for the employer rate and up to the statutory max for the employee rate. Thus, the phase in for the increase for each of the respective divisions for the employer rate is: local–2 years; state–3 years; law enforcement–6 years. The phase-in period for the employee increase is 6 years.

The percentage of the employer contribution rate used to fund health care increases by 0.25% per year for each of the 6 years that it takes to totally phase-in the employer and employee rate increases. Thus, by the final year of phase-in, the health care funding rate has increased from the current 4% level to 5.5%.

In this alternative, the pension financing years decreases from the current level of 26 to a low of 23 and then increases back up to 26 years.

Alternative 2 – This option phases in the employer and employee contribution rate increases at a rate of **0.10%** increase per year. The employer rate for the state and local divisions will increase up to the statutory maximum of 14%. However, the law enforcement division increase will cease at the level of 17.4% (18.1% statutory max) when the other two divisions have reached their max. Likewise, the employee rate increase will cease at the same time as the other divisions cease. The employee rate would reach a maximum of 9.2% as compared to the 10% statutory maximum. The phase-in period for the increase for each of the respective divisions for the employer rate is: local–5 years; state–7 years; law enforcement–7 years. The phase-in period for the employee increase is 7 years.

The percentage of the employer contribution rate used to fund health care increases by 0.10% per year for the first 6 years of implementation, which would increase the rate from the current 4% level to 4.6%. However, in the last year of

implementation, the health care funding rate would increase by 0.4% from the 4.6% up to the 5% level.

In this alternative, the pension financing years decreases from the current level of 26 to a low of 23 and then increases back up to 27 years.

The table below summarizes the results of each of these two alternatives.

Results of Alternatives 1 and 2								
	2003	2004	2005	2006	2007	2008	2009	2010
Alternative 1								
Employer rate								
Local	13.55%	13.80%	14.00%	14.00%	14.00%	14.00%	14.00%	
State	13.31%	13.56%	13.81%	14.00%	14.00%	14.00%	14.00%	
Law Enforcement	16.70%	16.95%	17.20%	17.45%	17.70%	17.95%	18.10%	
Employee rate	8.50%	8.75%	9.00%	9.25%	9.50%	9.75%	10.00%	
Health care funding	4.00%	4.25%	4.50%	4.75%	5.00%	5.25%	5.50%	
Pension Financing Years	26	24	23	23	24	25	26	
Alternative 2								
Employer rate								
Local	13.55%	13.65%	13.75%	13.85%	13.95%	14.00%	14.00%	14.00%
State	13.31%	13.41%	13.51%	13.61%	13.71%	13.81%	13.91%	14.00%
Law Enforcement	16.70%	16.80%	16.90%	17.00%	17.10%	17.20%	17.30%	17.40%
Employee rate	8.50%	8.60%	8.70%	8.80%	8.90%	9.00%	9.10%	9.20%
Health care funding	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	5.00%
Pension Financing Years	26	26	25	24	23	23	23	27

Thus, reviewing alternatives 1 and 2 without considering the other proposed health care changes (plan design and asset allocation), both of these alternatives allow for a gradual phase-in of rate increases and allow OPERS to gradually restore the health care funding to the previous level without increasing the pension financing period beyond the allowable limit.

Health Care Impact

The Board requested that information be provided with respect to the alternatives and the impact in conjunction with the other proposed changes. The other proposed changes include segregating the health care assets into a separate portfolio with a separate and more conservative asset investment guideline. The other proposed change is the implementation of the Health Care Preservation Plan (HCPP).

By implementing one of the suggested contribution rate increase alternatives, OPERS would be able to increase the health care funding rate. The following table provides a summary of the results of the implementation of Alternative 1 for each of the 6 years of implementation with and without asset allocation changes and the plan design changes. The table shows both the intermediate and pessimistic health care inflation assumption and the corresponding solvency period. The table of results shows that by implementing the health care asset allocation change, the change in the solvency period from intermediate health care inflation assumptions to pessimistic health care inflation assumptions becomes less dramatic. The table also shows that by implementing the HCPP changes, the solvency period is substantially increased.

Health Care Calculator Results

Health Care Funding Rate	Interest Earnings Assumption	Plan Design Changes	Health Care Inflation Assumption*	Solvency Period
4.0%	6.5%	N	I	15
4.0%	6.5%	N	P	12
4.0%	6.5%	Y	I	22
4.0%	6.5%	Y	P	16
4.0%	8.0%	N	I	16
4.0%	8.0%	N	P	12
4.0%	8.0%	Y	I	26
4.0%	8.0%	Y	P	17
4.25%	6.5%	N	I	15
4.25%	6.5%	N	P	12
4.25%	6.5%	Y	I	23
4.25%	6.5%	Y	P	16
4.25%	8.0%	N	I	16
4.25%	8.0%	N	P	13
4.25%	8.0%	Y	I	28
4.25%	8.0%	Y	P	18
4.5%	6.5%	N	I	15
4.5%	6.5%	N	P	12
4.5%	6.5%	Y	I	25
4.5%	6.5%	Y	P	17
4.5%	8.0%	N	I	17
4.5%	8.0%	N	P	13
4.5%	8.0%	Y	I	30
4.5%	8.0%	Y	P	19
4.75%	6.5%	N	I	16
4.75%	6.5%	N	P	12
4.75%	6.5%	Y	I	26
4.75%	6.5%	Y	P	18
4.75%	8.0%	N	I	18
4.75%	8.0%	N	P	13
4.75%	8.0%	Y	I	32
4.75%	8.0%	Y	P	19
5.00%	6.5%	N	I	16
5.00%	6.5%	N	P	13
5.00%	6.5%	Y	I	28
5.00%	6.5%	Y	P	18
5.00%	8.0%	N	I	18
5.00%	8.0%	N	P	14
5.00%	8.0%	Y	I	35
5.00%	8.0%	Y	P	20
5.25%	6.5%	N	I	17
5.25%	6.5%	N	P	13
5.25%	6.5%	Y	I	30
5.25%	6.5%	Y	P	15
5.25%	8.0%	N	I	19
5.25%	8.0%	N	P	14
5.25%	8.0%	Y	I	39
5.25%	8.0%	Y	P	21
5.5%	6.5%	N	I	18
5.5%	6.5%	N	P	13
5.5%	6.5%	Y	I	32
5.5%	6.5%	Y	P	19
5.5%	8.0%	N	I	20
5.5%	8.0%	N	P	14
5.5%	8.0%	Y	I	44
5.5%	8.0%	Y	P	22

* I Denotes Intermediate; P Denotes Pessimistic

Employer and Employee Impact

The following table reflects the impact of a 0.25% increase each year (Alternative 1) in the employer rates on the average annual employer liability. The first column in this table reflects the current average annual liability by employer type based on the current rates. The next columns reflect the new liability based on the new rates.

<u>Local Employer Rate</u> <u>(Employee Rate = 8.5%)</u>	<i>(current)</i>	<i>(+.25%)</i>	<i>(+.20%)</i>	
	13.55%	13.8%	14.0%	
Library	\$138,832	\$141,394	\$143,443	
Township	\$18,089	\$18,423	\$18,690	
Villages	\$39,589	\$40,320	\$40,904	
County	\$3,453,610	\$3,517,330	\$3,568,306	
Cities	\$1,055,471	\$1,074,944	\$1,090,523	
Transit Authority	\$2,365,261	\$2,408,901	\$2,443,812	
Housing Authorities	\$253,815	\$258,498	\$262,244	
University	\$2,574,531	\$2,622,031	\$2,660,032	
Hospital	\$3,049,983	\$3,106,256	\$3,151,274	
Miscellaneous	\$106,265	\$108,226	\$109,794	
<u>State Employer Rate</u>				
<u>(Employee Rate = 8.5%)</u>	<i>(current)</i>	<i>(+.25%)</i>	<i>(+.25%)</i>	<i>(+.19%)</i>
	13.31%	13.56%	13.81%	14.0%
State	\$2,448,915	\$2,494,913	\$2,540,911	\$2,575,869
University	\$10,876,534	\$11,079,807	\$11,284,081	\$11,439,329

The following table provides the impact of a 0.10% increase each year (Alternative 2) in the employer rates on the average annual employer liability.

<u>Local Employers</u>	<i>(current)</i>	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Employee Rate	8.50%	8.60%	8.70%	8.80%	8.90%	9.00%		
Employer Rate	13.55%	13.65%	13.75%	13.85%	13.95%	14.00%		
Factor	1.5941	1.5872	1.5805	1.5739	1.5674	1.5556		
Library	\$159,360	\$160,536	\$161,712	\$162,888	\$164,064	\$164,652		
Township	\$18,809	\$18,948	\$19,087	\$19,226	\$19,365	\$19,434		
Villages	\$42,001	\$42,311	\$42,621	\$42,931	\$43,241	\$43,396		
County	\$3,453,609	\$3,479,097	\$3,504,585	\$3,530,073	\$3,555,561	\$3,568,304		
Cities	\$1,055,469	\$1,063,259	\$1,071,048	\$1,078,838	\$1,086,627	\$1,090,522		
Transit Authority	\$2,729,146	\$2,749,288	\$2,769,429	\$2,789,570	\$2,809,711	\$2,819,782		
Housing Authorities	\$277,610	\$279,659	\$281,708	\$283,756	\$285,805	\$286,829		
University	\$2,574,528	\$2,593,528	\$2,612,528	\$2,631,529	\$2,650,529	\$2,660,029		
Hospital	\$3,049,982	\$3,072,491	\$3,095,000	\$3,117,509	\$3,140,019	\$3,151,273		
Miscellaneous	\$113,793	\$114,633	\$115,473	\$116,312	\$117,152	\$117,572		
<u>State Employers</u>								
Employee Rate	<i>(current)</i>	8.60%	8.70%	8.80%	8.90%	9.00%	9.10%	9.20%
Employer Rate	13.31%	13.41%	13.51%	13.61%	13.71%	13.81%	13.91%	14.00%
Factor	1.5659	1.5593	1.5529	1.5466	1.5404	1.5344	1.5286	1.5217
State	\$2,448,907	\$2,467,306	\$2,485,705	\$2,504,104	\$2,522,503	\$2,540,902	\$2,559,301	\$2,575,860
University	\$10,875,518	\$10,957,227	\$11,038,937	\$11,120,646	\$11,202,356	\$11,284,065	\$11,365,774	\$11,439,313

The following table reflects the impact of a 0.25% increase (Alternative 1) in the employee contribution for different levels of earnable salary.

Employee Contribution Rate (Non-Law)

Earnable Salary	<i>(current)</i> 8.5%	<i>(+.25%)</i> 8.75%	<i>(+.25%)</i> 9.0%	<i>(+.25%)</i> 9.25%	<i>(+.25%)</i> 9.5%	<i>(+.25%)</i> 9.75%	<i>(+.25%)</i> 10.0%
\$20,000	\$1,700	\$1,750	\$1,800	\$1,850	\$1,900	\$1,950	\$2,000
\$30,000	\$2,550	\$2,625	\$2,700	\$2,775	\$2,850	\$2,925	\$3,000
\$40,000	\$3,400	\$3,500	\$3,600	\$3,700	\$3,800	\$3,900	\$4,000
\$50,000	\$4,250	\$4,375	\$4,500	\$4,625	\$4,750	\$4,875	\$5,000
\$60,000	\$5,100	\$5,250	\$5,400	\$5,550	\$5,700	\$5,850	\$6,000
\$70,000	\$5,950	\$6,125	\$6,300	\$6,475	\$6,650	\$6,825	\$7,000
\$80,000	\$6,800	\$7,000	\$7,200	\$7,400	\$7,600	\$7,800	\$8,000
\$90,000	\$7,650	\$7,875	\$8,100	\$8,325	\$8,550	\$8,775	\$9,000
\$100,000	\$8,500	\$8,750	\$9,000	\$9,250	\$9,500	\$9,750	\$10,000
\$125,000	\$10,625	\$10,938	\$11,250	\$11,563	\$11,875	\$12,188	\$12,500
\$150,000	\$12,750	\$13,125	\$13,500	\$13,875	\$14,250	\$14,625	\$15,000

The following table reflects the impact of a 0.10% increase (Alternative 2) in the employee contribution for different levels of earnable salary.

Employee Contribution Rate (Non-Law)

Earnable Salary	<i>(current)</i> 8.5%	<i>(+.10%)</i> 8.60%	<i>(+.10%)</i> 8.70%	<i>(+.10%)</i> 8.80%	<i>(+.10%)</i> 8.90%	<i>(+.10%)</i> 9.00%	<i>(+.10%)</i> 9.10%	<i>(+.10%)</i> 9.20%
\$20,000	\$1,700	\$1,720	\$1,740	\$1,760	\$1,780	\$1,800	\$1,820	\$1,840
\$30,000	\$2,550	\$2,580	\$2,610	\$2,640	\$2,670	\$2,700	\$2,730	\$2,760
\$40,000	\$3,400	\$3,440	\$3,480	\$3,520	\$3,560	\$3,600	\$3,640	\$3,680
\$50,000	\$4,250	\$4,300	\$4,350	\$4,400	\$4,450	\$4,500	\$4,550	\$4,600
\$60,000	\$5,100	\$5,160	\$5,220	\$5,280	\$5,340	\$5,400	\$5,460	\$5,520
\$70,000	\$5,950	\$6,020	\$6,090	\$6,160	\$6,230	\$6,300	\$6,370	\$6,440
\$80,000	\$6,800	\$6,880	\$6,960	\$7,040	\$7,120	\$7,200	\$7,280	\$7,360
\$90,000	\$7,650	\$7,740	\$7,830	\$7,920	\$8,010	\$8,100	\$8,190	\$8,280
\$100,000	\$8,500	\$8,600	\$8,700	\$8,800	\$8,900	\$9,000	\$9,100	\$9,200
\$125,000	\$10,625	\$10,750	\$10,875	\$11,000	\$11,125	\$11,250	\$11,375	\$11,500
\$150,000	\$12,750	\$12,900	\$13,050	\$13,200	\$13,350	\$13,500	\$13,650	\$13,800

Other Considerations

With respect to the timing of implementation, the local rates are to be certified by the Board before the June meeting and the state rates are to be certified by the Board at the October meeting. The state rates are for the two-year period. Thus, the Board would need to make a final determination prior to certifying the rates.

Early communication is essential to a smooth transition. In addition, employer and employee communication will highlight that any contribution rate increases do not guarantee health care.

Employer accelerated contribution legislation has not yet been approved. Some employers have elected to remit monthly on a voluntary basis, while others are still remitting quarterly. Whenever the proposed legislation is enacted, those employers remitting monthly will have a cash impact.

OPERS is conducting a survey of employers and employees and will bring the results back to a future Board meeting.

OPERS staff has reviewed the fringe benefit pick-up plans currently on file. Less than 8% of OPERS employers have a fringe benefit pick-up plan. Most fringes benefit pick-up plans in existence cover less than 10 employees.

Next Steps

OPERS staff requests that the Board:

- Review survey results.
- Determine employee contribution rate cap.
- Finalize alternative preference.
- Determine implementation timeframe.