

**OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM**  
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**MEMORANDUM**

DATE: November 2, 2006

TO: OPERS Retirement Board Members

FROM: Karen Carraher – Finance Director  
Julie Reneau – Benefits Director

RE: **IV. Action Items:**  
**B. 2007 Mitigating Contribution Rate**

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**Action Requested:** That the Board adopt Option \_\_\_\_ as outlined as the mitigating contribution rate for the Member-Directed and the Combined plans starting January 1, 2007. That the Board establish the contribution rate percentage allocated to fund health care for the Member-Directed plan at \_\_\_\_ (4.5% or 5%) effective January 1, 2007.

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**Executive Summary:** To comply with the requirement of Section 145.87 of the Ohio Revised Code, the Board must take action to establish the “mitigating rate” for the Member-Directed and the Combined plans. This action is required because the Ohio Revised Code stipulates that a portion of the defined contribution plans’ employer contribution rate will be used for funding the defined benefit plan (Traditional Pension plan) to offset any negative financial impact due to the establishment of the new plans (Member-Directed plan and Combined plan). The Board’s actuary, Gabriel, Roeder, Smith & Company (GRS), has determined that the creation of these plans has had a small negative financial impact on the Traditional Pension plan and has prepared a report analyzing options available to address the issue. Additionally, the Board should determine the appropriate portion of the employer contribution rate to fund health care for the Member-Directed plan.

**Background:** When the defined contribution plans were established, the Ohio Revised Code stipulated that a portion of the defined contribution plans' employer contribution rate would be used for funding the defined benefit plan to offset any negative financial impact due to the establishment of the new plans (Member-Directed plan and Combined plan). Specifically, Section 145.87 of the Ohio Revised Code provides in pertinent part:

“For each member participating in a PERS defined contribution plan, the public employees retirement system shall transfer to the employer's accumulation fund a portion of the employer contribution required under section 145.48 of the Revised Code. The portion shall equal the percentage of earnable salary of members for whom the contributions are being made that is determined by an actuary appointed by the public employees retirement board to be necessary to mitigate any negative financial impact on the system of members' participation in the plan.”

“The board shall have prepared annually an actuarial study to determine whether the percentage transferred under this section should be changed to reflect a change in the level of negative financial impact resulting from the members' participation in a plan. The percentage transferred shall be increased or decreased to reflect the amount needed to mitigate the negative financial impact, if any, on the system, as determined by the study. A change shall take effect on the first day of the year following the date the conclusions of the study are reported to the board.”

While the Ohio Revised Code does not define “negative financial impact,” GRS initially recommended an interpretation based on whether the amortization period for the defined benefit plan's unfunded liabilities is greater than it would have been if only the defined benefit plan had existed. While this calculation is an appropriate measure, it becomes difficult to sustain as the plans mature and the members come and go from the system and move between plans. Therefore, once the initial calculation was completed, future calculations become increasingly difficult and increasingly uses the portion of the employer contribution rate applied to fund the unfunded liability as a proxy, which GRS included in their report for the current year.

In December 2005, the Board approved establishing an initial mitigating rate of 0.7% for local employers and 0.54% for state employers. These rates reflect the incremental increase in the employer contribution rate in effect for 2006 coupled with a re-alignment of the internal allocation of the contribution rates to align health care funding at the same rate for all three plans. Effective January 1, 2006, the Board selected these rates from a number of alternatives as these rates were intended to allow the Board to make incremental changes in this area and preserve the option for more analysis.

It is important to understand that assessing a mitigating contribution rate on the Member-Directed plan will directly reduce the contributions going into individuals' member-directed accounts and therefore reduce their future potential pension benefits. Such funds would instead be redirected to the Traditional defined benefit plan.

Following the decision and subsequent announcement to the members, the Board heard feedback from members of the Member-Directed plan. The members expressed their dissatisfaction with the arrangement and the rate and questioned the rationale of subsidizing the Traditional plan. As a result, the Board indicated an interest in changing the statute and eliminating the mitigating contribution rate.

On a related note, House Bill 586, effective March 31, 1997, enacted as Chapter 3305 of the Ohio Revised Code made Alternative Retirement Plans (ARP) available to academic and administrative employees of institutions of higher education. This population was expanded by Senate Bill 133. The enabling statute provided that employers of ARP participants were to contribute an amount up to 6% of pay to OPERS until the unfunded liability of OPERS was fully amortized. This statute was later modified to prohibit the retirement systems from charging the ARP a higher mitigating percentage than the systems charge their own internal defined contribution plans.

Prior to January 1, 1999, OPERS had an unfunded liability and charged the ARP participants a mitigating rate of 6%. Effective January 1, 1999, OPERS became fully funded and ceased collecting this rate from the ARP participants. No rate has been charged the ARP participants since that time, despite the fact that OPERS is no longer fully funded. OPERS was prohibited from charging the ARP participants a mitigating rate until OPERS established a mitigating rate for its own internal defined contribution plans, which it did effective January 1, 2006. Changes to the ARP rate are permitted periodically based on a study required to be conducted by the ORSC actuary. OPERS indicated in a June 28, 2005 letter to the ORSC from Milliman Consultants and Actuaries that the ARP supplemental rate will resume in OPERS at the lesser of 6%, or the rate determined by the OPERS actuary for the OPERS defined contribution plan beginning January 1, 2006. Although the Board did establish this rate effective January 1, 2006, ORSC has not yet implemented the same rate (0.7% for local employers and 0.54% for state employers) to the ARP participants. Thus, currently the only participants paying the rate are the OPERS participants of the Member-Directed and Combined plans. It is important to note that when OPERS eliminates the mitigating rate in statute and ceases to charge our own members, OPERS forfeits the ability to collect this amount from the ARP participants, although we are not collecting it currently.

**Issues:** If the OPERS Board wishes to change the mitigating contribution rate, it must take action to make the change effective January 1, 2007 with sufficient time for OPERS staff to notify impacted participants. Thus, the Board needs to make two decisions:

1. Determine the mitigating rate for 2007.
2. Determine the appropriate health care funding level for Member-Directed plan participants.

**Decision 1:** GRS has completed its annual analysis and finalized its Mitigating Contribution Report dated December 31, 2005 (see Attachment A). In their report they note that statute seems to provide the ability to consider the materiality of the impact of the effect of the Member-Directed and Combined plans on the Traditional plan in determining the mitigating rate. The actuary's report reflects the mitigating rate calculated to be 3.5%. However, their report goes on to note that no mitigating rate is actually "necessary" and that in the short term there would be no harm to the Traditional plan.

OPERS General Counsel concurs with GRS' interpretation of the statute and the corresponding basis for the conclusion in GRS' report. Additionally, OPERS staff is beginning work on legislation to eliminate the mitigating rate basis in the statute.

Thus, based on the GRS report and the intended future direction of eliminating the statute language, GRS and staff have proposed the following four options for establishing the mitigating rate for 2007:

**Option 1 – Maintain the current rate.** In this option, the mitigating rate would not change from its current rate (0.7% for local employers and 0.54% for state employers). The employer rate increase scheduled to take effect January 1, 2007 (0.15% for local employers and 0.23% for state employers) would be used to increase the health care funding (health care funding is scheduled to increase 0.5%) and the incremental funding needed to increase the health care funding rate would come from adjusting the component of the contribution rate used to fund pensions. Specifically, the change for local employers and state employers would be as follows:

<b>Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.15%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>0.70%</u>
Total Local Employer Rate	13.70%	13.85%
 <b>State Employer Rate</b>	 <u>Current Rates</u>	 <u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.23%
Health funding	4.50%	5.00%
Mitigating	<u>0.54%</u>	<u>0.54%</u>
Total State Employer Rate	13.54%	13.77%

See Attachment B for a complete table of the local and state rates for each of the three plans under all the options.

The advantage of Option 1 is that it maintains the status quo until such time as the legislation can be changed. Members' pension contribution rates will be minimally impacted (or not impacted, depending on the level of health care funding the Board selects), thereby avoiding additional negative reaction from the Member-Directed participants. The disadvantage of Option 1 is that it does not move the mitigating rate

closer to the full amount determined by the actuary. This option is appropriate if the Board's intention is to eliminate the mitigating rate via legislative changes.

**Option 2 – Eliminate the mitigating rate.** In this option, the mitigating rate would be totally eliminated. The 2006 mitigating rate combined with the employer rate increase scheduled to take effect January 1, 2007 (0.15% for local employers and 0.23% for state employers) would be used to increase the health care funding (health care funding is scheduled to increase 0.5%) and the excess funding would be used to increase the component of the contribution rate used to fund pensions. Specifically, the change for local employers and state employers would be as follows:

<b>Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.85%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>0.00%</u>
Total Local Employer Rate	13.70%	13.85%
 <b>State Employer Rate</b>	 <u>Current Rates</u>	 <u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.77%
Health funding	4.50%	5.00%
Mitigating	<u>0.54%</u>	<u>0.00%</u>
Total State Employer Rate	13.54%	13.77%

See Attachment B for a complete table of the local and state rates for each of the three plans under all the options.

The advantage of Option 2 is that it eliminates the issue with members caused by using a portion of their pension funding for the mitigating rate. Like Option 1, the disadvantage of Option 2 is that it does not move the mitigating rate closer to the full amount determined by the actuary. This option is appropriate if the Board's intention is to eliminate the mitigating rate via legislative changes. However, it is inconsistent based on the statutes as they currently exist.

**Option 3 – Increase current mitigating rate by incremental rate increase.** In this option, the mitigating rate would increase from its current rate (0.7% for local employers and 0.54% for state employers) by the incremental change in the employer rate scheduled to take effect January 1, 2007 (0.15% for local employers and 0.23% for state employers). The amount required to increase the health care funding (health care funding is scheduled to increase 0.5%) would come from adjusting the component of the contribution rate used to fund pensions. Specifically, the change for local employers and state employers would be as follows:

<b>Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.00%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>0.85%</u>
Total Local Employer Rate	13.70%	13.85%
 <b>State Employer Rate</b>	 <u>Current Rates</u>	 <u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.00%
Health funding	4.50%	5.00%
Mitigating	<u>0.54%</u>	<u>0.77%</u>
Total State Employer Rate	13.54%	13.77%

See Attachment B for a complete table of the local and state rates for each of the three plans under all the options.

The advantage of Option 3 is that it moves the mitigating rate closer to the full amount determined by the actuary. The disadvantage of Option 3 is that it will likely create additional dissatisfaction with the members as the contribution percentage allocated to funding pension decreases. This option is appropriate if the Board is not sure if it wants, or will be able, to eliminate the mitigating rate via legislative changes.

**Option 4 – Implement the full actuarial mitigating rate.** In this option, the mitigating rate would increase to the full amount determined by the actuary. The employer rate increase scheduled to take effect January 1, 2007 (0.15% for local employers and 0.23% for state employers) would be used to increase the mitigating rate. The additional amount required above the rate increase plus the additional health care funding (health care funding is scheduled to increase 0.5%) would come from adjusting downward the component of the contribution rate used to fund pensions. Specifically, the change for local employers and state employers would be as follows:

<b>Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	5.27%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>3.58%</u>
Total Local Employer Rate	13.70%	13.85%
 <b>State Employer Rate</b>	 <u>Current Rates</u>	 <u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	5.27%
Health funding	4.50%	5.00%
Mitigating	<u>0.54%</u>	<u>3.50%</u>
Total State Employer Rate	13.54%	13.77%

See Attachment B for a complete table of the local and state rates for each of the three plans under all the options.

The advantage of Option 4 is that it moves the mitigating rate to the full amount determined by the actuary. The disadvantages of Option 4 are that it will create considerable dissatisfaction with the members in the Member-Directed and Combined plans and may not be a viable choice for new members. Additionally, this option does not provide sufficient funding for the Combined plan to be preserved in its current form as the contribution percentage allocated to funding pension decreases. Neither GRS nor staff recommends this option.

Staff recommends either Option 1 or Option 2. GRS prefers Option 1 if the Board believes that it will be successful in achieving the desired statutory change, and Option 3 otherwise. GRS believes that Option 2 is also acceptable under the circumstances.

**Decision 2:** Once the Board has determined the appropriate mitigating rate for 2007, the Board needs to determine if it wishes to maintain the percentage of the contribution rate used to fund health care at the same level between all the plans.

In May 2006, staff surveyed participants of the Member-Directed plan to seek their input regarding the distribution of contributions between funding health care versus pension. The results of this survey were shared with the Board in September 2006. In general, the results indicated the Member-Directed plan participants preferred to fund pension and not increase the amount used to fund health care. (See Attachment C for a summary of the results of the survey).

Presently the percentage of the contribution rate allocated to funding health care is consistent between all three plans. The current contribution rate phase-in schedule reflects a planned increase in the contribution rate percentage allocated to funding health care from 4.5% to 5.0% for the Traditional and Combined plan members effective January 1, 2007. Member-Directed plan members contribute a portion of their contribution rate to a Voluntary Employees Beneficiary Association (VEBA or Retiree Medical Account), which can later be used to pay for qualified health care expenses on a tax-free basis. The Board has the authority to designate this funding at a level that is different from the Traditional and Combined plans.

Because health care is an important component of the Combined and Traditional plans, it is important to note that staff will work with the actuary to develop a methodology to incorporate the health care liability into the cost of purchasing service or transferring from one plan to another.

Attachment B reflects a complete table of the impact of this decision reflected for all plans under each of the options presented in Decision 1 above. The following example reflects the impact under Option 1 (maintain current rate option):

<b>MD Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.65%
Health funding	4.50%	4.50%
Mitigating	<u>0.70%</u>	<u>0.70%</u>
Total Local Employer Rate	13.70%	13.85%

<b>Comb. Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.15%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>0.70%</u>
Total Local Employer Rate	13.70%	13.85%

Staff recommends the Member-Directed plan health care funding be retained at the current 4.5% level based on the feedback obtained from the member survey.

#### **Other Issues To Be Addressed:**

The following issues are related to the mitigating rate issue and will be brought forward to the Board in the coming months.

Administrative Costs: In addition to the mitigating rate, there is also the issue of the start-up and on-going administrative infrastructure costs that result from the creation of the Member-Directed plan, the Combined plan and the VEBA. The funding for these expenses was provided by the Traditional defined benefit plan. Since each of these plans is a separate legal entity, each of the new plans was required to record a liability to reflect the amount owed to the Traditional Pension plan for this funding. Correspondingly, the Traditional Pension plan recorded a receivable due it from each of the new plans. The new plans have made payments on the amounts owed, and interest is charged annually to each of the new plans on any unpaid balance owed to the Traditional Pension plan.

As of December 31, 2005, the Traditional Pension plan was owed \$36,893,598 from the new plans. This liability consists of \$17,100,132 due from the Combined plan, \$18,468,306 due from the Member-Directed plan, and \$1,325,160 due from the VEBA. Please see the attached memo from the May 2006 Board meeting which provides a detailed explanation of the annual activity included as Attachment D.

The original source of funding for repayment of the start-up costs and on-going administrative expenses was intended to be a combination of a 0.10% portion of the member contribution rate (earmarked to fund the administrative costs) and forfeitures from the plans. Plan forfeitures have been significantly less than expected and accordingly, the sources of funding need to be reconsidered.

Originally, it was anticipated that these start-up costs could be repaid over approximately 10 years. However, given the size of the start-up costs, the relatively small number of members in the new plans, and the low amount of forfeitures, GRS and staff agree that it



is reasonable that this liability be amortized over a longer period of time (20 years) similar to the unfunded liabilities of the Traditional Pension plan. Spreading these costs over a longer period of time achieves better inter-generational equity because it avoids forcing the early participants of the defined contribution plans to bear the full burden of creating the administrative infrastructure, an infrastructure that benefits future participants as well. While the Traditional Pension plan is clearly better off with the 10-year amortization period, the amounts of money involved are small when compared with the assets of the Traditional Pension plan and consequently, the funded status of the Traditional Pension plan need not be the only consideration.

As discussed in prior meetings with the Board, staff is currently exploring available options with OPERS tax counsel. The results of this will be brought forward to the Board at a later date. Once those options are evaluated, a proposed plan for addressing the outstanding amounts will be proposed to the Board.

Member Communication: Communicating any Board action regarding the contribution is important to our Member-Directed plan participants. Once the Board determines the mitigating rate and health care funding rate, letters will be mailed to current Member-Directed plan participants and to those new members who are still within their 180-day selection period. The letter will explain the new rates and the rationale for the decision.

Internally, talking points and responses to frequently asked questions will be developed for our Member Services staff and for Citistreet (third-party administration vendor). Additionally, information will also be added to the Internet site.

#### Legislative Changes:

Based on the feedback from this month's Board discussion on the mitigating rate, staff will draft proposed statutory changes. Given that this issue impacts OPERS' members only, staff anticipates that they will be able to effect these changes. As noted previously, the elimination of the mitigating rate eliminates OPERS' ability to collect any contribution from ARP participants. However, OPERS is currently not collecting any contribution from these ARP participants.

#### **Summary**

The Board needs to determine a mitigating rate and health care funding percentage for the Member-Directed plan. Staff has presented four options:

- Option 1 – Maintain the current rate
- Option 2 – Eliminate the mitigating rate
- Option 3 – Increase mitigating rate by incremental rate increase
- Option 4 – Implement the full actuarial mitigating rate

Staff recommends either Option 1 or 2. GRS can support any of the alternatives.

The Board also needs to determine the health care funding percentage for the Member-Directed plan. Staff recommends retaining the health care funding of the Member-Directed plan at the current level of 4.5%.



**OHIO PUBLIC EMPLOYEES  
RETIREMENT SYSTEM  
MITIGATING CONTRIBUTION REPORT  
DECEMBER 31, 2005**

**GRS**

Gabriel Roeder Smith & Company

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November 3, 2006

The Retirement Board  
Ohio Public Employees Retirement System  
Columbus, Ohio

Ladies and Gentlemen:

The results of the *December 31, 2005 annual actuarial valuation* of the Ohio Public Employees Retirement System (OPERS), based upon Chapter 145 of the Code as amended, were presented to the Board on July 17, 2006. That valuation determined the contribution rates and amortization periods related to defined benefits provided by the State, Local Government, and Law Divisions of OPERS.

Each employer's contribution rate depends only on the Division (State, Local Government, Law) to which that employer belongs. In 2007, the rates will be 13.77%, 13.85%, and 17.17% respectively. These contribution rates, when combined with the future increases that the Board has approved, result in a combined amortization period of 20 years. Once OPERS receives contributions from employers, OPERS needs to direct the contributions to the pension and retiree health portions of specific plans (Traditional, Combined, and Member Directed).

The purpose of this report is to provide a recommendation to OPERS for employer contributions by Plan and Division that satisfy the requirements of ORC Section 145.87 related to mitigating negative financial impact of the Combined and Member Directed Plans on the Traditional Plan and that produce the same total contribution rates that were shown in the regular valuation report. We are acting in our capacity as advisors to the OPERS Board, which has fiduciary responsibilities for all of the OPERS plans.

The actuarial assumptions used in the valuations are identical to those that were used in the regular actuarial valuation as of December 31, 2005.

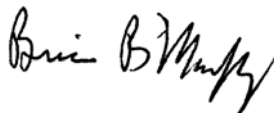
The valuation was completed in accordance with standards of practice prescribed by the Actuarial Standards Board and in conformance with Chapter 145 of the Revised Code of Ohio. To the best of our knowledge, this report is complete and accurate and the actuarial methods and assumptions produced results which are reasonable.

We acknowledge the helpful cooperation of staff with sincere appreciation.

Respectfully submitted,

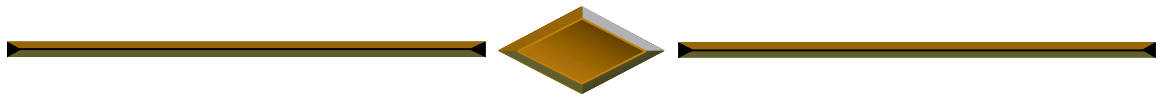


Randall J. Dziubek, A.S.A.



Brian B. Murphy, F.S.A.

## SECTION I



## Development of Mitigating Contribution

## **BACKGROUND**

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Section 145.87 of the Ohio Revised Code provides in part:

“For each member participating in a PERS defined contribution plan, the public employees retirement system shall transfer to the employers’ accumulation fund a portion of the employer contribution required under section 145.48 of the Revised Code. The portion shall equal the percentage of earnable salary of members for whom the contributions are being made that is determined by an actuary appointed by the public employees retirement board to be necessary to mitigate any negative financial impact on the system of members’ participation in the plan.”

Section 24.08 of the Plan Document of the Combined Plan (CP), and Section 21.08 of the Plan Document of the Member Directed Plan (MD) both read as follows:

“All expenses and costs associated with the administration and investments of the Plan shall be assessed against Plan assets, as determined by the Board. Administrative costs shall be explicitly assessed against individual Participant Accounts. Investment costs shall be assessed explicitly against each specific Investment Option in a manner determined by the Board and approved by appropriate federal regulating entities, if necessary.”

There are two important points that we see in the above wordings. First, the mitigating contribution must be made only to the extent that the actuary finds it to be “necessary”. This seems to provide the ability to consider the materiality of the effect of the CP and MD plans on the Traditional Plan, in addition to its absolute magnitude. Second, while administrative costs must be assessed against the CP and MD plans, the assessment does not appear to have to be full and immediate. The Board arguably has the latitude to wait until the MD and CP plans have grown to a size that makes the full assessment of administrative costs practical from a cost per person standpoint. Consequently, we do not deal with administrative expenses in this report. Legal Counsel, of course, would have the final say on the interpretations suggested above.

The mitigating contribution rate is currently set at 0.54% of payroll for State Division and 0.70% of payroll for Local Government, with the total contribution allocated as follows:

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## ACTUARIAL ANALYSIS

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This report envisions a four-step process for determining the contribution rate allocation among the various plans for calendar year 2007:

1. Determine the portion of the contribution rate for CP and MD participants that would have been applied to the unfunded liability contribution if those participants had instead been in the Traditional Plan.
2. Apply judgment to the final result, based upon the latitude provided in the statutes and discussed on page 1 of this report, under “Background”.
3. Assign that amount to the Traditional Plan, and remaining amounts to the MD and CP.
4. Determine the portion of the MD contribution that funds the RMA.

The first step is accomplished by looking at the entry age normal cost of the MD and CP participants and comparing it with the contribution rate. The normal cost figures in the table below were calculated specifically based upon the data for people in the Combined and Member Directed Plans, but based upon the benefits in the Traditional Plan.

**Error! Not a valid link.\*** The Health rate for the Member Directed Plan is shown as 5% for purposes of this discussion only. This rate will be set by the OPERS Board.

The basic mitigating contribution is the figure shown above as the UAAL portion of the contribution rate. That is the amount of unencumbered money that the Traditional Plan would have had if the Combined and Member Directed participants had been in the Traditional Plan. These funds would be applied to the funding of the unfunded liabilities and would have acted to reduce the amortization period. Since the figures are all very close to each other, ***we recommend that the basic mitigating contribution rate be defined to be (approximately) 3.5% of payroll for both plans and both divisions.***

Unfortunately, there are at least two problems with the above result. First, the calculation ignores the effects related to people who have exited the Member Directed Plan in the past. If those people had instead been in the Traditional Plan, at least some of them would have forfeited an employer financed benefit, producing a gain in the operation of the Traditional Plan. This effect is most likely very small at present, but would be difficult to measure. As time passes, the effect will grow in magnitude and become impossible to measure. Second, a mitigating rate at the level discussed above would make the Combined Plan unsustainable, but such a rate appears to be required by Statute in the long term.

The second step is a judgment step that involves considering the materiality and timing of the need for the mitigating contribution. While the Traditional Plan would certainly be better off in the near term if the total mitigating contribution were set at 3.5% of payroll, a mitigating contribution at that level would jeopardize the sustainability of the Combined Plan, while not materially affecting the Traditional Plan one way or the other. A similar result would hold for the Member Directed Plan. Consequently, the Board must weigh competing factors and determine the approach that best meets the needs of all stakeholders while fulfilling fiduciary duties to all plans.

It is important to remember that in terms of assets, the Traditional Plan is currently 500 times the size of the Member Directed and Combined Plans. Nothing that is done in the very short term with regard to the mitigating contribution will have a material effect on the Traditional Plan. *In particular, this means that in terms of Section 145.87, no mitigating contribution is actually “necessary”.* Consequently, if the Board chooses to deal with the mitigating rate gradually over time, we believe that no material disservice is done to the Traditional Plan, and that such action could, in the long run, result in more equitable treatment of people in the Combined and Member Directed Plans.

## RECOMMENDATIONS

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For 2007, we provide four options to the Board. The first option is to retain the mitigating contribution rates used in 2006. The second option is to eliminate mitigating contributions for 2007. The third option is to increase the mitigating rate in accordance with the contribution increase that is scheduled for 2007 in connection with the HCPP. The fourth option is to provide the full mitigating contribution discussed above.

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The employer rates shown under Option 4 for the Combined Plan are actually insufficient to fund the Combined Plan defined benefit. Selection of Option 4 would actually require an exploration of the practicality of taking the mitigating contribution from the *Member's* contribution rate, rather than the employer's.

All of the results on the previous page assume that the contribution into the RMA for Member Directed employees will be 5.00% in 2007. Any of the four options could also be used with a 4.50% contribution into the RMA, allowing an increased pension allocation for the Member Directed Plan. The alternate results under the four options (which only apply to the Member Directed Plan) are as follows:

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The employer rates shown under Option 4 for the Combined Plan are actually insufficient to fund the Combined Plan defined benefit. Selection of Option 4 would actually require an exploration of the practicality of taking the mitigating contribution from the *Member's* contribution rate, rather than the employer's.

Since the effect of this entire issue on the Traditional Plan is very small, we are comfortable with any of the listed options and the alternates.

It is our understanding that significant statutory changes are going to be explored in 2007 which, if enacted, will lead to the complete elimination of the mitigating rate calculation. Therefore, we see the choice among the options as being mostly dependent on the Board's view of the likelihood that the desired statutory changes will, in fact, be enacted. If, in the Board's view, statutory change is highly likely, then we are comfortable with both Options 1 and 2. We would prefer Option 1 in that instance, because it is more consistent with the statutes as they are *presently* written than Option 2. If, on the other hand, the Board thinks there is a high probability that the statutes will survive in their current form for at least another year, we would then choose between Option 3 and Option 4. In that instance, we prefer Option 3 over Option 4 because Option 4 is, in our view, inconsistent with maintaining the Combined Plan in the long term.

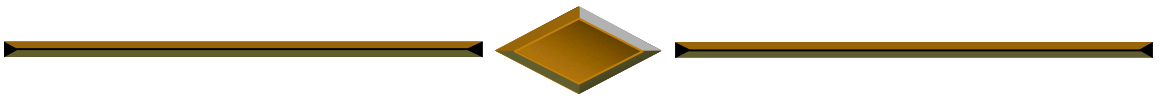
We see the issue of the 5% RMA allocation, versus the alternate 4.5% RMA allocation as largely one of policy, and have no particular recommendation on that point.

## **CONCLUDING REMARKS**

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The Combined and Member Directed Plans are both very small plans that are likely to grow in size over the next several years. Consequently, their effect on the Traditional Plan is small, but the amount of contribution rate shift it takes to undo the effect is relatively large. In the short term, the Combined Plan and Member Directed Plan are likely to grow relative to the Traditional Plan. During the early years of the growth period, required contribution shifts to the Traditional Plan may tend to be large and volatile. Next year's result could be quite different from the results in this report, for example. Statutory changes that are under discussion for 2007 will hopefully deal with this problem.

## **SECTION II**



## **State Division**

**STATE DIVISION  
TRADITIONAL PLAN  
AGE AND SERVICE SCHEDULE**

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**STATE DIVISION  
COMBINED PLAN  
AGE AND SERVICE SCHEDULE**

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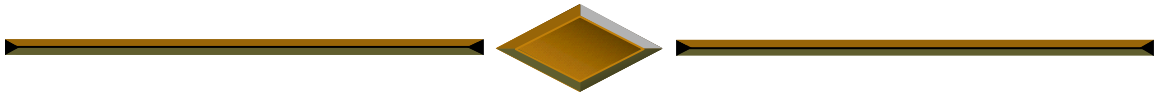


**STATE DIVISION  
MEMBER DIRECTED PLAN  
AGE AND SERVICE SCHEDULE**

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## **SECTION III**



### **Local Government Division**

**LOCAL GOVERNMENT DIVISION  
TRADITIONAL PLAN  
AGE AND SERVICE SCHEDULE**

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**LOCAL GOVERNMENT DIVISION  
COMBINED PLAN  
AGE AND SERVICE SCHEDULE**

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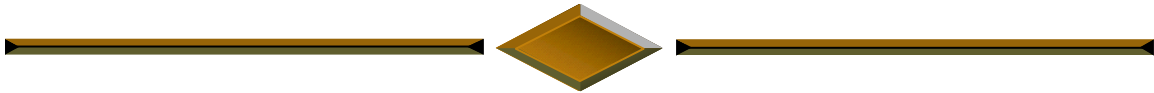
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**LOCAL GOVERNMENT DIVISION  
MEMBER DIRECTED PLAN  
AGE AND SERVICE SCHEDULE**

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## **SECTION IV**



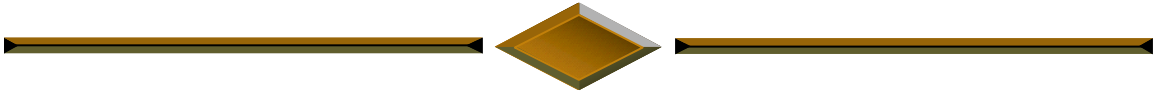
### **Public Safety Division**

**PUBLIC SAFETY DIVISION  
TRADITIONAL PLAN  
AGE AND SERVICE SCHEDULE**

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## **SECTION V**



### **Law Enforcement Division**

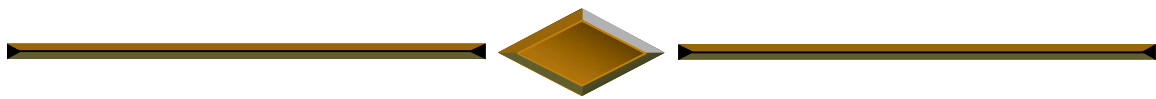


**LAW ENFORCEMENT DIVISION  
TRADITIONAL PLAN  
AGE AND SERVICE SCHEDULE**

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## **APPENDIX**



### **Key Results From Regular Valuation**

**SUMMARY OF PENSION DEFINED BENEFIT VALUATION RESULTS**  
**DECEMBER 31**  
**(\$ IN MILLIONS)**

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\* Based on HCPP schedule of employer and member contribution rates. For GASB purposes, amortization years are determined differently.

## COMMENTS

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*The December 31, 2005 actuarial valuations of members indicate* the following about the portion of employer contribution rates allocated to financing retirement allowances:

- The employer rates are sufficient to fully fund the cost of benefit commitments being made to members for service currently being rendered.
- After satisfying current cost requirements, the remaining portion of the employer rates provides sufficient funds to amortize unfunded actuarial accrued liabilities over a period of 21 years for the System in total.

***Experience.*** The computed amortization period, taking into account Health Care Preservation Plan (HCPP) scheduled increases in contribution rates is 20 years, compared with the 24 year period that had been reported in the December 31, 2004 valuation. This result was primarily due to favorable investment experience for the year ended December 31, 2005. Measured on a market value basis, investment return was over 9%. The market value of assets currently exceeds the funding value by \$3.2 Billion. Based upon the market value of assets, the funded percent would be 94% and the amortization period would be 8 years. Additional information concerning 2005 experience including other sources of gains and losses will be presented in a separate report of gain/loss experience.

***Conclusion.*** Based on the results of the December 31, 2005 regular annual actuarial valuation, it is our opinion that the Ohio Public Employees Retirement System continues to be in sound financial condition in accordance with actuarial principles of level percent of payroll financing.

**OPERS**  
**Mitigating Rate Analysis**  
**2007**

**Decision 1: Determine Mitigating Rate**  
**Local Rate**

Traditional Plan			Member-Directed Plan			Combined Plan	
2006 Current Rate							
2006 Local	Member	Employer	Member	Employer		Member	Employer
Pension	9.00%	9.20%	8.90%	8.50%		8.90%	8.50%
Healthcare		4.50%		4.50%			4.50%
Mitigating				0.70%			0.70%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.00%	13.70%	9.00%	13.70%		9.00%	13.70%
Option 1 - Maintain Current							
2007 Local	Member	Employer	Member	Decision 2 Employer	Employer	Member	Employer
Pension	9.50%	8.85%	9.50%	8.15%	8.65%	9.50%	8.15%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.70%	0.70%		0.70%
Administrative							
DC Payback							
Total	9.50%	13.85%	9.50%	13.85%	13.85%	9.50%	13.85%
Option 2 - Eliminate Mititgating							
2007 Local	Member	Employer	Member	Decision 2 Employer	Employer	Member	Employer
Pension	9.50%	8.85%	9.50%	8.85%	9.35%	9.50%	8.85%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.00%	0.00%		0.00%
Administrative							
DC Payback							
Total	9.50%	13.85%	9.50%	13.85%	13.85%	9.50%	13.85%
Option 3 - Current mitigating rate plus incremental increase in rates							
2007 Local	Member	Employer	Member	Decision 2 Employer	Employer	Member	Employer
Pension	9.50%	8.85%	9.50%	8.00%	8.50%	9.50%	8.00%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.85%	0.85%		0.85%
Administrative							
DC Payback							
Total	9.50%	13.85%	9.50%	13.85%	13.85%	9.50%	13.85%
Option 4 - Full actuarial mitigating rate							
2007 Local	Member	Employer	Member	Decision 2 Employer	Employer	Member	Employer
Pension	9.50%	8.85%	9.40%	5.27%	5.77%	9.40%	5.27%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				3.58%	3.58%		3.58%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.85%	9.50%	13.85%	13.85%	9.50%	13.85%

**OPERS**  
**Mitigating Rate Analysis**  
**2007**

**Decision 2: Determine Health Care Funding Percentage for Member-Directed State Rate**

Traditional Plan			Member-Directed Plan			Combined Plan	
2006 Current Rate							
2006 State	Member	Employer	Member	Employer		Member	Employer
Pension	9.00%	9.04%	8.90%	8.50%		8.90%	8.50%
Healthcare		4.50%		4.50%			4.50%
Mitigating				0.54%			0.54%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.00%	13.54%	9.00%	13.54%		9.00%	13.54%
Option 1 - Maintain Current							
2007 State	Member	Employer	Member	Decision 2		Member	Employer
				Employer	Employer		
Pension	9.50%	8.77%	9.40%	8.23%	8.73%	9.40%	8.23%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.54%	0.54%		0.54%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.77%	9.50%	13.77%	13.77%	9.50%	13.77%
Option 2 - Eliminate Mitigating							
2007 State	Member	Employer	Member	Decision 2		Member	Employer
				Employer	Employer		
Pension	9.50%	8.77%	9.40%	8.77%	9.27%	9.40%	8.77%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.00%	0.00%		0.00%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.77%	9.50%	13.77%	13.77%	9.50%	13.77%
Option 3 - Current mitigating rate plus incremental increase in rates							
2007 State	Member	Employer	Member	Decision 2		Member	Employer
				Employer	Employer		
Pension	9.50%	8.77%	9.40%	8.00%	8.50%	9.40%	8.00%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.77%	0.77%		0.77%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.77%	9.50%	13.77%	13.77%	9.50%	13.77%
Option 4 - Full actuarial mitigating rate							
2007 State	Member	Employer	Member	Decision 2		Member	Employer
				Employer	Employer		
Pension	9.50%	8.77%	9.40%	5.27%	5.77%	9.40%	5.27%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				3.50%	3.50%		3.50%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.77%	9.50%	13.77%	13.77%	9.50%	13.77%

**OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM**  
277 EAST TOWN STREET, COLUMBUS, OH 43215-4642  
1-800-222-PERS (7377)  
www.opers.org

**MEMORANDUM**

**DATE:** September 1, 2006

**TO:** Ohio PERS Retirement Board

**FROM:** Julie Reneau - Director, Benefits Administration  
Maria Roush – Market Research Analyst, Communications  
Michele Kowalik – Manager, Communications

**RE:** V. Discussion Items:  
C. Member-Directed Contribution Preference Survey

**Purpose** – The purpose of this memo is to communicate the results of the *Member-Directed Contribution Preference Survey*.

**Background** – In mid-May, mail surveys were sent to all 4,924 Ohio PERS Member-Directed Plan (M-D) participants to identify their preferences regarding the plan and the allocation of the M-D mitigation rate and contributions. The objectives of the project are to specifically assess preferences on post-retirement health care benefits, retiree medical accounts (RMAs), employer contribution allocations, and mitigation rate levels.

**Findings**

**Post-Retirement Health Care Benefits** - Since M-D Plan participants do not currently have access to OPERS health care insurance upon retirement, they were asked if they would apply for it if OPERS were to provide access to post retirement health care insurance at full cost (2006 non-Medicare base premium rate is \$890 per month, per adult). Almost half (49%) said they would not apply for it; only eight percent said they would, while the remaining 43 percent said they didn't know. Conversely, when asked how important is it to have access to OPERS-sponsored health care insurance upon retirement, thirty-seven percent (37%) of respondents said it is very important (rated 5 or 6 on a scale of 1-6). An additional 20 percent (20%) said that it is important. Therefore, the majority of respondents (57%) said that it is important.

**Retiree Medical Accounts** - More than half of respondents (52%) said they plan to cover retirement health care expenses via Medicare. However, respondents age 18-29 were less likely to say they plan to cover retirement health care expenses via Medicare (only 27% said they would). Another 34 percent of respondents intend to use funds from their RMA accounts. Those most likely to say this are respondents with six to 10 years

of service (50%)\* with 21-30 years until retirement (46%) and those with annual salaries of \$70,000 or more (49%).

Forty percent (40%) of respondents said that the RMA is very important to them. Another 21 percent (21%) said that it is important, indicating that the majority of respondents (61%) believe the RMA is important. Those respondents who said they do not foresee anyone having employer-sponsored health care in retirement (52%), as well as those with six to 10 years of service (63%) and those with annual salaries of \$60,000 to \$69,000 (55%) were more likely to say that the RMA is very important. Comparatively, those respondents who said they don't need the benefits associated with the Traditional Pension Plan/Combined Plan (18%) and those who gave low ratings to the importance of OPERS-sponsored health care (16%), as well as respondents who are 61 years or older (24%) and those who plan to retire in five years or less (20%) were less likely to say that the RMA account is very important.

**Employer Contribution Allocations and Mitigation Rate Levels** - Currently, 8.5% of the employer contribution goes to the member's retirement investment account (RIA) and 4.5% goes to the RMA. M-D participants were asked if they could choose their ideal distribution, what percentage of their employer's contribution would they prefer go into their RIA versus their RMA. The majority of respondents (72%) said the current proportion of employer contributions to their RIA (8.5%) and RMA (4.5%) is either ideal or acceptable. Thirty-one percent said the ideal distribution is 13.0% to their RIA and 0% to their RMA. However, 60 percent of respondents said that any distribution to the RMA ranging from 3.0%-5.5% is ideal.

Finally, knowing that the OPERS Board can change the mitigation rate each year, respondents were asked what mitigation rate percentage would cause them to consider changing their retirement plan from the M-D Plan to either the Combined Plan or Traditional Pension Plan. Almost half (48%) of respondents would consider changing plans when or before the mitigation rate reached 3.0%.

**Next Steps** – No action is required at this time. Some conclusions to consider in the future include:

- Although access to OPERS sponsored health care is important to the majority of M-D Plan participants, only a very small proportion would apply for it at full cost. Therefore, providing health care access to this group should only be considered if the associated cost to do so is nominal.
- Although the majority of M-D Plan participants say the RMA is important, only a third intend to use funds from their RMA accounts to cover retirement health care expenses. Those most likely to use their RMAs have six to 10 years of service with 21-30 years until retirement and annual salaries of \$70,000 or more. Future trend analysis will need to track M-D Plan participants with five years of service or less to assess if their mindsets change as they approach six to 10 or more years of public service. In addition, future analysis on what proportion of M-D Plan participants leave OPERS covered employer before they reach six to 10 years of service will need to be conducted.

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\* Years of service refers to the service credit on record with Ohio PERS, which may not include all time spent in public employment.



- The current employer contribution allocation to the retirement investment account (8.5%) and RMA (4.5%) is acceptable or ideal to the majority of M-D Plan participants; therefore, no changes need to be considered at this time.
- Since no business could afford to lose 20 percent or more of its customer base, it is advisable that the mitigation rate not exceed a little over 1.0% since 15 percent of respondents would consider changing plans at 1.0% and another 19 percent would consider doing so at 2.0%.

In October, the Board will review the actuarial findings from the Contribution Allocation Report with regards to setting the 2007 Defined Contribution mitigating rate.

**OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM**  
277 EAST TOWN STREET, COLUMBUS, OH 43215-4642  
1-800-222-PERS (7377)  
www.opers.org

**MEMORANDUM**

DATE: May 17, 2006

TO: OPERS Retirement Board Members

FROM: Karen Carraher, Director – Finance

RE: **DC Cost Allocation and Repayment**

**Purpose** – To update the Board on the annual costs of administering OPERS' defined contribution plans (Combined Plan, Member-Directed Plan and the Voluntary Employee Beneficiary Association or VEBA) and provide information on the repayment of those costs to the defined benefit plan.

**Background** – Beginning January 1, 2003, as a result of House Bill 628 (HB628), the Ohio Public Employees Retirement System (OPERS) began offering its members three retirement plans:

- Traditional Pension Plan - a defined benefit plan that existed prior to January 1, 2003,
- Member-Directed Plan - a defined contribution (DC) plan, the retiree health portion of which is the VEBA, and
- Combined Plan - a hybrid plan having features of both a defined benefit plan and a defined contribution plan

In order to cover the initial start-up administrative expenses involved with the creation of the new retirement plans, the Member-Directed Plan (including the VEBA) and the Combined Plan, and given the fact that these plans had no assets prior to creation, an "advance" was made from the Traditional Plan (TP) to each of the new plans to cover their start-up costs. Additionally annual operating costs for the years 2003 through 2005 have been advanced by the TP. The plans have made payments towards paying back the advances they received from the TP. A synopsis of the financial history of the three plans along with the balance each plan owes to the TP as of December 31, 2005 is provided below:

	<u>Combined Plan</u>	<u>Member-Directed Plan</u>	<u>VEBA</u>
<b>2002</b>			
Start-up Costs	\$ 3,066,736	\$ 4,100,984	\$ 1,162,730
12/31/02 Balance	\$ 3,066,736	\$ 4,100,984	\$ 1,162,730
<b>2003</b>			
Admin. Exp./Capital Purch.	\$ 5,841,372	\$ 7,527,206	\$ 1,496,776
Less: Repayment	\$ (665,603)	\$ (174,089)	\$ (413,767)
12/31/2003	\$ 8,242,505	\$ 11,454,101	\$ 2,245,739
<b>2004</b>			
Admin. Exp./Capital Purch.	\$ 5,480,617	\$ 4,157,736	\$ 715,470
Less: Repayment	\$ (777,866)	\$ (642,933)	\$ (1,013,506)
12/31/2004	\$ 12,945,256	\$ 14,968,904	\$ 1,947,703
<b>2005</b>			
Admin. Exp./Capital Purch.	\$ 4,707,089	\$ 4,619,937	\$ 913,394
Less: Repayment	\$ (552,213)	\$ (1,120,535)	\$ (1,535,937)
12/31/2005	\$ 17,100,132	\$ 18,468,306	\$ 1,325,160

Plan start-up costs include expenses such as printing and production of member materials, mailing costs, CitiStreet third-party administrator charges, an allocation of IT staff and project costs and an allocation of staff payroll expense for time spent on the project. Ongoing administrative costs reflect the staff time and expenses associated with the ongoing administration of these plans.

Since the funding for these costs were paid out of the Traditional Plan assets, a liability to the Traditional Plan is carried on the books of each of the three new plans (Combined, Member-Directed and VEBA). A corresponding receivable has been established in the Traditional Plan to reflect the funds due it for these start-up and annual costs. Accordingly, interest is charged to each of the new plans for any unpaid balance owed to the Traditional Plan as of the end of each fiscal year.

OPERS worked with tax counsel and the actuary to determine an appropriate interest rate to charge on the unpaid balance. Both tax counsel and the actuary recommend interest should be charged at a rate appropriate for a secure, virtually no-risk, short or mid-term investment. As such, they have recommended using a 10-year T-bill rate with a duration that approximated the originally anticipated repayment. Accordingly, OPERS is charging interest on the outstanding balance as of the beginning of the year at a rate of 4.25%, which approximates the ten-year T-bill rate as of December 31, 2004. Since the effective date of the new plans was January 1, 2003, interest is being charged

from that date, calculated with simple interest at the end of each year. The interest on the outstanding balance is included in each year's administrative expenses.

The initial analysis at the inception of the three new plans indicated that the sources of funds to be used for repayment would be sufficient to repay the debt within ten years. After the first two years of operation and initial start-up costs, GRS and staff lowered the enrollment estimates and forfeitures to more accurately reflect actual experience. OPERS staff have had exploratory discussions with tax counsel regarding the implications of collapsing the three separate plans into a single plan with three options. While this option would allow the elimination of the requirement of charging each of the separate plans for the expenses on a stand-alone basis, there are issues regarding the determination of the tax status. Based on these discussions, which included tax counsel, OPERS actuary and OPERS auditors, it was originally agreed that OPERS would re-evaluate the issue after the plans had time to mature. A preliminary re-evaluation timeframe of five years from the plans' inception was established.

#### **Next Steps**

OPERS staff have begun exploring options to addressing this issue. Staff has mailed a questionnaire to all participants in the Member-Directed plan to determine participants' interest in health care and their preferences in allocation of contribution percentages and willingness to accept administrative fee increases. Staff has also begun exploring increasing the investment fee charged to participants. In the coming months staff will be providing details on various options for generating sufficient revenues to satisfy the DC plans' obligations to the Traditional Plan and other options including collapsing the plans into one.

# Mitigating Contribution Rate

OPERS Board

November 15, 2006



# Requested Actions

1. To establish the “mitigating rate” for the Member-Directed and the Combined plans for 2007
2. To establish the contribution rate percentage allocated to fund health care (either 4.5% or 5%)
3. To clarify the Board’s preference to eliminate mitigating rate or not (legislation required to eliminate).



# Mitigating Rate

- Section 145.87 of the Ohio Revised Code
- Negative financial impact on the Traditional plan
  - 3.5% of payroll for both the Member-Directed and Combined plans
  - No definition of “negative financial impact” in statute
  - GRS calculation approximates mitigating rate equal to the contribution rate that would have been applied to fund the unfunded liability
  - More exact calculation is unsustainable



# History

- Initial mitigating rate determined by the Board in December 2005.

		<u>Combined Plan</u>	<u>Member-Directed Plan</u>
• Initial 2006 mitigating rate:	State	0.54%	0.54%
	Local	0.70%	0.70%

- Board expressed interest in seeking legislation to eliminate the mitigating rate
- No fee currently charged to ARP participants
- May 2006 survey of Member-Directed participants as to pension/health care funding preferences





# Action 1:

OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM

## Determining Mitigating Rate

- UAAL portion of rate
- GRS calculation of full actuarial mitigating rate is 3.5% of payroll
- 4 options suggested for Board consideration
  1. Maintain current rate
  2. Eliminate mitigating rate
  3. Increase current mitigating rate by incremental rate increase
  4. Implement full actuarial mitigating rate



# Options

## Option 1 ~ Maintain Current Rate

<b>Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.15%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>0.70%</u>
Total Local Employer Rate	13.70%	13.85%

<b>State Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.23%
Health funding	4.50%	5.00%
Mitigating	<u>0.54%</u>	<u>0.54%</u>
Total State Employer Rate	13.54%	13.77%

**Advantages:** Maintains status quo while allowing time for OPERS to seek legislation to eliminate or modify mitigating rate. Members' pension rates minimally impacted.

**Disadvantages:** Does not move mitigating rate closer to full actuarial mitigating rate.



# Options

## Option 2 ~ Eliminate Mitigating Rate

<b>Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.85%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>0.00%</u>
Total Local Employer Rate	13.70%	13.85%

<b>State Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	8.77%
Health funding	4.50%	5.00%
Mitigating	<u>0.54%</u>	<u>0.00%</u>
Total State Employer Rate	13.54%	13.77%

Advantages: Eliminates issue with members.

Disadvantages: Does not move mitigating rate closer to full actuarial mitigating rate.



# Options

## Option 3 ~ Increase rate by incremental rate increase

**Local Employer Rate**Current RatesNew Rates Effective 1/1/07

Pension funding	8.50%	8.00%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>0.85%</u>
Total Local Employer Rate	13.70%	13.85%

**State Employer Rate**Current RatesNew Rates Effective 1/1/07

Pension funding	8.50%	8.00%
Health funding	4.50%	5.00%
Mitigating	<u>0.54%</u>	<u>0.77%</u>
Total State Employer Rate	13.54%	13.77%

Advantages: Moves mitigating rate closer to full actuarial mitigating rate.

Disadvantages: Likely to create member dissatisfaction.



# Options

## Option 4 ~ Implement full actuarial mitigating rate

<b>Local Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	5.27%
Health funding	4.50%	5.00%
Mitigating	<u>0.70%</u>	<u>3.58%</u>
Total Local Employer Rate	13.70%	13.85%

<b>State Employer Rate</b>	<u>Current Rates</u>	<u>New Rates Effective 1/1/07</u>
Pension funding	8.50%	5.27%
Health funding	4.50%	5.00%
Mitigating	<u>0.54%</u>	<u>3.50%</u>
Total State Employer Rate	13.54%	13.77%

**Advantages:** Moves mitigating rate to full actuarial mitigating rate.

**Disadvantages:** Likely to create member dissatisfaction.  
Does not provide sufficient funding for pension.  
Not a viable option.



# Central Decision in Evaluating Options

- What is the Board's intention for the mitigating rate?
- If the Board wants to eliminate the mitigating rate:
  - Option 1
  - Option 2
- If the Board does not want to eliminate the mitigating rate or believes it will not be successful with legislation:
  - Option 3

# Recommendations

- Staff prefers Option 1 or 2
- GRS prefers Option 1 if Board believes it will be successful in achieving the desired statutory outcome ~ otherwise Option 3 or Option 2

## Decision 2

Determine the contribution rate allocated to fund health care for the Member-Directed Plan





	Traditional Plan		Member-Directed Plan			Combined Plan	
2006 Current Rate							
2006 State	Member	Employer	Member	Employer		Member	Employer
Pension	9.00%	9.04%	8.90%	8.50%		8.90%	8.50%
Healthcare		4.50%		4.50%			4.50%
Mitigating				0.54%			0.54%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.00%	13.54%	9.00%	13.54%		9.00%	13.54%
Option 1 - Maintain Current							
2007 State	Member	Employer	Member	Decision 2		Member	Employer
				Employer	Employer		
Pension	9.50%	8.77%	9.40%	8.23%	8.73%	9.40%	8.23%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.54%	0.54%		0.54%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.77%	9.50%	13.77%	13.77%	9.50%	13.77%
Option 2 - Eliminate Mitigating							
2007 State	Member	Employer	Member	Decision 2		Member	Employer
				Employer	Employer		
Pension	9.50%	8.77%	9.40%	8.77%	9.27%	9.40%	8.77%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.00%	0.00%		0.00%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.77%	9.50%	13.77%	13.77%	9.50%	13.77%



	Traditional Plan		Member-Directed Plan			Combined Plan	
2006 Current Rate							
2006 State	Member	Employer	Member	Employer		Member	Employer
Pension	9.00%	9.04%	8.90%	8.50%		8.90%	8.50%
Healthcare		4.50%		4.50%			4.50%
Mitigating				0.54%			0.54%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.00%	13.54%	9.00%	13.54%		9.00%	13.54%
Option 3 - Current mitigating rate plus incremental increase in rates							
2007 State	Member	Employer	Member	Decision 2		Member	Employer
				Employer	Employer		
Pension	9.50%	8.77%	9.40%	8.00%	8.50%	9.40%	8.00%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				0.77%	0.77%		0.77%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.77%	9.50%	13.77%	13.77%	9.50%	13.77%
Option 4 - Full actuarial mitigating rate							
2007 State	Member	Employer	Member	Decision 2		Member	Employer
				Employer	Employer		
Pension	9.50%	8.77%	9.40%	5.27%	5.77%	9.40%	5.27%
Healthcare		5.00%		5.00%	4.50%		5.00%
Mitigating				3.50%	3.50%		3.50%
Administrative			0.10%			0.10%	
DC Payback							
Total	9.50%	13.77%	9.50%	13.77%	13.77%	9.50%	13.77%



Traditional Plan			Member-Directed Plan			Combined Plan		
2006 Current Rate								
2006 Local	Member	Employer	Member	Employer		Member	Employer	
	Pension	9.00%	9.20%	8.90%	8.50%	8.90%	8.50%	
	Healthcare		4.50%		4.50%		4.50%	
	Mitigating				0.70%		0.70%	
	Administrative			0.10%		0.10%		
	DC Payback							
	Total	9.00%	13.70%	9.00%	13.70%	9.00%	13.70%	
Option 1 - Maintain Current								
2007 Local	Member	Employer	Member	Decision 2		Member	Employer	
				Employer	Employer			
	Pension	9.50%	8.85%	9.50%	8.15%	8.65%	9.50%	8.15%
	Healthcare		5.00%		5.00%	4.50%		5.00%
	Mitigating				0.70%	0.70%		0.70%
	Administrative							
	DC Payback							
Total	9.50%	13.85%	9.50%	13.85%	13.85%	9.50%	13.85%	
Option 2 - Eliminate Mititgating								
2007 Local	Member	Employer	Member	Decision 2		Member	Employer	
				Employer	Employer			
	Pension	9.50%	8.85%	9.50%	8.85%	9.35%	9.50%	8.85%
	Healthcare		5.00%		5.00%	4.50%		5.00%
	Mitigating				0.00%	0.00%		0.00%
	Administrative							
	DC Payback							
Total	9.50%	13.85%	9.50%	13.85%	13.85%	9.50%	13.85%	



Traditional Plan			Member-Directed Plan			Combined Plan		
2006 Current Rate								
2006 Local	Member	Employer	Member	Employer		Member	Employer	
	Pension	9.00%	9.20%	8.90%	8.50%	8.90%	8.50%	
	Healthcare		4.50%		4.50%		4.50%	
	Mitigating				0.70%		0.70%	
	Administrative			0.10%		0.10%		
	DC Payback							
	Total	9.00%	13.70%	9.00%	13.70%	9.00%	13.70%	
Option 3 - Current mitigating rate plus incremental increase in rates								
2007 Local	Member	Employer	Member	Decision 2		Member	Employer	
				Employer	Employer			
	Pension	9.50%	8.85%	9.50%	8.00%	8.50%	9.50%	8.00%
	Healthcare		5.00%		5.00%	4.50%		5.00%
	Mitigating				0.85%	0.85%		0.85%
	Administrative							
	DC Payback							
Total	9.50%	13.85%	9.50%	13.85%	13.85%	9.50%	13.85%	
Option 4 - Full actuarial mitigating rate								
2007 Local	Member	Employer	Member	Decision 2		Member	Employer	
				Employer	Employer			
	Pension	9.50%	8.85%	9.40%	5.27%	5.77%	9.40%	5.27%
	Healthcare		5.00%		5.00%	4.50%		5.00%
	Mitigating				3.58%	3.58%		3.58%
	Administrative			0.10%			0.10%	
	DC Payback							
Total	9.50%	13.85%	9.50%	13.85%	13.85%	9.50%	13.85%	



# Recommendations

Staff recommends Member-Directed plan health care funding be retained at 4.5% based on feedback obtained from member survey

## Other Issues

- Administrative costs
- Member communication
- Legislative changes