Ohio Public Employees Retirement System

OPERS

September 4, 2009 Delivered via E-mail transmission

The Honorable Todd Book, Chairman
The Honorable Kirk Schuring, Vice Chairman
The Honorable Keith Faber
The Honorable Sue Morano
The Honorable Lynn Wachtmann
The Honorable Dan Dodd
Mr. Doug Gillum
Mr. Richard Murray
Mr. Dale Van Vyven
Ohio Retirement Study Council
88 East Broad St. Suite 1175
Columbus, OH 43215

Dear Chairman Book, Vice Chairman Schuring, and members of the Ohio Retirement Study Council,

On behalf of the Board of Trustees of the Ohio Public Employees Retirement System, I am responding to your request for the submission of a plan to ensure the Ohio Public Employees Retirement System (OPERS) retains its funding within the 30-year statutory requirement. It is important to note that OPERS is currently within the 30-year limit mandated by statute. Consistent with our fiduciary duties, OPERS has a history of proactively managing the system to provide retirement security for our members and retirees and staying within the requirements of Ohio law. We see your request and any legislation enacted as another step toward ensuring the long-term sustainability of our system. In the remainder of this letter I will attempt to put this discussion in an historical perspective, discuss our funded status and outline our recommended plan.

Before sharing our approach to your request and our proposed plan, let me thank each member of the Council for your unanimous opposition to the recent proposal to reduce state contributions to OPERS by 43% for two years and repay them over 10 years. If approved, this reduction in contributions would have seriously threatened the retirement security of our members and retirees. Your support of OPERS members and retirees is greatly appreciated and can really be considered a critical first step in the plan you have requested from us.

Historical Context

At least two of the Ohio public pension funds and a number of other state public pension funds were established prior to the creation of Social Security. While the bill which created the Public Employees Retirement System was signed on June 30, 1933, the effort to create a public pension entity began as early as 1925. This historical reference demonstrates the commitment by the Ohio General Assembly and by the OPERS Board of Trustees of over 70 years of ensuring that public workers (and their dependents) are provided secure pension benefits after they retire. Coming directly from the hardships of the Great Depression, a period of time that took its toll on our nation and all Ohioans, the members of the General Assembly devised a system of retirement benefits to provide much needed economic stability and security. State employees began making their first contributions in 1935 and since that time, additional public entities have requested authority to become a part of OPERS. Today, the Fund supports over 936,000 members and retirees and paid out approximately $5.0 billion in benefits during 2008. In these difficult economic times, the OPERS mission is as important today as it was in 1933. We have weathered all sorts of difficulties since 1933. Through prudent and proactive management we will continue to ensure the retirement security of our members and retirees.

Management Approach and Funded Status

The OPERS Board of Trustees and staff have a long history of proactively addressing issues as evidenced by the many incremental changes to OPERS' pension and health care plans through the years. The Board has modified the benefit plans, added benefits, and/or changed or restructured pension benefits to maintain the solvency of the fund. Recent examples of this include:

- increasing the portion of funding from employers that is dedicated to pensions to ensure that OPERS is within the statutorily mandated 30-year funding level (March 2009);
- approving a new asset allocation strategy to improve our ability to make the annual investment return of 8% (June 2009);
- proposing an increase in the cost of purchasing service credit to reflect its true cost (October 2007);
- proposing statutory changes to increase the minimum earnable salary required to earn full-time service credit (May 2009);
- proposing statutory changes to the system's disability program (July 2009); and,
- initiating a separate investment strategy for health care and shifting a larger percentage of the cost to users of the benefit (2004).

As of December 31, 2007, OPERS was 96% funded. Due to the investment losses brought on by the unprecedented market declines in 2008, OPERS was 75% funded on December 31, 2008. Due to the conservative method of recognizing gains and losses, we have recognized about 75% of the 2008 loss. Based on the most recent investment information available as of the date of this letter, OPERS' year-to-date investment return is over 10%.

OPERS Plan

We began work on the most recent set of initiatives in July 2008 as part of a thorough review of our benefits. This review considered the changing demographics of our members as well as the funded status of the system. Since that time, the Board has considered and deliberated on many of the initiatives included in this plan and has approved staff working with the ORSC and members of the General Assembly to seek statutory changes. The Board has also deliberated on the plan design changes requested by ORSC staff. Our plan reflects the combination of both efforts.

In preparing the plan we have established dual goals of (1) adopting sufficient changes to ensure OPERS funding will remain within the required statutory 30-year limit through at least 2012, and (2) providing sufficient funding to allow OPERS to continue to provide meaningful health care to its members. Making the necessary changes to ensure OPERS remains within the 30-year limit through 2012 should allow sufficient time for the investment markets to recover from the 2008 investment market downturn.

Utilizing various estimates of near term investment returns, we established a target of reducing the System's liabilities by $4-$8 billion through plan design changes, which will allow OPERS to stay within the 30-year funding requirement through 2012
Our proposed plan to meet these goals is as follows:

- Purchase Service Credit – modify the formula for service credit purchases to be actuarially neutral rather than subsidized by the System participants.
- Minimum Earnable Salary – increase the minimum earnable salary eligible for full service credit to $1,000 per month with lesser amounts pro-rated.
- Membership Determination statute of limitations – establish a 5-year limit for individuals to initiate a membership determination.
- Board authority to establish the mitigating rate – provide the Board rather than the actuary the authority to establish the mitigating rate.
- Disability program changes to assist disabled recipient returning to work.
- Increase the retirement eligibility age by 2 years for all divisions
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  Specific recommendations are:
  - *General division* – Unreduced retirement available at age 67 with 5 years of service or at any age with 32 years. Reduced retirement available at age 62 with 5 years of service or age 57 with 25 years of service. The minimum age to retire and be eligible for health care would be 55.
  - *Law and Public Safety Division* – These divisions represent only 2.3% of active members. We recommend increases in the age of retirement but the ORSC may wish to consider consistency with changes made in the Ohio Police & Fire and Highway Patrol retirement ages.
- Modify the formula benefit for members of the general division to require 35 years of service before the formula increases to 2.5%.

- Modify the Cost of Living increase to equate to CPI, not to exceed 3%.
- Modify the final average salary calculation to be based on a 5-year average salary with annual increases limited to 10% (anti-spiking provision).
- Modify early retirement age reduction factors to be actuarially neutral rather than subsidized.
- Eliminate the minimum benefit calculation.
- Require intersystem transfers to be actuarially neutral rather than subsidized.
- Limit retroactivity of benefits for inactive participants to within 90 days of application receipt.
- Require members hired after the date of legislation to automatically be enrolled in the new plan (no transition).

The above plan is estimated to reduce the System's liabilities by $4.9 billion and 22 amortization years which are within the goals we set.

How we transition to this new plan will be important. We are not yet proposing a specific schedule but will work with our Board and the ORSC on a transition schedule which ensures adequate notice to our members. . For the purpose of the estimates used in our plan, we assumed a 5-year transition period following the date of the legislation, with some select components eligible for a more phased in implementation schedule.

Finally, the issue of stakeholder input when making benefit changes is an important part of garnering support and understanding. OPERS has a successful history of education and communication with members and retirees prior to benefit plan changes. Due to the short time-frame for the discussion of the ORSC-related proposals, the opportunity for robust discussion with our members and retirees and all the interested parties has been limited. We intend to continue this process during the coming months. We ask that the ORSC be open to hearing ideas that come from this process.

In closing, the Board will continue to work on refining its plan as the ORSC continues its deliberations. We thank the ORSC for its efforts. Working in a collaborative manner we will ensure appropriate and necessary changes are enacted that will benefit the members of OPERS and ensure the long-term strength of the fund.

Respectfully submitted,

Chris DeRose

Chris DeRose
Chief Executive Officer

c: Ken Thomas, Chairman, OPERS Board of Trustees
Cinthia Sledz, Vice Chairman, OPERS Board of Trustees
OPERS Board of Trustees
Aristotle Hutras, Executive Director, Ohio Retirement Study Council
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Ohio Public Employees Retirement System

September 2009

OPERS

All of Ohio's public pension systems, including OPERS, have been asked by the Ohio Retirement Study Council (ORSC) to look at a number of options that could help contain costs and strengthen their funds in light of the recent economic challenges.

As fiduciaries, the OPERS Board of Trustees and staff have a well-developed planning process that proactively manages the system to ensure long-term solvency. Proactive, insightful planning and timely decisions by the OPERS Board allow the fund to weather market volatility. This results in incremental changes over time.

For example, in recent years, OPERS has

- initiated a separate investment strategy for health care and shifted a larger percentage of the cost to users of the benefit (2004);
- increased the portion of funding from employers that is dedicated to pensions to ensure that OPERS is within the statutorily mandated 30-year funding level (March 2009);
- approved a new asset allocation strategy to improve our ability to make the annual investment return of 8% (June 2009);
- proposed increasing the cost of purchasing service credit to reflect its true cost (October 2007);*
- proposed statutory changes to increase the minimum earnable salary required to earn full-time service credit (May 2009)*; and,
- approved proposing statutory changes to the system's disability program (July 2009).*

* *requires the passage of legislation in the Ohio General Assembly*

With the passage of legislation by the Ohio General Assembly, these changes will allow OPERS to remain within the 30-year funding requirement.

Each System has a unique population and benefit structure, and OPERS' Board has evaluated options, as requested by ORSC, and considered what changes should be made. Consistent with their proactive approach to plan design by making incremental changes over time, the OPERS Board has discussed the following possible plan design change options, and will continue to evaluate plan design change options at its upcoming meetings.

Age & Service Eligibility – add two years to the current plan

Benefit Formula – maintain the current 2.2% x Final Average Salary (FAS) but increase the timeframe that the multiplier increases to 2.5% from 30 years of service to 35

Final Average Salary (FAS) – increase base FAS from the three highest years of earnings to the five highest years

Cost of Living Adjustment (COLA) – Maintain current 3% simple COLA except in years when the Consumer Price Index is less than 3%

Contribution Rate – No change in the current contribution rates, Members (10%) and Employers (14%)