PRELIMINARY ANALYSIS
PUBLIC EMPLOYEES RETIREMENT SYSTEM PROPOSAL
79th Oregon Legislative Assembly – 2017 Regular Session

This form provides an outline for the preliminary analysis of proposals submitted to the Senate Committee on Workforce to address the rising costs and long-term sustainability of the Public Employees Retirement System (PERS). A technical team, including but not limited to individuals from Legislative Counsel, Legislative Fiscal, and PERS, will analyze each proposal under the following criteria for the Committee's consideration.

- Constitutionality
- Order of Magnitude in Savings
- Actuarial Soundness
- Impact on Employer Contribution Rates
- Impact on State and Local Budgets
- Impact on Public Employee Benefits
- Impact on public Employee Workforce
- Equitability of Costs & Benefits to Public Employees
- Administrative Feasibility

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Measure Numbers/LC (if any): Senate Bill 560 as introduced.

Summary of Proposal: $100,000 cap on Final Average Salary used in pension benefit calculations and redirection of 6% member contribution from the IAP account to new member pension accounts.

Summary of Current Law: The 6% member contribution is currently made to an account in the Individual Account Program and paid as an account-based benefit to the member at retirement. The current cap on salary used for the purpose of calculating FAS parallels federal law.

PERS/Legislative Fiscal – There is currently a limit to the FAS for Tier Two and OPSRP members, who are subject to Internal Revenue Code Section 401(a)(17), which is $265,000 in 2016 and indexed with inflation in future years (increased to $270,000 for 2017). ORS 238A.330 requires a uniform six percent mandatory employee contribution to the IAP. The IAP has no unfunded liability and is not included in actuarial valuations because IAP assets are not available to pay a defined pension benefit.

Has a detailed actuarial analysis been completed for this proposal? Yes.

LFO – Milliman has completed an actuarial analysis dated October 28, 2016 ($100,000 FAS) and December 31, 2016 (6% redirect). Both are based on December 31, 2015 valuation. However, the Milliman analyses are not specifically based on SB 560, but rather the concept of limiting the FAS to $100,000 and the IAP redirect. In the absence of an actuarial analysis for SB 560, LFO is relying on the two actuarial documents.

ANALYSIS

The analysis should address each of the following criteria to the extent that information is available.

1. **Constitutionality**
   Legislative Counsel – Application of the cap on final average salary to years after January 1, 2018, appears to meet the Moro standard for protection of accrued benefits.

   Note, however, that Greg Hartman mentioned in his testimony an argument that the bill does not protect accrued benefits. As we understand the argument from his brief comment, a members would argue that to protect accrued benefits, the bill should apply the current final average salary calculation, regardless of when the salary was earned, to benefits accrued before the change. In a simplified example, if a member was earning $90,000 today and had worked 10 years, and at the end of the member's career the member was earning $150,000, the member would argue that the member should have the $150,000 final average salary applied to 10 years of the member's service.

   The counter to this argument would be that the member has not yet completed the performance necessary to accrue the benefit of the $150,000 final average salary. That view seems to be in accord with the opinion in Moro, but it is difficult to predict the outcome in the Supreme Court.

   Redirection of employee contributions to pay for benefits accrued on and after January 1, 2018, appears to meet the Moro standard for protection of accrued benefits, but the bill does not explain how to determine what benefits are accrued before and after January 1, 2018. Thus, the bill could be unconstitutional in application.

2. **Order of Magnitude in Savings (for next three biennia, if possible)** –
   PERS – See the referenced Milliman letters for reductions in liability that would result from these concepts. Please note that 2017-19 employer contribution rates have already been adopted, and those rate increases were limited by the PERS Board's rate collar policy. Cost reductions from this concept would be carried over to future biennia when the collar is fully implemented absent specific

direction from the legislature to apply those savings in the next cycle. Doing so would postpone the full implementation of non-collared rates.

LFO – The measure, if it were to become law, would generate system-wide employer rate savings beginning in the 2017-19 biennium. A preliminary estimate of these savings for the 2017-19 biennium is $1.4 billion total funds; however, savings may be reduced or eliminated if the measure is successfully challenged in court, modified through collective bargaining or grievance arbitration, or subsumed by the PERS Board rate collar policy.

3. **Actuarial Soundness** –
PERS – Within the context of whether this concept would, over the time period considered, allow projected employer contributions and investment income to fully fund the system, this concept would reduce that period (or lower costs during that period) as it reduces the benefits to be paid.

4. **Impact on Employer Contribution Rates (for next three biennia, if possible, including normal costs, unfunded actuarial liability (UAL), Individual Account Program/employee contributions, state agencies, school districts, and other PERS employers)** –

PERS - See the comment about the current employer rate setting cycle and implementation of the PERS Board's rate collar.

LFO – According to the Milliman actuarial analysis of this concept for the change to the final average salary, the normal cost rate for employers statewide would be reduced by 1.30% and the Unfunded Accrued Liability rate by 1.55% for a total uncollared rate reduction of 2.85%. The average system-wide employer rate would decline from 29.08% to approximately 26.23%.

According to the Milliman actuarial summary of this concept for re-directing member contributions, the normal cost rate for employers statewide would be reduced by 4.5% to the uncollared rate (the Milliman summary incorrectly shows the 2017-19 biennial impact as 6% rather than 4.5% for 18-months of the biennium) The average system-wide employer rate would decline from 29.08% to approximately 24.58%. In other words, the 4.5% redirect would begin to be used to pay a portion of an employee's normal cost with the employer paying the balance. The change does not reduce accrued liabilities or affect retiree benefits, but provides an additional funding source for the cost of new benefits earned by active members going forward.

5. **Impact on State and Local Budgets (cost savings and cost shifts, impact on General/Lottery Fund, and potential financial impact on collective bargaining**) –
PERS - See the comment about the current employer rate setting cycle and implementation of the PERS Board's rate collar.

   LFO – A preliminary estimate of the ***gross*** General/Lottery Fund savings for the 2017-19 biennium for state government and related to the ***$100,000 final average salary limitation*** is approximately $166.3 million for the final average salary change; however, savings may be reduced or eliminated if the measure is successfully challenged in court, modified through collective bargaining or grievance arbitration, or subsumed by the PERS Board rate collar policy.

   LFO – A preliminary estimate of the gross General/Lottery Fund savings for the 2017-19 biennium for state government and related to the ***redirect of the employee contribution*** is approximately $468. million; however, savings may be reduced or eliminated if the measure is successfully challenged in court, modified through collective bargaining or grievance arbitration, or subsumed by the PERS Board rate collar policy.

6. **Impact on Public Employee Benefits (Tier 1, Tier 2, Oregon Public Service Retirement Plan (OPSRP))** –
PERS – As to the $100,000 FAS limit, the average salary of state and school employees is approximately $56,000, and the average FAS for retirees in 2015 was approximately $72,000. The savings generated by this concept are mostly reflective of the assumption that those averages will increase at 3.5% each year so that, within a decade or two, the average public employee's salary will be constrained by that limit, reducing the benefit liability for those outer years to a large number of PERS members.

   The 6% redirection of member contributions generally will not change the amount of pension benefits the member ultimately receives. However, member accounts in the IAP will not grow with the 6% contribution of annual salary (but will continue to be subject to market earnings or losses while held by PERS). The ultimate affect that has on a member's IAP benefit depends on how many years that member was still planning to work before retiring or withdrawing their IAP balance.

   LFO – While, initially, the $100,000 limit impacts higher paid employers, including Tier 1 and Tier 2 active and inactive members, the $100,000 limit is not indexed to inflation and therefore, over time, will impact an increasing number of OPSRP members. The employees contribution redirect would impact all active member;

however, the IAP is much more important for funding the retirement benefit of OPSRP members.

7. **Impact on Public Employee Workforce (rate of retirements, employers' ability to recruit and retain employees)** –
   PERS - While no one can reliably predict this impact, we would note that, as of December 31, 2016, over 32% of non-retired members across all Tiers and employer groups (70,335 of 219,220) were eligible to retire based on age or years of service. This concept as drafted would reduce member's IAP benefits because of the 6% redirection. Also, the $100,000 cap may challenge employers recruiting for positions where salaries exceed that amount.

8. **Equitability of Costs and Benefits to Public Employees (costs/benefits)** –
   LFO – The measure would have a disproportionate impact on PERS members, both active members and new members, with PERS-eligible compensation of $100,000 or more. Additionally, the measure would impact only the Full-Formula calculation and not Money Match. The measure may have a disproportionate impact on police and firefighters and other PERS-eligible employees who have a large portion of their PERS-eligible compensation based on overtime. The 6% redirect would affect both employee-paid and employer-paid contributions.

9. **Administrative Feasibility** –
   PERS - There will be a fiscal impact to the agency to reprogram benefit calculation software to accommodate the $100,000 FAS limit. Also, we will need to design and implement an account administration structure to track these new accounts, credit earnings or losses annually, and then distribute them or transfer them to offset pension costs as circumstances warrant. Additionally, the agency will revise member education material in all formats to reflect provisions of the measure.

   LFO – LFO does not have sufficient information at this time to respond to this question; however, the measure is assumed to have a fiscal impact on the operational budget of PERS for costs associated with implementing the measure (e.g., information technology), as well as possible legal costs.

Technical Issues of Note:
PERS - PERS has submitted technical amendments to resolve some known issues on the statutory construct of the IAP redirection and its use in benefit payment scenarios like withdrawals and pre-retirement deaths.

Legislative Fiscal – The measure may require clarification to ensure that budgetary savings begin with the 2017-19 biennium and reduce the recalculated 2017-19 employer contribution rates adopted by the PERS Board. Also, a more complete fiscal analysis will be prepared as the measure advances through the legislative process.