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Budget Implications if the Supreme Court Overturns PERS Reforms

Questions have been raised about the consequences to the state's budget if statutory Public Employee Retirement System (PERS) reform of retirees' cost-of-living adjustment (COLA) and the out-of-state tax provision were to be overturned in their entirety by the Oregon Supreme Court.

Executive Summary

If the PERS Board follows its normal employer rate setting cycle, the Supreme Court's reversal of PERS reforms would not increase the currently projected PERS employer costs for the 2015-17 biennium. Rather, the liability increase from restoring these benefit payments would be normally reflected when the PERS Board adopts employer contribution rates for the 2017-19 biennium.

A Supreme Court reversal of PERS reforms is estimated to add 5.5% to employer contribution rates for the 2017-19 biennium and increase PERS costs by an estimated $319 million for state agencies and $358 million for school districts. Local governments could experience a similar 5.5% increase in rates.

Legislative Benefit Reform

The Legislature in 2013 (regular session and September/October special session) enacted SB 822 and SB 861, respectively. In general, the measures reduced the cost-of-living adjustment for all retirees and eliminated tax remedy payments for benefit recipients who are not subject to Oregon state income tax because they do not reside in Oregon. The net reduction in system-wide accrued liabilities (as of December 31, 2011) was approximately $5 billion, with a corresponding 4.4% of payroll reduction to employer rates. The 2013-15 system-wide savings was approximately $800 million total funds (General, Lottery, Other, and Federal).

Repayment of COLA and Tax Remedy (2015-17 biennium)

The first consequence of the Supreme Court overturning the law would be that retirees who did not receive the full COLA during the 2013-15 biennium or had their tax remedy payment eliminated would need to be paid the amounts they had not received by reason of the law, possibly with interest.[1] The fiscal impact of such payments is roughly estimated at $130 million to $155 million total funds. PERS maintains a Contingency Reserve Account, which has a balance of around $600 million, from which these payments could be made. Such an action would have no impact on 2015-17 or 2017-19 employer rates as the Contingency Reserve is excluded when determining the unfunded liability of the system.

Increase in Unfunded Liabilities (2017-19 biennium)

The second consequence of overturning the law is that system-wide unfunded actuarial liabilities (UAL) would be increased because the amount of benefits to be paid would increase. The additional UAL

[1] The subject of back interest is an open question; court judgments typically use a rate of 9%.

would be recouped over the system's regular amortization schedules, which vary by retirement program, or the PERS Board could choose to amortize this particular UAL increase on a different schedule. The UAL may be substantially more than the original reduction, depending on when employer rates are first increased to begin recovering the UAL.

Such an increase in the UAL would normally be incorporated into the PERS Board's 2017-19 employer contribution rate setting schedule and not trigger a recalculation of the 2015-17 employer rates adopted by the PERS Board in September 2014. In other words, the PERS Board's adopted employer contribution rates for the 2015-17 biennium would probably remain unchanged, absent direction from the Legislature to recalculate rates or a decision by the Board to recalculate rates based upon fiduciary responsibility considerations. This approach is similar to what was done following the Supreme Court's March 2005 ruling on the 2003 PERS reforms.

For example, if the employer rate increase follows the normal rate setting cycle, then 2017-19 biennium rates would need to increase by approximately 5.5% to recover $6.1 billion in UAL. Alternatively, employer rates would need to increase 4.5% to 5% for the 2015-17 biennium to recover $5 billion in UAL, if adjusted outside of the normal rate setting cycle. The difference in the UAL amounts is attributable to the delay in increasing employer contributions and forgone investment earnings over the intervening period (i.e., the time value of money).

Currently, the system-wide UAL is estimated to be $2.6 billion as of December 31, 2013, which means that the system is 96% funded, the highest level since 2007. If reform legislation is overturned, the UAL would increase to $8.7 billion and system funding would fall to 89% based on December 31, 2013 asset levels.

Other Considerations

Other factors will also influence the employer contribution rate for the 2017-19 biennium. Gains or losses on investments for calendar years 2014 and 2015 will determine the actual employer rates, and could either amplify or mitigate the impact of increasing the liabilities. However, it would require extraordinary returns for 2014 and 2015 in order to fully mitigate employer rate increases for the 2017-19 biennium from the Supreme Court overturning reform legislation.

Other possible considerations are the updating of actuarial equivalency factors and potential changes in actuarial methods and assumptions that the PERS Board might adopt.

It is important to note that, besides the 2013 statutory reforms, the PERS Board also administratively adopted updated actuarial methods and assumptions in 2013, which included: (a) reducing the assumed earnings rate from 8% to 7.75%; (b) changing the actuarial cost methodology from Projected Unit Credit to Entry Age Normal; (c) re-amortizing accumulated Tier 1 & 2 unfunded liabilities over 20 years; and (d) modifying the rate collar. In general, the first two changes increased employer rates, while the third change reduced employer rates. The last change has had no impact to date.[2]

State Fiscal Impact

If PERS reform was to be overturned, and if the PERS Board followed its normal rate setting cycle, then the fiscal impact is estimated as follows:

- State Agencies: Projected state agency payroll, including the Oregon University System, but excluding K-12 and local government, is roughly estimated to total $5.8 billion for the 2017-19 biennium. A

[2] For a detailed description of the PERS Board's administrative changes refer to: https://www.oregonlegislature.gov/lfo/Documents/2014-5_2015-17PERSEmployerRates.pdf

5.5% increase in the employer contribution rate would equal $319 million total funds over the biennium.

- School Districts: Projected payroll for school districts during the 2017-19 biennium is $6.5 billion. A 5.5% increase in the employer rate would equal $358 million in additional PERS costs over the biennium.

The PERS Board's rate collaring methodology would likely continue, or be triggered, for entities during the 2017-19 biennium, which would spread the projected rate increase over two or more biennia.[3]

Contingency Planning

A Supreme Court ruling in the spring of 2015 would occur during the 2015 legislative session, perhaps prior to the May revenue forecast. This would likely be too late in the 2015 session to allow time for significant budget adjustments and/or statutory PERS reform. The Legislature, however, would have time to begin contingency planning for the 2016 legislative session and the 2017-19 biennium. This may include: (a) limiting certain types of on-going payroll costs (e.g., compensation); (b) setting aside funding to mitigate the potential 2017-19 rate increase; and (c) revisiting remaining statutory reform options.

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This brief is available on the Legislative Fiscal Office website at www.oregonlegislature.gov/lfo

[3] For a detailed description of the PERS rate collar refer to:
https://www.oregonlegislature.gov/lfo/Documents/2014-2PERS_RateCollar.pdf