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 559 -10 amendment

Summary of Proposal: Changes, to an unspecified number, the multiplier used in calculation of final average salary. Increases the number of years used in the calculation of final average salary from three to five. Eliminates the use of vacation and sick leave in the calculation of final average salary. Establishes the assumed rate, for the purpose of benefit calculations, to be the lesser of that approved by the Board or the Pension Benefit Guaranty Corporation. Directs the six percent member contribution to a new member pension contribution account. Establishes that the contribution to the member pension account may be adjusted by the PERS Board based on the system's unfunded actuarial liability. Initial contribution rates, as a percentage of salary, have yet to be determined. Directs the Board to recalculate employer contribution rates effective July 1, 2017 to reflect provisions of the measure.

Summary of Current Law: The three tiers of PERS provide for a pension benefit and account based benefit at the time of a member's retirement. The pension benefit for each member is generally calculated based on a formula: Final Average Salary (over three years/36 months) x Years of Service x a statutory factor (different for general service, Police & Fire, and tier). The account based benefit, which was established in 2004, is distributed in a lump sum or in installments, funded by a member contribution of six percent of salary that are credited annually with market earnings and losses. The assumed interest or earnings rate is set administratively by the PERS Board.

Has a detailed actuarial analysis been completed for this proposal? No.

Since the measure contains more than one concept, a single actuarial analysis is need to understand the combined effects.

ANALYSIS

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

1. **Constitutionality**
   Legislative Counsel –
   Multiplication factor

   Without knowing the amount by which the factor is reduced or increased, constitutionality is indeterminate.

   Final average salary

   Application of the new calculation and removal of accumulated sick and vacation leave 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 this concept does not protect accrued benefits. As we understand the argument from his brief comment, a member 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 had worked for 10 years before the change, the member would argue that the member should have the 3-year 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 higher salary earned at the end of the member's career. That view seems to be in accord with the opinion in Moro, but it is difficult to predict the outcome in the Supreme Court.

   Assumed interest rate

   Appears to meet the Moro standard for protection of accrued benefits This proposal does not alter the amount of benefits accrued by a retiring member before the change, but affects only predictions about the growth of those amounts in the future.

However, note that this proposal would create an unusual situation in which the board uses the PBGC rate to predict future growth for money match, but may use a different assumed interest rate for other purposes, including the crediting of Tier 1 member accounts and the valuation of PERS for the purpose of setting employer contribution rates. One could argue that this difference in rates is unreasonable, especially because the use of the higher assumed interest rate would lower employer contribution rates, while the use of the lower assumed interest rate would reduce benefit payments.

Employee contributions

Using 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 – No actuarial analysis has been completed, so there are no projected savings from this concept.

   LFO – In absence of an actuarial analysis on this measure as well as a stated assumption regarding the assumed interest rate, a preliminary estimate of the savings cannot be accurately calculated. Additionally, any savings could 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. Potential savings could also be impacted by the passage of other PERS reform measures.

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, there is no data to conclude whether this concept would affect the system's actuarial soundness.

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 – 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, if any, 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 2017-19 rate cycle. Doing so would postpone the full implementation of non-collared rates, and well as impede scheduled progress towards reducing the system's unfunded actuarial liability.

As to whether this concept would in fact reduce system costs, we have not conducted an actuarial analysis on this concept so we cannot represent that there would or would not be cost savings. Actual experience would have to be observed over several cycles to see whether this in fact decreases the number of members who become eligible for PERS.

LFO – In absence of an actuarial analysis on this measure as well as a stated assumption regarding the assumed interest rate, a preliminary estimate of the employer rate impact cannot be accurately calculated. Additionally, any rate savings could 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. Potential savings could also be impacted by the passage of other PERS reform measures.

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 on item 4.

   LFO – In absence of an actuarial analysis on this measure as well as a stated assumption regarding the assumed interest rate, a preliminary estimate of the state government General/Lottery Fund impact cannot be accurately calculated. Additionally, any savings could 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. Potential savings could also be impacted by the passage of other PERS reform measures.

6. **Impact on Public Employee Benefits (Tier 1, Tier 2, Oregon Public Service Retirement Plan (OPSRP))**
   PERS – Absent actual experience under this proposal, we cannot predict how this concept will reduce member benefits.

7. **Impact on Public Employee Workforce (rate of retirements, employers' ability to recruit and retain employees)**

PERS – Absent actual experience under this proposal, we cannot predict how this concept will impact the public workforce including rate of retirements, recruitment, and retention.

8. **Equitability of Costs and Benefits to Public Employees (costs/benefits)**
   PERS – Given the variety of proposals in this amendment and their unspecified impact due to the blanks in the legislation, we are unable to opine as to their equitability.

9. **Administrative Feasibility**
   PERS – There will be a fiscal impact to the agency to reprogram benefit eligibility determinations and contribution start dates to accommodate the new standard. Additionally, the agency will revise member education material in all formats to reflect the new standard.
   LFO - The Oregon Judicial Department could have costs beyond what is currently budgeted for the appointment of a Special Master, if an expedited judicial review is sought.

Technical Issues of Note:
Legislative Fiscal – The measure contains a number of blank provisions and Technical Team was not provided with a stated assumption regarding the assumed interest rate.

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.