

Analysis  
**Public Employees Retirement System**  
2018 Preliminary Earnings Crediting Report

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**Analyst:** John Borden

**Request:** Acknowledge receipt of a report on preliminary 2018 earnings crediting

**Analysis:** ORS 238.670(5) requires the Public Employees Retirement System (PERS) Board to submit a report to the Legislature on the Board's preliminary plan to credit calendar year earnings of the Oregon Public Employees Retirement Fund (OPERF) to member and employer accounts and other reserves. Under the statute, the Board must provide the report at least 30 days before the Board makes its final earnings crediting decision. The Board is scheduled to make its final 2018 earnings crediting decision on April 1, 2019. Statute gives the PERS Board broad authority to make earnings crediting decisions and, according to the agency, allocations have generally been on a proportional basis for member and employer accounts.

On February 1, 2019, the PERS Board approved preliminary earnings crediting for calendar year 2018 of \$83.5 million. Allocating 2018 earnings will increase reserves subject to crediting from \$73.88 billion to \$73.96 billion for a 0.11% increase. This is below the \$5.3 billion in expected earnings based on the assumed earnings rate of 7.2%. Earnings also fell short of the one-year OPERF benchmark of 0.73% that is established by the Oregon Investment Council (OIC).

Of note is the actual market returns for private equity investments, which comprise over 20% of OPERF assets, are reported on a three-month lag as additional time is needed to value these non-public assets and returns. Therefore, the preliminary 2018 earnings crediting rate of return is based on private equity returns through September 30th, 2018 rather than December 31, 2018. Private equity returns for the fourth quarter 2018 returns will be reflected in the following year as part of the preliminary and then actual 2019 earnings crediting.

**Estimated Impact to Unfunded Accrued Liability**

The system-wide Unfunded Accrued Liability (UAL) UAL for calendar year 2017 is \$16.7 billion after considering \$5.6 billion in pre-paid employer side accounts. A preliminary actuarial estimate of the impact of the 2018 preliminary earnings on the UAL show that the UAL may increase between \$4.9 and \$7.8 billion to between \$21.6 and \$24.5 billion and that the funded status of the system may decline to between 72% to 75% funded.

**Employer Reserve Accounts and Oregon Public Service Retirement Program**

The preliminary earnings crediting of the employer reserve account is \$58.2 million for a balance of \$27.96 billion and a return of 0.20%. The preliminary earnings crediting for employer's Oregon Public Service Retirement Program Pension accounts is \$10.9 million for a balance of \$4.77 billion and a return of 0.22%.

## **Retiree Benefits**

Upon an individual's retirement, funds are transferred into a Benefits-in-Force Reserve account, which is used to fund retiree benefits payments. The preliminary earnings crediting for this account is \$45.3 million for a balance of \$21.89 billion and a return of 0.20%.

## **Member Accounts**

The preliminary earnings crediting for Tier One member regular accounts is \$264.6 million for a balance of \$3.94 billion. Earnings crediting for this account was at the 2018 assumed earnings rate of 7.2%. The preliminary earnings crediting for Tier Two regular member accounts was \$1.9 million for a balance of \$921.1 million and a return of 0.20%. Judge Member Accounts were credited with the assumed earnings rate of 7.2%. Member variable accounts, which are invested in equities, earned a negative 10.03% (after expenses).

## **Tier One Rate Guarantee Reserve**

The Tier One Rate Guarantee Reserve makes up any shortfall between the assumed earnings rate and investment returns for Tier One regular accounts. Since Tier One regular account earnings were below the assumed earnings rate of 7.2%, \$255.9 million was transferred into the Tier One member regular accounts leaving a balance in the Tier One Rate Guarantee Reserve of \$254.6 million.

## **Individual Account Program**

The preliminary crediting for the Individual Account Program (IAP) saw a reduction of \$63.2 million for a balance of \$8.7 billion and a return of -0.72%. On September 20, 2017, an administrative decision by the Oregon Investment Council moved the IAP to a target-date or age-based fund solution beginning January 2, 2018. IAP members were given no choice in investment option selection. Going forward, IAP and OPERF earnings are expected to deviate from one another with IAP earnings possibly lagging OPERF earnings over time.

## **Contingency Reserve**

When earnings on OPERF equal or exceed the assumed earnings rate, the PERS Board may credit up to 7.2% of earnings to the Contingency Reserve. Statutorily, contingency reserves are limited to pay for: (a) a deficit in the payment of retirement allowances; (b) employer insolvency; and (c) legal expenses. The overfunding of the Contingency Reserve had been an issue for the Legislature beginning with the 2012 earnings crediting report. Reserve funds are not accounted for in actuarial valuations and the deployment of any amount of reserves to member regular accounts and employer accounts would reduce employer rates. The Legislature in 2017 enacted SB 1067 which statutorily limited the maximum balance of the Contingency Reserve to \$50 million, which in the prior year resulted in the deployment of \$533.7 million in reserves to various accounts thereby reducing the UAL.

## **Expenses**

The preliminary earnings crediting for calendar year 2018 of \$84.9 million for OPERF and \$-51.4 million for the Variable Account, are the net of expenses, which include: \$693 million in calendar year investment expenses and brokerage commissions; \$4.2 million in administrative expenses directed by the OIC; \$22.7 million in State Treasury expenses; and \$64.7 million for PERS agency operational expenses. In addition, Variable Account 2018 earnings are insufficient to pay for \$1.1 million administrative expenses. Therefore, those expenses are charged against OPERF earnings (OAR 459-007-0005). Expenses are funded with earnings when they are sufficient (ORS 238.601(1)).

### Future Employer Contribution Rates

Adopted employer contribution rates have been published by the PERS Board for the 2019-21 biennium and are based on 2016 actual earnings crediting and 2017 earnings at the assumed rate of 7.2%. Advisory employer contribution rates for the 2021-23 biennium will be based on final earnings crediting for calendar years 2018 and 2019 and published in the fall of 2019.

**Legislative Fiscal Office Recommendation:** Acknowledge receipt of the report.

### Addendum-A

The following addendum summarizes reported PERS account earnings history from 1997 to 2018.

PERS Investment Earnings History (1997-2018)							
Years	Calendar Year	OPERF	Assumed Rate	Tier 1	Tier 2	Variable	IAP
1	1997	20.42%	8.00%	18.70%	20.42%	28.87%	--
2	1998	15.43%	8.00%	14.10%	13.63%	21.45%	--
3	1999	24.89%	8.00%	11.33%	21.97%	28.83%	--
4	2000	0.63%	8.00%	8.00%	0.54%	-3.24%	--
5	2001	-7.17%	8.00%	8.00%	-6.66%	-11.19%	--
6	2002	-8.93%	8.00%	8.00%	-8.93%	-21.51%	--
7	2003	23.79%	8.00%	8.00%	22.00%	34.68%	--
8	2004	13.80%	8.00%	8.00%	13.27%	13.00%	12.77%
9	2005	13.04%	8.00%	8.00%	18.31%	8.29%	12.80%
10	2006	15.57%	8.00%	8.00%	15.45%	15.61%	14.98%
11	2007	10.22%	8.00%	7.97%	9.47%	1.75%	9.46%
12	2008	-27.18%	8.00%	8.00%	-27.18%	-43.71%	-26.75%
13	2009	19.19%	8.00%	8.00%	19.12%	35.57%	18.47%
14	2010	12.44%	8.00%	8.00%	12.44%	15.17%	12.13%
15	2011	2.21%	8.00%	8.00%	2.21%	-7.80%	2.15%
16	2012	14.29%	8.00%	8.00%	14.68%	18.43%	14.09%
17	2013	15.76%	8.00%	8.00%	15.62%	25.74%	15.59%
18	2014	7.29%	7.75%	7.75%	7.24%	4.29%	7.05%
19	2015	2.21%	7.75%	7.75%	1.87%	-1.61%	1.85%
20	2016	7.10%	7.50%	7.50%	7.12%	8.77%	7.14%
21	2017	15.15%	7.50%	7.50%	15.12%	26.45%	14.45%
22	2018	0.11%	7.20%	7.20%	0.20%	-10.03%	-0.72%
22-year	Average	8.65%	7.90%	8.81%	8.54%	8.54%	--
20-year	Average	7.72%	7.89%	8.05%	7.69%	6.87%	--
15-year	Average	8.08%	7.85%	7.84%	8.33%	7.33%	7.70%
10-year	Average	9.58%	7.77%	7.77%	9.56%	11.50%	9.22%
5-year	Average	6.37%	7.54%	7.54%	6.31%	5.57%	5.95%
3-year	Average	7.45%	7.40%	7.40%	7.48%	8.40%	6.96%

# Public Employees Retirement System Heath

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**Request:** Report on earnings crediting by the Public Employees Retirement System (PERS) as required by ORS 238.670 (5).

**Recommendation:** Acknowledge receipt of the report.

**Discussion:** ORS 238.670 (5) requires that “at least 30 days before crediting any interest and other income received through investment of the Public Employees Retirement Fund to any reserve account in the fund, the [PERS] board shall submit a preliminary proposal for crediting to the appropriate legislative review agency, as defined in ORS 291.371 (1), for its review and comment.” The PERS Board is scheduled to approve final earnings crediting on April 1, 2019.

Earnings crediting is an annual process through which the PERS Board applies the earnings from investments in the Oregon Public Employees Retirement Fund (OPERF), less expenses and cash flow adjustments for the timing of benefit payments, to the various accounts within the trusts maintained by PERS. Earnings crediting is the result of applying Oregon Revised Statutes and rules adopted by the Board to the net earnings of the OPERF. Earnings credited to the various accounts are not the same thing as the earnings reported by the Oregon State Treasury. The OPERF earned 0.48 percent for calendar year 2018, while most of the accounts held by PERS were preliminarily credited with 0.20 - 0.22 percent, depending on expenses and cash flows associated with each program. Tier One member regular accounts are credited with the assumed rate, in this case 7.20 percent, in accordance with Oregon law.

The main discretionary crediting decision by the Board is related to the Contingency Reserve. The Contingency Reserve is dedicated to preventing a fund deficit due to employer insolvency and to paying for extraordinary legal expenses. As mandated by Senate Bill 1067 (2017), the balance of this account is limited to \$50 million. The balance of the account in 2018 was \$50 million, so no earnings were credited to the account.

The agency is also reporting on the earnings for the Individual Account Program, as a whole and for side accounts, even though these earnings are not subject to the reporting requirements of ORS 238.670 (5). The Individual Account Program (IAP), which is the defined contribution portion of PERS, had preliminary earnings of -0.72 percent in 2018, below the earnings of the various defined benefit plans. This is due to several reasons. Under the Target Date Funds model, IAP accounts are no longer invested exclusively in the OPERF, but are partially invested in a series of funds structured to match the age of the IAP participant. The target date funds for members with later retirement dates (for instance, Target Date 2060) experienced greater losses during 2018 than the PERS Fund due to their greater exposure to international and domestic equities.

Side accounts, described in the report as “UAL Lump-Sum Pmt. Side Accounts,” are employer prepayments of their liabilities held in the PERS trusts and invested in the OPERF. PERS reported that side accounts earned various rates during 2018 because contributions made during 2018 earn different rates depending on the date they were made. Side account earnings are credited to the liabilities of the employers who made the contributors and are not a general resource available for general system funding.



# Oregon

Kate Brown, Governor

## Public Employees Retirement System

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February 1, 2019

The Honorable Senator Betsy Johnson, Co-Chair  
The Honorable Senator Elizabeth Steiner-Hayward, Co-Chair  
The Honorable Representative Dan Rayfield, Co-Chair  
Joint Committee on Ways and Means  
900 Court Street NE  
H-178 State Capitol  
Salem, OR 97301-4048

Dear Co-Chairpersons:

### **Nature of the Request**

The Public Employees Retirement System (PERS) requests acknowledgement of receipt of this report on the PERS Board's preliminary crediting of 2018 earnings received through investment of the Oregon Public Employees Retirement Fund (OPERF) Regular Account. This report is provided in accordance with ORS 238.670(5), which requires PERS to submit a preliminary earnings crediting report to the appropriate legislative committee at least 30 days prior to the final allocation of earnings to member and employer accounts and other reserves. Final earnings crediting is currently scheduled for the April 1, 2019 PERS Board meeting.

### **Agency Action**

On February 1, 2019, the PERS Board approved, on a preliminarily basis, the allocation of approximately \$83.5 million in OPERF Regular Account 2018 earnings to member and employer accounts and other reserves.

In this preliminary action, the Board allocated earnings (net of expenses and other adjustments) at a rate of 0.20% to the Benefits in Force Reserve, 0.20% to Employer Reserves, 0.20% to Tier Two member regular accounts, -0.72% to Individual Account Program accounts as a whole, and 0.22% to the OPSRP Pension Reserve. The Contingency Reserve is \$50 million, and the Board may not allocate earnings to the reserve until it is less than \$50 million.

The Board also approved, on a preliminarily basis, crediting earnings at the 2018 assumed rate of 7.20% to Tier One member regular accounts, as required by ORS 238.255.

### **Action Requested**

PERS requests the Committee acknowledge receipt of the report.

### **Legislation Affected**

No legislation is affected by this request.

Joint Committee on Ways and Means

2/1/98

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Sincerely,

A handwritten signature in cursive script, appearing to read "Kevin Olineck".

Kevin Olineck  
Executive Director

**Attachment**

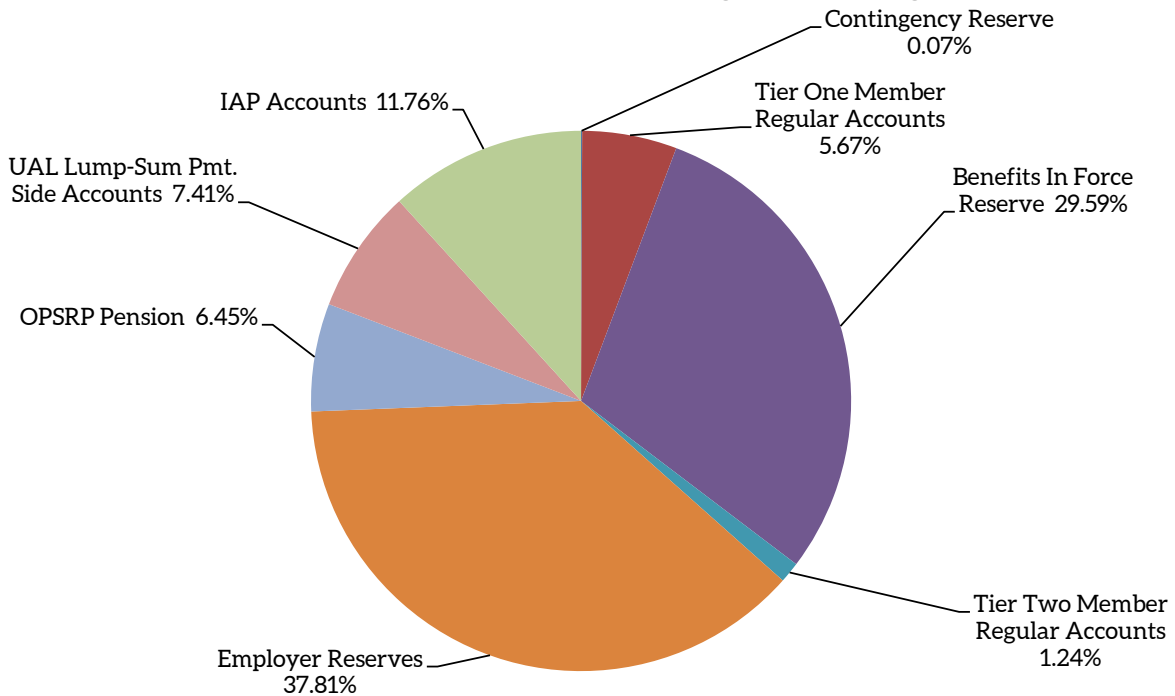
Preliminary 2018 Crediting and Reserving

## Oregon Public Employees Retirement System Preliminary 2018 Crediting and Reserving

(All dollar amounts in millions)

	Reserves Before Crediting	2018 Crediting	Reserves After Crediting	2018 Rates
Contingency Reserve	\$50.0	-	\$50.0	N/A
Tier One Member Regular Accounts	3,674.5	264.6	3,939.1	7.20%
Tier One Rate Guarantee Reserve	510.5	(255.9)	254.6	N/A
Benefits In Force Reserve	21,840.0	45.3	21,885.3	0.20%
Tier Two Member Regular Accounts	919.2	1.9	921.1	0.20%
Employer Reserves	27,904.0	58.2	27,962.2	0.20%
OPSRP Pension	4,763.3	10.9	4,774.2	0.22%
*UAL Lump-Sum Pmt. Side Accounts	5,460.3	21.7	5,482.0	Various
*IAP Accounts, as a whole	8,758.8	(63.2)	8,695.6	-0.72%
<b>Total</b>	<b>\$73,880.6</b>	<b>\$83.5</b>	<b>\$73,964.1</b>	

### 2018 Reserve Balances After 2018 Earnings Crediting



\*Informational only. Not affected by Board reserving or crediting decisions.  
IAP accounts receiving installments have already received 2018 earnings.

**Oregon Public Employees Retirement System  
Preliminary IAP TDF Earnings**

(All dollar amounts in thousands)

<b>TDF Fund</b>	<b>Reserves Before Crediting</b>	<b>2018 Crediting</b>	<b>Reserves After Crediting</b>	<b>2018 Rates</b>
RET Fund	\$370,324.9	(2,870.80)	\$367,454.1	-0.77%
2020 Fund	955,906.3	1,958.8	957,865.1	0.20%
2025 Fund	1,457,058.4	(10,107.6)	1,446,950.8	-0.69%
2030 Fund	1,563,190.9	(12,344.6)	1,550,846.3	-0.78%
2035 Fund	1,606,194.6	(3,594.6)	1,602,600.0	-0.22%
2040 Fund	1,304,221.8	(5,380.4)	1,298,841.4	-0.41%
2045 Fund	913,972.8	(18,547.3)	895,425.5	-2.02%
2050 Fund	436,609.8	(9,015.9)	427,593.9	-2.06%
2055 Fund	132,624.1	(2,877.2)	129,746.9	-2.16%
2060 Fund	18,680.8	(409.3)	18,271.5	-2.19%
<b>Total</b>	<b>\$8,758,784.4</b>	<b>-\$63,188.9</b>	<b>\$8,695,595.5</b>	