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Testimony on the -2 Amendment of HB 2297

Good afternoon Chair Grayber, Vice-Chairs Lewis and Tran, Committee Members - for the record, Kevin Olineck, Director PERS. With me today is Heather Case, the PERS Senior Policy Advisor. While the agency takes no position on this bill, we believe the committee might like more information about the effects of this bill on a member's PERS benefits, as well as the agency and participating employers.

The -2 amendment to HB 2297 presents an unprecedented concept with regard to PERS. It requires employers to pay for additional benefits to members for time not served with any participating public employer.

Tier 1/Tier 2 members have the option to purchase additional service time in specific circumstances. One of those options is to purchase military time served prior to establishing membership in the system. The statute allowing such a purchase for Tier 1 and 2 requires the member to pay the actuarial "full cost" to the system of providing the additional benefit. I'll provide an example of what this cost may be later in my testimony – it can be significant.

OPSRP was established as a simple and more cost-effective defined benefit program in an effort to move away from the complexity of the Tier 1/Tier 2 provisions. As such, the legislature specifically did not include any purchases in the OPSRP program.

Cost to employers

While the -2 amendment is not drafted as a purchase for OPSRP members, given the structure of the OPSRP program, the only way to administer it would be as a purchase.

Under the OPSRP program, all employers are treated as one employer for funding purposes in that the plan experience of employers (how their member's pension patterns differ from assumptions) is "pooled" and rates are established for employers with OPSRP members.

The -2 amendment requires all the employers for which the member worked to fund the benefit on a pro rata basis. Given the structure of the OPSRP program, it is not possible, on an actuarial basis, to charge employers individually through their employer rate for individual member benefits.

The only way for employers to fund these benefits for each individual on a pro rata basis is to administer the benefit as a purchase; meaning, calculating the full cost of the additional benefit to the system, determining the amount of that cost applicable to each of the member's employers and bill the employers up front for the entire cost. Otherwise, all employers, even those employers who did not employ the individual would be funding this additional benefit.

Cost of the purchase

We had our actuaries run a few example calculations to illustrate the cost to employers:

In one example, you have a retiring OPSRP PF member with monthly final average salary of $9,000 ($108,000 annually) who is age 53 with 22 years of service, the effect of three years of military service purchased by the employer(s) would be:

- Benefit before purchase: $9,000 x 1.8% x 22 years of service x 0.56 early retirement factor = $1,996
- Benefit after purchase: $9,000 x 1.8% x 25 years of service x 1.00 normal retirement factor = $4,050
- **Increase in monthly benefit at 53: $4,050 – $1,996 = $2,054**
- **Full cost purchase amount: $2,054 x 194.9 = $400,000**

If we use an example with the same final average salary but with age 52 and 21 years of service, the effect would be:

- Benefit before purchase: $9,000 x 1.8% x 21 years of service x 0.517 early retirement factor = $1,759
- Benefit after purchase: $9,000 x 1.8% x 24 years of service x 0.517 early retirement factor = $2,010
- **Increase in monthly benefit at 52: $2,010 – $1,759 = $251**
- **Full cost purchase amount: $251 x 197.16 = $50,000**

The cost of the employer-paid service purchase is much larger in the first example because in that scenario the military service puts the member over the 25 years of service threshold to receive an unreduced retirement. The existence of such big jumps in value would likely influence member timing-of-retirement behavior. (You would expect the 52 year old with 21 years of service to have a very strong incentive to work an additional year.)

The amount that the employers would be required to pay would be due in a lump sum payment, and would be required over and above the employer rates the employer currently is required to pay on covered payroll (currently 14.68%). This additional cost will likely have a more significant impact on smaller employers but there could be a significant impact nonetheless depending on how many of their employees qualify for the additional service time.

The option of this employer-paid military service purchase would reduce the working timeline of OPSRP PF members on average, since some members who qualify for the employer-paid purchase are likely to retire earlier than they would have without the provision. This might lead to a secondary effect of increasing the OPSRP PF normal cost rate due to shorter average working careers for full-career OPSRP PF members. Simply stated, anticipated contributions for these members would be reduced while the period would be providing a retirement payment increases.

Finally, while the intent of the full cost purchase structure would be to avoid any expected changes in costs to the rest of the OPSRP pool (other than the possible second-order effect noted above), in practice the actuarial assumptions underlying the purchase factors will never be realized perfectly. The experience gains or losses that occur on these extra benefits relative to what are built into the purchase amount will flow through the OPSRP UAL rate over time.

Potential equity issues

The amendment applies to OPSRP members only. If passed, there is a strong likelihood that we'd see a bill to provide the same option to Tier 1 & Tier 2 members as well. Which would, again, increase costs to employers. It also applies only to P&F members – not General Service members.

Because **all the employers** a P&F member has worked for will bear the burden of this cost, it will impact all employers, not just P&F employers. And will be an unexpected cost for many employers.

Potential for unintended consequences

The amendment's language only requires the last position to be a P&F position; it does not require the member to meet the P&F retirement eligibility standard (i.e. does not require that the last five years of service be P&F). A non-P&F member could be hired into a P&F position and be eligible for the employer-paid military purchase as long as the P&F position was their last position prior to retirement.

It may discourage some employers from hiring veterans once the employers realize the potential cost.

It increases complexity in administering retirement applications in that we'd have to verify military time.

Increase in "purchases"

Not many members take advantage of the full cost military purchase available to Tier 1/Tier 2 members due to the cost associated. These full cost purchases are generally made so the member can acquire enough service time to be eligible for full, or unreduced, retirement benefits, as illustrated above. Because the -2 amendment has no cost to the member, we anticipate any eligible member will take advantage of the option.

Required system changes

Finally, the amendment would require significant system programming changes. Currently, there are no purchase options available to OPSRP members, so PERS' system has no functionality to calculate or process these purchases. As explained above, the provision presented in the -2 amendment would be administered as a purchase of service time by the employer for the member.

System programming would be required to establish functionality for administering such a purchase for OPSRP members.