ANALYSIS

Public Employees Retirement System
SB 1566 (2018) Employer Incentive Funds

Analyst: John Borden

Request: Acknowledge receipt of a report on SB 1566 (2018) employer incentive funds.

Analysis: The Public Employees Retirement System (PERS) is directed by statute to report during each regular session to the Joint Committee on Ways and Means on the status of the School Districts Unfunded Liability Fund, Employer Incentive Fund, and the Unfunded Actuarial Liability Resolution Program that were established by SB 1566 (2018). SB 1049 (2019) made technical statutory changes to SB 1566, as well as provided funding for the Employer Incentive Fund and the Unfunded Accrued Liability Resolution program.

Background
Employers have the option to make voluntary lump-sum payments to PERS that are in addition to the employer's required contribution. With few exceptions (i.e., payment of transition liability), lump-sum payments are deposited into "side accounts," and are used to offset a portion of the contributing employer's PERS contribution rate as of a date selected by the employer or July 1 of the year following publication of the actuarial valuation for the year in which the additional deposit is made, according to an amortization schedule. Side account balances are never entirely utilized in a single biennium. Employers without a side account pay the employer contribution rate without any offset.

Side accounts, which are tracked separately from other employer reserves in the Oregon Public Employees Retirement Fund, are assets of the PERS system and reduce a participating individual employer's net unfunded pension actuarial accrued liability. Once deposits are made into side accounts, employers are unable to withdraw or repurpose the funds. Employees have no vested interest in these side accounts as they are an asset of a participating employer, not the employee. The state also has no ability to access (or re-appropriate) side account balances, as they are held in statutory trust accounts.

The 2023 preliminary earnings crediting report reflects that various lump-sum employer contributions, or "side accounts," have a balance of $5.4 billion and had an investment return of 6.37%.

School Districts Unfunded Liability Fund
SB 1566 established a School Districts Unfunded Liability Fund (SDULF). The PERS Board is required to create this pooled side account for school districts and proportionately distribute the side account among all school districts as an offset to employer contribution rates.

Since the SDULF was established in SB 1566 (2018), there have been no expenditures from the fund. The PERS Board has chosen to not deploy deposits to offset school district pool rates until the balance reaches a threshold of one percent of the school district's payroll multiplied by an amortization factor of approximately 5.16%. For the 2023-25 biennium, the threshold would be $466.5 million, based on the school district's payroll valuation ($9 billion or $90.4 million) multiplied by the 5.16% amortization factor. PERS reports that the balance of the SDULF is $48.2 million and below that threshold. At present, no further deposits into the SDULF are forecasted, other than interest earnings.

In addition, three SDULF revenue provisions are slated to be repealed or sunset during the 2023-25 biennium: excess capital gains (limited to calendar years 2019, 2021, and 2023); excess estate tax (limited to calendar years 2019, 2021, and 2023); and excess debt collections (December 31, 2024). Of these revenue streams, the unclaimed property transfer has produced revenue for the SDULF. The unclaimed property transfer provision will sunset during the 2027-29 biennium on January 2, 2027. The SDULF itself has no sunset date.

Apart from the PERS report is an important clarification on SDULF revenue. PERS previously reported to the Legislature that SDULF included a forecasted revenue estimate for estate taxes. However, the Department of Administrative Services - Office of Economic Analysis (DAS-OEA), in the December 2023 state revenue forecast, noted:

> The law stated that if estate tax revenues came in above their 10 year, or 5 biennia trend, then the amount above that trend line would be transferred to PERS. However a further review of the law also revealed the language also said the transfer would not occur if there was a personal income tax kicker generated in the same biennium. Our office regrets the error of previously expecting the transfer. The law also had a sunset date, and ultimately no estate tax revenue was transferred to PERS during the time the law was in effect.

In an update to the December of 2023 revenue forecast, the following statement was included:

> Note that the previously expected estate tax transfer to PERS has been removed from the forecast. This does not impact current tax collections or any potential kicker calculation, but does increase available resources by $60.5 million.

PERS consulted the Department of Justice and verified the re-interpretation of statute, which then necessitated that PERS return to the Department of Revenue an estimated $49 million, plus interest earnings, of excess estate tax that had been deposited into the SDULF.

Employer Incentive Fund

SB 1566 established an Employer Incentive Fund (EIF) to be used for a 25% match program for employer side accounts, which are for pre-paid employer contributions held in trust by PERS. Once deposited, side accounts funds may not be withdrawn except for the payment of employer contributions. All PERS entities, including school districts, community colleges, and public universities, are eligible to participate in the matching funds program. Employers must meet the following criteria: (a) provide cash deposits and not from borrowed funds; (b) provide a minimum contribution of $25,000; (c) have no transition liability; and (d) participate in the Unfunded Actuarial Liability Resolution Program (discussed below). The EIF sunsets on July 1, 2042.

The current revenue sources of the EIF include Lottery Funds from sports betting and one-time General Fund. EIF has a reported balance of $12.5 million but is forecasted to increase to $28.2 million. The DAS-OEA sports betting revenue forecast for the EIF (March 2024) is $28.2 million for the 2023-25 biennium, $40.3 million for the 2025-27 biennium, $42 million for the 2027-29 biennium, $44.5 million for the 2029-31 biennium, and $47.3 million for the 2031-33 biennium. Of note is that sports betting revenue for the EIF sunsets on December 31, 2041.

In contrast to the SDULF, the EIF has expended funds from the account. PERS reports that the EIF has matched $96.4 million in employer contributions for 110 participating employers. PERS plans on opening a new round of EIF applications during the 2023-25 biennium once the EIF reaches a balance of $25 million. The next application period may commence as early as the end of calendar year 2024. Any employer contributions and matching funds will be reflected in 2025-27 biennium and be used on an amortized basis to reduce employer contribution rates going forward until the side account balances have been exhausted.

Unfunded Accrued Liability Resolution Program

The measure created an Unfunded Actuarial Liability Resolution Program (UALRP) to assist an employer in the development of a plan to improve the employer's funded status. PERS has, after an initial slow start, completed implementation of this program. PERS employers had to meet the following criteria to participate in the UALRP: (a) identify their combined valuation payroll; (b) estimate the UAL amount and funded status using existing resources available online; and (c) use the web-based PERS' Employer Rate Projection tool to review the affect their intended lump sum payment and potential EIF match would have on their rates and contributions projected over the next ten biennia. PERS completed the acquisition and deployment of a more comprehensive and advanced Employer Rate Projection Tool that was funded as part of SB 1049 (2019). PERS is also now able to provide UAL information to state government agencies and entities as well as UAL educational guides.

Side Account Lump-Sum Payments

Apart from the reporting requirement, SB 1566 allows an entity making a lump sum cash payment of $10 million or higher into a side account to choose an amortization period of six years, 10-years, 16-years, or 20-years. There is also the option to defer when the side account takes effect; however, these become non-EIF matched side account contributions. After non-EIF contributions totaled $107 million during the 2019-21 biennium, there have been no further lump sum payments under this provision of the law. Of additional note is that only the Port of Portland chose the rate deferral option with a rate offset date of July 1, 2029, which is coupled with a ten-year amortization period.

Legislative Fiscal Office Recommendation:

The Legislative Fiscal Office recommends that the Joint Committee on Ways and Means acknowledge receipt of the report.

Request: Report on the status of the School Districts Unfunded Liability Fund, the Employer Incentive Fund, the Unfunded Actuarial Liability Resolution Program, and extended amortization options of $10 million or more as required in Senate Bill 1566 (2018) by the Public Employees Retirement System.

Recommendation: Acknowledge receipt of the report.

Discussion: The Public Employees Retirement System (PERS), as directed by Senate Bill 1566 (2018), is required to report by February 1 of each odd year the status of the unfunded liability fund accounts, the actuarial liability resolution program, and the extended amortization options established in the bill.

School Districts Unfunded Liability Fund (SDULF) - is a pooled side account intended to provide rate relief to school districts, public charter schools, and education service districts. There are three potential revenue sources, all of which have sunset dates, if earnings are available to fund the SDULF, including: interest on unclaimed property from the Department of State Lands (sunsets 2027); proceeds from debt collection (sunsets 2024); and proceeds from estate taxes and capital gains taxes (sunsets 2023).

At the time of the letter, PERS did not anticipate any deposits being made during calendar year 2024, from any revenue source. In late January, PERS was made aware of an unanticipated transfer from the Department of State Lands of $36.8 million. Prior to that deposit the account balance was $48.3 million, which is not sufficient to offset the needs of the School District Pool.

Employer Incentive Fund (EIF) – The EIF was established to be used as a one-time match program for side accounts, with a match rate up to 25 percent of a PERS contribution. Matching funds are primarily funded through Oregon Lottery sports betting proceeds, although General Fund investments have also been made. Side accounts allow a PERS employer to make lump-sum payment to prepay all or part of their pension unfunded actuarial liability (UAL). The funds are applied towards the UAL, reducing the employer's contribution rate, with payments from the side account amortized over a predetermined period of time.

PERS reports, as of November 2023, the EIF had a balance of $12.5 million. Between 2019 to 2023, matching funds of $96.4 million have been distributed to 110 participating employers. Currently, PERS receives approximately $3.6 million from Oregon Lottery sports betting quarterly. Assuming this transfer amount continues, the fund balance will reach $25 million by the end of 2024 and will trigger the next application period for PERS employers to join the program.

Unfunded Actuarial Liability (UAL) Resolution Program – As part of Senate Bill 1049 (2019) PERS was directed to develop an UAL Resolution Program for participating employers, in 2021 PERS launched an Employer Rate Projection Tool. This tool provides employers the ability to modify payroll contributions rates and predict how the changes will affect their contributions. In addition, PERS created a series of guides to help employers better understand the system and provide more context to the resource they receive when forecasting and budgeting. The guide to “Understanding Pension Obligation Bonds” is expected to be published this year to assist employers.

Extended Amortization Options – As part of Senate Bill 1566 (2018), PERS added additional options for side accounts with a balance greater than $10 million; allowing contributing employers to choose shortened amortization periods or select a deferred rate offset date.

Oregon
Tina Kotek, Governor

Public Employees Retirement System
Headquarters
11410 S.W. 68th Parkway, Tigard, OR
Mailing Address:
P.O. Box 23700
Tigard, OR 97281-3700
888-320-7377
TTY (503) 603-7766
www.oregon.gov/pers

January 16, 2024

Senator Elizabeth Steiner, Co-Chair
Representative Tawna Sanchez, Co-Chair
Joint Committee on Ways and Means
900 Court St NE
H-178 State Capitol
Salem, OR 97301

Dear Co-Chairs:

Nature of the Request

As required by Senate Bill 1566 (2018), PERS is providing the status of the School Districts Unfunded Liability Fund, the Employer Incentive Fund, the Unfunded Actuarial Liability Resolution Program, and extended amortization options of $10 million or more as of November 2023.

Agency Action

School Districts Unfunded Liability Fund

The School Districts Unfunded Liability Fund (SDULF) is a pooled side account intended to provide rate relief to all public school districts, public charter schools, and education service districts. The SDULF has three defined revenue sources: interest on unclaimed property from the Department of State Lands; proceeds from debt collection; proceeds from estate taxes and from capital gains taxes.

As of November 2023, the SDULF has a balance of $48,283,947. No deposits are anticipated during 2024 from any revenue source. The current funding is not sufficient to provide a meaningful offset for the School District Pool, which has a combined valuation payroll of $4,617,100,000 as of December 31, 2022.

Proceeds from estate taxes and capital gains taxes as an income source for the SDULF sunset in 2023, while the transfer of proceeds from debt collection as an income source for the SDULF sunsets in 2024. The transfer of interest on unclaimed property as an income source for the SDULF will sunset in 2027.

Employer Incentive Fund

The Employer Incentive Fund (EIF) provides a 25% match to employers making a lump sum payment from non-borrowed funds of at least $25,000. This lump sum payment may be used to establish a new side account or as a payment into an existing side account and is subject to the limitations stated in the statute. The first 90 days of the application period are dedicated to employers with a UAL as a percentage of payroll that exceeds 200% after which the application period is open to all employers.

As of November 2023, the EIF has a balance of $12,465,290. A total match amount of $96,421,899 was distributed to 110 participating employers located in 26 counties between 2019 and 2023.

PERS anticipates quarterly transfers from Lottery Funds reflecting proceeds from sports betting. The current quarterly transfer amount is $3,573,355. Based on this information, we expect that the fund balance will exceed $25 million by the end of 2024. Once this occurs, we will open the next application period, likely during early 2025.

Unfunded Actuarial Liability Resolution Program

Senate Bill 1049 modified the UAL Resolution Program (UALRP) to include the development of funding plans to improve the employers' funded status and to manage contribution rates. The bill also requires all PERS participating employers to participate in the UALRP whereas previously this was a requirement for only employers participating in EIF.

In 2021, PERS launched the new Employer Rate Projection Tool hosted using Microsoft Azure's "platform as a service" environment. This tool provides greater security as well as the capability to incrementally add employer requested features. Currently employers can modify payroll or contribution rates and determine how these changes will affect their contributions over time. In the future, the top requested modifications from employers are the ability to model additional scenarios of earnings and payroll growth rates.

PERS has created a series of guides to help employers understand the fundamentals of the system and provide context to the resources they receive when forecasting and budgeting.

Those guides are:

- Guide To Understanding Your Rate
- Guide to Understanding Your Valuation
- Guide to Understanding Unfunded Actuarial Liability
- Guide to Understanding Pooling
- Guide to Financial Modeling
- Guide to Understanding Pension Obligation Bonds

Extended Amortization Options

Senate Bill 1566 (2018) introduced additional amortization options for side accounts of at least $10 million. These include the ability to select a shortened amortization period of six, 10, or 16 years. Employers could also select a deferred rate offset date.

Summary

Employer Programs have been well received by PERS participating employers despite budgetary uncertainty. Employers appreciate incentives to proactively manage their contribution rates and appreciate the engaged role PERS has had in addressing knowledge gaps.

Action Requested

PERS requests the Committee acknowledge receipt of the report.

Legislation Affected

No legislation is affected by this request.

Sincerely,

Kevin Olineck, Director
Oregon Public Employees Retirement System