



# Oregon

Theodore R. Kulongoski, Governor

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## MEMORANDUM

To: Members of the PERS Board  
From: Steven Patrick Rodeman, Manager  
Policy, Planning, and Legislative Analysis Group  
Re: Analysis of Implementing Lipscomb Ruling

The Oregon Court of Appeals rejected the agency's request for a stay of Judge Lipscomb's decision pending appeal. The agency must therefore proceed to as soon as possible to implement the judge's decision in favor of both the petitioning employers and intervening PERS members. Staff has prepared the following summary and analysis of the recommended first steps to implement the judge's decision, with action items noted. Action must be commenced immediately, as referenced in the final action item listed.

### **Brief Summary**

Judge Lipscomb remanded three orders to the PERS Board: (1) The March 2000 order allocating earnings for calendar year 1999 as to petitioning employers and certain intervening PERS members; (2) The 1998 employer rate orders as to certain petitioning employers; and (3) The 2000 employer rate orders as to other petitioning employers. The judge concluded that these orders were in error in the following respects:

***Variable Annuity Match.*** PERS erred by requiring employers to match the amount of earnings allocated to a member's variable account. Instead, the annuities from both the regular and variable account should be calculated on the same basis, and then the allowance adjusted to reflect variable account returns under ORS 238.260(12).

***Modern Actuarial Factors.*** By not adopting actuarial factors that used updated mortality tables, PERS failed to pay benefits that were "actuarially equivalent," as required by ORS 238.300, and its adoption of OAR 459-005-0055 was invalid.

***1999 Crediting to Employers in Variable.*** Crediting earnings from the PERS Fund to employers as if they had participated in the variable account breached the contract with and fiduciary duty owed to members because all earnings on employee funds not statutorily directed to other purposes must be credited to employee accounts.

***Failure to Fund Contingency Reserve.*** PERS had no discretion to fail to fund, maintain, and use a contingency reserve as required by ORS 238.670(1).

***1999 Crediting to Gain/Loss Reserve.*** PERS abused its discretion in failing to allocate sufficient amounts out of 1999 earnings to meet its 30 month funding goal for the Gain/Loss reserve. PERS must either meet this goal or explain the inconsistency so the court can review.

***1999 Crediting to Employee Accounts.*** PERS abused its discretion to allocate 20% of 1999 earnings to Tier One regular employee accounts.

## **Analysis of Implementation**

### **I. Prospective Changes**

These changes should be made to the calculation of all prospective retirements:

#### **A. Variable Match Benefits Calculation**

Staff has identified two approaches that both should comply with the judge's decision and presented them to petitioner's counsel to seek their cooperation in agreeing on the appropriate method to be used. One of the two methods more closely follows the judge's interpretation of the applicable statutes, but mathematically yields the same retirement benefit as the method we currently employ. If the identified approach would yield a different benefit payment amount to a retired member, then staff would need to begin using that approach to calculate benefits for all member retirements as soon as that calculation method can be reasonably incorporated into our systems.

*Action Requested:* Direct staff initially to work with legal counsel to determine a calculation method that complies with the judge's decision and begin implementing that method promptly for all prospective retirements as soon as that method can reasonably be incorporated into the retirement allowance calculation process.

#### **B. Actuarial Factor Benefits Calculation**

Since the judge's decision was issued, HB 2004 has been enacted into law. It specifies which actuarial factors should be used to calculate retirement allowances as of July 1, 2003. The legislation becomes the operative law on this matter as of July 1, 2003, and the agency is compelled to follow it.

*Action Requested:* None, as staff will fully comply with HB 2004 as of that law's effective date.

### **II. Reconsideration of Past Orders**

#### **A. 1999 Earnings Allocation**

The PERS Board's March 2000 order allocating earnings for 1999 was challenged by both petitioners and intervenors, and each prevailed on part of their claims.

##### **1. Employer in Variable Rule**

If the transfer to employers to reflect performance in the variable account had not occurred, earnings for 1999 would have been credited at a different rate. The judge held that crediting resulted in a breach of contract and fiduciary duty, and that members were harmed to the extent that rate would have resulted in having more earnings credited to their account. Also, a threshold question has to be answered as to whether this relief is owed to just the intervening members or to all members affected by the board's decision.

*Action Requested:* Direct staff to work with legal counsel to determine whether re-crediting would have resulted in more earnings being distributed to those members and the impact re-crediting should have on members and employers otherwise affected by the decision.

## **2. Gain/Loss Reserve Crediting**

The Board has several options to consider in implementing this portion of the decision. Options include (1) re-crediting 1999 earnings to fully fund the Gain/Loss Reserve to the 30 month goal; (2) adopt a different funding policy for the Gain/Loss Reserve than the 30 month goal, like a phase-in from the 18 month goal to 30 months; (3) attempt to draft an explanation as to why the 30 month goal was not immediately implemented as part of the 1999 earnings allocation order.

*Action Requested:* Direct staff to study these options and recommend the best course of action at a future meeting.

## **3. Contingency Reserve Crediting**

Assuming this holding only affects the 1999 earnings allocation, the PERS Board needs to establish policy to determine what the appropriate funding requirements are for this reserve.

*Action Requested:* Direct staff to work with legal counsel to determine the appropriate risks to be covered by funding this reserve and, further, once those risks are determined, recommend to the board the amount of money necessary from the 1999 earnings allocation to fund those risks.

## **4. Other Reserve Crediting**

Although not part of the judgment, the judge's final opinion and order did note that upon remand of the March 2000 rate order, the board must comply with the Benefits in Force Reserve provisions before allocating the remaining earnings in accordance with its discretionary authority.

*Action Requested:* Direct staff to comply with the foregoing in deriving its recommendations for recalculating 1999 earnings crediting.

## **5. Crediting to Tier One Member Accounts**

Resolution of this question will depend on the other earnings crediting decisions outlined above. Hopefully, all the necessary re-crediting decisions can be made in concert so a net effect can be determined and actual transactions will be limited to one pass through the affected accounts.

*Action Requested:* Direct staff to make a recommendation for reallocating 1999 earnings to member accounts based on other necessary re-crediting actions and other factors relevant to determining the appropriate rate to credit member accounts in this year. Incorporate any issues raised by HB 2003's remedial actions related to earnings crediting.

## **B. 1998 Employer Rates (Certain Petitioners Only)**

The 1998 rate order was remanded for only two of the named eight<sup>1</sup> PERS employers who were the petitioners in this case, the city of Eugene and Lane County. Note also

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<sup>1</sup> The Eugene Water and Electric Board ("EWEB") was one of the original petitioners but the judge found that they were part of the city of Eugene so EWEB does not have independent party status. Their rates will be affected as they are part of the city of Eugene and they have appealed the judge's determination.

that only those employers whose rate orders were specifically remanded to the PERS Board are entitled to relief under the judge's decision.

**1. Actuarial Factors Used**

These rate orders were based on actuarial factors that the judge found to be invalid. These employer's rates will need to be re-determined as if the actuary had used the correct actuarial factors for retirements from these employers.

*Action Requested:* Direct staff to work with the actuary to establish the correct level of employer liabilities as if the correct actuarial factors had been used to estimate those liabilities for purposes of the 1998 employer rate order for the city of Eugene and Lane County and recommend to the board a course of action to implement those revised rate orders.

**2. Variable Annuity Match**

The subject rate orders should be reviewed depending on the effect of the benefit calculation model that is determined to be compliant with the judge's ruling. Particularly in this area, the question of the scope of this review will need to be determined to conclude the effect that these recalculations will have on the rate orders that were remanded.

*Action Requested:* Direct staff to work with legal counsel to define the parameters of retirement calculations that would affect the subject rate orders and to work with the actuary to determine the appropriate 1998 rate order for the city of Eugene and Lane County and recommend to the board a course of action to implement those revised rate orders. Again, include in this review a consideration of the remedial provisions of HB 2003.

**C. 2000 Employer Rates (Certain Petitioners Only)**

All eight petitioners filed timely challenges to their 2000 employer rate orders and all of those orders were remanded by the judge. The actions necessary are very similar to those outlined for the 1998 rate orders but for a broader number of employers.

**1. Actuarial Factors Used**

*Action Requested:* Direct staff to work with the actuary to establish the correct level of employer liabilities as if the correct actuarial factors had been used to estimate those liabilities for purposes of the 2000 employer rate order for all named petitioners in this case and recommend to the board a course of action to implement those revised rate orders.

**2. Variable Annuity Match**

*Action Requested:* Direct staff to work with legal counsel to define the parameters of retirement calculations that would affect the subject rate orders and to work with the actuary to determine the appropriate 2000 rate order for all named petitioners in this case and recommend to the board a course of action to implement those revised rate orders. Again, consider HB 2003's provisions.

### **3. Re-Crediting of 1999 Earnings**

As a consequence of re-crediting earnings for calendar year 1999, the employer rate orders may need to be adjusted to reflect changes from prior crediting decisions (crediting earnings for the employer in variable, for example).

*Action Requested:* Direct staff to work with legal counsel and the actuary to determine the effect of the re-crediting of 1999 earnings on the 2000 rate orders for all named petitioners in this case and recommend to the board a course of action to implement these revised rate orders.

### **III. Scope of Remedy**

An over-arching issue in implementing the judge's decision is who is entitled to the relief granted. On the one hand, only the named petitioners and intervenors are entitled to the relief granted and any adjustment to accounts or rates could be limited just to those parties. On the other hand, the board may be able make a policy decision to apply the relief to all affected members or employers. Resolution of this issue is particularly pertinent to the 1999 earnings crediting order as it affected all members and employers, but arguments could also be raised in relation to employer rate orders.

*Action Requested:* Direct staff to consult with legal counsel to explore options and develop a recommendation to the board on the scope of members and employers who should be granted relief under the judge's rulings.

### **IV. Implementation Timeline**

Another universal issue applicable to all the action items listed in this memo is the need to act expeditiously to implement these decisions. Given the nature of the issues involved, the potential scope of the remedies, and the other exigent circumstances that are calling on agency resources at the present time, predicting which order or the time frame in which these changes can be implemented would be premature at this point. Staff would propose that once the PERS Board has provided definitive direction on the range of issues by taking action on the items listed herein, staff will begin actions to implement those decisions immediately and provide an implementation schedule with proposed time lines for each action item approved, including a final target completion date, at the next opportunity.

*Action Requested:* Direct staff to begin implementing the judge's decision immediately and present an implementation schedule with proposed time lines for each action item and a final target completion date at the next opportunity.