



Oregon

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TO: Members of the PERS Board

FROM: Steven Patrick Rodeman

SUBJECT: IAP Remediation & Related Policy Issues

MEETING DATE	6/24/05
AGENDA ITEM	D.3. IAP

OVERVIEW

- **Subject:** Posting of contributions and earnings to member's accounts in the Individual Account Program (IAP) has not produced results consistent with member and employer expectations. This memo explores the possible remedial actions to consider that would align the IAP more closely with stakeholders' views.
- **Action:** Staff will be seeking policy direction from the PERS Board as to the appropriate remedial steps, if any. When that direction is provided, staff will solicit stakeholder input and return with the specific supporting actions (i.e., administrative rule modifications, amended agreements, etc.) necessary to support that direction.
- **Reasons:** Systemic problems continue to prevent the IAP from meeting agency and stakeholder expectations. When members received their IAP account statements and gained access to their current account status via the web site, they could compare their status to their expectations, and these inconsistencies became readily apparent. Staff suggests a range of options that could either modify these expectations or move the program closer to the results anticipated.
- **Policy Issue:**
 - Which alternative would result in an IAP that best fits the PERS Board's policy direction?

BACKGROUND

The IAP was created by HB 2020 (2003) to serve two purposes. First, it provided a component of the retirement program for newly hired workers that resulted in part of their benefit being based on their member contributions (6% of salary). Second, it became the repository for the member contributions that the 2003 PERS Reform Legislation diverted from PERS Chapter 238 Program (Tier One and Tier Two) members' regular and variable accounts. The law that was passed in August 2003 required the IAP to be established in time to receive member contributions on salary paid on and after January 1, 2004.

This relatively short implementation time frame was compounded by the program's second purpose. PERS had to create a new program, similar to but not exactly like the old member account structure. It had to be built on a new technology platform that would interact with the agency's antiquated system that was neither designed nor adaptable to support such a program. Employers would need to learn and adopt an entirely new reporting structure that accelerated and altered the format and scope of the employee demographic and financial data that needed to be transmitted.

PERS and its employers have been scrambling ever since. Through extraordinary efforts, the vast majority of the 2004 transactions that should have been posted to member IAP accounts have been completed. 173,240 IAP accounts have been established and, as of June 3, 2005, \$503.9 million in account balances are invested under the program. At this point, only 3,075 accounts having contributions totaling \$165,036.61 that perhaps should have been posted in 2004 are not reconciled.

Even with these efforts by all parties, the following issues continue with the program as it now stands:

- Because 2004 contributions were not posted in a regular and systematic fashion, some members who are apparently similarly situated (same employer, job, salary) did not receive similar results. One member may have received a higher apparent rate of return because his contributions were posted *en masse* mid-year when the unit values were favorable, while the other's account with regularly posted contributions went through the flat or negative return periods through the year.
- The IAP contains structural delays to allow for processing and posting contributions. Members expect that once the contributions are made on their behalf, they should begin to receive the benefit of any earnings on those funds. The system's inherent structural delays make substantiating that assumption very difficult.
- Employers continue to experience difficulty in adapting their payroll systems to make automated reports that comply with the format standards PERS created in the jClarety system. Getting two computer systems to interact is always problematic, and this situation is compounded by many factors including available time, budget, and expertise, disparate requirements, or inadequate training. Over the course of the last year, the effect of these problems has lessened, but by no means has it been consistently resolved across the some 775 reporting employer units.
- Members don't understand the IAP and the role it's intended to play in their retirement. Many were unaware of the shift from PERS Chapter 238 Program accounts, others expect the IAP to operate in a parallel manner to their pre-reform Tier One/Tier Two accounts, and some believe it should reflect their expectations of a benefit funded by member contributions with associated self-direction from a menu of investment choices, like a 401(k) account.

PROGRAM PRINCIPLES

Reviewing the principles that PERS has tried to follow in forming the IAP is important to understanding the current state of affairs and deciding the best remedy for the situation. The program's developers tried to incorporate these precepts:

1. IAP contributions and related earnings on those contributions would be held and used exclusively for the benefit of IAP members. Conversely, administrative costs of the program will be recovered from members' accounts, as required by ORS 238A.350
2. The program would be transparent as to earnings, contributions, and administrative costs. Members would be enabled to openly review their account status and history. Previously, members did not know what was going on with their account(s) between annual statement periods.
3. Employer reporting would incorporate rigorous data standards. RIMS is riddled with erroneous data, in a depth, breadth, and quality that even today cannot be reliably determined. The advent of web-based reporting was to allow filters and controls to be installed that would hopefully improve the quality of the data provided and retained.
4. Eligibility determination would be automated. One of the fundamentally vexing features of the PERS plan is the complexity involved in answering the threshold question of whether someone is eligible to participate. IAP designers hoped the automated reporting system could assume the responsibility for this determination.
5. Financial impacts would be isolated to the parties involved in the transaction. For example, a member's contribution is late in posting and earnings that would have accrued to that contribution are not credited to that member. The philosophy was that the impact of that resolution should be limited to the parties involved (employer, member, PERS) and not spread generally to other participants in the fund.

Now having some 18 months experience with the IAP and the struggles to reach "normal" operations, PERS staff would restate the principles as follows:

1. IAP contributions and related earnings are still tracked discretely. Earnings are to be applied exclusively for the benefit and use of IAP participants. Costs are also tracked discretely and allocated to the program.
2. Transparency is still a value. Member access to account information should be as close to real-time as possible and the operations of the IAP should be clearly stated so expectations can be matched against actual production.
3. High data standards do not automatically result in higher data accuracy. Inability to post records led in some circumstances to manipulating data so it will post instead of always driving to actually correcting the record. Predominantly, errors are occurring in demographic data, so making the entire report subject to high standards before posting adds a financial consequence when that's not necessarily the area in error.
4. Eligibility determinations cannot be efficiently automated. Determining whether an employee is an IAP member can be simple or extremely complex; building a system to filter for the extremely complex determinations makes everyone subject to that rigor. In the IAP alone, our philosophy on this evolved from:

- Report all data. When the system determines a member is eligible (600 hours in a calendar year), we'll bill for contributions. That built in complex determinations, inherent delays, and unacceptable financial consequences.
- Report all data and make estimated contributions. If the system later determines the member isn't eligible, we'll return the contributions. That placed an unacceptable financial burden on employers and members to make "loans" to PERS until it could determine whether the member was eligible.

These approaches all tried to solve for the difficult cases; instead, perhaps employers should make the eligibility determination with the system providing verification and notification when circumstances arise. This does push the eligibility determination back to the employers, but is aligned with historical practice.

5. Financial impacts should continue to be isolated to the transaction and involved parties. System operations have to be clear so accountability can be assessed and responsible parties need to agree to absorb the financial consequence of their actions.

BASELINE PRINCIPLES

Staff recommends that whatever remediation plan the PERS Board ultimately adopts, the plan should reflect the following principles:

1. Because the IAP contributions and earnings (or losses) are discretely tracked, the only issue regarding IAP earnings allocation is the method by which the earnings (or losses) are to be distributed, not the amount of IAP earnings (or losses) available.
2. Members should not be harmed financially. PERS should undertake to determine what member account balances would have been had every process worked as it should have and credit or debit accounts accordingly.
3. Transparency and simplicity should continue to be core values for the IAP. Member access should continue through established channels. The IAP structure should be explained in more explicit terms and greater detail.
4. The IAP structure and reporting system should be as simple and understandable as possible. The IAP should not be expected or designed to be more than the statute directs. The purpose, design, and scope of the IAP was not determined until the very close of the 2003 legislative session, with a four month implementation window. The statute itself requires a very simple account structure: contribute 6% of subject salary to an individual member's account that's adjusted at least annually for earnings, losses, and administrative charges. Account balances are invested by the OIC in conjunction with the PERS Fund.

The program as implemented, however, provided much more than this simple model, with wage and contribution reports reconciled at least monthly, on-going account balance fluctuations depending on month-to-month market performance, and inconsistent analogies to private sector 401(k) plans that blurred or obscured expectations. PERS staff would instead recommend considering a return to basics; let's get a simpler model working acceptably before we look to expand functionality to accomplish additional purposes (e.g., self-directed investments).

IAP SYSTEMIC CHANGE ALTERNATIVES

PERS staff has identified the following alternatives to address the issues raised by the current situation with the IAP:

1. Maintain Status Quo

Possible Actions:

- 1) Develop procedures to avoid future mistakes, based on lessons learned in administering the system to date.
- 2) Assess staff allocations and training and modify as necessary.
- 3) Assess employer assistance and training efforts and modify as necessary.
- 4) Assess relationship/procedures with CitiStreet and modify as necessary.
- 5) Assess member and employer communications and modify as necessary.

2. Minor Modifications to Status Quo

Possible Actions:

- 1) Change to more frequent posting of member contributions and determining associated strike price to reduce structural posting delays.
- 2) Remove 85% posting bar for employer reports. Instead, post all valid records as received and have employers adjust unposted/invalid wage and/or demographic data as off-line adjustments.
- 3) Modify procedures, staff allocations/training, employer assistance/training, CitiStreet contract, and member/employer communications as necessary.

3. Major Modifications to Status Quo

Possible Actions:

- 1) Change earnings crediting to annual adjustments.
- 2) Recalculate 2004 and 2005 IAP account transactions and correct accounts accordingly in one 24-month period adjustment.
- 3) Modify CitiStreet contract or find alternative administrative support structure.
- 4) Modify procedures, staff allocations/training, employer assistance/training, and member/employer communications as necessary.

4. Fundamental Systemic Changes

Possible Actions:

- 1) Work with stakeholders, the legislature, and Governor's office to develop a common vision and change the statutory structure of IAP accordingly during the 2007 Legislative Session. For example, a more traditional defined contribution plan model with payroll-based reporting and minimal eligibility requirements could be developed.
- 2) Outsource IAP component to third party administrator, similar to OSGP model.

PROPOSED COURSE OF ACTION

The above alternatives address the issues raised by the current situation with the IAP are just preliminary. They have not been subjected to stakeholder review and input, nor have we fully analyzed the consequences of each alternative to members, employers, and the agency. Staff proposes that we concentrate our efforts in the following areas in the interim between now and the PERS Board meeting in August:

- Determine a dollar figure for the aggregate impact to member accounts from how contributions were actually posted in 2004 to assess the extent to which systemic anomalies may have impacted their overall projected value.
- Determine what would be involved in synthesizing each separate IAP member account to compare its actual balance with the value it would have reached had the system operated as designed.
- Open discussions with stakeholders (using the Legislative stakeholder and Employer Advisory Committees) on the alternative approaches described above and engage them in developing a consensus suggestion on how to address the current situation and principles to apply in developing any systemic changes.
- Develop a strategy to correctly adjust IAP member accounts (probably a combined 24-month adjustment to reflect 2004 and 2005), to incorporate systemic changes starting with account balances as of January 1, 2006, and to issue corrected adjustments to members who have withdrawn or retired in the interim period.
- Assess how to implement these strategies and system changes within existing staff and budget limitations.
- Report interim findings at the PERS Board's August meeting with opportunity for additional Board and stakeholder feedback, then develop final recommended actions for consideration at the September Board meeting.

STAFF RECOMMENDATION

- Staff recommend that the Board authorize the above described course of action and provide additional policy direction, if necessary, to guide the process.