

MEMORANDUM

to: PERS Coalition
from: Greg Hartman
subject: Phil Kiesling's PERS analysis
date: February 16, 2010

As you are all aware, Phil Kiesling has decided to take up the cause of PERS reform. As a result he has produced a lengthy white paper which unfortunately has substantial factual errors as well as faulty analysis about PERS. Given the complexity of the system and the history of litigation over the last 20 years, it is not surprising that Mr. Kiesling, who is a newcomer to these issues, has struggled in trying to understand PERS issues. Unfortunately in some instances Mr. Kiesling's opinions have been given far more credence than they deserve. The purpose of this memo is to give a brief overview of the various and sundry proposals made by Mr. Kiesling to "fix" PERS. It is not meant to be a point-by-point refutation of his extensive white paper but rather to focus on the remedial portions of his analysis.

Collective Bargaining/PERS Pick-Up

Several of Mr. Kiesling's proposals relate to "fixing" PERS through the collective bargaining process with particular emphasis on PERS pick-up. Mr. Kiesling correctly points out that the 6% pick-up is a matter of collective bargaining. It has been a matter of collective bargaining since it first was introduced into the system in 1979. Mr. Kiesling's various suggestions for tweaks or changes which could be made to the pick-up seem to arise out of the very fundamental misunderstanding of the collective bargaining process which gives rise to employer pick-up of the employee 6% PERS contribution.

In every instance in which an employer agrees to the pick-up, employees agree to forego a comparably-valued increase in compensation. In each and every subsequent collective bargaining negotiation the value of the employer pick-up of the PERS contribution is considered a part of the overall employee compensation package. In fact in many current collective bargaining agreements there is express trade-off language which provides that in the event there is some substantial change in PERS pick-up, then employees will receive comparable increases in base wages. With or without that language public employees will insist on comparable compensation trade-offs if there is some substantial change in the PERS pick-up system.

To the extent Mr. Kiesling is proposing the elimination or substantial modification of the pick-up statute, he is resurrecting a Bill Sizemore proposal which eliminated pick-up and which was declared unconstitutional by the Oregon Supreme Court in the *Oregon State Police* case.

Money match/unused sick leave/2% COLA

Mr. Kiesling states that those who elect money match benefits may increase those benefits through the use of unused sick leave. This is wrong on several counts. First, PERS participants do not choose a form of pension benefit calculation. There are alternative calculation methods and members receive the calculation that produces the most favorable result. While an employer can agree to permit the use of unused sick leave to enhance final average salary, which will increase the full formula calculation (ORS 238.350), it has no impact on the calculation of money match benefits. Mr. Kiesling states that money match recipients receive a 2% COLA as a result of collective bargaining agreements. In fact, COLA adjustments are required for all PERS retirees by ORS 238.360. In the *Strunk* litigation which took place as a result of the 2003 legislative changes, the COLA statute was held to be contractual in nature.

Changing the current collaring system

Mr. Kiesling appears to be of two minds on the use of collaring by PERS to limit contribution rates. At one point he suggests limiting employer contribution rates to a single-collared 3% yet in support of generational equity he proposes elimination of the collaring approach altogether. Collaring is simply a method of limiting the volatility of employer contribution rates. A fundamental characteristic of a defined benefit system is that contribution rates will go up with bad investment returns and down as a result of good investment returns. Collaring simply moderates the severity of those changes.

Buyout package

Mr. Kiesling suggests consideration of a buy-out package for Tier One/Tier Two participants. He may not be aware that money match retirees can elect a double lump sum cash-out of the entire value of their pension benefit at retirement. My understanding is a relatively small number of PERS participants elect this double lump sum option. If Mr. Kiesling's concept is to pay an amount substantially in excess of what a member would be entitled to at retirement, it's difficult to understand how this may relieve a funding problem. If his proposal is to pay substantially less than they are entitled to at retirement, it is not likely to attract the positive attention of very many PERS participants.

The assumed earnings rate

Every two years as part of its review of employer contribution rates PERS reviews its underlying assumptions including the assumed earnings rate. Based on expert opinion provided not only by the actuary but also by the consultants for the Oregon Investment Council, that rate is set for the next two years and will form the basis for the analysis of employer contribution rates. It is also the rate which sets the earnings guarantee for Tier One members and is used to convert the money match amount to a monthly benefit. While the PERS board has the right to change this assumption it must do so after consideration of expert actuarial advice. A change in

this rate which was not based on expert actuarial advice but rather was for the purpose of lowering employee benefits would no doubt be held to be a violation of employee rights, as the Oregon Supreme Court has twice held that this guaranteed rate of return is a contractual commitment to PERS participants. As Mr. Kiesling correctly points out a lowering of that assumed earnings rate would have the impact of raising employer contribution rates because it would reflect a lower expectation of return on the assets which are already in the system.

Creation of a Tier Four system

There is no legal impediment to the State of Oregon adopting a new, Tier Four system for those employees who have not as yet entered public service. The creation of any new system would provide little rate relief for employers as they would continue to be obligated to pay the benefits promised under our current system for current employees and retirees.

Summary

A review of Mr. Kiesling's proposals shows that they do not add anything to the ongoing discussion about PERS, PERS benefits, or current concerns about employer contribution rates. You should feel free to share this memo with anyone who believes Mr. Kiesling's analysis has brought something new and different to the PERS conversation.