Backgrounder

House Bill 2003

"The PERS Reform and Stabilization Act of 2003"

Elements of Proposal

1. Implement Marion County Circuit Court Judge Paul Lipscomb's decision by directing prospective remedies to the unlawful practices that the judge identified in his opinion. This is done by:

    a. Setting aside out of future earnings an appropriate amount of PERS investment income in reserve accounts and making sure earnings are first used to guarantee there is sufficient money to pay retired members.

    b. Curing the Board's mistaken practice over the last 20 years in calculating the "Money Match" benefit for members who participate in the variable program. The Board's errors have resulted in people retiring with higher benefits than they are legally entitled to receive. The Board is directed to calculate the variable match correctly in the future and the cost of past errors is paid out of future earnings.

    c. Immediately and fully implementing accurate and up-to-date mortality tables, as of January 1, 2003. The court found that the Board is unlawfully inflating retirement benefits by using outdated mortality tables.

2. Eliminate the statutory requirement that employees contribute 6% of their salary to their retirement accounts.

3. Restructure PERS governance.

Implement Lipscomb Decision

Reserving Practices

- The most significant unlawful practice that has contributed to the problem PERS faces is the persistent practice of the PERS Board in failing to set aside adequate reserves out of investment income and crediting more than is prudent to member retirement accounts.

- By crediting more to member accounts, the Board had a dramatic effect on the benefits earned by members and a dramatic impact on the liability that must be paid by the employers.

- When the stock market went down, beginning in 2000, and because of past income crediting practices by the Board, there was insufficient money in the system's reserve accounts to meet the obligations of the Fund, most notably to Tier One members who are guaranteed a rate of return equal to at least the assumed earnings rate, currently set at 8%.

- The bill makes specific changes to the Board's reserving practices and requires the reserve accounts to be paid before excess earnings are credited to member accounts.

Money Match Benefits

- The major driver of the costs of today's system is a benefit called "Money Match."

- Basically, when employees retire, they get the higher of the benefit calculated under Money Match or Full Formula. The Full Formula is 1.67% of salary multiplied by years of service. *Example*: if a person worked for 30 years, they would receive 50% of their final salary as their retirement benefit, unless the Money Match calculation was higher. For police and fire employees, the formula is 2% of salary multiplied by years of service.

- Today, more than 95% of PERS employees retire under Money Match rather than Full Formula. The reason is because the Money Match calculation provides that a member will get a monthly benefit based on the amount in their account, multiplied by two. *Example*: If an employee retires with an account balance of $400,000, they would receive a monthly benefit as if the account had an $800,000 balance.

- The effect of PERS' practices over the last 20 years, combined with the legislature's decision to provide a guaranteed rate of return, has driven up account balances to such a level that employees are retiring in their mid to early 50's with benefits that exceed their final salary.

- By PERS' own estimates, the average benefit for a 30-year employee was approximately 106% of final salary in 2000.

- The legislature, when it adopted the Full Formula benefit and modified the Money Match benefit in the early 80's, intended retirement benefits for a long-term member to be closer to 50% of final salary. This proposal gradually scales back the benefits to what the legislature intended to provide and, when combined with Social Security, provides an average retirement income equal to about 75 to 85% of pre-retirement income.

1999 Earnings

- The judge also ruled that the PERS Board abused its discretion when it credited 20% to member accounts in 1999. He set aside that income allocation and directed the board to reallocate the income.

- The bill directs that employer costs resulting from the total amount of 1999 earnings above the 8% assumed rate that was credited to Tier One member accounts will be recovered out of future earnings. The bill does not direct the reallocation of any money previously credited to member accounts.

Accurate Mortality Tables

- The Board has been unlawfully calculating benefits using outdated mortality tables, resulting in higher retirement benefits than would result if the Board used more accurate and updated mortality factors.

- The bill directs the full and immediate implementation of the most current mortality tables and requires the tables to be updated in each biennial valuation.

Recovering Unlawful Benefits

- The bill does not take any money out of current retiree benefits and does not reduce the account balance of any member's account. Instead, excess benefits that have been paid and will be paid as a result of the mistakes and the increased costs associated with the excessive 1999 earnings allocation, will be paid out of future investment income though a deficit expense account established by the bill. Retirees whose current benefits are higher than provided by law will not receive an annual cost-of-living adjustment (COLA) until their lawful benefits with the annual COLA equal or exceed the actual benefits they are being paid.

- The bill outlines a mechanism to calculate the expected cost and to pay that amount out of future earnings to the fund before earnings are credited to current member accounts. The result is savings to employers over time without affecting the benefits received by retired members and without reducing the account balances of current PERS members.

- This proposal attempts to balance several different considerations to work our way out of this problem. One of those considerations is the effect on those who retired and, through no fault of their own, based their retirement decision on what they were told their retirement benefits would be. Dramatically reducing their benefits now could have a profound impact on their lives and they might have made different choices had they had the right facts. In contrast, those employees still working have more time to adjust their plans based on the new reality. The bill attempts to spread the cost of correction in a manner that puts relatively less burden on those people closer to retirement.

Eliminate Requirement of Employee Contribution

- The bill eliminates the requirement in the statute that employees contribute 6% of their income to the retirement plan.

- As the PERS system is structured now, employees are required to contribute 6% and employers are required to contribute whatever else is necessary to cover the cost of the benefits provided by the system. Thus, employees provide 6% and employers make up the difference.

- The employee's contribution goes into an account in the employee's name. Investment income is credited to member accounts annually. Tier One member accounts are guaranteed by statute to be credited with income at not less than the assumed interest rate, currently 8%.

- By eliminating the requirement that employees contribute to their accounts, the growth of all current accounts is slowed. This will gradually reduce the projected future cost of the Money Match benefit, which is the major driving force behind the escalating cost of the system.

- For employees who join the system after the effective date of this act, the Money Match benefit will no longer be available. They will retire under the Full Formula.

- Eliminating the employee contribution requirement allows employees and employers to reach agreement through collecting bargaining where the employer actually "picks up" the employee contribution. The State of Oregon pays the 6% for its employees, as do many but not all local governments.

- The bill provides, upon its effective date, all collective bargaining agreements may be reopened for the sole purpose of renegotiating the effect of eliminating the employee contribution requirement.

- The effect of this change will differ from employer to employer, and from employee to employee. *Examples*: Lane County does not pick up the employee contribution so when employees are no longer required to pay a retirement contribution, it will be determined at the bargaining table how much is allocated to raises and how much is retained to preserve county services. Multnomah County provides that if, for any reason, the employer no longer pays the employee contribution then the employee gets a 6% raise.

Savings to Taxpayers

- The savings to taxpayers are dramatic and immediate.

- There are two important points to note. First, the estimates are based on a very preliminary analysis by PERS' actuary of the fiscal impact of these changes. They are only estimates and are subject to further refinement. Second, the estimates use, as a point of comparison, the 2001 actuarial valuation of the PERS system just completed and we know that PERS has lost more money in 2002 because of poor investment earnings. So while the estimates give an idea of how much can be saved, it is important to note that PERS has continued to lose money since the 2001 valuation and the projected future costs of the system will continue to go up as long as investments continue to fall short of expectations.

- With those caveats, PERS' actuary estimates these changes will produce dramatic savings.

  √ As of the 2001 valuation, PERS had an unfunded actuarial liability (the amount needed to meet its obligations) of $5.6 billion. If every element of this proposal is adopted, the unfunded actuarial liability will be reduced to $667.4 million, a projected savings of $4.9 billion.

  √ Based on the 2001 valuation, the actuary has concluded that the total cost of PERS is equal to 22.48% of payroll. If the changes proposed here are adopted, the cost would drop to 12.65% of payroll, or a change in rate of 9.83%. The immediate annual savings to taxpayers is estimated at $614.8 million.

  √ A significant amount is saved by immediately and fully implementing accurate mortality tables. That change alone results in estimated savings of $1.7 billion and reduces employer contribution rates by 2.21% of payroll.

  √ Eliminating the requirement that employees pay 6% of income into their retirement account is perhaps the biggest surprise. It saves $1.9 billion and reduces employer contribution rates by 6.98%.

Impact on Benefits

- Reducing the cost of the system can only be accomplished by reducing projected future benefits. This proposal gradually ratchets down the benefits that current members will receive.

- According to the PERS actuary, the impact on projected benefits for members who are currently eligible for retirement or within a few years of retirement will be minor. The impact on projected future benefits for members who are still years away from retirement will be more dramatic.

- An employee earning $40,000 with 20 years of service who retires in 10 years would retire with a benefit equal to about 53% of final salary (before Social Security). The employee would still retire under Money Match, but with less of an enhanced benefit. Without a change, an employee in this category would retire at about 75% of final salary.

- An employee with 10 years or less of service and who retires in 20 years would retire using the Full Formula calculation and would receive 50% of final salary (before Social Security), rather than at 57% of final salary if no changes are made.

Make Up of PERS Board and Independent Legal Counsel

- The bill reduces the number of PERS board members to five, three of whom must be public members, not PERS participants. One of the five must be a non-management PERS member and one must be a representative of a PERS employer.

- Currently, the PERS board chooses it chair. Under this proposal, the Governor appoints the board chair.

- Currently, the board and PERS receives its legal services and advice from the Department of Justice. This bill would authorize and require the board to retain independent legal counsel who is not a member of PERS.

HB 2003 requested by City of Eugene, Oregon School Boards Association, Portland Business Alliance, Canby Utility Board, Rogue River Valley Irrigation District, Association of Oregon Counties, City of Huntington, Oregon Business Council, Associated Oregon Industries, Special Districts Association of Oregon, League of Oregon Cities, National Federation of Independent Businesses, Oregon Business Alliance.

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