**Subject:** IPO Report on PERS
**Attn:** 2018 nominees and cross-nominees
**From:** IPO subcommittee on government accountability
**Date:** 8/23/2018

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## Summary

No issue features more prominently in the ability of Oregon governments to provide services to citizens than the cost associated with Tier 1 and Tier 2 pensions of existing PERS retirees. Employer costs associated with PERS are currently 15 percent of payroll across all units of government (state, counties, cities, school districts, special districts). They are expected to rise to nearly 20 percent of payroll in the 2019-2021 biennium.

### Projected 2019-2021 Contributions

| ($ millions) | Projected 2017-19 Payroll* | (A) Projected 2017-19 Contribution | Projected 2019-21 Payroll* | (B) Projected 2019-21 Contribution | (B - A) Projected Contribution Increase |
|---|---|---|---|---|---|
| State Agencies | $ 5,920 | **$ 820** | $ 6,350 | **$ 1,125** | **$ 305** |
| School Districts | 6,630 | **925** | 7,100 | **1,300** | **375** |
| All Others | 7,650 | **1,130** | 8,200 | **1,540** | **410** |
| Total | $ 20,200 | **$ 2,875** | $ 21,650 | **$ 3,965** | **$ 1,090** |

The biggest financial costs associated with this rise in PERS liability relates to “defined benefit” pensions of Tier I and Tier II employees who retired prior to 2002 that far exceeded the capacity of the system to pay. Steps have been taken to reduce those costs, specifically with the addition of OSPRP (Tier III). However, although OSPRP is less generous than Tier I and Tier II, it is still, principally, a defined benefits plan. Oregon’s continued use of defined benefits pensions, as opposed to defined contribution plans, creates significant and ongoing unnecessary risk for local jurisdictions.

## Background

Oregon’s Public Employee Retirement System (PERS) was created in 1946 to help government workers including police, firefighters, teachers and others set aside money for retirement. For the first 30 years of the program, the state invested in generally conservative bonds and matched employee contributions (Money Match) into the retirement fund. This led to relatively weak financial performance and triggered a series of changes that destabilized the system.

In 1970, the state changed the system to allow more aggressive investment into stocks and in 1975, established a **“defined benefits”** retirement plan that guaranteed a 7-8.5% return on investment regardless of the performance of the fund. From 1975 - 2000, the average rate of return to the PERS fund was nearly double the guaranteed rate of return, but the PERS board, which was then dominated by the public employee unions, voted to credit the bulk of the returns to retirees rather than set money aside to stabilize the fund. As a result of these decisions and other decisions that heavily favored employees, the system paid out significantly more in benefits than it was designed for. So, the fund is now not able to sustain itself during market downturns which have happened in 2000 and several times since.

| | | Distributions (%) | | | |
|---|---|---|---|---|---|
| Year | Earnings (%) | Tier One | Tier Two | Variable Account | IAP |
| 1985 | 21.38 | 15.00 | | 27.99 | |
| 1986 | 22.70 | 18.37 | | 18.98 | |
| 1987 | 9.00 | 7.50 | | 4.54 | |
| 1988 | 16.86 | 13.50 | | 18.62 | |
| 1989 | 19.74 | 14.50 | | 26.84 | |
| 1990 | -1.53 | 8.00 | | -7.84 | |
| 1991 | 22.45 | 15.00 | | 35.05 | |
| 1992 | 6.94 | 8.00 | | 10.54 | |
| 1993 | 15.04 | 12.00 | | 12.65 | |
| 1994 | 2.16 | 8.00 | | -1.76 | |
| 1995 | 20.78 | 12.50 | | 29.92 | |
| 1996 | 24.42 | 21.00 | 24.42 | 21.06 | |
| 1997 | 20.42 | 18.70 | 20.42 | 28.87 | |
| 1998 | 15.43 | 14.10 | 13.63 | 21.45 | |
| 1999 | 24.89 | 11.33* | 21.97 | 28.83 | |
| 2000 | 0.63 | 8.00 | 0.54 | -3.24 | |
| 2001 | -7.17 | 8.00 | -6.66 | -11.19 | |
| 2002 | -8.93 | 8.00 | -8.93 | -21.51 | |

In 2003, in response to the impact of PERS expenses on state and local government, the Oregon legislature changed the composition of the PERS board, created the Oregon State Public Retirement Plan and began enrolling new employees hired after August, 2003 into the plan. OSPRP is a defined benefits plan that guarantees 1.5% of salary in retirement for each year up to 30 years of service and allows employees to invest into their own 401k-style side account.

Currently, the system’s total unfunded actuarial liability is $22 billion. That money affects the rates that employers must pay into the system, either from their general fund, or from side accounts they have established to offset these costs.

Although most of the liability attaches to Tier 1 employees who retired prior to 2002, the continued use of defined benefits pensions creates a similar risk for government units without significantly improving the cost mission of those units (the delivery of public services).

**Funded Status & Unfunded Actuarial Liability (UAL)**

| System-total Pension Funded Status ($ billions) | | | |
|---|---|---|---|
| *Valuation date:* | 12/31/2015 | 12/31/2016 | 12/31/2017 |
| *Assumed return:* | 7.50% | 7.20% | 7.20% |
| Actuarial liability | $ 76.2 | $ 81.0 | $ 84.1 |
| Assets (excluding side accounts) | 54.4 | 55.7 | 61.8 |
| **UAL (excluding side accounts)** | **$ 21.8** | **$ 25.3** | **$ 22.3** |
| **Funded status (excluding side accounts)** | **71%** | **69%** | **73%** |
| | | | |
| Side account assets | $ 5.6 | $ 5.4 | $ 5.6 |
| **UAL (including side accounts)** | **$ 16.2** | **$ 19.9** | **$ 16.7** |
| **Funded status (including side accounts)** | **79%** | **75%** | **80%** |



## Solutions

- Increase funding of state matching funds for side accounts to enable local jurisdictions to set aside funds to offset future PERS cost increases.

- Establish a new tier that is not based on a defined pension benefit, but instead is based on a defined contribution (e.g., 401k).

- Establish a new “cadillac pension” tax on all pension plans over a certain amount or that exceed 100% of final salary in retirement and use money from that fund to help defray expenses associated with PERS.

- Much of the problem moving forward on reforming PERS is the disagreement on legal limits of possible reforms and the cost savings. We need more and accurate and agreed upon data. The Legislature should authorize an independent outside counsel to review the top 10 PERS changes from the Democratic leadership and the Republican leadership and direct that counsel to report to the Legislature on the potential constitutionality of all proposed reforms. Any reforms thought to be constitutional, should be forwarded to Legislative Fiscal Office for economic scoring.

## Further Materials / Reading

- PERS: By the Numbers, PERS Board
- Oregon PERS: Impact of the Strunk Ruling, PERS Board
- Oregon’s $22 billion pension hole: How did we get here?, Oregonian
- A $76,000 monthly pension, NY Times