New Approaches to PERS Reform

- ✓Need for Reform: New Data
- ✓Impacts on Services. Spotlight on Education
- ✓Views of Public Employees & Oregon Voters
- ✓Framework for a Comprehensive Solution

OREGON BUSINESS PLAN

December 3, 2018

Sources

Data

October 2018 Milliman Report to PERS Board

September 2018 PERS by the Numbers

September 2018 State Economic and Revenue Forecast

August 2018 Milliman Report to PERS Board

November 2016 Milliman Report to PERS Board

Opinion Research

DHM Research: Focus groups of state and local government employees (8/21/18 & 8/25/18)

Public Opinion Strategies statewide survey of 600 registered voters (10/4-10/7/18)

Scope of the Problem

PERS Unfunded Liability = $22.3 Billion

$13,369

per

Oregon Household

$128,900

for every

Public Employee

PERS Costs as Payroll Costs

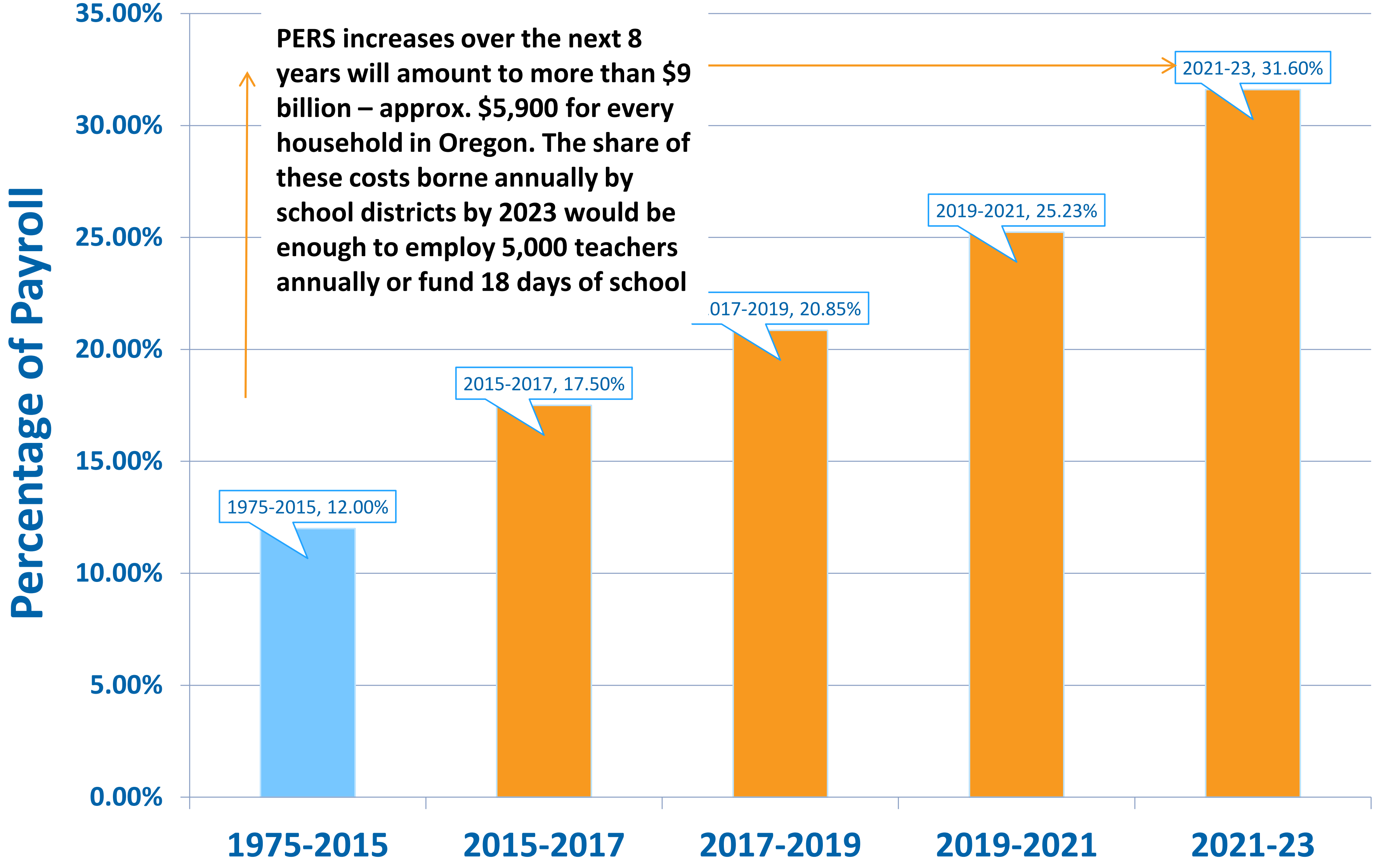
PERS "Base Rates" are nominal rates, before the offsets for side accounts and other adjustments

PERS "Net Rates" are effective rates, after the offsets for side accounts and other adjustments

Actual costs are a combination of **Net Rates** and **debt service for Pension Obligation Bonds** and average out to be one percent of payroll less than Base Rates

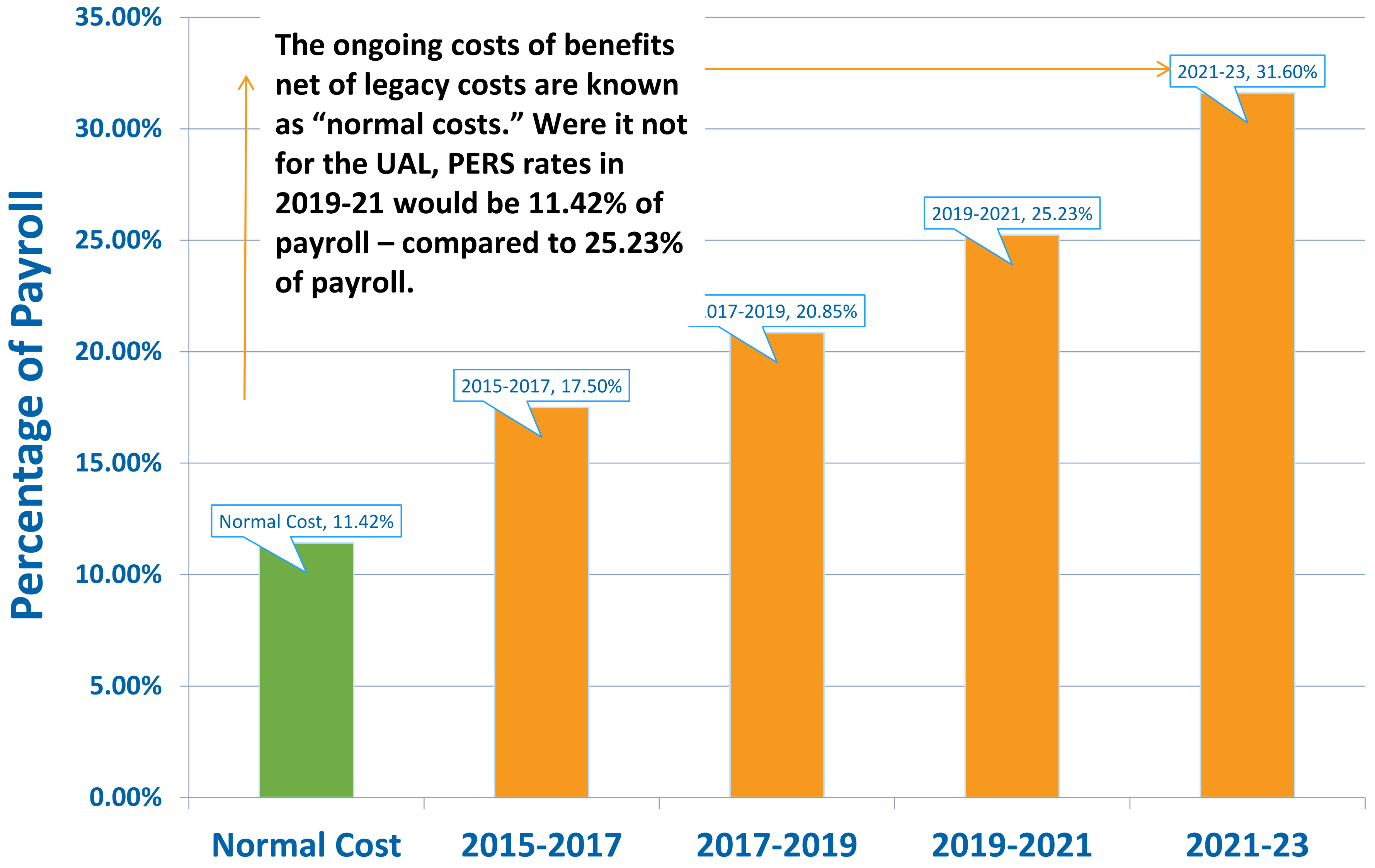
Past, Current & Projected PERS Employer Rates

(Base rates, excluding side accounts and IAP; rates beyond 2019-21 to be Updated in December 2018)



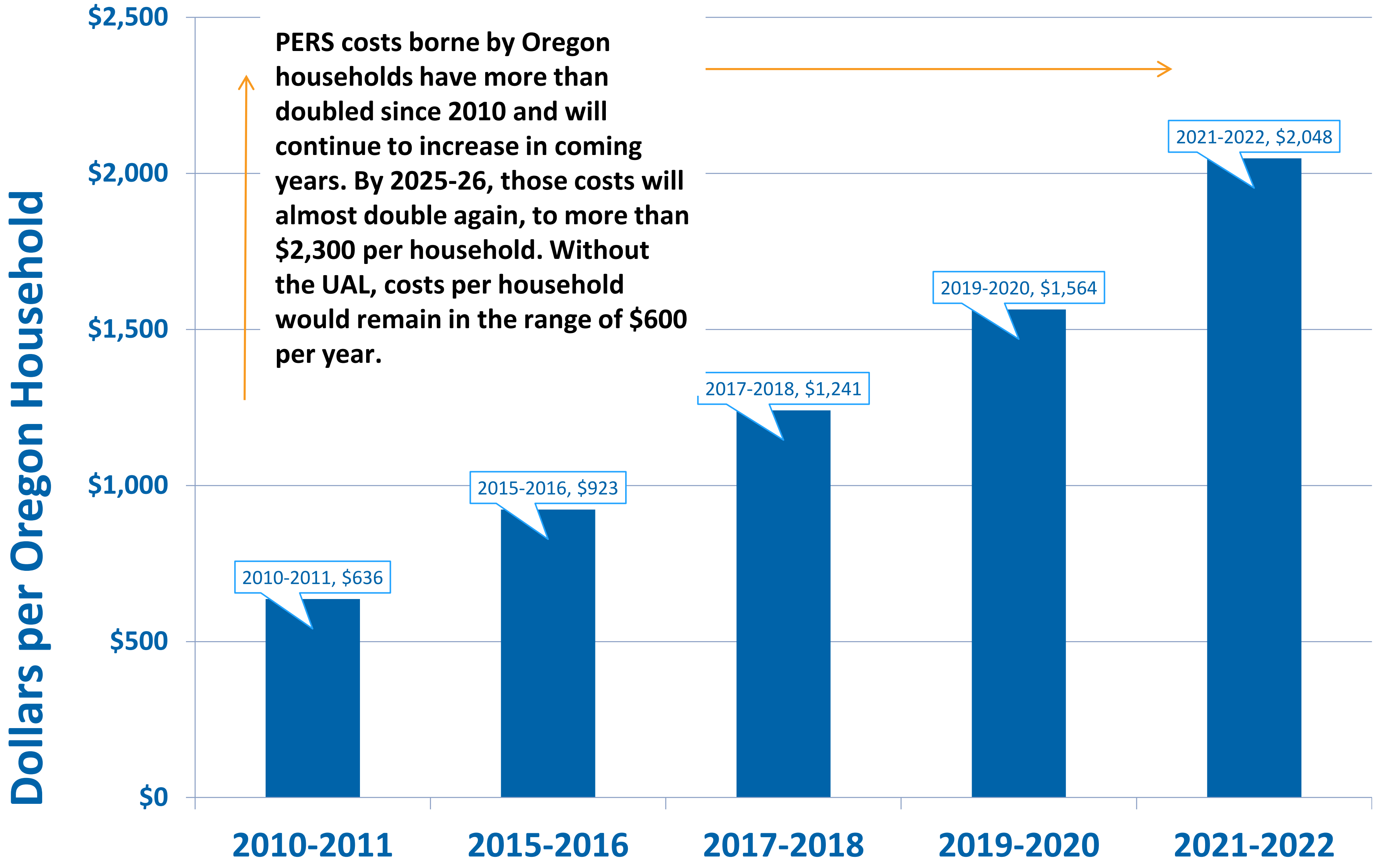
PERS Employer Rates Driven by UAL

(Base rates, excluding side accounts and IAP; rates beyond 2019-21 to be Updated in December 2018)



PERS Costs Borne by Oregon Households

(System-wide annual payroll costs divided by the number of Oregon households in each of the cited years)



PERS Costs: An Expensive 8 Years

Total projected **INCREASE** above 2016-17 over the following 8 years:

$9.9 Billion

(net of payroll growth)

K12 Schools	$3.2 Billion
State/Universities	$2.9 Billion
Cities/Counties/CCs/Other	$3.8 Billion

These are funds that will be diverted from budgets and services.

Impacts on Educaton

✓

- Jim Green, Executive Director
  Oregon School Boards Association
- Rex Fuller, President
  Western Oregon University

Takeaways

✓

✓Impact on taxpayers

✓Claims on budgets and effects on services

✓Barrier to a better future

"In a strong economy, we should be getting ahead, not falling behind."

Causes of the Problem

How PERS Defines Its Retirement Goals

The goal of the PERS system is to provide an adequate lifetime benefit after a career of public employment, which has been defined as:

50% of final average salary after 30 years + Social Security = 75 to 85%.

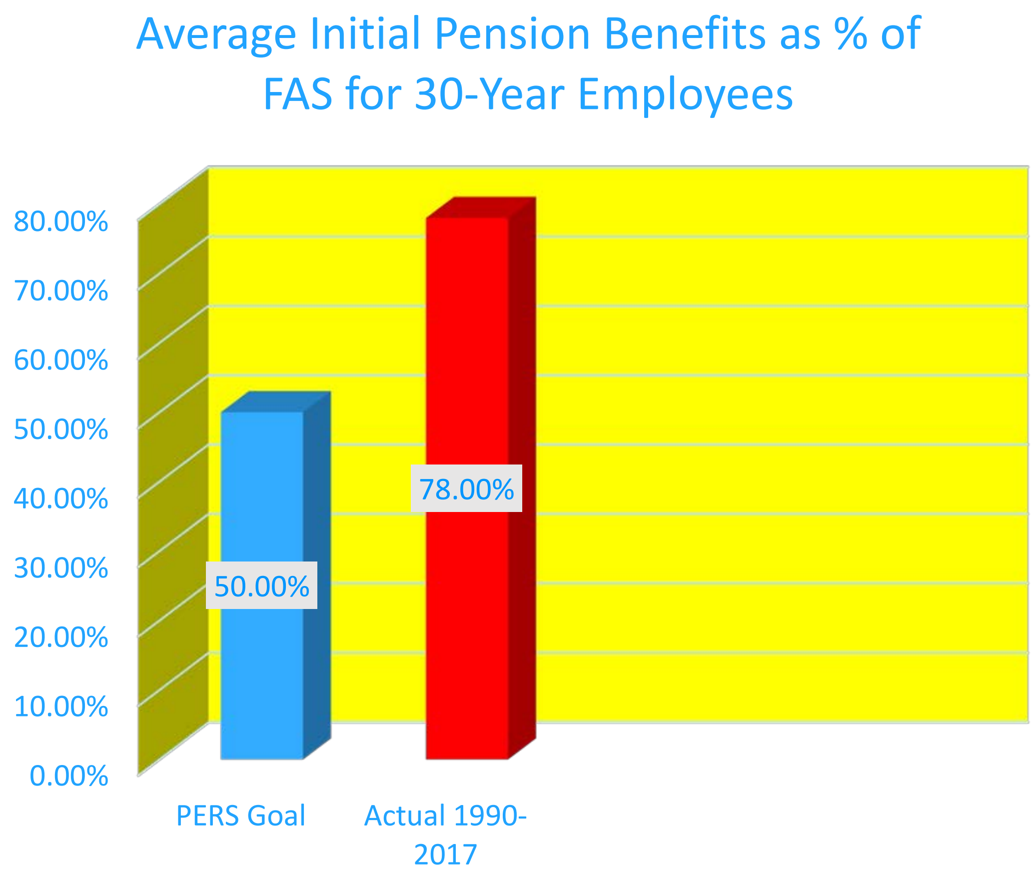
“In 1981…the PERS actuary advised legislators…that the Full Formula Benefit, when combined with Social Security Benefits, would provide 75 to 85 percent of preretirement income for career employees…The formula provides 50 percent of final average salary for career employees…”

--

Special Master’s Written Report and Recommended Findings of Fact
Hon. Judge David Brewer, April 8, 2004

Excesses of the system

- PERS payouts have far exceeded the system's goal
- Career employees' pensions have averaged 78% of final average salary since 1990
- More than half of all retires since 1997 have received benefits about the pension formula (Money Match)



The Money Match Problem

- Money Match payouts (for Tier 1 and 2) are responsible for the lion's share of the PERS UAL
  - Better than the years-of-service formula
  - Annuitized at overly generous rates

- Money Match payouts continue to represent a sizable portion of retirements (43% in 2017)

- Tier 1 and 2 employees with access to Money Match constitute 34% of the current workforce, slightly higher among K-12 employees

But Money Match Isn't the Only Problem

- ✓ **The Tier 1 salary base for the pension formula remains unlimited, while pensionable salaries for Tier 2 and OPSRP are capped at $275,000/year**

- ✓ **The use of unused sick leave and vacation in Tier 1 and 2 inflate final average salaries**

- ✓ **Even OPSRP benefits exceed the system's goal for career employees, now that the pension plan is supplemented with the Individual Account program**

A Tale of Two Retirement Plans

“Bare Bones” Tier 1 & 2

(w/o Money Match, or Sick Leave/Vacation)

Formula = 50% of FAS at 30 years

IAP = 6-9% of FAS at 15 yrs

Combined = 56-59% of FAS

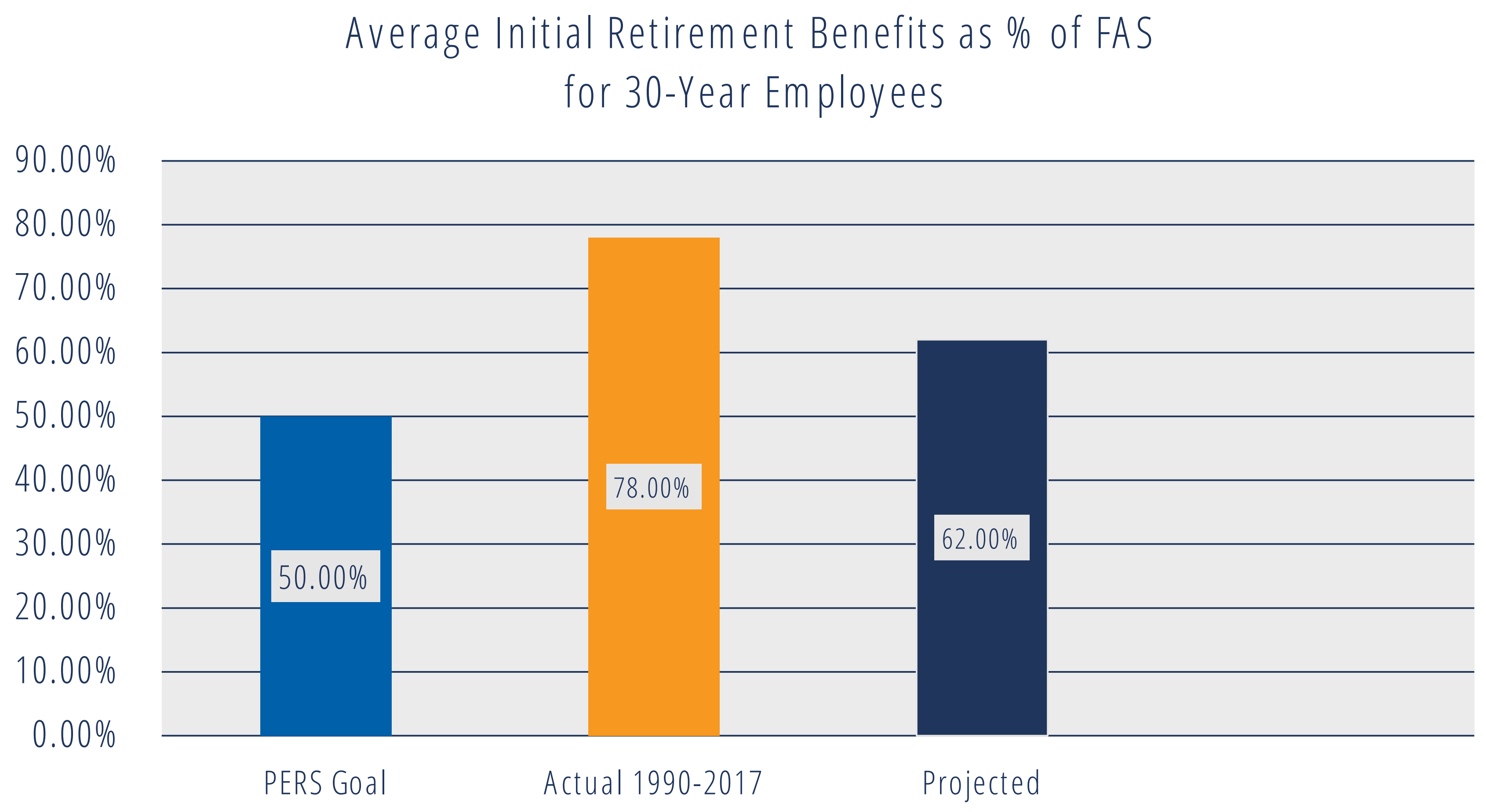
OPSRP

Formula = 45% of FAS at 30 years

IAP = 13-19% of salary at 30 yrs

Combined = 58-64% of FAS

Retirement Payouts Overshoot the PERS Target



What Can Be Done

LEGAL: Moro Decision Clarifies What Can Be Done

In Moro v. Oregon (2015), the Supreme Court changed its minds about what changes can be made to the system:

- Keep the promise for benefits earned to date, but:
- Changes may be made going forward:
  - <u>Benefits to be earned in the future are (with limited exceptions) modifiable</u>
  - <u>Employee contributions may be established</u> for pension benefits going forward (See also, *Strunk v. PERB*, 2005)
- Note: In Moro, the Court reversed its earlier OSPOA decision and rejected the "California rule."

How Far Can the *Moro* Decision Take Us?

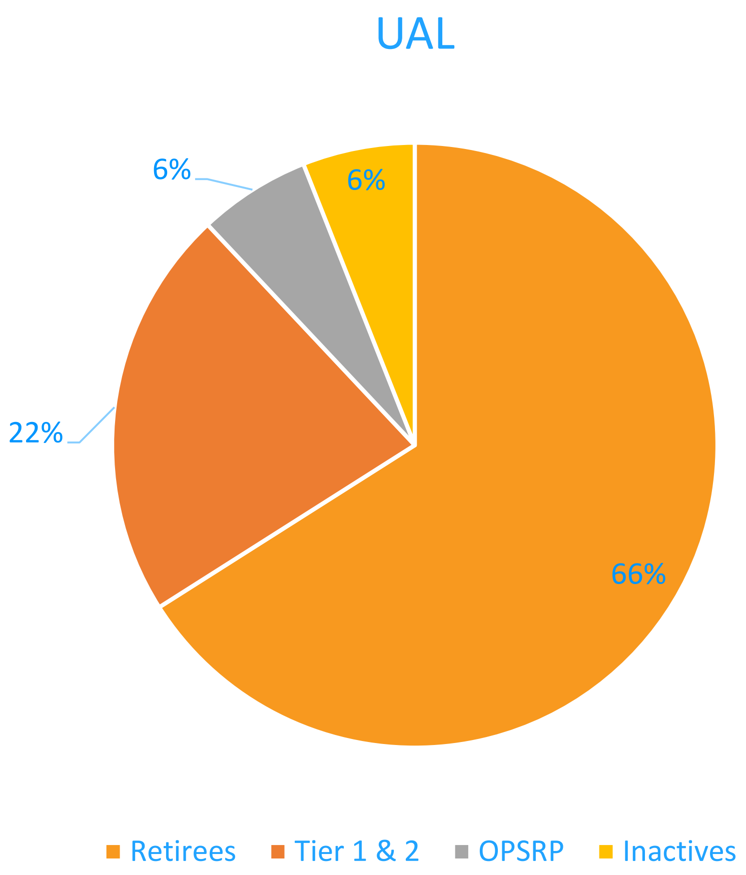
Legacy costs are baked in:

- Liabilities for those retired remain beyond the reach of reforms.
- Prior underfunding for current employees appear to remain beyond the reach of reforms.

But going forward costs can be reduced:

- But the ongoing costs of benefits accruing from now forward can be reduced via prospective benefit reductions or employee cost sharing

What Can We Reasonably Expect From Adjustments Affecting Current Employees?



One measure for fairness for cost reductions affecting current employees →

Underfunding for benefits accrued by active employees amounts to **$6.4 billion of the $22 billion UAL = 6 points of payroll**

What do public employees think?

PERS Focus Groups

August 2018

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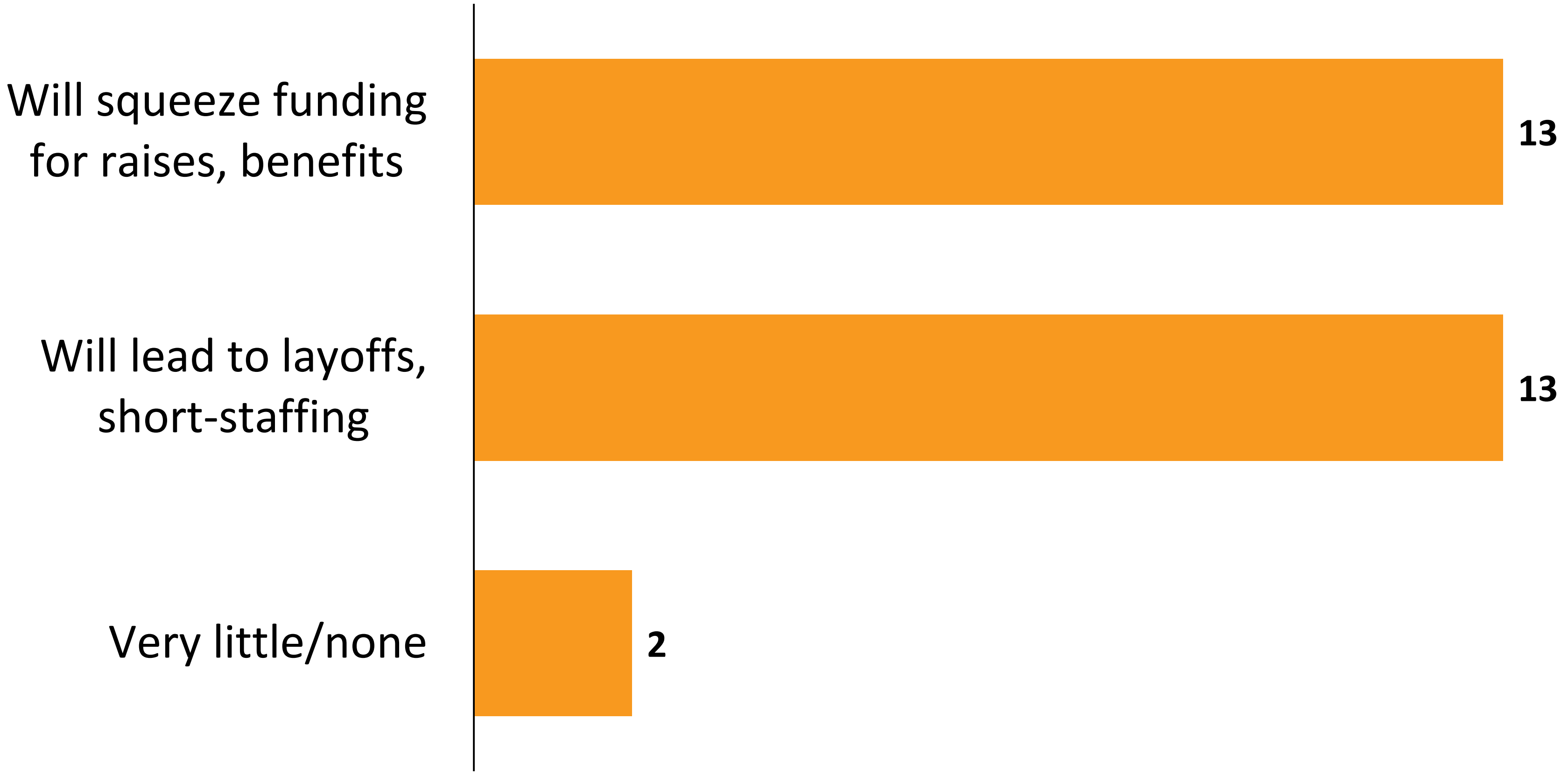
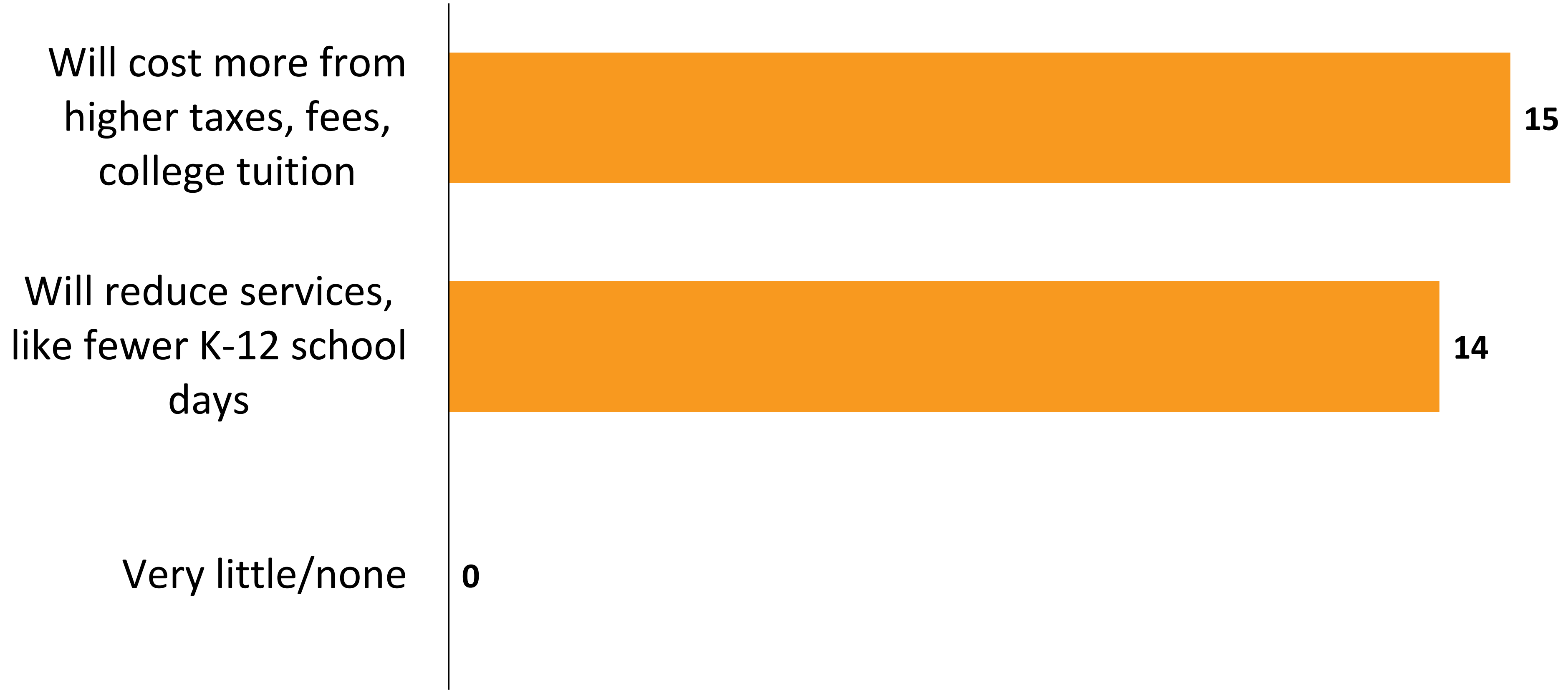
Methodology

- Two focus groups with Tier 3 PERS members
- Conducted August 21 and 25, 2018 in Portland and Salem
- Participants were either city employees (Portland group) or state employees (Salem group)

Impacts of PERS Costs at Work



Impacts of PERS Costs at Home

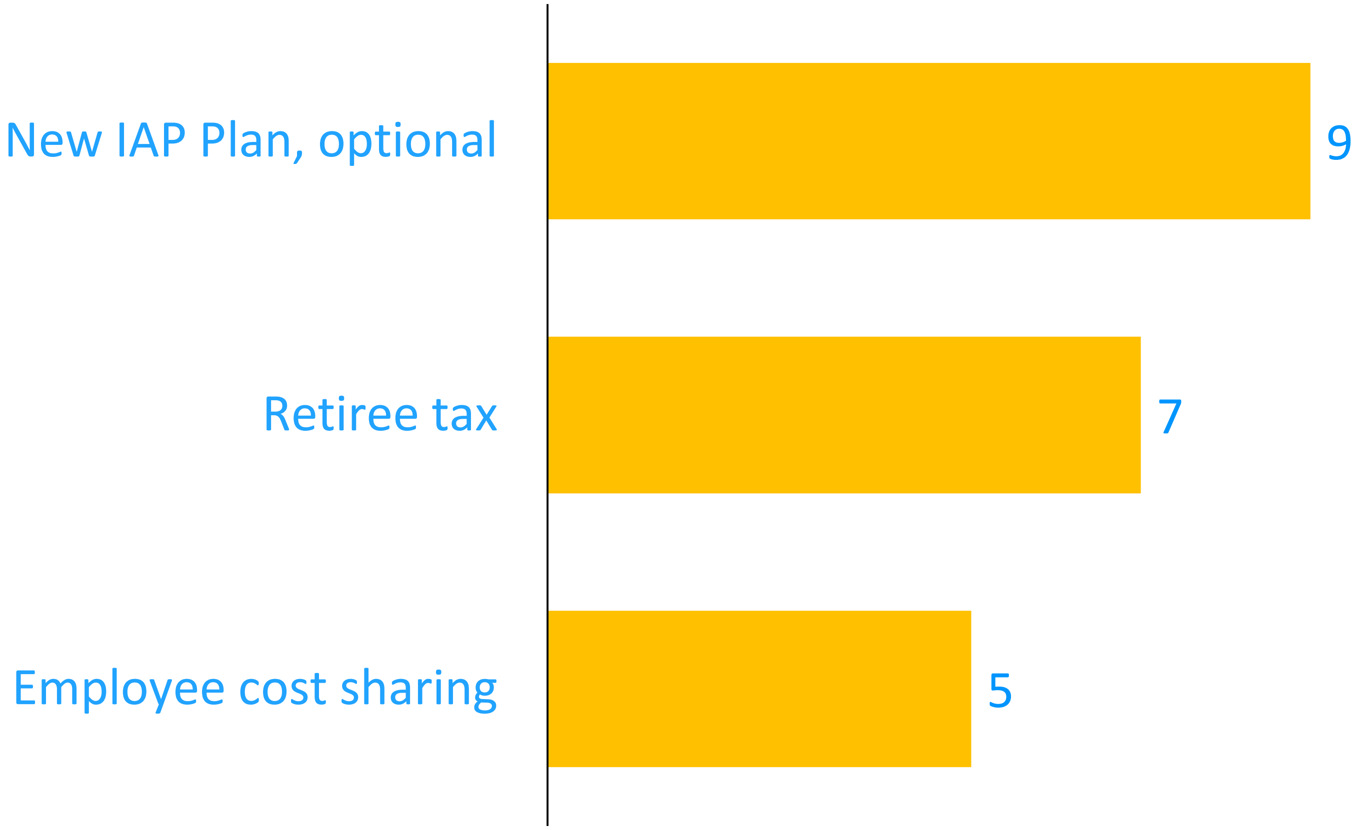


In Their Own Words:

“I’m appalled at the cost to taxpayers and how the state and pension system allowed this to happen. This is devastating our communities.”

“The state seems screwed. Not sure where they’re going to find the extra money. We already pay insane income taxes.”

Most Preferred Reform Options



Final Thoughts

- Participants seem willing to accept reforms that require modest contributions from PERS employees
- Perceptions of fairness are critical—between different tiers and between the wealthy and the middle class
- Participants—and voters generally—will likely continue to point to unworkable solutions because they lack deep understanding of the Supreme Court and tax structure limitations

Key Findings from Statewide Voter Survey

Survey of 600 registered voters, Oct. 4-7, 2018, found:

- Strong support for a defined contribution plan

- Strong support for employee cost sharing

Approaches to Reform

Touchstones for Reform

- **Fair:** Honor benefits earned to date…but correct the excesses that have plagued the system.
- **Legal:** Follow the path charted by the Oregon Supreme Court
- **Flexible**: Provide employee choices to suit career plans
- **Better**: Apply savings to improve and expand services for Oregonians.

Goals and Components of Comprehensive Reform

- Rebalance costs and benefits to offset future payroll rate increases for employers
- Ensure benefits are adequate, competitive for employers and affordable for taxpayers
- Create options for employees and employers
- All savings stay in budgets to preserve and enhance services
- Manage remaining liabilities so as not to place an undue burden on next generation of Oregonians (“kids in today’s classrooms”)

Approaches to Reform

- **Employee cost sharing**

- **Benefit rebalance**, to align with post-2003 structure

- **System rebalance**
  - **Pension plan or**
  - **Expanded IAP**

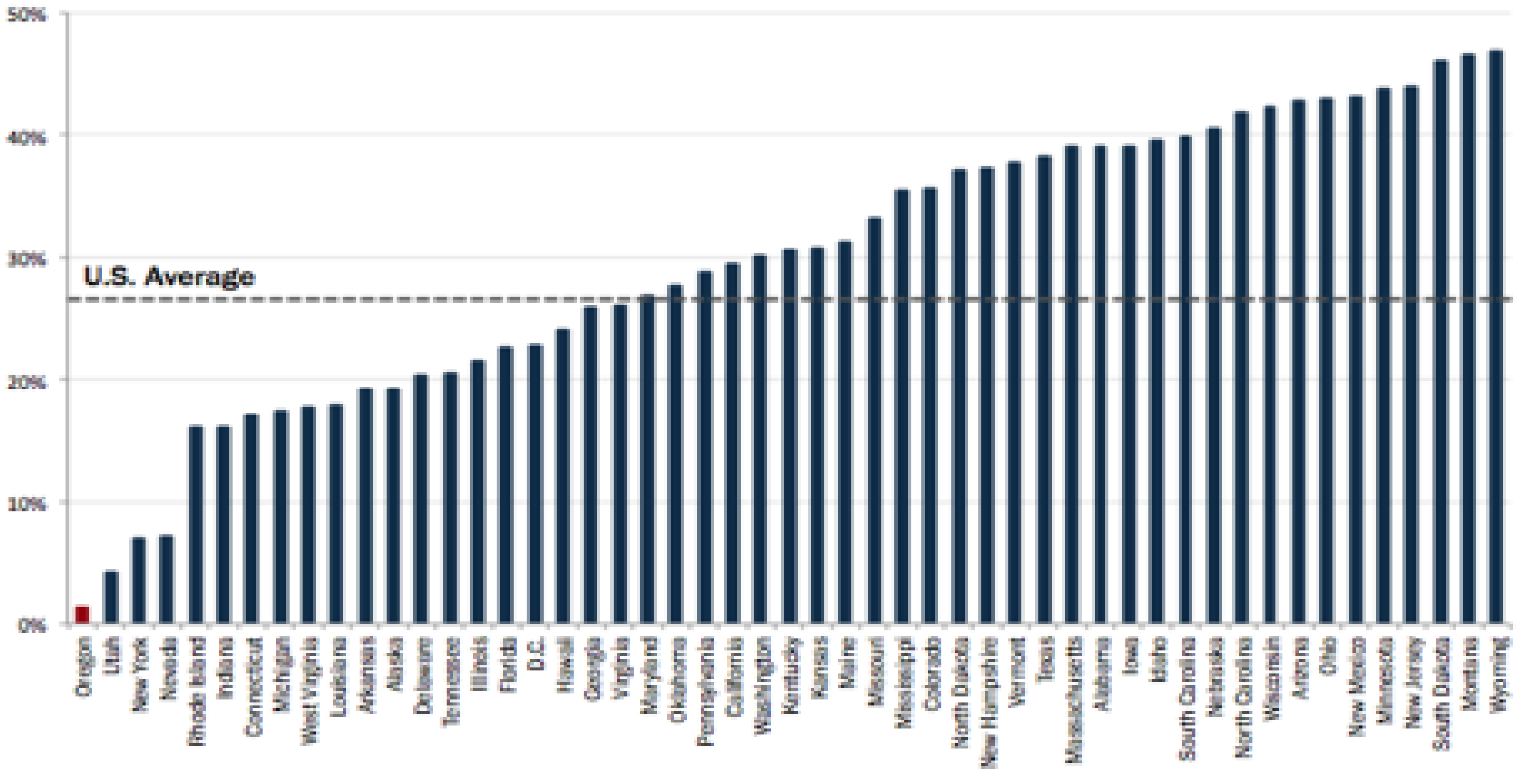
  but not both

- **Retiree "pay back" options**

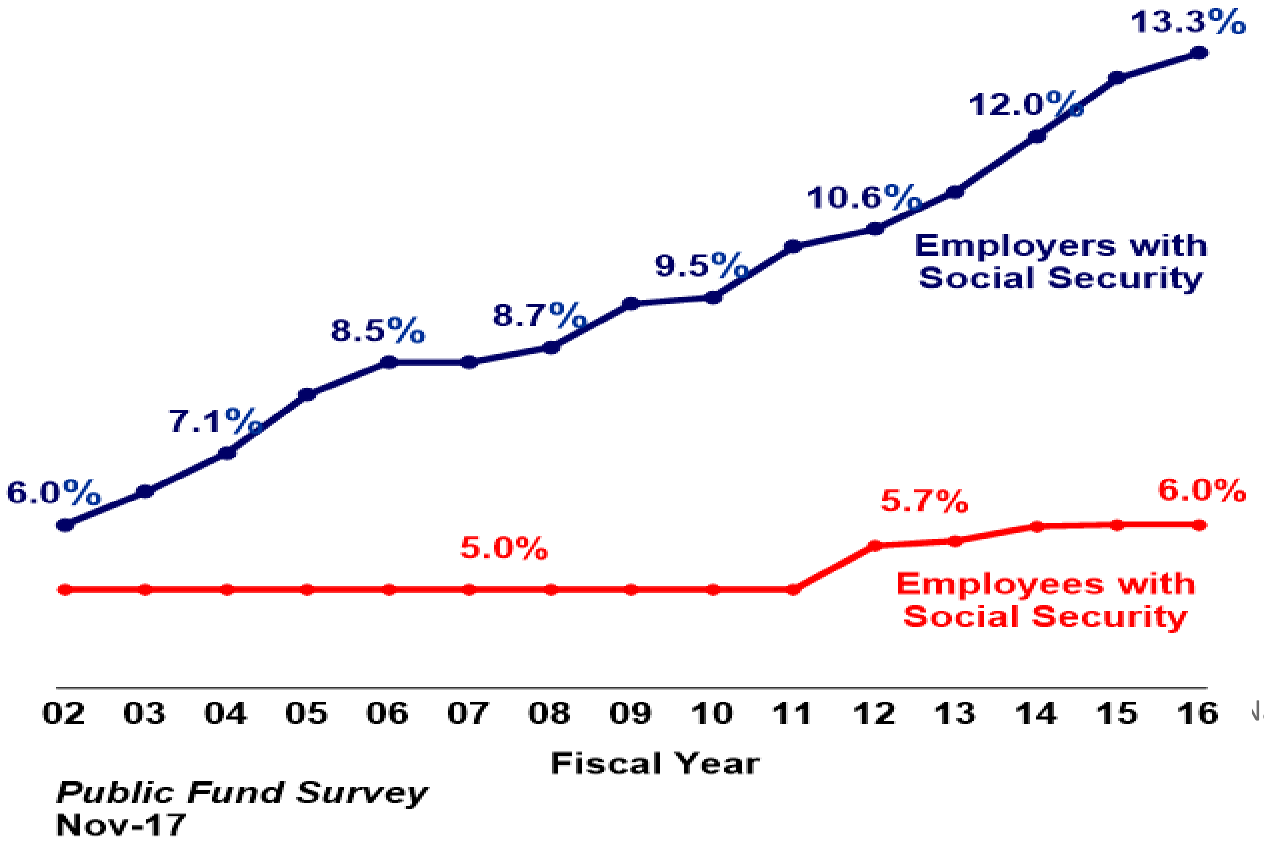
The Case for Employee Cost Sharing

Employee Contributions: Oregon Is an Outlier

Employee Share of Contributions, State and Locally Administered Defined Benefit Pension Systems, FY 2014



Average Contribution Rates Across U.S. Defined Benefit Plans

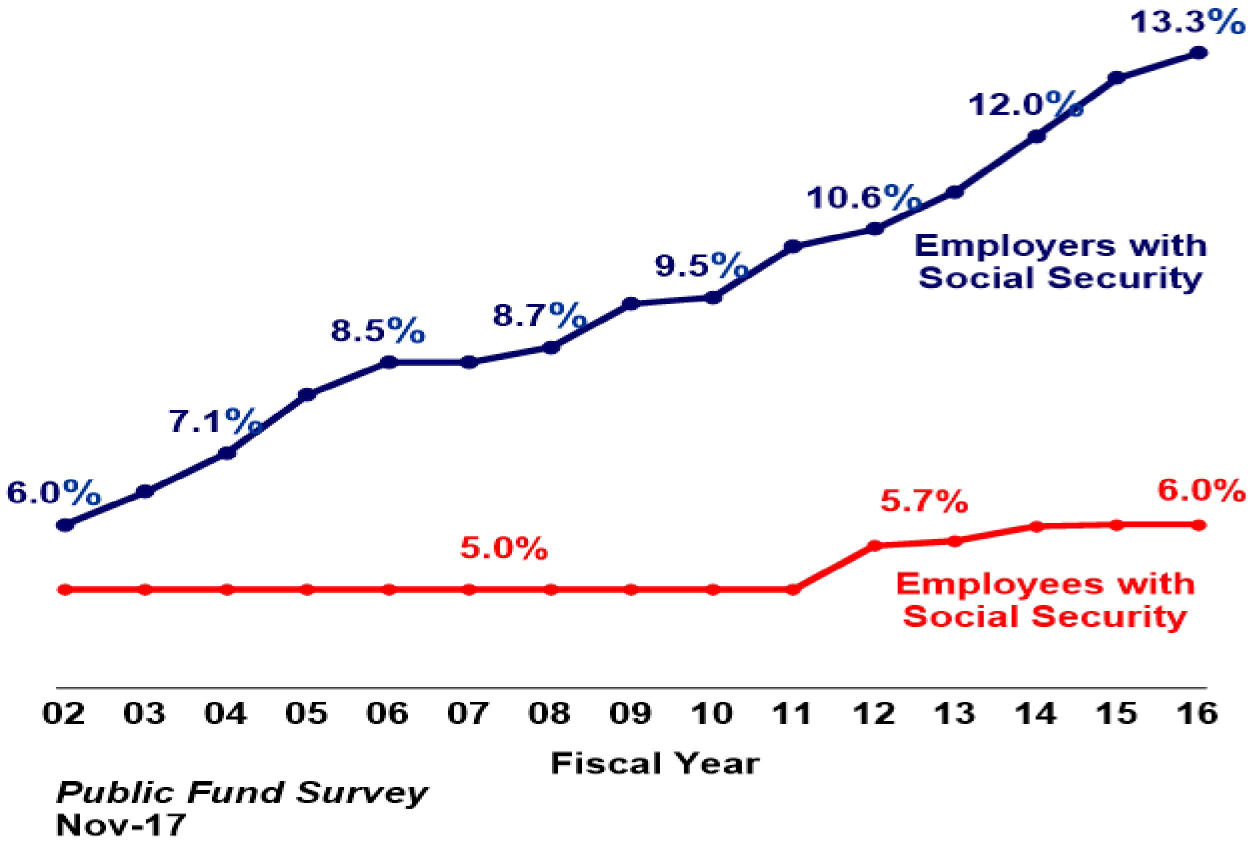


National Association of Retirement Administrators

Nationally, in 2016:

- Employers paid 13.3% of payroll
- Employees paid 6.0% of payroll

Average Contribution Rates Across U.S. Defined Benefit Plans



In Oregon,

- Employers paid 17.5% on 2016-17
- Employers pay 20.85% now
- Employers will pay 25.23% next year
- Employees pay 0

What about the IAP and the 6% Pickup?

(Mis)Understanding the IAP (Individual Account Program)

PERS includes a mandatory supplemental retirement savings plan for all employees, known as the IAP, but…

- As a defined contribution plan, the IAP is always fully funded
- The IAP has <u>no effect on the cost or funding</u> of the pension plan
- But the IAP is relevant to the benefit calculation because it provides an additional retirement benefit over and above the pension benefit

(Mis)Understanding the IAP Pick Up

Almost two thirds of employees receive the 6% pickup for their IAP contributions (67% of payroll).

Employers treat it as part of their employee pay packages. Many employers have CBA language requiring an offsetting pay increase upon termination of the pick up.

The 6%, whether picked up or not, is not a cost driver. It’s a fixed cost going forward.

Cost sharing and the IAP

Employee cost sharing can be coordinated with the IAP by:

- ✓ Allow the pickup to continue to cover employee contributions to the pension plan or new DC plan <u>or</u>
- Eliminate the IAP and the pickup <u>or</u>
- Making continuation to the IAP optional for employers (negotiable for bargaining units)

The Case for Rebalancing Benefits

Tier 1 & 2 Features Drive Costs

Tier 1 & 2 (General Service)

Formula = 1.67%/year = 50% of FAS at 30 years

Full benefits @ age 58 (Tier 1) or 60 (Tier 2) or 30 years of service

+ Money Match option
+ Sick Leave/Vacation option
+ Earlier retirement age

Cost to Employers =
15.3% of payroll ongoing
+ UAL amortization

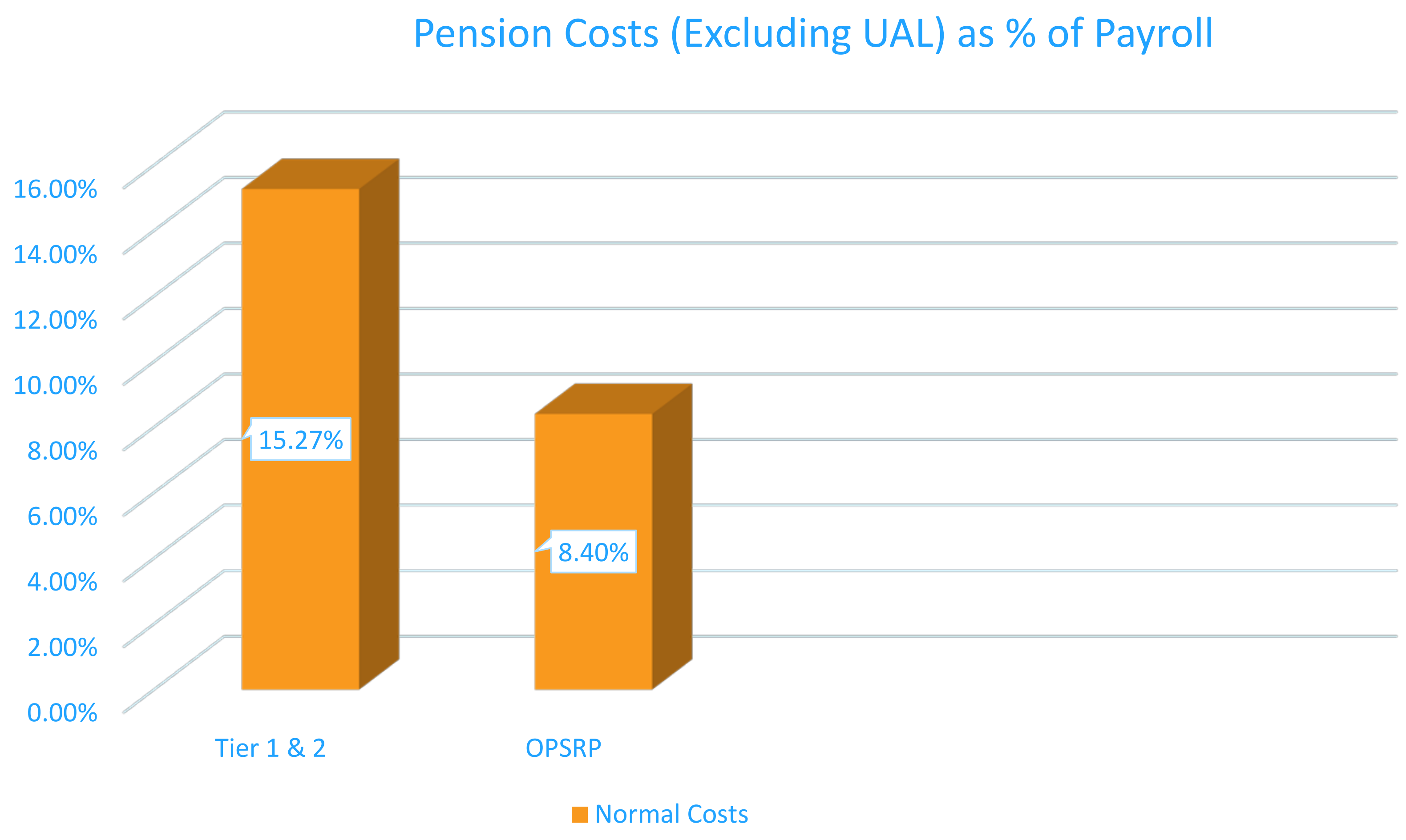
OPSRP (General Service

Formula = 1.5%/year = 45% of FAS at 30 years

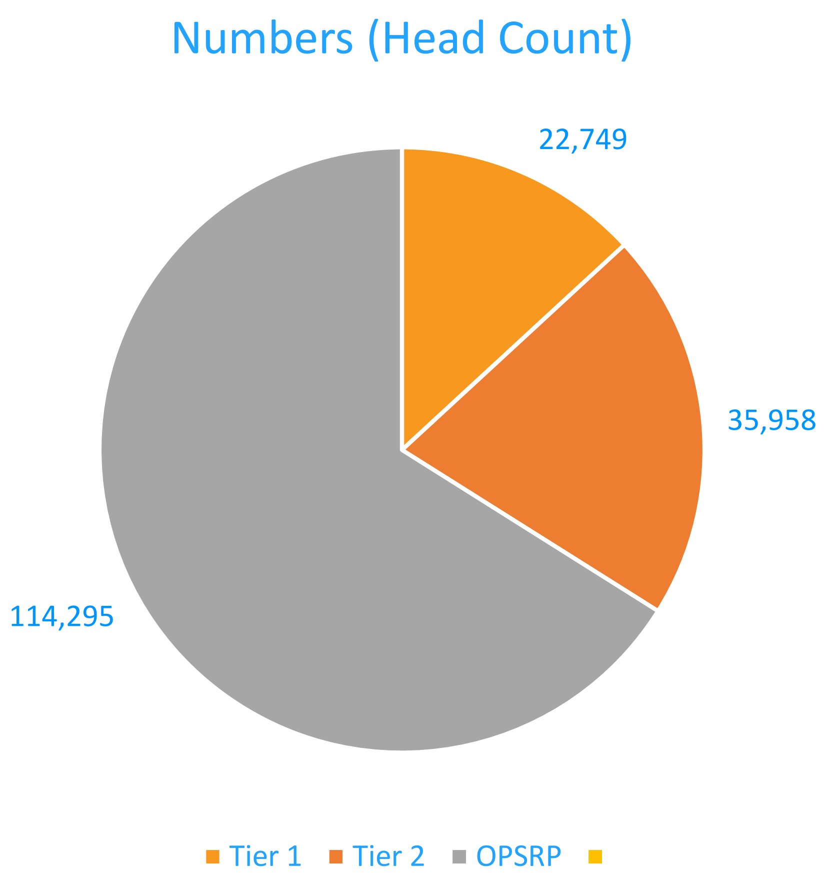
Full benefits @ age 65 or age 58 w/30 years

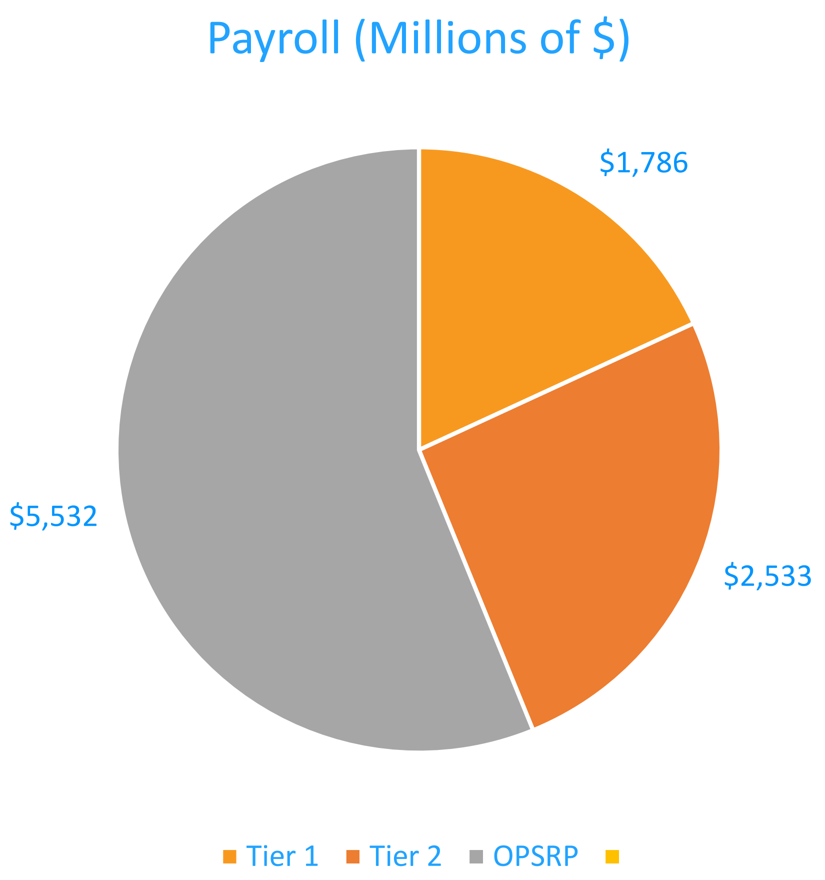
Cost to Employers =
8.4% of payroll ongoing
+ UAL amortization

Tier 1 & 2 Normal Costs Are Nearly 2X OPSRP



Tier 1&2 Employees Remain a Significant Portion of the PERS-Covered Workforce





OPSRP: Adequate, Affordable, Competitive

- OPSRP is an adequate and competitive plan for employees and more affordable for taxpayers
- OPSRP is better than Washington State's teachers' plan

	% Salary per Year of Service	Final Average Salary	EE Contribution to Supplemental Savings
Oregon PERS OPSRP	1.5%	3 years	6.0% fixed
WA State Teachers	1.0%	5 years	5.0% minimum

The Case for a Defined Contribution Plan

Defined Benefit vs. Defined Contribution

Defined Benefit

- Favors career employee over those who come and go
- Favors employees with high rates of pay progression
- Difficult to project and control costs

Defined Contribution

- More fair to short term and lower-paid employees
- More portable and compatible with private sector plans
- More predictable for employers

Defined Contribution: The OHSU Experience

OHSU employees have option of:

- Defined contribution plan fully paid by the Employer at 12% of pay

or

- PERS pension, with employees paying 6% for the IAP

- DC Plan is the default option, enrolling 95% of new hires
- Only 26% of employees remain in the PERS pension plan
- Savings on the 74% of employees in the DC plan equate to 2.5% of payroll for post-2003 hires

Defined Contribution: The Universities' Experience

Oregon's public universities have created options for faculty and administrators to choose coverage under an alternative defined contribution plan.

Perspective: Rex Fuller, President

Western Oregon University

Reforms and Solutions

OBC’s 2017 Reform Package

Cost Sharing:

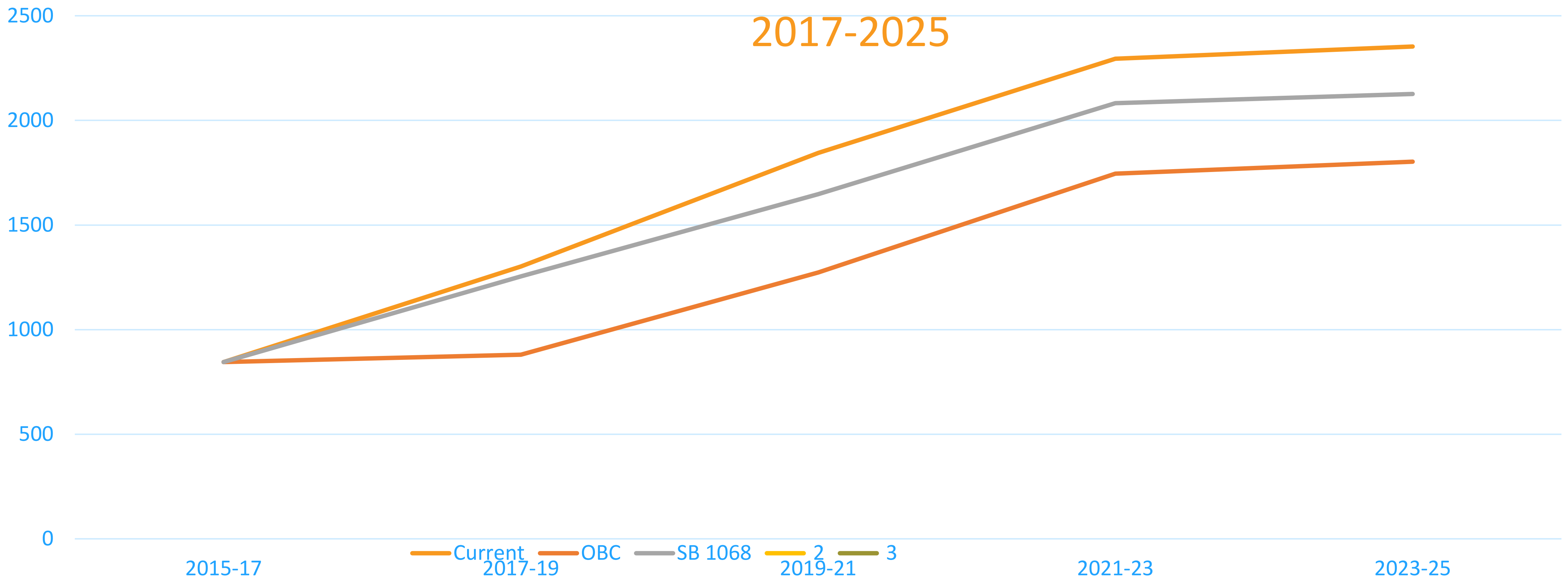
- Tier 1 & 2 employees pay 6% to support pensions
- OPSRP employees pay 3% to support pension

Benefit Rebalance:

- Tier 1 & 2 employees move to OPSRP benefit formula (except for retirement age)

Projected Savings from 2017 Proposals

Effects Over Next 8 Years: OBC Proposal vs. SB 1068



Oregon Business Plan.org

Favored Approaches for 2019

- ✓ Employee cost sharing in all plans
- ❑ Benefit rebalance → System rebalance
- ✓ Expanded IAP option to create an alternative DC plan
- ✓ Management of remaining liabilities
- ✓ Early retirement/pay back plan

Legislative Concepts for 2019

Employee Choice and Shared Responsibility

Statutory

- Enhance the IAP with employer funding to create a more robust defined contribution plan
- Require employee cost sharing (6%) in all plans
- Provide employee option to choose either the pension plan or the defined contribution plan
- Allow continuation of employer pickups

Budgetary

- Management of remaining liabilities

Employee Choice and Shared Responsibility

Employee Choice

(Staying in Pension Plan)

Employer Savings

Current with Pickup

Tier 1 & 2 & OPSRP → 6% of payroll

Current w/o Pickup → 6% of payroll

Working Retirement/Pay Back Plan

Create an option for Tier 1/2 employees who are retirement eligible to:

- to continue working for up to five years
- draw a salary and a retirement allowance
- contribute from salary to help buy down the UAL

Perspective: Mark Mulvihill, Superintendent
Inter-Mountain ESD

Limit and Manage Remaining Liabilities

- Ensure that we guard against continuing increases in the unfunded liabilities. Examples:
  - Effect of higher-than-projected salary increases
  - Employees share in cost increases (Risk sharing)
  - Defined contribution plan

- Manage the buy down of the UAL so as not to adversely affect kids in today's classrooms or overly burden future generations of Oregonians. Examples:
  - Bonding
  - Longer amortization periods
  - State assistance for schools and local governments
  - Prioritization of programs targeted for assistance

Key Takeaways

- Reforms can be legal
- Reforms can be fair
  - Benefits will remain adequate for employees
  - Employees can be given new choices to tailor benefits to career plans
  - Competitive for employers
  - More affordable for taxpayers
  - Less harm to services
- Magnitude of reforms can equal $6 billion (same as 2013 package) = 6 points of payroll for employers
- Role for the state in managing the amortization of the system’s liabilities
- Creates pathway to tax reform and “doing more with more”

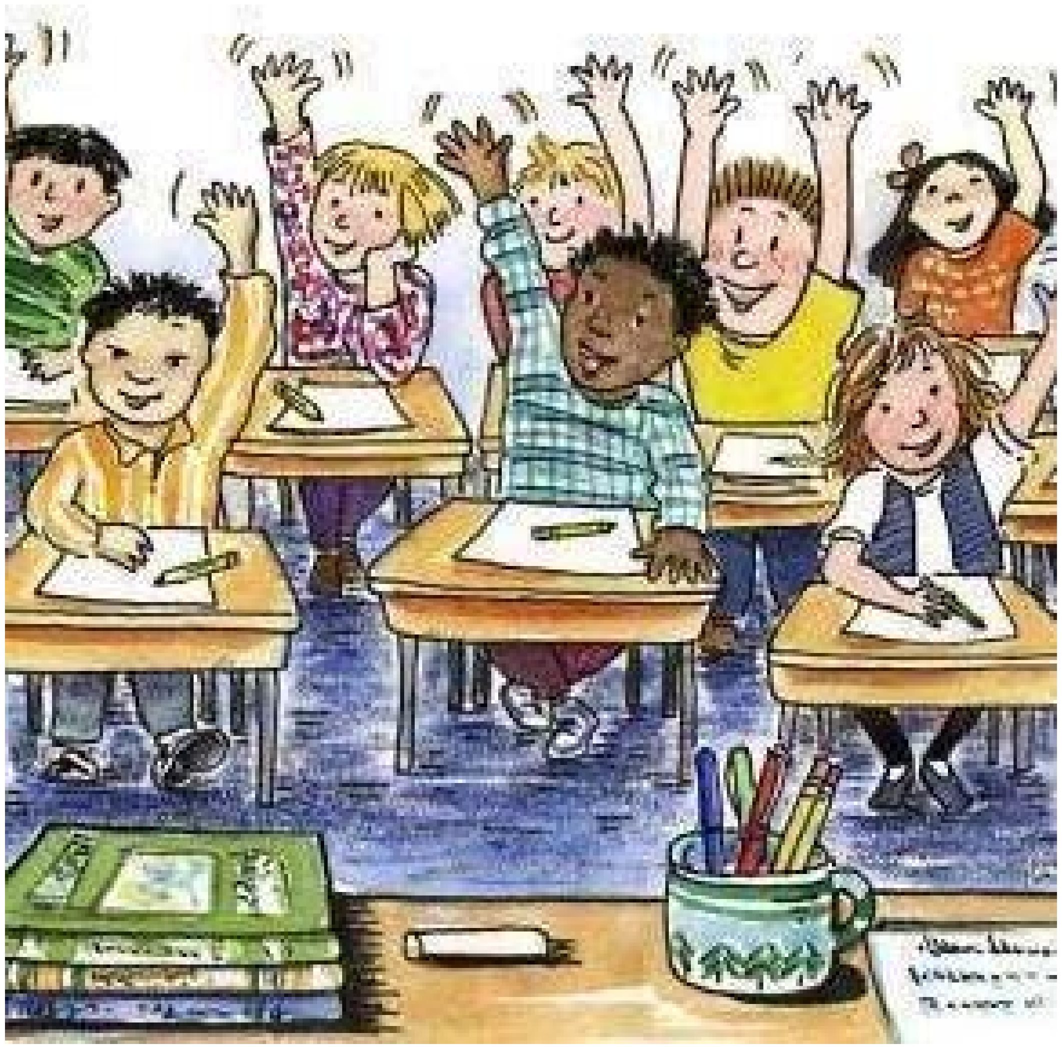
Best reason for reform?

Kids

in today's

and tomorrow's

classrooms!



Questions and Discussion

Tim Nesbitt
Jim Green
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Mark Mulvihill

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