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Background Brief on …

Public Employees Retirement System (PERS)

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Oregon's Public Employees Retirement System **(PERS)** enables public employers to provide their employees with retirement benefits. PERS has administered benefits since 1946, providing service and disability retirement income, death benefits, and retiree health insurance. PERS also administers a separate, deferred compensation program for state and local government employees.

State government, public schools, community colleges, and many local governments (cities, counties, and special districts) participate in PERS. Approximately 870 public employers participate in PERS, covering about 95 percent of state, school, and local government employees.

Governing Structure

The Oregon State Legislature sets PERS policy, including benefit levels, membership requirements, and retirement payment options. Oregon courts have held that the statutes governing PERS constitute a contract between public employers and their employees. The court decisions restrict the legislature, limiting the scope of policy changes that can be made through legislative action.

The Public Employees Retirement Board **(PERB)** implements and administers the policy choices made by the legislature. As trustee of the Oregon Public Employees Retirement Fund **(OPERF)**, the PERB has a fiduciary responsibility to administer the system in the best interest of the members contributing to the fund. The board has five members who are appointed by the Governor and confirmed by the Senate for three-year terms unless specified otherwise. One member must be a state employee in a management position or a person who holds office in the governing body of a participating public employer. One member must be a public employee in an appropriate bargaining unit. The remaining three members must have experience in business management, pension management, or investing and may not be a PERS member or beneficiary.

The board's main role is to administer the system as required in statute and monitor the plan for compliance with federal laws. The board hires an executive director and consultants to assist in the administration of the system.

The Oregon Investment Council **(OIC)** makes investment decisions for the OPERF. The OIC has five voting members: four appointed by the Governor who are qualified by training and experience in the field of investment, and the State Treasurer. In addition to the five members, the PERS Director serves as an ex officio, nonvoting member. The OIC also employs private-sector money managers. Funds are invested in common stocks, fixed income securities such as mortgages and corporate bonds, and a variety of other investments.

Membership

PERS is a single retirement plan with three primary programs: Tier One, Tier Two, and the Oregon Public Employees Retirement Plan **(OPSRP)**. PERS also maintains the Judge Member Program that includes any judge of the Oregon Supreme Court, Court of Appeals, Oregon Tax Court, and Circuit Courts.

The 1995 Legislative Assembly established a different level of benefits (Tier Two) for employees who were first employed on or after January 1, 1996 and before August 29, 2003. Members hired before that date are considered Tier One. In contrast to Tier One, Tier Two has a higher retirement age (generally, age 60 versus 58 for Tier One members), no guaranteed return on investments, no use of lump-sum vacation pay to increase final average salary, and disability retirement benefits that are offset by the total amount of disability (temporary or permanent) payment from workers' compensation. Benefits for Tier Two members are otherwise the same as for Tier One members.

Public employees hired on or after August 29, 2003 are a part of OPSRP, unless membership was previously established under Tier One or Tier Two. OPSRP is a hybrid pension plan (defined contribution/defined benefit) with two components: the Pension Program (defined benefit) and the Individual Account Program **(IAP)** (defined contribution). The Pension Program provides a life pension funded by employer contributions and is benefit-based and uses predictable criteria such as a pension determined by salary x length of service x a factor of 1.5 percent. The program has a normal retirement age of 65 for general service members (or 58 with 30 years of service).

Beginning on January 1, 2004, Tier One and Tier Two PERS member contributions were redirected into the IAP portion of OPSRP. Tier One and Tier Two PERS members retain their existing PERS accounts, but current contributions are deposited in the member's IAP, not into the member's Tier One or Tier Two account. As a defined contribution plan, it has no guaranteed benefit. Employees (or employers on behalf of employees) make contributions into the IAP and when a member retires, he or she receives the account balance (comprised of contributions and earnings or losses). The member may receive the IAP as a lump-sum payment or in equal installments over a 5, 10, 15, or 20-year period.

Membership in PERS is portable among participating Oregon employers. Both Tier One and Tier Two members must work 6 full calendar months for a PERS-covered employer in a qualifying position requiring at least 600 hours per calendar year to be considered an active member. Eligible Tier One and Tier Two retirees, spouses, and dependents can participate in the Oregon PERS Retiree Insurance Program that provides optional health, dental, and long-term care insurance plans. The program serves primarily Medicare-eligible (age 65 and over) public retirees and spouses with a $60 per month subsidy.

PERS Funding

PERS benefits are funded by contributions from participating employers, their employees, and earnings from investments.

The member contribution is fixed in statute at six percent of covered salary. Statutes allow employers to agree to pay the employee contribution. Since January 1, 2004, member contributions are deposited in the IAP and invested at market returns with no earnings rate guarantee. Member contributions are paid in one of three ways: employer-paid pre-tax, member-paid pre-tax or member-paid after tax – with approximately 70 percent paid on an employer-paid pre-tax basis.

Employer contribution rates are set by the PERB. The employer rate is paid based on a percentage of employee salary. Each employer's individual rate varies based on recommendations of PERS actuaries to ensure that the system has adequate long-term funding. When determining employer rates, actuaries consider employee demographics, wages, inflation, projected retirements, investment yields, and broad assumptions about trends affecting the system. Based on those assumptions, the actuary determines general needs for the system and then calculates a contribution rate for each individual employer in order to fund projected needs.

To limit volatility of individual Tier One and Tier Two employer rates, state agencies and community colleges are pooled for PERS funding purposes and other local government employers are allowed to join that pool on a voluntary basis. School districts are separately pooled and all school districts have the same base employer contribution rate. Actual rates vary as the majority of school districts have purchased bonds to offset their pension liabilities. Each pool and each unpooled local government employer is assigned a separate employer contribution rate. All participating public employers are pooled for OPSRP funding purposes.

After adjusting for employer side accounts, the net Tier One/Tier Two rate averages 8.1 percent beginning July 1, 2007, while the current rate for new employees under OPSRP is 6.03 percent of covered salary as of July 1, 2007.

The PERS Reform and Stabilization Act of 2003

The intent of House Bill 2003 (2003) was to reform PERS for the future in a way that generated savings for public employers while protecting the accrued benefits of employees. Reforms were also meant to resolve structural issues within the system. House Bill 2003 was primarily directed to the benefits payable to employees who became members of the system before the OPSRP went into effect (August 29, 2003). These employees are divided between Tier One members (those who became members before January 1, 1996) and Tier Two members (those who became members on or after January 1, 1996 and before August 29, 2003).

The three main reforms of House Bill 2003 were:

- Shift the six percent employee contribution from the PERS account to a separate defined contribution account (IAP).
- Alter the mechanism for crediting interest to Tier One member accounts – essentially suspending guaranteed earnings during periods of low investment returns. The guarantee of the "assumed rate" of earnings for Tier One members was also changed to be over the course of a member's career.
- Temporarily suspend future cost-of-living adjustments for members who retired between April 1, 2000 and March 1, 2004 who had excess interest credited to their accounts in 1999.

In combination with the use of updated mortality tables, these reforms have reduced the unfunded actuarial liability and lowered employer contribution rates.

Litigation

House Bill 2003 (2003) also established a process for expedited judicial review of any legal challenges to the legislatively approved PERS reforms. The Oregon Supreme Court had jurisdiction regarding challenges to the constitutionality of the changes made by the legislation or to claims of breach of contract. Since the PERS reforms were enacted, a number of court cases have been filed.

Strunk/City of Eugene

Strunk v. PERB was a challenge to various provisions of the 2003 reforms. The Oregon Supreme Court ruled that the cost-of-living-adjustment **(COLA)** freeze enacted by the 2003 Legislative Assembly to recover overpayments from earnings crediting in 1999 was invalid. As a result of the 2003 legislation, PERS temporarily suspended the COLA for Tier One members who retired with an effective date on or after April 1, 2000 and before April 1, 2004, under the Money Match calculation. The court also determined that PERS must annually credit the assumed rate, currently eight percent, to Tier One member's regular accounts. PERS credited zero percent to Tier One regular accounts in 2003 based on legislation passed that year.

In *City of Eugene v. PERS*, several employers and members sued to challenge PERS' policies on actuarial factors, variable match, and earnings crediting. The Marion County Circuit Court remanded the PERS Board's orders allocating 1999 earnings and setting employers rates for the petitioning employers. The board was directed to reissue these orders after the judge's final 2003 ruling on many PERS practices, such as actuarial factors, variable account calculations, and reserving. After the end of the 2005 Legislative Session, the Oregon Supreme Court issued its decision, ruling that the 2003 PERS reform legislation and a Settlement Agreement requiring PERS to reallocate 1999 earnings to Tier One benefit recipient accounts at 11.33 percent instead of 20 percent resolved the issues in the case.

The combined application of the *Strunk/City of Eugene* decisions varies on items such as when the Tier One member retired or will retire. In early 2006, the PERS Board issued an Order Adopting Repayment Methods for the recovery of overpayments under *Strunk* and *City of Eugene*. The board order affected Tier One members who retired on or after April 1, 2000 and before April 1, 2004 under the Money Match method and people who received or are receiving benefits based on 1999 account balances. The PERS board has pursued repayment of benefit overpayments made as a result of 1999 earnings crediting.

The Oregon Supreme Court awarded fees and costs to the plaintiff's attorneys in the *Strunk* case to be paid from earnings that would otherwise be credited to Tier One members for 2007. The PERS board will credit eight percent to Tier One regular accounts for 2007, with a portion of that eight percent being used to pay attorneys' fees and costs as directed by the court. In February 2008, the board approved a preliminary 2007 earnings crediting rate of 7.97 percent after subtracting from Tier One regular account earnings for the plaintiff's attorney fees/costs. Final earnings crediting will occur in March 2008.

Arken/Robinson

Arken v. PERS is a class action complaint filed on behalf of Tier One members who retired between April 1, 2000 and April 1, 2004, alleging that the withholding members' COLA from 2003 to 2006 constituted both a breach of their PERS contract and a violation of the state's wage and hour laws in light of the *Strunk* decision. It also alleged that the PERS board's intent to pursue collection actions against such retirees for alleged overpayment of 1999 earnings would also constitute a breach of their PERS contract.

Robinson v. State of Oregon and PERS challenged the board's attempts to reduce retiree benefits to recover alleged overpayments resulting from PERS' miscalculation of 1999 earnings to retirees' regular accounts, arguing that the 2003 legislative reforms established that PERS is required to treat any overpayments as administrative expenses.

In June 2007, the Multnomah County Circuit Court ruled in favor of both cases and ordered PERS to cease any collection activities against retirees. It further ordered PERS to immediately begin to pay back any money improperly collected from retirees as a result of the "Lipscomb settlement" and the subsequent recalculation of 1999 PERS earnings.

Young v. State of Oregon

Although *Young v. State of Oregon* focused on laws pertaining to exempt employees who were not due overtime for extra hours worked, it also affected PERS accounts. The state became liable for overtime hours worked by these employees during a 26 month period, July 1995 to August 1997. As a result of the court decision, approximately 1,850 current and former state employees are entitled to additional contributions to their PERS accounts. PERS is currently determining the overall project scope and securing project funding and anticipates account adjustments occurring from January 2008 to January 2009.

Recent Legislation

House Bill 2285 (2007) retroactively eliminated the "break-in service" provision as established under the 2003 PERS reforms. Prior to the legislation, a break-in service occurred when an active Tier One or Tier Two member performed no hours of service in a qualifying position for a period of six consecutive months or longer and were not exempt for reasons such as vacation, military duty, illness, or other authorized leave. If a break-in service was incurred, contributions were accrued under the OPSRP pension program. The measure also equalized the accrual of retirement credit by OPSRP members by changing the retirement credit calculation to be the same as for Tier One and Tier Two members and established provisions for school employees to ensure they receive a full years' worth of retirement credit if they were employed during the entire portion of an academic school year.

House Bill 2397 (2007) allowed PERS to accept rollover contributions from a retired member solely for the purpose of paying amounts claimed by the PERB as overpayments or other improperly made payments such as the financial obligation of some retirees created by the settlement of *City of Eugene v. PERS*. The bill also allowed a beneficiary to be paid for death benefits from a PERS member by an eligible rollover distribution to either an individual retirement plan or individual retirement annuity.

House Bill 2619 (2007) allows former PERS members who have been rehired to activate their inactive accounts. Prior to the bill's enactment, a former employee could access an account after it had terminated but a rehired employee had no method to activate an account.

There were also a number of bills from the 2007 Legislative Session that created exemptions for certain retirees to work beyond the statutory limit of 1039 hours per calendar year without losing their status as a retiree:

House Bill 2184 – Exempted the Deputy or Assistant Director of the Department of Human Services if the Governor approves the exception for the specific person in the position.

House Bill 2585 – Exempted a retired member employed as a teacher or administrator by a community college district or education service district **(ESD)** located in a county of 35,000 inhabitants or less or a speech-language pathologist or assistant by a school district or ESD (available to members who took early retirement if the date of employment was at least 6 months later than the retirement date).

House Bill 2619 – Exempted a retired member employed by the Legislative Assembly or the Oregon State Police for service during a legislative session.

Senate Bill 4 – Exempted retired nurse who was hired as a nurse or for the purpose of teaching nursing during a nursing workforce shortage declared by the Governor or the legislature.

Senate Bill 342 – Exempted a retired nurse hired as a nursing instructor or a retired member hired by the Department of Public Safety Standards and Training to provide training (exemptions not available to members who take early retirement).

These exemptions are only available to Tier One and Tier Two retirees and are not available to OPSRP Pension Program retirees.

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