Background Brief on …

Public Employees Retirement System (PERS)

Prepared by: Marjorie Taylor

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Legislative Committee Services
State Capitol Building
Salem, Oregon 97301
(503) 986-1813

Background

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 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 implements and administers the policy choices made by the Legislature. As trustee of the Oregon Public Employees Retirement Fund (OPERF), the PERS Board has a fiduciary responsibility to administer the system in the best interest of the members contributing to OPERF. 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 of PERS. The Board’s main role is to administer the system as required in statute. The Board also monitors 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 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 Director of PERS serves as an ex officio, non-voting 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.

Tier One, Tier Two, and OPSRP Membership

PERS is a single retirement plan with three primary programs: Tier One, Tier Two, and the Oregon Public Employees Retirement Plan (OPSRP).

The 1995 Legislature established a different level of benefits (called "Tier Two") for employees who were first employed on or after January 1, 1996. Members hired before that date are considered Tier One. In contrast to Tier One, Tier Two has a higher retirement age (age 60), no guaranteed return on investments, no use of lump-sum vacation pay to increase final average salary, and disability retirement benefits 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.

New 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. Membership in PERS is portable among participating Oregon employers.

PERS Funding

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

The employee contribution is fixed in statute at six percent of salary. Statutes allow employers to agree to pay the employee contribution.

Employer contribution rates are set by the PERS Board. 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.

2003 PERS Reform

The intent of House Bill 2003, approved by the Legislative Assembly in 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 HB 2003 were: 1) Shift the six percent employee contribution from the PERS account to a separate defined contribution account (Individual Account Program); 2) Alter the mechanism for crediting interest to Tier 1 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; 3) 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 lower employer contribution rates.

Oregon Public Service Retirement Plan (OPSRP)

House bill 2020, approved by the Legislative Assembly in 2003, created the Oregon Public Service Retirement Plan (OPSRP), which 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 OPSRP Pension Program provides a life pension funded by employer contributions. The program 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.

The IAP is applicable to all new hires and to all active Tier One and Tier Two members. 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 on 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.

Beginning January 1, 2004, Tier One and Tier Two PERS member contributions were redirected into the Individual Account Program (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.

Recent Litigation and Board Order

Legislation passed in 2003 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.

Strunk v. PERB

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 legislature 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 8 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.

City of Eugene v. PERS

In *City of Eugene v. PERS*, several employers and members sued to challenge PERS' policies on actuarial factors, variable match, and earnings crediting. 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 in the *City of Eugene v. PERS* case, 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.

Board Order

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 affects: 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 is pursuing repayment of benefit overpayments made as a result of 1999 earnings crediting.

Staff and Agency Contacts

Website: http://oregon.gov/PERS

Steve Delaney, PERS
503-603-7694

Marjorie Taylor, Committee Services
503-986-1755