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Background Brief on ...

Public Employees Retirement System (PERS)

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 the Oregon Savings Growth Plan (**OSGP**), which is 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. There are 872 public employers currently participating 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 PERB 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 employee, other than the state. One member must be a current or retired 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 PERB's main role is to administer the system as required in statute and monitor the plan for compliance with federal laws. They hire 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 are not a state employee or elected public official, the State Treasurer, and the PERS Executive Director, who serves as an ex officio, nonvoting member. The OIC also employs private-sector money managers and contract with private firms to carry out the Council's prescriptions. 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**). They also maintain the PERS Judge Member Program that includes any judge of the Oregon Supreme Court, Court of Appeals, Oregon Tax Court, and Circuit Courts.

There are two types of classifications for all three PERS primary programs. Examples of qualified positions for the Police and Fire classification include employees of the Department of Corrections, Oregon State Police

officers, local government police officers, adult parole and probation officers, the state and deputy state fire marshal, and persons employed by cities, counties, or districts whose duties involve firefighting. All other qualifying positions are classified as General Service.

An employee qualifies as a Tier One member if they began working for a PERS-participating employer on or before December 31, 1995, and worked six full calendar months in a qualifying position requiring at least 600 hours per calendar year. 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.

In contrast to Tier One, Tier Two has a higher retirement age for receiving full benefits (generally, age 60 versus 58 for Tier One members), two methods of calculating retirement benefits, no guaranteed return on investments, and no use of lump-sum vacation pay to increase final average salary. Benefits for Tier Two members are otherwise the same as for Tier One members; a contribution to the member's individual PERS account is six percent of their salary (whether paid by the employee or their employer).

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 multiplied by length of service multiplied by a factor of 1.5 percent (or 1.8 percent for members whose covered position is classified as Police and Fire). The program has a normal retirement age of 65 for general service members (or 58 with 30 years of service). "Final average salary" (**FAS**) is defined as the higher of the average of the

highest three consecutive years (or less if the member was employed for less than three years) or one-third of the employee's total salary in the past 36 months. In determining FAS, "excess" overtime - overtime paid above the average paid to employees of that class during the time period being averaged, as established by PERS rule - is not included.

Under the IAP, OPSRP members contribute six percent of their salary, and employers may agree to pay the six percent contribution. Beginning on January 1, 2004, Tier One and Tier Two PERS member contributions were redirected into the IAP portion of OPSRP; they retain their existing PERS accounts.

As a defined contribution plan, the IAP 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 five, 10, 15, or 20-year period, or over the member's anticipated life span.

Membership in PERS is portable among participating Oregon employers. Members must work for a PERS-covered employer in a qualifying position requiring at least 600 hours per calendar year to be considered an active member. Eligible 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 primarily serves Medicare-eligible (age 65 and over) public retirees.

As of December 31, 2008, there are a total of 171,000 active and 42,000 inactive retirees, 60,602 active 22,710 inactive Tier One members, 56,113 active and 19,238 inactive Tier Two members, and 53,854 active and 529 inactive OPSRP members.

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.

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.

House Bill 3401 (2009) directs the PERB to ask the Internal Revenue Service (**IRS**) for a ruling regarding whether the use of excess amounts in an employer's side account to offset employer-paid contributions to the IAP would cause the PERS Plan to lose its tax qualified status under

the Internal Revenue Code. If the IRS finds that practice acceptable and the PERB determines that the employer's side account exceeds what is necessary to fund the employer's actuarial liabilities, employer can request the Board to apply the excess amounts to offset employer-paid contributions.

PERS Retirees

Beginning on July 1, 2011, the provisions of Senate Bill 897 (2009) allow PERS members who are within two years of their earliest retirement date to request that PERS verify their retirement data and establish a minimum benefit threshold upon retirement. The verification of retirement data includes creditable service time and average final salary account balance (for all PERS members), and the member's regular and variable account balances and unused sick leave (for Tier One and Tier Two members only; unused sick leave data will not be available for verifications requested before July 1, 2012). Employers have a reasonable time to confirm information reported to PERS before verification is issued, but will not be able to change that information once the verification is issued. Members have 60 days after the verification is produced to dispute its accuracy. In turn, after the verification is produced and the member retires, their benefit will be calculated using data that is no less than the data included in the verification notice. Amounts can be adjusted to reflect activities that have taken place after the date specified in the verification and earnings credited up to the member's effective retirement date.

Currently, employment data for PERS members' data is not verified until retirement and employment data is shared with members via their annual statement, which does not include all of the data under the new verification statement process.

Retirees, their spouses, and eligible dependents can participate, at their own expense, in the PERS Health Insurance Program. The program includes options for medical and dental insurance, including Medicare supplemental plans, as well as long term care insurance plans.

If a retiree wishes to re-enter the workforce, the retiree's payments could be affected based on who their employer is and/or how many hours they work per year. Tier One, Tier Two, and OPSRP retirees who work for a private sector or non-PERS covered employer can work unlimited hours without any impact on their level of retirement benefits. A Tier One/Tier Two retired member working for a participating public employer can continue to receive retirement benefits as long as the period or periods of employment with one or more participating public employers do not total 1,040 hours or more in a calendar year. Retirement benefit payments will cease for an OPSRP retired member who is receiving a service retirement allowance and becomes employed in a qualifying position by a participating employer. They will also become an active member of the Pension Program upon employment.

Exceptions from the 1,040 rule are established via statute for Tier One and Tier Two retirees in a number of qualified positions for PERS-covered members. Examples include a registered nurse working as a nursing instructor, National Guard members on state active duty who are of normal retirement age, employees of a municipal police department of a city with a population of less than 15,000, and employees of the Legislative Assembly or the Oregon State Police for service during a legislative session. Overall, the retiree must be receiving normal retirement benefits in order to qualify for the exception. If a retiree works concurrently for a PERS employer under an exemption and a non-PERS employer and the position is not exempted, only the hours worked on the non-exempted position work towards the 1,040 hour limit.

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:

- Shifting the six percent employee contribution from the PERS account to a separate defined contribution account (IAP).
- Altering 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 suspending 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.

Since the enactment of House Bill 2003, modifications to the original legislation have been enacted. House Bill 2285 (2007) retroactively eliminated the “break-in service” provision as established under the 2003 PERS reforms. Prior to House Bill 2003, 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.

House Bill 2285 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 year’s worth of retirement credit if they were employed during the entire portion of an academic school year.

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* (also known as the *Lipscomb* case), 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 occurred in March 2008.

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.

Bell v. PERB: The focus of the *Bell* case is on the calculation of benefits at the time of retirement. The plaintiff's estimated benefits differed by over \$1,100 per month from her actual retirement benefits, and the PERS member testified that if she received accurate information from PERS in a timely fashion, she would have modified her date of retirement. The plaintiff prevailed in Marion County Circuit Court, and the Oregon Court of Appeals modified the amount of the jury award, refused to award interest, but granted leave to reconsider the interest issue if the Oregon Supreme Court were to reverse the appeal court's decision. The case is the basis of the provision in enacted Senate Bill 897 (2009) to establish a formal benefit verification process.

Murray v. PERB: In May 2010, the Oregon Court of Appeals reversed the PERB on its decisions to charge the PERS variable account for administrative expenses in years of account loss. Such losses occurred in 2001 and 2002, and the account was charged just under \$2 million to cover losses. The court rejected the defendant's argument that Oregon statutes allowed the treatment of the variable account differently than the overall umbrella of the PERS system and charge the variable account against what was termed as "negative interest." If the decision is uncontested, it will result in a reconfiguration of affected members' variable account amounts to reflect the amount that was taken to cover administrative expenses.

Arken/Robinson v. PERS: Both class action complaints were 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* and the subsequent recalculation of 1999 PERS earnings. The cases are currently in the Oregon Court of Appeals.

White v. PERB: This is the last remaining court case in response to the *City of Eugene* litigation. The case challenges the legal authority of the PERB from entering into a settlement of the court case without notification, involving, or engaging a key stakeholder in the litigation as it was decided in Marion County Circuit Court, as well as a number of PERS administrative actions taken as a result of the settlement. The Multnomah County Circuit Court ruled in favor of PERB on all issues, and the case is currently in the Oregon Court of Appeals.

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