



Oregon

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Actuarial Analysis of Senate Bill 822 March 28, 2013

Milliman, the actuarial firm retained by PERS, has completed its analysis of Senate Bill 822 (see attached). The analysis is needed to provide information on the cost reductions that would result from adoption of the bill.

The analysis estimates the impact on actuarial liability and employer contribution rates calculated in the December 31, 2011 actuarial valuation. The same assumptions used in that valuation have been used in Milliman's analysis of Senate Bill 822. The analysis is based on enacting both concepts, cost-of-living adjustment (COLA) reductions and elimination of out-of-state tax remedy, together.

The co-sponsors of Senate Bill 822 have signaled intent to also request that the PERS Board defer an additional portion of the currently scheduled 2013-15 employer contribution rate increases. That request is not contained in Senate Bill 822, so the Milliman analysis does not address the financial impact nor the potential structure of such a request.

Milliman's analysis shows that the COLA reductions and elimination of the out-of-state tax remedy would result in a decrease of \$3.2 billion in total liability and reduce employer contribution rates by 2.5 percent in the 2013-15 biennium. Applying that rate reduction to the projected system wide biennial payroll of \$18.4 billion would result in a \$460 million savings in the 2013-15 biennium.



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March 28, 2013

VIA E-MAIL

Paul Cleary
Executive Director
Oregon PERS

**Re: Request Number: 2013-003
Analysis of Senate Bill 822**

Dear Paul:

Per the request noted above, we have estimated the system-wide average effects of the PERS benefits modifications contained in Senate Bill 822 (SB 822).

We understand SB 822 to have the following effects on PERS benefits:

- The COLA increase provided in 2013 would be limited to 1.5%, in place of the existing limitation of 2%.
- Beginning in 2014, future COLA adjustments would be provided on a graded schedule according to the amount of a member's annual benefit, as shown in the table below. The COLA shown in the table below would be applied on a marginal basis. For example, the COLA for a member with a \$30,000 annual benefit would be calculated as 2.0% on the first \$20,000 and 1.5% on the next \$10,000, for a total increase of \$550.

Annual Benefit Amount	Applicable COLA
First \$20,000	2.00%
\$20,000 to \$40,000	1.50%
\$40,000 to \$60,000	1.00%
\$60,000 or more	0.25%

- The "tax remedy" benefit would be eliminated for all members and beneficiaries who are not Oregon residents.

The analysis estimates the impact on actuarial liability and contribution rates calculated in the December 31, 2011 actuarial valuation of the changes and implementation dates described herein. The elimination of the tax remedy benefit was assumed effective immediately as of the valuation date. Except as otherwise described in this letter, our analysis has used the same assumptions as the December 31, 2011 actuarial valuation.

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The consultants who worked on this assignment are pension actuaries. We have not explored any legal issues with respect to this proposed legislation. Milliman's advice is not intended to be a substitute for qualified legal or accounting counsel.

SUMMARY OF LIABILITY RESULTS

The table below has a summary of the valuation results for the most recent rate-setting valuation and the effect of SB 822 on those results. The changes proposed by SB 822 lower the actuarial liability and employer contribution rates via a reduction of benefits projected to be paid in the future.

We understand that the co-sponsors of SB822 have signaled intent to request that the PERS Board defer an additional portion of the currently scheduled 2013-2015 rate increases, with that additional deferral amount being unrelated to the proposed benefit changes. SB822 as currently drafted does not contain that request. As such, this letter addresses neither the financial impact nor the potential structure of such a request.

In the table below, "Accrued Liability" refers to the net present value of projected future benefits allocated to service already completed as of the valuation date in accordance with the current actuarial cost allocation method, while "Total Liability" includes the value attributable to anticipated future service for current active members. The contribution rate shown is a blended rate reflecting the weighted averages of Tier 1, Tier 2 & OPSRP payroll as of the valuation date. The base contribution rate is shown on an "uncollared" basis.

	12/31/2011 Total Liability (\$B)	12/31/2011 Accrued Liability (\$B)	2013-2015 Uncollared Base Pension Employer Contribution Rates (% of Payroll)		
			Normal Cost	UAL	Total
12/31/2011 Valuation Results	\$69.2	\$61.2	8.2%	15.5%	23.7%
SB 822 changes	(3.2)	(2.6)	(0.3%)	(2.2%)	(2.5%)

The \$3.2 billion reduction in Total Liability shown in the table above represents a 4.6% reduction compared to the December 31, 2011 valuation. The percentage reduction varies by individual member. The table below illustrates the weighted average decrease for three groups of members, based on status at December 31, 2011: actives, inactive who have not yet started benefits, and current retirees or beneficiaries in payment.

	Percentage Decrease in 12/31/2011 Total Liability			
	Current Actives	Current Inactives	Current Retirees	System Average
SB 822 changes	(4.9%)	(3.2%)	(4.5%)	(4.6%)

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ANALYSIS OF BENEFIT MODIFICATIONS

The decrease in both Total Liability and Accrued Liability shown is caused by reducing projected benefit payments for current and future retirees. The separate components of the SB 822 benefit modification differ in the groups they affect and the magnitude of the impact. Key aspects of the two changes are discussed individually below.

COLA Changes

The COLA changes reduce liabilities by reducing projected future benefit payments for current and future retirees. All members or beneficiaries receiving a COLA increase in 2013 would see a lower 2013 benefit increase due to the reduction in maximum COLA from 2.0% to 1.5%. In later years, only members with benefits in excess of the lowest threshold level (\$20,000) will be affected. The reduction in future COLA amounts will be most pronounced for members with larger benefits. As noted above, a member with a \$30,000 annual benefit will receive a COLA of \$550, which is equivalent to an effective COLA of 1.83%. A member with an \$80,000 annual benefit will receive a COLA of \$950, for an effective rate of 1.19%. The COLA thresholds are not indexed to increase with inflation in future years.

Remove Tax Remedy for Non-Residents

The two statutory provisions, collectively known as “tax remedy benefits”, considered in this analysis are the House Bill 3349 (“HB 3349”, section 238.364 of Oregon Revised Statutes (ORS)) and Senate Bill 656 (“SB 656”, ORS 238.366) benefit adjustments. We understand these provisions were added to statute after member benefits previously exempt from Oregon personal income tax became subject to the tax; the benefits provided by these sections were intended to mitigate the impact of the change in tax status of benefit payments.

Only members who joined the system prior to July 14, 1995 are eligible for HB 3349 and SB 656 adjustments. Eligible members who retired prior to 2012 receive the larger of either the HB 3349 or SB 656 adjustment. Due to a change in statute, a member who retires after 2011 is not eligible for the HB 3349 adjustment if they do not reside in Oregon. That statutory change did not affect members who retired prior to 2012, and the statutory change did not remove the SB 656 adjustment for post-2011 retirees.

The benefit adjustment provided by HB 3349 is based on the percentage of a member’s benefit attributable to service prior to October 1, 1991, and can range from a 0% to 9.9% increase in the benefit. This range varies based on the fraction of a member’s service that occurred prior to October 1, 1991. A member with no service prior to that date has a 0% HB 3349 adjustment, while a member with all service prior to that date has a 9.9% HB 3349 adjustment.

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The SB 656 benefit adjustment is defined as a fixed percentage increase to a member's benefit based on his or her total years of service. The increase schedule varies between General Service and Police and Fire members, with Police and Fire members receiving a more favorable schedule. The increase provided by SB 656 ranges from 0%, for those with less than 10 years of service, to 4%, which applies to General Service members with 30 or more years of service and Police and Fire members with 25 or more years of service.

SB 822 would remove both the HB 3349 and the SB 656 adjustments for all retirees and beneficiaries who reside outside of Oregon. In other words, SB 822 would expand the recent statutory modification in two ways. First, it would remove both adjustments, rather than just the HB 3349 adjustment. Second, the legislation would apply to all retirees and beneficiaries rather than just post-2011 retirements.

For purposes of this analysis, we have assumed that 15% of current and future benefits eligible for tax remedy adjustments are payable to non-Oregon residents and would be affected by this change. This assumption was provided by PERS, and was also used in the analysis we prepared in November 2012 estimating the effect of removing tax remedy benefits as a stand-alone change.

DATA, METHODS, ASSUMPTIONS AND PROVISIONS

Other than the exceptions and additions discussed in this letter, the data, methods, assumptions, and plan provisions used to calculate employer contribution rates are the same as those used in the December 31, 2011 system-wide actuarial valuation report. That information, including a discussion of the inherent limitations of use of actuarial valuation results, is herein incorporated to this letter by reference.

Our analysis does not include any assumed change in participant behavior such as retirement patterns due to the proposed changes in policy, or to bargaining agreements or employer pay practices as a result of these changes. Such potential impacts merit consideration. Actual experience will vary from assumption, and sometimes the variance from assumption will be significant. The variance will affect the long-term financial impact of the proposed legislation.

The assumption of 15% used in analyzing the change to the tax remedy benefit was provided by PERS; we do not have any data currently available to independently assess this assumption. To assess the impact of this proposed legislation on current retirees, we received additional data from PERS regarding the percentage increase in benefits due to tax remedy adjustments already incorporated in the current benefit levels for individual retirees. We did not audit the data, but have no reason to doubt its substantial accuracy.

The analysis shown here was conducted using the actuarial cost allocation method currently employed by the PERS Board. If this method was changed, the results could change significantly.

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In calculating the illustrative changes in uncollared employer base contribution rates, we assumed all changes in Accrued Liability were amortized over a 20-year period as a level percent of payroll using current valuation assumptions. This is the method currently used in the valuation when establishing new Tier 1/Tier 2 amortization bases. If a different amortization method were used, the overall impact on employer rates could be significantly different than shown in this letter.

ACTUARIAL BASIS AND QUALIFICATIONS

In preparing this letter and the valuation report on which it is based, we relied, without audit, on information (some oral and some in writing) supplied by Oregon PERS. This information includes, but is not limited to, statutory provisions, employee data, and financial information. We found this information to be reasonably consistent and comparable with information used for other purposes. This analysis depends on the integrity of this information. If any of this information is inaccurate or incomplete our results may be different and our calculations may need to be revised.

All costs, liabilities, rates of interest, and other factors for the System have been determined on the basis of actuarial assumptions and methods which are individually reasonable (taking into account the observed recent experience of PERS and reasonable expectations); and which, in combination, offer a reasonable estimate of anticipated future experience affecting PERS.

Future actuarial measurements may differ significantly from the current measurements presented in this analysis due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period, additional cost or contribution requirements based on the plan's funded status, or a change in the cost allocation method); and changes in plan provisions, applicable law, or administrative rules. Due to the limited scope of this estimate, we did not perform an analysis of the potential range of future measurements. The Board has the final decision regarding the valuation assumptions and adopted the assumptions used in the December 31, 2011 valuation at its July 2011 public meeting.

Actuarial computations presented in this estimate are for purposes of providing a high-level analysis of the proposed legislation to PERS. As such, they cannot be relied upon for financial reporting or other purposes, and calculations for purposes other than this use may be significantly different from the estimates contained in this letter. Accordingly, additional determinations may be needed for other purposes.

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Mr. Paul Cleary
March 28, 2013
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On the basis of the foregoing, I hereby certify that, to the best of my knowledge and belief, this analysis is complete and accurate and has been prepared in accordance with generally recognized and accepted actuarial principles and practices. I am a member of the American Academy of Actuaries and meet the Qualification Standards to render the actuarial opinion contained herein.

If you have any questions about our analysis or need any additional information, please let us know.

Sincerely,



Matt Larrabee, FSA, EA
Principal and Consulting Actuary

MRL:sdp
encl.

cc: Steve Rodeman, Debra Hembree, Marjorie Taylor, Scott Preppernau

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