

Agency Report Analysis  
**Public Employees Retirement System**  
2014 Preliminary Earnings Crediting

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**Analyst:** John Borden

**Request:** Acknowledge receipt of a report on preliminary 2014 earnings crediting.

**Recommendation:** Acknowledge receipt of the report.

**Analysis:** ORS 238.670(5) requires the Public Employees Retirement System (PERS) Board to submit a report to the Legislature on its preliminary plan to credit calendar year earnings of the Oregon Public Employees Retirement Fund (OPERF) to member and employer accounts and other reserves. Under the statute, the Board must provide the report at least 30 days before it makes its final earnings crediting decision. The Board is scheduled to make its final 2014 earnings crediting decision at its March 30, 2015 Board meeting.

On January 30, 2015, the PERS Board approved preliminary earnings crediting for calendar year 2014 of \$4.6 billion. In calendar year 2013, \$9.2 billion was credited to accounts.

Allocating 2014 earnings will increase those reserves subject to crediting from \$64.3 billion to \$68.9 billion for a 7.2% increase. This is below the 2014 assumed earnings rate of 7.75%.<sup>1</sup> The Oregon Public Employees Retirement Fund Policy [earnings] Benchmark for 2014, established by the Oregon Investment Council, returned 8.24% for 2014. PERS funded status remains unchanged from calendar year 2013 at an estimated 96%, according to PERS.

Earnings crediting is net of an estimated \$452.2 million in calendar year investment expenses and brokerage commissions directed by the Oregon Investment Council (OIC). Additional calendar year administrative expenses include: \$1 million for OIC; \$9.9 million for State Treasury; and \$42.3 million for PERS agency expenses.

The preliminary allocation of the \$4.6 billion includes:

- Member and Employer Account Allocations (\$2.2 billion): Tier One member accounts \$404.1 million; Tier Two member accounts \$59.1 million; Oregon Public Service Retirement Plan (OPSRP) Pension Employer Reserves \$134.1 million; and Tier One/Tier Two Employer Reserves \$1.6 billion.
- Benefit and Reserves Allocation (\$1.6 billion): Benefits-in-Force \$1.6 billion; Tier One Rate Guarantee Reserve \$5.6 million; with no allocation to the Contingency Reserves (see below).
- Other crediting outside of the Board's discretion (\$847.4 million): Employer Pre-Paid "Side" Accounts \$424.6 million and Individual Account Program (IAP) member accounts \$422.8 million.<sup>2</sup>

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<sup>1</sup> PERS Board changed the assumed earnings rate from 8% to 7.75% to become effective January 1st, 2014.

<sup>2</sup> Employee Health program accounts are also non-discretionary, and credited with actual earnings, which varied from 0.5387% to 6.96%.

Tier One member regular accounts were credited at the 2014 assumed earnings rate of 7.75%. Tier Two regular member accounts received a preliminary crediting rate of 7.25%, while the employers' OPSRP Pension accounts are expected to receive a rate of 7.11%. Variable accounts are estimated to earn 4.30% and IAP member accounts earnings crediting is estimated to be 6.93%. Attached to this analysis is a history of actual earnings crediting and the fund's performance relative to the policy benchmark over time.

Current 2013-15 employer rates were based on the system valuation as of December 31, 2011, which reflected earnings crediting for calendar years 2010 and 2011. Budgeted employer rates for 2015-17 are based on the system valuation as of December 31, 2013, which reflected earnings crediting for calendar years 2012 and 2013. Final crediting of calendar 2014 and 2015 earnings will impact 2017-19 employer rates, which will be based on the system valuation as of December 31, 2015.

### **Contingency Reserve**

By statute, the PERS Board can credit up to 7.5% of earnings to the Contingency Reserve, if earnings exceed the assumed earnings rate. Earnings for 2014 did not exceed the assumed earnings rate. The balance in the reserve account remains at \$651.1 million. Statutorily, contingency reserves are for: (a) employer insolvency; (b) legal expenses; (d) temporary supplemental payments [SB 861 (2013)];<sup>3</sup> and (c) unspecified contingencies.

### **Deployment of Contingency Reserve for "Unspecified Contingency"**

A PERS internal audit finding from July 2013 discovered that the agency incorrectly applied the final average salary statute when calculating benefits resulting in an overpayment to an estimated 3,500 beneficiaries for Tier Two and OPSRP Pension calculations for only local government retirees. While the error has since been corrected for those retiring after November of 2013, those who retired after 2005 and before November 2013 may continue to receive a miscalculated benefit.

PERS, in consultation with its actuary, estimates the cost of the overpayment to be \$6.7 million. This present value estimate is based on a sampling of retiree benefits rather than a detailed review of each retiree benefit calculation. Therefore, there is uncertainty associated with the estimate.

At its July 2014 meeting, the PERS Board approved the transfer of \$6.7 million from the Contingency Reserve Fund to the Benefits in Force Reserve Account to hold employers and members harmless for the estimated cost of the error. An alternative considered by the PERS Board, but not adopted, was to spend \$735,000 over 17 months to calculate the exact overpayment to each of the 7,900 potentially affected retired members. The recovery of overpayments would be an additional costs.

Statute gives the PERS Board discretion to pursue the recovery of overpayments, within a seven year statutory limit. Statute also gives the Board broad authority to define an "unspecified contingency."

### **Recommendation**

The Legislative Fiscal Office recommends acknowledging receipt of the report.

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<sup>3</sup> The PERS Board originally earmarked \$65 million of the Account's balance to pay the total cost of the SB 861 supplementary payments. The estimate has now increased to \$68.4 million.

## Addendum

### PERS Earnings/(Loss) Crediting History (Percent)

Year	Calendar Year	Tier One Crediting	Tier Two Crediting	Variable Crediting	Individual Account Program
1	2001	8.00	(6.66)	(11.19)	n/a
2	2002	8.00	(8.93)	(21.51)	n/a
3	2003	8.00	22.00	34.68	n/a
4	2004	8.00	13.27	13.00	12.77
5	2005	8.00	18.31	8.29	12.80
6	2006	8.00	15.45	15.61	14.98
7	2007	7.97	9.47	1.75	9.46
8	2008	8.00	(27.18)	(43.71)	(26.75)
9	2009	8.00	19.12	37.57	18.47
10	2010	8.00	12.44	15.17	12.13
11	2011	8.00	2.21	(7.80)	2.15
12	2012	8.00	14.68	18.43	14.09
13	2013	8.00	15.62	25.74	15.59
14	2014 - Preliminary	7.75	7.25	4.30	6.93
	14 Year Average	7.98	7.65	6.45	n/a
	10-Year Average	7.97	8.74	7.54	7.99
	5-Year Average	7.95	10.44	11.17	10.18
	3-Year Average	7.92	12.52	16.16	12.20
	1-Year Average	7.75	7.25	4.30	6.93

### Oregon Public Employees Retirement Regular Fund Performance comparison to Policy Benchmark

	OIC Policy Benchmark	Regular Account Earnings
10-Year Average	7.33	7.37
5-Year Average	10.36	10.28
3-Year Average	13.41	12.33
1-Year Average	8.24	7.29