

Agency Report
Public Employees Retirement System
Assumed Earnings Rate

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Request: Acknowledge receipt of a report on the assumed earnings rate.

Recommendation: Acknowledge receipt of the report.

Analysis: A budget note in HB 5034 (2015) directed the Public Employees Retirement System (PERS) to report as follows:

The Public Employees Retirement System (PERS) is directed to report to the Joint Committee on Ways and Means during the legislative session in 2016, or the next Emergency Board, if the PERS Board adopts any change to the assumed earnings rate. The report is to include an actuarial analysis specially focused on the change in the assumed earnings rate.

In July of 2015, the PERS Board reduced the assumed rate from 7.75% to 7.50%, effective January 1, 2016. A previous reduction from 8.00% to 7.75% was approved by the Board in July of 2013.

Definition and Application

The assumed earnings rate is the actuarial assumed rate of return on investments. Technically, the assumed earnings rate is comprised of a series of assumptions about current and projected interest rates; rates of inflation; historic and projected market rates of returns for various asset classes invested in by the Oregon Investment Council; and the historic returns on the PERS fund portfolio.

The assumed earnings rate is used to estimate long-term investment returns, determine the present value of assets and liabilities, credit some investment earnings, and calculate some member benefits. “Long-term” is considered by PERS to match the 20-year amortization period for Tier 1/Tier 2 plan liabilities.

Rate Setting Authority

Since PERS’ inception in 1946, the Legislature has delegated to the PERS Board the authority to set the assumed earnings rate administratively.¹ By statute, the Board undertakes a review of the assumed earnings rate each biennium. Once the rate is set, statute dictates that the rate becomes the guaranteed rate of returned for Tier 1 member accounts.²

Assumed Earnings Rate History

Over the last 70 years, the PERS Board has made nine changes to the assumed earnings rate. As the PERS investment portfolio diversified into more equity investments and produced higher actual rates of returns, the assumed earnings rate adopted by the PERS Board increased, until recently. The following table provides a history of assumed rate changes and the number of years each

¹ OAR 459-007-0007.

² ORS 238.255.

adopted rate was or has been in effect.

Year(s) Changed	Assume Earnings Rate	Years in Effect
2015	7.50%	<1
2013	7.75%	2
1989	8.00%	23
1979	7.50%	10
1975	7.00%	4
1973	5.50%	2
1970	5.00%	3
1966	3.75%	4
1946	2.25%	20

In a recent brief by the National Association of State Retirement Administrators (NASRA), out of 126 surveyed retirement plans, the average assumed earnings rate is 7.68% with a median of 7.75%.³

Actual Rates of Return

As an actuarial estimate of investment returns, the durability of the assumed earnings rate can be evaluated against a comparison of actual investment returns. The following table details actual investment returns for the Oregon Public Employees Retirement Fund and the median public pension investment returns from the NASRA study.

Investment Returns (for the period 12/31/2014)	Oregon Public Employees Retirement Fund Regular Account	NASRA Median Public Pension Investment Return
1 year	7.29%	6.1%
3 year	12.33%	11.3%
5 year	10.28%	9.5%
10 year	7.37%	6.5%
20 year	9.84%	8.4%
25 year	9.82%	8.5%

The Oregon Public Employees Retirement Fund Regular Account earnings return for calendar year 2015 is estimated at 2.11% before administrative costs (1.89% net of administrative costs).

Financial Impact of Assumed Earnings Rate Change

According to PERS, the reduction in the assumed rate from 7.75% to 7.50% increased the system's unfunded accrued liability (UAL) by \$1.7 billion and increased (uncollared) system-average employer contribution rates by 2%, based on the recent December 31, 2014 actuarial valuation.

The PERS Board change to the assumed earnings rate points to a common misunderstanding, which is that the projected increase in future employer rates is explained only by the Oregon Supreme Court

³ NASRA Issue Brief: Public Pension Plan Investment Return Assumptions (May 2015).

Moro decision.

The Supreme Court's decision to overturn some of the 2013 legislative reforms added about \$5.1 billion to the system's UAL of \$9.5 billion. The PERS Board, however, added about \$4.2 billion to the system's UAL due to administrative actions approved by the Board. Such decisions included the aforementioned assumed earnings rate that added \$1.7 billion as well as other methods and assumption changes, such as updating its mortality tables, and actual experience, along with 2014 earnings coming in below assumption, all of which added another \$2.5 billion to the 2014 UAL.

With 2015 earnings crediting of only 1.89% now known, the UAL will see a further increase due to actual earnings below the assumed earnings rate.

Recommendation

The Legislative Fiscal Office recommends acknowledging receipt of the report.