



# Oregon

Kate Brown, Governor

## Public Employees Retirement System

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**TO:** Members of the Joint Committee on Ways and Means  
**FROM:** Steven Patrick Rodeman, Executive Director  
**SUBJECT:** PERS Board Adoption of Assumed Earnings Rate (HB 5034 Budget Note Report)

A Budget Note in House Bill 5034 (2015), directed PERS to report to the Joint Committee on Ways and Means during the legislative session in 2016 if the Board adopted any change to the assumed earnings rate. The report was to “include an actuarial analysis specially focused on the change in the assumed earnings rate.” This report responds to that direction, as the PERS Board adopted a change to the assumed rate at its July 31, 2015 meeting.

### **BACKGROUND**

The assumed earnings rate is used at least three ways by Oregon PERS:

1. As a discount rate for determining “the current and prospective assets and liabilities of the system” in conducting the evaluation required under ORS 238.605 that is used to establish employer contribution rates;
2. As a component of the Actuarial Equivalency Factor (“AEF”) tables required by ORS 238.607 to compute payments to be made to members and their beneficiaries, as AEF tables are driven by assumptions regarding life expectancy and the rate of return over the projected duration of the payment;
3. As a guaranteed annual crediting rate for Tier One active member regular accounts, pursuant to ORS 238.255.

The PERS Board is directed to review actuarial methods and assumptions, including the assumed rate of return, every two years. This review prompts changes to these methods and assumptions, when warranted, that are then reflected throughout the system as the PERS Board executes its responsibilities under the statutes listed above to set employer rates, adopt AEF tables, and credit annual earnings to the various accounts in the system.

The assumed rate is a long-term investment return assumption based on the categories in which the Oregon Investment Council directs the PERS Fund assets to be invested. That asset allocation is then analyzed by investment consultants to the Council and by Milliman, PERS’ actuary, to project the expected return from that allocation over the next twenty years.

### **DATA REVIEWED FOR RECENT ASSUMED RATE CHANGE**

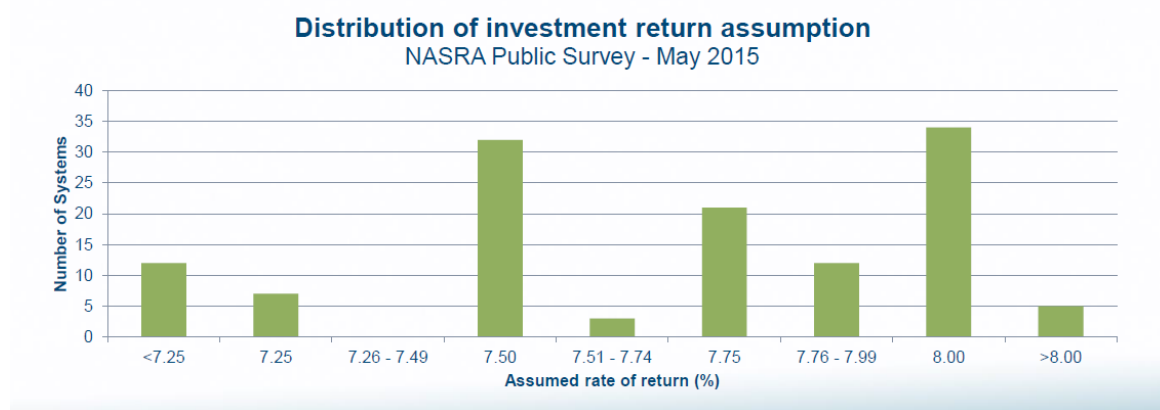
The PERS Board’s action in July 2015 reduced the assumed rate from 7.75% to 7.50%, effective for the system valuations to be performed at the close of 2014 and 2015, and for AEF tables and earnings crediting as of January 1, 2016 (to allow administrative changes that will reflect the rate change). The Board previously reduced the rate in July 2013 from 8.00% to 7.75%.

The Oregon Investment Council consultants and Milliman reported the following information at the July 31, 2015 PERS Board meeting with regard to projected returns:

Investment Return Estimates	Milliman	Callan*	Horizon*
Median annualized rate of return	6.99%	7.51%	7.25%
Assumed rate of inflation	2.50%	2.25%	2.41%
Timeframe modeled (years)	20	10-20	10

Milliman's Capital Market Outlook: Average Annualized Returns Over the next 20 Years	
75 <sup>th</sup> percentile	8.99%
60 <sup>th</sup> percentile	7.74%
<b>50<sup>th</sup> percentile</b>	<b>6.99%</b>
40 <sup>th</sup> percentile	6.25%
25 <sup>th</sup> percentile	5.03%

Milliman also reported a downward trend in return assumptions among public retirement plans. Over half of the 126 state-wide systems tracked by the National Association of State Retirement Administrators (NASRA) have reduced their return assumptions since 2008. The following chart shows the distribution of investment assumptions for these systems.



### **IMPACT of ASSUMED RATE CHANGE on MEMBERS and EMPLOYERS**

At the July PERS Board meeting, Milliman reported that the estimated impact of reducing the assumed earnings rate to 7.50% from 7.75% would be to increase the December 31, 2014 accrued system liability by \$1.7 billion. The estimated impact on uncollared, system-average employer contribution rates were reported as an increase of 1.4% for the system's Unfunded Actuarial Liability and 0.6% on Normal Cost.

The rate reduction also lowers retirement benefits calculated under Money Match because the member's account is projected to earn less over their projected remaining life, so the AEF used to convert the account balance to an annuity is reduced. PERS provided information to potentially impacted members to illustrate that, to retire with a similar monthly benefit before and after the rate reduction, a member would need to work about three additional months.

\*Callan is the OIC's general investment consultant; Horizon is a survey of investment return analysts referenced by Milliman.