

Agency Report
Public Employees Retirement System
2015 Earnings Crediting Report

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Request: Acknowledge receipt of a report on calendar year 2015 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 2015 earnings crediting decision at its March 28, 2016 Board meeting.

On January 29, 2016, the PERS Board approved preliminary earnings crediting for calendar year 2015 of \$1.25 billion. In calendar year 2014, \$4.6 billion was credited and in calendar year 2013, \$9.2 billion was credited to accounts.

Allocating 2015 earnings will increase those reserves subject to crediting from \$66.4 billion to \$67.7 billion for a 1.88% increase. This is below the 2015 assumed earnings rate of 7.75%.¹ The Oregon Public Employees Retirement Fund Policy [earnings] Benchmark for 2015, established by the Oregon Investment Council, returned 1.57% for 2015.

A preliminary estimate of the PERS funded status is 71%, but will be officially finalized this summer. The funded status in 2014 was 96% before the Supreme Court's Moro decision and other system changes and then 76% after such changes were incorporated into actuarial valuations. The funded status was 87% in 2013.

The \$1.38 billion in actual investment income netted against an estimated \$365.6 million in calendar year investment expenses and brokerage commissions directed by the Oregon Investment Council (OIC). Additional calendar year administrative expenses include: \$3.1 million for OIC; \$10 million for State Treasury; and \$43.1 million for PERS agency expenses.

Earnings Crediting

If the PERS Board follows their preliminary earnings crediting, Tier One member regular accounts will be credited at the 2015 assumed earnings rate of 7.75%. Tier Two regular member accounts will receive a crediting rate of 1.88%, while the employers' OPSRP Pension accounts are expected to receive a rate of 1.88%. Variable accounts are estimated to earn <1.60%> and IAP member accounts earnings crediting is estimated to be 1.87% (see the history of earnings crediting at the end of this report).

¹ The PERS Board changed the assumed earnings rate from 7.75% to 7.50% to become effective January 1st, 2016.

Final crediting of calendar 2014 and 2015 earnings will impact 2017-19 employer rates, which will be based on the yet-to-be completed system valuation as of December 31, 2015. Since the PERS' actuary used the assumed earnings rate for 2015, and now that actual returns are known and well below the assumed rate, a further, long-term increase in PERS rates is anticipated. The advisory rates for the 2017-19 biennium, published in the fall of 2015, likely will not change as most are already subject to the limits of rate collaring, and were developed based on year-to-date earnings projections that reflected the low returns that ultimately were realized for 2015.

Tier One Rate Guarantee Reserve

The Tier One Rate Guarantee Reserve makes up any shortfall between the assumed earnings rate and investment returns for Tier One regular accounts. Earnings on Tier One member regular accounts in excess of the assumed earnings rate is the revenue source for the reserve. Since Tier One regular account earnings were below the assumed earnings rate, \$280.8 million of the \$448.8 million account balance will be transferred to Tier One member accounts, which will leave a balance of \$168 million. Only beginning in 2013 did the reserve account regain liquidity after the impacts of the 2008 financial crisis and other years with below assumed rate earnings.

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. Since earnings for 2015 did not exceed the assumed earnings rate, for the second calendar year in a row, there were no funds deposited into the reserve. The balance in the reserve account remains at \$588.6 million.

Statutorily, contingency reserves are for: (a) employer insolvency; (b) legal expenses; (d) temporary supplemental payments [SB 861 (2013)]; and (c) unspecified contingencies.

Deployment of Contingency Reserve

The PERS Board, at its September 2015 meeting, considered the deployment of Contingency Reserve funds for: (a) an OPSRP contribution start date "misapplication" of the law and "inconsistent administration" for the years 2004-2015 plus back earnings (\$15.5 million) and (b) to re-pay most COLA benefits overturned by the Supreme Court (\$63.4 million).

The Board approved the COLA payment. Originally, \$9.8 million was used to pay the first year of supplementary payments. Once those payments were invalidated by the Supreme Court, the remaining \$55.2 million that was committed to fund those payments was released within the Contingency Reserve. Instead, \$62.5 million was transferred from the reserve to fund the first round of COLA restoration in October 2015, with about another \$3.4 million being used for the COLA restoration payments to be made in February 2016.

The Board deferred a decision on allocating funds for the OPSRP issue due to employee stakeholder objections about the ad hoc use of the reserve. The PERS Board is now in the process of developing policies and procedures for "unspecified contingency[ies]."²

² A similar concern arose last biennium, when 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 an agency error that 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.

Recommendation

The Legislative Fiscal Office recommends acknowledging receipt of the report.

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	7.75	7.24	4.29	7.05
15	2015	7.75	1.88	(1.60)	1.87
	15 Year Average	7.96	7.26	5.91	--
	10-Year Average	7.95	7.09	6.55	6.90
	5-Year Average	7.90	8.33	7.81	8.15
	3-Year Average	7.83	8.25	9.48	8.17
	1-Year Average	7.75	1.88	-1.60	1.87