PRELIMINARY ANALYSIS
PUBLIC EMPLOYEES RETIREMENT SYSTEM PROPOSAL
79th Oregon Legislative Assembly – 2017 Regular Session

This form provides an outline for the preliminary analysis of proposals submitted to the Senate Committee on Workforce to address the rising costs and long-term sustainability of the Public Employees Retirement System (PERS). A technical team, including but not limited to individuals from Legislative Counsel, Legislative Fiscal, and PERS, will analyze each proposal under the following criteria for the Committee's consideration.

- Constitutionality
- Order of Magnitude in Savings
- Actuarial Soundness
- Impact on Employer Contribution Rates
- Impact on State and Local Budgets
- Impact on Public Employee Benefits
- Impact on public Employee Workforce
- Equitability of Costs & Benefits to Public Employees
- Administrative Feasibility

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Date: March 2017

Measure Numbers/LC (if any): Senate Bill 559 as introduced

Summary of Proposal: Changes the Final Average Salary calculation from three years to five years for salary paid after January 1, 2018.

Summary of Current Law: At retirement, Full Formula benefit calculations are based on: Years of Service x Final Average Salary x Statutory Factor. The FAS is the high three years/final 36 months of a member's career (with some variation among Tier One, Tier Two, and OPSRP).

Has a detailed actuarial analysis been completed for this proposal? Yes, attached. Milliman letter dated October 28, 2016, based on December 31, 2015 valuation results. The Milliman analysis was not specifically based on SB 559, but rather the concept of changing the Final Average Salary calculation from three to five years**.**

LFO – In the absence of an actuarial analysis on SB 559, LFO is relying upon the October 28, 2016 actuarial analysis.

ANALYSIS

The analysis should address each of the following criteria to the extent that information is available.

1. **Constitutionality**
   Legislative Counsel – Application of the new calculation to years after January 1, 2018, appears to meet *Moro* standard for protection of accrued benefits. Note, however, that Greg Hartman mentioned in his testimony an argument that the bill does not protect accrued benefits. As we understand the argument from his brief comment, a member would argue that to protect accrued benefits, the bill should apply the current final average salary calculation, regardless of when the salary was earned, to benefits accrued before the change. In a simplified example, if a member had worked for 10 years before the change, the member would argue that the member should have the 3-year final average salary applied to 10 years of the member's service.

   The counter to the argument would be that the member has not yet completed the performance necessary to accrue the benefit of the higher salary earned at the end of the member's career. That view seems to be in accord with the opinion in *Moro*, but it is difficult to predict the outcome in the Supreme Court.

2. **Order of Magnitude in Savings (for next three biennia, if possible)**
   PERS - See page 3 of the Milliman letter for reductions in liability that would result from this concept. Please note that 2017-19 employer contribution rates have already been adopted, and those rate increases were limited by the PERS Board's rate collar policy. Cost reductions from this concept would be carried over to future biennia when the collar is fully implemented absent specific direction from the legislature to apply those savings in the next cycle. Doing so would postpone the full implementation of non-collared rates.

   LFO – The measure, if it were to become law, would generate system-wide employer rate savings beginning in the 2017-19 biennium. A preliminary estimate of these savings for the 2017-19 biennium is $99.7 million total funds; however, savings may be reduced or eliminated if the measure is successfully challenged in court, modified through collective bargaining or grievance arbitration, or subsumed by the PERS Board rate collar policy.

3. **Actuarial Soundness**
   PERS – Within the context of whether this concept would, over the time period considered, allow projected employer contributions and investment income to fully fund the system, this concept would reduce that period (or lower costs during that period) as it reduces the benefits to be paid.

4. **Impact on Employer Contribution Rates (for next three biennia, if possible, including normal costs, unfunded actuarial liability (UAL), Individual**

Account Program/employee contributions, state agencies, school districts, and other PERS employers)
PERS - See the comment about the current employer rate setting cycle and implementation of the PERS Board's rate collar.

LFO – According to the Milliman actuarial analysis of this concept, the normal cost rate for employers statewide would be reduced by 0.25% and the Unfunded Accrued Liability rate by 0.40% for a total **uncollared** rate reduction of 0.65%. The average system-wide employer rate would decline from 29.08% to approximately 28.43%.

5. **Impact on State and Local Budgets (cost savings and cost shifts, impact on General/Lottery Fund, and potential financial impact on collective bargaining)**
PERS - See the comment about the current employer rate setting cycle and implementation of the PERS Board's rate collar.

LFO – A preliminary estimate of the ***gross*** General/Lottery Fund savings for the 2017-19 biennium for state government is approximately $37.9 million; however, savings may be reduced or eliminated if the measure is successfully challenged in court, modified through collective bargaining or grievance arbitration, or subsumed by the PERS Board rate collar policy.

6. **Impact on Public Employee Benefits (Tier 1, Tier 2, Oregon Public Service Retirement Plan (OPSRP))**
PERS - As drafted, PERS understands that the three-year Final Average Salary, calculated for service/salary before January 1, 2018, would be preserved as a minimum FAS for non-retired members. The five-year FAS would be used for benefit calculations when it exceeds the three-year FAS. With that in mind, the five-year calculation is not likely to impact many Tier One members, may have some impact on Tier Two members, but will likely impact OPRSP members the most as they generally have the least amount of service time and salary in the system prior to the effective date of the measure.

LFO – The primary impact would be to Tier 2 and OPSRP members.

7. **Impact on Public Employee Workforce (rate of retirements, employers' ability to recruit and retain employees)**
PERS - While no one can reliably predict this impact, we would note that, as of December 31, 2016, over 32% of non-retired members across all Tiers and employer groups (70,335 of 219,220) were eligible to retire based on age or years of service. As this concept as drafted does not affect FAS until the five-

year average is higher, the likelihood of it triggering a wave of retirements seems small.

8. **Equitability of Costs and Benefits to Public Employees (costs/benefits)**
LFO – The measure may have a disproportionate impact on Tier 2 and OPSRP members who will have an increasing propensity to fall under the five-year FAS calculation.

9. **Administrative Feasibility**
PERS - There will be a fiscal impact to the agency to reprogram benefit calculation software to accommodate the new calculation. Additionally, the agency will revise member education material in all formats to reflect the new calculation.

LFO – LFO does not have sufficient information at this time to respond to this question; however, the measure is assumed to have a fiscal impact on the operational budget of PERS for costs associated with implementing the measure (e.g., information technology), as well as possible legal costs.

Technical Issues of Note:
Legislative Fiscal – The measure may require clarification to ensure that budgetary savings begin with the 2017-19 biennium and reduce the recalculated 2017-19 employer contribution rates adopted by the PERS Board. Also, a more complete fiscal analysis will be prepared as the measure advances through the legislative process.