

Analysis  
**Public Employees Retirement System**  
Contingency Reserve Fund Allocation

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**Analyst:** John Borden

**Request:** Acknowledge receipt of a follow-up report on Contingency Reserve Fund allocation.

**Recommendation:** Acknowledge receipt of the report, with instruction.

**Analysis:** The Public Employees Retirement System (PERS) Board on March 9, 2017, reported to the Legislature its preliminary plan to credit 2016 calendar year earnings of the Oregon Public Employees Retirement Fund (OPERF). The Joint Committee on Ways and Means - Subcommittee on General Government recommended to the Joint Committee on Ways and Means acknowledging receipt of the agency's report, but with the following instruction:

...prior to the allocation of any Contingency Reserve funds under ORS 238.670, that the PERS Board report to the Joint Committee on Ways and Means on the Board's specific recommendation as to which accounts the reserve funds should be deployed to and the associated rationale.

**Contingency Reserve Background**

When earnings on OPERF equal or exceed the assumed earnings rate, the PERS Board may credit up to seven and one-half percent of earnings to the Contingency Reserve. Statutorily, contingency reserves are for paying: (a) a deficit in the payment of retirement allowances; (b) employer insolvency; (c) legal expenses; and (d) unspecified contingencies.

The PERS Board's policy of rate collaring, or administratively limiting rate increases from one biennium to the next, practically eliminates the need for reserve funding. The overfunding of the Contingency Reserve has been an issue for the Legislature beginning with the 2012 earnings crediting report. Contingency Reserve funds are not accounted for in actuarial valuations and the deployment of any amount of reserves to member regular accounts and employer accounts would reduce employer rates.

The balance in the reserve account is \$583.7 million. The 2016 earnings crediting report makes note of an overfunding of the PERS Contingency Reserve by \$345.9 million, but gave no indication where these reserve funds would be deployed. Attached is a financial history of the Reserve.

**Agency Report**

On April 4, 2017, the PERS Board submitted the requested follow-up report, which stated that the Board, at its April 3, 2017 meeting, "...approved a motion to adopt the preliminary allocation of excess funds in the Contingency Reserve to the Benefits in Force Reserve, subject to adoption at a future PERS Board meeting, contingent on legislative reporting and review." The Benefits-in-Force Reserve account is used to fund Tier 1/Tier Two retiree benefits payments, upon an individual's retirement. The account is funded with employer and member (retiree) contributions and associated earnings. The amount of the allocation was unspecified as was the estimated change to the accrued

liability and employer rates.

**PERS Board Preliminary Allocation Decision**

There are two questions related to the PERS Board’s decision: (a) Is an allocation of Contingency Reserves to only the Benefits-in-Force Reserve account appropriate; and (b) Is the Board’s methodology for setting the Contingency Reserve balance reasonable.

Statutorily, the Oregon Public Employees Retirement Fund is comprised of employer, employee, and reserve accounts for the exclusive benefit of PERS members. Under the Board’s proposal, Contingency Reserves are not allocated back to the accounts from which the earnings were originally diverted to fund the Reserve. Alternatively, a proportional allocation would have been consistent with some of the past allocation decisions by former PERS Boards. The Board’s preliminary allocation also would mean no allocation to the Tier One Rate Guarantee reserve, among other accounts, which possibly could be considered underfunded and has, and may likely continue to require, Contingency Reserve allocations to remain solvent. Attached is a comparison of the Board’s allocation to a proportional allocation.

The PERS Board at its March 28, 2016, unanimously adopted “...a percentage basis funding level for the Contingency Reserve and establish the percentage at this time to be .25 of the accrued liability.” PERS has chosen not to formalize the Board’s decision in a written policy statement. The Board’s calculation methodology is based on an actuarial accrued liability of \$76.7 billion, as of December 2015, which translates to a proposed Contingency Reserve balance of \$190.5 million; however, there are several adjustments to that balance.

The Contingency Reserve balance includes adjustments for: employer contingency (\$25 million); a residual repayment of cost-of-living benefits payments overturned by the Supreme Court in the Moro decision (\$0.5 million); legal fees for the Moro case (\$1 million); and an Oregon Public Service Retirement Plan contribution start date “misapplication” of the law and “inconsistent administration” for the years 2004-2015, plus back earnings (\$21.8 million). These actions reduce (or hold in reserve) the Contingency Reserve balance to \$535.4 million from the reported \$583.7 million balance. The net result is an allocation of \$344.9 million, as opposed to the \$345.9 million previously reported, leaving a balance of \$237.8 million in the Reserve. The following table summarizes these actions.

PERS Board's Preliminary Contingency Reserve Balance		
Contingency Reserve Balance (as of 12/31/2016)		\$ 583,657,273
Less: Employer contingency	\$ (25,000,000)	
Less: October Moro payment	\$ (497,474)	
Less: Moro legal fees	\$ (1,001,136)	
Less: Oregon Public Service Retirement Plan error	\$ (21,809,890)	\$ (48,308,500)
Revised Balance		\$ 535,348,773
Preliminary allocation		\$ (344,857,273)
Proposed Contingency Reserve Target Balance*		\$ 190,491,500
Add: Employer contingency	\$ 25,000,000	
Add: October Moro payment	\$ 497,474	
Add: Oregon Public Service Retirement Plan error	\$ 21,809,890	\$ 47,307,364
Agency Adjusted Contingency Reserve Balance		\$ 237,798,864
*based on 0.25% of \$76.7 billion unfunded liability		

The Reserve policy adopted by the Board means that in periods of a high accrued liability, the Contingency Reserve target account balance would increase, and in periods of low accrued liability,

the Contingency Reserve target balance would decrease. This policy is at odds with the underlying rationale of a contingency reserve, which is to provide supplemental funding in periods of high accrued liability when the deployment of reserves would reduce the unfunded accrued liabilities and employer contribution rates. Additionally, how the Board's adopted target policy aligns with the statutorily permissible uses of the Contingency Reserve account is difficult to ascertain.

**Recommendation**

The Legislative Fiscal Office recommends acknowledging receipt of the report, with instruction that the Public Employees Retirement Board re-evaluate the statutory requirements related to an adequately funded Contingency Reserve balance.

*[Refer to tables on following page]*

## Contingency Reserve Account History

Oregon Public Employees Retirement System			
Regular (Fixed) Account			
Analysis of Contingency Reserve Activity			
Through December 31, 2016			
Date	Activity	Balance	Description for Activity
12/31/2003	\$ 524,818,646.48	\$ 524,818,646.48	Adjustment for 1999 change in crediting from 20.00% to 11.33%
	\$ 584,784,004.07		Lipscomb Settlement agreement transfer to employers
	\$ (61,410,984.00)		Transfer to select employers in settlement of Eugene case
12/31/2004	\$ 370,944,585.36	\$ 1,419,134,394.89	2004 Earnings
	\$ (1,169,134,394.89)		Distribute all but \$250,000,000 of Reserve proportionally to accounts and reserves
12/31/2005		\$ 250,000,000.00	
12/31/2006	\$ (3,977,823.66)		LSVP Contributions and Earnings authorized by Board
	\$ (707,864.19)		Reserve 2005 Law Change to apply salary definition retroactively
	\$ 50,000,000.00	\$ 295,314,312.15	2006 Earnings
12/31/2007	\$ 357,901,761.23	\$ 653,216,073.38	2007 Earnings
12/31/2008	\$ (101,713.42)	\$ 653,114,359.96	Remaining LSVP Contributions and Earnings charge to reserve
12/31/2009		\$ 653,114,359.96	No additional Crediting or Distributions
12/31/2010	\$ 81,312,000.00	\$ 734,426,359.96	Correction for CY2010 Retirement Earnings closed to Benefit Reserve in error.
12/31/2011	\$ (199,165,108.61)	\$ 535,261,251.35	Eliminate remaining deficit in Tier One Rate Guarantee Reserve from 2008 Losses
12/31/2012	\$ 64,900,000.00	\$ 600,161,251.35	2012 Earnings Net of \$2,000,000 for Murray Settlement
12/31/2013	\$ 67,541,530.47		
	\$ (65,000,000.00)	\$ 602,702,781.82	Establish Supplementary Payment Reserve
7/25/2014	\$ (6,700,000.00)	\$ 596,002,781.82	Transfer funds to Benefit Reserve for "Final Average Salary" settlement
12/31/2014	\$ -	\$ 596,002,781.82	No additional Crediting or Distributions
9/22/2015	\$ 55,199,362.15	\$ 651,202,143.97	Close 2014 Supplementary Payments to Contingency
10/12/2015	\$ (62,591,029.12)	\$ 588,611,114.85	Fund Retro COLA Payments
3/16/2016	\$ (4,953,841.57)	\$ 583,657,273.28	Fund 2016 Moro Payments
12/31/2016		\$ 583,657,273.28	No additional Crediting or Distributions

## Comparison of Board's Preliminary Allocation Compared to a Proportional Allocation

Comparison of Board's Preliminary Contingency Reserve Allocation Compared to a Proportional Allocation						
(All dollar amounts in millions)	Reserves After 2016 Crediting	Reserves with Preliminary Board Allocation	Reserves with Proportionate Allocation	Preliminary Board Allocation	Proportionate Allocation	Difference
Contingency Reserve	583.70	238.80	238.80	(344.90)	(344.90)	-
Tier One Member Regular Accounts	4,888.00	4,888.00	4,888.00	-	-	-
Tier One Rate Guarantee Reserve	180.80	180.80	238.86	-	58.06	(58.06)
Benefits In Force Reserve	22,011.70	22,356.60	22,173.08	344.90	161.38	183.52
Tier Two Member Regular Accounts	875.20	875.20	880.50	-	5.30	(5.30)
Employer Reserves	24,898.60	24,898.60	25,015.74	-	117.14	(117.14)
OPSRP Pension	3,006.60	3,006.60	3,009.62	-	3.02	(3.02)
*UAL Lump-Sum Pmt. Side Accounts	5,389.00	5,389.00	5,389.00	-	-	-
*IAP Accounts	7,347.80	7,347.80	7,347.80	-	-	-
				-	-	-
Total	69,181.40	69,181.40	69,181.40	-	-	-