

ANALYSIS

Public Employees Retirement System 2022 Preliminary Earnings Crediting

Analyst: John Borden

Request: Acknowledge receipt of a report on 2022 preliminary earnings crediting.

Analysis: ORS 238.670(5) requires the Public Employees Retirement System (PERS) Board to submit a report to the Legislature on the Board’s 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 the Board makes its final earnings crediting decision. The Board is scheduled to make its final 2022 earnings crediting decision on April 3, 2023. Statute gives the PERS Board broad authority to make earnings crediting decisions and, according to the agency, allocations have generally been on a proportional basis for member and employer accounts.

Of note is that the Legislature during the Second Special Session of 2020, enacted HB 4304, which expanded PERS reporting to the Legislature on annual preliminary earnings crediting to include all the agency’s funds and adds reporting requirements for investment and administrative expenses.

Preliminary Earnings Crediting

On February 3, 2023, the PERS Board approved preliminary **net** earnings loss for calendar year 2022 of a \$2.2 billion (associated **gross** earnings were a loss of \$941.2 million before investment and administrative expenses). Allocating 2022 net losses will decrease reserves subject to crediting from \$96.9 billion to \$94.7 billion for a 2.24% loss. This is estimated to be \$4.4 billion less the \$8.8 billion in expected gross earnings based on the assumed earnings rate of 6.9%. Addendum-A show earning history and the assumed rate for the last 25-years.

For perspective, the following table provides statistics for the past 12 years of preliminary earnings crediting reports to the Legislature.

2011-2022 Statistics (in billions)	Preliminary Earnings Crediting	Preliminary Earnings Return
Average return	\$5,668.7	8.5%
Highest return	\$16,289.2 (2021)	19.62% (2021)
Median return	\$5,209.2	7.28%
Low return	\$2,170.3 (2022)	-2.24% (2022)
Standard Deviation	\$4,978.2	6.8%

Of note is the actual market returns for private equity investments, which comprise over 26% of OPERF assets, are reported on a three-month lag as additional time is needed to value these non-public assets

and returns. Therefore, the preliminary 2022 earnings crediting rate of return is based on private equity returns through September 30, 2022, rather than December 31, 2022. Private equity returns for the fourth quarter 2022 returns will be reflected in the following year as part of 2023 earnings crediting.

Also, this report does not include the following: (a) an estimated \$41.5 million in earnings crediting above the reported amount due to the crediting associated with member account payouts during the year and earnings required to be credited to employer accounts during the year; and (b) by statute, earnings crediting for anything other than the OPERF, which excludes earnings crediting for various retiree health insurance accounts.

Estimated Impact to Unfunded Accrued Liability

The system-wide Unfunded Actuarial Liability (UAL) for calendar year 2021 was \$13.4 billion after taking into consideration \$6.6 billion in pre-paid employer side accounts. An actuarial estimate of the impact of the 2022 preliminary losses and other PERS Board changes on the UAL shows that the UAL may increase to \$20 billion, or by \$6.6 billion, and that the funded status of the system will decrease to 80%. The 2022 actuarial valuation will reflect the actual impact on the system.

Employer Reserve Accounts and Oregon Public Service Retirement Program

The preliminary earnings loss for the employer reserve account is \$852.7 million for a balance of \$42.1 billion and a return of -1.98%. The preliminary earnings loss for the employer Oregon Public Service Retirement Program Pension account is \$208.6 million for a balance of \$10.9 billion and a loss of 1.88%.

Employee Pension Stability Accounts

This is the first annual report to include information related to the redirection (starting July 1, 2020) of a portion of employee contributions from an employee's defined contribution plan, the Individual Account Program (IAP), to partially fund prospectively an employee's defined benefit or pension plan ("Employee Pension Stability Account"), if the PERS funded status is less than 90% funded and if an employee's earnings is more than \$3,333/month or approximately \$40,000 per year. Redirected funds will lower or offset the employer contribution resulting in employer savings. The redirect for each benefit plan, which began on July 1, 2020, are as follows: (a) Tier One: 2.5% of eligible salary and wages; (b) Tier Two: 2.5% of eligible salary and wages; and (c) Oregon Public Service Retirement Plan (OPSRP): 0.75% of eligible salary and wages.

The preliminary earnings loss of the Tier 1/Tier2 Employee Pension Stability Account is \$4.8 million for a balance of \$214.2 million and a loss of 2.19%. The preliminary earnings loss for the Oregon Public Service Retirement Program Employee Pension Stability Account is \$3.1 million for a balance of \$170.1 million and a loss of 1.79%. When combined, the two EPSA accounts have a balance of \$384.3 million for Calendar Year 2022, which suggest that the accounts have been able to meet their projected SB 1049 (2019) targeted savings.

Side Accounts

Employers have the option to make voluntary lump-sum payments to PERS that are in addition to the employer's required contribution. With few exceptions (i.e., payment of transition liability), lump-sum payments are deposited into "side accounts," and are used to offset a portion of the contributing employer's future PERS contribution rate, according to an amortization schedule.

The preliminary earnings loss of various lump-sum employer contributions, or "side accounts," is \$115.3 million for a balance of \$6.2 billion and a loss of 1.83%. Extended investment losses to employer side accounts funded with POB's would jeopardize the underlying financial viability of the issuance, as such

issuances are premised, over the long-term, on investment earnings exceeding borrowing costs (i.e., investment speculation).

Retiree Benefits

Upon an individual's retirement, funds are transferred into a Benefits-in-Force Reserve account, which is used to fund retiree benefit payments. The preliminary earnings loss for this account is \$353.2 million for a balance of \$18.4 billion and a loss of 1.88%.

Member Accounts

The preliminary earnings crediting for Tier One member regular accounts is \$157.5 million for a balance of \$2.4 billion. Earnings crediting for this account, by statute, was at the 2022 assumed earnings rate of 6.9%. Since the Tier One member regular account lost an estimated \$376 million, and such accounts are required to be credited at the assumed earnings rate, a transfer from the Tier One Guarantee Reverse of \$218.5 million was required to meet the assumed earnings rate threshold.

The preliminary earnings loss for Tier Two regular member accounts was \$20 million for a balance of \$1 billion and a loss of 1.88%. Member variable accounts, which are invested in equities for which a member may choose to participate, lost \$73.7 million or 24.43% leaving a remaining value of \$257.1 million. Given this loss, administrative expenses would have been paid by the OPERF or "regular" account; however, since that account also has reported losses, expenses will be paid from employer contributions, which will increase 2025-27 employer contribution rates.

Earnings from the Variable Account were insufficient to pay for the associated administrative expense. Therefore, those expenses will come from OPERF earnings (OAR 459-007-0005). Such costs are not recouped in future years when Variable Account earnings exceed expenses.

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. Since Tier One regular account earnings were below the assumed earnings rate of 6.9%, \$218.5 million was transferred from the Tier One Rate Guarantee Reserve thereby reducing the balance to \$742.2 million.

Individual Account Program

The preliminary loss for the Individual Account Program (IAP) was \$551.6 million for a balance of \$12.4 billion and an average loss of 4.25%. On September 20, 2017, an administrative decision by the Oregon Investment Council moved the IAP to a target-date, or age-based, fund solution beginning January 2, 2018. At the time, IAP members were given no choice in investment option selection; however, beginning on January 1, 2021, IAP members have had an investment choice [per HB 4159 (2018) and SB 1049 (2019)]. Under the target-date funds model, IAP accounts are no longer invested exclusively in the OPERF, but are partially invested in a series of funds structured to match the age of the IAP participant; however, beginning in 2020, retired member's funds that are in distribution status will be invested in the Oregon Short-Term Fund. This change in the IAP investment strategy was undertaken to de-risk members' accounts. IAP and OPERF earnings are expected to deviate from one another with IAP earnings possibly lagging OPERF earnings over time.

Health Insurance Accounts

Health Insurance Accounts are imbedded within the OPERF and are credited with actual earnings or losses after payment of administrative expenses. The preliminary losses for these accounts was \$17.2 million for a balance of \$896.1 million, with one account having earnings of 0.13% (State Retiree Health

Insurance Fund invested in the Treasury Short-Term Fund (SRHIA)) and two accounts experiencing losses (Retiree Health Insurance Premium Account (RHIPA): 1.15%; and Retirement Health Insurance Account (RHIA): 2.22%).

Contingency Reserve

When earnings on OPERF equal or exceed the assumed earnings rate, the PERS Board may credit up to 6.9% of earnings to the Contingency Reserve. Statutorily, contingency reserves are limited to pay for: (a) a deficit in the payment of retirement benefits; (b) employer insolvency; and (c) legal expenses. The overfunding of the Contingency Reserve had been an issue for the Legislature beginning with the 2012 earnings crediting report. 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. In 2017, the Legislature enacted SB 1067 which statutorily limited the maximum balance of the Contingency Reserve to \$50 million. The reported balance of the Contingency Reserve is \$50 million with no reported changes from the prior calendar year 2021 earnings crediting.

Investment Expenses

The Oregon Investment Council (OIC) is a policymaking body that sets investment policy, asset allocation targets, benchmark return targets, and makes portfolio decisions on investment purchases and sales. The OIC receives advice from outside investment and management consultants, but relies primarily upon the statutory Chief Investment Officer (i.e., State Treasurer) and the State Treasury Investment Program for staffing, including for investment analysis and recommendations. OIC is responsible for reviewing investment expenses as part of the investment selection process.

Investment expenses are incurred for: (a) investment manager fees; (b) commissions and other fees; (c) investment consultants; and (d) State Treasury expenses. The preliminary earnings crediting for calendar year 2021 are the net of expenses and, as such, are not subject to legislative budgetary control (i.e., expenditure limitation). These expenses totaled \$1.1 billion for calendar year 2022, based on the PERS report. The most current fiscal year investment expense data from the PERS Comprehensive Annual Financial Report for fiscal year 2022 and shows that investment expenses increased by \$442.7 million between Fiscal Year 2021 (\$999.7 million) and 2022 (\$1.4 billion) and that assets under management declined by \$1.4 billion during this period with total assets under management for 2022 being \$95.9 billion (see Addendum-B).

Retirement System Administrative Expenses

Administrative expenses total \$95.6 million for PERS agency operational expenses and include \$2.6 million for private vendor costs to administer the IAP and \$25.8 million of OST Fees. Expenses are funded with earnings when they are sufficient (i.e., positive)(ORS 238.601(1)). When earnings are negative, such as they were in Calendar Year 2022, administrative expenses are to be paid from employer contributions. Agency expenses increased significantly due to the estimated \$20 million in additional administrative expenses the agency projects will be spent on the implementation of SB 1049 (2019). The project expended \$29 million during the 2019-21 biennium and is estimating to expend another \$23.2 million for the 2021-23 biennium. PERS is expecting to expend an additional \$20 million on the project of the 2023-25 biennium.

Future Employer Contribution Rates

Adopted employer contribution rates have been published by the PERS Board for the 2023-25 biennium and are based on 2021 actual earnings crediting. For the 2025-27 biennium, advisory employer contribution rates will be based on 2022 actual earnings crediting and final adopted rates will be based on 2023 actual earnings. In short, holding all other PERS Board and actuarial variables constant, 2025-27

employer contribution rates may increase due the loss of investment income and the need to fund administrative expenses from employer contributions. This will be mitigated, in part, by the new rate collaring policy, whereby the 2023-25 rates were not decreased as much as if they had been uncollared.

Observational Analysis

There are several observations worth noting about the report and that raise concern.

1. Employee IAP contributions are predominately invested in target date or age-based funds, whose investments should be more conservatively invested as an employee approaches retirement. The age-based fund closest to retirement is the 2025 Fund. This fund has reported losses of 6.39% and that exceeds all other target date funds.
2. The losses reported for employee's IAPs differ materially from those reported for PERS employer accounts. For example, IAP losses averaged 4.25%, which is over double the 1.93% loss on all other non-IAP accounts. This is contrary to premise that the OPERF is invested more aggressively than employee IAP accounts.
3. The IAP Regular Account Fund, by which employee's participate by choice rather than a target fund, is predominately invested in the OPERF, and has a reported loss of 8.15%, however, OPERF itself reported a loss of only 2.24% for a difference of 5.92%. Why returns are not perfectly correlated for this account is difficult to understand.

Other observations include that fact that investment expenses, the primary driver for 2022 losses, increased from \$999.7 billion in 2021 to \$1.4 billion (or by 44.3%) in 2022. As a percentage of assets under management, investment expenses rose from 1.03% in 2021 to 1.5% in 2022 or to the highest level since 2002.

Legislative Fiscal Office Recommendation: The Legislative Fiscal Office recommends acknowledging receipt of the report.

Addendum-A

The following addendum summarizes reported calendar year PERS account earnings history from 1997 to 2022.

PERS Investment Earnings History (1997-2022)							
Years	Calendar Year	OPERF	Assumed Rate	Tier 1	Tier 2	Variable	IAP
1	1997	20.42%	8.00%	18.70%	20.42%	28.87%	--
2	1998	15.43%	8.00%	14.10%	13.63%	21.45%	--
3	1999	24.89%	8.00%	11.33%	21.97%	28.83%	--
4	2000	0.63%	8.00%	8.00%	0.54%	-3.24%	--
5	2001	-7.17%	8.00%	8.00%	-6.66%	-11.19%	--
6	2002	-8.93%	8.00%	8.00%	-8.93%	-21.51%	--
7	2003	23.79%	8.00%	8.00%	22.00%	34.68%	--
8	2004	13.80%	8.00%	8.00%	13.27%	13.00%	12.77%
9	2005	13.04%	8.00%	8.00%	18.31%	8.29%	12.80%
10	2006	15.57%	8.00%	8.00%	15.45%	15.61%	14.98%
11	2007	10.22%	8.00%	7.97%	9.47%	1.75%	9.46%
12	2008	-27.18%	8.00%	8.00%	-27.18%	-43.71%	-26.75%
13	2009	19.19%	8.00%	8.00%	19.12%	35.57%	18.47%
14	2010	12.44%	8.00%	8.00%	12.44%	15.17%	12.13%
15	2011	2.21%	8.00%	8.00%	2.21%	-7.80%	2.15%
16	2012	14.29%	8.00%	8.00%	14.68%	18.43%	14.09%
17	2013	15.76%	8.00%	8.00%	15.62%	25.74%	15.59%
18	2014	7.29%	7.75%	7.75%	7.24%	4.29%	7.05%
19	2015	2.21%	7.75%	7.75%	1.87%	-1.61%	1.85%
20	2016	7.10%	7.50%	7.50%	7.12%	8.77%	7.14%
21	2017	15.15%	7.50%	7.50%	15.12%	26.45%	14.45%
22	2018	0.11%	7.20%	7.20%	0.20%	-10.03%	-0.72%
23	2019	13.33%	7.20%	7.20%	13.29%	29.04%	13.20%
24	2020	7.66%	7.20%	7.20%	7.22%	11.71%	8.43%
25	2021	20.05%	6.90%	6.90%	20.22%	18.84%	16.26%
26	2022	-2.24%	6.90%	6.90%	-1.88%	-24.43%	-4.25%
25-year	Average	8.35%	7.76%	8.13%	8.25%	7.76%	--
20-year	Average	9.19%	7.70%	7.69%	9.29%	8.99%	--
15-year	Average	7.16%	7.59%	7.59%	7.15%	7.10%	6.61%
10-year	Average	8.64%	7.39%	7.39%	8.60%	8.88%	7.90%
5-year	Average	7.78%	7.08%	7.08%	7.81%	5.03%	6.58%
3-year	Average	8.49%	7.00%	7.00%	8.52%	2.04%	6.81%

Addendum-B

The following addendum summarizes reported fiscal year Investment Expenses from 2017 to 2022.

Public Employees Retirement System - Investment Expenses							
Source: PERS CAFR							
Fiscal Year	2022	2021	2020	2019	2018	2017	
Assets Under Management							
Debt Securities Managers	\$ 19,201,300,293	\$ 16,577,911,142	\$ 15,213,720,452	\$ 16,277,259,333	\$ 14,968,539,870	\$ 14,768,509,332	
Public Equity Managers	\$ 23,715,061,151	\$ 33,064,101,068	\$ 26,478,003,098	\$ 29,403,270,522	\$ 30,225,870,153	\$ 27,063,910,456	
Real Estate Managers	\$ 13,484,899,469	\$ 10,151,288,539	\$ 8,731,171,187	\$ 8,966,132,571	\$ 8,718,684,190	\$ 8,585,785,027	
Private Equity Managers	\$ 24,588,062,306	\$ 25,725,638,086	\$ 18,480,372,903	\$ 17,259,957,679	\$ 15,017,344,594	\$ 13,954,350,332	
Real Assets Managers	\$ 7,493,706,329						
Alternative Equity/Diversifying Strategies Managers	\$ 5,192,616,827	\$ 9,647,953,735	\$ 8,209,320,304	\$ 7,218,603,962	\$ 4,138,735,188	\$ 2,948,607,060	
Opportunity Portfolio Managers	\$ 2,248,492,239	\$ 2,125,974,636	\$ 1,652,118,971	\$ 1,717,803,743	\$ 1,587,753,762	\$ 1,364,144,854	
Total Assets Under Management	\$ 95,924,138,614	\$ 97,292,867,206	\$ 78,764,706,915	\$ 80,843,027,810	\$ 74,656,927,757	\$ 68,685,307,061	
Dollar Change	\$ (1,368,728,592)	\$ 18,528,160,291	\$ (2,078,320,895)	\$ 6,186,100,053	\$ 5,971,620,696	\$ (2,586,015,042)	
Percentage Change	-1.4%	23.5%	-2.6%	8.3%	8.7%	-3.6%	
Investment Managers' Fees							
Debt Securities Managers	\$ 17,714,283	\$ 17,557,644	\$ 20,468,792	\$ 19,441,705	\$ 22,230,766	\$ 30,560,952	
Public Equity Managers	\$ 71,004,252	\$ 72,963,272	\$ 60,429,729	\$ 68,037,878	\$ 72,775,356	\$ 72,478,320	
Real Estate Managers	\$ 90,653,217	\$ 74,324,131	\$ 66,969,188	\$ 65,533,767	\$ 71,653,741	\$ 72,287,039	
Private Equity Managers	\$ 274,264,054	\$ 240,298,187	\$ 240,246,208	\$ 221,756,053	\$ 231,579,067	\$ 198,093,147	
Real Assets Managers	\$ 94,747,844						
Alternative Equity Managers	\$ 25,096,343	\$ 109,486,893	\$ 88,132,992	\$ 78,341,548	\$ 68,760,668	\$ 40,596,887	
Opportunity Portfolio Managers	\$ 25,182,947	\$ 15,802,353	\$ 13,997,511	\$ 14,993,277	\$ 16,995,422	\$ 15,141,478	
	\$ 598,662,940	\$ 530,432,480	\$ 490,244,420	\$ 468,104,228	\$ 483,995,020	\$ 429,157,823	
Other Investment Service Fees							
Securities Lending				\$ -	\$ -	\$ -	
Commissions							
Investment Consultants	\$ 11,858,566	\$ 8,824,986	\$ 8,318,966	\$ 10,496,023	\$ 7,489,482	\$ 5,155,437	
State Treasury							
Oregon Investment Council							
Oregon Savings Growth Plan							
Commissions and Other Fees	\$ 831,889,374	\$ 460,423,737	\$ 347,530,492	\$ 433,208,401	\$ 212,727,035	\$ 119,410,367	
Total Other Investment Fees	\$ 843,747,940	\$ 469,248,723	\$ 355,849,458	\$ 443,704,424	\$ 220,216,517	\$ 124,565,804	
Total Investment Fees	\$ 1,442,410,880	\$ 999,681,203	\$ 846,093,878	\$ 911,808,652	\$ 704,211,537	\$ 553,723,627	
Dollar Change	\$ 442,729,677	\$ 153,587,325	\$ (65,714,774)	\$ 207,597,115	\$ 150,487,910	\$ 6,200,360	
Percentage Change	44.3%	18.2%	-7.2%	29.5%	27.2%	1.1%	
PERS Administrative Costs							
Grand Total All Costs	\$ 1,442,410,880	\$ 999,681,203	\$ 846,093,878	\$ 911,808,652	\$ 704,211,537	\$ 553,723,627	
Percentage of AUM	1.50%	1.03%	1.07%	1.13%	0.94%	0.81%	

Public Employees Retirement System

Lisper

Request: Report on the preliminary crediting of 2022 earnings received through investments of the Oregon Public Employees Retirement Fund regular account.

Recommendation: Acknowledge receipt of the report.

Discussion: Under ORS 238.670(5), the Public Employees Retirement System (PERS) is required to submit a preliminary proposal to the Legislature at least 30-days before making a final decision on the final allocation of earnings. The preliminary report estimates losses to be \$2.2 billion in the Oregon Public Employees Retirement Fund (OPERF) regular account. The PERS Board will meet on April 3, 2023 to decide whether to adopt the following preliminary findings:

Non-Discretionary Allocations:

- *Tier One Member Regular Accounts Reserve and Judge Member Accounts* - will be credited the assumed earning rate of 6.90 percent in effect for 2022. Due to negative earnings reported, the reserve will absorb and cover the mandatory crediting of the assumed earning rate, which is a reduction of \$218.5 million, leaving a \$742.2 million balance.
- *Tier Two member Regular Accounts* - will allocate a proportional share of the losses, which results in a preliminary rate of negative 1.89 percent.
- *Benefit-in-force* - will allocate a proportional share of losses, which results in a preliminary rate of negative 1.89 percent.
- *Employer Reserves* - will allocate a proportional share of losses, which results in a preliminary rate of negative 1.98 percent.
- *Oregon Public Service Retirement Plan (OPSRP)* - will allocate a proportional share of losses, which results in a preliminary rate of negative 1.88 percent.

Earnings allocations directed by statute or rule:

- *Individual Account Program (IAP)* - earnings for 2022 are a negative 4.25 percent after deducting IAP expenses. Losses are reported as \$555.4 million, leaving a \$11,999.7 million balance.

In accordance with Senate Bill 1049 (2019), effective July 1, 2020, for all currently employed Tier One/Tier Two and OPSRP members earning \$3,333/month or more (\$3,570 in 2022), a portion of their six percent monthly IAP contributions will be redirected to an Employee Pension Stability Account (EPSA). This account will be used to pay for part of the member's future pension benefit.

Tier One/Tier Two member EPSA accounts will be credited with the same rate as Tier Two Regular Member accounts, which is a negative 1.89 percent. OPSRP member EPSA accounts will be credited with the same rate as OPSRP Pension Member Accounts, which is a negative 1.88 percent.

- *Employer lump sum payment accounts* - these accounts are credited with actual earnings or losses, less administrative expenses. For 2022, the crediting rate for the side accounts established before January 1, 2022 is negative 1.79 percent. For new lump sum payment accounts, the crediting rate will vary depending on the time of the payments.

- *Health Insurance accounts* - for 2022, the rate for these accounts is negative 2.22 percent for Retirement Health Insurance Account (RHIA), negative 1.15 percent for Retiree Health Insurance Premium (RHIP) account, and 0.13 percent for Standard Retiree Health Insurance Account (SRHIA) (invested in the Treasury Short-Term Fund).
- *Variable Annuity account* - this account is credited with earnings and losses on its distinct asset allocation of the PERS Fund. There are insufficient Variable Annuity Account 2022 earnings to pay for administrative expenses, those expenses will be charged to the Regular Account 2022 earnings. For 2022, the Regular Account earnings are negative, and will be paid from Employer Contributions, its earnings are estimated to be a negative 24.43 percent.
- *Administrative expenses* - are funded by employer contributions when earnings are not sufficient, as they were in 2022 (ORS 238.610(1)).



February 3, 2023

TO: Members of the PERS Board
FROM: Richard Horsford, Chief Financial Officer
Matt Graves, Financial Reporting Manager
SUBJECT: 2022 Preliminary Earnings Crediting and Reserving

OVERVIEW

- Action: Allocate 2022 preliminary earnings crediting.
- Reason: ORS 238.670(5) requires PERS to submit a preliminary proposal to the appropriate legislative committee at least 30 days before making a final decision on earnings crediting.
- Subject: Crediting earnings for calendar year 2022 to the PERS Fund's accounts and reserves.

The PERS Board is charged with crediting the earnings from the PERS Fund each calendar year. Some of those allocations are directed by statute or rule; allocation of the balance, if any, is at the PERS Board's discretion.

2022 PRELIMINARY ALLOCATIONS

The PERS Board's Annual Earnings Crediting rule (see OAR 459-007-0005) directs the crediting to the Judge and Tier Two member regular accounts, as well as the OPSRP Pension Program, Benefits-in-Force, and Employer Reserves. Staff recommends the following allocations be adopted preliminarily by the PERS Board:

NON-DISCRETIONARY ALLOCATIONS

1. Tier One Member Regular Accounts Reserve and Judge Member Accounts

Credit Tier One Member Regular Accounts and Judge Member Accounts with the assumed earnings rate of 6.90% in effect during 2022.

Tier One Rate Guarantee Reserve: This reserve, established under ORS 238.255(1), is used to fund crediting of the assumed rate to Tier One member regular accounts when earnings are less than the assumed rate. Because earnings on Tier One member regular accounts for 2022 are negative, this reserve will absorb the losses attributed to Tier One Member Regular Accounts and Judge Member Accounts, plus cover the mandatory crediting of the assumed earnings rate, resulting in a reduction of \$218.5 million and a remaining balance of \$742.2 million.

2. Tier Two Member Regular Accounts

Allocate a proportional share of the remaining 2022 losses to Tier Two Member Regular Accounts except that the portion of the losses representing administrative expenses be paid solely from the Employer Reserves, which will result in a preliminary rate of -1.89%.

3. Benefits-in-Force

Allocate a proportional share of the remaining 2022 losses to Benefits-in-Force except that the portion of the losses representing administrative expenses be paid solely from the Employer Reserves, which will result in a preliminary rate of -1.89%.

4. Employer Reserves

Allocate a proportional share of the remaining 2022 losses to Employer Reserves, which will result in a preliminary rate of -1.98%. In years in which there are insufficient earnings on the PERS Variable and Regular Account to pay for administrative expenses, such as 2022, ORS 238.610(1) requires administrative expenses to be funded through employer contributions.

5. OPSRP Pension Plan Member Accounts

OPSRP member accounts usually are credited with a proportional share of available PERS Fund Regular Account earnings or losses, which will result in a preliminary rate of -1.88%.

EARNINGS ALLOCATIONS DIRECTED BY STATUTE OR RULE

The following reserves and accounts are allocated earnings by applicable statute or rule. In compliance with these restrictions, the preliminary earnings allocation reflects the following:

6. Individual Account Program (IAP)

These member accounts are credited with actual earnings or losses of the PERS Fund Regular Account as required by ORS 238A.350 (1). The overall preliminary IAP earnings for 2022 are -4.25% after deducting IAP expenses. The table below illustrates the IAP earnings by tranche.

Oregon Public Employees Retirement System Preliminary IAP TDF Earnings				
(All dollar amounts in thousands)				
TDF Fund	Reserves Before Crediting	2022 Crediting	Reserves After Crediting	2022 Rates
RAF Fund	\$ 656,557.3	\$ (53,550.2)	\$ 603,007.1	-8.15%
2025 Fund	1,474,935.9	(94,387.5)	1,380,548.4	-6.39%
2030 Fund	2,152,923.6	(116,480.9)	2,036,442.7	-5.41%
2035 Fund	2,608,514.6	(95,581.6)	2,512,933.0	-3.66%
2040 Fund	2,309,185.5	(49,659.0)	2,259,526.5	-2.15%
2045 Fund	1,781,245.2	(70,607.8)	1,710,637.4	-3.96%
2050 Fund	984,322.7	(49,619.0)	934,703.7	-5.04%
2055 Fund	426,178.6	(19,113.2)	407,065.4	-4.48%
2060 Fund	129,916.4	(4,640.8)	125,275.6	-3.57%
2065 Fund	31,305.1	(1,716.6)	29,588.5	-5.48%
Total	\$12,555,084.9	(\$555,356.6)	\$11,999,728.3	

In accordance with Senate Bill 1049 (2019), effective July 1, 2020, for all currently employed Tier One/Tier Two and OPSRP members earning \$3,333/month or more (\$3,570 in 2022), a portion of their 6%t monthly IAP contributions will be redirected to an “Employee Pension Stability Account.” The Employee Pension Stability Account (EPSA) will be used to pay for part of the member’s future pension benefit.

For earnings crediting purposes, Tier One/Tier Two member EPSA accounts will be credited with the same rate as Tier Two Regular Member accounts, which will result in a preliminary rate of -1.89%.

For earnings crediting purposes, OPSRP member EPSA accounts will be credited with the same rate as OPSRP Pension Member Accounts, which will result in a preliminary rate of -1.88%.

7. Employer Lump Sum Payment Accounts

These accounts are credited with actual earnings or losses of the PERS Fund Regular Account less administrative expenses, as authorized by ORS 238.225. For 2022, the preliminary crediting rate for the side accounts established before 1/1/2022 is -1.79%. The preliminary crediting rate for new lump sum payment accounts varies depending on the time of payments.

8. Health Insurance Accounts

These accounts are created as part of the PERS Fund and directed by statute to be credited with actual earnings or losses, less the expense related to the administration of the programs (ORS 238.410(7); 238.415(4); 238.420(4)). For 2022, the preliminary crediting rate for these accounts are -2.22% for RHIA, -1.15% for RHIPA, and 0.13% for SRHIA (invested in the Treasury Short-Term Fund).

Oregon Public Employees Retirement System Health Insurance Accounts Preliminary Rates	
Health Insurance Fund	2022
RHIA	-2.22%
RHIPA	-1.15%
SRHIA *	0.13%

* Invested in the Treasury Short-Term Fund

9. Variable Annuity Account

This account is credited with earnings and losses on its distinct asset allocation of the PERS Fund. The Variable Annuity Account is only invested in equities and therefore its earnings are discrete from those of the more diversified PERS Fund Regular Account. As there are insufficient Variable Annuity Account 2022 earnings to pay for administrative expenses, per OAR 459-007-0005, those expenses will be charged to the Regular Account 2022 earnings. For 2022, the Regular Account earnings are negative, and therefore those expenses will be paid from Employer Contributions. For 2022, preliminary Variable Annuity Account earnings are estimated to be -24.43%.

Administrative Expenses

PERS administrative costs are funded by employer contributions when earnings are not sufficient, as they were in 2022 (ORS 238.610(1)).

The following charts present preliminary earnings crediting and reserving for 2022:

Oregon Public Employees Retirement System Calendar Year 2022 Preliminary 2022 Crediting and Reserving No Contingency Reserve Funding (All dollar amounts in millions)								
	Reserves Before Crediting	Gross Investment Income (a)	Investment Expense (b)	Administrative Expenses (c)	Other Adjustments ⁴ (d)	Net 2022 Crediting (a+b+c+d)	Reserves After Crediting	2022 Rates
Tier One Member Regular Accounts	\$2,280.9	(\$18.8)	(\$38.1)	(\$3.1)	\$217.5	\$157.5	\$2,438.4	6.90%
Tier One Rate Guarantee Reserve	960.7	-	-	-	(218.5)	(218.5)	742.2	N/A
Tier Two Member Regular Accounts	1,063.9	(6.2)	(12.5)	(1.0)	(0.3)	(20.0)	1,043.9	-1.89%
Benefits In Force Reserve	18,738.0	(109.0)	(220.4)	(18.1)	(5.7)	(353.2)	18,384.8	-1.89%
Employer Reserves	42,983.9	(250.0)	(505.7)	(41.5)	(55.5)	(852.7)	42,131.2	-1.98%
Tier One/Two Employee Pension Stability Account ¹	219.0	(0.8)	(2.2)	-	(1.8)	(4.8)	214.2	-1.89%
OPSRP Pension	11,098.4	(60.7)	(121.7)	(15.5)	(10.7)	(208.6)	10,889.8	-1.88%
OPSRP Employee Pension Stability Account ²	173.2	(0.6)	(1.6)	-	(0.9)	(3.1)	170.1	-1.88%
IAP Accounts, as a whole ³	12,983.8	(457.0)	(112.8)	(16.2)	34.4	(551.6)	12,432.2	-4.25%
UAL Lump-Sum Pmt. Side Accounts ³	6,314.7	(38.1)	(77.0)	(0.2)	-	(115.3)	6,199.4	Various ⁵
Contingency Reserve	50.0	-	-	-	-	-	50.0	N/A
Total	\$96,866.5	(\$941.2)	(\$1,092.0)	(\$95.6)	(\$41.5)	(\$2,170.3)	\$94,696.2	

¹ Per OAR 459-007-0005 (14)(a), Tier One/Two Employee Pension Stability Account will receive the Tier Two Member rate.

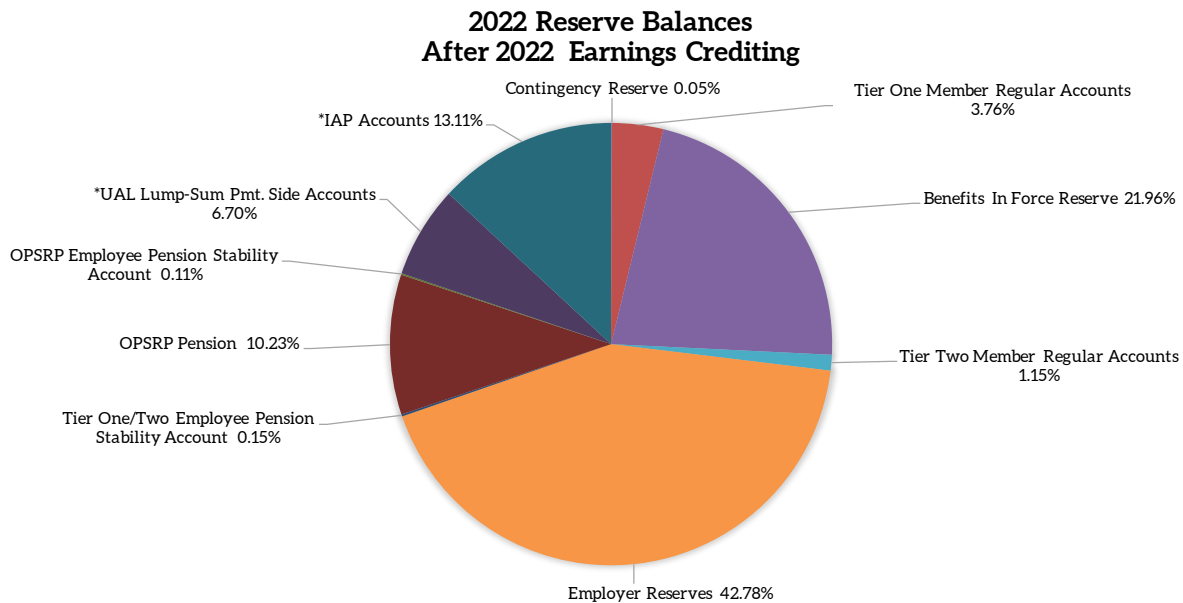
² Per OAR 459-007-0005 (14)(b), OPSRP Employee Pension Stability Account will receive the OPSRP Pension rate.

³ Informational only. Not affected by Board reserving or crediting decisions.

⁴ Primarily due to Tier One Rate Guarantee Reserve transfer to credit the assumed rate to the Tier One member regular account, defined benefit commingled earnings transfer, and the earnings credited to mid-year retirements. Also, includes CY2022 administrative expenses paid from employer contributions.

⁵ The preliminary earnings rate for the pre-2022 Side Accounts is -1.79%

Note: The actual market returns for private equity investments are reported on a three-month lag as additional time is needed to value these non-public assets and returns. Private equity returns for the fourth quarter will be reflected in the following year earnings crediting.



*Informational only. Not affected by Board reserving or crediting decisions. IAP accounts receiving installments have already received 2022 earnings.

BOARD OPTIONS

The PERS Board may:

1. Pass a motion to “adopt the preliminary crediting of earnings as presented for calendar year 2022, subject to final adoption at the April 3, 2023, PERS Board meeting.”
2. Pass a motion preliminarily allocating 2022 earnings in an alternative proportion, subject to final adoption at the April 3, 2023, PERS Board meeting.

STAFF RECOMMENDATION

Staff recommends the PERS Board choose Option #1.

NEXT STEPS

Preliminary Earnings Crediting: Once the board makes its preliminary allocation, staff will prepare and present the required report to the Joint Legislative Committee on Ways and Means. Any comments received from the committee will be presented to the PERS Board prior to the final crediting decision at its meeting on April 3, 2023.

This preliminary action and the resulting report to the Legislature do not prohibit the PERS Board from changing its final decision, such as if new information becomes available. If the board makes a significant change from its preliminary decision, staff will report the PERS Board’s actions to the Legislature.

C.4. Attachment 1: ORS 238.670 – *Reserve Accounts in Fund*

C.4. Attachment 2: OAR 459-007-0005 – *Annual Earnings Crediting Rule*

C.4. Attachment 3: ORS 238.610 – *Administrative Expenses of System, Rules*