PERS Reform 2019

- ✓New Facts and Figures
- ✓Impacts on Services
- ✓Views of Public Employees
- ✓Approaches to Reform
- ✓Potential Legislation

Tim Nesbitt for the Oregon Business Council

October 17, 2018

Sources

October 2018 Milliman Report to PERS Board

- ✓ 2019-21 employer rates and payroll data

September 2018 PERS by the Numbers

- ✓ Historic payroll data and payroll rates through 2017

September 2018 State Economic and Revenue Forecast

- ✓ Population data, actual and projected through 2026

August 2018 Milliman Report to PERS Board

- ✓ System-wide payroll rates (base and net) for 2019-21

November 2016 Milliman Report to PERS Board

- ✓ **Projected payroll rates (base and net) for 20-year horizon**

Various Legislative Revenue Office Reports

- ✓ State and local revenue data

PERS Unfunded Liability = $22.3 billion

$13,369

per

Oregon Household

$128,900

for every

Public Employee

Methodology: We use base rates

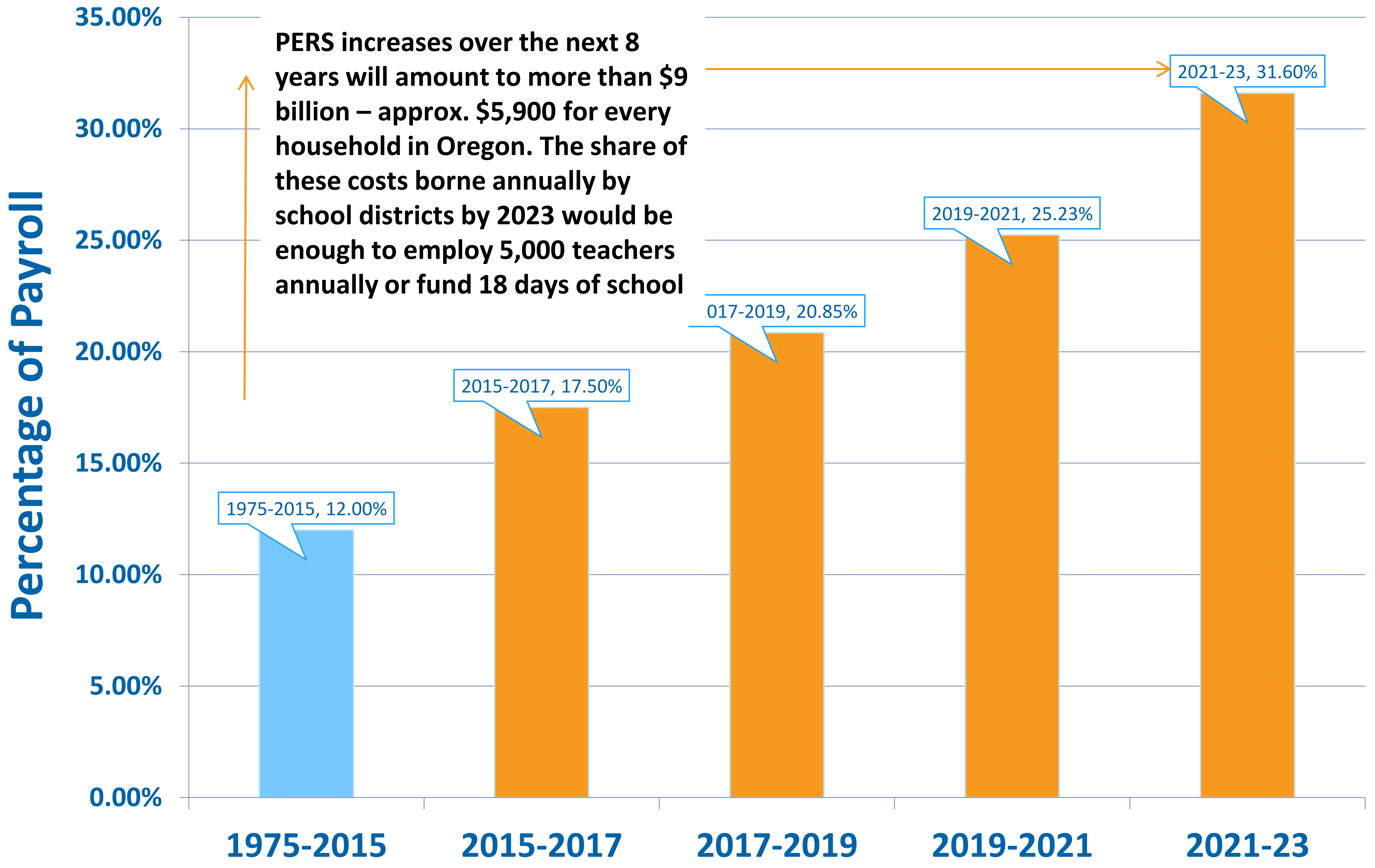
PERS "Base Rates" are nominal rates, before the offsets for side accounts and other adjustments

PERS "Net Rates" are effective rates, after the offsets for side accounts and other adjustments

Actual costs are a combination of **Net Rates** and **debt service for Pension Obligation Bonds** and average out to be one percent of payroll less than Base Rates

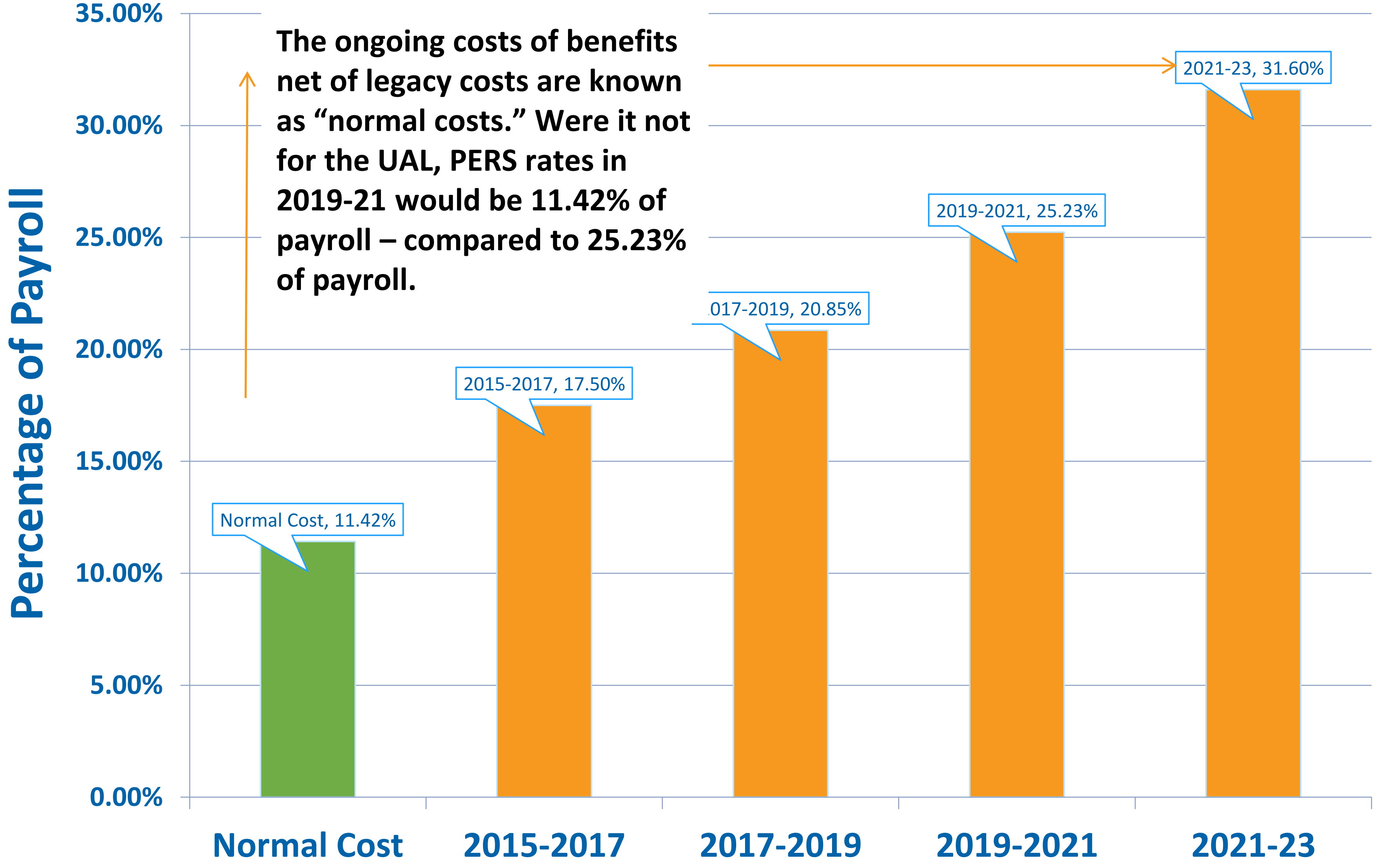
Past, Current & Projected PERS Employer Rates

(Base rates, excluding side accounts and IAP; rates beyond 2019-21 to be Updated in December 2018)



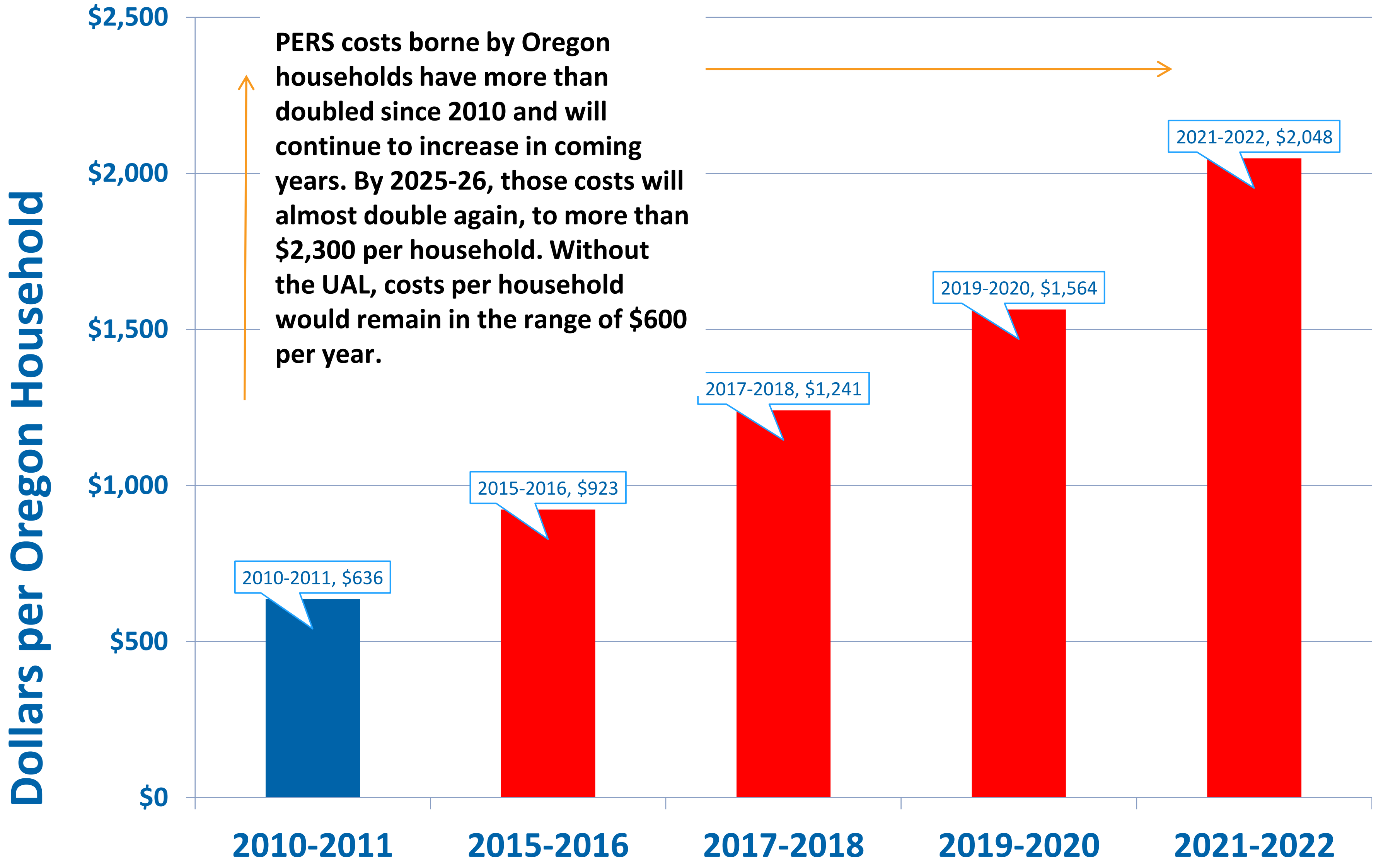
PERS Employer Rates Driven by UAL

(Base rates, excluding side accounts and IAP; rates beyond 2019-21 to be Updated in December 2018)



PERS Costs Borne by Oregon Households

(System-wide annual payroll costs divided by the number of Oregon households in each of the cited years)



PERS Costs: An Expensive 8 Years

Total projected **INCREASE** above 2016-17 over the following 8 years:

$9.9 Billion

(net of payroll growth)

K12 Schools	$3.2 Billion
State/Universities	$2.9 Billion
Cities/Counties/CCs/Other	$3.8 Billion

These are funds that will be diverted from budgets and services.

The Case for PERS Reform

✓

✓Impact on taxpayers

✓Claims on budgets and effects on services

✓Barrier to a better future

"In a strong economy, we should be getting ahead, not falling behind."

Impacts of PERS Costs: K12

- **Each 1% of payroll in K12** = $66 million in 2017-19, rising to **$71 million in 2019-21**

By 2023, the share of increased PERS costs borne by school districts will amounts to what it costs to pay for:

5,000 teachers

18 days of school

Touchstones for Reform

- **Fair:** Honor benefits earned to date…but correct the excesses that produced pensions far above what the system was designed to deliver. Rebalance so all public employees have adequate and affordable – but not exorbitant -- benefits.

- **Legal:** The Supreme Court has charted a constitutional path forward

What is Fair? Begin with Adequacy

The goal of the PERS system is to provide an adequate lifetime benefit after a career of public employment, which has been defined as:

50% of final average salary after 30 years + Social Security = 75 to 85%.

"In 1981…the PERS actuary advised legislators…that the Full Formula Benefit, when combined with Social Security Benefits, would provide 75 to 85 percent of preretirement income for career employees…The formula provides 50 percent of final average salary for career employees…"

--

Special Master's Written Report and Recommended Findings of Fact
Hon. Judge David Brewer, April 8, 2004

What is Fair? The 50% Goal

How PERS quantifies this 50%-of-salary goal for career employees:

- **The 50% of Final Average Salary excludes Social Security.**
- **Final Average Salary is defined as the average of the highest three years of pay during one's career**
- **A career is defined as 30 years**

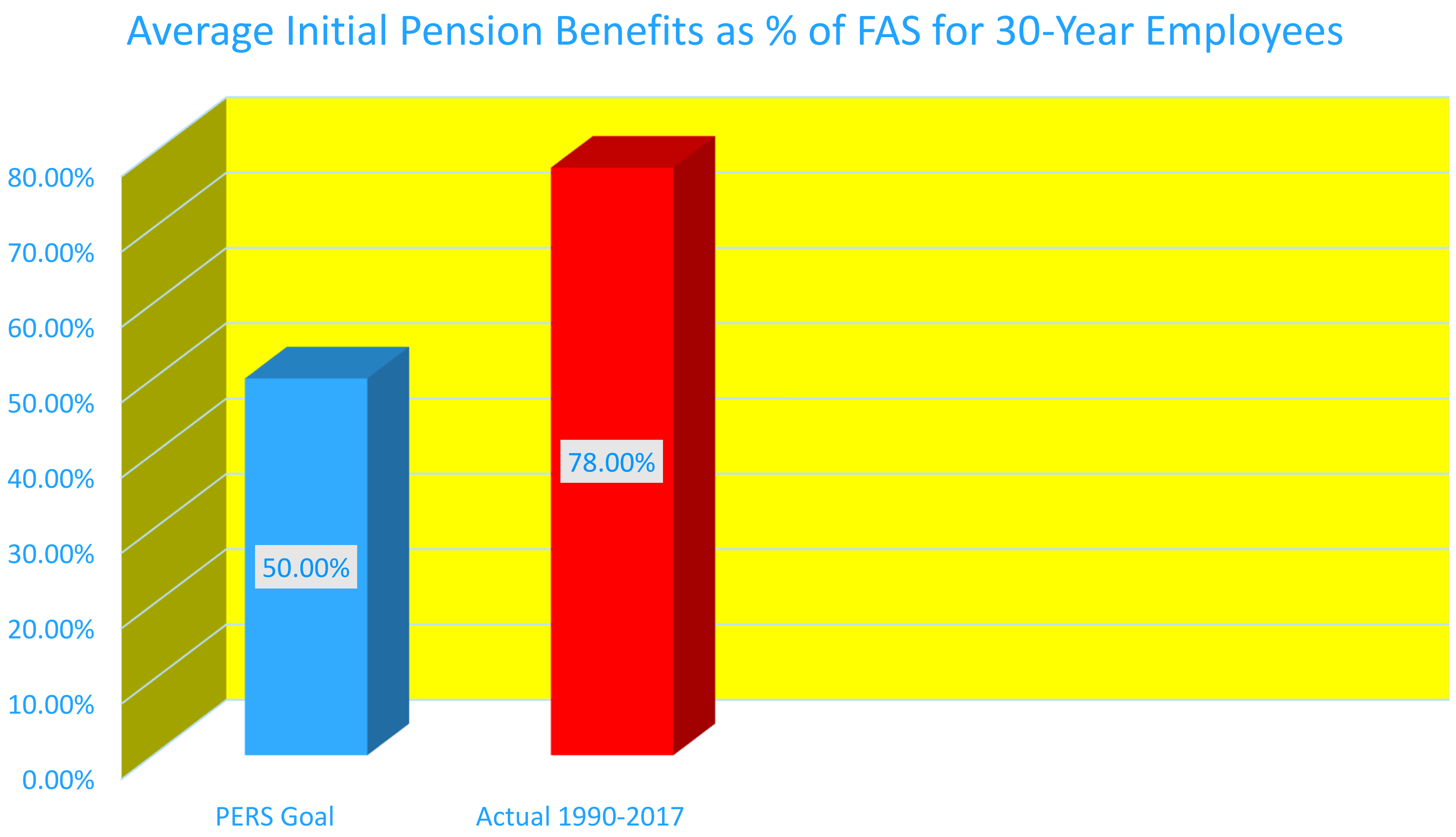
These are generous assumptions. Many employees work more than 30 years, and other public pension plans define final average salary as the highest five years.

Nonetheless………

FAIR: Correct the excesses of the system

- **PERS payouts have far exceeded the system's goals**
- **More than half of all retirees since 1997 have retired with initial pensions above PERS' own stated goal for adequate retirements (i.e. 50% of FAS @ 30 years)**

Pensions for Career Employees Averaged 78% of Final Average Salary since 1990



The Money Match problem

- ✓ **Money Match payouts (for Tier 1 and 2) are responsible for the lion's share of the PERS UAL, because of:**
  - ✓ **Initial pensions**
  - ✓ **Duplication of the COLA factor**

- ➢ **Money Match payouts continue to represent the majority of retirements among career employees (≥30 years of service)**

- ➢ **Tier 1 and 2 employees with access to Money Match constitute 34% of the current workforce, slightly higher among K-12 employees**

But Money Match isn't the only problem

- ✓The top seven PERS retirees, whose pension benefits average $600,000 per year, all retired under Full Formula, not Money Match
- ✓The Tier 1 salary base for the pension formula remains unlimited, while pensionable salaries for Tier 2 and OPSRP are capped at $275,000/year
- ✓The use of unused sick leave and vacation in Tier 1 and 2 inflate final average salaries
- ✓Even OPSRP benefits exceed the system's goal for career employees

Both Tier 1/2 & OPSRP Exceed the PERS Goal of 50% of FAS At 30 Years

<u>"Bare Bones" Tier 1 & 2</u> **(w/o Money Match, or Sick Leave/Vacation)**	**<u>OPSRP</u>**
Formula = 50% of FAS at 30 years	Formula = 45% of FAS at 30 years
IAP = 6% of FAS at 15 years	IAP = 13% of salary at 30 years
Combined = 56% of FAS	Combined = 58% of FAS

LEGAL: Moro decision clarifies what can be done

In Moro v. Oregon (2015), the Supreme Court changed its minds about what changes can be made to the system:

- Keep the promise for benefits earned to date, but:
- Changes may be made going forward:
  - <u>Benefits to be earned in the future are (with limited exceptions) modifiable</u>
  - <u>Employee contributions may be established</u> for pension benefits going forward (See also, *Strunk v. PERB*, 2005)
- Note: In Moro, the Court reversed its earlier OSPOA decision and rejected the “California rule.”

How far can the *Moro* decision take us?

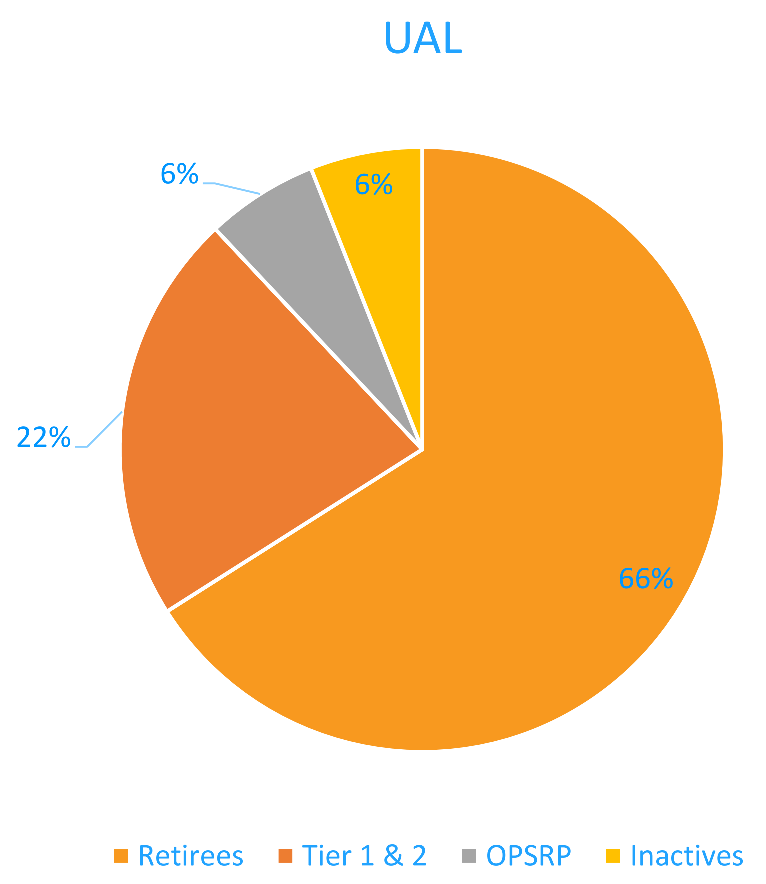
Legacy costs are baked in:

- Liabilities for those retired remain beyond the reach of reforms.
- Prior underfunding for current employees appear to remain beyond the reach of reforms.

But going forward costs can be reduced:

- But the ongoing costs of benefits accruing from now forward can be reduced with prospective benefit reductions or

What can we reasonably expect from adjustments affecting current employees?



One measure for fairness for cost reductions affecting current employees →

Underfunding for benefits accrued by active employees amounts to **$6.4 billion of the $22 billion UAL = 6 points of payroll**

Why public employees should care

If we do nothing…

- Not just adverse impacts on taxpayers and services, but…
- Adverse impacts on employees
  - Layoffs and reductions in staffing
  - Increased workloads
  - Constraints on funding to keep salaries aligned with the larger labor market

What do OPSRP employees think?

PERS Focus Groups

August 2018

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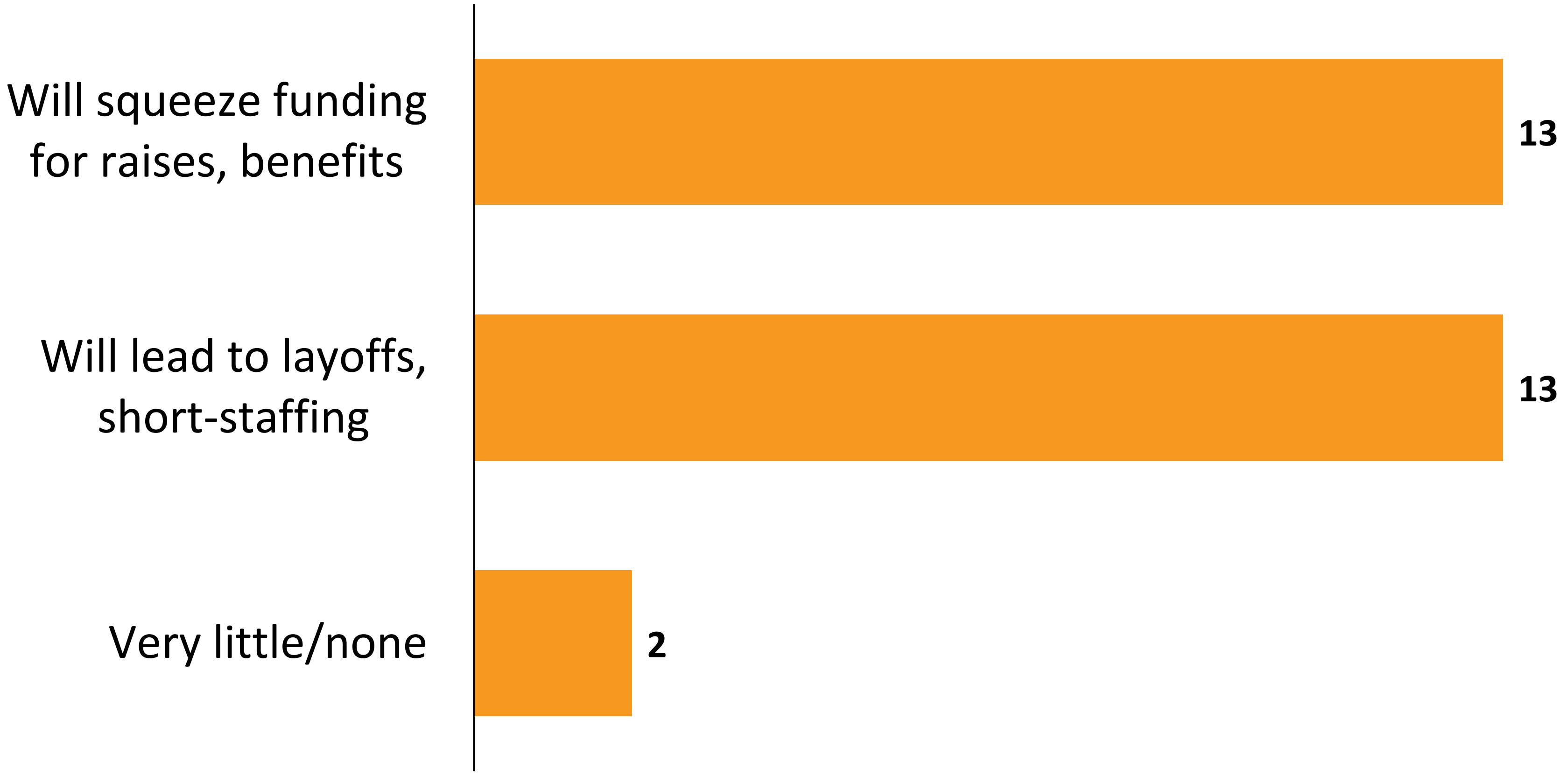
Methodology

- Two focus groups with Tier 3 PERS members
- Conducted August 21 and 25, 2018 in Portland and Salem
- Participants were either city employees (Portland group) or state employees (Salem group)

Impacts of PERS costs at work



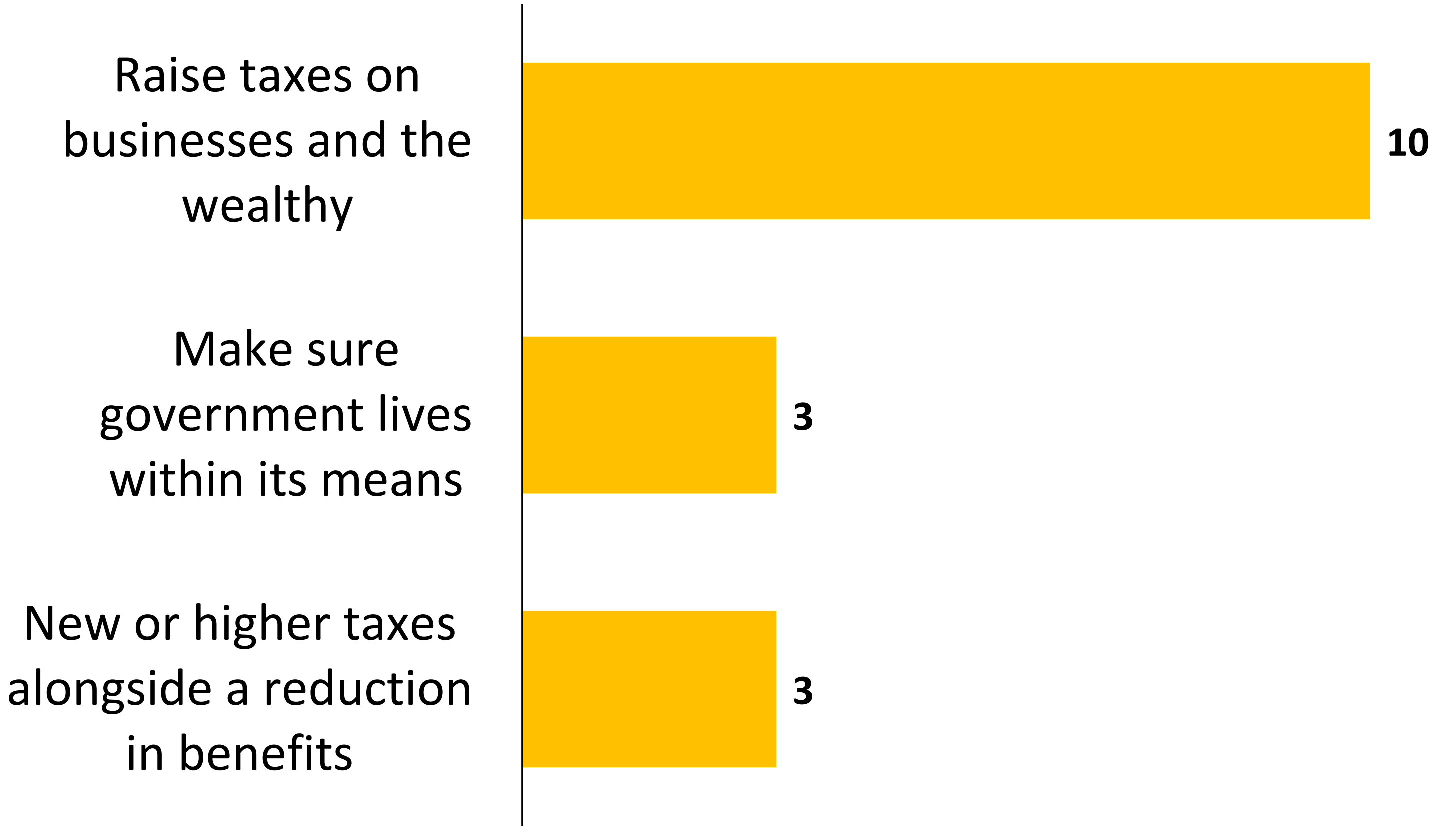
Impacts of PERS costs at home

In their own words:

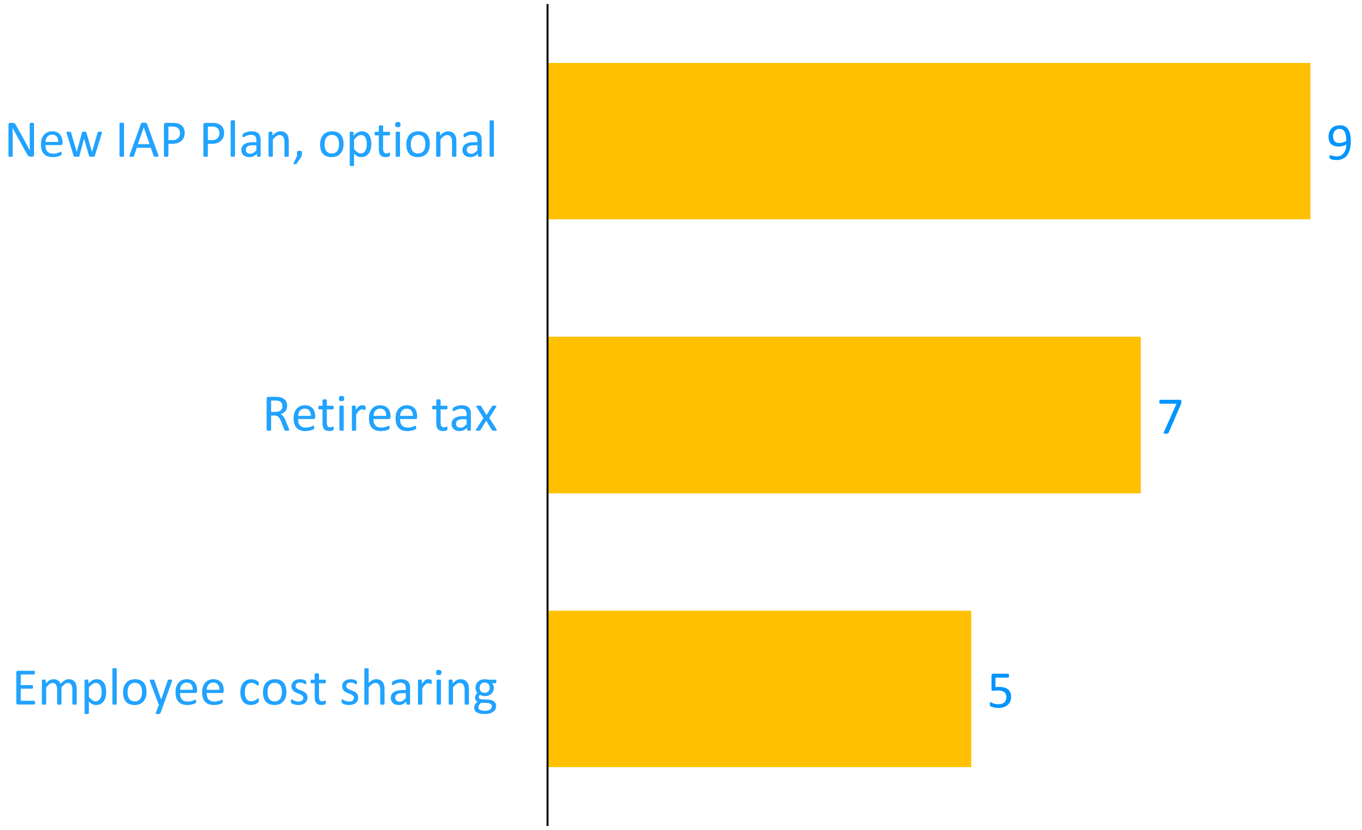
“I’m appalled at the cost to taxpayers and how the state and pension system allowed this to happen. This is devastating our communities.”

“The state seems screwed. Not sure where they’re going to find the extra money. We already pay insane income taxes.”

Initial "first choice" solutions



Most preferred reform options



Final thoughts

- Participants seem willing to accept reforms that require modest contributions from PERS employees
- Perceptions of fairness are critical—between different tiers and between the wealthy and the middle class
- Participants—and voters generally—will likely continue to point to unworkable solutions because they lack deep understanding of the Supreme Court and tax structure limitations

Principles for Reform

Four Principles for Comprehensive Reform

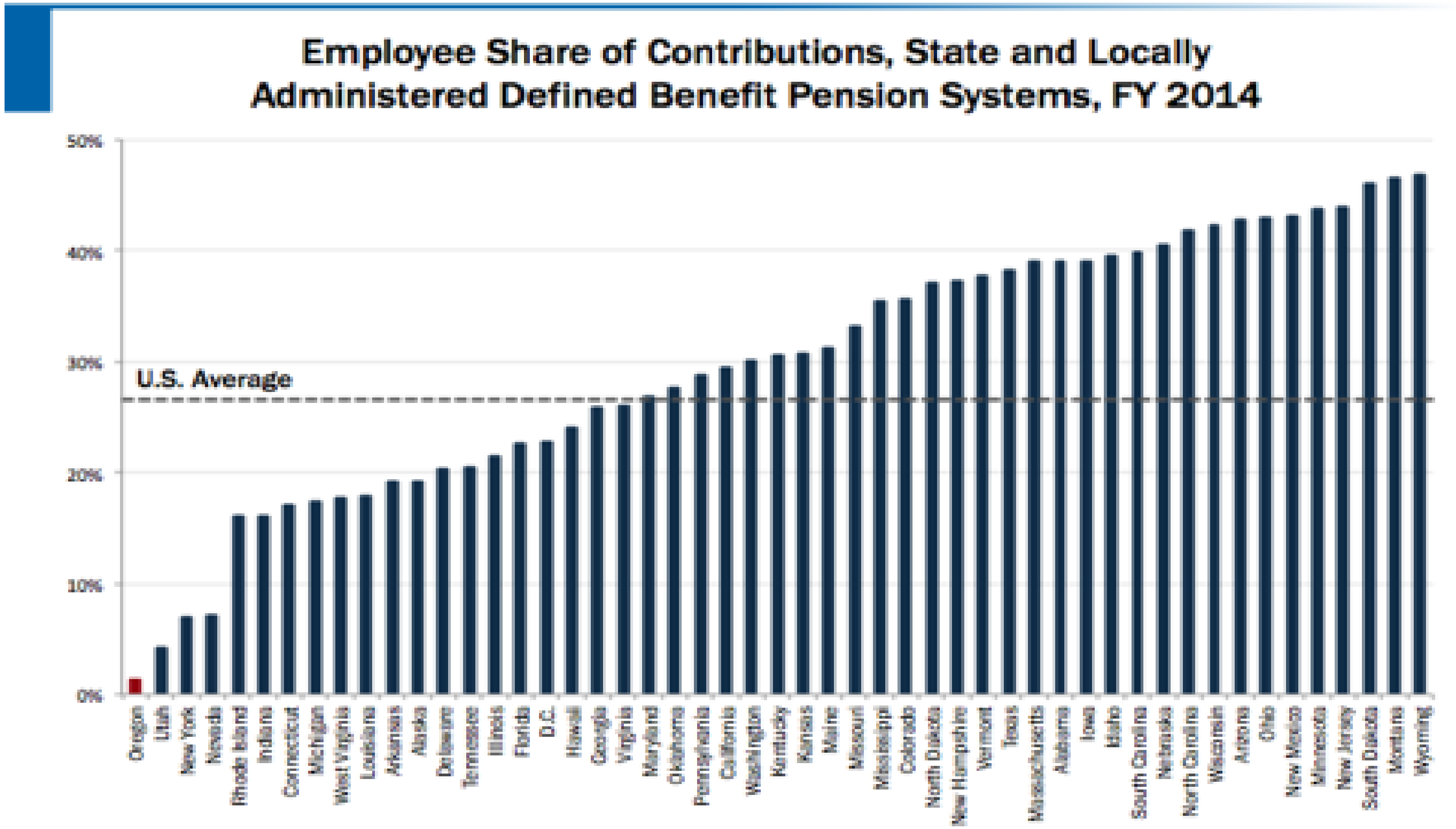
- Recognize the differences in costs and benefits for pre-2003 and post-2003 employees
- All savings stay in budgets to preserve and enhance services
- Adequate (for employees & employers) and Affordable for taxpayers
- Manage remaining liabilities so as not to place an undue burden on current generation ("kids in today's classrooms")

Approaches to Reform

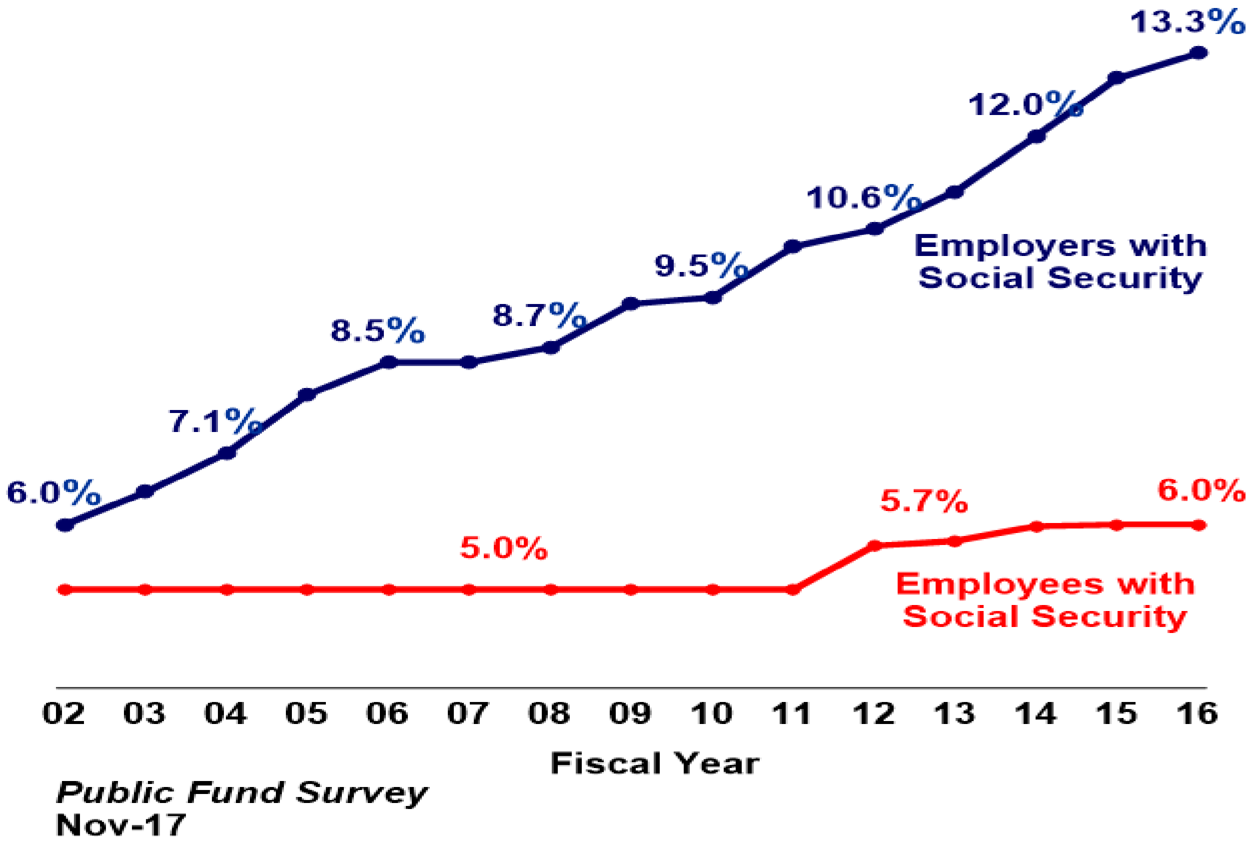
- **Employee Cost sharing**, focused on Tier 1 & 2
- **Benefit Rebalance**, to align with post-2003 structure
- **New defined contribution plan**, for new employees plus option for current employees
- Pathway to new revenue

The Case for Employee Cost Sharing

Employee contributions: Oregon is an outlier



Average Contribution Rates Across U.S. Defined Benefit Plans

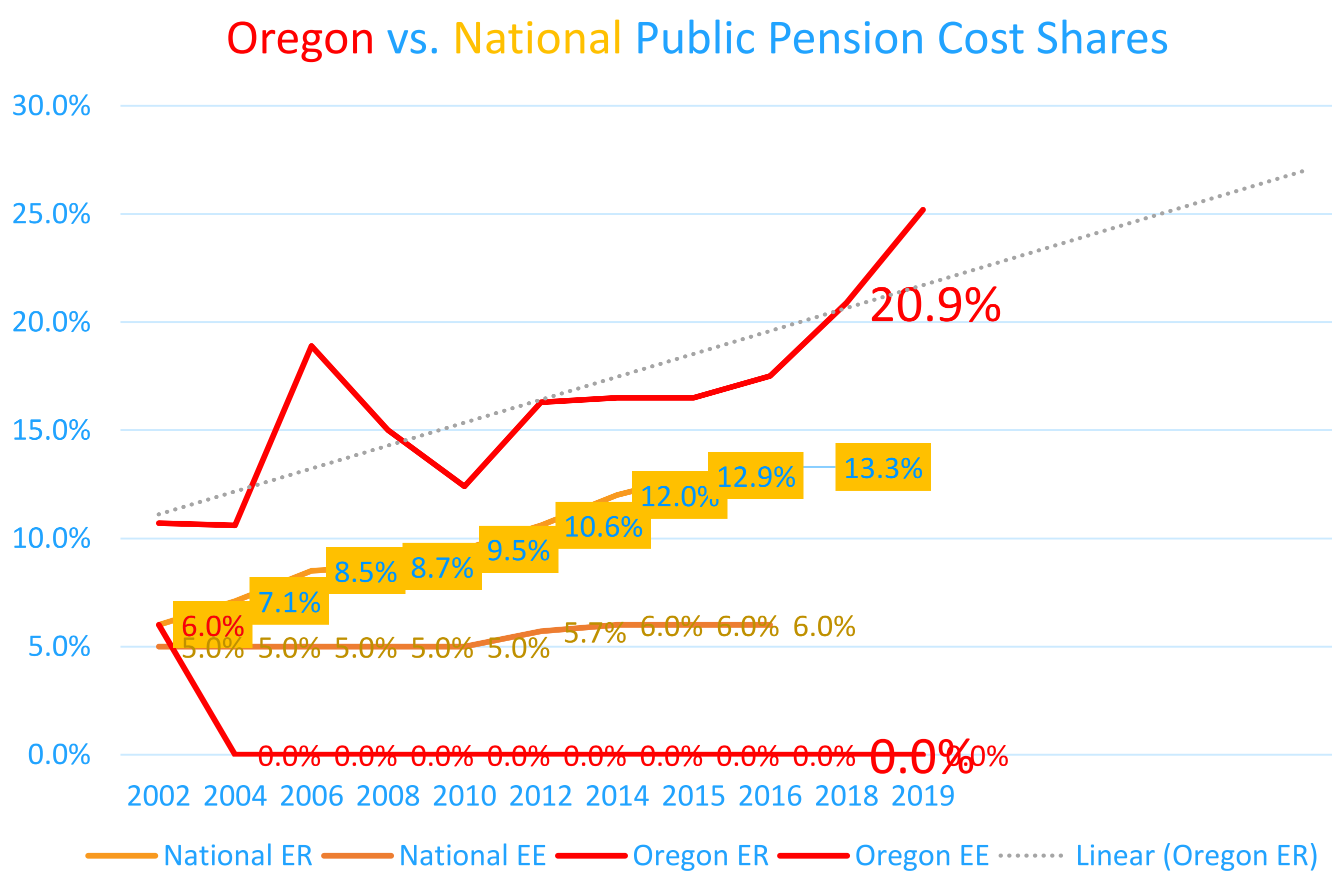


Nationally, in 2016:

- Employers paid 13.3% of payroll
- Employees paid 6.0% of payroll

Source: National Association of Retirement Administrators

Oregon's Pension Costs Are Paid in Full by Employers



In Oregon,

- Employers paid 17.5% on 2016-17
- Employers pay 20.85% now
- Employers will pay 25.23% next year
- Employees pay 0

The Case for Rebalancing Benefits

Tier 1 & 2 Features Drive Costs

Tier 1 & 2 (General Service)

Formula = 1.67%/year = 50% of FAS at 30 years

Full benefits @ age 58 (Tier 1) or 60 (Tier 2) or 30 years of service

+ Money Match option
+ Sick Leave/Vacation option
+ Earlier retirement age

Cost to Employers =
15.3% of payroll ongoing
+ UAL amortization

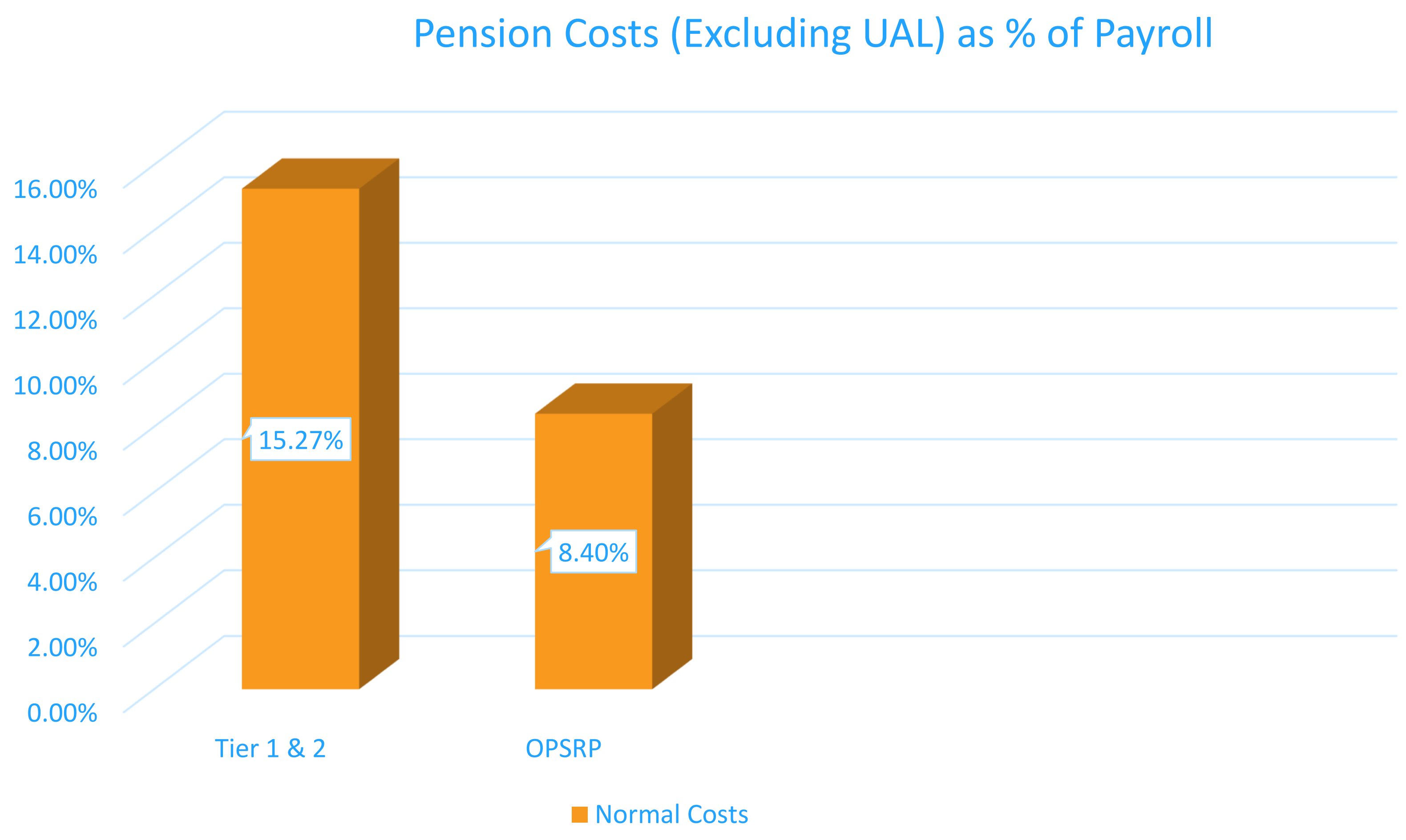
OPSRP (General Service

Formula = 1.5%/year = 45% of FAS at 30 years

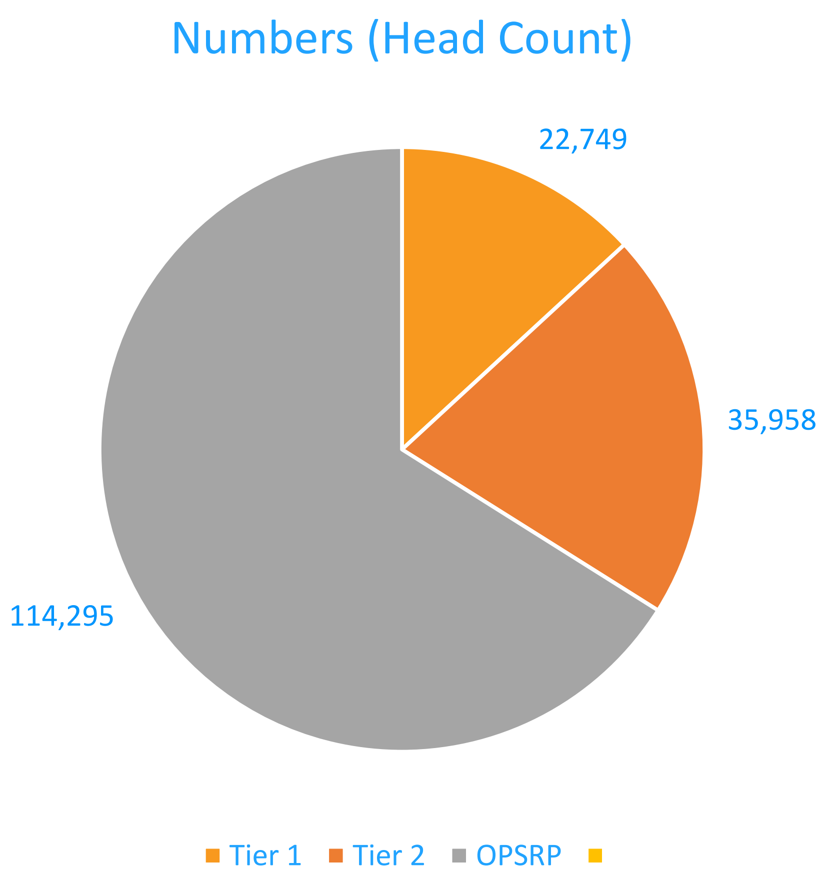
Full benefits @ age 65 or age 58 w/30 years

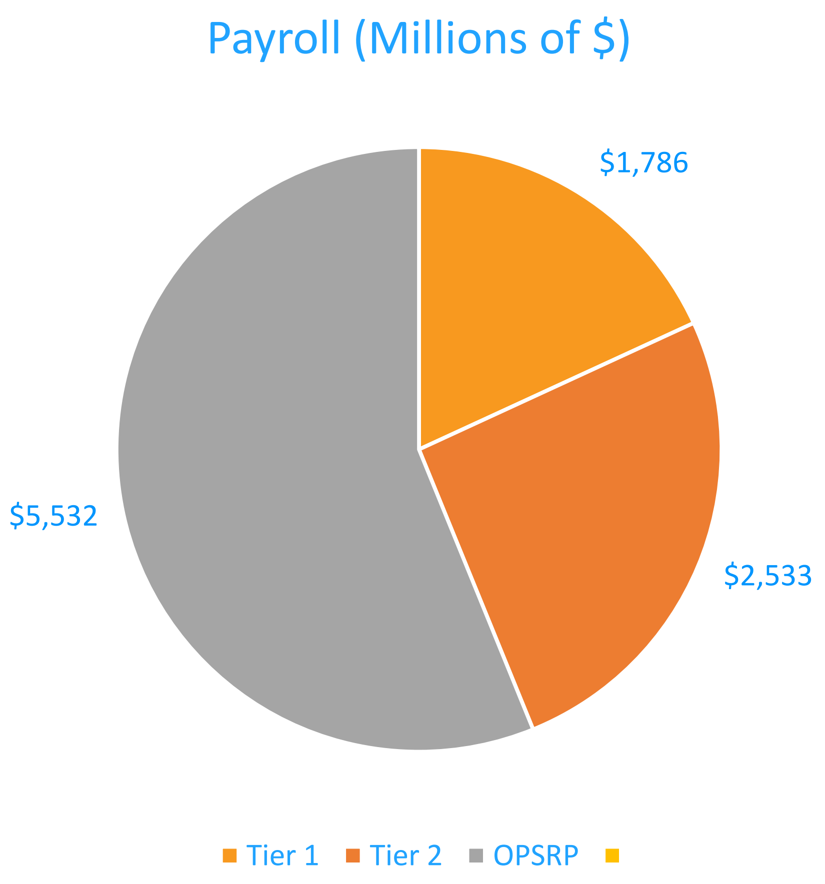
Cost to Employers =
8.4% of payroll ongoing
+ UAL amortization

Normal costs for Tier 1/2 are nearly twice those of OPSRP



Tier 1&2 Employees remain a significant portion of the PERS-covered workforce





OPSRP: Adequate, affordable, competitive

- OPSRP is an adequate and competitive plan for employees and more affordable for taxpayers
- OPSRP is better than Washington State's teachers' plan

	% Salary per Year of Service	Final Average Salary	EE Contribution to Supplemental Savings
Oregon PERS OPSRP	1.5%	3 years	6.0% fixed
WA State Teachers	1.0%	5 years	5.0% minimum

Rebalance Benefits

Equalize benefits for employees hired before and after 2003 – Move pre-2003 Tier 1/2 employees to a benefit structure for future service that is closer to the post-2003 OPSRP benefit structure. Involves changes to:

- Rate of accrual of benefits
- Cap on pensionable salaries
- No further use of unused sick leave, vacation
- Age for full benefits

OBC’s 2017 Legislation

OBC's 2017 Reform Package

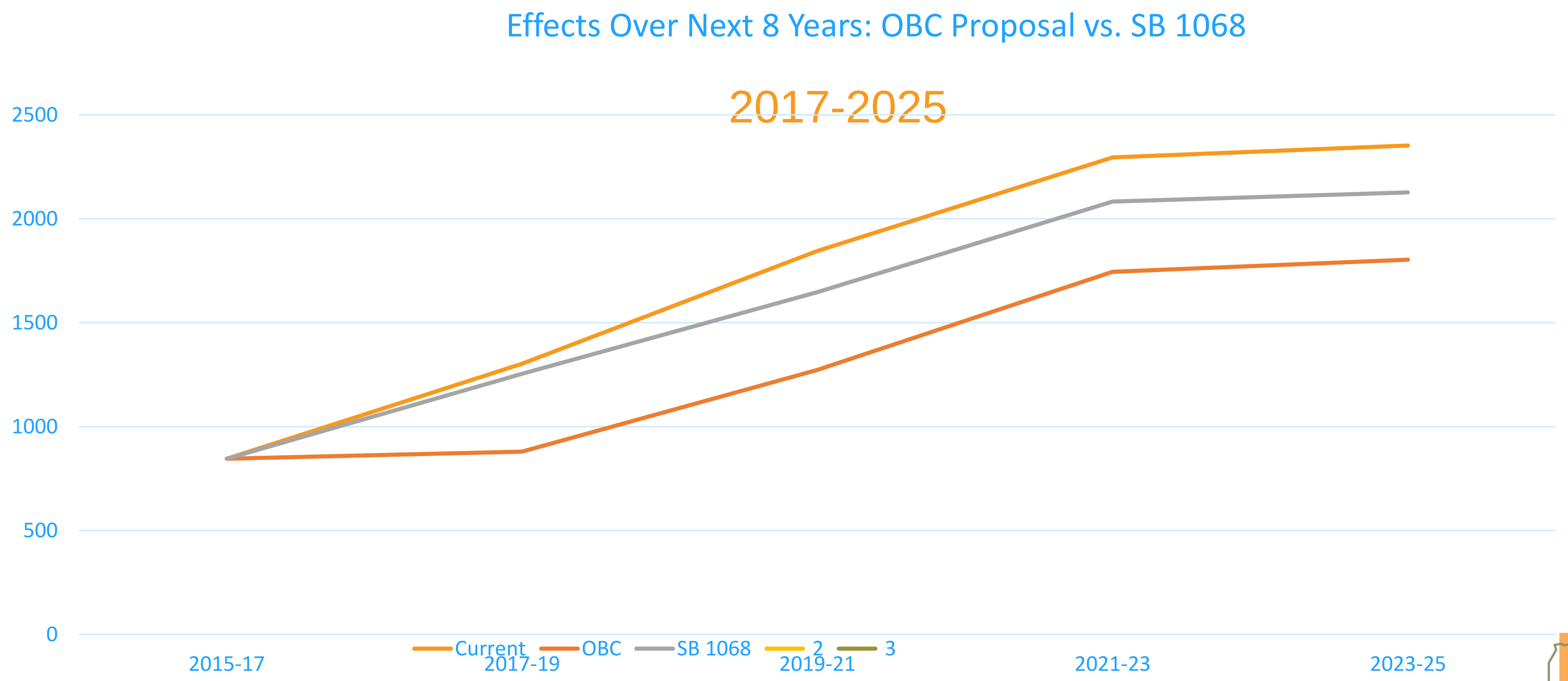
Cost Sharing:

- Tier 1 & 2 employees pay 6% to support pensions
- OPSRP employees pay 3% to support pension

Benefit Rebalance:

- Tier 1 & 2 employees move to OPSRP benefit formula (except for retirement age)

Projected Savings from 2017 Proposals



Oregon Business Plan.org

The Case for a Defined Contribution Plan

Defined Benefit vs. Defined Contribution

Defined Benefit

- Favors career Ees over those who come and go
- Favors Ees with high rates of pay progression
- Difficult to project and control costs

Defined Contribution

- More fair to short term and lower-paid employees
- More portable and compatible with private sector plans
- More predictable for employers

Defined Contribution: The OHSU Experience

<u>OHSU employees have option of:</u>

- Defined contribution plan fully paid by the Employer at 12% of pay

or

- PERS pension, with employees paying 6% for the IAP

- DC Plan is the default option, enrolling 95% of new hires

- Only 26% of employees remain in the PERS pension plan

- Savings on the 74% of employees in the DC plan equate to 2.5% of payroll for post-2003 hires

Reforms and Solutions

Potential Approaches for 2019

- Employee cost sharing
- DC plan
- Benefit rebalance
- Management of remaining liabilities

What about the IAP?

(Mis)Understanding the IAP (Individual Account Program)

PERS includes a mandatory supplemental retirement savings plan for all employees, known as the IAP, but…

- As a defined contribution plan, the IAP is always fully funded
- The IAP has no effect on the cost or funding of the pension plan
- But the IAP is relevant to the benefit calculation because it provides an additional retirement benefit over and above the pension benefit

(Mis)Understanding the IAP: It's Complicated!

Many employers pick up the 6% IAP and treat it as part of their employee pay packages

- Most such employers have CBA language requiring an offsetting pay increase upon termination of the pick up

In other jurisdictions, employees pay the 6%

Both Tier 1/2 & OPSRP Exceed the PERS Goal of 50% of FAS At 30 Years

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Cost sharing and the IAP

Employee cost sharing can be coordinated with the IAP by:

- ✓ Allowing employees to divert future IAP contributions to cover their pension contributions <u>or</u>
- Eliminating the IAP <u>or</u>
- Making continuation to the IAP optional for employers (and negotiable for bargaining units)

Legislative Concepts for 2019

Proposed Reforms for 2019

Statutory

- Employee cost sharing
  - 6% Tier 1 & 2; 3% OPSRP
  - Employee option for use of future IAP contributions for pension conribributions
- New Defined Contribution plan
- Benefit Rebalance (features to be determined)

Budgetary

- Management of remaining liabilities

Limit and Manage Remaining Liabilities

- Ensure that we guard against continuing increases in the unfunded liabilities. Examples:
  - Effect of higher-than-projected salary increases
  - Employees share in cost increases
  - Defined contribution plan

- Identify ways to manage the buy down of the UAL so as not to adversely affect kids in today's classrooms or overly burden future generations of Oregonians. Examples:
  - Bonding
  - Longer amortization periods
  - State assistance for schools and local governments
  - Prioritization of programs targeted for assistance

Key Take-aways

- Reforms can be legal
- Reforms can be fair
  - Benefits will remain adequate for employees
  - Competitive for employers
  - More affordable for taxpayers
  - Less harm to services
- Magnitude of reforms can equal $6 billion (same as 2013 package) = 6 points of payroll for employers
- Role for the state in managing the amortization of the system's liabilities
- Creates pathway to tax reform and "doing more with more"

PERS Reform Working Group

- Oregon School Boards Association
- League of Oregon Cities
- Association of Oregon Counties
- Community Colleges
- Universities