

Tier II Does Not Control PERS Costs

On November 21, the Director of the Public Employee Retirement System (PERS), Jim Voytko, presented evidence to the Speaker's PERS Task Force, which shattered the myth that Tier II will eventually bring system costs under control. Many policy makers, representatives of organized labor and even some public employers believe that once the majority of Tier I public employee members retire, employer contribution rates would decline to reasonable levels because of the elimination of the assumed earnings guarantee (Tier I accounts are guaranteed an assumed earnings rate, currently 8 percent).

The conclusions presented to the task force, chaired by Representative Tim Knopp (R- Bend), are based on a computer model of the retirement system devised to forecast future system costs, employee benefits and unfunded liabilities under various scenarios. The model shows that Tier II does not provide employers with either sustainable or predictable pension costs.

PERS staff found that even after the majority of Tier I members retire, public employer contribution rates to PERS could be 21.49 percent of payroll costs, before the 6 percent "pick-up" of the employee's share that many employers offer. According to PERS, the average employer rate from 1990-2002 was 9.73 percent of payroll.

According to Mr. Voytko, preliminary analysis suggests that Tier II's failure to contain employer PERS costs may be due to a mix of factors including a persistent unfunded actuarial liability (UAL), a combination of "money match" and "full formula" calculations being used to figure Tier II retirement benefits, and volatility in investment returns.

Mr. Voytko also reiterated conditions indicating the bleak short-term outlook for the system:

- The PERS UAL is likely to rise sharply over the next five years due to continued poor earnings of the PERS fund in the stock market (the UAL is expected to be \$15.9 billion as of December 31, 2002). The UAL is expected to decline very slowly over the next 20-25 years, provided that continuing declines in the stock market don't make it worse.
- A continuous stream of annual 8 percent investment returns is not sufficient to:
- Eliminate the likelihood of employer rates reaching at least 22-24 percent of payroll costs before the "pick-up";

- Eliminate a possible "call" in excess of \$2 billion. There is a 75 percent chance that between now and 2007 a statutory provision will be triggered that requires any UAL accrued and maintained for over five years to be paid off. This is commonly referred to as the "call" provision. However, the statute is silent on who is responsible for paying off the UAL, and PERS has said they would interpret the UAL to be the responsibility of public employers.
- Prevent a persistent UAL, even beyond the point when Tier I members are no longer the majority of the active participants in the system.
 - While an acceleration of Tier I member retirements increases the likelihood of a "call", slower-than-anticipated Tier I member retirements increase the costs of Tier I.

Steve Manton, pension manager for the City of Portland, and Maria Keltner, director of the Local Government Personnel Institute, both said they have suspected for quite some time that Tier II was not a panacea to PERS' problems as many believed.

Others seemed a bit more surprised by the PERS agency's findings. "The information we received today is shocking," said Mary Botkin of the American Federation of State and Municipal Employees, Council 75. Brian DeLashmutt, representing nurses and corrections employees, also admitted that the presentation suggests Tier II may be problematic and expressed hope that employer and labor representatives could work together to define the parameters of a "call" to eliminate the UAL. The League of Oregon Cities, Association of Oregon Counties, Special Districts Association of Oregon and Oregon School Boards Association are using an independent pension actuary to check the assumptions used by PERS, perform additional analysis of the data and run additional scenarios through the model. This additional analysis will provide empirical data to ensure that proposed reforms to PERS meet our goal of good benefits for employees at stable, sustainable costs to employers.

Representative Knopp will be looking to his colleagues and members of the work group for legislative proposals by December 11 to address

some of the issues associated with the high costs of PERS. LOC will be working through the Employer PERS Task Force—comprised of city and county finance and administrative managers and our partners in the School Boards and Special Districts Associations—to maintain a unified employer position on these issues and refine proposed reforms for submission to the legislature.

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