



Date: June 27, 2003
To: PERS Covered Cities
From: Ken Strobeck, Executive Director
Subject: PERS Reform Legislation

Enclosed you will find information about important Public Employee Retirement System (PERS) reform bills that have passed both chambers of the legislature to date.

PERS reform will continue to evolve -- throughout the remainder of the session, into the interim, and possibly beyond. We expect legislators to consider options for a successor plan and "cleanup" legislation to resolve conflicts in the various bills, and we expect legal challenges to be mounted in the courts.

This is far from the last word, so please stay tuned to our website, our legislative bulletin, and to our monthly newsletter "Local Focus" for the latest on changes to PERS. Feel free to contact Michelle Deister at the League with questions (mdeister@orcities.org, 503-588-6550).



PERS Reform Legislation

Questions and Answers

June, 2003

Q: What major bills relating to the Public Employee Retirement System (PERS) have been passed by the 2003 Legislature?

A: The following four major pieces of PERS-related legislation have been passed by the Legislature to date:

- HB 2001 - Prohibits PERS from crediting Tier One member regular accounts with earnings in excess of the assumed rate (currently 8 percent) until:

1) the deficit reserve account has been eliminated; and

2) the deficit reserve account has been fully funded for the three immediately preceding calendar years.

HB 2001 applies to earnings crediting for calendar year 2003 and after.

- HB 2003 - The PERS Reform Act of 2003. This bill provides a remedy for crediting practices found to be erroneous in the City of Eugene et. al. v. PERS lawsuit, and slows the growth of employee retirement accounts in an effort to reduce the unfunded liability of PERS and decrease employer rates.

To remedy past crediting practices, PERS is directed to recover the present value of the cost of any such benefits overpaid to already-retired members. This would be accomplished through future earnings of the PERS Fund and/or by temporarily withholding future cost of living adjustments to retirees until the improperly credited amount is paid back.

HB 2003 slows the growth of employee accounts, thereby reducing the amount that employers must “match” at retirement. This is accomplished two ways:

1) Regular accounts for Tier One employees will receive no annual earnings crediting until the deficit account is eliminated. However, the bill ensures that upon a member’s retirement, these accounts will be credited no less than an average of the assumed rate for each year the account existed; and

2) Starting January 1, 2004, employee 6% contributions will be paid into individual defined contribution “transition accounts,” and not into existing employee accounts. Employers are mandated to continue to pick up the 6 percent employee contribution until December 31, 2005 if they currently do so.

Thereafter, employers may decide by collective bargaining agreement or policy to pay part or all of the 6% employee contribution to the transition account or its future replacement account.

The PERS Board will seek tax-qualification status for the transition accounts, which will be charged for maintenance costs. The transition accounts will be invested similar to the larger PERS Fund, so there is the potential for additional earnings; however, there is no guaranteed rate of return and employers will not match the amount in the transition account upon the member’s retirement.

- HB 2004 - Requires the Board to use updated mortality tables when calculating monthly payments to retirees, effective July 1, 2003. The bill requires PERS to use a “look-back” calculation, so that members retiring on or after July 1, 2003 will receive no less than the monthly payment that the member was entitled to on June 30, 2003. A new set of mortality tables is to be adopted effective January 1, 2005 and once every two years thereafter.

HB 2004 also directs the PERS Board to review the life expectancy of certain police and fire members and adopt different mortality tables for them if their life expectancy is found to be significantly different than that of general service members. The bill provides for exclusive expedited appeal to the Oregon Supreme Court in the event of a legal challenge, and requires the PERS Board to recalculate the employer contribution rates to reflect passage of the bill.

- HB 2005 - Changes the composition of the PERS Board from 12 to 5 members with a majority not having an interest in PERS.

Q: The press has raised questions about the constitutionality of these bills. Will there be legal challenges?

A: Yes! Public employee unions have indicated that they will challenge provisions of HB 2003 and HB 2004 in court, on the grounds that they violate employees' "contract rights," or what was promised to employees as a pension. The bills contain language that facilitates an expedited review by the Oregon Supreme Court, but the possibility exists that challenges will be brought at the circuit and federal court level. If a suit related to PERS is filed against your city, please contact the League immediately. Litigation is not likely to be resolved before July 2004, and could take several years.

Q: How much will these bills save employers? Should I factor these bills into my city's 2003-04 budget?

A: The ultimate amount of PERS rate relief these bills provide will not be known until litigation is resolved. However, the PERS Board has indicated that it will adopt amended employer rates in late June to reflect passage of PERS-related legislation. *Preliminary estimates* suggest that HB 2001-A, HB 2003-B and HB 2004-C may result in a system-wide average employer rate reduction (from the rates released in January that were scheduled to go into effect July 1, 2003) of approximately 8 - 8.5% of payroll.

BUT . . .

BEFORE YOU FACTOR POSSIBLE RATE REDUCTIONS INTO YOUR BUDGET, CONSIDER THE FOLLOWING:

- Your city's PERS rate reduction could be higher or lower, depending on individual circumstance.
- We will not know the preliminary impact of these bills until rates are recalculated by the PERS actuary, scheduled to be released June 30, 2003. We will not know the actual impact for certain until litigation is resolved. Check the League's website after June 30 for a link to your city's revised PERS Rate.

- Expect higher employer rates in the future. To the extent that litigation results in changes to PERS reform, employer rates could increase in the future. In addition, employer rate orders following the next regular valuation (the next regular valuation after amended rates are released in late June) are expected to be higher than the amended 2003 rates. This is because the next regular valuation will recognize the remaining losses from 2001 not captured to date due to the PERS Board's policy of "smoothing" and because some 2002 losses to the fund are likely to be recognized.

Some cities are planning for future increases by putting savings in reserve accounts until the outcome of litigation is decided.

Q: How will legal challenges to these bills interplay with the "City of Eugene et. al vs. PERS" decision decided by Judge Lipscomb?

A: On June 11, Judge Rick Haselton of the Oregon Court of Appeals issued an order refusing a request from PERS and public-employee unions to stay the "City of Eugene" decision. As a result, the PERS board must do something to implement the decision rather than waiting a year or more for legal appeals to play out. And both chambers of the Legislature have passed HB 2409, which would expedite the matter to the Supreme Court for review.

However, it is unclear how implementing the "City of Eugene" decision will fit in with the passage of House Bills 2001, 2003, 2004 and 2005 and resulting litigation.

Jim Voytko, PERS executive director, said the board would hold a special meeting on June 30 to look at implementing the legislation and the "City of Eugene" decision.

The League will keep its members informed regarding the status of court rulings related to PERS.

Q: Are any other bills likely to pass between now and the close of the Legislative Session?

A: A successor retirement plan for new employees (hired after June 30, 2003) is being contemplated by the Legislature. Two competing structures are currently under consideration.

HB 2020-A creates a defined contribution (DC) plan, similar to a private sector 401(K). It passed the Republican-dominated House of Representatives but is unlikely to survive in the Senate. The DC Plan requires employers to contribute a minimum of 3% of salary for covered employees. Employers would contribute up to 6% maximum for covered general service employees and up to 7.15% maximum for covered police/fire employees.

The Senate is expected to consider a hybrid defined benefit/defined contribution plan.

Q: I'm getting a lot of questions about how these bills affect city employees. What should I tell them?

A: The important thing for employees to know is that their current account balance will not be reduced as a result of this legislation. However, employee account balances are unlikely to grow for the foreseeable future.

Specifically, Tier One members retiring on or after April 1, 2004, will not have earnings credited to their regular account in calendar year 2003 and after, IF:

- 1) there is a negative deficit account; or
- 2) the credit would result in a negative deficit account.

The minimum Tier One member regular account balance at retirement on or after April 1, 2004 will be no less than if this account had been credited with the assumed interest rate each year the account existed.

House Bill 2003 will also have an impact on retirees. Tier One members who retired with a money match benefit on or after April 1, 2000

and before April 1, 2004 will receive the higher of either the monthly payment on July 1, 2003 or the monthly payment due if 11.33% earnings had been credited to their regular account for calendar year 1999; these retirees will receive no future COLA increase on the non-variable portion of benefit until the 1999 recalculation amount exceeds their calculated amount.

Q: Retirement-eligible employees are asking whether they should retire now. What should I tell them?

A: Retirement is a very personal decision. If an employee is ready, both financially and psychologically, they might consider retirement. But if an employee is happy with his or her job, salary and benefit levels, and was not otherwise planning to leave, they should think very carefully about retirement. These employees should keep in mind that their current total account balance will not be reduced as a result of this legislation (although their estimated monthly payment could be slightly impacted by the new mortality tables going into effect July 1).

However, employees who are eligible or nearly eligible to retire will essentially be working without significant additional contributions to their existing Regular account balance. This is because HB 2003 specifies that upon a member's retirement, these accounts will be credited no less than an average of the assumed rate for each year the account existed (remember that PERS credited these accounts in excess of the assumed rate of return – 8% – in the late 1990s). However, some earnings are possible on the employee's individual defined contribution "transition account," established beginning January 1, 2004.

Stay tuned to our Legislative Bulletin and website (www.orcities.org) for the latest on PERS, or contact the League of Oregon Cities at 503-588-6550 for more information.