

PERS Employer Notification

Combined-Payroll UAL/Surplus Amortization Methodology

Proposed Implementation: Early 2006

Summary

Beginning in early 2006, the unfunded actuarial liability (UAL) portion of an employer's Tier One/Tier Two Pension Plan (T1/T2) rate will be applied against each employer's entire payroll, including the payroll from the Oregon Public Service Retirement Plan Pension Program (OPSRP). The exact start date will be provided in a subsequent employer notification. Even though this change is to "reset" T1/T2 contributions at the level originally planned by PERS' actuary, one result is that those employers with a T1/T2 UAL will see an increase in contributions due, while those employers with a T1/T2 surplus will see a decrease in contributions due. **Please note:** *This methodology does not change an employer's rate, it only changes the payroll base against which the UAL component of the employer's rate is applied.*

Issue

With the commencement of OPSRP in 2004, T1/T2 became a "closed" plan, meaning no new members will be added. Since that time, employers' T1/T2 payrolls have been declining and OPSRP payrolls increasing. As a result, the T1/T2 rate is being applied against a shrinking payroll base and the contributions that are being collected are lower than anticipated. This shift has been more pronounced among small employers, but this will have an increasing effect on all employers over time.

Employers' T1/T2 UALs or surpluses are amortized as a percentage of T1/T2 payroll. This amortization is part of the T1/T2 employer contribution rate calculated by the PERS actuary every two years. However, as T1/T2 payrolls decline, it is no longer possible to retain rate stability using this method. If PERS continues to amortize T1/T2 UALs and surpluses against T1/T2 payrolls alone, employer rates will fluctuate. For employers with a UAL, this would mean rates would increase, dramatically in some cases. For employers with a surplus, declining T1/T2 payrolls would mean less and less of the employer's surplus would be utilized over time.

Solution

To stabilize the payroll base against which T1/T2 UALs and surpluses are being amortized, PERS will begin using combined T1/T2 and OPSRP payrolls. This methodology was developed through a series of meetings with employers, employer representatives, and actuaries. Of the possible solutions studied, employers and employer representatives preferred the combined payroll UAL amortization methodology due to its greater compatibility with employer budget, payroll and cost allocation systems.

Under this method, dollars collected (or credited, in the case of a surplus) by applying a T1/T2 UAL or surplus amortization rate against this combined payroll base will be applied to the employer's T1/T2 UAL or surplus. OPSRP Pension Program assets, liabilities, and contributions will not be affected. However, by using the employer's entire payroll in the calculation, the effect of declining T1/T2 payrolls will be offset by the increasing OPSRP payrolls, thereby maintaining a stable amortization of T1/T2 UALs and surpluses.

Calculation Methodology

An employer's T1/T2 contribution rate is composed of two primary components:

- Normal cost; and
- UAL (or surplus) amortization.

Currently, these components are combined and expressed as a single rate, which is applied to the employer's T1/T2 payroll each pay period. Employers pay a separate rate for the OPSRP Pension Program, which is applied to the employer's OPSRP payroll. The employer's total contribution due for the pay period is the sum of these two calculations, plus the amount due for the Individual Account Program (IAP). The IAP is not affected by the combined-payroll methodology and will not be discussed further in this summary.

For example, an employer with a T1/T2 contribution rate of 15.50 percent, the current calculation of the employer's pension program contributions looks like this:

$$\begin{aligned} 15.50\% \times \text{T1/T2 payroll} &= \text{T1/T2 contributions due} \\ 8.04\%/11.65\% \times \text{OPSRP GS/P\&F payroll} &= \text{OPSRP contributions due} \end{aligned}$$

Under the combined payroll methodology, the components of the employer's T1/T2 contribution rate will no longer be combined into a single rate. Instead, each employer will have separate rates for normal cost and UAL (surplus) amortization. The normal cost component will continue to be applied only to T1/T2 payroll, just as it is now. However, the UAL (surplus) amortization rate component will be applied to both T1/T2 and OPSRP payrolls.

In this example, suppose the above employer's combined T1/T2 rate of 15.50 percent includes 11.50 percent for normal cost and 4.00 percent for UAL amortization. In this case, the calculation of the employer's pension program contributions would look like this:

$$\begin{aligned} (11.50\% \times \text{T1/T2 payroll}) + (4.00\% \times \text{T1/T2/OPSRP payroll}) &= \text{T1/T2 contributions due} \\ 8.04\%/11.65\% \times \text{OPSRP GS/P\&F payroll} &= \text{OPSRP contributions due} \end{aligned}$$

For an employer with a surplus rather than a UAL, the 4.00 percent UAL amortization rate would be applied as a credit:

$$\begin{aligned} (11.50\% \times \text{T1/T2 payroll}) - (4.00\% \times \text{T1/T2/OPSRP payroll}) &= \text{T1/T2 contributions due} \\ 8.04\%/11.65\% \times \text{OPSRP GS/P\&F payroll} &= \text{OPSRP contributions due} \end{aligned}$$

Note that in the above examples, the OPSRP rate does not change, nor does the amount of contributions due for OPSRP change. Employer statements will continue to reflect current OPSRP rates until those rates change effective July 1, 2007, based upon the 2005 Valuation. However, for internal budgeting purposes, it may be simpler to think of the new methodology as an increase (or decrease, for employers with a surplus) in OPSRP rates.

To Determine Normal Cost and UAL Rates:

Refer to Table 6 from the 2003 Valuation (enclosed). For most employers, the column headed "Default Schedule July 1, 2005" will show the correct rate components. For those employers who elected the optional rate schedule, the correct rates are in the column headed "Optional Schedule July 1, 2005." The employer's Normal Cost rate is on the "Normal Cost – Total" line. The UAL amortization rate is on the "Amortization of UAL – Total" line.

Lump-sum payments do not affect Normal Cost rates, but they do reduce UAL amortization rates. **For employers that have made a lump-sum payment** that reduced their rates below what is shown on Table 6, the UAL amortization rate can be calculated by subtracting the “Normal Cost – Total” rate in the applicable column from the employer’s current T1/T2 contribution rate. The result will be the employer’s UAL amortization rate. This rate may be negative. Once the employer’s Normal Cost and UAL amortization rates have been identified, the employer can substitute its employer rates and payrolls for those used in the following examples to determine the impact of the methodology change. Please note that the UAL rate can be either positive or negative. It is important that the rate continue to be represented as such in order to obtain a reasonable estimate.

Example: Assume the employer has a T1/T2 payroll of \$150,000 per pay period, and an OPSRP payroll of \$75,000 (GS only) per pay period and has a T1/T2 Normal Cost rate of 11.50% and a UAL rate of 4.00%. The employer also will have an OPSRP rate of 8.04% (GS only). Using the calculation method that will appear on the employer statement, the contribution due totals for each program will be as follows:

	Current Method	New Method
11.50% x \$150,000	\$17,250	\$17,250
+4.00% x \$150,000	+ \$ 6,000	
+4.00% x \$225,000	<u> </u>	+ \$ 9,000
	= \$23,250	= \$26,250 T1/T2 contribution
8.04% x \$ 75,000	<u>\$ 6,030</u>	<u>\$ 6,030</u> OPSRP contribution
	= \$29,280	= \$32,280 Total pension contributions

Under the new method, the amount of contributions due increased by \$3,000.

If the employer’s UAL rate is negative, all of the rates and numbers shown with a positive sign will turn negative:

	Current Method	New Method
11.50% x \$150,000	\$17,250	\$17,250
-4.00% x \$150,000	- \$ 6,000	
-4.00% x \$225,000	<u> </u>	- \$ 9,000
	= \$11,250	= \$ 8,250 T1/T2 contribution
8.04% x \$75,000	<u>\$ 6,030</u>	<u>\$ 6,030</u> OPSRP contribution
	= \$17,280	= \$14,280 Total pension contributions

Under the new method, the amount of contributions due decreased by \$3,000.

Note: For employers with larger surpluses or side accounts from lump-sum UAL payments, there is a possibility that the resulting contribution credit may exceed the amount owed for T1/T2 normal cost. PERS does not have the authority to refund these excess credits to the employer. However, it is important that employers receive the full benefit of a surplus or side account, if possible. In order to ensure this, for any payroll period in which an employer’s T1/T2 UAL amortization credit is greater than the employer’s T1/T2 normal cost, the excess credit may be used to offset the employer’s contributions due for the OPSRP pension program. Any excess amount cannot be applied against the IAP contributions due, since those represent member contributions.

For those few employers with credits remaining after T1/T2 and OPSRP contributions have been fully offset, PERS and its actuary will monitor and re-amortize unused credits to ensure employers get the maximum possible benefit from their surpluses and side accounts.

Alternative Approach (Budget/Cost Allocation Purposes Only)

For budget purposes, by using the same payroll figures but treating the new amortization methodology as a change in the OPSRP contribution rate rather than a change in payroll base, the employer can derive the same amount of contributions due. Adding the employer's 4.00 percent UAL rate to the OPSRP rate results in the following

$$\begin{array}{r} 15.50\% \times \$150,000 \\ 12.04\% \times \$75,000 \\ \hline \end{array} \quad \begin{array}{l} \$23,250 \text{ T1/T2 contribution} \\ \$ 9,030 \text{ OPSRP contribution} \\ = \$32,280 \text{ Total pension program contributions due} \end{array}$$

If the employer has a surplus resulting in a UAL rate of -4.00 percent, the rate can be used to offset the OPSRP rate resulting in the following:

$$\begin{array}{r} 7.50\% \times \$150,000 \\ 4.04\% \times \$ 75,000 \\ \hline \end{array} \quad \begin{array}{l} \$11,250 \text{ T1/T2 contribution} \\ \$ 3,030 \text{ OPSRP contribution} \\ = \$14,280 \text{ Total pension program contributions due} \end{array}$$

Please remember this method is to be used only for internal budgeting or cost allocation purposes if the employer finds this approach easier. The actual calculation method does not cause rates to change and the "Alternative Approach" should not be confused with the actual method by which PERS will be applying the rates.

Employer Statements

PERS and programming staff are still working on the best way to display the details of these calculations on employers' online statements. Statement changes will not be fully implemented until late in 2006. However, for the initial implementation of the combined-payroll methodology, employer statements will include a new line, "UAL Contribution Amount," which will reflect the total UAL contribution or credit calculated for that pay period. This total will be included in the total amount due shown on the statement to assist employers in reconciling their statements to their own calculations.

During the interim between initial implementation in early 2006, and full implementation of the more detailed statement, PERS staff can assist employers who are having difficulty reconciling the UAL contributions calculated by PERS with their own calculations.

The Future

Beginning July 1, 2007, the combined-payroll methodology will also be applied to any OPSRP UAL (surplus). At that time employers will see an OPSRP Pension Program UAL (surplus) amortization rate in addition to a rate for OPSRP Pension Program Normal Cost. The same calculation rules will apply to the OPSRP rates as those described previously. This will allow surplus credits from either pension program to offset contributions due for Normal Cost and UAL related to other pension programs, permitting maximum use of existing surpluses and side accounts. In addition, PERS will implement a process by which surplus or side account dollars in excess of what is needed for the applicable pension program (T1/T2 or OPSRP) can be moved into a side account for the other pension program (i.e., an employer's T1/T2 side account funds may be moved into an OPSRP side account and used to reduce the OPSRP rate, or vice-versa). This will ensure the fullest possible benefit to the employer of a surplus or side account,

regardless of payroll shifts between pension programs, while allowing PERS to continue to track contributions and credits discretely by plan as directed by statute.

Questions?

PERS Contact:

EDX Team

Portland area: (503) 598-7377 (Select “Employer” Option)

Outside Portland: 1-888-320-7377 (Select “Employer” Option)