State & Local Government Rate Pool Q & A

1. What is pooling?

Pooling allows separate employers to be part of one group for the purpose of determining employer pension costs and contribution rates. Pool participants share pension assets and future pension liabilities and surpluses. Employers in the pool jointly fund the future pension costs of all of the pooled participants.

2. Why join a pool?

Pooling promotes stability in employer rates by spreading the costs of unexpected events, such as disabilities, across multiple employers rather than the entire cost being assigned to a single employer. Because of this, employer rates for non-pooled employers can fluctuate significantly between valuations, while the rates of pooled employers tend to remain more stable.

The unpredictability of un-pooled rates is a concern for many local employers as they can cause financial difficulties when unexpected actuarial events occur. Because of the demonstrated stability of pooled rates for the state and schools, the 2001 Legislature chose to extend the opportunity for local governments to pool their rates with those of the state of Oregon. Since January 1, 2001, more than half of the local governments participating in PERS have joined this new pool.

It is important to note that pooling will not eliminate rate instability. Factors such as fluctuating investment earnings, legislation, and legal rulings will affect all employer rates, both pooled and non-pooled. Pooling mitigates the impact of events that are employer-specific, such as disabilities.

3. Which employers are eligible to join the State & Local Government Rate Pool (SLGRP)?

Cities, counties, and special districts that participate in PERS may choose to join the pool. State agencies, community colleges, and public institutions of higher education are required by law to be part of the pool. All Oregon school districts are required by law to be part of a separate school district pool.

4. Why do individually rated employers tend to have rate volatility as compared to those governments that have been actuarially pooled?

PERS is a pre-funded plan. This means the agency attempts to predict the cost of future benefits and fund for them before they are due. The advantage of this method is that investment earnings can assist in paying benefit costs. For Oregon PERS, this advantage has been significant. Employer contributions provide only 25 percent of the revenue needed to keep the PERS system fully funded, while investment earnings provide the rest.

To predict future pension costs, a number of assumptions must be made about the future experience of PERS members and the benefits they will accrue. Salary growth, retirement dates, number of disabilities, member mortality, number of refunds, and other demographic assumptions are among the assumptions developed.

To the degree that these actuarial assumptions are accurate, employer rates will be accurate as well. For the school district pool and the state agency pool, these assumptions have proven to be highly accurate. For individual employers, however, it is much less likely that these assumptions will accurately predict employee experience.

Example: One of the benefits PERS provides is a disability retirement. To properly fund the expected cost of disabilities, PERS must predict the future cost and charge employers accordingly. Based on past experience, PERS knows that fewer than 1 out of 1,000 members will become disabled in any particular year. Thus, each employer's rate includes a percentage to pay for disabilities based on this expectation. If an employer with five employees has one become disabled, that employer has experienced a 1 out of 5 disability rate, not the 1 out of 1,000 that it has been paying for. This kind of experience creates an unfunded actuarial liability (UAL) and the employer's rate must be increased, sometimes dramatically, to pay for the higher than expected level of benefits its employee group will receive.

In a pool, an employer that experiences a disability (or any other adverse actuarial experience) will share the costs of that experience with all the other members of the pool. Thus, the individual employer does not bear the entire cost. Also, it is much more likely that the pool will already be charging employers the proper amount for disability costs because predictions for large groups of employees tend to be more accurate than for smaller groups. Thus the prediction for disabilities is likely to be accurate for a pool. In this situation, the five-member employer's disability case will not increase rates.

The fewer employees an employer has, the less likely that assumptions about benefit levels will be accurate. In the Oregon PERS system, more than 60 percent of local governments have 10 or fewer employees (as of December 31, 2003). Because of the inability of individual employers to spread costs over a large payroll base, employer rates can and do swing dramatically from valuation to valuation.

As a result, individual employers may experience either an over-funded or under-funded situation, thereby causing potentially large swings in their employer rates as compared to those participating in a pool.

As stated previously, the primary advantage of pooling local governments is to provide increased rate stability to employers. Stabilized rates allow employers to budget pension costs with greater confidence.

5. Will the pooling of local governments save money?

Generally no. The reason for pooling is rate stability, not lower employer rates. But over the long term, the pool will likely be cost neutral for most employer participants.

6. Is pooling mandatory or voluntary for local government PERS employers?

Joining the SLGRP is voluntary for local governments, but, once enrolled, membership is permanent. Since the purpose of a pool is to promote rate stability, if employers were allowed to enter and leave at will, stability would be difficult—perhaps impossible—to achieve.

7. How does an employer join the pool?

To join the SLGRP, a local government employer must pass an ordinance or a resolution of its governing body and submit the resolution to PERS. The resolution or ordinance must be delivered to PERS on or before December 31 of the year preceding the effective date of entry into the pool (December 31, 2005 to join the SLGRP effective January 1, 2006). If mailed, the resolution or ordinance must be postmarked no later than midnight, December 31. Specific direction can be found in OAR 459 009 0070.

8. When would pooling begin for local governments electing to join the SLGRP?

Those local governments that pass resolutions or ordinances to join the pool and send them to PERS postmarked not later than December 31, 2005, will enter the pool effective January 1, 2006. Employers that send pooling resolutions to PERS between January 1, 2006, and December 31, 2007, will enter the pool effective January 1, 2008.

9. When would rates change based on membership in the SLGRP?

For employers joining the pool effective January 1, 2006, rates would first be adjusted based on pool membership as of July 1, 2009, based upon the results of the 2007 Actuarial Valuation.

10. What would our employer rate be if we join the SLGRP effective January 1, 2006?

PERS can request an actuarial calculation to estimate an individual employer's rate after pooling. However, there would be a cost for this calculation, borne by the employer. For most employers the rate change would be less than 1 percent.

11. How are rates for the SLGRP calculated?

Rate estimates and the actual rates each employer will pay will depend in part on each employer's actuarial surplus or unfunded liability at the time the employer enters the pool. There are three primary components to the employer rate:

- "Normal Cost," which is the projected future cost of those employees who have yet to retire;
- "Actuarial surplus" or "unfunded actuarial liability" amortization, which is the difference between actuarially projected assets and actuarially projected liabilities; and
- Pooled costs related to the PERS retiree health insurance program (RHIA).

Under the second bullet above, employers that participated in the Local Government Rate Pool will have a component related to the experience that emerged for that pool.

The normal cost rate will be adjusted for employers with a mix of General Service and Police & Fire employees as outlined later in this Q & A. Projected cost-of-living adjustments (COLAs) for future retirees are included in the normal cost part of the rate, but normal cost does not include the amortization of an individual employer's unfunded actuarial liability or surplus, nor does it include the cost related to the health insurance pool. The amortization of outstanding liability/surplus will increase or decrease the employer's total rate depending on the funded status of the individual employer at the time of joining the pool. The health insurance pool rate will add 0.59 percent to the pooled rate (based on the 2003 Valuation).

12. Will the SLGRP be responsible for actuarial liabilities or surpluses that existed prior to the employer's entry into the pool?

No. Actuarial liabilities or surpluses that existed prior to the employer's entry into the pool will remain the sole responsibility of the individual employer. None of these prior liabilities or surpluses will be passed on to the pool.

13. How will the amount of the pre-pooling unfunded actuarial liabilities or surpluses be determined?

Step one will be to set aside from the pooled liability the amount of the employer's actuarial liability or surplus as reported in the latest Actuarial Valuation. This is called the transition liability or surplus. The transition liability or surplus will remain the sole responsibility of the individual employer so that the SLGRP will not fund the costs of liabilities or benefit from the surpluses accrued by a local government prior to pooling.

14. How will these transition liabilities or surpluses be eliminated?

For employers joining the pool as of January 1, 2006, the transition liability or surplus will be amortized for up to 22 years from that date. For employers joining the pool after that date, the amortization period will be based upon the Board-approved amortization period in effect at the time the employer joins the pool. The employer will be charged (if liability) or will receive (if surplus) interest based upon the Board's assumed rate (currently 8 percent). The actuary will calculate for each employer an amortization schedule that will result in the elimination of the transition liability or surplus within the approved amortization period. The pooled rate for each employer will be adjusted upward or downward by an amount sufficient to meet the amortization schedule.

This amortization schedule will change should the Board change the assumed earnings rate. If the assumed earnings rate goes up, rate reductions from transition surpluses will be increased and the rate add-on from transition liabilities will also increase. If the assumed earnings rate is decreased, employers with transition surpluses will not see as much benefit and the cost to employers with transition liabilities will go down.

Every valuation period, the actuary will review the actual contributions received from each employer to ensure amounts received (for under-funded employers) or contribution reductions (for over-funded employers) are sufficient to amortize the transition amount. If the actual contributions received result in an over- or under-payment, the employer's rate will be adjusted to ensure that the amortization schedule is maintained.

This methodology will ensure that each employer will get full credit for its transition surplus or pay off its transition liability without any pre-pooling surplus or liability being assumed by the pool.

15. Employers may pay off their transition liabilities. How does this work?

Employers with an unfunded actuarial liability (including a transitional liability) may choose to pay off all or part of that liability through a lump-sum payment to PERS (supplemental UAL payment). This is possible regardless of whether or not the employer has joined the pool. Reducing or eliminating the unfunded actuarial liability will cause the employer's rate to be reduced. OAR 459-009-0084 and 0085 define this process.

For employers that want to make a supplemental UAL payment, PERS will ask the employer to provide a notice of the amount it intends to pay, and the proposed payment date, at least 45 days prior to the proposed payment date. The PERS actuary will then recalculate the employer's rate with an effective date of the first of the month following the date of the payment.

This methodology gives employers the ability to time their payments and also allows PERS to give employers prompt credit for their payments through a reduced employer rate.

16. How will actuarial gains and losses that arise <u>after</u> employers enter the pool be treated?

The actuarial gains and losses arising on or after the employer enters the SLGRP will become surpluses or liabilities of the pool. These surpluses or liabilities will be averaged and amortized over the Board-approved amortization period. The pooled component of each employer's rate will be adjusted up or down depending on whether the pool has a net surplus or liability. This methodology is the same as that used for a non-pooled employer. The only difference is that gains and losses in a pool are shared.

Employers that join the pool in the future will have their pooled employer rate adjusted so that the pool's actuarial gains or losses prior to the employer's entry date will not be included in the joining employer's rate.

17. What will happen to the balance in an individual employer's contribution account if the employer joins the SLGRP?

The employer's contribution account balance will be consolidated into a single contribution account for all local governments that have joined the pool. Earnings distributions and retirement charges after the date the employer joins the pool will be made to the pooled account, not to the individual employer's account. Only received contributions will be tracked by individual employer. This is necessary for the annual reconciliation process and provides the information that allows the actuary to determine whether each employer has made payments in accordance with its transition liability/surplus amortization schedule.

18. What costs will be included in the SLGRP's employer rate?

The components of the employer rate will be as follows:

- Normal cost to fully fund the member's benefit at the time of projected retirement (pooled);
- Addition or reduction to amortize the pool's biennial gains or losses (pooled);
- Addition or reduction to accurately amortize the transition liability or surplus amount (<u>not</u> pooled);
- For members of the Local Government Rate Pool only, an addition or reduction to accurately amortize the transition liability or surplus amount generated by the LGRP (pooled among LGRP members);
- Health insurance program costs (two pooled rates: one for state agencies/community colleges that includes RHIA and the retiree health insurance premium account (RHIPA), and one for all other participants in the pool that includes only RHIA).

These components are no different from those that make up non-pooled employer rates except for the addition or reduction in the rate to amortize the transition liability or surplus. Also, non-pooled employer rates currently have a 6 percent minimum no matter how well-funded the employer is. For employers that join the pool, the 6 percent minimum rate will be removed to allow for the full amortization of a transition surplus. As a result, some non-pooled employers that are currently paying the 6 percent minimum rate may pay a total pooled rate of less than 6 percent. The minimum contribution rate for pooled employers is the rate for the retiree health insurance premium, currently 0.59 percent.

Note: Contribution rates for the Oregon Public Service Retirement Plan Pension Program (OPSRP) are not included in the SLGRP rate. All employers are already pooled for OPSRP for actuarial purposes and pay a separate rate to fund that pension program.

19. How will the rates for the SLGRP be assigned so that general service employers do not subsidize employers with police and fire?

Because P&F members are eligible for higher benefits, contribution rates for P&F employees have historically been higher than the contribution rates for GS employees. Because of this, in the pool a P&F rate is calculated based solely on the experience of the P&F employees in the pool. A separate rate is calculated based upon the experience of GS employees in the pool. Each employer's total normal cost rate will be calculated by multiplying the GS pooled rate times the GS payroll to get the employer's GS cost. The P&F rate will be multiplied times the employer's P&F payroll to get the employer's P&F cost. By dividing the sum of the P&F and GS costs by total payroll, the actuary will provide an employer rate that represents a composite of its P&F and GS employee costs. As a result, each employer pays a rate proportionate to its P&F and GS member makeup.

Gains and losses caused by deviations from the anticipated experience will become part of the pool. However, the P&F experience and GS experience will be reviewed in every rate-setting valuation and the respective rates will be adjusted accordingly. Employers with P&F employees will pay for related P&F costs and employers with only GS employees will not subsidize P&F employers.

20. How are mergers and consolidations handled when one or both of the combining entities are in the pool?

OAR 459-009-0070 describes how mergers and consolidations will be handled. If two non-pooled employers merge or consolidate, the employer that results after the merger or consolidation may join the pool, subject to the same terms as any other local government electing to join. If the merger or consolidation involves one pooled employer and one non-pooled employer, the rule describes how the pooled and non-pooled employees will be treated. If both of the merging or consolidating employers are pooled, the resulting employer will be pooled.

21. Since some employers in the SLGRP offer the unused sick leave benefit and other employers in the pool do not, how does the pool allocate the resulting difference in costs?

All costs related to the use of accrued sick leave in the calculation of member benefits are shared by all participants in the pool, regardless of whether they provide this benefit to their employees or not. Because the Money Match benefit calculation does not use sick leave in the calculation of benefits and because Money Match represents a significant part of the liability for future Tier One retirees, costs related to this benefit should have a minor impact on the pool.

22. If an employer in the SLGRP has mostly Tier Two employees, does the employer pay the same normal cost as an employer with mostly Tier One employees?

No. The actuary calculates separate normal cost rates for Tier One and Tier Two employees. These rates are applied as a composite based upon the proportion of an employer's Tier One and Tier Two payroll to total payroll, using the methodology described for calculating P&F and GS rates in question #19.

23. How are disability costs divided among the employers in the pool?

Disability costs are projected by the actuary and are included in the normal cost part of the pooled rate. Because of this, all pool participants pay the same "disability rate" regardless of the disabilities experienced by individual pooled employers.