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November 15, 2012

VIA E-MAIL

Paul Cleary
Executive Director
Oregon PERS

Re: Request Number: 2012-008
Cost Allocation and Benefit Design Concepts Regarding Member Contributions and Employer Pick-up

Dear Paul:

Per your request, this letter provides an estimate of the potential effects on PERS Tier 1/Tier 2 and OPSRP liabilities of the following concepts related to member contributions to the Individual Account Program (IAP) and the practice of employers paying that contribution as a "pick-up":

- End the ability of employers to pick-up the 6% of payroll member contribution to the IAP
- Allow electing employers to pick up only a portion of the member contribution, such as 3% of payroll
- Eliminate the IAP contribution entirely
- Reduce the contribution to the IAP

The concepts listed above fall into two general categories. The first two concepts change the allocation of cost associated with the IAP contributions and benefits by either allowing or mandating cost-shifting from employers to members for situations where the employer currently assumes the cost. The last two concepts change the actual level of contributions (and thus, ultimately, benefits) associated with the IAP, not just the cost allocation of those contributions.

While the two approaches – cost reallocation versus contribution level changes – differ in significant respects for both members and employers, they can be viewed as essentially identical in terms of their impact on the defined benefit portion of the system. Our understanding is that the impact on the PERS defined benefit program of any change to the IAP contribution level – or employers' ability to pick up that contribution – would occur solely for members that satisfy all of the following conditions:

- Members in either Tier 1 or Tier 2
- Member contributions are paid by their employer as an "Employer Paid Pre-Tax" contribution (EPPT)
- Retirement benefits are based on Full Formula or Formula Plus Annuity.

For affected members, these proposals would reduce annual covered salary and, ultimately, the Final Average Salary (FAS) used for benefit calculation purposes, because EPPT is included in covered salary. The FAS is used in both Full Formula and Formula Plus Annuity calculations, but does not affect Money Match benefit calculations.

A reduction or elimination of the IAP member contribution would not affect the OPSRP benefits payable for OPSRP members, as any EPPT contributions are already excluded from covered salary in calculating OPSRP benefits.

Because either approach would have the same impact for this analysis, the results shown below do not distinguish between reduced employer IAP contributions arising from the concept of prohibiting employer pick-up of the contribution versus from the concept of eliminating the IAP contribution entirely. Distinctions between the concepts are discussed later in the letter.

The table below summarizes the December 31, 2011 valuation results under the current 6% IAP contribution level, as well as the effect of either a 3% or 0% IAP contribution and/or pick-up level. In developing these results, it was assumed that Tier 1/Tier 2 members reported for the valuation as receiving EPPT contributions would continue to receive them in the future to the extent permissible. In the most recent valuation, approximately 80% of Tier 1/Tier 2 payroll was for members whose IAP contributions were picked up.

“Accrued Liability” refers to the net present value of projected future benefits allocated to service already completed as of the valuation date in accordance with the current actuarial cost allocation method, while “Total Liability” includes the value attributable to anticipated future service for current active members. The contribution rate shown is a blended rate reflecting the weighted averages of Tier 1, Tier 2 & OPSRP payroll as of the valuation date. The contribution rate is shown on an “uncollared” basis.

	12/31/2011 Total Liability ($B)	12/31/2011 Accrued Liability ($B)	12/31/2011 Normal Cost ($B)	2013-2015 Uncollared Base Employer Contribution Rate (% of payroll)
12/31/2011 Valuation Results	$69.19	$61.20	$0.69	23.7%
Reduce IAP Contribution and/or Pick-up to 3%	(0.33)	(0.15)	(0.02)	(0.4%)
Eliminate IAP Contribution and/or Pick-up	(0.65)	(0.30)	(0.04)	(0.7%)

Our analysis estimates the impact if these changes had become effective on December 31, 2011. A change at that time would have affected both the December 31, 2011 actuarial liability and 2013-2015 employer contribution rate calculations. While any change would occur at a later date, estimating the impact as of a December 31, 2011 snapshot date allows for direct comparison to liability and employer contribution rate calculations from the most recently completed actuarial valuation.

Analysis and Other Considerations

The results shown above represent only the estimated impact of these concepts on Tier 1/Tier 2 and OPSRP combined employer rates. Any of these changes would produce other significant impacts for employers and members. For example, the concept of prohibiting employers from picking up the IAP contribution would lower overall compensation costs by 6% of payroll for employers currently paying member contributions, assuming no additional benefits or compensation are provided in its place. Meanwhile, members working for those employers would experience a reduction in their take-home pay as they would be required to pay the contribution themselves. For the concept where the IAP contribution itself is eliminated, members would not experience a reduction in take-home pay but would have lower projected retirement savings in their individual account. Members currently paying IAP contribution themselves, with no employer pick-up, would see an increase in their take-home pay if IAP contributions were eliminated.

Please note that the results presented do not attempt to assess the impact of any potential changes in pay practices, collective bargaining agreements, or member behavior that could occur if such a change were made. For example, if these changes led employers and members to negotiate pay or other benefit increases to partially or fully replace the value of reduced IAP contributions, this could partially or fully offset the reduction in liabilities and contribution rates shown above by increasing the FAS calculation. An employer that provided a base pay increase to offset elimination of EPPT, for example, would see the liabilities increase for its OPSRP members as EPPT is not included in the Final Average Salary calculation for OPSRP members but base pay is included.

Varying Impact on Member Benefits

The impact on the benefits received by members will vary according to the member's individual situation. For Tier 1/Tier 2 members who do not receive EPPT contributions, and for all OPSRP members, a change in the pick-up payment or IAP contribution rates won't affect the benefits they receive from the defined benefit program. However, changing the contribution to the IAP will affect the account balance available at retirement. That impact is not illustrated in this letter.

For Tier 1/Tier 2 members who do receive EPPT contributions, the benefit impact will depend on the benefit calculation formula that governs the benefit. For a member where the Money Match formula provides the greatest benefit at retirement, changing the pick-up or IAP contribution amounts (and thus Final Average Salary) will not affect the benefit. For a member with a benefit determined under either the Formula Plus Annuity or Full Formula methods, the benefit will be reduced, all else equal.

Data, Methods, Assumptions and Provisions

Other than the exceptions and additions noted below, the data, methods, assumptions, and plan provisions used to calculate employer contribution rates are the same as those used in the December 31, 2011 system-wide actuarial valuation report. That information, including a discussion of the inherent limitations of use of actuarial valuation results, is herein incorporated to this letter by reference.

The concepts studied would reduce or eliminate the value of the EPPT included in covered salary for some Tier 1/Tier 2 members. In our analysis, we assumed this change would apply to payroll earning after January 1, 2012. To estimate the reduction in plan liabilities resulting from these concepts, we modified the calculation of FAS to include the modified level of IAP contributions for the given scenario. We only applied this adjustment to members reported by PERS as receiving EPPT contributions in the December 31, 2011 actuarial valuation census data. In other words, we assumed that any members receiving EPPT contributions at the valuation date continue to receive them in the future to the extent EPPT contributions are allowed. In the December 31, 2011 actuarial valuation, about 80% of Tier 1/Tier 2 payroll was attributable to members who receive EPPT contributions. Our analysis assumed that a reduction or elimination of EPPT and/or the IAP contribution does not affect the underlying “subject salary” upon which PERS employer contribution rates are levied.

In calculating the illustrative changes in uncollared employer base contribution rates shown above, we assumed all changes in Accrued Liability were amortized over a 20-year period as a level percent of payroll using current valuation assumptions. This is the method currently used in the valuation when establishing new Tier 1/Tier 2 amortization bases. If a different amortization method were used, the overall impact on employer rates could be significantly different than shown in this letter.

ACTUARIAL BASIS AND QUALIFICATIONS

In preparing this letter and the valuation report on which it is based, we relied, without audit, on information (some oral and some in writing) supplied by Oregon PERS. This information includes, but is not limited to, statutory provisions, employee data, and financial information. We found this information to be reasonably consistent and comparable with information used for other purposes. The updated estimates depend on the integrity of this information. If any of this information is inaccurate or incomplete our results may be different and our calculations may need to be revised.

All costs, liabilities, rates of interest, and other factors for the System have been determined on the basis of actuarial assumptions and methods which are individually reasonable (taking into account the experience of the System and reasonable expectations); and which, in combination, offer a reasonable estimate of anticipated experience affecting the System.

Future actuarial measurements may differ significantly from the current measurements presented in this estimate due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan's funded status); and changes in plan provisions or applicable law. Due to the limited scope of this estimate, we did not perform an analysis of the potential range of future measurements. The Board has the final decision regarding the valuation assumptions and adopted the assumptions used in the December 31, 2011 valuation in July 2011.

Actuarial computations presented in this estimate are for purposes of providing a high-level analysis of the requested concepts for changes to the System. As such, they cannot be relied upon for financial reporting or other purposes, and calculations for purposes other than this use may be significantly different from the estimates contained in this letter. Accordingly, additional determinations may be needed for other purposes.

Milliman's work is prepared solely for the use of Oregon PERS. To the extent that Milliman's work is not subject to disclosure under applicable public records laws, Milliman's work may not be provided to third parties without Milliman's prior written consent. Milliman does not intend to benefit or create a legal duty to any third party recipient of its work product.

No third party recipient of Milliman's work product should rely upon Milliman's work product. Such recipients should engage qualified professionals for advice appropriate to their own specific needs.

The consultants who worked on this assignment are pension actuaries. We have not explored any legal issues with respect to the change concepts. Milliman's advice is not intended to be a substitute for qualified legal or accounting counsel.

On the basis of the foregoing, I hereby certify that, to the best of my knowledge and belief, this report is complete and accurate and has been prepared in accordance with generally recognized and accepted actuarial principles and practices. I am a member of the American Academy of Actuaries and meet the Qualification Standards to render the actuarial opinion contained herein.

If you have any questions about our response or need any additional information, please let us know.

Sincerely,

Matt Larrabee, FSA, EA
Consulting Actuary

MRL:sdp
encl.

cc: Steve Rodeman
Debra Hembree,
Scott Preppernau

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