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February 20, 2017

VIA E-MAIL

Steve Rodeman
Executive Director
Oregon PERS

Re: Actuarial Analysis of Accelerated Disbursement Option (ADO) Concept

Dear Steve:

This letter relates to your request to analyze PERS member census data in response to an inquiry regarding the actuarial effects of offering a potential Accelerated Disbursement Option (ADO). Prior to conducting any census analysis, I felt it was necessary to better understand the proposed ADO concept. To accomplish this and obtain familiarity with the mathematical operation of the proposed ADO's mechanics, I reviewed the relevant section of a document titled *PERS Realignment Strategy for Oregon*. My understanding is that the document was prepared by a committee of the Medford/Jackson County Chamber of Commerce.

The document attempts to illustrate a reduction in Unfunded Actuarial Liability (UAL) of $9.063 billion (from $21.800 billion to $12.737 billion) due to offering the ADO. The UAL reduction indicated in the document has two component sources:

- The majority of the indicated UAL reduction comes from the issuance of a $6.574 billion bond to pay immediate lump sums of $6.574 billion to members electing the ADO.

- The remaining $2.489 billion of UAL reduction comes from the difference between the present value of the Actuarial Accrued Liability of the electing members ($9.063 billion) and the amount distributed to those members via the ADO ($6.574 billion). That difference occurs because the value of the distributed ADO lump sums is materially below the present value Actuarial Accrued Liability for the electing members. Stated in percentage terms, the reduction from the Actuarial Accrued Liability present value to the value distributed via ADO lump sums in the document is 25% for current retirees (referred to as "Tier 1 Active Recipients" in the document) and 33% for other members.

Regarding the first bullet, the issuance of a $6.574 billion bond to pay $6.574 in lump sum ADO benefits would not reduce the system-related unfunded liability obligation. Our calculation of the most-widely circulated UAL figure ($21.8 billion in the most recent valuation) excludes from considered assets the value of prepaid employer contributions deposited into the PERS trust via issuance of employer-bonded debt. While the proceeds derived from employers issuing bonds will be used to help those employers fund future PERS contributions over time, establishment of the debt itself does not modify the present value of projected future system benefit payments.

The employers that issue pension-related debt have not reduced their financial burden, they have merely reorganized it.

The same principles apply with the ADO-related debt in my opinion. Disbursing $6.574 billion in lump sum benefit payments, while simultaneously establishing $6.574 billion in additional pension-related debt does not modify the overall unfunded liability burden of PERS. It merely modifies the nature and timing of the payments (and, depending on the bond arrangement, possibly the parties with responsibility) to recover from the system's overall underfunded position.

Regarding the second bullet, I think there are several reasons why the $2.489 billion UAL reduction indicated in the document would not occur. Please note that Milliman is not a law firm and cannot provide legal advice. I recommend PERS solicit guidance from legal counsel on the potential legal issues noted below, which I raise based on my professional experience rather than from legal training.

- **Potential legality of providing reduced benefits** – As noted above, the ADO as structured in the document provides lump sums in amounts that are 25% less than the Actuarial Accrued Liability (AAL) for currently retired members and are 33% less than the AAL for members who are not yet retired. We are not certain that offering members lump sums in amounts less than a present value measure of their benefits attributable to service already performed (AAL) would be legally permissible.

- **Potential legality of providing lump sum benefits to current retirees** – For ongoing private sector pension plans (i.e., plans not in the process of termination), the Department of Labor has recently published formal written notice that offering a settlement lump sum of the actuarial present value of estimated remaining monthly payments to current retirees is not legally permissible. The same legal prohibition may be in effect for PERS retirees. (The majority of the UAL reduction indicated in the document comes from lump sum ADO distributions to current retirees.)

- **Potential legality of providing lump sum benefits to current actives** – For private sector pension plans, an "in-service" lump sum distribution of benefits for an ongoing plan is legally impermissible. The same legal prohibition may be in effect for distribution to members currently in PERS-covered employment. (The second largest portion of the UAL reduction indicated in the document comes from lump sum ADO distributions to active members currently in PERS-covered employment.)

- **Rates of voluntary program election** – As detailed in the document, the illustrated UAL reduction occurs because 20% of current retirees and 25% of not-yet-retired members elect the ADO. As noted above electing members of those two groups would have 25% and 33% decreases, respectively, in the present values of their projected PERS benefits by electing the ADO. The ADO as proposed in the document would be a time-limited "window" offering to members. Forecasting the member election rate for a window offering is challenging. In my professional experience, all prior window offerings I have encountered included a time-limited increase in the present value of future benefits to incent participation. A program such as the one illustrated in the document, that offers a one-time material decrease in the present value of future benefits (if legally permissible) would not see high program participation levels in my professional opinion. Further, to the extent that any material level of participation actually occurred, the profile of electing participants might show what is actuarially referred to as *anti-selection*.Anti-selection would occur if most members electing lump sums did do so because their personal health situations would lead them to conclude that the ADO lump sum offer is more valuable than a series of monthly lifetime pension payments. If the electing members' assessments were correct, the anti-selection would lead to the window offering increasing long-term system costs.

After obtaining a detailed understanding of the mechanics of the ADO as illustrated in the document, we did not proceed with a detailed ADO-related census analysis. That decision was made due to factors cited above regarding the financial efficacy and potential issues of legal permissibility of the ADO, combined with a concern that undertaking such an analysis would not be an optimal use of agency financial resources.

ACTUARIAL BASIS AND QUALIFICATIONS

In preparing this letter and the valuation report on which it is based, I relied, without audit, on information (some oral and some in writing) supplied by Oregon PERS (the "System"). This information includes, but is not limited to, statutory provisions, employee data, and financial information. I 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 the results may be different and the 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, additional cost or contribution requirements based on the plan's funded status, or a change in the cost allocation method); and changes in plan provisions or applicable law. Due to the limited scope of this estimate, I 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, 2015 valuation in September 2015.

Actuarial computations presented in this estimate are for purposes of providing a high-level analysis of the requested change concepts 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. 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. While identifying potential issues based on professional experience, I 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.

The signing actuary is independent of the System. I are not aware of any relationship that would impair the objectivity of Milliman's work.

On the basis of the foregoing, I hereby certify that, to the best of our 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 members 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 me know.

Sincerely,

Matt Larrabee, FSA, EA, MAAA
Principal and Consulting Actuary

MRL:sdp

cc: Marjorie Taylor (PERS), Debra Hembree, (PERS), Scott Preppernau (Milliman)

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