HOUSE COMMITTEE ON PUBLIC EMPLOYEE RETIREMENT SYSTEM

April 01, 2003 Hearing Room E
3:00 PM Tapes 41 - 42

MEMBERS PRESENT: **Rep. Tim Knopp, Chair**
Rep. Alan Brown, Vice-Chair
Rep. Deborah Kafoury, Vice-Chair
Rep. Jeff Barker
Rep. Tom Butler
Rep. Greg Macpherson
Rep. Mary Nolan
Rep. Dennis Richardson
Rep. Wayne Scott

STAFF PRESENT: **Cara Filsinger, Administrator**
Annetta Mullins, Committee Assistant

MEASURE/ISSUES HEARD: **HB 2003 – Public Hearing**
HB 2008 – Public Hearing
HB 2020 – Public Hearing
HB 3169 – Public Hearing

These minutes are in compliance with Senate and House Rules. Only text enclosed in quotation marks reports a speaker's exact words. For complete contents, please refer to the tapes.

TAPE/#	Speaker	Comments
Tape 41, A		
003	Chair Knopp	Calls meeting to order at 3:22 p.m. and opens a public hearing on HB 2003.
HB 2003 – PUBLIC HEARING		
011	Bill Gary	Comments that he responded to the Legislative Counsel opinion on HB 2003 and HB 2004 in his letter dated March 26 **(SEE EXHIBIT G OF COMMITTEE MINUTES DATED MARCH 27, 2003).** Speaks to the issued detailed in the March 26 letter, beginning with contract rights.
075	Gary	Continues presentation.
110	Gary	Continues presentation.
123	Gary	Comments on the elimination of the six percent employee contribution contained in HB 2003.
134	Gary	Comments on the Lipscomb decision relating to paying the cost of the errors out of future earnings.
195	Gary	Comments on the urgency of getting HB 2003 passed and to the court for a decision.
213	Rep. Nolan	Asks if Gary said the only way for the state to enter into a contract is through statute or action of the legislature.
	Gary	Responds that the legislature can delegate to agencies the power to enter into contracts. The only court decisions that have found contractual rights are contractual rights in enacted statutes. The legislature defines the program through enactment of the statute and the job of the PERS Board is to administer the program and calculate the benefits that are provided by statute.

235	Rep. Nolan	The courts have only found contractual rights in the actions of the legislature. It is not the same as saying the courts have found further actions lack the force of contract and no other mechanism can create a contractual right. States that she does not think the courts have said the latter part.
	Gary	Responds that Rep. Nolan is correct. In the context of PERS there is no case that holds that the PERS Board does not have the power to create contractual obligations on the part of the state. The argument has never been litigated or presented to the court or the PERS Board. States that the attorney general has advised the PERS Board that it does not have the power to make contractual promises to PERS members. Adds there is a long line of judicial decisions which hold that members who deal with state agencies and rely on promises that are made by state agencies that go beyond the statutory authority of the agency do not have any rights.
272	Rep. Nolan	Comments she believes the question is whether actions taken by the Board were in derogation of the statutes or actually implemented the statutes and the statutes let stand policy decisions that in retrospect may not have been very wise.
	Gary	Responds that he is comfortable with the question being phrased that way if the issue is, as Legislative Counsel suggests, if a promise was made such as in the context of mortality tables they were promised by the Board they would use outdated mortality tables, then the question is did the legislature delegate to the PERS Board the authority to make that commitment. One way to look at that is to examine the statute to see if there is any evidence that the legislature intended to empower the PERS Board to increase benefits beyond those provided by statutes through a mechanism such as the use outdated mortality tables. Legislative Counsel says that is the question. State that it is surprising that Legislative Counsel doesn't answer the question. It seems the answer is obvious if one is familiar with the PERS statutes—the legislature never had that intent.
297	Rep. Barker	Comments he does not think the six percent can be changed without crossing the line.
	Gary	Responds that Rep. Barker is right in the sense this has been a part of the structure of PERS for a long time. Thinks the idea of eliminating the requirement of the employee contribution is not outside-the-box kind of idea. It is also a little counter intuitive because one would think eliminating the requirement that the employees contribute six percent would mean that the cost to the employer would go up; it does not. The effect of eliminating the employee contribution is that over time it diminishes the impact of the money match benefit. That is why it would save money. The argument that it breaches a contract right to eliminate the employee contribution has to be based on the fact that the money match itself is a contract right. They do not think there is a contract problem with eliminating the employee contribution.
376	Gary	Comments on the court decision on Measure 8. The decision does contain language that suggests there is a problem with changing benefits on a prospective basis. Thinks that is the most vulnerable aspect of the decision. The effect of eliminating the employee contribution is that it freezes the accrued benefits of

		members.
400	Rep. Barker	Comments on the need to escrow the money from changes in PERS until a court decision is made.
	Gary	States there will be a challenge to anything that saves money, and it would be prudent to not tie the horse to the decision until it has been upheld.
497	Chair Knopp	Closes the public hearing on HB 2003.
TAPE 42, A		
027	Chair Knopp	Opens public hearings on HB 2008, HB 2020, and HB 3169.
<u>HB 2008, HB 2020 AND HB 3169 – PUBLIC HEARINGS</u>		
	Rep. Greg Macpherson	Presents proposal for successor retirement plan **(EXHIBIT A).**
164	Rep. Macpherson	Continues presentation, commenting on cost of new system.
183	Rep. Macpherson	Continues presentation, explaining "Individual Account Program" **(EXHIBIT A).**
241	Rep. Macpherson	Continues presentation, speaking to investments pooled and professionally managed.
267	Rep. Barker	Asks what "final average salary" means.
	Rep. Macpherson	States this is in the drafting process and it will be explained in the proposed amendments; it is essentially a base pay definition.
262	Rep. Barker	Comments that the averages vary in length.
	Rep. Macpherson	Responds that his plan would use the same averaging rule as the current PERS system does.
	Rep. Barker	Asks if the disability at retirement, based on 10 years worked, would be based only on the 10 years worked.
	Rep. Macpherson	Explains how the disability would be determined.
	Rep. Barker	Asks what the final average salary would be.
	Rep. Macpherson	Explains it would depend on whether it was a service-connected disability. The final average salary would increase so it would keep pace with a comparable position. If it was not service connected, then it would not increase with the final average salary.
337	Rep. Barker	Asks if the replacement rate is capped at 45 percent of average salary.
	Rep. Macpherson	Responds it is not capped. If the person chose to work beyond the 30 years, they would continue to accrue the additional benefit. If a general service member worked for 40 years, they could get to a 60 percent pension. That is consistent with the objective that we need to build in inducements to public employees to continue providing service as long as they are ready, willing, and able to do that.
382	Rep. Butler	Asks if this would take away a portion of a person's retirement if they decided to work after retirement.
	Rep. Macpherson	Responds that this proposal would not take away any benefits from people who continue to work. The same current rule would apply if the person works more than 1040 hours in a year; they could not draw retirement and income.
393	Rep. Barker	Asks if a two-percent cost of living adjustment (COLA) is normally in private plans, and is the cost of the system rolled into the 8.08 payroll costs.
	Rep. Macpherson	Responds that the COLA is part of the 8.08 payroll expenses. The COLA is common in public plans but is fading in private plans.

421	Rep. Butler	Asks how much the outside disability benefit might cost and who would bear the cost.
	Rep. Macpherson	Responds that the amendments he will be bringing to HB 2008 anticipate there will be another vehicle that will provide a disability benefit available, particularly to our public safety employees because they put themselves in harms way. Believes it is important that we take care of them when they are stricken down. Explains that he has not attempted to build it into the amendments. A disability plan is something different and is an important part of the benefit package, and should be costed separately. States he would be pleased to work with members of the committee to determine what that should look like.
TAPE 41, B		
013	Rep. Butler	Asks if an employee is not covered by State Accident Industrial Fund (SAIF).
	Rep. Macpherson	Responds he believes workers' compensation is provided to public employees, and is not sure how workers' compensation fits with the disability benefit that is provided under PERS and other disability coverage.
030	Rep. Butler	Asks how many stakeholders have had input into the separate costing for the workers' compensation benefit or the disability benefit.
	Rep. Macpherson	States that the reference here is to retiree health benefits. Currently, part of the PERS system is retiree health benefits that provide coverage to individuals who retire before Medicare eligibility age. It is not strictly a retirement benefit. Believes a new system will be better if we take each of the pieces in small chunks. Believes designing a retirement program for new hires is the first order of business among this package. Believes there clearly needs to be a disability benefit. Believes retiree health benefits needs further discussion.
067	Rep. Butler	Comments that the employer contribution for the first five years under the Individual Account Program would not be vested. Asks if an employee has worked for three employers over the five years, some who have been contributing employers and some who have not bargained for that benefit, creates any kind of bookkeeping issue.
	Rep. Macpherson	Responds that Rep. Butler's question is one of the details he has not framed in his own mind. The question is what happens to the forfeited account that was contributed by the employer. The general expectation is that the forfeiture would apply as an offset against the employer's contribution and whether we trace the forfeiture back to each of the employers that made each contribution or whether the forfeiture is applied to the last employer's cost.
	Rep. Butler	Asks Rep. Macpherson if he envisions the current PERS system management would be the manager of the new retirement plan for public employees.
	Rep. Macpherson	Responds affirmatively.
106	Rep. Butler	Asks who the other stakeholders were at the table besides the Governor's office.
	Rep. Macpherson	Explains that this proposal has been described to selected members of the PERS Coalition through an arrangement by the

		Governor's staff and to a gathering of the local government employers and several members of the business community.
111	Rep. Brown	Asks if the Individual Account Program would be mandatory.
	Rep. Macpherson	Responds it would be mandatory for the employers who are in the PERS system now. There is no opportunity for employers to leave. Comments on uniformity for all public employees and administrative ease so individual employers are not striking special deals. On the Individual Account Program, the contribution level would be at six percent and could vary depending on what is provided by the employer and whether it is bargained or not.
149	Rep. Brown	Asks how the replacement rates compare with private industry.
	Rep. Macpherson	Comments on larger private employer plans. States this may be similar or a little on the high side. A typical pay replacement between the 401K side and the pension side for a larger private sector employer would often time be in the sixty to seventy percent of pay range that this is in.
182	Chair Knopp	Comments on costs and liability of the current PERS system and asks if the proposed plan is supportable and sustainable.
	Rep. Macpherson	Responds that anything that is done on the successor plan in the shorter term, next couple biennia, will not have a material impact on employer contribution rates. The proposal is a cheaper system than Tier II and will reduce employer contribution rates somewhat, but the impact is pretty gradual. With respect to the contribution rates, the key question is who is paying the member contribution. If the assumption is that when it is being picked up, it is being paid for by the employer and not the employee, then the analysis saying this is blended across the entire population is a 14 percent of pay plan—eight percent from the employer and six percent from the member.
	Macpherson	Adds that the six percent is a member contribution and if we don't provide it in a retirement benefit, employees will and should, expect to get the six percent in some other way because it was part of the package that was n the bargaining table and we cannot convince them to give it up at the bargaining table at one point and then at some later point decide it wasn't theirs anyway. States that the six percent is not set in statute so whether that contribution is picked up and whether it stays at six percent, is open to the bargaining process. There is an opportunity to reconfirm who is paying the contribution. Believes that is a significant aspect of the cost-sharing dimension of this proposal.
258	Chair Knopp	Asks why not make the six percent optional for the employee.
	Rep. Macpherson	Comments that could not be done without going into other provisions of the Revenue Code. States that Section 401A of the Tax Code, the provision that governs both of the programs that are a part of this proposed plan, does not allow governmental employers to use Section 401K, which allows individual election. The only way you can get individual salary reduction elections by governmental employees is by using Section 457, which is available now to all public employees in the state, and Section 403B for certain employers. Explains that individual elections can be done. It would be something each employer or the employer and the bargaining unit at the bargaining table could decide.

293	Rep. Richardson	Comments on the need for predictability of costs for employers. Asks how the unknowns of a system affect the balance between employer and employee risk.
	Rep. Macpherson	Responds his proposal has a defined benefit element, and that a substantial portion of the plan has become a defined contribution plan; it is a sharing of the predictability between employer and employee. The pension plan is predictable to the employee. It is a scaled down version of a define benefit plan that now exists. We are taking a system that has cost sharing between employee and employer with all the predictability in favor of the employee and the employer at risk for what happens to the contribution rate to one in which the system has been split so a portion is a core defined benefit that is predictable to the employee and unpredictable due to the vagaries of the stock market to the employers. In the Individual Account Program is just the opposite. There is great predictability by the employer and the employee is left with the uncertainties of what the market might generate. It has opportunity in it too because if the market becomes strong, it will perform well for the employees.
351	Rep. Richardson	Comments that disability is not included in the proposal and it is possible that the base portion could be as expensive as Tier II is presently.
	Rep. Macpherson	Responds that Rep. Richardson is right. Adds that it is not comparing apples to apples in terms of the benefit being delivered between Tier II and the pension program. The removal of the disability benefit from the retirement system is a significant cost savings.
375	Chair Knopp	Comments that it is about 50-50, overall the cost is about .75 percent for disability.
	Rep. Richardson	Comments that employers come from different geography and different financial position with different goals and mixes and some may feel it would be important to be able to attract younger employees who might be more interested in a better salary than a rich retirement plan. Asks if a defined benefit plan favors older employees rather than younger employees who may come and go.
	Rep. Macpherson	States he disagrees with the characterization but agrees with the fundamental difference incentive effect of the two different designs of the plan. A pension plan is more attractive to older workers and is an incentive to give inducement for employees to remain in a full career service. If the proposal were a pension program only, then it would be flawed and believes it is a flaw in the existing PERS system. While it is a very generous program to the full career people who are approaching retirement age, it does not offer so much to people who are early in their careers. In the proposal, we have the Individual Account Program with the six percent of pay that is fully vested and the opportunity for employers who want to enhance that to provide something more for the younger workers, there is something there for younger workers as well. One of the advantages of this design is it has something for both groups.
TAPE 42, B		
020	Rep. Richardson	Asks if Rep. Macpherson feels that we can afford to start off with a base of 8.08 and the six percent.

	Rep. Macpherson	States that the contribution is eight percent of pay by the employer and six percent by the member. If one assumes the employee contribution is being paid by the employer and the employees are not giving up six percent, the dynamic of collective bargaining can work that out. Eight percent of pay is within a reasonable range of payroll costs. Comments on testimony by Ron Parker, Hampton Affiliates, on March 20, that the appropriate percentage of payroll for an employer to spend on the retirement benefits was seven to ten percent.
	Rep. Macpherson	States that in terms of affordability it is a question of what the markets are going to generate over time. Three years ago PERS was nearly 100 percent funded because of the very strong markets through the 1990s. Since then we have seen the costs spiral upward. If the markets recover, this is a plan that is readily affordable. If we continue to see declines in the markets, any program will be very expensive because the design is based on an eight-percent return figure.
086	Rep. Nolan	States she wants to discuss the replacement rates, which are an inverse of the employer costs. Asks if there is experience on replacement rations and employer contributions for hi-tech and knowledge-based employers, and what kind of pensions do they offer.
108	Rep. Macpherson	Responds that the hi-tech industries by and large do not have defined benefit plans because it is a younger work force and because the nature of the industry where long-term commitment to a company is not in their thinking. They want something that is portable, they see it in an account now and can measure it readily, and can take it with them. States that he sees the public sector functioning much more as a counterpart to the more mature industries in the private sector. Comments on various types of plans in different business.
143	Rep. Nolan	Comments on recruitments and the ability of a retirement plan to attract top talent. Asks how this proposal would attract and retain the best talent.
	Rep. Macpherson	Responds that he thinks the design works well for recruitment and retention of talent. Until a year or two ago defined benefit plans were not compelling to a lot of employees because they saw wonderful returns in the stock markets and if they had 401K accounts, they saw double digit returns year after year. But with the declines in the markets, defined benefit plans are being appreciated a lot more for their reliability. Believes that component will be significant to people who are making career decisions as they see the uncertainties of the defined contribution market place, even though it is appropriate for them to have a stake in that market place as well.
192	Rep. Macpherson	Adds that we will always have to be creative in public service about coming up with ways to bring top flight people in, and there will always need to be specially crafted arrangements aside from the structure of a general retirement program to attract people to certain key positions in public agencies.
182	Rep. Nolan	Asks if Mark Johnson used the eight percent assumed rate on earnings.
	Rep. Macpherson	Responds affirmatively.

	Rep. Nolan	Suggests that the committee asks Johnson to look specifically at a period of time that mirrors 1999, 2000, and 2001 returns to see what it would do to the employer rates should the economy go through another down cycle. States that she is betting that if we had run this out starting on January 1, 2000, that employers would be kicking in more than eight percent on this plan. States that the structure of the plan has some impact on the employer contribution, but probably not nearly as much as the performance of the market.
207	Rep. Macpherson	States Rep. Nolan is right that the main consideration and cost of a defined benefit pension system is what is earned on the assets that are contributed. The 8.08 percent is the normal cost of the program. That is what it would cost over the long term if this were the only system in place and we had this population in it. Thinks an analysis of what would happen if we had commenced this plan at a particular point in time and went through a number of years in which the investment return experience was quite different from the eight percent, would not be particularly useful as compared to analyzing whether or not we think the eight percent is an appropriate assumption to make in costing any defined benefit system. States that if we think the economics of pensions have adjusted to a point where the eight percent is not appropriate and we should be using perhaps a seven percent return, this structure of benefits could be analyzed for normal costs based on some different rate of return. It could be done aside from the public policy decision on whether implementing this proposal without changing the assumed interest rate used in the PERS system. If we were assuming perhaps a seven percent rate of return, the 8.08 would become something significantly higher.
234	Rep. Nolan	Comments on short term perspectives by the legislature.
239	Rep. Scott	Comments that one of the things he thinks the legislature has been charged with is to reduce the financial drain caused by the current system. In analyzing the proposal and with the assumption that the six percent member contribution is picked up by the employer, which is probably a reality based on the current contracts, he does not know if we are accomplishing a savings. If we put everything into it, we are less than .75 percent differential from Tier II. States he is also concerned that without putting some additional stops in a plan that future people in the legislature could get us back into the same position as the current PERS system.
	Rep. Macpherson	Responds that we will not make a material impact on the costs in the PERS in any successor plan. If we had no system for people who come to work after July 1, we would still have spiraling employer contribution rates. The proposal is something that can be maintained over time. We do need long term thinking and would urge colleagues to maintain discipline over time; we need to introduce that discipline.
315	Chair Knopp	Comments that a defined benefit plan does leave open the possibility that should investments go bad, we could rack up an unfunded liability. States there is no mechanism in the proposal to control employer costs on the defined benefit side.
	Rep. Macpherson	Responds that the cost sharing and predictability sharing feature

		of the proposal is in having the Individual Account Program being a part of it. With respect to the reduced size of pension, it is the employer contribution responsibility combined with whatever the system earns over time.
	Chair Knopp	Comments the base is 45 percent of final average salary and for police and fire it is 19 percent of the Individual Account Program and 28 percent for general service on the Individual Account Program. States that with social security, police and fire would receive between 89 and 99 percent retirement and general service employees would receive 98 percent to 108 percent retirement at either 60 or 65 years of age depending on years of service.
351	Rep. Macpherson	Comments that the proposal does provide a good benefit. States a substantial part of that good benefit would be paid by the employees.
	Chair Knopp	Comments he believes the contributions will be 50/50.
376	Rep. Butler	Comments that Chair Knopp brings up an excellent point. States this is actually a 401A plan so the separate contributions to the Individual Account Program could be outside the scope of the W-2 income so there is no matching the 7.65 percent social security.
	Rep. Macpherson	Responds that being a 401A plan, it is not subject to spike attacks for either employer or employee, whereas if an employer and employee group decided to trade off and get cash compensation to replace part or all of the six percent employee contribution and allow the individuals to contribute to a 403B annuity program or a 457 plan, those contributions would be subject to FICA.
407	Rep. Butler	Comments that if we are going to consider who is contributing what, then the attempt is to protect the maximum out of the 15.3 percent social security tax shared between the employer and employee; it is paid half and half.
421	Chair Knopp	Asks if Rep. Macpherson's amendments will be available by Thursday.
	Rep. Macpherson	States he would like to have the amendments by Thursday, but it is not assured. Believes the amendments will be available by the end of the week.
	Chair Knopp	Closes the public hearings on HB 2008, HB 2020, and HB 3169.
476	Chair Knopp	Adjourns meeting at 5:16 p.m.

<u>EXHIBIT SUMMARY</u>

A – HB 2008, proposal for successor system, Rep. Macpherson, 1 p