

SENATE COMMITTEE ON GENERAL GOVERNMENT

January 28, 1999 Hearing Room C

3:00 p.m. Tapes 9 - 11

MEMBERS PRESENT: Sen. Verne Chair Duncan, Chair

Sen. Cliff Sen. Trow, Vice-Chair

Sen. Johnson Sen. Lim

Sen. Marylin Sen. Shannon

Sen. Frank Sen. Shields

STAFF PRESENT: Marjorie Taylor, Administrator

Patrick Brennan, Administrative Support

MEASURE/ISSUES HEARD: SB 110 Possible Reconsideration and Work Session

Informational Meeting

Overview of Public Employees Retirement System

-Fred McDonnal, Executive Director, PERS

-Steve Delaney, Government Relations, PERS

-Mark Johnson, Consulting Actuary

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 9, A		
005	Chair Duncan	Calls meeting to order at 3:07 p.m.
<u>SB 110 POSSIBLE RECONSIDERATION AND WORK SESSION</u>		

007	Sen. Trow	MOTION: Moves to SUSPEND the rules for the purpose of reconsidering the vote on SB 110.
009		VOTE: 3-0 EXCUSED: 2 - Sen. Shannon, Sen. Shields
	Chair Duncan	Hearing no objection, declares the motion CARRIED.
012	Sen. Trow	MOTION: Moves to RECONSIDER the vote by which SB 110 was sent to the floor with a DO PASS AS AMENDED Recommendation.
031	Marjorie Taylor	Administrator. States that SB 110 was voted out with the amendment changing the effective date of the bill to 10-1-1999. Says that, in the event that the effective date of the bill comes after 10-1-1999, there could be a problem in implementation. Says that Legislative Counsel's solution was to add an emergency clause that makes the bill effective 7-1-1999.
042	Sen. Shannon	States that she does not normally support emergency clauses, but that in this instance she agrees with the reason for including one.
044	Chair Duncan	Adds that the clause is purely for the purpose of meeting the requirements necessary to facilitate SB 110 as it was already passed out by the committee.
<u>SB 110 WORK SESSION</u>		
062	Sen. Trow	MOTION: Moves to ADOPT SB 110-1 amendments dated 1/28/99 (EXHIBIT A).
064		VOTE: 5-0 AYE: In a roll call vote, all members present vote Aye.
	Chair Duncan	The motion CARRIES.
066	Sen. Trow	MOTION: Moves SB 110 to the floor with a DO PASS AS AMENDED recommendation.
070		VOTE: 5-0 AYE: In a roll call vote, all members present vote Aye.

	Chair Duncan	<p>The motion CARRIES.</p> <p>SEN. DUNCAN will lead discussion on the floor.</p>
<u>INFORMATIONAL MEETING –PUBLIC EMPLOYEES RETIREMENT SYSTEM</u>		
082	Chair Duncan	Introduces the delegation from the Public Employees Retirement System (PERS).
086	Fred McDonnal	Director, PERS. Provides an overview of the presentation by the PERS Delegation (EXHIBIT B). Offers an introduction to the operation of PERS and its members. States that PERS has a total membership of 266,000, including 77,000 retirees. States that the pension roll for PERS members is \$96 million per month.
108	Chair Duncan	Mentions that he and Sen. Trow are both retired members of PERS.
112	McDonnal	States that the legislature is the primary policy maker for PERS. Discusses the involvement of the PERS board and the executive branch. Mentions that the Oregon Investment Council (OIC) is in charge of investing the \$31 billion PERS fund. States that the courts, federal regulation, and the IRS have influence over the operation of PERS as well. Discusses the revenues for PERS, and that the success of the plan has been that most of the revenues come from investment in the stock market.
149	Chair Duncan	Asks what percentage of PERS members invest in the fixed option versus the variable option.
152	McDonnal	States that, of member contributions, about 24% go to the more aggressive variable option. States that it has proved to be rewarding over the years. Discusses the difference between the fixed and variable options.
173	Sen. Lim	Mentions that there was a possible plan to invest PERS capital into the State of Oregon and asks how much money PERS invested within the state.
178	McDonnal	States that there is a sizeable amount that goes into Oregon, on the order of several million dollars, in such companies as Fred Meyer. States that he does not know the exact amount. Says that the OIC does not invest specifically in Oregon companies for the sake of keeping money within the state, but does so as part of a larger investment program. Says that the "prudent investor rule" has been adhered to by the OIC.
200	McDonnal	Discusses the health of the PERS system through examining its assets versus liabilities (EXHIBIT B, p.5). Mentions that the drop in the funding ratio was

		due in part to the state tax remedy. States that PERS is very healthy, especially in comparison to other state retirement programs.
223	McDonnal	Discusses contribution rates (EXHIBIT B, p.6-9). States that the actuary sets the contribution rates, adjusting it every two years. States that the numbers are actually through 1999, although the chart lists 1997, because 1997 was the beginning of the two year cycle.
250	Sen. Trow	Asks McDonnal if he expects the contribution rates to continue to rise during the next two year cycle.
252	McDonnal	States that he does not expect it to go up. States that the actuary will be able to answer the question more accurately. Adds that it is unlikely to rise as long as conditions remain constant.
265	Sen. Trow	Asks if the recent court cases have made it necessary to change the tax remedy and asks if the state should cease taxing and subsidizing.
270	McDonnal	States that there has been no need to change policy since the passage of HB 3349 (1995), that set increases at 9.8%.
275	Sen. Trow	Mentions that the bill was passed, in part, because of the lawsuits on the part of federal retirees who had sued the state. Asks if the fact that those retirees won their case has made a difference in PERS policy.
279	McDonnal	States that the case that Sen. Trow refers to has not made a difference, yet. Mentions that there is some "inequitable treatment," since federal employees are exempted while PERS employees are not. Says that the PERS employees are provided a benefit increase to offset the increase in taxation and that, in some cases, it more than offsets the increase. Says that he has heard that there may be subsequent litigation made, but that he has heard of none, and the threat of it has not altered PERS policy.
296	Sen. Trow	Asks if there are proposals on the part of PERS, in this regard.
297	McDonnal	States that there is no change. Says that the legislature may be considering changes with regards to exempting all retirees, but that he has not seen any as of yet. Mentions that the state contribution rate (EXHIBIT B, p.6) would have gone down had HB 3349 (1995) not passed. Discusses local government contribution rates (EXHIBIT B, p.8) and mentions that all local rates are calculated differently on the basis of their own experience.
332	Sen. Trow	States that there is a substantial increase in local government contributions, and asks what the source of that increase is, since it is not due to the tax relief program, according to the graph.
338	McDonnal	States that the increase is due mostly to the money match program. Says that there has been a big shift from a defined benefit plan, which PERS has

		historically been, to a defined contribution plan where members share in the investment returns. Says that the investment returns have been much larger than expected during the past several years, which has led to an increase in employer contribution rates.
351	Chair Duncan	Mentions that he has heard rumors and discussion regarding money match, and would like the issue to be discussed.
356	McDonnal	States that the increase in participation of the money match option has been, along with the tax break, the main reason why contribution rates have gone up recently.
359	Chair Duncan	Mentions that PERS has no money going into it from the state and that it is not state funded.
374	McDonnal	States that the money that goes into the system comes from three sources: <ul style="list-style-type: none"> • Investment returns, • Member contributions, and • Employer contributions.
380	Chair Duncan	Asks if General Fund dollars go into the PERS fund.
383	McDonnal	Answers that no money goes in from the General Fund.
384	Chair Duncan	Asks if it is anticipated that there will be a need for General Fund dollars in the future.
386	McDonnal	States he believes there will be no need. States that investment returns are designed to provide for the needed returns, and when they do not, then employee contributions go up. Says that there could also be a change in benefits or member contributions. Mentions that it would be a "huge change in policy" for state subsidization of the PERS fund.
TAPE 10, A		
005	Sen. Lim	Asks if there will be a reserve of money within the system in the future.
012	McDonnal	States that there are reserves and that the entire \$32 billion is a reserve in one form or another: <ul style="list-style-type: none"> • Employer reserves • Member reserves • Gain/Loss reserves • Contingency reserves States that when a member retires a "pot of money" is set up for them, because PERS is a pre-funded system.

017	Sen. Lim	Asks how PERS operates on such a small amount of cash reserves.
020	McDonnal	States that there are funds coming in from employers and that assets are liquidated monthly to cover the difference, if any. States that there is also a continuous influx of money from the investments, provided that they are making money.
034	McDonnal	Discusses Lane County as an example of the money match phenomenon (EXHIBIT B, p.11). States that the local governments are very sensitive about the tax remedy, as it has increased their contribution rates. Says that PERS is working with the local governments regarding possible alternatives that would provide them relief.
055	Chair Duncan	Asks how much notice is given to local governments on rate increases in regards to budget planning. Says that such large increases would be difficult to plan around without substantial lead time.
060	McDonnal	Answers that the local governments are given several options. Localities can defer rate increases with the understanding that the rate will be slightly higher when it actually goes into effect. Says that the PERS board is sensitive to the constraints of local government.
075	Sen. Trow	Asks if the increase will level out or decline.
077	McDonnal	Says that if all things remain equal then the rates will remain the same. States that, within existing conditions, the money match option will continue at a high rate.
086	Sen. Trow	Asks if the money match option was created as a result of a statute.
088	McDonnal	Answers that it was. Adds that the PERS system began as a money match-only system and that it was not until the 1980s that the formula began. Discusses the benefit calculation formula (EXHIBIT B, p.11). Notes that only 3% of retirees in 1998 retired under the full formula plan.
105	Chair Duncan	Asks him to go through the benefits calculation method for the committee.
108	McDonnal	Says that members are always given the highest option upon retirement. Says that money match provided more to 87% of 1998 retirees, which is why they received that plan. Explains the money match formula (EXHIBIT B, p.14). Explains that employee contributions are matched by the employer and that there is also a cost of living increase.
140	Sen. Shields	Asks if the example given in the exhibit is indicative of an average employee.
143	McDonnal	States that the average salary of members is actually higher than the example shown, about \$3500 per month.

147	Sen. Shields	Asks whether the formula changes over time.
155	McDonnal	States that the formula changes according to the rate that the board adopts upon the actuary's recommendation.
160	Chair Duncan	Asks if the rate fluctuates through retirement or if it is fixed at the time of retirement.
164	McDonnal	Says that the formula is fixed at retirement unless the member has remained in the variable plan.
169	Sen. Trow	Asks if there is a cost of living adjustment (COLA) figured in to retiree benefit payments, even though the rate is fixed at retirement.
176	McDonnal	Clarifies that it is the base benefit that remains constant and that there is a COLA adjustment made. States that the variable plan showed an increase over the past several years. Describes the "formula plus annuity" plan (EXHIBIT B, p.15).
193	Sen. Shields	Asks why it is only available to members that began paying into the system before 1981.
194	McDonnal	Answers that statute in the 1980s created the full formula and ended the formula plus annuity. States that he does not know why it was done.
201	Sen. Shields	Asks how long it will be before the formula plus annuity program "dies out."
203	McDonnal	States that it should end by around 2010. Says that the plan is very good, as it allows the employer control of cost and employee investment. Says that other retirement systems in the United States have similar plans.
223	McDonnal	Discusses COLA formulas (EXHIBIT B, p.16) and their connection with the consumer price index (CPI).
230	Sen. Trow	Mentions that some retired long ago, whose buying power has declined over time, and that the legislature has acted, in the past, to provide them assistance. States that there are many retirees who are currently in that situation.
245	McDonnal	Mentions ad hoc increases made by legislative statute.
250	Chair Duncan	Asks what the last measured CPI was listed.
252	McDonnal	Answers that it was about 4%. Refers to chart for explaining purchasing power changes versus the retirement date (EXHIBIT B, p.18).

266	Sen. Trow	Asks how many are in the different groups listed in the chart.
270	McDonnal	Replies that he does not know, but says that 3000-4000 retired each year. Estimates that about half of those currently collecting benefit payments retired before 1988. Offers to provide precise information at a later time.
281	Chair Duncan	Discusses the age of those groups that retired before 1981.
287	Sen. Lim	Asks about what goes into the COLA calculation. Asks why the purchasing power goes down when the benefits payments increase.
300	Mark Johnson	Consulting Actuary, PERS. Answers that the CPI is not designed for retirees, but is used to measure cost of housing and other living expenses.
314	Sen. Lim	Asks why the COLA does not keep up the purchasing power of retirees.
319	Johnson	Mentions that the automatic 2% increase within PERS does not always keep with CPI increase. Says that the legislature can raise the COLA through an ad hoc bill.
330	Sen. Lim	States that the COLA is not necessarily on even par with inflation.
331	Johnson	Agrees.
337	McDonnal	Discusses the Oregon Savings Growth Plan (EXHIBIT B, p.19). Mentions the PERS Health Insurance plan (EXHIBIT B, p.21).
386	McDonnal	Discusses the increase in retirements and the effect of those retirements on account balances. Discusses the baby boomers and their future effect upon retirement rolls, stating that retirements will probably triple within the next 5-10 years (EXHIBIT B, p.24).
TAPE 9, B		
002	Sen. Trow	Asks if those retirements pose a problem for PERS.
003	McDonnal	Answers that the boomer retirements do pose a problem, and that there is a move to look towards making the system more efficient to balance the cost increases.
009	Sen. Trow	Asks about the stability of the fund.
010	McDonnal	Answers that, since PERS is a pre-fund system, as long as benefits are being paid, stability will be assured.

014	Chair Duncan	Asks if the shift to the money match program will have an effect on the system's health.
016	McDonnal	Says that money match is the wave of the future.
019	Chair Duncan	Asks if that shift will cause trouble for PERS down the road.
021	McDonnal	States that, unless there are more good investment years like the past two, there will be a migration back to full formula retirees. States that the Tier 2 creation, which increased retirement age from 58 to 60, will help to stabilize the system over time.
034	Sen. Trow	Asks if there is a possibility of enacting a Tier 3 and what effect it might have on the system.
035	McDonnal	Answers that it would depend on where the Tier 3 was situated. Adds that one possibility is to bring back the outgoing system, or a straight contribution program, or something else entirely.
056	Sen. Trow	Mentions the contract that currently guarantees existing retirees the availability of the money match option.
059	McDonnal	Concurs and explains that all members currently in the system are guaranteed the continuation of their tier's benefits.
062	Chair Duncan	Asks for a review of the bills that PERS has been involved in introducing for the 1999 Session.
067	Steve Delaney	Legislative Liaison, PERS. Describes the seven bills sponsored by PERS for the 1999 Session (EXHIBIT B, pp.25-26).
074	Chair Duncan	Asks that the committee be informed by PERS as to who supports and opposes the various bills when they come up for public hearings.
081	Delaney	Continues description of PERS sponsored bills.
103	Chair Duncan	Asks a question regarding the rollover account described in SB 328.
104	Delaney	Clarifies that the rollover would include qualified plans from other states, such as 401(k) or other retirement plans.
106	McDonnal	Mentions that community colleges are one group that supports SB 328, since it would enhance their out-of-state staff and administrative recruiting efforts.

114	Delaney	Continues description of PERS sponsored bills. Mentions legislation sponsored by other groups that would have impact on PERS (EXHIBIT B, pp.27-28).
145	Johnson	Discusses actuarial issues (EXHIBIT C). States that there are two phases to the valuation (p.3).
190	Johnson	<p>Mentions three key findings (EXHIBIT C, p.4):</p> <ul style="list-style-type: none"> • Tax remedy cost increases employer contribution rates • Unprecedented interest earnings in 1996 and 1997 • Dominance of the money match option <p>States that most people currently in the PERS system will continue to benefit more from the money match option.</p>
230	Sen. Trow	Asks what the effect of a drop in investment gains to 10% would be.
232	Johnson	Answers that there would still be gains, meaning that money match would still be dominant. Says that the interest earned by employee and employer dollars both go to benefits, while under the full formula the investment gains on employer assets would reduce their contributions to the system. Says that because of that, a move back to the full formula is highly unlikely, which is why employers are concerned enough to begin discussing the possibility of a Tier 3.
258	Johnson	Outlines the impact of the HB 3349 (1995) tax relief measure (EXHIBIT C, p.5). Mentions the cost of retroactive tax remedies, as well as the future impact of tax remedies. States that employers were aware ahead of time about the rate increase due to tax relief.
295	Sen. Trow	Mentions that ballot initiatives have also cost employers money, which employers did not count on.
299	Johnson	Discusses the difference between the full formula and the money match formula (EXHIBIT C, p.8). States that there is \$10 billion established as a reserve, based upon an 8% interest rate. Says that if the reserve makes more than 8%, then employer costs are reduced.
341	Chair Duncan	Mentions that the money match issue is the primary concern on the part of employers.
343	Johnson	Concurs with the chair's statement.
351	Chair Duncan	Mentions that the retirement system has been good and that it attracts employees that otherwise might have left, which lends stability to the Oregon workforce. Says that that is not often considered when looking at the benefits of the system.
362	Johnson	States that the retention of workers actually hurts the PERS system because when more members retire into the system, the costs of supplying benefits to

		them goes up.
382	Chair Duncan	Asks for an example to describe how the interest rate affects the percentage of members taking the money match option.
390	Johnson	Explains the chart (EXHIBIT C, p.9) that outlines the relationship between interest rate and percentage of money match retirements annually. Notes that the year after a good interest year sees increases of retirees taking the money match formula.
TAPE 10, B		
020	Sen. Lim	Asks if the interest rate for 1998 will be high again.
024	Johnson	States that he does not know where the interest rate might be, but that virtually all retirees will, regardless, receive the money match formula.
034	McDonnal	Offers a preliminary interest rate for 1998 of 17-18% variable and 13-14% regular.
047	Johnson	Continues discussion of the money match formula (EXHIBIT C, pp.10-11).
070	Johnson	Discusses the process of predicting future earnings of the program. (EXHIBIT C, pp.12-13). Explains why adjustments were made to assumptions from 1995 to 1997.
118	Johnson	Discusses normal cost rate (EXHIBIT C, p.16). Defines normal cost rate as the average cost of the average member for a given year.
145	Johnson	Discusses actuarial liability (EXHIBIT C, p.17). Defines actuarial liability as the projected cost of providing benefits for all members in the system.
180	Johnson	Discusses total contribution rate (EXHIBIT C, p.19). Describes the ongoing and non-recurring reasons for the change in the average rate.
211	Chair Duncan	Asks if employer costs are expected to continue to increase.
214	Johnson	Says that the state and schools should stay the same, but that some localities may see increases. Says that the money match option is so dominant that there should be re-evaluation in order to make sure that costs do not continue to spiral upward.
246	Johnson	Discusses the contribution changes (EXHIBIT C, p.22).

268	Sen. Trow	Asks if the schools asked to defer the rate increase again.
269	Johnson	Answers that because employers knew about the HB 3349 tax relief, and could have planned for it, the board felt that there should not be a deferment on the rate increase. Uses the judges group as an example of the non-money match program.
290	Chair Duncan	Asks if the judges' investment is part of a separate account.
295	Johnson	Answers that it is part of the entire PERS fund. States that the judges had the same investment returned, but that the investment earnings went to reduce the state's contributions.
298		Discussion of SB 298, which deals with the retirement benefits of judges within the PERS system.
309	Johnson	Discusses local agency rates (EXHIBIT C, pp.23-24). Discusses the difference of rates among different sizes of employers (EXHIBIT C, p.25) which demonstrates the volatility of small employer rates.
347	Chair Duncan	Mentions that such small employers might be a municipality with only a handful of employees.
350	Johnson	Concurs with the chair's example. States that the vast majority of rate increases were among small employers, although a few large local agencies saw rate increases.
370	Chair Duncan	Asks if the small, local employers that saw rate increases have the option of deferring those increases.
372	Johnson	Notes that they have the option of deferring until 2000 or 2001.
380	McDonnal	Mentions that reconsideration requests have been made by some local governments, as well as deferment requests.
391	Johnson	Mentions that there is a task force involved with some agencies to look into options on how to deal with the increases. Discusses future rate changes for various employers (EXHIBIT C, p.27).
TAPE 11, A		
011	Sen. Trow	Asks about the relationship between the PERS system and other states' retirement systems.
014	Johnson	Agrees with Sen. Trow's statement that the PERS system is very healthy in

		comparison to other state's retirement systems.
017	Sen. Lim	Mentions that many bills before the committee are related to PERS.
021	Johnson	Mentions that the state legislators in California have no retirement plan at all.
035	Sen. Shannon	Mentions concern about an upcoming bill that would restrict investment. Asks why there is a problem with social security investment in the stock market. Asks about California's stance on market investment.
043	Johnson	Mentions that California's investment program is similar to that of PERS, with broad based investment.
046	Chair Duncan	Adjourns meeting at 4:58 p.m.

Submitted By, Reviewed By,

Patrick Brennan, Marjorie Taylor,
Administrative Support Administrator

EXHIBIT SUMMARY

A ñ SB 110, -1 Amendments, Staff, 1 p.

B ñ PERS, printed materials, Fred McDonnal, 54 pp.

C ñ PERS, printed materials, Mark Johnson, 28 pp.