INTERNATIONAL MUNICIPAL LAWYERS ASSOCIATION



Work Session: VI Personnel

Title: Oregon PERS: Reforming an Incorrigible Pension System

by

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Oregon PERS:
Reforming an Incorrigible Pension System

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Beginning in the late 1990s, a number of officials of public employers participating in the Public Employees Retirement System – better known as PERS – began noticing something quite strange: Even though PERS Fund Investments were booming, the extremely high investment returns were not resulting in lower contributions rates, as would be expected for most pension plans. Instead, contribution rates for employers were rising rapidly and were expected to continue to rise in almost all future scenarios.

A group of local employers asked for legal advice concerning the rate increases they received in 1998. Further discussions with and observations of PERS, along with extensive legal and legislative research, revealed a serious problem with the way PERS was structured and how the Public Employees Retirement Board, or PERB, was administering the system in light of that structure. The problems were extremely complex, and it appeared that any real and lasting solution would require a multi-pronged approach utilizing judicial, legislative, and administrative means. This presentation illustrates how this approach led to significant reforms of the system over the past seven or eight years.

The first approach to the problems was a judicial one: A group of eight local governments challenged three sets of actions taken by PERB in 1998 and 2000. This case, *City of Eugene v. PERB*, involved very detailed factual inquiries into how PERS is structured, what actions PERB took, and the probable consequences of those actions on both employers and employees. These questions required extensive technical testimony from both actuaries and accountants. The trial court concluded that PERB made a number of errors and remanded the challenged orders to PERS. That opinion was issued in October of 2002, just before the start of the 2003 legislative session. Both the trial and the decision garnered a great deal of public attention and spawned two official task forces – one by Governor

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Kitzhaber (later continued by Gov. Kulongoski), and another by the Oregon House. The public attention led directly to a second approach to the problem: legislative action.

Public employers, including many of those involved in the *City of Eugene* case, worked with the legislature to draft various bills introduced by the 2003 Legislative Assembly to reform PERS. In the end, four significant bills were passed. Two of these – HB 2003 and HB 2004 – were almost immediately challenged by several public employees and retirees. Those cases were consolidated and are known as *Strunk v. PERB*. Again, public employers were involved in defending the legislation, thereby reforming PERS, using a judicial approach.

Public employers have also become more closely involved in the administrative aspects of PERS, both through the implementation of the reform legislation and the *City of Eugene* judgment, and through the continuing administration of PERS. Continued attention by the stakeholders in PERS will be necessary to keep the system operating as it was intended to operate.

Oregon PERS: Reforming an Incorrigible Pension System



The other partner is you

PERS Prior to Reforms

- Sharply increasing benefits and costs
  - Average "career" retiree in 2000: 53 years old; 106% of final salary
- Sharply increasing employer contribution rates despite strong investment performance
- Increasing Unfunded Actuarial Liabilities (UALs)

Oregon PERS – Benefit Structure

- Three benefit calculation methods:
  - Full Formula (1981)
  - Pension Plus Annuity (1967)
  - Money Match (original)

Oregon PERS – Administration

- **PERS Board Errors**
  - Policy to increase benefits
    - Allocated excess earnings to member accounts
    - Allocated insufficient income to reserves
    - Used outdated mortality assumptions to calculate benefits
  - Resulted in dramatic growth in costs

Litigation: *City of Eugene v. PERB*

- Petition for Judicial Review of several administrative orders
  - Employer rate orders
  - Order allocating 1999 fund earnings
- Objectives
  - Discover and expose flaws in PERS
  - Create pressure to change PERB practices
  - Identify avenues for reform

City of Eugene Litigation - Claims

- Petitioners' claims
  - PERB's rate orders are higher than statutorily authorized
  - PERB's allocation of 1999 income at 20% is an abuse of discretion
- Intervenors' (union members') claims
  - Allocation of portion of 1999 income to employers' accounts was invalid

City of Eugene Litigation – Judgment

- Trial Court's decision (October 2002) vacating and remanding orders
  - The Board abused its discretion in allocating 1999 fund earnings
  - PERS's match of variable earnings was contrary to statute
  - PERS rule concerning actuarial equivalency factors was contrary to statutes

City of Eugene Litigation – Judgment

- PERB and intervenors appealed to Court of Appeals
- Both trial court and Court of Appeals denied PERB's motion to stay judgment early in 2003

Legislation – Key Bills

- **House Bill 2003**
  - Directs future member contributions to Individualized Account Program
  - Requires Board to change future interest crediting practices when reserves are in deficit or insufficient; protects right to assumed interest rate crediting over life of account
  - Suspends COLAs for certain retirees until allowance is correct

Legislation – Key Bills

- **House Bill 2004**
  - Requires accurate mortality tables to be adopted every two years
  - Look-back protection of accrued benefit
- Both HB 2003 and HB 2004 bills provided for expedited review by Oregon Supreme Court

Legislation – Key Bills

- **HB 2005**
  - Changed make-up and size of PERS Board
- **HB 2020**
  - Created OPSRP program for post-2003 employees
  - Formula pension and annuity based on account, with no interest guarantee

Legislation: 2003 Legislative Reforms

- Events leading to reforms
  - Court ruling in *City of Eugene*
  - Economic downturn in 2001, 2002
  - Legislative and Governor's Task Forces
  - New information from PERS
  - Employer coalition proposed prospective reforms

Strunk v. PERB: Litigation over legislative reforms

- Several suits filed by current and retired PERS members
- Primary claims: Breach or impairment of PERS contract
- Three defenses by PERB, employers
  - PERS contract does not promise what plaintiffs claim
  - No substantial impairment because reasonable expectation of members are preserved
  - Any impairment is justified as reasonable and necessary exercise of state police power

Strunk v. PERB: Challenged provisions

- HB 2004: updated actuarial tables
- HB 2003 § 1: directing employee contributions to IAP
- HB 2003 § 5: changing interest crediting requirement
- HB 2003 § 10: suspending COLA for certain retirees

Strunk v. PERB: The Decision

- Expedited briefing; decision in one year
- Holdings
  - HB 2004 (mortality tables) is valid
  - HB 2003 §1 (redirecting employee contributions) is valid
  - HB 2003 §5 (crediting change) is invalid
  - HB 2003 §10 (COLA suspension) is invalid
- *Strunk v. PERB*, 338 Or 145 (2005)

Settlement of *City of Eugene*

- In 2003, PERB agreed to dismiss appeal and implement judgment by:
  - Correcting rate orders
  - Following law as interpreted by trial court and as modified by reform legislation
- Intervenors attempted to pursue appeal despite settlement

City of Eugene Appeal: The Decision

- Supreme Court's holding: Intervenors' appeal is mooted by the 2003 legislation, actions of the PERB Board, and the decision in *Strunk*
- *City of Eugene v. PERB*, 339 Or 113 (2005)
- Court vacated trial court's judgment on reconsideration

PERS – Ongoing Legal Challenges

- *Robertson v. PERB* (federal constitutional challenges to reforms)
- *White v. PERB* (members' challenges to settlement agreement and related actions)
- *Arken v. PERB* (members' challenges to PERB's response to *Strunk* re COLA freeze)
- Other possible challenges to PERB's actions and rules

Net Results

- Member contribution redirected to IAP
- Mortality tables updated
- 1999 earnings reallocated from 20% to 11.33%
- Post-March 2000 retirees will receive COLAs but must repay overpayments