

# **Oregon PERS' Hybrid Plan**

## **Kansas Retirement Study Commission**

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# Agency Overview

- PERS provides retirement, death, and disability benefits for 95% of Oregon's public employees, serving 193,000 active members working for approximately 900 public employers, 39,000 inactive members, and 113,000 retired members
- PERS' retirement plan has four major components: Tier One, Tier Two, the Oregon Public Service Retirement Plan (OPSRP) Pension Program, and the member account-based Individual Account Program (IAP)
- PERS pays \$3.0 billion annually in benefits, 87% of which (\$2.6 billion) is injected directly into the Oregon economy
- Oregon Investment Council (OIC) oversees PERS Fund investments with staff support from the Oregon State Treasury. As of August 31, 2011, the OPERF was valued at about \$57 billion; investments have generated over 70% of total PERS revenue since 1970
- PERS was 65% funded in early 2003 (prior to PERS reform), grew to 112% funded in 2007; declined to about 80% funded in 2008; and was approximately 87% funded at the end of 2010

# Oregon's Hybrid System Background

- Oregon combined a revised DB plan with an Individual Account Program (IAP) to improve risk equity and reduce liabilities under 2003 legislative reforms
- Pre-reform, 30-year members retired with 100% of final average salary under legacy “money match” method; that method involves matching the member’s account and then annuitizing the doubled balance, so benefits were growing because high earnings crediting and 8% “guarantee” floor grew member accounts rapidly
- PERS viewed as “unsustainable;” liabilities growing at 10 to 12% annually; task forces that were formed and a legislative solution resulted in 2003 reforms

# OPSRP Pension Program Description

- Effective for all new hires on or after August 29, 2003
- Normal retirement age: 65 for general service; 60 for police and firefighters
- Final salary formula benefit only: 1.5% benefit factor for general service; 1.8% for police and firefighters
- No lump-sum vacation or accumulated sick leave included in three-year final average salary
- Funded by employers (non-contributory)
- Average normal cost: 6.35%

# IAP Description

- IAP became effective January 1, 2004; mandatory for all PERS-covered state, local government, and school employees (about 95% of public employees in Oregon)
- IAP reduced employer costs by diverting member contribution to accounts with no guaranteed earnings or employer “match” at retirement; investment and administrative costs deducted from earnings before crediting to member accounts
- Invested as part of overall PERS fund “regular account;” no self-directed investment options

# IAP Investment and Administration

- Earnings or losses credited annually to member accounts; no guaranteed rate of return
- Earnings credited to date of distribution using last known monthly earnings rate
- Retiring members are paid the IAP account balance in a lump sum or rollover; or in installments over a 5, 10, 15, or 20-year period; or over their “anticipated life-span”
- IAP account balance paid in a lump sum to beneficiaries upon a member’s death
- Disability covered by PERS DB plans, not IAP

# IAP Investment and Administration (continued)

- Third-party administrator for account maintenance and payments (currently ING); PERS had four months to create a structure for the IAP and associated electronic employer reporting
- Account balance available online (contributions to date and annual earnings credited)
- Annual earnings credited to IAP accounts have averaged 7.7% from 2004 through 2010, with 7% annualized return

# Oregon's Hybrid Experience

- 2003 reforms redirected employee contributions of 6% of salary from legacy accounts to IAP effective January 1, 2004, reducing “money match” benefits
- Reduced projected employer DB liabilities by \$1.9 billion
- Reduced replacement ratios by 25% so far, but shifted “full formula” costs to employers going forward without any post-2003 member DB contributions
- IAP is projected to pay 15 to 20% of final average salary after 30 years if investments average 8% annually



# IAP Investment Pros and Cons

- IAP dollars are co-mingled and invested with large diversified portfolio (~\$57 billion as of August 31, 2011), reducing investment expenses (~60 basis points)
- Administrative costs for all PERS programs are ~8 basis points
- Provides institutional fund investment vehicles (e.g., real estate and private equity) but does not allow members to match varying risk profiles or life stages
- Annual earnings crediting, monthly investment valuation, and lack of self-direction differs from newer members' "401(k)" experiences and expectations
- Lack of investment guarantee and no account annuitization at guaranteed rate differs from PERS legacy account experience and expectations for older members

# IAP Administrative Challenges

- Obtaining timely and accurate data from employers and avoiding prior period contribution adjustments; monthly reporting and reconciliation difficult for smaller employers
- Eligibility checks required on all accounts prior to distribution due to concurrent and part-time employment coverage in Oregon PERS
- Overall retirement processing workload and retirement spike backlogs each January 1 and July 1 are amplified by having to process two retirements (DB and IAP) for each member

# Individual Account Program History

<b>Year End (12/31)</b>	<b>Total Account Balance After Earnings Crediting (\$M)</b>	<b>Number of Member Accounts</b>	<b>Average Account Balance (\$)</b>	<b>Number of Distributions</b>
2004	423	162,119	2,611	2
2005	929	181,055	5,130	4,131
2006	1,397	197,491	7,072	6,557
2007	2,121	210,133	10,091	6,705
2008	1,851	218,192	8,484	8,624
2009	2,743	231,256	11,847	7,727
2010	3,537	236,265	14,970	8,695