



Oregon

Kate Brown, Governor

Public Employees Retirement System

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September 25, 2015

TO: Members of the PERS Board
FROM: Stephanie Vaughn, Manager, Policy Analysis & Compliance Section
SUBJECT: Adoption of Cost-of-Living Adjustment Rules:
459-005-0510, *Cost-of-Living Adjustment*
459-005-0520, *Supplementary Payment*

OVERVIEW

- Action: Adopt modifications to the Cost-of-Living Adjustment rules.
- Reason: Clarify the cost-of-living adjustment method for earned benefits.
- Policy Issue: Should PERS incorporate the service time ratio method to blend different cost-of-living adjustment (COLA) structures?

BACKGROUND

On April 30, 2015, the Oregon Supreme Court issued its ruling in the *Moro* case, invalidating the cost-of-living adjustment (COLA) reductions enacted by Senate Bill 822 (effective May 6, 2013) and Senate Bill 861 (effective October 6, 2013) as applied to benefits earned before the effective dates of those bills. As a result, members who have earned benefits both prior to the effective dates of the bills as well as after the effective dates will receive a blended COLA based on the COLA structure in effect when the benefits were earned. While the court specifically did not provide guidance on how to blend the different COLAs, it did reference a service time ratio method as an example of how a blended COLA could be derived.

In addition, the Supreme Court ruling voided the supplementary payment provision in SB 861, so OAR 459-005-0520, *Supplementary Payment* is proposed for repeal.

POLICY QUESTION & RECOMMENDATION

Should PERS incorporate the service time ratio method to blend different cost-of-living adjustment (COLA) structures?

The court decision ties the COLA in retirement to the COLA that was in effect when the benefits were earned. Unfortunately, how to determine when benefits are earned is not clear and the court did not direct a method in its decision. Benefits are not determined until a member retires, and there are many factors that affect a member's final benefit calculation. Attempting to determine the benefit a member has earned at a particular point in time, especially when that point is early- or mid-career, is problematic.

The court did point to ORS 238.364(5) as an example for calculating a blended rate. This statute describes how to calculate the "tax remedy" established by House Bill 3349 (1995). Specifically, it directs staff to "divide the number of years of creditable service performed before [the repeal

of the tax exemption] by the total number of years of creditable service during which the pension income was earned.” PERS then applies the tax remedy to this portion of the member’s benefit. This is referred to as the service time ratio method, and is the method used by Milliman in their presentation regarding the impact of the *Moro* case at the May 29, 2015 board meeting.

Staff considered other methods that prorate the COLA based on the member’s retirement benefit. The common challenge with these methods is that they involve determining a member’s benefit as of the effective date of the bills. A number of factors considered in calculating a retirement benefit are variable, changing over the course of a member’s career (e.g., sick leave, vacation, final average salary, etc.). The level of complexity involved in these methods invites confusion, more opportunity for miscalculations, and potential challenges.

The blended COLA methodology outlined in the rule modifications blends the COLAs based on creditable service or retirement credit earned by a member when a specific COLA was in effect. Because a member’s benefit is not determined until the member retires and includes factors that may or may not span the whole of the member’s career, prorating the COLA according to the service time ratio is the most reasonable, administratively feasible, and cost effective method. It is also the most straight-forward method, making it easier to communicate to members.

Staff recommends incorporating the service time ratio method of blending the different COLA structures. Examples of how this rule would be implemented were provided with the July memo when these rule modifications were noticed.

PUBLIC COMMENT AND HEARING TESTIMONY

A rulemaking hearing was held August 25, 2015, at 2:00 p.m. at PERS headquarters in Tigard. One member of the public attended and provided testimony, as summarized below. A second rulemaking hearing was held August 27, 2015, at 2:00 p.m. at Oregon State Archives in Salem. No members of the public attended. The public comment period ended September 1, 2015, at 5:00 p.m.

At the rulemaking hearing on August 25, 2015, Friedrich Rudolf Beyl provided public comment regarding OAR 459-005-0510. Mr. Beyl retired on July 1, 2013, with 30 years of service and received a Money Match benefit. He expressed support for the use of the service time ratio method to blend different COLAs, and appreciated the detailed examples attached to the July Board memo. He inquired as to the origin of the service time ratio. Staff showed Mr. Beyl the corresponding ORS 238.364, which outlines how to determine the service time ratio for tax remedy purposes. Mr. Beyl also concurred with Mr. Crummé’s concerns that the proposed rule modifications do not clearly address how a 2 percent COLA applies to the Tier One Money Match option.

PERS also received two public comment letters. Prior to the start of rulemaking, PERS received a letter dated May 5, 2015, from Doug Crummé in which he asks that rulemaking to implement *Moro* clearly address how the two percent COLA applies to the Tier One Money Match option. A copy of his letter is included as Attachment 4.

Mr. Crummé contends that Tier One members who retire under the Money Match benefit calculation have a right to a 2 percent COLA on their entire benefit, regardless of whether or not they continued to work beyond October 1, 2013. Mr. Crummé provides an example:

...The money match benefit is calculated based on the employee's life expectancy and the Tier One account balance at retirement. The account balance is based on employee and employer contributions through 2003 (after which contributions were terminated) and on net earnings or losses accruing on the account balance through the date of retirement. All other things being equal, an employee who retires from PERS employment on a particular date will receive the same money-match pension benefit whether the employee quits working for PERS employers after 2003 but short of retirement or the employee continues working for PERS employers through his or her eventual PERS retirement date...

Mr. Crummé's reasoning offers one method for implementing the *Moro* decision; however, it is not the only method, and it proceeds from some incorrect assumptions. Staff continues to recommend the service time ratio method of calculating COLA.

A member's benefit is not determined until their effective retirement date. Whether a member's retirement is ultimately calculated under the Money Match method cannot be determined until retirement (PERS uses whichever method provides the highest benefit). The highest benefit calculation can change from month to month for many members, depending on sick leave usage, pay raises, changes in jobs or position, etc. Using the service time ratio removes the arbitrary nature of a member's COLA in retirement being based solely on their calculation method.

For example, contrary to Mr. Crummé's assertion that all Tier One members will receive the same benefit regardless of when they retire (and then become eligible for a COLA), the following members received benefits from January 1, 2004, to before January 1, 2014, that were not retirements, and therefore not eligible for COLA:

- 894 Tier One members died before retiring, but received an employer match
- 1,170 Tier One members died before retiring, but did not receive an employer match
- 2,862 Tier One members withdrew
- 310 Tier One members went into Loss of Membership

This list shows that eligibility for COLA is contingent on actually applying for and receiving a retirement, and for thousands of Tier One members, they never became eligible for one.

As presented, therefore, staff continues to conclude that this rule complies with the *Moro* ruling by the using a service time ratio to allocate the yearly allowance, pension, or benefit before and after the legislative COLA change.

On August 31, 2015, Mr. Crummé provided a second public comment regarding OAR 459-005-0510. A copy of his email is included as Attachment 5. He suggests that the proposed amendments to the rule are inconsistent with the *Moro* decision. He also states that "Employee contract rights to Tier 1 benefits are solely for work performed through 2003. Employee's contract rights to Tier 1 benefits are not for work performed after 2003 or after 2013."

Mr. Crummé's statements are incorrect. The Tier One program was not frozen or terminated as of January 1, 2004. While the contributions for Tier One members were directed to the Individual Account Program (IAP) as of January 1, 2004, none of the other provisions of the program changed. Moreover, work performed after 2003 is still used in determining benefit

eligibility (e.g., 30 years of service) and amounts (e.g., tax remedy increases for those members who are eligible).

LEGAL REVIEW

The attached rules were submitted to the Department of Justice for legal review and any comments or changes are incorporated in the rules as presented for adoption.

IMPACT

Mandatory: No.

Impact: PERS will reprogram ORION to automate the annual cost-of-living adjustment.

Cost: There is no cost specific to the rule changes.

RULEMAKING TIMELINE

July 15, 2015	Staff began the rulemaking process by filing Notice of Rulemaking with the Secretary of State.
July 31, 2015	PERS Board notified that staff began the rulemaking process.
August 1, 2015	<i>Oregon Bulletin</i> published the Notice. Notice was sent to employers, legislators, and interested parties. Public comment period began.
August 25, 2015	First rulemaking hearing held at 2:00 p.m. at PERS in Tigard.
August 27, 2015	Second rulemaking hearing held at 2:00 p.m. at Oregon State Archives in Salem.
September 1, 2015	Public comment period ended at 5:00 p.m.
September 25, 2015	Board may adopt the permanent rule modifications.

BOARD OPTIONS

The Board may:

1. Pass a motion to “adopt modifications to the cost-of-living adjustment and supplementary payment rules, as presented.”
2. Direct staff to make other changes to the rules or explore other options.

STAFF RECOMMENDATION

Staff recommends the Board choose Option #1.

- Reason: Implement Senate Bill 861 (2013) annual cost-of-living adjustment due to the Oregon Supreme Court decision in *Moro*.

If the Board does not adopt: Staff would return with rule modifications that more closely fit the Board’s policy direction if the Board determines that a change is warranted.

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B.4. Attachment 1 – OAR 459-005-0510, *Cost-of-Living Adjustment*

B.4. Attachment 2 – OAR 459-005-0520, *Supplementary Payment*

B.4. Attachment 3 – Blended COLA Examples

B.4. Attachment 4 – May 5 Public Comment Letter from Doug Crummé

B.4. Attachment 5 – August 31 Public Comment Email from Doug Crummé