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November 8, 2012

VIA E-MAIL

Paul Cleary
Executive Director
Oregon PERS

Re: Request Number: 2012-008
Benefit Design Cost Analysis - Out-of-state Tax Remedy Change Concept

Dear Paul:

Per your request, this letter provides an estimate of the system-wide average effects of eliminating the "tax remedy" benefits for PERS members and beneficiaries who are not Oregon residents. The analysis estimates the impact if this change had become effective on December 31, 2011, and affected both current and future out-of-state retirees for all benefits payable subsequent to 2011. A change at that time would have affected both the December 31, 2011 actuarial liability and 2013-2015 employer contribution rate calculations. While any change to the statutory provisions regarding tax remedy benefits would occur at a later date, estimating the impact as of a December 31, 2011 snapshot date allows for direct comparison to liability and employer contribution rate calculations from the most recently completed actuarial valuation.

For purposes of this analysis, we have assumed that 15% of the benefits currently eligible for tax remedy adjustments are payable to non-Oregon residents and would be affected by this change. The table below has a summary of the valuation results and the estimated effect of the change. "Accrued Liability" refers to the net present value of projected future benefits allocated to service already completed as of the valuation date in accordance with the current actuarial cost allocation method, while "Total Liability" includes the value attributable to anticipated future service for current active members. As shown in the table below, the change is estimated to lower system Total Liability by approximately $390 million, lower Accrued Liability by approximately $380 million, and to lower the system-wide average employer contribution rate by 0.3% of payroll. The contribution rate shown is a blended rate reflecting the weighted averages of Tier 1, Tier 2 & OPSRP payroll as of the valuation date. The contribution rate is shown on an "uncollared" basis. If this concept was adopted, the actual impact on collared employer rates would depend on Board policy and/or legislative direction on how to implement such a change.

	12/31/2011 Total Liability ($B)	12/31/2011 Accrued Liability ($B)	2013-2015 Uncollared Base Employer Contribution Rate (% of payroll)
12/31/2011 Valuation Results	$69.19	$61.20	23.7%
Remove out-of-state Tax Remedy (assuming 15% of payments are out-of-state)	(0.39)	(0.38)	(0.3%)

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BACKGROUND AND OUR UNDERSTANDING

The two statutory provisions, collectively known as "tax remedy benefits", considered in this analysis are the House Bill 3349 ("HB 3349", section 238.364 of Oregon Revised Statutes (ORS)) and Senate Bill 656 ("SB 656", ORS 238.366) benefit adjustments. We understand these provisions were added to statute after member benefits previously exempt from Oregon personal income tax became subject to the tax; the supplementary benefits provided by these sections were intended to mitigate the impact of the change in tax status.

Only members who joined the system prior to July 14, 1995 are eligible for HB 3349 and SB 656 adjustments. Eligible members who retired prior to 2012 receive the larger of either the HB 3349 or SB 656 adjustment. Due to a change in statute, a member who retires on or after January 1, 2012 is not eligible for the HB 3349 adjustment if they do not reside in Oregon. That statutory change did not affect members who retired prior to 2012, and the statutory change did not remove the SB 656 adjustment for post-2011 retirees.

The benefit adjustment provided by HB 3349 is based on the percentage of a member's benefit attributable to service prior to October 1, 1991, and can range from a 0% to 9.9% increase in the benefit. This range varies based on the fraction of a member's service that occurred prior to October 1, 1991. A member with no service prior to that date has a 0% HB 3349 adjustment, while a member with all service prior to that date has a 9.9% HB 3349 adjustment.

The SB 656 benefit adjustment is defined as a set percentage increase to a member's total benefit based on his or her total years of service. The schedule of increases vary between General Service and Police and Fire members, with Police and Fire members receiving a more favorable schedule. The increase provided by SB 656 ranges from 0%, for those with less than 10 years of service, to 4%, which applies to General Service members with 30 or more years and Police and Fire members with 25 or more years.

The concept now under consideration would remove both the HB 3349 and the SB 656 adjustments for <u>all</u> retirees and beneficiaries who reside outside of Oregon. In other words, this concept would expand the recent statutory modification in two ways. First, it would remove both adjustments, rather than just the HB 3349 adjustment. Second, the concept would apply to all retirees and beneficiaries rather than just post-2011 retirements.

DATA, METHODS, ASSUMPTIONS AND PROVISIONS

Other than the exceptions and additions noted below, the data, methods, assumptions, and plan provisions used to calculate employer contribution rates are the same as those used in the December 31, 2011 system-wide actuarial valuation report. That information, including a discussion of the inherent limitations of use of actuarial valuation results, is herein incorporated to this letter by reference.

Please note that our analysis does not include any assumed change in member behavior as a result of a change in the tax remedy benefit. Such potential impacts merit consideration, but are

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beyond the scope of the analysis requested. In addition, this analysis is highly sensitive to the assumed level of benefits affected by the change. The assumption of 15% was provided by PERS; we do not have any data currently available to assess the accuracy of this assumption.

To assess the impact of this concept on current retirees, we received additional data from PERS regarding the percentage increase in benefits due to tax remedy adjustments already incorporated in the current benefit levels for individual retirees. We did not audit the data, but have no reason to doubt its substantial accuracy.

In calculating the illustrative changes in uncollared employer base contribution rates shown above, we assumed all changes in Accrued Liability were amortized over a 20-year period as a level percent of payroll using current valuation assumptions. This is the method currently used in the valuation when establishing new Tier 1/Tier 2 amortization bases. If a different amortization method were used, the overall impact on employer rates could be significantly different than shown in this letter.

ACTUARIAL BASIS AND QUALIFICATIONS

In preparing this letter and the valuation report on which it is based, we relied, without audit, on information (some oral and some in writing) supplied by Oregon PERS. This information includes, but is not limited to, statutory provisions, employee data, and financial information. We found this information to be reasonably consistent and comparable with information used for other purposes. The updated estimates depend on the integrity of this information. If any of this information is inaccurate or incomplete our results may be different and our calculations may need to be revised.

All costs, liabilities, rates of interest, and other factors for the System have been determined on the basis of actuarial assumptions and methods which are individually reasonable (taking into account the experience of the System and reasonable expectations); and which, in combination, offer a reasonable estimate of anticipated experience affecting the System.

Future actuarial measurements may differ significantly from the current measurements presented in this estimate due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions or actuarial methods; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan's funded status); and changes in plan provisions or applicable law. Due to the limited scope of this estimate, we did not perform an analysis of the potential range of future measurements. The Board has the final decision regarding the valuation assumptions and adopted the assumptions used in the December 31, 2011 valuation in July 2011.

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Actuarial computations presented in this estimate are for purposes of providing a high-level analysis of the requested concepts for changes to the System. As such, they cannot be relied upon for financial reporting or other purposes, and calculations for purposes other than this use may be significantly different from the estimates contained in this letter. Accordingly, additional determinations may be needed for other purposes.

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The consultants who worked on this assignment are pension actuaries. We have not explored any legal issues with respect to the change concepts discussed in this letter. Milliman's advice is not intended to be a substitute for qualified legal or accounting counsel.

On the basis of the foregoing, I hereby certify that, to the best of my knowledge and belief, this report is complete and accurate and has been prepared in accordance with generally recognized and accepted actuarial principles and practices. I am a member of the American Academy of Actuaries and meet the Qualification Standards to render the actuarial opinion contained herein.

If you have any questions about our response or need any additional information, please let us know.

Sincerely,

Matt Larrabee, FSA, EA
Consulting Actuary

MRL:sdp
encl.

cc: Steve Rodeman
Debra Hembree
Scott Preppernau

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