



Oregon

Theodore R. Kulongoski, Governor

January 29, 2010

TO: Members of the PERS Board

FROM: Dale S. Orr, Actuarial Services Manager

SUBJECT: 2009 Preliminary Earnings Crediting and Reserving

Item C.2.

Public Employees Retirement System

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OVERVIEW

- Action: Adopt 2009 preliminary earnings crediting and reserving decisions.
- Reason: ORS 238.670(5) requires PERS to submit a preliminary proposal to the appropriate legislative committee at least 30 days before making a final decision on earnings crediting.
- Subject: Crediting earnings for calendar year 2009 to the PERS Fund's accounts and reserves.
- Policy Issues:
 - Is the Contingency Reserve adequately funded?

The PERS Board is charged with crediting earnings from the PERS Fund each calendar year. Some of those allocations are directed by statute or rule; the balance are at the PERS Board's discretion.

NON-DISCRETIONARY EARNINGS ALLOCATIONS

The following reserves and accounts are allocated earnings by applicable statute or rule. In compliance with these restrictions, the preliminary earnings allocation will reflect the following:

- 1. Administrative Expenses:** Administrative costs are funded by earnings when they are sufficient, as they were in 2009 (ORS 238.610(1)). Earnings allocated to administrative expenses are reflected in the rates stated below for other accounts and reserves.
- 2. Health Insurance Accounts:** These accounts are created as part of the PERS Fund and directed by statute to be credited with actual earnings or losses, less the expense related to the administration of the programs (ORS 238.410(7); 238.415(4); 238.420(4)). For 2009, the preliminary rate credited to these accounts would be 18.13%.
- 3. Employer Lump-Sum Payment Accounts:** These accounts are credited with actual earnings or losses less administrative expenses, as authorized by ORS 238.225(10). For 2009, the preliminary rate credited to these accounts averaged 19.02%.
- 4. Variable Annuity Account and Individual Account Program (IAP):** These accounts are credited with actual earnings or losses, less a proportional charge for administrative expenses. Preliminary variable earnings for 2009 are estimated to be 37.46%, and IAP account earnings are estimated to be 18.48% for 2009.

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5. Tier One Rate Guarantee Reserve: This reserve, established under ORS 238.255(1), is to be used to credit the assumed rate to Tier One member regular accounts. The reserve went into a deficit in 2008; when in deficit status, earnings on the Tier One member regular accounts that are in excess of the assumed earnings rate must be used to offset that deficit. The amount of 2009 earnings used for this offset will depend, in part, on the Board's Contingency Reserve decision.

DISCRETIONARY EARNINGS ALLOCATIONS

According to ORS 238.670(1), in those years in which earnings exceed the assumed rate, up to 7.5% of earnings can be allocated to the Contingency Reserve. The Contingency Reserve is not credited with its own earnings or losses but, instead, funds are added to or transferred from the reserve only as directed by the Board.

As 2009 earnings exceeded the assumed rate, the PERS Board must again address whether the Contingency Reserve is adequately funded. Staff has developed three options for the Board's consideration in funding this reserve (charts showing the impact of each option are attached):

Option 1: Make no additional allocation. This would leave the reserve's balance at \$653.2 million, the balance set by the Board in allocating 2007 earnings, and maintained by the Board in allocating 2008 losses.

Option 2: Increase the reserve's balance by transferring the maximum amount of 2009 earnings allowed. This would increase the reserve's balance to \$1,162.7 million, an increase of \$509.5 million.

Option 3: Reduce the reserve's balance to a new benchmark, such as 1% of Fund reserves. This funding level, for example, would reduce the reserve's balance to \$513.0 million. This option could involve establishing a benchmark by which the Board can adjust the size of the Contingency Reserve as the size of the system changes. Choosing this option would result in approximately \$140.2 million being allocated from the Contingency Reserve to the Tier One Rate Guarantee Reserve, Tier Two member regular accounts and the Employer and Benefits-in-Force reserves.

POLICY ISSUE

- *Is the Contingency Reserve adequately funded?*

In 2007, the last year in which earnings exceeded the assume earnings rate, the Board set the current balance (\$653.2 million) based on the status of ongoing litigation and the unknown impact from unsettled financial markets. Those dynamics have not changed appreciably since the PERS Board established this funding level. Staff therefore recommends that the PERS Board make no additional allocation to the Contingency Reserve, and preserve the current balance of \$653.2 million.

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In addition to the Contingency Reserve allocation, the PERS Board's Annual Crediting Rule (OAR 459-007-0005) directs the crediting to the Judge and Tier Two member regular accounts, as well as the OPSRP Pension, Benefits-in-Force, and Employer reserves.

RECOMMENDED 2009 PRELIMINARY ALLOCATIONS

Staff recommends the following allocations be adopted preliminarily by the PERS Board:

1. Non-Discretionary Allocations

Credit administrative expenses, health insurance accounts, employer lump sum accounts, variable annuity account, and accounts in the Individual Account Program at the rates described above. Credit Tier One member Regular Accounts with the assumed earnings rate (8%) and credit the remainder of Tier One member Regular Account earnings to the Tier One Rate Guarantee Reserve.

2. Funding of Contingency Reserve

Credit zero percent of available 2009 earnings to the Contingency Reserve (Option 1), and preserve the current balance of \$653.2 million.

3. Judge Member Accounts

Credit Judge Member Accounts with the assumed earnings rate (8%).

4. Tier Two Member Regular Accounts, Benefits-In-Force and Employer Reserves

Credit Tier Two member regular accounts and the Benefits-In-Force and Employer reserves evenly with the remaining available earnings. Under this recommendation, the preliminary 2009 rate credited to these accounts and reserves would be 19.13%.

BOARD OPTIONS

The Board may:

1. **Adopt Staff's Recommendation:** Pass a motion to "adopt the staff's recommended preliminary crediting of earnings for calendar year 2009, subject to final adoption at the March 29, 2010 PERS Board meeting."
2. **Adopt an Optional Policy Position:** Pass a motion to "adopt the staff's recommended preliminary crediting of earnings for calendar year 2009, subject to final adoption at the March 29, 2010 PERS Board meeting," but amending that recommendation as follows:
 - Increase the Contingency Reserve by 7.5% of Regular Account earnings (Option 2);
 - Reduce the Contingency Reserve balance to 1% of Fund reserves (Option 3); or
 - Increase the Contingency Reserve funding by a stated dollar amount or percentage of available earnings.
3. **Develop alternative strategies:** Adopt an alternative preliminary crediting to the Contingency or other reserves. That alternative should be adopted to allow for adequate reporting to the legislature as required by ORS 238.670(5) and adopt final earnings crediting decisions at the PERS Board's March 29, 2010 meeting.

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NEXT STEPS

Once the Board makes its preliminary decisions, staff will prepare and present the required report to the Oregon Legislature's Ways and Means Committee. Any comments received from the committee will be presented to the Board prior to its final crediting decision on March 29, 2010.

This preliminary action and the resulting report to the Legislature do not prohibit the PERS Board from changing its final crediting and reserving decisions, such as if new information becomes available. If the Board makes a significant change from its preliminary decisions, staff will report the Board's actions to the Legislature.

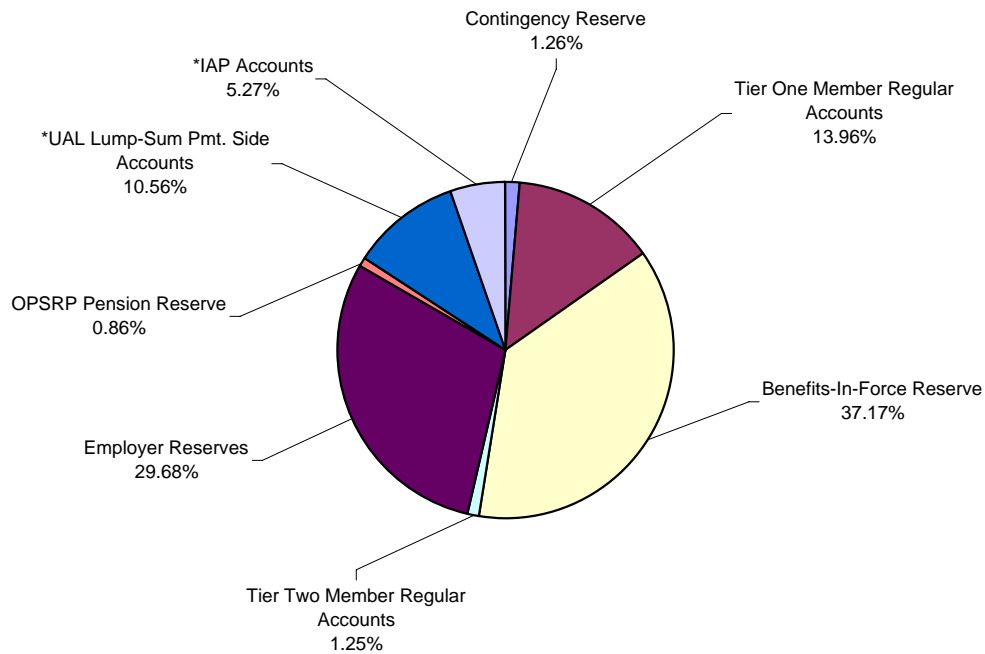
Attachments:

- Option 1: No Allocation to Contingency Reserve**
- Option 2: Contingency Reserve Receives 7.5% of Earnings**
- Option 3: Contingency Reserve Adjusted to 1% of Fund Reserves**

Option 1
2009 Preliminary Earnings Crediting
No Additional Allocation to Contingency Reserve
(All dollar amounts in millions)

Regular Account Reserve	Reserves Before Allocation	2009 Preliminary Allocation	Reserves After Allocation	2009 Preliminary Rates
Contingency Reserve	\$653.2	\$0.0	\$653.2	N/A
Tier One Member Regular Accounts	6,687.6	535.0	7,222.6	8.00%
Tier One Rate Guarantee Reserve	-978.5	557.4	-421.1	N/A
Benefits-In-Force Reserve	16,136.0	3,087.5	19,223.5	19.13%
Tier Two Member Regular Accounts	541.9	103.7	645.6	19.13%
Employer Reserves	12,885.4	2,465.5	15,350.9	19.13%
OPSRP Pension Reserve	377.1	65.4	442.5	17.35%
*UAL Lump-Sum Pmt. Side Accounts	4,567.7	891.6	5,459.2	Various
*IAP Accounts	2,297.7	425.6	2,723.4	18.48%
Total	\$43,168.2	\$8,131.8	\$51,300.0	

2009 Regular Account Reserve Balances
After 2009 Preliminary Crediting

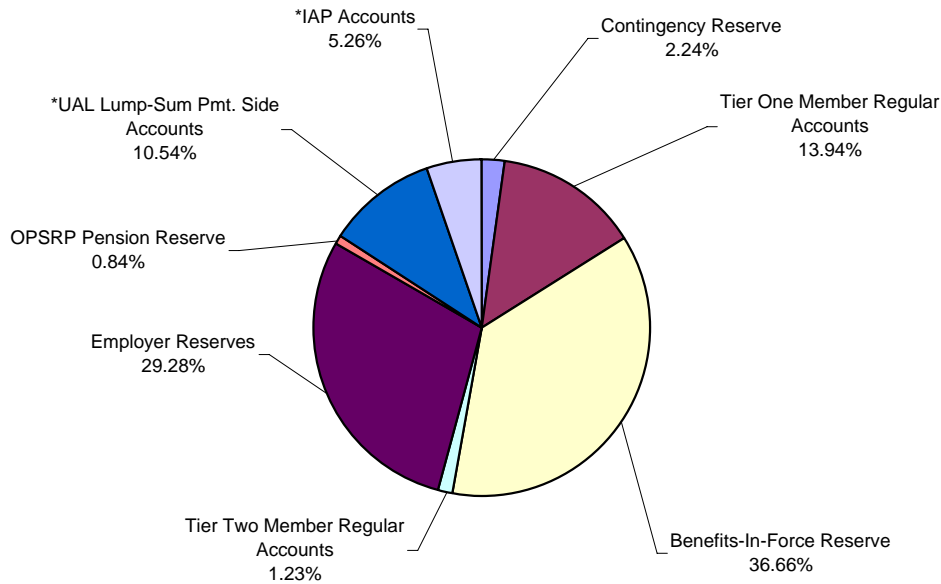


*Informational only. Not affected by Board reserving or crediting decisions.

Option 2
2009 Preliminary Earnings Crediting
 Allocate 7.5% of Earnings to Contingency Reserve
 (All dollar amounts in millions)

Regular Account Reserve	Reserves Before Crediting	2009 Preliminary Crediting	Reserves After Crediting	2009 Preliminary Rates
Contingency Reserve	\$653.2	\$509.5	\$1,162.7	N/A
Tier One Member Regular Accounts	6,687.6	535.0	7,222.6	8.00%
Tier One Rate Guarantee Reserve	-978.5	475.8	-502.6	N/A
Benefits-In-Force Reserve	16,136.0	2,856.9	18,992.9	17.71%
Tier Two Member Regular Accounts	541.9	96.0	637.9	17.71%
Employer Reserves	12,885.4	2,281.4	15,166.8	17.71%
OPSRP Pension Reserve	377.1	60.1	437.1	15.93%
*UAL Lump-Sum Pmt. Side Accounts	4,567.7	891.6	5,459.2	Various
*IAP Accounts	2,297.7	425.6	2,723.4	18.48%
Total	\$43,168.2	\$8,131.8	\$51,300.0	

2009 Regular Account Reserve Balances
 After 2009 Preliminary Crediting

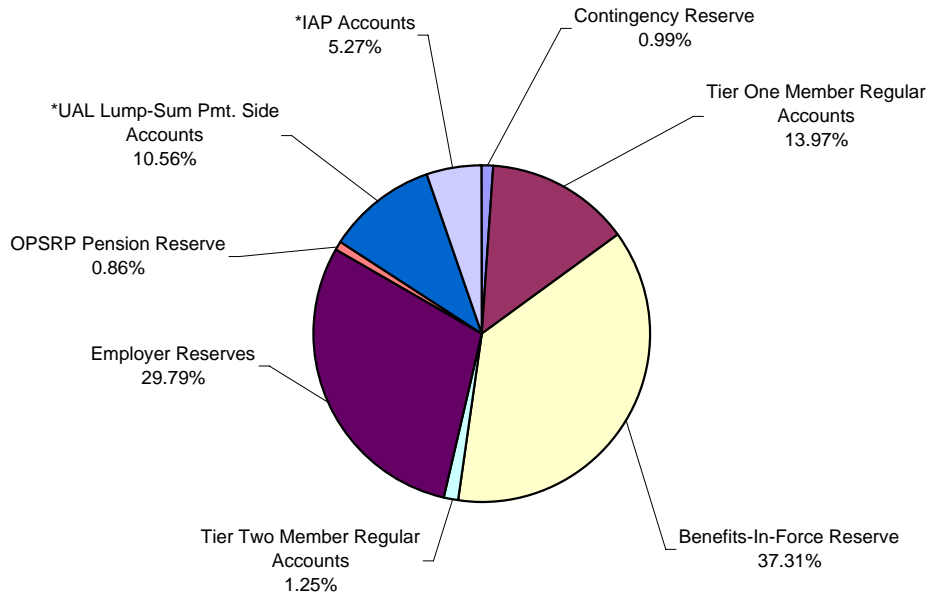


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Option 3
2009 Preliminary Earnings Crediting
 Maintain Contingency Reserve at 1% of Fund Reserves
 (All dollar amounts in millions)

Regular Account Reserve	Reserves Before Crediting	2009 Preliminary Crediting	Reserves After Crediting	2009 Preliminary Rates
Contingency Reserve	\$653.2	-\$140.2	\$513.0	N/A
Tier One Member Regular Accounts	6,687.6	535.0	7,222.6	8.00%
Tier One Rate Guarantee Reserve	-978.5	579.9	-398.6	N/A
Benefits-In-Force Reserve	16,136.0	3,151.0	19,287.0	19.53%
Tier Two Member Regular Accounts	541.9	105.8	647.8	19.53%
Employer Reserves	12,885.4	2,516.2	15,401.6	19.53%
OPSRP Pension Reserve	377.1	66.9	444.0	17.75%
*UAL Lump-Sum Pmt. Side Accounts	4,567.7	891.6	5,459.2	Various
*IAP Accounts	2,297.7	425.6	2,723.4	18.48%
Total	\$43,168.2	\$8,131.8	\$51,300.0	

2009 Regular Account Reserve Balances
 After 2009 Preliminary Crediting



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