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Effect of SB 1049 Cost Sharing Provisions on PERS-Covered Career Employees

Prior to 2004, all PERS-covered employees contributed 6% of salary to the PERS pension plan. In most cases, public employers picked up the 6% employee contribution in lieu of 6% of salary. But, in either case, the 6% contribution supported the pension plan.

Beginning in 2004, the employee contribution of 6% was diverted to a supplemental, 401(k)-style retirement savings plan, known as the Individual Account Program or IAP. Employer pickups of the 6% continued, but the 6% no longer support the pension plan. These contributions are now directed to the IAP.

What SB 1049 Does

SB 1049 reinstates employee contributions to the pension plan by redirecting a portion of future employee contributions from the IAP to the pension plan. By so doing, employee support for the pension plan will be re-established via the IAP, which means that no employee will suffer a reduction in salary or take-home pay as a result of this reinstatement of employee contributions to the pension plan.

The schedule of employee contributions enacted by SB 1049 beginning 7/1/20 are as follows, for employees who earn more than $2,500 per month:

- For Tier 1 and 2 employees (hired before 8/29/03), 2.5% will be redirected from future IAP contributions and deposited in employee accounts to support the pension plan, leaving 3.5% as the future contribution to the IAP; and,
- For OPSRP or Tier 3 employees, 0.75% of salary will be redirected from future IAP contributions and deposited in employee accounts to support the pension plan, leaving 5.25% as the future contribution to the IAP

Employee pension benefits will not be affected (with the exception of a cap on pensionable salaries of $195,000 a year enacted in another portion of the legislation). Also, employees' IAP account balances will be protected, but future contributions to their IAP accounts will be diminished and will slow the growth of this supplement retirement benefit.

How will these changes affect the total retirement package of a career employee, whom PERS defines as an employee who completes 30 years of service?

Again, the pension benefit for years of service will not change for all but a few employees earning more than $195,000 a year. But their IAP balances will accumulate lesser amounts over the course of a career.

We estimate the value of an IAP account funded at 6% of salary at 14.2% of final average salary (average of one's highest three years of salary) after 30 years of employment. This is based on the current contribution rate of 6% and:

- a salary that grows 3.5% a year (the system's actuarial assumption);
- with earnings compounded at 7% a year (the fund's experience since 2004); and,
- annuitization at 3.5% for 25 years of retirement (based on market annuities, with no cost-of-living adjustment thereafter).

Effect on OPSRP Employees

To reduce the IAP to 5.25% of salary for an OPSRP employee, the IAP would generate 12.4% of final average salary after 30 years with no cost-of0living adjustment thereafter.

By contrast, the pension formula will deliver 45% of final average salary, with annual cost-of-living adjustments thereafter. So the initial pension benefit is worth more over time for each percentage of final average salary.

Combining the IAP and the pension, the initial combined retirement benefit for a 30-year OPSRP employee will decline from 59% to 57% for new OPSRP employees, while those already in the system will secure a combined initial benefit of 58% of final average salary. Absent any change in the IAP, an OPSRP employee would have received an initial combined retirement benefit of 59% of final average salary.

These percentages do not include Social Security, which will provide an initial cost-of-living-adjusted benefit in the range of 25% to 35% of final salary for most employees.

Effect on Tier 1 and Tier 2 Employees

The effect of the higher pension contribution rate for Tier 1 and 2 employees, vis-à-vis OPSRP employees, will be offset by the higher pension formula provided to these employees, which equates to 50% of final average salary after 30 years of employment. (As is the case with OPSRP, this percentage does not include Social Security.)

But very few Tier 1 or Tier 2 employees, all of whom were hired prior to 2004, are likely to accrue more than 20 years of service under the IAP. For a Tier 1 or 2 employee, who earns a 6% IAP for 20 years, its value would equate to 11% of final average salary. When reduced to 3.5% under SB 1049, its value would decline to 6% of final average salary. Most Tier 1 and 2 employees, however, will experience some number of years with the pension plan and no IAP, an additional number of years with the pension plan plus a 6% IAP and another number of years with the pension plan and a 3.5% IAP.

In the case of a Tier 1 or 2 employee, the average pension after 30 years of service will, in most cases, be greater than 50% of nominal final average salary because of the effects of the Money Match option and the use of unused sick leave and vacation to boost the final average salary number. In 2017, PERS reported that the average Tier 1 or Tier 2 retiree with 30 years of service earned an initial pension of 53% of final average salary (enhanced by unused sick leave and vacation). Also, these retirees retired at a younger age than those in OPSRP. So the value of the IAP is likely to be worth proportionately less to them than the value of their pension.

Nonetheless, valuing the Tier 1/2 pension at 53% of final average salary and assuming 15 years in the IAP at 6% and 10 years at 3.5%, the IAP would equate to an initial additional retirement benefit of 11% of final average salary. The combined initial retirement benefit would amount to 64% of final average salary – compared to a combined initial retirement benefit of 66% under current law.

Effect of SB 1049 on Police and Fire Employees

We have not calculated the effects of SB 1049's cost sharing provisions on Police and Fire members. But its effects for these members will be less impactful than for general service members. This is because Police and Fire members get a larger pension benefit for their years of service and, commensurately, earn less of an IAP benefit during careers that tend to average less than 30 years.

Conclusion

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PERS has historically calibrated its goal for a retirement benefit for 30-year career employees at 50% of final average salary. But, with the addition of the IAP in 2004, Tier 1 and 2 employees are now on track to earn an initial benefit of 66% of final average salary and OPSRP employees are on track to earn 59% of final average salary.

With the changes incorporated in SB 1049, the retirement benefits as a percentage of final average salary will decline to an average of 64% for Tier 1/2 employee, 58% for current OPSRP employees and 57% for new hires.

Thus, the net effect of SB 1049 on initial retirement benefit packages for career employees in all tiers (with salaries below $195,000/year) will be approximately 1% to 2% of final average salary. Even then, those initial retirement benefits will comfortably exceed the PERS goal of 50% of final average salary.

Attachment: Effect of SB 1049 on Career Employee Retirement Packages