W.6.b.

Lane County Board of Commissioners

April 18, 2006

Mr. Michael Pittman, Chair
PERS Board of Directors
Public Employees Retirement System
PO Box 23700
Tigard, OR 97281

Dear Mr. Pittman:

Lane County appreciates the opportunity to share our thoughts and concerns about the changes in actuarial methodology being considered by the PERS Board. We deeply appreciate and support the Board's willingness to review the methodologies used by PERS' actuaries in the past, and your search for new ideas that will both support the funded status of PERS as well as create predictable and stable contribution rates for public employers.

We have heard information regarding the proposal that PERS adopt the Projected Unit Credit (PUC) method instead of the Entry Age Normal (EAN) methodology currently used in actuarial calculations, as well as the change from Asset Smoothing to Rate Collaring. We also noted the Board's decision at the March Board Meeting to deploy a significant portion of the PERS reserves.

SMOOTHING METHODOLOGY
Lane County had concerns about the Asset Smoothing methodology when it was first adopted. This method has made it very difficult for public employers to predict future rates in their long-term financial planning, even in times of better-than-average returns. The fact that Asset Smoothing also makes it difficult to determine the actual asset value at any point in time has only increased our dissatisfaction with this method.

While it is difficult for a public employer to deal with sudden spikes in contribution rates, it costs public employers more when an unfunded liability is repaid over a longer period of time. We believe that any smoothing methodology should allow for the repayment of unfunded actuarial liability as quickly as possible.

If the PERS Board believes that there must be some method in place to reduce volatility in employer rates, we do believe that the Rate Collaring Methodology is preferable to Asset Smoothing because:

1. The value of the assets are clearly stated, and
2. The three percent employer rate collar, with the possibility of allowing up to a 6% increase in times of severe rate fluctuation, allows for a

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quicker repayment of any liability created as a result of rates actually exceeding the maximum rate collar.

Lane County supports adoption of the Rate Collar Methodology.

BASIC ACTUARIAL METHODOLOGY

After reviewing information about this change, we do not find compelling reasons to adopt the PUC Method. We are concerned that this method:

1. Immediately creates a new $1.2 billion unfunded actuarial liability (UAL) in the PERS Tier 1 and Tier 2 system.
2. MERCER estimates that employers' Normal Cost rates will decrease from a system-wide average of a little more than 12% to about 9%, including the additional cost to amortize the new UAL, in the first year of implementation. However, the rate is projected to increase with every two-year valuation to almost 14% by 2022. Under Entry Age Normal, the current Normal Cost rate of 12% is estimated to gradually decrease over that time to a little less than 11%.
3. The additional employer rate necessary to repay this liability over a rolling five year period that would take almost 18 years to amortize, and would also apply to OPSRP earnings, thereby negating some of the cost savings that the Legislature hoped to effect by creating the OPSRP plan.
4. The advantages of this method appear to be due to assumptions made about the number of employees who will retire under Money Match. Over a relatively short period of time this method will no longer generate the most advantageous retirement benefit. It does not appear logical to change the current Basic Actuarial Method to address a benefit calculation that will gradually no longer be used.
5. At this point we have heard no indication from the PERS Board that they are considering a change to the PUC Methodology for the OPSRP program. In the interest of simplicity and comparability, it would seem that both systems should use the same methodology, the Entry Age Normal Method.
6. MERCER has stated that their research indicates that only about 13% to 15% of public entity pension systems use the PUC Method, even though it is the method most commonly used in the private sector. Given the number of private sector pension programs that are facing substantial underfunding, we would suggest that PERS should continue to use the Entry Age Normal Method, along with the majority of other public sector pension programs.
7. The PERS Board has chosen to make changes in the level of funding of the various PERS Reserves, and it appears that you will make changes to the Smoothing Methodology. We are concerned that there has not been enough study of possible outcomes if all these changes

are implemented at one time. We believe that there have been enough "unintended consequences" due to other changes over PERS' history to indicate caution and delay in implementing yet another change.

Lane County does not support adoption of the Projected Unit Credit Method at this time. However, we look forward to participating in discussions of a possible change to the Basic Actuarial Methodology in the future when the results of the change in Smoothing Method and Reserve Policy have had time to be evaluated.

RESERVE POLICY

Lane County noted the action taken by the Board at its March Board meeting to dramatically reduce reserve balances. We understand that even among the PERB members, there was not unanimity about the appropriate level of reserves that should be maintained, and we appreciate the thought and deliberation that was taken before voting on that proposal.

Lane County encourages the Board to continue to review the financial risks that face the PERS system and adjust the reserves as needed. We would respectfully ask that the Board remember that it is easier to increase reserves gradually over time from above average earnings than to increase employer rates in times of crisis and/or poor investment earnings.

Sincerely,

Bill Dwyer, Chair
Lane Board of County Commissioners