Oregon Pension Task Force Releases Report on Unconventional Funding Sources

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In 2017, Oregon Governor Kate Brown convened a special task force (Task Force) to study opportunities for the State and local agency employers to reduce the unfunded actuarial liabilities of the Oregon Public Employee Retirement System (OPERS). The Task Force, consisting primarily of private industry executives and senior government administrators, released its final report on November 1, 2017. (*2017 PERS UAL Task Force Final Report.*) This report sets forth a menu of options to generate additional sources of funds that could be used to reduce the unfunded liabilities of OPERS. The Task Force was specifically directed *not* to consider the typical topics of pension reform proposals: changes to benefit levels, actuarial methods, or investment programs. Instead, the Governor directed the Task Force to be creative and identify potential new funding sources that might be controversial, difficult, or possibly unsuccessful. The Final Report does just that, identifying nearly two dozen potential new funding sources.

The ideas described in the Final Report will likely be considered by Oregon and, to the extent feasible, by other states in their quest to increase funding levels. Pension plan administrators and lawyers should be aware of these potential changes in funding sources and should consider the role of the plan in efforts to implement them, recognizing the fiduciary duties of plan trustees and potential exclusive benefit rule issues.

Background

OPERS is the primary retirement system for public workers in Oregon. Plan sponsors include the State of Oregon (State) and its agencies, school districts, community colleges, public universities, cities, counties, and fire and utility districts. As of December 31, 2016, the unfunded actuarial liability (UAL) stood at nearly $20 billion and the plan was approximately 75% funded. The current funding policy of OPERS is to fully amortize the UAL over the next twenty years by, among other things, increasing employer contributions. The Task Force noted that these increases are expected to put pressure on public agency budgets and, at least potentially, impact the quality of public services provided to Oregonians.

New Funding Sources

The Final Report identified over twenty new funding sources. These included the following:

- **Excess Risk Capital.** Several state agencies maintain substantial amounts of cash and short-term liquid assets to cushion against financial downsides and maintain high credit ratings. This risk capital is rarely needed and often is never drawn down. Pooling these separate funds at the state level should reduce the total amount of risk capital needed, thus freeing up excess funds for transfer to reduce the OPERS UAL. In addition, the Task Force posited that the State could issue very long-term or perpetual notes (bonds) to state-controlled entities that need access to risk capital. After noting that the terms would need to be carefully structured to meet the financial distress and credit rating needs of the parties, the Task Force concluded that the proceeds from these perpetual bonds could be used to pay down the UAL. Like pension obligation bonds, the State would substitute UAL with a liability on a note but presumably the interest rates would be lower than pension obligation bonds.
- **One-Time Windfall Income.** Because of uncertainty, some public sector revenues may exceed anticipated levels. In Oregon, these include capital gains and estate taxes, lawsuit settlements, and school district fund surpluses. The Task Force recommended that use of these one time gains be considered.
- **Privatizing Public Universities.** Three public research universities are eligible for private financing in Oregon. The Task Force recommended the State consider transferring one or more of these universities to a private, not-for-profit entity that could be supported by a new philanthropic endowment and use the proceeds from the sale to reduce the UAL.
- **Natural Resources.** The Task Force recommended that the State consider new arrangements with the federal government, and public and private landowners covering timber harvesting, forest fire suppression costs, and water rights, to generate additional revenue.
- **Increasing State Lottery Revenue.** The Task Force noted that the Oregon Lottery Commission is considering expansion of the state lottery. Assuming this expansion results in more revenue, the Task Force recommended that the State consider dedicating a portion of the increased revenue to pay down the school districts' UAL.

PERS Resolution Program

The Task Force recommended that the State consider a new incentive program for local agency employers to reduce their UAL. Because the State has little or no control over local agency budgets, providing encouragement to these agencies to reduce their UAL could ultimately result in additional contributions and lowered pension costs. To provide this incentive, the State could create an incentive fund, which would provide a partial match for qualifying additional local employer contributions made by a certain date. This fund could be financed using the other sources identified in the Final Report. If the State made an additional contribution of $500 million from this fund, and local employers fully matched this contribution at a 25% match rate, then the UAL would be reduced by a total of $2 billion.

The Task Force noted that the State could consider negative incentives as well. These might include conditioning actuarial smoothing of rates on local agency participation in the incentive fund or similar actions that must be taken to reduce the agency's UAL.

Legal Issues

Managing the complexities of a new program to reduce UAL, the Task Force noted, would take significant work and resources. The PERS Resolution Program, in particular, would require OPERS staff to provide, at a minimum, information and technical support to the State and local agency employers. Although not mentioned in the Final Report, any changes to amortization periods, smoothing methods, or other actuarial practices designed to incentivize plan sponsors would need to be made by the public pension board – not the Governor.

When asked by the Governor or other state or local public officials to provide this type of assistance, public pension plans should carefully consider their fiduciary duties, plan provisions, and trust law restrictions before deciding on their roles in these efforts.

As trustees, the pension board owes duties of loyalty and prudence to the plan members. Improving the long-term security of retirement benefits by increasing the funded status of the plan is, by itself, beneficial to plan members. And legislative changes to plan operations made by plan sponsors without receiving input from the plan itself can have unintended dire consequences. But there are legal restrictions on the actions a pension plan may take. If authorized, providing accurate, non-confidential information to members and plan sponsors should be consistent with fiduciary standards. However, making changes in actuarial methods to incentivize employers might have negative impacts on the sound administration of the plan or might otherwise conflict with the duty of loyalty owed to plan members. Devoting plan resources to sponsors through technical assistance might implicate the requirement to use plan assets exclusively to pay benefits and system administrative expenses.

Finally, any conditions placed on the plan by sponsors in exchange for additional contributions should be very carefully evaluated. Even though the Task Force did nothing to suggest that the State or local agencies should obtain any concessions from the plan in return for increased contributions, past history suggests that it would not be unusual for plan sponsors to seek them. Plan trustees should thoroughly consider, on their own, the merits as well as the motivation and impact of any changes in plan operations or policy which might be considered in connection with a new program to reduce UAL.