

HOUSE BILL REPORT

HB 2491

As Reported By House Committee On:
Appropriations

Title: An act relating to the sharing of extraordinary investment gains.

Brief Description: Sharing extraordinary investment gains.

Sponsors: Representatives Carlson, H. Sommers, Ogden, Conway, Wolfe, Lambert, D. Sommers, O'Brien, Schoesler, Alexander and Gardner; by request of Joint Committee on Pension Policy.

Brief History:

Committee Activity:

Appropriations: 2/3/98, 2/7/98 [DPS].

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 30 members: Representatives Huff, Chairman; Alexander, Vice Chairman; Clements, Vice Chairman; Wensman, Vice Chairman; H. Sommers, Ranking Minority Member; Doumit, Assistant Ranking Minority Member; Gombosky, Assistant Ranking Minority Member; Benson; Carlson; Chopp; Cody; Cooke; Crouse; Grant; Keiser; Kenney; Kessler; Lambert; Linville; Lisk; Mastin; McMorris; Parlette; Poulsen; Regala; D. Schmidt; Sehlin; Sheahan; Talcott and Tokuda.

Staff: Denise Graham (786-7137).

Background: Assets invested in the retirement funds have been experiencing growth in recent years substantially above the projected rate of 7.5 percent. The compound average rate of return for the last four years is 13.7 percent. Over the 1997 interim, the Joint Committee on Pension Policy (JCPP) studied ways of using these better-than-expected returns to fund benefit increases. As a result of this work, the JCPP recommended several gain-sharing bills to the 1998 Legislature.

The Teachers' Retirement System (TRS) Plan I and the Public Employees' Retirement System (PERS) Plan I are defined benefit plans, which means that members receive a formula-driven benefit at retirement. Members of TRS and PERS Plan I pay 6 percent of salary toward the cost of their benefits. This contribution rate is set in statute and does

not vary when benefits are increased or when investment earnings are greater or less than assumed.

TRS and PERS Plan I are closed retirement systems that experienced chronic under-funding in the 1970s and 1980s. Under current law, PERS and TRS Plan I employer contribution rates are set at the level percentage of pay necessary to pay off the total costs of the systems by July 1, 2024. The current unfunded liability in TRS and PERS Plan I is \$5.2 billion. Better-than-expected investment returns are held in the pension trust funds. The pension contribution rates paid by employers (including the state and local governments) have been adjusted downward when earnings are higher than expected. Earnings below the projected level of 7.5 percent could result in higher employer contribution rates.

In 1993, pension contribution rates were adjusted downward due to higher-than-expected investment gains and faster-than-expected membership growth. As a result of the decrease in employer contribution rates, pension contributions made from the General Fund-State for the PERS, TRS and the Law Enforcement Officers' and Fire Fighters' (LEOFF) systems were \$49.4 million lower than they would have been had the rates not been decreased. That same year, legislation was enacted providing benefit increases for members of PERS, TRS and LEOFF. The increase in the employer contribution rates due to the new benefits raised the General Fund-State pension contributions during the 1993-95 biennium by \$27 million. Another \$25 million was transferred from the General Fund-State to the Budget Stabilization Account. In 1994, \$25 million was transferred from the Budget Stabilization Account to the newly created Pension Funding Account.

"Pop-Up" Benefit. A retiree under the Judicial Retirement System, LEOFF Plan II, TRS Plans I, II or III, or PERS Plans I or II, can choose a lower monthly benefit in exchange for his or her spouse receiving a benefit after the retiree's death. This is called a survivor option. Members of the pension systems who retired after January 1, 1996, receive a "pop-up" in their benefit if their spouse dies first; that is, the benefit the retiree receives "pops-up" to the level the benefit would have been if the retiree had not chosen the survivor option. (Surviving spouses of retired LEOFF Plan I members automatically receive the same benefit the retiree received during his or her lifetime, so the "pop-up" is irrelevant to the LEOFF Plan I system.)

Uniform COLA. PERS and TRS Plan I retirees receive an annual cost-of-living adjustment, called the Uniform COLA, beginning at age 66. The current COLA is 63 cents per month, per year of service. The COLA increases by 3 percent each year. Next year, PERS and TRS Plan I retirees will receive another 64 cents per month per year of service, in addition to the COLA amounts received in previous years.

Summary of Substitute Bill: When the compound average rate of investment returns on the pension funds over the previous four years exceeds 10 percent, half the earnings over 10 percent will be used to increase benefits and the other half will be used to

accelerate the amortization of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) Plan I costs.

The first gain sharing will occur July 1, 1998, and will fund the present actuarial value of a retroactive "pop-up" benefit for retirees who retired prior to 1996, as well as an increase in the Uniform COLA. Thereafter, gain sharing will occur January 1 of each even-numbered year whenever the four year compound average rate of investment returns on the pension funds is more than 10 percent. After the initial July 1, 1998, gain sharing, all subsequent gain sharing will take the form of an increase in the Uniform COLA.

The Office of the State Actuary will calculate the amount of the Uniform COLA increase and will inform the Department of Retirement Systems of the amount.

The following amounts are appropriated from the Pension Funding Account: \$12.5 million is appropriated for the TRS Plan I fund and \$12.5 million is appropriated for the PERS Plan I fund. Statutory language creating the Pension Funding Account is repealed.

The Legislature reserves the right to repeal the gain-sharing provisions of the bill.

Substitute Bill Compared to Original Bill: The original bill used the term "geometrically averaged" to describe the calculation of the gain-sharing amount. The substitute bill uses the term "compound average." The change in language does not change the actual calculation.

The original bill specified that, except for any appropriations made in the bill, monies in the Pension Funding Account are dedicated to funding LEOFF benefits. This language is deleted in the substitute bill.

The original bill left blank the amounts to be appropriated from the Pension Funding Account to the TRS and PERS Plan I funds. The substitute bill specifies the amounts to be appropriated.

Appropriation: The following amounts are appropriated from the Pension Funding Account: \$12.5 million is appropriated for the TRS Plan I fund and \$12.5 million is appropriated for the PERS Plan I fund.

Fiscal Note: Available.

Effective Date of Substitute Bill: Ninety days after adjournment of session in which bill is passed.

Testimony For: The gain-sharing provided in this bill is a good start. It would allow the state to share the success of retirement fund investments in a fiscally responsible manner. Retirees would like a greater share of the investment gains, however, and would prefer that the bill not lock in an increase in the Uniform COLA as the mechanism for sharing extraordinary gains. Finally, none of the gains should be used to decrease the plan I amortization period.

Testimony Against: None.

Testified: Helen Carlstrom and Bob Maier, Washington Education Association; Joe Beck, Retired Public Employees Council; Page Carter, PERS retiree; Pat Horn and George Eisentrout, Washington State Retired Teachers' Association; Doug Nelson, Public School Employees of Washington; Ed Montermini, PERS I retiree; John Kvamme, Washington Association of School Administrators; and Devone Smith, Public Employees' Pension Coalition.