Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Appropriations Committee

HB 1324

Brief Description: Replacing gain-sharing provisions with certain changes in benefits and setting contribution rates for the public employees', teachers', school employees', and public safety employees' retirement systems.

Sponsors: Representatives Fromhold, Conway, Crouse, Simpson and Linville; by request of Select Committee on Pension Policy.

Brief Summary of Bill

- Repeals Plan 1 gain-sharing in the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS), and replaces it with four contractually-guaranteed benefit increases: a 20-cent increase in the Annual Increase, an extension of eligibility for the $1,000 minimum benefit to members who have 20 years of service and have been retired for 25 years, an annual increase of the $1,000 minimum benefit by 3% per year, and an extension of the Annual Increase to all members retired for one year in the year that they turn 66.

- Modifies Plan 3 gain-sharing to remove future PERS and TRS Plan 3 gain-sharing distributions and replaces the SERS Plan 3 gain-sharing distribution formula with an annual benefit to SERS Plan 3 member accounts of $10 per year of service.

- Creates a prospective "Rule of 90" retirement formula that permits PERS, TRS, and the School Employees' Retirement System (SERS) Plan 2 and 3 members with a combination of age and years of service of at least 90 to receive an unreduced retirement allowance beginning at age 60.

- Opens TRS and SERS Plan 2 as an option for new members, and repeals the statutes providing an annual opportunity to change employee contribution rates in TRS, PERS, and SERS Plan 3.

- Establishes annual basic contribution rates in PERS, TRS, and SERS for the next four fiscal years, in place of biennial rates.

- Establishes minimum employer and state contribution rates for PERS, SERS, and TRS beginning in 2009.

Hearing Date: 2/17/05

Staff: David Pringle (786-7310).

Background:

Gain-sharing is a mechanism for increasing benefits created for the Teachers' Retirement System (TRS), the School Employees' Retirement System (SERS), and the Public Employees' Retirement System (PERS) Plans 1 and Plans 3 in 1998. It increases benefits in these plans when "extraordinary investment gains" are experienced by the plans.

The gain-sharing statutes define "extraordinary investment gains" as those that are earned when the compound average of investment returns on the pension funds over the previous four fiscal years exceed 10 percent. When the previous four fiscal year average exceeds 10 percent, a calculation is performed to determine a dollar amount that will be distributed to eligible members. The calculation is performed once per biennium for distributions in January of even-numbered years.

The method of distribution of extraordinary investment gains is different in each of the Plans 1 and Plans 3. In Plan 1, an amount equal to one-half of the extraordinary investment gains is used to permanently increase the Annual Increase Amount, also known as the "Uniform COLA", which serves to increase eligible retirees' benefits each year. Currently the Annual Increase Amount is $1.21 per month per year of service for a retiree, or approximately $36 per month for a retiree with 30 years of service. In 1998, distribution of extraordinary investment gains increased the Annual Increase Amount by $0.10, and in 2000 by an additional $0.28.

In Plan 3, extraordinary investment returns are calculated in generally the same manner as in the Plans 1. Extraordinary investment returns that are attributable to the Plan 3 portion of the combined Plan 2/3 retirement funds are determined, and distributions are made to the Plan 3 members in a lump sum dollar amount that is deposited into Plan 3 individual member and retiree accounts. An individual's distribution is proportionate to the amount of service credit that they have in Plan 3 to the total in their plan. For example, in 2000, TRS Plan 3 members received a gain-sharing distribution of $254 per year of service, so that a member with 20 years of service in Plan 3 would have received a lump-sum distribution of about $5,085 into his or her individual account.

The gain-sharing statutes were enacted by the Legislature with a reservation of contractual rights. The Legislature specifically reserved the right to amend or repeal the gain-sharing laws in the future, and no member or beneficiary has a right to receive a gain-sharing distribution after an amendment or repeal of the laws is enacted.

In the 2003 Actuarial Valuation, the Actuary determined that the future cost of gain-sharing distributions result in an effective reduction in the long-term average rate of return that can be assumed from the pension funds. The long-term average is lowered through the gain-sharing mechanism because in some periods of very good investment return, some extraordinary gains are distributed as additional benefits.

The effective long-term rate of return is lowered sufficiently by gain-sharing to represent a material future cost to the retirement plans, as compared to the cost of the benefits apart from gain-sharing, and the Actuary determined that higher contribution rates are required to fund the future gain-sharing costs. As part of the contribution rates the Actuary recommended to the Pension Funding Council (PFC), and the PFC adopted subject to approval by the Legislature, were additional employer contribution rate amounts to fund future gain-sharing costs in PERS, TRS, and SERS.

The 2004 Legislature provided some PERS and TRS Plans 1 retirees with an increase to the minimum benefit that are eligible receive, prior to optional reductions such as contribution withdrawals and survivor benefits. Eligibility for this "$1,000 minimum benefit" requires a PERS or TRS Plan 1 member to have earned 25 years of service credit during their career and also be retired for at least 20 years. The $1,000 minimum benefit enacted in 2004 is not annually adjusted for inflation. The Actuary projects that the pre-existing minimum benefit, which is about $32 per month per year of service increased by 3 percent each year, will surpass the value of the $1,000 minimum benefit for the eligible retirees by 2010.

Retirees in PERS and TRS Plans 1 begin to be eligible to receive the Uniform COLA increase to their benefit at age 66 and after at least one year of retirement, provided the member turns age 66 before July 1 of that year.

Summary of Bill:

Gain-sharing for Plan 1 is repealed, and modified in Plan 3
The gain-sharing laws for PERS and TRS Plans 1 are repealed. The gain-sharing laws for Plan 3 are modified so that the only benefit provided by the chapter is $10 dollars per year of service that is distributed annually into the individual member accounts of members of SERS Plan 3. PERS and TRS Plan 3 do not receive any further benefits from gain-sharing.

Plan 1 benefit improvements
Four benefit improvements are made to PERS and TRS Plan 1. The Annual Increase is raised by $0.20 effective July 1, 2005 from $1.25 under current law to $1.45 per month per year of service. A $1,000 minimum benefit, before optional reductions, is extended to members with 20 years of service and who have been retired for 25 years. The $1,000 minimum benefit is also increased by 3 percent per year. The criteria for initial eligibility for the Annual Increase are modified so that all retirees who have been retired for one year are eligible for the increase beginning in the year that they turn age 66.

"Rule of 90" and options in Plan 2 and 3
A prospective "Rule of 90" unreduced retirement age with a minimum retirement age of 60 for members of PERS, TRS, and SERS Plans 2 and 3. Only years of service earned after July 1, 2007, may be received unreduced. Years of service earned by a member before July 1, 2007, would, if a member retired upon eligibility under the modified Rule of 90, be reduced according to current law.

Individuals first entering membership in TRS and SERS after July 1, 2007 are offered the option of membership in Plan 2 or Plan 3, as is currently offered in PERS. The annual window offered to members of Plan 3 to change member contribution rates above a base contribution level of 5 percent is repealed.

Phase-in of contribution rate increases
A schedule of annual employer and member contribution rates are established for PERS, SERS, and TRS to replace the biennial rates that were recommended by the PFC for the 2005-07 biennium. The rates are lower than those recommended by the 2003 Actuarial Valuation for the 2005-07 biennium, and they are higher than those projected to be recommended by the 2005

Actuarial Valuation that will be conducted during 2006. Upon completion of the 2005 Actuarial Valuation, the PFC and the Actuary will review the rates created by the phase-in schedule and must recommend to the Legislature any changes that may be needed due to material changes in benefits, assumptions, methods, or experience of the retirement plans.

Minimum Rates
Minimum employer and state contribution rates are established for PERS, SERS, and TRS beginning in July and September of 2009. For PERS, beginning July 1, 2009, the minimum employer and Plan 2 employee contribution rates are 4 percent. Beginning September 1, 2009, the minimum SERS contribution rates are 4.25 percent for employers and Plan 2 employees, and the minimum TRS contribution rates are 5 percent for employers and Plan 2 employees. In addition, an employer contribution rate of 2.75 percent is added to PERS, TRS, and SERS employers until either the actuarial value of assets in Plan 1 exceed 125 percent of liability, or until June 30, 2024, when the unfunded liability in the Plans 1 has been paid.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and contains several effective dates. Please see the bill.