HOUSE BILL REPORT
HB 2391

As Reported by House Committee On:
Appropriations

Title: An act relating to retirement system gain-sharing and alternate benefits.

Brief Description: Eliminating retirement system gain-sharing and providing alternate pension benefits.

Sponsors: Representatives Fromhold, Conway and Moeller.

Brief History:
Committee Activity:
Appropriations: 3/27/07, 3/28/07 [DP].

Brief Summary of Bill

- Repeals gain-sharing for the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) Plans 1 and 3, and the School Employees' Retirement System (SERS) Plan 3 after the January 1, 2008, gain-sharing event, and eliminates gain-sharing for members that joined the Plans 3 after July 1, 2008.
- Provides an increase to the Annual Increase Amount (Uniform COLA) in PERS and TRS Plan 1 on July 1, 2009, of up to 13 cents, should the January 1, 2008 gain-sharing distribution provide less than a 34 cent increase in the Uniform COLA.
- Provides members of PERS Plans 2 and 3, TRS Plans 2 and 3, and SERS Plans 2 and 3 who have completed at least 30 years of service with improved early retirement reduction factors of 1 percent per year of service between age 60 and 65, maintaining the current reductions of 3 percent per year of service between ages 55 and 60.
- Provides a choice of Plan 2 or Plan 3 membership for new TRS and SERS members hired after July 1, 2007.

HOUSE COMMITTEE ON APPROPRIATIONS

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Majority Report: Do pass. Signed by 21 members: Representatives Sommers, Chair; Dunshee, Vice Chair; Cody, Conway, Darneille, Ericks, Fromhold, Grant, Haigh, Hunt, Hunter, Kagi, Kenney, Kessler, Linville, McDermott, McIntire, Morrell, Pettigrew, Schual-Berke and Seaquist.

Minority Report: Do not pass. Signed by 10 members: Representatives Alexander, Ranking Minority Member; Bailey, Assistant Ranking Minority Member; Buri, Chandler, Dunn, Hinkle, Kretz, McDonald, Priest and Walsh.

Staff: David Pringle (786-7310).

Background:

Gain-sharing
Gain-sharing is a mechanism created in 1998 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. 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 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.

Benefit Enhancements from Gain-sharing Distributions
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.

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. The Annual Increase Amount that will be effective July 1, 2007, is $1.33 per month per year of service for a retiree, or approximately $40 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.

January 1, 2008 Projected Gain-sharing
The next scheduled calculation period for gain-sharing will close on June 30, 2007, and incorporate the four prior fiscal years of investment return in calculating a gain-sharing distribution for January 1, 2008. The most recent projection by the Office of the State Actuary, dated March 26, 2007, projects that the four-year median investment return will be about 15.3 percent, resulting in a $0.26 increase in the Plan 1 Uniform COLA and a $228 per year of service distribution to members of Plan 3. There is no gain-sharing benefit in the Plans 2; however, in periods of sustained investment return significantly above the assumed long-term rate (currently 8 percent) member contribution rates are likely to decrease.

Why Gain-sharing Increases Pension Contribution Rates
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 a part of the contribution rates the Actuary recommended to the Pension Funding Council (PFC), and the PFC has adopted for the 2007-09 fiscal biennium, are employer contribution rates sufficient to fund future gain-sharing costs in PERS, TRS, and SERS. The portion of the contribution rates adopted for gain-sharing are projected to generate about $147 million General Fund-State and $340 million in total employer costs during the 2007-09 biennium. Over the next 25 years, the standard period for reflecting the long-term cost of pension system changes, gain-sharing is projected to cost about $3.0 billion General Fund-State and $6.7 billion in total employer contribution rate costs.

Choice of Plan 2 or 3 for New Members
Membership in Plan 2 or 3 is a choice for new retirement system-eligible employees in PERS, but new members of TRS and SERS may only join Plan 3. New PERS members have a 90-day period to choose membership in Plan 2, or by default become members of Plan 3.

Summary of Bill:

Gain-sharing is closed to members of PERS, TRS, and SERS Plans 3 who are hired after July 1, 2007. After the January 1, 2008, gain-sharing distribution, gain-sharing is eliminated for all members of the Plans 1 and Plans 3.

On July 1, 2009, the Annual Increase Amount (Uniform COLA) in PERS and TRS Plan 1 is increased by up to 13 cents. The increase is calculated by determining the difference between the actual January 1, 2008, gain-sharing amount and 34 cents; the Uniform COLA is increased by this difference (but may not be decreased by a negative number), up to 13 cents.

Early retirement reduction factors are improved for both members of the Plans 2 and 3 of PERS, SERS, and TRS. Members who have completed 30 or more years of service may early retire beginning at age 55, and receive a 1 percent per year reduction to benefits for each year between age 60 and 65. Between age 55 and 60, the reduction remains 3 percent per year of early retirement, as in current law.

Individuals who are employed in a position making them newly eligible for membership in TRS or SERS have a 90-day period to irrevocably choose membership in Plan 2 or Plan 3. The subsidized early retirement (improved early retirement reduction factors), the increases to the Uniform COLA, and the choice of Plan 2 for new entrants to TRS and SERS are intended as a replacement for gain-sharing, and are not provided as a matter of contractual right to members until there is legal certainty with respect to the repeal of gain-sharing, including the expiration of any statutory limitations on actions and the end of the process of judicial review. Any legal action brought under the bill must be commenced within three years after the effective date of the act.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed, except section 1, relating to Plan 3 gain-sharing; section 3, relating to a choice of Plan 2 or Plan 3 for new members of TRS; and section 4, relating to a choice of Plan 2 or Plan 3 for new members of SERS, which contain an emergency clause and takes effect July 1, 2007.

Staff Summary of Public Testimony:

(In support) Gain-sharing was a pension promise that was made to the plan members. It should be kept. When Plan 3 was created, risk was shifted to the employees, and gain-sharing was part of that deal. Our efforts have been to provide career employees with 30 years of service a realistic option of retiring, and HB 2391 provides that. Twelve thousand Teamsters have realized that the contractual right disclaimer was not really a pension benefit, but agency representations that have been made make a lawsuit a real threat. The Attorney General doesn't think such suits will be successful, but the poison pill language crafted here should be effective in preventing both gain-sharing and new benefits from being granted. We fear that such a suit could jeopardize the bill, however. While we would prefer to keep gain-sharing, as the Uniform COLA is the weakest part of the plan, HB 2391 provides the best immediate help for retirees, and we support it. This is a significant bill and we appreciate the effort that was put into preparing it. But as a representative of SERS members and serving on the Select Committee on Pension Policy (SCPP), we are not entirely satisfied with the trade-off value. The SERS gets the worst trade-off in HB 2391, and we hope that it can be improved to provide better equity. Though all the gain-sharing proposals provide advantages, we support a bill that eliminates gain-sharing. The PERS system is sound and very competitive for the recruitment of new employees. We urge the Legislature to take action and end gain-sharing this year. The trade-offs in HB 2391 are generally adequate, and only the Plan 1 trade-off and SERS employees are somewhat under-compensated. But the early retirement reduction factors are a big step forward deserving strong support. Our members originally thought that a total repeal of gain-sharing was needed to prevent double benefits from occurring, but the bill contains significant safeguards against this possibility. As a PERS Plan 2 employee, I'm in favor of the improvements to early retirement offered by HB 2391 after 30 years of service, even after 34 years of service.

(with concerns) We would like gain-sharing to continue, but if it does not, then provide something that part-time employees can actually take advantage of among the trade-off benefits. A 30 years of service requirement will exclude many of our members who start later, and often work part-time.

(Opposed with concerns) I'd like to reiterate my concerns that Plan 3 members and Plan 1 retirees bear the brunt of these changes. We have some additional ideas to improve these proposals that should be considered. About $3 billion over the next 25 years will be earned in the plans over the assumed rates of return. A 12 percent average would allow the state to pay the costs of gain-sharing without incurring additional costs, and the funds have been providing returns of this magnitude. The State Actuary has provided an incomplete analysis of the costs. Please retain gain-sharing or provide a fair replacement.

(Opposed) We have communicated the elements of this proposal to our members, and the reaction is disbelief. With the budget surplus, with the least adequate pension plans in the nation, our membership doesn't understand how these proposals are receiving serious consideration. It doesn't matter how you compare plans -- we compare poorly. TRS Plan 3 compared to the other global challenge states used in Washington Learns compares dismally. When members were persuaded to enter Plan 3 there was no caveat, no qualification. Please defeat these measures and keep your promises. A promise has been made and should be kept. Only school employees are really hurt by this, but a 34 cent trade-off value for retirees is less than fair - we want 46 cents, a dollar-for-dollar trade or we are better off with gain-sharing. The lack of an equal trade-off in benefits for retirees makes this bill unacceptable. I do not believe that the proper weight has been given to the income side, and the costs are over represented. Projected earnings above the assumed rate are extra and can be distributed by gain-sharing without cost. The short-term costs are not a burden to the General Fund as the benefits are to the retiree and the state. My children are in Plan 2 and 3. Many people transferred to Plan 3 with the carrot of gain-sharing hanging out there. I'm a Plan 1 retiree who has gotten no COLA for many years. When I first got my COLA at age 67 is was about

1.5 percent, not a real COLA at all. These were the promises made to me by the Department of Retirement Systems, but I doubt that the Attorney General looked at them. I realize that this was a $95 million item in the budget, but gain-sharing was a commitment and promise. My wife is a school psychologist and she decided to move to Plan 3. I understand the budget concerns, but the commitment must be kept in some fashion. I was one of the Legislators involved in the creation of gain-sharing, and the costs in Plan 1 were passed as an appropriate and responsible way to reach the flaws in the pension plans. At least consider a 46 cent increase for Plan 1 COLAs. Plan 3 was developed as a choice for employees that don't want to work for the public employers all the way until retirement, so an improvement that requires 30 years of service is ill-suited to the population the plan was designed for.

Persons Testifying: (In support) David Westberg, Stationary Engineers; Pat Thompson, Washington State Council of County and City Employees; Mike Ryherd, Teamsters Local Union 117; Amber Lewis, Washington Federation of State Employees; Cassandra de la Rosa, Retired Public Employees Council of Washington; Sophia Byrd McSherry; Washington State Association of Counties; John Kvamme, Washington Association of School Administrators and Association of Washington School Principals; Jim Justin, Association of Washington Cities; and Frank James.

(With concerns) Randy Dorn, Public School Employees of Washington.

(Opposed with concerns) Luis Moscoso and Grant Boyer, Washington Public Employees Association/United Food and Commercial Workers 365.

(Opposed) Leslie Main and Don Carlson, Washington State School Retirees Association; Charles Haase, Washington Education Association; Gene Forrester, Senior Lobby and Thurston County School Retirees Association; Eleanor Gilmore; and Tim Clark

Persons Signed In To Testify But Not Testifying: None.