Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Appropriations Committee

HB 1771

Brief Description: Changing certain public retirement systems.

Sponsors: Representative Sommers; by request of Office of Financial Management.

Brief Summary of Bill

- Discontinues gain-sharing for both Plan 1 and Plan 3 of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS) Plan 3 after the January 1, 2008, distribution date.
- Provides up to a 5 cent increase to the PERS and TRS Plan 1 annual increase amount should the January 1, 2008, gain-sharing increase to the Plan 1 annual increase amount be less than 23 cents.
- Establishes an optional assured benefit program (ABP) for members of Plan 3 hired prior to July 1, 2007, where in exchange for a irrevocable choice to make ongoing contributions into the ABP between July 1, 2008, and September 30, 2008, a member may receive at retirement either accumulated contributions plus investment earnings from the ABP, or an annuity equal to 1 percent of the member's average final compensation.
- Requires a member choosing to participate in the ABP to wait at least five years from the date of joining the ABP before drawing a benefit from the ABP program.
- Provides a choice of Plan 2 or Plan 3 membership for new TRS and SERS members hired after July 1, 2007.

Hearing Date: 3/27/07

Staff: David Pringle (786-7310).

Background:

Gain-sharing

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.

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 repealed for both Plan 1 and Plan 3 of PERS and TRS, and the School Employees' Retirement System (SERS) Plan 3 after the January 1, 2008 distribution date.

Beginning July 1, 2009, the annual increase amount for PERS and TRS Plan 1 is increased by up to 23 cents less the January 1, 2008, gain-sharing increase amount, but in no event may it either decrease the annual increase amount or increase it by more than 5 cents.

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 Assured Benefit Program (ABP) is created for members of Plan 3 who entered service before July 1, 2007. Between July 1, 2008 and September 30, 2008, members may make an irrevocable choice to direct member contributions into an ABP subaccount (5 percent of pay for members of PERS and SERS, and 6 percent of pay for members of TRS), and after at least 5 years elapses from the date that the member elected to participated in the ABP, to be eligible to receive an annuity equal to 1 percent of average final compensation for each year of service while contributing to the ABP.

At retirement, a member who joined the ABP may choose to receive (1) an annuity equal to 1 percent of a member's average final compensation (either at full retirement age or reduced for early retirement), or (2) the contributions made towards the ABP, plus any investment earnings, along with any other funds in the member's individual defined contribution account. An ABP-participating member who chooses the 1 percent annuity will also receive as a transfer into the member's individual defined contribution account any funds from his or her ABP subaccount not required to fund the 1 percent annuity.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect on July 1, 2007.