

# HOUSE BILL REPORT

## 2ESB 6378

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As of Second Reading

**Title:** An act relating to benefits and contributions for new members of the public employees' retirement system, the teachers' retirement system, and the school employees' retirement system.

**Brief Description:** Reforming the state retirement plans.

**Sponsors:** Senators Zarelli, Baumgartner, Parlette, Hill and Tom.

**Brief History:**

**Committee Activity:**

None.

### Brief Summary of Second Engrossed Bill

- Closes alternate early retirement benefits to new members of the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS).
- Creates a new subsidized early retirement benefit for members joining PERS, TRS, or SERS Plans 2 and 3 on or after May 1, 2013, that provides a 5 percent per year reduction in benefits from age 65 for members retiring with 30 or more years of service.
- Changes the investment rate of return assumption used for calculating contribution rates in the state retirement systems on July 1, 2013, to 7.9 percent, on July 1, 2015, to 7.8 percent, and on July 1, 2017, to 7.7 percent.
- Requires the Select Committee on Pension Policy to study risk classifications of employees in the Washington state retirement systems that entail either high degrees of physical or psychological risk.

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**Staff:** David Pringle (786-7310).

**Background:**

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*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.*

The Public Employees' Retirement System (PERS) provides benefits for all regularly compensated public employees and appointed officials unless they fall under a specific exemption from membership, such as qualification for another of the state retirement systems. Other, more specialized state retirement plans include: the Teachers' Retirement System (TRS), which provides retirement benefits for certificated instructional staff of public schools; the School Employees' Retirement System (SERS), which covers classified school employees; and the Public Safety Employees' Retirement System (PSERS) which provides benefits for employees with law enforcement duties who are not eligible for membership in the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF).

The PERS and TRS Plan 1 are defined benefit plans that provide a retirement allowance based on 2 percent of final average salary for each year of service. Members of Plan 1 are eligible to retire at any age with 30 or more years of service, from age 55 with at least 25 years of service, or from age 60 with at least 5 years of service. To fund the defined benefit, members of Plan 1 contribute to the plans at a fixed rate of 6 percent of pay, while employers make contributions at the same PERS or TRS employer rates as in Plan 2 and Plan 3.

The PERS and TRS Plans 1 were closed to new members on October 1, 1977. Any member of PERS or TRS who first established membership after the Plans 1 were closed belongs to either Plan 2 or Plan 3, as do all members of SERS. A new member has a window of 90 days after being hired to choose between Plan 2 and Plan 3. New members who fail to choose a plan are automatically enrolled in Plan 3.

The PERS, TRS, and SERS Plans 2 are defined benefit plans that provide a retirement allowance based on 2 percent of final average salary for each year of service, with a normal retirement age of 65 with 5 years of service. Contributions for the plan vary from year to year with actuarial requirements, are divided equally between employers and employees, and are each paid into the defined benefit pension fund for purposes of supporting the defined benefits at retirement.

The PERS, TRS, and SERS Plans 3 are hybrid defined-benefit and defined-contribution retirement plans. Employer contributions support a defined benefit of 1 percent of final average salary for each year of service, with a normal retirement age of 65. Employee contributions are made to an individual defined contribution account. The employee's contribution rate is selected by the employee during a period following each term of employment, and is fixed for the duration of the employment relationship. Employee contributions vary between 5 percent and 15 percent of pay, and there are a variety of investment options available for members, including participation in the same combined investment fund used for the defined benefit plans.

Early retirement with a reduced benefit is available in PERS, TRS, and SERS Plans 2 and 3 for members with at least 20 years but fewer than 30 years of service credit. The retirement allowance of a member of PERS, TRS, or SERS who retires early is reduced to reflect the full actuarial cost to the retirement system of the early retirement.

An alternative early retirement option with a reduced penalty was created in 2000 for members of the PERS, TRS, and SERS who have at least 30 years of service. The retirement allowance of a member who retires under the alternative early retirement provisions is

reduced by 3 percent for each year of difference between the member's age at retirement and age 65. The alternative early retirement option was enhanced in 2007 when the Legislature repealed the gain-sharing benefits that had been provided in PERS, TRS, and SERS. Under the enhanced provisions for alternative early retirement, a member with at least 30 years of service credit can retire as early as age 62 without a benefit reduction. Additionally, the benefit reduction for members retiring before age 62 is reduced to 2 percent for the first year before age 62 and 3 percent for each additional year, up to a 20 percent reduction for retirement at 55 years of age. The monthly retirement allowance of a member opting for an enhanced alternative early retirement will be reduced or suspended if the member returns to work for a retirement system eligible employer before reaching age 65.

By statute, a member does not have a contractual right to retire under the 2007 enhanced alternative retirement provisions. If the repeal of gain-sharing were held to be invalid in a final determination of the courts of law, any member who has not yet retired with an enhanced alternative early retirement benefit would lose the option to do so. In that case, the standard alternative early retirement option would still be available to members.

While the state retirement plans that are currently open to new members (Plans 2 and 3) are currently fully funded, unfunded accrued actuarial liabilities (UAALs) exist in both PERS 1 and TRS 1. This means that the value of the plan liabilities, in the form of members' earned benefits to date, exceed the value of the plan assets. As of the most recent actuarial valuation, the UAAL for PERS 1 is \$3.2 billion and the UAAL for TRS 1 is \$1.4 billion. In order to fund the Plan 1 UAALs, additional employer contributions are collected. The Plan 1 UAAL contribution rates are set at the levels required to amortize the UAALs over a rolling 10-year period, subject to minimum contribution rates of 5.25 percent of pay in PERS, SERS, and PSERS and 8 percent of pay in TRS. The Plan 1 UAAL contributions collected in TRS are also subject to temporary rate caps of: 6.50 percent in fiscal year 2012, 7.50 percent in fiscal year 2013, 8.50 percent in fiscal year 2014, and 9.50 percent in fiscal year 2015. The Plan 1 UAAL contributions collected in PERS, SERS, and PSERS, which go towards the PERS 1 unfunded liability, are subject to temporary rate caps of: 3.75 percent in fiscal year 2012, 4.50 percent in fiscal year 2013, 5.25 percent in fiscal year 2014, and 6.00 percent in fiscal year 2015. Current projections for the Plan 1 UAAL rates in fiscal years 2013 and 2014 are below the statutory maximum rates, at 3.80 percent in TRS and 3.53 percent in PERS, SERS, and PSERS.

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### **Summary of Bill:**

The subsidized alternate early retirement benefits in the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS) Plans 2 and 3 are closed to new members. For members that join these plans on or after May 1, 2013, a new subsidized early retirement benefit is created that provides members with a 5 percent per year reduction in benefits from age 65 to the age at retirement.

The investment rate of return assumption used for calculating contribution rates in the state retirement systems is changed on July 1, 2013, to 7.9 percent, on July 1, 2015, to 7.8 percent,

and on July 1, 2017, to 7.7 percent. The reduced rate of return assumptions shall only be used by the State Actuary after the effective date of each of the reduced investment rates of return. By June 17, 2017, the State Actuary shall submit recommendations regarding the long-term investment rate of return assumption to the Pension Funding Council.

The Select Committee on Pension Policy (SCPP) shall study risk classifications of employees in the Washington state retirement systems that entail either high degrees of physical or psychological risk. The SCPP, with the assistance of the Office of the Superintendent of Public Instruction, shall also study existing early retirement factors and job requirements that limit the effectiveness of the older classroom employee. The identified groups will be evaluated for inclusion in the Public Safety Employees' Retirement System or the creation of other early retirement factors in the other retirement systems. The SCPP will report to the legislative fiscal committees no later than December 15, 2012.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) None.

(Opposed) None.

**Persons Testifying:** None.

**Persons Signed In To Testify But Not Testifying:** None.