SENATE BILL REPORT
ESB 6378

As Passed Senate, March 3, 2012

Title: An act relating to the state retirement plans.

Brief Description: Reforming the state retirement plans.

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

Brief History:
Committee Activity: Ways & Means: 2/02/12.
Passed Senate: 3/03/12, 25-24.

SENATE COMMITTEE ON WAYS & MEANS

Staff: Erik Sund (786-7454)

Background: 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).

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.

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.

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.

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.

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 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.

Summary of Engrossed Bill: Members of PERS, TRS, and SERS who first establish membership after June 30, 2012, are ineligible for the alternative early retirement and enhanced early retirement options. A member with at least 20 years of service credit may retire early beginning at age 55, however the retirement allowance of a member choosing to do so will be subject to a reduction reflecting the full actuarial impact of early retirement.

PERS, TRS, and SERS Plans 2 are closed to new members after June 30, 2012; on July 1, 2012, new members will be enrolled in Plans 3

The employer contributions collected in PERS, TRS, SERS, and PSERS for the purpose of paying off the unfunded UAALs of PERS Plan 1 and TRS Plan 1 are suspended for Fiscal Year 2013. Employer UAAL contributions resume in Fiscal Year 2014.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

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

Staff Summary of Public Testimony: PRO: The state cannot afford to offer the early retirement options that would be closed by this bill. People are living longer and doing well at age 65 and 70.

CON: The Plans 2 should not be closed to new members. The quality of public services depends on the ability of government to recruit and retain qualified employees. Public employees are paid less than their private sector counterparts and one of the biggest attractions of public service is a stable, reliable defined-benefit pension plan. None of the employees that we represent can afford to risk their retirement livelihood in the stock market. Defined contribution accounts are too often depleted too quickly and a defined benefit of 1 percent per year of service is not enough to live on. We don't yet know if the Plans 3 will be successful, so it is too early to close the Plans 2. The State Investment Board isn't able to invest members' defined contribution funds as efficiently as the defined benefit plan funds, because they must invest defined contribution moneys in more liquid investments with lower returns. The alternative early retirement benefits should be retained. Under the provisions of this bill, many members would have to wait until age 65 to retire; some of them might end up working 35 or 40 years to get a full retirement benefit. There is no reason to change the state retirement systems, which are third best in the nation for funding. The problem isn't the system benefits, it's the failure of the Legislature to make the needed contributions. Employees shouldn't be punished for their employers' mistakes. The reason that the Plan 1 unfunded liabilities are so large is that the state has skipped too many payments. The unfunded liability contributions should not be skipped in 2013. Skipping payments again will just compound the problem.

Persons Testifying: PRO: Don Carlson, Select Committee on Pension Policy.

CON: Greg Bennett; Christian Dale, International Union of Operating Engineers 286; Mitch Denning, Alliance of Education Associations; Gene Forrester, Senior Lobby; Jeff Johnson, WA State Labor Council; John Kvamme, WA Assn. of School Administrators and Assn. of WA School Principals; George Masten, Retired Public Employees' Council; Pat McElligott, National Conference on Public Employee Retirement Systems; Vince Oliveri, Professional & Technical Employees; Pat Thompson, WA State Council of County & City Employees; Seamus Walsh Petrie, WA Public Employees' Assn.; Ester Wilfong, WA State School Retirees' Assn.; Lucinda Young, WA Education Assn.; Matt Zuvich, WA Federation of State Employees,