Washington State Legislature

Select Committee on Pension Policy

Gain-Sharing Study

December 2005

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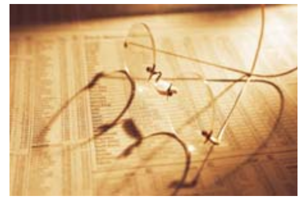


In the investment boom of the late 1990s numerous public retirement plans enhanced member benefits as a direct result of the strong returns experienced by their retirement plans' assets. In the State of Washington, certain retirement benefits were enhanced and others were created that were tied directly to the future investment performance of the retirement plans' assets – these benefits were called "gain-sharing."

The distribution of these gain-sharing benefits is triggered when the compounded annual rate of return of the retirement plans' assets is 10 percent or more for four years running. When that threshold is met, half the returns over 10 percent are used to augment Plan 1 members' post-retirement Uniform cost-of-living adjustment (COLA) and Plan 3 members' defined contribution accounts.

Because of the investment threshold method used to trigger the distribution of benefits, gain-sharing was originally assumed to pay for itself. But extensive review by the Office of the State Actuary (OSA) resulted in the identification of liabilities related to gain-sharing. In the 2003 Actuarial Valuation Report (AVR), future gain-sharing was recognized as adding $622 million to the present value of fully projected benefits (PVFPB) liability in the Plans 2/3, and increasing the unfunded actuarial accrued liability (UAAL) of PERS 1 and TRS 1 by $930 million.

In recognizing the costs of future gain-sharing, the OSA recommended the employer contribution rates be increased in the Public Employees' Retirement System Plan 1 and Plan 3 (PERS 1 and PERS 3), in the Teachers' Retirement System Plan 1 and Plan 3 (TRS 1 and TRS 3), and in the School Employees' Retirement System Plan 3 (SERS 3).

In lieu of raising contribution rates during a period of fiscal tightness, the legislature directed the Select Committee on Pension Policy (SCPP) under Chapter 370, section 6, subsection 10, Laws of 2005, to:

> *"study the options available to the legislature for addressing the liability associated with future gain-sharing benefits"* and *"report the findings and recommendations of its study to the legislative fiscal committees by no later than December 15, 2005."*

This report is in response to that study mandate.

Leading off this report is a discussion of the liability associated with future gain-sharing. In order to appreciate that liability, it is important to understand that gain-sharing benefits are paid entirely from employer contributions. In contrast to the cost-sharing design of the Plans 2, member contribution rates in the Plans 1 are fixed in statute and member contributions the Plans 3 are deposited into individual defined contribution accounts. As a result, any benefit enhancement in the Plans 1 or Plans 3, such as gain-sharing, will be paid (or funded) through increased employer contributions. At this point, gain-sharing benefits are neither pre-funded like other benefits, nor pay-as-you-go like Social Security. They are post-funded; contribution rates increase after a gain-sharing event. While there is a semblance of investment earnings to pay for gain-sharing because of the threshold mechanism to trigger an event, that mechanism actually undercuts the long-term returns on the plans' assets, thus adding to the plans' unfunded liabilities.

Who Benefits?

After understanding why there are liabilities associated with gain-sharing, it is also necessary to understand who receives and who doesn't receive gain-sharing benefits. Currently, gain-sharing provides benefits for current and future retired members of TRS and PERS Plans 1 as well as term-vested (those who are not actively employed but still eligible to receive a retirement allowance in the future), active, and retired members of the TRS, SERS, and PERS Plans 3. Plan 1 members receive a boost in the "annual increase amount" used in calculating their post-retirement Uniform COLA. Eligible Plan 3 members receive distributions to their individual accounts based on their years of service.

Plan 2 members do not participate in gain-sharing. During the period this benefit was being considered, the contribution rates in the Plans 2 were declining significantly. This was a result of the strong investment performance of the plan assets and the funding policy that allowed for quick contribution rate adjustments to accommodate those returns. This decline in contribution rates resulted in temporary increases in take-home pay for the Plan 2 members, which was considered a benefit of sorts. Past Plan 1 and 3 gain-sharing benefits, however, are permanent.

Since its creation, there have been two gain-sharing events. During those events, over $2 billion in gain-sharing was allocated either in the form of benefits or paying-down the PERS 1 and TRS 1 UAAL.

What can be done?

Gain-sharing is a material benefit that has significant liabilities and unique funding issues. Adding to its complexity is the fact that gain-sharing is one of a handful of retirement benefits whose statute contains a "non-contractual rights" clause. That clause states that the legislature can amend or repeal the benefit at any time. This clause has never been tested in court and, as a result, has some legal uncertainty. Because of that uncertainty, the SCPP requested a formal opinion from the Attorney General (AG) as to the validity of the non-contractual rights clause.

The Attorney General Opinion (AGO) dated November 2, 2005, stated that *"where the Legislature has enacted statutes providing 'gain-sharing' … members have no enforceable right or current reasonable expectation of receiving such benefits."* The AGO further said that *"the Legislature may amend or repeal these particular statutes at any time."* This AGO adds flexibility to the options the legislature may consider when dealing with the future liability of gain-sharing. (A complete copy of the AGO may be found in Appendix A of this report.)

While some may still be concerned with any legal risk, that risk is centered on current plan members. The standard established under the *Bakenhus v. Seattle* ruling was that benefits in place *at the time of hire* are a contractual right. So there is no legal risk to eliminate gain-sharing for those who are not yet hired, and the bulk of projected cost for future gain-sharing in the Plans 3 is for new members (see Figure 3).

The Study Mandate Options

The gain-sharing study mandate listed several possible options the legislature might use to address the future gain-sharing liability. The first option listed in the study mandate is to **repeal gain-sharing**. This would be the most straight-forward method of dealing with future gain-sharing liabilities as they would be eliminated altogether.

The second option listed in the study mandate would be to **suspend gain-sharing**. This would mean suspending the granting and funding of gain-sharing until some specific date in the future. This option would limit future liability to those gain-sharing events that would occur after the suspension period.

The third option would **delay** the inclusion of gain-sharing costs in the contribution rate calculations until after a gain-sharing event. This was the practice set forth in the original gain-sharing legislation for the first gain-sharing event.

The fourth option would be to **make gain-sharing discretionary** with the legislature. This would mean that the legislature would decide whether or not to grant a distribution in the event that the "extraordinary gain" threshold has been met. This would make gain-sharing similar to the ad hoc benefit improvements granted in the past and would limit gain-sharing liabilities to those benefits that were granted.

Possibly the most complex option listed in the study mandate involves **repealing gain-sharing benefits and providing alternative benefits**. Several factors need to be addressed with any replacement option. Would the replacement benefits be of equal or of lesser actuarial value than gain-sharing and, if replacement benefits were to be of lesser value, what proportion of the liability of gain-sharing would they replace? Would the replacement benefits be of a similar nature or would they be altogether different? (The cost of the various replacement options can be found in the Fiscal notes and Supplement in Appendix B.)

Alternative Options

Because the list of possible options to address the liability of future gain-sharing in the study mandate was open-ended, several other options were also explored. The option to **retain and pre-fund** gain-sharing would keep the benefit structure intact and initiate the funding of gain-sharing. That funding could be in any manner the legislature decided. (The cost to fully recognize the liability of future gain-sharing is illustrated in Figure 3.)

The option to **retain and post-fund** gain-sharing would delay the inclusion of gain-sharing rates until after a gain-sharing event. This was the practice set forth in the first gain-sharing event.

The option to **repeal gain-sharing and provide Plan 3 members a choice to return to the Plans 2** was also examined. This would recognize that the presence of gain-sharing benefits may have provided an incentive for members to transfer or join the Plans 3. Such a plan transfer option should be reviewed by tax counsel as it may have plan qualification issues and possible tax consequences.

The option to **increase the thresholds for a gain-sharing event** was also explored. A few variations of changing the current gain-sharing triggering mechanism have been priced. Raising the threshold from 10 to 12 percent would eliminate about one-third of the liability. Increasing the look back period from 4 to 8 years and increasing the threshold from 10 to 12 percent would eliminate about two-thirds of the liability.

The final alternative option discussed in this report would be to **replace the Plan 3 gain-sharing benefit with an employer-defined contribution** into a notional account invested by the employer. This would be like a supplemental defined benefit that would be available to members upon retirement in the form of a defined contribution.

Analyzing the Options

In analyzing the many options to address the future liability of gain-sharing, decision makers may first want to consider the following questions. Is gain-sharing affordable? Is gain-sharing sound pension policy?

- If gain-sharing is affordable, then a funding policy could be recommended or gain-sharing could be replaced with benefits of equal expense.
- If gain-sharing is not affordable it could be repealed outright or replaced with less expensive benefits.
- If gain-sharing were sound pension policy then the decision may be to retain the benefit and establish a funding policy.

➲ If gain-sharing were not sound pension policy then it may be repealed and replaced with alternative benefits that are funded in a more recognized method.

Decision Factors

After analyzing the various gain-sharing options and questions regarding affordability and sound pension policy, a decision process may consider several key factors that distinguish those options. Those factors could be the fiscal factors, legal factors, stakeholder interests, and SCPP goals. The following table is a synopsis of those considerations.

	Key Decision Factors			
Options	**Fiscal**	**Legal**	**Stakeholder Interests**	**SCPP Goals**
Repeal and not replace	Eliminates all gain-sharing liability; no 07-09 budget impact	Allowable under AGO, but could result in litigation	Would eliminate a benefit upon which members depend	Contrary to the SCPP goal to increase and maintain members' purchasing power
Repeal and replace	Liability depends on the portion of gain-sharing being replaced; 07-09 budget impact	Allowable under AGO, and minimizes possible litigation over a repeal	May result in a more frequent and desirable benefit	May help establish benefits more in keeping with SCPP goals
Suspend benefit and funding	Could eliminate the liability of an event that occurred during the suspension period	Allowable under AGO, but could result in litigation	May eliminate a benefit upon which members depend	Would be in conflict with SCPP goals
Make discretionary	Could eliminate the liability of an event that was triggered but not granted	Allowable under AGO, but could result in litigation	May eliminate a benefit upon which members depend	Would be in conflict with SCPP goals
Retain and pre-fund	Liability pre-funded; 07-09 budget impact	Eliminates any "systematic funding" concerns	Retains a benefit upon which members depend	Would be in keeping with SCPP goals
Retain and post-fund	Liability funded as in current practice; no 07-09 budget impact	Possible "systematic funding" concerns	Retains a benefit upon which members depend	Would be somewhat in conflict with SCPP goals

SCPP Recommendation

In their deliberations to reach a recommendation, the SCPP strived to balance the fiscal factors, legal factors, and stakeholder interests along with the committee's own findings and goals. The initial recommendation of the SCPP was to forward an omnibus bill that repeals and replaces Plan 1 and Plan 3 gain-sharing with the following provisions that represent about 50 percent of the 2007-09 projected costs for retaining and pre-funding future gain-sharing benefits:

- One-time $0.24 increase in the Plan 1 Uniform COLA;
- SERS and TRS 2/3 choice for new entrants;
- One-time prospective transfer window from Plan 3 to Plan 2 for all current Plan 3 members;
- Annual Plan 3 employer defined contributions for existing Plan 3 members of $12 per year of service increased by 3 percent per year; and,
- Repeal annual rate flexibility for PERS, TRS and SERS Plans 3.

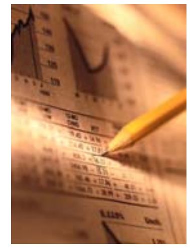
The following items were recommended by the SCPP to be stand-alone bills:

- Age 66 COLA eligibility for PERS 1 and TRS 1 retirees;
- Expanded eligibility — 20 years of service and 25 years of retirement — for the alternate $1,000 minimum benefit and 3 percent annual escalator for PERS 1 and TRS 1 retirees, and;
- Full Rule-of-90 eligibility (age plus years of service) for unreduced retirement in the Plans 2/3.

Advice from tax counsel regarding the Plan 3 to Plan 2 transfer was made available the evening before the December 13, 2005, SCPP meeting. That advice raised the possibility that the transfer proposal might be in conflict with existing Internal Revenue Service (IRS) public retirement plan regulations. Such a conflict could have significant tax consequences for the state, plan members, and employers.

Because of the added legal complexity of tax counsel advice, the lack of time to reconcile the SCPP proposal with that advice, and the statutory requirement to forward the SCPP Gain-sharing report to the fiscal committees by December 15, 2005, the SCPP recommends further study of gain-sharing in the 2006 interim.

Introduction



In the investment boom of the late 1990s numerous public retirement plans enhanced member benefits as a direct result of the strong returns experienced by their retirement plan's assets. In the State of Washington, certain retirement benefits were enhanced and others were created that were tied directly to the future investment performance of the retirement plans' assets – these benefits were called "gain-sharing."

Gain-sharing was originally proposed as a way to provide periodic non-contractual benefit increases to members of the PERS 1 and PERS 3, SERS 3, and TRS 1 and TRS 3 by tapping the "extraordinary investment gains" earned by the retirement funds. The OSA recently established a method to determine the cost of future gain-sharing benefits. In lieu of recognizing the cost of future gain-sharing benefits, the legislature has, per Chapter 370, section 6, subsection 10, Laws of 2005, directed the SCPP to...

> *"... study the options available to the legislature for addressing the liability associated with future gain-sharing benefits. These options may include, but shall not be limited to, repealing, delaying, or suspending the gain-sharing provisions in law; making gain-sharing discretionary; or replacing gain-sharing benefits with other benefits such as plan choice, employer defined contributions, retirement eligibility enhancements, and post-retirement adjustments. The select committee on pension policy shall report the findings and recommendations of its study to the legislative fiscal committees by no later than December 15, 2005."*

This SCPP study examines the liability related with gain-sharing, discusses the options outlined in the mandating legislation, analyzes those options in terms of their fiscal and policy concerns, and forwards a recommendation from the SCPP to the fiscal committees.

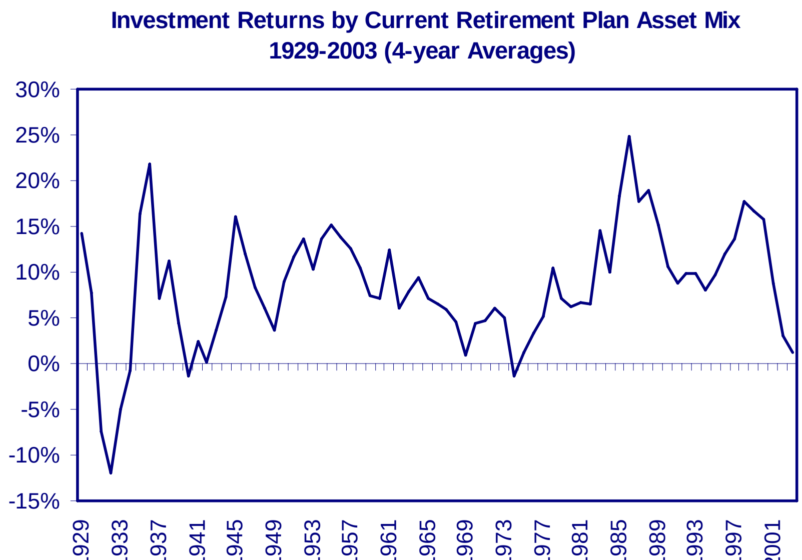
Understanding the Liability

Understanding the Liability of Gain-Sharing

Why is there a cost – a liability – associated with past and future gain-sharing? Principally, because it is a means to distribute material benefits and all benefits have a cost. Originally, those benefits were thought to have no cost because the source of the benefits was the "extraordinary" gains of the plan assets during the investment boom of the 1990s. Those gains were thought to be permanent – far enough above the historical norms to be outside that investment experience.

In examining the investment return history, however, the threshold for defining "extraordinary" gains – a compound rate of return above 10 percent over a four-year period – was not atypical for the plan assets' investment experience (see Figure 1). For instance, based on the current asset mix and the historical rates of return, there were 28 four-year periods between 1929 and 2003 where the average rate of return was above 10 percent. What is apparent from this history is that these periods of high returns are needed to balance the similarly frequent periods of low returns so that the average rate of return is close to the actuarial assumption.

Figure 1



Tracking the Liability and Cost of Gain-Sharing

With the advent of the 2002 Actuarial Valuation Report (AVR), the OSA gave the following notice in the Actuarial Certification section that gain-sharing was being examined:

"The gain-sharing benefit provision of PERS and TRS Plans 1, and PERS, TRS, and SERS Plans 3 are not reflected in this valuation. The funding methodology and materiality of these provisions is currently under review. If it is determined that the gain-sharing benefit provisions represent a material liability to the plans, then the actuarial value of the benefit provisions must be reflected in the liabilities of the plans unless contrary to existing law."

In the 2003 AVR, released in December of 2004, the OSA finalized its review of gain-sharing. Gain-sharing was recognized as a component in the normal cost of the Plans 2/3, and a component in the Unfunded Actuarial Accrued Liability (UAAL) of PERS 1 and TRS 1. In recognizing those costs, the OSA recommended contribution rate adjustments to fund future gain-sharing (see Figure 2).

Figure 2

Contribution Rate Recommendations 2003 Actuarial Valuation Report			
	PERS	TRS	SERS
Change in Employer Contribution Rates Due to Future Gain-sharing	0.65%	2.01%	2.35%

The OSA's projections of the cost of future gain-sharing recognizes that there are different liability dynamics for the Plans 1 compared to the Plans 3. The Plans 1 are closed plans; there are no new members to enter the plans to add to the existing gain-sharing liability. The Plans 3 are open plans; new members are continuously being added, thus adding to that liability and the cost to fund gain-sharing. As a result, the projected budget cost in the Plans 3 can be characterized as that which is related to current members and that which is related to future members. This can be illustrated in Figure 3 which shows the cost of future gain-sharing in a fiscal impact format. The table differentiates Plan 1 and Plan 3 costs, with the costs for current and future members in the Plans 3 also identified. While the cost for future Plan 3 members is the smallest proportion of the 2007-2009 tally, it constitutes the bulk of the cost through 2031.

Figure 3

Projected Cost of Future Gain-sharing in Plans 1 and Plans 3				
Costs (in millions)	Plan 1 Members	Plan 3 Members Current	Plan 3 Members Future	Total
2007-2009				
State:				
General Fund	$78.2	$80.3	$27.3	$185.8
Non-General Fund	$26.6	$10.3	$5.7	$42.6
Total State	**$104.8**	**$90.6**	**$33.0**	**$228.4**
Local Government	$74.9	$69.4	$30.3	$174.6
Total Employer	$179.7	$160.0	$63.3	$403.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	$1,031.4	$684.8	$1,818.7	$3,534.9
Non-General Fund	$359.0	$78.8	$364.3	$802.1
Total State	**$1,390.4**	**$763.6**	**$2,183.0**	**$4,337.0**
Local Government	$998.7	$552.7	$1,951.3	$3,502.7
Total Employer	$2,389.1	$1,316.3	$4,134.3	$7,839.7
Total Employee	$0.0	$0.0	$0.0	$0.0

Who Pays?

Gain-sharing benefits are provided to the Plan 1 members of PERS and TRS and the Plan 3 members of PERS, SERS, and TRS. The Plans 1 and Plans 3 are not equal cost-sharing plans; the Plan 1 member contribution rates are set in statute at 6 percent of pay, and the Plan 3 member contributions - chosen by the member upon joining - are deposited in individual defined contribution accounts. As these member rates are, in essence, fixed, any benefit enhancement in these plans would be funded by a contribution rate adjustment paid by the employer (unless there were an explicit statutory change in the member rates). That is why the contribution rates, which recognize the future cost of gain-sharing, are solely employer rates.

How is it Funded?

Currently, the liabilities of future gain-sharing benefits are not being recognized; monies are not set aside and invested, like the contributions for other retirement benefits in Washington's public retirement plans. If a retirement benefit is not systematically funded, it would typically be funded on a pay-as-you-go basis (similar to Social Security); in those instances, monies would be appropriated during the same period that the benefits were paid. But pay-as-you-go does not accurately describe how gain-sharing is funded despite the resemblance to pay-as-you-go provided by the statutory criteria used to trigger a gain-sharing event (see Figure 4).

Figure 4 - Plan 1 Gain-Sharing Increase Amount

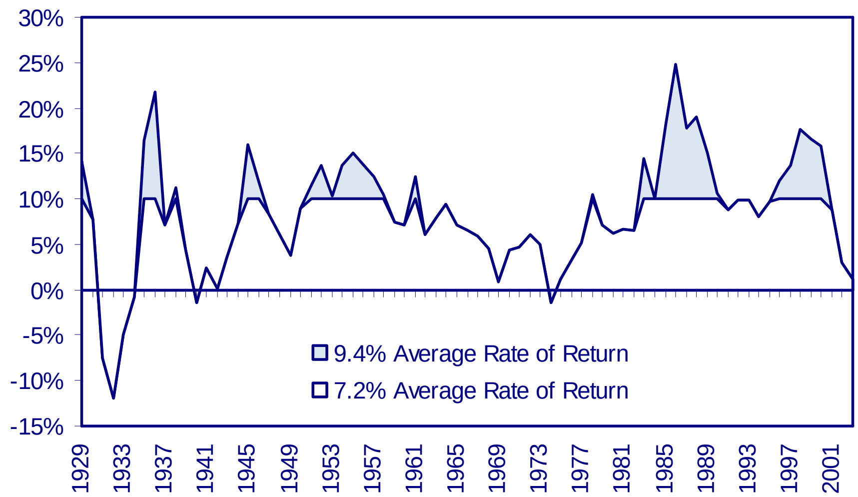
RCW 41.31.020
Gain-sharing increase amount calculated.

(1) The gain-sharing increase amount shall be the amount of increase, rounded to the nearest cent, that can be fully funded in actuarial present value by the amount of extraordinary investment gains, if any. The amount of extraordinary investment gains shall be calculated as follows:

(a) One-half of the sum of the value of the net assets held in trust for pension benefits in the teachers' retirement system plan 1 fund and the public employees' retirement system plan 1 fund at the close of the previous state fiscal year;
(b) Multiplied by the amount which the compound average of investment returns on those assets over the previous four state fiscal years exceeds ten percent.

Gain-sharing events and benefits are triggered by temporary gains and, as a result, those gains are not available to offset future losses. This can be illustrated by revisiting the graph showing the rate-of-return history. By artificially capping the asset gains at 10 percent, the assumed rate of future investment return is undercut and the average rate-of-return declines (see Figure 5). If the average return is reduced to below the actuarially assumed rate of return, contributions will need to increase to compensate.

Figure 5
Investment Rate of Return by Retirement Plan Asset Mix: 1929-2003 (4-year Averages)



If the costs of future gain-sharing benefits are not recognized at the time of the event, then gain-sharing could be described as a post-funded benefit. Contribution rates will increase after a gain-sharing event. Such a process results in higher contributions than would be required because there are unrealized investment gains.

Who Benefits?

Gain-sharing provides benefits for current and future retired members of TRS and PERS Plans 1 as well as term-vested (those who are not actively employed but still eligible to receive a retirement allowance in the future), active, and retired members of the TRS, SERS, and PERS Plans 3. The current counts of active, term-vested, service retirees, and survivors are included in Figure 6. Plan 2 members do not participate in gain-sharing.

Figure 6

Membership by System and Plan
2004 Actuarial Valuation

	PERS 1	PERS 3	TRS 1	TRS 3	SERS 3
Actives	17,829	19,855	9,862	49,302	29,430
Term Vested*	2,993	1,284	1,475	2,761	2,035
Service Retirees	46,572	190	31,366	472	445
Survivors	6,264	14	2,450	39	13

*Term-vested members are those who left employment, were vested, and who did not withdraw their contributions.

Plan 2 members were excluded from gain-sharing benefits because of their dynamic contribution rates. As investment returns on plan assets improved during the peak of the last investment cycle, Plan 2 contribution rates fell significantly, providing a temporary boost in members' take-home pay. The current rising contribution rates will result in a diminishment of Plan 2 member's take-home pay. Past Plan 1 and 3 gain-sharing benefits, however, are permanent.

How do They Benefit?

Currently, gain-sharing occurs when the compound average of investment returns on pension fund assets exceeds 10 percent for the previous four state fiscal years. The "compound average" recognizes the interest paid on previously earned interest as well as on the principal. Gain-sharing calculations are currently made once each biennium with potential distributions occurring in January of even-numbered years.

When the previous four-year compound average investment return exceeds 10 percent, calculations are performed to determine one-half the amount in excess of the 10 percent return that will be distributed to eligible Plan 1 and Plan 3 members.

Plan 1 Gain-Sharing Allotments

Plan 1 members receive an enhancement in the "annual increase amount" used in calculating their post-retirement Uniform COLA (see Figure 7). Eligible Plan 3 members, those whose account balances are $1,000 or more, receive distributions to their individual accounts based on their years of service.

Figure 7

Sample Uniform COLA calculation – 30 years of service

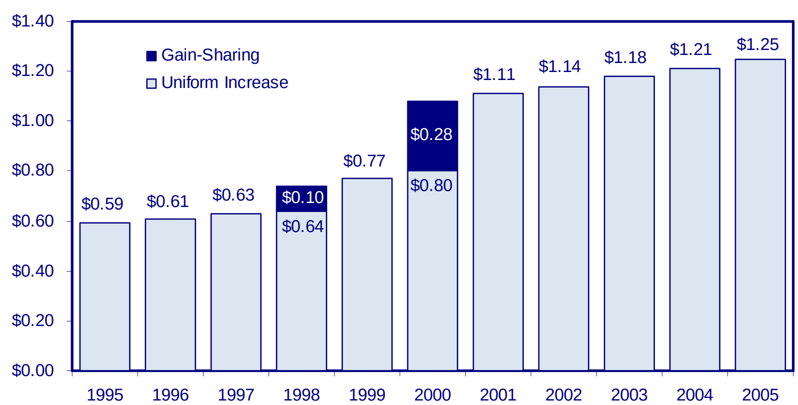
Annual Increase Amount × Years of Service = Monthly Benefit Increase
$1.25 × 30 = $37.50

While all Plan 1 members benefit from the gain-sharing allotments that permanently boost the Uniform COLA, Plan 3 members must qualify to receive gain-sharing distributions. Members must have at least $1,000 in their individual defined contribution accounts. Considering that the minimum contribution for Plan 3 members is 5 percent of pay, an average full-time worker would need less than one year of service to accumulate that amount.

Since its passage as Chapters 340 and 341, Laws of 1998, there have been two gain-sharing events for PERS 1 and TRS 1 members – in 1998 and 2000. In 1998, the first event for Plan 1 members was codified in Chapter 340 as an increase of 10 cents in the annual increase amount. The annual increase amount was scheduled to increase to 64 cents - gain-sharing boosted that to 74 cents. In 2000, the annual increase amount was scheduled to increase to 80 cents - gain-sharing boosted that by 28 cents to $1.08 (see Figure 8). All in all, a total of $924 million was allotted to Plan 1 members to augment their Uniform COLA.

Figure 8

PERS 1 and TRS 1 Annual Increase Amount



While $924 million was allotted in the form of permanent increases in the Uniform COLA, another $924 million was allotted to draw down the date for amortizing the UAAL of PERS 1 and TRS 1. After these two events, the date to amortize the Plan 1 UAAL was drawn down to December 31, 2016. Since then the UAAL amortization date has been returned to June 30, 2024, (chapter 11, subsection 1, second special session, Laws of 2001.)

Plan 3 Gain-Sharing Distributions

Gain-sharing events for Plan 3 members involve direct distributions to members' defined contribution accounts. The first distribution in 1998 paid $134.43 per year of service to eligible TRS 3 members; a total of $28 million was distributed. The distribution in 2000 paid $254.23 per year of service to eligible members, for a total disbursement of $73 million. The average Plan 3 member received $709.49 in 1998 and $2,051.52 in 2000.

Supplemental SERS 3 and PERS 3 Gain-Sharing Distributions

SERS 3 was created on September 1, 2000, and PERS 3 was created on March 1, 2002. Neither plan was in existence when the first TRS 3 gain-sharing distribution was paid. The original gain-sharing legislation provided for distributions equivalent to the 1998 and 2000 gain-sharing payments for PERS 2 members who transferred to SERS 3. Chapter 247, Laws of 2000 provided for a supplemental gain-sharing distribution equivalent to the 2000 payment for PERS 2 members who transferred into PERS 3. A total of $76 million was distributed to SERS 3 and PERS 3 members since the advent of gain-sharing.

Total Gain-Sharing Allotments

Taking all systems and plans into account, a total of over $2 billion has been allocated, either in the form of benefits or temporarily paying down the PERS 1 and TRS 1 UAAL (see Figure 9, next page).

Figure 9

Gain-sharing Allocations (dollars in millions)		
July 1998	PERS 1 & TRS 1	$580*
	TRS 3	$28
January 2000	PERS 1 & TRS 1	$1,268*
	TRS 3	$73
March 2001	SERS 3	$50
March 2003	PERS 3	$26
	TOTAL	$2,025

* Half to enhance the Annual Increase Amount and half to pay down the PERS 1 and TRS 1 UAAL.

Can it be Eliminated?

In light of the potential consequences related to the significant provisional changes being proposed, the SCPP asked for a formal opinion from the Attorney General's office (AG). Through the State Actuary the SCPP asked:

> *"Do the provisions in RCW 41.31.030, RCW 41.31A.020(4), RCW 41.31A.030(5), and RCW 41.31A.040(5), containing 'non-contractual rights' clauses, negate any contractual obligation of the state to provide gain-sharing benefits in the future?"*

The Attorney General Opinion (AGO) dated November 2, 2005, answered "yes," stating:

> *"Where the Legislature has enacted statutes providing 'gain-sharing' benefits to retirement system members if certain circumstances occur, but has included language reserving the right to repeal or modify such benefits before they are actually granted, pension system members have no enforceable right or current reasonable expectation of receiving such benefits."*

The AGO further stated:

> *"Here, the statutes in question have always clearly and unequivocally provided that the gain-sharing provisions do not create a contractual right in any public employee member or beneficiary to receive gain-sharing distributions in the future, and that the Legislature may amend or repeal these particular statutes at any time."*

(Note: For a complete copy of the AGO, see Appendix A.)

This opinion adds flexibility to the options the legislature may consider when dealing with the future liability of gain-sharing. While some may still be concerned with any legal risk to the removal of a retirement benefit for current members, there should be no such concern when changing benefits for new members. Different tiers of benefits occur when retirement plans are closed and new retirement plans open. The gist of the standard established under the *Bakenhus v. Seattle* ruling was that the benefits in place *at the time of hire* are a contractual right. Therefore, while there may be some legal risk to the repeal of gain-sharing for existing members, there is no legal risk for the elimination of gain-sharing for those who are not yet hired. In terms of addressing the liability associated with future gain-sharing, the bulk of the projected cost of future gain-sharing benefits in the Plans 3 is for new members (see Figure 3).

Understanding the Options

The study mandate in Chapter 370, section 6, subsection 10, Laws of 2005 directed the SCPP to study the options available to the legislature for addressing the liability associated with future gain-sharing. The list of options was open-ended; while it included those options in this immediate discussion, this section will also describe other options not mentioned in the study mandate including amending the mechanisms (thresholds) that trigger gain-sharing events. This section is followed by an analysis of the options.

Repeal and Not Replace

The first option listed in the study mandate is to repeal future gain-sharing. This would be the most straight-forward method of dealing with future gain-sharing liabilities as they would be eliminated altogether. What would not be eliminated in this option would be the possibility of litigation. Regardless of the AG's opinion, the employee and retiree groups could file claims in connection with a repeal of gain-sharing.

Repeal and Replace

Possibly the most complex option listed in the replacement study mandate would involve repealing gain-sharing benefits and providing alternative benefits. HB 1324, introduced by the SCPP during the 2005 legislative session, was an attempt to do just this.

One consideration within this option is whether or not those replacement benefits would be of equal or of lesser actuarial value than gain-sharing. One of the undesirable characteristics of gain-sharing is its uncertain availability from year to year; benefits are only available if certain investment conditions are met. If certainty was considered to have positive value and uncertainty a negative value, would a more certain benefit, say a lower cost annual benefit, be a satisfactory replacement? If the replacement benefits were to be of lesser value, what proportion of the liability of gain-sharing could be replaced?

The other consideration when discussing replacement benefits is whether they are of a similar nature or altogether different from gain-sharing. In an informal advice letter, the AG's recommendation was to replace any repealed benefit with a similar benefit. Therefore, if gain-sharing was used to enhance members' COLA, ideally the replacement should be COLA-related.

The repeal and replace option does have some contractual rights implications and requires an effort to work within the elements of the *Bakenhus* decision. If a court found contrary to the AG's opinion, employers might be liable for not only the gain-sharing benefits but any replacement benefit as well.

Suspend Benefits and Suspend Funding

Another option listed in the study mandate is to suspend gain-sharing. This would mean suspending the granting and funding of gain-sharing until some specific date in the future. In terms of addressing gain-sharing liability, the suspending option would limit the liability to those gain-sharing events that would occur after the suspension period. This has different policy implications than delaying funding, because the funding of gain-sharing would occur or resume after a specific date rather than after a gain-sharing event.

Make Discretionary

The option to make gain-sharing discretionary with the legislature would mean that the legislature would decide whether or not to grant a distribution in the event that the “extraordinary gains” thresholds have been met. This would, in essence, return the legislature to a position of granting ad hoc COLA improvements for PERS 1 and TRS 1 retirees. It would also be the first step in granting ad hoc benefit improvements or distributions for Plan 3 members.

Retain and Pre-Fund

The option to retain and pre-fund gain-sharing would keep the benefit structure intact and initiate the funding of future gain-sharing. That funding could be in any manner the legislature decided. The funding could be an immediate inclusion of contributions at the rates recommended by the OSA, or it could be a phase-in of rates similar to the phase-in of employer contributions in funding legislation passed during the last legislative session.

Retain and Post-Fund (Delay)

This option would mean delaying the inclusion of gain-sharing costs in the contribution rate calculations until after a gain-sharing event. This was the practice set forth in the original gain-sharing legislation for the first gain-sharing event. Normally the cost of new benefits implemented between actuarial valuations are accounted for in what is known as a “supplemental” contribution rate; this assures that members and employers pay for a benefit as it is being earned. In the original legislation, the first gain-sharing events were specifically exempted from the supplemental contribution rate provision in the funding chapter.

Other Options

The preceding discussions covered those specific options and provisions listed in the study mandate. The mandate, however, was open-ended in that its directive to the committee used the language, "*These options may include, but shall not be limited to....*" As a result, the following discussions will cover some of those alternative options.

Plan 3 to Plan 2 Transfer

One alternative option would be to repeal gain-sharing and provide an option to return to the Plans 2 for those who transferred into the Plans 3. This would recognize that the presence of gain-sharing may have been an incentive for Plan 2 members to transfer to Plan 3, and repealing gain-sharing should be accompanied by some remedy.

Change Gain-Sharing Thresholds

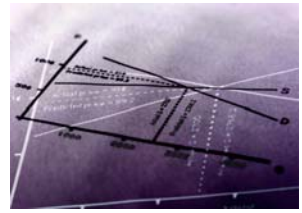
Another alternative option would be to increase the thresholds for a gain-sharing event. The rate of return threshold could be raised from 10 percent to 12 percent; this would eliminate about one-third of the liability. The rate of return threshold could be raised from 10 percent to 12 percent, and the look-back period could be lengthened from four years to eight years; this would eliminate about two-thirds of the liability. Decreasing the frequency of gain-sharing from every two years to every four years could also be used to pare the liability of future gain-sharing.

Employer Defined Contributions

The final alternative option discussed in this section is to replace the Plan 3 gain-sharing benefit with an employer-defined contribution. In this option, the employer would contribute a fixed percent of pay into a notional member account that would be guaranteed a fixed interest credit (i.e., 5.5 percent).

This would be funded similarly to a defined benefit plan, where the employer would be responsible for the investment risk and the defined employer contribution would not go into an individual Plan 3 member account but rather a member reserve under the Plan 2/3 Commingled Trust Fund. The value of the member account would be available upon separation from service as a lump sum or optional life annuity. Advice from tax counsel would be advisable prior to a formal pursuit of this option.

Analyzing the Options



Fiscal vs. Policy Concerns

Any proposed provision in retirement law involves deliberation that addresses both fiscal and policy concerns. The benefit design and funding method of gain-sharing benefits leads to fiscal and policy questions regarding its affordability and its policy soundness.

Is Gain-Sharing Affordable?

Gain-sharing does have a cost. Those costs are well documented in the supporting fiscal note and supplement that are attached to this report. The methodology for estimating the value of future gain-sharing is disclosed in the 2003 AVR.

If, after examining those costs, it is determined that gain-sharing is affordable, it would then be a matter of setting the funding policy to pay for gain-sharing or replace gain-sharing with an alternative benefit of equal expense.

> Setting the funding policy would allow the recognition of future gain-sharing liabilities or it would continue to post-fund gain-sharing after each event. Recognizing the liabilities of future gain-sharing would address part of the liability issue by allowing the accumulation of earnings to pay for future benefits.
>
> Replacing gain-sharing with alternative benefits of equal expense could resolve the uncertain aspect of gain-sharing. Providing added regularity to the benefit would also allow for the recognition of alternative benefits and compliance with overarching funding policy.

If, after examining those costs, it is determined that gain-sharing is not affordable, it would then be a matter of repealing gain-sharing outright or repealing and replacing gain-sharing with less expensive alternative benefits.

> Repealing gain-sharing and not replacing it with alternative benefits would eliminate all future gain-sharing liabilities (other than those associated with possible litigation).
>
> Repealing gain-sharing and replacing it with less expensive alternative benefits would involve decisions on how much less the alternative benefits would cost. Would those benefits be one-half the cost? Would they be one-third the cost? Would they be similar benefits or something altogether different?

Is Gain-Sharing Sound Pension Policy?

Then there is the question of whether gain-sharing is sound pension policy. In terms of the overarching policies within the public pension systems administered by Washington State, gain-sharing has broken new ground in terms of certainty – when and how much of a benefit members receive – and funding.

In terms of determinability, gain-sharing benefits are not easily predicted for any given year. While that is not a concern in terms of regulatory compliance, it may be a concern to plan members.

In terms of funding, gain-sharing is unique. All other retirement benefits in the Plans 1 and Plans 2/3 are pre-funded – contributions are made during the members working lives to pay for their benefits before they retire. Gain-sharing benefits are funded after-the-fact or post-funded – contribution rates will increase after a gain-sharing event rather than before.

If it is determined that gain-sharing is sound pension policy, it would then be a matter of retaining it as a benefit and setting the funding policy.

> Retaining the gain-sharing benefit would not require any legislative action.
>
> Setting the funding policy, as stated in the affordability discussion, would allow the recognition of future gain-sharing or it would continue to post-fund gain-sharing after each event. Recognizing future gain-sharing would address the liability issue by allowing the accumulation of earnings to pay for future benefits.

If it is determined that gain-sharing is not sound pension policy, it would then be a matter of repealing and replacing gain-sharing with alternative benefits and policy.

> Repealing gain-sharing and replacing it with alternative benefits and policy would involve decisions on how much the alternative benefits would cost. Would they be similar benefits or something altogether different? Would the policy guiding those alternative benefits be within the existing policy or would it be a new policy?

Key Decision Factors

In any decision to modify a provision such as gain-sharing, numerous factors may be taken into account. These factors may include fiscal factors, legal factors, stakeholder interests, and SCPP goals.

Fiscal factors center on the cost of gain-sharing or any proposed replacement. Those costs are outlined in the Fiscal Notes and supplement in Appendix B. But fiscal issues can delve beyond the dollars gleaned from these fiscal notes. Fiscal issues may also address funding methods as they have a direct bearing on the ultimate cost of a benefit. Recognizing the future costs, pay-as-you-go, or post-funding methods have very different impacts on employer contribution rates.

Legal factors may be addressed as well. The AGO provides some legal clarity on the non-contractual rights clause, and possibly assurance, to those who may consider amending or repealing gain-sharing. But possible litigation is never without cost and risk. Beyond the contractual rights issues (*Bakenhus v. Seattle*), there may also be funding issues for which members may take umbrage; the unique post-funding method used for gain-sharing may invite a contest based on members' right to a "systematically funded" retirement plan under *Weaver v. Evans*.

Stakeholder interests may also be considered in any decision to modify a benefit provision. Gain-sharing impacts a large number of active, retired, and even terminated-vested members of the various retirement systems. Despite its sporadic nature, members may have come to rely on gain-sharing distributions.

SCPP goals may also be considered in this decision process. Those goals outline the general policy driving the efforts of the Select Committee on Pension Policy (SCPP). Consideration for those goals may be considered a part of balancing fiscal and policy issues. A complete list of the SCPP goals can be found in Appendix C.

Analyzing the Options under the Decision Factors

Each of the options discussed in the preceding chapter of this report have distinct implications relative to the decision factors noted above. This section will discuss those options within the scope of each of those factors.

Repeal and Not Replace

Fiscal factors: By repealing gain-sharing, the amount needed to recognize future benefits would be eliminated. Were the future costs of gain-sharing to be recognized, it would require an increase in employer contribution rates of 0.71 percent in PERS, 2.18 percent in TRS, and 2.55 percent in SERS. General Fund State (GFS) costs would increase $185.8 million and total employer costs would increase $403 million in the 2007-09 biennium. GFS costs would increase $3.5 billion and total employer costs would increase $7.8 billion over the next 25 years. Since future gain-sharing benefits have never been recognized, this would result in state and local governments avoiding a potential expense.

Legal factors: In the AGO, plan members have no contractual right to future gain-sharing and the legislature has the right to amend or repeal it. Regardless of the AGO, the non-contractual rights clause has not been tested in court. A straight repeal may result in future litigation risk.

Stakeholder interests: Repealing gain-sharing would eliminate a material benefit to a large number of active, retired, and term-vested members. Those members may have come to rely on those benefits. Some members transferred into Plan 3 from Plan 2 because of the availability of gain-sharing. A straight repeal may result in stakeholders litigating to test the validity of a "non-contractual rights" clause.

SCPP Goals: As gain-sharing is used to enhance the PERS 1 and TRS 1 COLA, repealing and not replacing gain-sharing would be contrary to the SCPP goal to increase and maintain members' purchasing power.

Repeal and Replace

The gain-sharing study mandate referenced "… plan choice, employer defined contributions, retirement eligibility enhancements, and post-retirement adjustments" as possible replacement benefits. These replacements are generally similar to those in HB 1324 from the 2005 session. Except for the fiscal specifics, these replacement benefits have similar key decision factors.

The legal concerns with any repeal and replace proposal(s) for gain-sharing include not only the "non-contractual" issue as stated above, but also the nature and value of the replacement benefits. In 2004, at the Actuary's request the AG's office provided informal advice regarding the nature and value of possible replacement benefits for gain-sharing. The AG's informal advice on the nature of the replacement benefit was that if gain-sharing were repealed and replaced by another benefit, and litigation were to occur, courts favor comparable benefits that are similar to the old benefit. The AG also believed that it is reasonable to adjust the value of an uncertain and unpredictable benefit when determining the value of a comparable replacement which has little or no uncertainty. As a result, a more certain (frequent) replacement benefit could have a lesser actuarial liability than gain-sharing and still be considered of similar value.

Fiscal factors: Any replacement benefit's impact on the liability associated with future gain-sharing would depend on the portion of gain-sharing being replaced. If the replacement benefit(s) is (are) a one-to-one trade-off, there would be no diminution of the overall liability.

Legal factors: In the AGO, plan members have no contractual right to future gain-sharing and the legislature has the right to amend or repeal it. Providing replacement benefits, particularly more frequent benefits, could help mitigate possible future litigation risk.

Stakeholder interests: Any significant replacement benefit that was more frequent would be an advantage over the sporadic nature of the gain-sharing benefit. Additional issues involve the value of the replacement benefits. A one-for-one trade-off would be ideal from a members' perspective, but not realistic from a budget writers' perspective.

SCPP Goals: Any replacement benefit that helps to enhance member COLAs, retirement eligibility, and adheres to the statutory goals in the funding chapter would be in accordance with SCPP goals.

Additional legal factors and the fiscal impact for each of these replacement benefits will be outlined below. For a complete examination of the fiscal impact of each of these replacement benefits, please reference the updated fiscal note and supplement in Appendix B.

Plan Choice

Relative to the AG's informal advice, plan choice has no link to the original gain-sharing benefits. It has no relationship with annual disbursements to defined contribution accounts and is of no value to existing active, term-vested, or retired Plan 3 members who benefit from gain-sharing.

Fiscal Impact: The normal costs are higher in the Plans 2 compared to the Plans 3, so as new members join the Plans 2, those higher costs would be realized. As a result, plan choice would increase contribution rates by 0.13 percent in TRS, and 0.15 percent in SERS. State general fund costs in the 2007-09 fiscal year would be $2.4 million and total employer costs (state and local government combined) would be $4.2 million. State general fund costs over the next 25 years would reach $161.6 million and total employer costs would tally to $280.5 million.

Employer Defined Contributions

Annual employer contributions to Plan 3 members' defined contribution accounts would replace a portion of the gain-sharing distributions. In HB 1324, only SERS members would receive this benefit. Other proposals may include PERS 3 and TRS 3 members as well and the costs increase accordingly.

In terms of the AG's informal opinion, employer contributions are a good match as Plan 3 gain-sharing is used to provide distributions to Plan 3 member accounts.

Fiscal Impact: The fiscal impact of an annual employer contribution would depend on the amount being distributed and to which systems. In the original 2005 SCPP interim proposal, the amount of employer-provided defined contribution was to be $12 per year of service increased by 3 percent per year. According to the fiscal note, contribution rates would increase 0.10 percent in PERS, 0.54 percent in TRS, and 0.82 percent in SERS. State general fund costs in the 2007-09 fiscal year would be $34.1 million and total employer costs would be $66.8 million. State general fund costs over the next 25 years would reach $291.3 million and total employer costs would tally to $552.1 million.

Retirement Eligibility Enhancements

The current discussion on retirement eligibility has focused on lowering the retirement age in the Plans 2/3. Members of the Plans 2/3 are eligible for an unreduced retirement at age 65 with five/ten years of service. The principal focus is establishing a "Rule-of-90" in these plans. A Rule-of-90 would combine a member's age and years of service to determine retirement eligibility; a member who was age 55 with 35 years of service (55+35=90) would be eligible for an unreduced retirement benefit.

In terms of the AG's informal advice, trading away Plan 3 gain-sharing for a Rule-of-90 proposal has several policy challenges. An enhanced retirement eligibility benefit is not within the same scope as current gain-sharing benefits which provide distributions to Plan 3 members' defined contribution accounts. Additionally, trading away a Plan 3 benefit to provide an enhanced Plan 2 benefit is not within the scope of the same plan. Finally, such a provision does not benefit certain groups that are currently eligible for gain-sharing distributions – retirees and term-vested members for example. However, it does address SCPP goals concerning retirement eligibility.

Fiscal impact: The full Rule-of-90 would result in employer contribution rate increases of 0.73 percent in PERS, 1.00 percent in TRS, and 0.57 percent in SERS. State general fund costs in the 2007-09 fiscal year would be $75.7 million and total employer costs would be $191.6 million. State general fund costs over the next 25 years would reach $1.3 billion and total employer costs would tally to $3.1 billion. The costs for other variations on the Rule-of-90 can be found in Appendix D.

Post-Retirement Adjustments

Post-retirement adjustments refer to enhancing Plan 1 COLA provisions. In this analysis, several Plan 1 provisions were enhanced including the Uniform Increase Amount, the age eligibility standard to receive the Uniform COLA, and the age/service eligibility to receive the alternative $1,000 minimum benefit and the indexing of that benefit.

In terms of the AG's informal advice, each of these adjustments fall within the same scope as the original Plan 1 gain-sharing – that of enhancing or retaining Plan 1 retirees' purchasing power. While the age eligibility and $1,000 alternative minimum benefit impact a smaller share of the membership, they still stay within the scope of the original gain-sharing benefit.

Fiscal Impact: Increasing the "Uniform Increase Amount" by $0.24/month would result in increased employer contribution rates of 0.23 percent in PERS, 0.47 percent in TRS, and 0.23 percent in SERS. State general fund costs in the 2007-09 fiscal year would be $39.1 million and total employer costs would be $89.9 million. State general fund costs over the next 25 years would reach $515.8 million and total employer costs would tally to $1.2 billion. To examine the fiscal impact of the other individual Plan 1 benefit enhancements see the fiscal note and fiscal note supplement in Appendix B.

Plan 3 to Plan 2 Transfer

The final repeal and replace option examined in this report would be to provide Plan 3 members a choice to return to the Plans 2. This would recognize that the presence of gain-sharing benefits may have provided an incentive for members to transfer or join the Plans 3. The AGO may presume that members read the pension statutes, but the great majority of members peruse the plan information available through the Department of Retirement Systems. It has been alleged that this information did not discuss the non-contractual nature of gain-sharing. Additionally, such a plan transfer option should be reviewed by tax counsel as it may have plan qualification issues and possible tax consequences.

Fiscal Impact: Allowing Plan 3 members to prospectively return to Plan 2 would increase employer contributions by 0.01 percent in PERS, 0.18 percent in TRS, and 0.16 percent in SERS. The General Fund State (GFS) cost in 2007-09 would be $9.9 million, and total employer costs would be $17.1 million. Over 25 years, the GFS costs would be $86.9 million, and total employer costs would be $146.4 million.

Suspend Gain-Sharing Benefit and Suspend Funding

Fiscal factors: This option could eliminate the liability of a gain-sharing event that was suspended during the suspension period. This would limit the liabilities associated with future gain-sharing events to those that would occur after the suspension period, though the majority of those liabilities for Plan 3 will always be in the future.

Legal factors: In the AGO, any amendment to gain-sharing is allowable. While any such change has the risk of litigation, a suspended benefit would probably not be as great a risk as an outright repeal.

Stakeholder interests: Depending on the period, suspending gain-sharing benefits and funding may or may not eliminate a gain-sharing distribution. This could make gain-sharing even less predictable, less certain, and less desirable than it is currently.

SCPP goals: Suspending gain-sharing would be in conflict with the SCPP goal to maintain consistency with funding policies outlined in chapter 41.45 RCW – these are to provide for full funding, predictable rates, and funding of benefit increases over the working lives of the members.

Make Discretionary

Fiscal factors: Making gain-sharing discretionary with the legislature would only limit gain-sharing liabilities if gain-sharing distributions, though triggered, were not granted. It would not be possible to forecast such discretion in a funding model and the OSA would recommend the benefit be recognized in an accepted manner until there was some experience.

Legal factors: In the AGO, any amendment to gain-sharing is allowable. Any such change has the risk of litigation.

Stakeholder interests: Making gain-sharing distributions discretionary with the legislature may or may not eliminate a gain-sharing distribution. This makes gain-sharing potentially more sporadic than it is currently.

Retain and Pre-Fund

Fiscal factors: Recognizing the costs of future gain-sharing would address the future liabilities associated with gain-sharing only to the extent that the liability would be acknowledged and funded. This would require an increase in employer contribution rates of 0.71 percent in PERS, 2.18 percent in TRS, and 2.55 percent in SERS. GFS costs in the 2007-09 biennium would be $185.8 million and total local government costs would be $403 million. Over the next 25 years GFS costs would be $3.5 billion and total employer costs would be $7.8 billion.

Legal factors: Recognizing the costs of future gain-sharing would eliminate any “systematic funding” concerns there might be with the current funding method for gain-sharing.

Stakeholder interests: Retaining and recognizing the future costs of gain-sharing provides greater guarantee for currently eligible members - but not for Plan 2 members. This may also set the stage to trade gain-sharing for a benefit with greater certainty.

SCPP goals: Pre-funding would be in keeping with the SCPP goal to fund retirement benefits systematically.

Retain and Post-Fund (Delay)

*Fiscal factors***:** Delaying the funding of gain-sharing compounds the liabilities associated with future gain-sharing. When gain-sharing is funded – after an event– the contributions will be greater than had these costs been recognized earlier.

Legal factors: Post-funding a material benefit is outside the norm and may not be considered a "systematic funding" policy.

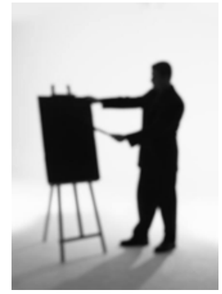
Stakeholder interests: This is the status quo benefit and funding policy. While it retains the existing benefit, it does not address the frequency or certainty of the benefit, nor does it address the funding aspect that makes the benefit more costly than it needs to be.

SCPP goals: Retention of the benefit is in keeping with the SCPP goals, but the funding method is contrary to the goal to maintain consistency with the funding policies outlined in RCW 41.45.

The following table is a synopsis of the key decision factors as outlined in this chapter.

Key Decision Factors				
Options	**Fiscal**	**Legal**	**Stakeholder Interests**	**SCPP Goals**
Repeal and not replace	Eliminates all gain-sharing liability; no 07-09 budget impact	Allowable under AGO, but could result in litigation	Would eliminate a benefit upon which members depend	Contrary to the SCPP goal to increase and maintain members' purchasing power
Repeal and replace	Liability depends on the portion of gain-sharing being replaced; 07-09 budget impact	Allowable under AGO, and minimizes possible litigation over a repeal	May result in a more frequent and desirable benefit	May help establish benefits more in keeping with SCPP goals
Suspend benefit and funding	Could eliminate the liability of an event that occurred during the suspension period	Allowable under AGO, but could result in litigation	May eliminate a benefit upon which members depend	Would be in conflict with SCPP goals
Make discretionary	Could eliminate the liability of an event that was triggered but not granted	Allowable under AGO, but could result in litigation	May eliminate a benefit upon which members depend	Would be in conflict with SCPP goals
Retain and pre-fund	Liability pre-funded; 07-09 budget impact	Eliminates any "systematic funding" concerns	Retains a benefit upon which members depend	Would be in keeping with SCPP goals
Retain and post-fund	Liability funded as in current practice; no 07-09 budget impact	Possible "systematic funding" concerns	Retains a benefit upon which members depend	Would be somewhat in conflict with SCPP goals

Recommendation



SCPP Recommendation and Supporting Findings

In their deliberations to reach a recommendation, the SCPP strived to balance the fiscal factors, legal factors, stakeholder interests, and policy issues surrounding gain-sharing with the committee's own findings and goals. Among the key findings are the following:

Fiscal Findings

Gain-sharing is a material benefit with a material liability. Because of the Plans 1 and Plans 3 are not equal cost-sharing plans, the cost of gain-sharing is paid through increased employer contributions. The cost to recognize gain-sharing's liability would be $185.8 million in GFS, and $403 million in total employer costs in 2007-09. The 25-year cost of recognizing gain-sharing would be $3.5 billion in GFS, and $7.8 billion in total employer costs.

Legal Findings

In the Attorney General's Opinion, the non-contractual clause in the gain-sharing statute allows the legislature to amend or repeal the benefit. The Attorney General also suggests (via an informal advice request) that were gain-sharing to be replaced with alternative benefits, those benefits should be of a similar nature.

Tax counsel advice to the Department of Retirement Systems cautioned against allowing Plan 3 to Plan 2 transfers for those who made an irrevocable choice to be in the Plans 3. Allowing such transfers may result in plan qualification issues under Internal Revenue Service retirement plan regulations, which in turn could have significant tax consequences for members, employers, and the State.

Stakeholder Interest Findings

Stakeholders have expressed concern with the certainty, systematic funding, contractual rights, and the Plan 2 exclusion from gain-sharing. Stakeholders may find that a more certain benefit is preferable to the sporadic distributions from gain-sharing. They may also prefer that all benefits be systematically funded. It can be assumed that stakeholders prefer a contractual benefit to one that can be granted and then taken away. Some stakeholders have also suggested that Plan 2 members were excluded from gain-sharing for erroneous reasons -- they received temporary pay increases from declining contribution rates while Plan 1 and Plan 3 members received permanent benefit increases from gain-sharing distributions.

SCPP Goals

To be in keeping with the funding goals of Chapter 41.45 RCW and the SCPP, the liability of gain-sharing, or any replacement benefit liability, should be recognized and funded in a systematic manner.

Benefit improvements for Plan 1 members would involve improving and maintaining their purchasing power, another SCPP goal. Benefit improvements for Plan 2/3 members that relate to retirement eligibility – improving the normal retirement age, would also be in keeping with SCPP goals.

It is also the SCPP's finding that certainty has a greater value than uncertainty. Any alternative, more regular benefits need not be as costly as gain-sharing.

Initial Proposal

The initial proposal considered by the SCPP was to repeal gain-sharing and replace it with the following more certain, and more inclusive alternative benefits that have a total cost of about half the 2007-09 projected costs for retaining and pre-funding future gain-sharing benefits:

- One-time $0.24 increase in the Plan 1 Uniform COLA;
- SERS and TRS 2/3 Plan choice for new entrants;
- One-time prospective transfer window from Plan 3 to Plan 2 for all current Plan 3 members;
- Employer defined contributions of $12 per year of service increased by 3 percent per year for existing Plan 3 members; and,
- Repeal annual rate flexibility for PERS, TRS and SERS Plans 3.

Stand-alone Bills

In concert with the SCPP goals, but recognizing that those eligible for benefits under these proposals have a less direct connection with those eligible for the original gain-sharing benefits, the following items were recommended by the SCPP to be stand-alone bills.

- Plan 1 age 66 COLA eligibility

- Expanded eligibility for alternative $1,000 minimum benefit and 3 percent annual escalator to Plan 1 members with 20 years of service who have been retired 25 years; and
- Full rule of 90 eligibility (age plus years of service) for unreduced retirement in the Plans 2/3.

Recommendation

Advice from tax counsel regarding the Plan 3 to Plan 2 transfer was made available the evening before the December 13, 2005 SCPP meeting. That advice raised the possibility that the transfer proposal might be in conflict with existing Internal Revenue Service (IRS) public retirement plan regulations. Such a conflict could have significant tax consequences for the state, plan members, and employers.

Because of the added legal complexity of tax counsel advice, the lack of time to reconcile the SCPP proposal with that advice, and the statutory requirement to forward the SCPP Gain-sharing report to the fiscal committees by December 15, 2005, the SCPP recommends further study of gain-sharing in the 2006 interim.

Appendices

Appendix A

Attorney General Opinion

PENSIONS – PUBLIC EMPLOYEES' RETIREMENT SYSTEMS – RETIREMENT – Effect of "non-contractual rights clause" on Legislature's future obligation to provide "gain-sharing benefits".

Where the Legislature has enacted statutes providing "gain-sharing" benefits to retirement system members if certain circumstances occur, but has included language reserving the right to repeal or modify such benefits before they are actually granted, pension system members have no enforceable right or current reasonable expectation of receiving such benefits.

****

November 2, 2005

The Honorable Matthew M. Smith
State Actuary
P.O. Box 40914
Olympia, WA 98504-0914

Cite as:
AGO 2005 No. 16

Dear Mr. Smith:

By letter previously acknowledged, you have requested our opinion on the following question:

> **Do the provisions in RCW 41.31.030, RCW 41.31A.020(4), RCW 41.31A.030(5), and RCW 41.31A.040(5), containing "non-contractual rights clauses", negate any contractual obligation of the state to provide gain-sharing benefits in the future?**

BRIEF ANSWER

For the reasons set forth below, we conclude that the answer to your question is yes, in that the Legislature retains the authority to amend or repeal the gain-sharing provisions of the public employee pension statutes in the future and, if it does so, no contractual claim can be made for gain-sharing distributions due after that date. While the Washington Supreme Court has held that the pension statutes do create certain rights for public employees that are contractual in nature, the Court has also held that those rights consist of a pension substantially in accord with the statutes as they exist when the employee begins service.

Here, the statutes in question have always clearly and unequivocally provided that the gain-sharing provisions do not create a contractual right in any public employee member or beneficiary to receive gain-sharing distributions in the future, and that the Legislature may amend or repeal these particular statutes at any time.

ANALYSIS

Your question concerns the "gain-sharing" provisions of the public employee pension statutes that the Legislature enacted in 1998 and amended in 2000 and 2003. RCW 41.31 and 41.31A provide for an additional payment to be made to members and beneficiaries of certain pension plans when there have been four consecutive years of "extraordinary gains". When gain-sharing occurs, half of the extraordinary gains are distributed to eligible members or beneficiaries.[1] RCW 41.31.020; RCW 41.31A.020(3), .030(3), .040(3). RCW 41.31 governs gain-sharing for persons covered by Public Employees' Retirement System (PERS) Plan 1 and Teachers' Retirement System (TRS) Plan 1. RCW 41.31A governs gain-sharing for persons covered by PERS Plan 3, TRS Plan 3, and School Employees' Retirement System (SERS) Plan 3.

However, in the 1998 act, as well as the 2000 and 2003 amendments, the Legislature enacted reservation of rights clauses that specifically limited the gain-sharing rights of current and future members and beneficiaries. The Plan 1 clause states:

> The legislature reserves the right to amend or repeal this chapter in the future and no member or beneficiary has a contractual right to receive this postretirement adjustment not granted prior to that amendment or repeal.

RCW 41.31.030. The Plan 3 clauses are worded substantially the same. They read:

> The legislature reserves the right to amend or repeal this section in the future and no member or beneficiary has a contractual right to receive this distribution not granted prior to that time.

RCW 41.31A.020(4), .030(5), .040(5).

Your question concerns the effect of the above provisions, in light of the law governing public pensions in this state. We turn first to the seminal Washington case on this subject, *Bakenhus v. City of Seattle*, 48 Wn.2d 695, 701, 296 P.2d 536 (1956). There, the Court stated:

> [T]he employee who accepts a job to which a pension plan is applicable contracts for a substantial pension and is entitled to receive the same when he has fulfilled the prescribed conditions. His pension rights may be modified prior to retirement, but only for the purpose of keeping the pension system flexible and maintaining its integrity.

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[1] The actual manner of distribution of the gain-sharing amount set out in detail in the statutes is complicated and not necessary to the discussion of the issues in this opinion.

The Court has since clarified that "at least some pension rights are contractual in nature". *Retired Pub. Employees Coun. v. Charles,* 148 Wn.2d 602, 624, 62 P.3d 470 (2003). While the pension statutes are not in themselves contracts, they provide the right to receive certain benefits that constitute deferred compensation to the employee for services rendered. *Noah v. State,* 112 Wn.2d 841, 844, 774 P.2d 516 (1989). If it were otherwise, these benefits would amount to mere gratuities that are prohibited by the state constitution. *Bakenhus,* 48 Wn.2d at 698. Accordingly, the following have been held to be vested rights that are protected from subsequent impairment: size of a pension (*Bakenhus*); right to the statutory retirement age at the time of employment (*Eagan v. Spellman,* 90 Wn.2d 248, 258, 581 P.2d 1038 (1978)); right to a practice of including certain lump sum payments in the calculation of retirement benefits (*Washington Ass'n of Cy. Officials v. Washington Pub. Employees' Ret. Sys. Bd.,* 89 Wn.2d 729, 733, 575 P.2d 230 (1978)); right to add to a pension by using accrued vacation pay (*Washington Fed'n of State Employees v. State,* 98 Wn.2d 677, 679, 658 P.2d 634 (1983)); and right to the systematic funding of the retirement system to maintain actuarial soundness (*Charles,* 148 Wn.2d at 625).

Nevertheless, the question remains: Assuming that a certain pension benefit created by statute constitutes a right contractual in nature, what is the extent of the right that has been created? *Bakenhus* answered as follows:

> The problem arises in determining the extent of the contractual undertaking on the part of the state or municipal authority which has promised the pension. . . . *The promise on which the employee relies is that which is made at the time he enters employment; and the obligation of the employer is based upon that promise.*

48 Wn.2d at 700 (emphasis added). This interpretation of the pension statutes is reasonable, *Bakenhus* continued, because it "gives effect to the reasonable expectations of the employee and at the same time allows the legislature the freedom necessary to improve the pension system and adapt it to changing economic conditions". *Id.* at 701.

The right to a public pension "commence[s] . . . with the first day of employment or service, and continue[s] to vest with each day's service thereafter". *Tembruell v. City of Seattle,* 64 Wn.2d 503, 506, 392 P.2d 453 (1964). Significantly, however, as clarified in *Noah*, such "vesting" refers to "the contractual right to a pension *substantially in accord with the statutes as they existed when the employee begins service*". *Noah,* 112 Wn.2d at 845 n.1 (emphasis added).

In the cases noted above, the Supreme Court invalidated attempts to rescind pension benefits previously granted to public employees. Those cases are all distinguishable from the present situation, however, because none of them involved statutes containing clauses that both specifically reserve the Legislature's right to amend or repeal the benefits in question in the future (*e.g.*, gain-sharing), *and* they clearly state that the Legislature is not granting any contractual right to any benefits not granted before such amendment or repeal. We find this difference to be critical, because the "contractual" theory underpinning *Bakenhus* (and subsequent public pension cases) stresses the importance of: (1) upholding the "reasonable expectations" of the member or beneficiary,[2] and (2) not reneging on the promise originally made to the members when they joined the pension system. We do not read the decisions to hold that the Legislature is prohibited from initially setting clear limits on the benefits being afforded to members and beneficiaries; rather, we read them to hold that the Legislature cannot later retroactively depart from the terms set forth in the original statutes granting such benefits.

A recent Oregon case related to pension benefits concurs with this reasoning. *Strunk v. Pub. Employees Ret. Bd.*, 338 Or. 145, 108 P.3d 1058 (2005). Although the Oregon Supreme Court has held that the pension statutes can create contractual rights for PERS beneficiaries, it has also held that the Legislature may limit the extent of such contractual rights by including clear statutory language to this effect. One of the issues raised in *Strunk* concerned the Oregon Legislature's 1991 repeal of the tax exemption for PERS benefits. The Oregon Supreme Court had held (in an earlier case, *Hughes v. Oregon,* 314 Or. 1, 838 P.2d 1018 (1992)) that this repeal in effect breached PERS members' contractual rights, requiring a legislative remedy. When the Oregon Legislature failed to act, class action litigation was brought, leading to a settlement for damages covering all PERS retirees who were PERS members before the effective date of the 1991 tax repeal. The Legislature adopted the terms of the settlement and codified them in the Oregon statutes, specifically Or. Rev. Stat. §§ 238.375 to 238.380. The implementation of these terms resulted in an annual increase in employer contribution rates to PERS of approximately 1.4 percent. Significantly, however, the Oregon Legislature included the following provision in Or. Rev. Stat § 238.375(3):

> No member of the system or beneficiary of a member of the system shall acquire a right, contractual or otherwise, to the increased benefits provided by [Or. Rev. Stat. §§ 238.375 - .380].

Strunk, 108 P.3d at 1079.

When the Oregon Legislature passed certain laws in 2003 lowering PERS retirement benefits, the PERS member petitioners in *Strunk* argued that doing so impermissibly repealed the benefits they had obtained by virtue of the settlement that had been codified into the Oregon PERS statutes. The court disagreed:

> Respondents argue, we conclude correctly, that the . . . settlement agreement by its specific terms limited petitioners' rights to those set out in the 1991 legislation and that that legislation expressly disavowed the creation of any contractual rights. The wording of ORS 238.375(3) . . . could not be clearer in that respect. Nothing about the context of that wording alters what we perceive to be the legislature's manifest intent. Because petitioners have failed to demonstrate a

[2] The "reasonable expectation" test is an objective test, rather than one based upon the specific expectations of individual employees. *Bowles v. Dep't of Ret. Sys.,* 121 Wn.2d 52, 67, 847 P.2d 440 (1993). Furthermore, a retirement system member is presumed to know the law by reading the pension statute. *Retired Pub. Employees Coun. v. State,* 104 Wn. App. 147, 151-52, 16 P.3d 65 (2001).

> contractual right that [the 2003 Oregon laws are] capable of breaching with respect to the . . . settlement, we reject their argument.

Id.

The Washington State Supreme Court has addressed the Legislature's power to amend contractual rights in public contracts in non-pension contexts. These cases indicate that contract rights may be made subject to future alteration by the Legislature, *if* the Legislature's reservation clause is clear and specific enough. In *Caritas Servs., Inc. v. Dep't of Social & Health Servs.*, 123 Wn.2d 391, 869 P.2d 28 (1994), at issue was whether amendments to the Nursing Homes Auditing and Cost Reimbursement Act of 1980 (RCW 74.46), and related regulations, unconstitutionally impaired contract rights by retroactively reducing nursing home reimbursement rates under the Medicaid program. The contract clause there provided:

> All rights and obligations of the parties to this agreement shall be . . . governed by the terms of this agreement or as set forth in the laws and regulations of the State of Washington and the United States, *as now existing or hereafter adopted or amended*, relating to the administration of the Title XIX Medicaid program, payment for services under such program and operation of nursing homes generally[.]

Caritas, 123 Wn.2d at 404 (ellipses and emphasis in original). The Court found that this language was not specific enough to allow the Legislature to subject the existing contract to future, retroactive modification. "[O]ur case law requires such reservation clauses to be made *explicitly* contingent on future acts of the Legislature with retroactive effect." *Id.* at 406 (emphasis in original). Similarly, in *Carlstrom v. State,* 103 Wn.2d 391, 393-95, 694 P.2d 1 (1985), the Court held that a reservation clause that made a public employment contract "subject to all present and future acts of the legislature" was not specific enough to subject the contract to retroactive modification. *Accord Cont'l Illinois Nat'l Bank & Trust Co. v. Washington,* 696 F.2d 692, 698-99 (9th Cir. 1983).

On the other hand, the Court in *Caritas* added: "To forestall confusion, we note that states or agencies may put potential contractors explicitly on notice that the terms of a public contract are subject to retroactive adjustment as the whims or the budgetary necessity of the state may dictate." *Caritas,* 123 Wn.2d at 406-07, n.9. *See also Trustees of Dartmouth College v. Woodward,* 17 U.S. 518, 666, 4 L. Ed. 629 (1819) (Story, J., concurring). In *Carlstrom,* the Court emphasized that "[t]he Legislature knows how to use plain English to make existing contracts subject to future modification" (*Carlstrom*, 103 Wn.2d at 398), thus implying that the Court would uphold and enforce such specific language in a future case. The Court has also reiterated that reservation clauses must adhere to policies of fairness, such as those underlying the public pension cases. *Caritas*, 123 Wn.2d at 407, n.9, citing Laurence H. Tribe, *American Constitutional Law* 618-19 (2d ed. 1988) ("noting that the most basic purposes of the contract clause point to the simple principle that the government must keep its word"), and citing *General Motors Corp. v. Romein,* 503 U.S. 181, 191, 112 S. Ct. 1105, 117 L. Ed. 2d 328 (1992) (retroactive legislation presents problems of unfairness where it deprives citizens of legitimate expectations).

Applying these principles, we believe that the provisions in RCW 41.31.030, 41.31A020(4), 41.31A.030(5), and 41.31A.040(5), containing "non-contractual rights clauses", are sufficient to negate any obligation of the state to provide gain-sharing benefits that have not been provided prior to any subsequent modification or repeal of the gain-sharing statutes. The reservation clauses here do not contain merely general statements that the gain-sharing statutes are "subject to all present and future acts of the legislature" (*Carlstrom*, 103 Wn.2d at 393-95), or that they are subject to laws "now existing or hereafter adopted or amended" (*Caritas*, 123 Wn.2d at 404). They go much further than this, stating not only that the Legislature reserves the right to amend or repeal these sections in the future, but also stating—clearly and explicitly—that "no member or beneficiary has a contractual right to receive [a gain-sharing] distribution not granted prior to that time" (RCW 41.31.030; RCW 41.31A.020(4), .030(5), .040(5)).

A retirement system member is presumed to know the law by reading the pension statute. *Retired Pub. Employees Coun. v. State,* 104 Wn. App. at 151-52. As the Oregon Supreme Court held in construing nearly identical language in *Strunk,* we do not believe the Legislature's expressed intent could be clearer in this respect. Furthermore, we do not believe that members or beneficiaries, in light of this language, can claim a "reasonable expectation" (in the words of *Bakenhus*) to receive a continuous and unending right to gain-sharing distributions in the future. "The promise on which the employee relies is that which is made at the time he enters employment; and the obligation of the employer is based upon that promise." *Bakenhus,* 48 Wn.2d at 700. The "promise" of the Legislature here included a specific—but clearly limited—right to receive gain-sharing.

We trust that the foregoing will be of assistance to you.

Sincerely,

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Appendix B

Draft Fiscal Notes and Supplement

DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	12/12/05	Omnibus gain-sharing bill

SUMMARY OF BILL:

This bill impacts the Public Employees' Retirement System Plan 1 and Plan 3, the Teachers' Retirement System Plan 1 and Plan 3, and the School Employees' Retirement System Plan 3 by:

- Repealing Plan 1 and Plan 3 gain-sharing.
- Providing a one-time permanent $0.24 increase in the Plan 1 Uniform COLA.
- Providing a one-time Plan 3 to Plan 2 prospective transfer window for all current Plan 3 members.
- Establishing Plan 2/3 choice for TRS and SERS new hires.
- Repealing annual rate flexibility for PERS, TRS, and SERS Plans 3.
- Establishing an annual Plan 3 employer defined contribution of $12 per year of service (increased by 3% per year) for existing Plan 3 members only (and after transfer window).

Effective Date: July 1, 2007

CURRENT SITUATION:

Currently, gain-sharing applies to the Plans 1 and 3 of PERS, TRS, and SERS. Gain-sharing is a mechanism that increases benefits. The increases are not automatic, but are contingent on the occurrence of "extraordinary investment gains." Extraordinary gains occur when the compound average of investment returns on pension fund assets exceeds 10% for the previous four state fiscal years. When this occurs, a calculation is performed to determine a dollar amount that will be distributed to eligible members. Gain-sharing calculations are currently made once each biennium with potential distributions occurring in January of even-numbered years. There have been two gain-sharing distributions since the inception of gain-sharing: one in 1998 and one in 2000.

When gain-sharing occurs, one-half of the gain for PERS 1 and TRS 1 is used to fund a permanent increase in the PERS 1 and TRS 1 Uniform COLA for current and future retirees. The gain is used to boost the Annual Increase Amount. The Annual Increase Amount, which increases each year by at least 3 percent, is multiplied by each retirees' total years of service to determine the annual uniform increase retirees receive when they are COLA eligible. Thirty-eight cents of the current annual increase amount is the result of gain-sharing. The Annual Increase Amount is scheduled to increase to $1.29 on July 1, 2006 and to $1.33 on July 1, 2007.

In the Plans 3, active, retired and terminated vested members receive gain-sharing distributions as a lump sum dollar amount that is deposited directly into their defined contribution accounts based on years of service credit.

Currently, of the three systems, PERS is the only one that has Plan 2/3 choice at hire. New PERS employees have a period of ninety days to make an irrevocable choice to become a member of Plan 2 or Plan 3. At the end of ninety days, if the member has not made a choice to become a member of Plan 2, he or she automatically becomes a member of Plan 3. In TRS and SERS, new employees automatically become members of Plan 3, and the Plans 2 are closed to new hires.

Current law provides that members of the Plans 3 may change their contribution rate option by notifying their employer in writing during the month of January. In practice, this provision is only available to TRS 3 members, as the IRS did not approve contribution rate flexibility for PERS and SERS when the plans were qualified this last year. Removal of the annual contribution choice provisions in PERS and SERS has become a matter of IRS compliance.

MEMBERS IMPACTED:

The 24 cent COLA and the repeal of Plan 1 gain-sharing will impact all 75,390 members of PERS 1 and all 45,961 members of TRS 1.

For a typical Plan 1 member impacted by this bill, the uncertain and irregular adjustment to the Annual Increase Amount provided by gain-sharing is exchanged for a definitely determinable increase. Instead of providing adjustments to the Annual Increase Amount with gain-sharing, the Annual Increase Amount would be permanently increased by 24 cents. A retiree with 25 years of service would get an initial increase of $6 per month. This $6 increase will become a permanent part of the Uniform COLA Annual Increase Amount, growing by 3% per year thereafter.

The repeal and modification of Plan 3 gain-sharing for PERS, TRS and SERS could potentially impact all current and future members of PERS 3, TRS 3, and SERS 3, including all of the active Plan 3 members except those that would not meet the requirement of having a minimum $1,000 balance in the member account, all of the Plan 3 annuitants, all of the Plan 3 terminated vested members meeting the minimum balance requirement, and any Plan 3 terminated non-vested members who are rehired.

(As of September 30, 2004)	PERS 3	TRS 3	SERS 3
Active	19,855	49,302	29,430
Annuitants	222	541	481
Terminated and Vested	1,284	2,761	2,035
Total	21,361	52,604	31,946

The $12 Plan 3 contribution will impact the same Plan 3 members impacted by the repeal of gain-sharing, to receive the contribution at any time in the future, a Plan 3 member would need to meet the eligibility requirements on the effective date of the act and the eligibility requirements on the effective date of a future distribution.

The Plan 3 contribution multiplier would increase at 3% per year and the contribution amount would increase for each additional year of service. The amount would continue to be deposited to the eligible member's defined contribution (DC) account for life, or until termination of employment if the member is non-vested. Below is a summary of costs for an average member and sample benefits for an active member with ten years of service in each system:

(As of September 30, 2004)	PERS 3	TRS 3	SERS 3
Contribution per year of service	$12	$12	$12
Average present value of benefits (all members)	$2,900	$3,600	$2,700
Total contribution to DC account, 1st year*	$120	$120	$120
Total contribution to DC account, 2nd year*	$136	$136	$136
Total contribution to DC account, 20th year*	$610	$610	$610

**Active member, assuming member remains continuously active on a full-time basis.*

Regarding the Plan 2/3 prospective choice, this will impact TRS and SERS members hired on or after July 1, 2007. We estimate that from October 1, 2007 to September 30, 2008, there will be a total of 4,568 new TRS members and 5,452 new SERS members. The number of new members is expected to increase each year. We estimate that 50% of these new members would elect to join Plan 2 and 50% would elect Plan 3.

All active members of the Plans 3 could be impacted by the provision that would allow a window of opportunity to join Plan 2 for prospective service. For members electing to transfer, the prior service would remain in Plan 3, and future service would be credited in Plan 2. Some of these impacted members are currently in Plan 3 by way of transfer. Some TRS 3 and SERS 3 actives are in Plan 3 solely because Plan 2 membership was closed when they entered service. There are also some PERS 3 actives who entered after the creation of Plan 3 by electing to join Plan 3 (or failing to join Plan 2 within 90 days of hire). We estimate that about 50% of Plan 3 members would elect to transfer. Below is a breakdown of this membership status:

Plan 3 Active Membership Status *(As of September 30, 2004)*	PERS 3	TRS 3	SERS 3
Transferred from Plan 2	12,203	21,821	15,307
Hired after Plan 3 inception date*	7,652	27,481	14,123
Total Active Membership	19,855	49,302	29,430

**PERS new entrants have a choice between Plan 2 and Plan 3. TRS and SERS new entrants must join Plan 3.*

The removal of the Plan 3 provision that allows members to change their employee contribution rate by notifying their employer in writing during the month of January would affect 19,855 active PERS 3 members, 49,302 active TRS 3 members, and 29,430 active SERS 3 members. This change would impact the defined contribution portion of the plan and would have no impact on benefits under the defined benefit plan. Transferring from Plan 3 to Plan 2 might have an impact on eligibility for retiree medical benefits, but this would not have an impact on contribution rates for the defined benefit pension plan.

ASSUMPTIONS:

We assumed that employer contribution rates would decrease after the proposed repeal of gain-sharing because rates under current policy and generally adopted by the PFC, subject to legislative approval, include the cost of future gain-sharing benefits. The cost impact was developed using the same logic as used for the 2003 valuation (rates were determined assuming a delayed effective date from the valuation date to 2007).

For pricing the cost of prospective choice, we determined the Entry Age Normal Cost rate (EANC) for Plan 2 as if every active Plan 2 and Plan 3 member were in Plan 2, and we determined the EANC for Plan 3 as if every active Plan 2 and Plan 3 member were in Plan 3. We calculated the excess of the employer portion of the EANC for Plan 2 over the EANC for Plan 3 and then took 50% of the difference to reflect our assumption that 50% of new members in TRS and SERS would elect to join Plan 2 and 50% would elect Plan 3. Since the choice would only apply to new members, we assumed no rate increase for choice for the current members, and applied the rate increase for choice to the projected payroll for the new members only.

We considered making an adjustment for the cost of prospective choice based on the age of members who would elect Plan 2 compared to the age of members who would elect Plan 3, however, after reviewing the choices made by new members in PERS over an 18-month period, there was no significant difference in choice based on age.

In pricing the opportunity for Plan 3 members to Plan 2, for prospective service we assumed that approximately 50% of the current actives would elect to do so. In addition, we assumed that the members who would choose this option would be the older half of the actives, since Plan 2 provisions generally benefit older members more than do Plan 3 provisions.

For the $12 Plan 3 contribution, we projected the total years of credited service for eligible Plan 3 members, active and inactive, under current assumptions, multiplied the service by the indexed benefit, and took the present value at 8%.

FISCAL IMPACT:

Description:

The decrease in contribution rates from the proposed repeal of future gain-sharing is partially offset by the increase due to the proposed benefit improvements.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing (decreasing) the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

(Dollars in Millions)		Current*	Increase	Total
Actuarial Present Value of Projected Benefits	PERS	$28,718	$(286)	$28,432
(The Value of the Total Commitment to all Current Members)	TRS	$16,407	$(283)	$16,124
	SERS	$2,296	$(57)	$2,239
Unfunded Actuarial Accrued Liability	PERS 1	$3,052	$(229)	$2,823
(The Portion of the Plan 1 Liability that is Amortized at 2024)	TRS 1	$1,816	$(179)	$1,637
Unfunded Liability (PBO)	PERS	$(162)	$(228)	$(390)
(The Value of the Total Commitment to all Current Members Attributable to Past Service)	TRS	$309	$(233)	$76
	SERS	$(360)	$(32)	$(392)

**Includes the value of future gain-sharing benefits.*

Increase in Contribution Rates: (Effective 07/01/07 for PERS; 09/01/07 for TRS and SERS)	PERS	TRS	SERS
Current Members			
Employee (Plan 2)			
Repeal Gain-Sharing	0.00%	0.00%	0.00%
Plan 2/3 Prospective Choice	0.00%	0.00%	0.00%
Transfer to Plan 2 for Prospective Service	0.01%	0.18%	0.16%
Plan 3 Contribution	0.00%	0.00%	0.00%
Total Benefit Improvements	0.01%	0.18%	0.16%
Net Employee (Plan 2)	0.01%	0.18%	0.16%
Employer State			
Repeal Plan 1 Gain-Sharing	(0.46%)	(0.94%)	(0.46%)
$0.24 Plan 1 Uniform COLA Increase	0.23%	0.47%	0.23%
Net Plan 1 Employer State	(0.23%)	(0.47%)	(0.23%)
Repeal Plan 2/3 Gain-Sharing	(0.25)%	(1.24)%	(2.09)%
Plan 2/3 Prospective Choice	0.00%	0.00%	0.00%
Transfer to Plan 2 for Prospective Service	0.01%	0.18%	0.16%
Plan 3 Contribution	0.10%	0.54%	0.82%
Total Benefit Improvements	0.11%	0.72%	0.98%
Net Plan 2/3 Employer State	(0.14)%	(0.52)%	(1.11)%
Total Employer State - Current Members	(0.37)%	(0.99)%	(1.34)%

Increase in Contribution Rates:

(Effective 07/01/07 for PERS; 09/01/07 for TRS and SERS)	PERS	TRS	SERS
New Entrants*			
Employee (Plan 2)			
Repeal Plan 3 Gain-Sharing	0.00%	0.00%	0.00%
Plan 2/3 Prospective Choice	0.00%	0.13%	0.15%
Transfer to Plan 2 for Prospective Service	0.00%	0.00%	0.00%
Plan 3 Contribution	0.00%	0.00%	0.00%
Total Benefit Improvements	0.00%	0.13%	0.15%
Net Employee (Plan 2)	0.00%	0.13%	0.15%
Employer State			
Repeal Plan 3 Gain-Sharing	(0.34)%	(1.05)%	(2.50)%
Plan 2/3 Prospective Choice	0.00%	0.13%	0.15%
Transfer to Plan 2 for Prospective Service	0.00%	0.00%	0.00%
Plan 3 Contribution	0.00%	0.00%	0.00%
Total Plan 2/3Benefit Improvements	0.00%	0.13%	0.15%
Net Employer State - New Entrants	(0.34)%	(0.92)%	(2.35)%

**Rate change applied to future new entrant payroll and used for fiscal budget determinations only. A single supplemental rate increase, equal to the increase for current members, would apply initially for all members or employers.*

Fiscal Budget Determinations (repeal gain-sharing - all plans):

As a result of the lower required contribution rates, the decrease in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$0.0	$0.0	$0.0
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($24.3)	($127.5)	($34.0)	($185.8)
Non-General Fund	($42.6)	$0.0	$0.0	($42.6)
Total State	($66.9)	($127.5)	($34.0)	($228.4)
Local Government	($59.9)	($63.6)	($51.1)	($174.6)
Total Employer	($126.8)	($191.1)	($85.1)	($403.0)
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	($445.1)	($2,251.3)	($838.5)	($3,534.9)
Non-General Fund	($802.1)	$0.0	$0.0	($802.1)
Total State	($1,247.2)	($2,251.3)	($838.5)	($4,337.0)
Local Government	($1,120.2)	($1,124.3)	($1,258.2)	($3,502.7)
Total Employer	($2,367.4)	($3,375.6)	($2,096.7)	($7,839.7)
Total Employee	$0.0	$0.0	$0.0	$0.0

Fiscal Budget Determinations (benefit improvements - all plans):

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$0.0	$0.0	$0.0
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$10.4	$63.0	$12.1	$85.5
Non-General Fund	$17.8	$0.0	$0.0	$17.8
Total State	$28.2	$63.0	$12.1	$103.3
Local Government	$25.2	$31.5	$18.0	$74.7
Total Employer	$53.4	$94.5	$30.1	$178.0
Total Employee	$1.0	$3.0	$2.1	$6.1
2006-2031				
State:				
General Fund	$126.6	$793.2	$135.8	$1,055.6
Non-General Fund	$214.6	$0.0	$0.0	$214.6
Total State	$341.2	$793.2	$135.8	$1,270.2
Local Government	$303.3	$396.2	$204.0	$903.5
Total Employer	$644.5	$1,189.4	$339.8	$2,173.7
Total Employee	$7.7	$98.1	$56.6	$162.4

Fiscal Budget Determinations (all changes - all Plans):

As a result of the higher (lower) required contribution rate, the increase (decrease) in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($13.9)	($64.5)	($21.9)	($100.3)
Non-General Fund	($24.8)	$0.0	$0.0	($24.8)
Total State	**($38.7)**	**($64.5)**	**($21.9)**	**($125.1)**
Local Government	($34.7)	($32.1)	($33.1)	($99.9)
Total Employer	($73.4)	($96.6)	($55.0)	($225.0)
Total Employee	$1.0	$3.0	$2.1	$6.1
2006-2031				
State:				
General Fund	($318.5)	($1,458.1)	($702.7)	($2,479.3)
Non-General Fund	($587.5)	$0.0	$0.0	($587.5)
Total State	**($906.0)**	**($1,458.1)**	**($702.7)**	**($3,066.8)**
Local Government	($816.9)	($728.1)	($1,054.2)	($2,599.2)
Total Employer	($1,722.9)	($2,186.2)	($1,756.9)	($5,666.0)
Total Employee	$7.7	$98.1	$56.6	$162.4

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. All benefit improvement costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2004 actuarial valuation report of the Teachers' Retirement System, School Employees' Retirement System, and Public Employees' Retirement System. Gain-sharing costs were based on the methods used in the 2003 valuation, adjusted for the delay in the recognition of the cost of gain-sharing.

2. As with the costs developed in the actuarial valuation, the emerging costs of the Systems will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This draft fiscal note is intended for use only during the 2006 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members. Benefit improvement rate increases are based on rates that exclude the cost of gain-sharing.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Aggregate Funding Method: The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

Entry Age Normal Cost Method (EANC): The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

Supplement to Gain-Sharing Omnibus Bill Fiscal Note

(December 12, 2005)

Fiscal Budget Determinations (repeal Plan 1 gain sharing only):

As a result of the lower required contribution rates, the decrease in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($16.1)	($56.1)	($6.0)	($78.2)
Non-General Fund	($26.6)	$0.0	$0.0	($26.6)
Total State	**($42.7)**	**($56.1)**	**($6.0)**	**($104.8)**
Local Government	($37.9)	($28.0)	($9.0)	($74.9)
Total Employer	($80.6)	($84.1)	($15.0)	($179.7)
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	($217.4)	($733.1)	($80.9)	($1,031.4)
Non-General Fund	($359.0)	$0.0	$0.0	($359.0)
Total State	**($576.4)**	**($733.1)**	**($80.9)**	**($1,390.4)**
Local Government	($511.2)	($366.2)	($121.3)	($998.7)
Total Employer	($1,087.6)	($1,099.3)	($202.2)	($2,389.1)
Total Employee	$0.0	$0.0	$0.0	$0.0

Fiscal Budget Determinations (Plan 1 $0.24 uniform COLA increase):

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$8.1	$28.0	$3.0	$39.1
Non-General Fund	$13.3	$0.0	$0.0	$13.3
Total State	**$21.4**	**$28.0**	**$3.0**	**$52.4**
Local Government	$19.0	$14.0	$4.5	$37.5
Total Employer	$40.4	$42.0	$7.5	$89.9
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	$108.7	$366.8	$40.3	$515.8
Non-General Fund	$179.6	$0.0	$0.0	$179.6
Total State	**$288.3**	**$366.8**	**$40.3**	**$695.4**
Local Government	$255.6	$183.2	$60.5	$499.3
Total Employer	$543.9	$550.0	$100.8	$1,194.7
Total Employee	$0.0	$0.0	$0.0	$0.0

Fiscal Budget Determinations (Plan 1 all changes):

As a result of the higher (lower) required contribution rates, the increase (decrease) in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$0.0	$0.0	$0.0
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($8.0)	($28.1)	($3.0)	($39.1)
Non-General Fund	($13.3)	$0.0	$0.0	($13.3)
Total State	($21.3)	($28.1)	($3.0)	($52.4)
Local Government	($18.9)	($14.0)	($4.5)	($37.4)
Total Employer	($40.2)	($42.1)	($7.5)	($89.8)
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	($108.7)	($366.3)	($40.6)	($515.6)
Non-General Fund	($179.4)	$0.0	$0.0	($179.4)
Total State	($288.1)	($366.3)	($40.6)	($695.0)
Local Government	($255.6)	($183.0)	($60.8)	($499.4)
Total Employer	($543.7)	($549.3)	($101.4)	($1,194.4)
Total Employee	$0.0	$0.0	$0.0	$0.0

Fiscal Budget Determinations (Repeal Plan 3 gain sharing only):

As a result of the lower required contribution rates, the decrease in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$0.0	$0.0	$0.0
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($8.2)	($71.4)	($28.0)	($107.6)
Non-General Fund	($16.0)	$0.0	$0.0	($16.0)
Total State	($24.2)	($71.4)	($28.0)	($123.6)
Local Government	($22.0)	($35.6)	($42.1)	($99.7)
Total Employer	($46.2)	($107.0)	($70.1)	($223.3)
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	($227.7)	($1,518.2)	($757.6)	($2,503.5)
Non-General Fund	($443.1)	$0.0	$0.0	($443.1)
Total State	($670.8)	($1,518.2)	($757.6)	($2,946.6)
Local Government	($609.0)	($758.1)	($1,136.9)	($2,504.0)
Total Employer	($1,279.8)	($2,276.3)	($1,894.5)	($5,450.6)
Total Employee	$0.0	$0.0	$0.0	$0.0

Fiscal Budget Determinations (Plan 3 transfer prospectively to Plan 2):

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$0.2	$8.3	$1.4	$9.9
Non-General Fund	$0.4	$0.0	$0.0	$0.4
Total State	**$0.6**	**$8.3**	**$1.4**	**$10.3**
Local Government	$0.6	$4.2	$2.0	$6.8
Total Employer	$1.2	$12.5	$3.4	$17.1
Total Employee	$1.0	$1.6	$1.4	$4.0
2006-2031				
State:				
General Fund	$1.6	$75.9	$9.4	$86.9
Non-General Fund	$3.4	$0.0	$0.0	$3.4
Total State	**$5.0**	**$75.9**	**$9.4**	**$90.3**
Local Government	$4.4	$37.8	$13.9	$56.1
Total Employer	$9.4	$113.7	$23.3	$146.4
Total Employee	$7.7	$9.6	$9.0	$26.3

Fiscal Budget Determinations (Plan 2/3 prospective choice):

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$0.0	$0.0	$0.0
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$0.0	$1.8	$0.6	$2.4
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$1.8	$0.6	$2.4
Local Government	$0.0	$0.9	$0.9	$1.8
Total Employer	$0.0	$2.7	$1.5	$4.2
Total Employee	$0.0	$1.4	$0.7	$2.1
2006-2031				
State:				
General Fund	$0.0	$123.5	$38.1	$161.6
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$123.5	$38.1	$161.6
Local Government	$0.0	$61.7	$57.2	$118.9
Total Employer	$0.0	$185.2	$95.3	$280.5
Total Employee	$0.0	$88.5	$47.6	$136.1

Fiscal Budget Determinations (Plan 3 employer defined contributions):

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$0.0	$0.0	$0.0
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$2.1	$24.9	$7.1	$34.1
Non-General Fund	$4.1	$0.0	$0.0	$4.1
Total State	$6.2	$24.9	$7.1	$38.2
Local Government	$5.6	$12.4	$10.6	$28.6
Total Employer	$11.8	$37.3	$17.7	$66.8
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	$16.3	$227.0	$48.0	$291.3
Non-General Fund	$31.6	$0.0	$0.0	$31.6
Total State	$47.9	$227.0	$48.0	$322.9
Local Government	$43.3	$113.5	$72.4	$229.2
Total Employer	$91.2	$340.5	$120.4	$552.1
Total Employee	$0.0	$0.0	$0.0	$0.0

Fiscal Budget Determinations (Plan 2/3 all benefit improvements):

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$2.3	$35.0	$9.1	$46.4
Non-General Fund	$4.5	$0.0	$0.0	$4.5
Total State	**$6.8**	**$35.0**	**$9.1**	**$50.9**
Local Government	$6.2	$17.5	$13.5	$37.2
Total Employer	$13.0	$52.5	$22.6	$88.1
Total Employee	$1.0	$3.0	$2.1	$6.1
2006-2031				
State:				
General Fund	$17.9	$426.4	$95.5	$539.8
Non-General Fund	$35.0	$0.0	$0.0	$35.0
Total State	**$52.9**	**$426.4**	**$95.5**	**$574.8**
Local Government	$47.7	$213.0	$143.5	$404.2
Total Employer	$100.6	$639.4	$239.0	$979.0
Total Employee	$7.7	$98.1	$56.6	$162.4

Fiscal Budget Determinations (Plan 2/3 all changes):

As a result of the higher (lower) required contribution rates, the increase (decrease) in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$0.0	$0.0	$0.0
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($5.9)	($36.4)	($18.9)	($61.2)
Non-General Fund	($11.5)	$0.0	$0.0	($11.5)
Total State	($17.4)	($36.4)	($18.9)	($72.7)
Local Government	($15.8)	($18.1)	($28.6)	($62.5)
Total Employer	($33.2)	($54.5)	($47.5)	($135.2)
Total Employee	$1.0	$3.0	$2.1	$6.1
2006-2031				
State:				
General Fund	($209.8)	($1,091.8)	($662.1)	($1,963.7)
Non-General Fund	($408.1)	$0.0	$0.0	($408.1)
Total State	($617.9)	($1,091.8)	($662.1)	($2,371.8)
Local Government	($561.3)	($545.1)	($993.4)	($2,099.8)
Total Employer	($1,179.2)	($1,636.9)	($1,655.5)	($4,471.6)
Total Employee	$7.7	$98.1	$56.6	$162.4

DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	12/12/05	Z-0959.2

SUMMARY OF BILL

This legislation impacts the Public Employees' Retirement System Plan 1 (PERS 1) and the Teachers' Retirement System Plan 1 (TRS 1) by:

- Establishing a $1,000 alternative minimum benefit for members with 20 years of service who have been retired 25 years.
- Establishing a 3% annual escalator for both $1,000 alternative minimum benefit provisions.

Effective Date: July 1, 2006

CURRENT SITUATION:

The current $1,000 alternative minimum benefit was established in 2004. PERS 1 and TRS 1 members with 25 years of service who have been retired 20 years are eligible for this benefit. The benefit has no automatic escalator and, as a result, will effectively cease in 2010 when the original minimum benefit, which increases each year by the Annual Increase Amount, will produce a benefit greater than $1,000 for a retired member with 25 years of service.

MEMBERS IMPACTED:

The new eligibility requirements for the $1,000 minimum will impact 561 out 54,465 PERS 1 retirees , and 497 out of 34,624 TRS 1 retirees. Indexing the $1,000 will impact an additional 391 PERS 1 members and 338 TRS 1 members.

A typical member newly eligible for the alternative minimum under this bill will see their monthly benefit in 2006 increase from $821 to $1,030 before voluntary reductions. Due to the new indexing provision, members currently receiving the alternative minimum in 2006 will see their monthly benefit increase from $1,000 to $1,030 before voluntary reductions. Thereafter, the alternative minimum will continue to increase by 3% a year for all members receiving the benefit.

FISCAL IMPACT:

Description:

The benefit improvements in this bill will increase the required employer contribution rate for the PERS and TRS Plan 1 UAAL. Current funding policy requires SERS employers to pay the PERS Plan 1 UAAL contribution rate, therefore, this bill will have a fiscal impact on SERS employers.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

(Dollars in Millions)		Current	Increase	Total
Actuarial Present Value of Projected Benefits	PERS 1	$12,818	$11	$12,829
(The Value of the Total Commitment to all Current Members)	TRS 1	$10,360	$3	$10,363
Unfunded Actuarial Accrued Liability	PERS 1	$2,563	$11	$2,574
(The Portion of the Plan 1 Liability that is Amortized at 2024)	TRS 1	$1,415	$3	$1,418
Unfunded Liability (PBO)	PERS 1	$2,254	$11	$2,265
(The Value of the Total Commitment to all Current Members Attributable to Past Service)	TRS 1	$1,192	$3	$1,195

Increase in Contribution Rates: (Effective 09/01/06 unless indicated otherwise)	PERS/ SERS	TRS
Employee	0.00%	0.00%
Employer State	0.01%	0.01%

Fiscal Budget Determinations:

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.1	$0.3	$0.1	$0.5
Non-General Fund	$0.2	$0.0	$0.0	$0.2
Total State	**$0.3**	**$0.3**	**$0.1**	**$0.7**
Local Government	$0.3	$0.1	$0.1	$0.5
Total Employer	$0.6	$0.4	$0.2	$1.2
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$0.4	$0.6	$0.2	$1.2
Non-General Fund	$0.6	$0.0	$0.0	$0.6
Total State	**$1.0**	**$0.6**	**$0.2**	**$1.8**
Local Government	$0.8	$0.3	$0.2	$1.3
Total Employer	$1.8	$0.9	$0.4	$3.1
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	$4.9	$8.0	$1.9	$14.8
Non-General Fund	$8.1	$0.0	$0.0	$8.1
Total State	**$13.0**	**$8.0**	**$1.9**	**$22.9**
Local Government	$11.3	$4.0	$2.6	$17.9
Total Employer	$24.3	$12.0	$4.5	$40.8
Total Employee	$0.0	$0.0	$0.0	$0.0

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2004 actuarial valuation report of the Teachers' Retirement System and Public Employees' Retirement System.

2. As with the costs developed in the actuarial valuation, the emerging costs of the Systems will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This draft fiscal note is intended for use only during the 2006 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members. Benefit improvement rate increases are based on rates that exclude the cost of gain sharing.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Aggregate Funding Method: The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

Entry Age Normal Cost Method (EANC): The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	12/8/05	Z-0942.1

SUMMARY OF BILL

This legislation impacts the Public Employees' Retirement System Plan 1 (PERS 1) and the Teachers' Retirement System Plan 1 (TRS 1) by amending Uniform COLA eligibility requirements to include all retirees who have been retired one year and will have attained age 66 by December 31st of the calendar year in which the increase is given.

Effective Date: July 1, 2006

CURRENT SITUATION:

The current Uniform COLA provisions require PERS 1 and TRS 1 members to have been retired one year and to be at least age 66 on July 1st to be eligible for the adjustment paid on July 1st. The Uniform COLA increase amount for 2006 will be $1.29 per month/per year of service. This amount increases by at least 3% per year.

MEMBERS IMPACTED:

This bill will impact half the members in PERS 1 and TRS 1 under age 65–approximately 16,178 PERS 1 and 11,283 TRS 1 members. The table below shows membership by age and status.

TRS Plan 1	Under Age 65	Total
Receiving a Benefit	11,499	34,624
Actives	9,620	9,862
Terminated & Vested	1,446	1,475

PERS Plan 1	Under Age 65	Total
Receiving a Benefit	12,610	54,568
Actives	16,893	17,829
Terminated & Vested	2,854	2,993

A typical member impacted will receive the Uniform COLA one year earlier. In 2006, this amounts to an additional $387 for a retiree with 25 years of service.

ASSUMPTIONS:

PERS and TRS Plan 1 members under the age of 65 whose birth date falls between July 2 and December 31 will receive the Uniform COLA one year earlier under this bill. We assumed that one-half of the PERS 1 and TRS 1 members currently under the age of 65 fall into this group and will be eligible to receive the Uniform COLA one year earlier.

FISCAL IMPACT:

Description:

The benefit improvements in this bill will increase the required employer contribution rate for the PERS and TRS Plan 1 UAAL. Current funding policy requires SERS employers to pay the PERS Plan 1 UAAL contribution rate; therefore, this bill will have a fiscal impact on SERS employers.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

(Dollars in Millions)		Current	Increase	Total
Actuarial Present Value of Projected Benefits	PERS 1	$12,818	$34	$12,852
(The Value of the Total Commitment to all Current Members)	TRS 1	$10,360	$30	$10,390
Unfunded Actuarial Accrued Liability	PERS 1	$2,563	$34	$2,597
(The Portion of the Plan 1 Liability that is Amortized at 2024)	TRS 1	$1,415	$30	$1,445
Unfunded Liability (PBO)	PERS 1	$2,254	$32	$2,286
(The Value of the Total Commitment to all Current Members Attributable to Past Service)	TRS 1	$1,192	$29	$1,221

Increase in Contribution Rates: (Effective 09/01/06 unless indicated otherwise)	PERS/ SERS	TRS
Employee	0.00%	0.00%
Employer State	0.03%	0.06%

Fiscal Budget Determinations:

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.4	$1.6	$0.2	$2.2
Non-General Fund	$0.7	$0.0	$0.0	$0.7
Total State	$1.1	$1.6	$0.2	$2.9
Local Government	$0.9	$0.9	$0.2	$2.0
Total Employer	$2.0	$2.5	$0.4	$4.9
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$1.0	$3.5	$0.4	$4.9
Non-General Fund	$1.7	$0.0	$0.0	$1.7
Total State	$2.7	$3.5	$0.4	$6.6
Local Government	$2.5	$1.8	$0.6	$4.9
Total Employer	$5.2	$5.3	$1.0	$11.5
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	$14.7	$48.5	$5.5	$68.7
Non-General Fund	$24.3	$0.0	$0.0	$24.3
Total State	$39.0	$48.5	$5.5	$93.0
Local Government	$34.2	$24.2	$8.1	$66.5
Total Employer	$73.2	$72.7	$13.6	$159.5
Total Employee	$0.0	$0.0	$0.0	$0.0

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2004 actuarial valuation report of the Teachers' Retirement System and Public Employees' Retirement System.

2. As with the costs developed in the actuarial valuation, the emerging costs of the Systems will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This draft fiscal note is intended for use only during the 2006 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members. Benefit improvement rate increases are based on rates that exclude the cost of gain sharing.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Aggregate Funding Method: The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

Entry Age Normal Cost Method (EANC):   The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	12/8/05	Z-0954.1

SUMMARY OF BILL:

This bill impacts the Plans 2 and 3 of the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS) and the School Employees' Retirement System (SERS) by offering unreduced retirement to any vested member for whom the sum of the number of years of the member's age and the number of years of the member's service credit equals ninety or more ("rule of 90").

Effective Date: July 1, 2006

CURRENT SITUATION:

Currently, in the PERS, TRS and SERS Plans 2/3, a member is eligible for either normal, early or alternate early retirement. The early retirement provisions involve reduced benefits. Normal retirement is a full benefit.

In the Plans 2, normal retirement is available to those who have earned at least five years of service credit and who have attained age 65. This bill would add another category of retirement that involves a full or "unreduced" benefit. It would apply to any vested member for whom the sum of the number of years of the member's age and the number of years of the member's service credit equals ninety or more ("rule of 90").

In the Plans 3, normal retirement is currently available to any member who is at least age 65 and who has completed ten service credit years, or who has completed five service years including twelve service credit months after attaining age 54. This bill would provide an unreduced retirement benefit to any vested Plan 3 member who satisfies the rule of 90.

MEMBERS IMPACTED:

	PERS 2	PERS 3	TRS 2	TRS 3	SERS 2	SERS 3
Number of Affected - Active	83,165	15,023	5,184	38,873	11,988	16,629
Total Active Members	118,572	19,855	7,470	49,302	20,424	29,430

For a member impacted by this bill, the increase in benefits would be the removal of benefit reduction for early retirement without the Rule of 90. For example, a member retiring at age 60 with 30 years of service would be entitled to an unreduced benefit instead of a benefit with a 15% reduction.

This bill would also increase the number of retirees eligible for subsidized medical benefits from the Public Employees' Benefit Board (PEBB).

The table below shows the number of new non-medicare eligible retirees by year we expect under this bill:

New Retirements Under Rule of 90 by Year *Not Eligible for Medicare*						
	2006	2007	2008	2009	2010	2011
TRS	30	46	81	123	190	286
PERS	86	125	193	299	426	560
SERS	32	41	62	88	113	143
Total	148	212	336	510	729	989

Note: 50% of PERS retirements are from State agencies.

ASSUMPTIONS:

We assumed that there would be an increase in retirement rates due to the rule of 90. The additional rates or "kickers" are provided at the end of this fiscal note.

FISCAL IMPACT:

Description:

The liabilities and rates do not include the value of future gain-sharing benefits. Chapter 370, Laws of 2005 delayed recognition of the cost of future gain-sharing benefits until the 2007-2009 biennium.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System (for existing members impacted by this bill) and the required actuarial contribution rate as shown below:

(Dollars in Millions)		Current	Increase	Total
Actuarial Present Value of Projected Benefits (The Value of the Total Commitment to all Current Members)	PERS 2/3	$ 15,280	$ 815	$ 16,095
	TRS 2/3	$ 5,256	$ 386	$ 5,642
	SERS 2/3	$ 2,126	$ 83	$ 2,209
Unfunded Actuarial Accrued Liability (The Portion of the Plan 1 Liability that is Amortized at 2024)	PERS 1	$ 3,563	$ (24)	$ 2,539
	TRS 1	$ 1,415	$ (23)	$ 1,392
Unfunded Liability (PBO) (The Value of the Total Commitment to all Current Members Attributable to Past Service)	PERS 2/3	$ (2,927)	$ 446	$ (2,481)
	TRS 2/3	$ (1,427)	$ 194	$ (1,233)
	SERS 2/3	$ (439)	$ 49	$ (390)

Increase in Contribution Rates: (Effective 9/1/06)	PERS	TRS	SERS
Current Members			
Employee (Plan 2 only)	0.73%	1.00%	0.57%
Employer State	0.73%	1.00%	0.57%
New Entrants*			
Employee (Plan 2 only)	0.27%	N/A	N/A
Employer State	0.27%	0.53%	0.22%

**Rate change applied to future new entrant payroll and used for fiscal budget determinations only. A single supplemental rate increase, equal to the increase for current members, would apply initially for all members or employers.*

Fiscal Budget Determinations:

As a result of the higher required contribution rate, the increase in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$7.1	$24.3	$2.6	$34.0
Non-General Fund	$14.0	$0.0	$0.0	$14.0
Total State	**$21.1**	**$24.3**	**$2.6**	**$48.0**
Local Government	$19.2	$13.4	$3.9	$36.5
Total Employer	$40.3	$37.7	$6.5	$84.5
Total Employee	$31.2	$4.2	$2.2	$37.6
2007-2009				
State:				
General Fund	$17.3	$52.4	$6.0	$75.7
Non-General Fund	$34.0	$0.0	$0.0	$34.0
Total State	**$51.3**	**$52.4**	**$6.0**	**$109.7**
Local Government	$46.7	$26.2	$9.0	$81.9
Total Employer	$98.0	$78.6	$15.0	$191.6
Total Employee	$76.2	$8.4	$4.9	$89.5
2006-2031				
State:				
General Fund	$267.8	$924.2	$90.4	$1,282.4
Non-General Fund	$524.0	$0.0	$0.0	$524.0
Total State	**$791.8**	**$924.2**	**$90.4**	**$1,806.4**
Local Government	$719.7	$464.1	$135.7	$1,319.5
Total Employer	$1,511.5	$1,388.3	$226.1	$3,125.9
Total Employee	$1,002.8	$56.6	$34.5	$1,093.9

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 actuarial valuation report of the Teachers' Retirement System, School Employees' Retirement System, and Public Employees' Retirement System. Fiscal Budget Determinations were based on 2004 data. This excludes the cost of future gain-sharing.

2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

Rule of 90

Kicker Added to Retirement Probability						
	PERS Male	PERS Female	SERS Male	SERS Female	TRS Male	TRS Female
Age						
55	0.35	0.29	0.30	0.30	0.30	0.30
56	0.35	0.29	0.30	0.30	0.30	0.30
57	0.35	0.29	0.30	0.30	0.30	0.30
58	0.29	0.22	0.30	0.30	0.30	0.30
59	0.29	0.22	0.30	0.30	0.30	0.30
60	0.29	0.22	0.30	0.30	0.30	0.30
61	0.29	0.22	0.25	0.30	0.30	0.30
62	0.29	0.16	0.25	0.20	0.30	0.20
63	0.11	0.16	0.25	0.20	0.25	0.20
64	0.11	0.16	0.25	0.20	0.25	0.20

The kicker (additional retirement rate) is added to the retirement probability at the age when a member is first eligible for the Rule of 90. For each year after the year first eligible, 25% of the kicker is added.

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This draft fiscal note is intended for use only during the 2006 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members. Benefit improvement rate increases are based on rates that exclude the cost of gain sharing.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Appendix C

SCPP Goals

Goals for Washington State Public Pensions

Revised and Adopted October 18, 2005

1. Contribution Rate Setting: To establish and maintain adequate, predictable and stable contribution rates, with equal cost-sharing by employers and employees in the Plans 2, so as to assure the long-term financial soundness of the retirement systems.

2. Balanced Long-Term Management: To manage the state retirement systems in such a way as to create stability, competitiveness, and adaptability in Washington's public pension plans, with responsiveness to human resource policies for recruiting and retaining a quality public workforce.

3. Retirement Eligibility: To establish a normal retirement age for members currently in the Plans 2/3 of PERS, SERS, and TRS that balances employer and employee needs, affordability, flexibility, and the value of the retirement benefit over time.

4. Purchasing Power: To restore lost purchasing power and, to the extent feasible, to increase future purchasing power of retiree benefits in the Plans 1 of PERS and TRS while providing long-term benefit security to retirees.

5. Consistency with the Statutory Goals within the Actuarial Funding Chapter: To be consistent with the goals outlined in the RCW 41.45.010:

    a. to provide a dependable and systematic process for funding the benefits to members and retirees of the Washington State Retirement Systems;
    b. to continue to fully fund the retirement system plans 2 and 3, and the Washington State Patrol Retirement System, as provided by law;
    c. to fully amortize the total costs of PERS 1, TRS 1 and LEOFF 1, not later than June 30, 2024;
    d. to establish predictable long-term employer contribution rates which will remain a relatively predictable portion of future state budgets; and
    e. to fund, to the extent feasible, benefit increases over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service.

Appendix D

Rule-of-90 Alternatives

Select Committee on Pension Policy
Gain-Sharing Subgroup
Rule of 90 for Unreduced Retirement

(August 10, 2005)

Rule of 90 for Unreduced Retirement - Immediate Effective Date
Benefit Improvements and Rate Increases Effective in 2006

Estimated Fiscal Impact

	Rule of 90 All Service				Rule of 90 Prospective Only			
Costs (in Millions):	PERS	TRS	SERS	Total	PERS	TRS	SERS	Total
Increase in Contribution Rates								
Employee (Plan 2 Only)	0.73%	1.00%	0.57%		0.27%	0.53%	0.22%	
Employer	0.73%	1.00%	0.57%		0.27%	0.53%	0.22%	
2006-2007								
State:								
General Fund	$7.1	$24.3	$2.6	$34.0	$3.1	$14.1	$1.1	$18.3
Non-General Fund	$14.0	$0.0	$0.0	$14.0	$6.0	$0.0	$0.0	$6.0
Total State	**$21.1**	**$24.3**	**$2.6**	**$48.0**	**$9.1**	**$14.1**	**$1.1**	**$24.3**
Local Government	$19.2	$13.4	$3.9	$36.5	$8.2	$7.7	$1.7	$17.6
Total Employer	$40.3	$37.7	$6.5	$84.5	$17.3	$21.8	$2.8	$41.9
Total Employee	$31.2	$4.2	$2.2	$37.6	$12.7	$2.2	$0.9	$15.8
2007-2009								
State:								
General Fund	$17.3	$52.4	$6.0	$75.7	$8.0	$31.6	$2.9	$42.5
Non-General Fund	$34.0	$0.0	$0.0	$34.0	$15.6	$0.0	$0.0	$15.6
Total State	**$51.3**	**$52.4**	**$6.0**	**$109.7**	**$23.6**	**$31.6**	**$2.9**	**$58.1**
Local Government	$46.7	$26.2	$9.0	$81.9	$21.4	$15.8	$4.3	$41.5
Total Employer	$98.0	$78.6	$15.0	$191.6	$45.0	$47.4	$7.2	$99.6
Total Employee	$76.2	$8.4	$4.9	$89.5	$32.4	$4.4	$1.9	$38.7
2006-2031								
State:								
General Fund	$267.8	$926.2	$90.4	$1,284.4	$195.6	$740.0	$70.5	$1,006.1
Non-General Fund	$524.0	$0.0	$0.0	$524.0	$380.6	$0.0	$0.0	$380.6
Total State	**$791.8**	**$926.2**	**$90.4**	**$1,808.4**	**$576.2**	**$740.0**	**$70.5**	**$1,386.7**
Local Government	$719.7	$464.1	$135.7	$1,319.5	$522.6	$370.1	$105.5	$998.2
Total Employer	$1,511.5	$1,390.3	$226.1	$3,127.9	$1,098.8	$1,110.1	$176.0	$2,384.9
Total Employee	$1,002.8	$56.6	$34.5	$1,093.9	$635.4	$30.2	$13.3	$678.9

Note: All data based on preliminary 2004 valuation

Rule of 90 for Unreduced Retirement - Three-Year Delay in Effective Date
Benefit Improvements and Rate Increases Effective in 2009

Estimated Fiscal Impact

	Rule of 90 All Service				Rule of 90 Prospective Only			
Costs (in Millions):	PERS	TRS	SERS	Total	PERS	TRS	SERS	Total
Increase in Contribution Rates								
Employee (Plan 2 Only)	0.94%	1.32%	0.76%		0.27%	0.53%	0.22%	
Employer	0.94%	1.32%	0.76%		0.27%	0.53%	0.22%	
2009-2011								
State:								
General Fund	$20.2	$69.2	$7.1	$96.5	$8.2	$35.0	$3.1	$46.3
Non-General Fund	$39.5	$0.0	$0.0	$39.5	$16.1	$0.0	$0.0	$16.1
Total State	**$59.7**	**$69.2**	**$7.1**	**$136.0**	**$24.3**	**$35.0**	**$3.1**	**$62.4**
Local Government	$54.2	$34.6	$10.7	$99.5	$22.0	$17.5	$4.5	$44.0
Total Employer	$113.9	$103.8	$17.8	$235.5	$46.3	$52.5	$7.6	$106.4
Total Employee	$88.9	$10.6	$5.7	$105.2	$32.1	$4.3	$1.7	$38.1
2011-2013								
State:								
General Fund	$22.2	$71.5	$7.6	$101.3	$10.1	$39.1	$3.7	$52.9
Non-General Fund	$43.5	$0.0	$0.0	$43.5	$19.5	$0.0	$0.0	$19.5
Total State	**$65.7**	**$71.5**	**$7.6**	**$144.8**	**$29.6**	**$39.1**	**$3.7**	**$72.4**
Local Government	$59.7	$35.7	$11.4	$106.8	$26.8	$19.5	$5.4	$51.7
Total Employer	$125.4	$107.2	$19.0	$251.6	$56.4	$58.6	$9.1	$124.1
Total Employee	$96.9	$9.7	$5.7	$112.3	$37.7	$3.9	$1.6	$43.2
2009-2034								
State:								
General Fund	$323.2	$1,161.9	$109.4	$1,594.5	$231.6	$868.0	$83.5	$1,183.1
Non-General Fund	$631.6	$0.0	$0.0	$631.6	$450.7	$0.0	$0.0	$450.7
Total State	**$954.8**	**$1,161.9**	**$109.4**	**$2,226.1**	**$682.3**	**$868.0**	**$83.5**	**$1,633.8**
Local Government	$867.1	$580.2	$163.8	$1,611.1	$619.1	$433.4	$124.9	$1,177.4
Total Employer	$1,821.9	$1,742.1	$273.2	$3,837.2	$1,301.4	$1,301.4	$208.4	$2,811.2
Total Employee	$1,182.3	$58.5	$36.7	$1,277.5	$724.7	$23.7	$10.7	$759.1

Note: All data based on preliminary 2004 valuation

Rule of 90 with Age 60 Minimum

(September 15, 2005)

Rule of 90 for Unreduced Retirement - Effective in 2006

Estimated Fiscal Impact

	Rule of 90 - Minimum Age 60 All Service				Rule of 90 - Minimum Age 60 Prospective Only			
Costs (in Millions):	PERS	TRS	SERS	Total	PERS	TRS	SERS	Total
Increase in Contribution Rates								
Employee (Plan 2 Only)	0.50%	0.70%	0.47%		0.18%	0.34%	0.17%	
Employer	0.50%	0.70%	0.47%		0.18%	0.34%	0.17%	
2006-2007								
State:								
General Fund	$4.9	$16.9	$2.1	$23.9	$2.0	$9.0	$0.9	$11.9
Non-General Fund	$9.6	$0.0	$0.0	$9.6	$4.0	$0.0	$0.0	$4.0
Total State	**$14.5**	**$16.9**	**$2.1**	**$33.5**	**$6.0**	**$9.0**	**$0.9**	**$15.9**
Local Government	$13.1	$9.3	$3.2	$25.6	$5.5	$5.0	$1.3	$11.8
Total Employer	$27.6	$26.2	$5.3	$59.1	$11.5	$14.0	$2.2	$27.7
Total Employee	$21.4	$3.0	$1.8	$26.2	$8.5	$1.4	$0.7	$10.6
2007-2009								
State:								
General Fund	$11.9	$36.3	$4.9	$53.1	$5.3	$20.3	$2.2	$27.8
Non-General Fund	$23.3	$0.0	$0.0	$23.3	$10.4	$0.0	$0.0	$10.4
Total State	**$35.2**	**$36.3**	**$4.9**	**$76.4**	**$15.7**	**$20.3**	**$2.2**	**$38.2**
Local Government	$32.0	$18.2	$7.4	$57.6	$14.2	$10.1	$3.3	$27.6
Total Employer	$67.2	$54.5	$12.3	$134.0	$29.9	$30.4	$5.5	$65.8
Total Employee	$52.1	$5.9	$4.1	$62.1	$21.6	$2.8	$1.4	$25.8
2006-2031								
State:								
General Fund	$181.8	$619.6	$72.4	$873.8	$130.3	$474.8	$54.1	$659.2
Non-General Fund	$355.5	$0.0	$0.0	$355.5	$253.8	$0.0	$0.0	$253.8
Total State	**$537.3**	**$619.6**	**$72.4**	**$1,229.3**	**$384.1**	**$474.8**	**$54.1**	**$913.0**
Local Government	$488.3	$310.5	$108.5	$907.3	$348.5	$237.4	$81.3	$667.2
Total Employer	$1,025.6	$930.1	$180.9	$2,136.6	$732.6	$712.2	$135.4	$1,580.2
Total Employee	$679.3	$39.9	$28.1	$747.3	$423.5	$19.2	$10.3	$453.0

Note: All data based on preliminary 2004 valuation.

Rule of 90 Retirement Ages

(October 4, 2005)

Rule of 90 Retirement Ages

Retirement age when first eligible for unreduced benefits after adding a Rule of 90 retirement age

	Hire Age	Retirement Age	Number of Active Plan 2/3 Members in 2004 PERS	TRS	SERS	Total
	18	54	1,345	0	232	1,577
	20	55	3,687	32	647	4,366
	22	56	7,691	3,623	1,093	12,407
	24	57	10,309	8,799	1,359	20,467
	26	58	10,486	6,871	1,481	18,838
	28	59	10,604	5,240	1,717	17,561
	30	60	10,531	4,365	2,222	17,118
	32	61	10,137	3,777	3,145	17,059
	34	62	9,720	3,284	3,993	16,997
	36	63	9,504	3,217	4,717	17,438
	38	64	9,007	3,167	5,124	17,298
	40	65	45,406	14,397	24,124	83,927
Total			138,427	56,772	49,854	245,053

	Hire Age	Retirement Age	Number of Active Plan 2/3 Members in 2004 PERS	TRS	SERS	Total
	18	54	1%	0%	0%	1%
	20	55	3%	0%	1%	2%
	22	56	6%	6%	2%	5%
	24	57	7%	15%	3%	8%
	26	58	8%	12%	3%	8%
	28	59	8%	9%	3%	7%
	30	60	8%	8%	4%	7%
	32	61	7%	7%	6%	7%
	34	62	7%	6%	8%	7%
	36	63	7%	6%	9%	7%
	38	64	7%	6%	10%	7%
	40	65	33%	25%	48%	34%
Total			100%	100%	100%	100%

Attaining Rule of 90 Retirement Ages by Year

(October 7, 2005)

Attaining Rule of 90 Retirement Age by Year
TRS

Age	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
54	0	0	0	0	0	0	0	0	0	0	0	0
55	0	0	0	0	0	0	0	0	0	0	1	1
56	0	0	0	0	0	4	50	36	26	23	647	786
57	0	0	0	0	10	91	199	207	155	108	6,577	7,347
58	0	0	0	5	54	151	174	157	130	141	7,191	8,003
59	0	0	7	48	112	137	110	104	103	167	5,156	5,944
60	0	2	37	72	107	99	74	100	128	149	4,025	4,793
61	1	41	80	89	67	71	96	87	103	107	3,211	3,953
62	18	43	82	62	56	74	82	107	113	138	2,756	3,531
63	65	46	29	41	71	92	76	93	117	124	2,483	3,237
64	52	35	29	53	74	83	90	127	149	144	2,379	3,215
65	111	87	122	187	269	373	508	641	814	899	11,951	15,962
Total	247	254	386	557	820	1,175	1,459	1,659	1,838	2,000	46,377	56,772

Attaining Rule of 90 Retirement Age by Year
PERS

Age	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
54	0	0	0	0	0	0	0	6	11	17	384	418
55	0	0	0	0	0	0	20	73	118	105	2,123	2,439
56	1	0	0	0	0	22	100	180	163	120	4,784	5,370
57	1	0	0	0	45	155	266	241	215	179	8,518	9,620
58	0	0	0	45	143	247	194	206	212	257	9,069	10,373
59	1	0	37	146	234	238	179	199	228	295	9,006	10,563
60	1	47	101	217	216	226	212	264	312	325	8,696	10,617
61	20	137	188	207	216	164	205	279	318	305	8,294	10,333
62	94	124	185	156	186	213	275	290	277	337	7,777	9,914
63	205	139	114	180	189	249	271	268	309	349	7,549	9,822
64	230	101	114	128	230	268	227	280	306	350	6,866	9,100
65	737	454	701	824	1,097	1,391	1,679	1,939	2,156	2,452	36,428	49,858
Total	1,290	1,002	1,440	1,903	2,556	3,173	3,628	4,225	4,625	5,091	109,494	138,427

Attaining Rule of 90 Retirement Age by Year
SERS

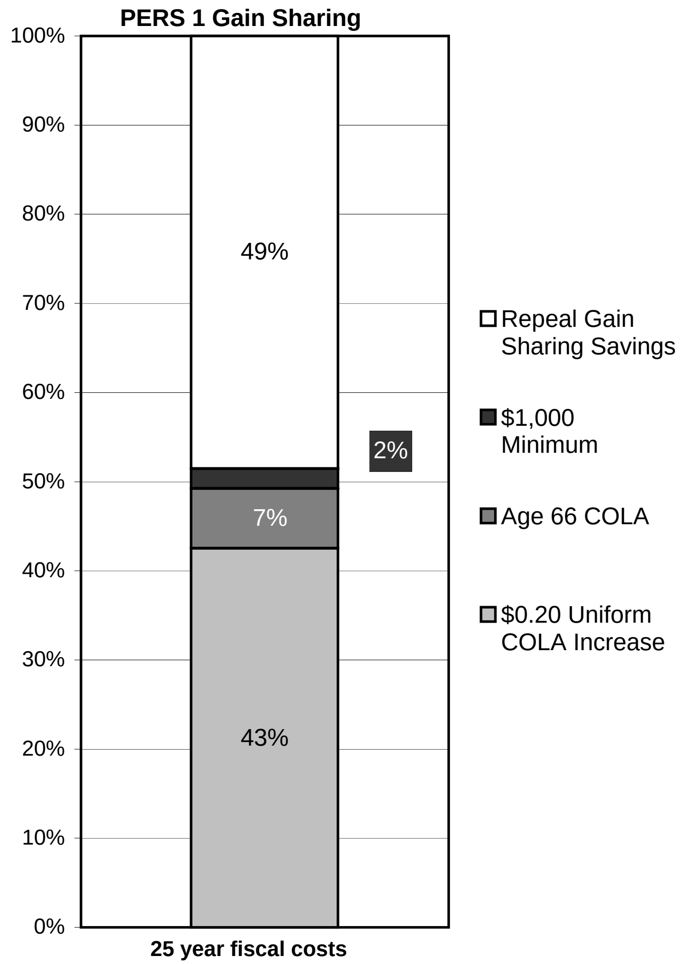
Age	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
54	0	0	0	0	0	0	0	1	3	3	45	52
55	0	0	0	0	0	0	2	6	13	19	422	462
56	0	0	0	0	0	5	11	23	16	17	767	839
57	0	0	0	0	1	25	16	23	18	24	1,192	1,299
58	0	0	0	6	18	27	24	28	33	26	1,242	1,404
59	0	0	3	16	21	26	31	32	29	38	1,373	1,569
60	0	4	21	33	23	33	35	32	40	50	1,668	1,939
61	3	25	35	43	40	29	49	76	60	72	2,199	2,631
62	20	28	58	52	60	65	83	82	79	88	2,930	3,545
63	53	58	43	65	83	88	90	84	131	136	3,583	4,414
64	77	36	50	61	96	104	97	132	145	163	4,002	4,963
65	276	178	269	378	446	610	760	949	1,080	1,252	20,539	26,737
Total	429	329	479	654	788	1,012	1,198	1,468	1,647	1,888	39,962	49,854

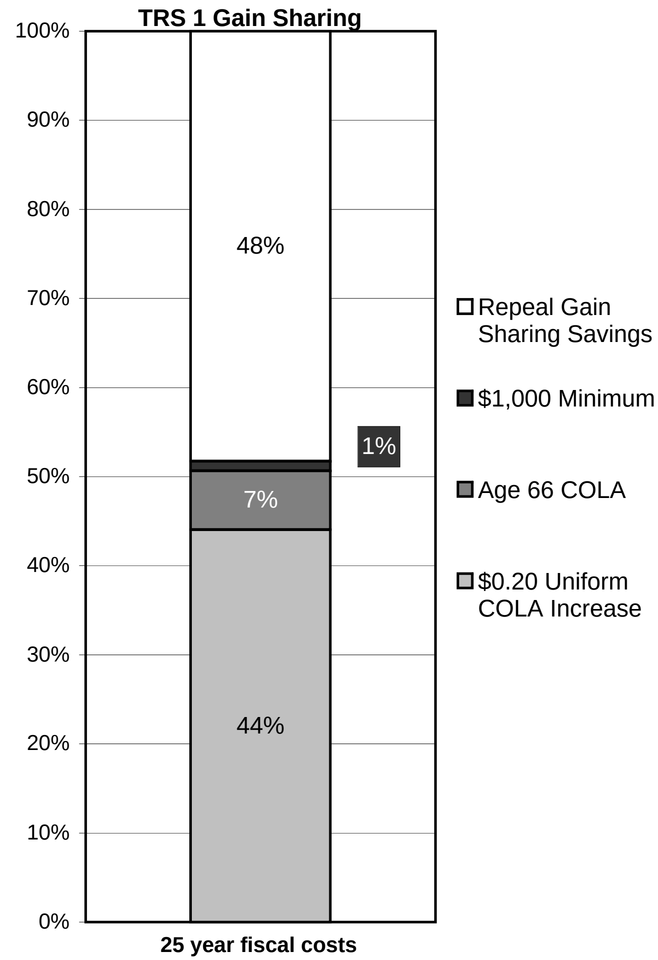
Appendix E

Gain-Sharing Trade-Off Bar Graph Analysis

Select Committee on Pension Policy

Fiscal Analysis of HB 1324 - Plan 1

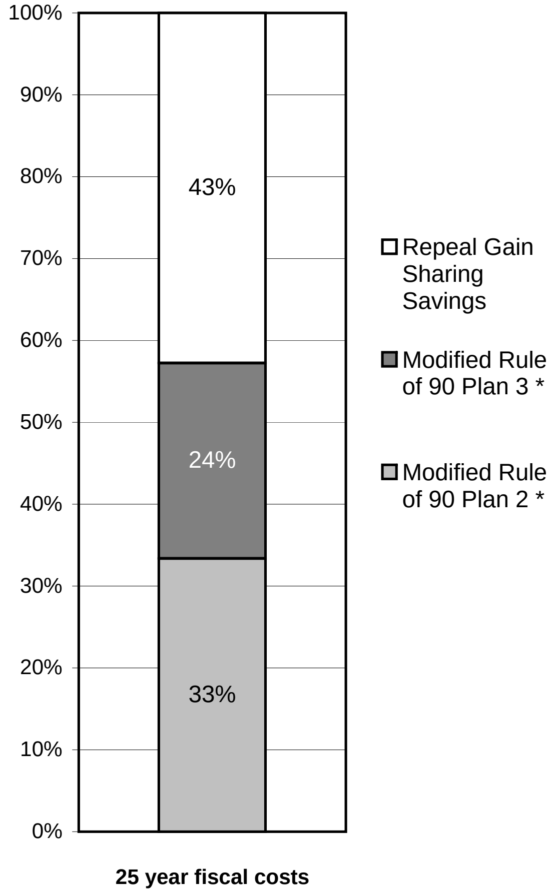




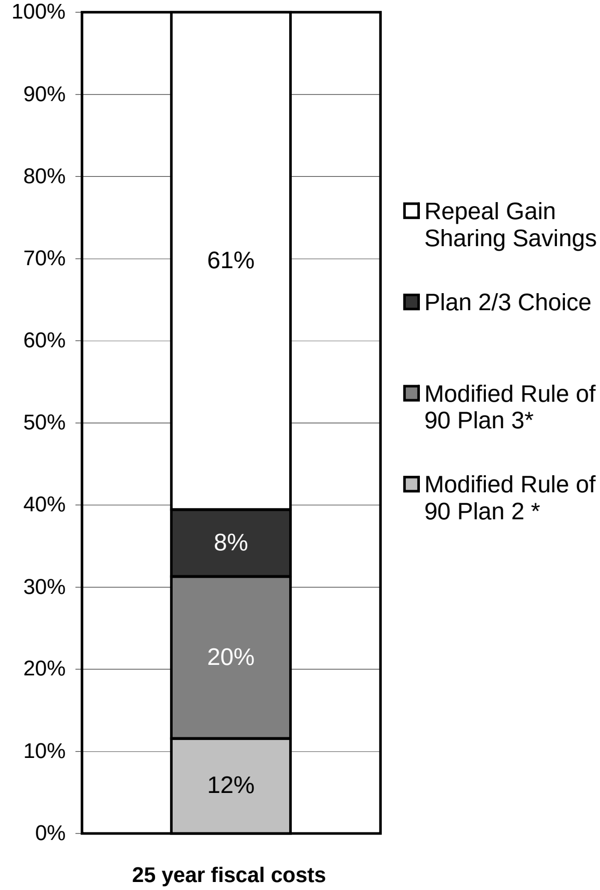
Select Committee on Pension Policy

Fiscal Analysis of HB 1324 - Plan 2/3

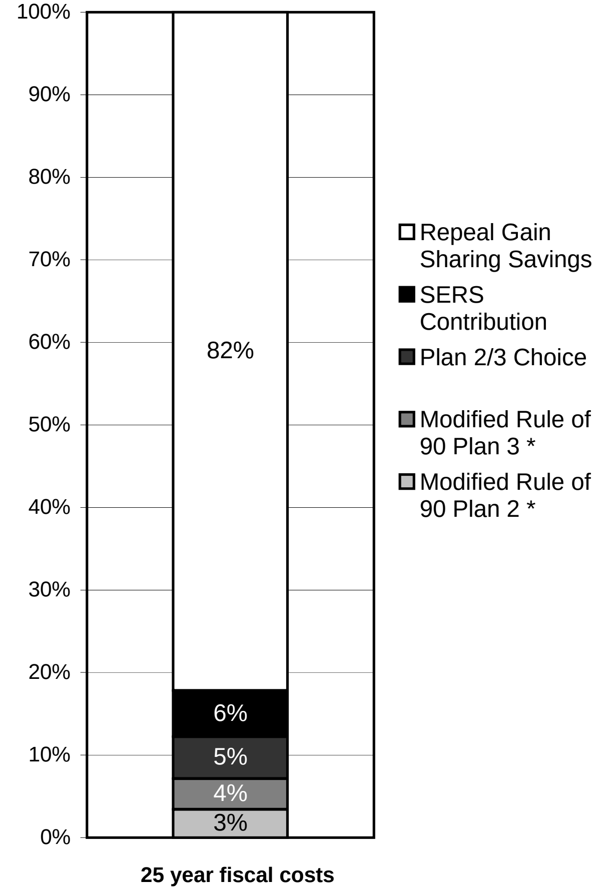
PERS 2/3 Gain Sharing
Current and Future Members



TRS 2/3 Gain Sharing
Current and Future Members



SERS 2/3 Gain Sharing
Current and Future Members

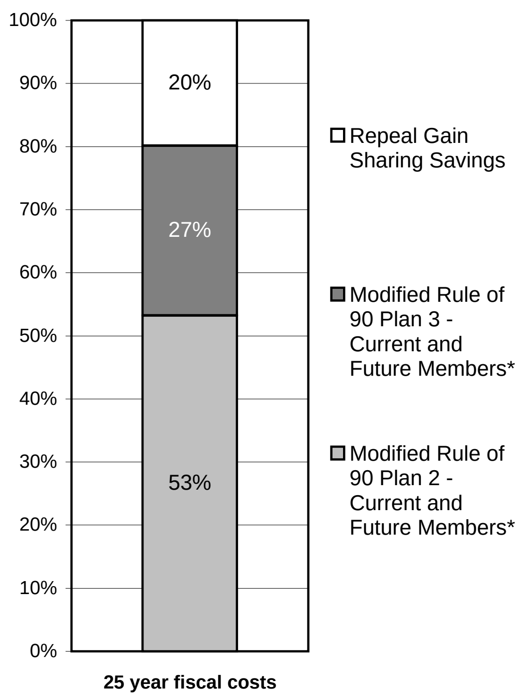


* Rule of 90 for prospective service only, minimum age 60

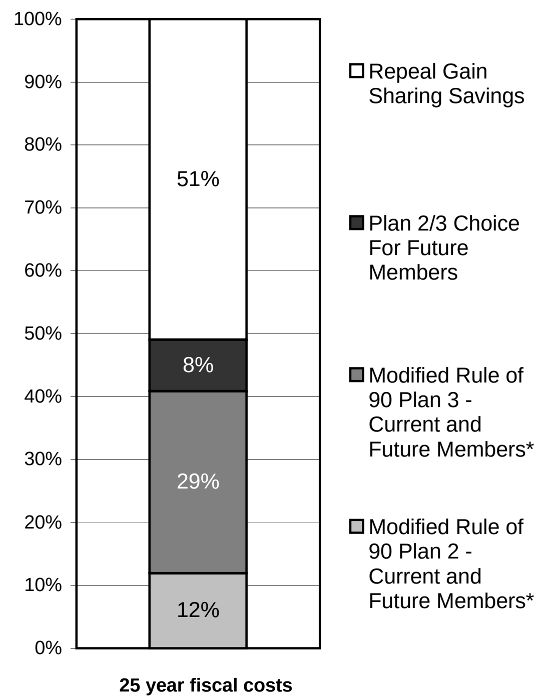
Select Committee on Pension Policy
Gain-Sharing Subgroup

Rule of 90 with Age 60 Minimum

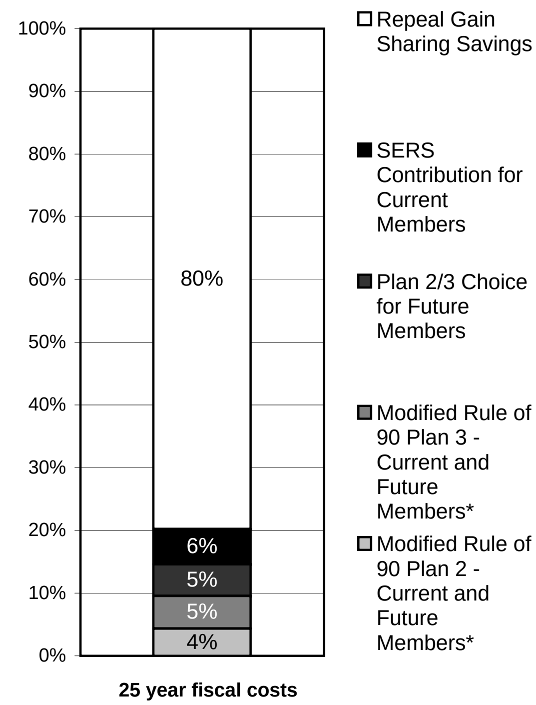
PERS 2/3 Gain Sharing
Current and Future Members



TRS 2/3 Gain Sharing
Current and Future Members



SERS 2/3 Gain Sharing
Current and Future Members

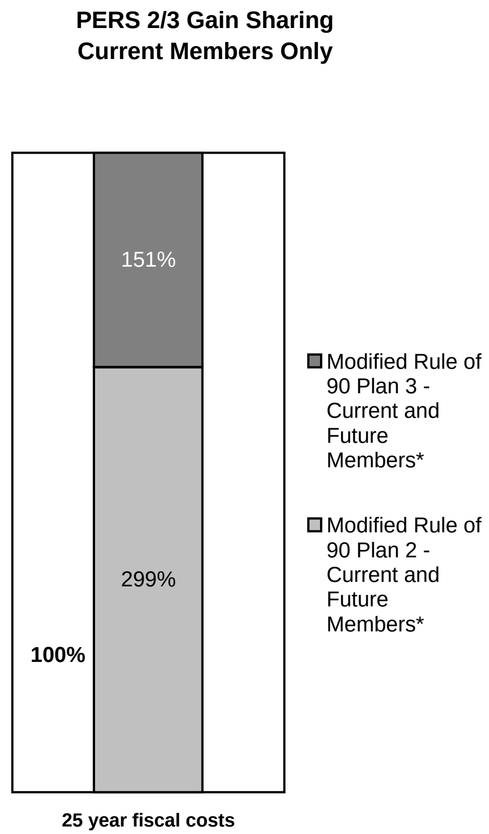


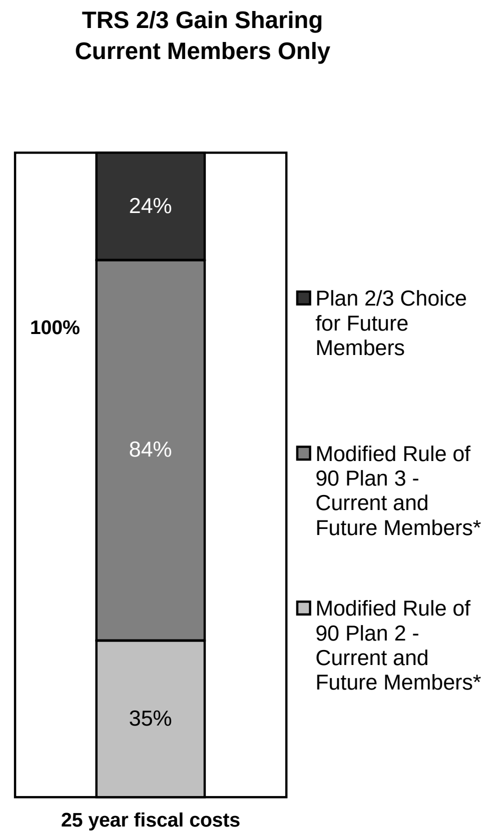
*Rule of 90 for all service, miniumum age 60

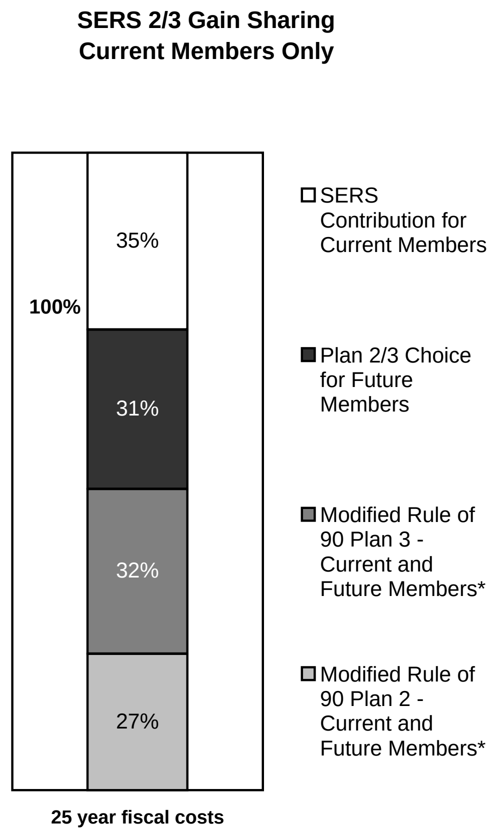
Select Committee on Pension Policy

Gain-Sharing Subgroup

Rule of 90 with Age 60 Minimum



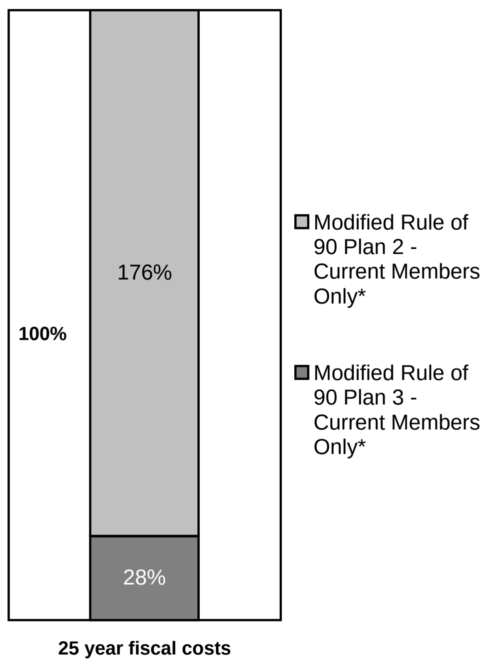




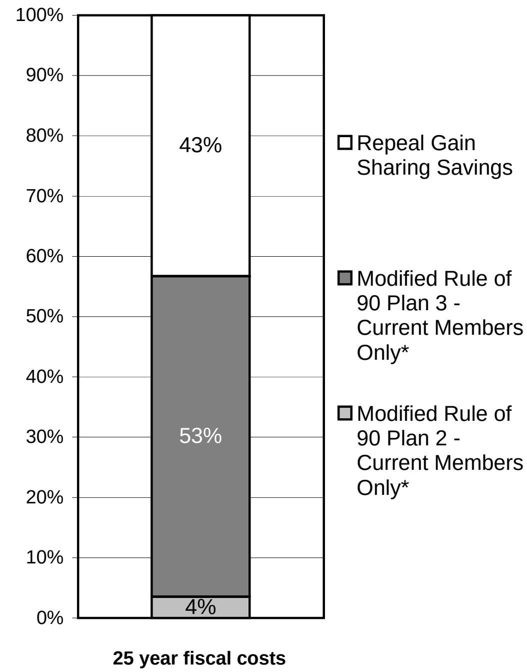
*Rule of 90 for all service, miniumum age 60

Rule of 90 with Age 60 Minimum

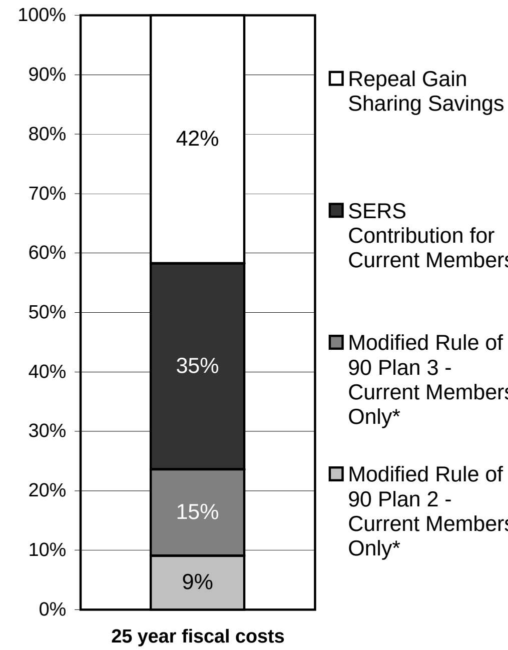
PERS 2/3 Gain Sharing
Current Members Only



TRS 2/3 Gain Sharing
Current Members Only



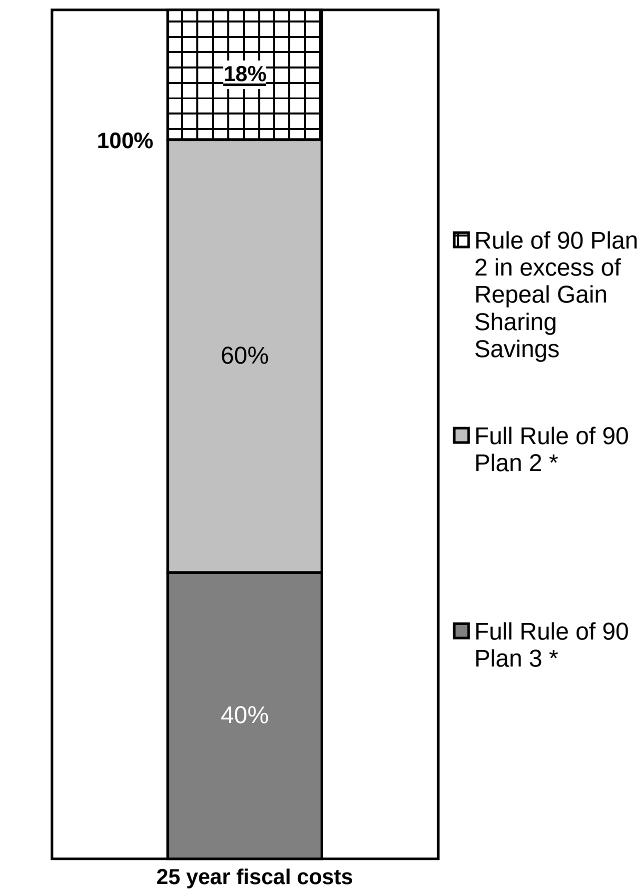
SERS 2/3 Gain Sharing
Current Members Only



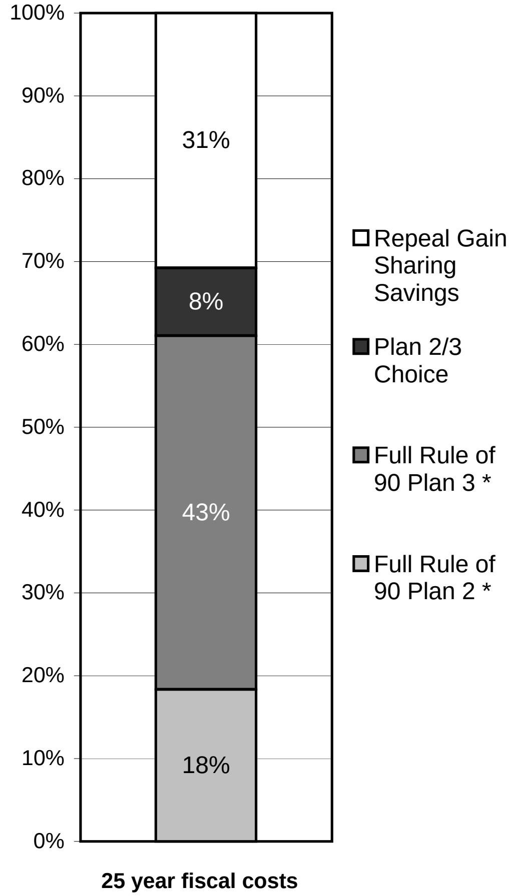
*Rule of 90 for all service, miniumum age 60

Fiscal Analysis of HB 1324 - Plan 2/3

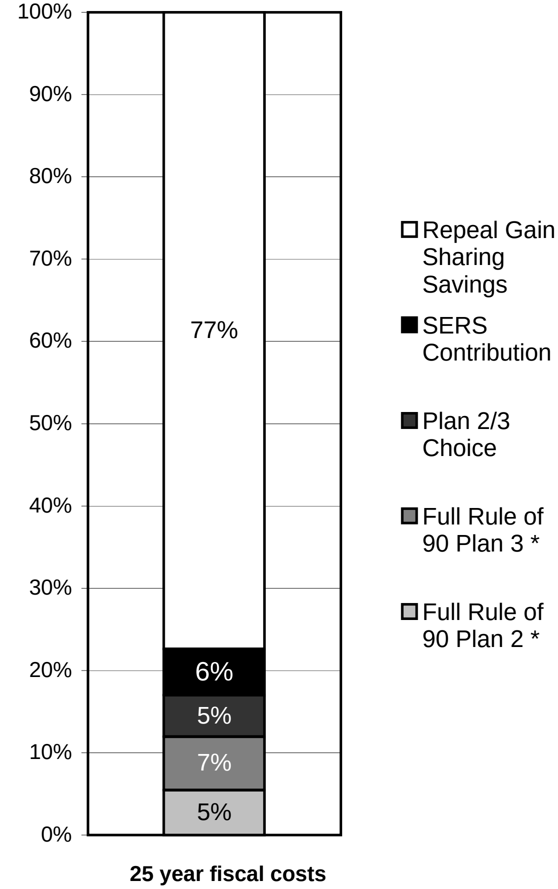
PERS 2/3 Gain Sharing
Current and Future Members



TRS 2/3 Gain Sharing
Current and Future Members



SERS 2/3 Gain Sharing
Current and Future Members



*Rule of 90 for all service, no minimum age