Select Committee on Pension Policy

P.O. Box 40914
Olympia, WA 98504-0914
actuary.state@leg.wa.gov

Regular Committee Meeting

July 18, 2006

10:00 AM - 12:00 PM
House Hearing Room A
Olympia

AGENDA

10:00 AM	**(1)**	**Approval of Minutes**
10:05 AM	**(2)**	**Post-Retirement Employment** - Laura Harper, Senior Research Analyst/Legal *Public Testimony*
10:45 AM	**(3)**	**Plan 1 Funding Method**, Matt Smith, State Actuary *Public Testimony*
11:15 AM	**(4)**	**Gain-Sharing**, Robert Wm. Baker, Senior Research Analyst *Public Testimony*
NOON	**(5)**	**Adjourn**

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(360) 786-6140
Fax: (360) 586-8135
TDD: 1-800-635-9993

January

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Select Committee on Pension Policy

2006 Meeting Dates

Full - 10:00 am – 12:00 pm
Executive - 12:30 – 2:30 pm
JLOB, Olympia, WA 98504

January 17, 2006 – *meeting cancelled*
February 21, 2006
March 21, 2006
April 18, 2006 – *meeting cancelled*
May 16, 2006
June 20, 2006
July 18, 2006
August 22, 2006 – *no meeting planned*
September 19, 2006
October 17, 2006
November 21, 2006
December 12, 2006

No Subgroups have been formed
Reserved Subgroup Dates
Location to be determined
2:00 – 4:00 pm – Mondays

April 17, 2006
May 15, 2006
June 19, 2006
July 17, 2006
August 21, 2006
September 18, 2006
October 17, 2006
November 20, 2006
December 11, 2006

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Goals for Washington State Public Pensions

Revised and Adopted September 27, 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 increase and maintain the purchasing power of retiree benefits in the Plans 1 of PERS and TRS, to the extent feasible, 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.

Select Committee on Pension Policy

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REGULAR COMMITTEE MEETING
DRAFT MINUTES

June 20, 2006

The Select Committee on Pension Policy met in House Hearing Room A, Olympia, Washington on June 20, 2006.

Committee members attending:

Senator Pridemore, Chair	Robert Keller
Representative Fromhold, Vice-Chair	Sandy Matheson
Elaine Banks	Corky Mattingly
Lois Clement	Glenn Olson
Representative Crouse	Senator Mark Schoesler
Senator Fraser	J. Pat Thompson
	David Westberg

Senator Pridemore, Chair, called the meeting to order at 10:05 a.m.

(1) Approval of Minutes

It was moved to approve the May 16, 2006, Full Committee Draft Minutes. Seconded.

MOTION CARRIED

(2) Dual Membership

Laura Harper, Senior Research Analyst, Legal, reported on the "Dual Membership." Discussion followed.

(3) $150,000 Death Benefit

Darren Painter, Research Analyst, reported on the "$150,000 Death Benefit." Discussion followed.

(4) Service Credit Purchase Due to Injury

Bob Baker, Senior Research Analyst, reported on the "Service Credit Purchase Due to Injury." Discussion followed.

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TDD: 1-800-635-9993

The following people testified:
Steve Nelsen, Executive Director, LEOFF 2 Retirement Board
Paul Neal, representing Washington State Troopers Association

The meeting adjourned at 11:30 a.m.

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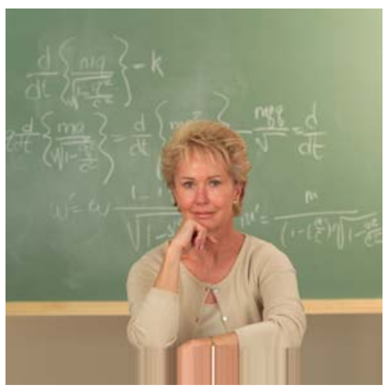
Post-Retirement Employment Program Report

Public Employees' Retirement System Plan 1

Teachers' Retirement System Plan 1



Prepared for:
Select Committee on Pension Policy
Senate Committee on Ways and Means
House of Representatives Committee on Appropriations

Matt Smith, FCA, EA, MAAA
State Actuary

Laura Harper, JD, CPP
Senior Research Analyst

Office of the State Actuary

November 2005

Executive Summary

Hot topics in the world of public employee retirement systems do not generally garner much attention outside the world of actuaries, attorneys, and benefits specialists. At least one retirement issue, however, attracts the attention of employers, employees, politicians, and the media alike – post-retirement employment or the practice of "retire-rehire."

As one of the more controversial issues for public pension systems, retire-rehire has received considerable attention in the press and Washington State is no exception. Washington's expanded post-retirement employment opportunities were the subject of analysis in Governing Magazine (July 2003). They were highlighted in numerous newspaper articles and editorials, including those published by the Olympian (September 9, 2002, and August 1, 2004), the Seattle Times (January 30, 2003, and February 1, 2002), the News Tribune (April 21, 2003), the Columbian (September 26, 2002), and the Daily of the University of Washington (May 7, 2004). They were also the subject of a King5 Investigative Report (May 24, 2004).

Perceptions of retire-rehire vary and opinions run deep. Public sector programs involving the re-employment of retirees are more sensitive than those in the private sector because of the perceptions they generate and their potential impact on taxpayers. Proponents of post-retirement employment argue that once a retirement benefit is earned, it should not matter whether the retiree returns to work with the same employer or whether that

Retire-Rehire:
Under retire-rehire, retired members return to work and earn a salary while drawing a retirement pension.

The following "windows" illustrate different views of workforce strategies in the public sector.

Actuarial View
- Identify costs
- Project future liabilities
- Monitor experience and assumptions

Employee View
- Increase long-term financial security
- Gain flexibility in later years of career
- Increase level of enjoyment and fulfillment

Employer View
- Retain experience base
- Address labor shortages
- Add workforce flexibility

Retirement System View
- Manage complexity
- Communicate change
- Avoid legal challenges and plan qualification issues

Political View
- Identify social and financial consequences
- Consider criticisms and perceptions
- Manage special interests while maintaining fairness

retiree works while drawing a pension. Opponents believe that drawing a public pension and earning a salary at the same time is “double dipping” and not retirement. As a philosophical matter, the retire-rehire debate gets to the very purpose of retirement – that is, whether a retirement pension is to provide income security to those leaving the workforce, or whether it is a reward for completing a determined number of years in a career.

Changing workforce dynamics are altering our views of retirement, and the retire-rehire issue is one bellwether for this shift. As the workforce is aging, older workers are expressing both the need and the desire to remain in the workforce longer. Accordingly, for those age 65 and older, the percentage of income from work is increasing. At the same time, employees are showing an interest in more flexible work arrangements that will enhance their enjoyment of work in their later years. Similarly, employers are focusing on experienced workers as important resources in their workforce plans.

The retire-rehire debate raises the question of whether the retirement system should be used as a personnel tool for achieving human resource goals. Washington’s 2001 expansion of the retire-rehire program for the Teachers’ Retirement System (TRS) and the Public Employees’ Retirement System (PERS) Plans 1 was initially implemented in response to a shortage of employees with skills in high demand. It allows retirees who desire to work up to 1,500 hours in a calendar year to be re-employed after a waiting period. The retiree can receive both a pension and a salary during the period of post-retirement employment. Since the Plans 1 are service-based plans, the retire-rehire program was used to counter built-in Plan 1 incentives to retire early such as the “30 years and out” retirement eligibility and the 60 percent benefit cap.

"Changing workforce dynamics are altering our views of retirement...."

A 2005 study mandate from the Washington State Legislature directed the Office of the State Actuary (OSA) to conduct an actuarial analysis of the expanded retire-rehire program for the Plans 1 of TRS and PERS. The OSA was also asked to investigate a range of legislative alternatives to the current retire-rehire program. Those alternatives include several proposals to increase the maximum retirement allowance in the Plans 1 beyond 60 percent of final compensation, all of which have been priced; amendments to the existing program, some of which have been priced; repeal of the 2001 expansion of the existing program; a phased retirement program, and a Deferred Retirement Option Plan (DROP).

Certainly cost is a significant factor in determining the future of the current retire-rehire program in Washington State, but there are many other decisions to be made in evaluating whether to retain the current program or to develop and implement one or more alternative workforce strategies. Ultimately, any selected strategy should reflect the goals for the program. **This report does not recommend a goal or strategy.** Instead, it examines retire-rehire and its alternatives from the perspectives of employers, employees and policy makers, while analyzing the issue from administrative and actuarial perspectives. This report is intended as a tool for decision-makers as well as those who seek to influence them.

In examining retire-rehire and its alternatives, the OSA recognizes that the service-based plan design of TRS 1 and PERS 1 encourages members to retire earlier and seek additional employment opportunities with their employers prior to leaving the workforce. Generally speaking, the legislature can respond by taking any of the following paths:

1. Do nothing, leaving retirees to fend for themselves.
2. Change the plan design to grant incentives for members to stay longer (such as removing or increasing the Plan 1 benefit cap).
3. Create additional employment opportunities and workplace flexibility such as retire-rehire, DROP or phased retirement.

The latter two paths assume that conditions warrant or require public sector opportunities for retirement system members to work longer. Taken together, the three paths represent a full spectrum of strategies that embody differing values about the role of the public employee retirement system in workplace dynamics.

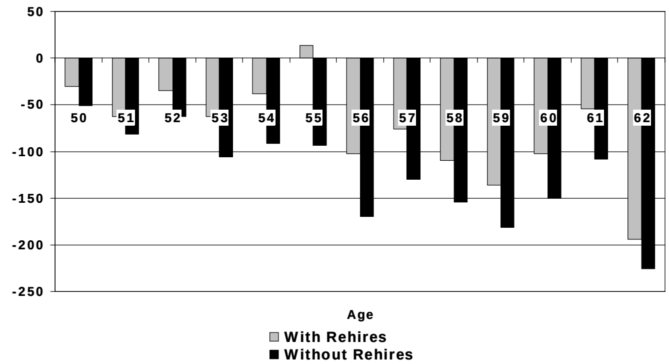
In 2001 the legislature chose the path of creating additional employment opportunities and workplace flexibility by expanding its post-retirement employment program. Whether the program has been an effective workforce strategy for meeting human resource goals is beyond the scope of analysis by the OSA. In any event, the current program is drawing attention and scrutiny in the media as cases of abuse, or perceived abuse, have made headlines over the last several years. Also, as the state budget has faced repeated shortfalls, legislators have questioned whether the program is creating unintended costs for the Plans 1 that need to be managed.

Actuarial Experience Study

In order to determine the cost of the current program, the OSA has conducted an actuarial experience study. This study looks at retirement data from the inception of the expanded program and compares (a) the actual and expected retirements of all TRS and PERS Plan 1 members with (b) the actual and expected retirements of members excluding those rehired after retirement. The hypothesis of the study is that the two groups should have the same retirement behavior if retire-rehire has no effect.

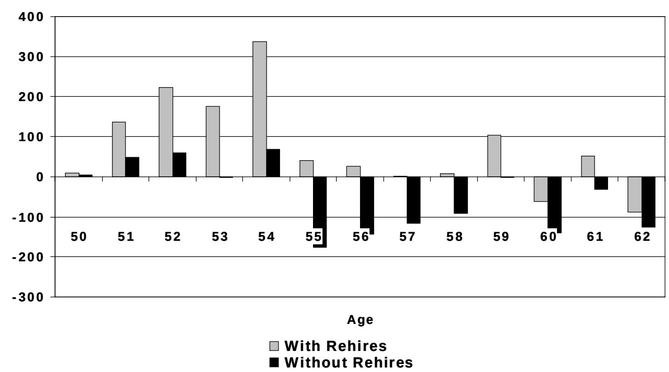
PERS Plan 1

Actual Minus Expected Retirements During Experience Study Period



TRS Plan 1

Actual Minus Expected Retirements During Experience Study Period



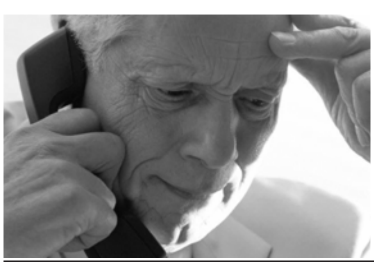
Actuarial Experience Study:

An actuarial experience study compares assumptions with actual statistics of events related to those assumptions. Experience may include estimates where data are incomplete or insufficient.

The charts illustrate that the difference between actual and expected retirements - with rehires and without them - is different at every age. Thus, **the conclusion of the study is that the retire-rehire program has an effect on retirement behavior.** The effect is that members are retiring earlier, and earlier retirement has a retirement system cost. Why is there a cost? When retirements that were assumed and funded to occur at a later date occur earlier, the attendant retirement benefits must be paid sooner than expected and over a longer period of time. Also, there is a loss of expected member contributions to the retirement system.

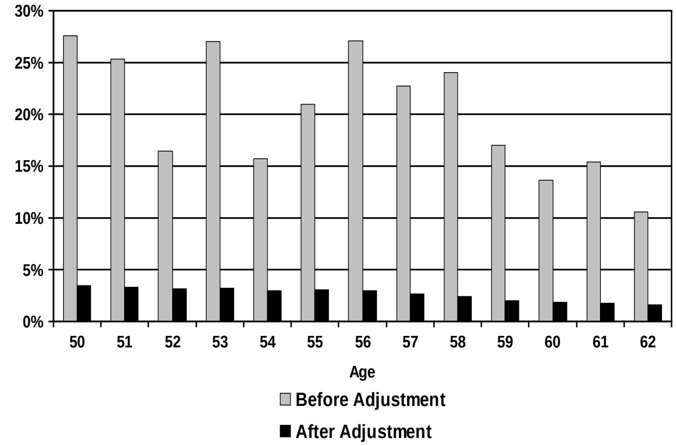
In order to determine the appropriate amount of the change in retirement experience that should be attributed to the expanded retire-rehire program and applied to future retirement expectations, the data from this study was adjusted according to actuarial standards of practice using a series of factors. These factors include adjustments for a partial experience period and a credibility weighting. The other adjustment factor is based on the portion of rehires that are working over the pre-2001 hour limits (currently 40 percent of rehires).

The following bar charts illustrate the increase in retirement rates for PERS 1 and TRS 1 due to the 2001 program changes. The increases are shown before and after applying the adjustment factors.



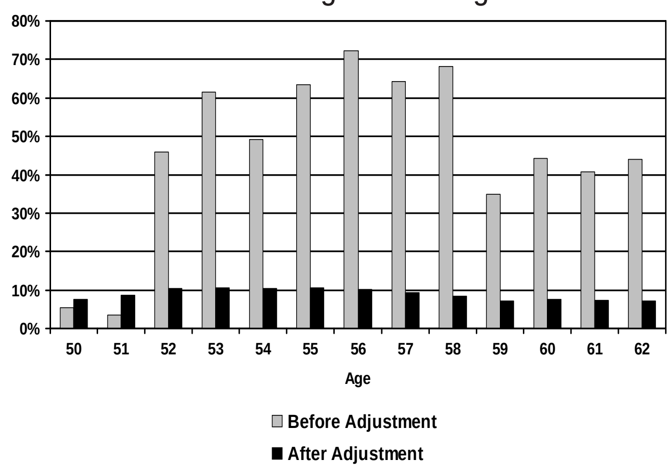
PERS Plan 1

Increase in Retirement Rates
Due to Program Changes



TRS Plan 1

Increase in Retirement Rates
Due to Program Changes



These charts illustrate that in the current experience study, application of the adjustment factors resulted in an assumption change about future retirement rates that was attributed to a relatively small percentage of the total experience differential found in the study. As more experience data is gathered in the future, the adjustment factor for partial experience will automatically fall away. This means that if the same experience continues into the future, the costs of the program will increase over time. (See Experience Study Methodology, page 11 et seq.)

Once the change in retirement experience was identified and adjusted, retirement system costs were projected using the new assumptions about future retirement rates.

The results, based on data available since the program's inception in 2001, require a 0.06 percent increase in employer contribution rates to pay for the existing program in TRS 1 and a 0.01 percent increase in employer contribution rates for PERS 1.

Projected Long-Term Increase in Employer Contribution Rates for 2001 Expansion

Retirement Plan	Required Rate Increase
TRS 1	0.06%
PERS 1	0.01%

The projected fiscal impacts of continuing the program in its current form include a total employer cost of $7.5 million for the 2007-2009 biennium, and a 25-year total employer cost of $101.5 million.

Projected Fiscal Impacts of 2001 Expansion

Period	Total Employer Costs
2007-2009	$ 7.5 million
25-year cost	$101.5 million

If the current program continues into the future, its attendant costs will be included in the calculation of the unfunded actuarial accrued liability (UAAL) for the Plans 1, which currently stands at approximately $4 billion. Payments for this liability are collected from employers in the form of contribution rates that are represented as a percentage of payroll. As set forth in current funding policy, the employers who participate in paying these costs are not limited to just employers of Plan 1 members; instead, the costs are spread among all PERS, TRS, School Employees' Retirement System (SERS), and Public Safety Employees' Retirement System (PSERS) employers and amortized at 2024 (the date by which virtually all Plan 1 members are expected to retire).

The special funding policy of "spreading" the Plan 1 costs was adopted in order to make payments more manageable. The effect of this funding policy is that any contribution rate increase associated with a Plan 1 benefit improvement will be much smaller than otherwise required under the standard approach used for pricing benefit increases in the other plans. In other words, a benefit improvement in the Plans 1 will appear to be much less expensive than the same benefit improvement in the Plans 2/3. Thus, awareness of the Plan 1 funding policy is an important factor in assessing the magnitude of projected costs.

Alternatives

The 2005 legislative study mandate also requested that the OSA examine **alternatives to the current retire-rehire program**. One alternative is to encourage members to work beyond normal retirement eligibility without retiring. An incentive for longer service could be created by amending the Plans 1 so that members can continue to accrue benefits by working more years. This could be accomplished by removing the current cap on Plan 1 retirement benefits or otherwise **increasing the maximum retirement allowance** that can be earned by Plan 1 members late in their career. Presumably, this change in plan design would reward members for staying in the workforce longer and thereby reduce the need to re-employ retirees.

System-wide Incentives:

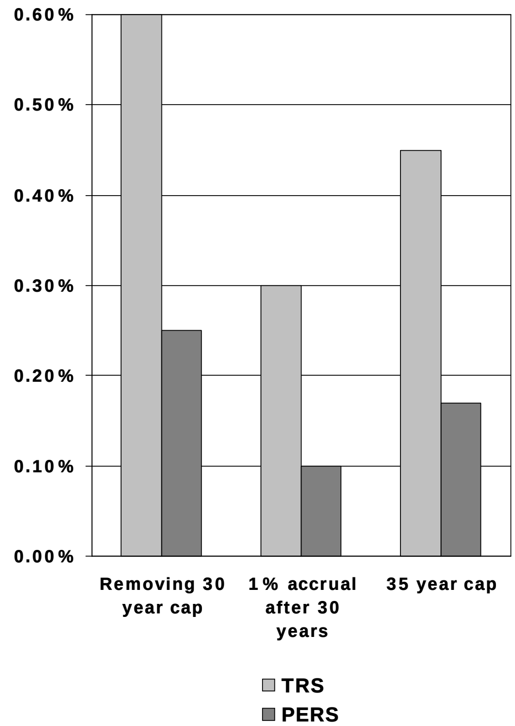
System-wide incentives give members who choose to continue to work past normal retirement age the opportunity to accrue additional benefits that will enhance their final retirement pension.

Eliminating the Plan 1 benefit cap proved to be the most expensive of all the alternatives examined in this report. For this reason, two less expensive alternatives are presented that would still offer some opportunity for members who stay in the workforce longer to accrue a better benefit. One would allow members to continue to accrue a 1 percent benefit (instead of 2 percent) after reaching 30 years of service. The other would increase the benefit cap from 30 years to 35, meaning that members could continue to accrue a 2 percent benefit until reaching 35 years of service, resulting in a maximum retirement allowance of 70 percent.

The first of the following three charts summarizes and compares the resulting increase in employer contribution rates associated with these three strategies for increasing the maximum retirement allowance. Contribution rates are expressed as a percentage of pay for TRS and PERS 1, respectively. The contribution rate chart is followed by two additional charts that summarize the fiscal impacts of these strategies for the 2007-2009 biennium and over 25 years. All three charts assume that the current program is replaced and each chart already accounts for the savings that would result from replacing the current program.

Change in Employer Contributions Rates

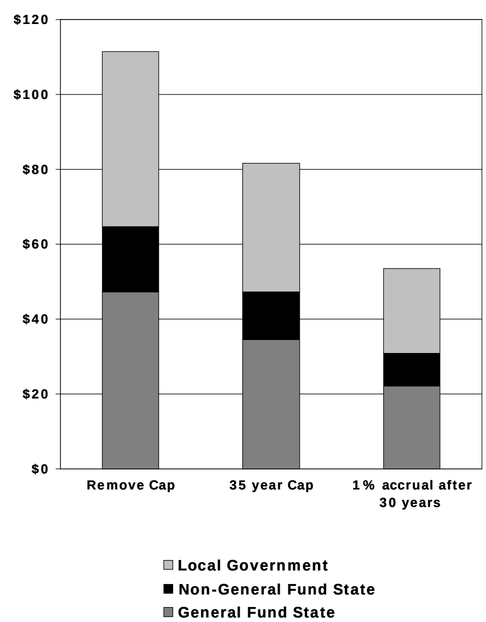
(After recognizing cost of current program)



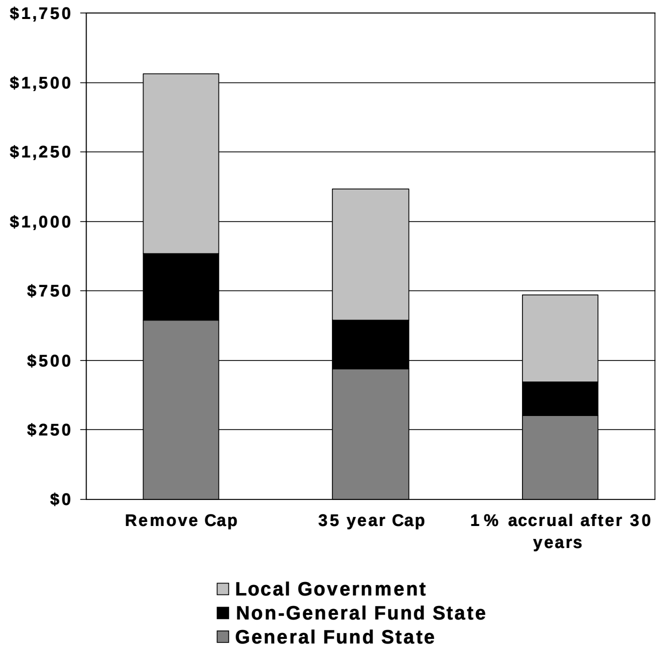
2007-2009 Fiscal Costs, PERS & TRS

(After recognizing cost of current program)

$ Millions



25 Year Fiscal Costs, PERS & TRS
(After recognizing cost of current program)
$ Millions



Any of these strategies to increase the maximum retirement allowance will be expensive in relation to other alternatives because they are system-wide changes that can apply to any active member. From a member perspective, the approach is consistent in its application and provides a desirable benefit to participants. From an employer perspective, legal impediments are few but cost is significant. As a workforce strategy, this approach is more appropriate for targeting an age cohort than a specific job sector. In any event, this approach raises the issue of whether it is appropriate to change the design and benefit structure of a closed plan whose members will all be retired in a matter of two decades.

"The OSA priced two proposals for amending the current program, both of which would decrease the current program's costs."

Another alternative for the legislature to consider is to **keep the existing program but amend it**. In fact, many legislative amendments have been proposed since the current program's inception in 2001. They include the following: reduce or eliminate the costs; create more parity between PERS 1 and TRS 1; avoid "insider agreements" to rehire particular individuals; and limit the applicability of the program. In contrast, two proposals would have expanded the program by increasing or eliminating the cumulative lifetime limits.

The OSA has priced two proposals for **amending** the current program, both of which would decrease the current program's costs. The elements in the first proposal are contained in SHB 1326/SB 5244 (2005), a copy of which is provided in the appendix. This bill, a slightly amended version of the Select Committee on Pension Policy's 2004 interim proposal (SCPP proposal), would bring parity to the Plans 1 by establishing additional controls in TRS 1 similar to those in PERS 1. It also would increase the cumulative lifetime limit in PERS 1 from 1,900 to 3,165 (hours worked over 867) and would create a new cumulative lifetime limit of 1,900 working hours for TRS 1. (Note: The original SCPP version proposed a cumulative lifetime limit of 3,165 hours for both plans.)

The second proposal for amending the current program that was priced by the OSA would apply the SCPP program changes, but would also reduce the retirement benefit paid to retirees while working by 50 percent. This proposal was not introduced as legislation during the 2005 session, but it could be considered as a compromise between retaining an amended program and repealing it altogether.

From a member perspective, amending the program to create parity would bring more consistency to the program. From an employer perspective, it would reduce costs somewhat by applying more restrictions to the TRS 1 program participants than currently exist. As a workforce strategy, the program could be rendered less effective if, for example, teacher shortages persist and the ability to address them is reduced. In any event, perceptions of the program could be improved by amendments that achieve more parity and establish controls to avoid potential abuse.

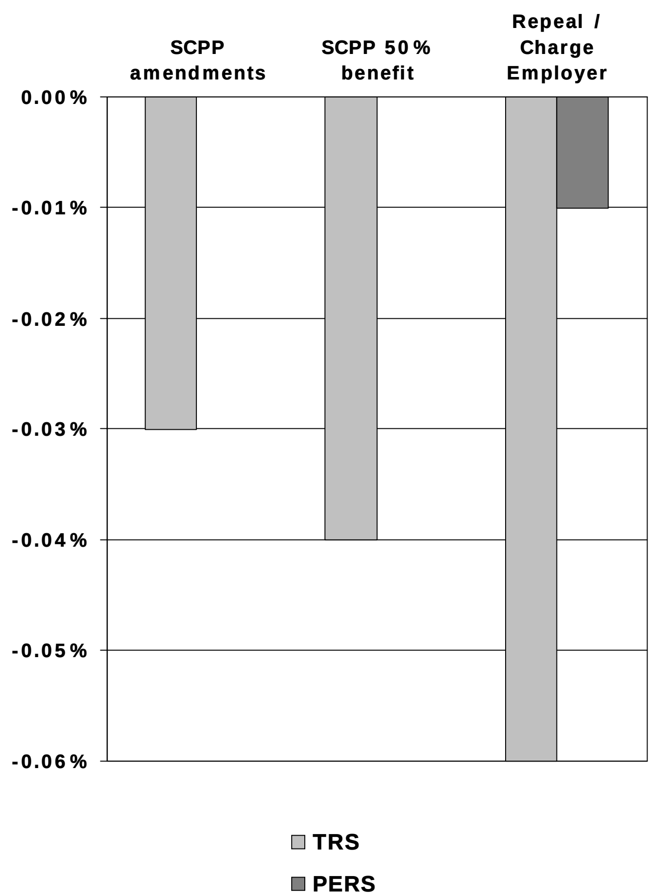
Repealing the 2001 program expansion would, as a fiscal matter, result in retirement system savings that are at least equivalent to the costs identified by this report as being attributable to the program. The major area of concern in deciding whether to repeal the current program is the legal issue of vested or contractual rights. The legislation that created the 2001 program expansion included a "no contractual rights clause." The ability of the legislature to restrict employee reliance upon a statutory expansion of benefits by utilizing a "no contractual right clause" has not yet been tested in the Washington courts.

From a member perspective, **repealing** the current program would be a reduction in benefits. From an employer perspective, there could be cost savings but less flexibility for hiring experienced employees. As a work-force strategy, repeal could be appropriate if there is no longer a need for the program; but if the program is still needed to address labor shortages, then keeping the program or re-placing it with an alternate strategy may be necessary. In any event, the cloud of legal uncertainty makes costs associated with the repeal option uncertain. Under a worst case scenario, a repeal and replacement of the current program could result in employers picking up litigation costs, the costs of all or part of the repealed program, and the costs of any replacement program.

The first of the following three charts illustrates the changes in employer contribution rates that would result from (a) amending the program and (b) amending it with a 50 percent benefit reduction. Contribution rates are expressed as a percentage of pay. For comparison purposes, these two options are presented along with the option of either repealing the program altogether or charging employers the full cost of the program. This third option, (i.e. repeal or charge employers), is the option that would eliminate the cost of the current program altogether– either because the program no longer exists or because the program is fully funded by employers who utilize the program through increased contribution rates. All three options show a savings because they are evaluated in light of the cost of the existing program.

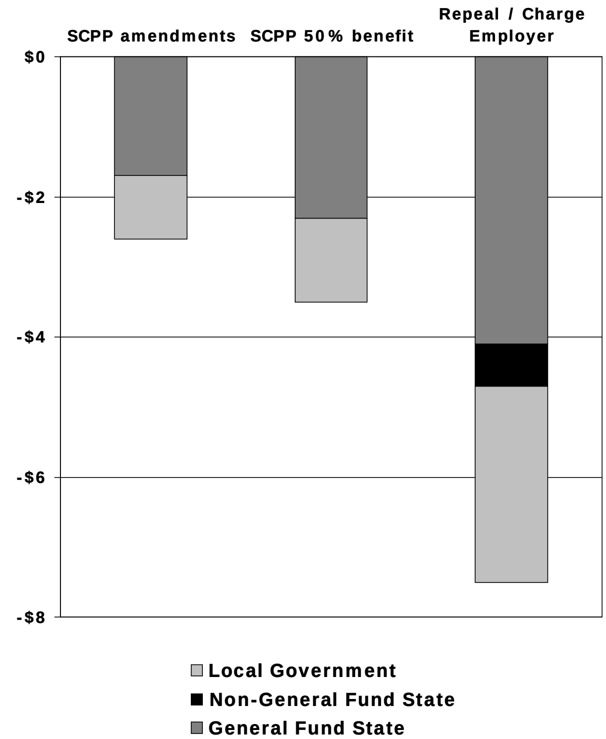
Two additional charts illustrate the fiscal impacts of amending the program as outlined in SHB 1326/SB 5244 (2005), and amending it with a 50 percent benefit reduction. Again, these two options are presented along with the option of either repealing the program altogether, or charging employers the full cost of the program (i.e. no cost option). All three options show a savings because they were evaluated in light of the cost of the current program.

Change in Employer Contribution Rates
(After recognizing cost of current program)



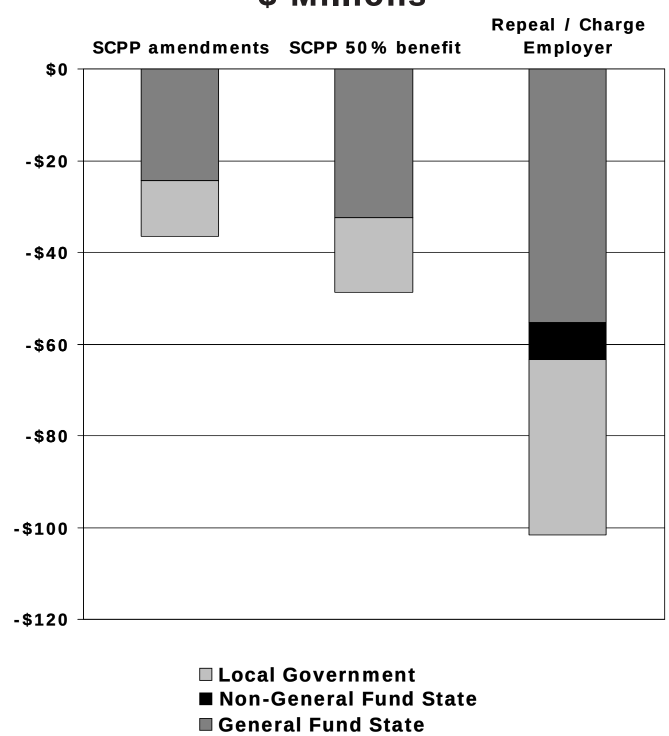
2007-2009 Fiscal Costs, PERS & TRS
(After recognizing cost of current program)

$ Millions



25 Year Fiscal Costs, PERS & TRS
(After recognizing cost of current program)

$ Millions



Phased Retirement:
Phased retirement allows members to receive part of a retirement benefit and work part-time, while continuing to earn part of a benefit.

Other Workforce Strategies

Should the legislature seek to explore other workforce strategies, it may also wish to consider the possibility of a **phased retirement program**. Phased retirement could replace or complement retire-rehire. It could allow members to transition into retirement by working part-time and receiving a partial benefit. Such members would have dual status: partially retired and partially in service.

The IRS has proposed rules to allow for phased retirement programs, but the rules are not yet final. Any legislation authorizing such a program for the Plans 1 would be premature until that time. Also, implementation of a phased retirement program would require significant planning in terms of IRS compliance testing, new programming, and integration with other benefits and programs.

From a member perspective, phased retirement could provide the kind of late-career flexibility that would allow or encourage members to work longer. From an employer perspective, it may allow for the retention of experienced staff. As a workforce strategy, it can be used to target specific sectors or can be used on a system-wide basis. The program can be designed as a benefit that allows employees to transition out of the workforce earlier, or costs can be controlled by structuring the program to avoid early retirements.

A **Deferred Retirement Option Plan (DROP)** is another workforce strategy for end-of-career employees. It may be designed to manage critical sector shortages by encouraging employees to stay longer or it may be structured as an incentive to retire early. DROPs may be designed to have a cost or to be cost-neutral.

In a standard DROP, a member who is eligible for retirement makes an election to enter the DROP for a set period. During that period, the employee becomes a retiree for pension purposes while still working for the employer and drawing a salary. No service credit is earned during the DROP period. However, the member's retirement benefit is paid into a special account where it can accumulate and earn interest or be invested by the member. At the end of the DROP period, the retirement benefit is paid directly to the member and the balance in the DROP account can be distributed or rolled over according to plan rules.

The biggest risk with a DROP program is that it is impossible to predict who will opt for DROP and who will stay with the traditional pension plan. This can cause unintended consequences. If more employees opt to participate in DROP than expected, DROPs can even cause staffing crunches. Similarly, DROPs may create funding problems if there is a significant unexpected increase in early retirements. Still, if carefully designed, DROPs can be a useful workforce strategy.

DROP - Deferred Retirement Option Program:
In a DROP, members "retire" and direct their retirement pension into a special account while continuing to work for the same employer. At the conclusion of the DROP period, they have access to the accumulated benefits in the account. Members do not accrue new service credit during the DROP period.

To summarize, the legislature faces an array of choices with respect to the current retire-rehire program for the Plans 1. It will be necessary to specifically define the policy goals for any program changes in order to effectively implement one or more of the strategies described in this report. In deciding whether to incur a cost in connection with any Plan 1 benefit enhancements, policy makers will need to balance the need for long-term benefit security in the Plans 1 against the more immediate human resource needs that may be emerging in the public workforce.

Applying "Views" of Post-Retirement Employment to the Alternatives

	Actuarial View	Employee View	Employer View	Retirement System View	Political View
Retire-Rehire (Current)	Costs are determined over time.	Job may not be available.	Can address workforce shortages.	In place.	Controversial; popular with certain stakeholders.
Increase Maximum Allowance	Most costly.	System-wide benefit.	Provides incentives to work longer.	Requires program changes and member communication.	More consistent. More costly.
Amend Current Program	Cost varies.	More parity; more restrictions possible.	Could interfere with employer goals.	Litigation likely with certain amendments.	Litigation likely with certain amendments.
Repeal Current Program	Saves benefit costs.	Takes something away.	Could magnify shortages/lead to hiring crunch.	Litigation likely.	Litigation likely.
Phased Retirement	Targets costs.	Provides flexibility.	Facilitates retention of older workers.	Very complex; breaks new ground.	Responds to workforce trends and older employees; IRS regs. not final; timing uncertain.
DROP	Targets costs; some risk.	Provides flexibility.	Facilitates retention or replacement of older workers.	Very complex; some risks of unintended consequences.	Possible criticism for effects on highly paid employees; some risk of unintended consequences.

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Select Committee on Pension Policy

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December 2, 2005

Senator Margarita Prentice, Chair
Senate Ways and Means Committee

Senator Joseph Zarelli, Ranking Minority Member
Senate Ways and Means Committee

Representative Helen Sommers, Chair
House Appropriations Committee

Representative Gary Alexander, Ranking Minority Member
House Appropriations Committee

RE: 2005 Post-Retirement Employment Program Report

Dear Chair Prentice, Chair Sommers, Senator Zarelli and Representative Alexander:

The Office of the State Actuary (OSA) has delivered its 2005 Post-Retirement Employment Program Report to the Select Committee on Pension Policy (SCPP), as required by Chapter 518, Laws of 2005. The SCPP has considered the report and offers the following response and recommendations:

1. <u>Further study is needed.</u> While the report is responsive to the study mandate, it is clear that cost is just one of many factors in determining an appropriate workforce strategy for public employees. The expanded post-retirement employment program was originally introduced to respond to workforce shortages, primarily in the education sector. The OSA report took no position as to whether the program has been successful in addressing these shortages, or whether the program is necessary to continue to avert them, assuming they still exist.

While the OSA has access to certain data collected by the Department of Retirement Systems for the purpose of performing actuarial valuations, data from other sources would be required to fully evaluate the success of the program as a personnel tool. We recommend that some other entity may be more appropriate than the OSA to profile the state's public workforce, evaluate workforce needs, set personnel goals, and recommend an appropriate strategy to reach those goals. Perhaps a multidisciplinary task force would be an appropriate body to undertake this effort.

The expanded retire-rehire program is currently available in the Plans 1 of the Public Employees' Retirement System and Teachers' Retirement System. By far the largest employers in these plans are the K-12 employers, so we would view representatives of that group as critical to the success of any further study. Other affected entities include state agencies, counties, higher education institutions, county subdivisions and cities.

2. <u>No immediate or significant changes in current practices are required at this time</u>. In light of our recommendation for further study, we believe that significant legislative action would be premature. However, we are recommending, as a sort of "stopgap measure," legislation that would implement certain procedural safeguards to help avoid abuses within the program. These safeguards would involve no changes to hour limits or waiting periods, and thus, would have **no cost**. Instead, we recommend that employers be required to hire retirees pursuant to a written policy. Further, we recommend consistency between PERS 1 and TRS 1 regarding the following: a) prohibitions against prior agreements to rehire retirees, and b) requirements that employers document their need to hire retirees and keep records of their hiring processes.

Thank you for your consideration of these recommendations. We would be happy to discuss them with you in more detail.

Sincerely,

Representative Bill Fromhold, Chair
Select Committee on Pension Policy

Senator Karen Fraser, Vice-Chair
Select Committee on Pension Policy

cc: Matt Smith, State Actuary
David Schumacher, Sr. Staff Coordinator/Capital Budget Coordinator
Charlie Gavigan, Staff Coordinator

Summary of 2006 Legislation, Post-Retirement Employment

At-a-Glance

Last year's SCPP bill was designed to refine the current retire-rehire program by:

- Discouraging abuses
- Creating parity between PERS 1 and TRS 1

SHB 2689 and SB 6448

(Bailey – Mulliken)

Required employers utilizing the expanded retire-rehire program in the Plans 1 of PERS and TRS to hire retirees pursuant to a written policy; applied the following to TRS 1 to provide consistency with PERS 1: prohibition of prior agreements, documentation of need, documentation of the hiring process, a one and one-half month waiting period, and a 1,900-hour cumulative lifetime limit on hours worked in excess of 867. *The original bill had less consistency with PERS 1 in that it did not extend the break in service requirement for TRS 1 members participating in the expanded retire-rehire program from one month to one and one-half months, or impose a prospective 1,900-hour cumulative lifetime limit on hours that a TRS 1 retiree may work in excess of 867 hours annually without suspension of retirement benefits.*

Status at sine die: The bill passed the House with amendments, was heard and passed by Ways and Means, but was not heard in the full Senate.

Fiscal Impact: The total employer savings would have been $0.0 million for 2006-2007, ($2.6 million) for 2007-2009, and ($35.3 million) for 2006-2031.

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Laura Harper
Senior Research Analyst
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The Select Committee on Pension Policy

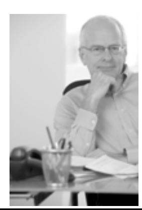
Post-Retirement Employment

Laura Harper, Senior Research Analyst, Legal

July 18, 2006

A continuing discussion...

- Purpose of retirement?
- Relationship between work and retirement?
- Appropriate period for retirement?
- How do retirement systems interact with a changing workforce?



Checking in …

- Where is the Select Committee on Pension Policy on this issue today?
  - Quick recap of issue since 2001
  - Reminder re: last session's proposal
- Stay the course or change the direction?

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Key Legislation

- Significant program expansion in 2001: 1,500 hours
  - Work nine months in PERS 1
  - Work a full school year in TRS 1
- Additional procedural "safeguards" for program in 2003
  - Vetoed for TRS 1
  - Remain for PERS 1

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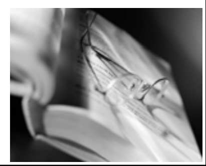
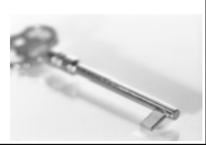
2005 Study Mandate

- Directed to the Office of the State Actuary
- Determine cost of current program
- Study alternatives
- Report to fiscal committees by December 1, 2005



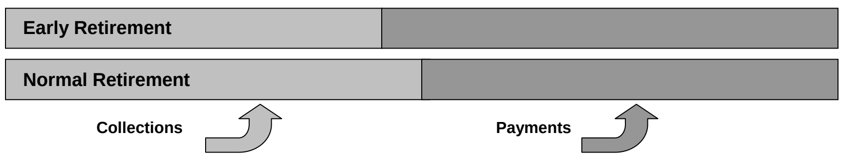
Actuarial Experience Study

- Key finding:
  The retire-rehire program expansion resulted in earlier Plan 1 retirements



Earlier Retirement Has a Cost

- Payment period for retirement benefits is longer
- Collection period for investment earnings and contributions is shorter



Cost to Employers

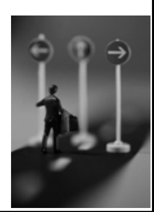
Retirement System	Required Rate Increase
TRS 1	0.06%
PERS 1	0.01%

Projected Fiscal Impacts

Period	General Fund - State	Total Employer Costs
2007-2009	$ 4.1 million	$ 7.5 million
25-year cost	$55.3 million	$101.5 million

Alternatives to Program

- System-wide incentives (remove or modify Plan 1 benefit cap)
- Amend current program
- Repeal current program
- Phased retirement
- Deferred Retirement Option Plan (DROP)

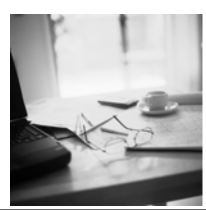


SCPP Response: Two-Pronged Recommendation

- Workforce study is needed
- No significant program changes, but implement safeguards in TRS 1

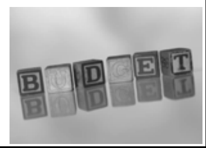
Last Year's Recommendation for Study

- SCPP saw a need to tie workforce strategies to human resource goals
- SCPP took no position on who should conduct a study or set those goals
- Steps outlined by SCPP:
  - Profile workforce
  - Evaluate workforce needs
  - Set personnel goals
  - Recommend strategies



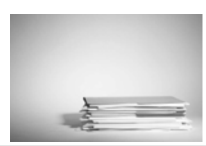
2006 Outcome

- Governor's proposed supplemental budget included workforce study
- Study would have examined:
  "... how the state can structure its human resource and retirement practices to address the diverse needs of the changing workforce . . . ."
- Provision not included in final budget



Last Year's SCPP Legislative Proposal

- Implement procedural safeguards to avoid abuses
  - Prohibit prior agreements
  - Document need
  - Document hiring process
- No provisions re: waiting period and hour limits
- Cost neutral



2006 Legislative Outcome

- Bill was amended in House
  - For TRS 1, amendment increased waiting period and set hour limits
  - Even more parity with PERS 1
  - Similar to SCPP's 2005 bill
  - Amendment generated **cost savings**
- Passed Appropriations, House, Ways & Means
- Was not heard by full Senate

Stay the Course or Change It?

- What are the priorities of the SCPP for this interim?
- Have priorities changed since last year?

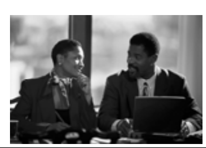
Decision Factors

- Fiscal impacts
- Stakeholder interests
  - Employer views
  - Employee views
- Retirement system impacts
- Political implications
- Legal risks

Relationship to SCPP Goals

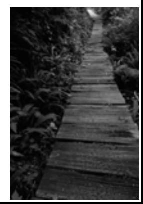
- Goal 2: Balanced Long-Term Management

"… responsiveness to human resource policies for recruiting and retaining a quality public workforce."



Next steps?

- Executive Committee will discuss how to move this issue forward
- No additional hearing scheduled at this time



The Select Committee on Pension Policy

Plan 1 Funding Method

Matt Smith, FCA, EA, MAAA
State Actuary

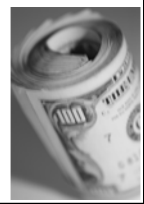
July 18, 2006

The Basics

- Plan 1 Unfunded Liability is an “unfunded prior service cost”
- Based on service credit that has already been earned, not future service credit
- This type of unfunded liability is common

The Basics

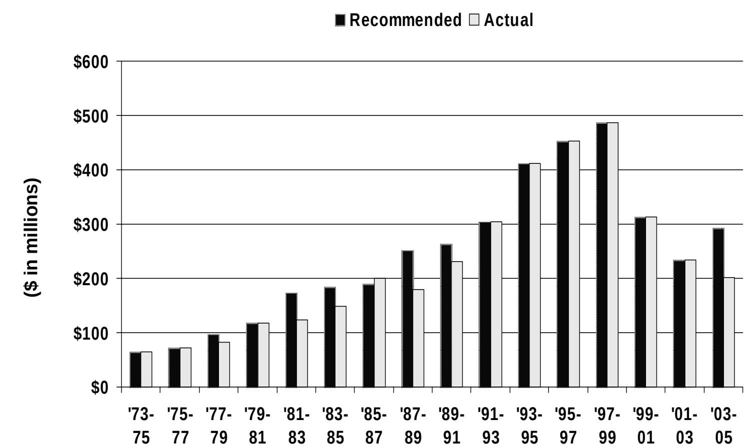
- UAAL = Unfunded Actuarial Accrued Liability
- Must be funded in the future and combined with on-going retirement costs (normal costs)



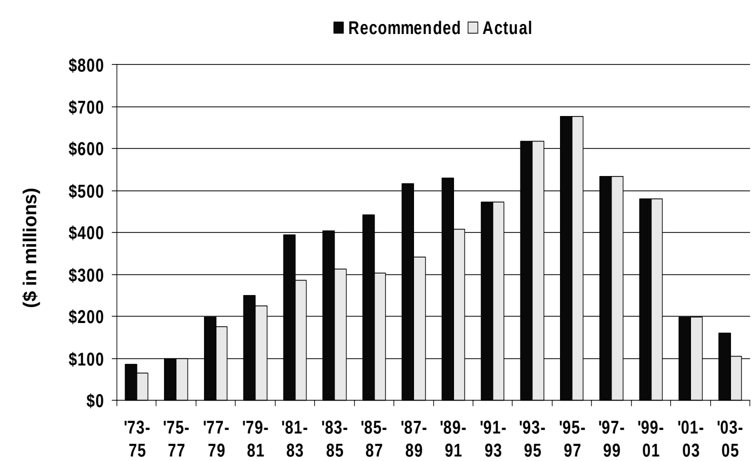
The Basics

- Where does it come from?
  - Past under-funding
  - Benefit improvements for past service
  - Investment and other experience losses

PERS Employer Contributions



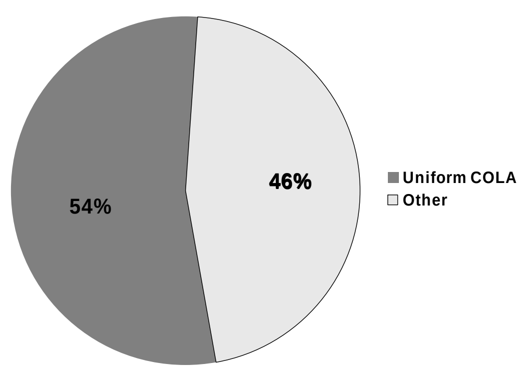
TRS Employer Contributions



Plan 1 Benefit Improvements

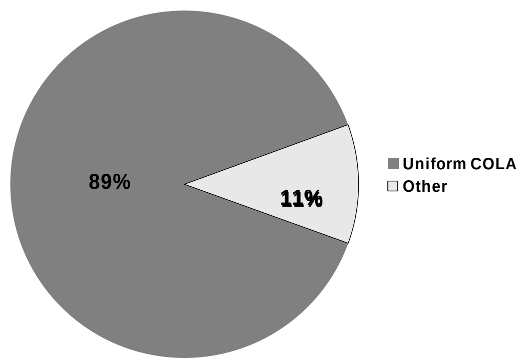
- Benefit multiplier of 2% for all service
  - A change from 1% plus member's contributions as an annuity
- Uniform COLA
  - PERS 1 and TRS 1 did not have a COLA at plan inception
- Gain-sharing benefit
  - $900 million in Plan 1 UAAL that is currently suspended

Uniform COLA as a Percentage of PERS 1 UAAL*



* 9/30/2024 valuation date; excludes the cost of future gain-sharing benefits.

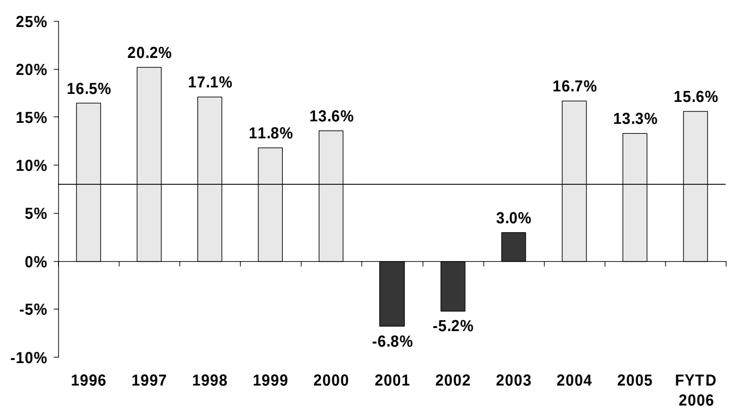
Uniform COLA as a Percentage of TRS 1 UAAL*



* 9/30/2004 valuation date; excludes the cost of future gain-sharing benefits.

CTF Annual Returns*

Fiscal Year ended June 30



* Source: Washington State Investment Board; CTF =Commingled Trust Fund

Amortization Methods - Basics

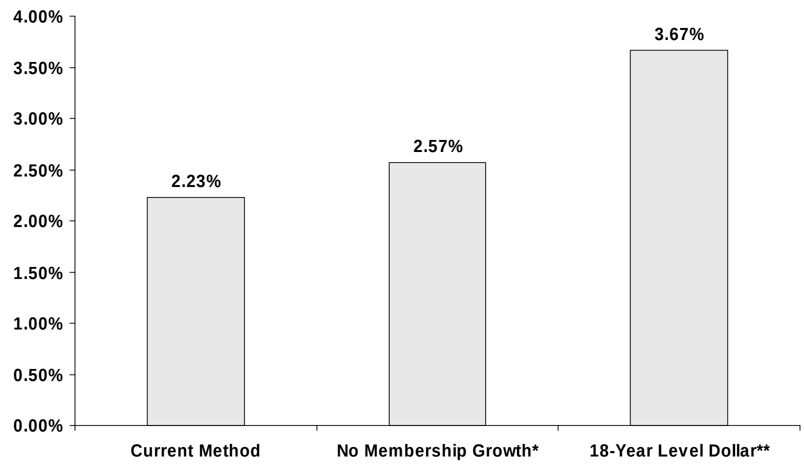
- Measure the unfunded liability under the plan's actuarial cost method
- Select an amortization period
- Select an amortization basis
  - Level percentage of payroll
  - Level dollar

Plan 1 Amortization Method

- Cost method is modified Aggregate
- Amortization date is June 30, 2024
  - Eighteen years from today's date
- Amortization basis is unique
  - Level percentage of projected payroll for the system, not the plan
  - Includes assumed growth of system membership
- Employer obligation

PERS 1 UAAL Rates

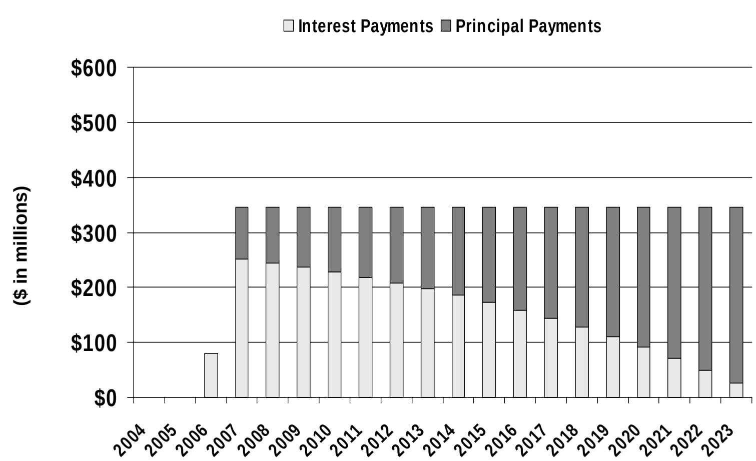
September 30, 2004 Valuation Date



** Current method with no assumed membership growth*

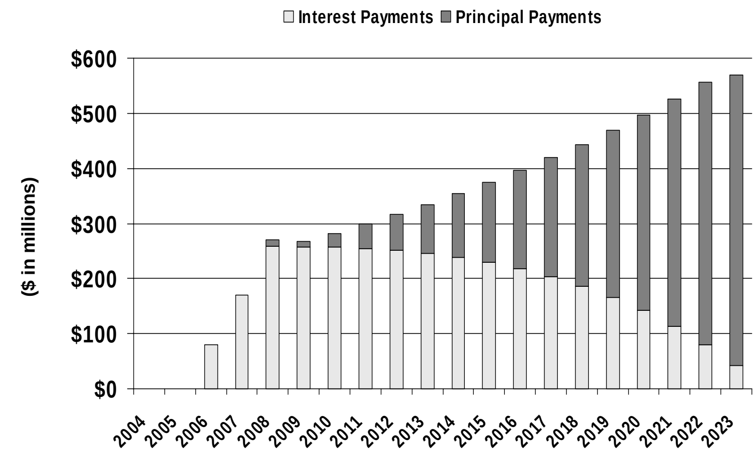
*** First-year cost displayed as a percentage of current annual pay*

PERS 1 UAAL Payment Schedule - Level Dollar*



** 17 level payments at 8% annual interest; starting in 2007. Schedule provided for illustrative purposes only.*

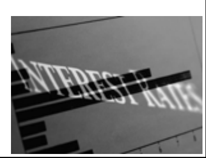
PERS 1 UAAL Payment Schedule - Current Method*



** Schedule provided for illustrative purposes only. Does not represent the actual amortization schedule.*

PERS 1 UAAL Payment Schedules

- Both amortize UAAL in 18 years
- Current method produces $3.4 billion in interest charges
- Level dollar method produces $2.8 billion in interest charges
- The difference: $600 million in additional interest charges



Comparative Systems

- All use the Entry Age Normal method
- Thirty-year amortization period most common
- All use the level percentage of payroll basis
- No systems spread liability across all plans (except CalPERS)*
- Ohio and Seattle have a variable amortization period
  - Adjust amortization period to stabilize rates

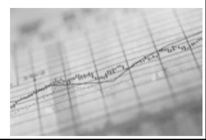
** CalPERS shares UAAL within state government tiers and among small (less than 100 employees) employers.*

Purpose of Current Method

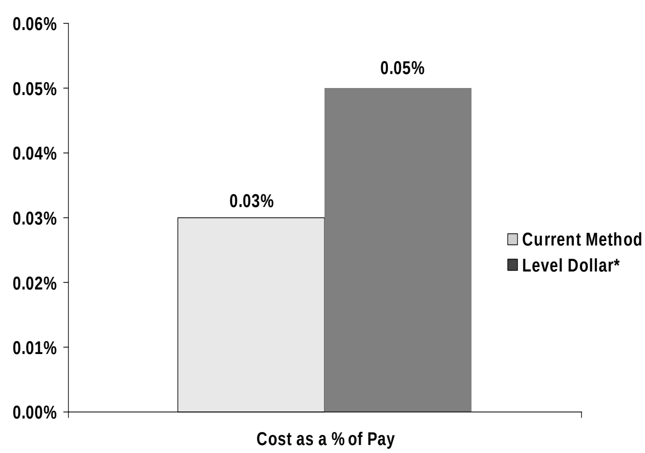
- Attain desired goal of funding unfunded <u>prior</u> costs in Plan 1 by June 30, 2024
  - Originally established in 1989 (35-year amortization)
- Produce a reasonable and manageable schedule of contributions
  - Recognizing limitations on the availability of future contributions (tax dollars)
- Same contribution rate for all employers within a system (except for LEOFF)
- Fund benefit improvements?

Funding Benefit Improvements

- Consider a benefit improvement funded under two alternative financing approaches
  - One increases the PERS 1 UAAL rate by 0.03%
  - One increases the PERS 1 UAAL by 0.05%
- Both increase the PERS 1 UAAL by $34 million
- Which has a better chance of success?

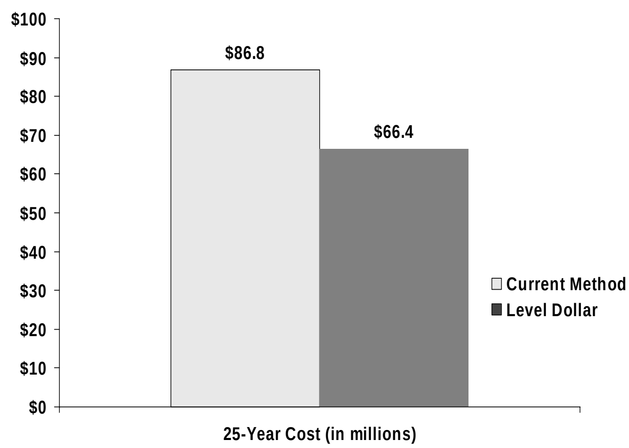


Funding Benefit Improvements - Example



** Level dollar cost is displayed as a percentage of current annual pay*

Funding Benefit Improvements - Example



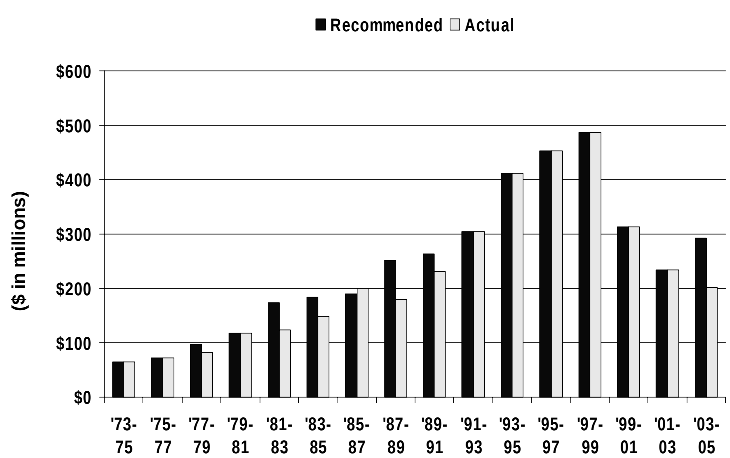
Funding Benefit Improvements

- Increase on the Plan 1 UAAL is the key funding-decision factor
- Current method obscures the cost of benefit improvements
- Method intended to address challenges of paying for unfunded prior service costs
- Future benefit improvements may become prohibitively expensive as we approach amortization date

Funding Benefit Improvements

- Extending the financing period for benefit improvements has two costs
  - Assumed interest cost (from deferred financing)
  - Pay now or pay more later
  - Loss of potential earnings above the assumed investment return rate (the “lost opportunity” cost)

PERS Employer Contributions



Lost Opportunity Cost

- PERS employer contributions from 1973-2005
  - Recommended = $3.9 billion
  - Actual = $3.6 billion
- The $300 million difference accumulated with actual investment return would have grown to $1.8 billion today
- PERS 1 UAAL = $2.6 billion*

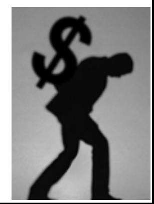
** 9/30/2004 valuation date; excludes the cost of future gain-sharing benefits.*

Intergenerational Equity?

- Deferred payment schedule shifts the burden to future taxpayers
- Future taxpayers will not benefit from members' services
- All Plan 1 members will be retired when payments are highest

Recap

- Plan 1 UAAL came from multiple sources
- Unfunded liability is common
- Plan 1 funding method is not common
- Current method obscures the cost of benefit improvements
- Lost opportunity cost and intergenerational inequity



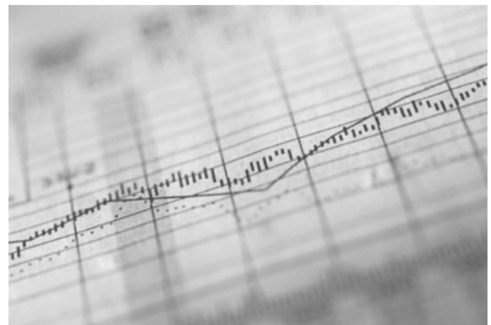
Policy Questions

- Is the Plan 1 funding method serving its intended purpose?
- Will it produce a reasonable and manageable schedule of contributions?
- Is the current method too backloaded?
- Should Plan 1 benefit improvements have a separate funding policy?
- How do you balance the need to fund unfunded prior costs with the need for benefit improvements?

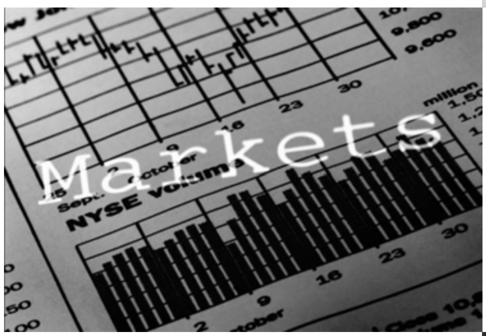
Next Steps

- Executive Committee will recommend next course of action for this issue
- Currently scheduled for the October meeting

Washington State Legislature



Select Committee on Pension Policy



Gain-Sharing Study

December 2005

Prepared by:
The Select Committee on Pension Policy
PO Box 40914 - Olympia, Washington 98504-0914
Phone: 360.786.6140 - E-mail: actuary.state@leg.wa.gov

Executive Summary

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.

Alternative Gain-Sharing Proposal

(January 9, 2006)

Plan 1 Trade-off

Plan 1 gain-sharing would be repealed and replaced with a .24 cent increase in the Annual Increase Amount used in calculating members' Uniform COLA. On July 1, 2007, the annual increase amount would be $1.57 instead of the scheduled $1.33. As a result, an eligible Plan 1 member with 30 years of service would receive an annual increase of $565.20 instead of $478.80. Since the .24 cent adjustment is permanent, the subsequent adjustments are greater as well – in 2008 the Annual Increase Amount would be $1.62 instead of $1.37; an eligible retiree with 30 years of service would receive an annual increase of $583.20 on top of the year-earlier amount.

Plan 3 Trade-off

Under this alternative proposal, Plan 3 gain-sharing and Plan 3 contribution rate annual choice would be repealed and replaced with the following:

- Plan 2/3 choice for new members of TRS and SERS.
- An optional 2 percent Plan 3 defined benefit (DB) accrual with a defined contribution (DC) annuity off-set (prospective). This would be for members of TRS, SERS, and PERS who opted to switch to Plan 3 and for PERS members who chose PERS 3 upon employment. Members must have been continuously employed since joining Plan 3 and must have joined Plan 3 prior to the effective date of this act.
- A one-time and prospective Plan 3 to Plan 2 transfer window for TRS and SERS members who were mandated into Plan 3.

Technical Sections

- RCW 41.45.061 *Contribution rates for Plan 2 members* clean-up section.
- RCW 41.45.070 *Supplemental rate* section amended so no supplemental rate would result from this act until July 1, 2007.
- RCW 41.45.054 *Contribution rates -- Applicable dates* section decodified.

- Temporary non-contractual rights section.
- Effective date section – July 1, 2007.

Two-Percent Defined Benefit with Annuity Off-Set

Under this proposal, eligible Plan 3 members could choose a prospective 2 percent DB option which would be off-set by an annuity "purchased" by the member's DC at retirement. This is, in essence, an employer-backed guarantee that the value of the member's retirement benefit will be at least 2 percent of the member's average final compensation (AFC) times the member's years of service – the equivalent of a Plan 2 defined benefit. The off-set from the DC account would be no more than 1 percent. Members would need ten years of prospective service; or five years, including 12 service-credit months after attaining age 54, to be vested in this benefit.

Members eligible to participate in the 2 percent DB with annuity off-set would be required to invest specified minimum amounts in the Washington State Investment Board, Commingled Trust Fund. Members could also invest additional Plan 3 amounts in other higher or lower risk portfolios, at their choosing.

Members would not be required to take their DC retirement benefits in the form of an annuity. All the distribution options available to other Plan 3 members would still be available to members electing this option.

Two-Percent DB with Annuity Off-Set Examples

The following examples of an annuity off-set DB are based on a member who is age 45 on the effective date of the act and who retires at age 65 with an AFC of $5,000 per month. The member would have 20 years of prospective service and would meet the eligibility provisions qualifying them for a prospective employer-provided benefit equal to 40 percent of AFC or $2,000/month before off-set. This example assumes that significant down-market experience during the member's service may result in a lower DC balance.

Two-Percent Defined Benefit with Annuity Off-Set Examples		
	High DC Balance	**Low DC Balance**
Employee DC contribution plus earnings	$158,400	$129,600
Balance required for 1% annuity	$144,000	$144,000
Monthly annuity from DC	$1,100	$900
Employer provided monthly annuity	$1,000	$1,100
Total monthly benefit *	$2,100	$2,000
Employee DC surplus (deficit) *	$14,400	($14,400)

* Annuity payout of DC account is not required.

SCPP 2006 Sponsored Gain-Sharing Legislation

At-a-Glance

The SCPP forwarded four gain-sharing related bills to the 2006 legislature. Three of the bills dealt with benefit provisions that had been included in the omnibus gain-sharing bill of 2005, but which the Committee felt would have more success as free-standing legislation: the expanded $1,000 alternative minimum benefit in PERS 1 and TRS 1, the Age 66 COLA for PERS 1 and TRS 1, and the Rule-of-90 for the Plans 2/3.

The final bill was the gain-sharing trade-off bill, which sought to repeal and replace gain-sharing with a variety of benefits that were valued at about half the cost of future gain-sharing benefits.

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HB 2687 / SB 6453 — $1,000 Minimum Benefit (Bailey - Mulliken)

Establishes a $1,000 minimum benefit in the Plans 1 of PERS and TRS for those with at least 20 years of service and who have been retired at least 25 years; provides a 3 percent escalator for both $1,000 minimum benefits (the other being the $1,000 minimum benefit already available to those with 25 years of service and who have been retired 20 years).

Status at sine die: This bill passed the House and the Senate without amendment and was delivered to the Governor.

Final status: The Governor signed the bill into law on March 27, 2006; codified as Chapter 244, Laws of 2006.

HB 2686 / SB 6454 — Age 66 COLA (Bailey - Mulliken)

Amends the Uniform COLA eligibility requirements of the PERS and TRS Plans 1 to include all retirees who have been retired one year and will have attained age 66 by December 31 (instead of July 1) of the calendar year in which the increase is given.

Status at sine die: This bill passed the Senate without amendment. It received a hearing in House Appropriations but was not forwarded from the committee.

HB 2679 / SB 6445 — Rule-of-90

(Conway - Fraser)

Provides unreduced retirement benefits to any vested member of the TRS, SERS, and PERS Plans 2/3 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 90 or more.

Status at sine die: This bill did not receive a hearing in the House or the Senate.

HB 3183 / SB 6795 — Gain-sharing Trade-off

(Fromhold - Fraser)

Repeals Plan 1 gain-sharing and provides a $0.24 increase in the Uniform Increase Amount used in calculating Plan 1 members' uniform COLA. Repeals Plan 3 gain-sharing, eliminates TRS 3 annual contribution rate choice, provides Plans 2/3 choice in TRS and SERS for new hires, provides an option to move to Plan 2 for TRS and SERS members mandated into Plan 3, and provides an optional 2 percent defined benefit accrual with a defined contribution annuity offset for TRS, SERS, and PERS members who chose to be in Plan 3.

Status at sine die: This bill did not receive a hearing in the House or the Senate.

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The Select Committee on Pension Policy

Gain-Sharing

Robert Wm. Baker, Senior Research Analyst

July 18, 2006

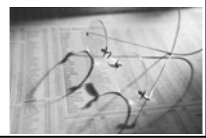
Presentation Elements

- Where the SCPP has been
  - Gain-sharing study key findings
  - SCPP policy direction
  - SCPP proposals
- Where the SCPP wants to go?
  - Evaluation questions

2005 Gain-Sharing Study

(Chapter 370, Laws of 2005)

"… study the options available to the legislature for addressing the liability associated with future gain-sharing benefits."



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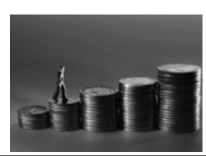
Present Value of Future Gain-sharing: 2004 Valuation

(Dollars in millions)

	Plans 1	Plans 3	Total
Total	$959	$621	$1,580



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Recommended Employer Contributions Due to Future Gain-Sharing*

PERS	TRS	SERS
0.65%	2.01%	2.35%

*Source: 2003 Actuarial Valuation Report

Projected Cost of Future Gain-Sharing Total Employer Costs

(Dollars in Millions)

	Plan 1 Members	Plan 3 Members Current	Plan 3 Members Future	Total
2007-2009	$179.7	$160.0	$63.3	$403.0
2006-2031	$2,389.1	$1,316.3	$4,134.3	$7,839.7

Study Mandate Options

- Repeal
- Suspend
- Delay recognizing costs
- Make discretionary
- Repeal and replace

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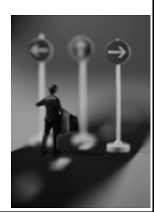
Alternative Options

- Retain and pre-fund
- Retain and post-fund
- Repeal and allow Plan 3 members to return to Plan 2
- Increase gain-sharing thresholds
- Replace Plan 3 gain-sharing with an employer DC



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Framework for Analyzing the Options

- Is gain-sharing sound pension policy?
- Is gain-sharing affordable?
- Decision factors

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Is Gain-sharing sound retirement policy?

- Yes
  - Retain benefit and set funding policy
- No
  - Repeal
  - Repeal and replace

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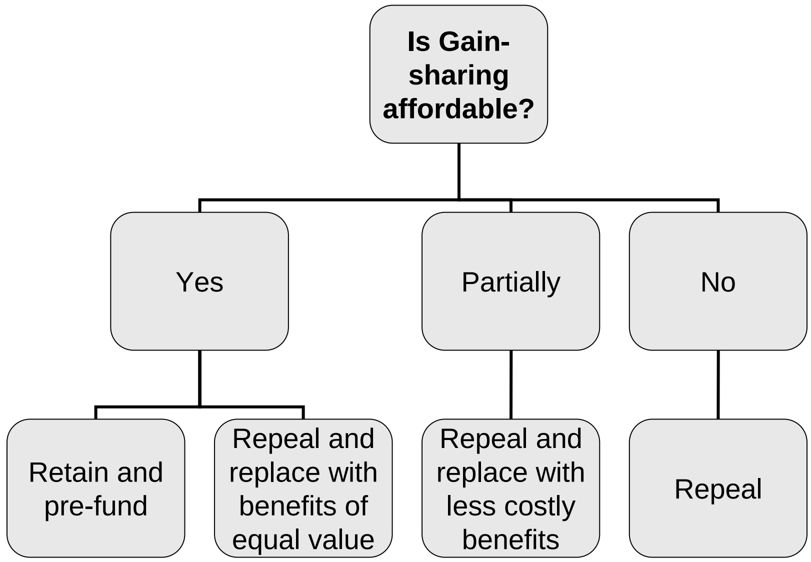
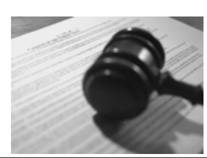


Decision Factors

- Fiscal
- Legal
- Stakeholder interests
- SCPP goals

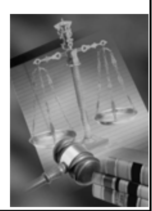


Fiscal Factors

- Unrecognized liability
- Cost to pre-fund would be new
- Era of increasing contributions

Legal Factors

- Attorney General Opinion
- Tax Counsel Advice



Attorney General Opinion

Non-Contractual Clause

- "... members have no enforceable right or current reasonable expectation of receiving such benefits."
- "... the legislature may amend or repeal these particular statutes at any time."

Tax Counsel Advice

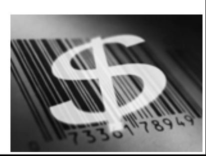
- Plan 3 to Plan 2 transfer may be in conflict with IRS regulations
  - One-time irrevocable election made previously
- Could have significant tax consequences for the State, plan members, and employers

Stakeholder Interests

- Retain or improve benefits
- Avoid or minimize fiscal impact from unplanned expenses

SCPP Goals

- Contribution rate setting
- Balanced long-term management
- Retirement eligibility
- Purchasing power
- Consistency with the statutory goals within the funding chapter



2005 SCPP Policy Direction

- Repeal and replace
  - Replace with benefits about half the value of future gain-sharing liabilities
- Include Plan 2
  - Reasons for excluding from gain-sharing re-examined

SCPP Trade-Off Proposal

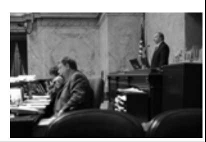
- Repeal Plan 1 and Plan 3 gain-sharing
- 24¢ increase in Uniform COLA
- Plan 2/3 choice for SERS and TRS new hires
- Plan 2 transfer window for those mandated into TRS 3 and SERS 3
- Plan 2 value guarantee for Plan 3 members (prospective)
- Repeal Plan 3 member rate flexibility

SCPP Stand-Alone Proposals

- Age 66 COLA for PERS 1 and TRS 1
- $1,000 alternative minimum benefit for PERS 1 and TRS 1 members with 20 years of service and retired 25 years
- Full Rule-of-90 for Plans 2/3

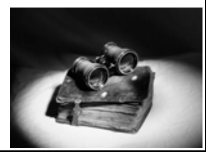
2006 SCPP Gain-Sharing Legislation

- Gain-sharing trade-off: HB-3183 / SB-6795
  - Neither received a hearing
- Age 66 COLA: SB-6454 / HB-2686
  - Passed Senate, did not pass Appropriations
- $1,000 Minimum: SB-6453 / HB-2687
  - Chapter 244, Laws of 2006
- Rule-of-90: SB-6445 / HB-2679
  - Neither received a hearing



What's Been Covered
(Where the SCPP has been)

- Gain-sharing liability
- Mandatory and alternative options
- Framework for analysis
- SCPP policy direction
- Proposals



Evaluation Questions
(Where the SCPP wants to go?)

- Why did last year's proposals fail?
  - Too complex?
  - Too costly?
  - Last minute change detrimental?
- Did conflicting stakeholder perspectives hinder efforts?
  - Granting a benefit; or
  - Taking away a benefit

Evaluation Questions (cont)

- Is "Repeal and Replace" the desired course of action?
  - Too much legal risk?
- Are there alternate courses?
  - New plan instead of Plan 3 to Plan 2 transfer?
- Will the next gain-sharing event (possibly in 2008) influence the timing and value of any proposal?

Next Steps

- SCPP Executive Committee direction
  - Possible options and pricing
- Scheduled for October meeting