From: Andy Johnson
To: Office State Actuary, WA
Subject: Indexing of average final compensation for inflation
Date: Sunday, May 7, 2023 9:32:35 PM

Greetings:

I am writing to request that the Select Committee on Pension Policy consider the feasibility of indexing average final compensation for inflation under PERS Plans 2 and 3.

Under current law, PERS members receive cost-of-living adjustments on an annual basis. See RCW 41.40.640 and 41.40.840. However, these adjustments apply only to the benefit of members who have been receiving a retirement allowance for at least one year. This means that the benefits of members who separate from state service after vesting are exposed to inflation until the member begins drawing on their defined benefit.

This problem is particularly acute for a PERS member who chooses to devote the first portion of his or her career to state service but ends his or her career with a non-PERS employer. For example, take a college graduate who wanted to take advantage of the federal Public Service Loan Forgiveness program, which requires 10 years of public service. If this PERS member works for 10 years in state service, say from age 22 to age 32, with an average final compensation of $50,000, the member's defined benefit will be $10,000 per year under PERS 2. However, if this PERS member ends state service and spends the next 33 years in non-PERS employment, that $10,000 defined benefit will not be adjusted for inflation. Assuming 2.5% annual inflation, the $10,000 defined benefit will provide only $4,382 in purchasing power when the member reaches age 65.

In the above example, the contributions of the member and the member's employer will enjoy over 33 years of long-term investment growth—currently estimated at 7% per year by the Pension Funding Council. The value of the contributions in nominal terms will increase by over 900%, and in real terms by over 450%. But the member's benefit will stay the same in nominal terms, and in real terms decline by over 50%.

This is not a contrived example. With an increasingly mobile workforce, a significant population of military families, and federal programs like Public Service Loan Forgiveness, many state employees will not spend their entire careers in Washington State service. Even if they choose to remain in public service, membership in a federal pension system or the pension system of another state will not alleviate the failure to adjust average final compensation for inflation.

I propose to amend RCW 41.40.010(6), defining "average final compensation," by adding:

(d) In calculating average final compensation under this subsection for a member of plan 2 or 3, the department of retirement systems shall adjust the result for inflation occurring during the adjustment period. The adjustment period consists of full calendar months, and begins the first month following the last of the sixty service credit months used under (b) of this subsection and ends the last full month that precedes the effective date of the member's retirement. No inflation adjustment shall be made if the adjustment period is less than twenty-four months. The determination of which service credit months to use under (b) of this subsection shall be made prior to applying the inflation adjustment under this subsection (d). Inflation adjustments shall be made using each month's consumer price index—Seattle, Washington area for urban wage earners and clerical workers, all items, compiled by the bureau of labor statistics, United States department of labor. This subsection (d) applies only to members with an effective date of retirement after the effective date of this act.

Thank you for your public service and your consideration of this important issue.

Sincerely,
Andy Johnson