FINAL BILL REPORT
EHB 2391

C 491 L 07
Synopsis as Enacted

Brief Description: Eliminating retirement system gain-sharing and providing alternate pension benefits.

Sponsors: By Representatives Fromhold, Conway and Moeller.

House Committee on Appropriations
Senate Committee on EnterCommittee

Background:

Gain-sharing.
Gain-sharing is a mechanism created in 1998 for increasing benefits created for the Teachers' Retirement System (TRS), the School Employees' Retirement System (SERS), and the Public Employees' Retirement System (PERS) Plans 1 and Plans 3. It increases benefits in these plans when "extraordinary investment gains" are experienced by the plans.

The gain-sharing statutes define "extraordinary investment gains" as those that are earned when the compound average of investment returns on the pension funds over the previous four fiscal years exceed 10 percent. When the previous four fiscal year average exceeds 10 percent, a calculation is performed to determine a dollar amount that will be distributed to eligible members. The calculation is performed once per biennium for distributions in January of even-numbered years.

The gain-sharing statutes were enacted by the Legislature with a reservation of contractual rights. The Legislature specifically reserved the right to amend or repeal the gain-sharing laws in the future, and no member or beneficiary has a right to receive a gain-sharing distribution after an amendment or repeal of the laws is enacted.

Benefit Enhancements from Gain-sharing Distributions.
The method of distribution of extraordinary investment gains is different in each of the Plans 1 and Plans 3. In Plan 1, an amount equal to one-half of the extraordinary investment gains is used to permanently increase the Annual Increase Amount, also known as the "Uniform COLA," which serves to increase eligible retirees' benefits each year.

Retirees in PERS and TRS Plans 1 begin to be eligible to receive the Uniform COLA increase in their benefit at age 66 and after at least one year of retirement, provided the member turns age 66 before July 1 of that year. The Annual Increase Amount that will be effective July 1, 2007, is $1.33 per month per year of service for a retiree, or approximately $40 per month for a retiree with 30 years of service. In 1998, distribution of extraordinary investment gains increased the Annual Increase Amount by $0.10, and in 2000 by an additional $0.28.

In Plan 3, extraordinary investment returns are calculated in generally the same manner as in the Plans 1. Extraordinary investment returns that are attributable to the Plan 3 portion of the combined Plan 2/3 retirement funds are determined, and distributions are made to the Plan 3 members in a lump sum dollar amount that is deposited into Plan 3 individual member and retiree accounts. An individual's distribution is proportionate to the amount of service credit that he or she has in Plan 3 to the total in the individual's plan. For example, in 2000, TRS Plan 3 members received a gain-sharing distribution of $254 per year of service, so that a member with 20 years of service in Plan 3 would have received a lump-sum distribution of about $5,085 into his or her individual account.

January 1, 2008, Projected Gain-sharing.
The next scheduled calculation period for gain-sharing will close on June 30, 2007, and will incorporate the four prior fiscal years of investment return in calculating a gain-sharing distribution for January 1, 2008. The most recent projection by the Office of the State Actuary, dated March 26, 2007, projects that the four-year median investment return will be about 15.3 percent, resulting in a $0.26 increase in the Plan 1 Uniform COLA and a $228 per year of service distribution to members of Plan 3. There is no gain-sharing benefit in the Plans 2; however, in periods of sustained investment return significantly above the assumed long-term rate (currently 8 percent) member contribution rates are likely to decrease.

Why Gain-sharing Increases Pension Contribution Rates.
In the 2003 Actuarial Valuation, the Actuary determined that the future cost of gain-sharing distributions results in an effective reduction in the long-term average rate of return that can be assumed from the pension funds. The long-term average is lowered through the gain-sharing mechanism because in some periods of very good investment return, some extraordinary gains are distributed as additional benefits.

The effective long-term rate of return is lowered sufficiently by gain-sharing to represent a material future cost to the retirement plans, as compared to the cost of the benefits apart from gain-sharing, and the Actuary determined that higher contribution rates are required to fund the future gain-sharing costs. As a part of the contribution rates the Actuary recommended to the Pension Funding Council (PFC), and the PFC has adopted for the 2007-09 fiscal biennium, are employer contribution rates sufficient to fund future gain-sharing costs in PERS, TRS, and SERS. The portion of the contribution rates adopted for gain-sharing are projected to generate about $147 million General Fund-State and $340 million in total employer costs during the 2007-09 biennium. Over the next 25 years, the standard period for reflecting the long-term cost of pension system changes, gain-sharing is projected to cost about $3.0 billion General Fund-State and $6.7 billion in total employer contribution rate costs.

Choice of Plan 2 or 3 for New Members.
Membership in Plan 2 or 3 is a choice for new retirement system-eligible employees in PERS, but new members of TRS and SERS may only join Plan 3. New PERS members have a 90-day period to choose membership in Plan 2, or by default become members of Plan 3.

Summary:

Gain-sharing is closed to members of PERS, TRS, and SERS Plans 3 who are hired after July 1, 2007. After the January 1, 2008, gain-sharing distribution, gain-sharing is eliminated for all members of the Plans 1 and Plans 3.

On July 1, 2009, the Annual Increase Amount (Uniform COLA) in PERS and TRS Plan 1 is increased by up to 20 cents. The increase is calculated by determining the difference between the actual January 1, 2008, gain-sharing amount and 40 cents; the Uniform COLA is increased by this difference (but may not be decreased by a negative number), up to 20 cents.

Early retirement benefits are improved for both members of the Plans 2 and 3 of PERS, SERS, and TRS. Members who have completed 30 or more years of service may early retire without reductions in benefits at age 62. (Between age 55 and 62, the reduction remains about 3 percent per year of early retirement so that the total reduction at age 55 is a reduction to 80 percent of a member's unreduced benefit.)

Any member who retires under the improved early retirement provisions of the act is thereafter ineligible to receive benefits while working in any compensated arrangement for a retirement system-participating employer.

Individuals who are employed in a position making them newly eligible for membership in TRS or SERS have a 90-day period to irrevocably choose membership in Plan 2 or Plan 3.

The subsidized early retirement (improved early retirement reduction factors), the increases to the Uniform COLA, and the choice of Plan 2 for new entrants to TRS and SERS are intended as a replacement for gain-sharing, and are not provided as a matter of contractual right to members until there is legal certainty with respect to the repeal of gain-sharing, including the expiration of any statutory limitations on actions and the end of the process of judicial review. Any legal action brought under the act must be commenced within three years after the effective date of the act.

Votes on Final Passage:

House	52	45
Senate	26	21

Effective: July 22, 2007
July 1, 2007 (Sections 1, 3 and 7)