Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Appropriations Committee

HB 1043

Brief Description: Adjusting public pension gain-sharing increase amounts.

Sponsors: Representative Sommers; by request of Office of Financial Management.

Brief Summary of Bill

- Conditions gain-sharing distributions in the Public Employees' Retirement System, the Teachers' Retirement System, and the School Employees' Retirement System Plans 1 and 3 after January 1, 2005, on authorization by the Legislature.
- Specifies that the cost of benefit increases from gain-sharing distributions is included in the next actuarial valuation after the effective date of the increase, and is not subject to the temporary supplemental contribution rate process.

Hearing Date: 2/17/05

Staff: David Pringle (786-7310).

Background:

Gain-sharing is a mechanism for increasing benefits created for the Teachers' Retirement System (TERS), the School Employees' Retirement System (SERS), and the Public Employees' Retirement System (PERS) Plans 1 and Plans 3 in 1998. 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 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. Currently the Annual Increase Amount is $1.21 per month per year of service for a retiree, or approximately $36 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 the Plans 3, extraordinary investment returns are calculated in generally the same manner. 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 they have in Plan 3. For example, in 2000, Plan 3 members received a gain-sharing distribution of $254.23 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.

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.

In the 2003 Actuarial Valuation, the Actuary determined that the future cost of gain-sharing distributions result 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 part of the contribution rates the Actuary recommended to the Pension Funding Council, and the Pension Funding Council adopted subject to approval by the Legislature, were additional employer contribution rate levels to fund future gain-sharing costs in PERS, TRS, and SERS.

Summary of Bill:

The gain-sharing mechanism does not result in benefit increases in PERS, TRS, or SERS Plans 1 and 3 after January 1, 2005, unless authorized by the Legislature. The cost of gain-sharing is only incorporated into the basic contribution rates for the retirement plans beginning with the next valuation after the effective date of the gain-sharing benefit increases. Gain-sharing is not included in the supplemental contribution rate process; rather it is included in the basic contribution rates adopted after the next actuarial valuation conducted after the effective date of the gain-sharing increase.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect July 1, 2005, except for sections 7 and 9 which take effect July 1, 2006. Sections 6 and 8 expire July 1, 2006.

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