Multiple Agency Fiscal Note Summary

Bill Number: 6795 SB	**Title:** Pension gain-sharing

Estimated Cash Receipts

Agency Name	2005-07		2007-09		2009-11	
	GF- State	Total	GF- State	Total	GF- State	Total
Department of Retirement Systems	0	1,300,000	0	0	0	0
Total $	0	1,300,000	0	0	0	0

Local Gov. Courts *						
Local Gov. Other **						
Local Gov. Total						

Estimated Expenditures

Agency Name	2005-07			2007-09			2009-11		
	FTEs	GF-State	Total	FTEs	GF-State	Total	FTEs	GF-State	Total
Office of the State Actuary	.0	0	0	.0	(111,600,000)	(134,300,000)	.0	(128,300,000)	(155,400,000)
Department of Retirement Systems	4.2	0	1,612,644	4.5	0	1,236,347	.0	0	0
Total	4.2	$0	$1,612,644	4.5	$(111,600,000)	$(133,063,653)	0.0	$(128,300,000)	$(155,400,000)

Local Gov. Courts *									
Local Gov. Other **									
Local Gov. Total									

Prepared by: Jane Sakson, OFM	**Phone:** 360-902-0549	**Date Published:** Final 2/10/2006

* See Office of the Administrator for the Courts judicial fiscal note

** See local government fiscal note

FNPID: 13828

Individual State Agency Fiscal Note

Bill Number: 6795 SB	Title: Pension gain-sharing	Agency: 035-Office of State Actuary

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

FUND					
Total $					

Estimated Expenditures from:

		FY 2006	FY 2007	2005-07	2007-09	2009-11
Fund						
All Other Funds-State	000-1	0	0	0	(22,700,000)	(27,100,000)
General Fund-State	001-1	0	0	0	(111,600,000)	(128,300,000)
Total $		0	0	0	(134,300,000)	(155,400,000)

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☐ Requires new rule making, complete Part V.

Legislative Contact:		Phone:	Date: 01/23/2006
Agency Preparation:	Robert Baker	Phone: 586-9237	Date: 02/09/2006
Agency Approval:	Matthew M. Smith	Phone: 360-753-9144	Date: 02/09/2006
OFM Review:	Jane Sakson	Phone: 360-902-0549	Date: 02/10/2006

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2006	FY 2007	2005-07	2007-09	2009-11
FTE Staff Years					
A-Salaries and Wages					
B-Employee Benefits					
C-Personal Service Contracts					
E-Goods and Services					
G-Travel					
J-Capital Outlays					
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements					
T-Intra-Agency Reimbursements					
Total:	$0	$0	$0	$0	$0

Part IV: Capital Budget Impact

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	2/8/06	SB 6795/HB 3183

SUMMARY OF BILL:

This bill impacts the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS) by repealing gain-sharing and annual contribution rate choice in TRS 3, and providing for the following alternative benefits:

- The "Annual Increase Amount" used in calculating members' Uniform COLA in PERS 1 and TRS 1 is increased by 24 cents. This would raise the July 1, 2007 amount from $1.33 to $1.57 per month for each year of service.

- Plan 2/3 choice is added for new hires in TRS and SERS (same structure for choice as in PERS).

- TRS 3 and SERS 3 members who have entered the system since their respective plans opened will have a window of opportunity to transfer prospectively to Plan 2.

- Current Plan 3 members who chose to enter Plan 3 either through transfer, or through choice upon employment with a PERS employer, will be provided a one-time opportunity to participate prospectively in a 2% defined benefit (DB) accrual in Plan 3 with a 1% defined contribution (DC) annuity offset.

Members who exercise the option to receive the 2% prospective benefit in Plan 3 with offset must direct minimum defined contribution amounts (5% in PERS and SERS, 6% in TRS) to the Washington State Investment Board investment program.

Eligibility for the 2% prospective benefit in Plan 3 with offset is further defined as 10 years of service after the option is exercised or 5 years of service if it includes 12 months after age 54.

Effective Date: July 1, 2007 (except for Section 7 which takes effect on July 1, 2008).

CURRENT SITUATION:

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

Plan 1 Gain-Sharing

When a gain-sharing event occurs, one-half of the gain for PERS 1 and TRS 1 is used to fund a permanent increase in the PERS 1 and TRS 1 Uniform COLA for current and future retirees. The monthly Uniform COLA is determined by multiplying each member's years of service by the "Annual Increase Amount". The most recent Annual Increase Amount was $1.25; an eligible member with 30 years of service received a monthly COLA of $37.50 (30 years of service times $1.25). The Annual Increase Amount increases each year by at least 3%. Gain-sharing is also used to boost the Annual Increase Amount; 38 cents of the current amount compounded at 3 percent is a result of past gain-sharing. The Annual Increase Amount is scheduled to increase to $1.29 on July 1, 2006, and to $1.33 on July 1, 2007.

Plan 3 Gain-Sharing

In the Plans 3, active, retired, and terminated vested members receive gain-sharing distributions as a lump sum dollar amount that is deposited directly into their defined contribution accounts based on years of service credit. A member will qualify for gain-sharing by having a balance of at least $1,000 in their account. There have been two gain-sharing distributions since the inception of gain-sharing: one in 1998 and one in 2000.

Plan Choice

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

Plan 3 Benefit

A retiring Plan 3 member currently receives a defined benefit (DB) that is equal to 1% of the member's average final compensation (AFC) per month per year of service. Members do not contribute to this 1% DB. Instead, they contribute to a defined contribution (DC) account, the contents of which they may withdraw as they see fit upon separation from employment.

Plan 3 Contribution Rates

Current law provides that members of the Plans 3 may change their contribution rate option by notifying their employer in writing during the month of January. In practice, this provision is only available to TRS 3 members, as the IRS did not allow for contribution rate flexibility in PERS and SERS when the plans were recently qualified.

MEMBERS IMPACTED:

Plan 1 Gain-sharing

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

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

For another example, on July 1, 2007, an eligible retiree with 30 years of service credit would receive an additional $7.20 per month for the first year. On July 1, 2008, the same retiree would receive an additional $14.62 per month for the second year. Only July 1, 2009, the same retiree would receive an additional $22.26 per month for the third year. On July 1, 2021, the same retiree would receive an additional $133.93 per month for the fifteenth year and so on. (The additional amounts are cumulative and the amount of the additional increase in each year is compared to an initial increase of $0).

Plan 3 Gain-sharing

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

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

Plan 2/3 Choice

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

Prospective Transfer from Plan 3 to Plan 2

Only members of TRS 3 and SERS 3 who were mandated into Plan 3 could be impacted by the provision that would allow a window of opportunity to prospectively earn service in Plan 2. These members are in Plan 3 solely because Plan 2 membership was closed when they entered service. There are currently 27,481 TRS 3 actives hired since TRS 3 opened and 14,123 SERS 3 active members hired after SERS 3 opened.

The following example for a Plan 2/3 prospective transfer assumes a Plan 3 member with an Average Final Compensation (AFC) of $5,000 per month and 10 years of service (YOS) before and 20 YOS after the effective date of the proposal (July 1, 2007):

Prospective Transfer from Plan 3 to Plan 2

	Plan 2	Plan 3*	Total
Monthly benefit at age 65	$2,000 = 2% of AFC × 20 YOS	$500 = 1% of AFC × 10 YOS	$2,500

**Example does not include benefit from Plan 3 defined contributions before transfer. AFC in Plan 2 used in Plan 3 benefit calculation (based on revised portability provision in proposal).*

Prospective 2% DB Accrual in Plan 3

The prospective 2% DB accrual with 1% DC offset in Plan 3 would impact all members eligible to participate, namely those who opted into Plan 3 either through transfer or through current PERS Plan 2/3 choice.

Plan 3 Active Membership through Choice

(As of September 30, 2004)	PERS 3	TRS 3	SERS 3
Transferred from Plan 2	12,203	21,821	15,307
Hired after Plan 3 inception date*	7,652	0	0

**This number also includes those who failed to make a choice, and so were placed in Plan 3 by default.*

The following two examples of the prospective 2% DB accrual assume a Plan 3 member with an AFC of $5,000 per month and 10 years of service before and 20 years of service after the effective date of the proposal (July 1, 2007).

Prospective 2% Benefit in Plan 3
Account Balance Less than Value of 1% Annuity

A.	Employer provided defined benefit (DB) - monthly	$1,500 = 1% of AFC × 30 YOS
B.	Plan 3 defined contribution (DC) account value at separation*	$129,600
C.	Value of Plan 3 DC account as an annuity	$900
D.	1% of AFC for service after election	$1,000 = 1% of AFC × 20 YOS
E.	Additional employer provided DB (excess of D over C)	$100 = $1,000 - $900
F.	Total benefit at age 65 (A + C + E)**	$2,500 = $1,500 + $900 + $100

**Account value based on minimum required contributions after election.*

***Annuity payout assumed, but not required under the proposal. Example does not include benefit from Plan 3 defined contributions before July 1, 2007.*

Account Balance Greater than Value of 1% Annuity

A.	Employer provided defined benefit (DB) - monthly	$1,500 = 1% of AFC × 30 YOS
B.	Plan 3 defined contribution (DC) account value at separation*	$158,400
C.	Value of Plan 3 DC account as an annuity	$1,100
D.	1% of AFC for service after election	$1,000 = 1% of AFC × 20 YOS
E.	Additional employer provided DB (excess of D over C)	$0
F.	Total benefit at age 65 (A + C + E)**	$2,600 = $1,500 + $1,100 + $0

**Account value based on minimum required contributions after election.*

***Annuity payout assumed, but not required under the proposal. Example does not include benefit from Plan 3 defined contributions before July 1, 2007.*

Plan 3 Contribution Rates

The removal of the Plan 3 provision that allows members to change their employee contribution rate by notifying their employer in writing during the month of January would affect 49,302 active TRS 3 members. This change would impact the defined contribution portion of the plan and would have no impact on benefits under the defined benefit plan.

ASSUMPTIONS:

We assumed that employer contribution rates would decrease after the proposed repeal of gain-sharing because the suspension of liability for future gain-sharing ends at the beginning of the 2007-09 biennium. The cost impact was developed using the same logic as used for the 2003 valuation (rates were determined assuming a delayed effective date from the valuation date to 2007).

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

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

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

Under the method for determining the fiscal impact of the prospective 2% defined benefit offset formula in Plan 3, a 2% defined benefit accrual was offset by the actuarial equivalent value of the defined contribution plan balance as an annuity, with a maximum of a 1% offset. Actuarial equivalence, for this purpose, was based on 8% interest and both pre- and post-retirement mortality.

For the effective date of the prospective 2% DB offset formula in Plan 3, we assumed that it would first apply ten years after the July 1, 2007 effective date, or five years for members age 55 and over. We assumed that all eligible Plan 3 members would elect to participate prospectively in these benefit provisions.

The defined contribution plan balance was projected based on the minimum required contribution rate (5% for PERS and SERS, and 6% for TRS), accumulated with earnings based on the Washington State Investment Board's (SIB) current asset mix. Rates of return were decreased from the SIB expected return based on the weighted average of the excess, if any, of the return for each percentile (using a total of ten percentiles), over the SIB's expected return for the given period. These rates were dependent on the investment horizon. The longer the investment horizon, the less likely that the compounded returns would be below the expected return, and the less of an interest rate reduction from the expected return. The following table shows the annual return that was assumed on the defined contribution account balance for each year.

Time Horizon	Annual Return
Years 1-5	5.77%
Years 6-10	7.05%
Years 11-20	7.33%
Beyond 20 years	7.55%

The projected account balances were converted to monthly annuities discounted for mortality and 8% interest. The following table provides sample factors that were used to convert the Plan 3 account balances at decrement to deferred monthly annuities payable at age 65 for ages under 65, and for immediate monthly annuities at age 65 and above.

	PERS 2/3	SERS 2/3	TRS 2/3
40	0.0436255	0.0428364	0.0427864
45	0.0314450	0.0307269	0.0306775
50	0.0222775	0.0216271	0.0215804
55	0.0156338	0.0150454	0.0150041
60	0.0104851	0.0099838	0.0099513
65	0.0072458	0.0068158	0.0067919
70	0.0084366	0.0078162	0.0077883

The excess, if any, of the benefit provided by a 1% accrual rate on service after the effective date, over the the projected Plan 3 account balance as an annuity, was determined to be the benefit increase provided at normal retirement age.

We assume that contribution rate changes for Plan 2 benefit changes under this bill are 100% employer paid and that there is no increase to the Plan 2 member rate for current members. As new entrants enter Plan 2, we assume that the 50%/50% employee/employer cost sharing policy will apply.

FISCAL IMPACT:

Description:

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

Actuarial Determinations:

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

(Dollars in Millions)		Current*	Increase	Total
Actuarial Present Value of Projected Benefits	PERS	$28,718	$(283)	$28,435
(The Value of the Total Commitment to all Current Members)	TRS	$16,407	$(418)	$15,989
	SERS	$2,296	$(80)	$2,216
Unfunded Actuarial Accrued Liability	PERS 1	$3,052	$(248)	$2,804
(The Portion of the Plan 1 Liability that is Amortized at 2024)	TRS 1	$1,816	$(195)	$1,621
Unfunded Liability (PBO)	PERS	$(162)	$(280)	$(442)
(The Value of the Total Commitment to all Current Members Attributable to Past Service)	TRS	$309	$(347)	$(38)
	SERS	$(360)	$(79)	$(439)

**Includes the cost of future gain-sharing benefits*

Increase in Contribution Rates: (Effective 7/01/07 unless indicated otherwise)	PERS	TRS	SERS
Current Members			
Employee			
Repeal Gain-Sharing (effective 7/1/07 for PERS, 9/1/07 for TRS and SERS)	0.00%	0.00%	0.00%
Plan Choice	0.00%	0.00%	0.00%
Prospective Plan 3 to Plan 2 Transfer	0.00%	0.00%	0.00%
Plan 3 2% DB Accrual	0.00%	0.00%	0.00%
Total Benefit Improvements	0.00%	0.00%	0.00%
Net Employee (Plan 2)	0.00%	0.00%	0.00%
Employer State			
Plan 1			
Repeal Gain-Sharing (effective 7/1/07 for PERS, 9/1/07 for TRS and SERS)	(0.46)%	(0.94)%	(0.46)%
$0.24 Uniform COLA Increase	0.23%	0.47%	0.23%
Net Plan 1 Employer State	(0.23)%	(0.47)%	(0.23)%
Plan 2/3			
Repeal Gain-Sharing (effective 7/1/07 for PERS, 9/1/07 for TRS and SERS)	(0.25)%	(1.24)%	(2.09)%
Plan Choice	0.00%	0.00%	0.00%
Prospective Plan 3 to Plan 2 Transfer	0.00%	0.15%	0.17%
Plan 3 2% DB Accrual	0.16%	0.33%	0.69%
Total Plan 2/3 Benefit Improvements	0.16%	0.48%	0.86%

Increase in Contribution Rates: (Effective 7/01/07 unless indicated otherwise)	PERS	TRS	SERS
Net Plan 2/3 Employer State	(0.09)%	(0.76)%	(1.23)%
Total Employer State	(0.32)%	(1.23)%	(1.46)%
New Entrants*			
Employee			
Repeal Gain-Sharing (effective 7/1/07 for PERS, 9/1/07 for TRS and SERS)	0.00%	0.00%	0.00%
Plan Choice	0.00%	0.13%	0.15%
Prospective Plan 3 to Plan 2 Transfer	0.00%	0.00%	0.00%
Plan 3 2% DB Accrual	0.00%	0.00%	0.00%
Total Plan 2/3 Benefit Improvements	0.00%	0.13%	0.15%
Net Employee (Plan 2)	0.00%	0.13%	0.15%
Continued			
Employer State			
Repeal Gain-Sharing (effective 7/1/07 for PERS, 9/1/07 for TRS and SERS)	(0.34)%	(1.05)%	(2.50)%
Plan Choice	0.00%	0.13%	0.15%
Prospective Plan 3 to Plan 2 Transfer	0.00%	0.00%	0.00%
Plan 3 2% DB Accrual	0.00%	0.00%	0.00%
Total Plan 2/3 Benefit Improvements	0.00%	0.13%	0.15%
Net Employer State	(0.34)%	(0.92)%	(2.35)%

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

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

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

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($24.4)	($127.5)	($34.0)	($185.9)
Non-General Fund	($42.6)	$0.0	$0.0	($42.6)
Total State	**($67.0)**	**($127.5)**	**($34.0)**	**($228.5)**
Local Government	($59.9)	($63.7)	($51.1)	($174.7)
Total Employer	($126.9)	($191.2)	($85.1)	($403.2)
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	($445.6)	($2,251.4)	($838.6)	($3,535.6)
Non-General Fund	($802.2)	$0.0	$0.0	($802.2)
Total State	**($1,247.8)**	**($2,251.4)**	**($838.6)**	**($4,337.8)**
Local Government	($1,120.4)	($1,124.5)	($1,258.3)	($3,503.2)
Total Employer	($2,368.2)	($3,375.9)	($2,096.9)	($7,841.0)
Total Employee	$0.0	$0.0	$0.0	$0.0

Fiscal Budget Determinations (benefit improvements - all plans):

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

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$11.4	$51.9	$11.0	$74.3
Non-General Fund	$19.9	$0.0	$0.0	$19.9
Total State	**$31.3**	**$51.9**	**$11.0**	**$94.2**
Local Government	$28.0	$25.9	$16.5	$70.4
Total Employer	$59.3	$77.8	$27.5	$164.6
Total Employee	$0.0	$1.4	$0.7	$2.1
2006-2031				
State:				
General Fund	$134.8	$691.9	$129.2	$955.9
Non-General Fund	$229.9	$0.0	$0.0	$229.9
Total State	**$364.7**	**$691.9**	**$129.2**	**$1,185.8**
Local Government	$325.4	$345.6	$193.7	$864.7
Total Employer	$690.1	$1,037.5	$322.9	$2,050.5
Total Employee	$0.0	$88.5	$47.6	$136.1

Fiscal Budget Determinations (all changes - all plans):

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

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	$0.0	$0.0	$0.0	$0.0
Local Government	$0.0	$0.0	$0.0	$0.0
Total Employer	$0.0	$0.0	$0.0	$0.0
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($13.0)	($75.6)	($23.0)	($111.6)
Non-General Fund	($22.7)	$0.0	$0.0	($22.7)
Total State	($35.7)	($75.6)	($23.0)	($134.3)
Local Government	($31.9)	($37.8)	($34.6)	($104.3)
Total Employer	($67.6)	($113.4)	($57.6)	($238.6)
Total Employee	$0.0	$1.4	$0.7	$2.1
2006-2031				
State:				
General Fund	($310.8)	($1,559.5)	($709.4)	($2,579.7)
Non-General Fund	($572.3)	$0.0	$0.0	($572.3)
Total State	($883.1)	($1,559.5)	($709.4)	($3,152.0)
Local Government	($795.0)	($778.9)	($1,064.6)	($2,638.5)
Total Employer	($1,678.1)	($2,338.4)	($1,774.0)	($5,790.5)
Total Employee	$0.0	$88.5	$47.6	$136.1

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

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

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

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

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

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

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

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. For the purposes of the fiscal note, any change to the Plan 1 UAAL or the Plan 1 amortization rate as the result of changes in benefit provisions of Plans 2/3 were not reflected in the fiscal impact. The cost of benefit increases to Plan 1 increases the UAAL.

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

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

GLOSSARY OF ACTUARIAL TERMS:

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

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

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

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

- Normal cost; plus
- Amortization of the unfunded liability

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

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

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

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

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

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

Individual State Agency Fiscal Note

Bill Number: 6795 SB	Title: Pension gain-sharing	Agency: 124-Department of Retirement Systems

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

FUND	FY 2006	FY 2007	2005-07	2007-09	2009-11
Department of Retirement Systems Expense Account-State 600-1		1,300,000	1,300,000		
Total $		1,300,000	1,300,000		

Estimated Expenditures from:

	FY 2006	FY 2007	2005-07	2007-09	2009-11
FTE Staff Years	0.3	8.1	4.2	4.5	0.0
Fund					
Department of Retirement Systems Expense Account-State 600-1	23,918	1,588,726	1,612,644	1,236,347	0
Total $	23,918	1,588,726	1,612,644	1,236,347	0

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☒ Requires new rule making, complete Part V.

Legislative Contact:		Phone:	Date: 01/23/2006
Agency Preparation:	Jeff Wickman	Phone: (360) 664-7303	Date: 01/30/2006
Agency Approval:	Sandra J. Matheson	Phone: (360) 664-7312	Date: 01/31/2006
OFM Review:	Doug Jenkins	Phone: 360-902-0563	Date: 01/31/2006

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

This bill prospectively repeals and replaces gain sharing benefits for Plan 1 and Plan 3 members/retirees of the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), and School Employees' Retirement System (SERS) with the following benefits:

· A permanent one-time $0.24 increase in the annual uniform cost of living adjustment (COLA) for PERS and TRS Plan 1 retirees. The amount will increase to $1.57 per month per year of service credit.
· Effective July 1, 2007 newly hired employees eligible for membership in SERS or TRS will have the option of choosing membership in either Plan 2 or Plan 3.
· Effective July 1, 2007 SERS and TRS Plan 3 members that were mandated into Plan 3 have a one-time choice to prospectively transfer to Plan 2. Members will have from July 1, 2007 through June 30, 2008 to make this prospective transfer.
· Effective July 1, 2007 any TRS, SERS or PERS Plan 3 members who exercised an irrevocable option to join Plan 3 will have a one-time irrevocable option to prospectively participate in a new monthly annuity offset calculation in Plan 3. Members opting into this program remain in Plan 3 and must contribute a minimum amount of contributions (5% for PERS and SERS, 6% for TRS) to the Washington State Investment Board (WSIB) Total Allocation Portfolio (TAP). Members who chose Plan 3 can exercise this option between July 1, 2007 and June 30, 2008. Members choosing the annuity offset program and contributing more than the minimum contribution required may choose to self-direct the portion above the minimum contribution amount.

The bill also makes the following changes to PERS, TRS and SERS:

· Removes the annual rate flexibility option for Plan 3 members effective July 1, 2008.
· Establishes that Plan 2 member contribution rates be equal to the combined Plan 2 and Plan 3 employer rate, and that Plan 2 rates will not increase as a result of this bill.

The bill establishes the following general provisions:

· If any portion of the bill is found to conflict with the favorable tax treatment of the plans, only that portion of the bill is deemed inoperable.
· The legislature reserves the right to amend or repeal the bill in order to comply with a final determination on favorable tax treatment by the Internal Revenue Service.
· The legislature reserves the right to alter or abolish benefits provided in this bill any time prior to July 1, 2007.
· Except for the removal of contribution rate flexibility, all other provisions are effective July 1, 2007.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

Due to the cost of this proposal, DRS may need to increase its administrative fee by 0.01% in Fiscal Year 2008.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

See attached.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2006	FY 2007	2005-07	2007-09	2009-11
FTE Staff Years	0.3	8.1	4.2	4.5	
A-Salaries and Wages	16.846	470,206	487,052	430,460	
B-Employee Benefits	3.882	117,794	121,676	117,422	
C-Personal Service Contracts					
E-Goods and Services	3.190	1,000,726	1,003,916	628,465	
G-Travel				60,000	
J-Capital Outlays					
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements					
T-Intra-Agency Reimbursements					
Total:	$23,918	$1,588,726	$1,612,644	$1,236,347	$0

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	**Salary**	FY 2006	FY 2007	2005-07	2007-09	2009-11
Benefit Marketing Representative	51,779		1.2	0.6	2.0	
Communication Consultant 4	54,375		2.0	1.0	0.1	
Information Technology Specialist 4	60,033		0.8	0.4	0.3	
Office Assistant 3	31,053		0.1	0.1	0.5	
Project Coordinator	63,033	0.1	1.0	0.6	0.3	
Project Manager	69,555	0.2	1.0	0.6	0.2	
Public Information Officer 4	53,094		1.0	0.5	0.1	
Retirement Services Analyst 2	41,404		0.2	0.1	1.0	
Retirement Services Analyst 3	44,659		0.8	0.4	0.2	
Total FTE's		0.3	8.1	4.2	4.5	0.0

Part IV: Capital Budget Impact

No impact.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

New rules will be required.

Administrative Assumptions

Plan 1 COLA increase

- PERS and TRS Plan 1 retirees eligible for the uniform COLA adjustment will receive an increase reflecting the permanent one-time increase effective with their July 2007 benefit payment.

Optional TRS and SERS Plan 3 Membership

- For reporting purposes, the Department of Retirement Systems (DRS) and the employer will consider the employee to be a Plan 2 member until the individual makes a choice or defaults to Plan 3 after 90 days.
- Substitute teachers and substitute classified school employees have the option of joining either TRS or SERS. Currently, if the member chooses to join, they must become a Plan 3 member. Because of this, DRS requires employers to report substitutes as "potential" Plan 3 members. After the effective date of the bill all substitute teachers and substitute classified school employees will have the option of joining either Plan 2 or Plan 3. This will require that substitutes be reported initially in Plan 2, not Plan 3.
- Substitutes previously reported in Plan 3 as "potential" members will be converted to Plan 2 as of the effective date of the bill.
- Employer payroll reporting systems will require modifications to support optional plans.

Annuity Offset

- The calculation of the annuity offset will apply to service credit earned after election to participate.
- Any member funds invested in WSIB at the time of election would not be affected by this choice. Members can continue to self-direct these funds with no impact to the annuity offset calculation.
- The annuity offset is the actuarial equivalent of the value of the TAP account from the date of election until the date of separation. If this value is less than the calculation of one percent of the members average final compensation on the service credit earned after election, then the difference, or annuity offset, will be added to the members guaranteed defined benefit payment. If the calculation of this value exceeds one percent then no annuity offset will be provided.
- Any member who chose to join Plan 3, whether vested or not, may choose to participate in the annuity offset program.
- Members who choose to participate in the annuity offset can restore contributions plus interest to their member account upon reentry to the plan.
- Members participating in the annuity offset must direct a minimum contribution to the SIB TAP and cannot move these contributions to another Plan 3 investment program.
- Members can withdraw, rollover or establish periodic payments for their TAP account without affecting the calculation of the annuity offset.
- To participate in the annuity offset program a member must earn 10 years of service credit after the date of electing to join the program or five service credit years including 12 service credit months after the age of 54. Members who elect to participate in the annuity offset that do not vest will not receive an additional benefit, if any, from this program.

Transfer Choice From Plan 3 to Plan2

- Members who were mandated into Plan 3 after July 1, 1996 for TRS and September 1, 2000 for SERS are eligible for this transfer choice.
- A member must be active in Plan 3 between July 1, 2007 and June 30, 2008 to prospectively transfer to Plan 2.
- Substitute employees entering membership after July 1, 2007 would have the choice to enter Plan 2.
- Mandated members who choose to go to Plan 2, would not have the annual choice to transfer to Plan 3.
- Dual Plan members will be treated as much like current dual system members as possible.
- Retirement benefits payments would be treated like portable systems are treated – including a payment from each plan. The Plan 3 benefit would be calculated using the 1% formula; the Plan 2 benefit would be calculated using the 2% formula.
- Retirees of both plans would receive one 1099 form that includes information from both plans.
- Dual plan members would receive an annual statement for each plan.
- If a member opts to go to Plan 2, the member would not be able to withdraw the Plan 3 defined contributions until separated from all system employment
- A “Welcome to Plan 2” letter would be generated for the member.
- The transfer would be effective on the date of election, including mid-month dates.

The assumptions above were used in developing the following workload impacts and cost estimates.

Benefits/Customer Service

There are over 106,000 Plan 3 members who will have new opportunities created by this proposal. Additional staff will be needed to respond to member questions. Benefits Unit staff will also support the modification of DRS' automated systems, the creation of member communications, and the modification of policies, procedures and rules to support this legislation. The tasks associated with implementing this bill are:

- Respond to member questions, written and telephone
- Define business requirements for the automated systems
- Develop new rules and operating policies
- Conduct user acceptance testing
- Conduct staff training
- Review communication materials
- Update the Retirement Services Division Online Operations Manual

Retirement Services Analyst 3 – 13 months (salaries/benefits)	$62,240
Retirement Services Analyst 2 (two) – 13 months (salaries/benefits)	$115,856
Office Assistant 3 – 13 months (salaries/benefits)	$45,726
Computer workstation (three)	$4,785
Total Estimated Benefits/Customer Service Costs	$228,607
Total Estimated Benefits/Customer Service Costs (05-07 Biennium)	**$65,146**
Total Estimated Benefits/Customer Service Costs (07-00 Biennium)	**$163,461**

Member Communications

To ensure the successful implementation of this bill, a comprehensive member communication, education program will be required. Education and communication materials will need to be updated and/or created to meet the different member groups' needs. The communication tasks associated with implementing this bill include:

- Inform members of the options available to them via individual letters.
- Provide annuity offset member seminars and workshops for all affected Plan 3 members.
- Update, print and distribute member handbooks for Plans 2 and 3 of SERS, PERS and TRS
- Create SERS and TRS Plan Choice Booklets
- Create Plan 3 Annuity Offset Option Booklets
- Create *Retirement Outlook* articles to notify members of the changes to the retirement rules and gain sharing
- Create Frequently Asked Questions for the DRS Internet and a *Facts at a Glance* for DRS staff
- Update regular DRS retirement seminars and pension workshop materials to provide the new information

Printing and distribution costs	$506,500
Public Information Officer 4 – 13 months (salaries/benefits)	$84,616
Communications Consultant 4 (two) – 13 months (salaries/benefits)	$148,068
Benefit Marketing Representative (four) – 16 months (salaries/benefits)	$348,956
Laptop/monitor/docking station (two)	$5,080
Travel Expenses	$60,000
Vehicle Expenses	$49,000
Total Estimated Member/Retiree Communications Costs	$1,202,220
Total Estimated Member Communications Costs (05-07 Biennium)	**$475,939**
Total Estimated Member Communications Costs (07-09 Biennium)	**$726,281**

Automated Systems

With the implementation of the TRS, SERS and PERS Plan 3, DRS modified its automated systems to allow members to transfer service credit and contributions from Plan 2 to Plan 3. These systems will again be modified to allow members to return to Plan 2 but only on a prospective basis. All service and contributions will remain in Plan 3. Members electing to opt into the new programs will be tracked to ensure the election is irrevocable. In addition new benefit rules will be added to calculate the annuity offset. The specific changes to DRS' automated systems will be:

- Configure the SERS and TRS benefit plans to support a membership choice of Plan 2 or 3 for new members.
- Modify Member Information System (MIS), Web Based Employer Transmittal (WBET) and the Employer Information System (EIS) to support the new choices and benefit options.
- Convert potential member substitutes previously reported in Plan 3 to Plan 2.
- Store and display the new choices, values and amounts within the automated systems.
- Calculate the new offset adjustments for retirements and re-retirements.
- Segregate member contributions to the new offset investment manager for members choosing the new offset option.
- Modify system interfaces to send offset choice information to and from the record keeper.
- Modify Member Information System to all members to be dual plan members.

Information Technology Specialist 4 – 16 months (salaries/benefits)	$112,016
Programmer time of 6,304 hours @ $95 per hour	$598,880
DIS cost* of $500 per week for 105 weeks	$52,500
External Quality Assurance	$50,000
Total Estimated Automated Systems Costs	$813,396
Total Estimated Automated System Costs (05-07 Biennium)	**$534,258**
Total Estimated Automated System Costs (07-09 Biennium)	**$279,138**

**cost for mainframe computer processing time and resources at the Department of Information Services*

Internal Operations

The changes to PERS, SERS and TRS membership options will impact procedures throughout DRS' operations and infrastructure. These operational requirements will increase administrative complexity and will require project management and coordination to implement this bill.

Project Manager – 18 months (salaries/benefits)	$128,018
Project Coordinator - 19 months (salaries/benefits)	$123,560
Computer workstation (two)	$3,190
Total Estimated Internal Operations Costs	$254,768
Total Estimated Internal Operations Costs (05-07 Biennium)	**$187,301**
Total Estimated Internal Operations Costs (07-09 Biennium)	**$67,467**

Tax Treatment

DRS will work with the Attorney General's Office (AGO) to identify areas within the proposal that require review and confirmation in order to retain a favorable tax treatment under federal requirements. Identified areas will be addressed through a request for private letter ruling submitted to the Internal Revenue Service (IRS). External tax counsel familiar with IRS private letter ruling process will assist will the development of questions and support DRS and the AGO for this effort.

One-time cost for tax counsel	$50,000
Total Estimated Tax Treatment Costs (05-07 Biennium)	**$50,000**

Record Keeping

DRS contracts with an external third party company to provide record keeping services for member defined contributions accounts in SERS, TRS and PERS Plan 3. The new annuity offset program will require the creation of new prospective accounts for each member who elects this program. Changes will be required to modify the existing systems that support the Plan 3 defined contribution accounts. In addition, the costs of record keeping services negotiated by DRS are based in part on the amount of assets in Plan 3. The number of participants drives assets in large part. Since new members eligible for SERS and TRS are currently required to join Plan 3, the growth in assets can be projected based on prior history. This bill gives eligible new employees a choice of entering either Plan 2 or Plan 3. The bill also allows 46 percent of the current Plan 3 members to transfer back to Plan 2. It is unknown at this time how many members will exercise this option to return to Plan 2. Although not quantifiable at this time, beyond the estimated cost impact of specific modifications that are reflected below, fluctuations in the growth of Plan 3 membership could impact DRS' contract with the third party record keeper. **Fees may need to be renegotiated if there is a material change in Plan 3 enrollment.**

Record keeper modifications	$300,000
Total Estimated Record Keeping Costs (05-07 Biennium)	**$300,000**
Total Estimated Record Keeping Costs (07-09 Biennium)	**$0**

ESTIMATED TOTAL COST TO IMPLEMENT THIS BILL:

	2005-07	**2007-09**	**2009-11**
BENEFITS/CUSTOMER SERVICE	**$65,146**	**$163,461**	**$0**
MEMBER COMMUNICATIONS	**$475,939**	**$726,281**	**$0**
AUTOMATED SYSTEMS	**$534,258**	**$279,138**	**$0**
INTERNAL OPERATIONS	**$187,301**	**$67,467**	**$0**
TAX TREATMENT	**$50,000**	**$0**	**$0**
RECORD KEEPING	**$300,000**	**$0**	**$0**
ESTIMATED TOTAL COSTS	**$1,612,644**	**$1,236,347**	**$0**