

FINAL BILL REPORT

HB 2535

C 172 L 04

Synopsis as Enacted

Brief Description: Permitting members of the public employees' retirement system plan 2 and plan 3 and the school employees' retirement system plan 2 and plan 3 who qualify for early retirement or alternate early retirement to make a one-time purchase of additional service credit.

Sponsors: By Representatives Alexander, Fromhold, Conway, Rockefeller, G. Simpson, Kessler, Moeller, Chase, Bush and Armstrong; by request of Select Committee on Pension Policy.

House Committee on Appropriations
Senate Committee on Ways & Means

Background:

A vested member of the Public Employees' Retirement System (PERS) or the School Employees' Retirement System (SERS) Plans 2 or 3 may retire with an unreduced defined benefit at age 65. At retirement in Plan 2 a member receives 2 percent of the member's final average salary for each year of credited service. In Plan 3, a member receives 1 percent of the member's final average salary for each year of credited service and may withdraw his or her accumulated member contributions and earnings.

A member of the PERS or the SERS Plan 2 may apply for early retirement after 20 years of credited service beginning at age 55. A member of the PERS or the SERS Plan 3 may apply for early retirement after 10 years of credited service beginning at age 55. If a member in Plan 2 or Plan 3 applies for early retirement with less than 30 years of service, his or her benefit is actuarially reduced for the member's age difference at retirement and age 65. This actuarial reduction typically averages about 8 percent per year. A member who applies for early retirement with 30 or more years of service has his or her benefit reduced instead by 3 percent per year.

Members of the PERS and the SERS generally have the opportunity to participate in deferred compensation plans. These plans permit an individual to place a portion of salary into a special account prior to being subject to payroll tax reductions. The Department of Retirement Systems (DRS) operates a deferred compensation program consistent with the federal tax requirements of 26 United States Code section 457, commonly called a "457

Plan", in which employees of the state, counties, municipalities and other political subdivisions may participate. Some school districts and local governments may also participate in other deferred compensation-type plans commonly referred to as "403(b)" or "401(k)" plans. Individuals may also be able to deposit funds into accounts with preferential tax treatment such as Individual Retirement Accounts (IRAs).

In recent years, changes in federal law have liberalized the rules on the transfer of funds between tax-deferred accounts, including government defined benefit pension plans like the PERS and the SERS, and deferred compensation accounts such as 457, 403(b), and 401(k) plans. Many state and local government pension plans have subsequently provided the opportunity for members to transfer funds, including funds from tax-deferred accounts, into these plans to add up to five years of service credit to a member's defined benefit.

Summary:

A member who applies for early retirement in the PERS or the SERS Plan 2 or 3 may, at the time of retirement, file an application with the DRS to purchase up to five years of additional service credit. The cost of the additional service credit is the actuarial equivalent value of the resulting increase in the member's benefit.

The member may pay all or part of the cost of the additional service credit with an eligible transfer from a qualified retirement plan. The DRS must adopt rules to ensure that all purchases and transfers comply with the requirements of the federal Internal Revenue Code and regulations.

Additional purchased service credit is not regular membership service credit and may not be used to qualify a member for the 3 percent per year early retirement reduction available to members of the PERS and the SERS Plans 2 or 3 with 30 years of service.

Votes on Final Passage:

House 94-0
Senate 47-0

Effective: July 1, 2006

RCW 41.32.067

Purchase of additional benefits -- Conditions.

A member may purchase additional benefits subject to the following:

- (1) The member shall pay all reasonable administrative and clerical costs; and
- (2) The member shall make a member reserve contribution to be actuarially converted to a monthly benefit at the time of retirement.

Multiple Agency Fiscal Note Summary

Bill Number: 2535 HB	Title: Service credit purchase
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Estimated Cash Receipts

Agency Name	2003-05		2005-07		2007-09	
	GF- State	Total	GF- State	Total	GF- State	Total
Total \$						

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

Estimated Expenditures

Agency Name	2003-05			2005-07			2007-09		
	FTEs	GF-State	Total	FTEs	GF-State	Total	FTEs	GF-State	Total
Office of the State Actuary	.0	0	0	.0	0	0	.0	0	0
Department of Retirement Systems	.0	0	0	.7	0	211,944	.0	0	0
Total	0.0	\$0	\$0	0.7	\$0	\$211,944	0.0	\$0	\$0

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

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Prepared by: Jane Sakson, OFM	Phone: 360-902-0549	Date Published: Final 1/19/2004
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* See Office of the Administrator for the Courts judicial fiscal note

** See local government fiscal note

Individual State Agency Fiscal Note

Bill Number: 2535 HB	Title: Service credit purchase	Agency: 035-Office of State Actuary
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Part I: Estimates

No Fiscal Impact

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: David Pringle	Phone: 360-786-7310	Date: 01/15/2004
Agency Preparation: Laura Harper	Phone: 360 586-7616	Date: 01/16/2004
Agency Approval: Matthew M. Smith	Phone: 360-753-9144	Date: 01/16/2004
OFM Review: Jane Sakson	Phone: 360-902-0549	Date: 01/19/2004

FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:

CODE: DATE:

BILL NUMBER:

Office of the State Actuary

035 1/15/04

HB 2535/SB 6251

SUMMARY OF BILL:

This bill impacts the Public Employees' Retirement System (PERS) and School Employees' Retirement System (SERS) Plans 2 and 3 by allowing eligible members, at the time of retirement, to purchase up to five years of additional service credit.

Eligible members would include only members who are eligible for early retirement under the provisions of the system. Additional service credit purchased under this bill does not constitute membership service and, therefore, could not be used to qualify for retirement.

A member purchasing additional service credit under this bill would pay the full actuarial cost of the service credit with a lump sum payment, eligible rollover, direct rollover, and/or trustee-to-trustee transfer from an eligible retirement plan (at the time of retirement).

Effective Date: 7/1/2006

CURRENT SITUATION:

This option is not currently available through the Department of Retirement Systems. Current members, however, could purchase an equivalent annuity through a private sector annuity provider. The cost of an annuity will vary from provider to provider and will vary based on the particular annuity product offered.

MEMBERS IMPACTED:

Any future retiree from PERS or SERS plans 2 and 3 could potentially be impacted by this bill. As of our latest actuarial valuation, there were 132,448 active members in PERS plans 2 and plan 3 and 49,791 active members in SERS plans 2 and plan 3.

FISCAL IMPACT:

None.

We have assumed that this benefit proposal will not change future retirement behavior in the affected retirement systems since existing members currently have access to private-sector annuity providers that currently provide similar annuity products. We have also assumed that the full actuarial cost will include the cost of any adverse selection that may develop due to mortality experience and/or interest rate timing by the member.

Individual State Agency Fiscal Note

Bill Number: 2535 HB	Title: Service credit purchase	Agency: 124-Department of Retirement Systems
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Part I: Estimates

No Fiscal Impact

Estimated Cash Receipts to:

FUND					
Total \$					

Estimated Expenditures from:

	FY 2004	FY 2005	2003-05	2005-07	2007-09
FTE Staff Years	0.0	0.0	0.0	0.7	0.0
Fund					
Department of Retirement Systems	0	0	0	211,944	0
Expense Account-State 600-1					
Total \$	0	0	0	211,944	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: David Pringle	Phone: 360-786-7310	Date: 01/15/2004
Agency Preparation: Jeff Wickman	Phone: (360) 664-7303	Date: 01/16/2004
Agency Approval: John Charles	Phone:	Date: 01/16/2004
OFM Review: Doug Jenkins	Phone: 360-902-0563	Date: 01/17/2004

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.

Currently members of Public Employees' Retirement System (PERS) and School Employees' Retirement System (SERS) Plans 2 can qualify for retirement prior to age 65 under the following provisions:

- Early Retirement with at least 20 years of service credit and attaining at least age 55 or
- Alternate Early Retirement with at least 30 years of service credit and attaining at least age 55.

PERS and SERS Plan 3 members can qualify for retirement prior to age 65 under the following provisions:

- Early Retirement with at least 10 years of service credit and attaining at least age 55 or
- Alternate Early Retirement with at least 30 years of service credit and attaining at least age 55.

In both situations the benefits are subject to reductions. If the member has less than 30 years of service, the full actuarial reduction applies. If the member has 30 or more years of service, the reduction is three percent per year.

This bill provides members of PERS and SERS Plans 2 and 3 who qualify, based on earned service credit and the member's age, for Early Retirement or Alternate Early Retirement to make a one-time purchase of up to five years of additional unearned service credit at the time of filing a written application for retirement. The additional service credit must be purchased by paying an actuarial equivalent value of the resulting increase in the member's benefit, with a lump sum payment, eligible rollover, direct rollover, or trustee-to-trustee transfer from a eligible retirement plan. Service credit purchased on this bill would be used only to increase the member's retirement allowance, not to qualify the member for retirement.

This bill has an effective date of July 1, 2006.

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.

No impact.

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 2004	FY 2005	2003-05	2005-07	2007-09
FTE Staff Years		0.00		0.7	
A-Salaries and Wages				76,939	
B-Employee Benefits				17,695	
C-Personal Service Contracts					
E-Goods and Services				117,310	
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	\$211,944	\$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 2004	FY 2005	2003-05	2005-07	2007-09
Info Tech Applic Spec 4	57,252				0.3	
Project Manager	70,500				0.2	
Public Info Officer 2	45,816				0.2	
Total FTE's					0.7	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.

II. C - Expenditures

Administrative Assumptions

- This bill affects PERS Plan 2, PERS Plan 3, SERS Plan 2 and SERS Plan 3 members eligible to retire with reduced benefits prior to age 65.
- Members who qualify, may purchase up to five years service credit, in whole month increments.
- DRS will calculate the cost of unearned service credit using actuarial tables provided by the Office of the State Actuary (OSA).
- Payments for Plan 2 unearned service credit will be put into the member's account and will be refundable upon termination or death of the member; payments for Plan 3 unearned service credit will be put into the appropriate defined benefit trust fund and will not be refundable upon the termination or death of the member.
- The increased benefit due to the purchase of unearned service credit will be included in cost of living adjustment (COLA) calculations.
- When determining Plan 3 gain sharing payments if any, purchased unearned service credit will not be included in the calculations.
- The unearned service credit will be tracked separately from the member's earned service credit and will not be used for retirement eligibility(including portability situations).
- If a retiree who has purchased unearned service credit returns to work as a retiree and exceeds the 867-hour per year limit, his/her entire pension payment will be stopped following established return to work rules.
- DRS will develop a new process to estimate the cost of the unearned service credit based on an estimated retirement date and an estimated average final compensation (AFC) amount.
- DRS will develop a new billing process for buying unearned service credit at the time of retirement.
- The Online Retirement Benefit Estimator (ORBE) would be updated to allow members to estimate the cost of purchasing unearned service credit and the resulting increase in benefit.
- DRS will report to the Office of the State Actuary (OSA) the benefit increases due to the purchase of unearned service credit.

Member Communications

Member handbooks and publications will need to be updated to educate members about the new unearned service credit purchase option. The updated publications will be placed on the DRS Web site. Members will be notified of changes via the *Retirement Outlook*.

Tasks required to implement this bill include:

- Notify members and employers of the changes via standard agency communications
- Update the Web sites
- Update the member handbooks for PERS Plan 2, PERS Plan 3, SERS Plan 2 and SERS Plan 3
- Update the PERS and SERS Plan 2 and 3 Recovery of Withdrawn or Optional Service Credit brochure
- Create a new form and cover letter, explaining the purchase process

Public Information Officer 2 – 4 months (1/06-04/06, salaries/benefits)	\$18,782
Printing	<u>\$1,400</u>
Total Estimated Member Communications Costs	\$20,182

Automated Systems

Implementation of this bill requires modification of DRS' integrated information systems. An Information Technology Application Specialist (ITAS) will work with the program developers to identify system-related business requirements and participate in user acceptance testing of the required system changes. (Changes will be required in the Member Information, Benefits and Cash Management Systems.) Other tasks for the ITAS include:

- Conduct staff training
- Update the Retirement Services Division (RSD) Online Operations Manual
- Assist with the update of member handbooks and development of agency WACs

DRS systems currently manage all service credit as earned credit through employment. In order to implement this change, DRS' integrated information systems will need to be modified to track purchased unearned service credit separately from earned service credit. Current processes, including retirement estimates and benefit calculation, will need to be modified to use only earned service for retirement qualification but include unearned service credit when calculating the benefit amount.

Modifications to the Member Information System:

- Add an indicator to identify unearned service credit
- Create a new type of optional bill to calculate and process the purchase of unearned service credit
- Ensure that current processes that calculate and display earned service credit ignore unearned service credit

Modifications to the Benefits Systems:

- Change benefit computation to create a benefit adjustment due to the purchase of service credit
- Modify retirement letters to show the benefit increase due to the purchase of service credit

Modifications to the Cash Management System:

- Modify the systems to trigger a retirement recalculation when unearned service credit bills are paid in full

Modify Online Retirement Benefits Estimator (ORBE):

- Create a benefit estimate to purchase additional service for PERS and SERS Plan 2 and Plan 3

Information Technology Application Specialist 4 – 8 months (11/05 – 06/06, salaries/benefits)	\$46,947
Programming, testing and verification 1,078 hours @ \$95 per hour	\$102,410
DIS cost* of \$500 per week per programmer (for 27 weeks)	\$13,500
Total Estimated Automated Systems Costs	\$162,857

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

Project Management

Introducing a new program to purchase additional service credit at the time of retirement permanently impacts all aspects of the department's operations. New processes, materials and services will be incorporated into DRS' existing infrastructure. These new operational requirements increase the administrative complexity, and thereby require staff to develop and implement the new services and features. Project management/coordination will be required to implement this bill.

Project Manager – WMS 2 – half-time for 8 months (11/05 – 06/06, salaries/benefits)	\$28,905
Total Estimated Project Management Costs	\$28,905

ESTIMATED TOTAL COST TO IMPLEMENT THIS BILL:

	<u>2003-05</u>	<u>2005-07</u>	<u>2007-09</u>
Member Communications	\$0	\$20,182	\$0
Automated Systems	\$0	\$162,857	\$0
Project Management	\$0	\$28,905	\$0
ESTIMATED TOTAL COST	\$0	\$211,944	\$0

HOUSE BILL REPORT

HB 2536

As Passed House:
February 11, 2004

Title: An act relating to permitting members of the public employees' retirement system plan 2 and plan 3 and the school employees' retirement system plan 2 and plan 3 to buy down the early retirement reduction amounts.

Brief Description: Permitting members of the public employees' retirement system plan 2 and plan 3 and the school employees' retirement system plan 2 and plan 3 to buy down the early retirement reduction amounts.

Sponsors: By Representatives Alexander, Fromhold, Conway, Rockefeller, G. Simpson, Moeller, Chase, Bush and Armstrong; by request of Select Committee on Pension Policy.

Brief History:

Committee Activity:

Appropriations: 1/22/04, 1/26/04 [DP].

Floor Activity:

Passed House: 2/11/04, 94-0.

Brief Summary of Bill

- Permits members of the Public Employees' Retirement System and the School Employees' Retirement System Plans 2 and 3 to "buy-down" reductions that are made to pension benefits when a member retires before age 65.
- The early retirement reduction buy-down may be purchased at time of retirement at full actuarial cost.
- A member purchasing service may pay all or part of the cost with a transfer from an eligible retirement account.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: Do pass. Signed by 27 members: Representatives Sommers, Chair; Fromhold, Vice Chair; Sehlin, Ranking Minority Member; Pearson, Assistant Ranking Minority Member; Alexander, Anderson, Boldt, Buck, Chandler, Clements, Cody, Conway,

Cox, Dunshee, Grant, Hunter, Kagi, Kenney, Kessler, Linville, McDonald, McIntire, Miloscia, Ruderman, Schual-Berke, Sump and Talcott.

Staff: David Pringle (786-7310).

Background:

A vested member of the Public Employees' Retirement System (PERS) and School Employees' Retirement System (SERS) Plans 2 and 3 may retire with an unreduced defined benefit at age 65. At retirement in Plan 2, a member receives 2 percent of the member's final average salary for each year of credited service. In Plan 3, a member receives 1 percent of the member's final average salary for each year of credited service, and may withdraw his or her accumulated member contributions and earnings.

Beginning at age 55, a member of PERS or SERS Plan 2 may apply for early retirement after 20 years of credited service. Beginning at age 55, a member of PERS or SERS Plan 3 may apply for early retirement after 10 years of credited service. If a member in Plan 2 or 3 applies for early retirement with less than 30 years of service, his or her benefit is actuarially reduced for the member's age difference at retirement and age 65. This actuarial reduction typically averages about 8 percent per year. A member who applies for early retirement with 30 or more years of service has his or her benefit reduced instead by 3 percent per year.

Members of PERS and SERS generally have the opportunity to participate in deferred compensation plans. These plans permit an individual to place a portion of salary into a special account prior to being subject to payroll tax reductions. The Department of Retirement Systems (DRS) operates a deferred compensation program consistent with the federal tax requirements of 26 United States Code section 457, commonly called a "457 Plan", in which employees of the state, counties, municipalities and other political subdivisions may participate. Some school districts and local governments may also participate in other deferred compensation-type plans commonly referred to as "403(b)" or "401(k)" plans. Individuals may also be able to deposit funds into accounts with preferential tax treatment such as Individual Retirement Accounts (IRAs).

In recent years, changes in federal law have liberalized the rules on the transfer of funds between tax-deferred accounts, including government defined benefit pension plans like PERS and SERS, and deferred compensation accounts such as 457, 403(b), and 401(k) plans. Many state and local government pension plans have subsequently provided the opportunity for members to transfer funds, including funds from tax-deferred accounts, into these plans to add up to five years of service credit to a member's defined benefit.

Summary of Bill:

A member who applies for early retirement from PERS or SERS Plans 2 or 3 may, at the time of retirement, file an application with the DRS to "buy-down" or purchase an offset to all or part of the reduction that will be made to his or her pension. The cost of the buy-down is the actuarial equivalent value of the resulting increase in the member's benefit.

The member may pay all or part of the cost of the buy-down with an eligible transfer from a qualified retirement plan. The DRS shall adopt rules to ensure that all fund transfers for purposes of the buy-down comply with the requirements of the federal Internal Revenue Code and regulations.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect July 1, 2006.

Testimony For: None.

Testimony Against: None.

Persons Testifying: None.

Persons Signed In To Testify But Not Testifying: None.

RCW 41.50.088

Employee retirement benefits board -- Duties.

(1) The board shall adopt rules as necessary and exercise the following powers and duties:

(a) The board shall recommend to the state investment board types of options for member self-directed investment in the teachers' retirement system plan 3, the school employees' retirement system plan 3, and the public employees' retirement system plan 3 as deemed by the board to be reflective of the members' preferences;

(b) By July 1, 2005, the board shall make optional actuarially equivalent life annuity benefit payment schedules available to members and survivors that may be purchased from the combined plan 2 and plan 3 funds under RCW 41.50.075; and

(c) Determination of the basis for administrative charges to the self-directed investment fund to offset self-directed account expenses;

(2) The board shall recommend to the state investment board types of options for participant self-directed investment in the state deferred compensation plan, as deemed by the board to be reflective of the participants' preferences.