

## **SENATE COMMITTEE ON JUDICIARY**

**March 23, 1999 Hearing Room C**

**3:00 p.m. Tapes 88- 91**

**MEMBERS PRESENT: Sen. Bryant, Chair**

**Sen. Courtney, Vice-Chair**

**Sen. Brown**

**Sen. Burdick**

**Sen. Nelson**

**Sen. Qutub**

**Sen. Tarno**

**GUEST MEMBERS: Sen. Duncan**

**Sen. Lim**

**Sen. Trow**

**Sen. Shannon**

**STAFF PRESENT: Anne Tweedt, Counsel**

**Judith Minnich, Administrative Support**

**MEASURE/ISSUES HEARD: Informational Meeting**

**Overview of Public Employees Retirement System and Benefit  
Structure**

These minutes are in compliance with Senate and House Rules. Only text enclosed in quotation marks reports a speaker's exact words. For complete contents, please refer to the tapes.

TAPE/#	Speaker	Comments
Tape 88, A		

004	Chair Bryant	Calls the meeting to order at 3:14 p.m.
<b><u>INFORMATIONAL HEARING</u></b>		
035	<b>Jon Yunker</b>	<p><b>Director, Department of Administrative Services</b></p> <p>Indicates that he will be giving an overview of the PERS issues. The PERS system is very complicated and others will discuss the details. Historically, PERS has been a very good system. The difficulty now is that the employer contribution for the money match option has gone up dramatically. There is a significant unfunded liability for a few local governments. Short-term help for these local governments is needed and a long term solution for the unfunded liability is needed. There is a system problem with the money match option for retirees. Employers must be able to invest in the same way employees can, or a cap on the percentage which must be contributed by the employer needs to be in place. There are several proposals to address these problems.</p>
184	Chair Bryant	When HB 3349 passed, we hoped that it would survive a court challenge. It did not. Once we have made up the difference to federal employees, then both State and Federal retirees can be taxed. Is that correct?
188	Yunker	That is my understanding. The long term fix is to tax both federal and state retirement income, but for tax monies received before 1991, we must refund taxes paid or increase benefits. In 1995 we created a second tier of benefits which allows us to tax the state benefits.
227	Chair Bryant	Should we have seen this coming?
230	Yunker	Yes. When the stock market goes up, you expect it to be good news for everyone, but it didn't help employers when they had to match high earnings without the ability to invest in instruments which had high rates of return.
244	<b>Robert Muir</b>	<p><b>Assistant Attorney General, Department of Justice (DOJ)</b></p> <p>Submits written testimony and testifies on the PERS system (<b>EXHIBIT A</b>). Indicates that the DOJ has no official position on any of the bills that have been introduced. Indicates there are several things which must be considered.</p> <ul style="list-style-type: none"> <li>• You cannot violate existing contract rights for existing employees.</li> <li>• You cannot threaten the tax exemption for PERS under IRS 401(a). It must remain a tax exempt trust with the exclusive beneficiaries being employees.</li> </ul> <p>Discusses the contradictory Supreme Court findings in recent cases. Discusses benefit level calculations: money match and full formula. Money match requires that the employer match the funds in the employee's account. Full formula is a percentage of average highest three years of the employee's earnings. The employee gets the method which gives the highest return.</p>
<b>Tape 89, A</b>		

044	Muir	Discusses funding of the employee's account. Discusses the variable account that is available to the employee. Discusses the administrative options open to the PERS Board.
053	Chair Bryant	If we fix the money match by indicating that there is a cap, are we limited to creating a third tier?
058	Muir	Yes. Discusses case law relating to assumed rate of return.
070	Chair Bryant	Discusses PERS bills that have been introduced which create a defined benefit plan. This would have to be a third tier for new employees.
080	Sen. Trow	Is it possible to let local government participate in better returns?
084	Muir	Yes, we could enlarge the variable account to include the employer accounts. There are several different ways to do this.
097	Sen. Trow	Are there any legal impediments to allowing employers to invest in the variable account?
101	Muir	We need to make sure that discrimination does not occur between beneficiaries of the trust.
112	Sen. Trow	Can we use the reserve funds to help the local jurisdictions out this year?
114	Muir	Indicates that the PERS Board has been discussing these issues. Discusses the limitations on the Board's decision making ability.
132	<b>Fred McDonnal</b>	<p><b>Executive Director, Public Employees Retirement System (PERS)</b></p> <p>Submits written testimony and testifies on the PERS system (<b>EXHIBIT A</b>). Discusses the funding level of the current PERS system and the amount spent each month on benefits. Discusses the responsibilities of the Legislative and Executive branch in the operation of the PERS system. Discusses the impact that court decisions, federal statutes and regulations have made on the system. Discusses investment options available to employees and employers. Reviews history of the employer's contribution rate in relationship to the funds needed for HB 3349. All school districts are pooled into one rate. All state agencies pool their rates, but local jurisdictions don't. Indicates that the increase due to the impact of HB 3349 was anticipated and ample notice given to participating employers. The successes of the stock market that led to short falls in the money match formula were not anticipated. Discusses the trend toward use of the money match option over time. Mentions the impact of the cost of living adjustment (COLA) guarantee. Discusses distribution of benefit levels within the system.</p>
407	Sen. Brown	Who are the people in the high range on page B-14 of the handout?

419	McDonnal	Typically, they are doctors, agency heads, higher education officials, and some local government officials.
448	Chair Bryant	Do you know how many people retire within the guidelines of 75-85% of their salary?
453	McDonnal	I can provide this for you. As I remember, the salary replacement rate for all those who retired since 1988 is about 50%. Some people, particularly in the past few years, have replaced almost all of their salary or more. There are 700-800 people currently retired and making more at retirement than when employed.
<b>Tape 88, B</b>		
050	Sen. Courtney	What is the prediction for retirement rates ten years out from today?
051	McDonnal	In ten years, two to three times as many people per year will retire as now.
062	Sen. Courtney	Have you gone farther out than ten years?
065	McDonnal	Yes, but I don't recall the figures.
067	Sen. Courtney	How do you fund the COLA?
068	McDonnal	The COLA is funded through employer contributions.
084	Sen. Trow	We have had bills come through to authorize an increase to the COLA beyond the rate of inflation, and each time we have done this the analyst has indicated it wouldn't change the employer's rate. That was before the impact of the money match.
093	McDonnal	That is correct. In 1989 we did authorize an increase beyond the rate of inflation. But without the additional increase the employer rates would have gone even lower than they did that year.
099	Sen. Lim	Discusses the PERS system and possibilities of investment crash.
110	McDonnal	Discusses the long term record of the PERS system. Believes that if the economy went down, it would effect everything. The PERS system is a pre-funded system. A catastrophe is always possible, however.
136	Sen. Nelson	Please explain why employers are having trouble funding their share?
139	McDonnal	Discusses the combination of increased employee participation in the variable

		funds and high returns in the stock market causing employee funds to have high returns. Explains that the employer, while barred from investing in high return instruments, must match those earnings.
167	Sen. Nelson	How does the variable work?
170	McDonnal	The 6% contributed by the employees may be allocated into a variable account if the employee chooses. If the domestic equities outperform the balanced fund, then employers have to match those dollars when they retire.
194	Sen. Duncan	During the 1981-82 period, in lieu of a salary increase, the PERS match was picked up by the state. It was very economical at that time.
214	Sen. Brown	Was there another way to solve the tax inequity issue we solved by HB 3349?
223	Chair Bryant	The first bill we sent to the governor called for no taxation of any retirees. That was vetoed because it would have also exempted private retirement funds.
234	Sen. Lim	Asks about employer pickup of employee contribution.
250	Sen. Tarno	Under current law are the employers allowed to enter into the variable program?
256	McDonnal	We feel that the employers can participate if it is constructed carefully.
266	Sen. Trow	Do we need legislation to do that?
270	McDonnal	I have heard both that it is legal and that it is not since the statute is silent on the issue.
273	Sen. Tarno	Why aren't local jurisdictions investing in the variable account right now?
276	McDonnal	We haven't had the ability to give them that option. We do believe the option is allowed, if properly constructed.
290	<b>Mark Johnson</b>	<b>Actuary, Milliman &amp; Robertson, Inc.</b>  Submits written testimony and testifies on the PERS system ( <b>EXHIBIT A</b> ). Discusses actuarial assumptions and the PERS system. The two main findings are that HB 3349 with a present value cost of \$1.3 billion will take 1.4% of payroll over the next 30 years and the present stock market success has led to an increase in retirements under the money match option.
330	Sen. Duncan	Why does it matter when a person retires in March, or June?

340	Johnson	This is what has been referred to as the last known rate. These are administrative practices and we will discuss them a little further on. Discusses the impact of HB 3349. All employers were aware that HB 3349 would have a financial impact.
356	Sen. Trow	Asks how the rate of employer contributions are determined. What causes the difference between local jurisdiction and other participants?
364	Johnson	On the average, turnover is higher in the local jurisdiction causing less people to stay until retirement. Discusses the reasons for money match becoming so attractive. Twenty years of good interest has made the money match the most generous plan for most everyone.
<b>Tape 89, B</b>		
002	Johnson	Discusses the history of interest rates and their effects on retirement rates and options. Cites examples in Exhibit A. In 1995, the chances of this stock market gain taking place were sixteen to one against it happening. Discusses normal cost rate increase.
113	Chair Bryant	In 1995, the State's unfunded liability was \$2.2+ billion. What was the cause of that?
118	Johnson	The dollar amount is less important than the percentage amount of the payroll. Discusses components of the unfunded liability, including HB 3349, increased employer match, and the \$60 medicare subsidy. The medicare subsidy was completely unfunded.
147	Sen. Trow	The medicare subsidy passed because there was a feeling that the cost of medical care had outstripped everything.
153	Johnson	That is true and it happened in 1985.
169	Chair Bryant	Can that subsidy be changed?
170	Muir	I believe that opinion was issued 2-3 years ago, and the opinion then was that it was a contract right.
186	Johnson	Small groups have widely fluctuating rates due to their size. Discusses the different options that the local jurisdictions have for handling increased rates. Suggests pooling possibilities among the smaller groups to smooth out their demographics.
293	Sen Trow	Does allowing employers to benefit from variable rate help?

298	Johnson	If we continue allowing employees to earn at a high rate, but keep employers from doing so, that is a recipe for disaster.
319	Sen. Duncan	If we had let employers invest in the variable account would it have solved all these problems?
337	Johnson	Not all problems, but it would have made a huge difference.
350	Sen. Duncan	Could you do a computer simulation to see if that would have worked?
363	Chair Bryant	What are other states doing with these retirement issues?
366	Johnson	It varies a lot. Contribution rates go up and down depending on a variety of factors, however, states with a defined benefit are trending down. Exclusively defined benefits are lower and stable.
393	<b>Elizabeth Harchenko</b>	<p><b>PERS, Board Member</b></p> <p>Submits written testimony and testifies on PERS issues (<b>EXHIBIT A</b>). Reviews work of special committee of the PERS board. Indicates there are three areas they were looking at in considering changes.</p> <ul style="list-style-type: none"> <li>• Allocation of reserves to cover the mandated employer match of 8%.</li> <li>• Discussed establishment of deficit reserves to smooth out fluctuations but need to continue studying this.</li> <li>• Actuarial methods and assumptions. To include the manner in which earnings are credited to employee accounts.</li> </ul>
497	Sen. Trow	If you established a special reserve fund, could it be used right away?
501	Harchenko	The real benefits will be long term.
<b>Tape 90, A</b>		
050	Harchenko	Discusses the manner in which earnings are credited to each account. The administrative practice has been to give the last known rate to the employee upon retirement for the year in which he retires.
078	Sen. Duncan	Discussed an example of PERS treatment of retirement under different methods.
094	Harchenko	Discusses the administrative practice of referring back to a prior year's earnings rate. The PERS Board is looking for a way to let employers participate in the variable account. An amendment is being drafted to actively permit it. Discusses the cap on equity accounts. The statutes are silent on the issue of employer's participation in the variable account.

128	Chair Bryant	I think the legislature should fix that silence rather than leave it up to a future judicial interpretation.
134	Harchenko	<p>Discusses several options which PERS has offered local governments to allow them to catch up with their contributions. Indicates there needs to be discussion and review to decide how to assist in smoothing out small employer rates.</p> <p>Indicates the PERS Board would like some legislative guidance regarding the pooling of non-school local employers. Indicates the actuarial rates are promising. Asks for clear legislative authority to pool smaller employers if it would be beneficial.</p> <p>Discusses SB 884 that allows the retiring member to withdraw all his funds, including the employer match, at retirement. Such an option would result in the member entirely leaving the system. This could benefit the member and PERS would no longer be eligible for COLAs and the health insurance subsidy.</p>
222	Sen. Brown	Discusses the need for a spousal sign off if PERS benefits change.
225	McDonnal	Indicates this is a routine practice now.
230	Sen. Duncan	How many people take out all their money now?
234	Harchenko	We think 15-20% do this. The big unresolved issue was trying to use current assets to eliminate the unfunded liability for employers. By statute we would be violating our obligation to benefit the members.
273	<b>Jim Hill</b>	<p><b>State Treasurer</b></p> <p>Submits written testimony and testifies on the PERS system (<b>EXHIBIT B</b>). The PERS system is sound and well managed. The unfunded liability is relatively small. Indicates that in order to allow employers to participate in the variable account we will need to</p> <p>eliminate the investment cap on stocks. Suggests that SB 1135 be amended to do this.</p>
<b>Tape 90, A</b>		
019	Hill	Continues testimony on PERS issues.
045	Chair Bryant	We tried to increase the cap last session. What would the penalty be if the cap was exceeded?
047	Hill	I don't know, but we must follow the law.



051	Chair Bryant	Discusses the financial impact of HB 3349.
072	Sen. Trow	I wonder if there are federal contract rights now for this.
079	Hill	Emphasizes that PERS is a very good system and any fix that is made should keep that in mind.
098	Chair Bryant	Adjourns hearing at 5:40 p.m.

Submitted By, Reviewed By,

Judith Minnich, Anne Tweedt,  
Administrative Support Counsel

#### **EXHIBIT SUMMARY**

**A ñ Overview of Public Employees Retirement System and Benefit Structure, March 23, 1999, 56 pp**

**B ñ Written testimony dated March 23, 1999, Jim Hill, 6 pp**