



# PERS Gain-Sharing Benefit Too Costly for Employers

## AWC's Position on Gain Sharing

AWC believes the gain-sharing benefit is simply too costly for employers, and had the Legislature been aware of the significant future costs the benefit may never have been adopted.

After considering the fiscal and legal issues, AWC's Legislative Committee recommended last fall that the gain-sharing benefit be repealed after one additional disbursement. The AWC Board adopted that position as one of Association's top legislative priorities for 2007.

## Background

Gain-sharing is a mechanism that triggers benefit increases for members of plans 1 and 3 of the public employees' (PERS), teachers', and school employees' retirement systems when the pension funds experience "extraordinary investment gains." Under gain-sharing, when the compounded annual rate of return of retirement plans' assets is 10 percent or more for four consecutive years, half of the amount over 10 percent is distributed to members. Plan 1 retirees receive a boost in their "annual increase amount" used to calculate their post-retirement Uniform COLA. Eligible Plan 3 members receive distributions to their individual accounts based on their years of service.

Gain-sharing calculations are made once each biennium with potential distributions occurring in January of even-numbered years. There have been two gain-sharing events since the benefit was adopted in 1998, and an additional distribution is scheduled to occur in January of 2008.

**Originally thought to have little or no impact on pension rates, it is now understood that gain-sharing is a material benefit that has significant liabilities.** Gain-sharing events and benefits are triggered by temporary gains, and, as a result, those gains are not available to offset future losses.

It is important to note that **the gain-sharing benefit is funded solely by employers** – employees do not share in the cost of gain-sharing. And currently the cost of gain-sharing is not recognized – no money is being set aside and invested to cover the cost of the benefit. Maintaining the gain-sharing benefit would require significant increases in the employer pension contribution rate. This would cost more than \$6.7 billion over the next 25 years – with the local government share at nearly **\$1.12 billion.**

Unlike most other pension benefits, gain-sharing was enacted with a "**non-contractual rights**" clause. In other words, employees do not have a right to future gain-sharing benefits and the legislature may amend or repeal the gain-sharing benefit at any time. The State Attorney General has confirmed this in a November 2005 opinion letter, but there is still some legal uncertainty and the courts may not allow the State to repeal the benefit.

## Current Legislative Proposals

- **HB 1771/SB 5779:** These bills would implement Governor Gregoire's proposal to address gain-sharing. Gain-sharing would be eliminated after the 2008 distribution. Instead of future gain-sharing payments, Plan 1 members would receive up to an additional \$.05 increase in the Uniform COLA Amount effective July 1, 2009, if the 2008 gain-sharing event results in less than a \$.23 adjustment. Eligible plan 3 members could use their prospective deferred contributions to receive an Assured Benefit – an annuity guaranteed to equal 1% of Average Final Compensation, resulting in a 2% benefit formula at retirement.

Under this proposal, the employer contribution rate as of July 1, 2007 would be 6.04%, down from the adopted rate of 6.46%. The July 1, 2008 rate would be 7.60%, down from the adopted rate of 8.02%. **Savings to local governments over the next 25 years would total more than \$700 million.**

The Governor's proposal is consistent with AWC's position on gain-sharing.

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- **SB 5668:** Sponsored by Sen. Karen Fraser (D-Olympia), this bill would retain gain-sharing for current members but eliminate it for new hires. There would be long-term savings under this approach (about 60% of the savings generated by the Governor's proposal), but it would not reduce employer contribution rates in the short-term.
- **HB 2116:** Sponsored by Rep. Barbara Bailey (R-Oak Harbor), this bill would eliminate the gain-sharing benefit for future hires and change the formula so that after the next gain-sharing distribution, future events would be based on a 14% trigger rather than a 10% trigger. The bill would also apply cost savings towards the Plan 1 unfunded liability.

## Messages to Legislators:

- **Support legislation to repeal gain-sharing following the January 2008 distribution.**
- AWC and cities could support the approach in **HB 1771/SB 5779** or similar legislation that would provide modest benefit increases for Plan 1 and Plan 3 members in addition to the repeal of gain-sharing after one additional disbursement. (Since gain-sharing does not impact Plan 2 members, Plan 2 benefit enhancements should not be tied to the repeal of gain-sharing.)
- We have a significant concern that a court could determine that the gain-sharing benefit cannot be repealed – with employers ending up paying for both gain-sharing and for the cost of any additional benefits granted.

## For More Information

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