AFSCME Facts

The Truth about the Washington Public Employees' Retirement System

In the 1930's and 1940's, the PERS, TRS, WSPRS, Judges and many local pension plans were created. Today, these plans cover over 300,000 workers and provide benefits to another 177,000 retirees, beneficiaries and inactive members. The PERS plan is the largest of these, covering over 262,000 members.

From July 1, 2007 through June 30, 2008, there were 3,808 members of PERS who retired with an average benefit of $19,990 per year, which was equivalent to 39 percent of their pay at retirement.

Benefit Levels and Eligibility

There are three tiers of benefit in the PERS plan, as follows:

Tier 1 – For workers hired by 9/30/1977

Tier 2* – For workers hired after 9/30/1977, provides a full DB benefit

Tier 3* – For workers hired after 9/30/1977, provides a combination DB/DC benefit

* Workers choose between Tiers 2 and 3 during the first 90 days of service

An employee becomes "vested" or has the right, after satisfying a minimum service requirement, to ultimately receive a pension benefit regardless of whether the employee remains a member of the pension plan. For tier 2, vesting occurs after 5 years. In most cases, tier 3 requires 10 years of service for vesting. According to the Wisconsin Legislative Council's *2008 Comparative Study of Major Public Employee Retirement Systems*, nearly three-quarters of the public plans surveyed require five or fewer years of service to vest. Private sector plans typically provide vesting at five years.

Employees can typically retire at age 65 with 5 years of service under tier 2 and age 65 with 10 years of service under tier 3. A reduced benefit is also available for members of tiers 2 and 3 who attain age 55 and meet the service requirements. Members of tier 2 contribute between 3.15-3.9 percent of pay towards their pension costs, while members of tier 3 make contributions to the DC component. Most members are also paying pay towards (and included in) Social Security and Medicare.

The benefit formula uses a service credit multiplier. For most employees (tier 2), PERS uses a service credit multiplier of 2 percent, while those who choose tier 3 have a multiplier of 1percent (which is supplemented by a DC account).

For example, the benefit for a hypothetical 20-year PERS participant with a final average salary of $40,000 would be calculated in the following manner:

If retiring with 15 years of service:
$40,000 *x* 15 years of service *x* service credit multiplier of 2% = $12,000

If retiring with 25 years of service:
$40,000 *x* 25 years of service *x* service credit multiplier of 2% = $20,000

If retiring with 35 years of service:
$40,000 *x* 30 years of service *x* service credit multiplier of 2% = $24,000

For those in tier 3, the defined benefit amount would be half of that provided under tier 2.

Because an employee's benefit can be calculated using a formula based on a percentage of final average pay and years of service, employers can efficiently manage the workforce. For example, 401(k) plan participants may invest too little, or their investments may provide insufficient returns, thus preventing employees from retiring and causing some employees to remain on the job even when their ability to perform job duties is declining. This can complicate the employer's role, forcing decisions with unpleasant consequences for everyone. This flexibility was utilized by the city during the current economic downturn, when an early retirement program was used to reduce the number of employees in targeted areas of city government.

Funding Sources

Revenues used to pay benefits come from three sources: employee contributions, employer contributions, and returns on investments. PERS, like other healthy public sector pension plans, receives the bulk of its revenues in the form of investment returns. Despite two severe recessions which negatively affected investment returns during the last decade, the sources of plan revenues over the past 10 years were:

- Investment Income: $4.6 billion (58% of total),
- Employer Contributions: $1.8 billion (23% of total), and
- Employee Contributions: $1.6 billion (20% of total).

PERS is Financially Sound

There have been some recent claims that retirement systems like PERS are facing a financial crisis. These claims are rarely true, and they are not true of PERS. The 2010 CAFR notes that the PERS plans held assets with an actuarial value of $28.0 billion, which are dedicated to $32.4 billion in liabilities (as of June 30, 2009, which are the most recent figures in the CAFR) – meaning the plan was 86.6 percent.

A recent National Association of State Retirement Administrators report points out that Washington governments spent just 1.51 percent of their budgets on pension contributions in FY 2008, far less than the national average of 2.89 percent. (Issue Brief: State and Local Government Spending on Public Employee Retirement Systems, National Association of State Retirement Administrators, January 2011). Due to the recent investment losses, contributions are expected to increase to up to 5 percent nationally.

It should come as no surprise that the 2008 and 2009 market downturn adversely impacted all investors. What is surprising is that some individuals fail to account for the fact that defined benefit plan funding is structured to be carried out indefinitely. PERS is designed for the long haul and does not have a shrinking investment horizon like defined contribution savings plans that cover individual employees.

According to a recent survey by the Center for State and Local Government Excellence the national average for large public sector plans was 78 percent as of June 30, 2009; most experts recommend a pension plan maintain a funding ratio of 80 percent or higher. A plan's funding ratio is simply a comparison of assets to accrued pension obligations. A retirement system's liabilities are amortized over time – similar to paying off a mortgage. And, if investment results bounce back from the recent sharp decline – that will help payoff the unfunded obligations. In other words, a plan's funding status is a snapshot that captures a government's ongoing effort at one point in time to fund its future pension liability. If a state is consistently making its annual required contribution, its pension plan can have a funded ratio below 100 percent yet still be on track toward full actuarial funding.

Defined benefit plans like PERS have access to professional investment managers who are trained in developing ongoing, long-term investment strategies that include an optimum mix of growth potential and risk. Participants and taxpayers benefit from the favorable investment performance of pooled pension fund assets. The wide range of investment options open to large pension plans, such as foreign and domestic stocks and bonds, real estate, and venture capital, also improve investment returns. Furthermore, PERS' investments are not affected by the retirement timing of a particular employee so the investment horizon never has to be shortened – which prevents the need to move to an extremely conservative investment portfolio when an employee reaches retirement.

Current funding of DB plans actually reduces long-term costs over time through the compounding of contributions and interest earnings. To a large extent, investment returns dictate the level of contributions needed to keep pension plans funded at healthy levels because those returns provide about two-thirds of plan revenues which provide retirement benefits. Actuarial projections assume that over the long-term, PERS will earn 8 percent each year on its investments. In some years returns will be below that rate and in others returns will exceed it. Over the most recent 5 years for which data is available, PERS has fallen short of its eight percent target, with an average annual return of 4.08 percent from July 1, 2004 through June 30, 2009 – *see page 90, FY 2010 CAFR.* This includes disappointing investment returns in 2009 which resulted in a loss of 22.84 percent. However, the fund returns have exceeded the assumed 8 percent over the past 20 years.

When returns are strong and above the actuarial assumed rate, the employer's level of contributions will generally be lower than expected. When returns are less than projected, those actuarial losses are amortized through increased employer contributions, which is one reason why contributions needed from the employer will increase over the levels needed earlier in the decade.

Plan investments not only benefit plan participants, but are also a critical part of the economic fabric of the state, creating thousands of jobs. According to the National Institute on Retirement Security (NIRS), each dollar in taxpayer contributions to PERS supports $9.69 in long-term economic activity in the state. This reflects the fact that taxpayer contributions are a minor source of financing for retirement benefits that ultimately provide income and jobs for others. NIRS estimates that retiree expenditures stemming from state and local pension plan benefits support about 21,000 jobs in the state and the total income to state residents supported by pension expenditures was $3.23 billion, *"Pensionomics: Measuring the Economic Impact of State and Local Pension Plans," National Institute on Retirement Security*, February 2009.

AFSCME believes in a society of opportunity; where all workers not only earn a living wage and can afford to see a doctor when they are sick, but where we all have the opportunity to reach our full potential in our chosen careers and where we all have the opportunity to retire with dignity when our work is done. For decades PERS has provided workers and their beneficiaries with secure retirement benefits and there is no reason to believe it will not continue to be able to do so.