SB 5851: Creating a Defined-contribution Retirement Plan Option for Public Employees

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Introduction

A long-standing Washington Policy Center recommendation is that the state transition from costly defined-benefit pension plans to a stable defined-contribution retirement plan for new state employees.[1] A defined-benefit plan promises workers they will receive a certain dollar benefit level every month after they retire, while a defined-contribution plan provides workers a stable contribution toward the pension during their working life, along with tax-free employee contributions, which the worker can draw from during retirement.

The private sector has been moving steadily away from defined-benefit plans for decades, instead offering employees defined-contribution pensions that provide retirement payments to an employee's pension while helping companies accurately project future pension costs. Two bills introduced in the Senate would move the state in this direction.

SB 5851 (creating a defined-contribution retirement plan option for public employees) was introduced by Sen. Barbara Bailey (R–Oak Harbor) on February 22. The proposal would create a new optional defined-contribution pension plan for current state workers and for new hires. The proposal would save state and local government (taxpayers) an estimated $436 million over the next 25 years.

A different proposal, SB 5856 introduced by Sen. Rodney Tom (D–Medina) on February 25, would make the transition to the new defined-contribution plan mandatory for current state employees under the age of 45 and for new hires. A fiscal note on the impact of SB 5856 is not available.

The Senate Ways & Means Committee did not approve Sen. Tom's SB 5856. Instead SB 5851 was approved by the committee on March 1. Because SB 5851 is still moving and SB 5856 was not approved, this paper will focus on the impact of SB 5851.

Details of SB 5851

According to the intent section of SB 5851 (in part):

> The legislature recognizes the need for public employees, public safety employees, teachers, and school employees, to have a secure and viable retirement benefit, not only for their own

[1] *Policy Guide For Washington State*, fourth edition, Washington Policy Center, 2012.

financial protection, but also so that public funds are spent prudently for their intended purpose.

The legislature also recognizes the need for public employers and taxpayers to have consistent and predictable pension funding obligations in support of employee retirement benefits.

Therefore, it is the intent of the legislature to provide a defined-contribution retirement plan option for new public employees, teachers, and school employees that uses best practices of defined-contribution plans to provide opportunity and flexibility to accrue a viable retirement benefit, while providing stable funding requirements for public employers and taxpayers.[2]

To accomplish this goal the bill would provide state employees who are currently in the state's open defined-benefit pension plan (Plan 2) and the hybrid defined-benefit/defined-contribution plan (Plan 3), as well as new hires, the option of enrolling in the new defined-contribution plan. The state's most costly defined-benefit plan (the one with the billions in unfunded liabilities) was closed to new enrollees in 1977.

Fiscal Note

The potential cost savings for SB 5851 exceeds $400 million. According to the state actuary:

> We expect a 25-year total employer [state and local government] savings of $436 million as a result of this bill. We expect a long-term savings because employers [state and local government] would contribute less to the PESP than they would, under current law, to a DB [defined-benefit] plan for the affected members. Employers, and members remaining in the DB plans, are expected to contribute higher contribution rates than we assume under current law.[3]

Budget Impacts			
(dollars in millions)	**2013–15**	**2015–17**	**25-year**
General Fund - State	($2.2)	($4.4)	($240.3)
Local Government	($1.2)	($2.9)	($163.0)
Total Employer	($3.5)	($7.5)	($436.2)

State actuary's note: We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.

The estimated savings for just the 2017–19 biennium is $38 million.

Legislative Authority over Pension Policy

Although the legislature has little say over state employee collective bargaining agreements negotiated in secret with the governor that determine compensation levels (other than a simple "yes" or "no" vote), pension policy is explicitly exempted from union negotiations and is set directly by lawmakers.[4]

[2] "SB 5851: Creating a defined-contribution retirement plan option for public employees," at apps.leg.wa.gov/documents/billdocs/2013-14/Pdf/Bills/Senate%20Bills/5851-S.pdf.
[3] "Fiscal note for SB 5851, at fortress.wa.gov/binaryDisplay.aspx?package=34888.
[4] "RCW 41.80.020: Scope of bargaining," at apps.leg.wa.gov/RCW/default.aspx?cite=41.80.020.

While the legislature maintains this authority, there are legal restrictions which limit the type of changes that can be made. A 1956 state Supreme Court ruling (the Bakenhus case) found that a pension promise is a contractual right. This makes changes for existing employee plans at risk of a lawsuit. By making the new defined-contribution pension plan optional for current state employees, SB 5851 avoids implicating this court decision.

Obviously no contractual right exists for future state employees, so offering only the new defined-contribution plan to new hires as a retirement benefit is well within the authority of the legislature.

Next Steps for Reforming Washington's Pension System

For future pension benefits, Washington should transition to a defined-contribution plan, as proposed by SB 5851. These plans are now common in the private sector because they provide a retirement benefit for employees while helping companies accurately project future pension costs. Employees in such plans are not forced to rely on political conditions that might change in the future.

Effective state pension reform should be based on the following principles:

- Do not skip any pension payments
- Close the current defined-benefit plan to new hires
- Direct all savings toward paying down unfunded pension liabilities
- Enroll new hires into a defined-contribution plan
- Constitutionally require the actuarially recommend pension payment and require a supermajority vote to enact new benefits

Conclusion

It is important to maintain diligence on the state's existing pension obligations while pursuing additional reforms. Part of what has contributed to the state's unfunded pension liability is legislators and the governor not making the required contributions over the past decade so that lawmakers could spend that money on other programs. Washington's multibillion-dollar pension problem was not created overnight, so it will take time to eliminate these unfunded liabilities. Starting these reforms will require the conviction to do what is in the best interest of all citizens and state workers, not just narrow special interests.

Moving to a defined-contribution pension option as proposed by SB 5851 would be a step in the right direction. While it should remain optional for current employees, the new defined-contribution plan should be the only pension option offered to new hires, so the state's remaining defined-benefit plans are closed, and the burden of their financial liability on taxpayers gradually reduced. Any savings realized by adopting SB 5851 should be used to pay down the state's multibillion-dollar unfunded pension liability, so there isn't the temptation for lawmakers to increase state spending elsewhere in the budget.

Jason Mercier is director of the Center for Government Reform at Washington Policy Center, a non-partisan independent policy research organization in Washington state. Nothing here should be construed as an attempt to aid or hinder the passage of any legislation before any legislative body.