



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #323

Early Retirement Creditable Service Calculations for Certain Part-Time Employees (ETF)

[LFB 2009-11 Budget Summary: Page 237, #8]

CURRENT LAW

Under current law, a Wisconsin Retirement System (WRS) participant, other than a teacher, librarian, or administrator, with at least 0.75 of a year of creditable service (1,428 hours) in any annual earnings period must be treated as having one year of creditable service for that annual earnings period for the determination of creditable service for the purpose of calculating actuarial discounts of annuities provided to individuals retiring before reaching normal retirement age (early retirement). To be eligible for this treatment of creditable service, the participant may not be a protective occupation participant and must have earned only a partial year of creditable service in at least five of the 10 annual earnings periods immediately preceding the annual earnings period in which the participant terminated covered employment.

GOVERNOR

For the purpose of determining the actuarially discounted annuity relating to early retirement only, provide that a participant's amount of creditable service in any annual earnings period would be treated as the amount of creditable service that a teacher, librarian, or administrator would earn for that annual earnings period. Because ETF defines full-time employment to be 1,320 hours per year for a teacher, librarian, or administrator, the bill would reduce the number of hours needed to qualify for a year of creditable service, from 1,428 hours to 1,320 hours per year for the purpose of determining the actuarially discounted annuity relating to early retirement only. The provision would first apply to those who are participating employees in the WRS on the effective date of the bill.

DISCUSSION POINTS

1. The statutory section affected by the AB 75 provision is limited to the determination of creditable service of certain part-time employees for the purpose of calculating actuarial discounts of annuities provided to individuals retiring before reaching normal retirement age (early retirement). The provision would not affect the creditable service provisions under current law pertaining to the calculation of a retirement annuity. As explained below, the bill's provision applies only to a technical adjustment to a discount factor applied to a preliminary annuity amount that is being adjusted for early-retirement purposes.

2. The bill would retain the current law provision that, to be eligible for this treatment of creditable service, the participant must have earned only a partial year of creditable service in at least five of the 10 annual earnings periods immediately preceding the annual earnings period in which the participant terminated covered employment. The only change would be the threshold number of hours at which a full year of creditable service would be used in the annuity discount calculation for early retirees in certain part-time positions. Department of Employee Trust Funds (ETF) officials indicate that the provision does not raise any systemic or administrative concerns for the agency.

3. A formula benefit will be paid to a WRS participant who is no longer in covered employment and has reached age 55 (age 50 for protective classification employees) and requests an annuity. Upon reaching these age thresholds, payment of a separation benefit is no longer permitted should the participant leave WRS covered employment.

Participants requesting an annuity after reaching the minimum retirement age threshold but before attaining the "normal retirement age" for their employment classification, are deemed to have taken an "early retirement." [Normal retirement age for teaching and non-teaching general employees is 65 years.] For individuals taking an early retirement, an actuarial discount is applied against the formula-generated annuity amount received. This discount is not a penalty for early retirement. Instead, it is designed to compensate the retirement system for a longer annuity payout period and a shorter asset accumulation period than had been assumed under the system's valuation process.

For participants taking an early retirement, a standard 0.4% per month actuarial discount factor is applied for each month of early retirement before the participant's normal retirement date. [On an annualized basis, the actuarial discount factor is 4.8%.] Then, depending on the participant's employment classification, a two-step series of adjustments are made.

First, for any general or elected or state executive classification employee who has attained the age of 55, the standard 0.4% monthly reduction factor is itself reduced by 0.001111% for each month of total creditable service the participant has earned. Further, if a participant has worked part-time in five of the last 10 years prior to the year in which the annuity will begin, those years in which at least 0.75 of a year of creditable nonteaching service has been earned can be treated as a full year for purposes of calculating this reduction factor. Since the 0.4% monthly reduction factor

cannot be reduced below zero, a participant with at least 360 months (30 years) of service credits will no longer have any actuarial reduction applied (except as described next) to his or her formula annuity amount upon taking an early retirement.

Second, the 0.001111% offset to the standard 0.4% monthly discount factor does not apply for any retirement months taken before the general or elected and state executive participant attains age 57. Consequently, for any such participant retiring before age 57, a full 0.4% actuarial reduction factor will be applied for each month of retirement before age 57. This 0.4% monthly reduction applies regardless of the amount of creditable service previously earned. The full 0.4% monthly reduction factor also applies to any early retirement taken by protective category employees.

4. Under the bill, for those WRS participants who are eligible for this treatment (a non-protective occupation participant who has earned only a partial year of creditable service in at least five of the 10 annual earnings periods immediately preceding the annual earnings period in which the participant terminated covered employment), the number of hours needed to qualify for a year of creditable service, for the purpose of calculating actuarial discounts of annuities provided to individuals retiring before reaching normal retirement age, would be reduced from 1,428 hours to 1,320 hours per year.

5. The provision would have some cost to the retirement system because it would enhance the final annuities for some WRS participants. Officials at ETF indicate that an actuarial study would be required to make a precise estimate of the costs to the system. However, an example of a single hypothetical part-time employee may serve to provide a sense of the magnitude the provision could have for an individual retiring under these circumstances.

The example compares the annuity of a part-time employee under current law provisions, with the annuity he or she would receive under the AB 75 provision. The assumptions are that the employee: (a) will retire on January 1, 2010, at age 60; (b) has worked part-time in a 0.70 FTE position for 20 years; and (c) had final average earnings of \$14.35 per hour.

Based on this example, the individual would receive a monthly annuity of \$513.50 under current law and \$541.77 under the AB 75 provision. The AB 75 provision would result in a \$28.27 monthly increase in the annuity, or about \$339 annually, for the individual.

6. The Department estimates that there are approximately 30,800 currently active, non-teaching WRS participants who meet the part-time standard of having earned only a partial year of creditable service in at least five of the last 10 annual earnings periods.

7. Under current law, no bill or bill amendment creating or modifying any system for, or making any provision for, the retirement of or payment of pensions to public officers or employees, may be acted upon by the Legislature until it has been referred to the Joint Survey Committee on Retirement Systems and that Committee has submitted a written report on the bill or amendment. The report must address the probable costs involved, the effect on the actuarial soundness of the retirement system and the desirability of such proposal as a matter of public policy.

On February 17, 2009, AB 75 was referred to the Joint Survey Committee on Retirement Systems.

Further, the Cochairpersons of the Joint Survey Committee on Retirement Systems or the Cochairpersons of the Joint Committee on Finance, may make a determination that the bill or amendment may have a significant fiscal impact on the costs, actuarial balance or goals of the WRS and order the attachment of an independent actuarial opinion on the impact. The Cochairpersons or presiding officer ordering the opinion must direct the Legislative Counsel Staff to obtain, and make payment for, the opinion.

8. According to ETF officials, the provision relating to the annuity adjustment for certain part-time employees seeking early retirement, may be viewed as requiring an actuarial study because the provision may affect required contribution rates WRS employers. However, it is also possible that the fiscal effect of the provision would be too small to actually move the contribution rate. The Cochairpersons of the Joint Survey Committee on Retirement Systems and the Cochairpersons of the Joint Committee on Finance may determine that the provision would not have a "significant" fiscal impact on the WRS and forego the actuarial study. However, in the absence of a study, the provision's fiscal effect on the WRS cannot be accurately stated.

9. In summary, the AB 75 provision relating to the annuity adjustment for certain part-time employees seeking early retirement would result in somewhat enhanced annuity payments for these individuals. The fiscal effect of the change may not be sufficiently great to actually affect WRS contribution rates; however, an actuarial study would be required to precisely estimate any potential effect. The provision maintains the current law part-time standard that must be met for this treatment (the employee must have earned only a partial year of creditable service in at least five of the 10 annual earnings periods immediately preceding retirement) and would apply to all part-time workers meeting this standard. Finally, ETF officials indicate that the provision does not raise systemic or administrative concerns for the agency. The Committee may wish to approve the provision under AB 75.

Governor's Budget Errata

10. In a budget errata report dated March 31, 2009, the state budget office indicates that the Governor's intent is to make the AB 75 provision apply only to school district educational support personnel (ESP) employees. An ESP employee is defined in statute as any school district employee other than a teacher, librarian, or administrator. The errata report also indicates that the calculation of the annuity discount under the provision "would only include Educational Support Personnel service to the extent that they (ETF) have records available."

11. Administration budget officials indicate that the reason for limiting the provision relating to part-time employee annuity discounts to school district ESP employees only is as follows:

"The Governor's budget includes changes in the Wisconsin Retirement System (WRS) to treat Educational Support Personnel the same as teachers. The formula for full time service for Educational Support Personnel would parallel that of teachers. The early

retirement formula for part-time service for Educational Support Personnel would also parallel that of teachers. It is the intent of the Governor to make these changes applicable only to Educational Support Personnel so they are treated the same as teachers in the WRS."

12. According to ETF officials, applying the provision only to school district ESP employees would present an administrative burden on the Department. Before July 1, 1997, school district ESP employees were not distinguished from all other general category employees; as of that date, by law, these employees were changed to a newly created "ESP" classification. A year later, technical college ESP employees were also classified as "ESP", effective July 1, 1998, but under a separate statutory definition. However, service for both types of ESP employees is reported to ETF and credited identically, and appears exactly the same on these employees' WRS records. [The Department estimates that there are approximately 20,000 currently active, non-teaching WRS participants who meet the part-time standard (a partial year of creditable service in at least five of the last 10 annual earnings periods) and who have at least some ESP creditable service.]

As a result, school district ESP service cannot be distinguished from technical college ESP service on ETF records without additional research to determine which type of employer reported service each year. Furthermore, the general category service earned by both groups prior to the creation of the new ESP categories cannot be distinguished from any other general category service without significantly more analysis of the work history of individuals considering early retirement. Many employees have a varied work history that includes service in multiple employment categories. Under the Governor's errata modification, in many cases an employee's service credit would need to be manually reviewed year-by-year in order to distinguish between school district employment and employment with other types of public employers. For some employees with lengthy service, this could require retrieval and examination of old paper employer reports. Under the AB 75 provision, there would be no need to distinguish between school district ESP, technical college ESP, and general category service because the provision would apply to all educational support and general category service.

13. The Governor's errata report indicates that the modified provision "would only include ESP service to the extent that they (ETF) have records available." Two clarifications could be made to make the Governor's errata proposal more administratively manageable. First, make the provision applicable only to service credited as ESP service. This means that the only service that would be treated the same as teacher service (for the purpose of calculating the actuarial reduction for early retirement) would be the ESP service earned after July 1, 1997. Service earned before that date (when these employees were reported as general category employees) would be treated under the ".75" provision in current law that is applied to all non-teaching service. Second, also apply the provision to service earned as a technical college ESP employee, which can extend back to July 1, 1998 (again, with the current ".75" treatment applied to service earned prior to that date). Since both school district and technical college ESP employees are identically classified in the WRS, applying this provision to both ESP groups would simplify administration and assure equitable treatment.

14. However, ETF officials have noted that limiting the provision only to school district and technical college ESP service could be disadvantageous to ESP employees, because the pre-July 1, 1997, or July 1, 1998, service would be treated under the less beneficial ".75" provision under current law. The provision under AB 75 would allow ETF to treat all part-time years of previous service as if the ESP employee was a teacher (for the purpose of the actuarial reduction for early retirement only). For a school district ESP employee with partial years of service before July 1, 1997 (or for a technical college ESP employee before July 1, 1998), the AB 75 provision could produce a higher final annuity than the Governor's approach as stated in the errata report.

15. Finally, one additional issue should be considered by the Committee. If the Governor's intent of having the provision apply only to school district ESP employees is adopted, serious equity issues are raised. The current law provision (and the AB 75 provision) treats all part-time general category employees (with part-time service in five of the last 10 years), including ESP employees, in the same manner with respect to the annuity discount adjustment. Therefore, all part-time, non-teaching WRS participants are treated equitably with respect to the early retirement adjustment. The Governor's requested revision would modify this treatment.

This can be illustrated with an example. Assume that two part-time WRS participants are exactly the same age, began WRS employment at the same time, worked the same number of hours each year, had identical partial years of service, have exactly the same earnings each year, and retire early at the same time. In this scenario, the WRS contributions and the interest earned on those contributions are identical for each employee. Assume further that one participant has always been a school district ESP employee, and one has been a non-teaching employee who always worked at a state mental health institution. Under current law, and under the AB 75 provision as drafted, these two employees would receive identical retirement benefits. Under the Governor's errata report proposal, the ESP employee would receive a larger formula retirement benefit than the mental health institution employee, although their work histories and the funding for their retirement benefits have been identical.

16. In summary, the Governor's intent to make the AB 75 provision apply only to school district ESP employees raises a number of concerns. First, because of the way WRS records are maintained, it would be problematic to manually reconstruct the work histories of part-time participants affected by the provision. Second, for some ESP employees, probably those with higher amounts of creditable service, the Governor's revised approach could result in a lower annuity than under the AB 75 provision. Finally, the modified provision, if adopted, would provide more favorable pension annuities to school district ESP employees than to other part-time, non-teaching general employees.

The provision under AB 75, as currently drafted, provides the same, or in some cases a better, treatment of ESP employees than the revised proposal specified in the errata report. In addition, the AB 75 provision would be significantly more manageable for ETF to administer, and would treat all affected part-time WRS participants in an equitable manner.

ALTERNATIVES

1. Adopt the Governor's provision to provide, for certain part-time WRS participants and for the purpose of determining the actuarially discounted annuity relating to early retirement only, that a participant's amount of creditable service in any annual earnings period would be treated as the amount of creditable service that a teacher, librarian, or administrator would earn for that annual earnings period. The provision would first apply to those who are participating employees in the WRS on the effective date of the bill.

2. Modify the provision to reflect the Governor's intent, as indicated in the budget errata report dated March 31, 2009, to make the provision apply only to school district educational support personnel employees. Provide that the calculation of the annuity discount under the provision would only include educational support personnel service to the extent that the Department of Employee Trust Funds have records available.

3. Adopt Alternative 2, but clarify that the provision would apply only to creditable service as an educational support personnel employee beginning on or after July 1, 1997. Provide that creditable service prior to this date would be treated under the current law provision for determining the actuarially discounted annuity for part-time participants.

4. Adopt Alternative 2, but clarify that the provision would apply only to creditable service as an educational support personnel employee beginning on or after July 1, 1997. Provide that creditable service prior to this date would be treated under the current law provision for determining the actuarially discounted annuity for part-time participants. Provide that the provision would apply to creditable service as a technical college educational support personnel employee beginning on or after July 1, 1998. Provide that creditable service prior to this date would be treated under the current law provision for determining the actuarially discounted annuity for part-time participants.

5. Delete the provision.

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