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In The

# State of Washington

GENERAL SUMMARY OF THE RESULTS OF A
RESEARCH STUDY OF PUBLIC EMPLOYEE
RETIREMENT SYSTEMS IN THE STATE

DECEMBER, 1962

Report by

A. A. WEINBERG, Consulting Actuary

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LEGISLATIVE COUNCIL
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# WASHINGTON STATE LEGISLATIVE COUNCIL
# SUBCOMMITTEE ON LABOR, UNEMPLOYMENT COMPENSATION AND PENSIONS

## Special Report on Study of Retirement Systems 1961-1963 Biennium

### SUBCOMMITTEE MEMBERS

KEITH H. CAMPBELL, *Chairman*
ROBERT M. SCHAEFER
THOMAS L. COPELAND
EDWARD F. RILEY
HERBERT H. FREISE

The mandate by the 1961 legislature for a study of all public retirement systems in Washington state (SCR 9) resulted in an intensive study by the subcommittee of the Legislative Council. During the biennium the committee held five major meetings in connection with this study, including full-scale public hearings on July 1, 1961, January 6, 1962, and November 9, 1962, the latter being conducted with the cooperation of the entire membership of the Legislative Council. The nationally recognized consulting actuary retained by the Council, Mr. A. A. Weinberg of Chicago, was present at two of the Labor Subcommittee meetings. In addition, he consulted with the committee on many other occasions and with staff, as well as with representatives of all retirement systems. An extensive body of data was collected, including statutes and amendments for each retirement system, actuarial surveys and valuations, membership handbooks and reports and studies and similar publications from other states. Recommendations and proposals were received from many organizations and individuals. These were all evaluated by the consulting actuary, Mr. Weinberg. His complete report has been published in full in a limited quantity. This report contains a summary of his conclusions and recommendations.

As a result of the intensive study, the subcommittee drafted and recommended to the Council nineteen specific bills. Practically all of these were approved by the Council and will be introduced as recommendations to the 1963 session. These are listed in the biennial report of the Legislative Council to the 38th Legislature.

The contract with the consulting actuary requested these items as part of his report:

1. **Actuarial review of each system, to give independent appraisal of soundness, financing, assurance of benefits, and structure.**
2. **Determine opinion on specific suggestions, such as teachers paying on full salary instead of on part only, resolutions by employee groups, etc.**
3. **Determine various ways in which pensions of those retired can keep pace with inflation.**
4. **Discuss investment policies, interest earnings, administrative costs of the various systems.**
5. **Comparison of the benefits offered public employees under the different systems.**

6. **Possibility of establishing uniform, consistent benefits for the different systems.**
7. **Possibility of consolidating any of the systems.**
8. **Specific improvements in the basic statute for each system.**
9. **Analysis of future effect of OASDI and suggested revisions in our plans which may result from the federal program.**

The following observations should be made regarding the work of the subcommittee, consulting actuary, and the staff:

**First**, the factual material developed and utilized was accepted, confirmed, and in no case materially challenged by any group or individual. The professional and actuarial data was recognized by other recognized actuaries and financial experts as being thorough and valid. The expressions of concern, or statements of opposition (other than on specific questions of policy), that occasionally arose would develop from misinterpretation of newspaper headlines; e.g., articles referring to "unfunded liabilities", and "unsound retirement systems" which referred primarily to certain systems were inaccurately thought to refer to other systems which are soundly financed.

**Second,** since the subcommittee had contracted for sweeping analysis and complete recommendations by the actuary, it was imperative that the composite, broad point of view be followed through and **all recommendations be studied and carried through for final action by the entire Legislative Council, rather than making final determination at the subcommittee level.** It is evident that when many major changes in policy were involved, diverse reactions would naturally result from employee groups, governing boards, and other agencies. But the subcommittee at all times offered full opportunity for presentation of all differing views, any recommendations, and alternative proposals. The philosophy of the legislative process was in effect followed. A basic policy of the subcommittee was to recognize the "vested right" concept and to adopt no recommendation which in any way whatever would affect or impair rights of present employees.

**Third,** the earnest and sincere approach of the committee, and the appraisal of its work and recommendations were indicated by the many endorsements and the general comment in the press, from organizations, and the public as the entire project. Specific approval on individual recommendations came from many sources. A few examples of comment:

"The bipartisan Legislative Council deserves much credit for its intensive study during the present interim period of public retirement systems."—Seattle Post-Intelligencer.

"The work of the Legislative Council's subcommittee on labor, unemployment compensation and pensions and its consulting actuary pose a monumental challenge to the new Legislature meeting Jan. 14."—Seattle Times.

"I was very impressed with the report . . . and would generally endorse each of your conclusions. Needless to say, it is my fervent hope that this report is not casually read and laid aside, but becomes the basis for sorely needed sound legislation within this state with regard to our retirement systems."—Thomas P. Bleakney, Consulting Actuary, Milliman & Robertson, Inc., Consulting Actuaries.

"May I express our sincere feeling of admiration for the excellent work you have done in carrying our your assigned task of investigating the various state retirement systems."—Ralph V. Stevens, Executive Secretary, Seattle Teachers Association.



"Probably the most constructive job done by the State Legislative Council since the 1961 Legislature adjourned has been to complete comprehensive studies of the state's 66 separate retirement plans and prepare a blue print for their consolidation and funding."—C. E. Johns, Tacoma News Tribune. Similar comments appeared in the Vancouver Columbian and other papers.

"We would strongly urge that the two recommendations under consideration" (relating to investments) "be accepted for these recommendations are timely and should prove highly beneficial."—Richard T. Langan, Vice President, Moody's Investors Service.

The State Employees' Retirement Board expressed opposition to several proposals, but expressly endorsed Recommendations #3, 5, 6, 11, and "The Board and administrative staff wish to express their sincere appreciation for the courteous and attentive consideration received from the members of the Legislative Council and its Chairman and for the privilege to comment on the suggested recommendations of its subcommittee."

Regardless of the ultimate outcome of the specific bills in the 1963 session, the study has accomplished the following results:

1. **For the first time, complete, reliable information is available on the many public retirement systems in this state;**
2. **The present liabilities, funded and unfunded, are stated for all the systems;**
3. **A start is made on an effort to promote uniformity, equity and consistency in Washington's public retirement program;**
4. **Better investments and higher earnings will be sought;**
5. **Machinery for continuing review, and for screening all proposed legislation, may be established;**
6. **Long-range planning and financing plans have been outlined;**
7. **The legislature for the first time will have information regarding the numerous retirement systems, and proposed legislation.**

KEITH H. CAMPBELL, *Chairman,*
Subcommittee on Labor, Unemployment
Compensation and Pensions.

### REPORT BY A. A. WEINBERG

## FOREWORD

This report to the 38th session of the Legislature of the State of Washington represents a summary of the findings in a study of pension, retirement and benefit plans in this state affecting state and local employees, including the personnel of institutions of higher learning.

**Legislative Directive—HCR 9—1961 Session**

This study was undertaken pursuant to a directive contained in Concurrent Resolution No. 9 adopted by the Legislature on February 28, 1961.

**Objective**

The objective of this study was to evaluate the provisions of these plans in the light of established concepts, standards and trends for similar provisions for public employees in other states, and to establish the full financial impact of these plans, both present and prospective, by means of acturial reports and valuations.

**Vested Rights**

The State Supreme Court, in a decision several years ago, established a contractual status for pension provisions and gave validity to the concept of deferred compensation for these provisions. Informed legislative action on pensions in this state, therefore, takes on added significance. This far-reaching decision dictates the necessity for a cautious approach to all liberalizing proposals affecting these provisions and a critical analysis and complete cost determination thereof.

Because of the broad aspects of the subject and its complexity, reference should be made to the full report on this study for a more complete understanding of the results thereof.



## THE PUBLIC EMPLOYEE PENSION PROBLEM IN THE STATE OF WASHINGTON

The impetus for a study of the pension problem relating to public employees in the State of Washington stems from a combination of several factors and conditions, and set in motion a public reaction for a thorough analysis and evaluation of the problem in the light of accepted principles and establish concepts governing retirement planning for public employees.

The several factors and conditions prompting this study may briefly be described as follows:

**Financial Liabilities (P. 8 and P. 9)**

1. The rapidly growing financial burdens of retirement plans to the state and local governments, with continuing increases in cost on account of new liberalizing proposals and with no apparent limit to the level of cost of these plans.

**Divided and Overlapping Membership (P. 10)**

2. The problems arising from the maintenance of divided and overlapping memberships for employees of the same governmental unit or for employees of the same occupational classifications with coverage provided in two or more retirement systems.

**Multiplicity of Systems (P. 10 and P. 11)**

3. The multiplicity of individual retirement systems which number 62 separate and independent operating units, most of which are too small in terms of membership and scope of operation to warrant their independent existence according to the usual standards.

**Unfinanced Obligations (P. 11 and P. 12)**

4. The precarious financial condition of most retirement systems in which there exists incurred and unfinanced obligations of substantial proportions, and prospective obligations of indeterminate amounts.

**Pressure for Benefits (P. 12)**

5. Recurring proposals for larger benefits, and other liberalizing changes, under the leap-frog concept, improperly conceived and inadequately financed coupled, as inevitably such a program must be, with substantially increased and disproportionate cost burdens to the public.

**Inadequate Investment Policy (P. 13)**

6. The lack of a consistent and realistic investment policy within reasonable standards and limitations, and the inability under existing arrangements and procedures to take full advantage of current investment opportunities for the purpose of maximizing investment income.

**Puzzle for Legislators (P. 16-18)**

7. The perplexity of legislators in the interpretation and understanding of proposed pension legislation with little or no information available as to the meaning or intent of the proposals and their financial significance from a current and long-range viewpoint.

It is a strange paradox that many public employees in this state, who are the principal beneficiaries of these plans, either fail to appreciate the undesirable long term consequences of the existing haphazard policy or remain indifferent to it. The failure of comprehension or the existing indifference is manifested by objections and opposition to recommended principles and standards. This is all the more difficult to understand in the light of the fact that these principles and standards are designed to strengthen the underlying structure of these systems and thus minimize the possibility of future impairment of the rights and benefits accruing to the employees.

**Table 1. MEMBERSHIP AND FINANCIAL DATA**

| | |
|---|---|
| Number of retirement laws | 10 |
| Number of individual and independent retirement plans | 62 |
| Aggregate membership of employees now in service | 96,000 |
| Number of beneficiaries on the pension rolls | 20,000 |
| Aggregate annual revenues | $ 80,000,000 |
| Annual expenditures | $ 15,000,000 |
| Total present assets | $338,000,000 |
| Unfunded accrued liability—Actuarial deficit (analogous to bonded debt) | $401,200,000 |



## RAPIDLY GROWING FINANCIAL BURDEN

The appropriation by the state for the 1961-1963 biennium in the case of the several retirement systems to which the state is a contributor amounted to $48,250,000. This is double the appropriation by the state in 1955.

The increase in current service cost and past service obligations created by amendments enacted in 1961 affecting these retirement systems and the insufficiency of current biennial appropriations in meeting the full financial requirements of the systems according to actuarial criteria will mean increasingly greater demands upon the state in future years and much higher appropriation requirements. Proposals for amendments to existing laws now in prospect for presentation at the 1963 session of the Legislature will serve to compound this financial burden and mean still greater costs to the state for both future and past service.

The requirements of the federal old-age, survivors and disability insurance program covering employees of the several departments of the state are essentially a part of the total retirement burden to the state and local governments. All members of state-financed retirement systems are covered by social security with the exception of the state patrol. The combination of that program with the established retirement systems is on a full supplemental basis, thus resulting in a higher cost than if the retirement systems had been coordinated and an adjustment made of the benefit schedules thereof in consideration of social security coverage. In the area of cost burdens for pensions, therefore, effect must also be given to the social security cost rate. The social security schedule provides for an upward gradation of costs for years to come. The latest increase in these costs is effective January 1, 1963, equal to ½ of 1% of payroll for the state and the same rate for the employees. In terms of dollars, this means additional appropriations by the state for the ensuing biennium for social security of an amount exceeding $3,000,000.

In the case of the local governments, the financial impact of pensions is perhaps more striking, particularly in relation to police and fire pensions. Current contributions toward these pensions represent only a fraction of their total cost burden, even without consideration of the requirements on account of past service liabilities. The present total contributions by the cities are 10% of payroll for policemen, and 9% of payroll for firemen. This compares with a normal cost to the cities for policemen of 22% of payroll, and 19% of payroll for firemen. If amortization of past service costs is included, the annual obligation would be increased in the case of police from 22% of payroll to 41% of payroll; and in the case of firemen from 19% of payroll to 36% of payroll.

Policemen and firemen are not under social security and do not have dual coverage. The oft-voiced objection of these groups to coordination with social security is that the local plans might be placed in jeopardy and their existing rights and benefits might become impaired. These fears have proved to be unfounded in other jurisdictions which have coordinated their police and fire systems with social security.

The statewide cities retirement system and the several systems in operation for cities of the first class represent the only bright spot in the general picture. These systems are systematically funding their obligations. Their costs are under constant control and are reasonably equated to an equitable cost burden.

## Multiplicity of Systems and Divided Memberships

One of the most striking defects of the existing situation is the legislative assumption that a sound retirement plan can be established and administered without regard to the number of participants. The proper operation of a retirement system requires the application of basic factors which are dependent upon the law of averages. In systems having small memberships it becomes extremely difficult, if not impossible to apply actuarial factors. Under such conditions, financial provisions become speculative and the ultimate results are inadequate revenues, disproportionate sharing of costs and distorted benefit schedules. Recognition of the inherent difficulties attendant upon the operation of small membership systems is essential to an understanding of the problems of the police and fire retirement systems.

Another basic defect contributing materially to the general confusion is the practice of providing coverage in more than one retirement system for employees of the same occupational classification or of the same governmental unit. The system for state employees permits cities, counties and other governmental units to participate and a number of such units have coverage therein. This arrangement results in larger costs to these cities because of the liberality of provisions and higher standards of the plan for state employees in comparison with the general plan underlying the statewide cities retirement system which was established primarily for the city employees. Participation of all cities, other than those of the first class, in the statewide cities retirement system, would not only effect a lower cost obligation, but would bring about the desired uniformity and standardization of coverage for these employees.

A division of membership exists among non-academic employees of the schools of higher learning. These employees may choose to join the system applicable to state employees or elect to participate in individual plans in effect in these five schools covered by the Teachers' Insurance & Annuity Association.

Three different systems are in effect for policemen. Some policemen are members of the system for state employees; others participate in the statewide city employees' retirement system; while still others are in the police relief and pension funds. Benefits, qualifying conditions and contribution rates vary materially with the three systems.

A crazy-quilt pattern of divided memberships and small operating units exists with no effort having been made to maintain an orderly program of coverage on a uniform and non-discriminatory basis for specific occupational groups. The legislative history presents a picture of constant and recurring attempts by piecemeal and patchwork methods to strengthen the inherent weaknesses in the laws governing these systems without regard to an intelligent policy or definite standards conforming to concepts and principles of sound pension legislation.

The following table illustrates the multiplicity of systems and the type of coverage for the various occupational groups of employees.



**Table 2**

**NUMBER OF SYSTEMS IN OPERATION AND TYPE OF COVERAGE**

| Name of System | Number of Systems | Employees Covered |
|---|---|---|
| Employees' Retirement System of the State of Washington—(for State government, cities, counties and other governmental units) | 1 | (a) State government employees<br>(b) Non-academic employees of schools of higher learning<br>(c) Policemen of 20 cities<br>(d) General employees of 20 cities<br>(e) Employees of political subdivisions |
| Washington State Patrol Retirement System— | 1 | (a) Members of State Patrol |
| Schools of Higher Education—<br>University of Washington<br>Washington State University<br>Central Washington State College<br>Eastern Washington State College<br>Western Washington State College | 5 | (a) Faculty members<br>(b) Certain non-academic employees |
| Judges' Retirement Fund | 1 | (a) Supreme Court judges<br>(b) Superior Court judges |
| Washington State Teachers' Retirement System | 1 | (a) Public School teachers |
| Statewide City Employees' Retirement System—(for cities) | 1 | (a) General employees<br>(b) Policemen |
| Police Relief and Pension Funds in First Class Cities | 10 | (a) Policemen only |
| Cities of First Class Retirement and Disability Systems | 4 | (a) General employees only |
| Firemen's Relief and Pension Funds | 37 | (a) Firemen only |
| Volunteer Firemen's Relief and Pension fund | 1 | (a) Volunteer firemen only |
| Total | 62 | |

## Accrued Liabilities

Accrued obligations are not theoretical or speculative. They constitute real liabilities, actuarially determined after being discounted for interest and for releases due to such factors as deaths and separations from service without right to retirement benefits. The accrued liabilities of the existing systems have been in a steady upward trend and have reached large proportions as will be noted in Table 3.

The liabilities represent fixed debts which ultimately must be met by state appropriations and taxes imposed upon residents of the municipalities. The liabilities increase currently by interest at the prescribed rates. But if current revenues for the systems are insufficient to meet each year's incurred pension liability for service during the year, as has been the case with most systems, the deficiency becomes an accrued liability.

No accrued liability exists in the case of the five schools of higher learning.

Both the academic and non-academic personnel of these schools (with a few exceptions in the case of certain non-academic employees) are covered by the Teachers' Annuity & Insurance Association of New York. Under this plan of coverage the accruing pension credits for these employees are fully funded by current contributions on the part of the employees and the schools.

**Table 3**

**ACCRUED LIABILITIES OF PRESENT SYSTEMS**

| Name of System | Amount of Accrued Liability |
|---|---|
| (a) State Employees' Retirement System[1] | $ 97,000,000 |
| (b) Washington State Patrol Retirement System | 1,500,000 |
| (c) Schools of Higher Learning—5 Schools | None |
| (d) Judges Retirement Fund | 4,500,000 |
| (e) Teachers' Retirement System | 182,000,000 |
| (f) Statewide Cities Retirement System[2] | 2,500,000 |
| (g) Police Pension Funds, in 10 First Class Cities | 47,000,000 |
| (h) General Employees' Retirement Systems[2], in 4 First Class Cities—Seattle, Spokane, Tacoma, Bremerton | 5,200,000 |
| (i) Volunteer Firemen's Relief and Pension Fund—Service Retirement Annuities | 3,500,000 |
| (j) Firemen's Relief and Pension Funds, in 37 Cities | 58,000,000 |
| TOTAL | $401,200,000[3] |

[1] The 1961 amendments increased current service costs and obligations for this system rendering inadequate the established contribution rate for the state.

[2] These systems are being properly financed in accordance with a systematic method of funding.

[3] Amounts are shown at closely approximated figures at date of report due to the many variable factors influencing their determination and the constant changes in the liabilities.

## Pressures for Greater Benefits

Substantial benefit increases were granted firemen in 1961 with no provision for the financing of these increased benefits. The 1961 legislation also made it mandatory to provide medical, hospital and nursing care in the case of disabled firemen. The plans for policemen include medical and health care benefits which are completely outside of the scope and functions of a retirement plan. Medical benefits are also prescribed for retired policemen.

Another 1961 amendment affecting policemen provides for the escalation of pensions in keeping with upward salary adjustments. This has created a substantial obligation for the cities and may have a marked effect upon future state policy because of the established precedent. It involves obligations of indeterminative amounts and may be described as a "$50,000,000" potential.

Costly liberalizing changes were approved in 1961 for state employees by amendment of the state employees' retirement act. These changes have created a dislocation in the financial structure underlying this system and have greatly increased its costs and liabilities.

One of the most far-reaching proposals now in prospect for the 1963 session of the Legislature, in terms of benefit changes and cost, is that affecting the Teachers' Retirement System. A number of changes are suggested which, if properly financed in accordance with actuarial criteria, would involve an increase in state appropriations of about $5,000,000 a biennium. This is equal to approximately 20% above the amounts required by the present plan.



Notwithstanding the major changes enacted in 1961, involving a large cost increase, additional changes affecting the State Employees' Retirement System are contemplated involving cost increases. Proposals have been presented on behalf of other groups of employees calling for cost increases of some proportions.

The impact of ever-changing conditions, revisions of employment policies, a broadening of the public consciousness of the objectives and financial implications of these plans and the continuing desires of employees to upgrade benefits make the subject of pensions one requiring constant re-evaluation and analysis. While revisions in benefit schedules may be merited under changing economic conditions when considered in the isolation of an individual group, such proposals should be reconciled to the more compelling principles which involve a number of related basic factors, not the least of which is the problem of adequately financing the proposed increases in terms of their full cost witihn the financial ability of government. A broader problem exists, however, which should seek to preserve both to the employees and the public as an employer the salutary benefits of retirement system protection.

## Investment Authority and Policy Direction

The stability of a retirement system may well depend upon the judgments and decisions on the investment of its reserves. The governing board of trustees by law have full responsibility in this highly important function. A retirement system is regarded as occupying the position of the highest type of trust. The prudent investment of pension reserves requires special skills and professional guidance and direction. A retirement system rarely contains personnel among the members of the governing board of trustees or its administrative staff who are qualified to direct this highly specialized type of operation.

The long period of accumulation of pension reserves points up the basic importance of interest in the financing of pension benefits. An increase in yield on investments of one percentage point may make it possible to increase benefits by more than 25% or cut costs about 20%. The primary objective in retirement system operations, therefore, is to make the funds as productive as possible. Many factors are inherent in this function and must be applied in the attainment of this objective.

A study of the investment operations of the retirement systems in this state discloses that no effort has been made to establish and maintain a well designed investment program for the purpose of obtaining the maximum income within a reasonable and conservative investment policy. An effective investment policy encompasses the type of securities to be acquired, the conditions to govern acquisitions and the procedures for making investments. A considerable variance exists in the prescribed investment authority for the different systems. In the execution of this authority, the investments have not followed any systematic or well-defined procedure because of a minimum of professional advice. Considering the magnitude of operations and the size of their investment accounts, their record on the whole has probably been satisfactory. It is evident, however, from an examination of the investment accounts that the systems have not been fully alert to all investment possibilities.

The limitations of public revenue sources and the recognition of the possibilities of improved income on invested reserves has resulted in a movement among retirement systems throughout the country, both public and private, for a re-examination of their investment authority and a modernization of the investment procedures. Investment counselling service has been employed for this purpose for guidance and advice in this important effort.

A re-examination and revision of the investment authority and investment procedures in the State of Washington is an essential need, for the establishment of more realistic policies and the realization of maximum income on invested reserves.

## SERVICE RETIREMENT ANNUITIES FOR VOLUNTEER FIREMEN

The State of Washington has the unique distinction of being the only state to maintain a plan of service retirement annuities for volunteer firemen. The annuity consists of a flat dollar amount financed by a nominal contribution by the members but, for the most part, by a diversion of miscellaneous revenues allocated for benefits for these persons. These persons perform service voluntarily, intermittently and without compensation. They have insurance protection for occupational disability or occupational death which provisions are justified considering the hazards to which they may be exposed. But it is difficult to reconcile the provisions of a service retirement annuity for voluntary service, without salary, with any principle or policy governing retirement planning under any conditions.

Needless to say, the plan lacks proper balance and adequate financing. It involves a large deficiency, as has been noted in another part of this report.

Considerable doubt exists as to the propriety or legality of applying revenues accruing to the system from certain miscellaneous sources for this purpose.

### The "Bakenhus" Decision

The early traditional concept of public pensions, namely, that a pension does not create a vested or contractual right in the employee, remains the prevailing judicial view in the majority of the states. However, the impact of a developing social consciousness concerning the need and importance of pensions as a tool of management has resulted in some courts adopting the view that such pensions are in the nature of contractual or vested rights. The scope and extent of these concepts, however, remain uncertain and somewhat vague by reason of judicial reluctance to impose a total restraint upon the legislature in respect to amendments designed to improve the financial status of these systems.

The Supreme Court of the State of Washington has held in *Bakenhus v. City of Seattle*, 48 Wn. (2d) 695, 296 P. (2d) 536 (1956) that

> "* * * the employee who accepts a job to which a pension plan is applicable contracts for a substantial pension and is entitled to receive the same when he has fulfilled the prescribed conditions. His pension rights may be modified prior to retirement, but only for the purpose of keeping the pension system flexible and maintaining its integrity."

The reference in the above quote to modification of the plan before retirement "for the purpose of keeping the pension system flexible and maintaining its integrity" is somewhat vague and obscure. If it is intended to mean that pension rights may be modified prior to retirement for the purpose of keeping the system flexible and maintaining its integrity then a downgrading of



benefits and qualifying conditions may be made. If this expression has reference to the solvency of the system for the purpose of preserving its integrity, then the only way to achieve this objective is by a modification on a restricted basis of the existing provisions.

The doctrine laid down by the State Supreme Court has been construed to establish a contractual and vested right in both the accrued and prospective benefits to an employee as of the date of becoming a member of the retirement system. This points up the importance of a thorough review and study of all future pension proposals and a complete evaluation thereof in terms of the accrued and prospective liabilities for present and future employees.

Viewing the matter from a different perspective, it has long been the established rule that an employee does not acquire any vested right in any public office or employment. Even civil service laws may be repealed, or jobs abolished for reasons of economy or government policy. Therefore, if legal vesting in a pension expectance for both past and service to be rendered in the future is recognized, then an anomalous principle exists that an employee has no vested right in his job, but does have a vested right in his retirement system.

The real security of any retirement system lies in its financial structure and in the soundness of the principles which define the rights, benefits and expectancies of the employees. Constitutional and statutory provisions which seek to assure the protection of pension rights cannot be self-executing in the face of a financially insolvent system and lack of funds from governmental sources. True vesting can be achieved only if a system is soundly conceived and properly financed.

### Escalation of Retirement Benefits

The 1961 legislation affecting policemen established a most costly provision to the local governments, one involving large and indeterminate obligations. Reference is made to the escalation of the retirement benefits in keeping with future changes in salaries. The full financial impact of this legislation cannot be evaluated precisely. One thing is clear, however, that it will be sizable. An obligation has been imposed which will become increasingly greater with the passing years and which will form a basis for similar changes in other retirement systems unless it is quickly repealed.

The legislation has been described as a "$50,000,000" potential. If extended to other large groups of employees, this proposal together with the principle laid down by the "Bakenhus" decision, has created a present and prospective burden of tremendous proportions to the state and local governments.

Illustrative of the effects of this type of legislation in other jurisdictions, it is noted that in the City of Detroit one-fourth of the retirement benefit payments to policemen and firemen now represent the direct effect of an escalation provision. While the City of Los Angeles did not actually adopt an escalation plan, several court decisions rendered during recent years held that pensions for the retired firemen and policemen were of a fluctuating character and should be related to the current salaries of the active members. As a result, the eventual tax requirements to finance the police and fire retirement system will approximate 49% of total payroll for these services. Considering the large backlog of liabilities already incurred in the case of the policemen and firemen's retirement systems in the state of Washington, the financial burdens both present and prospective, are seemingly beyond comprehension.

## Possible Solutions

A proper evaluation of corrective measures designed to bring about an orderly and constructive policy for the state requires an understanding of the basic deficiencies of the existing pension structure. These deficiencies have been described in this report. Mention has been made of the piecemeal amendatory process which has characterized the pension legislation to date and the continued disregard of proper pension principles. The absence of a well-defined statewide pension policy and proper direction in the effectuation of this policy is responsible in a large measure for the unbalanced and costly pension structure and the continuous increase in costs and liabilities.

**Multiplicity of systems.** Obviously, a more rigid control over pension policy and costs can be achieved with fewer pension laws and a smaller number of individual systems. The large number of systems in operation can be reduced through the process of consolidation principally among the police and fire systems under a statewide standard plan of benefit and contribution provisions, but without the welfare benefits. Welfare provisions should be left to the discretion of the individual cities in accordance with their own judgment and ability to provide for these services. Under a plan proposed to the Council, the number of separate systems may be reduced from 62 to 11, with the plans in operation for the five state schools of higher learning being considered as individual units.

All cities and towns should be participants in one retirement system, namely, the statewide cities retirement system. This system has a more flexible plan of benefits and contributions than that for state employees and would give the cities some measure of control or regulation over their local administrative problems. The retirement plans in effect for the judiciary and for members of the state patrol should be placed with the state employees retirement system, for purposes of administration and policy guidance, with no change in their benefit or contribution schedules.

**Police and fire personnel.** With the exception of cities of the first class, all police and fire personnel should be participants in the statewide cities retirement system under a separate plan of benefits and contributions which shall be standard for all such personnel within the state. In the case of the several cities of the first class, police and fire personnel may participate in the systems in effect for these cities, but according to the same standard plan of benefit and contribution provisions that are applicable to all other policemen and firemen.

By this means standardization will be achieved in this important area of pension coverage, and responsibility for the proper direction and operation of the retirement systems will be placed with the local governments.

**Overlapping memberships.** This constitutes one of the most flagrant violations of good pension policy. Membership distribution among the several systems should be adjusted so as to eliminate coverage in two or more different retirement systems of employees of the same governmental units and in the same occupational categories. The present arrangement represents a basic weakness in the existing pension structure. It tends to create confusion and dissatisfaction among the employees and is certainly not conducive to a sound and non-discriminatory pension policy.



**New amendatory proposals.** Amendatory proposals affecting the existing laws should be thoroughly and critically evaluated in terms of their full financial implications and in relation to an overall statewide policy. This contemplates a predetermination of the full lifetime cost of such proposals. The test of actuarial soundness lies in the adequacy of specific revenues prescribed to finance a change on an accrual basis. Each proposal should be carefully examined and analyzed in terms of its impact statewide, since other employee groups generally request a similar change once a precedent is established.

**Volunteer firemen.** The law pertaining to this system should be repealed and the present system dissolved. Its assets should be transferred to the state employees' retirement system which shall assume the liabilities to pay retirement annuities to those with vested rights. Retirement coverage for persons not on retirement should be discontinued immediately and a refund paid to these persons of the amounts of their contributions, without interest. Special provision should be made in the state employees' retirement act for the payment of benefits on account of occupational disability or death occasioned directly by an act of performance of duty.

**Financing pensions.** Pension cost is properly a part of compensation for services rendered. This cost constitutes an integral part of payroll. The obligation is not speculative or contingent, but is definite and accruing for the employees who will survive at retirement. It is on account of these employees that reserves must be accumulated to meet the obligations for payments during their expected future lifetime after retirement. Part of these reserves come from contributions by the members and interest increments. The remainder constitutes the employer's obligation.

The employer's obligation, therefore, should not be treated as an extraneous expense, but as a current operating charge. This cost, therefore, should be budgeted on a departmental basis in the same manner as personal service cost, thus giving full effect to its real concept. This method is prudent and economical and establishes a current control over pension cost. It places this cost in the payroll budget where it belongs. It makes it convenient for the employer to meet this cost, since it must be taken into account in the employment of new personnel. In the final analysis, it would effect a reduction in overall governmental expenditures because it would make it necessary to give full effect to this cost in all aspects of governmental operations.

**Total pension obligation.** Contributions by the employer toward federal social security should be considered as a part of the total pension obligation. Pension cost must properly be expressed as the actual incurred current obligation, according to actuarial criteria, rather than in relation to the year's cash payments. This cost also should be translated into terms of a percentage of current payroll. A truer perspective of cost is obtained by this method.

In this presentation costs for social security purposes should be included. In expressing these costs, the ultimate social security contribution rate payable beginning January 1, 1968, should be used rather than the prevailing rate.

A total per capita cost computed on the foregoing basis is rarely presented. This should be a part of the current cost determination in actuarial surveys or valuations so as to provide information to the state and local government officials of a true index of the total obligations for pensions in terms of the individual employees.

**Investment authority and policy direction.** The investment of reserves has assumed an increasingly important function in retirement system operations. Interest income accounts for a substantial part of the cost of a retirement annuity, ranging from 25% to 40% of the cost. The upward trend in the financial requirements for the systems and the limitations of the sources of revenue have given emphasis to the importance of obtaining a maximum return on invested reserves. Safety of principal while a basic requisite in any investment program is of particular importance to a public agency because a loss of principal is not as readily replaceable as in private enterprise because of statutory and revenue limitations.

The investment authority for the several retirement systems should be broadened and clearly defined. Investment advisory services should be provided the systems through a state agency, preferably a pension review commission, who would maintain professional counselling service for this purpose. The maximum advantages in the investment of reserves would be realized from such an arrangement with a consequent increase in revenues and a strengthening of the financial condition of the systems.

**Continuing pension study.** Retirement plans have become a subject of major importance in government. Constantly changing economic and social conditions, the increasing impact of social security and the revisions of employment policies make it imperative that a study and re-evaluation of pension philosophy be continuously maintained. It is doubtful that retirement policies will ever reach a state of definite and permanent stabilization.

Because of the expanding influence of these plans in the fiscal affairs of government, and in the light of the conditions affecting the existing retirement systems, a pension review commission should be created which would define the state policy on this subject and formulate standards and principles for the guidance of the Legislature and other public officials in this important area of public administration. This commission would be expected to examine and evaluate all amendatory proposals affecting the retirement systems and submit a report and recommendation relative thereto. The commission would also act as an advisory agency on the investment policies for the several retirement systems maintaining investment counselling services for this purpose and employing other personnel as may be necessary. Its efforts would be directed towards the improvement and strengthening of the existing systems in accordance with established concepts and principles. Its periodic reports would serve to provide information relative to investment policy and retirement legislation for the purpose of resolving many of the basic problems arising in the operation of the systems.

**INFLATION—**

The commission could also undertake a study of the problem of meeting the deterioration of the value of pension income due to economic trends. It could attempt to develop a practical plan along sound and constructive lines financed with specific revenues. The plan for escalation now in effect for policemen should be repealed forthwith.



**CODIFICATION—**

It could also undertake a project for the codification and clarification of the existing retirement laws, so as to place them in a substantially standard form to facilitate their interpretation and application.

**POLICY—**

Such a commission can contribute immeasurably to the development of an orderly pension policy in the state. The expense of maintaining the commission would be insignificant in comparison with the savings to be achieved in terms of reduced pension obligations and the maintaining of a well-regulated and effective retirement program.

**Conclusion.** The principles underlying the foregoing solutions have not been formulated upon the basis of abstract theory. They have been compounded from the experience through the years of other retirement systems and the equation of all pertinent factors to indisputable principles underlying progressive and present-day pension policies for public employees.