



Public Retirement Program: Brain-Drain vs. Retire-Rehire

BRIEFLY

Post-retirement employment opportunities allow government agencies to better retain and recruit experienced workers. However, the 2001 retire--rehire expansion will cost Washington an estimated \$101.5 million over the next 25 years. With the pension system already facing a \$4 billion unfunded liability, lawmakers must balance the demographic challenges of an aging workforce with budgetary realities.

Over the next several decades, the number of public employees eligible to retire will substantially increase. Along with the potential loss of institutional memory and expertise, state and local governments anticipate a substantial drain on their pension systems.

In addressing the challenges of an aging workforce, policymakers confront several competing problems. State managers want to retain experienced workers, but pension rules reduce incentives for eligible retirees to remain in the workforce. In addition, younger employees may feel that expanding post-retirement employment opportunities for older workers blocks their chances for advancement. And recent efforts to make it easier for retirees to continue their public employment have increased the costs of a pension system already facing a \$4 billion unfunded liability.

This brief focuses on the impact of post-retirement employment (commonly referred to as the 'retire-rehire' program) on Washington's pension system.

CHALLENGES OF AN AGING GOVERNMENT WORKFORCE

In 2002, the Rockefeller Institute of Government reported that 46.3 percent of government workers were 45 years of age or older, compared to 31.2 percent of private sector workers (Abbey & Boyd, 2002). In Washington, more than 50 percent of government workers were 45 or older in 2000 (DOP, 2000a).

According to the Pew Charitable Trust's Government Performance Project, 63.7 percent of Washington's full-time public employees are eligible for retirement within the next ten years – the highest rate in the nation (GPP, 2005; OSA, 2005, p. 41). While many retirement-eligible employees will choose to remain in the workforce, the number of retirements is projected to steadily increase (OSA, 2005, p. 39).

Of particular concern is the accelerating retirement of TRS 1 (Teachers' Retirement System Plan 1) and PERS 1 (Public Employees' Retirement System Plan 1) employees. These government workers were first hired before October 1, 1977 and represent a large portion of the experienced workforce.



Figure 1. Comparison of PERS and TRS Plans 1, 2 and 3

	Plan 1	Plan 2	Plan 3
Benefit	Service-based	Age-based	Age-based
Maximum Benefit Accrual	Restricted after 30 years	No cap on service years	No cap on service years
Benefit Calculation	Two percent of average final compensation (AFC) for each year of service credit, maximum 60 percent of AFC	Two percent of AFC for each year of service, regardless of the number of years worked	One percent of AFC for each year of service, regardless of the number of years work
Reductions for Retiring Early	No early retirement provision but eligible for normal retirement at age 60 with five years of service, at age 55 with 25 years, or at any age with 30 years of service	Members eligible for normal retirement at age 65 with five years of service but can retire early in return for reduced benefits	Members eligible for normal retirement at age 65 with ten years of service but can retire early in return for reduced benefits
Effect	Less incentive to continue work after 30 years so members tend to retire at earlier age	Members are rewarded for working past age 65	Members are rewarded for working past age 65

Source: OSA, 2005, p. 2 – 3

Figure 2. Overview of Plan 1 Post-Retirement Employment Program

Benefit	PERS	TRS
Retire-Rehire Program	Post-retirement employment allowed within same retirement system	Post-retirement employment allowed within same retirement system
Waiting Period	If seeking to work for more than 867 hours, must wait 90 days	Must wait 30 days
Number of Hours	Can work up to 1,500 hours a calendar year without suspension of pension benefits	Can work up to 1,500 hours a fiscal year without suspension of pension benefits
Lifetime Limit	Subject to a 1,900 hour cumulative limit on the number of work hours allowed beyond 867 a year before suspension of benefits	N/A

Source: OSA, 2005, p. 3

Unlike Plans 2 and 3, Plan 1 caps the number of service years used in calculating employees’ pension benefits so many members choose to retire after 30 years of employment, regardless of their age or desire to remain in the workforce. Some of these members then return to work in the private sector or for government agencies that allow them to receive a salary while simultaneously drawing on their pension benefits. See Figure 1.

ESTABLISHMENT OF RETIRE-REHIRE

Retired public employees were originally prevented from returning to work for an employer with the same retirement plan. But, in the mid-1960s, post-retirement employment restrictions began to loosen, allowing pensioners to work a certain number of hours per year before their retirement benefits were suspended (SCPP, 2003, p. 8-9). Since then, numerous changes have been made to the retire-rehire program, largely in the number of hours employees are allowed to work and the rules that returning workers and their employers are required to follow.

2001 Changes. During the most expansive period of the last business cycle, some public employers – particularly school districts – experienced difficulty retaining experienced workers and filling vacancies. In response, ESSB 5937 expanded post-retirement employment opportunities for Plan 1 members by increasing the number of hours that retirees can work without suspension of benefits to 1,500 hours a year. The bill originally contained a sunset clause but that provision was vetoed by Governor Gary Locke.

Recent Changes. In 2003, SHB



1829 established a lifetime limit on the number of hours a PERS 1 retiree can work (above 867 hours a year) for a PERS eligible employer before suspension of benefits. The bill also lengthened the wait period to 90 days and tightened the procedural requirements for hiring and keeping records of retired PERS 1 employees. In addition, SHB 1829 requires employers to document a justifiable need to hire a PERS 1 retiree and prohibits verbal and written agreements for rehire. While the bill included similar restrictions for TRS 1 retirees, these restrictions were vetoed by Governor Locke. See Figure 2.

A number of Plan 1 retire-rehire bills were introduced during the 2004 and 2005 legislative sessions (including a second attempt to extend the 2003 PERS 1 changes to TRS 1), but none passed. However, the 2005 budget bill directed the Office of the State Actuary (OSA) to study the cost of the 2001 expansions.

IMPACT OF RETIRE-REHIRE

In November 2005, OSA released a report documenting that post-retirement employment increases the state's pension obligations by boosting the number of early retirees.

Workforce Impact. According to OSA, the expansion of the retire-rehire program has encouraged earlier retirement and greater use of retire-rehire opportunities. Seventy-five percent of PERS 1 and TRS 1 retirees that returned to the workforce between July 2001 and March 2005 returned to work for their former employer (OSA, 2005, p. 6). And 70 percent of these employees returned within 12 months of retirement (p. 10).

In addition to greater utilization, many returning workers are taking advantage of increased limits on hours. Thirty-eight percent of rehires are working over the pre-2001 hour limits, and TRS 1 members that retired since the 2001 expansion are twice as likely to work over the prior hour limits than TRS 1 members that retired before the expansion (OSA, 2005, p. 10).

Financial Impact. While not a direct benefit enhancement, the expansion of the retire-rehire program imposes large costs on the pension system. Greater than anticipated retirements requires earlier funding of benefits and longer payout times, and the loss in member contributions to the trust fund reduces revenues (OSA, 2005, executive summary p. 4).

OSA estimates that the retire-rehire expansions, if left intact, will cost an estimated \$101.5 million over the next 25 years (OSA, 2005, p. 16). If the same experience of greater than anticipated retirements continues into the future, the cost of the post-retirement employment program will be even higher (p. 17).

Socializing Costs. Unless employer contribution rates are raised, future costs of the 2001 retire-rehire expansion will further increase the Plan 1 unfunded actuarial accrued liability (UAAL). Already, PERS 1 and TRS 1 have accumulated an estimated \$4 billion in unfunded future obligations. By law, this liability must be fully amortized by 2024. But in order to do so, the cost has been spread across all PERS, TRS, SERS (School Employees' Retirement System) and, starting July 1, 2006, PSERS (Public Safety Employees' Retirement System) employers (OSA, 2005, p. 18).



EMPLOYEE AND EMPLOYER IMPACT

Post-retirement employment opportunities allow government agencies to better retain experienced workers and government employees to continue working while simultaneously drawing a pension benefit. However, for employers and employees not participating in the program, as well as for taxpayers that finance these benefits, the retire-rehire program includes several drawbacks and potential for misuse.

Employer Benefits. The retire-rehire program allows employers to retain their experience base, address labor shortages, and add workforce flexibility. And, according to State Superintendent of Public Schools Terry Bergeson, “without the ability to rehire highly qualified veteran educators, administrators, and other school staff our districts would find themselves struggling to find the same caliber of employees for their hard to fill positions” (SCPP, 2003, Appendix C).

But while the rehire-retire program allows agencies to attract and retain experienced workers, employers are not required to pay the full cost of hiring a retiree. Instead, post-retirement employment is financed by all employers required to fund the Plan 1 UAAL.

Employee Benefits. For employees, the retire-rehire program allows for increased long-term financial security and increased flexibility during the last few years of their career. However, there are also concerns that post-retirement employment opportunities diminish younger workers’ ability to compete for entry level jobs and career advancement opportunities (Washington State Legislature, 2006).

Loopholes. Even with the PERS 1 restrictions implemented in 2003, the retire-rehire program contains a number of loopholes and potential for misuse. For example, many institutions of higher education offer both a PERS or TRS retirement plan and a separate school retirement plan. This allows some workers to retire and return to work full-time under the school retirement plan (earning a salary and accruing new benefits) while still drawing a PERS or TRS pension allowance (OSA, 2005, p. 7).

Washington’s Unemployment Insurance (UI) program provides another opportunity for retirees to receive additional benefits. Even though workers return with the understanding that these positions are not permanent, under current law, they are eligible for UI if they worked at least 680 hours (OSA, 2005, p. 8).

SHB 1829 requires the Department of Retirement Services and the Employment Security Department to notify employers about the possible unemployment compensation consequences of hiring retirees. However, no legislation has been enacted to prevent this misuse.

RETIRE-REHIRE REFORM OPTIONS

In addition to an actuarial analysis, OSA’s post-retirement employment report discussed alternatives to the current retire-rehire program. Suggested reforms include encouraging members to work beyond normal retirement eligibility without retiring, amending the existing program, repealing the 2001 expansion, implementing a phased retirement program,



Figure 3. Comparison of Alternatives to 2001 Expansion

	Summary	Argument For	Argument Against
Increase Maximum Allowance	Remove benefit cap, allow members to accrue a one percent benefit after reaching 30 years of service, or increase benefit cap to 35 years	Provides incentives to work longer, thus reducing need to re-employ retirees	A system-wide change – would apply to any active member, making it very costly
Amend Current Program	Reduce costs, create more parity between PERS 1 and TRS 1, avoid “insider agreements” to rehire, limit the applicability of the program, increase the cumulative lifetime limit, etc.	Allows employers to keep the current program while removing some perceived problems	Litigation likely with certain amendments
Repeal Current Program	Remove 2001 expansions	Cost savings of approximately \$101.5 million over the next 25 years (after recognizing program cost)	Litigation likely, although legislation included a “no contractual rights” clause
Charge Employers	Charge employers the cost of hiring retirees by increasing their contribution rates	Removes socialized costs	Imposes too high a cost on employers relying on post-retirement employment to attract experienced workers
Phased Retirement	Allow members to transition into retirement by working part-time and receiving partial benefit	Provides flexibility and allows for retention of older workers	Very complex
Deferred Retirement Option Plan	An alternate pension plan that allows a member to become a retiree for pension purposes while continuing to work	Provides flexibility and allows for retention or replacement of older workers	Very complex and could have unintended consequences

Source: OSA, 2005, p. 20 – 37

and considering a Deferred Retirement Option Plan. See Figure 3.

In response to the OSA report, SCPP prepared and proposed a bill for the 2006 legislative session (introduced as HB 2689 and SB 6448) aimed at improving procedural safeguards and addressing inconsistencies between the PERS 1 and TRS 1 retire-rehire requirements (SCPP, 2005). However, SCPP recommended further study of the post-retirement employment program before considering major changes.

ON THE AGENDA

With healthier than anticipated general fund revenues, lawmakers in the 2006 session are faced with an additional \$1.45 billion to either spend or put into reserves. Governor Christine Gregoire initially proposed using \$176 million of this to pay down the pension system budget gap and the Senate has proposed spending \$350 million. But while this turnaround in proposed funding is promising (UAAL payments were suspended in the 2003-2005 and 2005-2007 budgets), it still falls short of catching up to current obligations.

In addition to paying down the UAAL, some lawmakers support either repealing or amending recently enacted pension benefits, including the retire-rehire program. A number of Plan 1 post-retirement employment related bills have already been introduced this session, including legislation that would extend 2003 PERS 1 restrictions to TRS 1, raise the cap on retirement allowances, remove all or some of the 2001 and 2003 provisions, or limit the ability to hire a retiree to sectors with documented labor shortages.



LOOKING FORWARD

The extension of post-retirement employment opportunities in 2001 helped alleviate some of the pressures of an aging workforce as well as the increased difficulty of hiring and retaining experienced workers during economic expansions. But while an aging workforce poses a challenge, some state analysts argue that the retire-rehire program is not the only means of maintaining an experience base. Agencies can also work to better prepare the next generation of workers by changing existing policies regarding recruitment, hiring, training and development, promotion and career mobility, knowledge management, and program evaluation (Conte, 2006, p. 24-25).

In Washington, Marty Brown, legislative liaison for Governor Gregoire, recently encouraged the use of succession planning and mentoring (Honoré, 2005). And, in 2000, the Washington State Department of Personnel released a workforce planning guide to assist employers in “providing strategic methods for addressing present and anticipated workforce issues” and as well as ways to overcome the state’s “compensation and civil service restrictions” (DOP, 2000b).

Preparing for the mass retirement of government workers – whether in the form of retire-rehire reforms or policy alternatives – will not be easy. But with a \$4 billion unfunded pension liability due in 2024, lawmakers must balance demographic challenges with budgetary realities.

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