HOUSE BILL REPORT
HB 1206

As Reported By House Committee On:
Appropriations

Title: An act relating to creating new retirement systems.

Brief Description: Restructuring the retirement systems.

Sponsors: Representatives Carlson, Sommers, Cooke and Dellwo.

Brief History:
Committee Activity:
Appropriations: 3/1/95, 3/4/95 [DPS].

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 23 members: Representatives Silver, Chairman; Clements, Vice Chairman; Huff, Vice Chairman; Pelesky, Vice Chairman; Sommers, Ranking Minority Member; Valle, Assistant Ranking Minority Member; Beeksma; Brumsickle; Carlson; Cooke; Crouse; Foreman; Hargrove; Hickel; Jacobsen; Lambert; Lisk; McMorris; Reams; Rust; Sehlin; Sheahan and Talcott.

Minority Report: Do not pass. Signed by 6 members: Representatives Chappell; G. Fisher; Grant; Poulsen; Thibaudeau and Wolfe.

Staff: Dan Chang (786-7191).

Background: There are currently two different kinds of retirement plans for public employees (PERS) Plan I and Plan II; and teachers (TRS) Plan I and Plan II. These plans provide a guaranteed "defined benefit" based on a formula that multiplies the number of years an employee has worked and the average final salary by 2 percent.

For each of the retirement plans, the employer and employee both make contributions based upon a percent of the employee's salary.

Vested employees who decide to leave service before they are eligible to retire have two options: 1) withdraw all their employee contributions plus 5.5 percent interest; or 2) leave their contributions in the retirement system and, upon reaching retirement age, begin to draw a pension based upon the final average salary they had when they left their job. There are many employees who want to leave their employment but find their retirement savings will not provide a reasonable value unless they stay until the required retirement age.

The Joint Committee on Pension Policy (JCPP) surveyed employers and employees in 1991 and 1992 on the issue of retirement age in the Plan II system and found three prevailing concerns. First, employees felt that if they left before age 65, they would not get a good return on their contributions. Second, younger employees felt they were making contributions to a plan from which they would not benefit.   Third, they found that the Plan II system was paternalistic and inflexible in the form and timing of retirement benefits.

Based on these conclusions, the JCPP adopted policies for developing an alternative to Plan II. First, post-retirement income should include a combination of Social Security, retirement benefits, and the employee's savings. Second, employees must take an active role in ensuring a sufficient post-retirement income. Third, employees should be given tools for planning their retirement and should have more flexibility in determining the form and timing of their own benefits. Fourth, the purpose of a retirement benefit is to provide income after leaving the work force, not for transitioning between careers. Fifth, a vested employee who leaves employment should receive a retirement benefit that properly reflects his or her length of service.

The JCPP developed Plan III in 1993 and further refined it during the 1994 interim. Efforts were taken to ensure that the new plan be as neutral as possible in its effect on employees: it should not inhibit employees from changing careers or employer; it should not encourage employees to stay in jobs they consider highly stressful, and it should not encourage employees to seek early retirement.

Summary of Substitute Bill: The Public Employees' Retirement System (PERS) Plan III and the Teachers' Retirement System (TRS) Plan III are created, each consisting of two separate parts: a "defined benefit" portion and a "defined contribution" portion.

Purpose

The purpose of Plan III is to give vested employees more flexibility in determining the form and timing of their benefit and to allow employees to change careers. The plan also allows employees to obtain a reasonable value toward their retirement benefit if they decide to leave their employment before retiring. Plan III is designed to minimize requests for early retirement, and to create a plan that is comparable in cost to Plan II. Any new employee hired after July 1, 1996, will belong to Plan III for PERS and TRS.

Defined Benefit- Employer Contributions

The defined benefit consists of employer-only contributions which will be invested by the State Investment Board (SIB). The defined benefit contributions will result in a guaranteed retirement allowance equal to 1 percent of the employee’s average final salary for each year of service. Under the defined benefit, the employer pays contributions that are similar to the rate the employer paid on behalf of employees under Plan II. A combined Plan II and Plan III employer rate will be adopted by the Economic and Revenue Forecast Council every two years. These employer contributions are non-refundable.

<u>Defined Contribution - Employee Contributions</u>
The defined contribution portion consists of employee-only contributions, which are invested by the State Investment Board (SIB) or through a self-directed investment authorized by the Employee Retirement Benefits Board (ERBB). Employees must make a permanent choice from one of three of a set of statutorily set contribution rates or from options developed by the ERBB.

<u>Retirement Age, Vesting, and Disbursement of Contributions</u>:
The Defined Benefit
Normal retirement age remains 65 for PERS and TRS. Early retirement age is 62 with 10 years of service for PERS and TRS. Employees who leave employment can obtain the defined benefit allowance at normal retirement age if they are vested by either having 10 years of service or reaching 55 with five years of service. If the employee has at least 20 years of service and quits before the normal retirement age, this allowance increases at a rate of 3 percent per year until he or she reaches normal retirement age. This permits employees to leave employment before retirement age yet receive, at retirement age, a defined benefit similar to that which would have been received if the employee had continued to work.

The Defined Contribution
When the employee quits or retires, the employee receives his or her defined contributions plus investment earnings as a lump sum or under other payment options made available by the ERBB. There is no formula-defined pension under the defined contribution portion.

<u>Employee Contribution Rates</u>
PERS and TRS Plan II employee contribution rates are fixed at the rates in place on July 1, 1996. Beginning September 1, 1998, the employee contribution rate shall not exceed the employer Plan II and III rates. Any benefit increases in Plan II shall continue to be shared equally between the employer and employee in Plan II.

<u>Option to Join Plan III</u>
Members of Plan II have the irrevocable option to transfer their contributions and service credit to Plan III. If a Plan II member decides to transfer, the member’s employee contributions are transferred to defined contribution portion of Plan III.

Members who transfer by January 1, 1997, will receive an additional 20 percent on the amount of their transferred contributions accumulated as of July 1, 1996.

Administration
The Department of Retirement Systems assumes the powers and duties of the Committee on Deferred Compensation as part of the newly created Employee Retirement Benefits Board. The board consists of six members appointed by the Governor; the director of the Department of Retirement Systems will serve as the chair and ex-officio member of the board. The six members include two members representing PERS, one retired and one active; two members representing TRS, one active and one retired; and two members with experience in defined contribution plan administration. The board is responsible for: 1) pre-selected options for members to choose from if they select self-directed investments for their defined contribution portion of Plan III; 2) optional benefit payment schedules; 3) the approval of annuities; 4) administrative charges for self-directed investments; and 5) the selection of the investment option for the deferred compensation program.

Substitute Bill Compared to Original Bill: In addition to the contribution rate options established in the original bill, the Employee Retirement Benefits Board may offer additional contribution rate options. If a member dies before retirement, a person or persons, a trust, an organization, or the member's estate may receive a refund of the member's contributions. The recipient of the refund need no longer have an "insurable interest" in the member's life. The substitute bill also makes technical corrections.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: Ninety days after adjournment of session in which bill is passed.

Testimony For: Employees should have some flexibility and freedom of choice and should be actively involved in and take responsibility for their retirement planning. House Bill 1206 allows members to change careers before normal retirement and provides greater opportunities for investing their contributions. The plan represents the most effective retirement program by combining defined benefit plan features with defined contribution plan features. Plan II members appreciate the opportunity to choose Plan III. Transferring the functions of the deferred compensation committee to the Department of Retirement Systems results in efficiencies and recognizes deferred compensation and higher education 403(b) plans as an integral component of retirement planning.

There is current mounting pressure as Plan II members grow older with no options to change careers or access to their retirement benefits till age 65. The answers are not simple, but the problem is there.

Testimony Against: The retirement age should be age 62. Though House Bill 1206 moves in the right direction of solving the problem, it does not go far enough. It does not touch the problem; retirement age. Correctional and other workers burn out long before they are old enough to retire. Members still are not able to retire under a full benefit until age 65. The actuarial reduction at age 62 is too big. The pie should be carved up differently.

Testified: Bill Vogler, Washington Association of Counties (pro); Sheryl Wilson, Department of Retirement Systems (pro); Maureen Morris, Association of Washington Cities (pro); Jean Heath (pro); John Kvamme, Washington Association of School Administrators, (pro with concerns); Karen Davis, Washington Education Association (con); Devone Smith, Washington Federation of State Employees (con); Randy Parr, Service Employees International Union (concerns); Kristi Slaten, citizen (concerns); and Rick Hubble, citizen (concerns).