HOUSE BILL ANALYSIS
HB 2487

Brief Description: Creating the Washington school employees' retirement system.

Background:

Provisions of TRS and PERS Plans I and II

Membership in the Teachers' Retirement System is limited to certificated staff of school districts and educational service districts. Membership in the Public Employees' Retirement System (PERS) includes state and some higher education employees, many employees of local governments, and classified K12 employees.

Under TRS and PERS Plan I, which consists of employees hired before October 1977, members can retire at any age after 30 years of service; at age 55 with 25 years of service; or at age 60 with five years of service. Normal retirement for plan II members is age 65; early retirement age in plan II is 55 with 20 years of service, with the benefit actuarially reduced from age 65.

The benefit allowance for both plan I and plan II is 2 percent of average final compensation times the years of service. Vesting occurs after five years. Retirement contributions for plans I and II are made by both the employer and the employee as a percentage of the employee's pay. The employer and employee retirement contribution for TRS Plan II is currently 6.03 percent of compensation. The employer and employee retirement contribution for PERS Plan II is currently 4.65 percent of compensation.

Members of plans I and II who leave employment before retirement can either withdraw their own contributions plus interest, currently set at 5.5 percent, or leave their contributions in the retirement system and draw a retirement allowance after reaching retirement age. The retirement allowance of an employee who chooses to leave his or her contributions in the system is based on the average salary the employee had when a member of TRS or PERS.

The JCPP Discusses Retirement Plan Design and Retirement Policy

The Joint Committee on Pension Policy (JCPP) spent several years in the early 1990s studying the design of the plan II systems. The committee found that employees' major objection to plan II centered around the retirement age. Employees felt that if they leave before age 65, they do not get a good return on their contributions; younger employees felt they were making contributions to a retirement plan they will get very little out of.

The JCPP found that the TRS and PERS Plan II design acts as golden handcuffs– to hold onto employees who want to leave or change careers before reaching age 65. The plan II system, the committee found, is paternalistic and allows employees very little choice or flexibility in the form or timing of their benefits. The committee also found that lowering the plan II retirement age to 62 would cost over $30 million GF-S in 1996.

As the JCPP set out to design an alternative to plan II, they adopted the policy that any new plan design should be as neutral as possible in its effect on employees: it should not inhibit employees from changing careers or employers; it should not encourage employees to stay in jobs they consider highly stressful; and it should not encourage employees to seek early retirement. The committee also adopted the policy that any new plan should not exceed the costs of plan II.

The committee contrasted defined benefit plans such as plans I and II, in which the employer assumes responsibility for providing a specific retirement allowance for the employee's lifetime, with defined contribution plans. Defined contribution plans guarantee only that certain contributions will be made to the plan; they do not guarantee specific benefits upon retirement. The committee found that defined contribution plans encourage employees to assume responsibility for their long-term retirement income; they allow employees more flexibility in determining how their contributions are invested; and they are portable in that the contributions can go with the employee when the employee changes careers or employers.

Plan III

In 1994, the JCPP recommended that a new retirement plan be enacted for PERS and TRS, consisting of a defined benefit portion and a defined contribution portion. TRS Plan III was enacted in 1995. Membership in TRS III consists of all K12 certificated staff first hired on or after July 1, 1996, and all TRS II members who opt to transfer to TRS III. PERS Plan III has been considered by the Legislature but not enacted.

Defined Benefit. The TRS Plan III defined benefit provided at retirement is 1 percent of final average salary times the number of years of service. The defined benefit of a member who leaves employment with at least 20 years of service is increased by 3 percent each year from the time of separation to the date the retirement allowance begins. Normal retirement age is 65 with 10 years of service. Early retirement is at age 55 with at least 10 years of service. The retirement allowance under early retirement is actuarially reduced from age 65. The defined benefit is funded by an employer contribution rate only; employee contributions do not fund the defined benefit portion of plan III.

Defined Contribution. The defined contribution portion of plan III is funded by employee contributions (although an employer contribution can be made to these accounts if authorized in the appropriations act). Upon entry into plan III, the employee must make an irrevocable choice of a contribution structure. The options provided by statute are as follows: Option A is 5 percent of compensation at all ages; Option B is 5 percent of compensation up to age 35, 6 percent from age 35 to 44, and 7.5 percent age 45 and above; and Option C is 6 percent up to age 35, 7.5 percent from age 35 to 44, and 8.5 percent at age 45 and above. Other options can be developed by the Employee Retirement Benefits Board (ERBB). To date, the ERBB has authorized additional contribution rates of 7 percent up to age 35, 10 percent from age 35 to 44, and 15 percent age 45 and above.

All investment earnings on the member's contributions accrue to the member's account. A plan III member can choose to invest either through the State Investment Board in the same portfolio the SIB invests all other TRS Plan II and III monies, or through self-directed investments authorized by the ERBB. Members who choose to self-direct must pay the expenses caused by self-directed investments.

When an employee leaves covered employment for any reason, the employee can withdraw his or her contributions plus investment earnings as a lump sum or under payment options developed by the ERBB. There is no formula-driven pension under the defined contribution portion of plan III.

Transfer payment. Members of TRS Plan II have the irrevocable option of transferring their contributions plus interest as well as their service credit to TRS Plan III. Those who did so before January 1, 1998, received an additional 40 percent of their plan II accumulated contributions as of January 1, 1996. The transfer payment under the 1995 legislation was 20 percent. This was increased in 1997 to 40 percent in order to maintain about the same employer contribution rate in TRS Plan II as the rate would be if plan III had not been created.

Employee Retirement Benefits Board. The Employee Retirement Benefits Board was created within the Department of Retirement Systems in the 1995 legislation. One of the board's responsibilities is creating investment options for plan III members opting to self-invest.

Summary:

Washington School Employees Retirement System. The Washington School Employees' Retirement System (SERS) is created. Membership consists of all Teachers' Retirement Plan I members, and all Washington School Employees' Retirement System Plan II and Plan III members. Teachers' Retirement System Plan II and Teachers' Retirement System Plan III are renamed Washington School Employees' Retirement System Plan II and Plan III, respectively.

Classified Employees Transferred to SERS. All classified employees who are members of PERS Plan II and who are employed by a school or educational service district are transferred to SERS Plan II as of January 1, 1999. The employee contribution rate for all classified SERS Plan II employees is the same employee contribution rate of PERS Plan II. All SERS Plan II classified employees may make an irrevocable choice to transfer to SERS Plan III. The accumulated contributions of SERS Plan II members transferring to SERS Plan III are transferred to the member's account in the defined contribution portion of SERS Plan III.

Transfer Payment. Classified employees who request to transfer from SERS Plan II to SERS Plan III prior to September 1, 1999, receive an additional transfer payment of 65 percent of the members' accumulated contributions as of January 1, 1999.

The transfer payment provided to teachers who transferred to plan III prior to January 1, 1998, is increased from 40 percent to 65 percent.

Gain Sharing. When investment earnings on the pension funds average more than 10 percent during the previous four years, certain SERS III members and retirees receive half of the gains over 10 percent through a payment to their defined contribution account. The gain sharing distribution is made once each biennium. The first distribution is made July 1, 1998. Thereafter, distributions will be made January 1 of each even-numbered year. The amount of the distribution is based on members' years of service.

The following SERS III members and retirees will receive a gain sharing distribution: active members with more than $1,000 in their account; retired members; and vested members who have purchased an annuity from the trust or have more than $1,000 in their account.

The Legislature reserves the right to amend or repeal the gain sharing provisions.

The State Investment Board

The State Investment Board (SIB) is responsible for creating investment options for plan III members who choose to self-direct their investments, based on recommendations from the Employee Retirement Benefits Board. The SIB is the trustee for the money in members' defined contribution accounts.

No state board, commission, agency, officer, employee or member is liable for losses resulting from investments selected by the SIB or for any reasonable attempts to implement the member's investment directions.

Roman Numerals Changed to Arabic

The Code Revisers' Office is instructed to change all numerical designations of the retirement plans from Roman numerals to Arabic numerals (plan I becomes plan 1, etc.).

Effective Date: The bill takes effect January 1, 1999.

Fiscal Note: Available.