SENATE BILL REPORT
SB 5851

As Reported by Senate Committee On:
Ways & Means, February 28, 2013

Title: An act relating to creating a defined contribution retirement plan option for public employees.

Brief Description: Creating a defined contribution retirement plan option for public employees.

Sponsors: Senators Bailey, Hill and Baumgartner.

Brief History:
Committee Activity: Ways & Means: 2/27/13, 2/28/13 [DPS, DNP].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 5851 be substituted therefor, and the substitute bill do pass.
Signed by Senators Hill, Chair; Baumgartner, Vice Chair; Honeyford, Capital Budget Chair; Bailey, Becker, Braun, Dammeier, Hewitt, Padden, Parlette, Rivers, Schoesler and Tom.

Minority Report: Do not pass.
Signed by Senators Hargrove, Ranking Member; Nelson, Assistant Ranking Member; Conway, Fraser, Hasegawa, Hatfield, Keiser, Kohl-Welles, Murray and Ranker.

Staff: Pete Cutler (786-7474)

Background: The Public Employees' Retirement System (PERS) provides benefits for all regularly compensated public employees and appointed officials unless they fall under a specific exemption from membership, such as qualification for another of the state retirement systems. The Teachers' Retirement System (TRS) provides retirement benefits for certificated instructional staff of public schools. The School Employees' Retirement System (SERS) provides benefits for classified school employees. The Public Safety Employees' Retirement System (PSERS) covers employees with law enforcement related duties who are not eligible for membership in the Law Enforcement Officers' and Fire Fighters' Retirement System.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

PERS, TRS, SERS, and PSERS Plans 2 are defined benefit plans that provide a retirement allowance based on 2 percent of the retiree's final average salary for each year of service, with a normal retirement age of 65. Early retirement benefits are available beginning at age 55, with reductions depending on the member's age and years of service. Contributions for the Plans 2 vary from year to year with actuarial requirements, are divided equally between employers and employees, and are paid into each plan's defined benefit fund to pay retirement allowances and other benefits.

PERS, TRS, and SERS Plans 3 are hybrid defined-benefit and defined-contribution retirement plans. Employer contributions finance a retirement allowance based on 1 percent of the retiree's final average salary for each year of service, with a normal retirement age of 65. Early retirement benefits are similar to those offered in Plan 2. Plan 3 employee contributions are made to the employee's defined contribution account. The employee selects a contribution rate within 90 days of becoming a plan member and the rate is fixed for the duration of the employment relationship. Employees have several contribution options between 5 and 15 percent of pay, and a variety of investment options, including participation in the defined benefit plan investment portfolios managed by the State Investment Board. There is no PSERS Plan 3.

State institutions of higher education are authorized to offer a defined contribution Higher Education Retirement Plan (HERP) to faculty and employees exempt from civil service. The HERP employee contribution rates are typically 5 percent of pay until age 35, 7.5 percent until age 50, and an option to increase to 10 percent of pay from age 50 until retirement. The HERP employer contribution rates are typically 5 percent of pay until age 35 and 6 percent of pay thereafter. All employer and employee contributions are deposited into the employee's account.

Summary of Bill (Recommended Substitute): The Washington Public Employees Savings Plan (PESP) is created as a new defined contribution plan option for persons who are eligible for membership in PERS, TRS, SERS, and PSERS Plans 2 and PERS, TRS, and SERS Plans 3, and who were employees first hired in an eligible position on or after July 1, 2014. Members of those plans as of July 1, 2014, have the option to make an irrevocable choice to transfer to PESP between January 1, 2015, and July 1, 2015.

Members of PESP must contribute to their defined contribution accounts at a rate equal to 5 percent of salary up to age 35 and 7.5 percent beginning at age 35. Employers must contribute to members' accounts at a rate equal to 80 percent of the employee contribution rate. Members with less than five years of service are not vested in employer contributions and the earnings on those contributions. In addition to the contributions made to member accounts, school district and educational service district employers will also make contributions required to pay off the unfunded actuarial accrued liabilities of TRS Plan 1; other employers of PESP members will make contributions required to pay off the unfunded liabilities of PERS Plan 1.

For persons who transfer from Plans 2 and Plans 3:
- service in Plan 2 or 3 is transferred to PESP on July, 1, 2015, for determining vesting eligibility for employer matching contributions;

- Plan 2 member-accumulated contributions are transferred to PESP on July 1, 2015, with accrued interest through the transfer date;
- Plan 3 member accounts are transferred to PESP on July 1, 2015;
- an additional transfer payment, representing the employer-provided portion of the member's accrued retirement benefit on June 30, 2015, is credited to each qualified member's account on July 1, 2017.

The State Investment Board (SIB) will develop investment options for PESP member accounts. The Department of Retirement Systems (DRS) is responsible for administering the new plan and must adopt rules that allow members the option to rollover funds from other tax-qualified accounts, subject to Internal Revenue Service (IRS) requirements. DRS must also adopt rules providing members and survivors the option to purchase an annuity from a state-administered fund, subject to IRS approval.

EFFECT OF CHANGES MADE BY WAYS & MEANS COMMITTEE (Recommended Substitute): New employees that do not make a decision regarding which retirement plan they wish to join become members of PESP. Individuals that participate in another employer-sponsored defined contribution plan or annuity plan cannot also be members of PESP for the same employment.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: The bill takes effect on July 1, 2014.

Staff Summary of Public Testimony on Original Bill: PRO: We support the concept of providing additional retirement plan options for state employees. Pensions are in decline and are volatile. Currently in this state there are about 620 private sector defined benefit plans, and about 14,000 401k plans. Employers are moving away from providing defined benefit plans and are using defined contribution plans instead. Younger workers like the portability and other aspects of defined contribution plans.

CON: If the state changes to a 401k-type plan or a strict defined contribution plan such as Plan 3, it will affect every public retirement recipient and all taxpayers. SIB would not be able to make long-term investments and would have to rely on more short-term liquid investments that lower investment earnings. It would dramatically affect the returns that have made the state systems among the top 4 percent of the best-funded plans in the country. Actuaries agree that investment earnings can provide between 75 percent and 84 percent of the funding for defined pension benefits, with the remainder coming from employees and employers. Our retirement system is not in trouble, is not broken, and the Legislature should not do damage to it. Our organization generally opposes the concept of defined contribution plans, but it is hard to argue against providing additional choices to employees. It is not clear whether the bill would have a negative impact on the other retirement plans. A recent study by the National Institute on Retirement Security found defined benefit plans are more efficient and can deliver the same benefits for one-half the administrative cost of defined contribution plans. West Virginia had a bad experience with a defined contribution plan it created and replaced it with a defined benefit plan after a few years. We remain concerned about the possible impact on SIB's rate of return and oppose the proposed change until we can be certain it does not impact the other plans.

Plans 2 and 3 are quite stable and well funded. The state has an excellent deferred compensation program and a good defined benefit program. The bill is unnecessary. It also shifts all the risk to employees. While the choice to join the plan is optional, it is also irrevocable and could cause damage to some employees. The security of the pension at the end of a career of public service is an important attraction to recruit and retain employees. There is not a need for a bill. This bill was not reviewed by the Select Committee on Pension Policy (SCPP) and all pension bills ought to go to SCPP for review. Persons who want to change jobs frequently can use the deferred compensation program; an additional choice is not necessary. The new plan might put SERS at risk. The major problem with the state retirement systems is the past underfunding of PERS 1 and TRS 1.

OTHER: DRS will need time to make changes to reporting systems. An implementation date in 2015 would significantly reduce the cost and risk of making the changes needed to implement the new retirement plan.

Persons Testifying: PRO: Amber Carter, Assn. of WA Business.

CON: Greg Devereux, Katie Nelson, WA Federation of State Employees; Randy Parr, WA Education Assn.; George Masten, Retired Public Employees Council; Pat Thompson, County and City Employees; Sharon Silar, Service Employees International Union Healthcare 1199NW; Ed Gonion, WA State School Retirees Assn.; Adrienne Thompson, Professional and Technical Employees, Local 17; Gene Forrester, John Kvamme, citizens.

OTHER: Dave Nelsen, DRS.