

# SENATE BILL REPORT

## ESHB 1206

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As Reported By Senate Committee On:  
Ways & Means, April 3, 1995

**Title:** An act relating to creating new retirement systems.

**Brief Description:** Restructuring the retirement systems.

**Sponsors:** House Committee on Appropriations (originally sponsored by Representatives Carlson, Sommers, Cooke and Dellwo).

**Brief History:**

**Committee Activity:** Ways & Means: 4/3/95 [DPA, DNPA].

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### SENATE COMMITTEE ON WAYS & MEANS

**Majority Report:** Do pass as amended.

Signed by Senators Rinehart, Chair; Loveland, Vice Chair; Bauer, Drew, Finkbeiner, Gaspard, Hargrove, Hochstatter, Johnson, Long, McDonald, Pelz, Roach, Snyder, Spanel, Strannigan, Sutherland, West and Winsley.

**Minority Report:** Do not pass as amended.

Signed by Senator Fraser.

**Staff:** Denise Graham (786-7715)

**Background:** The Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) each have two plans for employees. Public employees and teachers hired before October 1, 1977 are members of PERS and TRS Plan I. Public employees and teachers hired on or after October 1, 1977 are members of PERS and TRS Plan II.

Members of Plan I 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. Average final compensation in Plan I is the highest two consecutive service years; in Plan II average final compensation is the highest 60 months of consecutive service credit.

If an employee leaves before retirement, he or she can either withdraw accumulated contributions plus interest, currently set at 5.5 percent, or leave contributions in the retirement system and draw a retirement allowance when he or she reaches 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 the public employees' or teachers' retirement system.

Retirement contributions for Plans I and II are made by both the employer and the employee as a percentage of the employee's pay.

In 1990, the Joint Committee on Pension Policy (JCPP) adopted a resolution stating that the committee would study the issue of retirement age in the Plan II systems by surveying employers and employees. Throughout 1991 and 1992, the JCPP examined the results of the retirement age study. 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 are making contributions to a plan they will get very little out of.

The JCPP found that the current 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 and timing of their benefits. The committee also found that lowering the Plan II retirement age to 62 would cost \$31.5 million GF-S in fiscal year 1996.

In September 1993, the JCPP adopted the following policies that would underlie the development of alternatives to Plan II: sufficient income after leaving the workforce should be from a combination of Social Security, retirement benefits and employee's savings; employees must take responsibility for planning for their retirement and for insuring they have a sufficient income after retirement; employees should be given tools to plan for their own retirement and should have more flexibility in determining the form and timing of their benefits; the purpose of a retirement benefit is to provide income after leaving the workforce, as opposed to after leaving one career for another, and to provide, to employees who vest and leave, reasonable value toward their ultimate retirement for their length of service. In addition, the committee 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 final policy adopted by the committee was 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. Defined contribution plans encourage employees to assume responsibility for their long-term welfare. They allow employees more flexibility in determining how their contributions are invested. In addition, defined contribution plans are portable in that the contributions go with the employee when the employee changes careers or employers.

In keeping with the principles adopted in 1993, the JCPP developed Plan III in 1993 and further refined it during the 1994 interim. Plan III is a split plan in that it contains both a defined contribution portion and a defined benefit portion.

**Summary of Amended Bill:** The Teachers' Retirement System (TRS) Plan III is established. Membership consists of TRS employees hired after July 1, 1996 and those members of TRS Plan II opting to transfer to Plan III.

Defined Benefit Plan. Vesting of membership benefits occurs after completing ten years of service, or after completing five years of service if the member is at least age 55. The vested retirement allowance is 1 percent of average final compensation (AFC) times the years of service. The AFC is the highest 60 months of consecutive service credit. A cost-of-living adjustment of 3 percent annually is provided beginning the year after retirement.

The retirement allowance of a vested member who separates from service with at least 20 years of service is compounded at .25 percent monthly from the time of separation to the date the retirement allowance begins.

Normal retirement age is 65. Early retirement age is 62 if the member has 10 years of service. The retirement allowance under early retirement is actuarially reduced from age 65.

Only employers contribute to the defined benefit portion of the plan; the contributions consist of a percentage, to be determined by the Economic and Revenue Forecast Council, of each employees' pay.

Defined Contribution Plan. Only employees contribute to the defined contribution plan. Upon entry into Plan III, the employee must make an irrevocable choice of one of three possible contribution structures. Option A is 5 percent of employee pay at all ages. Option B is 5 percent of pay up to age 35; 6 percent of pay from age 35 to 44; and 7.5 percent of pay from age 45 and above. Option C is 6% of pay up to age 35; 7.5% of pay from age 35 to 44; and 8.5% of pay from age 45 and above.

The contributions are invested by the State Investment Board (SIB) or through a self-directed investment authorized by the newly created Employee Retirement Benefits Board (ERBB). Members who choose to self-directed investments must pay the investment expenses.

On termination of service for any reason, the employee receives his or her contributions plus investment earnings as a lump sum or under other payment options made available by the ERBB. There is no formula-driven pension under the defined contribution portion.

Members of TRS Plan II have the irrevocable option of transferring their contributions and service credit to TRS Plan III. If a Plan II member decides to transfer, his or her employee contributions plus interest are transferred to the defined contribution portion of Plan III. Those transferring by January 1, 1998, will receive an additional 20 percent of their Plan II accumulated contributions as of January 1, 1996.

Employee Retirement Benefits Board. 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 (ERBB). The Board consists of six members appointed by the Governor; the Director of the Department of Retirement Systems service as ex officio member and is the chair of the board. The six members include two members representing the 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.

Every two years, the Economic and Revenue Forecast Council adopts long-term economic assumptions to be used in determining contribution rates. The Council works with the Department of Retirement Systems, the State Actuary and the State Investment Board in developing the economic assumptions.

The benefits provided in the bill are not a matter of contractual right prior to July 1, 1996, the effective date of the act. The legislature retains the right to alter or abolish these benefits prior to the effective date.

Members of PERS Plan II who are educational staff associates may transfer into TRS Plan III.

**Amended Bill Compared to Substitute Bill:** The substitute engrossed bill did not change the frequency that the Economic and Revenue Forecast Council adopts economic assumptions to be used in developing contribution rates from every six to every two years.

The substitute engrossed bill did not specify that the benefits provided in the bill are not a matter of contractual right prior to the effective date of the act.

The substitute engrossed bill did not allow those educational staff associates who are members of PERS II to transfer into TRS III.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect on July 1, 1996.

**Testimony For:** None.

**Testimony Against:** None.

**Testified:** No one.