

# HOUSE BILL REPORT

## SSB 6306

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### As Passed House - Amended:

March 4, 1998

**Title:** An act relating to the Washington school employees' retirement system.

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

**Sponsors:** Senate Committee on Ways & Means (originally sponsored by Senators Long, Winsley, Rossi, Bauer, Roach and Anderson; by request of Joint Committee on Pension Policy).

### Brief History:

#### Committee Activity:

Appropriations: 2/19/98, 2/26/98 [DPA].

#### Floor Activity:

Passed House - Amended: 3/4/98, 64-33.

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## HOUSE COMMITTEE ON APPROPRIATIONS

**Majority Report:** Do pass as amended. Signed by 23 members: Representatives Huff, Chairman; Alexander, Vice Chairman; Clements, Vice Chairman; Wensman, Vice Chairman; H. Sommers, Ranking Minority Member; Doumit, Assistant Ranking Minority Member; Benson; Carlson; Cooke; Crouse; Dyer; Grant; Lambert; Linville; Lisk; Mastin; McMorris; Parlette; Poulsen; D. Schmidt; Sehlin; Sheahan and Talcott.

**Minority Report:** Do not pass. Signed by 8 members: Representatives Gombosky, Assistant Ranking Minority Member; Chopp; Cody; Keiser; Kenney; Kessler; Regala and Tokuda.

**Staff:** Denise Graham (786-7137).

### Background:

Provisions of TRS and PERS Plan II. Membership in the Teachers' Retirement System (TRS) 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 K-12 employees.

Under TRS Plan I and PERS Plan I, which consist 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.

TRS Plan II consists of employees hired between September 1977 and July 1996. PERS Plan II consists of employees hired after September 1977. Normal retirement age for members of TRS Plan II and PERS Plan II is 65.

The benefit allowance for both TRS and PERS Plan II is 2 percent of average final compensation times years of service. Retirement contributions for TRS and PERS Plan II are made by both the employer and the employee as a percentage of the employee's pay.

Members of TRS and PERS Plan II who leave employment before retirement can either withdraw their own contributions plus interest, currently set at 5.5 percent, or they can 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's Discussion of 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 TRS and PERS 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.

TRS 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 K-12 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.

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 employer contributions only.

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 at 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 at 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 (SIB) 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 a transfer payment of 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 approximately 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 ERBB 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 who opt to self-invest.

Investment Gains. Assets invested in the retirement funds have been experiencing growth in recent years substantially above the projected rate of 7.5 percent. The compound average rate of return for the last four years is 13.7 percent. Over the 1997 interim, the JCPP studied ways of using these better-than-expected returns to fund benefit increases. As a result of this work, the JCPP recommended to the Legislature several bills containing gain-sharing provisions.

Health Benefits. When an employee of the state, a school district or educational service district retires, he or she can purchase health benefits from the Washington State Health Care Authority (HCA) if he or she begins purchasing the benefit immediately upon retirement. TRS Plan III members, like the members of other TRS and PERS plans, can begin purchasing a health benefit upon retirement. In addition, a member of TRS Plan III who leaves employment before being eligible to retire, who is at least age 55 and has at least 10 years of service can purchase health benefits from the HCA if he or she begins purchasing the benefit immediately upon leaving employment.

### **Summary of Bill:**

Washington School Employees Retirement System. The Washington School Employees' Retirement System (SERS) Plans II and III are created. The benefits and provisions of SERS Plan II are similar to those in PERS Plan II and the benefits and provisions of SERS Plan III are the same as those in TRS Plan III. All classified employees who are members of PERS Plan II and who are employed by a school district or an educational service district are transferred to SERS Plan II as of September 1, 2000. 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. All new classified school district or educational service district employees hired on or after September 1, 2000, are members of SERS Plan III.

Transfer Payment. Classified employees who request to transfer from SERS Plan II to SERS Plan III prior to March 1, 2001, receive a transfer payment of 65 percent of the members' accumulated contributions as of January 1, 2000.

The transfer payment provided to teachers who transferred to TRS Plan III prior to January 1, 1998, is increased from 40 percent to 65 percent of their January 1, 1996, accumulated contributions.

Gain-Sharing. Gain-sharing will occur in even-numbered years whenever the compound average rate of investment returns on the pension funds over the previous four years exceeds 10 percent. The total gain-sharing amount will be half of the investment returns over 10 percent on employer contributions, and will be paid to SERS Plan III and TRS Plan III members and retirees through a payment to their defined contribution account. The amount distributed to a member is based on the member's years of service.

The first gain-sharing for TRS Plan III members will take place July 1, 1998. Thereafter, the gain-sharing calculation for TRS Plan III will be made in January of each even-numbered year. The first gain-sharing for SERS Plan III will take place March 2001, but will be distributed based on service credit accumulated as of August 1997. The amount distributed per year of service will be the same amount per year of service as was distributed to TRS Plan III members on July 1, 1998. Also in March 2001, a second gain-sharing calculation will be made for SERS Plan III. The calculation will be based on service credit accumulated as of August 1999. The amount distributed per year of service will be the same amount per year of service as was distributed to TRS Plan III members on January 1, 2000. Thereafter, the gain-sharing calculation for SERS Plan III members will take place in January of each even-numbered year.

The Office of the State Actuary will calculate the amount per year of service to be distributed and will inform the Department of Retirement Systems of that amount.

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

The State Investment Board. The State Investment Board (SIB), in consultation with the Employee Retirement Benefits Board, will develop and implement administrative changes to mitigate the impact on other pension funds of the movement of Plan III members in and out of the SIB portfolio. The changes should be designed to minimize the impact of the self-directed investing option on the SIB's asset allocation strategy, liquidity needs and transaction costs.

The Department of Retirement Systems, based upon the recommendation of the SIB, may require members to provide up to 90 days' notice before moving funds from the SIB portfolio to a self-directed investment option.

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.

Health Benefits. A SERS Plan III member may purchase health benefits from the Health Care Authority if: (1) he or she retires and begins receiving a retirement allowance; or (2) he or she leaves employment and is at least 55 years old and has at least 10 years of service. The member must begin to purchase the health benefit immediately upon retirement or separation from employment.

Studies. The Joint Committee on Pension Policy (JCPP) will study the issue of a TRS/SERS merger and report their findings to the Legislature by January 15, 1999.

The Department of Retirement Systems is directed to study the costs of administering the plan III systems, ways to decrease those costs, and methods of charging members for higher cost investment options. The department will report to the JCPP by September 1998.

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.).

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Amended Bill:** The bill takes effect September 1, 2000, except for sections 303, 306-309, 404, 505, 507, 515, 701, 707, and 710-713, which take effect 90 days after adjournment of session in which bill is passed.

**Testimony For:** Sixty percent of the teachers eligible to transfer to Plan III did so. The Legislature shouldn't let the confusion over the liquidity issues stop the Legislature from moving forward on plan III. The liquidity issue could be easily addressed.

**Testimony Against:** Returns on all the retirement funds could be reduced. Deferred compensation programs are already available, and there is no need for a defined contribution retirement program. Classified K-12 employees should not be provided a plan III because they are not sophisticated enough to make good investment decisions.

**Testified:** Doug Nelson, Public School Employees; Kathy Whitlock, Bethel School District; Kye Hillig, Auburn School District; John Kvamme, Washington Association of School Administrators; Bob Maier, Washington Education Association (all pro); Owen Linch, Teamsters Joint Council 28; Ellie Menzie; Greg Devereux, Washington Federation of State Employees; Pat Thompson, Washington State Council of City Employees; Pat McElligott, WSCFF/WSCPO/SIB; Sarah Scanlon, Public Employees Pension Coalition; Dianne Hibbard, SEIU 9288; Dale Nusbaum, Amalgamated Transit Union; Dale Daugharty, I.U.O.E. 609; Lynn Larson, I.U.O.E. 286; Don Briscoe, I.F.P.T.E. Local 17; Randy Withrow, Washington State Council of County and City Employees (all con); Doug Tanabe, Department of Personnel; Jim Parker and Christopher Ailman, State Investment Board; and John Charles, Director, Department of Retirement Systems (neutral).