

HOUSE BILL ANALYSIS

ESSB 6530

Title: An act relating to plans 2 and 3 of the state retirement systems.

Brief Description: Pertaining to plans 2 and 3 of the state retirement systems.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Fraser, Long, Snyder, Franklin, Bauer, Honeyford, Jacobsen, Fairley, Haugen, Roach, Zarelli, Rasmussen, Goings, McAuliffe, Patterson, Eide, Winsley, Hale, Costa, Kohl-Welles, Stevens, B. Sheldon, Gardner and Spanel; by request of Joint Committee on Pension Policy).

Background: Plan 2 and Plan 3. In 1977, the Legislature created new retirement plans for the Public Employees' Retirement System (PERS Plan 2), the Teachers' Retirement System (TRS Plan 2), and the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF Plan 2). These are defined benefit pension plans where a member's retirement benefit is 2 percent of final average salary times years of service. Normal retirement age in PERS Plan 2 and TRS Plan 2 is 65. Normal retirement age in LEOFF Plan 2 is 55. The member contribution rate in PERS Plan 2 is equal to the employer contribution rate. The LEOFF Plan 2 contribution rates split the cost of the plan between the member (50 percent), the employer (30 percent), and the state (20 percent).

Members of TRS, PERS and LEOFF Plan 2 who leave employment before retirement can either withdraw their own contributions plus 5.5 percent interest, or they can leave their contributions in the retirement system and draw a retirement allowance after reaching retirement age. The retirement allowance of a PERS Plan 2 or TRS Plan 2 member, or a LEOFF Plan 2 member with less than 20 years of service who leaves employment and leaves his or her retirement contributions in the system, is based on the salary the member had before leaving employment. The retirement allowance of a LEOFF Plan 2 member who leaves employment with at least 20 years of service and leaves his or her retirement contributions in the system is increased by 3 percent each year from the time of separation to the date the retirement allowance begins.

Between 1990 and 1992 the Joint Committee on Pension Policy (JCPP) conducted a review of the Plan 2 retirement age policy. As a result of the study, the JCPP proposed the creation of a new Plan 3 design. The Plan 3 design consists of a defined benefit portion and a defined contribution portion. One of the goals of the JCPP in designing Plan 3 was that it be cost neutral to the state. Legislation enacted in 1995 created TRS Plan 3. Legislation enacted in 1998 created a new School Employees' Retirement System (SERS), with a Plan 2 and a Plan 3, for classified school district employees.

The Plan 3 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 3 is funded by employee contributions. Upon entry into Plan 3, the employee must make an irrevocable choice of a contribution level. The choices range from 5 percent of salary to 15 percent of salary. All investment earnings on the member's contributions accrue to the member's account. A Plan 3 member can choose to invest either through the State Investment Board (SIB) in the same portfolio the SIB invests all other state retirement fund assets, or in one of several other funds offered by the SIB, in conjunction with the Employee Retirement Benefits Board. When a Plan 3 member leaves covered employment, the employee can withdraw his or her contributions plus investment earnings without destroying the defined benefit.

All teachers first hired on or after July 1, 1996, are mandated to join TRS Plan 3. Members of TRS Plan 2 have the option to transfer to TRS Plan 3. TRS Plan 2 members who transferred to TRS Plan 3 before January 1, 1998, received an additional transfer payment into their defined contribution accounts equal to 65 percent of their accumulated member contributions.

The new School Employees' Retirement System will become effective on September 1, 2000. All classified school district and educational service district employees who are members of PERS Plan 2 will automatically be transferred to SERS Plan 2, which is identical to PERS Plan 2. All SERS Plan 2 members will have the option to transfer to SERS Plan 3 which has the same design as TRS Plan 3. SERS Plan 2 members who transfer to SERS Plan 3 before March 1, 2001, will receive an additional transfer payment of 65 percent of their accumulated member contributions. All classified employees first hired on or after September 1, 2000, are mandated to join SERS Plan 3.

Extraordinary Gains and Gain Sharing. In 1998 the Legislature enacted a new pension benefit, called gain sharing,– which uses high investment returns to fund benefit increases in certain state retirement plans, including TRS Plan 3 and SERS Plan 3. Plan 3 gain sharing distributions are made every two years when there are extraordinary gains. Extraordinary gains– are defined as a four year average investment return in the Plan 2 and Plan 3 retirement trust funds in excess of 10 percent. A portion of the investment returns in excess of 10 percent are distributed to Plan 3 individual member accounts based on each member's years of service.

Plan 3 Retiree Annuity Payment Options. The Employee Retirement Benefits Board (ERBB) was created when TRS Plan 3 was created. One of the board duties is to select payment options for the Plan 3 defined contribution accounts, such as fixed and

participating annuities and payments that bridge to social security or defined benefit plan payments. The ERBB also may approve the creation of annuity options that can be purchased from the combined TRS Plan 2 and Plan 3 fund or the combined SERS Plan 2 and Plan 3 fund. The ERBB has not created any such annuity options to date.

Early Retirement Reduction Factors. Members of PERS Plan 2, TRS Plan 2, and SERS Plan 2 may apply for early retirement if they are at least age 55 and if they have at least 20 years of service. Members of TRS Plan 3 and SERS Plan 3 may apply for early retirement if they are at least age 55 and have at least 10 years of service. Members of LEOFF Plan 2 may apply for early retirement if they are at least age 50 and have at least 20 years of service. In each of these plans, the retirement allowance is actuarially reduced to offset the cost of beginning the retirement allowance early. The factors vary by plan and age, but average about 8 percent per year for a person who chooses to retire five years earlier than normal retirement.

State agencies and higher education institutions employ about 65,000 PERS Plan 2 members. Local government employs about 54,000 PERS Plan 2 members and about 12,000 LEOFF Plan 2 members.

Summary of Proposed Striking Amendment: Optional PERS Plan 3. A new PERS Plan 3 is created, effective March 1, 2002, for employees of state agencies and higher education institutions, and effective September 1, 2002, for employees of local governments. PERS Plan 3 is a split plan similar to TRS Plan 3, with a defined benefit portion and a defined contribution portion. The design of the defined benefit portion of PERS Plan 3 is the same as PERS Plan 2, except Plan 3 has a 1 percent benefit at retirement rather than 2 percent. The defined benefit portion is funded entirely by employer contributions; PERS Plan 3 members make no contributions to the funding of the defined benefit.

Current members of PERS Plan 2 have the option to transfer to Plan 3; those who do so have their service credit and accumulated contributions transferred to their individual account in Plan 3.

PERS members first hired after the effective date of PERS Plan 3 have the option of selecting membership in either Plan 2 or Plan 3. The option must be exercised within 90 days of employment.

Plan 2 to Plan 3 Transfer Payments. Those PERS Plan 2 members who are state agency and higher education employees and who transfer between March 1, 2002, and September 1, 2002, and who earn service credit in February 2003, receive a transfer payment to their defined contribution accounts equal to 110 percent of their accumulated contributions. Those local government employees who transfer from PERS Plan 2 to PERS Plan 3 between September 1, 2002, and June 1, 2003, and who earn service credit in February 2003, receive a 111 percent transfer payment. The transfer payments are made on June 1, 2003.

Plan 3 Gain Sharing Payments. The same gain sharing provisions provided in TRS Plan 3 and SERS Plan 3 are included in PERS Plan 3. The first gain sharing payment is paid June 1, 2003, and is equal to the gain sharing payments made to TRS Plan 3 members in January 2000 and in January 2002.

Plan 3 Annuity Payment Options. The ERBB is required to make optional actuarially equivalent life annuity benefit payment schedules available to Plan 3 members no later than July 1, 2005. These annuity options may be purchased from the TRS, SERS, or PERS combined Plan 2 and Plan 3 funds.

LEOFF Plan 2 Retirement Age and Early Retirement Reduction Factors. The normal retirement age for LEOFF Plan 2 is reduced to age 53. In addition to current early retirement provisions, a LEOFF Plan 2 member who is at least 50 years old and has at least 25 years of service may receive a benefit reduced by 3 percent for each year the member is less than age 53.

PERS, TRS, and SERS Plans 2 and Plans 3 Early Retirement Reduction Factors. In addition to current early retirement provisions, a member of Plan 2 or Plan 3 of PERS, TRS or SERS who is at least age 55 and has at least 30 years of service may receive a benefit that is reduced by 3 percent for each year the member is less than age 65.

Appropriation: None.

Effective Date: The bill contains several effective dates. Please refer to the bill.

Fiscal Note: Available.