

Dual Member ESAs

Issue

Stakeholders have requested the SCPP study allowing Plan 3 members hired into that plan to transfer to Plan 2. Stakeholders have further suggested that Educational Staff Associates (ESAs) who have service in both Plan 2 and Plan 3 of different systems could serve as a pilot group for achieving the broader objective. Stakeholders have further asked if these members are penalized by having their service in different systems. Members with service in more than one system are often referred to as dual members.

This issue raises three questions for policy makers.

- ❖ Should Plan 3 members who were hired into that plan design be given the opportunity to transfer to Plan 2?
- ❖ Should dual-member ESAs be the first group given the opportunity to transfer to Plan 2?
- ❖ Are members penalized by having service in more than one system?

Background

Plan 2 and Plan 3 represent different plan design trade-offs that are geared for different workforce needs. Until July 1, 2007, all newly hired school employees were required to join Plan 3. School employees hired after July 1, 2007, may choose between Plan 2 or Plan 3 at time of hire. Tax counsel has advised that allowing Plan 3 members who were required to join that plan to transfer to Plan 2 could potentially jeopardize the plan qualification status with the Internal Revenue Service (IRS).

Some school employees, including ESAs, may have service in Plan 2 and Plan 3 of different retirement systems. ESAs represent one subgroup within nearly 8,000* dual-system/dual-plan current and former school employees. ESA positions include, but are not limited to: communications disorder specialist, occupational therapist, physical therapist, reading resource technician, school counselor, school nurse, school psychologist, school social worker, and school librarian.

**As of September 23, 2009.*

Policy Highlights

- ❖ Policy makers may wish to consider if requests to transfer are driven by a plan design that no longer meets the needs of the workforce or by specific individuals seeking to maximize their benefits.

- ❖ Allowing members to transfer from Plan 3 to Plan 2 may have implications for the plan tax qualification under IRS regulations.
- ❖ Policy makers may wish to consider if an incremental approach will add more complexity to the retirement systems and require more time and effort than a more comprehensive approach.
- ❖ Policy makers may question if being a dual-member creates any unique plan design concerns that would not apply to the larger group of all plan members.
- ❖ Policy makers may question if job duty or dual-member status is the best criteria for selecting groups for transfer.
- ❖ Dual-membership provisions protect the value of the benefits within each system so members are not disadvantaged because they have service in more than one system.

Committee Activity

Staff briefed the committee at the December meeting. No further action was taken.

Staff Contact

Darren Painter, Senior Policy Analyst
360.786.6155
painter.darren@leg.wa.gov

In Brief

Issue

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Member Impact

The Department of Retirement Systems (DRS) does not collect data sufficient to identify ESAs. However, data from DRS shows nearly 8,000 current and former school employees are Plans 2/3 dual-members.*

**As of September 23, 2009.*

Dual-Member ESAs

This report was presented to the SCPP on December 15, 2009, and has not been updated to reflect subsequent action.

Current Situation

Stakeholders representing school employees have requested the SCPP study allowing Plan 3 members hired into that plan to transfer to Plan 2. Stakeholders have further suggested that a specific group of Plan 3 members could serve as a pilot group for achieving the broader objective. The members suggested by stakeholders are Educational Staff Associates (ESAs) who have service in both Plan 2 and Plan 3 of different systems. Stakeholders have further asked if these members are penalized by having their service in different systems. Members with service in more than one system are often referred to as dual members.

Background

Stakeholders have raised three questions for policy makers to consider.

- ❖ Should Plan 3 members who were hired into that plan design be given the opportunity to transfer to Plan 2?
- ❖ Should dual-member ESAs be the first group given the opportunity to transfer to Plan 2?
- ❖ Are members penalized by having service in more than one system?

Understanding some of the key differences between the Plan 2 and Plan 3 designs and how these differences can impact members' benefits is helpful in addressing the first question. Understanding how dual-member ESAs are similar to and differ from other Plan 3 members is helpful in addressing the second question. Finally, understanding statutory provisions for dual-members is helpful in addressing the third question.

Plan 2 and Plan 3 Are Geared For Different Needs

Plan 2 and Plan 3 represent different plan design trade-offs that are geared for different workforce needs. Plan 2 is a Defined Benefit (DB) plan design geared more toward career employees. In contrast, Plan 3 is a hybrid plan design with both a DB component and a Defined Contribution (DC) component. This design is geared more toward a

mobile workforce. The Plan 2 design affords little benefit risk or benefit control to members. The Plan 3 design gives members more control over their benefits at increased member risk.

Plan 2 members receive a benefit based on service and salary. The amount of that benefit is guaranteed regardless of investment performance. Plan 3 members receive an employer-funded DB of half the amount provided in Plan 2. Plan 3 members also contribute to a DC account that provides funds that members can access when they separate from service—similar to a private-sector 401(k). Plan 3 members choose a contribution rate at the time of hire and may select from a variety of investment options.

The amount that Plan 3 members accumulate in their accounts will depend on a variety of factors including:

- ❖ The contribution rate chosen by member.
- ❖ The investment choices made by the member.
- ❖ How long the member contributes to the account.
- ❖ Investment performance.

Some Plan 3 members may not be able to produce the equivalent of a Plan 2 benefit.

Upon retirement, Plan 3 members can use their DC accounts to purchase an annuity benefit from the plan. Members are not guaranteed to have sufficient funds in their DC account to purchase an annuity that, when combined with their employer provided annuity, will provide the equivalent of a Plan 2 benefit. Members who start in Plan 3 late in their career and members who are building their accounts during periods of poor market performance may find it difficult, if not impossible, to produce the equivalent of a Plan 2 benefit under the Plan 3 design.

Membership in Plan 3 was mandatory for some school employees.

Plans 2/3 school employees are covered by the Teachers' Retirement System (TRS) or the School Employees' Retirement System (SERS). The first Plan 3 was implemented for TRS in 1995 and the design was later provided in SERS and the Public Employees' Retirement System (PERS). Until July 1, 2007, all newly hired school employees were required to join Plan 3. School employees hired after July 1, 2007, may choose between Plan 2 or Plan 3 at time of hire.* Since its existence, Plan 3 has always been optional for PERS members.

Allowing Plan 3 members required to join that plan to transfer to Plan 2 could potentially jeopardize plan qualification with the IRS.

The Plans 2/3 are governmental defined benefit plans for purposes of Internal Revenue Service (IRS) tax qualification. The IRS has been growing more restrictive with regards to choice of contribution rates within these types of plans. The IRS will typically allow an irrevocable choice at the time of hire, which Plan 3 members make, but subsequent rate choices while still an employee are not considered a feature of DB plans by the IRS. Allowing Plan 3 members to transfer to Plan 2, which has a different contribution rate than Plan 3, would likely

constitute another rate choice in the eyes of the IRS. Tax counsel has advised that allowing Plan 3 members who were required to join that plan to transfer to Plan 2 could potentially jeopardize the plan qualification status with the IRS.

**Plan choice in SERS and TRS was established as part of legislation that repealed gain sharing and is currently subject to litigation.*

Other Plan 3 Members Are Similarly Situated With ESAs

Stakeholders have suggested that ESAs be the first group of Plan 3 members allowed to transfer to Plan 2. ESA positions include, but are not limited to: Communications disorder specialist, occupational therapist, physical therapist, reading resource technician, school counselor, school nurse, school psychologist, school social worker and school librarian.

Some ESAs began their public careers in PERS-covered employment. If they later went to work for a school district in a TRS-qualified position, they were placed in TRS and became dual PERS/TRS members. Some may have become dual Plan 2/Plan 3 members if their PERS service was in Plan 2 and they were required to join TRS 3. In some cases, the work they did for their PERS employer was substantially the same as the work they do for their TRS employer.

In addition to ESAs, other school employees can be dual-system/dual-plan members. Any person who starts working for a PERS employer and then takes a job with a school district (or the reverse) can find themselves a dual-system/dual-plan member. Data from the Department of Retirement Systems indicates around 8,000* current and former school employees are dual-system/dual-plan members with service in both Plan 2 and Plan 3 of different systems. The department does not collect data necessary to identify how many of these are ESAs.

Other school employees can be dual-system/dual-plan members.

In addition to ESAs, other members who go to work for a new employer doing essentially the same job can be placed in a new system and plan. There are many positions in common between school districts and other public employers including clerical, custodial, and maintenance positions. PERS members working in one of these positions who go to work for a school district in a similar position can become dual-system/dual-plan members as well. The reverse can also happen: school employees who go to work outside a school district doing the same job can become dual-system/dual-plan members.

**As of September 23, 2009.*

Dual-membership provisions protect the value of the benefits within each system.

Statutory Provisions Address Dual-Member Concerns

Stakeholders have asked if dual members are penalized by having their service in more than one system. The Legislature has made provision in statute to address concerns with members having service in different retirement systems.* Dual members can use service from both systems to qualify for retirement in either system, and they can use their highest salary from either system to calculate their retirement benefits in both systems. These provisions are designed to protect the value of the benefits within each system. Dual-membership provisions do not address how different plan designs impact the total benefits a member receives for his or her entire career as a public employee.

**Chapter 41.54 RCW.*

Policy Analysis

Stakeholders have raised three questions for policy makers.

- ❖ Should Plan 3 members who were hired into that plan design be given the opportunity to transfer to Plan 2?
- ❖ Should dual-member ESAs be the first group given the opportunity to transfer to Plan 2?
- ❖ Are members penalized by having service in more than one system?

The first two questions relate to the broader policy of plan transfer. The last question more narrowly relates to policy around dual members. This paper will address the dual member question first, and then move on to the broader questions around plan transfer.

Dual-Membership Provisions Protect The Value Of Benefits

The Legislature has recognized the unique concerns of dual members and made provision in statute to address them. These provisions protect the value of the benefits within each system so members are not disadvantaged because their service is in more than one retirement system.

Policy makers may question if being a dual member creates any unique plan design concerns.

Dual-membership provisions do not address differences in plan design. As discussed earlier, plan design can have a significant impact on retirement benefits for public employees. However, given that dual-member concerns are addressed in statute, policy makers may question if being a dual member creates any unique plan design concerns that would not apply to the larger group of all plan members. Some policy makers may feel that all Plan 3 members who were required to join that plan are similarly situated whether or not they have service in another system.

Requests To Transfer May Be Driven By Different Factors

Stakeholders have raised the question of whether Plan 3 members who were required to join that plan upon hire should be allowed to transfer to Plan 2. They have not specified under what conditions such a transfer would occur, but have suggested that it be revenue-neutral to the system.

Policy makers may wish to consider if requests to transfer are driven by a plan design that no longer meets the needs of the workforce or by specific individuals seeking to maximize their benefits.

In evaluating requests to transfer out of Plan 3, policy makers may wish to consider what is driving the requests. Is the Plan 3 design no longer meeting the needs of the workforce? Are certain individuals seeking to maximize their benefits by finding the best plan design for their individual circumstances? The answers to these questions may influence how policy makers approach this issue.

Policy makers who question if the Plan 3 design is meeting the needs of the workforce may wish to consider revisiting the issue of plan design for school or other public employees. Policy makers may also wish to consider if changes can be made to the Plan 3 design that would alleviate some of the concerns generating the requests to transfer out. However, some policy makers may prefer to wait until Plan 3 has established a longer track record before opening up the plan design issue.

Policy makers who feel this is more a matter of individuals seeking to maximize their benefits may question the timing of the requests and if some members may later regret a decision to transfer. Financial markets have recently experienced significant downturns. This may contribute to members' requests to transfer out of Plan 3. When markets recover will these same members seek to go back to Plan 3 so they can participate in the market gains? If their individual circumstances change in the future and they feel they would get a better benefit out of Plan 3, will these members also seek to return to Plan 3?

Policy makers may wish to consult with tax counsel when considering a specific transfer proposal.

Allowing members to transfer from Plan 3 to Plan 2 may have implications for the plan tax qualification under IRS regulations. Policy makers may wish to consult with tax counsel when considering a specific transfer proposal.

An Incremental Approach Has Implications For Policy Makers

Stakeholders have also suggested that policy makers may wish to take an incremental approach to the broader issue of allowing members hired into Plan 3 to transfer to Plan 2. This would likely involve allowing members to transfer over a period of time on a group-by-group basis.

Policy makers may consider if an incremental approach will add more complexity to the retirement systems and require more time and effort.

Policy makers may question if job duty or dual member status is the best criteria for selecting groups for transfer.

An incremental approach to this issue has several implications for policy makers. Allowing one group of members to transfer out of Plan 3 may create envy among other Plan 3 members and may increase pressure to allow other groups to transfer. Policy makers may wish to consider if an incremental approach will add more complexity to the retirement systems and require more time and effort than a more comprehensive approach.

Should Dual-Member ESAs Be First?

An incremental approach requires policy makers to decide which group of members should go first. Stakeholders have suggested that dual member ESAs could be this group. These members represent a small subclass of similarly situated Plan 2/Plan 3 dual members. The distinguishing characteristic of ESAs is their job duties. Some policy makers may question if job duties are the best criteria to select groups of dual members for transfer. Policy makers who feel that dual members do not have any unique plan design concerns would likely question whether transfers should start with dual members at all.

Other States

The questions raised by stakeholders involve specific situations arising under Washington's plan provisions that are not directly comparable to Washington's peer states.

Conclusion

Stakeholders have raised the issue of allowing Plan 3 members hired into that plan to transfer to Plan 2. They have suggested that policy makers may wish to take an incremental approach to this issue by using dual-member ESAs as a pilot group. In evaluating this issue, policy makers may wish to consider if the requests to transfer are being driven by a plan design that no longer meets the needs of the workforce or by specific individuals seeking to maximize their benefits. Policy makers may consider if an incremental approach to this issue will add more complexity to the retirement systems and require more time and effort than a more comprehensive approach. Some policy makers may question if job duty or dual-member status is the best criteria for selecting groups for transfer. Finally, policy makers may wish to consult with tax counsel when considering a specific transfer proposal.

Stakeholder Input

*Correspondence from:
Randy Parr, WEA,
September 11, 2009.*

Wallis, Keri

From: RParr@washingtonea.org
Sent: Friday, September 11, 2009 4:50 PM
To: Office State Actuary, WA
Subject: WEA Issue for 2009 Interim
Attachments: SCPP 2009 WEA Issues.pdf

OSA staff and SCPP Members;

Attached please find WEA's letter regarding the issue we would ask the committee to study during this brief 2009 interim. I plan to bring copies for sharing with the committee and/or executive committee at next Tuesday's meeting, but wanted to send this a few days in advance for possible inclusion in committee materials at your next meeting.

Please feel free to contact me should you have any questions.

Randy Parr
Budget Analyst-Lobbyist
Olympia Public Policy Center
Washington Education Association
360-943-3150
253-765-7155
rparr@washingtonea.org



September 11, 2009

Select Committee on Pension Policy
Executive Committee Members
P. O. Box 40914
Olympia, WA 98504-0914

Dear Executive Committee Members;

On behalf of the 81,000 members of the Washington Education Association, we would appreciate your consideration of the following issue for study and/or action during the 2009 interim in preparation for the 2010 Legislative Session.

The WEA has a number of priorities for pension improvements that we expect to address in the future. However, we recognize the committee has only a limited time for studying issues this interim, and are not seeking any efforts on your behalf that require prolonged deliberation. However, while we are not asking the SCPP to act this year, the WEA does continue to have as its highest priority the enactment of Rule of 85 legislation.

The one issue WEA would seek the committee to study this year would be an option for those members of TRS and SERS Plan 3 who were hired in to that plan tier to transfer to their respective Plan 2. We would expect such a transfer to be effected in a manner that would be revenue neutral to the pension system. Should such an undertaking be deemed too large for the short time available to the committee this interim, we would suggest a means by which such an effort could be "piloted" with a small sub-class of system members. The WEA has raised this specific issue in the past, but this year would seek your consideration as a means to explore methods for affecting the larger objective:

- **Education Staff Associates with multiple employers.** Several certificated professions are common to both the state and school systems. These include speech language pathologists, physical therapists and others. Some of these employees began their careers in the state system under PERS 2 and then gained

employment in schools where they were enrolled in TRS 3 (or the reverse). There is a concern that combining these two plans do not add up to a whole pension benefit. We would ask the committee to study the issue of those whose employment has forced them to earn service credit in the two separate systems in this manner and seek a resolution that assures that their career of public service to the state results in a full pension without having been penalized for service in two separate systems. (see RCW 41.32.032 for how this was addressed in the 1980's)

We are prepared to discuss this issue in more detail and would welcome the opportunity to work with the committee in determining the best way to address the issue. Thank you for your consideration.

Sincerely;

A handwritten signature in black ink, appearing to read "Randy Parr". The signature is fluid and cursive, with a long horizontal stroke at the end.

Randy Parr
Budget Analyst/Lobbyist
Washington Education Association
(360) 943-3150
(360) 481-2825