

**Select Committee on Pension Policy**

**TRS 3 Member Rate Flexibility**

Aaron Gutierrez, MPA, JD  
Policy Analyst

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**Does The SCPP Want To Recommend Legislation To Remove The TRS 3 Member Rate Flexibility Provision?**

- TRS 3 received conditional IRS determination letter
  - IRS qualified the plan
  - Contingent on legislative removal of member rate flexibility
- DRS asked SCPP to recommend legislation removing that provision



## Today's Presentation

- Quick overview of Plans 3
- Member rate selection and the rate flexibility provision
  - Background and history
- Plan qualification
  - What are determination letters?
  - What are the implications for disqualification?
  - Recent determination letter
  - Sample perspectives of proposal
- Possible next steps



## Basic Components Of PERS 3, TRS 3, SERS 3

- Two parts
  - Defined benefit (DB)
    - Traditional pension
    - Same as Plan 2, but half the size
    - Funded by employer
      - Rate recommended by SCPP and set by PFC and Legislature
  - Defined contribution (DC)
    - Similar to 401(k)
    - Funded by member
      - Rate chosen by member
      - If no choice made, default rate is 5 percent



### Member Rate Options For PERS 3, TRS 3, And SERS 3

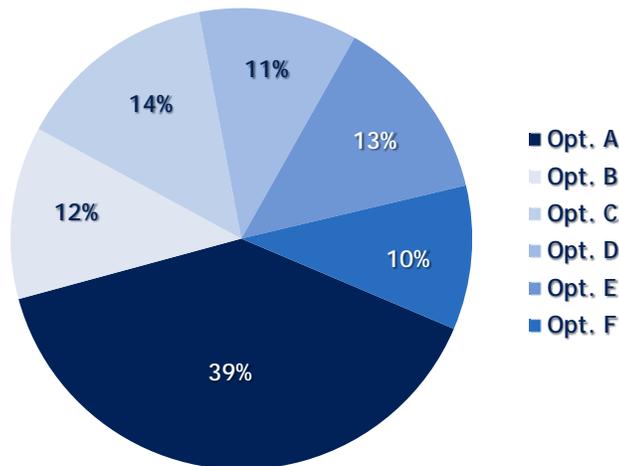
- Set in statute
- DRS authorized to create additional options

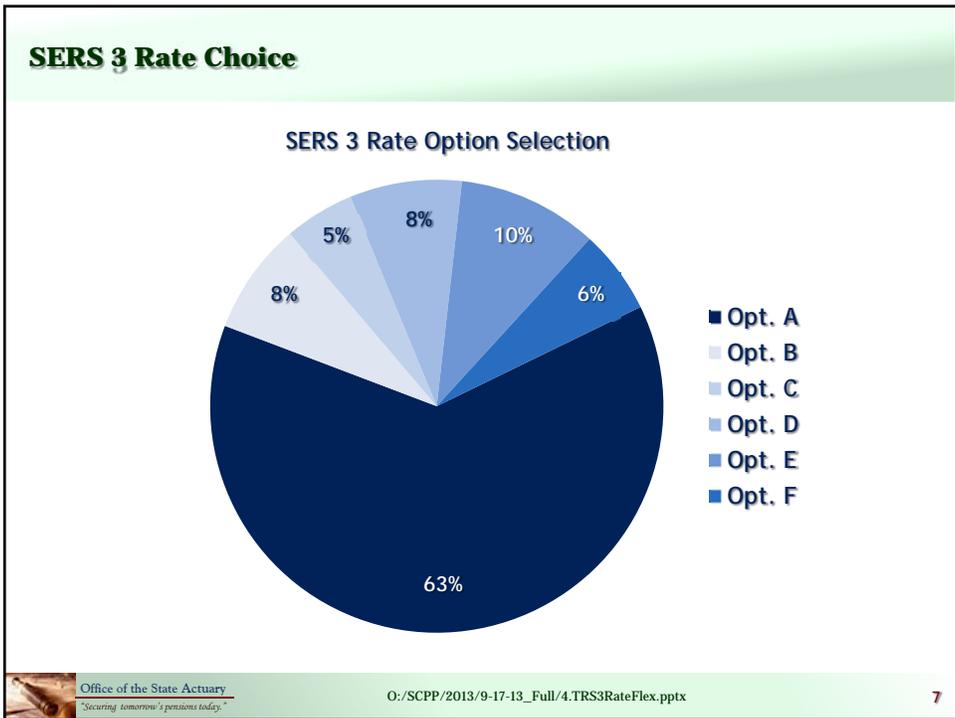
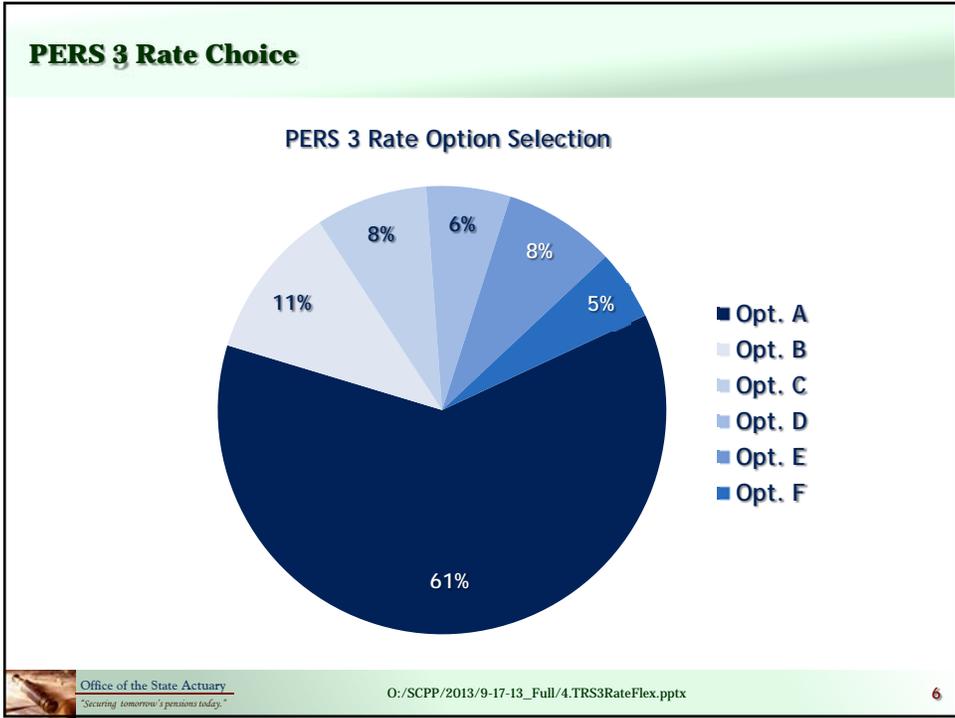
| Rate Option        | Total Rate |
|--------------------|------------|
| Option A (Default) | 5.0%       |
| <b>Option B</b>    |            |
| Until age 35       | 5.0%       |
| Age 35 to 44       | 6.0%       |
| Age 45 and up      | 7.5%       |
| <b>Option C</b>    |            |
| Until age 35       | 6.0%       |
| Age 35 to 44       | 7.5%       |
| Age 45 and up      | 8.5%       |
| Option D           | 7.0%       |
| Option E           | 10.0%      |
| Option F           | 15.0%      |



### TRS 3 Rate Choice

TRS 3 Rate Option Selection





## Other Ways to Choose Overall Contribution Amount

- Two other savings vehicles available for many Plans 3 members
- Deferred Compensation Program (457)
  - Available for most state employees
  - Defined contribution plan
  - Voluntary and pre-tax
  - Select your own rate and change at any time
- Tax Sheltered Annuity (403(b))
  - Available for most teachers
  - Defined contribution plan
  - Generally voluntary and pre-tax
  - Terms vary by school district



## Next Up

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## Rate Selection

- All Plans 3 members must choose a rate option within 90 days of employment or receive default option
  - For PERS 3 and SERS 3 this is permanent
  - Only way to change rates is to switch employers
- TRS 3 members can change their rate option in January of each year



## In 2003 All Plans 3 Were Given Yearly Rate Flexibility

- Enacted under Chapter 156, Laws of 2003
  - Not part of original TRS 3 design enacted in 1996
- Provision still in statute



### Provision Was Never Administered For PERS/SERS 3

- TRS 3 was qualified by IRS with *proposal* for rate flexibility in 2002
- When PERS 3/SERS 3 submitted to IRS with same proposal, it was struck down
  - No PERS 3/SERS 3 members allowed to change rates
  - Only TRS 3 members have been able to change rate options



### TRS 3 Rate Option Changes Per Year

| TRS 3 Contribution Rate Changes* |                             |                             |               |                                   |
|----------------------------------|-----------------------------|-----------------------------|---------------|-----------------------------------|
| Data As Of January 23, 2013      |                             |                             |               |                                   |
| Year of Rate Change              | Contribution Rate Decreased | Contribution Rate Increased | Total Changes | Population (as of valuation date) |
| 2004                             | 1,138                       | 3,135                       | 4,273         | 49,302                            |
| 2005                             | 602                         | 1,069                       | 1,671         | 51,473                            |
| 2006                             | 654                         | 1,245                       | 1,899         | 53,371                            |
| 2007                             | 565                         | 1,341                       | 1,906         | 51,856                            |
| 2008                             | 585                         | 1,348                       | 1,933         | 52,360                            |
| 2009                             | 1,074                       | 1,057                       | 2,131         | 53,010                            |
| 2010                             | 729                         | 1,038                       | 1,767         | 52,292                            |
| 2011                             | 715                         | 1,136                       | 1,851         | 52,178                            |
| 2012                             | 659                         | 934                         | 1,593         | 51,489                            |
| 2013                             | 551                         | 1,201                       | 1,752         | **                                |
| <b>Grand Total</b>               | <b>7,272</b>                | <b>13,504</b>               | <b>20,776</b> |                                   |
| <b>Percentages</b>               | <b>35%</b>                  | <b>65%</b>                  |               |                                   |

\*The counts are for employment periods (EMSPs) that have more than one rate code. The counts do not include members who separated and changed their contribution rate upon reemployment.

\*\*Population data for 2013 is not yet available.



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## What Is Plan Qualification?

- Favorable tax status under Internal Revenue Code (IRC) 401
  - Plans must comply with complex set of rules
    - On paper and in practice
- Determination letters
  - Statement from IRS that plan is qualified on paper
- DRS must administer consistent with IRC
  - State statute requires conflicts between Plans 3 provisions and IRC be resolved in favor of IRC



## Possible Implications Of Plan Disqualification

- Full scope of impacts not known
  - According to IRS publications, *at least* the following will occur
- All contributions considered taxable income (i.e. contributions made post-tax) and subject to withholding
  - Includes both member and employer contributions
- Members taxed on plan earnings (i.e. investment returns) in the year earned
  - Includes earnings from both member and employer contributions
- Impacts may apply to TRS 3 *and* TRS 2
  - IRS considers them to be a single plan



## Recent IRS Determination Letter

- Conditional requalification of TRS 3
  - Contingent on legislative removal of member rate flexibility
  - If not removed, plan may lose favorable tax status
- Letter included timetable
  - Law must be passed and signed in 2014 legislative session
  - Rulemaking must be completed within 91 days of session
- If provision removed, TRS 3 members would have one final chance to select rate option in January of 2015



## Perspectives On This Proposal May Differ

- Some may see this as purely a plan qualification issue
  - Statute requires consistency with IRC
- Others may see this as a cutback of benefits
  - Provision has been in statute for ten years
  - Unlike PERS 3/SERS 3, members of TRS 3 have exercised this option
- Some may also see this as a trade-off
  - A benefit cut in exchange for retention of tax benefits



## Summary

- IRS re-qualified TRS 3 contingent on legislative removal of member rate flexibility provision
- If not removed, TRS 2 and TRS 3 risk disqualification and loss of favorable tax status
- If removed, the January 2015 rate selection window will be the last (unless member changes employers)
- Removal could be viewed as a plan qualification issue, a cutback in benefits, or a trade-off
- Other investment vehicles can provide rate flexibility



## Possible Next Steps

- Nothing further at this time
- Recommend legislation to remove TRS 3 member rate flexibility



## Appendix



## Plans 3 Rate Option Selection

| Plan 3 Contribution Rate Selected For Current Members |               |             |               |             |               |             |                |             |
|---|---------------|-------------|---------------|-------------|---------------|-------------|----------------|-------------|
| <i>Data as of March 22, 2013</i>                      |               |             |               |             |               |             |                |             |
| Contribution Rate Selected                            | PERS 3        |             | SERS 3        |             | TRS 3         |             | Grand Total    |             |
|   | Count         | Percent     | Count         | Percent     | Count         | Percent     | Count          | Percent     |
| A - 5%  | 17,169        | 61%         | 19,718        | 63%         | 21,024        | 39%         | 57,912         | 51%         |
| B - 5%, 6%, 7.5%                                      | 3,199         | 11%         | 2,612         | 8%          | 6,730         | 12%         | 12,541         | 11%         |
| C - 6%, 7.5%, 8.5%                                    | 2,385         | 8%          | 1,634         | 5%          | 7,598         | 14%         | 11,617         | 10%         |
| D - 7%  | 1,784         | 6%          | 2,577         | 8%          | 6,090         | 11%         | 10,451         | 9%          |
| E - 10%   | 2,243         | 8%          | 3,065         | 10%         | 7,008         | 13%         | 12,316         | 11%         |
| F - 15%   | 1,503         | 5%          | 1,845         | 6%          | 5,603         | 10%         | 8,951          | 8%          |
| <b>Grand Total</b>                                    | <b>28,283</b> | <b>100%</b> | <b>31,451</b> | <b>100%</b> | <b>54,053</b> | <b>100%</b> | <b>113,789</b> | <b>100%</b> |

*Notes:*

A "current Plan 3 member" means a member in a Plan 3 who does not have a separation date reported.

Data provided by the Department of Retirement Systems.

Participants in Option A may have selected that option or defaulted. Default can occur actively or passively.

