

Plans 3 Rate Choice

Issue

Should Public Employees' Retirement System (PERS) Plan 3 members be given an opportunity to select a different contribution rate for their Plan 3 Defined Contribution (DC) account?

Background

Washington retirement plans are tax-qualified and meet certain Internal Revenue Service (IRS) requirements for asset management, benefit payments, and contributions. Qualified plans receive tax advantages such as the ability to make pre-tax contributions and defer tax on investment earnings.

The Plans 3 are hybrid plans consisting of both a Defined Benefit and DC component. Members contribute to an individually managed DC account which is similar to a 401K, while employers fund a traditional pension that is about half the size of Plan 2. New Plan 3 members may select from a variety of contribution rates for their DC account. However, once selected, members may only change their contribution rate after changing employers.

The original design of the Plans 3 allowed members to select a different contribution rate for their DC account every year. However, this annual rate choice was removed by the Legislature after the IRS stopped qualifying plans with that feature.¹

The Public Employees' Retirement System, Teachers' Retirement System (TRS), and School Employees' Retirement System (SERS) have a Plan 3.

Highlights

- ❖ Tax-qualification provides significant financial advantages to participants in the retirement system.
- ❖ While the original design of the Plans 3 included annual member rate choice, this was removed after the IRS stopped qualifying plans with that feature.
- ❖ In July of 2024, DRS asked tax counsel if Plan 3 members could be given an opportunity to change their contribution rate.
- ❖ According to tax counsel:
 - Members choose a rate when first joining the plan and that choice is irrevocable while with the same employer.
 - Allowing members to change the rate without changing employers would jeopardize the plan's qualification status with the IRS.

¹In 2002, the IRS qualified TRS 3 with annual member rate change. However, it wouldn't qualify PERS 3 or SERS 3 with this feature a few years later, and members were never provided the rate change option. In 2012, the IRS reviewed TRS 3 again and required the rate change option to be removed to maintain the Plan's qualification. In response, the Legislature removed rate choice from all Plans 3 in 2014.

Committee Activity

The SCPP received an initial briefing at the July meeting and took no further action.

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