

February 2010

Dear Plan 3 member,

Thank you for your letter to Director Hill regarding the possibility of an annual opportunity for members of the Public Employees' Retirement System (PERS) and School Employees' Retirement System (SERS) Plan 3 to change their member contribution rates. He has asked me to respond on his behalf.

We understand your desire to bring PERS and SERS Plan 3 into conformity with Teachers' Retirement System (TRS) Plan 3. The question of such "rate flexibility," however, is governed entirely by federal regulation, and the Department of Retirement Systems (DRS) is not in a position to act in a way that is contrary to these regulations.

DRS submitted TRS Plan 3 for plan qualification to the Internal Revenue Service (IRS) in 2000. The request included a proposal to allow TRS members to change their contribution rates once a year. In 2002, the IRS qualified the TRS plan, with the annual rate flexibility option.

TRS was the first Plan 3 fully implemented. In 2000, when it was submitted to the IRS, the SERS plan had been passed by the legislature, but was not yet in effect and PERS Plan 3 had not yet passed the legislature.

In 2002, after receiving the favorable TRS Plan 3 determination, DRS submitted a request for qualification of PERS and SERS Plan 3. The submission included a request to allow PERS and SERS Plan 3 members to change contribution rates in January of each year.

After a lengthy review, the IRS determined that PERS and SERS would not receive federal tax qualified status as defined benefit plans if the annual contribution rate change option was included in the plans. To receive plan qualification, the rate change proposal was removed.

Since the IRS' refusal to approve rate flexibility in PERS and SERS, the IRS has issued guidance underscoring its position on rate flexibility. The IRS, apparently in order to protect the federal tax base, has recently and consistently taken steps to guard against the expansion of a governmental employee's ability to defer taxation on additional income through their government sponsored defined benefit plans by placing limits on changes government employees may make to their contribution rate.

PERS, SERS and TRS must comply with the provisions of IRS code that govern defined benefit retirement plans for governmental employees. If any legislative change to the plan conflicts with IRS code, the plan may be disqualified by the IRS resulting in significant cost to the governmental employers and employees. The favorable plan determination means that PERS, SERS and TRS can continue to operate under the provisions of section 401(a) of the IRS code which includes the ability for members to contribute to Plan 3 on a tax-deferred basis.

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All the Washington retirement plans are presently before the IRS for requalification. The Department does not know whether the IRS will continue to qualify TRS Plan 3 with the existing "rate flexibility" feature. We anticipate the IRS review of the plans to be completed in 2010.

DRS has done everything in its authority to work the issue through the IRS. In the process, DRS has kept the best interest of all the members in mind.

Sincerely,

Marcie Frost
Deputy Director