LEOFF Plan 2 Retirement Board

Contribution Rate Setting

Final Proposal
July 23, 2014

Discussion Points

- Statutory Duty to Set Rates
- Goals and Achievements
- Options

Statutory Duty

- Board Authorized to Set Rates
  - RCW 41.26.725
- Set Rates in Even-numbered Years
  - RCW 41.45.0604

Goals and Achievements

- Fully-funded Status
  - Maintain 100% or Better Funded Status
  - Projection of Fully-funded Status through 6/30/2017
- Stable Contribution Rates
  - Predictable Increases
  - Level Rates through 6/30/2017

Options

1. Maintain Existing Contribution Rates

- 100% of EANC based on 2011 Valuation Report
  - 8.41% Member, 5.05% Employer, 3.36% State

LEOFF Plan 2 Retirement Board

Options

2. Adjust Contribution Rates to New EANC

a. 100% of EANC <u>Before</u> Updated Assumptions

- 8.60% Member, 5.16% Employer, 3.44% State

b. 100% of EANC <u>After</u> Updated Assumptions

- 8.85% Member, 5.31% Employer, 3.54% State

Options

3. Switch to an Aggregate Funding Method with a 90% Floor

- Aggregate After Updated Assumptions
  - 7.97% Member, 4.78% Employer, 3.19% State

Comparison

OPTION	MEMBER	EMPLOYER	STATE
Option 1: Maintain Existing Rates	8.41%	5.05%	3.36%
Option 2a: 100% EANC Before Updated Assumptions	8.60%	5.16%	3.44%
Option 2b: 100% EANC After Updated Assumptions	8.85%	5.31%	3.54%
Option 3: Aggregate/90% Floor After Updated Assumptions	7.97%	4.78%	3.19%

Any Questions?

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CONTRIBUTION RATE SETTING

FINAL PROPOSAL
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ISSUE STATEMENT

The short-term policy issue to be addressed by the Board is to determine whether or not the existing fixed contribution rates should remain in effect or be adjusted to reflect the Preliminary Results of the *2013 Actuarial Valuation Report*.

OVERVIEW

The Board is required by law to adopt member, employer, and state LEOFF Plan 2 contribution rates for the 2015-17 biennium no later than July 31, 2014. The Board has previously adopted rates through June 30, 2017 but may consider changes.

The current adopted contribution rates are 8.41% member, 5.05% employer and 3.36% state and are effective through June 30, 2017. The contribution rate is calculated at one hundred percent of the entry age normal cost (EANC) of the plan based on the Actuary's *2011 Actuarial Valuation Report*.

BACKGROUND & POLICY ISSUES

DUTY TO SET CONTRIBUTION RATES

The Board has a statutory duty to set contribution rates for LEOFF Plan 2 in even-numbered years. Prior to the creation of the Board on July 1, 2003 under Initiative 790, basic contribution rates for LEOFF Plan 2 were set by the Pension Funding Council (PFC), subject to revision by the Legislature. The PFC would receive contribution rate recommendations from the Office of the State Actuary (OSA) on all of the state retirement plans, including LEOFF Plan 2. This process is still used today for all of the other state retirement systems. After the creation of the Board, OSA now makes contribution rate recommendations for LEOFF Plan 2 directly to the Board and the Board sets contribution rates. Rates set by the Board may be subject to Legislative Revision.

MAINTAINING FINANCIAL INTEGRITY OF THE PLAN – STRATEGIC PLAN

In 2004 the Board, as part of its strategic plan, set maintaining the financial integrity of the plan as of its top priorities. Maintaining the stability of contribution rates was one of the objectives set for reaching this goal. The first step in achieving stable rates was to increase contribution rates to meet the levels needed to fund current benefits. The Board realized the contribution rates which had been artificially low could not be raised to the full extent needed without creating financial hardships for the members, employers and state. Instead, the Board adopted a four-year plan of annual increases to raise rates through June 30, 2009 (see appendix A).

The Board then adopted two policies to further stabilize long-term contribution rates. One was the adoption of a minimum contribution rate of 90% of the EANC of the plan. The second was to establish a funding corridor. Under the funding corridor policy a 30% maximum and minimum ratio of actuarial to market asset value was established. This helps ensure rates do not remain artificially too high or low. In addition to these policies the Legislature passed a statutory funding policy in 2003 that allows gains and losses to be "smoothed" over a period of up to eight years, depending on the magnitude of the deviation between actual investment return and the current return assumption.

TEMPORARY FUNDING POLICY CHANGES

In July 2008 the Board adopted a temporary change in funding policy by adopting fixed rates for the next four years (July 1, 2009 through June 30, 2013) that were equal to 100% of the EANC as of June 30, 2007. In July 2010, as part of their two-year rate-setting cycle, the Board reviewed the existing funding policy and moved to extend the current temporary funding policy through June 30, 2017.

This temporary funding policy allows the Board to maintain rate stability and 100% funded status through June 2017. The Board's policy will allow for the fund to recognize all of the losses from 2008 and 2009 without having to increase contribution rates. Most Washington pension plans will have significant pressure to increase rates in the next biennia as they recognize the same losses from 2008 and 2009.

At the July 2012 Meeting, the Board decided to adjust the temporary funding policy enacted in 2010 by adopting rates based on 100% of the Entry Age Normal Cost (EANC) from the *2011 Actuarial Valuation Report,* rather than continuing to use the rates from the *2007 Actuarial Valuation Report.*

MORTALITY IMPROVEMENTS AFFECT RATES

According to Office of the Chief Actuary (OCACT) for the Social Security Administration (SSA), factors contributing to generally rapid overall rate of improvement during past century include: Access to primary medical care, discovery and availability of antibiotics and immunizations, clean water supply and waste removal, and a rapid growth in the standard of living.[1] All of these factors contributing to one another result in longer life spans, and thus more pension payments to be made.

The principal factor affecting the increase in proposed rates for the upcoming biennium is the switch from Scale AA to Scale BB on the RP-2000 Mortality table.

Scale AA was first released in 2005, and adopted by the board in August 2006. However, "a noticeable degree of mismatch between Scale AA rates and actual mortality experience for ages under 50, and the Scale AA rates were lower than actual mortality improvement rates for most ages over 55."

[1] OSA Preliminary Presentation to LEOFF 2 Board at June 18th, 2014 Meeting

This separation of assumed rates and actual experience led to the Office of the State Actuary implementing an interim scale in 2012 called Scale BB.

Scale BB is meant to do two things: first to align assumptions to be more in line with experience, and second to prepare for the upcoming change in the soon to be released RP-2014 mortality table which uses a 2-dimensional scale for the first time. Rather than simply looking at age only as was done in the past, a 2D scale looks at age and the year of birth.

POLICY OPTIONS

Option 1: Maintain Existing Fixed Contribution Rate through June 30, 2017

Under this option the Board is not required to do anything. The contribution rates will continue at 100% of the EANC based on the *2011 Actuarial Valuation Report*. The rates under this option would be: 8.41% Member, 5.05% Employer, and 3.36% State.

Option 2a: Adjust Contribution Rates to New EANC without Updated Assumptions

Under this option the Board would adopt a contribution rate of 100% of the EANC, with no updated assumptions, based on the Preliminary Results of the *2013 Actuarial Valuation Report.* The rates under this option would be: 8.60% Member, 5.16% Employer, and 3.44% State.

Option 2b: Adjust Contribution Rates to New EANC with Updated Assumptions

Under this option the Board would adopt a contribution rate of 100% of the EANC including the updated assumptions, based on the Preliminary Results of the *2013 Actuarial Valuation Report.* The rates under this option would be: 8.85% Member, 5.31% Employer, and 3.54% State

Option 3: Switch to Aggregate Rate with a 90% Floor with Updated Assumptions

Under this option the contribution rate would be based on the aggregate actuarial cost of the plan as of the *2013 Actuarial Valuation Report* with updated assumptions; and with adjustments, as needed, for a 90% rate floor and the 30% maximum/minimum asset corridor. The rates under this option would be: 7.97% Member, 4.78% Employer, and 3.19% State.

OPTION COMPARISON	MEMBER	EMPLOYER	STATE
Option 1: Maintain Existing Rates	8.41%	5.05%	3.36%
Option 2a: 100% EANC Before Updated Assumptions	8.60%	5.16%	3.44%
Option 2b: 100% EANC Before Updated Assumptions	8.85%	5.31%	3.54%
Option 3: Aggregate/90% Floor After Updated Assumptions	7.97%	4.78%	3.19%

SUPPORTING INFORMATION

Appendix A: 2005 – 2009 Weighted Annual Contribution Rate Increase Schedule
Appendix B: Historical Contribution Rates
Appendix C: Rate-Setting Statutes
Appendix D: Funding Methods Defined

APPENDIX A

2005-2009 WEIGHTED ANNUAL CONTRIBUTION RATE INCREASE SCHEDULE

YEAR	MEMBER	EMPLOYER	STATE
July 1, 2005	6.75%	4.05%	2.70%
July 1, 2006	7.55%	4.53%	3.02%
July 1, 2007	8.30%	4.98%	3.32%
July 1, 2008	8.49%	5.09%	3.39%

APPENDIX B
HISTORICAL CONTRIBUTION RATES

EFFECTIVE DATE	MEMBER	EMPLOYER	STATE
10/1/77	8.14%	4.88%	3.26%
7/1/79	8.08%	4.85%	3.23%
7/1/81	7.74%	4.65%	3.09%
7/1/83	7.90%	4.74%	3.16%
7/1/85	7.00%	4.70%	3.13%
7/1/87	8.09%	4.85%	3.24%
7/1/89	7.60%	4.56%	3.04%
1/1/92	7.01%	4.21%	2.80%
9/1/93	8.41%	5.05%	3.36%
9/1/96	8.43%	5.06%	3.37%
9/1/97	8.48%	5.09%	3.39%
7/1/99	5.87%	3.52%	2.35%
5/1/00	5.41%	3.25%	2.16%
9/1/00	6.78%	4.07%	2.71%
7/1/01	4.50%	2.70%	1.80%
4/1/02	4.39%	2.64%	1.75%
7/1/03	5.05%	3.03%	2.02%
2/1/04	5.07%	3.04%	2.03%
9/1/04	5.09%	3.06%	2.03%
7/1/05	6.75%	4.05%	2.70%
9/1/05	6.99%	4.20%	2.79%
7/1/06	7.79%	4.68%	3.11%
9/1/06	7.85%	4.72%	3.13%
7/1/07	8.60%	5.17%	3.43%
9/1/07	8.64%	5.19%	3.45%
7/1/08	8.83%	5.30%	3.53%
7/1/09	8.45%	5.07%	3.38%
9/1/09	8.46%	5.08%	3.38%
7/1/13	8.41%	5.21%	3.20%
9/1/13	8.41%	5.05%	3.36%

APPENDIX C
RATE-SETTING STATUTES

RCW 41.26.725
Board of trustees — Contributions — Minimum and increased benefits

(1) The board of trustees shall establish contributions as set forth in this section. The cost of the minimum benefits as defined in this plan shall be funded on the following ratio:

Employee contributions	50%
Employer contributions	30%
State contributions	20%

(2) The minimum benefits shall constitute a contractual obligation of the state and the contributing employers and may not be reduced below the levels in effect on July 1, 2003. The state and the contributing employers shall maintain the minimum benefits on a sound actuarial basis in accordance with the actuarial standards adopted by the board.

(3) Increased benefits created as provided for in RCW 41.26.720 are granted on a basis not to exceed the contributions provided for in this section. In addition to the contributions necessary to maintain the minimum benefits, for any increased benefits provided for by the board, the employee contribution shall not exceed fifty percent of the actuarial cost of the benefit. In no instance shall the employee cost exceed ten percent of covered payroll without the consent of a majority of the affected employees. Employer contributions shall not exceed thirty percent of the cost, but in no instance shall the employer contribution exceed six percent of covered payroll. State contributions shall not exceed twenty percent of the cost, but in no instance shall the state contribution exceed four percent of covered payroll. Employer contributions may not be increased above the maximum under this section without the consent of the governing body of the employer. State contributions may not be increased above the maximum provided for in this section without the consent of the legislature. In the event that the cost of maintaining the increased benefits on a sound actuarial basis exceeds the aggregate contributions provided for in this section, the board shall submit to the affected members of the plan the option of

paying the increased costs or of having the increased benefits reduced to a level sufficient to be maintained by the aggregate contributions. The reduction of benefits in accordance with this section shall not be deemed a violation of the contractual rights of the members, provided that no reduction may result in benefits being lower than the level of the minimum benefits.

(4) The board shall manage the trust in a manner that maintains reasonable contributions and administrative costs. Providing additional benefits to members and beneficiaries is the board's priority.

[2003 c 93 § 1; 2003 c 2 § 6 (Initiative Measure No. 790, approved November 5, 2002)].

RCW 41.45.0604
Contribution rates — Law enforcement officers' and firefighters' retirement system plan 2.

(1) Not later than July 31, 2008, and every even-numbered year thereafter, the law enforcement officers' and firefighters' plan 2 retirement board shall adopt contribution rates for the law enforcement officers' and firefighters' retirement system plan 2 as provided in RCW 41.26.720(1)(a).

(2) The law enforcement officers' and firefighters' plan 2 retirement board shall immediately notify the directors of the office of financial management and department of retirement systems of the state, employer, and employee rates adopted. Thereafter, the director shall collect those rates adopted by the board. The rates shall be effective for the ensuing biennial period, subject to any legislative modifications.

[2007 c 280 § 3; 2003 c 92 § 4.]

APPENDIX D
FUNDING METHODS DEFINED

Aggregate Funding Method[2]

The aggregate funding method is a standard actuarial funding method. The annual cost of benefits under the aggregate method is equal to the normal cost. The method does not produce an unfunded actuarial accrued liability. The normal cost is determined for the entire group rather than on an individual basis.

Entry Age Normal Cost Method (EANC)[3]

The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components: normal cost plus amortization of the unfunded liability. The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

Fixed Normal Cost Method: Variation of Entry Age Normal Cost Method

Under the Entry Age Normal Cost (EANC) method, there are two components: the normal cost, and the UAAL (surplus or deficit) which is amortized over time. Under the fixed normal cost (FNC) method, the amortization of the unfunded liability is eliminated. Instead, rates are tied to the normal cost and the UAAL will fluctuate up and down (within the corridor) depending on investment performance. This method provides more stable rates than the EANC

[2] "Glossary of Actuarial and Pension Terms". Office of the State Actuary. 13 Jan 2012. Web. 3 July 2012.
[3] "Glossary of Actuarial and Pension Terms". Office of the State Actuary. 13 Jan 2012. Web. 3 July 2012.