LEOFF Plan 1/LEOFF Plan 2 Merger

LEOFF Plan 2 Retirement Board

July 27, 2011

Overview

- Initial presentation of issue
- Current status of both plans
- Policy issues raised by a merger
- Discussion and questions are encouraged

Issue Description

- A financial merger of the LEOFF Plan 1 and LEOFF Plan 2 retirement funds raises a number of issues for plan members and retirees, LEOFF employers and the State related to funding policies, governance, and potential budget impacts.

Background - Investment

- The LEOFF Plan 1 retirement fund and the LEOFF Plan 2 retirement fund are commingled for investment purposes.

- The Commingled Trust Fund earned 13.22% for the 2009-10 fiscal year which will be reflected in the upcoming actuarial valuations for both plans.

Background - Contributions

- Contributions for LEOFF Plan 1 have been suspended since 1999/2000.

- Contributions for LEOFF Plan 2 are adopted by the Board as a percentage of payroll pursuant to a 50/30/20 cost sharing arrangement between members, employers and the State.

- Rates through June 30, 2017 are:
  8.46% Member
  5.08% Employer
  3.38% State

Background – Actuarial Funding method

- LEOFF Plan 1 uses a variation of the Frozen Initial Liability Cost Method.
- LEOFF Plan 2 uses the Aggregate Funding Method to calculate the normal cost or expected long-term cost of the plan.

Background – Long-term Economic Assumptions

- The Current Assumptions for LEOFF Plan 2 are:

Investment Rate of Return	8.00%
Salary Growth	4.50%
Inflation	3.50%
Growth in Membership	1.25%

- LEOFF Plan 1 assumptions are the same except that the Salary Growth Assumption is 4.00%.

Background – Demographic Assumptions

- Different demographic assumptions are calculated for LEOFF Plan 1 and LEOFF Plan 2 including:
  - Future rates of retirement and disability.
  - Total length of service.
  - Life expectancy after retirement.
  - Life expectancies of surviving spouses and other beneficiaries

Background – Asset Value "Smoothing"

- The value of assets used in the Actuarial Valuation Report is not the actual market value of assets.

- The Actuarial Value of Assets smoothes investment returns over time depending on how much the actual rate of return deviates from the expected rate of return.

- Both LEOFF Plans 1 and 2 have a very large amount of deferred investment losses.

  LEOFF Plan 1 $1.257 billion as of June 30, 2009
  LEOFF Plan 2 $1.255 billion as of June 30, 2009

Background – Asset Value Corridor

- Both LEOFF Plan 1 and LEOFF Plan 2 have a requirement that the Actuarial Value of Assets cannot be less than 70% nor more than 130% of the Market Value of Assets.

- The ratio was 129% for LEOFF Plan 2 as of June 30, 2009.

Background – Funded Status

- The funded status was 128% for LEOFF Plan 2 and 125% for LEOFF Plan 1 as of June 30, 2009 if you used the actuarial value of assets.
- The funded status was 99% for LEOFF Plan 2 and 97% for LEOFF Plan 1 as of June 30, 2009 if you used the market value of assets.
- This reporting method calculates liabilities using the Projected Unit Credit actuarial cost method which is not used in either LEOFF Plan 1 or LEOFF Plan 2.

Background - Governance

- The LEOFF Plan 2 Board adopts contribution rates and actuarial policies and recommends benefit changes to the Legislature.
- LEOFF Plan 1 falls under authority of the Select Committee on Pension Policy and the Pension Funding Council.

Background – Legislative History

- HB 2097 in 2011 proposed a financial merger of LEOFF Plan 1 and LEOFF Plan 2 but did not pass.

- The 2011-13 biennial operating budget included a requirement for the Office of the State Actuary to study issues related to merging LEOFF Plan 1 and LEOFF Plan 2.

- SB 6166 in 2001 would have closed LEOFF Plan 1 and distributed surplus fund assets but did not pass.

BACKGROUND – LEGAL FRAMEWORK

- "Exclusive Benefit" rule in federal law
- Merger case law in other states but none in Washington.
- *Bakenhus* and subsequent cases in Washington provide limits on benefit changes and funding requirements.

Policy Issue – Commingled Investment

- How does a merger affect the analysis of whether or not LEOFF Plan 1 should remain in the Commingled Trust Fund?

Policy Issue – Investment Volatility

- Would a merger require additional measures to either reduce investment volatility or manage investment volatility?

Policy Issue – LEOFF Plan 1 Unfunded Liability

- There is a statutory requirement to pay off any unfunded liability in LEOFF Plan 1 no later than June 30, 2024.

- LEOFF Plan 1 currently does not have an unfunded liability.

Policy Issue – LEOFF Plan 1 Supplemental Rate

- If an unfunded liability emerges in LEOFF Plan 1, the State could pay that expense by charging a supplemental contribution rate to LEOFF employers as a percentage of LEOFF Plan 2 payroll.

- This method was used by the State to pay the cost of the unfunded liabilities in PERS 1 and TRS 1.

- Some cost likely to pass to LEOFF Plan 2 members through bargaining.

Policy Issue – Financial Efficiencies

- An increase in assets in LEOFF Plan 1 currently cannot reduce costs for employers or the State.
- An increase in assets in a merged plan could reduce costs for members, employers and the State.

Policy Issue – Risk Transfer

- The risk of any future costs for LEOFF Plan 1 currently lies primarily with the State and employers. LEOFF Plan 2 member risk is indirect and hard to quantify.
- In a merged plan, the risk for employers and the State would likely be reduced. LEOFF Plan 2 members would bear a direct risk.
- The risk may be positive.
- Is the current 50/30/20 split mandated in a merged plan?

Policy Issue – Asset Value Corridor

- The current ratio of the actuarial value of assets to the market value of assets increases the risk that poor investment return in the future could spike contribution rates.

- This risk is likely to remain for six years until the investment losses from 2008-2009 have been fully recognized.

Policy Issue – Salary Growth Assumption

- There is currently a difference between the Salary Growth Assumption for LEOFF Plan 1 members and LEOFF Plan 2 members.
- The impact of this difference would not appear to be significant given the relatively small population of active LEOFF Plan 1 employees and their relatively limited projected future service.

Policy Issue – Funding Authority

- The long-term cost of insufficient contributions or inaccurate long-term assumptions is magnified in a merged plan.
- The importance of rate-setting and adopting assumptions is increased in a merged plan.
- This authority is currently the subject of debate and could be clarified in either statute or litigation.

Policy Issue – Board Composition

- To what extent would a merger affect the composition of the LEOFF Board?

OSA Study – Potential Input

- Projected impact on contribution rates
- Projected impact on funding status
- Differences in funding schedules
- Differences in funding policies
  - Salary Growth Assumption
  - Projected improvements in life expectancy

OSA Study – Potential Input

- Impact of merger on projected LEOFF Plan 1 liabilities
- Impact of merger on LEOFF Plan 1 investment policies
- Impact on LEOFF Plan 1 “Pay as You Go” risk
- Impact of merger on State pension risk measures
  - Pension contributions exceeding 8% of General Fund State (GFS)
  - Bond rating

OSA Study – Potential Input

- Effect of merger on projected unfunded liability costs for the State, employers and LEOFF Plan 2 members
  - State pays all costs
  - Employers pays all costs via supplemental rate
  - State, employers and Plan 2 members pay costs according to 50/30/20 split

- Possibility of separate funding policies for LEOFF Plan 1 and LEOFF Plan 2 liabilities

OSA Study – Potential Input

- Risk of decrease in LEOFF Plan 1 benefits under current law
- Effect of changing to a 4.5% Salary Growth Assumption for LEOFF Plan 1
- Demonstrate the projected future funding status of LEOFF Plan 1 using both funded ratio and size of fund

OSA Study – Potential Input

- Other questions?
- Timeline for providing input

LEOFF Plan 1/LEOFF Plan 2 Merger

Questions?

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LEOFF Plan 1/LEOFF Plan 2 MERGER

Questions?

LEOFF 1/LEOFF 2 Merger

Initial Consideration

July 27, 2011

1. Issue

A financial merger of the LEOFF Plan 1 and LEOFF Plan 2 retirement funds raises a number of issues for plan members and retirees, LEOFF employers and the State related to funding policies, governance, and potential budget impacts.

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3. Members Impacted

A merger of the LEOFF 1 and LEOFF 2 retirement funds could affect all current and future member participants and annuitants in LEOFF Plan 1 and LEOFF Plan 2. According to the Preliminary 2010 Actuarial Valuation Report, as of June 30, 2010, LEOFF Plan 1 had 301 active participants and 8,008 annuitants. LEOFF Plan 2 had 16,775 active participants and 1,639 annuitants.

4. Current Situation

The Law Enforcement Officers' and Fire Fighters' (LEOFF) Retirement System is a cost-sharing multiple-employer retirement system. Membership includes all full-time, fully compensated, commissioned law enforcement officers, and firefighters. There are two tiers in the LEOFF system referred to as LEOFF Plan 1 and LEOFF Plan 2. Both LEOFF Plan 1 and LEOFF Plan 2 provide defined retirement benefits which are financed from a combination of investment earnings, employer and employee contributions, and contributions from the State.

The LEOFF Plan 1 retirement fund and the LEOFF Plan 2 retirement fund are separate trust funds. The assets of each fund may be used solely to pay for the liabilities of the associated retirement plan. The funds are commingled for investment purposes but they are accounted for separately and reported separately in both annual financial reports and annual actuarial valuations.

5. Background Information

The Legislature established the Law Enforcement Officers' and Fire Fighters' (LEOFF) Retirement System in 1969 by consolidating various municipal police and fire fighter pension systems and transferring the members to the new state system in 1970. The LEOFF Retirement fund was established to pay for the liabilities of this new retirement system.

On October 1, 1977, the original LEOFF system (Plan 1) was closed to new members and a new tier of benefits, LEOFF Plan 2, was established for all new LEOFF members. LEOFF Plan 2 currently remains open. A separate LEOFF Plan 2 retirement fund was established to pay for the liabilities of this new plan.

Investment of Pension Funds

The Washington State Investment Board (WSIB) has the responsibility for investing the state administered pension funds, including both the LEOFF Plan 1 retirement fund and the LEOFF Plan 2 retirement fund. The statutory mandate for the WSIB is to maximize return at a prudent level of risk.[1] The retirement funds collectively are called the Commingled Trust Fund (CTF). Established on July 1, 1992, the CTF is a diversified pool of investments including fixed income, public equity, private equity, real estate and tangible assets.

The CTF return was 13.22 % for the 2009-2010 fiscal year.[2] The net assets held in trust for all the pension and benefit funds in the CTF totaled $57,630,138,000 as of June 30, 2010[3]. The net assets held in trust for LEOFF Plan 1 was $4,586,358,000[4] or approximately 8% of the total pension and benefit funds in the CTF. The net assets held in trust for LEOFF Plan 2 was $5,081,657,000[5] or approximately 9% of the total pension and benefit funds in the CTF.

LEOFF 1 Contributions

LEOFF Plan 1 is a cost-sharing multiple employer retirement system which has been funded by a combination of contributions from three parties: the employers, the employees, and the state (as the creator and sponsor of the plan). Initially, the contribution rates for LEOFF Plan 1 were set at 6% of salary for both employees and employers. State contributions were made by ad hoc legislative appropriations unrelated to employee salaries. The relative historical share of contributions to the Plan 1 fund from the three parties is: 77 percent from state appropriations, 11.5 percent from employer contributions, and 11.5 percent from employee contributions[6].

The assets of the Plan 1 retirement fund came to exceed the total actuarial liabilities of the system during the late 1990s primarily because of large contributions from the state and

[1] RCW 41.33A.110
[2] 2010 Comprehensive Annual Financial Report, Washington State Department of Retirement Systems, p.89
[3] 2010 Comprehensive Annual Financial Report, Washington State Department of Retirement Systems, p.29
[4] 2010 Comprehensive Annual Financial Report, Washington State Department of Retirement Systems, p.27
[5] 2010 Comprehensive Annual Financial Report, Washington State Department of Retirement Systems, p.28
[6] Senate Bill Report, 2ESSB 6166 (2001)

higher-than-expected investment returns. The state ceased making appropriations to the plan after June 30, 1999. Member and employer contributions were statutorily suspended in June 2000.

The Office of the State Actuary provides an Actuarial Valuation Report to the Pension Funding Council every two years and the Council has the authority adopt any changes to the state contribution rate for LEOFF 1 as may be required. There were approximately 250 active LEOFF Plan 1 members and 8000 annuitants as of Decembers 31, 2010.[7]

LEOFF 2 Contributions

LEOFF Plan 2 is a cost-sharing multiple employer retirement system which is funded by a combination of contributions from three parties pursuant to a statutory cost sharing formula under which the members pay 50 percent of the total annual required contributions, the employers pay 30 percent, and the State pays 20 percent.[8] These costs are charged to members, employers and the State as a percentage of the member's salary.

The cost of the plan is evaluated annually by the Office of the State Actuary in their annual Actuarial Valuation Report. The contribution rates are adopted periodically by the LEOFF Plan 2 Retirement Board[9] based on the current and projected costs of the plan, the current and projected funding status of the plan and three statutory funding goals:

- To fully fund the plan;[10]
- To establish long-term state, employer and member contribution rates which will remain a relatively predictable and stable portion of future state, employer and member budgets;[11] and,
- To fund, to the extent feasible, all benefits for plan 2 members over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service.[12]

The LEOFF Plan 2 Retirement Board has adopted modifications to the second goal to include the additional objective of rate stability and to reflect the interests of employers and members, not just the State. The original statutory goal was simply, "To establish long-term employer contribution rates which will remain a relatively predictable portion of future state budgets."

Rates are also adjusted periodically by the LEOFF Plan 2 Retirement Board to reflect increased costs as a result of benefit improvements.[13] The current contribution rates adopted by the LEOFF Plan 2 retirement Board through June 30, 2017 are 8.46 percent member, 5.08 percent employer, and 3.38 percent State.

[7] Unpublished ad hoc report, Department of Retirement Systems
[8] RCW 41.26.725(1)
[9] RCW 41.26.725 and RCW 41.45.0604
[10] RCW 41.45.010(1)
[11] RCW 41.45.010(4)
[12] RCW 41.45.010(5)
[13] RCW 41.45.070

There were approximately 16,951 active LEOFF Plan 2 members and 1,367 annuitants as of June 30, 2009.[14]

Funding Policies

Both LEOFF Plan 1 and LEOFF Plan 2 are valued and funded according to a complex arrangement of actuarial funding methods, long-term economic assumptions, demographic assumptions and actuarial funding policies. Many of these policies are the same for both plans but there are some differences which are important to understand and consider in the context of a financial merger of the plans.

Actuarial Funding Method

A variation of the Frozen Initial Liability Cost Method is used in LEOFF Plan 1 to determine the normal cost of the plan and the actuarial accrued liability for retirement and other pension benefits. Under this method, the Unfunded Actuarial Accrued Liability (UAAL) is equal to the unfunded actuarial present value of projected benefits less the actuarial present value of future normal costs for all active members and is reset at each valuation date. The present value of future normal costs is based on the aggregate normal cost for LEOFF Plan 2 and the resulting UAAL is amortized by June 30, 2024 as a level percentage of projected system payroll. The projected payroll includes pay from LEOFF Plan 2 as well as projected payroll from future new entrants.[15] There is currently a positive UAAL for LEOFF Plan 1.

There is a statutory funding policy to fully amortize any unfunded liability which may emerge in LEOFF 1 no later than June 30, 2024.[16] Both the State and LEOFF employers are likely to incur increased costs if LEOFF Plan 1 comes out of fully funded status which would create a need for LEOFF Plan 1 funding policies to be developed and coordinated with LEOFF Plan 2 funding policies established by the Board.

The Aggregate Cost Method is used in LEOFF Plan 2 to determine the normal cost and the actuarial accrued liability. Under this method, the unfunded actuarial present value of fully projected benefits is amortized over the future payroll of the active group. The entire contribution is considered normal cost and no UAAL exists.[17]

[14] 2009 Actuarial Valuation Report, Office of the State Actuary
[15] 2009 LEOFF Actuarial Valuation Report, Office of the State Actuary p. 36
[16] RCW 41.45.010(2)
[17] 2009 LEOFF Actuarial Valuation Report, Office of the State Actuary p. 36

Long-Term Economic Assumptions

In order to calculate the necessary current contribution rates for a plan, it requires projecting the future costs of paying out plan benefits, projecting the future value of current retirement fund assets and future contributions, and converting these projections into present day values. These calculations require the use of long-term economic assumptions. Certain key assumptions were codified in 2001 for both LEOFF Plan 1 and LEOFF Plan 2 as follows:[18]

Investment Rate of Return	8.00%
Salary Growth	4.50%
Inflation	3.50%
Growth in Membership	1.25%

Beginning July 1, 2009, the salary growth assumption for LEOFF Plan 1 was changed to equal the sum of the inflation assumption and a productivity growth assumption of 0.5% (4.00%). This is currently the only difference in long-term economic assumptions between LEOFF Plan 1 and LEOFF Plan 2.

Demographic Assumptions

Assumptions about future non-economic events are also an important necessary component of the overall funding policies for both LEOFF 1 and LEOFF 2. Key demographic assumptions include:

- Members' future rates of retirement and disability.
- Their total length of service.
- Their life expectancy after retirement.
- The life expectancies of their surviving spouses and other beneficiaries.

The Office of the State Actuary performs an experience study at least once every six years to determine at what rate the above factors have actually occurred in the retirement systems.[19] The experience study compares actual experience to the assumptions and, if necessary, OSA makes adjustments to the rates for future actuarial valuations. For LEOFF Plan 2, any changes recommended by OSA must be adopted by the LEOFF Plan 2 Retirement Board.[20]

The most recent demographic experience study was published by the Office of the State Actuary in September, 2008. The study covered experience from 2001-2006. The study reported experience in LEOFF 1 separate from LEOFF 2 and developed different assumptions for each plan. One of the recommendations of that study was to modify mortality assumptions to take into account projected future improvements in life expectancy. These recommendations were adopted by the LEOFF 2 Board and incorporated into actuarial assumptions for LEOFF 2. The recommendations were adopted by the Legislature for LEOFF Plan 1 in 2009 but delayed until after the 2009-11 biennium.

[18] RCW 41.45.035
[19] RCW 41.45.090
[20] RCW 41.26.720

Actuarial Value of Assets v. Market Value of Assets ("Smoothing")

For the actuarial valuation report, the Office of the State Actuary calculates the actuarial value of assets using an asset smoothing method adopted by the Legislature in 2003.[21] The asset smoothing method applies to both LEOFF Plan 1 and LEOFF Plan 2. Each year OSA determines the amount the actual investment return deviates from the expected investment return and smoothes that year's gain or loss according to the following table:

Annual Gain/Loss		
Rate of Return	Smoothing Period	Annual Recognition
15% and up	8 years	12.5%
14-15%	7 years	14.29%
13-14%	6 years	16.67%
12-13%	5 years	20%
11-12%	4 years	25%
10-11%	3 years	33.33%
9-10%	2 years	50%
7-9%	1 year	100%
6-7%	2 years	50%
5-6%	3 years	33.33%
4-5%	4 years	25%
3-4%	5 years	20%
2-3%	6 years	16.67%
1-2%	7 years	14.29%
1% and lower	8 years	12.5%

In 2009, LEOFF Plan 2 had a market value of assets of $4.309 billion and an actuarial value of assets of $5.564 billion for a total of $1.255 billion in deferred investment losses as follows:[22]

Plan year ending	Percent deferred	Amount deferred
6/30/2009	87.50%	(1,447 million)
6/30/2008	75%	(368 million)
6/30/2007	62.50%	290 million
6/30/2006	50%	142 million
6/30/2005	37.50%	108 million
6/30/2004	0.00%	0
6/30/2003	12.50%	19 million
Total:		**(1,256 million)**

Note: Totals do not agree due to rounding.

In 2009, LEOFF Plan 1 had a market value of assets of $4.355 billion and an actuarial value of assets of $5.612 billion for a total of $1.257 billion in deferred investment losses.[23]

[21] 2009 LEOFF Actuarial Valuation Report, Office of the State Actuary p. 36
[22] 2009 LEOFF Actuarial Valuation Report, Office of the State Actuary p. 18

Asset Value Corridor

Additionally, to ensure the actuarial value of assets maintains a reasonable relationship to the market value of assets, a 30% asset value corridor was statutorily adopted in 2004.[24] This means that the actuarial value of assets may not exceed 130% nor drop below 70% of the market value of assets. The asset value corridor applies to both LEOFF 1 and LEOFF 2. In 2009, the asset value ratio for LEOFF 2 was 129%.[25]

The Funded Status of LEOFF 1 and LEOFF 2

The funded status of a plan is calculated by comparing the plan's assets to the present value of earned pension benefits of the plan's members. A plan's funded status can vary significantly depending on the assumptions and methods used to determine the value of the plan's assets and liabilities. The Office of the State Actuary has historically reported the funding status for both LEOFF 1 and LEOFF 2 by comparing the actuarial value of assets (AVA) to the liabilities of the plan calculated using the Projected Unit Credit (PUC) actuarial cost method and the long-term earnings assumption of 8.00%. The historical reports of the funded status for LEOFF 1 and LEOFF are found in the following table.[26]

Funded Ratio	LEOFF 2	LEOFF 1
2009*	128%	125%
2008*	133%	128%
2007*	129%	123%
2006*	116%	117%
2005*	114%	114%
2004	117%	109%
2003	125%	112%
2002	137%	119%
2001*	154%	129%
2000*	161%	136%
1999	154%	125%
1998	160%	117%
1997*	155%	108%
1996	130%	89%
1995	126%	80%
1994*	124%	68%
1993	127%	68%
1992	128%	65%
1991	154%	66%
1990	153%	65%
1989*	158%	65%
1988	153%	66%
1987	157%	69%
1986	142%	57%

*Assumptions changed

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23 2009 LEOFF Actuarial Valuation Report, Office of the State Actuary p. 22 & 23
24 RCW 41.45.035(3)(a)
25 2009 LEOFF Actuarial Valuation Report, Office of the State Actuary p. 18
26 2009 LEOFF Actuarial Valuation Report, Office of the State Actuary p. 21

The use of this particular funded status reporting method is helpful for comparing a plan's funding progress over time, measuring the impact of assumption changes, or serving as a standard for comparing plans that use different funding methods. For instance, the funded ratio for LEOFF 2 has always been 100% if you compare the LEOFF 2 funding method to the actuarial value of assets since any UAAL which might emerge is immediately corrected by a contribution rate change. So simply reporting under that method will hide the impact of any assumption changes or economic experience.

However, this particular funded status measurement can also be very misleading if taken out of context. The funded ratio may appear either overstated or understated to the extent that the actuarial value of assets deviates substantially from the market value of assets. For instance, when a plan has a large amount of deferred investment losses like both LEOFF 2 and LEOFF 1 currently have, using this funded status measurement will result in a funding ratio that is overstated. If the market value of assets was used instead of the actuarial value of assets the 2009 funded ratios would be 99% for LEOFF 2 instead of 128% and 97% for LEOFF 1 instead of 125%. Use of this funded status measurement has historically been erroneously cited as a justification for both improving benefits without a corresponding rate increase or decreasing contributions to the plan.

It is also important to note that the PUC actuarial cost method is not used in either LEOFF 1 or LEOFF 2 to calculate the liabilities of the plan for funding purposes. This can also serve to either overstate or understate the funded ratio of a plan depending on the extent to which the PUC actuarial cost method deviates from the actuarial cost method which is used for calculating funding requirements. Historically, the PUC actuarial cost method has resulted in lower short-term costs and increased long-term costs when compared to the Aggregate Funding Method used in LEOFF Plan 2.

Governance

LEOFF Plan 2

Effective July 1, 2003, the LEOFF Plan 2 Retirement Board was established by Initiative 790 to provide governance of LEOFF Plan 2. The Board's duties include adopting contribution rates, actuarial assumptions, and actuarial methods. The Board is also responsible for studying pension issues and recommending policy changes to the Legislature for the LEOFF Plan 2 retirement plan.

LEOFF Plan 1
In 2003 the Select Committee on Pension Policy (SCPP) was established by the Legislature to study pension issues, develop pension policies, and make recommendations to the Legislature.[27] The SCPP is a 20-member committee composed of elected officials, stakeholder representatives, employer representatives, and the Directors of the Department of Retirement Systems and the Office of Financial Management. Prior to 2003, the Joint Committee on Pension Policy (JCPP) performed these duties.

The SCPP meets during the legislative interim. Its specific areas of interest include benefits design, retirement eligibility requirements and pension funding methods. The SCPP receives the results of actuarial audits administered by the Pension Funding Council, and reviews and makes recommendations to the Pension Funding Council regarding changes to retirement assumptions or contributions rates. Under current law, the SCPP may form a public safety subcommittee to study pension issues affecting members of LEOFF, the Public Safety Employees Retirement System (PSERS), and the Washington State Patrol Retirement System (WSPRS)[28].

Legislative History

House Bill 2097 was proposed during the 2011 Legislative session but did not pass. This legislation would have financially combined the LEOFF Plan 1 and LEOFF Plan 2 retirement funds. The legislation would not have changed the benefits for either plan but the combined fund would have been responsible for the liabilities of both plans. The state LEOFF 2 contribution rate was reduced to 2.96% for the 2011-13 biennium but there were no changes to the LEOFF 2 employer or member rates and there were no changes to the LEOFF Plan 1 rates already at 0.00% for members, employers and the State. The legislation would have moved LEOFF Plan 1 governance under the LEOFF Board including adopting all actuarial assumptions and setting contribution rates in the future. It also specified that contribution rates and actuarial assumptions adopted by the Board would not be subject to legislative revision. The legislation provided that all expenses of the LEOFF Board would be paid out of the LEOFF retirement fund and the Board was authorized to use the retirement fund for any legal expenses related to protecting the fund.

Section 105 of House Bill 1087 (the 2011 budget bill) required the Office of the State Actuary to study the issue of merging LEOFF plans 1 and 2 into a single fund. The Department of Retirement Systems is to assist the state actuary by providing information and advice as the state actuary requests, and the state actuary may contract for services as needed to conduct the study. The state actuary is directed to solicit the input of the LEOFF Plan 2 Retirement Board and organizations representing members and retirees of LEOFF Plan 1. The results of the study shall be reported to the ways and means committees of the House of Representatives and the Senate by December 15, 2011.

[27] RCW 41.04.281
[28] RCW 41.04.278(2)(a)

Legal Framework

Under federal law, the assets of a tax-qualified retirement plan such as LEOFF Plan 1 and LEOFF Plan 2 may be used only for the exclusive benefit of members of the plan.

There is a body of state case law across the country regarding plan mergers which may be illustrative of potential issues in evaluating a merger but there is no similar case law in Washington.

There is a significant body of Washington case law defining members' rights to retirement benefits and to have their retirement plan funded on a sound actuarial basis.

6. Policy Issues

Investment Policy Issues

Commingled Investment

There has been some consideration in the past as to whether LEOFF 1 assets should remain invested in the commingled or whether it would be more appropriate to invest these assets in a more conservative fund to minimize the risk of investment volatility since LEOFF 1 has been closed to new members since 1977 and the future benefits payments are more predictable, have a shorter duration and would be easier to immunize. However, there is a cost associated with a lower earning assumption. The Office of the State Actuary recently estimated that a 5.5% earnings assumption would mean that LEOFF Plan 1 would only have a 76% funded ratio.[29] Since LEOFF 2 is an open and ongoing plan, merging LEOFF 1 with LEOFF 2 would affect analysis of this issue.

Investment Volatility

If the current LEOFF 2 funding policies are used to determine funding requirements for both plans, then covering both LEOFF 1 and LEOFF 2 liabilities using just the LEOFF 2 salary base could increase the impact of investment volatility on members, employers and the State in a merged fund. To the extent that the effects of investment volatility are magnified by a merger, would a merger create a need to reduce investment volatility or can any additional volatility risk be appropriately managed with current or new funding policy tools?

[29] 2009 LEOFF Actuarial Valuation Report, Office of the State Actuary p. 23

Funding Policy Issues

LEOFF 1 Unfunded Liability

There is a statutory funding policy to fully amortize any unfunded liability which may emerge in LEOFF 1 no later than June 30, 2024.[30] If an unfunded liability emerges in LEOFF 1, this policy requirement could significantly impact funding requirements for LEOFF members, employers and the State in a merged plan. The Legislature recently repealed a similar funding policy requirement for the Public Employees' Retirement System (PERS) Plan 1 and the Teachers' Retirement System (TRS) Plan 1 and developed a new policy.

LEOFF 1 Supplemental Rate

When a unfunded liability emerged in both PERS Plan 1 and TRS Plan 1, the State adopted a supplemental rate to cover this cost which is charged to employers as a percentage of salary of all PERS or TRS employees, not just those in Plan 1. If an unfunded liability were to emerge in LEOFF Plan 1, the State could adopt a similar supplemental rate to cover that cost. The additional cost to LEOFF employers would likely be shared with LEOFF 2 members indirectly through the bargaining process since less money would be available for salaries, equipment and other expenses.

Financial Efficiencies

There are currently no required contributions to LEOFF Plan 1 from the State, employers or members and haven't been any required contributions for some time. Therefore, any increase in assets, such as from positive investment performance, will not decrease plan costs. Assets in the retirement fund are strictly protected under federal law for pension plans and cannot be withdrawn from the fund and used for any state or employer purpose.

A merger of the LEOFF Plan 1 and LEOFF Plan 2 retirement funds commingles both the assets and liabilities of each plan. Therefore, any increase in assets due to positive economic or demographic experience will decrease plan costs for LEOFF members, LEOFF employers and the State.

Risk Transfer

The assets invested in the LEOFF 1 retirement fund are currently projected to be sufficient to meet the projected liabilities of the plan. Currently, the State would be responsible for any increased plan costs and required contributions in the future. The two primary risks of increased costs are 1) less-than-expected investment returns; and 2) higher-than-expected inflation. A merger of the LEOFF Plan 1 and LEOFF Plan 2 retirement funds commingles the liabilities of both plans. So, an increase in LEOFF 1 costs would become the shared responsibility of LEOFF members, LEOFF employers and the State.

[30] RCW 41.45.010(2)

Asset Value Corridor

Both LEOFF Plan 1 and LEOFF Plan 2 currently have a very substantial amount of deferred investment losses from the historically poor investment returns of 2008-2009. The Asset Value Corridor was at 129% for LEOFF 2 in 2009 and cannot exceed 130%. So the increase in risk of a contribution rate spike from poor investment performance, particularly over the next six years, is significant.

Salary Growth Assumption

Currently, the long-term economic assumption for salary growth is 4.00% for LEOFF 1 members and 4.50% for LEOFF 2 members. However, given the relatively few number of active LEOFF 1 members, the impact of the difference in this assumption may be negligible on the calculation of future funding requirements.

Governance Policy Issues

Importance of Funding Authority

The LEOFF Plan 2 Retirement Board has the responsibility for adopting contribution rates for LEOFF Plan 2 as well as the actuarial methods and assumptions which underlie those contribution rates. The increased impact of insufficient contribution rates or poor economic or demographic experience on plan costs increases the importance of setting appropriate rates and assumptions.

LEOFF 1 Representation on the LEOFF Board

The current LEOFF Plan 2 Retirement Board is composed of plan members, LEOFF employers and the Legislature. All of the plan member representatives are required to be from LEOFF Plan 2 and at least one Board member must be a retiree. There is no requirement that the employer representatives or legislators be members or retirees of any retirement plan. Currently, one member representative is a retired LEOFF 2 member and one employer representative is an active LEOFF 1 member. A merger of LEOFF 1 and LEOFF 2 would require consideration of whether, or how, to change the current Board structure.

LEOFF 2 Board Input into Office of State Actuary Study

The Office of the State Actuary is currently conducting a study of the issue of merging LEOFF plans 1 and 2 into a single fund which is due to be reported to the Ways and Means Committees of the House of Representatives and the Senate by December 15, 2011. OSA has solicited the input of the LEOFF Plan 2 Retirement Board. The following questions might be appropriate for the Board to ask the Office of the State Actuary to address in their report:

1. How would a merger of LEOFF 1 and LEOFF 2 affect the projected contribution rates for both plans and impact the Board's goal of stable contribution rates? Project rates for each plan separately, both before and after the merger. Use stochastic methods to show the range of possible rate outcomes. Demonstrate the impact of the merger on the possibility that LEOFF 2 member rates will exceed 10%.

2. How would a merger affect the Board's goal of full funding for LEOFF Plan 2? Provide the funding ratios for both plans before the merger and the funding ratio of the merged plan using both the actuarial and market value of assets.

3. Identify any differences between the current rate-setting cycles for LEOFF Plan 1 and LEOFF Plan 2.

4. What funding policy differences currently exist between LEOFF Plan 1 and LEOFF Plan 2? For example, the salary growth assumption, payment of the LEOFF 1 UAAL by 2024, demographic assumptions such as projected improvements in life expectancy, etc.

5. What impact, if any, will a merger have on the expected liabilities for LEOFF Plan 1? What are the risks and measures? Provide stochastic projections for investment returns and inflation.

6. How would a merger affect the analysis of current LEOFF 1 investment policies? Does a merger eliminate any need to consider a separate investment policy for LEOFF 1 assets?

7. What is the risk of LEOFF Plan 1 going into "pay as you go" status and how would a merger affect that risk?

8. What is the effect of a merger on state pension risk measures as reflected in the Pension Score Card? For instance, what is the effect of a merger on the chance that pensions will consume more than 8% of the State general Fund? What is the effect on the total weighted score? Is there a risk measure associated with the impact of pension liabilities on State bond issuances?

9. How would a merger affect the current cost policies for LEOFF 1? What are the projected costs if the State pays 100% of LEOFF 1 costs? What are the projected employer rates if any future LEOFF 1 costs are paid for via a supplemental rate charged to LEOFF employers?

10. How would a merger affect the current 50-30-20 cost-sharing requirement for LEOFF 2 liabilities? Could you continue to track LEOFF 1 liabilities separately in a merged plan?

11. To what extent could benefits be decreased in LEOFF Plan 1 under current law if an unfunded liability emerges in LEOFF Plan 1 and the decrease in liabilities is determined to be necessary for the actuarial soundness of the plan?

12. How would a change to a 4.5% salary growth assumption for LEOFF 1 affect a merged plan?

13. Graph the projected future LEOFF 1 liabilities and assets to demonstrate the projected lifespan of the plan. Overlay projections of future LEOFF 1 funded ratios with the amount of assets projected to be in the plan.

7. Supporting Information

Appendix A – HB 2097 Fiscal Note

Appendix A - HB 2097 Fiscal Note

Multiple Agency Fiscal Note Summary

Bill Number: 2097 HB	**Title:** LEOFF plans 1 and 2 merger

Estimated Cash Receipts

NONE

Estimated Expenditures

Agency Name	2011-13			2013-15			2015-17		
	FTEs	GF-State	Total	FTEs	GF-State	Total	FTEs	GF-State	Total
Office of the State Actuary	.2	0	0	.2	0	0	.2	0	0
Office of the State Actuary	.0	(15,000,000)	(15,000,000)	.0	0	0	.0	0	0
Department of Retirement Systems	.0	0	116,471	.0	0	0	.0	0	0
Law Enforcement Officers' and Fire Fighters' Plan 2 Retirement Board	2.0	0	369,815	2.0	0	354,692	2.0	0	354,692
Total	2.2	$(15,000,000)	$(14,513,714)	2.2	$0	$354,692	2.2	$0	$354,692

Estimated Capital Budget Impact

NONE

This package contains two fiscal notes from the Office of the State Actuary. One reflects the fiscal impact on the pension systems, while the other covers the administrative cost.

Prepared by: Jane Sakson, OFM	**Phone:** 360-902-0549	**Date Published:** Final

* See Office of the Administrator for the Courts judicial fiscal note

** See local government fiscal note

FNPID 30236

FNS029 Multi Agency rollup

Individual State Agency Fiscal Note

Bill Number: 2097 HB	Title: LEOFF plans 1 and 2 merger	Agency: 035-Office of State Actuary

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

NONE

Estimated Expenditures from:

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.2	0.2	0.2	0.2	0.2
Account					
Total $					

Estimated Capital Budget Impact:

NONE

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☐ Requires new rule making, complete Part V.

Legislative Contact:	David Pringle	Phone: 360-786-7310	Date: 04/20/2011
Agency Preparation:	Won Lisa	Phone: 360-786-6150	Date: 04/22/2011
Agency Approval:	Matthew M. Smith	Phone: 360-786-6140	Date: 04/22/2011
OFM Review:	Jane Sakson	Phone: 360-902-0549	Date: 04/22/2011

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

This bill impacts the Law Enforcement Officers' and Firefighters' (LEOFF) Retirement System by merging the assets and liabilities of LEOFF 1 and LEOFF 2; expanding and modifying the authority of the LEOFF 2 Board (Board), which includes the authority to establish contribution rates, funding methods and assumptions, and benefit improvements for LEOFF 1. The Office of the State Actuary (OSA) provides services to the Board as documented under RCW 44.44.04(7), chapter 2, Laws of 2003.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

Under RCW 39.34.130 and section 5(5), chapter 2, Laws of 2003, the Board reimburses OSA for services provided.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

This proposed merger expands the scope of services and duties of the Board. OSA assumes this expansion will increase the actuarial services provided to the Board. It is further assumed that there will be no offsetting workload reduction for OSA to the Select Committee on Pension Policy due to this merger. OSA will incur one-time expenses to establish the initial combined actuarial valuation and on-going expenses to produce the combined annual valuations thereafter. OSA will also incur on-going expenses to consult and provide actuarial analysis which may include, but is not limited to the following:

•Prepare preliminary and final fiscal notes on all board-proposed pension legislation
•Perform an annual actuarial valuation
•Prepare an annual actuarial valuation report
•Perform experience studies as required by law
•Prepare an experience study report as required by law
•Prepare all other actuarial studies and reports as required by law
•Consult with the board concerning the determination of actuarial assumptions and methods
•Consult with the board concerning actuarial issues as may be requested from time to time

The above-listed functions will increase our agency expenditures as detailed in Part III (Expenditure Detail).

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.2	0.2	0.2	0.2	0.2
A-Salaries and Wages	21,441	21,441	42,882	42,882	42,882
B-Employee Benefits	4,698	4,698	9,396	9,396	9,396
C-Personal Service Contracts					
E-Goods and Services	2,373	2,373	4,746	4,746	4,746
G-Travel					
J-Capital Outlays					
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements	(28,512)	(28,512)	(57,024)	(57,024)	(57,024)
T-Intra-Agency Reimbursements					
9-					
Total:	$0	$0	$0	$0	$0

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2012	FY 2013	2011-13	2013-15	2015-17
Actuary	11,889	0.1	0.1	0.1	0.1	0.1
Administrative Assistant	5,185	0.0	0.0	0.0	0.0	0.0
Senior Actuarial Analyst	8,415	0.1	0.1	0.1	0.1	0.1
Senior Policy Analyst	8,845	0.0	0.0	0.0	0.0	0.0
State Actuary	14,488	0.0	0.0	0.0	0.0	0.0
Total FTE's	48,822	0.2	0.2	0.2	0.2	0.2

Part IV: Capital Budget Impact

NONE

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Individual State Agency Fiscal Note

Bill Number: 2097 HB	Title: LEOFF plans 1 and 2 merger	Agency: 035-Office of State Actuary

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

NONE

Estimated Expenditures from:

		FY 2012	FY 2013	2011-13	2013-15	2015-17
Account						
General Fund-State	001-1	(7,300,000)	(7,700,000)	(15,000,000)	0	0
	Total $	(7,300,000)	(7,700,000)	(15,000,000)	0	0

Estimated Capital Budget Impact:

NONE

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☐ Requires new rule making, complete Part V.

Legislative Contact:	David Pringle	Phone: 360-786-7310	Date: 04/20/2011
Agency Preparation:	Laura Harper	Phone: 360 786-6145	Date: 05/06/2011
Agency Approval:	Matthew M. Smith	Phone: 360-786-6140	Date: 05/06/2011
OFM Review:	Jane Sakson	Phone: 360-902-0549	Date: 05/06/2011

Request # -3

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

NONE

Part IV: Capital Budget Impact

NONE

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

ACTUARY'S FISCAL NOTE

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	**035**	**5/6/11**	**HB 2097 – Revised**

WHAT THE READER SHOULD KNOW

The Office of the State Actuary ("we") prepared this fiscal note based on our understanding of the bill as of the date shown above. We intend this fiscal note to be used by the Legislature during the 2011 Legislative Session only.

We advise readers of this fiscal note to seek professional guidance as to its content and interpretation, and not to rely upon this communication without such guidance. Please read the analysis shown in this fiscal note as a whole. Distribution of, or reliance on, only parts of this fiscal note could result in its misuse, and may mislead others.

SUMMARY OF RESULTS

This bill merges the Plan 1 and Plan 2 retirement funds of the Law Enforcement Officers' and Fire Fighters' (LEOFF) Retirement System, and places LEOFF 1 under the governance of the LEOFF Board (Board). The bill also sets LEOFF 2 contribution rates for the 2011-13 Biennium.

Impact on Pension Liability			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Today's Value of All Future Pensions	$74,789	$0.0	$74,789
Earned Pensions Not Covered by Today's Assets	$5,773	$0.0	$5,773

Impact on Contribution Rates (Effective 7/1/2011)	
2011-2013 State Budget	**LEOFF**
Employee (Plan 2)	0.00%
Employer	
Current Annual Cost	0.00%
Plan 1 Past Cost	0.00%
Total	**0.00%**
State	
Current Annual Cost	(0.42%)
Plan 1 Past Cost	0.00%
Total	**(0.42%)**

Budget Impacts			
(Dollars in Millions)	**2011-2013**	**2013-2015**	**25-Year**
General Fund-State	($15.0)	$0.0	($28.3)
Total Employer	($15.0)	$0.0	($49.7)

Note: We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.

See the Actuarial Results section of this fiscal note for additional detail including how this proposal changes affordability and pay-go risks in the retirement systems.

WHAT IS THE PROPOSED CHANGE?

Summary Of Changes

This bill impacts LEOFF by:

1. Merging the LEOFF 1 and LEOFF 2 retirement funds.
2. Expanding and modifying the authority of the Board, which includes the authority to establish contribution rates, funding methods and assumptions, and benefit improvements for LEOFF 1.
3. Providing for the possibility of LEOFF 1 representation on the Board.
4. Authorizing the payment of legal expenses out of the system's trust fund.
5. Providing that various Board actions are not subject to revision by the Legislature.
6. Changing current funding methods and assumptions for LEOFF 1.
7. Setting 2011-13 rates for LEOFF 2.
8. Clarifying the application of the LEOFF 2 cost-sharing method.
9. Removing LEOFF-related issues from the purview of the public safety subcommittee of the Select Committee on Pension Policy (SCPP).

Merges The Plan Assets

The LEOFF Retirement Fund is established in the Treasury to fund benefits provided by LEOFF Plans 1 and 2. This new fund replaces individual retirement funds for LEOFF Plans 1 and 2 respectively. (See Section 4 of the bill.)

Expands And Modifies Board Authority

The Board is renamed the Law Enforcement Officers' and Fire Fighters' Retirement Board, with the reference to "Plan 2" removed. (See Section 7 of the bill.)

The Board is granted general oversight and fiduciary duties for LEOFF 1 immediately, except that basic rate-setting authority for LEOFF 1 begins with the 2013-15 Biennium. (See Sections 3, 7, 8, and 15 of the bill.)

The Board must adopt basic contribution rates for both LEOFF Plans 1 and 2 no later than July 31, 2012, and again in every even-numbered year thereafter. (See Section 15 of the bill.) Basic rates for both plans would be subject to the supplemental rate provision in current law. (See Section 17 of the bill.)

The Board must also adopt changes in the long-term economic assumptions, recognition of asset values that vary from the long-term investment rate of return assumption, or limits on the extent to which the market value of assets can deviate from the actuarial value of assets used in actuarial studies. (See Section 12 of the bill.)

The Board's actions regarding rate setting and adoption of actuarial tables, assumptions, and cost methodologies are not subject to legislative revision. (See Sections 8 and 12 of the bill.)

Membership of the Board may include members of LEOFF 1. (See Section 6 of the bill.)

Funds used for administrative expenses of the Board are not subject to allotment of expenditures under Chapter 43.88 RCW. The LEOFF 2 expense fund used to pay these expenses is expanded to include LEOFF 1. (See Section 10 of the bill.)

The Board is authorized to use earnings in the LEOFF trust fund to pay legal expenses that are primarily incurred for the purpose of protecting the trust fund or in compliance with statute. (See Section 19 of the bill.)

Changes Funding Policy

The bill removes the stated goal of the Legislature to fully amortize the costs of LEOFF 1 by June 30, 2024, and instead states that the Legislature intends to fully fund the combined LEOFF Plans 1 and 2. (See Section 11 of the bill.)

The salary growth assumption for LEOFF 1 is increased from 4.0 percent to 4.5 percent. (See Section 12 of the bill.)

The cost-sharing method currently in effect for LEOFF 2 is clarified to continue applying only to LEOFF 2 after the merger. (See Section 9 of the bill.) The bill is silent with respect to a cost-sharing method for LEOFF 1.

Establishes 2011-13 Rates For LEOFF 2

Plan 2 contribution rates for the 2011-13 Biennium are set as follows:

- 8.46 percent member.
- 5.08 percent employer.
- 2.96 percent state.

(See Section 1 of the bill.)

SCPP

The bill removes the study of LEOFF-related issues from the public safety subcommittee of the SCPP. (See Section 18 of the bill.)

Effective Date: 90 days after session.

What Is The Current Situation?

Plan Assets

Two funds exist in the Treasury for use in funding LEOFF benefits:

- LEOFF Plan 1 Retirement Fund.

- LEOFF Plan 2 Retirement Fund.

All contributions to these systems are paid into these funds.

Oversight Authority

The LEOFF 2 Board was created in 2003 to serve as fiduciaries, and generally provide oversight to LEOFF 2.

Oversight for LEOFF 1 is provided by the Legislature. Under current law, no contributions are required to fund LEOFF 1 unless the most recent actuarial valuation indicates that LEOFF 1 has unfunded liabilities. (See RCW 41.26.080.)

The LEOFF 2 expense fund is used to pay expenses of the Board. The LEOFF 2 Board has authority to set policies related to this fund. All expenditures from the expense fund must conform to allotment procedures under Chapter 43.88 RCW.

The director of the Department of Retirement Systems (DRS) is authorized to use trust fund earnings to pay legal and medical expenses that are primarily incurred for the purpose of protecting the trust fund or in compliance with statute.

Current Funding Policy

In addition to basic rates, DRS must charge supplemental rates to pay for the cost of additional benefits provided to members.

The Legislature has stated its intent to fully amortize the costs of LEOFF 1 by June 30, 2024, and the PFC is directed to adopt biennial rates for LEOFF 1 that are sufficient to achieve this goal. Currently, RCW 41.26.080 provides that no contribution is required for LEOFF 1 unless the most recent actuarial valuation report shows the plan has unfunded liabilities.

The current salary growth assumption for LEOFF 1 is set in RCW 41.45.035 as the sum of the inflation growth and productivity growth, which equals 4 percent. This assumption excludes merit and longevity increases.

Rates For LEOFF 2

The rates currently in effect for LEOFF 2 and adopted by the Board until 2017 are as follows:

- 8.46 percent member.
- 5.08 percent employer.
- 3.38 percent state.

(See the LEOFF 2 *2009 Actuarial Valuation Report.*)

SCPP

Under current law, the SCPP may form a public safety subcommittee to study pension issues affecting members of LEOFF, the Public Safety Employees Retirement System

(PSERS), and the Washington State Patrol Retirement System (WSPRS). (See RCW 41.04.278(2)(a).)

Who Is Impacted And How?

The bill does not change benefits of any members of LEOFF Plans 1 or 2.

Based on the funding policy we assumed for the merged plan, this bill impacts all 16,951 active Plan 2 members of LEOFF 2 through increased or decreased contribution rates depending on actual plan experience.

WHY THIS BILL HAS A COST AND WHO PAYS FOR IT

Why This Bill Has A Cost/Savings

We found two items from this bill that have a cost/savings: the merger of assets and liabilities and the reduction of state funding to LEOFF Plan 2 in 2011-13. Based on the funding policy we assumed for this pricing, the merger by itself produces an expected savings. The reduction of state funding in 2011-13, by itself, produces an expected short-term savings and an expected long-term cost. The combination of both changes produces an expected savings on a short and long-term basis.

- **Savings from Merger** – By 2016, we expect LEOFF 1 to have a 2.3 percent surplus under current law. By merging the two plans, and applying the funding policy we assumed for this pricing, we expect lower future LEOFF 2 contribution rates since the plan will incorporate this 2.3 percent surplus. We expect LEOFF 1 will have no required contributions before and after the merger.
- **Impact from Reduction of State Funding** – The state portion of the LEOFF 2 contribution rate is lowered by 42 basis points for the 2011-13 Biennium under the provisions of this bill, which creates a short-term savings. This results in a loss of pre-funding, which will be made up in the future by increased contributions from members, employers and the state due to the loss of assumed 8 percent annual investment earnings (interest) from the forgone prefunding.

Please see How the Results Change When The Assumptions Change and How the Risk Measures Changed for information on how the expected costs of this bill and the financial risks can change from our best-estimate assumptions.

Who Will Pay For These Costs?

Based on the funding policy we assumed for the merged plan, LEOFF 2 members, employers, and the state will pay for these costs and receive the savings consistent with their normal funding method:

- Members will pay 50 percent.

- Employers will pay 30 percent.
- State will pay 20 percent.

Based on our latest analysis and information, we do not expect an unfunded liability to re-emerge in LEOFF 1. Also, we assume the LEOFF Board will recommend no further improvement to LEOFF 1 benefits, and will not impose contribution rates on LEOFF 1 members or LEOFF 1 employers. Therefore, for purposes of this pricing, we assume future costs of the merged plan will be paid consistent with the current LEOFF 2 funding method over LEOFF 2 salaries. See Assumptions We Made for more explanation.

HOW WE VALUED THESE COSTS

Assumptions We Made

Since the bill does not specify a funding policy for LEOFF 1, we made assumptions in that area. We assumed the Board would continue to charge a zero contribution rate for LEOFF 1 active members and LEOFF 1 employers. Based on our latest analysis and information, we do not expect LEOFF 1 to come out of full funding under current law.

We viewed the bill as both a governance change, and also as a merger of plan assets and liabilities as of the effective date of the bill. After the merger, unless LEOFF 1 and LEOFF 2 assets and liabilities are separately accounted for, there will be no future basis for quantifying the emergence of any LEOFF Plan 1 UAAL. For our analysis, we did not separately account for LEOFF 1 and LEOFF 2 after the merger.

We assumed the Board would recommend no further improvement to LEOFF 1 benefits.

Consistent with the prescription in the bill, we assumed LEOFF 1 salaries would grow by 4.5 percent per year exclusive of merit or longevity increases.

For LEOFF Plan 2, we assumed contribution rates in 2013-17 remain unchanged from the rates previously adopted by the Board. After that, and consistent with the assumptions described above, we further assumed that contribution rates collected over LEOFF 2 payroll will cover all future required contributions for the merged plan.

In How the Risk Measures Change and How the Results Change When Assumptions Change, we used current law projections in addition to projections under the provisions of this bill. For these current law projections, we assumed that the state, through GF-S contributions, would fully amortize any future unfunded liability in LEOFF 1 by 2024.

Otherwise, we developed these costs using the same assumptions as disclosed in the June 30, 2009, *Actuarial Valuation Report* (AVR).

How We Applied These Assumptions

Using our projection system, we calculated expected liabilities, assets, and expected benefit payments in LEOFF Plans 1 and 2 under current law and using current assumptions. We recorded the expected contributions in each year of the projection. This established the expected contributions under current law.

Next, we calculated expected liabilities and expected benefit payments in LEOFF 1 using a 4.5 percent general salary increase assumption. We combined this output with the output of the current law projections for LEOFF 2 to establish our expected liabilities and benefits payments for the merged plan. To determine expected assets for the merged plan, we lowered the state's contribution rate for the 2011-13 Biennium from 3.38 percent to 2.96 percent. We then applied the current LEOFF 2 funding policy to the new assets and liabilities (greater of the normal cost under the Aggregate funding method or 90 percent of the normal cost under the Entry Age Normal method). We recorded the expected contributions in each year of the projection. This established the expected contributions in the merged plan.

We compared the contributions under current law and the merged plan to determine the expected cost of the bill.

Otherwise, we developed these costs using the same methods as disclosed in the AVR.

Special Data Needed

We developed these costs using the same assets and data as disclosed in the AVR.

ACTUARIAL RESULTS

How The Liabilities Changed

This bill will not impact the present value of future benefits payable under either plan.

How The Present Value of Future Salaries (PVFS) Changed

The change in the general salary increase assumption will change PVFS in LEOFF 1. However, since we assume LEOFF 2 will take on the assets and liabilities of LEOFF 1, and further assume that LEOFF 1 active members and LEOFF 1 employers will not pay future contributions, this bill will not impact the PVFS used in the funding of the merged plan.

How Contribution Rates Changed

We show the expected Plan 2 member contribution rates both "before" and "after" the proposed merger in the table below.

LEOFF 2 Member Contribution Rates		
FY	Before	After
2012	8.46%	8.46%
2013	8.46%	8.46%
2014	8.46%	8.46%
2015	8.46%	8.46%
2016	8.46%	8.46%
2017	8.46%	8.46%
2018	7.98%	7.43%
2019	7.98%	7.43%
2020	8.47%	8.34%
2021	8.47%	8.34%
2022	8.61%	8.58%
2023	8.61%	8.58%
2024	8.66%	8.66%
2025	8.66%	8.66%
2026	8.70%	8.70%
2027	8.70%	8.70%
2028	8.72%	8.73%
2029	8.72%	8.73%
2030	8.75%	8.75%
2031	8.75%	8.75%
2032	8.77%	8.77%
2033	8.77%	8.77%
2034	8.78%	8.79%
2035	8.78%	8.79%
2036	8.80%	8.80%

The state rate during the 2011-13 Biennium decreases by 0.42 percent. Otherwise, the state rate is 40 percent of the member rates shown above. The local employer rate is 60 percent of the member rates shown above. The rates above, and the budget impacts below, reflect all the expected impacts from this bill.

How This Impacts Budgets And Plan 2 Employees

Budget Impacts	
(Dollars in Millions)	**LEOFF**
2011-2013	
General Fund	($15.0)
Non-General Fund	0.0
Total State	**($15.0)**
Local Government	0.0
Total Employer	**($15.0)**
Total Plan 2 Employee	**$0.0**
2013-2015	
General Fund	$0.0
Non-General Fund	0.0
Total State	**$0.0**
Local Government	0.0
Total Employer	**$0.0**
Total Plan 2 Employee	**$0.0**
2011-2036	
General Fund	($28.3)
Non-General Fund	0.0
Total State	**($28.3)**
Local Government	(21.4)
Total Employer	**($49.7)**
Total Plan 2 Employee	**($34.7)**

Note: Totals may not agree due to rounding. We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.

The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

As with the costs developed in the actuarial valuation, the emerging costs of the system will vary from those presented in the AVR or this fiscal note to the extent that actual experience differs from the actuarial assumptions.

The results of our analysis could also change under a different interpretation of the bill.

How The Risk Measures Changed

Using our risk model, we compared risk measures before and after the merger to evaluate how certain financial risks to the state, LEOFF 1, and LEOFF 2 change under this proposal. We evaluated changes in affordability risk for the state, pay-go risk, funded status, and LEOFF 2 member contribution rates.

This bill will affect the overall risk and affordability of the pension systems as shown below. Overall, the merger improves the risk measures captured under the Pension Score

Card. Affordability risk improves because the merged plan eliminates the risk of spiking LEOFF 1 contributions near 2024. Under the current assumed funding policy, should an unfunded liability in LEOFF 1 re-emerge, it must be fully amortized, through GF-S contributions, by 2024. This funding policy can produce spiking contributions under scenarios where unfunded liability in LEOFF 1 re-emerges near 2024.

The pay-go risk measures under the all-systems Pension Score Card do not change. The closed plan pay-go measures include PERS 1 and TRS 1 only. These are unchanged by this bill. The changes in LEOFF 2 pay-go measures due to the merger are not large enough to impact the all-systems measures for the open plans.

Pension Score Card, Before Merger – All Systems		
Category *(Dollars in Billions)*	**Value**	**Score**
Affordability		
Chance Pensions will Consume More than 8% of GF-S[1]	18%	37
5% Chance GF-S[1] Consumption will Exceed	9.9%	39
5% Chance Employer Contribution Rate will Exceed	20.1%	44
Risk		
Chance of PERS 1, TRS 1 in Pay-Go[2]	41%	19
Chance of Open Plan in Pay-Go[2]	13%	47
5% Chance Annual Pay-Go Cost[3] in PERS 1, TRS 1 Exceed	$1.7	38
5% Chance Annual Pay-Go Cost[3] in Open Plans Exceed	$4.0	11
Chance of Total Funded Status Below 60%	34%	24
Total Weighted Score		**33**

[1]*Currently 2.7% of GF-S.*

[2]*When today's value of annual cost exceeds $50 million.*

[3]*Pay-Go costs on top of normal pension costs.*

Pension Score Card, After Merger – All Systems		
Category *(Dollars in Billions)*	**Value**	**Score**
Affordability		
Chance Pensions will Consume More than 8% of GF-S[1]	2%	91
5% Chance GF-S[1] Consumption will Exceed	7.4%	71
5% Chance Employer Contribution Rate will Exceed	18.1%	51
Risk		
Chance of PERS 1, TRS 1 in Pay-Go[2]	41%	19
Chance of Open Plan in Pay-Go[2]	13%	47
5% Chance Annual Pay-Go Cost[3] in PERS 1, TRS 1 Exceed	$1.7	38
5% Chance Annual Pay-Go Cost[3] in Open Plans Exceed	$4.0	11
Chance of Total Funded Status Below 60%	34%	24
Total Weighted Score		**51**

[1]*Currently 2.7% of GF-S.*

[2]*When today's value of annual cost exceeds $50 million.*

[3]*Pay-Go costs on top of normal pension costs.*

For more detail please see Appendix A. Please see our *2010 Risk Assessment Report* (RAR) for additional background on how we developed and how to interpret the Pension Score Card.

HOW THE RESULTS CHANGE WHEN THE ASSUMPTIONS CHANGE

To determine the sensitivity of the actuarial results to the best-estimate assumptions or methods selected for this pricing we varied the following assumptions and methods:

- **Annual investment returns** – We modeled the plans earning 7 percent annual investment return instead of 8 percent under our best-estimate pricing. Under current law we would expect LEOFF 1 to remain fully funded under 8 percent annual investment returns. However, analyzing a loss of assumed investment returns (7 percent actual instead of 8 percent assumed) allows us to demonstrate the impact of LEOFF 2 "absorbing" hypothetical unfunded liability that would have re-emerged in LEOFF 1 had it not been merged with LEOFF 2. Under this scenario, LEOFF 1 funded status drops to a minimum of 90 percent.
- **Annual investment returns and source of hypothetical UAAL payments** – We modeled the same investment returns as above and assumed payment of future LEOFF 1 UAAL, under current law, by local government instead of the state.

Who would pay for the effects of hypothetical future LEOFF 1 UAAL under current law is an important assumption when evaluating the impacts of the proposed merger under economic scenarios that are not expected. For example, if you assume, under current law, the state is fully responsible for amortizing any future LEOFF 1 UAAL (as we assumed in our best-estimate pricing), and if you further assume that LEOFF 1 contributions continue to be zero, then the merger could be viewed as shifting 50 percent of future Plan 1 UAAL payments from the state to Plan 2 members, and 30 percent to local government employers. On the other hand, if you assume, under current law, local government is fully responsible for amortizing any future Plan 1 UAAL, then the hypothetical emergence of Plan 1 UAAL under the merger could be viewed as shifting 20 percent of future UAAL payments from local government to the state, and 50 percent to Plan 2 members.

Using the investment return scenario described above to generate a hypothetical future LEOFF 1 UAAL, the tables below show the Plan 1 UAAL "cost-shift" that results from the merger when you assume either the state would pay LEOFF 1 UAAL under current law ("state pays") or local government would pay LEOFF 1 UAAL under current law ("local government pays").

State Pays Plan 1 UAAL Under Current Law Funding Policy 25-Year Costs*			
(Dollars in millions)	Plan 1 UAAL Contributions Before Merger	Plan 1 UAAL Contributions After Merger	Change in Plan 1 UAAL Contributions
Plan 2 Member Costs	$0	$480	$480
Employer Costs	0	288	288
State Costs	923	192	(731)
Total	$923	$959	$36

**Totals may not agree due to rounding.*

Local Government Pays Plan 1 UAAL Under Current Law Funding Policy 25-Year Costs*			
(Dollars in millions)	Plan 1 UAAL Contributions Before Merger	Plan 1 UAAL Contributions After Merger	Change in Plan 1 UAAL Contributions
Plan 2 Member Costs	$0	$480	$480
Employer Costs	923	288	(635)
State Costs	0	192	192
Total	$923	$959	$36

**Totals may not agree due to rounding.*

Under this sensitivity analysis, LEOFF 2 members are absorbing Plan 1 UAAL costs that they would not have previously. State or local government will experience a cost/savings depending on who would have paid for the LEOFF 1 UAAL under current law. The contributions after merger exceed the contributions before merger because total plan contributions, on average, occur later under the merger and don't accrue as much investment return as under the current law assumption that fully amortizes UAAL by 2024.

ACTUARY'S CERTIFICATION

The undersigned hereby certifies that:

1. The actuarial cost methods are appropriate for the purposes of this pricing exercise.
2. The actuarial assumptions used are appropriate for the purposes of this pricing exercise.
3. The data on which this fiscal note is based are sufficient and reliable for the purposes of this pricing exercise.
4. Use of another set of methods and assumptions may also be reasonable, and might produce different results.
5. We prepared this fiscal note for the Legislature during the 2011 Legislative Session.
6. We prepared this fiscal note and provided opinions in accordance with Washington State law and accepted actuarial standards of practice as of the date shown on page one of this fiscal note.

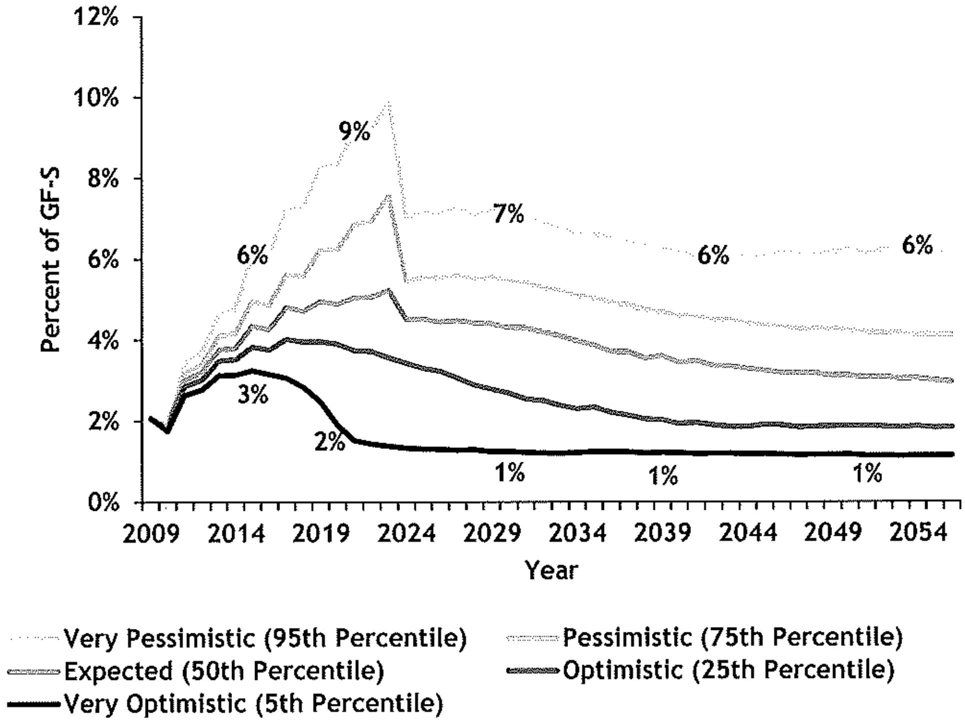
While this fiscal note is meant to be complete, the undersigned is available to provide extra advice and explanations as needed.

Matthew M. Smith, FCA, EA, MAAA
State Actuary

APPENDIX A – HOW THE RISK MEASURES CHANGED

As noted in the body of the fiscal note, the assumed current LEOFF 1 funding policy can produce spiking contributions under scenarios where unfunded liability in LEOFF 1 re-emerges near 2024. We demonstrate this point in the graph below. This graph displays the percentage of the GF-S allocated to pensions in the future. Note the spikes in the graph occurring near 2024 under the pessimistic and very pessimistic outcomes.

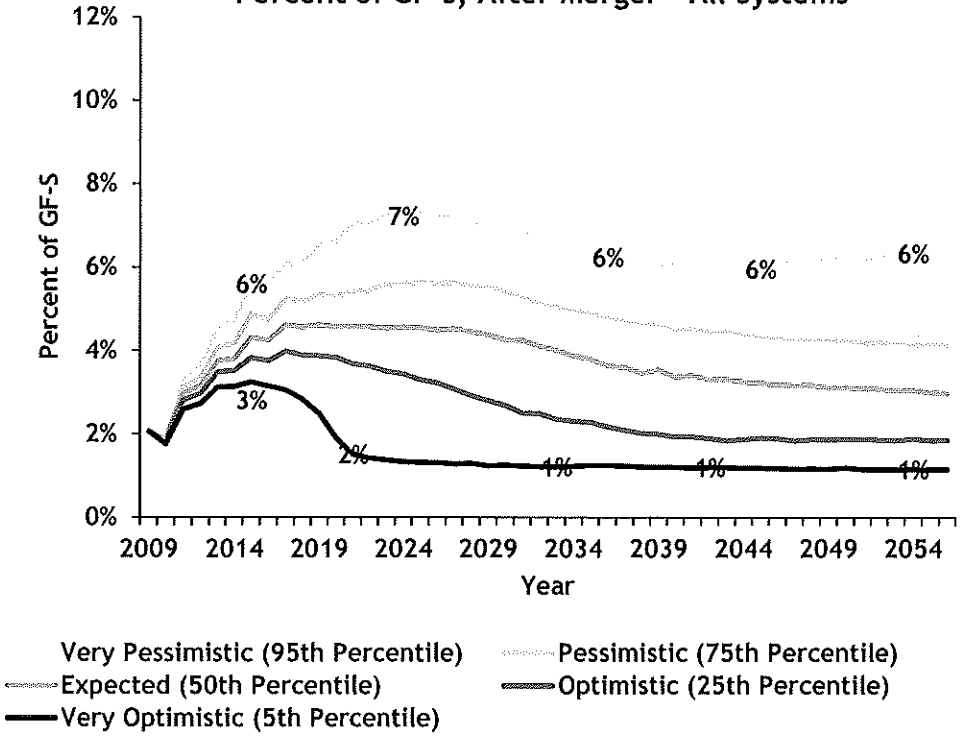
Figure 1
Percent of GF-S, Before Merger - All Systems



The merged plan removes the fixed 2024 amortization date and spreads total plan costs over an open and ongoing period – consistent with the open nature of the merged plan.

The following graph demonstrates the removal of spiking LEOFF 1 contribution requirements under the merged plan.

Figure 2
Percent of GF-S, After Merger - All Systems



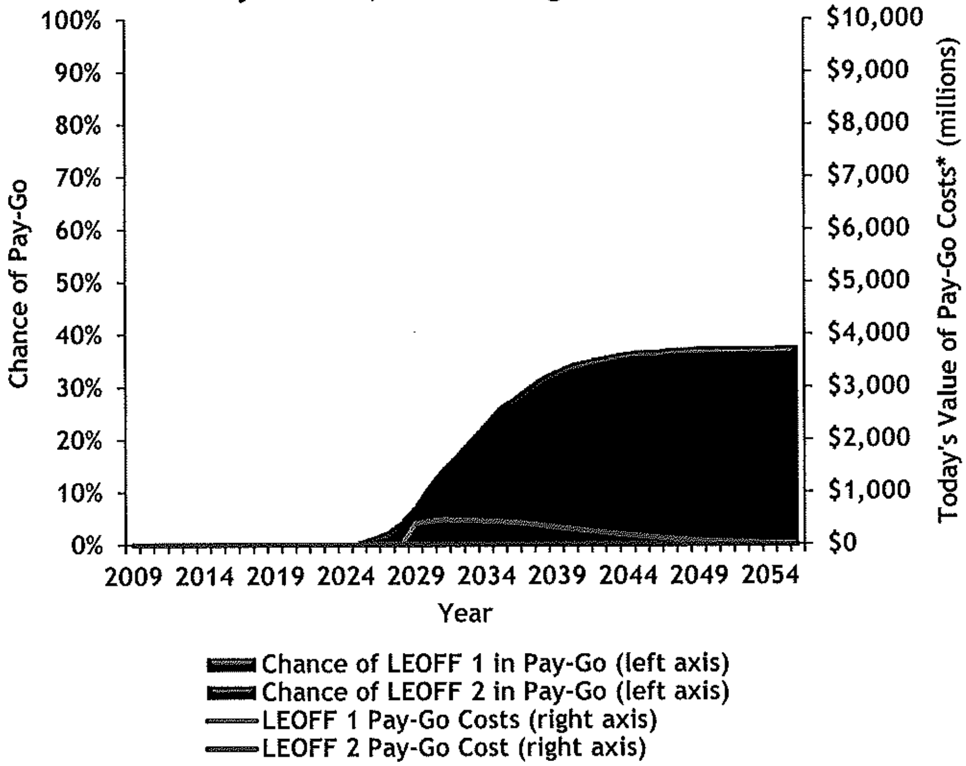
Should an unfunded liability re-emerge in LEOFF 1, it may not be quantifiable as a LEOFF 1 cost under a merged plan where plan assets are indistinguishable, and if so, LEOFF 2 contributions would absorb it. Using the current LEOFF 2 cost-sharing formula, members would absorb 50 percent of the cost, employers would absorb 30 percent, and the state would absorb the remaining 20 percent. Under this outcome, the state absorbs 20 percent of the cost instead of 100 percent assumed under current law. This serves to decrease future assumed contributions from the GF-S and increase the affordability of pensions from the perspective of the state's budget. Please see How The Results Change When The Assumptions Change for additional details on the cost-sharing of LEOFF 1 UAAL.

Plan-Specific Risk Measures – Pay-Go, Funded Status, Plan 2 Member Rates

Since the all-systems Pension Score Card measures do not isolate LEOFF 1 and 2, we turned our attention to plan-specific risk measures for LEOFF 1 and 2. We started with Pay-Go risk measures.

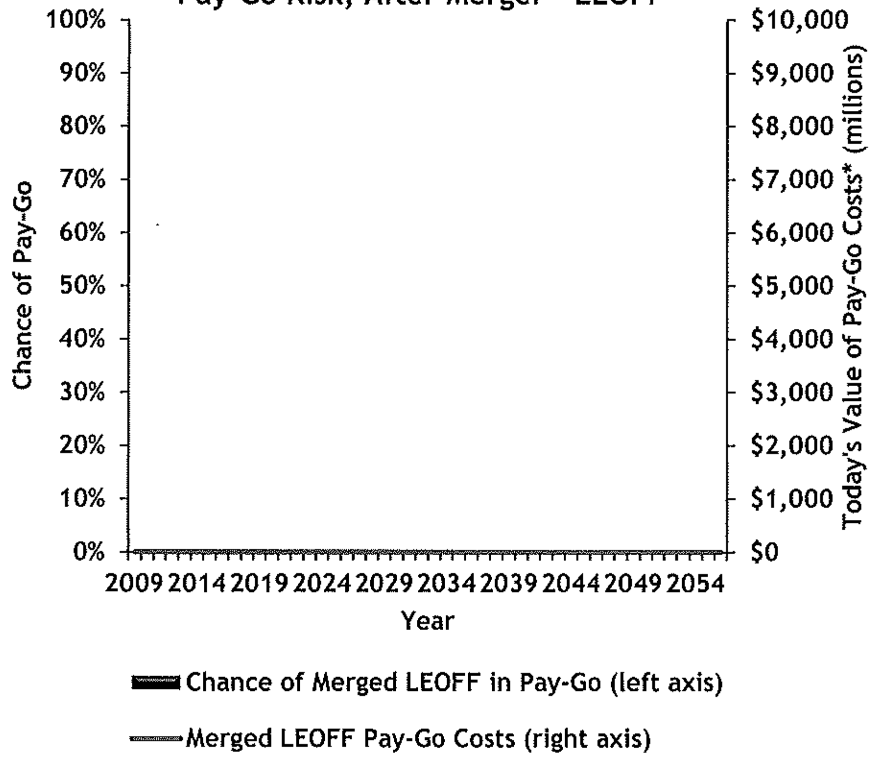
Under current funding policy, LEOFF 1 has a 39 percent chance of pay-go and LEOFF 2 has no pay-go risk. We demonstrate these risk measures in the following graph.

Figure 3
Pay-Go Risk, Before Merger - LEOFF



Under the merged plan, pay-go risk is 0.1 percent. The reduction of LEOFF 1 pay-go risk occurs due to (1) the addition of LEOFF 2 assets to fund LEOFF 1 benefits that become payable before LEOFF 2 benefits and (2) the replacement of a closed-plan funding policy with an open-plan funding policy that provides on-going contributions. We display pay-go risk measures for the merged plan below.

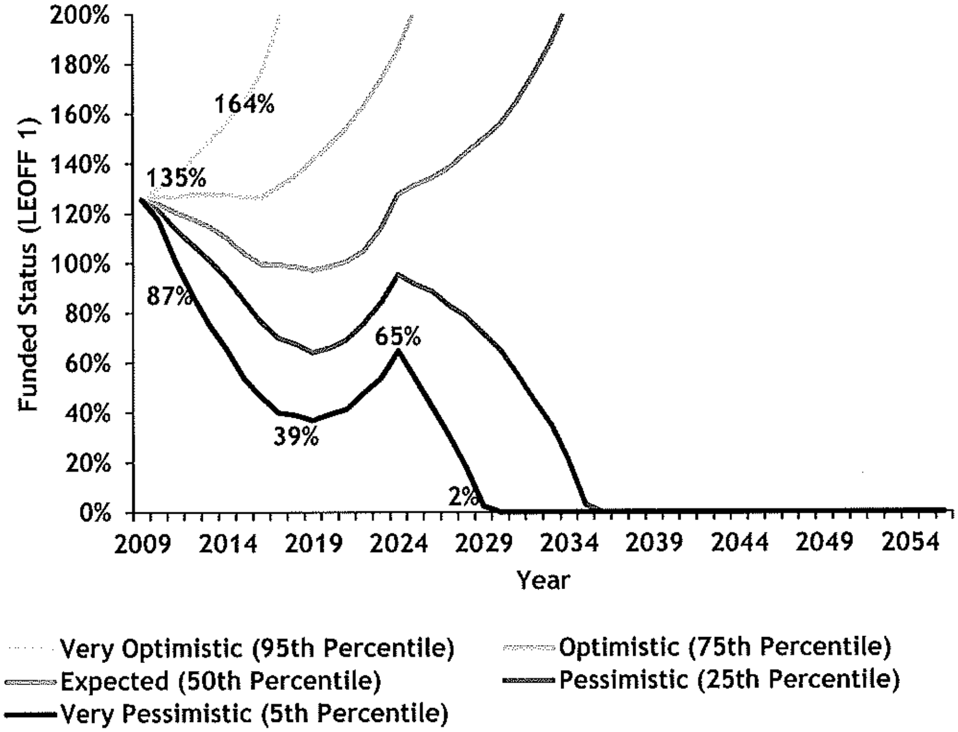
Figure 4
Pay-Go Risk, After Merger - LEOFF

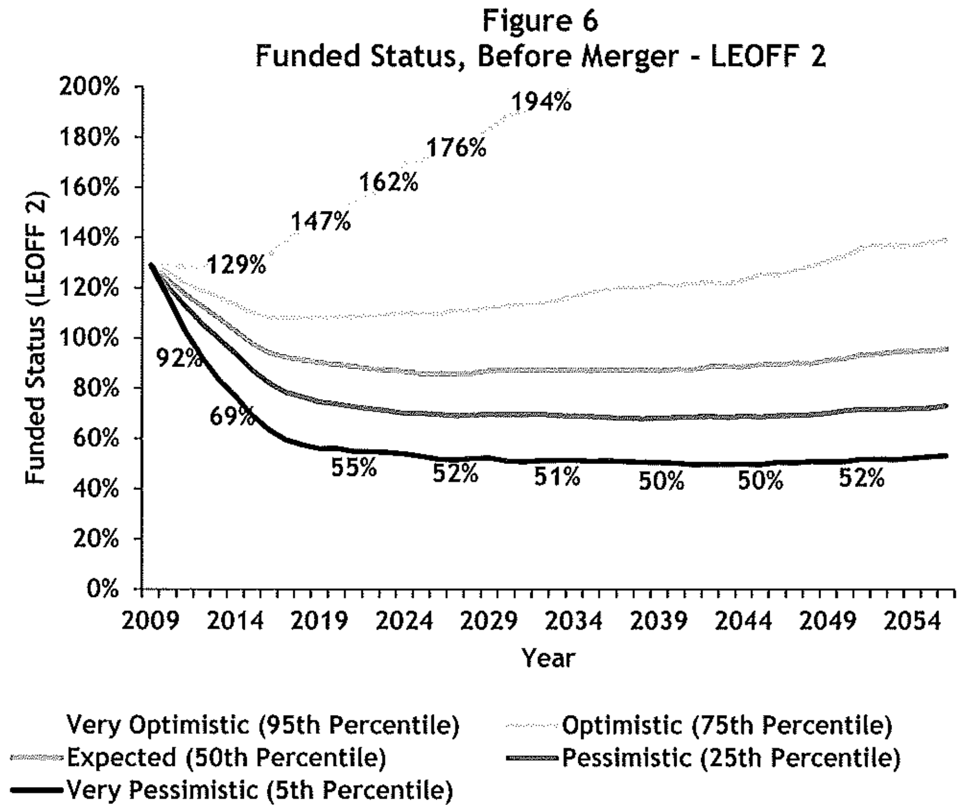


Funded Status

Next, we reviewed how the funded status changes under this bill. The following two charts demonstrate funded status outcomes for both LEOFF 1 and LEOFF 2 before the merger.

Figure 5
Funded Status, Before Merger - LEOFF 1

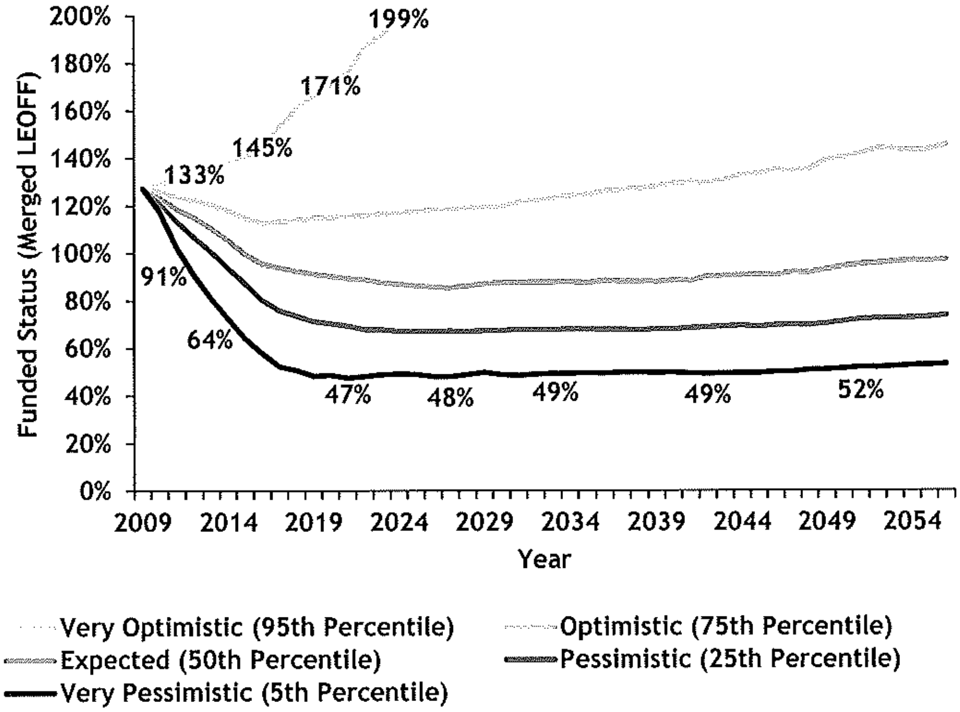




Under LEOFF 1's current funding policy and asset allocation, the plan has a high chance of building a surplus and a high chance of prematurely exhausting assets with benefit payments remaining (pay-go). We expect LEOFF 2's funded status will hover around 100 percent in the long-run. We also found there's a 5 percent chance of LEOFF 2's funded status falling below 60 percent and a 5 percent chance of increasing to at least 200 percent.

As displayed in the following graph, we found the projected funded status of the merged plan is similar to LEOFF 2 before the merger, except if high/low funded status outcomes occur in the future, the funded status becomes higher/lower under these outcomes. This occurs because of the higher assets and liabilities of the merged plan. Under very unfavorable economic outcomes, asset returns will fall, but the liabilities will be larger due to the merger. This results in lower funded status for the merged plan than the funded status that would occur in LEOFF 2 by itself. On the other hand, under the most favorable economic outcomes, assets will grow larger due to the larger asset base from the merger. This results in higher funded status for the merged plan than LEOFF 2 by itself.

Figure 7
Funded Status, After Merger - LEOFF



Plan 2 Member Contribution Rates

Lastly, we reviewed the potential impact on Plan 2 member contribution rates. The following two graphs display Plan 2 member contribution rate outcomes before and after the merger if past practices continue in the areas of full funding and future benefit improvements ("past practices"). Please see the RAR for Plan 2 member contribution rate outcomes if the plan receives 100 percent of future actuarially required contributions and receives no future benefit improvements ("current law").

Figure 8
Member Contribution Rates, Before Merger - LEOFF 2, Past Practices

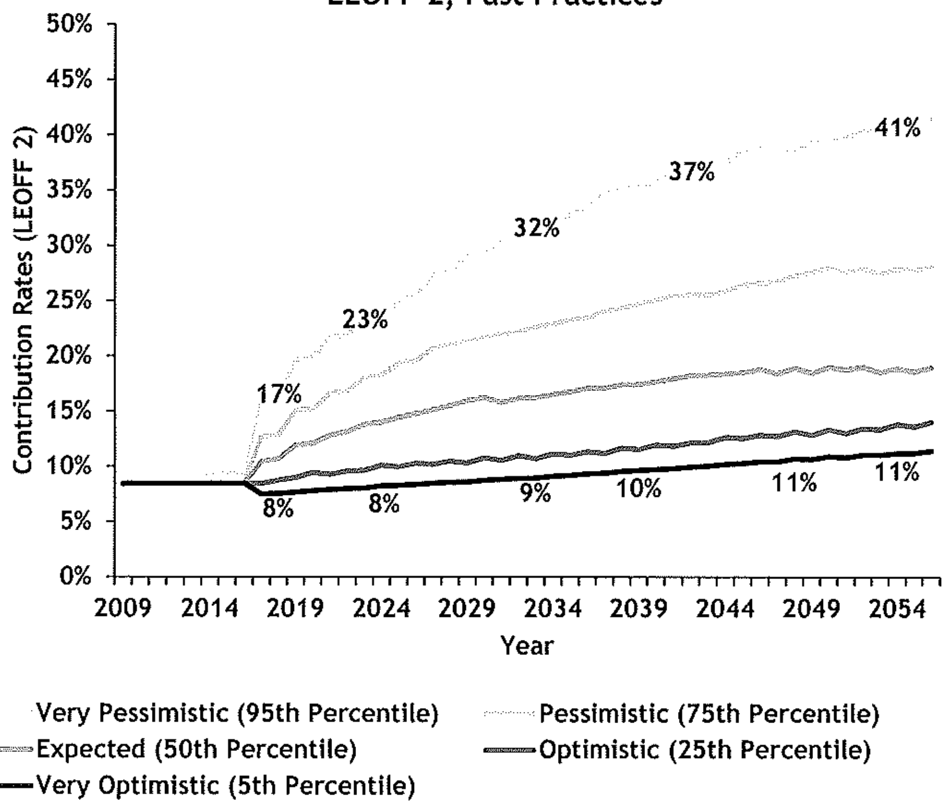
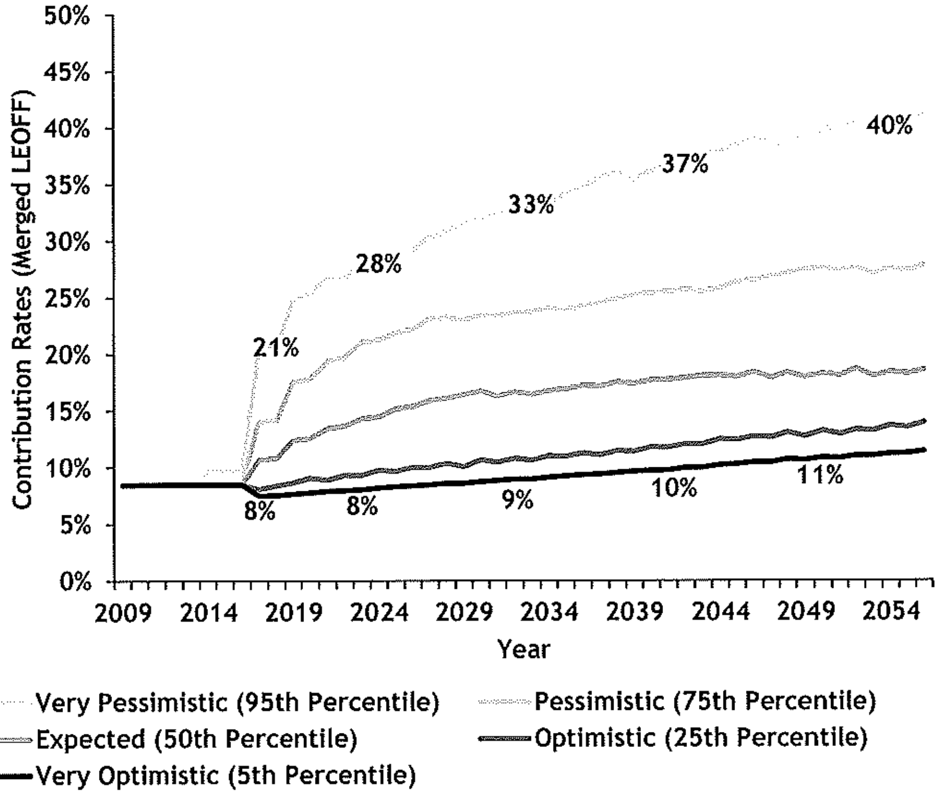


Figure 9
Member Contribution Rates, After Merger - LEOFF 2, Past Practices



Please see the RAR for a complete description of the development of the risk assessment model we used for this analysis. The RAR also contains a complete description of the assumptions, methods, and data we used in the underlying risk analysis.

GLOSSARY OF ACTUARIAL TERMS

Actuarial Accrued Liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of actuarial assumptions (i.e. interest rate, rate of salary increases, mortality, etc.).

Aggregate Funding Method: 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): The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- ❖ Normal cost.
- ❖ Amortization of the unfunded actuarial accrued 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.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Projected Unit Credit (PUC) Liability: The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Projected Benefits: Pension benefit amounts that are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded PUC Liability: The excess, if any, of the Present Value of Benefits calculated under the PUC cost method over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

Individual State Agency Fiscal Note

Bill Number: 2097 HB	Title: LEOFF plans 1 and 2 merger	Agency: 124-Department of Retirement Systems

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

NONE

Estimated Expenditures from:

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.1	0.0	0.0	0.0	0.0
Account					
Department of Retirement Systems Expense Account-State 600-1	116,471	0	116,471	0	0
Total $	116,471	0	116,471	0	0

Estimated Capital Budget Impact:

NONE

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☒ Requires new rule making, complete Part V.

Legislative Contact:	David Pringle	Phone: 360-786-7310	Date: 04/20/2011
Agency Preparation:	George Pickett	Phone: 360-664-7950	Date: 04/26/2011
Agency Approval:	Marcie Frost	Phone: 360-664-7224	Date: 04/26/2011
OFM Review:	Heather Matthews	Phone: (360) 902-0543	Date: 04/26/2011

Request # 11-049-1

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

This bill consolidates the trust funds for both Plan 1 and Plan 2 of the Law Enforcement Officers' and Fire Fighters' (LEOFF) Retirement System into a new fund for all LEOFF members and retirees. The following sections of the bill impact the Department of Retirement Systems (DRS):

- Section 1: Identifies contribution rates for employers, members and the state from July 1, 2011 through June 30, 2013.
- Section 2: States that due to the temporary nature of section 1, it will not be codified.
- Section 3: Updates RCW 41.26.080 to state that future contribution rates for LEOFF Plan 1 members will be established by the LEOFF Board beginning July 1, 2013.
- Sections 4, 6 and 7: Identifies one fund for all LEOFF members by striking references to separate plans and funds.
- Section 5: Changes definitions and adds the definition of "System" to refer to LEOFF Retirement System.
- Section 8: Provides that the adoption of actuarial tables, assumptions and costs, as identified by the LEOFF Board, are not subject to legislative revision.
- Section 10: Lifts the allotment of expenditures for administrative expenses for the LEOFF Board.
- Section 19: Grants the LEOFF Board the authorization to pay any legal fees from the LEOFF trust fund.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

No impact.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

ADMINISTRATIVE ASSUMPTIONS

- Members and retirees will maintain their membership with either LEOFF 1 or LEOFF 2.
- Current retirement benefit structures and membership rules will remain separate and unchanged for each system.
- The Office of the State Treasurer (OST) will create a new combined fund for all LEOFF members.
- The balance of the current LEOFF 1 and 2 funds will be consolidated and transferred to this new fund.
- There will be separate contribution rates for each plan.
- Because of the separate contribution rates for each system, DRS will maintain the distinction between LEOFF 1 and LEOFF 2 when accounting for incoming contributions to the new LEOFF fund.
- DRS will apply for plan qualification with the Internal Revenue Service (IRS).
- Contributions will begin being reported to the new LEOFF fund 90 days after the legislature adjourns.

The assumptions above were used in developing the following workload impacts and cost estimates.

FISCAL SERVICES

Fiscal staff will be responsible for the following tasks as it pertains to implementation of this bill:

- Preparation and testing of new system updates and accounting/reconciliation spreadsheets
- Edits to the Comprehensive Annual Financial Report
- Test and review updated AFRS reports
- Coordination with OST regarding reporting of contributions to the new LEOFF fund and consolidation of contributions in the closing LEOFF funds
- Staff training

Fiscal Analyst 3 – 80 hours (salaries/benefits) = $2,772
Total Estimated Benefits/Customer Service Costs = $2,772

PLAN QUALIFICATION

As a part of our standard practice, DRS will seek a plan qualification determination from the Internal Revenue Service (IRS) for the merger of LEOFF 1 and LEOFF 2. Special tax counsel familiar with IRS plan qualification issues would be contracted, through the state's Attorney General's Office, for this effort. This process is estimated to take approximately six months.

One-time cost for tax counsel to lead plan determination effort = $100,000
Total Estimated Plan Qualification Costs = $100,000

AUTOMATED SYSTEMS

The Department of Retirement Systems' (DRS) automated systems will require modifications to implement this bill.

Information Technology Specialist 4 – 12 hours (salaries/benefits = $539
Programming, testing, and verification – 128 hours @ $95 per hour = $12,160
DIS*cost of $500 per week for 2 weeks = $1,000
Total Estimated Automated Systems Costs = $13,699

*cost for mainframe computer processing time and resources at the Department of Information Services

ESTIMATED TOTAL COST TO IMPLEMENT THIS BILL:

2011-13
FISCAL SERVICES = $2,772
PLAN QUALIFICATION = $100,000
AUTOMATED SYSTEMS = $13,699
ESTIMATED TOTAL COSTS = $116,471

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.1		0.0		
A-Salaries and Wages	2,447		2,447		
B-Employee Benefits	864		864		
C-Personal Service Contracts					
E-Goods and Services	113,160		113,160		
G-Travel					
J-Capital Outlays					
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements					
T-Intra-Agency Reimbursements					
9-					
Total:	$116,471	$0	$116,471	$0	$0

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2012	FY 2013	2011-13	2013-15	2015-17
Fiscal Analyst 3	53,148	0.0		0.0		
Info Tech Specialist 4	71,496	0.0		0.0		
Total FTE's	124,644	0.1		0.0		0.0

Part IV: Capital Budget Impact

NONE

No impact.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Rules will need to be updated.

Individual State Agency Fiscal Note

Bill Number: 2097 HB	Title: LEOFF plans 1 and 2 merger	Agency: 341-LEOFF 2 Retirement Board

Part I: Estimates

☐ No Fiscal Impact

Estimated Cash Receipts to:

NONE

Estimated Expenditures from:

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	2.0	2.0	2.0	2.0	2.0
Account					
Law Enforcement Officers' and Firefighters Retirement System Plan 2 Expense Acct-Non-Appropriated 548-6	192,469	177,346	369,815	354,692	354,692
Total $	192,469	177,346	369,815	354,692	354,692

Estimated Capital Budget Impact:

NONE

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☐ Requires new rule making, complete Part V.

Legislative Contact:	David Pringle	Phone: 360-786-7310	Date: 04/20/2011
Agency Preparation:	Dianna Wilks	Phone: (360) 664-7666	Date: 04/26/2011
Agency Approval:	Steve Nelsen	Phone: 360-586-2323	Date: 04/26/2011
OFM Review:	Jane Sakson	Phone: 360-902-0549	Date: 04/27/2011

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

LEOFF Plan1/Plan 2 Fund Merger (HB 2097)

HB 2097 financially combines the LEOFF Plan 1 and LEOFF Plan 2 retirement funds. The benefits do not change for either plan, but the combined fund would be responsible for the liabilities of both plans. The merger reduces the state contribution rate for the 2011-13 biennium by $15 million, but does not change the LEOFF Plan 1 member rates already at 0.00%. HB 2097 moves LEOFF Plan 1 governance under the LEOFF Plan 2 Board including adopting all actuarial assumptions and setting rates in the future. It specifies that contribution rates and actuarial assumptions adopted by the Board would not be subject to legislative revision and provides that all expenses of the LEOFF Board will be paid out of the LEOFF retirement fund. The Board is also authorized to use the retirement fund for any legal expenses related to protecting the fund.

The proposed merger expands the scope of services and duties for the LEOFF Plan 2 agency. The LEOFF Plan 2 Board/agency currently serves 16,951 active members, and 1,367 retirees and beneficiaries. Merging LEOFF Plan 1and LEOFF Plan 2 will add 301 active members and 8,008 annuitants (2010 Preliminary Actuarial Valuation Report).

The LEOFF Plan 2 Board trust fund will incur a one-time expense to establish each FTE and ongoing salary thereafter. A summary of the impact of each position requested is provided below:

Research Analyst

- Collects, organizes, and analyzes data regarding pension related issues.
- Develops and recommends policy proposals concerning pension benefits, funding, and administration for Board consideration.
- Provides research, analysis, and prepares reports on benefit issues.
- Drafts or reviews, analyzes, and interprets pension-related legislation, coordinating with Board members, legislators, committees, legislative staff, or executive branch officials as directed.
- Researches tax consequences of changes in pension statutes.
- Presents topics of a complex and technical nature at Board meetings.
- Responds to inquiries from constituents, legislative and executive branch officials, providing information on pension legislation and related issues.
- Prepares bill analysis and background materials for Board proposals and fiscal notes.

Administrative Assistant 4

- Provides administrative support to an eleven member Board and agency staff.
- Responds to inquiries, questions, and correspondence on LEOFF Plan 2 Retirement Board matters.
- Composes, edits, and types correspondence.
- Coordinates monthly Board meetings including agenda and material preparation.
- Manages mail including distribution, review and handling of correspondence needing immediate action.
- Acts as agency's Public Disclosure Officer.
- Prepares minutes for Administrative Committee meetings and monthly Board meetings.

- Sets up and maintains files of correspondence and records.
- Participates in strategic and staff planning processes.
- Coordinates with Deputy Director and budget staff in preparing request packages and budget-related responses to the legislature.
- Directs and/or coordinates special projects.
- Coordinates agency matters within the agency and with other governmental agencies and stakeholders.
- Performs delegated technical duties for the LEOFF Plan 2 Retirement Board.
- Supply and inventory coordinator.

The above listed functions will increase our agency expenditures as detailed in Part III (Expenditure Detail).

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

The expenditure assumptions include 2 FTE's; salaries and benefits for one Administrative Assistant at $66,536 annually and one Research Analyst at $96,461. Goods and Services includes one-time costs for both employees; new desks $3,774, partitions to create working spaces $3,000, desk chairs $800, side chairs $300, file cabinets $550, bookcases $600, laptops and accessories $6,150 and phones $330 for a total of $15,504. Then the overhead costs of supplies additional phone lines, internet costs, payroll costs, software for a total of $9,860; plus travel costs of approx $4,952 per year.

There will be additional costs for work performed by the Office of the State Actuary in the amount of $28,512 per year.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	2.0	2.0	2.0	2.0	2.0
A-Salaries and Wages	122,076	122,076	244,152	244,152	244,152
B-Employee Benefits	40,922	41,764	82,686	83,528	83,528
C-Personal Service Contracts					
E-Goods and Services	38,372	37,836	76,208	75,672	75,672
G-Travel	4,952	4,952	9,904	9,904	9,904
J-Capital Outlays	15,429		15,429		
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements					
T-Intra-Agency Reimbursements					
9-					
Total:	$221,751	$206,628	$428,379	$413,256	$413,256

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2012	FY 2013	2011-13	2013-15	2015-17
Administrative Assistant 4	48,168	1.0	1.0	1.0	1.0	1.0
Research Analyst (Band 2)	73,908	1.0	1.0	1.0	1.0	1.0
Total FTE's	122,076	2.0	2.0	2.0	2.0	2.0

Part IV: Capital Budget Impact

NONE

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.