Dual Membership Preliminary Follow-up Report

Washington State Law Enforcement Officers' and Fire Fighters' Plan 2 Retirement Board

October 25, 2006

Brief Overview

- Key Areas for Action
- SCPP Action
- Options

Key Areas for Action

- Base Salary
- Thirty-year Cap
- Inflation Adjustment for Twenty-years of Service

Dual Membership Issues

- Base Salary
  - Excludes salary elements that would otherwise be used for calculating a retirement benefit under the individual plans

Dual Membership Issues

- Thirty-year Cap
  - Potential Benefit Reduction

Dual Membership Issues

- Inflation Adjustment for Twenty-years of Service
  - LEOFF Plan 2 excluded from combining service to qualify

Option 1: Amend Base Salary Language

- Include payment types defined as salary in both dual member systems

Option 2: Amend Thirty-year Cap

- Eliminate the potential benefit reduction for a LEOFF Plan 2 member with over thirty years combined service but less than 15 years of Plan 1 service

Option 3: Add LEOFF Plan 2 to 20 year Inflation Adjustment

- Add LEOFF Plan 2 to list of systems that are allowed combine service credit from all systems qualify for the 20 year inflation adjustment

Summary

- Pursue Legislative Changes to:
  - Change “base salary” definition
  - Remove thirty-year cap limitation
  - Include all service to qualify for inflation adjustment for twenty years of service
- Joint Legislation with the Select Committee on Pension Policy

Dual Membership

Questions?

Dual Membership

Preliminary Follow-up Report

October 25, 2006

1. Issue

An initial presentation was given in August 2005, on dual membership. The subject was reintroduced during this interim. This report is a follow-up report to the April 2006 Preliminary report and incorporates the outcome from the Select Committee on Pension Policy (SCPP) meeting on the topic of dual membership.

2. Staff

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3. Members Impacted

Based on the data provided by the Office of the State Actuary (OSA) as of September 30, 2004, there were 14,754 active, 1,788 inactive and 413 retired LEOFF Plan 2 members. Of the 14,754 active members, 1,485 have dual membership; of the 1,788 inactive members, 505 have dual membership; and of the 413 retired members, 57 have dual membership; for a total of 2,047 LEOFF 2 members who currently have dual membership.

4. Current Situation

Under the current portability statutes (RCW 41.54), when members meet age and service requirements from one system, they are eligible to retire out of all systems; however, not all systems allow for portability. For example, LEOFF Plan 1, the Judges and Judicial systems are not included in the portability statutes. A complete list of dual member systems is listed in Appendix A.

5. Background Information and Policy Issues

History

Dual membership or portability was created with the passage of ESSB 5150 in 1987. LEOFF Plan 2 was added as a dual member system in 1993. The purpose of portability was to ensure that employees, who serve the public in multiple careers, neither had their benefit increased nor decreased due to their career path in multiple public retirement systems.

Features of Dual Membership

- Allows members to combine their service credit in all systems to qualify for benefits in each system.
- Allows members to restore withdrawn contributions from a prior system within two years of establishing membership in the current system.
- Allows members to combine service credit from all systems to qualify for a disability retirement, but only in their current system. If they qualify for a disability retirement, they can receive a service retirement from the prior system, including actuarial reductions, if applicable.
- Allows Plan 3 members to combine service credit from all systems to qualify for the inflation factor feature.
- Allows members to combine service credit from all systems to qualify for a survivor benefit. Many of the plans, including LEOFF Plan 2, require a minimum of 10 years of service credit in order for the surviving spouse or eligible minor children to be eligible for a retirement allowance.
- Allows members to substitute the base salary from any of the systems as compensation used in calculating the retirement allowance. The base salary does not include overtime, vacation leave cash-outs or other similar types of compensation enhancements. This feature can be particularly attractive if the member's service in the inactive system occurred in the past when compensation was much lower.

LEOFF Plan 2 Dual Membership Issues

During the 2005 Interim, the Board studied dual membership and the following three issues:

1. **Base salary**. Under the current dual membership statutes, a member can choose to use their "base salary" from any dual member system in which they are members to calculate their retirement benefit in that system. However, the definition of "base salary" is not as inclusive as the "salary" definitions used for benefit calculations under the individual plans (Appendix B). This means that certain compensation elements that would be used for calculating a retirement benefit under an individual system would not be used for calculating a dual member retirement benefit.

For example the definition for "base salary" in the dual member statutes does not include overtime but would be included in calculating benefits under both PERS and LEOFF. This exclusion of certain salary elements appears to be in conflict with the original intent of the dual membership statutes which was to not diminish a member's retirement benefit because of a career change.

2. **Thirty-year cap.** If a member is a dual member in LEOFF Plan 2 and PERS Plan 1, they are subject to a potential cap on their benefit calculation. Under the current dual membership statutes, the combined pension benefits from both plans may not exceed the maximum allowable benefits for any one of the dual member's plans. PERS Plan 1 has a limit (cap) of 30 years for calculating the maximum benefit allowance. Even though LEOFF Plan 2 does not have a 30-year cap, the dual member's benefit could still be affected by the Plan 1 cap if their combined service exceeds 30 years.

3. **Inflation factor for twenty years of service.** LEOFF Plan 2, PERS Plan 3, SERS Plan 3, and TRS Plan 3 all have an inflation factor provision within each system. This inflation factor increases a member's benefit by twenty-five one-hundredths of a percent, compounded each month from the member's date of separation to the date retirement benefits are received. Under the current dual membership statutes, all of the systems allow members to combine service to qualify for the inflation factor, except LEOFF Plan 2.

At the December 8, 2005 meeting, the Board was presented the following three policy options:

1. **Option 1: Use all elements of salary as defined in the plan 2 and plan 3 systems**
   Change the definition of "base salary" in the dual membership statutes to provide that any payment type included in the definition of "salary" for both dual member plans will be included in "base salary".
2. **Option 2: Eliminate thirty-year cap.**
   A dual member in LEOFF Plan 2 and either TRS Plan 1 or PERS Plan 1 would not be subject to the thirty-year benefit limitation if they had less than 15 years in the plan 1 system.
3. **Option 3: Include LEOFF Plan 2 in the inflation adjustment**
   Add LEOFF Plan 2 to the list of plans that allow a member to use their service credit in all systems and qualify for inflation adjustment. The change to the dual member statutes to include LEOFF Plan 2 would be straightforward and would make the application consistent among all plans that have the inflation adjustment for twenty years of service.

The Board's recommendation was to defer action on this subject until the 2006 interim and work cooperatively with the SCPP on joint legislation. The SCPP at their October 17, 2006 moved the dual membership issue forward to the November Executive Committee meeting for a recommendation. The Executive Committee is expected to make a recommendation to the full Committee for consideration at the December 12, 2006 SCPP meeting.

7. Supporting Information

Appendix A – Dual Membership Systems
Appendix B – Salary RCWs
Appendix C – Examples

APPENDIX A: Dual Membership Systems

- **LEOFF Plan 2**
- **PERS Plan 1**
- **PERS Plan 2**
- **PERS Plan 3**
- **PSERS (effective July 1, 2006)**
- **SERS Plan 2**
- **SERS Plan 3**
- **TRS Plan 1**
- **TRS Plan 2**
- **TRS Plan 3**
- **Statewide City Employees' Retirement System (SCERS)**
- **First-class city retirement systems of Seattle, Tacoma, and Spokane**

APPENDIX B: Salary RCWs

LEOFF Plan 2:

"Basic salary" for plan 2 members, means salaries or wages earned by a member during a payroll period for personal services, including overtime payments, and shall include wages and salaries deferred under provisions established pursuant to sections 403(b), 414(h), and 457 of the United States Internal Revenue Code, but shall exclude lump sum payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, or any form of severance pay. In any year in which a member serves in the legislature the member shall have the option of having such member's basic salary be the greater of:

(i) The basic salary the member would have received had such member not served in the legislature; or

(ii) Such member's actual basic salary received for non-legislative public employment and legislative service combined. Any additional contributions to the retirement system required because basic salary under (b)(i) of this subsection is greater than basic salary under (b)(ii) of this subsection shall be paid by the member for both member and employer contributions.

PERS Plan 2 & 3:

"Compensation earnable" for plan 2 and plan 3 members, means salaries or wages earned by a member during a payroll period for personal services, including overtime payments, and shall include wages and salaries deferred under provisions established pursuant to sections 403(b), 414(h), and 457 of the United States Internal Revenue Code, but shall exclude non-money maintenance compensation and lump sum or other payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, or any form of severance pay.

SERS Plan 2 & 3:

"Compensation earnable" for plan 2 and plan 3 members, means salaries or wages earned by a member during a payroll period for personal services, including overtime payments, and shall include wages and salaries deferred under provisions established pursuant to sections 403(b), 414(h), and 457 of the United States internal revenue code, but shall exclude non-money maintenance compensation and lump sum or other payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, or any form of severance pay.

TRS Plan 2 & 3:

"Earnable compensation" for plan 2 and plan 3 members, means salaries or wages earned by a member during a payroll period for personal services, including overtime payments, and shall include wages and salaries deferred under provisions established pursuant to sections 403(b), 414(h), and 457 of the United States Internal Revenue Code, but shall exclude lump sum payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, or any form of severance pay.

Dual Membership Definitions:

"Base salary" means salaries or wages earned by a member of a system during a payroll period for personal services and includes wages and salaries deferred under provisions of the United States internal revenue code, but shall exclude **overtime payments** [emphasis added], non-money maintenance compensation, and lump sum payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, any form of severance pay, any bonus for voluntary retirement, any other form of leave, or any similar lump sum payment.

Appendix C – Examples

<u>Thirty-year Cap Example:</u>
A member retires at age 54, with a total of 35 years combined service; 13 years in PERS Plan 1 and 22 years in LEOFF Plan 2. Their LEOFF Plan 2 final average salary is $50,400 per year ($4,200/month). Their PERS Plan 1 average final salary is $54,000 per year ($4,500/month).

Step 1: **Determine benefit cap by calculating a monthly benefit in each system as if all of the service credit had been earned in one system subject to each system's rules.**

L2 = .02 x $4,200 x 35	P1 = .02 x $4,500 x 30 (can only use 30 because of cap)
L2 = $2,940.00	P1 = $2,700.00

The largest calculation amount is their benefit cap. In this example, their benefit cap is **$2,940.00.**

Step 2: Calculate their monthly benefit in each system based on each system's rules.

L2 = .02 x $4,200 x 22	P1 = .02 x $4,500 x 13
L2 = $1,848.00	P1 = $1,170.00

Step 3: Add the benefits from Step 2 and compare to benefit cap from Step 1. If the combined monthly benefits are greater than the cap, reduce the benefits proportionately in each to equal the cap.

Monthly benefit	= L2 + P1	Benefit cap	= $2,940
	= $1,848 + $1,170		= $2,940
	= $3,018		= $2,940

The monthly benefit is greater than the benefit cap ($3,018 - $2,940 = $78) therefore, both benefits would be reduced proportionately, to equal the benefit cap.

L2 = $1,848 – ($78 x (1848/3018))	P1 = $1,170 – ($78 x (1170/3018))
L2 = $1,848 - $48	P1 = $1,170 - $30
L2 = $1,800	P1 = $1,140

If the statute was changed to eliminate the 30-year cap, the member would be entitled to a monthly benefit of $3,072, instead of the capped benefit of $2,940.

Inflation Factor Example:
A member leaves employment at age 46 with four years of service credit in PERS Plan 2 and 18 years in LEOFF Plan 2. At age 53, they retire out of both systems, but choose to defer their PERS Plan 2 benefit until age 65. Their final average salary (FAS) when they terminated at age 46 is $4,500.

Under current dual membership statutes, the FAS would not qualify for the inflation factor because they have less than 20 years of service in LEOFF Plan 2. Their monthly benefit at age 53 would be $1,620.00.

If the LEOFF 2 statute was changed to be consistent with the Plan 3 Systems, their monthly benefit at age 53 would be $1,772.36.