



# **SUPPLEMENTAL RATE ADOPTION**

**LEOFF Plan 2 Retirement Board**

**October 26, 2011**

# OVERVIEW

- HB 2070
- Cost of Bill
- Options



# HB 2070

## ○ Salary Reductions

- Reduced work hours
- Mandatory leave without pay
- Temporary layoffs
- Reduction to current pay



# COSTS

- Office of the State Actuary
  - Original costs – two basis points member  
one basis point employer  
one basis point state
  - Preliminary cost from study



# OPTIONS

- Adopt a zero supplemental rate based on the preliminary information from the Actuary's office.
- Delay adoption and ask for a full report from the Actuary's office at November's meeting.



QUESTIONS?



# LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS' PLAN 2 RETIREMENT BOARD

## Supplemental Rate Adoption

### Final Proposal

October 26, 2011

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#### 1. Issue

The Board must decide whether it is necessary to increase contribution rates due to the passage of Substitute House Bill 2070, determining salary for pension purposes.

#### 2. Staff

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#### 3. Members Impacted

Based on the preliminary actuarial data as of June 30, 2010, there were 16,775 active LEOFF Plan 2 members. Adopting supplemental contribution rates impacts all active LEOFF Plan 2 members, employers and in most cases the state.

#### 4. Current Situation

One of the main goals of the Board is to ensure the actuarial soundness of the plan. In order to maintain that goal, it may be necessary for the Board to pay for any benefit improvements via adoption of a supplemental contribution rate increase.

## **5. Background Information**

One of the primary functions of the Board is to adopt contribution rates. The Board is required to use an accredited actuary using approved actuarial methods to determine the cost of the plan and the cost of any benefit improvements. The statutes covering adoption of supplemental contribution rates for LEOFF Plan 2 include RCW 41.26.720, 41.45.0604 and 41.45.070. These statutes can be found in Appendix A.

Not all benefit improvements will have costs sufficient to increase contribution rates, but if they do, the Board has the task of adopting a supplemental rate increase, usually effective September 1 following the effective date of the legislation.

During the 2011 legislative session, HB 2070 passed that stated a member's pension based on salaries earned during the 2011-13 biennium will not be reduced by compensation due to reduced work hours, mandatory leave without pay, temporary layoff, or reductions to current pay if the measures are an integral part of an employer's expenditure reduction efforts. The Office of the State Actuary (OSA) provided a revised fiscal note on June 14, 2011 indicating the cost of that benefit enhancement would require a contribution rate increase of two basis points for the member (0.02%), one basis point for the employer (0.01%) and one basis point for the state (0.01%).

### **Policy Issues**

The normal process for adopting a supplemental rate increase is for the Board to take action in July for an effective date of September 1, based on the recommendation of OSA and the assumptions used in their fiscal note. However, in this case, it may be appropriate to defer adoption of the supplemental rate until a later date. The estimated cost of this benefit depends on how many members actually have their work hours reduced, have mandatory leave without pay, temporary layoffs or reduced salaries. The Actuary based his costs on the assumption that twenty-five percent of the active members in local government would have a two percent reduction in pay. A larger sample survey of this employer group may provide more reliable data.

The consequence of delaying the adoption of a supplemental rate is the loss of earnings on the contributions that would have been made, if indeed the original assumptions are correct. However, in this case, a delay in the adoption of a supplemental rate will not create a significant risk of underfunding the plan due to the relatively modest cost of the benefit improvement and the relatively delay.

### **History**

At the July 27, 2011 meeting the Board looked at two options concerning the cost of implementing HB 2070. One option was to implement the OSA recommended four basis



point supplemental rate increase, effective September 1, 2011. The other option was to delay the supplemental rate adoption until a study could be conducted to determine a more accurate number of members impacted by this bill and see if there would be an impact to the costs. The Board chose the latter option.

At the time this report was completed for the October Board meeting, OSA's preliminary findings indicated the cost of HB 2070 was not significant enough to raise contribution rates. OSA has not prepared a formal report on the information received from the study.

## **6. Policy Options**

### **Policy Option 1: Adopt Zero Supplemental Rate at October Meeting**

Under this option the Board would recommend no increase in the contribution rates.

### **Policy Option 2: Delay Adoption of Supplemental Rate and Ask the OSA for a Presentation at November's Board Meeting**

Under this option the Board would delay taking any action until OSA could provide a complete report and recommendation on the contribution rate impact from HB 2070.

## **7. Appendix A – Contribution Rate Statutes**

### **Appendix B – Letter on Costs from OSA**

## APPENDIX A – Contribution Rate Statutes

### RCW 41.26.720 Board of trustees — Powers — Meeting procedures — Quorum — Judicial review — Budget.

1) The board of trustees have the following powers and duties and shall:

(a) Adopt actuarial tables, assumptions, and cost methodologies in consultation with an enrolled actuary retained by the board. The state actuary shall provide assistance when the board requests. The actuary retained by the board shall utilize the aggregate actuarial cost method, or other recognized actuarial cost method based on a level percentage of payroll, as that term is employed by the American academy of actuaries. The actuary retained by the board shall adjust the actuarial cost method to recognize the actuarial present value of future revenue that will be included in the calculation of the market value of assets pursuant to RCW [41.26.805](#)(2), using the methods and assumptions employed by the state actuary in RCW [41.26.805](#)(9). In determining the reasonableness of actuarial valuations, assumptions, and cost methodologies, the actuary retained by the board shall provide a copy of all such calculations to the state actuary. If the two actuaries concur on the calculations, contributions shall be made as set forth in the report of the board's actuary. If the two actuaries cannot agree, they shall appoint a third, independent, enrolled actuary who shall review the calculations of the actuary retained by the board and the state actuary. Thereafter, contributions shall be based on the methodology most closely following that of the third actuary;

(b)(i) Provide for the design and implementation of increased benefits for members and beneficiaries of the plan, subject to the contribution limitations under RCW [41.26.725](#). An increased benefit may not be approved by the board until an actuarial cost of the benefit has been determined by the actuary and contribution rates adjusted as may be required to maintain the plan on a sound actuarial basis. Increased benefits as approved by the board shall be presented to the legislature on January 1st of each year. The increased benefits as approved by the board shall become effective within ninety days unless a bill is enacted in the next ensuing session of the legislature, by majority vote of each house of the legislature, repealing the action of the board;

(ii) As an alternative to the procedure in (b)(i) of this subsection, recommend to the legislature changes in the benefits for members and beneficiaries, without regard to the cost limitations in RCW [41.26.725](#)(3). Benefits adopted in this manner shall have the same contractual protections as the minimum benefits in the plan. The recommendations of the board shall be presented to the legislature on January 1st of each year. These measures shall take precedence over all other measures in the legislature, except appropriations bills, and shall be either enacted or rejected without change or amendment by the legislature before the end of such regular session;

(c) Retain professional and technical advisors necessary for the accomplishment of its duties. The cost of these services may be withdrawn from the trust;

(d) Consult with the department for the purpose of improving benefit administration and member services;

(e) Provide an annual report to the governor and the legislature setting forth the actuarial funding status of the plan and making recommendations for improvements in those aspects of retirement administration directed by the legislature or administered by the department;

(f) Establish uniform administrative rules and operating policies in the manner prescribed by law;

(g) Engage administrative staff and acquire office space independent of, or in conjunction with, the department. The department shall provide funding from its budget for these purposes;

(h) Publish on an annual basis a schedule of increased benefits together with a summary of the minimum benefits as established by the legislature which shall constitute the official plan document; and

(i) Be the fiduciary of the plan and discharge the board's duties solely in the interest of the members and beneficiaries of the plan.

(2) Meetings of the board of trustees shall be conducted as follows:

(a) All board meetings are open to the public, preceded by timely public notice;

(b) All actions of the board shall be taken in open public session, except for those matters which may be considered in executive session as provided by law;

(c) The board shall retain minutes of each meeting setting forth the names of those board members present and absent, and their voting record on any voted issue; and

(d) The board may establish, with the assistance of the appropriate office of state government, an internet web site providing for interactive communication with state government, members and beneficiaries of the plan, and the public.

(3) A quorum of the board is six board members. All board actions require six concurring votes.

(4) The decisions of the board shall be made in good faith and are final, binding, and conclusive on all parties. The decisions of the board shall be subject to judicial review as provided by law.

(5) A law enforcement officers' and firefighters' retirement system plan 2 expense fund is established for the purpose of defraying the expenses of the board. The board shall cause an annual budget to be prepared consistent with the requirements of chapter [43.88](#) RCW and shall draw the funding for the budget from the investment income of the trust. Board members shall be reimbursed for travel and education expenses as provided in RCW [43.03.050](#) and [43.03.060](#). The board shall make an annual report to the governor, legislature, and state auditor setting forth a summary of the costs and expenditures of the plan for the preceding year. The board shall also retain the services of an independent, certified public accountant who shall annually audit the expenses of the fund and whose report shall be included in the board's annual report.

[2008 c 99 § 5; 2003 c 2 § 5 (Initiative Measure No. 790, approved November 5, 2002).]

## Notes:

**Findings -- Purpose -- 2008 c 99:** See note following RCW [41.26.800](#).

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

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

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

[2007 c 280 § 3; 2003 c 92 § 4.]

### **Notes:**

**Severability -- Effective date -- 2003 c 92:** See RCW [41.26.905](#) and [41.26.906](#).

## RCW 41.45.070 Supplemental rate.

\*\*\* CHANGE IN 2009 \*\*\* (SEE [6161-S.SL](#)) \*\*\*

(1) In addition to the basic employer contribution rate established in RCW [41.45.060](#) or [\\*41.45.054](#), the department shall also charge employers of public employees' retirement system, teachers' retirement system, school employees' retirement system, public safety employees' retirement system, or Washington state patrol retirement system members an additional supplemental rate to pay for the cost of additional benefits, if any, granted to members of those systems. Except as provided in subsections (6), (7), and (9) of this section, the supplemental contribution rates required by this section shall be calculated by the state actuary and shall be charged regardless of language to the contrary contained in the statute which authorizes additional benefits.

(2) In addition to the basic member, employer, and state contribution rate established in RCW [41.45.0604](#) for the law enforcement officers' and firefighters' retirement system plan 2, the department shall also establish supplemental rates to pay for the cost of additional benefits, if any, granted to members of the law enforcement officers' and firefighters' retirement system plan 2. Except as provided in subsection (6) of this section, these supplemental rates shall be calculated by the actuary retained by the law enforcement officers' and firefighters' board and the state actuary through the process provided in RCW [41.26.720](#)(1)(a) and the state treasurer shall transfer the additional required contributions regardless of language to the contrary contained in the statute which authorizes the additional benefits.

(3) The supplemental rate charged under this section to fund benefit increases provided to active members of the public employees' retirement system plan 1, the teachers' retirement system plan 1, and Washington state patrol retirement system, shall be calculated as the level percentage of all members' pay needed to fund the cost of the benefit not later than June 30, 2024.

(4) The supplemental rate charged under this section to fund benefit increases provided to active and retired members of the public employees' retirement system plan 2 and plan 3, the teachers' retirement system plan 2 and plan 3, the public safety employees' retirement system plan 2, or the school employees' retirement system plan 2 and plan 3 shall be calculated as the level percentage of all members' pay needed to fund the cost of the benefit, as calculated under RCW [41.45.060](#), [41.45.061](#), or [41.45.067](#).

(5) The supplemental rate charged under this section to fund postretirement adjustments which are provided on a nonautomatic basis to current retirees shall be calculated as the percentage of pay needed to fund the adjustments as they are paid to the retirees. The supplemental rate charged under this section to fund automatic postretirement adjustments for active or retired members of the public employees' retirement system plan 1 and the teachers' retirement system plan 1 shall be calculated as the level percentage of pay needed to fund the cost of the automatic adjustments not later than June 30, 2024.

(6) A supplemental rate shall not be charged to pay for the cost of additional benefits granted to members pursuant to chapter 340, Laws of 1998.

(7) A supplemental rate shall not be charged to pay for the cost of additional benefits granted to members pursuant to **\*\*chapter [41.31A](#) RCW**; section 309, chapter 341, Laws of 1998; or section 701, chapter 341, Laws of 1998.

(8) A supplemental rate shall not be charged to pay for the cost of additional benefits granted to members and survivors pursuant to chapter 94, Laws of 2006.

(9) A supplemental rate shall not be charged to pay for the cost of the additional benefits granted to members of the teachers' retirement system and the school employees' retirement system plans 2 and 3 in sections 2, 4, 6, and 8, chapter 491, Laws of 2007 until September 1, 2008. A supplemental rate shall not be charged to pay for the cost of the additional benefits granted to members of the public employees' retirement system plans 2 and 3 under sections 9 and 10, chapter 491, Laws of 2007 until July 1, 2008.

[2007 c 491 § 12; 2006 c 94 § 3; (2005 c 327 § 10 expired July 1, 2006); 2004 c 242 § 41. Prior: (2003 1st sp.s. c 11 § 3 repealed by 2005 c 327 § 11); 2003 c 92 § 5; prior: 2001 2nd sp.s. c 11 § 16; 2001 2nd sp.s. c 11 § 15; 2000 c 247 § 505; 1998 c 340 § 10; 1995 c 239 § 310; 1990 c 18 § 2; 1989 1st ex.s. c 1 § 1; 1989 c 273 § 7.]

## Notes:

**Reviser's note:** \*(1) RCW [41.45.054](#) was decodified by 2005 c 370 § 5, effective September 1, 2005.

\*\* (2) Chapter [41.31A](#) RCW was repealed by 2007 c 491 § 13, effective January 2, 2008, however, RCW [41.31A.020](#) was also amended by 2007 c 491 § 1 and 2007 c 492 § 10. For rule of construction, see RCW [1.12.025](#)(1).

**Severability -- Conflict with federal requirements -- 2007 c 491:** See notes following RCW [41.32.765](#).

**Effective date -- 2006 c 94 § 3:** "Section 3 of this act takes effect July 1, 2006." [2006 c 94 § 4.]

**Expiration date -- 2005 c 327 § 10:** "Section 10 of this act expires July 1, 2006." [2005 c 327 § 13.]

**Effective date -- 2004 c 242:** See RCW [41.37.901](#).

**Effective date -- 2003 1st sp.s. c 11:** See note following RCW [41.45.035](#).

**Severability -- Effective date -- 2003 c 92:** See RCW [41.26.905](#) and [41.26.906](#).

**Effective date -- 2001 2nd sp.s. c 11:** See note following RCW [41.45.010](#).

**Effective date -- 2001 2nd sp.s. c 11:** See note following RCW [41.45.030](#).

**Effective dates -- Subchapter headings not law -- 2000 c 247:** See RCW [41.40.931](#) and [41.40.932](#).

**Effective date -- 1998 c 341:** See RCW [41.35.901](#).

**Effective date -- 1998 c 340:** See note following RCW [2.10.146](#).

**Intent -- Purpose -- 1995 c 239:** See note following RCW [41.32.831](#).

**Effective date -- Part and subchapter headings not law -- 1995 c 239:** See notes following RCW [41.32.005](#).

**Effective date -- 1990 c 18:** See note following RCW [41.45.060](#).

Benefits not contractual right until date specified: RCW [41.34.100](#).

## **APPENDIX B – Letter on Costs from OSA**



# Office of the State Actuary

*"Securing tomorrow's pensions today."*

October 21, 2011

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## **RE: HB 2070: COMPARISON OF SURVEY RESULTS**

The Office of the State Actuary ("we") have completed our review of the survey results provided by AWC and the LEOFF 2 Board, and have reached the following conclusions about the local government assumptions in our actuarial fiscal note for HB 2070:

1. The assumptions for PERS and PSERS are within the range of reasonability.
  - When compared with the survey data, we found the PERS and PSERS numbers were pretty close. Further, our level of certainty in the survey data (based on the approximate 50 percent response rate) suggests that the original assumptions in the fiscal note continue to be reasonable.
2. The assumption for LEOFF is high.
  - If we were to revise the LEOFF assumption based on the survey data, it would decrease significantly. The revised assumption would have a high probability of not triggering a supplemental rate.





Our conclusion for LEOFF is based on the following:

- The actuarial fiscal note for HB 2070 assumed that 25 percent of the population would experience a 2 percent qualifying pay reduction.
- The survey data for LEOFF shows approximately 1.0 percent of the population receiving an average qualifying pay reduction of 3.3 percent.
- In order to show an apples-to-apples comparison, we need to state the survey results as a percent of the population receiving a 2.0 percent qualifying pay reduction. The 1.0 percent of the population receiving a 3.3 percent qualifying pay reduction is equivalent to 1.6 percent of the population receiving a 2.0 percent pay reduction.
- Therefore, the survey data for LEOFF shows about 1/15 of the impact assumed in the actuarial fiscal note for HB 2070.

Please note that if we re-priced HB 2070, our assumption would not necessarily line up perfectly with the survey data. Our revised assumption would be a mixture of our previous assumption and the survey data. We believe the survey data to be reasonably accurate with a fairly high response rate, so our assumption would likely be heavily weighted towards the survey data. However, we would not defer entirely to the survey data since it does not reflect the entire population.

For illustration purposes only, this letter will show the general magnitude of a contribution rate impact to LEOFF 2 for HB 2070 if our assumption matched the survey data.

- The actuarial fiscal note for HB 2070 showed a contribution rate impact for LEOFF 2 of 0.016 percent member, 0.010 percent employer, and 0.006 percent state, which would have led to supplemental rates of 0.02 percent member, 0.01 percent employer, and 0.01 percent state.
- Re-pricing HB 2070 using the survey data as our assumption would lead to a rate impact for LEOFF 2 of 0.001 percent member, 0.001 percent employer, and 0.000 percent state. This would result in no supplemental rate.

Our assumption would need to be approximately five times higher than the survey data shows in order to trigger a supplemental rate. This leads us to the conclusion that there is a very high probability we would not recommend a supplemental rate for LEOFF 2 if we re-priced the proposal using the new data.



Additional detail regarding these conclusions or a repricing of HB 2070 can be provided upon request. Please refer to the actuarial fiscal note for HB 2070 for all assumptions and methods.

Please also note that we did not review the assumptions for K-12, because the survey data did not include K-12 employers.

We appreciate your patience while we worked through the data. If you have any questions, please contact our office.

Sincerely,

Aaron Gutierrez  
Policy Analyst

cc: Matt Smith, State Actuary  
Troy Dempsey, Actuary  
Jane Sakson, Office of Financial Management  
Marcie Frost, Department of Retirement Systems  
David Pringle, House Ways and Means Staff  
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