Member Contributions to Benefit Improvement Account Preliminary Follow-up Report

LEOFF Plan 2 Retirement Board

October 27, 2010

Key Issue

- The Board is not authorized to charge additional member only contributions to fund benefit improvements.

Background

- Current Contribution Process
- Alternate Revenue Bill
- Additional Member Contributions

Current Contribution Process

- Current Contribution Rate: 16.92%
  - Member – 8.46%
  - Employer – 5.08%
  - State – 3.38%

Alternate Revenue

- 2008 Legislature passed alternate revenue bill (ESSB 6573)
  - Phased-in approach
    - $2.5 million in 2011
    - $5.0 million in 2013
    - $10.0 million in 2015
    - $25.0 million in 2017

Additional Member Contributions

- A 1% contribution rate would generate approximately $109.6 million in contributions after 5 years.
  - Assumes an 8% rate of return

Summary

- Current Contribution Process
- Alternate Revenue
- Additional Member Contributions

Member Contributions to Benefit Improvement Account

QUESTIONS?

Member Contributions to Benefit Improvement Account

Preliminary Follow-up Report

October 27, 2010

1. Issue

The LEOFF Plan 2 Retirement Board (Board) does not have the authority to charge additional contributions to members only for the purpose of funding benefit improvements.

2. Staff

Greg Deam
Senior Research and Policy Manager
(360) 586-2325
greg.deam@leoff.wa.gov

3. Members Impacted

This would impact all active members. According to the *2008 Actuarial Valuation Report* provided by the Office of the State Actuary (OSA), there are 16,626 active members as of June 30, 2008.

4. Current Situation

Under the current laws, member benefits are funded through contributions as a percentage of salary and investment earnings from the benefit fund. The current contribution rate is 16.92% and is split between the members, the employers and the state. The members pay 50%, the employers pay 30% and the state pays 20%.

During the 2008 legislative session the Legislature passed an alternate revenue bill (ESSB 6573) which created another source for funding benefit improvements.

5. Background Information and Policy Issues

When LEOFF Plan 2 was created in October of 1977 the plan was designed to be funded by having the members, the employers and the state make contributions based as a percentage of salary. In addition to the contributions made, the investment earnings on those contributions and future contributions would fund the plan. Any benefit improvements made to the plan would have to be funded through increased contribution rates. This can limit the number and size of benefit improvements because of the competition for budget dollars for employers and the state.

In response to these possible limitations, the Board introduced legislation creating an avenue for additional funding to improve member's benefits. The legislation that was passed is often referred to as the "alternate revenue" bill. This bill calls for a plan whereby the benefit fund can receive additional revenue from the general state revenues. However, in order for that transfer to take place, two things need to happen. First, the general state revenues need to exceed the previous fiscal biennium's revenue by five percent and the Legislature must also appropriate the funds. If both conditions are met, the transfers begin in 2011 and continue by September 30 of odd-numbered years in each subsequent fiscal biennium. The amounts that can be transferred are $2.5 million for 2011, $5 million in 2013, $10 million in 2015, $25 million in 2017, and in subsequent fiscal biennium the lesser of one-third of the general state revenue increase or $25 million.

Another possible source of funds that has been suggested is additional member contributions. These contributions would not be tied to existing benefits nor would it change the current funding practice in place where members, employers and the state share in a 50%, 30%, 20% split respectively.

Policy Issues

The Board would need to determine whether or not they should adopt a policy that would allow members to contribute directly into the benefit improvement account. There are several key points to consider if such a policy is adopted. One factor to consider is the level of the contribution rate needed in order to raise enough revenue to pay for a benefit improvement. Another issue may be whether or not a member would be willing to make contributions if they may retire before the benefit improvement is in place. A third point is the precedence it may set for funding future benefit enhancements. This may be seen as a new method of funding benefit improvements instead of the traditional method of sharing the cost with employers and the state

Revenue Generation

An example of the revenue the member only contributions could raise can be seen in Appendix A. In this example OSA used a 1% contribution rate on all member salaries to calculate the possible revenue that could be generated.

6. Supporting Information

Appendix A: Member Contribution into the Benefit Improvement Account – Office of the State Actuary (November 2009)

Office of the State Actuary
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360.786.6140
actuary.state@leg.wa.gov
http://osa.leg.wa.gov

Member Contributions into the Benefit Improvement Account

November 10, 2009

What would happen if LEOFF 2 members contributed an extra 1.00 percent of pay into a separate account? How much would be in the account after ten years? What's the value of those contributions in today's dollars? How does this value compare to the LEOFF 2 liabilities? This handout will answer these questions and provide additional context for the LEOFF 2 Retirement Board.

If LEOFF 2 members contribute an extra 1.00 percent of pay into the Benefit Improvement Account (BIA), those contributions will accumulate with interest over time. The BIA is a subaccount within the Commingled Trust Fund (CTF), so the interest earned on the contributions will equal the returns on the CTF. Over the last three fiscal years, 2007 through 2009, the CTF saw a 20 percent increase in a year and a 20 percent decrease in another year.

The following table shows how the contributions could accumulate over time depending on the interest earned on the CTF. The percentiles represent the chance the account value is less than the value shown. For example, after twenty years there is a 25 percent chance the account has less than $913.7 million. After five years there's a 98 percent chance the account has between $75.0 and $166.3 million.

Accumulated Value (Dollars in Millions)				
	Years of 1% Member Contributions Beginning 7/1/2010			
Percentile	5	10	20	48
1	$75.0	$175.7	$537.0	$5,230.4
5	$83.9	$206.9	$671.0	$7,228.8
10	$88.8	$224.8	$754.9	$8,545.9
25	$98.2	$258.6	$913.7	$11,716.3
50	$109.6	$303.4	$1,152.4	$16,992.0
75	$122.6	$357.6	$1,471.1	$25,388.7
90	$136.2	$419.3	$1,850.1	$37,511.0
95	$145.8	$462.2	$2,140.4	$47,327.0
99	$166.3	$550.5	$2,862.1	$72,468.5

The values in the table above represent possible account values in the future. In the annual valuation when we determine the contribution rates for LEOFF 2, we use present values. We convert the future dollar amounts into today's value, or present values. The following table shows the present values of the account values above.

360.786.6140
actuary.state@leg.wa.gov
http://osa.leg.wa.gov

Present Value as of 7/1/2010* (Dollars in Millions)				
	Years of 1% Member Contributions Beginning 7/1/2010			
Percentile	5	10	20	48
1	$51.0	$81.4	$115.2	$130.1
5	$57.1	$95.8	$144.0	$179.8
10	$60.5	$104.1	$162.0	$212.5
25	$66.8	$119.8	$196.0	$291.4
50**	$74.6	$140.5	$247.2	$422.6
75	$83.4	$165.6	$315.6	$631.4
90	$ 92.7	$194.2	$396.9	$932.9
95	$99.2	$214.1	$459.2	$1,177.0
99	$113.2	$255.0	$614.1	$1,802.2

** Eight percent annual interest.*
*** Roughly equal to earning 8 percent annual interest each year.*

Since these values are present values, they are comparable to the liabilities shown in a fiscal note or the annual valuation reports. While these present values can be compared to liabilities, there are some significant differences between these projected asset values and plan liabilities. The liabilities of LEOFF 2 are based on the contractual benefits of the plan. Once provided, these benefits cannot be reduced or cut-back in the future for current members. The account values shown above are based on a stream of contributions that are not contractually obligated. The present values shown are based on the assumption that the contributions get made for the number of years shown. If a benefit gets tied to a stream of contributions expected to be paid into the BIA and for whatever reason those contributions don't come in, or investment experience is poor, the resulting contractual benefit payments will likely be funded by LEOFF 2 in the form of increased contribution rates.

In developing the account values shown in this handout, unless otherwise noted, we used the same assumptions, methods, and data described in the Report on Financial Condition. We prepared this handout for the LEOFF 2 Board for their November 18, 2009, meeting. This handout is for illustration purposes only and is meant to show the range of possible outcomes from implementing a contribution into the BIA of 1.00 percent of LEOFF 2 member salaries.

The undersigned, with actuarial credentials, meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein. If you have any questions, I am available to provide extra advice and explanations as needed.

Chris Jasperson, ASA, EA, MAAA
Associate Pension Actuary

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