



# Deferred Compensation as Salary Final Proposal

LEOFF Plan 2 Retirement Board

December 17, 2008

# Background Summary

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- Key concepts
  - Services rendered
  - Payment in lieu of
- Ambiguities still remain

# Key Issue

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- Employer contributions to LEOFF Plan 2 members' 457 Deferred Compensation Plans are not consistently included in the definition of basic salary.

# Proposal Summary

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- Employer contributions to 457 Deferred Compensation Plans would be basic salary
  - Collective bargaining agreement
  - Employment agreement, or
  - Written program of benefits
- Cost
  - 0.12% member
  - 0.07% employer
  - 0.05% state

# Deferred Compensation as Salary

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QUESTIONS?

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

## Deferred Compensation

### Final Proposal

December 17, 2008

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#### 1. Issue

Employer contributions to LEOFF Plan 2 members' 457 Deferred Compensation Plans are not consistently included in the definition of basic salary.

#### 2. Proposal Summary

The proposal would allow employer contributions to a member's 457 Deferred Compensation plan only if agreed to in a collective bargaining agreement, employment contract or written program of benefits between the employer and employee. It would include both matching and mandatory employer contributions.

#### 3. Staff

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#### 3. Members Impacted

Based on the actuarial data as of June 30, 2007, there were 16,009 active LEOFF Plan 2 members and 924 retirees. Changes to what is included in basic salary could impact both active LEOFF Plan 2 members, and retirees, if the changes are made to a retired member's final average salary (FAS), retroactively.

#### 4. Current Situation

Most public employers offer a 457 deferred compensation plan. Member contributions are voluntary and are includable in basic salary. Employers are not required to contribute to the 457 deferred compensation plan, but they can. Under certain circumstances employer contributions to a member's 457 account can be included in basic salary, but under other situations, they are not.

## 5. Background Information and Policy Issues

### Background

It is important to remember that a member's retirement benefit is calculated using the formula, 2% x FAS x years of service (YOS). FAS for LEOFF Plan 2 members consists of the monthly average of the member's basic salary for the highest consecutive sixty service credit months.

Under current law, member contributions to the LEOFF Plan 2 defined benefit accounts are includable in basic salary and are mandatory. Employer contributions are also mandatory, but are not included in basic salary.

It is clear from the statutes that if a member's salary or wages include deferred salary under sections 403(b), 414(h) and 457 of the United States Internal Code, they are part of basic salary. The statutes do not specifically include 401(a) defined contribution plans, nor do they distinguish between member and employer contributions. Through administrative practice, the Department of Retirement Systems (DRS) has in some cases, included employer contributions in basic salary and not, in others.

The LEOFF Plan 2 Retirement Board (Board) originally reviewed this topic in the 2005 and 2006 Interims. At the end of the 2006 Interim, the Board passed a motion that the subject needed to be presented to the Select Committee on Pension Policy (SCPP) for consideration as joint legislation as this policy could affect more than just LEOFF Plan 2 members. A letter sent to the SCPP on June 5 of 2007, included this topic along with several others offering to work together with them on developing this legislation. This topic was not a part of the SCPP work-plan for the 2007 Interim. The Board introduced a bill to the 2008 Legislature, which did not pass.

There are two key concepts that are necessary to understand this issue. The first is that in order for salaries or wages to be included in basic salary they must be for *services rendered*. The second key concept to understanding this policy issue is *payments in lieu of*.

### Services Rendered

Payment is considered for *services rendered* if the member has an absolute right to receive the payment as part of his or her employment. The concept of *services rendered* becomes especially important when looking at employer-paid contributions.

For example, if an employer offers to make a payment to a 457 deferred compensation plan for any employee, either as a percentage of salary or a specified amount per hour, the employer contributions are included as part of basic salary. Members have an absolute right to receive the contributions as part of his or her employment.

On the other hand, if an employer offers a 457 deferred compensation plan and a match, based on whether or not the member contributes, then it is not included in basic salary. The

match is not for *services rendered*, since the member does not have an absolute right to receive the additional contribution for performing the duties required of his or her position.

### **Payment in Lieu of**

A *payment in lieu of* occurs when a new payment type is created as a replacement for an existing payment that has the characteristic of the payment it has replaced. Whether or not the payment is includable or not includable in basic salary is not dependent upon what the payment is called, but rather on the nature of the payment.

For example, employer contributions to Social Security are not part of basic salary. Creating a payment type that is, in essence, a substitute for Social Security but with a different name, would be a *payment in lieu of* and would not be considered basic salary.

Another example of employer contributions not included in salary is payments to a health care account. If, through the bargaining process, employer contributions to health care are exchanged for an increase in salary, the raise may not be considered “salary” for pension purposes because it is “in lieu of” something not includable.

### **Statistical Information**

According to the 2005 Board survey of the 368 LEOFF Plan 2 employers, 331 (89.9%) offered a 457 deferred compensation plan and 92 (25%) of those offered some sort of contribution match.

### **Policy Issues**

Even though deferred compensation is discussed in both statute and administrative rule, ambiguities still remain.

- Should any employer contributions to a 457 deferred compensation plan be included in basic salary or only those that do not require member contributions?
- Should 401(a) and 401(k) contributions be treated the same as other deferred wages?
- Should *payments in lieu of* restrictions on “salary” be modified with respect to employer contributions to deferred salary accounts?

These policy questions become particularly important as employers and bargaining units try to negotiate total compensation packages. It will be very important to determine whether or not a specific item will or will not be included in a member’s retirement calculation. Under all of the options, the intent is to create a clear definition of salary, and when employer contributions to a 457 plan should be included.

## History

The Board first heard an initial presentation on this issue during the 2005 Interim. The issue was reviewed again during the 2006 Interim and the Board decided to defer it until the 2007 Interim. The Board introduced a bill in both the House and Senate for the 2008 Legislative Session. The House bill (HB 3049) did not receive a hearing and the Senate bill (SB 6635) received a hearing in Senate Ways and Means, but was not passed out of committee.

## 6. Options

### **Option 1: Include employer contributions to a 457 deferred compensation plan as basic salary, unless they are in lieu of Social Security.**

Under this option employer contributions to deferred compensation plans would be considered salary, even if:

- 1) Employee contributions are required, or
- 2) They are *in lieu of* non-includable payments, other than Social Security.

### **Option 2: Include employer contributions to a 457 deferred compensation plan as basic salary.**

Under this option employer contributions to deferred compensation plans would be considered salary, even if:

- 1) Employee contributions are required, or
- 2) They are *in lieu of* any non-includable payments, including Social Security. This option is similar to option 1, but with a broader scope.

### **Option 3: Add 401(a) and 401(k) defined contribution plans to the definition of basic salary and include employer contributions from a 457, 401(a) or 401(k) deferred compensation plan as basic salary.**

Under this option member and employer contributions to deferred compensation plans (457), 401(a) and 401(k) wage deferral plans, would be included in the definition of basic salary. Contributions would be included even if the plan was negotiated as a replacement for a previously excluded payment, such as Social Security. These plans would be excluded from the “payments in lieu of” restrictions.

### **Option 4: Include employer contributions to a 457 deferred compensation plan as basic salary only if they have been identified as salary in the collective bargaining agreement, employment contract or written program of benefits.**

Under this option employer contributions to deferred compensation plans would be considered salary only if agreed to in a collective bargaining agreement, employment agreement, or written program of benefits and would include both matching and mandatory employer contributions.

The Board has previously looked at the first three options and recommended option 2. In order to help reduce costs, the fourth option has been added.

## **7. Costs**

In 2006, the Office of the State Actuary (OSA) did not believe contribution rates would increase as a result of LEOFF 2 salaries increasing uniformly. However, if members could negotiate for benefit packages that increase salaries only during the final average salary period it would result in increased pension benefits that would not have been funded fully over the course of the members' careers. If a large enough portion of members negotiated benefits packages of this nature, contribution rates would increase for LEOFF Plan 2.

A new fiscal note prepared by OSA for the 2008 Legislative Session indicates that costs will be incurred because salary growth will exceed projections for members who have this added to their salary. A copy of the fiscal note is provided as Appendix D.

In response to the Board's new option (Option 4 above), OSA has provided a one-page Executive Summary indicating the cost of this new proposal. It is attached as Appendix E.

## **8. Supporting Information**

**Appendix A – Salary RCWs**

**Appendix B – Basic Salary WACs**

**Appendix C – 2008 Bill**

**Appendix D – Office of the State Actuary Fiscal Note – 2008 Session**

**Appendix E – Office of the State Actuary Executive Summary, Option 4 Proposal**

**Appendix F – Draft Bill**

## Appendix A –Salary RCWs

### RCW 41.26.030 Definitions.

(12)(b) "Final average salary" for plan 2 members, means the monthly average of the member's basic salary for the highest consecutive sixty service credit months of service prior to such member's retirement, termination, or death. Periods constituting authorized unpaid leaves of absence may not be used in the calculation of final average salary.

(13)(b) "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 nonlegislative 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.

## Appendix B – Basic Salary WACs

**WAC 415-104-298 Purpose and scope of basic salary rules.** WAC [415-104-299](#) through [415-104-405](#) codify the department's existing interpretation of statutes and existing administrative practice regarding classification of payments as basic salary in LEOFF Plan I and LEOFF Plan II. The department has applied and will apply these rules to determine the proper characterization of payments occurring prior to the effective dates of these sections.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#), 97-01-016, § 415-104-298, filed 12/6/96, effective 1/6/97.]

**WAC 415-104-299 Basic salary table.** The following table will help you determine whether certain types of payments are basic salary under LEOFF Plan 1 or 2. Be sure to read the referenced rule to ensure that you have correctly identified the payment in question. The department determines basic salary based upon the nature of the payment, not the name applied to it. See WAC 415-104-311 (Plan 1) and WAC 415-104-360 (Plan 2).

Type of Payment	LEOFF 1 Basic Salary?	LEOFF 2 Basic Salary?
Additional Duty Pay	Yes - WAC 415-104-3205	Yes - WAC 415-104-360
Allowances (i.e. uniform)	No - WAC 415-104-3404	No - WAC 415-104-390
Basic Monthly Rate	Yes - WAC 415-104-3200	Yes - WAC 415-104-360
Cafeteria Plans	No - WAC 415-104-3303	Yes - WAC 415-104-367
Deferred Wages Attached to Position	Yes - WAC 415-104-3201(1)	Yes - WAC 415-104-363(1)
Deferred Wages not attached to a Position	No - WAC 415-104-3306	No - WAC 415-104-363(2)
Disability Payments	No - WAC 415-104-340	No - WAC 415-104-380
Education Attainment Pay	No - WAC 415-104-3301	Yes - WAC 415-104-375
Employer taxes/contributions	No - WAC 415-104-3401	No - WAC 415-104-383
Fringe Benefits, including insurance	No - WAC 415-104-3402	No - WAC 415-104-385
Illegal Payments	No - WAC 415-104-3403	No - WAC 415-104-387
Leave Cash Outs/Severance	No - WAC 415-104-3304	No - WAC 415-104-401
Longevity	Yes - WAC 415-104-311	Yes - WAC 415-104-375
Overtime	No - WAC 415-104-3305	Yes - WAC 415-104-370
Paid Leave	Yes - WAC 415-104-3203	Yes - WAC 415-104-373
Payments in Lieu of Excluded Items	No - WAC 415-104-350	No - WAC 415-104-405
Performance Bonuses	No - WAC 415-104-3302	Yes - WAC 415-104-377
Retroactive Salary Increase	Yes - WAC 415-104-3202	Yes - WAC 415-104-365
Reimbursements	No - WAC 415-104-3404	No - WAC 415-104-390
Retirement or Termination Bonuses	No - WAC 415-104-3406	No - WAC 415-104-395
Shift Differential	Yes - WAC 415-104-3204	Yes - WAC 415-104-379
Special Salary or Wages	No - WAC 415-104-330	Yes - WAC 415-104-375
Standby Pay	No - WAC 415-104-3405	No - WAC 415-104-393
Tuition/Fee Reimbursement	No - WAC 415-104-3404	No - WAC 415-104-390
Workers' Compensation	Not Applicable	No - WAC 415-104-380

[Statutory Authority: RCW 41.50.050(5) and chapter 41.26 RCW. 03-06-042, § 415-104-299, filed 2/27/03, effective 4/1/03. Statutory Authority: RCW 41.50.050, 99-16-075, § 415-104-299, filed 8/3/99, effective 9/3/99. Statutory Authority: RCW 41.50.050 and 41.50.055, 97-01-016, § 415-104-299, filed 12/6/96, effective 1/6/97.]

**WAC 415-104-301 What is basic salary?** (1) **Basic salary is the compensation used to determine LEOFF contributions and LEOFF retirement allowances.** A payment from an employer to a member does not qualify as basic salary unless it meets the statutory definition of basic salary in RCW [41.26.030](#)(13) which is explained in greater detail in WAC [415-104-311](#) through [415-104-405](#).

(2) **The definition of basic salary is different for Plan I and Plan II.** WAC [415-104-311](#) through [415-104-350](#) define basic salary for Plan I. WAC [415-104-360](#) through [415-104-405](#) define basic salary for Plan II.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-301, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-360 How is basic salary for LEOFF Plan II determined?** (1) **What payments are included in LEOFF Plan II basic salary?** Other than the specific exclusions listed in WAC [415-104-397](#) and [415-104-401](#), a payment that is a salary or wage earned during a calendar month for personal services rendered by a member to an employer qualifies as LEOFF Plan II basic salary.

(a) Certain payments that are not for personal services rendered also qualify if there is a specific statutory provision identifying those payments as LEOFF Plan II basic salary. See WAC [415-104-373](#).

(b) Specific types of payments that qualify as LEOFF Plan II basic salary include, but are not limited to, the payments described in WAC [415-104-363](#)(1) and 415-104-365 through 415-104-379.

(c) Other payments not specifically listed qualify as basic salary for LEOFF Plan II only if those payments are a salary or wage for services rendered.

(2) **Basic salary is earned when the service is rendered, rather than when payment is made.**

(3) **Salary characterizations are based upon the nature of the payment.** Whether a payment is basic salary depends upon whether the payment is earned as a salary or wage for services rendered. The name given to the payment is not controlling. The department determines whether a payment is basic salary by considering:

(a) What the payment is for; and

(b) Whether the reason for the payment brings it within the statutory definition of basic salary.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-360, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-363 Deferred wages.** (1) **If earned for services rendered, deferred wages are basic salary.** If a member earns salary or wages for services rendered during a payroll period but defers receipt of payment, those earnings are basic salary for LEOFF Plan II. Deferred wages include, but are not limited to:

(a) Member contributions to LEOFF;

(b) Salaries or wages deferred pursuant to sections 401(k), 403(b), 414(h), 457, or other similar sections of the United States Internal Revenue Code.

(2) **Deferred wages that a member does not have an absolute right to in exchange for rendering service to an employer are not basic salary.** If an employer offers additional payment that is conditioned on taking some action in addition to providing services, the payment is based upon the additional action and is not earned for services rendered. The payment does not qualify as basic salary for LEOFF Plan II.

**Example:** An employer offers to make a contribution to a deferred compensation plan on a member's behalf only if the member elects to defer a portion of his or her salary. Because the member does not have an absolute right to receive the contribution based solely on rendering service, the payment is not basic salary for LEOFF Plan II.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-363, filed 12/6/96, effective 1/6/97.]

**WAC 415-104-365 Retroactive basic salary increases are LEOFF Plan II basic salary.** A retroactive salary increase received for a pay period that a member worked is a salary or wage for services rendered and is basic salary for LEOFF Plan II.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-365, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-367 Cafeteria plans.** Compensation received in any form under the provisions of a "cafeteria plan," "flexible benefits plan," or similar arrangement pursuant to section 125 of the United States Internal Revenue Code is basic salary for LEOFF Plan II if the member has an absolute right to receive cash or deferred payments in lieu of the fringe benefits offered. In such an instance, the fringe benefits are being provided in lieu of cash and are considered basic salary, just as the cash would be. If there is no cash option, the value of the fringe benefit is not a salary or wage and is not basic salary for LEOFF Plan II. See WAC [415-104-385](#).

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-367, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-370 Overtime is LEOFF Plan II basic salary.** Overtime, additional pay earned for working time in excess of regularly scheduled shift(s), is a salary or wage for services rendered. Overtime payments are basic salary for LEOFF Plan II. Overtime includes, but is not limited to:

(1) **Additional pay for working on a holiday.** If a member receives an extra payment because he or she worked on a scheduled holiday, the payment is overtime. The employer may make the additional payment when the holiday occurs or in a lump sum at some other time. In either case, the payment is basic salary for LEOFF Plan II;

**Example:** A fire fighter works on Christmas day. As compensation for working a holiday, she is given the option of taking some other day off with pay or of receiving an extra day's pay. If she opts for the extra day of pay, this payment is overtime and is LEOFF Plan II basic salary. If she opts to take a day off, this is paid leave and qualifies as LEOFF Plan II basic salary.

(2) **Callback pay**, which is a special rate of pay some employers provide members for being called back to work after the end of the member's regular shift;

(3) **Court pay**, which is an additional payment for appearing in court or performing other duties outside of a member's regularly scheduled shift.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-370, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-373 Paid leave is LEOFF Plan II basic salary.** Payments received from an employer for authorized paid absences from work are basic salary for LEOFF Plan II. These payments may or may not be for services rendered. Paid leave is basic salary only to the extent that it is the equivalent of the basic salary a member would have earned had the member been working. The portion of any payment identified as paid leave that exceeds that amount is not basic salary.

(1) **Leave payments earned for services rendered.** Most LEOFF members earn a certain number of leave hours per month, such as sick leave. The leave hours are earned by rendering service during the month the leave was accumulated. The payment a member receives when he or she uses an earned leave day is a deferred salary or wage for services previously rendered. It is basic salary to the extent that it is equal to the basic salary the member would have earned had he or she been working.

**Example:** Assume a member accrues eight hours sick leave per month. The accrued leave in the member's sick leave balance is earned for personal services rendered during a payroll period. When the member is absent from work and uses the sick leave, the sick leave payment is basic salary.

(2) **Leave payments not earned for services rendered.** If an employer authorizes a period of paid leave but does not require the use of leave previously earned for services rendered, the payment is not a salary or wage for services rendered. However, RCW [41.26.520](#) authorizes service credit for all periods of paid leave. Because the

periods are creditable, the pay received is considered basic salary to the extent that it is equal to the basic salary the member would have earned had he or she been working.

(3) **Payments upon reinstatement or in lieu of reinstatement are paid leave and therefore qualify as basic salary.** The payment will count as basic salary for the payroll periods when the person would have earned the payment had he or she been working. In order for a payment in lieu of reinstatement to qualify as paid leave, the person's termination date must occur after the payroll period when the payment would have been earned. Because the periods are creditable, the pay received is considered basic salary to the extent that it is equal to the basic salary the member would have earned had he or she been working.

(4) **Union leave.** Periods of authorized leave to serve as an elected official of a labor organization which meet the requirements of RCW [41.26.520](#) qualify for service credit. The salary payments provided by the employer subject to reimbursement from the union qualify as basic salary for LEOFF Plan II to the extent that they do not exceed the highest paid job class covered by the collective bargaining agreement negotiated between the labor organization and the employer. The portion of any payment identified as paid leave in excess of that amount is not basic salary.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-373, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-374 LEOFF Plan 2 part-time leave of absence. (1) What are the LEOFF Plan 2 part-time leave rules for law enforcement officers?**

- (a) You must be a current LEOFF Plan 2 **law enforcement** member;
- (b) Your employer must authorize you to work part time and go on an unpaid part-time leave of absence;
- (c) While in part-time work/part-time leave status, you cannot do any other work for pay for your employer; and
- (d) When you return to full-time employment, the employment must be with the same employer who granted you the part-time leave.

(2) **May I purchase service credit for periods of part-time leave?** See WAC [415-02-175](#) for information about purchasing service credit for an unpaid authorized leave of absence.

[Statutory Authority: RCW [41.50.050](#)(5). 04-20-005, § 415-104-374, filed 9/23/04, effective 10/24/04. Statutory Authority: RCW [41.50.050](#)(5) and [41.26.520](#). 02-18-047, § 415-104-374, filed 8/28/02, effective 9/1/02.]

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**WAC 415-104-375 Salary or wages not attached to a position are LEOFF Plan II basic salary.** A salary or wage for services rendered to an employer is basic salary for LEOFF Plan II regardless of whether the services are attached to a position.

**Example:** If an employee receives additional salary based upon his or her education, that additional salary is basic salary for LEOFF Plan II even if his or her position does not require that level of education. The payment of a higher salary based upon educational attainment is part of the total compensation for the services provided by the employee.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-375, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-377 Performance bonuses are LEOFF Plan II basic salary.** Payments you earn for meeting or exceeding performance goals set by your employer are a salary or wage for services rendered and qualify as basic salary for LEOFF Plan II. In order to qualify as basic salary, a performance bonus must be documented in an employer policy or specific agreement between the employer and member prior to earning the bonus.

**Example:** An employer offers an annual bonus to a member if he or she meets a certain performance goal, i.e., stays accident free for a year. If the member meets the goal and is paid the bonus, the bonus would be considered basic salary.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-377, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-379 Shift differential is LEOFF Plan II basic salary.** Additional payments to a member for working swing shift or night shift are a salary or wage for services rendered. Those payments are basic salary for LEOFF Plan II.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-379, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-380 Disability payments. (1) Disability leave supplement.** Under certain circumstances, LEOFF II members are entitled to a disability leave supplement for periods of disability leave. See RCW [41.04.500](#) through [41.04.550](#).

(a) Employer contributions to the disability leave supplement under RCW [41.04.510](#)(3) are not a salary or wage for services rendered and do not qualify as basic salary. Although the payments are paid leave, they are specifically excluded from basic salary by RCW [41.04.525](#).

(b) The member paid portion of the disability leave supplement is funded through use of the member's accumulated sick or vacation leave. This portion of the disability leave supplement is, therefore, basic salary, see WAC [415-104-373](#). The member will receive only partial service credit for the accumulated leave portion of the disability leave supplement.

(c) A member may apply to receive full service credit for some periods of duty disability under RCW [41.26.470](#)(3).

(2) **Workers' compensation.** Payments made to a member under Title [51](#) RCW are neither a salary or wage for services rendered nor paid leave. The payments are not basic salary for LEOFF II. This is true whether the payments come from the workers' compensation trust fund or from an employers' self-insurance program authorized under Title [51](#) RCW.

(3) **Private insurance.** Some employers provide additional disability insurance as a supplement to workers' compensation. Any payment from a third party insurance company is neither paid leave nor payment for services rendered. It does not qualify as basic salary for LEOFF Plan II.

(4) **Disability leave banks.** If an employer maintains a disability leave bank which may be used to make salary replacement payments for members during periods of disability, such payments are paid leave and qualify as basic salary subject to the provisions of WAC [415-104-373](#): Provided, however, That if the leave provided to an employee is based upon leave earned by another employee then it is a form of shared leave and does not qualify as basic salary.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-380, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-383 Employer taxes and contributions are not LEOFF Plan II basic salary.** (1) Any payment by a member's employer of the employer portion of taxes imposed by the Federal Insurance Contribution Act is not a salary or wage and does not qualify as basic salary for LEOFF Plan II.

(2) Employer contributions to LEOFF Plan II are not a salary or wage paid to the member and do not qualify as basic salary.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-383, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-385 Fringe benefits are not LEOFF Plan 2 basic salary.** Fringe benefits provided by an employer are not a salary or wage and therefore do not qualify as basic salary for LEOFF Plan 2. Fringe benefits include, but are not limited to:

(1) Employer retirement contributions;

(2) Any type of insurance such as medical, dental or life insurance; and any employer contribution to meet the premium or charge for the insurance; or

(3) Any employer payments into a private fund to provide health or welfare benefits for the member (or the member and the member's dependents), with the exception of compensation paid pursuant to a bona fide cafeteria plan, flexible benefit plan or similar arrangement as described in WAC [415-104-367](#).

[Statutory Authority: RCW [41.50.050](#)(5) and chapter [41.26](#) RCW. 03-06-042, § 415-104-385, filed 2/27/03, effective 4/1/03. Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-385, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-387 Illegal payments are not LEOFF Plan II basic salary.** If an employer disburses a payment that the employer does not have legal authority to make, that payment does not qualify as basic salary for LEOFF Plan II.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-387, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-390 Reimbursements or allowances in lieu of a reimbursement are not LEOFF Plan II basic salary.** (1) **Reimbursement.** If an employer reimburses a member for expenses incurred in providing services for the employer, the purpose of the payment is to pay the member back for out-of-pocket expenses. The payment is not compensation. It is not a salary or wage and is not basic salary for LEOFF Plan II.

(2) **Allowance.** An allowance paid in lieu of a specific reimbursement for expenses a member is expected to incur in providing services for the employer is characterized the same as a specific reimbursement. The purpose of the payment is to reimburse the member for out-of-pocket expenses. The payment is not compensation. It is not a salary or wage and does not qualify as basic salary for LEOFF Plan II.

**Example:** An employer provides an annual stipend for the purchase of a uniform or other clothing required for the performance of a members' duties. The payment is a reimbursement for expenses incurred or expected to be incurred and is not basic salary for LEOFF Plan II.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-390, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-393 Standby pay is not LEOFF Plan II basic salary.** Payments to a member for time not actually worked when the member must be available to work if the need arises, are not a salary or wage for services rendered. Any such payment does not qualify as basic salary for LEOFF Plan II.

**Example:** Some employers provide payments to a member at less than the member's regular hourly rate in exchange for the member being available to come into work after his or her shift if called, although the member may not be called. Such payments, often referred to as "standby pay," are not basic salary for LEOFF Plan II.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-393, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-395 Termination or retirement bonuses are not LEOFF Plan II basic salary.** An additional payment based on notification of a member's intent to terminate or retire is in consideration for the notification of intent to retire or terminate. The payment is not a salary or wage for services rendered and is not basic salary for LEOFF Plan II.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-395, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-397 Statutorily excluded payments are not LEOFF Plan II basic salary.** Payments authorized by a statute that excludes the payment from the calculation of a public retirement allowance do not qualify as basic salary.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-397, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-401 Cash outs of accrued leave or other forms of severance pay are not LEOFF Plan II basic salary.** (1) A cash out from an employer for unused accrued leave, is a deferred salary or wage for services previously rendered. However, the payment is not basic salary because it is specifically excluded from the definition of basic salary in RCW [41.26.030](#) (13)(b).

(2) **Other forms of severance pay are not basic salary.** Any form of severance payment received from an employer upon termination, is not included as basic salary in LEOFF Plan II because it is excluded from the statutory definition of basic salary.

[Statutory Authority: RCW [41.50.050](#) and [41.50.055](#). 97-01-016, § 415-104-401, filed 12/6/96, effective 1/6/97.]

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**WAC 415-104-405 Payments in lieu.** A payment or any other transfer in lieu of an item that does not qualify as basic salary, is not basic salary. The only exception is compensation paid pursuant to bona fide cafeteria plan, flexible benefit plan or similar arrangement as described in WAC [415-104-3302](#).

[Statutory Authority: RCW [41.50.050](#)]

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HOUSE BILL 3049

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State of Washington

60th Legislature

2008 Regular Session

By Representatives Williams, Priest, Conway, Roach, VanDeWege, Sullivan, Simpson, Hurst, Kenney, and Kelley; by request of LEOFF Plan 2 Retirement Board

Read first time 01/21/08. Referred to Committee on Appropriations.

1 AN ACT Relating to employer contributions to an account formed  
2 under section 457 of the United States internal revenue code for the  
3 benefit of members of the law enforcement officers' and firefighters'  
4 retirement system plan 2; amending RCW 41.26.030; and providing an  
5 effective date.

6 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

7 **Sec. 1.** RCW 41.26.030 and 2005 c 459 s 1 are each amended to read  
8 as follows:

9 As used in this chapter, unless a different meaning is plainly  
10 required by the context:

11 (1) "Retirement system" means the "Washington law enforcement  
12 officers' and firefighters' retirement system" provided herein.

13 (2)(a) "Employer" for plan 1 members, means the legislative  
14 authority of any city, town, county, or district or the elected  
15 officials of any municipal corporation that employs any law enforcement  
16 officer and/or firefighter, any authorized association of such  
17 municipalities, and, except for the purposes of RCW 41.26.150, any  
18 labor guild, association, or organization, which represents the  
19 firefighters or law enforcement officers of at least seven cities of

1 over 20,000 population and the membership of each local lodge or  
2 division of which is composed of at least sixty percent law enforcement  
3 officers or firefighters as defined in this chapter.

4 (b) "Employer" for plan 2 members, means the following entities to  
5 the extent that the entity employs any law enforcement officer and/or  
6 firefighter:

7 (i) The legislative authority of any city, town, county, or  
8 district;

9 (ii) The elected officials of any municipal corporation;

10 (iii) The governing body of any other general authority law  
11 enforcement agency; or

12 (iv) A four-year institution of higher education having a fully  
13 operational fire department as of January 1, 1996.

14 (3) "Law enforcement officer" beginning January 1, 1994, means any  
15 person who is commissioned and employed by an employer on a full time,  
16 fully compensated basis to enforce the criminal laws of the state of  
17 Washington generally, with the following qualifications:

18 (a) No person who is serving in a position that is basically  
19 clerical or secretarial in nature, and who is not commissioned shall be  
20 considered a law enforcement officer;

21 (b) Only those deputy sheriffs, including those serving under a  
22 different title pursuant to county charter, who have successfully  
23 completed a civil service examination for deputy sheriff or the  
24 equivalent position, where a different title is used, and those persons  
25 serving in unclassified positions authorized by RCW 41.14.070 except a  
26 private secretary will be considered law enforcement officers;

27 (c) Only such full time commissioned law enforcement personnel as  
28 have been appointed to offices, positions, or ranks in the police  
29 department which have been specifically created or otherwise expressly  
30 provided for and designated by city charter provision or by ordinance  
31 enacted by the legislative body of the city shall be considered city  
32 police officers;

33 (d) The term "law enforcement officer" also includes the executive  
34 secretary of a labor guild, association or organization (which is an  
35 employer under RCW 41.26.030(2)) if that individual has five years  
36 previous membership in the retirement system established in chapter  
37 41.20 RCW. The provisions of this subsection (3)(d) shall not apply to  
38 plan 2 members; and

1 (e) The term "law enforcement officer" also includes a person  
2 employed on or after January 1, 1993, as a public safety officer or  
3 director of public safety, so long as the job duties substantially  
4 involve only either police or fire duties, or both, and no other duties  
5 in a city or town with a population of less than ten thousand. The  
6 provisions of this subsection (3)(e) shall not apply to any public  
7 safety officer or director of public safety who is receiving a  
8 retirement allowance under this chapter as of May 12, 1993.

9 (4) "Firefighter" means:

10 (a) Any person who is serving on a full time, fully compensated  
11 basis as a member of a fire department of an employer and who is  
12 serving in a position which requires passing a civil service  
13 examination for firefighter, and who is actively employed as such;

14 (b) Anyone who is actively employed as a full time firefighter  
15 where the fire department does not have a civil service examination;

16 (c) Supervisory firefighter personnel;

17 (d) Any full time executive secretary of an association of fire  
18 protection districts authorized under RCW 52.12.031. The provisions of  
19 this subsection (4)(d) shall not apply to plan 2 members;

20 (e) The executive secretary of a labor guild, association or  
21 organization (which is an employer under RCW 41.26.030(2) as now or  
22 hereafter amended), if such individual has five years previous  
23 membership in a retirement system established in chapter 41.16 or 41.18  
24 RCW. The provisions of this subsection (4)(e) shall not apply to plan  
25 2 members;

26 (f) Any person who is serving on a full time, fully compensated  
27 basis for an employer, as a fire dispatcher, in a department in which,  
28 on March 1, 1970, a dispatcher was required to have passed a civil  
29 service examination for firefighter;

30 (g) Any person who on March 1, 1970, was employed on a full time,  
31 fully compensated basis by an employer, and who on May 21, 1971, was  
32 making retirement contributions under the provisions of chapter 41.16  
33 or 41.18 RCW; and

34 (h) Any person who is employed on a full-time, fully compensated  
35 basis by an employer as an emergency medical technician.

36 (5) "Department" means the department of retirement systems created  
37 in chapter 41.50 RCW.

1 (6) "Surviving spouse" means the surviving widow or widower of a  
2 member. "Surviving spouse" shall not include the divorced spouse of a  
3 member except as provided in RCW 41.26.162.

4 (7)(a) "Child" or "children" means an unmarried person who is under  
5 the age of eighteen; or (~~mentally or physically handicapped~~) has  
6 mental or physical disabilities as determined by the department, except  
7 a (~~handicapped~~) person with disabilities in the full time care of a  
8 state institution, who is:

9 (i) A natural born child;

10 (ii) A stepchild where that relationship was in existence prior to  
11 the date benefits are payable under this chapter;

12 (iii) A posthumous child;

13 (iv) A child legally adopted or made a legal ward of a member prior  
14 to the date benefits are payable under this chapter; or

15 (v) An illegitimate child legitimized prior to the date any  
16 benefits are payable under this chapter.

17 (b) A person shall also be deemed to be a child up to and including  
18 the age of twenty years and eleven months while attending any high  
19 school, college, or vocational or other educational institution  
20 accredited, licensed, or approved by the state, in which it is located,  
21 including the summer vacation months and all other normal and regular  
22 vacation periods at the particular educational institution after which  
23 the child returns to school.

24 (8) "Member" means any firefighter, law enforcement officer, or  
25 other person as would apply under subsections (3) or (4) of this  
26 section whose membership is transferred to the Washington law  
27 enforcement officers' and firefighters' retirement system on or after  
28 March 1, 1970, and every law enforcement officer and firefighter who is  
29 employed in that capacity on or after such date.

30 (9) "Retirement fund" means the "Washington law enforcement  
31 officers' and firefighters' retirement system fund" as provided for  
32 herein.

33 (10) "Employee" means any law enforcement officer or firefighter as  
34 defined in subsections (3) and (4) of this section.

35 (11)(a) "Beneficiary" for plan 1 members, means any person in  
36 receipt of a retirement allowance, disability allowance, death benefit,  
37 or any other benefit described herein.

1 (b) "Beneficiary" for plan 2 members, means any person in receipt  
2 of a retirement allowance or other benefit provided by this chapter  
3 resulting from service rendered to an employer by another person.

4 (12)(a) "Final average salary" for plan 1 members, means (i) for a  
5 member holding the same position or rank for a minimum of twelve months  
6 preceding the date of retirement, the basic salary attached to such  
7 same position or rank at time of retirement; (ii) for any other member,  
8 including a civil service member who has not served a minimum of twelve  
9 months in the same position or rank preceding the date of retirement,  
10 the average of the greatest basic salaries payable to such member  
11 during any consecutive twenty-four month period within such member's  
12 last ten years of service for which service credit is allowed, computed  
13 by dividing the total basic salaries payable to such member during the  
14 selected twenty-four month period by twenty-four; (iii) in the case of  
15 disability of any member, the basic salary payable to such member at  
16 the time of disability retirement; (iv) in the case of a member who  
17 hereafter vests pursuant to RCW 41.26.090, the basic salary payable to  
18 such member at the time of vesting.

19 (b) "Final average salary" for plan 2 members, means the monthly  
20 average of the member's basic salary for the highest consecutive sixty  
21 service credit months of service prior to such member's retirement,  
22 termination, or death. Periods constituting authorized unpaid leaves  
23 of absence may not be used in the calculation of final average salary.

24 (13)(a) "Basic salary" for plan 1 members, means the basic monthly  
25 rate of salary or wages, including longevity pay but not including  
26 overtime earnings or special salary or wages, upon which pension or  
27 retirement benefits will be computed and upon which employer  
28 contributions and salary deductions will be based.

29 (b) "Basic salary" for plan 2 members, means salaries or wages  
30 earned by a member during a payroll period for personal services,  
31 including overtime payments, and shall include wages and salaries  
32 deferred under provisions established pursuant to sections 403(b),  
33 414(h), and 457 of the United States Internal Revenue Code, but shall  
34 exclude lump sum payments for deferred annual sick leave, unused  
35 accumulated vacation, unused accumulated annual leave, or any form of  
36 severance pay. Basic salary includes all contributions made by an  
37 employer to a member's account established pursuant to section 457 of  
38 the United States internal revenue code even if the employer's

1 contributions are conditioned upon the member making contributions. In  
2 any year in which a member serves in the legislature the member shall  
3 have the option of having such member's basic salary be the greater of:

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

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

12 (14)(a) "Service" for plan 1 members, means all periods of  
13 employment for an employer as a firefighter or law enforcement officer,  
14 for which compensation is paid, together with periods of suspension not  
15 exceeding thirty days in duration. For the purposes of this chapter  
16 service shall also include service in the armed forces of the United  
17 States as provided in RCW 41.26.190. Credit shall be allowed for all  
18 service credit months of service rendered by a member from and after  
19 the member's initial commencement of employment as a firefighter or law  
20 enforcement officer, during which the member worked for seventy or more  
21 hours, or was on disability leave or disability retirement. Only  
22 service credit months of service shall be counted in the computation of  
23 any retirement allowance or other benefit provided for in this chapter.

24 (i) For members retiring after May 21, 1971 who were employed under  
25 the coverage of a prior pension act before March 1, 1970, "service"  
26 shall also include (A) such military service not exceeding five years  
27 as was creditable to the member as of March 1, 1970, under the member's  
28 particular prior pension act, and (B) such other periods of service as  
29 were then creditable to a particular member under the provisions of RCW  
30 41.18.165, 41.20.160 or 41.20.170. However, in no event shall credit  
31 be allowed for any service rendered prior to March 1, 1970, where the  
32 member at the time of rendition of such service was employed in a  
33 position covered by a prior pension act, unless such service, at the  
34 time credit is claimed therefor, is also creditable under the  
35 provisions of such prior act.

36 (ii) A member who is employed by two employers at the same time  
37 shall only be credited with service to one such employer for any month  
38 during which the member rendered such dual service.

1 (b) "Service" for plan 2 members, means periods of employment by a  
2 member for one or more employers for which basic salary is earned for  
3 ninety or more hours per calendar month which shall constitute a  
4 service credit month. Periods of employment by a member for one or  
5 more employers for which basic salary is earned for at least seventy  
6 hours but less than ninety hours per calendar month shall constitute  
7 one-half service credit month. Periods of employment by a member for  
8 one or more employers for which basic salary is earned for less than  
9 seventy hours shall constitute a one-quarter service credit month.

10 Members of the retirement system who are elected or appointed to a  
11 state elective position may elect to continue to be members of this  
12 retirement system.

13 Service credit years of service shall be determined by dividing the  
14 total number of service credit months of service by twelve. Any  
15 fraction of a service credit year of service as so determined shall be  
16 taken into account in the computation of such retirement allowance or  
17 benefits.

18 If a member receives basic salary from two or more employers during  
19 any calendar month, the individual shall receive one service credit  
20 month's service credit during any calendar month in which multiple  
21 service for ninety or more hours is rendered; or one-half service  
22 credit month's service credit during any calendar month in which  
23 multiple service for at least seventy hours but less than ninety hours  
24 is rendered; or one-quarter service credit month during any calendar  
25 month in which multiple service for less than seventy hours is  
26 rendered.

27 (15) "Accumulated contributions" means the employee's contributions  
28 made by a member, including any amount paid under RCW 41.50.165(2),  
29 plus accrued interest credited thereon.

30 (16) "Actuarial reserve" means a method of financing a pension or  
31 retirement plan wherein reserves are accumulated as the liabilities for  
32 benefit payments are incurred in order that sufficient funds will be  
33 available on the date of retirement of each member to pay the member's  
34 future benefits during the period of retirement.

35 (17) "Actuarial valuation" means a mathematical determination of  
36 the financial condition of a retirement plan. It includes the  
37 computation of the present monetary value of benefits payable to  
38 present members, and the present monetary value of future employer and

1 employee contributions, giving effect to mortality among active and  
2 retired members and also to the rates of disability, retirement,  
3 withdrawal from service, salary and interest earned on investments.

4 (18) "Disability board" for plan 1 members means either the county  
5 disability board or the city disability board established in RCW  
6 41.26.110.

7 (19) "Disability leave" means the period of six months or any  
8 portion thereof during which a member is on leave at an allowance equal  
9 to the member's full salary prior to the commencement of disability  
10 retirement. The definition contained in this subsection shall apply  
11 only to plan 1 members.

12 (20) "Disability retirement" for plan 1 members, means the period  
13 following termination of a member's disability leave, during which the  
14 member is in receipt of a disability retirement allowance.

15 (21) "Position" means the employment held at any particular time,  
16 which may or may not be the same as civil service rank.

17 (22) "Medical services" for plan 1 members, shall include the  
18 following as minimum services to be provided. Reasonable charges for  
19 these services shall be paid in accordance with RCW 41.26.150.

20 (a) Hospital expenses: These are the charges made by a hospital,  
21 in its own behalf, for

22 (i) Board and room not to exceed semiprivate room rate unless  
23 private room is required by the attending physician due to the  
24 condition of the patient.

25 (ii) Necessary hospital services, other than board and room,  
26 furnished by the hospital.

27 (b) Other medical expenses: The following charges are considered  
28 "other medical expenses", provided that they have not been considered  
29 as "hospital expenses".

30 (i) The fees of the following:

31 (A) A physician or surgeon licensed under the provisions of chapter  
32 18.71 RCW;

33 (B) An osteopathic physician and surgeon licensed under the  
34 provisions of chapter 18.57 RCW;

35 (C) A chiropractor licensed under the provisions of chapter 18.25  
36 RCW.

37 (ii) The charges of a registered graduate nurse other than a nurse

1 who ordinarily resides in the member's home, or is a member of the  
2 family of either the member or the member's spouse.

3 (iii) The charges for the following medical services and supplies:

4 (A) Drugs and medicines upon a physician's prescription;

5 (B) Diagnostic X-ray and laboratory examinations;

6 (C) X-ray, radium, and radioactive isotopes therapy;

7 (D) Anesthesia and oxygen;

8 (E) Rental of iron lung and other durable medical and surgical  
9 equipment;

10 (F) Artificial limbs and eyes, and casts, splints, and trusses;

11 (G) Professional ambulance service when used to transport the  
12 member to or from a hospital when injured by an accident or stricken by  
13 a disease;

14 (H) Dental charges incurred by a member who sustains an accidental  
15 injury to his or her teeth and who commences treatment by a legally  
16 licensed dentist within ninety days after the accident;

17 (I) Nursing home confinement or hospital extended care facility;

18 (J) Physical therapy by a registered physical therapist;

19 (K) Blood transfusions, including the cost of blood and blood  
20 plasma not replaced by voluntary donors;

21 (L) An optometrist licensed under the provisions of chapter 18.53  
22 RCW.

23 (23) "Regular interest" means such rate as the director may  
24 determine.

25 (24) "Retiree" for persons who establish membership in the  
26 retirement system on or after October 1, 1977, means any member in  
27 receipt of a retirement allowance or other benefit provided by this  
28 chapter resulting from service rendered to an employer by such member.

29 (25) "Director" means the director of the department.

30 (26) "State actuary" or "actuary" means the person appointed  
31 pursuant to RCW 44.44.010(2).

32 (27) "State elective position" means any position held by any  
33 person elected or appointed to statewide office or elected or appointed  
34 as a member of the legislature.

35 (28) "Plan 1" means the law enforcement officers' and firefighters'  
36 retirement system, plan 1 providing the benefits and funding provisions  
37 covering persons who first became members of the system prior to  
38 October 1, 1977.

1 (29) "Plan 2" means the law enforcement officers' and firefighters'  
2 retirement system, plan 2 providing the benefits and funding provisions  
3 covering persons who first became members of the system on and after  
4 October 1, 1977.

5 (30) "Service credit year" means an accumulation of months of  
6 service credit which is equal to one when divided by twelve.

7 (31) "Service credit month" means a full service credit month or an  
8 accumulation of partial service credit months that are equal to one.

9 (32) "General authority law enforcement agency" means any agency,  
10 department, or division of a municipal corporation, political  
11 subdivision, or other unit of local government of this state, and any  
12 agency, department, or division of state government, having as its  
13 primary function the detection and apprehension of persons committing  
14 infractions or violating the traffic or criminal laws in general, but  
15 not including the Washington state patrol. Such an agency, department,  
16 or division is distinguished from a limited authority law enforcement  
17 agency having as one of its functions the apprehension or detection of  
18 persons committing infractions or violating the traffic or criminal  
19 laws relating to limited subject areas, including but not limited to,  
20 the state departments of natural resources and social and health  
21 services, the state gambling commission, the state lottery commission,  
22 the state parks and recreation commission, the state utilities and  
23 transportation commission, the state liquor control board, and the  
24 state department of corrections.

25 NEW SECTION. **Sec. 2.** This act takes effect July 1, 2012.

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# Multiple Agency Fiscal Note Summary

<b>Bill Number:</b> 3049 HB	<b>Title:</b> Definition of basic salary
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## Estimated Cash Receipts

Agency Name	2007-09		2009-11		2011-13	
	GF- State	Total	GF- State	Total	GF- State	Total
<b>Total \$</b>						

Local Gov. Courts *						
Local Gov. Other **						
Local Gov. Total						

## Estimated Expenditures

Agency Name	2007-09			2009-11			2011-13		
	FTEs	GF-State	Total	FTEs	GF-State	Total	FTEs	GF-State	Total
Office of the State Actuary	.0	600,000	600,000	.0	1,500,000	1,500,000	.0	1,600,000	1,600,000
Department of Retirement Systems	.0	0	0	.0	0	0	.0	0	0
<b>Total</b>	<b>0.0</b>	<b>\$600,000</b>	<b>\$600,000</b>	<b>0.0</b>	<b>\$1,500,000</b>	<b>\$1,500,000</b>	<b>0.0</b>	<b>\$1,600,000</b>	<b>\$1,600,000</b>

Local Gov. Courts *									
Local Gov. Other **									
Local Gov. Total									

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<b>Prepared by:</b> Jane Sakson, OFM	<b>Phone:</b> 360-902-0549	<b>Date Published:</b> Final 2/ 4/2008
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\* See Office of the Administrator for the Courts judicial fiscal note

\*\* See local government fiscal note

# Individual State Agency Fiscal Note

<b>Bill Number:</b> 3049 HB	<b>Title:</b> Definition of basic salary	<b>Agency:</b> 035-Office of State Actuary
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## Part I: Estimates

No Fiscal Impact

### Estimated Cash Receipts to:

<b>FUND</b>					
<b>Total \$</b>					

### Estimated Expenditures from:

	FY 2008	FY 2009	2007-09	2009-11	2011-13
<b>Fund</b>					
General Fund-State 001-1	0	600,000	600,000	1,500,000	1,600,000
<b>Total \$</b>	0	600,000	600,000	1,500,000	1,600,000

*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:	Phone:	Date: 01/30/2008
Agency Preparation: Nelsen Dave	Phone: 360-786-6144	Date: 01/30/2008
Agency Approval: Matthew M. Smith	Phone: 360-786-6140	Date: 01/30/2008
OFM Review: Jane Sakson	Phone: 360-902-0549	Date: 01/30/2008

## 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

	FY 2008	FY 2009	2007-09	2009-11	2011-13
FTE Staff Years					
A-Salaries and Wages					
B-Employee Benefits					
C-Personal Service Contracts					
E-Goods and Services					
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					
<b>Total:</b>	\$0	\$0	\$0	\$0	\$0

## Part IV: Capital Budget 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.

# FISCAL NOTE

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBERS:
<b>Office of the State Actuary</b>	<b>035</b>	<b>1/30/08</b>	<b>HB 3049 / SB 6635</b>

## INTENDED USE

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 2008 Legislative Session only.

We advise other 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.

## EXECUTIVE SUMMARY

This bill includes employer contributions to member 457 accounts (deferred compensation) in the definition of salary for the Law Enforcement Officers’ and Fire Fighters’ Retirement System Plan 2 (LEOFF 2), and makes those contributions pensionable.

<b>Increase in Actuarial Liabilities</b>			
<i>(Dollars in Millions)</i>	<b>Current</b>	<b>Increase</b>	<b>Total</b>
<b>Actuarial Present Value of Projected Benefits</b>	\$10,320	\$54	\$10,374
<b>Unfunded Actuarial Accrued Liability</b>	(\$702)	\$0	(\$702)
<b>Unfunded Liability (PVCBP)</b>	(\$1,259)	\$22	(\$1,237)

<b>Total Increase in Contribution Rates</b>	
<b>Current Biennium</b>	<b>LEOFF</b>
Employee (Plan 2)	0.13%
Employer	0.08%
State	0.05%

<b>Fiscal Costs</b>			
<i>(Dollars in Millions)</i>	<b>2008-2009</b>	<b>2009-2011</b>	<b>25-Year</b>
General Fund-State	\$0.6	\$1.5	\$37.9
Total Employer	\$1.6	\$3.8	\$94.9

See the Actuarial Results section of this fiscal note for more detail.

## **CHANGE TO PENSION SYSTEM**

### **Summary of Change**

This bill impacts the LEOFF 2 by expanding the definition of basic salary in RCW 41.26.030 to include all employer payments to a deferred compensation plan (457 plan as designated by the IRS) on behalf of the member.

Effective Date: July 1, 2012

### **Current Situation**

Employer payments to 457 plans on behalf of members may be included as basic salary in LEOFF Plan 2 if the employer makes the payments as a condition of the member's employment, and not based upon the member performing some action besides rendering service. For example, consider the situation when employers offer payments to match contributions made by the employee. Because the employer payments are contingent upon the member contributing, and not upon the member rendering services, current law excludes the employer contributions from basic salary.

### **Members Impacted**

We estimate this bill could affect all 15,718 active members of LEOFF 2 through increased Final Average Salaries (FAS). Furthermore, we expect 6,969 ( $15,718 * 44.34\% = 6,969$ ; 44.34% is from (10) in the Assumptions Made section) of the current active members will actually receive improved benefits, since their employers offer matching plans. We approximated this number based on 2005 data. Because of the collective bargaining process and the deferred effective date of this bill, the percent of active LEOFF 2 members whose employers offer matching plans could change by the effective date of the bill.

We estimate this bill will increase the benefits for a typical member by about 3.5 percent. We calculated the average match for employers who supplied details of their matching plan to be 3.69 percent.

Additionally, this bill impacts all LEOFF 2 members through increased contribution rates.

See the Data Used section of this fiscal note for more details.

## **WHY THIS CHANGE HAS A COST AND WHO PAYS FOR IT**

### **Why this Bill Has a Cost**

Essentially, this bill increases the pensionable salary of half the active LEOFF 2 population by an average of 3.5 percent. The increase in salaries would result in an increase in liabilities since the majority of LEOFF 2 benefits are based on the members' FAS. The increase in base salaries would also increase the Present Value of Future Salaries (PVFS) for LEOFF 2. In general, increases in liability increase contribution rates, and increases in PVFS decrease contribution rates.

The valuation data doesn't contain any information about LEOFF 2 members whose employers offer a matching plan. We were given data identifying employers who offer a matching plan, but not exactly which members take part in those plans. The staff for the LEOFF 2 Retirement Board gave us member counts by employer with limited matching plan detail by employer. Since we cannot identify specific members who join matching plans we developed an average salary increase per member, and applied this increase to all members.

### **Who will Pay for these Costs**

Under this bill, the increase in contribution rates caused by increases in liability would be partially offset by the decrease in contribution rates caused by increases in PVFS. The increase in contribution rates would be fully offset if the salary increases only occurred at the beginning of a member's career. Since the average LEOFF 2 member has 11.9 years of service, the increase in contribution rates won't be fully offset, and this bill will result in a contribution rate increase for LEOFF 2.

This bill has an effective date of July 1, 2012. This deferred effective date will cause lower liability and PVFS increases than a similar bill with an immediate effective date. The result will be a slightly lower contribution rate increase than if this bill had an immediate effective date.

This bill doesn't allow for an alternate funding method. LEOFF 2 will subsidize the increase in liability that results from this bill in the usual way:

- 50 percent member.
- 30 percent employer.
- 20 percent State.

## HOW WE VALUED THESE COSTS

### Change in Methods

To calculate the impact of this bill on LEOFF 2 we had to determine the average percentage increase in salary to apply to each member. To determine the average salary increase per member we used data collected in a 2005 survey of all LEOFF 2 employers. To apply the salary increase, we increased the assumed rate of salary inflation from 4.5 percent to about 5.9 percent for one year ( $1.045 * 1.0132795 - 1 = 5.888\%$  – we show the derivation of the 1.32795% in the Assumptions Made section below). We applied the additional salary inflation to our valuation software in the fourth year of the valuation to approximate the four-year deferral in the bill's effective date. We used our valuation software to compute the increase in liability and PVFS as a result of this bill.

Otherwise, we developed these costs using the same methods as disclosed in the September 30, 2006 actuarial valuation report (AVR).

We used the Entry Age Normal actuarial funding method to determine the fiscal budget changes for future new entrants. We used the Aggregate actuarial funding method to determine the fiscal budget changes for current plan members.

### Assumptions Made

The average salary increase we applied to each member in the fourth year of the valuation drives the cost of this pricing exercise. In order to compute the average salary increase, we made assumptions to answer these questions:

1. How many members do employer matching plans cover?
2. What's the average matching plan amount as a percent of salary?
3. Of the members whose employers offer a match, how many participate in the matching plan?
4. Of the members who participate in the matching plans, how many utilize the maximum employer match?

We used the following assumptions to develop the average salary increase per member:

1. **How many members do employer matching plans cover?** We used the survey data provided by the LEOFF 2 Retirement Board to estimate the number of members covered by employer matching plans. Each employer told the surveyor whether or not they offered a Deferred Compensation (DC) plan. If an employer offered a DC plan, they stated whether or not they offered a DC match and in some cases they stated the IRS classification of their DC plan. We excluded any plan that wasn't a 457 plan. If the specific IRS classification wasn't provided, we

assumed the plan was a 457 plan. Some employers gave detailed data as to which members the plan covered. Some plans were offered to just police officers, just fire fighters, or only to the chief. We assumed 58 percent of LEOFF 2 members are police officers and 42 percent are fire fighters. The total number of employees covered by an employer matching DC plan, adjusted using all additionally provided detail, is 6,729.

- 2. What's the average matching plan amount as a percent of salary?** Using the counts from question 1 above for any employer matching plan that includes annual-match detail, we calculated the average-annual match as a percent of salary. Some employers reported matching a flat-dollar amount; some match a percent of salary. Whatever detail an employer provided, we converted it to an annual flat-dollar amount. To convert percent-of-salary matches to annual flat-dollar amounts, we used the average LEOFF 2 salary from the 2005 AVR. We used the 2005 average salary in this instance because the survey data was collected in 2005. We computed that the employers who provided matching detail employed 4,549 members. That is 68 percent ( $4,549 / 6,729 = 67.6\%$ ) of the total number of members currently employed by an employer offering a match.

For each employer that gave matching detail we multiplied the number of members covered by the match by the maximum-annual match provided. The sum across all employers of this product is the expected total-dollar amount contributed to the various matching plans. We divided this total amount paid by the 4,549 members to yield an average-per-member contribution of \$2,655.88 ( $\$12,080,382.39 / 4,549 = \$2,655.88$ ). We converted this flat-dollar amount into a percent of pay by dividing by the average LEOFF 2 salary reported in the 2005 AVR. This conversion showed that an average plan matches 3.69 percent of pay.

For employers who didn't provide matching detail, we assumed they match member contributions at an average rate of 3.5 percent of salary. Essentially we assumed the 32 percent of members covered by employer-matching plans for which we had no match detail, would receive matches at almost the same rate as the 68 percent for whom we had data.

- 3. Of the members whose employers offer a match, how many participate in the matching plan?** We contacted the three largest employers offering matching plans: the Cities of Seattle, Spokane, and Tacoma. The Cities of Spokane and Tacoma responded as of the date of this fiscal note. Spokane offers an employer match of up to 4 percent of salary. Tacoma offers a match of up to \$192 per pay period. Spokane reported that 94 percent of their fire fighters and 92 percent of their police officers participate in the matching plan, and in general, it's the younger members who don't participate. Tacoma reported that 89 percent of their employees take part in the matching plan. For employers that offer a matching plan, we assumed that 90 percent of all members would participate in the matching plan.

The City of Seattle provides 3.0 percent employer contributions to fire fighters' 457 accounts that current law includes in salary for pension purposes. The Seattle police officers can participate in an employer matching plan of up to 3.5 percent of salary.

4. **Of the members who participate in the matching plans, how many utilize the maximum employer match?** We asked the Cities of Spokane and Tacoma this question. Spokane said that almost none of their employees who take part in the match receive less than the maximum employer match. Tacoma didn't provide a response for this question. We assumed that 95 percent of employees who participate in the match would contribute enough to receive the maximum employer match.

We computed the average percent-of-salary increase using the following assumptions and calculations:

- (1) = number of members employed per employer eligible to participate in the matching plan.
- (2) = annual match provided by employer.
- (3) = 90 percent assumed matching plan participation rate.
- (4) = 95 percent assumed maximum matching rate.
- (5) = individual employer's total dollars contributed = (1) \* (2) \* (3) \* (4).
- (6) = total dollars contributed = the sum of (5) across all employers offering a matching plan.
- (7) = total number of members eligible for an employer match = 6,729.
- (8) = individual average annual flat-dollar amount contributed on behalf of members eligible for an employer match = (6) / (7) = \$2,233.06.
- (9) = total members reported by employers in the survey = 15,176.
- (10) = percent of all members reported who are eligible for an employer match = (7) / (9) = 44.34%.
- (11) = individual average annual flat-dollar amount contributed = (8) \* (10) = \$990.15.
- (12) = average LEOFF 2 salary from the 2006 AVR = \$74,562.

(13) = additional average salary increase applied in the fourth year of the valuation for all LEOFF 2 active members assumed as a result of this bill  
= (11) / (12) = 1.32795%.

Otherwise, we developed these costs using the same assumptions as disclosed in the 2006 AVR.

### **Data Used**

The staff for the LEOFF 2 Retirement Board provided us with a spreadsheet titled *LEOFF Plan 2 2005 Benefit survey.xls*. The data within the spreadsheet was collected via an exhaustive survey of LEOFF 2 employers. The survey contained the following fields:

- Jurisdiction.
- Number of employees.
- Type of employer (city, county, fire district, port, or university).
- Employ Police (yes, no).
- Employ FF (yes, no).
- Social Security for Police (yes, no).
- SS for FF (yes, no).
- Medicare (yes, no).
- SS replacement plan (yes, no).
- DC plan (yes, no).
- DC match (yes, no).
- DC detail.
- Access to retirement benefit (yes, no).
- Emplr Cont (yes, no).
- Retire benefit detail (PEBB, Teamsters, WFCA, AWC).

We relied on the data within this spreadsheet to price the impact of this bill on LEOFF 2. We reviewed the data carefully. Not all fields contained data for each record. Where necessary, we made assumptions regarding blank fields. We listed most of those assumptions in the Assumptions Made section above.

The format of the data entry wasn't consistent in some of the fields. We edited the data to create consistency between records within certain fields, namely fields where the record entries were either a yes or a no. An audit of this data was not performed.

For the City of Seattle fire fighter and police officer 457 plan information we went to the following website: <http://www.seattle.gov/personnel/resources/agreements.asp>.

Otherwise, we developed these costs using the same assets and data as disclosed in the 2006 AVR.

## ACTUARIAL RESULTS

### Liability Changes

This bill will impact the actuarial funding of LEOFF 2 by increasing the present value of future benefits payable under the system as shown below.

<i>(Dollars in Millions)</i>	<b>Current</b>	<b>Increase</b>	<b>Total</b>
<b>Actuarial Present Value of Projected Benefits</b>			
<i>(The Value of the Total Commitment to all Current Members)</i>			
LEOFF 1	\$4,316	\$0	\$4,316
LEOFF 2	<u>6,004</u>	<u>54</u>	<u>6,058</u>
<b>LEOFF Total</b>	<b>\$10,320</b>	<b>\$54</b>	<b>\$10,374</b>
<b>Unfunded Actuarial Accrued Liability</b>			
<i>(The Portion of the Plan 1 Liability that is Amortized at 2024)</i>			
<b>LEOFF 1</b>	<b>(\$702)</b>	<b>\$0</b>	<b>(\$702)</b>
<b>Unfunded Liability (PVCPB)</b>			
<i>(The Value of the Total Commitment to all Current Members Attributable to Past Service)</i>			
LEOFF 1	(\$738)	\$0	(\$738)
LEOFF 2	<u>(521)</u>	<u>22</u>	<u>(499)</u>
<b>LEOFF Total</b>	<b>(\$1,259)</b>	<b>\$22</b>	<b>(\$1,237)</b>

### Present Value of Future Salaries (PVFS) Changes

This bill will impact the actuarial funding of LEOFF 2 by increasing the PVFS of the members of the system as shown below.

<i>(Dollars in Millions)</i>	<b>Current</b>	<b>Increase</b>	<b>Total</b>
<b>Actuarial Present Value of Future Salaries</b>			
<i>(The Value of the Future Salaries Expected to be Paid to Current Members)</i>			
LEOFF 2	\$13,900	\$114	\$14,014

### Contribution Rate Changes

The rounded increase in the required actuarial contribution rate results in the supplemental contribution rate shown below that applies in the current biennium. However, we will use the un-rounded rate increase to measure the fiscal budget changes in future biennia.

<b>Increase in Contribution Rates: (Effective 9/1/2008)</b>	
<b>System/Plan</b>	<b>LEOFF</b>
<b>Current Members</b>	
Employee (Plan 2)	0.130%
Employer	0.078%
State	0.052%
<b>New Entrants*</b>	
Employee (Plan 2)	0.053%
Employer	0.032%
State	0.021%

*\*Rate change applied to future new entrant payroll through the effective date of this act, and used for fiscal budget changes only. A single supplemental rate increase equal to the increase for current members would apply in the current biennium for all members or employers.*

### **Fiscal Budget Changes**

<b>Fiscal Costs</b>	
<i>(Dollars in Millions)</i>	<b>LEOFF</b>
<b>2008-2009</b>	
General Fund	\$0.6
Non-General Fund	<u>0.0</u>
Total State	0.6
Local Government	<u>1.0</u>
Total Employer	1.6
Total Employee	\$1.6
<b>2009-2011</b>	
General Fund	\$1.5
Non-General Fund	<u>0.0</u>
Total State	1.5
Local Government	<u>2.3</u>
Total Employer	3.8
Total Employee	\$3.8
<b>2008-2033</b>	
General Fund	\$37.9
Non-General Fund	<u>0.0</u>
Total State	37.9
Local Government	<u>57.0</u>
Total Employer	94.9
Total Employee	\$94.9

*Note: Totals may not agree due to rounding.*

The analysis of this bill doesn't 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 AVR, 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.

## SENSITIVITY ANALYSIS

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

- Participation Rate – Member participation rate in employer matching plans.
- Max Match Rate – Percent of maximum match utilized by members.
- Percent Match – Match amount as a percent of salary for employer plans where detail was not provided.

A sensitivity test is conducted by changing one assumption at a time while holding the other assumptions constant, and recording the change in outputs. The table below summarizes the results of our sensitivity tests.

Sensitivity Tests						
Assumptions				Results		
				Increase In:		
				<i>(Dollars in Millions)</i>		
Participation Rate	Max Match Rate	Percent Match	Assumed Salary*	Liability	PVFS	Total Supplemental Rate
Base - 90%	Base - 95%	Base - 3.5%	1.33%	\$54	\$114	0.26%
100%	Base	Base	1.48%	60	127	0.28%
80%	Base	Base	1.18%	48	101	0.24%
Base	100%	Base	1.40%	57	120	0.28%
Base	90%	Base	1.26%	51	108	0.24%
Base	Base	4%	1.39%	57	119	0.28%
Base	Base	3%	1.27%	\$52	\$109	0.24%

*\*In the fourth year of the valuation corresponding to 2012.*

A scenario test involves selecting groups of assumptions, and recording the change in outputs after the pricing is conducted using the assumption groups. Aside from the base pricing, we selected two other groups of assumptions. The first group contained the assumptions associated with the highest impact to the plan. The second group contained the assumptions associated with the lowest impact to the plan. The table below summarizes the results of our scenario tests.

Scenario Tests								
Assumptions						Results		
						Increase In:		
						<i>(Dollars in Millions)</i>		
Scenario Test	Participation Rate	Max Match Rate	Percent Match	Assumed Salary*	Liability	PVFS	Total Supplemental Rate	
Base	90%	95%	3.50%	1.33%	\$54	\$114	0.26%	
High	100%	100%	4.00%	1.62%	66	139	0.32%	
Low	80%	90%	3.00%	1.07%	\$44	\$92	0.20%	

\*In the fourth year of the valuation corresponding to 2012.

We didn't attempt to quantify the impact on LEOFF 2 of employers changing from making contingent matches to making non-contingent contributions, as occurred with Seattle fire fighters. This type of behavior change could increase the contribution rates of LEOFF 2 in about the same magnitude as presented in this fiscal note. The increase in contribution rates could be higher because all employees would receive the maximum contribution whereas for this fiscal note we assumed 90 percent of the employees would receive 95 percent of the maximum employer match.

Since current law includes non-contingent employer contributions as salary we don't explicitly calculate an increased contribution rate to approximate the impact of employers changing from making contingent matches to making non-contingent contributions. Instead the increase in salaries would show up in the valuation data as being higher than assumed, resulting in a loss to the system. Losses to the system, under current law, are accounted for directly under the actuarial funding method used in Washington State – the aggregate method – in the form of increased contribution rates.

## 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, assumptions, and data may also be reasonable, and might produce different results.
5. This fiscal note has been prepared for the Legislature during the 2008 Legislative Session.
6. This fiscal note has been prepared, and opinions given, in accordance with Washington State law and accepted actuarial standards of practice as of the date shown on page 1 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

## 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 liability. The normal cost is determined for the entire group rather than 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 – the:

- Normal cost.
- Amortization of the unfunded liability.

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

**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.

**Present Value of Credited Projected Benefits (PVCBP):** 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 which 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 Liability (Unfunded PVCBP):** The excess, if any, of the Present Value of Credited Projected Benefits 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

<b>Bill Number:</b> 3049 HB	<b>Title:</b> Definition of basic salary	<b>Agency:</b> 124-Department of Retirement Systems
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## Part I: Estimates

**No Fiscal Impact**

*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:	Phone:	Date: 01/30/2008
Agency Preparation: George Pickett	Phone: (360)664-7009	Date: 01/30/2008
Agency Approval: Sandra J. Matheson	Phone: (360) 664-7312	Date: 01/30/2008
OFM Review: Ryan Black	Phone: 360-902-0417	Date: 02/02/2008

## **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 changes the definition of basic salary for the purpose of employer contributions to an account formed under section 457 of the Internal Revenue Code for the benefit of members of Plan 2 of the Law Enforcement Officers' and Firefighters' Retirement System. The change will allow employer contributions to a 457 plan on behalf of a member to be included in the member's retirement benefit calculation.

These changes do not have a fiscal impact on the Department of Retirement Systems.

### **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.*

No impact.

## **Part III: Expenditure Detail**

### **Part IV: Capital Budget Impact**

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.*

New or modified rules will be required.

## Appendix F – Draft Bill: Deferred Compensation as Salary

**Sec. 1.** RCW 41.26.030 and is amended to read as follows:

As used in this chapter, unless a different meaning is plainly required by the context:

(1) "Retirement system" means the "Washington law enforcement officers' and firefighters' retirement system" provided herein.

(2)(a) "Employer" for plan 1 members, means the legislative authority of any city, town, county, or district or the elected officials of any municipal corporation that employs any law enforcement officer and/or firefighter, any authorized association of such municipalities, and, except for the purposes of RCW [41.26.150](#), any labor guild, association, or organization, which represents the firefighters or law enforcement officers of at least seven cities of over 20,000 population and the membership of each local lodge or division of which is composed of at least sixty percent law enforcement officers or firefighters as defined in this chapter.

(b) "Employer" for plan 2 members, means the following entities to the extent that the entity employs any law enforcement officer and/or firefighter:

(i) The legislative authority of any city, town, county, or district;

(ii) The elected officials of any municipal corporation;

(iii) The governing body of any other general authority law enforcement agency; or

(iv) A four-year institution of higher education having a fully operational fire department as of January 1, 1996.

(3) "Law enforcement officer" beginning January 1, 1994, means any person who is commissioned and employed by an employer on a full time, fully compensated basis to enforce the criminal laws of the state of Washington generally, with the following qualifications:

(a) No person who is serving in a position that is basically clerical or secretarial in nature, and who is not commissioned shall be considered a law enforcement officer;

(b) Only those deputy sheriffs, including those serving under a different title pursuant to county charter, who have successfully completed a civil service examination for deputy sheriff or the equivalent position, where a different title is used, and those persons serving in unclassified positions authorized by RCW [41.14.070](#) except a private secretary will be considered law enforcement officers;

(c) Only such full time commissioned law enforcement personnel as have been appointed to offices, positions, or ranks in the police department which have been specifically created or otherwise expressly provided for and designated by city charter provision or by ordinance enacted by the legislative body of the city shall be considered city police officers;

(d) The term "law enforcement officer" also includes the executive secretary of a labor guild, association or organization (which is an employer under RCW [41.26.030\(2\)](#)) if that individual has five years previous membership in the retirement system established in chapter [41.20](#) RCW. The provisions of this subsection (3)(d) shall not apply to plan 2 members; and

(e) The term "law enforcement officer" also includes a person employed on or after January 1, 1993, as a public safety officer or director of public safety, so long as the job duties substantially involve only either police or fire duties, or both, and no other duties in a city or town with a population of less than ten thousand. The provisions of this subsection (3)(e) shall not apply to any public safety officer or director of public safety who is receiving a retirement allowance under this chapter as of May 12, 1993.

(4) "Firefighter" means:

(a) Any person who is serving on a full time, fully compensated basis as a member of a fire department of an employer and who is serving in a position which requires passing a civil service examination for firefighter, and who is actively employed as such;

(b) Anyone who is actively employed as a full time firefighter where the fire department does not have a civil service examination;

(c) Supervisory firefighter personnel;

(d) Any full time executive secretary of an association of fire protection districts authorized under RCW [52.12.031](#). The provisions of this subsection (4)(d) shall not apply to plan 2 members;

(e) The executive secretary of a labor guild, association or organization (which is an employer under RCW [41.26.030\(2\)](#) as now or hereafter amended), if such individual has five years previous membership in a retirement system established in chapter [41.16](#) or [41.18](#) RCW. The provisions of this subsection (4)(e) shall not apply to plan 2 members;

(f) Any person who is serving on a full time, fully compensated basis for an employer, as a fire dispatcher, in a department in which, on March 1, 1970, a dispatcher was required to have passed a civil service examination for firefighter;

(g) Any person who on March 1, 1970, was employed on a full time, fully compensated basis by an employer, and who on May 21, 1971, was making retirement contributions under the provisions of chapter [41.16](#) or [41.18](#) RCW; and

(h) Any person who is employed on a full-time, fully compensated basis by an employer as an emergency medical technician.

(5) "Department" means the department of retirement systems created in chapter [41.50](#) RCW.

(6) "Surviving spouse" means the surviving widow or widower of a member. "Surviving spouse" shall not include the divorced spouse of a member except as provided in RCW [41.26.162](#).

(7)(a) "Child" or "children" means an unmarried person who is under the age of eighteen or mentally or physically handicapped as determined by the department, except a handicapped person in the full time care of a state institution, who is:

(i) A natural born child;

(ii) A stepchild where that relationship was in existence prior to the date benefits are payable under this chapter;

(iii) A posthumous child;

(iv) A child legally adopted or made a legal ward of a member prior to the date benefits are payable under this chapter; or

(v) An illegitimate child legitimized prior to the date any benefits are payable under this chapter.

(b) A person shall also be deemed to be a child up to and including the age of twenty years and eleven months while attending any high school, college, or vocational or other educational institution accredited, licensed, or approved by the state, in which it is located, including the summer vacation months and all other normal and regular vacation periods at the particular educational institution after which the child returns to school.

(8) "Member" means any firefighter, law enforcement officer, or other person as would apply under subsections (3) or (4) of this section whose membership is transferred to the Washington law enforcement officers' and firefighters' retirement system on or after March 1, 1970, and every law enforcement officer and firefighter who is employed in that capacity on or after such date.

(9) "Retirement fund" means the "Washington law enforcement officers' and firefighters' retirement system fund" as provided for herein.

(10) "Employee" means any law enforcement officer or firefighter as defined in subsections (3) and (4) of this section.

(11)(a) "Beneficiary" for plan 1 members, means any person in receipt of a retirement allowance, disability allowance, death benefit, or any other benefit described herein.

(b) "Beneficiary" for plan 2 members, means any person in receipt of a retirement allowance or other benefit provided by this chapter resulting from service rendered to an employer by another person.

(12)(a) "Final average salary" for plan 1 members, means (i) for a member holding the same position or rank for a minimum of twelve months preceding the date of retirement, the basic salary attached to such same position or rank at time of retirement; (ii) for any other member, including a civil service member who has not served a minimum of twelve months in the same position or rank preceding the date of retirement, the average of the greatest basic salaries payable to such member during any consecutive twenty-four month period within such member's last ten years of service for which service credit is allowed, computed by dividing the total basic salaries payable to such member during the selected twenty-four month period by twenty-four; (iii) in the case of

disability of any member, the basic salary payable to such member at the time of disability retirement; (iv) in the case of a member who hereafter vests pursuant to RCW [41.26.090](#), the basic salary payable to such member at the time of vesting.

(b) "Final average salary" for plan 2 members, means the monthly average of the member's basic salary for the highest consecutive sixty service credit months of service prior to such member's retirement, termination, or death. Periods constituting authorized unpaid leaves of absence may not be used in the calculation of final average salary.

(13)(a) "Basic salary" for plan 1 members, means the basic monthly rate of salary or wages, including longevity pay but not including overtime earnings or special salary or wages, upon which pension or retirement benefits will be computed and upon which employer contributions and salary deductions will be based.

(b) "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. Basic salary includes all contributions made by an employer to a member's account established pursuant to section 457 of the United States internal revenue code for the period of the collective bargaining agreement, employment contract or written program of benefits between the employer and employee only if those contributions are identified as salary for pension purposes in the collective bargaining agreement, employment contract or written program of benefits. 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 nonlegislative 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.

(14)(a) "Service" for plan 1 members, means all periods of employment for an employer as a firefighter or law enforcement officer, for which compensation is paid, together with periods of suspension not exceeding thirty days in duration. For the purposes of this chapter service shall also include service in the armed forces of the United States as provided in RCW [41.26.190](#). Credit shall be allowed for all service credit months of service rendered by a member from and after the member's initial commencement of employment as a firefighter or law

enforcement officer, during which the member worked for seventy or more hours, or was on disability leave or disability retirement. Only service credit months of service shall be counted in the computation of any retirement allowance or other benefit provided for in this chapter.

(i) For members retiring after May 21, 1971 who were employed under the coverage of a prior pension act before March 1, 1970, "service" shall also include (A) such military service not exceeding five years as was creditable to the member as of March 1, 1970, under the member's particular prior pension act, and (B) such other periods of service as were then creditable to a particular member under the provisions of RCW [41.18.165](#), [41.20.160](#) or [41.20.170](#). However, in no event shall credit be allowed for any service rendered prior to March 1, 1970, where the member at the time of rendition of such service was employed in a position covered by a prior pension act, unless such service, at the time credit is claimed therefore, is also creditable under the provisions of such prior act.

(ii) A member who is employed by two employers at the same time shall only be credited with service to one such employer for any month during which the member rendered such dual service.

(b) "Service" for plan 2 members, means periods of employment by a member for one or more employers for which basic salary is earned for ninety or more hours per calendar month which shall constitute a service credit month. Periods of employment by a member for one or more employers for which basic salary is earned for at least seventy hours but less than ninety hours per calendar month shall constitute one-half service credit month. Periods of employment by a member for one or more employers for which basic salary is earned for less than seventy hours shall constitute a one-quarter service credit month.

Members of the retirement system who are elected or appointed to a state elective position may elect to continue to be members of this retirement system.

Service credit years of service shall be determined by dividing the total number of service credit months of service by twelve. Any fraction of a service credit year of service as so determined shall be taken into account in the computation of such retirement allowance or benefits.

If a member receives basic salary from two or more employers during any calendar month, the individual shall receive one service credit month's service credit during any calendar month in which multiple service for ninety or more hours is rendered; or one-half service credit month's service credit during any calendar month in which multiple service for at least seventy hours but less than ninety hours is rendered; or one-quarter service credit month during any calendar month in which multiple service for less than seventy hours is rendered.

(15) "Accumulated contributions" means the employee's contributions made by a member, including any amount paid under RCW [41.50.165\(2\)](#), plus accrued interest credited thereon.

(16) "Actuarial reserve" means a method of financing a pension or retirement plan wherein reserves are accumulated as the liabilities for benefit payments are incurred in order that sufficient funds will be available on the date of retirement of each member to pay the member's future benefits during the period of retirement.

(17) "Actuarial valuation" means a mathematical determination of the financial condition of a retirement plan. It includes the computation of the present monetary value of benefits payable to present members, and the present monetary value of future employer and employee contributions, giving effect to mortality among active and retired members and also to the rates of disability, retirement, withdrawal from service, salary and interest earned on investments.

(18) "Disability board" for plan 1 members means either the county disability board or the city disability board established in RCW [41.26.110](#).

(19) "Disability leave" means the period of six months or any portion thereof during which a member is on leave at an allowance equal to the member's full salary prior to the commencement of disability retirement. The definition contained in this subsection shall apply only to plan 1 members.

(20) "Disability retirement" for plan 1 members, means the period following termination of a member's disability leave, during which the member is in receipt of a disability retirement allowance.

(21) "Position" means the employment held at any particular time, which may or may not be the same as civil service rank.

(22) "Medical services" for plan 1 members, shall include the following as minimum services to be provided. Reasonable charges for these services shall be paid in accordance with RCW [41.26.150](#).

(a) Hospital expenses: These are the charges made by a hospital, in its own behalf, for

(i) Board and room not to exceed semiprivate room rate unless private room is required by the attending physician due to the condition of the patient.

(ii) Necessary hospital services, other than board and room, furnished by the hospital.

(b) Other medical expenses: The following charges are considered "other medical expenses", provided that they have not been considered as "hospital expenses".

(i) The fees of the following:

(A) A physician or surgeon licensed under the provisions of chapter [18.71](#) RCW;

(B) An osteopathic physician and surgeon licensed under the provisions of chapter [18.57](#) RCW;

(C) A chiropractor licensed under the provisions of chapter [18.25](#) RCW.

(ii) The charges of a registered graduate nurse other than a nurse who ordinarily resides in the member's home, or is a member of the family of either the member or the member's spouse.

(iii) The charges for the following medical services and supplies:

(A) Drugs and medicines upon a physician's prescription;

(B) Diagnostic X-ray and laboratory examinations;

(C) X-ray, radium, and radioactive isotopes therapy;

(D) Anesthesia and oxygen;

(E) Rental of iron lung and other durable medical and surgical equipment;

(F) Artificial limbs and eyes, and casts, splints, and trusses;

(G) Professional ambulance service when used to transport the member to or from a hospital when injured by an accident or stricken by a disease;

(H) Dental charges incurred by a member who sustains an accidental injury to his or her teeth and who commences treatment by a legally licensed dentist within ninety days after the accident;

(I) Nursing home confinement or hospital extended care facility;

(J) Physical therapy by a registered physical therapist;

(K) Blood transfusions, including the cost of blood and blood plasma not replaced by voluntary donors;

(L) An optometrist licensed under the provisions of chapter [18.53](#) RCW.

(23) "Regular interest" means such rate as the director may determine.

(24) "Retiree" for persons who establish membership in the retirement system on or after October 1, 1977, means any member in receipt of a retirement allowance or other benefit provided by this chapter resulting from service rendered to an employer by such member.

(25) "Director" means the director of the department.

(26) "State actuary" or "actuary" means the person appointed pursuant to RCW [44.44.010](#)(2).

(27) "State elective position" means any position held by any person elected or appointed to statewide office or elected or appointed as a member of the legislature.

(28) "Plan 1" means the law enforcement officers' and firefighters' retirement system, plan 1 providing the benefits and funding provisions covering persons who first became members of the system prior to October 1, 1977.

(29) "Plan 2" means the law enforcement officers' and firefighters' retirement system, plan 2 providing the benefits and funding provisions covering persons who first became members of the system on and after October 1, 1977.

(30) "Service credit year" means an accumulation of months of service credit which is equal to one when divided by twelve.

(31) "Service credit month" means a full service credit month or an accumulation of partial service credit months that are equal to one.

(32) "General authority law enforcement agency" means any agency, department, or division of a municipal corporation, political subdivision, or other unit of local government of this state, and any agency, department, or division of state government, having as its primary function the detection and apprehension of persons committing infractions or violating the traffic or criminal laws in general, but not including the Washington state patrol. Such an agency, department, or division is distinguished from a limited authority law enforcement agency having as one of its functions the apprehension or detection of persons committing infractions or violating the traffic or criminal laws relating to limited subject areas, including but not limited to, the state departments of natural resources and social and health services, the state gambling commission, the state lottery commission, the state parks and recreation commission, the state utilities and transportation commission, the state liquor control board, and the state department of corrections.

# DRAFT FISCAL NOTE SUMMARY

RESPONDING AGENCY:	CODE:	DATE:	PROPOSAL [NAME or Z-NUMBER]:
Office of the State Actuary	035	11/25/08	LEOFF 2 Deferred Comp as Salary

## WHAT THE READER SHOULD KNOW

This document represents the first page of a draft fiscal note. The Office of the State Actuary (“we”) prepared this summary based on our understanding of the proposal as of the date shown above. We intend this summary to be used by the Law Enforcement Officers’ and Fire Fighters’ Retirement System Plan 2 Board (LEOFF 2) throughout the 2008 Interim only. We will prepare a complete draft fiscal note to replace this preliminary summary prior to the start of the 2009 Legislative Session. If a legislator introduces this proposal as a bill during the next legislative session, we will prepare a final fiscal note based on that bill language. The actuarial results shown in this summary may change when we prepare our final version for the Legislature.

## SUMMARY OF RESULTS

This proposal makes employer contributions to 457 member accounts (deferred compensation) pensionable as salary provided the applicable collective bargaining agreement specifies the contributions as salary. This proposal only impacts the LEOFF 2.

Impact on Pension Liability			
<i>(Dollars in Millions)</i>	Current	Increase	Total
Today's Value of All Future Pensions	\$6,149	\$51	\$6,200
Earned Pensions Not Covered by Today's Assets	(\$974)	\$20	(\$954)

Impact on Contribution Rates: (Effective 9/1/2009)	
2009-2011 State Budget	LEOFF
Employee (Plan 2)	0.12%
Employer	0.07%
State	0.05%

Budget Impacts			
<i>(Dollars in Millions)</i>	2009-2011	2011-2013	25-Year
General Fund-State	\$1.7	\$2.2	\$61.4
Total Employer	\$4.2	\$5.5	\$153.4

We will prepare a draft fiscal note for this proposal prior to the 2009 Legislative Session.