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Tiered Multiplier Benefit Improvement

COMPREHENSIVE REPORT
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ISSUE STATEMENT

A benefit improvement purchased using the Benefit Improvement Account should meet the policy goals of the Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 2 Board while also adhering to the legislative intent of the Benefit Improvement Account.

OVERVIEW

This report will provide background on the history and purpose of the LEOFF Plan 2 Benefit Improvement Account (BIA). It will also identify policy options for the Board to consider with purchasing a benefit improvement using the BIA.

BACKGROUND AND POLICY ISSUES

History of the Benefit Improvement Account

In 2008, the legislature created the Benefit Improvement Account (BIA). The BIA was initially to be funded through periodic appropriations from the State's General Fund when certain revenue criteria were met. Despite those criteria being met, the appropriations were never made and instead, the BIA has been funded through transfers from the LEOFF Plan 2 Trust Fund into the BIA.

In creating the BIA the legislature recognized that:

> the current benefit formula and contributions for [LEOFF] 2 are inadequate to modify that formula in recognition of the shorter working careers for firefighters and police officers. […] In recognition of the physical demands of the professions and the inherent risks faced by law enforcement officers and firefighters, eligibility for retirement in [LEOFF] 2 system has been set at age fifty-three. However, the benefit formula is designed for careers of thirty-five to forty years, making retirement at age fifty-three an unrealistic option for many.[1]

[1] https://lawfilesext.leg.wa.gov/biennium/2007-08/Pdf/Bills/Session%20Laws/Senate/6573-S.SL.pdf?cite=2008%20c%2099%20%C2%A7%203

The minimum amount of income often cited as necessary for income replacement at retirement is 60%. The benefit formula for the Department of Retirement Systems (DRS) administered pension systems, including LEOFF Plan 2, is: 2% x Years of Service x Final Average Salary. To reach 60% replacement income using this formula a member must have a 30-year career.

In the state pension systems for general public employees, teachers, school employees, and most other public employees in Washington State, the normal retirement age is 65 years old. However, for LEOFF Plan 2 normal retirement age is 53 years old.[2] The earlier normal retirement age is due to the physical demands and risks inherent in LEOFF covered positions. This, coupled with a benefit formula designed for 30-year careers, results in the average LEOFF Plan 2 member replacing only approximately 47% of their pre-retirement income through their LEOFF Plan 2 benefit. The 2020 projected average salary of a LEOFF 2 member is $10,390 per month. The average LEOFF Plan 2 member retires at age 56 with 23.5 years of service. These averages would result in a benefit of $4,883 per month.

Policy Goals of the Board

One policy goal frequently discussed by the Board is that this benefit improvement should apply as broadly as possible. The Board has discussed providing a benefit to as many members as possible while also recognizing the limitations of the cost of the benefit. The Board recognized that the BIA was funded by transfers from the LEOFF Plan 2 trust fund, which contains contributions made by active and retired LEOFF Plan 2 members. Therefore, the Board reasoned that current members and retirees should receive a benefit since they have already helped pay for it through past contributions. Furthermore, the Board discussed prioritizing a larger benefit for members who spend a career in LEOFF Plan 2, since the longer someone worked in a LEOFF 2 covered position the larger their contribution to the funds in the BIA.

The Board has also discussed a policy goal to improve retention with the benefit improvement. One of the primary goals of any pension plan is to recruit and retain employees. Employers may be particularly interested in improving recruitment and retention through the benefit improvement.

Lump Sum Benefit

The Board has identified a lump sum benefit as a benefit improvement option for LEOFF Plan 2 retirees. A lump sum benefit is a one-time payment made to retirees from the BIA. The issue

[2] Normal Retirement age for Public Safety Employees' Retirement System (PSERS) Plan 2 is 62, and LEOFF 1 is 50

the Board has identified with a lump-sum benefit is how to design that benefit in a way that best meets the Board's policy goal of equity.

The options identified by the Board are:
1. $20,000 lump sum for retirees; or
2. $100 per month of service credit for retirees.

Option 1 would be less complex to administer. It provides the same benefit to all vested members, which may be viewed as the most straightforward way to distribute a benefit. However, from an accumulated contributions standpoint, it may be considered unfair for a member with 5 years of service credit to receive the same benefit as a member with 20 or more years.

Option 2 addresses this issue of proportionality by providing a lump sum benefit based on the amount of service credit a retiree has earned. For example, a retiree with 5 years of service credit (60 months of service credit) would receive a lump sum payment of $6,000; a retiree with 10 years of service credit (120 months of service credit) would receive a lump sum payment of $12,000; a retiree with 20 years of service (240 months of service credit) would receive a lump sum payment of $24,000; and, a retiree with 25 years of service (300 months of service credit) would receive a lump sum payment of $30,000.

This option would also provide a minimum benefit of $20,000 to catastrophic or duty disability retirees, as well as duty death beneficiaries. While Option 2 would be more complex to administer, it provides a benefit that meets the Board's goal of providing more benefit to career employees.

The Board has also discussed providing retirees who receive a lump sum benefit the option of purchasing an actuarially equivalent annuity with those funds. This is a benefit that can be provided at no-cost to the plan. However, there is some risk in allowing members to purchase an annuity, as the experience of the plan could result in not aligning with the assumptions used by the Office of the State Actuary (OSA) in pricing the annuity factors for purchasing an annuity. Although, there is the possibility that the experience of the plan could result in a savings. This is a risk that the plan already takes on with the Purchase of Additional Annuity and Purchase of Service Credit benefits.

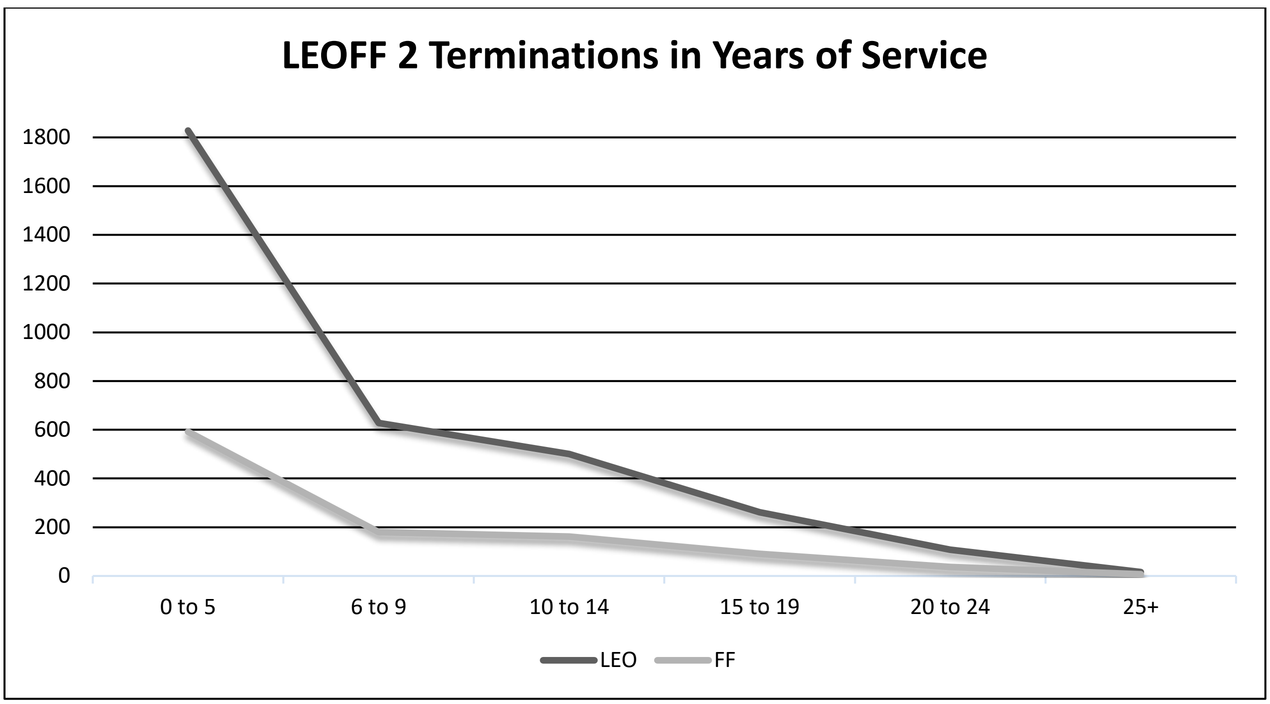
Tiered Multiplier Benefit

The Board has identified a tiered multiplier as a benefit improvement for active members that meets its policy goals of equity and retention. The tiered multiplier benefit would increase the plan benefit multiplier from 2% to 2.5% for the years of service between 15 and up to 26.

This benefit would improve retirement income so that retirees can be closer to the 60% income replacement goal, while also incentivizing members to remain in LEOFF Plan 2. OSA estimated that the average member's retirement benefit will increase by about 9 percent with a mid-career multiplier.[3]

The years of service between 15 and 26 were identified in part because, by this point, employers have significantly invested in their employees' training and employees have greater knowledge through their extensive work experience. However, a concern with this benefit improvement is that it does not provide a benefit to members who work less than 15 years. The Board has recognized that this concern could be addressed by providing the lump sum benefit to members who work less than 15 years.

Below is a chart of data from 1995-2015 that shows at what service credit range fire fighters and law enforcement officers terminated from LEOFF service:



Who qualifies for which benefit improvement?

Determining who qualifies for which benefit improvement is driven by the policy goals of the Board discussed above. In particular, the Board recognizes that the BIA was funded by transfers from the LEOFF Plan 2 trust fund, which contains contributions made by active and retired LEOFF Plan 2 members.

[3] https://fnspublic.ofm.wa.gov/FNSPublicSearch/GetPDF?packageID=62887

Also, since there are different benefits for retirees versus active members versus new hires, the Board has discussed the importance of identifying a date in the bill which determines the benefit a person will qualify for. The Board has also discussed backdating that delineation date in the bill so that it does not cause unexpected issues for the plan, such as a surge in retirements or members delaying planned retirement. The date that has been identified for delineating these benefits is February 1, 2021.

Below is a table breaking down which groups of LEOFF Plan 2 members qualify for the lump sum benefit improvement, tiered multiplier benefit improvement, choice between lump sum benefit or tiered multiplier benefit, or no benefit improvement. This list does not specify all potential situations.

Retired as of 2/1/21	
LEOFF 2 Member Group	**Benefit Improvement**
Retired as of 2/1/21	Lump sum
Duty or catastrophic disability retired as of 2/1/21	Lump sum (minimum of $20k)
Beneficiary of line-of-duty death who died prior to 2/1/21	Lump sum (minimum of $20k)
Survivor beneficiary, member deceased as of 2/1/21	Lump sum
Member deceased as of 2/1/21 with no survivor beneficiary	No benefit
Withdrawn	No benefit

LEOFF 2 Member Active as of 2/1/21	
LEOFF 2 Member Group	**Benefit Improvement**
Still active	Choice of lump sum or tiered multiplier
Now retired	Choice of lump sum or tiered multiplier
Duty or catastrophic disability retirement	Choice of lump sum (minimum of $20k) or tiered multiplier
Beneficiary of line-of-duty death who was active as of 2/1/21	Choice of lump sum (minimum of $20k) or tiered multiplier
Survivor beneficiary, member deceased after 2/1/21	Choice between a lump sum or tiered multiplier benefit at retirement
Survivor beneficiary in service death not line-of-duty	Choice of lump sum or tiered multiplier
No survivor beneficiary, member deceased after 2/1/21 before effective date of the bill	Lump sum to beneficiary or estate
No survivor beneficiary in service death not line of duty	Lump sum to beneficiary or estate
Withdrawn	No benefit
Inactive as of 2/1/21 and vested	Choice of lump sum or tiered multiplier
Inactive and not vested	No benefit
Inactive and not vested as of 2/1/21, returns to LEOFF employment after 2/1/21 and becomes vested	Choice of lump sum or tiered multiplier

New Member after 2/1/21	
LEOFF 2 Member Group	**Benefit Improvement**
New members after 2/1/21	Tiered multiplier
Withdrawn	No benefit

Members active as of February 1, 2021 would receive the option of choosing between the lump sum benefit or the tiered multiplier. Some of the policy reasons for this choice are that these members contributed to the funds used to purchase the benefit improvement and may be at a point of their career where the tiered multiplier could help their employer retain them. The following is an example of how this choice of benefit would work for this group of members:

> Member is currently 45 years old with 20 years of service credit. They work for an additional 10 years and retire at age 55 with an Average Final Compensation of $10,000. This member will have two benefit options at retirement:
>
> - Option 1: 2% x 30 yrs x $10k for a monthly benefit of $6000 plus a lump sum of $36,000
> - Option 2: (2% x 20 yrs + 2.5% x 10 yrs) x $10K for a monthly benefit of $6500

This option would also apply to members who are inactive as of February 1, 2021 but not retired. Some of the policy reasons behind offering these members the option between the benefits are that they also have contributed to the benefit improvement account and offering them the potential incentive of the tiered multiplier may bring them back to LEOFF service. The following is an example of how this choice of benefit would work for this group of members:

> Member is currently inactive with 17 years of service credit and an Average Final Compensation of $10,000. This member will have two benefit options at retirement:
>
> - Option 1: 2% x 17 yrs x $10k for a $3400 monthly benefit plus a lump sum of $20,400
> - Option 2: (2% x 15 years + 2.5% x 2years) x $10K for a monthly benefit of $3500 per month

Implementation of a Benefit Improvement using the Benefit Improvement Account

Previous benefit improvements to LEOFF Plan 2 have been paid for through contribution rate increases. The BIA is a new method for funding a benefit improvement and it has never been used. The intent of the BIA was to prefund a benefit improvement so that there would be no impact on contributions. However, the current LEOFF Plan 2 funding policies would result in a contribution rate increase even with enough money in the BIA to fully purchase the benefit improvement.

The Board's strategic plan goals for the funding policy are stable rates and a fully funded plan. To achieve this goal, the Board sets the contribution rate at the greater of the Aggregate Funding Method or the Minimum Rate Funding Policy. Currently, the Minimum Rate Funding Policy is greater than the Aggregate Funding Method. The Minimum Rate Funding Policy is based on the Normal Cost of Entry Age Normal Cost Method (expected long-term cost of the plan excluding the current level of assets). The Minimum Rate Funding Policy contains a rate floor and a rate ceiling based on the funded status of the plan. The floor is set at 100% of the minimum rate if the funded status is equal to or less than 105%. The ceiling is set at 90% of the minimum rate if the funded status exceeds 105%.

Under current funding policies a benefit improvement would result in an increase to liabilities to the plan. There is no current policy for using assets in the BIA to offset that increase in liabilities. Therefore, the Board must determine a policy that allows the assets in the BIA to offset the increase in liabilities caused by a benefit improvement, so there is no increase in required contributions.

Two options for the Board to address this issue are:

1. Fix rates for the remainder of the current biennium and the next biennium according to the Board's current funding policy and develop a policy in consult with OSA that allows the assets in the BIA to offset the increase in liabilities from the benefit improvement so that there is no increase in required contributions; or,
2. Fix rates for the remainder of the current biennium and the next biennium according to the Board's current funding policy and then develop a policy in consult with OSA that would allow the assets in the BIA to offset the increase in liabilities from the benefit improvement such that there is no increase in required contributions.

Option 1 would allow the Board to immediately address the issue. It would also allow OSA to use the new funding policy in its 25-year cost impact for the fiscal note. This would give the legislature the opportunity to see the long-term cost impact of the benefit improvement. However, it does not give much time for the Board to work with OSA to identify and study options.

Option 2 gives the Board time to work with OSA to identify options and then study those options. However, without such a policy in the bill the long-term cost in the fiscal note would reflect current law and as noted above, current law would not reflect the intended rate reductions from the BIA. Therefore, the long-term costs of the bill would not be accurately reflected in the fiscal note for legislation.

POLICY OPTIONS

Lump Sum Benefit:

1. $20,000 lump sum; or,
2. $100 per month of service;
    a. Minimum of $20,000 benefit for catastrophic disability retirees, duty disability retirees, and duty death beneficiaries.

Tiered Multiplier Benefit:

1. Increase multiplier to 2.5% for years of service between 15 and up to 26.

Options for implementation of a benefit:

1. Develop a policy in consult with OSA that allows the assets in the BIA to offset the increase in liabilities from the benefit improvement so that there is no increase in required contributions; or,
2. Fix rates for the remainder of the current biennium and the next biennium according to the Board's current funding policy and then develop a policy in consult with OSA that would allow the assets in the BIA to offset the increase in liabilities from the benefit improvement such that there is no increase in required contributions.

LEOFF
Plan 2 Retirement Board

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November 17, 2021

Issue

- A benefit improvement purchased using the Benefit Improvement Account should meet the policy goals of the Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 2 Board while also adhering to the legislative intent of the Benefit Improvement Account

Background

- In creating the BIA the legislature recognized that:

> “the current benefit formula and contributions for [LEOFF] 2 are inadequate to modify that formula in recognition of the shorter working careers for firefighters and police officers. […] In recognition of the physical demands of the professions and the inherent risks faced by law enforcement officers and firefighters, eligibility for retirement in [LEOFF] 2 system has been set at age fifty-three. However, the benefit formula is designed for careers of thirty-five to forty years, making retirement at age fifty-three an unrealistic option for many.”

Benefit Formula

- Income replacement standard for retirement is often cited as 60%
- The benefit formula for Washington State administered pension systems, including LEOFF Plan 2, is: 2% x Years of Service x Final Average Salary
- To reach 60% replacement income using this formula a member must have a 30-year career

Average LEOFF 2 Member Benefit

- The average LEOFF Plan 2 retiree replaces approximately 47% of pre-retirement income:
  - Has a Final Average Salary of approximately $10,000 per month
  - Retirees at age 56 with 23.5 years of service
  - Receives a benefit of approximately $4,700 per month

Board's Policy Goals with BIA

- The Board has discussed the following policy goals of purchasing a benefit improvement using the BIA:
  - The benefit should apply as broadly as possible
    - Provide a benefit to as many members as possible while also recognizing the limitations of the cost of the benefit
    - Recognize that retirees helped fund the BIA
    - Prioritize a larger benefit for members who spend a career in LEOFF Plan 2
  - Retention
    - One of the primary goals of any pension plan is to recruit and retain employees
    - Improve retention of LEOFF members

Lump Sum Benefit

1. $20,000 lump sum payment to all retirees
   - Pros - Simple to administer and could be seen as most fair option since everyone gets the same amount
   - Cons - No proportionality to years of service
2. $100 per month of service and a minimum of $20,000 for catastrophic and duty disability retirees, and duty death beneficiaries
   - Pros – Benefit value proportionate to service
   - Cons – More complex to administer

Examples - Option 2

- 5 years of service credit would receive a lump sum payment of $6,000
- 10 years of service credit would receive a lump sum payment of $12,000
- 20 years of service would receive a lump sum payment of $24,000
- 25 years of service would receive a lump sum payment of $30,000

Tiered Multiplier Benefit

- The tiered multiplier benefit would increase the plan benefit multiplier from 2% to 2.5% for the years of service for active members between 15 and up to 26
  - Pros - Improve retirement income so that retirees can be closer to the 60% income replacement goal; incentivizes members to remain in LEOFF Plan 2
  - Cons - Does not provide a benefit to members who work less than 15 years

Who gets which benefit?

Retired as of 2/1/21	
LEOFF 2 Member Group	**Benefit Improvement**
Retired as of 2/1/21	Lump sum
Duty or catastrophic disability retired as of 2/1/21	Lump sum (minimum of $20k)
Beneficiary of line-of-duty death who died prior to 2/1/21	Lump sum (minimum of $20k)
Survivor beneficiary, member deceased as of 2/1/21	Lump sum
Member deceased as of 2/1/21 with no survivor beneficiary	No benefit
Withdrawn	No benefit

LEOFF 2 Member Active as of 2/1/21	
LEOFF 2 Member Group	**Benefit Improvement**
Still active	Choice of lump sum or tiered multiplier
Now retired	Choice of lump sum or tiered multiplier
Duty or catastrophic disability retirement	Choice of lump sum (minimum of $20k) or tiered multiplier
Beneficiary of line-of-duty death who was active as of 2/1/21	Choice of lump sum (minimum of $20k) or tiered multiplier
Survivor beneficiary, member deceased after 2/1/21	Choice between a lump sum or tiered multiplier benefit at retirement
Survivor beneficiary in service death not line-of-duty	Choice of lump sum or tiered multiplier
No survivor beneficiary, member deceased after 2/1/21 before effective date of the bill	Lump sum to beneficiary or estate
No survivor beneficiary in service death not line of duty	Lump sum to beneficiary or estate
Withdrawn	No benefit
Inactive as of 2/1/21 and vested	Choice of lump sum or tiered multiplier
Inactive and not vested	No benefit
Inactive and not vested as of 2/1/21, returns to LEOFF employment after 2/1/21 and becomes vested	Choice of lump sum or tiered multiplier

New Member after 2/1/21	
LEOFF 2 Member Group	**Benefit Improvement**
New members after 2/1/21	Tiered multiplier
Withdrawn	No benefit

Example of Active Member

- Member is currently 45 years old with 20 years of service credit. They work for an additional 10 years and retire at age 55 with an Average Final Compensation of $10,000. This member will have two benefit options at retirement:
- Option 1: 2% x 30 yrs x $10k for a monthly benefit of $6000 plus a lump sum of $36,000
- Option 2: (2% x 20 yrs + 2.5% x 10 yrs) x $10K for a monthly benefit of $6500

Other Decisions

- Date for determining benefits – February 1, 2021
- Option to purchase annuity with lump sum benefit

Implementation

1. Develop a policy in consult with OSA that allows the assets in the BIA to offset the increase in liabilities from the benefit improvement so that there is no increase in required contributions
   - Pros – Allows OSA to use the new policy to identify the long-term costs of the bill
   - Cons – Timeframe is aggressive

2. Fix rates for the remainder of the current biennium and the next biennium according to the Board's current funding policy and then develop a policy as described in option 1.
   - Pros – Allows time to work with OSA to identify options and for the Board to understand the option
   - Cons – The long-term costs of the bill would not be accurately reflected in the fiscal note

Options

1. Lump Sum Benefit
   a) $20,000 lump sum payment to all retirees with over 5 years of service
   b) $100 per month of service and a minimum of $20,000 for catastrophic and duty disability retirees, and duty death beneficiaries
2. Tiered Multiplier
   a) Increase the plan benefit multiplier from 2% to 2.5% for the years of service between 15 and up to 26
   b) Other
3. Implementation
   a) Develop a policy as part of bill
   b) Fix rates for next three years and then develop a policy

Next Steps

- Final Briefing at December Meeting
  - Staff will draft bill and work with OSA on fiscal analysis
  - Fiscal analysis may not be completed in time for December meeting

Thank You

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