

BOARD MEETING AGENDA

OCTOBER 19, 2022 • 9:30AM



LOCATION - Hybrid Meeting

In-Person:
Washington State Investment Board
2100 Evergreen Park Drive SW, Suite 100
Olympia, WA 98502

Or Virtual Meeting Information at
www.leoff.wa.gov

TRUSTEES

DENNIS LAWSON, CHAIR
Central Pierce Fire and Rescue

JASON GRANNEMAN, VICE CHAIR
Clark County Sheriff's Office

MARK JOHNSTON
Vancouver Fire Department

AJ JOHNSON
Snohomish County Fire

SENATOR JEFF HOLY
Spokane Police Department (Ret)

TARINA ROSE-WATSON
Spokane Int'l Airport Police Dept

PAT MCELLIGOTT
East Pierce County Fire

JAY BURNEY
City of Olympia

WOLF OPITZ
Pierce County

REPRESENTATIVE STEVE BERGQUIST
WA State Representative

SENATOR ANN RIVERS
WA State Senator

STAFF

Steve Nelsen, Executive Director
Tim Valencia, Deputy Director
Jessie Jackson, Executive Assistant
Jessica Burkhart, Administrative Services Manager
Jacob White, Senior Research and Policy Manager
Karen Durant, Senior Research and Policy Manager
Tammy Sadler, Benefits Ombudsman
Sarah White, Benefits Ombudsman
Tor Jernudd, Assistant Attorney General

**THEY KEEP US SAFE,
WE KEEP THEM SECURE.**

- | | |
|--|-----------------|
| 1. Health of the Retirement Plan –
Projection Analysis and Inflation Impacts | 9:30 AM |
| <i>Lisa A. Won, Deputy State Actuary, OSA</i>
<i>Frank Serra, Senior Actuarial Analyst, OSA</i> | |
| 2. Board Expectations | 10:30 AM |
| <i>Tim Valencia, Deputy Director</i> | |
| 3. Strategic Planning – SWOT Analysis | 11:00 AM |
| <i>Steve Nelsen, Executive Director</i> | |
| 4. Proposed Calendar 2023 | 12:00 PM |

**Lunch is served as an integral part of the meeting.*

In accordance with RCW 42.30.110, the Board may call an Executive Session for the purpose of deliberating such matters as provided by law. Final actions contemplated by the Board in Executive Session will be taken in open session. The Board may elect to take action on any item appearing on this agenda.

Projection Analysis and Inflation Impacts

Presentation to: LEOFF 2 Board

Lisa Won, ASA, FCA, MAAA, Deputy State Actuary

Frank Serra, Senior Actuarial Analyst



What We'll Be Sharing Today...

PART 1

- Projection Analysis
 - Background
 - Deferred investment gains/losses
 - Funded ratio and contribution rate projections

PART 2

- Inflation Impacts
 - Background
 - Historical and forecasted inflation
 - Effects of inflation on COLAs and salary growth



Part 1: Projection Analysis

Difference Between Valuations and Projections

■ Valuations

- Deterministic (best estimate results)
 - Point-in-time snapshot of current plan measures
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■ Projections

- Deterministic or stochastic (variable results)
- 50 years of future valuations
- Forecast of plan measures

What Is Included in Projections?

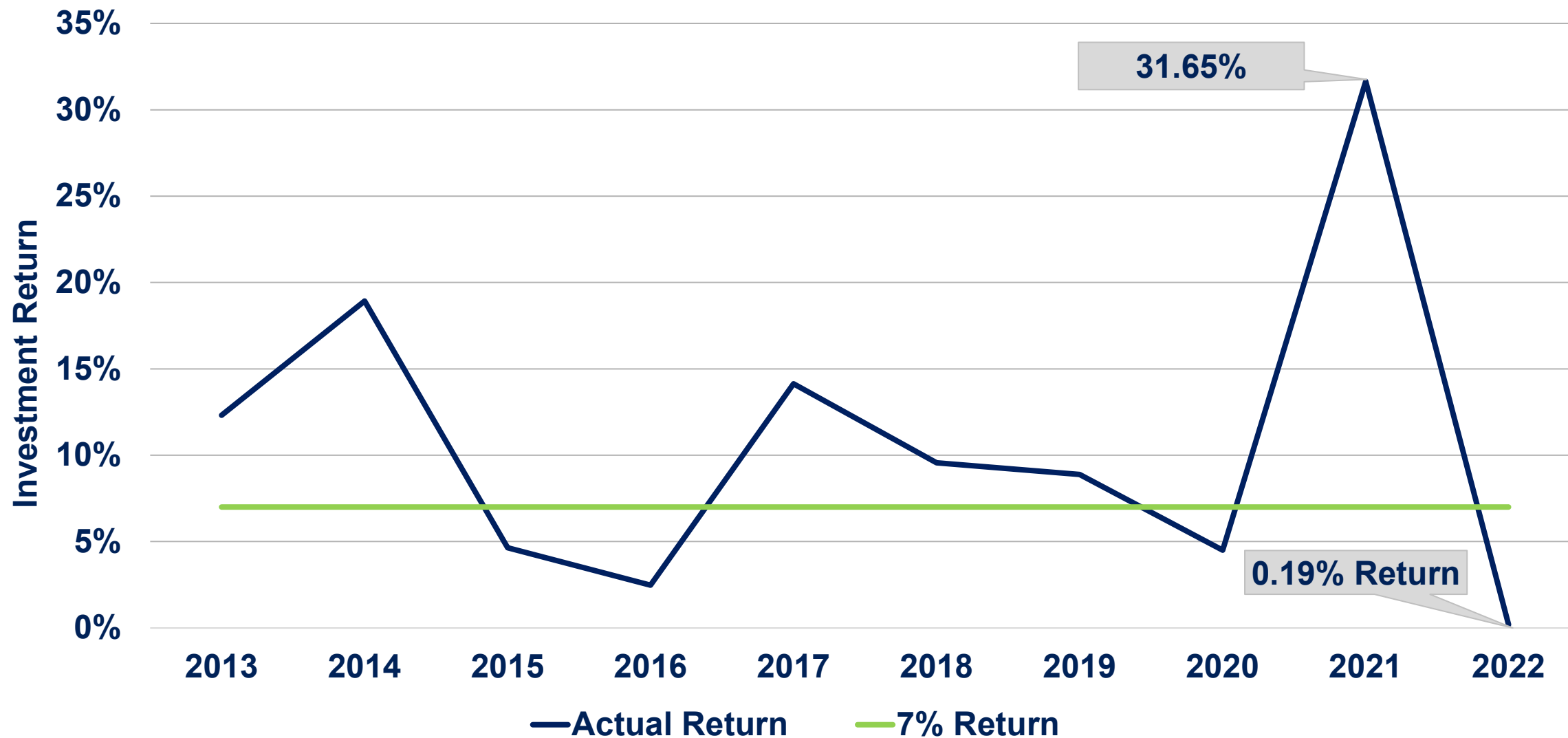
- Recognition of deferred investment gains/losses over time
- All future experience occurs as expected
- Assumptions regarding future new members joining the plan
- Stochastic projections model variability of investment earnings assumption
 - Includes 2,000 different scenarios of investment earnings
 - Likelihood of earnings provided by WSIB
 - Does not represent every possible outcome



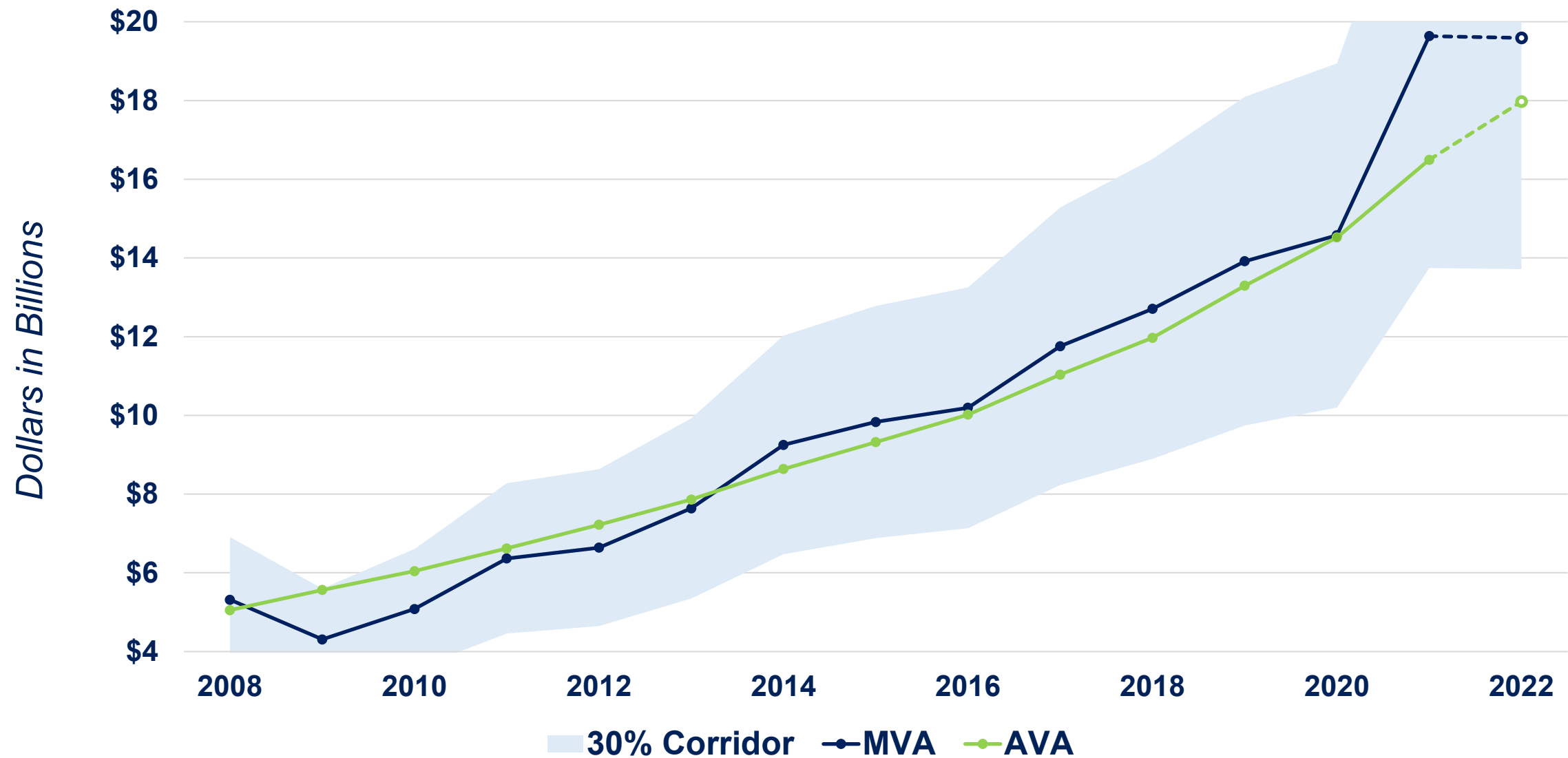
What Are Deferred Investment Gains/Losses?

- When actual earnings vary from expected (7.0%), investment gains/losses are smoothed over a period up to 8 years
- Actuarial Value of Assets (AVA) is asset smoothing method
- Aims to reduce market volatility that impacts plan measures
 - Funded status
 - Contribution rates
- Expect deferred gains/losses to offset over the long-term

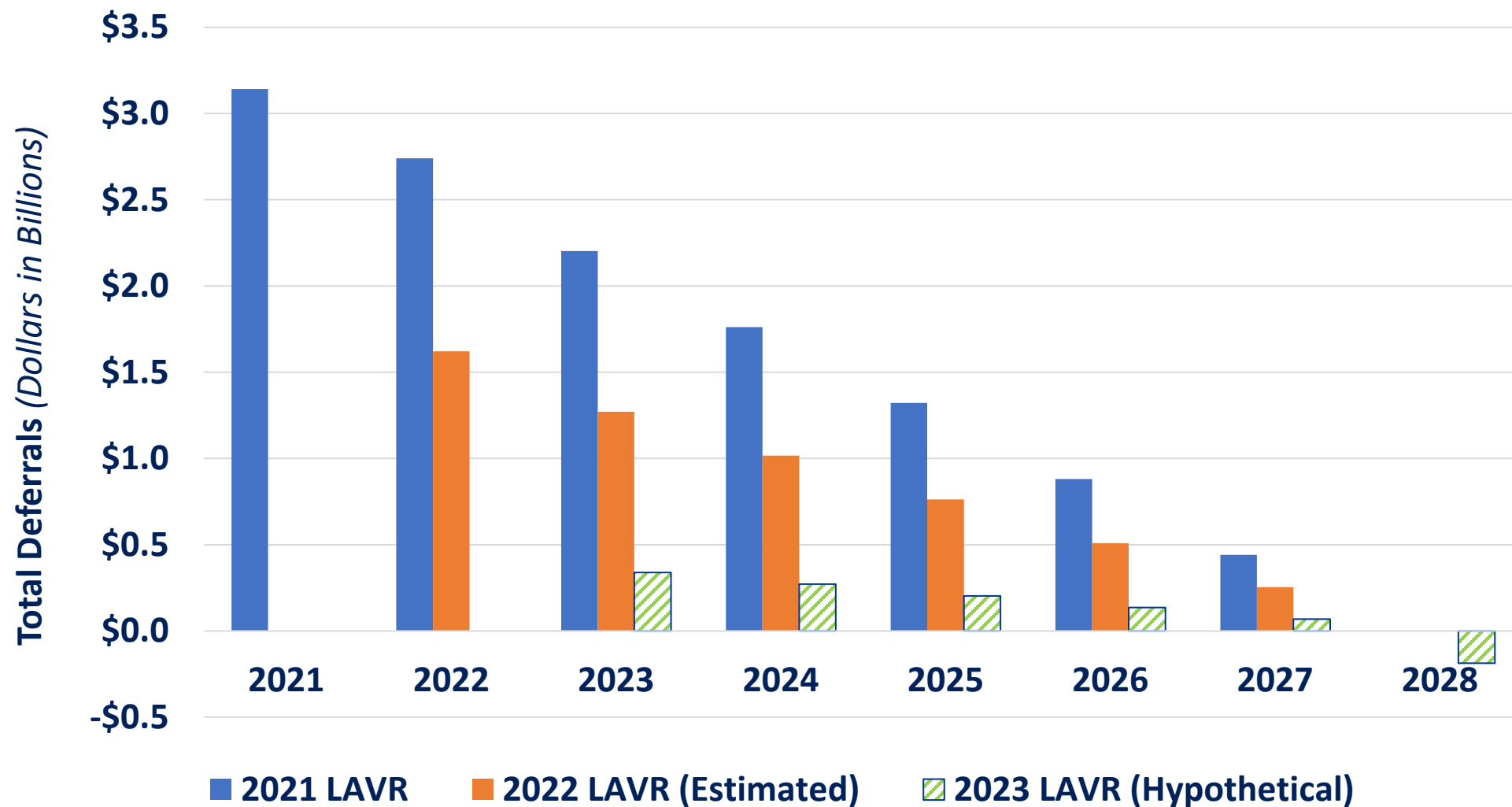
Historical Investment Returns



Actuarial Value of Assets Smooths Investment Gains/Losses



Projected Deferrals



Projection of Plan Measures

■ Funded Ratio

- Compares AVA to value of members' earned benefits
- 100% means there are enough assets to pay for earned benefits

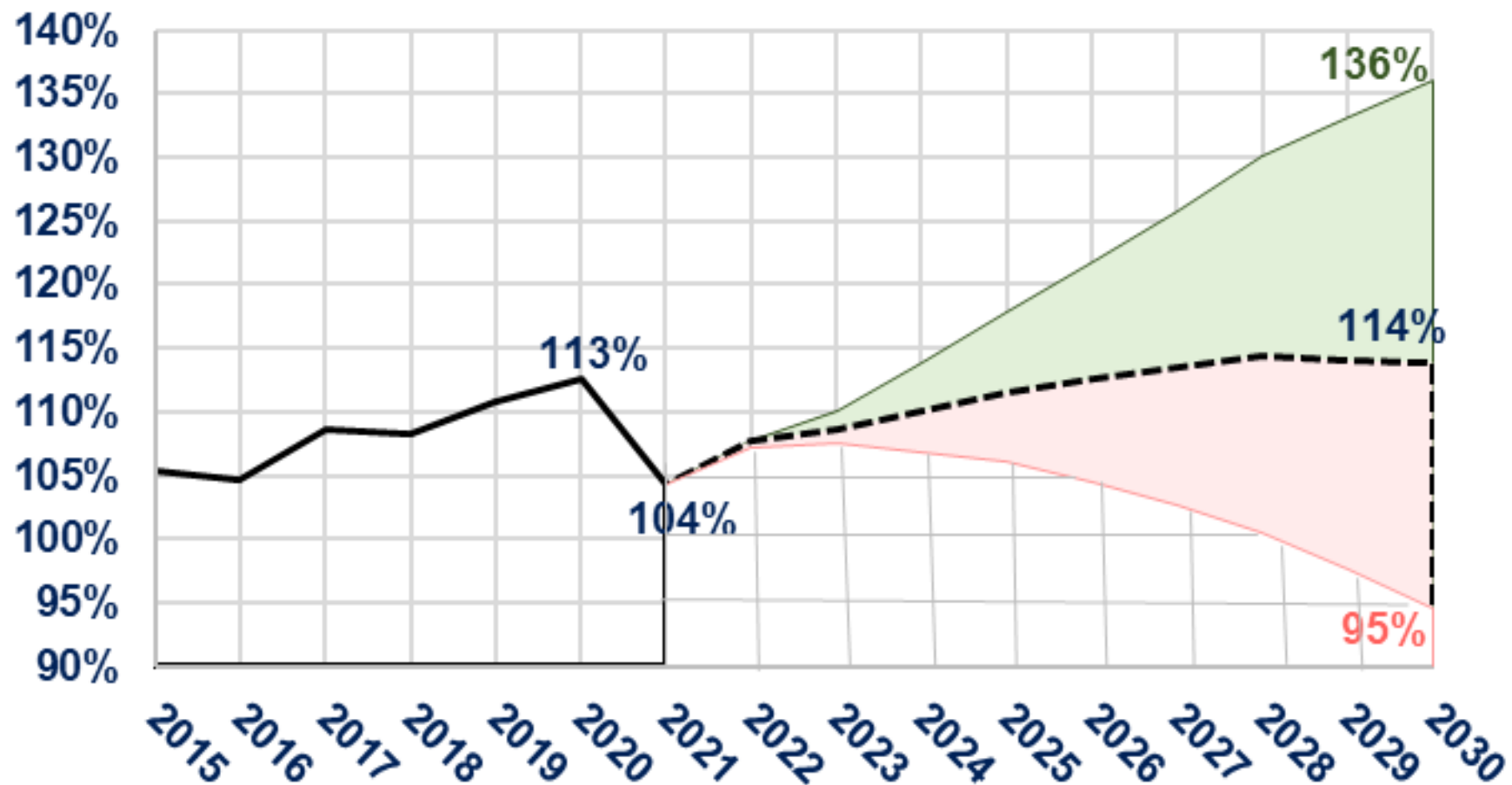
■ Contribution Rates

- Based on LEOFF 2 contribution rate policy under SHB 1701

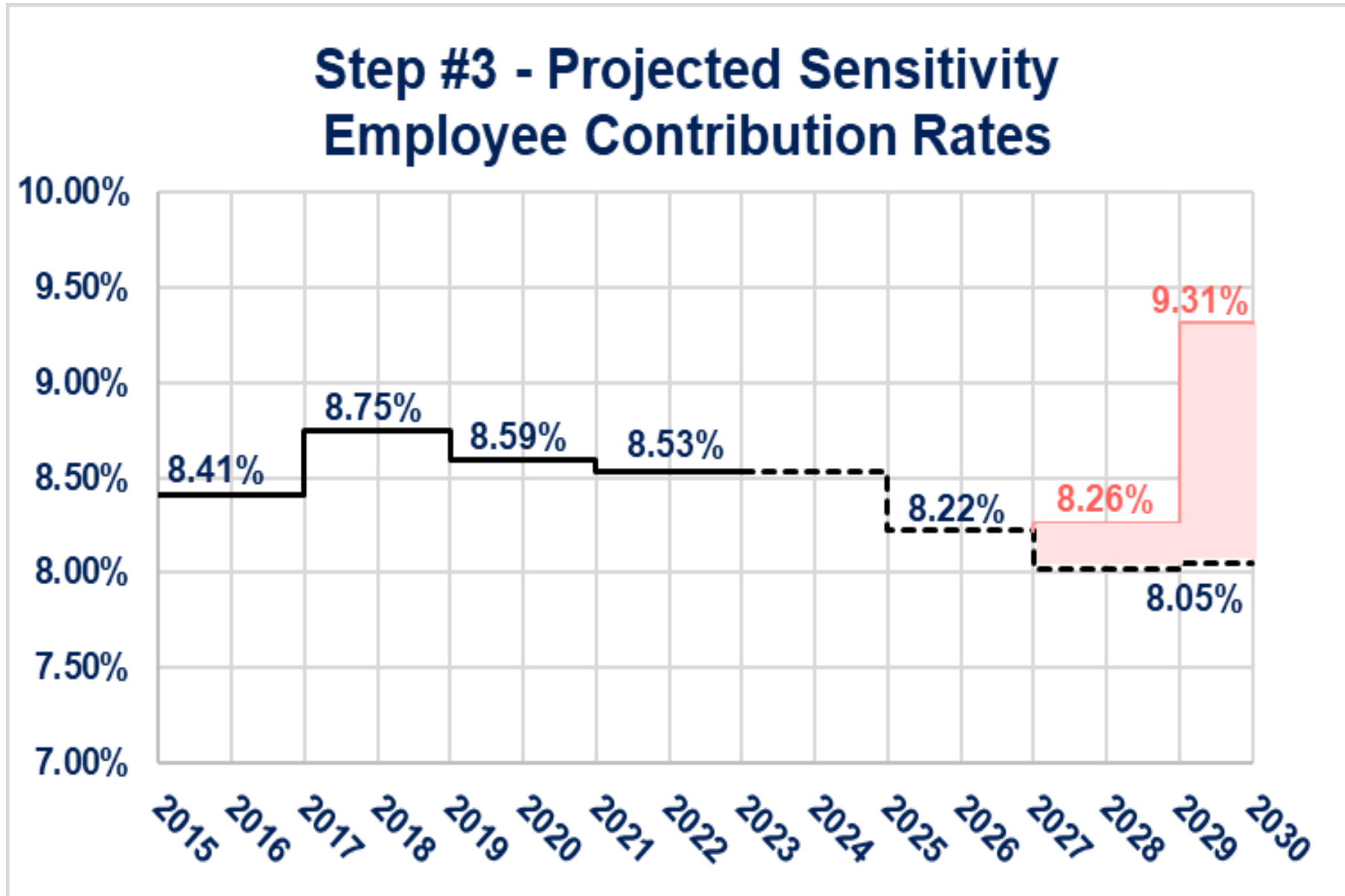
■ Projections are an estimate of the future funding progress of the plan and actual results may look significantly different

Funded Ratio Projection

Step #3 - Projected Sensitivity Funded Ratio



Employee Contribution Rate Projection



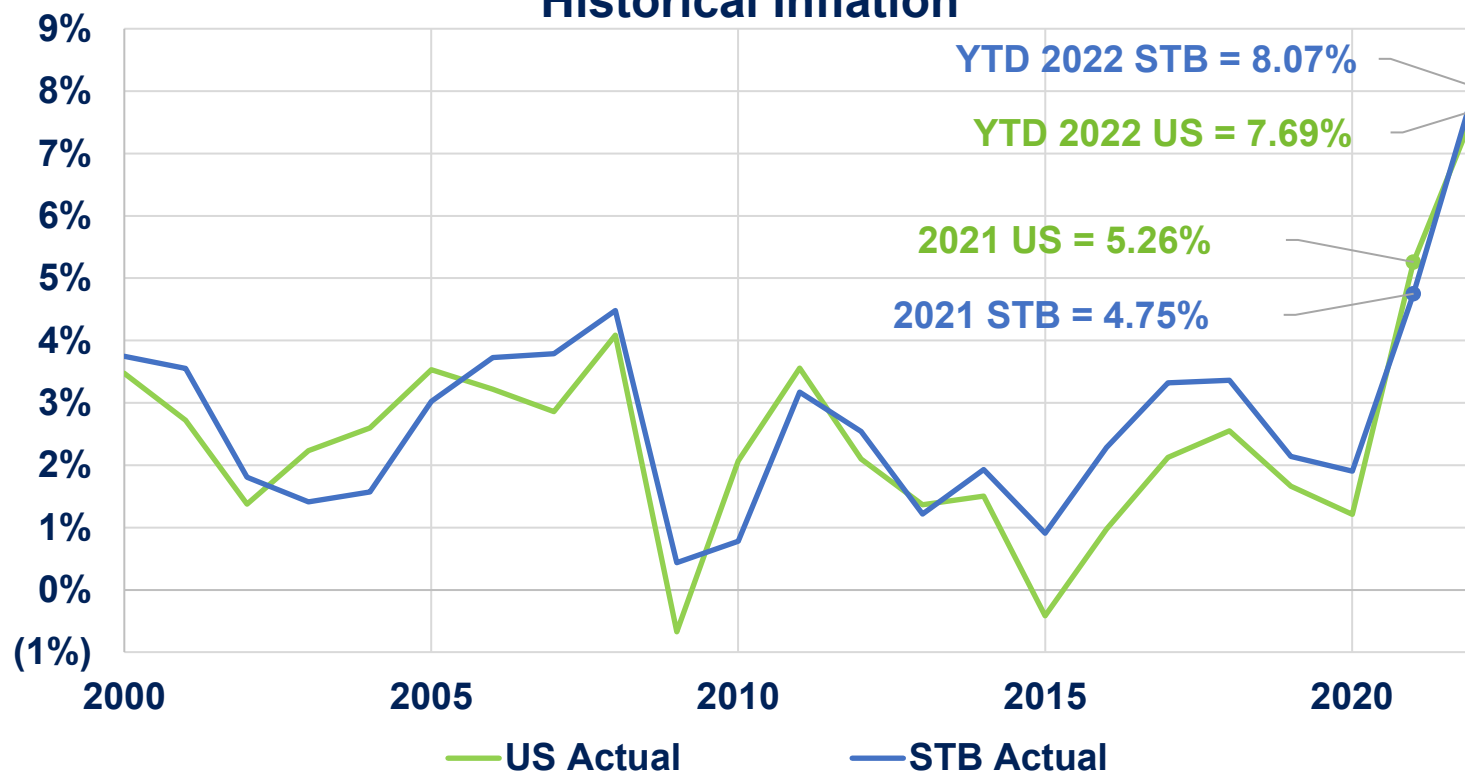
Part 2: Inflation Impacts

Inflation Background

- Measured based on Seattle-Tacoma-Bellevue (STB) CPI
- Current assumption is 2.75% per year
 - OSA studies this assumption in odd-numbered years as part of our Economic Experience Study (EES)
- Unexpected inflation impacts the plan in two ways
 - Possible adjustment to assumptions if long-term expectations change
 - Changes in plan cost reflecting difference in actual vs assumed inflation
 - Retiree member COLAs
 - Active member salaries

Historical and Forecasted Inflation

Historical Inflation



Median National Inflation Forecasts by Year

Horizon	10 Years	20-30 Years
2022	2.48%	2.44%
2021	2.30%	2.30%
2020	2.02%	1.67%
2019	2.18%	1.89%
2018	2.22%	2.19%

Source: Society of Actuaries presentation "Inflation - Effects, Forecasts, and Role in Pension Valuations", September 7, 2022.
 Note: Median of 8-10 expert inflation forecasters (e.g., Congressional Budget Office, Social Security Administration, Federal Reserve Bank).

- Our current long-term national inflation assumption is 2.35% per year
- Forecasts account for short-term volatility in the context of forecast horizon

Inflation Used to Determine Member COLAs

- Member COLAs are based off STB inflation
 - Capped at 3% increase per year
 - Includes banking feature
- Banking limits volatility and recognizes unexpected inflation over time
 - Somewhat analogous to deferred investment gains/losses

COLA Banking Example

Year	Inflation	COLA	Bank Change	Total Bank
2019	2.14%	2.14%	0.00%	0.00%
2020	1.90%	1.90%	0.00%	0.00%
2021	4.75%	3.00%	1.75%	1.75%
2022	8.00%	3.00%	5.00%	6.75%
2023	2.50%	3.00%	(0.50%)	6.25%
2024	1.00%	3.00%	(2.00%)	4.25%

Note: Inflation values for 2022 and beyond are hypothetical and for illustration only.

Inflation Can Drive Salary Growth Changes

- Active member salaries may increase to counter rising inflation
 - Difficult to estimate size and timing of unexpected salary growth
- Impact of larger than expected salary growth recognized in annual valuations

Impacts of High Inflation On Plan Measures

	If Retiree COLAs Increase More than Expected	If Active Salaries Increase More than Expected
Liability	↑	↑
Funded Ratio	↓	↓
Contribution Rates	↑	↑

- Long-term inflation assumption revisited every two years

What Did We Cover Today?

■ Projection Analysis

- Smoothing gains/losses aims to reduce volatility
- Over the next decade, funded ratio is trending toward 114% and employee contribution rates are trending toward 8%

■ Inflation Impacts

- Affects member COLAs and salary growth
- Periods of high inflation increase liability, lowering funded ratio and increasing contribution rates
- OSA will revisit long-term inflation assumption as part of next year's EES

Questions? Please Contact: The Office of the State Actuary

leg.wa.gov/OSA; state.actuary@leg.wa.gov

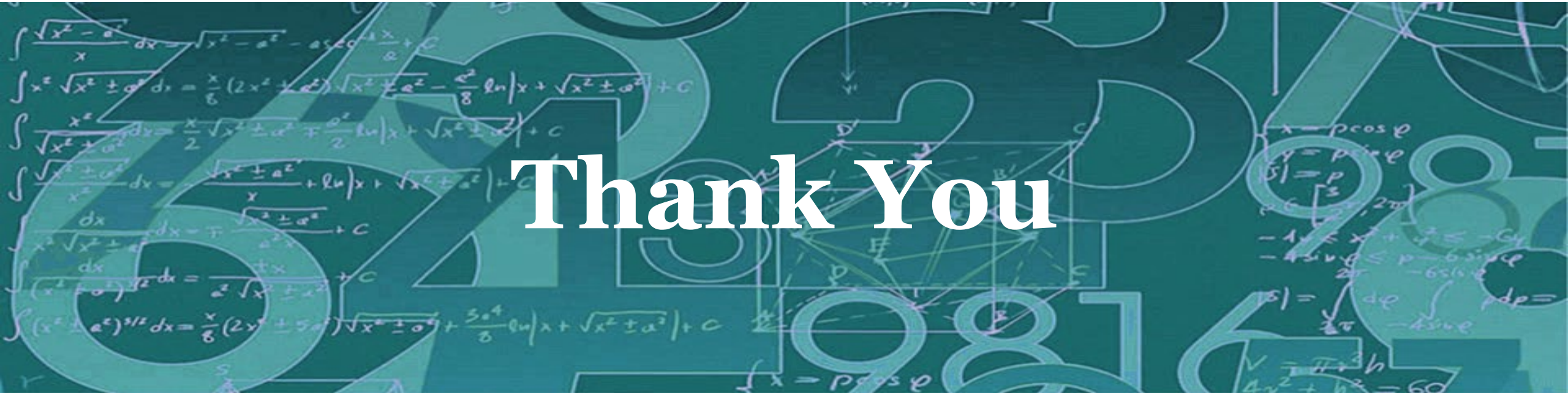
360-786-6140, PO Box 40914, Olympia, WA 98504

Lisa Won, ASA, FCA, MAAA, Deputy State Actuary

Frank Serra, Senior Actuarial Analyst

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Thank You

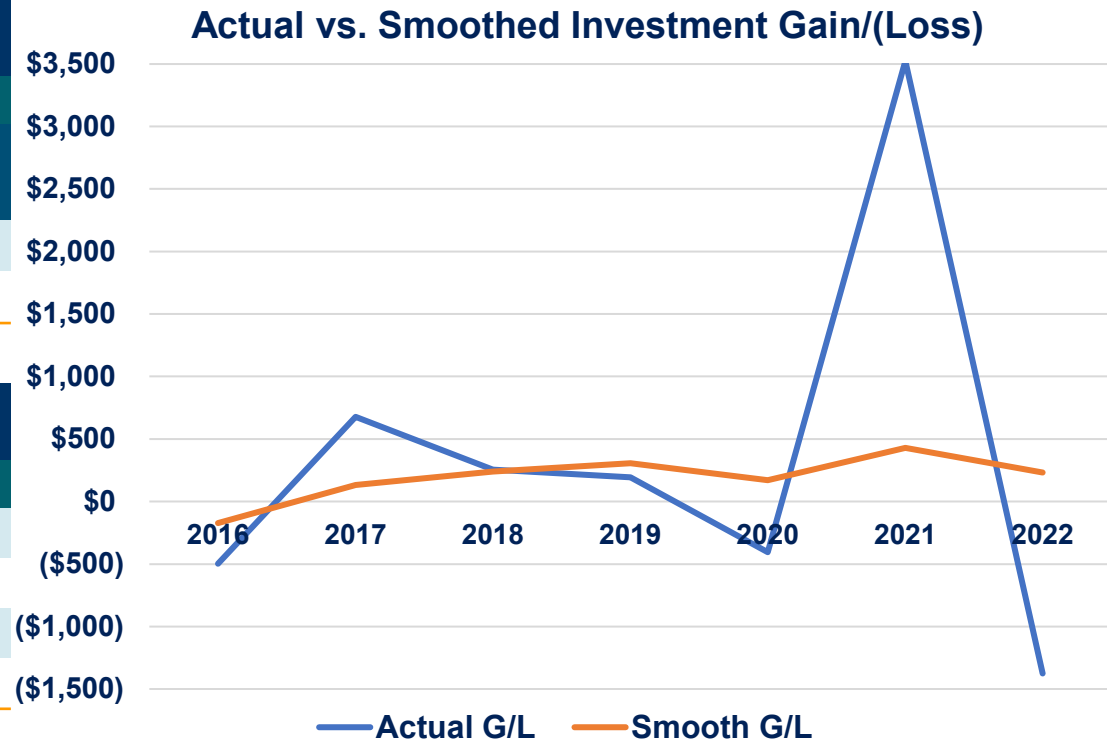


Appendix – Deferred Gains/Losses

- AVA is asset smoothing method that aims to reduce volatility
 - Smooth investment gains/losses over a period up to 8 years
- Expect deferred gains/losses to offset over the long-term

Investment Gain / (Loss)					
	Act Inv	Exp Inv	Smoothing	Per Year	
(\$ in M)	Earnings	Earnings	Gain / (Loss)	Years	Gain / (Loss)
2021	\$4,599	\$1,075	\$3,524	8	\$440
2022	\$36	\$1,340	(\$1,304)	7	(\$186)

Gain / (Loss) Smoothing					
(\$ in M)	2021	2022	2023	2024-2028	2029
Pre-2021	(\$11)	(\$38)	\$97	--	--
2021	\$440	\$440	\$440	\$440	--
2022	--	(\$186)	(\$186)	(\$186)	--
Total	\$429	\$216	\$351	\$254	\$0





Board Member Expectations

October 19, 2022

Excellence Starts with Understanding Expectations

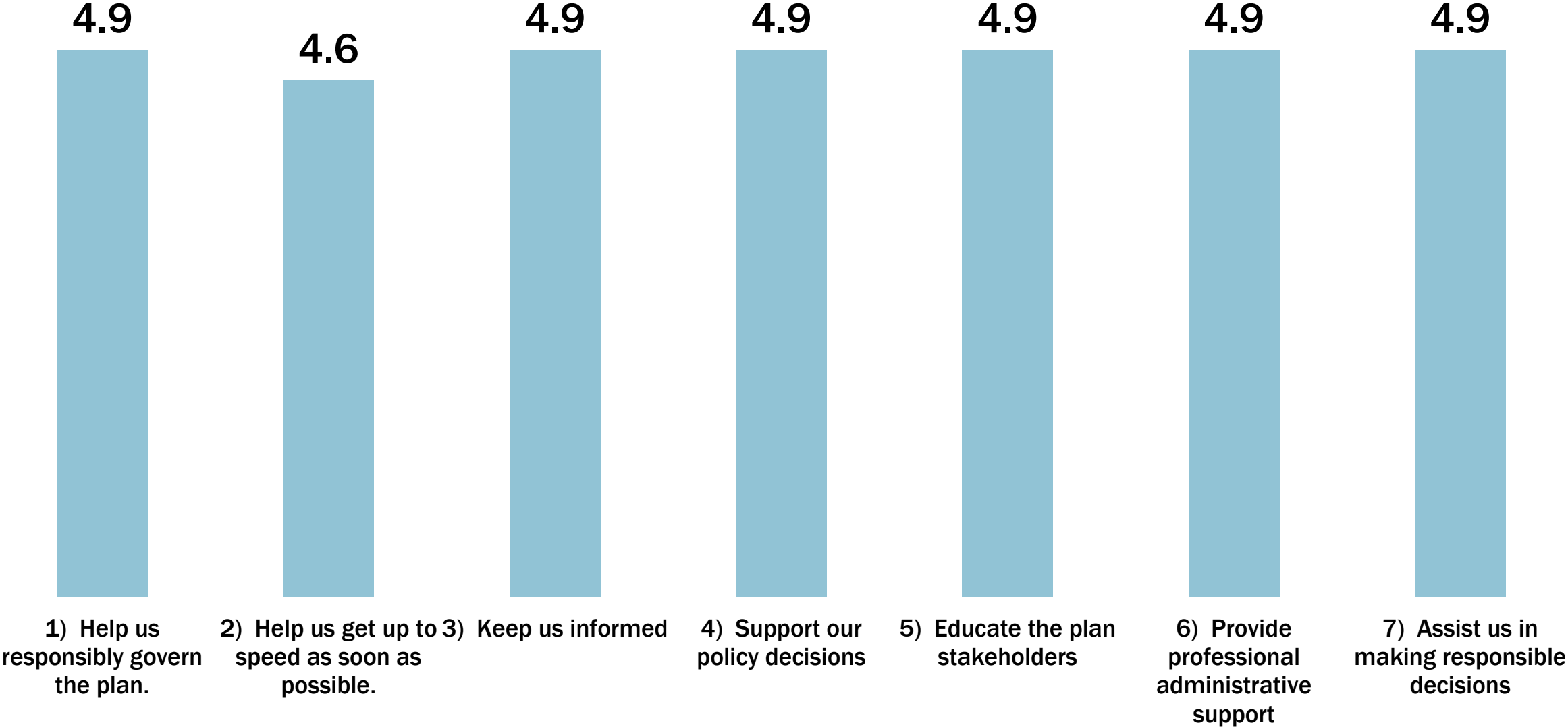
- You are our primary customers
 - Success for the team means meeting or exceeding your expectations
 - The team needs to be clear about Board member expectations as we develop processes to support your mission
 - The team needs feedback to ensure we are on the right track

Board Expectations

1. Responsibly govern the plan
2. Help us get up to speed as soon possible
3. Keep us informed
4. Support our policy decisions
5. Educate the plan stakeholders
6. Provide professional administrative support
7. Assist us in making responsible decisions

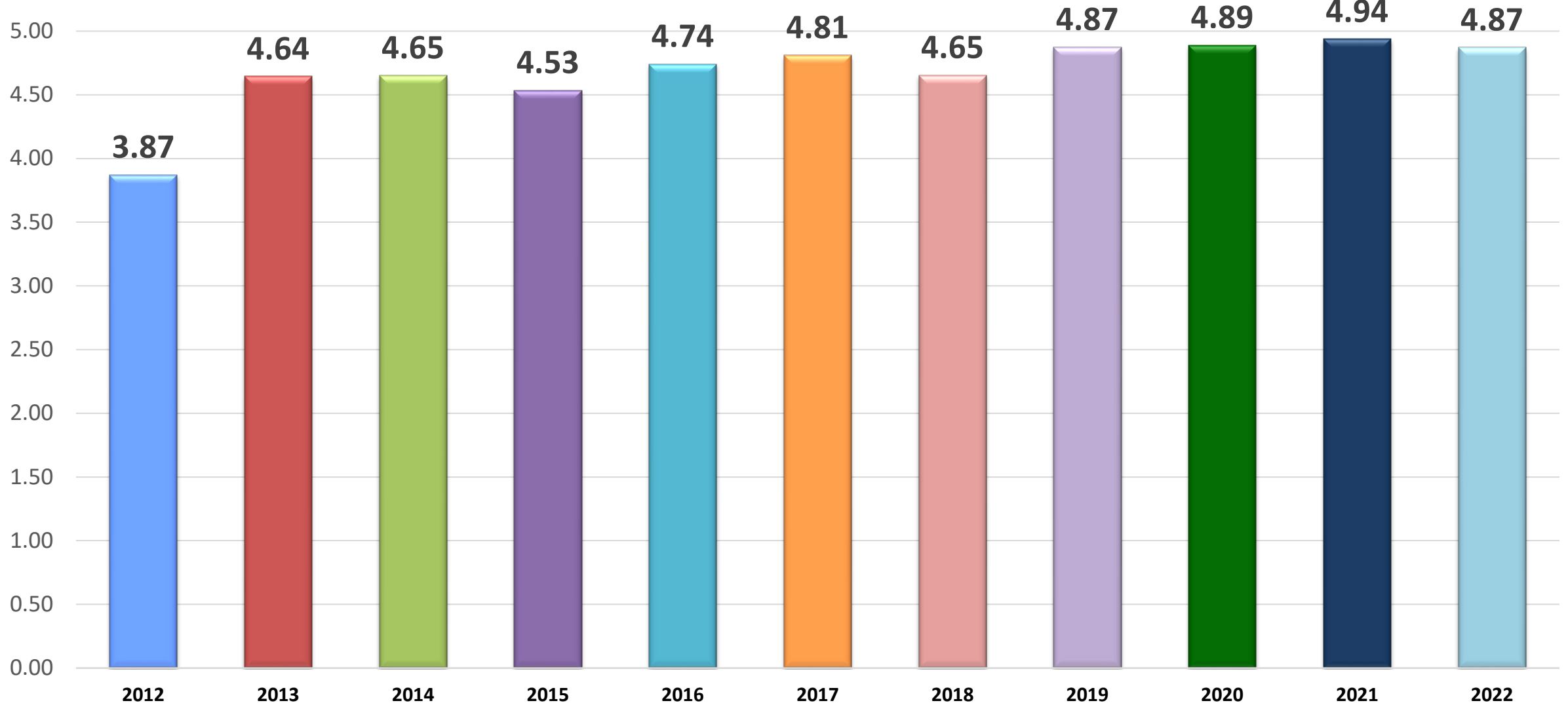
2022 Satisfaction by Expectation

5.0 = Extremely Satisfied

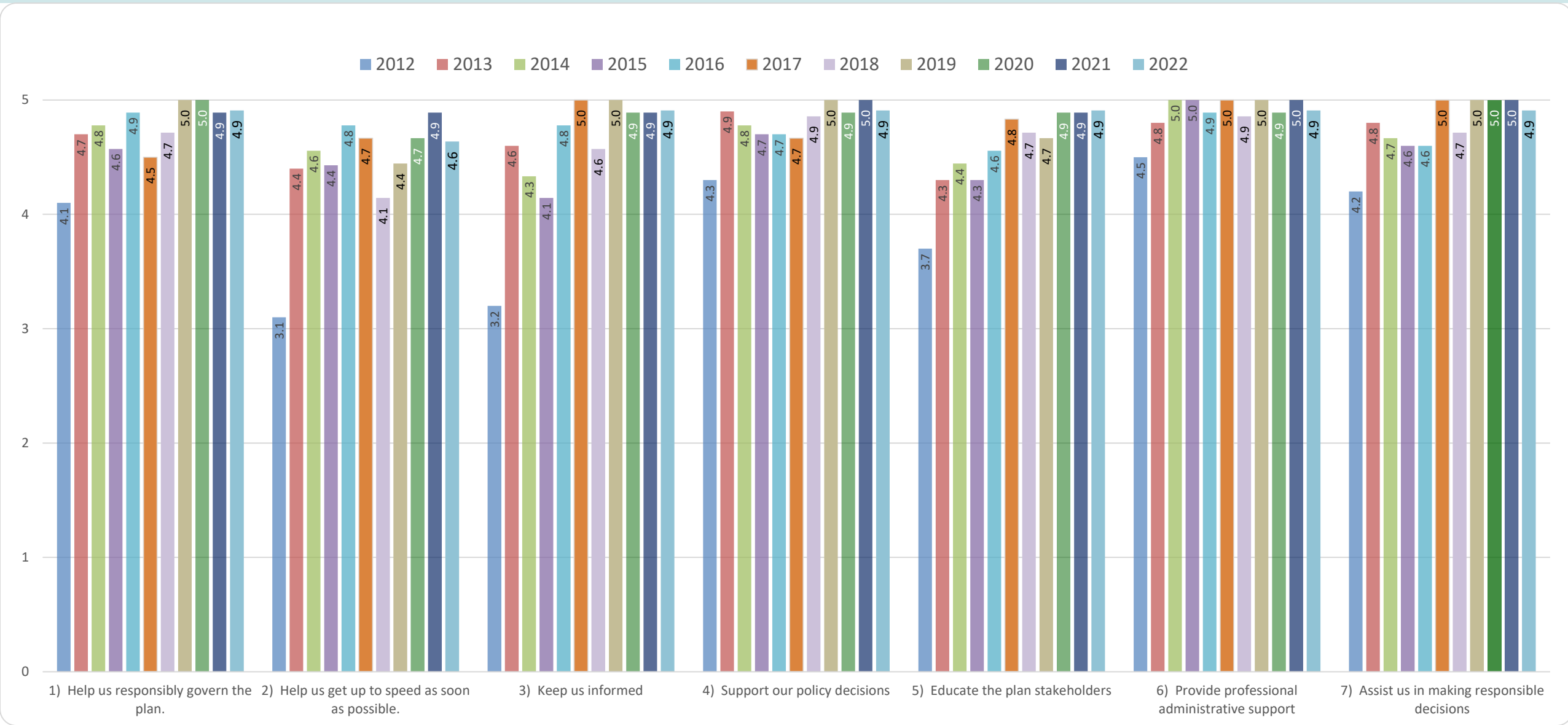


Satisfaction by Year 2012 - 2022

5.0 = Extremely Satisfied



Satisfaction by Question 2012 - 2022





Discussion

- **Clarity regarding expectations is key to success.**
- **Have any expectations changed, or new expectations emerged?**
- **What improvements will exceed your expectations?**

SWOT analysis is a method for identifying and analyzing/discussing internal strengths and weaknesses and external opportunities and threats (current and future potential) that shape current and future operations and help develop strategic goals.

- **Strengths:** characteristics of the organization that give it an advantage
- **Weaknesses:** characteristics that place the organization at a disadvantage
- **Opportunities:** elements in the environment that the organization could use to its advantage
- **Threats:** elements in the environment that could cause trouble for the organization

Strengths and weaknesses are usually considered *internal*, while opportunities and threats are usually considered *external*

SWOT ANALYSIS



SWOT ANALYSIS

SWOT ANALYSIS CONSIDERATIONS: These are the types of questions that organizations may ask to guide discussion about strengths, weaknesses, opportunities, and threats.

STRENGTHS

What is your competitive advantage?
What unique resources do you have?
What are you/organization doing well?
What is our strongest/best asset?
What unique resources can you draw on?
What do others see as your strengths?
What processes work successfully?

WEAKNESSES

Where/what could you improve?
What products/services are underperforming?
Where are you lacking resources?
Where do you have fewer resources than others?
What are others likely to see as weakness?
What are you detractors saying?
Do you have gaps on your team?
What do you need to be more successful?
What processes need to be improved?
What expertise or information do you lack?

OPPORTUNITIES

What trends are evident in the marketplace?
What trends might positively impact you?
What demographics are we not serving well?
What opportunities are open to you?
What trends could you take advantage of?
How can you turn your strengths into opportunities?
Are there products/services your customers ask for that you could provide?
What are your peers doing/offering which you could provide?
What new technology can you use?
Can you expand your operations?

THREATS

How easy is it for someone to poach key employees?
How would the loss of key employees affect you?
Are there any upcoming law or regulation changes that will impact you?
What are competitors doing?
How are consumer trends changing?
Are there new regulations that potentially could harm our operations or products?
What threats could harm you?
What is your competition doing?
What threats do your weaknesses expose to you?
Can you conduct business if a natural disaster strikes?



SWOT ANALYSIS

Fill out each quadrant with the strengths, weaknesses, opportunities, and threats that are unique to the Board. Use questions from page before as a guide to provoke thought and discussion.

<p style="text-align: center;"><u>STRENGTHS</u></p>	<p style="text-align: center;"><u>WEAKNESSES</u></p>
<p style="text-align: center;"><u>OPPORTUNITIES</u></p>	<p style="text-align: center;"><u>THREATS</u></p>

2023-2025 Strategic Plan

PRIORITY GOALS	1. Enhance the benefits for the members.	2. Provide the stakeholders with a voice in plan governance.	3. Maintain the financial integrity of the plan.	4. Inform the stakeholders.
OBJECTIVES	<ol style="list-style-type: none"> 1. Add benefits that are affordable for stakeholders 2. Identify viable alternative revenue sources for benefit enhancements 	<ol style="list-style-type: none"> 1. Enhance communication media for the stakeholders 2. Maintain stakeholder confidence in the integrity of the plan 	<ol style="list-style-type: none"> 1. Maintain prudent financial policies 2. Identify additional funding mechanisms 3. Maintain the stability of contribution rates 	<ol style="list-style-type: none"> 1. Manage expectations 2. Increase member understanding of the balance between desired enhancements and fiscal realities 3. Increase member understanding of the benefits provided in LEOFF 2 Plan
TACTICS	<ul style="list-style-type: none"> • Propose legislation that improves the plan for the stakeholders • Compare plans from other states and relevant organizations • Obtain stakeholder input for needed changes in the plan • Research and monitor Federal pension and tax laws • Monitor benefits for workers injured in the line of duty • Assess, evaluate, modify, or revise existing benefits 	<ul style="list-style-type: none"> • Provide opportunities for member communication/feedback • Take a leadership role in making presentations to stakeholder groups • Solicit information about stakeholder priorities and issues • Make presentations at public hearings • Maintain a wide range of communication media such as Web site, newsletter, and conference outreach • Inform stakeholders about opportunities for communication/feedback 	<ul style="list-style-type: none"> • Adopt adequate contribution rates • Adopt financially sustainable budget for board operations • Adopt economic assumptions, actuarial tables and cost methodologies • Commission independent audits • Research other options for revenue • Identify best practices from other states and organizations • Consult with strategic partners regarding rate stability • Ensure the reliability of rate projections • Provide information on the fiscal reality of the plan • Promote Fiduciary education 	<ul style="list-style-type: none"> • Provide stakeholder access to understandable fiscal and policy analysis • Provide additional DRS LEOFF 2 seminars and workshops throughout the state • Develop simple and direct forms of communication to the members • Provide comparison information to best practices in other states • Provide the LEOFF Actuarial Valuation Report as a tool for members

2023-2025 Strategic Plan

MEASURES

Goal	Method of Measurement	Target
4	Seminars and workshops devoted to the priorities of the Board	Make a minimum of five presentations before stakeholders each year
1	Board proposals that are approved by the Legislature	100% approval rate
1 & 2	Research supporting proposals	Every proposal includes a research component
2 & 4	Comprehensive communication program with targets and schedule	
2 & 4	Feedback from the membership	Conduct outreach at 4 stakeholder conferences Conduct expectation interviews/surveys with Trustees
2 & 3	Independent audits: <ul style="list-style-type: none"> Board expenses Actuary's assumptions 	Audit Targets <ul style="list-style-type: none"> Board expenses—no findings Actuary's assumptions—performed on timely basis
3	Deviation from the expected long-term cost of the plan	Maintain deviation within 10% of long-term cost
3	Current and appropriate funding policies	Review, revise and adopt funding policies for LEOFF Plan 2
3	Funded ratio under actuarial standards	At least 100%
3	Actual performance vs. projections in key planning areas	Actual expenditures will not exceed projected expenditures
2 & 4	Newsletter	Minimum of two per year

What do you see as the greatest risk to the plan?

- With the strength of our plan the legislators may look to fill budget shortfalls.
- Increasing retirements and lowered new hires.
- Potential legislative efforts to alter contributions adopted by the Board in response to decreased tax collections caused by the COVID crisis.
- Over promising new or expanded benefits without making commensurate adjustments to contribution rates.
- Establishment of socialized medicine causing an immediate mass retirement of those members between age 50 & 65 (Medicare eligibility) who remain employed due to availability/affordability of medical coverage.
- Sudden reduction in membership and participants.
- A repeat of the 2007-2008 downturn.
- Unsure

What do you see as the greatest strength of the plan?

- Our funding status
- LEOFF2 Management
- Adoption by the Board of conservative, stable contribution rates that result in funding levels that don't put benefits at risk and that are able to weather economic downturns without having to increase rates during those downturns.
- Adherence to fiscally responsible and actuarially sound management.
- Performance, reputation, 95% of the legislature has no institutional memory of plan governance prior to I-790 & the fact that legislative members are on the L2B.
- Management
- The LEOFF 2 staff
- Member strength and relationships with elected officials

2023 Board Meetings



January						
S	M	T	W	T	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
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29	30	31				

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August						
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29	30	31				

November						
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December						
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10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

MEETING LOCATION: Hybrid meetings will be held at 2100 Evergreen Park Dr
SW Olympia, WA 98502 and virtually via Microsoft Teams
CONTACT: Phone: 360.586.2320 Recep@leoff.wa.gov

Meeting Dates

State Holidays