LEOFF
Plan 2 Retirement Board

Contribution Rate Adoption

July 24, 2024

Issue

The Board may adopt contribution rates for the 2025 - 2027 and 2027 - 2029 biennia

LEOFF 2 Board Funding Policies

Board's goals – Fully funding plan and stable contribution rates

1. 4-year Rate Adoption
   - Adopted rates may still be updated with each new rate-setting valuation
2. Current Statutory Minimum Rate Funding Policy
   - The rate tier policy adopted in statute as part of benefit improvement legislation to manage expected impact of 2021 deferred gains

Minimum Rate Funding Policy	
Funded Ratio (FR)	**Minimum Rate***
1. FR less than 105%	100% EANC - Offset Rate
2. FR at least 105% but less than 110%	90% EANC - Offset Rate
3. FR at least 110%	80% EANC

**EANC is the Normal Cost under the Entry Age Normal cost method.*

Introduction

- Board has balanced the two funding goals using the expected long-term cost of the plan (normal cost of the EAN method) as the baseline
  - If all assumptions are met that is what the current plan provisions will cost
  - Will be stable and will fully fund the plan if assumptions are met
- Issues influencing rate decision
  1. Funding Method: Aggregate method is one method for calculating contribution rates, the Board has historically used the expected long-term cost of the plan
  2. OSA identified two costs of recent inflation: COLA banking modeling change and salary experience
  3. 4-year rate adoption: deferred gains being recognized and potential additional inflation costs

Aggregate and Minimum Rates

Under the plan funding policy, the contribution rate is the greater of:

- <u>**Aggregate Rates**</u>
  - Actuarial cost method for the plan originally set in statute
  - Rate fluctuates with plan experience and changes in assets
  - Rates can experience sharp changes when assumptions or benefit provisions change
- <u>**Minimum Rates**</u>
  - Calculated from expected long term cost of the plan (normal cost)
  - Different “tiers” of rates based on funded status
    - Rates can experience sharp changes when moving between tiers
  - New Offset Rate for BIA transfer

Current Contribution Rates

- The Board adopted rates for 2023 - 2025 and 2025 - 2027 biennia under 4-year rate adoption in July 2022
  - Member = 8.53%
  - Employer = 5.12%
  - State = 3.41%
- Included language to reassess 2025 - 2027 contribution rates based on results of 2023 Actuarial Valuation Report

Results of 2023 AVR

Contribution Rate Summary			
	Member	Employer	State
Current Adopted Rates*	8.53%	5.12%	3.41%
2023 Valuation			
Funded Status = 102%			
Contribution Rate = Aggregate	9.43%	5.66%	3.77%

Current Adopted Rates* → **Currently adopted rates for the 2025-27 Biennium.*

Contribution Rate Projections

- Deferred gains
  - $1.276 Billion
- Recent inflation experience has exceeded expectations
  - Unclear if salary experience will continue to exceed expectations
- Projections (see email from OSA in Board Materials)
  - In 2027, under current projections and if all current assumptions are realized, the funded ratio is expected to exceed 105%, when all the current deferred investment gains are recognized
    - See Appendix slide for OSA's methods and assumptions when making this assessment
  - This will trigger the rate reduction to 90% Minimum Rate tier

Funded Status

Changes to LEOFF 2 Funded Status	
Funded Status — 2021 Valuation	**104.3%**
Investment Returns/Recognizing Past Deferred Gains	2.4%
Plan Experience	(2.9%)
Funded Status — 2022 Valuation	**103.7%**
Investment Returns/Recognizing Past Deferred Gains	2.5%
Plan Experience	(3.0%)
COLA Banking Modeling Change	(1.5%)
Funded Status — 2023 Valuation	**101.7%**

Budget Impacts

Estimated LEOFF 2 Contributions - 2025-27 Biennium				
($ in Millions)	Member	Employer	State	Total
Currently Adopted Rates	**8.53%**	**5.12%**	**3.41%**	
Fiscal Year 2026	$259	$155	$103	$517
Fiscal Year 2027	$269	$161	$108	$538
2023 Valuation Rates	**9.43%**	**5.66%**	**3.77%**	
Fiscal Year 2026	$286	$172	$114	$572
Fiscal Year 2027	$297	$179	$119	$595
Change in Contributions	**0.90%**	**0.54%**	**0.36%**	
Fiscal Year 2026	$27	$16	$11	$55
Fiscal Year 2027	$28	$17	$11	$57

Totals may not agree due to rounding.

See Appendix slide for OSA's methods and assumptions when determining budget impacts

COLA Banking Methodology Change

- Recent inflation experience means that all members who retired prior to June 30, 2023 will receive a 3% COLA until their bank is exhausted (perhaps 15+ years)
- COLA methodology change from 2.75% to 3% only applies to current annuitants in 2023 valuation (data as of June 2022) due to their COLA banks growing from recent high inflation
- Current active members don't have a COLA bank so assumption remains 2.75%
- COLA banking methodology change did not increase EANC component of Minimum rate calculation
  - EANC represents the cost of benefits for active members only

Option 1: Leave the rates already adopted, step up to 9.2% over 5 years beginning in FY 2028

- Pros – Balances stable contribution rates with fully funding the plan; gives additional time for experience to play out and see what the long-term effect will be; gives employers and members time to prepare for increasing rates (if necessary)
- Cons – Miss out on investment returns from increased contribution rates in the 2025 - 2027 biennium
- COLA Banking Methodology Change – The methodology change is incorporated but since the EANC is not increased the incorporation of the methodology change has no effect on Minimum rates. The cost of the methodology change will be reflected in the funding ratio of the plan
- History – The Board had instances in the past where rates were predicted to temporarily decrease in the short term and then rise, the Board chose to keep the rates stable through that short term volatility. Similar to what the Board is facing know, except a temporary increase instead of a temporary decrease

Option 1: Rate Table

Fiscal Year	Member Rate	Employer Rate	State Rate
2026	8.53%	5.12%	3.41%
2027	8.53%	5.12%	3.41%
2028	8.66%	5.20%	3.46%
2029	8.80%	5.28%	3.52%
2030*	8.93%	5.36%	3.57%
2031*	9.07%	5.44%	3.63%
2032*	9.20%	5.52%	3.68%

*If necessary

Option 2 - Begin step up to 9.2% immediately over 5 years

- Pros – Begin step up in rates earlier to capture additional contributions and potentially investment gains in the 2025 - 2027 biennium
- Cons – Contribution rate increase may turn out to be unnecessary if current actuarial projections are met
- COLA Banking Methodology Change – The methodology change is adopted; Since the EANC is not increased the adoption of the assumption has no effect on Minimum rates. The cost of the methodology change will be reflected in the funding ratio of the plan
- History – Board has previously stepped up rate increases in annual increments

Option 2: Rate Table

Fiscal Year	Member Rate	Employer Rate	State Rate
2026	8.66%	5.20%	3.46%
2027	8.80%	5.28%	3.52%
2028	8.93%	5.36%	3.57%
2029	9.07%	5.44%	3.63%
2030*	9.20%	5.52%	3.68%

*If necessary

Option 3: Adopt aggregate rate for 2025 – 2027 and 2027-2029 biennia

- Pros – Rates fully reflect recent plan experience; captures potential investment gains in 2025 - 2027 biennium
- Cons – Does not meet goal of rate stability; rates would go up 9.43% immediately; increase in contribution rates may be unnecessary if current actuarial projections are met
- COLA Banking Methodology Change – The methodology change is incorporated; full impact of the change is reflected in rates immediately
- History – Board has historically not used aggregate funding method because of rate volatility, particularly when there is a significant assumption change

Option 3: Rate Table

Fiscal Year	Member Rate	Employer Rate	State Rate
2026	9.43%	5.68%	3.77%
2027	9.43%	5.68%	3.77%
2028*	9.43%	5.68%	3.77%
2029*	9.43%	5.68%	3.77%

*Board will have opportunity to reassess 2027 - 2029 contribution rates based on results of 2025 Actuarial Valuation Report

Board Action

- Option 1: Leave the rates already adopted for 2025 - 2027, and in FY 2027 begin step up to 9.2% over 5 years. Incorporate COLA banking methodology change proposed by OSA.
- Option 2: Begin step up to 9.2% immediately over 5 years. Incorporate COLA banking methodology change proposed by OSA.
- Option 3: Adopt aggregate rate of 9.43% for 2025 – 2027 and 2027 - 2029 biennia instead of the expected long-term cost of the plan (normal cost). Board will reevaluate the rates for the 2027-2029 biennium. Incorporate the COLA banking methodology change proposed by OSA.

Thank You

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Actuarial Disclosures – Slide 8

- Using our (OSA) professional judgement as well as reviewing the preliminary 2023 AVR and our most recent published projections, we believe it's reasonable to assume, at this time, that the LEOFF 2 funded status would exceed 105% at the June 30, 2027 measurement date.

- We made this assessment assuming contribution rates follow current law funding policy and all plan experience matches current assumptions. This means Minimum Rates would be expected to reduce consistent with the 105% funded status tier calculation.

- Actual funded status will depend on actual plan experience, adopted contributions, and any changes to plan provisions, assumptions, or methods. We're happy to replace this qualitative analysis with our updated projections available later this year.

- We prepared this analysis at your request and to inform the LEOFF 2 Board's contribution adoption at their July 2024 meeting. This analysis may not be appropriate for other purposes. This analysis will become outdated. Please do not rely on this analysis beyond the current rate adoption cycle.

- Kyle Stineman, ASA, MAAA served as the reviewing and certifying actuary for this analysis. Please let us know if you have questions or need additional information.

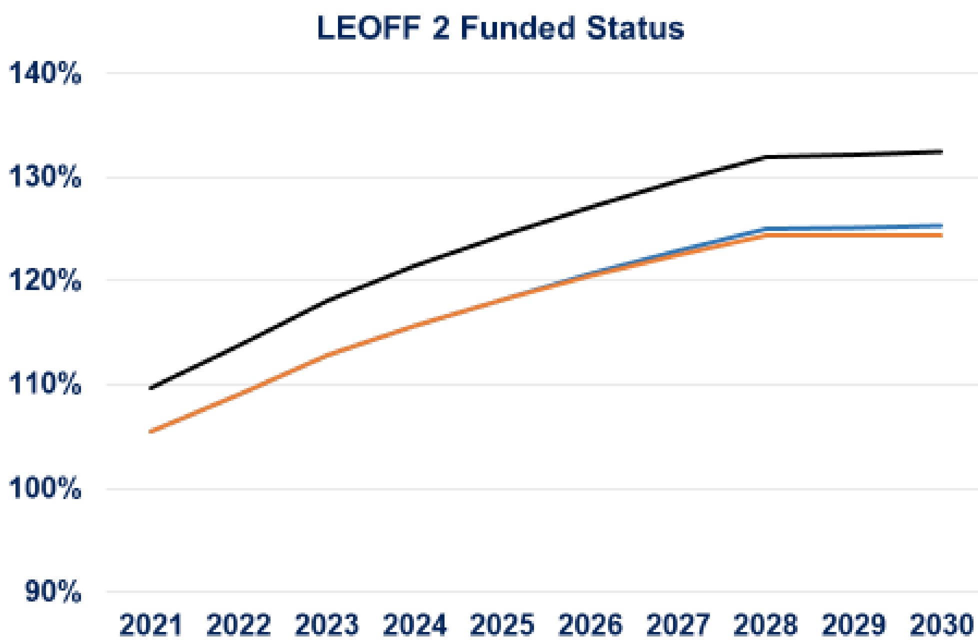
Actuarial Disclosures – Slide 10

- The budget estimates are calculated by multiplying the respective contribution rates by projected salaries in the 2025-27 Biennium. We estimated salaries for this period by projecting the total salary for LEOFF 2 from the 2023 Actuarial Valuation Report with assumed 0.80% system growth and 3.25% general salary growth. Please see the Projection and Risk Assumptions Study and 2023 Economic Experience Study for the development of the system growth and general salary growth assumptions, respectively.

- We produced these budget impacts to assist the Board in understanding the costs of changing the currently adopted contribution rates. Please don't use this information for other purposes. These budget estimates will vary to the extent that actual total salaries differ from this projection. We are available to update this analysis in the future.

- Kyle Stineman, ASA, MAAA served as the reviewing and certifying actuary for this budget estimate. Please let us know if you have questions or need additional information.

Draft Bill with 0.70% Reduction to Rates: Funded Status and Contribution Rates



Total Employer Contribution Rates

Biennium	Current Law	Draft Bill	Offset
2023-25	8.53%	8.53%	8.53%
2025-27	8.32%	9.01%	8.31%
2027-29	8.36%	9.04%	8.34%
2029-31	8.40%	9.08%	8.38%

**Selected flat 0.70% reduction to draft bill contribution rates for illustrative purposes only. Actual offset calculation may vary in magnitude, duration, and timing.*

*Source: December 2021 Presentation by OSA