

# Multiple Agency Fiscal Note Summary

<b>Bill Number:</b> 6563 SB	<b>Title:</b> LEOFF plans 1 and 2 merger
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## Estimated Cash Receipts

NONE

## Estimated Expenditures

Agency Name	2011-13			2013-15			2015-17		
	FTEs	GF-State	Total	FTEs	GF-State	Total	FTEs	GF-State	Total
Office of the State Actuary	.2	0	0	.2	0	0	.2	0	0
Department of Retirement Systems	.0	0	16,350	.0	0	0	.0	0	0
Law Enforcement Officers' and Fire Fighters' Plan 2 Retirement Board	1.4	0	334,057	1.8	0	382,652	1.0	0	219,312
Actuarial Fiscal Note - State Actuary	.0	0	(74,900,000)	.0	0	700,000	.0	0	400,000
<b>Total</b>	<b>1.6</b>	<b>\$0</b>	<b>\$(74,549,593)</b>	<b>2.0</b>	<b>\$0</b>	<b>\$1,082,652</b>	<b>1.2</b>	<b>\$0</b>	<b>\$619,312</b>

## Estimated Capital Budget Impact

NONE

<b>Prepared by:</b> Jane Sakson, OFM	<b>Phone:</b> 360-902-0549	<b>Date Published:</b> Final 2/ 6/2012
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\* See Office of the Administrator for the Courts judicial fiscal note

\*\* See local government fiscal note

FNPID 31699

# Individual State Agency Fiscal Note

<b>Bill Number:</b> 6563 SB	<b>Title:</b> LEOFF plans 1 and 2 merger	<b>Agency:</b> 035-Office of State Actuary
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## Part I: Estimates

**No Fiscal Impact**

**Estimated Cash Receipts to:**

NONE

**Estimated Expenditures from:**

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.2	0.2	0.2	0.2	0.2
<b>Account</b>					
<b>Total \$</b>					

**Estimated Capital Budget Impact:**

NONE

*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: Erik Sund	Phone: 360-786-7454	Date: 02/01/2012
Agency Preparation: Kelly Burkhart	Phone: 360-786-6142	Date: 02/03/2012
Agency Approval: Lisa Won	Phone: 360-786-6150	Date: 02/03/2012
OFM Review: Jane Sakson	Phone: 360-902-0549	Date: 02/04/2012

Request # -1

## 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 impacts the Law Enforcement Officers' and Firefighters' (LEOFF) Retirement System by merging the assets and liabilities of LEOFF 1 and LEOFF 2; expanding and modifying the authority of the LEOFF 2 Board (Board), which includes the authority to establish contribution rates, funding methods and assumptions, and recommend benefit improvements for LEOFF 1. The Office of the State Actuary (OSA) provides services to the Board as documented under RCW 44.44.04(7), chapter 2, Laws of 2003.

### 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.*

This proposed merger expands the scope of services and duties of the Board. OSA assumes this expansion will increase the actuarial services provided to the Board. It is further assumed that there will be no offsetting workload reduction for OSA to the Select Committee on Pension Policy due to this merger. OSA will incur one-time expenses to establish the initial combined actuarial valuation and on-going expenses to produce the combined annual valuations thereafter. OSA will also incur increased on-going expenses to consult and provide actuarial analysis which may include, but is not limited to the following:

- Prepare preliminary and final fiscal notes on all board-proposed pension legislation
- Perform an annual actuarial valuation
- Prepare an annual actuarial valuation report
- Perform experience studies as required by law
- Prepare an experience study report as required by law
- Prepare all other actuarial studies and reports as required by law
- Consult with the board concerning the determination of actuarial assumptions and methods
- Consult with the board concerning actuarial issues as may be requested from time to time

The above-listed functions will increase our agency expenditures as detailed in Part III (Expenditure Detail).

### Part III: Expenditure Detail

#### III. A - Expenditures by Object Or Purpose

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.2	0.2	0.2	0.2	0.2
A-Salaries and Wages	21,441	21,441	42,882	42,882	42,882
B-Employee Benefits	4,698	4,698	9,396	9,396	9,396
C-Personal Service Contracts					
E-Goods and Services	2,373	2,373	4,746	4,746	4,746
G-Travel					
J-Capital Outlays					
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements	(28,512)	(28,512)	(57,024)	(57,024)	(57,024)
T-Intra-Agency Reimbursements					
9-					
<b>Total:</b>	\$0	\$0	\$0	\$0	\$0

#### III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2012	FY 2013	2011-13	2013-15	2015-17
Actuary	11,889	0.1	0.1	0.1	0.1	0.1
Administrative Assistant	5,185	0.0	0.0	0.0	0.0	0.0
Senior Actuarial Analyst	8,415	0.1	0.1	0.1	0.1	0.1
Senior Policy Analyst	8,845	0.0	0.0	0.0	0.0	0.0
State Actuary	14,488	0.0	0.0	0.0	0.0	0.0
<b>Total FTE's</b>	48,822	0.2	0.2	0.2	0.2	0.2

### Part IV: Capital Budget Impact

NONE

### 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.*

# Individual State Agency Fiscal Note

<b>Bill Number:</b> 6563 SB	<b>Title:</b> LEOFF plans 1 and 2 merger	<b>Agency:</b> 124-Department of Retirement Systems
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## Part I: Estimates

No Fiscal Impact

### Estimated Cash Receipts to:

NONE

### Estimated Expenditures from:

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.1	0.0	0.0	0.0	0.0
<b>Account</b>					
Department of Retirement Systems	16,350	0	16,350	0	0
Expense Account-State 600-1					
<b>Total \$</b>	16,350	0	16,350	0	0

### Estimated Capital Budget Impact:

NONE

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- 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: Erik Sund	Phone: 360-786-7454	Date: 02/01/2012
Agency Preparation: George Pickett	Phone: 360-664-7950	Date: 02/02/2012
Agency Approval: Marcie Frost	Phone: 360-664-7224	Date: 02/02/2012
OFM Review: Cherie Berthon	Phone: 360-902-0659	Date: 02/02/2012

Request # 12-003-1

## 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 consolidates the trust funds for both Plan 1 and Plan 2 of the Law Enforcement Officers' and Fire Fighters' (LEOFF) Retirement System into one fund for all LEOFF members and retirees. The following sections of the bill impact the Department of Retirement Systems (DRS):

- Section 1: Identifies contribution rates for employers, members and the state from the first of the month in which the section takes effect, through June 30, 2013.
- Section 2: States that due to the temporary nature of section 1, it will not be codified.
- Section 3: Updates RCW 41.26.080 to state that future contribution rates for LEOFF Plan 1 members will be established by the LEOFF Board beginning July 1, 2013.
- Sections 4 and 8: Identifies one fund for all LEOFF members by striking references to separate plans and funds.
- Section 5: Adds a new section stating that LEOFF members will be entitled to retirement benefits identical to the benefits they would have received in their participating plan (Plan 1 or Plan 2) prior to the merger.
- Section 6: Changes definitions and adds the definition of "System" to refer to LEOFF Retirement System.
- Section 9: Provides that the adoption of actuarial tables, assumptions and costs, as identified by the LEOFF Board, are not subject to legislative revision if certified by the State Actuary as reasonable.
- Section 10: Establishes funding ratios for the combined Plan 1 and Plan 2 benefits between member, employer and state contributions.
- Section 11: Changes the LEOFF Plan 2 expense fund into an expense fund covering both plans, and it removes the expense fund from the allotment process.
- Section 20: Grants the LEOFF Board the authorization to pay legal fees directly from the LEOFF trust fund.
- Section 21: Provides that Section 1 takes effect immediately.

### 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.*

#### ADMINISTRATIVE ASSUMPTIONS

- The rates in Sections 1 and 10 do not include administrative fees.
- Port Authorities and Universities are covered in the rate reduction outlined in Section 1.
- Current retirement benefit structures and membership rules will remain separate and unchanged for each plan.
- The Office of Financial Management (OFM) will create a combined trust fund for LEOFF Plan 1 and LEOFF Plan 2.

- The balance of the current LEOFF 1 and 2 funds will be consolidated into this fund.
- There can be separate contribution rates for each plan.
- Because of the possibility of separate contribution rates for each plan, DRS will maintain the distinction between LEOFF 1 and LEOFF 2 when accounting for incoming contributions and billings to the new LEOFF fund.
- DRS will apply for plan qualification with the Internal Revenue Service (IRS).

The assumptions above were used in developing the following workload impacts and cost estimates.

## FISCAL SERVICES

Fiscal staff will be responsible for the following tasks as it pertains to implementation of this bill:

- Preparation and testing of system updates and accounting/reconciliation spreadsheets
- Edits to the Comprehensive Annual Financial Report
- Test and review updated AFRS reports
- Coordination with the Office of State Treasurer, the State Investment Board, and OFM regarding investing and reporting of contributions and benefit payments related to the combined LEOFF fund and consolidation of contributions in the closing LEOFF fund
- Staff training

Fiscal Analyst 3 – 80 hours (salaries/benefits) = \$2,671

Total Estimated Benefits/Customer Service Costs = \$2,671

## PLAN QUALIFICATION

As a part of our standard practice, DRS will seek a plan qualification determination from the Internal Revenue Service (IRS) for the merger of LEOFF 1 and LEOFF 2. External tax counsel, however, has recommended that the state seek a new determination letter from the IRS as part of the next Cycle C process in 2014. As a result, there will not be additional costs for plan qualification outside of the normal process for all systems and plans. Funds for the full Cycle C process will be requested in the 2013-15 budget process, if necessary.

## AUTOMATED SYSTEMS

The Department of Retirement Systems' (DRS) automated systems will require modifications to implement this bill.

Information Technology Specialist 4 – 12 hours (salaries/benefits) = \$519

Programming, testing, and verification – 128 hours @ \$95 per hour = \$12,160

DES\*cost of \$500 per week for 2 weeks = \$1,000

Total Estimated Automated Systems Costs = \$13,679

\*cost for mainframe computer processing time and resources at the Department of Enterprise Services

ESTIMATED TOTAL COST TO IMPLEMENT THIS BILL:

2011-13

FISCAL SERVICES = \$2,671

PLAN QUALIFICATION = \$0

AUTOMATED SYSTEMS = \$13,679

ESTIMATED TOTAL COSTS = \$16,350

### Part III: Expenditure Detail

#### III. A - Expenditures by Object Or Purpose

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.1		0.0		
A-Salaries and Wages	2,374		2,374		
B-Employee Benefits	816		816		
C-Personal Service Contracts					
E-Goods and Services	13,160		13,160		
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					
9-					
<b>Total:</b>	\$16,350	\$0	\$16,350	\$0	\$0

#### III. B - Detail: List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA

Job Classification	Salary	FY 2012	FY 2013	2011-13	2013-15	2015-17
Fiscal Analyst 3	51,552	0.0		0.0		
Info Tech Specialist 4	69,348	0.0		0.0		
<b>Total FTE's</b>	120,900	0.1		0.0		0.0

### Part IV: Capital Budget Impact

NONE

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.

Rules will need to be updated.

# Individual State Agency Fiscal Note

Revised

<b>Bill Number:</b> 6563 SB	<b>Title:</b> LEOFF plans 1 and 2 merger	<b>Agency:</b> 341-LEOFF 2 Retirement Board
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## Part I: Estimates

No Fiscal Impact

**Estimated Cash Receipts to:**

NONE

**Estimated Expenditures from:**

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.8	2.0	1.4	1.8	1.0
<b>Account</b>					
Law Enforcement Officers' and Firefighters Retirement System Plan 2 Expense Acct-Non-Appropriated 548-6	127,193	206,864	334,057	382,652	219,312
<b>Total \$</b>	127,193	206,864	334,057	382,652	219,312

**Estimated Capital Budget Impact:**

NONE

*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: Erik Sund	Phone: 360-786-7454	Date: 02/01/2012
Agency Preparation: Dianna Wilks	Phone: (360) 664-7666	Date: 02/03/2012
Agency Approval: Steve Nelsen	Phone: 360-586-2323	Date: 02/03/2012
OFM Review: Jane Sakson	Phone: 360-902-0549	Date: 02/03/2012

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## 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.*

#### LEOFF Plan1/Plan 2 Fund Merger (SB 6563)

SB 6563 financially combines the LEOFF Plan 1 and LEOFF Plan 2 retirement funds. The benefits do not change for either plan, but the combined fund would be responsible for the liabilities of both plans. The merger reduces the state contribution rate for the remainder of 2011-13 biennium to 0.00%, and it does not change the LEOFF Plan 1 member rates already at 0.00%. SB 6563 moves LEOFF Plan 1 governance under the LEOFF Board including adopting all actuarial assumptions and setting rates in the future. It specifies that contribution rates and actuarial assumptions adopted by the Board would not be subject to legislative revision and provides that all expenses of the LEOFF Board will be paid out of the LEOFF retirement fund. The Board is also authorized to use the retirement fund for any legal expenses related to protecting the fund.

The proposed merger expands the scope of services and duties for the LEOFF Plan 2 agency. The LEOFF Plan 2 Board/agency currently serves 16,775 active members, and 1,639 retirees and beneficiaries. Merging LEOFF Plan 1 and LEOFF Plan 2 will add 301 active members and 8,008 annuitants (2010 Actuarial Valuation Report).

The LEOFF Board trust fund will incur a one-time expense to establish each FTE and ongoing salary thereafter. A summary of the impact of each position requested is provided below:

#### Research Analyst

- Collects, organizes, and analyzes data regarding pension related issues.
- Develops and recommends policy proposals concerning pension benefits, funding, and administration for Board consideration.
- Provides research, analysis, and prepares reports on benefit issues.
- Drafts or reviews, analyzes, and interprets pension-related legislation, coordinating with Board members, legislators, committees, legislative staff, or executive branch officials as directed.
- Researches tax consequences of changes in pension statutes.
- Presents topics of a complex and technical nature at Board meetings.
- Responds to inquiries from constituents, legislative and executive branch officials, providing information on pension legislation and related issues.
- Prepares bill analysis and background materials for Board proposals and fiscal notes.

#### Administrative Assistant 4

- Provides administrative support to an eleven member Board and agency staff.
- Responds to inquiries, questions, and correspondence on LEOFF Retirement Board matters.
- Composes, edits, and types correspondence.
- Coordinates monthly Board meetings including agenda and material preparation.
- Manages mail including distribution, review and handling of correspondence needing immediate action.
- Acts as agency's Public Disclosure Officer.
- Prepares minutes for Administrative Committee meetings and monthly Board meetings.

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- Sets up and maintains files of correspondence and records.
- Participates in strategic and staff planning processes.
- Coordinates with Deputy Director and budget staff in preparing request packages and budget-related responses to the legislature.
- Directs and/or coordinates special projects.
- Coordinates agency matters within the agency and with other governmental agencies and stakeholders.
- Performs delegated technical duties for the LEOFF Retirement Board.
- Supply and inventory coordinator.

The above listed functions will increase our agency expenditures as detailed in Part III (Expenditure Detail).

## **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.*

The expenditure assumptions include 2 FTE's; salaries and benefits for one Administrative Assistant at \$48,168 annually (Reduced to \$46,723 due to 3% reduction in FY 12 and FY 13) and one Research Analyst at \$79,200 (Reduced to \$76,824 due to 3% reduction in FY 12 and FY 13). Goods and Services includes one-time costs for both employees; new desks \$3,774, partitions to create working spaces \$3,000, desk chairs \$800, side chairs \$300, file cabinets \$550, bookcases \$600, laptops and accessories \$6,150 and phones \$330 for a total of \$15,504. Then the overhead costs of supplies additional phone lines, internet costs, payroll costs, software for a total of \$9,860; plus travel costs of approx \$4,952 per year.

The salary and benefits are calculated as 5 months in FY 12 (Feb-June) 12 months in FY 13 and FY 14. In FY 15, 7 months for the Research Analyst and 12 months for the AA4. Then in FY 16 and FY 17 12 months for the AA4 only.

There will be additional costs for work performed by the Office of the State Actuary in the amount of \$28,512 per year.

### Part III: Expenditure Detail

#### III. A - Expenditures by Object Or Purpose

	FY 2012	FY 2013	2011-13	2013-15	2015-17
FTE Staff Years	0.8	2.0	1.4	1.8	1.0
A-Salaries and Wages	51,478	123,547	175,025	221,736	96,336
B-Employee Benefits	16,887	40,529	57,416	75,340	37,400
C-Personal Service Contracts					
E-Goods and Services	38,372	37,836	76,208	75,672	75,672
G-Travel	4,952	4,952	9,904	9,904	9,904
J-Capital Outlays	15,504		15,504		
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements					
T-Intra-Agency Reimbursements					
9-					
<b>Total:</b>	\$127,193	\$206,864	\$334,057	\$382,652	\$219,312

#### III. B - Detail: List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA

Job Classification	Salary	FY 2012	FY 2013	2011-13	2013-15	2015-17
Administrative Assistant 4	48,168	0.4	1.0	0.7	1.0	1.0
Research Analyst (Band 2)	79,200	0.4	1.0	0.7	0.8	
<b>Total FTE's</b>	127,368	0.8	2.0	1.4	1.8	1.0

### Part IV: Capital Budget Impact

NONE

### 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.

# Individual State Agency Fiscal Note

<b>Bill Number:</b> 6563 SB	<b>Title:</b> LEOFF plans 1 and 2 merger	<b>Agency:</b> AFN-Actuarial Fiscal Note - State A
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## Part I: Estimates

No Fiscal Impact

**Estimated Cash Receipts to:**

NONE

**Estimated Expenditures from:**

	FY 2012	FY 2013	2011-13	2013-15	2015-17
<b>Account</b>					
All Other Funds-State 000-1	(18,200,000)	(56,700,000)	(74,900,000)	700,000	400,000
<b>Total \$</b>	(18,200,000)	(56,700,000)	(74,900,000)	700,000	400,000

**Estimated Capital Budget Impact:**

NONE

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- Requires new rule making, complete Part V.

Legislative Contact: Erik Sund	Phone: 360-786-7454	Date: 02/01/2012
Agency Preparation: Aaron Gutierrez	Phone: 360-786-6152	Date: 02/06/2012
Agency Approval: Matt Smith	Phone: 360-786-6147	Date: 02/06/2012
OFM Review: Jane Sakson	Phone: 360-902-0549	Date: 02/06/2012

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## **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**

NONE

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

NONE

## **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.*

**SUMMARY OF RESULTS**

This bill merges the Plan 1 and Plan 2 retirement funds of the LEOFF Retirement System, and places LEOFF 1 under the governance of the LEOFF Board (Board). The bill also lowers the state's contribution rate to LEOFF 2 to zero for the remainder of the 2011-13 Biennium.

<b>Impact on Contribution Rates (Effective 3/1/2012 - 6/30/2013)</b>	
<b>Fiscal Years 2011-2013 State Budget</b>	<b>LEOFF</b>
Employee (Plan 2)	0.00%
Total Employer	0.00%
Total State	(3.38%)

<b>Budget Impacts</b>			
<i>(Dollars in Millions)</i>	<b>2011-2013</b>	<b>2013-2015</b>	<b>25-Year</b>
<b>General Fund-State</b>	(\$79.3)	\$0.7	(\$78.0)
<b>Local Government</b>	\$0.0	\$1.1	\$1.5
<b>Total Employer</b>	(\$79.3)	\$1.8	(\$76.5)

*Note: We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.*

**HIGHLIGHTS OF ACTUARIAL ANALYSIS**

The reduction of the state's contribution results in a short-term savings to the state and a long-term cost to the LEOFF system from the loss of assumed investment earnings on the forgone state contributions. However, under the assumed funding policy of the merged plan, we expect the savings from the merger will offset the long-term cost of these forgone contributions resulting in an expected net savings to the state of \$78 million over the next 25 years.

If all our assumptions are realized in the future, LEOFF 1 will have a surplus (more assets than needed to cover all projected benefits). Instead of addressing the LEOFF 1 surplus at the end of the plan's life after all benefits have been paid, we assume the funding policy of the merged plan will apply the expected surplus to the future contribution requirements of the merged plan resulting in an expected long-term savings from reduced contribution requirements.

The fiscal impact of the merger, however, depends heavily on future economic outlooks and the assumed funding policy for the merged plan. For example, under pessimistic outlooks, where LEOFF 1 would have insufficient assets in the future to cover all projected benefits, the merger results in a combined cost to employers and Plan 2 members of \$570 million over the next 25 years. This combined cost could increase to \$1.1 billion under funding policies that recognize the expected surplus faster under these pessimistic outlooks.

See the remainder of this fiscal note for further details on the summary and highlights presented here plus additional risk analysis.

## WHAT IS THE PROPOSED CHANGE?

### Summary Of Change

This bill impacts the following systems:

- ❖ Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 1 and Plan 2.

Effective Date: Section 1 of this bill (establishing rates for LEOFF 2) is effective immediately upon passage. All remaining sections are effective 90 days after session.

This bill makes several changes to current statute. The following changes impact the pricing of this bill.

1. Merging the LEOFF 1 and LEOFF 2 retirement funds.
2. Retaining pre-merger benefits after the merger.
3. Setting 2011-13 rates for LEOFF 2.
4. Modifying the authority of the Board, which includes the authority to establish contribution rates, funding methods and assumptions for the merged plan.
5. Changing current funding policy and assumptions for LEOFF 1.
6. Establishing a cost-sharing method for the merged plan.

### ***Merging Retirement Funds***

Section 4 of the bill strikes the words "Plan 1" from the Plan 1 fund and strikes all references to the Plan 2 fund. For purposes of this pricing, we assume this means that the Plan 2 fund will be closed, all assets merged into the retitled Plan 1 fund ("LEOFF fund"), and the LEOFF fund will serve as the fund for the combined plan.

We further assume that the Plan 2 Benefit Improvement Account (see RCW 41.26.805), which is a subaccount of the Plan 2 fund, will not be closed when the Plan 2 fund is closed, but will instead become a subaccount of the LEOFF fund.

### ***Retaining Benefits***

Section 5 of the bill states that plan participants are entitled to the same benefits immediately after the merger as immediately prior to the merger including, but not limited to, any benefits provided to active or retired members of Plan 1 by city or county disability boards. For purposes of this pricing, we assume this means that benefits for plan members will not be diminished by the merger.

***Setting 2011-13 Rates For LEOFF 2***

Section 1 of the bill sets contribution rates for Plan 2 for the 2011-13 Biennium. Beginning on the first of the month in which the section takes effect, contribution rates are set as follows:

- ❖ 8.46 percent member.
- ❖ 5.08 percent employer.
- ❖ 0.00 percent state.

***Modifying Board Authority***

Section 3 of the bill requires the Board to establish contribution rates for Plan 1 beginning July 1, 2013.

Section 16 of the bill states that the Board must adopt rates for both Plan 1 and Plan 2 no later than July 31, 2012, and then in every even-numbered year thereafter. This section further states that rates adopted by the Board are not subject to legislative revision if the rates are certified as reasonable by the state actuary.

For purposes of this pricing, we assume these provisions mean the Board will have prospective authority to establish rates for Plan 1 as of the effective date of the bill.

Sections 9 and 13 of the bill state that the Board's authority to adopt tables, assumptions, and methods is no longer subject to legislative revision if the Board's action is certified as reasonable by the state actuary.

***Changing LEOFF 1 Funding Policy and Assumptions***

Section 12 strikes the provision stating that it is a goal of the Legislature to fully amortize the total costs of Plan 1 by June 30, 2024.

Section 15 strikes a similar provision that required the Pension Funding Council (PFC) to adopt rates for Plan 1 at the level needed to fully amortize the total costs of the plan by June 30, 2024.

Section 13 of the bill removes a reference to Plan 1 from a subsection of RCW 41.45.035 that set a new growth in salaries assumption as of July 1, 2009. It is unclear what the resulting growth in salaries assumption would be. We assumed a Plan 1 general salary growth of 4.0 percent in pricing this bill. We considered changing the assumption to match the 4.5 percent assumption in LEOFF 2, but determined the differences in assumptions are immaterial for LEOFF 1 due to the small number of active members remaining in the plan.

Section 18 of the bill removes a reference to Plan 2 in the statute establishing the supplemental rate process for Plan 2. We assume this means the supplemental rate process applies to Plan 1 and Plan 2.

***Establishing Cost-Sharing Method***

Section 10 of the bill states that the cost of benefits for the combined Plan 1 and Plan 2 will be apportioned using the cost sharing structure currently in place for Plan 2:

- ❖ 50 percent member.
- ❖ 30 percent employer.
- ❖ 20 percent state.

**What Is The Current Situation?**

***Retirement Funds***

Two separate funds exist in the Treasury for use in funding and paying LEOFF benefits:

- ❖ LEOFF Plan 1 Retirement Fund.
- ❖ LEOFF Plan 2 Retirement Fund.

***Rates For LEOFF 2***

The rates currently in effect for LEOFF 2 and adopted by the Board until 2017 are as follows:

- ❖ 8.46 percent member.
- ❖ 5.08 percent employer.
- ❖ 3.38 percent state.

(See the LEOFF 2 2009 Actuarial Valuation Report.)

***Board Authority***

The LEOFF 2 Board was created in 2003 to serve as fiduciaries and generally provide oversight to LEOFF 2.

Oversight for LEOFF 1 is provided by the Legislature, the PFC, and the Select Committee on Pension Policy.

***Current Funding Policy***

The Legislature has stated its intent to fully amortize the costs of LEOFF 1 by June 30, 2024, and the PFC is directed to adopt biennial “basic rates” for LEOFF 1 that are sufficient to achieve this goal. Currently, RCW 41.26.080 provides that no contribution is required for LEOFF 1 unless the most recent actuarial valuation report shows the plan has unfunded liabilities. For purposes of this pricing under current law scenarios only, we assumed the state would be solely responsible for amortizing any unfunded LEOFF 1 liabilities in the future.

In addition to basic rates, DRS must charge supplemental rates to pay for the cost of additional benefits provided to members.

The current salary growth assumption for LEOFF 1 is set in RCW 41.45.035 as the sum of the inflation growth and productivity growth, which equals 4 percent. This assumption excludes merit and longevity increases.

### Who Is Impacted And How?

For purposes of this pricing, we assume the bill does not change benefits of any members of LEOFF Plan 1 or 2.

This bill impacts all 16,775 active LEOFF 2 members through increased or decreased contribution rates depending on future economic outlooks and Board-adopted funding policy for the merged plan. If the Board adopts contribution rates for LEOFF 1 members, the bill could impact the remaining 301 LEOFF 1 active members (as of June 30, 2010) through increased contribution rates.

### WHY THIS BILL HAS A COST AND WHO PAYS FOR IT

#### Why This Bill Has A Cost Or Savings

We found two provisions of this bill that could have costs/savings: (1) the reduction of state funding to LEOFF during 2011-13 and (2) the merger of assets and liabilities.

- ❖ **Impact from Reduction of State Funding** – The reduction of the state's contribution results in a short-term savings to the state and a long-term cost to the LEOFF system from the loss of assumed investment earnings on the forgone state contributions.
- ❖ **Impact from Merger** – As shown in the table below, if all our assumptions are realized ("expected" column), the surplus (or negative unfunded liability) in LEOFF 1 will fall to \$996 million in 2016 and then increase to over \$5 billion by 2037. Instead of addressing the LEOFF 1 surplus at the end of the plan's life after all benefits have been paid, we assume the funding policy of the merged plan will apply the expected surplus to the future contribution requirements of the merged plan resulting in an expected long-term savings from reduced contribution requirements.

**LEOFF 1 Unfunded Actuarial Accrued Liability (UAAL), Before Merger**  
(Dollars in Millions)

Year	Optimistic	Expected	Pessimistic
2010	(\$1,160)	(\$1,160)	(\$1,160)
2013	(1,561)	(1,218)	(832)
2016	(1,870)	(996)	(46)
2019	(3,008)	(1,439)	329
2022	(4,077)	(1,810)	414
2025	(6,186)	(2,966)	(537)
2028	(6,992)	(2,871)	358
2031	(8,896)	(3,617)	542
2034	(11,422)	(4,557)	790
2037	(\$14,210)	(\$5,742)	\$804

\*The volatility under the pessimistic scenario is explained by the assumed June 30, 2024, amortization date under current law.

Under the assumed funding policy of the merged plan, we expect the savings from the merger will offset the long-term cost of the reduction in state funding resulting in an expected net savings to the state, employers, and Plan 2 members.

The fiscal impact of the merger, however, depends heavily on future economic outlooks and the assumed funding policy for the merged plan. Please see How The Results Change When The Assumptions Change and How the Risk Measures Changed for information on how the expected costs of this bill and the financial risks can vary from our best-estimate assumptions.

**Who Will Pay For These Costs?**

Based on the funding policy we assumed for the merged plan, the costs of the merged plan will be shared as follows:

- ❖ LEOFF 2 members will pay 50 percent.
- ❖ Employers will pay 30 percent.
- ❖ State will pay 20 percent.

We assume the LEOFF Board will not impose contribution rates on LEOFF 1 members (consistent with current law when LEOFF 1 remains fully funded), but would impose employer and state contribution rates on all LEOFF system payroll (including LEOFF 1) beginning in 2013-15.

For purposes of this pricing, we assume future costs of the merged plan will be paid consistent with the current LEOFF 2 funding method. See Assumptions We Made for more explanation.

We estimate the assumed collection of state and employer contribution rates on remaining LEOFF 1 payroll will increase total employer contributions by \$1.8 million in 2013-15. See the Budget Impacts table for further details.

## HOW WE VALUED THESE COSTS

### Assumptions We Made

In addition to the assumptions stated previously, we assumed LEOFF contribution rates in 2013-17 will remain unchanged from the rates previously adopted by the Board. We also assumed that the minimum contribution rates after 2017 would be based on 90 percent of required rates under the Entry Age Normal Cost (EANC) method. After that, and consistent with the assumptions described above, we further assumed that contribution rates collected over all payroll as described above will cover all future required contributions for the merged plan.

We assumed that the change to the state contribution rate for the 2011-13 Biennium would begin March 1, 2012.

In How The Risk Measures Change and How The Results Change When Assumptions Change, we used projections to show contribution requirements before and after a merger. For the before merger projections, we assumed that the state, through GF-S contributions, would fully amortize any future unfunded liability in LEOFF 1 by 2024.

Otherwise, we developed these costs using the same assumptions as disclosed in the *June 30, 2010, Actuarial Valuation Report (AVR)*.

### How We Applied These Assumptions

Using our projection system, we calculated expected liabilities, assets, and expected benefit payments in LEOFF Plans 1 and 2 using current assumptions and methods. We recorded the expected contributions in each year of the projection. This established the expected contributions before a merger.

Next, we combined projected liabilities for LEOFF 1 and 2 to establish our expected liabilities and benefits payments for the merged plan. To determine expected assets for the merged plan, we lowered the state's contribution rate for the 2011-13 Biennium from 3.38 percent to 0.00 percent. We then applied the current LEOFF 2 funding policy to the new assets and liabilities. This policy charges stable contribution rates through June 30, 2017. Beginning July 1, 2017, contribution rates are the greater of the normal cost under the Aggregate Actuarial Cost Method or 90 percent of the normal cost under the EANC method. While we did not assume contributions would be charged to Plan 1 members, we did apply contribution rates for employers and the state on Plan 1 salaries, beginning July 1, 2013. We recorded the expected contributions in each year of the projection. This established the expected contributions in the merged plan.

We then compared the contributions before and after a merger to determine the expected cost of the bill.

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

**Special Data Needed**

We developed these costs using the same assets and data as disclosed in the AVR. In addition, we recognized investment returns of 21.14 percent through June 30, 2011 when estimating projected asset values.

**ACTUARIAL RESULTS**

**How The Liabilities Changed**

For purposes of this pricing, we assume the bill does not change benefits. Therefore, this bill is not expected to impact the present value of future benefits payable under either plan.

**How The Present Value of Future Salaries (PVFS) Changed**

This bill will impact the actuarial funding of LEOFF by increasing the PVFS of the members of the system as shown below. In the Before Merger table, we show the PVFS for LEOFF 2 under the current funding policy for current law. In the After Merger table, we have combined LEOFF 1 and LEOFF 2 PVFS according to the new assumed funding policy for the merged plan.

<b>Present Value of Future Salaries - Before Merger</b>	
<i>(Dollars in Millions)</i>	
<b>Actuarial Present Value of Future Salaries</b>	
<i>(The Value of the Future Salaries Expected to be Paid to Current Members)</i>	
<b>LEOFF 2</b>	<b>\$17,360</b>

<b>Present Value of Future Salaries - After Merger</b>	
<i>(Dollars in Millions)</i>	
<b>Actuarial Present Value of Future Salaries</b>	
<i>(The Value of the Future Salaries Expected to be Paid to Current Members)</i>	
<b>LEOFF 1/2</b>	<b>\$17,435</b>

**How Contribution Rates Changed**

We show the expected contribution rates both “before” and “after” the merger by year in the table below.

## Actuary's Fiscal Note

<b>LEOFF Contribution Rates*</b>						
<b>Fiscal Year</b>	<b>Member</b>		<b>Employer</b>		<b>State</b>	
	<b>Before</b>	<b>After</b>	<b>Before</b>	<b>After</b>	<b>Before</b>	<b>After</b>
2012	8.46%	8.46%	5.08%	5.08%	3.38%	0.00%
2013	8.46%	8.46%	5.08%	5.08%	3.38%	0.00%
2014	8.46%	8.46%	5.08%	5.08%	3.38%	3.38%
2015	8.46%	8.46%	5.08%	5.08%	3.38%	3.38%
2016	8.46%	8.46%	5.08%	5.08%	3.38%	3.38%
2017	8.46%	8.46%	5.08%	5.08%	3.38%	3.38%
2018	7.55%	7.54%	4.53%	4.52%	3.02%	3.02%
2019	7.55%	7.54%	4.53%	4.52%	3.02%	3.02%
2020	7.62%	7.62%	4.57%	4.57%	3.05%	3.05%
2021	7.62%	7.62%	4.57%	4.57%	3.05%	3.05%
2022	7.70%	7.70%	4.62%	4.62%	3.08%	3.08%
2023	7.70%	7.70%	4.62%	4.62%	3.08%	3.08%
2024	7.79%	7.79%	4.67%	4.67%	3.12%	3.12%
2025	7.79%	7.79%	4.67%	4.67%	3.12%	3.12%
2026	7.86%	7.86%	4.72%	4.72%	3.14%	3.14%
2027	7.86%	7.86%	4.72%	4.72%	3.14%	3.14%
2028	7.94%	7.94%	4.76%	4.76%	3.18%	3.18%
2029	7.94%	7.94%	4.76%	4.76%	3.18%	3.18%
2030	8.01%	8.01%	4.81%	4.81%	3.20%	3.20%
2031	8.01%	8.01%	4.81%	4.81%	3.20%	3.20%
2032	8.08%	8.08%	4.85%	4.85%	3.23%	3.23%
2033	8.08%	8.08%	4.85%	4.85%	3.23%	3.23%
2034	8.15%	8.15%	4.89%	4.89%	3.26%	3.26%
2035	8.15%	8.15%	4.89%	4.89%	3.26%	3.26%
2036	8.20%	8.20%	4.92%	4.92%	3.28%	3.28%

*Note: Rates before collected over all LEOFF 2 salaries. Member rates after the merger collected over all LEOFF 2 salaries. Employer and State rates after the merger collected over all LEOFF 2 salaries before 7/1/2013; over all LEOFF salaries 7/1/2013 and beyond.*

*\*Effective 3/1/2012.*

**How This Impacts Budgets And Employees**

<b>Budget Impacts</b>	
<i>(Dollars in Millions)</i>	<b>LEOFF</b>
<b>2011-2013</b>	
General Fund	(\$79.3)
Non-General Fund	0.0
<b>Total State</b>	<b>(\$79.3)</b>
Local Government	0.0
<b>Total Employer</b>	<b>(\$79.3)</b>
<b>Total Employee</b>	<b>\$0.0</b>
<b>2013-2015</b>	
General Fund	\$0.7
Non-General Fund	0.0
<b>Total State</b>	<b>\$0.7</b>
Local Government	1.1
<b>Total Employer</b>	<b>\$1.8</b>
<b>Total Employee</b>	<b>\$0.0</b>
<b>2011-2036</b>	
General Fund	(\$78.0)
Non-General Fund	0.0
<b>Total State</b>	<b>(\$78.0)</b>
Local Government	1.5
<b>Total Employer</b>	<b>(\$76.5)</b>
<b>Total Employee</b>	<b>(\$0.5)</b>

*Note: Totals may not agree due to rounding. We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.*

The analysis of this bill does not 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 actuarial valuation, 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.

The results of our analysis could also change under a different interpretation of the bill.

**How the Risk Measures Changed**

Using our risk model, we compared risk measures before and after the merger to evaluate how certain financial risks change under this proposal. We evaluated changes in pay-go risk, funded status, and contribution rates.

Before a merger, LEOFF 1 faces up to a 30 percent chance of pay-go. Pay-go risk is the risk that plan assets will be insufficient to cover benefit payments in the future. Over the next fifty years, we found LEOFF 2 has virtually zero chance of

pay-go status before the merger. After the merger, all pay-go risk virtually disappears for the merged plan over the next fifty years.

Under current funding policy, the projected funded status of LEOFF 1 can vary widely before a merger depending on whether assets remain sufficient to cover benefit payments in the future. When assets and liabilities are merged, the funded status of the merged plan resembles the funded status of LEOFF 2 before merger with increases/decreases under very optimistic/very pessimistic outcomes only.

Under the current assumed funding policy for LEOFF 1, the state could experience spiking contribution requirements under outcomes where unfunded liability in LEOFF 1 re-emerges near 2024. After a merger, those spiking contributions were eliminated.

Lastly, we found under both pessimistic and very pessimistic outcomes that LEOFF 2 member contribution rates after the merger increase above before-merger levels.

Please see Appendix A and Appendix B for details about how risk measures change under this bill. Please see our *2010 Risk Assessment Report (RAR)* for additional background on how we developed and how to interpret the risk measures.

### HOW THE RESULTS CHANGE WHEN THE ASSUMPTIONS CHANGE

As mentioned previously, the fiscal impact of the merger depends heavily on future economic outlooks and the assumed funding policy for the merged plan. To determine the sensitivity of the actuarial results to the best-estimate assumptions or methods selected for this pricing, we varied the following assumptions and methods.

- ❖ **Varying Economic Scenarios** – We calculated the impact on total contributions under both optimistic and pessimistic outcomes from our risk assessment model, while assuming the Board maintains its current funding policy for the newly merged plans as described in the Assumptions We Made section.
- ❖ **Varying Funding Policy and Economic Scenarios** – We viewed the impact on total contributions under both optimistic and pessimistic outcomes from our risk assessment model, while assuming a different Board-adopted funding policy as follows:
  - ◇ The rates the Board previously adopted through 2017 would end in 2013.
  - ◇ The minimum contribution rates after the 2011-13 Biennium would be based on 80 percent of

EANC rates, rather than the current Board-adopted 90 percent.

**Varying Economic Scenarios**

The optimistic and pessimistic outcomes under our risk model frame a range of likely outcomes when we allow several economic assumptions to vary over time. The table below shows fiscal cost impacts for those outcomes, along with our best-estimate (deterministic) fiscal impact, when we use the methods and assumptions described in the body of this fiscal note.

<b>Budget Impacts - Varying Economic Scenarios</b>			
<i>(Dollars in Millions)</i>	<b>Optimistic</b>	<b>Expected</b>	<b>Pessimistic</b>
<b>2011-2013</b>			
General Fund	(\$79.3)	(\$79.3)	(\$79.4)
Non-General Fund	0.0	0.0	0.0
<b>Total State</b>	<b>(\$79.3)</b>	<b>(\$79.3)</b>	<b>(\$79.4)</b>
Local Government	0.0	0.0	0.1
<b>Total Employer</b>	<b>(\$79.3)</b>	<b>(\$79.3)</b>	<b>(\$79.3)</b>
<b>Total Employee</b>	<b>\$0.0</b>	<b>\$0.0</b>	<b>\$0.0</b>
<b>2013-2015</b>			
General Fund	\$0.7	\$0.7	\$0.5
Non-General Fund	0.0	0.0	0.0
<b>Total State</b>	<b>\$0.7</b>	<b>\$0.7</b>	<b>\$0.5</b>
Local Government	1.1	1.1	1.2
<b>Total Employer</b>	<b>\$1.8</b>	<b>\$1.8</b>	<b>\$1.8</b>
<b>Total Employee</b>	<b>\$0.0</b>	<b>\$0.0</b>	<b>\$0.0</b>
<b>2011-2036</b>			
General Fund	(\$78.0)	(\$78.0)	(\$255.6)
Non-General Fund	0.0	0.0	0.0
<b>Total State</b>	<b>(\$78.0)</b>	<b>(\$78.0)</b>	<b>(\$255.6)</b>
Local Government	1.5	1.5	311.6
<b>Total Employer</b>	<b>(\$76.5)</b>	<b>(\$76.5)</b>	<b>\$56.0</b>
<b>Total Employee</b>	<b>(\$0.5)</b>	<b>(\$0.5)</b>	<b>\$514.4</b>

*Assumes plan(s) will be funded at the actuarially required level and that no benefit improvements will occur in the future.*

We see the same fiscal impacts under both the expected and optimistic impacts due to the presence of assumed contribution rate floors. In other words, no matter how good the economic outlook, the rates will not drop below the rate floor.

When economic conditions worsen, we see under the pessimistic outcome that the merger results in increased total fiscal costs. This happens in this pessimistic scenario because under assumed funding policy contribution requirements are lowered on the expectation of a long-term LEOFF 1 surplus and the current surplus becomes an unfunded liability over time. Under this outcome, the plan

will have to make up the lost contributions plus lost assumed investment earnings.

We also see in the pessimistic outcome that the state shows a larger savings, while local employers and members have increased costs. The state savings are partly explained by the suspended state contributions in the first biennium. The remaining state savings under this outcome occur from an assumed shift in LEOFF 1 funding responsibility from the state under current law to LEOFF 2 members and LEOFF employers under the assumed funding policy for the merged plan. Under the merger, 80 percent of the cost of any future LEOFF 1 unfunded liability transfers from the state to LEOFF 2 members and LEOFF employers.

**Varying Funding Policy And Economic Scenarios**

To show how a different funding policy impacts the results, we changed the assumed funding policy for our best-estimate pricing by ending the previously Board-adopted rates after the current biennium and lowering the minimum contribution rates to 80 percent of EANC rates. The table below shows optimistic, deterministic (expected), and pessimistic results under the assumed alternate funding policy.

<b>Budget Impacts - Varying Funding Policy and Economic Scenarios</b>			
<i>(Dollars in Millions)</i>	<b>Optimistic</b>	<b>Expected</b>	<b>Pessimistic</b>
<b>2011-2013</b>			
General Fund	(\$79.3)	(\$79.3)	(\$79.4)
Non-General Fund	0.0	0.0	0.0
<b>Total State</b>	<b>(\$79.3)</b>	<b>(\$79.3)</b>	<b>(\$79.4)</b>
Local Government	0.0	0.0	0.1
<b>Total Employer</b>	<b>(\$79.3)</b>	<b>(\$79.3)</b>	<b>(\$79.3)</b>
<b>Total Employee</b>	<b>\$0.0</b>	<b>\$0.0</b>	<b>\$0.0</b>
<b>2013-2015</b>			
General Fund	(\$18.4)	(\$18.4)	(\$18.6)
Non-General Fund	0.0	0.0	0.0
<b>Total State</b>	<b>(\$18.4)</b>	<b>(\$18.4)</b>	<b>(\$18.6)</b>
Local Government	(27.5)	(27.5)	(27.3)
<b>Total Employer</b>	<b>(\$45.9)</b>	<b>(\$45.9)</b>	<b>(\$45.9)</b>
<b>Total Employee</b>	<b>(\$47.4)</b>	<b>(\$47.4)</b>	<b>(\$47.4)</b>
<b>2011-2036</b>			
General Fund	(\$399.0)	(\$399.0)	(\$151.1)
Non-General Fund	0.0	0.0	0.0
<b>Total State</b>	<b>(\$399.0)</b>	<b>(\$399.0)</b>	<b>(\$151.1)</b>
Local Government	(481.6)	(481.6)	465.4
<b>Total Employer</b>	<b>(\$880.7)</b>	<b>(\$880.7)</b>	<b>\$314.2</b>
<b>Total Employee</b>	<b>(\$804.1)</b>	<b>(\$804.1)</b>	<b>\$773.0</b>

*Assumes plan(s) will be funded at the actuarially required level and that no benefit improvements will occur in the future.*

## **Actuary's Fiscal Note**

Once again, the optimistic and expected results are identical due to the stabilizing effect of assumed minimum contribution rates. However, the minimum contribution rates are lower under this alternate funding policy than under the funding policy for our best-estimate assumptions. Thus, we see that the long-term optimistic and expected fiscal savings are larger than the savings in the previous table. As a result, surplus assets from LEOFF 1 are recognized faster producing larger reductions in future plan contribution requirements.

On the other hand, the pessimistic long-term cost is even higher than under the best-estimate assumed funding policy for the merged plan. This happens in this pessimistic scenario because under assumed funding policy contribution requirements are lowered on the expectation of a long-term LEOFF 1 surplus and the current surplus becomes an unfunded liability over time. Similar to the pessimistic outcome in the previous table, the plan will have to make up the lost contributions plus lost assumed investment earnings. In this case, however, the lost contributions are larger since the expected surplus was recognized faster.

Again we note in the pessimistic outcome that the state experiences budget savings over 25 years while local employers and members see increased costs for the reasons stated in the previous scenario (suspended state contributions during 2011-13; assumed transfer of LEOFF 1 funding responsibility from the state to LEOFF 2 members and LEOFF employers ).

### **WHAT THE READER SHOULD KNOW**

The Office of the State Actuary (“we”) prepared this fiscal note based on our understanding of the bill as of the date shown in the footer. We intend this fiscal note to be used by the Legislature during the 2012 Legislative Session only.

We advise 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.

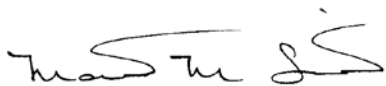
**ACTUARY'S CERTIFICATION**

The undersigned hereby certifies that:

1. The actuarial cost and asset valuation 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 and assumptions may also be reasonable, and might produce different results.
5. The risk analysis summarized in this fiscal note involves the interpretation of many factors and the application of professional judgment. We believe that the data, assumptions, and methods used in our risk assessment model are reasonable and appropriate for the purposes of this pricing exercise. The use of another set of data, assumptions, and methods, however, could also be reasonable and could produce materially different results.
6. We prepared this fiscal note for the Legislature during the 2012 Legislative Session.
7. We prepared this fiscal note and provided opinions in accordance with Washington State law and accepted actuarial standards of practice as of the date shown in the footer of this fiscal note.

The undersigned, with actuarial credentials, meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

While this fiscal note is meant to be complete, the undersigned is available to provide extra advice and explanations as needed.



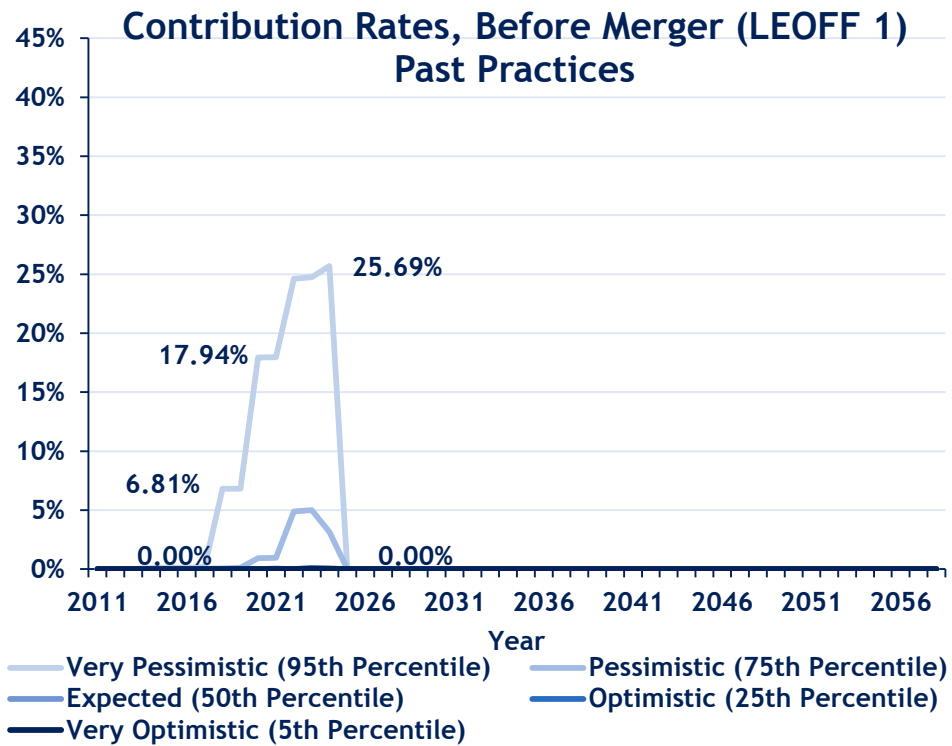
Matthew M. Smith, FCA, EA, MAAA  
State Actuary

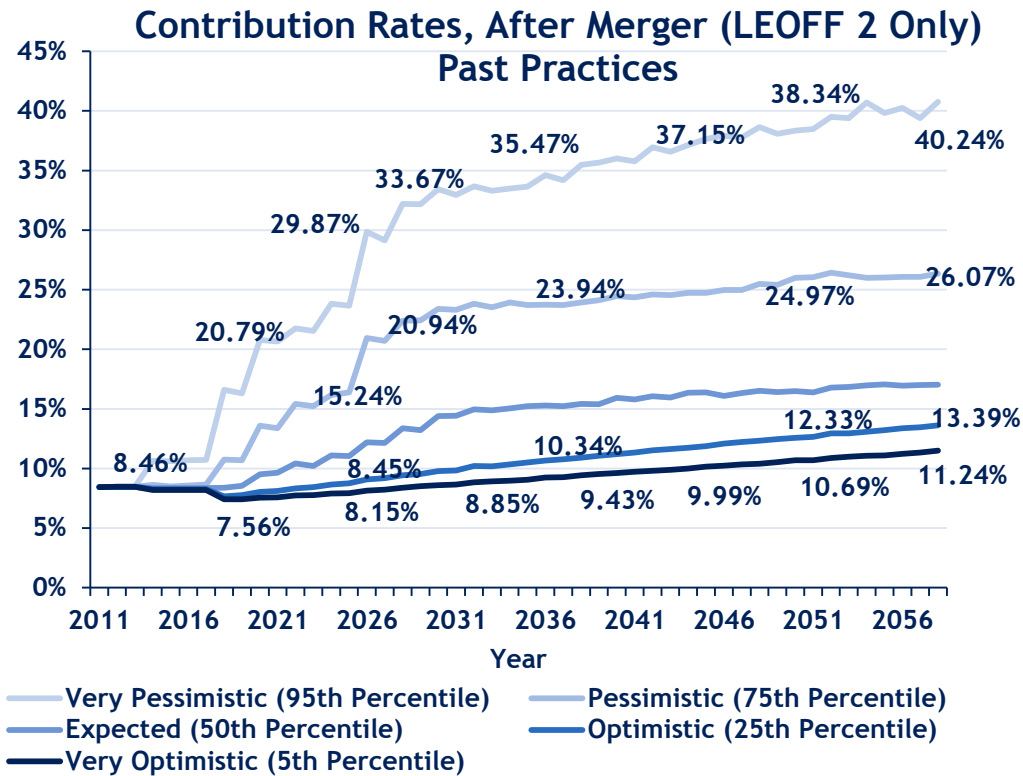
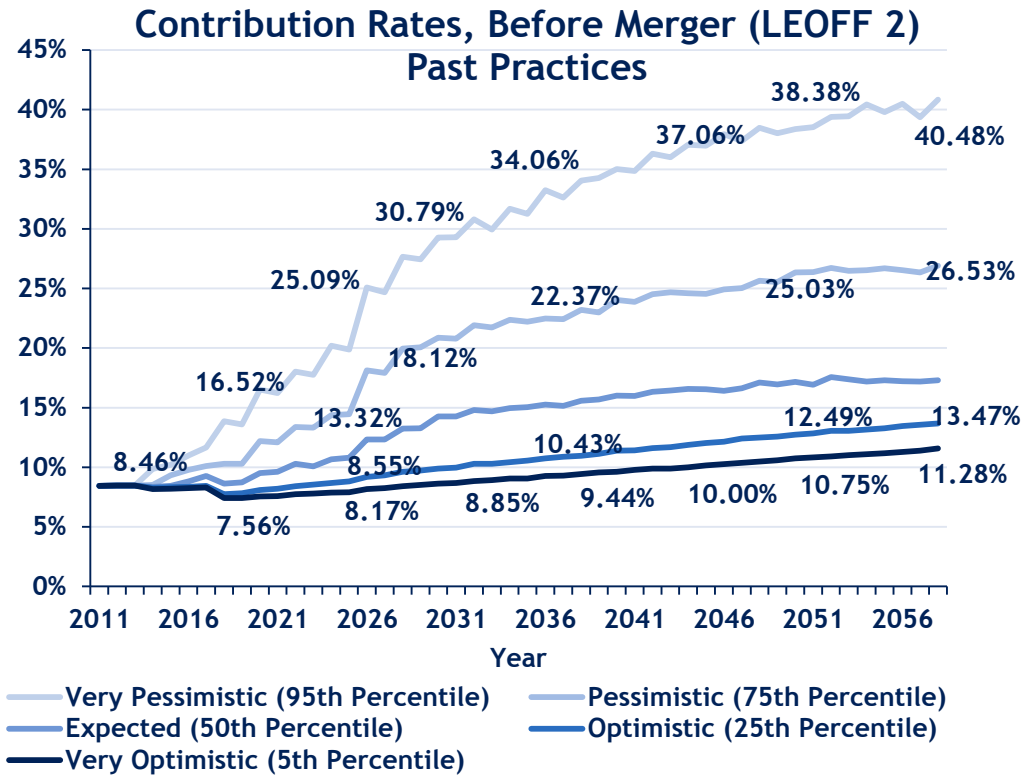
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**APPENDIX A – HOW THE RISK MEASURES CHANGED**

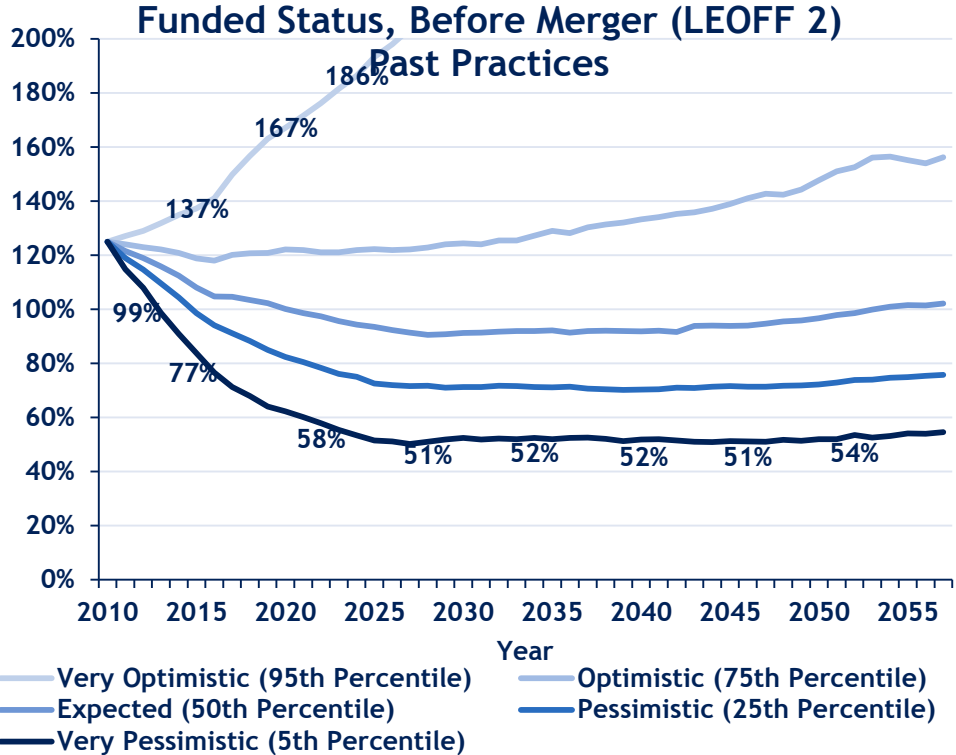
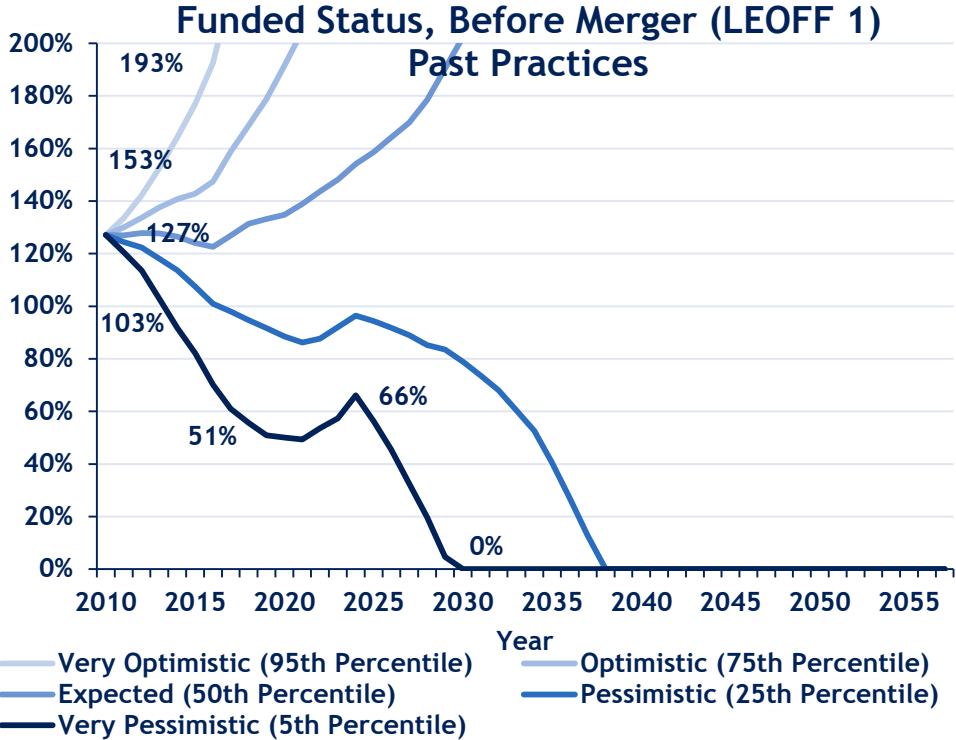
The risk measures in this appendix reflect results when past practices continue in the areas of full funding and future benefit improvements (“past practices”). Please see Appendix B for resulting risk measures if the plan receives 100 percent of future actuarially required contributions and receives no future benefit improvements (“current law”).

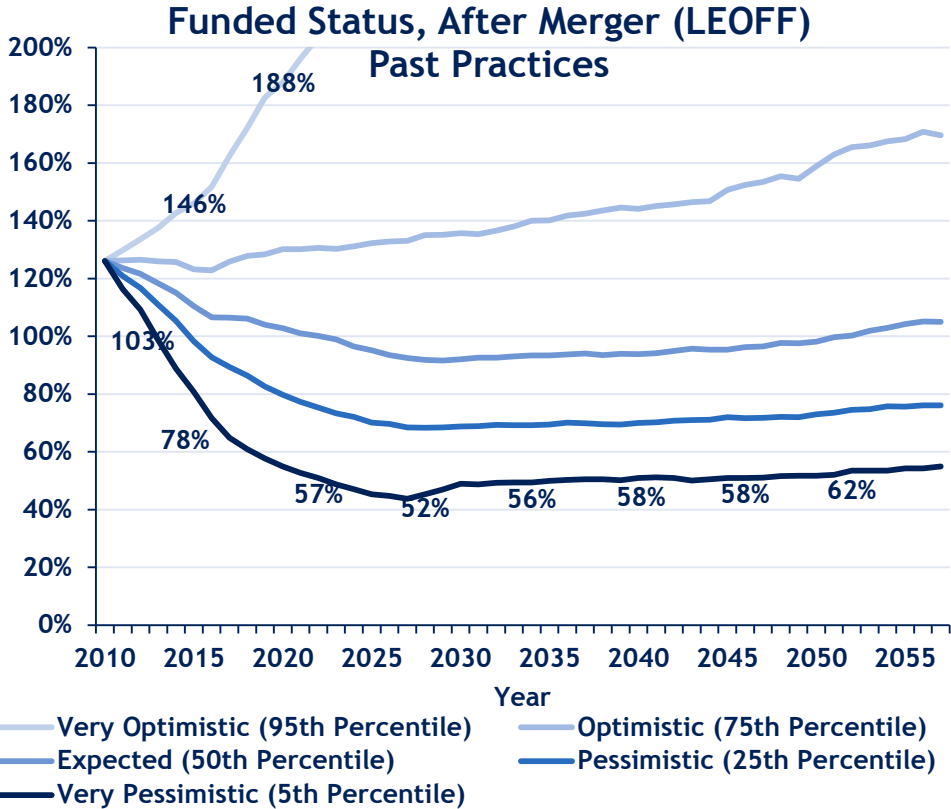
**Contribution Rates**

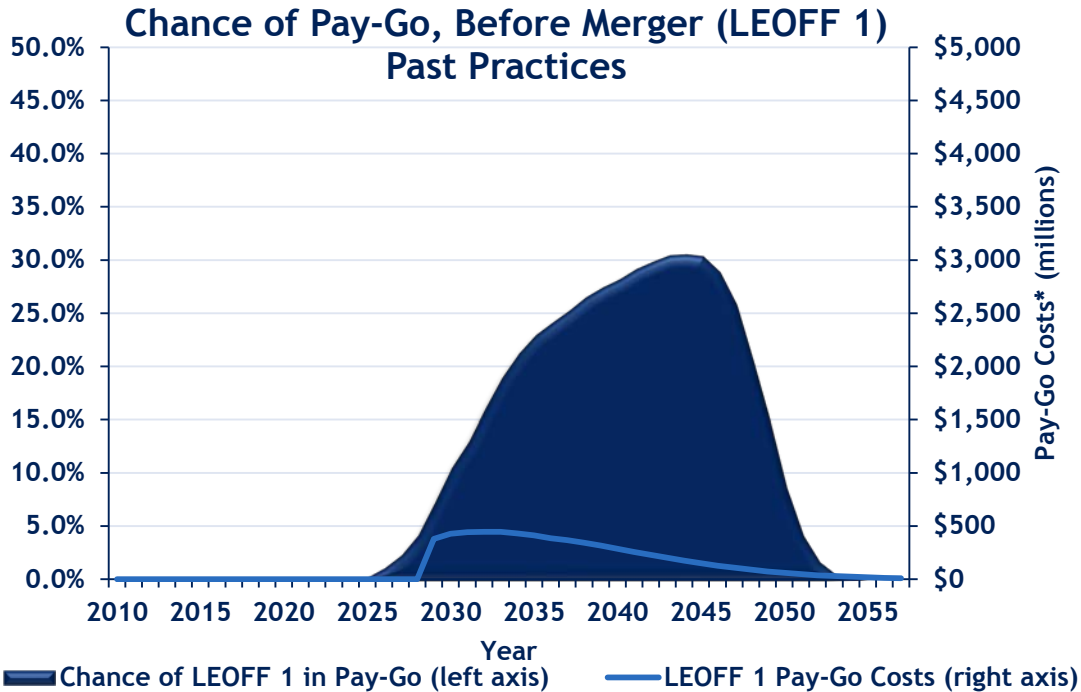




Funded Status

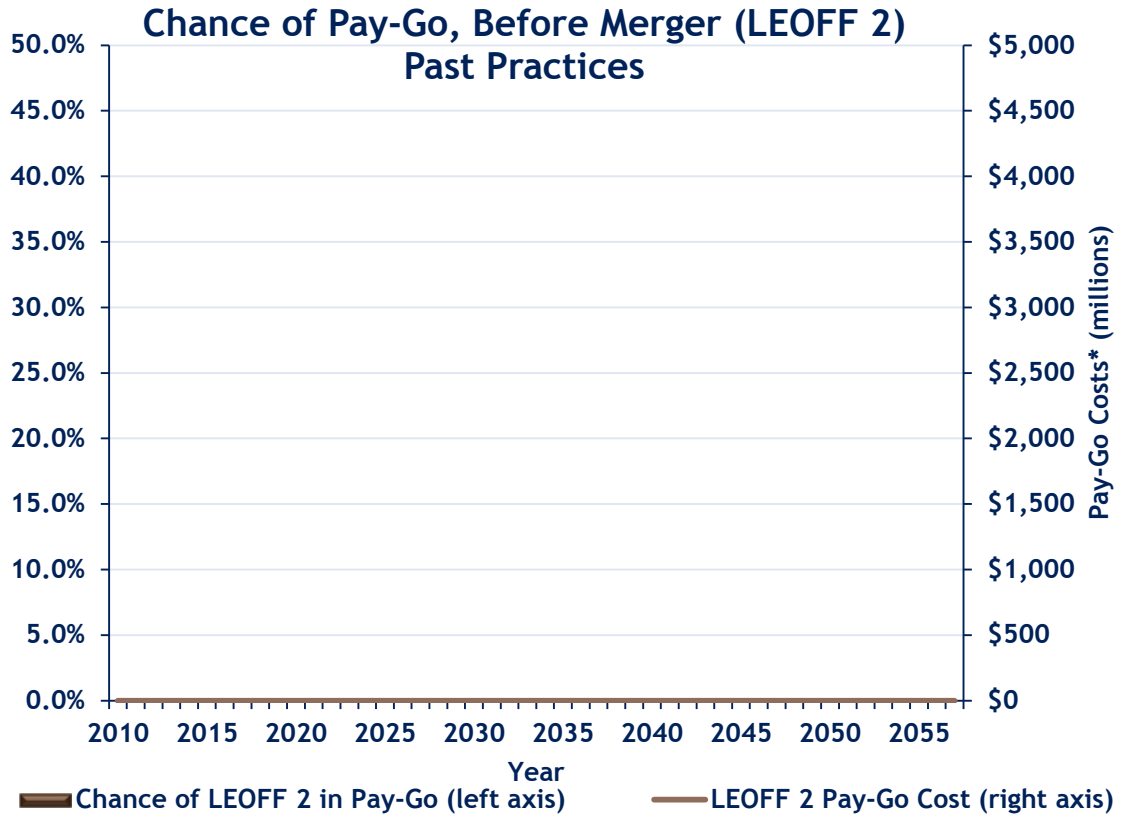




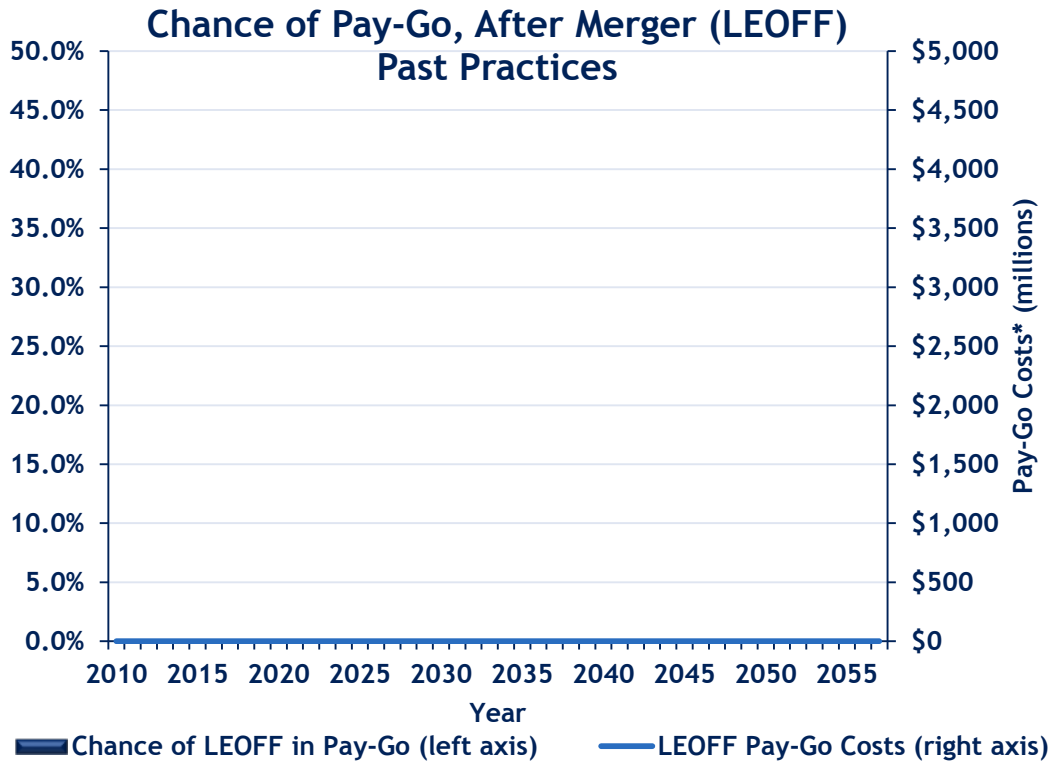


\*Pay-Go Costs on Top of Normal Pension Costs.

# Actuary's Fiscal Note



*\*Pay-Go Costs on Top of Normal Pension Costs. LEOFF 2 is not expected to enter a pay-go status.*



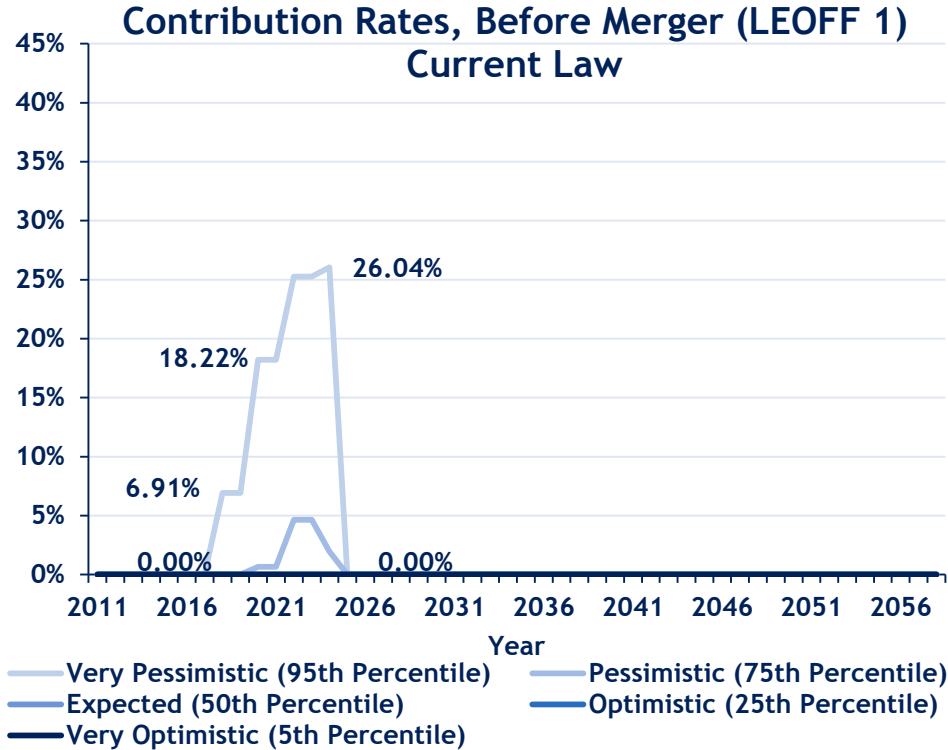
*\*Pay-Go Costs on Top of Normal Pension Costs.*

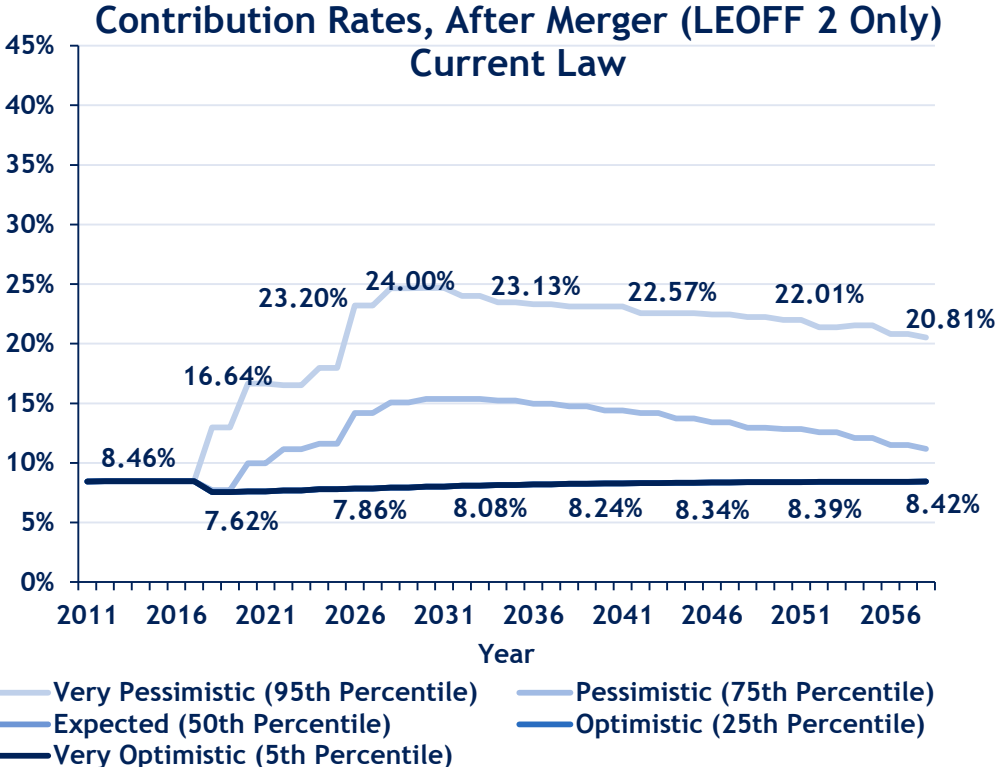
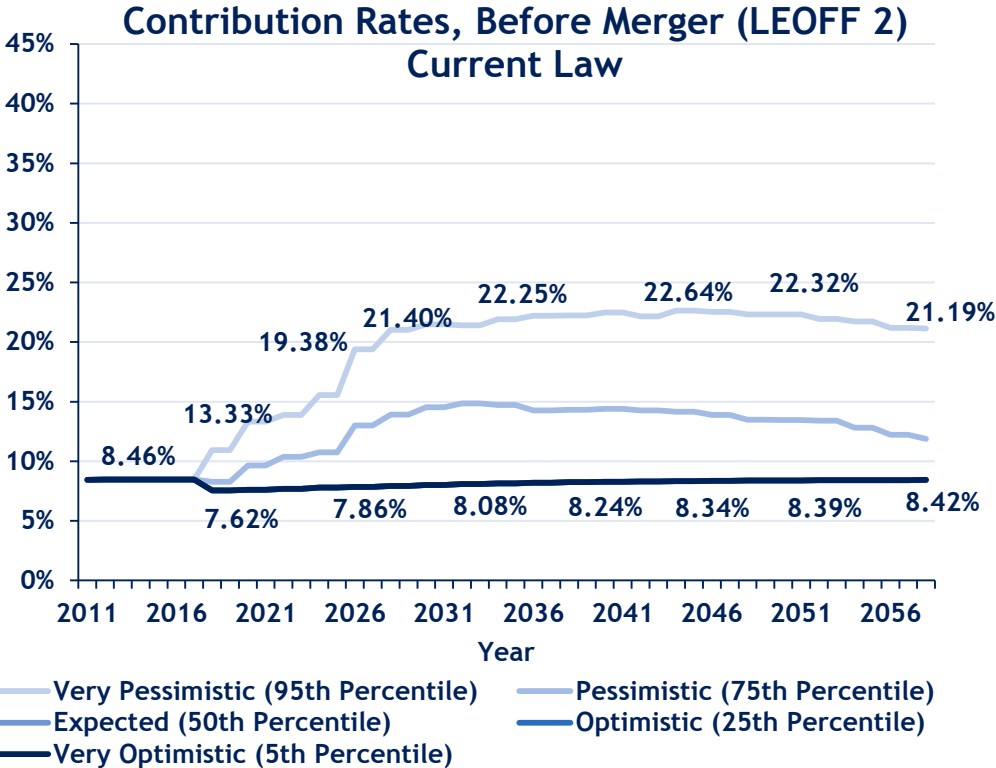
Please see the RAR for a complete description of the development of the risk assessment model we used for this analysis. The RAR also contains a complete description of the assumptions, methods, and data we used in the underlying risk analysis.

**APPENDIX B – ADDITIONAL RISK MEASURES**

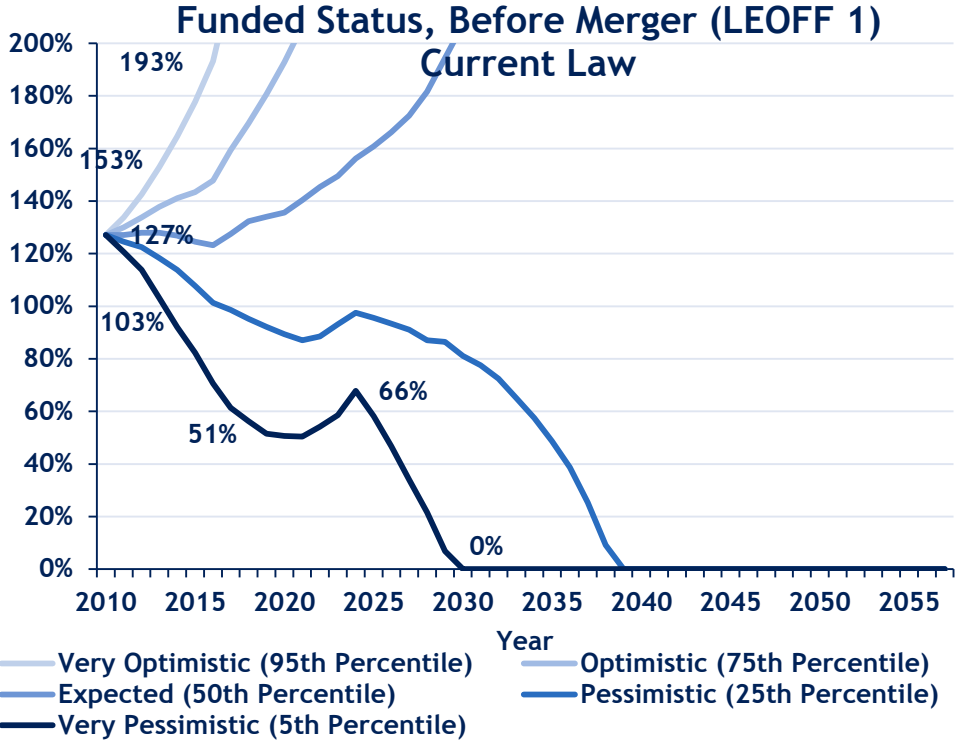
In Appendix A, we displayed risk measures under our past practices assumptions. In this appendix, we show the corresponding graphs under current law, which assumes that the plans receive 100 percent of future actuarially required contributions and receive no future benefit improvements.

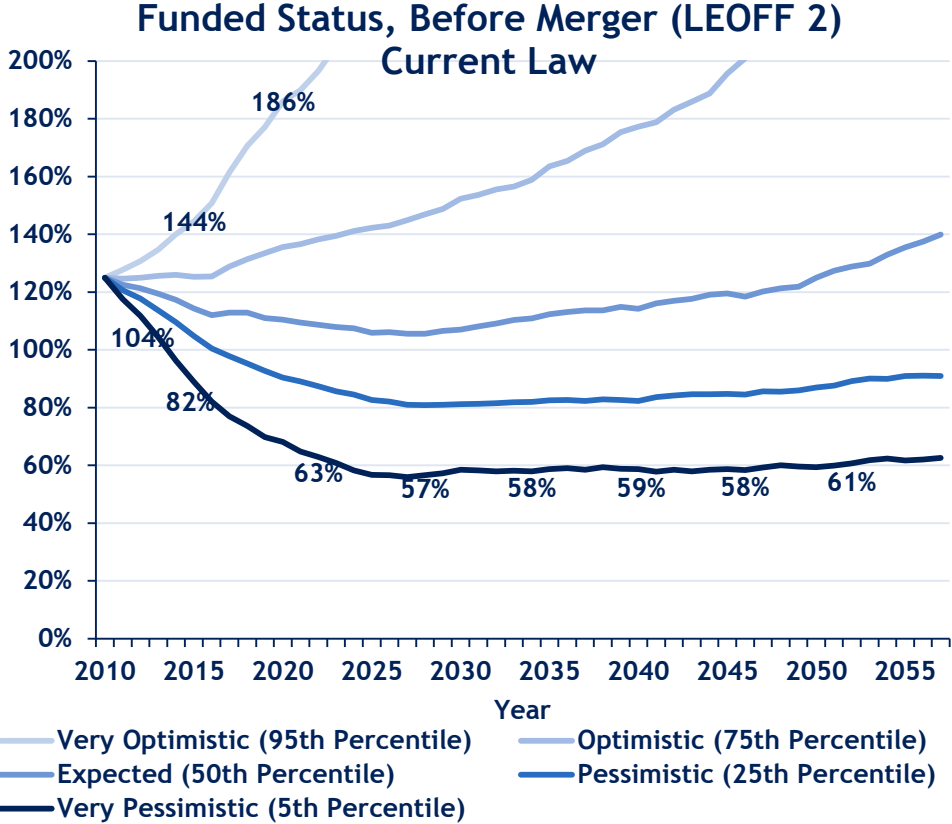
**Contribution Rates**

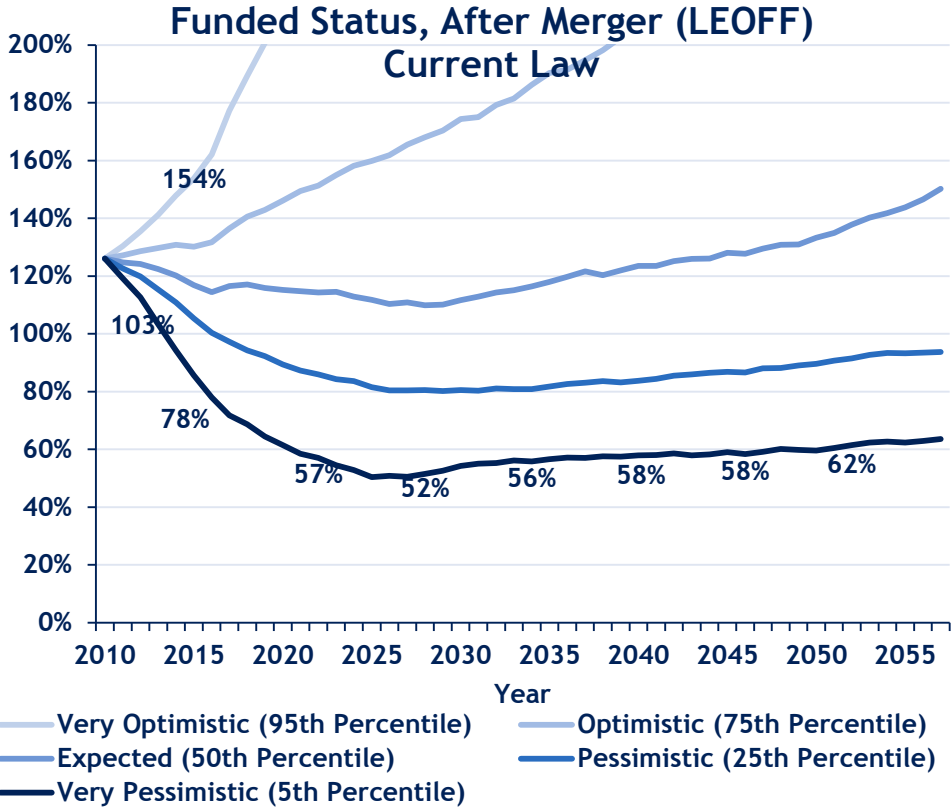




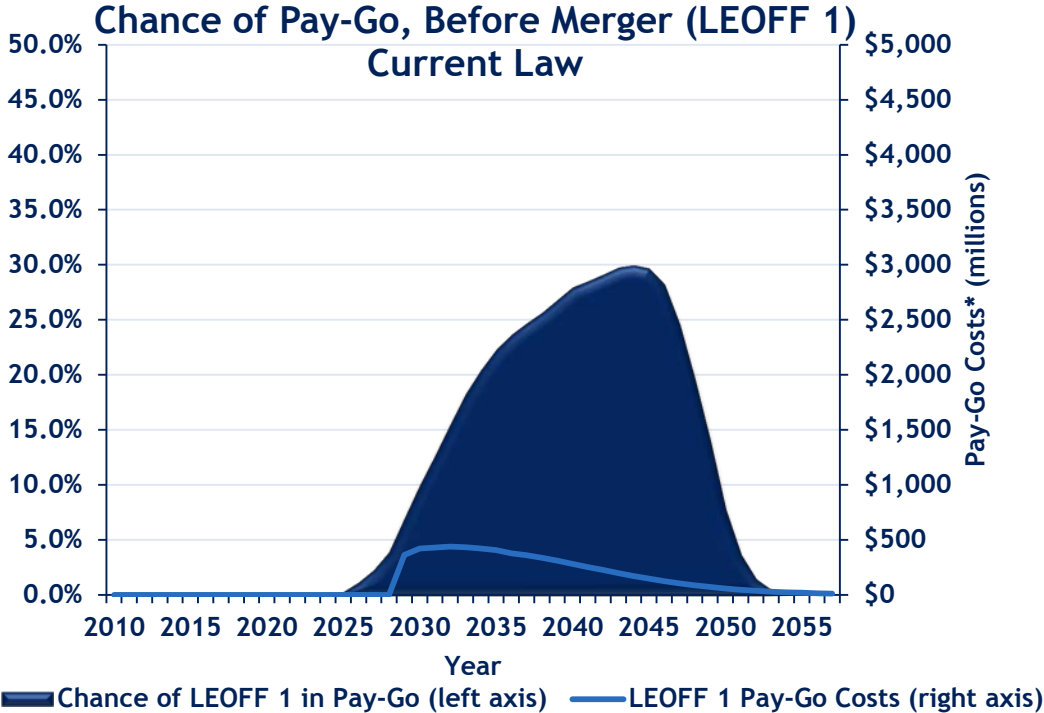
Funded Status





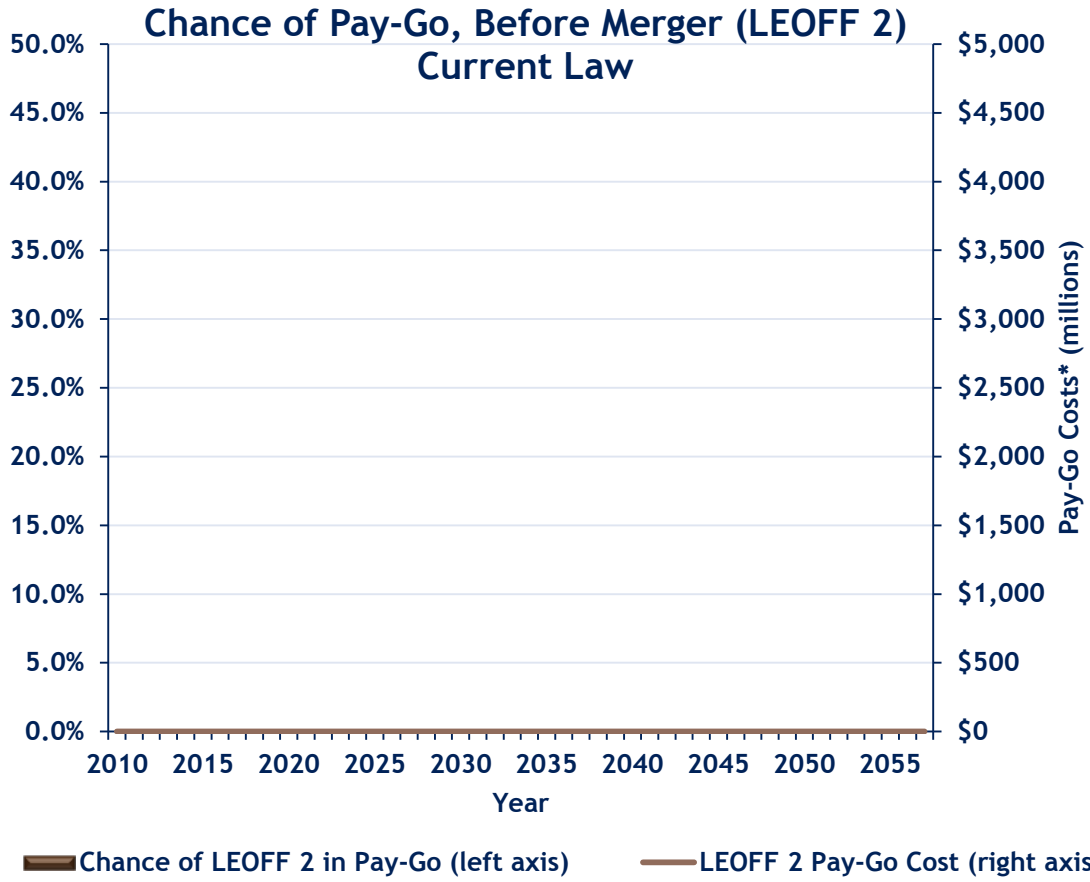


Pay-Go Risk

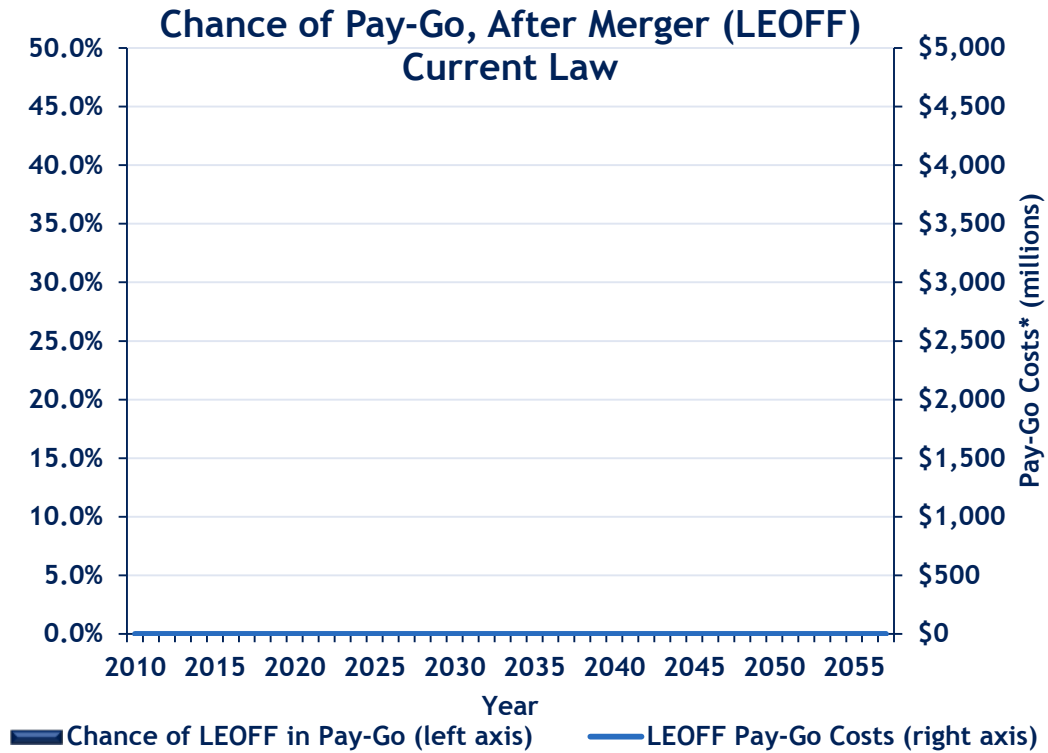


\*Pay-Go Costs on Top of Normal Pension Costs.

# Actuary's Fiscal Note



*\*Pay-Go Costs on Top of Normal Pension Costs. LEOFF 2 is not expected to enter pay-go status.*



*\*Pay-Go Costs on Top of Normal Pension Costs.*

Please see the RAR for a complete description of the development of the risk assessment model we used for this analysis. The RAR also contains a complete description of the assumptions, methods, and data we used in the underlying risk analysis.

**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 actuarial accrued liability. The normal cost is determined for the entire group rather than on 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:

- ❖ Normal cost.
- ❖ Amortization of the unfunded actuarial accrued 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.

**Projected Unit Credit (PUC) Liability:** 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 that 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 PUC Liability:** The excess, if any, of the Present Value of Benefits calculated under the PUC cost method 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.

## GLOSSARY OF RISK TERMS

**Affordability:** Measures the affordability of the pension systems. Affordability risk measures the chance that pension contributions will cross certain thresholds with regards to the General-Fund and contribution rates.

**“Current Law”:** Scenarios in which assumptions about Legislative behavior are excluded. These scenarios show projections regarding the current state of Washington statutes.

**Optimistic:** A measurement of the pension system under favorable conditions (above expected investment returns, for example). Optimistic refers to the 75<sup>th</sup> percentile, where there is a 25 percent chance of the measurement being better and 75 percent chance of the measurement being worse. Very optimistic refers to the 95<sup>th</sup> percentile.

**“Past Practices”:** Scenarios in which assumptions regarding Legislative behavior are introduced. These assumptions include actual contributions below what are actuarially required and improving benefits over time. These scenarios are meant to project past behavior into the future.

**Pay-Go:** The trust fund runs out of assets, and payments from the General-Fund must be made to meet contractual obligations.

**Pessimistic:** A measurement of the pension system under unfavorable conditions (below expected investment returns, for example). Pessimistic refers to the 25<sup>th</sup> percentile, where there is a 75 percent chance of the measurement being better and 25 percent chance of the measurement being worse. Very pessimistic refers to the 5<sup>th</sup> percentile.

**Premature Pay-Go:** Pay-go payments, measured in today's value, which might be considered “significant” in terms of the potential impact on the General-Fund.

**Risk:** Measures the risk metrics of the pension systems, including the chance that the pension systems will prematurely run out of assets, the amount of potential pay-go contributions, and the chance that the funded status will cross a certain threshold.

**Risk Tolerance:** The amount of risk an individual or group is willing to accept with regards to the likelihood and severity of unfavorable outcomes.