

## Background

This issue was studied at the request of the LEOFF 2 Retirement Board. The LEOFF 2 Board proposed amending the portability chapter in order to mitigate several adverse impacts on public employees who change retirement systems one or more times during their careers and retire as dual members.

## Committee Activity

Presentations:

June 20, 2006 - Full Committee and Executive Committee

October 17, 2006 - Full Committee

November 21, 2006 - Executive Committee

Proposal:

December 12, 2006 - Full Committee

## Recommendation to Legislature

- Change the definition of base salary to include previously excluded payments (such as overtime) that are reportable in all of a dual member's retirement systems. The Washington State Patrol Retirement System was excluded from this benefit based on a request from the Washington State Patrol Troopers' Association.
- Lift portability's "maximum benefit rule" (a rule designed to protect Plan 1 benefit caps) for members with less than fifteen years of service in one capped plan and service in one uncapped plan.
- Add LEOFF 2 to the list of retirement plans whose members can combine service under portability in order to receive indexing of the term-vested benefit available to those with at least twenty years of service.

## Staff Contact

Laura Harper, Senior Research Analyst, Legal  
360.786.6145; harper.laura@leg.wa.gov

## In Brief

### PROPOSAL

*"Dual membership," or "portability," is a voluntary program for retirement system members who once belonged to another participating system within the State of Washington. The LEOFF 2 Board is proposing several program changes to address situations, which, in its view, may unnecessarily penalize its members' pension benefits when they change public sector careers. These "penalties" involve issues around salary restrictions, benefit limitations and access to benefit indexing. Resolution of these issues could affect members in other retirement systems.*

*In OSA discussions with the Department of Retirement Systems (DRS), a fourth issue was identified: disparate treatment of inactive members under portability. All four issues are covered in this briefing paper.*

Laura Harper  
Senior Research Analyst,  
Legal  
360.786.6145  
harper.laura@leg.wa.gov

# Dual Membership

## Current Situation

### Who's In?

Dual membership, also known as "portability," is a voluntary program available to persons who are active members in any of the retirement systems listed below, and who once belonged to another of these systems: Public Employees' Retirement System (PERS) Plans 1, 2, and 3; Teachers' Retirement System (TRS) Plans 1, 2, and 3; School Employees' Retirement System (SERS) Plans 2 and 3; Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 2; Washington State Patrol Retirement System (WSPRS) Plans 1 and 2; City Retirement Systems for Seattle, Spokane, and Tacoma; and Statewide City Employees' Retirement System (SCERS). The Public Safety Employees' Retirement System (PSERS) will be added to this list effective July 1, 2006.

### Who's out?

LEOFF 1 and the Judges' and Judicial Retirement Systems are not included in the portability statute. In order to qualify for dual membership, members cannot have retired from any Department of Retirement Systems (DRS) - administered system, nor can they be receiving a disability retirement or disability leave benefits from any DRS retirement system.

### How does it work?

Generally, dual membership prevents members from being unduly advantaged or disadvantaged by moving from one public employee retirement system to another. Participation in the dual membership program is an optional, non-contractual right that allows the following:

1. Dual members may restore service credit withdrawn from another dual member system.

*"Dual Membership" allows members to:*

- ❖ *Restore service credit*
- ❖ *Combine service credit*
- ❖ *Use highest base salary to calculate benefits*

2. They may combine service credit earned in all participating systems to become eligible for benefits, e.g. retirement benefits; survivor benefits; disability benefits; and PERS, SERS, and TRS Plan 3 indexing.
3. They may use their highest "base salary" in a dual member system to calculate their retirement benefit another system.

## Example

Lee is a 43-year-old PERS 2 member with ten years of service credit who joins PSERS and works for another ten years. Under the dual membership program, Lee can elect to combine service credit from the two retirement systems at age 53 and qualify for early retirement under PSERS. Lee can also use his highest base salary from either system to calculate his final benefit in the other system. Each retirement system will pay its share of the total benefit.

### **PERS 2 Benefit:**

$2\% \times 10 \text{ years service credit} \times \text{average final compensation} \times \text{ERRF} \div 12 \text{ months} = \text{PERS benefit}$

### **PSERS Benefit:**

$2\% \times 10 \text{ years service credit} \times \text{average final compensation} \times \text{ERRF} \div 12 \text{ months} = \text{PSERS benefit}$

Detailed examples of dual membership scenarios are provided in the attached copy of DRS website materials entitled, *What is Dual Membership and How Does It Affect Me?* As can be seen from the examples, there are many instances in which dual membership allows members to receive higher benefits than if they had received separate benefits from each system. However, there are some instances in which members would not be better off as dual members. For that reason, dual membership is voluntary.

*PSERS has added an estimated 1,867 dual members to the state retirement system.*

## Members Impacted

As of September 30, 2005, there were 9,897 active retirement system members with dual membership, and an additional 1,502 dual members who were not active in either system. With the addition of the new PSERS plan in July, it is estimated that 1,867 dual members have been added to the state retirement system since July 1, 2006.

DRS reports that last year there were approximately 180 calculations, 90 recalculations, and 800 estimates under portability. Currently, most portability cases involve members of both PERS and TRS, or PERS and First Class Cities.

## History

The LEOFF 2 Board brought the issue of dual membership before the SCPP Executive Committee during the 2005 interim. At that time the Committee determined that it was too late in the interim to study the issue and deferred the matter to the 2006 interim.

Dual membership was established with the passage of ESSB 5150 in 1987, the year that the Joint Committee on Pension Policy (JCPP) was established. LEOFF 2 was added as a dual member system in 1993. The SCPP has not studied dual membership, although the proposed legislation was presented to the JCPP in 1987.

## Policy Analysis

Neither the original portability statute nor the original session law provides an official record of the legislative intent of the dual membership statute. However, pension portability provisions that facilitate members to move more easily from one retirement system to another are common in public sector retirement systems. Many states provide portability of retirement benefits through purchases and transfers of service credit, or the ability to combine service credit.

When a member can transfer service credit from one retirement system to another within the same state, the

*Approximately half of public sector systems allow members to transfer or combine service credit when moving from one retirement system to another within the same state.*

practice is referred to as intrastate portability (or reciprocity). Some states do not have intrastate portability per se, but have laws that yield the same result by allowing the combining of service credit. Washington's portability statute is in the latter category. While it does not provide for routine service credit transfers when members join a new participating retirement system, it does allow for dual membership in the systems, which results in the ability to combine service credit.

According to Calhoun and Moore's, *The Governmental Plans Answer Book*\*, of 52 public sector systems surveyed, 52 percent allowed for transferring or combining service credit earned elsewhere, 46 percent did not, and another 2 percent did not respond to the question. Similarly, a 1999 portability survey conducted by the National Council on Teacher Retirement\*\* found that of 45 systems surveyed, 58 percent provided the ability to transfer or combine service in systems within the state and 42 percent did not.

\*Panel Publishers, New York, 2002, page 2-21.

\*\*<http://www.nctr.org/resources/poranaly.htm>, accessed on May 22, 2006.

Within Washington's comparative systems there are several programs similar to this state's dual membership program. The **California** Public Employees' Retirement System (CalPERS) method for addressing the issue of members moving in and out of CalPERS and other public employee retirement systems is not to transfer service credit from one system to another; rather, service credit years are combined for the purpose of meeting vesting and benefit eligibility requirements. Each system then pays a retirement benefit based on the years of service in that respective system, subject to the membership, benefits, and rights of that system. California calls its system reciprocity and allows each member's highest eligible average earnings to be used when calculating the retirement benefit under any reciprocal system.

**Florida** uses a similar approach to California's. The average final compensation is the average of the five highest fiscal years of earnings. **Wisconsin's** approach is also consistent with California's, in that service credits are not transferred from one system to another, but are instead combined for benefit eligibility purposes. It differs, however, in that each retirement system calculates benefits using the benefit

formula in effect on the date the member terminates all employment within the participating systems. The final average earnings from each earlier system are increased by the “national salary index,” updated to the last day paid for the last employment covered under one of the participating systems.

Combining service credit and corresponding benefits for portability can be a relatively simple procedure when the underlying plans are very similar. However, when the benefit structures are very different, the process can be more of a challenge. One challenge in Washington’s portability program is integrating a partial benefit from a Plan 1 with a partial benefit from a Plan 2 or 3. Some of the Plan differences are highlighted below:

Plans 1	Plans 2/3
60% cap	No cap
24 month AFC	60 month AFC
Include annual leave cash outs	Do not include annual leave cash outs
Service based retirement	Age based retirement

These plans vary considerably in basic design. Where the underlying systems vary greatly in structure, there is more potential under portability for unintended negative consequences for individuals with unique circumstances. There is also more potential for windfalls resulting in unintended risks being imposed on the retirement system.

Washington’s portability statute utilizes several tools to address the complexity of its underlying systems. To avoid penalizing individuals, members get to use their highest base salary from either system to calculate the benefit from the other system. They can use all the service credit from both systems in order to qualify for benefits. In those instances in which they are better off retiring from each system and not under dual membership, they can choose to do so and are not required to participate in the dual membership program.

To avoid penalizing the participating retirement systems, Washington’s portability statute uses a “base salary” definition that strips out elements of compensation that could be used to “spike” the final benefit such as overtime, sick leave cash outs, and other lump sum payments. It also requires that the total benefit be limited to the largest

amount the dual member would receive if all of the member's service had been rendered in one system – the "maximum benefit rule."

The following issues raise questions as to whether Washington's portability statute achieves the appropriate balance between allowing members to move freely between public employee retirement systems without creating undue penalties for them or their retirement systems.

## Issues Raised Under Washington's Portability Statute

The LEOFF 2 Board raised the first three of the following four issues. DRS identified the fourth issue.

### 1. Base salary definition

The portability statute's definition of base salary excludes the following components of compensation:

- ❖ Overtime
- ❖ Non-money maintenance compensation
- ❖ Lump sum payments for deferred annual sick leave
- ❖ Unused accumulated vacation
- ❖ Unused annual leave
- ❖ Any form of severance pay
- ❖ Any bonus for voluntary retirement
- ❖ Any other form of leave
- ❖ Any similar lump sum payment

*Overtime and lump sum payments are excluded from "base salary."*

See RCW 41.54.010(1). There is no legislative history indicating why Washington's portability statute excludes these elements of compensation from the definition of base salary. Thus, one can only speculate as to the policy reasons for the provision. The exclusions could be viewed as a means to limit costs associated with the dual membership program, especially costs to dual members' inactive systems. They could also have the purpose of

preventing members from using these elements to inflate their final pension benefits.

Generally speaking, leave cash-outs, leave payments, and other lump sum payments have been treated as compensation within the Plans 1 and not the Plans 2/3. In contrast, overtime is a part of compensation throughout the Plans 1, 2, and 3.

Since overtime is an element of compensation in most plans, its exclusion from the base salary definition is likely to cause the most consternation in members. For example, a member could earn overtime in two systems, pay pension contributions on the overtime, and yet not be allowed to include the overtime when substituting base salary under portability. This has been a member complaint in LEOFF 2. With the advent of PSERS, this complaint could become more widespread.

The following DRS-administered plans specifically include overtime in the definition of "earnable compensation":

- ❖ LEOFF Plan 2
- ❖ PERS Plans 2 and 3
- ❖ SERS Plans 2 and 3
- ❖ TRS Plans 2 and 3
- ❖ WSPRS Plans 1 and 2

PERS and TRS Plans 1 do not specifically include overtime in the definition, but they also do not exclude it. This paper has not examined the practices of the First Class Cities with respect to overtime. However, most Washington State Retirement Systems have categories of members whose salary may include overtime as a component of compensation and who pay pension contributions on overtime amounts. In fact, covered employers do not even report overtime separately to DRS. It is included within total wages, and must be manually calculated and excluded for dual members. DRS reports that overtime is an issue in 10-20 percent of its portability cases, and these usually involve a LEOFF 2 member.

As a general matter, overtime plus leave cash-outs and other lump sum payments could result in end-of-career paychecks that are significantly higher than those ever

received during the member's career. However, this risk is somewhat mitigated by the use of compensation averaging. The various Washington State retirement plans provide for an average final compensation of 24 (Plans 1) to 60 (Plans 2, 3) of the highest paid service credit months. A longer averaging period will usually yield a lower final benefit. Salary averaging is part of the balance between giving the member a benefit based on relatively current salary and protecting retirement systems from having to pay for final benefits that were not funded over the working lifetimes of their members.

The LEOFF 2 Board is proposing that payments defined as salary or compensation in **both** dual member systems should be included in base salary for portability purposes. The requirement of commonality of compensation elements between the two systems is intended to prevent members from utilizing portability to "game" the system, while still allowing members to get the benefit of compensation elements that were part of benefit packages.

The several states within Washington's comparative systems that have portability provisions similar to those in this state do not have an over-arching exclusion of overtime or other elements from salary. They simply use the member's best average final compensation to calculate the final benefit. For example, **California** uses the highest final compensation from either system, as defined by that system. This assumes that each system has built-in safeguards against pension ballooning. Some California plans use 12-month highest compensation and some use 36-month highest compensation. Members may use either as long as they retire on the same date from both systems. (Arkansas, Illinois, and Kentucky also use the highest final compensation from either plan.) **Florida's** definition of average final compensation is standardized across the various systems and uses the five highest fiscal years of earnings.

**Wisconsin's** approach is unique. Wisconsin uses the actual final average earnings from each system. However, in order to avoid penalizing the dual member's proportionate benefit from the earlier system, the final average earnings from the earlier system is increased by the "national salary

index" in 42 USC 415 (b)(3)(A), updated to the last day of paid employment.

All of these systems have implemented a variation on the policy that members should receive proportionate benefits from each system without using an outdated salary amount for the final benefit. In other states, as in this state, selecting the appropriate salary amount for calculating benefits under a dual membership program is one of the keys to making the program work for both members and employers.

The LEOFF 2 Board's proposal raises the following policy questions for the SCPP:

- A. If the portability statute is changed to include elements previously excluded from the definition of base salary, which elements should they be? Is overtime distinguishable from other elements that are currently excluded?
- B. If overtime, leave cash-outs, and lump sum payments are included in base salary for portability purposes, will retirement systems be forced to pay for benefits that were not funded over the working lives of their members?
- C. Will the requirement that the specific elements of compensation be present in both of the dual member's systems in order to be included in the portability benefit protect against this funding concern?

*Selecting the appropriate salary amount is one of the keys to making the dual membership program work.*

## 2. Benefit Limitations

Several of Washington's retirement systems have a "cap" on the percentage of average earnings that can be used to determine a member's final retirement benefit. Participating retirement systems with capped benefits include the following:

- ❖ WSPRS Plans 1 and 2 (75 percent cap)
- ❖ The Plans 1 of and PERS and TRS (60 percent cap)
- ❖ The City of Seattle (60 percent cap)
- ❖ The City of Spokane (64.5 percent cap)

The portability statute also limits the total benefit that can be obtained under dual membership. The "maximum benefit rule" provides that the total retirement benefit under dual membership shall not exceed the largest amount the dual member would receive if all the service had been rendered in any one system. Thus, if one or both of a dual member's retirement systems has a benefit cap, DRS will:

- A. Determine the maximum benefit. DRS computes the benefit for each system as if all career service and earnings occurred in that system, and using the plan provisions of that system, including any benefit cap. The system with the highest benefit establishes the maximum benefit.
- B. Determine the individual benefit. DRS will determine the individual benefit under each system and add the individual benefits together.
- C. Compare the total of the individual benefits with the maximum. If the total exceeds the maximum benefit, the benefits from each system will be proportionately reduced until the total equals the maximum benefit.

*Benefit "caps" and "the maximum benefit rule" are distinct concepts. Benefit caps apply to individual plans. The maximum benefit rule is part of the portability statute.*

An **example** of the application of this rule to a member in capped retirement systems is provided in Example 5 on page 7 of the attached DRS materials entitled *What is Dual Membership and How Does it affect Me?* In analyzing dual membership, it is helpful to keep the distinction between "caps" and the "maximum benefit rule" in mind. "Caps" refer to limits on the final retirement benefit within the individual plans. For example, in PERS and TRS Plan 1, members' final retirement benefit cannot exceed 60 percent of average final compensation. The "maximum benefit rule" is a concept under portability that limits the total benefit a member can receive from two systems.

Some history of specific portability provisions may be of interest in considering how benefit caps relate to portability. The original 1987 version of the portability statute strictly limited the total retirement benefit that dual

members could receive. It included a so-called "minimum benefit rule," which provided that:

*The total sum of the retirement allowances received under this chapter shall not exceed the **smallest** amount the dual member would receive if all the service had been rendered in any one system.*

*The "minimum benefit rule" was changed to the "maximum benefit rule" in 1996.*

At that time, most retirement system members were Plan 1 members and many of the dual members were in PERS 1 and TRS 1, both of which limited the ultimate retirement benefit to 60 percent of average final compensation. The minimum benefit rule prevented members from using dual membership as a means to avoid these Plan 1 caps.

Eventually, with new employees entering the Plans 2 and 3, there were more and more dual members in both capped and uncapped plans. Members were earning more service credit in uncapped systems, and dual membership was becoming less and less attractive for some members. The minimum benefit rule was changed in 1996 to a "maximum benefit rule," which currently provides:

*The total sum of the retirement allowances received under this chapter shall not exceed the **larger** amount the dual member would receive if all the service had been rendered in any one system.*

For members of capped and uncapped plans, this more recent version of the portability statute moved closer toward the implicit policy of allowing dual members to receive proportionate benefits from each retirement system without using an outdated salary amount for the final benefit.

As of September 30, 2005, there were approximately 1,000 members that were active in one capped and one uncapped plan, and another 200 inactive members who were in one capped and one uncapped plan. DRS estimates that about 5 percent of portability cases involving a Plan 1 cap result in imposition of the maximum benefit rule, and this is usually because of a large discrepancy between the average final compensation in the two systems.

The LEOFF 2 Board proposes to “ease restrictions on total service credit” for a dual member:

- ❖ Who is in one capped plan and one uncapped plan
- ❖ Who has less than 15 years of service credit in a capped plan.

Why 15 years? Fifteen years is consistent with the estoppel rule, which generally prohibits members who have 15 or more years of service and are receiving or eligible to receive a benefit from one system from becoming a member of a second system. Fifteen years also represents one-half of a Plan 1 career. Accordingly, this suggested “threshold” might help reduce the ability of members to “game” the system by switching from a capped to an uncapped plan. Also, according to staff, the LEOFF 2 Board does not oppose retaining benefit restrictions for members who are in two capped plans.

There is potentially another means for “easing restrictions” for these dual members by creating an exception to the maximum benefit rule for the suggested group. Such “easing of restrictions” could be viewed consistent with the codified legislative policy that persons hired into eligible positions shall accrue service credit for all service rendered, and their benefits shall be calculated in a manner that prevents the arithmetic lowering of benefits. See RCW 41.50.005(2) and (3).

On the other hand, lifting the cap or suspending the maximum benefit rule for some members within a plan and not others could create pressure to do the same for other members. It may also be viewed as inconsistent with the policy that the retirement systems of the state shall provide similar benefits wherever possible. See RCW 41.50.005(1). This latter policy is especially compelling where members are similarly situated.

The LEOFF 2 Board’s proposal raises the following policy questions for the SCPP:

- A. Would easing restrictions for certain dual members constitute a benefit improvement? Or is this more like the removal of a “penalty” under portability?
- B. Would easing restrictions for some dual members create pressures to do the same for others?

- C. Would easing restrictions for some dual members cause their retirement systems to take on obligations which were not funded over the working lifetimes of the affected members' careers?

### **3. Combining Service to Qualify for the Indexed Twenty-Year Term-Vested Benefit in LEOFF 2**

PERS, SERS, and TRS "Plan 3 indexing," provides for a 3 percent per year increase in the defined benefit portion of Plan 3 for any member who has terminated and is vested with at least twenty years of service. Such members are referred to as "term-vested." How is this relevant to dual membership? The portability statute allows dual members to combine service for the purpose of qualifying for the indexed term-vested defined benefit in the Plans 3. PERS, SERS, and TRS 3 are all specifically mentioned in the portability statute. See RCW 41.54.030(1)(b).

LEOFF 2 also provides a 3 percent per year benefit increase for members who have terminated and are vested with twenty years of service. This benefit was established in Section 5 of Chapter 517, Laws of 1993 (before the Plans 3 were established). When this law was passed, the bill specified that LEOFF 2 would be included as a system under portability, but it did not specifically amend RCW 41.54.030 to include the ability to combine service credit for qualifying for the indexed term-vested benefit. This was most likely an oversight.

With the establishment of the Plans 3, the portability statute was specifically amended to allow members to combine service credit in order to qualify for the indexed term-vested benefit. Adding LEOFF 2 to the list in subsection (1)(b) would be consistent with the codified legislative policy to provide similar benefits wherever possible.

### **4. Active vs. Inactive Employees**

The systems are not alike with respect to treating inactive employees as actives for portability purposes. In the PERS and the WSPRS Plans 1 there are different retirement eligibility rules for active and inactive members. If

members are active, they generally may retire earlier without a reduction in benefits than if they are inactive.

Current law allows PERS 1 inactive members (i.e., term-vested members who are no longer employed in that system) to be treated as actives for portability purposes. Portability does not allow such treatment for inactive members of the WSPRS. For example, an inactive member who is term-vested in WSPRS 1 and active in another system, and whose combined service would otherwise allow WSP retirement at age 55, would be required to wait to age 60 to retire. See RCW 43.43.280(2). This is an inconsistency in the application of the active vs. inactive rules within the portability statute itself.

DRS relies upon RCW 41.54.030(4), (which refers to the PERS 1 active eligibility standard in RCW 41.40.180), for the proposition that inactive members of PERS 1 are to be treated as active members under portability. Cases illustrating this inconsistency between PERS 1 and WSPRS 1 are relatively rare. However, resolving this discrepancy would be consistent with the codified legislative policy to provide similar benefits wherever possible. See RCW 41.50.005(1).

## General Policy Questions

What is the distinction between creating a benefit improvement, correcting an inconsistency, and lifting a penalty?

Is cost a factor in making these distinctions?

How can the dual membership program best achieve the goals of allowing members to move from one public employee retirement system to another without suffering a diminution of their total benefit?

How can the portability statute best protect the underlying retirement systems from unintended costs associated with dual membership?

## Conclusion

Most programs that facilitate intrastate portability seek to achieve a balance that allows members to move smoothly

and efficiently between public employee retirement systems. An ideal balance gives members full credit for service in each plan, while avoiding negative impacts on individuals and their retirement plans.

## Legislative Proposal

On December 12, 2006, the SCPP voted to recommend legislation that would:

- Amend the definition of base salary to include previously excluded payments (such as overtime) that are reportable in all of a dual member's retirement systems. The Washington State Patrol Retirement System was excluded from this benefit based on a request from the Washington State Patrol Troopers Association.
- Lift portability's "maximum benefit rule" (a rule designed to protect Plan 1 benefit caps) for members with less than 15 years of service in one capped plan and service in one uncapped plan.
- Add LEOFF 2 to the list of retirement plans whose members can combine service under portability in order to receive indexing of the term-vested benefit available to those with at least 20 years of service.

## Bill Draft

Attached.

## Fiscal Note (Draft)

Attached.

## Stakeholder Correspondence

Attached.

O:\Reports\Interim Issues\2006\Issues\4. Dual Membership\_issue\_paper.doc

---

**BILL REQUEST - CODE REVISER'S OFFICE**

---

BILL REQ. #: Z-0318.2/07 2nd draft

ATTY/TYPIST: LL:bat

BRIEF DESCRIPTION: Addressing the portability of public retirement benefits.

1 AN ACT Relating to the portability of public retirement benefits;  
2 amending RCW 41.54.010, 41.54.030, and 41.54.070; providing an  
3 effective date; and declaring an emergency.

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

5 **Sec. 1.** RCW 41.54.010 and 2004 c 242 s 58 are each amended to read  
6 as follows:

7 The definitions in this section apply throughout this chapter  
8 unless the context clearly requires otherwise.

9 (1) "Base salary" means salaries or wages earned by a member of a  
10 system during a payroll period for personal services and includes wages  
11 and salaries deferred under provisions of the United States internal  
12 revenue code, but shall exclude overtime payments, nonmoney maintenance  
13 compensation, and lump sum payments for deferred annual sick leave,  
14 unused accumulated vacation, unused accumulated annual leave, any form  
15 of severance pay, any bonus for voluntary retirement, any other form of  
16 leave, or any similar lump sum payment; except that forms of payment  
17 which are excluded under this subsection shall be included in base  
18 salary when reportable to the department in all of a dual member's

1 retirement systems, and when none of the dual member's retirement  
2 systems are the Washington state patrol retirement system.

3 (2) "Department" means the department of retirement systems.

4 (3) "Director" means the director of the department of retirement  
5 systems.

6 (4) "Dual member" means a person who (a) is or becomes a member of  
7 a system on or after July 1, 1988, (b) has been a member of one or more  
8 other systems, and (c) has never been retired for service from a  
9 retirement system and is not receiving a disability retirement or  
10 disability leave benefit from any retirement system listed in RCW  
11 41.50.030 or subsection (6) of this section.

12 (5) "Service" means the same as it may be defined in each  
13 respective system. For the purposes of RCW 41.54.030, military service  
14 granted under RCW 41.40.170(3) or 43.43.260 may only be based on  
15 service accrued under chapter 41.40 or 43.43 RCW, respectively.

16 (6) "System" means the retirement systems established under  
17 chapters 41.32, 41.40, 41.44, 41.35, 41.37, and 43.43 RCW; plan 2 of  
18 the system established under chapter 41.26 RCW; and the city employee  
19 retirement systems for Seattle, Tacoma, and Spokane.

20 **Sec. 2.** RCW 41.54.030 and 2003 c 294 s 13 are each amended to read  
21 as follows:

22 (1) A dual member may combine service in all systems for the  
23 purpose of:

24 (a) Determining the member's eligibility to receive a service  
25 retirement allowance; and

26 (b) Qualifying for a benefit under RCW 41.26.530(2), 41.32.840(2),  
27 41.35.620, or 41.40.790.

28 (2) A dual member who is eligible to retire under any system may  
29 elect to retire from all the member's systems and to receive service  
30 retirement allowances calculated as provided in this section. Each  
31 system shall calculate the allowance using its own criteria except that  
32 the member shall be allowed to substitute the member's base salary from  
33 any system as the compensation used in calculating the allowance.

34 (3) The service retirement allowances from a system which, but for  
35 this section, would not be allowed to be paid at this date based on the  
36 dual member's age may be received immediately or deferred to a later

1 date. The allowances shall be actuarially adjusted from the earliest  
2 age upon which the combined service would have made such dual member  
3 eligible in that system.

4 (4) The service retirement eligibility requirements of RCW  
5 41.40.180 shall apply to any dual member whose prior system is plan 1  
6 of the public employees' retirement system established under chapter  
7 41.40 RCW.

8 **Sec. 3.** RCW 41.54.070 and 1996 c 55 s 6 are each amended to read  
9 as follows:

10 (1) The benefit granted by this chapter shall not result in a total  
11 benefit less than would have been received absent such benefit.

12 (2) The total sum of the retirement allowances received under this  
13 chapter shall not exceed the largest amount the dual member would  
14 receive if all the service had been rendered in any one system. When  
15 calculating the maximum benefit a dual member would receive: ~~((1))~~

16 (a) Military service granted under RCW 41.40.170(3) or 43.43.260 shall  
17 be based only on service accrued under chapter 41.40 or 43.43 RCW,  
18 respectively; and ~~((2))~~ (b) the calculation shall be made assuming  
19 that the dual member did not defer any allowances pursuant to RCW  
20 41.54.030(3). When a dual member's combined retirement allowances  
21 would exceed the limitation imposed by this ~~(section)~~ subsection, the  
22 allowances shall be reduced by the systems on a proportional basis,  
23 according to service. The limitation imposed by this subsection shall  
24 not apply to a dual member with:

25 (i) Less than fifteen years of service credit in a plan with a  
26 retirement benefit cap as defined by the department; and

27 (ii) Service credit in a plan with no retirement benefit cap.

28 NEW SECTION. **Sec. 4.** This act is necessary for the immediate  
29 preservation of the public peace, health, or safety, or support of the  
30 state government and its existing public institutions, and takes effect  
31 July 1, 2007.

--- END ---

# DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	12/6/06	Z-0318.2

## SUMMARY OF BILL:

This bill impacts the teachers' retirement system (TRS), the public employees' retirement system (PERS), the statewide city employees' retirement system, the school employees' retirement system (SERS), the public safety employees' retirement system (PSERS), the Washington state patrol retirement system (WSPRS), plan 2 of the law enforcement officers and firefighters' retirement system (LEOFF2), and the city employee retirement systems for Seattle, Tacoma and Spokane. The bill amends the chapter providing portability of public employee retirement benefits to remove certain adverse impacts on public employees who change retirement systems during the course of their careers:

1. Overtime - Allows previously excluded forms of payment that are reportable (for contribution purposes) in each of a dual member's retirement systems to be included within the portability chapter's "base salary" definition with the following exception: neither of the dual member's retirement systems can be the Washington state patrol retirement system. As a practical matter, this will mostly apply to overtime. The change will allow certain members to use more of their compensation to determine their final retirement benefit.
2. Service Cap - Lifts portability's "maximum benefit rule" for dual members who have (a) less than 15 years of service in one capped plan; and (b) service in one uncapped plan.
3. Indexing - Adds LEOFF Plan 2 to the list of plans that are able to combine service under portability to receive indexing of the term-vested benefit for members with at least twenty years of service.

Effective Date: July 1, 2007

## CURRENT SITUATION:

Currently the portability chapter limits the definition of "base salary" that is used to calculate a dual member's final retirement benefit. Portability's definition excludes overtime payments, non-money maintenance compensation, lump sum payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, any form of severance pay, any bonus for voluntary retirement, any other form of leave or any similar lump sum payment. See RCW 41.54.010.

Currently, all dual members are subject to the "maximum benefit rule." This limit on a dual member's total retirement benefit is found in RCW 41.54.070. It provides: "The total sum of the retirement allowances received under this chapter shall not exceed the largest amount the dual member would receive if all the

service had been rendered in any one system." When a dual member's combined retirement allowances would exceed this limitation, the allowances are reduced by the systems on a proportional basis, according to service.

Currently, LEOFF Plan 2 is omitted from the list of plans whose members can combine service under portability for the purpose of receiving indexing of the term-vested benefit for members with at least 20 years of service. See RCW 41.54.030 (1)(b).

**MEMBERS IMPACTED:**

We estimate that 11,754 active dual members out of the total 290,111 active members of LEOFF, PERS, TRS, SERS, and WSPRS as of September 30, 2005 would be affected by this bill.

The following table provides counts of dual members within Washington State's retirement systems. Not all dual members would be impacted by the each provision. The provision on overtime may impact all dual members, the provision on the service cap would only impact dual members with service in a Plan 1 and Plan 2/3, and the provision on indexing would only impact LEOFF Plan 2 dual members.

Summary of Active Dual Members						
As of 9/30/2005						
Active System	Dual Member System					Total
	LEOFF	PERS	TRS	SERS	WSPRS	
LEOFF		1,545	32	17	23	1,617
PERS	266		361	757	6	1,390
PSERS ( <i>Estimated</i> )		1,857				1,857
TRS	29	5,148		1,084	0	6,261
SERS	15	293	152		1	461
WSPRS	10	154	3	1		168
<b>Total</b>	<b>320</b>	<b>8,997</b>	<b>548</b>	<b>1,859</b>	<b>30</b>	<b>11,754</b>
Dual members not active in either dual system.						1,502
Estimated Dual Plan 1/Plan 2,3 Members active in one system.						1,000
Estimated Dual Plan 1/Plan 2,3 Members not active in either system.						100

The bill would also impact all PSERS members who elected to transfer from PERS. We received preliminary counts of the PERS members who chose to transfer into PSERS from DRS indicating that 1,857 members elected to transfer.

We estimate that for a typical member impacted by this bill, the increase in benefits would be a 1 percent to 11 percent increase in the benefit from the dual member system.

## METHODS AND ASSUMPTIONS:

### Actuarial Methods

#### Overtime

We developed the assumptions about overtime earned by active members from the respective systems as described below. We took the ratios of the number of inactive Dual Members (DM) now active in a given system to the total inactive DM regardless of current active system. To determine the percentage liability increase to the system the DM were inactive in, we used the benefit increase from overtime (1), the percent of retirees in the active system who had dual membership in another system (2), and spread this liability over the Terminated Vested (TV) population of the inactive system (3). We divided this number by two since on average DM have half the service per system:

Percent liability increase to inactive system = (1) x (2) x (3) / 2 summed over all active/inactive combinations for a fixed inactive system.

We repeated this step for all active/inactive combinations for each system and summed the results to get the total liability increase for each respective system. The total liability increase as a percent was multiplied by the systems' Present Value of Fully Projected Benefits (PVFB) to convert the percent to a dollar amount. The dollar amount of liability was divided by the systems' Present Value of Future Salaries (PVSa) to determine the contribution rate increase, if any.

#### Service Cap

We compared the numbers of DM who were active in a system with an uncapped accrual percentage that came from a capped system (e.g. active in a Plan 2, inactive in a Plan 1) with the total actives in the uncapped system. Example: Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 2 members could be DM in the Public Employees' Retirement System (PERS) Plan 1, Teachers' Retirement System (TRS) Plan 1, and the Washington State Patrol Retirement System (WSPRS) Plan 1. For each of the capped inactive systems, we formed the ratio of the number of DM per inactive system to the total DM who are active in an uncapped system. For each of these combinations we assumed a certain percentage of the DM would actually be able to increase their benefit under this proposal. For those people who would utilize the benefit we assumed they would receive a 7.5 percent increase in their benefit and that they had half the average service as a non-DM in the active system. The percentage liability increase for each combination is the product of the ratio of actives in the uncapped system retiring from a capped system (1), multiplied by the rate at which that group was assumed to benefit from the proposal (2), times the percent increase in benefit (3), divided by two:

Percent liability increase to active system = (1) x (2) x (3) / 2 summed over all active/inactive combinations for a fixed active system.

For each active uncapped system the total percentage liability increase is the sum of the individual combinations of percentage liability increases for each combination of DM from a capped plan. We converted these respective liability percentage increases to contribution rate increases in the same manner described in Proposal 1.

## Indexing of Terminated Vested Benefits

We started with the LEOFF 2 terminated vested liabilities (1) and took 10 percent of that liability (2) to assign to the DM who would benefit from this proposal. We assumed their benefit would increase by 15 percent (3) and that they had half the service of the average member. We divided by LEOFF 2 PVSal to determine the rate increase.

$$\text{Dollar liability increase to LEOFF 2} = (1) \times (2) \times (3) / 2$$

The methods chosen are reasonable for the purpose of the actuarial calculations presented in this fiscal note. Use of another set of methods may also be reasonable and might produce different results.

## Actuarial Assumptions

In determining the costs of these proposals we identified dual members from the 2005 valuation data and studied the amount of overtime earned by active members. We then developed assumptions on how many dual members would be impacted by each proposal and how much the liability would increase for members impacted.

- For all provisions we assumed there would be no change in retirement behavior resulting from the passing of any single proposal or combination of these proposals into law.
- We assumed, based on a study of average overtime earned by active members per system, that liabilities for dual members would increase in the inactive system due to overtime earned in the active system at the following rates:

Active System	Overtime Rate
PERS	3.00%
PSERS	10.00%
TRS	0.00%
SERS	1.00%
LEOFF	11.00%
WSPRS	9.00%

- We assumed that 20 percent of dual members would benefit from lifting the “maximum benefit rule” (the service cap) and that the average increase in benefits would be 7.5 percent.
- We assumed that 10 percent of LEOFF 2 terminated vested members would benefit from combining service to receive the indexed term-vested benefit (indexing)
- We assumed any contribution rate increases would be supplementary rates effective September 1, 2007.

The assumptions chosen are reasonable for the purpose of the actuarial calculations presented in this fiscal note. Use of another set of assumptions may also be reasonable and might produce different results.

**Data**

We relied upon system membership data provided by the Department of Retirement Systems (DRS). We also relied upon DRS for an estimate of the number of members who transferred to the Public Safety Employees' Retirement System (PSERS). An audit of the data was not performed, however, we believe the data to be reasonable for the purpose of the actuarial calculations presented in this fiscal note. Use of different data may also be reasonable and may produce different results.

**FISCAL IMPACT:**

**Description:**

The provision on overtime would have a cost and impact on contribution rates. The provisions on the service cap and indexing would have a cost, but the new plan changes would apply to so few members that the costs would not impact contribution rates.

**Actuarial Determinations:**

The proposal will impact the actuarial funding of the system by increasing the present value of benefits payable under the systems and the required actuarial contribution rate as shown below:

<i>(Dollars in Millions)</i>	System/Plan	Current	Increase	Total
<b>Actuarial Present Value of Projected Benefits</b>				
(The Value of the Total Commitment to all Current Members)	PERS	\$31,601	\$8	\$31,609
	TRS	\$17,119	\$0	\$17,119
	SERS	\$2,473	\$1	\$2,474
	LEOFF	\$9,700	\$0	\$9,700
	WSPRS	\$803	\$0	\$803
<b>Unfunded Actuarial Accrued Liability</b>				
(The Portion of the Plan 1 Liability that is Amortized at 2024)	PERS	\$3,567	\$0	\$3,567
	TRS	\$2,147	\$0	\$2,147
	LEOFF	(\$584)	\$0	(\$584)
<b>Unfunded Liability (PBO)</b>				
(The Value of the Total Commitment to all Current Members Attributable to Past Service)	PERS	\$828	\$8	\$836
	TRS	\$969	\$0	\$969
	SERS	(\$315)	\$1	(\$314)
	LEOFF	(\$974)	\$0	(\$974)
	WSPRS	(\$80)	\$0	(\$80)

<b>Increase in Contribution Rates</b> (Effective 9/1/2007)	
<b>System/Plan</b>	<b>PERS</b>
<b>Current Members</b>	
Employee	0.01%
Employer	0.01%
<b>New Entrants</b>	
Employee	0.01%
Employer	0.01%

As a result of the higher required contribution rates, the estimated increase in funding expenditures for all proposals and systems combined is projected to be:

<b>Dual Membership - Projected Costs</b>	
Costs (in Millions)*	<b>PERS</b>
<b>2007-2009</b>	
State:	
General Fund	\$0.2
Non-General Fund	<u>0.3</u>
<b>Total State</b>	<b>0.5</b>
Local Government	<u>0.7</u>
<b>Total Employer</b>	<b>1.2</b>
<b>Total Employee</b>	<b>\$1.0</b>
<b>2009-2011</b>	
State:	
General Fund	\$0.2
Non-General Fund	<u>0.3</u>
<b>Total State</b>	<b>0.5</b>
Local Government	<u>0.8</u>
<b>Total Employer</b>	<b>1.3</b>
<b>Total Employee</b>	<b>\$1.0</b>
<b>2007-2032</b>	
State:	
General Fund	\$1.7
Non-General Fund	<u>2.7</u>
<b>Total State</b>	<b>4.4</b>
Local Government	<u>6.8</u>
<b>Total Employer</b>	<b>11.2</b>
<b>Total Employee</b>	<b>\$9.2</b>

## Sensitivity Analysis

For the benefit improvement related to overtime, if the experience of Average Final Compensation (AFC) increase from overtime were 50 percent higher than we assumed for all active systems, the contribution rates would increase as follows:

System	Member	Employer	State
PERS	0.01%	0.01%	
PSERS	0.00%	0.00%	
TRS	0.00%	0.00%	
SERS	0.01%	0.01%	
LEOFF	0.00%	0.00%	0.00%

For the benefit improvements related to the service cap and indexing, assuming a 50 percent higher than expected increase in benefits still had no impact on contribution rates.

## STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the preliminary September 30, 2005 actuarial valuation report of the Public Employees' Retirement System, the Teachers' Retirement System, the School Employees' Retirement System, the Law Enforcement Officers' and Fire Fighters' Retirement System, and the Washington State Patrol Retirement System.
2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.
3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:
4. 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.
5. This draft fiscal note is intended for use only during the 2007 Legislative Session.
6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.
7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.
8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members.

## GLOSSARY OF ACTUARIAL TERMS:

**Actuarial accrued liability:** Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

**Actuarial Present Value:** The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

**Aggregate Funding Method:** The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

**Entry Age Normal Cost Method (EANC):** The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

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

**Normal Cost:** Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

**Pension Benefit Obligation (PBO):** The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

**Projected Benefits:** Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

**Unfunded Liability (Unfunded PBO):** The excess, if any, of the Pension Benefit Obligation 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.



STATE OF WASHINGTON  
LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS'  
PLAN 2 RETIREMENT BOARD

P.O. Box 40918 • Olympia, Washington 98504-0918 • (360) 586-2320 • FAX (360) 586-2329 • [www.leoff.wa.gov](http://www.leoff.wa.gov)

March 9, 2006

**RECEIVED**

MAR 10 2006

Office of  
The State Actuary

Select Committee on Pension Policy  
C/O The Office of the State Actuary  
Post Office Box 40914  
Olympia, Washington 98504-0914

Dear Honorable Members of the Select Committee on Pension Policy:

On behalf of the Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 2 Retirement Board (Board), I would like to congratulate you on another successful legislative session.

I want to bring three topics to your attention as you begin preparations for the 2006 interim. It is my hope that the Select Committee on Pension Policy (SCPP) and the Board can work cooperatively on these issues to develop legislation. Two of these topics, Dual Membership Corrections and Service Credit Purchase for Duty-Related Injury, came up in 2005 and were deferred by both the SCPP and the Board for full study in 2006. The third topic, Adding an Inflationary Adjustment to the \$150,000 Death Benefit, arose as a result of Board legislation in the 2006 session.

I have provided a brief summary of each topic for your reference:

**Dual Membership**

The Board studied impacts of making changes to the current dual membership statutes last year. Under the current portability statutes (RCW 41.54), there are situations where a member's pension benefits would seem to be unnecessarily penalized, if the member changes careers. Changes to the dual membership statutes studied by the Board included:

- Easing restrictions on total service credit if a Plan 2 member has less than 15 years of Plan 1 service.
- Adding indexing to all plans that allow shared service to qualify for indexing.
- Redefining base salary so that payments defined as salary or compensation, in both dual member systems, would be included in base salary.



**Service Credit Purchase for Duty-Related Injury**

The Legislature passed a bill in the 2004 session, which increased the period of service credit that could be purchased by a PERS member, who is on a leave of absence for a duty-related injury. The Board would like to study extending this policy to other pension plans, including LEOFF Plan 2.

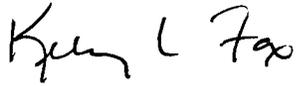
**Inflationary Adjustment for \$150,000 Death Benefit**

As you may be aware, the Board recommended legislation on this topic in 2006 (SHB 2933 - Death Benefit for Occupational Illnesses), which was passed with an amendment removing the annual inflation increase. Since other retirement plans also provide a lump-sum death benefit, legislators expressed an interest in the Board working with the SCPP to study the effect of adding this inflationary adjustment to all the plans.

Please feel free to contact me or Steve Nelsen, LEOFF 2 Board Executive Director, should you have any questions or like any additional information. Steve can be reached at (360) 586-2320 or [steve.nelsen@leoff.wa.gov](mailto:steve.nelsen@leoff.wa.gov), and I can be contacted at (360) (360) 943-3030 or [pres@wscff.org](mailto:pres@wscff.org).

We would be happy to meet with you to discuss these topics at an upcoming SCPP or LEOFF Plan 2 Retirement Board meeting. Thank you for your consideration and we look forward to working with you.

Sincerely,



Kelly Fox, Chair

cc: Matt Smith, State Actuary



# WASHINGTON STATE PATROL TROOPERS ASSOCIATION

200 UNION AVE. SE STE. 200, OLYMPIA, WA 98501 (360) 704-7530 FAX (360) 704-7527

**COPY**

November 14, 2006

The Honorable Craig Pridemore, Chair  
Select Committee on Pension Policy  
5419 NE Chateau Drive  
Vancouver, WA 98661

Dear Senator Pridemore,

It has come to our attention that the Select Committee on Pension Policy is considering two portability issues affecting the Washington State Patrol Retirement System. The first is a LEOFF 2 Board proposal that would include overtime in the base salary of the WSPRS portion for employees that have left the state patrol and subsequently entered the LEOFF 2 system. We are told that this change would cause a .02% increase in the contribution rate of current WSPRS members and the employer. The members of the Washington State Patrol Troopers Association are OPPOSED to this change at this time.

The second portability issue involves "active member status for former WSPRS members that leave the system before retirement eligibility and enter PERS 2" and establishes dual membership. An active WSPRS member can retire at age 55, however in inactive member can only exercise a retire option at age 60. To change this policy the active WSPRS members and employers contribution rate would be increased by .09%. The members of the Washington State Patrol Troopers Association are OPPOSED to this change as well.

We appreciate the work of the SCPP on the WSPRS Rate Stabilization bill and look forward to seeing that measure once again recommended to the 2007 Legislature. Rate stabilization is the number one priority policy issue for the members of the Troopers Association. We would like to see this policy approved by the legislature before any further costly changes to the system are introduced.

Thank you for your consideration.

Sincerely,

Tom Pillow  
President

Cc: Representative Bill Fromhold