Disability Benefits

Description Of Issue

The SCPP considered the disability benefits provided in the Plans 2/3 of the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS). Stakeholders submitted a proposal to the SCPP on this issue.

This issue raises two immediate policy questions:

- ❖ Should the state assume more responsibility to provide disability protection? If yes,
- ❖ Should the improvements be provided to members through pension enhancements, through insurance products, or both?

Policy Highlights

- ❖ In the design of the Plans 2/3, members have the primary responsibility to provide income replacement if disabled.
- ❖ The Plans 2/3 provide access to the value of the benefit earned to date when members become disabled.
- ❖ Not all employers offer access to disability insurance products.
- ❖ There are many ways to design a disability benefit within the retirement plans or through insurance products.
- ❖ Changing certain aspects of a disability benefit without fully studying the impacts may create additional issues to consider.

Options For Changing Plan 2/3 Disability Benefits

Policy makers who wish to address the disability benefits for members of the Plans 2/3 may consider the following options:

- ❖ **Option 1: The Original Stakeholder Proposal.**
    - o Provide increased disability pension benefits to Plans 2/3 members based upon years of service and age and using the current standard for disability.

  - Also requires the Washington State Institute for Public Policy (WSIPP) to study options for providing access to disability insurance to all members of the Plans 2/3.

- **Option 2: Revised Stakeholder Proposal.**
  - The same as the original stakeholder proposal except that in order to qualify for the increased pension benefits, members must meet the standard of disability used by the Social Security Administration.

- **Option 3: Insurance Study Only.**
  - This option would implement the study portion only of Option 1 and Option 2.

Committee Activity

Staff briefed the Committee on this issue in October and December. The Committee held a public hearing and took executive action in December. The Committee recommended a revised version of Option 3 to the Legislature. The revised Option 3 expands the study to include pension benefits.

Recommendation To 2009 Legislature

Direct the Washington State Institute for Public Policy, with the assistance of the Office of The State Actuary, to study options for addressing the needs of PERS Plan 2/3, TRS Plan 2/3, and SERS Plan 2/3 members for adequate disability benefit coverage.

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Disability Benefits

In Brief

ISSUE

If disability benefits should be improved, should the improvements come through modifying the pension-provided benefits, through insurance products, or both? Stakeholders have made a recommendation to improve the pension-provided benefits in the PERS, TRS, and SERS Plans 2/3 and to study supplemental insurance options.

MEMBER IMPACT

This issue impacts all members of PERS, TRS, and SERS Plans 2/3 who meet the disability standard. See Table 1 for data on current disability retirees in these systems or plans.

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Introduction

The Select Committee on Pension Policy (SCPP) is being asked to improve the disability benefits provided in the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS) Plans 2/3. This issue raises two immediate policy questions:

- Should the state assume more responsibility to provide disability protection for these members? If yes,
- Should the improvements be provided to members through pension enhancements, through insurance products, or both?

The SCPP has undertaken comprehensive study of disability benefits in the 2005 and 2007 Interims. This paper will not seek to reproduce all that same information, but instead will focus on the two primary questions above as it relates to PERS, TRS, and SERS Plans 2/3, the plans addressed in the stakeholder proposal. However, if the Committee chooses to move forward on this issue, additional policy considerations could be developed in a future issue paper.

See Appendix A for new information and analysis specifically related to changing the disability standard in the Plans 2/3.

Table 1

Plan 2/3 Disability Retirements
Source: 2007 Actuarial Valuation Report

	PERS		TRS		SERS	
	Plan 2	Plan 3	Plan 2	Plan 3	Plan 2	Plan 3
Count	1,549	48	87	44	156	57
Avg. Current Age	63.7	57.5	62.7	58	61.3	60.5
Avg. Yrs Retired	6.9	2.1	6.3	4.4	3.6	3.3
Avg. Benefit Received	$374	$229	$544	$210	$289	$191

Current Situation In The Plans 2/3

Currently, members have several potential sources that may provide some level of disability benefit. They are:

- Pension provided benefits.
- Insurance provided benefits.
- Other programs.

These three areas of potential disability coverage are explained in greater detail below.

Pension Benefits

A Plans 2/3 member is eligible for a disability benefit from their retirement plan when they are "totally incapacitated for continued employment by an employer." To *qualify* for the benefit, it doesn't matter how you became disabled, your age when you became disabled, or your years of service when you became disabled. An eighteen-year-old employee in their first month of employment can qualify for a disability retirement (although the value of the benefit would be quite small).

Once the Department of Retirement Systems (DRS) approves the disability, members are provided an *earned disability benefit.* This benefit type is calculated using the member's age, salary average, and years of service, and simply provides access to the benefit earned up to the point where the member left employment due to the disability. Since this typically occurs before a member was eligible to begin drawing their retirement benefit, the monthly benefit value is adjusted to reflect the longer time it will be paid out.

This monthly amount can seem small when spread over a long lifetime. It is likely that some disabled members, when shown the small monthly value of their benefit, choose instead to withdraw their contributions and interest.

The earned disability benefit for a Plans 2/3 member retiring at age 50 is actuarially reduced to 24 percent of its base amount.

Table 2 on the next page provides an example of how this type of benefit is calculated.

A PERS, TRS, or SERS Plan 2 member who becomes disabled and retires at age 50 would receive a benefit reduced to 24 percent of its base amount.

Table 2

PERS, TRS, or SERS Plan 2 Earned Disability Retirement Benefit Source: OSA	
Age	50
Average Final Compensation (AFC)	$4,000
Years of Service	20
Base Percent	40%
Base Benefit (monthly)	$1,600
Actuarial Adjustment Factor (15 yrs early)	24%
Adjusted Benefit (monthly)	$384

Note: A Plan 3 member of the same age and AFC would have a defined benefit based on a 1 percent formula; the base percent, base benefit, and adjusted benefit would be half the amounts in the above table. The Plan 3 member would also have access to the accumulations in their defined contribution account.

Insurance Benefits

In addition to the earned disability benefit within the Plans 2/3, some members may also purchase disability insurance through their employer, though not all employers provide access to insurance for their employees. The state offers benefits to all employees of state agencies and the Legislature through the Public Employees' Benefits Board (PEBB). Local government employers and school districts choose their own benefit packages for employees, of which the benefits offered by PEBB are one option.

Members may also purchase insurance benefits through their employer, though not all employers provide access and not all members with access purchase the coverage.

One example of a disability insurance program is the insurance program offered to all eligible state employees. For state employees, a small insurance benefit is provided, paid for by the state, and the member can purchase additional coverage. However, not all members choose this additional coverage. The Health Care Authority (HCA) statistics show that only 40 percent of eligible state employees actually purchase this benefit.

There is a wide variety of disability insurance benefits programs that public employers can offer. Each program can vary the qualification requirements, the amounts paid, and the time-period over which they are paid. Typically, insurance benefits pay a percentage of the member's salary at the time of injury or illness. The percentage of salary replaced is often a choice of the holder, up to a plan maximum percentage. The policy holder can sometimes pick the period of payments, and many offer lifetime payout options. Insurance companies also offer products to address short-term disabilities and, in many cases, the short-term and long-term benefits are in the same policy. This issue paper will focus on the long-term products, as they are most comparable to pension-provided disability retirement benefits.

Other Disability Benefit Programs

Plans 2/3 members may also receive disability benefits from other state or federal programs. Members disabled because of an on-the-job injury may receive benefits from the Workers' Compensation program through the Department of Labor and Industries (L&I) or a similar "self-insured" workers' compensation program operated by their employer. Also, disability benefits are available for any member covered under the Federal Social Security program. In Washington State, most PERS, TRS, or SERS Plans 2/3 employees are covered by Social Security.

Background

This section of the issue paper provides some history of the disability provisions within the Plans 2/3, as well as some background about other methods of providing disability benefits within pension systems. Disability benefits in other plans differ from the earned disability benefit provided in the Plans 2/3. Examples of the disability benefits offered in the other retirement systems in Washington will illustrate these differences.

History

With the creation of the Plans 2 in 1977, there was a definitive shift in benefit policy. The Plans 1 in each system tended to provide additional benefits to members other than pure retirement benefits. These benefits included such items as free military service credit, medical benefits, additional survivor payments, and enhanced benefits for disabled members. In the design of the Plans 2, many of those "non-retirement" benefits were eliminated, which reduced the long-term cost of the plans. That policy design regarding additional benefits carried into the design of the Pans 3 in the middle and late 1990s.

Legislative improvements in disability benefits have occurred over the past several years. In 2004, the SCPP sponsored legislation that created PSERS. The disability provision in the PSERS plan allows members with ten years of service credit to retire with a benefit actuarially reduced from age sixty; five years earlier than in PERS, TRS, or SERS.

The most recent improvements in disability benefits have focused on LEOFF 2 and have moved the plan away from the earned benefit design for work related disabilities.

The other legislative improvements have focused on Law Enforcement Officers' and Fire Fighters' (LEOFF) Retirement System Plan 2 disability benefits, and have moved the plan away from the earned disability benefit design used in the Plans 2/3. Changes passed in the 2004, 2005, and 2006 legislative sessions provided additional disability benefits to members who suffer a work or duty-related injury or illness.

In the 2005 and 2007 interims, the SCPP studied comprehensive disability benefits policies. However, no proposals were submitted to the Legislature based upon either study.

Other Methods Of Providing Disability Benefits Within Pension Systems

There are two other primary methods of providing disability benefits within pensions, other than the earned disability benefit method provided by the Plans 2/3. They are:

- ❖ Enhanced earned disability benefit.
- ❖ Guaranteed disability benefit.

These two methods are explained in greater detail below.

The Enhanced Earned Disability Benefit

The enhanced earned disability benefit is not fully reduced for early retirement.

This method provides members with a benefit calculated like the earned disability benefit in the Plans 2/3, but the benefit is either not fully reduced or not reduced at all for early retirement. Because the benefit is not fully reduced, the member will receive additional value over their lifetime. PERS 1 non-duty disability and TRS 1 disability are examples of enhanced earned disability benefits. Table 3 below shows how the benefits are calculated in these plans.

Table3

TRS and PERS Plan 1 Enhanced Earned Disability Retirement Benefit Source: OSA		
Plan	**TRS 1**	**PERS 1**
Age	50	50
Average Final Compensation (AFC)	$4,000	$4,000
Years of Service	20	20
Base Percent	40%	40%
Base Benefit (monthly)	$1,600	$1,600
Adjustment Factor (per year early)	0%	2%
Adjusted Benefit (monthly)	$1,600	$1,440

This table shows the increased monthly benefit provided to disabled members in an enhanced earned benefit plan, as compared to the earned disability benefits provided to members of the Plans 2/3 (shown in Table 2), given the same age, salary average, and years of service. Again, the enhanced earned disability benefits provide additional lifetime value to the member.

The Guaranteed Disability Benefit

This type of benefit provides disability retirees with a percentage of their salary at the time they were disabled, regardless of their age and years of service. This type of benefit also typically provides more lifetime benefit than an earned disability benefit.

Table 4 on the following page provides an example of how LEOFF Plan 1 calculates its guaranteed disability benefit.

Table 4

LEOFF Plan 1 Guaranteed Disability Retirement Benefit Source: OSA	
Age	40
Final Average Salary (FAS)	$4,000
Years of Service	20
Base Percent	Always 50%
Benefit (monthly)	$2,000

A guaranteed disability benefit provides a percentage of salary, regardless of age or years of service.

As this example shows, the benefit provided is not based upon age, nor is it based upon years of service. In this guaranteed disability plan, the disabled member will always receive half of his or her salary average, even if the disability occurred in the first month of employment.

Funding The Three Methods Of Providing Disability Benefits In Pension Systems

The primary difference between these methods is how they are funded.

As explained earlier in the paper, earned disability benefits, such as in the Plans 2/3, only provide access to the benefit value already earned when the member became disabled. The value of that benefit is spread over a lifetime, resulting in the reduced monthly payment. The benefits received are funded by the individual member and employer contributions, plus interest.

Enhanced disability benefits provide greater lifetime value than the member had earned when they became disabled.

The enhanced earned disability benefit and the guaranteed disability benefit provide **greater** lifetime value to a member than what they had earned when they became disabled. This greater value is funded by additional member and employer contributions paid by *all* plan members. Essentially, the increased value of an enhanced disability benefit is subsidized by all the rest of the plan members and employers. Providing greater benefits for the few based on contributions by all can create additional policy considerations. This is what the stakeholders are proposing, and the considerations of this will be discussed later in the policy section of the issue paper.

Recap

To summarize, the three methods of providing disability benefits in the pensions are:

Earned disability benefit: Reduced benefit to spread value over a lifetime (Plans 2/3).

Enhanced earned disability benefit: Additional value added by eliminating or reducing early retirement adjustments. Additional value funded through additional contributions by all members.

Guaranteed disability benefit: Additional value added by paying a percentage of salary regardless of age or years of service when disabled. Additional value funded through additional contributions by all members.

Stakeholder Proposal

The Public Employees for Pension Reform (PEPR) coalition provided a proposal to the SCPP that increases the Plans 2/3 disability benefits.

The PEPR Coalition provided the committee with a proposal to increase the disability benefits in the Plans 2/3 and to examine options to provide standard disability insurance access to all Plan 2/3 members.

This proposal calls for an enhanced disability benefit within the Plans 2/3. This benefit would be funded by additional contributions by all members and employers. The proposal does not differentiate between duty and non-duty causes of disability (both receive the same level of benefit) nor does it call for the benefits provided to be off-set if receiving benefits from other sources, such as L&I or Social Security. The type of benefit provided is an enhanced earned disability benefit, and the standards to qualify for the benefit would remain unchanged.

The proposal also calls for expanded access to disability insurance products. This would ensure all Plans 2/3 members would have the option to purchase disability insurance, regardless of whether their employer offers the benefit.

The details of their proposal are as follows:

- **Provide an enhanced earned disability benefit to PERS, TRS, and SERS Plans 2/3 members with more than ten years of service, based on 30-year Early Retirement Reduction Factors (ERRFs).**

- No change in current rules governing disability eligibility (duty and non-duty).
- Eligible Plans 2/3 members with 20 or more years of service could retire using an ERFF that is a reduction of 3 percent for each year of age less than 62.
- Eligible Plans 2/3 members with ten or more years of service, but less than 20 could retire using a reduction equal to 3 percent for each year of age under age 65.

❖ **Supplemental Option**: **Opt-In Disability Retirement Insurance provided through either DRS or HCA.**
The SCPP would ask the Washington State Institute for Public Policy (WSIPP) or other appropriate body to study, develop proposals, and report back on insurance product options:
- For members who do not qualify (due to less than ten years of service) for the above disability retirement provisions.
- For additional replacement income for members that do qualify for the disability retirement proposal (above), but need additional income to compensate for the reduced retirement benefit.
- Available to all Plans 2/3 members, regardless of whether their employer offers the benefit.

Policy Analysis

The two primary policy questions regarding disability benefits in the Plans 2/3 are:

1. Should the state assume more responsibility to provide disability protection? If yes,
2. Should the improvements be provided to members through pension enhancements, through insurance products, or both?

The design of the Plans 2/3 placed the responsibility to provide replacement income when disabled primarily on the member.

Should The State Assume More Responsibility?

What role should government play in the lives of its employees? As mentioned earlier, the Plans 2/3 design generally only provides traditional retirement benefits. Consequently, the disability benefit offered within the plans is only the value of the accrued service to the time of disability. This value can seem small on a monthly basis when spread over a long lifetime. However, it was never the intent in the Plans 2/3 design to have the pension system be the primary provider of income should the member become disabled. The design only ensures the member has access to his or her accrued retirement value. In contrast, benefits provided by the other plans are more generous, and provide a more substantial replacement of income when disabled.

If the plan design does not provide the primary source of replacement income, then the burden to provide that income falls to the member. Notwithstanding other forms of mandatory disability coverage, such as Social Security benefits or workers' compensation programs, this can be accomplished through employer-provided or individually obtained insurance policies. To decide to assume more responsibility for the state, therefore, would imply a judgment by policy-makers that individual responsibility in this area is not resulting in adequate coverage.

Finally, most employees will one day retire (from some employment, if not necessarily public employment), and most will also have need of medical attention at some point, but the majority of workers will not suffer a career ending disability. Are mandates for all employees appropriate when not all will ever use the benefit? Or, conversely, is the impact of the event when it does happen significant enough from a societal standpoint to ensure all are protected?

Is Individual Responsibility Working?

Many members aren't choosing to purchase insurance coverage. As previously provided, only 40 percent of state employees purchase additional disability insurance. One reason could be lack of information. Perhaps members aren't aware of the benefit, or aren't aware of the value of ensuring adequate replacement income. Another factor could be cost. Paying premiums for a statistically unlikely occurrence may not be a high priority, particularly for new, lower-paid employees entering the workforce.

Other members can't purchase insurance coverage. Not all employers offer this benefit to their employees. Members who don't have access through their employer would have to purchase private insurance. While this is possible for some, this usually requires meeting insurability standards based upon health, age, occupation, and personal practices. These standards can be difficult to meet. Employer-provided insurance usually doesn't require meeting insurability standards if members join within a short time after becoming employed.

Is Individual Responsibility The Standard For Other Benefits?

Should the state assume what is best for the employee and mandate an "acceptable" amount of disability coverage? There are examples of this approach with regard to other government employee benefits.

For some employee benefits, such as retirement, the state assumes more responsibility and requires employee participation.

One example of mandating coverage is the mandatory membership for the retirement plans. Members generally do not have the choice to belong to one of the state-administered retirement plans. If they meet certain eligibility standards, they are *required* to belong and to contribute. It is a condition of their employment. The state also requires medical coverage for its eligible state employees. An eligible employee can only waive participation in the medical programs offered if they are covered by some other medical insurance program, such as through a spouse or other employment.

Conversely, the state does not mandate additional life or disability insurance coverage for its employees. The state pays for minimal life and disability coverage through insurance products, but does not require additional coverage beyond the minimum. While the state offers options for both, participation is voluntary and the employee pays the full cost of additional coverage. This is also true with additional savings programs, such as the deferred compensation program administered by DRS, and the health savings account administered by HCA. Both of these programs are optional to state employees, not required.

Are There Other Options Besides Expanding The Role Of The State?

If members aren't purchasing or can't provide their own adequate disability coverage, are there other options besides expanding the role of the state through pension enhancements or insurance products? One other possible approach would be through enhanced education. Perhaps enhanced member education could increase participation in the plans offered if members are choosing not to purchase adequate coverage. If members cannot participate in plans because employers do not offer disability protection as a benefit, perhaps employer education or encouragement to offer the benefits could expand access to members.

Should Disability Improvements Be Provided To Members Through The Pension System?

If the desire is to assume more responsibility to protect members in the event of a disability, then the next question is how to provide that protection. This can be done through changes to the benefits provided by the retirement systems or through insurance policies. Each of these methods has advantages and disadvantages.

Disability benefits provided by the pension systems are typically lower-cost to members.

In general, there are several positive aspects to providing enhanced benefits through the retirement systems. First, this method can provide cost advantages. The pension systems provide benefits to all members, regardless of the likelihood of becoming disabled. This means members with low risk of becoming disabled and members with a higher risk of becoming disabled are all in the same "risk pool." Insurance policies are typically purchased by members who may feel they are more likely to need the policy, due to riskier occupation or hobbies, poor health, etc. Therefore, insurance risk pools generally have a higher frequency of claims, which raises costs to the member. Also, unlike an insurance provider, there is no profit margin with pension-provided benefits.

Second, this method would also ensure a standard eligibility criteria and level of coverage for all plan members. Whether members weren't choosing coverage previously, or couldn't, this approach would ensure an enhanced level of protection for all.

Finally, by providing the benefits within the retirement systems, members would have more assurance that their disability coverage would be available throughout their career. State pension law would have to be amended to change the benefits once they are granted.

Disadvantages To Pension-Provided Enhancements

Providing enhanced benefits through the pensions does have some potential disadvantages. In the current situation, employers have the choice to subsidize disability insurance protection for employees. However, the funding policy in the Plans 2/3 would require employers to contribute to this benefit. This is a potential cost increase for employers that currently don't subsidize employee disability coverage.

Also, while providing enhanced benefits may increase the overall replacement income of a disabled member, this coverage may still be insufficient for some members. If they do not have access to additional insurance products, or choose not to purchase additional insurance coverage, there still could be gaps in their level of protection.

Disability benefits provided by the pension systems may still leave gaps in some members' coverage.

Finally, by enhancing the benefits through the pension system, benefits for some are subsidized through contributions by all. As explained earlier in this paper, an enhanced disability beneficiary receives more benefit than they individually have earned or paid for. This invites a higher level of public interest in ensuring only truly eligible members are approved for the benefits, and that additional care is made to validate that they continue to be disabled as time progresses. This level of public protection from fraud can be administratively expensive to provide, and opens the system to public criticism if errors are made. This also requires extensive administrative support to ensure members who are denied benefits have due process.

Should Enhanced Benefits Be Provided Through Insurance Products?

Providing enhanced benefits through insurance products allows great flexibility in developing proposals. As stated earlier in the paper, not all Plans 2/3 members have access to employer provided disability insurance. If policy makers wish to focus improvements on these members, one approach would be to explore having a state agency offer insurance that would be available to all plan members regardless of who employs them. This would ensure access to coverage without mandating participation. This approach is part of the stakeholder proposal.

With an insurance program, employers also have the flexibility to choose whether or not to subsidize some of the employee cost, and employees may be able to choose a variety of coverage options to match their need. This maintains the flexibility employers and members currently have.

Finally, policy makers could have the flexibility to design coverage that is mandatory for all plan members, like the pension-provided benefits, or offer other designs that are less prescriptive, such as an "opt-out" provision. This option would initially enroll members into a designated level of insurance coverage, but members would have the option to end or modify their coverage if they desire. Opt-out provisions typically result in higher rates of participation while still providing member choice.

Disadvantages To Insurance-Provided Enhancements

There are other considerations to providing enhanced coverage through insurance products. As discussed earlier, disability insurance benefits are generally purchased by individuals more likely to become disabled, which increases individual cost. Insurance companies are in business to make a profit, so cost to the members for similar benefits is typically higher.

Providing enhanced benefits through insurance products is typically more expensive for the member for a given coverage level.

The use of an insurance provider to administer benefits can be a challenging administrative requirement. While the administrator of the contract would not have to develop the infrastructure to satisfy the public interest in ensuring against fraud or providing due process, it does require extensive selection processes and contract oversight. This is particularly true for benefits as sensitive as disability benefits.

Finally, disability coverage through an insurance provider may not be as stable as through the pension system. Each new contract can result in differences in cost and coverage levels, which may present challenges to protecting the long-term affordability of the benefits. The desire of policy makers to provide the benefit to members could also change over time. It may be easier to discontinue insurance benefits than to remove a pension benefit in statute.

Summary Of Pros And Cons

Table 5 below provides a summary of the pros and cons from various views for providing enhanced benefits through the retirement system or through expanded access to insurance products.

Table 5

Views on Disability Benefit Policies		
View	**Retirement System Provided**	**Insurance Provided**
Fiscal (State)	Costly to the plans, so state carries responsibility	Cost shifts to individuals and employer
Employee	Potential gaps in coverage; less member cost; availability of coverage more secure	More flexibility to vary the timing and amount of coverage; member costs typically higher; less assurance of continued coverage
Employer	Required payments due to plan funding policy	Employer choice to subsidize member cost
Retirement System	Expanded infrastructure to address public expectations for accountability	Expanded contract process and oversight responsibilities
Political	Open to requests from those desiring more coverage.	Broader access to insurance coverage may lead to less criticism of existing pension policy
Public	Greater interest in ensuring against fraud	Greater interest in contract oversight accountability

Other Questions If Expanding Pension-Provided Benefits

There are a number of additional questions that arise, each with policy implications, if the committee decides to provide enhanced disability pension benefits to members.

- Should benefits be enhanced for duty-related injuries or illnesses only, for non-duty related, or both?
- Should the additional benefits be off-set by other sources, such as Workers' Compensation or Social Security?
- Should benefits be enhanced earned or guaranteed benefits?
- Should the standard for disability be changed or remain as is, and should it differ between PERS, TRS, and SERS?

These questions were raised in 2005 and 2007, and if the decision is to expand the disability retirement provisions, these policy questions can be explored again in a future issue paper.

Disability Benefit Policies In Comparative State Systems

The one provision that is commonplace in the comparative systems is the absence of an early retirement reduction in calculating a duty or non-duty disability benefit.

Among the comparative systems there is similar variability in disability retirement benefit policies as in Washington's systems. Some systems use the enhanced earned benefit policy, while others use the guaranteed benefit policy. The one provision that tends to be commonplace is the absence of any reduction for early retirement in calculating either a duty or non-duty disability benefit. Each of the comparative states provides enhanced benefits within their retirement plan.

Most of the comparative systems use the enhanced earned benefit approach to disability benefits. Iowa and Minnesota provide an enhanced earned benefit without a reduction for early retirement. Florida, Seattle, and Ohio PERS provide the same, but also set minimum benefit percentages (Ohio PERS also has a maximum percentage). Idaho, Oregon, Colorado, and Wisconsin provide disability benefits based on combining what the member has earned plus what the member would have earned up to an assumed "normal" retirement age.

A few other systems use the guaranteed approach to disability benefits. CalSTRS, Ohio TRS, and Missouri all guarantee specific percentages of a member's salary at the time of disability.

Summary Of Analysis

The original design in the Plans 2/3 placed more responsibility on the member to ensure their own adequate disability coverage. For some benefits, like retirement and medical, the state assumes more responsibility to ensure the member has adequate coverage. If the choice is to assume more responsibility for the member, then there are pros and cons to enhancing pension-provided benefits or expanding the use of insurance policies.

Pension benefits generally cost less to the member for a given level of coverage than insurance, but may still leave gaps in coverage. Insurance benefits offer more flexibility to fit your coverage to your personal situation, but there is less assurance of stable coverage over the long-term. Expanding the pension-provided benefits raises additional policy questions that can be fully developed if the committee wishes to proceed in that direction.

The Plans 2/3 are the only Washington-administered plans that do not provide enhanced value to the disability benefits provided. An analysis of comparative states shows each system provides some form of enhanced disability benefit within their retirement plan, and none of the systems require any reduction for early retirement.

Possible Options

Option 1: Maintain Current Policy.

The first possible option for the committee is to maintain the current policy in the Plans 2/3 and assume no additional responsibility for the disability benefits of the members. The committee could encourage system employers to:

- ❖ Provide disability coverage, if they don't already.
- ❖ Increase the member education of the benefits of disability protection.

This would add no additional costs to the system and maintain the original plan design.

Option 2: Expand Insurance Coverage.

The second possible option is to look into expanding insurance coverage to all members of the Plans 2/3, since some employers do not provide disability insurance access as a benefit to their employees. These insurance benefits would be available to members regardless of their employer.

This would require study by an organization knowledgeable in the insurance industry to ensure adequate options are explored. Some of these options could include mandatory membership, or opt-out provisions for employees. Additionally, this could potentially expand the administrative cost and role of a state agency. DRS currently doesn't administer insurance benefits, and the HCA doesn't provide benefits to all public employees in the state.

Option 3: Enhance the Benefits Provided by the Plans 2/3.

A third option is to enhance the disability benefits provided within the Plans 2/3. This would add cost to the system, involve several additional policy decisions, and have administrative impacts.

Option 4: Combination of Previous Options.

A fourth option could be to combine elements of the insurance and pension-provided enhancement approaches. The stakeholder proposal does this. Their proposal is a combination of Option 2 and Option 3. The proposal calls for a study of disability insurance options that could be provided to all Plans 2/3 members regardless of their employer, and for the Plans 2/3 to provide an enhanced earned disability benefit from the pension system.

Revised Proposal

At their October meeting, the Executive Committee instructed staff to draft bill language to implement the stakeholder proposal, and bring the bill draft to the Executive Committee in November. The stakeholder proposal called for enhanced pension benefits based upon years of service combined with studying options for broader access to disability insurance for all members.

At their November meeting, the Executive Committee voiced concern with two aspects of the stakeholder proposal:

- The cost.
- Whether the current disability standard in the Plans 2/3 was narrow enough to prevent future employment while receiving the enhanced benefits.

The Executive Committee directed staff to draft a new bill for a work session, public testimony, and possible executive action in December. The new proposal would provide the same benefits and insurance study, but the new benefits would be paid only if the members meet the standard of disability used by the Social Security Administration (SSA), which is a total disability standard. ***See Appendix A for information and analysis of the newly proposed disability standard.*** The Chair also requested staff to prepare a bill draft for the December meeting providing for a study of insurance options only.

Options Considered At December Meeting

1. Implement the original stakeholder proposal.
2. Implement the revised proposal from the Executive Committee which uses the SSA standard for disability.
3. Implement only a study of insurance options by the WSIPP.
4. The Committee may also choose to take no further action on this issue.

Committee Activity

Staff briefed the Committee on this issue in October and December. The Committee held a public hearing and took executive action in December. The Committee recommended to the Legislature a revised version of Option #3 from the December meeting (with the study expanded to include pension benefits).

Executive Committee Recommendation

None.

Stakeholder Input

Correspondence attached from:

Public Employees for Pension Reform (PEPR), 9/4/2008 .

Correspondence on file from:

John McGuire, 5/9/2008.

John Kvamme, WASA & AWSP consultant, 5/15/2008.

Matt Zuvich, Chair, PEPR, 9/10/2008.

Recommendation To 2009 Legislature

Direct the Washington State Institute for Public Policy, with the assistance of the Office of The State Actuary, to study options for addressing the needs of PERS Plan 2/3, TRS Plan 2/3, and SERS Plan 2/3 members for adequate disability benefit coverage. Recommended December 16, 2008.

Bill Draft

A Code Reviser bill draft to implement the SCPP recommendation is attached (Z-0397.1/09).

Draft Fiscal Note

Attached.

Appendix A

Changing The Disability Standard In The Plans 2/3

At their November meeting, the Executive Committee voiced concern with two aspects of the stakeholder proposal:

- The cost.
- Whether the current disability standard in the Plans 2/3 was narrow enough to prevent future employment while receiving the enhanced benefits.

The Executive Committee directed staff to draft a new bill. The new proposal would provide the same benefits and insurance study, but the new benefits would be paid only if the members meet the standard of disability used by the Social Security Administration, which is a total disability standard.

This appendix will provide information about the current disability standard in the Plans 2/3 and the proposed new standard. It will also attempt to answer the following questions:

1. Will changing the standard address the concerns with the original stakeholder proposal?
2. Does changing the standard impact other aspects of the disability program?

Current Disability Standard In The Plans 2/3

The current "occupational" disability standard in the Plans 2/3 provides benefits to members when they can no longer perform work for a public employer.

Currently, members are eligible to receive their benefit due to disability when they are "totally incapacitated for continued employment by an employer." Administrative code further defines this as "totally incapacitated to perform your job or any other position for an employer for which you are qualified by training or experience." This type of standard is generally referred to as an "occupational" disability standard.

The occupational standard provides benefits to members when they can no longer perform work for a public employer due to a permanent injury or illness. This benefit is not for disabilities that are likely to improve over time.

Proposed New Standard - The Social Security Standard*

The current proposal to change the eligibility standard in the Plans 2/3 would mirror the standard used by the Social Security Administration for their disability benefit determinations. The general standard for Social Security is based upon an inability to work. Essentially, applicants are approved for a benefit if:

- They cannot do the work they did before.
- SSA decides they cannot adjust to other work because of their medical conditions.
- Their disability has lasted or is expected to last for at least one year or to result in death.

The Social Security Standard is a "total" disability standard, and to qualify members must be unable to perform any substantially gainful employment for any employer, public or private.

This standard is generally considered a "total" disability standard. However, the SSA standard is not necessarily a permanent standard. While most disabilities that are total are also likely to be permanent, some may be total and long-lasting, but not necessarily permanent. Recovery from multiple surgeries related to a serious accident may be an example. Individuals in this situation may have a total disability for a year or more, but they could be reasonably expected to recover and return to work at a later date.

Total disability generally implies the member is no longer able to work in any "substantially gainful" way for any employer, public or private. This determination requires an assessment of whether employees are currently able, or could become able for other employment, based upon their experience, age and education. SSA defines substantially gainful employment as earning at least $980 per month in 2009. This earnings limit is adjusted annually.

* Social Security Administration Website, www.ssa.gov/pgm/links_disability.htm

Analysis

Changing the standard for disability was proposed in response to two voiced concerns with the stakeholder proposal:

- The cost.
- Whether the current disability standard in the Plans 2/3 was narrow enough to prevent future employment while receiving the enhanced benefits.

Attempting to address the concerns by changing the disability standards in the Plans 2/3 raises the following questions:

1. Will changing the standard address the concerns with the original stakeholder proposal?
2. Does changing the standard impact other aspects of the disability program?

Does The Proposed Disability Standard Address The Concerns With The Stakeholder's Proposal?

Cost

The first concern with the original stakeholder proposal was cost. Will changing the standard lower the cost of the proposal? Actuarial pricing for the Executive Committee's revised proposal may be available at the December meeting, but was not available at the time of writing.

Ability To Work While Still Receiving A Disability Benefit

Another concern with the original stakeholder proposal was that the current disability standard in the Plans 2/3 was not strict enough to prevent a recipient from becoming employed elsewhere while still receiving a disability allowance. Is this a likely possibility in the Plans 2/3?

For general government and educational employees there is likely little difference in who qualifies for disability under either an occupational or total disability standard.

The current occupational standard provides benefits to members with permanent disabilities that prevent them from performing *any* work for a public employer for which they are qualified by education/training or experience. It would be rare for public employees and school employees to qualify under this standard and still be able to work elsewhere. Most public and school employers offer some positions that require very little specialized skill or training, such as many entry-level positions. If members' disabilities would allow them to work elsewhere, they would also likely be able to work one of these positions, which would disqualify them under the occupational standard.

There may be more possibility for a teacher with a qualifying disability to work elsewhere. A teacher who meets the occupational standard must be unable to teach. For example, it is possible some medical conditions may prevent teachers from teaching in front of dozens of students, such as anxiety disorders triggered by public speaking, but wouldn't prevent them from other employment without a public speaking requirement.

Does Changing The Standard Impact Other Aspects Of The Disability Program?

Designing a disability program is a combination of complex policy decisions, many of which are often interdependent. Changing certain aspects of that program without fully studying the possible impacts may create additional issues to consider. The following sections address some of the possible impacts of changing the disability standard in this proposal.

Does The Proposed New Standard Match The Design For Providing The Increased Benefit?

The original stakeholder proposal maintained all structures in the current disability program design, but provides more benefit to those who qualify within that design. Implementing a presumably narrower standard for providing increased disability benefits changes one of the structures in the design.

If members receive more benefit when they have a more severe disability, should age be a factor in how much additional benefit they receive?

The current benefit structure provides a higher monthly benefit to those members with a disability who are closest to the normal age of retirement. The structure is based partially on age. The design of providing increased benefits to members in the stakeholder proposal mirrors that structure. Younger or middle aged employees who qualify for the benefits will still have a large reduction in their monthly allowance, but they will likely receive that allowance longer than an older employee. Older employees may see a higher monthly amount, but they will likely receive it for less time.

Linking a narrower standard to increased benefits implies that those most severely disabled, those most in need, should receive additional benefit. The criterion for providing benefits has now changed. Now, the new value introduced into the design of the program is that severity or need of the members impacts who receives more benefit. If severity or need determines eligibility to receive additional benefit, should age be a factor in determining the amount of the benefit provided? Does the younger employee with a total disability need less than an older employee, given the same years of service? The current structure may no longer be appropriate if there is a new value introduced into the design of how members qualify for benefits.

Coordination With Other Benefits Received

Should the enhanced benefits be off-set with other benefits the member may receive, such as Workers Compensation benefits?

Making the disability standard more restrictive may increase the likelihood that members qualifying for disability may also qualify for other benefits, such as workers compensation benefits for line of duty injuries or illnesses, or social security benefits. When providing enhanced disability benefits in these situations, there may be increased expectation from the public or others that benefits be coordinated to ensure members aren't receiving significantly more income while disabled than while working.

Administrative Impacts

Applying the SSA standard to increased benefits for Plans 2/3 members adds additional complexity to a labor intensive process. Changing the standard creates two tiers of disability benefits; an occupational benefit where the member receives the earned retirement allowance, and a total disability benefit with an enhanced earned retirement allowance. This second tier involves assessing the ability to work within the comprehensive employment market, a specialized area of expertise not currently required of the DRS.

Changing the disability standard creates two tiers of disability benefits, and may increase the complexity and infrastructure needs of the Department.

Additionally, because the SSA standard only requires the disability to last for one year, this may require more frequent follow-up with recipients than is currently required. As discussed earlier, some members may qualify for disability under the SSA standard even if there is a reasonable expectation of recovery from the disabling condition after a year or more. Under the current occupational standard, the disability must be permanent in order to qualify, so the likelihood of members recovering from their disability is less.

Other Systems

With one exception, the other systems and plans within Washington State use an occupational standard for disability.

With the other systems in Washington State, the standard for disability is an occupational standard, with one exception. Generally, the other systems provide a disability benefit if the member no longer can perform duties for an employer in their system. The lone exception is the benefit provided to LEOFF Plan 2 members who are totally disabled in the line of duty. The standard for qualifying for this benefit is the SSA standard. If members qualify, they are provided 70 percent of their final average salary, which is off-set by Workers' Compensation and Social Security benefits such that they can receive a total amount from all sources no greater than 100 percent of final average salary.

Other States

When evaluating the disability benefits provided to general government or educational employees in twelve of the systems within our comparative states, four states use a total disability standard similar or exactly the same as the SSA standard. Of these four systems, Iowa, Minnesota, Wisconsin, and Idaho, three off-set the benefits provided with workers' compensation benefits if the members were receiving both.

Eight of twelve of our comparative systems use an occupational disability standard for general government or educational employees. The remaining four use a total disability standard.

The remaining eight systems provided benefits based upon an occupational disability standard. Of these eight, only Oregon and Missouri off-set the benefits with workers compensation benefits.

None of the twelve systems had different medical standards for disability based upon duty or non-duty distinctions. Four had years of service requirements for non-duty eligibility and none had a service requirement for duty disability. Only one state provided different benefit amounts based upon duty or non-duty distinctions. Florida provides an unreduced earned benefit for both duty and non-duty disabilities, but the minimum benefit provided is 25 percent for non-duty and 42 percent for duty disabilities.

Conclusion

Designing a disability program is a combination of complex policy decisions, many of which are often interdependent. Changing certain aspects of that program without fully studying the possible impacts may create additional issues to consider.

The proposal to narrow the disability standard to that used by the SSA for increased disability benefits in the Plans 2/3 attempted to accomplish two goals; lowering the cost of the proposal and restricting the eligibility for additional benefits to only those that cannot work anymore. Pricing of the new proposal will likely address whether the first goal is met. Analysis of how the occupational standard is applied to general government and educational employees shows there is likely little difference between either standard in who qualifies for disability.

Additionally, other issues are raised when changing the standard. If members receive more benefit when they are more severely disabled, is age an appropriate criteria in determining how much they receive? Since the narrower disability standard may increase the likelihood of members receiving other benefits, should the increased benefits be off-set? Will there be additional pressure from the public to ensure members don't receive duplicative coverage? Finally, do policy makers want to consider the additional administrative complexity and infrastructure for DRS that changing the standard could create?

Research shows that the standards for disability benefits in the other systems and plans within Washington State are occupational standards, with one exception. The systems within our comparative states tend to use occupational standards, but some do use total disability standards.

Possible Options

Option 1: Use SSA standard and proposed method for increasing benefits.

The first option is to maintain the current revised proposal. This would increase disability benefits only for members who qualify under the Social Security standard for disability. This option would also retain the insurance study requirement of the WSIPP.

Option 2: Use SSA standard but modify method for increasing benefits.

This option would allow policy makers to match the method for increasing benefits with the presumably narrower standard for qualifying. One approach could be to provide increased benefits, but remove age as a determining factor in how the benefits are calculated. Possible methods of achieving this would be to remove the percentage reduction from the normal retirement age, or to provide a flat percentage of salary regardless of age. Provisions to off-set benefits could also be included. This option would also retain the insurance study requirement of the Washington State Institute for Public Policy.

Option 3: Maintain the current standard of disability and proposed method for increasing benefits.

This is the option originally proposed by the stakeholders. It would maintain the current occupational disability standards used in the Plans 2/3. This option would also retain the insurance study requirement of the. WSIPP

Option 4: Move forward with an insurance study only.

The committee could move forward only with requiring the WSIPP to study insurance options for Plans 2/3 members.

Option 5: Continue to study the issue in the next interim.

This option would allow the committee to continue studying the complex issues with increasing disability benefits in the upcoming interim.

Option 6: Take no action.

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BILL REQUEST - CODE REVISER'S OFFICE

BILL REQ. #: Z-0397.1/09

ATTY/TYPIST: LL:cro

BRIEF DESCRIPTION: Studying disability benefit options for members of the public employees' retirement system plan 2 and plan 3, the teachers' retirement system plan 2 and plan 3, and the school employees' retirement system plan 2 and plan 3.

AN ACT Relating to a study of disability benefit options for members of the public employees' retirement system plan 2 and plan 3, the teachers' retirement system plan 2 and plan 3, and the school employees' retirement system plan 2 and plan 3; and creating a new section.

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

NEW SECTION. **Sec. 1.** During the 2009 legislative interim, the Washington state institute for public policy, with the assistance and support of the office of the state actuary, shall study the options available to the legislature for addressing the needs of members of the public employees' retirement system plan 2 and plan 3, the teachers' retirement system plan 2 and plan 3, and the school employees' retirement system plan 2 and plan 3, to have adequate disability benefit coverage through disability benefits under the public pension systems, through access to long-term disability insurance coverage, or a combination of both. Options could include but are not limited to recommended statutory changes to the public pension systems, an insurance product available to all members administered by a state agency, expansion of eligibility for the current long-term disability benefits offered by the public employees' benefits board, or other options as developed by the institute. The institute shall report the findings and recommendations of its study to the select committee on pension policy no later than November 1, 2009.

--- END ---

DRAFT
ACTUARY'S FISCAL NOTE

RESPONDING AGENCY:	CODE:	DATE:	PROPOSAL [NAME or Z-NUMBER]:
Office of the State Actuary	**035**	**12/31/2008**	**Z-0397.1 / Z-0398.1**

WHAT THE READER SHOULD KNOW

The Office of the State Actuary ("we") prepared this draft fiscal note based on our understanding of the proposal as of the date shown above. We intend this draft fiscal note to be used by the Select Committee on Pension Policy, throughout the 2008 Interim only. If a legislator introduces this proposal as a bill during the next legislative session, we will prepare a final fiscal note based on that bill language. The actuarial results shown in this draft fiscal note may change when we prepare our final version for the Legislature.

We advise readers of this draft 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 draft fiscal note as a whole. Distribution of, or reliance on, only parts of this draft fiscal note could result in its misuse, and may mislead others.

SUMMARY OF RESULTS

There is no fiscal impact resulting from this proposal.

This bill directs the Washington State Institute for Public Policy, with the assistance of the Office of The State Actuary, to study options for addressing the needs of Plans 2/3 members for adequate disability benefit coverage.

WHAT IS THE PROPOSED CHANGE?

Summary Of Change

This proposal impacts the following systems:

- Public Employees' Retirement System (PERS) Plans 2/3
- Teachers' Retirement System (TRS) Plans 2/3
- School Employees' Retirement System (SERS) Plans 2/3

The proposal calls for a study by the Washington State Institute for Public Policy, with the assistance of the Office of The State Actuary, to study options for addressing the needs of PERS Plans 2/3, TRS Plans 2/3, and SERS Plans 2/3 members for adequate disability benefit coverage.

Assumed Effective Date: 90 days after session.

What Is The Current Situation?

Members of the Plans 2/3 gain access to their earned retirement benefit upon qualification for disability. This benefit is actuarially reduced from the normal age of retirement to account for earlier access. Qualification for a disability retirement is based upon a member's inability to perform his / her current job or any other job by an employer for which he / she is qualified based upon skills, experience, or training, due to a permanent disabling condition. There is no service qualifier, no distinction between duty and non-duty disablement, and no off-sets with other benefit sources. Additionally, members may have the option to purchase long-term disability insurance through their employer if coverage is part of the benefits package offered to employees.

Who Is Impacted And How?

This proposal does not directly impact any members of the affected systems, as it only provides for a study of benefits.

WHY THIS PROPOSAL DOES NOT HAVE A COST

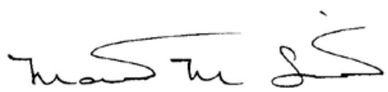
This proposal does not have a cost because it does not change benefit provisions.

ACTUARY'S CERTIFICATION

The undersigned hereby certifies that:

1. This draft fiscal note has been prepared for the Select Committee on Pension Policy.
2. This draft fiscal note has been prepared, and opinions given, in accordance with Washington State law and accepted actuarial standards of practice as of the date shown on page 1 of this draft fiscal note.

This draft fiscal note is a preliminary actuarial communication and the results shown may change. While this draft 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

Public Employees for Pension Reform

A coalition of Washington State Public Employee Unions and Retiree Associations serving active and retired state and public employees

Disability Benefits

September 4, 2008

Proposal: **Provide an Earned Disability Benefit to those w/ more than 10 yrs of service, based on 30 yr. ERRF's[1].**

- No change in current rules governing disability eligibility (duty and non-duty)
- Permanently Disabled Individuals with 20 or more years of service could retire using an ERFF that is a reduction of 3% for each year of age less than 62.
- Permanently Disabled Individuals with 10 or more years of service, but less than 20 could retire using a reduction equal to 3% for each year of age under age 65. This would be consistent with the Alternate Early Retirement reduction factors provided in C 247 L 2000. [RCW 41.32.765 (3)(a); 41.35.420 (3)(a); 41.40.630 (3)(a)]

Supplemental Option: **Opt-In Disability Retirement Insurance provided through either DRS or HCA.**

- Insure against the loss of pension benefits for both Duty and non-Duty related catastrophic events to be offered through the Department of Retirement Systems for participation by all system employers.
- The Select Committee on Pension Policy would ask the Washington State Institute for Public Policy (WSIPP) or other appropriate body (Insurance Commissioners office?) to study and develop proposals:
    - For individuals who do not qualify (due to less than 10 years of service) for the above Disability Retirement provisions.
    - For replacement income for individuals that do qualify for the Disability Retirement proposal (above) but need additional income to compensate for the reduced retirement benefit.
- The WSIPP or other appropriate body would report back any results to the SCPP for formulation of any legislative proposals.

[1] ERRF is an Early Retirement Reduction Factor