TRS 1 Survivor Benefit Payment Options

Issue

Teachers' Retirement System (TRS) 1 members may withdraw any portion of their contributions at retirement and receive an actuarially reduced pension. This is referred to as a partial lump sum option, or PLOP. Survivors of members who die prior to retirement do not have access to a PLOP. Instead, qualified survivors must choose between a full refund of the member's contributions or a survivor pension. Fewer than ten survivors a year are likely impacted by this issue.

Stakeholders have proposed providing survivors of retirement-eligible members the same PLOP provided to members.

This issue raises two key questions for policy makers:

- Should TRS 1 survivors be provided a PLOP?
- If so, should it be provided to all qualified survivors or only survivors of retirement-eligible members?

Policy Highlights

- PLOPs do not impact the expected financial value of the benefit.
- This may be viewed as an issue of member/survivor flexibility at member/survivor cost, or as an issue of benefit consistency.
- Policy makers will likely consider to what extent surivors are similarly situated with members, and whether they should have the same benefit payment flexibility as members.
- PLOPs may increase the risk that future retirement income will become inadequate for some survivors.
- The stakeholder proposal increases benefit flexibility for survivors and benefit consistency between members and survivors. However, under the stakeholder proposal, not all survivors who qualify for a pension will have access to a PLOP.

Committee Activity

Staff briefed the full committee on this issue in October. The Executive Committee directed staff to prepare a bill draft implementing the stakeholder proposal.

What Is The Next Step?

A public hearing with possible executive session is scheduled for the November meeting.

Materials

- Updated Executive Summary.
- Revised Issue Paper.
- Bill Draft.
- Draft Acturial Fiscal Note.

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TRS 1 Survivor Benefit Payment Options

In Brief

Issue

TRS 1 members may withdraw their contributions at retirement and receive an actuarially reduced pension. This is referred to as a partial lump sum option, or PLOP. Survivors of members who die prior to retirement do not have access to a PLOP.

Stakeholders have proposed providing survivors of retirement-eligible members the same PLOP provided to members.

This issue raises two key questions for policy makers. Should TRS 1 survivors be provided a PLOP? If so, should it be provided to all qualified survivors or only survivors of retirement-eligible members?

Member Impact

Fewer than ten survivors a year are likely impacted by this issue.

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Current Situation

Teachers' Retirement System (TRS) 1 members have the option to withdraw their contributions at retirement and receive a reduced pension. This option, however, is not available to survivors of members who die prior to retirement.

Upon retirement, TRS 1 members may withdraw* all or part of their accumulated member contributions with interest and receive an actuarially reduced pension. The reduction is designed to offset the amount of the pension that would have otherwise been financed by the withdrawn contributions. The reduction is based on the amount withdrawn–the greater the withdrawal, the greater the reduction. This type of option is often referred to as partial lump sum option, or PLOP.

In contrast to members, survivors do not have access to a PLOP. The options provided to survivors depend on whether or not the survivor qualifies to receive a pension from the plan. To qualify for a survivor pension, the member must be eligible for retirement or have ten or more years of service at the time of death.

Qualified survivors of active TRS 1 members who die prior to retirement may generally choose *between:*

a) A full refund of the member's accumulated contributions with interest, or
b) A survivor pension.

Qualified survivors choosing a refund forfeit the survivor pension. Survivors who do not qualify for a pension receive a refund of the member's accumulated contributions with interest.

Based on past experience, fewer than ten TRS 1 members a year are expected to die and leave a qualified survivor.

**Withdrawn contributions may be paid in cash to the member or rolled into a qualifying retirement account. In some cases, withdrawn contributions are subject to a 20 percent withholding tax.*

Example

Jim is a TRS 1 member who plans to retire at age 60 after 30 years of service with an expected final average salary of $75,000. Jim expects

to have $150,000 in accumulated contributions and interest in his member account.

The following table illustrates the impact of the PLOP on Jim's pension.

Impact of PLOP on TRS 1 Monthly Pension		
Contributions Withdrawn	Monthly Pension*	Percent Reduction In Monthly Pension
$0	$3,750	0%
$75,000	$3,155	16%
$150,000	$2,560	32%

** Excluding other optional adjustments or COLAs. Assumes a PLOP reduction factor of .007931.*

If Jim dies after 30 years of service and before retiring, his survivor could not withdraw any of Jim's contributions and still receive a survivor pension. Instead, Jim's survivor can choose one of the following:

a) A refund of all $150,000 of Jim's contributions, or
b) A survivor pension based on Jim's base pension of $3,750/month.**

***Additional reductions apply for a joint-life payment form and if the member was not eligible to retire.*

Other Washington Plans

TRS 1 is unique among Washington's Defined Benefit (DB) plans in providing members a PLOP. In Washington's other DB plans (the Plans 1 and Plans 2), members who withdraw their contributions forfeit their pension.

TRS 1 is unique among Washington's DB plans in providing members a PLOP.

Washington's Plans 3 do allow members to withdraw their contributions at retirement and still receive a pension–similar to a PLOP. This is due to the Plan 3 hybrid design. The Plan 3 design features a DB funded by the employer and a Defined Contribution (DC) funded by the member. Plan 3 members may withdraw their contributions and investment earnings from their DC account upon retirement without impacting their DB pension. However, the DB pension provided in Plan 3 accrues at half the rate of a Plan 1 or Plan 2 pension.

Other States/Peer Systems*

The majority of Washington's peer states do not provide a PLOP in their systems covering teachers. Those that do are divided on the issue of providing survivors with a PLOP. Seven peer states (CA, CO, FL, ID, IA, MN, and WI) do not provide PLOP at all. Missouri and

Other states are divided on the issue of providing PLOPs to survivors.

Oregon provide a PLOP to members only. Ohio provides a PLOP to members and qualified survivors of retirement-eligible members.

Though not covering teachers, the city of Seattle's retirement system provides a PLOP to members and all qualified survivors.

**Based on information obtained from plan administrator web sites on 10/08/2010.*

Policy Analysis

This issue raises two key questions for policy makers:

- Should TRS 1 survivors be provided a PLOP?
- If so, should it be provided to all qualified survivors or only survivors of retirement-eligible members?

Policy makers may view this as an issue of flexibility or consistency. However viewed, policy makers will likely consider to what extent survivors are similarly situated with members, and whether survivors should have the same benefit payment flexibility as members. Policy makers may also consider impacts on retirement planning, benefit adequacy, and benefit value.

A discussion of how PLOPs impact the value of benefits from the plan will help put this issue in context and lay the foundation for discussions of other policy considerations.

PLOPs do not impact the expected value of benefits paid.

PLOPs are designed to be actuarially equivalent. This means PLOPs do not increase or decrease the expected financial value of the benefits paid by the plan. A PLOP does impact the timing of when those benefits are paid. Survivors who do not have access to a PLOP will still receive the full value of their survivor pension. However, they do not have the option of receiving what is essentially a cash-advance on the pension. The value added by a PLOP is flexibility.

Policy makers may view this as an issue of flexibility.

This may be viewed as providing increased member flexibility at member cost.

A PLOP provides increased flexibility to recipients in the way they draw their benefits. This may be viewed as a policy of providing increased member flexibility at member cost. Such a policy allows members more choices in the amount and form of their benefits–as long as individual members pay the full cost of their optional benefits. Some policy makers may feel this policy should apply to survivors as well. These policy makers would likely see providing a PLOP to survivors as a logical extension of the policy. Other policy makers may distinguish between members and survivors in this area of policy. These policy makers may feel that survivors are not members and do not need the same benefit payment flexibility provided to members.

Survivors are generally given less benefit flexibility than members.

Washington's plan designs differentiate between members and survivors in the area of benefits flexibility. Survivors are generally given less benefit flexibility than members. For example, survivors are not allowed to designate their own survivor or make certain optional purchases of additional benefits* provided to members.

**Examples include the extra annuity or enhanced COLA available in Plan 1.*

Policy makers may view this as an issue of consistency.

Legislative policy is to provide similar retirement benefits wherever possible.

The Legislature has set forth as retirement policy and intent that "The retirement systems of the state shall provide similar benefits wherever possible." (RCW 41.50.005). Some policy makers may apply this to benefits *within* plans as well as benefits *between* plans. They may feel that members and survivors within a plan should be treated the same where practical. They may not see a compelling reason to provide a PLOP to members and not survivors. Other policy makers may feel that survivors are different from members and that consistency between the two is not an issue.

The Legislature and the SCPP have taken recent action to address the issue of benefit consistency. In 2007 and 2008, the SCPP recommended that survivors of Public Employees' Retirement System Plan 1 inactive members be given the same survivor annuity provided to survivors of active members. The Legislature enacted this recommendation in 2009.

This raises two questions for policy makers viewing this issue with an eye towards consistency.

These actions suggest a desire on the part of policy makers to provide similarly situated individuals with similar benefits. This raises two questions for policy makers viewing this issue with an eye towards consistency:

- Are survivors similarly situated with members for purposes of this benefit?
- If so, are all qualified survivors similarly situated or only survivors of retirement-eligible members?

Policy makers who answer yes to the above questions would likely prefer that a PLOP be provided to *all* qualified survivors in TRS 1– whether or not the member was eligible to retire at the time of death.

PLOPs can impact individual's retirement planning.

Whether policy makers approach this issue with a view towards flexibility or consistency, they may take into account potential impacts on individual retirement planning. Members may use funds obtained from a PLOP however they wish. This could include paying down debt, investing for future income, or personal consumption. Retirement plans may be disrupted if a couple had planned on withdrawing the

members' contributions at retirement, but the member dies and the survivor is not given access to those funds.

PLOPs may raise concerns about benefit adequacy.

Some policy makers may have reservations about providing an option that has the potential to adversely impact adequacy of benefits.

Policy makers may also have concerns about the potential impact of PLOPs on survivors' pensions. In some cases, a PLOP can reduce monthly pensions by nearly half–before factoring in other reductions that apply to survivor pensions. Significant reductions in monthly pensions may increase the risk that survivors' future retirement income will not meet their future financial needs. This may lead survivors to feel their benefit has become inadequate and seek additional benefits from the plan. Some policy makers–even those favoring increased flexibility or consistency–may have reservations about providing an option that has the potential to adversely impact adequacy of benefits down the road.

On the other hand, some policy makers may not have reservations if benefit adequacy concerns are driven by individual choices. They may feel that individuals are in the best position to determine their own income needs and the amount of financial risk they can take. Policy makers with this view may feel comfortable allowing individuals to live with the consequences of choosing a reduced lifetime payment in exchange for up-front cash.

Stakeholder Proposal

Stakeholders have proposed providing survivors of TRS 1 retirement-eligible members the same PLOP provided to TRS 1 members. The stakeholder proposal gives survivors increased benefit flexibility at their own cost and increases benefit consistency between members and their survivors. The trade-off for this increased flexibility and consistency is increased risk that future retirement income may become inadequate for some survivors.

Under the stakeholder proposal, survivors will have access to a PLOP if the member would have. However, some TRS 1 survivors who qualify for a survivor pension will not have access to a PLOP.

The stakeholder proposal raises a different issue around benefit consistency. Under the stakeholder proposal, some TRS 1 survivors who qualify for a survivor pension will not have access to a PLOP. The stakeholder proposal would provide a PLOP only to survivors of retirement-eligible members. However, survivors of non-retirement-eligible members will qualify for a survivor pension if the member had at least ten years of service at the time of death. While the majority of active TRS 1 members are retirement-eligible, it is still likely that some non-retirement-eligible members will die and leave a qualified survivor over the next few years.

In considering this proposal, policy makers may weigh which is more important: consistency between a member and his or her survivor, or

consistency between survivors. Some policy makers may feel that survivors should only have an annuity withdrawal option if the member would have had one. Other policy makers may feel that all survivors who qualify for a survivor pension are similarly situated and should be provided with a PLOP.

Conclusion

TRS Plan 1 members have the option to withdraw their contributions at retirement and receive a reduced pension–referred to as a PLOP. This option is not available to survivors of members who die prior to retirement. Stakeholders have proposed making the PLOP provided to TRS 1 members available to survivors of TRS 1 retirement-eligible members.

This issue raises two key questions for policy makers.

- Should TRS 1 survivors be provided a PLOP?
- If so, should it be provided to all qualified survivors or only survivors of retirement-eligible members?

In responding to these questions, policy makers will likely consider to what extent survivors are similarly situated with members, and whether survivors should have the same benefit payment flexibility as members. Policy makers may also consider impacts on retirement planning, benefit adequacy, and benefit value.

Stakeholder Input

Correspondence on file from: John Kvamme, WASA & AWSP, May 20, 2010 & July 8, 2010.

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Wallis, Keri

From: john kvamme [jekvamme@yahoo.com]
Sent: Thursday, May 20, 2010 12:01 PM
To: Smith, Matt
Cc: Conway, Rep. Steve
Subject: WASA & AWSP 2010 Interim Pension Issues
Attachments: 2010 Interim proposed issues.doc

Matt

Attached is a listing of pension issues that are a priority to WASA & AWSP. Please include this in the list of correspondence for the June SCPP meeting. Thank you!

John Kvamme

WASA and AWSP
Retirement and Health Benefits
2010 Interim Proposed Legislative Issues

Plan 2/3 Administrator ERRF Retirement Solution: Due to the administrator contract year, by statute going from July 1 to June 30, almost all administrators will be short two service months if they were to retire July 1 of their 30th service year. These administrators can take advantage of early retirement if they wait till September 1 to begin their retirement, however without a new contract they would have no salary or pension and need COBRA health coverage for that July and August**.** A possible solution is to allow these administrators that complete their 30th administrative fiscal year to begin their pension on July 1 of that year.

Survivor Access to Plan 1 TRS Annuity: Allow the survivor of an active Plan 1 TRS member that is qualified to retire under RCW 41.32.480 at the time of death, the option to withdraw the member's account balance and receive an actuarially adjusted pension benefit as provided to retiring members under RCW 41.32.497.

Change Plans 2/3 Default: New employees hired into TRS, SERS or PERS eligible positions must make a choice between being a member of Plan 2 or of Plan 3. If a choice is not made the new member is defaulted into Plan 3. We recommend the default be to Plan 2 rather than to Plan 3.

Indexed $150,000 Death Benefit: Automatically adjust the $150,000 death benefit for inflation by indexing the benefit to changes in the Consumer Price Index with a maximum change of 3 percent per year. Such a death benefit would be provided to survivors of public employees who die as a result of duty-related injury or illness.

Future Pension Issues: A number of important issues that impact our members that have been submitted to the Select Committee on Pension Policy (SCPP) in the past that are probably inappropriate for attention at this time due to their cost and the economic conditions within the state and nation are: **Plan 3 Vesting, Plan 2 Access to the PEBB and Plan 2/3 Postretirement Employment Related to Early Retirement.**

RECEIVED
JUL 08 2010
Office of
The State Actuary

TO: Select Committee on Pension Policy members

FROM: John Kvamme, WASA and AWSP Consultant

DATE: July 8, 2010

RE: Survivor Access to Plan 1 TRS Annuity

I am requesting that the SCPP board or executive committee consider having the State Actuary Office do a review and then a board work study presentation on the "Survivor Access to Plan 1 TRS Annuity" issue at one of the next SCPP meetings. The issue does not appear to be complex and there should be little or no cost to implement this change.

There are member survivors that have been negatively impacted by the present Plan 1 survivor statute. This especially happens in instances where the member and his or her spouse had specific plans for the use of the annuity at retirement such as paying off mortgages, etc.

Your consideration of this request is appreciated.

AN ACT Relating to providing a partial lump sum benefit payment option for certain survivors of active members of the teachers' retirement system plan 1; and amending RCW 41.32.520.

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

Sec. 1. RCW 41.32.520 and 2009 c 226 s 5 are each amended to read as follows:

(1) Except as specified in subsection (3) of this section, upon receipt of proper proofs of death of any member before retirement or before the first installment of his or her retirement allowance shall become due his or her accumulated contributions, less any amount identified as owing to an obligee upon withdrawal of accumulated contributions pursuant to a court order filed under RCW 41.50.670, and/or other benefits payable upon his or her death shall be paid to his or her estate or to such persons, trust, or organization as he or she shall have nominated by written designation duly executed and

filed with the department. If a member fails to file a new beneficiary designation subsequent to marriage, divorce, or reestablishment of membership following termination by withdrawal, lapsation, or retirement, payment of his or her accumulated contributions, less any amount identified as owing to an obligee upon withdrawal of accumulated contributions pursuant to a court order filed under RCW 41.50.670, and/or other benefits upon death before retirement shall be made to the surviving spouse, if any; otherwise, to his or her estate. If a member had established ten or more years of Washington membership service credit or was eligible for retirement, the beneficiary or the surviving spouse if otherwise eligible may elect, in lieu of a cash refund of the member's accumulated contributions, the following survivor benefit plan actuarially reduced, except under subsection (4) of this section, by the amount of any lump sum benefit identified as owing to an obligee upon withdrawal of accumulated contributions pursuant to a court order filed under RCW 41.50.670:

(a) A widow or widower, without a child or children under eighteen years of age, may elect a monthly payment of fifty dollars to become effective at age fifty, provided the member had fifteen or more years of Washington membership service credit. A benefit paid under this subsection (1)(a) shall terminate at the marriage of the beneficiary.

(b) The beneficiary, if a surviving spouse or a dependent (as that term is used in computing the dependent exemption for federal internal revenue purposes) may elect to receive a joint and one hundred percent retirement allowance under RCW 41.32.530.

(i) In the case of a dependent child the allowance shall continue until attainment of majority or so long as the department judges that the circumstances which created his or her dependent status continue to exist. In any case, if at the time dependent status ceases, an amount equal to the amount of accumulated contributions of the deceased member has not been paid to the beneficiary, the remainder shall then be paid in a lump sum to the beneficiary.

(ii) If at the time of death, the member was not then qualified for a service retirement allowance, the benefit shall be based upon the actuarial equivalent of the sum necessary to pay the accrued regular retirement allowance commencing when the deceased member would have first qualified for a service retirement allowance.

(c) A beneficiary who qualifies for survivor benefits under (b) of this subsection and who is the beneficiary of a member who was eligible for retirement may choose the following survivor benefit plan in lieu of the allowance provided in (b) of this subsection. The qualified beneficiary may irrevocably elect to withdraw all or a part of the member's accumulated contributions, other than any amount paid under RCW 41.50.165(2), and receive a reduction in the allowance provided under (b) of this subsection of the actuarially determined amount of monthly annuity which would have been purchased by said contributions.

(2) If no qualified beneficiary survives a member, at his or her death his or her accumulated contributions, less any amount identified as owing to an obligee upon withdrawal of accumulated contributions pursuant to a court order filed under RCW 41.50.670, shall be paid to his or her estate, or his or her dependents may qualify for survivor benefits under benefit plan (1)(b) or (1)(c) in lieu of a cash refund of the members accumulated contributions in the following order: Widow or widower, guardian of a dependent child or children under age eighteen, or dependent parent or parents.

(3) If a member dies within sixty days following application for disability retirement under RCW 41.32.550, the beneficiary named in the application may elect to receive the benefit provided by:

(a) This section; or

(b) RCW 41.32.550, according to the option chosen under RCW 41.32.530 in the disability application.

(4) The retirement allowance of a member who is killed in the course of employment, as determined by the director of the department of labor and industries, or the retirement allowance of a member who has left the employ of an employer due to service in the national

guard or military reserves and dies while honorably serving in the national guard or military reserves during a period of war as defined in RCW 41.04.005, is not subject to an actuarial reduction. The member's retirement allowance is computed under RCW 41.32.480.

--- END ---

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ACTUARY'S FISCAL NOTE

RESPONDING AGENCY:	CODE:	DATE:	PROPOSAL:
Office of the State Actuary	**035**	**11/08/2010**	**TRS 1 Survivor Partial Lump Sum Option**

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 during the 2010 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

This bill provides a partial lump sum benefit payment option for certain survivors of active members of the Teachers' Retirement System (TRS) Plan 1.

Impact on Pension Liability			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Today's Value of All Future Pensions	$74,789	$0.2	$74,789
Earned Pensions Not Covered by Today's Assets	$5,773	$0.2	$5,773

Impact on Contribution Rates: (Effective 9/1/2011)	
2011-2013 State Budget	**TRS**
Employee (Plan 2)	0.00%
Employer	
Current Annual Cost	0.00%
Plan 1 Past Cost	0.00%
Total	0.00%

Budget Impacts			
(Dollars in Millions)	**2011-2013**	**2013-2015**	**25-Year**
General Fund-State	$0.0	$0.0	$0.2
Total Employer	$0.0	$0.1	$0.3

Please see the Actuarial Results section of this draft fiscal note for additional detail.

WHAT IS THE PROPOSED CHANGE?

Summary Of Benefit Improvement

This bill impacts TRS Plan 1. This bill allows survivors of members who die prior to retirement the same partial lump sum benefit payment option that is provided to members. In order to qualify for the option, the member must have been eligible to retire at the time of death, and the survivor must be eligible to receive a survivor pension from the plan.

Effective Date: 90 days after session.

What Is The Current Situation?

TRS 1 members may withdraw any portion of their contributions at retirement and receive an actuarially reduced pension on the remaining balance. The actuarial reduction is designed to offset the amount of the pension that would otherwise have been funded by the withdrawn contributions. This is referred to as a Partial Lump Sum Option, or PLOP.

Currently, survivors of member who die prior to retirement may select either a return of the member's contributions or a monthly lifetime benefit, but not both. If the survivor selects a return of the member's contributions, they forfeit an on-going survivor annuity.

Who Is Impacted And How?

As of June 30, 2009, TRS 1 has 5,204 active members. We estimate this proposal would affect no more than ten TRS 1 survivors per year. Furthermore, we assume there will be approximately six TRS 1 survivors per year who will be eligible for the improved benefits. The number of members affected by this proposal will decrease each year since this plan is closed to new members and is maturing into an all-retiree population.

We estimate this proposal will increase the survivor annuities we expect the plan to pay for certain eligible survivors. See the following section for an explanation. This proposal may also have a different expected cost when we apply different assumptions. Please see the section "How The Results Change With Different Assumptions" for further details.

WHY THIS PROPOSAL HAS A COST AND WHO PAY FOR IT

Why This Proposal Has A Cost

This proposal has a cost because it will increase the survivor annuities we expect the plan to pay for certain eligible survivors. Some eligible survivors elect a return of contributions instead of an annuity under current plan provisions. These survivors forfeit the on-going annuity when they make that election. With this proposal, eligible survivors who elect a return of contributions will also receive a reduced monthly pension. The monthly pension they receive will be actuarially reduced to offset the amount of the lump sum withdrawn; however, it is still a larger benefit than a return of contributions with no

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monthly pension. Therefore, we expect the plan to pay out more survivor annuities under this proposal than under current law.

There is no expected cost under this proposal for eligible survivors who would elect a monthly pension under current plan provisions. Under this proposal, the eligible survivor can elect a lump sum withdrawal of the member's contributions but their monthly pension will be actuarially reduced to offset the expected value of the withdrawal. However, as the experience of the system emerges, if the lump sum benefit received is more or less than the actual value of the reduced monthly pension, then there will be a cost or savings to the plan. Please see the section "How The Results Change When The Assumptions Change" for additional detail on how costs or savings could emerge.

Who Will Pay For These Costs?

Employers of all TRS members will pay for the cost of this benefit improvement through increases in the TRS 1 Unfunded Actuarial Accrued Liability (UAAL) contribution rate. TRS 1 members pay a prescribed six percent contribution rate and their contribution rates will not increase under this proposal.

The expected cost of the additional lump sum benefit is paid by the eligible survivor through an actuarially reduced monthly pension. However, as the experience of the system emerges, if the lump sum benefit received is more or less than the actual value of the reduced monthly pension, then the TRS UAAL contribution rates will decrease or increase accordingly.

HOW WE VALUED THESE COSTS

Assumptions We Made

For the eligible survivors that we expect will elect a return of contributions and forfeit an on-going survivor annuity under current provisions, we assume they will receive an additional reduced monthly pension under this proposal. In other words, we changed our assumption in the valuation model to assume every eligible survivor elects a monthly pension. For more detail on how we developed this assumption please see Appendix A.

For the eligible survivors that we expect will elect a monthly pension, we assume that the reduction in the survivor's monthly pension will be actuarially equivalent to the additional lump sum benefit. Please see the section "How The Results Change When The Assumptions Change" for additional detail.

How We Applied These Assumptions

Our valuation model uses an age-based probability table to estimate the number of eligible survivors who elect a monthly pension when a member dies prior to retirement. We increased the values in this table, as outlined in Appendix A, to reflect additional eligible survivors that we assume will elect to receive monthly pensions.

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Otherwise, we developed these costs using the same methods as disclosed in the June 30, 2009, Actuarial Valuation Report (AVR).

Special Data Needed

We developed these costs using the same assets and data as disclosed in the AVR.

ACTUARIAL RESULTS

How The Liabilities Changed

This proposal will impact the actuarial funding of TRS 1 by increasing the present value of future benefits payable under the plan as shown below.

Impact on Pension Liability			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Actuarial Present Value of Projected Benefits			
(The Value of the Total Commitment to all Current Members)			
TRS 1	$10,956	$0.2	$10,956
TRS 2/3	8,661	0.0	8,661
TRS Total	**$19,617**	**$0.2**	**$19,617**
Unfunded Actuarial Accrued Liability			
*(The Portion of the Plan 1 Liability that is Amortized According to Funding Policy)**			
TRS 1	**$2,676**	**$0.2**	**$2,676**
Unfunded PUC Liability			
(The Value of the Total Commitment to all Current Members Attributable to Past Service that is Not Covered by Current Assets)			
TRS 1	$2,692	$0.2	$2,692
TRS 2/3	(947)	0.0	(947)
TRS Total	**$1,745**	**$0.2**	**$1,745**

Note: Totals may not agree due to rounding.
** TRS 1 is amortized over a ten-year period.*

How The Present Value of Future Salaries Changed

This proposal does not change the Present Value of Future Salaries (PVFS) of the members of TRS 1 so there is no impact on the actuarial funding of TRS 1 due to the PVFS.

How Contribution Rates Changed

The increase in the required actuarial contribution rate does not round up to the minimum supplemental contribution rate of 0.01 percent, therefore the proposal will not affect contribution rates in the current biennium. However, we will use the un-rounded rate increase below to measure the budget changes in future biennia.

Impact on Contribution Rates: (Effective 9/1/2011)	
System/Plan	**TRS**
Current Members	
Employee (Plan 2)	0.000%
Employer	
Normal Cost	0.000%
Plan 1 UAAL	0.001%
Total	0.001%
New Entrants*	
Employee (Plan 2)	0.000%
Employer	
Normal Cost	0.000%
Plan 1 UAAL	0.001%
Total	0.001%

** Rate change applied to future new entrant payroll and used to determine budget impacts only. Current members and new entrants pay the same contribution rate.*

How This Impacts Budgets And Employees

Budget Impacts	
(Dollars in Millions)	**TRS**
2011-2013	
General Fund	$0.0
Non-General Fund	0.0
Total State	**$0.0**
Local Government	0.0
Total Employer	**$0.0**
Total Employee	**$0.0**
2013-2015	
General Fund	$0.0
Non-General Fund	0.0
Total State	**$0.0**
Local Government	0.0
Total Employer	**$0.1**
Total Employee	**$0.0**
2011-2036	
General Fund	$0.2
Non-General Fund	0.0
Total State	**$0.2**
Local Government	0.1
Total Employer	**$0.3**
Total Employee	**$0.0**

Note: Totals may not agree due to rounding.

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The analysis of this proposal does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

As with the costs developed in the actuarial valuation, the emerging costs of the system will vary from those presented in the AVR or this draft fiscal note to the extent that actual experience differs from the actuarial assumptions.

HOW THE RESULTS CHANGE WHEN THE ASSUMPTIONS CHANGE

To determine the actuarial reduction in the monthly pension we make several assumptions including:

- Expected rate of investment return.
- Expected rate of mortality for the annuitant.

As with any actuarial calculation that involves estimating future events, actual experience may differ from the underlying assumptions made. When actual experience differs from what we assumed would occur, the system experiences an actuarial gain or loss. An actuarial gain would decrease plan liabilities (or increase assets); whereas, an actuarial loss would increase plan liabilities (or decrease assets). Therefore, we cannot say with certainty that the actuarial equivalent aspect of this proposal will not impact plan liabilities in the future.

If the survivors who elect lump sum payments, on average, live longer/shorter than assumed, the system will experience actuarial gains/losses in the future. In the case of survivors living longer than expected, the survivors forgo (through the reduction for the optional lump sum withdrawal) more in annuity payments than expected, resulting in a gain to the plan. In other words, if a survivor lives longer than expected, the plan gains from applying a reduction to the annuity longer than expected. If the actual rate of investment return is more/less than the assumed rate, the system will experience actuarial gains/losses from this assumption as well. In the case of actual investment returns below the prescribed 8 percent assumption, the actual value of the reductions in annuities will exceed their expected value, resulting in a gain to the plan. In other words, if actual investment return is less than assumed, the plan gains from exchanging reduced annuity payments of a higher value/cost to the plan with a lump sum withdrawal of a lower value. For these two assumptions, we will not know whether a gain or loss has occurred until the Department of Retirement Systems (DRS) has made all payments under the annuity contract.

To determine the sensitivity of the actuarial results to the best-estimate assumptions selected for the actuarial equivalent part of this pricing we varied the following assumptions:

- **Mortality rate –** We determined the cost to the plan if the monthly pension reduction was calculated based on lower expected mortality rates than currently assumed in the administrative factors (people live longer than assumed). For

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this sensitivity we applied 50 percent of the Society of Actuaries' scale AA mortality improvement table to the mortality rates used in the current administrative factors.

- **Investment returns** – We determined the cost to the plan if the monthly pension reduction was calculated based on a lower expected investment return than the assumed rate in statute (investments pay less than assumed). For this sensitivity we used a 7.5 percent investment return rather than the current prescribed assumption of 8 percent.
- **All of the above** – We determined the cost to the plan if both of these assumptions are incorrect, as described above, at the same time.

The table below shows the expected results compared to the three sensitivity runs outlined above. The example outlines the impact for an average retirement-eligible active TRS 1 member whose survivor, age 61, elects a lump sum benefit withdrawal of $152,611 on the member's death. We provide this analysis to give the reader a sense of how the expected costs of this proposal may change under different assumptions. Readers should not use this table for individual retirement planning or construe the information provided as advice or guidance in the selection of optional payment forms.

Sensitivity Example - 61 Year Old Survivor Elects $152,611 Lump Sum Withdrawal			
Scenario	Lump Sum Payment to Survivor	Present Value of Pension Reduction	Gain to the System
1) Expected	$152,611	$152,611	$0
2) Lower Mortality Than Expected	152,611	153,773	1,162
3) Lower Asset Returns Than Expected	152,611	158,544	5,933
4) Scenarios 2 and 3	$152,611	$159,809	$7,198

When lower expected mortality rates and lower expected asset returns occur at the same time, the gain (savings) to the plan is greater than the sum of each gain because of the interaction of these assumptions.

Although we expect mortality to improve and investment returns to be less than the prescribed eight percent, if the opposite actually happens, then we would see costs to the plan instead of the savings listed above.

The expected cost of this proposal may also change if more or less future survivors select a return of contributions benefit under current law than we anticipate under our current assumptions. However, we don't believe the cost differences in this area are significant when evaluated in relation to total plan costs. Therefore, we have not included sensitivity analysis for this area of the pricing.

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ACTUARY'S CERTIFICATION

The undersigned hereby certifies that:

1. The actuarial cost methods are appropriate for the purposes of this pricing exercise.
2. The actuarial assumptions used are appropriate for the purposes of this pricing exercise.
3. The data on which this draft fiscal note is based are sufficient and reliable for the purposes of this pricing exercise.
4. Use of another set of methods and assumptions may also be reasonable, and might produce different results.
5. We prepared this draft fiscal note for the Select Committee on Pension Policy.
6. We prepared this draft fiscal note and provided opinions in accordance with Washington State law and accepted actuarial standards of practice as of the date shown on page one of this draft fiscal note.

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

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APPENDIX A – ASSUMPTIONS WE MADE

We assume that some qualified survivors will elect a monthly pension when the active member dies and was eligible to retire. We also assume that some survivors will elect a return of contributions and forfeit the monthly pension. We set these valuation assumptions based on data we receive that includes the number of survivors that elect a monthly pension. In other words, our assumption includes both the probability that a member leaves a survivor and the probability that a survivor elects a monthly pension. In our valuation model, we refer to this as "Percent Married" (PM).

In order to price this proposal, we need to determine, under current plan provisions, the probability that a member leaves a survivor and that survivor elects a return of contributions. We do not have specific data on this probability so we had to make an assumption.

We studied our age-based PM table and determined the highest percent married as our estimated probability that a member leaves a survivor, regardless of what benefit choice that survivor makes. We ran this new probability table through our valuation model to estimate the change in liabilities if all eligible survivors elect a monthly pension on the member's death. The difference between this valuation and our base valuation (which uses PM) is the expected increase in liabilities for this proposal.

The following table details the current valuation assumption (PM) and the assumed probability that a member has an eligible survivor (PS).

	PM		PS	
Age	Male	Female	Male	Female
40-44	0.598	0.408	0.729	0.491
45-49	0.647	0.458	0.729	0.491
50-61	0.696	0.458	0.729	0.491
62-69	0.729	0.491	0.729	0.491
70-80	0.729	0.441	0.729	0.441

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

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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 on an individual basis.

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

- Normal cost.
- Amortization of the unfunded liability.

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

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

Projected Unit Credit (PUC) Liability: The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

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

Unfunded PUC Liability: The excess, if any, of the Present Value of Benefits calculated under the PUC cost method over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

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