Plan 2/3 Default

Issue

Stakeholders have asked the SCPP to revisit the issue of changing the default plan from Plan 3 to Plan 2 and consider making a recommendation to the 2011 Legislature.

Background

New hires in the the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS) are required to choose between Plan 2 and Plan 3. New employees who do not make a choice are currently defaulted into Plan 3.

Plan 2 is a defined benefit plan. Plan 3 is a hybrid defined benefit/defined contribution plan and provides a smaller guaranteed benefit in combination with a member account similar to a 401(K) plan.

Committee/Legislative Activity

The SCPP studied this issue in 2008, and recommended a bill that would change the default to Plan 2 for PERS only. The Legislature considered the PERS-only proposal in 2009 (HB 1722/ SB 5307), but did not enact it.

The SCPP revisited this issue in 2009. The Committee considered changing the default plan to Plan 2 for PERS, TRS, and SERS, and eliminating the plan default altogether. Ultimately, the Committee did not recommend a new bill.

A non-SCPP bill that would change the default to Plan 2 for all three systems was considered by the Legislature in 2010 (SB 6516). It was not enacted.

In November 2010, the Executive Committee directed staff to bring both the 2009 PERS-only bill and the 2010 all-systems bill before the full committee for a public hearing.

Policy Considerations

- ❖ Have the values changed that made the Plan 3 design the policy preference for the default plan?
- ❖ There may be issues with changing the default at this time.
  - Legal considerations around current gain-sharing litigation.
  - Financial market conditions.

- If policy makers don't have a policy preference for continuing the Plan 3 default, how should they decide which plan should be the default?
  - Look at historical data of plan choice preference?
  - Determine which plan best serves the needs of new employees?

What Is The Next Step?

A public hearing with possible executive session is scheduled for the December meeting for the two prior bills changing the default from Plan 3 to Plan 2 for:

- PERS only.
- All systems (PERS, TRS, and SERS).

Materials

- Revised Executive Summary and Issue Paper.
- Stakeholder correspondence from:
  - John Kvamme, WASA & AWSP, May 20, 2010.
  - Ester Wilfong, Gordon Irle, and Leslie Main, WSSRA, August 4, 2010.
- HB 1722 (PERS only) and SB 6516 (PERS, TRS, and SERS) bill drafts and fiscal notes.

O:\SCPP\2010\12-14-10_Full\3.Plan_2-3_Default_Exec_Summary.docx

Plan 2/3 Default

In Brief

Issue

New employees hired into PERS, TRS, or SERS eligible positions must choose to be a member of Plan 2 or Plan 3. Members who don't choose are "defaulted" into membership in Plan 3. Stakeholders have suggested that members who don't choose should be defaulted into Plan 2.

Member Impact

This change would impact all new hires into PERS, TRS, and SERS eligible positions. Since the inception of optional membership, beginning for PERS in March 2002, over 95,000 new employees have been faced with the Plan 2 or Plan 3 choice. Of these, nearly 18,000 have been defaulted into Plan 3. See Appendix A for more information.

Darren Painter
Senior Policy Analyst
360.786.6155
darren.painter@leg.wa.gov

This report was revised to remove outdated procedural text and references. The remainder of the report is substantively unchanged from 2009 Interim.

Introduction

The SCPP is being asked to change the optional plan choice default provisions in the Plans 2/3 of the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS).

The requested change would require new employees who failed to choose Plan 2 or Plan 3 to become permanent members of Plan 2 by default. Currently, new employees who fail to choose a plan are permanently defaulted into membership in Plan 3. This request raises two immediate policy questions:

- ❖ Should the plan default be changed, particularly at this time?
- ❖ If so, how should the default be determined?

Current Situation

New employees hired into eligible positions in PERS, TRS, and SERS have ninety days from their first day of employment to choose whether to become members of Plan 2 or Plan 3. New employees who do not decide within the ninety-day window become members of Plan 3 by default. Whether members choose or are defaulted into a plan, their plan designation cannot change; the decision or designation is irrevocable.

History

TRS Plan 3, implemented in 1995, was the first Plan 3 in Washington State. At the time, all new teachers were required to be members of Plan 3. This was also true for SERS Plan 3, implemented in 2000. Classified employees hired after 2000 were also required to become members of SERS Plan 3.

The choice of Plan 3 as the default plan began with the implementation of PERS Plan 3 in March 2002. When PERS Plan 3 was created, the Legislature gave new public employees the irrevocable choice upon hiring to become a member of Plan 2 or Plan 3. If a new employee failed to make a choice, they were defaulted into PERS Plan 3.

Using Plan 3 as the default plan started with PERS in 2002 and was later expanded to TRS and SERS in 2007.

In 2007, the Legislature continued to use Plan 3 as the default plan when they implemented optional membership in TRS and SERS. These benefits, and others, were passed in HB 2391, which also repealed the provisions of gain-sharing. Some of the provisions of this bill are currently being litigated.

Comparing Plan 2 and Plan 3

Plan 2 and Plan 3 provide different designs to accrue a retirement benefit. Understanding the differences in the design of the two plans may help policy makers understand the potential impact of changing the default plan to future new employees. Below is a description of the benefit design provided by each plan.

Plan 2 is a defined benefit plan that provides a monthly payment for life based upon a formula.

Plan 2 is a **defined benefit retirement plan** that provides a monthly payment for life based upon a formula. The benefit is defined because the formula is known. The Plan 2 benefit formula is: 2% X years of service X salary average. The Plan 2 benefit is funded by equal employee and employer contributions, which may vary over time depending upon the funding needs of the plan. The full benefit is guaranteed by the state of Washington, so employees do not carry the investment risk for their benefits, the state does.

Some Benefits Of Plan 2

For a new employee who will remain a member until retirement, DB plans, like the Plans 2, are generally a very cost effective method to provide lifetime retirement income.*

Plan 2 offers a cost effective method to provide replacement income at retirement.

First, because they "pool" all members into a common fund, defined benefit plans only have to collect enough contributions and earnings to fund the "average" lifetime of the member. Members who fund their own retirement would have to contribute and earn more in order to ensure they wouldn't outlive their savings if they lived longer than the average.

Second, because large defined benefit plans invest over a very long time horizon, they can afford to take on more investment risk, which should lead to higher returns. Individual members are often advised to change their investment allocations to less risky products as they near and enter retirement, which leads to lower lifetime investment returns.

Finally, defined benefit plans generally achieve higher investment returns than individual investors. Defined benefit plans use investment professionals, have access to investment asset classes that individuals typically don't, and can use their size to negotiate lower investment fees. Over a long career, a small increase in investment returns can provide a significantly higher benefit.

** Beth Almeida and William Fornia, "A Better Bang for the Buck," National Institute on Retirement Security, <http://www.nirsonline.org/index.php>, August 2008, <http://www.nirsonline.org/storage/nirs/documents/ky_dc_working_group.pdf>, accessed August 2008.*

Plan 2 offers members a lower risk retirement plan that requires little involvement in managing the benefit.

Plan 2 is also of value to members who don't want to assume the primary responsibility and risk for their own retirement funding. In a defined benefit plan, the plan sponsor assumes the responsibility and the risk to invest and provide a retirement benefit for the employees. This provides the member with a secure, known benefit that is guaranteed. For members who lack the investment confidence, the desire to more directly manage their retirement income or the time to accrue substantial earnings, this option can be desirable. However, members do still bear the responsibility to determine if the amount provided by the plan is sufficient for their own retirement needs, and make additional plans if it is not.

Plan 3 is a **hybrid retirement plan**, because it contains two separate components:

- A defined contribution account.
- A defined benefit account.

The defined contribution account is funded by the member's own contributions. The plan gives members the choice of how much they want to contribute to their own retirement, and options to manage investing those contributions over time. Currently, Plan 3 members have six contribution rate options, beginning at 5 percent, and over nine separate investment funds from which to choose. New employees, who become members of Plan 3 by default, are also defaulted into a contribution rate of 5 percent and into an investment option that provides the same mix of investments and rate of return as the retirement trust funds managed by the Washington State Investment Board (WSIB).

This is called a "defined contribution" account because the benefit received by members from the account is not defined; only the amount of contributions into the account is defined. The benefit received from the account is based upon how much members contribute and the associated investment earnings. There is no guaranteed return on the contributions, so members carry the full investment risk. This type of retirement option is very similar to the "401K" retirement plans commonly offered by private employers.

The defined benefit account in Plan 3 is paid by the employer contributions. The defined benefit provided is similar to the Plan 2 defined benefit, a lifetime monthly payment based upon a formula, guaranteed by the state. However, because member contributions are not funding the defined benefit in Plan 3 like they are in Plan 2, the value is half that of the Plan 2 benefit. The Plan 3 defined benefit formula is: 1% X years of service X salary average.

Some Benefits Of Plan 3

Plan 3 offers members more value if leaving the workforce before retiring.

Many new employees will never draw a lifetime monthly payment from their retirement plan. It is estimated that less than half of all new PERS employees will remain employed for the five years necessary to earn a guaranteed benefit at age 65.* Also, some new employees may work long enough to earn a benefit, but will leave public employment prior to age 65. The Plans 3 were designed in recognition of this new, more mobile workforce. The policy statement in the legislation that created TRS Plan 3 stated "…public employees need the ability to make transitions to other private or public sector careers, and … the retirement system should not be a barrier…."

To accommodate this recognition of greater mobility, Plan 3 provides more opportunity to receive value for both member and employer contributions should employees leave employment prior to retirement. In Plan 2, members who leave employment can withdraw the contributions made to the plan and any interest that has been credited to their account. However, if they do so, they forfeit all right to a future defined benefit from the system. This means Plan 2 members who withdraw never receive any benefit from all the contributions made by the employer.

In Plan 3, the benefit is split into the defined contribution and the defined benefit accounts. Plan 3 members who leave prior to retirement can withdraw their contributions from the defined contribution account, and it does not impact their eligibility for an employer-funded defined benefit payment in the future. If Plan 3 members earn a guaranteed future payment, they retain the value from the employer contributions.

** Office of the State Actuary, 2007 Actuarial Valuation Report, September 2008.*

Plan 3 gives members greater flexibility and control within their retirement plan.

Plan 3 also offers members more control over their retirement planning. With the increased awareness of the stock market in the late 1980s and early 1990s, many employees wanted flexibility and control over their retirement contributions. Plan 3 provides flexibility in the amount of contributions and control over how they are invested. Plan 2 does not provide these benefits. Even if the new employees do not choose Plan 3 initially, this flexibility and control may be desired later in their career.

Plan 3 shifts some risk of providing a retirement benefit to members, but provides features to help mitigate that risk.

However, with this increased flexibility and control comes increased risk. Members in Plan 3 are assuming more risk for their future retirement benefit than Plan 2 members. Part of the benefit from Plan 3 comes from the members own contributions and earnings, on which there is no guaranteed return. Therefore, depending upon the amount invested and the earnings, members may or may not have as much income replacement at retirement as Plan 2 members may have.

Some policy makers may question whether a plan designed for active management that shifts some retirement risk to members is appropriate for new employees who cannot choose a retirement plan in ninety days. While there is more risk to members in this plan, there are several design options within Plan 3 that attempt to mitigate some of that risk.

First, as stated earlier, members who are defaulted into Plan 3 are also defaulted into the WSIB investment option. This provides them with access to a professionally managed, low-fee, and diverse investment portfolio, the same portfolio that funds the defined benefit plans in Washington. This option mitigates some of the risk for individual investors.

Second, the Plans 3 provide an option for members to purchase a lifetime monthly annuity with their contributions at the time of retirement, paid out of the state retirement funds. Because this annuity is purchased from the state, it provides more benefit for less cost than what could typically be purchased in the private sector, and removes some of the risk of members outliving the value of their investments.

Finally, members still receive a defined benefit payment funded from the employer contributions. This ensures there is some level of secure monthly income being earned.

Policy Analysis

The request to change the plan membership default in the Plans 2/3 raises two immediate policy questions:

- Should the default be changed, particularly at this time?
- If so, how should the default be determined?

Should The Plan Default Be Changed?

As discussed earlier in this paper, Plan 3 was the original choice as the default plan for PERS, and has remained the default choice as optional membership was expanded to TRS and SERS. As shown in Appendix A, nearly 18,000 members have been defaulted into Plan 3 since the creation of optional membership. This amounts to approximately 19 percent of all new employees.

The question for policy makers is: Have the values changed that made the Plan 3 design the policy preference for the default plan?

Have the values changed that made the Plan 3 design the policy preference for the default plan?

The Plan 3 design offers value for the mobility and flexible retirement planning needs of many new employees. For employers, it offers a retirement plan that helps recruit from the private sector, which primarily offers defined contribution retirement plans for employees. For the state of Washington, as the plan sponsor, the Plan 3 design shifts some of the investment risk for providing a benefit to members, and lowers the long-term cost of the plan that the state guarantees. As explained earlier, the Plan 3 members carry the investment risk for their own contributions, and the state guarantees the value of the defined benefits paid by employer contributions. Since the Plan 3 defined benefit is half the value of the Plan 2 defined benefit, the state accrues less liability with Plan 3. Shifting the investment risk and lowering the long-term liability were key benefits to the state of implementing Plan 3 and designating Plan 3 as the default plan.

Have the values in the Plan 3 design changed? Do policy makers no longer consider lowering the long-term liability for the state a goal? If the values discussed above have not changed, then some reason must override the design values in significance to consider changing the current plan default. Otherwise, retaining Plan 3 as the default plan would be the consistent approach.

Should The Default Be Changed At This Time?

In addition to the question of whether the Plan 3 default should be changed at all, there are also two concerns raised by the timing of this request. First, as mentioned earlier, the Legislature continued the use of Plan 3 as the default plan when they implemented plan choice for TRS and SERS in HB 2391. Some of the benefit provisions in this bill are in current litigation, and the provisions of plan choice may be impacted by the outcome of this litigation. As a result, the committee may want to consult with their Assistant Attorney General before making a decision on this proposal.

Changing the plan default at this time may raise legal concerns.

Second, policy makers may want to consider whether the desire to change Plan 3 as the default may be linked to current market conditions. As discussed earlier, in Plan 3 members invest their contributions. When the financial markets are in a downturn, as they are now, the reaction to this financial climate may be that this exposure to investment risk is too great for members to accommodate. Therefore, some feel Plan 2 should be the default plan because the benefit is guaranteed and the state, as plan sponsor, should carry the investment risk, not members. This reaction may not fully consider the cyclical nature of the financial markets. The markets have had periods of tremendous gain, as well as loss. Volatility is part of their nature. When the financial markets are earning significant returns, will there be another request to change the default back to Plan 3 so members can participate in the gains?

Policy makers may want to consider whether the desire to change the default from Plan 3 may be linked to current market conditions.

How Should The Plan Default Be Determined?

If policy makers no longer feel Plan 3 should be the default plan for new employees from a broad-based policy perspective, then how should they choose which plan should be the default? Two possible approaches are:

- Use historical plan choice data to set the default.
- Determine which plan best serves the needs of new employees.

Using Historical Data To Set Plan Default

Historical data shows a strong preference for Plan 2 among PERS employees, but the data is somewhat less clear for school employees and teachers.

Appendix A provides detail of new employee choice in the Plans 2/3. PERS has had optional membership since March of 2002, so there is more historical data available. In PERS, over 64 percent of new employees choose Plan 2. An additional 17 percent choose Plan 3, and the remaining 19 percent are defaulted into Plan 3. This data indicates a strong preference in PERS for Plan 2.

SERS data also indicates a preference for Plan 2 of 48 percent to 32 percent choosing Plan 3. The remaining 20 percent are defaulted into Plan 3. TRS new members have a slight preference for Plan 3 of 46 percent to 40 percent choosing Plan 2. The remaining 14 percent of new teachers are defaulted to Plan 3.

While this data does show a strong preference for Plan 2 among PERS employees, the data is somewhat less clear for school employees and teachers. Also, since optional membership for SERS and TRS was implemented only 16 months ago, there is far less data in those plans from which to base a decision. If taking the approach to use historical data to determine the plan default choice, policy makers may want to consider whether enough data is available in SERS and TRS to make an informed choice.

Which Plan Best Serves The New Employees?

Policy makers may also set the plan default based upon a judgment of which plan best serves the new employees. This determination is complicated: however, as Plan 2 and Plan 3 were each designed to best serve the needs of different members. As discussed earlier in this paper when comparing the benefits in the two plans, Plan 2 may provide more value to the new employees who stay and retire from the system, or who don't want the primary responsibility or the risk of managing their own retirement. Plan 3 may be preferable for the new employees who will likely leave public employment prior to retirement, or those who may remain, but want more flexibility and options than a typical defined benefit plan provides.

Policy makers would need to determine which group of new members they would like to best serve. Those new employees who will stay to retirement age may be benefited by a Plan 2 default, and those who leave prior to retiring may be benefited by a Plan 3 default.

Should There Be Different Defaults For Different Members?

Instead of one default for all retirement systems, other approaches could include defaults based upon each system's demographics, or plan default based upon groupings of new employees.

Applying one default plan for all the Plans 2/3 would necessarily mean some members are defaulted into a plan that may not be best suited for their needs. A different approach may be to fit the default to the demographics of new employees in the retirement system. For example, PERS and SERS new employees are far more likely to leave the workforce prior to the normal age of retirement than new TRS employees. Would a Plan 3 default suit these employees better since it may provide more value to a departing worker? If new employees in TRS are more likely to work to the normal age of retirement, should they be given a Plan 2 default since Plan 2 is a cost effective means of providing retirement income? This approach could result in different default plans among the three retirement systems.

Another approach would be to fit the default to groupings of new employees specifically. For example, Plan 3 may be more valuable to younger employees who have time to invest and manage their contributions through market volatility. Plan 3 may be a logical choice as the default for these new employees. But what of new employees that enter the workforce at later ages? They may not have time to earn significant investment gains in Plan 3. New employees past a certain age may benefit from being defaulted into Plan 2. This approach could result in different plan defaults within each retirement system.

Is Eliminating the Default Provision a Viable Option?

Upon review, eliminating the default and changing the default to Plan 2 requires very different analyses. Eliminating the default would require policy makers to revisit some fundamental principles and aspects of Washington's retirement systems.

In discussing the elimination of the default provision, policy makers may need to consider compliance with federal law and the need for mandatory participation.

Compliance with Federal Law

Federal law does not explicitly bar the state from offering a choice of plans for more than ninety days, but any modification that could extend or eliminate that time period could raise questions of whether the benefits are definitely determinable.

Under federal law,[1] a defined benefit plan, or portion of a plan, must have definitely determinable benefits that are not subject to employer discretion. If an employee were allowed to wait for an extended period of time before being placed (by choice or default) into a plan, that employee's benefits would remain undeterminable for that extended period of time.

[1] See 26 CFR 1.401-1 and 26 USC §401(a).

Mandatory Participation

Since the inception of retirement systems in Washington, the Legislature has chosen to require mandatory participation. A default provision serves to ensure this participation since it is difficult, if not impossible, to force someone to make an affirmative choice. Without a default, employees could theoretically wait until the day they retire to affirmatively make a selection.

Default provisions are used in two other programs that require mandatory participation.

New employees must choose a medical and dental plan within 31 days. If they do not make the choice during the allotted time, they are defaulted into the Uniform Medical Plan and Uniform Dental Plan.[2]

At the federal level, new employees must complete and submit an IRS form W-4 to the employer in order for the employer to calculate the employee's withholding. If the employee does not complete and submit a form W-4, the employer must withhold income taxes as though the employee was single, with no withholding allowances.[3]

[2] WAC 182-08-197.

[3] See IRS Publication 15, Section 9, p. 16.

Other States*

Only two comparative systems offer similar plan choice to new employees, and both systems default members into the defined benefit option.

Among the comparative states, only two systems offer new employees a choice between a defined benefit plan and some form of defined contribution or hybrid plan: Ohio PERS and the Florida Retirement System.

Ohio PERS gives new employees a choice between a traditional defined benefit plan like Plan 2, a hybrid retirement plan like Plan 3, and a defined contribution plan. If members do not choose a plan, they are defaulted into the traditional defined benefit plan.

The Florida Retirement System gives new members the option to participate in a defined benefit plan and a defined contribution plan. Like Ohio PERS, if members fail to make a timely choice, they are defaulted into the defined benefit plan.

**As of November 2010.*

Conclusion

There is a request to the SCPP to change the plan choice default in the Plans 2/3. Plan 3 has been the policy choice as the plan default since the inception of optional membership in 2002 and remained the default choice when optional membership was expanded in 2007. Have the plan design values that drove that default policy changed?

Is now the right time to change the plan default? There are also timing considerations concerning changing the plan default. These include possible legal concerns and the impact of the current financial markets on the desire for change.

If policy makers don't have a policy preference for continuing the use of Plan 3 as the default, how should they determine which plan should be the default?

- Look at historical data of plan choice preference?
- Make a determination of which plan best serves the needs of new employees?

A look at similar situations in comparative state systems shows that only two systems offer new employees a similar plan choice as Washington. In both of those systems, members who fail to choose within their allotted time period are defaulted into a defined benefit plan.

O:\SCPP\2010\12-14-10_Full\3.Plan_2-3_Default_Issue_Paper.docx

Appendix A

Plan 3 Choice Data As of September 2009						
System and Plan	PERS 3		TRS 3		SERS 3	
	Count	Percent of Total	Count	Percent of Total	Count	Percent of Total
New Members	94,128		7,526		8,359	
New Members Opting Into Plan 2	60,040	64%	2,999	40%	4,005	48%
New Members Opting Into Plan 3	16,114	17%	3,106	41%	2,403	29%
New Members Defaulting Into Plan 3	17,974	19%	1,421	19%	1,951	23%

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.**

Washington State School Retirees' Association

4276 Pacific Avenue SE, Lacey, WA 98503-1216 ~ 360-413-5493 / fax 360-413-5497 / 1-800-544-5219 ~ www.wssra.org

MEMORANDUM

RECEIVED

AUG - 4 2010

Office of
The State Actuary

TO: Select Committee on Pension Policy

FROM: Ester Wilfong, WSSRA Legislative Committee Co-Chair
Gordon Irle, WSSRA Legislative Committee Co-Chair
Leslie Main, WSSRA Legislative Coordinator

DATE: August 2, 2010

SUBJECT: WSSRA Priorities for 2010-11

The Washington State School Retirees' Association (WSSRA) again looks forward to working with members of the Select Committee on Pension Policy (SCPP) to address issues of concern to current and future school retirees. WSSRA has general goals and specific objectives which represent the continuing interests and concerns of 16,400+ statewide members that will be pursued as conditions permit. Following are WSSRA's Legislative Goals for 2010-11:

(Due to the continuing economic challenges facing the State of Washington, WSSRA intends on focusing on the objectives in highlighted print.)

WSSRA LEGISLATIVE GOALS ~ 2010-11

WSSRA: Providing leadership and promoting action.

Recovery of lost purchasing power for all TRS/PERS 1 retirees.

Objectives:

- Preservation and protection of the full value of the Teacher Retirement System / Public Employees Retirement System (TRS/PERS) Plan 1 defined benefit from inflation:
  - Short-term – **Protection** / improvement of the Plan 1 dollars/per months/per years of service post-retirement adjustment known as the Uniform Cost-of-Living Adjustment (COLA).
  - Long-term – Establishment of a true, Consumer Price Index (CPI)-based, Plan 1 COLA, consistent with the COLA provided to Plan 2/3 retirees.

Full funding of Washington State's Plan 1 and Plans 2/3 pension systems.

Objectives:

- Adherence to RCW 41.45.010 which calls for "dependable and systematic funding processes and pension contribution rates which will remain a relatively predictable proportion of future state budgets."
- Re-establishment of the June 30, 2024, amortization date for the Teacher Retirement System / Public Employees Retirement System (TRS/PERS) Plan 1 Unfunded Liabilities.

Pension improvements for active members of TRS/SERS/PERS.

Objectives:

- Establishment of Plan 2 as the default plan for new hires in the Teacher Retirement System / School Employees Retirement System / Public Employees Retirement System (TRS/SERS/PERS).
- Improvement of the $150,000 death benefit for survivors of active members of TRS/SERS/PERS killed in the course of employment.
- Re-establishment of the Employees Retirement Benefits Board (ERBB) to address issues related to Plan 3 member Defined Contribution plans (i.e. self-directed investment options for Plan 3 defined contribution plans, payment options available for Plan 3 members, recommendations on investment options for the Deferred Compensation Program, etc.).
- Removal of age restrictions on 5-year vesting eligibility criteria for members of TRS/SERS/PERS Plan 3.
- Improvement of pension benefits which address concerns unique to classified school employees in SERS 2/3 and current TRS/SERS/PERS 3 retirees remaining from the 2007 repeal of Gain Sharing.
- A full retirement benefit for TRS/SERS/PERS Plan 2/3 members below the alternate Early Retirement Reduction Factor (ERRF) eligibility option of age 62 with 30 years of service.

Improved health insurance benefits and lower premiums for school retirees.

Objectives:

- Increases in the Public Employee Benefits Board (PEBB) Medicare eligible retiree subsidies that reflect increases in the rate of medical inflation.
- Protection plan design and containment of costs related to PEBB sponsored retiree health insurance plans (i.e. comprehensive benefit coverage - the type and level of benefit coverage and containment of costs - co-payments, deductibles, and monthly premiums).
- A "2nd chance" PEBB enrollment window for those state and K-12 employees who retired prior to 1/1/01, missed their initial enrollment opportunity, and can meet PEBB continuity of care requirements.

Improved livelihood for current and future school retirees.

Objectives:

- Support efforts of other senior advocate groups on long-term care and health care reform.
- Support efforts of other senior advocate groups on consumer privacy and protection, and fraud prevention.
- Support efforts of other senior advocate groups when their goals are consistent with ours.

Regarding WSSRA's top objectives for 2010-11:

Objective: Protection / improvement of the Plan 1 dollars/per months/per years of service post-retirement adjustment known as the Uniform Cost-of-Living Adjustment (COLA)

In the context of the current economic climate and the pension system Risk Assessment policies under development, WSSRA is compelled to have ***protection*** of the Uniform Plan 1 COLA as one of its top priorities for the 2010 Interim and 2011 Session. Much attention has been given to previously enacted benefit improvements, especially for members of TRS/PERS 1, as an underlying cause for the increasing pension costs the state is currently facing. **We believe that it is not the much needed enacted benefit improvements that are the problem, but *the Legislature's failure to pay for such improvements* that is the problem.**

The worth of a defined benefit is measured by how it retains its value over time. Plan 1 benefit improvements have been enacted because the original design of Plan 1 did not provided for adequate protection from inflation. Moreover, these benefits play a critical role in the economic vitality of the State of Washington. We encourage the SCPP to incorporate objective ***and*** subjective factors, such as follows, in their considerations of pension Risk Assessment:

- The principled "value" of maintaining Plan 1 benefit improvements which have ***helped*** to regain lost purchasing power – According to past reports by the Office of the State Actuary, even with the Gain Sharing improved Uniform Plan 1 COLA, members of TRS Plan 1 who retired during the mid-1970s have lost approximately 50% of their purchasing power (PERS 1, approximately 40%).
- The potential negative impact on employee recruitment and retention if Washington State becomes known for ***not*** living up to pension benefit promises that have been, or may be, made to current and future employees and retirees, and
- The cost/benefit "multiplier effect" of retiree pension benefits as they flow throughout the economy – The National Institute for Retirement Security (NRIS) in their February 2009 study, ***Pensionomics: Measuring the Economic Impact of State and Local Pension Plans*** found that:
  - ◇ **Every $1 in state and local pension benefits paid to retirees in Washington State supported $1.37 in total output.** This "multiplier" incorporates the impacts of retiree spending ($2.35 million), and induced impacts of retiree spending ($1.5 billion), to arrive at a total state economic impact of $3.2 billion in 2006.

Note: The NIRS study also measured the cost/benefit "multiplier effect" of retiree pension contributions, and found that **every $1 contributed by taxpayers in the form of employer and employee pension contributions to Washington pension plans over the last 30 years amounts to $9.69 in increased economic activity.** This reflects the multiplier effect of taxpayer contributions to pension funds that are invested and the impact of those investments as they ripple through the economy.

The ***Pensionomics*** summary of Washington State is attached, and the complete findings of this important NRIS study are available on the internet using the following link:
http://www.nirsonline.org/index.php?option=com_content&task=view&id=184&Itemid=88.

Objective: Adherence to RCW 41.45.010 which calls for "dependable and systematic funding processes and pension contribution rates which will remain a relatively predictable proportion of future state budgets"

WSSRA appreciates the SCPP's unanimous recommendation of support to the Pension Funding Council for the adoption of the State Actuary's recommended pension contribution rates for the 2011-13 biennium. We are also gratified that the Pension Funding Council has adopted these rates.

The next hurtle will be whether the Legislature adheres to these rates as they build the State's budget for the forthcoming biennium. As pointed out during WSSRA's testimony at the July 20th SCPP meeting, the Legislature has acted over the last decade to cut pension funding by:

- reducing pension contribution rates mid-biennium, *2SSB 6404 (2000)*
- amending statute to provide that, ***"The contribution rate changes adopted by the PFC shall be subject to revision by the Legislature,"*** *ESSB 6167 (2001)*
- changing economic assumptions and actuarial methods used in pension actuarial valuations, *ESSB 6167 (2001)*
- moving the amortization date from 12-31-16 (realized from '98 and '00 Gain Sharing) back to 6-30-24, *ESSB 6167 (2001)*
- suspending payments on the Unfunded Liability for the 2003-05 and 2005-07 biennia, *SB 6029 (2003)*
- amending statutory pension funding goals to provide increased flexibility in manipulating contribution rates, *ESHB 1044 (2005)*
- avoiding recognition of the cost of future Gain Sharing distributions as a material liability of the pension funds (a.k.a. "pre-funding"), *ESHB 1044 (2005)*
- most recently, under *SSB 6161 (2009)* ~
  - repealing the 2024 Plan 1 Unfunded Liability amortization date established under the 1989 Pension Reform Act, and amending statutory *pension funding goals* by replacing references to the 2024 date with references to the new 10-year rolling amortization schedule in, plus
  - suspending adoption of revised mortality tables and two contribution rate floors (levels beyond which rates cannot fall) due to go into effect at the beginning of the 2009-11 biennium: one for the TRS/PERS 1 Unfunded Liability and one for employer and member contribution rates for Plans 2/3 basic benefits in TRS/SERS/PERS, and
  - reducing the 2009-11 Unfunded Actuarial Accrued Liability (UAAL) pension contribution rates by 63.7% from those adopted by the Pension Funding Council.

The days of the Legislature manipulating pension contribution rates for short-term budget relief must end now. WSSRA asks SCPP members for their active support during the 2011 Session of enactment of the PFC's 2011-13 adopted pension contribution rates.

Objective: Establishment of Plan 2 as the default plan for new hires in the Teacher Retirement System / School Employees Retirement System / Public Employees Retirement System (TRS/SERS/PERS).

Considering the previously projected long-term savings that would be realized by the enactment of Plan 2 as the default plan for new hires in TRS/SERS/PERS, we also ask that the SCPP reconsider recommending this legislation for consideration before the Legislature during the 2011 Session. As with the issue of responsible pension funding, WSSRA correspondingly requests the active support for the Plan 2 default issue throughout the legislative process.

Objective: Improvement of the $150,000 death benefit for survivors of active members of TRS/SERS/PERS killed in the course of employment

Regarding improvement of the $150,000 death benefit provided to active members of TRS/SERS/PERS, WSSRA seeks uniformity of this benefit with that enacted for members of LEOFF 2 and the WSPRS during the 2010 Session: The $150,000 benefit would be increased to reflect inflation impacts since the benefit was established (approximately $214,000), and automatically adjusted each year by an amount equal to the Consumer Price Index (CPI) for urban wage earners and clerical workers for the Seattle / Tacoma / Bremerton area up to a maximum of 3 percent per year. Under the best of circumstances, this benefit would never be utilized. However, having this benefit indexed to the CPI will ensure that the value of this important benefit is maintained.

WSSRA looks forward to working with the SCPP during the 2010 Interim and 2011 Session to address these challenging and critical issues. Please contact WSSRA at 1-800-544-5219 if you have any questions regarding these requests. Thank you.

Cc: Matt Smith, Washington State Actuary
Ed Gonion, WSSRA Executive Director

NATIONAL INSTITUTE ON
Retirement Security
Reliable Research. Sensible Solutions.

WASHINGTON

Pensionomics:

Measuring the Economic Impact of State and Local Pension Plans

Key Findings

Benefits paid by state and local pension plans support a significant amount of economic activity in the state of Washington.

Pension benefits received by retirees are spent in the local community. This spending ripples through the economy, as one person's spending becomes another person's income, creating a *multiplier effect*.

Expenditures stemming from state and local pensions supported...

- 21,035 jobs that paid $1.3 billion in wages and salaries
- $3.2 billion in total economic output
- $462.9 million in federal, state, and local tax revenues

... in the state of Washington.

Each dollar paid out in pension benefits supported $1.37 in total economic activity in Washington.

Each dollar "invested" by Washington taxpayers in these plans supported $9.69 in total economic activity in the state.

Overview

Expenditures made by retirees of state and local government provide a steady economic stimulus to Washington communities and the state economy. In 2006, 129,378 residents of Washington received a total of $2.35 billion in pension benefits from state and local pension plans, with $2.17 billion paid from plans within the state and the remainder originating from plans in other states.

The average pension benefit received was $1,516 per month or $18,191 per year. These modest benefits provide retired teachers, public safety personnel and others who served the public during their working careers income to meet basic needs in retirement.

Impact on Jobs and Incomes

Retiree expenditures stemming from state and local pension plan benefits supported 21,035 jobs in the state. The total income to state residents supported by pension expenditures was $1.3 billion.

Of this, the greatest share, $717.6 million, was comprised of employee compensation (wages and salaries). Proprietors' income (self-employment income) represented $101.6 million, and other property income (including payments from interest, rent, royalties, profits and dividends) totaled $491.3 million.

Economic Impact

State and local pension funds in Washington and other states paid a total of $2.35 billion in benefits to Washington residents in 2006. Retirees' expenditures from these benefits supported a total of $3.2 billion in total economic output in the state, and $1.5 billion in value added in the state.

$2.3 billion in direct economic impacts were supported by retirees' expenditures on goods and services from businesses in the state. An additional $472.1 million in indirect economic impact resulted when these businesses purchased additional goods and services, generating additional income in the local economy. $491.5 million in induced impacts occurred when employees hired by businesses as a result of the direct and indirect impacts made expenditures, supporting even more additional income.

Total Economic Impact **$3.2 billion**

For more information on the data and methodology used for these estimates, please refer to *Pensionomics: Measuring the Economic Impact of State and Local Pension Plans*
National Institute on Retirement Security: Washington DC. February 2009. www.nirsonline.org

Economic Multipliers

Taxpayer Contribution Factor*

$1.00
Contributed by taxpayers to Washington pensions over 30 years

$9.69
total output

Each $1 in taxpayer contributions to Washington's state and local pension plans supported $9.69 in total output in the state. This reflects the fact that taxpayer contributions are a minor source of financing for retirement benefits - investment earnings and employee contributions finance the lion's share.

Pension Benefit Multiplier

$1.00
pension benefits paid to retirees in Washington

$1.37
total output

Each $1 in state and local pension benefits paid to Washington residents ultimately supported $1.37 in total output in the state. This "multiplier" incorporates the direct, indirect, and induced impacts of retiree spending, as it ripples through the state economy.

* Caution should be used in interpreting this number, because the Census data used reflect the taxable status of contributions only; because employee contributions may be reported as taxpayer contributions, the multiplier here may be underestimated.

Impact on Tax Revenues

State and local pension payments made to Washington residents supported a total of $462.9 million in revenue to federal, state and local governments. Taxes paid by retirees and beneficiaries directly out of pension payments totaled $82.4 million. Taxes attributable to direct, indirect and induced expenditures accounted for $380.5 million in tax revenue.

Federal Tax	312.9 million
State/Local Tax	149.2 million
Other Corporate Taxes	0.7 million
Total	**$462.9 million**

Economic Impacts by Industry Sector

The economic impact of state and local pension benefits was broadly felt across various industry sectors in the state. The ten industry sectors with the largest employment impacts are presented in the table below.

Industry	Employment Impact (# Jobs)	Value Added Impact ($ millions)	Income Impact ($ millions)	Output Impact ($ millions)
Health Care and Social Assistance	4,778	$250.9	$247.9	$397.0
Retail Trade	4,008	210.8	166.8	316.5
Accommodation and Food Services	2,376	68.6	60.9	133.4
Other Services (Except Public Administration)	1,859	54.9	51.1	101.4
Real Estate and Rental and Leasing	1,099	121.9	101.2	180.7
Finance and Insurance	935	115.4	110.3	206.0
Professional, Scientific, and Technical Services	854	51.0	50.0	95.1
Wholesale Trade	844	102.5	80.1	152.0
Arts, Entertainment, and Recreation	674	20.1	17.9	34.1
Administrative and Waste Services*	648	25.1	57.2	40.4

* The North American Industry Classification System classifies this industry as Administrative and Support and Waste Management and Remediation Services.

Z-0396.1

HOUSE BILL 1722

State of Washington 61st Legislature 2009 Regular Session

By Representatives Crouse, Conway, Seaquist, and Simpson; by request of Select Committee on Pension Policy

Read first time 01/28/09. Referred to Committee on Ways & Means.

AN ACT Relating to plan membership default provisions in the public employees' retirement system; and amending RCW 41.40.785.

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

Sec. 1. RCW 41.40.785 and 2000 c 247 s 302 are each amended to read as follows:

(1) All employees who first become employed by an employer in an eligible position on or after March 1, 2002, for state agencies or institutes of higher education, or September 1, 2002, for other employers, shall have a period of ninety days to make an irrevocable choice to become a member of plan 2 or plan 3. At the end of ninety days, if the member has not made a choice to become a member of plan 2, he or she becomes a member of plan 2 or plan 3 as follows:

(a) He or she becomes a member of plan 3 if first employed by an employer in an eligible position on or after March 1, 2002, but prior to July 1, 2009, for state agencies or institutes of higher education, or on or after September 1, 2002, but prior to July 1, 2009, for other employers; or

(b) He or she becomes a member of plan 2 if first employed by an employer in an eligible position on or after July 1, 2009.

(2) For administrative efficiency, until a member elects to become a member of plan 3, or becomes a member of plan 3 by default pursuant to subsection (1) of this section, the member shall be reported to the department in plan 2, with member and employer contributions. Upon becoming a member of plan 3 by election or by default, all service credit shall be transferred to the member's plan 3 defined benefit, and all employee accumulated contributions shall be transferred to the member's plan 3 defined contribution account.

--- END ---

ACTUARY’S FISCAL NOTE

RESPONDING AGENCY:	CODE:	DATE:	Bill Number:
Office of the State Actuary	**035**	**1/27/10**	**HB 1722 / SB 5307**

WHAT THE READER SHOULD KNOW

The Office of the State Actuary (“we”) prepared this fiscal note based on our understanding of the bill as of the date shown above. We intend this fiscal note to be used by the Legislature during the 2010 Legislative Session only.

We advise readers of this fiscal note to seek professional guidance as to its content and interpretation, and not to rely upon this communication without such guidance. Please read the analysis shown in this fiscal note as a whole. Distribution of, or reliance on, only parts of this fiscal note could result in its misuse, and may mislead others.

SUMMARY OF RESULTS

This bill changes the Plan 2/3 membership plan default in the Public Employees’ Retirement System (PERS) from Plan 3 to Plan 2. This bill doesn’t increase the benefits or liabilities of the current Plan 2/3 members from this system, but would change future contribution levels due to assumed changes in future plan membership.

Impact on Pension Liability			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Today's Value of All Future Pensions	$70,619	$0.0	$70,619
Earned Pensions Not Covered by Today's Assets	$5,411	$0.0	$5,411

Impact on Contribution Rates: (Effective 09/01/2010)	
2010-2011 State Budget	**PERS**
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)	**2010-2011**	**2011-2013**	**25-Year**
General Fund-State	$0.0	$0.0	($10.1)
Total Employer	$0.0	$0.1	($50.8)

See the Actuarial Results section of this fiscal note for additional detail.

WHAT IS THE PROPOSED CHANGE?

Summary Of Change

This bill impacts the following system:

- PERS Plans 2/3

This bill would change the current plan membership default from Plan 3 to Plan 2. New employees who first become employed by an employer in eligible positions after July 1, 2010, would have 90 days to choose membership in Plan 2 or Plan 3. If the new employee does not make a choice within 90 days, they become a member of Plan 2.

For administrative ease employers report all new employees in Plan 2 until they choose membership in Plan 3. At that point the Department of Retirement Systems (DRS) transfers the member's service credit to their Plan 3 defined benefit accounts and the member's Plan 2 contributions to their Plan 3 defined contribution accounts.

Assumed Effective Date: 90 days after session.

What Is The Current Situation?

New employees who first become employed by an employer in a PERS eligible position have 90 days to choose membership in Plan 2 or Plan 3. If the new employee does not make a choice within 90 days, they become a member of Plan 3, contribute at the minimum contribution rate (5 percent), and the Washington State Investment Board invests their contributions.

For administrative ease employers report all new employees in Plan 2 until they choose to join or default into Plan 3. At that point DRS transfers the member's service credit to their Plan 3 defined benefit accounts and the member's Plan 2 contributions to their Plan 3 defined contribution accounts.

Who Is Impacted And How?

This bill will impact all future members of PERS who don't choose a pension plan. This bill does not impact the benefits of the current members of this system.

This bill potentially impacts all current PERS Plan 2 active members through decreased contribution rates. Additionally, this bill will not affect member contribution rates in Plan 3 since Plan 3 members do not contribute to their employer-provided defined benefit.

See the Special Data Needed section of this fiscal note for more details.

WHY THIS BILL HAS A COST AND WHO PAYS FOR IT

Why This Bill Has A Cost

We assume this bill will increase the percentage of new entrants that go into Plan 2 in the future. On average, we expect members of Plan 2 to work longer and retire later than members of Plan 3 because Plan 2 has a more strict early retirement eligibility standard. Plan 3 members are eligible to retire at age 55 after ten years of service; whereas, Plan 2 members are eligible to retire at age 55 after twenty years of service.

When we assume more members join Plan 2 in the future, costs in the affected system change in two areas:

- System contribution rates decrease slightly since the longer assumed working careers in Plan 2 means the system will have more future salary to fund future benefits. Since the employer provided benefits in Plan 2 and Plan 3 are very similar, increasing the assumed salary available to fund those benefits decreases the contribution rates.
- Projected contributions on existing system benefits (before the proposed changes under this bill) will increase since the affected systems will levy contribution rates on a larger projected future salary base due to longer expected working careers of Plan 2 members.

The expected change in projected contributions on existing system benefits due to larger projected future salary offsets the savings of this bill from slightly lower contribution rates. Please see the Actuarial Results Section for more detail.

Who Will Pay For These Costs?

To the extent that the cost of PERS changes because of this bill, the employers and active Plan 2 members will fund those changes using the same funding method as the other costs of the plan. Employers will pay the defined benefit costs for Plan 3 members and half the cost for Plan 2 members. Plan 2 members pay for the other half of their costs.

HOW WE VALUED THESE COSTS

Assumptions We Made

We assumed the portion of new entrants going into Plan 2 would increase for PERS from two-thirds to three-quarters. We also assumed future new entrants would have the same demographic characteristics (or profile) as the combined Plan 2/3 new entrants in the 2008 valuation data. Therefore, we did not assume different new entrant profiles by plan as we did in our prior fiscal note for this bill (in the 2009 Legislative Session) and in our projection system. With this assumption change, differences in plan design influence the cost more so than assumed changes in future new entrant profiles by plan.

For more detail please see Appendix A.

How We Applied These Assumptions

We used our liability projection system to project the current group of active members into the future. First we updated our existing projections to reflect a combined Plan 2/3 new entrant profile instead of plan specific profiles. This established a new base run for this pricing exercise. Then using the new entrant assumptions described above (an increase in members joining Plan 2 in the future) in combination with the 1.25 percent total membership growth assumption in PERS we replaced the current active members as they left active service, and allowed the active populations to increase each year. We compared the results of this new projection to our new base-run projections to isolate future contribution differences and changes in future system salary due to this bill.

Special Data Needed

DRS provided us with new entrant data for PERS. Data for this system included new entrants starting in March of 2002 through September of 2009. The data included – the:

- Total number of new entrants into the system.
- Number of members opting into Plan 2.
- Number of members opting into Plan 3.
- Number of members defaulting into Plan 3.

Otherwise, we developed these costs using the same assets and data as disclosed in the June 30, 2008, Actuarial Valuation Report (AVR).

For more detail please see Appendix B.

ACTUARIAL RESULTS

How The Liabilities Changed

This bill does not impact the liabilities for the current active members of PERS since it does not change the benefits of any plan.

How Contribution Rates Changed

This bill does not impact the contribution rates for the current active members of PERS in the 2009-11 Biennium. But this bill does change projected contributions for the Plans 2/3 of this system in future biennia due to changes in future plan membership. We used these projected contribution changes to measure the budget changes in future biennia.

How This Impacts Budgets

Because this bill changes both future contribution rates and the assumed value of future salaries available to make contributions, we decided to split the budget impact into the two main components of the cost: (1) change in contribution rates, and (2) change in expected future salaries.

The results of our projections indicate that PERS would experience a slight decrease in contribution rates in future biennia. The impact of this component alone will decrease future system cost. The following table shows the projected budget impact of this change. We do not expect any impact in the first two biennia from this change.

Budget Impacts – From Change in Contribution Rates	
(Dollars in Millions)	**PERS**
2010-2035	
General Fund	($10.5)
Non-General Fund	(15.0)
Total State	**($25.5)**
Local Government	(27.3)
Total Employer	**($52.8)**

Note: Totals may not agree due to rounding.

On the other hand, we also expect an increase in expected future salary for PERS. The impact of this component alone will increase future system cost. The following table shows the projected budget impact of this change. We do not expect any impact in the current biennium from this change.

Budget Impacts – From Change in Expected Future Salary	
(Dollars in Millions)	**PERS**
2011-2013	
General Fund	$0.0
Non-General Fund	0.0
Total State	**$0.1**
Local Government	0.1
Total Employer	**$0.1**
2010-2035	
General Fund	$0.4
Non-General Fund	0.6
Total State	**$1.0**
Local Government	1.1
Total Employer	**$2.1**

Note: Totals may not agree due to rounding.

The total budget impact for PERS is the sum of these two prior tables. Notice that the decrease in contribution rates has a greater impact than the increase in expected future salary for this system. The following table shows the combined impact of these two components.

Budget Impacts - Total	
(Dollars in Millions)	**PERS**
2010-2011	
General Fund	$0.0
Non-General Fund	0.0
Total State	**$0.0**
Local Government	0.0
Total Employer	**$0.0**
2011-2013	
General Fund	$0.0
Non-General Fund	0.0
Total State	**$0.1**
Local Government	0.1
Total Employer	**$0.1**
2010-2035	
General Fund	($10.1)
Non-General Fund	(14.4)
Total State	**($24.5)**
Local Government	(26.3)
Total Employer	**($50.8)**

Note: Totals may not agree due to rounding.

Note that we did not provide the budget impact on employees since most of the budget change for employees is due to the plan into which members default and not due to the cost of this bill. More specifically, defaulting members will pay the Plan 2 calculated member rate in future biennia, compared to the fixed 5 percent of salary that these members would have contributed had they defaulted into Plan 3.

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

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

HOW THE RESULTS CHANGE WHEN THE ASSUMPTIONS CHANGE

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

- The proportion of new entrants becoming Plan 2 members by default in the long-term. We looked at the 25-year budget impacts of assuming the following percentages of new entrants becoming Plan 2 members:
  - 70 percent.
  - 80 percent.

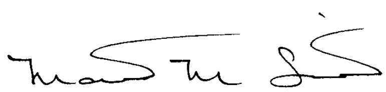
25-Year Budget Impacts	
(Dollars in Millions)	**PERS**
70% of New Entrants into Plan 2	
General Fund	($4.3)
Non-General Fund	(6.1)
Total State	**($10.4)**
Local Government	(11.2)
Total Employer	**($21.6)**
75% of New Entrants into Plan 2 (Best Estimate)	
General Fund	($10.1)
Non-General Fund	(14.4)
Total State	**($24.5)**
Local Government	(26.3)
Total Employer	**($50.8)**
80% of New Entrants into Plan 2	
General Fund	($13.8)
Non-General Fund	(19.6)
Total State	**($33.4)**
Local Government	(35.7)
Total Employer	**($69.1)**

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 fiscal note is based are sufficient and reliable for the purposes of this pricing exercise.
4. Use of another set of methods, assumptions, and data may also be reasonable, and might produce different results.
5. We prepared this fiscal note for the Legislature during the 2010 Legislative Session.
6. We prepared this fiscal note and provided opinions in accordance with Washington State law and accepted actuarial standards of practice as of the date shown on page one of this fiscal note.

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



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

APPENDIX A – ASSUMPTIONS WE MADE

In general we assume that two-thirds of all future entrants into PERS will choose to join Plan 2, and that the remaining one-third will enter Plan 3. This represents our best-estimate assumption on future long-term behavior. The data provided by DRS, shown in Appendix B, shows the portion of new entrants who defaulted into Plan 3. We converted the proportions shown into values corresponding to our one-third/two-thirds assumption in the following manner for PERS:

(1) Portion of new entrants we assume enters Plan 3 = 33 percent.
(2) Portion of new entrants who actually entered Plan 3 = 36 percent.
(3) Portion of new entrants who actually entered Plan 3 by default = 19 percent.
(4) Portion of (1) we assumed entered Plan 3 by default = (1) * (3) / (2) = 18 percent.
(5) Portion of members who defaulted into Plan 3 who we assumed did not specifically want to be in Plan 3 = 67 percent.
(6) Portion of (4) we assume would default into Plan 2 under this bill = (4) * (5) = 12 percent.
(7) Portion of new entrants we assume enters Plan 3 under this bill = (1) – (6) = 22 percent.

The above process led to 22 percent of new entrants becoming PERS 3 members. We assumed 75 percent of new entrants would enter Plan 2 and 25 percent would enter Plan 3. Please note that we rounded the intermediate results for display purposes, but used the unrounded results in all calculations above.

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

APPENDIX B – SPECIAL DATA NEEDED

DRS provided the following data:

Department of Retirement Systems - Plan 3 Choice Data

Data provided starting March of 2002 for PERS.

Plan 3 Choice Data		
System and Plan	**PERS 3**	
	Count	**Percent of Total**
New Members	94,128	
New Members Opting Into Plan 2	60,040	64%
New Members Opting Into Plan 3	16,114	17%
New Members Defaulting Into Plan 3	17,974	19%

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 which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded 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.

S-3550.1

SENATE BILL 6516

State of Washington 61st Legislature 2010 Regular Session

By Senator Hobbs

Read first time 01/15/10. Referred to Committee on Ways & Means.

AN ACT Relating to plan membership default provisions in the public employees' retirement system, the teachers' retirement system, and the school employees' retirement system; and amending RCW 41.32.835, 41.35.610, and 41.40.785.

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

Sec. 1. RCW 41.32.835 and 2007 c 491 s 3 are each amended to read as follows:

(1) All teachers who first become employed by an employer in an eligible position on or after July 1, 2007, shall have a period of ninety days to make an irrevocable choice to become a member of plan 2 or plan 3. At the end of ninety days, if the member has not made a choice to become a member of plan 2, he or she becomes a member of plan 3 <u>or plan 2 as follows:</u>

<u>(a) Becomes a member of plan 3 if first employed by an employer in an eligible position on or after July 1, 2007, but prior to July 1, 2010;</u>

<u>(b) Becomes a member of plan 2 if first employed by an employer in an eligible position on or after July 1, 2010.</u>

These plan choice and default provisions are subject to the rights reserved by the legislature in subsection (3) of this section.

(2) For administrative efficiency, until a member elects to become a member of plan 3, or becomes a member of plan 3 by default under subsection (1) of this section, the member shall be reported to the department in plan 2, with member and employer contributions. Upon becoming a member of plan 3 by election or by default, all service credit shall be transferred to the member's plan 3 defined benefit, and all employee accumulated contributions shall be transferred to the member's plan 3 defined contribution account.

(3) The plan choice provision as set forth in section 3, chapter 491, Laws of 2007 was intended by the legislature as a replacement benefit for gain-sharing. Until there is legal certainty with respect to the repeal of chapter 41.31A RCW, the right to plan choice under this section is noncontractual, and the legislature reserves the right to amend or repeal this section. Legal certainty includes, but is not limited to, the expiration of any: Applicable limitations on actions; and periods of time for seeking appellate review, up to and including reconsideration by the Washington supreme court and the supreme court of the United States. Until that time, all teachers who first become employed by an employer in an eligible position on or after July 1, 2007, may choose either plan 2 or plan 3 under this section. If the repeal of chapter 41.31A RCW is held to be invalid in a final determination of a court of law, and the court orders reinstatement of gain-sharing or other alternate benefits as a remedy, then all teachers who first become employed by an employer in an eligible position on or after the date of such reinstatement shall be members of plan 3.

Sec. 2. RCW 41.35.610 and 2007 c 491 s 7 are each amended to read as follows:

(1) All classified employees who first become employed by an employer in an eligible position on or after July 1, 2007, shall have a period of ninety days to make an irrevocable choice to become a member of plan 2 or plan 3. At the end of ninety days, if the member has not made a choice to become a member of plan 2, he or she becomes a member of plan 3 <u>or plan 2 as follows:</u>

<u>(a) Becomes a member of plan 3 if first employed by an employer in</u>

an eligible position on or after July 1, 2007, but prior to July 1, 2010;

(b) Becomes a member of plan 2 if first employed by an employer in an eligible position on or after July 1, 2010.

These plan choice and default provisions are subject to the rights reserved by the legislature in subsection (3) of this section.

(2) For administrative efficiency, until a member elects to become a member of plan 3, or becomes a member of plan 3 by default under subsection (1) of this section, the member shall be reported to the department in plan 2, with member and employer contributions. Upon becoming a member of plan 3 by election or by default, all service credit shall be transferred to the member's plan 3 defined benefit, and all employee accumulated contributions shall be transferred to the member's plan 3 defined contribution account.

(3) The plan choice provision as set forth in section 7, chapter 491, Laws of 2007 was intended by the legislature as a replacement benefit for gain-sharing. Until there is legal certainty with respect to the repeal of chapter 41.31A RCW, the right to plan choice under this section is noncontractual, and the legislature reserves the right to amend or repeal this section. Legal certainty includes, but is not limited to, the expiration of any: Applicable limitations on actions; and periods of time for seeking appellate review, up to and including reconsideration by the Washington supreme court and the supreme court of the United States. Until that time, all classified employees who first become employed by an employer in an eligible position on or after July 1, 2007, may choose either plan 2 or plan 3 under this section. If the repeal of chapter 41.31A RCW is held to be invalid in a final determination of a court of law, and the court orders reinstatement of gain-sharing or other alternate benefits as a remedy, then all classified employees who first become employed by an employer in an eligible position on or after the date of such reinstatement shall be members of plan 3.

Sec. 3. RCW 41.40.785 and 2000 c 247 s 302 are each amended to read as follows:

(1) All employees who first become employed by an employer in an eligible position on or after March 1, 2002, for state agencies or institutes of higher education, or September 1, 2002, for other

employers, shall have a period of ninety days to make an irrevocable choice to become a member of plan 2 or plan 3. At the end of ninety days, if the member has not made a choice to become a member of plan 2, he or she becomes a member of plan 3 or plan 2 as follows:

(a) Becomes a member of plan 3 if first employed by an employer in an eligible position on or after March 1, 2002, but prior to July 1, 2010, for state agencies or institutions of higher education, or on or after September 1, 2002, but prior to July 1, 2010, for other employers;

(b) Becomes a member of plan 2 if first employed by an employer in an eligible position on or after July 1, 2010.

(2) For administrative efficiency, until a member elects to become a member of plan 3, or becomes a member of plan 3 by default pursuant to subsection (1) of this section, the member shall be reported to the department in plan 2, with member and employer contributions. Upon becoming a member of plan 3 by election or by default, all service credit shall be transferred to the member's plan 3 defined benefit, and all employee accumulated contributions shall be transferred to the member's plan 3 defined contribution account.

NEW SECTION. **Sec. 4.** If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

--- END ---

ACTUARY'S FISCAL NOTE

RESPONDING AGENCY:	CODE:	DATE:	Bill Number:
Office of the State Actuary	**035**	**1/26/10**	**SB 6516**

WHAT THE READER SHOULD KNOW

The Office of the State Actuary ("we") prepared this fiscal note based on our understanding of the bill as of the date shown above. We intend this fiscal note to be used by the Legislature during the 2010 Legislative Session only.

We advise readers of this fiscal note to seek professional guidance as to its content and interpretation, and not to rely upon this communication without such guidance. Please read the analysis shown in this fiscal note as a whole. Distribution of, or reliance on, only parts of this fiscal note could result in its misuse, and may mislead others.

SUMMARY OF RESULTS

This bill changes the Plan 2/3 membership plan default in the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS), from Plan 3 to Plan 2. This bill doesn't increase the benefits or liabilities of the current Plans 2/3 members from these systems, but would change future contribution levels due to assumed changes in future plan membership.

Impact on Pension Liability			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Today's Value of All Future Pensions	$70,619	$0.0	$70,619
Earned Pensions Not Covered by Today's Assets	$5,411	$0.0	$5,411

Impact on Contribution Rates: (Effective 09/01/2010)			
2010-2011 State Budget	**PERS**	**TRS**	**SERS**
Employee (Plan 2)	0.00%	0.00%	0.00%
Employer:			
Current Annual Cost	0.00%	0.00%	0.00%
Plan 1 Past Cost	0.00%	0.00%	0.00%
Total	0.00%	0.00%	0.00%

Budget Impacts			
(Dollars in Millions)	**2010-2011**	**2011-2013**	**25-Year**
General Fund-State	$0.0	$0.1	($15.3)
Total Employer	$0.0	$0.3	($60.5)

See the Actuarial Results section of this fiscal note for additional detail.

WHAT IS THE PROPOSED CHANGE?

Summary Of Change

This bill impacts the following systems:

- PERS Plans 2/3
- TRS Plans 2/3
- SERS Plans 2/3

This bill impacts the Plans 2 and 3 of these systems. This bill would change the current plan membership default from Plan 3 to Plan 2. New employees who first become employed by an employer in eligible positions after July 1, 2010, would have 90 days to choose membership in Plan 2 or Plan 3. If the new employee does not make a choice within 90 days, they become a member of Plan 2.

For administrative ease employers report all new employees in Plan 2 until they choose membership in Plan 3. At that point the Department of Retirement Systems (DRS) transfers the member's service credit to their Plan 3 defined benefit accounts and the member's Plan 2 contributions to their Plan 3 defined contribution accounts.

Effective Date: 90 days after session.

What Is The Current Situation?

New employees who first become employed by an employer in PERS, TRS, and SERS eligible positions have 90 days to choose membership in Plan 2 or Plan 3. If the new employee does not make a choice within 90 days, they become a member of Plan 3, contribute at the minimum contribution rate (5 percent), and the Washington State Investment Board invests their contributions.

For administrative ease employers report all new employees in Plan 2 until they choose to join or default into Plan 3. At that point DRS transfers the member's service credit to their Plan 3 defined benefit accounts and the member's Plan 2 contributions to their Plan 3 defined contribution accounts.

Who Is Impacted And How?

This bill will impact all future members of PERS, TRS, and SERS who don't choose a pension plan. This bill does not impact the benefits of the current members of these systems.

This bill potentially impacts all current PERS, TRS, and SERS Plan 2 active members through decreased contribution rates. Additionally, this bill will not affect member contribution rates in Plan 3 since Plan 3 members do not contribute to their employer-provided defined benefit.

See the Special Data Needed section of this fiscal note for more details.

WHY THIS BILL HAS A COST AND WHO PAYS FOR IT

Why This Bill Has A Cost

We assume this bill will increase the percentage of new entrants that go into Plan 2 in the future. On average, we expect members of Plan 2 to work longer and retire later than members of Plan 3 because Plan 2 has a more strict early retirement eligibility standard. Plan 3 members are eligible to retire at age 55 after ten years of service; whereas, Plan 2 members are eligible to retire at age 55 after twenty years of service.

When we assume more members join Plan 2 in the future, costs in the affected systems change in two areas:

- System contribution rates decrease slightly since the longer assumed working careers in Plan 2 means the system will have more future salary to fund future benefits. Since the employer provided benefits in Plan 2 and Plan 3 are very similar, increasing the assumed salary available to fund those benefits decreases the contribution rates.
- Projected contributions on existing system benefits (before the proposed changes under this bill) will increase since the affected systems will levy contributions rates on a larger projected future salary base due to longer expected working careers of Plan 2 members.

The expected change in projected contributions on existing system benefits due to larger projected future salary offsets the savings of this bill from slightly lower contribution rates. The amount of this offset varies by affected retirement system. Please see the Actuarial Results Section for more detail.

Who Will Pay For These Costs?

To the extent that the combined cost of PERS, TRS, and SERS change because of this bill, the employers and active Plan 2 members will fund those changes using the same funding method as the other costs of the plan. Employers will pay the defined benefit costs for Plan 3 members and half the cost for Plan 2 members. Plan 2 members pay for the other half of their costs.

HOW WE VALUED THESE COSTS

Assumptions We Made

We assumed the portion of new entrants going into Plan 2 would increase for PERS, TRS, and SERS from two-thirds to three-quarters. We also assumed future new entrants would have the same demographic characteristics (or profile) as the combined Plan 2/3 new entrants in the 2008 valuation data. Therefore, we did not assume different new entrant profiles by plan as we did in our prior fiscal note for this bill (in the 2009

Legislative Session) and in our projection system. With this assumption change, differences in plan design influence the cost more so than assumed changes in future new entrant profiles by plan.

For more detail please see Appendix A.

How We Applied These Assumptions

We used our liability projection system to project the current group of active members into the future. First we updated our existing projections to reflect a combined Plan 2/3 new entrant profile instead of plan specific profiles. This established a new base run for this pricing exercise. Then using the new entrant assumptions described above (an increase in members joining Plan 2 in the future) in combination with the 1.25 percent total membership growth assumption in PERS and SERS, and 0.90 percent in TRS, we replaced the current active members as they left active service, and allowed the active populations to increase each year. We compared the results of this new projection to our new base-run projections to isolate future contribution differences and changes in future system salary due to this bill.

Special Data Needed

DRS provided us with new entrant data for PERS, TRS, and SERS. Data for these systems included new entrants starting in: March of 2002 for PERS, and July of 2007 for TRS and SERS; through September of 2009. The data by system included – the:

- ❖ Total number of new entrants into the system.
- ❖ Number of members opting into Plan 2.
- ❖ Number of members opting into Plan 3.
- ❖ Number of members defaulting into Plan 3.

Otherwise, we developed these costs using the same assets and data as disclosed in the June 30, 2008, Actuarial Valuation Report (AVR).

For more detail please see Appendix B.

ACTUARIAL RESULTS

How The Liabilities Changed

This bill does not impact the liabilities for the current active members of PERS, TRS, and SERS since it does not change the benefits of any plan.

How Contribution Rates Changed

This bill does not impact the contribution rates for the current active members of PERS, TRS, and SERS in the 2009-11 Biennium. But this bill does change projected contributions for the Plans 2/3 of these systems in future biennia due to changes in future plan membership. We used these projected contribution changes to measure the budget changes in future biennia.

How This Impacts Budgets

Because this bill changes both future contribution rates and the assumed value of future salaries available to make contributions, we decided to split the budget impact into the two main components of the cost: (1) change in contribution rates, and (2) change in expected future salaries.

The results of our projections indicate that all three systems would experience a slight decrease in contribution rates in future biennia. The impact of this component alone will decrease future system cost. The following table shows the projected budget impact of this change. We do not expect any impact in the first two biennia from this change.

Budget Impacts – From Change in Contribution Rates				
(Dollars in Millions)	**PERS**	**TRS**	**SERS**	**Total**
2013-2035				
General Fund	($10.5)	($7.8)	($2.6)	($21.0)
Non-General Fund	(15.0)	0.0	0.0	(15.0)
Total State	**($25.5)**	**($7.8)**	**($2.6)**	**($36.0)**
Local Government	(27.3)	(4.0)	(3.3)	(34.6)
Total Employer	**($52.8)**	**($11.8)**	**($5.9)**	**($70.6)**

Note: Totals may not agree due to rounding.

On the other hand, we also expect an increase in expected future salary for all three systems. The impact of this component alone will increase future system cost. The following table shows the projected budget impact of this change. We do not expect any impact in the current biennium from this change.

Budget Impacts – From Change in Expected Future Salary				
(Dollars in Millions)	**PERS**	**TRS**	**SERS**	**Total**
2011-2013				
General Fund	$0.0	$0.1	$0.0	$0.1
Non-General Fund	0.0	0.0	0.0	0.0
Total State	**$0.1**	**$0.1**	**$0.0**	**$0.2**
Local Government	0.1	0.0	0.0	0.1
Total Employer	**$0.1**	**$0.1**	**$0.0**	**$0.3**
2010-2035				
General Fund	$0.4	$5.2	$0.1	$5.7
Non-General Fund	0.6	0.0	0.0	0.6
Total State	**$1.0**	**$5.2**	**$0.1**	**$6.3**
Local Government	1.1	2.3	0.1	3.8
Total Employer	**$2.1**	**$7.8**	**$0.2**	**$10.1**

Note: Totals may not agree due to rounding.

The total budget impact for each system is the sum of these two prior tables. Notice that the decrease in contribution rates has a greater impact than the increase in expected future salary for all systems. The following table shows the combined impact of these two components.

Budget Impacts - Total				
(Dollars in Millions)	**PERS**	**TRS**	**SERS**	**Total**
2010-2011				
General Fund	$0.0	$0.0	$0.0	$0.0
Non-General Fund	0.0	0.0	0.0	0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	0.0	0.0	0.0	0.0
Total Employer	**$0.0**	**$0.0**	**$0.0**	**$0.0**
2011-2013				
General Fund	$0.0	$0.1	$0.0	$0.1
Non-General Fund	0.0	0.0	0.0	0.0
Total State	**$0.1**	**$0.1**	**$0.0**	**$0.2**
Local Government	0.1	0.0	0.0	0.1
Total Employer	**$0.1**	**$0.1**	**$0.0**	**$0.3**
2010-2035				
General Fund	($10.1)	($2.6)	($2.5)	($15.3)
Non-General Fund	(14.4)	0.0	0.0	(14.4)
Total State	**($24.5)**	**($2.6)**	**($2.5)**	**($29.7)**
Local Government	(26.2)	(1.3)	(3.2)	(30.7)
Total Employer	**($50.8)**	**($4.0)**	**($5.7)**	**($60.5)**

Note: Totals may not agree due to rounding.

Note that we did not provide the budget impact on employees since most of the budget change for employees is due to the plan into which members default and not due to the cost of this bill. More specifically, defaulting members will pay the Plan 2 calculated member rate in future biennia, compared to the fixed 5 percent of salary that these members would have contributed had they defaulted into Plan 3.

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

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

HOW THE RESULTS CHANGE WHEN THE ASSUMPTIONS CHANGE

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

- The proportion of new entrants becoming Plan 2 members by default in the long-term. We looked at the 25-year budget impacts of assuming the following percentages of new entrants becoming Plan 2 members:
  - 70 percent.
  - 80 percent.

25-Year Budget Impacts				
(Dollars in Millions)	**PERS**	**TRS**	**SERS**	**Total**
70% of New Entrants into Plan 2				
General Fund	($4.3)	($0.6)	($1.2)	($6.1)
Non-General Fund	(6.1)	0.0	0.0	(6.1)
Total State	**($10.4)**	**($0.6)**	**($1.2)**	**($12.2)**
Local Government	(11.2)	(0.3)	(1.5)	(12.9)
Total Employer	**($21.6)**	**($0.9)**	**($2.3)**	**($25.1)**
75% of New Entrants into Plan 2 (Best Estimate)				
General Fund	($10.1)	($2.6)	($2.5)	($15.3)
Non-General Fund	(14.4)	0.0	0.0	(14.4)
Total State	**($24.5)**	**($2.6)**	**($2.5)**	**($29.7)**
Local Government	(26.2)	(1.3)	(3.2)	(30.7)
Total Employer	**($50.8)**	**($4.0)**	**($5.7)**	**($60.5)**
80% of New Entrants into Plan 2				
General Fund	($13.8)	($11.1)	($4.6)	($29.4)
Non-General Fund	(19.6)	0.0	0.0	(19.6)
Total State	**($33.4)**	**($11.1)**	**($4.6)**	**($49.0)**
Local Government	(35.7)	(5.6)	(5.7)	(47.0)
Total Employer	**($69.1)**	**($16.8)**	**($10.2)**	**($96.0)**

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 fiscal note is based are sufficient and reliable for the purposes of this pricing exercise.
4. Use of another set of methods, assumptions, and data may also be reasonable, and might produce different results.
5. We prepared this fiscal note for the Legislature during the 2010 Legislative Session.
6. We prepared this fiscal note and provided opinions in accordance with Washington State law and accepted actuarial standards of practice as of the date shown on page one of this fiscal note.

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

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

APPENDIX A – ASSUMPTIONS WE MADE

In general we assume that two-thirds of all future entrants into PERS, TRS, and SERS will choose to join Plan 2, and that the remaining one-third will enter Plan 3. This represents our best-estimate assumption on future long-term behavior. The data provided by DRS, shown in Appendix B, shows the portion of new entrants who defaulted into Plan 3. We converted the proportions shown into values corresponding to our one-third/two-thirds assumption in the following manner for each system. The example below shows the calculations for PERS:

(1) Portion of new entrants we assume enters Plan 3 = 33 percent.
(2) Portion of new entrants who actually entered Plan 3 = 36 percent.
(3) Portion of new entrants who actually entered Plan 3 by default = 19 percent.
(4) Portion of (1) we assumed entered Plan 3 by default = (1) * (3) / (2) = 18 percent.
(5) Portion of members who defaulted into Plan 3 who we assumed did not specifically want to be in Plan 3 = 67 percent.
(6) Portion of (4) we assume would default into Plan 2 under this bill = (4) * (5) = 12 percent.
(7) Portion of new entrants we assume enters Plan 3 under this bill = (1) – (6) = 22 percent.

The above process led to 22 percent of new entrants becoming PERS 3 members. We assumed 75 percent of new entrants would enter Plan 2 and 25 percent would enter Plan 3. Please note that we rounded the intermediate results for display purposes, but used the unrounded results in all calculations above.

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

APPENDIX B – SPECIAL DATA NEEDED

DRS provided the following data:

Department of Retirement Systems - Plan 3 Choice Data*

Data provided starting March of 2002 for PERS, and July of 2007 for TRS and SERS; and ending September of 2009.

Plan 3 Choice Data						
System and Plan	PERS 3		TRS 3		SERS 3	
	Count	Percent of Total	Count	Percent of Total	Count	Percent of Total
New Members	94,128		7,526		8,359	
New Members Opting Into Plan 2	60,040	64%	2,999	40%	4,005	48%
New Members Opting Into Plan 3	16,114	17%	3,106	41%	2,403	29%
New Members Defaulting Into Plan 3	17,974	19%	1,421	19%	1,951	23%

**Please consider the long-term nature of our best-estimate assumption when comparing this short-term experience data for TRS and SERS to our best-estimate assumptions.*

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 which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded 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.