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**ATTORNEY/CLIENT PRIVILEGE**

***Via E-mail***

Aaron Gutierrez
Policy Analyst
Washington Office of the State Actuary
P.O. Box 40914
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***Re: S-2806.3/13 3rd Draft***

Dear Aaron:

*This letter is given to you in confidence and with the attorney-client privilege. We have not delivered or mailed any copies of this letter to anyone else, other than those individuals noted in this letter. You should disclose the contents of this letter only in accordance with our contract.*

This letter is in response to your e-mail of June 6, 2013, where you asked us to provide our comments on the above referenced bill draft (the "Draft"), which merges the assets of the Teachers Retirement System Plan 1 ("TRS 1") and the Law Enforcement Officers and Firefighters Plan 1 ("LEOFF 1"). You asked that we only perform a quick review of the Draft, identifying if there is anything that would raise a "red flag" for plan qualification purposes. You did not ask us to review the drafting or precise verbiage.

**COMMENTS**

In prior analysis that we have provided to you, we have identified the following key issues with respect to a merger of TRS 1 and LEOFF 1:

1. The merger must take into consideration the Exclusive Benefit Rule as contained in Internal Revenue Code ("Code") Section 401(a)(2) and related guidance.

2. Although Code Section 414(*l*) is not applicable to a governmental plan such as TRS 1 and LEOFF 1, we believe that there are principles in Code Section 414(*l*) that can be useful in satisfying the Exclusive Benefit Rule.

3. The plans must be administered in accordance with their terms.

4. The merger should be contingent on approval by the Internal Revenue Service ("IRS") as part of the determination letter process.

This Draft follows our recommendations in the following ways:

1. New Sec. 1 provides that the merger of TRS 1 and LEOFF 1 will be administered in a way that is consistent with the plan qualification requirements of the Code. We believe that this will be an important statement for the IRS as they review the merged plan.

2. New Sec. 2 provides that benefits of TRS 1 members will continue to be paid from TRS 1 and that benefits of LEOFF 1 members and their survivors will be paid from TRS 1. This new section is important because it demonstrates that the merger is not intended to modify benefit payments.

3. New Sec. 3 provides that the merger may not impact benefits for members of either plan. The director of the Department of Retirement Systems ("DRS") is authorized to determine whether any impact is occurring and modify the administration of the merger so that there is no reduction or increase in benefits. This section is consistent with the concept that benefits are to be paid in accordance with plan terms. Sec. 3 could directly provide, or the director should take into consideration, the provisions of Code Section 414(*l*), which require that, after a merger, each member of each merged plan must be entitled to receive a benefit immediately after the merger which equal to the benefit the member would have been entitled to receive immediately before the merger in accordance with the plan terms.

4. New Sec. 3 also requires DRS to submit a request for a determination letter to the IRS, to confirm the qualified status of the merged plan. This is consistent with our prior recommendation.

5. Amendments in Sec. 9 to RCW 41.45.060 require that employer and state contribution rates must be a level percentage of pay in order to fully fund TRS 1, taking into account benefits for members of LEOFF 1. This will be an important point to make to the IRS with regard to the Exclusive Benefit Rule.

6. Amendments in Sec. 12 to RCW 41.50.075 provide for the closing of LEOFF 1 and the transfer of LEOFF 1 assets and liabilities to TRS 1. You have indicated that the Draft's intent is to treat LEOFF 1 as a separate retirement tier within TRS 1. After the merger of LEOFF 1 assets and liabilities in TRS 1, the IRS will treat TRS 1 as a **single plan** covering all members of both LEOFF 1 and TRS 1.[1]

[1] We have raised with you a question about the amortization method of unfunded accrued liabilities for LEOFF 1 members in the Sec. 9 amendments to RCW 41.45.060(8). We recommend that the funding method for those

The assets of the merged TRS 1 plan will be available to pay the benefits of the retirees and beneficiaries of both LEOFF 1 and TRS 1. **It is permissible to treat LEOFF 1 as a tier of benefits within the merged plan, but LEOFF 1 will not be treated for IRS purposes as a separate plan.** This is an important issue that must be understood by the Legislature in the consideration of the Draft and by DRS in the administration of TRS 1 and the preparation of CAFRs. In future CAFRs, LEOFF 1 can be described as a tier within the merged plan with certain benefits and certain individuals who are entitled to those benefits.

7. New Sec. 15 provides that the merger of TRS 1 and LEOFF 1 must be administered in accordance with the qualification requirements of the Code and any provision of the ultimate legislation must be interpreted to meet that goal. We believe that this will be an important provision for the IRS.

8. New Sec. 15 also provides that if the IRS determines that the merger is in conflict with the Code and that conflict cannot be resolved by statutory or regulatory changes then sections 2 and 6 through 14 of the legislation would be null and void. This provision is in keeping with our recommendation that the merger related provisions be contingent on IRS approval in order to protect the qualified status of TRS 1 and LEOFF 1.

## CONCLUSION

We have reviewed the Draft on the basis you have requested and have commented on any potential "red flags" for the IRS from a qualification standpoint. Our view is contingent on the ultimate legislation continuing to require IRS approval of the merger. Our view is also contingent on the implementation of the legislation in a manner consistent with the Exclusive Benefit Rule and in accordance with the principles of Code Section 414(*l*).

As part of the IRS review, we would anticipate that the IRS would ask us questions about the merger, which could ultimately result in requests from the IRS for regulatory action or additional statutory changes.

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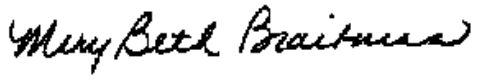
liabilities reflect the merged status of the assets and liabilities of the two plans. However, this is not a code compliance requirement.

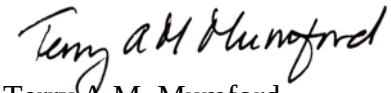
Please let us know if there are further questions that should be addressed.

Very truly yours,

ICE MILLER LLP



Mary Beth Braitman



Terry A.M. Mumford

/jls

cc: Matthew M. Smith
Pete Cutler