SCPP Study: School Employee ERFs

Issue

Recent legislation (Chapter 7, Laws of 2012, First Special Session) modified Early Retirement Factors (ERFs) for newly hired employees in the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS). It also required the Select Committee on Pension Policy (SCPP) to study two things.

- High-risk job classifications.
- Classroom Employee ERFs.

This report responds to the mandate to "study existing ERFs and job requirements that may limit the effectiveness of the older classroom employee."

Background

The normal retirement age for teachers in TRS Plans 2/3 is age 65. Early retirement is available to members who have attained age 55 and meet the minimum service requirements of twenty years in Plan 2 or ten years in Plan 3.

Early retirement provides members the option to start receiving benefits at earlier ages in exchange for a reduction in initial benefits. The default reduction for early retirement is a full actuarial reduction. However, retirees meeting certain criteria can qualify for one of several smaller reductions (i.e. higher take-home benefits) known as ERFs.

In addition to creating the study mandate, the recent legislation decreased early retirement factors (i.e. lower take-home benefits) for employees hired on or after May 1, 2013, in most state pension systems.

Policy Questions

This issue raises the following questions.

- Should ERFs for classroom employees be adjusted to facilitate the retirement of classroom employees whose effectiveness is diminished?
- If so, how should they be adjusted, and for which employees?

Findings

Classroom effectiveness is subjective and difficult to define, and committee staff are not experts in education policy. Staff reviewed existing studies of teacher retirement and classroom effectiveness to identify factors that may impact classroom effectiveness. The factors identified by those sources can be grouped in two categories: work conditions and personal factors.

- Work Conditions.
  - Physical Aspects.
    - Class size too large/excessive workload.
    - Lack of security or potential for violence.
    - Poor or deteriorating facilities.
  - Policy/Human Resources.
    - Ineffective leadership.
    - Lack of effective colleagues/mentoring/networking.
    - Overly prescriptive policies/lack of control.
- Personal Factors.
  - Career stage.
    - A teacher's effectiveness may be different in the fifth year of teaching than in the twenty-fifth.
  - Health and health care.
    - People age differently, may experience different health problems, and experience different injuries.
  - Work not challenging enough.
    - If the work is not challenging enough, it can lead to a loss of engagement in the classroom environment.
  - Sense of efficacy.
    - If a teacher does not feel effective, he or she is not likely to be as effective.
  - Qualifications and training.
    - Advanced degrees and certification may or may not impact effectiveness.

Staff also reviewed available data regarding teacher retirement plans in other states and found that almost all teacher retirement plans have more than one option for unreduced retirement eligibility.

- Most teacher plans (including Washington's TRS plans) have at least one option based on a combination of age and service.
    - This includes about one-fifth of teacher plans that have a "Rule of __" option, where the member qualifies for normal retirement when the member's age and service combine to equal a number. Common numbers are 80, 85, and 90.
- About half the teacher plans in other states have a service-only option.

Policy Highlights

- The findings did not identify pension provisions as factors impacting classroom effectiveness. Instead, pension provisions were raised as ways to manage the impacts of the identified factors.
- Pension policy may be better suited to address factors related to age and service, because it can influence the decision to retire. Other policies (such as human resources policy) may be better suited to address other factors, and current policies may already be addressing these factors to some extent.
- The new ERFs reduce the early retirement benefits available for new hires. This likely reduces the incentive for classroom employees to retire earlier, and may result in members working longer.
    - Experience data will not be available until new teachers hired on or after May 1, 2013, have worked 30 years.
- Washington State has a new teacher and principal evaluation system. Once fully implemented, the new system may inform decision-making in this area.
- There may be many options for addressing the identified factors, both in and outside the pension system. Policy makers may disagree on whether pension provisions should be changed. Two examples:
    - Pension policy could be used to retain experienced workers, or encourage retirement and replacement with younger workers.
    - A factor like class size may be better addressed by hiring more teachers or building more classrooms, rather than by changing pension policy.
- If policy makers choose to modify pension provisions, they may wish to consider the following:
    - State policy is to provide consistent benefits, unless unique job requirements warrant different benefits.

- ◊ Pension changes are long term and may create contractual rights.
- ◊ Benefit improvements can impact long-term plan affordability.

Options For Further Study

Continued study of classroom effectiveness by SCPP staff may not materially change the findings of this study. However, the SCPP and other policy makers may wish to consider other study of ERFs in the future.

Committee Activity

The SCPP studied this issue at the May, June, July, September, October, and November meetings. At the November meeting, the Full Committee adopted the study with an additional finding about retirement eligibility in other states.

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In Brief

Issue

Should ERFs for classroom employees be adjusted to facilitate the retirement of classroom employees whose effectiveness is diminished? If so, how, and for who?

Member Impact

The study mandate is geared toward members of TRS Plans 2/3. However, it may also impact members of SERS Plans 2/3.

As of the 2011 valuation, there are 62,463 active members of TRS Plans 2/3, and 52,332 active members in SERS Plans 2/3.

SCPP Study: School Employee ERFs

In 2012 the Legislature passed 2ESB 6378 (Chapter 7, Laws of 2012, First Special Session). Among other provisions, this bill modified Early Retirement Factors (ERFs) for newly hired employees in the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS). It also required the Select Committee on Pension Policy (SCPP) to study two things.[1]

- High-risk job classifications.
- Classroom Employee ERFs.

This report addresses classroom employee ERFs. The study of high-risk job classifications is contained in a separate report.

Specifically, this report responds to the mandate to "study existing ERFs and job requirements that may limit the effectiveness of the older classroom employee."

Issues

For the purpose of this study, the issues have been defined as follows.

- Should ERFs for classroom employees be adjusted to facilitate the retirement of classroom employees whose effectiveness is diminished?
- If so, how should they be adjusted, and for which employees?

For the purpose of this study, we have assumed that "classroom employee" means "classroom teacher," as defined in RCW 28A.150.203(7). Specifically, this includes certificated professionals working in a position that requires the certification and whose primary duty is daily educational instruction of students.

Thus, the study will be largely geared toward members of TRS Plans 2/3, but with some discussion of members of SERS Plans 2/3.[2]

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[1] *Please see **Attachment A** for a copy of the study language.*

[2] *TRS Plan 1 and PERS Plans 1/2/3 are excluded for two reasons: First, PERS 1 and TRS 1 do not have ERFs, and are closed to new members. Second, while there are some PERS 1 members who began working in schools before the creation of SERS, the proportion is small and shrinking.*

Background

Plan Membership

The following information provides a very high level description of TRS and SERS plan membership to help frame the study. For complete details on plan membership and other provisions, please see the DRS Handbooks or the relevant statutes, RCW 41.32 and RCW 41.35.

TRS membership is limited to employees who provide classroom instruction at a school or Educational Service District (ESD). While teachers are the most obvious members, TRS membership also includes others who are serving, or have served, in an instructional capacity. This includes, for example, school principals, some administrators, educational staff associates (ESAs), and doctors hired to provide classroom instruction.

SERS membership covers classified employees in schools and ESDs. This generally includes positions such as administrative staff, custodial staff, and bus drivers.

Early Retirement Generally

Early retirement benefits provide members the option to receive benefits at earlier ages in exchange for a reduction in benefits.

At the highest level, employees can leave employment at any time, and may do so for a variety of reasons ranging from retirement to pursuit of a new career. If vested, those employees are eligible to receive benefits upon retirement. However, a vested employee who leaves earlier than the minimum retirement age for their retirement plan may not file for retirement (and start receiving benefits) until they reach that minimum age.

Early retirement provides members the option to start receiving benefits at earlier ages in exchange for a reduction in benefits.

The normal retirement age for Plans 2/3 members is age 65. Early retirement benefits are available to members who have attained age 55 and meet the minimum service requirements of twenty years in Plan 2 or ten years in Plan 3. Under early retirement, pensions are actuarially reduced for each year the member retires prior to reaching age 65.

This reduction to a member's initial retirement benefits is intended to compensate for the increased cost to the retirement system. This cost arises for two reasons: First, because a person retiring early will be receiving benefits for a longer time. Second, because the member is paying fewer contributions (along with the state/employer portions) than were expected based on the normal retirement age.

Early Retirement Factors

Alternate early retirement benefits are available to Plans 2/3 members who have reached age 55 and have at least 30 years of service credit.

Alternate early retirement is considered a subsidized form of early retirement because benefits are not actuarially reduced. Members who retire early under these alternate early retirement provisions still have their benefits reduced, but not as much as if they'd retired with a full actuarial reduction.

Employees hired on or after May 1, 2013, will be eligible for ERFs of 5 percent for each year prior to age 65.

There are three sets of ERFs: 2013 ERFs, the 2008 ERFs, and the 2000 ERFs.

- **2013 ERFs –** The 2013 ERFs were established in 2ESB 6378, and only apply to new PERS Plans 2/3, TRS Plans 2/3, and SERS Plans 2/3 members hired on or after May 1, 2013. The reduction is 5 percent for each year the member retires prior to reaching normal retirement (age 65).

Employees hired before May 1, 2013, may choose to retire under either the 2000 ERFs, or 2008 ERFs, as follows.

- **2000 ERFs –** Eligible members may retire and receive a pension reduced by 3 percent for each year the member retires prior to attaining age 65. Members retiring under this provision may return to work in an eligible position for a covered public employer prior to age 65 and, subject to certain restrictions, still receive their full pension.
- **2008 ERFs –** Eligible members may retire with unreduced pensions beginning at age 62. Members retiring between ages 55 and 62 have their pension reduced by a specified percentage that is less than the reduction provided under the 2000 ERFs. Members retiring under this provision are generally prohibited from receiving their full pension if they return to work in any capacity for a covered public employer before they reach age 65.

Early retirement benefits are reduced more under the 2013 ERFs than under prior ERFs, but less than a full actuarial reduction.

Early Retirement Reduction Factors				
Age	Full Actuarial Reduction	2000 ERFs	2008 ERFs	2013 ERFs*
55	0.358	0.70	0.80	0.50
56	0.395	0.73	0.83	0.55
57	0.435	0.76	0.86	0.60
58	0.481	0.79	0.89	0.65
59	0.531	0.82	0.92	0.70
60	0.588	0.85	0.95	0.75
61	0.652	0.88	0.98	0.80
62	0.724	0.91	1.00	0.85
63	0.805	0.94	1.00	0.90
64	0.896	0.97	1.00	0.95
65	1.00	1.00	1.00	1.00

**Applied for members hired on or after May 1, 2013, with at least 30 years of service.*

Hypothetical Examples

Retirement system members who retire early under the 2013 ERFs will receive lower benefits than they would have under the 2000 or 2008 ERFs. However, these members will still receive better benefits than they would under a full actuarial reduction (with no ERF applied).

To illustrate, a hypothetical Plan 2 member who retires with 30 years of service and an Average Final Compensation (AFC) of $50,000 would receive the following.

	Full Actuarial Reduction*	2000 ERFs	2008 ERFs	2013 ERFs (New Hires)
Age 55				
ERF	0.358	0.70	0.80	0.50
Reduction	64.2%	30%	20%	50%
Initial Annual Benefit	$10,740	$21,000	$24,000	$15,000
Age 60				
ERF	0.588	0.85	0.95	0.75
Reduction	41.2%	15%	5%	25%
Initial Annual Benefit	$17,640	$25,500	$28,500	$22,500
Age 62				
ERF	0.724	0.91	1.00	0.85
Reduction	27.6%	9%	0%	15%
Initial Annual Benefit	$21,720	$27,300	$30,000	$25,500

**The full actuarial reduction shown here is hypothetical, and provided for illustration and comparison only. A Plans 2/3 member with 30 years of service would qualify for one or more of the ERFs.*

Under the same circumstances, a hypothetical Plan 3 member would receive the following. Please note, however, that a Plan 3 member will receive the following amounts *in addition to* the member's defined contribution account.

	Full Actuarial Reduction*	2000 ERFs	2008 ERFs	2013 ERFs (New Hires)
Age 55				
ERF	0.358	0.70	0.80	0.50
Reduction	64.2%	30%	20%	50%
Initial Annual Benefit	$5,370	$10,500	$12,000	$7,500
Age 60				
ERF	0.588	0.85	0.95	0.75
Reduction	41.2%	15%	5%	25%
Initial Annual Benefit	$8,820	$12,750	$14,250	$11,250
Age 62				
ERF	0.724	0.91	1.00	0.85
Reduction	27.6%	9%	0%	15%
Initial Annual Benefit	$10,860	$13,650	$15,000	$12,750

**The full actuarial reduction shown here is hypothetical, and provided for illustration and comparison only. A Plans 2/3 member with 30 years of service would qualify for one or more of the ERFs.*

Classroom Effectiveness

The study mandate requires a look at ERFs and other job requirements that may limit the effectiveness of the older classroom employee.

Classroom effectiveness is a subjective term and difficult to define. Further, defining this term is not necessary to fulfill the study mandate, and is outside of pension policy and the expertise of staff. Thus, staff has relied on existing studies of teacher retirement and classroom effectiveness to identify factors that can impact classroom effectiveness.

Staff relied on existing studies and other resources to identify factors that may impact classroom effectiveness.

It should be noted that this was not an exhaustive review of studies of this subject. Due to the time constraints, staff largely focused on studies previously identified by the Washington State Institute for Public Policy as either directly or partly addressing teacher retirement and classroom effectiveness. This list was supplemented by sources provided by the Office of the Superintendent of Public Instruction (OSPI), as well as LexisNexis and Google searches.

A list of the reviewed sources is provided in **Appendix B**.

Sources Did Not Define Classroom Effectiveness

The primary purpose for reviewing the sources was to identify factors that may impact classroom effectiveness, rather than to define effectiveness itself. That said, a definition of classroom effectiveness would further inform this study, so staff kept an eye open for such definitions.

In brief, the reviewed sources either did not define classroom effectiveness, or did so in a manner that was not useful to the study. For example, more than one source identified the general qualities that an effective teacher should have, such as the ability to create a good lesson plan, or have good interaction with the students.

The following two excerpts illustrate how some of the sources approached classroom effectiveness.

- *"There is no consensus measure for teacher effectiveness. The simulations* [in the report] *thus make a simplifying assumption that the design of retirement benefits may affect teacher effectiveness, regardless of how effectiveness is calculated. This means that the simulations do not have to specify the exact measure of teacher effectiveness but rather design a way of capturing changes in teacher effectiveness under different retirement methods."* Weller, Pg. 13.
- *"[T]eacher quality is a function of underlying ability, X, where X is drawn from some distribution with finite variance and is valued by the larger labor market."* Koedel, page 20.

Findings: Factors That Can Impact Classroom Effectiveness

The review of existing studies and other sources identified 11 factors that can impact classroom effectiveness. These factors can be grouped in two categories: work conditions and personal factors.

The factors that can impact effectiveness can generally be grouped into two categories: Work conditions and personal factors.

Work Conditions

The impact of work conditions on classroom effectiveness is largely self-explanatory, and can be further divided into the physical aspects, and policy/human resource aspects.

- Physical Aspects.
  - Class size too large/excessive workload.
  - Lack of security or potential for violence.
  - Poor or deteriorating facilities.
- Policy/Human Resources.
  - Ineffective leadership.
  - Lack of effective colleagues/mentoring/networking.
  - Overly prescriptive policies/lack of control.

Personal Factors

- Career stage.
  - A teacher's effectiveness may be different in the fifth year of teaching than in the twenty-fifth.
- Health and health care.
  - People age differently, and may experience different health problems, and experience different injuries.
- Work not challenging enough.
  - If the work is not challenging enough, it can lead to a loss of engagement in the classroom environment.
- Sense of efficacy.
  - If a teacher does not feel effective, he or she is not likely to be as effective.
- Qualifications and training.
  - Advanced degrees and certification may or may not impact effectiveness.

Policy Analysis

As noted above, the study mandate requires the SCPP to study ERFs in the context of the effectiveness of older classroom employees. To determine if ERFs should be adjusted to facilitate the retirement of classroom employees with diminished effectiveness, policy makers may wish to consider the following.

First, should the factors identified above be addressed by pension policy?

Second, if policy makers conclude that pension policy should be changed, there may be multiple options for addressing these factors that are available for consideration.

Should The Identified Factors Be Addressed Through Pension Policy?

To determine this, policy makers may wish to consider:

- The findings did not identify pension provisions as factors impacting classroom effectiveness.
- Pension policy is likely better suited to addressing some factors more than others.
  - Current non-pension policies may also be addressing these factors.
  - Some factors may be better addressed outside the pension system.
- The new ERFs likely reduce the incentive for new teachers to retire early.
- Washington's new teacher evaluation system may help inform any decision-making.

The Findings Did Not Identify ERFs As Factors Impacting Classroom Effectiveness

The reviewed sources did not identify pension provisions as factors impacting effectiveness.

The reviewed sources did not identify ERFs, or other pension policies as factors that can impact classroom effectiveness. Instead, pension policy and plan design were raised as ways to manage the impacts of the factors identified above.

In other words, changing a benefit multiplier or early retirement age will not make someone a more effective teacher. However, if a teacher's effectiveness is impacted by another factor, such as the member's health, the plan design can help mitigate or manage that impact.

Two examples can illustrate this impact. Assuming that only a finite amount of teaching positions are available:

- Pension policy can encourage teachers to retire earlier. This is useful if you value the energy and recent training of younger teachers.[3]
- Pension policy can encourage teachers to work longer. This is useful if you value retaining experienced teachers.

It should be noted that Washington's retire-rehire program was created, and later expanded, in order to retain experienced workers. Specifically, the program was intended to counter built-in incentives for earlier retirement in the Plans 1, and keep effective employees on the job longer.[4] When the SCPP studied the retire-rehire program in 2005, it reported that more TRS members were using the program than members of PERS.

Pension Policy Is Likely Better-Suited To Address Some Factors More Than Others

Pension policy may be better-suited to addressing factors like age and length-of-service than factors like class size.

Pension provisions can impact the decision to retire. Thus, they may encourage members to continue working despite diminished effectiveness, or retire while still effective.

As noted above, pension provisions will not directly cause a teacher to be effective or ineffective. However, pension provisions can influence the decision to retire.

Thus, when looking at age and service-related factors, plan design or provisions may be encouraging teachers to work longer, despite a diminished effectiveness. Some possible examples include when a member feels compelled to work longer:

- To reach normal retirement age, or early retirement eligibility.
- To avoid early retirement benefit reductions.

However, if classroom effectiveness is not directly tied to age-related issues, or is only connected on a case-by-case basis, then it is also possible that plan provisions are encouraging effective and experienced teachers to retire earlier. One possible example would be when a member feels compelled to retire after reaching a point where the member's benefits are at their peak (either literally or practically).

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[3] *Since the study mandate requires a look at impacts to the "older classroom employee," this report is not intended to address issues related to younger teachers, such as recruitment. To the extent that pension policy can impact recruitment and retention, readers of this report may also wish to read a report currently being prepared by the Washington Institute for Public Policy (WSIPP). While the two studies are not connected, their subject matter may be complementary. Specifically, the WSIPP study compares retirement benefits in Washington to plans in other states. This will include some discussion of benefit adequacy and barriers to portability. WSIPP's report is due December 1, 2012.*

[4] *See the 2005 Post-Retirement Employment Program Report.*

Current Policies May Already Address Some Factors

Current policies, both pension and non-pension, already address some factors related to age and length of service. However, policy makers may disagree on whether current provisions are sufficient to address effectiveness. Current provisions include:

- Deferred Retirement.
  - Teachers may leave service at any time they choose and wait to file for retirement. If they do not apply for retirement until the normal retirement age, there is no reduction in their benefits.
    - TRS 2 allows for a full deferment. In other words, the member will not receive any pension checks until filing for retirement.
    - TRS 3 allows a member to defer the DB portion, while taking the DC portion immediately.[5]
  - However, Plans 2 members are not eligible for post-retirement healthcare benefits under PEBB if they do not retire immediately after leaving service.[6]
- 182-Day Contract (approx.).[7]
  - Teachers work on a 182-day contract, and receive summers off from work.
- In-Service Days.
  - Provides time for training and curriculum development away from students.
- Sabbaticals and Teachers on Special Assignment (TOSA).
  - Rules for sabbaticals and TOSAs are set by the individual district or ESD.

There are several options built into current rules that allow teachers to take a temporary break to allow for added variety, training, or rest.

Some Factors May Be Better Addressed Outside The Pension System

Other policies, such as human resource policy, may be better suited to address factors that aren't directly related to age and length-of-service.

For example, a factor like class size may be more directly affected by hiring more teachers than by changing retirement provisions. Similarly, a factor like deteriorating facilities may be better addressed through capital budgeting and purchasing policy.

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[5] *For distribution options, please see RCW 41.34.070.*

[6] *For more information, please see page 3 of the SCPP report "School Administrator Contract Year."*

[7] *The length of a school year is set in statute at 180 days. According to OSPI, teacher contract lengths can vary by district, but generally are one or two days longer than the school year.*

The New ERFs Likely Reduce The Incentive For New Teachers To Retire Earlier

The ability to leave employment and receive pension benefits earlier than normal is itself an incentive to retire earlier. Ignoring other factors, the more pension benefits are reduced, the less incentive to retire early.

Since the new ERFs increase the reduction (i.e., lower the early retiree's take-home pay), they reduce the incentive for new teachers to retire earlier than age 65. However, it remains to be determined whether or not that change in the early retirement incentive is big enough to create a material change in behavior.

Since the 2013 ERFs only affect newly-hired employees who earn thirty years or service, experience data will not be available for at least 30 years.

Due to a lack of data, it is not possible to determine with certainty whether or not the ERF changes will bring a material change to retirement behavior. Further, experience data will not be available until these new teachers hired on or after May 1, 2013, have earned 30 years of service credit.

For the purpose of pricing the bill, the actuarial fiscal note for 2ESB 6378 prepared by the Office of the State Actuary (OSA) assumed that the bill would cause a material change in retirement behavior. Specifically, OSA assumed that the bill would result in new hires retiring later than they would have if the prior ERFs (2000 and 2008) were available to them. For more information, please see page 21 of the actuarial fiscal note, provided as **Attachment B** of this report.

ERFs are not the only consideration for an employee considering early retirement.

However, ERFs are not the only factors members might consider when deciding whether or not to retire early. In addition to the ERFs, and the factors identified above, members might also consider any of the following:

- Personal assessment of classroom effectiveness and desire to continue working (i.e. feeling "burned out").
- Other work opportunities, such as a new career or a job with a different workload.
- Finances and/or debt (i.e. ability to trade full paycheck for retirement benefits).
- Ability to increase pension benefits, such as an upcoming raise or additional year of service.

Washington Is Developing A New Teacher Evaluation System

Washington State has a new teacher and principal evaluation system that is currently being phased in that will address effective teaching and leading. This process will culminate with all school districts adopting new evaluation systems for the 2013-14 school year. ESSB 5895 (2012) requires that all teachers and principals be transitioned to the new

A new teacher evaluation system is being phased in for Washington. Data from the system may be useful in decision making.

evaluation system by the 2015-16 school year. A detailed report, The Teacher/Principal Evaluation Pilot, is available on the OSPI website. There is also a website dedicated to the pilot program.

In brief, E2SSB 6696 (2010) required OSPI to collaborate with stakeholder organizations to develop new evaluation models for classroom teachers and principals. ESSB 5895 (2012) requires OSPI to prescribe a common method for calculating the evaluation performance rating for each of the preferred instructional frameworks and leadership frameworks.

The new evaluation system is still being phased-in. However, enacting legislation requires that the new system use criteria developed by organizational stakeholder groups to define effective teaching and leading. As such, policy makers may wish to wait until data from the new evaluation system has been processed before proceeding further.

There May Be Multiple Options For Addressing The Identified Factors

If policy makers conclude that the identified factors should be addressed through pension policy, and that current provisions are not sufficient, then there may be multiple options available for consideration.

In evaluating any option for adjusting pension provisions, policy makers may wish to consider:

- Benefit consistency.
- Long-term impacts and contractual rights.
- Plan affordability and sustainability.

Identified Options

If policy makers conclude that the factors should be addressed by pension policy, two potential options have been identified thus far. Other options may also be available, depending on the chosen goal(s).

The study mandate[8] anticipates the adjustment of ERFs. At the highest level there are essentially only two possibilities:

- "Roll back" the new ERFs to earlier levels.
- Other New ERFs.

At the July meeting of the SCPP, the chair encouraged the committee members and any stakeholders in the gallery to provide feedback or guidance to staff on the development of the study.

Shortly afterward, staff received letters from stakeholders requesting the committee consider a "True Rule of 90." A Rule of 90 would allow members to qualify for normal (unreduced) retirement when their age

[8] *Please see **Attachment A** for a copy of the study language.*

and years of service combine to equal 90. The impact of a "Rule of 90" would depend on how the change is constructed, and to whom it would apply. However, it would likely improve benefits beyond where they were prior to the creation of the new ERFs.

The correspondence as of November 8, 2012, is reproduced in **Attachment C**, and available on the SCPP Correspondence page.

Benefit Consistency

If pension provisions are to be adjusted, policy makers may wish to consider who should receive those adjustments. Specifically, the adjustments could be provided to either of the following:

- Teachers.
- All school employees.

State policy is to provide consistent benefits unless unique job conditions suggest otherwise. If policy makers conclude provisions should be changed, should they be changed for teachers only, or all school employees?

As a general policy, the state provides consistent benefits to all employees unless differences are needed to address unique job requirements, conditions, or other factors.[9] Teachers and other school employees each have their own retirement systems. However, only some plan provisions in those systems are unique. For example, the early retirement and ERF provisions for TRS Plans 2/3 and SERS Plans 2/3 are identical to PERS Plans 2/3.

However, the study mandate refers to the term "classroom employee." As noted above, this is assumed to mean classroom teachers. Thus, one option would be to limit any pension policy changes to teachers. This option may be appropriate if policy makers feel there are aspects of the actual classroom environment that are sufficiently different from classified employee positions (such as bus drivers and custodians) as to warrant benefit adjustments that are not provided to other school employees.

Other policy makers may feel that working in education is itself sufficiently different from other state employment as to warrant different benefits. Thus, a second option would be to limit any pension policy changes to teachers and other school employees. For example, it could be argued that any state employee can suffer from diminished effectiveness. However, when the effectiveness of a school employee is diminished, the effect is to basic education. The Washington State Constitution (see Article IX) places a priority on basic education, and some may feel that this priority warrants benefit adjustments for school employees that are not applied to other state employees.

[9] RCW 41.50.005.

History shows that once a benefit is granted to one group of public employees, others who do not receive that benefit will want it, and likely pursue it. Thus it is likely that any employee groups not chosen to receive this benefit will pursue it at a later date.

Pension Changes Are Long-Term

Pension plan changes are generally long-term and can create contractual rights.

Pension plan changes are generally long-term and can create contractual rights. Policy makers may wish to consider whether or not the aspect or factor being addressed is likely to change in the future.

For example, the general population is trending toward living longer lives, and staying healthy and active into more advanced ages.[10] Will the ideal retirement age increase as well?

Also, if pension provisions are changed to address something like class size, will class sizes stay consistent, or change as a result of education and fiscal policy?

Plan Affordability And Sustainability

The 2013 ERFs were created during a time of pension reform and budget crisis. Policy makers may want to consider the fiscal impact of any changes to ERFs or other retirement provisions.

While 2ESB 6378 did not possess an intent section, the new ERFs were enacted during a time of pension reform in response to a budget crisis, and resulted in a savings to the system. In recent years, the Legislature has considered and passed several measures that address the long-term sustainability of the retirement systems. For example, in 2011 the Legislature enacted SHB 2021, which eliminated certain cost-of-living adjustments.

Generally, any reduction to the ERFs (i.e., higher take-home pay for early retirees) will carry a cost to the system. The actual magnitude of the cost will depend on how those ERFs are restructured and who receives those adjustments.

Policy makers may want to consider the overall fiscal impact of any change to retirement provisions on state budgeting and the retirement systems. Also, changes to the retirement system are typically long-term and may create contractual rights. As such, additional study and actuarial pricing may also be appropriate before proceeding.

Other States

In order to complete the research within the given timeline for the study, staff began by researching Washington's peer states, then utilized data compiled by the National Education Association (NEA) and the National Conference of State Legislatures (NCSL). Staff did not audit this data.

[10] *See **Appendix C** for average ages of active plan members over the preceding ten years.*

Thus far, staff has found no indication that ERFs in other states are tied to a qualitative measure such as classroom effectiveness.

Staff chose these resources for the following reasons. The NEA data provided a comprehensive review of current provisions across the nation. However, it was compiled in 2010, and does not capture changes made since then. The NEA data also does not include all plans in all states. Instead, it focuses plans that have some teachers or school employees. Some of the listed plans are closed to new members.

The NCSL data is more recent, having been updated to June of 2012. However, it only shows the incremental changes made year-by-year, and does not provide a comprehensive overview of current plan provisions.

Overall, it may not be possible to determine board or legislative motivation for selecting age requirements and reduction factors used in each of these states. However, staff has thus far found no evidence in research to suggest that the early retirement factors are tied to any qualitative measure.

Washington's Peer States

Of Washington's peer states, only three of the ten have a separate retirement system open to new teachers. Of those with separate systems, the early retirement factors consist of one of three options:

- Full actuarial reduction.
- A table of reduction factors describing the factor for each level of age and/or service.
- A consistent percentage multiplied by the time remaining before the retiree reaches the normal retirement age.

Depending on age and service credit, the reductions for early retirement vary from 0 to 6 percent.

Please see **Appendix A** for additional details on early retirement provisions in Washington's peer states.

NEA Data

In brief, about half the states have a separate retirement plan for teachers. Of those, almost all teacher plans have more than one option for determining retirement eligibility.

Most of the teachers' plans have an option based on both a minimum age and length of service. Within those, the normal retirement age ranges from age 50 to 65, and the earliest early retirement age was 45.

About half the teachers' plans have a service-only option, while around one-fifth have a “Rule of __” option. A “Rule of __” option means that the member qualifies for normal retirement when the member's age and service combine to equal a number. Common numbers are 80, 85, and 90.

In addition, some pure DC plans allow normal retirement at any age with five or less years of service

The NEA data is available on their Legislative Summaries and Reports page.

NCSL Data

According to the NCSL, 44 states have changed plan provisions since 2009. Changes to plan provisions are difficult to summarize, given that there are multiple plans per state, multiple tiers per plan, and multiple options within a given tier.

At the highest level, the NCSL reports show the following:

- Twenty-eight states increased the minimum age requirement for normal retirement.
- Five states changed early retirement eligibility or factors.
- At least three states closed a plan or tier to new members.
- Seven states enacted early retirement incentives.

The NCSL reports dating back to 1999 are available on their Pension and Retirement Plans: Resources page.

A 2012 summary presentation is available on the NCSL website.

Options for Further Study

Continued study of classroom effectiveness by SCPP staff may not materially change the findings of this study. However, the SCPP and other policy makers may wish to consider other study of ERFs in the future.

Conclusion

"Classroom effectiveness" is a subjective term, and there is no consensus definition. Instead of concentrating on locating a definition, staff reviewed existing studies of teacher retirement and classroom effectiveness to identify factors that may impact classroom effectiveness.

The factors identified by those sources can be grouped in two categories: work conditions and personal factors. Most of the identified factors are not unique to teachers, and the sources did not identify ERFs or other pension provisions as impacting effectiveness.

Pension policy is likely better suited to addressing factors related to age and service. Current non-pension policies may also be addressing these factors, for example by providing teachers with summer breaks to rest and reenergize. Some factors may be better addressed outside the pension system, for example through human resource policy.

The new ERFs created by 2ESB 6378 reduce the incentive to retire before age 65. However, it will take at least 30 years to determine with any certainty whether or not this incentive is strong enough to change retirement behavior. If employees work longer due to this reduced incentive, then it is possible they may do so with diminished effectiveness.

In Washington, a new teacher and principal evaluation system is in the pilot stages, and when complete will assist in measuring teacher effectiveness. Some policy makers may wish to wait until data from the new evaluation system has been processed before proceeding further.

If policy makers conclude that plan provisions should be changed, they may want to consider benefit consistency and potential long-term impacts, such as any impacts to the affordability and sustainability of the plan.

Appendices

- Appendix A – Washington's Peer States.
- Appendix B – Sources Reviewed.
- Appendix C – Average Age of Active Plan Members.

Attachments

- Attachment A – Study Mandate.
- Attachment B – Actuarial Fiscal Note for 2ESB 6378 (2012 c 7).
- Attachment C – Correspondence as of November 8, 2012.
  - Tuck Gionet, August 16, 2012.
  - Dick Abrams, August 2, 2012.
  - Bob Simoni, August 2, 2012.
  - Jordan Sneva, August 2, 2012.
  - Conrad Wold, August 2, 2012.
  - Bob Simoni, October 30, 2012.

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Appendix A

Washington's Peer States

Early retirement provisions for teachers in Washington's peer states vary in structure and complexity. The following represents highly-summarized retirement provisions for newly hired teachers, or for general public employees (non-public safety) if appropriate.

Please note that not all states have separate retirement systems for teachers, some plans have closed, and many provisions have changed in recent years creating different benefits for employees based on hire date. Some options (such as supplemental investment options) may not be listed here. Please refer to the appropriate state retirement system for complete details and information.

Oregon

Oregon does not have a separate plan for newly-hired teachers. Normal retirement for teachers is at age 65, or age 58 with 30 years of service. Early retirement with no reduction is available at age 55 with 30 years of service.

Idaho

Idaho does not have a separate plan for newly hired teachers. Normal retirement for teachers is at age 65 with at least 60 months of service, with a possible "late increase" at age 70. Early retirement with full actuarial reduction is available at age 55 with at least 60 months of service. Unreduced early retirement is available subject to the Rule of 90 (where age and service equals 90).

California

Newly hired teachers are part of the California State Teachers' Retirement System (CALSTRS). Normal retirement is available at age 60 with five years of service. Multiple early retirement options are available:

- Alternative A -- "Standard Early Retirement."
  - Available at age 55 with five years of service.
  - Benefits are reduced 0.01 percent for each month under age 60.
- Alternative B -- "30 and Out."
  - Available for those who retire from age 50-55 with 30 years of service credit.

- ♢ Benefits are reduced 0.01 percent for each month under age 60.
- ♢ Benefits are reduced additional 0.005 percent for each month under age 55.

❖ Alternative C -- "Early Retirement Limited Term Reduction Plan."

- ♢ Available from age 55-60 with five years of service.
- ♢ Benefits are temporarily reduced as follows: First, benefits are calculated as if the member retired at 60, but the member receives only half the amount. This one-half allowance continues until the total amount paid **after** the retiree reaches age 60 is equal to the amount paid **prior** to age 60. When that point is reached the retiree's monthly allowance will be increased to the original calculated benefit amount.

Colorado

Colorado does not have a separate plan for newly-hired teachers.[11] There are three options for normal retirement:

1. Age 65 with five years of service.
2. Age 58 with 30 years of service.
3. Any age with 35 years of service.

Early retirement with a full actuarial reduction is available at three points:

1. Age 50 with 25 years of service.
2. Age 55 with 20 years of service.
3. Age 60 with five years of service.

Florida

Florida does not have a separate plan for newly hired teachers. Normal retirement for teachers is available at age 65 with eight years of service, or at any age with 33 years of service.

Early retirement is available at any age with eight years of service. Benefits will be reduced 5 percent for each year below normal retirement age.

[11] *The Denver Public School (DPS) system was recently merged into CO Public Employees Retirement Association (PERA). According to PERA customer service, all other teachers in CO are members of PERA. Normal retirement options for DPS teachers differ from teachers in the PERA. For clarity, only the PERA rules are provided here.*

Iowa

Iowa does not have a separate plan for newly hired teachers. There are three options for normal retirement:

1. Age 65.
2. Age 62 with 20 years of service.
3. Rule of 88 (where age and service must exceed 88).

Early retirement is available with a reduction based on when the service was earned. For service through June 30, 2012, the reduction is 3.00 percent for each year (or 0.25 percent for each month) prior to the closest normal retirement age. For service earned starting July 1, 2012, the reduction increases to 6 percent times the number of years (or 0.50 percent times the number of months) prior to age 65.

Minnesota

Newly hired teachers are members of the Teachers' Retirement Association. Normal retirement for teachers is available the year the member is eligible for full Social Security benefits (not to exceed age 66).

Early retirement is available from age 55, with a 4-6 percent reduction for each year prior to normal retirement age.

Missouri

Missouri does not have a separate plan for newly-hired teachers. There are three options for normal retirement:

1. Age 60 with five years of service.
2. Any age with 30 years of service.
3. Rule of 80 (where age and service equals 80).

Early retirement is available at age 55 with five years of service, or at any age with 25 years of service. Both early retirement options have unique reduction factors. Tables showing the reductions are available on the Age-Reduced Calculation page of Missouri's Public Education Employee Retirement System website.

Ohio

Newly hired teachers are members of the State Retirement System of Ohio (STRSOH). Ohio offers three plans for teachers: DB, DC, and Combined (hybrid plan similar to Plans 3 in Washington).

Defined Benefit

Normal retirement is available at age 65 with 30 years of service. Early retirement is available at the following points:

- Any age with 30 years of service.
- Age 55 with25 years of service.
- Age 60 with five years of service.

Benefits will be reduced using a schedule available on the Active Members page of the STRSOH website.

Defined Contribution

Normal retirement is available at the latter of the following:

- The month in which the member reaches age 50.
- The last day of the member's actual employment in an STRS Ohio-covered position.
- The month the member applies.

Combined

Normal retirement is available at different points for the DB and DC portions.

Wisconsin

Wisconsin does not have a separate plan for newly hired teachers. Normal retirement is available at age 65. Early retirement is available at age 55, with a reduction of 0.4 percent per month between ages 55 and 57. Between age 57 and normal retirement age the 0.4 percent is reduced by 0.00001111 percent for each month of creditable service.

APPENDIX B

Sources Reviewed

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- Costrell, Robert, "Efficiency and Equity in the Time Pattern of Teacher Pension Benefits: An Analysis of Four State Systems," April 2007, accessed August 2012.
- National Board for Professional Teaching Standards, "Getting It Right: A Comprehensive Guide to Developing and Sustaining Teacher Evaluation and Support Systems," 2011, accessed August 2012.
- Weller, Christian, "Buyer Beware: The Risks to Teacher Effectiveness from Changing Retirement Benefits," September 2011, accessed August 2012.

APPENDIX C

The following table shows the average age of all active members in PERS Plans 1/2/3, TRS Plans 1/2/3, and SERS Plans 2/3.

Please note that the Plans 1 (PERS 1 and TRS 1) have been closed to new members since 1977. The lack of new members entering the system pushes the average age of active members upward.

Average Age of Active Members								
Valuation Year	PERS 1	PERS 2	PERS 3	TRS 1	TRS 2	TRS 3	SERS 2	SERS 3
2011	60.78	48.10	43.34	61.54	46.42	45.23	51.06	49.86
2010	60.14	47.61	42.83	60.87	47.63	44.73	50.97	49.35
2009	59.47	47.13	42.37	60.03	47.83	44.00	50.57	48.75
2008	58.73	46.58	41.83	59.24	49.23	43.42	50.63	48.07
2007	57.94	46.26	41.81	58.29	51.83	42.85	51.15	47.25
2006	57.32	46.13	41.97	57.67	51.25	42.13	50.55	46.81
2005	56.58	45.67	41.82	56.88	50.67	41.85	49.81	46.45
2004	55.89	45.13	41.81	56.13	50.06	41.53	49.06	46.17
2003	55.19	44.62	42.16	55.38	49.33	41.12	48.30	45.76
2002	54.56	44.01	42.70	54.61	48.58	40.57	47.48	45.16

Attachment A

NEW SECTION. **Sec. 8.** The select committee on pension policy, with the assistance of the department of labor and industries, shall study the issue of risk classifications of employees in the Washington state retirement systems that entail either high degrees of physical or psychological risk to the members' own safety or unusually high physical requirements that result in elevated risks of injury or disablement for older employees. The select committee on pension policy, with the assistance of the office of the superintendent of public instruction, shall also study existing early retirement factors and job requirements that may limit the effectiveness of the older classroom employee. The study shall identify groups and evaluate them for inclusion in the public safety employees' retirement system or the creation of other early retirement factors in the teachers' or school employees' retirement systems. The select committee on pension policy shall report the findings and recommendations of its study to the legislative fiscal committees by no later than December 15, 2012.

Passed by the Senate April 10, 2012.
Passed by the House April 10, 2012.
Approved by the Governor May 2, 2012.
Filed in Office of Secretary of State May 2, 2012.

Attachment B

Actuary's Fiscal Note For 2ESB 6378 – Revised

SUMMARY OF RESULTS

This bill reduces subsidized early retirement benefits for newly hired members in Plans 2/3 of PERS, TRS, and SERS retirement systems, lowers the prescribed rate-of-return assumptions used in determining contribution requirements, and requires the SCPP to perform a pension study.

Impact on Contribution Rates (Effective 7/1/2012)*						
Fiscal Year 2013 State Budget	**PERS**	**TRS**	**SERS**	**PSERS**	**LEOFF**	**WSPRS**
Employee (Plan 2) / Total Employer	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**

**Please see the remainder of this fiscal note for contribution rate impacts beyond July 1, 2012.*

Budget Impacts			
(Dollars in Millions)	**Fiscal Year 2013**	**2013-2015**	**25-Year**
General Fund-State	$0.0	($4.4)	($180.7)
Local Government	$0.0	($4.1)	($173.8)
Total Employer	$0.0	($9.6)	($382.5)

Note: We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.

HIGHLIGHTS OF ACTUARIAL ANALYSIS

We expect the reduction of subsidized early retirement benefits for new hires in PERS, TRS, and SERS Plans 2/3 to decrease employer costs and Plan 2 contribution rates. For this Plans 2/3 provision alone, we expect a 25-year total employer savings of over $1.6 billion.

The lower rate-of-return assumptions will not change actual benefits paid or the actual rate of return the plans experience, but will change the timing of future contributions and dollar amount of future investment returns. As a result, we expect the lower rate-of-return assumptions to temporarily increase contribution requirements resulting in higher employer costs and Plan 2 contribution rates over the next 25 years. For this provision alone, we expect a 25-year total employer cost of over $1.2 billion. We expect a 50-year total employer savings of approximately $4 billion from the additional prefunding that occurs during the next 25 years.

When we consider both provisions together, we expect a total employer savings of $382.5 million over the next 25 years. We expect the change in subsidized early retirement benefits will change future retirement behavior, but found the expected cost of this provision does not change that much when we assume different retirement behavior.

We found overall affordability remained unchanged and risk improved as measured under the Pension Score Card. However, we expect long-term affordability and Plan 2 contribution rates for current members to improve over the lifetime of the plans. Please see the Risk Analysis section and Appendix B for more detailed information.

See the remainder of this fiscal note for additional details on the summary and highlights presented here.

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Actuary's Fiscal Note For 2ESB 6378 – Revised

WHAT IS THE PROPOSED CHANGE?

Summary Of Change

This bill impacts the following systems by changing the prescribed Rate-of-Return (ROR) assumptions for determining contribution rate requirements:

- Public Employees' Retirement System (PERS).
- Teachers' Retirement System (TRS).
- School Employees' Retirement System (SERS).
- Public Safety Employees' Retirement System (PSERS).
- Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) Plan 1.
- Washington State Patrol Retirement System (WSPRS).

ROR assumptions are set as follows:

- 7.9 percent, beginning July 1, 2013.
- 7.8 percent, beginning July 1, 2015.
- 7.7 percent, beginning July 1, 2017.

This bill also changes benefits for members in Plans 2/3 of PERS, TRS, and SERS retirement systems by removing existing options for subsidized early retirement for members newly hired on or after May 1, 2013, and replacing these options with a new option. Specifically, it removes the 2000 and 2008 Early Retirement Factors (ERFs), and replaces them with a 5 percent reduction for each year of early retirement prior to age 65. To be eligible for the 5 percent ERF, you must be age 55 or older, and have at least 30 years of service.

The bill requires the State Actuary, in 2017, to submit information regarding the experience and financial condition of each state retirement system three months earlier than under current law (see RCW 41.45.030). This change does not affect the pricing of the bill.

The bill requires the Select Committee on Pension Policy to study job classifications in the pension systems. The study does not affect the pricing of the bill.

Effective Date: 90 days after session.

What Is The Current Situation?

The normal retirement age for members in the affected Plans 2/3 is age 65. Early retirement benefits are available to members who have attained age 55 and meet the minimum service requirements of twenty years in Plan 2 or ten years in Plan 3. Under early retirement, pensions are actuarially reduced for each year the member retires prior to attaining age 65.

Alternate early retirement benefits are available to Plans 2/3 members who have attained age 55 and have at least 30 years of service credit. Pensions are reduced

for alternate early retirement, however, the reduction is less than under early retirement. Alternate early retirement is considered a subsidized form of early retirement because benefits are not actuarially reduced. Statute provides two different sets of alternate early retirement provisions: 2000 ERFs and 2008 ERFs. These provisions differ in pension reductions and retire-rehire restrictions. Eligible members may choose to retire under either provision as follows.

- **2000 ERFs –** Eligible members may retire and receive a pension reduced by 3 percent for each year the member retires prior to attaining age 65. Members retiring under this provision may return to work in an eligible position for a covered public employer prior to age 65 and, subject to certain restrictions, still receive their full pension.
- **2008 ERFs –** Eligible members may retire with unreduced pensions beginning at age 62. Members retiring between ages 55 and 62 have their pension reduced by a specified percentage that is less than the reduction provided under the 2000 ERFs. Members retiring under this provision are generally prohibited from receiving their full pension if they return to work in any capacity for a covered public employer before they reach age 65.

The ROR is one of four prescribed long-term economic assumptions used by the State Actuary to determine contribution rate requirements for the state retirement systems. These long-term economic assumptions were originally set in statute. The Pension Funding Council (PFC) has authority to revise these assumptions, subject to revision by the Legislature.

On October 1, 2011, the PFC adopted new economic assumptions for the plans impacted by this bill. The table below displays the current assumptions and new assumptions, which become effective July 1, 2013 under current law.

Assumption	Current	Adopted
Inflation	3.50%	3.00%
General salary growth	4.00%	3.75%
Annual investment return	8.00%	7.90%
Growth in system membership*	0.90% (TRS), 1.25% (Others)	0.80% (TRS), 0.95% (Others)

** Used to determine employer contribution requirements for the Plan 1 UAAL only.*

Actuary's Fiscal Note For 2ESB 6378 – Revised

Who Is Impacted And How?

We estimate this bill could affect all 154,923 active members of PERS 2, TRS 2, SERS 2, PSERS, and WSPRS 1/2, and all employers of PERS, TRS, SERS, PSERS, and WSPRS through different contribution rates. We expect PERS, TRS, and SERS Plan 2 members and employers to experience an eventual decrease in contribution rates through the reduction of subsidized ERFs for members hired on or after May 1, 2013. We further expect Plan 2 and WSPRS members and employers to experience temporary contribution rate increases as a result of higher contribution rate requirements from the lower ROR assumption. However, we expect the additional prefunding from the temporary increase in contribution requirements will result in lower contribution requirements in the long-term.

This bill will not affect member contribution rates in Plan 1 since they are fixed in statute. 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.

Employer rate impacts vary by year since they include changes to both the Plan 1 UAAL rate and the Plans 2/3 normal cost. Please see How Contribution Rates Changed for further details.

This bill will also affect members hired on or after May 1, 2013, in PERS, TRS, and SERS through decreased benefits in the form of 5 percent subsidized ERFs. Five percent subsidized ERFs have reduction factors larger than the subsidized ERFs reduction factors under the current law, as shown in the table below.

Subsidized Early Retirement Reduction Factors			
Age	2000 ERFs	2008 ERFs	2ESB 6378 ERFs*
55	0.70	0.80	0.50
56	0.73	0.83	0.55
57	0.76	0.86	0.60
58	0.79	0.89	0.65
59	0.82	0.92	0.70
60	0.85	0.95	0.75
61	0.88	0.98	0.80
62	0.91	1.00	0.85
63	0.94	1.00	0.90
64	0.97	1.00	0.95
65	1.00	1.00	1.00

**Applied for members hired on or after May 1, 2013, with at least 30 years of service.*

For example, a member hired on or after May 1, 2013, who retires at age 61 with 30 years of service would have their annual pension reduced by 20 percent under this bill rather than 2 percent under current law. For a member in Plan 2 with an average final salary of $50,000, under current law the ERF would be 0.98, resulting in an initial annual benefit of $29,400. Under this bill, the ERF would be 0.80 resulting in an initial annual benefit of $24,000.

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WHY THIS BILL HAS A COST/SAVINGS AND WHO PAYS FOR IT

Why This Bill Has A Cost/Savings

The two major provisions of this bill have separate types of impacts:

- **Change in ROR Assumption –** An assumption change that does not change actual benefits paid or the actual rate of return the plans will experience, but does change the timing of future contributions. This change in timing results in temporary increases in contribution requirements (additional prefunding) followed by lower contribution requirements for employers and Plan 2 members (due to additional prefunding).
- **Change to Subsidized ERFs for Members Hired on or after May 1, 2013 –** A benefit reduction that lowers the liabilities and costs associated with future members. It begins as a small savings (when there aren't many new hires in the system) and becomes a larger savings over time.

See Appendix A for further details on the budget impacts of this bill by major provision.

Who Will Pay For/Receive These Costs/Savings?

The costs/savings that result from this bill will be divided between members and employers according to standard funding methods that vary by plan:

- Plan 1: 100 percent employer.
- Plan 2: 50 percent member and 50 percent employer.
- Plan 3: 100 percent employer.

PERS, SERS, and PSERS employers will realize the impacts on the PERS UAAL payment from a lower assumed ROR, whereas TRS employers will realize the impacts on the TRS UAAL payment.

HOW WE VALUED THESE COSTS

Assumptions We Made

We made the following assumption changes for each of the two major provisions of this bill.

- **Change in ROR Assumption –** To determine the change in the present value of future benefits (and salaries) for current and future members at future measurement dates, we changed the investment return assumptions in our valuation software according to the schedule specified in the bill. We assumed that the prescribed ROR assumption for a given biennium should

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be applied in the contribution rate-setting valuation for that biennium. For example, the 2013-15 ROR of 7.9 percent would be included in the 2011 valuation.

To determine the projected assets at each future valuation date, we changed the expected long-term rate of investment return from 8.0 percent to 7.7 percent.

For purposes of this pricing, we changed all economic assumptions consistent with the assumption changes adopted by the PFC in 2011. We further assumed that the changes in this bill for the ROR do not revise the actions of the PFC concerning all other economic assumptions.

- **Change to Subsidized ERFs for Members Hired on or after May 1, 2013 –** We assumed future members would retire later (work longer) under 5 percent subsidized ERFs. Specifically, we assumed new hires would have lower rates of retirement after 30 years of service than currently assumed.

The savings from reducing subsidized early retirements for members hired on or after May 1, 2013, assumes the continuation of these benefits for new hires under current law. According to current law, if the courts, through a final court action, reinstate gain-sharing benefits, the 2008 ERFs are removed prospectively by operation of law. Should this occur, then the expected net savings attributed to this bill would decrease.

Please see Appendix C for further details on the assumption changes we made for this pricing.

How We Applied These Assumptions

We calculated the cost of this bill by comparing the current situation ("base") to the expected scenario if this bill passed ("pricing").

The base is a projection that includes:

- The long-term economic assumptions adopted by the PFC for determining the present value of future benefits and salaries for current and new members.
- An expected 7.7 percent rate of return on assets.
- New hires having access to the 2000 and 2008 subsidized ERFs.

Based on this projection we observe both the required contribution rates and the projected payroll. The multiplication of these two items results in the base fiscal costs.

The pricing is a projection that includes:

- The ROR assumptions for determining the present value of future benefits and salaries changing by year as specified in the bill.

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- An expected 7.7 percent rate of return on assets.
- New hires on or after May 1, 2013, having access to 5 percent subsidized ERFs (and therefore retiring later on average).

Based on this projection we observe the new required contribution rates and projected payroll. The multiplication of these two items results in the pricing fiscal costs.

We then compare the pricing fiscal costs to the base fiscal costs to determine the expected impact from this bill.

For determining the projected assets available at each future valuation date, we hold the expected long-term return on assets constant under both the base and pricing because the bill does not change the actual ROR the plans will experience. Using this method we can isolate the impact on projected contribution requirements from changing the ROR assumptions and the timing of future contribution requirements.

Since the 5 percent subsidized ERF provisions are effective May 1, 2013, we applied an additional ten-month interest adjustment to that portion of the liability change to reflect the delayed effective date (for the period July 1, 2012 to May 1, 2013).

Otherwise, we developed these costs using the same methods as disclosed in the *June 30, 2010, Actuarial Valuation Report* (AVR).

Special Data Needed

We developed these costs using the same assets and data as disclosed in the AVR. In addition, we recognized investment returns of 21.14 percent through June 30, 2011, when estimating projected asset values.

ACTUARIAL RESULTS

How The Liabilities Changed

This bill does not change the present value of future benefits, measured at June 30, 2010, payable to current members so there is no impact on pension liability for current members at this measurement date. We include the estimated impact of benefit changes for future hires and the impact of changes in pension liabilities at future measurement dates in the budget impact section.

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Impact on Pension Liability - Current Members			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Actuarial Present Value of Projected Benefits			
(The Value of the Total Commitment to all Current Members)			
PERS 1	$12,721	$0.0	$12,721
PERS 2/3	26,041	0.0	26,041
PERS Total	**$38,762**	**$0.0**	**$38,762**
TRS 1	$9,305	$0.0	$9,305
TRS 2/3	9,111	0.0	9,111
TRS Total	**$18,416**	**$0.0**	**$18,416**
SERS 2/3	**$3,461**	**$0.0**	**$3,461**
PSERS 2	**$425**	**$0.0**	**$425**
LEOFF 1	$4,401	$0.0	$4,401
LEOFF 2	7,904	0.0	7,904
LEOFF Total	**$12,306**	**$0.0**	**$12,306**
WSPRS 1/2	**$953**	**$0.0**	**$953**
Unfunded Actuarial Accrued Liability			
*(The Portion of the Plan 1 Liability that is Amortized According to Funding Policy)**			
PERS 1	**$3,094**	**$0.0**	**$3,094**
TRS 1	**$1,345**	**$0.0**	**$1,345**
LEOFF 1	**($1,161)**	**$0.0**	**($1,161)**
Unfunded Projected Unit Credit Liability			
(The Value of the Total Commitment to all Current Members Attributable to Past Service that is Not Covered by Current Assets)			
PERS 1	$3,238	$0.0	$3,238
PERS 2/3	(2,202)	$0.0	(2,202)
PERS Total	**$1,036**	**$0.0**	**$1,036**
TRS 1	$1,439	$0.0	$1,439
TRS 2/3	(886)	$0.0	(886)
TRS Total	**$554**	**$0.0**	**$554**
SERS 2/3	**($296)**	**$0.0**	**($296)**
PSERS 2	**($23)**	**$0.0**	**($23)**
LEOFF 1	($1,180)	$0.0	($1,180)
LEOFF 2	(1,204)	$0.0	(1,204)
LEOFF Total	**($2,384)**	**$0.0**	**($2,384)**
WSPRS 1/2	**($138)**	**$0.0**	**($138)**

Note: Totals may not agree due to rounding.
** PERS 1 and TRS 1 are amortized over a ten-year period. LEOFF 1 must be amortized by June 30, 2024.*

How The Present Value of Future Salaries (PVFS) Changed

This proposal does not change the PVFS of the current members at the measurement date of June 30, 2010. We include the estimated PVFS impact of later assumed retirement for new hires and impact of changes in PVFS at future measurement dates in the budget impact section.

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Impact on Pension Liability - Current Members			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Actuarial Present Value of Projected Benefits			
(The Value of the Total Commitment to all Current Members)			
PERS 1	$12,721	$0.0	$12,721
PERS 2/3	26,041	0.0	26,041
PERS Total	**$38,762**	**$0.0**	**$38,762**
TRS 1	$9,305	$0.0	$9,305
TRS 2/3	9,111	0.0	9,111
TRS Total	**$18,416**	**$0.0**	**$18,416**
SERS 2/3	**$3,461**	**$0.0**	**$3,461**
PSERS 2	**$425**	**$0.0**	**$425**
LEOFF 1	$4,401	$0.0	$4,401
LEOFF 2	7,904	0.0	7,904
LEOFF Total	**$12,306**	**$0.0**	**$12,306**
WSPRS 1/2	**$953**	**$0.0**	**$953**
Unfunded Actuarial Accrued Liability			
*(The Portion of the Plan 1 Liability that is Amortized According to Funding Policy)**			
PERS 1	**$3,094**	**$0.0**	**$3,094**
TRS 1	**$1,345**	**$0.0**	**$1,345**
LEOFF 1	**($1,161)**	**$0.0**	**($1,161)**
Unfunded Projected Unit Credit Liability			
(The Value of the Total Commitment to all Current Members Attributable to Past Service that is Not Covered by Current Assets)			
PERS 1	$3,238	$0.0	$3,238
PERS 2/3	(2,202)	$0.0	(2,202)
PERS Total	**$1,036**	**$0.0**	**$1,036**
TRS 1	$1,439	$0.0	$1,439
TRS 2/3	(886)	$0.0	(886)
TRS Total	**$554**	**$0.0**	**$554**
SERS 2/3	**($296)**	**$0.0**	**($296)**
PSERS 2	**($23)**	**$0.0**	**($23)**
LEOFF 1	($1,180)	$0.0	($1,180)
LEOFF 2	(1,204)	$0.0	(1,204)
LEOFF Total	**($2,384)**	**$0.0**	**($2,384)**
WSPRS 1/2	**($138)**	**$0.0**	**($138)**

Note: Totals may not agree due to rounding.
** PERS 1 and TRS 1 are amortized over a ten-year period. LEOFF 1 must be amortized by June 30, 2024.*

How The Present Value of Future Salaries (PVFS) Changed

This proposal does not change the PVFS of the current members at the measurement date of June 30, 2010. We include the estimated PVFS impact of later assumed retirement for new hires and impact of changes in PVFS at future measurement dates in the budget impact section.

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How Contribution Rates Changed

This bill does not impact benefits for current members so there is no 2013 supplemental contribution rate required for the current biennium.

We used the rounded employer rate changes shown below for the Plan 1 UAAL and Plans 2/3 and WSPRS Normal Cost (NC) to measure the budget changes in future Fiscal Years (FY).

Employer Contribution Rate Change By Year								
FY	PERS 1 UAAL	PERS 2/3 NC	TRS 1 UAAL	TRS 2/3 NC	SERS 2/3 NC	PSERS 2 NC	LEOFF 1 UAAL	WSPRS 1/2 NC
2013	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2014	0.00%	(0.02%)	0.00%	(0.05%)	(0.02%)	0.00%	0.00%	0.00%
2015	0.00%	(0.02%)	0.00%	(0.05%)	(0.02%)	0.00%	0.00%	0.00%
2016	0.08%	0.30%	0.00%	0.23%	0.33%	0.21%	0.00%	0.16%
2017	0.08%	0.30%	0.00%	0.23%	0.33%	0.21%	0.00%	0.16%
2018	0.15%	0.64%	0.00%	0.51%	0.68%	0.50%	0.00%	3.00%
2019	0.15%	0.64%	0.00%	0.51%	0.68%	0.50%	0.00%	3.00%
2020	0.00%	0.53%	0.00%	0.39%	0.57%	0.50%	0.00%	3.38%
2021	0.00%	0.53%	0.00%	0.39%	0.57%	0.50%	0.00%	3.38%
2022	0.00%	0.31%	0.00%	0.21%	0.35%	0.44%	0.00%	2.52%
2023	0.00%	0.31%	0.24%	0.21%	0.35%	0.44%	0.00%	2.52%
2024	0.00%	0.12%	0.00%	0.06%	0.14%	0.36%	0.00%	1.68%
2025	0.00%	0.12%	0.00%	0.06%	0.14%	0.36%	0.00%	1.68%
2026	(0.31%)	(0.04%)	0.00%	(0.07%)	(0.03%)	0.28%	0.00%	0.98%
2027	0.00%	(0.04%)	0.00%	(0.07%)	(0.03%)	0.28%	0.00%	0.98%
2028	0.00%	(0.15%)	0.00%	(0.18%)	(0.14%)	0.21%	0.00%	0.42%
2029	0.00%	(0.15%)	0.00%	(0.18%)	(0.14%)	0.21%	0.00%	0.42%
2030	0.00%	(0.24%)	0.00%	(0.26%)	(0.22%)	0.15%	0.00%	(0.02%)
2031	0.00%	(0.24%)	0.00%	(0.26%)	(0.22%)	0.15%	0.00%	(0.02%)
2032	0.00%	(0.32%)	0.00%	(0.34%)	(0.28%)	0.09%	0.00%	(0.34%)
2033	0.00%	(0.32%)	0.00%	(0.34%)	(0.28%)	0.09%	0.00%	(0.34%)
2034	0.00%	(0.37%)	0.00%	(0.40%)	(0.31%)	0.05%	0.00%	(0.60%)
2035	0.00%	(0.37%)	0.00%	(0.40%)	(0.31%)	0.05%	0.00%	(0.60%)
2036	0.00%	(0.41%)	0.00%	(0.45%)	(0.34%)	0.01%	0.00%	(0.82%)
2037	0.00%	(0.41%)	0.00%	(0.45%)	(0.34%)	0.01%	0.00%	(0.82%)

Contribution rates changes vary by source (normal cost versus UAAL) and by system.

LEOFF 1, WSPRS, and PSERS are not affected by the change to subsidized early retirement. In these plans we see the impact of the change in the assumed ROR only. If all assumptions are realized, we expect LEOFF 1 to remain fully funded before and after this bill. We found the change in the assumed ROR triggers the member maximum rate in WSPRS earlier than under current law. This results in larger employer rate increases beginning in FY 2018.

The normal cost rates in PERS, TRS, and SERS are impacted by both the change in the assumed ROR and the reduction in subsidized early retirement for new hires. The impact of the changes to the ROR assumption surfaces in FY 2016

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since we already assume a 7.9 percent ROR under current law for this pricing. In other words, this bill does not change the ROR assumption until 2015-17 when the prescribed rate becomes 7.8 percent (with a subsequent change in 2017-19 when the prescribed rate becomes 7.7 percent). For this change alone, we see temporary increases in required contribution rates (leading to additional prefunding) followed by decreases in required contribution rates (due to the additional prefunding). We expect decreases in the required contribution rates for PSERS to emerge beyond 25 years.

PERS, TRS, and SERS Plans 2/3 normal cost rates decrease due to the reduction of subsidized ERFs for all impacted systems. TRS experiences the largest future rate savings from this benefit change because TRS has the highest utilization of subsidized early retirement under current law, followed by PERS and then SERS.

The combined effect of (a) the change in the assumed ROR and (b) the reduction of subsidized early retirement benefits for new hires leads to decreased contribution requirements beginning in FY 2026 for PERS, TRS, and SERS.

Please see Appendix A for estimated contribution rate changes for each of the major provisions of this bill.

How This Impacts Budgets And Employees

Budget Impacts							
(Dollars in Millions)	PERS	TRS	SERS	PSERS	LEOFF	WSPRS	Total
Fiscal Year 2013							
General Fund	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Non-General Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total State	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Local Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Employer	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Total Employee	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**
2013-2015							
General Fund	($0.8)	($3.3)	($0.3)	$0.0	$0.0	$0.0	($4.4)
Non-General Fund	(1.1)	0.0	0.0	0.0	0.0	0.0	(1.1)
Total State	**($1.9)**	**($3.3)**	**($0.3)**	**$0.0**	**$0.0**	**$0.0**	**($5.5)**
Local Government	(2.0)	(1.7)	(0.4)	0.0	0.0	0.0	(4.1)
Total Employer	**($4.0)**	**($5.0)**	**($0.7)**	**$0.0**	**$0.0**	**$0.0**	**($9.6)**
Total Employee	**($3.0)**	**($1.2)**	**($0.3)**	**$0.0**	**$0.0**	**$0.0**	**($4.5)**
2012-2037							
General Fund	($35.8)	($159.9)	($3.9)	$16.9	$0.0	$1.9	($180.7)
Non-General Fund	(51.0)	0.0	0.0	1.8	0.0	21.2	(28.0)
Total State	**($86.8)**	**($159.9)**	**($3.9)**	**$18.7**	**$0.0**	**$23.1**	**($208.7)**
Local Government	(92.8)	(81.3)	(4.8)	5.1	0.0	0.0	(173.8)
Total Employer	**($179.6)**	**($241.2)**	**($8.6)**	**$23.8**	**$0.0**	**$23.1**	**($382.5)**
Total Employee	**($96.9)**	**($184.3)**	**($16.2)**	**$23.7**	**$0.0**	**$1.7**	**($272.0)**

Note: Totals may not agree due to rounding. We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.

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

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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 Risk Measures Changed

This bill will affect the overall risk and affordability of the pension systems as shown below. Generally, we found affordability remained unchanged and pay-go risks improved.

Pension Score Card

	Base		Pricing	
Category *(Dollars in Billions)*	**Value**	**Score**	**Value**	**Score**
Affordability				
Chance Pensions will Consume More than 8% of GF-S[1]	6%	80	6%	80
5% Chance GF-S[1] Consumption will Exceed	8.1%	61	8.1%	61
5% Chance Employer Contribution Rate will Exceed	17.3%	54	17.3%	55
Risk				
Chance of PERS 1, TRS 1 in Pay-Go[2]	27%	33	26%	34
Chance of Open Plan in Pay-Go[2]	9%	51	7%	53
5% Chance Annual Pay-Go Cost[3] in PERS 1, TRS 1 Exceed	$1.5	40	$1.5	40
5% Chance Annual Pay-Go Cost[3] in Open Plans Exceed	$9.9	0	$9.1	0
Chance of Total Funded Status Below 60%	26%	36	26%	37
Total Weighted Score		**50**		**50**

[1] *Currently 2.7% of GF-S.*

[2] *When today's value of annual cost exceeds $25 million.*

[3] *Pay-Go costs on top of normal pension costs.*

We found the reduction of the subsidized ERFs improves affordability by lowering required contributions throughout the projection period. However, the impact on affordability risk was minimal as measured under the score card. Under current law, most affordability risks surface in 2024. This corresponds with the year the LEOFF 1 UAAL would need to be fully amortized under pessimistic scenarios.

The reduction of the subsidized ERFs results in smaller assumed open-plan funding shortfalls in the future which increases overall funded status and decreases the chance of pay-go in the open plans. This provision also reduces the open plan pay-go amount since lower benefits are expected.

We also see that changes in the ROR assumption increase pre-funding in all plans over current assumptions, which improves long-term funded status and pay-go risks for all plans.

The combination of the change in ROR assumption and the reduction of the subsidized ERFs results in slightly lower assumed funding shortfalls for both open and closed plans in the future as compared to current law.

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Please see Appendix B for further details about how risk measures change under this bill.

Please see our *2010 Risk Assessment Report* (RAR) for additional background on how we developed and how to interpret the risk measures.

HOW THE RESULTS CHANGE WHEN THE ASSUMPTIONS CHANGE

To determine the sensitivity of the actuarial results to the best-estimate assumptions or methods selected for this pricing we looked at the impact of varying retirement behavior for the 5 percent subsidized ERF benefit change.

We performed sensitivity analysis on the benefit change for members first hired on or after May 1, 2013. To see how sensitive the results are to assumed retirement behavior, we compared our best-estimate pricing for the ERF benefit change to the following two scenarios:

- **Higher Savings: No Retirement Behavior Change –** In this scenario, we assumed no change in retirement behavior for new hires with at least 30 years of service. In other words, we assumed new hires would retire at the same rate as current members who have access to more favorable early retirement benefits.
- **Lower Savings: Later Retirement –** In this scenario, we assumed new hires with at least 30 years of service would retire later than what we assumed in our best-estimate pricing. Specifically, we assumed new hires would have the same rate of retirement after 30 years of service as they do currently before 30 years of service.

The table below shows the results of our sensitivity analysis. We found that the results were not that sensitive to assumed changes in retirement behavior. This occurs because the savings for later assumed retirement are offset by lower savings from the ERF changes. When we assume no change in retirement behavior (or earlier retirement than under our best-estimate assumptions), the cost of earlier assumed retirement is offset by higher savings from the ERF changes.

Please see Appendix A for our best-estimate results by major provision of the bill.

Sensitivity of Best Estimate Fiscal Impact – 5% ERFs Only

(Dollars in Millions)	Lower Savings Later Retirement	Best-Estimate	Higher Savings No Retirement Behavior Change
25-Year GF-S	($720.3)	($739.8)	($779.2)
25-Year Total Employer	($1,640.1)	($1,685.1)	($1,771.1)

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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 in the footer. We intend this fiscal note to be used by the Legislature during the 2012 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.

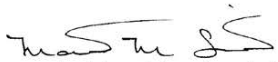
ACTUARY'S CERTIFICATION

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. The risk analysis summarized in this fiscal note involves the interpretation of many factors and the application of professional judgment. We believe that the data, assumptions, and methods used in our risk assessment model are reasonable and appropriate for the purposes of this pricing exercise. The use of another set of data, assumptions, and methods, however, could also be reasonable and could produce materially different results.
6. We prepared this fiscal note for the 2012 Legislative Session.
7. 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 in the footer of this fiscal note.

The undersigned, with actuarial credentials, meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

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



Matt Smith, FCA, EA, MAAA
State Actuary

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APPENDIX A – INDIVIDUAL COMPONENT COSTS

This Appendix shows the fiscal costs associated with the major provisions of the bill. We show two categories below:

- **ROR Assumption Changes –** The impact of changing the investment return assumption over time.
- **Plans 2/3 Benefit Change –** The impact of reducing subsidized ERFs for newly hired members on or after May 1, 2013.

Please note the sum of each category does not equal the total cost of this proposal due to the interaction of the two categories in our pricing.

The tables below show the impact of changing the investment return assumption according to the following schedule.

- 7.9 percent, beginning July 1, 2013 (already assumed under current law).
- 7.8 percent, beginning July 1, 2015.
- 7.7 percent, beginning July 1, 2017.

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Employer Contribution Rate Change By Year – ROR Assumption Changes Only								
FY	PERS 1 UAAL	PERS 2/3 NC	TRS 1 UAAL	TRS 2/3 NC	SERS 2/3 NC	PSERS 2 NC	LEOFF 1 UAAL	WSPRS 1/2 NC
2013	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2014	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2015	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2016	0.08%	0.36%	0.00%	0.37%	0.38%	0.21%	0.00%	0.16%
2017	0.08%	0.36%	0.00%	0.37%	0.38%	0.21%	0.00%	0.16%
2018	0.15%	0.74%	0.00%	0.74%	0.77%	0.50%	0.00%	3.00%
2019	0.15%	0.74%	0.00%	0.74%	0.77%	0.50%	0.00%	3.00%
2020	0.00%	0.67%	0.00%	0.67%	0.68%	0.50%	0.00%	3.38%
2021	0.00%	0.67%	0.00%	0.67%	0.68%	0.50%	0.00%	3.38%
2022	0.00%	0.48%	0.00%	0.53%	0.48%	0.44%	0.00%	2.52%
2023	0.00%	0.48%	0.22%	0.53%	0.48%	0.44%	0.00%	2.52%
2024	0.00%	0.31%	0.00%	0.41%	0.29%	0.36%	0.00%	1.68%
2025	0.00%	0.31%	0.00%	0.41%	0.29%	0.36%	0.00%	1.68%
2026	(0.31%)	0.17%	0.00%	0.31%	0.13%	0.28%	0.00%	0.98%
2027	0.00%	0.17%	0.00%	0.31%	0.13%	0.28%	0.00%	0.98%
2028	0.00%	0.06%	0.00%	0.22%	0.02%	0.21%	0.00%	0.42%
2029	0.00%	0.06%	0.00%	0.22%	0.02%	0.21%	0.00%	0.42%
2030	0.00%	(0.02%)	0.00%	0.15%	(0.06%)	0.15%	0.00%	(0.02%)
2031	0.00%	(0.02%)	0.00%	0.15%	(0.06%)	0.15%	0.00%	(0.02%)
2032	0.00%	(0.08%)	0.00%	0.07%	(0.11%)	0.09%	0.00%	(0.34%)
2033	0.00%	(0.08%)	0.00%	0.07%	(0.11%)	0.09%	0.00%	(0.34%)
2034	0.00%	(0.13%)	0.00%	0.02%	(0.14%)	0.05%	0.00%	(0.60%)
2035	0.00%	(0.13%)	0.00%	0.02%	(0.14%)	0.05%	0.00%	(0.60%)
2036	0.00%	(0.17%)	0.00%	(0.02%)	(0.17%)	0.01%	0.00%	(0.82%)
2037	0.00%	(0.17%)	0.00%	(0.02%)	(0.17%)	0.01%	0.00%	(0.82%)

Budget Impacts – ROR Assumption Changes Only			
(Dollars in Millions)	Fiscal Year 2013	2013-2015	25-Year
General Fund-State	$0.0	$0.0	$536.5
Local Government	$0.0	$0.0	$520.6
Total Employer	$0.0	$0.0	$1,233.7

Note: We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.

The lower rate-of-return assumptions will not change actual benefits paid or the actual rate of return the plans experience, but will change the timing of future contributions and dollar amount of future investment returns. As a result, we expect the lower rate-of-return assumptions to temporarily increase contribution requirements resulting in higher employer costs and Plan 2 contribution rates over the next 25 years. For this provision alone, we expect a 25-year total employer cost of over $1.2 billion. We expect a 50-year total employer savings of approximately $4 billion from the additional prefunding that occurs during the next 25 years.

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The tables below show the impact of changing subsidized ERFs for Plans 2/3 members hired on or after May 1, 2013.

Contribution Rate Change By Year – Plans 2/3 Benefit Change Only

FY	PERS 1 UAAL	PERS 2/3 NC	TRS 1 UAAL	TRS 2/3 NC	SERS 2/3 NC
2013	0.00%	0.00%	0.00%	0.00%	0.00%
2014	0.00%	(0.01%)	0.00%	(0.05%)	(0.02%)
2015	0.00%	(0.01%)	0.00%	(0.05%)	(0.02%)
2016	0.00%	(0.06%)	0.00%	(0.13%)	(0.05%)
2017	0.00%	(0.06%)	0.00%	(0.13%)	(0.05%)
2018	0.00%	(0.10%)	0.00%	(0.21%)	(0.08%)
2019	0.00%	(0.10%)	0.00%	(0.21%)	(0.08%)
2020	0.00%	(0.13%)	0.00%	(0.27%)	(0.10%)
2021	0.00%	(0.13%)	0.00%	(0.27%)	(0.10%)
2022	0.00%	(0.17%)	0.02%	(0.31%)	(0.13%)
2023	0.00%	(0.17%)	0.00%	(0.31%)	(0.13%)
2024	0.00%	(0.19%)	0.00%	(0.34%)	(0.14%)
2025	0.01%	(0.19%)	0.00%	(0.34%)	(0.14%)
2026	0.00%	(0.20%)	0.00%	(0.36%)	(0.15%)
2027	0.00%	(0.20%)	0.00%	(0.36%)	(0.15%)
2028	0.00%	(0.21%)	0.00%	(0.38%)	(0.16%)
2029	0.00%	(0.21%)	0.00%	(0.38%)	(0.16%)
2030	0.00%	(0.22%)	0.00%	(0.39%)	(0.16%)
2031	0.00%	(0.22%)	0.00%	(0.39%)	(0.16%)
2032	0.00%	(0.22%)	0.00%	(0.40%)	(0.17%)
2033	0.00%	(0.22%)	0.00%	(0.40%)	(0.17%)
2034	0.00%	(0.23%)	0.00%	(0.40%)	(0.16%)
2035	0.00%	(0.23%)	0.00%	(0.40%)	(0.16%)
2036	0.00%	(0.23%)	0.00%	(0.41%)	(0.16%)
2037	0.00%	(0.23%)	0.00%	(0.41%)	(0.16%)

Budget Impacts - Plans 2/3 Benefit Change Only

(Dollars in Millions)	Fiscal Year 2013	2013-2015	25-Year
General Fund-State	$0.0	($4.0)	($739.8)
Local Government	$0.0	($3.1)	($727.3)
Total Employer	$0.0	($7.7)	($1,685.1)

Note: We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.

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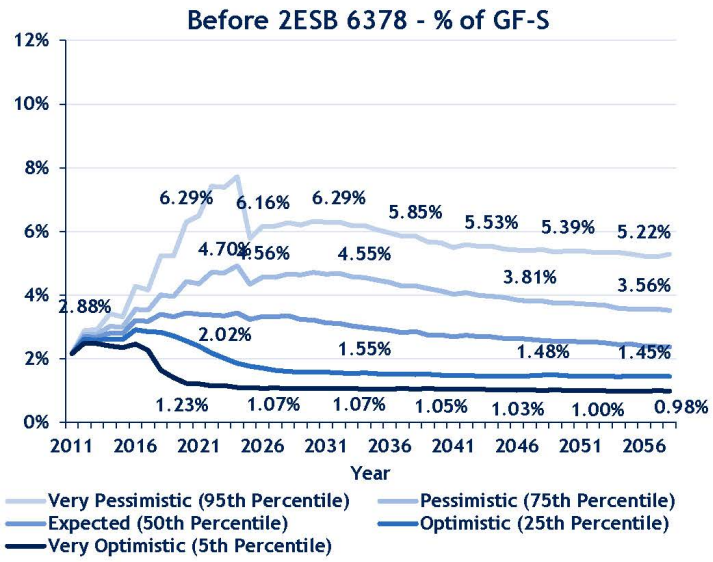
APPENDIX B – HOW THE RISK MEASURES CHANGED (FULL PROPOSAL)

Two impacts that we don't see on the scorecard shown in the body of the fiscal note include:

- **Long-Term Affordability –** Long-term affordability improves based on both the reduction of the subsidized ERFs for new hires and the increased pre-funding associated with lower ROR assumptions.
- **Current Plan 2 Member Contribution Rates –** Plan 2 member contribution rates are expected to decrease in the long-term.

The graphs below show these two impacts. Please note that the "Before 2ESB 6378" graphs include the PFC's adoption of new economic assumptions as shown in the table on page 4 of this fiscal note.

First, the percent of GF-S shows the short-term increase in cost due to the ROR assumption changes and the long-term decrease in costs associated with this bill. More specifically, the right portion of these two graphs can be compared to see the longer-term impact. Under the full range of optimistic to pessimistic scenarios, this bill will have lower costs.



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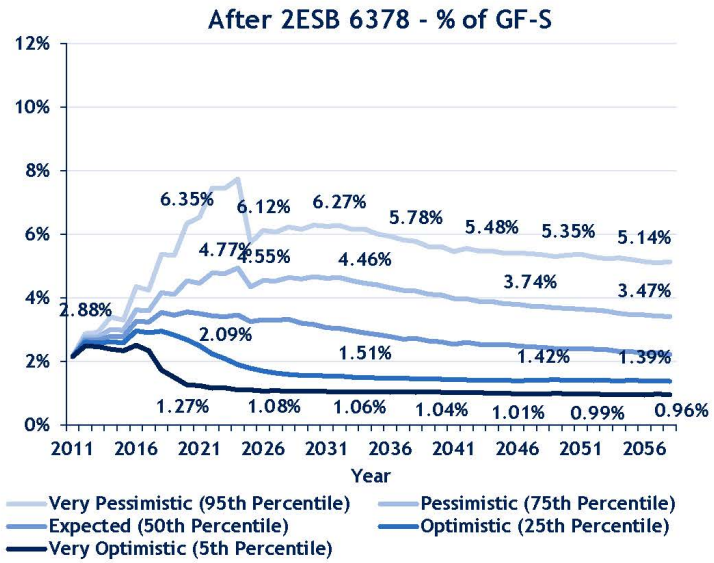

The following contribution rate graphs show how Plan 2 members will be impacted by this bill. Generally, this shows a consistent, but more thorough, analysis to what we displayed and discussed in the body of the fiscal note for the Plans 2/3 rate changes by year.

Generally, when we compare the "before" graphs to the "after" graphs, we see that PERS and TRS Plan 2 member contribution rates initially increase due to the ROR assumption changes, and then decrease in the long-term due to the reduction of subsidized ERFs for new hires and the additional pre-funding under the ROR assumption changes. These graphs produce the same general contribution rate change patterns shown on page 9 of this fiscal note. SERS has a similar impact as PERS.

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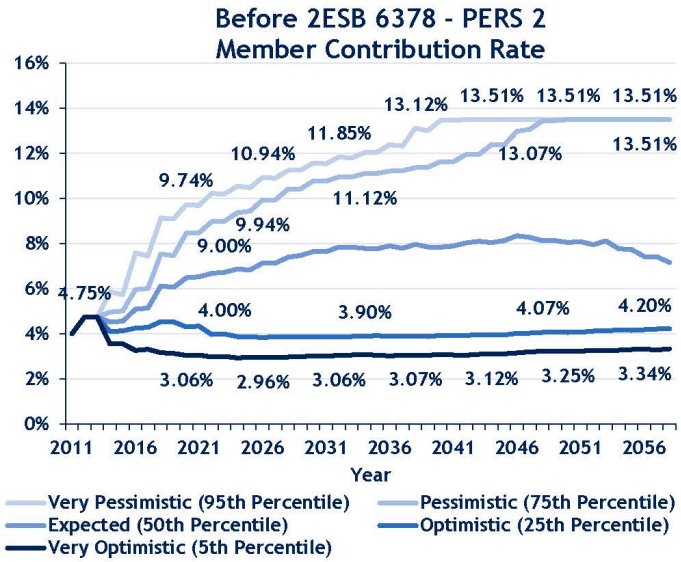

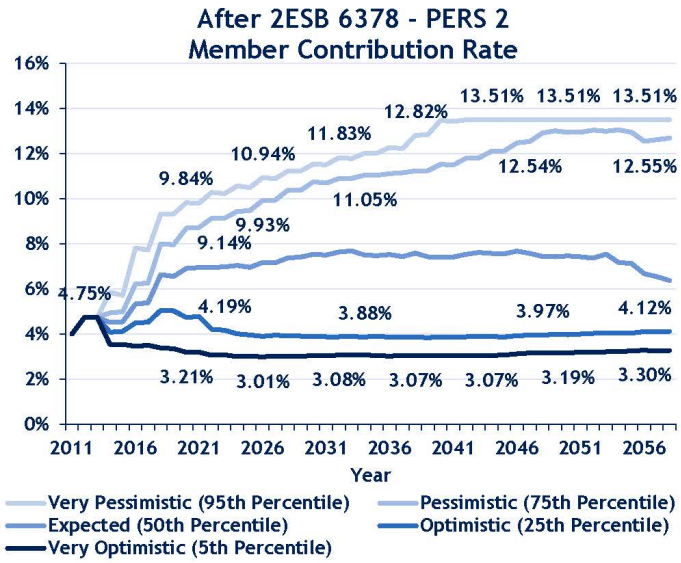

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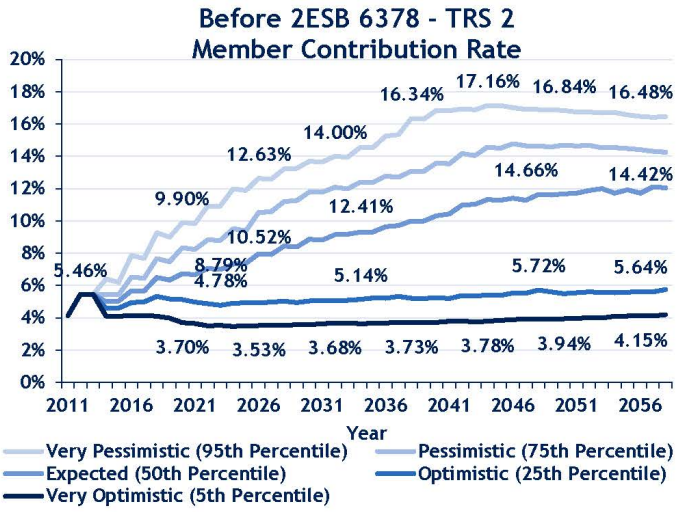
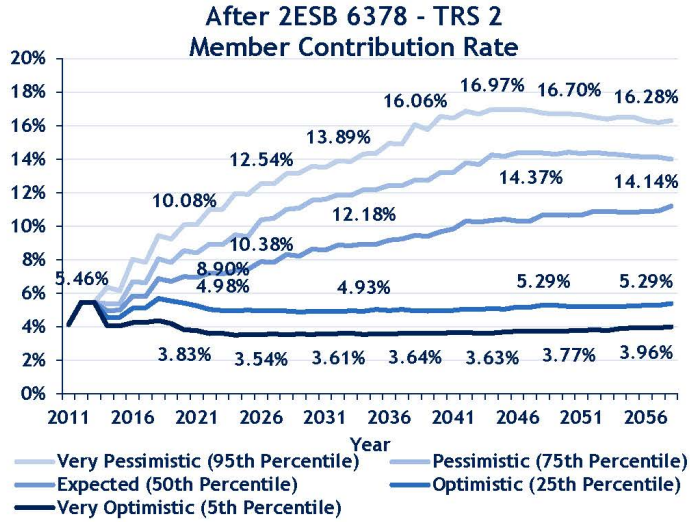


**Excludes member maximum rates under RCW 41.45.061.*



**Excludes member maximum rates under RCW 41.45.061.*

Actuary's Fiscal Note For 2ESB 6378 – Revised

APPENDIX C – ASSUMPTIONS WE MADE

In addition to the assumption changes outlined in the body of this fiscal note, we updated the new entrant profile used in our projection system for both the "base" and "pricing" projections.

In order to ensure that we ran the same new entrant population through each projection (regardless of the percent going into Plan 2 versus Plan 3), we updated our new entrant profile for this pricing. This updated new entrant profile is a weighted average of two-thirds of our current Plan 2 new entrant database and one-third of our current Plan 3 new entrant database. This updated new entrant profile in our projection system allows us to consistently project the same future members to the pension system no matter what percent goes into Plan 2 or Plan 3.

Below, we show the new entrant profiles we used for PERS, TRS, and SERS in our projections.

New Entrant Profiles											
PERS				TRS				SERS			
Age	Salary	Sex	Weight	Age	Salary	Sex	Weight	Age	Salary	Sex	Weight
24	$34,000	M	10.5%	25	$50,533	M	6.7%	24	$19,167	M	3.0%
24	$34,000	F	10.5%	25	$50,533	F	15.6%	24	$19,167	F	12.1%
29	$38,800	M	9.8%	29	$53,400	M	8.6%	29	$20,400	M	2.6%
29	$38,800	F	9.8%	29	$53,400	F	20.0%	29	$20,400	F	10.3%
34	$41,133	M	7.3%	34	$55,300	M	4.5%	34	$19,433	M	2.6%
34	$41,133	F	7.3%	34	$55,300	F	10.6%	34	$19,433	F	10.6%
39	$41,700	M	5.8%	39	$55,467	M	3.0%	39	$18,733	M	3.2%
39	$41,700	F	5.8%	39	$55,467	F	7.1%	39	$18,733	F	12.9%
44	$41,733	M	5.3%	44	$56,067	M	2.7%	44	$18,767	M	3.1%
44	$41,733	F	5.3%	44	$56,067	F	6.4%	44	$18,767	F	12.4%
49	$42,200	M	4.5%	49	$56,733	M	2.0%	49	$19,467	M	2.2%
49	$42,200	F	4.5%	49	$56,733	F	4.7%	49	$19,467	F	9.0%
57	$43,433	M	6.7%	56	$62,767	M	2.4%	57	$19,467	M	3.2%
57	$43,433	F	6.7%	56	$62,767	F	5.7%	57	$19,467	F	12.7%

Actuary's Fiscal Note For 2ESB 6378 – Revised

We changed the retirement assumptions in PERS, TRS, and SERS Plans 2/3 for members hired after May 1, 2013. We expect those members to work longer due to lower subsidized ERFs than current members. The table below displays those retirement rates.

	PERS 2/3 (SVC >= 30)				SERS 2/3 (SVC >= 30)			
	Current Rates		Pricing Rates		Current Rates		Pricing Rates	
Age	Male	Female	Male	Female	Male	Female	Male	Female
55	0.13	0.14	0.062	0.065	0.13	0.14	0.062	0.065
56	0.12	0.12	0.062	0.062	0.12	0.12	0.062	0.062
57	0.13	0.13	0.069	0.069	0.13	0.13	0.069	0.069
58	0.14	0.13	0.099	0.071	0.14	0.13	0.099	0.071
59	0.18	0.28	0.118	0.139	0.18	0.28	0.118	0.139
60	0.14	0.15	0.112	0.117	0.14	0.15	0.112	0.117
61	0.22	0.20	0.149	0.156	0.22	0.20	0.149	0.156
62	0.33	0.29	0.287	0.252	0.33	0.29	0.287	0.252
63	0.25	0.25	0.224	0.224	0.25	0.25	0.224	0.224
64	0.60	0.60	0.576	0.576	0.55	0.55	0.526	0.526
65	0.45	0.45	0.450	0.450	0.45	0.45	0.450	0.450

	TRS 2/3							
	Current Rates				Pricing Rates			
	Svc = 30		Svc >= 31		Svc = 30		Svc >= 31	
Age	Male	Female	Male	Female	Male	Female	Male	Female
55	0.24	0.21	0.15	0.13	0.097	0.081	0.069	0.055
56	0.23	0.23	0.17	0.15	0.101	0.101	0.080	0.073
57	0.25	0.25	0.18	0.16	0.115	0.140	0.088	0.105
58	0.31	0.27	0.20	0.18	0.146	0.153	0.100	0.115
59	0.38	0.29	0.21	0.24	0.182	0.166	0.108	0.144
60	0.41	0.32	0.23	0.21	0.244	0.193	0.164	0.144
61	0.48	0.43	0.24	0.24	0.277	0.260	0.169	0.174
62	0.60	0.60	0.40	0.35	0.410	0.410	0.318	0.296
63	0.50	0.50	0.30	0.30	0.346	0.372	0.249	0.274
64	0.55	0.50	0.55	0.50	0.526	0.476	0.526	0.476
65	0.50	0.45	0.50	0.45	0.500	0.450	0.500	0.450

For purposes of pricing the Plans 2/3 benefit change only (that provision by itself), we used the economic assumptions as disclosed in the AVR. For purposes of pricing the Plans 2/3 benefit change with the other provisions of this bill, we used the economic assumptions as disclosed in the body of this fiscal note.

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

Actuary's Fiscal Note For 2ESB 6378 – Revised

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 actuarial accrued liability. The normal cost is determined for the actuarial accrued 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 actuarial accrued 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) based on the PUC method.

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

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

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

Actuary's Fiscal Note For 2ESB 6378 – Revised

GLOSSARY OF RISK TERMS

Affordability: Measures the affordability of the pension systems. Affordability risk measures the chance that pension contributions will cross certain thresholds with regards to the General-Fund and contribution rates.

"Current Law": Scenarios in which assumptions about Legislative behavior are excluded. These scenarios show projections regarding the current state of Washington statutes.

Optimistic: A measurement of the pension system under favorable conditions (above expected investment returns, for example). Optimistic refers to the 75th percentile, where there is a 25 percent chance of the measurement being better and 75 percent chance of the measurement being worse. Very optimistic refers to the 95th percentile.

"Past Practices": Scenarios in which assumptions regarding Legislative behavior are introduced. These assumptions include actual contributions below what are actuarially required and improving benefits over time. These scenarios are meant to project past behavior into the future.

Pay-Go: The trust fund runs out of assets, and payments from the General-Fund must be made to meet contractual obligations.

Pessimistic: A measurement of the pension system under unfavorable conditions (below expected investment returns, for example). Pessimistic refers to the 25th percentile, where there is a 75 percent chance of the measurement being better and 25 percent chance of the measurement being worse. Very pessimistic refers to the 5th percentile.

Premature Pay-Go: Pay-go payments, measured in today's value, which might be considered "significant" in terms of the potential impact on the General-Fund.

Risk: Measures the risk metrics of the pension systems, including the chance that the pension systems will prematurely run out of assets, the amount of potential pay-go contributions, and the chance that the funded status will cross a certain threshold.

Risk Tolerance: The amount of risk an individual or group is willing to accept with regards to the likelihood and severity of unfavorable outcomes.

Attachment C

The SCPP welcomed input and comments from stakeholders throughout the study on school employee ERFs. The comments and opinions contained within the correspondence do not necessarily reflect any recommendations or opinions of the SCPP. Factual representations provided in the correspondence have not been verified by staff.

Wallis, Keri

From: The Gionet's <cgionet@earthlink.net>
Sent: Thursday, August 16, 2012 11:01 AM
To: Office State Actuary, WA; Dunshee, Rep. Hans; Hope, Rep. Mike
Subject: Teacher retirement Rule of 90

Senator Conway:
As one of the original members of TRE - Teachers for Retirement Equity - I ask you and the Select Committee on Pension Policy to revisit a true rule of 90 for one of the hardest working assets in the state of Washington - your public school teachers.

Please let me know if I may be of any assistance in this matter.

Tuck Gionet
Snohomish High School
30 years of teaching and counting!

1

Wallis, Keri

From: Richard Abrams <dick_abrams@hotmail.com>
Sent: Thursday, August 02, 2012 7:17 PM
To: Office State Actuary, WA

To: Senator Steve Conway
Select Committee on Pension Policy
From: Dick Abrams, Ph.D.

Senator Conway;

As an educator in our state for the past 34 years, I am asking that you and your committee consider passing a True Rule of 90 for retiring educators in our state. I am still working and realize that this legislation may not pass in my time, but my son and daughter are both educators in our state and I am hoping that they will continue to teach and work in our state. They know that we have the worst retirement system in the United States (only state in the Union where an educator must work until the age of 65 to receive full pension benefit), and they are actively seeking employment in other states.

I would hope that the legislature would see the benefits of improving our current system by making retirement more attractive to aging educators like myself, and having the increased ability to hire younger (and cheaper) educators and being able to keep them. Thank you for your consideration.

Dick Abrams, Ph.D.
School Psychologist/Teacher/Coach

1

Wallis, Keri

From: Jordan Sneva <stanwoodxc@yahoo.com>
Sent: Thursday, August 02, 2012 1:47 PM
To: Office State Actuary, WA
Subject: Please help....

Hello,

Please help *look at implementing a True Rule 90 for teachers. It matters and would help the economy. Please consider every kids' future and how mathematically it is financially beneficial for the state.*

Thank you,

Jordan

1

Wallis, Keri

From: cwoldies@aol.com
Sent: Thursday, August 02, 2012 12:08 AM
To: Office State Actuary, WA; Davis, Randy
Subject: Rule of 90

Good Morning. I am a former high school English teacher who retired last year after 32 years teaching in the State of Washington. It recently has come to my attention that the Select Committee on Pension Policy is in the initial stages of considering the "Rule of 90", allowing Washington State teachers to retire with full benefits when their service credit years and ages equal 90. This would benefit the taxpayers of Washington State in two ways.

First, students would benefit from a younger, more energized teaching force. Currently, the state is facing a hidden crisis in its K-12 system, one that nobody seems to be talking about.There is an entirely unique demographic shift, completely unprecedented, occurring among K-12 faculties across our state. The problem is that the teaching force is aging, and new teachers aren't able to find employment. To illustrate, when I retired following the 2010-2011 school year, there was not one teacher on our faculty of 50+ who was in his/her 20's. As teachers retire from my former school, they are either replaced by other experienced teachers within the school district or the positions go unfilled, greatly increasing class sizes.This next school year, one teacher will retire from my old school. In the following 3-5 years, it is likely that no teachers will retire, as the staff, largely made up of people in their mid 40's to mid 50's and almost entirely Plan 3 individuals, works to age 62. The net result is a steadily aging faculty, with no room for new people to be hired.The State of Washington is looking at a greater number of teachers who will be "hanging on" as they teach progressively larger classes.The effects over the next 5 years on student learning are likely to be dramatic.

The second reason why I hope you will consider the "Rule of 90" is the financial savings for the state. Older, experienced teachers are simply much more expensive that younger , less experienced teachers. Teachers at the end of their careers earn approximately twice what a beginning teacher makes. As faculties across the state continue to age, the costs for employing them continues to rise.The state, in effect, is paying progressively more for potentially less, as without question, many senior teachers, people in their late 50's and early 60's especially, are often fading in terms of performance.On this matter, I speak from personal experience. I wasn't the same teacher, simply in terms of energy, at age 61 that I was at age 41 or younger.

I hope the committee takes these thoughts into consideration and works to establish a true "rule of 90" for Washington teachers. All parties will benefit, teachers, taxpayers, and particularly students.

Conrad Wold

1

Wallis, Keri

From: Simoni, Bob <simonib@monroe.wednet.edu>
Sent: Tuesday, October 30, 2012 10:54 AM
To: Office State Actuary, WA
Subject: True Rule 90 for Teachers

In Sept, after the letters came in about Rule 90, there was discussion about the topic. Randy Parr even testified that he had research that shows it saves money. So there was some talk.....at the full committee meeting. Then at the executive committee meeting the 2 leading conservatives (***Representative Barbara Bailey** and **Senator Mark Schoesler)** did not want to hear anything about it. The discussion was effectively ended on the Rule 90 topic for the time being.

Staff that is doing the report required by legislation on "older less effective classroom employees" will be presenting a report in Nov to the full committee for approval, which then goes to legislature in Jan. The basic message of this report is that pension policy might not be the best way to deal with this issue. I was trying to tie in the rule 90 with the report and we did get it mentioned but, that is all. I have seen the draft of the report and it does no harm, might actually be useful to keep bringing the topic back up. It is suppose to be on the website somewhere but I can't find it.

Really, until we get some more militant action by any group of teachers i.e. coming and testifying, postcards, letters for an extended time and lobbying, nothing much is going to occur. It is going to take some time and long term effort but, it is hard to get younger teachers concerned about pension issues.

Please help all teachers, there is 87,000 of us and we have the oldest retirement system in the state and now we have the worst. We need to improve this to a true 90 ASAP. The Teachers in the State of Washington have had to pack this State for the last 35 years. Gov. Dan Evans borrowed from our retirement funds and then started plan 2 because the State could not repay us. Then they took 408 million again in 2007. But when all is good and everyone is making money, no one looks at paying us back or making a retirement system again. No they take furlough days, as leader of WEA we need this to be you're top priority, to get a retirement system back in place.

New teachers will leave this profession as they are required to have more certificates and they do not want to teach until the age of 65. Charter schools might be needed, as they might be able to get a retirement system in before the age of 65.

Thank you for your support.

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