Pension Merger Issue Brief

Ensure any pension merger does not create new negative impacts for cities.

In 2016 the Legislature directed a study about the possibility of merging the Law Enforcement Officers' and Fire Fighters' (LEOFF) 1 pension system and the Teachers' Retirement System (TRS) 1, as well as examining the potential merger of the LEOFF 1 and LEOFF 2 systems. The Select Committee on Pension Policy and the LEOFF 2 Board are currently working with the State Actuary to prepare a study by December 2016.

While AWC has not yet taken a position on a potential merger, we have identified several areas where more clarification is needed, and cities need assurances that any merger will not create new negative fiscal impacts.

A potential merger should not:

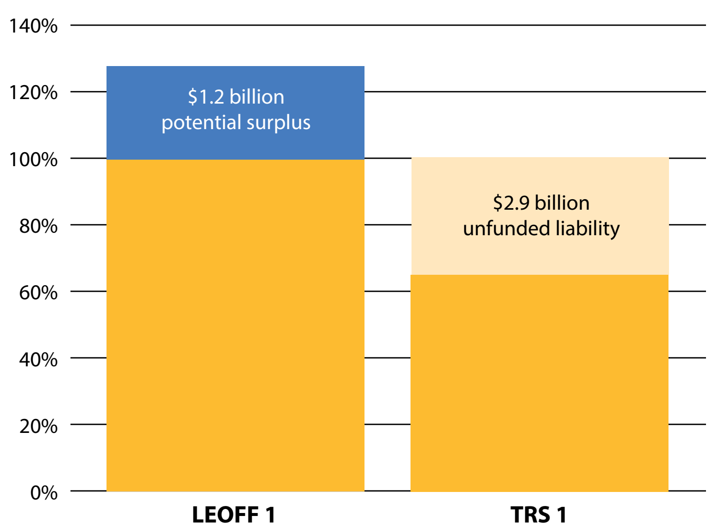
- Destabilize the LEOFF 1 system in a manner that requires new employer contributions.
- Result in any new benefits that increases employer contribution rates.

A potential merger should:

- Fully respond to legal issues and obtain IRS approval. Merging pension systems and any payouts to retirees or employers should be conditioned on final IRS approval of a merger.
- Address governance of the merged funds to ensure that employers have equal standing.

If a merger results in withdrawing surplus funds from LEOFF 1, a proportional amount of surplus funds representing the amount attributed to employer LEOFF 1 contributions (approximately 11%) should be returned to employers to help offset the costs of LEOFF 1 medical benefits.

Current pension funding status



More details

The LEOFF 1 retirement system was created by the Legislature in 1969. At that time, the state consolidated 52 municipal police and fire pension systems and transferred their existing members to the new LEOFF system. Cities and counties retained responsibility for benefits existing for "pre-LEOFF" members and their beneficiaries.

Employers and employees were both required to immediately start contributing to the new system at a rate of 6% of annual salary for members; however, the state failed to begin making significant financial contributions to the LEOFF system until 1976. The initial unfunded liability as of March 1, 1970 was estimated at $239 million, by 1974 that had grown to $400-500 million.

more details on back

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More details cont.

The reasons for the growth in unfunded liability are complex, but can be attributed at least in part to:

- Lower-than-anticipated retirement age of 50 (versus 55);
- The Legislature at the time not making the necessary contributions to the new system; and
- A higher-than-expected number of early retirements due to disability.

When the state created the LEOFF retirement system, it also required employers to provide medical benefits to retirees for necessary and reasonable medical expenses. Those benefits are defined by state law and local LEOFF 1 Disability Boards. In a 2015 report, the State Actuary estimated the current liability for providing medical benefits at about $3 billion to cover costs of approximately 7,800 eligible LEOFF 1 members. Many cities struggle with these ongoing costs, especially as the inflation rate for medical expenses is regularly in the double digits and there are few insurance options for long-term and assisted care, the most expensive part of medical care.

By 1976 it was clear that the LEOFF system as it was established in 1969 was not fiscally sustainable. The Bakenhaus Supreme Court decision of 1956 protects existing public pension benefits, making it nearly impossible to change benefits for existing members. As a result, the Legislature opted to close the LEOFF plan and create a new LEOFF 2 plan in 1977 for all police officers and fire fighters entering service. The original LEOFF plan became known as LEOFF 1.

As of June 2000 all employer, employee and state contributions to the LEOFF 1 plan were suspended. LEOFF 1 is currently estimated to be funded at 127% with a potential surplus of $1.2 billion. Under RCW 41.26.080 no additional contributions will be required of employers and employees unless the actuarial valuation shows the plan has unfunded liabilities. The State Actuary predicts that LEOFF 1 would become underfunded only in a "very pessimistic" scenario which has a likelihood only about 5% in their simulated outcomes.

While there have been occasional efforts to discuss what to do with the LEOFF 1 surplus – it is important to note that the actual surplus cannot be determined until the plan has completely closed.

There are outstanding legal issues regarding the ability to merge LEOFF 1 with either TRS 1 or LEOFF 2. Any merger would be subject to IRS approval.

The appeal of a LEOFF 1/TRS 1 merger for the state is clear – the TRS 1 plan is currently underfunded (65% funded with an estimated $2.9 billion unfunded liability) and requires significant contributions by the state. The TRS 1 plan is significantly larger than LEOFF 1. TRS 1 has 34,800 retirees and 1,025 active members while LEOFF 1 has 7,750 retirees and 120 active members.

The appeal of a LEOFF 1/LEOFF 2 merger is similar for the state in that it allows the Legislature to access the potential surplus for General Fund expenses and reduce the state contributions to the LEOFF 2 system.

Under the current LEOFF 2 system contributions are split between the employee, employer, and the state. The employee contributes 50%, employers 30%, and the state 20%. The LEOFF 2 plan has approximately 16,700 active members and 3,300 retirees.

During the 2013-15 biennium, the state contributed $114.4 million to the LEOFF 2 system. According to the 2011 merger study by the State Actuary, a merger of LEOFF 1 and LEOFF 2 could save $1.85 billion in contributions over 25 years. However, if as part of a merger proposal the Legislature removed money from the fund for other purposes, then the reduction in contributions would likely be smaller. The impact of the merger could also vary depending on whether or not the state retained its responsibility for 20% on the contributions. In a 2011 legislative proposal, the state would have reduced its contributions for a limited period of time to generate short-term savings to the General Fund.

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