

SENATE BILL REPORT

SB 6166

As Reported By Senate Committee On:
Ways & Means, March 29, 2001

Title: An act relating to termination and restatement of plan 1 of the law enforcement officers' and fire fighters' retirement system.

Brief Description: Restating plan 1 of the law enforcement officers' and fire fighters' retirement system.

Sponsors: Senators Brown, Snyder, Long, Fraser, Rossi, Constantine, Spanel, B. Sheldon and Carlson.

Brief History:

Committee Activity: Ways & Means: 3/28/01, 3/29/01 [DPS, DNP].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 6166 be substituted therefor, and the substitute bill do pass.

Signed by Senators Brown, Chair; Constantine, Vice Chair; Fairley, Vice Chair; Fraser, Kline, Kohl-Welles, Long, Regala, Rossi, B. Sheldon, Snyder, Spanel, Thibaudeau, Winsley and Zarelli.

Minority Report: Do not pass.
Signed by Senator Honeyford.

Staff: Steve Jones (786-7440)

Background: The Legislature established the Law Enforcement Officers' and Fire Fighters' (LEOFF) Retirement System in 1969 by consolidating various municipal police and fire fighter pension systems and transferring the members to the new state system. In 1977, the original LEOFF system (Plan 1) was closed to new members; subsequent employees became members of Plan 2.

The LEOFF retirement system is a defined benefit plan, whereby the plan benefits are guaranteed by statute and are not dependent on the level of employer/employee contributions or the market performance of the plan's investments. LEOFF Plan 1 has been funded by a combination of contributions from three parties: the employers (local governments), the employees, and the state (as the creator and sponsor of the plan). At the time LEOFF 1 was created, the state assumed responsibility for approximately \$100 million of unfunded liabilities from the local government police and fire pension plans. As recently as 1980, less than 25 percent of the plan's liabilities had been funded. Because of large contributions from the state and high investment returns, the assets of the Plan 1 retirement fund now significantly exceed the total actuarial liabilities of the system. All further contributions to the plan were suspended in June 2000.

Based on the most recent valuation study, the LEOFF Plan 1 Retirement Fund has current assets of approximately \$5 billion, of which approximately \$1 billion is surplus to the actuarial liabilities of the fund. The historical contribution levels to the Plan 1 fund reflect the financial obligation undertaken by the state to eliminate the large, previously unfunded liabilities: 77 percent of the fund is attributable to contributions from the state, 11.5 percent from employer contributions, and 11.5 percent from employee contributions.

Several legal principles govern the use of these surplus assets. Under federal law, the assets of a tax-qualified retirement system may be used only for the exclusive benefit of members of the system. No reversion of assets is permitted while the plan is in existence. However, once a plan is terminated, the members of the retirement system do not have an ownership interest in those assets that are surplus to the actuarial needs of the system. State and federal courts (including the U.S. Supreme Court in the 1999 *Hughes Aircraft* decision), have held that members of a defined benefit plan have a right only to the promised pension benefits and have no claim to the members' contributions or to any surplus assets.

These decisions are consistent with retirement law in Washington State. In the 1956 *Bakenhus* case, the state Supreme Court held that members of the state's retirement systems have a constitutionally protected contractual right to a secure retirement benefit, funded on a sound actuarial basis. While Washington courts have not ruled on the ownership of surplus assets, the *Bakenhus* decision is consistent with cases in other jurisdictions holding that the members' legal rights do not extend beyond the defined pension benefits. For example, the federal Court of Appeals (*Koster v. Davenport*, 8th Circuit, 1999) held that the sponsors of several fire fighter pension plans, who bore the risk of market fluctuations in the plan's investments, were entitled to enjoy the benefits of excess funding.

Summary of Substitute Bill: The Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 1 Retirement System is restructured. All members of the system are transferred to the new **Restated LEOFF Retirement System**, which includes a defined benefit plan that exactly duplicates the provisions and benefits of the old system, and a new defined contribution plan. The defined benefit component is fully funded by a transfer of sufficient assets from the old Plan 1 fund to guarantee the actuarial soundness of the new plan, with no further contributions required from employers or employees.

The remaining assets of the Plan 1 Retirement Fund, which are surplus to the actuarial needs of the defined benefit plan of the Restated LEOFF system, are distributed to three new funds:

- (1) **LEOFF Defined Contribution Retirement Plan** will fund self-directed individual retirement accounts for each member of the former LEOFF Plan 1 system. The details and investment options for this defined contribution plan will be determined by a Council of Advisors consisting of LEOFF members, both active and retired. This plan receives 12 percent of the Plan 1 surplus assets, representing the members' proportionate share of contributions to LEOFF Plan 1.
- (2) **LEOFF Medical Benefits Risk Pool** assists local governments in providing medical benefits and long-term care for LEOFF 1 retirees. It receives 12 percent of the surplus assets, reflecting the contribution level of local government LEOFF employers.

- (3) **State Surplus Assets Reserve Fund** consists of the remainder of the LEOFF Plan 1 assets, to be used to guarantee the actuarial soundness of the Restated LEOFF defined benefit plan (in case of any future adverse actuarial experience) and to provide a budget reserve fund for state government.

Substitute Bill Compared to Original Bill: The substitute bill allows the State Investment Board greater flexibility in timing the distribution of assets to meet cash flow needs and appropriate asset allocation within the state's investment pool. The substitute bill also increases the actuarial reserve requirements of the statue surplus assets reserve fund.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect on July 1, 2001.

Testimony For: The bill is a creative, equitable, and innovative method to distribute surplus assets of the LEOFF Plan 1 retirement system, without reducing the retirement benefits of any member or beneficiary. The distribution fairly reflects the state, employer, and employee contributions to the fund. The state contributed the majority of the funds, and bears the risk of the fund's investments. The medical benefits risk pool will help cities, counties, and fire districts meet the burdensome obligation of providing lifetime medical coverage and long-term care for LEOFF 1 retirees. Small jurisdictions are at the mercy of the health care costs of their retirees.

Testimony Against: Pension system funds should be used exclusively for benefits for the system members. This bill is an inappropriate raid on the pension funds, and the distribution is not equitable. The assets of the pension fund are a form of deferred compensation for the members, and they deserve a larger share of the assets. LEOFF 1 members need more time to study this proposal. Local governments agreed to assume the cost of retirees' medical care in return for the state's agreement to assume all of the unfunded liabilities of the municipal pension systems. Local governments can use existing revenue mechanisms to pay these medical costs.

Testified: Bill Vogler, Washington Assoc. of Counties (pro); Dan LaRoche, Douglas County Sheriff (pro); Jim Justin, Assoc. of Washington Cities (pro); Dick Warbrouck, Mark Curtis, and Clarence Williams, LEOFF 1 Coalition (con); John O'Brien and Ed Montermini, Retired Public Employees Council (con); Leslie Main, Washington State School Retirees Assoc. (con); Cody Arledge, Washington State Council of Fire Fighters; Bill Hanson, Washington Council of Police and Sheriffs.