LEOFF
Plan 2 Retirement Board

LEOFF 1/LEOFF 2 Merger

INITIAL CONSIDERATION

July 27, 2016

PRESENTATION GOALS

- General Principles of Plan Mergers
  - Applied to LEOFF 1/LEOFF 2
    - Background & history
  - Frequently Asked Questions
  - Question & Answer Format
  - Conversational Style

WHAT IS A "MERGER"

- One of two ways that a plan can end
  - Financial transaction with legal consequences
    - Plan assets are combined
    - Plan liabilities are combined
    - Plan benefits are unchanged
    - Analogous to a "marriage" of plans

WHAT IS A PLAN TERMINATION?

- One of two ways that a plan can end
  - Winding up of obligations
    - Any remaining liabilities are annuitized
    - Any remaining assets revert to the plan sponsor
    - Analogous to a “death” of a plan
  - Merger and termination are very different concepts

WHAT IS THE PURPOSE OF A MERGER?

- “Win-Win”
  - Investment opportunities
  - Risk mitigation
  - Funding improvements/savings

HOW WOULD A MERGER AFFECT THE STATE BUDGET?

- A plan merger can reduce required State contributions to the new plan
  - Base contributions
  - Supplemental contributions to reduce a plan's unfunded liability
  - State contributions to LEOFF 2 are approximately $130 million/biennium

WHO OWNS THE LEOFF 1 SURPLUS?

- All assets in the LEOFF 1 fund are held in trust for the exclusive benefit of LEOFF 1 beneficiaries - “Exclusive Benefit Rule”

HOW MUCH IS THE LEOFF 1 SURPLUS?

- The preliminary 2015 actuarial valuation report identifies the LEOFF 1 surplus at $1.097 billion

  <u>But</u>, 3 important variables:

  - What is the current data?
  - Market value or "smoothed" value?
  - What assumptions are used?

HOW DOES A MERGER AFFECT BENEFITS?

- A plan merger does not affect benefits
  - New plan would have 2 tiers - LEOFF 1 and LEOFF 2 - with same benefits as now
  - State law prevents reduction in benefits
  - The merger legislation may have additional sections that affect benefits

IS A MERGER LEGAL?

State Law Issues

- Benefits are protected
  - Benefit reduction protections – Bakenhus
  - Plan funding protections - Weaver

IS A MERGER LEGAL?

Federal Law Issues

- Public plans must be “qualified” in order to receive favorable tax treatment
  - Qualification requires IRS review and approval
  - Qualification provides tax benefits and bankruptcy protection

WHAT ARE THE RISKS FROM A LEOFF 1/LEOFF 2 MERGER?

- Re-emergence of LEOFF 1 unfunded liability
  - Decrease in future funding increases risk
- Risk transfer to LEOFF 2 members
  - Can mitigate this risk in legislation
- Other changes included in legislation

DOES A LEOFF 1/LEOFF 2 MERGER AFFECT PLAN GOVERNANCE?

- A merger does not need to affect current pension plan governance
  - LEOFF 2: LEOFF 2 Board
  - LEOFF 1: SCPP and PFC

- LEOFF 1 disability boards are unchanged by a merger of LEOFF pension plans

HOW DOES A MERGER AFFECT PLAN FUNDING?

- A merger may change both the short-term and long-term needs of the plan
  - The funding ratio of the merged plan may differ from the original plans
    - Required contributions may change
  - The normal cost of the benefits in the merged plan is not different
    - Payout schedule may change

HOW DOES A MERGER AFFECT INVESTMENT POLICY?

- A LEOFF 1/LEOFF 2 merger would not affect investment policy
  - Both plans are administered by the Washington State Investment Board
    - Both plans are currently invested in the Commingled Trust Fund
  - Merger of LEOFF 1 with open plan might address some LEOFF 1 risks

NEXT STEPS

- The next presentation is scheduled for September 21, 2016
  - The presentation will cover the same topic areas as this presentation
  - Specific information and analysis will be provided related to LEOFF Plan 2

QUESTIONS

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