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Public Policy

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LONG-TERM DISABILITY BENEFITS OF MEMBERS OF THE PUBLIC EMPLOYEE, TEACHER, AND SCHOOL EMPLOYEE RETIREMENT SYSTEMS: FOLLOW-UP STUDY

BACKGROUND

In 2009, the Legislature directed the Washington State Institute for Public Policy (Institute) to study and make recommendations regarding disability benefits available to members of Washington State's Public Employees', Teachers', and School Employees' Retirement Systems (Plans 2/3).[1]

The 2009 study identified instances where Plans 2/3 members experience relatively low total benefits compared with other retirement plans, and provided recommendations to improve long-term disability (LTD) insurance options for public employees. It also identified areas of further investigation: the fiscal impacts of providing an enhanced disability benefit through the retirement system and requests for information to the insurance industry for products that may improve disability retirement income for affected Plan members.

The 2010 Legislature directed the Institute to continue the study of long-term disability benefits for public employees and further develop the options identified in the Institute's 2009 report, including options related to the Public Employees Benefits Board (PEBB) programs, other LTD insurance proposals, and the Plans 2/3 retirement system.[2] This report summarizes the findings and recommendations of the 2009 Institute report and

- Describes implementation efforts of the Health Care Authority regarding enhanced education, changes to PEBB LTD products, and their investigation of new LTD products;
- Describes statutory changes and fiscal impacts associated with providing enhanced disability benefits to Plans 2/3 members; and
- Discusses policy advantages and disadvantages for insurance and pension options.

Summary

Early disability retirement pensions for Plans 2 and 3 members of the state's Public Employees', Teachers', and School Employees' Retirement Systems, can be considerably smaller than benefits provided by other public employee retirement systems. Due to the Plans' earned benefit structure, members retiring early due to disability may incur potentially large actuarial reductions to their monthly benefits. Replacement income through optional long-term disability (LTD) insurance is available to most Plan members but only 40 percent enroll. Additionally, LTD insurance is not uniformly available to all Plans 2/3 members in smaller jurisdictions.

In 2009, at legislative request, the Washington State Institute for Public Policy (Institute) provided recommendations to improve LTD insurance coverage. The recommendations included the following: enhance Public Employees' Benefits Board (PEBB) communication with new hires to increase enrollment in LTD coverage; examine specific options to increase or expand PEBB LTD coverage; and, issue a Request for Information to the private insurance market for an LTD product that would cover all public employees (not just members of PEBB). The Institute also recommended a fiscal analysis of statutory changes to the pension system that would improve Plans 2/3 disability retirement benefits.

The Health Care Authority (HCA), over the 2010 legislative interim, instituted an improved communication program for new hires including a web-based informational video and newsletter. HCA is undertaking an effort to determine the feasibility of either providing a one-time open enrollment period for PEBB's Optional LTD or increasing PEBB's employer-paid Basic LTD maximum benefit. They are also investigating the feasibility of offering LTD insurance to *all* Plans 2/3 members (not just the third of Plan members in PEBB). HCA will issue a report on these analyses in 2011.

The Office of the State Actuary (OSA) estimated fiscal impacts of providing an enhanced disability benefit within Plans 2/3 for individuals with more than 10 years of service. Under the proposal, the $1,000 monthly disability benefit of a qualifying member aged 40, with 15 years of service, would be increased to $2,273 (or to $2,667 for a 50-year-old member with 25 years of service). The OSA estimates the 2011–13 biennial budget impacts of this proposal at approximately $15.1 million (General Fund--State), $45.2 million (total employer), and $27.2 million (total employee), with average budget impacts of a similar magnitude in subsequent biennia. An enhanced benefit would also increase the number of disability retirement applications and the need for fraud prevention associated with higher disability benefits, imposing additional administrative costs on the Department of Retirement systems.

Suggested citation: Jim Mayfield (2010). *Long-term disability benefits of members of the public employee, teacher, and school employee retirement systems: Follow-up study.* Olympia: Washington State Institute for Public Policy, Document No. 10-11-4101.

[1] Laws of 2009, ch. 564, § 105 (2); (ESHB 1244)
[2] Laws of 2010, ch. 37, § 105 (3); (ESSB 6444)

Disability Retirement in PERS, TRS, and SERS Plans 2 and 3

The following section describes the membership and benefit structures of Plans 2 and 3 of Washington State's Public Employees', Teachers', and School Employees' Retirement Systems. We describe the early retirement disability benefits offered through these pension plans and provide comparisons with disability retirement benefits offered by other Washington State retirement systems and a sample of peer states.

Who Are Plans 2 and 3 Members?

The six largest retirement systems administered by the Washington State Department of Retirement Systems (DRS) are the following:

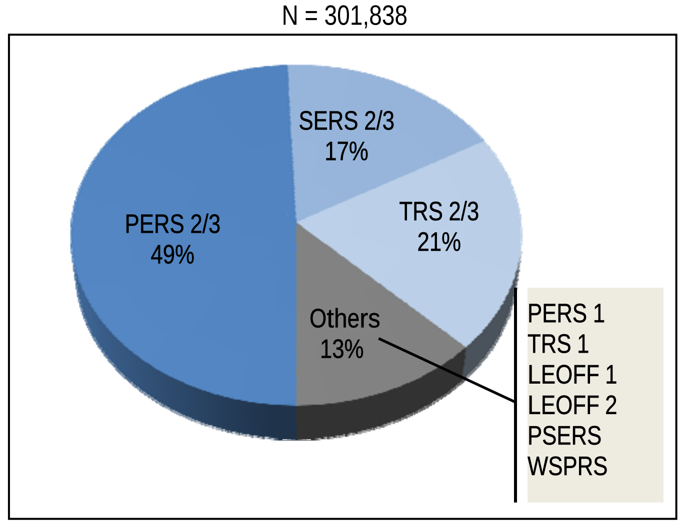
- **PERS:** Public Employees' Retirement System (Plans 1, 2, and 3)
- **TRS:** Teachers' Retirement System (Plans 1, 2, and 3)
- **SERS:** School Employees' Retirement System (Plans 2 and 3)
- **PSERS:** Public Safety Employees' Retirement System
- **LEOFF:** Law Enforcement Officers' and Fire Fighters' Retirement System (Plans 1 and 2)
- **WSPRS:** Washington State Patrol Retirement System.

The primary focus of this study is early disability retirement benefits available to members in Plans 2/3 of PERS, TRS, and SERS. The following public employees are eligible for these plans:[3]

- PERS 2 and 3: employees of state agencies, counties, and municipalities (excluding Tacoma, Seattle, and Spokane); non-teaching staff in public higher education; employees of public utilities, fire, health, irrigation, port, water, and other public service districts; and judges.
- SERS 2 and 3: classified employees in public schools, school districts, and Educational Service Districts.
- TRS 2 and 3: certified teachers, administrators, and educational staff at public schools, school districts, and Educational Service Districts.

[3] RCW 41.32, 41.35, and 41.40

Exhibit 1
Public Retirement Systems' Active Membership as of 2009

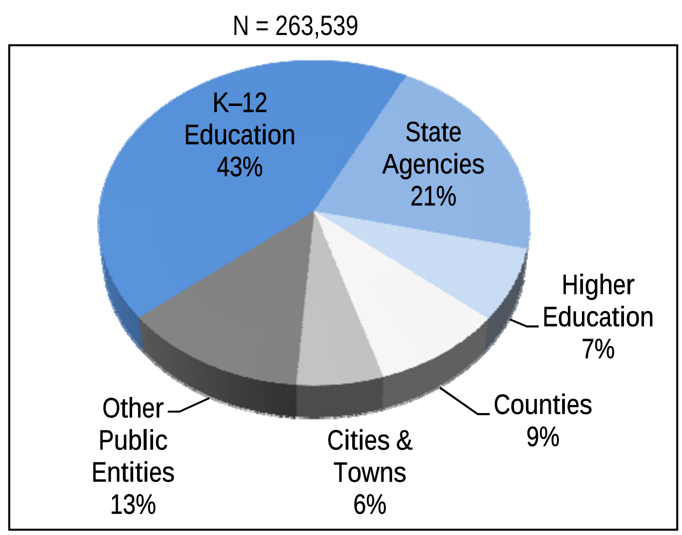


WSIPP, 2010

Over 263,500 members were covered by Plans 2/3 in 2009, or 87 percent of the active membership in Washington State's public employee retirement systems (Exhibit 1). The largest, PERS 2 and 3, represented 49 percent of active members.

Public education (K–12) had the most members within Plans 2/3 (43 percent, Exhibit 2), followed by state agencies, which employed 21 percent of active Plans 2/3 members.[4]

Exhibit 2
PERS, TRS, and SERS Plans 2 and 3 Active Membership by Employer (2009)



WSIPP, 2010

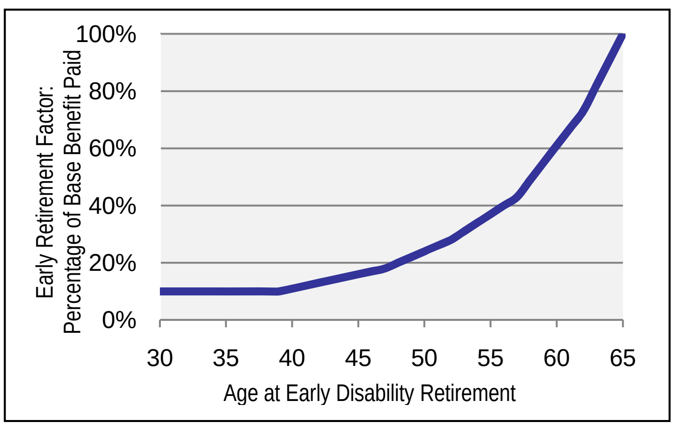
[4] Office of the State Actuary (2010). *Washington State 2009 actuarial valuation report.* Olympia, WA: Author.

What Are Early Disability Retirement Benefits for Plans 2 and 3 Members?

Members of Plans 2/3 are eligible for early disability retirement payments if they become "totally incapacitated for continued employment" by a plan employer and leave employment due to the disability.[5] The disabling illness or injury does not need to be duty-related, and there are no minimum years of service required to qualify for a benefit. Plan members who stop working due to disability apply to DRS, which then determines eligibility.

The amount of Plans 2/3 disability benefits members receive is a function of age, salary, service credits, and the system in which the individual is enrolled. Considered an *earned* benefit, the size of a disability retirement payment under Plans 2/3 is based on the benefits earned up to the time an employee leaves employment due to the disabling injury or illness. For Plan 2 members, the *base benefit* amount is calculated at .02 (.01 for Plan 3) times the number of service credit years times the average final compensation (AFC).

Exhibit 3
Early Retirement Factors for Plans 2/3 Members With Less Than 30 Years of Service Credit



WSIPP, 2010

Because early disability retirements occur prior to the Plans 2/3 retirement age of 65, benefits are actuarially reduced using an Early Retirement Factor (ERF) to account for the longer payout period over the employee's remaining lifetime (Exhibit 3). The actuarial reduction can result in a low monthly benefit relative to other retirement systems, particularly for Plans 2/3 members with fewer than 30 years of service credit.[6]

At age 65, members receive their full retirement benefit (the ERF is 100 percent). The disability retirement benefit for someone retiring at age 50 with fewer than 30 years of service, however, is reduced to 24 percent of the individual's base amount; the benefit is reduced to 10 percent of the base if the individual retires at age 39 or younger (Exhibit 3).

The monthly retirement disability benefit for a Plans 2/3 member retiring due to a disability is calculated as follows:

Calculating Early Disability Retirement For Plans 2 and 3

Plans 2 Monthly Benefit	= .02	x	Years of Service	x	Average Final Compensation	x	Early Retirement Factor
Plans 3 Monthly Benefit[7]	= .01	x	Years of Service	x	Average Final Compensation	x	Early Retirement Factor

To illustrate the potential effect of the actuarial reduction in disability retirement benefits, we calculate the benefit for a hypothetical case of a 50-year-old Plans 2/3 member, with 20 years of service, and an AFC of $4,000 per month (Exhibit 4). After accounting for years of service and actuarially adjusting for the number of years prior to retirement age, the maximum monthly benefit would be $384 and $192 for a Plan 2 or Plan 3 member, respectively.[8]

[5] This "occupational disability standard" is less strict than the Social Security "total disability" standard. The primary difference is the ability to perform duties material to an individual's occupation versus any gainful employment.

[6] Members with 30 or more years of service credit may retire as early as age 55. Their benefits are reduced by a smaller amount than members retiring with less than 30 years.
[7] Plans 3 members have access to the accumulations in their defined contribution accounts.
[8] Members may receive a lump sum cash amount if monthly payments are $50 or less.

Exhibit 4
Monthly Disability Retirement for a 50-Year-Old Member of Plans 2 or 3

Benefit Plan	20 Years' Service Credit Plans 2	Plans 3*
Age	50	50
Average Final Compensation	$4,000	$4,000
Years of Service	20	20
Base Percentage	0.02	0.01
Base Benefit	$1,600	$800
Early Retirement Factor	0.24	0.24
Actuarially Adjusted Benefit	$384	$192

*Plans 3 members can also access their accrued contributions.

As of 2009, there were 2,092 disability retirements in Plans 2/3 (Exhibit 5). The average age at retirement was just under 57, and the average monthly benefit was $387. Those with disability retirements averaged 13.3 years of service credit and were earning an average final compensation (AFC) of $2,862 before their disability.[9]

Exhibit 5
Plans 2/3 Disability Retirements as of June 2009

	Total
Number of Retirements	2,092
Average Age at Retirement	56.8
Average Years Retired	7.3
Average Years Service	13.3
Average Final Compensation	$2,862
Average Monthly Benefit	$387

Source: Office of the State Actuary.

How Do Plans 2 and 3 Disability Retirement Benefits Compare With Other Washington State Retirement Systems?

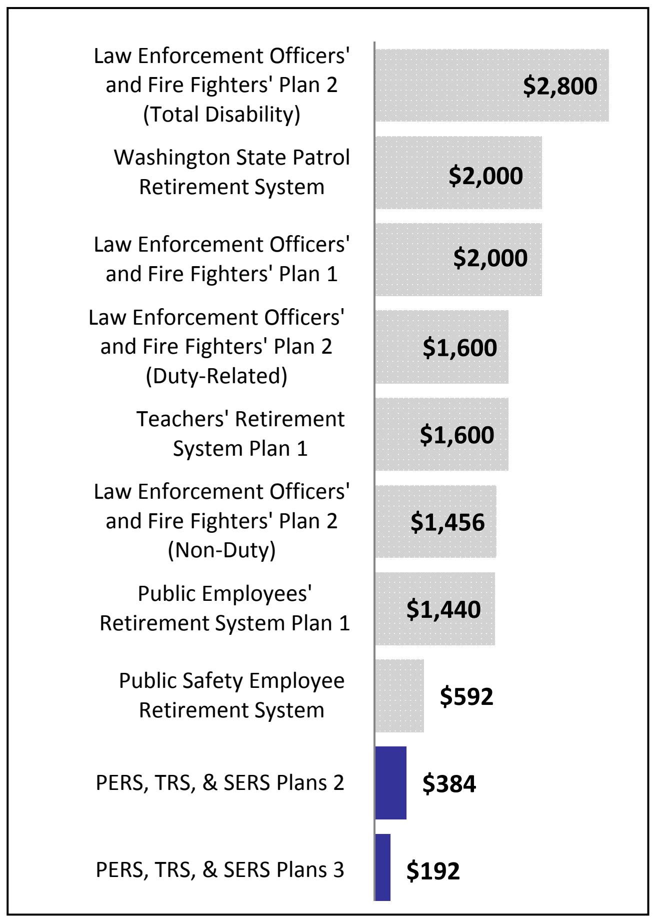
The payout associated with an early disability retirement depends on a number of factors. One such factor is the benefit structure of the retirement system. Various plans provide *guaranteed* benefit amounts, *enhanced* benefits, or *earned* benefits.

Guaranteed benefit systems provide members with a fixed percentage of their salaries. Earned disability benefits, as described earlier, take service credit years and early retirement factors into account. Enhanced benefits are not subject to the actuarial adjustments of earned benefit plans.

The other benefit systems available in Washington State (besides PERS, TRS, and SERS Plans 2/3) use guaranteed or enhanced benefit structures; therefore, these other systems tend to provide larger monthly disability retirement benefits (Exhibit 6) than the actuarially reduced *earned* benefits provided to members of Plans 2/3.

Enhanced disability benefits under PERS 1 and TRS 1 are not reduced as much as the *earned* benefits under Plans 2/3. If the hypothetical 50-year-old Plan 2 member in the previous example had been a member of PERS 1, the monthly disability retirement amount would have been $1,440 instead of $384.

Exhibit 6
Monthly Disability Retirement Benefits by System for 50-Year-Old With 20 Years Service Credit and $4,000 Final Average Monthly Salary



WSIPP, 2010

Note: These examples are simplified for expository purposes. More detailed descriptions of disability benefits by plan are provided in Exhibit 7.

[9] Email from Darren Painter, Senior Policy Analyst, Washington State Office of the State Actuary November 2, 2010.

Members of LEOFF 1 receive a *guaranteed* disability benefit, which provides members a fixed percentage of salary. Regardless of age or years of service, LEOFF 1 members receive 50 percent of their Final Average Salary (FAS) if eligible for disability retirement; in the hypothetical case, $2,000 per month. LEOFF 2 provides a combination of earned, enhanced, and guaranteed benefits to members depending on the type of disability: non-duty, duty-related, or total disability.

Disability retirement benefits for the Plan 2 member in our previous example replace only 10 percent of that member's pre-disability earnings, compared with 36 to 70 percent replacement in other Washington State retirement systems.

Exhibit 7
Disability Retirement Benefits by Washington State Retirement System and Plan

Plan	Disability Retirement Benefit Based on . . .
PERS, TRS, SERS 2 and 3	Years of service and Average Final Compensation (AFC), actuarially reduced from age 65.
PERS 1	Duty: the lesser of 2/3 of AFC or $4,200 per year. Converts to service retirement allowance at age 60 with service credited for disability period. Offset by workers' compensation. Non-duty: Earned benefit reduced 2 percent per year under age 55.
TRS 1	Permanent Disability: Service retirement if eligible (30 years service; age 60 or older with five or more years service; or age 55 or older with 25 years of service); or 2 percent, times AFC, times service credit years. May also be eligible for a refund of member contributions plus accrued interest. Temporary Disability: Allowance of $180/month for up to two years.
LEOFF 1	50 percent of Final Average Salary (FAS), plus 5 percent of FAS for each child, not to exceed 60 percent of FAS.
LEOFF 2	Total Duty: 70 percent of FAS, with offsets, not to exceed 100 percent of FAS. Duty: 10 percent of FAS, plus 2 percent of FAS for each year of service beyond five. Non-duty: Earned benefit, actuarially reduced from age 53.
PSERS	Years of service and AFC, actuarially reduced from age 60.
WSPRS	Duty: 50 percent of final compensation, offset with workers' compensation. Non-duty: 50 percent of final compensation, Social Security, group insurance, and other pensions. Earnings offsets if under age 50.

Source: Office of the State Actuary (2008, September). *2007 actuarial valuation report*. Olympia, WA: Author.

How Do Plans 2 and 3 Disability Retirement Benefits Compare With Other States?

In a previous analysis of this issue, the Office of the State Actuary examined the structure of retirement systems in other states and the City of Seattle.[10] The analysis revealed that the actuarial adjustment that reduces monthly disability retirement benefits in Plans 2/3 is not a common practice in the other retirement systems. Consequently, monthly disability benefits in those other public systems are a larger percentage of the workers' final compensation than under Washington State's Plans 2/3.

Of the systems examined, all provide guaranteed or enhanced benefits for employees retiring early due to disability (Exhibit 8). In each case, employees in these other systems would receive higher monthly disability retirement benefits than those in Washington's Plans 2/3.

- California, Missouri, and Ohio TRS provide a guaranteed benefit set to a specific percentage of the employee's salary at the time of the disability retirement;
- Iowa and Minnesota provide a benefit without reduction for early retirement;
- Florida, Ohio PERS, and Seattle provide a benefit without reduction and set a fixed percentage for minimum benefits; and
- Colorado, Idaho, Oregon, and Wisconsin provide what the employee would have earned had he or she worked to retirement age.

Five of the systems examined offset benefits with workers' compensation. Several of these states—California, Colorado, Missouri, and Ohio—do not withhold Social Security for public employees, a factor that influences the level of pension benefits.

Eight of the comparative systems use an occupational disability standard, similar to Plans 2/3, for determining disability. Four states use the stricter Social Security total disability standard; four systems have minimum service requirements for non-duty disabilities; and one system provides different disability retirement benefits for duty and non-duty disabilities.

Exhibit 8

Benefit Structure for Early Disability Retirements in Other State and City Pension Systems

	Benefit Structure		
	Guaranteed	Enhanced	Earned
State/City	Fixed Percentage of Employees' Salary	No Reduction for Early Retirement	Reduced for Early Retirement
Washington Plans 2/3			✓
California	✓		
Colorado		✓	
Florida		✓	
Idaho		✓	
Iowa		✓	
Minnesota		✓	
Missouri	✓		
Ohio PERS		✓	
Ohio TRS	✓		
Oregon		✓	
Wisconsin		✓	
City of Seattle		✓	

[10] Select Committee on Pension Policy (2009). *Disability benefits.* Olympia, WA: Author.

LONG-TERM DISABILITY INSURANCE FOR MEMBERS OF PLANS 2 AND 3

In addition to disability retirement benefits discussed in the previous section, long-term disability (LTD) insurance is available to most Plans 2/3 members. LTD insurance provides employees additional protection against lost wages resulting from long-term or permanent injury or illness. Insurance-based LTD benefits are available to Plans 2/3 members through the Public Employees Benefits Board (PEBB) or through other benefit plans offered by their employers.

All state agency employees and higher education staff in Plans 2/3 are covered by the PEBB Basic employer-paid LTD insurance. They also have an option to purchase additional coverage through the PEBB Optional LTD group insurance. PEBB LTD is underwritten by The Standard Insurance Company.

Other Plans 2/3 employers, such as counties, cities, school districts, and other local government entities, may apply for PEBB benefits or provide their own benefit package, including LTD coverage. Given the earned benefit structure of Plans 2/3, LTD insurance is a potentially important source of replacement income for Plans 2/3 members who retire early due to a disability.

Public Employees Benefits Board Basic and Optional LTD Insurance Coverage

What are LTD benefits with PEBB and how much do they cost? Plans 2/3 members employed by a PEBB-participating employer receive Basic LTD insurance at no cost to the employee. This plan pays, after deductions, $50 to $240 per month. The Optional LTD ensures a maximum benefit of 60 percent of the first $10,000 in pre-disability earnings per month after deductions ($100 per month minimum).[11] Deductable income sources include benefits from Social Security, retirement disability, and workers' compensation.

Employers enrolled in PEBB pay $2 per month per employee for Basic LTD coverage.[12] Benefits under both the Basic and Optional LTD insurance are subject to waiting periods (subject to accumulated sick leave): 90 days after disability for the Basic LTD and 30 to 360 days for the Optional LTD as determined by the employee. Monthly payroll premium deductions for the Optional LTD are based on the waiting period selected by the employee (Exhibit 9).

Exhibit 9
Monthly PEBB Optional LTD Premiums (percentage of earnings)

Benefit Waiting Period	Higher Education Retirement Plan Employees	Plans 2/3 Employees
30 days	2.48%	1.96%
60 days	1.26%	1.04%
90 days	0.69%	0.57%
120 days	0.40%	0.34%
180 days	0.30%	0.27%
240 days	0.29%	0.26%
300 days	0.27%	0.24%
360 days	0.26%	0.23%

Source: PEBB

The Plans 2/3 employee in our ongoing example who earns $4,000 per month working for a state agency would pay a monthly premium of $78.40 if electing a 30-day disability waiting period or $9.20 if electing a waiting period of 360 days. If permanently disabled and unable to perform duties for which the member is reasonably qualified, the member would receive a maximum benefit (from all sources) of $240 per month under Basic LTD and $2,400 per month if covered by both the Basic and Optional LTD.

According to a survey of other state LTD plans, only Washington offers a Basic (employer-paid) and Optional (employee-paid) LTD benefit.[13] Washington's Basic LTD through the PEBB is well below the market in terms of the monthly benefits paid. The PEBB Optional LTD coverage, however,

[11] Plans 2/3 members electing optional coverage are also eligible for retirement supplement benefits if they have five or more years of employment with a Plan employer. These benefits contribute to the employee's retirement during the period of disability.

[12] The Standard Insurance Company (2008, May 7). *2009 employee benefits renewal for Washington state*. Portland, OR: Author.

[13] The market study was conducted by the benefit consulting firm, Mercer. Ten of the states examined are the "peer" states used for comparisons by the Office of the State Actuary. Two additional states, Illinois and Pennsylvania, were added to the survey to provide a larger sample.

is comparable to those offered by the other states examined in the analysis.[14]

What Is the Disability Standard for the PEBB LTD Insurance? Disability standards for PEBB LTD change over time and have more limitations than standards used for Plans 2/3 early disability retirements. During the waiting period and for the first 24 months of disability, the PEBB-covered employee must have an injury or illness rendering the individual unable to perform "with reasonable continuity the material duties" of their own occupation. After 24 months, the disability standard becomes stricter. The employee must be unable to perform the duties associated with *any* gainful occupation for which the plan member is reasonably qualified (based on education, training, and experience).

Additionally, PEBB LTD plans do not provide benefits for mental, emotional, behavioral, or stress-related disabilities after 24 months (unless the employee is hospitalized). Assuming no other limitations are in effect, benefits continue until the employee is (1) no longer disabled, (2) reaches a maximum benefit period (12 to 42 months, determined at the age when disability began), or (3) reaches the age of 65.

Who signs up for Optional LTD coverage? All employees of PEBB-covered employers are automatically enrolled in the PEBB Basic LTD plan. New employees have 31 days to elect coverage in the Optional PEBB LTD plan without providing proof of insurability. According to the Washington State Health Care Authority, 60 percent of eligible Plans 2/3 employees do not sign up for the Optional LTD coverage.

If an employee does not enroll in the Optional LTD, there is no guarantee he or she may enroll later. After the initial 31-day grace period, employees must provide The Standard Insurance Company evidence of insurability if they wish to enroll in PEBB's Optional LTD coverage. Of the 7,070 evidence-of-insurability claims submitted from 2003 through 2007 by employees seeking to add Optional LTD coverage or change their waiting periods, 37 percent were declined.[15]

Who Has Access to PEBB LTD Benefits? All state agency and higher education employees who are members of Plans 2/3 (Exhibit 1) are automatically enrolled in the employer-paid PEBB Basic LTD and are eligible for the PEBB Optional LTD insurance.

The PEBB benefit package is available to all eligible Plans 2/3 employers (cities, counties, school districts, public utility districts, etc.).[16] Employers must purchase the full package of PEBB benefits, including medical/vision, dental, life, and LTD; and, their enrollment is subject to Health Care Authority (HCA) approval. Most municipalities, counties, school districts, and other public employers are not members of PEBB:[17]

- **School Districts in PEBB.** There are 295 school districts and nine Educational Service Districts in Washington State. Of these, 50 mostly smaller districts were enrolled in a PEBB with LTD insurance in 2009.
- **Other Public Employers in PEBB.** There are over 708 public employers (including 281 municipalities and 39 counties) potentially eligible to enroll in PEBB. Of these, 174 were enrolled in PEBB with LTD insurance in 2009, including two smaller towns. No counties were enrolled.[18]

Non-PEBB LTD Insurance Coverage Provided by Other Public Employers

The majority of municipalities, counties, school districts, and local public employers in Washington State are not members of PEBB; rather, they provide their own employer- or employee-paid LTD insurance. With few exceptions, these plans are similar in most respects (waiting periods, premiums, and benefits) to PEBB's Optional LTD insurance.[19]

Non-PEBB School Districts. Of the 245 school districts not enrolled with the PEBB, 72 have group disability plans provided directly through The Standard Insurance Company.[20] According to the

[14] Ralph Trieselmann & Angela Bui (2009, September). *Washington state institute for public policy long term disability benchmarking*, Seattle: Author.
[15] The Standard Insurance Company.

[16] All eligible employers are described in WAC 182-12-111.
[17] Jim Mayfield (2009). *Long-term disability benefits of members of the public employee, teacher, and school employee retirement systems*. Olympia: Washington State Institute for Public Policy, Document No. 09-11-4101.
[18] Source: Washington State Health Care Authority
[19] Mayfield, 2009
[20] Ryan Woodland, Consultant, National Accounts, The Standard Insurance Company. For proprietary reasons, Standard did not disclose the districts with which it carries insurance.

Washington Education Association (WEA), most districts with over 500 employees provide their own employer-paid LTD coverage, primarily through Standard.[21] The remaining districts use a combination of employer/employee-paid LTD.

Smaller school districts tend to offer voluntary LTD coverage (10 to 35 percent of employees elect this coverage). Other smaller districts (about 10 to 15 percent of all districts) offer only LTD coverage with maximum benefits of 40 percent of pre-disability earnings (compared with 60 percent provided in the PEBB Optional LTD).[22]

Non-PEBB Public Employers. According to the most recent statewide survey, 97 cities and 20 counties pay all or part of the LTD insurance premium for their largest group of non-uniformed employees. The remaining cities or counties in Washington may offer employees access to a group plan into which eligible employees voluntarily enroll.

Much of the LTD insurance for Washington cities and counties is through products underwritten by Standard. Standard estimates that roughly 150,000 public employees are covered under their LTD plans, in addition to those covered under PEBB.[23] There are approximately 478,000 state and local government employees in Washington State.[24]

For this report, it was not possible to report, precisely, on the LTD coverage available to all public employees. According to employee association representatives, most city and county employees have access to some form of employer-paid or employee-paid group LTD coverage comparable to that provided through PEBB. Responses to telephone and email inquiries conducted for a previous study, however, confirmed that there are small jurisdictions and agencies in which an employee's only option for LTD insurance is in the private, individual LTD insurance market. Group LTD insurance is unavailable to a relatively small, but unknown, number of Plans 2/3 members.

What if the Employer Does Not Provide an LTD Plan? Individual plans on the private market are available. Rates for individual plans vary according to age, health, occupation, and policy features, such as waiting periods and maximum benefit amounts. Plans are purchased through financial planners, life insurance agents, or sometimes, mortgage companies.

Individual plans offer more flexibility and can be locked in for the working career. Individual plans, however, are more expensive than group plans. The average annual premium for a group LTD policy in 2008 was $238 per person, while an individual plan may cost an employee as much as $2,000.[25] Also, the person seeking coverage must demonstrate insurability, unlike group plans that usually offer grace periods for new employees.

[21] The WEA also offers its own group LTD plan underwritten by American Fidelity.
[22] Randy Parr, Washington Education Association
[23] Ryan Woodland, The Standard Insurance Company
[24] Washington State Employment Security Department (2009). *Employment situation report for June*. Olympia, WA: Author.

[25] JHA. 2*008 U.S. group disability market survey summary report.* Available from: http://www.genre.com/sharedfile/pdf/GDMS200904-en.pdf; and Insure.com (2008, November 26). *The basics of long term disability insurance*. Available from: http://www.insure.com/articles/disabilityinsurance/long-term-disability.html.

WORKERS' COMPENSATION AND SOCIAL SECURITY DISABILITY INSURANCE

Other possible sources of income replacement for disabled Plans 2/3 employees include workers' compensation for work-related disabilities, and Social Security Disability Insurance (SSDI), for a total disability expected to last more than one year.

Workers' Compensation for Duty-Based Disability. Members of Plans 2/3 who become unable to work as a result of a work-related injury or occupational illness may be eligible for workers' compensation though the Washington State Department of Labor and Industries.[26] If a doctor certifies that a member is unable to work as a result of a work-related injury or illness, that member is eligible for Labor and Industries' "time-loss benefits." Time-loss benefits are 60 to 75 percent (depending on marital status and number of dependents) of a worker's gross income at the time of the disability. Time-loss payments cannot exceed 120 percent of the annual average wage in Washington State ($55,507 in 2008).[27] These benefits are tax free**.**

Time-loss payments continue until the employee is able to return to work. If, based on medical and vocational reports, an injury or illness results in a permanent inability to work (including loss of multiple limbs or sight), an employee may receive a monthly pension for life.[28] This permanent total disability award is equal to the time-loss payment to which the employee was entitled. If the employee is also receiving Social Security disability, payments may be reduced to meet the maximums allowed under federal law.

In addition to time-loss payments, workers may also be awarded compensation for permanent partial disabilities for loss of specific bodily functions. Permanent partial disability awards may be deducted from any future total disability pension related to the same disability.

If disabled and receiving a time-loss benefit, the example employee earning $4,000 would receive monthly workers' compensation payments ranging from about $2,700 to $3,400, depending on marital status and number of dependents (this example assumes no Social Security income offsets). The award calculation is based on gross income (plus employer-paid health benefits).[29]

As many as 95 percent of disabling injuries or illnesses are not work related, so workers' compensation benefits will not be available to most disabled employees.[30]

Social Security Disability Insurance (SSDI). Federal SSDI pays a monthly cash benefit to eligible employees unable to work for a year or more because of a serious disability. To be eligible, a worker must have a minimum number of work credits with a covered employer and a medical condition meeting Social Security's disability standard. Minimum work credits depend on age and yearly earnings over time. Most mid-career employees in Plans 2/3 would meet the work credit requirements. If awarded, SSDI benefits continue until the individual is able to work again or until retirement age, when SSDI benefits automatically convert to a retirement benefit of the same amount.

SSDI covers long-term, total disability. No benefits are awarded for partial or short-term disability. A worker is considered disabled if unable to perform the duties of his or her prior job; cannot adjust to any other work (considering medical condition, age, experience, education, and transferable skills); and, if the disability has lasted, or is expected to last, for at least one year or result in death.

Disability payments from private sources do not influence SSDI benefits; however, workers' compensation and other public benefits may reduce monthly SSDI payment amounts. The total amount of all benefits, combined, cannot exceed 80 percent of pre-disability earnings. State and local government retirement benefits are not counted if Social Security taxes were deducted from earnings.

The 50-year-old Plans 2/3 member from our previous examples, earning $4,000 a month, would

[26] Companies with at least $25 million in assets, and some governmental entities, may qualify for self-insurance.

[27] The annual average wage is determined by the Washington State Employment Security Department. Additional benefits may include medical care and other services associated with the disability.

[28] Pension recipients have several Pension Survivor Options to choose from: an unreduced single life pension; a reduced joint and 50 percent pension; or a further reduced and 100 percent pension.

[29] In this example, health care benefits are valued at the monthly employer contribution of $561 for Group Health Classic coverage.

[30] Council for Disability Awareness. *2008 long-term disability claims review*. Available from: http://www.disabilitycanhappen.org/research/CDA_LTD_Claims_Survey_2008.asp.

receive a SSDI benefit of $1,411 per month. With spouse and children, the maximum family benefit would be $2,630 per month.[31] The maximum benefit of combined SSDI and workers' compensation would be $3,200 (80 percent of $4,000). Any amount above that level would result in an equal reduction in the SSDI payment.

The total disability standard for SSDI is relatively strict. The approval rate for SSDI claims was 38 percent in 2008. About 30 percent of individuals who are already receiving other long-term disability insurance benefits did not qualify for SSDI assistance in 2008.[32]

POTENTIAL DISABILITY BENEFITS FROM ALL SOURCES: RETIREMENT, LTD, WORKERS COMPENSATION, AND SSDI

Eligibility and the nature of the disability determine total monthly income potentially available to a disabled employee. Plans 2/3 members may receive a retirement disability benefit from the state if they meet the definition of "total incapacity for continued employment," but might not receive workers' compensation if the disabling illness or injury is not work related. The length of time members may receive long-term disability insurance benefits depends on their ability to perform *any* gainful employment for which they are qualified, rather than just the material duties of their own or a comparable occupation.

Exhibit 10 describes key eligibility parameters that determine which replacement income sources are available to a disabled plan member.

Plan members who are no longer able to work due to a disability may, in addition to their own resources, receive replacement income from their Plans 2/3 retirement systems, LTD insurance, workers' compensation, and SSDI. What would the 50-year-old employee in our ongoing example expect to earn from all of these possible sources combined? For simplicity, we base the examples (Exhibit 11) on a single Plan 2 employee with no dependents, or other complicating issues that would influence the benefit amounts.

The scenarios examined are based on a combination of factors: work-related and non-work related disabilities, availability of LTD insurance, enrollment in Optional LTD insurance, eligibility for workers' compensation or SSDI benefits, income offsets, and maximum benefits allowed. The replacement income from all sources combined ranges from $384 per month to almost $3,200. Without workers' compensation, a maximum benefit of $2,400 is available for those with Optional LTD insurance. The lowest replacement incomes are for plan members with non-duty disabilities who do not have Optional LTD insurance and who do not qualify for SSDI.

Based on the hypothetical scenarios illustrated in Exhibit 11, Plans 2/3 employees with long-term disabilities will receive the lowest total benefit amounts if they have the following characteristics:

- Under the age of 55 with less than 30 years of service and, therefore, receiving an actuarially reduced disability pension;
- Experiencing non-duty related disabilities that do not meet workers' compensation or SSDI standards; and
- Limited or no LTD insurance.

[31] Estimates derived using the Social Security Quick Benefits Calculator. Available from: http://www.ssa.gov/OACT/quickcalc/index.html.

[32] Council for Disability Awareness. *2008 long-term disability claims review*. Available from: http://www.disabilitycanhappen.org/research/CDA_LTD_Claims_Survey_2008.asp.

Exhibit 10
Key Factors Influencing Eligibility Across Benefit Programs
(checkmark indicates a benefit is provided)

	Plans 2/3	PEBB LTD Insurance	Workers' Compensation	SSDI
Type of Incapacity				
Occupational (own occupation)	✓	✓[a]	✓	-
Total (any gainful employment)	-	✓[b]	✓	✓
Duty-related	✓	✓	✓	✓
Not duty-related	✓	✓	-	✓
Mental, stress-related, etc.	✓	✓[c]	✓[d]	✓
No Minimum Service Requirements	✓	✓	✓	-
Available to All Plan 2/3 Members	✓	-	✓	✓

Notes:
[a] For the first 24 months
[b] After 24 months
[c] First 24 months only
[d] If work-related

Exhibit 11
Total Income Replacement From All Sources:
50-Year-Old With 20 Years of Service Credit and a
Final Average Monthly Salary of $4,000 (single and no dependents)

	Plan 2 Disability Retirement	Basic LTD Insurance*	Optional LTD Insurance*	Workers' Compensation	SSDI	Total
Not Work-Related	$384	$0	$0	$0	$0	**$384**
	$384	$0	$0	$0	$1,411	**$1,795**
	$384	$50	$0	$0	$0	**$434**
	$384	$50	$0	$0	$1,411	**$1,845**
	$384	$240	$1,776	$0	$0	**$2,400**
	$384	$240	$365	$0	$1,411	**$2,400**
Work-Related	$384	$0	$0	$2,700	$0	**$3,084**
	$384	$0	$0	$2,584	$116	**$3,084**
	$384	$50	$0	$2,700	$0	**$3,134**
	$384	$50	$0	$2,634	$66	**$3,134**
	$384	$50	$50	$2,700	$0	**$3,184**
	$384	$50	$50	$2,684	$16	**$3,184**

*Based on PEBB Basic and Optional LTD Plans. Other employer LTD plans may differ.

Note: The cell value is $0 if the disabled employee is not eligible (i.e., does not meet the SSDI disability standard or did not purchase Optional LTD) for a benefit or if the benefit is not available (i.e., employer does not provide LTD insurance).

CONCLUSIONS AND RECOMMENDATIONS OF THE 2009 INTERIM REPORT

The Institute's 2009 report examined the disability benefits available to Plan 2 and 3 members, considered statutory changes to the retirement systems, and investigated relevant insurance products for consideration by policymakers.[33] The report concluded with the following:

The earned benefit structure of pension Plans 2/3 (actuarially reduced) results in disability retirement benefit amounts that, for some members, may be considerably smaller than those provided under differently structured systems. A number of issues contribute to potentially large differences in total benefits available for some Plans 2/3 members retiring early due to a disability:

- Potentially large actuarial reductions for early disability retirement;
- 60 percent of Plans 2/3 members do not enroll in PEBB Optional LTD insurance (an important source of potential replacement income);
- Over one-third of the Plans 2/3 members who apply for Optional LTD insurance coverage after the new employee grace period are declined;[34]
- LTD insurance plans are not uniformly available to all Plans 2/3 members in smaller jurisdictions; and
- Members with non-duty-related disabilities are not eligible for workers' compensation.

Industry experts, including the state's insurance vendor, reported that no existing insurance products address the issues described above.

The 2009 Institute report recommended that the Health Care Authority and the Department of Retirement Systems, in coordination with the Select Committee on Pension Policy, the Office of the State Actuary, and other public employers, estimate financial and administrative impacts associated with two sets of options, organized below based on whether the goal is to increase participation in LTD insurance and/or to increase maximum benefits.

If the goal is to increase employee participation in, or availability of, LTD insurance:

- ✓ Increase awareness of Optional LTD insurance by instituting an improved communication program for new hires;
- ✓ Work with the state's insurer to provide a one-time open enrollment period for all employees to enroll in the PEBB Optional LTD plan, without requiring evidence of insurability; and
- ✓ Issue a Request for Information to the insurance industry for a comparable product providing LTD insurance to all other public employer groups in the retirement system.

If the goal is to increase maximum benefits:

- ✓ Work with the state's insurer to increase the PEBB Basic LTD plan maximum benefit to bring it closer to the market median, including changes in the integration of Basic benefits with Social Security, disability retirement benefits, workers' compensation, and other sources of income.
- ✓ Issue a Request for Information to the insurance industry for a group insurance product (including a retirement supplement) that replaces the actuarial reduction in benefits of plan members taking a disability retirement; and
- ✓ Consider providing an earned disability benefit without an actuarial adjustment for permanently disabled plan members meeting minimum years of service criteria.

[33] Mayfield, 2009
[34] Includes Optional plan members who also are applying to change the benefit waiting period.

Further Development of the 2009 Report Recommendations[35]

Study Direction. The 2010 Legislature directed the Institute to further develop the recommendations of the 2009 report. The recommendations fall into four general areas of investigation:

- Improve communications regarding Optional LTD benefits;
- Increase or expand PEBB LTD coverage;
- Issue Requests for Information to the private insurance market for new LTD products; and
- Describe fiscal and administrative impacts of statutory changes that improve disability benefits through the pension system.

The following section provides new information where available and describes ongoing efforts by agency staff to review and address the administrative, financial, and legal implications of the 2009 report recommendations.

Recent Agency Activities. The HCA is coordinating its analysis of LTD insurance-related recommendations with the contracted disability vendor (Standard Insurance) and other stakeholders. The Office of the State Actuary (OSA) provided a fiscal analysis and draft statutory language for a proposal (see Appendix) to increase disability benefits paid through the pension system.

Improved Communications Regarding Optional LTD Plans

The goal of improved communications is to increase the number of employees who enroll in LTD. Currently only 40 percent of PEBB-eligible employees do so.

Over the 2010 interim, PEBB has taken steps to improve communications with new hires and current employees of PEBB-member employers. PEBB's customer service unit has focused on two areas of improvement: a benefits orientation video for new hires and a newsletter targeting all eligible employees.

PEBB Introduces New-Hires Video. PEBB created a one-hour video that covers all PEBB benefits, including LTD insurance. The video, designed for new hires, was added to the PEBB new-hire web page in early October 2010.[36]

The video is being distributed to all member agency PEBB contacts to be included in new employee orientations along with existing new-hire employee benefit packets.

PEBB Issues Newsletter Describing LTD Benefits. In August 2010, PEBB-covered employees were sent the PEBB newsletter, *For Your Benefit,* which included the article "[i]f you become disabled, do you know if you're covered?" The two-page article describes the PEBB Basic and Optional LTD plans, provides an example of what both plans pay in the event of a disability or illness, and explains how employee premiums for the Optional LTD are calculated. The article reminds employees that they may apply to enroll in the Optional LTD plan at any time, subject to proof of good health.

Impact of Improved Communication. Due to the recent deployment of the video and state hiring freeze, there is no preliminary information on the possible effect of PEBB efforts to improve communications. Similarly, it is not known if the newsletter resulted in an increase in participation in Optional coverage. However, preliminary data from Standard indicates an increase in applications.

The newsletter and new-hire video target employees participating in the PEBB program—about a third of all Plan 2 and 3 members (Exhibit 2). These do not impact the majority of Plans 2/3

35 Mayfield, 2009

36 http://www.pebb.hca.wa.gov/employeepacket_meddental.html

members. If the goal is to communicate the benefits of additional LTD coverage to all Plans 2/3 members, a need remains for a more comprehensive communication strategy and coordination of effort.

Increase or Expand PEBB LTD Coverage

The Institute's 2009 report included two recommendations regarding PEBB's LTD plans:

- Investigate the possibility of increasing the maximum benefit of the employer-paid Basic LTD plan; and
- Consider a one-time open enrollment period for the employee-paid Optional LTD plan.

These recommendations are currently under review by HCA staff, in collaboration with their insurance vendor and consultant.

Increasing the Basic LTD Maximum Benefit. Currently, PEBB's Basic LTD provides a maximum payout of $240 a month to an employee with a qualifying disability or illness. Premiums for the Basic LTD are paid by the employer.

The Standard Insurance Company provided premium rates that would be associated with larger monthly maximum disability benefits of $1,000 to $3,000 (Exhibit 12) if such a change were to occur.[37] Lifting the maximum payment of the Basic LTD from $250 to $3,000 would increase the employer's monthly premium from $2 per employee to $24.[38]

Increasing the Basic LTD maximum benefit places greater responsibility for income replacement on the employer. This is reflected, in part, by decreases in employee-paid premiums for individuals enrolled in the Optional LTD plan that would result (Exhibit 13): the larger the Basic LTD payout, the smaller the employee-paid premiums for Optional LTD.

Exhibit 12
Increasing the PEBB Basic LTD Benefit: Employer-paid Premiums

	Current Plan	Option 1	Option 2	Option 3
Maximum Monthly Basic LTD Benefit	$240	$1,000	$2,000	$3,000
Monthly Premium per Employee	$2	$8	$16	$24
Annual Premiums (in Millions)*	$3.4	$11.9	$23.8	$35.7

*Based on 124,186 members.
Source: The Standard Insurance Company.

Exhibit 13
Increasing the PEBB Basic LTD Benefit: Estimated Changes in Employee-paid Premiums for Optional LTD Insurance

	Percentage of Earnings Paid (Higher Education / Other Employees)			
Waiting Period (Days)	**Current** ($240)	**Option 1** ($1,000)	**Option 2** ($2,000)	**Option 3** ($3,000)
30	2.48 / 1.96	2.23 / 1.76	1.86 / 1.47	1.49 / 1.18
60	1.26 / 1.04	1.13 / 0.94	0.95 / 0.78	0.76 / 0.62
90	0.69 / 0.57	0.62 / 0.51	0.52 / 0.43	0.41 / 0.34
120	0.40 / 0.34	0.36 / 0.31	0.30 / 0.26	0.24 / 0.20
180	0.30 / 0.27	0.27 / 0.24	0.23 / 0.21	0.18 / 0.17
240	0.29 / 0.26	0.26 / 0.23	0.22 / 0.20	0.17 / 0.16
300	0.27 / 0.24	0.24 / 0.22	0.20 / 0.18	0.16 / 0.15
360	0.26 / 0.23	0.23 / 0.21	0.19 / 0.17	0.15 / 0.14

Source: The Standard Insurance Company.

One-time Open Enrollment for Optional LTD Insurance. Sixty percent of employees do not enroll in PEBB's Optional LTD plan during the new employee grace period. An open enrollment period would provide an opportunity for these employees to enroll in Optional LTD without needing to provide proof of insurability.[39]

Standard Insurance has agreed to work with PEBB to examine the possibility of implementing an open enrollment period, under the condition that no changes are made in the current Basic LTD coverage (the proposed increase in maximum

[37] Gary Montag (2009). *Benefit and cost summary proposal. An employee benefits proposal for Washington State Health Care Authority.* Portland, OR: Standard Insurance Company.
[38] Rates guaranteed until January 1, 2011.

[39] There would be a preexisting condition exclusion over a specified time period.

monthly benefits). Standard will assist PEBB in educating employees about their Optional LTD insurance and offer them an opportunity to purchase the optional coverage during a special open enrollment period.

Increasing or Expanding LTD Coverage: Next Steps. Specific implementation details and costs associated with increasing PEBB's Basic LTD maximum benefit or offering an open enrollment for the Optional LTD, have yet to be established. HCA is currently working with its insurance vendor and consultants to analyze these options, as well as their potential costs and other impacts. A report from HCA describing the results of their analysis of these proposals is expected in 2011.

As with PEBB's efforts to improve communications with members, these proposals focus on employees participating in PEBB. The majority of public employees in Plans 2/3 would not be affected by these changes. Any changes in their LTD insurance plans would need to be coordinated through their employers. There are currently no plans for doing so.

Requests for Information for LTD Insurance Products

During the 2009 legislative interim, the Institute investigated the availability of supplemental insurance products for Plans 2/3 members retiring early due to disability. The majority of Plans 2/3 members have access to employee- or employer-paid group LTD insurance similar to PEBB's Optional plan. Employees may not have LTD insurance for two reasons: (1) many do not enroll in an available plan during the new-employee grace period; or (2) their employer does not provide LTD insurance. Observations of industry experts and the experiences of peer states indicate that there are no existing insurance products that deal with these specific issues.

The Institute's 2009 report[40] recommended issuing Requests for Information to the insurance industry for group LTD insurance products that would be available to all Washington State public employees. Such a product would be comparable to PEBB Optional LTD and/or would replace the actuarial reduction of benefits to Plans 2/3 members taking a disability retirement.

[40] Mayfield, 2009

Requests for Information had not been issued at the time of this report. These proposals require additional development by HCA before requesting information from the insurance market. A complicating issue is the number and diversity of the public employer groups in Plans 2/3: counties, cities and towns; school districts; and public service districts of all sizes, many of which already provide employer- or employee-paid LTD insurance. Within a single jurisdiction there may be multiple collective bargaining agreements and benefit packages.

The HCA is taking the initiative to further develop these proposals. They are working in collaboration with their consultants and Standard Insurance to describe precisely how these proposals should be structured (e.g., whether all public employers would be required to participate) and administered (by HCA or DRS or another entity). A report by the HCA, expected in 2011, will provide details of the proposals and assessments of their feasibility.

Increasing Disability Benefits Through the Pension System: A Stakeholder Proposal

Stakeholder Proposal. The statutory changes considered in this report would provide an enhanced disability benefit within Plans 2/3 paid for by member and employer contributions. These changes are almost identical to a proposal developed by an employee stakeholder group and presented to the Select Committee on Pension Policy (SCPP) in the 2008 interim.[41]

The more recent proposal, however, incorporates the disability standard used by Social Security. Under this proposal, disability benefits are determined as follows:[42] provide an earned disability benefit to Plans 2/3 members with more than 10 years of service, based on 30-year Early Retirement Reduction Factors (ERRF).

- ✓ Permanently disabled individuals with 20 or more years of service could retire using an ERRF of 3 percent for each year of age less than 62;
- ✓ Permanently disabled individuals with 10 or more years of service, but less than 20, could retire using a reduction equal to 3 percent for each year of age under age 65;

[41] Select Committee on Pension Policy, 2009.
[42] OSA staff provided a draft of the statutory changes required for these new provisions. See Appendix A.

- ✓ The disability standard for early retirement would be the same as the Social Security standard; and
- ✓ There would be no changes in rules governing duty or non-duty disability eligibility.

Under the proposed enhanced benefit structure, qualified Plans 2/3 members would receive a larger monthly benefit than they would under the earned disability currently in use (Exhibit 14). For example, a 50-year old Plans 2 member with 20 years of service who qualified for a disability retirement would receive $1,024 per month instead of the $384 per month under the current structure.

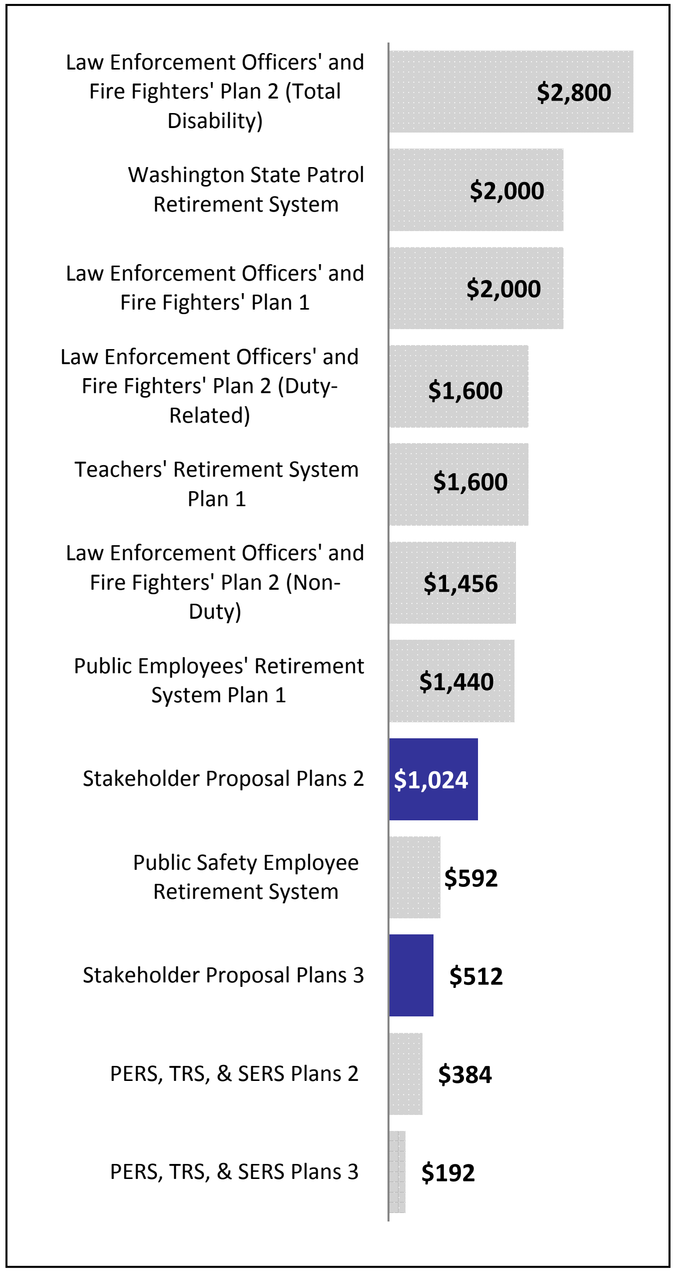
Fiscal and Administrative Impacts. The proposal increases disability retirement payment amounts and would drive up the number of disabled members selecting an immediate annuity over a return of contributions. The OSA estimates that today's value of all future pensions would increase from $74.8 billion under the current structure to $75.1 billion under the proposal, a $281.6 million increase (see Appendix B).

If implemented, the OSA estimates the 2011–13 biennial budget impacts of this proposal would be approximately $15.1 million (General Fund--Sate), $45.2 million (total employer), and $27.2 million (total employee). Over 25 years, they estimate total impacts of $215.9, $636.3, and $394.4 million, respectively. Employer and employee (Plans 2 only) contribution rates would increase for PERS, TRS, and SERS by 0.16, 0.10, and 0.15 percent, respectively.[43]

In addition to the fiscal impacts on the state, employers, and employees, the proposal would impose additional administrative burdens on the Department of Retirement Systems. Disability determinations and appeals for denials are staff intensive. A proposal that makes the disability retirement provisions more attractive, such as the one described here, will result in an increase in determinations and appeals. DRS would be required to process more than 300 additional cases each year (see Appendix B). Additionally, using the Social Security disability standard, as proposed for the enhanced benefits, creates more complexity for DRS staff, but is not significantly more restrictive than the existing current standards.

Exhibit 14

Comparing the Stakeholders' Proposal: Monthly Disability Retirement Benefits by Retirement System for 50-Year-Old With 20 Years of Service Credit and a Final Average Monthly Salary of $4,000



WSIPP, 2010

Note: These examples are simplified for expository purposes. More detailed descriptions of disability benefits by plan are provided in Exhibit 7.

[43] Plans 3 members do not contribute to the employer-provided defined benefit.

KEY ISSUES AND ANALYSIS[44]

The state faces two primary issues regarding disability retirement benefits under Plans 2/3:

- Should the state take on more responsibility for income replacement when a Plans 2/3 member retires early due to a disability?
- If the state takes on more responsibility, should it use insurance products, the pension system, or a combination of both?

Should the State Take on More Responsibility for Income Replacement?

Plans 2/3 retirement systems were not intended to provide a significant source of income for a member who retires early due to a disability. The Plans only provide access to the accrued retirement value of an employee's service. These Plans are therefore less generous than other state plans with respect to pension-based disability retirement benefits.

As currently structured, Plans 2/3 members are responsible for preparing for financial security in the event of a career-ending disability. The typical means for doing so is optional LTD insurance through the employer and/or individual policies. However, many members (60 percent of state employees) do not purchase additional disability insurance, and some employers do not provide group LTD insurance. Additionally, there is no guarantee a member will meet the insurability standards required to purchase private, individual policies.

Some Plans 2/3 members may retire early due to a disability without adequate LTD insurance or other sources of replacement income. Does this justify mandated coverage for all employees? If the answer is "yes," it is a judgment by policymakers that individual and employer responsibility fails to provide adequate coverage for Plan members.

The state can take on more responsibility through enhancements to the pension system or improved access to LTD insurance products, or both. Alternatively, education may help increase employee participation in existing disability insurance plans and encourage more public employers to expand their benefit options.

[44] Adapted from Select Committee on Pension Policy, 2009

Should the State Enhance Disability Retirements Through the Retirement System and/or Insurance Products?

Disability retirement benefits can be increased through changes in the pension system, increased availability of insurance products, or both. There are advantages and disadvantages to both approaches.

Pension-based Enhancements: Advantages. There are several advantages to enhancing disability retirement through the pension system that influence member costs and the standardization and stability of coverage:

- <u>Lower costs for members:</u> Because the pension system covers all employees, members with a low risk of disability are "pooled" with members who have a higher risk of disability. This, combined with the zero-profit margins of the pension system, results in lower per-member costs in comparison with insurance-based options.
- <u>Standardized coverage:</u> Enhanced retirement though the pension system provides similar standards of eligibility and coverage for all plan members.
- <u>Stable coverage:</u> Unless state pension law is amended, members have assurances that enhanced disability retirements through the pension system will be available throughout their career.

Pension-based Enhancements: Disadvantages. There are disadvantages to disability retirement enhancements through the pension system from the perspective of employers, ineligible employees, administrators, and policymakers:

- <u>Increased employer costs:</u> An enhanced disability retirement will increase costs for employers who do not currently subsidize employee disability insurance.
- <u>Continuing "gaps" in coverage:</u> While enhanced disability retirement increases benefits overall, it does not guarantee a minimally adequate replacement income for everyone, especially for those who do not purchase additional insurance coverage.
- <u>Higher administrative costs:</u> An enhanced benefit requires greater administrative support to reduce fraud and provide due process for members denied benefits.
- <u>Less flexibility for policymakers:</u> In contrast to insurance-based enhancements, it would be more difficult for policymakers to discontinue or change this benefit once adopted.

Insurance-based Enhancements: Advantages. Insurance-based enhancements to disability retirement provide considerable flexibility in program design:

- Variety of coverage options: Proposals may provide multiple coverage options to meet a variety of employee needs.
- Employer choice: Depending on the proposal, employers may have the choice to subsidize their employees' disability coverage.
- Mandated or non-mandated options: Policymakers can design proposals that mandate coverage for all, mandate enrollment but provide an opt-out clause, or ensure access to a group plan for all public employees without mandating coverage.
- More flexibility for policymakers: In contrast to a pension-based enhancement, it would be relatively easy for policymakers to discontinue or change this benefit.

Insurance-based Enhancements: Disadvantages. We identify three disadvantages to disability retirement enhancements through the insurance system:

- Higher costs for members: On average, individuals who purchase LTD insurance tend to be higher risk. Therefore, insurance-based benefits tend to be more expensive than pension-based benefits for a given level of coverage. This is in addition to higher costs associated with for-profit private insurance.
- Less stable coverage: Disability coverage through a private insurer is not as stable as a pension-based retirement disability. Costs, benefit levels, and eligibility may change from contract to contract.
- Need for contract oversight: Administering disability benefits through a contracted insurer requires a selection process and an agency responsible for supervising the contract. (Increasing benefits through existing products [i.e., PEBB Basic LTD], would be less costly in this respect than adding a new insurance product that covered all public employees.)

POLICY OPTIONS

There are five policy options for consideration, some of which await a further analysis by HCA to be completed in 2011:

- Maintain the current system but with improved employee education;
- Increase the PEBB Basic LTD Plan;
- Offer a one-time open enrollment for PEBB Optional LTD;
- Offer LTD insurance for all public employees; and/or
- Enhance Plans 2/3 pension system disability retirements.

Option 1. Maintain Current System With Enhanced Education

This option maintains the current Plans 2/3 pension system and insurance structure. PEBB members would continue to be educated about LTD benefits through recently adopted new-hire orientations and ongoing targeted communications. The goal of this option is to increase voluntary enrollment in PEBB's Optional LTD Plan.

This option adds no additional costs to the pension system and assumes no additional responsibility for member disability benefits. The educational enhancements do not impact employees or employers who are not members of PEBB. Policymakers could additionally consider the following:

- Encourage non-PEBB member employers to provide group disability coverage and enhanced education regarding the value of LTD insurance; and/or
- Provide enhanced education to all Plans 2/3 members through a communication effort administered by a state agency.

Option 2. Increase PEBB Basic LTD Plan

This option increases the maximum benefit of the PEBB Basic LTD Plan, providing all PEBB employees a more generous disability benefit. Because the Basic Plan is employer-paid, it places greater responsibility for income security on the employer. The current premium for a $240 maximum benefit is $2 per employee per month. Premiums would increase in proportion to the maximum monthly benefit, ranging from $8 per month for a $1,000 maximum, to $24 per month for a $3,000 maximum. The goal of this option is to bring the Basic Plan premium closer to the market median while shifting greater responsibility to the employer.

Changes to PEBB's Basic LTD Plan will influence the enrollment and employee costs associated with the PEBB Optional Plan. The HCA, along with its insurer and consultants, continues to investigate cost and implementation issues associated with this option and will issue a report on findings in 2011. This policy alternative will likely be coordinated with Option 3.

Option 2 maintains the current Plans 2/3 structure and adds no additional costs to the pension system. Insurance costs for PEBB-participating employers will increase, and employee costs will decrease. This option would not directly influence non-PEBB employers or employee insurance.

Option 3. One-time Open Enrollment for the PEBB Optional LTD Plan

We know that 60 percent of PEBB participants do not enroll in Optional LTD during the new-hire grace period. A one-time open-enrollment option, coordinated with a targeted communication campaign, would provide an opportunity for PEBB participants to enroll in the Optional Plan without proof of insurability. Standard Insurance would collaborate with HCA in providing the enhanced education campaign prior to the special open enrollment period. The goal is to increase overall enrollment in employee-paid LTD insurance.

HCA continues to examine this option along with other proposals regarding PEBB insurance products and will issue a report with recommendations in 2011.

Option 3 does not change the pension system or impose additional costs. The responsibility for income replacement remains with the employee, and there will continue to be a number of employees who do not enroll. Non-PEBB employees and employers are not affected by this option.

Option 4. Provide LTD Insurance Coverage for All Employees

Not all public employers provide disability insurance. Under this option, an employee-paid, group disability insurance plan would be made available to all public employees. The structure of the proposed plan or plans—optional, mandatory with opt-out, maximum benefits—has yet to be determined, but the goal would be to ensure *all* public employees have access to adequate LTD insurance.

Creating this new insurance product is a complex undertaking requiring considerable knowledge of the insurance industry, Washington State's public employers, collective bargaining issues, and other complicating factors. HCA, in collaboration with its industry consultants and Standard Insurance, will develop and assess the feasibility of insurance proposals prior to issuing Requests for Information to the industry. This work is expected to be completed in 2011.

There would be no additional costs to the pension system under this option. There would, however, be additional costs associated with providing a new insurance product, whether by HCA or DRS. HCA administers bundled insurance products to about 30 percent of public employees in Plans 2/3. Adding a statewide product would expand their costs. DRS does not administer insurance products and would most likely contract that function to a third party.

Option 5. Provide an Enhanced Disability Benefit for Some Plans 2/3 Members

Based on a stakeholder proposal, this option offers an enhanced disability benefit within Plans 2/3 for individuals with more than 10 years of service. The option lowers risks for Plans 2/3 members and places additional responsibility for disability income on the state and employers. The OSA estimates the 2011–13 biennial budget impacts of this proposal at $15.1 million (General Fund--State), $45.2 million (total employer), and $27.2 million (total employee), with average budget impacts of similar magnitude in subsequent biennia.

In addition to retirement system costs, an enhanced benefit will impose new administrative burdens on DRS. Resources would need to be allocated to support the increased fraud prevention associated with higher disability benefits and to provide due process for members denied benefits. Policymakers may consider requesting a DRS fiscal analysis of this proposal.

The enhanced disability benefit does not guarantee an "adequate" disability requirement. While it increases disability benefits for Plans 2/3 members overall, there will continue to be a need for additional sources of replacement income through LTD insurance for some members.

OSA

September 14, 2010 (9:26 AM)

AN ACT Relating to disability benefits in the public employees' retirement system plan 2 and plan 3, the teachers' retirement system plan 2 and plan 3, and the school employees' retirement system plan 2 and plan 3; amending RCW 41.32.790, 41.32.880, 41.35.440, 41.35.690, 41.40.670, 41.40.825; and providing an effective date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

Sec. 1. RCW 41.32.790 and 1995 c 144 s 15 are each amended to read as follows:

(1) A member of the retirement system who becomes totally incapacitated for continued employment by an employer as determined by the department upon recommendation of the department shall be eligible to receive an allowance under the provisions of RCW 41.32.755 through 41.32.825. The member shall receive a monthly disability allowance computed as provided for in RCW 41.32.760 and shall have the allowance actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

Any member who receives an allowance under the provisions of this section shall be subject to comprehensive medical examinations as required by the department. If medical examinations reveal that a member has recovered from the incapacitating disability and the member is offered reemployment by an employer at a comparable compensation, the member shall cease to be eligible for the allowance.

(2)(a) A member of the retirement system who becomes totally disabled and is unable to perform any substantial gainful activity as defined in section (b) due to a physical or mental condition that may be expected to result in death or that has lasted or is expected to last at least twelve months shall be eligible to receive a monthly disability allowance computed as provided for in RCW 41.32.760 and adjusted as follows:

(i) Members with less than ten years of service shall receive an allowance that is actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(ii) Members with at least ten years of service but less than twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(iii) Members with at least twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-two.

(b) Substantial gainful activity is defined as average earnings in excess of one thousand dollars a month in 2010 adjusted annually as determined by the director based on federal social security disability standards.

(c) Any person in receipt of an allowance under the provisions of this section may be required to provide any financial records and is subject to comprehensive medical examinations as deemed necessary by the department in order to determine continued eligibility for such an allowance.

((~~(2)~~))(3)(a) If the recipient of a monthly retirement allowance under this section dies before the total of the retirement allowance paid to the recipient equals the amount of the accumulated contributions at the date of retirement, then the balance shall be paid to the member's estate, or the person or persons, trust, or organization as the recipient has nominated by written designation duly executed and filed with the director, or, if there is no designated person or persons still living at the time of the recipient's death, then to the surviving spouse, or, if there is neither a designated person or persons still living at the time of his or her death nor a surviving spouse, then to his or her legal representative.

(b) If a recipient of a monthly retirement allowance under this section died before April 27, 1989, and before the total of the retirement allowance paid to the recipient equaled the amount of his or her accumulated contributions at the date of retirement, then the department shall pay the balance of the accumulated contributions to the member's surviving spouse or, if there is no surviving spouse, then in equal shares to the member's children. If there is no surviving spouse or children, the department shall retain the contributions.

Sec.2. RCW 41.32.880 and 1995 c 239 s 114 are each amended to read as follows:

(1) A member of the retirement system who becomes totally incapacitated for continued employment by an employer as determined by the department shall be eligible to receive an allowance under the provisions of plan 3. The member shall receive a monthly disability allowance computed as provided for in RCW 41.32.840 and shall have this allowance actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

Any member who receives an allowance under the provisions of this section shall be subject to comprehensive medical examinations as required by the department. If these medical examinations reveal that a member has recovered from the incapacitating disability and the member is offered reemployment by an employer at a comparable compensation, the member shall cease to be eligible for the allowance.

(2)(a) A member of the retirement system who becomes totally disabled and is unable to perform any substantial gainful activity as defined in section (b) due to a physical or mental condition that may be expected to result in death or that has lasted or is expected to last at least twelve months shall be eligible to receive a monthly disability allowance computed as provided for in RCW 41.32.840 and adjusted as follows:

(i) Members with less than ten years of service shall receive an allowance that is actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(ii) Members with at least ten years of service but less than twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(iii) Members with at least twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-two.

(b) Substantial gainful activity is defined as average earnings in excess of one thousand dollars a month in 2010 adjusted annually as determined by the director based on federal social security disability standards.

(c) Any person in receipt of an allowance under the provisions of this section may be required to provide any financial records and is subject to comprehensive medical examinations as deemed necessary by the department in order to determine continued eligibility for such an allowance.

((~~(2)~~))(3) If the recipient of a monthly retirement allowance under this section dies, any further benefit payments shall be conditioned by the payment option selected by the retiree as provided in RCW 41.32.851.

Sec. 3. RCW 41.35.440 and 1998 c 341 s 105 are each amended to read as follows:

(1) A member of the retirement system who becomes totally incapacitated for continued employment by an employer as determined by the department upon recommendation of the department shall be eligible to receive an allowance under the provisions of RCW 41.35.400 through 41.35.599. The member shall receive a monthly disability allowance computed as provided for in RCW 41.35.400 and shall have this allowance actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

Any member who receives an allowance under the provisions of this section shall be subject to comprehensive medical examinations as required by the department. If these medical examinations reveal that a member has recovered from the incapacitating disability and the member is offered reemployment by an employer at a comparable compensation, the member shall cease to be eligible for the allowance.

(2)(a) A member of the retirement system who becomes totally disabled and is unable to perform any substantial gainful activity as defined in section (b) due to a physical or mental condition that may be expected to result in death or that has lasted or is expected to last at least twelve months shall be eligible to receive a monthly disability allowance computed as provided for in RCW 41.35.400 and adjusted as follows:

(i) Members with less than ten years of service shall receive an allowance that is actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(ii) Members with at least ten years of service but less than twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(iii) Members with at least twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-two.

(b) Substantial gainful activity is defined as average earnings in excess of one thousand dollars a month in 2010 adjusted annually as determined by the director based on federal social security disability standards.

(c) Any person in receipt of an allowance under the provisions of this section may be required to provide any financial records and is subject to comprehensive medical examinations as deemed necessary by the department in order to determine continued eligibility for such an allowance.

((~~(2)~~))(3) If the recipient of a monthly retirement allowance under this section dies before the total of the retirement allowance paid to the recipient equals the amount of the accumulated contributions at the date of retirement, then the balance shall be paid to the member's estate, or the person or persons, trust, or organization as the recipient has nominated by written designation duly executed and filed with the director, or, if there is no designated person or persons still living at the time of the recipient's death, then to the surviving spouse, or, if there is no designated person or persons still living at the time of his or her death nor a surviving spouse, then to his or her legal representative.

Sec. 4. RCW 41.35.690 and 1998 c 341 s 210 are each amended to read as follows:

(1) A member of the retirement system who becomes totally incapacitated for continued employment by an employer as determined by

the department shall be eligible to receive an allowance under the provisions of plan 3. The member shall receive a monthly disability allowance computed as provided for in RCW 41.35.620 and shall have this allowance actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

Any member who receives an allowance under the provisions of this section shall be subject to comprehensive medical examinations as required by the department. If these medical examinations reveal that a member has recovered from the incapacitating disability and the member is offered reemployment by an employer at a comparable compensation, the member shall cease to be eligible for the allowance.

(2)(a) A member of the retirement system who becomes totally disabled and is unable to perform any substantial gainful activity as defined in section (b) due to a physical or mental condition that may be expected to result in death or that has lasted or is expected to last at least twelve months shall be eligible to receive a monthly disability allowance computed as provided for in RCW 41.35.620 and adjusted as follows:

(i) Members with less than ten years of service shall receive an allowance that is actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(ii) Members with at least ten years of service but less than twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(iii) Members with at least twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-two.

(b) Substantial gainful activity is defined as average earnings in excess of one thousand dollars a month in 2010 adjusted annually as determined by the director based on federal social security disability standards.

(c) Any person in receipt of an allowance under the provisions of this section may be required to provide any financial records and is subject to comprehensive medical examinations as deemed necessary by the department in order to determine continued eligibility for such an allowance.

((~~(2)~~))(3) If the recipient of a monthly retirement allowance under this section dies, any further benefit payments shall be conditioned by the payment option selected by the retiree as provided in RCW 41.35.220.

Sec. 5. RCW 41.40.670 and 1995 c 144 s 7 are each amended to read as follows:

(1) A member of the retirement system who becomes totally incapacitated for continued employment by an employer as determined by the department upon recommendation of the department shall be eligible to receive an allowance under the provisions of RCW 41.40.610 through 41.40.740. The member shall receive a monthly disability allowance computed as provided for in RCW 41.40.620 and shall have this allowance actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

Any member who receives an allowance under the provisions of this section shall be subject to comprehensive medical examinations as required by the department. If these medical examinations reveal that a member has recovered from the incapacitating disability and the member is offered reemployment by an employer at a comparable compensation, the member shall cease to be eligible for the allowance.

(2)(a) A member of the retirement system who becomes totally disabled and is unable to perform any substantial gainful activity as defined in section (b) due to a physical or mental condition that may be expected to result in death or that has lasted or is expected to last at least twelve months shall be eligible to receive a monthly disability allowance computed as provided for in RCW 41.40.620 and adjusted as follows:

(i) Members with less than ten years of service shall receive an allowance that is actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(ii) Members with at least ten years of service but less than twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(iii) Members with at least twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-two.

(b) Substantial gainful activity is defined as average earnings in excess of one thousand dollars a month in 2010 adjusted annually as determined by the director based on federal social security disability standards.

(c) Any person in receipt of an allowance under the provisions of this section may be required to provide any financial records and is subject to comprehensive medical examinations as deemed necessary by the department in order to determine continued eligibility for such an allowance.

((~~(2)~~))(3) The retirement for disability of a judge, who is a member of the retirement system, by the supreme court under Article IV, section 31 of the Constitution of the state of Washington (Amendment 71), with the concurrence of the department, shall be considered a retirement under subsection (1) of this section.

((~~(3)~~))(4)(a) If the recipient of a monthly retirement allowance under this section dies before the total of the retirement allowance paid to the recipient equals the amount of the accumulated contributions at the date of retirement, then the balance shall be paid to the member's estate, or the person or persons, trust, or organization as the recipient has nominated by written designation duly executed and filed with the director, or, if there is no designated person or persons still living at the time of the recipient's death, then to the surviving spouse, or, if there is no designated person or persons still living at the time of his or her death nor a surviving spouse, then to his or her legal representative.

(b) If a recipient of a monthly retirement allowance under this section died before April 27, 1989, and before the total of the retirement allowance paid to the recipient equaled the amount of his or her accumulated contributions at the date of retirement, then the department shall pay the balance of the accumulated contributions to the member's surviving spouse or, if there is no surviving spouse, then in equal shares to the member's children. If there is no surviving spouse or children, the department shall retain the contributions.

Sec. 6. RCW 41.40.825 and 2000 c 247 s 310 are each amended to read as follows:

(1) A member of the retirement system who becomes totally incapacitated for continued employment by an employer as determined by the department shall be eligible to receive an allowance under the provisions of plan 3. The member shall receive a monthly disability allowance computed as provided for in RCW 41.40.790 and shall have this allowance actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

Any member who receives an allowance under the provisions of this section shall be subject to comprehensive medical examinations as required by the department. If these medical examinations reveal that a member has recovered from the incapacitating disability and the member is offered reemployment by an employer at a comparable compensation, the member shall cease to be eligible for the allowance.

<u>(2)(a) A member of the retirement system who becomes totally disabled and is unable to perform any substantial gainful activity as</u>

defined in section (b) due to a physical or mental condition that may be expected to result in death or that has lasted or is expected to last at least twelve months shall be eligible to receive a monthly disability allowance computed as provided for in RCW 41.40.790 and adjusted as follows:

(i) Members with less than ten years of service shall receive an allowance that is actuarially reduced to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(ii) Members with at least ten years of service but less than twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-five.

(iii) Members with at least twenty years of service shall receive an allowance that is reduced three percent per year to reflect the difference in the number of years between age at disability and the attainment of age sixty-two.

(b) Substantial gainful activity is defined as average earnings in excess of one thousand dollars a month in 2010 adjusted annually as determined by the director based on federal social security disability standards.

(c) Any person in receipt of an allowance under the provisions of this section may be required to provide any financial records and is subject to comprehensive medical examinations as deemed necessary by the department in order to determine continued eligibility for such an allowance.

((~~(2)~~))(3) If the recipient of a monthly retirement allowance under this section dies, any further benefit payments shall be conditioned by the payment option selected by the retiree as provided in RCW 41.40.845.

NEW SECTION. **Sec. 7.** This act takes effect January 1, 2012.

--- END ---

DRAFT
ACTUARY'S FISCAL NOTE

RESPONDING AGENCY:	CODE:	DATE:	PROPOSAL NAME:
Office of the State Actuary	**035**	**10/29/2010**	**Plan 2/3 Total Disability ERRFs**

WHAT THE READER SHOULD KNOW

The Office of the State Actuary ("we") prepared this draft fiscal note based on our understanding of the proposal as of the date shown above. We intend this draft fiscal note to be used by the Washington State Institute for Public Policy during the 2010 Interim only. If a legislator introduces this proposal as a bill during the next Legislative Session, we will prepare a final fiscal note based on that bill language. The actuarial results shown in this draft fiscal note may change when we prepare our final version for the Legislature.

We advise readers of this draft 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 draft fiscal note as a whole. Distribution of, or reliance on, only parts of this draft fiscal note could result in its misuse, and may mislead others.

Summary of Results

This proposal increases the disability benefits provided by the Plans 2/3 of the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS) for longer service employees who become disabled and are entirely unable to engage in substantial gainful employment.

Impact on Pension Liability			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Today's Value of All Future Pensions	$74,789	$281.6	$75,071
Earned Pensions Not Covered by Today's Assets	$5,773	$0.0	$5,773

Impact on Contribution Rates: (Effective 9/1/2011)			
2011-2013 State Budget	**PERS**	**TRS**	**SERS**
Employee (Plan 2)	0.16%	0.10%	0.15%
Employer:			
Current Annual Cost	0.16%	0.10%	0.15%
Plan 1 Past Cost	0.00%	0.00%	0.00%
Total	0.16%	0.10%	0.15%

Budget Impacts			
(Dollars in Millions)	**2011-2013**	**2013-2015**	**25-Year**
General Fund-State	$15.1	$14.3	$215.9
Total Employer	$45.2	$43.5	$636.3

See the Actuarial Results section of this draft fiscal note for additional detail.

WHAT IS THE PROPOSED CHANGE?

Summary Of Benefit Improvement

This proposal impacts the following systems:

- PERS Plans 2 and 3.
- TRS Plans 2 and 3.
- SERS Plans 2 and 3.

Members who become totally unable to perform substantial gainful activity due to a disabling condition that is expected to result in death or last at least twelve months, as defined by the Social Security Administration, may be eligible for enhanced pension benefits as follows:

- If the member has at least ten years of service but less than 20, they could receive a monthly retirement allowance reduced by 3 percent per year from age 65.
- If a member has at least 20 years of service, they could receive a monthly retirement allowance reduced by 3 percent per year from age 62.

No distinction is made between duty and non-duty related injuries or illnesses for purposes of benefit eligibility or payment amounts.

Effective Date: 90 days after session.

What Is The Current Situation?

Plan 2/3 members who are totally incapacitated for continued employment by an employer are eligible to receive their accrued pension benefit, actuarially adjusted from age 65 to reflect the longer payout period. There are no age or service qualifications for this benefit, and no distinction between duty and non-duty related injuries or illnesses is made for purposes of benefit eligibility or payment amounts.

Who Is Impacted And How?

We estimate this proposal could affect all 148,881 active members of PERS 2/3, all 62,184 active members of TRS 2/3, and all 52,474 active members of SERS 2/3. We expect approximately an additional 171 PERS members, 68 TRS members, and 69 SERS members to apply for disability benefits per year. Overall, we expect 424 PERS members, 83 TRS members, and 180 SERS members will be affected through improved benefits per year.

The table below shows the expected counts of affected members. Please see the Assumptions We Made section for why we'd expect to see more disabilities under this proposal than we currently see now. The "Qualify" columns represent the number of disabilities that would qualify under the new disability standard in the bill. The "Not Qualify" columns represent the number of disabilities that would qualify under the current standard, but not the new standard.

Number of Disabilities in First Year						
	Current			Pricing		
Plan	Not Qualify	Qualify	Total	Not Qualify	Qualify	Total
PERS 2	74	223	297	74	367	442
PERS 3	10	30	41	10	57	67
TRS 2	3	3	7	3	17	21
TRS 3	12	12	25	12	66	79
SERS 2	16	47	63	16	75	91
SERS 3	21	64	85	21	105	126

We estimate this proposal will increase the benefits for a typical member by increasing the amount of their disability benefit. For example, a 40-year-old member with 15 years of service would have a disability benefit of $1,000 increased to $2,273. A 50-year-old member with 25 years of service would have a disability benefit of $1,000 increased to $2,667.

This proposal impacts all Plan 2 members of PERS, TRS, and SERS through increased contribution rates. This proposal will not affect member contribution rates in Plan 3 since Plan 3 members do not contribute to their employer-provided defined benefit.

WHY THIS PROPOSAL HAS A COST AND WHO PAYS FOR IT

Why This Proposal Has A Cost

This proposal has a cost because it provides a larger disability benefit to members with qualifying disablements after ten to thirty years of service, or for members with qualifying disablements after more than thirty years of service under the age of 55.

This proposal does not affect the “true” rate of disablement that the system will experience, the total mortality rate of the system, or the total number of retirement system exits per year. The following sections explain how we priced the proposal to avoid any unintended impacts from these items.

Who Will Pay For These Costs?

These costs will be paid under the normal cost-sharing terms of the plans. Plan 2 members and Plan 2/3 employers will each share equally in the cost of this proposal.

HOW WE VALUED THESE COSTS

Assumptions We Made

Currently, a member experiencing a disability may select from a return of contributions benefit, disability or retirement benefit (depending on whether the member is retirement eligible). In many instances, members who experience a disability under current plan provisions select a return of contributions benefit instead of a disability benefit since the return of contributions benefit provides more value for the member. The Department of Retirement Systems reports these members as terminated from service instead of experiencing a disability. Similarly, a member experiencing a disability who selects a retirement benefit is reported as a retiree. For those two reasons, our current disability rates measure less than the “true” rate of disablements in our retirement systems.

We needed to make an assumption for the true rate of disablement. We used a combination of Minnesota's, Iowa's, and Wisconsin's disability experience to set an assumption for the "true" rate of disablement. We used these states' experience because they have a similar disability standard as this proposal.

We further assumed that all members with disabilities select an immediate annuity over a return of contributions benefit.

For more detail (including the assumed rates of disablement) please see "Assumptions We Made" on page 41.

How We Applied These Assumptions

We took two steps to update our current model. These steps were taken so that the model assumes the correct number of disabilities in a given year:

1. Extended our disability rates beyond retirement eligibility (see "How We Applied These Assumptions" on page 44, for why). We lowered our retirement rates to keep the total number of retirement system exits the same.
2. Increased disability rates to their "true" value (see "Assumptions We Made" for why). We lowered our termination and retirement rates to keep the total number of retirement system exits the same.

After the first two steps were taken, we valued the disability benefits using the new Early Retirement Factors (ERF). The difference before and after the ERF change determined the expected cost of the proposal.

For more detail please see "How We Applied These Assumptions."

ACTUARIAL RESULTS

How The Liabilities Changed

This proposal will impact the actuarial funding by increasing the present value of future benefits payable as shown below.

Impact on Pension Liability			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Actuarial Present Value of Projected Benefits			
(The Value of the Total Commitment to all Current Members)			
PERS 1	$14,215	$0.0	$14,215
PERS 2/3	24,472	211.3	24,684
PERS Total	**$38,687**	**$211.3**	**$38,899**
TRS 1	$10,956	$0.0	$10,956
TRS 2/3	8,661	5.9	8,707
TRS Total	**$19,617**	**$45.9**	**$19,663**
SERS 2/3	**$3,260**	**$24.4**	**$3,284**
Unfunded Actuarial Accrued Liability			
*(The Portion of the Plan 1 Liability that is Amortized According to Funding Policy)**			
PERS 1	**$4,208**	**$0.0**	**$4,208**
TRS 1	**$2,676**	**$0.0**	**$2,676**
Unfunded PUC Liability			
(The Value of the Total Commitment to all Current Members Attributable to Past Service that is Not Covered by Current Assets)			
PERS 1	$4,169	$0.0	$4,169
PERS 2/3	(2,560)	127.1	(2,433)
PERS Total	**$1,609**	**$127.1**	**$1,737**
TRS 1	$2,692	$0.0	$2,692
TRS 2/3	(947)	26.1	(920)
TRS Total	**$1,745**	**$26.1**	**$1,771**
SERS 2/3	**($341)**	**$15.1**	**($326)**

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 will not impact the actuarial funding by changing the PVFS of the members as shown below.

Present Value of Future Salaries			
(Dollars in Millions)	**Current**	**Increase**	**Total**
Actuarial Present Value of Future Salaries			
(The Value of the Future Salaries Expected to be Paid to Current Members)			
PERS 2	$60,070	$0.0	$60,070
PERS 3	13,777	0.0	13,777
PERS 2/3	**$73,737**	**$0.0**	**$73,847**
TRS 2	$5,500	$0.0	$5,500
TRS 3	37,299	0.0	37,299
TRS 2/3	**$42,799**	**$0.0**	**$42,799**
SERS 2	$4,444	$0.0	$4,444
SERS 3	7,440	0.0	7,440
SERS 2/3	**$11,883**	**$0.0**	**$11,883**

Note: Totals may not agree due to rounding.

How Contribution Rates Changed

The rounded increase in the required actuarial contribution rate results in the supplemental contribution rate shown below that applies in the current biennium. However, we will use the un-rounded rate increase to measure the budget changes in future biennia.

Impact on Contribution Rates: (Effective 9/1/2011)			
System/Plan	**PERS**	**TRS**	**SERS**
Current Members			
Employee (Plan 2)	0.158%	0.095%	0.150%
Employer:			
Normal Cost	0.158%	0.095%	0.150%
Plan 1 UAAL	0.000%	0.000%	0.000%
Total	0.158%	0.095%	0.150%
State			
Current Annual Cost			
Plan 1 Past Cost			
Total			
New Entrants*			
Employee (Plan 2)	0.064%	0.046%	0.058%
Employer:			
Normal Cost	0.064%	0.046%	0.058%
Plan 1 UAAL	0.000%	0.000%	0.000%
Total	0.064%	0.046%	0.058%

** Rate change applied to future new entrant payroll and used to determine budget impacts only. Current members and new entrants pay the same contribution rate.*

How This Impacts Budgets And Employees

Budget Impacts				
(Dollars in Millions)	**PERS**	**TRS**	**SERS**	**Total**
2011-2013				
General Fund	$5.9	$6.9	$2.3	$15.1
Non-General Fund	8.4	0.0	0.0	8.4
Total State	**$14.3**	**$6.9**	**$2.3**	**$23.5**
Local Government	15.3	3.5	2.8	21.7
Total Employer	**$29.7**	**$10.4**	**$5.1**	**$45.2**
Total Employee	**$22.9**	**$$2.2**	**$2.1**	**$27.2**
2013-2015				
General Fund	$5.8	$6.4	$2.1	$14.3
Non-General Fund	8.3	0.0	0.0	8.3
Total State	**$14.1**	**$6.4**	**$2.1**	**$22.6**
Local Government	15.1	3.2	2.6	20.9
Total Employer	**$29.1**	**$9.6**	**$4.7**	**$43.5**
Total Employee	**$22.8**	**$2.0**	**$1.9**	**$26.6**
2011-2036				
General Fund	$82.7	$105.7	$27.5	$215.9
Non-General Fund	117.9	0.0	0.0	117.9
Total State	**$200.6**	**$105.7**	**$27.5**	**$333.8**
Local Government	214.5	53.7	34.2	302.5
Total Employer	**$415.1**	**$159.4**	**$61.7**	**$636.3**
Total Employee	**$303.7**	**$58.8**	**$31.9**	**$394.4**

Note: Totals may not agree due to rounding.

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

As with the costs developed in the actuarial valuation, the emerging costs of the system will vary from those presented in the AVR or this draft fiscal note to the extent that actual experience differs from the actuarial assumptions.

HOW THE RESULTS CHANGE WHEN THE ASSUMPTIONS CHANGE

To determine the sensitivity of the actuarial results to the best-estimate assumptions selected for this pricing we varied the following assumption:

- ❖ The “true” rate of disablement. We changed our assumption for the true rate from the pricing assumption (the use of the other three states’ rates), to using PERS current rates plus 35 percent of the social security disability rates.

The table below shows the comparison of our best-estimate assumption to the sensitivity analysis.

Sensitivity of Assumptions		
Rate Impact	Pricing Assumption	PERS + 35% Social Security Rates (Sensitivity)
PERS	0.158%	0.283%
TRS	0.095%	0.291%
SERS	0.150%	0.305%

The table below shows the fiscal impacts under the sensitivity assumptions.

Budget Impacts			
(Dollars in Millions)	**2011-2013**	**2013-2015**	**25-Year**
General Fund-State	$34.9	$34.1	$526.0
Total Employer	$92.3	$91.0	$1,349.4

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 draft fiscal note is based are sufficient and reliable for the purposes of this pricing exercise.
4. Use of another set of methods, assumptions, and date may also be reasonable, and might produce different results.
5. We prepared this draft fiscal note for the Washington State Institute for Public Policy.
6. We prepared this draft fiscal note and provided opinions in accordance with Washington State law and accepted actuarial standards of practice as of the date shown on page one of this draft fiscal note.

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

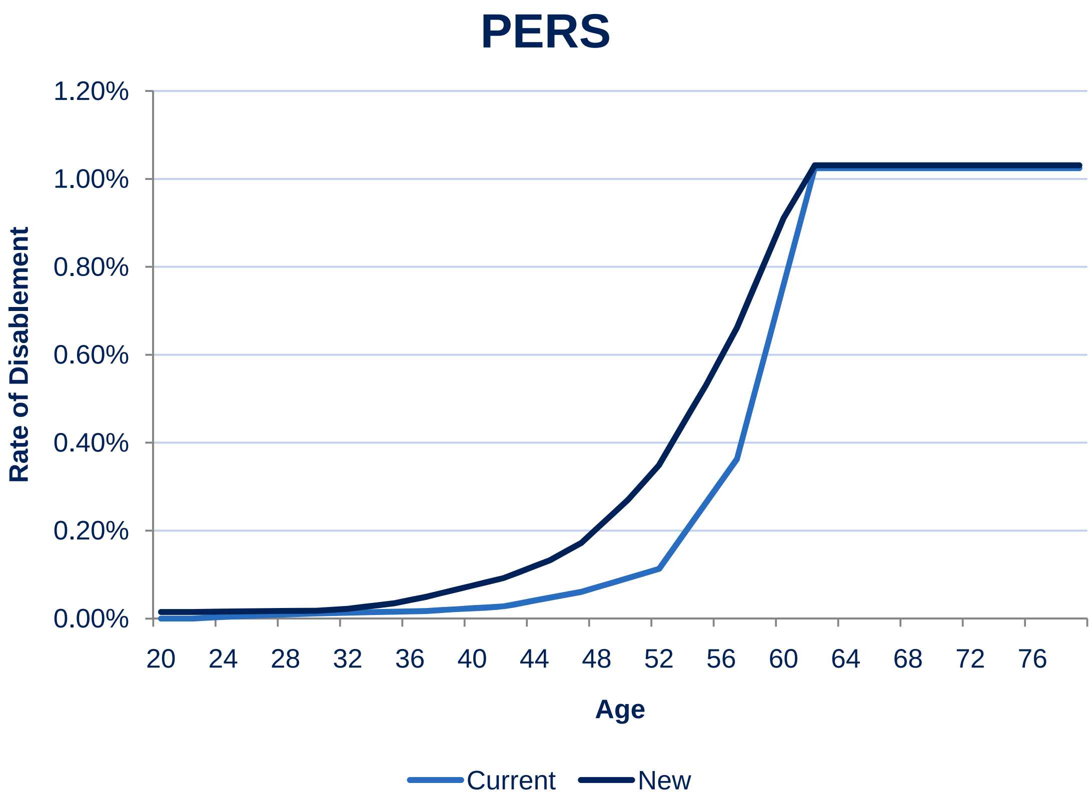
Supervising Actuary

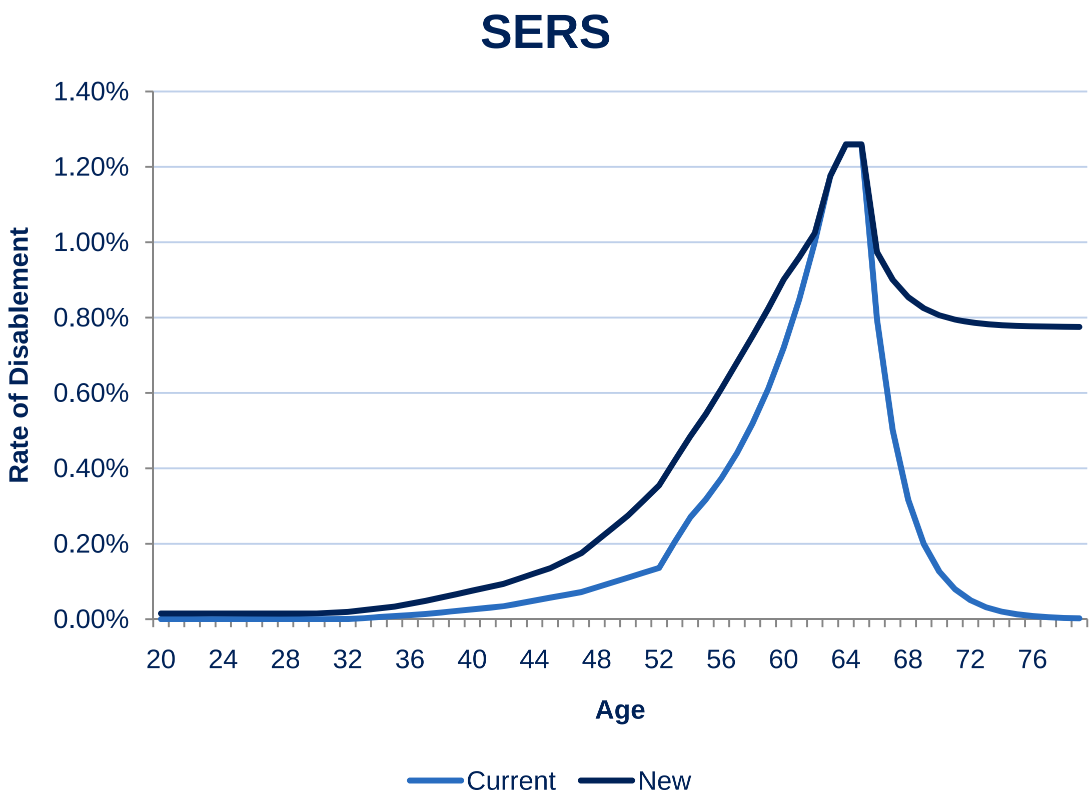
Matthew M. Smith, FCA, EA, MAAA

State Actuary

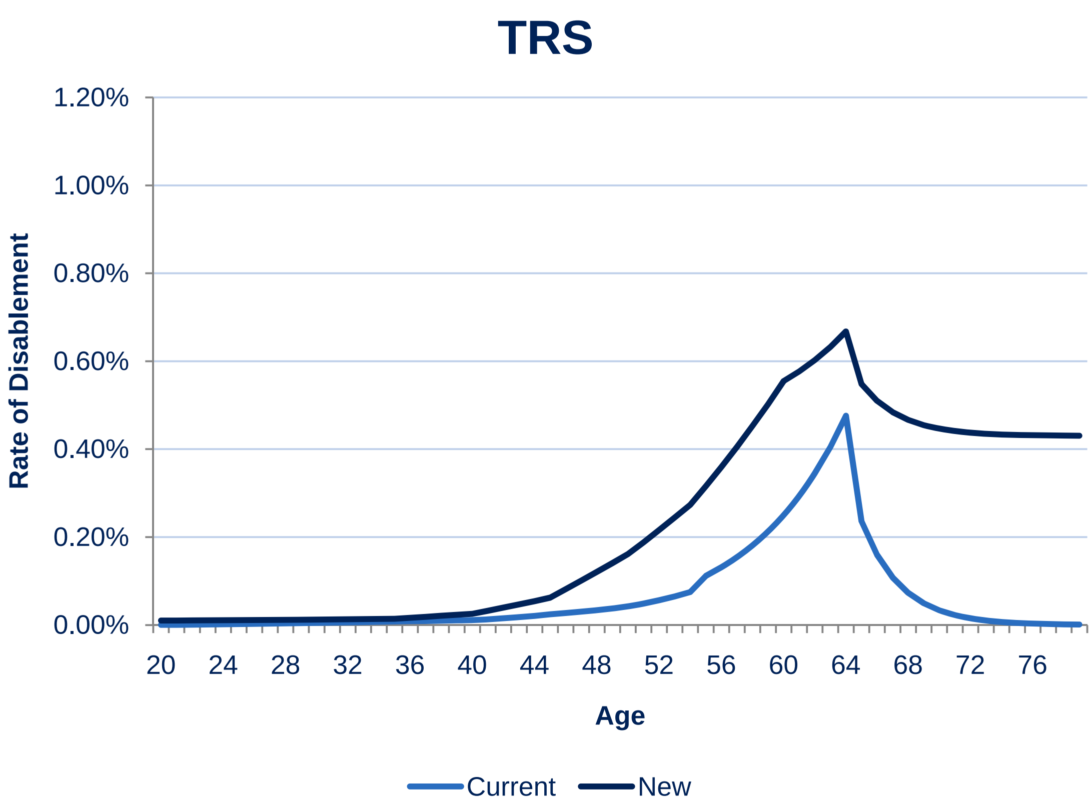
ASSUMPTIONS WE MADE

We assumed PERS and SERS would follow the disability experience of Minnesota and Iowa. We used an average of the two state's rates to create our assumption. The graph below shows the assumption relative to the current rates.





We assumed TRS would follow the disability experience of Wisconsin's teacher's plan. The graph below shows the assumption relative to the current rates.



We assumed that two-thirds of all future entrants into PERS, TRS, and SERS will choose to join Plan 2, and that the remaining one-third will enter Plan 3.

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

HOW WE APPLIED THESE ASSUMPTIONS

Since disability benefits are currently equivalent to retirement benefits when a member is retirement eligible, we do not currently assume disabilities occur beyond retirement eligibility. However, this proposal would make the disability benefit more valuable than the retirement benefit in certain circumstances. For this reason, we first had to extend our current disability assumptions to all age and service combinations (beyond retirement eligibility). We added this as a first step to the "base", which means it does not impact the pricing results.

In addition, we also believe the "true" rate of disablement is higher than our current assumptions (see "Assumptions We Made" for a discussion of why). We increased our disability rates in line with the assumption outlined in the assumption section. This was also added to the "base", since this proposal will not impact the actual rate of disablements (and the mortality rates of the affected members). Likewise, the total number of members exiting the retirement system in a year will not change. So we decreased termination and retirement rates in an equal amount to the disability rate increase.

The steps above outline the process we took to update our current model so that it was ready to correctly determine the expected cost of the proposed change in ERFs for disabled members. The last step we took to price the proposal was to value the disability benefits using the improved ERFs for disabled members. The difference before and after the ERF change determined the cost of the proposal.

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

We used the Entry Age Normal Cost Method to determine the fiscal budget changes for future new entrants. We used the Aggregate Funding Method to determine the fiscal budget changes for current plan members.

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 liability. The normal cost is determined for the entire 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 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).

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.

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