

Comprehensive Annual Financial Report

Washington State
Department of Retirement Systems
Funds of the State of Washington
For the Fiscal Year Ended June 30, 2011

Prepared by the Washington State Department of Retirement Systems

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www.drs.wa.gov

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Introductory Section



Message from the Director



This last year, the number of retirements continued a steady trend upward, while our resources became even leaner. A significant challenge, but it's one we have been preparing for some time to meet.

One way to do so is to ensure our priorities are aligned with those that are of the highest value to our more than 400,000 customers. How do you know if your customers are fully satisfied with your services? You ask.

In 2011 we asked a representative group of customers about a key DRS product – the benefit estimates we produce for those nearing retirement. Then we asked our team members for ideas on how to most effectively deliver on what customers said they needed, following the Lean principles that have seen resounding success in state government and private sector companies. Over the coming year, we will complete that work and put ideas into action.

On a simultaneous track, we made operational changes that included simplifying our online services and encouraging more use of our Web resources, which can be updated quickly and cost less than paper. As a result, we saw a rise in the number of people registering for online access to their retirement accounts.

We also continued work on building an online application for retirement, which will be launched in early 2012. Given the eight distinctly different retirement systems we administer, an online application is an intensive undertaking, but once complete, it will make the retirement process easier for many of our customers and offer an additional option for others.

This coordinated approach led to CEM Inc., an international firm that benchmarks the performance of public pension plans, finding once again that even though Washington's plans are among the most complex in the country to administer, our administrative cost is significantly lower than what would be expected.

It's an affirmation that is especially meaningful because we are able to achieve this cost-effectiveness while providing a high level of customer care. Customers who call or visit DRS talk with a knowledgeable team member who considers it a privilege to help ensure they receive the retirement benefits earned during a career in public service.

We take pride in our solid record of success, but no high-performing organization is ever content with being good at what they do. We are asking ourselves and our customers the questions that will lead to continuous improvement. We're good, but we strive to be great.

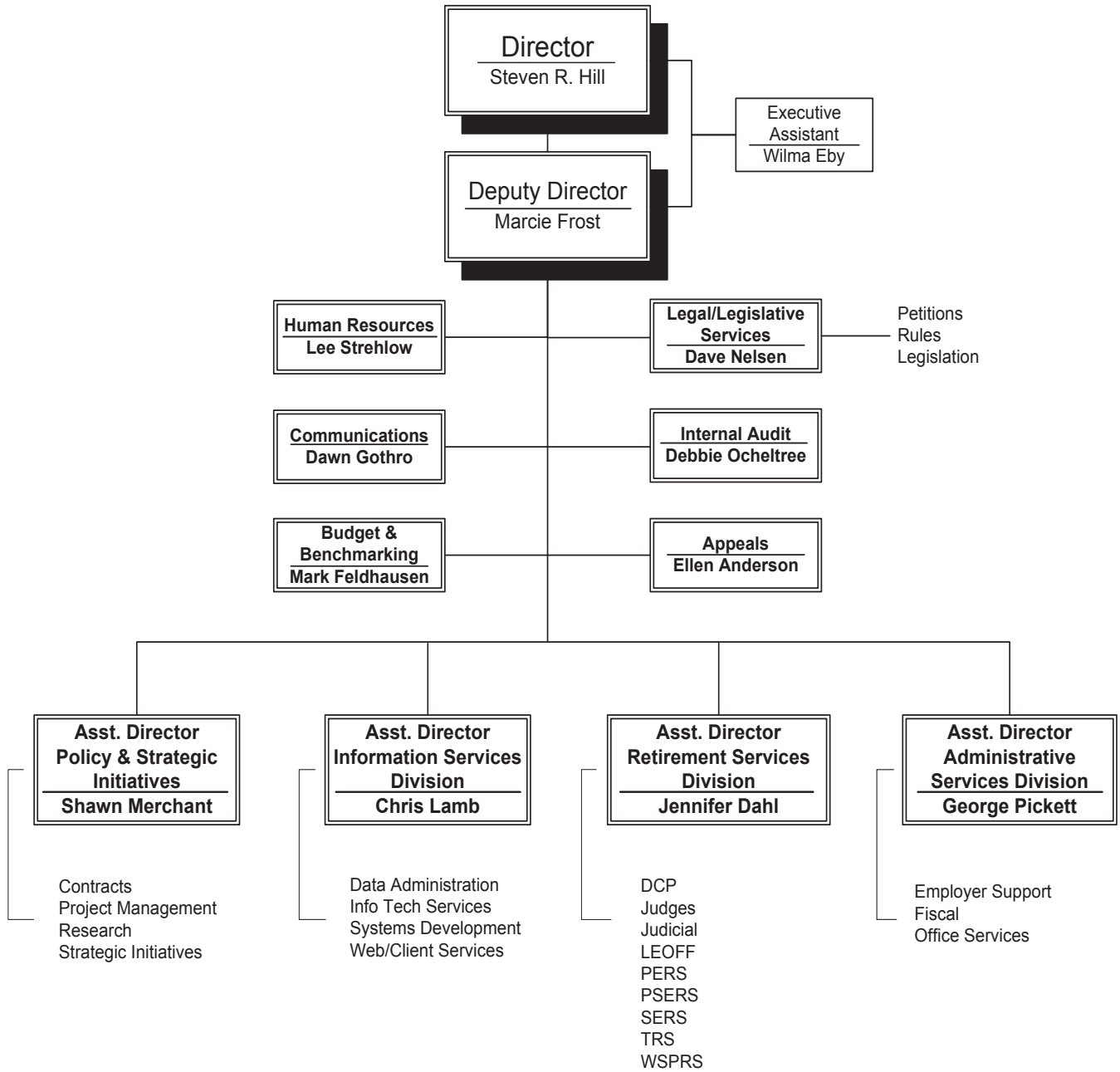
In the following pages, we offer our annual financial report for your review.

Sincerely,

A handwritten signature in black ink, appearing to read "Steve Hill".

Steven R. Hill
Director
November 2011

Department of Retirement Systems' Organization – June 2011



Pension System Roles and Responsibilities

DEPARTMENT OF RETIREMENT SYSTEMS

Collects and accounts for employer and employee contributions; maintains retirement records; pays benefits; communicates pension information; provides investment education; and administers the Deferred Compensation Program.

The governor appoints the director of DRS.

PO Box 48380 Olympia, WA 98504-8380
Telephone: (360) 664-7000 or toll free at 1-800-547-6657
Web site: www.drs.wa.gov

LEGISLATIVE FISCAL COMMITTEES

Review and report on retirement bills to the full Legislature.

The legislative fiscal committees are the House Ways and Means Committee and the Senate Ways and Means Committee.

House Ways and Means Committee
PO Box 40600, Olympia, WA 98504-0600
Telephone: (360) 786-7155 or toll-free at 1-800-562-6000
(Legislative Hotline)
Web site: www.leg.wa.gov

Senate Ways and Means Committee
PO Box 40482, Olympia, WA 98504-0482
Telephone: (360) 786-7715 or toll-free at 1-800-562-6000
(Legislative Hotline)
Web site: www.leg.wa.gov

SELECT COMMITTEE ON PENSION POLICY

Studies pension issues and retirement finances. Develops pension policies and recommends pension legislation.

The Select Committee on Pension Policy is composed of four members of the Senate, four members of the House of Representatives, four representatives of active state retirement system members, two representatives of retired members, four employer representatives and the directors of the Office of Financial Management and the Department of Retirement Systems.

**Committee Membership
(June 30, 2011)**

Representative Barbara Bailey	Don Carlson – TRS Retirees
Representative Bill Hinkle	Randy Davis – TRS Actives
Representative Tim Ormsby	Bob Keller – PERS Actives
Representative Pat Sullivan	Corky Mattingly – PERS Employers
Senator Steve Conway (Vice Chair)	Doug Miller – PERS Employers
Senator Steve Hobbs	Glenn Olson – PERS Employers
Senator Janea Holmquist Newbry	J. Pat Thompson – PERS Actives
Senator Mark Schoesler	Bob Thurston – WSPRS Retirees
Marty Brown – Director, Office of Financial Management	David Westberg – SERS Actives
Steven R. Hill – Director, Department of Retirement Systems	Vacant – Employer Representative

Can be contacted through the State Actuary’s Office
 PO Box 40914, Olympia, WA 98504-0914
 Telephone: (360) 786-6140
 Web site: www.leg.wa.gov/scpp

PENSION FUNDING COUNCIL

Adopts economic assumptions for pension funding and member and employer pension contribution rates for LEOFF Plan 1, PERS, PSERS, SERS, TRS and WSPRS.

Membership consists of the directors of DRS and the Office of Financial Management, and the Chairs and Ranking Minority Members of the Senate Ways and Means Committee and the House Ways and Means Committee.

Council Membership

- Marty Brown – Director, Office of Financial Management
- Steven R. Hill – Director, Department of Retirement Systems, Chairperson
- Representative Gary Alexander – Ranking minority member, Ways and Means Committee
- Representative Ross Hunter – Chair, Ways and Means Committee
- Senator Ed Murray – Chair, Ways and Means Committee
- Senator Joseph Zarelli – Ranking minority member, Ways and Means Committee

Can be contacted through DRS. See information on preceding page.

OFFICE OF FINANCIAL MANAGEMENT

Advises the governor on pension and funding policies and issues. The governor appoints the director of OFM

PO Box 43113, Olympia, WA 98504-3113
Telephone: (360) 902-0555
Web site: www.ofm.wa.gov

WASHINGTON STATE INVESTMENT BOARD

Invests and accounts for pension funds. The Board consists of ten voting and five non-voting members.

Voting membership consists of the director of DRS; the state treasurer; the director of the Department of Labor and Industries; a state senator; a state representative; an active member of LEOFF, PERS, SERS, and TRS; and a retired member of one of the seven systems.

Non-voting members are selected by voting members based on their experience and expertise on investment matters.

Board Membership (Voting Members, June 30, 2011)

Lisa Brown
State Senator

Steven R. Hill
Director, Department of Retirement Systems

George Masten
Representative of Retired Members

Patrick McElligott (Chair)
Representative of LEOFF

James L. McIntire (Vice Chair)
State Treasurer

Judi Owens
Representative of SERS

Natasha Pranger
Representative of PERS

Mike Ragan
Representative of TRS

Sharon Tomiko Santos
State Representative

Judy Schurke
Director, Department of Labor and Industries

(Non-voting Members, June 30, 2011)

William A. Longbrake
Investment Professional

Richard Muhlebach
Investment Professional

Robert S. Nakahara
Investment Professional

David Nierenberg
Investment Professional

Jeffrey T. Seely
Investment Professional

PO Box 40916, Olympia, WA 98504-0916
Telephone: (360) 956-4600
Web site: www.sib.wa.gov

OFFICE OF THE STATE ACTUARY

Acts as an advisory agency to the Legislature and to the director of DRS. Performs actuarial studies and reports on retirement bills. Creates formulas used to compute benefit payment adjustments that are based on early retirement, cost-of-living or long-term survivor benefits.

The State Actuary is appointed by the Select Committee on Pension Policy.

PO Box 40914, Olympia, WA 98504-0914
 Telephone: (360) 786-6140
 Web site: *osa.leg.wa.gov*

DRS ADVISORY COMMITTEE

Serves in an advisory role to the director of DRS. The committee consists of members representing active and retired members of the retirement systems administered by DRS, a professional with experience in defined contribution plan administration and a Deferred Compensation Program participant.

**Committee Membership
 (June 30, 2011)**

PERS

Patrick J. Dull
 Active

John I. Payne
 Active

Eva Jean Ann Shamley
 Retired

Mary L. Sherman
 Active

SERS

Jonni Elizabeth Lissner
 Active

Cherri Ingersoll
 Retired

LEOFF

Patrick McElligott
 Active
 (Fire Fighter)

Mark J. Mears
 Active
 (Law Enforcement Officer)

Richard Warbrouck
 Retired

TRS

Nancy Baldwin (Chair)
 Retired

Darrell Heisler
 Active

WSPRS

Lt. Michael L. Turcott
 Active

Rick Jensen
 Retired

JRS

Judge Michael Heavey
 Active

DCP

Kathy Whitlock
 Participant

**Defined Contribution Plan
 Administration**

Deirdre Walker
 Weyerhaeuser

Can be contacted through DRS. See information on page 5.

LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS' PLAN 2 RETIREMENT BOARD

Policy-making board that studies pension issues, acts as fiduciary of LEOFF Plan 2, sets contribution rates and recommends pension policy to the Legislature for LEOFF Plan 2 members. The LEOFF Plan 2 Retirement Board consists of three active fire fighters, three active police officers, three employers and two legislators.

Committee Membership (June 30, 2011)

Kelly Fox, Chair Fire Fighter Representative	Jeff Holy Law Enforcement Representative	Paul Golnik Employer Representative
Pat Hepler Fire Fighter Representative	Ryan Martin Law Enforcement Representative	Glenn Olson Employer Representative
Mark Johnston Fire Fighter Representative	Jack L. Simington, Vice Chair Law Enforcement Representative	Vacant Position Employer Representative
Representative Kevin Van De Wege		Senator Jim Honeyford

PO Box 40918, Olympia WA 98504-0918
(360) 586-2320
Web site: www.leoff.wa.gov

Letter of Transmittal



STATE OF WASHINGTON
 DEPARTMENT OF RETIREMENT SYSTEMS
 P.O. Box 48380 • Olympia, Washington 98504-8380

November 15, 2011

The Honorable Christine Gregoire, Governor
Members of the Sixty-Second Legislature
Members of the Select Committee on Pension Policy
 State of Washington
 Olympia, Washington 98504

We are pleased to present to you the Department of Retirement Systems' Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2011. This CAFR is designed to comply with the requirements of RCW 41.50.050(4) and RCW 41.50.780(9).

Responsibility for the accuracy of the data and the fairness and completeness of this presentation, including all disclosures, rests with the management of the Department of Retirement Systems (DRS). To the best of our knowledge, the enclosed data is accurate in all material respects and is reported in a manner designed to provide a fair representation of the financial position and results of the operations of the department.

Peterson Sullivan LLP, Certified Public Accountants, have issued an unqualified ("clean") opinion on DRS' financial statements for the year ended June 30, 2011. The independent auditor's report is located at the front of the Financial Section of this report.

Management's discussion and analysis (MD&A) immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction with it.

Agency Description and History

As of June 30, 2011, DRS administered eight statewide public employee retirement systems, which were comprised of 12 defined benefit pension plans and three combination defined benefit/defined contribution plans.

The purpose of DRS is to administer the pension plans for state employees, teachers and classified educational employees, law enforcement officers and fire fighters, and other employees of participating political subdivisions. As of June 30, 2011, there were 1,325 covered employers participating in multiple systems and/or plans administered by DRS. The eligibility requirements and provisions of each plan can be found in Note 2 of the Notes to the Financial Statements. DRS also administers a deferred compensation program. Additionally, DRS is responsible for all accounting and reporting services and the collection of contributions for the Judicial Retirement Account (JRA), a defined contribution pension plan administered by the State of Washington Administrative Office of the Courts.

The Washington State Legislature created the Department of Retirement Systems in 1976 to administer the Public Employees' (PERS), Teachers' (TRS), Law Enforcement Officers' and Fire Fighters' (LEOFF), Washington State Patrol (WSPRS), and Judicial (JRS) retirement systems, and the Judges' Retirement Fund (Judges).

Significant events in DRS history are listed below:

1930s-1940s

The PERS, TRS, WSPRS, Judges and many local police and fire fighters' retirement systems were created.

1950s-1960s

Independent administration of individual retirement systems continued.

1970

Local police and fire fighters' retirement systems were consolidated into LEOFF.

1976

The Department of Retirement Systems was created to administer state retirement systems.

The Office of the State Actuary was created to provide pension cost estimates.

1977

The LEOFF Plan 2, PERS Plan 2 and TRS Plan 2 were created.

1981

The Washington State Investment Board was created to handle the investment of all state trust funds.

1987

The Joint Committee on Pension Policy was created.

1995

The TRS Plan 3 was created effective July 1, 1996.

1996

The state Deferred Compensation program was transferred to DRS.

DRS assumed accounting and reporting responsibility for the Judicial Retirement Account (JRA) defined contribution plan.

1998

The School Employees' Retirement System (SERS) Plans 2 and 3 were created effective September 1, 2000.

The Pension Funding Council was created.

1999

The PERS Plan 3 was created effective March 1, 2002, for state and higher education employees, and effective September 1, 2002, for local government employees.

2001

The WSPRS Plan 2 was created effective January 1, 2003.

2003

The LEOFF 2 Board was established effective July 1, 2003.

The Joint Committee on Pension Policy became the Select Committee on Pension Policy effective July 27, 2003.

2004

The Public Safety Employees' Retirement System (PSERS) was created effective July 1, 2006.

2007

The Judges' Benefit Multiplier bill, effective January 1, 2007, gave justices and judges in PERS and TRS a one-time irrevocable option to increase their contributions in order to fund a larger retirement benefit.

2010

E2SHB 2617 eliminated the Employee Retirement Benefits Board (ERBB) effective June 30, 2010. The duties of the ERBB transferred to the Director of DRS.

Accounting System and Internal Control

This report has been prepared to conform with the principles of accounting and reporting established by the Governmental Accounting Standards Board (GASB). The basic financial statements are presented in accordance with guidelines established by GASB Statement No. 25, *Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans*, and other GASB statements, as appropriate. Specific accounting treatments are detailed in the Notes to the Financial Statements found in the Financial Section of this report.

Management is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the government are protected from loss, theft, or misuse, and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management. In addition, budgetary controls are maintained by the Office of Financial Management and the Washington State Legislature.

Funding

The intent of public pension funding in Washington state is to provide a dependable and systematic process for financing the benefits provided by the retirement systems. Measurements of funding status indicate how well a retirement plan is accomplishing that goal. There are two standard indicators of funding status: the funding ratio and the existence of an unfunded liability. Both measure the benefit obligations, or liabilities, of a plan against its assets. If the funding level is adequate, the ratio of total accumulated assets to total liabilities will be larger and more funds will be

available for investment purposes. Also, an adequate funding level gives the participants assurance that their pension benefits are secure.

The actuarial value of assets available as of the latest actuarial date for all systems is \$58,448 million. The accrued liability is \$61,582 million. The accrued liability exceeds the net actuarial value of assets available for benefits by \$3,133 million. The ratio of assets to liabilities is 95 percent, compared to 92 percent last year. Current contribution rates remain in keeping with the goal of attaining a funding ratio of 100 percent by the amortization dates applicable to each plan (June 30, 2024 for LEOFF Plan 1, and a rolling ten year period for PERS Plan 1 and TRS Plan 1), as required by chapter 41.45 RCW. Valuations are performed for all DRS-administered retirement systems on a yearly (July 1 through June 30) basis. These calculations are prepared by the Office of the State Actuary and reflect the latest valuation results. Additional actuarial information is included in the Actuarial Section of this report.

Investments

Under RCW 43.33A.030, trusteeship of the Retirement Funds is vested within the voting members of the Washington State Investment Board (WSIB). The WSIB has sole authority and responsibility for the investment of all state and local pension fund assets. The enabling statute requires the WSIB to “...establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk.” The policies adopted by the WSIB include provisions for the setting of strategic asset allocation objectives, as well as strategies and return objectives for individual asset classes. A summary of the asset allocation can be found in the Investment Section of this report.

For Fiscal Year 2011, the commingled trust fund (CTF) investments provided a 21.14 percent rate of return. The CTF annualized rate of return over the last three years was 1.90 percent and 4.86 percent over the last five years.

The day-to-day management of pension fund assets is the responsibility of WSIB staff. Further investment information is included in the Investment Section of this report.

Departmental Initiatives

The department's activities are highlighted in the "Message from the Director" on page 3 of this Introductory Section.

Professional Awards

The Government Finance Officers' Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to DRS for its comprehensive annual financial report for the fiscal year ended June 30, 2010. This was the seventeenth consecutive year that DRS has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

In October 2011, DRS also received the Public Pension Standards 2011 Recognition Award for Administration from the Public Pension Coordinating Council (PPCC). The PPCC is a coalition of three national associations that serve public pension funds. It represents substantially all employees of state and local government in the United States. Eligibility for this award entails meeting the professional standards for plan administration as set forth in the Public Pension Standards. These standards are intended to reflect minimum expectations for public retirement system administration.

Acknowledgments

This report was made possible by the staff of DRS based in part on information provided by the Office of Financial Management, the Office of the State Actuary, the Office of the State Treasurer and the Washington State Investment Board. Each member of these agencies has our sincere appreciation.

This report is intended to provide complete and reliable information that can be used to make management decisions, determine compliance with legal provisions, and evaluate responsible stewardship of DRS-administered retirement system funds.

Respectfully submitted,



Steven R. Hill

Director

Professional Awards (page 1 of 2):

Certificate of Achievement for Excellence in Financial Reporting

Presented to
Washington State
Department of Retirement Systems

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2010

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



A stylized, handwritten signature in black ink.

President

A stylized, handwritten signature in black ink.

Executive Director

Professional Awards (page 2 of 2):



Public Pension Coordinating Council

***Recognition Award for Administration
2011***

Presented to

Washington State Department of Retirement Systems

In recognition of meeting professional standards for
plan administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script that reads "Alan H. Winkle".

Alan H. Winkle
Program Administrator

2011 Washington State Legislative Actions

The 2011 Washington State Legislature passed five pension-related bills that were signed into law by Governor Gregoire. These bills are described below:

BILLS THAT APPLY TO MORE THAN ONE SYSTEM

- House Bill 1625 changes the default investment option for Plan 3 members of PERS, SERS and TRS who fail to choose a retirement plan within the allotted 90 days. The previous default investment option was the Washington State Investment Board (WSIB) Total Allocation Portfolio (TAP). The new default investment option is the Retirement Strategy Fund that is based on the member's age and an assumed retirement at age 65.
- Engrossed Substitute House Bill 1981 affects retirees of PERS and TRS Plans 1 by limiting (to 867) the hours a retiree can work before their pension benefit is suspended. This limit begins January 1, 2012.

Other provisions of this law affect higher education employees by:

- Applying the return to work provisions of PERS, SERS, TRS and PSERS to higher education positions eligible for the Higher Education Retirement Plans (HERPs).
- Limiting the ability of higher education institutions and entities to offer HERPs only to exempt employees;
- Prohibiting a higher education institution from offering participation in a HERP to any newly hired employee that has retired or is eligible to retire from a DRS-administered retirement system;
- Giving newly hired employees in HERP-eligible positions the option to participate in PERS or TRS Plan 3, or participate in a HERP;
- Requiring the Office of the State Actuary to oversee an actuarial valuation of the guaranteed minimum retirement benefit provisions.
- Discontinuing the guaranteed minimum retirement benefit provisions for all newly hired HERP participants;
- Requiring higher education institutions to submit a percentage of HERP-covered employees' salary to DRS to be invested by the Washington State Investment Board. These funds will be used to pay supplemental benefits to eligible HERP retirees. This provision is effective January 1, 2012;
- Giving the Select Committee on Pension Policy the authority to review HERP benefits and make recommendations to the Legislature, and;
- Limiting General Fund payments to higher education institutions and entities to no more than six percent of salary in matching contributions to HERP participants.

- Substitute House Bill 2021 eliminates an automatic annual benefit increase for retirees and beneficiaries in Plan 1 of PERS and TRS after June 30, 2011. This bill also lowers the minimum employer contribution rates for the unfunded liability in both plans, and increases the Adjusted Minimum Benefit limit to \$1,545 per month.
- House Bill 2070 requires DRS to include qualifying compensation that was foregone during the 2011-2013 biennium when calculating the pension benefit of retiring government employees. Qualifying compensation includes the three percent salary reduction for state employees. This applies to members of PERS, TRS, SERS, PSERS, WSPRS and LEOFF.

PUBLIC SAFETY EMPLOYEES' RETIREMENT SYSTEM

- House Bill 1263 modifies the employer definition within PSERS to include correctional entities formed by PSERS employers under the Interlocal Cooperation Act.

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