



2007-09 Operating Budget Request Part I: The Strategic Plan

Vision

DRS resources and services assist members in achieving long-term financial security.

Mission Statement

To provide our members with long-term financial tools, information, resources and retirement services that align with their changing lives.

Guiding Principles

- The personal financial security of our members is a key part of the economic vitality of Washington State.
- Long-term financial security provides the opportunity for individuals to reach their personal goals.
- Lifetime financial security is more likely to be achieved when individuals have access to unbiased information and instruments that recognize the challenges of saving.
- An informed, competent, self-confident staff provides outstanding services to plan members.
- Appreciation for performance, mutual accountability for underperformance, and recognition for outstanding performance are the foundation of the employee/employer relationship.

Values

Trust, respect, communication, honesty, resources, opportunity, appreciation, recognition, accountability and flexibility

Listing of Statutory Authority References

Legislative authority for the Department of Retirement Systems is established by Chapter 41.50 of the Revised Code of Washington (RCW). It consolidates administration of the state's public retirement systems (including one retirement fund), the Deferred Compensation Program and the Dependent Care Assistance Program into a single department. The Governor appoints the department's director with the consent of the Senate.

In addition to Chapter 41.50, which establishes the Department of Retirement Systems, specific authority for each of the retirement systems and funds is codified in the following chapters in RCW:

- 2.10 Judicial Retirement System (JRS)
- 2.12 Judges' Retirement Fund (Judges)
- 41.26 Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF)
- 41.32 Teachers' Retirement System (TRS)
- 41.34 Plan 3 Retirement System Contributions
- 41.35 School Employees' Retirement System (SERS)
- 41.37 Public Safety Employees' Retirement System (PSERS)
- 41.40 Public Employees' Retirement System (PERS)
- 43.43 Washington State Patrol Retirement System (WSPRS)
- 41.50.780 Deferred Compensation Program (DCP)
- 41.04.600 Dependent Care Assistance Program (DCAP)

The department must also conform to numerous miscellaneous references found throughout the RCW and the United States Internal Revenue Code.

Goals, Objectives and Strategies

- Manage the State of Washington pension and savings plans for the benefit and convenience of our customers.
 - Make it easy for our customers to provide the information we need to deliver outstanding service.
- Provide financial tools and services that encourage member savings and personal financial growth.
 - Understand the long-term financial security needs of our members.
 - Expand financial security education to reach all members.
 - Increase the number of members preparing for lifetime financial security.
- Continuously earn the public trust.
 - Increase communication about the pension system to citizens.
 - Provide reliable and consistent information in all customer interactions.
 - Reduce the number of administrative disputes entering the resolution process.

- Implement and administer laws within the intent of the legislature.
 - Increase DRS and stakeholder understanding of legislative intent before implementing new laws.
- Be a model employer.
 - Identify competencies for all management positions.
 - Increase employee participation in organizational changes.
 - Provide a training curriculum that develops and maintains a competent, confident staff.

DRS' goals and strategies support statewide result number 10 in the Priorities of Government to ***“strengthen government’s ability to achieve results efficiently and effectively.”***

Activity Inventory and Performance Measures

The activity descriptions included in this section have been summarized in the bullets below to serve as a quick reference. (More complete descriptions can be found in the agency’s activity inventory.) In summarizing the activities, however, we didn’t want to lose the following facts/figures from Fiscal Year 2005 that provide a perspective on the magnitude of the agency’s impact.

- Net assets held in trust for pension and other benefits totaled over \$51 billion.
- DRS provided service to over 560,000 members and 1,300 public employers.
- DRS disbursed over \$2 billion in benefits.
- DRS collected over \$732 million in employer and member contributions.
- The data provided by employers contained in excess of 1 million line items of member information each month.
- The Deferred Compensation Program served more than 48,000 participants, with plan assets exceeding \$1.9 billion.
- The Dependent Care Program served more than 1,100 participants, with annual deferrals totaling \$4.5 million.

It is also important to understand the critical links between DRS’ activities, as they function together in support of a single mission. DRS’ primary mission of producing accurate and timely retirement benefits to retirees and beneficiaries is directly supported by six of the agency’s eight activities.

The other two activities, Deferred Compensation and Dependent Care, are self-financed by program participants and employer tax savings, respectively.

The agency's mission supports the state's numerous legal and fiduciary obligations to retirement system members arising from the State Constitution and the Washington State Supreme Court, as well as federal trust law, Internal Revenue Code pension

provisions, and state statute. Elimination of or significant reduction to any of the associated activities could cause the agency to fail to meet these obligations.

- **Administration** provides executive leadership on plan administration, legal, planning and support to the Governor on pension issues, and other administrative support services.

A primary measure we've associated with this activity is the agency's cost effectiveness, as measured in a public pension administration benchmarking study performed by an independent firm:

- Actual costs are 25 percent lower than benchmarked predicted administrative costs.
- **Retirement Customer Services** provides direct service to active, retired and inactive members of the state's public retirement systems.

Some of the key performance measures for this activity reflect the agency's responsiveness to customers:

- 90 percent of incoming correspondence answered within five days,
- 90 percent of customer requests for benefit estimates responded to within five days,
- 90 percent of all incoming phone calls answered within 30 seconds by a knowledgeable employee, and
- 100 percent of walk-in customers greeted by a knowledgeable employee within a four-minute average.
- **Retirement Information Systems** maintains and develops the automated systems that are essential for data collection and processing, and disbursement processing.

A couple of performance measures for this activity deal with increasing the capability and use of our automated systems:

- Develop a new electronic retirement application process by July 2007 (to augment the existing paper process, which is also slated for redesign and improvement), and
- Achieve a 10 percent increase in the cumulative average of members and retirees enrolled in web services by July 2007.
- **Trust Fund Accounting** provides all phases of accounting for the pension/trust funds, from collection of contributions, to withdrawals and pension disbursements, to tax reporting to the Internal Revenue Service.

Various performance measures are in place for the agency's accounting processes to safeguard the assets flowing through the agency (contributions and disbursements). A key measure is to keep receivables low so that member and employer contributions are available for investment:

- Collect past-due retirement contributions from employers, reducing the dollar value of past due debit employer receivables by 25 percent in FY 2006.

- **Member Data Services** processes essential member information submitted by public employers, and provides training to and performs audits of public employers.

A performance measure used for this activity focuses on the outcome of how successful we are in helping employers clean up incoming member data so that future financial processes can be timely and accurate:

- Benefit estimates are within five percent of the actual benefit amount for members' planning up to two years prior to retirement.

- **One-Time Projects** represents the costs associated with changes to the existing public pension systems approved and funded each legislative session.

Similar to other state agencies, the primary measure for legislative projects is that they be completed on time and within budget. Although projects required of DRS have ranged from a few thousand dollars, to implement and communicate a minor benefit change, to millions of dollars, to implement a new and complex retirement system, all have been successfully implemented on time and within budget.

- **Deferred Compensation Program Management** allows public employees to defer and invest a portion of their salary until retirement or termination of public employment.

The primary performance measure for the Deferred Compensation Program is its ongoing success in adding new participants:

- Increase voluntary DCP participation by 10 percent by December 31, 2007.

- **Dependent Care Program Management** allows public employees to set aside a portion of their salary to cover dependent care expenses.

The Dependent Care Program, at approximately one percent of the agency's budget, does not have separate or unique performance measures.

Performance Assessment

DRS uses the balanced scorecard (BSC) to actively measure and monitor the agency's performance. The BSC is integrated into agency operations as a tool to ensure that the agency has a more complete perspective of its performance. The tool requires the agency to look at how it's doing from five different perspectives, arguing that too many companies have historically only looked at one or two (primarily financial health and sometimes customer satisfaction), to their eventual downfall. In addition to those two perspectives, the BSC adds: public value and benefit, internal process, and learning and growth. (Essentially, the value the company adds, the strength of its internal processes, and how it develops its own staff, respectively.)

The agency's BSC system currently contains approximately 120 measures covering all areas of the agency. The units and divisions update the system on a monthly basis and management is able to pull various reports at any time to assess the performance of the agency. Representative performance measures have been identified above in the activity inventory discussion. They reflect that the agency is accomplishing its mission, in a cost-effective manner.

Key indicators are developed for each program to highlight and subsequently analyze service levels, assess program performance and communicate status of high priority projects. Results are shared with the Director and her leadership through a twice-monthly forum.

Appraisal of the External Environment

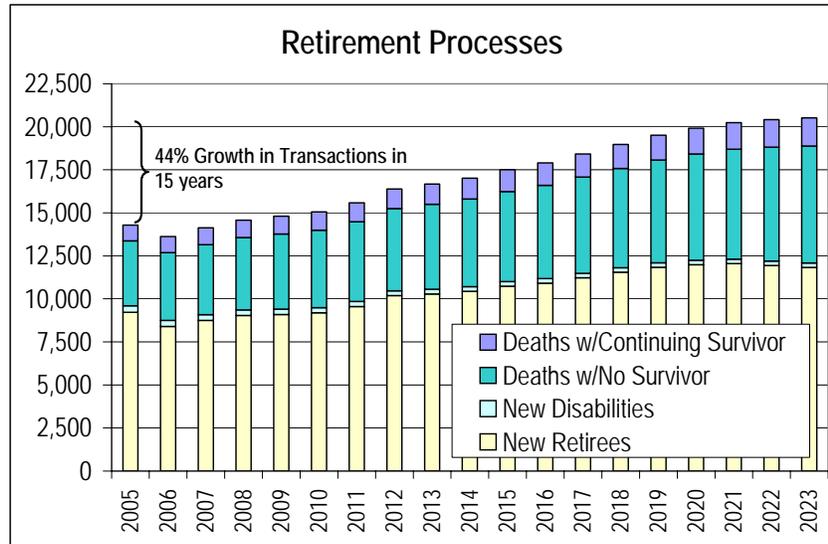
Over the past year, DRS has increased its interaction with the external environment. In addition to the historical relationships with various pension organizations (e.g., the National Association of State Retirement Administrators and the Public Pension Coordinating Council); DRS, the Health Care Authority and the State Investment Board joined the Employee Benefit Research Institute (EBRI). EBRI, based in Washington, DC, has been conducting research on retirement plans since its founding in 1978. The agency has also met with numerous retiree organizations and editorial boards within the state to discuss pensions and retirement. These discussions have provided invaluable input into developing strategies to accomplish the agency's mission.

Economy – The primary impact of improvements in the state's economy is the availability of revenue to partially offset the cost of resuming payments on the unfunded accrued actuarial liability in Plan 1 of TRS and PERS, and the gradual increases in member and employer contribution rates. Additionally, the performance of the pension funds managed by the State Investment Board have exceeded the assumed rate of return in FY 2004, 2005 and the first half of FY 2006, and the most recent Actuarial Valuation Report identified that the actuarial value of the pension assets exceeded the present value of credited projected benefits (liabilities) producing a credited projected funded ratio of 105%. Many other public and private pension systems are not in as healthy of a position when it comes to their funded status.

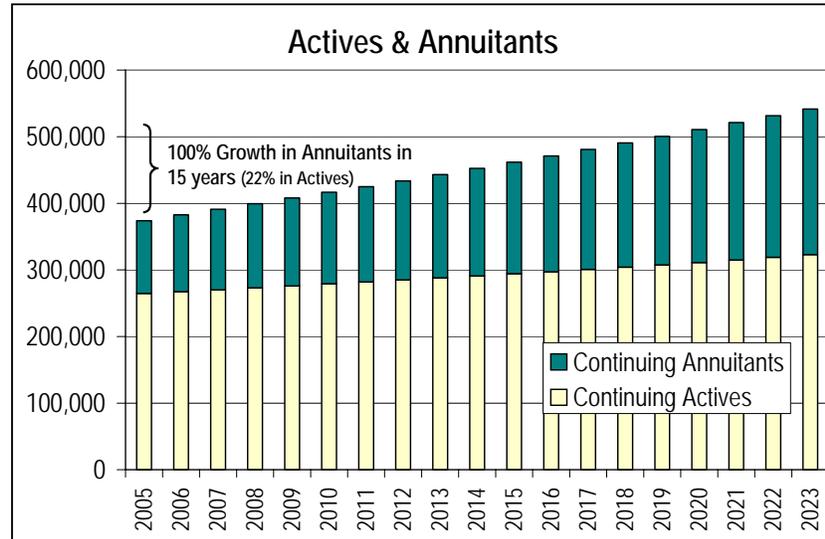
An aging population – The first wave of Baby Boomers is rapidly approaching retirement age. This changing demographic will impact DRS in several ways. First, it will mean increased workloads as a larger number of people than ever before in history exits the workforce. Second, significant policy issues will arise as the population ages. With older workers representing a larger contingent of the retirement systems membership, member concern is shifting from the size of employee contributions to retirement age requirements and other benefit issues, like disability benefits and the ongoing cost of health care.

Client Characteristics – In the near future, DRS will experience significant increases in the customer population and workloads.

A primary measure of workload growth for DRS is the combined number of “retirement processes” (i.e., retirements, disability retirements and death benefits). As shown in the chart to the right, developed from data provided by the Office of the State Actuary, the volume of the associated transactions is projected to grow by 44 percent in 15 years.



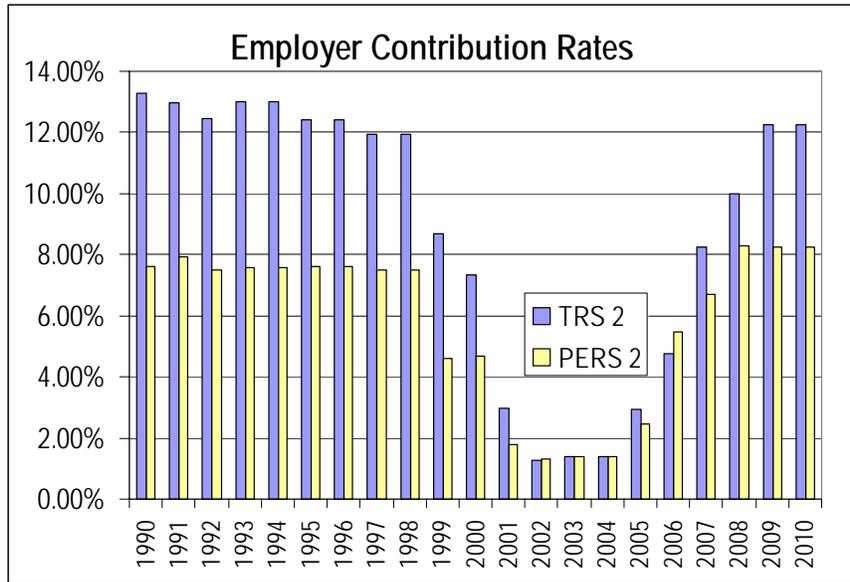
Another measure of workload growth is the number of active and retired members (“annuitants”) who will require ongoing service from DRS (e.g., pension payments, 1099s, benefit information, etc.). As shown in the chart to the right, the number of annuitants is expected to double by the year 2023, reflecting not only the impact of the Baby Boomers but also the fact that retirees, in general, are living longer.



DRS’ pursuit of technology to reach and provide services to members will not only free staff to assist in areas where personal contact is needed or desired by the member, but also increase customer satisfaction and maintain cost-effectiveness.

Legislation – During the 2006 interim, DRS will continue to participate in and/or track the development of legislation for the 2007 Session, primarily through our Director’s membership in the Select Committee on Pension Policy and our interaction with the Law Enforcement Officers’ and Fire Fighters’ Retirement System Plan 2 Board. Early indications are that various groups will pursue: pieces of legislation that didn’t pass in the 2006 Session, amendments to legislation that did pass in 2006 and new legislation on issues like disability benefits.

The context those requests likely will be placed in, however, is the gradual increase in contribution rates, back to historical levels last seen in the 1990's. The graph to the right contains actual employer rates from 1990 through 2005 and projected rates through 2010 from the Office of the State Actuary's website.



On a federal level, Congress and the President remain

interested in the subject of retirement savings, including potential changes to the Internal Revenue Code, Social Security benefits and the Pension Benefit Guaranty Corporation. Non-governmental pension research organizations have also gotten involved, publicly debating the merits and drawbacks of defined benefit and defined contribution plan structures.

It is unknown if, when, or in what form those changes may ultimately become law, but any change to retirement plans potentially impacts DRS. DRS must be prepared to implement the changes. The agency's reliance on integrated technology, while allowing for efficient and cost-effective operations, requires thorough analysis and meticulous reprogramming to incorporate even minor modification. DRS must also be prepared to continue to provide accurate and unbiased information that will enable its members to make wise decisions about retirement planning.

Media headlines – Over the past couple of years the national pension-related headlines have shifted from the losses in retirement savings, due to the market downturn and corporate scandals (e.g., Enron), to the termination or “freezing” of large corporate pensions (e.g., the airline and automobile industries). The latter has even found its way into state pension systems, with the State of Alaska passing a law identifying that public employees and teachers hired on or after July 1, 2006 will be enrolled in a new defined contribution plan, instead of the historical defined benefit plan. Washington State headlines, on the other hand, have tended to cover the impact on the budget of returning to historical contribution levels, making payments towards the Plan 1 unfunded liability and funding gain-sharing. Although the national headlines have not driven policy changes in our state, they have raised awareness of the topic.

Major Partners – DRS works with several external partners in serving active and retired members. The following list describes key strategic relationships.

- **Select Committee on Pension Policy (SCPP)** - a 20-member standing legislative committee composed of four members of the Senate, four members of the House, four members representing active employees, two members representing retired employees, four employer representatives, and the directors of DRS and OFM. The SCPP holds meetings throughout the year to study pension issues, develop pension policies, study the financial condition of state pension systems, develop funding policies, and make recommendations to the Legislature.
- **Office of the State Actuary** - an advisory agency to the Legislature and to DRS on current economic conditions and trends. The Actuary uses historical data to compute risk factors and required increases or decreases in the contribution rates for employers and system members. The Actuary also creates the factors that are used to compute benefit payment adjustments for early retirement, cost of living, or long-term survivor benefits.
- **DRS Advisory Committee** - a 12-member advisory committee that represents the active and retired members of the retirement systems administered by DRS.
- **State Investment Board (SIB)** - a 15-member board composed of the directors of DRS and the Department of Labor and Industries, the State Treasurer, one state representative, one state senator, five active and/or retired members of the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), School Employees' Retirement System (SERS) and Law Enforcement Officers' and Fire Fighters' (LEOFF) Retirement System, and five non-voting members who are experienced and qualified in the field of investments. Among the SIB's duties is the sole responsibility for the investment of all retirement trust funds.
- **Employee Retirement Benefits Board (ERBB)** - a 13-member board composed of active and retired members of PERS, TRS and SERS, individuals with experience in defined contribution plan administration, a participant in the Deferred Compensation Program (DCP) and the Director of DRS. The ERBB recommends to the SIB investment options for the self-directed investment program in Plan 3 and the DCP, selects payment schedules that will be made available to members and survivors of members, recommends actuarially equivalent annuities that may be purchased from the Total Allocation Portfolio investment option, and determines administrative charges to the self-directed investment fund to offset self-directed account expenses.
- **Third Party Record Keepers** - a financial record keeping company that contracts with DRS to track the individual member investment accounts. The role is currently performed by ICMA Retirement Corporation for TRS Plan 3, PERS Plan 3 and SERS Plan 3 members; and by CitiStreet for DCP participants.
- **Law Enforcement Officers' and Fire Fighters' (LEOFF) Plan 2 Board** - an 11-member board of trustees composed of three law enforcement officers, three fire fighters, three employer representatives, one member of the House and one member of the Senate. The LEOFF Plan 2 Board holds meetings throughout the year to study pension issues, develop pension policies, study the financial condition of state pension systems, develop funding policies, and make recommendations to the Legislature on LEOFF Plan 2.

- **Pension Funding Council (PFC)** - a six-member council composed of the directors of DRS and the Office of Financial Management, and the chair and ranking minority members of the House Appropriations Committee and the Senate Ways and Means Committee. The PFC was created to adopt changes to economic assumptions and contribution rates.

Assessment of Internal Capacity and Financial Health

Internal Capacity – As part of the agency’s comprehensive strategic planning process, DRS’ senior managers thoroughly review and assess the organization’s strengths and weaknesses twice each year, especially in regard to recent accomplishments and ongoing goals and objectives. DRS also participates in an extensive external survey of public retirement system administrators to obtain an objective measure of cost-effectiveness compared to peer agencies.

The two key areas that have the greatest impact on DRS’ internal capacity for peak performance are technology and staffing.

In regard to the agency’s technology infrastructure, DRS operates with a complex blend of both mature and innovative information systems applications. The agency’s benefits processing applications, developed and implemented in the mid-1990’s, utilize COBOL and Natural languages. More recent systems development activities have focused on innovative client server applications that provide Internet-based interfaces to allow customers and employers to access agency services and conduct business with DRS online.

The agency has an effective security program in place to protect its information systems from external vulnerability. As a result, DRS has not experienced any successful infections for more than four years and as viruses and worms become more sophisticated, DRS will continue to dedicate resources for the expansion and reinforcement of security precautions and measures.

Most of the agency’s technology success can be directly attributed to its staff’s capabilities. Project management, which includes systems development projects, is an area where DRS particularly excels. DRS has a highly effective project management program in place, with standard practices and tools that are used consistently. The agency has repeatedly proven its ability to manage projects on time and within budget.

DRS is currently well staffed by highly qualified employees. To supplement the skills of DRS’ staff, the agency has often relied upon contractors to perform specialized technology services. The agency has established strong relationships with vendors of such services, and does not foresee any changes that would limit availability of those services in the future. This strategic reliance on contractors has proven to be extremely valuable for the purpose of implementing legislative changes quickly to meet the specified effective dates.

Financial Health – DRS operates out of three fund sources.

- The primary source is the **DRS Expense Account (fund 600)**. This appropriated fund receives its revenue from public employers as a percentage rate of their salary expenditures. (See RCW 41.50.110.) The rate has fluctuated between 0.16 percent and 0.23 percent over the past 20 years, typically increasing for a few years at a time to address increased costs/appropriations associated with new system/plan implementations. It has been at 0.19 percent since September 1, 2004 and will be reduced to 0.18 percent on September 1, 2006. The rate has yet to be identified for the 2007-2009 biennium, as additional trend data on the total salary base, and the estimated appropriations for DRS and the Office of the State Actuary are essential components of the calculation.
- Another source is the **Deferred Compensation Administrative Account (fund 888)**. This nonappropriated fund receives its revenue from participants in the state's Deferred Compensation Program as a percentage rate of their total assets in the program. (See RCW 41.50.780.) As plan assets have grown, the rate to cover DRS' services has been reduced from 0.79 percent when the program started in July 1988, to the current rate of 0.0425 percent (which covers administrative costs at DRS and at the Washington State Investment Board). The rate has yet to be identified for the 2007-2009 biennium, as additional data on the projected size of the asset base and the balance in fund 888 are essential components of the calculation.
- The remaining source is the **Dependent Care Administrative Account (fund 03T)**. This appropriated fund receives its revenue from employer savings of Old Age and Survivor Disability Insurance taxes realized from salary reductions on behalf of program participants. (See RCW 41.04.615.) The rate to cover DRS' services is based on participation levels and actual expenses incurred to administer the program. It has ranged between 42 and 52 percent of the employer savings since July 1998. The rate has yet to be identified for the 2007-2009 biennium, as additional data on projected participation levels, the balance in the fund and the appropriation level are essential components of the calculation.

