BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND PILOTS, Respondent.	Docket TP-

TESTIMONY OF

STEVEN L. DIESS

ON BEHALF OF THE PUGET SOUND PILOTS

NOVEMBER 19, 2019

Williams, Kastner & Gibbs PLLC
601 Union Street, Suite 4100
Seattle, Washington 98101-2380
(206) 628-6600

6989762.1

EXHIBIT LIST		
Exhibit No.	**Description**	**Page Referenced**
SD-2	Actuarial Analysis of PSP Retirement Plan	2

Williams, Kastner & Gibbs PLLC
601 Union Street, Suite 4100
Seattle, Washington 98101-2380
(206) 628-6600

6989762.1

I. IDENTIFICATION OF WITNESS

Q: Please state your name, business and business address.

A: My name is Steven L. Diess. I am President and co-owner of Independent Actuaries, Inc., located at 4500 Kruse Way, Suite 200, Lake Oswego, Oregon 97035.

Q: How long have you been principal of or employed by Independent Actuaries, Inc.?

A: I was hired as a consulting actuary by the company in 2005. In 2007, I was invited to become a partner in the company, joining three other employee shareholders.

Q: In your capacity at Independent Actuaries could you please describe what you do, generally?

A: In very general terms, our firm places a value on events that may or may not occur in the future. The work that we do typically involves benefits that are payable to individuals over their retired lifetime, such as in deferred compensation plans or pension plans.

Q: Please describe your experience in evaluating deferred compensation and pension plans as an actuary?

A: I have been involved in the valuation of pension plans for my entire 25-year career as an actuary. These plans have ranged in size from one participant to over 10,000 participants, and have been sponsored by business entities in both the public and private sectors. My involvement with deferred compensation plans is more limited, simply because these plans are less common and typically don't require annual actuarial valuations. However, I have been involved with several of them over the years, and the general practice and process of valuing deferred compensation plans is identical to the valuation of pension plans.

Williams, Kastner & Gibbs PLLC
601 Union Street, Suite 4100
Seattle, Washington 98101-2380
(206) 628-6600

6989762.1

Q: Is this your first time testifying at the Washington Utilities and Transportation Commission?

A: Yes, it is but I have testified in various court proceedings over the years in Clackamas County and Multnomah County, both in Oregon. These proceedings have typically involved the division of property in the case of dissolution of marriage.

II. PURPOSE OF YOUR TESTIMONY

Q: **Can you please tell the Commission what role, if any, you played in the preparation of the Applicant's proposed tariff in this proceeding?**

A: Yes. I have been tasked with reviewing one of the material expense items, the Amended Retirement Program of Puget Sound Pilots' (PSP retirement program) and conducting an actuarial analysis of the plan as of January 1, 2019.

Q: Have you caused to be prepared an exhibit which provides analysis of that plan?

A: Yes, identified as Exh. SD-2, attached herein, is a copy of that report with accompanying exhibits which analyzes projected population counts and benefit payment amounts.

Q: Have you also prepared an overview or summary of your analysis to which you can allude?

A: Yes. In Exh. SD-3 page 2, is a condensed summary of our findings of the PSP retirement program as it currently stands and which alludes to analysis of viability of that plan.

Q: What, in a nutshell, were those conclusions?

A: That the PSP retirement program, essentially a "pay-go" or self-funding system much like the original Social Security Plan in that it funds retirement benefits with present pilots' income, is fiscally sound and, based on our analysis, able to fund itself for the

Williams, Kastner & Gibbs PLLC
601 Union Street, Suite 4100
Seattle, Washington 98101-2380
(206) 628-6600

6989762.1

indefinite future predicated upon currently available financial and reporting data and various assumptions that my report explains and which are elaborated upon in my testimony below.

Q: Can you please highlight and list what underlying assumptions you made in compiling statistics with respect to pilot ages, length of service, cyclical retirement and replacement by newly-revised operations, etc.?

A: We collected snapshot census data for active and retired pilots as of January 1, 2019, including those pilots currently using ETO and comp time/callback time prior to officially retiring, as well as data for individuals currently in the training program. Based on this snapshot data, we developed a demographic assumption set, including the ages at which pilots are generally hired, the rates that they retire at various ages and service levels, and their marital status and spouses ages. We also utilized assumptions about mortality rates at various ages, separate for males and females, as well as the rate at which these mortality rates will improve in the future, all based on published and generally accepted mortality studies. Finally, for purposes of our open group projection, we assumed that future hires will be demographically similar to pilots who have been hired in the past.

Q: Can you tell the Commission the criteria upon which an actuary would judge the viability of a retirement plan and compare and contrast defined benefit and defined contribution plans to place the rather unique PSP deferred compensation system in context?

A: Yes. First, I'll discuss the difference between defined benefit and defined contribution plans. Essentially, they do just what the names say they do. In defined contribution plans, such as 401(k) or 403(b) plans, what is known (or defined) is the amount that is

Williams, Kastner & Gibbs PLLC
601 Union Street, Suite 4100
Seattle, Washington 98101-2380
(206) 628-6600

6989762.1

being contributed each year. The unknown part is what those contributions will accumulate to when the participant is ready to retire; that will depend on investment experience. Defined benefit plans work the other way: The defined item is the benefit that the participant will receive in retirement, and what is unknown is how much will need to be contributed each year to fund that benefit.

Q: Can you address the concept of risk in the context of retirement plans?

A: Yes. A big part of sponsoring any type of retirement plan or deferred compensation program is managing the risk associated with it. Two main types of risk are investment risk and longevity risk. Investment risk pertains to the possibility of invested plan assets not performing as expected; in general, if plan assets underperform, more money will need to be contributed to pay out the same level of retirement benefits. Longevity risk has to do with retirees dying earlier or later than expected. In general, if a retiree lives longer than expected, he or she will need more retirement money.

Q: In defined benefit plans how are these risks addressed?

A: In a defined contribution plan, both main types of risk are borne by the plan participant. In a defined benefit plan, both main types of risk are borne by the plan sponsor. It is important to note that the plan sponsor is much better suited to bear the longevity risk than is the plan participant. There is a 50% chance that any individual participant will live longer than expected. If a participant has a defined contribution plan (like a 401(k) plan), there is simply an account balance from which to draw retirement income, and there is a significant chance that the participant will outlive his or her retirement assets.

Q: How does this differ from a defined benefit plan?

A: In a defined benefit plan, participants get benefits payable for their lifetime, so they are guaranteed not to outlive their retirement assets. Further, some participants will live

Williams, Kastner & Gibbs PLLC
601 Union Street, Suite 4100
Seattle, Washington 98101-2380
(206) 628-6600

6989762.1

longer than expected and some will live shorter than expected; for the plan as a whole, it typically comes out in the wash. In other words, the longevity risk to the plan sponsor (who is funding the plan benefits) is minimal; it acts like an insurance pool.

Q: What is the PSP's program?

A: The PSP retirement program is a defined benefit program. This type of program can either be pre-funded or be pay-as-you-go. In the private sector, pre-funding is required, to provide some level of protection to plan participants (in that the employer can't simply walk away from their payment obligation). In general, an actuary is needed to determine the liability of the plan (the present value of future expected payment streams for current participants). This liability is compared to the assets that have been set aside to fund the benefits, and a minimum required contribution is determined.

Q: How do pay-as-you-go plans operate?

A: For pay-as-you-go plans, there are no invested assets. Instead, retiree benefits are paid by the plan sponsor as those payments arise, essentially funded by the work of active plan participants. Since there are no invested assets, there is no investment risk. In summary, as a pay-as-you-go defined benefit plan, the PSP retirement program has no investment risk, and the longevity risk is borne by the plan sponsor, as is most appropriate. It is my understanding that there is considerable trust between current retired pilots and active pilots. The retired pilots believe that they can rely on the active pilots to generate the income needed to fund their benefits, and the active pilots know that in "paying it forward," income to fund their own retirement benefits will be generated by the next generation of pilots.

Q: Based on these plan descriptions and distinctions, what is your view of the long-term viability/sustainability of the PSP retirement program?

Williams, Kastner & Gibbs PLLC
601 Union Street, Suite 4100
Seattle, Washington 98101-2380
(206) 628-6600

6989762.1

A: Given all this, it is my opinion that the PSP retirement program is viable and sustainable into the foreseeable future. It is hard to imagine a scenario, now or in the future, in which benefits to retirees would not or could not be paid as my accompanying reports and schedules underscore.

Q: Does this conclude your testimony for now?

A: Yes, it does.

Williams, Kastner & Gibbs PLLC
601 Union Street, Suite 4100
Seattle, Washington 98101-2380
(206) 628-6600

6989762.1