Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Appropriations Committee

HB 2236

Brief Description: *Modifying the process through which economic assumptions, contribution rates, and valuation methodologies are established for the public pension systems.*

Sponsors: *Representatives Sehlin and H. Sommers.*

Brief Summary of Bill

- *Legislative intent regarding the state's pension funding processes is modified in recognition of the improvement in the funding status of the state retirement systems since 1989.*
- *New long-term economic assumptions and a new asset value smoothing technique are adopted for use in state retirement system actuarial studies.*
- *New employer, state, and Plan 2 member contribution rates are adopted for the 2001-2003 biennium for the Public Employees Retirement System (PERS), the Teachers Retirement System (TRS), the School Employees Retirement System, and the Law Enforcement Officers and Fire Fighters Retirement System.*
- *The target date for fully funding all PERS 1 and TRS 1 liabilities is moved from December 31, 2016, to June 30, 2024.*
- *The roles of the Pension Funding Council and the Legislature in adopting economic assumptions, asset value smoothing techniques, and contribution rates are clarified.*

Hearing Date: *4/10/01*

Staff: *Andrea Hardy (786-7349).*

Background:

In 1989 the Legislature established new processes to provide for the systematic funding of

the various state-administered retirement plans, including Public Employees Retirement Systen (PERS), Teachers Retirement System (TRS), School Employees Retirement System (SERS), Law Enforcement Officers and Fire Fighters (LEOFF), and the Washington State Patrol Retirement System (WSPRS). The 1989 pension funding bill established new employer contribution rates in statute, required the Economic and Revenue Forecast Council (ERFC) to adopt the economic assumptions to be used by the State Actuary in conducting valuation studies of the state retirement systems, and required the ERFC to recommend changes in employer contribution rates once every six years.

The Governor was required to use the rates established in the bill to prepare a proposed budget. A statement of legislative intent was also adopted, which included the goals of fully funding Plan 1 liabilities by June 30, 2024, maintaining the fully funded status of the Plan 2 systems, and establishing predictable long-term employer contribution rates that would remain a relatively constant proportion of future state budgets.

In 1999 several of the state retirement plans had very large unfunded liabilities: PERS 1 had about $2.3 billion in unfunded liabilities and a funding ratio of 66 percent; TRS 1 had about $2.4 billion in unfunded liabilities and a funding ratio of 60 percent; and LEOFF 1 had $1.2 billion in unfunded liabilities and a funding ratio of 65 percent. These funding ratios had increased from 56 percent, 38 percent, and 22 percent respectively since 1980, primarily due to the strong investment returns from 1985 to 1989.

In 1992 the Legislature amended the funding statutes to lower the employer contribution rates, based on the most recent actuarial studies. In 1993 the Legislature again amended the funding statutes to lower the employer contribution rates in light of updated actuarial valuation studies, and it also provided that the ERFC would adopt future changes to the employer contribution rates every two years in addition to adopting changes to the economic assumptions every six years. Later the statute was amended to provide that the ERFC would adopt changes to the economic assumptions every other year in odd-numbered years.

In 1998 the pension funding process was amended again to create a new Pension Funding Council (PFC) which would take over the role of the ERFC in adopting changes to economic assumptions and employer contribution rates. The PFC consists of the directors of the Department of Retirement Systems 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 has no separate staff or funding. It receives staff support from a workgroup consisting of staff persons who are appointed by the PFC members, plus staff representing the State Investment Board and the ERFC. The PFC can adopt changes to employer contribution rates with four votes, but the statutes are unclear whether it requires four or five votes to change the economic assumptions.

The PFC adopted changes to employer contribution rates in 1998 for use in the 1999-2001 biennium, and again in 2000 for use in the 2001-2003 biennium. The rates adopted by the PFC in both years were the developed in the most recent State Actuary valuation studies of the state retirement plans.

The Legislature amended the pension funding statutes in the 2000 supplemental budget to provide that the PFC rates would be used through April 2000, and new rates reflecting the most recent actuarial valuation studies would be implemented on May 1, 2000. The 2000 amendments to the pension funding statutes were challenged in court by retiree organizations who claimed the changes could not be made in the budget itself, and that the Legislature had not reserved the right to make future changes to the funding statutes.

The 1999 actuarial valuation studies indicate:

- *The PERS 1 unfunded liabilities have been reduced to $809 million, and the plan has a 93 percent funding ratio;*

- *the TRS 1 unfunded liabilities have been reduced to $663 million, and the plan also has a 93 percent funding ratio; and*

- *the LEOFF 1 unfunded liabilities have been entirely eliminated, and the plan has a 125 percent funding ratio.*

The long-term economic assumptions used in the valuation studies that the PFC is charged to review and adjust include: investment returns (currently 7.5 percent), salary growth (currently 4 percent), inflation (currently 3.5 percent), and growth in membership salaries. The PFC has never changed the economic assumptions. The last changes were made by the ERFC in 1997. During the 1999 PFC review of the long-term economic assumptions, the council's consulting actuary indicated that the current assumption for investment returns was lower than the 8 percent assumption which was most common for other large public sector pension plans, and the salary growth assumption was lower than the 4.8 percent average of the salary growth assumptions used by those same plans.

Summary of Bill:

Legislative intent regarding the state's pension funding processes is modified in recognition of the improvement in the funding status of the state retirement systems since 1989. New long-term economic assumptions are adopted in statute for use in state retirement system actuarial studies. The investment return assumption is increased to 8 percent per year and the salary growth assumption is increased to 4.5 percent per year. A new asset value smoothing technique which provides for actuarial gains and losses to be spread evenly over a four-year period is adopted. New employer, state, and Plan 2 member contribution rates are adopted for the 2001-2003 biennium for PERS, TRS, SERS, and LEOFF. The target date for repayment of the PERS 1 and TRS 1 unfunded liabilities is moved back from December 31, 2016 to June 30, 2024.

The roles of the PFC and the Legislature in adopting economic assumptions, asset value smoothing techniques, and contribution rates are clarified. The staffing for the PFC is transferred to the Office of the State Actuary and the PFC workgroup is abolished. The PFC is authorized to retain independent actuarial advice. The PFC is only subject to the Open Public Meetings Act with regard to its scheduled meetings, and is exempt with regard to other meetings that are consistent with the legislative exemption.

Appropriation: *None.*

Fiscal Note: *Requested on April 9, 2001.*

Effective Date: ***The bill contains an emergency clause and takes effect on July 1, 2001, except for sections 2, 4, 8, 13, 14, and 16, which take effect March 1, 2002.***