FINAL BILL REPORT
ESSB 6167

PARTIAL VETO
C 11 L 01 E2
Synopsis as Enacted

Brief Description: Ensuring sound actuarial funding of the state retirement systems.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Brown, Snyder, Spanel and B. Sheldon).

Senate Committee on Ways & Means

Background: 1989 Pension Funding Reforms. In 1989 the Legislature established new processes to provide for the systematic funding of the various state-administered retirement plans, including the Public Employees Retirement System (PERS), the Teachers Retirement System (TRS), the School Employees Retirement System (SERS), the Washington State Patrol Retirement System (WSPRS) and the Law Enforcement Officers and Fire Fighters Retirement System (LEOFF). Contribution rates were initially placed in statute and the Governor was required to use those rates in preparing a proposed budget. A statement of legislative intent was 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.

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 used by the State Actuary in conducting valuation studies of the state retirement systems, and also required the ERFC to recommend changes in employer contribution rates once every six years.

In 1990 several of the state retirement plans had very large levels of 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 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 through 1989.

Changes to Funding Statutes Since 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 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, the director of 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 Economic and Revenue Forecast Council. The PFC can adopt changes to employer contribution rates with four votes; 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 rates developed in the most recent State Actuary valuation studies of the state retirement plans.

Another major pension funding change was made in 1998 with the establishment of the investment "gains sharing" program. All extraordinary investment gains in the PERS 1 and TRS 1 funds are now used for two purposes: 50 percent to fund PERS 1 and TRS 1 cost-of-living adjustment (COLA) increases; and 50 percent to more rapidly pay off the PERS 1 and TRS 1 unfunded liabilities. In odd-numbered years, investment earnings that exceed a 10 percent average rate of return over the prior four years are defined to be "extraordinary investment gains." Since 1998 more than $1.8 billion in extraordinary gains have been used for the two purposes; as a result, the current deadline for paying off the PERS 1 and TRS 1 unfunded liabilities is December 31, 2016.

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 some 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 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: 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 the Public Employees Retirement System (PERS), the Teachers Retirement System (TRS), the School Employees Retirement System (SERS), and the Law Enforcement Officers and Fire Fighters Retirement System, Plan 2 (LEOFF 2). 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 Pension Funding Council (PFC) and the Legislature in adopting economic assumptions, asset value smoothing techniques, and contribution rates, is 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 also retain independent actuarial advice.

Votes on Final Passage:

Senate 26 21

Second Special Session

Senate 26 16
House 51 36

Effective: July 1, 2001
March 1, 2002 (Sections 2-4, 8, 13, 14, 16)

Partial Veto Summary: The provisions which would have eliminated the pension funding work group and transferred staffing responsibility to the Office of the State Actuary were deleted.