Appropriations Committee

HB 2541

Brief Description: Establishing an asset smoothing corridor for actuarial valuations used in the funding of the state retirement systems.

Sponsors: Representatives Conway, Fromhold and Moeller; by request of Select Committee on Pension Policy.

Brief Summary of Bill

- Establishes a 30 percent limit on the difference between actuarial and market value of assets for purposes of actuarial studies performed on the Public Employees' Retirement System, the School Employees' Retirement System, the Law Enforcement Officers' and Fire Fighters' Retirement System, and the Washington State Patrol Retirement System.

Hearing Date: 1/22/04

Staff: David Pringle (786-7310).

Background:

Each year, the Office of the State Actuary conducts an actuarial valuation of each system and plan in the Washington retirement systems. The primary purpose of the actuarial valuation is to determine the required contribution rates that each plan and system require, but the valuations also provide detailed analysis of member and retiree demographics, and of changes in benefit obligations and fund values.

The choice of an actuarial funding method determines the way pension contributions will be allocated across members' working careers. The total cost of a pension is determined by the benefits paid out less the returns on investment of fund assets. All standard actuarial funding methods are designed to completely fund a member's retirement benefit before retirement.

The current actuarial funding method used for Plans 2 and 3 of the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the School Employees' Retirement System (SERS) is the aggregate funding method. Under the aggregate method, normal or annual costs are equal to the difference between the present value of all future benefits to be paid out less current assets. This difference (the cost) is spread as a level percentage of members' future pay. The aggregate method therefore does not allow an unfunded liability to exist.

Pension fund assets are valued on an actuarial basis, rather than a market value basis, to reduce the instability in contribution rates year-to-year. The 2003 Legislature enacted EHB 2254 (Chapter

11, Laws of 2003), which instituted a new method of averaging, or smoothing, gains or losses over a period of time that varies up to eight years. The length of time over which a given year's gains or losses are smoothed is dependent on the amount of variation of a year's investment return from the long-term rate. Prior to 2003, the actuarial the value of assets was required to recognize changes to asset values that vary from the long-term investment rate of return assumption over a four year period. The long-term investment rate of return is 8 percent per year.

Over periods where the return on assets either consistently exceeds or fails to meet the expected rates, the actuarial value of assets could produce contribution rates are not actuarially reasonable when considering the actual market value of the assets. Private pension plans regulated by the Federal Internal Revenue Service are subject to a "market value corridor" when determining the actuarial value of assets. The private sector market value corridor limits the difference of the actuarial and market value of assets to 20 percent. Governmental plans are exempt from these federal regulations.

Summary of Bill:

A 30 percent market corridor of assets is established for actuarial studies performed by the State Actuary. Beginning with actuarial studies performed after July 1, 2004, the actuarial value of assets shall not be greater than 130 percent or less than 70 percent of the market value of assets as of the valuation date.

The State Actuary shall periodically review the asset smoothing method and recommend changes to the Legislature.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.