

HOUSE BILL REPORT

HB 1044

As Reported by House Committee On:
Appropriations

Title: An act relating to pension funding methodology.

Brief Description: Changing pension funding methodology.

Sponsors: Representative Sommers; by request of Office of Financial Management.

Brief History:

Committee Activity:

Appropriations: 4/18/05 [DPS].

Brief Summary of Substitute Bill

- Suspends contributions towards the cost of future gain-sharing benefit distributions in the Public Employees' Retirement System (PERS), the School Employees' Retirement System (SERS), and the Teachers' Retirement System (TRS) for the 2005-2007 biennium.
- Directs the Select Committee on Pension Policy (SCPP) to study the options available to address the liability associated with future gain-sharing distributions during the 2005 interim, and report the findings and recommendations of the study to the fiscal committees of the Legislature.
- Suspends contribution rates for the unfunded liabilities in PERS and TRS Plans 1 during the 2005-2007 biennium.
- Begins a four-year phase-in of annual contribution rates, including establishing basic contribution rates in PERS, SERS, and TRS for the 2005-2007 biennium, and directs the Pension Funding Council to adopt annual contribution rates for the 2007-2009 biennium that complete the four-year phase-in schedule.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 17 members: Representatives Sommers, Chair; Fromhold, Vice Chair; Cody, Conway, Darneille, Dunshee, Grant, Haigh, Hunter, Kagi, Kenney, Kessler, Linville, McDermott, McIntire, Miloscia and Schual-Berke.

Minority Report: Do not pass. Signed by 11 members: Representatives Alexander, Ranking Minority Member; Anderson, Assistant Ranking Minority Member; McDonald, Assistant Ranking Minority Member; Armstrong, Bailey, Buri, Clements, Pearson, Priest, Talcott and Walsh.

Staff: David Pringle (786-7310).

Background:

The Office of the State Actuary is responsible for recommending appropriate member and employer contribution rates for the Public Employees', Teachers', School Employees', and Washington State Patrol Retirement Systems to the Pension Funding Council (PFC), which adopts the rates for each fiscal biennium. Included as part of the rates recommended by the State Actuary to the PFC for the 2005-07 biennium were pre-funding for the gain-sharing benefit in the Plans 1 and 3 and contributions towards paying off the unfunded liabilities in the Plans 1.

Gain-sharing was created by the 1998 Legislature as a mechanism to increase member benefits in PERS 1, PERS 3, TRS 1, TRS 3, and SERS 3. These increases occur whenever there are extraordinary investment gains, which are defined as compound average of investment returns on pension fund assets that exceeds 10 percent over a period of four fiscal years. Once each biennium, the State Actuary determines whether gain-sharing benefits will be made. Any distributions occur in January of even-numbered years. In Plan 1, half of all extraordinary gains are used to enhance the Uniform Cost-of-Living Adjustment (Uniform COLA) that is given to eligible retirees each year. In Plan 3, half of the extraordinary gains are paid directly into eligible members' and retirees' defined contribution accounts. There have been two gain-sharing distributions since 1998, which resulted in combined benefit improvements costing roughly \$1.1 billion. When the gain-sharing benefit was created by the 1998 Legislature, language was included in the law to reserve the right of the Legislature to amend or repeal the gain-sharing benefits.

The cost of future gain-sharing has never been reflected in the basic contribution rates for the affected systems and was not included in the 2002 actuarial valuation, as the funding methodology and materiality of the gain-sharing provisions were under review. The recent 2003 Actuarial Valuation Report (prepared in December 2004) identified gain-sharing as a material liability and included this liability in calculating the basic contribution rates recommended by the State Actuary to the PFC.

While the state retirement plans that are currently open to new members (the Plans 2 and 3) are currently fully funded, unfunded accrued actuarial liabilities (UAALs) exist in both PERS 1 and TRS 1. This means that the value of the plan liabilities, in the form of members' earned benefits to date, are exceeded by the value of the plan assets. As of the most recent actuarial valuation, the UAAL for PERS 1 is \$2.6 billion and the UAAL for TRS 1 is \$1.4 billion. The statutory funding policy for paying off the UAAL in the Plans 1 is codified as a goal within the actuarial funding chapter. Per statute, the funding process for the state retirement systems is intended to fully amortize the total Plan 1 costs by not later than June 30, 2024. The

payments towards the UAAL are included in employer rates and are not shared by members. Under Chapter 11 of the Laws of 2003 (EHB 2254) the Legislature suspended the employer contributions towards the PERS 1 and TRS 1 unfunded liabilities for the duration of the 2003-05 biennium.

The State Actuary's recommended employer 2005-07 contribution rates under current law are 5.73 percent for PERS, 6.74 percent for TRS, and 7.56 percent for SERS. The recommended Plan 2 member rates for the same period are 3.38 percent for PERS 2, 2.48 percent for TRS 2, and 3.51 percent for SERS 2. Member rates in PERS 1 and TRS 1 are fixed at 6 percent. Member contributions in PERS 3, TRS 3, and SERS 3 are made into members' individual defined contribution accounts and do not affect pension system funding.

Summary of Substitute Bill:

Recognition of the cost of future gain-sharing benefits in retirement system contribution rates is delayed until after the 2005-2007 fiscal biennium. The Select Committee on Pension Policy will study the options available to the Legislature for addressing future gain-sharing liability, including: repealing, delaying, or suspending the gain-sharing provisions, making gain-sharing discretionary, or replacing gain-sharing with other benefits.

Contributions toward the UAAL in PERS 1 and TRS 1 are suspended for the 2005-2007 fiscal biennium. Annual contribution rates for PERS, TRS, and SERS employers and Plan 2 members are specified for each year of the 2005-2007 fiscal biennium, as part of a four-year phase-in of contribution rate increases projected for the 2005-2009 period. The employer contribution rates for FY 2006 are 2.50 percent for PERS, 2.75 percent for SERS, and 2.73 percent for TRS, and the Plan 2 member contribution rates for FY 2006 are 2.50 percent for PERS, 2.75 percent for SERS, and 2.48 percent for TRS. For FY 2007 the employer contribution rates are 3.50 percent for PERS, 3.75 percent for SERS, and 3.25 percent for TRS, and the Plan 2 member contribution rates are 3.50 percent for PERS, 3.75 percent for SERS, and 3 percent for TRS. The Pension Funding Council is required, upon completion of the 2005 Actuarial Valuation, to adopt contribution rates that complete the four-year phase-in schedule, adjusted for any material changes in benefits, assumptions, methods or experience.

Substitute Bill Compared to Original Bill:

The original bill changed pension funding methods by changing state funding law from requiring the use of the aggregate funding method to the projected unit credit method to calculate a combined Plan 2 and 3 employer contribution rate for PERS, SERS, and TRS. Also, rather than suspending the start of funding the cost of future gain-sharing benefits, the original bill assumed that gain-sharing benefits would be distributed only upon legislative approval, and contributions would be collected to fund benefits only after distribution to members of the Plans 1 and Plans 3.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill contains an emergency clause and takes effect July 1, 2005, except for sections 2 and 4 of the bill, which take effect July 1, 2006.

Testimony For: None.

Testimony Against: None.

Persons Testifying: None.

Persons Signed In To Testify But Not Testifying: None.