Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Appropriations Committee

HB 2681

Brief Description: Establishing minimum contribution rates for the public employees' retirement system, the public safety employees' retirement system, the school employees' retirement system, and the teachers' retirement system.

Sponsors: Representatives Conway, Fromhold, Lovick, Green, Sells, Kenney, Quall, Simpson, Moeller and Morrell; by request of Select Committee on Pension Policy.

Brief Summary of Bill

- Sets minimum contribution rates beginning in 2009 for amortizing the unfunded liability in the Public Employees' Retirement System (PERS) Plan 1 of 2.68 percent of compensation, and in the Teachers' Retirement System (TRS) Plan 1 of 4.71 percent of compensation.
- Sets a process for determining the minimum employer and employee contribution rates beginning in 2009 for PERS, TRS, and the School Employees' Retirement System (SERS) Plans 2 and 3 of 80 percent of normal cost using the entry age actuarial method.

Hearing Date: 1/18/06

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 portion of the present value of a pension that is allocated to a particular period of a member's career, most typically an annual period, is referred to in actuarial practice as the "normal cost." 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, though they may allocate different portions of the total cost to different periods of a member's career.

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 "entry age normal cost method" is another standard actuarial funding method that determines the cost of funding an individual member's benefit from the time of entry into the system, calculated to be a level percentage of pay throughout a member's career. This method may be used to determine the cost of a plan's benefit structure, regardless of the amount of assets in the plan prior to a member's entry.

The current funding method used for PERS and TRS Plan 1 is tailored to address amortization of the unfunded accrued actuarial liabilities (UAAL) of the Plans 1 by June 30, 2024, and to spread the cost of repaying the unfunded liabilities to all employers of members of PERS, TRS, SERS, and after July 1, 2006, the Public Safety Employees' Retirement System. The Legislature suspended contributions towards amortizing the Plans 1 UAAL during the 2003-05 and 2005-07 fiscal biennia. These suspensions resulted in an increase in the actuarially-required contribution rates necessary to fully amortize the UAAL over the remaining years until to June 30, 2024.

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 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 assumed long-term investment rate of return is 8 percent per year.

Over periods where the return on assets consistently either fail to meet or exceed the expected rates, the actuarial value of assets could produce contribution rates that are either significantly above or below the long-term cost of the retirement plans. During the 1990's, investment returns substantially in excess of expected rates of return and adjustments to assumptions about future rates of return caused the actuarial valuations to indicate contribution rates significantly below the long-term expected rates. Contribution rates rose significantly between the 2003-05 fiscal biennia and the 2005-07 fiscal biennia, and current projections by the State Actuary indicate further substantial increases towards the long-term expected rates during the next two fiscal biennia.

Summary of Bill:

Minimum employer contribution rates are established for amortizing the UAAL beginning July 1, 2009, for PERS Plan 1 at 2.68 percent, and beginning September 1, 2009 for TRS Plan 1 at 4.71 percent. These minimum contribution rates remain in effect until the actuarial value of assets in either PERS Plan 1 or TRS Plan 1 equal 125 percent of actuarial liabilities, or June 30, 2024, whichever comes first.

A process for determining minimum contribution rates for employers and employees in PERS, TRS, and SERS Plans 2 and 3 is established. The contribution rate for the normal cost portion of these Plans 2 and 3 is set at 80 percent of employer or employee normal cost calculated under the entry age normal cost method.

Upon completion of each biennial actuarial valuation, the State Actuary shall review the appropriateness of the minimum contribution rates and recommend changes to the Legislature, if needed.

The term "normal cost" is defined as the portion of the cost of benefits allocated to a period of time under the actuarial method, typically twelve months.

Appropriation: None.

Fiscal Note: Requested on January 12, 2006.

Effective Date: The bill takes effect on July 1, 2009.