



The Select Committee on Pension Policy

Pensions 103 - Governance

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Office of the State Actuary

"Securing tomorrow's pensions today."

Building The Structure

- **Make policy**
 - What are my goals?
 - How will I pay for it?
- **Delegate**
 - What is my level of expertise?
 - Who might do it better?
- **Oversee**
 - Are they qualified?
 - Will they understand what I want?
 - Will their work meet my standards?
 - Will they be timely and on budget?
 - Will I still be in charge or will I lose control?



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Who's In Charge?

- Those who "govern" have authority to carry out certain activities for others
 - Act on behalf of others
 - Act for benefit of others
- Those who carry out activities are subject to scrutiny
 - Accountable to those who gave them authority
 - May lose authority if don't perform well



Actions Of Those Who Govern

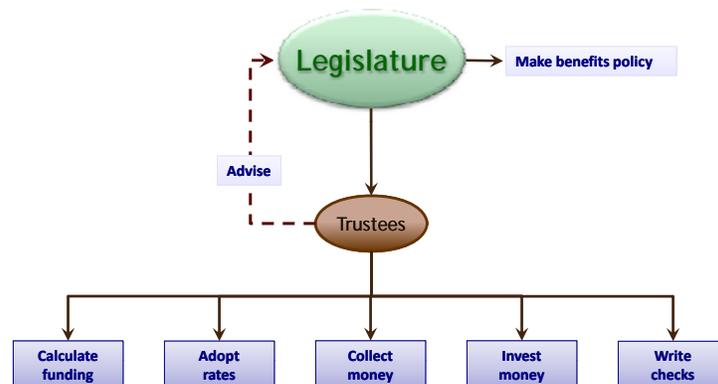
- Make policy
 - What is the desired outcome?
- Delegate
 - Who can best carry out the necessary tasks?
- Oversee
 - Is the desired outcome being achieved?
 - Are the tasks being carried out effectively, efficiently, and fairly?

Pension Governance In Washington

- Benefits policy is to pay pensions for life
- Financing plan is systematic actuarial funding
- Carrying out these policies requires
 - Calculate funding requirements
 - Adopt contribution rates
 - Collect the money
 - Invest the money
 - Write the checks
- Legislature can delegate these functions



Washington's First Model – Delegate To Trustees



Who Were The Trustees

- State elected officials
 - Auditor
 - Attorney General
 - Insurance Commissioner
 - Superintendent of Public Instruction
 - Treasurer
- Plan members
 - Active and retired
 - Number grew over time
- No legislators on boards
- No governor appointments



Why Use Trustees?

- Trustees have expertise
- Can focus exclusively on the business of pensions
- Highest legal duty to
 - Act for benefit of others
 - Act on behalf of others
 - "Fiduciary" responsibility
- Most common model in state retirement systems

What Does It Mean To Be A Trustee?

- Duty of loyalty
 - Put self-interest aside
 - Act for the exclusive benefit of past, present, and future members
- Duty of prudence
 - Act in a way that a reasonable person facing a similar situation would act
- Trustees can be held liable if they fail in these duties



Legislature Trusted The Trustees

- Legislature's policies would be carried out
 - Efficiently
 - Effectively
 - Fairly
- Trustees would be accountable
- Those who govern are subject to scrutiny
 - Accountable to those who gave them authority
 - May lose authority if they don't perform well

Separate Boards Of Trustees

- Legislature delegated authority to individual retirement systems' boards of trustees
- Retirement board for teachers
- Retirement board for public employees

By The 1960's Things Were Going Wrong

- Unfunded liabilities emerged in the Plans 1
- Inconsistencies in benefits policies and administration of benefits by the retirement boards
- 1963 - Legislature formed special commission to look at the state retirement systems



In The 1970's The Legislature Stepped In

- Took away some authority from retirement boards
 - Set funding policy
 - Administer plans
 - Oversee actuarial work
- Legislature kept control over funding policy
- Legislature delegated plan administration and actuarial functions to others

DRS Created In 1976

- The Department of Retirement Systems (DRS) was created to serve as the "plan administrator" for all plans
 - Executive branch agency
- Collects the contributions and writes the checks
- Performs other administrative duties
 - Makes rules and regulations to implement benefits policy
 - Enrolls members and maintains accounts
 - Helps members understand and apply for benefits
 - Assures IRS compliance
 - Files reports



OSA Also Created In 1976

- The Office of the State Actuary (OSA) provides actuarial services
 - Non-partisan, independent, legislative agency
- In-house pension experts
 - Unique among the states
 - Most states contract with private actuarial firms
- Actuarial services include
 - Calculating funding requirements
 - Advising the Legislature and Governor on benefits and funding policy
 - Preparing actuarial fiscal notes for every pension bill dropped

Legislature Stepped In Again In 1980

- Took away retirement boards' authority to invest pension funds
- Delegated investment authority for all plans to a new board of trustees
- Overrode Governor's veto to create the new investment board



WSIB Created In 1981

- The Washington State Investment Board (WSIB) oversees investments for all plans
 - Board includes legislators, state officials, and stakeholders
 - Voting board members are trustees
 - Supported by a state agency
- WSIB has special expertise
 - Receives training
 - Hires and contracts with investment professionals
- Charged with maximizing returns using prudent level of risk
 - Sets investment policy and invests contributions
 - About 75 percent of plan costs covered by investment returns

Retirement Boards Abolished In 1982

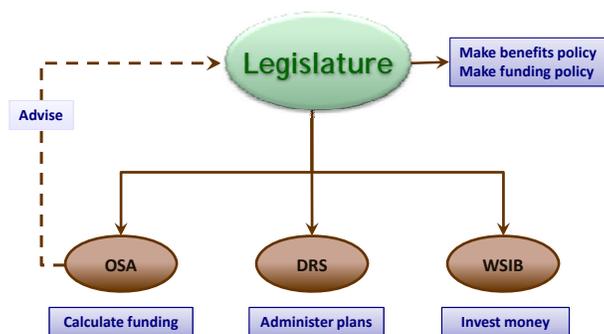
- Any remaining duties transferred to DRS
- Part of broader bill to eliminate state boards and commissions
- What were the conditions at that time?
 - Boards had a track record
 - Boards had little authority left
 - State in financial crisis
 - Budget cuts, tax increases, workforce reductions



Why Did Early Trustee Model Fail In Washington?

- Problem with model?
 - Composition?
 - No legislators on boards
 - No Governor-appointees
 - Adequate oversight?
- Problem with people?
 - Did they act in their self interest despite higher legal duties?
 - Did they have the proper training and expertise?
- External problems?
- Those who act on behalf of others must carry out their activities well or their authority can be revoked

Washington's Next Model – Legislative



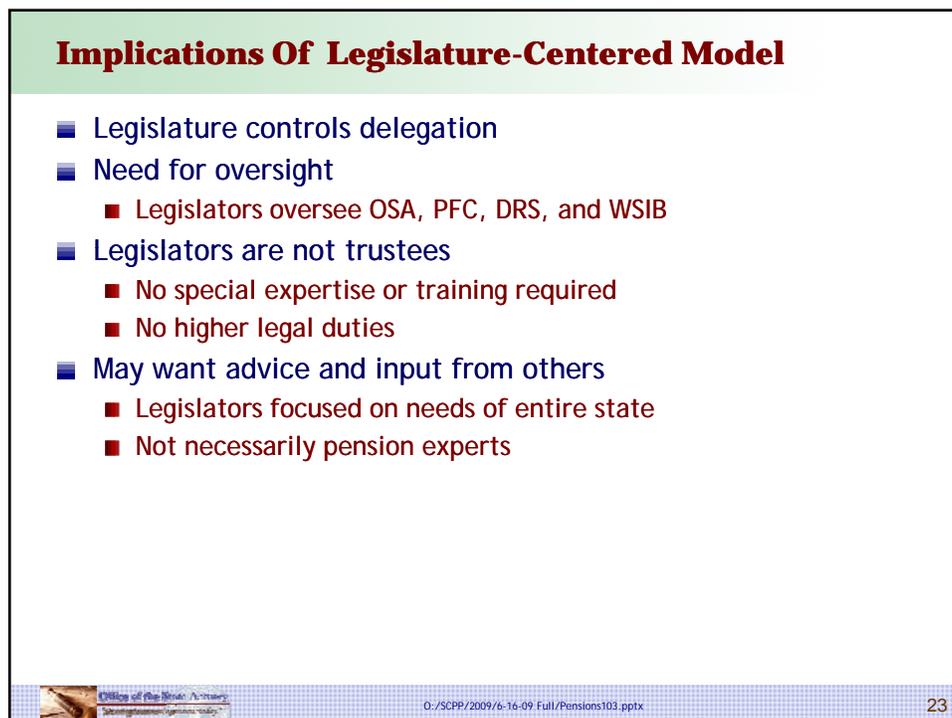
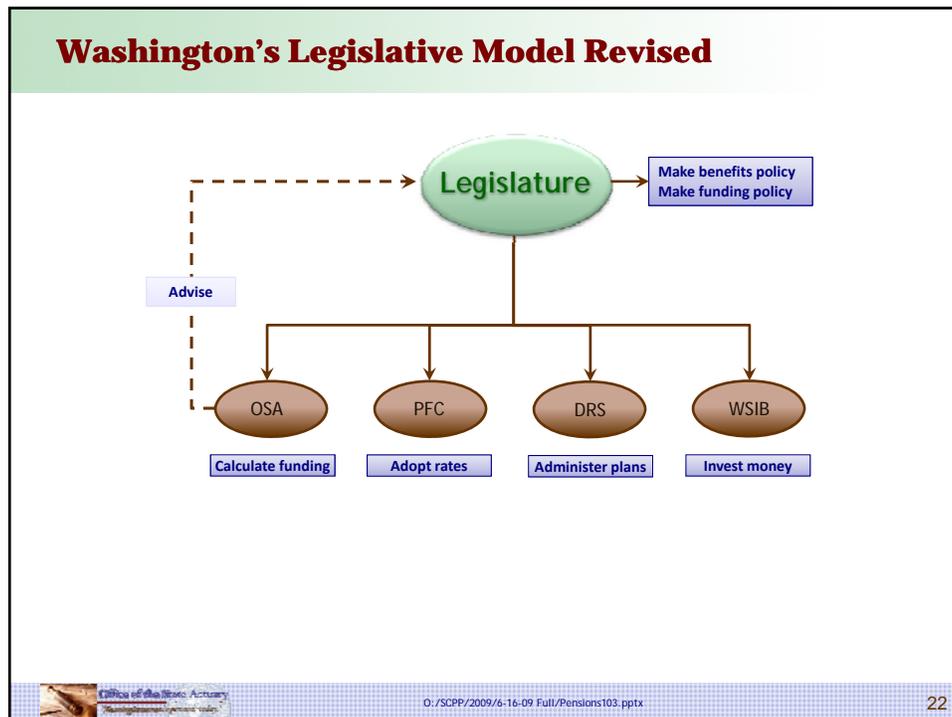
PFC Created In 1998

- Pension Funding Council (PFC) adopts contribution rates
 - Body of legislators and executive branch officials
 - Mostly state budget writers
- Adopts long-term economic assumptions and member and employer contribution rates
 - In open public meetings
 - Subject to revision by Legislature
- Prior to PFC others adopted rates
 - Economic and Revenue Forecast Council adopted employer rates and long-term economic assumptions
 - DRS adopted member rates

Another Veto

- Bill creating PFC would have made it easier to change economic assumptions
 - Required fewer votes
 - Allowed changes outside of two-year rate-setting cycle
- Governor vetoed that section of bill
 - "...risk that adjustments in long-term economic assumptions could be made to address short-term budget problems, rather than ... funding pensions in a responsible long-term manner."





Legislature Used Different Advisors Over Time

- Public Pension Commission
- Office of the State Actuary
- Joint Committee on Pension Policy
- Select Committee on Pension Policy



Public Pension Commission (1963-1975)

- Created to advise on benefits and funding policy
- First structure designed to operate on a state-wide level
 - Evaluate pension proposals for policy and cost implications
 - Begin developing standard pension policy for all the state retirement systems
- Allowed policy for separate state retirement systems to be considered as a whole
- Disbanded about the time that governance shifted away from retirement Boards and Plans 1 were closed

Office Of The State Actuary (1976-Present)

- Charged with directly advising and consulting with the Legislature and the Governor
 - Advises on funding policy
 - Advises on benefits policy
- Required to prepare actuarial fiscal notes explaining the financial impact of pension bills
- Allows Legislature access to independent, non-partisan, pension experts



Joint Committee On Pension Policy (1987-2003)

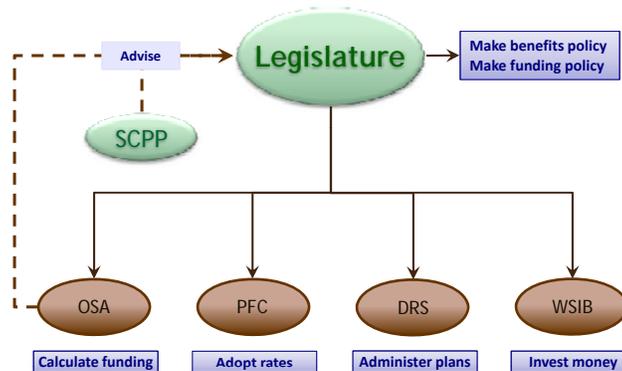
- Advised Legislature on benefits and funding policy
 - All legislators
 - Staffed by OSA
- Allowed Legislature to:
 - Develop pension knowledge
 - Filter pension proposals
- Replaced by Select Committee on Pension Policy in 2003

Select Committee On Pension Policy (2003-Present)

- Quasi-legislative body
 - Members include stakeholders, legislators, state officials
 - Staffed by OSA
- Studies benefits and funding policy and makes recommendations to Legislature
 - No fiduciary duties
 - Recommending body
- Allows stakeholders a place "at the table"



Washington's Model Today



Observations Under The Current Model

- Legislature retains control of benefits and funding policy
- More entities are tied to funding than to benefits
- State budget writers have a lot of influence
- Only the investment function is overseen by trustees
 - Most common model is for trustees to oversee all functions



LEOFF Plan 2 Is An Exception

- Law Enforcement Officers' and Fire Fighters' Plan 2 Board created by initiative of the people in 2002
 - Legislators and stakeholders
 - Appointed by Governor
- Modified Board of Trustees model
 - Board has authority over benefits and funding policy, subject to actions of Legislature
 - WSIB invests funds
 - DRS administers plan

Observations From History Of Governance

- Washington has tried different governance models
- Legislature has always retained control of benefits policy
- The Legislature has used different advisers on pension policy over the years
- Biggest governance change was made when there were external pressures



What Changes Are Being Discussed Today?

- 2009 bills to suspend or abolish SCPP
 - Conditions similar to when Board of Trustees were abolished
 - Funding challenges in Plans 1
 - Financial crisis
- Troopers have sought a board for the Washington State Patrol Retirement System
 - Proposed bills in 2008 and 2009
 - Voiced concerns that interests not adequately addressed

Evaluating Governance

- People?
- Processes?
- Structures?
- A combination?
- Context?
 - When will something external to governance affect it?



Back To The Basics

- Make policy
 - Clear and consistent goals
 - Good advice
- Delegate
 - Expertise
 - Trust
- Oversee
 - Accountability
 - Take back authority if not satisfied

Hallmarks Of Good Governance

- Policies are working
 - The promise is being kept
 - The shared values and goals are maintained
 - The policies accommodate change
- Delegation is working
 - All the right interests are represented
 - The delegates have the right expertise
 - They act within the scope of their authority
 - They do their jobs according to plan
 - They act for the good of the whole instead of in their own self interest
- Adequate oversight in place

Oversight Is Ongoing

- Accountability measures are built into the structure
 - Checks and balances in roles
 - Various interests and expertise represented
 - Fair and open processes
- Evaluation and self-evaluation
 - Studies
 - Feedback mechanisms
 - Compliance testing
 - Audits
 - Regular reporting



Governance Is More Than The Model

- Those who govern are subject to scrutiny
 - **Accountable to those in charge**
- Levels of authority and trust determine governance structure
- Governance models can change; basic activities of governance continue!