



OSA Recommendation on Economic Assumptions

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Economic Assumptions – Some Context

- Economic assumptions used to fund retirement systems
 - Inflation
 - General salary growth
 - Annual investment return
 - Growth in system membership
- Assumptions reviewed every two years
 - Opposite the rate-setting cycle
- Many players in assumption setting cycle
 - Office of the State Actuary (OSA)
 - SCPP
 - Pension Funding Council (PFC)
 - Legislature



How Does The Cycle Work?

- OSA performs study every two years, reports to SCPP and PFC
 - Financial condition of the retirement systems
 - Recommended assumptions
- SCPP makes recommendation to PFC on assumptions
 - Tentatively scheduled for October
- PFC may adopt new assumptions
 - By October 31
 - Subject to revision by Legislature



SCPP Has Statutory Duty In Cycle

- SCPP required to study and make recommendations on changes to economic assumptions to PFC
 - RCW 41.04.281(4)
- SCPP last studied full set of assumptions during 2007 cycle
 - Studied general salary growth off-cycle in 2008

Where Are We In The Cycle?

- OSA completed actuarial work and provided reports
 - Report on Financial Condition
 - Report on Long-Term Economic Assumptions
 - Sent to SCPP and PFC members
- SCPP will be briefed today
- PFC will meet at end of September to consider reports



Today's Briefing

- Highlights of the two reports
- Recommended long-term economic assumptions
- State actuary's perspective on the financial condition
- State actuary's recommended process to address financial condition

Focus Of Current Cycle On Financial Condition

- Systems face significant short- to medium-term funding challenges
- Business as usual not likely to see them through
- Meeting the challenges will require coordinated action



Summary Of Financial Condition

- Health of the plans varies
 - Most are healthy
 - Some are at-risk
- Employer contribution rates projected to increase above highest levels ever collected
- Step increases required to meet future contribution funding challenges

Today's Health Assessment

Today's Health Assessment			
Plan	Funded Status*	Min. Projected Funded Status**	Health
PERS 1	71.7%	47.0%	At-Risk
PERS 2/3	119.2%	88.0%	Healthy
TRS 1	77.3%	50.8%	At-Risk
TRS 2/3	125.8%	88.1%	Healthy
SERS 2/3	121.0%	88.1%	Healthy
PSERS 2	131.1%	103.9%	Healthy
LEOFF 1	128.6%	93.6%	Healthy***
WSPRS 1/2	121.4%	83.7%	Borderline Unhealthy

*Based on preliminary 2008 Actuarial Valuation Report.

**Based on current assumptions.

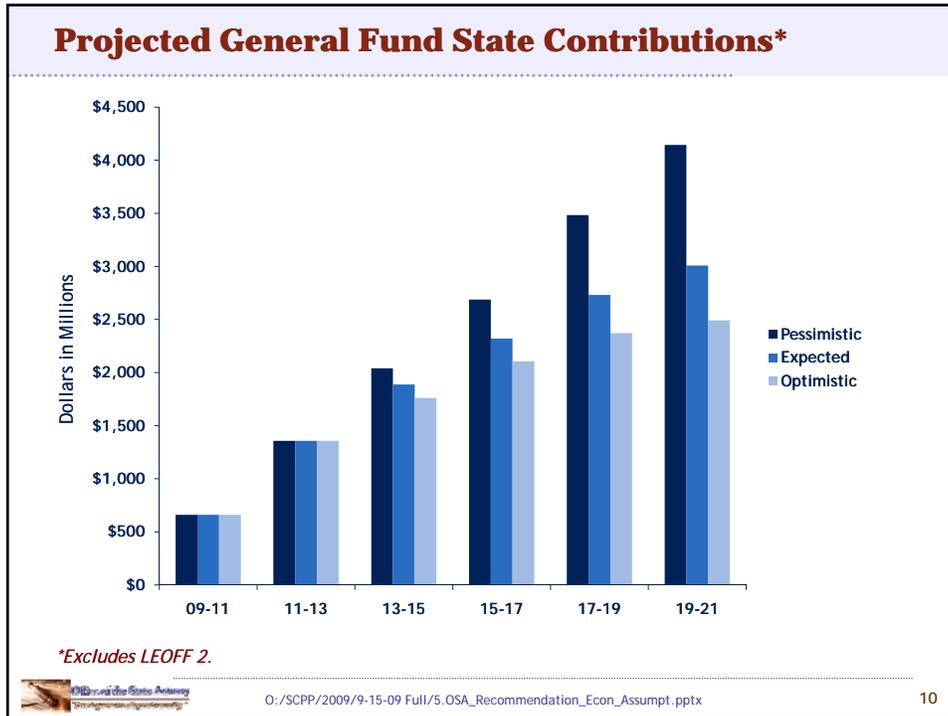
***Assumes reinstatement of prior funding policy and resumption of contributions.



Total Employer Contribution Rate

Total Employer Contribution Rates					
System	Current	Projected Max	Historical Max	% Over Current	% Over Historical Max
PERS	5.13%	13.72%	8.65%	167.45%	59%
TRS	5.98%	17.93%	13.06%	199.83%	37%
SERS	5.27%	14.29%	7.38%	171.16%	94%
PSERS	7.68%	11.99%	9.27%	56.12%	29%
LEOFF 1	0.00%	1.72%	101.2%	NA	NA
WSPRS	6.17%	28.91%	24.12%	368.56%	20%





Concluding Thoughts On Financial Condition

- Retirement systems face significant short- to medium-term funding challenges
- Steep increases in future contributions required
- Plans 2/3 remain healthy, but PERS 1 and TRS 1 at-risk of running out of assets prematurely
- Plan health will weaken if employers can't make contributions
- Coordinated action recommended

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Summary Of Long-Term Economic Assumptions

- Current assumptions are reasonable but do not reflect our best estimates
- OSA recommends changing
 - Inflation
 - Annual investment return
 - Growth in system membership
- Assumptions determine when costs are recognized
 - Actual experience determines actual costs
 - When assumptions don't match experience, the resulting gain/loss flows through to future contribution rates

Recommended Economic Assumptions

Assumption	Current*	Recommended*
Inflation	3.50%	3.25%
General salary growth	4.00%	4.00%
Annual investment return	8.00%	7.50%
Growth in system membership	0.90% (TRS), 1.25% (Others)	0.90% (TRS), 1.15% (Others)

*Excludes LEOFF 2.

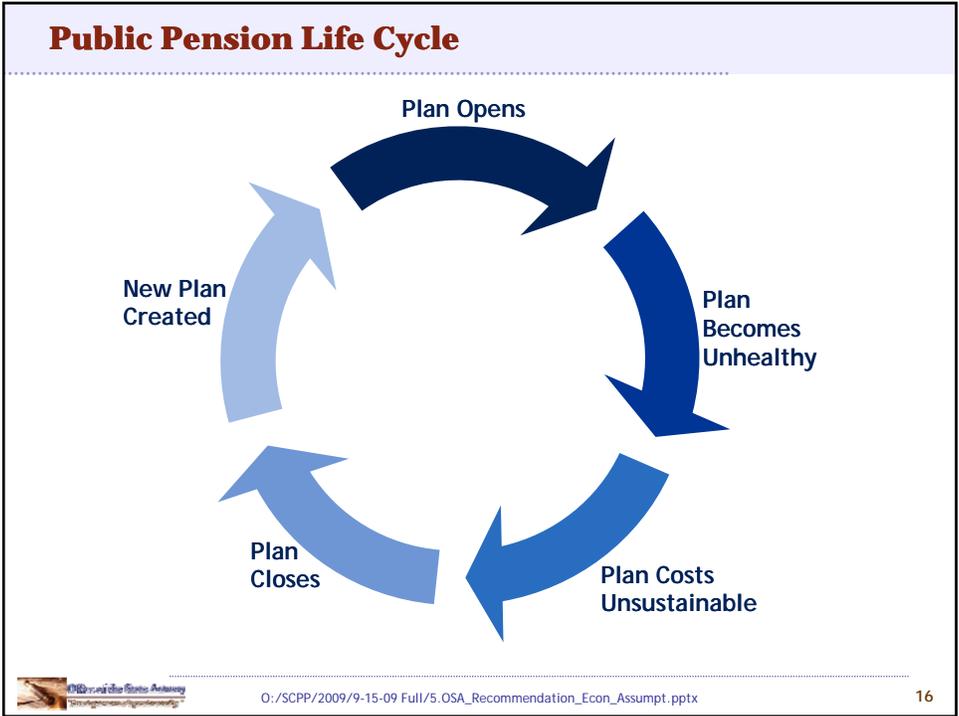
Concluding Thoughts On Economic Assumptions

- Current assumptions are reasonable but not our best estimates
- Adopting OSA's recommended assumptions improves the long-term health of plans
 - Makes short- to medium-term funding challenges worse
- Recommend coordinating changes to economic assumptions with a plan to manage funding challenges



Check-In

- What's been covered so far?
 - Highlights of reports on financial condition and long-term economic assumptions
 - Health assessment for retirement systems
 - OSA recommendations on long-term economic assumptions
- What's next in this presentation?
 - Another perspective on financial condition
 - Recommended process to address financial condition



- ### Pension Life Cycle In Washington
- Plans 1
 - Opened in 1930s and 1940s
 - Unfunded liability added with benefit improvements over time
 - Funding shortfalls created additional unfunded liability
 - Costs became unsustainable
 - Plans closed
 - Plans 2/3 created
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- A photograph of a blue sign with the word 'Closed' written in white, hanging from a string.
- Washington State Auditor
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Lessons Learned From Plans 1

- Avoid unfunded liability
- Avoid benefit improvements you can't fund over members' working careers
- Make regular and systematic contributions



Initial Application Of Lessons Learned To Plans 2/3

- Avoid unfunded liability
 - Selected funding method that prevents it
- Avoid benefit improvements you can't fund over members' working careers
 - Selected funding method that prevents it
- Make regular and systematic contributions
 - Enacted Funding Reform Act of 1989



Plans 2/3 Assessment Today

- Avoid unfunded liability?
 - Yes
 - Initial funding method remains
- Avoid benefit improvements you can't fund over members' working careers?
 - No
 - Gain sharing benefits
 - Improved benefits when contributions at historically low and unsustainable levels



Plans 2/3 Assessment Today

- Make regular and systematic contributions?
 - Yes from 1977 to 1999
 - No from 2000 to present
 - Contributions lowered to historically low and unsustainable levels
 - Subsequent increases deferred
 - Cost of gain sharing delayed
 - Cost of improving life spans delayed



Where Are We In The Plans 2/3 Life Cycle Today?

- Thirty-two years later we see similarities to Plan 1 life cycle
- Health beginning to deteriorate
- Additional contributions required to stabilize health
- Risk of unsustainable costs, especially when combined with Plan 1 costs



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Convergence Of Life Cycles

- PERS 1 and TRS 1
 - Closed since 1977, but significant legacy costs remain
- Plans 2/3
 - Open since 1977 and healthy today, but significant contributions required to prevent repeat of Plan 1 life cycle



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Stopping The Pension Life Cycle

- Break from past practices
- Shift in focus to identifying, measuring, and managing retirement system risks
- Recommendation
 - Perform risk analysis with risk measures



Risk Analysis With Risk Measures

- Suggested process
 - Clearly identify health risks to retirement systems
 - Establish a process for measuring these risks
 - Analyze the risks using risk measures
 - Develop recommendations for managing the risks



Identifying Risks

- Answer key questions
- For example
 - What's failure for the plans?
 - What level of cost is unaffordable for employers and Plan 2 members?
 - What level of funded status is unacceptable?
 - What level of contribution volatility is unacceptable for government budgeting?



Analyzing Risks With Risk Measures

- Measure and analyze identified risks
- For example, determine chance
 - Plans 1 run out of money
 - Plans 2/3 drop below certain funded status
 - Contribution rates increase above a certain level
 - Contributions increase more than a certain percent from one biennium to the next



Identifying Ways To Manage Risk

- Final step
- Identify options to manage those risks
- For example
 - How do risk measures change with new funding or investment policies?
 - What about changes to actuarial assumptions and methods?
 - New decision-making tools for pensions?



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The Goal

- Improve the health of the state's retirement systems
- Break the pension life cycle for the Plans 2/3
- Create shared ownership in the solution
- Institutionalize the solution



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Next Steps for SCPP

- Make recommendation to PFC regarding long-term economic assumptions
 - Tentatively scheduled for October meeting
- Options
 - No change to assumptions at this time
 - Adopt OSA recommended assumptions
 - Adopt recommended assumptions in coordination with plan to manage future health of retirement systems (state actuary's recommended approach)
 - Other?
- Decide if SCPP wants to take lead in performing a risk analysis with risk measures
 - If so, determine level of coordination with others (i.e., Legislature, PFC, LEOFF 2 Board)

