

Constitutional Amendment on Minimum Pension Funding

Background

At the November 2009 meeting, the Executive Committee instructed staff to provide a briefing on the potential for a constitutional amendment on minimum pension funding.

Amending the Constitution

Under Article XXIII, Section 1 of the Washington State Constitution, the State Constitution may be amended upon a two-thirds vote of each house, followed by ratification by a majority of the voters in the next general election.

The State Constitution can also be amended by Constitutional Convention (under Article XXIII, Sections 2 and 3).

There have been 102 amendments to the State Constitution, and the most recent amendments were ratified by the voters in 2007. Some sections of the State Constitution remain exactly as originally drafted. Other sections have been modified as many as six times.¹

¹ Article VII, Section 2 (Limitation on Levies) was modified by amendments in 1944, 1972, 1976, 1986, 1997, 2002, and 2007.

Policy Analysis

Generally, when preparing a constitutional amendment on pension funding, policy makers may wish to consider four things:

- ❖ Purpose of Constitutional Amendments
- ❖ Scope
- ❖ Specificity
- ❖ What is "minimum pension funding"?

Purpose of Constitutional Amendments

The State Constitution is more difficult to change than a statute, and that can be good or bad. For example, the Constitution is less subject to changing trends. However, it is also not as responsive to changing conditions. As such, many feel that a constitution should only contain broad principles of governance that do not change often, if at all.

The State Constitution has previously been amended to address a pension issue. Specifically, Article XXIX was created by amendment in 1968,² and provided that funds in the public pension and retirement systems could be invested as authorized by law.

Actual pension funding methods have never been placed in the Constitution. However, statutes have been enacted to establish pension funding methods, and some have included fixed minimum rates for retirement plans. As a general rule, a Constitutional Amendment could defer to those statutes, incorporate the methods and rates adopted in those statutes, or override them altogether.

² *This section was subsequently amended in 1985 and 2000.*

Scope

Each of the retirement systems and plans administered by the State of Washington has its own needs and requirements, so a single funding standard may not apply to all plans.

Policy makers may wish to choose between the following:

- ❖ Limiting application of the amendment to certain plans only.
- ❖ Listing each plan and method individually.
- ❖ Deferring to the Legislature to enact or revise statutes setting plan-specific policies and rates.

Specificity

At opposite ends of the spectrum, an amendment could be a broad statement of the Legislature's intent to fund pensions, or it could include precise methods, assumptions and formulae.

A broad statement of policy and intent allows for flexibility in response to changing methodology and economic conditions. However, broad statements are hard to enforce because there is often no way to quantify a term like "paramount duty". Further, the broader the amendment, the more likely it will have to defer to statutes for implementation.

On the other hand, a precise statement is much easier to enforce, but greater precision typically brings greater complexity and rigidity. For example, the more complex the assumptions and formulae, the more terms will be used. If these terms are not defined in the amendment (explicitly, or by reference), then they create the potential for legal action. Thus, the more complex the assumptions and formulae, the more definitions will need to be accounted for.

What is "minimum pension funding"?

The term "minimum pension funding" means different things to different people. For example, some might feel a fixed rate is appropriate, while others may feel a variable rate tied to an economic indicator is more appropriate.

There are many ways to determine what a minimum should be, and a full list of options would be too long to list here. However, the following list provides some initial options for further consideration and research:

- ❖ Methods for calculating rates could be established.
 - ◇ Actuarial methodology and standards of practice may change over time.
- ❖ Rates could be fixed.
 - ◇ A fixed rate would be the simplest option administratively, but it would not be responsive to changing economic realities.
- ❖ Fixed minimum rates could be established.
 - ◇ A minimum rate, or floor, could minimize underfunding and deferment of payments.
- ❖ A variable rate could be tied to a trigger.
 - ◇ For example, if the funded status of a plan drops below a certain percentage, a minimum rate will be established. Conversely, if the funded status rises above a certain point the contribution rates will be lowered or eliminated.
- ❖ New criteria for changing rates could be established.
 - ◇ For example, rates may not go above or below a set range without a supermajority of votes.

Other States

Many states have provisions in their Constitution stating that retirement benefits are a contractual right, or that calculations must adhere to generally accepted actuarial standards of practice. Some state constitutions also restrict the investment of pension funds.

However, none of Washington's peer states have put minimum employer contribution rates into their constitution, and only one state (Oregon) has established constitutional minimum contribution rates for public employees.³

³ *Employee contribution rates are fixed at 6% of the employee's salary or gross wage.*