Select Committee on Pension Policy



The State of the State's Pension Systems

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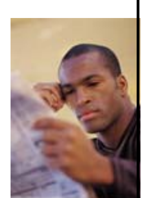
October 19, 2010

State Pensions In The News

- Frequent news articles
- Some concerns about future solvency and affordability after asset losses from the "Great Recession"
- A lot of information out there
  - Not all consistent
  - Disputed in some areas
  - Definitely confusing
- We hope to provide some clarity today as it pertains to Washington State

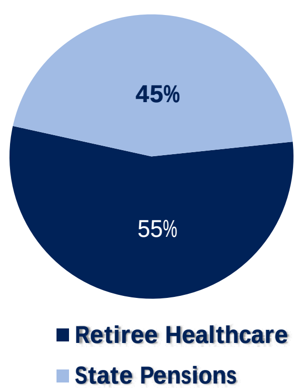


PEW Report

- Public pensions hit national radar screen after release of 2010 report from PEW Center on the States
  - PEW Charitable Trusts
  - Independent, non-profit policy organization founded in 1948
- "The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform"
- According to PEW, that's "the gap at the end of fiscal year 2008 between the $2.35 trillion states had set aside to pay for employees' retirement benefits and the $3.35 trillion price tag of those promises"

Trillion Dollar Gap?

- Includes state pensions and state retiree healthcare
  - Very different animals
- $452 billion from state pensions
  - Contractual obligation of most states
- $555 billion from healthcare for state retirees
  - Assumes continuation of existing benefits
  - Not a contractual obligation of most states
  - Some dispute over this liability



Today's Presentation

- Pensions only
- Washington's numbers in PEW study
- State of our state's pension systems
  - Where are our systems today?
  - How did we get there?
  - Where are we headed?

Washington's Public Pension Systems

- Public Employees' Retirement System (PERS)
- Teachers' Retirement System (TRS)
- School Employees' Retirement System (SERS)
- Public Safety Employees' Retirement System (PSERS)
- Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF)
- Washington State Patrol Retirement System (WSPRS)
- Other small systems not included in this presentation

Washington State Participant Data Summary*

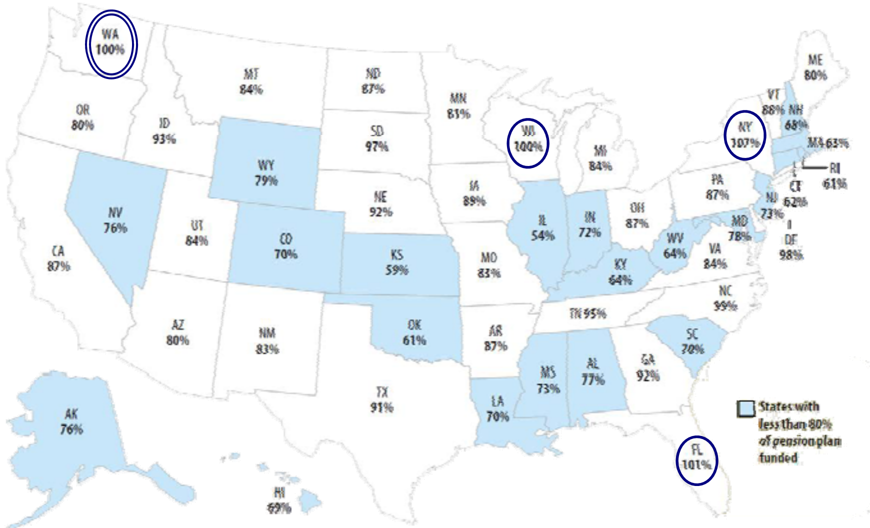
All Systems	June 30, 2009
Active Members	
Number	301,838
Average Annual Salary	$54,026
Average Age	46.8
Average Years of Service	11.3
Retirees and Beneficiaries	
Number	129,703
Average Annual Benefit	$19,917

** Source: 2009 Actuarial Valuation Report, Office of the State Actuary*

Numbers For Washington State In PEW Study

- $179 million "surplus" for pensions – all systems combined for reporting purposes
  - Each individual plan stands on its own
  - Measured at June 30, 2008
- Only three other states in that situation in 2008
  - Florida
  - New York
  - Wisconsin

Pension Funding Comparison



SOURCE: Pew Center on the States, 2010

Focus On Washington

- For remainder of presentation
- Share latest analysis from
  - 2009 actuarial valuation
  - 2010 OSA risk assessment
- What's the state of our state's pension systems?

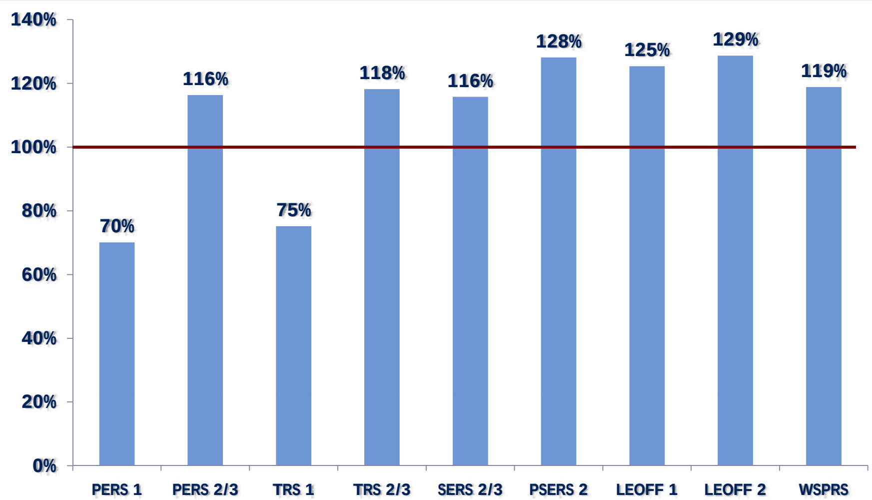
Funded Status at June 30, 2009, By Plan*

(Dollars in millions)	PERS		TRS		SERS
	Plan 1	Plan 2/3	Plan 1	Plan 2/3	Plan 2/3
Accrued Liability	$13,945	$15,701	$10,838	$5,213	$2,162
Valuation Assets	$9,776	$18,260	$8,146	$6,160	$2,503
Unfunded Liability	$4,169	($2,560)	$2,692	($947)	($341)
Funded Ratio	**70%**	**116%**	**75%**	**118%**	**116%**

(Dollars in millions)	PSERS	LEOFF		WSPRS
	Plan 2	Plan 1	Plan 2	
Accrued Liability	$54	$4,477	$4,325	$758
Valuation Assets	$69	$5,612	$5,564	$900
Unfunded Liability	($15)	($1,135)	($1,239)	($143)
Funded Ratio	**128%**	**125%**	**129%**	**119%**

** Source: 2009 Actuarial Valuation Report, Office of the State Actuary.*

All Plans Healthy Except PERS 1 And TRS 1



Good News

- All but two of the state's plans were fully funded heading into the Great Recession
- Major pension reform occurred over 30 years ago in our state
- Other states now moving in the direction of Washington State's earlier reforms

Pension Reform In Washington State

- Plans 1 closed to new members in 1977
- Plans 2 created with age 65 normal retirement
  - Equal cost sharing between employee and employer
- Hybrid plans (Plans 3) first created in 1996
  - Combination defined benefit (DB) and defined contribution (DC)
  - Employer assumes risk of providing guaranteed lifetime DB
  - Employee assumes risk of providing DC

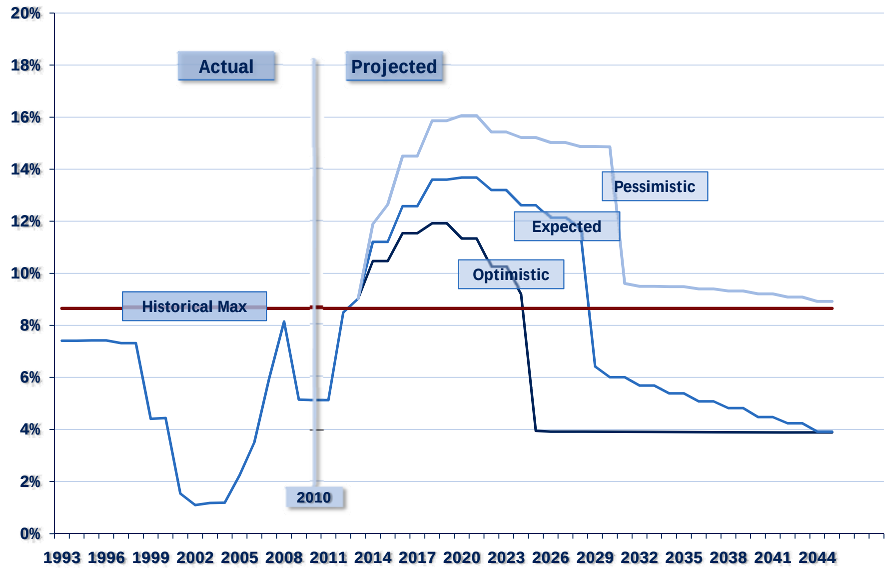
Other States Following Washington's Lead

- At least five states created hybrid plans in last ten years
  - GA, MI, OH, OR, UT
- Other changes in 2010
  - Closing plans and opening new tiers
    - MS, UT, VA
  - Increasing or establishing employee share of costs
    - CO, FL, MN, WY
  - Increasing retirement age
    - CO, IL, MS
  - Not an exhaustive list and more changes expected
- "More states have enacted significant retirement legislation in 2010 than in any other year in recent memory."
  -- Ron Snell, NCSL

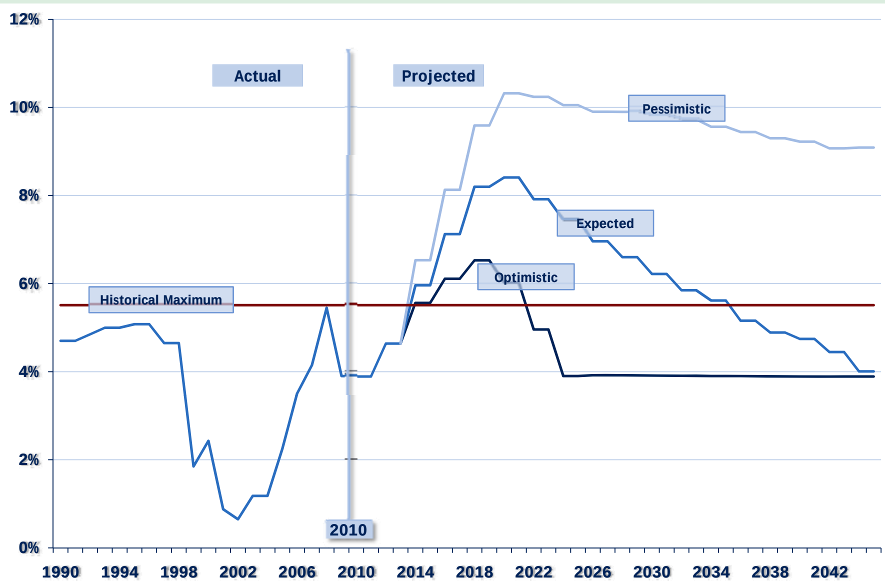
Not All Good News

- We haven't seen the full effects of the Great Recession
  - Asset losses from 2008-09 recognized over time
- Significant increases in required contributions coming
  - To keep healthy plans healthy
  - Return unhealthy plans to health
- Funded status expected to fall and then recover
  - Decrease will depend on future funding/contribution levels and actual investment performance
- Let's examine projected contribution rates and funded status

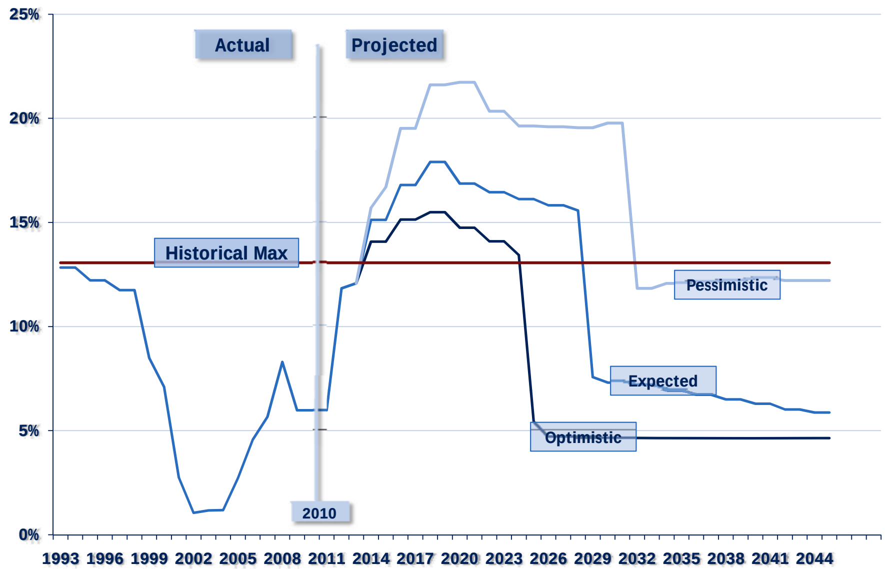
Projected Employer Contribution Rates - PERS



Projected Plan 2 Member Contribution Rates - PERS



Projected Employer Contribution Rates - TRS



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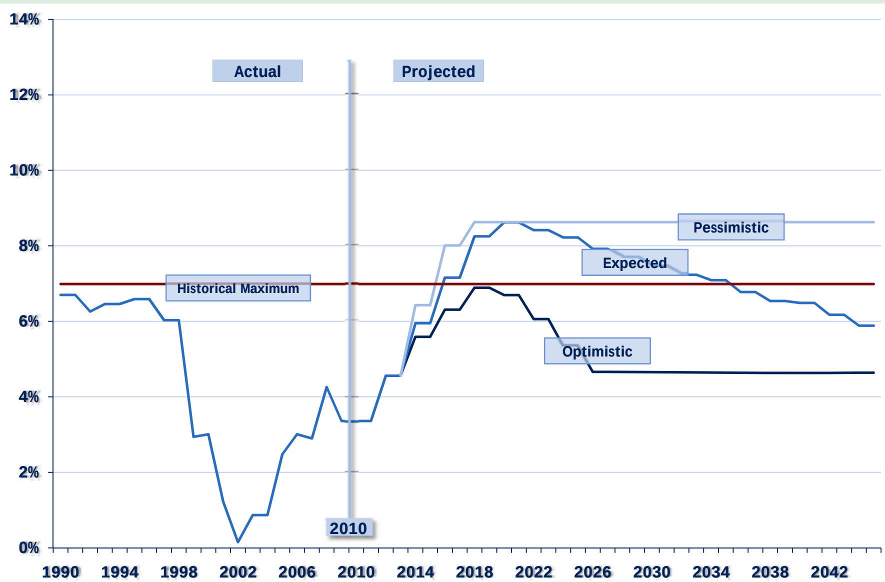
18

Projected Plan 2 Member Contribution Rates - TRS



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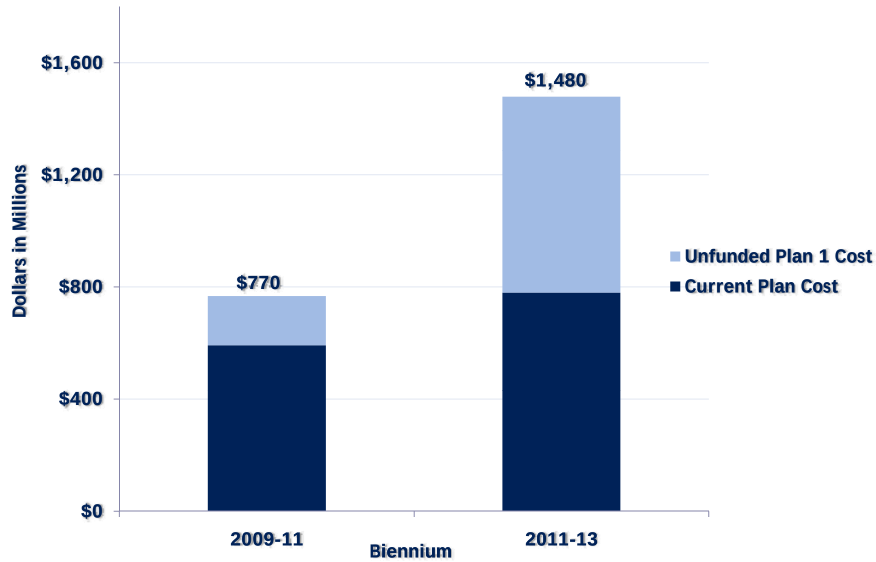
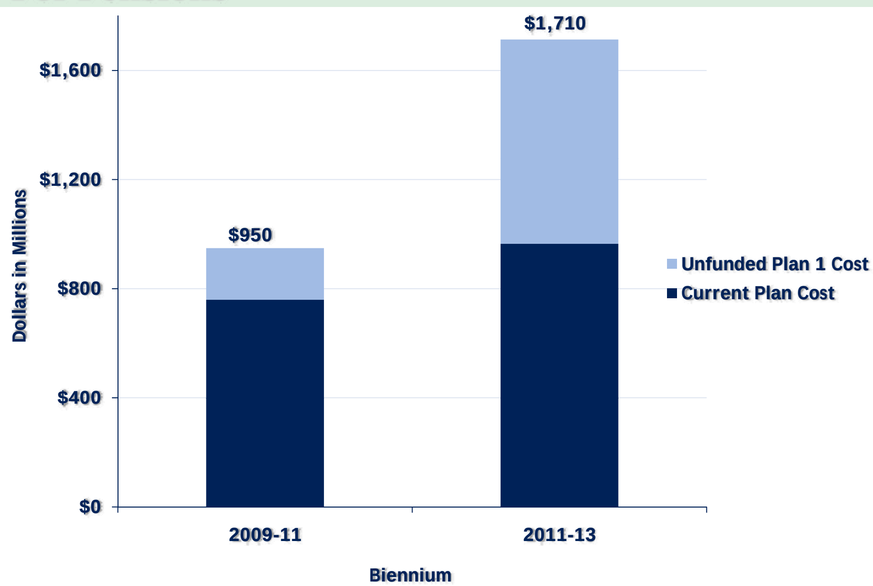
19

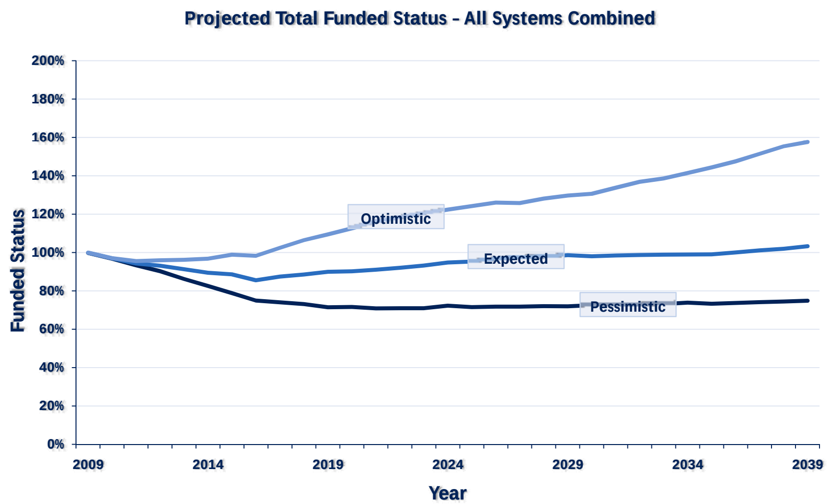
Estimated GF-S Employer Contributions For Pensions



Estimated Local Government Employer Contributions For Pensions



Projected Funded Status



**Total funded status for illustration only. Actual funded statuses vary by plan. Assumes full funding and no future benefit improvements.*

Recap: Where Are Our Systems Today?

- All but two systems are fully funded
  - One of only four states fully funded at 2008
- We reformed our systems over 30 years ago
  - Other states now following our lead
- We haven't seen the full effects of the Great Recession
- Significant increases in required contributions coming
- Funded status expected to fall and then recover

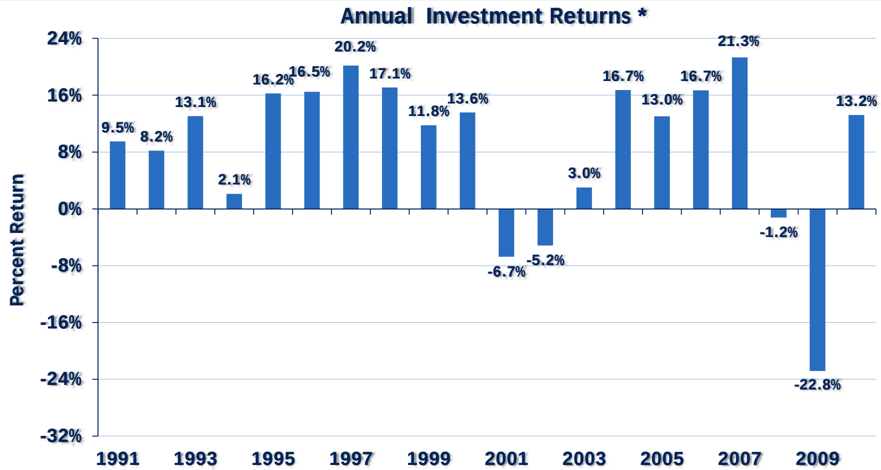
How Did We Get Here?

- We're fortunate to be better off than most states
- But, why are our contributions increasing so much?
- Past sheds light on present
- Twenty-year look-back
- Start with basics
  - Income
  - Expenses
- Closer look at Plan 1 legacy costs

Investments On Track

- Investments represent roughly 75 percent of pension income
  - When pensions are pre-funded on systematic basis
- Returns need to hit or exceed 8 percent statutory assumption
  - We count on this when developing contribution rates
- Over last 20 years, investment returns were right at benchmark

8.23 Percent Average Annual Return Over Past 20 Years



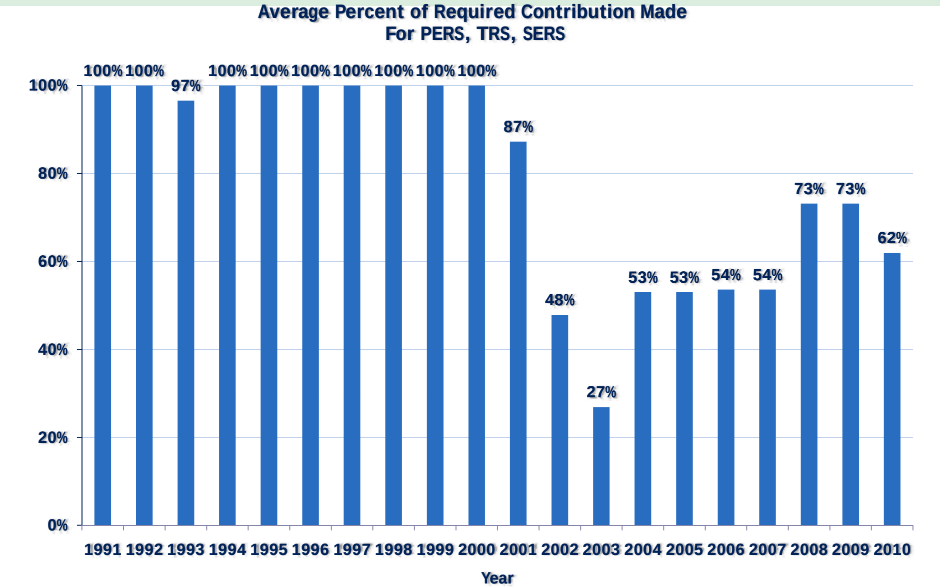
*Notes:
Fiscal year, time-weighted returns. Dollar-weighted returns vary by plan.

The Commingled Trust Fund (CTF) was created in 1993. Returns for 1993 and later are for the CTF as reported by WSIB. Returns prior to 1993 are total fund returns reported by the Department of Retirement Systems' Comprehensive Annual Financial Report.

Underfunding Decreased Income

- The remainder of pension income comes from member and employer contributions
  - Roughly 25 percent of total pension costs
- Over past 20 years, about 80 percent of required contributions were made
  - Contributions missed in good times and bad
- Underfunding = lost income and lost investment opportunities

Eighty Percent Of Required Contributions Made



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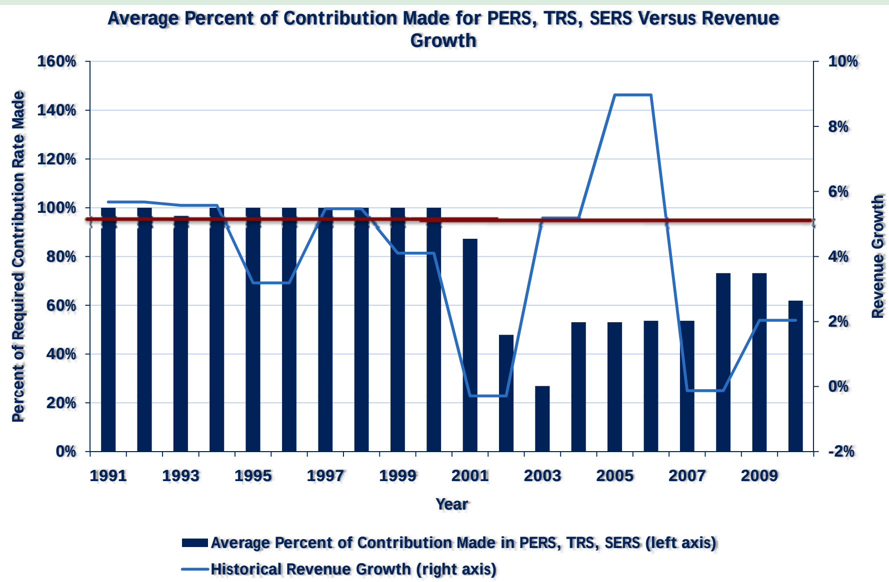
Contributions Missed In Good Times And Bad



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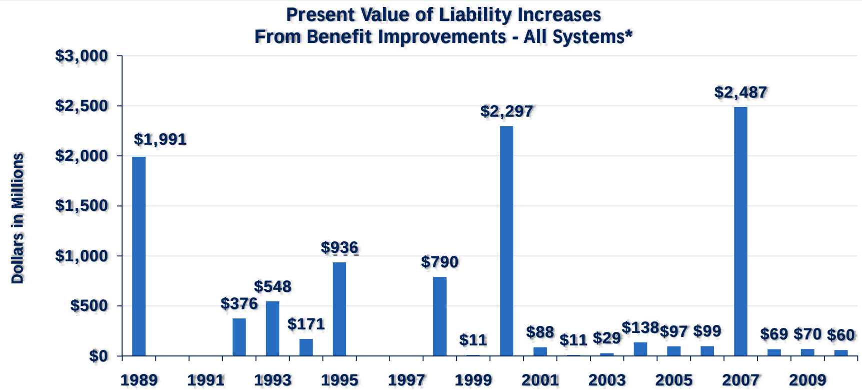
Benefit Improvements Increased Expenses



1989 – Plan 1 Age 65 COLA after 40% loss of purchasing power from age 65.
1995 – Plan 1 Uniform COLA.
1998 – Plan 1 Gain-Sharing (excluding cost of future gain-sharing benefits).
2000 – Plan 2/3 subsidized early retirement reduction factors with 30 years of service.
2007 – Gain-sharing replacement benefits.

** In 2010 dollars (based on 8% annual interest).*
Note: Does not include impacts of Plan 3 gain-sharing prior to 2008 gain-sharing event. Does not include savings from repealing future gain-sharing since cost never recognized previously.

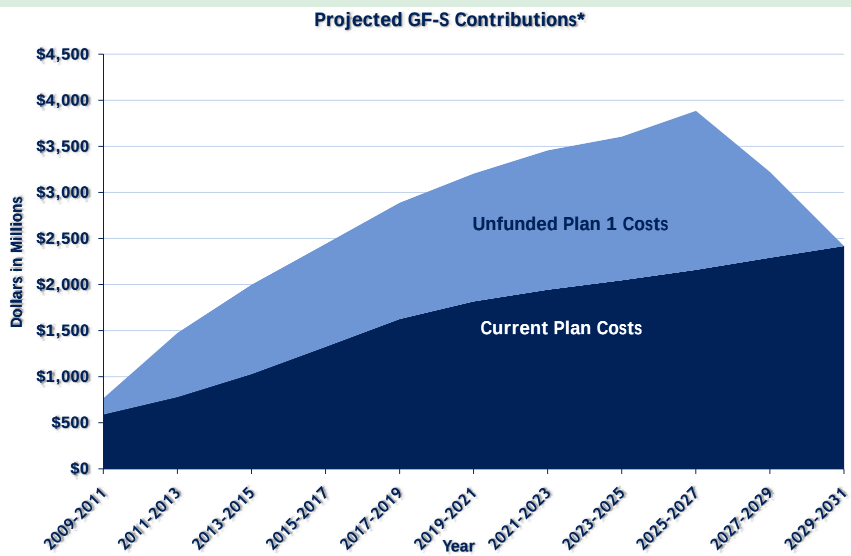
Recap: Income And Expenses

- Investment returns on track over past 20 years
- Underfunding decreased income
  - 80 percent of required contributions made
- Benefit increases also increased expenses
  - 0.5 percent annual growth in liabilities over past 20 years
- Next up: a closer look at Plan 1 legacy costs

A Closer Look At Plan 1 Legacy Costs

- Plan 1 legacy costs
  - Costs for unfunded liabilities from plans closed to new members over 30 years ago
  - PERS 1 and TRS 1
- Unfunded liabilities come from past underfunding and retroactive benefit improvements
  - Retroactive = applies to service credit already earned
- Plan 1 legacy costs “overlay” the financing plan for the open and on-going plans
  - Plan 1 costs shared by all system employers (Plan 1, 2, and 3)
  - Employees do not pay for Plan 1 legacy costs
  - A big part of required contribution increases today

Plan 1 Legacy Costs Overlay Current Plan Costs



*Under expected investment scenario.

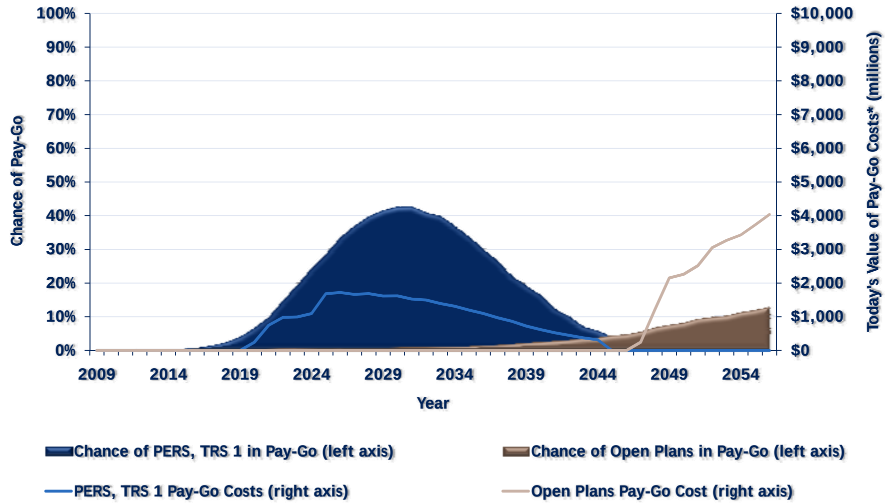
Recap: How Did We Get Here?

- Results of 20-year look-back
- Underfunding decreased income
- Benefit improvements increased expenses
- Plan 1 legacy costs overlay current plan costs

Tomorrow's Challenges

- Open plans still strong but require increased contributions in a difficult economy to remain healthy
- PERS 1 and TRS 1 unhealthy and have "pay-go" risk
  - Plans could run out of money with significant benefits remaining
  - Pay-go = pay for contractual benefits as they come due
  - No prefunding; loss of investment earnings
- Delicate balance
  - Managing plan health and pay-go risks
  - State and local government budgets
  - Employee take-home pay (Plan 2)
- Funding decision: pay now or pay more later

Pay-Go Risk: If Past Practices Continue



*Pay-Go Costs on top of Normal Pension Costs. Source: 2010 Risk Assessment.

Where Do We Go From Here?

- A continuation of past funding shortfalls and benefit improvement practices will increase financial risks for the state's pension plans
  - More details available in OSA's 2010 Risk Assessment
- Financial risks to lessen or avoid
  - Unsustainable or unaffordable costs
  - Pay-go funding in PERS 1 and TRS 1
- What are some opportunities for the future?

Opportunities

- Fully fund our plans
  - Funding shortfalls increase financial risks
- Avoid large benefit improvements until risk and affordability measures improve
- Risk management
  - Amend policies to eliminate unacceptable risks and mitigate acceptable risks
  - New tools available to identify and quantify financial risks for pension systems: OSA's risk model
  - Select Committee on Pension Policy (SCPP) discussing risk management strategies this interim

The State Of Our State's Public Pension Systems

- In aggregate, we're better off than most states
- We've already reformed our systems
  - Other states following our lead
- Steep increases in contributions coming
  - For both open and closed plans
- Significant affordability challenges ahead
  - Pay now or pay more later
  - Continued funding shortfalls will increase financial risks
- Opportunities
  - Fully fund plans
  - Avoid large benefit improvements
  - Risk management
- New tools available for risk management
- SCPP discussing risk management strategies

References

- Pensions 101, 102, 103
  - Pensions 101 - Funding
  - Pensions 102 - Plan Design
  - Pensions 103 - Governance
- 2009 Actuarial Valuation Report
  - Office of the State Actuary: Actuarial Valuations
- 2010 OSA Risk Assessment
- Department of Retirement Systems

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Questions?