Options for Managing Pension Risks: Constitutional Amendment

Issue

The issue before the SCPP is whether to recommend a constitutional amendment as a tool for managing financial risks to the state pension systems.

Committee Activity

In September 2010, OSA presented the results of its *2010 Risk Assessment* to the SCPP. In October the SCPP had a work session on possible options for managing pension risks. In response, the Executive Committee directed staff to prepare a work session for November that would focus more narrowly on options for a *constitutional amendment* to manage pension risks.

In November, staff presented multiple constitutional options related to several areas of pension risk: funding, benefit improvements, and legacy costs. Also, the State Treasurer attended the meeting and distributed his own proposal for a constitutional amendment.

After the full committee meeting, the Executive Committee discussed the constitutional options raised at the work session, the Treasurer's proposal, and Senate Joint Resolution (SJR) 8223, a proposed constitutional amendment introduced in the 2010 Legislative Session. The Executive Committee did not reach a consensus regarding how to proceed.

The chair requested that staff prepare a work session for December that would compare the SJR 8223, State Treasurer's proposal, and the options previously presented to the full SCPP.

Materials

1. Executive Summary.
2. "Grid" generally comparing SJR 8223, Treasurer's proposal and options previously discussed.
3. Briefing Paper on options from November 16, 2010, SCPP meeting.
4. SJR 8223 (2010).
5. State Treasurer's "Draft Constitutional Amendment for Pension Funding."

6. State Treasurer's explanation, "Constitutional Amendment Related to Pension Funding."

Next Steps

- Take no further action.
- Develop an SCPP recommendation.
  - Pursue one or more of the options discussed.
  - Develop one or more new options.
- Study or endorse a non-SCPP proposal.
  - SJR 8223.
  - State Treasurer's Proposal.
  - Other?
- Pursue strategies other than constitutional amendments.

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Options for Managing Pension Risks – Constitutional Amendment*	SJR 8223	Treasurer Proposal
Full funding	X	
Full funding with over-ride by supermajority	X	
Dedicated reserves		
Eighty percent funding		X
Waiting period for changes to methods and assumptions		X
Non-contractual benefits		
Strict funding for retroactive benefit improvements		
Avoid benefit improvements in unhealthy plans		
Supermajority for unfunded benefit improvements		
Voter approval for unfunded benefit improvements		
Pay off legacy costs	X	X
No new legacy costs		X

**These options were generally outlined in the SCPP's November 16, 2010, work session:*
Handout: http://www.leg.wa.gov/SCPP/Documents/2010/11-16/4.ConstAmend.pdf .
Power Point: http://www.leg.wa.gov/SCPP/Documents/2010/11-16/4.PPT_ConstAmnd.pdf

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Options for Managing Pension Risks: Constitutional Amendment

This handout is a "menu" of possibilities for managing key financial risks for pensions by amending the state constitution. Some ideas have been discussed by the SCPP and others in the past. Some ideas are new. Some of the options are general principles and some are very specific. Some suggestions are substantive and some are procedural. The options presented are not all-inclusive. They are aimed at improving financial risk measures identified in the 2010 Risk Assessment in the areas of funding, benefit improvements and Plan 1 legacy costs. See the Office of the State Actuary's 2010 Risk Assessment at the following link for additional background: osa.leg.wa.gov/Actuarial_Services/RiskAssessment/RA.htm

These are not OSA recommendations. This handout is a discussion document designed to expose the SCPP to a variety of options for utilizing constitutional amendments as tools for managing financial risks. As discussed in earlier briefings, there are pros and cons to constitutional amendments, and there will be pros and cons to the options outlined below. For a summary of last interim's briefing, see page 77 of the 2009 Interim Issues Full Report at the following link: leg.wa.gov/SCPP/Documents/2010/2009IntIss/2009_FR.pdf. See also the State Actuary's presentation at the October 19, 2010, SCPP meeting entitled Options for Managing Pension Risks: leg.wa.gov/SCPP/Documents/2010/10-19/7.PPT_Options.pdf.

A. Funding

The 2010 Risk Assessment found that over the past twenty years the largest state pension plans received about 80 percent of the contributions they needed under the funding policies in place at the time. The Risk Assessment also found that asset gains from positive investment returns were captured early and subsequent losses were deferred. These short-term funding policies resulted in additional underfunding over the past twenty years. A funding mandate in the state constitution would force the Legislature to provide a specified level of pension funding each year and could reduce or eliminate budgetary flexibility to underfund pensions.

1. Annual Funding at 100 Percent

This option would require the Legislature to assure that the total contribution rate for each state-administered pension plan is sufficient to fully fund, on an annual basis, 100 percent of the expected long-term annual cost of the plan.

(a) Procedural Flexibility

Would required funding be too onerous? Should there be an opportunity for legislative flexibility when tax revenues falls short? The stricter the consitutional mandate, the more desire there may be for an "out." One way to provide this would be to allow exceptions based on the affirmative vote of a supermajority, e.g. three-fifths,two-thirds, or three fourths of the members the House and Senate. Balancing the original mandate with flexibilty becomes critical, as the mandate can be rendered meaningless if the flexibility is too great.

(b) Dedicated Reserves

If there is concern that tax revenues may not be available to live up to the mandate, it might be necessary to add an option requiring "overfunding" when revenue growth is strong. Putting more money into pensions in good times would create a source of funds (i.e., a "credit balance") to tap into when revenue growth is unfavorable. Safeguards could include only allowing underfunding when there is an availabe credit balance.

Another approach, outside the pension system, could be to require that part of the state's rainy day fund be earmarked for pensions. The Legislature could transfer earmarked funds to make a portion of the state's required contributions for pensions when revenue growth is unfavorable.

2. Annual Minimum Funding at 80 Percent

If a full funding mandate is too strict, a minimum funding mandate could be implemented. Under this option, the Legislature would be required to assure that the total contribution rate for each state-administered pension plan is sufficient to fund, on an annual basis, 80 percent of the expected long-term annual cost of the plan.

Minimum rates are a tool for stabilizing pension contributions. They can help prevent contributions from dropping to artificially low levels when markets are volatile. The Pension Funding Council adopts contribution rates, and the Legislature can amend them if it so chooses. Under this option, the Legislature would have a duty to assure that the adopted rates meet the 80 percent standard.

The 80 percent standard is consistent with current funding policy for the open plans. Placing this funding standard in the constitution would mandate minimum funding and take away the Legislature's ability to reduce funding below these floors when it passes the budget bill. The 80 percent standard would not prevent the Legislature from providing full funding or from funding pension reserves.

The need for legislative flexibility or pension reserves may not seem as compelling if the constitutional mandate is minimum funding instead of full funding. However there is more long-term financial risk if minimum funding is the standard and not full funding. Additionally, even a minimum funding standard could prove onerous during

weak economic environments prompting the need for potential legislative flexibility or pension reserves.

3. Waiting Period for Changes to Methods or Assumptions

Another way to help reduce or eliminate outcomes that result in underfunding might be to require a waiting period before a change in actuarial methods or assumptions can become effective. For example, a two-year waiting period could deter policy makers from making assumption or method changes for the primary purpose of reducing contribution rates in an upcoming biennium.

B. Benefit Improvements

The 2010 Risk Assessment found that over the past 20 years, benefit improvements increased liabilities in the largest state pension plans by .45 percent annually. Constitutional provisions could be used to limit how much liability is added to these plans in the future. The constitution could allow for flexible benefits that can be adjusted in the future, or it could mandate stricter funding policies for new benefit improvements.

Several examples are provided below. These approaches would require close attention in future legislative enactments. Statutes and (if needed) rules would specify how these principles would be carried out for specific benefit improvements.

1. Flexible or Non-Contractual Benefits

Under this option, lawmakers would be given the explicit authority to designate a new benefit improvement as discretionary or non-contractual. The goal would be to provide clear flexibility to adjust the new benefit in the future. This option could allow the Legislature to reduce, withhold or repeal such benefits. The flexibility could be very broad, or it could be contained. For example, the ability to reduce, withhold, or repeal discretionary benefits could be limited to benefits not yet earned. This would protect benefits already paid and benefits for service that has already been earned.

2. Strict Funding Policy for Retroactive Benefit Improvements

Under this option a strict funding policy could be adopted for retroactive benefit improvements. Retroactive benefit improvements reach back in time and apply to service that was earned in the past. This creates what's called "unfunded prior service" costs since the previous contributions made on past service did not anticipate a higher cost from the subsequent benefit improvement. This type of benefit improvement can add significant unfunded liability to a pension plan. To avoid passing unfunded costs from these kinds of benefits on to future generations, a

constitutional amendment could require that new benefit improvements for past service be fully funded over a short period of time. For example they could be funded over the year or biennium in which they are enacted. This effectively means that a funding source for a retroactive benefit improvement must be immediately available.

3. Avoid Improvements to Unhealthy Plans

This option could limit or prohibit benefit improvements for plans with a funded status below a certain threshold - say, 80 percent. Funded status is the relationship between assets and accrued liabilities at a given point in time. If the funded status is 100 percent, then there is one dollar in actuarial assets for each dollar of accrued liability (earned benefits). Eighty percent is a common threshold used in the private sector to distinguish healthy plans from unhealthy plans.

4. Supermajority or Voter Approval

This option could require a supermajority of the Legislature, or even voter approval to add new unfunded benefits to pension plans. The greater the potential liability, the more there may be a need for additional caution. Procedural hurdles could discourage the addition of significant new unfunded liabilities. One challenging aspect of this approach is how to develop triggers that are practical and stand the test of time.

C. Plan 1 Legacy Costs

Plan 1 legacy costs were approaching $7 billion as of June 30, 2009 (the date of the most recent actuarial valuation). There is a statutory funding method (currently suspended in order to provide budgetary relief through 2015) for paying off the Unfunded Actuarial Accrued Liabilities (UAAL) for the Public Employees' Retirement System (PERS) 1 and the Teachers' Retirement System (TRS) 1. A constitutional amendment could mandate that this funding method be followed.

1. Annual Minimum Funding Until Legacy Costs Are Fully Paid

This option would require the Legislature, beginning in 2015, to assure that minimum amounts are contributed each year to pay off the UAAL in PERS 1 and TRS 1. This minimum obligation can be expressed as a percentage of pay for all active employees.

The Legislature need not be limited to contribution rates as the sole source for contributions as long as the amount of the minimum contributions is clear. The Legislature is then free to collect the contributions as a percentage of pay, or to raise the required amounts by some other means. The Legislature is also free to pay off legacy costs more quickly if it so chooses.

Minimum funding would exclude amounts that might be collected for new benefit improvements. The minimum amounts would remain in effect for each plan until the plan's UAAL is fully funded.

2. Prevent Legacy Costs from Re-Emerging

The constitution could require the Legislature to reasonably assure that once the UAAL is fully funded, it will not re-emerge. Legislative strategies to implement such a principle could include funding policies as well as investment policies. The implementing policies would not necessarily be needed in the constitution as long as the goal or principle is clear.

Examples of such policies would be requiring that contributions be collected until the plans are more than 100 hundred percent funded so that there is a cushion to absorb market fluctuations. Another example would be to transition assets into "safe" investment vehicles (i.e. lower risk, lower returning asset classes) once full funding is achieved.

Next Steps

There is a wide range of available options:

1. Take no further action.
2. Develop an SCPP recommendation.
    a. Pursue one or more of the options discussed.
    b. Develop one or more new options.
3. Study or endorse another proposal.
4. Pursue strategies other than constitutional amendments.

S-3624.2

SENATE JOINT RESOLUTION 8223

State of Washington 61st Legislature 2010 Regular Session

By Senators Schoesler, Hobbs, Hewitt, Murray, Honeyford, Parlette, Shin, Berkey, Sheldon, Becker, King, Holmquist, Stevens, Pflug, McDermott, Swecker, McCaslin, Delvin, and Kilmer

Read first time 01/19/10. Referred to Committee on Ways & Means.

BE IT RESOLVED, BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE STATE OF WASHINGTON, IN LEGISLATIVE SESSION ASSEMBLED:

THAT, At the next general election to be held in this state the secretary of state shall submit to the qualified voters of the state for their approval and ratification, or rejection, an amendment to the Constitution of the state of Washington by adding a new section to read as follows:

Article . . ., section 1. (1) Prior to the beginning of each biennium, the state actuary, appointed and authorized as provided by statute, or successor entity, shall conduct an actuarial valuation of all state-administered public employee retirement plans. The state actuary's valuation shall be subject to an independent actuarial audit.

(2) The pension funding council, appointed and authorized as provided by statute, or successor entity, shall utilize the actuarial valuation and audit to determine employer retirement contribution rates in all state-administered public employee retirement plans for the upcoming biennium.

(3) Each biennium the legislature shall appropriate moneys to fund the state employer retirement contribution rates identified in

subsection (2) of this section. Legislative action that would result in employer retirement contribution rates in any state-administered public employee retirement plan being less than the amount determined in subsection (2) of this section shall require a vote of three-fifths of the members elected to each house of the legislature, unless the reduction is the result of statutory modifications to retirement benefits not guaranteed by this Constitution.

(4) This section does not create or alter any contractual, statutory, or constitutional rights to receive public employee retirement benefits.

BE IT FURTHER RESOLVED, That the secretary of state shall cause notice of this constitutional amendment to be published at least four times during the four weeks next preceding the election in every legal newspaper in the state.

--- END ---

Draft Constitutional Amendment for Pension Funding

BE IT RESOLVED, BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE STATE OF WASHINGTON, IN LEGISLATIVE SESSION ASSEMBLED:

THAT, At the next general election to be held in this state the secretary of state shall submit to the qualified voters of the state for their approval and ratification, or rejection, an amendment to Article ... of the Constitution of the state of Washington **by adding new sections** to read as follows:

Article . . . , Section 1. **Intent and Application.** To ensure more fiscal discipline in budgeting and to improve intergenerational equity for taxpayers, minimum standards shall apply to public pension plans administered by the state of Washington. Retirement benefits provided under these plans should, to the maximum extent possible, be funded over the working lives of plan members so that employer costs are paid by the taxpayers who receive the benefit of those members' service.

This article applies to any defined benefit component of a public employee retirement plan administered by the state of Washington, except, as of the effective date of this section, the judges retirement fund, judicial retirement system, law enforcement officers'

and firefighters' retirement system plan 1, and the volunteer firefighters' and reserve officers' relief and pension fund.

Article . . ., Section 2. **Contributions, Open Plans.** For each state-administered pension plan that is open to new entrants, the legislature shall ensure that annual contributions are paid into the plan in amounts sufficient to fund at least eighty percent of the expected long-term annual cost of benefits under the plan, calculated as normal cost under the entry age normal actuarial cost method. These annual contributions shall remain in effect until the present value of fully projected benefits exceeds the actuarial value of assets for that plan as of the most recently published actuarial rate-setting valuation.

Article . . ., Section 3. **Contributions, Closed Plans.** Beginning July 1, 2015, the legislature shall ensure that annual employer contributions are made to plan 1 of the public employees' retirement system in amounts totaling no less than 5.25 percent of the salaries of all active members of the public employees' retirement system, public safety employees' retirement system, school employees' retirement system, and any newly-created retirement plan for public employees that were previously covered under the public employees' retirement system.

Beginning September 1, 2015, the legislature shall ensure that annual employer contributions are made to plan 1 of the teachers' retirement system in amounts totaling no less than 8.00 percent of the salaries of all active members of the teachers' retirement system, and any newly-created retirement plan for teachers that were previously covered under the teachers' retirement system.

These annual employer contributions shall be used for the sole purpose of amortizing the unfunded actuarial accrued liability of the plan, and they exclude any amounts required to fund new benefit improvements that become law after the effective date of this section. These annual employer contributions shall remain in effect until the actuarial value of assets in the plan equals at least one hundred percent of the actuarial accrued liability.

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Article . . ., Section 4. **Policies to Prevent Future Unfunded Actuarial Accrued Liability.** The legislature shall adopt policies to reasonably ensure that once the unfunded actuarial accrued liability in a closed plan is fully funded, it will not re-emerge. In addition, the legislature shall adopt policies that reasonably prevent the emergence of an unfunded actuarial accrued liability in any open plan, or in any plan that is closed to new entrants after the effective date of this section.

Article . . ., Section 5. **Changing Actuarial Methods and Assumptions.** Legislative changes to actuarial methods or economic assumptions that result in lower expected long-term annual pension costs take effect two years following the date of enactment or at the beginning of the next fiscal biennium, whichever is later.

BE IT FURTHER RESOLVED, That this amendment is a single amendment within the meaning of Article XXIII, section 1 of the state Constitution.

The legislature finds that the changes contained in this amendment constitute a single integrated plan for managing risks in funding pensions for members and beneficiaries of the state-administered pension plans. If this amendment is held to be separate amendments, this joint resolution is void in its entirety and is of no further force and effect.

BE IT FURTHER RESOLVED, That the secretary of state shall cause notice of the foregoing constitutional amendment to be published at least four times during the four weeks next preceding the election in every legal newspaper in the state.

--- END ---

DRAFT

Constitutional Amendment Related to Pension Funding

Sec.	Proposed Language	Effect of Language
1	To ensure more fiscal discipline in budgeting and to improve intergenerational equity for taxpayers, minimum standards shall apply to public pension plans administered by the state of Washington. Retirement benefits provided under these plans should, to the maximum extent possible, be funded over the working lives of plan members so that employer costs are paid by the taxpayers who receive the benefit of those members' service. This article applies to any defined benefit component of a public employee retirement plan administered by the state of Washington, except, as of the effective date of this section, the judges retirement fund, judicial retirement system, law enforcement officers' and firefighters' retirement system plan 1, and the volunteer firefighters' and reserve officers' relief and pension fund.	The intent and application section declares that the purpose of the amendment is to provide greater fiscal discipline and consistency in budgeting and funding of the state's retirement systems by improving intergenerational equity. This amendment does not apply to the retirement plans listed because of either their small size or current funded status.
2	For each state-administered pension plan that is open to new entrants, the legislature shall ensure that annual contributions are paid into the plan in amounts sufficient to fund at least eighty percent of the expected long-term annual cost of benefits under the plan, calculated as normal cost under the entry age normal actuarial cost method. These annual contributions shall remain in effect until the present value of fully projected benefits exceeds the actuarial value of assets for that plan as of the most recently published actuarial rate-setting valuation.	Contribution rates for open plans may never fall below 80% of entry age normal cost (EANC), unless the plan is fully funded, meaning the value of the pension assets is at least equal to the value of all the projected benefits for current members. *The EANC rate represents the long-term expected contribution rate of the plan from a member's entry (or hire) date to their expected retirement. The EANC adjusts for future changes in plan benefits and assumptions.*
3	Beginning July 1, 2015, the legislature shall ensure that annual employer contributions are made to plan 1 of the public employees' retirement system in amounts totaling no less than 5.25 percent of the salaries of all active members of the public employees' retirement system, public safety employees' retirement system, school employees' retirement system, and any newly-created retirement plan for public employees that were previously covered under the public employees' retirement system. Beginning September 1, 2015, the legislature shall ensure that annual employer contributions are made to plan 1 of the teachers' retirement system in amounts totaling no less than 8.00 percent of the salaries of all active members of the teachers' retirement system, and any newly-created retirement plan for teachers that were previously covered under the teachers' retirement system.	Fixed rates are established to systematically eliminate the unfunded actuarial accrued liability (UAAL) in the closed plans, PERS 1 and TRS 1. *UAAL is the excess of the projected value of earned pension benefits over the current value of assets.*

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Sec.	Proposed Language	Effect of Language
	These annual employer contributions shall be used for the sole purpose of amortizing the unfunded actuarial accrued liability of the plan, and they exclude any amounts required to fund new benefit improvements that become law after the effective date of this section. These annual employer contributions shall remain in effect until the actuarial value of assets in the plan equals at least one hundred percent of the actuarial accrued liability.	New employer contributions do not include amounts required to fund new benefit improvements.
4	The legislature shall adopt policies to reasonably ensure that once the unfunded actuarial accrued liability in a closed plan is fully funded, it will not re-emerge. In addition, the legislature shall adopt policies that reasonably prevent the emergence of an unfunded actuarial accrued liability in any open plan, or in any plan that is closed to new entrants after the effective date of this section.	The Legislature is directed to adopt policies to prevent emergence of an unfunded actuarial accrued liability.
5	Legislative changes to actuarial methods or economic assumptions that result in lower expected long-term annual pension costs take effect two years following the date of enactment or at the beginning of the next fiscal biennium, whichever is later.	This section requires a two year waiting period for changes that lower long-term costs, and hence, contribution rates.

DRAFT

Washington State School Retirees' Association
4276 Pacific Avenue SE, Lacey, WA 98503-1216 ~ 360-413-5496 / fax 360-413-5497 / 1-800-544-5219 ~ www.wssra.org

To: Select Committee on Pension Policy

From: Leslie Main, WSSRA Legislative Coordinator

Date: December 14, 2010

Re: Summary of WSSRA's 11/16/10 Testimony before the SCPP

Per the request of Don Carlson, Retiree Representative on the Select Committee on Pension Policy (SCPP), following is a summary of the testimony offered by the Washington State School Retirees' Association (WSSRA) 1116/10:

WSSRA has not taken a formal position on any of the proposals considered today, or whether a Constitutional amendment is the way to go.

With the current budget crisis there are two things that could be done immediately:

1. Immediate adherence to previously established contribution rate floors for basic and unfunded liabilities, currently not recognized under SSB 6161 (2009), and
2. Enactment of the actuarially recommended contribution rates adopted by the Pension Funding Council for the 2011-13 biennium.

Beyond that, another immediate action could be taken that statutorily could accomplish many of the same intended purposes as a constitutional amendment. Granted, such action to repeal any statute could be reversed by the Legislature when it became convenient, but the provisions that I refer to for repeal is contained in RCW 41.45.060 enacted in 2001 under E SSB 6167. E SSB 6167 provided that, "The contribution rates changes adopted by the Pension Funding Council shall be subject to revision by the Legislature."

With all respect to the Legislature as a whole, we sitting out in the audience over this Interim, and the last few years, watching the development of the State Actuary's Risk Assessment, have known that the primary risk to the pension funds is the Legislature itself. Particularly with respect to the language they provided themselves with in 2001 that provided them to manipulated contribution rates over the forthcoming decade, which they did. Considering this statute was enacted at the beginning of the decade, when these manipulations really got started. Now since were on the other side of "happy valley" maybe immediate action could be taken to address this issue.

Regarding proposed constitutional amendments:
WSSRA mostly supports Treasurer McIntire's proposal as it focuses almost wholly on the problem, which is pension funding. For example, whether its provisions mandating an 80% funding level for plans 2/3 (or 85%, as proposed by Rep. Bailey in legislation that would brought as statutory change), that can be considered and discussed. WSSRA would lean more towards a 100% funding level, because unless you have a 100% funding level you run the risk that after Plans 2/3 close, and the Plan's funding stream (i.e. the number in the plan members still employed) is reduced to zero over time, the Legislature play the same kind of games with the remaining 20% of funding that would still required (to pay the retired and surviving members of the plan). The actuarially recommended contribution (ARC) is what it is, and that needs to be paid.

The other part of the Treasurer's proposal that we do particularly concur with, are provisions which deal with situations I mentioned before of contribution rate manipulations, particularly with respect to mid-biennium rate changes. Delay of implementation of any changes made to actuarial assumptions and methods, to the next year, or even the next biennium, since assumptions are usually set in advance of contribution rates, would be very much something to consider.

What we do have concerns about are proposals that would link the funding of future benefit improvements to the health of the system. There were bills last Session which tied future benefit improvements to qualifying requirements such as completion of the Risk Analysis process, and attainment of an 85% funding ratios. Under the Treasurer's proposal, Plan 1 benefit improvements would be required to be funded separate from the Unfunded Liability amount covered by the contribution rate floor.

Those kinds of proposals place the burden of the Legislature's underfunding of pensions on current retirees, particularly for Plan 1. Plan 1 members paid 6% of pay their entire career, while the State used money it should have put toward its pension contributions on other non-pension political priorities. Plan 1 member benefit improvements, which have been identified with evidence as being needed, may be put on hold because the Legislature's avoided its responsibility over the last decade by underfunding of pension contributions.

During the 2010 Session, WSSRA appreciated working with Sen. Scheosler on his proposed constitutional amendment which would have required a 2/3 vote of the Legislature to override the Actuarially Recommended Contribution (ARC) rate. We look forward to continuing that work with Senator Schoesler. While meeting with the Senator during Session, WSSRA had suggested that it would be more effective, to prohibit from changing recommended ARC rates put forth by the Pension Funding Council entirely, but that at least of 2/3 vote would place constraints on the Legislature then currently exists. Thus, this still is an idea that merits further consideration.

Sen. Schoesler's proposal also provided an "out" to this 2/3 requirement by permitting the Legislature to reduce contribution rates via repeal of benefits considered as "not constitutionally protected." The Senator indicated during the '10 Session that his intent was for the provision to be applied prospectively only. WSSRA remains concerned whether benefits of both current and future retirees would be potentially impacted, by misapplication of the interpretation of these provisions, by future Legislatures. **Regardless of whether such provisions are to be applied to current or future retiree benefit security, Plan members have always made their statutorily required contribution rates. Members of the retirement system should not have to take responsibility for the State's underfunding of its pension systems obligations.**

Regarding budget challenges the State and local governments are currently facing, what can we say? We feel your pain. During the decade of pension manipulations, county, city and State government was pressed to meet budget challenges in the hard times, (as well as the good times). State and local government budget writers were seeking budget relief from savings realized via reductions to pension contribution rates, they got those savings. Now it's time for everyone to pay up and pay their bills. Whether it is individual citizens, the county, city, state, or country, we need to pay our bills.

Thank you for your time.

View the testimony of WEA, WFSE, and WSSRA representatives at the very beginning of the following PART B link:
http://www.tvw.org/media/mediaplayer.cfm?evid=2010110081B&TYPE=V&CFID=6686807&CFTOKEN=84552080&bhcp=1

Washington State School Retirees' Association

4276 Pacific Avenue SE, Lacey, WA 98503-1216 ~ 360-413-5493 / fax 360-413-5497 / 1-800-544-5219 ~ www.wssra.org

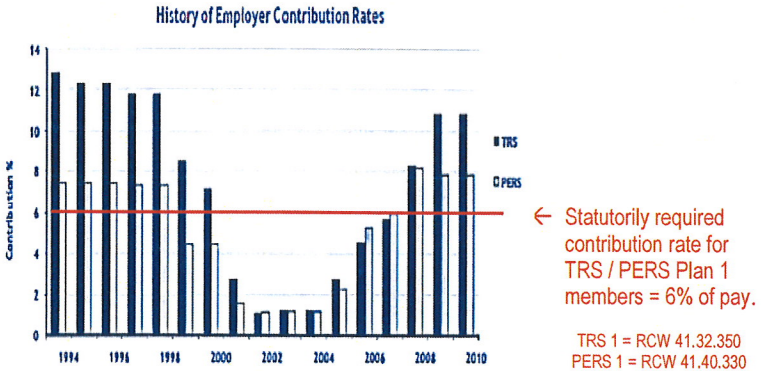
WSSRA Legislative Priorities ~ 2011

Responsible Pension Funding

The days when the Legislature could manipulate employer pension contribution rates at will, and *enjoy* spending the "savings" on other non-pension political priorities, are over.

The graph *"History of Employer Contribution Rates"* illustrates the period known as "Happy Valley" during which the Legislature happily enjoyed the short-term "budget savings" realized from **underfunding school and state employee pensions**:

- reducing pension contribution rates mid-biennium, *2SSB 6404* ***(2000)***
- amending statute to provide that, ***"The contribution rate changes adopted by the PFC shall be subject to revision by the Legislature,"*** *ESSB 6167* ***(2001)***
- under *ESSB 6167* ***(2001)*** ~
  - ◇ changing economic assumptions and actuarial methods used in pension actuarial valuations, and
  - ◇ moving the amortization date from 12-31-16 (realized from '98 and '00 Gain Sharing) back to 6-30-24.



Source of Graph: Office of the State Actuary 6/16/09 Source of Red Line & Text: WSSRA

- suspending payments on the Unfunded Liability for the 2003-05 and 2005-07 biennia, *EHB 2254* ***(2003)***
- amending statutory pension funding goals to provide increased flexibility in manipulating contribution rates, *ESHB 1044* ***(2005)***
- avoiding recognition of the cost of future Gain Sharing distributions as a material liability of the pension funds (a.k.a. "pre-funding"), *ESHB 1044* ***(2005)***
- most recently, under *SSB 6161* ***(2009)*** ~
  - ◇ repealing the 2024 Plan 1 Unfunded Liability amortization date established under the 1989 Pension Reform Act, and amending statutory *pension funding goals* by replacing references to the 2024 date with references to the new 10-year rolling amortization schedule,
  - ◇ suspending adoption of revised mortality tables and two contribution rate floors due to go into effect at the beginning of the 2009-11 biennium, and
  - ◇ reducing the 2009-11 Unfunded Actuarial Accrued Liability (UAAL) pension contribution rates by 63.7% from those adopted by the Pension Funding Council.

WSSRA strongly supports enactment of pension contribution rates for the 2011-13 biennium as proposed by the State Actuary, and adopted by the Pension Funding Council. **It's time for the Legislature to step up and take responsibility for its pension funding obligations!**

Expected Year-to-Year Increases of GF-S and Total Employer Contributions

(Dollars in Millions)	Projected Dollar Contributions		Biennial Percent Increase	
Biennium	GF-S	Total Employer	GF-S	Total Employer
2009-11	$661.0	$1,739.6		
2011-13	1,357.4	3,429.1	105.4%	97.1%
2013-15	1,887.9	4,765.7	39.1%	39.0%
2015-17	2,321.2	5,866.1	23.0%	23.1%
2017-19	2,730.8	6,922.6	17.6%	18.0%
2019-21	3,008.3	7,582.6	10.2%	9.5%
2021-23	3,228.1	8,079.0	7.3%	6.5%
2023-25	3,345.3	8,461.1	3.6%	4.7%
2025-27	3,597.3	9,021.5	7.5%	6.6%
2027-29	2,914.0	7,348.3	(19.0%)	(18.5%)
2029-31	2,095.2	5,355.4	(28.1%)	(27.1%)
2031-33	$2,233.4	$5,658.4	6.6%	5.7%

Source of Data: Office of the State Actuary 6/16/09

Protection of School Retiree Pension & Health Benefits

Re: Pension Benefits Already Enacted

It's not the enactment of MUCH NEEDED pension benefit improvements that's the problem; it's the Legislature's failure to pay for such benefits - that's the problem.

Even with the Gain Sharing improved Uniform Plan 1 COLA, a non-CPI based post-retirement adjustment, erosions in the purchasing power of Plan 1 pension benefits continue. The State Actuary has found that TRS / PERS Plan 1 members who retired during the 1970s have lost approximately 50% of their purchasing power. **The modest pension benefit improvements enacted to date must be protected!**

Re: Pension Benefit Changes Proposed

The increasing momentum to "save money" by establishing a 401(k) type fully Defined Contribution (DC) plan, with no guaranteed lifetime benefit, is misguided.

The National Institute on Retirement Security, August 2008, study, *"A Better Bang for the Buck: The Economic Efficiencies of DB Plans,"* found that **economic efficiencies of Defined Benefit (DB) pension plans deliver the same retirement income at 46% lower cost than DC plans**. Moreover, even if fully DC plan was established, other current pension employer obligations would still have to be met (i.e. the TRS1 /PERS 1 $6.9 billion unfunded liability). **The retirement security of future school employees must be protected!**

Re: Retiree Health Benefits

Under RCW 41.05.065, the benefit design of PEBB sponsored health plans must remain "substantially equivalent" to those offered in 1993. These provisions serve to protect the extremely comprehensive nature of PEBB retiree health insurance offerings.

The PEBB is currently working on a ***value based*** "PEBB Portfolio Redesign." WSSRA supports value as much as any organization. However, caution is needed to ensure that attempts at increasing "value" (i.e. decreasing costs) do not result in PEBB sponsored health insurance plans which turn out to be inadequate. **The comprehensive nature of PEBB retiree benefits must be protected!**

WASHINGTON

NATIONAL INSTITUTE ON Retirement Security
Reliable Research. Sensible Solutions.

Pensionomics:
Measuring the Economic Impact of State and Local Pension Plans

Key Findings

Benefits paid by state and local pension plans support a significant amount of economic activity in the state of Washington.

Pension benefits received by retirees are spent in the local community. This spending ripples through the economy, as one person's spending becomes another person's income, creating a *multiplier effect.*

Expenditures stemming from state and local pensions supported...

- 21,035 jobs that paid $1.3 billion in wages and salaries
- $3.2 billion in total economic output
- $462.9 million in federal, state, and local tax revenues

... in the state of Washington.

Each dollar paid out in pension benefits supported $1.37 in total economic activity in Washington.

Each dollar "invested" by Washington taxpayers in these plans supported $9.69 in total economic activity in the state.

Overview

Expenditures made by retirees of state and local government provide a steady economic stimulus to Washington communities and the state economy. In 2006, 129,378 residents of Washington received a total of $2.35 billion in pension benefits from state and local pension plans, with $2.17 billion paid from plans within the state and the remainder originating from plans in other states.

The average pension benefit received was $1,516 per month or $18,191 per year. These modest benefits provide retired teachers, public safety personnel and others who served the public during their working careers income to meet basic needs in retirement.

Impact on Jobs and Incomes

Retiree expenditures stemming from state and local pension plan benefits supported 21,035 jobs in the state. The total income to state residents supported by pension expenditures was $1.3 billion.

Of this, the greatest share, $717.6 million, was comprised of employee compensation (wages and salaries). Proprietors' income (self-employment income) represented $101.6 million, and other property income (including payments from interest, rent, royalties, profits and dividends) totaled $491.3 million.

Economic Impact

State and local pension funds in Washington and other states paid a total of $2.35 billion in benefits to Washington residents in 2006. Retirees' expenditures from these benefits supported a total of $3.2 billion in total economic output in the state, and $1.5 billion in value added in the state.

$2.3 billion in direct economic impacts were supported by retirees' expenditures on goods and services from businesses in the state. An additional $472.1 million in indirect economic impact resulted when these businesses purchased additional goods and services, generating additional income in the local economy. $491.5 million in induced impacts occurred when employees hired by businesses as a result of the direct and indirect impacts made expenditures, supporting even more additional income.

Total Economic Impact **$3.2 billion**

For more information on the data and methodology used for these estimates, please refer to *Pensionomics: Measuring the Economic Impact of State and Local Pension Plans* National Institute on Retirement Security: Washington DC. February 2009. www.nirsonline.org

Economic Multipliers

Taxpayer Contribution Factor*

$1.00
Contributed by taxpayers to Washington pensions over 30 years

$9.69
total output

Each $1 in taxpayer contributions to Washington's state and local pension plans supported $9.69 in total output in the state. This reflects the fact that taxpayer contributions are a minor source of financing for retirement benefits - investment earnings and employee contributions finance the lion's share.

Pension Benefit Multiplier

$1.00
pension benefits paid to retirees in Washington

$1.37
total output

Each $1 in state and local pension benefits paid to Washington residents ultimately supported $1.37 in total output in the state. This "multiplier" incorporates the direct, indirect, and induced impacts of retiree spending, as it ripples through the state economy.

* Caution should be used in interpreting this number, because the Census data used reflect the taxable status of contributions only; because employee contributions may be reported as taxpayer contributions, the multiplier here may be underestimated.

Impact on Tax Revenues

State and local pension payments made to Washington residents supported a total of $462.9 million in revenue to federal, state and local governments. Taxes paid by retirees and beneficiaries directly out of pension payments totaled $82.4 million. Taxes attributable to direct, indirect and induced expenditures accounted for $380.5 million in tax revenue.

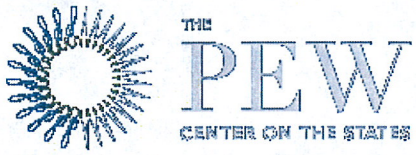
Federal Tax	312.9 million
State/Local Tax	149.2 million
Other Corporate Taxes	0.7 million
Total	**$462.9 million**

Economic Impacts by Industry Sector

The economic impact of state and local pension benefits was broadly felt across various industry sectors in the state. The ten industry sectors with the largest employment impacts are presented in the table below.

Industry	Employment Impact (# Jobs)	Value Added Impact ($ millions)	Income Impact ($ millions)	Output Impact ($ millions)
Health Care and Social Assistance	4,778	$250.9	$247.9	$397.0
Retail Trade	4,008	210.8	166.8	316.5
Accommodation and Food Services	2,376	68.6	60.9	133.4
Other Services (Except Public Administration)	1,859	54.9	51.1	101.4
Real Estate and Rental and Leasing	1,099	121.9	101.2	180.7
Finance and Insurance	935	115.4	110.3	206.0
Professional, Scientific, and Technical Services	854	51.0	50.0	95.1
Wholesale Trade	844	102.5	80.1	152.0
Arts, Entertainment, and Recreation	674	20.1	17.9	34.1
Administrative and Waste Services*	648	25.1	57.2	40.4

*The North American Industry Classification System classifies this industry as Administrative and Support and Waste Management and Remediation Services.



The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform

$1 trillion. 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.

Why does it matter? Because every dollar spent to reduce the unfunded retirement liability cannot be used for education, public safety and other needs. Ultimately, taxpayers could face higher taxes or cuts in essential public services.

A February 2010 report from the Pew Center on the States, *The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform*, shows why states must take strong action now—or taxpayers will suffer later.

To a significant degree, the $1 trillion reflects states' own policy choices and lack of discipline:

- failing to make annual payments for pension systems at the levels recommended by their own actuaries;
- expanding benefits and offering cost-of-living increases without fully considering their long-term price tag or determining how to pay for them; and
- providing retiree health care without adequately funding it.

Key Findings

Retirement benefits provide a reliable source of post-employment income for government workers, and they help public employers retain qualified personnel. **For states that have not been disciplined about fulfilling their obligations, the financial pressure builds each year.**

- In 2000, just over half the states had fully funded pension systems. By 2006, that number had shrunk to six states. By 2008, only four—**Florida, New York, Washington** and **Wisconsin**—could make that claim.
- In eight states—**Connecticut, Illinois, Kansas, Kentucky, Massachusetts, Oklahoma, Rhode Island** and **West Virginia**—more than one-third of the total pension liability was unfunded. Two states—**Illinois** and **Kansas**—had less than 60 percent of the necessary assets on hand.
- Nine states were deemed solid performers, having enough assets to cover at least 7.1 percent—the 50-state average—of their non-pension liabilities. Only two states—**Alaska** and **Arizona**—had 50 percent or more of the assets needed.
- Forty states were classified as needing improvement, having set aside less than 7.1 percent of the funds required. Twenty of these have no assets on hand to cover their obligations.

WSSRA Note: 2-23-10

The State of Washington's public pension system, **as a whole**, is fully funded. However:

1. This fully funded status is primarily due to the relatively young nature of Plan 2, whose majority of member have yet to retire, and
2. The funding status, as a whole, would be higher if not for the offset impact of the Plan 1 Unfunded Liability.

How the Legislature's failure to make appropriate pension contributions, particularly to the Plan 1 Unfunded Liability, impacts the funding status of Washington's public pension system is discussed on the reverse side.

State Fact Sheets

To help policy makers and the public understand the challenges states are facing, Pew assessed all 50 states on how well they are managing their public sector retirement benefit obligations. See reverse side.

Methodology

Pew's analysis for "The Trillion Dollar Gap" is based on data from states' own Comprehensive Annual Financial Reports, pension plan system annual reports and actuarial valuations. Pew researchers analyzed the funding performance of 231 state-administered pension plans and 159 state-administered retiree health care and other non-pension benefit plans, which include some localities' and teacher plans.

Media Inquiries

View *The Trillion Dollar Gap* via the internet using the following link: http://www.pewcenteronthestates.org/report_detail.aspx?id=56695.

If you are with the media and would like additional information on *The Trillion Dollar Gap*, please contact Matt Mulkey, communications manager, The Pew Center on the States, 202.862.9864.

The Pew Charitable Trusts applies the power of knowledge to solve today's most challenging problems. Pew's Center on the States identifies and advances state policy solutions.

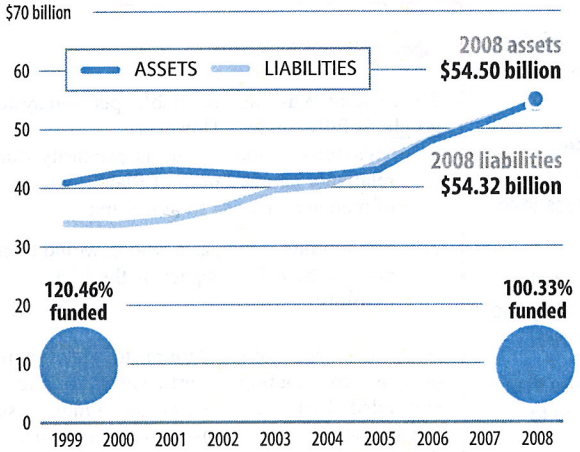
THE PEW CENTER ON THE STATES

The Trillion Dollar Gap
Underfunded State Retirement Systems and the Roads to Reform
Washington

WASHINGTON needs to improve how it manages its long-term liabilities for both pensions and retiree health care and other benefits. The state has failed to meet its actuarially required contributions since 2001. And while the level still exceeds the 80 percent benchmark that the U.S. Government Accountability Office says is preferred by experts, the percentage of its liabilities that is funded has declined from a high of 126 percent in 2000 to 100 percent in 2008. Washington conducts its actuarial valuations on December 31, so the state's most recent data reflect more of the pension fund investment losses of the 2008 calendar year than states with valuations on June 30. In 2006, Washington created a pension funding stabilization account with an initial appropriation of $350 million. That same year, the state increased employer contribution rates for various retirement plans. Meanwhile, as of 2007, Washington had failed to set aside any assets to cover its $7.9 billion long-term liability for retiree health care and other benefits.

PENSIONS, 1999 – 2008

Washington's pension liabilities grew 60 percent between 1999 and 2008, outpacing assets, which grew 33 percent in that period.



Total Bill Coming Due:	$54,322,900
Portion Unfunded:	-$179,100
Annual Required Contribution (ARC):	$1,545,600
Percentage ARC Funded:	62.62%

Note: In thousands

PENSIONS: NEEDS IMPROVEMENT

HEALTH CARE & OTHER BENEFITS, 2007

Retiree health care and other benefits are 13 percent of Washington's total retirement bill but are all of the state's retirement funding shortfall.

Washington's health care and other post-employment benefit programs are **unfunded.**

Total Bill Coming Due:	$7,901,610
Portion Unfunded:	$7,901,610
Annual Required Contribution (ARC):	$682,797
Percentage ARC Funded:	22.89%

Note: In thousands

HEALTH CARE & OTHER BENEFITS: NEEDS IMPROVEMENT

Solid performer
Needs improvement
Serious concerns

Our grades assess states on how well they manage their retirement obligations. Each state can earn up to four points for its pension plans: two points for a funding ratio of at least 80 percent; one for an unfunded liability below covered payroll; and one for paying an average of at least 90 percent of the ARC during the past five years. Solid Performer = 4 points. Needs Improvement = 2–3 points. Serious Concerns = 0–1 points. Grading for health care and other benefits is simpler because most states have only recently begun to fund and collect data on these liabilities. States are solid performers if they have set aside assets equal to at least 7.1 percent of their liabilities (the 50-state average), or they need improvement if they have contributed less.

For more details, read the full report at www.pewcenteronthestates.org/TrillionDollarGap.

The Pew Center on the States is a division of The Pew Charitable Trusts that identifies and advances effective solutions to critical issues facing states. Pew is a nonprofit organization that applies a rigorous, analytical approach to improve public policy, inform the public and stimulate civic life.

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FACT Sheet

NATIONAL INSTITUTE ON
Retirement Security
Reliable Research. Sensible Solutions.

A Better Bang for the Buck
The Economic Efficiencies of Defined Benefit Pension Plans

Overview

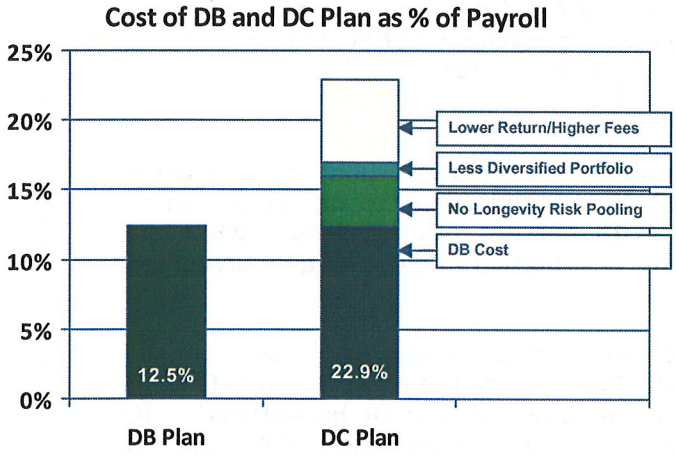
The National Institute on Retirement Security has released a new report, "A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans." The report presents an original analysis on the efficiencies of defined benefit pension (DB) plans, and the costs of DB plans as compared to 401(k)-type individual defined contribution (DC) plans.

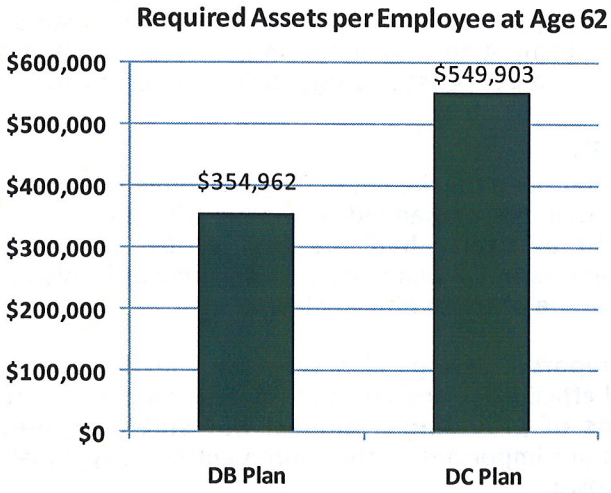
The report's analysis and findings serve as a myth buster with respect to the costs of defined benefit pension plans. Specifically, the embedded **economic efficiencies of DB plans make them nearly half the cost of DC plans, or a 46 percent cost savings**.

Policy and decision makers can utilize these findings to make informed decisions about retirement security issues and to evaluate claims that DC plans save money. The report concludes that DB plans should remain a centerpiece of retirement income policy and practice, especially in light of current fiscal and economic constraints facing corporate and government retirement plan sponsors.

Methodology

The model makes an "apples to apples" calculation of the actual dollar contributions required for a DB and DC plan to achieve the same target retirement benefit. The target retirement benefit in the model is $26,684. Together with Social Security benefits, this retirement benefit allows a retiree to replace 83% of pre-retirement income, which meets generally accepted standards of retirement income adequacy.





Key Findings

The DB plan provides the best bang for the retirement buck. Under the model, the DB plan provides the same retirement income at nearly **half the cost - 46 % less** than individual 401(k)-type DC accounts.

Under the DB plan, contributions of 12.5% of payroll each year are required to fund the target retirement benefit. The DB plan will need to have $355,000 set aside for each participant by the time the worker turns 62. In contrast, the DC plan requires contributions of 22.9% of payroll each year. The less-efficient DC plan will need to have $550,000 set aside for each participant in the plan by the time the worker turns 62. In other words, the DB plan can provide the same benefit at a cost that is 46% lower than the DC plan. The **DB plan can do more with less providing the same benefit for nearly $200,000 less per participant.**

Economic Efficiencies Are Embedded in DB Plans

DB plans have certain embedded characteristics that drive their economic efficiencies:

1. **DB Plans Avoid "Over-Saving."** We won't all live to be ninety-five or one hundred. But in an individual plan, many of us will want to save enough to last until very old age to avoid the risk of running out of money. However, a DB plan only has to save for the AVERAGE life expectancy, which is much lower and which actuaries can calculate with a high degree of accuracy. By saving for a realistic average life expectancy, the DB plan realizes **a 15% cost savings** over the DC plan. In technical terms, this is called "longevity risk pooling."

2. **DB Plans Stay Forever Young.** Individuals age. Therefore, those in individual retirement plans must adjust their asset allocation to ensure sufficient cash is on hand to last throughout retirement. Most financial advisors counsel downshifting from higher risk/higher return investments to lower risk/lower return investments as they get older. This protects individuals from the risk of a stock market crash, but progressively reduces the investment returns that can be earned in retirement piggybanks. However, a DB plan exists across generations and therefore can always maintain the most optimal asset allocation. There isn't a need to be overly weighted in lower return/risk bonds or cash. This results in **a 5% cost savings** over the DC plan.

3. **DB Plans Achieve Higher Investment Returns.** The higher returns of DB plans as compared to individual accounts can be attributed a combination of professional asset management and lower fees. A retirement plan that earns greater investment returns will require less money in contributions. Even seemingly small differences in annual returns compound over time. In our model, a 1% difference in annual investment returns results in **a 26% cost savings** over a career, as compared to the DC plan.

Summary

"A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans," makes it clear that the embedded economic efficiencies of DB plans enable them to deliver the **same benefit at nearly half the cost of DC plans, or a 46 percent cost savings**. While the efficiencies of DB plans are well documented, this report is important in terms of quantifying the magnitude of those efficiencies.

The report's findings also serve as a myth buster to conventional wisdom with respect to the fiscal efficiencies and costs of DB pension plans. In fact, **DB plans are the most fiscally efficient means of providing a modest but stable retirement income that cannot be outlived**. DC plans are important to the retirement security equation, but they were not designed to stand on their own.

Policy and decision makers can utilize this data to make informed decisions about retirement security issues and to evaluate claims that DC plans save money. The report concludes that DB plans should remain a centerpiece of retirement income policy and practice, especially in light of current fiscal and economic constraints facing corporate and government retirement plan sponsors.