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State of the State's Pension Systems



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State Of The State's Pensions

- A national leader in pensions
- Certain risks and challenges ahead
- Opportunities to plan for the future and remain a national leader



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Today's Presentation

- "Pensions 101" to start
- State of the state's pensions
- Additional pension references and Appendix



What Are Pensions?

- Lifetime retirement payments
- Promises made today to pay benefits in the future



Pension Promise Is A Contract

- Since 1956, pension promise has been deemed a contractual right (*Bakenhus* case)
- Money must be available when pension payment becomes due
- How do you secure a promise for something that happens in the future?



Washington Uses A Financing Plan To Satisfy Contract

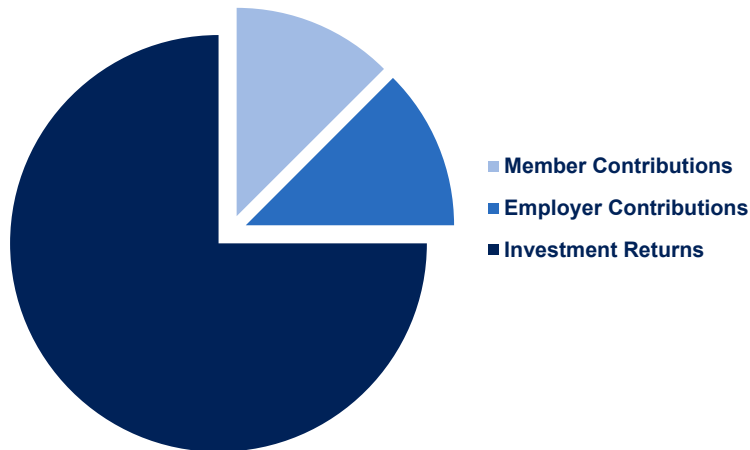
- Regular contributions over time
 - "Systematic actuarial funding"
- Uses the power of investing to help pay pension costs

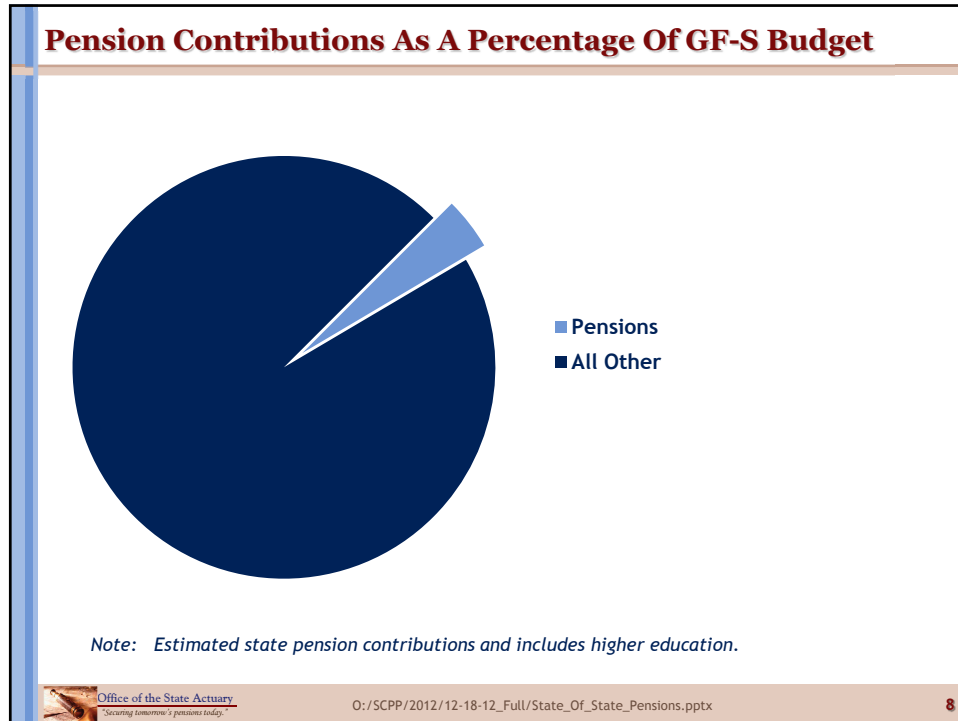


Where Does The Money Come From?

- Members and employers (taxpayers) make contributions
- DRS collects contributions as a percentage of each paycheck
- Contributions pooled and held in a trust fund
 - Managed by WSIB
 - WSIB mandate
 - Maximize returns at a prudent level of risk


Pension Trust Fund





What Is Systematic Actuarial Funding?

- Balance between two opposite approaches
 - Pay-as-you-go
 - Up-front contribution
- Three key considerations when selecting funding approach
 - Financing cost
 - Short term vs. long term
 - Investment risk
 - Fairness across generations
- “Intergenerational equity”
 - Funding a pension plan so costs of members’ benefits are paid by the taxpayers who received services from those members



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Pay-As-You-Go

- Contributions made as benefits are paid
- Most expensive financing plan in long term
 - Little time to invest
 - Less potential earnings
 - Less potential investment risk
- Least expensive in short-term
 - No contributions made until employee retires
- Does not support intergenerational equity
 - Contributions made after a member retires
 - Future generations pay for past generations

Up-Front Payment

- Single lump sum contribution today for all future benefits
- Least expensive financing plan in long term
 - Maximum time to invest
 - Greater potential earnings
 - Greater potential investment risk
- Most expensive in short-term
 - All contributions made up-front, single lump sum
- Does not support intergenerational equity
 - All contributions made today
 - Today's generation pays for future generations



Systematic Actuarial Funding

- Washington uses this approach
- Regular contributions over time
- Investment returns earned systematically over time
 - “Middle ground” between pay-as-you-go and up-front payment plans
- Investment risk is spread over time
- Supports intergenerational equity
 - Contributions made over members’ careers
 - Today’s generation pays for today’s generation



How Does It Work?

- Estimate future pension benefits
 - What will future benefits be?
 - When will they be paid and for how long?
- Estimate returns on future invested contributions?
 - What will future investment returns look like?
- Select an actuarial cost method
 - What are the regular contributions required over time?



Actuarial Cost Method

- Allocates a pension plan's cost over a member's working career
- Determines annual and on-going cost while member works
 - "Normal cost"
 - The regular contributions over time under systematic actuarial funding
- If everything happens as planned, normal cost will accumulate with investment earnings and completely fund a member's pension at the time of his/her retirement



Measuring Plan Health

- Has everything happened as planned?
- Are we on track with our systematic actuarial funding plan?
- Two key measurements
 - Funded status
 - Unfunded Actuarial Accrued Liability (the "UAAL")



Funded Status

- Comparison of plan assets to today's value of earned pensions
 - Point-in-time measurement
- A funded status of at least 100 percent means a plan has at least \$1 in assets for each \$1 of earned pension liability
 - On track with systematic actuarial funding plan

UAAL

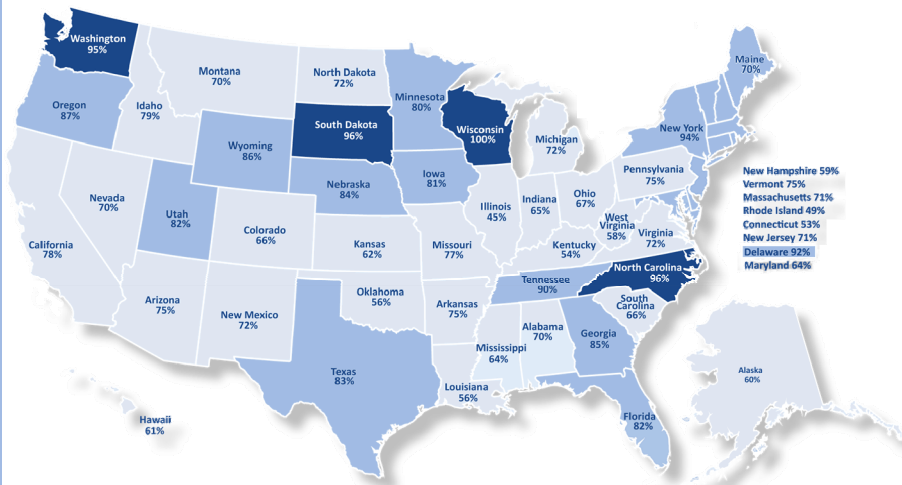
- Occurs when a plan does not have sufficient assets to cover earned pension liabilities
 - Funded status less than 100 percent
- Off track with systematic actuarial funding plan
- Requires additional contributions to get back on track
 - Normal cost plus UAAL contributions
 - Intergenerational equity is weakened
- If you don't get back on track, funding plan will ultimately become pay-as-you-go



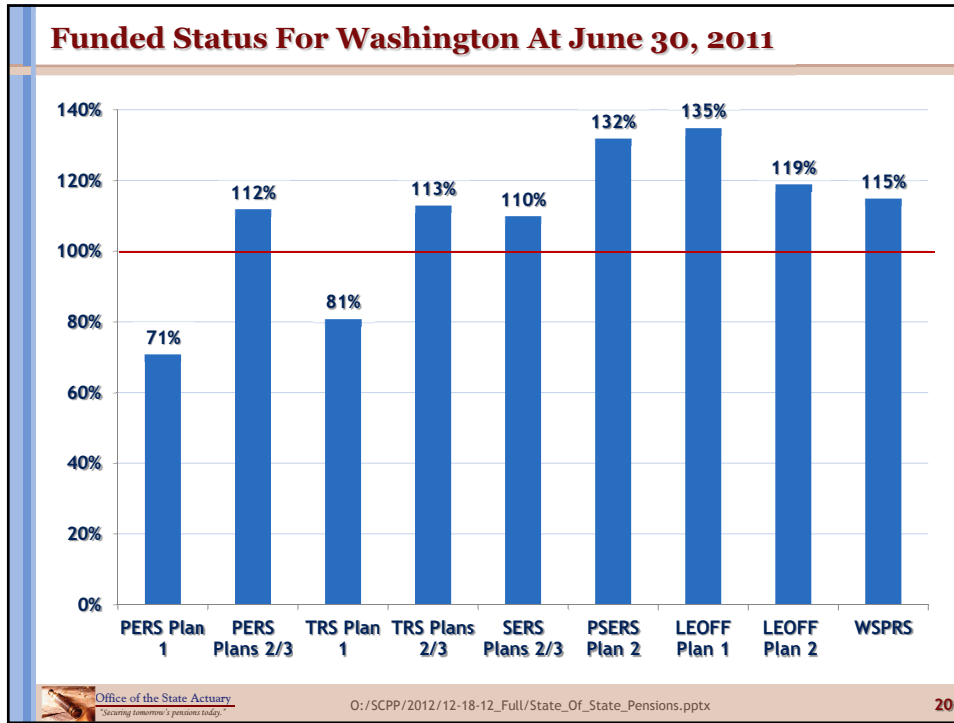
Recap: Pensions 101

- Pensions are promises made today to make lifetime retirement payments in the future
- Funded by member and employer contributions plus investment returns
- Washington uses systematic actuarial funding to secure future pensions
- Systematic actuarial funding supports intergenerational equity
- Actuarial measurements determine whether the state's on track with the financing plan
 - Funded status
 - UAAL

Top Four Funded Status Nationally



Source: The PEW Center on the States June 2012 report, "The Widening Gap Update."



Funded Status And Unfunded Liability At June 30, 2011

Funded Status on an Actuarial Value Basis*											
(Dollars in Millions)	PERS		TRS		SERS	PSERS	LEOFF		WSPRS	Total	
	Plan 1	Plans 2/3	Plan 1	Plans 2/3	Plans 2/3	Plan 2	Plan 1	Plan 2			
Accrued Liability	\$12,567	\$18,815	\$9,258	\$6,299	\$2,607	\$107	\$4,135	\$5,576	\$829	\$60,193	
Valuation Assets	\$8,883	\$20,997	\$7,485	\$7,141	\$2,872	\$141	\$5,565	\$6,621	\$949	\$60,654	
Unfunded Liability	\$3,684	(\$2,182)	\$1,773	(\$842)	(\$265)	(\$34)	(\$1,430)	(\$1,044)	(\$120)	(\$461)	
Funded Ratio	2011	71%	112%	81%	113%	110%	132%	135%	119%	115%	101%

Note: Totals may not agree due to rounding.

**Accrued liabilities represent the present value of future benefits for current members earned at the valuation date assuming an expected rate of return on assets of 7.9% per year (7.5% for LEOFF 2). All assets have been valued under the actuarial asset method (the "smoothing" method).*

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Amortization of Plan 1 Unfunded Liability

- Paid by employers only
- Phasing in higher Plan 1 UAAL contribution requirements under new method adopted in 2009
- Full contribution rate requirements begin in 2015
 - Increase from 2.30 (current) to at least 3.50 percent (2015) in PERS
 - Increase from 2.43 (current) to at least 5.75 percent (2015) in TRS
- Expected amortization dates
 - 2027 in PERS 1
 - 2026 in TRS 1
 - Will occur sooner/later under optimistic/pessimistic outcomes

Top Investment Performance

- WSIB's ten-year returns through June 30, 2010, after fees, best for public funds
- Based on Bloomberg survey of public pension funds with more than \$20 billion in assets
- According to Bloomberg, WSIB's ten-year returns benefitted from investments in
 - Private equity
 - Real estate



Complex Plans With Cost Effective Administration

- Third most complex public pension system
- DRS' cost per active member and annuitant well below peer average
 - \$59 for DRS
 - \$82 for peer average
- According to CEM Benchmarking analysis in 2011



Leader In Pension Reform

- Closed Plans 1 to new members in 1977
- Created Plans 2 with age 65 normal retirement age
- One of the first states to adopt hybrid plan design in 1996 (TRS 3)
- Other states following Washington's earlier examples
- Cost-reduction reforms occurred in 2007 and 2011
 - Repeal of "gain-sharing benefits" in PERS 1, TRS 1 and Plans 3
 - Repeal of PERS 1 and TRS 1 Uniform Cost-of-Living-Adjustment (UCOLA)
 - Legislature relied on "reservation of rights" clause

2012 Pension Reform

- Adoption of new economic assumptions
 - Reduces long-term costs
 - Increases short-term costs
 - See Appendix for further details
- Reduced early retirement benefits for new hires in PERS, TRS, and SERS
 - Lowers long-term costs as new hires replace current members



Litigation Risks Remain

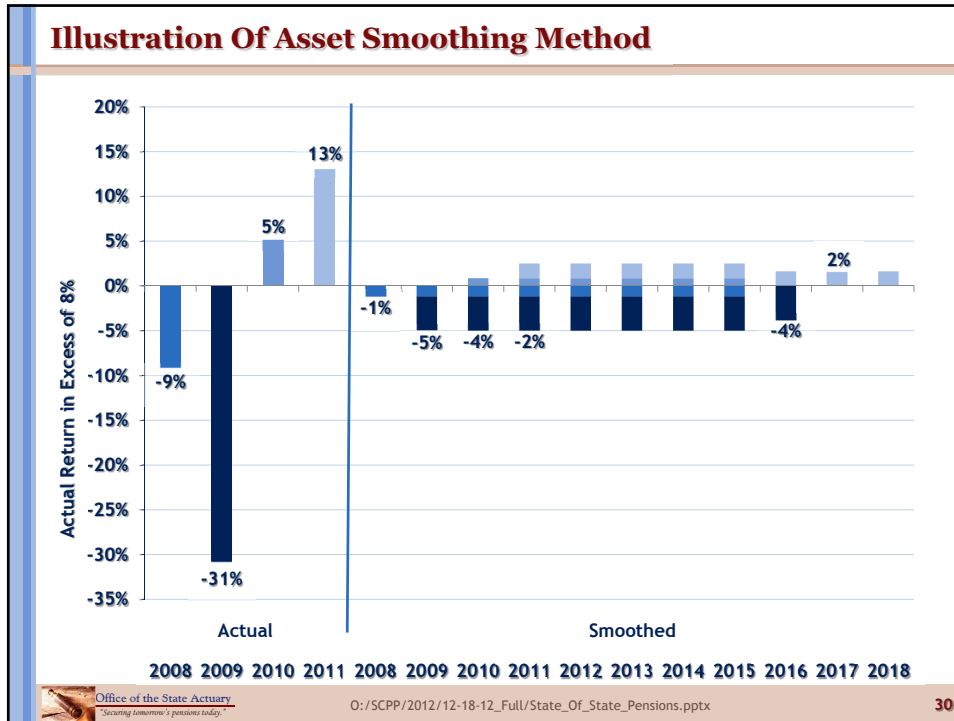
- Potential reinstatement of recently repealed benefits would weaken affected plans' financial health
 - Gain-sharing benefits
 - PERS 1 and TRS 1 UCOLA
- Full analysis included in 2011 Report on Financial Condition
- Potential funded status and budget impacts included in the Appendix
 - Based on 2010 analysis
 - 2010 analysis provides context and general magnitude only



Recovery Underway, Not Complete

- Investment returns of 13.2 and 21.1 percent for fiscal years ending June 30, 2010 and 2011
- Recovered most, but not all of past investment losses from Great Recession
- Actuarial funding based on "smoothed" investment returns
- Annual returns above/below expected return (i.e., 8 percent) spread over a maximum of eight years





Actuarial Value Of Assets At June 30, 2011

Calculation of Actuarial Value of Assets	
All Plans	
(Dollars in Millions)	Total
a. Market Value of Assets	\$57,350
b. Deferred Gains and (Losses)	
Plan Year Ending	
6/30/2011	5,547
6/30/2010	1,531
6/30/2009	(11,090)
6/30/2008	(2,724)
6/30/2007	2,058
9/30/2006	892
9/30/2005	482
Total Deferral	(\$3,304)
c. Market Value less Deferral (a-b)	\$60,654
d. 70% of Market Value of Assets	\$40,145
e. 130% of Market Value of Assets	\$74,555
f. Actuarial Value of Assets*	\$60,654

Note: Totals may not agree due to rounding.
*Actuarial Value of Assets can never be less than 70% or greater than 130% of the Market Value of Assets.

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Future Contribution Increases Expected

- With \$3.3 billion in deferred investment losses at June 30, 2011, we expect contributions to increase above current levels
- Also phasing-in higher Plan 1 UAAL requirements
- Important note
 - Future contribution increases depend on actual investment performance plus actual funding and benefit levels
- Employer contribution rate projections beyond 2013-15 in Appendix

Employer Contribution Rates*

	Current	2013-15
PERS	7.05%	9.03%
TRS	7.89%	10.21%
SERS	7.43%	9.64%
PSERS	8.71%	10.36%
LEOFF 1	0.00%	0.00%
LEOFF 2	5.08%	5.05%
WSPRS	7.91%	7.91%

Note: LEOFF 2 represents the local employer rate. The state also contributes 20% of the total contribution rate.

- PERS, SERS, and PSERS employers pay for the PERS 1 UAAL and employer normal cost
- TRS employers pay for the TRS 1 UAAL and employer normal cost

*Excludes administrative expense rate of 0.16%. Current rates based on 2009 AVR plus subsequent legislative changes.

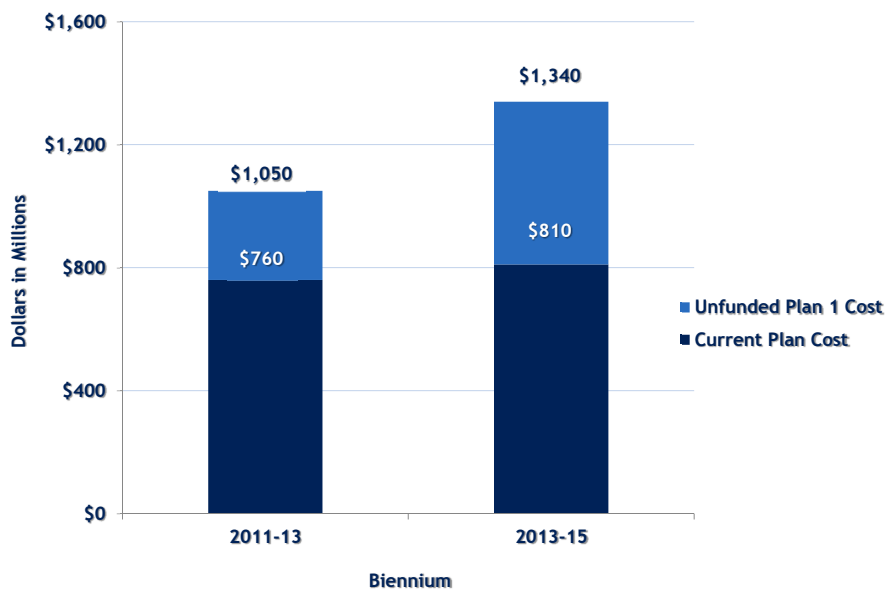
Plan 2 Member Contribution Rates

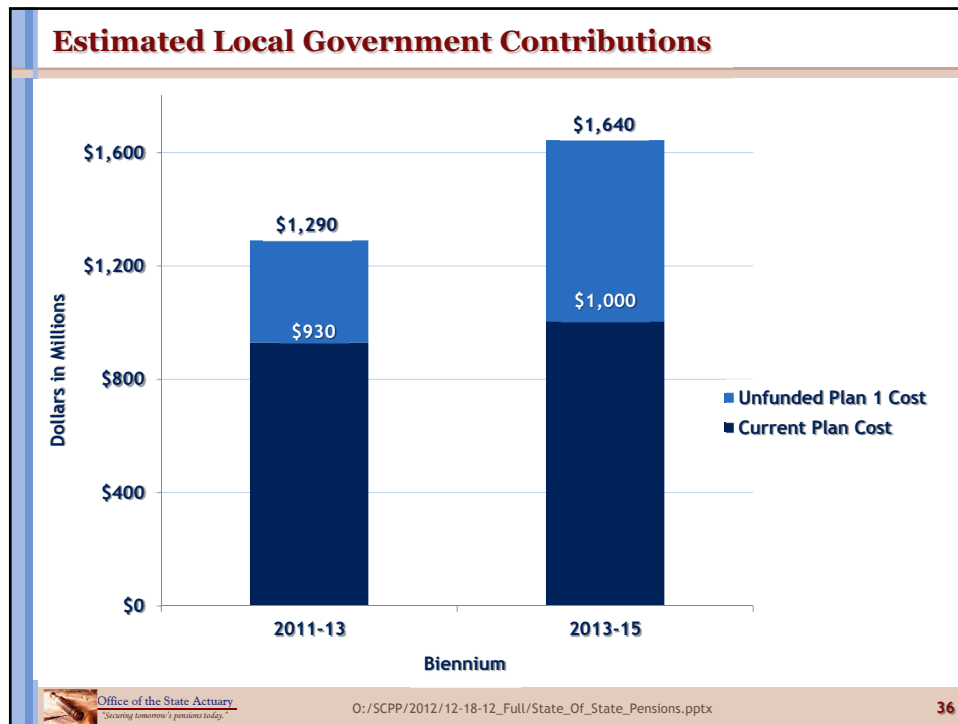
	Current	2013-15
PERS	4.64%	4.92%
TRS	4.69%	4.96%
SERS	4.09%	4.64%
PSERS	6.36%	6.36%
LEOFF 1	0.00%	0.00%
LEOFF 2	8.46%	8.41%
WSPRS*	6.59%	6.59%

* Rate applies to Plan 1 and Plan 2 members.

- Plan 2 members do not pay for the Plan 1 UAAL (employee normal cost only)

Estimated General Fund State (GF-S) Contributions





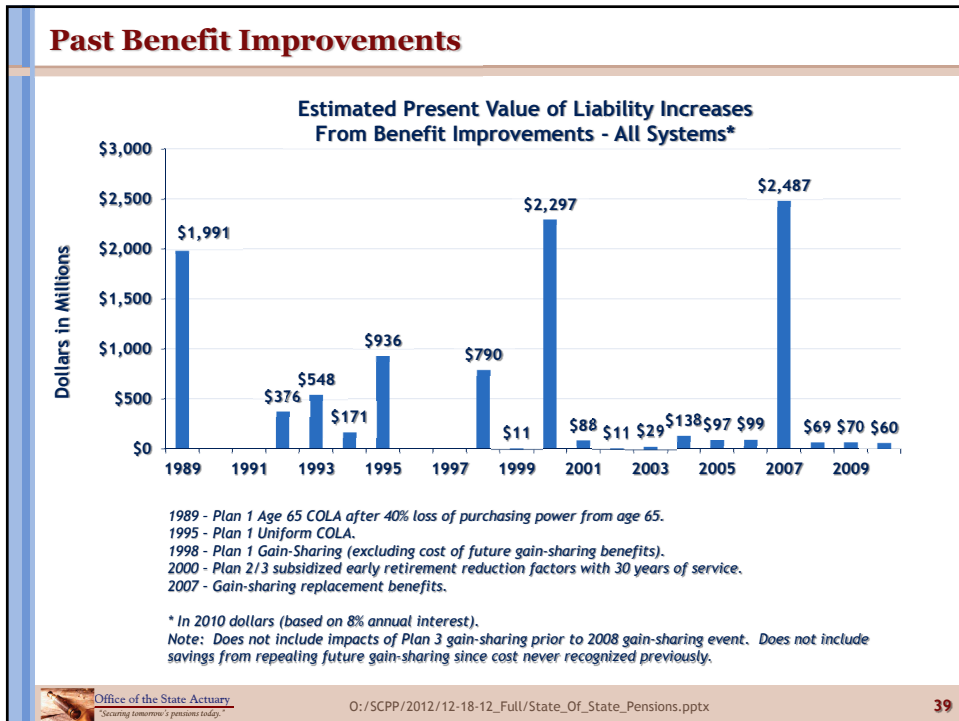
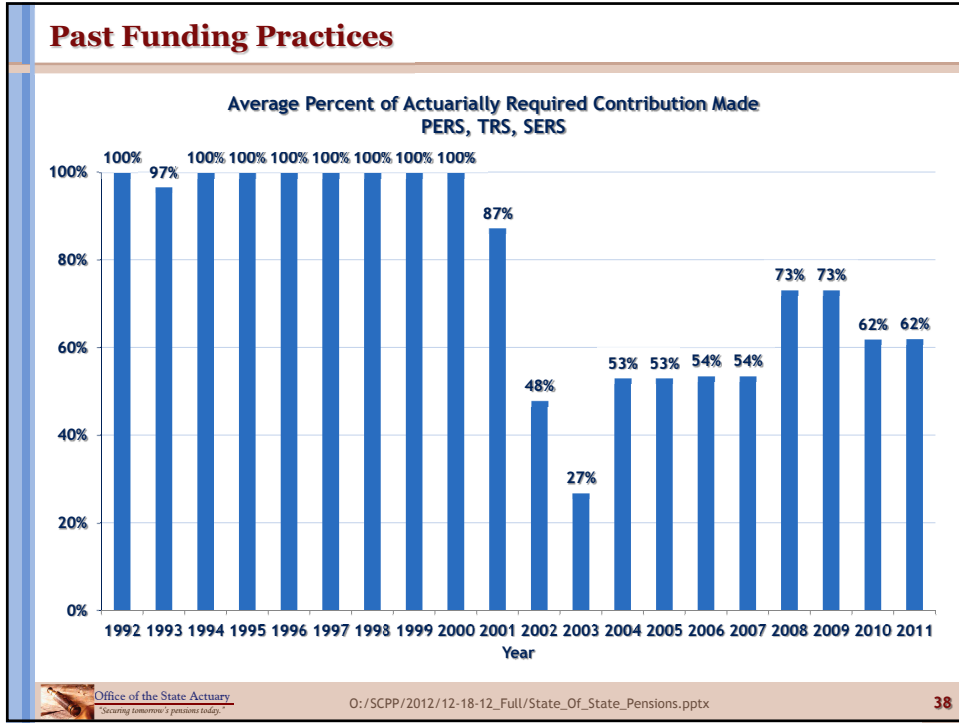
Planning For The Future

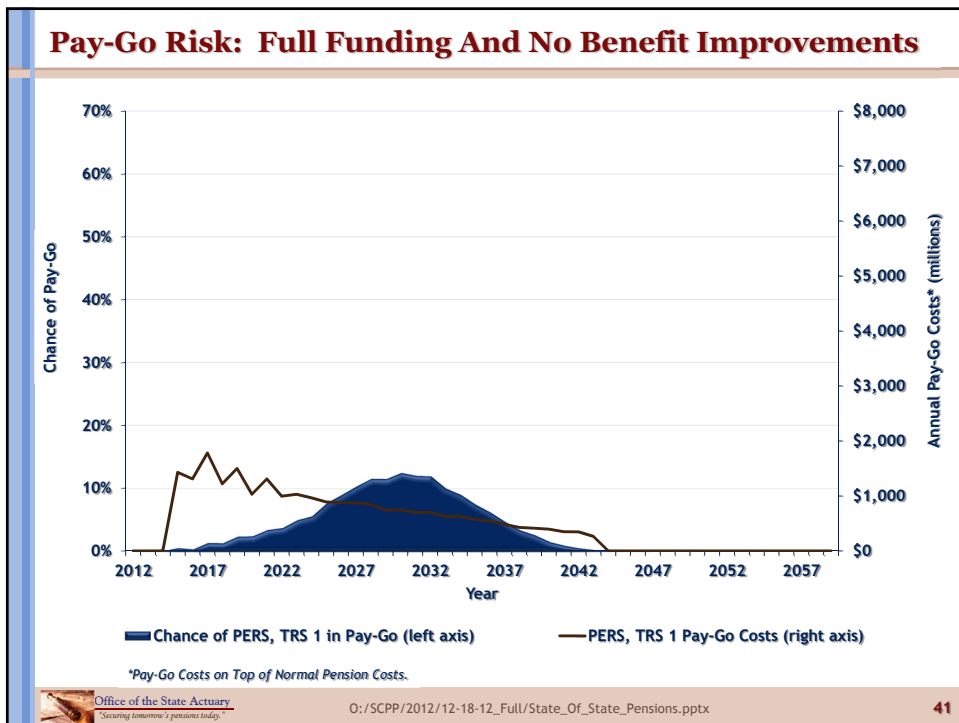
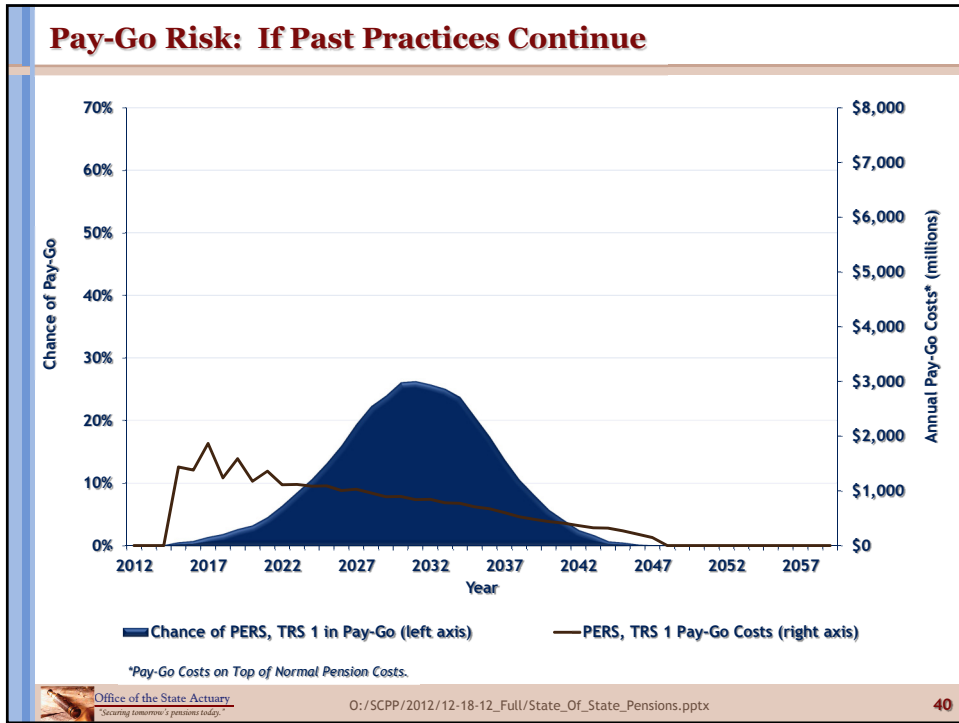
- Apply lessons learned
- Pension plans require consistent, stable, and adequate funding to remain affordable
 - Funding shortfalls today increase future contribution requirements
 - Pay now or pay more later
- Certain benefit improvements can weaken affordability and sustainability of state pensions
- Full funding and no further benefit improvements will reduce chances of pay-go funding in PERS 1 and TRS 1

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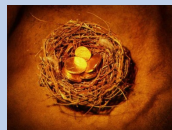
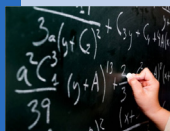
State Of The State's Pensions

- Top four funded status nationally
- Best investment performance over ten-year period
- Cost effective administration
- Leader in pension reform
- Certain risks and challenges ahead
- Opportunities for future planning
- Remain a national leader in pensions

Additional Pension References

- [Department of Retirement Systems](#)
- [Washington State Investment Board](#)
- [Office of the State Actuary](#)
 - [2011 Actuarial Valuation Report](#)
 - [Report on Financial Condition](#)
 - [Risk Assessment Report](#)
- [Select Committee on Pension Policy](#)
 - [Pension Primer](#)
 - [Pensions 101](#)
 - [Pensions 102 - Plan Design](#)
 - [Pensions 103 - Governance](#)

Questions?



Appendix

New Economic Assumptions Established In 2ESB 6378*

	Prior	2ESB 6378
Investment Return	8.00%	7.90%
Inflation	3.50%	3.00%
General Salary Increase	4.00%	3.75%

- 2ESB 6378 assumption changes effective for contribution rate requirements beginning July 1, 2013
- Assumed ROR becomes 7.8 percent beginning July 1, 2015 and 7.7 percent beginning July 1, 2017
- 2ESB 6378 assumed to not revise the 2011 actions of the Pension Funding Council

* Chapter 7, Laws of 2012 1st special session. Excludes LEOFF 2.



Litigation Risks - Potential Funded Status Impacts

	Funded Status on an Actuarial Value Basis			
	2010 Funded Status ¹	After Restoration of Gain-Sharing ²	After Restoration of UCOLA ³	After Restoration of Gain-Sharing and UCOLA ⁴
PERS 1	74%	72%	66%	63%
PERS 2/3	113%	112%	N/A	112%
TRS 1	84%	82%	72%	70%
TRS 2/3	116%	109%	N/A	109%
SERS 2/3	113%	105%	N/A	105%

¹Based on 2010 Actuarial Valuation Report (AVR); intended to provide context and general magnitude only.

²Based on AVR results after restoration of gain-sharing and continuation of replacement benefits.

³Based on AVR results after restoration of UCOLA for all participants.

⁴Based on AVR results after restoration of gain-sharing and UCOLA.



Litigation Risks - Potential 2013-15 Budget Impacts

Increase in 2013-15 Employer Contributions			
(Dollars in Millions)	After Restoration of Gain-Sharing ¹	After Restoration of UCOLA ²	After Restoration of Gain-Sharing and UCOLA ³
General Fund	\$206.5	\$410.5	\$639.7
Non General Fund	37.4	105.9	149.4
Total State	243.9	516.4	789.1
Local Government	185.9	381.9	589.2
Total Employer	\$429.8	\$898.2	\$1,378.4

Note: Totals may not agree due to rounding. Figures intended to provide context and general magnitude only.

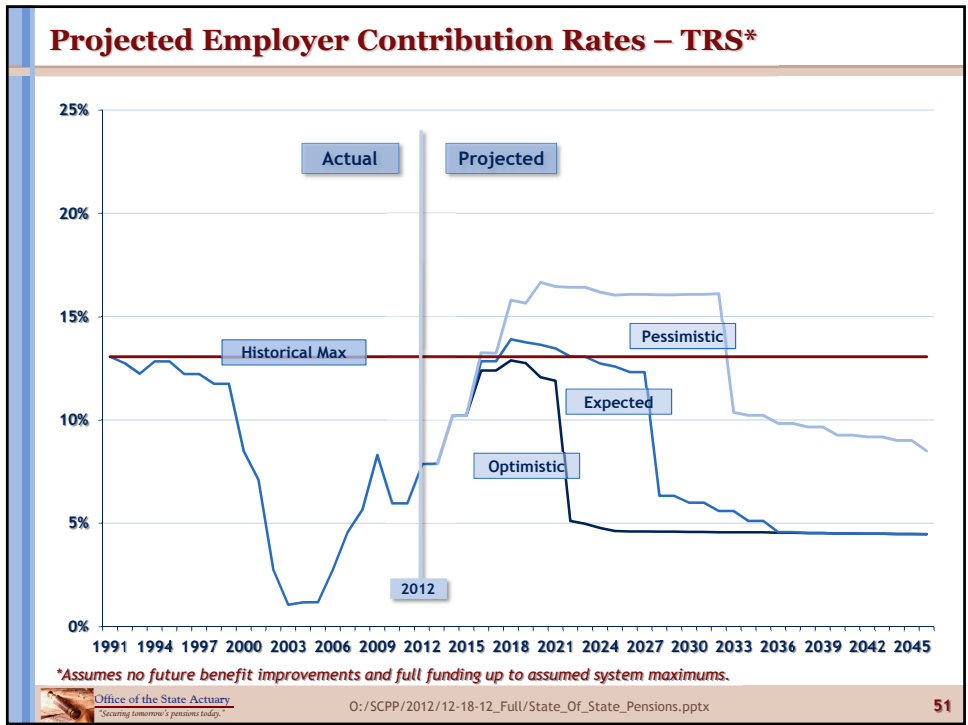
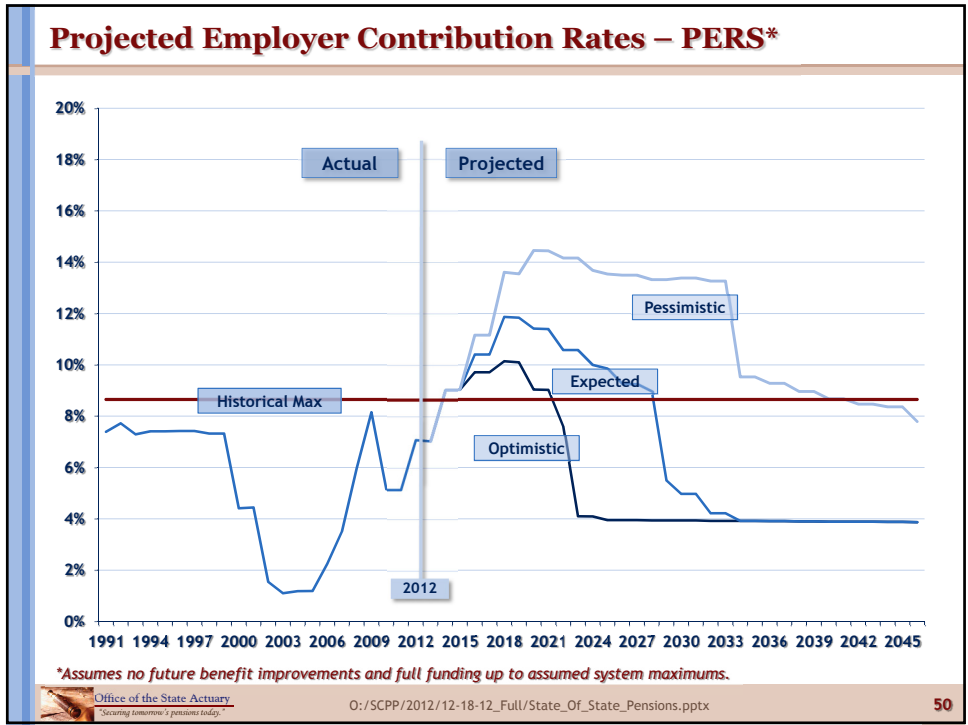
¹Based on AVR results after restoration of gain-sharing and continuation of replacement benefits.

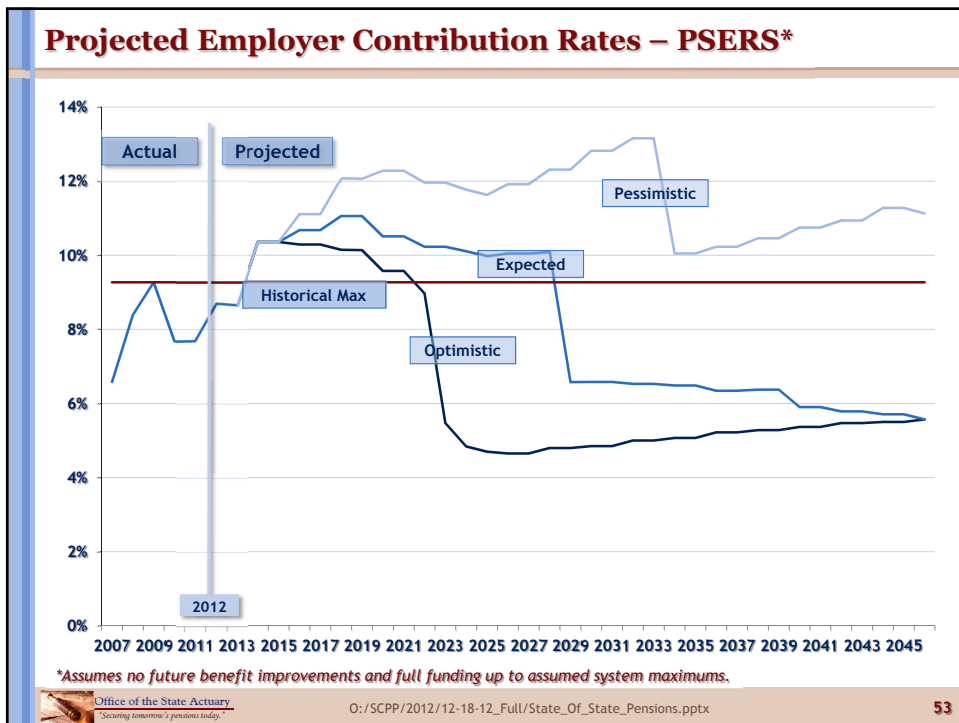
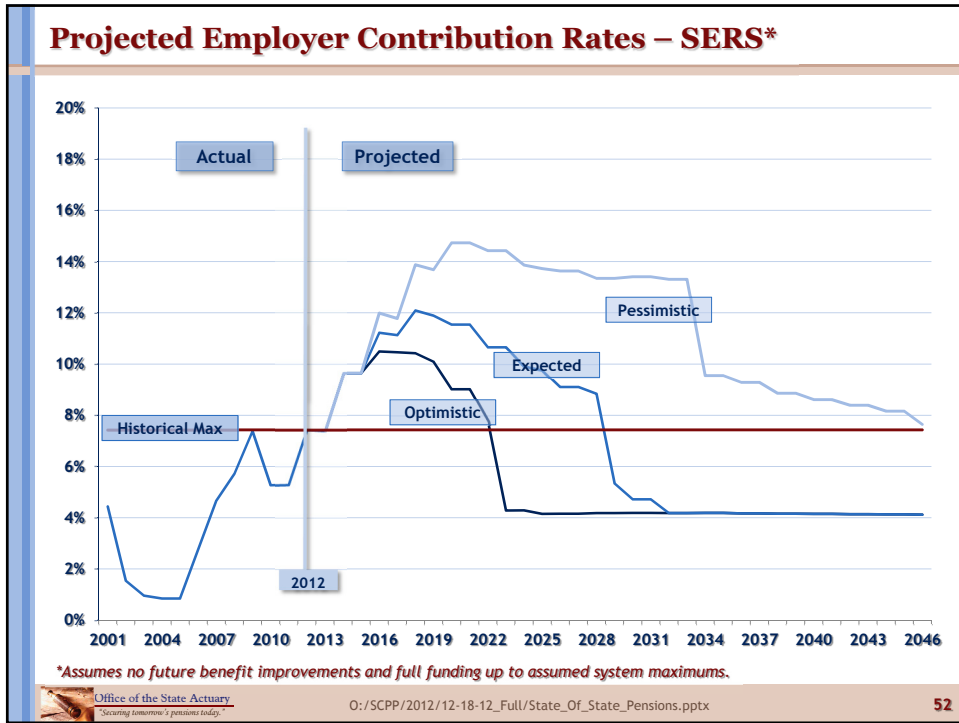
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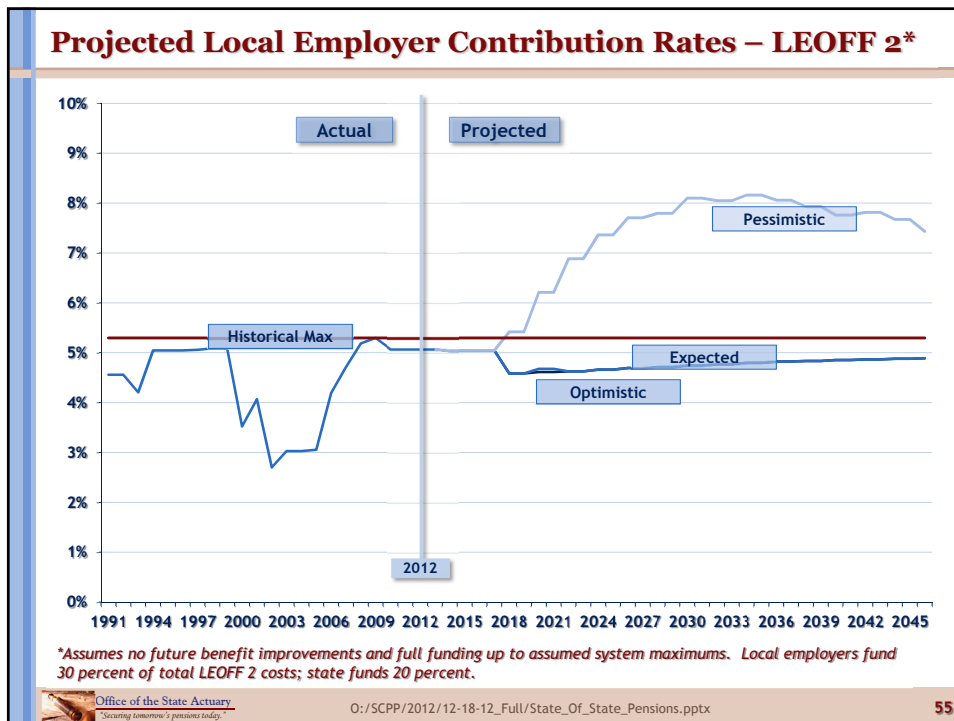
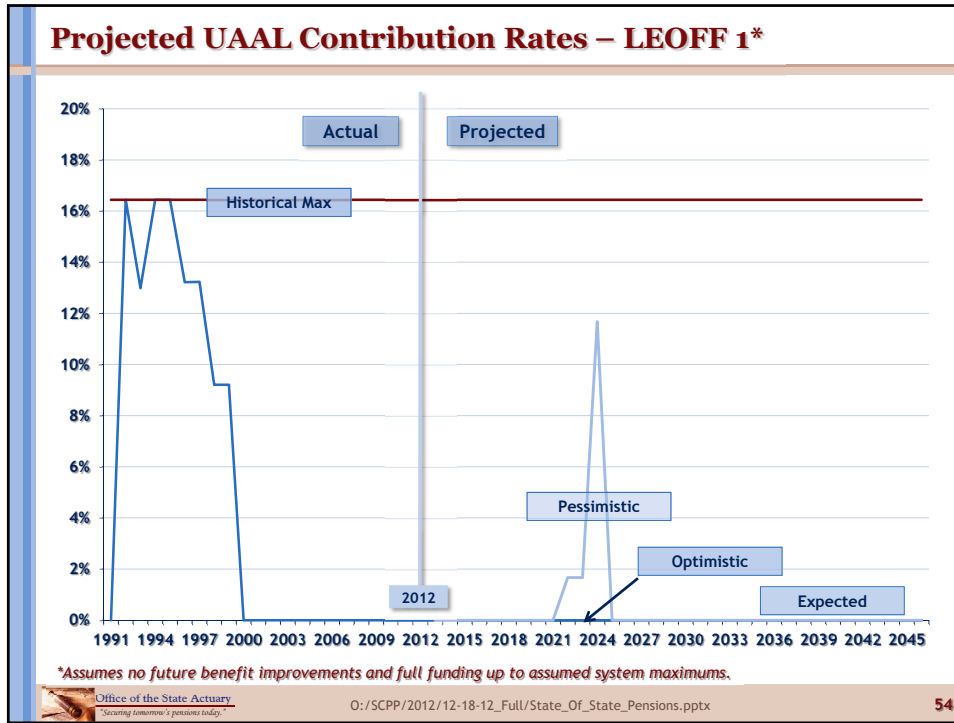
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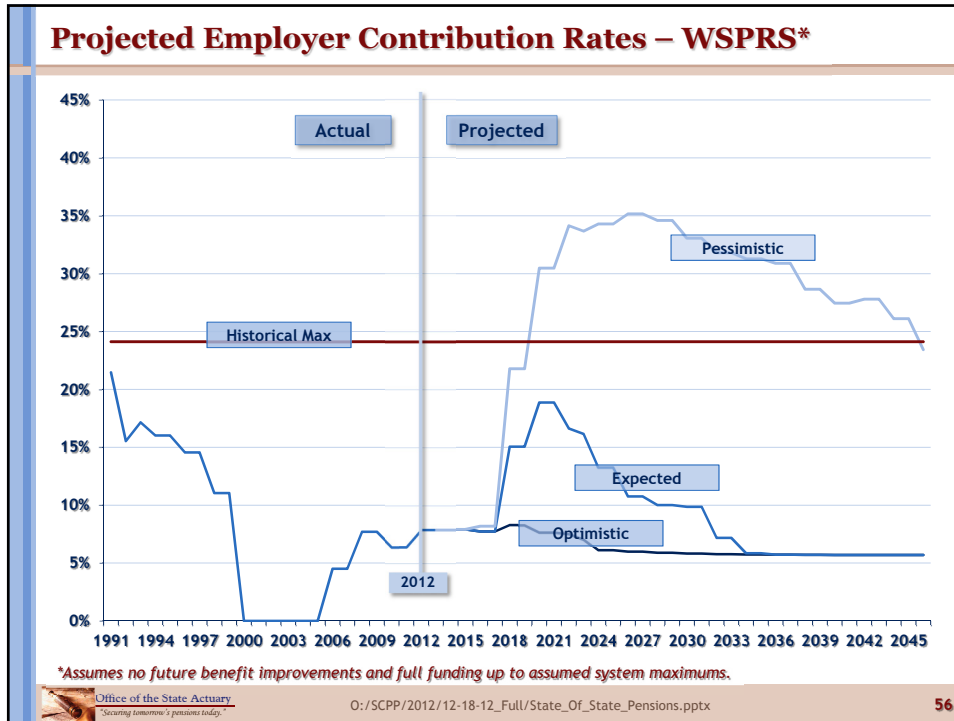
Projected Employer Contribution Rates

- The next seven slides reflect projected employer contribution rates based on
 - Asset returns through June 30, 2012
 - June 30, 2011, Actuarial Valuation Report
 - Legislative changes through the 2012 Legislative Session
- We update our projections at least annually
- Please replace these projections when more recent projections become available
- Please see the 2010 Risk Assessment for further information on projected contribution rates









- ### Source Links
- Slide 19 O:/Presentations/2012/SRC_HRC_Slide-19.xlsx
 - Slide 40 <S:\Resources\Projections\2011\Risk Assessment\2011 Val Risk Analysis Output shift PT1 ceil, fix L2 supp - System Max Fix.xlsx>
 - Slide 41 <S:/Resources\Projections\2011\Risk Assessment\2011 Val Risk Analysis Output shift PT1 ceil, fix L2 supp - System Max Fix - CL for RA.xlsx>
 - Slide 36-37 <S:\Price12\SCPP\June 27 Meeting\Est Contribution Charts - Adopted 2011 rates.xlsx>
 - Slides 48-53 <S:\Resources\Projections\2011\EmpRateCharts 2011 Val.xlsx>
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