



Washington State Legislature 

2009 Pension Funding Check-Up

Matt Smith, FCA, EA, MAAA
State Actuary


Laura Harper
Policy and Research Services Manager


 Office of the State Actuary
"Securing tomorrow's pension benefits."

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Retirement Plans "Physical"

- What's their history?
- Are they healthy today?
- What is their prognosis for the future?



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Check-Up For Largest Plans

- Funding issues drive the focus of this presentation
- Largest plans are biggest cost-drivers
 - Washington has 15 plans
- Basic principles can apply to all systems and plans



TRS And PERS Are The Largest Plans

- Plans 1 opened in 1938 and 1947
 - Teachers' Retirement System (TRS 1)
 - Public Employees' Retirement System (PERS 1)
- Designed to pay lifetime benefits ("pensions")
 - Promise to pay benefits in the future



Pension Promise Is A Contract

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



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Washington Uses A Financing Plan To Satisfy The Contract

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



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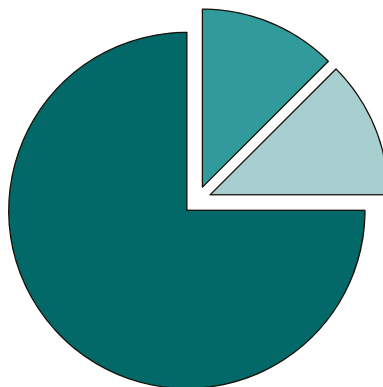
Where Does The Money Come From?

- Members and employers pay contributions
 - Members are public employees
 - Employers are state and local governments
 - Members and employers share the costs
- Contributions are collected as a percent of each paycheck
 - Results in regular payments over time
- Contributions are pooled and held in a trust fund
 - Fund grows through investing



Pension Trust Fund

- About 75 percent of pension costs are covered by investment returns



- Member Contributions
- Employer Contributions
- Investment Returns



Healthy Financing Plan Has Fairness Across Generations

- Intergenerational equity (IE)
- Legislative policy found in statute
- Goal is to fund benefits over members' working lifetimes
 - Taxpayer costs are paid by the taxpayers who get the services
 - No generation gets unfair burden or benefit



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Financing Plans Have Unfunded Liability

- All financing plans have unfunded future liability
 - Unpaid cost of benefits we expect members to earn in future
 - Pension contributions fund expected liabilities
- Unfunded past liability is a health risk
 - Unpaid cost of benefits already earned in the past
 - Pension contributions were not enough
 - Current generation pays for current and past generation
 - PERS 1 and TRS 1 have unfunded past liability



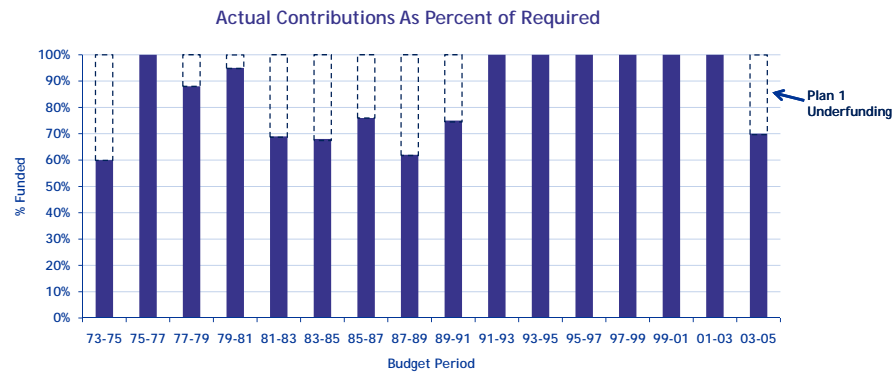
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How Did Unfunded Past Liability Accumulate In Plans 1?

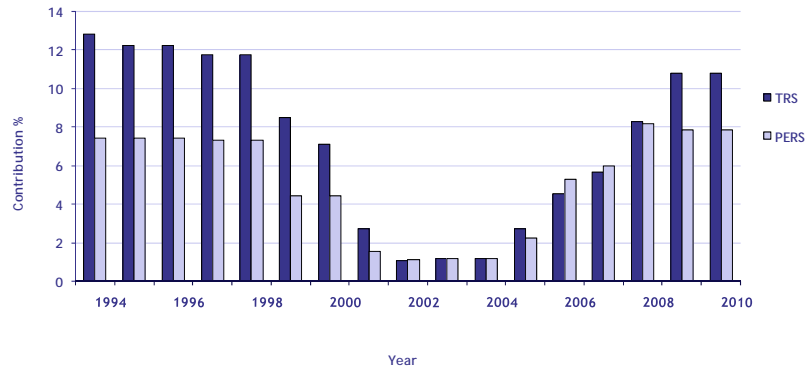
- Underfunding by the Legislature
- Short-term funding policy
 - Pay less now, pay more later
- Retroactive benefit improvements
 - Add benefits for service already earned
 - Current generation pays for current and past generations

Examples Of Underfunding



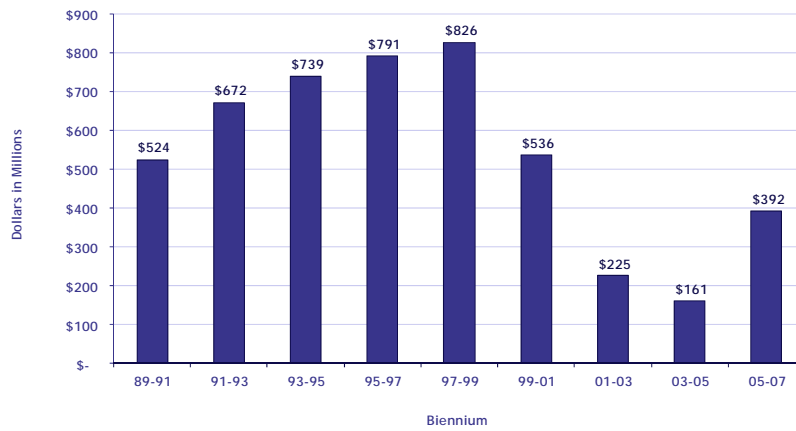
Example of Short-Term Funding Policy

History of Employer Contribution Rates



Example of Short-Term Funding Policy

History of Employer Contributions from GF-S



Examples of Retroactive Benefit Improvements

- Pension formula improved in early 1970s
 - Original formula: 1 percent multiplier, plus an annuity based on the member's account balance
 - Improved formula: 2 percent multiplier
- Significant cost-of-living adjustment (COLA) added in 1995
 - No inflation protection in original plan design
- Gain-sharing added in 1998 (repealed in 2007; in litigation)
- Benefits were granted for past service
 - Not funded over members' working lifetimes

Legislature Closed Plans 1 In 1977

- Benefits unaffordable
- No new employees in TRS 1 or PERS 1 after 1977 ("closed plans")
- Unfunded past liability continues



Plans 2/3 Designed To Address Health Problems In Plans 1

- Make plans more affordable
 - Equal cost-sharing between members and employers
 - Later retirement ages
- Avoid pressure for retroactive benefit increases
 - Include COLA in original plan design
- Start over with funding
 - New open-ended funding horizon
- Use a different funding method ("aggregate")
 - Does not allow an unfunded past liability to accumulate



Recap Of Health History

- Plans 1
 - Opened in 1938, 1947
 - Health risks developed over time
 - Closed to new hires in 1977
- Plans 2/3
 - Designed to avoid some of the health risks from Plans 1
- Recent history: minimum contribution rates
 - Recommendation of the SCPP, adopted by Legislature
 - Scheduled to go into effect for 2009-2011 but delayed in 2009 pension budget provisions

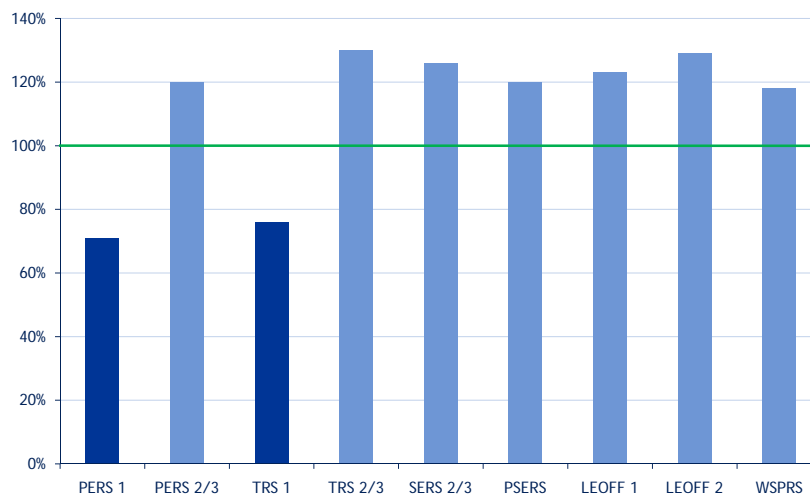


Health Assessment

- Healthy plans have sufficient assets to pay earned benefits
- Measured by the “funded status”
- Healthy plans - at least 80 percent funded
- Unhealthy plans - at least 60, but less than 80 percent funded
- Poor health, at risk plans - less than 60 percent funded
 - At risk of running out of assets (prematurely if closed plan)



Funded Status By Plan – At June 30, 2007



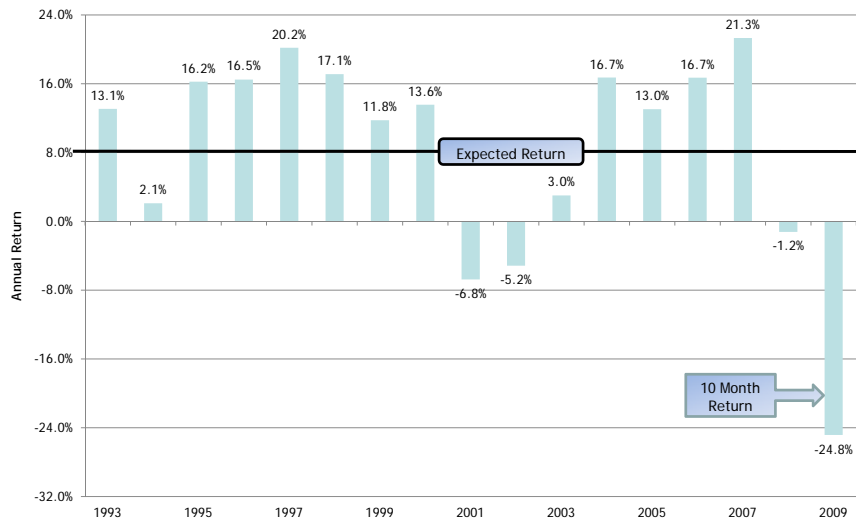
What's Changed Since Last Valuation?

- Unprecedented change in a short period of time
- Assets dropped more than 25 percent since last actuarial valuation (\$15 billion)
- Total restructure of Plan 1 funding method



Recent Investment Activity

Annual Return By Fiscal Year*



* As reported by WSIB



Plan 1 Funding Method Restructured

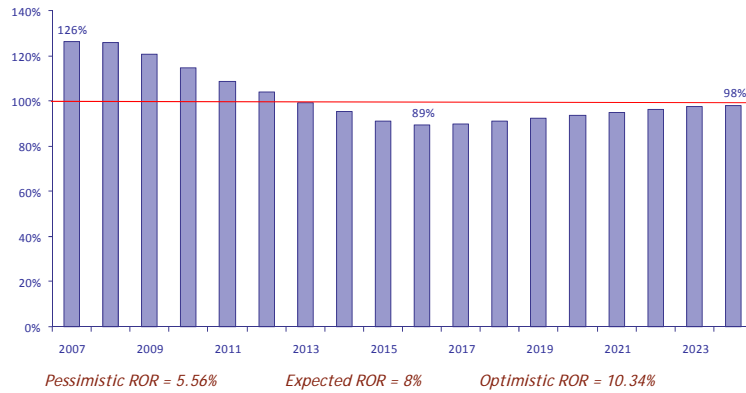
- Why was the method restructured?
 - Spike in contributions
 - Possibility of running out of money
 - Budget deficit
- How was the method restructured?
 - Maximum contribution rates specified for upcoming biennium
 - Rate relief to help balance budget deficit
 - 2024 full-funding date eliminated
 - Reduce spiking contributions
 - Obligation funded over a rolling ten-year period
 - Starting in 2015, maintain higher minimum rates until fully funded
 - Reduce chances of running out of money prematurely

Prognosis

- Pension systems facing unprecedented challenges
- Future contribution requirements will increase significantly
- Effects amplified by poor health of Plans 1
- So much will depend on future investment performance and funding policy



Plan 2/3 Funded Status – Expected Investment Outlook*



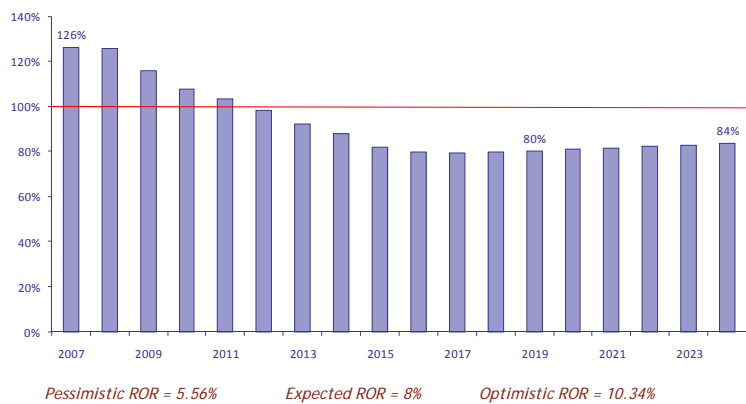
* All Plans 2/3 combined.



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Plan 2/3 Funded Status – Pessimistic Investment Outlook*



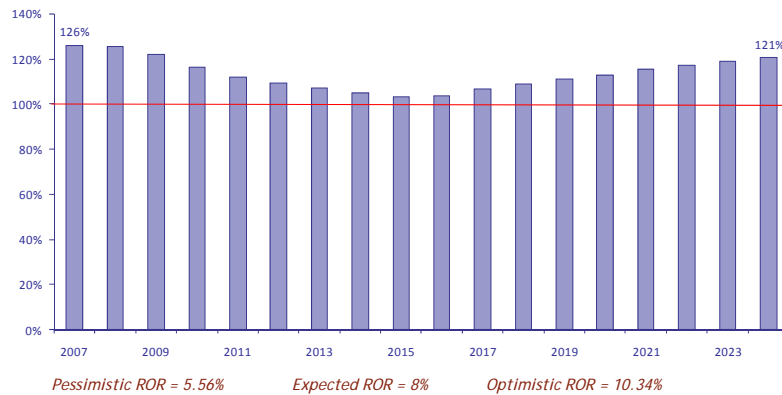
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Plan 2/3 Funded Status – Optimistic Investment Outlook*



* All Plans 2/3 combined.



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Plan 2/3 Health Assessment

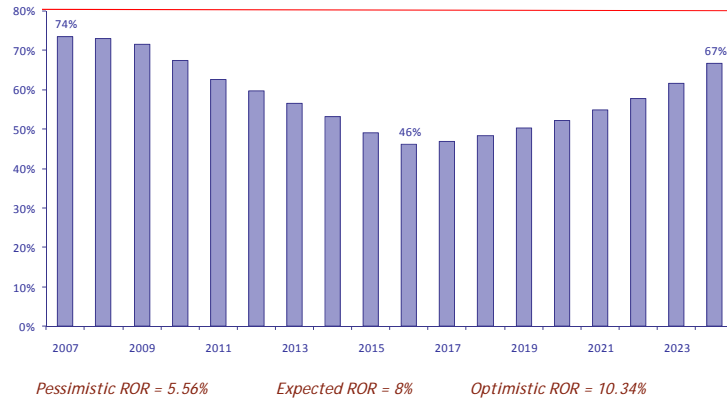
- Plans healthy and well positioned to weather the storm
 - Assumes all future contributions made under existing policy
- Optimistic outlook
 - 10.34 percent rate of return (ROR) over next 15 years
 - Plans remain at least 100 percent funded
- Expected outlook
 - 8 percent ROR over next 15 years
 - Plans drop to 89 percent funded then recover
- Pessimistic outlook
 - 5.56 percent ROR over next 15 years
 - Plans drop to 80 percent funded with an extended recovery period



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Plan 1 Funded Status – Expected Investment Outlook*



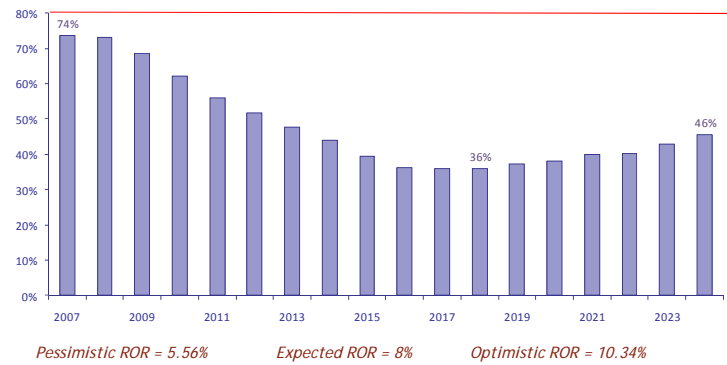
* PERS 1 and TRS 1 combined.



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Plan 1 Funded Status – Pessimistic Investment Outlook*



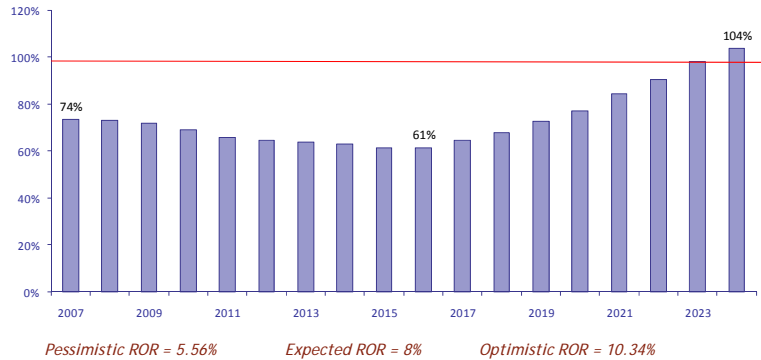
* PERS 1 and TRS 1 combined.



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Plan 1 Funded Status – Optimistic Investment Outlook*



* PERS 1 and TRS 1 combined.



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Plan 1 Health Assessment

- PERS 1 and TRS 1 in poor health
 - Assumes all future contributions made under restructured funding method
- At risk of running out of assets prematurely
 - Results in “pay-as-you-go” funding of contractual benefits
- Optimistic outlook
 - 10.34 percent rate of return (ROR) over next 15 years
 - Plans drop to 61 percent funded and then fully funded by 2024
- Expected outlook
 - 8 percent ROR over next 15 years
 - Plans drop to 46 percent funded and then recover by 2024
- Pessimistic outlook
 - 5.56 percent ROR over next 15 years
 - Plans drop to 36 percent funded and don't recover by 2024



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Returning Plans 1 To Health

- Actuarial recommendations to manage health risks
 - Reduce chances of “pay-as-you-go” financing of significant contractual benefit payments
- Make all contributions required under restructured funding method
 - Maintain higher minimum rates until unfunded past liability is paid
- Provide additional funding when opportunities present
- No benefit improvements until plans return to health
- Closely manage and monitor assets and liabilities



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Results of Pension Check-Up

- Today's health challenges for pensions are unprecedented
 - Asset losses
 - Uncertain investment outlook
 - Budget pressures
 - Pressure amplified by Plans 1 unfunded past liability
- Opportunity to return Plans 1 to clean bill of health
 - Funding method restructured
 - Increase funding in the future
- Plans 2/3 are open and healthy
 - If managed well, prognosis is good
 - Open-ended funding horizon
 - Ability to recover from down markets



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- Please use the entire presentation. Distribution of, or reliance on, only parts of the presentation could result in its misuse and may mislead others.
- Readers are advised to seek professional guidance as to the presentation's content and interpretation, and should not rely upon this presentation without such guidance.
- Unless indicated otherwise, all data, assumptions, and methods used in this presentation match those disclosed in the 2007 Actuarial Valuation Report.
- Projections reflect actual asset returns through April 30, 2009.
- Presentation was prepared and recommendations provided in accordance with Washington State law and actuarial standards of practice as of the date on the title slide.

