Individual State Agency Fiscal Note

Bill Number: 6893 SB	**Title:** Unfunded liabilities accts	**Agency:** 035-Office of State Actuary

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

FUND					
Total $					

Estimated Expenditures from:

	FY 2006	FY 2007	2005-07	2007-09	2009-11
Fund					
All Other Funds-State 000-1	0	0	0	(8,600,000)	(9,700,000)
General Fund-State 001-1	0	0	0	(19,000,000)	(21,400,000)
Total $	0	0	0	(27,600,000)	(31,100,000)

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☐ Requires new rule making, complete Part V.

Legislative Contact:	Phone:	Date: 03/06/2006
Agency Preparation: Laura Harper	Phone: 360 586-7616	Date: 03/06/2006
Agency Approval: Matthew M. Smith	Phone: 360-753-9144	Date: 03/06/2006
OFM Review: Jane Sakson	Phone: 360-902-0549	Date: 03/06/2006

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2006	FY 2007	2005-07	2007-09	2009-11
FTE Staff Years					
A-Salaries and Wages					
B-Employee Benefits					
C-Personal Service Contracts					
E-Goods and Services					
G-Travel					
J-Capital Outlays					
M-Inter Agency/Fund Transfers					
N-Grants, Benefits & Client Services					
P-Debt Service					
S-Interagency Reimbursements					
T-Intra-Agency Reimbursements					
Total:	$0	$0	$0	$0	$0

Part IV: Capital Budget Impact

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

OFM Notes:

Initial appropriation would be discussed in a fiscal note by Agency 090, State Treasurer.

FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	3/3/06	SB 6893

SUMMARY OF BILL:

This bill impacts the Plan 1 of the Public Employees' Retirement System (PERS 1) and Plan 1 of the Teachers' Retirement System (TRS 1). It creates "unfunded liabilities stabilization accounts" within the system funds. Expenditures from the accounts may be used only for the payment of Plan 1 unfunded liabilities and may not be used to pay for any new benefit or for any benefit increase that takes effect after July 1, 2005. An increase that is provided in accordance with a formula that is in existence on July 1, 2005, is not considered an increase for this purpose.

The bill also appropriates money into the accounts. $215.4 million for PERS 1 and $291.5 million for TRS 1 are appropriated for the 2007 fiscal year from the general fund to the unfunded liability stabilization accounts in each fund. Of those amounts, $76.7 million for PERS 1 and $103.8 million for TRS 1 are to be expended by the state treasurer as soon as practicable into the commingled trust fund in order to satisfy the actuarially required general fund state payments for the PERS 1 and TRS 1 unfunded actuarial accrued liability (UAAL) for the 2005-2007 biennium, including the payments that were suspended in the first year of the biennium. The remainder of the appropriations are to be held in the stabilization accounts until further transfers are authorized, and the moneys are to be used solely for satisfying the general fund state payments for the PERS 1 and TRS 1 UAAL during the 2007-2009 biennium. The State Investment Board (SIB) is directed to invest the funds in accordance with the standards of care set forth in SIB Chapter of state law, while minimizing the risk of loss of the principal.

Finally, for the 2007 fiscal year only, the bill establishes a "local employer contribution rate" of 3.44 percent for PERS and for the Public Safety Employees' Retirement System (PSERS), to be used for the sole purpose of amortizing the PERS 1 UAAL.

Effective Date: 90 days after session.

CURRENT SITUATION:

As of the most recent actuarial valuation, the UAAL for PERS 1 is $2.563 billion. The UAAL for TRS 1 is $1.415 billion. The statutory funding policy for paying off the UAAL in the Plans 1 is codified as a goal within the actuarial funding chapter. RCW 41.45.010(2) states that the funding process for the state retirement systems is intended to fully amortize the total Plan 1 costs by not later than June 30, 2024. The Plan 1 UAAL is paid by employers (not members) as specified in Chapter 41.45 RCW. The contribution rates for the 2007-2009 biennium are estimated to be 2.63% for the PERS 1 UAAL and 3.85% for the TRS 1 UAAL. These results exclude the cost of future gain-sharing benefits.

The legislature suspended payments for the UAAL in the current and previous biennia (2003-2005 and 2005-2007). Regular UAAL payments are scheduled to resume in the upcoming biennium (2007-2009). Under current funding policy, there is no "split rate" for local and state employer contributions in PERS 1.

MEMBERS IMPACTED:

The bill would impact all 75,390 members of PERS 1 and all 45,961 members of TRS 1 by recommencing employer contributions for amortizing the unfunded liability in 2006-07 instead of 2007-08.

PERS Plan 1	Members
Receiving a Benefit	54,568
Actives	17,829
Terminated & Vested	2,993

TRS Plan 1	Members
Receiving a Benefit	34,624
Actives	9,862
Terminated & Vested	1,475

Member contributions would not change as a result of this bill.

ASSUMPTIONS:

The bill specifies a contribution rate of 3.44% for PERS and PSERS local employers for the PERS 1 UAAL for 2006-07. The bill specifies general fund state contribution amounts for 2006-07 of $76.7 million for the PERS 1 UAAL and $103.8 million for the TRS 1 UAAL. We assume that there are no contributions for 2006-07 for the PERS 1 UAAL from PERS and PSERS non-general fund state employers and from SERS local employers. We assume that there are no contributions for 2006-07 for the TRS 1 UAAL from TRS local employers.

We assume that the 2007-2024 Plan 1 UAAL rates will be reduced by a level rate so that the expected present value of projected contributions during the entire amortization period would be the same as the expected present value of projected contributions that would have been collected without the 2006-07 contributions. In determining the level reduction to the long term rates, we used assumptions from the Actuarial Valuation Report including: 8% interest, 4.5% salary inflation and 1.25% (PERS/SERS/PSERS) or 0.9% (TRS) membership growth.

We determined the present value of the rates from 2006-2024 under the current law. Then we found a set of rates with the same present value, after changing the 0.00% rate for 2006-2007 to the rates provided in the bill, and subtracting a level rate for each year from 2007-2024. We assume that the total 2006-07 UAAL contributions specified in the bill are equivalent to rates for 2006-07 of 2.21% for PERS 1 for all PERS 1 employers and 2.53% for TRS 1 for all TRS 1 employers. These rates were compared to the current law rates to determine the rate difference. Under this method, we developed reductions in rates of 0.15% in PERS 1 and 0.20% in TRS 1, which were used to reduce the rates for 2007-09 and thereafter.

The contribution rates provided in the bill would make up part of the contributions that were suspended for the 2005-07 biennium through legislation passed in 2005. The long term Plan 1 UAAL rates increased as a result of the suspension. This bill makes up for part of the suspended contributions, and makes the long term Plan 1 UAAL rates lower. As a result, the long-term rate reduction from this bill is less than the long-term increase from the suspension.

The rates for employers are summarized in the tables below.

PERS 1 UAAL Rates for PERS and PSERS Employers

	2005-06	2006-07	2007-09	2009-11
Rates before 2005 Legislation	1.70%	1.70%	2.38%	2.88%
Change from 2005 Legislation	-1.70%	-1.70%	0.25%	0.25%
Rates after 2005 legislation	0.00%	0.00%	2.63%	3.13%
Change from SB 6893 (effective 7/1/06)	0.00%	3.44%*	-0.15%	-0.15%
Rates after SB 6893	0.00%	3.44%*	2.48%	2.98%

PERS 1 UAAL Rates for SERS Employers

	2005-06	2006-07	2007-09	2009-11
Rates before 2005 Legislation	1.70%	1.70%	2.38%	2.88%
Change from 2005 Legislation	-1.70%	-1.70%	0.25%	0.25%
Rates after 2005 legislation	0.00%	0.00%	2.63%	3.13%
Change from SB 6893	0.00%	0.00%	-0.15%	-0.15%
Rates after SB 6893	0.00%	0.00%	2.48%	2.98%

TRS 1 UAAL Rates for Employers

	2005-06	2006-07	2007-09	2009-11
Rates before 2005 Legislation	1.99%	1.99%	3.55%	4.91%
Change from 2005 Legislation	-1.99%	-1.99%	0.30%	0.30%
Rates after 2005 legislation	0.00%	0.00%	3.85%	5.21%
Change from SB 6893	0.00%	0.00%	-0.20%	-0.20%
Rates after SB 6893	0.00%	0.00%	3.65%	5.01%

**Rate applies to PERS and PSERS local employers only.*

We assumed that the differences in the PERS 1 rate for SERS local employers, PERS and PSERS general fund state employers, and PERS and PSERS non-general fund state employers would for 2006-07 only, and that starting in 2007-09, the PERS 1 rates would be the same for all PERS employers. We assumed that the differences in the TRS 1 rates for TRS local employers and TRS general fund state employers would apply for 2006-07 only, and that starting in 2007-09, the TRS 1 rates would be the same for all TRS employers. We assumed that 7.28% of the SERS payroll for a fiscal year is earned between July 1 and August 31. We assumed that the PERS 1 General Fund - State contribution from SERS employers is about 35% of the PERS 1 General Fund State contribution from PERS/PSERS employers.

We assume that the appropriations to the unfunded liabilities stabilization account would not impact the retirement system rates until the funds are transferred and authorized for payment to the Plan 1 UAAL. While the appropriation is in the stabilization account, we expect that it would be invested in fixed income vehicles and generate annual investment earnings of about 5%, which would reduce the future contribution requirements from other sources, but we assume that it would not result in additional advance funding for the retirement system.

The activity in the stabilization account is assumed to proceed as follows:

	PERS	TRS	SERS	Total
Stabilization account initial deposit	$159.5	$291.5	$55.9	$506.9
2005-2007 Catch-Up Payment	-58.1	-103.8	-18.6	-180.5
2006-2007 Fund Balance	101.4	187.7	37.3	326.4
2006-2007 Fund Interest Earned	5.1	9.4	1.8	16.3
2006-2007 Fund Total	106.5	197.1	39.1	342.7
2007-2008 UAAL GF Payment	-42.3	-106.0	-15.8	-164.1
2007-2008 Fund Balance	64.2	91.1	23.3	178.6
2007-2008 Fund Interest Earned	3.2	4.6	1.2	9.0
2007-2008 Fund Total	67.4	95.7	24.5	187.6
2008-2009 UAAL GF Payment	-44.8	-95.7	-16.7	-157.2
2008-2009 Fund Balance	22.6	0.0	7.8	30.4
2008-2009 Fund Interest Earned	1.1	0.0	0.4	1.5
2008-2009 Fund Total	23.7	0.0	8.2	31.9
2009-2010 UAAL GF Payment	-23.7	0.0	-8.2	-31.9
2009-2010 Fund Balance	0.0	0.0	0.0	0.0
2009-2010 Fund Interest Earned	0.0	0.0	0.0	0.0
2009-2010 Fund Total	0.0	0.0	0.0	0.0

FISCAL IMPACT:

Description:

As a result of the contributions provided under this bill for fiscal year 2007, there would be a long-term reduction in the Plan 1 UAAL contribution rates starting in the 2007-09 of 0.15% for PERS 1 and 0.20% for TRS 1.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing (decreasing) the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

(Dollars in Millions)		Current*	Increase	Total
Actuarial Present Value of Projected Benefits	PERS	$28,099	$0	$28,099
(The Value of the Total Commitment to all Current Members)	TRS	$15,616	$0	$15,616
	SERS	$2,126	$0	$2,126
Unfunded Actuarial Accrued Liability	PERS 1	$2,563	$0	$2,563
(The Portion of the Plan 1 Liability that is Amortized at 2024)	TRS 1	$1,415	$0	$1,415
Unfunded Liability (PBO)	PERS	$(673)	$0	$(673)
(The Value of the Total Commitment to all Current Members Attributable to Past Service)	TRS	$(235)	$0	$(235)
	SERS	$(439)	$0	$(439)

**Does not include the cost of future gain-sharing benefits.*

Year	PERS/PSERS	TRS	SERS
2006-2007	3.44%*	0.00%	0.00%
2007-2009 and thereafter	(0.15)%	(0.20)%	(0.15)%

**Rate applies to PERS and PSERS local employers only.*

There is no change to the members rates.

Fiscal Budget Determinations:

As a result of the changes in contribution rates, the changes in funding expenditures is projected to be:

Costs (in Millions):	PERS	TRS	SERS	Total
2006-2007				
State:				
General Fund	$58.1	$103.8	$18.6	$180.5
Non-General Fund	$0.0	$0.0	$0.0	$0.0
Total State	**$58.1**	**$103.8**	**$18.6**	**$180.5**
Local Government	$130.3	$0.0	$0.0	$130.3
Total Employer	$188.4	$103.8	$18.6	$310.8
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	($5.3)	($11.9)	($0.8)	($19.0)
Non-General Fund	($8.6)	$0.0	$0.0	($8.6)
Total State	**($13.9)**	**($11.9)**	**($1.8)**	**($27.6)**
Local Government	($12.4)	($6.0)	($2.7)	($21.1)
Total Employer	($26.3)	($17.9)	($4.5)	($48.7)
Total Employee	$0.0	$0.0	$0.0	$0.0
2006-2031				
State:				
General Fund	($12.9)	($52.5)	($7.8)	($73.2)
Non-General Fund	($117.0)	$0.0	$0.0	($117.0)
Total State	**($139.9)**	**($52.5)**	**($7.8)**	**($190.2)**
Local Government	($36.2)	($78.0)	($39.4)	($153.6)
Total Employer	($166.1)	($130.5)	($47.2)	($343.8)
Total Employee	$0.0	$0.0	$0.0	$0.0

State Actuary's Comments:

This fiscal note involves calculations that require assumptions about future economic events and acts of future Legislatures. It assumes that the cost of future gain sharing will not be recognized, that the contribution rates for 2007-2009 will be adjusted with a long term level rate reduction equivalent to the 2006-07 contributions specified under this bill, and that the Plan 1 amortization payments will resume in 2006 with no change in the amortization date. If any of these events occur differently than assumed, then the long term cost of this bill will change.

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2004 actuarial valuation report of the Public Employees' Retirement System, the Teachers' Retirement System, and the School Employees' Retirement System.

2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This fiscal note is intended for use only during the 2006 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Aggregate Funding Method: The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

Entry Age Normal Cost Method (EANC): The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.