UAAL Paydown Q and A

Note: The 2021 legislature included a $800 M paydown of the Plan 1 TRS unfunded liability in their 2021-23 biennial budget. However, the actual payment of those funds (the transfer of the $800 M from the state's general fund to the pension fund) is delayed until June 30, 2023. What follows is background information on the reasons the legislature decided to address the unfunded liability problem at this time, the implications of that decision, and why this is a positive development for WSSRA members.

The technical term that state fiscal personnel use when they refer to unfunded liability is UAAL. What does UAAL mean?

Unfunded Actuarial Accrued Liability (UAAL) refers to the amount of money a particular pension plan needs to achieve full funding, or 100% retiree coverage. A fully funded pension plan assures that enough money exists in the particular pension account to support ongoing and life-long monthly checks for each retiree in that plan. The "actuarial" feature means that each retiree's life span is calculated based on life expectancy assumptions used by the Office of State Actuary (OSA).

What is the current status of UAAL in the state's various pension plans?

Of the state's 15 retirement plans, all are at or near 100% funding with two exceptions: TRS Plan 1 and PERS Plan 1. Both of those plans are approximately 2/3 (66+%) funded, or in dollar figures $2.8 B in arrears for TRS 1 and $4 B short for PERS 1.

Why does that matter?

Plan 1 TRS and PERS are the only state pension plans that do not have an annual and automatic Cost of Living Adjustment (COLA) built into the plans. Therefore, pension advocacy organizations like WSSRA annually must convince the legislature to grant ad hoc COLAs—a challenging task to say the least. Over the last decade that has happened only twice (a 1.5% COLA in 2018 and a 3% COLA in 2020—both of which were capped at the first $25,000 of pension income). Legislators often respond to COLA requests by saying that Plan 1 TRS and PERS first need to be properly funded before a solution to the annual COLA problem can be addressed. They also point out that granting a COLA makes the UAAL situation worse.

Why are Plan 1 TRS and PERS the only state plans that are underfunded?

When TRS and PERS were first formed in the 1930's and 1940's life expectancy was much lower than it is today. Consequently, employer and employee monthly pension payments were set low—six percent—and were not allowed to change as life expectancies increased. Predictably, those plans became underfunded, something that was not "caught" by budget leaders until the mid-1970's when the movement to form Plan 2 took shape. The pre-set six percent rate also meant that contribution rates were not increased when the Plan 1 UCOLA (1995-2011) and gainsharing were implemented—further worsening the problem. Notably, Plan 2/Plan 3 regulations allow legislators to move pension rates up (or down) in order to meet projected plan costs as determined by the state actuary. The six percent Plan 1 <u>employee</u> rate was never changed, but, eventually, the Plan 1 <u>employer</u> rate was increased (most recently via 2009 legislation) in order to reduce UAAL.

Was there a plan in place to address the UAAL problem prior to the 2021 legislative session?

Yes. After the mid-2000's when the legislature routinely skipped (or significantly reduced) Plan 1 TRS and PERS pension payments in budget cutting moves, fiscal experts realized that those measures seriously worsened Plan 1 UAAL. They proposed a way to address the problem through increasing payments over several years—establishing a two-decade "glide path" to eliminate the Plan 1 UAAL by 2030. Notably, the last several legislatures realized the error of their predecessor's ways and have not lessened pension payments since 2012 but unfunded liabilities still remain. Budget leaders fully understand that large UAALs are not a good thing. UAALs are essentially a bill that needs to be paid either now, or in the future with interest. Either way the bill will come due. The longer the legislature waits to address unfunded pension liability, the worse the situation becomes.

Under the current system, what state agency or organization actually makes the annual UAAL payment?

For PERS 1, it is the state's general fund, local governments, and special districts – transit agencies and public utilities. For TRS 1, employers—school districts—make the payment through higher employer pension rates. For 2020-21, school districts paid 14 percent of each employee's salary back to the state in pension payments. Eight percent of this payment was to account for active employees—Plan 2 or Plan 3 folks—but the remaining six percent was to paydown the UAAL for long-retired Plan 1 teachers.

So, if the legislature makes the $800 M pension payment in June of 2023, will school districts benefit? Will the pension payment rate decrease?

Under the new paydown plan the UAAL payoff will occur sooner and districts will therefore get out from under the TRS 1 payments years earlier than in the current plan. Correspondingly, employer pension payment rates will decrease.

Are there other benefits to the $800 M transfer?

Yes. Money in the state's general fund is conservatively held—meaning that it earns low interest. However, money in the state's pension fund is part of the Comingled Trust Fund that is managed by the Washington State Investment Board (WSIB). Over the past decade WSIB investments have returned an average of 9% per year. Assuming a 7.5% rate of return holds for the near term, the movement of $800 M to the pension account in 2023 will result in over $600 M of new investment income for the pension funds – further reducing Plan 1 UAAL. In fact, it is estimated that the $800 M payment, with added investment earnings, will pay off half of the current $2.8 B Plan 1 TRS UAAL.

Who were the key legislators who pushed through the UAAL paydown?

The prime supporter of the UAAL paydown was Senator Christine Rolfes (D-Bainbridge) who is the chair of the Senate Ways and Means Committee and the chief Senate budget writer. She, along with Senate Majority Leader Andy Billig (D-Spokane), were the two leaders who pushed the concept, included it in the Senate's original budget, secured caucus support, and marshalled it through the conference committee process with House leadership. The latter group, by the way, did not address the UAAL paydown in its budget, but did include a modest Plan 1 COLA (1.5% on the first $17,600 of income, or $22/month) in the House proposed budget. In the end the House's minimum COLA with its $14 M cost was not included in the final budget, but the Senate's $800 M UAAL payment was. Finally, the UAAL paydown enjoys bipartisan support, with Republican leadership in the Senate and the House historically favoring proposals to reduce pension liability. Senate Minority Leader John Braun (R-Chehalis) has been advocating similar paydown ideas for several years.

What concerns exist regarding the delayed (June 30, 2023) transfer of the $800 M from the general fund to the pension account?

The biggest fear is that, in either the 2022 or 2023 legislative sessions, the $800 M earmarked for the pension account will be repurposed to meet some other need. A bad revenue picture, a recession, or some unforeseen economic mess could lead legislators to use the proposed pension transfer dollars as a way to "find" new money. WSSRA will work diligently to make sure that doesn't happen. Knowing there is strong support in the Senate to not touch the pension transfer is reassuring, but we won't be able to fully relax until the $800 M is actually moved to the pension fund on June 30, 2023.

So, all in all this $800 M UAAL paydown is a good thing for school retirees?

It is a very good thing. Plan 1 COLAs have been granted far too infrequently over the last two decades, resulting in school retirees losing between 16% and 45% of their pension's purchasing power. Given current COLA politics, it is clear that a permanent COLA solution can only be realized when unfunded liability drops to near zero. This $800 M UAAL paydown greatly helps to make that happen much quicker than present in the current plan. Our job for the next two years is to actively lobby to make sure that the transfer happens on June 30, 2023.