

Attachment 3: Office of the State Treasurer

Aaron,

Thank you for reaching out to OST for input on our views of the potential impacts of SHB 2034 and SSB 5085. We are happy to provide input to the study produced by the SCPP in December.

Regarding the first question: *“I understand OST’s role in pensions is typically related to pension disclosures in bond sales and managing the associated bank accounts (incl. the Pension Funding Stabilization Account).”*

It’s true that OST has an interest in the state’s pension system in connection with our disclosure obligations related to the state’s bond financings. However, OST also has an equally important interest in the state’s pension system as we are tasked with managing the state’s relationship with the credit rating agencies that rate the state’s debt. Given the size and scope of the state’s pension system, the rating agencies pay close attention to its management and carefully monitor any changes or adjustments made to its operations or governing assumptions. Rating agencies would view any changes that decrease the system’s funding status, increase risk, or otherwise negatively impact operations as negative developments.

Your second question: *“If enacted, what impacts would SHB 2034 have?”*

From a credit perspective, the issue with SHB 2034 was primarily related to the bill’s plan to take surplus funds from LEOFF 1 and transfer them out of the pension system and into to the Pension Funding Stabilization Account. OST’s concern is that the bill would then allow those surplus funds to be transferred into the General Fund.

In a time of increased financial risk, this would reduce the aggregate funding status of the state’s pension system, which will be viewed by rating agencies and investors as a credit negative. The rating agencies and investors will likely view this for what it is – the state pulling funds out of the retirement system (which have grown through decades of diligent contributions and favorable investment earnings) to be deposited in the PFSA. Section 505 of the bill gives the legislature the authority to transfer funds from the PFSA

to the state General Fund. If transferred from the PFSA to the general fund, its most likely that the funds would be used as another one-time revenue source to help balance the state's structurally unbalanced operating budget. Credit rating agencies mentioned this practice in comments about our credit outlook.

"We could revise our outlook [from positive] to stable if, in the face of budgetary pressure, lawmakers delay taking corrective action or rely extensively on one-time solutions to remediate potential gaps. We also could lower the rating if the state opts to use available reserves, leading the state to fall below target levels." S&P (September 20, 2024) as cited in the [2025 Debt and Credit Analysis](#) by the Office of the State Treasurer.

Your last question: *"If enacted, what impacts would SSB 5085 have?"*

Of the two bills, 5085 is the more attractive option from a credit perspective, as it appears to use the LEOFF 1 surplus to eliminate the remaining unfunded liability in the PERS Plan 1 and TRS Plan 1. In other words, this approach uses the LEOFF 1 surplus as a one-time source of funds to fix a long-term problem, rather than funding short-term operational costs. Eliminating the unfunded liability in the PERS and TRS systems will provide a long-term benefit to the state in the way of reduced PERS and TRS system contributions. From a credit perspective, this is a much more financially prudent and sustainable approach than authorizing pension funds to be used to address an ongoing general fund structural deficit.

Finally, you mentioned that you would welcome any additional context or information that might be helpful to the study. Both of the LEOFF 1 surplus bills contemplate using excess funds in the LEOFF 1 retirement account. At the same time, ESSB 5357 changed the investment return assumption for the state's pension systems from 7.00% to 7.25% without any compelling market data as a reason for the adjustment. It is unwise to expect that future pension fund returns will match 10-20 year performance.

With the higher assumed rate of return, it is likely that the LEOFF 1 surplus will be overstated, making it difficult to predict the amount of funds needed to maintain LEOFF 1's 120% funding level, while also making it difficult to determine how much excess funding there is to distribute in the ways contemplated by either SB 5085 or HB 2034. The State Actuary makes it clear in its fiscal note on ESSB 5357 that *"If future investment experience is different than assumed, there will also be budget impacts beyond the 2027-29 biennium."*

We would encourage an in-depth discussion on the potential medium and long term impacts of ESSB 5357 on the implementation of either SB 5085 or HB 2034 to the state's

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pension system health, taking into account the impact on the potential surplus as a result of increasing the system's assumed rate of return from 7.00% to 7.25%.

One other thing to note. Credit rating agencies will update our credit analysis later this month. There may be more to consider once we receive that update.

We are more than happy to be helpful as the report continues to evolve. Please let us know if there is more we can do.

Best regards

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