A Discussion of Retirement Systems in Alaska

House Finance Committee

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Legislative Finance Division

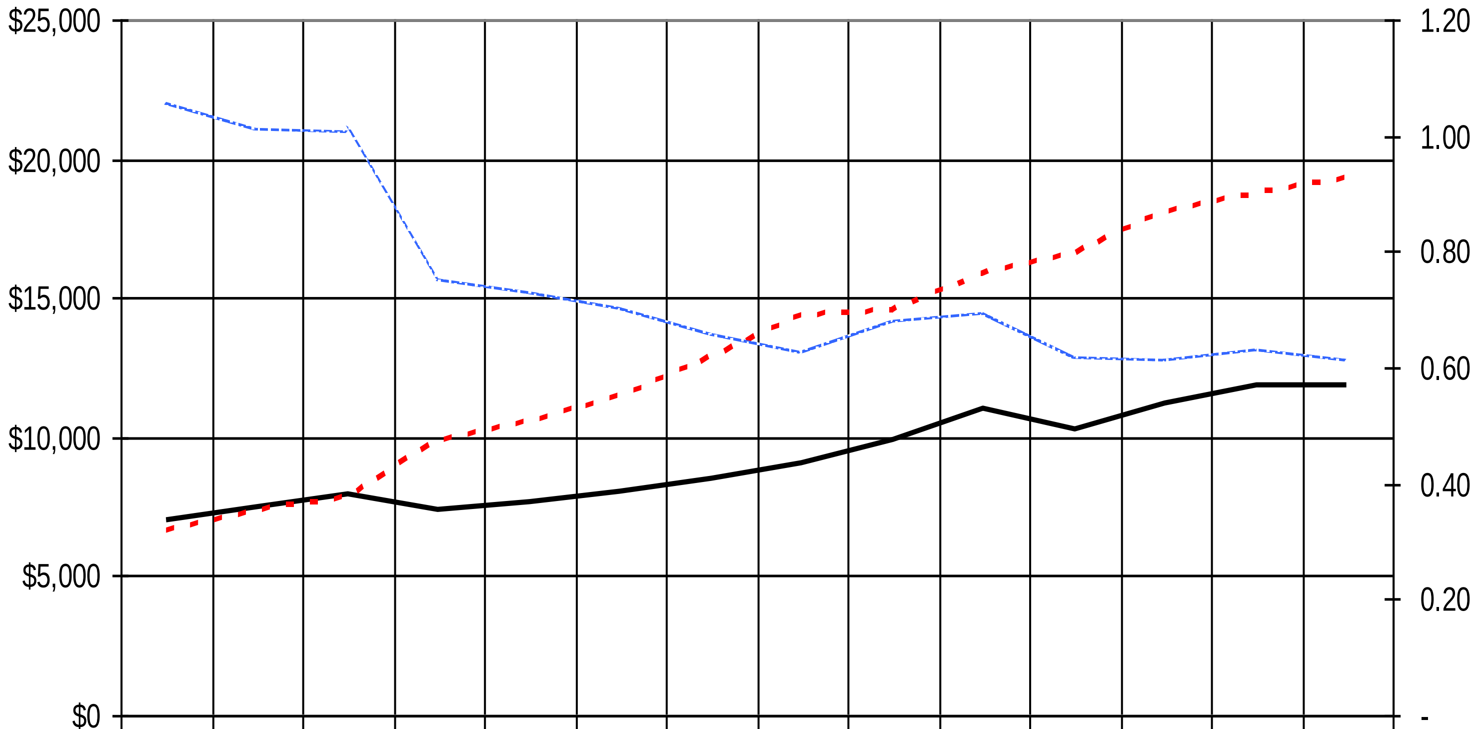
Are Alaska's Public Employee Retirement Systems Healthy?

If not, what can be done about it?

Measuring the Health of a Retirement System

1. **Funding Ratio = Assets/Liabilities.**
2. **Unfunded Liability—just a dollar amount; not a relative measure.**
3. Are employers paying the actuarially required contribution (ARC)?
4. Are contributions causing financial stress?

PERS Assets and Liabilities

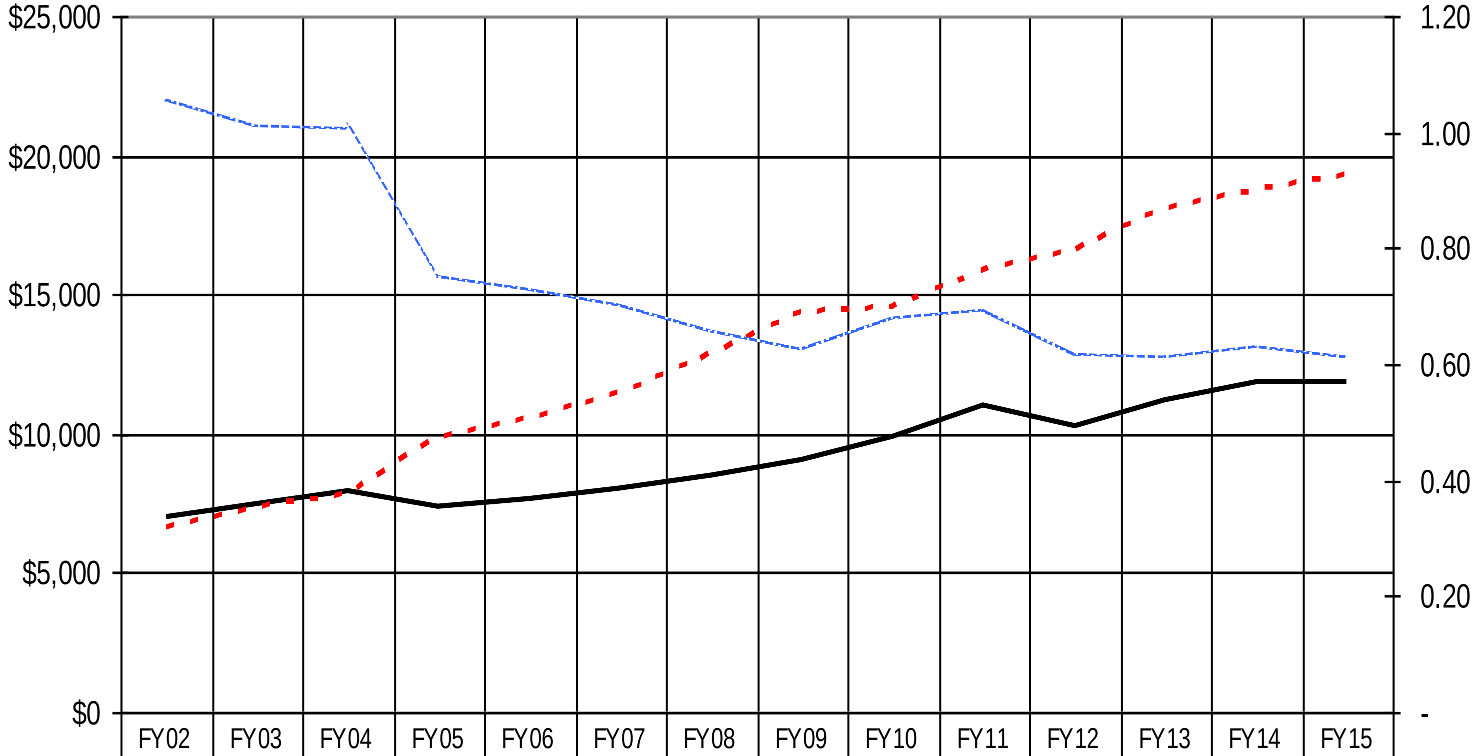


	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Assets	7,016	7,455	7,942	7,413	7,687	8,030	8,443	9,041	9,901	11,040	10,243	11,157	11,814	11,832
Liabilities	6,649	7,377	7,869	9,860	10,562	11,444	12,845	14,388	14,571	15,888	16,579	18,132	18,741	19,292
Funding Ratio	1.06	1.01	1.01	0.75	0.73	0.70	0.66	0.63	0.68	0.69	0.62	0.62	0.63	0.61

Unfunded Liability is the Consequence of Assumptions that Fail to Materialize

- **Benefits may exceed expectations**. (Liability increases)
- **Contributions or earnings may be less than anticipated**. (Assets fail to increase as expected)

PERS Assets and Liabilities



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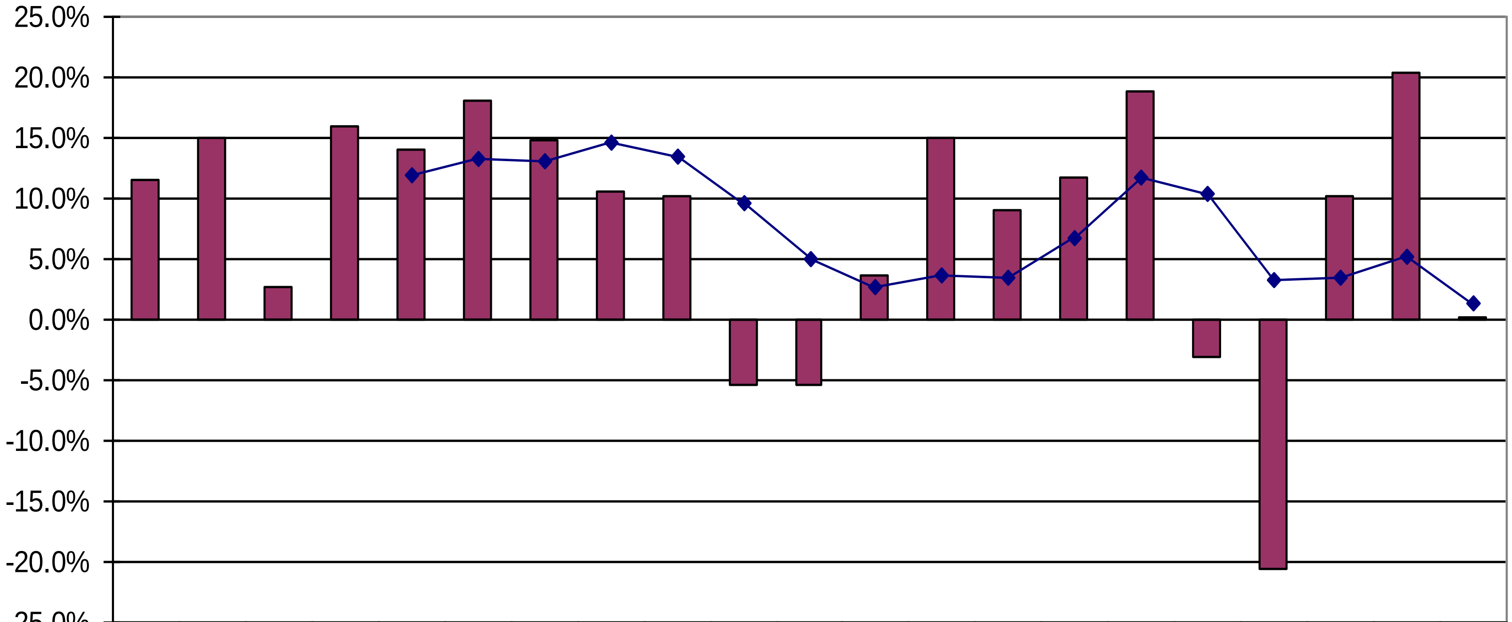
How Volatility of Investment Returns Affects Unfunded Liability						
		Assets	**Liability**	**Unfunded Liability**	**Funding Ratio**	**Contribution Rate**
Year 1 Start		$ 12,000	$ 12,000	$ -	100.0%	
Benefits Payments		$ (1,000)	$ (1,000)			
Net		$ 11,000	$ 11,000			
Accrued Liability			$ 1,350			
Earnings	8.0%	$ 920				
Contributions (set in advance)		$ 430				17.9%
Year 1 End		$ 12,350	$ 12,350	$ -	100.0%	
Year 2 Start		$ 12,350	$ 12,350	$ -	100.0%	
Benefits Payments		$ (1,000)	$ (1,000)			
Net		$ 11,350	$ 11,350			
Accrued Liability			$ 1,378			
Earnings	8.0%	$ 948				
Normal Contributions		$ 430				17.9%
Past Service Contributions		$ -				0.0%
Year 2 End		$ 12,728	$ 12,728	$ -	100.0%	17.9%
Change in UL				$ -		

Rates of Return on PERS Investments



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Annual Rate of Return	11.6%	15.0%	2.7%	16.0%	14.0%	18.2%	14.7%	10.6%	10.2%	-5.4%	-5.5%	3.7%	15.1%	9.0%	11.7%	18.9%	-3.1%	-20.5	10.2%	20.4%	0.2%
5-Year Average Return					11.9%	13.2%	13.1%	14.7%	13.5%	9.7%	4.9%	2.7%	3.6%	3.4%	6.8%	11.7%	10.3%	3.2%	3.4%	5.2%	1.4%

Take-away Points Regarding Earnings

1. Earnings are volatile and unpredictable.
2. Small variations can be addressed by smoothing, amortization and good fortune.
3. When variations are small, unfunded liability is a soft liability that can be repaid with earnings (rather than contributions).
4. The road to recovery from large losses can be very long—so long that the system may appear to be broken.
5. The system is unlikely to stay broken in the long-run.
6. If you pay what you owe, the system will fix itself.
7. As time passes, assumptions are replaced with reality.

Measuring the Health of a Retirement System

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4. Are contributions causing financial stress?

Measuring the Health of a Retirement System

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What Fiscal Stress???

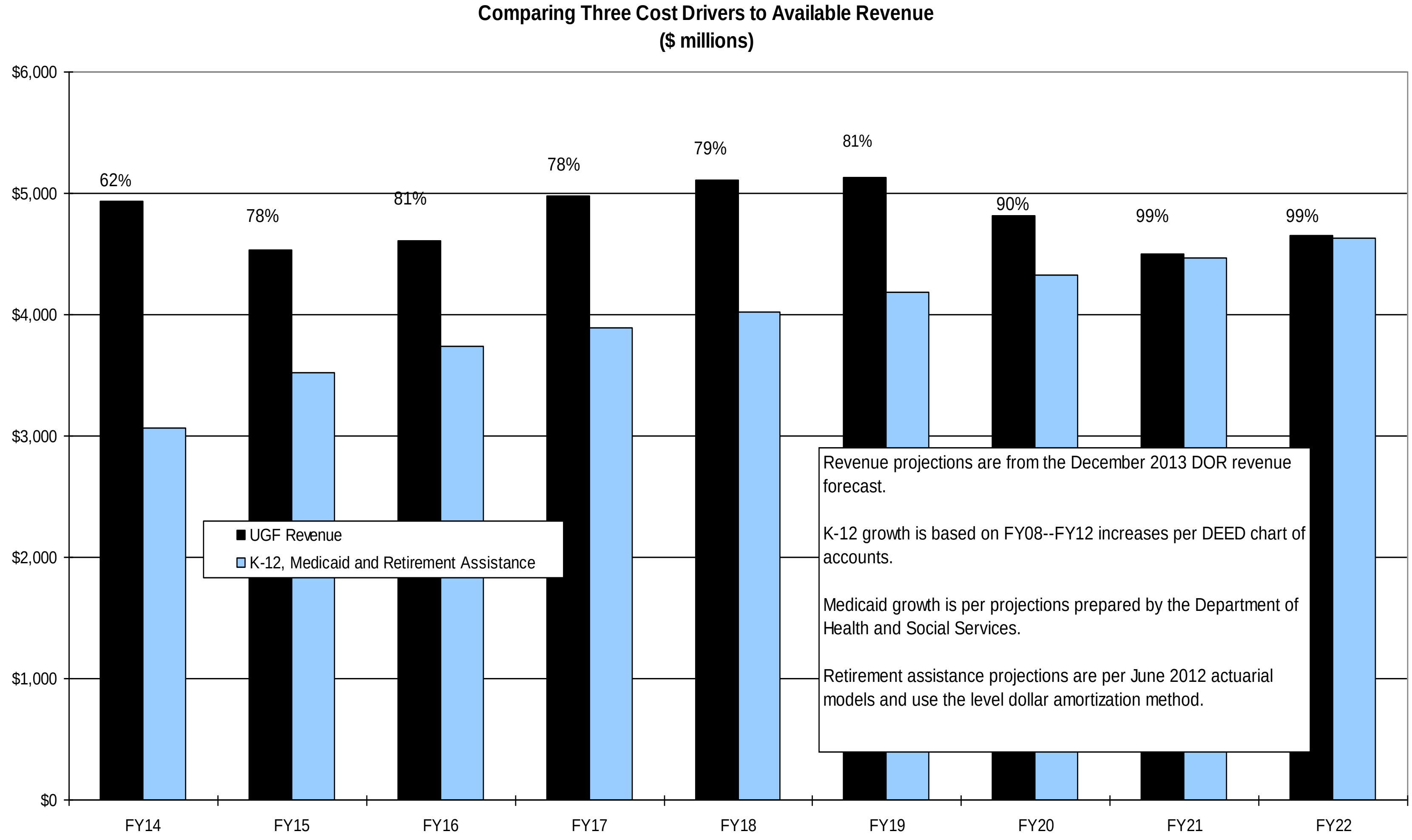
- The state may be paying too much into retirement plans, but it is better to choose to pay when we can afford it than be forced to pay when we cannot afford it.
- When budget surpluses turn into deficits, we can work to reduce state costs.
- Until then, state contributions reduce the magnitude of the future fiscal problem.

Books, Bonds and Budgets

- **Accountants**: Must report net pension liability on the balance sheet.
- **Rating Agencies**: Use a common set of assumptions to make system health comparable.
- **Legislators**: GASB no longer provides guidance.

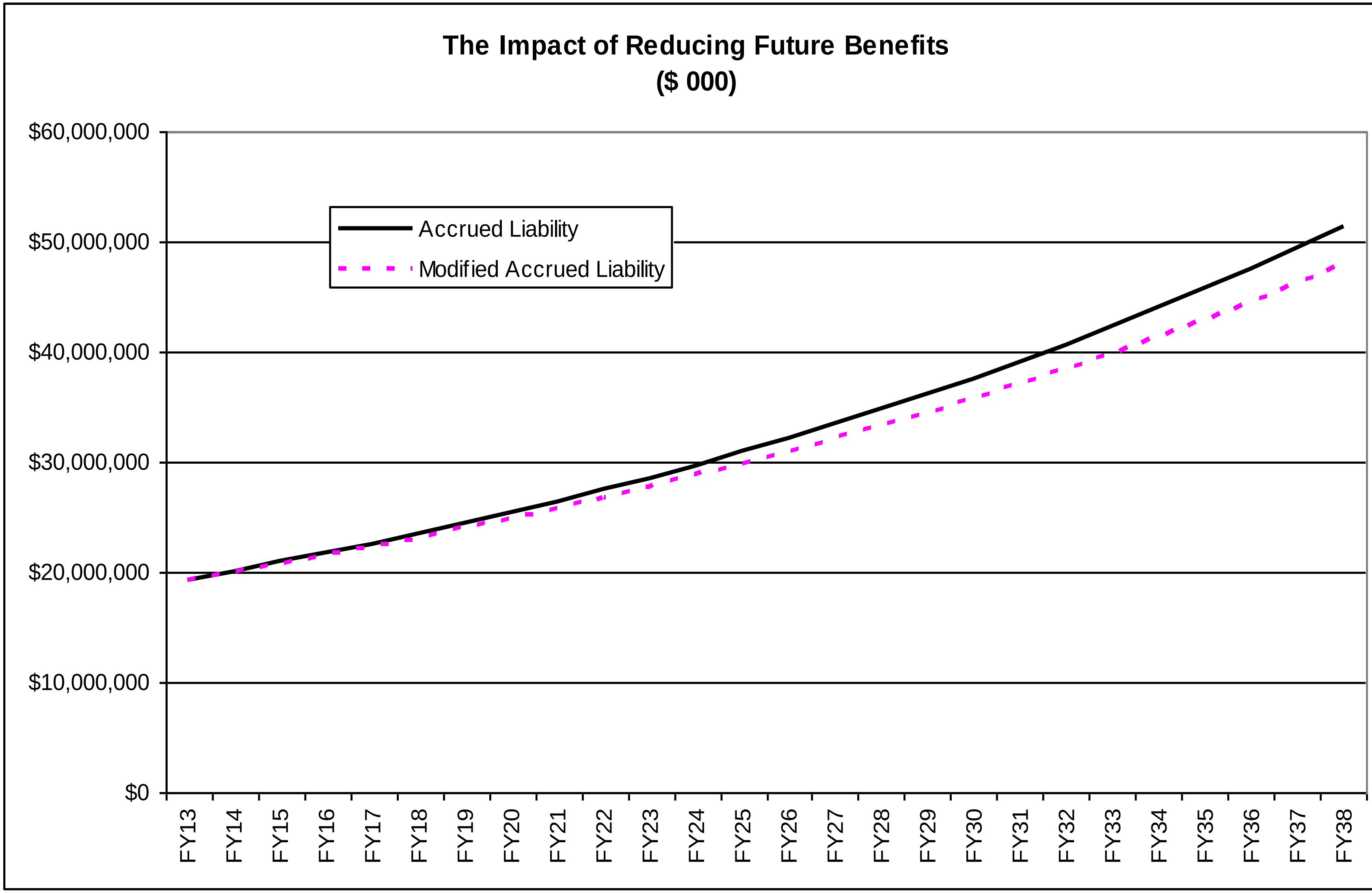
Advice from a National Pension Funding Task Force

- **Put funding guidelines in statute.** Describe computation of the ARC (Annual Required Contribution). Show the plan to bring the system to full funding.
- The numeric approach offers sound guidance, but the funding ratio and other actuarial measures are not the most important measure of system health. **What really matters is what is affordable.**


Comparing Three Cost Drivers to Available Revenue
($ millions)
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
62%
78%
81%
78%
79%
81%
90%
99%
99%
FY14
FY15
FY16
FY17
FY18
FY19
FY20
FY21
FY22
UGF Revenue
K-12, Medicaid and Retirement Assistance
Revenue projections are from the December 2013 DOR revenue forecast.
K-12 growth is based on FY08--FY12 increases per DEED chart of accounts.
Medicaid growth is per projections prepared by the Department of Health and Social Services.
Retirement assistance projections are per June 2012 actuarial models and use the level dollar amortization method.

What Other States Have Done to Improve Retirement System Health

1. Increase Assets
   - Increase employee contributions
2. Reduce Benefits
   - Raise the retirement age
   - Increase service requirements
   - Reduce post-retirement adjustments
   - Adopt hybrid plans


The Impact of Reducing Future Benefits
($ 000)
$60,000,000
$50,000,000
$40,000,000
$30,000,000
$20,000,000
$10,000,000
$0
Accrued Liability
Modified Accrued Liability
FY13
FY14
FY15
FY16
FY17
FY18
FY19
FY20
FY21
FY22
FY23
FY24
FY25
FY26
FY27
FY28
FY29
FY30
FY31
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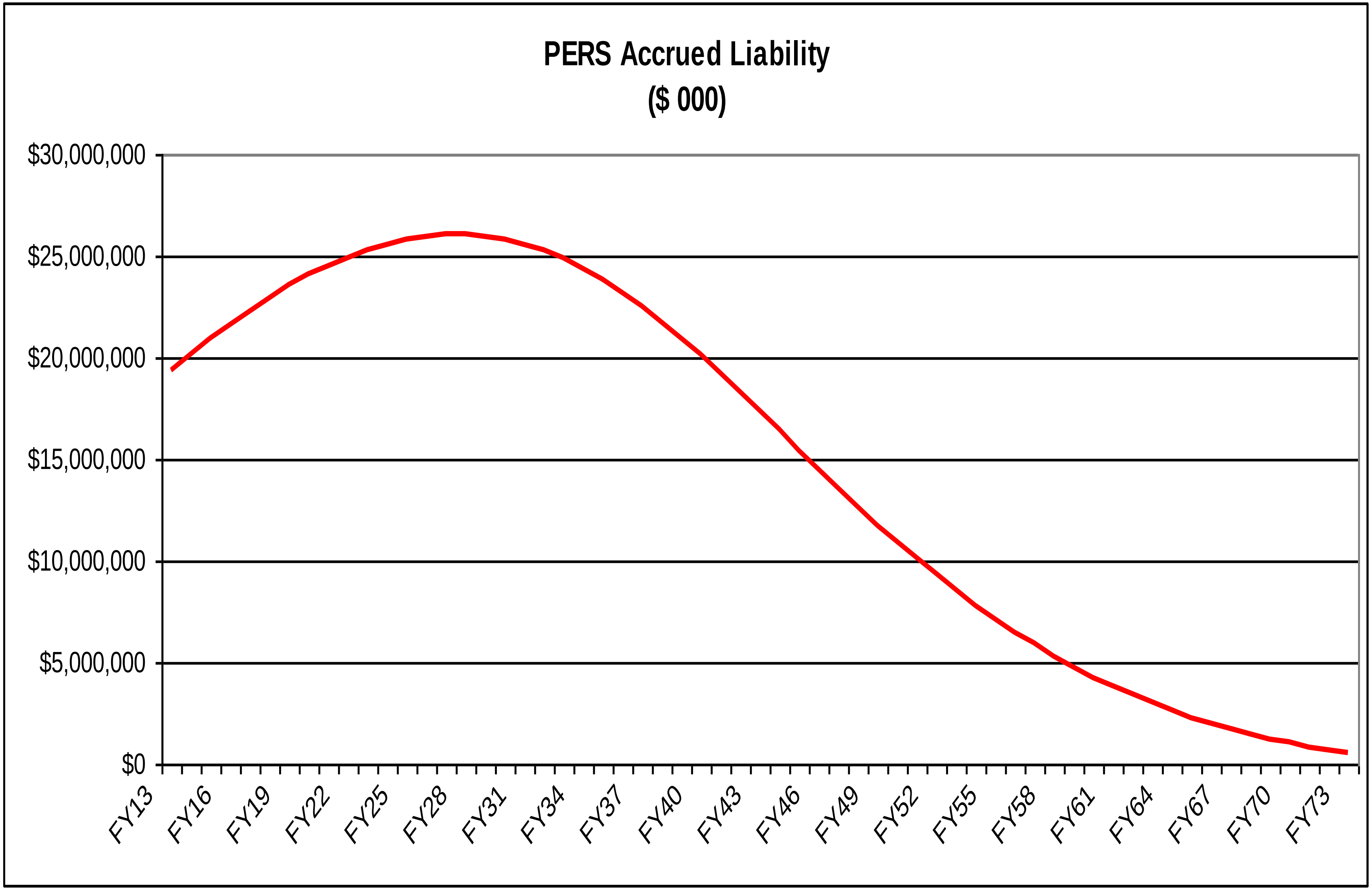
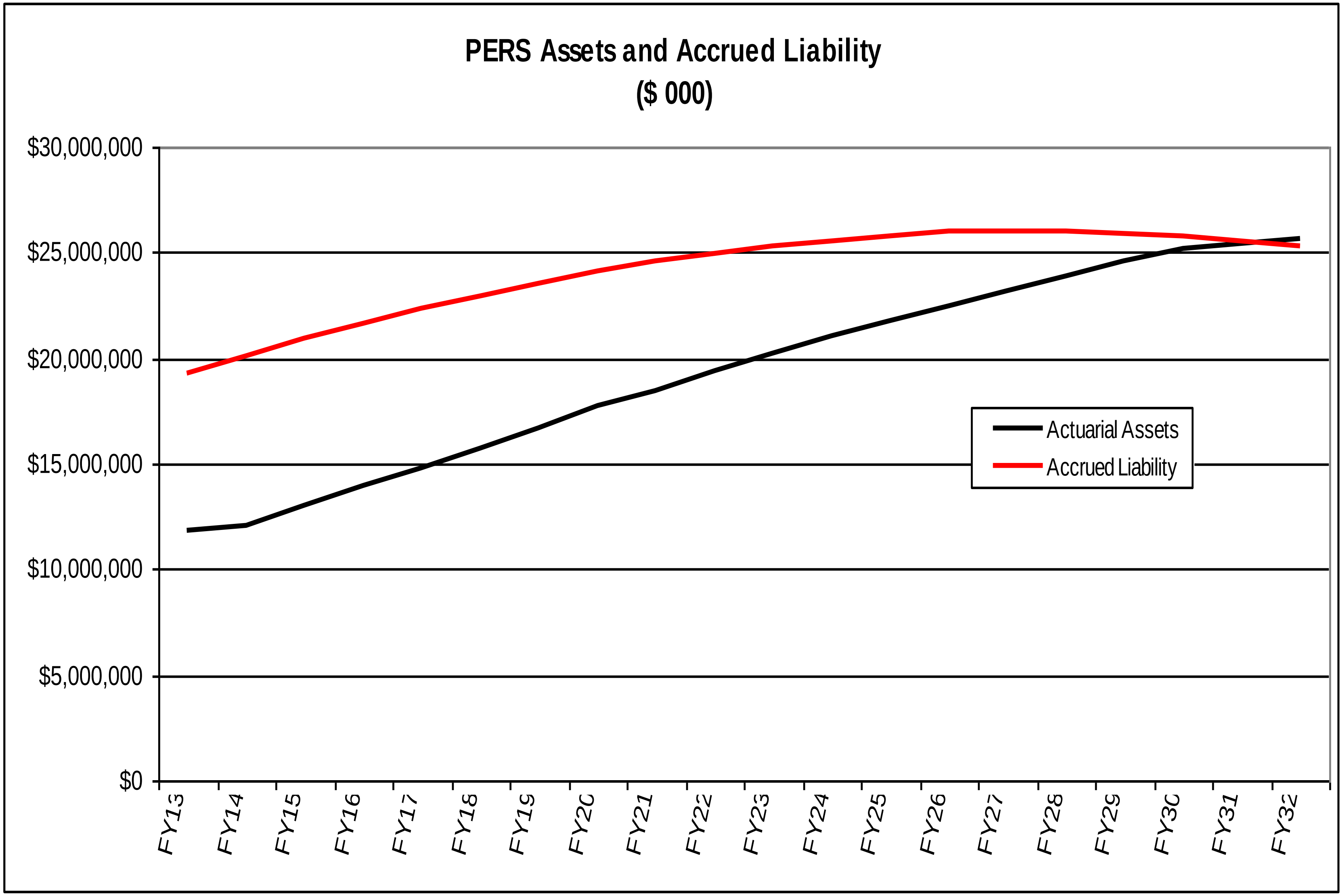
FY33
FY34
FY35
FY36
FY37
FY38



PERS Accrued Liability
($ 000)
$30,000,000
$25,000,000
$20,000,000
$15,000,000
$10,000,000
$5,000,000
$0
FY13
FY16
FY19
FY22
FY25
FY28
FY31
FY34
FY37
FY40
FY43
FY46
FY49
FY52
FY55
FY58
FY61
FY64
FY67
FY70
FY73

A National Task Force Recommends that Pension Funding Policies:

1. Be based on actuarially determined contribution rates—and the calculation of rates should be in statute so the plan is clear to employees, retirees, administrators, boards, and legislators.
2. Collect a consistent percentage of payroll—use the Level Percent of Pay amortization method.
3. Be disciplined—to ensure that promised benefits can be paid (i.e., pay the ARC).
4. Maintain intergenerational equity (i.e., the cost of benefits should be paid by the generation of taxpayers that were served by the employees who earned those benefits).
5. Require clear reporting to show how and when plans will be fully funded and the progress toward that goal.


PERS Assets and Accrued Liability
($ 000)
$30,000,000
$25,000,000
$20,000,000
$15,000,000
$10,000,000
$5,000,000
$0
FY13
FY14
FY15
FY16
FY17
FY18
FY19
FY20
FY21
FY22
FY23
FY24
FY25
FY26
FY27
FY28
FY29
FY30
FY31
FY32
Actuarial Assets
Accrued Liability

What is the Goal?

and

What Options Might Achieve It?

Goal: a healthy system—meaning a system with a plan to eliminate unfunded liability in a reasonable time at an affordable cost.

Concluding Advice

1. Outline your plan in statute.
2. Avoid paying less than the plan.
3. Avoid paying more than we can afford.