

# Alaska Variable Retirement Plan

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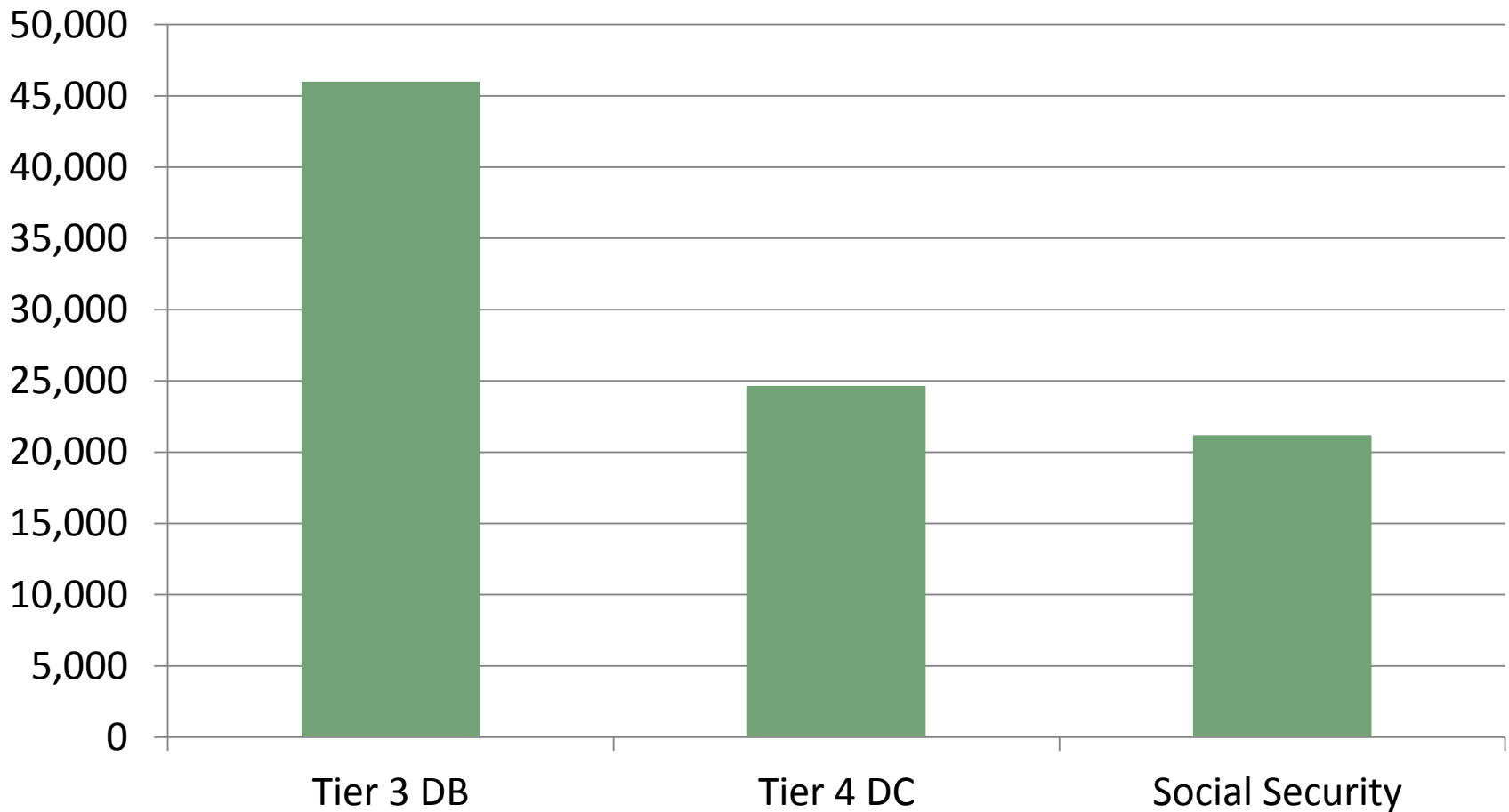
# Alaska Variable Retirement Plan

- Why is change necessary?
- Proposed structure of variable retirement plan
- Examples

# Why is change necessary?

	Police & Fire	Other PERS
Hire Age	<b>31</b>	<b>37</b>
Retirement Age	<b>56</b>	<b>60</b>
Years of Service	<b>25</b>	<b>23</b>
DB Benefit as Percent of Final Average Compensation (based on Tier 3 provisions)	<b>57%</b>	<b>50%</b>
DCR Benefit as Percent of Final Average Compensation (calculated based on reduced return and uncertain longevity)	<b>31%</b>	<b>30%</b>
Reduction of Benefit % due to DCR program	<b>26%</b>	<b>20%</b>

# Illustration of hypothetical police/fire benefits - \$80,000 Final Average Salary



# The DCR healthcare is not likely to provide adequate pre-Medicare benefits

- Consider average of tier 4 police/fire
  - Average hire age is 32, now age 36
  - Assume male, retires at 25 years of service in 2034 at age 57
  - Will get Medicare supplement coverage at age 65
  - Will need 8 years of pre-Medicare insurance
- He will have 3% HRA contributions
  - But will only have enough of a HRA balance to pay for 30% of health insurance cost (member plus spouse) based on 7% return
- Will need to use other sources to pay for remaining 70%
- In 2013, a \$1,647 monthly premium is 39% of average PERS pay
  - But by 2034, it will be over 58%
  - This is because health care costs are projected to increase faster than wages

# Key pros and cons of DB and DC programs

- DB Plans are more cost effective at providing retirement benefits
  - DB pension plans pool “longevity risks”
  - DB pension plans can maintain a better diversified portfolio because, unlike individuals, they do not age
  - DB pension plans achieve better investment returns because of professional asset management and lower fees
- DC Plans are more consistent with individual responsibility
  - Benefit is a clearly defined contribution from the employer and employee to a trust
  - Benefit is more under the control and full ownership of the individual
  - Benefit is much more portable
  - No risk of unfunded liabilities to employer

## How does HB 247 strike a compromise?

- Start with fixed employer contribution and agree to manage plan within that budget
- Design current target benefit levels
  - Consider mix between pensions and health
  - Consider benefits provided by DCR and latest DB
- Build in benefit and/or employee contribution adjustment mechanisms
- Utilize lower discount rate to provide cushion against adverse experience

# Contributions for Police and Fire Members

	Latest Tier Defined Benefit	Defined Contribution Retirement	Variable Benefit Plan
Members	7.50%	8.00%*	9.00%*
Employers make total contributions of 22%, allocated as follows:	10.51% for Normal Cost; 11.49% for legacy unfunded liabilities	5% toward DCR accounts; 2.72% toward DCR liabilities; 3% average toward HRA; 11.28% toward legacy unfunded liabilities	14% toward pension; 8% for legacy unfunded liabilities



# Contributions for non - Police and Fire Members

	Latest Tier Defined Benefit	Defined Contribution Retirement	Variable Benefit Plan
Members	6.75%	8.00%*	8.00%*
Employers make total contributions of 22%, allocated as follows:	9.00% for Normal Cost; 13.00% for legacy unfunded liabilities	5% toward DCR accounts; 1.88% toward DCR liabilities; 3% toward HRA; 12.12% toward legacy unfunded liabilities	12% toward pension; 10% for legacy unfunded liabilities

# Actuarial and governance safeguards to ensure adequately funded program

- Utilize reduced actuarial discount rate (1% less than prior tiers) to evaluate funded position
- Keep overtime pay on a DCR basis only
- Ability to increase employee contributions
- Transition benefits from DCR are at full actuarial cost
- Build up reserves in good times to provide added funding during bad times
- Increased normal retirement age versus Tier 3
  - Age 55 with 20 years for Police & Fire, versus 20 years service only from tier 3
  - Age 60 with 30 years for others, versus 30 years service only from tier 3

# Safeguard #1 - Council Adjustments

- Employee contributions
- Cost of living increases
- Benefit formula
- Health care cost sharing

# PORC will make decisions to adjust

- Protective Occupation Retirement Council will have responsibility and authority to make periodic adjustments
  - Limited variation between actuarial requirement and contribution rates would be acceptable
  - Board will review annually
  - May build in triggers for change
- Employer contributions will not change

# Flexible benefit design safeguards to ensure adequately funded program

Benefit Provision	Floor Benefit	Target Benefit
Plan formula – P&F	2% per year of service	2% for first 10, 2.5% after
Plan formula – Other	2% per year of service	2% for first 10, 2.25% for 10-20, 2.5% after 20
Alaska Cost of Living Adjustment	None	10%
Post Retirement Purchasing Adjustments	None	Same as Tier 3: CPI - based
Health reimbursement	Based on 2013 health premium rates	Based on current health premium rates

# Safeguard #2 – Actuarial Methods

- Build in margin in actuarial assumptions
- Asset valuation method that minimizes gains/losses within acceptable range
- Build reserves in good times to provide added funding during bad times

# Safeguard #3 – Reduced Discount Rate

- Target the pension and health care benefits to be equal to latest tier DB
- Determine the costs based on 7% discount rate rather than 8%
- Seek additional funding for this level, and then commit to this fixed employer contribution rate going forward
  - This is 14% employer contribution for Police and Fire
  - This is 12% employer contribution for Other PERS
- Monitor experience and adjust benefits and/or contributions as necessary going forward

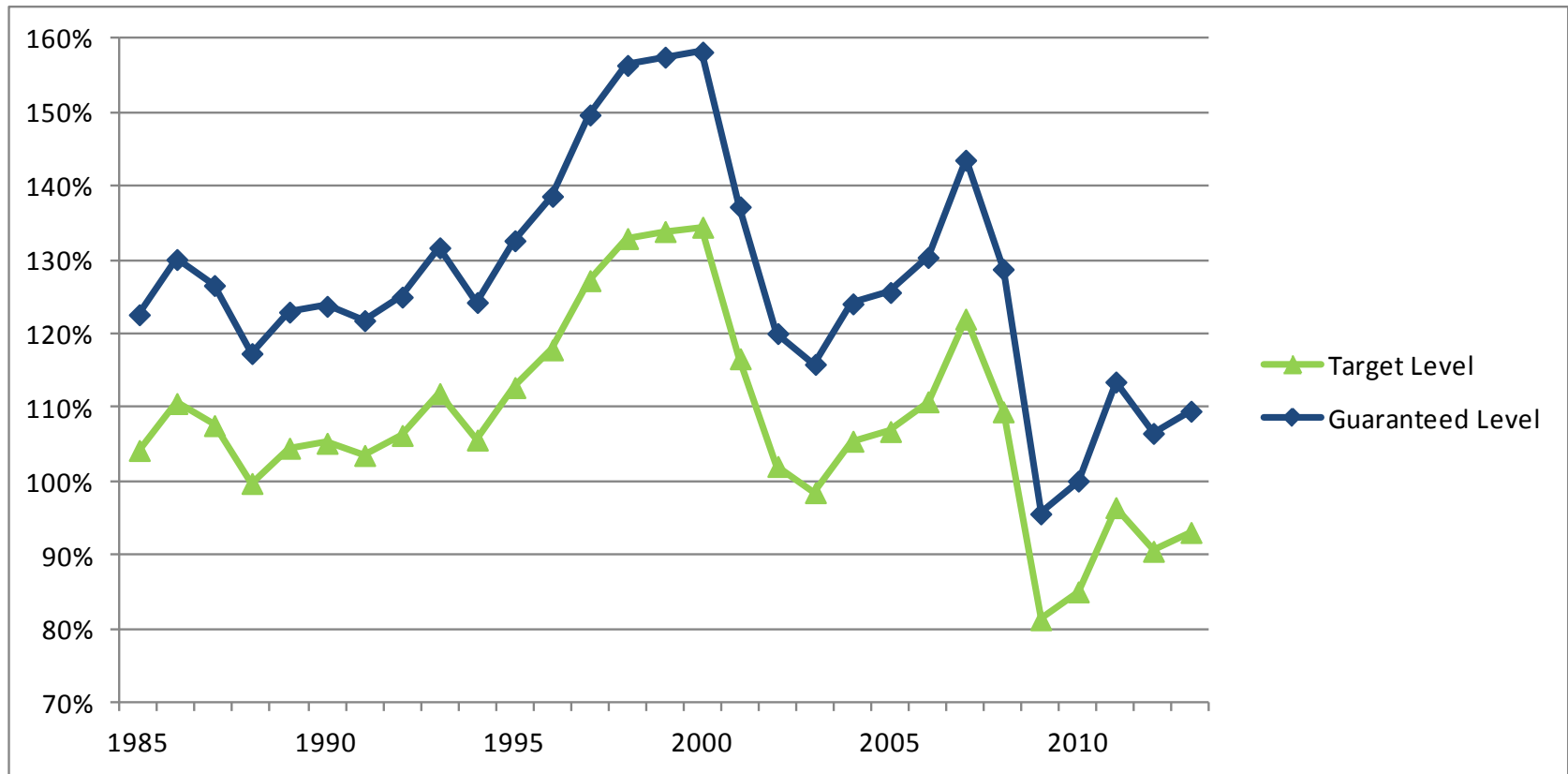
# Variable Benefit Plan Simulations

- We modelled how plan might have worked if it had started at various times over the last fifty years
- We modeled investment returns
  - Based on historical Alaska fund returns since 1981
  - Based on national return statistics prior to 1981
- We used state population statistics to simulate police & fire populations
- We used national wage statistics to estimate average wage growth



# How would our program have worked if begun in 1985

- This was the average case: funding levels ranged from 80% - 158%



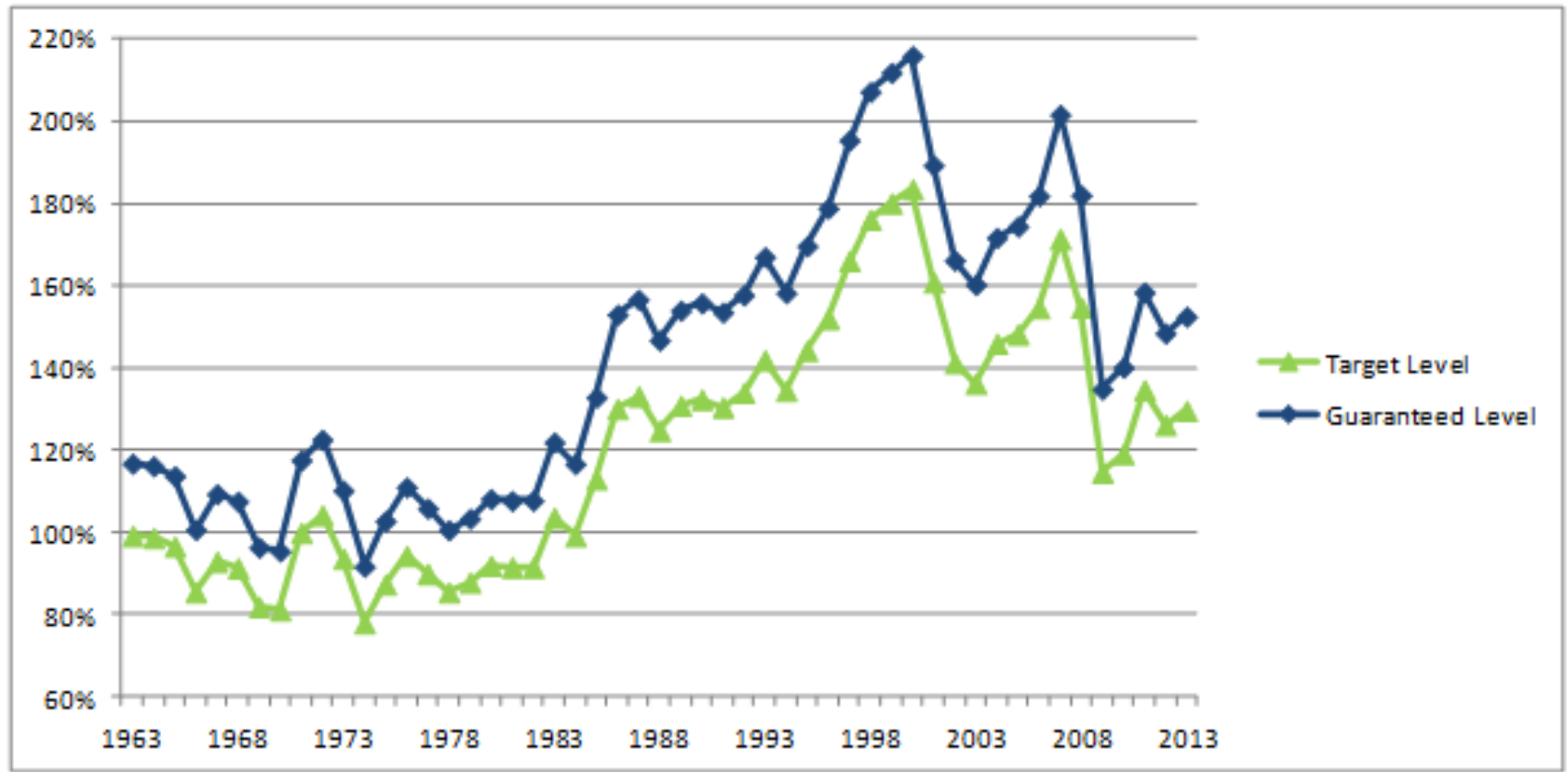
# Pro Forma findings

	Worst Case	Best Case	Typical Case
First year of new program	1996	1963	1985
<b>FUNDED RATIOS BASED ON TARGET LEVEL OF BENEFITS</b>			
Target funded ratio as of 2013	87%	130%	93%
Target funded ratio after 15 years	78%	90%	134%
Worst target funded ratio in plan history	73% (2009)	78% (1974)	81% (2009)
Highest target funded ratio in history	107% (2007)	184% (2000)	134% (2000)
Difference between high and low	34% (2 years)	106% (26 y)	53% (9 yrs)
<b>FUNDED RATIOS BASED ON GUARANTEED LEVEL OF BENEFITS</b>			
Worst funded ratio in plan history	86%	92%	96%
Highest funded ratio in history	126%	216%	158%
Guaranteed funded ratio as of 2013	103%	153%	110%

Note that funded ratios are based on market value of assets. Use of smoothed actuarial value of assets would have made all funded ratios closer to 100%

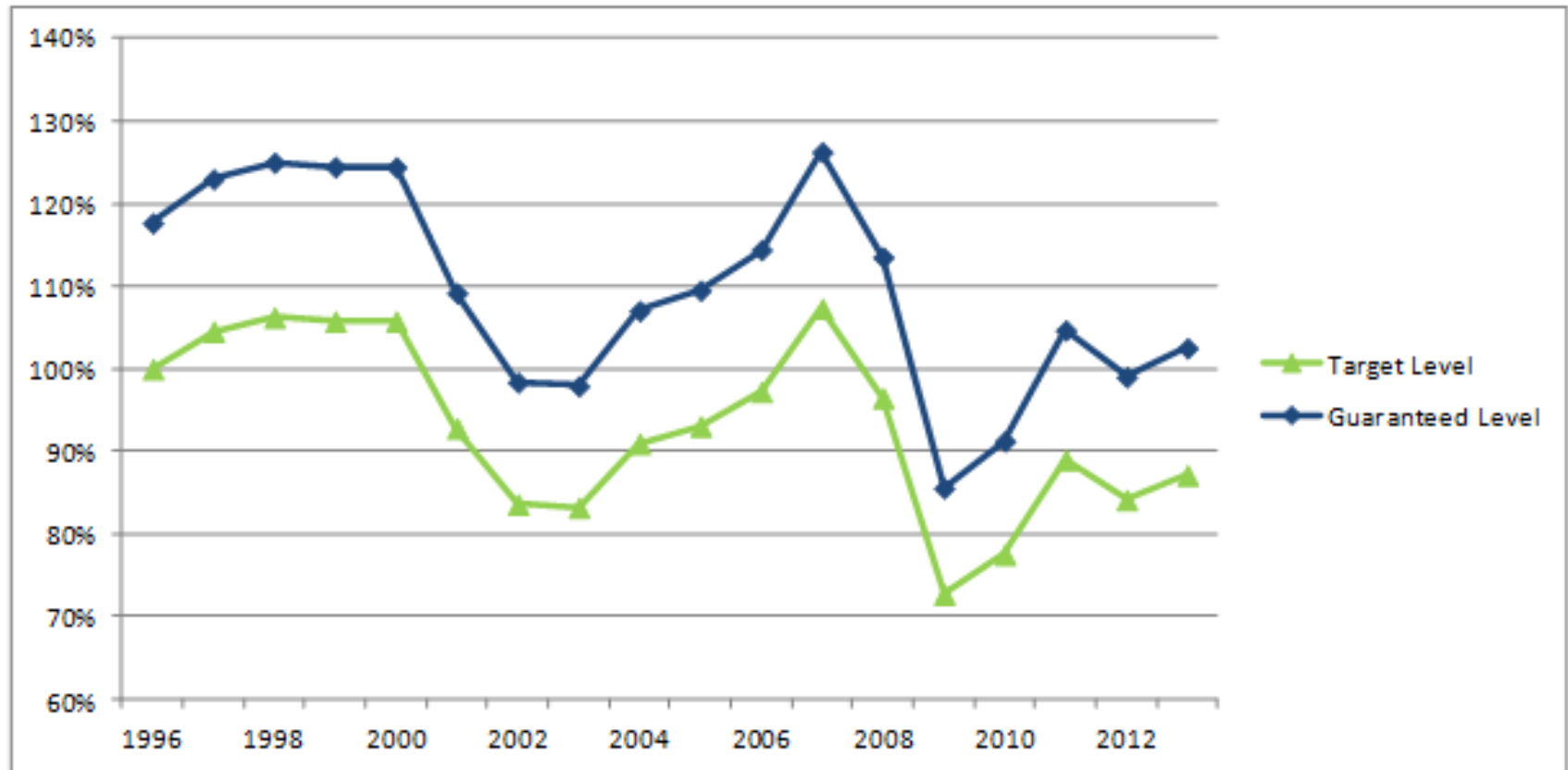
# How would our program have worked if begun in 1963

- This was the best case: funding levels ranged from 78% - 216%



# How would our program have worked if begun in 1996

- This was the worst case: funding levels ranged from 73% - 126%



# How have other states operated?



# Case Study – Wisconsin



- Cost of Living Adjustment is dependent on fund returns
- At retirement, each member has a fixed benefit
- A variable benefit is added to this, based on fund returns
- The variable benefit itself can go down as well as up, but the fixed benefit does not decrease
- Following 2008, the variable benefit did decrease, but has recovered

# Case Study – FPPA



- Colorado Fire and Police Pension Association
  - Formed in 1980, creating new statewide plan
  - Contributions are fixed at 8% employee + 8% employer
  - This level is sufficient for core DB plan
  - Excess contributions went into DC plan during good times
  - Board has discretion over COLA, keeping costs below 16%

# Case Study – SDRS



- Historically among best funded state plans
- SDRS is considered a hybrid DB plan with DC features
- History of substantive benefit improvements funded by favorable investment results—including retirees
- Fixed member and employer contributions
- Statutory triggers requiring Board recommendations for corrective actions/no higher employer contributions
- Primary benefit change tied COLA to Funded Ratio and CPI
- Retirees received smaller COLA as a result



# Case Study – Ohio



- Employer contributions are fixed for each of five pension systems
- Major pension reform completed in 2012
- Systems were and are required to develop plans to keep funded periods within 30 years
- Systems are now imposing plan reductions in many cases
- Like Alaska, plans include retiree healthcare

# Proposed 14% & 12% employer contribution is consistent

- Recently modified police & fire plans
  - Utah employer contribution of 12.0%
  - Ohio employer contribution of 14.0% for non-emergency, 19.5% for Police, & 24.0% for Fire
- Major Alaska employers
  - Wells Fargo
    - 6% match on 401(k)
    - Plus 6.2% Social Security for total of **12.2%**
  - Alaska Airlines
    - 7% match on 401(k) plus 1.5% Stock Purchase Plan subsidy
    - Plus 6.2% Social Security for total of **14.7%**

# Recap

- Alaska has concern with potential future unfunded liabilities
- DCR provides inadequate benefits
- HB 247 is a potential solution
  - If actuarial experience is as expected, benefits will be paid comparable to Tier 3
  - If actuarial experience is unfavorable, lower benefits will be paid
  - Individuals do not take this risk, the government does not take this risk, pools of individuals do

# Questions?

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