

Alaska Variable Retirement Plan SB 83

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Alaska Variable Retirement Plan

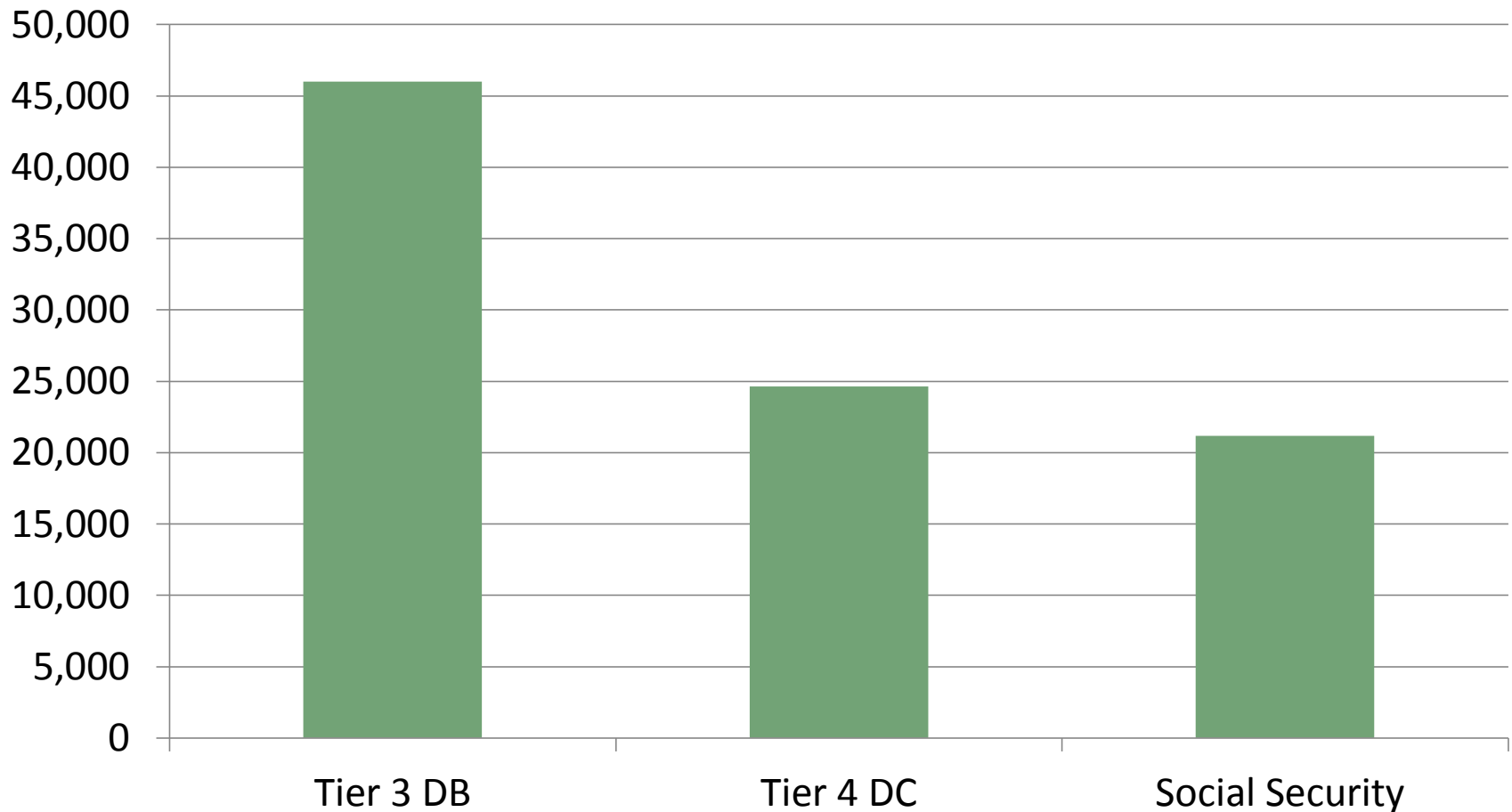
- Why is change necessary?
- Proposed structure of variable retirement plan
- Examples

Why is change necessary?

Tier 3 provided adequate benefits, Tier 4 does not

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

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 SB 83 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

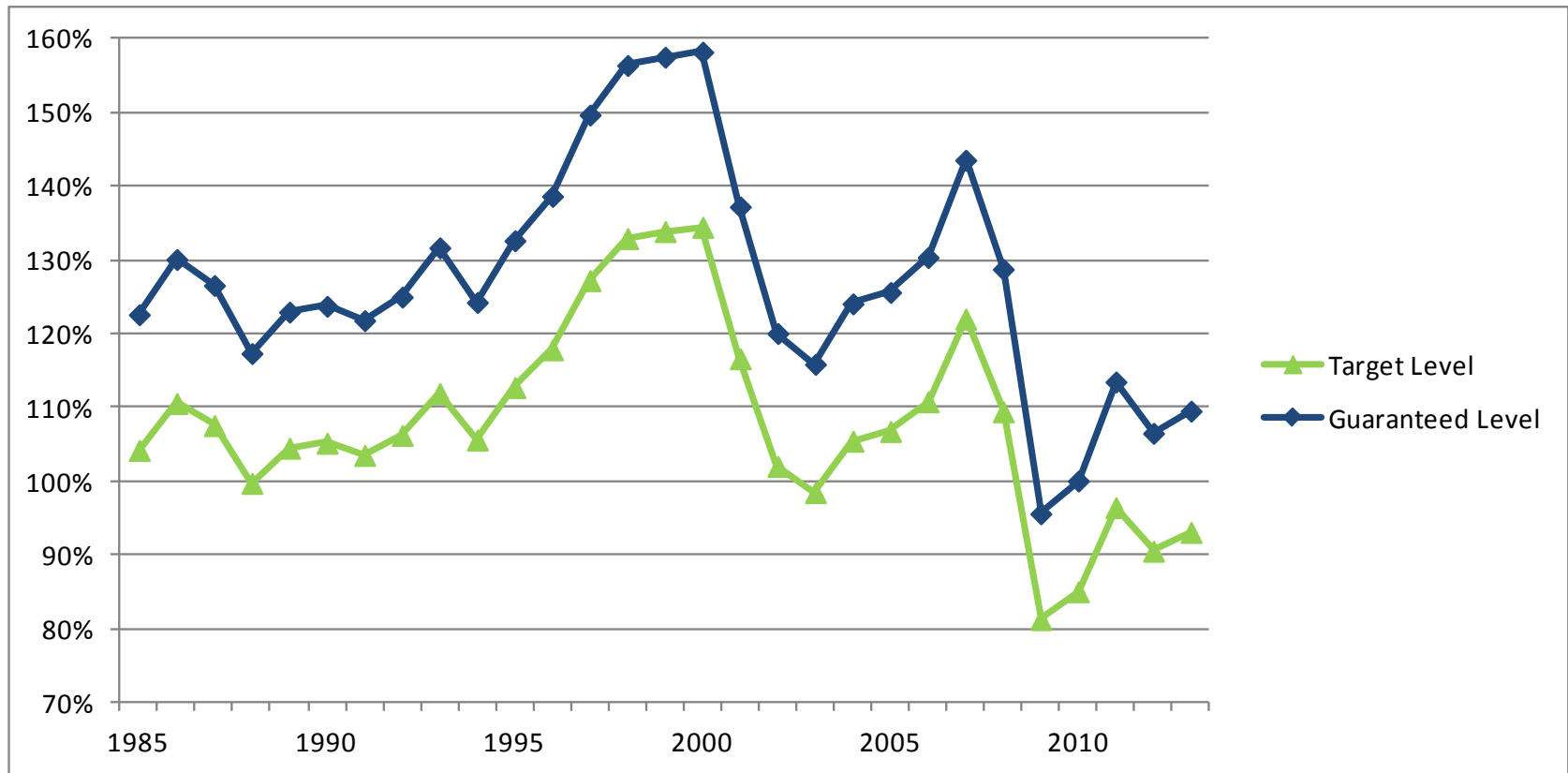
- Target the pension and health care benefits to be equal to latest tier DB
- Determine the costs based on 7% discount rate rather than 8%
- Seek additional funding for this level, and then commit to this fixed employer contribution rate going forward
 - This is 14% employer contribution for Police and 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%



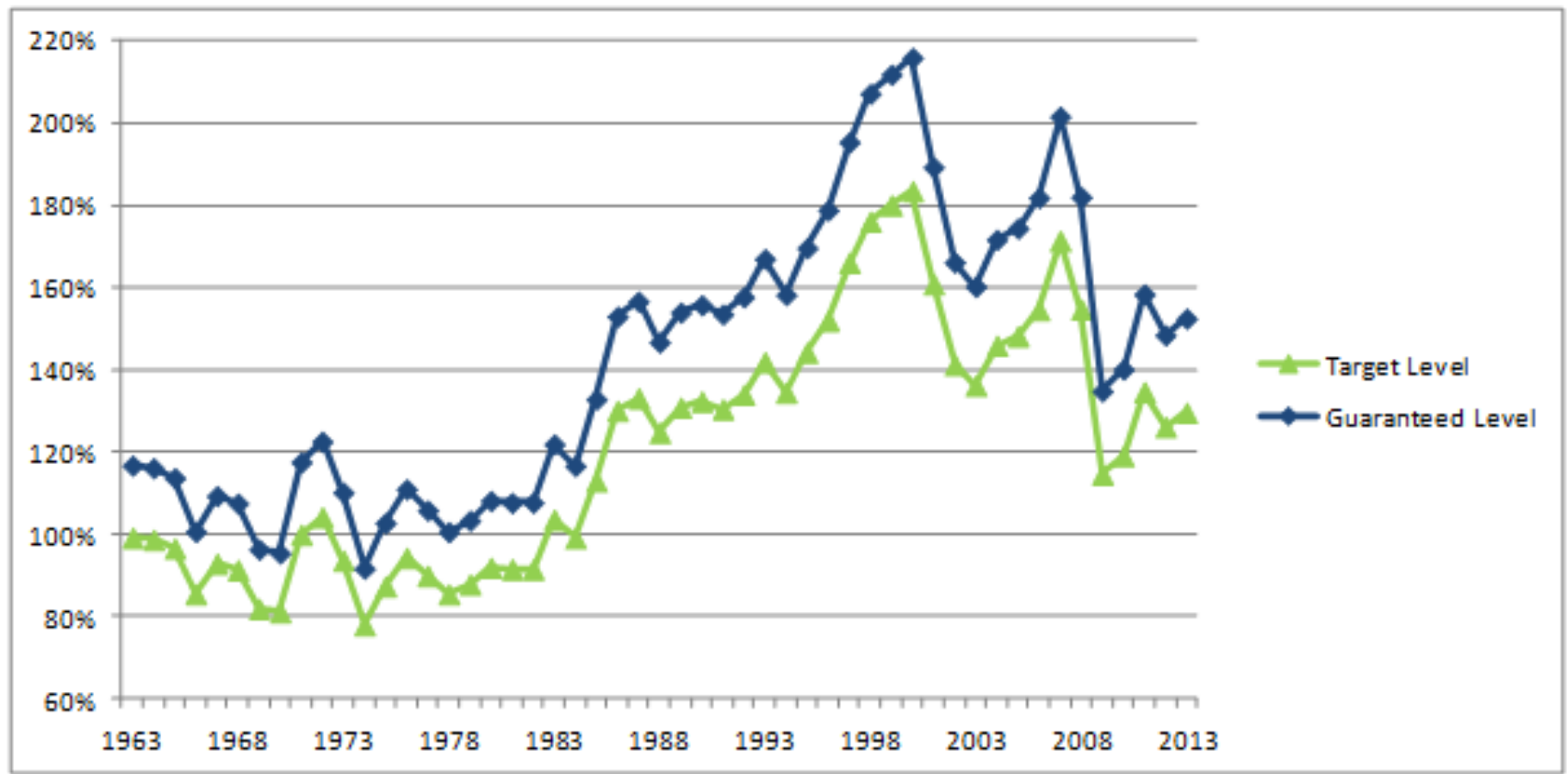
Pro Forma findings

	Worst Case	Best Case	Typical Case
First year of new program	1996	1963	1985
FUNDED RATIOS BASED ON TARGET LEVEL OF BENEFITS			
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)
FUNDED RATIOS BASED ON GUARANTEED LEVEL OF BENEFITS			
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%

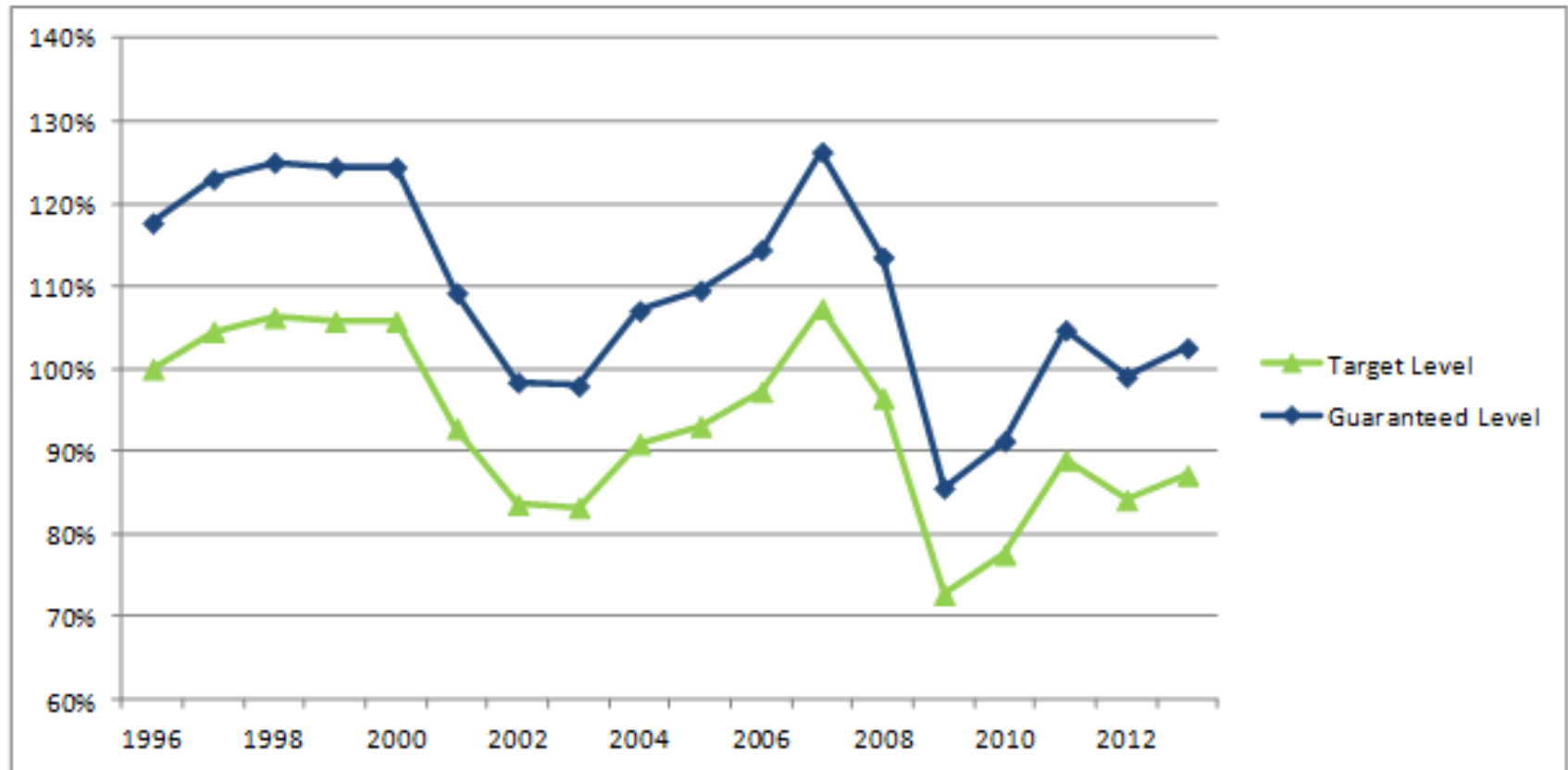
How would our program have worked if begun in 1963

- 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—included 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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