**Testimony on Alaska HB 55: Additional Risk Mitigation Measures Needed**

Prepared for: Members of the Alaska Senate Labor and Commerce Committee

Prepared by: Ryan Frost, Policy Analyst

Date: January 28, 2022

Good afternoon, my name is Ryan Frost and I'm a policy analyst with the Pension Integrity Project at Reason Foundation. I've been with Reason since 2019, but prior to that, I spent 7 years as the Research and Policy Manager for the Law Enforcement Officers and Firefighters Pension System in Washington State, or LEOFF 2 for short. LEOFF 2 has been one of the top-three best funded plans since its inception in the mid 1970's, and that's primarily been accomplished by keeping up to date with best practices in plan and funding design.

Our pension team has been a key pro-bono technical consultant on 55 pension reforms over the past 6 years, the two largest being the public safety plan in Arizona and the Texas employee's retirement system. Those reforms include new defined benefit tiers, new hybrid design tiers, new cash balance tiers, and new defined contribution tiers. Each of those reforms has at its very foundation, a way of paying for the pension system that ensures costs do not eat into state and local budgets, and that these important benefits earned by employees are fully funded for their retirement.

If it's the legislature's desire to open a guaranteed-benefit design to the public safety employees of Alaska, that can most certainly be done, but it must be done in a way that protects the state from financial risk. This bill would attach new public safety employees to a plan that has had trouble with funding spanning back two decades, only sitting at 76% funded even after the largest one-year market return in recent history. I'd like to lay out a few pension best practices for the committee to consider, and where HB 55 falls short.

A successful plan pays the full actuarially determined rate using a full 50/50 cost sharing method. For a defined benefit plan, this means that when underperformance happens in the market, or any of the other dozens of economic and demographic assumptions aren't met, employees and employers equally share the paydown of that added debt to the pension system.

This bill has been sold as being "risk shared", but neither pays the actual cost of earned benefits, as determined by the plan's actuary, nor equally shares those costs between all stakeholders. Setting rates in statute, and capping those rates for employees, is a funding design from yesteryear that no longer follows the best practices in pension design.

The best funded plans also don't look to past investment experience when setting future assumed rates of return. The median rate of return across the country sits at 7%. This bill would put all employees into a plan assuming 7.38%. Not only does that number fail to track with past investment experience in Alaska, but it also severely overestimates the 10–15-year market assumptions used by other institutional investors.

For example, two of the largest three plans in the country, the California Public Employees Retirement System and the New York State and Local System, have both stated in the past year that they only assume to earn 6% over the next 10 years. Both systems made immediate and prudent changes to their assumed rates of return, with New York dropping all the way down to 5.9%.

This bill has been sold as being “cost neutral” due to having the same contribution rate as the DC plan, but if this new tier earns even an optimistic 6.5%, while assuming 7.38%, costs will rapidly begin to spike. Quite quickly, the cap on the employee rate will be hit, and the employer rate will continue to climb higher and higher to pay for those missed returns and the added interest, at 7.38%, that each year of missed returns adds to the plans unfunded liabilities.

In conclusion, there is way forward that can meet whatever needs this legislative body and stakeholders desire, but HB55 as currently written would not put this new tier on a successful path. We’d be happy to work with the committee and stakeholders to help draft a design that best meets those needs and follows current best practices in pension design. Thank you for your time today, and I’d be happy to answer any questions.

**Alaska Public Employees' Retirement System (PERS)**

# House Bill 55 Threatens Alaska's Pension Progress

*Several states facing major pension challenges have successfully transitioned to lower risk retirement designs. House Bill 55 and other active legislation during Alaska's 2022 session attempt to accomplish that goal but currently lack the risk and cost assurances required to achieve long-term sustainability and resiliency.*

**A Successful Plan:** Splits the actuarially determined cost of benefits equally between taxpayers and Employees.
**House Bill 55:** Neither pays the actual cost of earned benefits, nor equally shares those costs between all stakeholders.

- ✓ Equally sharing the actuarially determined cost of defined benefits means when underperformance happens in the market, or any of the other dozens of economic and demographic assumptions aren't met, employees and employers equally share the paydown of that added debt to the pension system.
- ✓ HB55 setting rates in statute, and capping those rates for employees, risk systematically underfunding PERS long-term.

**A Successful Plan:** Relies on accurate, realistic actuarial assumptions to mitigate risk.
**House Bill 55:** Relies on the assumption that plan assets will return 7.38% while the median assumed rate of return across the country sits at 7% and continues to fall.

- ✓ Not only does that number fail to track with past investment experience in Alaska, but it also severely overestimates the 10–15-year market assumptions used by other institutional investors.
- ✓ California Public Employees Retirement System and the New York State and Local System have both stated in the past year that they only assume to earn 6% over the next 10 years.
- ✓ Both systems made immediate and prudent changes to their assumed rates of return, with New York dropping all the way down to 5.9%.

**Did You Know?**
**PERS still has $3.7 billion in unfunded liabilities and even after historic market returns still sits at only 76% funded.**

**A Successful Plan:** Balances risk so the pension system maintains proper funding.
**House Bill 55:** Claims to be "cost neutral" but makes little effort to change the benefit design of the legacy defined benefit plan, which is still $3.7 billion in debt.

- ✓ Overly optimistic assumptions are likely to result in the cap on employee contributions being hit, making the employer rate climb higher due to missed returns, and compounded interest.

**Bottom-Line:** *There is a way forward that can meet whatever Alaska policymakers and stakeholders desire, but HB55 as currently written falls short of assuring cost and risk.*

**PENSION INTEGRITY PROJECT CONTACTS**

- Leonard Gilroy, Senior Managing Director (lenard.gilroy@reason.org)
- Ryan Frost, Policy Analyst (ryan.frost@reason.org)

Reason Foundation is a national 501(c)(3) public policy research and education organization with expertise across a range of policy areas, including public sector pensions, transportation, infrastructure, education, and criminal justice. For more information about the Pension Integrity Project at Reason Foundation, visit reason.org.