

ALASKA HOUSE WAYS & MEANS COMMITTEE

# COSTS AND RISKS OF PROPOSED PUBLIC RETIREMENT PLAN CHANGES

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Prepared by:

**Pension Integrity Project at Reason Foundation**

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# About the Pension Integrity Project

We offer pro-bono technical assistance to public officials to help them design and implement pension reforms that improve plan solvency and promote retirement security, including:

- *Customized analysis* of pension system design, trends
- *Independent actuarial modeling* of reform scenarios
- Consultation and modeling around *custom policy designs*
- Latest pension reform *research and case studies*
- *Peer-to-peer mentoring* from state and local officials who have successfully enacted pension reforms
- Assistance with *stakeholder outreach*, engagement and relationship management
- Design and execution of *public education programs* and media campaigns



# Policy Objectives

- **Keeping Promises:** Ensure the ability to pay 100% of the benefits earned and accrued by active workers and retirees
- **Retirement Security:** Provide retirement security for all current and future employees
- **Predictability:** Stabilize contribution rates for the long-term
- **Risk Reduction:** Reduce pension system exposure to financial risk and market volatility
- **Affordability:** Reduce long-term costs for employers/taxpayers and employees
- **Attractive Benefits:** Ensure the ability to recruit 21st Century employees
- **Good Governance:** Adopt best practices for board organization, investment management, and financial reporting



# Brief History of Alaska's Retirement Systems

- **1940s:** TRS established
- **1960s:** PERS established
- **Early 2000s:** significant growth in unfunded liabilities
- **2006:** pensions closed to new hires, offering instead the defined contribution (DCR) plan
- **2006-today:** frequent efforts to bring back the defined benefit (DB) pension plan
- **2022:** Reform rollbacks (HB 55 & HB 220) pass in the House, not the Senate
  - Pension Integrity Project Analysis indicates that if the 2022 rollbacks had passed, the state would have developed new pension debt after -4.08% returns in year one:
    - \$33 million for public safety (HB 55)
    - \$254 million for PERS & TRS combined (HB 220)

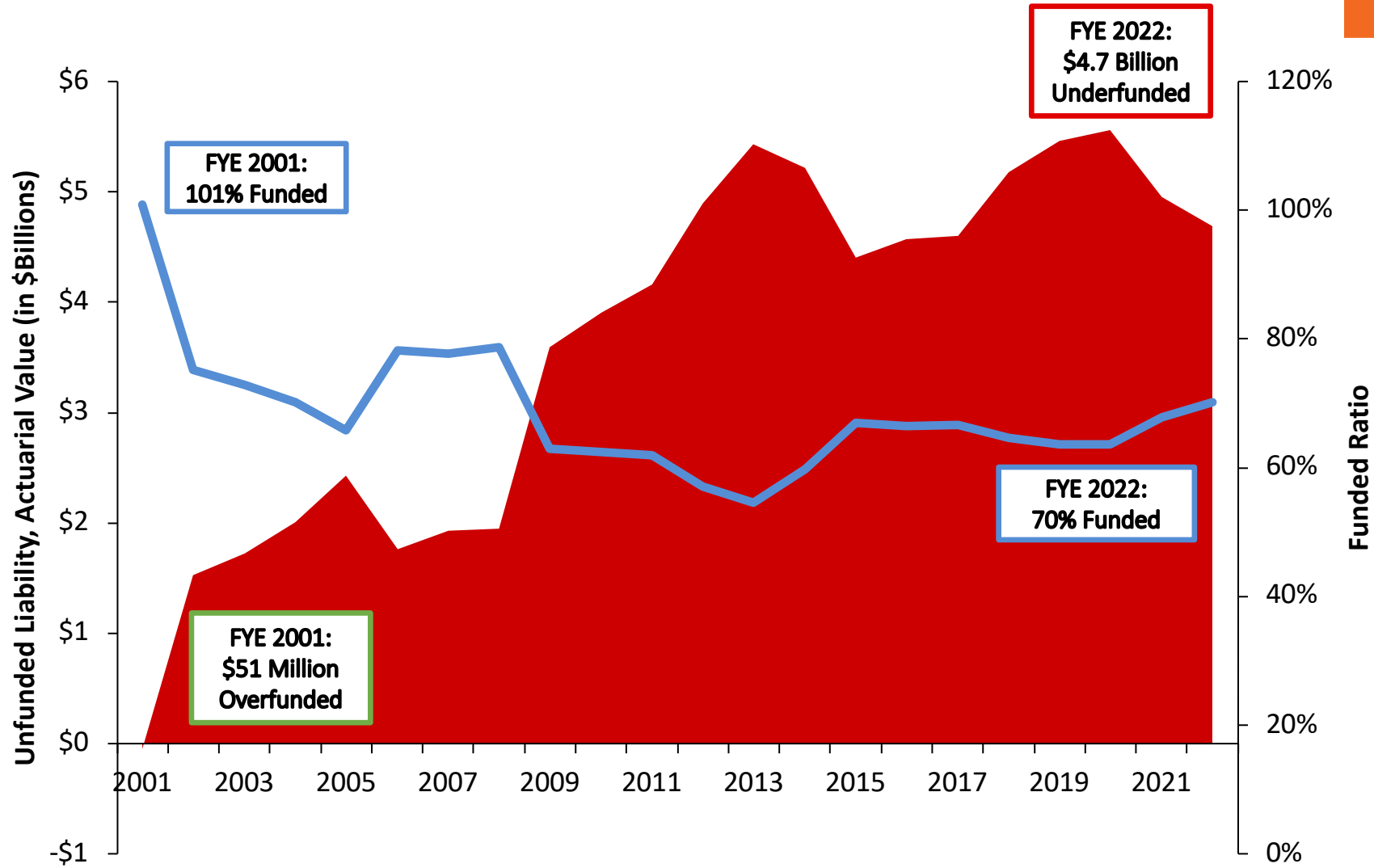


# CHALLENGES FACING PERS & TRS

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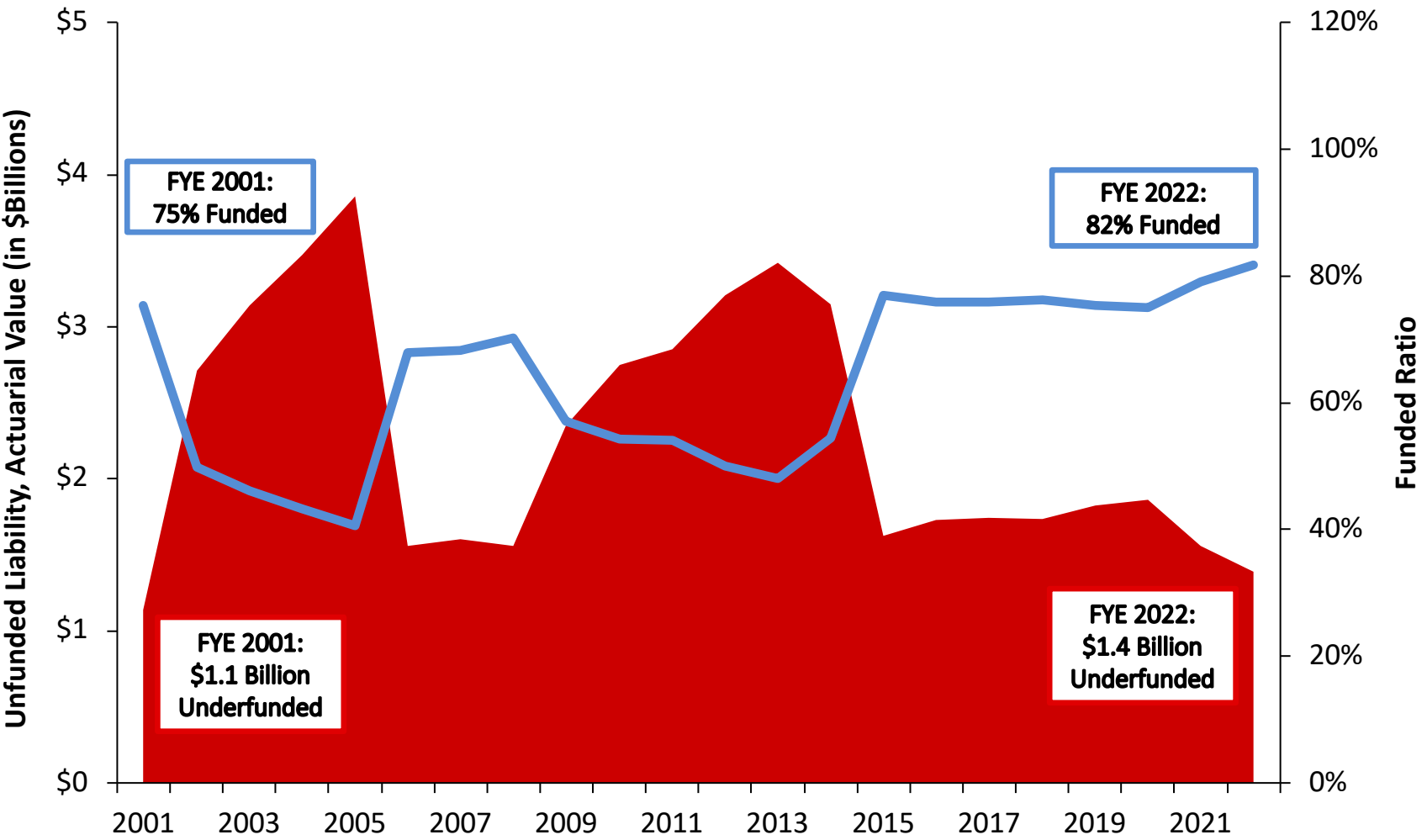
# A History of PERS Funding (2001-2022)



Source: Pension Integrity Project analysis of actuarial value of assets and actuarial accrued liability found in PERS valuation reports and ACFRs.



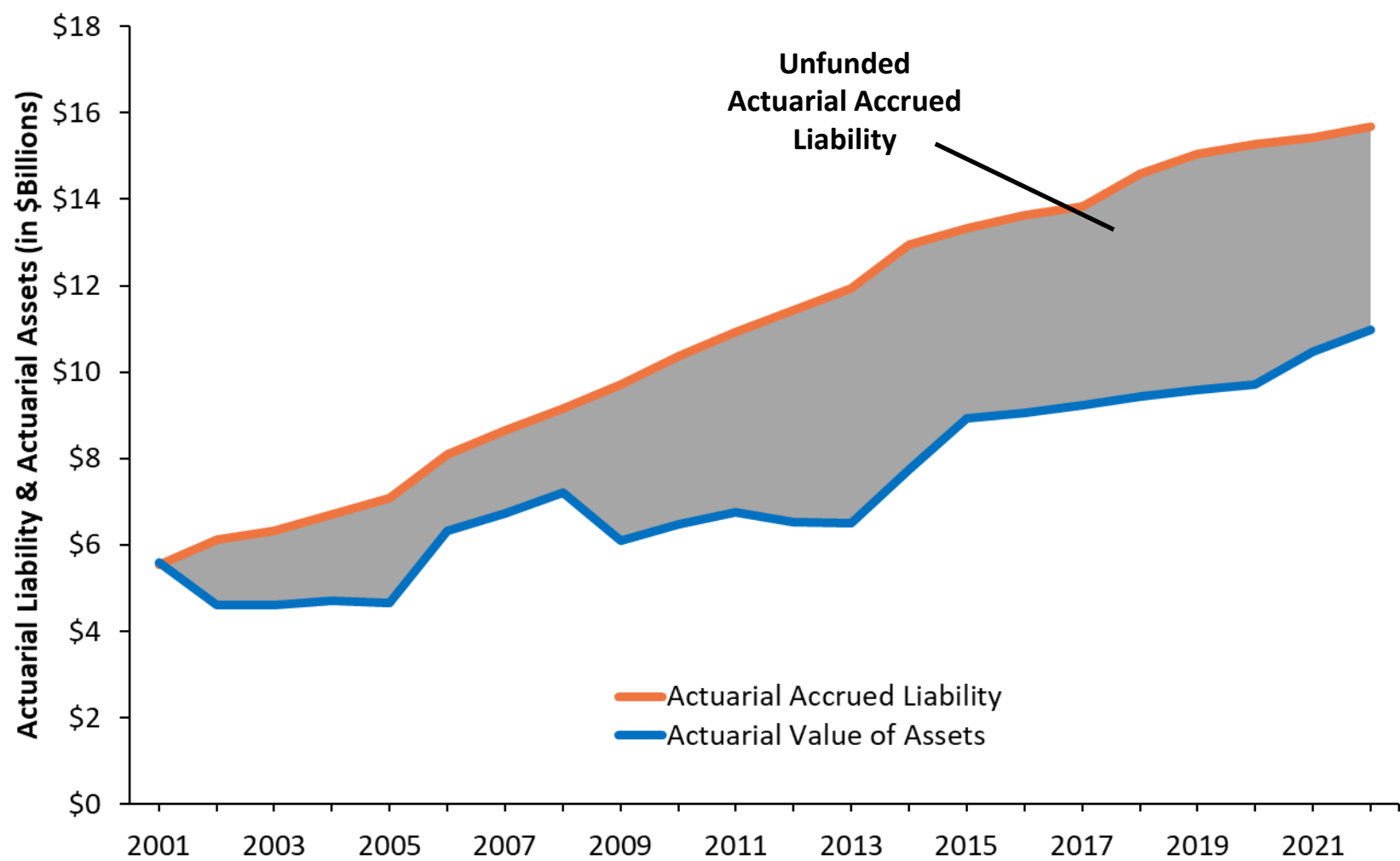
# A History of TRS Funding (2001-2022)



Source: Pension Integrity Project analysis of actuarial value of assets and actuarial accrued liability found in TRS valuation reports and ACFRs.



# PERS Liabilities are Growing Faster than Assets

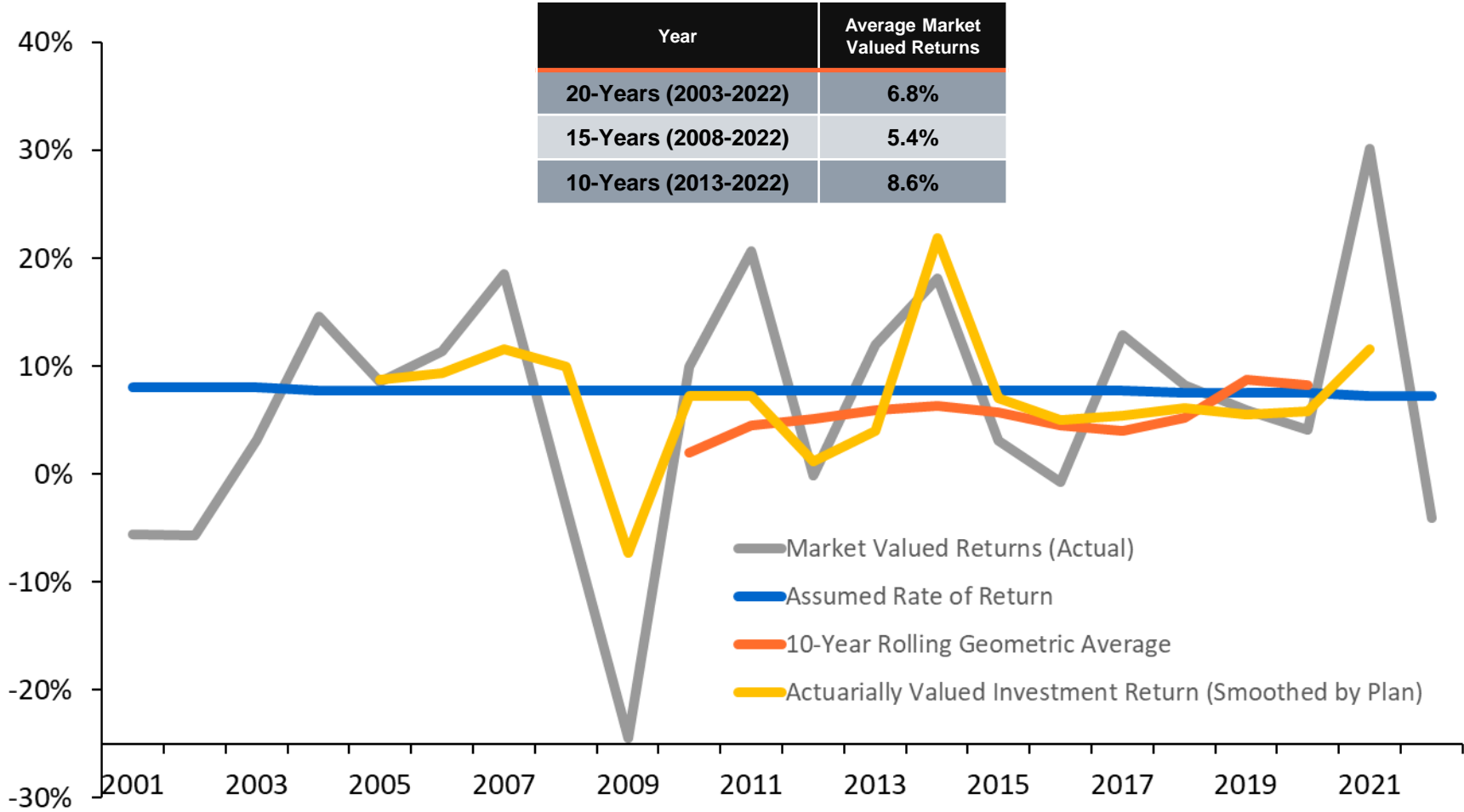


Source: Pension Integrity Project analysis of actuarial value of assets and actuarial accrued liability found in PERS valuation reports and ACFRs.





# PERS Investment Return History, 2001-2022



Source: Pension Integrity Project analysis of investment returns found in PERS valuation reports and ACFRs.

# Probability Analysis: Measuring the Likelihood of Alaska Plans Achieving Various Rates of Return



Possible Rates of Return	Probability of PERS & TRS Achieving A Given Return Based On:							
	Plan Assumptions & Experience		Short-Term Market Forecast				Long-Term Market Forecast	
	Based on PERS & TRS Assumptions	PERS & TRS Historical Returns	Research Affiliates 10-Year Forecast	JP Morgan 10-15 Year Forecast	BNY Mellon 10-Year Forecast	Horizon 10-Year Market Forecast	BlackRock 20-Year Forecast	Horizon 20-Year Market Forecast
8.0%	40%	19%	8%	11%	17%	26%	52%	35%
7.5%	47%	26%	11%	15%	22%	32%	59%	42%
7.25%	51%	29%	13%	18%	25%	36%	62%	46%
7.0%	54%	32%	15%	21%	28%	39%	65%	49%
6.5%	61%	39%	20%	28%	35%	46%	71%	56%
6.0%	68%	47%	26%	35%	42%	53%	76%	64%
5.0%	79%	62%	40%	52%	58%	67%	86%	75%

Source: Pension Integrity Project Monte Carlo model based on PERS & TRS asset allocation and reported expected returns by asset class. Forecasts of returns by asset class generally by BNYM, JPMC, BlackRock, Research Affiliates, and Horizon Actuarial Services were matched to the specific asset class of PERS & TRS. Probability estimates are approximate as they are based on the aggregated return by asset class. For complete methodology contact Reason Foundation.

# Probability Analysis: Measuring the Likelihood of Alaska Plans Achieving Various Rates of Return



## PERS & TRS Assumptions & Experience

- A probability analysis of PERS & TRS historical returns over the past 21 years (2001-2022) indicates only a small chance (29%) of hitting the plan’s 7.25% assumed return in 2023+ period.
- PERS & TRS actuaries calculate a 51% chance of achieving their investment return target each year.

## Short-Term Market Forecast

- Returns over the short to medium term can have significant negative effects on funding outcomes for mature pension plans with large negative cash flows like PERS & TRS.
- Analysis of capital market assumptions publicly reported by leading financial firms (BNY Mellon, JPMorgan, and Research Affiliates) suggests that over a 10-15 year period, PERS & TRS returns are likely to fall short of assumptions.

## Long-Term Market Forecast

- Longer-term projections typically assume PERS & TRS investment returns will revert back to historical averages.
  - ✓ The “reversion to mean” assumption should be viewed with caution given historical changes in interest rates and a variety of other market conditions that increase uncertainty over longer projection periods, relative to shorter ones.
- Forecasts showing long-term returns near 8% being likely also show a significant chance that the actual long-term average return will fall far shorter than expected.
  - ✓ For example, according to BlackRock’s 20-year forecast the probability of achieving an average return of 7.25% or higher is about 62%, but the probability of earning a rate of return below 5% is about 14%.



# PENSION ROLLBACK CONCERNS

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# HB 22 / SB 11 / SB 35 / SB 88 Issues

- **Problem #1:** Poor Plan Design
  - The proposed pension plan does little to balance risk between employees/employers
- **Problem #2:** Minimal Actuarial Scrutiny
  - Pension Integrity Project modeling of **PERS** and **TRS** through a standard stress scenario shows clear costs and added funding challenges that HB22 / SB35 / SB11 / SB 88 may heap on the state
- **Problem #3:** Pension Cost Increases Already Coming
- **Problem #4:** Pension Swap Won't Solve Retention Issues



## Problem #1: Poor Plan Design

- Plan assumptions are an outlier among other defined benefit plans.
- Some bills close the DC plan to all new hires.
- Capped employee contribution rates.
  - Employees: 8%-10%
  - Employers: 12% + unfunded liabilities
- Puts less money into underfunded legacy PERS tier.



## Problem #2: Minimal Actuarial Scrutiny

- There is no publicly available long-term actuarial forecasting or stress testing performed by the PERS/TRS actuaries.
- Supporters claim that “tweaks to the new pension would eliminate financial risk to the state” but those claims have faced minimal actuarial scrutiny to support them.
- What happens to costs and unfunded liabilities if plan experience differs from expectations?
- The proposed reform rollback would commit Alaska to unpredictable long-term costs. It is crucial to consider the costs over decades, not just a few years.
- Recognizing the need for a long-term perspective on funding and costs, we prepared modeling of the proposed reform rollbacks.



## Problem #3: Pension Cost Increases Coming

- The bills propose the use of a 7.25% assumed rate of return, discount rate, and DC annuitization rate.
- They also propose the ability to transfer all assets from the DC plan into the new DB plan.
- The legacy pension tier also still uses a 7.25% rate.
- National average is now under 7% and dropping quickly.
- When Alaska PERS and TRS lowers their assumptions, costs will go up dramatically for legacy and new tiers.



## Problem #4: Pension Swap Unlikely to Solve Retention Issues



- Pension rollback bill supporters are concerned with recruitment and retention challenges.
- Proponents claim they are having trouble recruiting and retaining members due to the lack of a defined benefit pension for their members.
- However, this claim does not hold up to the data, as 86% of police stations across the country are facing a shortage of members.
- Every one of those stations, outside of Alaska, has a pension with some defined benefit component.
- In fact, we have an academic working paper that shows retention rates did not change when Alaska swapped from a DB to DC in 2005.



# RISK ANALYSIS OF HOUSE BILL 22 / SENATE BILL 35

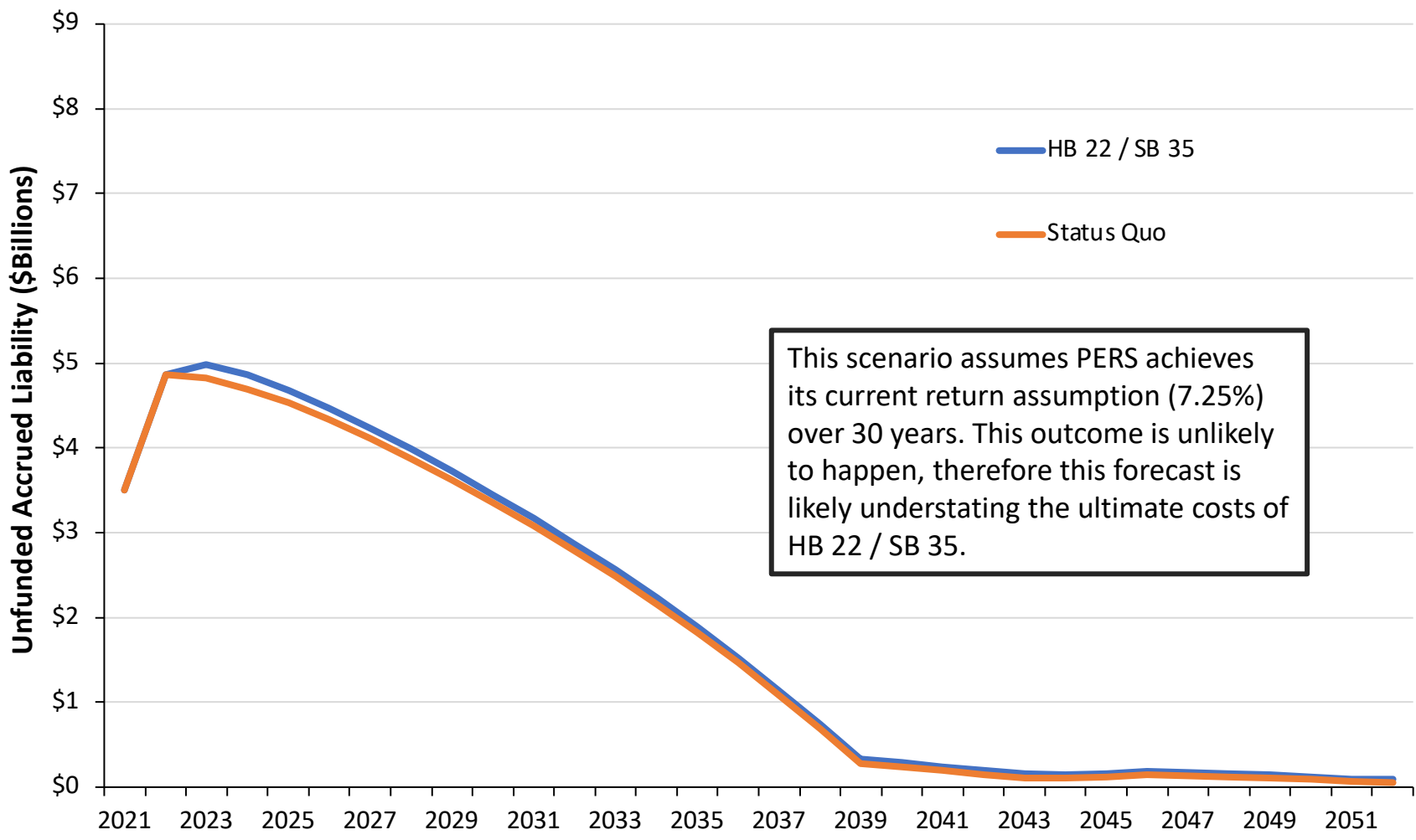
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How would reopening the pension for public safety workers impact state debt and budgets?



# Proponents Will Suggest Little to No Impact on Debt

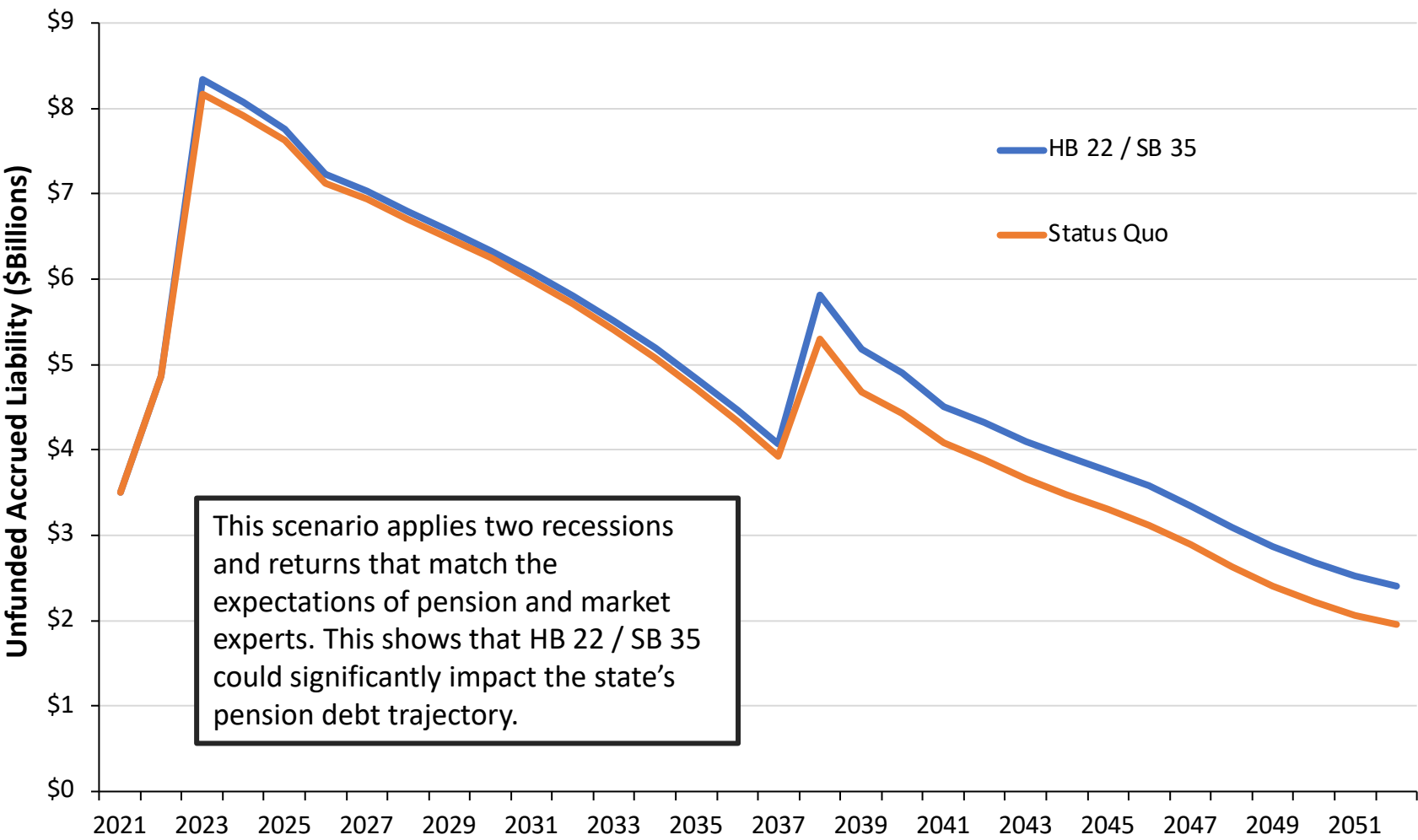
## Pension Debt Forecast : No Stress



Source: Pension Integrity Project actuarial forecast of Alaska PERS unfunded liabilities using market value of assets.  
Scenario assumes fund achieves a constant 7.25%.

# A More Likely Scenario Reveals True Debt Impact

## Pension Debt Forecast : Stress Return Scenario Applied



Source: Pension Integrity Project actuarial forecast of Alaska PERS unfunded liabilities using market value of assets.  
scenario applies recession returns in 2023-26 and 2038-41 and 6% returns in all other years.



# Long-term Cost Impact of HB 22 / SB 35

## No Stress

	Status Quo	HB 22 / SB 35
Total Employer Contribution: Alaska PERS (2023-52)	\$13.3 billion	\$13.3 billion
Unfunded Liability: Alaska PERS (2052)	\$0.1 billion	\$0.1 billion
All-in Cost to Employers	\$13.4 billion	\$13.4 billion

## Standard Stress Applied

	Status Quo	HB 22 / SB 35
Total Employer Contribution: Alaska PERS (2023-52)	\$20.4 billion	\$20.8 billion
Unfunded Liability: Alaska PERS (2052)	\$2.0 billion	\$2.4 billion
All-in Cost to Employers	\$22.4 billion	\$23.2 billion

Source: Pension Integrity Project 30-year actuarial forecast of Alaska PERS.  
Stress scenario applies recession returns in 2023-26 and 2038-41 and 6% returns in all other years. Values are adjusted for inflation.



# RISK ANALYSIS OF SENATE BILL 11

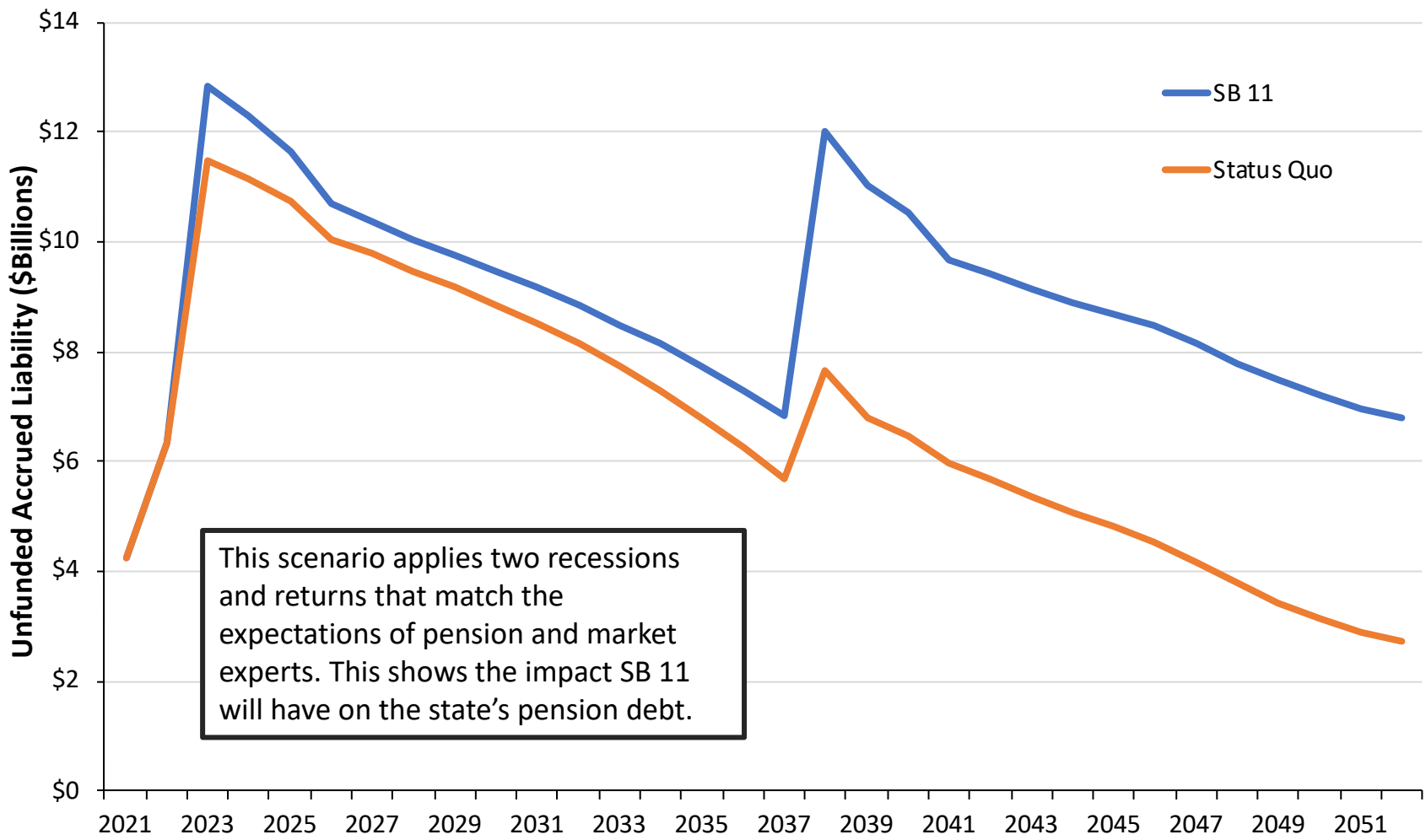
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How would reopening the pension for all public workers impact state debt and budgets?



# Impact of SB 11 on Alaska Pension Debt

Pension Debt Forecast : Stress Return Scenario Applied



This scenario applies two recessions and returns that match the expectations of pension and market experts. This shows the impact SB 11 will have on the state's pension debt.

Source: Pension Integrity Project actuarial forecast of Alaska PERS & TRS unfunded liabilities using market value of assets.  
Scenario applies recession returns in 2023-26 and 2038-41 and 6% returns in all other years.



# Long-term Cost Impact of SB 11

## No Stress

	Status Quo	SB 11
Total Employer Contribution: Alaska PERS & TRS (2023-52)	\$17.7 billion	\$19.8 billion
Unfunded Liability: Alaska PERS & TRS (2052)	\$0.0 billion	\$0.5 billion
All-in Cost to Employers	\$17.7 billion	\$20.3 billion

## Standard Stress Applied

	Status Quo	SB 11
Total Employer Contribution: Alaska PERS & TRS (2023-52)	\$28.5 billion	\$33.6 billion
Unfunded Liability: Alaska PERS & TRS (2052)	\$2.7 billion	\$6.8 billion
All-in Cost to Employers	\$31.2 billion	\$40.4 billion

Source: Pension Integrity Project 30-year actuarial forecast of Alaska PERS & TRS.  
Stress scenario applies recession returns in 2023-26 and 2038-41 and 6% returns in all other years. Values are adjusted for inflation.





# RISK ANALYSIS OF SENATE BILL 88

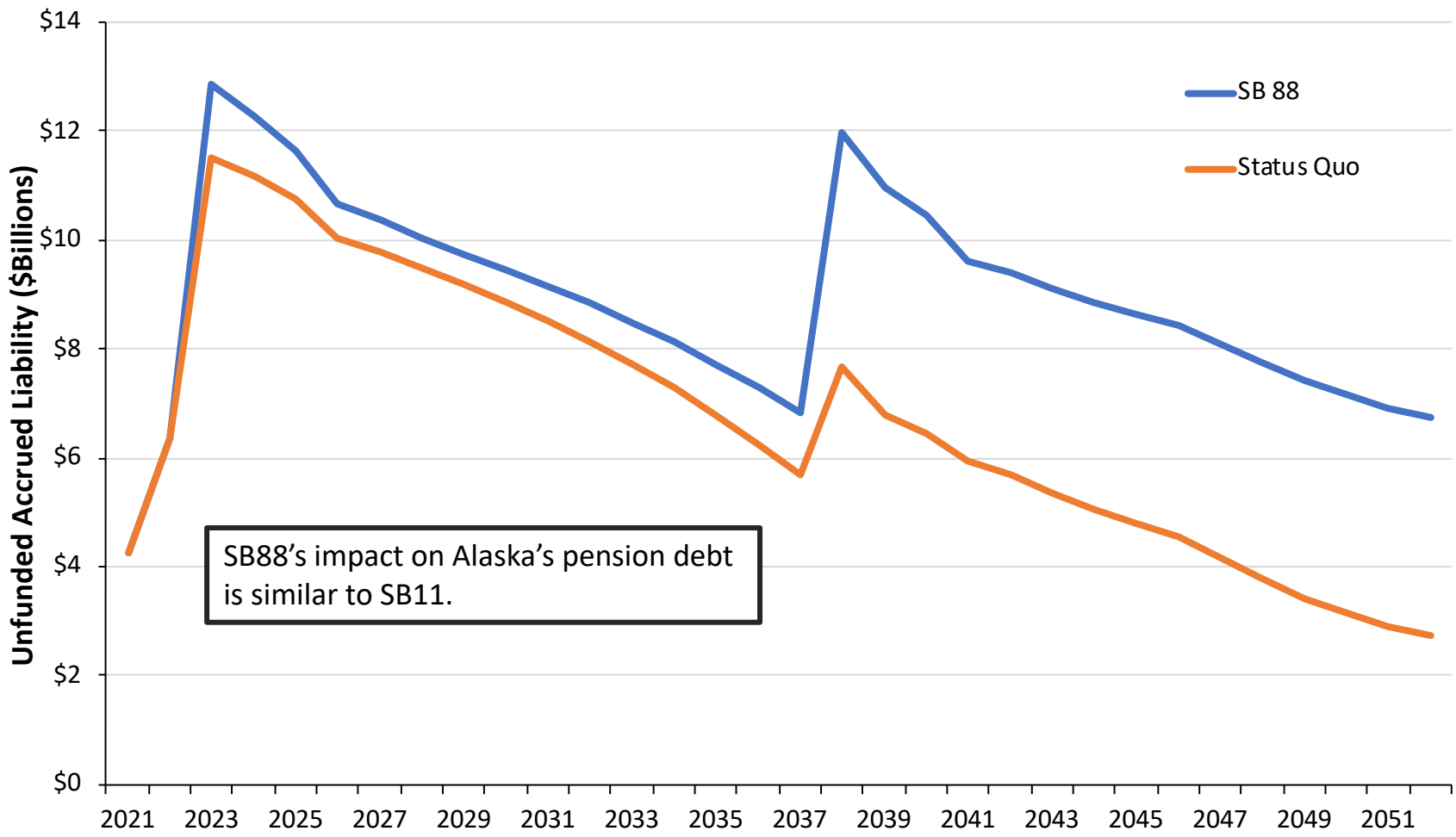
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How would reopening the pension for all public workers (with adjustments to retirement eligibility) impact state debt and budgets?



# Impact of SB 88 on Alaska Pension Debt

Pension Debt Forecast : Stress Return Scenario Applied



Source: Pension Integrity Project actuarial forecast of Alaska PERS & TRS unfunded liabilities using market value of assets.  
Scenario applies recession returns in 2023-26 and 2038-41 and 6% returns in all other years.



# Long-term Cost Impact of SB 88

## No Stress

	Status Quo	SB 88
Total Employer Contribution: Alaska PERS & TRS (2023-52)	\$17.7 billion	\$19.3 billion
Unfunded Liability: Alaska PERS & TRS (2052)	\$0.0 billion	\$0.5 billion
All-in Cost to Employers	\$17.7 billion	\$19.8 billion

## Standard Stress Applied

	Status Quo	SB 88
Total Employer Contribution: Alaska PERS & TRS (2023-52)	\$28.5 billion	\$33.1 billion
Unfunded Liability: Alaska PERS & TRS (2052)	\$2.7 billion	\$6.7 billion
All-in Cost to Employers	\$31.2 billion	\$39.8 billion

Source: Pension Integrity Project 30-year actuarial forecast of Alaska PERS & TRS.  
Stress scenario applies recession returns in 2023-26 and 2038-41 and 6% returns in all other years. Values are adjusted for inflation.

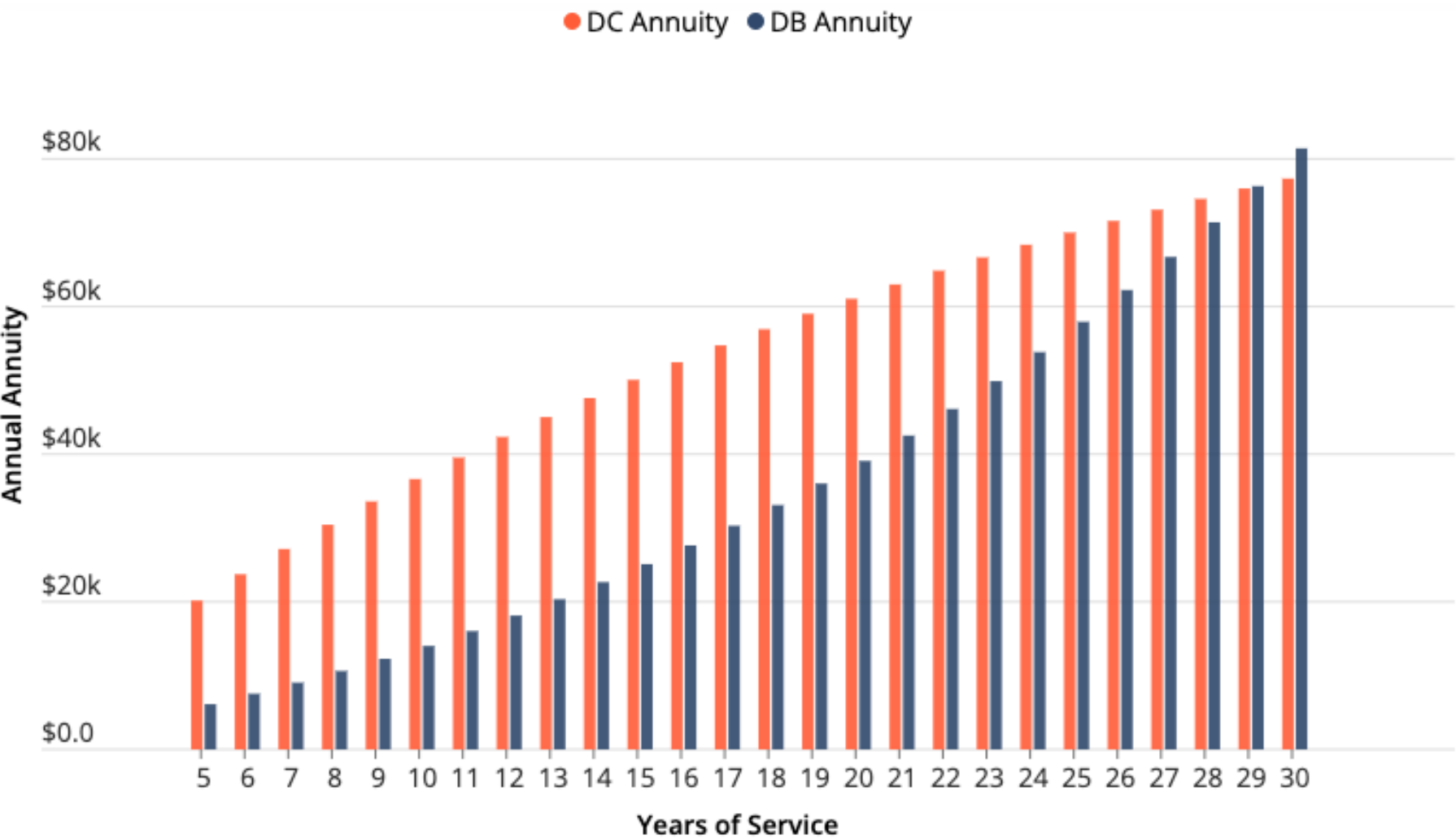


# EVALUATION OF RETIREMENT PLANS AND RETENTION

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# DB vs DC: Who Does it Benefit?

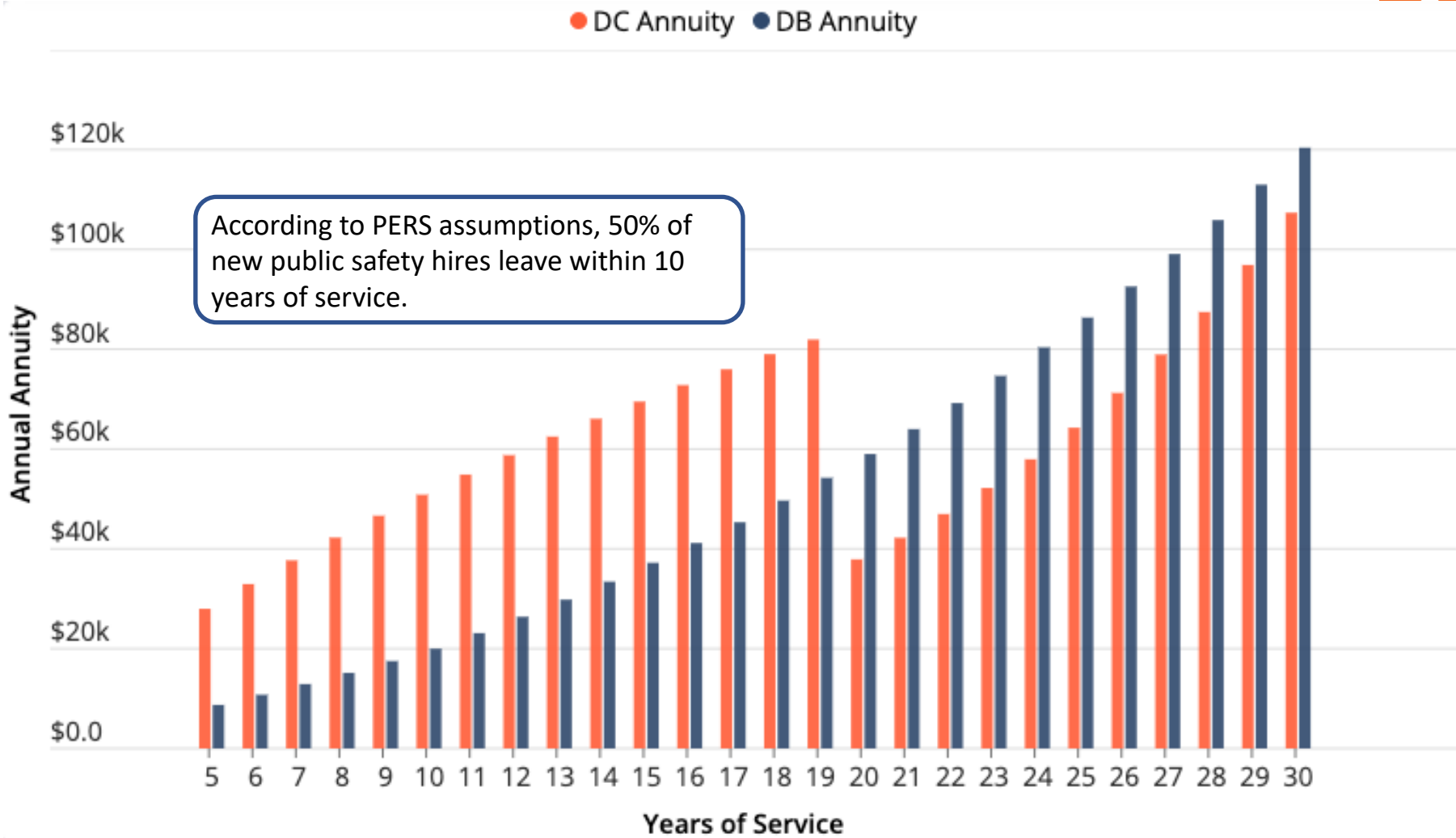
PERS Non-Public Safety



Source: Pension Integrity Project 30-year benefit forecast of Alaska PERS (non-public safety) DC & DB plan closed in 2006.  
Analysis uses entry age 30, assumed 7% return, 5.89% annuity payout rate, and 2.75% wage increase rate.

# DB vs DC: Who Does it Benefit?

PERS Public Safety

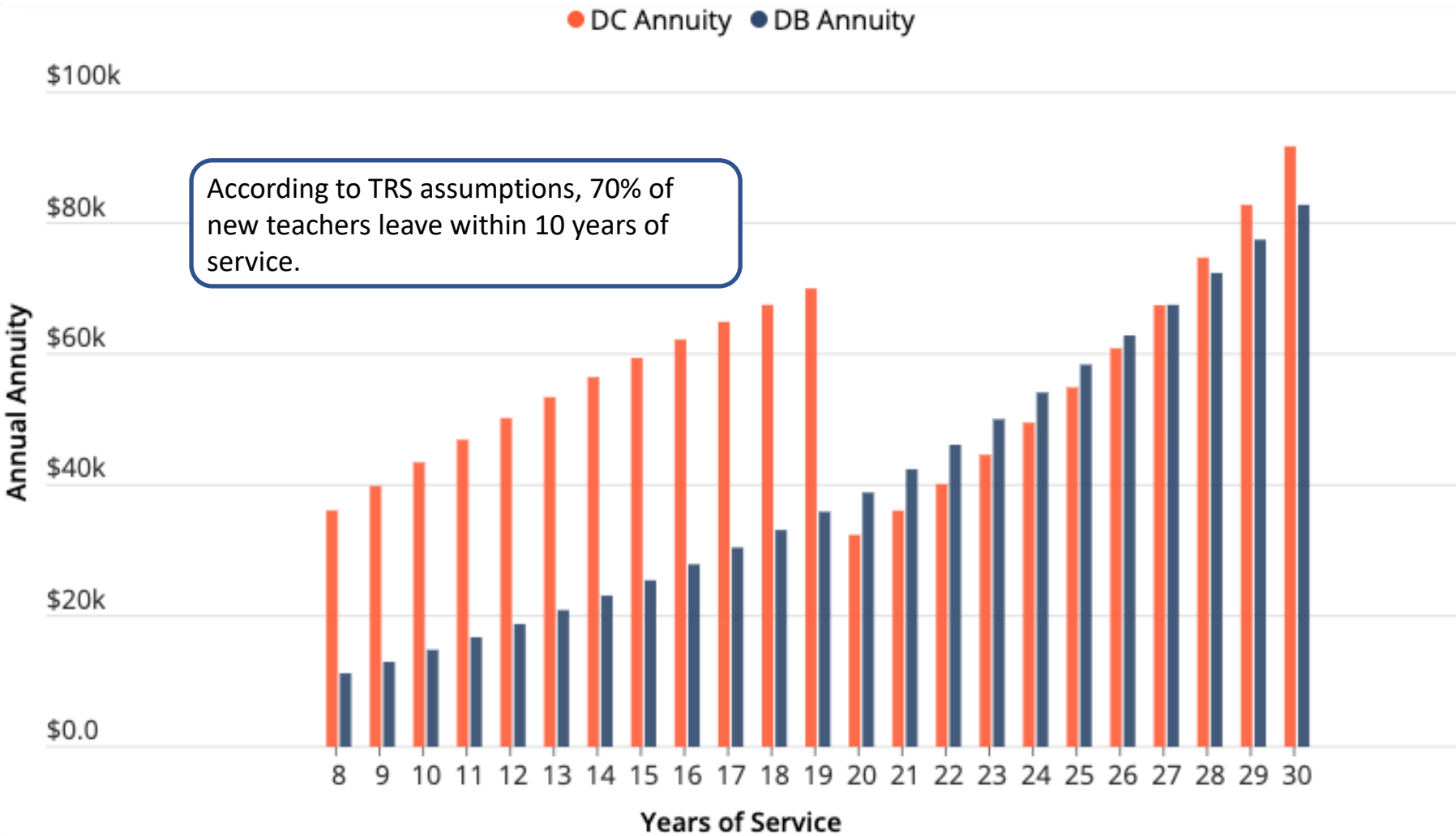


Source: Pension Integrity Project 30-year benefit forecast of Alaska PERS public safety DC & DB plan closed in 2006.  
Analysis uses entry age 30, assumed 7% return, 5.89% annuity payout rate, and 2.75% wage increase rate.



# DB vs DC: Who Does it Benefit?

TRS



Source: Pension Integrity Project 30-year benefit forecast of Alaska TRS DC & DB plan closed in 2006.  
Analysis uses entry age 30, assumed 7% return, 5.89% annuity payout rate, and 2.75% wage increase rate.



# Main Takeaways

- Under a more realistic return scenario:
  - HB 22 / SB 35 could cost the state an additional \$800 million.
  - SB 11 could cost the state an additional \$9.2 billion (PERS & TRS combined).
  - SB 88 could cost the state an additional \$8.6 billion.
- Pensions are not the solution to Alaska's recruitment and retention challenges:
  - Recent polling of young public workers ranks retirement benefits well below other factors like compensation and quality of life offerings.
- DC Rates for public safety could be improved due to shorter careers.
- Granting all employees access to the SBS-AP would make Alaska's pension plans some of the best in the country.
- The current DC plan greatly benefits members who do not work a full career with the same employer.
  - There is a tradeoff here between making sure all Alaskans are best prepared for retirement and the "golden handcuff" of a DB pension.
- These proposals do not include risk-reducing policies to protect Alaska from runaway costs:
  - Minimal cost sharing
  - Not aligned with market expectations
  - No improvements to amortization policies





# Questions?

## Pension Integrity Project at Reason Foundation

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