

**SB**

**220**

<TARGET><BILL>SB 220</BILL><SUBJECT>SB  
220</SUBJECT><COMM>SFIN28</COMM></TARGET>

## **SB 220 – PERS/TRS STATE CONTRIBUTIONS**

Section 1. This section amends the Teachers' Retirement System (TRS) state assistance statute (AS 14.25.085). This statute was enacted in 2008 by SB 125, and currently provides that the state shall appropriate the amount sufficient to fully pay the total past service liability for the year at the employer contribution rate adopted by the Alaska Retirement Management Board (ARMB). In practice, this means that the State appropriates the amount that reflects the difference between the TRS employer contribution rate cap of 12.56% and the actuarial contribution rate to the TRS trust funds. In FY14, this amount was approximately \$317mm.

Section 1 amends AS 14.25.085 to implement the Governor's proposal. Under the Governor's proposal, \$1.1 billion would be appropriated from the constitutional budget reserve to the TRS trust fund, and then from FY16-FY36, an annual flat payment of \$343mm would be appropriated as state assistance.

According to Buck Consultants, the Governor's plan would convert the actuarial approach for TRS from an actuarial ratemaking paradigm to a fixed contribution paradigm. In a ratemaking paradigm, each year the actuary calculates what contribution rate is necessary to pay down the accumulated past service liability. In Alaska, this has resulted in highly volatile employer contribution rates that over the past decade have ranged from 12% to over 70%.

In a fixed contribution paradigm, the rate volatility is eliminated. Instead the annual contribution is fixed. In the case of TRS, the annual contribution is fixed at \$343mm. What can change each year, however, is the term of the amortization. Under the Governor's plan, the initial amortization term is 21 years—fixed payments of \$343mm through FY36. In the event of actuarial losses, the actuary may advise that the amortization term needs to be extended. So if there is a market downturn that results in investment losses in FY18, the actuary may advise that the amortization term must be extended to FY43 in order to fully amortize the TRS unfunded liability.

Conversely, actuarial gains could result in a shortening of the amortization term of less than 21 years. Under the Governor's plan, the length of the amortization term necessary to pay down the unfunded liability will be evaluated each year.

There could be cases where the actuarial loss over a particular period is sufficiently profound that payment of \$343mm over any length of amortization term is insufficient to fully pay off the unfunded liability. In such case, the actuary will assign a date on which the TRS trust fund will exhaust its funds unless the \$343mm annual payment amount is increased. The actuaries call this date the "cross-over" point.

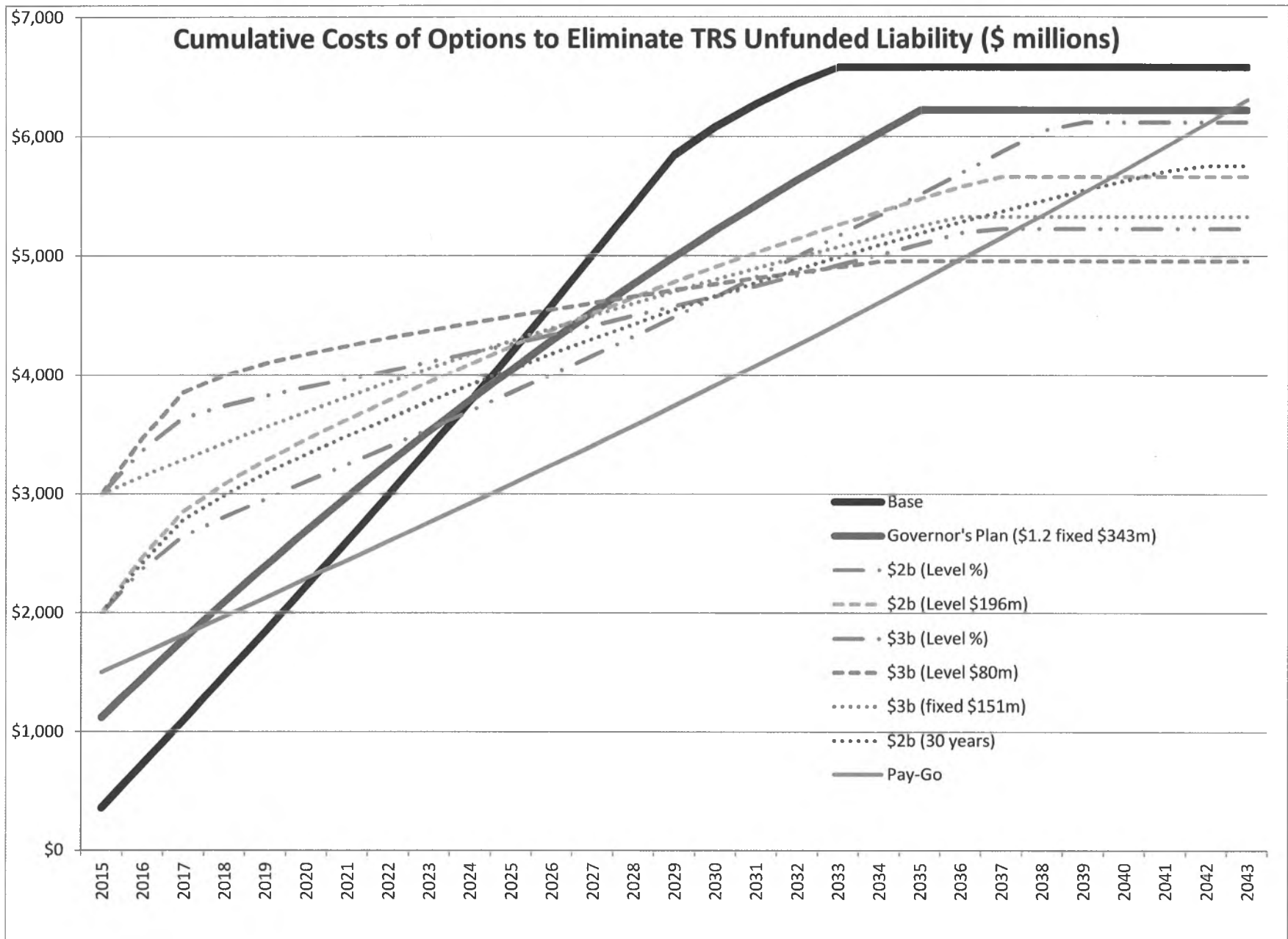
The last new sentence of the amendment to AS 14.25.085 is intended to address situations where a cross-over point is reached. It provides that the state will appropriate an additional fixed amount sufficient to amortize the unfunded liability over a period consistent with actuarial standards.

Section 2. This section implements the same amendment as does section 1, for the Public Employees' Retirement System (PERS) state assistance statute, AS 39.35.280.

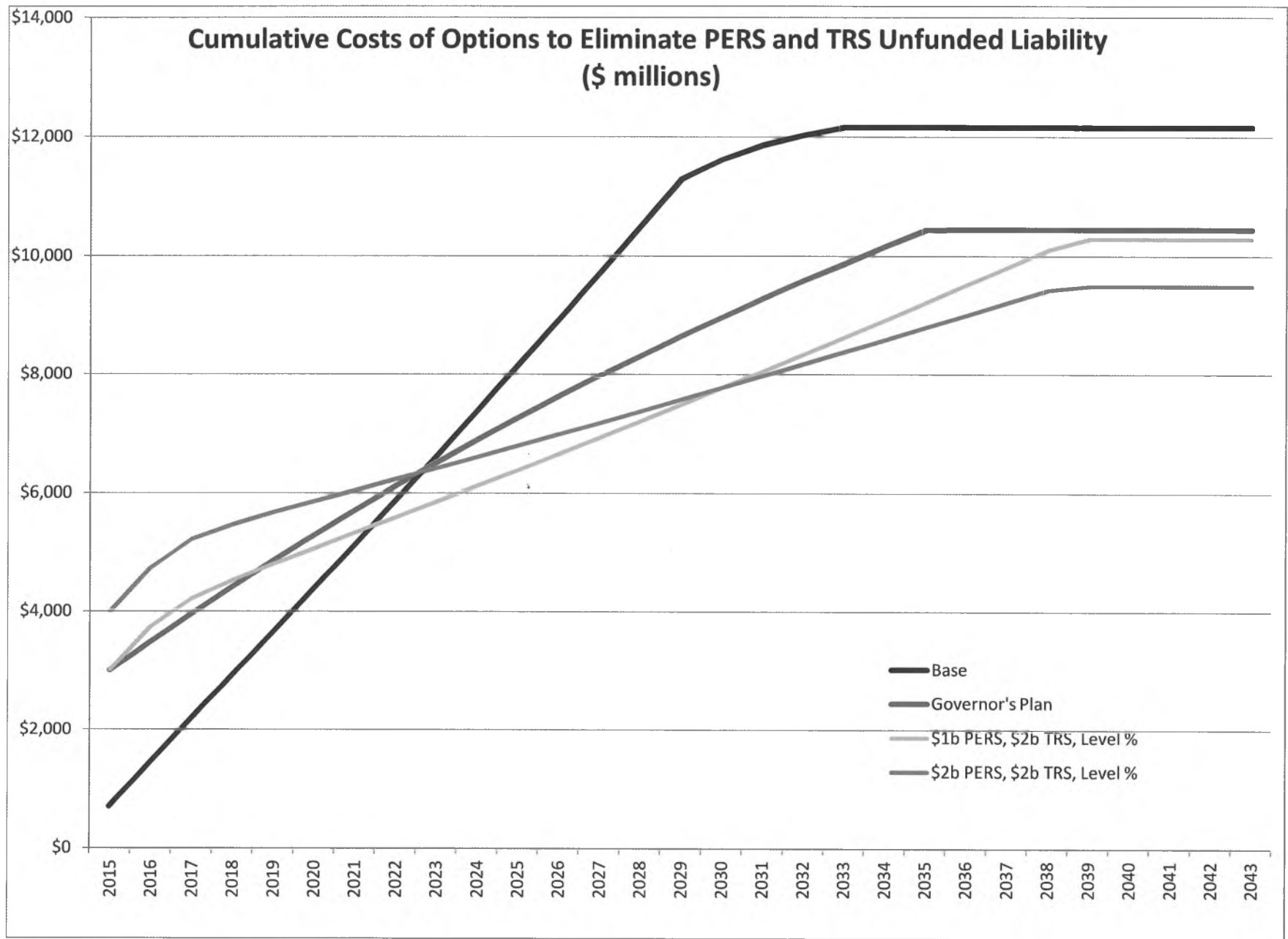
A benefit to making this amendment in the PERS context, is that a fixed contribution paradigm aligns the respective interests of all PERS employers. PERS employers all share in the actuarial gains, through having a shorter amortization schedule, and share in actuarial losses, through having a longer amortization schedule. Under the current version of AS 39.35.280, PERS municipal employers are largely indifferent to the impact of market downturns that create new unfunded liability because their rate does not change, and the State absorbs 100% of the impact of any new unfunded liability. The Governor's proposal cost shares such new unfunded liability in a fair way by extending the amortization term, so that PERS employers pay at the 22% capped contribution rate for a longer period of time.

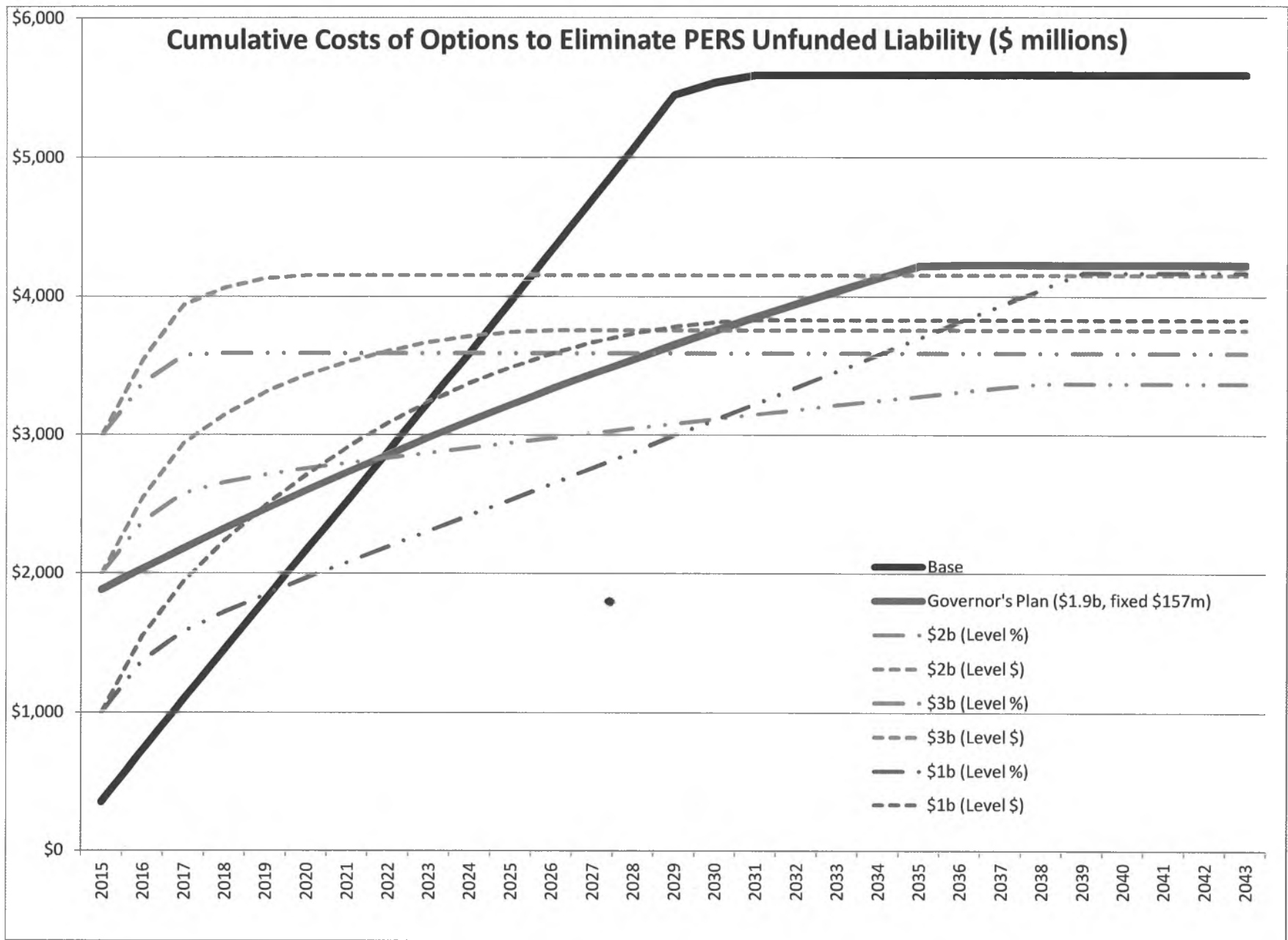
Section 3. This section makes the bill contingent on the enactment of constitutional budget reserve fund appropriations to TRS in the amount of \$1.1 billion, and to PERS in the amount of \$1.9 billion.

Section 4. Establishes the effective date of this act as July 1, 2014.











**PERS Options**

Undiscounted Annual State Assistance											Enter Rate	Discounted Annual State Assistance										
	Base	Gov	5	5								Base	Gov	0	0	1	1	2	2	3	3	
cash	0	1.1	0	0	1	1	2	2	3	3	3.00%			0	0	1	1	2	2	3	3	
method	%	fixed	%	\$	%	\$	%	\$	%	\$	103.00%			fixed	%	\$	%	\$	%	\$	%	
funding Ratio																						
FY15	63%	63%	63%	63%	63%	63%	63%	63%	63%	63%												
FY17	68%	73%	67%	69%	70%	71%	75%	76%	81%	81%												
FY25	87%	80%	73%	80%	75%	84%	80%	86%	85%	90%												
FY35	100%	96%	82%	92%	92%	93%	88%	95%	92%	97%												
FY40	100%	100%	99%	100%	100%	100%	100%	100%	100%	100%												
	<b>6,982,877</b>	<b>5,034,370</b>	<b>6,636,550</b>	<b>4,701,262</b>	<b>5,517,676</b>	<b>4,319,413</b>	<b>3,743,070</b>	<b>3,938,484</b>	<b>3,619,890</b>	<b>4,215,767</b>			<b>5,586</b>	<b>4,224</b>	<b>4,668</b>	<b>3,989</b>	<b>4,167</b>	<b>3,830</b>	<b>3,371</b>	<b>3,757</b>	<b>3,595</b>	<b>4,152</b>
2015	349,686	1,881,370	349,686	519,676	1,000,000	1,000,000	2,000,000	2,000,000	3,000,000	3,000,000	1.000	-	350	1,881	350	520	1,000	1,000	2,000	2,000	3,000	3,000
2016	385,669	157,000	385,669	563,210	385,669	565,882	385,669	565,882	385,669	565,882	0.971	1	374	152	374	547	374	549	374	549	374	549
2017	388,301	157,000	218,740	414,136	218,740	414,136	218,740	414,136	218,740	414,136	0.943	2	366	148	206	390	206	390	206	390	206	390
2018	390,328	157,000	200,568	371,378	155,140	324,912	85,310	228,604	15,481	132,296	0.915	3	357	144	184	340	142	297	78	209	14	121
2019	406,837	157,000	191,186	337,915	140,840	286,762	63,572	180,955	0	75,148	0.888	4	361	139	170	300	125	255	56	161	-	67
2020	412,481	157,000	193,263	315,020	137,691	259,168	51,958	142,996	0	27,104	0.863	5	356	135	167	272	119	224	45	123	-	23
2021	425,201	157,000	196,247	293,045	137,994	236,241	48,151	118,576	0	1,201	0.837	6	356	131	164	245	116	198	40	99	-	1
2022	438,935	157,000	201,294	272,887	140,531	215,433	46,678	97,214	0	0	0.813	7	357	128	164	222	114	175	38	79	-	-
2023	453,913	157,000	206,823	252,430	143,411	195,265	45,950	76,875	0	0	0.789	8	358	124	163	199	113	154	36	61	-	-
2024	470,898	157,000	213,920	232,438	147,644	175,259	46,282	57,328	0	0	0.766	9	361	120	164	178	113	134	35	44	-	-
2025	489,027	157,000	221,347	212,560	152,399	155,441	46,950	37,486	0	0	0.744	10	364	117	165	158	113	116	35	28	-	-
2026	508,109	157,000	229,851	192,914	158,440	136,278	48,333	18,432	0	0	0.722	11	367	113	166	139	114	98	35	13	-	-
2027	527,647	157,000	238,289	171,994	163,935	115,221	49,657	0	0	0	0.701	12	370	110	167	121	115	81	35	-	-	-
2028	547,671	157,000	247,012	150,481	169,558	94,012	50,897	0	0	0	0.681	13	373	107	168	102	115	64	35	-	-	-
2029	567,701	157,000	255,195	127,569	174,882	71,509	51,629	0	0	0	0.661	14	375	104	169	84	116	47	34	-	-	-
2030	138,911	157,000	264,465	104,104	181,177	48,578	52,722	0	0	0	0.642	15	89	101	170	67	116	31	34	-	-	-
2031	81,562	157,000	273,831	80,265	186,986	24,529	53,909	0	0	0	0.623	16	51	98	171	50	117	15	34	-	-	-
2032	0	157,000	284,251	56,218	194,119	787	55,767	0	0	0	0.605	17	-	95	172	34	117	0	34	-	-	-
2033	0	157,000	294,533	30,242	200,950	0	56,577	0	0	0	0.587	18	-	92	173	18	118	-	33	-	-	-
2034	0	157,000	304,588	2,780	207,262	0	57,341	0	0	0	0.570	19	-	90	174	2	118	-	33	-	-	-
2035	0	157,000	315,159	0	213,478	0	57,875	0	0	0	0.554	20	-	87	174	-	118	-	32	-	-	-
2036	0	13,000	324,310	0	219,190	0	57,755	0	0	0	0.538	21	-	7	174	-	118	-	31	-	-	-
2037	0	0	332,480	0	223,836	0	56,390	0	0	0	0.522	22	-	-	174	-	117	-	29	-	-	-
2038	0	0	342,042	0	229,196	0	54,958	0	0	0	0.507	23	-	-	173	-	116	-	28	-	-	-
2039	0	0	351,801	0	234,608	0	0	0	0	0	0.492	24	-	-	173	-	115	-	-	-	-	-
2040	0	0	0	0	0	0	0	0	0	0	0.478	25	-	-	-	-	-	-	-	-	-	-
2041	0	0	0	0	0	0	0	0	0	0	0.464	26	-	-	-	-	-	-	-	-	-	-
2042	0	0	0	0	0	0	0	0	0	0	0.450	27	-	-	-	-	-	-	-	-	-	-
2043	0	0	0	0	0	0	0	0	0	0	0.437	28	-	-	-	-	-	-	-	-	-	-

# Example of Rating Criteria

US States			
Broad Rating Factors	Weighting	Rating Sub-Factors	Weighting
Economy	20%	Income	10%
		Industrial Diversity	5%
		Employment Volatility	5%
Governance	30%	Financial Best Practices	15%
		Financial Flexibility/Constitutional Constraints	15%
Finances	30%	Revenues	10%
		Balances and Reserves	10%
		Liquidity	10%
Debt	<u>20%</u>	Bonded Debt	10%
		Adjusted Net Pension Liabilities	<u>10%</u>
Total	100%	Total	100%

- The criteria are not static as each state is unique, and Alaska is in particular different from most other states.
- Additional factors include growth expectations, poverty rates, conservative governance, political polarization, structural imbalance, cash flow borrowing, pension liabilities/funding efforts, borrowing on behalf of local governments

4/12/14

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# PERS/TRS Funding Solution

## Governor Sean Parnell

**Department of Administration**  
**Department of Revenue**

April 2014

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# Agenda

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- **Introduction**  
Angela Rodell, Commissioner  
Department of Revenue
- **Section One: Basic PERS/TRS Facts**  
Mike Barnhill, Deputy Commissioner  
Department of Administration
- **Section Two: Investment Issues**  
Gary Bader, Chief Investment Officer  
Department of Revenue
- **Section Three: Governor Parnell's Proposal**  
Angela Rodell, Commissioner  
Department of Revenue
- **Questions/Discussion**

# Section One

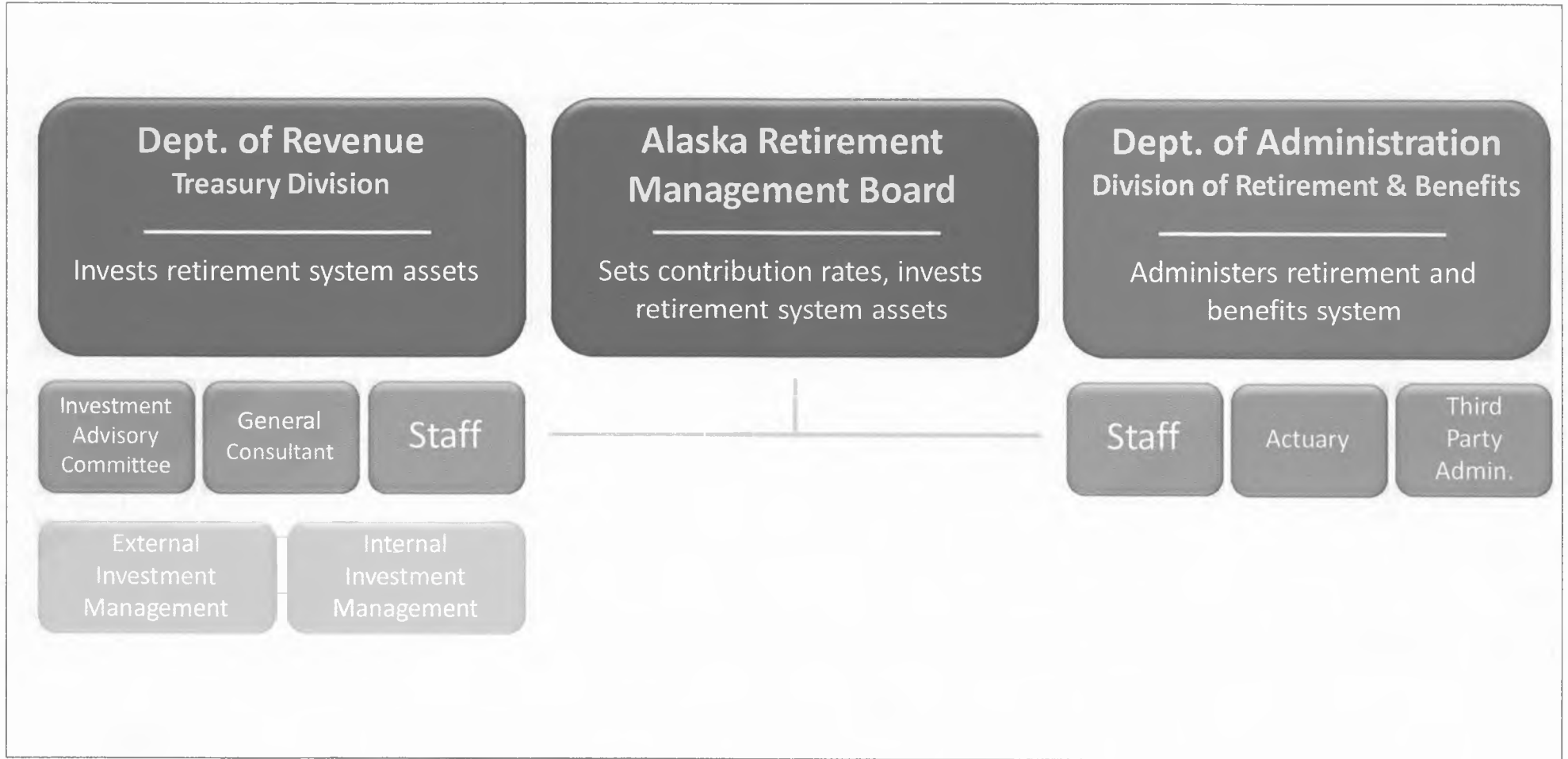
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## PERS/TRS BASIC FACTS

Deputy Commissioner Mike Barnhill  
Department of Administration

# Organization



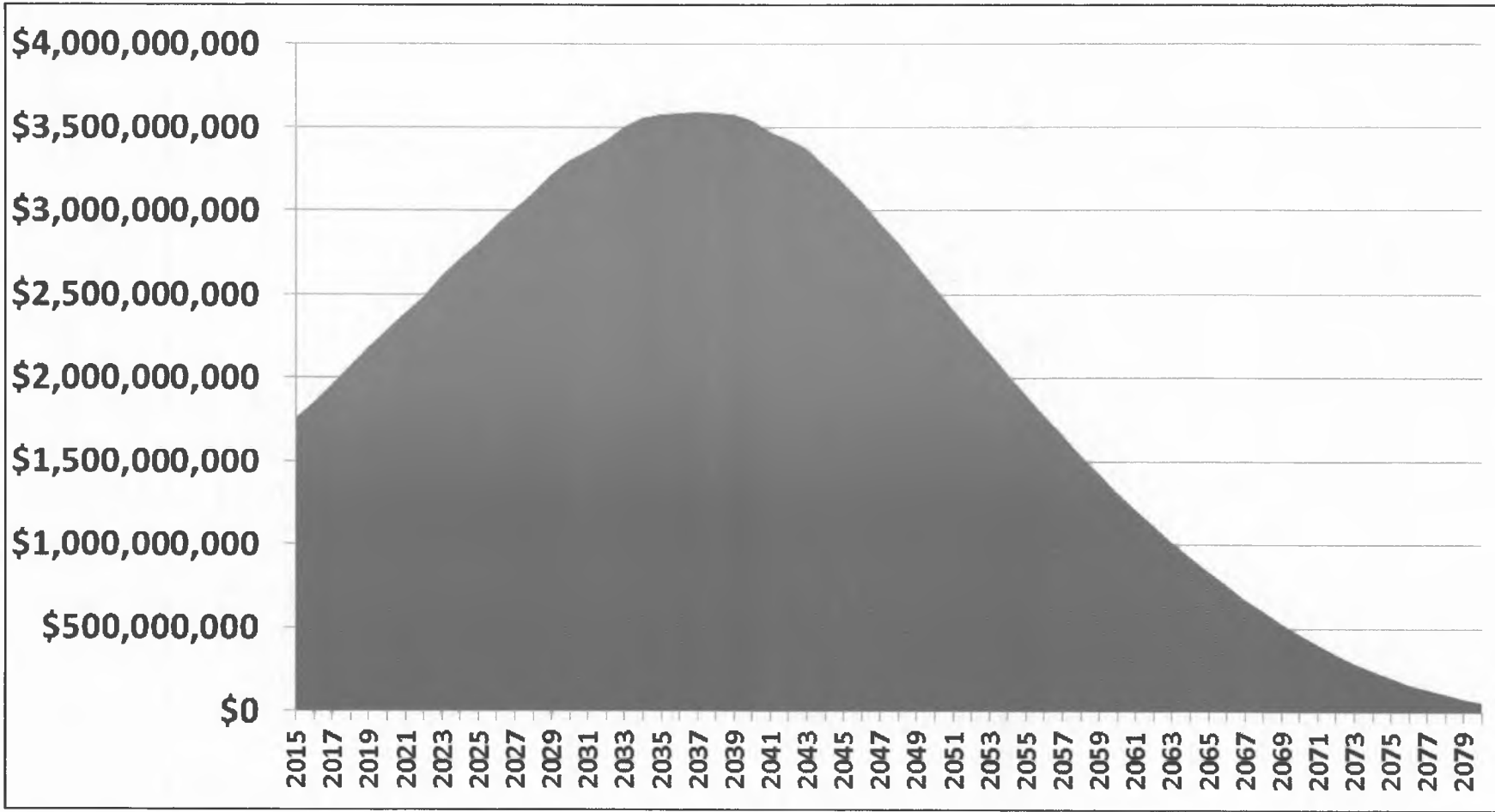
# Membership

## MEMBERSHIP STATISTICS AS OF DECEMBER 31, 2013

	PERS					TRS				JRS	NG	SBS	DCP
	DB		DC			DB		DC					
	Tier I	Tier II	Tier III	Tier IV	TOTAL	Tier I	Tier II	Tier III	TOTAL				
Active Members	3,020	5,645	11,947	15,760	36,372	1,067	5,468	4,201	10,736	74	n/a	28,485	7,685
Terminated Members	2,296	5,139	11,285	7,114	25,834	457	2,570	1,407	4,434	4	n/a	13,881	2,653
Retirees & Beneficiaries	23,094	5,377	1,756	4	30,231	10,442	1,299	-	11,741	108	642	n/a	n/a
Managed Accounts	n/a	n/a	n/a	6,549	6,549	n/a	n/a	1,746	1,746	n/a	n/a	953	918
Retirements - 2nd QTR FY14	133	110	80	n/a	323	17	21	n/a	38	-	25	n/a	n/a
Full Disbursements - 2nd QTR FY14	23	26	133	379	561	12	27	50	89	-	n/a	544	124
Partial Disbursements - 2nd QTR FY14	n/a	n/a	n/a	32	32	n/a	n/a	10	10	n/a	n/a	485	460

Prepared by Division of Retirement and Benefits

# Benefits



**Pay \$136 billion in benefits payments over next 70 years**

**Current PERS/TRS account balance: \$19.9 billion**

**Unfunded Liability: approx \$11.9 billion**

# Defined Benefits

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**Defined Benefit Pension:** fixed benefit amount from date of retirement to death

**Contributions + Investment Earnings = Benefits + Expenses**

IF

Experience equals actuarial assumptions

**Actuarial Assumptions:**

Inflation, Investment Return, Mortality, Date of Retirement, Cost of Healthcare, Payroll Growth, Disability, Spouse Age, Dependent Children, COLA, Plan Expenses, Turnover

*Experience that falls short of projections leads to unfunded liability*

**Employer Takes the Risk**

# Events

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2002 – Milliman actuarial audit; dotcom collapse

2003 – FY 2002 valuations released with revised assumptions.

\$4.1B unfunded liability

2005 – SB 141 enacted: DB plans closed; DC plans created; PERB/TRB/ASPIB sunset; ARM Board created

2007 – ARM Board files suit against Mercer for actuarial negligence; SB 123 enacted: PERS cost share

2008 – SB 125 enacted: employer contribution rates capped; state assistance begins; Great Recession begins

2009 – PERS / TRS investment loss: (20.5%)

2010 – Mercer litigation settled for \$500mm (net \$403mm); other states begin to cut DB benefits, change plans;

2012 – ARMB adopts level dollar amortization; \$11.9B unfunded liability

2013 – 12.5% investment gain; recession over?

# PERS/TRS Balance Sheet

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**PERS DB:**

Assets (actuarial value, 6/30/12)	\$11,832,030,000
Accrued Liabilities (6/30/12)	<u>19,292,361,000</u>
Unfunded Liability	(\$ 7,460,331,000)
Funding Ratio	61.3%

**TRS DB:**

Assets (actuarial value, 6/30/12)	\$4,869,154,000
Accrued Liabilities (6/30/12)	<u>9,346,444,000</u>
Unfunded Liability	(\$4,477,290,000)
Funding Ratio	52.1%

**Total DB:**

Assets (actuarial value, 6/30/12)	\$16,701,184,000
Accrued Liabilities (6/30/12)	<u>28,638,805,000</u>
Unfunded Liability	(\$11,937,621,000)
Funding Ratio	58.3%

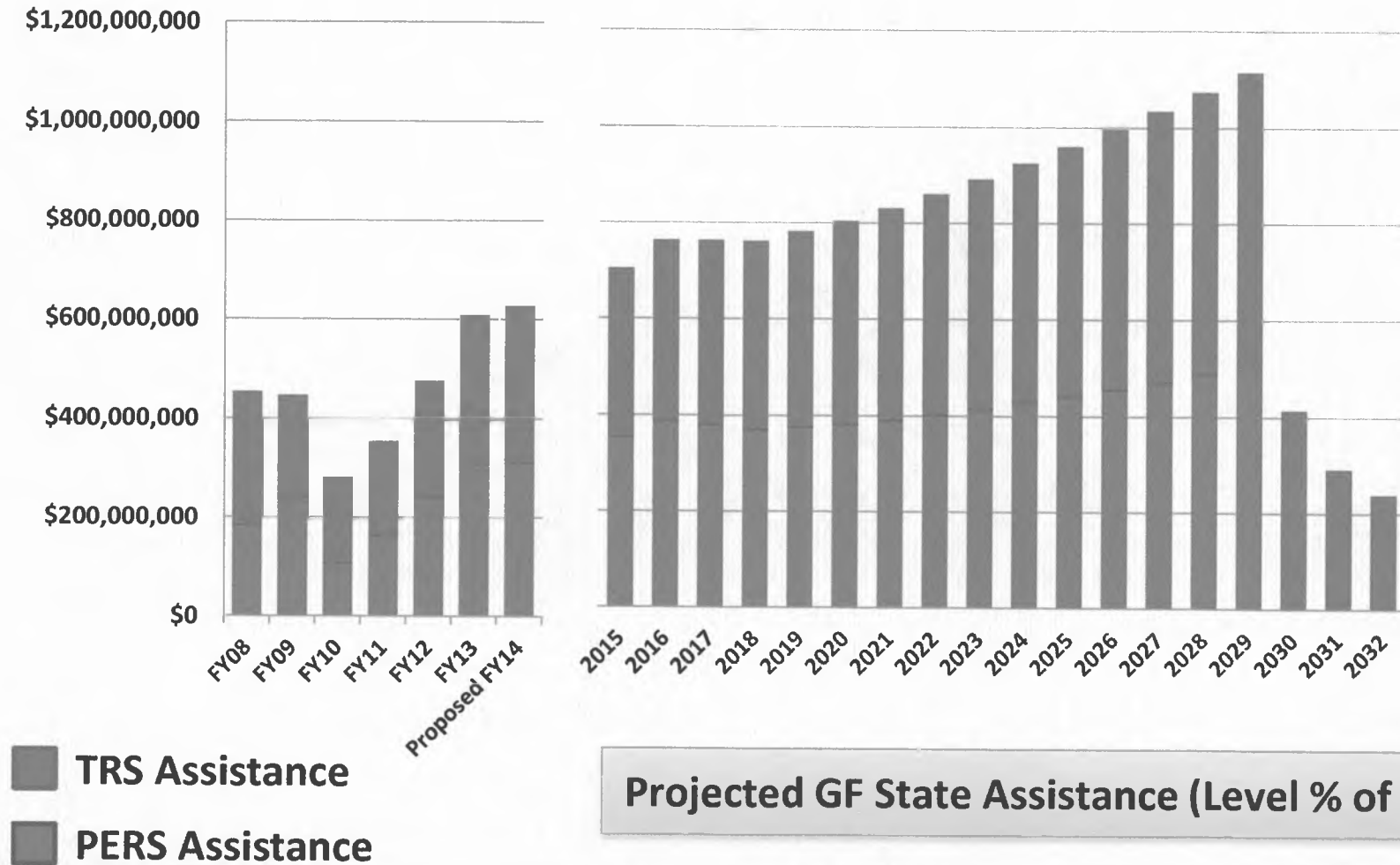
Note: Treasury reports PERS/TRS DB assets of \$20.8B as of February 28, 2014.

Source: Buck Consultants

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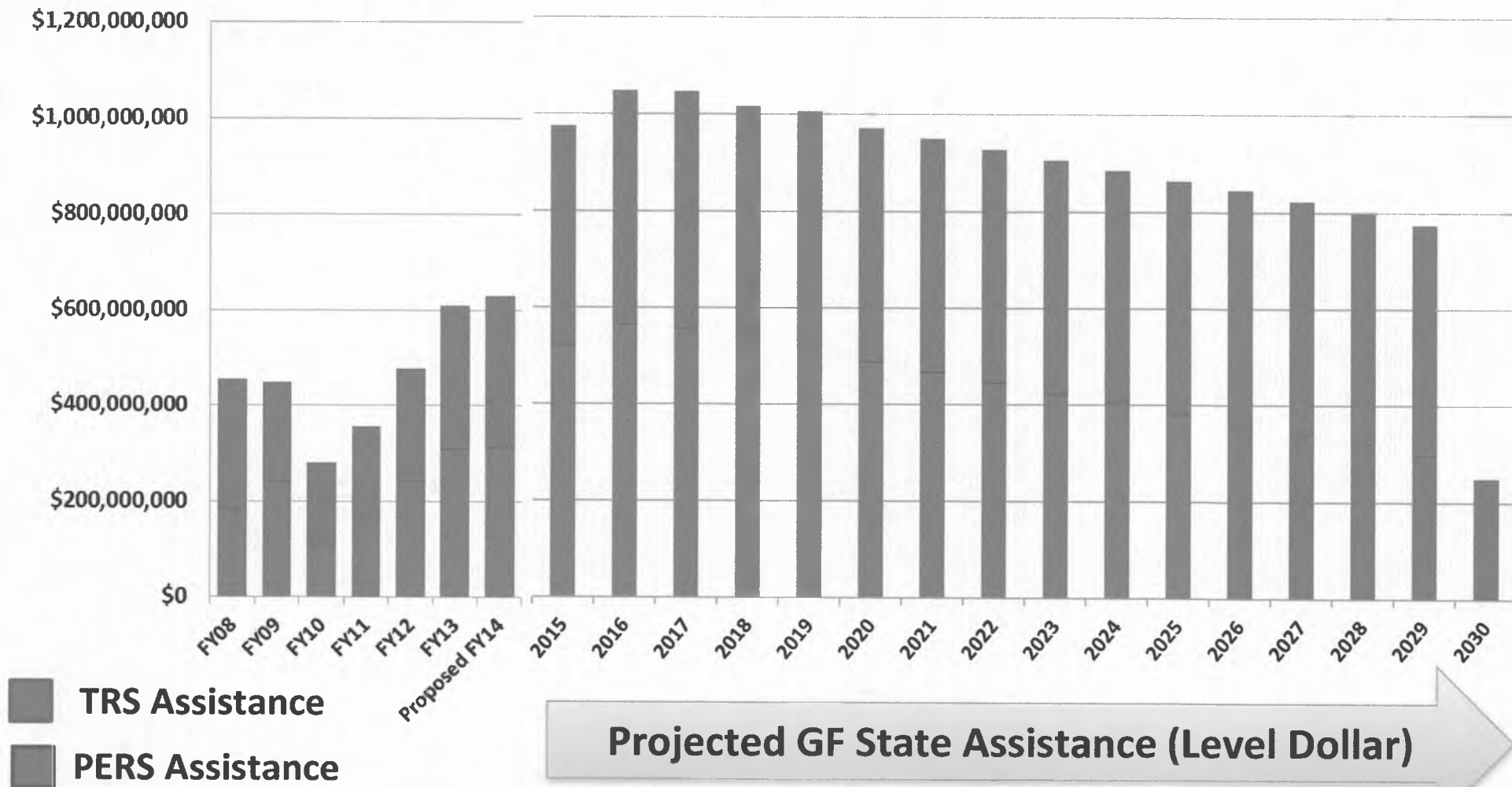
# PERS/TRS Approaches to Unfunded Liability

## PERS/TRS GF State Assistance (SB125)



# PERS/TRS Approaches to Unfunded Liability

## PERS/TRS GF State Assistance (SB125)



# Section Two

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## INVESTMENT ISSUES

Gary Bader, Chief Investment Officer  
Department of Revenue

# Fund Liquidity Analysis

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Although there is a substantial unfunded liability in both the PERS and TRS, there are billions of dollars to pay benefits well into the future.

Benefits payments will increase substantially in the next decade. Unless addressed, the combination of increased benefit payments and insufficient assets in the trusts will require investing in more liquid assets.

# Comparative Returns

As of June 30, 2013 (%)

	PERS/TRS	CBR	APFC
Last Quarter	1.00%	-0.36%	-0.56%
One Year	12.53%	5.73%	10.93%
Three Year	11.09%	6.22%	10.17%
Five Year	3.94%	3.68%	4.15%
Ten Year	6.96%	3.85%	6.83%
July 1, 2001*	5.59%	4.17%	5.85%
July 1, 1991*	7.76%	5.02%	7.74%

- FY1992 is first full fiscal year for which return data available for the CBR Main account (start July 1, 1991).
- FY2002 is first full fiscal year for which data available for the CBR Sub-Account (start July 1, 2001).

# ARMB Private Equity Program

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- Private equity is largely made up of interests in limited partnerships that make equity investments in privately held operating companies
- Private equity is expected to deliver long-term returns in excess of the public markets and to enhance diversification
- To earn higher returns, private equity gives up liquidity
- Performance has been good, generating 10.2% returns through 2013 versus a public market equivalent return of 4.6% for the S&P 500 and 5.1% for the Russell 3000
- The private equity program has generated \$800 million in additional fund value for the ARMB compared to investing in the public equity markets
- The ARMB started investing in private equity in 1998 and now has \$1.7 billion invested across 200+ partnerships; private equity is a 9% asset allocation for the ARMB

# Section Three

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## GOVERNOR PARNELL'S PROPOSAL

Angela Rodell, Commissioner  
Department of Revenue

## Problem: \$11.9 Billion Retirement System Unfunded Liability

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- The Public Employees Retirement System (PERS) and Teachers' Retirement System (TRS) combined unfunded liability is \$11.9 billion
- State Assistance payments to PERS and TRS rise from \$629 million in FY2014 to over \$1 billion per year
- Funding State Assistance solely through the operating budget crowds out funding for other vital public services
- Rating agencies express concern with the increasing liability

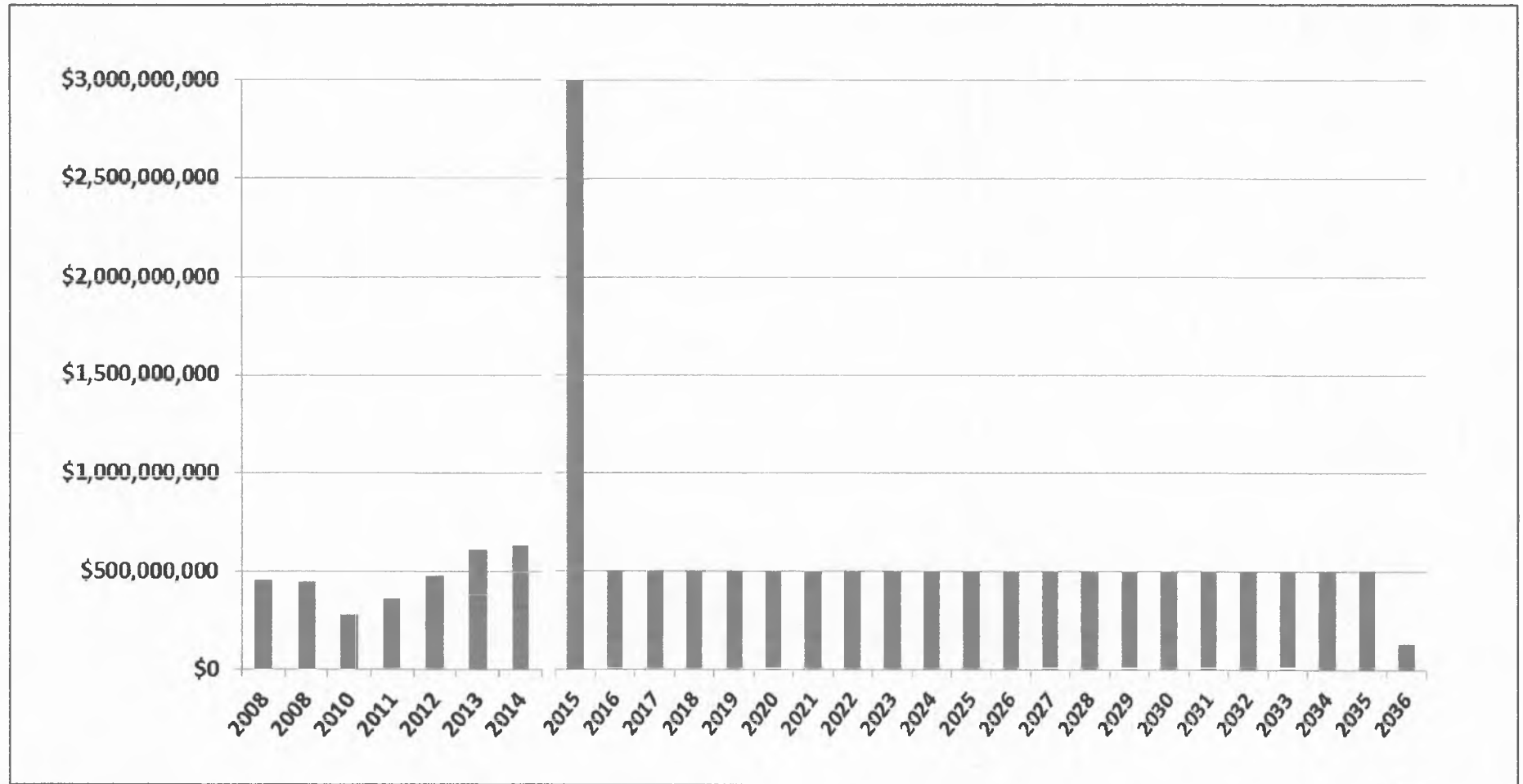
## Proposal: \$3 Billion Investment in Trust Funds

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- Invest a total of \$3 billion in the Retirement Trusts in FY2015:
  - \$1.12 billion – Teachers' Retirement Fund
  - \$1.88 – Public Employees' Retirement Fund
- Funding source: the Constitutional Budget Reserve
- Includes state assistance payments for FY2015
- Beginning FY 2016, State Assistance payments would be fixed at \$500 million annually:
  - \$157 Million – PERS
  - \$343 Million – TRS
- State Assistance projected until FY2036; length of time depends on actuarial gains or losses experienced

# Governor's Proposal



- TRS Assistance
- PERS Assistance

Payments capped at \$500mm per year

# Governor Parnell's Approach

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- Pays down the retirement system debt rather than passing it on to future generations
- A comprehensive and straight-forward approach addressing the problems of both PERS and TRS retirement systems
- Addresses Alaska's biggest budget driver while keeping the State's promise to our retired public servants
- Dramatically reduces future operating budget obligations and provides predictability for future budget planning
- Improves municipal balance sheets and aligns the interest of the State of Alaska with our municipalities by sharing gains and losses
- Addresses the number one credit concern raised by rating agencies
- Improves and strengthens the health of the retirement systems

Thank You

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QUESTIONS?