

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3026



State of Alaska PERS & TRS Combined

Financial Projections ('000 omitted)

Total Assets

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2003 Projection	Actual Growth
1994	6,852,262	7,403,413	7,962,757	8,540,481	9,126,369	9,718,047	10,310,885	10,908,394	11,504,225	12,094,355	6.52%	
1995		7,442,146	7,991,239	8,552,339	9,121,335	9,696,836	10,275,690	10,855,836	11,438,471	12,018,413	6.17%	8.61%
1996			8,130,009	8,746,883	9,390,408	9,932,211	10,467,611	10,991,735	11,524,613	12,068,061	5.81%	8.93%
1997				9,005,532	9,553,907	10,127,253	10,710,618	11,295,186	11,880,566	12,471,231	5.58%	9.54%
1998					10,017,632	10,573,292	11,151,933	11,748,209	12,340,047	12,935,217	5.25%	9.96%
1999						10,831,973	11,402,246	12,011,278	12,619,155	13,215,400	5.10%	9.59%
2000							11,638,773	12,291,658	12,949,182	13,600,013	5.33%	9.23%
2001								12,313,985	12,947,946	13,600,150	5.09%	8.73%
2002									11,101,869	11,493,903	3.53%	6.22%
2003										11,439,566		5.86%
2004												

Total Liabilities

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2003 Projection	Actual Growth
1994	\$ 7,381,591	\$ 7,939,650	\$ 8,521,560	\$ 9,115,400	\$ 9,716,804	\$ 10,324,287	\$ 10,939,115	\$ 11,553,458	\$ 12,164,713	\$ 12,770,934	6.28%	
1995		\$ 7,884,639	\$ 8,456,536	\$ 9,048,884	\$ 9,650,517	\$ 10,259,243	\$ 10,870,257	\$ 11,487,771	\$ 12,100,792	\$ 12,707,516	6.15%	6.81%
1996			\$ 7,920,395	\$ 8,487,521	\$ 9,077,740	\$ 9,682,606	\$ 10,296,517	\$ 10,917,084	\$ 11,537,170	\$ 12,158,936	6.31%	3.59%
1997				\$ 8,854,185	\$ 9,431,123	\$ 10,041,501	\$ 10,664,838	\$ 11,267,255	\$ 11,878,841	\$ 12,495,041	5.91%	6.25%
1998					\$ 9,732,748	\$ 10,300,514	\$ 10,908,027	\$ 11,516,013	\$ 12,105,062	\$ 12,694,397	5.46%	7.16%
1999						\$ 10,369,627	\$ 10,919,801	\$ 11,530,751	\$ 12,135,844	\$ 12,715,143	5.23%	7.03%
2000							\$ 11,575,780	\$ 12,225,797	\$ 12,893,954	\$ 13,546,251	5.38%	7.79%
2001								\$ 12,471,721	\$ 13,052,584	\$ 13,649,550	4.62%	7.78%
2002									\$ 15,271,234	\$ 16,045,872	5.07%	9.51%
2003										\$ 16,397,262		9.27%
2004											5.60%	7.24%

Discount Rate 8.25%
Population Growth 1.00%





Analysis of Valuation
Cumulative Change in Average Employer Contribution Rate
1998 through 2003

Type of Gain or Loss	Impact Years	PERS		
		Weighted Absolute Change	Absolute Change 1998-2003	Payroll Impact (000's)
Assumption Changes	1998, 2000, 2002	(34.19%)	11.15%	\$ (77,050)
Investment Experience	All	(11.62%)	3.79%	\$ (26,190)
Health Experience	2002	(11.28%)	3.68%	\$ (25,430)
Demographic Experience	All	(8.89%)	2.90%	\$ (20,040)
Asset Valuation Method	2000, 2002	(4.42%)	1.44%	\$ (9,951)
Contri Shortfall Due to 2 Year Calculated Rate	2003	(3.37%)	1.10%	\$ (7,601)
102% Funding Ratio Adjustments	1998, 2001, 2003	(2.02%)	0.66%	\$ (4,561)
Ad hoc PRPA	1998 thru 2002	(1.56%)	0.51%	\$ (3,524)
System Benefit Changes	2001, 2002	(0.64%)	0.21%	\$ (1,451)
Salary Experience	All but 2000	6.47%	2.11%	\$ 14,581
Past Service Amortization Change	2002	15.52%	5.06%	\$ 34,966
		100.00%	32.61%	\$ 225,344





PERS Analysis of Valuation
 Cumulative Change in Average Employer Contribution Rate
 1998 to 2003

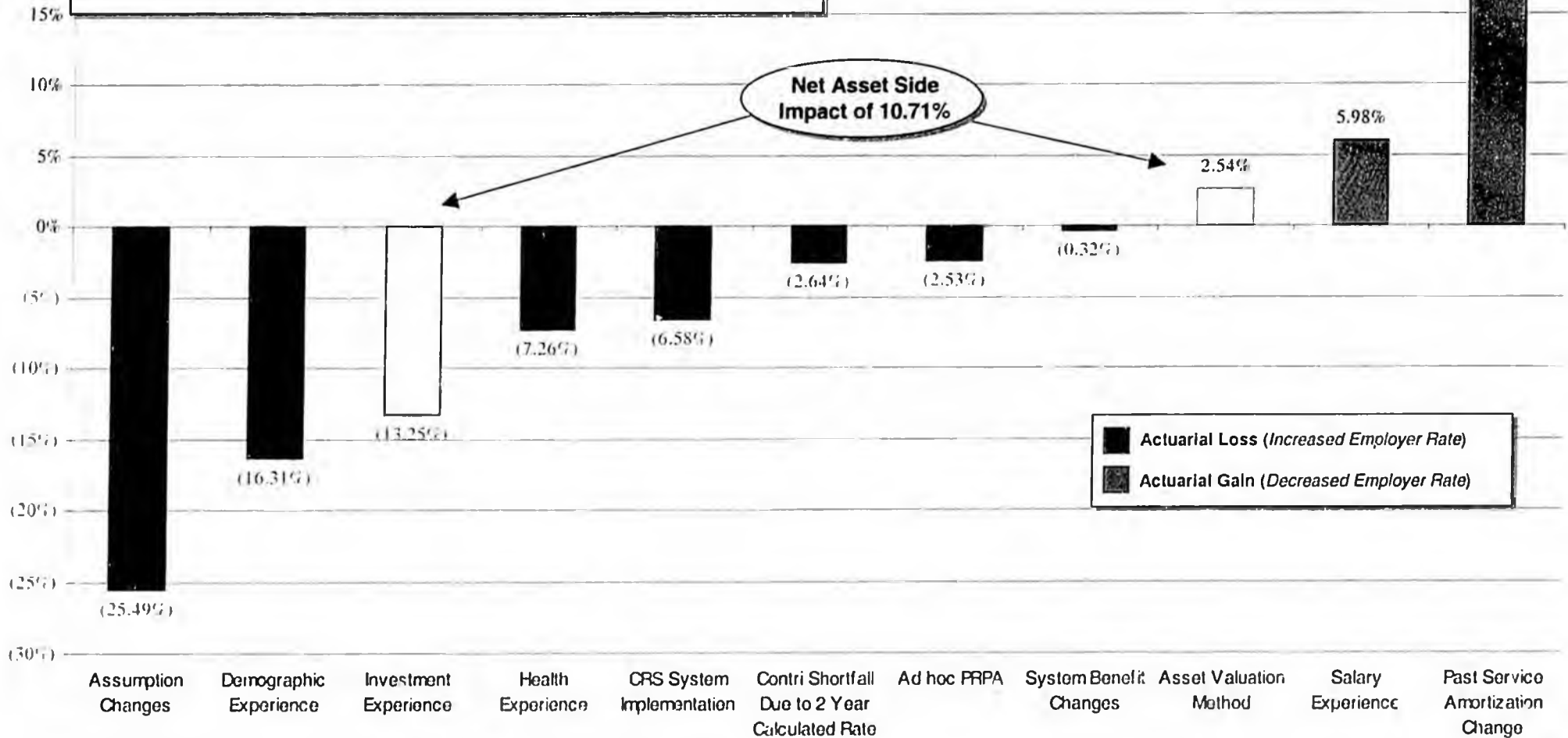
Type of Gain or Loss (as of June 30)	Weighted Absolute Change	Absolute Change	Total	2004	2003	2002	2001	2000	1999	1998
Health Experience	11.28%	3.68%	3.68%		0.00%	3.68%	0.00%	0.00%	0.00%	0.00%
Salary Experience	6.47%	2.11%	(2.11%)		(0.19%)	(0.20%)	(1.03%)	0.00%	(0.23%)	(0.46%)
Investment Experience	11.62%	3.79%	3.79%		0.31%	7.24%	0.11%	(0.12%)	(0.49%)	(3.26%)
Demographic Experience	8.89%	2.90%	2.90%		0.40%	1.21%	0.77%	(0.81%)	0.21%	1.12%
Net Gains & Loss Due to Experience			8.26%	0.00%	0.52%	11.93%	(0.15%)	(0.93%)	(0.51%)	(2.60%)
Asset Valuation Method	4.42%	1.44%	1.44%		0.00%	4.11%	0.00%	(2.67%)	0.00%	0.00%
102% Funding Ratio Adjustments	2.02%	0.66%	0.66%		(0.90%)	0.00%	0.57%	0.00%	0.00%	0.99%
Past Service Amortization Change	15.52%	5.06%	(5.06%)		0.00%	(5.06%)	0.00%	0.00%	0.00%	0.00%
Contribution Shortfall compared to average Employer Calculated rate	3.37%	1.10%	1.10%		1.10%					
Assumption Changes	34.19%	11.15%	11.15%		0.00%	6.98%	0.00%	3.09%	0.00%	1.08%
System Benefit Changes	0.64%	0.21%	0.21%		0.00%	0.04%	0.17%	0.00%	0.00%	0.00%
Ad hoc PRPA	1.56%	0.51%	0.51%		0.00%	0.14%	0.06%	0.07%	0.04%	0.20%
Total Non-Recurring Changes	100.00%	32.61%	10.01%	0.00%	0.20%	6.21%	0.80%	0.49%	0.04%	2.27%
Composite (Gain) or Loss During Year				0.00%	0.72%	18.14%	0.65%	(0.44%)	(0.47%)	(0.33%)
Beginning Average Employer Contribution Rate				25.63%	24.91%	6.77%	6.12%	6.56%	7.03%	7.36%
Ending Average Employer Contribution Rate				25.63%	25.63%	24.91%	6.77%	6.12%	6.56%	7.03%
Annual Payroll (000's)					1460783	1402686	1360401	1321480	1283549	1235439
Annual Contribution					363881	94962	83257	86689	90233	90928
Yr to Yr Change					268919	11705	-3433	-3544	-695	





(1)

Factors Contributing to TFS Employer Rate Increase*
 (% of Cumulative 1998 to 2003 Rate Increase Attributed to Each Factor)



* TRS Employer Rate increased 25.85% from 13.0% in 1998 to 38.85% in 2003

A Combination of Factors Created Our Present Situation





Analysis of Valuation

Cumulative Change in Average Employer Contribution Rate 1998 through 2003

Type of Gain or Loss	Impact Years	TRS		
		Weighted Absolute Change	Absolute Change 1998-2003	Payroll Impact (000's)
Assumption Changes	2000, 2002	(25.49%)	13.52%	\$ (16,106)
Demographic Experience	All	(16.31%)	8.65%	\$ (10,305)
Investment Experience	All	(13.25%)	7.03%	\$ (8,375)
Health Experience	2002	(7.26%)	3.85%	\$ (4,586)
CRS System Implementation	2001	(6.58%)	3.49%	\$ (4,158)
Contri Shortfall Due to 2 Year Calculated Rate	2003	(2.64%)	1.40%	\$ (1,668)
Ad hoc PRPA	1998 thru 2002	(2.53%)	1.34%	\$ (1,596)
System Benefit Changes	2001	(0.32%)	0.17%	\$ (203)
Asset Valuation Method	2000, 2002	2.54%	1.35%	\$ 1,608
Salary Experience	All but 2002	5.98%	3.17%	\$ 3,776
Past Service Amortization Change	2002	17.12%	9.08%	\$ 10,817
		100.00%	53.05%	\$ 63,197





TRS Analysis of Valuation
 Cumulative Change in Average Employer Contribution Rate
 1998 to 2003

Type of Gain or Loss (as of June 30)	Weighted Absolute Change	Absolute Change	Total	2004	2003	2002	2001	2000	1999	1998
Health Experience	7.26%	3.85%	3.85%		0.00%	3.85%	0.00%	0.00%	0.00%	0.00%
Salary Experience	5.98%	3.17%	(3.17%)		0.10%	(0.11%)	(1.68%)	0.00%	(0.64%)	(0.84%)
Investment Experience	13.25%	7.03%	7.03%		0.43%	15.03%	1.35%	(3.35%)	(3.73%)	(2.70%)
Demographic Experience	16.31%	8.65%	8.65%		1.35%	4.21%	2.66%	(0.91%)	0.80%	0.54%
Net Gains & Loss Due to Experience			16.36%	0.00%	1.88%	22.98%	2.33%	(4.26%)	(3.57%)	(3.00%)
Asset Valuation Method	2.54%	1.35%	(1.35%)		0.00%	0.03%	0.00%	(1.38%)	0.00%	0.00%
CRS System Implementation	6.58%	3.49%	3.49%		0.00%	0.00%	3.49%	0.00%	0.00%	0.00%
Past Service Amortization Change	17.12%	9.08%	(9.08%)		0.00%	(9.08%)	0.00%	0.00%	0.00%	0.00%
Contribution Shortfall compared to average Employer Calculated rate	2.64%	1.40%	1.40%		1.40%					
Assumption Changes	25.49%	13.52%	13.52%		0.00%	6.84%	0.00%	6.68%	0.00%	0.00%
System Benefit Changes	0.32%	0.17%	0.17%		0.00%	0.00%	0.17%	0.00%	0.00%	0.00%
Ad hoc PRPA	2.53%	1.34%	1.34%		0.00%	0.36%	0.16%	0.16%	0.11%	0.55%
Total Non-Recurring Changes	100.00%	53.05%	9.49%	0.00%	1.40%	(1.85%)	3.82%	5.46%	0.11%	0.55%
Composite (Gain) or Loss During Year				0.00%	3.28%	21.13%	6.15%	1.20%	(3.46%)	(2.45%)
Beginning Average Employer Contribution Rate				38.85%	35.57%	14.44%	8.29%	7.09%	10.55%	13.00%
Ending Average Employer Contribution Rate				38.85%	38.85%	35.57%	14.44%	8.29%	7.09%	10.55%
Annual Payroll (000's)					532630	509437	496188	482571	466414	469433
Annual Contribution					189456	73563	41134	34214	49207	61026
Yr to Yr Change					115894	32429	6920	-14992	-11820	





Assumptions:

Demographic Assumptions *Relate to the plan’s populations and how they are expected to change over time*

- Total Turnover Rate
- Retirement Rates
- Mortality Rates
- Disability Rate
- Assumed Retirement Date if Being Age 50

Economic Assumptions *Relate to the expected long-term financial experience of the plan*

- Total Inflation
- Annual Salary Increases
- Annual investment return
- Post Retirement Health Premium Trend

Actuarial Assumptions *In addition to Demographic and Economic Assumptions, the following additional assumptions are inputs in the actuarial analysis*

- Target Funding Ratio
- Spouse’s Age
- Contribution Refund Rates
- Post-Pension Retirement Adjustments
- Marital Status
- COLA – % of retirees receiving
- Dependent Children
- New entrants
- Expenses

Assumption Changes:

As a result of a 2000 experience study in which system experience was compared to actuarial assumptions, a new set of assumptions was adopted in December of 2000. The net effect of the change resulted in an actuarial loss of 3.09% in PERS and 6.68% in TRS.

As a result of the 2002 Actuarial Audit performed by Milliman USA, a new set of actuarial assumptions were adopted effective June 30, 2002. Assumption changes included Health Cost Trends, Mortality, % of Retirees receiving COLA, Turnover Rates, Assumed Retirement Ages. For 2002, changes in the health cost trend assumption only, resulted in an actuarial loss in TRS of 6.84% and in PERS by 6.98%.





Investment Experience:

Adjustments as a result of differences between assumed investment results and actual investment experience (results).

In 2002, the board changed the asset valuation method and immediately recognized a¹ deferred losses. This resulted in an actuarial loss in PERS of 7.24% and in TRS of 15.03%.

Health Experience:

Adjustments as a result of differences between assumed health expenses and actual health experience (costs).

On June 30, 2002, the assumed total blended Health premium was reset to the actual total blended premium for FY03. The resetting increased the total employer contribution rate by 3.85% in TRS and 3.68% in PERS. Going forward, the difference between the assumed rate and the actual rate will be tracked annually and reduced if the gap becomes too wide.

Demographic Experience:

Adjustments as a result of comparing assumptions about the demographic statistics (i.e. population) of the system, with the actual statistics. Factors include - number of active participants, average age of participants, average credited service, number of beneficiaries, number of vested/terminated, etc.

CRS System Implementation:

The Div of Retirement & Benefits implemented a new administrative system (CRS) in 2000 for TRS . The new system provides more accurate data to be used in the annual actuarial valuations. Due to the differences in the data between the old and new systems, there were one-time data adjustments which affected the liabilities calculated for the System. The net effect of these changes was to increase the 2001 employer contribution rate in TRS by 3.49%.

Contribution Shortfall:

2003: An average employer calculated rate are determined 2 years prior to the fiscal year. So the 2003 valuation is setting the FY05 and FY06 rates. When the next year's valuation is finished, the difference between the new calculated rate and the one from the year prior determines the shortfall.





Asset Valuation Method:

PERS:

Prior to 2002, in developing asset valuations, PERS used what's called the corridor method. Investment returns are expected to be equal to the investment assumption of 8.25%. The valuation assets, plus (minus) the outstanding balance of previously amortized amounts, are then compared to a 5% corridor around the market value of assets. Any amount outside the corridor is amortized and applied to the employer contribution rates as a level percentage of the present value of pay over 20 years under the 1% population scenario. For 2000, recognition of additional investment gains outside the corridor resulted in an actuarial gain of 2.67%.

Effective June 30, 2002 - As a result of the Actuarial Audit performed by Milliman USA in 2002, the Board adopted a new asset valuation method. This new smoothing method - recognizes 20% of the investment gain or loss in each of the current and preceding four years. This method is being phased in over the next five years. Due to this change, the accumulated adjustment from the corridor method is now included in the amortization of the unfunded liability. Elimination of the corridor adjustment created a 2002 actuarial loss of 4.11% in PERS.

TRS:

Prior to 2000, in developing asset valuations, TRS used a smoothing technique to smooth over five years the difference between actual and expected return. One purpose was to adopt a method which better accomplished the goal of smoothing volatility in investment returns.

Beginning in 2000, TRS began using the corridor method instead of the smoothing method. The corridor adjustment for 2000 resulted in an actuarial gain of 1.38%.

Effective June 30, 2002 - As a result of the Actuarial Audit performed by Milliman USA in 2002, the Board adopted a new asset valuation method. This new smoothing method - recognizes 20% of the investment gain or loss in each of the current and preceding four years. This method is being phased in over the next five years. Due to this change, the accumulated adjustment from the corridor method is now included in the amortization of the unfunded liability. Elimination of the corridor adjustment created a 2002 actuarial loss of .03% in TRS.





102% Funding Ratio Adjustments:

1998: PERS Board adopted an actuarial method that would target an ultimate funding ratio of 102%. An adjustment is made to the current and projected unfunded accrued liability so that the projected employer contributions to the System will result in an ultimate funding ratio of 102%. The 1998 adjustment created an actuarial loss of 0.99%.

2001: The adjustment for the 102% Target Funding Ratio created an actuarial loss of 0.57%

2003: Effective June 30, 2003, the PERS Board eliminated the requirement that the average employer contribution rate be calculated based on 102% of the system's accrued liability and instead adopted a target ratio of 100%. The change created an actuarial gain of 0.90%.

Ad hoc PRPA

1998: An ad hoc Post Retirement Pension Adjustment (PRPA) was granted which increased benefit payments to many Tier I (hired before July 1, 1990) retirees and producing an actuarial loss to TRS of approx. \$28,954,000 and PERS of \$28,204,000.

1999: An ad hoc PRPA was granted producing an actuarial loss to TRS of \$5,681,000/PERS of \$6,084,000

2000: An ad hoc PRPA was granted producing an actuarial loss to TRS of \$8,410,000 & PERS of \$9,495,000

2001: An ad hoc PRPA was granted producing an actuarial loss to TRS of \$8,226,000 & PERS of \$8,897,000

2002: An ad hoc PRPA was granted producing an actuarial loss to TRS of \$19,456,000 & PERS of \$20,105,000





System Benefit Changes:

2001 - TRS/PERS - Effective June 30, 2001, all retired member over age 60 and all members who retire with at least twenty-five years of membership service become eligible for full System-paid post employment healthcare benefits, regardless of hire date.

2002 - PERS - Effective June 30, 2002: For all Police/Fire member, the number of years for calculation of average monthly compensation is now 3 years; the occupational death benefit for survivors of Police/Fire members is not the greater of 50% of the member's final salary or 75% of the normal retirement benefit the member would have earned had the member survived to normal retirement age; upon reaching normal retirement age, a disabled Police/Fire member now receives the greater of his/her disability benefit or his/her normal retirement benefit.

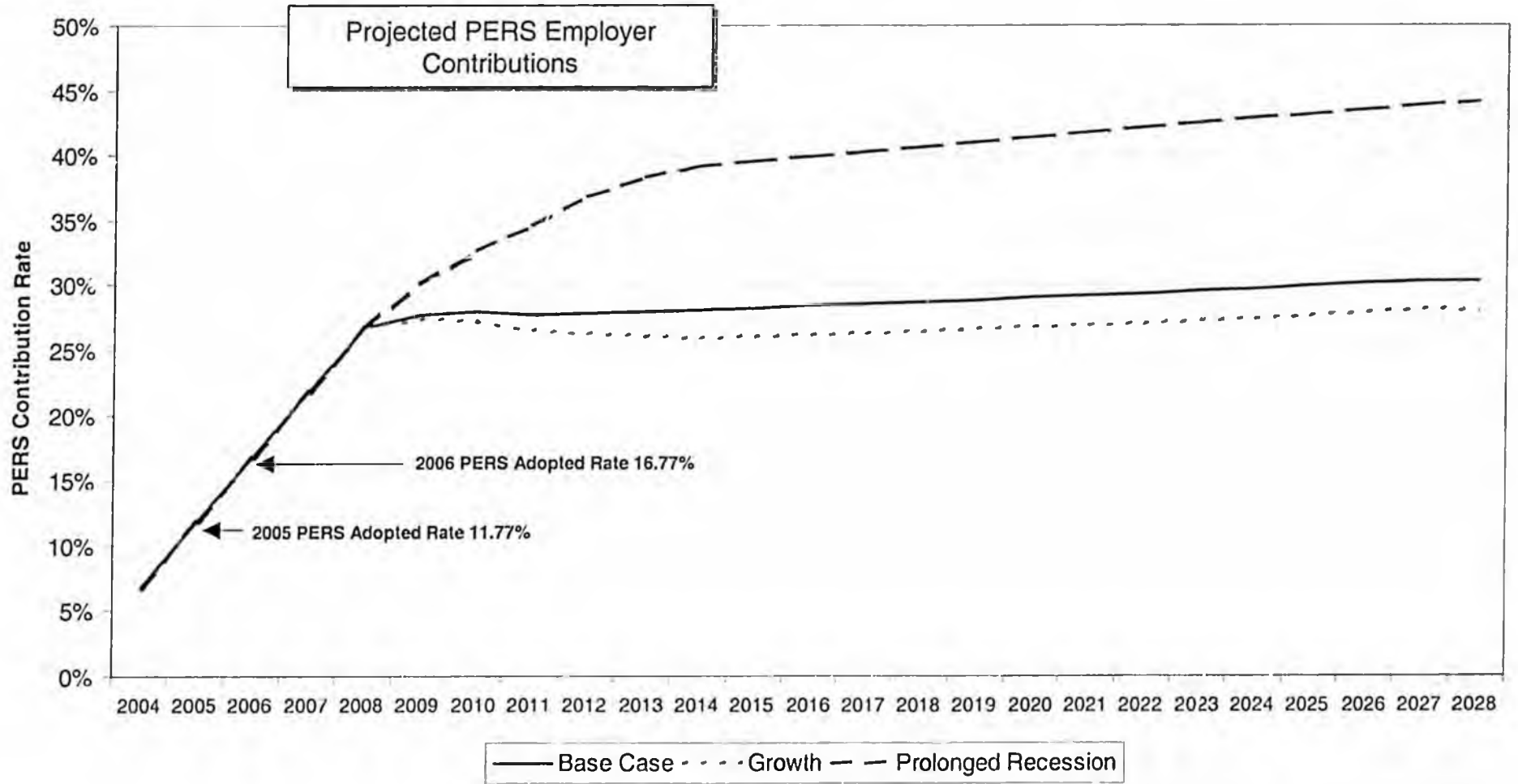
Salary Experience:

Adjustments as a result of differences between assumed salary increases and actual salary experience. For both PERS and TRS, salary increases over the past several years have been less than anticipated which has resulted in net actuarial gains to both systems.

Past Service Amortization Change:

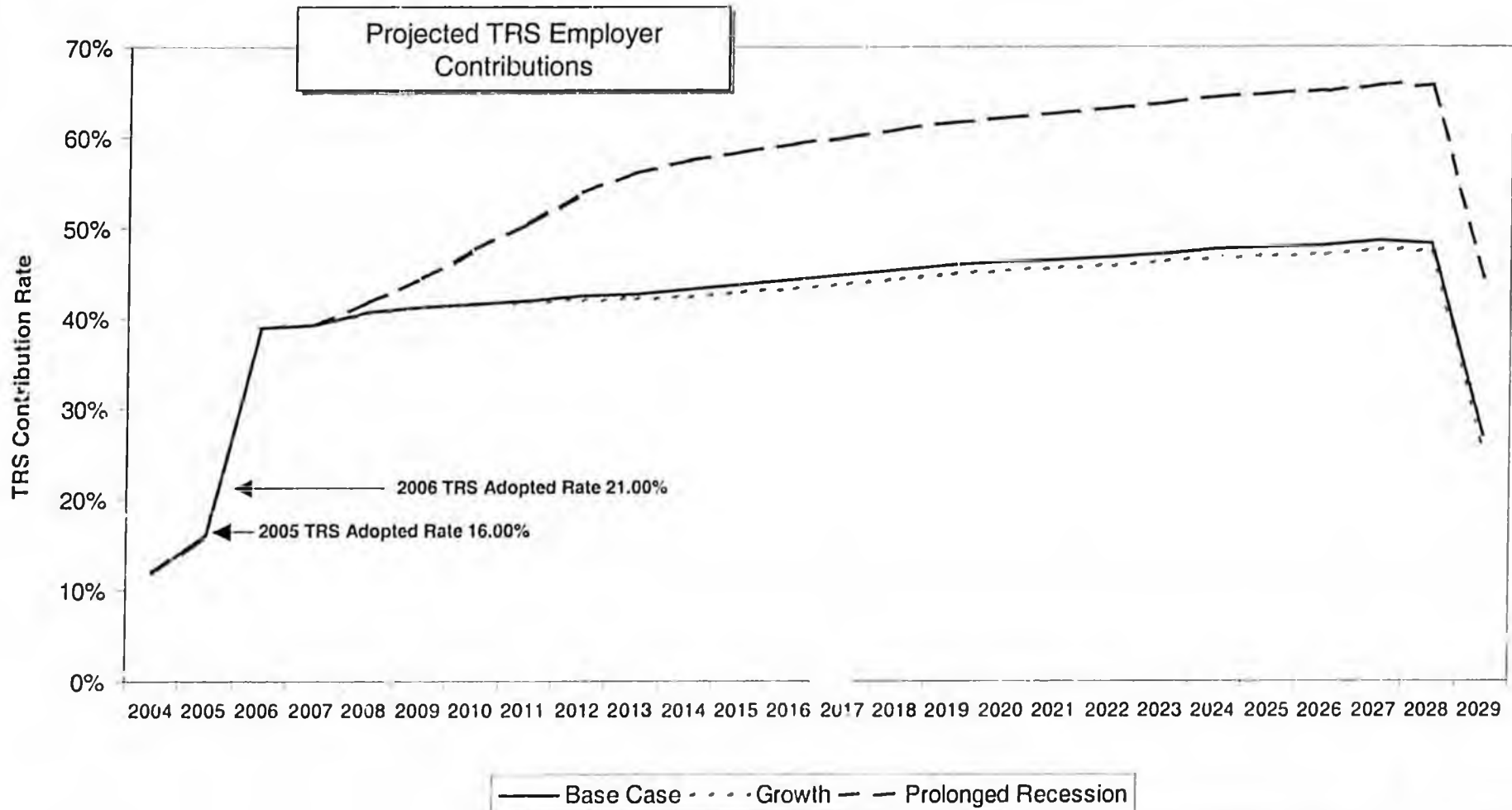
As a result of the 2002 Actuarial Audit performed by Milliman USA in 2002, effective June 30, 2002, the Board adopted a 25-year fixed period level percentage of pay amortization of the Unfunded Accrued Liability. This change is consistent with the 5-year recognition of gains or losses used in the new asset valuation method. The change in the Past Service Amortization methodology caused an actuarial gain in TRS of 9.08% and PERS of 5.06%.





To Catch Up, We're Now Facing Untenable Contribution Rates

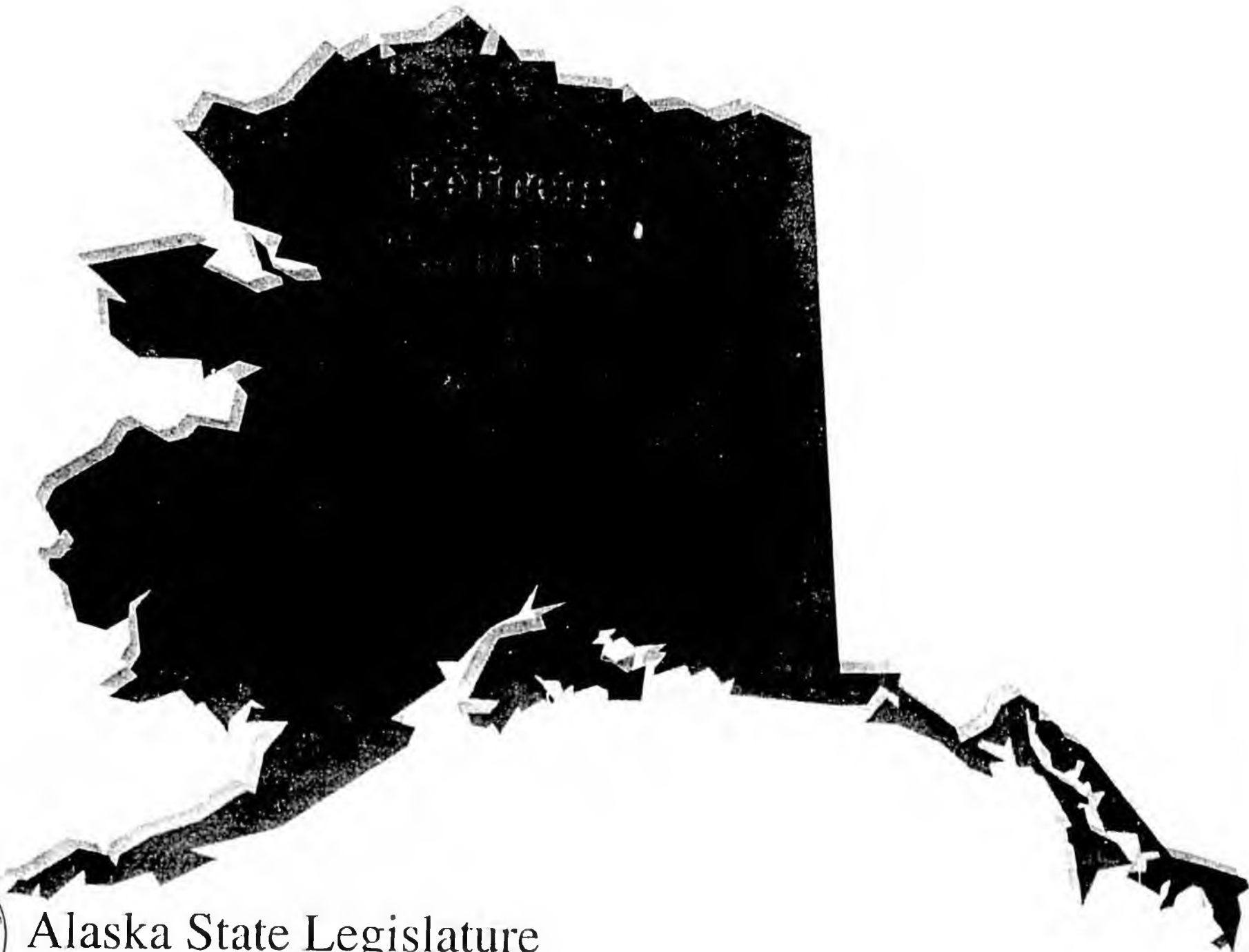




To Catch Up, We're Now Facing Untenable Contribution Rates



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Alaska State Legislature
Senate Finance Committee



SB 141 Walk Through





Our analysis looked at both components of the problem

Structural Component

To Identify the systemic problems in PERS/TRS

Financial Component

To Identify the causes of our liability growth

With the goal of developing solutions

- 1. How do we prevent this from happening again?*
- 2. How can we fix the system and bring it back into balance?*
- 3. How can we better predict and control costs going forward?*

- 1. How can we stabilize future employer contribution rates?*
- 2. How can we provide near term financial relief to employers?*
- 3. How do we develop a long term solution to funding the \$5.0 billion gap?*



We considered the Administration's 2004 Tier Committee work during our analysis and in our solutions

Tier Committee Data Reviewed:

- *Tier Alternative Recommendations*
- *Employer survey*
- *Member focus group results*
- *Benchmarking*
- *Benefit levels*
- *Demographic projections*
- *Implications of Medicare changes*
- *Trends, issues and alternatives*
- *Cost analysis and projections*



Defined Benefit Plan

- *Benefit level is fixed*
- *Benefit is based on a formula involving salary, years of service, age, etc.*
- *Benefit is paid for life and to qualified survivors*
- *Future benefit payments are NOT affected by the plan's funding level*

Examples: PERS & TRS

Defined Contribution Plan

- *Contribution level is fixed*
- *Benefit is based on the amount of money invested and earned in employee's account*
- *Benefit is paid until account runs out*
- *Future benefit payments are driven by investment performance*

Examples: SBS & Deferred Compensation

Defined Benefit (DB) vs Defined Contribution (DC)





Defined Benefit Plan

Advantages:

- *Pooling of longevity risk*
- *Guaranteed income stream*
- *System favors longer-service employees*

Challenges:

- *Employer bears investment risk*
- *Estimation of Liabilities*
- *Rising health costs*
- *Unpredictable or controllable costs*

Defined Contribution Plan

Advantages:

- *Portability*
- *Self-directed investing*
- *Contribution equity among employees*
- *Predictability*
- *Stable costs*
- *Shifting of investment risk*
- *No long-term administrative costs*

Challenges:

- *Workforce management*
- *Employee education*
- *Accurate retirement planning*

Defined Benefit (DB) vs Defined Contribution (DC)





	Current PERS Tier I/II & TRS Tier 1 DB Plan	Current PERS Tier II/III & TRS Tier II DB Plan	Senate Bill 141 DC Plan
PERS Employee Contribution Rate	6.75% other 7.5% Police/Fire 9.6% school district	6.75% or 7.5 Police/Fire 7.5% Police/Fire 9.6% school district	8% all members voluntary % up to IRS limits
TRS Employee Contribution Rate	8.65%	8.65%	8% all members
Vesting	5 years PERS 8 year TRS	5 years PERS 8 year TRS	Immediate for employee contributions Fully vested in employer contributions after 5 years.
Retirement Age	55 normal - 50 early 30 years "all others" 20 Police/Fire 20 Teachers	60 normal - 55 early 30 years "all others" 20 Police/Fire 20 Teachers	Any age
PERS and TRS Benefit Formula	2% up to 2.5% multiplier per year DB multiplier x years of service x high 3 years avg salary	2% up to 2.5% multiplier per year DB multiplier x years of service x high 3 (TRS) or 5 (PERS) years avg salary	11.5% per year to DC account + investment earnings. HRA account accumulated over working lifetime

Overview of New Tier Benefits



	Current PERS Tier I/II & TRS Tier 1 DB Plan	Current PERS Tier II/III & TRS Tier II DB Plan	Senate Bill 141 DC Plan
Medical	<p>Do not have to retire directly from system to be service or age eligible for medical coverage.</p> <p>Medical plan premium paid by retirement system for all retirees and dependents.</p> <p><i>Except</i>, Tier II retirees and survivors pay full premium under age 60.</p>	<p>Do not have to retire directly from system to be service or age eligible for medical coverage.</p> <p>Must have 10 years of service for system-paid coverage over age 60.</p> <p>Employees with less than 10 years pay full premium for access to coverage.</p>	<p>Must retire directly from system with minimum of 10 years of service for medical coverage and access to HRA.</p> <p>Access to medical coverage at age 65 with 10 years of service, or at any age after (1) 25 years for peace officer/firefighter, or (2) 30 years for all others.</p> <p>Retiree and survivors pay full premium until Medicare eligible.</p> <p>After Medicare age eligible, retiree shares cost based on years of service.</p> <p>Reimbursed for qualified medical expenses from HRA.</p>
Normal Cost Rate – PERS	13.24% - Current Normal Cost Rate	13.24% - Current Normal Cost Rate	8.25% - reduces normal cost rate by 38%
<i>unfunded liability portion</i>	12.39% - Past Service Rate	12.39% - Past Service Rate	N/A
Normal Cost Rate – TRS	14.28% - Current Normal Cost Rate	14.28% - Current Normal Cost Rate	8.25% - reduces normal cost rate by 42%
<i>unfunded liability portion</i>	24.57% Past Service Rate	24.57% Past Service Rate	N/A
Future exposure and volatility in investment earnings and increasing medical costs.	Employer bears all the risk.	Employer bears all the risk.	<p>Employer risk is minimal: medical inflation with a capped percentage and shared with employee.</p> <p>Employee bears investment risk.</p>

Overview of New Tier Benefits





“Normal cost” rate comparisons under Public Employees’ Retirement System

	Normal Cost Rates	
	DC Plan	PERS
Medical normal cost rate	3.75%	8.68%
Defined contribution rate	11.50%	11.37%
HRA contribution rate	1.00%	0.0%
Gross normal cost rate	16.25%	20.05%
Member contribution rate	(8.00)%	(6.81)%
Employer normal cost rate	8.25%	13.24%





“Normal cost” rate comparisons under Teachers’ Retirement System

	Normal Cost Rates	
	DC Plan	TRS
Medical normal cost rate	3.75%	9.07%
Defined contribution rate	11.50%	13.90%
HRA contribution rate	1.00%	0.0%
Gross normal cost rate	16.25%	22.97%
Member contribution rate	(8.00)%	(8.69)%
Employer normal cost rate	8.25%	14.28%



SB 141 – Retirement Security Act

SB 141 Walk-through

State of Alaska

Division of Retirement & Benefits

Normal Cost rate and Actuarial Computed Rate from FY 1983 through FY 2006

Valuation report date June 30	Fiscal year of rate	PERS				TRS			
		Normal Cost rate	Actuarial Computed Rate	Board Adopted Rate	Unfunded Liability	Normal Cost rate	Actuarial Computed Rate	Board Adopted Rate	Unfunded Liability
1980	1983	11.46%	13.78%	n	-2.32%	11.95%	16.84%	n	-4.89%
1981	1984	12.03%	13.68%	o	-1.65%	13.51%	17.42%	o	-3.91%
1982	1985	11.36%	13.62%		-2.26%	13.64%	17.96%		-4.32%
1983	1986	11.82%	13.59%	d	-1.77%	13.13%	17.36%	d	-4.23%
1984	1987	12.31%	13.84%	a	-1.53%	13.91%	13.28%	a	0.63%
1985	1988	11.13%	9.55%	l	1.58%	11.62%	13.28%	l	-1.66%
1986	1989	10.20%	9.38%	a	0.82%	9.36%	11.16%	a	-1.80%
1987	1990	9.23%	9.30%	9.30%	-0.07%	9.14%	8.19%	11.64%	0.95%
1988	1991	10.37%	12.00%	12.00%	-1.63%	11.86%	12.27%	10.54%	-0.41%
1989	1992	12.00%	14.20%	14.20%	-2.20%	13.26%	15.16%	11.87%	-1.90%
1990	1993	12.83%	13.58%	13.58%	-0.75%	14.07%	19.65%	12.00%	-5.58%
1991	1994	10.18%	13.72%	13.72%	-3.54%	9.05%	15.59%	12.00%	-6.54%
1992	1995	10.90%	13.70%	13.70%	-2.80%	8.57%	13.36%	12.00%	-4.79%
1993	1996	11.29%	12.82%	12.82%	-1.53%	9.06%	12.48%	12.00%	-3.42%
1994	1997	10.36%	12.14%	12.14%	-1.78%	9.70%	14.96%	12.00%	-5.26%
1995	1998	10.61%	11.90%	8.00%	-1.29%	10.10%	14.94%	12.00%	-4.84%
1996	1999	9.85%	7.74%	7.74%	2.11%	8.97%	10.52%	12.00%	-1.55%
1997	2000	9.89%	7.36%	7.74%	2.53%	9.21%	13.00%	12.00%	-3.79%
1998	2001	8.67%	7.03%	7.40%	1.64%	8.99%	10.55%	12.00%	-1.56%
1999	2002	8.07%	6.56%	6.75%	1.51%	8.88%	7.09%	11.00%	1.79%
2000	2003	10.07%	6.12%	6.75%	3.95%	9.40%	8.29%	11.00%	1.11%
2001	2004	9.53%	6.77%	6.77%	2.76%	10.36%	14.44%	12.00%	-4.08%
2002	2005	13.31%	24.91%	11.77%	-11.60%	14.76%	35.57%	16.00%	-20.81%
2003	2006	13.24%	25.63%	16.77%	-12.39%	14.28%	38.85%	21.00%	-24.57%

Annual Contribution Rate Must Equal Normal Cost Rate





SB 141 – Retirement Security Act

SB 141 Walk-through

State of Alaska Public Employees' and Teachers' Retirement Systems
 Valuation Data as of June 30, 2003 (Actuarial Valuation Tables 1.5(a))
 Projections Going Forward Based on 1% Population Growth

Fiscal Year	PERS					TRS				
	Total Normal Cost Rate	Member Contribution Rate	Employer Normal Cost Rate	One-Half Normal Cost Rate	Change to Employee Cost	Total Normal Cost Rate	Member Contribution Rate	Employer Normal Cost Rate	One-Half Normal Cost Rate	Change to Employee Cost
2006	20.05%	6.81%	13.24%	10.03%	3.22%	22.97%	8.69%	14.28%	11.49%	2.80%
2007	19.80%	6.81%	12.99%	9.90%	3.09%	21.71%	8.69%	13.02%	10.86%	2.17%
2008	19.73%	6.81%	12.92%	9.87%	3.06%	21.72%	8.69%	13.03%	10.86%	2.17%
2009	19.66%	6.81%	12.85%	9.83%	3.02%	21.81%	8.69%	13.12%	10.91%	2.22%
2010	19.58%	6.81%	12.77%	9.79%	2.98%	21.87%	8.69%	13.18%	10.94%	2.25%
2011	19.52%	6.81%	12.71%	9.76%	2.95%	21.90%	8.69%	13.21%	10.95%	2.26%
2012	19.44%	6.81%	12.63%	9.72%	2.91%	21.93%	8.69%	13.24%	10.97%	2.28%
2013	19.38%	6.81%	12.57%	9.69%	2.88%	21.81%	8.69%	13.12%	10.91%	2.22%
2014	19.31%	6.81%	12.50%	9.66%	2.85%	21.94%	8.69%	13.25%	10.97%	2.28%
2015	19.25%	6.81%	12.44%	9.63%	2.82%	22.06%	8.69%	13.37%	11.03%	2.34%
2016	19.26%	6.81%	12.45%	9.63%	2.82%	22.24%	8.69%	13.55%	11.12%	2.43%
2017	19.23%	6.81%	12.42%	9.62%	2.81%	22.44%	8.69%	13.75%	11.20%	2.53%
2018	19.21%	6.81%	12.40%	9.61%	2.80%	22.66%	8.69%	13.97%	11.30%	2.64%
2019	19.24%	6.81%	12.43%	9.62%	2.81%	22.88%	8.69%	14.19%	11.40%	2.75%
2020	19.27%	6.81%	12.46%	9.64%	2.83%	23.05%	8.69%	14.36%	11.53%	2.84%
2021	19.31%	6.81%	12.50%	9.66%	2.85%	23.16%	8.69%	14.47%	11.58%	2.89%
2022	19.36%	6.81%	12.55%	9.68%	2.87%	23.30%	8.69%	14.61%	11.65%	2.96%
2023	19.42%	6.81%	12.61%	9.71%	2.90%	23.60%	8.69%	14.91%	11.80%	3.11%
2024	19.52%	6.81%	12.71%	9.76%	2.95%	23.92%	8.69%	15.23%	11.96%	3.27%
2025	19.63%	6.81%	12.82%	9.82%	3.01%	24.11%	8.69%	15.42%	12.06%	3.37%
2026	19.76%	6.81%	12.95%	9.88%	3.07%	24.27%	8.69%	15.58%	12.14%	3.45%
2027	19.92%	6.81%	13.11%	9.96%	3.15%	24.81%	8.69%	16.12%	12.41%	3.72%
2028	19.86%	6.81%	13.05%	9.93%	3.12%	24.81%	8.69%	16.12%	12.41%	3.72%
2029	19.79%	6.81%	12.98%	9.90%	3.09%	24.82%	8.69%	16.13%	12.41%	3.72%
2030	19.73%	6.81%	12.92%	9.87%	3.06%	24.85%	8.69%	16.16%	12.43%	3.74%
2031	19.68%	6.81%	12.87%	9.84%	3.03%	24.88%	8.69%	16.19%	12.44%	3.75%
2032	19.63%	6.81%	12.82%	9.82%	3.01%	24.92%	8.69%	16.23%	12.46%	3.77%

Information from Mercer Human Resources Consulting

Employee Contribution Greater of Statutory Rate or 1/2 Normal Cost Rate





Refunded Accounts By System

PERS	Tier 1	
	>5	5,251
	3-5	5,292
	<3	31,179
	Tier 2	14,999
	Tier 3	7,667
Total		64,388
TRS	Tier 1	
	>8	388
	6-8	369
	<6	10,008
	Tier 2	2,534
Total		13,299
PERS/TRS Total		77,687

All these members refunded their contributions when they left state service.

However, they can come back, set up their indebtedness, pay off the indebtedness, serve until vested and then get a benefit from the system.

5,639 members are already vested.

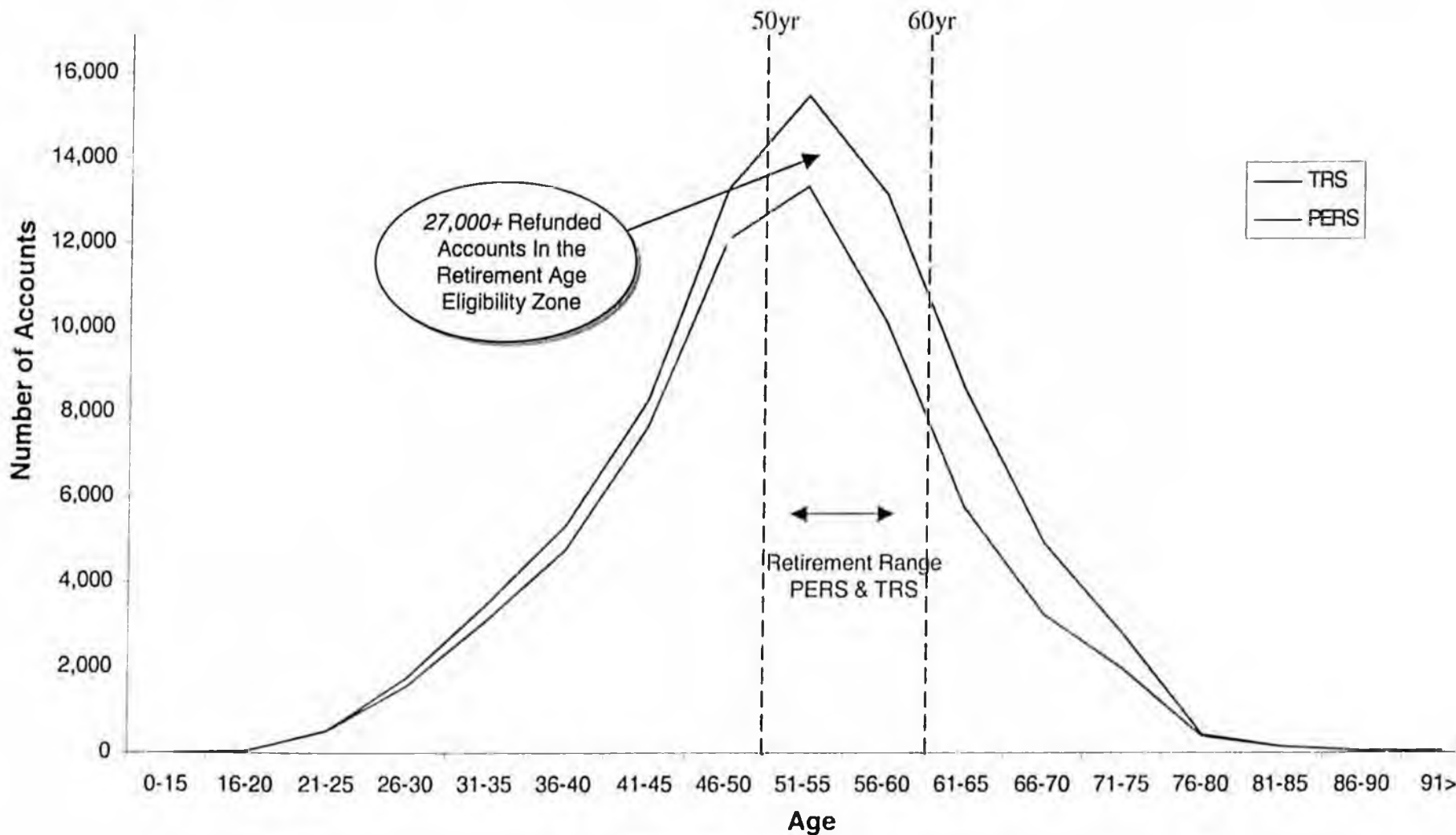
They can be rehired, pay their indebtedness, leave immediately and have 100% system paid medical at retirement.

Refunded Accounts Represent a Looming Liability for the System





Age Distribution of PERS & TRS Refunded Accounts



Refunded Accounts Represent a Looming Liability for the System



Benefit enhancing legislation added **\$37.7 Million** to our *unfunded liability* in 2001 alone

Passed in 2001, HB 242

Enhanced medical benefits to existing employees by providing full system paid medical to retired members over age 60 and all members who retire with at least 25 years of service (TRS & Police/Fire) and 30 years of service (PERS) regardless of hire date.

- When it passed, the bill increased our system liabilities by **\$23.7 Million**
- Using today's health cost trends, that number has grown to **\$37.7 Million**

This Session, there are several new bills that if passed would enrich benefits for existing employees and increase our unfunded liability:

HB 6 – Allowing Fish & wildlife enforcement officers to claim credit as peace officers

HB 40 – Allowing retired peace officers medical benefits after 20 years instead of 25

SB 21 – Adding child or vulnerable adult protection workers to the police/fire employee class

We Need Better Fiscal Analysis Before Enacting Legislation Affecting Benefits





PRPA Awarding History				
PRPA Date	Monthly Benefit Increase			Resulting Actuarial Loss
	PERS	TRS	Total	
1995	Paid in '97	Paid in '97	NA	
1996	Paid in '97	Paid in '97	NA	
1997	\$ 2,289,639	\$ 2,877,374	\$ 5,167,013	
1998	\$ 171,502	\$ 149,500	\$ 321,002	\$ 57,158,000
1999	\$ 163,715	\$ 147,366	\$ 311,081	\$ 11,765,000
2000	\$ 158,034	\$ 133,226	\$ 291,260	\$ 17,905,000
2001	\$ 508,787	\$ 445,192	\$ 953,979	\$ 17,123,000
2002	\$ 585,443	\$ 502,968	\$ 1,088,411	\$ 39,561,000

AdHoc PRPA's Have a Huge Effect on Future Liabilities





PRPA ELIGIBILITY AND CALCULATION

	PRPA Issued	Eligibility Requirements	Calculation
Ad Hoc	July 1st of every year. Members must meet eligibility requirements as of July 1st.	Must be a Tier I PERS or TRS member. (Appx 24,500) Must be a change in the Consumer Price Index (CPI) from date of retirement to date of PRPA issuance.	3 Step calculation: 1) Determine the % difference in the current CPI% less the CPI% at retirement. Multiply the base benefit by this percentage. 2) Determine the 4% c
Automatic	July 1st of every year. Members must meet eligibility requirements as of July 1st.	1) Must be age 60, or 2) have been receiving retirement benefits for 5 yrs (PERS), 8 yrs (TRS), or 3) be receiving disability benefits.	If member meets minimum age or service eligibility, receives 50% of the % change in CPI applied to the base benefit plus any prior PRPAs granted. Disability recipients and members who are age 75 receive 75% of the % of change in CPI.

AdHoc PRPA's Have a Huge Effect on Future Liabilities



Presentation by
Neil Slotnick
D Law
4/1/05

IN THE SUPERIOR COURT FOR THE STATE OF ALASKA
THIRD JUDICIAL DISTRICT AT ANCHORAGE

A. John Gallant, et. al.,)
)
Plaintiff,)
vs.)
)
Public Employees' Retirement)
System, et. al.,)
)
Defendant.)
_____)

Case No. 3AN-02-9748 Civil

ORDER

Plaintiffs are beneficiaries of Alaska's public employee pension system, denominated Public Employees' Retirement System (PERS), or Teacher Retirement System (TRS) for educators. All plaintiffs live outside Alaska or plan to do so. They represent the class of all similarly situated beneficiaries. Their class action lawsuit challenges cost of living provisos, AS 39.35.480 (PERS) and AS 14.25.142 (TRS), which add a ten per cent cost-of-living allowance to the basic monthly benefit of retirees or disabled pensioners residing in Alaska, but not to pensioners residing elsewhere, or to those traveling away from their Alaska residences for more than ninety days. Plaintiffs allege this proviso violates the right to travel and to migrate interstate, in violation of state and federal constitutional guarantees.

The parties have not submitted their constitutional dispute to the court for resolution. Instead, they have stipulated to resolution of the

Distributed 4/1/05 ✓
Presentation by Neil Slotnick

ancillary issue of severability of the allegedly offending residency and physical presence requirements of the respective statutes. Thus, for purposes of the instant cross-motions for summary judgment regarding severability, the State concedes *arguendo* a violation of a protected right to travel.

By way of relief, the Plaintiffs seek a ruling that the cost of living allowance should be severed from the impermissible residency and physical presence requirements, thereby rendering all beneficiaries equally eligible for the supplement, regardless of their locales. They argue this result is required by Alaska's common law of severability. They also argue that the cost of living provisos cannot be invalidated in their entirety if the offending residency and physical presence clauses are deemed non-severable under Alaska common law, the normal consequence of a non-severability finding. This is because Article XII, § 7 of the Alaska Constitution precludes diminishment or impairment of accrued retirement system benefits. Since the ten per cent benefit cannot be eliminated for Alaska residents, and since the constitutionally infirm limitation excluding non-Alaskans is void, the effective result is a constitutionally mandated severance; the residency clause is void, but the benefit grant itself cannot be eliminated.

Plaintiffs intend to seek unspecified past damages for those denied the supplement, presumably reaching backward as permitted by any applicable statute of limitations, and injunctive relief decreeing the

prospective entitlement of all to the supplement. The State, in contrast, seeks a ruling that the demise of the residency and physical presence clauses so implicates the core intent of the enacting legislature that those clauses are not severable; to cure the right to travel violation, the entire ten per cent supplement must fall, as to residents and non-residents alike. The State contends the constitutional accrued benefits clause does not bar this outcome, because of an implied-in law caveat in the employment contracts of the class, to the effect that only those benefits conferred by a constitutional statute are protected from diminishment.

A. IS THE TEN PER CENT SUPPLEMENT AN ACCRUED BENEFIT THAT MAY NOT BE DIMINISHED OR IMPAIRED?

AS 39.35.480 reads in relevant part as follows:

Cost-of-living allowance. (a) While residing the state, a person receiving a benefit under this chapter who is 65 years of age or older or who is receiving a disability benefit is entitled to receive a monthly cost-of-living allowance in addition to the basic benefit. The amount of this allowance shall be \$50 or 10 percent of the basic benefit whichever is greater.

AS 14.25.142 is identical in substance. Article XII, Section 7 of the Alaska Constitution states:

Retirement Systems. Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired.

Participants in the statutorily created PERS and TRS plans have a contractual relationship with their employers. The Alaska constitution's

public employees' benefit clause "equates retirement benefits with contract rights"; statutory retirement benefits are considered a bargained-for consideration, which vest at the time of employment rather than at retirement. Duncan v. Retired Public Employees of Alaska, 71 P.3d 882, 891 (Alaska 2003).

The State, conceding *arguendo* a right-to-travel violation, in effect argues that this violation triggers an implied condition subsequent in the employment contract: the vesting of the ten per cent supplement for resident beneficiaries is impliedly dependent on the outcome of subsequent constitutional litigation. Thus, the Court must determine whether such a condition subsequent is implied in the contract between beneficiaries and their respective employers. Does Alaska's law of contract require such a finding, or does Article XII, § 7 precludes such an outcome independently of the law of contract?

The answer to both questions is implied in the closely analogous case State v. Allen, 625 P.2d 844 (Alaska 1981). There, Alaska voters had repealed, by referendum, an unpopular enhanced pension plan for elected officials. The State, as here, took the position that the statutory overturn triggered a contractual implied condition subsequent, relieving the state of the duty to provide the benefits to already vested public officials, such that Article XII, § 7 no longer applied.

The Alaska Supreme Court disagreed, both on contract and on constitutional grounds. As to the contract argument, the Court held:

The *Restatement* defines "condition subsequent" as a condition which, if it occurs, "will extinguish a duty to make compensation for breach of contract after the breach has occurred."....Because conditions subsequent have the effect of causing a forfeiture of contract rights that are otherwise due and enforceable, they are not favored by the law...Generally speaking, "the intent to create a condition subsequent must appear expressly or by clear implication" if such a condition is to be found. (Id. p. 848, citations omitted).

The Court at that point factored in a constitutional analysis

Further, we share appellees' apprehension that finding a condition subsequent to be implicit in the contract under consideration would undermine article XII, Section 7. We believe that if the possibility of repeal of a law could function as an implicit condition subsequent to a contract formed under that law, the protection of contract rights afforded by article XII, section 7, would be seriously eroded. Even assuming the extreme likelihood of the subsequent repeal of a legislative enactment...we are of the view that article XII, section 7, and AS 01.10.100(a) [stating that repeal of any law does not extinguish rights vested thereunder] preclude the finding of an implicit condition subsequent in the contracts under consideration. Id. at 848-849.

It is scarcely conceivable, in light of the holding of *State v. Allen*, supra., that our Supreme Court would find that Article XII, § 7 permits divestiture of clearly stated contract rights of residential beneficiaries, merely because the constitutional rights of non-resident beneficiaries have been infringed by unequal treatment.

Plaintiffs' Motion for Partial Summary Judgment, on Article XII, § 7 grounds, is styled as a request for a finding of constitutionally required severability. The Court instead grants partial summary judgment on the related rationale that Article XII, § 7 prohibits reduction of the ten per

cent supplement as to class members, while they are Alaska residents. The reason for this limited holding is as follows.

The contract rights of the class derive from the plain meaning of the PERS/TERS statutes. Under the plain wording of those statutes, class members who remain in Alaska have a contract right to the cost of living supplement, and those who depart do not. If all class members are here found entitled to the supplement, that result will flow either from Alaska's common law of severability, to the effect that under certain circumstances unconstitutional language can be excised from a statute, leaving the remainder intact; or from the constitutionally based law of remedies for right to travel violations.

Both Plaintiffs and the State assume in their briefing that a finding that all class members are entitled to the supplement regardless of locale, will necessarily vest that right in all, so that a future legislature could not enact a constitutionally viable cost of living differential applicable to current employees. This Court does not here adopt the mutual assumption of the parties that any relief mandated by common law severability principles or constitutional right to travel remedies, as opposed to contract principles, implicates Article XII, § 7, the contract based no-diminishment clause. The parties have not thoroughly briefed this issue, and the Court takes no position thereon at this time.

B. IS THE ENTIRE CLASS ENTITLED TO THE SUPPLEMENT AS A RIGHT TO TRAVEL VIOLATION REMEDY AS A MATTER OF CONSTITUTIONAL LAW?

In Saenz v. Roe, supra, the United States Supreme Court reviewed a California statute imposing a durational residency requirement on newly arrived citizens, limiting their welfare benefits during the first year of residency to the benefit level of their states of prior residence. The trial court found the statute violative of the federal right to travel, because it "produces substantial disparities in benefit levels and makes no accommodation for the different costs of living that exist in different states", *Id.* p. 494, and decreed that new citizens should receive the full benefits accorded all others. The Supreme Court affirmed that decision.

Similarly, in Alaska Pacific Assurance Company v. Brown, 687 P.2d 264 (Alaska 1984), the Alaska Supreme Court reviewed a statute that reduced workers compensation benefits for out-of-state recipients, based on the lower wage rates prevailing in other states. The Court held that the statute imposed a substantial penalty upon the right of the Plaintiff class to travel outside of Alaska, and that the State had failed to meet its high burden of justification. Therefore, all workers were to be treated the same, and to receive benefits at the Alaska rate.

The PERS/TERS statutes are different in form, though not in substance, because they purport to grant Alaskans a supplement, rather than to deny non-Alaskans a benefit received by Alaskans. Elimination of the COLA statute altogether, as opposed to severance and elimination the residency and physical presence components in order to create a residence neutral supplement, is the state's proposed remedy. The State

argues that this elimination of the supplement for all is mandated by Alaska's common law principles of statutory construction in a severability determination. In fact, both parties focus on the issue of severability as central to this case, and stipulate to resolution of this issue even before predicate issues of constitutionality are definitively resolved.

The Court, however, concludes that severability is largely a moot point in this case. This is because the public retirement benefits clause of the Alaska constitution trumps the common law severability outcome sought by the State. The State wishes that the benefit be obliterated for all; as noted above, Alaska's constitution prevents that outcome. If this Court found that the residency and physical presence clauses were unalterably integral to the statutory scheme, and therefore struck the entire COLA provision, the right to travel violation would be perpetuated, rather than eliminated. The public benefits constitutional clause precludes elimination of vested contract rights; the class has a vested right to the supplement during Alaska residency, but not otherwise; and absent residence-neutral enabling legislation, non-residents would not be entitled to the supplement. Thus, residents would continue to get the supplement, and non-resident would not. The right to travel violation would endure.

On these facts, the form of the statute as conferring a benefit on Alaskans only, rather than as subtracting a benefit from non-Alaskans in

a discrete statutory section that can be surgically struck, cannot compel this Court to engage in a severability determination that could end in a constitutionally impermissible result. The normal outgrowth of a right to travel violation, as illustrated by Saenz and Alaska Pacific Assurance Company v. Brown, supra, is to confer on the non-resident the same benefit received by the resident. This is particularly appropriate where, as here, the non-residents are residual holders of the right in any event; under the statutes, they become re-eligible for the benefit simply by returning to Alaska.

On these unique facts, the constitutionally required remedy for this presumed right to travel violation is a holding that all present employees are entitled to the supplement, unless and until the Alaska legislature enacts a constitutionally permissible cost of living differential applicable to non-residents.

C. ARE THE PERS/TRS RESIDENCY AND PHYSICAL PRESENCE RULES SEVERABLE, SO THAT FUTURE EMPLOYEES ALSO GET THE SUPPLEMENT?

As noted above, present employees and beneficiaries have a constitutional trump card. Those who reside in Alaska, and those who have departed Alaska but elect to return, are constitutionally entitled to the ten per cent supplement, without diminishment. All present employees must be treated equally. Thus, a determination as to severability cannot affect present employees. It can affect future employees, however. If the COLA survives as a residence-neutral

provision, new employees will get the supplement; otherwise, they will not.

Alaska's common law severability standard was announced in Lunden Transport, Inc. v. State, 532 P.2d 700, 713 (Alaska 1975):

The test for determining the severability of a statute is twofold. A provision will not be deemed severable "unless it appears both that, standing alone, legal effect can be given to it and that the legislature intended the provision to stand, in case others included in the act and held bad should fall". (Citation omitted).

The first prong of the test turns upon whether the text remaining when offending provisions are struck makes logical sense on its own. State of Alaska v. Kenaitze Indian Tribe, 894 P.2d 632 (Alaska 1995). Here, the redacted AS 39.35.480 would read:

Sec. 39.35.480. Cost-of-living-a[A]llowance. (a) ~~While residing in the state, a [A]person receiving a benefit under this chapter who is 65 years of age or older or who is receiving a disability benefit is entitled to receive a monthly cost-of-living allowance in addition to the basic benefit. The amount of this allowance shall be \$50 or ten percent of the basic benefit, whichever is greater.~~

~~(b) A person receiving a cost of living allowance under this section shall notify the administrator when the person expects to be absent from the state for a continuous period that exceeds 90 days. After that notification, the person is no longer entitled to receive the monthly cost of living allowance, except that a person may be absent from the state for not more than six months without loss of the cost-of-living allowance if the absence is the result of illness and required by order of a licensed physician. Upon returning to the state, and upon notification to the administrator, the person is again entitled to receive the monthly cost of living allowance, commencing with the first monthly benefit payment made after notification of the person's return.~~

~~(b)(c) While residing in the state, a [A] public employee of the Territory of Alaska who participated in the Public Employees' retirement Act established by ch. 41 SLA 1949, and who retired before June 22, 1981, is entitled to the cost of living [an] allowance equal to 25 percent of the amount received under ch. 41 SLA 1949.~~

~~(d) For purposes of this section, "residing in the state" means domiciled and physically present in the state. Being absent from the state for a continuous period of 90 days or less or six months or less when ordered by a physician does not change a person's status as "residing in the state."~~

With the offending provisions struck, the remainder makes logical sense on its own, affording 65-year-olds and the disabled a supplement.

To paraphrase *Kenaitze*, supra at p. 639, whether the legislature would have intended the subsection as redacted to stand had it known that the residency and physical presence limitations would be held unconstitutional on right-to-travel grounds is a question which cannot be answered with complete confidence. Alaska's generic severability statute, AS 01.10.030, creates a "slight presumption" of severability which, when coupled with the need to preserve an important state interest such as subsistence hunting, has previously carried the day in a severability determination. *Kenaitze*, supra.

The PERS statute includes a statement of legislative purpose, as follows:

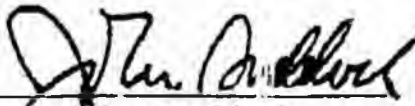
The purpose of this chapter is to encourage qualified personnel to enter and remain in the service of the state or a political subdivision or public organization of the state by establishing a system for the payment of retirement, disability, and death benefits to or on behalf of employees.

The TRS statute has an analogous provision. The State argues that the cost-of-living clauses have a secondary purpose, to encourage benefit recipients to remain in Alaska, not only by affording them the means to remain in a high cost locale, but also by discouraging migration away from Alaska to places "where their benefits, including the COLA, will go further". State's Opposition Memo., p.19. This formulation fails on two grounds. There is no legislative history demonstrating a purpose to discourage egress from Alaska by retirees or the disabled. In fact, such a purpose would be misguided, for the State has no reasonable interest in preventing her aged citizens from moving to warmer and gentler climes, her disabled citizens to superior medical facilities or better sidewalks, her grandparents to the proximity of grandchildren, or her golfers to the links. Such a purpose would not only be malign, it would violate that component of the right to travel affording all citizens free egress, the right to leave. See Saenz v. Roe, 526 U.S. 489, 119 S.Ct. 1518, 143 L.Ed.2d 689 (1999).

The reasonably inferable intent of the legislature in the COLA provision is to afford Alaskans who chose to remain relief from our generally higher cost of living, by reallocating to them a portion of the benefits of those who move to less expensive locales and who can purchase an equal standard of living with a diminished benefit. Maintaining the legislatively envisioned standard of living of Alaska retirees and disabled persons is a goal furthered by severability, and not

by elimination of the benefit, the effect of a finding of non-severability of the unconstitutional provisions. Similarly, the overarching goal of the entire retirement statute, to encourage qualified workers to work for the State, is furthered by retention of the benefit for Alaskans.

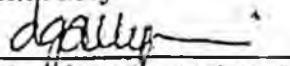
Dated this 4th day of August, 2003 at Anchorage, Alaska.



John Suddock
Superior Court Judge

I certify that on 8-5-03 a copy of this order was mailed to counsel at their address of record.

Ray Brown
John Gaguine
Keith Levy

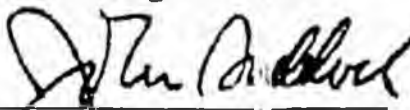


Administrative Assistant

Addendum to Order

Plaintiff's Motion for Partial Summary Judgment to the effect that the residency and physical presence requirements are severable is granted consistently with this opinion.

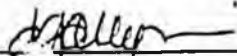
Dated this 7th day of August, 2003 at Anchorage, Alaska.



John Suddock
Superior Court Judge

I certify that on 8-7-03 a copy
of this order was mailed to counsel
at their address of record.

Ray Brown
John Gaguine
Keith Levy


Administrative Assistant

ASPIB Asset Allocation Background

Michael J. O'Leary CFA
Executive Vice President
Callan Associates Inc.

April 6, 2005



Topics

- Firm background
- Asset Allocation Concepts & Practices
 - Modeling approach
 - PERS & TRS
 - Industry perspective
- Current challenge
 - Inflation sensitivity
 - Actuarial discount rate



Callan Associates Inc.

- Independent employee owned pure investment consulting firm serving 289 plan sponsor clients as of 12/31/04.
- 171 employees including dedicated specialists in quantitative modeling, manager research, and performance monitoring
- Largest investment consulting practice serving public funds
 - 88 Public fund clients with aggregate assets of \$692 billion
 - average more than 22 asset liability and 100 asset allocation studies annually
 - last conducted an asset liability study in 2003
 - annually update asset allocation only analysis



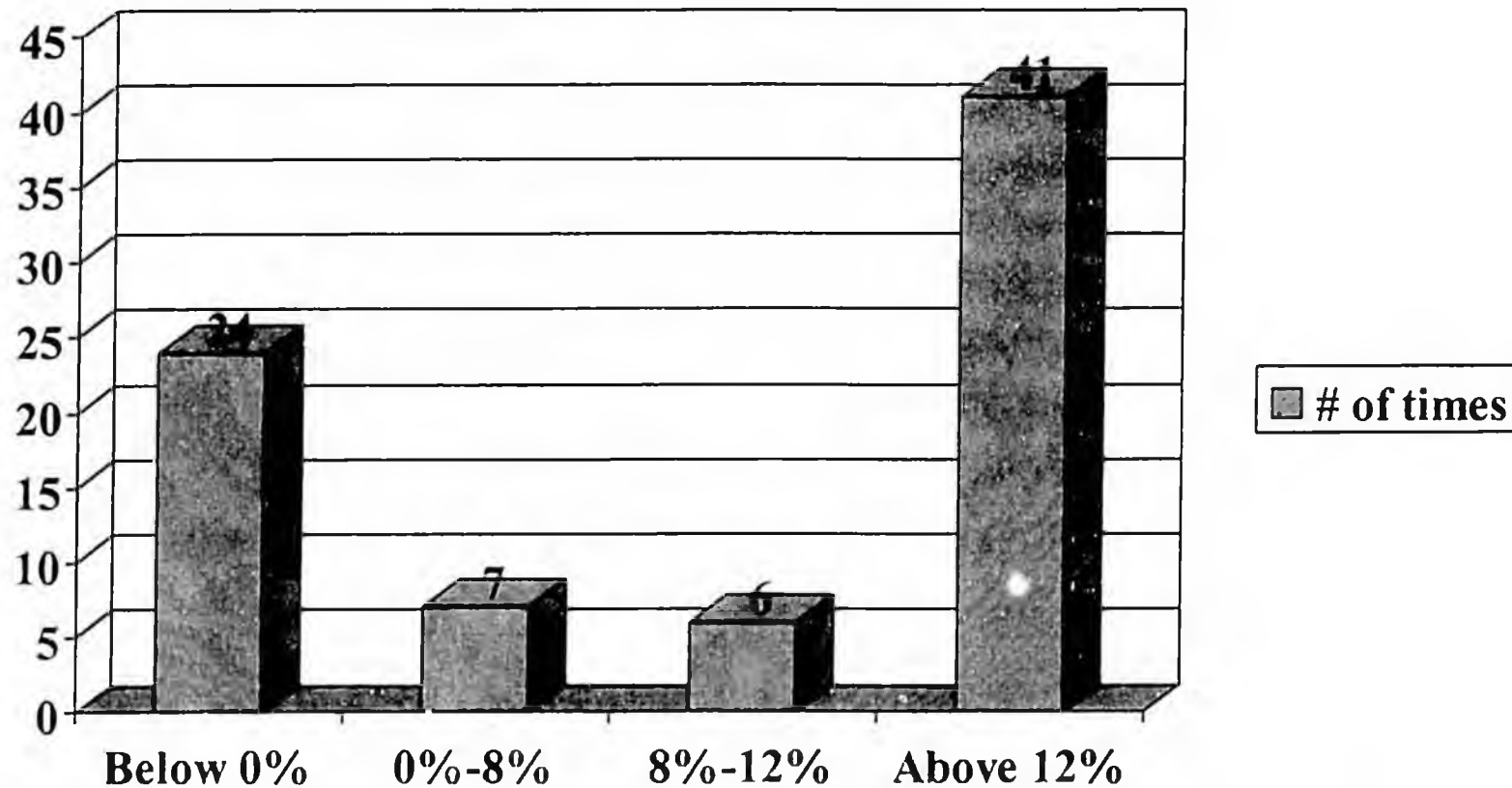
Empirical Evidence

- On average, bearing greater risk has produced greater return.
- Table based on annual returns for 4 asset types (1926-2003):

	Average Rate of Return	Average Risk Premium over T-bills	Standard Deviation
Large Cap Stocks	10.4%	6.5%	23.1%
Small Cap Stocks	12.7%	8.8%	40.1%
LT Corporate Bonds	5.9%	2.0%	7.8%
T-bills	3.9%	0.0%	1.6%



Annual Stock Market Returns 1926-2003



Graph & data obtained from Vanguard web site. Based on data from S&P (1926-1970) and Dow Jones Wilshire 5000 Composite Index (1971-2003). Over the 78 years, stocks were below their long-term average (10.4% plus or minus 2%) in 31 years.



Measuring Risk

- The generally accepted view of risk involves the spread of returns in relation to an average level of performance.
- The average is the arithmetic mean.
- The spread is expressed in terms of standard deviation around the mean return.
- This view assumes all returns can be statistically represented by a normal distribution.
- Risk-adjusted returns are returns adjusted by the standard deviation.



Measuring Risk

An Illustration

Expected Annual Return = 9.0 %

Standard Deviation of Return = 16.9 %

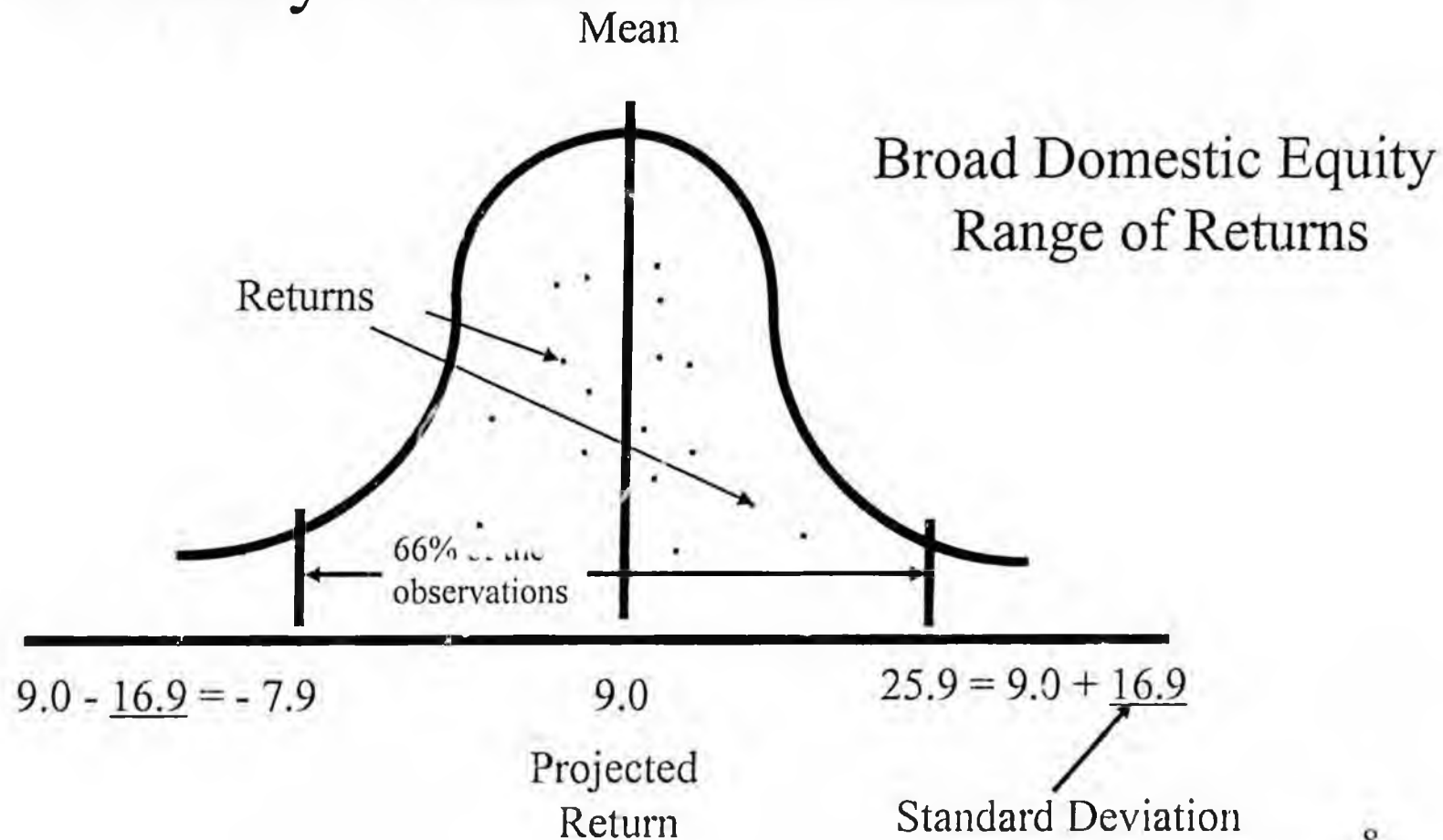
2 out of 3 years, the return is expected to fall within a range of one standard deviation = -7.9 to 25.9%

95% of the time, the return is expected to fall within a range of two standard deviations = -24.8 to 42.8%

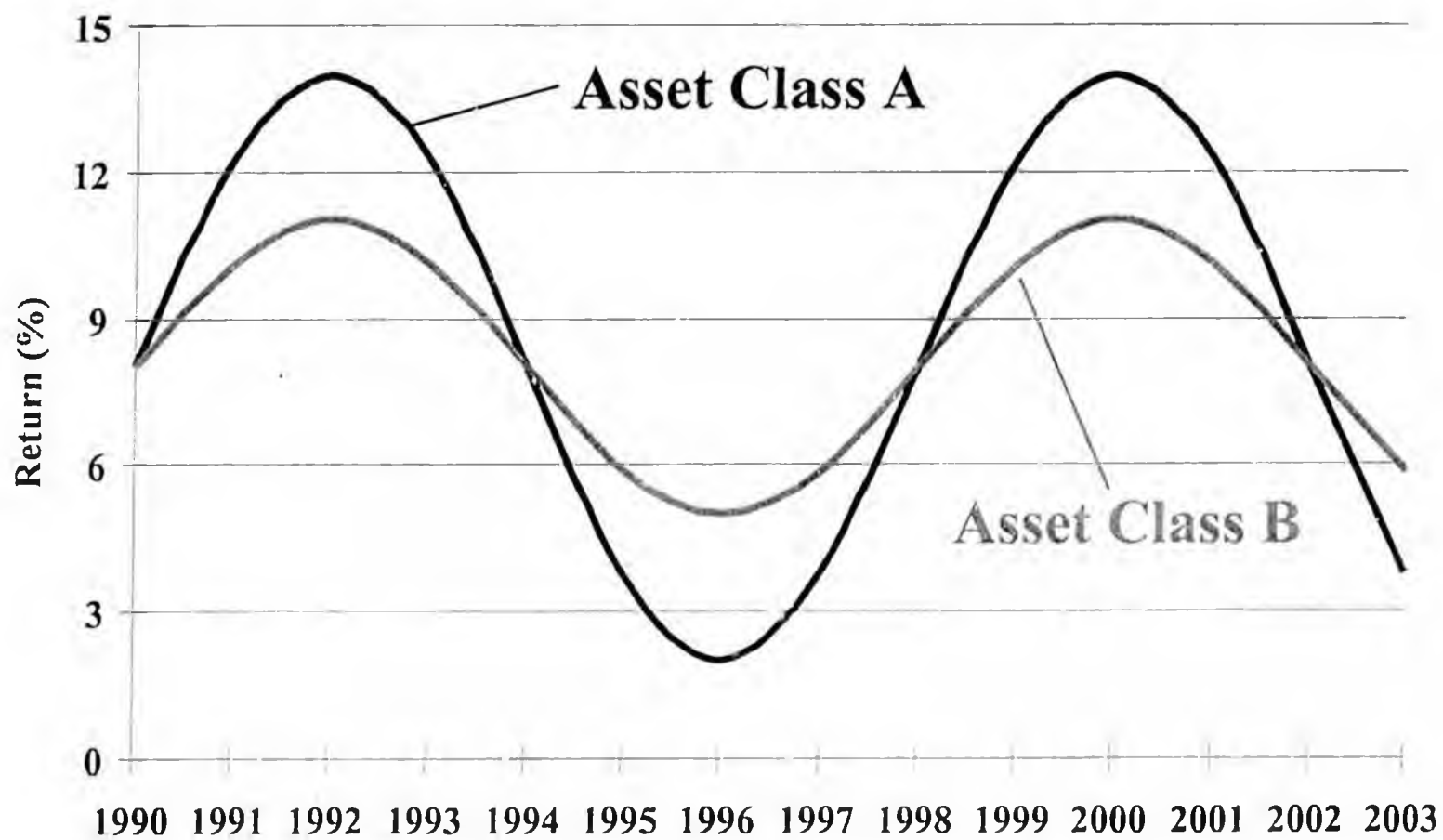


Measuring Risk

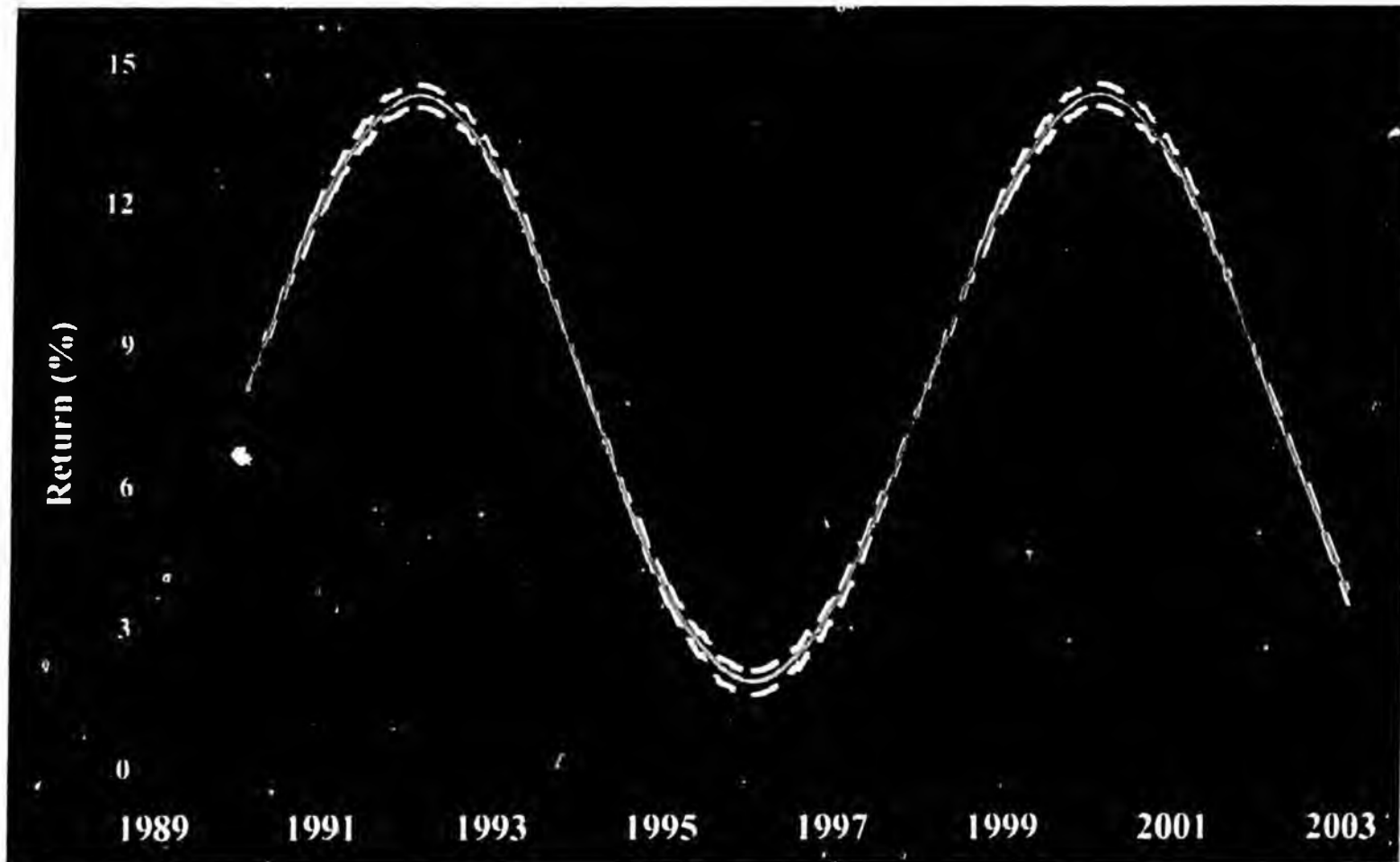
- Standard Deviation - Measures the Variability of Returns from Their Mean



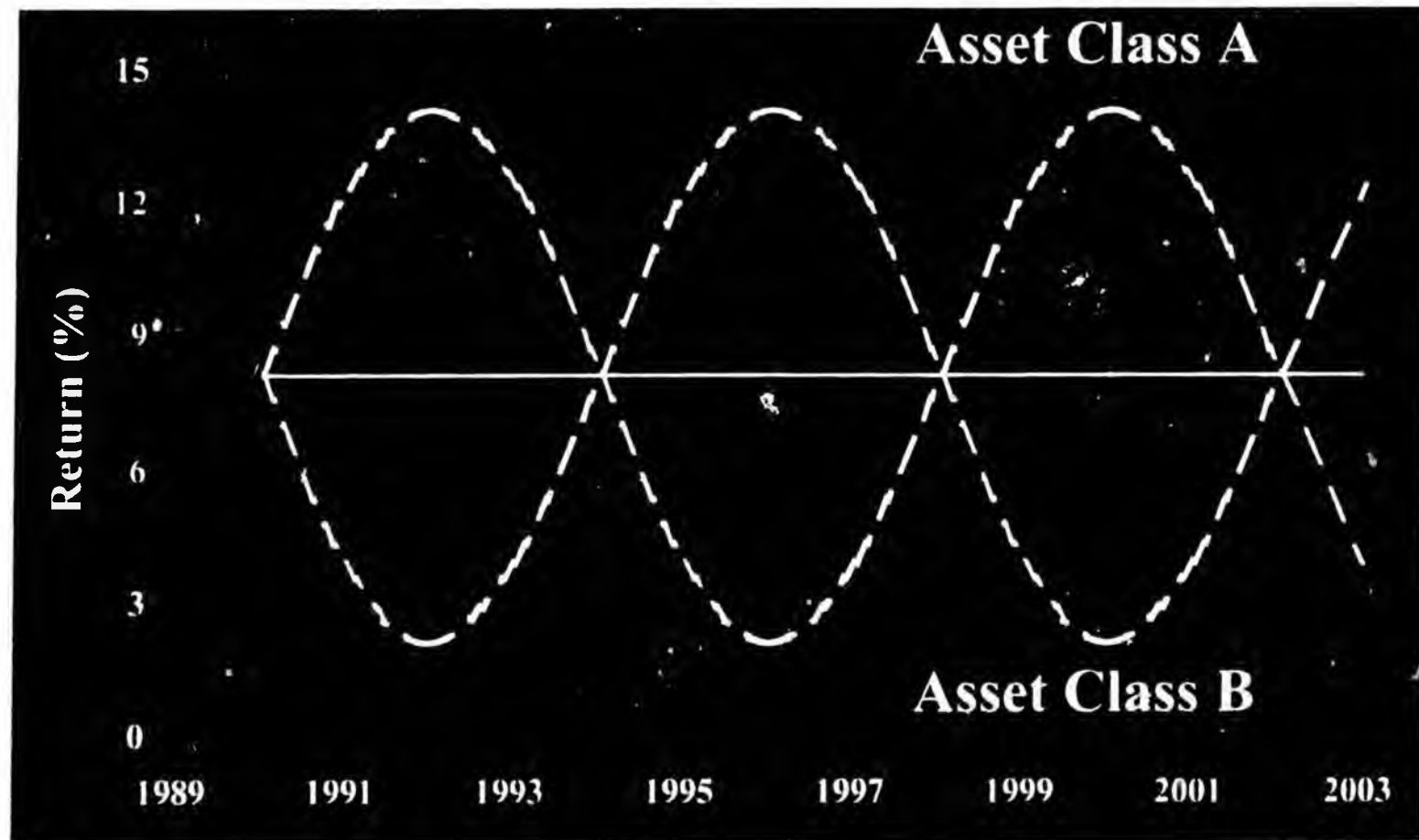
Returns Will Go Up and Down



Perfect Correlation (+1)

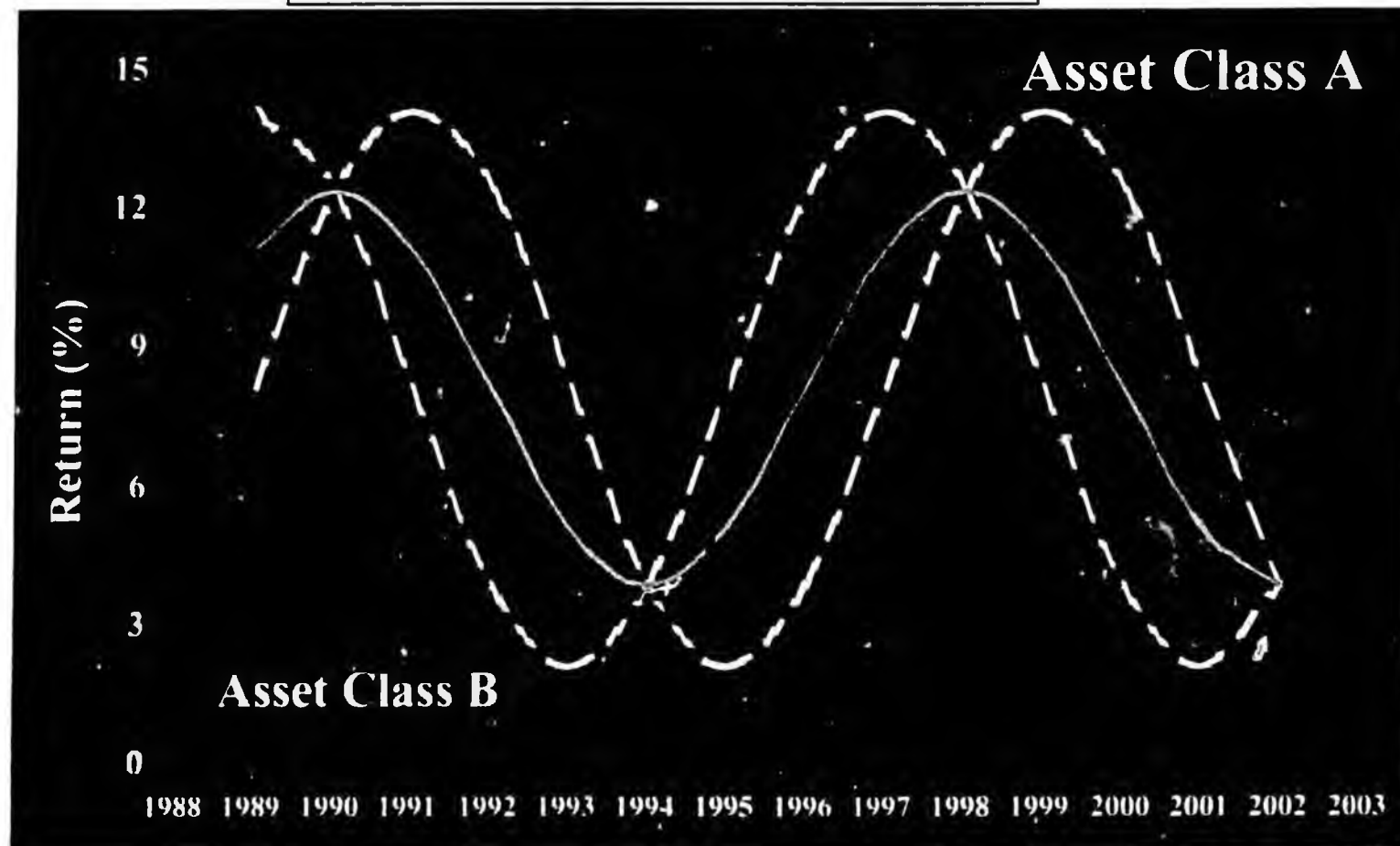


Perfect Negative Correlation (-1)



Correlation and Diversification

Portfolio Volatility Reduced



Key to Diversification

- The key is to diversify across assets (or managers) that are sensitive to different macroeconomic variables.
- Combining assets (or managers) with low correlations improves diversification.
- Combining assets (or managers) with high correlations provides little or no diversification benefits.



Efficient Portfolios

- For any given rate of return, no other portfolio has less risk.
- For any given level of risk, no other portfolio provides superior returns.
- Efficient portfolios lie somewhere on the efficient frontier.
- In practice, it is not uncommon to find portfolios that are inefficient in a risk-return context.

Asset Liability Concepts

$$\text{Benefits} = \text{Contributions} + \text{Earnings} - \text{Expenses}$$

Benefits - traditional retirement benefits dependent on future inflation impacting salaries and post retirement adjustments

Contributions - dependent on funding status, plan demographics, expected earnings & discount rate, actuarial budgeting approach

Earnings - dependent on asset allocation policy, manager success and cost (frequently dominated by size factors but also varied by asset type).

Often misunderstood reality = actuarial loss is failure to achieve assumed actuarial return. (8.25% per year for AK). Simply failing to earn anything over 3 years results in a \$1 million liability becoming a \$1.268 liability



Asset Projections

Callan 2005-2009 Risk/Return Assumptions

Asset Class	Index	Projected Annual Return	Projected Standard Deviation (Risk)
Equities			
Broad Domestic Equity	Russell 3000	9.00%	16.90
Large Cap	S&P 500	8.85%	16.40
Small/Mid Cap	Russell 2500	9.85%	22.70
International Equity	MSCI EAFE	9.25%	20.10
Fixed Income			
Domestic Fixed	LB Aggregate	4.75%	4.50
Non-USS Fixed	Citi Non-US Gov't	4.65%	9.60
Other			
Real Estate	Callan Real Estate	7.60%	16.50
Private Equity	VE Post Venture Cap	12.00%	34.00
Cash Equivalents	90-Day T-Bill	3.25%	0.80
Inflation	CPI-U	2.60%	1.40

Our Capital Market Projections define uncertainty

We are not predicting a specific return, but the breadth of possible returns and the likelihood of their occurrence

Risk, equal to standard deviation of return, means how wide the range of returns can be around the expected return



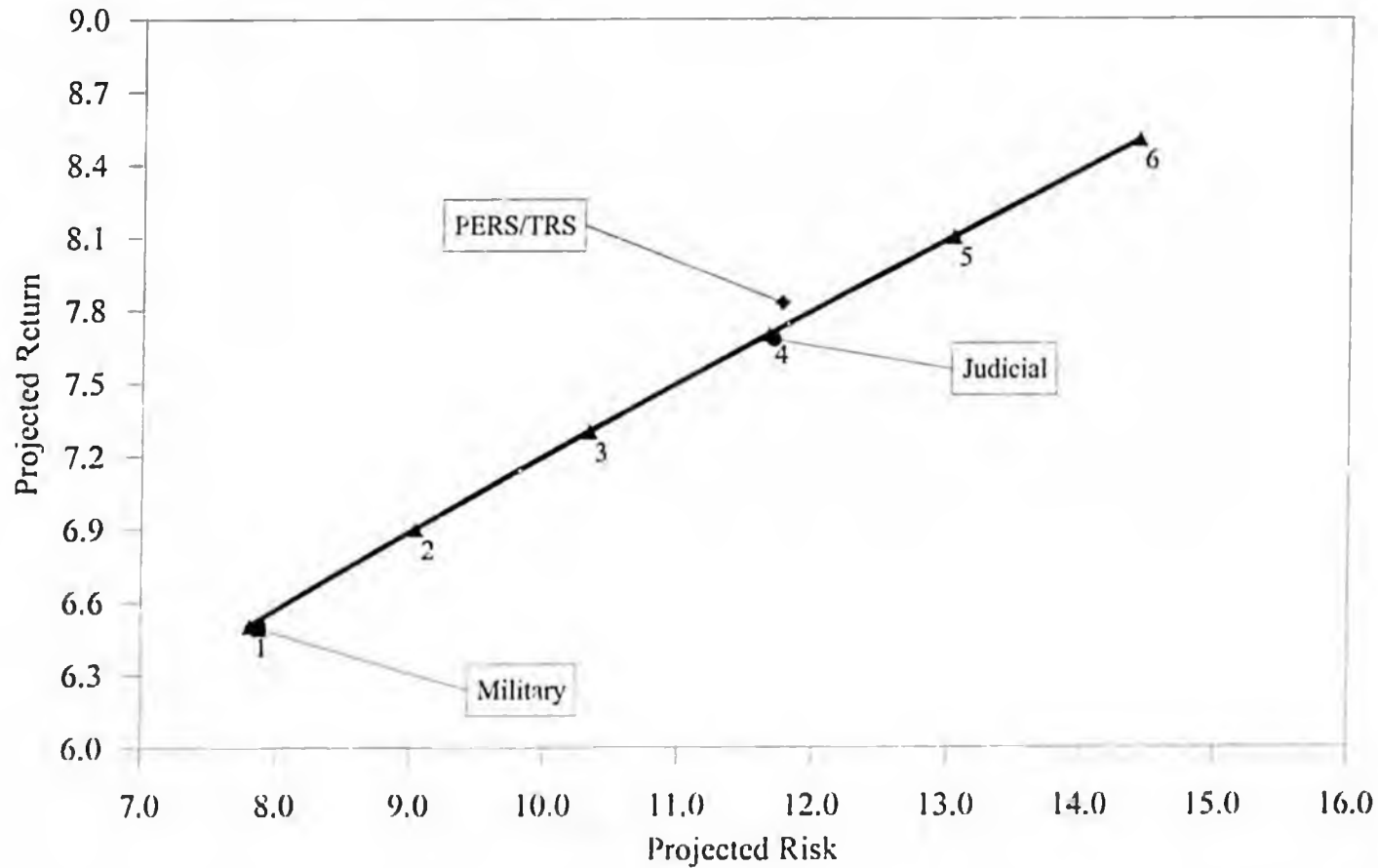
Efficient Frontier Mixes & Proposed Asset Mix Policies

Component	Max	Portfolio								
		Military	Mix 1	Mix 2	Mix 3	Mix 4	Judicial	PERS/TRS	Mix 5	Mix 6
Large Cap	100	24	18	22	26	31	32	30	36	40
Small/Mid Cap	100	6	4	5	5	6	9	6	7	8
International Equity	100	10	8	10	12	14	18	15	16	19
Domestic Fixed	100	60	54	45	36	27	24	24	18	8
Non US Fixed	100	0	5	4	4	3	3	2	2	2
Real Estate	15	0	6	7	8	8	9	9	9	9
Private Equity	6	0	3	4	5	6	0	6	6	6
High Yield	10	0	2	3	4	5	2	2	6	8
Absolute Return	0	0	0	0	0	0	3	3	0	0
Other	0	0	0	0	0	0	0	3	0	0
Totals		100	100	100	100	100	100	100	100	100
Expected Return		6.49	6.50	6.90	7.30	7.70	7.68	7.83	8.10	8.50
Standard Deviation		7.87	7.79	9.03	10.33	11.66	11.70	11.76	13.03	14.42
Sharpe Ratio		0.44	0.45	0.43	0.42	0.40	0.40	0.41	0.39	0.38

Please note that the optimizer was not allowed to select "absolute return" or "other". Illiquid investments in private equity and "other" were not made available for use in the Judicial or Military mixes. Real estate & private equity were also excluded from consideration for the Military program.

Efficient Frontier Graph

-Efficient Frontier
2005 Adjusted Optimization Set



PRS/TRS is above the efficient frontier because asset categories not available to the optimizer are included in the policy (absolute return & other)

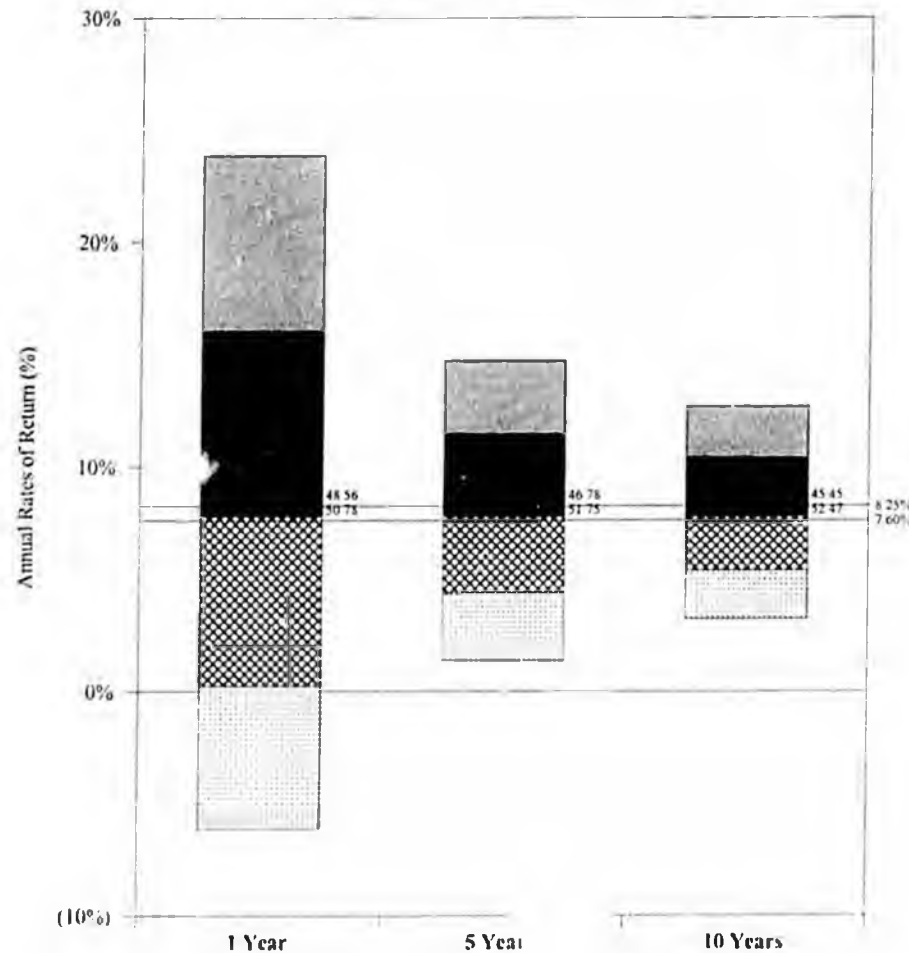


Unique Factors

- Medical program inclusion
 - extraordinary health inflation at bad time
 - projecting medical inflation at rates well in excess of projected returns for any asset class (i.e. 10% or more for next 5 years)
 - terminal projected inflation rate = 5% versus Callan CPI projection of 2.6%.
- Embedded salary inflation assumption greater than Callan inflation projection & inflation embedded in current financial markets (e.g. TIPS)
- Actuary is assuming less than 5% “real return”

PERS/TRS Multiple Time Horizons

Range of Projected Rates of Return
PERS/TRS
Optimization Set: 2005adjusted



	1 Year	5 Year	10 Years
10th Percentile	23.85%	14.72%	12.66%
25th Percentile	15.98%	11.40%	10.34%
Median	7.83%	7.83%	7.83%
75th Percentile	0.25%	4.37%	5.37%
90th Percentile	(6.12%)	1.35%	3.21%

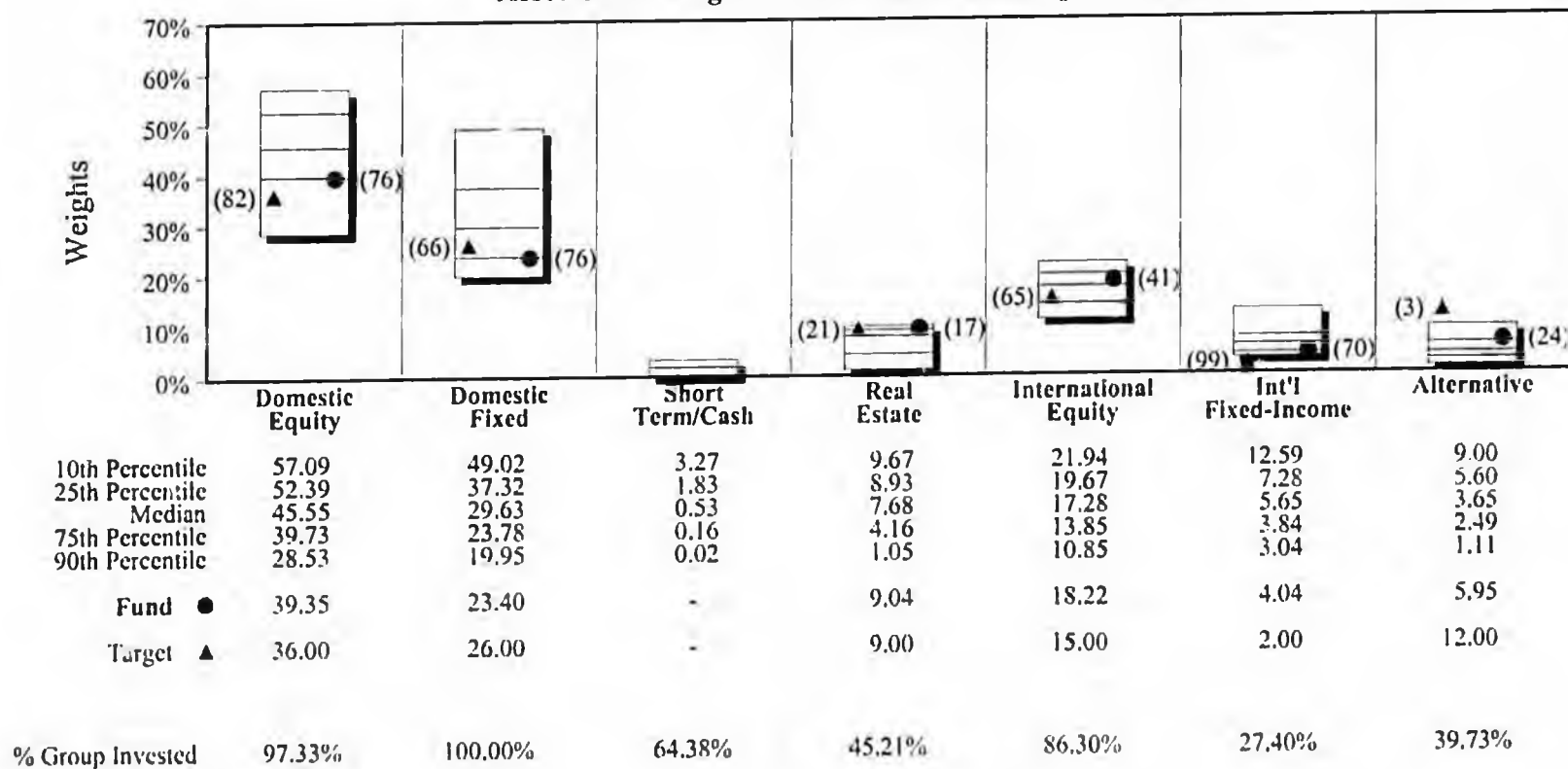
By striving for a slightly higher expected return, the PERS/TRS policy achieves a slightly greater probability of exceeding a 5% real return.

The inclusion of "other" also slightly reduces the downside return possibility (90th percentile).



Asset Allocation Versus Public Funds

Asset Class Weights vs CAI Public Fund Sponsor Database



Note that "alternative" includes private equity, absolute return & other



Thirteen & 1/4 Year Attribution Analysis

Thirteen And One-Quarter Year Annualized Cumulative Attribution Effect

PERS

Asset Class	Effective Weight	Avg Trgt Weight	Actual Return	Target Return	Manager Effect	Asset Allocation
Domestic Equity	40%	39%	10.30%	11.28%	(0.39%)	0.01%
Domestic Fixed-Income	38%	37%	7.59%	7.23%	0.13%	(0.17%)
High Yield	0%	0%	-	-	0.00%	(0.00%)
Real Estate	5%	6%	7.93%	7.61%	0.00%	0.02%
International Equity	13%	12%	8.49%	6.15%	0.32%	(0.02%)
Int'l Fixed-Income	3%	3%	-	-	0.03%	0.07%
Private Equity	1%	2%	-	-	(0.09%)	0.03%
Other	0%	0%	-	-	0.00%	0.01%
Absolute Return	0%	0%	-	-	(0.00%)	0.01%
Short Term/Cash	0%	0%	-	-	0.00%	0.01%

Total **8.94% = 8.96% x (0.00%) x (0.02%)**

Thirteen And One-Quarter Year Annualized Cumulative Attribution Effect

TRS

Asset Class	Effective Weight	Avg Trgt Weight	Actual Return	Target Return	Manager Effect	Asset Allocation
Domestic Equity	41%	39%	10.30%	11.28%	(0.39%)	0.06%
Domestic Fixed-Income	37%	37%	7.59%	7.23%	0.13%	(0.14%)
High Yield	0%	0%	-	-	0.00%	(0.00%)
Real Estate	5%	6%	7.88%	7.61%	(0.00%)	0.01%
International Equity	13%	12%	8.56%	6.15%	0.32%	(0.03%)
Int'l Fixed-Income	3%	3%	-	-	0.02%	0.08%
Private Equity	1%	2%	-	-	(0.09%)	0.03%
Other	0%	0%	-	-	0.00%	(0.00%)
Absolute Return	0%	0%	-	-	(0.00%)	0.01%
Short Term/Cash	0%	0%	-	-	0.00%	0.01%

Total **9.00% = 8.96% x (0.01%) x 0.04%**



PROPOSED AMENDMENTS FOR THE ORP STATUTE

The University of Alaska is seeking amendments to AS 14.40 Article 5 which authorizes the University's Optional Retirement Program. The Optional Retirement Program is a defined contribution plan which has been in operation for several years. Current challenges regarding health care expenses and the increasing employer contributions to PERS and TRS have led the UA administration to believe that the Board of Regents need greater flexibility in the design of the ORP. Most of the requested changes are designed to give the University's Board of Regents greater flexibility in crafting a program that would meet the University's changing needs.

The major proposed changes would allow the University the flexibility to:

- Include a health plan, if needed;
- Expand the potential pool of plan participants to include all employees (currently only faculty and administrators);
- Give a one-time second opportunity for employees who previously rejected ORP to join the ORP;
- Require new employees to participate in the University Retirement Plan; and
- Include lump sum payments or other types of plan distributions so long as the plan complies with federal law for a qualifying program.

The proposed changes would also provide these clarifications:

- That like PERS/TRS, ORP is not a subject of bargaining under PERA, and
- That the University may create new tiers.

Other proposed changes are technical changes necessary for the functioning and qualification of the program.

Provided by University
3/31/05

UNIVERSITY OF ALASKA
Statewide Office of Human Resources

Summary of the
Optional Retirement Program

The university's Optional Retirement Program (ORP) is a defined contribution alternative to the state sponsored defined benefit plans for faculty and executive staff, the Teachers' Retirement System and the Public Employees' Retirement System respectively.

The university's obligation under ORP is to make a contribution that is tied to a rolling three year average of the TRS rate. In FY05, the employer contribution is 13%, the employee contribution is 8.65%, for a total of 21.65%. By comparison, the TRS rates this year are 16.00% from the employer, 8.65% from the employee, for a total of 24.65%. There is no health benefit provided by ORP. Vesting is immediate. The employee's plan choice --- whether to participate in ORP, or TRS or PERS --- is irrevocable.

ORP's advantages to the university include an enhanced ability to compete in the national market for top faculty and administrators with other universities and corporations offering primarily defined contribution plans like ORP. In addition, the university has the advantage of relieving its liability under the retirement plan from the obligation to provide a costly health benefit upon retirement. ORP participants generally prefer the plan because it provides full portability, although some are concerned about the absence of a health benefit in the plan and the inherent uncertainties of the market.

Approximately 750 faculty and staff participate in ORP. Faculty comprise 90% of plan participants and executives 10%. At present, ORP's assets are \$315 million.

January 25, 2005

Provided by University
3/8/05

RETIREMENT PROGRAM COMPARISON CHART

	Teachers Retirement System (TRS)	Public Employees Retirement System (PERS)	UA Optional Retirement Program (ORP)
Plan Type	Defined Benefit	Defined Benefit	Defined Contribution
Internal Revenue Service Governing Code	401(a)	401(a)	Employer contribution 401(a) Employee contribution 403(b)
Social Security Replacement Plan	Yes	Yes	Yes
State Of Alaska Governing Code	AS 14.24	AS 39.35	AS 14.40.661
Eligibility	Faculty	Administrative and Executive Staff	Faculty and Executive Staff
Vesting	8 years of service	5 years of service	Immediate
Health Coverage After Retirement	Yes Tier I — Medical at no cost Tier II — Medical at age 60 at no cost	Yes Tier I — Medical at no cost Tier II — Medical at age 60 at no cost Tier III — Must have 10 years of service and be 60 for no cost medical	No
Contribution Rate Setting Authority	State of Alaska Division of Retirement	State of Alaska Division of Retirement	University of Alaska
Methodology For Setting Rates	Actuarial Model	Actuarial Model	3 year rolling average of the TRS contribution rate
Rates For FY04	Employer 12% Employee 8.65% Total 20.65%	Employer 5.58% Employee 6.75% Total 12.33%	Employer 11.66% Employee 8.65% Total 20.31%
Projected Rates FY05	Employer 16.00% Employee 8.65% Total 24.65%	Employer 10.58% Employee 6.75% Total 17.33%	Employer 13.00% Employee 8.65% Total 21.65
Subject Of Bargaining	No	No	Possible
Participation Rate	ACCFE — 174 (56%) UNAC — 328 (39%) Executive — 23 (24%) Total — 525 (95% faculty)	Faculty do not participate in PERS	ACCFE — 139 (44%) UNAC — 511 (61%) Executive — 73 (76%) Total — 725 (90% faculty)
Average Age			ACCFE — 53 UNAC — 50 Executive — 55

PROPOSED STATUTORY CHANGES FOR ORP

ALASKA STATUTES

Title 14. Education, Libraries, and Museums.

Chapter 40. The University of Alaska, the Community Colleges, and the Alaska Aerospace Development Corporation.

Article 5. ~~Optional~~ University Retirement Program.

Sec. 14.40.661 Authority of board.

(a) The board may establish and maintain an optional or required university retirement program for eligible employees in which retirement and death benefits (which may include a health benefit) are provided through the purchase of annuity contracts, either fixed, variable, or a combination of fixed and variable. Participation in the program is in place of participation in a state retirement system.

(b) The board shall

(1) provide for the administration of the program, including procedures for resolving complaints from participating employees;

(2) designate the company or companies to which payment of the contributions required under AS 14.40.691 may be made, after considering the

(A) nature and extent of the rights and benefits that the contracts will provide to employees who elect to participate and to their beneficiaries;

(B) relation of the contractual rights and benefits to the contributions to be made under AS 14.40.661 - 14.40.799;

(C) suitability of the contractual rights and benefits to the needs and interests of employees ~~electing to~~ who participate and to the interest of the university in the employment and retention of employees;

(D) ability of the designated company or companies to provide rights and benefits under the contracts; and

(E) efficacy of the contracts in the recruitment and retention of faculty and administrators;

(3) take other actions required to ensure that the program ~~qualifies as a qualified trust~~ complies with underapplicable provisions of 26 U.S.C. 401(a) to 417 (Internal Revenue Code);

(4) establish new tiers for employees when deemed necessary by the board.

(c) Retirement and pension plans or programs of the university are not subject to bargaining under AS 23.40.070-.260.

Sec. 14.40.671 Participation.

Provided by University
3/31/05

(a) An employee in a participating position may elect to participate in the optional university retirement program or to participate in the appropriate state retirement system, except that the board may establish a system which requires participation by new employees in the university retirement system. Eligibility to participate in the program begins on an employee's appointment to a participating position. If the board establishes a required program for new employees, a second one-time election to participate in the program may be offered to employees who previously opted not to participate in the optional retirement program.

(b) An election to participate in the program is irrevocable. The election shall be made in writing on a form provided by the board and approved for the state by the commissioner of administration. The form must be filed with the ~~board~~ university no later than 30 days after the date on which the employee is notified of eligibility ~~first becomes eligible~~ to participate in the program. A copy of the form shall be delivered to the appropriate state retirement system. The election becomes irrevocable on the date it is received by the board.

(c) ~~The election to participate~~ Participation in the program constitutes a waiver of all rights and benefits under the state retirement systems earned on or after the effective date of the election ~~while the employee's is participating~~ participation in the program.

(d) Except as provided in (e) of this section, if a nonvested member of a state retirement system ~~elects to participate~~ participates in the program, the employee may choose to transfer the amount in the employee's contribution account to the program. If the employee chooses to transfer the account, the appropriate state retirement system shall pay to the university on behalf of the employee an amount equal to the balance in the account. The payment must be made within 45 days after the ~~election~~ notice of participation is received by the state retirement system. The financial officer of the university shall ~~immediately~~ pay the amount received to the designated company or companies for the benefit of the employee as soon as possible. An employee who transfers assets under this subsection may not reclaim the corresponding service in the state retirement system if the employee is reemployed under the state retirement system.

(e) An employee whose rights to transfer assets out of a state retirement system are subject to a qualified domestic relations order is entitled to transfer assets from the state retirement system to the program only if the requirements for receiving a refund under AS 14.25.150(b) or AS 39.35.200(c), as appropriate, are met.

(f) If a vested member of a state retirement system ~~elects to participate~~ participates in the program, the employee ceases to be an active member of the retirement system on the effective date of the participation in the program. The employee retains all benefits accrued in the state retirement system.

(g) An employee who does not ~~elect to participate~~ participates in the program under this section becomes or remains a member of the appropriate state retirement system.

Sec. 14.40.681 Retirement system membership.

An eligible employee ~~electing to participate~~ participating in the program may not participate in a state retirement system during the time the employee is employed in a participating position. If the employee is later employed in a position covered by a state retirement system that is not a participating position, the employee may not continue to participate

In the program and shall begin to participate in the state retirement system.

Sec. 14.40.691 Contributions.

- (a) The university shall contribute on behalf of each employee participating in the program an amount established by the board.
- (b) An employee participating in the program shall contribute to the program an amount established by the board.
- (c) The board may specify that contributions required by this section are made by a reduction in salary under 26 U.S.C. 414(h)(2) or similar provisions under 26 U.S.C. 403(b) (Internal Revenue Code).
- (d) The financial officer of the university shall pay the contributions authorized or required by this section to the designated company or companies for the benefit of each participant.

Sec. 14.40.701 Benefits.

Payment of benefits to participants of the program is the responsibility of the company or companies designated by the board and is not the responsibility of the board, the university, or the state. The benefits are payable to participants or their beneficiaries in accordance with the terms of the ~~annuity contract or contracts. However, retirement benefits must be paid in the form of a lifetime income. Except for death benefits, a single sum cash payment is not permitted under this section.~~ plan document.

Sec. 14.40.799 Definitions.

In AS 14.40.661 - 14.40.799,

- (1) "appropriate state retirement system" means the state retirement system that includes the employee's position;
- (2) "board" means the Board of Regents of the University of Alaska;
- (3) "contribution account" means the member contribution account under AS 14.25 or the employee contribution account under AS 39.35, whichever is appropriate;
- (4) "employee" means an employee of the University of Alaska or a community college under AS 14.40;
- (5) "participating position" means a position that is a permanent position that is at least a .5 full-time appointment as
 - (A) ~~a faculty appointment; or~~
 - (B) ~~an administrator and the position has been designated by the board for inclusion in the program;~~and is included in the plan document.

(6) "program" means the optional university retirement program;

(7) "state retirement system" means the teachers' retirement system under AS 14.25 or the public employees' retirement system under AS 39.35;

(8) "university" means the ~~University~~ University of Alaska.

ALASKA STATUTES

Title 39. Public Officers and Employees.

Chapter 35. Public Employees' Retirement System of Alaska.

Article 2. Membership.

Sec. 39.35.120 Commencement of participation.

(a) An employee of the state shall be included in this system upon commencement of employment with the state, or on January 1, 1961, whichever is later. Unless an employee has elected to participate in the optional university retirement program under AS 14.40.661 - 14.40.799, an employee of a political subdivision or public organization that becomes an employer shall be included in the system on the effective date of the employer's participation or the date of the employee's commencement of employment with the employer, whichever is later.

(b) Inclusion in the system is a condition of employment for an employee except as otherwise provided for

(1) an elected official;

(2) an employee making an election under AS 39.35.150(b); and

(3) an employee of the university who ~~has elected to participate~~ participate in the optional university retirement program under AS 14.40.661 - 14.40.799.

ALASKA STATUTES

Title 14. Education, Libraries, and Museums.

Chapter 25. Teachers' Retirement.

Sec. 14.25.040 Membership.

(a) Unless a teacher or member has ~~elected to participate~~ participated in the optional university retirement program under AS 14.40.661 - 14.40.799 or has filed an **election** under AS 14.25.043(b), a teacher or member contracting for service with a participating employer