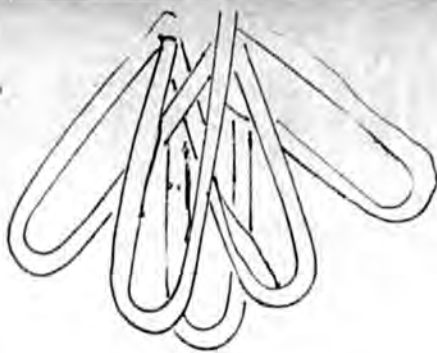


ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

3088 SCOMM 14.2: HOUSE SPECIAL COMMITTEE ON WAYS & MEANS 2005-2006

Conclusion

- Exempting Nation's Biggest Fields Unwise.
- Profit Margins 200% & 300% Higher Than Most Big Wall Street Companies.



City of St. Mary's
P.O. Box 209
St. Mary's, AK 99658
(907) 438-2515, Fax (907) 438-2719

12 July, 2005

Director Melanie Millhorn
Alaska Department of Administration
Division of Retirement and Benefits
P.O. Box 110203
Juneau, Alaska, 99811-0203

Re: **City of Saint Mary's Termination from the Alaska Public Employees'
Retirement System ("PERS")**

Dear Ms. Millhorn:

The City of Saint Mary's (the "City") in accordance with attached City Council Resolution #2005-10, dated 5 July, 2005, rescinds its termination from PERS, which termination previously was deemed effective 30 June, 2004, pursuant to City Council Resolution #2004-02 that was adopted on 04/15/04. Please take immediate steps to return the City's status and participation under PERS to the status quo that was in effect immediately prior to any notice of termination by the City.

Let me explain why the City has been forced to take this step. As you are aware, the City of Saint Mary's, similar to other small Municipalities in Rural Alaska, has faced severe financial crises in recent years. As part of the City's continuing efforts toward sustaining financial stability, the City took steps to terminate its participation from PERS, effective 30 June, 2004, thinking such action would provide some fiscal relief.

Prior to the City taking these steps, the City researched the amount of its termination liability from PERS. In particular, the City based its decision to terminate participation in PERS on the amounts published by PERS as representing the unfunded liability attributable to the City. For example, the City reviewed the Supplement to PERS Actuarial Valuation report, dated 30 June, 2002, which computed the City's unfunded liability to be \$144,435. Also the Supplement, dated 30 June, 2003, reported this amount to be \$163,890, a relatively small \$19,455 difference from the June, 2002 figure. Former City Manager Walton Smith likewise spoke to PERS Staff concerning the liability amount. This was confirmed in the telephone conference on 20 May, 2005, between City representatives and PERS Staff, including yourself and Defined Benefits Accounting Supervisor, Kevin Worley. During this conference, Mr. Worley clearly stated he had told former City Manager Smith, prior to the City's termination becoming effective, that the City's unfunded liability would be \$163,890.

On 19 April, 2005, the City was presented with a notification of final billing (termination liability). Lo and behold, the City was astonished to learn that the amount of termination

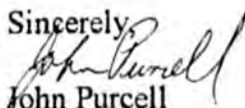
liability had ballooned to a whopping \$541,624 sum, nearly *four times* the amount previously reported by PERS as the unfunded liability amount. No one ever had informed the City that the termination liability could be so astronomically higher than the unfunded liability amount previously reported by PERS and stated by Mr. Worley. Indeed, if the City had any inkling or had been informed by Division Staff in the spring of 2004 that the final liability would have been of such a magnitude, the City never would have decided to terminate from the PERS system in the first place.

To make matters even worse, PERS intends to charge interest of 8.25% until the entire unfunded termination liability amount is completely paid. Simply stated, the City is unable to incur such a massive liability without devastating the City's resources and its ability to provide essential services, particularly public safety services, to the Saint Mary's Community.

The City, therefore, is left with no other choice but to rescind its termination from PERS and return its participation to the status quo that was in place immediately prior to the City's 2004 notice of termination. Please contact me as soon as possible in order that we may make arrangements to remit the payments that would have been made in the normal course of the past year, had the City never served notice of termination -- which notice hereby is rescinded and withdrawn, in accordance with Resolution #2005-10.

Thank you for your prompt attention to this matter.

Sincerely,



John Purcell
City Manager

cc. Sven Pauken, Mayor
& City Council Members (6)
City of Saint Mary's

Ray Matiashowski, Commissioner
Department of Administration

James Clark, Chief of Staff
Office of the Governor

Representative Richard Foster, HD-39

Senator Donald Olson, SD-T

Walton Smith, Former City Manager

Kevin Ritchie, Executive Director
Alaska Municipal League

1 Representative Woodie Salmon

Senator Lyman Hoffman

Senator Albert Kookish

Senator Gary Wilken

Senator Bert Stedman

Representative Mary Kapsner ✓

Representative Carl Moses

Representative Bill Thomas

Former Representative Andrew Halcro

Alaska Conference of Mayors

1
.. Alaska Municipal Managers Association

City of St. Mary's
P.O. Box 209
St. Mary's, AK 99658
(907) 438-2515, Fax (907) 438-2719

CITY OF SAINT MARY'S, ALASKA

RESOLUTION 2005-10

RESCINDING THE CITY OF SAINT MARY'S 2004 TERMINATION FROM THE PUBLIC EMPLOYEES' RETIREMENT SYSTEM; AND AUTHORIZING THE ALASKA DIVISION OF RETIREMENT AND BENEFITS TO RETURN THE CITY'S STATUS AND PARTICIPATION IN THE PERS SYSTEM TO THE STATUS QUO THAT WAS IN PLACE IMMEDIATELY PRIOR TO THE CITY'S 06/30/04 EFFECTIVE DATE OF TERMINATION FROM THE SYSTEM.

WHEREAS, in the fourth quarter of FY-04, the City of Saint Mary's, classified as a First Class City within the State of Alaska, solely because of its budgetary inability to continue making payments into the Public Employees' Retirement System (PERS) and with the understanding, based on information provided by the Alaska Department of Administration-Division of Retirement and Benefits (hereafter Division) that its unfunded PERS liability at the time of termination would be in a bearable \$144,435 to \$163,890 range, passed and submitted Resolution 2004-02, on 04/15/04, requesting to be terminated as an employer member within the PERS system effective 06/30/04; and,

WHEREAS, both the City Manager in 2004 and the City Council were not given any explicit higher computation amount by Division Staff during the period 04-15-06/30/04, different than the \$163,890 unfunded liability figure that Department Staff explicitly had provided during that period -- a fact that recently was confirmed during a telephone conference on 05/20/05 between City Staff and PERS Staff that included the Division Director; and,

WHEREAS, understandably, this City Council was shocked to learn from a 19 April, 2005 Notification Letter from Division Staff (one year subsequent to the Council having passed Resolution 04-02) that its final PERS termination liability had been determined to be a whopping sum of \$541,624 -- some \$377,734 more than the maximum figure that the City had received from the Division prior to 06/30/04; and,

WHEREAS, the City Council never would have submitted the 04/15/04 PERS termination Resolution 02-04, if it should have had any indication that its final termination liability, apparently determined some eight and one half months after the City's effective date of termination, would finally have been computed at an unfathomable sum of \$541,624; plus interest payments set at 8.25% if the entire principal amount was not paid by 06/01/05 -- a Division determination that this Council has appealed in its entirety; and,

WHEREAS, this City Council, having already been forced to cut municipal services to the Saint Mary's Community to the bone -- particularly Public Safety services which, to a large extent, will have to be covered by the Alaska State Troopers -- has no other choice but to rescind its termination from PERS and return its PERS participation to that which existed prior to the City's rendered 2004 notice of PERS termination;

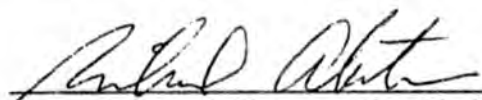
NOW, THEREFORE, BE IT RESOLVED, that the Saint Mary's City Council hereby rescinds its 2004 termination from the Public Employees' Retirement System and authorizes the Director, Division of Retirement and Benefits, to return the City's status and participation under PERS to the status quo that was in place immediately prior to any notice of termination by the City.

BÉ IT FURTHER RESOLVED, that this City Council asks that the Division Director contact the Saint Mary's City Manager as soon as possible, in order that arrangements may be made for the City to remit payments that would have been made over the past year had the City never served notice of termination.

PASSED AND APPROVED BY A DULY CONSTITUTED QUORUM OF THE SAINT MARY'S CITY COUNCIL, THIS 5thTH DAY OF JULY, 2005.

Signed: 
Sven Paukan, Mayor

Attest:


Richard Alstrom, City Clerk



Notes for Ways and Means Meeting
December 7, 2005
Anchorage LIO

The Chairman asked me to recap my testimony in Fairbanks, where I addressed three questions:

1. What is the significance of the unfunded liability of Alaska's retirement systems?
2. What financial resources are available to address the problem?
3. How do available resources and the unfunded liability affect fiscal planning?

Defining the Problem

Figure 1 Graph showing PERS/TRS Unfunded Liability of \$5.7 billion

- Retirement systems all over the country look about the same—a gap appears in 2002. This gap is the unfunded liability.
- Some systems are worse off than Alaska—they tend to be systems that increased benefits when surpluses were available (from the stock market boom).
- Alaska did not increase benefits—we were just hit with the normal factors that caused assets to decline while liabilities increased.
 - Poor investment returns
 - Health care cost increases
 - New life expectancy tables

The graph prompts the following questions:

1. Why do we have a problem if we didn't do anything wrong?

People have asked how bureaucrats, or the administration, or the actuaries could have been surprised by the appearance of a gap. But the Chairman indicated early in this process that he was more interested in looking forward than in assessing blame, so I will point again to the three major factors that created the gap—investment returns, health costs and actuarial assumptions—and turn to the future.

2. What does this \$5.7 billion unfunded liability mean to retirees, employees, state finances, communities, school districts?

- Retirees—not much; benefits are pretty well set in stone.
- Employees—no rate increase, but it is tough to negotiate higher take-home pay when total compensation is under so much pressure.
- Employers—higher rates, in the absence of massive cash infusions. Rates will go up 5 points annually until they reach roughly 50% of salary for TRS and 30% of salary for PERS. This is the impact of most significance to the state.

3. The gap appeared in a flash, can it vanish as quickly? Will it? Is action required to close the gap?

This is opinion, but I think you should expect the gap to grow before it begins to shrink. Less assets means less earnings, so even better market

performance is unlikely to close the gap by a significant amount. The rate increases are designed to close the gap over a period of 25 years.

4. If rate increases will solve the problem, are we looking for a solution when none needs to be found?

- While it may be fair to say that we do not face a crisis in the sense that the legislature does not have to come up with \$5.7 billion this session, the rate increases will apply significant financial pressure to communities, school districts and state agencies (and to legislators who will be expected to help).
- The primary reason to be concerned about solutions other than rate increases is that rate increases are unacceptable or unaffordable.

5. Does the state have a responsibility for the entire \$5.7 billion gap? Should it accept higher rates or try to stabilize rates with infusions of cash?

- See **Figure 2** for shares of the system liability.
- If the focus is the **state** itself, rate increases may be an acceptable solution. The state's share of the unfunded liability is about \$2 billion (35%). Adding the University brings the state total to \$2.2 billion (39%). Money for personnel costs comes from various fund sources, only half is General Funds. So why fix the problem with a pure general fund cash infusion? It would cost an extra \$1 billion GF.
- But look at **school districts**. Their share of the gap is \$2.3 billion for TRS (41%) plus another \$400 million for PERS, (for a total \$2.7 billion, or 48%). Essentially, the state will fill the gap with general funds now or later, because the state pays for most of the cost of K-12 education. It may make sense to contribute cash now to avoid higher costs in the future.
- The same goes for **communities**, except that the state arguably is not responsible for operating costs of communities, at least not in the same direct manner as school district funding. Their share of the gap is about \$700 million (12%).

6. Can the state afford to contribute enough cash to make a difference?

This starts a discussion of the second question the Chairman asked me to address.

State resources available to address the problem

Figure 3 Projections of surplus revenue

This figure shows we face limitations on actions because we don't have \$5.7 billion.

FY05—no surplus available. (line 31)

FY06—the year began with no surplus projected, but oil is much higher than projected, giving a projected surplus of \$1.2 billion. (line 31)

FY07—line 31 shows another projected surplus (\$235 million)

These numbers are before supplemental appropriations, (line 33). Subtracting money that is likely to be spent in the supplemental process gives a total surplus of \$1.2 billion. (line 40)

FY08 and beyond—expenditures are likely to increase, and deficits are likely.

The bottom line:

- we have a **one-time** surplus of about \$1.2 billion
- that amount is insufficient to fill the entire \$5.7 billion gap
- but using the surplus to reduce the unfunded liability would reduce future costs, effectively rolling the surplus forward to a time when surpluses are not anticipated.

Fiscal Planning

You know three things

1. The legislature will not be forced to come up with money to fill the entire \$5.7 billion gap.
2. \$1.2 billion is available to address the problem.
3. There will be competing needs/desires for this surplus.

There really aren't that many options

1. Spend it now
2. Save it
 - Deposit to Permanent Fund (untouchable)
 - Let it fall into the Constitutional Budget Reserve Fund (CBR) as the system was designed to work (requires a supermajority vote to access)
 - Pay some of the retirement systems unfunded liability (rolls money forward to distant future)
 - Capitalize the Public Education Fund (rolls surplus forward to next year)

If you are looking for recommendations, I would put the FY06 surplus in the Public Education Fund to fund FY07 K-12 education. This doesn't save (or cost) anything, it just takes the surplus off the table early and moves decisions to the full FY07 process rather than the more abbreviated supplemental process. As part of that process, the legislature could pay up to \$1.2 billion of the unfunded liability of the retirement system. I would put it all toward TRS. The impacts of doing so include:

- TRS rates would stabilize after FY08 (at about 30% of salary), avoiding massive annual increases in the education formula.
- Rates for state employees would increase (to about 30% of salary), but nongeneral funds would pay half of the increase.
- Local government rate increases would have to be addressed through a municipal assistance/revenue sharing program, if the state chooses to address the problem at the local government level.

**Testimony of
Michael Lamb, CFO
Fairbanks North Star Borough
Ways and Means Committee PERS/TRS Funding Shortfall Issue
December 7, 2005, 1:30 p.m. – 4:00 p.m.**

Thank you Mr. Chairman and Committee members.

My name is Michael Lamb. I hold professional certifications as a certified public accountant and as a certified government financial manager (Association of Government Accountants). I am and have been the Chief Financial Officer for the Fairbanks North Star Borough since 1998. Prior to that I was the Chief Financial Officer for the City of Saint Paul since January 1990. Accordingly, I have over fifteen years experience as a chief financial officer for Alaskan municipalities fairly evenly split between a smaller City government and a larger borough.

Let me thank you for the opportunity to testify today on what I believe is an issue that has impacted most, if not all, of our communities already and will continue to well into the future.

This issue impacts the State's delivery of its services, the universities delivery of its programs, it impacts municipalities programs and services, accordingly it impacts all residents of the State. As I only have three minutes I shall try to be concise and make, or reconfirm, some points that others have made that need to be kept in mind when **conceptualizing funding shortfall solutions**.

1st, the PERS program I think is misnamed as the Public Employees Retirement Program because of the perception that it sets. PERS is, by design and in reality, an employee and elected officials retirement program. This statement of reality is in no way intended to suggest elected officials should not be part of this or any other program. The purpose of this statement is that whatever financial condition the program finds itself in it, it must be kept in mind when thinking about funding solutions one must consider who all of the benefactors of the Program are. I suggest that those direct benefactors indeed are employees, but also are school board members, council members, assembly members and legislators. I would also suggest for consideration that all of our respective entities are also benefactors of the Program in that this Program has been the reason that we have been able to deliver our programs and services in that it has been a hiring and a retention tool. Accordingly, the funding solution should not be seen as a solution that only benefits employees, as that would be in my opinion inaccurate.

2nd, I don't remember the City of St. Paul's numbers and percentages but I do know the Borough's numbers and percentages as it relates to who has paid into the system in the past, in other words, who has paid more or less in the past, which is important to consider when looking at future options. From FY 1983 to FY 2004 the cumulative percentage of payroll to be paid into the PERS program per the actuary was 80.95%. In five fiscal years (94, 95, 96, 97 & 98) the Borough paid in cumulatively 13.03% more than the actuarially determined rate, bringing the

entities contribution up to 93.98%. During this same time period employees cumulative percentage of payroll paid in was 145.25%! Essentially, given the actuaries determined amount the Borough should pay into the system, which it 100% funded, for every \$1 dollar the Borough paid in, employees paid in \$1.79. This relationship is important to understand because I have heard that employees haven't paid their fair share and they should pay more. In the case of the Borough, any under-funding that has occurred shouldn't be believed that it is because employees didn't pay their fair share, the numbers don't support this and this should be kept in mind when talking about funding solutions. Employees are potentially part of the solution mix, I just want the record to reflect that their contribution rates impact has been to lessen the under-funding, not make it larger.

3rd, Let me now speak about the Borough's role in this under-funding and the consequential impacts. The Borough has year, after year, after year always written the checks to the Program for 100% of what can only be fairly perceived and described as a demand for payment letter, and all of those checks cleared! Essentially, the Borough like all of the other recipients of those demand for payment letters that set the rates to be submitted, paid what they had a contractual obligation to pay. On the other side of the contract were the State and the actuary. I believe that it is fairly well accepted as fact that in summary their obligation and responsibility was to determine and then send a materially accurate demand for payment letter such that the Program would function as obligated when those obligations came due. Why is this important, because in trying to construct a fair funding solution consideration needs to be given to whose lack of performance caused the shortfall that is now being discussed.

4th, Even if one could reasonably suggest that the Borough somehow benefited from the lower rates in the past because its benefit costs were kept artificially low the problem is that the Borough operates under a locally approved tax cap. The cap was designed, and the public recognizes, that without adding programs or services from year to year inflationary costs will drive up the costs to deliver those services yearly, they are willing to pay those increases and have a CPI component built into the cap to raise it from year to year. Once the tax assessments are set for a fiscal year they become the baseline for the next year that the CPI can be added to. The Cap allows for the ability to absorb increases, but if they aren't recognized or budgeted for you can't go back and get those funds. The Borough 100% funded the PERS demand letters and rates. It could have over the years absorbed through incrementally higher base lines been able to pay more. The Cap does not allow for these kinds of under budgeting scenarios caused by understated third-party expenditure projections. What this means for the Borough is that any funding solution that continues to ratchet up the payroll percentage rate, and therefore real dollar contributions to the Program, must come by reducing some other program or service delivered to the residents because the Cap doesn't allow for unlimited taxing. And in this instance, again, our Cap would have allowed the Borough to pay more in the past, that was taken away by the understated demand letters.

5th, As a second class borough, not only are we and the residents confronted with a huge PERS underfunded liability, but the Fairbanks North Star Borough School District is a component unit of the Borough. What's the relevance for this issue? Their financial problems are also our financial problem! This relationship compounds the tax cap problem I just spoke about. Education funding is the number one priority in our budget. Funding for all other programs and

services at the Borough dwarf in size compared to what goes to the school district. When money has to shift from other programs and services to cover ever increasing PERS costs in the Borough there seems no way to not also reduce in some fashion the amount of funding that goes to the District because they are they are by far the biggest slice of funding pie. So, when considering funding solutions and options there will be a direct impact on the education of the students of this State, especially for Boroughs with school districts.

Though I have a lot of thoughts on this topic, time is short. Let me say that I do think there is a funding issue. I think it is an issue with a large price tag. I think that though there is a large price tag I think the number is perhaps quite fuzzy because of widely swinging actuarial results from year to year. I think a great deal of consideration needs to be given to the significant detrimental financial impacts some solutions could try to shift to municipalities that have already seen their capital matching grant program funding go away, their municipal assistance funding go away and their revenue sharing funding go away. I think that the number of local governments that have already in the last couple of years literally closed their doors and no longer exist will grow and hit larger communities if a funding solution doesn't consider capping local contribution rates. I very much support the resolution put forth by the AML to limit local contributions and that actuarially determined rates higher get paid for by the State. Though the actual unfunded liability number is in question there is no doubt that it is a large number. I very much support the concept of pension bonds to reduce the 8.25% rate of earning the Program demands from those that they sent understated demand for payment letters to!

Let me conclude with saying thank you for the time to testify and end by saying that I am not blind to the fact that a funding solution must include all parties. I, for the reasons I have just spoken on think that local governments share of a funding solution ought to be reflective of and limited to local governments role in creating the shortfall.

Testimony to the House Ways and Means Committee – December 7, 2005

Good afternoon Mr. Chairman and members of the committee.

My name is Judy Salo. I live in Kenai and have since 1969. I am a former teacher, former state president of NEA/Alaska, and a former member of both bodies of the Alaska Legislature.

I realize that the purpose of this hearing and others that you have held around the state is to deal with budget shortfall issues related to the retirement systems. I am sure that you do not wish to rehash the arguments for and against the passage of SB 141. With that in mind I will try to keep the issues separate.

I must first say, however, that the passage of SB 141 did little to address the real problems faced by the state, employers, and employees in Alaska. To the contrary it potentially causes new financial issues as the system will not be sustained with the contributions of new members after the effective date of July '06. I come before you today to ask you to consider specific legislation before that effective date and I'd like to give you a few reasons that you should do so.

1. Temporary financial circumstances were used to insinuate a demise of the Retirement systems – those circumstances have changed.
2. Mercer's change in actuarial assumptions in 2003 created a distorted picture of crisis – and thus the Chicken Little approach that served other political agendas.
3. Hearings like this one should have been held around the state prior to introduction of this sweeping legislation.
4. The State of Alaska has no financial crisis and as part of an alternative solution would have funds to make the systems sound (and make-up for the lack of contributions over time that helped create the underfunding.)
5. Health care cost containment needs to be a part of any solution rather than just shifting that burden totally to future retirees (it's kind of like amassing a huge federal deficit – it doesn't hurt now – it undoubtedly will later).

6. The anticipated consequences of SB 141 on Alaskan education are all negative. The only group likely to be advantaged would be those choosing to leave in mid-career.

I would like to see this committee propose legislation that would delay the effective date of SB141 and establish the Retirement Revision Task Force. The Task Force would meet during 2006 and submit to the 2007 legislature alternatives to SB141 that address the issues of long term financial solvency of our state retirement systems especially in regard to rising Health Care Costs.

Passage of this type of legislation would give the legislature the opportunity to turn a terrible situation into an opportunity to fairly and thoroughly address the real problems of rising retirement obligations. There would be great incentive for all parties at the table to work to maximize the quality and integrity of the retirement systems. The additional time to allow thoughtful input and debate would be a welcome alternative to the politics of last session, which brought about this legislation.

It's not often that a legislature admits error, but it has been done. Errant laws have actually been repealed – I'm not asking you to do that – I'm asking you to take the time to do it right – and to see if there is a way to solve the real issue and maintain the type of retirement system that the founders of our constitution envisioned – one that will continue to help attract and keep good employees in the state of Alaska.

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Representative Weyhrauch and members of the Ways and Means Committee:

Fifty years ago, 55 delegates from around the Territory of Alaska drafted the Alaska Constitution

The National Municipal League named our Constitution "one of the best, if not THE best, state constitutions ever written".

These distinguished Alaskans must have been aware of the value of public service when they wrote that "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." In one archived report of recommendations from the Executive Director of the Public Administration Service to the young state in 1959 stressed, "Successful public personnel programs throughout the country seems to indicate that an effective personnel program requires ... a sound retirement system". (H.G. Pope)

We respectfully ask the members of the (H) Ways and Means Committee to ensure the soundness of the retirement systems for current and future retirees. In these days of corporations reneging on promises to their own employees, we ask that the State of Alaska, like the delegates to the constitutional convention, renew its commitment to the people who have built this state: the teachers who taught our engineers; the engineers who designed our highways; the public road crews that maintain and plow those roads; the public safety officers who ensure our safety. As many legislators have said repeatedly over the last year, absolutely none of the liability in PERS or TRS is the fault of the employees.

How can you resolve the liability? We are fortunate to be in a position where there are choices including using the surplus to honor your commitments; exploring using funds from the AHFC, or reviewing the use of Amerada Hess funds. The State has the means to fulfill its promise and if there is one thing we hope to see from this committee, it is a statement emphasizing the will to do so.

Thank you for taking the time out of your busy personal schedules during the interim to tackle a difficult subject. We appreciate your willingness and interest in resolving the problem. And thank you for allowing us to add our comments.

Cindy Spanyers

PERS/TRS UNDERFUNDING

**Testimony of Sam Trivette, President
Retired Public Employees of Alaska
Alaska House Ways & Means Committee
December 7, 2005**

- PERS and TRS trust funds have been less than 100% funded most of the time over the last 25 years. This is true of most other public pension trust funds. Only a few times have PERS/TRS been over 100% funded. Over time, the funds have always returned to 100% funding. Current funding status should not be considered a crisis needing drastic measures. Don't Panic!!
- Much of the less than 100% funding can be attributed to changes in the actuary assumptions. The previous actuary hired by the State made significant errors. These include inaccurate information about the cost of health care, salary assumptions, true costs of legislation, mortality tables, etc. These mistakes were not made by PERS/TRS employers or the employees. And the employers and employees should not be required to pay the increased premiums because of this inaccurate information. The Legislature should fund these increases, helping out every municipality and school district in Alaska who relied on the State's contract actuary.
- With the significant budget surplus anticipated next Fiscal Year, the Legislature should fund the additional 5% employer contribution to the PERS/TRS funds.
- The Legislature should consider using some additional surplus money to pay down the "unfunded liability" for the reasons noted above.
- The "unfunded liability" figures provided by the State's former actuary are based upon systems that are used by a small number of actuary professionals. The Legislature's actuary has urged the numbers be recalculated using more commonly used system of calculations. Research has shown that even minor changes [even a quarter of a percent in an assumption] in calculation methods can have a major impact upon the calculated funding ratio.
- It is well established that the cost of health care is what is causing the problem with the PERS/TRS trust funds. If the Legislature wants to address this issue, it must give the Alaska Retirement Management Board oversight of the retirement system expenditures. SB 141 did not provide this authority. The ARM Board has the responsibility to balance assets and liabilities, but no authority over spending. The previous cooperative efforts of Retirement & Benefits, former PERS and TRS Boards, Retiree Organizations, and the health care administrator produced millions of dollars in savings ANNUALLY.

- Once a report is available by the new contract actuary in the Spring 2006, we will be able to assess our true funding status and begin to implement a plan to reduce the underfunding in rational manner.
- RPEA looks forward to working with the Legislature, the administration and the ARM Board to address these issues. New legislation may be necessary to achieve the full funding goal.

SCOMM

142.12

6.9 billion shortfall

State of Alaska Retirement Systems

Actuarial Presentation to the Alaska
Retirement Management Board and
Special Committee on Ways and Means

March 23 and 24, 2006

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Agenda

- Actuarial Process
- Review of Mercer's 2004 Actuarial Valuation
- 2005 Actuarial Valuation Results
- Questions

Actuarial Process

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State of Alaska Retirement Systems

- Alaska consists of four traditional defined benefit (DB) pension plans
 - Public Employees' Retirement System (PERS)
 - Teachers' Retirement System (TRS)
 - Judicial Retirement System (JRS)
 - National Guard and Naval Militia Retirement System (NGNMRS)
- In addition to the traditional DB plans, a defined contribution (DC) plan was added effective for new hires after July 1, 2006
- A postemployment healthcare plan covers all members in the DB and DC plans
- Actuarial valuations are performed annually as of June 30. The most recent is as of June 30, 2005 for PERS and TRS. JRS and NGNMRS are performed biannually with the next scheduled valuation to be performed June 30, 2006

Actuarial Valuation

- Quantifies the benefit obligation
 - Present value of future pension payments calculated using service at the valuation date
 - Also called Accrued Liability
- Determines actuarial soundness of statutory contribution
 - If not sound, additional contribution required by State
 - Measures current funded status
 - Early warning system for potential funding problems

Actuarial Valuation (cont'd)

- The process includes:
 - Membership data
 - Financial data
 - Benefit structure
 - Actuarial assumptions
 - Funding method
 - Asset valuation method
- Expected benefit payments over future years is calculated and discounted back to the valuation date
- Calculations are performed on each member and summed

Actuarial Assumptions

- Used to quantify amount and value of future benefit payments
 - Demographic (amount)
 - Economic (value)
 - Healthcare (combination of demographic and economic)
- Should be a realistic “best guess” based on:
 - Past history
 - Future expectations
 - Long time horizon (40+ years)
- Inflation should be consistently applied to salary increases/COLAs (liability), investment return (assets) and healthcare trend
- Assumptions are recommended by the Actuary, approved by the Alaska Retirement Management Board
- Should be explicit - each assumption individually reasonable
- Setting of assumptions is a blend of art and science

Summary of Current Economic Assumptions

	<u>PERS & TRS</u>
• Investment Return	8.25%
• Inflation	3.50%
• Interest on Contributions	4.50%
• Salary Increases	
– Inflation	3.50%
– Productivity	0.50%*
– Economic Portion	4.00%*
• Payroll Growth	4.25%
• COLAs	
– Post Retirement Pension Adjustments	1.75% at age 60 or after 5 years (8 years for TRS) of payments; 2.625% at age 65 or upon disability
– Alaska	10% for those living in Alaska
• Healthcare Trend	Medical trend starts at 9.5% and grades to 5% over 9 years; Prescription drug trend starts at 14% and grades to 5% over 9 years

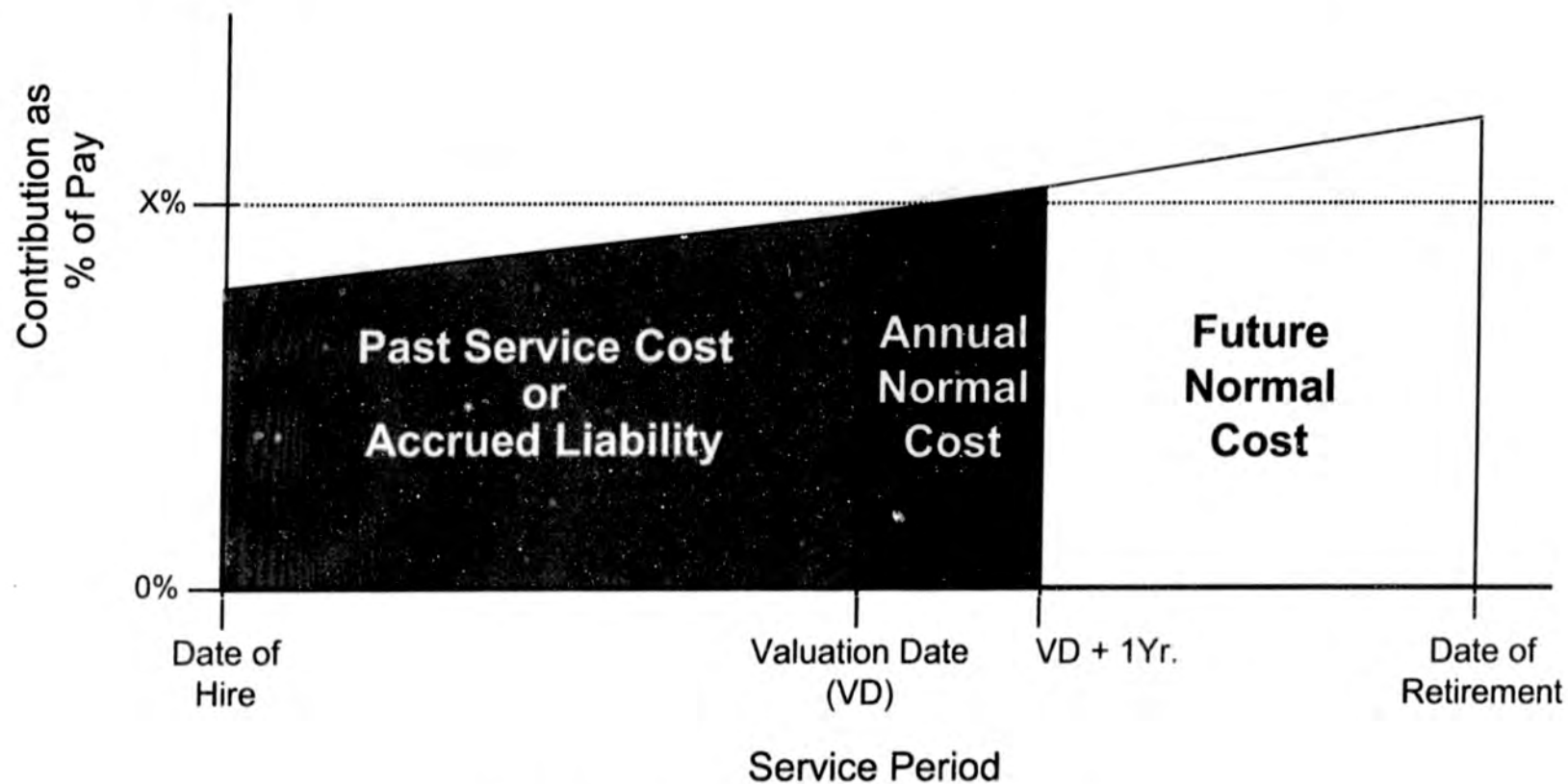
**Productivity for PERS Police/Fire is 1%, and the economic portion is 4.5%.*

Actuarial Cost Method

- Used to allocate pension cost from year to year
- Determines pattern of funding - "Pay me now or pay me later"
- Projected Unit Credit Cost Method - Used to allocate cost between past and future service
 - Normal Cost - cost of benefits due to service during the year beginning on the valuation date and projecting salaries
 - Accrued Liability - represents present value of benefits credited with respect to service earned as of the valuation date
 - Unfunded Accrued Liability - Accrued liability minus actuarial value of assets
 - Actuarial Contribution - Normal cost plus amortization payment of unfunded liability (25 years) as a percent of pay

Funding Process

Projected Unit Credit Method

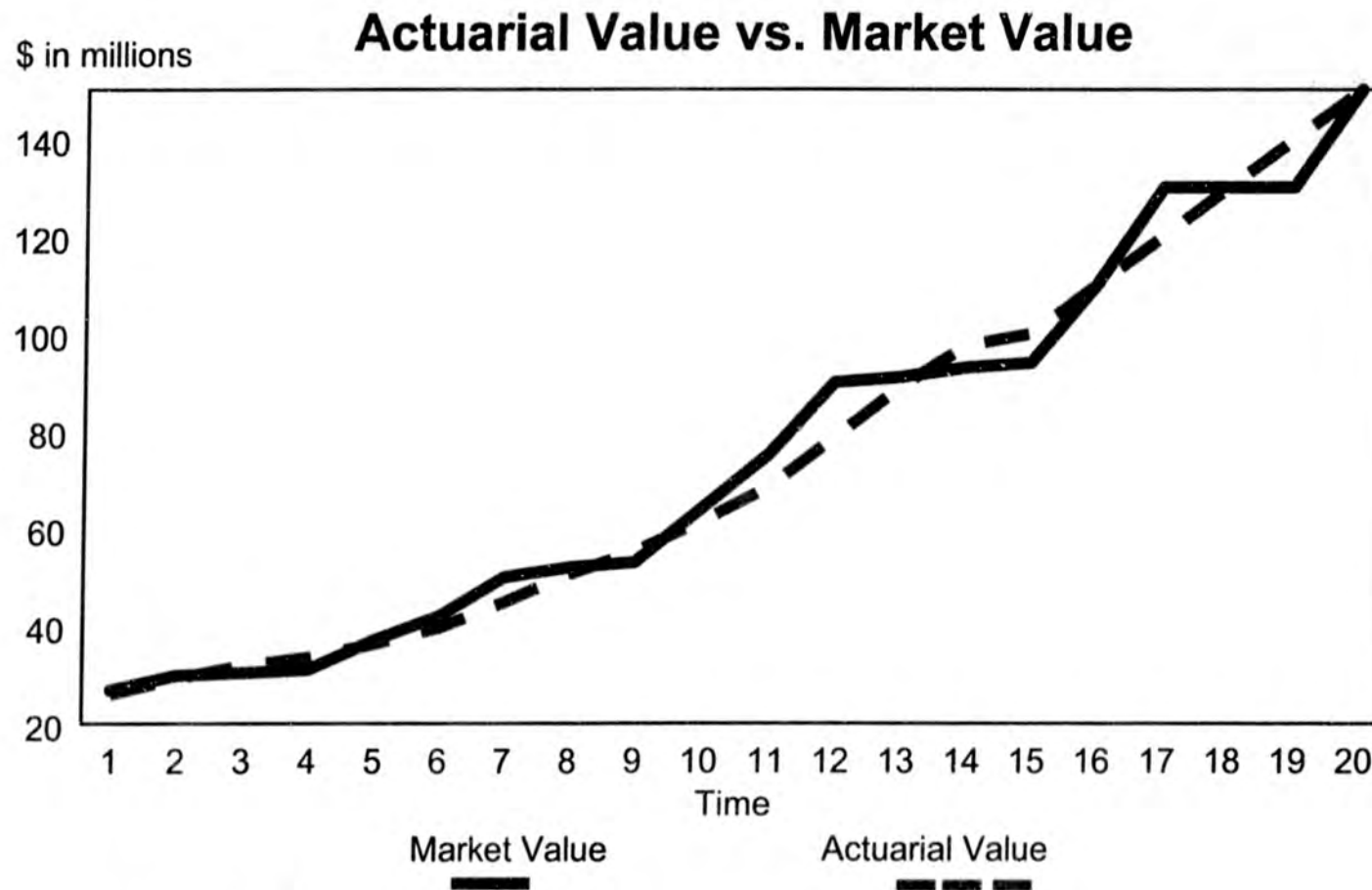


Accrued Liability - Assets = Unfunded/(Surplus)

Asset Valuation Method

- 5-year smoothing of Market Value
- Each year, a base is determined equal to difference between expected and actual return
- 20% of each base over last 5 years is recognized in Actuarial Value
- Constrained to be within 80% and 120% of Market Value
- Reduces volatility on actuarial contribution, but does not eliminate volatility
- Asset value reinitialized at Market Value on June 30, 2002.
Phase-in of 20% of each base occurs over five years

Example of Asset Smoothing Method



Actuarial Value is expected to be:

- Below Market when market is doing well
- Above Market when market is doing poorly

Review of Mercer's 2004 Actuarial Valuation

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Review of Mercer's 2004 Valuation

- Reviewed assumptions and methods
- Replicated the 2004 valuation results
- Completed PERS and TRS
- JRS and NGNMRS will be completed later this year

Comments on Actuarial Review

- Projected Unit Credit Method is more likely to produce increasing normal cost rates. Entry Age Method is expected to produce more stable normal cost rates
- Investment return assumption of 8.25% is reasonable long-term given current asset allocation policy
- Payroll growth assumption is overstated. We will recommend reducing from 4.25% to 4.0% for next valuation
- Demographic assumptions are generally reasonable, although we want to carefully review retirement rates during the experience analysis

*longevity
life expectancy
withdrawal patterns
retirement patterns*

Comments on 2004 Replication

- Buck results matched Mercer results closely for TRS
- Minor differences in valuation process on TRS “washed out,” so differences not material
- Mercer understated the healthcare benefits in the PERS valuation by 7%
- Minor differences in valuation process of PERS pension benefit not material

Replication of Mercer's Results

TRS (\$ in thousands)

	Mercer	Buck	%
Pension Accrued Liability	\$ 4,216,480	\$ 4,200,341	(0.38%)
Healthcare Accrued Liability	1,907,120	1,933,624	1.39%
Total	\$ 6,123,600	\$ 6,133,965	0.17%
Pension Normal Cost	\$ 71,119	\$ 70,264	(1.20%)
Healthcare Normal Cost	46,104	46,194	0.20%
Total	\$ 117,223	\$ 116,458	(0.65%)
Normal Cost Rate	13.76%	13.61%	(1.09%)
Past Service Rate	28.02%	28.14%	0.43%
Total Employer Contribution Rate	41.78%	41.75%	(0.07%)

Replication of Mercer's Results

PERS (\$ in thousands)

	Mercer	Buck	%
Pension Accrued Liability	\$ 6,711,507	\$ 6,676,235	(0.53%)
Healthcare Accrued Liability	4,732,409	5,088,308	7.52%
Total	\$11,443,916	\$11,764,543	2.80%
Pension Normal Cost	\$ 165,003	\$ 164,834	(0.10%)
Healthcare Normal Cost	131,483	144,123	9.61%
Total	\$ 296,486	\$ 308,957	4.21%
Normal Cost Rate	13.32%	14.16%	6.31%
Past Service Rate	14.87%	16.21%	9.01%
Total Employer Contribution Rate	28.19%	30.37%	7.73%

2005 Actuarial Valuation Results

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Changes Since Last Year

- No change in Benefit Provisions
- No change in Actuarial Assumptions
- No change in Asset Valuation Method
- No change in Funding Method
- Changes to assumptions and methods will be recommended in June with the results of the experience analysis

Public Employees' Retirement System

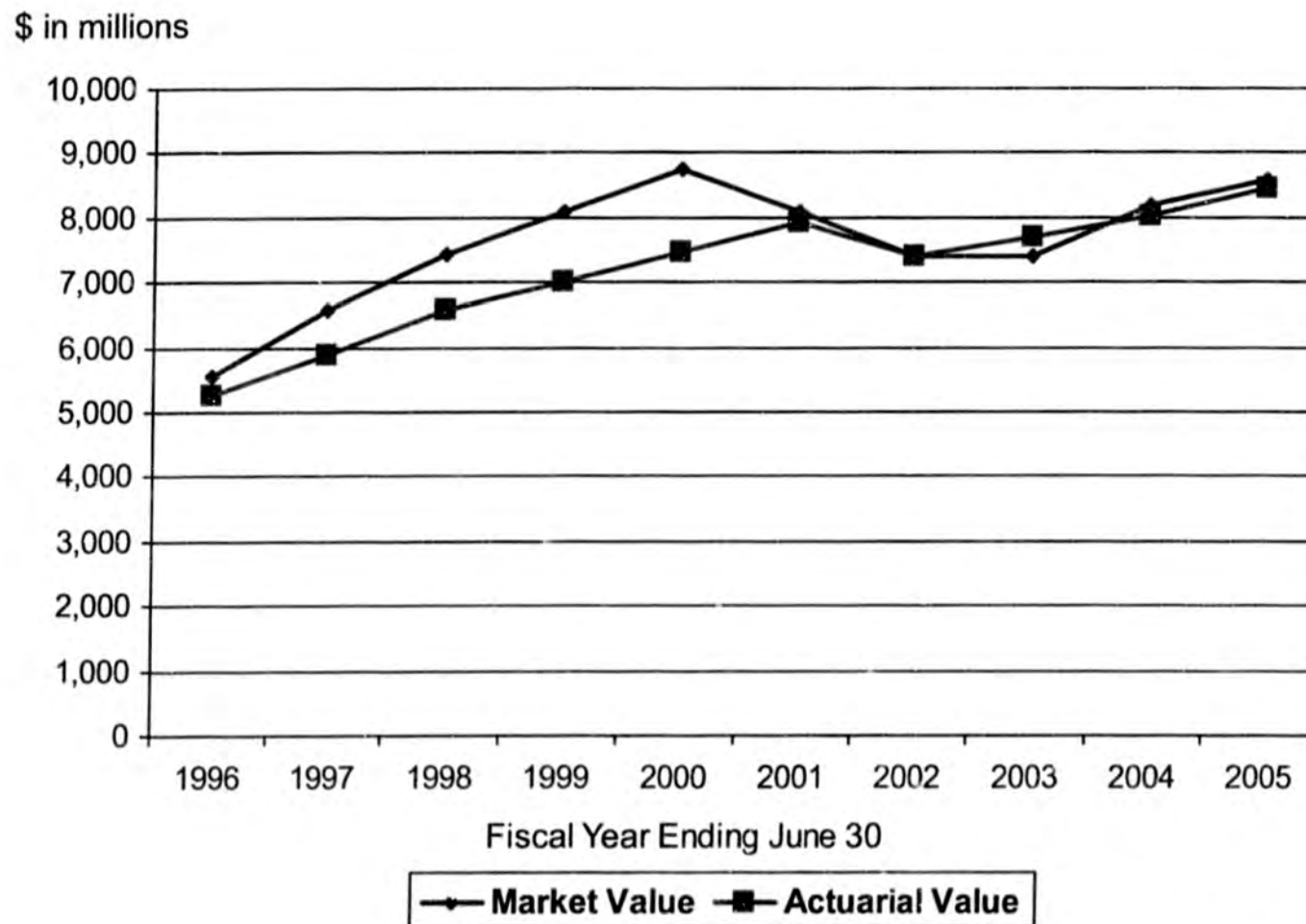
Police/Fire and Others Combined

Pension and Postemployment Healthcare

Total System Assets (\$ in millions)

	Year Ending	
	June 30, 2004	June 30, 2005
1. Actuarial Value (BOY)	\$7,687	\$8,030
Contributions	224	293
Disbursements	(498)	(567)
Expected Return on Market Value	599	663
2. Preliminary Actuarial Value (EOY)	\$8,012	\$8,419
3. 5-year Smoothing	18	24
4. Actuarial Value (EOY)	\$8,030	\$8,443
5. Future Smoothing Amount	147	148
6. Market Value (EOY)	\$8,177	\$8,591

Asset Smoothing for Public Employees' Retirement System Pension and Postemployment Healthcare 1996 – 2005



Public Employees' Retirement System

Police/Fire and Others Combined

Pension and Postemployment Healthcare

(\$ in millions)

	July 1, 2004	July 1, 2005
1. Number		
- Active	33,612	33,730
- Inactive Non Vested	11,860	12,761
- Vested Terminations	5,965	6,105
- Retired and beneficiaries	<u>19,572</u>	<u>20,703</u>
- Total	71,009	73,299
2. Annual Compensation	\$1,472	\$1,513
3. Assets		
- Market Value	\$8,177	\$8,591
- Actuarial Value	8,030	8,443
- % AV to MV	98.2%	98.3%
4. Annual Benefit Payments		
- Total	\$498	\$567
- % of Market Value	6.1%	6.6%
5. Accumulated Member Contributions		
- Total for Actives and Inactives	\$1,339	\$1,389
- Average (actual)	\$26,040	\$26,405

Public Employees' Retirement System

Police/Fire and Others Combined

Pension and Postemployment Healthcare

Actuarial Contribution Under Projected Unit Credit Method (\$ in millions)

Funding	July 1, 2004	July 1, 2005
1. Actuarial Accrued Liability	\$ 11,444	\$ 12,845
2. Actuarial Value of Assets	<u>8,030</u>	<u>8,443</u>
3. Unfunded Actuarial Accrued Liability	\$ 3,414	\$ 4,402
4. Funded Ratio	70.2%	65.7%
5. Annual Actuarial Contribution		
– Normal Cost	\$ 296	\$ 338
– Amortization of Unfunded (25) Years	<u>219</u>	<u>285</u>
– Total Contribution	\$ 515	\$ 623
– % of Pay	35.00%	39.27%
6. Member Contribution		
– Amount	\$ 100	\$ 109
– % of Pay	6.81%	6.84%
7. Employer Required Contribution		
– Amount	\$ 415	\$ 514
– % of Pay	28.19%	32.43%

Public Employees' Retirement System

Police/Fire and Others Combined

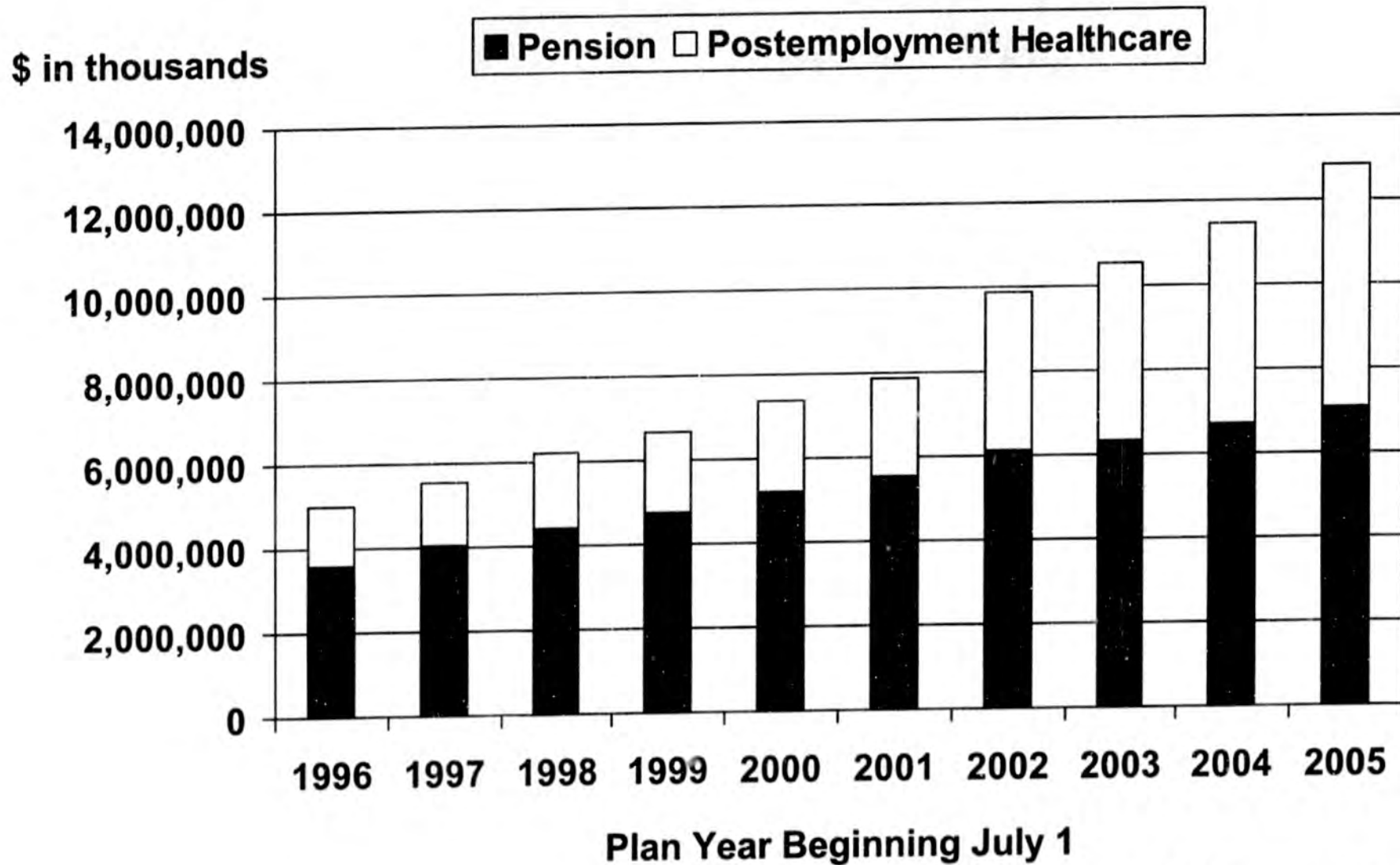
Pension and Postemployment Healthcare

Actuarial Contribution Under Projected Unit Credit Method (\$ in millions)

Funding	Pension	Postemployment Healthcare	Total
1. Actuarial Accrued Liability	\$ 7,087	\$ 5,758	\$ 12,845
2. Actuarial Value of Assets	<u>6,017</u>	<u>2,426</u>	<u>8,443</u>
3. Unfunded Actuarial Accrued Liability	\$ 1,070	\$ 3,332	\$ 4,402
4. Funded Ratio	84.9%	42.1%	65.7%
5. Annual Actuarial Contribution			
– Normal Cost	\$ 181	\$ 157	\$ 338
– Amortization of Unfunded (25) Years	<u>70</u>	<u>215</u>	<u>285</u>
– Total Contribution	\$ 251	\$ 372	\$ 623
– % of Pay	15.83%	23.44%	39.27%
6. Member Contribution			
– Amount			\$ 109
– % of Pay			6.84%
7. Employer Required Contribution			
– Amount			\$ 514
– % of Pay			32.43%

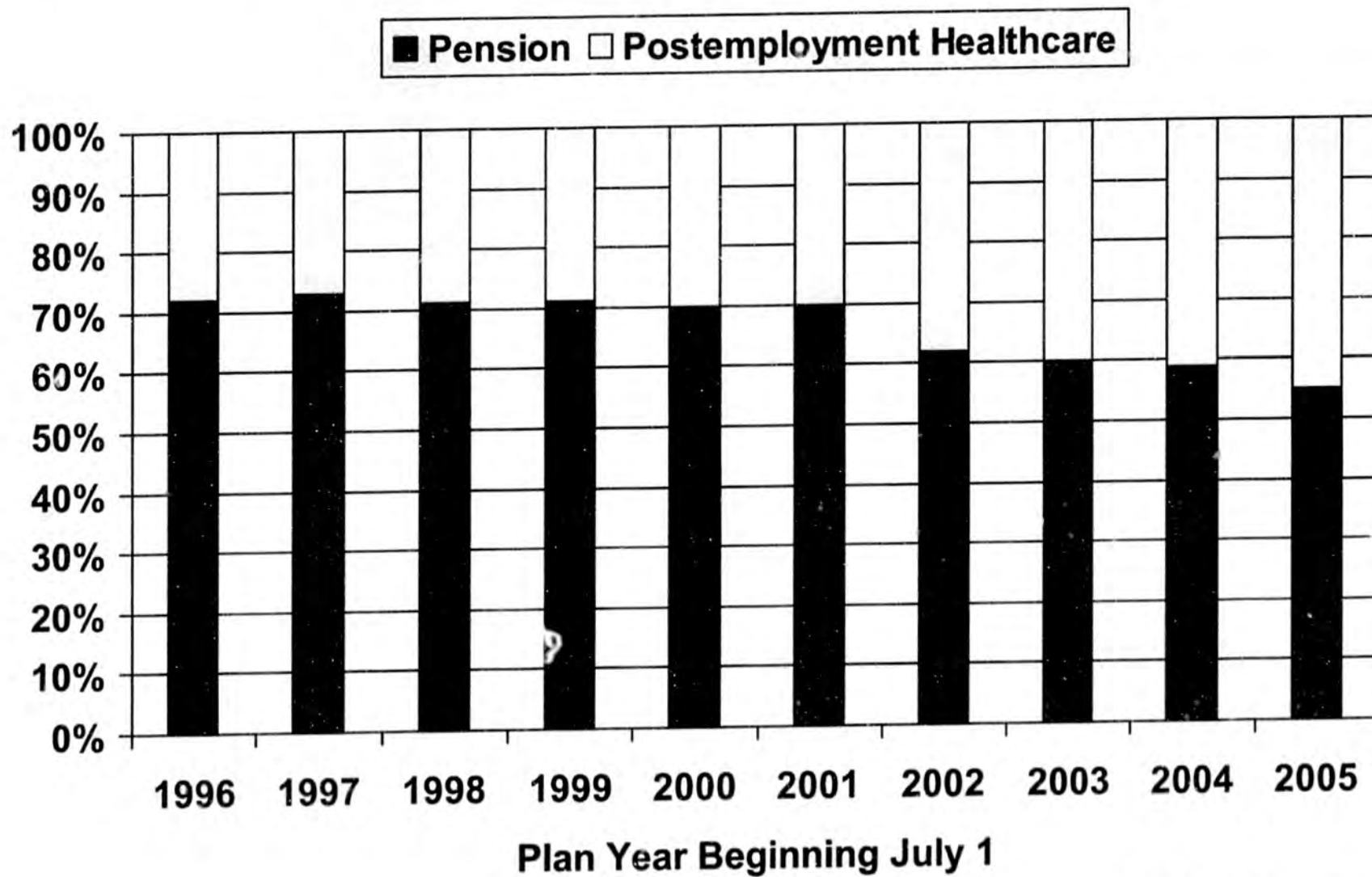
PERS Actuarial Accrued Liability History

Pension and Postemployment Healthcare



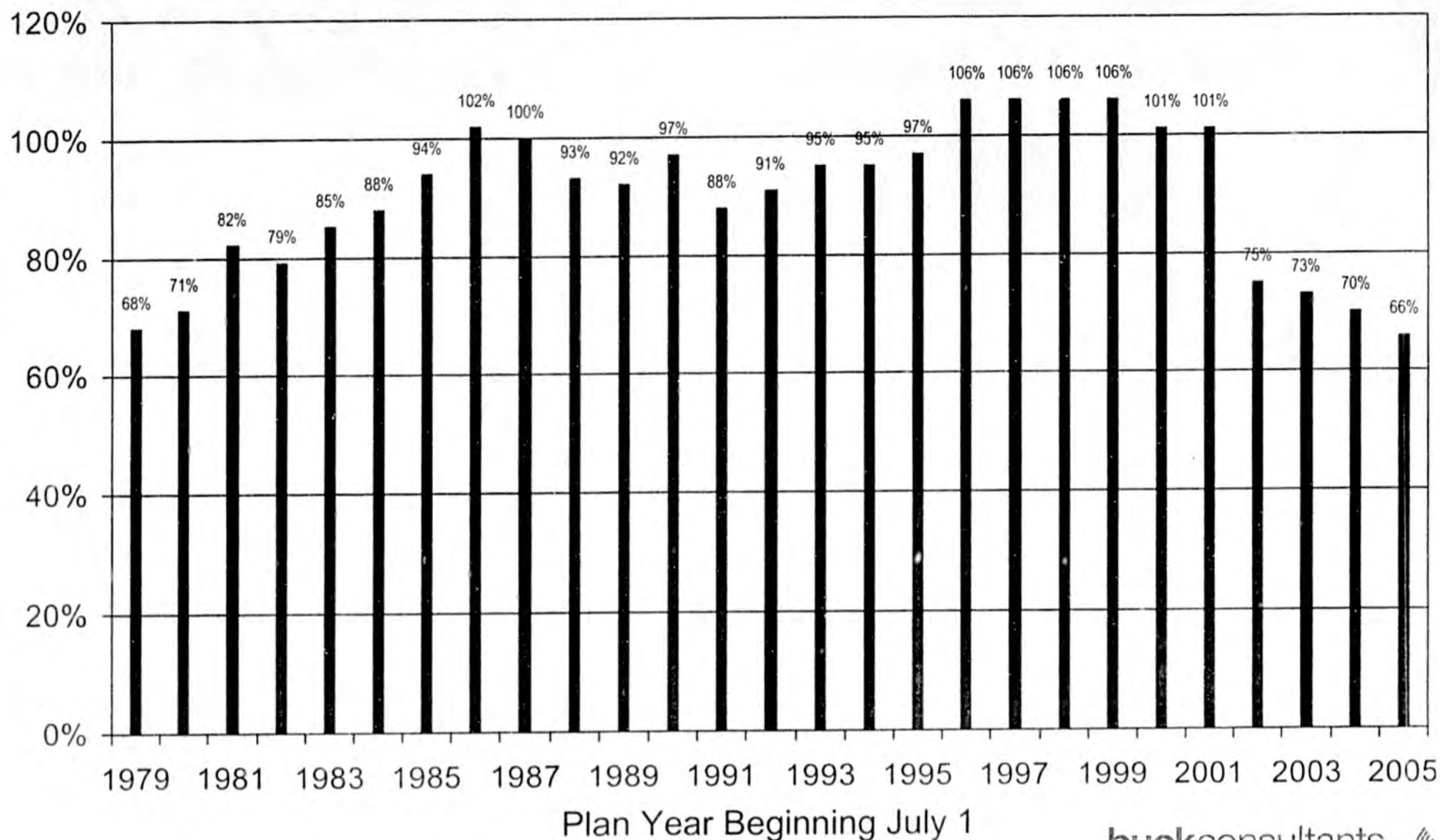
PERS Actuarial Accrued Liability History

Distribution % Between Pension
and Postemployment Healthcare



PERS Funding Ratio History

Pension and Postemployment Healthcare Based on Valuation Assets



Teachers' Retirement System

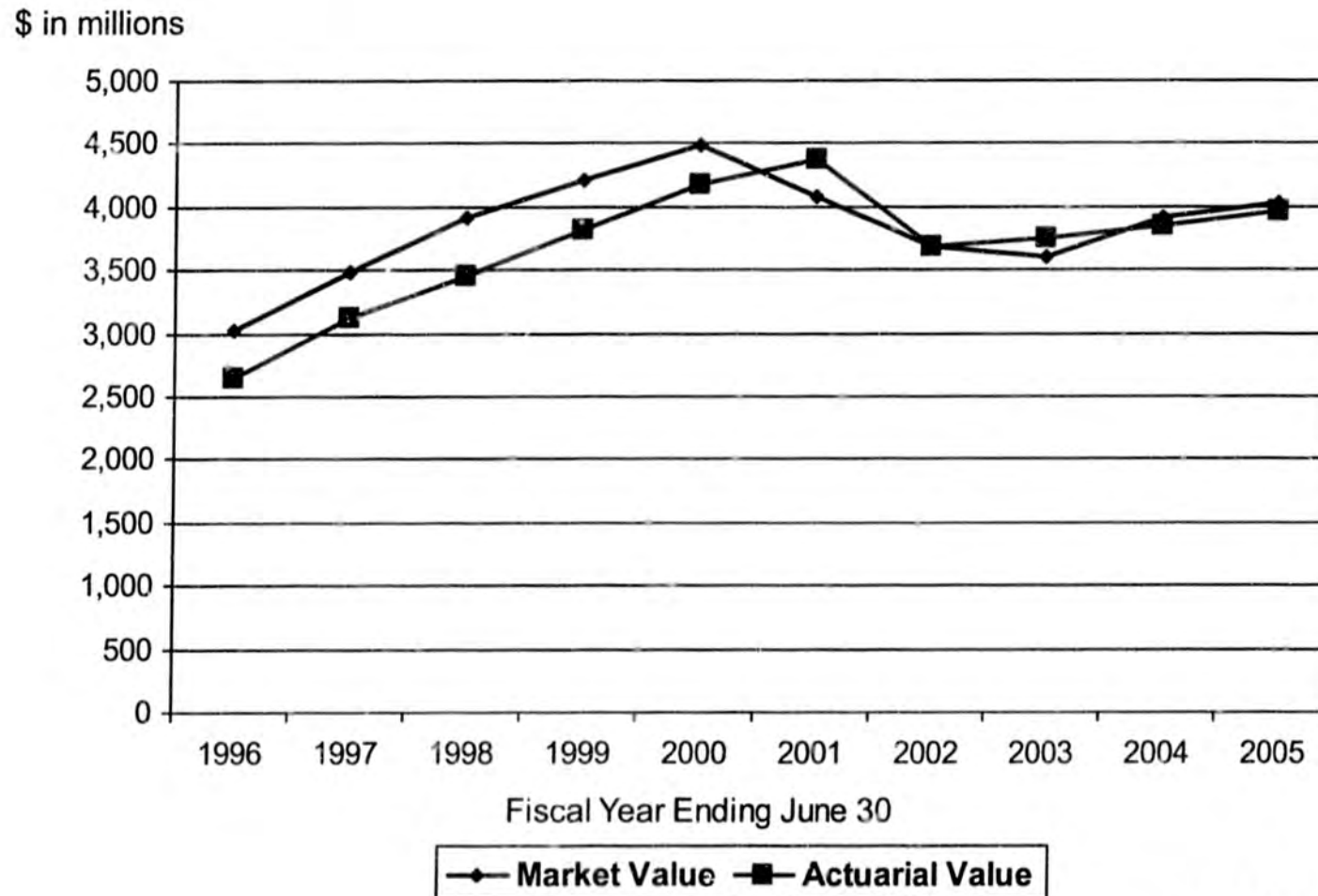
Pension and Postemployment Healthcare

Total System Assets (\$ in millions)

	Year Ending	
	June 30, 2004	June 30, 2005
1. Actuarial Value (BOY)	\$3,752	\$3,845
Contributions	126	150
Disbursements	(329)	(359)
Expected Return on Market Value	289	314
2. Preliminary Actuarial Value (EOY)	\$3,838	\$3,950
3. 5-year Smoothing	7	9
4. Actuarial Value (EOY)	\$3,845	\$3,959
5. Future Smoothing Amount	67	68
6. Market Value (EOY)	\$3,912	\$4,027

- yr end '05
6/30
sufficient
to pay cost
of accruing
benefits

Asset Smoothing for Teachers' Retirement System Pension and Postemployment Healthcare 1996 – 2005



Teachers' Retirement System

Pension and Postemployment Healthcare

(\$ in millions)

	July 1, 2004	July 1, 2005
1. Number		
- Active	9,688	9,656
- Inactive Non Vested	2,746	2,874
- Vested Terminations	724	826
- Retired and beneficiaries	<u>8,707</u>	<u>9,020</u>
- Total	21,865	22,376
2. Annual Compensation	\$522	\$536
3. Assets		
- Market Value	\$3,912	\$4,027
- Actuarial Value	3,845	3,959
- % AV to MV	98.3%	98.3%
4. Annual Benefit Payments		
- Total	\$329	\$359
- % of Market Value	8.4%	8.9%
5. Accumulated Member Contributions		
- Total for Actives and Inactives	\$647	\$672
- Average (actual)	\$49,203	\$50,300

Teachers' Retirement System

Pension and Postemployment Healthcare

Actuarial Contribution Under Projected Unit Credit Method (\$ in millions)

Funding	July 1, 2004	July 1, 2005
1. Actuarial Accrued Liability	\$ 6,123	\$ 6,499
2. Actuarial Value of Assets	<u>3,845</u>	<u>3,959</u>
3. Unfunded Actuarial Accrued Liability	\$ 2,278	\$ 2,540
4. Funded Ratio	62.8%	60.9%
5. Annual Actuarial Contribution		
– Normal Cost	\$ 117	\$ 119
– Amortization of Unfunded (25) Years	<u>146</u>	<u>166</u>
– Total Contribution	\$ 263	\$ 285
– % of Pay	50.46%	50.83%
6. Member Contribution		
– Amount	\$ 45	\$ 49
– % of Pay	8.68%	8.69%
7. Employer Required Contribution		
– Amount	\$ 218	\$ 236
– % of Pay	41.78%	42.14%

Teachers' Retirement System

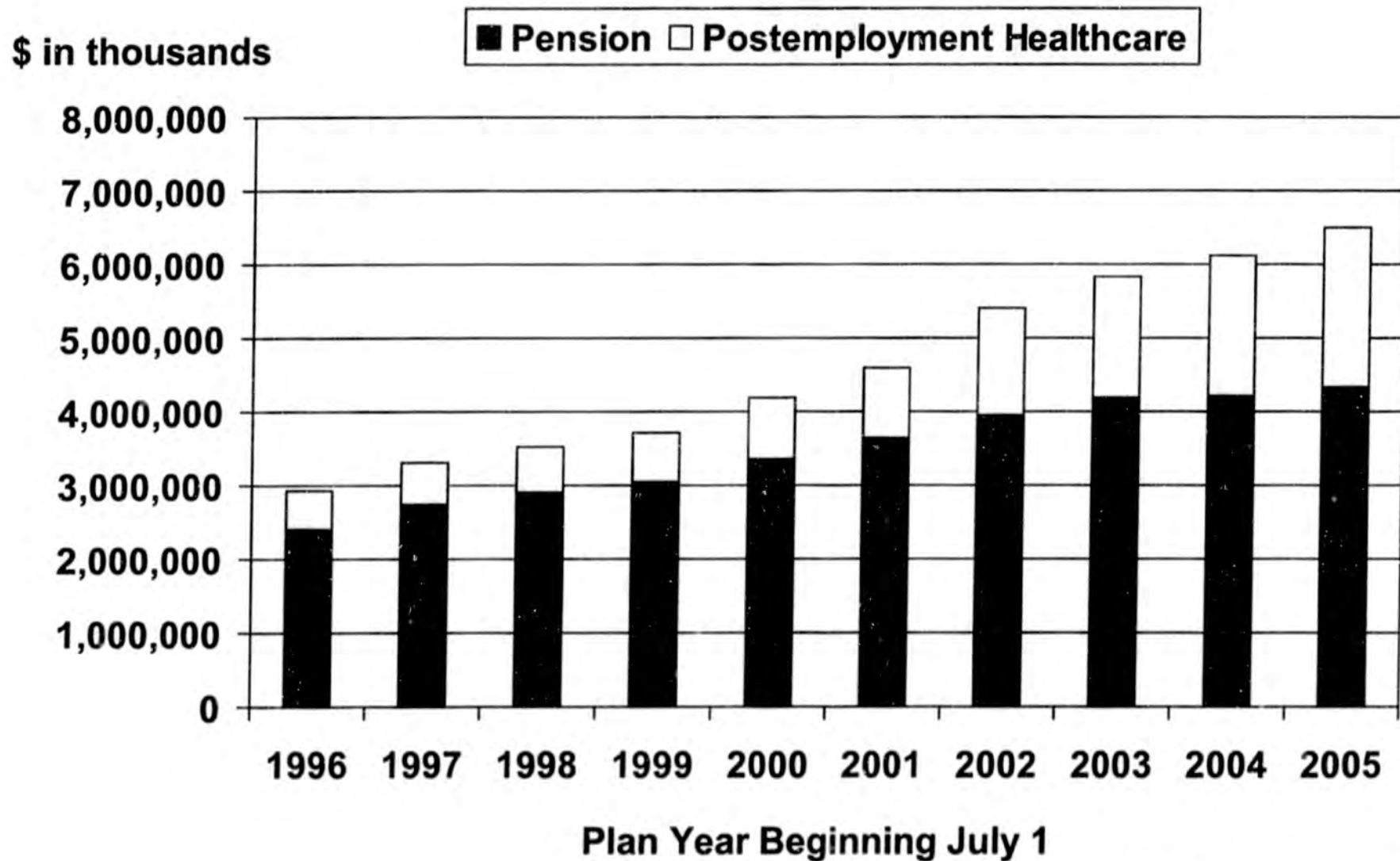
Pension and Postemployment Healthcare

Actuarial Contribution Under Projected Unit Credit Method (\$ in millions)

Funding	Pension	Postemployment Healthcare	Total
1. Actuarial Accrued Liability	\$ 4,335	\$ 2,164	\$ 6,499
2. Actuarial Value of Assets	<u>3,185</u>	<u>774</u>	<u>3,959</u>
3. Unfunded Actuarial Accrued Liability	\$ 1,150	\$ 1,390	\$ 2,540
4. Funded Ratio	73.5%	35.8%	60.9%
5. Annual Actuarial Contribution			
– Normal Cost	\$ 71	\$ 48	\$ 119
– Amortization of Unfunded (25) Years	<u>75</u>	<u>91</u>	<u>166</u>
– Total Contribution	\$ 146	\$ 139	\$ 285
– % of Pay	26.04%	24.79%	50.83%
6. Member Contribution			
– Amount			\$ 49
– % of Pay			8.69%
7. Employer Required Contribution			
– Amount			\$ 236
– % of Pay			42.14%

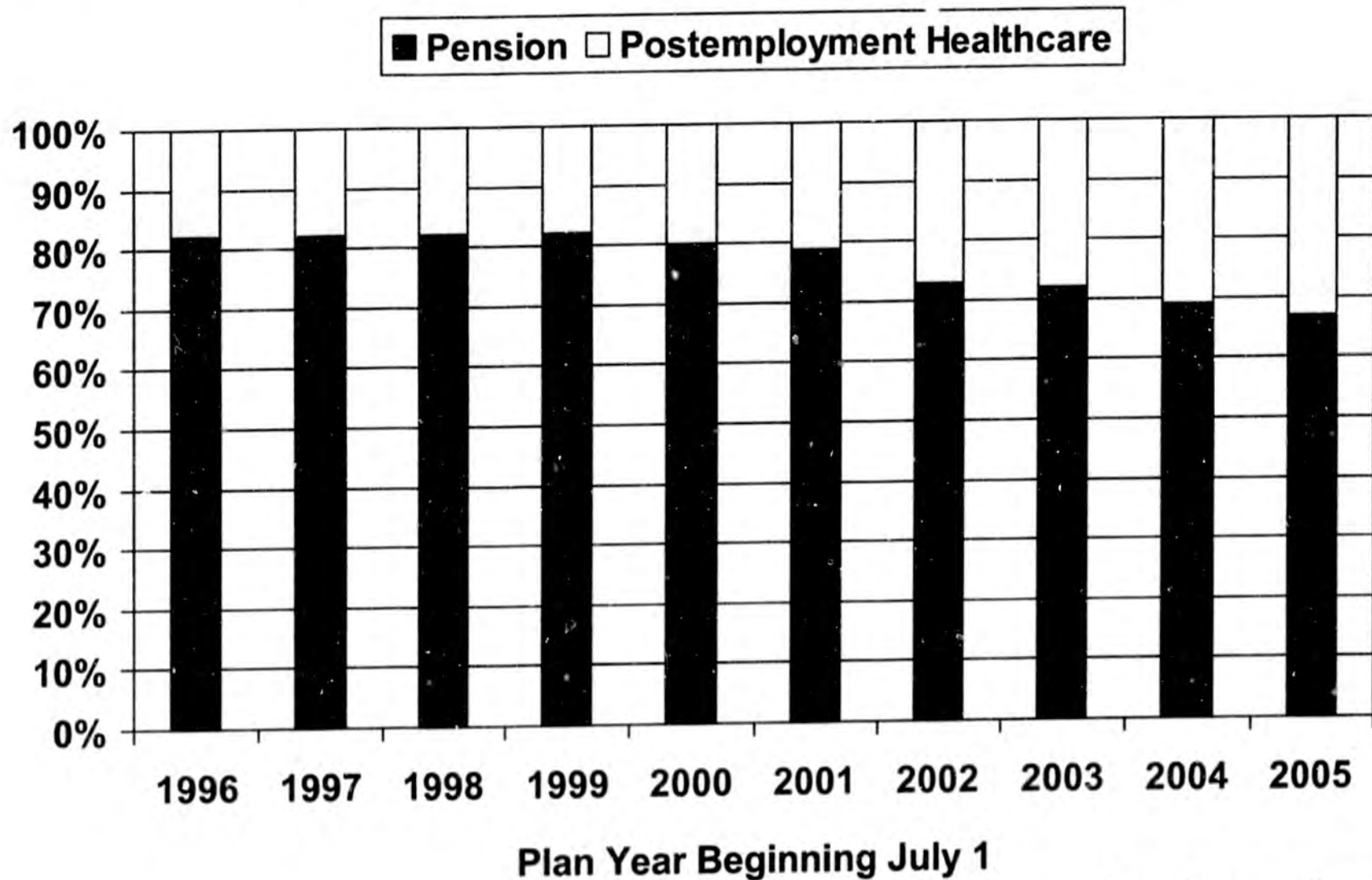
TRS Actuarial Accrued Liability History

Pension and Postemployment Healthcare



TRS Actuarial Accrued Liability History

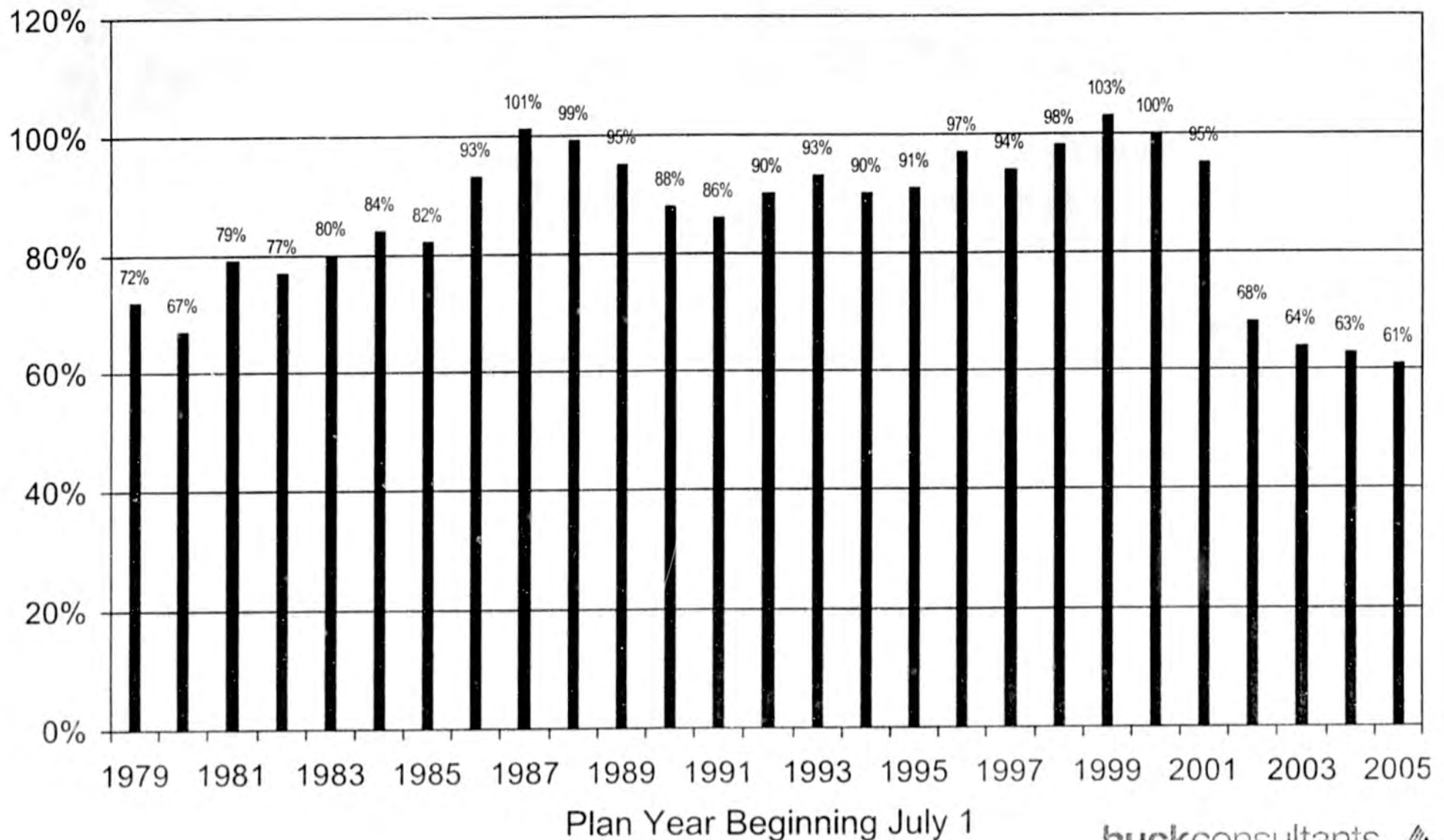
Distribution % Between Pension and Postemployment Healthcare



Plan Year Beginning July 1

TRS Funding Ratio History

Pension and Postemployment Healthcare
Based on Valuation Assets



Conclusions and Comments

PERS and TRS

- Modest asset gains on market value experienced during last year. Rate of return was about 8.55%, or .30% greater than 8.25% assumed.
- Delayed gains from prior years along with the investment gain during last year resulted in Actuarial Value return of 9.1%, or .85% more than 8.25% assumed.
- Loss on liabilities due to decremental experience, healthcare claims and trend, and changes from prior actuary

*- what happens
+ what is expected
health, experience
survival rates*

Conclusions and Comments (cont'd)

- Changes in Unfunded Liability (\$ in millions)

	<u>PERS</u>	<u>TRS</u>
2004 Unfunded Liability	\$ 3,414	\$ 2,278
- Expected increase	65	41
- Asset (gain)	(35)	(15)
- Decremental and other losses	726	117
- Contribution shortfall	<u>232</u>	<u>119</u>
2005 Unfunded Liability	\$ 4,402	\$ 2,540

Conclusions and Comments (cont'd)

- Increased employer contribution rates required for PERS and TRS

	<u>PERS</u>	<u>TRS</u>
- 2004	28.19%	41.78%
- 2005	32.43%	42.14%
- Change	+4.24%	+0.36%

- Funded ratios declined over last year

	<u>PERS</u>	<u>TRS</u>
- 2004	70.2%	62.8%
- 2005	65.7%	60.9%
- Change	(4.5%)	(1.9%)

Conclusions & Comments – Medicare Part D

- Medicare Part D subsidy is best near-term option
- Wrap-around or PDP likely best long-term option (economically and for accounting)
- GASB proposes treating the subsidy differently than FASB:
 - FASB uses liability net of subsidy, GASB does not
 - GASB Proposed Technical Bulletin No. 2006-a

Conclusions & Comments – Medicare Part A

- Impact of Medicare Part A proportional to members with Part A coverage
- This proportion will grow over time, lowering State costs
- It may be cheaper to pay Medicare Part A premiums than to pay "no-Part A" hospital claims
- Incent retirees to report FICA-covered non-State and FICA-covered spouse employment
- Medicare is likely to pay less to hospitals than the State currently pays
- Hospital backlash?



Questions?

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