ALASKA PUBLIC EMPLOYEE'S RETIREMENT SYSTEM (PERS)

COSTS AND RISKS OF ALASKA PENSION CHANGES

ALASKA POLICY FORUM

Prepared by:

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May 10, 2022

reason FOUNDATION

About the Pension Integrity Project

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

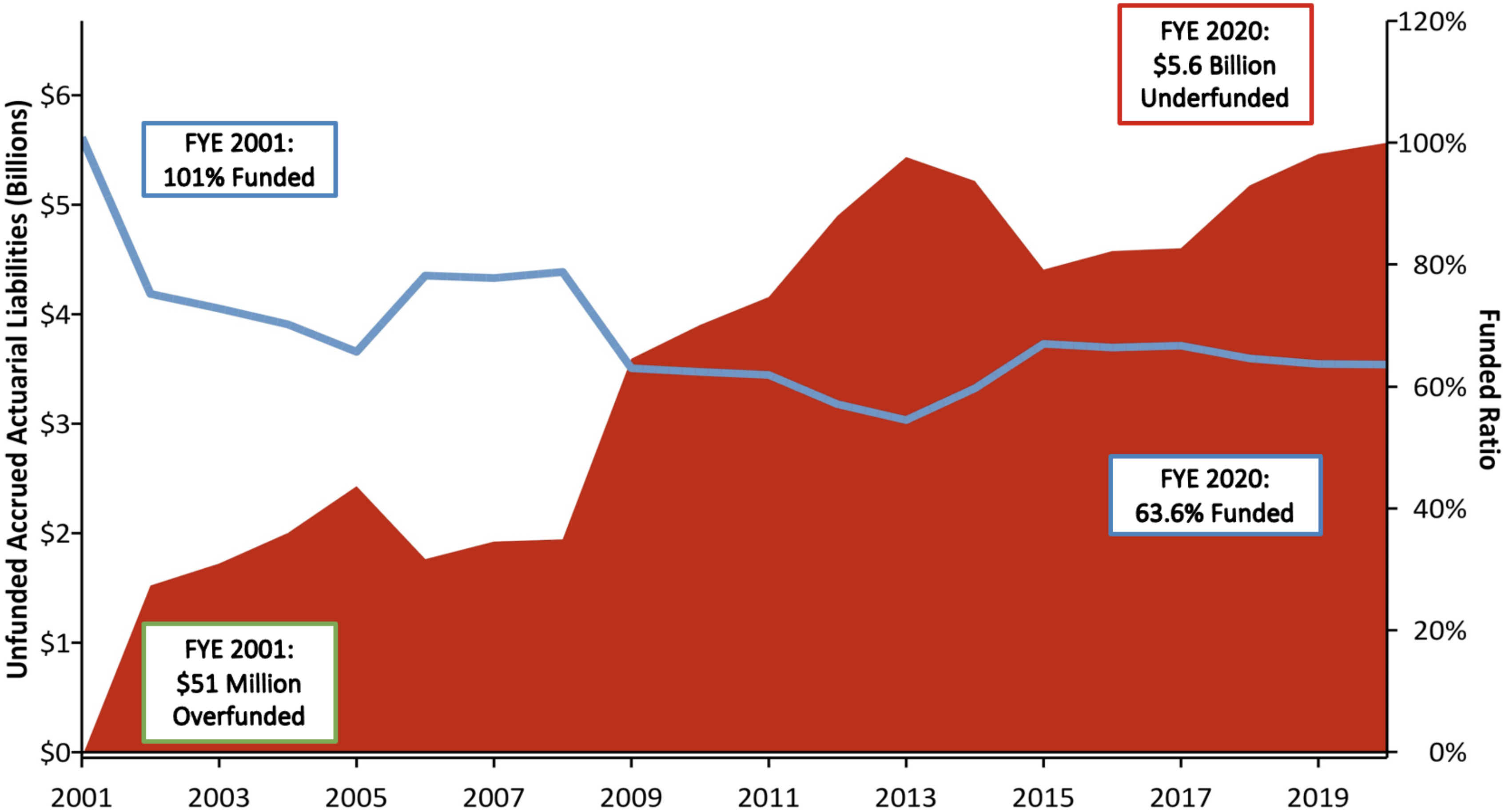
- *Customized analysis* of pension system design, trends
- *Independent actuarial modeling* of reform scenarios
- Consultation and modeling around *custom policy designs*
- Latest pension reform *research and case studies*
- *Peer-to-peer mentoring* from state and local officials who have successfully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

Policy Objectives

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

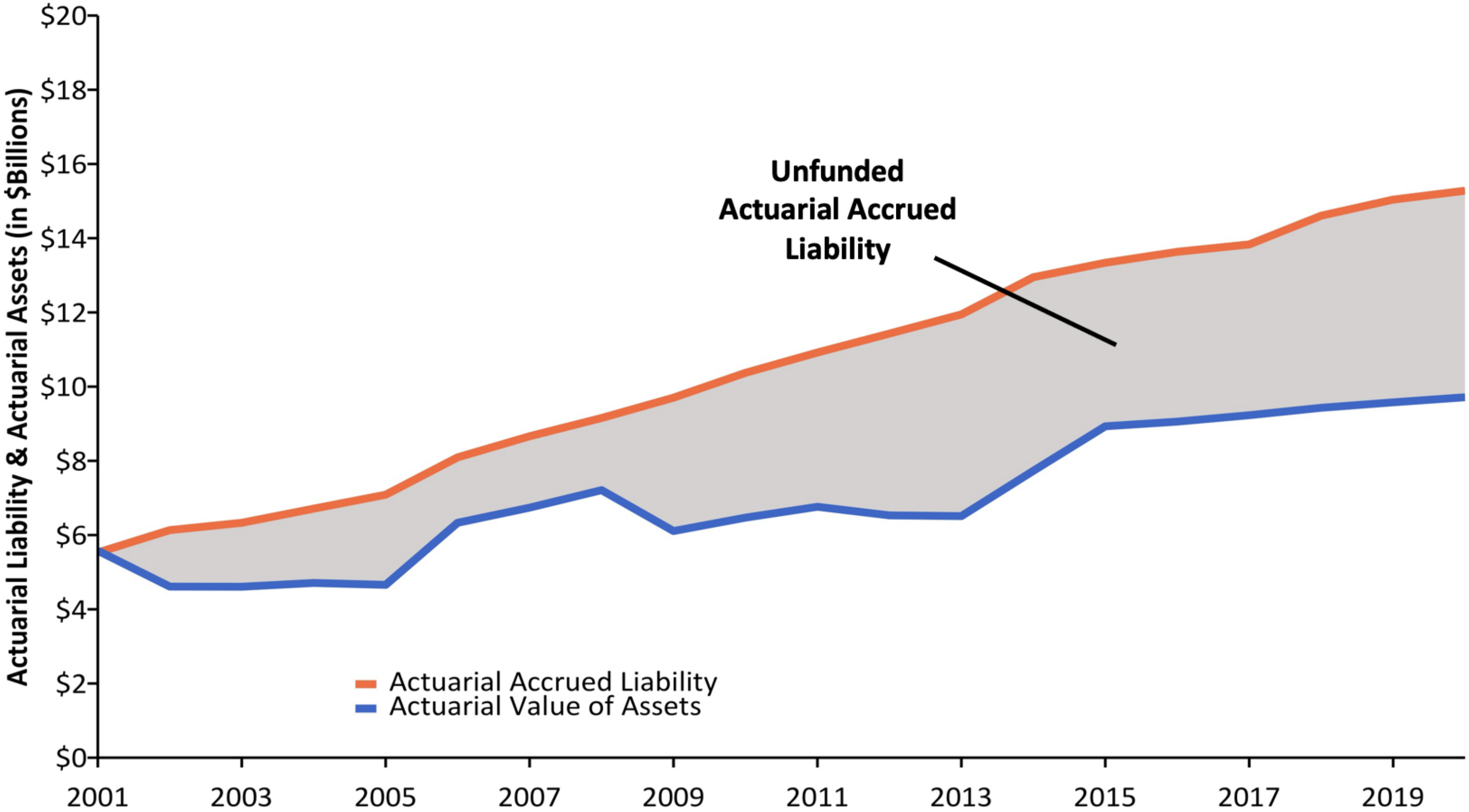
CHALLENGES FACING AK PERS

A History of PERS Solvency (2001-2020)



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

PERS Liabilities are Growing Faster than Assets



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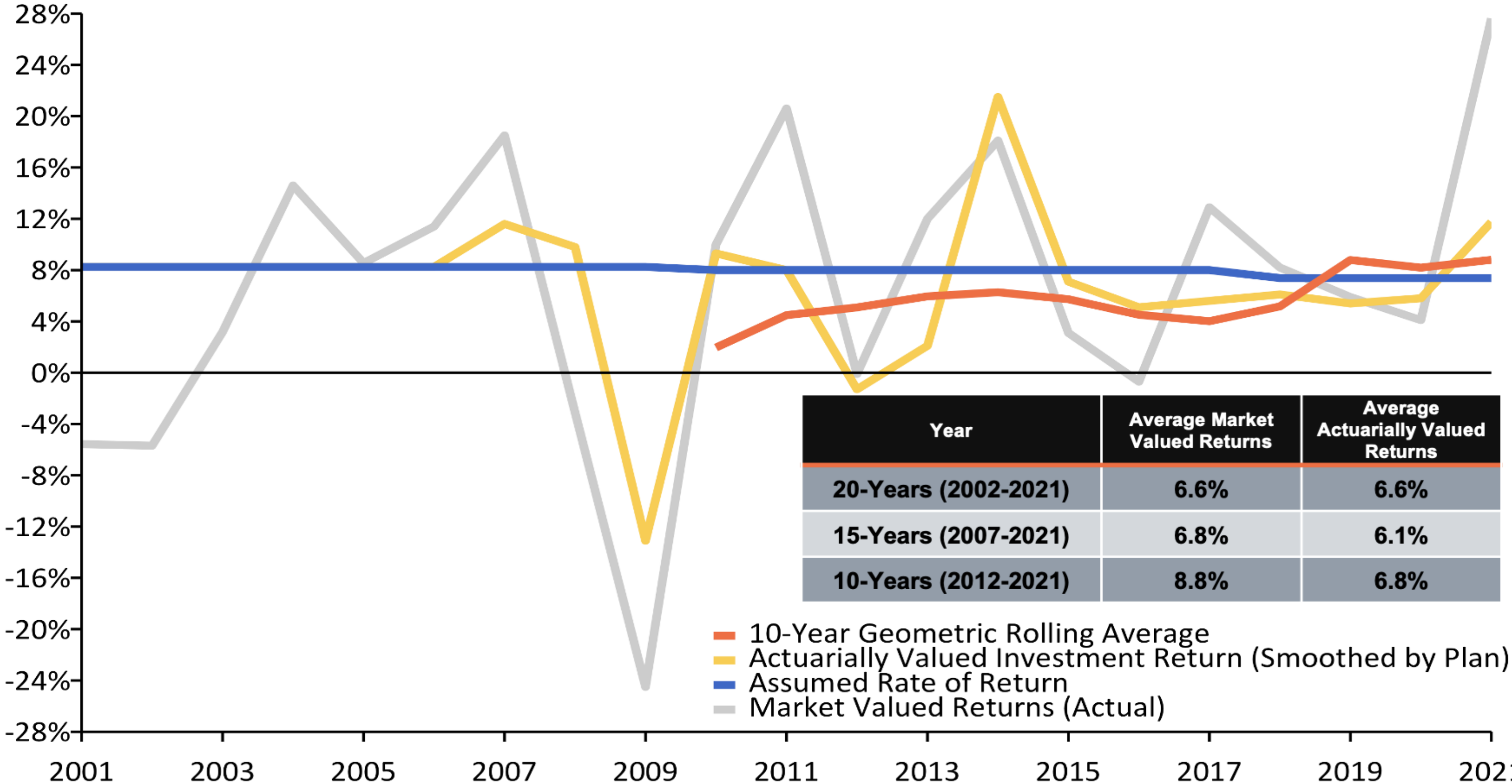
Investment Return History, 2001-2020



Year	Average Market Valued Returns	Average Actuarially Valued Returns
20-Years (2002-2021)	6.6%	6.6%
15-Years (2007-2021)	6.8%	6.1%
10-Years (2012-2021)	8.8%	6.8%

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

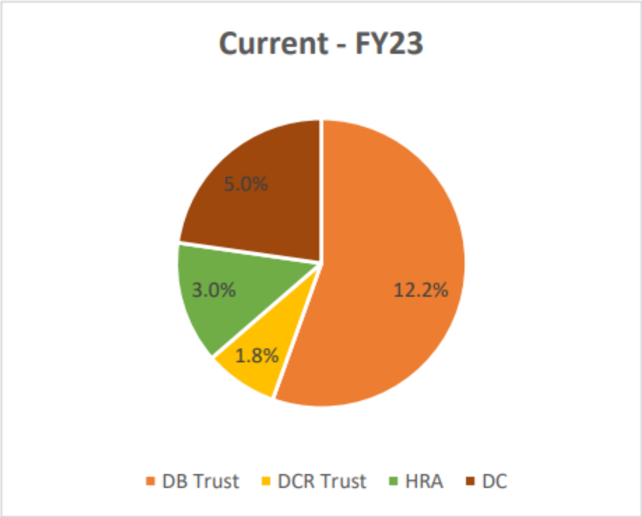
HOUSE BILL 55 PROBLEMS

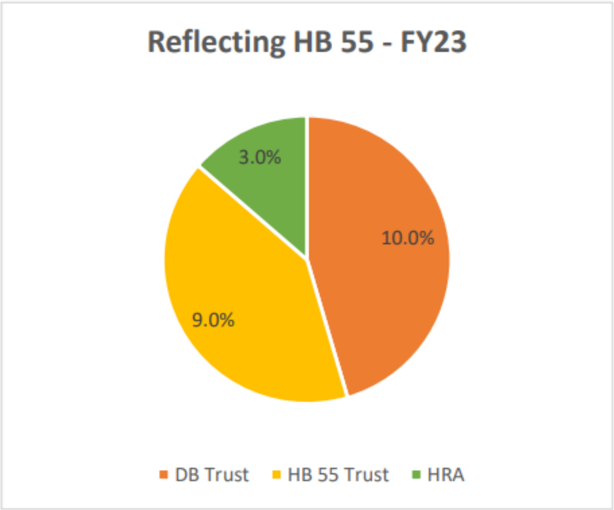
HB 55 Issues

- Problem #1: Poor Plan Design
- Problem #2: Minimal Actuarial Scrutiny
    - Pension Integrity Project Modeling
- Problem #3: Pension Cost Increases Coming
- Problem #4: Pension Swap Won’t Solve Retention Issues

Problem #1: Poor Plan Design

- Closes the current DC plan to all new hires.
- Capped contribution rates.
  - Employees: 8%-12%
  - Employers: 10% + unfunded liabilities
- Plan assumptions are an outlier among other defined benefit plans.
- Underfunds legacy PERS tier.





Problem #2: Minimal Actuarial Scrutiny

- There is no publicly available long-term actuarial forecasting or stress testing.

- Supporters claim that “tweaks to the new pension would eliminate financial risk to the state” but those claims have faced minimal actuarial scrutiny to support them.

- Buck flagged risks, but did not quantify them…

- What happens to HB 55 costs and unfunded liabilities if plan experience differs from expectations?

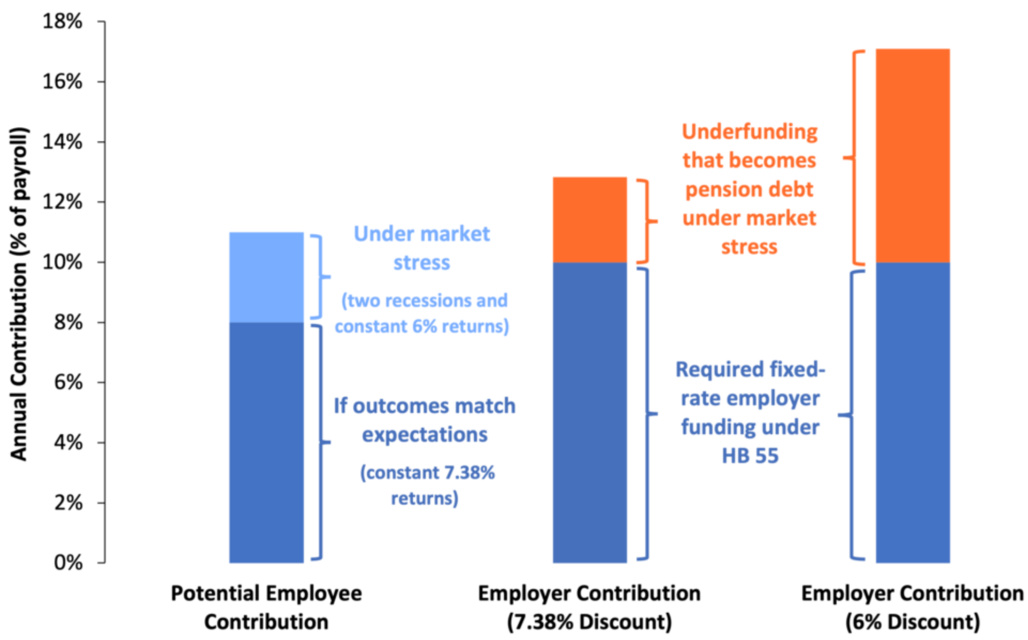
- HB 55 would commit Alaska to unpredictable long-term costs, it is crucial to consider the costs over decades, not just a few years.

- Recognizing the need for a long-term perspective on funding and costs, we prepared preliminary modeling of the proposed new HB 55 tier.

Stress-Test Modeling On New Tier Under HB 55

- Under baseline (plan hits 100% of assumptions, 100% of the time) 30-year employer contributions would be $743 million.
- Under market stress scenarios (recession in 2023/2038 and a 6% long term rate of return) 30-year employer contributions would be $887 million.
- Figure 1 breaks down the ranges of annual contributions both employees and employers could expect under the proposed plan.

Fig 1. Market Stress on Employee and Employer Contributions under HB 55



Stress-Test Modeling On New Tier Under HB 55

- Applying the two-recession stress scenario shows that the new plan could go from no unfunded obligations to having as much as $302 million in pension debt by the end of the modeled 30-year window (figure 2).
- Modeling of the new pension shows that a single recession year in 2023 could immediately generate unfunded liabilities and go from fully funded to 71% funded after just one bad year of losses (figure 3).

Fig 2. Unfunded Liability Forecast under HB 55

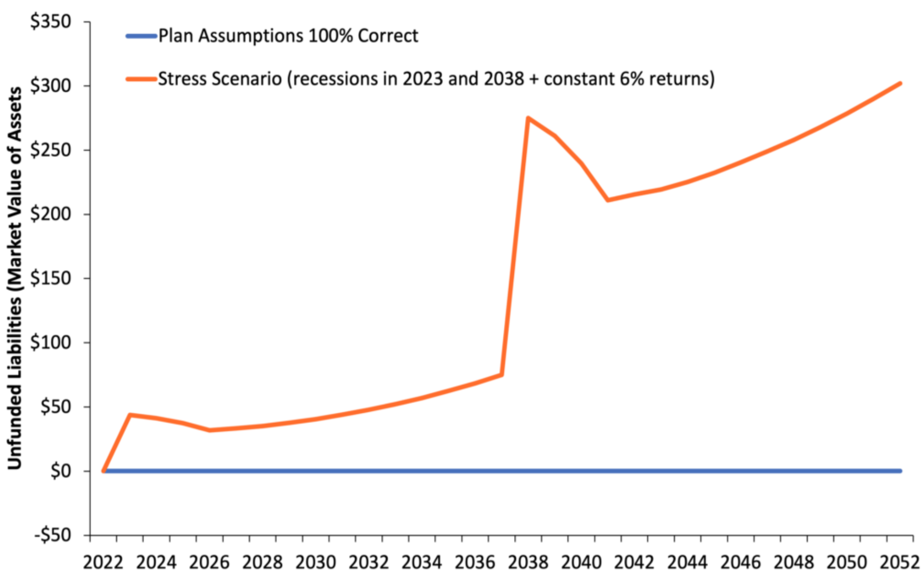
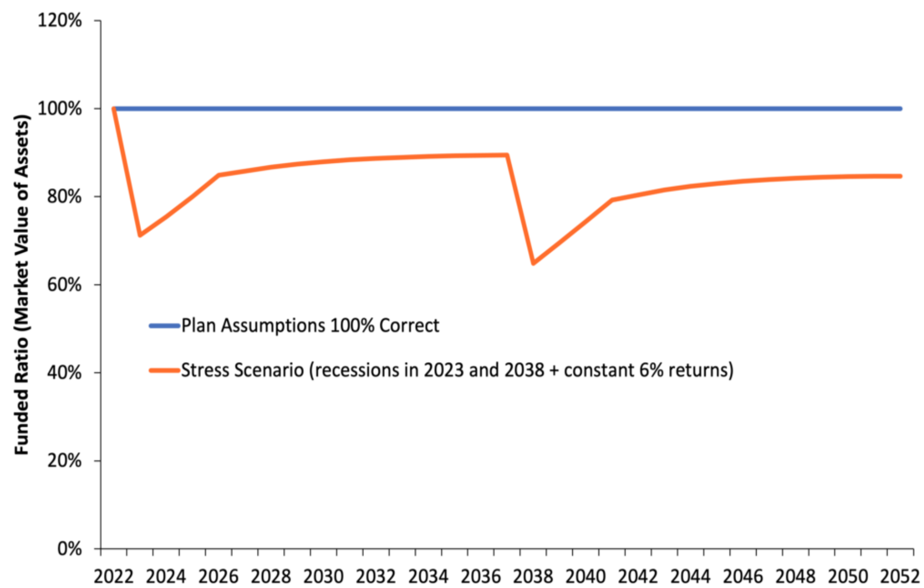


Fig 3. Funding Forecast under HB 55



Problem #3: Pension Cost Increases Coming

- HB 55 proposes the use of a 7.38% assumed rate of return, discount rate, and DC annuitization rate.

- HB 55 proposes to transfer all assets from the DC plan into the new DB plan.

- The legacy pension tier also still uses a 7.38% rate.

- National average is now under 7%.

- When Alaska PERS lowers their assumptions, costs will go up dramatically for both tiers.

- Adjusting the discount rate of the plan down to 6% could result in required contributions rising more than 7% over the current rate, totaling 17% of payroll.

Problem #4: Pension Swap Won't Solve Retention Issues

- House Bill 55 is being proposed by public safety associations concerned with recruitment and retention challenges.
- Proponents claim they are having trouble recruiting and retaining members due to the lack of a defined benefit pension for their members.
- However, this claim does not hold up to the data as 86% of police stations across the country are facing a shortage of members.
- Every one of those stations, outside of Alaska, has a pension with some defined benefit component.
- In fact, we have an academic working paper that shows retention rates did not change when Alaska swapped from a DB to DC in 2005.

Wrap-Up

- A 5-year employer cost projection is not a sufficient actuarial analysis and is embarrassingly narrow compared to what most actuarial firms conduct on proposed pension proposals.

- Why does HB 55 use 7.38%, far higher than the national average, when a previous proposal to put public safety into a defined benefit used 7%?

- Why doesn't this proposal use best practices from other pension reforms across the country?
    - Texas, Arizona, Michigan, and Colorado are among the states that have recently adopted new, risk-managed pension-like guaranteed retirement plans that also do not disproportionately burden employers with financial risk.

- Why close the DC plan when that design greatly benefits members who do not work a full career with the same employer?

Questions?

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