State of Alaska Pension Benefits & Challenges

Bucket List for Public Employee Retirees

OLLI Course – Day #1  October 2013

By: Charlie Gallagher, Dr. Ron Johnson and Frank Abegg
Day #1 Topics

- PERS & TRS Pension History
- Social Security Reforms (WEP & GPO)
- State Pension Financial Crises
- Pension Related Lawsuits
- Pension Underfunding
- Future Outlook for Existing and Future State Retirees
Video – Retirement Planning

Class Comments or Questions
PERS Participation (2011)

PERS:
160 Member Employers
3 Defined Benefit (DB) Tiers
   26,237 retirees
   6,253 terminated members entitled to future benefits
26,442 actives (70.3%)
58,932 total members

1 Defined Contribution (DC) Tier
   0 retirees
   554 terminated members entitled to future benefits
11,182 actives (29.7%)
11,736 total members

Source: FY 2011 PERS CAFR
TRS Participation (2011)

TRS:

58 Member Employers

2 Defined Benefit (DB) Tiers

10,598 retirees

840 terminated members entitled to future benefits

7,832 actives (74.1%)

19,270 total members

1 Defined Contribution (DC) Tier

0 retirees

502 terminated members entitled to future benefits

2,738 actives (25.9%)

3,240 total members

Source: FY 2011 TRS CAFR
The information on this timeline is not intended to replace the Alaska Statutes, the Alaska Administrative Code or Federal law. Language contained in the Alaska Statutes and the Alaska Administrative Code govern the plans.
1975 PERS Pension – TIER I

- Jointly Funded by Employees and State
- Vesting after 5 years service
- Pension based on 3 highest years
- Normal retirement at age 55, early at age 50
- PERS retirement at any age after 30 years
- Alaskan COLA @ 10% of base benefit
- PRPA – Post Retirement Pension Adjustment
- Medical & Disability coverage
1975 TRS Pension – TIER I

- Jointly Funded by Employees and State
- Vesting after **8 years** service
- Pension based on 3 highest years
- Normal retirement at age 55, early at age 50
- Teachers can retire at any age after 20 years
- Alaskan COLA @ 10% of base
- PRPA – Post Retirement Pension Adjustment
- Medical & Disability coverage
1986-1996 TIER II & III Changes

**TIER II [PERS & TRS]**
- Normal retirement increased to age 60 and early retirement at age 55
- Medical coverage delayed until age 60 or 25 years of service [no age limit for TIER I]
- COLA delayed until age 65 and older

**TIER III [PERS]**
- Pension benefit - 5 highest consecutive years
- Medical coverage at age 65 with 10 years of service.
- If Medicare eligible, employee pays from 10% to 30% depending on years of service
2006 State DCR Plan

State changes retirement program from Defined Benefit (DB) Pension to DCR Plan (similar to 401-K) for new employees (PERS TIER IV and TRS TIER III)

- Employee contributes 8% and State matches 5% (PERS) or 7% (TRS) into a tax-deferred account. State contributions vest 100% to employee in 5 years

- No retiree medical coverage until age 65 (if 10 years of service); employee pays 10% to 30%
Alaska Public Pension Actions

Medicare 1966
SS to SBS 1978
Hammond vs. Hoffbeck Lawsuit 1981
WEP/GPO 1983

PRPA Reduce
NEA/TRS/PERS Lawsuits 1990-1999
ARMB vs. Mercer Lawsuit 2005

TIER I
1970 1980 1985

TIER II-III
TIER III-IV
1978  Social Security to SBS Plan

• 1978 - the State established Supplemental Benefit System [SBS] and UA Pension Plan to replace Social Security
• SBS is a tax deferred 401-K type employee retirement fund
• Teachers allowed to add more contributions to SBS
• Some Municipalities just dropped Social Security and did not add an SBS Plan
Social Security Reforms

• **1977 - Government Pension Offset (GPO)**
  – Social Security *benefit for spouses and widows reduced by 2/3 of their own government pensions* (from non-Social Security covered employment)

• **1983 - Windfall Elimination Provision (WEP)**
  – Social Security benefit *reduced for people with government pensions and less than 30 years of “substantial” income paid into Social Security*
## GPO Impact on Social Security

<table>
<thead>
<tr>
<th></th>
<th>NO GPO IMPACT</th>
<th>GPO IMPACT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Husband’s SS Pension</td>
<td>$ 2,000/month</td>
<td>$ 2,000/month</td>
</tr>
<tr>
<td>Spouse’s SS Benefit (50% of Husband’s SS)</td>
<td>$ 1,000/month</td>
<td>$ 1,000/month</td>
</tr>
<tr>
<td>Total SS Benefit</td>
<td>$ 3,000/month</td>
<td>$ 3,000/month</td>
</tr>
<tr>
<td>Spouse’s State Pension</td>
<td>$ 900/month</td>
<td>$ 900/month</td>
</tr>
<tr>
<td><strong>SS Benefit Reduction</strong></td>
<td><strong>$ 0</strong></td>
<td><strong>- $ 600/month</strong></td>
</tr>
<tr>
<td><strong>Couple’s Total Retirement Benefits</strong></td>
<td><strong>$3,900/month</strong></td>
<td><strong>$ 3,300/month</strong></td>
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</table>
WEP Impact on Social Security

• If you paid Social Security tax on **30 years** of “substantial earnings”

    No Impact on Social Security Pension

• If you paid Social Security tax on **less than 30 years** of “substantial earnings”

    Up to **$380 Reduction** on Social Security Pension
Alaskan Seniors Affected by WEP/GPO

- According to Senator Begich’s office over **8,000** Alaskan Seniors are currently impacted

  - **6,000 Seniors** have reduced Social Security pension due to WEP

  - **2,000 Senior Widows or Spouses** have reduced Social Security survivor benefits due to GPO
1981 Hammond vs. Hoffbeck Lawsuit

- Lawsuit filed against State by NEA-AK, RPEA and ASEA

Article XII Section 7 of **Alaska Constitution** states:

“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.**”

Alaska Supreme Court **Decision:** An employee’s **retirement benefits, including health coverage, constitute a contract and shall not be diminished or impaired.**
Alaska Pension Benefits Reduced

- **1986** - State TIER I pensions changed for new employees to reduce pension benefits

- **1990s** – **SBS** suffered huge financial loss when Lincoln Savings and Loan collapsed. State found at fault. Legislature had to bail out SBS.
1991 Lawsuit – PRPA & Medicare B

1991 – NEA/Alaska Lawsuit – Medicare Part B and State’s non-payment of PRPA

1996 - Settlement

- State will pay PRPA (inflation adjustment) to retirees

- Retirees will pay for Medicare Part B coverage, and Medicare becomes primary health care after age 65 with State health plan as secondary provider
2000 Lawsuit – Health Plan Changes

• **1999** - State made changes to Retiree Health Plan coverage
• **2000** - RPEA/NEA/AFSME Lawsuit – claimed State’s changes reduced retirees’ overall medical benefits
• **2003** – Alaska Supreme Court agreed and declared the State retiree health plan is a “contract” and protected under the State Constitution
2002-2005 State Financial Crisis

• 2002 - Governor Murkowski suspended PRPA inflation adjustments of State pensions
• 2005 – State recognized its pension programs were underfunded $6.5 Billion
  – State Legislature approved switching from DB to Defined Contribution Retirement (DCR) Plan
  – TRS/PERS Board eliminated
    • Administration to manage benefits programs (retirees and employees lost representation)
    • Alaska Retirement Management Board (ARMB) to manage pension investments (2 appointed & 2 Labor)
PERS / TRS
Basic Facts – Organization

Dept. of Revenue
Treasury Division
Invests retirement system assets

Alaska Retirement Management Board
Sets contribution rates, invests retirement system assets

Dept. of Administration
Division of Retirement & Benefits
Administers retirement and benefits system

Investment Advisory Committee
General Consultant
Staff
External Investment Management
Internal Investment Management

Staff
Actuary
Third Party Admin.
2007 Mercer Lawsuit

• 2007 - ARMB filed suit against Mercer, the State’s actuary consultant, for alleged mistakes of $1.8 Billion in the State TRS and PERS pension fund deficit

• State pensions had been underfunded by $8.4 Billion

• 2010 - State of Alaska settled lawsuit with Mercer for $500 Million
Class Comments or Questions
State of Alaska Pension Under Funding Crisis

What Its Future May Hold
Video – Seekins and Thomas 2006

Class Comments or Questions
The Setting

• We have about 59 K members in PERS DB [defined benefit] plans and

• About 19 K in TRS DB plans

• Roughly half have already retired

• It will cost about $140 B over the next 70 years to fund the retirees [pension & med]

• Total DB retiree pop will peak at ~ 60 K in 2024
Membership Projection

Projected Active Member Count

Fiscal Year Ending June 30

Tier 1 Actives  Tier 2 Actives  Tier 3 Actives


Number of Members

0 5,000 10,000 15,000 20,000 25,000 30,000
The Setting (2)

• On June 30, 2011, we had $17 B in assets and $11 B in unfunded liabilities

• In theory, we could pay the future benefits if we put another $11 B into the pot then

• [plus of course what current employees/employers contribute]

• A weak link is our current assumption re

• ROI [return on investments]
Liability Components

• Of the total $29 B liability, $17 B is for pensions and $12 B for health care

• Pensions are ~ 60% funded and Health Care 50%

www.pewstates.org. 2011
Paying Down the Unfunded Liability

• In 2012, Alaska contributed $610 Million toward the $11 Billion Unfunded Pension Liability [UL]
• This is part of a level % amortization plan
• This plan requires annual input of over $1 Billion by 2025
• Alaska now has $17 Billion in State budget reserves
• Alaska may have much less by 2025

Note: The UL represents the amount by which the liabilities exceed the assets. It is the difference between what a pension plan promises to pay and what funds are set aside to fulfill these promises.
State Pension Liability

• The Level Dollar UL Pay Down would have resulted in a $868 Million payment for FY 2012

• Gov. Parnell in the Spring of 2012 said he could be supportive of Level Dollar Pay Down

• Later, the administration said they would not support a Level Dollar Pay Down

• Attempt by Senate to insert an extra $1 Billion that FY toward UL vetoed by House leadership
Future State Contribution Decision

Projected PERS/TRS Combined SB125 Assistance

Source: Feb 2012 Alaska Senate Finance Presentation by Barnhill and Rodell
State Contribution Rate History

These are % of payroll

SB 125 capped PERS employer contribution rates at 22% and TRS employer contribution rates at 12.56% beginning in FY 2009.

Source: Feb 2012 Alaska Senate Finance Presentation by Barnhill and Rodell
## State Pension Under Funded 2011

### PERS DB:
- Assets (actuarial value, 6/30/11): $11,813,774,000
- Accrued Liabilities (6/30/11): $18,740,550,000
- Unfunded Liability: $6,926,776,000
- Funding Ratio: 63.0%

### TRS DB:
- Assets (actuarial value, 6/30/11): $4,937,937,000
- Accrued Liabilities (6/30/11): $9,128,795,000
- Unfunded Liability: $4,190,858,000
- Funding Ratio: 54.1%

Source: PERS /TRS FY 2011
CAFR [comp annual fin rpt]  

For FY 2013, PERS + TRS DB balances grew by 1.9 B to 17.8 B
PERS Funding Ratio History
Pension and Postemployment Healthcare Based on Valuation Assets

Plan Year Beginning July 1

- 1979
- 1981
- 1983
- 1985
- 1987
- 1989
- 1991
- 1993
- 1995
- 1997
- 1999
- 2001
- 2003
- 2005
- 2007
- 2009

Percentage: 68%, 71%, 79%, 79%, 85%, 88%, 93%, 92%, 86%, 91%, 95%, 98%, 97%, 100%, 100%, 100%, 100%, 100%, 101%, 101%, 75%, 73%, 70%, 66%, 68%, 70%, 62%
State Pension Investment Performance

At end of CY 2011, ARM board managed $19 Billion in investments across 18 different plans with 27% domestic equity, 21% foreign, 17% fixed and 18% real assets.

Source: Feb 2012 Alaska Senate Finance Presentation by Barnhill and Rodell

<table>
<thead>
<tr>
<th>Annualized Returns through 6/30/2011</th>
<th>PERS</th>
<th>TRS</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Year</td>
<td>21.18%</td>
<td>21.36%</td>
<td>21.27%</td>
</tr>
<tr>
<td>3 Year</td>
<td>2.36%</td>
<td>2.41%</td>
<td>2.39%</td>
</tr>
<tr>
<td>5 Year</td>
<td>4.32%</td>
<td>4.36%</td>
<td>4.34%</td>
</tr>
<tr>
<td>10 Year</td>
<td>5.43%</td>
<td>5.46%</td>
<td>5.44%</td>
</tr>
</tbody>
</table>

At end of CY 2011, ARM board managed $19 Billion in investments across 18 different plans with 27% domestic equity, 21% foreign, 17% fixed and 18% real assets.

Source: Feb 2012 Alaska Senate Finance Presentation by Barnhill and Rodell

For FY 2013, PERS and TRS investments returned ~ 12.5%

25 yr US state public fund pension returns ~ 8%/yr [via NASRA, 2012]
Pension Promises Made?

Pay $141 billion in benefits payments over next 70 years

Current PERS/TRS account balance: $15.4 billion
Unfunded Liability: $11.1 billion

Source: Feb 2012 Alaska Senate Finance Presentation by Barnhill and Rodell
Fiscal Year 2012 Summary

• During 2012 the PERS/TRS DB funds had a loss of $260 Million with ending balance of $15.4 Billion. [$17.8 Billion in April 2013]

• The 2012 annual financial deficit was in spite of Alaska contributing $610 Million toward the unfunded liability plus investment earnings of $80 Million

• Explained by payments to retirees
State Pension Liability
Permanent Fund Bail-Out?

• The Alaska Constitution does not allow the principal of the Permanent Fund to be spent without a 2/3 vote of the Legislature plus a vote of the people [i.e. this would need a change to our Constitution].

• At the same time, the Constitution provides that the State will honor its “contract” commitments to its retirees
State vs. Private Pension ROR

- The State’s $11 Billion UL assumes an 8% annual rate of return (ROR) on investments.
- US Corporations required to assume a corporate bond rate of return less than 5%.
- Canadian and European public and private funds assume 4% to 6% ROR.

Alaska’s Pension’s UL would more than double if ROR is 5%.

Andonov et al, 2012
Private Corporations

• Subject to the restrictions of the Employee Retirement Income Security Act of 1974 (ERISA)

• Pension Protection Act of 2006 (PPA) Mandates use of a high-quality corporate yield curve when discounting plan liabilities

www.hks.harvard.edu/mrcbg
The Big Picture

• Total assets in US retirement plans ~ $15 T which is approximately size of our GDP or nat debt.

• Other states have large unfunded liabilities

• [CA: $154 - $476 B depending on ROI assumption]

• Some have increased employee contributions, changed service requirements, etc.

www.hks.harvard.edu/mrcbg; Conf of State Legislatures, 2012
New Accounting Rules

• A June, 2013 Moody study indicates the 50 US states, on average, have just $0.48 to pay each dollar of promised pension benefits.

• Total shortage is about $1 trillion.

• Alaska was worst with a shortfall of more than 20% of its total gross domestic product.

• Moody's review assumed investment returns between about four and 6%. Alaska currently assumes 8%.

• By 2015, GASB suggest states assume investment returns similar to corporate bonds [between four and 6%]

From ADN [via NY Times] and Financial Times- June 2013.
Detroit


FEWER WORKERS, MORE RETIREES
Over time, the balance between active workers and retired workers has tipped. Here is a look at the make up of Detroit's general retirement system, one of two of the city's pension plans.

2004
- 51% of workers were active (paying into the system).
- 49% of workers were retired (drawing benefits from the system).

2011
- 39% of workers were active (paying into the system).
- 61% of workers were retired (drawing benefits from the system).

DEBT BREAKDOWN
How the city's debt and long-term obligations break down:

- Government debt: $2.9 billion
- Detroit Water and Sewerage Department debt: $5.9 billion
- Unfunded pension liability: $3.5 billion
- Unfunded retiree health care liability: $5.7 billion

SOURCE: Emergency manager Kevyn Orr's 45-day report and proposal for creditors
Video – Public Pension Crisis - NBR

Class Comments or Questions
What Should the State Do?

• The Legislature should **increase forward funding** to reduce the unfunded liability
  – A one time infusion (~ $2 Billion) or
  – Another is to **adopt a level dollar pay down plan** instead of our current level % plan

Either of these would reduce payments needed in the 2020’s and reduce total payout
What Can We Do to Ensure Our Future Retirement Benefits?

Get Involved!
Critical Must Do Checklist

• **Get Involved** – Join and actively support your public retiree organizations (RPEA, AKREA)

• **Stay Informed** - on the status of your future retirement benefits

• **Contact your Legislators and Governor** to increase and/or forward fund the DB retiree pension plans and reduce their growing unfunded liability

• **Testify at Legislative Hearings** this winter in support of appropriating the necessary funds to pay down the State’s unfunded pension liability

*Your involvement today is critical to ensuring your future retirement benefits*
PASSING THE PENSION TIME BOMB

PUBLIC SECTOR  PRIVATE SECTOR

2020

EEEK!
Class Comments or Questions
Organizations and State Contact List

• Governor Sean Parnell
  – www.gov.state.ak.us
  – Email: governor@gov.state.ak.us
  – Phone:(907)465-3500

• Alaska Retirement Management Board
  – www.treasury.dor.alaska.gov/dnn/armb/

• State Long Term Care Ombudsman
  – www.akoltco.org

• Retired Public Employees Association (RPEA)
  – www.rpea.afea-aft.org

• Alaska Retired Educators Association (AKREA)
  – www.akrea.org
State Pension Documents - Websites

• Alaska Dept. of Administration – Retirement & Benefits
  – Retirement Plan Booklets
    • http://doa.alaska.gov/drb/resources/booklets.html
  – Audited Pension Plans Financial Reports
  – Pension Plans Actuarial Evaluation Reports
    • http://doa.alaska.gov/drb/retirement/valuations_portal.html

• Pew Research - Public Pension Report
  – http://www.pewstates.org/research/reports/the-widening-gap-update-85899398241
Day #2 Topics

• Senior Population & Trends

• Long Term Care
  – Medicare & Medicaid
  – Long Term Care Options and Cost
  – Status of State of Alaska’s LTC Insurance

• What Can We Do Today to Help Ensure Our Future LTC Insurance Benefits?
OUR RETIREMENT FUND IS WIPED OUT

WE’LL NEVER SURVIVE ON A GOVERNMENT PENSION

THERE’S ONLY ONE WAY OUT

OUR MUTUAL FUNDS HAVE TANKED

WE HAVE TO TAKE UP SMOKING

SMOKERS’ EARLY DEATHS SAVE ON PENSIONS, HEALTH CARE, AND HOUSING

PENDING HUMAN RIGHTS REPORT REVEALED