From Alaska Municipal League: last updated November 2018

PERS – Municipal Policy Brief

Early History: The State of Alaska established the Public Employee Retirement System (PERS) in 1961, and since that time has had sole administrative control over actuaries, actuarial methods and assumptions, investment of all assets, and establishment of employee rates. The State has managed investment income since 1969 and has credited investment income to employee accounts solely from the current employer's active account, versus directly. The State created the Retirement Reserve Account (RRA) in 1971 (authorizing it in 1974), and began paying retiree benefits with "blended" employer dollars in 1971. Blended accounting meant that instead of keeping individual employer accounts separate, funding was reallocated and comingled such that no single employer's contributions can be accounted for accurately. Employers were unaware of the blended accounting until 2006. One of the impacts of blended accounting is that one employer's actions affect all other employer's liabilities. It is important to recognize that the majority of municipalities are members of PERS.

Mismanagement: The comingling of employer accounts was compounded by a number of State decisions between 1994 and 2006. The State stopped transferring employer contributions to the RRA as employees retired; the State controlled the timing of employee "appointment" to retirement and the subsequent employee account transfers to the RRA; the State reallocated each employer's and employee's RRA contributed assets, based upon RRA liabilities; the State determined each employer's unfunded obligation after reallocating the employer's assets; the State set the employer's past service cost rates based upon the reallocated asset results; and most importantly, the State set and paid prior normal cost rates that were lower than they should have been. Ultimately, the State did not administer PERS in accordance with its own laws. Throughout this time, municipalities followed the instructions of the State and paid into PERS what was required.

2008 Statute Change: In recognition of the State's responsibility for the majority of the unfunded pension and health benefit liability, in 2008 the State amended its statues regarding employer contributions to PERS and TRS, placing a cap on employer contributions at 22% of payroll and TRS contributions at 12.56% of payroll, with the State accepting responsibility for any costs in excess of this amount (the "on behalf" payment). The 2008 legislation is a recognition by the Legislature of the State's responsibility for the unfunded liability and its responsibility, subject to annual appropriations, for payments required to satisfy PERS contribution rates required to amortize the unfunded pension liability over 25 years (extended another five years with a $3 billion pay down).

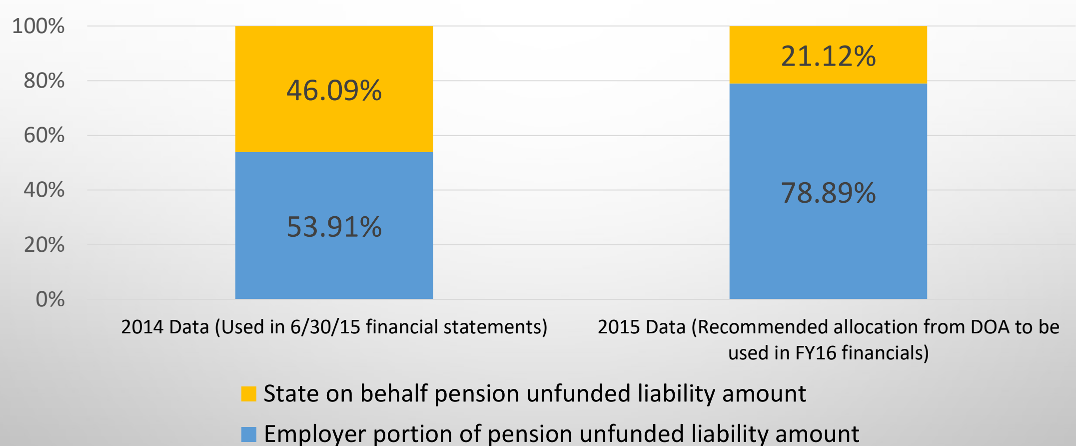
Current challenges: The unfunded liability, and the state's "on behalf" payment, remains contentious, and a budget line item that is frequently focused on by State officials and legislators. Understanding the history of PERS – and the State's responsibility – is important in this context. For municipalities, many have become "prisoners of PERS" – unable to leave without a costly termination study and still the unfunded liability to address. Uncertainty related to the PERS pool of participants as well as investment returns is a real concern for most municipalities.

Ways forward: The Alaska Municipal League will work with the State and Legislature to remove the need for and costs of termination studies, regularly evaluate and adjust the base employee rate, and reduce penalties during the transition for employers who need to leave PERS. AML opposes any decrease in the State “on behalf” rate over 22% and will work with the State and Legislature to develop pathways for paying down the overall unfunded liability.

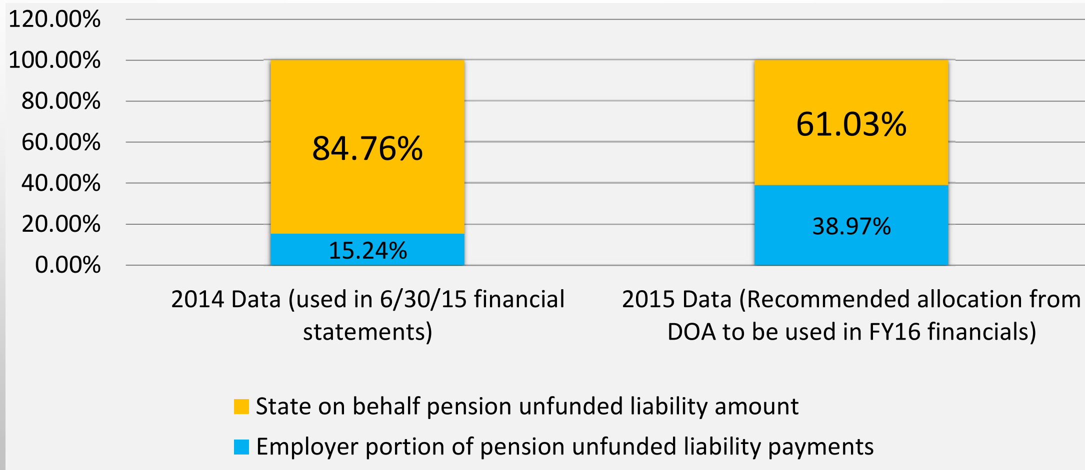
AML SUMMER MEETING

PERS AND TRS LIABILITY

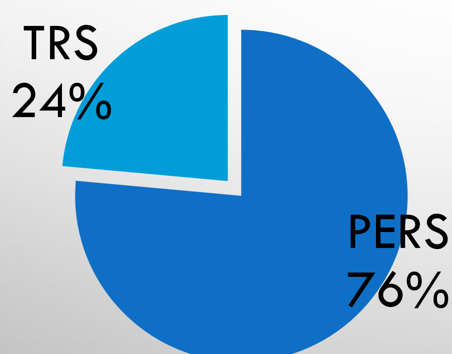
ALLOCATION OF PERS PENSION UNFUNDED LIABILITY



ALLOCATION OF TRS PENSION UNFUNDED LIABILITY

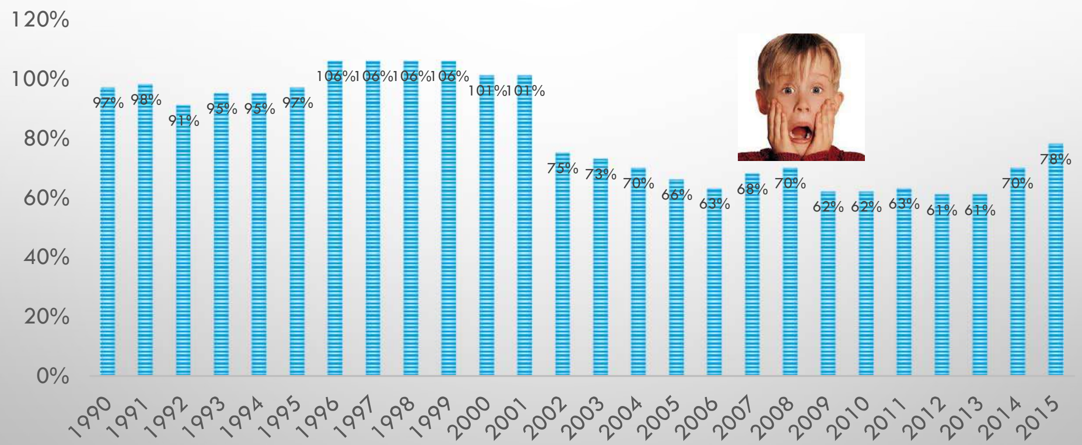


PERS AND TRS DEFINED BENEFIT (DB) PLAN PARTICIPANTS DEC. 31, 2015

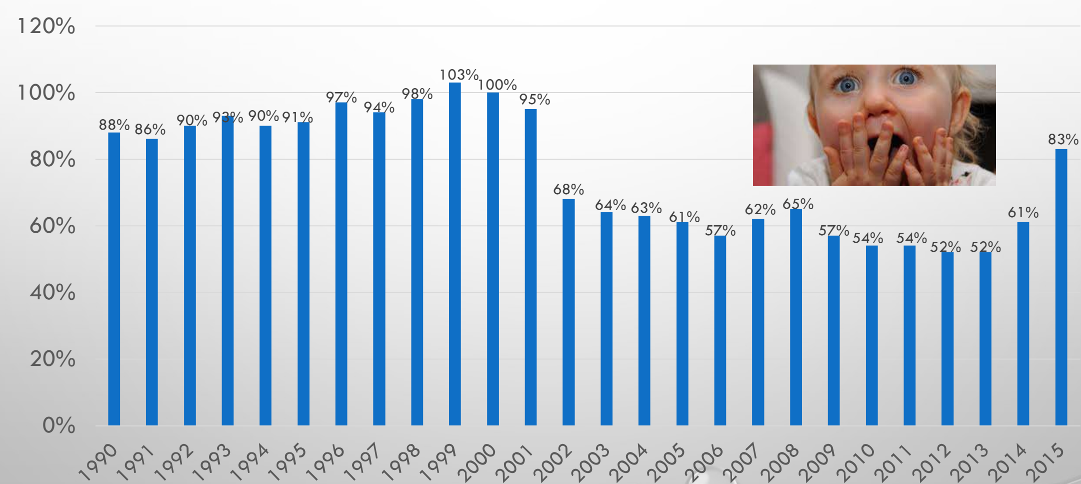


	Total	Active
PERS	67,885	17,306
TRS	20,915	5,609

PERS FUNDING RATIO HISTORY



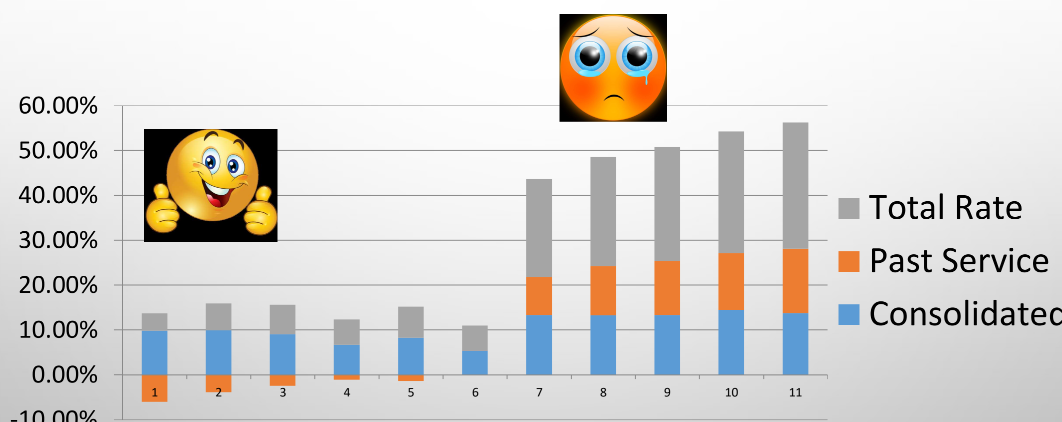
TRS FUNDING RATIO HISTORY



INVESTMENT RETURNS 1999-2004

Alaska Retirement Management Board			
FISCAL YEAR RETURNS	PERS	TRS	AVERAGE
1999	10.59%	10.67%	10.63%
2000	10.16%	10.25%	10.21%
2001	-5.37%	-5.44%	-5.40%
2002	-5.48%	-5.49%	-5.49%
2003	3.67%	3.68%	3.67%
2004	15.08%	15.09%	15.09%

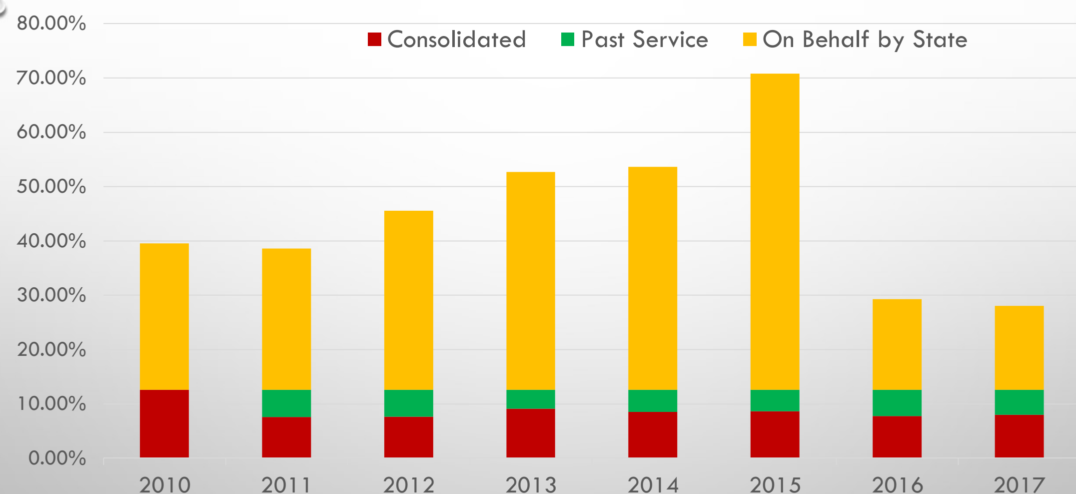
KGB PERS EMPLOYER RATES 1999-2009



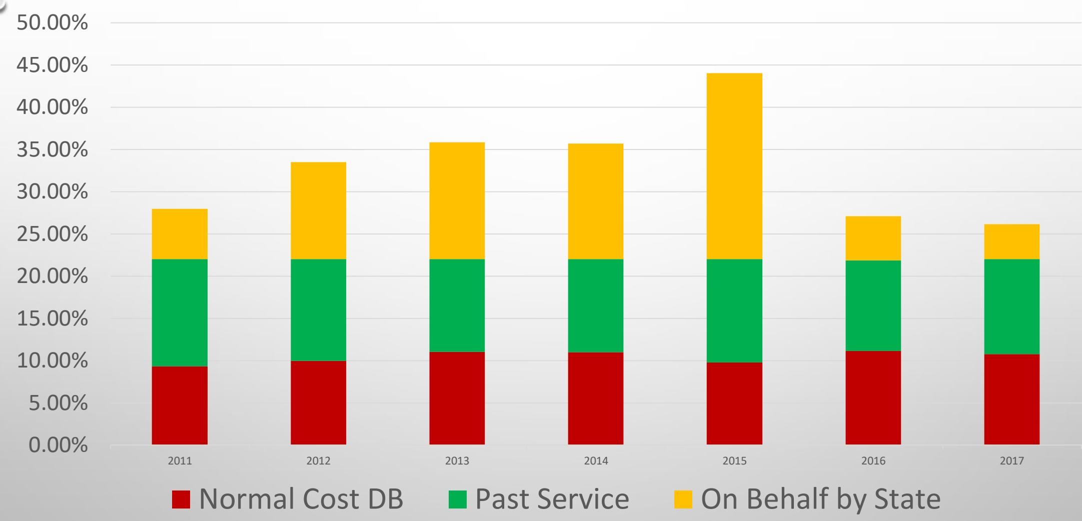
WHAT DID THE LEGISLATURE DO IN 2006 AND 2008

- IN 2006 THE LEGISLATURE CLOSED OFF THE DB PROGRAM, AND SHIFTED TO DEFINED CONTRIBUTION RETIREMENT FOR NEW EMPLOYEES.
- IN 2008 THE LEGISLATURE ADOPTED THE CAPPED EMPLOYER RATES AT 22% OF PERS PAYROLL FOR PERS EMPLOYERS AND 12.56% OF TRS PAYROLL FOR TRS EMPLOYERS.
- UNDER THE 2008 LEGISLATION THE STATE BECAME RESPONSIBLE TO PAY RATES OVER THESE LIMITS AS NECESSARY TO PAY THE ACTUARIALLY REQUIRED RATES.

RECENT TRS CONTRIBUTION RATES



RECENT PERS CONTRIBUTION RATES

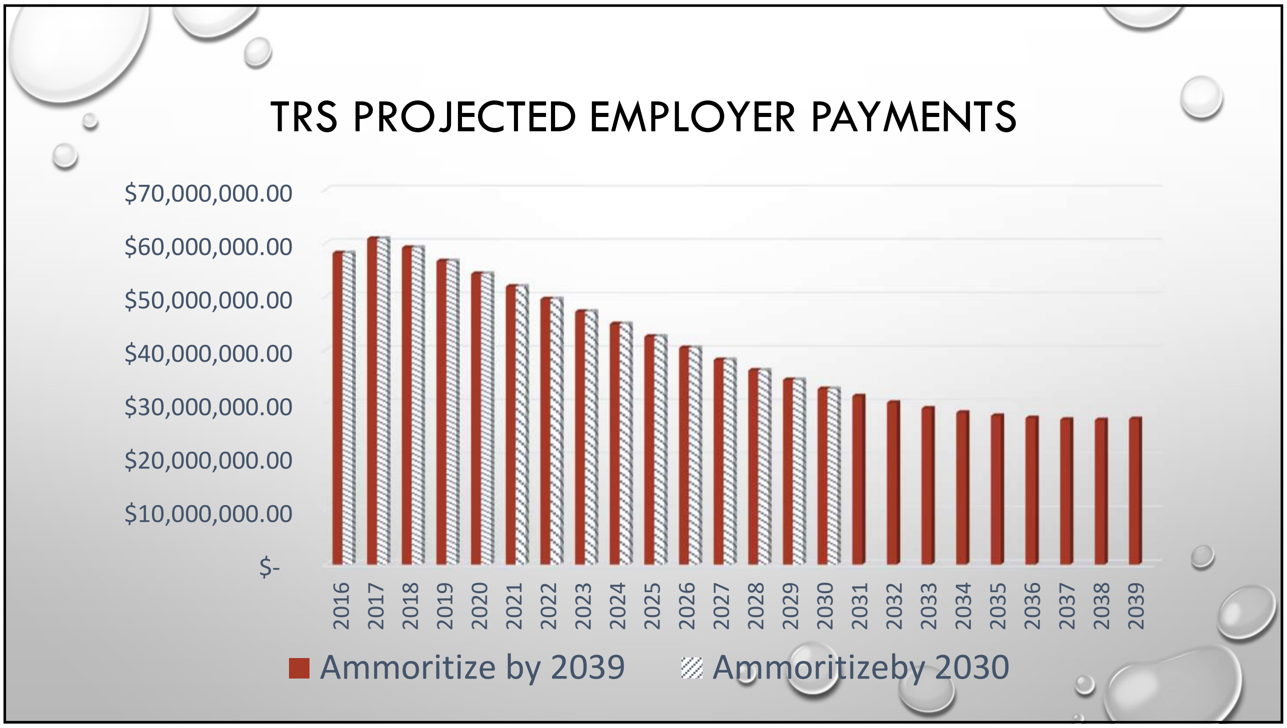


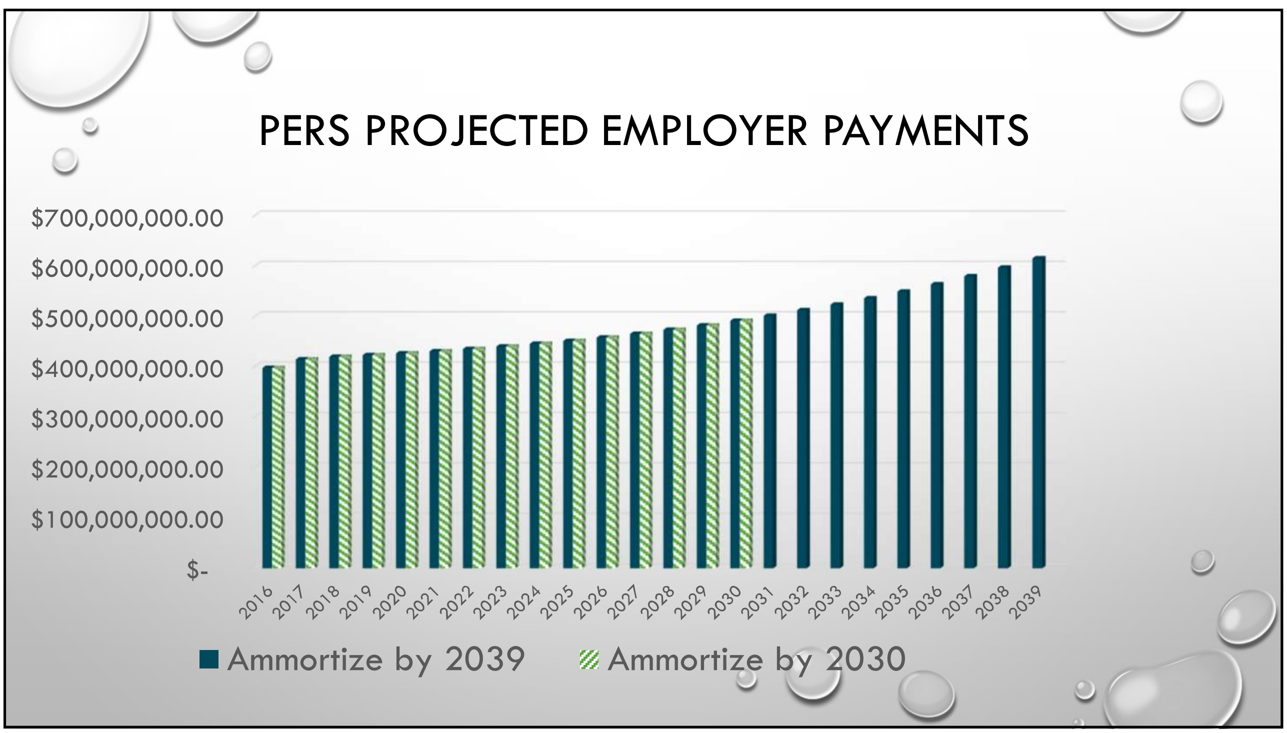
WHAT DID THE LEGISLATURE DO IN 2014 ?

- THEY PAID DOWN THE UNFUNDED PERS LIABILITY BY $1 BILLION.
- THEY PAID DOWN THE UNFUNDED TRS LIABILITY BY $2 BILLION.
- THEY EXTENDED THE AMORTIZATION PERIOD BY 9 YEARS.
- THEY REQUIRED THAT THE ARM BOARD USE THE PERCENT OF PAY METHOD FOR AMORTIZATION.
- COMBINED, THESE REDUCED THE AMOUNT OF ONGOING STATE PAYMENTS, AND INCREASED PERS AND TRS EMPLOYER LIABILITY SIGNIFICANTLY.
- THIS SHIFTED A LARGER PERCENTAGE OF THE LIABILITY TO PERS AND TRS EMPLOYERS.

PERS Rates Compared	2008	2017	2018
Employer DB Normal Cost Rate	14.48%	9.60%	8.54%
Employer DB Past Service Cost Rate	7.52%	12.40%	13.46%
State Additional Contributions	10.51%	4.14%	1.23%
Total Rate	32.51%	26.14%	23.23%

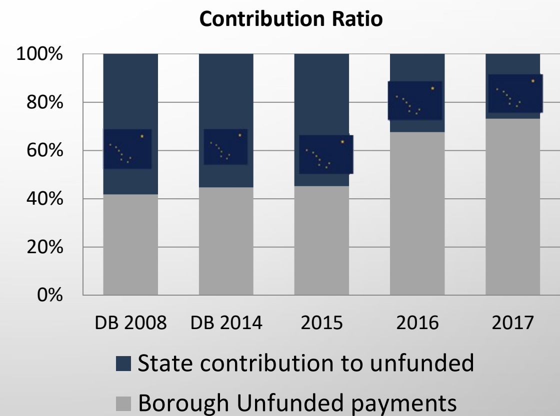
TRS Rates Compared	2008	2017	2018
Employer DB Normal Cost Rate	12.56%	9.68%	8.65%
Employer DB Past Service Cost Rate	0%	2.88%	3.91%
State Additional Contributions	29.70%	15.46%	11.56%
Total Rate	42.26%	28.02%	24.12%


TRS PROJECTED EMPLOYER PAYMENTS
$70,000,000.00
$60,000,000.00
$50,000,000.00
$40,000,000.00
$30,000,000.00
$20,000,000.00
$10,000,000.00
$-
2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035 2036 2037 2038 2039
Ammoritize by 2039
Ammoritizeby 2030

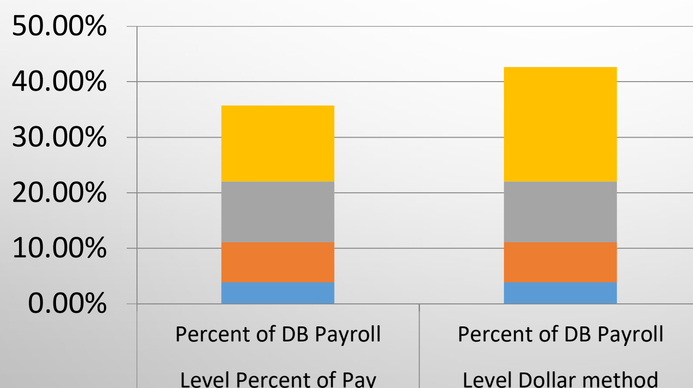

PERS PROJECTED EMPLOYER PAYMENTS
$700,000,000.00
$600,000,000.00
$500,000,000.00
$400,000,000.00
$300,000,000.00
$200,000,000.00
$100,000,000.00
$-
2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035 2036 2037 2038 2039
Ammortize by 2039
Ammortize by 2030

SHIFTING FROM THE STATE TO EMPLOYERS

	PERS		PERS Projected		
	DB 2008	DB 2014	2015	2016	2017
Borough Unfunded payments	7.52%	10.99%	12.2	10.75%	11.23%
State contribution to unfunded	10.51%	13.68%	14.82	5.19%	4.14%



PERCENT OF PAY VERSUS LEVEL DOLLAR CONTRIBUTIONS (2014)



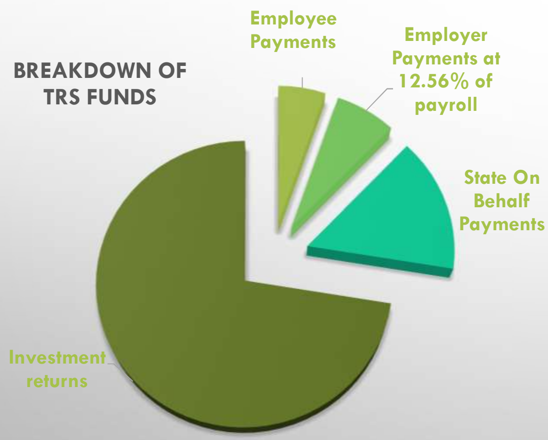
YOU MAY SEE SOMETHING LIKE THIS ON YOUR CREDIT CARD STATEMENTS

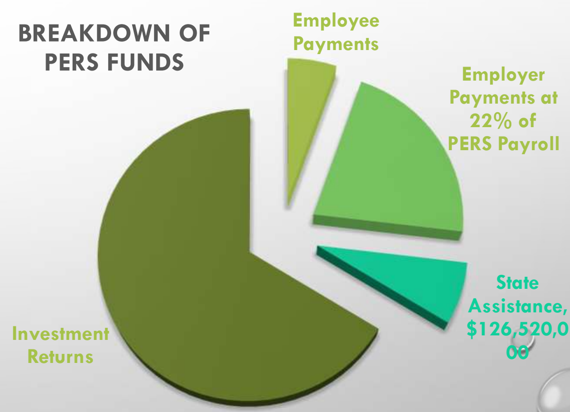
If you make no additional charges using this card and each month you pay	You will payoff the balance shown on this statement in about	And you will end up paying an estimated total of
Only the Total Minimum Payment	12 Years	$4,155.00
$79.00	36 months	$2,844.00 (savings = $1,311.00)

WHAT IMPACTS THE UNFUNDED LIABILITY

- 1. INVESTMENT RETURNS
- 2. PAYROLL SIZE
- 3. CONTRIBUTION RATES
- 4. HEALTH CARE COSTS
- 5. MORTALITY

2015 INCREASES TO FUND BALANCE





INVESTMENT RETURNS 2005-2015

TRS Historical Asset Rates of Return

Year Ending	Actuarial Value	
	Annual	Cumulative*
June 30, 2005	9.1%	9.1%
June 30, 2006	9.6%	9.3%
June 30, 2007	11.9%	10.2%
June 30, 2008	10.2%	10.2%
June 30, 2009	(7.9)%	6.3%
June 30, 2010	8.1%	6.6%
June 30, 2011	6.9%	6.6%
June 30, 2012	0.7%	5.9%
June 30, 2013	3.7%	5.6%
June 30, 2014	22.7%	7.2%
June 30, 2015	7.2%	7.2%

PERS Historical Asset Rates of Return

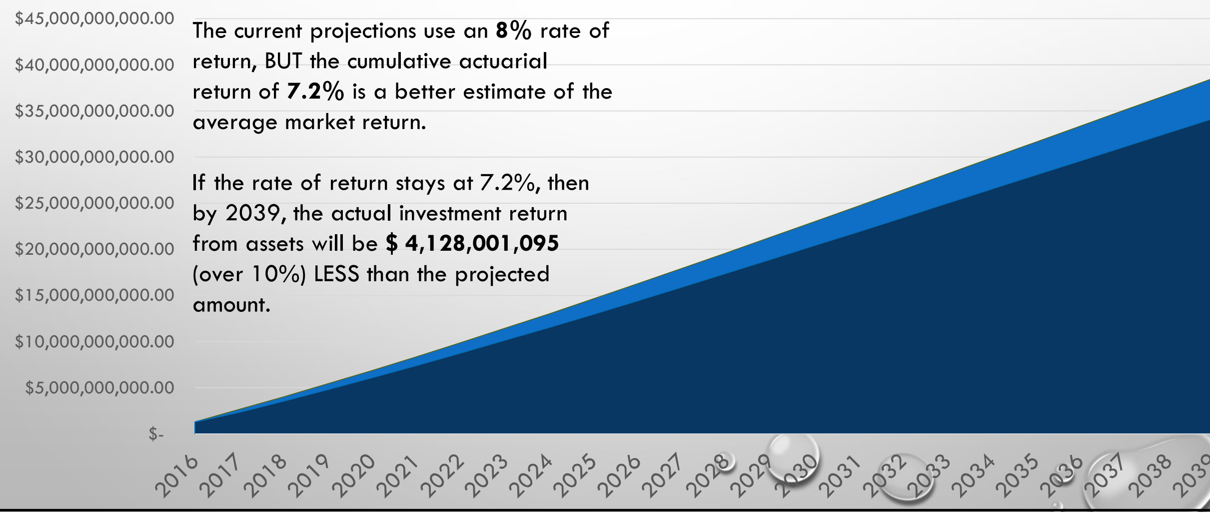
Year Ending	Actuarial Value	
	Annual	Cumulative*
June 30, 2005	8.7%	8.7%
June 30, 2006	9.3%	9.0%
June 30, 2007	11.6%	9.9%
June 30, 2008	10.0%	9.9%
June 30, 2009	(7.3)%	6.2%
June 30, 2010	7.2%	6.4%
June 30, 2011	7.2%	6.5%
June 30, 2012	1.2%	5.8%
June 30, 2013	4.0%	5.6%
June 30, 2014	21.9%	7.1%
June 30, 2015	7.0%	7.1%

POTENTIAL INVESTMENT SHORTFALL IN PERS

Investment Return on Assets Comparison:
8% Return Rate v. 7.1% Return Rate

The current projections use an **8%** rate of return, BUT the cumulative actuarial return of **7.2%** is a better estimate of the average market return.

If the rate of return stays at 7.2%, then by 2039, the actual investment return from assets will be **$ 4,128,001,095** (over 10%) LESS than the projected amount.

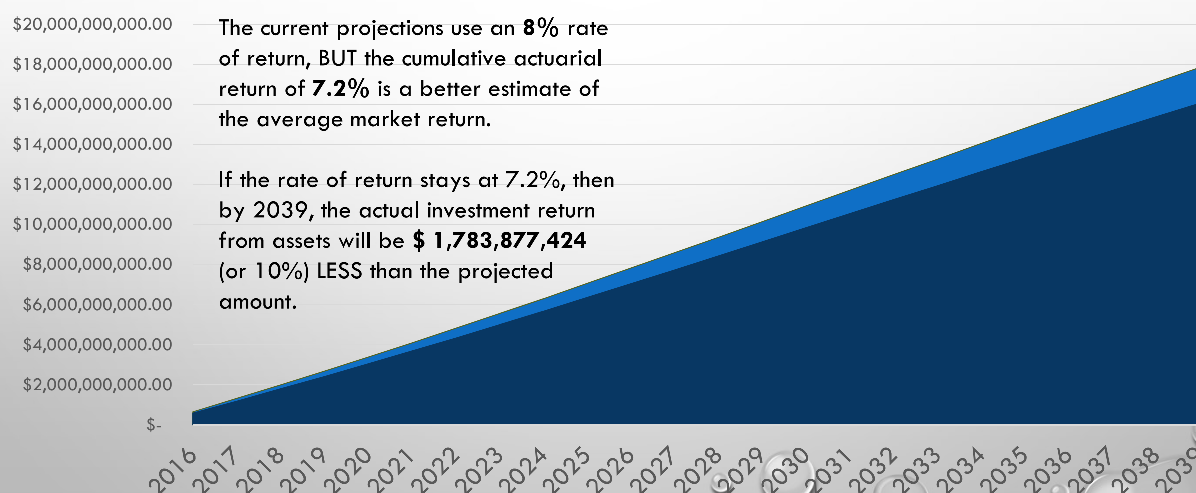


POTENTIAL INVESTMENT SHORTFALL IN TRS

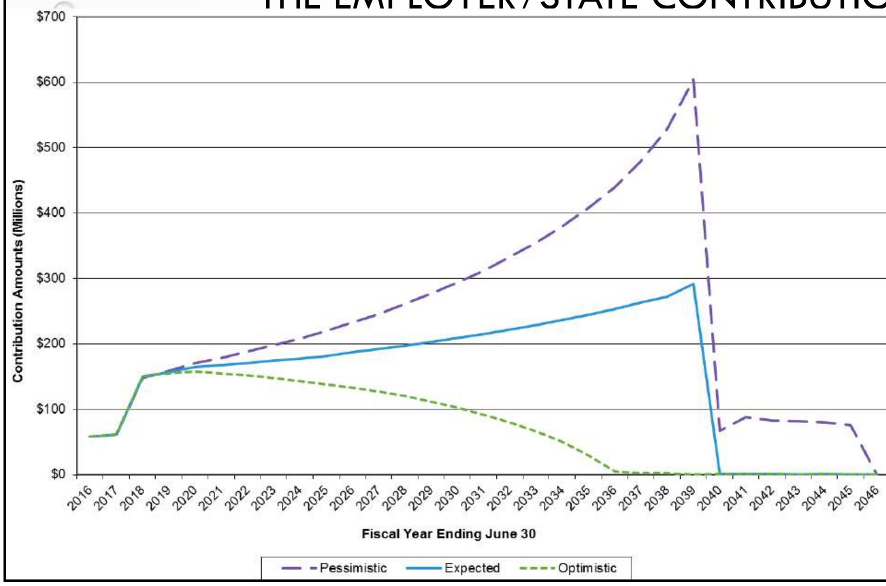
Investment Return on Assets Comparison:
8% Return Rate v. 7.2% Return Rate

The current projections use an **8%** rate of return, BUT the cumulative actuarial return of **7.2%** is a better estimate of the average market return.

If the rate of return stays at 7.2%, then by 2039, the actual investment return from assets will be **$ 1,783,877,424** (or 10%) LESS than the projected amount.



IMPACT VARIOUS INVESTMENT RATES OF RETURN HAVE ON THE EMPLOYER/STATE CONTRIBUTION AMOUNT



The **purple dashed line** shows what the employer/state contribution would be if the investment rates of return are **7.25%.**

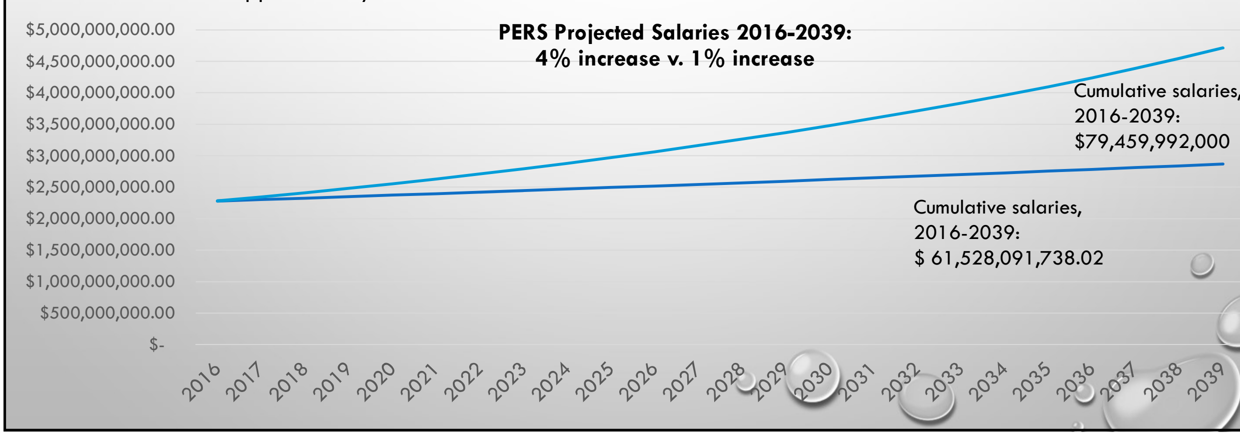
The **blue line** shows the employer/state contribution amount if the rates of return stay at the projected rate of **8%.**

The **green dashed line** shows what the contribution amounts would be if the rates of return were raised to **8.75%.**

WHAT IF TOTAL PERS PAYROLL ONLY GROWS 1% ?

In the 2016-2039 salary projections, the average annual percentage of salary growth is 4%.
HOWEVER, the current inflation rate in the U.S. is approximately 1%.

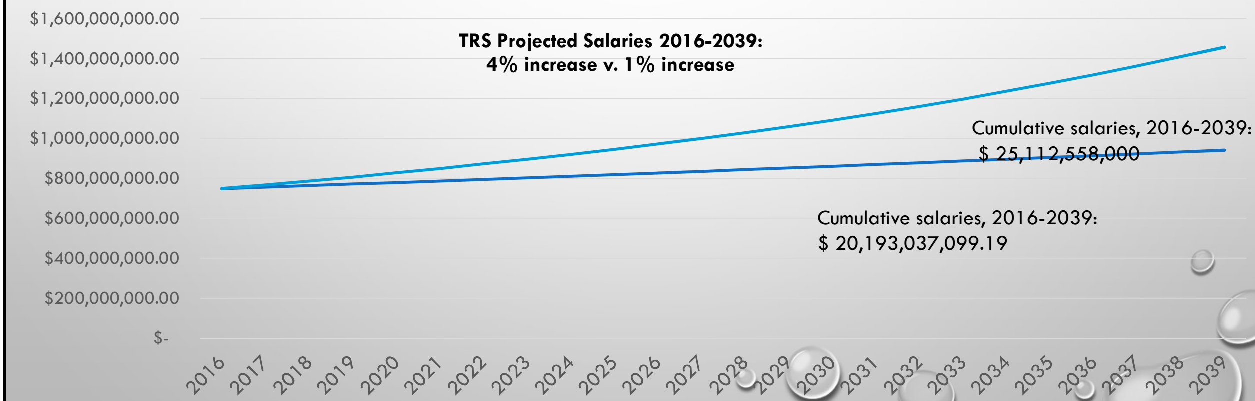
If salaries grow at 1%, then the 2016-2039 cumulative salaries will be **$17,931,900,262** LESS than the projected total by 2039.



WHAT IF TRS PAYROLL ONLY GROWS AT 1% ?

What would happen if salaries increased by 1%, rather than the projected annual rate of 4%?

If salaries grow at 1%, then the 2016-2039 cumulative salaries will be **$ 4,919,520,900.81** LESS than the projected total by 2039.



WHAT CAN WE LEARN ?

- 1. THE 2014 LEGISLATION INCREASED THE AMOUNT EMPLOYERS WILL PAY BOTH IN DOLLARS AND PERCENTAGE.
- 2. IF INVESTMENT RETURNS OR PAYROLL GROWTH ARE LOWER THAN EXPECTED, THE RATE WILL GO HIGHER. EACH 1% IN REDUCED INVESTMENT RETURN IS EQUIVALENT TO A 8.95 % OF PAYROLL.
- 3. WITH THE STATE CUTTING BUDGETS AND EMPLOYERS LOOKING FOR WAYS TO REDUCE COSTS, THERE IS A REAL RISK THAT THE PAYROLL GROWTH PROJECTIONS WILL NOT BE MET.
- 4. RAISING THE CAP OR ELIMINATING THE STATE ON BEHALF PAYMENTS WILL TRANSFER THIS RISK OF INCREASED COSTS TO EMPLOYERS.
- 5. IF THE STATE IS REDUCING PAYROLL, AND HAVING LITTLE ON BEHALF CONTRIBUTIONS, THEN THE STATE SHOULD NOT BE EXEMPT FROM TERMINATION STUDY REQUIREMENTS AND ASSOCIATED COSTS.