

LFD Informational Paper 24-1: Alaska’s Public Retirement Systems

A Legislative Research/Legislative Finance collaboration

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Overview

The State of Alaska provides [several retirement programs](#) to distinct groups of state and local employees and retirees. The Teachers’ Retirement System (TRS) and Public Employees’ Retirement System (PERS), enacted in statute in 1955 and 1960 respectively, are by far the largest. Collectively, over 87,000 employees and retirees of [participating municipalities, public K-12 school districts, and the University of Alaska](#) were members of these systems at the onset of fiscal year (FY) 2024. Since 2005, the [Alaska Retirement Management Board](#) (ARM Board) has served as the fiduciary of the State’s retirement plans and controls investment of the Trust’s assets.

Pursuant to Article XII, Section 7 of the Alaska Constitution, membership by state and municipal employees in a retirement system is a contractual relationship and “accrued benefits” of these systems cannot be “diminished or impaired.” The Alaska Supreme Court has interpreted this provision to mean that reductions to retirement benefits impact only employees hired after the effective date of the change (*Hammond v. Hoffbeck*, 1981). As a result, the benefits offered to an individual on the date of hire are protected barring a constitutional amendment.

Retirement Plan “Tiers”

Legislatures have reacted to increases in numbers of participating employees and retirees, and higher costs for services due to inflation and other factors, by creating new cohort groups, or “tiers” that changed formulas for calculating pensions, increased normal retirement ages, altered retiree medical coverage, and other adjustments aimed at reducing costs. Anyone hired by a participating employer after the effective date of a new tier is locked into that benefit for the duration of program membership.

There are currently four tiers of PERS and three tiers of TRS, with effective dates as follows:

<u>PERS</u>		<u>TRS</u>	
Tier I	January 1, 1961 - June 30, 1986	Tier I	July 1, 1955 - June 30, 1990
Tier II	Enrolled after June 30, 1986	Tier II	Enrolled after June 30, 1990
Tier III	Enrolled after June 30, 1996	Tier III	Enrolled after June 30, 2006
Tiers IV	Enrolled after June 30, 2006		

Each iteration of retirement tiers differed from predecessors in substantive ways; however, those in place through FY 2006 offered a “defined benefit” (DB) income stream. That is, a traditional pension in which both employer and employee contribute a specified amount, which is pooled and invested on behalf of all employees in the plan. Regardless of the investment performance of the Trust, the employee is guaranteed a monthly pension upon retirement based on a formula that multiplies a percentage of average salary over a specified period by the number of years of total service. In this system, the employer bears the risk of investment returns being insufficient to cover benefits. Further, in Alaska’s DB plans, the State’s health plan premiums are covered for vested retirees that meet age and years of service requirements.

Implemented in 2006, Tier IV of PERS and Tier III of TRS represented a fundamental shift from previous benefits plans. In these “defined contribution” (DC) models, employer and employee contributions are pooled in participant-directed, 401k-style investment accounts in which the employee bears the risk of insufficient investment return and there is no guaranteed retirement income. Although common in the private sector—just 16% of full-time privately employed Americans had access to a DB plan in 2018—DC plans are rare for state and local government employees, over 90% of whom are covered by DB plans. (Alaska and Michigan are currently the only two states that mandate DC plans for all new employees.) The change to a DC model reduced employers’ contribution rates for new employees but was primarily meant to arrest the growth of future pension obligations by eliminating the defined benefit for new hires.

Supplemental Benefits and Social Security

The [Supplemental Benefits System](#) (SBS) is a defined contribution, tax-advantaged plan under section 401(a) of the Internal Revenue Service code that exists in tandem with the State’s retirement systems. A pre-tax contribution of 6.13% is automatically deducted from employees’ salaries and matched by a contribution from employers, for a total of 12.26% of salary. Investments are administered by a third-party firm with allocation options among several mutual funds and other investment vehicles directed and managed by the employee. Terms of contribution limits, withdrawal, taxation, and penalty are akin to 401(k) plans offered in the private sector. The State also offers an IRS section 457 [deferred compensation](#) plan that allows participants to save part of their pre-tax income.

The State and some municipalities participate in SBS, but school districts do not.

Non-Participation in Social Security Insurance

Throughout the 1970s several local governments in Alaska ceased participation in the federal Social Security system. In 1978, employees of the State voted to rescind Supplemental Security Income (SSI) coverage and therefore lost access to the monthly retirement income that is its main benefit (officially known as “Old-Age, Survivors, and Disability Insurance [OASDI]). On January 1, 1980, the SBS was established by the State to replace OASDI benefits. Although the concept of returning public employees in Alaska to the Social Security system and eliminating the SBS has been raised, the process is complicated, requires approval of employees, and is otherwise unlikely to succeed.

Employer Contribution Rates and Unfunded Pension Liabilities

In the late 1990s and early 2000s, poor and negative investment returns along with rapidly increasing medical costs and other factors combined to require dramatically increased contributions rates, which varied among employers under Alaska law. In 2006 alone, rates for some non-state PERS and TRS

employers more than doubled as a percentage of payroll, threatening serious impacts to the fiscal operations of municipalities and school districts. In response, [SB 125 was enacted](#) in FY 2008 setting respective contribution rates for PERS and TRS employers at 22% and 12.56% of payroll. Total annual contributions required to maintain the plans' service liability are set by the ARM Board based on actuarial projections. Pursuant to SB 25 (AS 14.25.085, specifically), the State is required to meet its employer obligation and to contribute any amount of obligations from other employers exceeding 22% of payroll. For example, the PERS employers' [contribution rate for FY 24](#) is set at 25.10%. As such, the State of Alaska is obligated to make the 25.10% contribution for its own employees plus an amount totaling 3.10% of every other participating employers' payrolls.

In FY22, SB 55 (Ch. 9 SLA 21) removed the employer contribution cap for the State as a PERS employer, which allowed for the full actuarial amount to be contributed through State agencies' operating budgets using agency fund sources. This simultaneously reduced the Additional State Retirement Contribution which is typically funded with a direct appropriation of general funds to PERS Trust. In FY22, Rate Adjustment transactions were used to add general funds or other receipt authority to agency budgets to ensure sufficient funding and authority to meet the increased contribution amount. In FY22, the Enacted budget increased agency operations by \$72,871.7 (with a mix of UGF and other fund sources) and the Additional State Retirement Contribution was reduced by \$95,794.5, for a net savings of \$22,922.8 UGF. Subsequent Rate Adjustments in FY23 adjusted the distribution of funding based on a year of experience with realizable/unrealizable receipt authority fund sources, and Rate Adjustments were not submitted in FY24, or to date in the FY25 budget process.

Many of the same issues that led to dramatically increased costs for employers contributed to a [pension funding shortfall](#) that came to light in 2003. In addition to those factors, serious errors by the retirement system's actuary were identified that year through an audit. In late 2002, actuarial reports showed that PERS was more than 100% funded and TRS was at 95%. Following the audit, fiscal year-end (June 20, 2003) reports put actual funding levels for PERS and TRS at 75.2% and 68.2% of future obligations, respectively, raising concerns about the solvency of the systems.

Table 1: PERS - Actuarial and Employer Rates

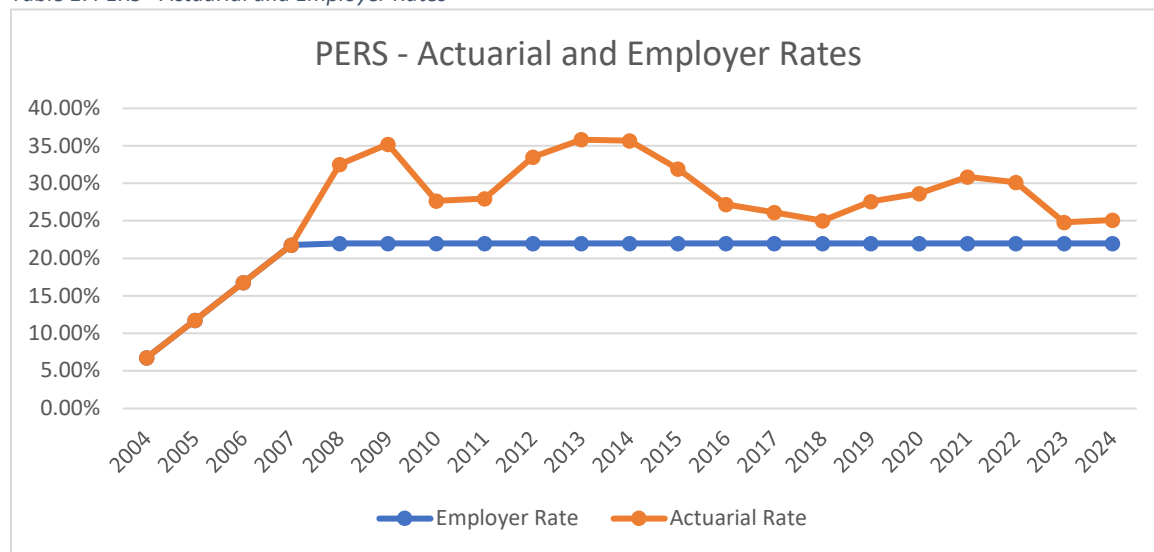
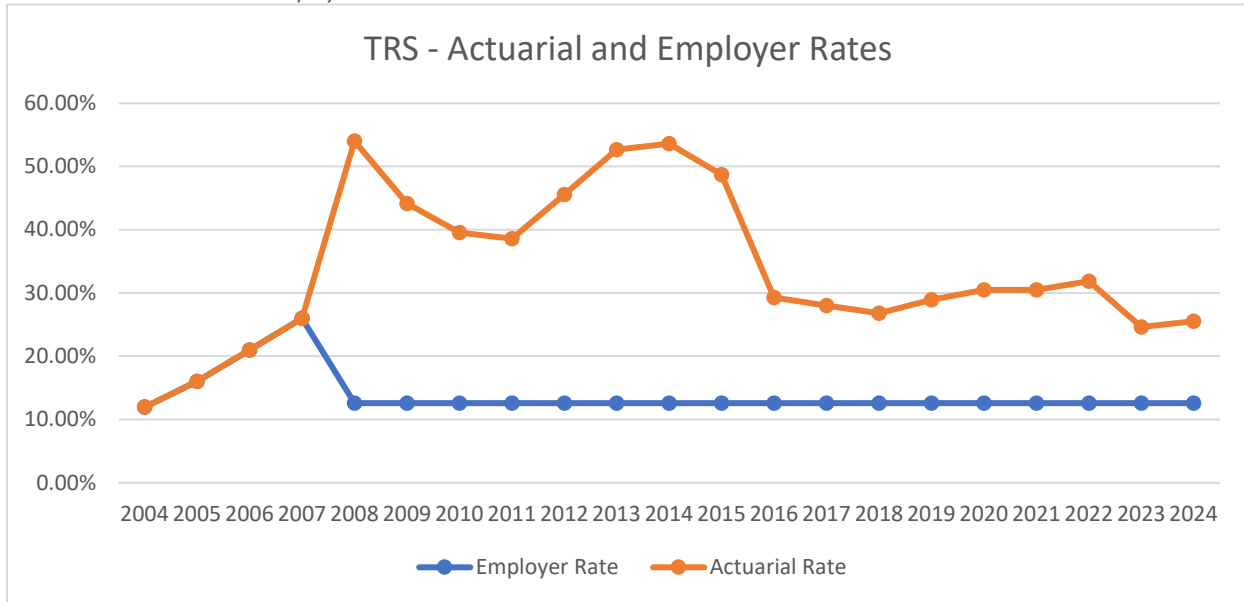
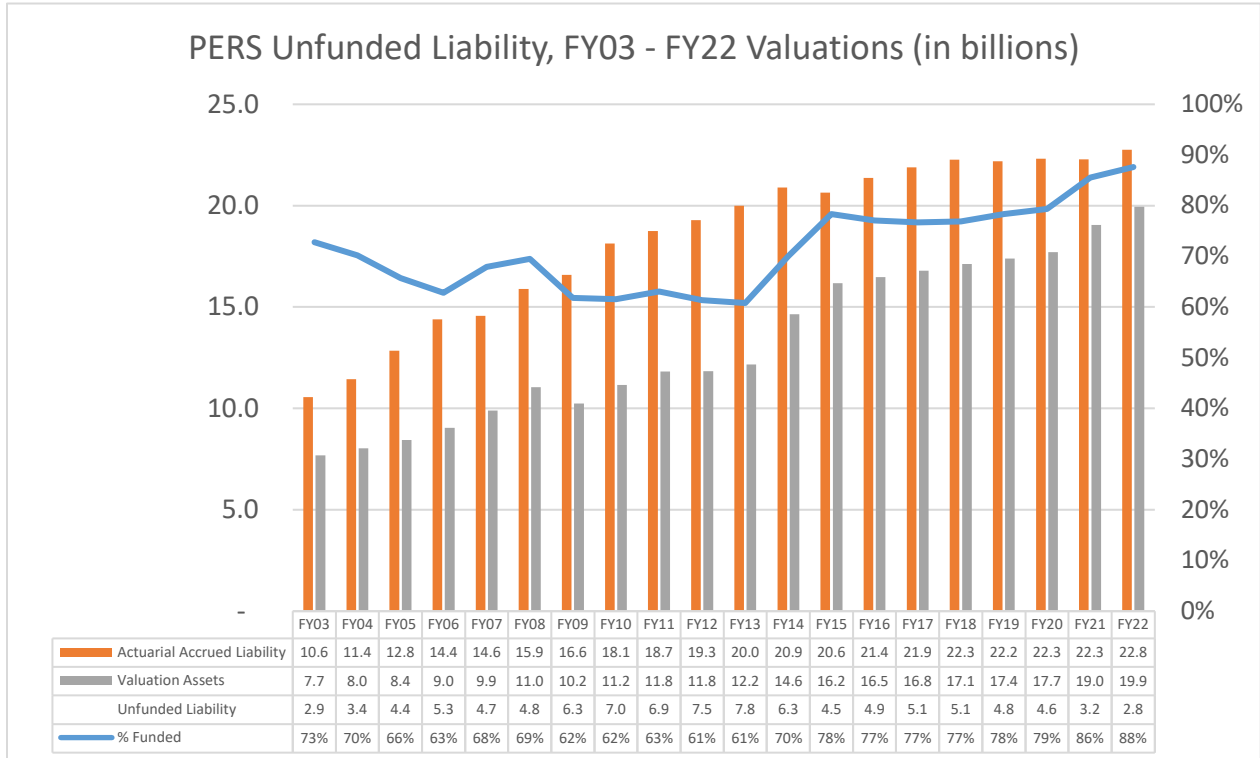


Table 2: TRS Actuarial and Employer Rates



Fallout from the funding crisis included the creation of the defined contribution plans discussed above. In addition, the State brought a \$2.8 billion lawsuit against its former actuary, Mercer Consultants, for malpractice, breach of contract, and unfair trade practices. The suit was settled in 2010 with Mercer agreeing to pay the State \$500 million, about one-fifth of which went toward attorneys' fees.

Table 3: PERS Unfunded Liability, FY 2003 - FY 2022 Valuations (in millions)



Despite changes to the retirements systems, pension shortfalls continued to grow. Although estimates varied, reports of unfunded liabilities up to \$12 billion motivated special appropriations in the FY 2015 operating budget totaling \$2 billion to PERS and \$1 billion to TRS (see Table 4). These appropriations included \$700 million required for current year obligations. Subsequently, the [State enacted a 25-year amortization plan](#) to eliminate the pension liability in 2039 (See Table 5). The plan calls for increasing annual payments that, combined, will total \$10.815 billion over time.

Table 4: Impact of FY 15 Lump Sum Appropriation to Cost of State Retirement Assistance (FY 2006 – FY 2024)

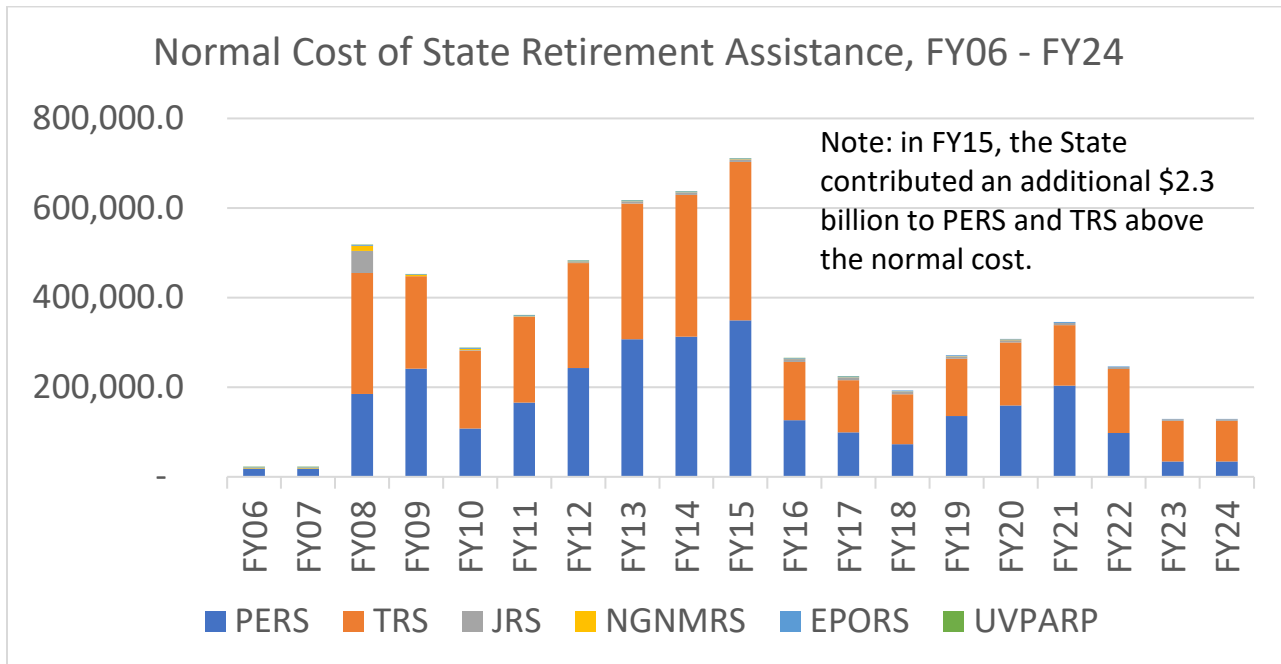
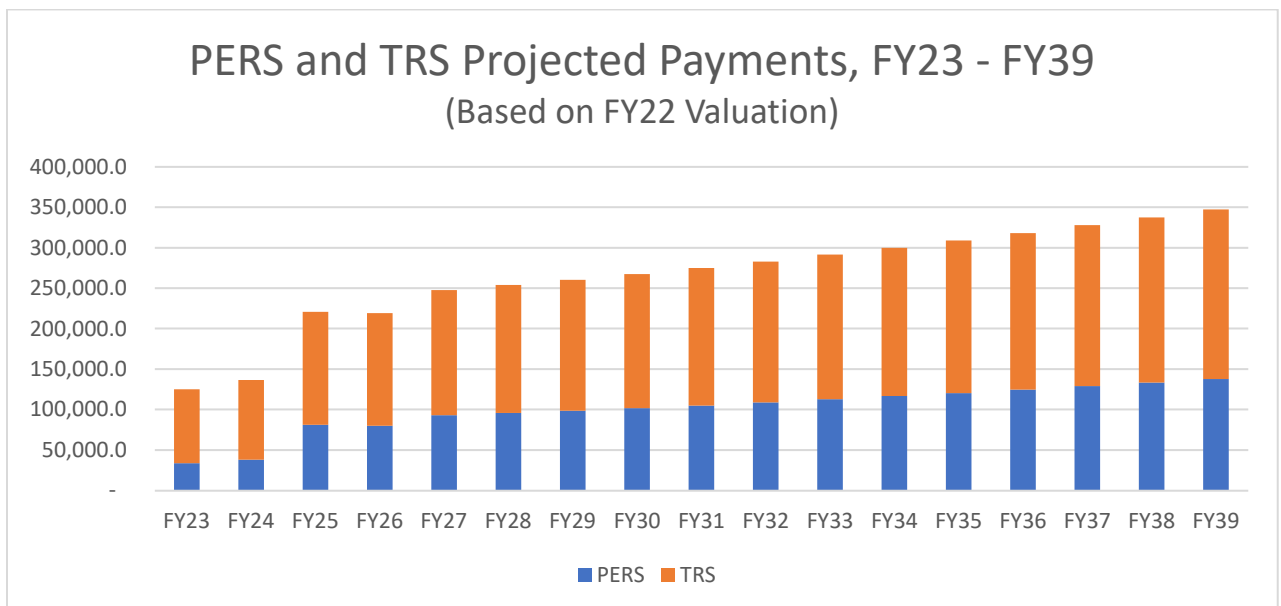


Table 5: PERS and TRS Projected Payments (FY 2022 - FY 2039) Based on FY22 Valuation



Past and Projected State Contribution

Since capping the employer rates in FY08, Alaska's state assistance to retirement payments has become a significant item in the operating budget. In FY24, the \$140 million payment comprised approximately 3% of the UGF operating budget. According to a [report by the Equable institute](#), this is proximate to the national median.

The unfunded liability is calculated by comparing the retirement system's current assets to the projected system costs. Since PERS and TRS are "closed" systems (new employees are not enrolled in the defined pension program), the assets need to last as long as the last beneficiary is still receiving benefits. The State's actuary makes assumptions regarding investment returns, inflation, health care cost increases, and the lifespan of beneficiaries. As of 2020, the ARM Board assumes investment returns of 7.38% and inflation of 2.50%, for a "real" return of 4.88%. This assumption is in line with [the national median assumption](#) of 7.25%, but this is a source of controversy in many states. Adopting a lower return assumption results in higher payments in the short-term, but reduces the risk of a spike in payments due to underperforming investments.

Since the passage of HB 385 in 2014, the State's annual payment for PERS and TRS is calculated using a formula that is designed to avoid large annual swings in payments. The payments are "smoothed" using a five-year average of past investment returns to determine the unfunded liability for each fiscal year. This is then amortized over a closed term of 25 years, meaning the period starting in 2014 and ending in 2039. The annual payment is calculated by the ARM Board and adopted annually. Since this methodology was adopted, the State has made the recommended payment each year.

One potential risk with this methodology is that even with smoothing, the payments may become increasingly volatile as we approach the end of the 25-year amortization period because there would be fewer remaining payments to spread any changes. To address this, in 2017 the ARM Board adopted a "layering" approach. With this approach, the original 2014 unfunded liability will be paid off by 2039, but any further increases to the unfunded liability due to actuarial changes (such as investment underperformance) would be paid off over a new 25-year period. This will prevent wild swings in payments as we approach 2039.

Glossary of Terms

Excerpt from Alaska Department of Administration
Division of Retirement and Benefits

Accessed on 2/12/2024 at:

<https://drb.alaska.gov/help/glossary.html#.X20jtWhKiUk>

Actuarial Accrued Liability (Past Service Cost)

The excess of the present value of a pension fund's total liability for future benefits and fund administrative expenses over the present value of the normal cost of those benefits as accrued for the current year.

Actuarial Adjustment (PERS)

Equality in value of the aggregate expected payments under two different forms of pension payments, considering expected mortality and interest earnings on the basis of tables adopted from time to time by the Public Employees' Retirement Board.

Actuarial Assumptions

Factors which actuaries use in estimating the cost of funding a defined benefit pension plan. Examples include: the rate of return on plan investments; mortality rates; and the rates at which plan participants are expected to leave the system because of retirement, disability, termination, etc.

Actuarially Determined Contribution (ADC)

The ADC is equal to the sum of (1) the employer's "normal cost" of retirement benefits earned by employees in the current year plus administrative expenses expected to be paid from the trust in the upcoming year, and (2) the amount needed to amortize any existing unfunded accrued liability over a period of 25 years.

Alaska Deferred Compensation Plan

The Alaska Deferred Compensation Plan allows you to voluntarily set aside a portion of your income before it is taxed. The amount set aside, plus any change in value (interest, gains and losses), is payable to you or your beneficiary at a future date. Upon becoming eligible to participate in the Plan, you may elect to defer your income on a pre-tax basis. By doing so, you agree to reduce your salary by an agreed-upon amount. This amount may not exceed certain requirements.

Alaska Retirement Management Board (ARMB)

The Alaska Retirement Management Board serves as the trustee of the assets of the state's retirement systems, the State of Alaska Supplemental Annuity Plan and the deferred compensation program for state employees. The board manages and invests fund assets in a manner that is sufficient to meet the liabilities and the pension obligations of the system.

Alaska Supplemental Annuity Plan

The Alaska Supplemental Annuity Plan (SBS-AP) is a defined contribution plan governed by section 401(a) of the Internal Revenue Code. A portion of your wages and a matching employer contribution are made pre-tax to this plan instead of contributions to Social Security. These contributions plus any change in value (interest, gains and losses), is payable to you or your beneficiary at a future date.

Deferred Compensation Plan

The Deferred Compensation Plan allows you to voluntarily set aside a portion of your income before it is taxed. The amount set aside, plus any change in value (interest, gains and losses), is payable to you or your beneficiary at a future date. Upon becoming eligible to participate in the Plan, you may elect to defer your income on a pre-tax basis. By doing so, you agree to reduce your salary by an agreed-upon amount. This amount may not exceed certain requirements.

Defined Benefit Plans

Pensions based on years of service and salaries. Retirees receive a defined monthly check, with the employer taking on the investment risk of the retirement funds. Many state, municipal and school employees around the nation once belonged to such plans.

Defined Contribution Plans

Retirement savings accounts based on employee and matching employer contributions. If the employee's investment choices perform poorly, or if the employee contributes little to the account, the employee receives less money at retirement. More employers are switching to defined contribution plans to lessen their financial risk and to allow their workers to take the money with them when they change jobs.

Employer (TRS)

A public school district, the Board of Regents of the University of Alaska, the Department of Education and Early Development, the National Education Association of Alaska, the Regional

Resource Centers, or the state legislature with respect to a state legislator who elects membership under AS 14.25.040(b).

Employer (PERS)

- The State of Alaska;
- A nonprofit regional corporation, but only with respect to village public safety officers employed by the corporation who have not terminated participation in the system; or
- A political subdivision or public organization of the state that participates in the system.

Funded Ratio

The ratio of a plan's current assets to the present value of earned pensions. There are several acceptable methods of measuring a plan's assets and liabilities. In financial reporting of public pension plans, funded status is reported using consistent measures by all governmental entities. According to the Government Accounting Standards Board (GASB), the funded ratio equals the market value of assets divided by the actuarial accrued liability calculated under the Entry Age Normal cost method.

Normal Cost

The normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year. The employer normal cost equals the total normal cost of the plan reduced by employee contributions.

Public Employees' Retirement System (PERS)

The Public Employees' Retirement System (PERS) includes a defined benefit plan that is for government employees first hired on or before June 30, 2006 and a hybrid defined contribution plan that has some defined benefit components for employees first hired on or after July 1, 2006

On January 1, 1961, the Alaska legislature established the Public Employees' Retirement System (PERS) to attract and retain qualified people into public service employment. The PERS offers a variety of benefits to its members and their survivors. These benefits, when combined with other income, are designed to provide members with financial security during their retirement years. For more information read the [Public Employees' Retirement System Information Handbook](#).

SB 141 (2005)

Closed the defined benefit plans and created a new retirement and retiree health plan. Signed into law July 27, 2005 Chapter 9 FSSLA 05.

SB 123 (2007)

Technical correction bill. Allowed the Alaska Retirement Management Board to apply the percent of pay past service cost against both defined benefit and defined contribution salaries. Signed into law June 6, 2007 Chapter 20 SLA 07.

SB 125 (2008)

Changed the PERS to a cost-share plan and set the employer rate at 22%. Established that the State will pay the difference between the 22% and the actuarially determined rate. Signed into law April 8, 2008 Chapter 13 SLA 08

Supplemental Annuity Plan

The Alaska Supplemental Annuity Plan (SBS-AP) is a defined contribution plan governed by section 401(a) of the Internal Revenue Code. A portion of your wages and a matching employer contribution are made pre-tax to this plan instead of contributions to Social Security. These contributions plus any change in value (interest, gains and losses), is payable to you or your beneficiary at a future date.

Supplemental Benefits System (SBS)

SBS includes the following:

- Life insurance
- Accidental Death and Dismemberment coverage
- Survivor benefits
- Disability benefits (short term and long term disability plans)
- Dependent Care Assistance Plan

Supplemental Contribution Account (TRS)

The account maintained by the system to record the supplemental contributions of each member, including interest and adjustments to the account.

Teachers' Retirement System

On July 1, 1955, the Alaska legislature established the Teachers' Retirement System (TRS) to attract qualified people into public service employment. The TRS offers a variety of benefits to its members and their survivors. These benefits, when combined with other income, are designed to provide members with financial security during their retirement years. For more information read the [Teachers' Retirement System Information Handbook](#).

The Teachers' Retirement System (TRS) includes a defined benefit plan that is for government employees first hired on or before June 30, 2006 and a hybrid defined contribution plan that has some defined benefit components for employees first hired on or after July 1, 2006.

Unfunded Actuarial Accrued Liability (UAAL)

The excess, if any, of the Actuarial Accrued Liability over the Actuarial Value of Assets. In other words, the present value of benefits earned to date that are not covered by current plan assets.