Alaska Retirement Management Board

August 8, 2013
Pension Funding

State has the constitutional obligation to fund its retirement obligations

The State has actively managed its mandate to fund pension obligations

- Prior to 2001: Alaska's main retirement systems enjoyed funding ratios over 100%

- Since 2001: Investment losses, recalibration of OPEB liabilities and changes in actuarial methods resulted in an unfunded liability

- 2005: State establishes the Alaska Retirement Management Board (ARM Board) to consolidate oversight and investment management of the major systems

- 2006: State closes the Defined Benefit (DB) plans, and established a Defined Contributions (DC) plan for new employees (SB141)

- 2008: (SB 125) State reforms and caps employer contribution rates
  - *Employer contribution rates rose dramatically for school districts, local governments, and state agencies*
  - *To establish a fair and equitable solution, the State capped employer rates at 22% for PERS (AS 39.35.255) and 12.56% for TRS (AS 14.25.070)*
  - *State now funds the difference between these caps and annual required contribution as a separate line item (referred to as the "SB 125 Contribution")*

- 2008: Final passage of $5 billion bond authorization (AS 37.15.900 et. Seq.)
The State has actively managed its mandate to fund pension obligations

- PERS: House Bill 65 appropriates $312.5 million from the general fund to the Department of Administration for deposit in the System's defined benefit pension fund and retiree healthcare trust as partial payment of the participating employers' contributions for the fiscal year ending June 30, 2014. This appropriation is to fund the difference between the statutory required contribution established in Senate Bill 125 of 22.00% and the Board adopted rate of 35.68% for fiscal year 2014.

- TRS: House Bill 65 appropriates $316.8 million from the general fund to the Department of Administration for deposit in the System's defined benefit pension fund and retiree healthcare trust as partial payment of the participating employers' contributions for the fiscal year ending June 30, 2014. This appropriation is to fund the difference between the statutory required contribution established in Senate Bill 125 of 12.56% and the Board adopted rate of 53.62% for fiscal year 2014.
Pension Obligation Bonds

A pension obligation bond allows the State to:

- Come closer to full funding of pension obligation
- Take advantage of low interest rates
- Trade upon the excellent investment performance
- Use the AAA ratings from the 3 major rating agencies to obtain a high rating
- Provide savings to and maintain liquidity of the general fund
Advantages and Challenges of POB

- Advantages
  - Can be a significant tool in funding pension liability
  - Provides funding at low interest rates levels
  - Can be issued as variable or fixed rate bonds
  - Can be structured to anticipate future general fund strengths and weaknesses

- Challenges
  - Income from investment of bond proceeds may not be greater than debt service
  - Does not eliminate the potential of future funding deficits
Historical 30-Year & 10-Year US Treasury

"UST 10" 10 YR AVG - 3.48%
"UST 10" 20 YR AVG - 4.57%

"UST 30" 10 YR AVG - 4.18%
"UST 30" 20 YR AVG - 5.11%

* The current UST 30 YR is 147 basis points lower than the 20 Year average. The current UST 10 YR is 199 basis points lower than the 20 Year average.
Flow of Funds

State of Alaska

Annual Appropriations

Department of Administration

Bond Proceeds

AK POBC

Annual Contract Payments

Bond Proceeds

Trustee

Debt Service

Investors

Debt Service

Governed by Trust Indenture

Governed by Funding Agreement
Moody's downgrades Chicago to A3 from Aa3, affecting $8.2 billion of GO and sales tax debt; due in large part to pension funding

Outlook: Negative

The downgrade of the GO rating reflects Chicago's very large and growing pension liabilities and accelerating budget pressures associated with those liabilities. The city's budgetary flexibility is already burdened by high fixed costs, including unrelenting public safety demands and significant debt service payments. The current administration has made efforts to reduce costs and achieve operational efficiencies, but the magnitude of the city's pension obligations has precluded any meaningful financial improvements. These credit challenges are balanced against key credit strengths that support the A3 rating, particularly Chicago's long-standing role as the center of one of the most diverse economies in the nation and its broad legal authority to generate revenues from a large property tax base and a larger sales tax base.

The negative outlook reflects the formidable legal and political barriers to pension reform in the State of Illinois and the scheduled dramatic increase in city pension contributions required in 2015 under current state law. While the onus is on the state to reduce the city's pension obligations, it is the purview of the city to increase revenues to support those obligations. Absent significant growth in the city's operating revenues, escalating pension funding requirements will increasingly strain the city's operating budget, as pension outlays compete with other spending priorities, including debt service and public safety.
Current Events: Detroit

Detroit’s filing for bankruptcy protection has significant national implications

Like Alaska, Michigan has a provision in its State Constitution that protects Pensions

§ 24 Public pension plans and retirement systems, obligation.

Sec. 24. The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.

The Emergency Financial Manager has proposed a reduction in Detroit’s pension obligation

Michigan AG to defend public pensions, state constitution in Detroit bankruptcy filing (Detroit Free Press, July 29, 2013)

Detroit’s bankruptcy filing has brought uncertainty to the marketplace.