ALASKA HOUSE STATE AFFAIRS SUBCOMMITTEE

SB 88 BILL ANALYSIS

Prepared by:

Pension Integrity Project at Reason Foundation

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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

SB 88 CONCERNS

Problem #1: Poor Plan Design

- Plan assumptions are an outlier among other defined benefit plans.
  - Starting a new pension tier at a 7.25% assumed rate of return.
    - Bills from last session would have started new tier at 7.38%, which if passed, would've already added hundreds of millions in unfunded liabilities due to assumption change and 2022 investment losses.

- Closes the DC plan to all new hires instead of offering it as an option.
  - DC plans are more beneficial for non-career workers.
  - Average new employee holds 7-8 jobs over the course of their career.

- Capped employee contribution rates.
  - Employees: 8%-12%
  - Employers: 12% + all unfunded liabilities
  - **Increases to employee rates are at discretion of board instead of automatic.**
    - In many states, projected increases to employee contributions are met with demands from employee groups to raise salary at commensurate amounts.

- The small changes made by bill proponents do not, practically speaking, take any of the **real** risk off the table.
    - Cost sharing, discount rates, longevity are where the needle moves for taking down risk.
    - Largest cost savings is from elimination of 10% residency COLA.

Problem #2: Pension Cost Increases On Horizon

- The bills propose the use of a 7.25% assumed rate of return, discount rate, and DC annuitization rate.

- The bill also proposes the ability to transfer all employee assets from the DC plan into the new DB plan to purchase service credit.

- The legacy pension tier also uses a 7.25% rate and is projected to pay off unfunded liabilities by 2039.
    - Backloading of debt payments means larger and larger state-as-an-employer contributions until 2039.

- National average is now 6.91% and dropping quickly.

- Survey of largest public pension systems shows they expect to earn around 6% over the next 10-15 years.

- When/if Alaska PERS and TRS lowers their investment return assumptions (as they did in 2022), costs will go up dramatically for both the legacy and new tiers.

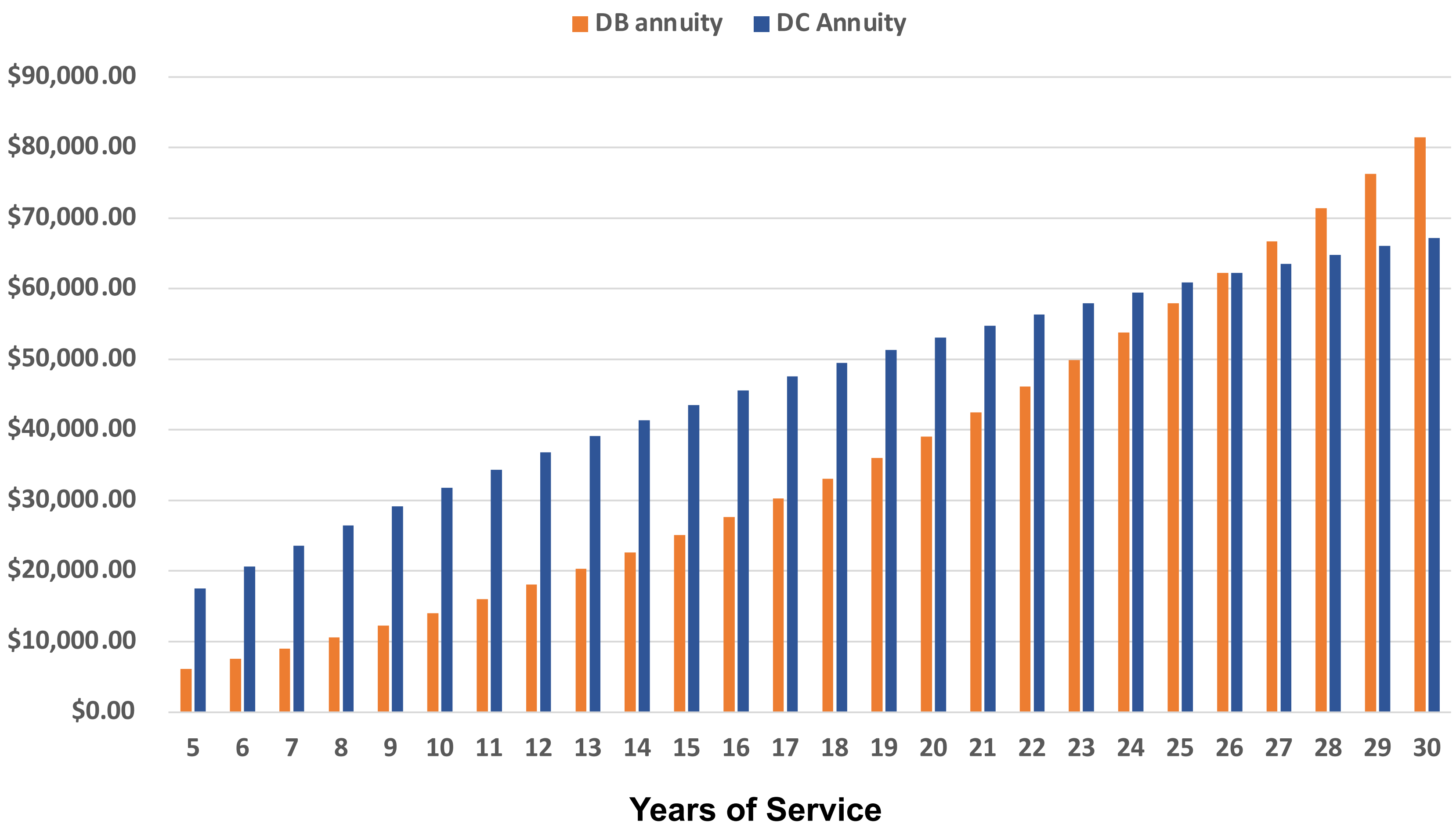
Problem #3: Pension Swap Unlikely to Solve Retention Issues

- Across the country, median state employee tenure is 6.3 years.
  - Most state employees have access to a defined benefit plan.
- 86% of police stations across the country are facing a shortage of members (National Police Foundation).
  - Every one of those stations, outside of Alaska, has a pension with some defined benefit component.
- Police resignations are still increasing nationwide; 29 percent more resignations in 2023 than in 2019 (Police Executive Research Forum).
- We have an academic working paper that shows retention rates for Alaska teachers were not impacted by the swap from a DB to DC in 2005.
- Public employee surveys show that retirement benefits rank far below other factors for recruitment and retention.

EVALUATION OF RETIREMENT PLANS AND RETENTION

DC Plan Benefits Most New Hires

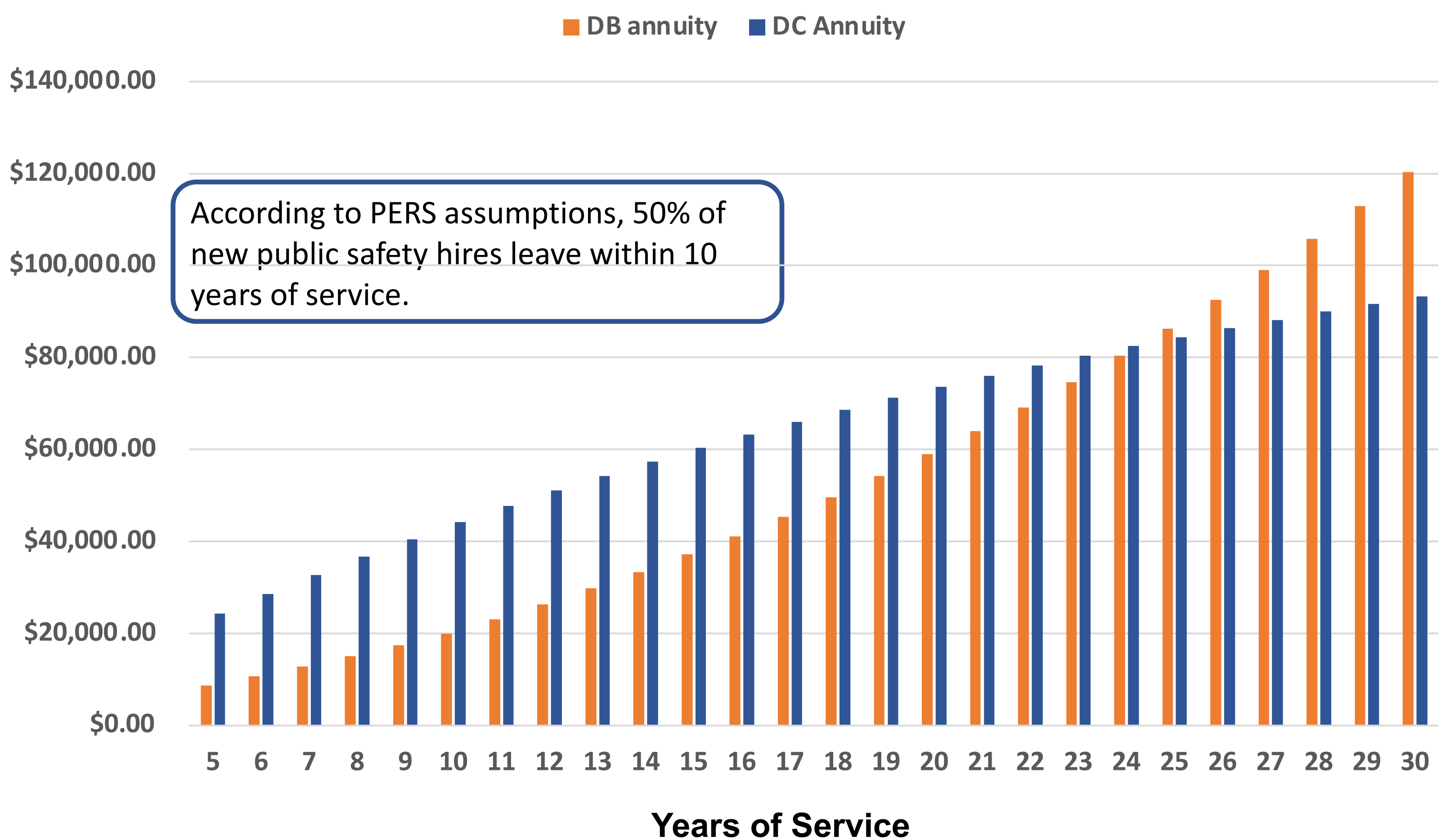
PERS Non-Public Safety



Source: Pension Integrity Project 30-year benefit forecast of Alaska PERS (non-public safety) DC & DB plan closed in 2006. Analysis uses entry age 30, assumed 7% return, 5.89% annuity payout rate, and 2.75% wage increase rate.

DC Plan Benefits Most New Hires

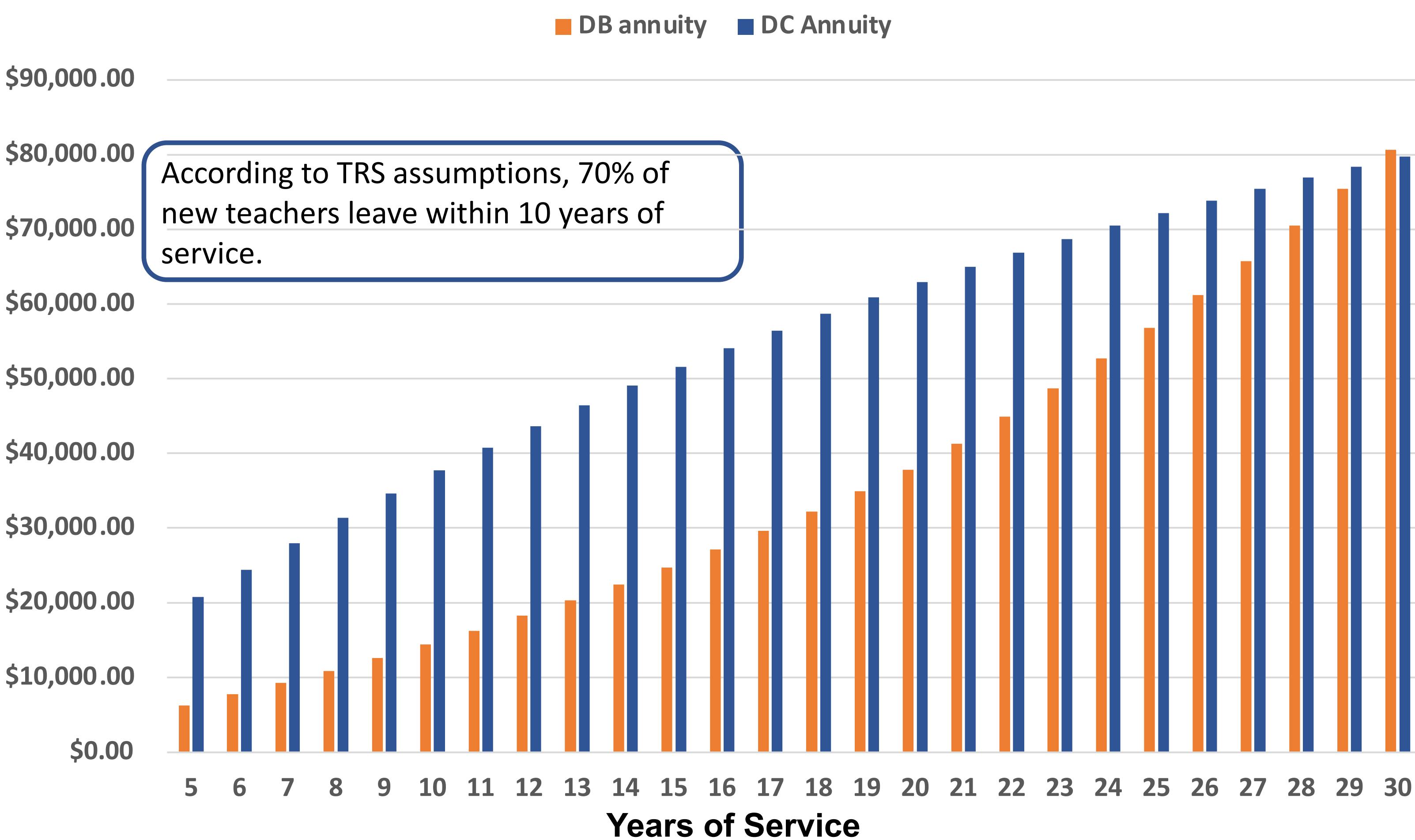
PERS Public Safety



Source: Pension Integrity Project 30-year benefit forecast of Alaska PERS public safety DC & DB plan closed in 2006. Analysis uses entry age 30, assumed 7% return, 5.89% annuity payout rate, and 2.75% wage increase rate.

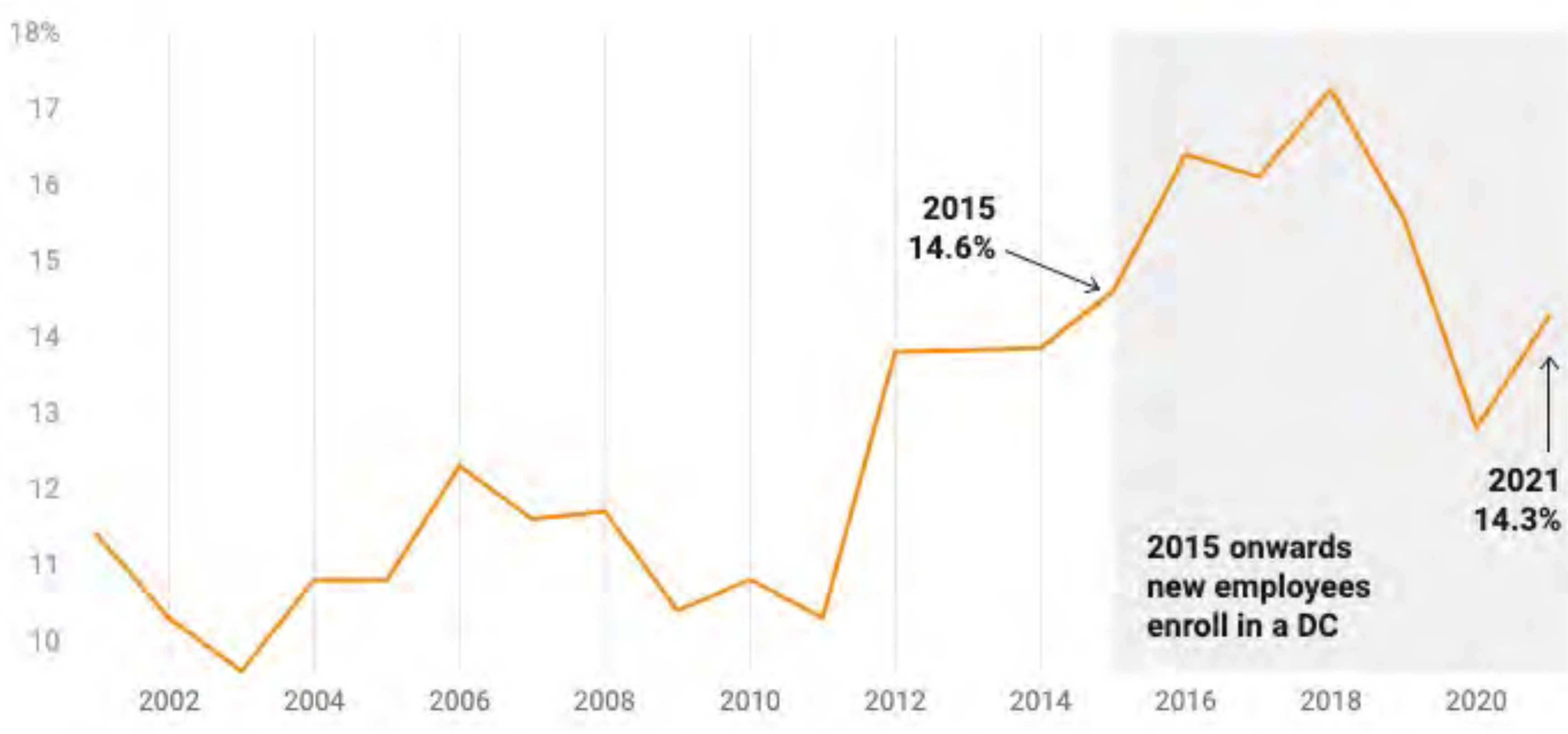
DC Plan Benefits Most New Hires

TRS



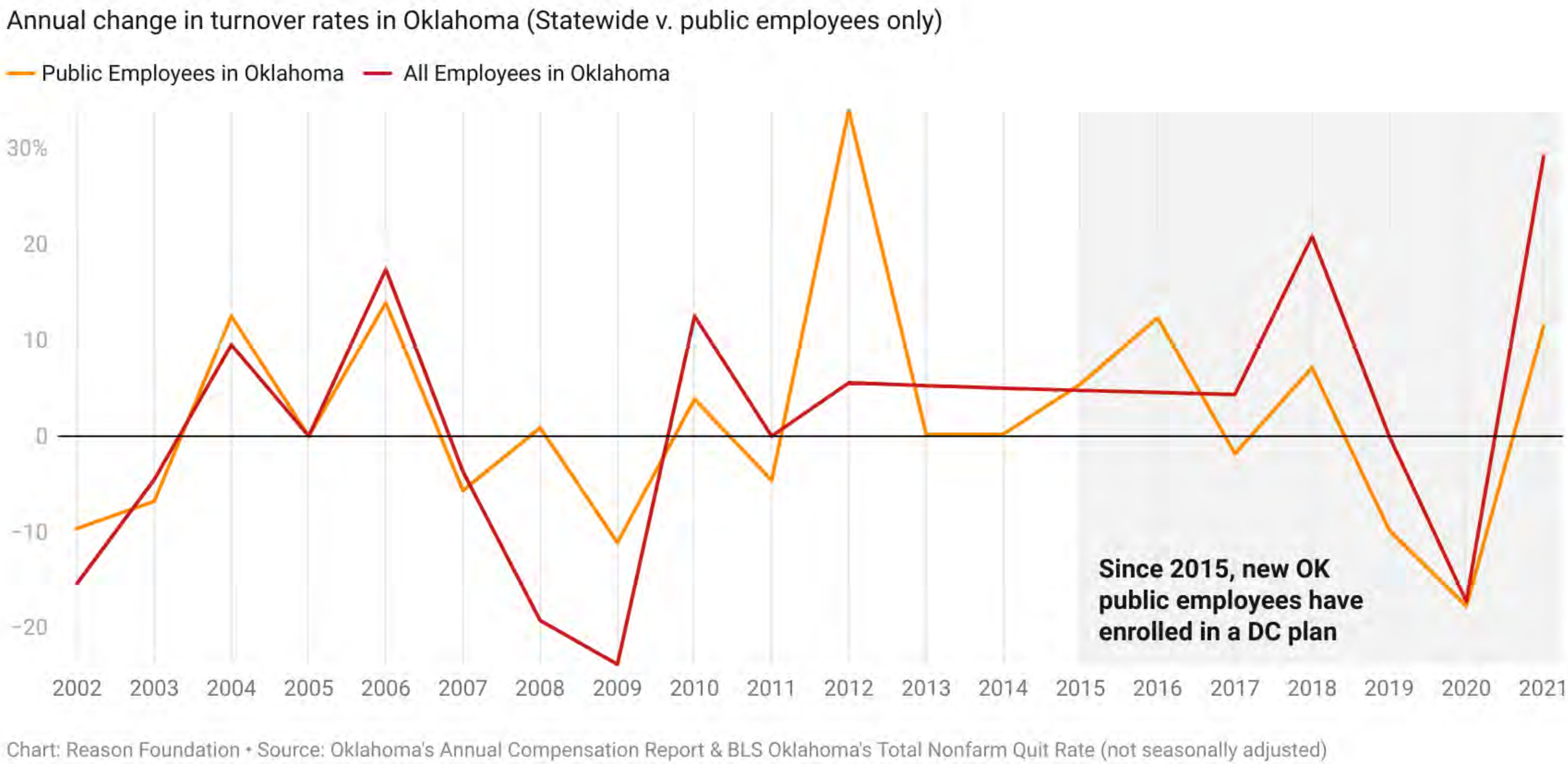
Source: Pension Integrity Project 30-year benefit forecast of Alaska TRS DC & DB plan closed in 2006.
Analysis uses entry age 30, assumed 7% return, 5.89% annuity payout rate, and 2.75% wage increase rate.

Oklahoma Public Employee Turnover Similar to Pre-DC Rates



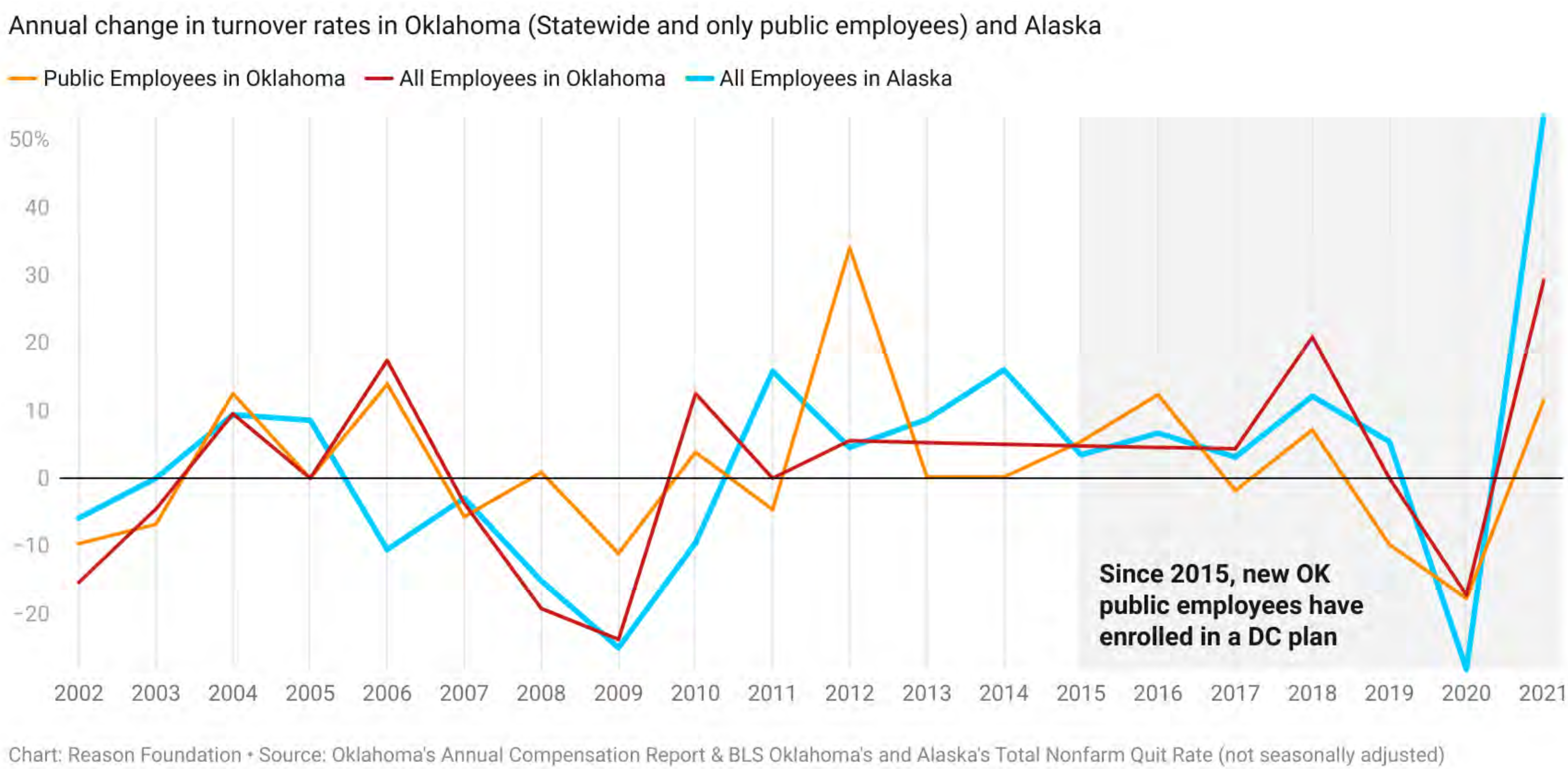
Source: Oklahoma Annual Compensation Report. Turnover is measured by what percentage of public employees who voluntarily left service each year.

Changes in Oklahoma PERS Turnover Rate Follows Statewide and Private Sector Trends



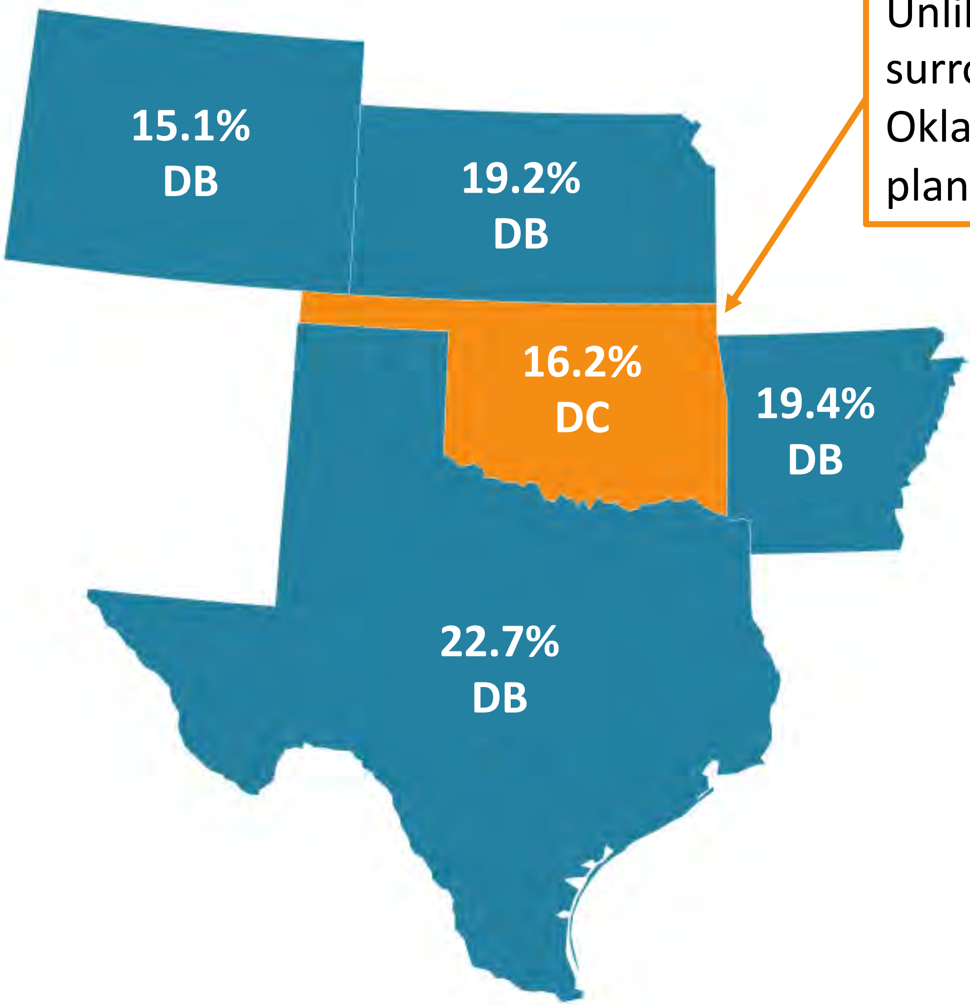
Sources: Oklahoma Compensation Report & BLS Oklahoma total nonfarm quit rate. Graph displays the % change in the quit rate.

Changes in Alaska's Turnover Rate Follows Oklahoma's Statewide & Public Employee Trends



Sources: Oklahoma Compensation Report, BLS Oklahoma, & BLS Alaska total nonfarm quit rate. Graph displays the % change in the quit rate.

Oklahoma's Public Employee DC Plan Has Not Led to Increased Turnover Rates



Unlike its surrounding state's, Oklahoma has a DC plan For new hires

Oklahoma's turnover is second lowest among its peers, despite using a DC plan for newly hired public workers

Source: State government workforce reports

Impact of DB to DC Transition

Employee Preferences and Retention

- A study on Washington State Teachers Retirement System (WSTRS) found that transitioning to a hybrid DB-DC plan **did not significantly affect** employee turnover (Goldhaber et al., 2017)
- Younger and less experienced workers, such as teachers in Florida, have shown a preference for DC plans due to their **flexibility and portability** (Chingos and West, 2015)
- A study of the transition from the Civil Service Retirement System (CSRS) to the Federal Employees Retirement System (FERS) showed that retention rates **are the same** after employees stay on the job for about 10 years (Ippolito 2002)

DC Plans and Mobility

- **Enhancement** to traditional plans results in **accelerated** teacher **retirement** and **reduced** average teacher **quality**, while DC plans produce the opposite effect based on the analysis of Tennessee teachers (Ni, Podgursky, 2022)
- Employees with higher mobility tendencies **self-select into the DC plan** based on the analysis of large unionized nonfaculty university employees (Goda et al. 2017)
- The decision to retire is sensitive to normal retirement age and the flexibility of **DC plans enables earlier** retirement than DB plans among Oregon public sector employees (Chalmers, Johnson and Reuters, 2014)

Salary vs. Pension Benefits vs. Economic Conditions

- **Changes in the salary** of federal workers rather than pension benefits have been found to be a greater motivator for retention, suggesting that immediate financial considerations may outweigh long-term pension benefits. (Falk et al. 2018)
- Other factors, such as improving economic conditions and the relative attractiveness of the private sector, can also influence employee separations and retention rates, as seen in Utah (Clark et a., 2016)

Impact of Changes in Pension Plan Generosity

Impact on Retirement Timing and Retention

- Based on a national sample of pensions plans, eliminating a 3 percent COLA could delay the retirement of affected workers by approximately 4.5 months, highlighting the impact of cost-of-living-adjustment (COLA) changes in public sector retirement plans (Fitzpatrick and Goda, 2020).
- A study on the St. Louis Public Schools (SLPS) in Missouri analyzed the effects of a 1999 pension enhancement. Simulations of retirement behavior for representative senior teachers point to earlier retirement age as a result of the enhancements. By contrast, moving from the post-1999 to a DC-type plan would extend the teaching career of a representative senior teacher by roughly two years (Ni et al., 2022).
- A benefit enhancement reform of the California State Teachers' Retirement System (CalSTRS) had a weak but positive impact on retirement timing, indicating that changes in pension plan generosity can influence retirement decisions in a minor way (Brown, 2013).
- More than a quarter of Illinois teachers were unwilling to pay 19 cents for pension enhancements worth one dollar in present value. However, the majority of teachers purchased the upgrade, and among those who did not, the net benefit of the upgrade was negative given their retirement timing (Ni et al., 2022).
- A 2005 reform in Rhode Island's Employees' Retirement System of Rhode Island (ERSRI), which cut benefits for non-vested members, led to a 2.4-percentage-point increase in the rate of separation, suggesting that changes in plan generosity can impact employee retention (Quinby and Wettstein, 2019).

Impact on Worker Quality

- Enhancements to traditional plans in Tennessee accelerate teacher retirement and reduce average teacher quality, whereas defined contribution (DC) plans produced the opposite effect (Ni et al., 2022).
- A study investigating the effect of pension reform on the retention and productivity of workers found that a reform reducing pension annuities and increasing penalties for early retirement had no effect on worker output (Johnston, 2021)
- A study using administrative microdata from Missouri found no evidence to suggest that pension incentives raise teacher quality, prompting a call for experimentation with alternative retirement benefit structures (Koedel et al., 2013).

Worker Knowledge of Incentives and Benefits

Understanding of Pension Features and Incentives

- Many participants in the Washington State Teachers' Retirement System cannot accurately recognize their plan type, which further highlights the limited knowledge of public sector workers regarding their pension benefits (DeArmond and Goldhaber, 2010).
- Workers often do not know their employer's match in their pension plans, which could lead to suboptimal choices in retirement planning. This was revealed in a study by Beshears et al. (2011) which used data from a large 401(k) plan in the U.S.
- Workers have difficulty understanding their retirement plans and the incentives they generate. This was shown in studies by Chan and Stevens (2008) using data from the Health and Retirement Study, and Mastrobuoni (2011) using data from the Social Security Administration's Master Beneficiary Records.

Awareness of Pension Benefits

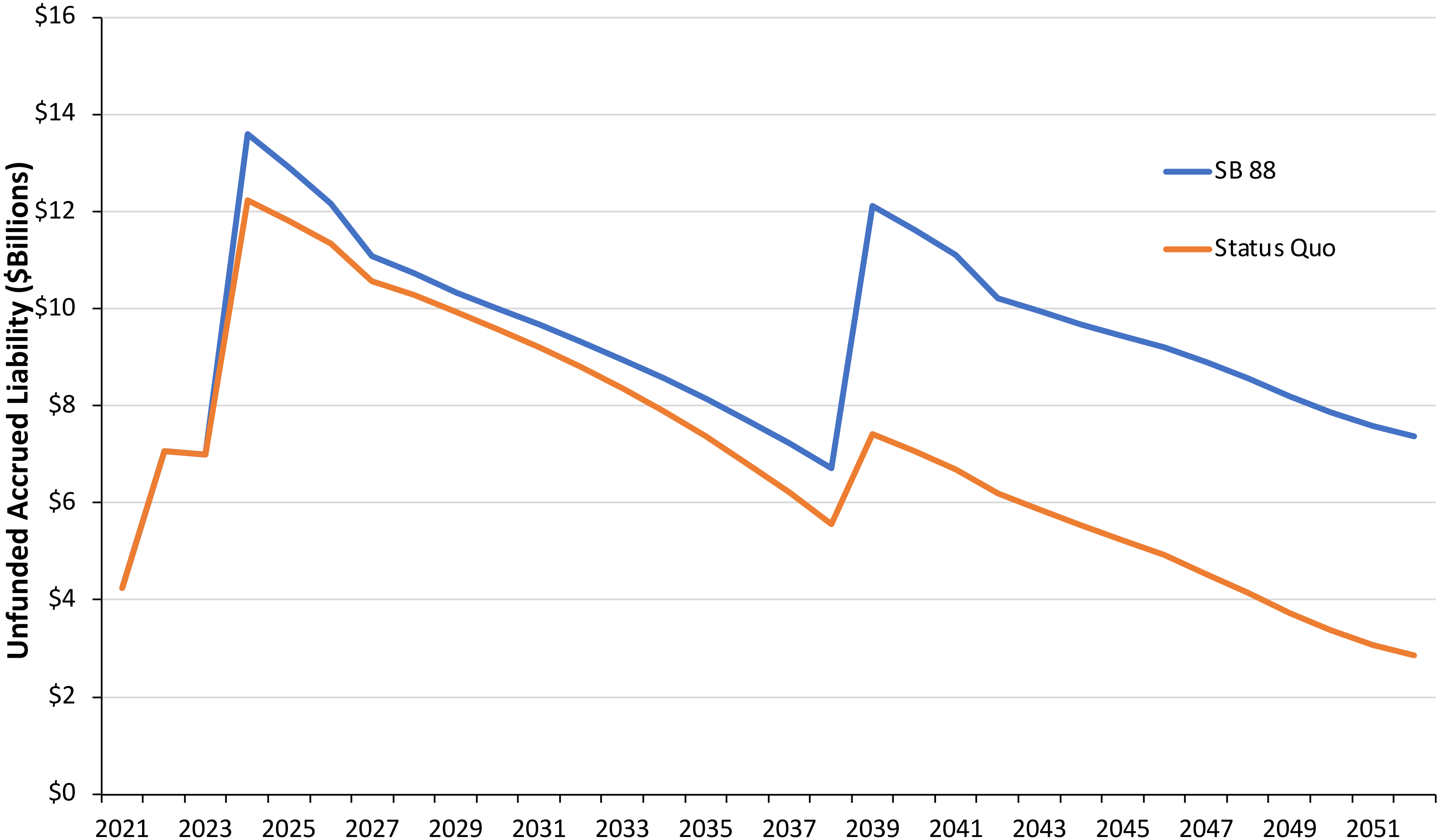
- A nationally representative survey of over 2,000 teachers revealed a wide range of preferences among teachers, casting doubt on the validity of using pensions as an effective recruitment tool. This study by Fuchsman, McGee, and Zamarro (2023) presented teachers with hypothetical scenarios involving varying levels of current compensation and future retirement benefits.
- A cross-sectional survey of over 1,000 teachers found that a significant proportion of respondents could not correctly identify their retirement plans or accurately know their retirement ages. This study by Fuchsman, McGee, and Zamarro (2021) indicates a lack of understanding that could lead to suboptimal choices and impact financial security during retirement.

RISK ANALYSIS OF SENATE BILL 88

How would reopening the pension for all public workers (with adjustments to retirement eligibility) impact state debt and budgets?

SB 88 Adds to Alaska's Pension Debt

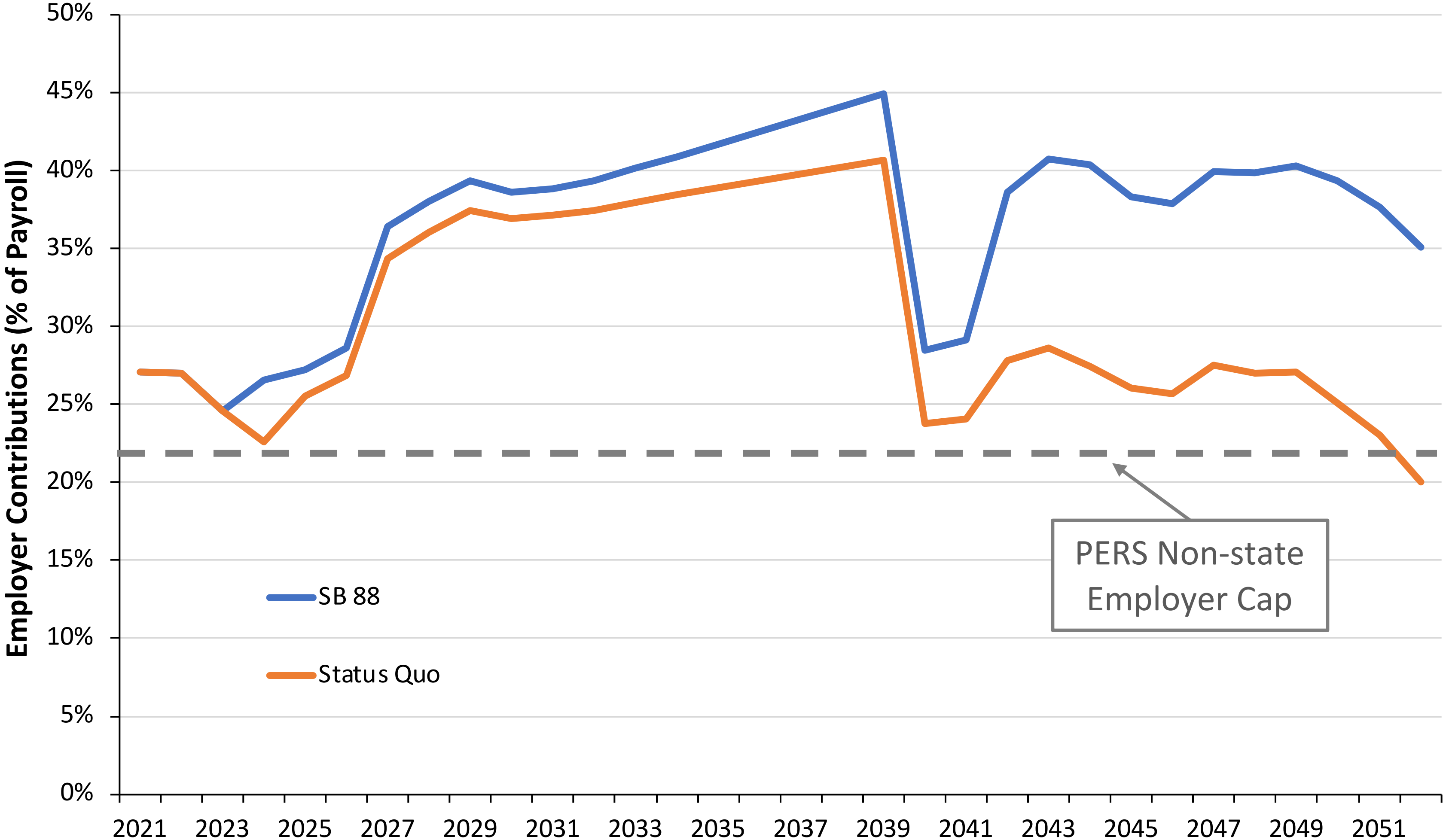
Pension Debt Forecast : Stress Return Scenario Applied



Source: Pension Integrity Project actuarial forecast of Alaska PERS & TRS unfunded liabilities using market value of assets.
Scenario applies recession returns in 2024-27 and 2039-42 and 6% returns in all other years.

SB 88 Adds to Alaska's Annual Costs

Employer Contribution Forecast : Stress Return Scenario Applied



Source: Pension Integrity Project actuarial forecast of Alaska PERS unfunded liabilities using market value of assets.
Scenario applies recession returns in 2024-27 and 2039-42 and 6% returns in all other years.

Long-term Cost Impact of SB 88

No Stress (If everything goes as the plan assumes today)

	Status Quo	SB 88
Total Employer Contribution: Alaska PERS & TRS (2023-52)	$19.3 billion	$21.5 billion
Unfunded Liability: Alaska PERS & TRS (2052)	$0.1 billion	$0.6 billion
All-in Cost to Employers	$19.4 billion	$22.1 billion

Standard Stress Applied

	Status Quo	SB 88
Total Employer Contribution: Alaska PERS & TRS (2023-52)	$22.2 billion	$27.7 billion
Unfunded Liability: Alaska PERS & TRS (2052)	$10.5 billion	$14.6 billion
All-in Cost to Employers	$32.7 billion	$42.3 billion

Source: Pension Integrity Project 30-year actuarial forecast of Alaska PERS & TRS.

Stress scenario applies recession returns in 2024-27 and 2039-42 and 6% returns in all other years. Values are adjusted for inflation.

Main Takeaways

- We agree with Buck that SB 88 will increase employer costs.
  - Buck projects a $1.2 billion cost over 15 years.
  - We project a $2.8 billion cost over 30 years.

- SB 88 could ultimately cost the state an additional $9.6 billion.
  - If market returns are like the previous 24 years.

- There is no empirical data from any source that shows SB 88 will have an impact on recruitment and retention.

The fundamental policy question is: **Is it worth the cost and risk to achieve maybe nothing on recruitment and retention?**

Questions?

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