

A Study on the
People's Affordable College Tuition Program
For the State of Alabama



by

The Retirement Systems of Alabama

August 2009

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As directed by Act 2009-808, SJR 150 of the Regular Session, this actuarial study of financial issues related to the Alabama Prepaid Affordable College Tuition Program is herewith provided to the Honorable Bob Riley, Governor, State of Alabama, and to each individual member of the Alabama Legislature.

Executive Summary

Alabama and fifteen other states offer Prepaid Affordable College Tuition (PACT) programs, all of which vary significantly in design. Approximately 40 percent of the states guarantee contracts in some fashion.

There are currently at least four lawsuits brought by contract holders. The state's immunity should be a bar to any lawsuits brought against the state or the PACT Board; however, the court may find exceptions to the immunity defense.

There have been distinctions made between pre-95 PACT contracts and post-95 contracts because the former contained the word "guarantee." However, under basic contract law, there is no distinction between a contract to provide goods or services at a stated price and one guaranteeing to provide goods or services at a stated price. Thus, there is no legal reason to treat the pre-95 contracts and the post-95 contracts differently. It is difficult to predict the outcome of the current or future litigation; the only certainty is that it will be lengthy and expensive.

The PACT deficit is influenced by rates of return on investments and future tuition increases. Historically, tuition increases have averaged approximately 7.25 percent per year. However, for the 2009-2010 academic year, several state universities have raised tuition at rates much higher than the historical average of 7.25 percent. The financial study upon which this report is based assumes that in fiscal years 2011 and after, the annual tuition increases would be 7.25 percent.

The ability to modify plan benefits does not exist because the benefits are set by statute and modification will result in additional lawsuits with potential results favoring PACT contract holders. The only ability to affect the costs of the program is by managing tuition cost.

The PACT Board's actuary, upon the advice of their investment consultants, used an assumed rate of return of 8.02 percent annually. Upon consulting with our own investment staff and their advisors, we settled on a variable assumed interest rate of 5 percent for the first three years, 4.5 percent for the next two years, and 3 percent for the remaining years. This was based on the current market uncertainties plus acknowledging the fact that, because the program is closed to new investors, the required liquidity in later years would reduce the expected returns. It was also felt that to err on the side of a potential surplus would be preferable to addressing any future deficit. We also assumed a range of tuition increases to illustrate the impact upon the costs of the program.

The following financial data and projected outcomes relating to the PACT Program are based upon an actuarial study performed using critical key assumptions including, but not limited to, expected investment return, tuition inflation and cancellation rates. If actual performance differs from these assumptions, the outcomes may be significantly different from those outlined in this report. For example, the cancellation rate of contracts is estimated to be 1 percent per year to matriculation; however, should a larger percentage of participants exercise their right to cancel their contracts, the amounts necessary to fund the program for the remaining participants would be higher. It should be noted that subsequent to the letter to participants in March 2009 warning of the impairment of the PACT Program, over 1,600 contract holders withdrew their funds. A negative perception by the remaining contract holders following this report will likely cause another round of contract cancellations. The complete list of assumptions can be found on page 26 of the attached study.

Table 1 illustrates the PACT Program deficit based on varying annual tuition increase assumptions.

Table 1—PACT Program Deficit
(\$ amounts in millions)

Annual Tuition Increase	Deficit
7.25%	\$641.8
3.75%	\$422.0
0.00%	\$247.0

Funding schedules can provide flexibility in funding the program's deficit much the same as a mortgage is used to fund the purchase of a home. The longer the payment period, the lower the periodic payments and the higher the total cost.

Options for funding the PACT Program deficit are virtually limitless as far as time periods and methods. We chose the following four illustrations in Table 2 for consideration. Detailed schedules by year can be found on pages 14 – 25 of the attached study.

Table 2—Funding Options
(\$ amounts in millions)

Funding Schedule	7.25% Tuition Inflation	3.75% Tuition Inflation	0.00% Tuition Inflation
Option A—Fully fund in FYE 2011	\$641.8	\$422.0	\$247.0
Option B—Pay-as-you-go	\$1,006.4	\$660.4	\$386.8
Option C—\$100 million per year	\$748.2	\$458.9	\$256.6
Option D—Level funding over 18 years (initial amount per year)	\$932.8 (\$52.1)	\$608.7 (\$34.2)	\$355.0 (\$19.8)

The first option (Option A) for a lump-sum payment to fund the deficit, as set forth in Table 1 above, is the overall least expensive option, but is clearly not doable without a new revenue source.

The other extreme choice (Option B) is to fund on a pay-as-you-go basis, which estimates a delayed appropriation schedule based upon the following runoff of funds available at an estimated 7.25 percent annual tuition increase.

Option C illustrates funding \$100 million per year, which would require a funding period ranging between 7.5 and 2.5 years before enough funds are available for the PACT Program to sustain itself.

Finally, Option D outlines the funding requirements if the state annually appropriates level amounts over the eighteen-year period beginning FYE 2011 in order to adequately fund the program until the last beneficiary completes matriculation. In light of the financial pressure experienced by state budgets due to current economic conditions, this approach or one very similar appears to be the most realistic approach to stabilizing and ensuring the future success of the PACT Program.

Table 3 estimates that if the assumed 7.25 percent increase in tuition rates, investment returns ranging from 5 percent to 3 percent and cancellation rates of 1 percent are actually experienced, the PACT Program would run out in fiscal year 2015.

Table 3—PACT Program Runoff
(\$ amounts in millions)

Fiscal Year Ending	Beginning of Year Assets	Benefit Payments	Contract Holder Payments
2010	\$483.2	\$110.0	\$17.9
2011	\$411.9	\$111.9	\$11.5
2012	\$328.5	\$106.2	\$10.0
2013	\$245.3	\$105.5	\$ 8.1
2014	\$155.8	\$107.2	\$ 6.2
2015*	\$ 58.6	\$107.5	\$ 4.6

**For Fiscal 2015, there would be enough funds to pay the November 2014 tuition payment and only 25% of the March 2015 tuition payment.*



Alabama PACT

Financial Study

August 2009



August 2009

Retirement Systems of Alabama
201 South Union Street
Montgomery, AL 36130

Gentlemen:

Buck Consultants, LLC (Buck) was retained to complete this actuarial valuation of the Alabama PACT program, compare the results to the March results presented to the PACT Board by its current actuary and to present potential financial arrangements that address a substantial unfunded liability. The results of the valuation presented in this report are as of May 31, 2009.

Data Used

This valuation was performed using contract data supplied by the Plan Administrator and financial data supplied by the Plan's Investment Consultant. Buck did not audit the data although they were reviewed for reasonableness and consistency with the prior year's information. The results of the valuation are dependent on the accuracy of the data.

Changes in Assumption

Actuarial Resources Corporation is the PACT Board's current actuary. We reviewed their 2008 actuarial report and the update they prepared as of March 31, 2009. We were not able to use the exact same actuarial demographic assumptions due to differences in Prepaid Tuition plan actuarial software and the desire to expedite the analysis. Despite the differences, we were able to approximate the same assumptions and the resulting liability was not significantly different than of that generated by Actuarial Resources.

Purpose of This Report

This report is prepared for The State of Alabama in accordance with Act 2009-808, SJR 150 of the 2009 Regular Session, for use in review of the operation of the Plan. It is expected that this report will be used for the purpose of determining potential contributions to be made to the Plan. Use of this report for any other purpose may not be appropriate and may result in mistaken conclusions due to failure to understand applicable assumptions, methodologies, or inapplicability of the report for that purpose. No one may make any representations or warranties based on any statements or conclusions contained in this report without the written consent of Buck.

Actuarial Status of the Plan

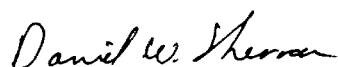
The actuarial assumptions used to value the Plan as of September 30, 2009 for funding purposes (using the 7.25% tuition inflation rate) are, individually and in the aggregate, reasonable and in combination represent our best estimate of anticipated experience under the Plan. Tuition inflation rates of 3.75% and 0.00% are included to represent what the results would be if the state were able to control the rates.

Based on the foregoing, the cost results and actuarial exhibits presented in this report were determined on a consistent and objective basis in accordance with applicable Actuarial Standards of Practice and generally accepted actuarial procedures. They fully and fairly disclose the actuarial position of the Plan based on the participant contract and asset data submitted.

Qualifications

Daniel Sherman is an Associate of the Society of Actuaries, and a Member of the American Academy of Actuaries. He served as the actuary to the Alabama PACT plan for ten years, and is the current actuary for the Texas prepaid tuition programs. He meets the Qualification Standards of the Academy to render the actuarial opinions contained herein. This report has been prepared in accordance with all applicable Actuarial Standards of Practice, and we are available to answer questions concerning it.

BUCK CONSULTANTS, LLC



Daniel Sherman, ASA, MAAA, EA
Director and Consulting Actuary

Overview

This report presents the results of a valuation of the Alabama PACT program as of May 31, 2009. The results of the valuation are consistent with the results shown in the May 18, 2009 letter to the PACT Board from Robert Crompton of Actuarial Resources Corporation. In addition to matching the results of Actuarial Resources, we also performed valuations of the plan under different assumptions in order to demonstrate the possible outcomes of actual experience versus the expected.

Essentially, if the contracted benefits for the 48,147 active contracts as of March 31, 2009 can not be reduced and the assumptions are realized, according to Actuarial Resources, the state has a \$460 million unfunded liability that needs to be addressed. Payments by the state can be made in any number methods. This report shows the results of several methods. The only real differences are investment returns, interest on the unfunded liability and tuition inflation.

Assumptions. The valuation results presented by Actuarial Resources are based on the assumption that the investment consultant's expected return of 8.02% per year continues for the life of the plan. We do not believe that this return can be maintained for the life of the program. Prior to the freezing of new contracts, the number of new contracts had been declining. This requires moving investments into more liquid asset classes. Increased liquidity generally reduces the expected return on the investments. The Board's decision earlier in 2009 to stop issuing new contracts means the likelihood of realizing an investment return greater than 8% is not reasonable.

Based on current economic conditions and the need to move to more liquid assets to cover contract benefit payments, we used investment return assumptions in the range of 3% to 5% for determining the unfunded liability. For example, under Option 1 using 7.25% tuition inflation, the assumed investment returns are as follows:

<u>Fiscal Year End</u>	<u>Rate</u>
2010 - 2012	5.0%
2013 - 2014	4.5%
2015 +	3.0%

Our presentations of alternative funding schedules include the expected return by year.

Funding Schedules. We examined a variety of options available to the state to cover the unfunded liability of the program. The tables in this report do not cover all possible approaches, but will give the reader a sense of what is possible and the range of possible commitments. The least costly approach in absolute dollars is to place as much money as necessary into the fund as soon as possible. Due to the time value of money, the most expensive are the Pay-as-you-go schedules.

Plan Changes. This report does not include analysis of potential reductions in the unfunded liability due to plan modifications. Due to the contractual nature of the program, any adjustments to the program within the scope of modifications allowed under the contracts will have a minimal impact on the size of the unfunded liability.

Financial Results

This table summarizes the principal results from our valuation and the one prepared by Actuarial Resources using the same actuarial assumptions. The purpose of this exercise was to verify that the actuary was generating results consistent with the data and actuarial assumptions used. Any changes in actuarial assumptions, methods, or plan provisions between the two valuations are described after the summary.

Valuation Date	March 31, 2009	September 30, 2009*
Value of cash, investments and contract receivables	\$ 503,301,396	\$ 531,094,330
Actuarial value of future benefit payments	\$ 963,529,466	\$ 990,279,435
Deficit	\$ 460,228,070	\$ 459,185,105

* Projected from March 31st data and May 31st assets. Valuation assumptions are the same as those used as of March 31, 2009 by Actuarial Resources Corporation.

Assets

For the two month period ended May 31, 2009, the Plan's market value of assets experienced a significantly greater return than the 8.02% expected annual return. This generated an actuarial gain of approximately \$30 million for the period.

The assets by type are:

Valuation Date	March 31, 2009	May 31, 2009
Large cap equities	\$ 173,277,202	\$ 198,955,617
Small cap equities	36,968,914	44,171,326
International equities	73,295,887	90,193,304
Domestic fixed income	151,623,683	140,805,087
Cash and equivalents	<u>10,570,979</u>	<u>3,980,716</u>
Total	\$ 445,736,665	\$ 478,106,050

Tuition Inflation

At the time of this writing we have received enough information to indicate that the Weighted Average Tuition for the 2009 valuation will be between 9% and 10%, higher than what was used for the 2008 valuation. We assumed an increase of 9.5% for this year, followed by 7.25% per year thereafter. We also calculated the impact on the unfunded liability assuming future tuition increases are 0% and 3.75% per year starting with FYE 2011.

Plan Continuation - Summary of Funding Options

The following is a summary of the results showing the total costs to the State of Alabama to maintain the program under varying assumptions on tuition inflation and funding schedules. The total costs shown are on an absolute basis. These figures include the change in the investment return assumption as described above. Other than the Pay-as-you-go approach, each funding schedule starts in FYE11. The investment return assumption is capped at 5% for every future year. Cash flow details on these options are shown later in the report.

On the previous page we showed the unfunded liability as of September 30, 2009 based on assumptions used by Actuarial Resources as \$460 million. The somewhat comparable figure below is Option 2 using 7.25% tuition inflation. The difference is due to the change in assumed investment returns, the tuition increase for this year at 9.5% (rather than 7.25%) and a one year lag in making the payment (FYE 2011 versus FYE 2010).

The differences in values in a column is due to the time value of money. Under Option 1, the State would pay nothing until FYE 2015. Therefore, Option 1 is equal to Option 2 plus interest on the unfunded liability from FYE 2011 until the dates of payment.

Funding Schedule	7.25% Tuition Inflation	3.75% Tuition Inflation	0.00% Tuition Inflation
Option 1 - Pay-as-you-go	\$ 1,006,400,000	\$ 660,400,000	\$ 386,800,000
Option 2 - Fully fund in FYE 2011	641,800,000	422,000,000	247,000,000
Option 3 - \$100 million per year	748,200,000	458,900,000	256,600,000
Option 4 - Level funding over 18 years (initial amount per year)	932,800,000 (52,100,000)	608,700,000 (34,200,000)	355,000,000 (19,800,000)

Plan Termination

We examined the financial requirements if the State decides to terminate the plan in two ways. Under the first approach, we assumed the plan will continue for those beneficiaries that have already matriculated, and refunds will be paid for those beneficiaries that have not matriculated. The second approach is a refund for all contract beneficiaries. There was a significant increase in the number of cancellations since February of 2009. Due to the dates of our various pieces of data not lining up on a single date, our estimates of the cost of refunds are shown in ranges.

The refund value of all active contracts that are expected to matriculate in FYE 2011 and later is estimated to be between \$325 million and \$350 million as of September 30, 2009. The present value of future benefits for those that have already reached matriculation on or before FYE 2010, is \$190 million. Therefore the total liability under the first approach is between \$515 million and \$540 million, compared to assets of \$480 million.

If the plan is terminated and all active contracts received a refund based on the current rules, the \$190 million liability for those who have reached matriculation becomes refund payments of about \$50 million to \$60 million. When combined with the refunds for those not yet at matriculation, the total liability is between \$375 million and \$410 million. Under this scenario, the beneficiaries that are currently in school or starting this fall would likely see a substantial reduction in their benefits.

Under both approaches, for beneficiaries that have not yet matriculated, the oldest contracts would see the largest reduction in value due to the time value of money and the difference between tuition inflation and the 1% interest credit for refunds.

OPTION 1 – 7.25% TUITION INFLATION

Projected Cash Flow Assuming No State Appropriations Until 2015

If the State of Alabama decides to permit the trust fund to be depleted before appropriating funds to cover tuition payments, the projected results are as follows:

Table 1 (millions)

<u>FYE</u>	<u>BoY Assets</u>	<u>Benefit Payments</u>	<u>Contract Holder Payments</u>	<u>State Payments</u>	<u>Investment Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	111.9	11.5	0.0	5.00%
2012	328.5	106.2	10.0	0.0	5.00%
2013	245.3	105.5	8.1	0.0	4.50%
2014	155.8	107.2	6.2	0.0	4.50%
2015	58.6	107.5	4.6	44.0	3.00%
2016	0.0	106.5	4.1	103.1	3.00%
2017	0.0	103.5	3.5	100.6	3.00%
2018	0.0	99.5	2.9	97.2	3.00%
2019	0.0	96.9	2.4	95.0	3.00%
2020	0.0	93.4	1.9	91.9	3.00%
2021	0.0	88.4	1.6	87.4	3.00%
2022	0.0	82.7	1.1	82.0	3.00%
2023	0.0	72.7	0.8	72.3	3.00%
2024	0.0	60.9	0.5	60.7	3.00%
2025	0.0	50.2	0.3	50.2	3.00%
2026	0.0	40.1	0.1	40.2	3.00%
2027	0.0	31.8	0.0	32.0	3.00%
2028	0.0	23.4	0.0	23.5	3.00%
2029	0.0	15.0	0.0	15.1	3.00%
2030	0.0	7.9	0.0	8.0	3.00%
2031	0.0	2.7	0.0	2.7	3.00%
2032	0.0	0.4	0.0	0.4	3.00%
Total	0	1624.4	77.5	1006.4	

The sum of values may not match the total shown due to rounding.

OPTION 1 – 3.75% TUITION INFLATION**Projected Cash Flow Assuming No State Appropriations Until 2016**

If the State of Alabama decides to permit the trust fund to be depleted before appropriating funds to cover tuition payments, the projected results are as follows:

Table 2 (millions)

<u>FYE</u>	<u>BoY</u> <u>Assets</u>	<u>Benefit</u> <u>Payments</u>	<u>Contract Holder</u> <u>Payments</u>	<u>State Payments</u>	<u>Investment</u> <u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	108.3	11.5	0.0	5.00%
2012	332.2	99.4	10.0	0.0	5.00%
2013	256.3	95.5	8.1	0.0	4.50%
2014	177.6	93.9	6.2	0.0	4.50%
2015	95.1	91.0	4.6	0.0	3.00%
2016	9.8	87.3	4.1	73.8	3.00%
2017	0.0	82.0	3.5	79.1	3.00%
2018	0.0	76.3	2.9	73.9	3.00%
2019	0.0	71.9	2.4	69.9	3.00%
2020	0.0	67.0	1.9	65.4	3.00%
2021	0.0	61.4	1.6	60.2	3.00%
2022	0.0	55.5	1.1	54.7	3.00%
2023	0.0	47.2	0.8	46.7	3.00%
2024	0.0	38.2	0.5	37.9	3.00%
2025	0.0	30.5	0.3	30.4	3.00%
2026	0.0	23.6	0.1	23.6	3.00%
2027	0.0	18.1	0.0	18.2	3.00%
2028	0.0	12.9	0.0	12.9	3.00%
2029	0.0	8.0	0.0	8.0	3.00%
2030	0.0	4.1	0.0	4.1	3.00%
2031	0.0	1.4	0.0	1.4	3.00%
2032	0.0	0.2	0.0	0.2	3.00%
Total	0	1283.7	77.5	660.4	

The sum of values may not match the total shown due to rounding.

OPTION 1 – 0.00% TUITION INFLATION

Projected Cash Flow Assuming No State Appropriations Until 2017

If the State of Alabama decides to permit the trust fund to be depleted before appropriating funds to cover tuition payments, the projected results are as follows:

Table 3 (millions)

<u>FYE</u>	<u>BoY Assets</u>	<u>Benefit Payments</u>	<u>Contract Holder Payments</u>	<u>State Payments</u>	<u>Investment Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	104.4	11.5	0.0	5.00%
2012	336.3	92.3	10.0	0.0	5.00%
2013	267.9	85.5	8.1	0.0	5.00%
2014	201.0	81.0	6.2	0.0	5.00%
2015	133.6	75.7	4.6	0.0	4.50%
2016	66.3	70.0	4.1	0.0	3.00%
2017	0.9	63.4	3.5	59.4	3.00%
2018	0.0	56.8	2.9	54.3	3.00%
2019	0.0	51.6	2.4	49.5	3.00%
2020	0.0	46.4	1.9	44.7	3.00%
2021	0.0	41.0	1.6	39.6	3.00%
2022	0.0	35.7	1.1	34.8	3.00%
2023	0.0	29.3	0.8	28.6	3.00%
2024	0.0	22.8	0.5	22.4	3.00%
2025	0.0	17.6	0.3	17.4	3.00%
2026	0.0	13.1	0.1	13.0	3.00%
2027	0.0	9.7	0.0	9.7	3.00%
2028	0.0	6.6	0.0	6.7	3.00%
2029	0.0	4.0	0.0	4.0	3.00%
2030	0.0	2.0	0.0	2.0	3.00%
2031	0.0	0.6	0.0	0.6	3.00%
2032	0.0	0.1	0.0	0.1	3.00%
Total		1019.6	77.5	386.8	

The sum of values may not match the total shown due to rounding.

ALABAMA PACT - OPTION 2 - 7.25% TUITION INFLATION**Projected Cash Flow Assuming State Appropriation in 2011**

If the State of Alabama decides to contribute the entire unfunded liability in 2011, the projected results are as follows:

Table 4 (millions)

<u>FYE</u>	<u>BoY</u> <u>Assets</u>	<u>Benefit</u> <u>Payments</u>	<u>Contract Holder</u> <u>Payments</u>	<u>State Payments</u>	<u>Investment</u> <u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	111.9	11.5	641.8	5.00%
2012	986.3	106.2	10.0	0.0	5.00%
2013	936.1	105.5	8.1	0.0	5.00%
2014	882.0	107.2	6.2	0.0	5.00%
2015	821.5	107.5	4.6	0.0	5.00%
2016	756.1	106.5	4.1	0.0	5.00%
2017	687.9	103.5	3.5	0.0	5.00%
2018	618.8	99.5	2.9	0.0	5.00%
2019	549.7	96.9	2.4	0.0	5.00%
2020	479.4	93.4	1.9	0.0	5.00%
2021	408.8	88.4	1.6	0.0	5.00%
2022	339.3	82.7	1.1	0.0	5.00%
2023	271.9	72.7	0.8	0.0	5.00%
2024	211.1	60.9	0.5	0.0	4.50%
2025	158.4	50.2	0.3	0.0	4.50%
2026	114.1	40.1	0.1	0.0	4.50%
2027	78.0	31.8	0.0	0.0	3.00%
2028	47.9	23.4	0.0	0.0	3.00%
2029	25.4	15.0	0.0	0.0	3.00%
2030	10.9	7.9	0.0	0.0	3.00%
2031	3.1	2.7	0.0	0.0	3.00%
2032	0.4	0.4	0.0	0.0	3.00%
Total		1624.4	77.5	641.8	

The sum of values may not match the total shown due to rounding.

ALABAMA PACT - OPTION 2 - 3.75% TUITION INFLATION**Projected Cash Flow Assuming State Appropriation in 2011**

If the State of Alabama decides to contribute the entire unfunded liability in 2011, the projected results are as follows:

Table 5 (millions)

<u>FYE</u>	<u>BoY Assets</u>	<u>Benefit Payments</u>	<u>Contract Holder Payments</u>	<u>State Payments</u>	<u>Investment Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	108.3	11.5	422.0	5.00%
2012	764.8	99.4	10.0	0.0	5.00%
2013	710.5	95.5	8.1	0.0	5.00%
2014	655.4	93.9	6.2	0.0	5.00%
2015	597.4	91.0	4.6	0.0	5.00%
2016	537.9	87.3	4.1	0.0	5.00%
2017	478.6	82.0	3.5	0.0	5.00%
2018	421.2	76.3	2.9	0.0	5.00%
2019	366.3	71.9	2.4	0.0	5.00%
2020	312.7	67.0	1.9	0.0	5.00%
2021	261.0	61.4	1.6	0.0	5.00%
2022	212.1	55.5	1.1	0.0	4.50%
2023	165.6	47.2	0.8	0.0	4.50%
2024	125.1	38.2	0.5	0.0	4.50%
2025	91.9	30.5	0.3	0.0	4.50%
2026	64.8	23.6	0.1	0.0	3.00%
2027	42.8	18.1	0.0	0.0	3.00%
2028	25.7	12.9	0.0	0.0	3.00%
2029	13.3	8.0	0.0	0.0	3.00%
2030	5.5	4.1	0.0	0.0	3.00%
2031	1.5	1.4	0.0	0.0	3.00%
2032	0.2	0.2	0.0	0.0	3.00%
Total		1283.7	77.5	422.0	

The sum of values may not match the total shown due to rounding.

ALABAMA PACT - OPTION 2 – 0.00% TUITION INFLATION**Projected Cash Flow Assuming State Appropriation in 2011**

If the State of Alabama decides to contribute the entire unfunded liability in 2011, the projected results are as follows:

Table 6 (millions)

<u>FYE</u>	<u>BoY</u> <u>Assets</u>	<u>Benefit</u> <u>Payments</u>	<u>Contract Holder</u> <u>Payments</u>	<u>State Payments</u>	<u>Investment</u> <u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	104.4	11.5	247.0	5.00%
2012	589.4	92.3	10.0	0.0	5.00%
2013	533.7	85.5	8.1	0.0	5.00%
2014	480.1	81.0	6.2	0.0	5.00%
2015	426.7	75.7	4.6	0.0	5.00%
2016	374.4	70.0	4.1	0.0	5.00%
2017	324.9	63.4	3.5	0.0	5.00%
2018	279.1	56.8	2.9	0.0	4.50%
2019	235.9	51.6	2.4	0.0	4.50%
2020	195.8	46.4	1.9	0.0	4.50%
2021	158.8	41.0	1.6	0.0	4.50%
2022	125.3	35.7	1.1	0.0	4.50%
2023	95.3	29.3	0.8	0.0	4.50%
2024	70.2	22.8	0.5	0.0	4.50%
2025	50.4	17.6	0.3	0.0	3.00%
2026	34.3	13.1	0.1	0.0	3.00%
2027	22.1	9.7	0.0	0.0	3.00%
2028	12.9	6.6	0.0	0.0	3.00%
2029	6.5	4.0	0.0	0.0	3.00%
2030	2.6	2.0	0.0	0.0	3.00%
2031	0.7	0.6	0.0	0.0	3.00%
2032	0.1	0.1	0.0	0.0	3.00%
Total		1019.6	77.5	247.0	

The sum of values may not match the total shown due to rounding.

OPTION 3 – 7.25% TUITION INFLATION**Projected Cash Flow Assuming \$100 million Annual State Appropriations starting in 2011**

If the State of Alabama decides to contribute \$100 million each year into the trust fund until the entire unfunded liability is covered starting in 2011, the projected results are shown in Table 7 below. The difference between this approach and Option 1 is interest on the unfunded liability.

Table 7 (millions)

<u>FYE</u>	<u>BoY</u>	<u>Benefit</u>	<u>Contract Holder</u>		<u>Investment</u>
	<u>Assets</u>	<u>Payments</u>	<u>Payments</u>	<u>State Payments</u>	<u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	111.9	11.5	100.0	5.00%
2012	431.0	106.2	10.0	100.0	5.00%
2013	455.4	105.5	8.1	100.0	5.00%
2014	479.8	107.2	6.2	100.0	5.00%
2015	501.7	107.5	4.6	100.0	5.00%
2016	522.9	106.5	4.1	100.0	5.00%
2017	545.5	103.5	3.5	100.0	5.00%
2018	571.7	99.5	2.9	48.2	5.00%
2019	549.7	96.9	2.4	0.0	5.00%
2020	479.4	93.4	1.9	0.0	5.00%
2021	408.8	88.4	1.6	0.0	5.00%
2022	339.3	82.7	1.1	0.0	5.00%
2023	271.9	72.7	0.8	0.0	5.00%
2024	211.1	60.9	0.5	0.0	4.50%
2025	158.4	50.2	0.3	0.0	4.50%
2026	114.1	40.1	0.1	0.0	4.50%
2027	78.0	31.8	0.0	0.0	3.00%
2028	47.9	23.4	0.0	0.0	3.00%
2029	25.4	15.0	0.0	0.0	3.00%
2030	10.9	7.9	0.0	0.0	3.00%
2031	3.1	2.7	0.0	0.0	3.00%
2032	0.4	0.4	0.0	0.0	3.00%
Total		1624.4	77.5	748.2	

The sum of values may not match the total shown due to rounding.

OPTION 3 – 3.75% TUITION INFLATION**Projected Cash Flow Assuming \$100 million Annual State Appropriations starting in 2011**

If the State of Alabama decides to contribute \$100 million each year into the trust fund until the entire unfunded liability is covered starting in 2011, the projected results are shown in Table 8 below. The difference between this approach and Option 1 is interest on the unfunded liability.

Table 8 (millions)

<u>FYE</u>	<u>BoY</u> <u>Assets</u>	<u>Benefit</u> <u>Payments</u>	<u>Contract Holder</u> <u>Payments</u>	<u>State Payments</u>	<u>Investment</u> <u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	108.3	11.5	100.0	5.00%
2012	434.7	99.4	10.0	100.0	5.00%
2013	466.5	95.5	8.1	100.0	5.00%
2014	501.7	93.9	6.2	100.0	5.00%
2015	538.5	91.0	4.6	58.9	5.00%
2016	536.4	87.3	4.1	0.0	5.00%
2017	477.0	82.0	3.5	0.0	5.00%
2018	419.5	76.3	2.9	0.0	5.00%
2019	364.5	71.9	2.4	0.0	5.00%
2020	310.9	67.0	1.9	0.0	5.00%
2021	259.1	61.4	1.6	0.0	5.00%
2022	210.1	55.5	1.1	0.0	5.00%
2023	164.3	47.2	0.8	0.0	5.00%
2024	124.5	38.2	0.5	0.0	4.50%
2025	91.2	30.5	0.3	0.0	4.50%
2026	64.1	23.6	0.1	0.0	4.50%
2027	42.8	18.1	0.0	0.0	3.00%
2028	25.7	12.9	0.0	0.0	3.00%
2029	13.3	8.0	0.0	0.0	3.00%
2030	5.5	4.1	0.0	0.0	3.00%
2031	1.5	1.4	0.0	0.0	3.00%
2032	0.2	0.2	0.0	0.0	3.00%
Total		1283.7	77.5	458.9	

The sum of values may not match the total shown due to rounding.

OPTION 3 – 0.00% TUITION INFLATION**Projected Cash Flow Assuming \$100 million Annual State Appropriations starting in 2011**

If the State of Alabama decides to contribute \$100 million each year into the trust fund until the entire unfunded liability is covered starting in 2011, the projected results are shown in Table 9 below. The difference between this approach and Option 1 is interest on the unfunded liability.

Table 9 (millions)

<u>FYE</u>	BoY	Benefit	Contract Holder		Investment
	<u>Assets</u>	<u>Payments</u>	<u>Payments</u>	<u>State Payments</u>	<u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	104.4	11.5	100.0	5.00%
2012	438.8	92.3	10.0	100.0	5.00%
2013	478.0	85.5	8.1	56.6	5.00%
2014	479.7	81.0	6.2	0.0	5.00%
2015	426.2	75.7	4.6	0.0	5.00%
2016	373.9	70.0	4.1	0.0	5.00%
2017	324.4	63.4	3.5	0.0	5.00%
2018	278.5	56.8	2.9	0.0	5.00%
2019	236.6	51.6	2.4	0.0	4.50%
2020	196.5	46.4	1.9	0.0	4.50%
2021	159.5	41.0	1.6	0.0	4.50%
2022	126.0	35.7	1.1	0.0	4.50%
2023	96.1	29.3	0.8	0.0	4.50%
2024	71.0	22.8	0.5	0.0	3.00%
2025	50.4	17.6	0.3	0.0	3.00%
2026	34.3	13.1	0.1	0.0	3.00%
2027	22.1	9.7	0.0	0.0	3.00%
2028	12.9	6.6	0.0	0.0	3.00%
2029	6.5	4.0	0.0	0.0	3.00%
2030	2.6	2.0	0.0	0.0	3.00%
2031	0.7	0.6	0.0	0.0	3.00%
2032	0.1	0.1	0.0	0.0	3.00%
Total		1019.6	77.5	256.6	

The sum of values may not match the total shown due to rounding.

OPTION 4 – 7.25% TUITION INFLATION**Projected Cash Flow Assuming Level State Appropriations starting in 2011 for 18 years**

If the State of Alabama decides to contribute a level amount each year for 18 years, into the trust fund until the entire unfunded liability is covered starting in 2011, the projected results are shown in Table 10 below. Due to the varying benefit payments, it is not possible to have an equal amount every single year. The best fit is presented. The difference between this approach and Option 1 is interest on the unfunded liability.

Table 10 (millions)

<u>FYE</u>	<u>BoY</u> <u>Assets</u>	<u>Benefit</u> <u>Payments</u>	<u>Contract Holder</u> <u>Payments</u>	<u>State Payments</u>	<u>Investment</u> <u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	111.9	11.5	52.1	5.00%
2012	381.9	106.2	10.0	52.1	5.00%
2013	354.8	105.5	8.1	52.1	5.00%
2014	325.1	107.2	6.2	52.1	5.00%
2015	290.2	107.5	4.6	52.1	5.00%
2016	251.7	106.5	4.1	52.1	5.00%
2017	211.6	103.5	3.5	52.1	5.00%
2018	172.1	99.5	2.9	52.1	4.50%
2019	133.5	96.9	2.4	52.1	4.50%
2020	95.3	93.4	1.9	52.1	4.50%
2021	58.6	88.4	1.6	62.1	3.00%
2022	34.7	82.7	1.1	62.1	3.00%
2023	15.5	72.7	0.8	62.1	3.00%
2024	5.7	60.9	0.5	62.1	3.00%
2025	7.3	50.2	0.3	42.8	3.00%
2026	0.0	40.1	0.1	42.8	3.00%
2027	2.6	31.8	0.0	38.8	3.00%
2028	9.6	23.4	0.0	38.8	3.00%
2029	25.4	15.0	0.0	0.0	3.00%
2030	10.9	7.9	0.0	0.0	3.00%
2031	3.1	2.7	0.0	0.0	3.00%
2032	0.4	0.4	0.0	0.0	3.00%
Total		1624.4	77.5	932.8	

The sum of values may not match the total shown due to rounding.

OPTION 3 – 3.75% TUITION INFLATION**Projected Cash Flow Assuming Level State Appropriations starting in 2011 for 18 Years**

If the State of Alabama decides to contribute a level amount each year for 18 years, into the trust fund until the entire unfunded liability is covered starting in 2011, the projected results are shown in Table 11 below. Due to the varying benefit payments, it is not possible to have an equal amount every single year. The best fit is presented. The difference between this approach and Option 1 is interest on the unfunded liability.

Table 11 (millions)

<u>FYE</u>	<u>BoY</u> <u>Assets</u>	<u>Benefit</u> <u>Payments</u>	<u>Contract Holder</u> <u>Payments</u>	<u>State Payments</u>	<u>Investment</u> <u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	108.3	11.5	34.2	5.00%
2012	367.3	99.4	10.0	34.2	5.00%
2013	328.1	95.5	8.1	34.2	5.00%
2014	289.0	93.9	6.2	34.2	5.00%
2015	247.7	91.0	4.6	34.2	5.00%
2016	205.6	87.3	4.1	34.2	5.00%
2017	164.8	82.0	3.5	34.2	4.50%
2018	126.1	76.3	2.9	34.2	4.50%
2019	91.0	71.9	2.4	34.2	4.50%
2020	58.3	67.0	1.9	34.2	3.00%
2021	28.4	61.4	1.6	44.1	3.00%
2022	12.9	55.5	1.1	44.1	3.00%
2023	2.5	47.2	0.8	44.1	3.00%
2024	0.0	38.2	0.5	44.1	3.00%
2025	6.3	30.5	0.3	44.1	3.00%
2026	20.4	23.6	0.1	15.5	3.00%
2027	12.8	18.1	0.0	15.5	3.00%
2028	10.4	12.9	0.0	15.5	3.00%
2029	13.3	8.0	0.0	0.0	3.00%
2030	5.5	4.1	0.0	0.0	3.00%
2031	1.5	1.4	0.0	0.0	3.00%
2032	0.2	0.2	0.0	0.0	3.00%
Total		1283.7	77.5	608.7	

The sum of values may not match the total shown due to rounding.

OPTION 3 – 0.00% TUITION INFLATION**Projected Cash Flow Assuming Level State Appropriations starting in 2011 for 18 Years**

If the State of Alabama decides to contribute a level amount each year for 18 years, into the trust fund until the entire unfunded liability is covered starting in 2011, the projected results are shown in Table 12 below. Due to the varying benefit payments, it is not possible to have an equal amount every single year. The best fit is presented. The difference between this approach and Option 1 is interest on the unfunded liability.

Table 12 (millions)

<u>FYE</u>	<u>BoY</u>	<u>Benefit</u>	<u>Contract Holder</u>		<u>Investment</u>
	<u>Assets</u>	<u>Payments</u>	<u>Payments</u>	<u>State Payments</u>	<u>Return</u>
2010	\$ 483.2	\$ 110.0	\$ 17.9	\$ 0.0	5.00%
2011	411.9	104.4	11.5	19.8	5.00%
2012	356.5	92.3	10.0	19.8	5.00%
2013	309.4	85.5	8.1	19.8	5.00%
2014	264.9	81.0	6.2	19.8	5.00%
2015	220.9	75.7	4.6	19.8	4.50%
2016	177.6	70.0	4.1	19.8	4.50%
2017	137.8	63.4	3.5	19.8	4.50%
2018	102.4	56.8	2.9	19.8	4.50%
2019	71.5	51.6	2.4	19.8	3.00%
2020	43.5	46.4	1.9	25.6	3.00%
2021	25.4	41.0	1.6	25.6	3.00%
2022	11.9	35.7	1.1	25.6	3.00%
2023	3.0	29.3	0.8	25.6	3.00%
2024	0.0	22.8	0.5	25.6	3.00%
2025	3.2	17.6	0.3	25.6	3.00%
2026	11.7	13.1	0.1	7.9	3.00%
2027	6.8	9.7	0.0	7.9	3.00%
2028	5.1	6.6	0.0	7.9	3.00%
2029	6.5	4.0	0.0	0.0	3.00%
2030	2.6	2.0	0.0	0.0	3.00%
2031	0.7	0.6	0.0	0.0	3.00%
2032	0.1	0.1	0.0	0.0	3.00%
Total		1019.6	77.5	355.0	

The sum of values may not match the total shown due to rounding.

ALABAMA PACT**Actuarial Assumptions and Methods*****Economic Assumptions***

Interest rate:	2008 Actuarial Valuation: 8.02% per year March 31, 2009 Actuarial Valuation: 8.02% per year May 31, 2009 Actuarial Valuation: 5.00% for near term, decreasing to an ultimate rate of 3% per year.
Investment & administrative expenses:	None (rate of investment return assumed to be “net of expenses”).
Tuition Inflation:	2008 Actuarial Valuation: 7.25% per year May 31, 2009 Actuarial Valuation: 9.5% for 2009-10, 7.25% thereafter. Additional forecasts were executed using 3.75% and 0% for years starting in FYE 2011.
Bias:	14% for both Four-year universities and Two-year colleges

Non-economic Assumptions

Mortality and Disability:	None
Cancellation rates:	1% per year prior to matriculation
Utilization:	Beneficiaries are assumed to enroll in college at the date indicated as their anticipated college entrance date. For 4-year contracts, we assume that the average beneficiary will use 128 credit hours and 8 semester fee payments. Within an academic year, contract usage is assumed to be 45% for the fall semester, paid November 1, 45% for the spring semester, paid March 1 and 10% for the summer semester, paid August 1.
State Appropriations:	All state appropriations are assumed to be deposited in the trust on average as of March 1.

Legal Considerations

Under current law, the PACT Program is part of the Wallace-Folsom College savings Investment Plan, an agency and instrumentality of the state of Alabama, administered by the State Treasurer. The PACT Program is overseen by a board, an agent of the state, which has broad authority to enter contracts and invest the PACT Trust Fund.

Current Lawsuits

There are three lawsuits pending in the Circuit Court of Montgomery County and one lawsuit pending in federal court that have been brought by PACT contract holders due to the publicized financial crisis in the PACT Program. At this point, however, the plaintiffs are unable to show that they have been damaged because PACT has made all required tuition payments. Motions to dismiss these lawsuits are pending, and based on several legal theories, there are valid grounds to support dismissal. It is impossible, however, to predict with certainty how and when any court will rule. It is possible that the courts will wait to make any dispositive rulings in the cases until the Legislature has had an opportunity to address the fiscal crisis.

Potential Future Litigation

The termination of the PACT Program or any unilateral change of the terms, rights, or obligations under any of the PACT contracts will result in litigation.

All PACT participants entered contracts with the Board, whereby the Board accepted prepayment for college tuition at state schools and agreed to provide, in the future, tuition payments to the state schools. Some distinction has been made regarding the pre-1995 PACT contracts because they contain the word "guarantee." Based on basic contract law, there is no difference of obligation regarding an agreement to provide a good or service at a stated cost or guaranteeing to provide a good or service at a cost. There is no reason to legally treat the obligation under the pre-1995 contracts differently than those entered in 1995 and thereafter.

The PACT law provides that PACT contracts are not debts or obligations of the state. The law establishing PACT also specifically provides that the Board members and investment managers, when acting prudently, are not personally liable for investment losses. The most important defense that the state, PACT Program, Board members, and administrators have is immunity. Immunity should be an absolute bar to any lawsuits against the state and the PACT Board; however, in a situation where courts perceive that individuals have been treated unfairly, the courts may go to great lengths to craft exceptions to the immunity defense.

Even if the state were ultimately successful in litigation regarding terminating the PACT Program or altering the PACT contracts, it would most likely be after numerous long and expensive court battles.

Survey of Other States

Colorado	No	Closed to new investors in 2002. In 2003, participants had the option to withdraw funds, transfer to other savings plans, or leave funds in the plan with the understanding that there would be additional modifications.
Florida	Yes	If the program is terminated, all participants within 5 years of enrollment guaranteed full promised benefits and others will receive a refund plus interest.
Illinois	No	Governor may request from the Legislature funds needed to cover any shortfall. If financially infeasible, program to discontinue prospectively.
Kentucky	Partial	Closed to new investors in 2003. No state guarantee; however, the plan has a reserve funded with 75% of the state's unclaimed property.
Maryland	No	Governor includes amount in budget, but if Legislature does not fund, the Board adjusts terms of all contracts. Must be paid back in two years. Currently, discussing the need to raise the price of a locked-in tuition.
Massachusetts	Yes	Backed by bonds secured by full faith and credit.
Michigan	No	If insufficient funds, contracts can be terminated and assets prorated.
Mississippi	Yes	Backed by full faith and credit of the state.
Nevada	No	Specifically states that this is not an obligation of the state, morally or otherwise.
South Carolina	No	Closed to new investors in 2006. A return of contributions, plus interests of 4% is guaranteed.
Tennessee	No	If insufficient funds, contracts terminated and assets prorated.
Texas <i>(2 plans)</i>	No	Original plan closed in 2003 and was not guaranteed. New plan between the participant and the universities opened in 2008.
Virginia	No	An appropriation in the state budget could be used as an interest-free loan to the plan, if it were necessary. Currently considering raising the price of a locked-in tuition to guarantee the fund's long-term viability.
Washington	Yes	Guaranteed by the full faith and credit of the state.
West Virginia	Partial	Closed to new investors in 2003, but Legislature created an escrow to guarantee payment. Lawmakers currently considering pumping \$8 million into the program.

Notes in red indicate what other states have done or are considering to address financial concerns.

States with Prepaid Plans



- All states provide a Prepaid Plan or a Savings Plan, or both.
- 16 states have a Prepaid Plan, all of which vary in design. (Some state's Savings Plan includes elements of a prepaid tuition plan.)
 - Initially faced with deficits, many Prepaid Plans reacted either by closing to new investors while the fund was still viable or by increasing the premiums.
 - Since 2003, six (6) states have closed their Prepaid Plans to new investors (one opened a new plan).