Memorandum

To: Mike Barnhill, Deputy Commissioner, DOA
From: Larry Semmens, Soldotna City Manager
Date: February 11, 2011
Subject: Termination Study Impacts

You asked that I summarize my concerns regarding termination studies. My concerns are in the areas of equity, materiality, accuracy, and enforcement.

There is a much higher likelihood of the provisions of 39.35.625 applying to a small municipality than a large employer. Adjusting staffing levels for budgetary purposes can easily result in the termination of a group, department or other classification (group) in a small municipality. A large employer could eliminate many positions, thus having a material dollar impact on PERS contributions but not trigger the provisions of either .625 or .255 (2008 floor). Since small municipalities are often challenged fiscally, these provisions make it very difficult to effectively manage staffing levels. Staff costs are usually 75% or more of total budget making staffing the only area to effectively deal with revenue shortfall. Small municipalities are affected materially but the impact on the system is immaterial. Large employers that stay above the 2008 floor can make many position cuts without incu rring the cost of either termination studies or past service cost on the salary of a group that has no continuing salary. Thus the termination provisions have minimal impact on the large employers. Shouldn't all employers be treated equally by application of the 2008 salary floor in section .255 rather than subjecting small employers to termination costs in section .625?

Regarding past service liability, when total payroll of an employer is up from 2008, one could argue that the PERS has not been negatively impacted by that employer eliminating a group. However DRB doesn't consider this. If the employers total payroll exceeds the 2008 floor they should be considered to have met the responsibility to pay the past service liability. I think the 2008 floor is the fairest way to deal with past service liability.

If .625 is brought into play there are many variables which have to be given consideration:

1. When a position is eliminated it doesn't always mean the person in the position was terminated from employment, furthermore, they could get a PERS position in the future which would negate the termination cost that was previously assessed. If a group of several employees is involved it would seem that those still employed would be exempt from the termination study and from past service cost payments. I think you refer to this as double counting. It will be very complicated to keep up with.
2. Paying the past service rate on the salary of a terminated group for the next 30 years could easily exceed any possible actual past service liability generated by the group. **If all of the group were Tier IV there would be almost no past service liability generated, but the employer is obligated to pay the**

past service liability generated, but the employer is obligated to pay the past service rate on the salary of the terminated group until the unfunded liability is paid off. This is not reasonable. Consider that if the employees affected were short term DB employees the past service liability would also be low. If Buck is calculating normal cost correctly any employee hired since Buck was employed should have little or no past service liability.

3. The methodology of Buck's calculation does not consider all relevant facts. The Ketchikan example is a good one. The subject was Tier I, 59 years old with 34 years in the system. My thought is the person is generating an actuarial surplus since he didn't retire at 30 years of service. Buck doesn't consider this in their calculation. Instead they ignore these facts and calculate the present value of the benefits which will be paid out 'early' based on the assumption that the subject is going to work well beyond age 55. Buck knows that only a fraction will continue to work beyond retirement age, but I don't think they apply any probability factor to their calculation of the termination cost. Instead they simply calculate the present value cost of the person retiring compared to what it would have cost at some point in the future. It would be interesting to query the data to find out how many Tier I's with 34 years keep on working to whatever age Buck assumed this person was going to be if he didn't retire when he did. Consider that every time someone retires at age 55, or at any age younger than Buck's assumed age, there is a hit to the system that Buck apparently has not considered. The conclusion to be drawn is that the total liability they are reporting is grossly understated. They calculated that the system took a hit of $123,000 when the Ketchikan person retired. This is not reasonable for this set of facts and should be carefully considered in light of the liability estimates they have made.

Another big issue is that DRB believes the State is exempt from compliance with section .625 because the State doesn't have a participation agreement with PERS. This is a thin argument which is clearly not equitable to the other members of the plan. This means that the entity that has over half of the total payroll of the system and therefore over half of the past service liability that drives the past service cost rate, can eliminate departments, groups or other classifications without paying the costs. The impact of this is born by the other members of PERS. The thought that the State's actions only impact the State is not correct. When the State does not properly contribute to PERS according to the same rule every other employer has to follow, the system doesn't get the funds the actuary is anticipating and the result is higher rates for longer periods. All employers are going to participate in rectifying this. Note that the past service rate is going above 22% in FY 2012. I wonder how much of this is caused by the State not contributing according to the actuarial assumptions.

As I mentioned, I think the State is underfunding PERS with contract employees that do not meet the IRS test of independent contractors and by employing retired PERS members in long term temporary positions that would normally be filled with a PERS employee. The State does this because they have to in order to hire competent staff. Why shouldn't municipalities be allowed the same ability to manage?

I continue to argue against requiring a termination study, but if one is required all relevant facts need to be considered. Currently the methodology of the calculation is designed to deliver the highest possible termination cost.

I hope that you and your staff will recognize:

1. that .625 termination studies are making it difficult to manage staffing levels,
2. that application of the requirement discriminates against small municipalities even though their impact is immaterial, and
3. that enforcement is going to be costly and nearly impossible to do equitably.

With two auditors that have apparently only accomplished 12 field audits since 2003, it seems unlikely that the State is properly staffed to deal with the workload that this law imposes. Employers do not understand the requirements, do not consider the requirements or alternatives available to them when dealing with staffing changes, and consequently will often be out of compliance with the law.

In conclusion I reiterate that a simple requirement such as maintaining and enforcing the 2008 floor as the base salary amount on which PERS payments must be calculated will be equitable and easy to administer and enforce. Such a requirement will have minimal impact on the PERS compared to the cost of properly enforcing the current law.

Senator Paskvan's bill accomplishes this so I am in support of the bill.

If you have any questions of me I am available at your convenience.