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April 8, 2025

RE: Senate Bill 55

Thank you for this opportunity to provide testimony in relation to SB 55, which would force PERS and TRS employers (and employees) not currently participating in Social Security or the State's Supplemental Benefits System to do so.

We could approach this simply from the perspective of the cost involved. For PERS employers, this bill would result in between \$19 million and \$42 million in additional costs. The \$19 million figure is if employers simply paid their 6.12%, increasing the employee's benefits by that amount. In this scenario, employees would also be required to contribute \$19 million from their salaries, or reduce their current take home pay by 6.12%, even as their benefits increased correspondingly.

The \$42 million is a hold harmless approach, which means that the employer would increase the employee's salary sufficiently to have no net loss to take home pay, even as the overall benefit grew and was actually increased overall as a result, relative to the first scenario.

The employers we're talking about in these scenarios include 21 municipal employers, the University of Alaska, and some school districts. The University of Alaska makes up a large portion of that total impact, or would be required to contribute between \$6 and \$10 million more as a result of SB 55. For municipalities, this would be addressed through local taxation. Communities like Kenai, Soldotna, Petersburg, and so on would see a potential increase of their mil rate or other taxes to cover this unfunded State mandate. For school districts, this would be a reduction of the BSA as it applies to educational attainment, as those dollars move to administrative costs instead.

Note that school districts are both PERS and TRS employers. As PERS employers, some already participate in SBS or Social Security. They do not as TRS employers, and as such this bill would require them to contribute an additional \$55 million, if you increase salaries to hold employees harmless. This is all calculated using FY24 payroll, for reference. And again, this would come at the expense of the BSA. The proposal to offset this by the State taking on these costs in the short term is helpful, and a similar structure be applied to all employers to mitigate some of the shock experienced by employers and employees. Of course, the end result is the same.

It's worth noting that these increases could come at the expense of other types of benefits or components of a compensation package that these employers have put in place. Employers may have to reduce the increment by which salaries grow, reconsider premium coverage for health insurance for employees and families thereof, or make choices about increasing overall staff size, thus limiting the capacity they have for delivering community services.

We could approach it just from that perspective.

But we think it's also worth putting this bill in the broader context of the State's struggle to develop, administer, and maintain an effective pension system that adequately delivers even benefits to public employees. In this, to some extent we agree with the bill sponsor – the value of just PERS and TRS, without Social Security or the SBS, has diminished the overall retirement benefit that accrues to employees of approximately a quarter of all employers.

It is worth taking a moment to reflect on the history of PERS, which we know this Committee is familiar with but is worth having on the record and for awareness of the public. PERS and TRS were established as an alternative to Social Security. In their original iterations – as a defined benefit – they provided not just the equivalent of a pension but also that of Social Security.

Many of the employers that SB 55 targets joined PERS with this in mind. PERS and TRS presented a meaningful option for them to attract employees. The numbers speak for themselves, including those provided in today's presentation by the sponsor. If we assume that the sponsor is trying to get everyone to an equivalent of about 25.24% of payroll dedicated to retirement savings, then we have an easy way to measure where this is happening and where it is not.

However, SB 55 is directed at, maybe, the wrong target. It is not by employer that we should be looking at, but Tier of current PERS and TRS plans.

For instance, normal costs presented by DRB this last week noted the following: PERS Tier 1 at 28.12, and for public safety at 34.31. The PERS Tier 2 and 3 normal costs today are at 16.57 and 14.61 respectively, which if you add Social Security and SBS on top would represent an oversavings, to some degree. In fact, when you add SBS on top of a Tier 1 normal cost, you have a retirement benefit of more than 40%. For public safety employees who receive both a Tier 1 (there are 9 of them) and SBS, their total retirement benefit is more than 46%.

Employers joined PERS at a Tier 1 rate that effectively meets the criteria set out by the bill sponsor. But then because of the net pension liability they faced barriers to adjusting when that benefit was diminished. It could be argued that when Tier 2 and 3 were implemented, and especially when the State moved to a Tier 4, the State should have communicated to these employers that the safety net they had relied on was no longer in place. I imagine that there should have been a provision in their participation agreements that would have provided them a way to consider alternatives to what no longer achieved the goals of the program.

Instead, they were locked into a net pension liability that is expected today to last until FY 53. As we know, they've been paying 22%, while the normal cost for a Tier 4 employee is 8.98%. That difference is what weakens the ability for employers to do more to address the current needs of employees, in many cases. Now, it's worth pointing out that this 8.98% is different than what we saw presented today as the employer plus employee contribution. That's because there's a difference between what goes in and what goes out. In this case, the value of the Tier 4 normal cost plus the SBS is actually only 21%.

So, while this bill is focused on bringing employers under SBS, some would argue that it should instead evaluate the different levels of benefits across tiers. And some would debate the fairness of a total retirement benefit to Tier 1 employees of 40% and for a Tier 4 employee about half that. Ultimately, I would imagine a system of benefits to public employees that

structures alternatives to Social Security relative to the total benefit accrued, and not by employer type. This is the question, right? How do we structure a system of competitive compensation across employee and employer types that is even and fair?

We don't have good reasons for why TRS isn't similarly structured, except to note that if it had been, the State's responsibility for funding it would have been challenging, to say the least, since TRS is funded mainly through the BSA and general fund. Today the normal cost for TRS Tier 1 14.21 and for Tier 2 14.77, while for Tier 3 it is 10.74. Those all fall below the benefit experienced by PERS employees in Tiers 1 and 2, and 3 to some extent. SBS or Social Security would make a significant difference in these regards, as would the increase of a TRS contribution by 2%. For these, there's still a fairness question but mostly it will be a matter of where do districts and the State come up with sufficient resources to make up the difference.

I want to come back to PERS and TRS being an alternative to Social Security, if I might. In 1991, Social Security coverage became mandatory for most state and local government employees who were not covered under public retirement systems. The IRS lays out clear guidelines in this regard - A governmental retirement plan must meet certain minimum benefit or contribution standards to qualify as a public retirement system, and thereby serve as a "replacement" plan exempting the participants from mandatory Social Security coverage. These standards are based solely on meeting a minimum benefit level provided (defined benefit plan), or a minimum amount contributed (defined contribution plan) to the participant.

There are three types of defined contribution public employee plans to additionally consider as a replacement to Social Security or SBS, which SB 55 might take into account.

- Section 401(a) - Qualified Plan
- Section 403(b) – Annuity for public schools and 501(c)(3) organizations
- Section 457(b) – Nonqualified, eligible deferred compensation plans for state and local governments and tax-exempt organizations

Each of these, if an employer were to have one, is considered an eligible plan as a replacement for Social Security. Title 26, Chapter 1, Subchapter C Part 31 of the Code of Federal Regulations says, “A defined contribution retirement system maintained by a State, political subdivision or instrumentality thereof meets the requirements of [paragraph \(e\)\(2\)\(i\)](#) of this section with respect to an employee if and only if allocations to the employee's account (not including earnings) for a period are at least 7.5 percent of the employee's compensation for service for the State, political subdivision or instrumentality during the period. Matching contributions by the employer may be taken into account for this purpose.”

For the Social Security Administration's purposes, public employers are allowed to have a Section 218 agreement, which allows them to select an alternative to Social Security. The State of Alaska has one, which is irrevocable. PERS, again, was the State's first replacement for Social Security. When it created SBS it moved its employees under the new system.

Public employees are brought under a Section 218 Agreement in groups known as coverage groups. There are two basic coverage groups: absolute coverage groups and retirement system coverage groups. An absolute coverage group is composed of employees whose positions are

not covered under a public retirement system. A retirement system coverage group is composed of employees whose positions are covered under a public retirement system.

A public retirement system may be covered under a Section 218 Agreement only after a referendum is held. All States are authorized to use the majority vote referendum process. If a majority of all the eligible members vote in favor of coverage, all current and future employees in positions under the retirement system will be covered.

Today, state and local government employers are classified as either voluntary (Section 218) employers or mandatory employers. Voluntary employers have voluntarily enrolled all eligible employees in Social Security. Mandatory employers must enroll their employees in Social Security unless they are already enrolled in a qualifying public retirement system.

Under Section 218 Agreements, Social Security coverage is extended to groups of employee positions known as coverage groups. Coverage is not extended on an individual basis. Various laws and regulations govern how coverage may be extended to state and local government positions through referendums held by the state among eligible employees covered by a retirement system. All states are authorized to use a majority vote referendum process. Twenty three states are also authorized to use a divided vote referendum process (discussed below). Typically, states allow their political subdivisions (such as a school board) to decide whether to hold a referendum on coverage.

Why is this important?

First, we have a standard to look to of 7.5% replacement cost for a defined contribution to be the equivalent of Social Security. It can be made up of employee and employer cost.

Second, we know that there are multiple paths to getting there, beyond SBS, which the Social Security Administration and IRS allows for.

Third, we know that employers have a choice in the type of system they think best fits them. If not for the PERS net pension liability, they might even have more choice.

Fourth, additionally, employees have a choice. Different employee groups could have different outcomes based on their needs.

There is a process established here that is important to follow, and SB 55 could take into account these steps as part of its own.

In conclusion, the bill sponsor is correct in identifying the need – the current iteration of PERS and TRS meet the requirement of an alternative to Social Security, but do not do that and act as a meaningful pension at all. We can no longer view them as both. That said, there is no requirement that employers participate in a pension, either, and the majority of public employers in the state do not. All employers currently in PERS and TRS satisfy the requirements of participating in a Social Security alternative.

The target on non-participating employers ignores the differences between tiers of PERS and TRS, and if the goal is an equalized benefit structure overall, there is a different approach to be considered that could or should offer an increased benefit structure to those who currently are underbenefited. This more targeted approach should respond to choices made by the employer,

as well as by employees. Employers may already offer an additional alternative to a pension, such as those allowed by the IRS. And employees will need to evaluate their own loss of purchasing power in the short term.

Ultimately, this is a compensation package selection that is up to employers, who faced with SB 55's increased contribution requirements of between \$19 and \$42 million would likely have to find trade offs in what else they currently offer. This is the exact conversation that Congress had in 2021, when evaluating whether to force all state and local governments into Social Security, irrespective of their own alternatives, such as SBS.

We want to thank this Committee, and the bill sponsor, for providing us the opportunity to contribute these perspectives, and encourage your consideration of not just the costs involved, but the process necessary to address the imbalances identified herein.