SENATOR KIM ELTON

SB 23 – Restoring Pension Benefits for Public Employees

Sponsor Statement

SB 23 returns guaranteed pension and health care benefits to Alaska public employees. It will make it easier to recruit and retain teachers, police officers, firefighters, and other public employees.

Analyses by actuaries and the state Division of Retirement and Benefits show that Alaska's defined benefit pension – paying a guaranteed monthly benefit plus health care – costs the same as the new defined contribution system but provides much better benefits. In a worst-case scenario, monthly costs might increase by $5 per public employee. With SB 23, Alaskans get more benefit for the same cost, strengthening the $1.5 billion retirees contribute to Alaska's economy.

SB 23 repeals the laws putting public employees into risky individual savings account plans, and enrolls them in the least expensive pension plans, the current public employee tier III and teacher tier II. The state already administers these tiers for thousands of members, so no new bureaucracy is required.

A few years ago, Alaska beefed up oversight of the pension system: now two actuaries analyze the health of the pension funds, there are more frequent experience studies and the state stopped the practice of sometimes paying less than the cost of benefits. SB 23 keeps these smart reforms, making Alaska pensions stronger than ever.

Without the defined benefit of Social Security, teachers and public employees face excessive risk in individual accounts. On average these accounts earn much less than professionally managed pension funds. The state is now paying some employees to attend investing seminars during work hours – instead of doing their jobs.

The K-12 teachers and university professors who educate our children, the police and firefighters who protect our families, and the public employees who serve our state and cities deserve a secure retirement in return for their service.

I respectfully ask for your support.

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SENATE BILL NO. 23

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-SIXTH LEGISLATURE - FIRST SESSION

BY SENATORS ELTON, Ellis, French, Wielechowski, Menard

Introduced: 1/21/09
Referred: Labor and Commerce, State Affairs, Finance

A BILL

FOR AN ACT ENTITLED

"An Act repealing the defined contribution retirement plans for teachers and for public employees; providing a defined benefit retirement plan for teachers and public employees; making conforming amendments; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* **Section 1.** AS 14.25.008 is repealed and reenacted to read:

Sec. 14.25.008. Definitions. In AS 14.25.001 - 14.25.008,

(1) "plan" means a retirement plan established under AS 14.25.009 - 14.25.220;

(2) "system" means the Teachers' Retirement System of Alaska.

* **Sec. 2.** AS 14.25.009 is repealed and reenacted to read:

Sec. 14.25.009. Defined benefit retirement plan under AS 14.25.009 - 14.25.220. AS 14.25.009 - 14.25.220 set out a defined benefit retirement plan as the teachers' retirement plan.

* **Sec. 3.** AS 14.25.040(a) is amended to read:

(a) Unless a teacher or member participates in a university retirement program under AS 14.40.661 - 14.40.799, has filed an election under AS 14.25.043(b), or has elected under **former** AS 14.25.540 to participate in the plan established in **former provisions of** AS 14.25.310 - 14.25.590, a teacher or member contracting for service with a participating employer is subject to AS 14.25.009 - 14.25.220.

* **Sec. 4.** AS 14.25.070(b) is amended to read:

(b) The employer shall transmit the contributions calculated in (a) of this section to the administrator in accordance with AS 14.25.065. The administrator shall allocate contributions received for full payment of

(1) the actuarially determined employer normal cost for the plan; and

(2) all contributions required by **former** AS 14.25.350 and **by** AS 39.30.370 for the fiscal year.

* **Sec. 5.** AS 14.25.070(d) is amended to read:

(d) Notwithstanding (a) of this section, the annual employer contribution rate may not be less than the rate sufficient to allow payment of the employer normal cost and the employer contributions required under **former** AS 14.25.350 and **under** AS 39.30.370.

* **Sec. 6.** AS 14.25.143(a), as that subsection read following amendment by sec. 3, ch. 146, SLA 1980, until amended by sec. 12, ch. 106, SLA 1988, as amended by sec. 18, ch. 9, FSSLA 2005, is amended to read:

(a) When the **board** [ADMINISTRATOR] determines that the cost of living has increased and that the financial condition of the retirement fund permits, the administrator shall increase benefit payments to persons receiving benefits under this plan. [FOR PURPOSES OF THIS SUBSECTION, THE FINANCIAL CONDITION OF THE FUND WOULD ONLY PERMIT AN INCREASE IN BENEFITS WHEN THE RATIO OF TOTAL FUND ASSETS TO THE ACCRUED LIABILITY MEETS OR EXCEEDS 105 PERCENT. IN THIS SUBSECTION, "ACCRUED LIABILITY" MEANS THE PRESENT VALUE OF ALL MEMBER BENEFITS ACCRUED BY MEMBER SERVICE IN THIS PLAN.]

* **Sec. 7.** AS 14.25.143(a), as that subsection read following amendment by sec. 12, ch. 106, SLA 1988, until amended by sec. 12, ch. 97, SLA 1990, as amended by sec. 19, ch. 9, FSSLA

2005, is amended to read:

(a) When the **board** [ADMINISTRATOR] determines that the cost of living has increased and that the financial condition of the retirement fund permits, the administrator shall increase benefit payments to persons receiving benefits under this plan. [FOR PURPOSES OF THIS SUBSECTION, THE FINANCIAL CONDITION OF THE FUND WOULD ONLY PERMIT AN INCREASE IN BENEFITS WHEN THE RATIO OF TOTAL FUND ASSETS TO THE ACCRUED LIABILITY MEETS OR EXCEEDS 105 PERCENT. IN THIS SUBSECTION, "ACCRUED LIABILITY" MEANS THE PRESENT VALUE OF ALL MEMBER BENEFITS ACCRUED BY MEMBER SERVICE IN THIS PLAN.]

* **Sec. 8.** AS 14.25.220(1) is amended to read:

(1) "active member" means a member who is employed by an employer, is receiving compensation on a full-time or part-time basis and is making contributions to the plan, or a member making contributions under **former** AS 14.20.330 or 14.20.345;

* **Sec. 9.** AS 14.25.532 is amended to read:

Sec. 14.25.532. Pension forfeiture. The provisions of AS 37.10.310 apply to pension benefits under **former provisions of** AS 14.25.310 - 14.25.590.

* **Sec. 10.** AS 14.40.671(e) is amended to read:

(e) An employee whose rights to transfer assets out of a state retirement system are subject to a qualified domestic relations order is entitled to transfer assets from the state retirement system to a university retirement program only if the requirements for receiving a refund under AS 14.25.150(b), **former AS 14.25.360** [14.25.360], AS 39.35.200(c), or **former AS 39.35.760** [39.35.760], as appropriate, are met.

* **Sec. 11.** AS 14.40.799(3) is amended to read:

(3) "contribution account" means the member contribution account under AS 14.25.009 - 14.25.220, the individual account under **former provisions of** AS 14.25.310 - 14.25.590, the employee contribution account under AS 39.35.095 - 39.35.680, or the individual account under **former provisions of** AS 39.35.700 - 39.35.990, whichever is appropriate;

* **Sec. 12.** AS 37.10.220(a) is amended to read:

(a) The board shall

(1) hold regular and special meetings at the call of the chair or of at least five members; meetings are open to the public, and the board shall keep a full record of all its proceedings;

(2) after reviewing recommendations from the Department of Revenue, adopt investment policies for each of the funds entrusted to the board;

(3) determine the appropriate investment objectives for the defined benefit plans established under the teachers' retirement system under AS 14.25 and the public employees' retirement system under AS 39.35;

(4) assist in prescribing the policies for the proper operation of the systems and take other actions necessary to carry out the intent and purpose of the systems in accordance with AS 37.10.210 - 37.10.390;

(5) provide a range of investment options and establish the rules by which participants can direct their investments among those options with respect to accounts established under

(A) **<u>former</u>** AS 14.25.340 - 14.25.350 (teachers' retirement system defined contribution individual accounts);

(B) AS 39.30.150 - 39.30.180 (State of Alaska Supplementary Annuity Plan);

(C) **<u>former</u>** AS 39.35.730 - 39.35.750 (public employees' retirement system defined contribution individual accounts); and

(D) AS 39.45.010 - 39.45.060 (public employees' deferred compensation program);

(6) establish the rate of interest that shall be annually credited to each member's individual contribution account in accordance with AS 14.25.145 and AS 39.35.100 and the rate of interest that shall be annually credited to each member's account in the health reimbursement arrangement plan under AS 39.30.300 - 39.30.495; the rate of interest shall be adopted on the basis of the probable effective rate of interest on a long-term basis, and the rate may be changed from time to time;

(7) adopt a contribution surcharge as necessary under AS 39.35.160(c);

(8) coordinate with the retirement system administrator to have an annual actuarial valuation of each retirement system prepared to determine system assets, accrued liabilities, and funding ratios and to certify to the appropriate budgetary authority of each employer in the system

(A) an appropriate contribution rate for normal costs; and

(B) an appropriate contribution rate for liquidating any past service liability;

(9) review actuarial assumptions prepared and certified by a member of the American Academy of Actuaries and conduct experience analyses of the retirement systems not less than once every four years, except for health cost assumptions, which shall be reviewed annually; the results of all actuarial assumptions prepared under this paragraph shall be reviewed and certified by a second member of the American Academy of Actuaries before presentation to the board;

(10) contract for an independent audit of the state's actuary not less than once every four years;

(11) contract for an independent audit of the state's performance consultant not less than once every four years;

(12) obtain an external performance review to evaluate the investment policies of each fund entrusted to the board and report the results of the review to the appropriate fund fiduciary;

(13) by the first day of each regular legislative session, report to the governor, the legislature, and the individual employers participating in the state's retirement systems on the financial condition of the systems in regard to

(A) the valuation of trust fund assets and liabilities;

(B) current investment policies adopted by the board;

(C) a summary of assets held in trust listed by the categories of investment;

(D) the income and expenditures for the previous fiscal year;

(E) the return projections for the next calendar year;

(F) one-year, three-year, five-year, and 10-year investment performance for each of the funds entrusted to the board; and

(G) other statistical data necessary for a proper understanding of the financial status of the systems;

(14) submit quarterly updates of the investment performance reports to the Legislative Budget and Audit Committee; [AND]

(15) develop an annual operating budget; **and**

(16) administer pension forfeitures required under AS 37.10.310 using the procedures of AS 44.62 (Administrative Procedure Act).

* **Sec. 13.** AS 37.10.310(c) is amended to read:

(c) A state pension benefit under (a) of this section does not include

(1) insurance, voluntary wage reductions, involuntary wage reductions, or supplemental or health benefits under AS 39.30.090 - 39.30.495 or former AS 39.37.145;

(2) member or employee contributions under AS 14.25.050, 14.25.055, 14.25.075, **former AS 14.25.340** [14.25.340], **former AS 14.25.360(a)** [14.25.360(a)], AS 22.25.011, AS 39.35.160, 39.35.165(f), 39.35.180, **former AS 39.35.730** [39.35.730], **former AS 39.35.760(a)** [39.35.760(a)], or former AS 39.37.070.

* **Sec. 14.** AS 37.10.390(4) is amended to read:

(4) "retirement systems" or "systems" means the teachers' retirement system, the judicial retirement system, the Alaska National Guard and Alaska Naval Militia retirement system, the public employees' retirement system, the **former** State of Alaska Teachers' and Public Employees' Retiree Health Reimbursement Arrangement Plan, and the elected public officers' retirement system under former AS 39.37.

* **Sec. 15.** AS 39.30.090(a) is amended to read:

(a) The Department of Administration may obtain a policy or policies of group insurance covering state employees, persons entitled to coverage under AS 14.25.168, **former AS 14.25.480** [14.25.480], AS 22.25.090, AS 39.35.535, **former AS 39.35.880** [39.35.880], or former AS 39.37.145, employees of other participating governmental units, or persons entitled to coverage under AS 23.15.136, subject to the following conditions:

(1) A group insurance policy shall provide one or more of the following benefits: life insurance, accidental death and dismemberment insurance, weekly indemnity insurance, hospital expense insurance, surgical expense insurance, dental expense insurance, audiovisual insurance, or other medical care insurance.

(2) Each eligible employee of the state, the spouse and the unmarried children chiefly dependent on the eligible employee for support, and each eligible employee of another participating governmental unit shall be covered by the group policy, unless exempt under regulations adopted by the commissioner of administration.

(3) A governmental unit may participate under a group policy if

(A) its governing body adopts a resolution authorizing participation, and payment of required premiums;

(B) a certified copy of the resolution is filed with the Department of Administration; and

(C) the commissioner of administration approves the participation in writing.

(4) In procuring a policy of group health or group life insurance as provided under this section or excess loss insurance as provided in AS 39.30.091, the Department of Administration shall comply with the dual choice requirements of AS 21.86.310, and shall obtain the insurance policy from an insurer authorized to transact business in the state under AS 21.09, a hospital or medical service corporation authorized to transact business in this state under AS 21.87, or a health maintenance organization authorized to operate in this state under AS 21.86. An excess loss insurance policy may be obtained from a life or health insurer authorized to transact business in this state under AS 21.09 or from a hospital or medical service corporation authorized to transact business in this state under AS 21.87.

(5) The Department of Administration shall make available bid specifications for desired insurance benefits or for administration of benefit claims and payments to (A) all insurance carriers authorized to transact business in this state under AS 21.09 and all hospital or medical service corporations authorized to transact business under AS 21.87 who are qualified to provide the desired benefits; and (B) to

insurance carriers authorized to transact business in this state under AS 21.09, hospital or medical service corporations authorized to transact business under AS 21.87, and third-party administrators licensed to transact business in this state and qualified to provide administrative services. The specifications shall be made available at least once every five years. The lowest responsible bid submitted by an insurance carrier, hospital or medical service corporation, or third-party administrator with adequate servicing facilities shall govern selection of a carrier, hospital or medical service corporation, or third-party administrator under this section or the selection of an insurance carrier or a hospital or medical service corporation to provide excess loss insurance as provided in AS 39.30.091.

(6) If the aggregate of dividends payable under the group insurance policy exceeds the governmental unit's share of the premium, the excess shall be applied by the governmental unit for the sole benefit of the employees.

(7) A person receiving benefits under AS 14.25.110, AS 22.25, AS 39.35, or former AS 39.37 may continue the life insurance coverage that was in effect under this section at the time of termination of employment with the state or participating governmental unit.

(8) A person electing to have insurance under (7) of this subsection shall pay the cost of this insurance.

(9) For each permanent part-time employee electing coverage under this section, the state shall contribute one-half the state contribution rate for permanent full-time state employees, and the permanent part-time employee shall contribute the other one-half.

(10) A person receiving benefits under AS 14.25, AS 22.25, AS 39.35, or former AS 39.37 may obtain auditory, visual, and dental insurance for that person and eligible dependents under this section. The level of coverage for persons over 65 shall be the same as that available before reaching age 65 except that the benefits payable shall be supplemental to any benefits provided under the federal old age, survivors, and disability insurance program. A person electing to have insurance under this paragraph shall pay the cost of the insurance. The commissioner of administration shall adopt regulations implementing this paragraph.

(11) A person receiving benefits under AS 14.25, AS 22.25, AS 39.35, or former AS 39.37 may obtain long-term care insurance for that person and eligible dependents under this section. A person who elects insurance under this paragraph shall pay the cost of the insurance premium. The commissioner of administration shall adopt regulations to implement this paragraph.

(12) Each licensee holding a current operating agreement for a vending facility under AS 23.15.010 - 23.15.210 shall be covered by the group policy that applies to governmental units other than the state.

* **Sec. 16.** AS 39.30.097(b) is amended to read:

(b) The commissioner of administration is authorized to prefund medical benefits provided by **former** AS 14.25.480, AS 39.30.300, and **former** AS 39.35.880 by establishing an irrevocable trust that is exempt from federal income tax under 26 U.S.C. 115 and subject to the applicable financial reporting, disclosure, and actuarial requirements of the Governmental Accounting Standards Board.

* **Sec. 17.** AS 39.30.300 is amended to read:

Sec. 39.30.300. State of Alaska Teachers' and Public Employees' Retiree Health Reimbursement Arrangement Plan established. The State of Alaska Teachers' and Public Employees' Retiree Health Reimbursement Arrangement Plan is established for teachers who first become members of the defined contribution plan of the teachers' retirement system under **former provisions of** AS 14.25.310 - 14.25.590 on or after July 1, 2006, and employees of the state, political subdivisions of the state, and public organizations of the state who first become members of the defined contribution plan of the public employees' retirement system under **former provisions of** AS 39.35.700 - 39.35.990 on or after July 1, 2006.

* **Sec. 18.** AS 39.30.380 is amended to read:

Sec. 39.30.380. Termination of employment. A person who terminates employment before meeting the eligibility requirements of **former** AS 14.25.470 or **former** AS 39.35.870 loses any right to the contributions made on behalf of the person to the teachers' and public employees' retiree health reimbursement arrangement trust fund. If a person returns to employment with a participating employer by December 31 of the year in which the person reaches 65 years of age, the person's account balance shall be restored in the amount recorded on the date of termination from the trust, adjusted for inflation at the rate of the Consumer Price Index for Anchorage, Alaska. The earlier period of employment with a participating employer shall be credited toward eligibility for medical benefits.

* **Sec. 19.** AS 39.30.390 is amended to read:

Sec. 39.30.390. Eligibility and reimbursement. Persons who meet the eligibility requirements of **former** AS 14.25.470 and **former** AS 39.35.870 are eligible for reimbursements from the individual account established for a member under the plan, except members do not have to retire directly from the system. A person who is the dependent child of an eligible member is eligible for reimbursements if the eligible member and surviving spouse have both died so long as the person meets the definition of dependent child.

* **Sec. 20.** AS 39.30.400 is amended to read:

Sec. 39.30.400. Benefits payable from the individual account. (a) The administrator may deduct the cost of monthly premiums from the individual account for retiree major medical insurance on behalf of an eligible person who elected retiree major medical insurance under **former** AS 14.25.480 or **former** AS 39.35.880.

(b) Upon application of an eligible person, the administrator shall reimburse to the eligible person the costs for medical care expenses as defined in 26 U.S.C. 213(d). Reimbursement is limited to the medical expenses of

(1) an eligible member, the spouse of an eligible member, and the dependent children of an eligible member; or

(2) a surviving spouse and the dependent children of an eligible member dependent on the surviving spouse.

(c) When the member's individual account balance is exhausted, the insurance premium deductions under (a) of this section and the reimbursement of medical care expenses under (b) of this section end.

(d) If all eligible persons die before exhausting the member's individual account, the account balance shall revert to the plan.

* **Sec. 21.** AS 39.30.495(3) is amended to read:

(3) "compensation" has the meaning given in **former** AS 14.25.590;

* **Sec. 22.** AS 39.30.495(5) is amended to read:

(5) "eligible person" means a person who meets the eligibility requirements of **former** AS 14.25.470 or **former** AS 39.35.870;

* **Sec. 23.** AS 39.30.495(6) is amended to read:

(6) "employer" has the meaning given in **former** AS 14.25.590 for employers of teachers in the defined contribution plan established in **former provisions of** AS 14.25.310 - 14.25.590 and has the meaning given in **former** AS 39.35.990 for employers of public employees in the defined contribution plan established in **former provisions of** AS 39.35.700 - 39.35.990;

* **Sec. 24.** AS 39.30.495(9) is amended to read:

(9) "member" means a member of the defined contribution plan of the teachers' retirement system in **former provisions of** AS 14.25.310 - 14.25.590 or a member of the public employees' retirement system in **former provisions of** AS 39.35.700 - 39.35.990;

* **Sec. 25.** AS 39.35.008(2) is repealed and reenacted to read:

(2) "plan" means a retirement plan established under AS 39.35.095 - 39.35.680;

* **Sec. 26.** AS 39.35.008(3) is repealed and reenacted to read:

(3) "system" means the Public Employees' Retirement System of Alaska.

* **Sec. 27.** AS 39.35.095 is repealed and reenacted to read:

Sec. 39.35.095. Defined benefit retirement plan under AS 39.35.095 - 39.35.680. AS 39.35.095 - 39.35.680 set out a defined benefit retirement plan as the public employees' retirement plan.

* **Sec. 28.** AS 39.35.255(b) is amended to read:

(b) The administrator shall allocate contributions received for full payment of

(1) the actuarially determined employer normal cost for the plan; and

(2) all contributions required by AS 39.30.370 and **former** AS 39.35.750 for the fiscal year.

* **Sec. 29.** AS 39.35.255(d) is amended to read:

(d) Notwithstanding (a) of this section, the annual employer contribution rate may not be less than the rate sufficient to allow payment of the employer normal cost and the employer contributions required under AS 39.30.370 and **former** AS 39.35.750.

* **Sec. 30.** AS 39.35.475(a), as that subsection read following amendment by sec. 34, ch. 146, SLA 1980, until amended by sec. 41, ch. 82, SLA 1986, as amended by sec. 112, ch. 9, FSSLA 2005, is amended to read:

(a) When the **board** [ADMINISTRATOR] determines that the cost of living has increased and that the financial condition of the retirement fund permits, the administrator shall increase benefit payments to persons receiving benefits under this plan. [FOR PURPOSES OF THIS SUBSECTION, THE FINANCIAL CONDITION OF THE FUND WOULD ONLY PERMIT AN INCREASE IN BENEFITS WHEN THE RATIO OF TOTAL FUND ASSETS TO THE ACCRUED LIABILITY MEETS OR EXCEEDS 105 PERCENT. IN THIS SUBSECTION, "ACCRUED LIABILITY" MEANS THE PRESENT VALUE OF ALL MEMBER BENEFITS ACCRUED BY MEMBER SERVICE IN THIS PLAN.]

* **Sec. 31.** AS 39.35.620(k) is amended to read:

(k) Termination of an employer's participation in the plan does not bar future participation in the system by that employer if the employer is current with payments on amounts due under AS 39.35.625. [IF A PREVIOUSLY TERMINATED EMPLOYER RETURNS TO THE SYSTEM, THE EMPLOYER MAY ONLY PARTICIPATE IN THE PLAN ESTABLISHED UNDER AS 39.35.700 - 39.35.990. EMPLOYEES MAY BE CREDITED UNDER AS 39.35.700 - 39.35.990 ONLY WITH SERVICE SUBSEQUENT TO THE DATE OF RETURN.]

* **Sec. 32.** AS 39.35.932 is amended to read:

Sec. 39.35.932. Pension forfeiture. The provisions of AS 37.10.310 apply to pension benefits under **former provisions of** AS 39.35.700 - 39.35.990.

* **Sec. 33.** AS 14.25.012(c), 14.25.310, 14.25.320, 14.25.330, 14.25.340, 14.25.345, 14.25.350, 14.25.360, 14.25.370, 14.25.380, 14.25.390, 14.25.400, 14.25.410, 14.25.420, 14.25.430, 14.25.440, 14.25.450, 14.25.460, 14.25.470, 14.25.480, 14.25.485, 14.25.486, 14.25.487, 14.25.488, 14.25.489, 14.25.490, 14.25.500, 14.25.510, 14.25.520, 14.25.530, 14.25.540, 14.25.550, 14.25.560, 14.25.580, 14.25.582, 14.25.590; AS 39.35.700, 39.35.710,

39.35.720, 39.35.725, 39.35.730, 39.35.740, 39.35.750, 39.35.760, 39.35.770, 39.35.780, 39.35.790, 39.35.800, 39.35.810, 39.35.820, 39.35.830, 39.35.840, 39.35.850, 39.35.860, 39.35.870, 39.35.880, 39.35.890, 39.35.891, 39.35.892, 39.35.893, 39.35.894, 39.35.895, 39.35.900, 39.35.910, 39.35.920, 39.35.930, 39.35.940, 39.35.950, 39.35.955, 39.35.957, 39.35.958, 39.35.960, 39.35.965, 39.35.970, 39.35.972, and 39.35.990 are repealed.

* **Sec. 34.** The uncodified law of the State of Alaska is amended by adding a new section to read:

RETIREMENT PLAN ELECTION OPTION. (a) A teacher who was hired on or after July 1, 2006, and before the effective date of this section and who is a member of the defined contribution plan of the teachers' retirement system under former provisions of AS 14.25.310 - 14.25.590 may make a one-time election before September 1, 2009, or within 90 days after the effective date of this section, whichever is later, to participate in the defined benefit retirement plan under AS 14.25.009 - 14.25.220 and to transfer any contributions, including employer contributions, made to the defined contribution plan before that date.

(b) A public employee who was hired on or after July 1, 2006, and before the effective date of this section and who is a member of the defined contribution plan of the public employees' retirement system under former provisions of AS 39.35.700 - 39.35.990 may make a one time election before September 1, 2009, or within 90 days after the effective date of this section, whichever is later, to participate in the defined benefit retirement plan under AS 39.35.095 - 39.35.680 and to transfer any contributions, including employer contributions, made to the defined contribution plan before that date.

(c) In this section, "employer" has the meaning given in AS 14.25.590 or AS 39.35.990, as applicable, as those sections read the day before the effective date of sec. 33 of this Act.

* **Sec. 35.** The uncodified law of the State of Alaska is amended by adding a new section to read:

RETIREMENT PLAN ELECTION PROCEDURE; REGULATIONS REQUIRED. (a) The election to participate in the defined benefit retirement plan under sec. 34 of this Act must be made in writing on forms and in the manner prescribed by the administrator. Before accepting an election to participate in the defined benefit retirement plan, the administrator shall provide the employee planning on making an election to participate in the defined benefit retirement plan with information, including calculations to illustrate the effect of moving the employee's retirement plan from the defined contribution retirement plan to the defined benefit retirement plan as well as other information to clearly inform the employee of the potential consequences of the employee's election.

(b) An election made under sec. 34 of this Act to participate in the defined benefit retirement plan is irrevocable. On making the election, the participant shall be enrolled as a member of the defined benefit retirement plan, the member's participation in the plan shall be governed by the provisions for the defined benefit retirement plan, and the member's participation in the defined contribution retirement plan shall terminate. The participant's enrollment in the defined benefit retirement plan shall be effective the first day of the month after the administrator receives the completed enrollment forms. An election made by an eligible member who is married is not effective unless the election is signed by the individual's spouse.

(c) As directed by the participant, the Alaska Retirement Management Board shall transfer or cause to be transferred the appropriate amounts to the designated account. The administrator shall credit the participant with a service credit that is equal to the participant's actual service or the actuarially calculated value of the employer and employee contribution transferred, whichever is less. The board shall establish transfer procedures by regulation, but the actual transfer may not be later than 30 days after the effective date of the member's participation in the defined benefit retirement plan unless the major financial markets for securities available for a transfer are seriously disrupted by an unforeseen event that also causes the suspension of trading on any national securities exchange in the country where the securities were issued. In that event, the 30-day period of time may be extended by a resolution of the board. Transfers are not commissionable or subject to other fees and may be in the form of securities or cash as determined by the board. Securities shall be valued on the date of receipt in the participant's account.

(d) In this section,

(1) "administrator" means the person appointed or designated by the commissioner of administration under AS 39.35.050 for a public employees' retirement plan and under AS 14.25.003 for a teachers' retirement plan;

(2) "board" means the Alaska Retirement Management Board established

under AS 37.10.210;

(3) "defined benefit retirement plan" means the retirement plan established under

(A) AS 14.25.009 - 14.25.220 for a teacher; or

(B) AS 39.35.095 - 39.35.680 for a public employee;

(4) "defined contribution retirement plan" means the retirement plan established under

(A) former provisions of AS 14.25.310 - 14.25.590 for a teacher; or

(B) former provisions of AS 39.35.700 - 39.35.990 for a public employee.

* **Sec. 36.** The uncodified law of the State of Alaska is amended by adding a new section to read:

ADOPTION OF REGULATIONS. The commissioner of administration shall proceed immediately to adopt regulations consistent with this Act, but in no event may the regulations take effect before the effective date of sec. 34 of this Act.

* **Sec. 37.** The uncodified law of the State of Alaska is amended by adding a new section to read:

INSTRUCTION TO REVISOR OF STATUTES. The revisor of statutes shall submit to the Alaska Legislative Council a draft bill making conforming amendments to the statutes of the State of Alaska consistent with this Act to clarify that the teachers' retirement system and the public employees' retirement system consist only of defined benefit plans.

* **Sec. 38.** Sections 35 and 36 of this Act take effect immediately under AS 01.10.070(c).

SENATOR KIM ELTON

MEMORANDUM

February 4, 2009

To: Senator Joe Paskvan, Chair
Senate Labor & Commerce Committee

From: Kim Elton

Re: Sectional Analysis, SB 23

Sec. 1 Updates the definition of a retirement "plan" in the teachers' retirement system to remove references to the DC plan repealed by the bill. It also updates the definition of "system."

Sec. 2 Replaces language limiting the DC plan to employees hired after July 1, 2006 with language describing the defined benefit teachers' retirement system.

Secs. 3-5 Adjust references for the purpose of applying existing law to teachers who elect to remain in the former DC plan, repealed by the bill.

Secs. 6 and 7 Allow the Alaska Retirement Management Board, rather than the administrator, to adjust pension payments for inflation when the financial condition of the TRS trust fund permits, by removing the 105 percent minimum funding ratio.

Secs. 8-24 Adjust references for the purpose of applying existing law to teachers and public employees who elect to remain in the former DC plan, repealed by the bill.

Sec. 12 Adjusts a reference to ensure the Alaska Retirement Management Board continues oversight of the health reimbursement arrangement portion of the former DC plan, repealed by the bill.

Secs. 13 through 24 Adjust references for the purpose of applying existing law to teachers and public employees who elect to remain in the former DC plan, repealed by the bill.

Sec. 25 Updates the definition of a retirement "plan" in the teachers' retirement system to remove references to the DC plan repealed by the bill.

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__Sec. 26__ Updates the definition of a retirement "system" in the public employees' retirement system to remove references to the DC plan repealed by the bill.

__Sec. 27__ Replaces language limiting the DC plan to employees hired after July 1, 2006 with language describing the defined benefit public employees' retirement system.

__Secs. 28 and 29__ Adjust references for the purpose of applying existing law to public employees who elect to remain in the former DC plan, repealed by the bill.

__Sec. 30__ Allows the Alaska Retirement Management Board, rather than the administrator, to adjust pension payments for inflation when the financial condition of the PERS trust fund permits, by removing the 105 percent minimum funding ratio.

__Sec. 31__ Removes language, made obsolete by the repeals in Section 33 of the bill, regarding the return of previously terminated employers to PERS.

__Sec. 32__ Adjusts a reference for the purpose of applying existing law to public employees who elect to remain in the former DC plan, repealed by the bill.

__Sec. 33__ Repeals the defined contribution retirement systems for both teachers and other public employees.

__Sec. 34__ Gives employees hired into the defined contribution plans who have not refunded out of those plans a 90-day period from the effective date of the bill (or until September 1, 2009, whichever is later) to irrevocably convert into PERS tier III or TRS tier II, as appropriate. It also gives them the opportunity to transfer their contributions from the DC plan to the DB plan if they make the switch.

__Sec. 35__ Sets for the procedure for the conversion election in Sec. 34 and allows the Alaska Retirement Management Board to adopt regulations related to the conversion. The choice to convert is irrevocable, and certain information must be provided to the employee. Employees who transfer receive credited service in the defined benefit plan equal to the lesser of the employee's actual service or the actuarially calculated value of the employer and employee money transferred from the defined contribution account.

__Sec. 36__ Allows the Commissioner of Administration to adopt regulations to implement and make specific the bill's provisions.

__Sec. 37__ Instructs the Revisor of Statutes to submit a bill via the Legislative Council to make technical or clarifying changes, if needed.

__Sec. 38__ is an immediate effective date for sections 35 and 36 of the bill.

Dear Governor Palin:

The mission of the American Fisheries Society (AFS) is to improve the conservation and sustainability of fishery resources and aquatic ecosystems by advancing fisheries and aquatic science and promoting the development of fisheries professionals. The fisheries professionals within the Alaska Chapter of AFS strive to meet this objective through a sustained effort in the advancement and development of Alaska's aquatic resources. The Past Presidents Committee, comprised of individuals representing the Chapter's institutional knowledge and experience, is deeply concerned about trends in recruitment and retention of the state employees responsible for the conservation and sustainable management of the State's fisheries resources.

In 2006, the retirement and benefits package for state employees was changed from defined benefits to defined contributions. This change will create a very mobile work force that is able to switch employers and take their retirement package with them. Incentives need to be in place to retain good employees or they will seek better pay and benefits with the private sector or other government agencies. In the absence of salary and retirement packages that at least equal those offered by other entities, the recruitment and retention of qualified individuals into state positions will become increasingly difficult.

As past presidents of the AFS Alaska Chapter, we believe the future of Alaska's fisheries is directly linked to the quality and experience of aquatic resource professionals in state employment. Recent and anticipated upcoming retirements by many long-term employees, combined with the lack of retention and recruitment of newer employees, will leave few individuals with the experience necessary to effectively manage, research, and develop Alaska's aquatic resources. We feel that competition in the job market will become more intense in the future, especially when a gas pipeline is constructed. Therefore, we urge you to work with the legislature to re-examine the long-term impacts of current salary schedules and recent changes to the retirement and benefits package on employee retention.

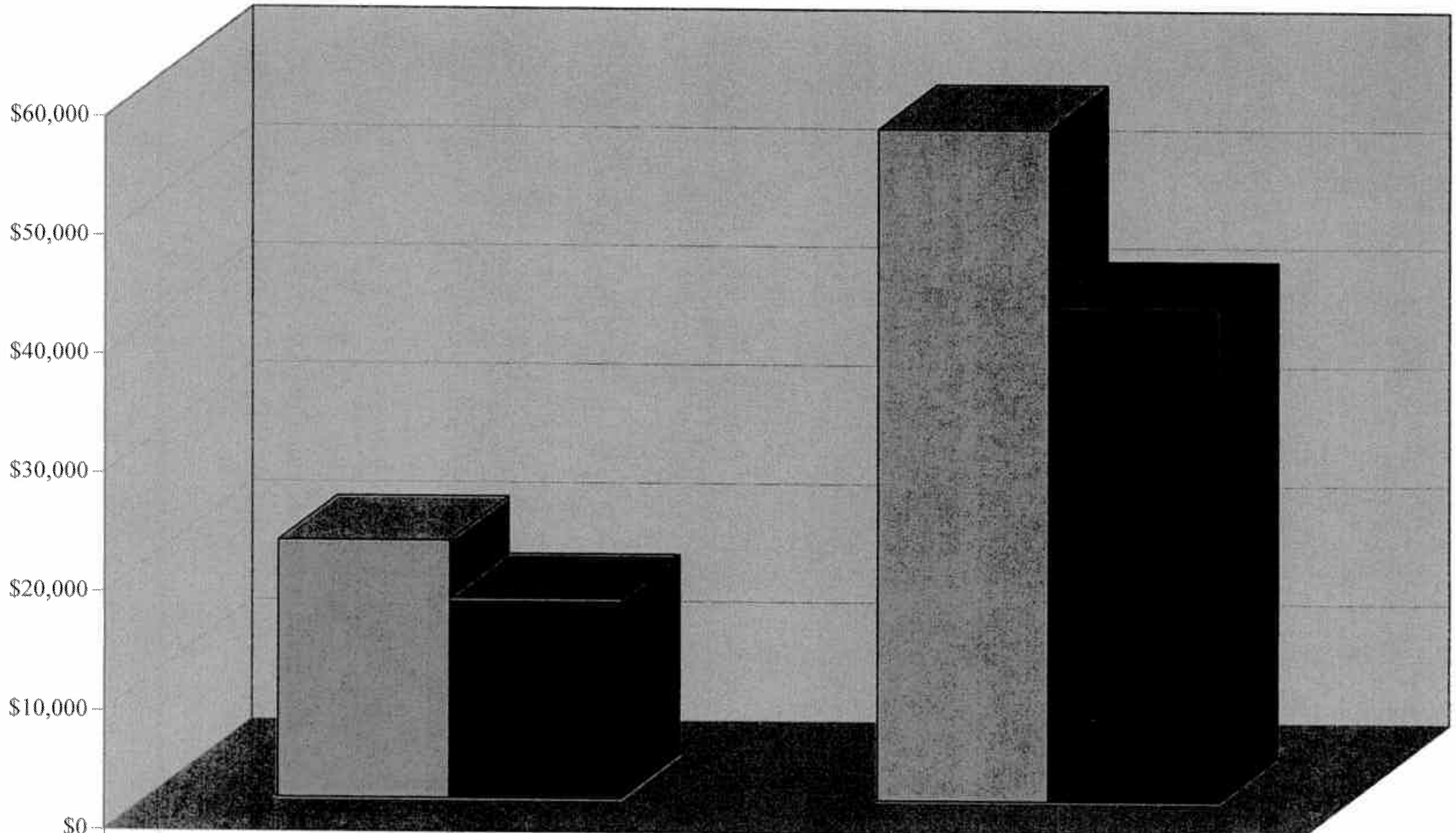
Thank you for your consideration of this issue that has such broad effects on a part of the Alaska economy that employs so many people in our state.

Sincerely,

Jamal Moss, Scott Maclean, Hal Geiger, Tim Joyce, Carol Kerkvleit, Bill Bectol, Cindy Hartmann, Alex Wertheimer, Tom Kron, and Bill Wilson

cc- all current Alaska Legislators

Value of Employer-Paid Benefits
(31-year old new employee)



	PERS - Others	TRS
DB Plan	21652	56550
DCR Plan	16791	41667

Based on data provided by Buck Consultants, letter dated May 4, 2006

Assumes a married member with starting salary of $35.5/year.

SENATOR KIM ELTON

Memorandum

TO: Sens. Hoffman and Stedman, co-chairs, and Finance Committee members

FROM: Sen. Kim Elton

RE: Defined Benefit/Defined Contribution

DATE: March 30, 2007

Attached are slightly reformatted charts codifying data provided by Buck Consultants in their letter dated March 19, 2007. The Buck letter responds to requests by the committee to disaggregate by tiers data that previously was dumped into only two buckets for comparison purposes—a defined benefit bucket and a defined contribution bucket. Now we have several buckets of data—four PERS buckets (tiers 1-4) and three TRS buckets.

The normal cost charts for PERS and TRS are easy-to-read comparisons of PERS pension and medical costs by tier and TRS pension and medical costs by tier. The third chart, the accrued liability chart, puts dollar amounts to liabilities by tier.

Here are some demonstrable basics revealed by the Buck data:

- the PERS tier 3 DB employees are just slightly more expensive than the new DC employees;
- the new TRS DC employees are very slightly more expensive than the TRS tier 2 DB employees;
- the very slight cost advantage of a PERS tier 4 over a tier 3 is erased when tier 4 employees leave early and take employer dollars that, if left in the system, would help meet pension benefit obligations in the out years; so
- the DB PERS tier 3 and the DB TRS tier 2 fundamentally fixed the problems the governor claimed had to be fixed by his new DC plan.

There also are some other DB/DC inferences that can be drawn:

- recruitment for quality public employees is made more difficult when Alaska is a defined contribution pension system (without even the backstop of the defined Social Security benefit) because professionals can work with other public employers that are just as competitive on wages and almost all of whom provide a defined benefit pension; and
- retention is made more difficult with the portability provisions of the defined contribution because relatively short-term employees can take their contributions as-well-as employer contributions out of the retirement systems and go to

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another public employer that provides a defined benefit (any federal employer, or any other state, or almost all municipalities or school districts outside Alaska). As we know, a high percentage of teachers and public employees leave before five years and now new DC employees have a special financial inducement to leave—they can cut and run and take the employer dollars, too.

These inferences are now backed with anecdotal Alaska evidence, even after less than a year's experience with tier 4. Further, the anecdotal Alaska evidence mimics the real-life experience of the two states that actually moved to a defined contribution but later back-tracked because of recruitment and retention problems.

Given the instructive Buck numbers that finally compare the immediately previous DB plans to the replacement DC plan and given, too, the cost-sharing bills that will spread the past service costs to employers regardless of tiers, we need to review what we wrought with SB141.

We must not assume our only options now are passing a DC 'fix-it' bill and passing a cost sharing bill that spreads the pain of past service costs. At a minimum we must also decide whether to give new employees a choice of tier 3 or DC in the PERS system or tier 2 and DC in the TRS system. If the cost differences are a wash, why limit the ability of employers to recruit and retain, and limit new employees to a risky defined contribution plan?

Normal Cost

Employer Normal Cost Rate	PERS Pension	PERS Medical	PERS Total	# of Active & Retired[1]
Tier 1 (DB)	9.15%	10.46%	19.61%	26,263
Tier 2 (DB)	5.33%	10.41%	15.74%	10,999
Tier 3 (DB)	1.55%	9.28%	10.83%	18,719
Tier 4 (DC)	5.67%	3.99%	9.66%	2,214

[1] as of October, 2006

Employer Normal Cost Rate	TRS Pension	TRS Medical	TRS Total	# of Active & Retired[2]
Tier 1 (DB)	7.18%	8.02%	15.20%	11,872
Tier 2 (DB)	2.16%	8.96%	11.12%	7,635
Tier 3 (DC)	7.56%	3.99%	11.55%	754

[2] as of October, 2006

Accrued Liability[3]

Accrued Liability (DB)	PERS Pension	PERS Medical	PERS Total	TRS Pension	TRS Medical	TRS Total
Tier 1	$5,628,778	$4,036,751	$9,665,530	$3,925,023	$1,816,223	$5,741,247
Tier 2	1,123,559	1,334,674	2,458,233	409,562	347,748	757,309
Tier 3	334,854	386,224	721,078	N/A	N/A	N/A
Total	$7,087,191	$5,757,650	$12,844,841	$4,334,585	$2,163,971	$6,498,556
Assets°			$8,442,919			$3,958,939
Accrued Liability			$4,401,922			$2,539,617

[3] per Buck Consultants letter, March 2007

°PERS DB net assets as of 6/30/2008 were $10,726,913,000.
TRS DB net assets as of 6/30/2008 were $4,804,371,000.

Alaska Department of Administration

Retirement and Benefits

Do I need to take Leave to Attend Seminars?

To All Employees,

Questions have arisen about whether attendance at Retirement and Benefits seminars constitute work time. This memorandum is to clarify this matter.

If an employee attends a Retirement & Benefits sponsored seminar during his/her regularly scheduled work day, the time is counted as work time. Approval to be away from the work site must be secured from the supervisor in advance. If the seminar is offered outside the employee's regularly scheduled work day it will not be counted as work time and is not compensable time.

If there is any question about whether or not a State sponsored event is work time, please contact your Human Resource Service Center for assistance.

Nicki Neal
Director, Division of Personnel
Department of Administration

6th Floor State Office Building, PO Box 110203, Juneau, AK 99811-0203
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AN ISSUE IN BRIEF
CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

SEPTEMBER 2006, NUMBER 52

INVESTMENT RETURNS: DEFINED BENEFIT VS. 401(k) PLANS

BY ALICIA H. MUNNELL, MAURICIO SOTO, JERILYN LIBBY, AND JOHN PRINZIVALLI*

Introduction

Pension coverage in the private sector has shifted from defined benefit plans where professionals manage the money to 401(k) plans where participants invest their own accounts. The supposition is that individuals are not very good at investing their own money. The question is whether the supposition is borne out by the facts. That is, are returns on 401(k) plans markedly lower than those on traditional defined benefit plans?

This *brief* first reports rates of return on defined benefit and 401(k) plans over the period 1988-2004. The second section then looks at the holdings of the two types of plans to see whether the differences in returns can be explained by a more risky portfolio. The third section speculates about the role fees play in the results. The fourth section explores the implications of the findings for 401(k) participants. The final section reports on Individual Retirement Accounts (IRAs), because the assets in these accounts now exceed holdings in either defined benefit or defined contribution plans, and most of the money is rolled over from employer-sponsored plans.

The bottom line is that over the period 1988-2004 defined benefit plans outperformed 401(k) plans by one percentage point. This outcome occurred despite the fact that 401(k) plans held a higher portion of their assets in equities during the bull market of the 1990s. Part of the explanation may rest with higher fees, which are deducted before returns are reported to participants. But the one percentage point shortfall understates the investment problem in 401(k) plans, since an aggregate number does not reflect the fact that more than half of participants in 401(k) plans do not follow the prudent investment strategy of diversifying their holdings. Finally, the available data suggest that IRAs produce even lower returns than 401(k) plans, which, if true, implies trouble ahead given the massive amount of money that is being rolled over into these accounts.

* Alicia H. Munnell is the Director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor in Management Sciences at Boston College's Carroll School of Management. Mauricio Soto is a senior research associate, Jerilyn Libby is a research associate, and John Prinzivalli is a student research assistant at the CRR. The authors would like to thank Sylvester Schieber and Brendan McFarland for providing access to Watson Wyatt's previous research and Peter Diamond and Francis Vitagliano for helpful comments.

Rates of Return in Defined Benefit and 401(k) Plans

Financial assets in private sector defined benefit and defined contribution plans (including IRAs) totaled $8.5 trillion at the end of 2005 (see Table 1). At that time, defined benefit assets accounted for only 23 percent of the total, while self-directed defined contribution plans and IRAs made up the rest. Thus, the question of how individuals fare when investing their own retirement funds is an important one.

Table 1. Private Sector Retirement Assets, Year End 2005

Type of plan	Billions of dollars	Percent of total
Defined benefit	$1,916.5	22.7 %
Defined contribution	2,868.7	33.9
IRAs	3,667.0	43.4
Total	8,452.2	100.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

The first step in assessing the performance is to compare median annual rates of return for defined benefit and 401(k) plans. The analysis focuses on companies that sponsor both types of plans to minimize the effect of company or participant characteristics on the results.[1] The formula for calculating rate of return is one commonly used by actuaries.[2] It relates the change in assets ($A_t - A_{t-1}$), netting out the impact of benefit payments from the plan (B) and contributions to the plan (C), to initial assets (A_{t-1}) plus half of net inflows (C – B):

$$\text{Rate of return} = \frac{(A_t - A_{t-1}) + B - C}{(A_{t-1}) + \frac{1}{2}(C - B)}$$

The Department of Labor's Form 5500 filings provide data on assets, contributions, and benefits for each plan over the period 1988-2004.[3]

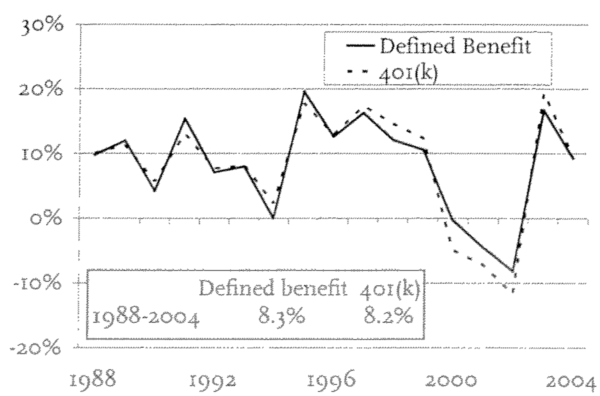
Returns, even median returns, can be calculated in a number of ways. The analysis presented below starts with the simplest approach, and one used in earlier studies, that arrays the plans and reports the return for the plan at the 50th percentile. In terms of the example shown below, the median rate of return would be 5 percent. One obvious question is whether comparing median rates of return is the right exercise, since three-quarters of the total assets in the example are in Plan A earning 10 percent. An alternative measure would be one that weighted returns by plan assets, and then identified the median. Such an approach would yield a return of 10 percent in this example. In our view, this is the preferred approach, although both results are reported below.

Example: Unweighted versus Weighted Medians

Plan	Assets	Rate of return
Plan A	$75	10 %
Plan B	20	5
Plan C	5	2

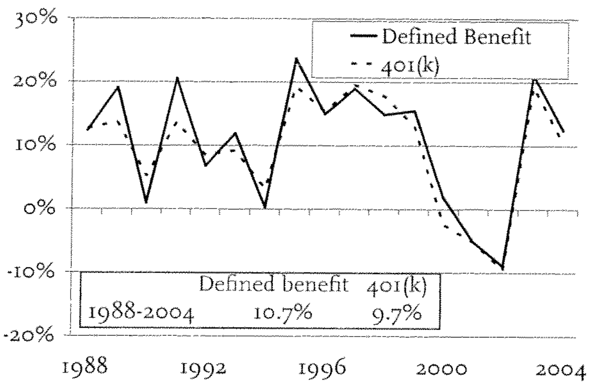
Figure 1 shows the simple medians over the period 1988-2004.[4] During the period, the average of this measure suggests that the performance of defined benefit and 401(k) plans is virtually identical — 8.3 percent versus 8.2 percent.[5]

Figure 1. Unweighted Median Rates of Return for Defined Benefit and 401(k) Plans, 1988-2004



Source: Authors' calculations from U.S. Department of Labor (1990-2006).

FIGURE 2. WEIGHTED MEDIAN RATES OF RETURN FOR DEFINED BENEFIT AND 401(K) PLANS, 1988-2004



Source: Authors' calculations from U.S. Department of Labor (1990-2006).

Figure 2 recalculates rates of return weighting returns by assets in the plan. Two factors change. First, the returns are higher. Second, defined benefit plans appear to have outperformed 401(k) plans by one percentage point (10.7 percent versus 9.7 percent).

The higher return reflects the fact that larger plans have historically performed better than smaller ones (see Table 2). The usual explanation is that large plans can hire better managers and spread fees over a larger base. Size matters much less for 401(k) plans, because the outcome reflects a myriad of individual investment decisions.

TABLE 2. MEDIAN RATES OF RETURN BY ASSET QUINTILE FOR DEFINED BENEFIT AND 401(K) PLANS, 1988-2004

Asset quintile	Defined benefit	401(k)
Largest 20 percent	10.1 %	8.8%
Second	8.9	8.1
Third	8.2	7.8
Fourth	7.4	7.6
Smallest 20 percent	5.6	6.6

Source: Authors' calculations from U.S. Department of Labor (1990-2006).

The Impact of Portfolio Allocation

One question is the extent to which portfolio differences can explain differences in rates of return. Based on historical performance, stocks have a high yield and big fluctuations in annual rates of return; corporate bonds have a lower yield and much less variation; Treasury bills are the most predictable investment but provide the lowest return (see Table 3).

TABLE 3. ANNUAL TOTAL RETURNS ON VARIOUS FINANCIAL INSTRUMENTS, 1926-2005

Financial instrument	Rate of return	Standard deviation
Stocks	10.4%	20.2%
Long-term corporate bonds	5.9	8.5
Intermediate government bonds	5.3	5.7
U.S. Treasury bills	3.7	3.1
Inflation	3.0	4.3

Source: Ibbotson Associates (2006). Based on copyrighted works by Ibbotson and Sinquefield. All rights reserved. Used with permission.

Table 4 shows a breakdown by type of investment for both defined benefit and defined contribution plans.[6] Defined benefit plans appear to hold about 59 percent of assets in equities, compared to 35 percent for defined contribution plans.[7] But that is not the end of the story because mutual funds also reflect equity holdings, and mutual funds are a very important component of the assets of defined contribution plans. In 2005, roughly 78 percent of the mutual fund assets in 401(k) plans were equities.[8] Applying that percentage to both the defined benefit and defined contribution mutual fund numbers yields total equity holdings of 67 percent in defined benefit plans and 65 percent in defined contribution plans.

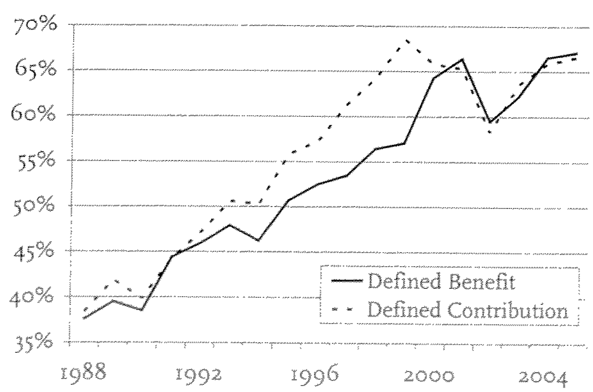
Table 4. Percentage Distribution of Assets in Private Sector Defined Benefit and Defined Contribution Plans, Year End 2005

Financial instrument	Defined benefit	Defined contribution
Equities	58.8%	35.2%
Mutual funds	10.6	38.5
Bonds	21.9	6.7
Cash	3.1	4.5
GICs	3.6	8.7
Other	2.0	6.4
Total	100.0	100.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

Figure 3 shows the percentage of the portfolios in equities for defined benefit and defined contribution plans over the period 1988-2005, where a portion of mutual funds are included in equities as described above. The higher share in equities for defined contribution plans in the late 1990s allowed 401(k) plans to outperform defined benefit plans. The reliance on equities also meant that 401(k) participants were hurt more when the stock market collapsed in 2000, and then did better when the stock market recovered.

Figure 3. Equities as a Percent of Total Portfolio, Defined Benefit and Defined Contribution Plans, 1988-2005



Sources: Authors' calculations from U.S. Board of Governors of the Federal Reserve System (2006); Investment Company Institute (2005); and Investment Company Institute (2006b).

One interesting aspect of Figure 3 is not the difference between the defined benefit and defined contribution portfolios, but the fact that both professional managers and individual 401(k) participants dramatically increased their holdings of equities over the period. If defined benefit portfolios were optimally balanced in the early 1990s with about 40 percent in equities, what would make 65 percent optimal by the end of the period? In the case of defined benefit plans, an aging beneficiary population would argue, if anything, for less equity investment. Some potential explanations include: 1) professional managers, like individual investors, forgot to re-balance; 2) professional managers, like individual investors, got swept up in the euphoria of the boom and purposely increased their holdings of stocks; 3) sponsors of fully funded defined benefit plans felt like they could gamble with their "surplus" funds; or 4) defined benefit managers wanted to hold the market portfolio and the boom caused equities to increase as a share of the total market. Regardless of the explanation, defined benefit and defined contribution plans both held 40 percent of their portfolios in equities in 1990 and increased their holdings to 65 percent by 2000. The difference is that during most of that period, individual 401(k) investors had higher equity holdings.

The Role of Fees

Another possible explanation for the lower return in defined contribution plans is investment fees, which typically account for 75 to 90 percent of total expenses associated with managing 401(k) plans.[9] These fees compensate providers of, say, mutual funds for selecting the stocks and undertaking the research that leads to buy and sell decisions. These fees are usually assessed as a percentage of invested assets, and are paid by the employee in that they are deducted directly from investment returns.[10]

Mutual funds are the major investment vehicle for 401(k) participants, and Table 5 reports the fees for alternative investments. The fees vary substantially depending on whether the investments are actively managed or follow an index. For example, an actively managed Global Fund costs 1.72 percent of assets annually compared to 0.59 percent for an S&P Index Fund. Given these charges, it is probably reasonable to assume that fees reduce the gross return on 401(k) plans by about one percentage point.

Of course, defined benefit plans also involve some expenses but these are small compared to those associated with 401(k) plans.[11]

Table 5. Mutual Fund Fees as a Percent of Assets, July 31, 2006

Category	Fee
Global Fund	1.72%
Equity Income Fund	1.33
Balanced Fund	1.22
Intermediate Bond Fund	0.92
S&P Index Fund	0.59
Institutional Money Market Fund	0.45

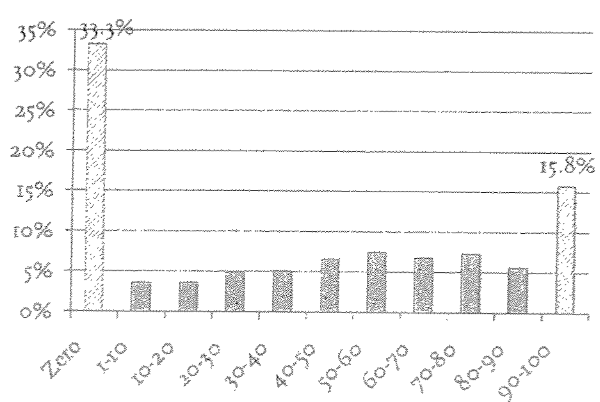
Source: Lipper (2006).

The Implications for Individual 401(k) Participants

So far the discussion has focused only on totals and averages, which tell us little about how individuals might invest. After all, if a plan has 100 participants and half invest all their assets in stocks and the other half all their assets in bonds, the aggregate data suggest that participants are well diversified when in fact they are not. Therefore, it is useful to look at investment data from particular 401(k) plans to see whether the individual participants have balanced portfolios or whether the balance simply reflects offsetting behavior.

As shown in Figure 4, detailed data on the asset allocation of individual participants show that nearly half of all participants have either none of their account in equities or virtually all of their account in equities. So even though the aggregate data suggest that participants make sensible investment choices on average, the individual data reveal that a majority of participants are not diversified at all. Given their choices, most participants face the risk of ending up with inadequate retirement income or exposing themselves to large swings in the value of their assets.[12] Thus, the one percentage point difference in returns between defined benefit and 401(k) plans understates the poor investment decisions made by individuals.

Figure 4. Equities as a Percent of 401(k) Participant Account Balances by Percent of Participants, 2005



Source: Holden and VanDerhei (2006).

Table 6. Asset Holdings and IRAs by Institution, Year End 2005

Institution	Percent of total
Mutual funds	39.0 %
Life insurance companies	11.1
Money market mutual funds	4.4
Commercial banking	4.6
Saving institutions	1.5
Credit unions	1.3
Other self-directed accounts	38.0
Total	100.0
Memorandum: total assets (billions)	$3,667.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

The Inclusion of IRAs

It has become impossible to ignore the role of IRAs. As shown earlier in Table 1, IRAs now hold more money than either defined benefit or defined contribution plans. And even though most IRAs are not sponsored by employers, the Investment Company Institute (2006b), the national association for mutual fund companies, reported that 94 percent of the money flowing into traditional IRAs was rolled over from employer-sponsored plans in the period 1997-2003.[13] Although detailed information is not available, it is probably reasonable to assume that most of the rollovers come from defined contribution plans — although lump-sum payments are becoming increasingly common in defined benefit plans.

Only limited information is available on the asset allocation in IRAs. The Flow of Funds data show only the type of institution holding the account, as opposed to the type of asset in the account (see Table 6). About 73 percent of the mutual fund assets — the largest component — are in stock.[14] But no information is available on the composition of IRA assets held by other institutions, which hold the majority of the assets.

The Investment Company Institute (2006a) provides data on beginning-year assets, year-end assets, contributions, rollovers, and withdrawals for traditional IRAs that make it possible to calculate the aggregate average return for the period 1998-2003. Table 7 summarizes these results and compares them to returns earned on defined benefit and 401(k) plans over the same period. If estimates of the flows into and out of IRAs are correct, the rate of return numbers suggest that IRA investments produced significantly lower returns than either defined benefit or 401(k) plans during the six-year period.[15] More important than the precise numbers, however, is the message that the performance of IRAs will have a significant impact on the retirement security of people in the future.

Table 7. Rate of Return for IRAs, Defined Benefit Plans and 401(k)s, 1998-2003

Year	IRA	Defined benefit	401(k)
1998	13.6 %	14.9 %	17.8 %
1999	15.7	15.5	13.1
2000	-6.0	1.8	-2.4
2001	-4.6	-5.1	-5.1
2002	-8.1	-8.9	-9.5
2003	12.1	21.2	19.4
1998-2003	3.8	6.6	5.6

Source: Authors' estimates based on Investment Company Institute (2006a).

Conclusion

Three main conclusions emerge from this review. First, defined benefit plans outperformed 401(k) plans over the period 1988-2004. This conclusion is most evident using the weighted median. A higher equity allocation most likely led to higher 401(k) returns during the 1990s, while fees inevitably reduced returns. These two effects may well have balanced each other out, leaving a one percentage point shortfall due to poor timing and other investment mistakes.

Second, lower returns are only one component of the investment problems facing 401(k) investors. The other is that despite a reasonable mix for 401(k) assets in the aggregate, nearly half of 401(k) participants are either nearly fully invested in stocks or hold no stocks at all. That is, nearly 50 percent of participants are not diversified in their retirement accounts. The combination of the lack of diversification and the lower returns suggests that introducing balanced portfolios as a default, which would remove the individual from the decision making, would significantly improve the performance of 401(k) plans.

Finally, IRAs are now bigger than either defined benefit or defined contribution plans, and their performance is going to have a major impact on retirement security in the future. Preliminary data suggest that IRAs underperform employer-sponsored plans. IRAs are too big and important a form of retirement saving to not know what is going on with these accounts. Some mechanism is needed to identify the asset allocations in these accounts as well as document the inflows and outflows. Only by including IRAs will it be possible to understand fully how well people are investing for retirement.

Endnotes

1 This formulation follows Watson Wyatt (2002 and 2003). Calculations for the entire universe of plans showed very similar results.

2 Including one half of contributions less benefits assumes that net inflows occur at an even rate over the year so that on average half the annual net inflows are available for investment. This assumption is necessary because the Form 5500 lacks detailed information on the timing of benefits and contributions over the year.

3 See Buessing and Soto (2006) for a detailed description of the Form 5500 data.

4 The median refers to the across-firm rates of return per year for defined benefit and defined contribution plans. The average returns shown are the arithmetic means of the median rates of return over the period 1988-2004. The geometric means do not differ widely from the arithmetic means calculated for the unweighted and weighted median rates of return. Appendix Table A1 shows the unweighted and weighted median rates of return as well as the arithmetic and geometric means.

5 For the 1990-2002 period, the results are similar to results from Watson Wyatt (2004) with defined benefit plans outperforming 401(k) plans. The difference in defined benefit and 401(k) returns is 0.35 percent while Watson Wyatt showed a difference of 0.56 percent for this period. The improved performance of 401(k)s over the 1988-2004 period comes simply from adding four more years of data to what was a very close outcome.

6 Separate data on 401(k) plans are not available on a comparable basis. But in 2004, 401(k) assets accounted for 88 percent of total private sector defined contribution assets for plans sponsored by employers with 100 or more employees. See Munnell and Perun (2006).

7 Since most 401(k) participants invest through mutual funds, the high number for "Equities" for defined contribution plans (that is, direct equity holdings as opposed to equities held through mutual funds) in Table 4 is surprising. The explanation is that "Equities" include pools of stocks that companies set up themselves for their 401(k) plans; only mutual funds bought off the shelf are included in the mutual fund line. The other large category of direct equity holdings is employer stock. The final category of direct equity investment arises from a relatively small percentage of 401(k) participants who invest directly through brokerage accounts.

8 Investment Company Institute (2006a).

9 Munnell and Sundén (2004).

10 Fees are generally not explicitly reported in the Form 5500. See U.S. Department of Labor (2004).

11 Council of Institutional Investors (2005).

12 Of course, critics contend that assessing individuals' 401(k) holdings without knowing their entire asset holdings is of limited value. They argue that most people who save through a 401(k) plan also have Social Security, human capital, defined benefit pension wealth, housing, and taxable savings. But for most people taxable savings are miniscule, and their 401(k) plan is their major financial asset. Thus the investment allocation within their 401(k) plan is important.

13 In 2005, assets in traditional IRAs accounted for 90 percent of total IRA assets. This share was down slightly from 95 percent in 1997.

14 Investment Company Institute (2006a).

15 One likely explanation for the lower returns in IRAs is that IRAs are often held by older workers who have rolled over their 401(k) assets. Older workers tend to invest in assets with lower returns to avoid the potentially large fluctuations that are associated with riskier investments.

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APPENDIX

Appendix A

Table A1. Unweighted and Weighted Median Rates of Return for Defined Benefit and 401(k) Plans, 1988-2004

Year	Unweighted		Weighted	
	Defined benefit	401(k)	Defined benefit	401(k)
1988	9.8	10.1	12.4	12.7
1989	12.0	11.3	19.1	13.7
1990	4.2	5.7	1.0	5.2
1991	15.4	13.1	20.6	13.7
1992	7.1	7.7	6.8	8.5
1993	8.0	8.2	11.9	9.2
1994	0.0	2.3	0.3	3.2
1995	19.6	17.8	23.7	19.3
1996	12.6	12.9	15.0	15.4
1997	16.3	17.4	19.0	19.6
1998	12.1	14.6	14.9	17.8
1999	10.6	12.4	15.5	13.1
2000	-0.3	-4.9	1.8	-2.4
2001	-4.4	-7.1	-5.1	-5.1
2002	-8.2	-11.7	-8.9	-9.5
2003	16.7	19.4	21.2	19.4
2004	9.3	9.7	12.5	10.5
Arithmetic Mean	8.3	8.2	10.7	9.7
Geometric Mean	8.0	7.8	10.2	9.3

Source: Authors' calculations from U.S. Department of Labor (1990-2006).

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The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and forge a strong link between the academic community and decision makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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Alaska Division of Retirement and Benefits

Public Employees' Retirement System (PERS) Plan Comparison Chart

Feature	Tier I 1/1/61 - 6/30/86	Tier II Entered on or after 7/1/86	Tier III Entered on or after 7/1/96	Tier IV Entered on or after 7/1/06
Employee Contribution	Pre-tax employee contribution: 6.75% beginning 1/1/87—all others 7.5% beginning 1/1/87—police and fire 9.6% beginning 7/1/99—school district	Pre-tax employee contribution: 6.75% beginning 1/1/87—all others 7.5% beginning 1/1/87—police and fire 9.6% beginning 7/1/99—school district	Pre-tax employee contribution: 6.75% beginning 1/1/87—all others 7.5% beginning 1/1/87—police and fire 9.6% beginning 7/1/99—school district	Pre-tax employee contribution: 8% all employees Employee may make additional contributions.
Employer Contribution	Determined by annual actuarial valuation.	Determined by annual actuarial valuation.	Determined by annual actuarial valuation.	5% DC Account 1.75% Health Plan - determined by annual actuarial valuation after FY07. HRA - Flat dollar amount per employee based on 3% of the employer's average annual employee compensation. .4% Disability - P/F .3 All others
Vesting	Members vest with 5 years of service.	Members vest with 5 years of service.	Members vest with 5 years of service.	100% vested in employee contributions from inception. Vested in employer contributions based on the following schedule: 25% after 2 years of service, 50% after 3 years, 75% after 4 years and 100% after five years.
Qualifications for Retirement	Normal retirement age is 55, with early retirement at age 50; police/fire members can retire at any age after 20 years of police/fire service; all other members can retire at any age after 30 years of membership service. Early retirement reduction will be 1/2% per month or 6% per year for every year less than the required normal retirement age.	Normal retirement age is 60, with early retirement at age 55; police/fire members can retire at any age after 20 years of police/fire service; all other members can retire at any age after 30 years of membership service. Early retirement reduction will be 1/2% per month or 6% per year for every year less than the required normal retirement age.	Normal retirement age is 60, with early retirement at age 55; police/fire members can retire at any age after 20 years of police/fire service; all other members can retire at any age after 30 years of membership service. Early retirement reduction will be 1/2% per month or 6% per year for every year less than the required normal retirement age.	None for investment account. Taxes and penalties may apply if withdrawn before age 59-1/2. See requirements for Retirement Medical Coverage.
Benefit Calculation Formula	Benefit formula is 2% for first 10 years **and all years of service prior to July 1, 1986,** 2.25% for the next 10 years, 2.5% per year thereafter. Benefit calculation is determined on the average of the high three consecutive years' salary. Police/Fire - 2% X 10, 2.5% over 10.	Benefit formula is 2% for first 10 years, 2.25% for the next 10 years, and 2.5% per year thereafter. Benefit calculation is determined on the average of the high three consecutive years' salary. Police/Fire - 2% X 10, 2.5% over 10.	Benefit formulas did not change; however, the benefit calculation is determined on the average of the high **five** consecutive years' salary. The benefit calculation for police and fire members is the average of the high **three** consecutive years regardless of tier (effective 2002).	DC account balance plus investment earnings. May be received in several different payment options. Payout options include lump sum payments, rollovers to another qualified plan, or annuities. Annuities may be taken as a lifetime annuity, joint and survivor annuity, or for a period certain.
Alaska Cost-of-living Increases (COLA)	An Alaska Cost-of-Living Allowance is payable to benefit recipients who remain domiciled in Alaska after retirement. The allowance is $50 or 10% of the base benefit, whichever is greater.	An Alaska Cost-of-Living Allowance is payable to benefit recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. The allowance is $50 or 10% of the base benefit, whichever is greater.	An Alaska Cost-of-Living Allowance is payable to benefit recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. The allowance is $50 or 10% of	None provided.

More detailed information may be found on the Division website, www.state.ak.us/drb, or in the PERS Information Handbook.

*Credited service includes all service used in the calculation of a retirement benefit.

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Feature	Tier I 1/1/61 - 6/30/86	Tier II Entered on or after 7/1/86	Tier III Entered on or after 7/1/96	Tier IV Entered on or after 7/1/06
			the base benefit, whichever is greater.	
Post Retirement Pension Adjustments (PRPA) (Inflation Protection)	PRPA increases granted on an ad hoc basis. If an ad hoc is not granted, tier I employees must be age 60 or over or receiving benefits for 5 years to qualify for the automatic PRPA. The automatic PRPA legislated in 1986 applied to all members regardless of hire date.	Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 5 years.	Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 5 years.	None provided.
Retirement Medical Coverage	Medical coverage is provided to all benefit recipients and their eligible dependents. The retiree medical plan premium is paid by the retirement system.	Medical coverage is provided to disabilitants, regardless of age and benefit recipients over age 60 or • Peace officer/fire members with 25 years of police/fire service • all other members with 30 years of membership service and their eligible dependents. The retirement system pays the retiree medical plan premium. Retirees and survivors under age 60 must pay the full premium cost if they want coverage.	Same as Tier II. However, employees must accrue a minimum of 10 years of **credited service***, to have system-paid coverage at age 60. Employees with less than 10 years must pay the full premiums as long as they wish to continue medical coverage.	Access to medical coverage at Medicare eligible age with 10 years of service or at any age with 25 years of service for peace officers and firefighters or with 30 years of service for all others. Must retire directly from the system. If not eligible for Medicare, must pay full premium. May use health reimbursement arrangement (HRA) account to pay premiums. Once the HRA is exhausted, member self- pays premiums. When eligible for Medicare, the percentage of premium paid by the retiree or surviving spouse is: 10-14 years of service - 30% 15-19 years - 25% 20-24 years - 20% 25-29 years - 15% 30 years or more - 10%
Disability Benefits	Disability benefits for members: nonoccupational disability benefits are calculated as a normal retirement. Occupational disability provides 40% of the gross monthly compensation. Different occupational disability formula available before 7/1/76.	Disability benefits for members: nonoccupational disability benefits are calculated as a normal retirement. Occupational disability provides 40% of the gross monthly compensation.	Disability benefits for members: nonoccupational disability benefits are calculated as a normal retirement. Occupational disability provides 40% of the gross monthly compensation.	Must be a total and presumably permanent disability whose cause is directly related to performance of duties of the job or an on the job injury. Benefit is 40% of salary, earns service while on occupational disability. Employer continues to make all required contributions as if the member were working, plus the member's required contributions to the DC account, without deduction from the member's disability payment. Disability benefits cease when the member becomes eligible for normal retirement at Medicare eligible age and 10 years of service or at any age with 25 years of service for peace officers and firefighters or with 30 years of service for all others. Medical insurance is available to members receiving disability when member is eligible for a normal retirement.

More detailed information may be found on the Division website, www.state.ak.us/drb, or in the PERS Information Handbook.

*Credited service includes all service used in the calculation of a retirement benefit.

Alaska Division of Retirement and Benefits

Teachers' Retirement System (TRS) Plan Comparison Chart

Feature	Tier I July 1, 1955 – June 30, 1990	Tier II Entered on or after July 1, 1990	Tier III Entered on or after July 1, 2006
Employee Contribution	Pre-tax employee contribution: 8.65% beginning 1/1/91	Pre-tax employee contribution: 8.65% beginning 1/1/91	Pre-tax employee contribution: 8% Employee may make additional contributions.
Employer Contribution	Determined by annual actuarial valuation.	Determined by annual actuarial valuation.	7% - DC account 1.75% Health Plan - determined by annual actuarial valuation after FY07. HRA - Flat dollar amount per employee based on 3% of the employer's average annual employee compensation.
Vesting	Members vest with 8 years of service.	Members vest with 8 years of service.	100% vested in employee contributions from inception. Vested in employer contributions based on the following schedule: 25% after 2 years of service, 50% after 3 years, 75% after 4 years and 100% after five years.
Qualifications for Retirement	Normal retirement age is 55, with early retirement at age 50; teachers can retire at any age after 20 years of membership service.	Normal retirement age is 60, with early retirement at age 55; teachers can retire at any age after 20 years of membership service.	None for investment account. Taxes and penalties may apply if withdrawn before age 59 1/2. See requirements for Retirement Medical Coverage.
Benefit Calculation Formula	Benefit formula is 2% for the first 20 years **and all years of service prior to July 1, 1990**, 2.5% thereafter. Benefit calculation is determined on the average of the high three contract salaries.	Benefit formula is 2% for the first 20 years, 2.5% thereafter. Benefit calculation is determined on the average of the high three contract salaries.	DC account balance plus investment earnings.
Alaska Cost-of-living Increases (COLA)	An Alaska Cost-of-Living Allowance is payable to benefit recipients who remain domiciled in Alaska after retirement. The allowance is 10% of the base benefit.	An Alaska Cost-of-Living Allowance is payable to benefit recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. The allowance is 10% of the base benefit.	None provided.

More detailed information may be found on the Division website, www.state.ak.us/drb, *or in the TRS Information Handbook.*

Feature	Tier I July 1, 1955 – June 30, 1990	Tier II Entered on or after July 1, 1990	Tier III Entered on or after July 1, 2006
Post Retirement Pension Adjustments (PRPA) (Inflation protection)	PRPA increases granted on an ad hoc basis. If an ad hoc is not granted, tier I employees must be age 60 or over or receiving benefits for 8 years to qualify for the automatic PRPA. The automatic PRPA legislated in 1990 applied to all members regardless of hire date.	Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 8 years.	None provided.
Retirement Medical Coverage	Medical coverage is provided to all benefit recipients and their eligible dependents. The retiree medical plan premium is paid by the retirement system.	The retirement system pays the retiree medical plan premium for all disabilitants regardless of age, for retirees and survivors over age 60 and for retirees with at least 25 years of membership service. This coverage includes eligible dependents. Retirees and survivors under age 60, with less than 25 years of membership service must pay the full premium cost if they want coverage.	Access to medical coverage at Medicare eligible age with 10 years of service or at any age with 30 years of service. Must retire directly from the system. If not eligible for Medicare, must pay full premium. May use health reimbursement arrangement (HRA) account to pay premiums. Once the HRA is exhausted, member self- pays premiums. When eligible for Medicare, the percentage of premium paid by the retiree or surviving spouse is: 10-14 years of service - 30% 15-19 years - 25% 20-24 years - 20% 25-29 years - 15% 30 years or more - 10%
Disability Benefits	Disability benefits are 50% of base salary, plus 10% for each eligible dependent child up to a maximum of 4 children.	Disability benefits are 50% of base salary, plus 10% for each eligible dependent child up to a maximum of 4 children.	Must be a total and presumably permanent disability whose cause is directly related to performance of duties of the job or an on the job injury. Benefit is 40% of salary, earns service while on occupational disability. Employer continues to make all required contributions as if the member were working, plus the member's required contributions to the DC account, without deduction from the member's disability payment. Disability benefits cease when the member becomes eligible for normal retirement at Medicare eligible age and 10 years of service or at any age with 30 years of service. No medical insurance until eligible for normal retirement.

More detailed information may be found on the Division website, www.state.ak.us/drb, *or in the TRS Information Handbook.*

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February 9, 2009

The Honorable Joe Paskvan, Chair
Senate Labor and Commerce Committee
Alaska State Capitol, Room 7
Juneau, AK 99801-1182

RE: SB 23 (Elton)--Support

Dear Chair Paskvan:

On behalf of the members of AARP in Alaska, we encourage you and your colleagues on the Senate Labor and Commerce Committee to support SB 23, authored by Senator Kim Elton and co-sponsored by Senators Ellis, French, Menard, Thomas, McGuire, Davis, Wielechowski and you.

Lifetime financial security is a cornerstone of the American dream: if you work hard and follow the rules, you will be able to retire without financial worries. For most Alaskans, Social Security forms the base of a secure retirement and it is augmented by pensions, IRA's, 401-K's and savings. However few of our teachers or state and municipal employees participate in Social Security. Our defined benefit pensions under TRS and PERS were a stable substitute for Social Security. You cannot outlive Social Security. You cannot outlive a defined benefit pension.

Alaskans who make it to 65 have to prepare financially for a long time in retirement. Of all the women who reach age 65, 29% will also reach age 90. Eighteen percent of men who reach age 65 will also reach age 90.

Our newly hired public employees will only have the defined contribution plan. What will Alaska do with retired teachers, police officers and firefighters who outlive their contributions and have no defined benefit plan under PERS or TRS and do not participate in Social Security?

SB 23 will return to a system that will provide reasonable pension benefits that cannot be outlived.

We urge an "AYE" vote on SB 23.

Should you have any questions about our position, please feel free to contact me (586-3637) or Patrick Luby, AARP Advocacy Director (907-762-3314).

Thank you for your consideration.

Sincerely,

Marie Darlin

Marie Darlin, Coordinator
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CC: Vice-Chair Joe Thomas
Senator Bettye Davis
Senator Kevin Meyer
Senator Con Bunde
Senator Kim Elton