HOUSE FINANCE COMMITTEE
April 12, 2006
1:48 p.m.

CALL TO ORDER

Co-Chair Meyer called the House Finance Committee meeting to order at 1:48:07 PM.

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair
Representative Kevin Meyer, Co-Chair
Representative Bill Stoltze, Vice-Chair
Representative Mike Hawker
Representative Jim Holm
Representative Reggie Joule
Representative Mike Kelly
Representative Beth Kerttula
Representative Carl Moses
Representative Bruce Weyhrauch

MEMBERS ABSENT

Representative Richard Foster

ALSO PRESENT

Representative Paul Seaton; Katie Shows, Staff, Representative Paul Seaton; Melanie Millhorn, Director, Division of Retirement and Benefits, Department of Administration; Virginia Ragle, Assistant Attorney General, Labor and State Affairs, Department of Law; Jim Duncan, Alaska State Employees Association; Tom Harvey, Executive Director, NEA-Alaska; Representative Ethan Berkowitz; Representative John Harris

PRESENT VIA TELECONFERENCE

Nancy Duez, Fairbanks Education Association, Fairbanks

SUMMARY

HB 475 "An Act describing contributions to the health reimbursement arrangement plan for certain teachers and public employees; clarifying eligibility for membership in that health reimbursement arrangement plan; relating to the 'administrator' of the Public Employees' Retirement System of Alaska; and providing for an effective date."

HB 475 was heard and HELD in Committee for further consideration.

HB 399 "An Act establishing the office of elder fraud and assistance; and relating to fraud involving older Alaskans."

HB 399 was POSTPONED to a later date.

HB 470 "An Act relating to the mandatory use of motor vehicle headlights."

HB 470 was POSTPONED to a later date.

1:48:12 PM

HOUSE BILL NO. 475

"An Act describing contributions to the health reimbursement arrangement plan for certain teachers and public employees; clarifying eligibility for membership in that health reimbursement arrangement plan; relating to the 'administrator' of the Public Employees' Retirement System of Alaska; and providing for an effective date."

REPRESENTATIVE PAUL SEATON, sponsor of HB 475, referred to the revisions in the sponsor statement throughout his testimony (copy on file.) He addressed Number 6: "Clarifies requirements for non-vested Tier II or Tier III employees who wish to transfer to Tier IV." It establishes a 12-month window with an extension for another 12 months. A transferee would have to pay for their previous years before they could count those years for a defined benefits plan.

Representative Kerttula asked for information about buying back time for someone that wants to transfer into a defined contribution plan.

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Representative Seaton explained that there are two elements. One is someone coming back into the system. Someone who was employed and had left the system would have to initiate a buy back before 2010. The conversion from the defined benefits plan to the defined contribution plan is only for people who are not vested. The employer must make a selection, but first must get an accounting of the person's liability. It is a liability on employers.

Representative Kerttula commented that the employer has to approve of the transfer. Representative Seaton said that is correct - the employer must make a selection.

1:53:23 PM

Representative Seaton addressed revision Number 7: "Clarifies the basis for calculation employer contribution rates."

KATIE SHOWS, STAFF, REPRESENTATIVE PAUL SEATON, explained this revision. The contribution rates have all been previously calculated on the entire wage base. With the adoption of a Tier IV, employees do not have the past service cost associated with them. This language clarifies that the past service cost rate that will be applied to the employer, will be applied to the entire wage base, which means it will include the salaries of both defined contribution and defined benefit employees. It is the same dollar amount as the past service cost. She termed it an accounting procedure. Representative Seaton added that it would amortize the employer's past service cost rate over a period of 25 years.

1:55:39 PM

Representative Seaton addressed Number 8: "Gives regulatory authority to the appropriate party." He related that it reassigns authority to the commissioner.

Representative Seaton briefly addressed Number 9: "Changes the basis for calculation HRA employer contributions to meet IRS tax qualifications." It would be 3 percent of the average wage across all employer groups. Everyone gets exactly the same contribution rate. Number 10 addresses changes to definitions.

Representative Seaton read Number 11: "Disallows employment with NEA as counting towards Tier IV retirement eligibility."

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Number 12: "Establishes provisions for employer termination of participation in the plan." Currently an employer can terminate from the defined benefit program, which was an omission from SB 141.

Number 13: "Clarifies defined benefit and defined contribution components of the plan." Number 14: "Establishes adherence to IRS limitations." Those limitations are maximum amounts that can be contributed by an individual. They could also apply to someone who is converting from a defined benefits plan to a defined contribution plan.

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Representative Seaton referred to a memorandum regarding the differences between Version I, which is what came out the State Affairs Committee and Version L. The difference between S and L is drafting errors. He noted that the Ice Miller study helped to make sure everything was IRS compliant. He mentioned the sectionals available to read.

Co-Chair Meyer noted that all of that information is in members' packets.

1:59:28 PM

Representative Weyhrauch asked about the intent of the bill regarding employers in over-funded status. Representative Seaton stated his intent that Sections 3, 38, 77, 79, and 80 apply only to employers that are over funded. The applications of these sections would not legally allow employers funding status to drop below 100 percent. Representative Weyhrauch said that addresses it and an amendment is not needed.

Representative Weyhrauch asked about a letter ruling by the IRS. He noted that the analysis on page 3 indicates that if the amendment is not adopted, the IRS may not recognize and apply the special rules of the Section 414 K structure, which may result in an IRS plan determination failure. He asked for clarification. Representative Seaton explained that after a plan is in place there will be a review by the IRS to determine compliance. Representative Weyhrauch said that runs contrary to what the Division says. He suggested that the Division elaborate on this section.

2:02:18 PM

Representative Kerttula asked if an employer opts out of the defined contribution plan, what happens to employees. She wondered if they would have to seek social security. Representative Seaton responded that if an employee opts out, employees immediately become vested in the plan. He suggested the Department of Retirement and Benefits speak to that issue. Representative Kerttula noted that this applies only to municipalities and the state cannot opt out. Representative Seaton said that is his understanding.

2:04:04 PM

MELANIE MILLHORN, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, addressed Representative Weyhrauch's question about the Division requiring rulings by the IRS in order to implement SB 141 on July 1, 2006. She said the answer is no, but the Division has worked closely with Ice Miller, a legal tax advisor, in order to conform to IRS rulings. The Division is working to obtain plan determination letters and private letter

rulings as a result of incorporating these provisions found in HB 475. It takes time for the IRS to provide those. She emphasized that the Division does not need any rulings right now.

Representative Kerttula restated her question about what happens to employees if the employer opted out of the defined contribution plan. Ms. Millhorn responded that they would have to have some type of retirement or pension system in place, or social security could also satisfy that.

Ms. Millhorn commented that the plan provisions need to be adopted, and the bill needs to pass out of committee and become enacted by the legislature in order to avoid a plan determination failure.

2:08:28 PM

Co-Chair Meyer asked what would happen if the bill does not pass this session. He wondered if it could be passed retroactive to July 1, 2006. Ms. Millhorn replied that there would be a number of adverse effects. The death and disabilities benefits in Sections 73 and 77 would not be funded properly because employers would not be funding them. Entitlement disputes would arise. Co-Chair Meyer said his concern is that this would go into effect July 1 and there could be something wrong with it. He wondered if an error could be fixed retroactively or if it would be better to postpone the effective date.

Ms. Millhorn saw no advantage to postponing the bill. She stressed that the changes encompassed in HB 475 address all of the issues for proper implementation.

VIRGINIA RAGLE, ASSISTANT ATTORNEY GENERAL, LABOR AND STATE AFFAIRS, DEPARTMENT OF LAW, reported about survivor benefits not being allowed under federal tax codes if this is not changed on July 1. The constitution does not allow for those benefits to be changed.

2:12:37 PM

Representative Hawker recalled that the same thing was said this time last year when he suggested that the plan would not qualify. It did not undergo a judicious review. He pointed to eleven statements regarding failure to comply with IRS determinations. He noted two statements regarding no funding source for benefits if the bill does not pass. He expressed concern and suggested deferring the effective date pending a legal review.

Ms. Millhorn responded that these provisions passed last session are unique in the sense that this is a hybrid plan. The legislature has conferred fixed and guaranteed benefits

for both the defined contribution plan and the defined benefits plan. Last year it was noted that if there were a defined benefit benefit, there would be challenges associated with it. She related the legal tax review that has been done by Ice Miller. Due diligence was completed and every issue was identified. The Department of Administration is comfortable with the bill. Representative Hawker stressed that benefits should not be conferred until the complexities and consequences of the bill are understood.

2:17:45 PM

Representative Kerttula referred to Section 16, survivor benefits. She wondered if the individual contribution would be received when the pension runs out.

Ms. Ragle responded that the way it is structured now, that is taken into account. A new survivor benefit is being setup in lines 12-23, based on advice by legal council, to make it a true hybrid plan, which would comply with the tax code.

2:20:54 PM

Representative Kerttula pointed out that it is called a pension. She wondered if that is the benefit. She asked about employer contributions. Ms. Ragle replied that contributions would have to be made by the employer on behalf of the employee. Representative Kerttula summarized that after the survivor pension is gone, the other account is used. Ms. Ragle agreed.

Representative Kerttula asked if there are changes in occupational disability. Ms. Ragle replied that it is slightly different in that it includes the concept that if comparable employment is available outside of PERS, that would also result in the end of occupation disability benefits. Representative Kerttula asked if comparable work were available, a person would not have to go off of benefits. She wondered if the new change is more of a bright line. Ms. Ragle said she does not know if it is a bright line, but it fits the Division's definition of when occupation disability benefits should end.

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Ms. Millhorn provided an example of an Alaska Supreme Court decision, the Morton Case, where a person receiving disability benefits received a higher PERS disability benefit. Representative Kerttula requested a copy of the case.

2:25:21 PM

Representative Kerttula inquired about Section 40 of the new CS where "credited service" is not creditable under the section. She asked what that applies to. Ms. Ragle replied that in last year's bill, SB 141, a number of provisions were removed. This one was not caught. It has to do with reinstatement of service that is being taken out, effective in 2010. Representative Kerttula asked if Ms. Ragle agreed with Representative Seaton's statements about reinstatement payments begun before 2010. Ms. Ragle said yes.

2:27:39 PM

NANCY DUEZ, FAIRBANKS EDUCATION ASSOCIATION, FAIRBANKS, expressed confusion about the bill. She emphasized that it is too important an issue to rush. She said implementation in 11 weeks is too short. She asked for a delay of SB 141 so that many questions could be answered. She questioned if vested employees could become eligible for social security because they would then come under the social security windfall elimination provision in government pension offset.

2:30:11 PM

TOM HARVEY, EXECUTIVE DIRECTOR, NEA-ALASKA, noted he has provided written testimony (copy on file). He pointed to an error on page 2, line 3, of HB 475 regarding what assumptions will be used. He suggested that AS 24.08.036 places a specific burden on the legislative body. He questioned if the burden has been met. He maintained that employer rates for past service costs will continue to rise as amortized liability is applied to a shrinking payroll paid to members of the defined benefits plan. He suggested that an increased liability has been created. He suggested amending HB 475 by delaying implementation until July 1, 2008.

Mr. Harvey spoke of his recent experience going through the IRS determination process. He suggested getting it right before implementing, instead of implementing and then going through a process with the IRS. His company applied for a voluntary compliance process with the IRS, which took almost two years. He suggested that the proposal to delay until 2008 the effective date of the provision in SB 141 that establishes a floor on employer contributions, does not add liability to the claims or to the taxpayers. These are unfunded plans, so some employers have overpaid and some have underpaid. If the date is delayed, those who have underpaid don't have to meet minimum contributions, and liability of the plan is increased. He suggested looking at a method for extension for those who have overpaid, and having the rest pay a minimum rate.

2:36:03 PM

Mr. Harvey spoke to the death and disability issue. He was surprised that the benefits were not the same as the defined benefits plan. He termed it a faulty decision. He suggested that last year the same benefits were planned for police and firefighters as those in the present plan. The sponsor indicated that there would be no policy changes.

Mr. Harvey sought clarification about the calculation of employer contribution rates. He wondered why past service cost rate escalating to over 100 percent is a problem. SB 141 changed the way the ad hoc post retirement pension adjustment is awarded. It requires that the funds reach 105 percent.

Mr. Harvey noted that he raised other questions in his written testimony. He observed that he supports the section that addresses NEA because it no longer qualifies as a TRS or PERS employer. NEA now provides its own retirement system. He said that NEA Alaska's criticism is not a reflection of the sponsor. If the sponsor had been given time to develop HB 238 last year, it could have led to a hybrid plan that met approval. He requested that HB 475 be amended to delay the implementation of SB 141 until July 1, 2008.

2:41:56 PM

Co-Chair Chenault inquired if NEA was in favor of taking NEA out of the bill because it has its own plan. Mr. Harvey replied that NEA was covered by a defined benefits plan for many years and is now covered by a defined contribution plan. The employees have requested to go back to a defined benefits plan, but cost was too high. They regret the decision to go to a defined contribution plan. He added that NEA's staff is far more highly compensated than PERS employees are.

2:43:12 PM

JIM DUNCAN, ALASKA STATE EMPLOYEES ASSOCIATION, stated opposition to the defined contribution plan. He addressed the question of the IRS determination. He said he heard Ms. Millhorn say that a plan determination failure would have a major adverse impact on plan participants. He opined that one cannot pre-judge what the IRS will say about the defined contribution plan compliance. He spoke of his background with taxes and financial planning. He warned that you never know what an IRS determination will be. He concurred that in July of 06, a contribution plan not in compliance will have major adverse impacts. He encouraged a later effective date of at least a year. It may take a year to get a final determination.

2:47:44 PM

Representative Kerttula asked what happens when there is a plan determination failure by the IRS. Mr. Duncan replied if members are not in compliance, then employer/employee contributions would both be taxable. That would be a major impact on plan participants and on future retirement benefits.

2:49:08 PM

Representative Weyhrauch pointed out that last year there was an issue about long and short-term costs to the state. He wondered if the fiscal note analysis in the bill is legally sufficient.

2:50:58 PM

Ms. Ragle said it complies with statutory requirements.

Representative Weyhrauch termed the IRS a “black hole”. He suggested an amendment stating if the plan is not in compliance with the IRS then the effective date would be deferred to a later date until they do comply. Ms. Ragle responded that if the plan goes into effect on July 1, it is hard to understand how that amendment would have effect. Representative Weyhrauch read the rest of the amendment that said that employees hired after June 30, 2006 would be considered hired only if Section A becomes a reality. If IRS issues a non-compliance ruling, those employees would be covered. Ms. Ragle said there still could be vesting problems in the defined contribution plan from those who have rights under that plan that they don’t want to relinquish. Representative Weyhrauch said the key question is how to address the IRS risk.

2:53:48 PM

Representative Kerttula suggested that the plan could be contingent upon favorable ruling by the IRS. Ms. Ragle replied that the effective date would have to be delayed for that to work. Representative Kerttula agreed that it could be delayed until the ruling from the IRS.

Representative Kelly suggested notifying new employees of the possible risks and the pending IRS ruling, and not delaying the bill.

2:56:36 PM

Ms. Duez restated her question regarding employees’ ineligibility for social security when an employer opted out. Alaska is a non-social security state and as of July 1, will be the only non-social security state with a defined

contribution system. She asked what the impact on employees would be.

Ms. Millhorn responded that now, under the defined benefits plan, employees are subject to the windfall elimination provision and the government pension offset. Once they leave they are still subject to these provisions. If they worked for an employer that participates in social security, they would continue to earn benefits under social security.

Ms. Duez hoped that this concern is being addressed. She wished for more clarification when the employer decides not to participate. Ms. Millhorn said she would call Ms. Duez and discuss it further.

3:00:24 PM

Co-Chair Chenault asked for the results of that conversation to be shared with the committee.

Ms. Millhorn noted that the Division has received expert tax advice. She addressed what would happen if this plan does not work. It would result in a plan qualification failure. At that point remedies would be worked out with the IRS to correct those issues. She expressed confidence in proceeding because of the excellent legal advice the Division has received.

HB 475 was heard and HELD in Committee for further consideration.

3:02:24 PM

HOUSE BILL NO. 399

> "An Act establishing the office of elder fraud and assistance; and relating to fraud involving older Alaskans."

HB 399 was postponed to a later date.

HOUSE BILL NO. 470

> "An Act relating to the mandatory use of motor vehicle headlights."

HB 470 was POSTPONED to a later date.

ADJOURNMENT

The meeting was adjourned at 3:02 PM.