

**ALASKA STATE LEGISLATURE
HOUSE STATE AFFAIRS STANDING COMMITTEE**

February 15, 2005

8:05 a.m.

MEMBERS PRESENT

Representative Paul Seaton, Chair
Representative Carl Gatto, Vice Chair
Representative Jim Elkins
Representative Bob Lynn
Representative Jay Ramras
Representative Berta Gardner
Representative Max Gruenberg

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Mike Kelly

COMMITTEE CALENDAR

EXECUTIVE ORDER 113

- HEARD AND HELD

OVERVIEW(S): DEPARTMENT OF ADMINISTRATION: DIVISION OF
RETIREMENT AND BENEFITS Tier IV PERS/Tier III TRS

- HEARD

PREVIOUS COMMITTEE ACTION

Executive Order 113: See House State Affairs minutes from
2/8/05

WITNESS REGISTER

MELANIE MILLHORN, Director
Division of Retirement & Benefits
Department of Administration
Juneau, Alaska

POSITION STATEMENT: Co-presented an overview [continued from 2/1/05] of the division's proposed Tier IV PERS/Tier III TRS, on behalf of the Department of Administration.

BOB REYNOLDS

Mercer Human Resource Consulting

No address provided

POSITION STATEMENT: Co-presented an overview [continued from 2/1/05] of the division's proposed Tier IV PERS/Tier III TRS, on behalf of the Department of Administration.

KEVIN BROOKS, Deputy Commissioner

Office of the Commissioner

Department of Administration

Juneau, Alaska

POSITION STATEMENT: Answered questions on behalf of the administration during the overview of the proposed Tier IV PERS/Tier III TRS.

KATHY LEA, Retirement Manager

Division of Retirement & Benefits

Department of Administration

Juneau, Alaska

POSITION STATEMENT: Answered questions on behalf of the division during the overview of the proposed Tier IV PERS/Tier III TRS.

JOSEPH M. BEEDLE, Vice President for Finance

Office of Finance

University of Alaska, Fairbanks

Fairbanks, Alaska

POSITION STATEMENT: Testified on behalf of the university during the overview of the proposed Tier IV PERS/Tier III TRS.

JIM JOHNSEN, Vice President for Faculty and Staff Relations

University of Alaska

Fairbanks, Alaska

POSITION STATEMENT: Testified on behalf of the university and answered questions related to the Optional Retirement Program (ORP) during the overview of the proposed Tier IV PERS/Tier III TRS.

ACTION NARRATIVE

CHAIR PAUL SEATON called the House State Affairs Standing Committee meeting to order at [8:05:54 AM](#). Present at the call to order were Representatives Elkins, Lynn, Gardner, Gruenberg,

and Seaton. Representatives Gatto and Ramras arrived as the meeting was in progress.

EXECUTIVE ORDER 113

CHAIR SEATON announced that the first order of business was Executive Order 113.

CHAIR SEATON explained that the committee has before it two work drafts that address the inclusion of the legislative branch's telecommunications under the auspices of the Department of Administration.

8:06:41 AM

REPRESENTATIVE GARDNER moved that the committee [place before it] work draft Version 24 LS 0464\A. There being no objection, Version 24 LS 0464\A was before the committee.

8:07:07 AM

CHAIR SEATON explained the differences between the two work drafts.

8:08:31 AM

CHAIR SEATON, in response to a question from Representative Lynn, clarified that the version before the committee [exempts] the legislature [from EO 113]. If anyone, during the hearing of the bill, wishes to also exempt the Alaska Permanent Fund Corporation and Alaska Housing Finance Corporation, he/she could do so through an amendment at a later date.

8:09:12 AM

REPRESENTATIVE GRUENBERG asked if the railroad is also included "under the executive order."

8:09:21 AM

CHAIR SEATON said his staff will find out the answer to that question. He said, "Neither one of these [work drafts] mentions the Alaska railroad." In response to Representative Elkins, he clarified that existing law exempts the railroad and neither one of the suggested work drafts would change that.

OVERVIEW(S)

DEPARTMENT OF ADMINISTRATION

8:10:46 AM

CHAIR SEATON announced that the next order of business was the overview from the Department of Administration regarding the Public Employees' System (PERS) and its proposed Tier IV and the Teachers' Retirement System (TRS) and its proposed Tier III.

8:11:50 AM

MELANIE MILLHORN, Director, Division of Retirement & Benefits, Department of Administration, presented a continuation of the overview which was begun on 2/1/05. She directed attention to two handouts [included in the committee packet]: One is [titled, "State of Alaska PERS & TRS Proposals House State Affairs, previously referred to during the House State Affairs Standing Committee's 2/1 meeting] and the other is [titled, "Alaska Legislative Report, Response to Questions from House State Affairs on The Public Employees' Retirement System and The Teachers' Retirement System," dated February 2005 and presented to the committee on this date].

8:13:16 AM

BOB REYNOLDS, Mercer Human Resource Consulting, co-presenting the overview on behalf of the Department of Administration, directed attention to the handout in the committee packet, entitled, "State of Alaska PERS & TRS Tier Proposals, House State Affairs." He noted that the committee had received a summary of the first portion of that handout at a previous meeting. He reminded the committee that two alternative tier plans are described in the handout; they are called Alternative 1 and Alternative 2. Mr. Reynolds directed attention to slide 40, on page 22, which shows normal cost rates for Alternative 1. He explained that means what the costs of the system would be in the absence of any unfunded liability.

MR. REYNOLDS, in response to a request for clarification, reviewed the overview shown in slide 16, on page 10, which describes the components of Alternative 1 and 2. In response to a question from Representative Gruenberg, he explained that both alternatives were arrived at by the "tier committee of the boards" to recommend to the "full boards."

8:17:04 AM

CHAIR SEATON clarified that the purview of the legislature is to define the benefits and tiers, and to construct new tiers, but it cannot diminish accrued benefits to employees. He reminded the committee members that they are looking at two [alternatives under consideration] for the purpose of understanding the system; they are not considering the tiers as a proposal or a bill.

[8:18:19 AM](#)

MR. REYNOLDS returned to slide 16, on page 10. He noted that subsequent slides, on pages 11-21 provide more detail. In response to a previously stated question regarding what normal cost rates mean, he directed attention to slide 2, on page 1, which shows the employer contribution rates for PERS, and slide 3, on page 2, which shows the employer contribution rates for TRS. He said these slides show the calculated actuarial contribution rates needed to fully fund the systems after a 25-year period. The rates are composed of two components: a normal cost rate, which provides for benefits expected to be earned by active members during the fiscal year; and the past service rate, which is the part of the contribution that is intended to pay off the unfunded liability over 25 years. He explained that the past service rate would not exist if the systems were fully funded; it is the "make-up" part of the contribution.

[8:21:26 AM](#)

MR. REYNOLDS, in response to remarks by Chair Seaton, confirmed that the contributions shown on slides 2 and 3 relate to employer contributions, and in each of the two systems, employee members make contributions, as well.

[8:21:36 AM](#)

CHAIR SEATON added that the normal cost rate is expected to pay 100 percent of the retirees' benefits.

MR. REYNOLDS responded, "Yes, correct, together with the members. This is the employer's portion of that."

[8:22:07 AM](#)

MR. REYNOLDS, in response to a question from Representative Gatto, said the benefit is expected to cover the additional

years post retirement. He said the idea is to fund a member's benefit during his/her working lifetime.

MR. REYNOLDS redirected attention to slide 40, on page 22. He noted that the numbers shown in parentheses are related to the current program. He noted that the four components of Alternative 1 are: the medical normal cost rate, the defined benefit normal cost rate, the defined contribution rate, and the health reimbursement account (HRA). He highlighted details of the slide.

[8:25:50 AM](#)

MR. REYNOLDS, in response to a question from Chair Seaton, explained that the medical normal cost rates for TRS and PERS are conceptually the same program. However, the PERS "others" members have a later normal retirement date, so TRS provides medical benefits for Medicare for a longer period prior to eligibility; therefore, the teachers' benefits cost a little bit more, because they are being provided over a longer period of time prior to Medicare eligibility. He concluded, "So, it relates to the retirement ages that are built in to the two systems - not the level of the medical benefits themselves."

[8:26:48 AM](#)

MR. REYNOLDS, in response to a follow-up question from Chair Seaton, directed attention to slide 17, on page 11, which shows the normal retirement for both PERS and TRS. PERS has a "25-year-and-out" system.

[8:27:51 AM](#)

CHAIR SEATON indicated that "the differences" are structural and are mostly related to the number of years before retirement.

[8:28:13 AM](#)

MR. REYNOLDS replied, "That's correct for both the medical and the defined benefit; and then, of course, the costs for the defined contribution component are solely related to the actual contribution level itself"

[8:28:51 AM](#)

MR. REYNOLDS, in response to a question from Chair Seaton, explained that the committee - made up of two members from each

board - arrived at different recommendations for the two systems, in part based on overall cost level objectives; their focus was to decide what level of benefits and what ultimate cost level to the employer was desired.

8:30:08 AM

MR. REYNOLDS directed attention to slide 41, on page 23, which shows similar information to slide 40, but for Alternative 2. He noted that the defined benefit component was eliminated. What would have been the costs for the defined benefit portion of Alternative 1 was combined with the defined contribution component. He noted that the costs for the medical component are the same as for Alternative 1; the costs for the defined contribution portion are higher, because of the inclusion of the defined benefits component; and the costs for the HRA are the same as Alternative 1. Alternative 1, although it is expected to have average costs, would be expected to be more volatile and less predictable than Alternative 2.

8:32:19 AM

MR. REYNOLDS, in response to a question from Representative Gruenberg, said, given a choice, employees would choose a retirement plan that is most advantageous to themselves. Typically, older, longer-service members would choose Alternative 1, because more benefit would be delivered to those members through the defined benefit plan, whereas younger, shorter-service members would tend to favor Alternative 2, where benefits would build up faster. He clarified that there is nothing about either of the alternative programs that would mean all members would choose one alternative over the other.

8:34:02 AM

MS. MILLHORN noted that when the meeting to discuss new tiers took place last November, there were a number of employers present. She said the needs of each group represented by an employer were different based upon that area's population. She offered examples.

8:36:00 AM

CHAIR SEATON recalled that the analysis of the member surveys showed that Alternative 2 was seen as more clearly understandable. He said, "It's a lot easier to understand a

defined contribution program than it is the mix of defined benefit and defined contribution."

MS. MILLHORN concurred.

[8:37:05 AM](#)

MS. MILLHORN, in response to a question from Representative Gruenberg, directed attention to a handout in the committee packet, entitled, "Alaska Legislative Report Response to Questions from House State Affairs on The Public Employees' Retirement System and The Teachers' Retirement System," dated February 2005. She noted that 20 pages, beginning on page 22, show the individual employer responses. Beginning on page 40 is a list of unions that were asked to participate in the survey. She explained that some of them did not choose to participate. She offered further details.

[8:38:30 AM](#)

REPRESENTATIVE GATTO said young people feel they will never see the money they pay into social security. He asked if there is the same thought with respect to PERS and TRS.

[8:39:39 AM](#)

MS. MILLHORN said she doesn't think so. People working under the current TRS tiers vest after eight years. The average credited service under TRS is 10.5 years, so most of those parties do vest and do receive benefits.

[8:41:38 AM](#)

REPRESENTATIVE GRUENBERG asked which alternative the state would pick.

[8:42:15 AM](#)

MS. MILLHORN suggested that the deputy commissioner address that question.

[8:42:33 AM](#)

CHAIR SEATON reminded Representative Gruenberg that it's not the administration that is coming forward with a proposal, but the legislature that is looking at the long-term problem of \$5.6 billion unfunded liability and structural problems.

[8:43:19 AM](#)

REPRESENTATIVE GRUENBERG said he would still like to hear from the administration.

[8:43:46 AM](#)

KEVIN BROOKS, Deputy Commissioner, Office of the Commissioner, Department of Administration, stated that the department and the administration do support the formation of new tiers. He said the administration's belief is that switching the makeup of the tiers will provide more predictability related to future costs. He said, "We do believe that there's an interest in younger workers coming into the work force for defined contribution plans that provide portability. And really, all this is in recognition of a very significant \$5 billion-plus problem that we have to come to grips with." In response to a question from Representative Gruenberg, he confirmed that he thinks the defined contribution plan [Alternative 2] would be the preferred option for the administration."

[8:45:48 AM](#)

MS. MILLHORN returned to the handout showing the slides. She directed attention to a table on page 24, which shows the normal cost rate and the actuarial computed rate from fiscal year 1983 (FY 83) through FY 06 for PERS and TRS. She highlighted sections of the table.

[8:47:16 AM](#)

MR. REYNOLDS noted that page 24 shows a history of the normal cost rates over time. He pointed out that regarding any medical component in either alternative and the defined benefit component in Alternative 1, the normal costs are subject to changes in the population and changes over time in actuarial assumptions.

[8:48:57 AM](#)

MR. REYNOLDS, in response to a request for clarification made by Representative Gruenberg, stated that the chronological variation relates to the fact that the costs are being modeled actuarially. Over time, he explained, the population of the system changes, which affects the cost of the model. Furthermore, the assumptions that are being put into the model

have changed. In particular, there have been increases in population longevity that have affected the calculations, as well as a change in the expectation into the future in the rise in level of medical costs. Mr. Reynolds said the difference between the normal cost rate and the actuarial computed rate is related to the system's funded status at a given point in time. The difference between the normal cost rate and the computed rate is the past service rate; therefore, if the system has "an underfunding," that means there will be a past service contribution needed, in addition to the normal cost rate, to provide for the long-term funding of the system. He offered an example from the table on page 24.

[8:51:23 AM](#)

REPRESENTATIVE GRUENBERG noted that the last four years' actuarial computed rate for PERS shows the greatest change. He asked if that represented a change in actuaries.

[8:52:00 AM](#)

MR. REYNOLDS answered no. He said it represented a change in both circumstances of the fund and some of the underlying assumptions occurring at the same time. He explained that, by circumstances, he means health care costs and assets of the fund. He said actuaries periodically examine the assumptions and make recommendations to the boards. Periodic actuarial audits are performed by an independent firm that may recommend changes. He said, "The combination of those changes and the circumstances that I previously described did result in this increase that you see on the last four lines of the chart."

[8:53:34 AM](#)

MR. REYNOLDS, in response to a question from Chair Seaton, provided further details. In response to a follow-up question from Chair Seaton, he said he would ask the division to supply information relating to the last three years and ten years and an analysis of the factors that have contributed to changes in the actuarial rates, as well as the funded status of the systems.

[8:54:34 AM](#)

MS. MILLHORN noted that the valuation report shows an itemized change by experience and assumption changes, which leads to the

calculated rate. She said she could provide the summary sheets to the committee.

[8:55:49 AM](#)

REPRESENTATIVE GRUENBERG said the committee needs to know why there was such a dramatic change in the actuarial computed rate between 2001 and 2002.

[8:56:32 AM](#)

MS. MILLHORN, in response to a question from Chair Seaton regarding "how much of that was driven by the health care assumptions," recollected that "that change increased the employer contribution rate by 8.5 percent." She directed attention to the PERS valuation of 1996, "which is the fiscal year 1999," and noted that that was the time that the legislature adopted Tier III, and that is the point at which the normal cost rate decreased. Pointing to TRS in 1991, "which is the fiscal year 1994," she noted that the legislature adopted Tier II, and thus the normal cost rate showed a reduction.

[8:57:52 AM](#)

REPRESENTATIVE GARDNER asked if there would be an expectation that some of the "massive discrepancy" shown between the years 2001 to 2002 would be resolved if the President's social security plan is adopted and many more people have investments in the stock market.

[8:58:31 AM](#)

MR. REYNOLDS said he cannot predict what changes there will be to social security and "what impact that will have on the markets." He surmised that the influence that [adopting the President's plan] might have is to potentially lead to a revision of some of the underlying assumptions. He noted that one of the key assumptions that [Mercer] makes at arriving at the results is the rate of earnings that will occur in the future, and it is currently assumed that those investments in the future will earn 8.25 percent, which is based on an analysis of how the funds are currently allocated and a detailed analysis of the expectations for each asset class. He said, "If something were to occur that would lead us to revise our expectations of the earnings of the fund in the future, then that could affect these results." He offered an example. He

noted that if the funds earn less, than more would need to come from the employers, and vice versa.

[8:59:57 AM](#)

CHAIR SEATON recognized that Representative Mike Kelly joined the committee table.

[9:00:10 AM](#)

REPRESENTATIVE GATTO asked if the actuarially computed rate data is used to adjust the normal cost rate.

[9:00:58 AM](#)

MR. REYNOLDS said the actuarial number, as well as "all the components" are reported to the PERS and TRS boards. He said there is a correlation between the numbers, but there is a considerable variability. He stated that there are actuarial techniques being used to attempt to mitigate the volatility; without those techniques, the numbers would be even more volatile, because a large number of hard-to-predict influences are in play. He offered examples.

[9:03:35 AM](#)

MR. REYNOLDS, in response to a question from Chair Seaton, confirmed that the assumptions that underlie [the normal cost rate and the actuarial computed rate] are the same. The only difference is that the computed rate takes into account the funding deficit or surplus.

[9:04:17 AM](#)

MR. REYNOLDS, in response to a question from Representative Kelly, reported that the estimated actual return for FY 04 was approximately 15.1 percent for the two systems. He said he doesn't yet know a year-to-date return or end-of-year estimate for FY 05. He said the assumption is that, over the course of the year, the investments will earn 8.25 [percent], but he said there will be variability. In response to a follow-up question from Representative Kelly asking if he expects an excess of 10 percent, Mr. Reynolds said he has no expectation of what the markets will do between now and June 30.

[9:05:10 AM](#)

MR. REYNOLDS directed attention to slides 43 and 44, on page 29, which show cost projections of actuarial rates for PERS and TRS, respectively. He explained that the solid line shows the projected increase of rates for the current plan, while the broken line shows the projected path with the proposed new tier. He explained that any cost reductions would take some time to be fully realized.

[9:08:57 AM](#)

CHAIR SEATON observed that it would be 2020 before a school district, for example, would see any difference in the contribution rate for an employee, and that difference would be about 2 percent. He offered his understanding that that's because the graphs assume that the employer contribution rate for all employees will be the same because it's paying off the unfunded liability, and the only difference is that there will be a normal cost differential - a difference in the normal cost rate between the existing system and the new tier.

[9:10:49 AM](#)

MR. REYNOLDS said he thinks that's a good analysis.

[9:11:32 AM](#)

MS. MILLHORN, in response to a question from Chair Seaton, confirmed that the feedback from employers has been that they recognize [the proposals for a new tier] would not immediately change the employer contribution rate, but they advocate for a new tier because it's necessary to do so. She listed specific employees who had expressed that interest. In response to a follow-up question regarding whether the employers had any suggestions for lowering the employer cost rate, she said the focus was just on the two alternatives presented.

[9:12:32 AM](#)

CHAIR SEATON asked if there had been any suggestions made regarding lowering the employer contribution rate.

[9:12:52 AM](#)

MS. MILLHORN offered her recollection that the focus had just been on the two alternatives.

[9:13:11 AM](#)

MR. REYNOLDS turned to page 21 of the previously mentioned handout containing responses to questions, which shows the retirement program's financial management as including: funding policies, which cover assumptions and methods; the investment policy, which covers assets; and the benefits policy, which covers plan provisions. He stated that the costs of the system are directly related to the benefits. The money to provide those benefits comes from two places: the contributions to the system - from the members and the employers - and the investment earnings. Assuming the investment policy is as efficient as it can be, there are only two places to look to reduce costs over time: reducing the benefits, which a new tier would accomplish, or putting in more cash up front.

[9:16:31 AM](#)

REPRESENTATIVE KELLY said, "All these numbers that you give are the employers' contribution net of the employees' contribution."

[9:16:51 AM](#)

MR. REYNOLDS confirmed that these charts show figures for employers; the member costs would be "on top of that."

[9:17:00 AM](#)

REPRESENTATIVE KELLY suggested another source could be from the existing, active employees.

[9:17:24 AM](#)

MR. REYNOLDS said he has been asked to model that and will provide charts. He said it's not rocket science; if the current rates are 10 percent and the member rates are increased to 15 [percent], then, over the long term, it would be expected that the employer rates would decrease by that 5 percent.

[9:17:45 AM](#)

CHAIR SEATON noted that the figures are set once a year, and he explained how the bar charts can be used. He also noted a legal opinion is available in the committee packet and on Representative Kelly's web site. He offered further details.

[9:20:47 AM](#)

MS. MILLHORN, in response to a question from Chair Seaton, confirmed that at the time that the new tiers were being formulated, the impression was that an employee contribution rate could not be changed, because that had been the interpretation at the time. She said that has been corrected through the opinion from Legislative Legal and Research Services.

[9:20:55 AM](#)

REPRESENTATIVE KELLY said it's fair to say that that's an opinion [from Legislative Legal and Research Services] which may be unpopular with some.

[9:23:23 AM](#)

MS. MILLHORN, in response to a question from Chair Seaton, explained that "IMP" [shown on many columns of the spreadsheets in the "response to questions" handout] stands for "importance."

[9:24:10 AM](#)

CHAIR SEATON offered his understanding that [the columns on the spreadsheets in the "response to questions" handout] correlate with the slides in [the "tier proposals" handout]. Specifically, question 1 on the spreadsheet correlates with slide 46, on page 34.

[9:24:43 AM](#)

MS. MILLHORN confirmed that is correct.

[9:25:50 AM](#)

MR. REYNOLDS noted that slides 46-71 show results of the PERS survey, while slides 73-100 show results of the TRS survey. Each slide shows one question's response. The [spreadsheet] shows how each employer responded. He explained that on slide 46, the letters "A" through "E" show where the five largest employers weighed in. At the bottom of the slide are comments that were taken verbatim. The key implications are conclusions that Mercer Human Resource Consulting drew from the survey.

[9:28:34 AM](#)

CHAIR SEATON observed that the bar chart at the top right corner of the slide shows the level of importance. He surmised that

all employees may score on one side of a question; however, they might consider that the issue is of lower importance when considering "the design of the plan."

[9:29:08 AM](#)

MR. REYNOLDS answered that's correct.

[9:29:13 AM](#)

REPRESENTATIVE GATTO noted that medical coverage consistently scored high in level of importance for employers.

[9:29:36 AM](#)

MR. REYNOLDS revealed that one of the key conclusions that was drawn by the committee from the survey was that the plan should provide some level of medical coverage. One of the other key conclusions was that further cost sharing of the cost of that coverage with members might be in order.

[9:30:03 AM](#)

CHAIR SEATON noted that slide 98 shows that predictability and stability also scored high in importance.

[9:31:29 AM](#)

MR. REYNOLDS, in response to a question from Representative Kelly, said, "These are what we think is the most likely outcome, but as you know, the median only shows you what the middle is - it doesn't show you how wide the spread of possible outcomes is." A program is subject to a great deal of potential change and volatility, based on future demographics, health care, and "911" - a change in the investments.

[9:32:09 AM](#)

REPRESENTATIVE KELLY responded, "So, that chart seems to me to have a little Novocain in it." He said there could be another \$5.6 billion problem "built into that down the road," because "they are assumptions."

[9:32:32 AM](#)

MR. REYNOLDS concurred.

9:32:40 AM

CHAIR SEATON suggested looking at the base changes in the system that really impact it. He offered examples, including taking the average of the highest three years for retirement and changing that in other tiers to more years. He indicated that there's nothing wrong with taking employment at a higher rate, but expressed that a system "that allows these things to go in and be a charge against system" is a problem.

9:35:06 AM

MS. MILLHORN explained the various tier index averages for various employees and how different calculations are done depending on the tier.

9:36:09 AM

MR. REYNOLDS, in response to a question from Chair Seaton, said moving from three years to five reduces system costs for the nonmedical component by about 4 percent. He continued as follows:

The committee did look at the whole issue of what the averaging period should be, and basically was weighing two factors: One was keeping people's benefits as current as possible with inflation during their working lifetime, but mitigating the influence of large changes in compensation in the last few years of employment. A three-year average is a lot more subject to increase if there's a large bonus paid in the last year than a career average, for example.

And the alternative that the committee arrived at in the defined benefits component of Alternative 1 was to use a career average - an average of pay over the member's entire career - but to index that pay forward to retirement with inflation, similar to the way social security does the calculation. Social security takes your pay in any given year, [and] then ratchets it up with inflation to age 61, roughly, before computing the average. It's a little bit complicated.

The issue is that, in trying to accomplish something, you ... build in a lot of complexity into the system; you can sometimes over-engineer it. But in this case,

the committee did arrive at a career average rather than a final three or five.

[9:37:50 AM](#)

CHAIR SEATON asked, "Depending on how the [Consumer Price Index] (CPI) was, ... it could basically eat up ... most of your investment return, couldn't it?" Chair Seaton calculated that with an assumed 8.25 investment return and an inflation rate of 4 percent, the return would be 4.25 percent.

[9:38:33 AM](#)

MR. REYNOLDS answered that's correct. He added, "On the other hand, if it's built into the system, we can attempt to predict and fund for it." He offered an example of the post-retirement pension adjustments. He noted that in contrast to that are the ad hoc post-retirement pension adjustments (PRPAs), for which funding predictions cannot be made.

[9:39:46 AM](#)

MS. MILLHORN, in response to a question from Chair Seaton, said the ad hoc PRPAs are recommended by the PERS and TRS boards to the commissioner of administration who has the authority to grant or not grant them. She noted that the ad hoc PRPAs have been rejected for the past two years. She explained that they are a significant cost factor; over the last 14 years, 8 ad hoc PRPAs have been granted. If the last year's recommended PRPA had to been granted it would have cost approximately \$34 million to PERS in accrued liability and approximately \$37 million in accrued liability to TRS. She indicated that plan changes have represented approximately \$500 million "over the last years," and noted that the administration has asked Mercer Human Resource Group to "determine what the breakout is between the ad hoc PRPA and the other plan changes through legislation." In response to follow-up questions from Chair Seaton, she said the authority for the ad hoc PRPAs are found in AS 39.35.475 and are specific to and affect only Tier I PERS and TRS members.

[9:42:16 AM](#)

CHAIR SEATON mentioned cost-of-living adjustments for regional employees and asked if contributions are made on those expenses and if they are then included into the base wage on which retirement is calculated.

[9:43:15 AM](#)

KATHY LEA, Retirement Manager, Division of Retirement & Benefits, Department of Administration, said a geographic differential can be included in a member's retirement calculation if that member has served half his/her service in an area with a differential. Contributions are taken from their compensation as the member receives it. She added, "If they do not qualify for using the geographic differential in their calculation, the contributions that have been made on that portion are refunded to them." In response to a question from Chair Seaton regarding overtime pay, she confirmed that that is also "calculated on PERS."

[9:44:43 AM](#)

REPRESENTATIVE GATTO indicated that police in Anchorage are allowed to work overtime on a seniority basis and, because of that, are able to put in extravagant weeks in order to "bill their pay up to as high as they can get it."

[9:45:41 AM](#)

MR. REYNOLDS explained that the pay increases in the system are averaged, which would include those pay increases that are occurring in the last three years of employment, thus, if a pattern has been occurring, it is predictable and can be accounted for.

[9:47:14 AM](#)

CHAIR SEATON asked if it would be difficult to get a comparison between a sample population, such as police and fire employees, in order to see the structural analysis of the system if overtime is counted in PERS or if it isn't.

[9:47:36 AM](#)

MR. REYNOLDS responded that the only analysis done is a periodic analysis, which is performed every five years.

[9:47:57 AM](#)

CHAIR SEATON asked Ms. Millhorn to prepare "a little instructional sheet" for the committee. He indicated that he has looked on the administration's web site, but the information is quite lengthy and complex.

MS. MILLHORN said, "Sure."

[9:48:34 AM](#)

JOSEPH M. BEEDLE, Vice President for Finance, Office of Finance, University of Alaska, Fairbanks, surmised that part of the interest on the committee's part is in response to a recent address by the university's President Mark Hamilton, wherein he stated that approximately \$87 million of unfunded liability has been avoided because of the university's Optional Retirement Plan (ORP). He noted that ORP was adopted approximately 15 years ago and is a defined contribution alternative to the plans previously discussed by the committee. He said ORP is designed for "regular" faculty and executive staff. The university's obligation under ORP is to make contributions tied to a rolling three-year average of the TRS rate. There is no health benefit provided under ORP. He clarified, "Certainly the calculations under TRS [assume] a health benefit; so the calculation is based on something that provides a benefit to include health." Vesting is immediate. Mr. Beedle stated, "This is an employee's plan choice. Whether they participate in ORP, TRS, or PERS is irrevocable; once the employee chooses at time of hire, then that is irrevocable."

MR. BEEDLE said the advantages to the university include: an enhanced ability to compete in the national market for top faculty and administrators with other universities; and corporations offering to find contribution plans, such as a 401k. The university has the advantage of relieving its liability under the retirement plan from the obligation to provide for a costly health benefit upon retirement. He said the ORP participants prefer the plan, because it provides full portability. The employee is vested on day one and whatever he/she contributes, along with whatever is contributed by the employee, will be owned by the employee. The funds can be taken immediately by the employee and, even if the employee dies upon retirement, the funds would go to his/her estate. The funds are also fully portable to an IRA or self-directed type of investment. One concern is attracting those who may not stay through tenure. Mr. Beedle noted that approximately 800 people participate in ORP and it represents approximately \$50 million of base salary or 25 percent of the university's employee base. He stated that it's been utilized on a voluntary basis in a significant way. Faculty composes approximately 90 percent of participants, with the remaining 10 percent being executives.

[9:53:19 AM](#)

MR. BEEDLE directed attention to a [one-page, two-sided] handout in the committee packet from the University of Alaska, entitled, "Summary of the Optional Retirement Program." The other side of the summary shows a retirement program comparison chart, which compares TRS, PERS, and ORP. The chart compares the following: Internal Revenue Service (IRS) governing code; social security replacement plan; State of Alaska governing code; eligibility; vesting; health coverage after retirement; contribution rate setting authority; methodology for setting rates; rates for FY 04; projected rates for FY 05; subject of bargaining; participation rate; and average age. Mr. Beedle offered details regarding the comparison chart.

[9:55:24 AM](#)

MR. BEEDLE noted that the university also has a pension plan that is similar to the State of Alaska's Supplemental Benefits System (SBS) plan. The difference, he explained, is that the university has capped its plan at \$42,000, so it's about \$3,200 a year, per employee, at maximum - nearly half the amount of that of the state. He said the university's retirement benefits will grow from approximately \$27 million in [FY] 05 to \$65.5 million in FY 08. Currently, retirement benefits account for approximately 18 percent of the university's total benefits package. Salary makes up the majority, and health benefits are 12.5 percent. Total combined benefits at the university, including all staff benefits, are approximately 33 percent.

MR. BEEDLE, in response to a question from Chair Seaton, confirmed that the university does have a health plan for those employees currently employed.

[9:57:36 AM](#)

CHAIR SEATON offered his understanding that about 25 percent of [the university's] employees have said they would rather select the three-year TRS average as a defined contribution plan, rather than having a portion of that money as a health plan.

[9:58:20 AM](#)

MR. BEEDLE confirmed that is true. In response to a follow-up question from Chair Seaton, he said the other 75 percent have not had the option to make that selection, because [ORP] is restricted to "regular" faculty and executive employees of the

university system. He clarified that the 25 percent previously mentioned is 25 percent of the total employees.

CHAIR SEATON asked what percent of the "regular" and executive employees have opted for [ORP].

MR. BEEDLE deferred to Mr. Johnsen.

[9:59:04 AM](#)

JIM JOHNSEN, Vice President for Faculty and Staff Relations, University of Alaska, directed the committee's attention to the participation rate of ORP on the comparison chart. He explained that at the time the chart was prepared, there were 725 participants, 90 percent of whom were faculty members.

[10:00:21 AM](#)

CHAIR SEATON clarified that he wanted to know what percentage of those who could select ORP actually have.

[10:00:34 AM](#)

MR. JOHNSEN answered:

There are approximately 250 members of the [Alaska] Community College Faculty Union, 44 percent of whom have selected ORP; approximately 950 members of the United Academic Faculty Union, 61 percent of whom have selected ORP, and then about 120 or so total executives, 76 percent [of whom] have selected [ORP].

[10:01:08 AM](#)

REPRESENTATIVE GRUENBERG asked why the most highly paid employees are in ORP while some of the lower paid employees are not even eligible.

[10:01:34 AM](#)

MR. BEEDLE said it was unknown originally who would participate. He explained that those who choose ORP are choosing to sacrifice having a [built-in] health care plan and to manage their own retirement. He said it has been rewarding to see self-selection by the faculty. In response to a follow-up question from Representative Gruenberg regarding what the university is doing for those who do not make as much money, he said they

participate in either PERS or TRS. He said, "I think it's a great challenge to consider this new tier opportunity the state is considering and the education that would go along with it to allow employees the opportunity to make a decision on a defined contribution that then they help determine - as they do with SBS ... [and] the university pension - where to invest it and how to prepare for their future."

[10:05:10 AM](#)

MR. BEEDLE added that one attribute that the university did not anticipate was the elevation of health costs. He said:

It's based on TRS for a payment, so it has the potential of exceeding the maximum allowed by IRS for a contribution, and we would have this artificial limitation under ORP. We also appreciate that we did not anticipate the growing cost. So, we've avoided this unfunded actuarial liability, but we have not avoided the cap - we have not been able to stop the cost at a certain level.

MR. BEEDLE said he is intrigued by the state's studies on a defined contribution that would be at "a sum-certain amount." Regarding ORP, he indicated that there might be an opportunity for the university to "fix that amount" and to consider "other employee options to join this plan."

[10:06:38 AM](#)

CHAIR SEATON clarified that "we're" talking about the cost rate, plus the unfunded liability section of TRS. He asked, "So, is that what raps you into ... that section; instead of having a three-year normal cost rate, you take the three-year whatever the rate is, including the rate to pay off the unfunded liabilities?"

[10:07:12 AM](#)

MR. BEEDLE responded as follows:

The bonus ... of this current extraordinary event in time will accrue to new employees that benefit by ORP at a very high rate as compared to the private sector. And so, ... the snake swallowing this balloon will benefit, and pass, and accrue to those new employees that may not experience this same bubble effect that

the state and we are experiencing in PERS and TRS. So, ... in hindsight ..., it might have been something that, as a finance person, I would have recommended a number not to exceed, other than simply that imposed by the IRS as a maximum.

[10:08:11 AM](#)

CHAIR SEATON said the committee will "take this under consideration."

ADJOURNMENT

There being no further business before the committee, the House State Affairs Standing Committee meeting was adjourned at [10:08:30 AM](#).