

MINUTES
SENATE FINANCE COMMITTEE
March 21, 2005
9:03 a.m.

CALL TO ORDER

Co-Chair Green convened the meeting at approximately [9:03:40 AM](#).

PRESENT

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senator Con Bunde, Vice-Chair
Senator Fred Dyson
Senator Bert Stedman
Senator Lyman Hoffman
Senator Donny Olson

Also Attending: Public testifiers in Juneau are listed in the minutes in the order in which they testified.

Attending via Teleconference: Public Testimony was presented in the order reflected in the minutes.

SUMMARY INFORMATION

SB 141-PUBLIC EMPLOYEE/TEACHER RETIREMENT

The Committee heard Statewide public testimony on the bill. The bill was held in Committee.

#sb141

SENATE BILL NO. 141

"An Act relating to the teachers' and public employees' retirement systems and creating defined contribution and health reimbursement plans for members of the teachers' retirement system and the public employees' retirement system who are first hired after July 1, 2005; establishing the Alaska Retirement Management Board to replace the Alaska State Pension Investment Board, the Alaska Teachers' Retirement Board, and the Public Employees' Retirement Board; adding appeals of the decisions of the administrator of the teachers' and public employees' retirement systems to the jurisdiction of the office of administrative hearings; and providing for an

effective date."

This was the third hearing for this bill in the Senate Finance Committee.

ROGER LIEBNER testified via teleconference from Anchorage and voiced concern about the changes proposed in the bill; specifically the damage they would inflict on public education. In 1977 when he moved to the State, the education system was growing and improving; and salaries and the retirement plan were competitive "relative to the Lower 48". However, teachers' salaries today are no longer competitive. Because it is currently difficult to recruit teachers, "many back door" alternative paths to teaching have been developed "to circumvent traditional employee standards ... primarily in the Bush area". Recently adopted legislation would assist in continuing the practice of hiring retired teaching professionals to fill vacant positions. While this bill seeks to establish a Defined Contribution Plan (DCP) similar to those of private enterprises, non-competitive salaries and the "deteriorating retirement tiers would further compound the employment picture". The Public Employees Retirement System (PERS) currently has a Supplemental Benefit System (SBS) component that the Teachers Retirement System (TRS) does not have. This bill is bad legislation.

Co-Chair Green requested testimony to be limited to three minutes.

PAT WELLINGTON, Member, Public Employees Retirement System Board and Alaska State Pension Investment Board (ASPIB), testified via teleconference from Anchorage and recounted that his 50-years of service to the State included being a United States Marshall, a State Trooper, the Commissioner of the Department of Public Safety, and fire department service. He spoke to reports that infer that the current governing structure of the PERS, Teachers Retirement System (TRS), and ASPIB boards "are responsible for the current actuarial shortfalls. These inferences are totally without merit..." He shared the credentials of the seven PERS/TRS board members appointed by Governor Frank Murkowski. ASPIB board members are likewise "distinguished", as are the three advisors they hired. "Last fiscal year, ASPIB earned 15.1-percent on its investments and last month ASPIB was selected by Institutional Investors Money Management Organization as one of the three outstanding large public pension investment funds in the nation". In light of this success, he questioned the reason the Board should be changed. The inference that these boards have contributed "in some way" to the actuarial shortfall is erroneous. The Legislature, rather than the Boards, established the benefit structures. "The Boards and the elected members, in particular, have a vested interest in the

financial soundness of the fund". The inference that the Boards established "lower contribution rates than recommended by the Actuarial, is preposterous and flies in the face of logic".

Mr. Wellington stated that further research would reflect that "the adopted contribution rate brought both systems to 95 and 100-percent funding ratios in 2000 and 2001. It wasn't until the actuarial assumptions were changed in 2002 that the funding ratio dropped 20-percent. The TRS and PERS Board rely on experts" and he questioned whether the proposed Board would ignore expert advice. Changing the Board structure would not improve decisions. The Department of Administration, without exploring alternatives and without a draft bill, desired that the Boards adopt a new plan. While this bill provides details, he asked how thoroughly the process has been investigated. This bill should advance a new DCP "only after" the following four questions could be answered: were a police officer, trooper, or fireman with four years of service killed in line of duty, what benefits would be available to his or her survivors; were a correctional officer assaulted and disabled how would the DCP address his or her disability; were a teacher or principal killed or disabled in the line of duty what benefits would be available to his or her survivors; and four; "what's the rush" as the funding status "has been worse off in the past and recovered to 100 percent funding". He declared that the picture is not always as depicted.

JIM DUNCAN, Business Manager, Alaska State Employees Association (ASEA)/AFSCME Local 52 testified via teleconference from Anchorage "in strong opposition to this legislation and the impact it would have on current" and future employees. The real or perceived under-funding status of the funds should be addressed by "very serious and comprehensive review before this legislation progresses". The causes of the situation are the stock market decline that was not projected by the Actuary; health care cost increases "that the actuaries failed to project accurately"; and changes in retiree demographics as retirees are living longer. Current employees should not be held responsible: they did not cause or control these situations. Nonetheless, this legislation is asking that they pay. There would be "a direct impact" on employees' status of living were employee contributions to increase by up to five percent annually. ASEA members' most recent pay increase was three percent in December 2002 and an additional 1.5 percent might be forthcoming in July 2005. This 4.5 percent increase in 2.5 years would not keep pace with cost of living increases. This legislation would also require employees to increase their contribution by five percent as of July 1, 2005. Employees "would be taking a step backwards".

Mr. Duncan stated that this legislation would move future employees

from a Defined Benefit Plan (DBP) to a Defined Contribution Plan (DCP). This would be asking "future employees to roll the dice and place their retirement at risk without surety as to what they would have when" upon retirement. Finally, this legislation would have negative impacts on the State's ability to retain and recruit employees.

Mr. Duncan urged the Committee to solicit "an independent verification" regarding "whether the amount of under-funding that is now asserted is correct" as well as to determine what future contribution level would "be required to offset the problem" were one to exist. In addition, the impact on the current PERS system should be evaluated to determine whether it might experience "a sudden decrease in the pool of the individuals who contribute to it". The impact would be significant were all employees moved to a new DCP and no longer contributing to the current DBP system. Careful evaluation of the proposed system on the recruitment and retention of employees should be conducted, as he believed it would have a negative impact on employment and therefore State services. He warned that this legislation might be unconstitutional in regards to language that would require current employees to increase their contribution levels. Further clarification of these concerns should be conducted before the legislation advances.

(b) The maximum increase in the contribution rate for a member from one year to the next may not be more than five percentage points, as actuarially calculated.

Senator Stedman pointed out that the employee contribution language referenced by Mr. Duncan is located in Section 8(b), page seven, lines 22 and 23 of the bill. It is anticipated that this language would be eliminated from the bill, as the rate would be difficult to calculate. As is, the language is applicable to a potential split of the Normal Cost Rate of "the benefits being accrued today or tomorrow," and not the unfunded liability. Currently the employer/employee contribution split of the Normal Cost Rate is two-thirds and one-third, respectfully. The contribution split should be further discussed with consideration given to changing it to a 50/50 split. Were this to occur, the total maximum increase for the employee would equate to approximately a two or three-percent increase. This would be "a far cry from five". At this time, it is uncertain whether a change to the Normal Cost Rate would be included in the final version adopted by the Committee. "Clearly, there is no intent of increasing employee contributions to pay for the five billion [dollar] Past Service liability".

Co-Chair Green stressed that Version 24-LS0637\G of the bill is the beginning draft document. Testifiers are encouraged "to provide

input and serious suggestions for amendments and re-writes"...in order to assist the Committee in solving "what is seen as a fairly impressive problem".

Senator Bunde asked that people contemplate an answer to the question that, were the plans' beneficiaries "not responsible for the cost of the program, who should be".

Senator Dyson asked whether ASEA would support utilizing the Earnings Reserve Account (ERA) to fund the shortfall, were the five billion dollar shortfall verified.

Mr. Duncan commented that, in addition to accurately determining the amount of the shortfall, exploration as to whether the State would have any "recourse against the actuaries who did not identify the changing variables" affected by the decreased stock market impact, the rising costs of health care, and other variables. There is responsibility on the part of the actuaries to use "the proper variables and adjust the requirements accordingly". In addition, "there is historical precedent for the Legislature recognizing that beneficiaries" are not the cause of the problem and "should not be asked to pay for it". It was determined that employees should be held harmless. He urged for that precedent to be maintained. It is the job of the Legislature to determine a funding source for the unfunded liability. These items should be a consideration when considering this legislation.

Senator Dyson agreed that verifying the amount of the unfunded liability; determining whether there is any course of recovery; and determining how to pay for the under-funding is the course of action to take. He asked that ASEA consider the option of utilizing money from the Permanent Fund Earnings Reserve Account to assist in funding the shortfall.

JAY DULANY, Retired State Employee and Former Director, Division of Motor Vehicles, Department of Administration, testified via teleconference from Anchorage because he has "a vested interest" in this subject. While the total unfunded amount might be in question, there is "no doubt that the retirement system is under-funded". The cause of the situation is the downturn in the Financial Market and the increases in health care costs. The downturn in the Financial Market has affected a lot of people as well as the State's Permanent Fund holdings. While the Legislature has chosen not to get involved with the Permanent Fund, it has chosen to address the retirement system. This bill would make changes to "a perfectly good system" that anyone in either "the public or private sector could be proud of". The changes being proposed, such as establishing a Super Board, make no sense. He spoke favorably about

the current board members' qualifications. The bill would not address the under-funding situation, and in fact, "exacerbates the situation by removing all new hires from the system so there would be no new contributions." He urged the bill to be "scraped".

LARRY SEMMENS, Finance Director, City of Kenai, testified via teleconference from Kenai and commended Senator Stedman "on his masterful presentation of this complex data". The issue is complicated and other factors beyond the decreased financial market investment value have contributed to the problem. The City of Kenai has and would continue to struggle to budget for the current and future employer contribution increases. Unless the proposed changes in this bill are enacted, the City would be required to reduce its staff. There would be no alternative. He questioned the inclusion of the cost-of-living calculation specified on page 66 of the bill, as surely the retirees who are currently covered would not be supportive of that language. The City participated in the PERS/TRS Tier Review questionnaire that was conducted and indicated its support for a DCP. While he voiced being uncertain as to whether a 11.5 percent contribution level would be sufficient, its inclusion in the discussion is welcome.

Senator Olson asked, for clarification, whether Mr. Semmens supported the legislation.

Mr. Semmens replied that at this point in time, it is too early to provide a definitive response. He would appreciate the Legislature's willingness to review all of the alternatives. While this bill is presenting a lot of alternatives, he is concerned that it might "be biting off more than should be chewed at one time". Continuing, he noted that some of the ideas such as creating one Board to manage both the liabilities and the assets are "on target". However, he noted that, "the ASPIB Board is doing a great job". The question is whether the proposed nine-member Board would possess the expertise required to manage these investments.

SAM TRIVETTE, President, Retired Public Employees of Alaska (RPEA), testified via teleconference from Anchorage on behalf of those who have retired from public service in the State. He shared that he and other organization members have attended PERS/TRS and ASPIB board meetings for several years. The organization closely monitors Legislative hearings on these subjects. There has been little testimony from either current or recent past Board members or staff consultants in regards to this legislation. Those involved in the Boards over the past ten years could provide "a more complete picture of what and why decisions were made". The organization recommends that an invitation be extended to those individuals "now" in order to acquire more complete information "on which to

base new legislation" rather than to continue with the bill sponsors' "misconceptions about how the Boards work, their processes, and why certain decisions are made". "Blame has been heaped on the Boards for financial issues" that were beyond their control" such as the downturn in the economy, rising medical expenses, and the actuarial assumptions.

Mr. Trivette continued that, "the Boards are very aware of the underfunding and the increased costs" and "have taken steps to contain the costs they can control". One example was the Boards' successful endeavor to get employees to utilize generic rather than name brand drugs. "The sponsors of the legislation acknowledge that the bill would not address any of the problems of the current underfunding". There is no guarantee that a new Board would bring any more experience or expertise than the current Boards and "their very competent staff and professional consultants have". If there was an easy solution, another "large pension fund in the Lower 48 would have discovered it by now". Medical cost increases have lowered from double-digit numbers to less than ten percent. Part of that is the result of the hard work of the PERS/TRS Boards, Aetna Insurance, and cooperative efforts with retiree organizations. Trust Fund returns have exceeded the actuarial assumptions. "Don't fix what is not broken".

Mr. Trivette opined that in his experience of working with boards and commissions in both the public and private sector, it would be difficult for one Board with nine members to undertake the volume of work that the 18 people on the three boards currently conduct. Little attention has been paid to the demands that would be placed on the Board members. Another important task of the PERS/TRS Board is the appeal hearings of the Division's Administrator. The members "have first hand knowledge of retiree, employer, and employee issues". They issue fair decisions based on decades of experience; "the system is working. Look at their decisions. Their record is excellent". RPEA would be recommending to its 28,000 Alaska retiree members as well as active public employees, that efforts be furthered to defeat this bill. A bill should be developed that would provide real solutions. He reiterated the suggestion that current and former PERS/TERS and ASPIB Board Members be invited to assist in the development of ideas. He himself has developed a list of things that could further the effort to save money and help the fund improve.

Co-Chair Wilken commented that, as a Legislator, it is his job "to try to fix a system ...that is broken". "The wheels may not be coming off the wagon but the lug-nuts are loose and that's why we are sitting here". The Legislature was unaware there was a problem with the systems until 15 months ago. In addition to the \$170 million

bill the Legislature was "handed", "we're being told that for the next twenty years, we'll be asked to contribute" 50-percent of teachers' salaries and approximately 30 or 35-percent for PERS employees to a retirement system. "I think it is broken. There is plenty of blame to go around, and part of the blame rests on the Boards". "It is perfectly wise for us and proper for us to question the involvement of everyone from the actuarials to the boards". When faced with a \$170 million bill "and a daunting contribution rate", there is something broken". Numerous revisions to this legislation would be expected. "For you" and others "to defend the boards' lack of involvement or lack of blame in this" is "a little bit distressing". He would prefer to hear statements such as "we did the best we could, we have a system that today is going to burden, if not changed, the people of Alaska for a generation". This is the task being undertaken by the Legislature. "The Boards' hands are not clean". We need help in fixing this. The Boards are going "to change because the current system doesn't work".

PEGGY COWAN, Superintendent of Schools, Juneau School District (JSD), testified in Juneau and voiced appreciation for the Senate's leadership in the effort to address the PERS/TRS retirement concerns. While the JSD Board of Education has not, of yet, taken a formal position on the bill, her "initial concerns" about the bill include its possible impact on teacher retention and recruitment. "Quality teaching", learning, and instruction depend on quality teachers, instructors, and staff ". At past teacher recruitment job fairs, the JSD had long lines of people interested in working in Juneau; however, that is no longer the case even though the District and community have strong attributes. "It is no longer a buyer's market". Research must be conducted to compare this proposal to retirement benefits in other states. This would be a key element in attracting new employees. "The linkage" of this complex bill to the base student allocation "is concerning". As per her previous testimony before the Committee in regards to HB 1-INCREASE AMT OF BASE STUDENT ALLOCATION, its proposed base student allocation (BSA) of \$4,919 would be inadequate for the JSD. Therefore, as this legislation proceeds, consideration should be provided to increasing the BSA amount.

Senator Bunde, a former teacher, commented that when he taught, there were more teaching jobs available than there were teachers; thus teachers could pick and choose where they desired to teach. "The cycle goes up and down and back and forth". He asked whether other states are also experiencing lower applicants at the job fairs.

Ms. Cowan affirmed that, "it is a nationwide issue". To that point, Alaska should be striving to position itself as best possible. Some

states provide incentives such as a \$10,000 signing bonus. While Alaska does not have the funds to compete in that regard, its "good retirement system has been one of the carrots that we have had". While acknowledging that the underfunding issue is of concern, efforts should be made to make changes that would allow the State to remain competitive.

Senator Bunde hoped that Ms. Cowan shared the Legislature's concern in this matter, for "if things continue the way they are, for every two new teachers you hire, eventually, there's a third one you won't be able to hire because of the monies" the schools would be required to contribute to the retirement system. In 1975, there were a total of 20,000 State employees, "including teachers, supporting 1,700 retirees. Last year, there were 43,000 State employees supporting 28,000 retirees". Were this trend to continue, there would be concern that the ability to hire new people would be challenged.

Ms. Cowan reiterated her appreciation for the efforts to address the retirement system issue. The JSC, with both PERS and TRS employees, must address the retirement funding issue while continuing to provide a strong but affordable benefit and retirement system. She applauded the fact that the Legislature has increased funding to education; however acknowledged that it was used to support the retirement systems rather than the classrooms. Increasing money to the classrooms is required in order to improve student education opportunities.

BRUCE LUDWIG, Business Manager, Alaska Public Employees Association/American Association of Teachers testified in Juneau and thanked "Senator Stedman for making a very complicated subject fairly easy to understand". He "lauded the goals" identified by the Committee in this regard; however, he opined that the most important goal, that being the "recruitment and retention of qualified people", was missed. The Association represents approximately 8,000 active and 3,000 retired employees throughout the State. Recruitment efforts have been difficult for the past five years, specifically in regards to State Troopers, fish biologists, engineers, or nursing positions. Scientific fields are "particularly difficult" to recruit. The biggest and perhaps "the only benefit" of a good retirement system, from an employer's viewpoint, is its ability to attract and retain "quality" employees. Few states have DCPs, as they are not as attractive to employees as DBP. People for the most part "are not individual investors". The decline in the stock market is the reason the systems and everybody's "in the hole right now". In addition, health care costs are increasing at "astronomical rates". This must be addressed at the national level as it is affecting individuals,

worker's compensation, and a wide range of other issues.

Mr. Ludwig stated that the Association is very opposed to a DCP. "More bang for the buck" is provided with a DBP than a DCP. A DCP does not provide disability or death benefits, and absent these, the burden would fall on the State through Medicare and would further burden the Workers Compensation system. The bill does not address the five billion dollar deficit. It "does not fix it, it's a past debt". "Throwing the baby out with the bath water is not the answer".

Senator Stedman stated that it would be beneficial to the discussion were those who feel that a DCP rate structure would negatively affect recruitment and retention efforts propose an alternative recommendation to the contribution rate structure that would allow employers to remain competitive. The bill currently proposes an approximate 8.25 percent rate.

Co-Chair Wilken, responding to Mr. Ludwig's comments, clarified for the record, that it is a common misconception that the system's current deficit was the result of a decline in the stock market. In reality, the stock market underperformed the State's portfolio projections by four percent for 20-months". Other than that timeframe, the return met or exceeded actuarial projections.

Co-Chair Wilken asked whether the Association could provide any data to reflect to what extent the retirement plan is a factor in the State's ability to recruit employees.

Mr. Ludwig was uncertain that such data was available.

Co-Chair Wilken stated that the argument that a DCP would not attract employees has been voiced numerous times. However, no supporting data has been provided to reflect that "the retirement system is a major contributing" factor to the decision; specifically to first time hires. He also asked whether any Association members participate in the Supplemental Benefit System (SBS) program.

Mr. Ludwig affirmed that there are members in the SBS program.

Co-Chair Wilken voiced that the SBS program is a defined contribution. He asked whether there would be any comparison between the SB 141 proposal and the SBS program; in other words, do those members "generally support the SBS plan".

Mr. Ludwig responded that they do; however, there is a DBP plan "backing them up". He noted that his personal retirement is similar

to the SB 141 proposal, and he "can't come close to PERS or SBS". "SBS has had a phenomenal performance".

Senator Bunde shared that several of his constituents have experienced similar employee recruitment difficulties as the State. He also recalled that when he initially began teaching, his salary range was a "far more important" consideration than the retirement benefit, as at the time that issue was at least 25 years into the future. To that point, he pondered "which has greater impact; beginning salaries or retirement benefits ... every dollar we put into retirement is a dollar we can't put into beginning salaries". While understanding that pertinent data is currently unavailable in this regard, he asked for suggestions as to how this data could be obtained.

Mr. Ludwig responded that the average person does not think about retirement until they are 35 to 40 years of age, and that, prior to that time, the salary range is of primary interest. However, he stressed that whatever plan is developed must "be attractive to everybody", as the State hires at all "strata of the workforce": entry, middle, and upper level positions. He noted that a DCP is attractive to younger people and a DBP appeals to the middle and older worker. The SBS is an additional benefit.

Senator Hoffman characterized the DCP as "the suitcase plan" as, were an employee to leave State employment, they could move their benefits with them. However, the concern is that were the employee to seek employment with another state, the portability factor would not be considered a benefit as few other states have adopted DCPs. In addition, the portability aspect of a DCP should be of concern as the State could exacerbate its current recruitment difficulties by losing long term, experienced employees who might acquire employment with another state. Continuing the current DBP would assist in stopping the "brain drain".

Mr. Ludwig agreed that the DBP "is an anchor that keeps people here". A recent public safety employees' salary study [copy not provided] conducted by David Reaume, indicated that these salaries "have fallen behind all other jurisdictions". The high salaries that Alaska offered in previous years have declined and the State now offers "middle of the road salaries". Because people could earn more money working elsewhere, a good retirement benefit package is crucial in attracting employees. The private sector benefit package is predominately a 401(k) program; public sector employment is primarily a defined benefit program. This is "one of the things that attracts people to public service".

Senator Hoffman expressed support for addressing the State's

retirement system's unfunded liability and noted that his comments should not be misconstrued as opposing changes to the State's retirement benefits. He noted however, that the State is "far better off than three-fourths if not more of the states' retirement programs as they presently exist". Such things as changing and unifying the Board structures should be the first step rather than making "massive changes when everyone agrees we need to look at recruitment and retention as a major factor in anything we do. This legislation might be too big of a step all at once". Perhaps this sort of legislation should be developed incrementally. While noting that this legislation does not address the plans' unfunded liability, "something must be done".

Senator Bunde voiced that there are two sides to every coin. While there is concern that the portability of the DCP could result in a brain drain, another factor that should be considered is that those who might leave are "sour on Alaska"; they are "burnt out" and are simply "handing around" until they reach retirement. Allowing those individuals to leave might be a good thing.

Co-Chair Green considered the portability of the plan a benefit, as demographic studies indicate that rather than people working for one employer for decades, the trend is to change employers approximately every seven to ten years. She voiced appreciation for the multitude of good ideas and suggestions have been presented today, and asked that those who testified provide specifics in writing. She reiterated that this legislation is in its infancy and the bill's sponsor and the Committee "are very open to the conversation". Finance Committee members are "very worried and troubled that every time the increase for the current year is talked about, we are the deep pocket; regardless of which public agency is involved. There is the expectation that the State of Alaska is going to continue to fund shortfalls and increases each year. She warned that this would not be the case. Alternatives must be developed. The systems must be prioritized, reorganized, and improved to include mechanisms such things as health reimbursement programs, efficiencies, and cost savings. Individual employees must be involved in addressing their health care and savings issues, for the State of Alaska would not continue to be the lone source of funds for the plans. Therefore, everyone should contemplate what should occur in this legislation to improve the systems. She garnered that similar concerns about retention and other issues occurred when the implementation of Tier 2 and Tier 3 were being discussed.

Senator Olson asked Mr. Ludwig his view about creating a single nine-member board to manage the plans: specifically his thoughts on its proposed membership.

Mr. Ludwig recommended that the PERS/TRS participants and retirees elect the PERS/TRS employee representatives on the Board.

In response to a question from Senator Olson, Mr. Ludwig clarified that the current proposal would have those members appointed by the Governor.

Co-Chair Green understood therefore, that Mr. Ludwig's concern regards the Board members appointment process.

Mr. Ludwig concurred and stated that the complaints he has heard are contrary to the complaints the Legislature is hearing. There is concern that the PERS/TRS Board would not approve such things as occupational disability.

Co-Chair Green asked Mr. Ludwig whether he thought "it strange that" neither a Board nor a Board member had notified the Legislature about the underfunding issue until it had reached gigantic proportions. Last year, the Committee asked the PERS/TRS Boards "to go forth and create a list of things that we need to change, what can we do in Legislation to help make it better, and consider a Tier 4 plan". A PERS/TRS Board subcommittee worked diligently to address the issues and develop a plan; however, neither Board supported it. Consequently, the Committee did not receive any suggestions or recommendations. "The status quo is not satisfactory".

Co-Chair Green reiterated her appeal to testifiers that specific suggestions or changes in the legislation be provided. Senator Stedman, the bill's sponsor, "is ready to work".

JOHN BROWN, President, Fairbanks Central Labor Council, testified via teleconference from Fairbanks to address the long-term consequences a DCP would have on the State. Were the Members to research a 401(k) per capital distribution plan, they would learn that a DCP "is not a pension and it never would be for 90-percent of the people out there". This is worrisome in its regard to both employee retention and "the economic wellbeing of our State" and its citizens. Statistics indicate that instead of saving the money in their Defined Contribution Plan for retirement, people utilize it to purchase such things as a house, a vacation, or a new car. Changing to a DCP "would do nothing to solve the unfunded liability" of the current plans, and, in the future, a DCP would result in fewer people being able to financially take care of themselves in retirement. Society and governments would be required to assist them. "This is a big mistake: there are hundreds of ways to address the unfunded liability". While being unprepared to

provide specifics at this moment, he avowed that a DCP would be a huge mistake" for the State "economically and socially". Currently, more than \$50 million a month is received in the State through a DBP. "That is a huge impact". Were the State "to switch to a DCP, over time, it would result in the loss of "a huge economic engine" to the State.

Co-Chair Green requested further explanation about how changing from a DBP to a DCP could negatively impact the economy of the State.

Mr. Brown expressed that, in a DCP, people tend not to save and retain their money toward retirement. Therefore, a DCP would not create the "kind of wealth that a DBP does". He noted that the Operating Engineers Association Plan has accumulated a total of two billion dollars. Ten-percent on that amount is a "huge amount of money". In contrast, individual investors would not "leave that money there to build up; it doesn't make that kind of rollup on interest rates when you have a good year". While acknowledging that PERS must address its unfunded liability, he declared that there is time available in which it could address its unfunded liability; however, were the plan changed and monetary contributions to the plan to cease, its ability to "fix itself down the road when there are good investment years" would diminish. Ceasing monetary contributions to the Plan would just make the current situation "worse". This is what would occur were a DCP implemented.

Senator Bunde voiced the understanding that, as a member of SBS, which is a DCP, he could not remove money from the plan. This would be similar to the DCP being proposed in this legislation. A person could not remove their money unless they were to retire or terminate their employment with the State.

Mr. Brown understood otherwise: a person could access their SBS money. He suggested that this be further researched.

Co-Chair Green asked that any suggestion or solutions about how to address the plans' \$500 billion unfunded liability be provided to the Committee.

[NOTE: The remaining testifiers presented in Juneau.]

KEVIN RITCHIE, Executive Director, Alaska Municipal League (AML), expressed that AML has been working with representatives of school districts, the University of Alaska, and municipal officials as well as the PERS/TRS Boards regarding the retirement and benefit issue. The funding of the PERS/TRS systems over the next two years at the local level is a "critical issue". Also of importance is the

examination of the entire system in regards to what could "be changed and what makes sense". The information that has been developed is impressive and reflects the Legislature's and the Department of Administration's understanding "of the depth of the issue". "It would be wrong to think that anybody would be for or against this bill; the question is what needs to be changed". He voiced appreciation for the fact that "this is a platform" through which to present changes and discuss the issues. Rather than solely being a State challenge, this issue is a tremendous problem for everyone: municipalities, school districts, and the University. AML is looking forward to working with the Legislature to further develop the bill.

Senator Bunde noted that AML has had frequent discussions with the Legislature regarding past municipal revenue sharing and the fact that municipal revenue sharing would not be forthcoming to address the debt that PERS/TRS has caused. Therefore, it is incumbent upon AML to work with the Legislature to address the issue in order to avert further sharing of the debt at the local level.

[10:14:22 AM](#)

Co-Chair Green remarked that this bill is on an accelerated schedule, and therefore any person wishing to testify should do so at this time.

MARY FRANCIS, Executive Director, Alaska Association of School Administrators, shared that many of the Association's school superintendents are meeting in Juneau this week. One of topics of discussion is this legislation. There is a consensus of strong support among the attendees about the Legislature's efforts "to overhaul and improve the State's retirement system". Additional work would be required to address the concern about how this bill would align with the Base Student Allocation (BSA) for FY 06. The Association is willing to work with the Legislature to address its concerns.

TOM HARVEY, Executive Director, NEA-Alaska, informed that 90-percent of the people in the TRS system and 30-percent of the people in the PERS system are NEA-Alaska members. While he had planned to provide written comments, he has chosen to testify due to the accelerated schedule of the bill. He complimented the bill's sponsor, Senator Stedman, on the efforts he has exerted on the legislation; particularly that Senator Stedman had contacted the Association in regards "to a number of issues". He specifically appreciated Senator Stedman's earlier remarks clarifying that the employee contribution language located in Section 8(b), page seven, lines 22 and 23 of the bill was not attributed to him and would

likely be removed from the bill.

Mr. Harvey further appreciated and voiced approval of Co-Chair Wilken comments that the stock market is not the root of the underfunding problem, as the ASPIB Board and its investments "have far exceeded what has been necessary to sustain the system as it was defined by the actuaries". The actuarial assumption changes that were made in 2002 should be the primary focus, as that change caused the scenario to change from "appearing to be fully funded to being five billion dollars under-funded. While there have been a few "plausible" answers to how this situation occurred, there have not been many answers. Hopefully, "the real answer" as to why those 2002 assumptions "are the right assumptions" will surface over the next few months and thereby could further affirm the actual under-funded level.

Mr. Harvey stated that the question would then become "how to build a system to avoid the five billion dollar problem". Since the answer to why the assumptions were changed has not been accurately identified, the answer as to how to change the system could not be developed. He communicated that he is not opposed to a DCP. The union he represents has a DCP. It is managed by 25 "very highly compensated people who have the ability" and the time to make decisions about their investments. The concern is that the average public employee does not have the time to make educated investment decisions on a regular basis. He referenced the experience of the State of Nebraska, which adopted a DCP 22 years ago for State employees. This year Nebraska changed its plan from being solely a DCP pension system to a mixed system, as "they discovered that the average individual makes investments on a more conservative basis than" necessary and as a result "ended up losing two to three percent a year". Over a 30 to 40 year period of time for retirement, this would equate to a loss of "close to 100-percent of what they could have gained had the investments been done by a group of people who have a better understanding of the investment environment, such as the ASBIP Board".

Mr. Harvey continued that the issue of compensation must also be addressed; "Do they have enough money to contribute what is necessary". According to his calculations, the percentage specified in this bill would be insufficient for retirement and the employee "would be coming back to the State for assistance:" particularly after they make their medical payments. As specified in the bill, a limited amount of money would be available after paying such things as property taxes, and food and clothing in respect to the standard of living they presently experience. The "promise of a pension plan" to a servant to the State is that one's standard of living at retirement would remain at the level it was prior to retirement. A

person in private practice does not have this promise. "That is a distinct difference" between the private sector and the public sector.

Mr. Harvey agreed that the DCP's affect on employee retention is a concern. He voiced disagreement with the argument that people, specifically educators, moved to the State, primarily due to its retirement system that allowed people to retire after 20 years with a good medical component. Research however, does support the fact that these elements are in the top three reasons that people remain in the State. Job satisfaction is number one; salary is number two; and retirement benefits are number three. "The retirement keeps them here for at least 20-years, or beginning in 2011, 25-years". The DCP defined in the bill would vest an employee after five years; public school data indicates that "the fifth year is the year of the itch" in that many educators, in their third, fourth or fifth teaching year begin to make decisions about their career. 48-percent of educators change professions within the first five years, and "the 52-percent that remain are making decisions about their future". This State does not provide sufficient teacher supply to meet the demand; it is a highly competitive situation. Therefore, developing a system that would allow teachers after their fifth year to return home to a state where they could make a similar salary as offered in Alaska is questionable, particularly since the State has lost the competitive salary edge experienced in the 1980s and 1990s. We would be "at risk of not retaining them". While agreeing that the portability factor is beneficial in that it could bring in new ideas and concepts, it "is less of a good thing" when it pertains to the education field. Stability in a school is beneficial to student achievement and is instrumental in providing a quality education.

Senator Dyson voiced appreciation for Mr. Harvey's remarks. In regards to the comments pertaining to retaining one's standard of living after retirement, he asked whether Mr. Harvey was inferring that the State has the responsibility to ensure that everyone has a retirement income that might equate to \$50,000, \$60,000, or \$70,000 a year.

Mr. Harvey apologized if his remarks inferred that a public service employee should receive the exact same compensation into his or her retirement. The intent of his remarks was to express that public service people have an expectation that they would maintain a similar standard of living after they retire. The compensation could be less at retirement, as many expenses such as house payments would not be experienced, as the house would likely be paid for by that time. Therefore, a retiree's expenses would be less than when they were active employees. All public servants

expect to have "a similar dignity" in their retirement as they had when actively employed.

Senator Dyson commented about the issue of those individuals who might not be prudent with their money; in that "there is still a social contract that the taxpayers of the State have to make up whatever delta there might be".

Mr. Harvey communicated that it would be possible that some folks would end up at poverty level and require State services. This has occurred in some states. It would be unfortunate were this to occur in Alaska.

Senator Dyson voiced being impressed with the clear and logical comments about what attracts people to the State. However, not included in the list of attractions was "a love for our State, its beauty, resources, opportunities, and people". Particularly missing in the list of what attracts teachers to the State was "a commitment and a calling to serve our kids". One of "the tragedies" of this State's history is that people come here, use State resources, make their money, and then go back home. It is his hope that people would be attracted to and live in the State "because of a love and commitment to this extraordinary State and its people". He would choose "to disincentivise ... the transient pirates" and would prefer to attract people for other reasons besides monetary reasons.

Mr. Harvey expressed that teachers who come to the State do have a calling to teach children. That calling is the number one incentive. "The issue is, is it an incentive" to remain in the State once they retire. The number of education retirees who stay in the State is increasing. They would stay "if they can maintain their dignity in retirement".

STEVE BRADSHAW, Superintendent, Sitka School District, praised the Legislature's, and particularly Senator Stedman's, courage in furthering this bill. He noted that his job and that of the Committee are similar in respect to the fact that, in developing a budget, "there's never going to be enough money...". This legislation is an attempt to "solve a problem" that must be addressed. However, the question of how and by whom that problem would "be paid for" must be answered. The State is fortunate that the price of North Slope crude oil is high and would result in a \$600 million dollar surplus. It is certain that the health insurance expenses of the retirement plans would not decrease. These costs must be financed. He applauded the previous year's efforts to develop alternate State revenues to replace declining oil revenues. Solving the State's revenue problem is "the number one issue that we are faced with".

This is a difficult task. "The State is nothing more than the people in the State ... we need to solve our problems financially and find a way to fund the State that isn't based on whether the price of oil is going to be \$55 per barrel or going to be \$20 per barrel". Solving problems such as this is the responsibility of the Legislature. The task is not easy, for when such things as taxes are proposed, "people want to vote you out of the place". Until the State's revenue problems are solved, the State's dependency on oil would continue to be an obstacle no matter "what bump in the road we get".

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Senator Bunde, while sharing the concern about the State's dependency on oil revenue, stressed that the increased oil revenues being experienced this year should not be characterized as a surplus; the State "is not rolling in dough". He urged the testifier to review SB 88, which is sponsored by Senator Wilken. That bill would provide a 15 to 20 year fiscal plan that could serve as "a bridge to the future".

RICHARD CARLSON, Superintendent, City of Klawock School District, thanked the Committee for undertaking "this difficult task". A five-and-a-half billion dollar shortfall is indicative "of a major problem" that must be fixed. Rather than focusing on a specific element of the problem, the discussion must consider the entire system. To that point, his "concern is simply a matter of logistics, I guess, in wedding" this legislation to HB 1-INCREASE AMT OF BASE STUDENT ALLOCATION. He encouraged the Committee to view these as two separate issues, "each with merit on their own".

Co-Chair Green agreed that "they are two separate issues and we want them to be that way. Were it not for the PERS/TRS dilemma, \$38 million would not be" included in the BSA this year. Many Legislators do not support tying the \$38 million to the BSA. In an effort "to generate more conversation and more cooperation and to really move forward on SB 141, we will have it as a proviso". With the passage of SB 141, it would be attached, and would become a part of the final. "They are inextricably tied, and yet they're very, very, very separate". Saying that the BSA has been increased by millions of dollars could be considered "duplicitous", were it known that more than 50-percent of that amount would be to support the PERS/TRS problem. Other State entities' PERS/TRS obligations must be provided for today and in the future. "It's a big deal". She encouraged the public to assist in developing avenues through which to address the issue.

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Senator Stedman stated that as the discussion on this complex and sensitive issue has advanced, "rhetoric to make one point verses another point" has occurred. It should be restated that the benefit structure currently provided to PERS/TRS retirees "is not in jeopardy". Current employees would be "moderately" affected by certain aspects of the legislation; however, there is no intent to make "any radical changes" to the current tiers, but rather "to bring forward" issues such as "cost containment and the fairness of the fee structure" for discussion. Other than "the concept" being included in the bill, there is little that addresses the five billion dollar funding shortfall. "There are two distinct problems". It is "more important" to address the Board and Tier issues first and then address the underfunding issue. Were the underfunding problem restructured first, the scenario could repeat itself going forward and become insurmountable. He assured that even though this legislation does not directly address the underfunding issue, once some form of this legislation is finalized, that issue would be addressed.

Senator Stedman declared that the "competitive nature" of the new tier structure could easily "be over-dramatized" as he did not believe that people would be living in poverty after working 20 or 30 years. "Most people in the country save approximately ten percent" per year for retirement. That is approximately the amount specified for retirement in this bill. The contribution amounts are "not set in stone"; they are a point upon which to begin discussion. Some of the labor organizations have presented differing contribution amounts, and "that's fine".

Senator Stedman conveyed that the work conducted by the PERS/TRS Boards Tier Review Subcommittee at the request of the Senate Finance Committee was the basis for this legislation. Efforts were conducted over many months. It should be emphasized that the previous year school funding was dramatically increased partly to account for the increase in PERS/TRS obligations. Another increase was provided in the budget this year and the demand would continue in the future. He warned however, that any increase in money to address the past service liability is diverting money from the classroom and is eliminating funds for various state departments. On the local level, the obligation is removing funds that could have been used for such things as paving streets and improving sewer systems. "We're diverting cash flow from this generation to pay for liabilities incurred from a previous generation", as far back as the 1970's. He stressed that there should be concern that we not "unduly burden future generations of Alaskans to pay for the benefit structures of today and yesterday". It would be extremely difficult for the State of Alaska to forecast the health care costs

for a fifty year old man who might live to reach his nineties. Therefore, going forward, "we need to be able to have a benefit structure in place that is fair for the employees and fair for the citizens of the State"...a balance must be reached. It is "debatably out of balance" today, as the State is "definitely diverting" its cash flow for today to address issues that are 30 years old.

Senator Stedman encouraged testifiers to offer suggestions for amendments. Legislative staff could "fine-tune" the suggestions into the "proper kind of language". "Get it on the table so we can talk about it". When the issues at hand are in focus and the bill is revised to reflect that, it could be acted upon. He welcomed more "on-point" suggestions, particularly from involved professionals such as labor unions or management.

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Senator Bunde, addressing the argument that the bill would not address the approximate five billion dollar underfunding gap, voiced that this bill might prevent the gap from widening further. He asked Senator Stedman to further discuss how the underfunding issue would be addressed.

Senator Stedman hoped that the Committee would adopt the legislation "with revisions" and "task the new Board" to develop "specific recommendations" about how to address the underfunding issue. The goal would be to have those recommendations considered during the next Legislative Session. Although he would be surprised were it to prevail, one option that has been mentioned would be to receive "an equity infusion" from the corpus of the Permanent Fund. Other options could include changing targeted funding levels, developing cost containments, or undertaking pension bond restructuring.

Senator Stedman stated that efforts to tie in a debt funding mechanism with the restructuring of the Retirement System would be "complex" and therefore "too easy to get off-point in the discussion". The preferred method would be to address "the structural problems with the boards" and then address the debt. He agreed with Senator Bunde, that otherwise, the debt could continue to occur. In addition, over time, the number of retired employees would continue to increase, "relative to employed citizens", and thus would place further liability on the system under the current structure.

Co-Chair Wilken asked regarding the aforementioned "accelerated" bill schedule.

Co-Chair Green communicated that Legislative staffers have been working diligently toward the development of a committee substitute. The goal is to have a committee substitute developed prior to the end of March. To that point, significant Committee time would be dedicated to the bill. She encouraged people to provide their suggestions, ideas, and comments to the Committee "post haste".

Senator Bunde "hoped ... that the suggestion that we just hide our heads under the blanket and hope that this would go away would not be a viable option".

Co-Chair Green stated that a solution to the issue must be obtained.

Co-Chair Green communicated that an additional opportunity for public testimony would be available during the March 22, 2005 Committee meeting.

The bill was HELD in Committee.

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ADJOURNMENT

Co-Chair Green adjourned the meeting at 10:54 AM.