

MINUTES
SENATE FINANCE COMMITTEE
March 31, 2005
9:07 a.m.

CALL TO ORDER

Co-Chair Green convened the meeting at approximately [9:07:09 AM](#).

PRESENT

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

Also Attending: SENATOR GARY STEVENS; SENATOR BEN STEVENS; TERRY THURBON, Acting Chief Administrative Law Judge, Office of Administrative Hearings, Department of Administration; JOE BEEDLE, Vice President for Finance, University of Alaska; GEORGE SULLIVAN, Chair, Public Employees' Retirement Board; RICHARD J SOLIE, SR., Vice Chair, Teachers' Retirement Board; TRACI CARPENTER, Staff to Co-Chair Green; MELANIE MILLHORN, Director, Division of Retirement and Benefits, Department of Administration; KATHLEEN STRASBAUGH, Assistant Attorney General, Labor and State Affairs Section, Civil Division, Department of Law;

Attending via Teleconference: From Fairbanks: JIM JOHNSEN, Vice President for Faculty and Staff Relations, University of Alaska

SUMMARY INFORMATION

SB 141-PUBLIC EMPLOYEE/TEACHER RETIREMENT

The Committee heard testimony from the Office of Administrative Hearings, Department of Administration; the University of Alaska; and Board Members of the Teachers Retirement System and the Public Employees' Retirement System. 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 seventh hearing for this bill in the Senate Finance Committee.

Co-Chair Green informed the Committee that the role, functions and responsibilities of the Administrative Law Judge and the Office of Administrative Hearings in the appeals process would be further clarified.

TERRY THURBON, Acting Chief Administrative Law Judge, Office of Administrative Hearings, Department of Administration stated that the Office, which was created by SB 203 during the Twenty-Fourth Alaska State Legislature, became operational in July 2004. SB 141 would specify that the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS) would be administered by the Department of Administration, and, in addition, would specify that rather than PERS/TRS appeals being heard by a PERS/TRS Board, appeals would be heard by the Office of Administrative Hearings, also located within the Department of Administration. This has resulted in the perception that the appellants would not receive a fair hearing, as the appeal would be heard by an entity in the same Department as the entity that made the decision. The law that created the Office is multi-faceted with the mandate that it be an independent hearing office. The Office must be housed somewhere, and therefore it was placed in the Department of Administration in the same sense that the Alaska Public Offices Commission, the Office of Public Advocacy, and the Public Defender Agency are. "There is no department consisting of independent agencies in State government"; and organizationally, they must be placed somewhere. Appreciation for being placed in the Department of Administration was voiced, as the Office has been provided great accounting and other support from the Department's Division of Administrative Services.

Ms. Thurbon stressed that even though the Office is placed within the Department of Administration, "decisionally, the Office of Administrative Hearings is independent". Laws that have been

established to clarify this include conditions pertaining to the appointment and duties of the Chief Administrative Law Judge (CALJ). The CALJ is appointed by the Governor, subject to confirmation by the Legislature, for a five-year term and could be dismissed "only for good cause". These conditions provide the CALJ insulation from the perception that the CALJ might be subject to pressure. The CALJ extends this insulation to the Administrative Law Judges whom the Chief hires and supervises. The CALJ also oversees peer review and ensures that there is consistency in decision-making. There is "a barrier between the Department in which the Office is organizationally housed and the actual decision making function".

Ms. Thurbon commented that another important aspect is that the Office provides a central appeals panel in that individual hearing officers were removed from the Department of Administration, the Department of Revenue, and the Department of Commerce, Community and Economic Development and physically placed in one locale, independent of any other agency. This removes any inadvertent interaction with other agencies and members of the public.

Ms. Thurbon noted that the Office has been charged with the development of a code, or Cannon, of Hearing Officer Conduct. Included in these Cannons are such things as the obligation to decide cases independently, impartially, and fairly. One of the specific statutory goals of the Office is "to increase the public party's perception of the fairness in administrative adjudication". She stressed that while presentations or forums assist in getting the message out, the public's perception of fairness must be reinforced "one hearing at a time". This fairness issue must be shown in correspondence, in discussions leading up to the hearing, the presentation the ALJ makes at the beginning of the hearing, in the decisions that are levied, and other interactions. The public perception has improved in the short period of time that the Office has been in operation. The Office has issued approximately 150 decisions since January 2005 with only one request for reconsideration and approximately three requests for clarification on decisions. She noted that, when possible, she conducts a survey of participants regarding "their sense of how the hearing was handled" and she recounted some of those discussions. Efforts are made to issue non-judgmental and clear decisions that would be "well received by all the audiences that have to read them". She reiterated that the public perception issue would be addressed one case at a time.

Co-Chair Green voiced appreciation for "the thorough explanation".

AT EASE: [9:18:34 AM](#) / 9:19 AM

Co-Chair Green noted that the University would now present information regarding its Optional Retirement Program (ORP).

JOE BEEDLE, Vice President for Finance, University of Alaska, informed the Committee that he would be presenting proposed Statutory changes to the ORP, the University's defined contribution plan (DCP). The University (UA) has been studying the consequences and the expenses associated with the acceleration of employer contribution rates to its benefit plans and have determined that the status quo UA retirement and health care and other benefit expenses are projected to grow at a compounded rate of 19-percent through the year 2008; these expenses would exceed the revenue capabilities of the UA. The University's Board of Regents and the University president, Mark Hamilton, have furthered "research efforts" to modify the University's retirement plans consistent with current Statutes.

Mr. Beedle shared that the UA base salary in 2004 amounted to approximately \$246 million; the base salary with growth and nominal salary adjustments would increase to \$291 million or 4.3 percent compounded growth through the year 2008. UA benefit expenses would increase from \$74 million to \$148 million during that timeframe, were no changes made. The 2004 all-inclusive benefit amounted to 30-percent; for example, an employee earning \$1,000 would receive the equivalent of \$1,300 were benefits factored in. In 2008, the benefits' rate would equate to 54-percent were the status quo to continue. "Something must be done".

Mr. Beedle noted that at a March 17, 2005 meeting with the Board of Regents, President Hamilton communicated the desire that "rapid action" to address this situation occur. The University has the ability to make changes that other public entities do not have. Significant adjustments, such as "Best Practice Behavior" by its employees, have been made to the UA health care plan that should produce rewards by lowering the costs of the current plan. The next step would be to address the long-range cost issue.

Mr. Beedle stated that from the year 2005 through 2008, cumulative health care and retirement benefits would experience an increase of \$99.5 million. The Board and UA management are supportive of expanding the UA's ORP Defined Contribution Plan, which operates "exactly as a 401(K) plan". It does not provide health care benefits during retirement. During the time of "the oil price collapse" in 1986 and 1987, UA was successful in getting Legislative approval allowing it to create its Defined Contribution Plan or ORP.

Mr. Beedle recounted that, at the time, UA was experiencing difficulty in recruiting personnel; specifically research scientists. Such people are typically employed under Term Employment Contracts rather than tenure employment positions. As such, their employment arrangement might range from a five to eight year term and would not qualify them to vest in PERS/TRS or receive tenure status at UA. Thus the idea of the portable benefits provided in a Defined Contribution Plan was attractive ... "and it worked". Today, more than 750 people, or 25-percent of UA salaries, are, at their option, "voluntarily" employed under the DCP that allows the employee to manage for their own retirement. The UA ORP plan is restricted to full-time faculty and executives. Currently, 90-percent of the employees enrolled in ORP are faculty.

Mr. Beedle recalled that, initially, ORP "used an index rate that, in hindsight, was less than perfect". It was based on a three-year moving average of the TRS rate. UA is advocating changing this formula to correspond with Legislative action that would provide all public employees options that differ from those being offered today. In hindsight, the desire would have been to change the index rate to one "that is sufficient at the market to attract and retain top quality employees". "In hindsight, no one knew the disparity in the unfunded liability would occur".

Mr. Beedle continued that were Legislative action regarding a new Tier for PERS and TRS not imminent, UA is proposing that it be allowed to expand ORP to allow, "or perhaps require", new employees to consider health care benefits in their retirement.

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Mr. Beedle noted that President Hamilton and the Board of Regents support modifying the ORP Statute, AS 14.40 Article 5, in order to expand the plan.

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Mr. Beedle pointed out that proposed expansion language has been provided to members in a handout titled "Proposed Amendments for the ORP Statute" [copy on file] with the request that consideration be provided for either including the language in SB 141 or separate legislation. UA would be appreciative of any assistance in this matter.

Co-Chair Green asked whether the aforementioned handout's language is in draft or final form.

Mr. Beedle understood the language to be in final form. He

reiterated the desire to have separate legislation address this UA request were SB 141 to not advance this Session.

JIM JOHNSEN, Vice President for Faculty and Staff Relations, University of Alaska, testified via teleconference from Fairbanks and spoke to the University's situation in context of what is occurring in the State overall. "Public employer retirement costs are skyrocketing due to low earnings, retirement fund investments, historically low contribution rates, and retiree health costs".

[09:30:49 AM](#)

Mr. Johnsen communicated that while UA is willing to work with the Legislature on the initiatives being considered, its primary interest "is in retaining its ability to recruit and retain top quality faculty and staff from across the country". Currently UA provides three retirement plans and options to benefit eligible employees: PERS, TRS, and the ORP. Factoring in inflation and cost projections and were the current trend to continue, UA's total retirement cost of payroll for employer/employee contributions in FY 07 would exceed 34-percent for TRS, 37-percent for PERS, and 29-percent for ORP.

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Mr. Johnsen noted that in addition, all benefit eligible UA employees participate in a separate DCP pension plan to which the UA contributes 7.65-percent of salary, up to \$42,000. This is similar to the State's Supplemental Benefit System (SBS) program with the exception that the UA program has an annual limit of \$42,000 of salary.

Mr. Johnsen stated that in the context of health cost increases, UA projects over the next three years, FY 05 through FY 08, retirement cost increases of approximately \$40 million and health cost increases of approximately \$22 million. UA is familiar with the Legislature's and PERS/TRS Boards' efforts to contain these costs.

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Mr. Johnsen stressed that in administering its retirement plan, UA actively makes efforts to maintain UA's competitive status with other universities and corporations for top quality faculty and staff. UA believes that a retirement plan must provide "a responsible level of retirement benefits, must mitigate the affects of rising costs either through modifying benefits for future employees and/or increased Legislative funding and/or increased employee funding". The UA must "stay in front of efforts" to

contain benefit costs as demonstrated by its actions in developing the ORP in the 1980s as well as the establishment of the limit on the UA's pension plan contributions. Furthermore, UA has determined that any changes to the plans must include input from the affected faculty and staff. That process has begun. In addition, UA is supportive of increasing the role of the defined contribution concept, primarily due to its portability and cost effectiveness.

Mr. Johnsen, acknowledging that the State's Constitution prohibits the diminishment of a retirement benefit, communicated that the question has arisen regarding whether ORP has the same Constitutional status as PERS and TRS. UA's position is that "it does enjoy that same status" in that its plan holders should also be protected from diminished benefits. On the basis of a recent Legislative Council opinion, the UA has determined that either "the Legislature or the UA could modify the ORP plan in terms of eligibility for the program as well as future contribution rates".

Mr. Johnsen reiterated that faculty, all of whom are covered by collective bargaining agreements, account for 90-percent of the ORP plan participants. Changes could be made to the PERS/TRS plans without negotiations with collective bargaining units. The UA believes that ORP should also "be insulated from the collective bargaining requirement". According to a 2004 survey [copy not provided] conducted by the College and University Personnel Association, current UA contribution rates are generous. The combined employer/employee median national contribution rate is currently 14-percent: currently the PERS rate is 17.33-percent; the TRS rate is 24.65-percent; and ORP is at 21-percent. Were the current trends to continue, UA staff benefit rates for faculty would increase to more than 50-percent. This rise in cost, unless paid by the State, reduced by plan changes, or addressed by an increase in employee contribution shares, would result in a reduction of programs and services. Higher benefit rates would also impair the UA faculty's ability to compete on a nationwide basis for research grants.

Mr. Johnsen reiterated that while UA would support Legislative efforts to contain costs, it must maintain its ability to recruit and retain quality faculty and staff. Changes to the ORP law are being sought. He read the aforementioned "Proposed Amendments for the ORP Statute" handout as follows.

The major proposed changes would allow the University the flexibility to:

- Include a health plan, if needed;
- Expand the potential pool of plan participants to include

all employees (currently only faculty and administrators);

- Give a one-time second opportunity for employees who previously rejected ORP to join the ORP;
- Require new employees to participate in the University Optional Retirement Plan; and
- Include lump sum payments or other types of plan distributions as long as the plan complies with federal law for a qualifying program.

The proposed changes would also provide these clarifications:

- That like PERS/TRS, ORP is not a subject of bargaining under PERA, and
- That the University may create new tiers.

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Mr. Johnsen stated that since its inception, the ORP plan has been "very positive": it is portable" and has immediate vesting. Those features have provided UA the opportunity "to recruit more effectively" on a national basis. The fact that ORP vesting is not dependent on retiring from UA removes the incentive for an employee to remain at the UA "solely for the purpose of vesting". The plan's lack of a health benefit has enabled the UA to avoid a long-term health cost liability which otherwise would have amounted to approximately \$87 million.

Mr. Johnsen shared, however, that there is concern among some faculty members that ORP does not include a retiree medical benefit. The opportunity provided by ORP to select among several professional managers with a multitude of investment options provides employees choices in regards to the management of their own retirement accounts. In addition, the fact that UA manages "the account means that the program could be overseen by the Board of Regents ... and plan changes could be managed through the consultative process that is inherent in higher education".

[09:41:11 AM](#)

Mr. Johnsen commented that UA is supportive of ORP and wishes "to enhance it in the years to come".

Senator Hoffman, referencing the importance UA has placed upon being able to recruit and retain employees as well as its statements that the benefits of the defined contribution plan are portability and contain costs, asked regarding the experience UA

has had in retaining employees.

Mr. Johnsen responded that the goal is to establish retirement benefits, health care benefits, and compensation at levels that "don't drive" an employee's decision. In other words, the goal is to instead drive the employment decision by allowing the employee to focus on their research, their teaching, or their administrative tasks. The majority of the universities in the country have defined contribution plans similar to ORP; therefore, UA is able "to even the playing field" with the ORP plan and allow the faculty member's decision to stay to be based on academics or programmatic grounds rather than on what type of retirement program are provided.

Senator Hoffman asked regarding the retention record of those enrolled in ORP since the 1980s.

Mr. Johnsen expressed that the retention has been "very, very good. The University turnover rate is quite low". Many academics come to Alaska with the intent to stay for a few years and instead decide this is home and remain. UA's ability to recruit and retain at this point is strong.

Senator Bunde disclosed for the record that both he and his wife are Tier I recipients. He also shared that he has heard from the public that a change from the current retirement system would affect recruitment and retention efforts. Tier II or Tier III employees are as excellent a teacher as those in the Tiers before them and "it is likely" that employees in a new tier would also be excellent teachers. "The notion" that a change in the retirement system would leave the State "with the dregs at the bottom of the employment barrel ... is not representative of the talent pool we have" in the State. Private sector employers who offer DCP would argue that their businesses have been able to attract good employees.

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Senator Stedman asked whether the Board of Regents could change the methodology utilized for determining UA's employer contribution rate, which currently is the total of both the Normal Rate and the Past Service Cost. The Past Service Cost is the unfunded liability component. The current methodology is in part a contributor to the projection that the UA contribution rate would increase to 50-percent, which, were it to occur, would result in "an extensive list of applicants for employment".

Mr. Beedle agreed and replied that this is an opportunity for the UA to modify the current index, which is based on a three-year TRS

rate. The rate itself is the TRS Board's annual recognized rate that is subject to the five-percent increase or decrease limit per year. This rate "is artificially lower than the necessary rate so that people have a chance to absorb and plan". The UA would desire more clarity in Statute regarding whether the ORP rate and the plan are subject to collective bargaining.

Senator Stedman understood therefore that UA is utilizing the "Total Rate or the combination of the Normal Cost and the Past Service Cost. Clearly, tying the rate into the Past Service Cost would be a problematic situation that needs to be resolved for the University".

SENATOR GARY STEVENS commented regarding the portability verses stability issue that Senator Hoffman raised, in that school districts have characterized this as a "double-edged sword" in that there are both pros and cons in the situation. To that point, he asked the UA to differentiate the advantages and disadvantages of changing from a system that provides stability to one that provides portability.

Mr. Beedle stated that while it is a double-edged sword, there are opportunities provided by employee turnover. UA has experienced approximately a ten percent annual turnover. This might exceed that experienced by the State "as represented by salaries". The opportunity to attract new people, as the UA expands and begins new and different programs, is a benefit. The cost of training new employees is a disincentive. While people might be attracted to UA because of the portability factor, they tend to stay due to other attributes of the University. "The current momentum, the current success, the current growth, the current competitiveness", quality improvements, and good and consistent leadership the school is experiencing, together with the portable defined contribution plan, tend to enhance recruitment efforts rather than being "a disincentive" to those people who have chosen to remain.

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Mr. Johnsen addressed "the pros and cons" of DCP by commenting that the Plan is more "market sensitive" than a DBP. The DCP allows the employee to make more decisions regarding their retirement fund investments. The downside to that is that the employee might not be as competent in making those decisions, as would a large institutional fund. "There is also concern about the lack of a medical benefit in the ORP or other Defined Contribution Plans". This concern is being increasingly heard from faculty members, and UA is investigating the possibility of incorporating health savings accounts into the ORP.

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Senator Hoffman noted that the projected increases in benefit expenses provided by Mr. Johnsen did not correspond with those provided by Mr. Beedle.

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Mr. Beedle clarified that his references were for the years 2004 through 2008 whereas Mr. Johnsen had referenced the years 2005 through 2008. Also included in Mr. Beedle's benefit totals references were retirement, pension, health and any other benefit that UA employees receive, including tuition waivers.

Co-Chair Green asked for verification that the amendment proposals being referenced were included in the "Proposed Amendments for the ORP Statute" handout.

Mr. Beedle concurred and noted that the changes proposed for AS 14.40 Article 5 would allow UA to make the changes outlined by Mr. Johnsen.

Co-Chair Green asked whether UA would be available to respond to questions were these proposals included in the forthcoming committee substitute.

Mr. Beedle replied in the affirmative.

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Mr. Beedle summarized that it is not uncommon amongst both private and public universities nationwide to have a DCP that might be "slightly different than some government entities". UA should be viewed more like a State corporation than a State agency due to the fact that "62-percent of its revenue is generated from the University and approximately 38-percent will come from general funds". UA has an entrepreneurial component in terms of revenue generation and unlike a State agency, it is not limited to receiving State general funds "to accommodate their retirement program", as the UA would anticipate "the majority of the costs to be passed onto programs and revenue sources outside of the University". Funding the program in this manner was anticipated when the ORP program was initiated in the 1980s.

Mr. Beedle noted that while salaries amount to less than ten percent of the total expenditures of the Alaska Industrial Development & Export Authority (AIDEA), the Alaska Housing Finance

Corporation (AHFC), and the Alaska Railroad, UA salaries amount "to 60 percent of the cost of operating the university". This is the reason for "the sense of urgency as the University would otherwise" be "challenged to bear this cost through other than just State sources". Therefore, UA is requesting assistance with "the tools" through which to address the issue.

Co-Chair Green informed Members that the University's request would be considered as an amendment to SB 141.

[10:00:13 AM](#)

Senator Hoffman asked for further clarification regarding the University's recommendation that current PERS/TRS members be given an additional one-time opportunity to participate in the ORT program. The understanding is that this recommendation would not serve to eliminate PERS/TRS.

Mr. Johnsen responded that the proposal would allow one "additional opportunity to people who had the option in the past and who instead of choosing ORP", selected PERS or TRS. These people would be provided another opportunity to participate in ORP. Another recommendation is that the Board of Regents would be able to consider requiring all new employees to participate in ORP. "The legislation, as drafted, would provide" that ability to the Board of Regents.

Senator Hoffman understood therefore that the Board of Regents rather than the Legislature would make this determination.

Mr. Johnsen affirmed.

[10:00:49 AM](#)

Senator G. Stevens asked how the situation would be addressed were a person, at retirement, to have spent half their career in TRS and the other half in PERS.

Mr. Beedle responded that the answer would depend on which Tier the employee was in and where they were in regards to vesting and other retirement qualifications. Upon retirement, they would be entitled to their benefits, which would have been "collectively invested and managed through the Retirement Board's investment efforts". In a DCP, the employee would be provided information that would describe their responsibility, their risk, and the personal responsibility they would be assuming. Choices would be made regarding who would manage those funds for their retirement. "There is nothing to say that the University won't include some vesting schedule" in the

future; the modifications being proposed would allow for that.

Mr. Beedle expressed that there would be two separate investment options to existing members: the current PERS/TRS or the ORP. The Board of Regents would be able to consider the option of allowing those participating in SBS to rollover, to the extent allowable, portions of their SBS into ORP.

Co-Chair Green thanked the University for the presentation.

GEORGE SULLIVAN, Chair, Public Employees Retirement System (PERS) Board, informed the Committee that he is an 83-year resident of the State.

Co-Chair Green interjected to acknowledge that today was Mr. Sullivan's eighty-third birthday. [Applause]

Mr. Sullivan stated that other PERS/TRS Board members; specifically Dr. Richard Solie, Sr. and Kerry Jarrell, who had recently testified before the Committee, were tasked with addressing the bill's specifics. He, on the other hand, would be reviewing "the hemorrhaging" of the systems. The present plan and the indebtedness issue would continue for quite some time due to the fact there would still be Tier I, II, and III members. Nonetheless, legal changes to some areas of the system could help the situation.

Mr. Sullivan shared several areas of concern including: while an Attorney Generals Office letter has since been written to prohibit the practice, the Anchorage School District last year provided retiring principals a \$10,000 bonus that were factored into their retirement pension calculations; and Anchorage police and fire employees with seniority have the authority "under a union contract to get all the overtime, especially in their last three years ... which pumps up their retirement". In addition, there have been situations in which employees were absorbed into a labor group, which resulted in additional liabilities to the system.

Co-Chair Green understood that the issue of bonuses for departing members is addressed in the legislation. There is also Legislative interest in addressing the high three years issue. Alternative suggestions might include calculating the retirement on an average of the entire working career or a longer span of time.

Mr. Sullivan understood that language in the bill would address the high-three year base salary issue.

Co-Chair Green clarified that, to date, this issue has not been addressed in the bill. However, it is an issue of interest. Another

issue of concern is how to address "the proliferation of ... low salaried elected people who after a minimum number of months and years are fully vested in the health plan". Efforts should be made to ensure "that there is legitimate participate" by these people to insure "that they would contribute enough" to the system which would provide them a lifetime of health benefits after retirement.

Mr. Sullivan acknowledged that this was a factor in some people's participation in elected positions. However, this is a component of the system: "Nobody' at fault, and everybody's at fault" from the Boards, to the Legislature, to the Actuary and others. "But everybody is very sincere in wanting to get it corrected".

Mr. Sullivan suggested that some of the amendments that have occurred over the years in the Tiers plans should be eliminated. "Many little things" have incurred expenses to the programs.

[10:10:31 AM](#)

Mr. Sullivan voiced pleasure that, from July 1, 2004 through February 2005, the Investment Fund earned one billion dollars.

Mr. Sullivan asked that consideration be provided to retaining the two separate PERS and TRS Boards. Members of those Boards have made great contributions. The current appeals process could be likened to a jury by one's peers.

Co-Chair Green noted that current Board members could apply for appointment to the new board. Many are "fully qualified and have good experience". The "reconfiguration of the system" would provide "one point of responsibility, authority, power and fiduciary", in addition to being the sole source of information provided to the Legislature and others.

Mr. Sullivan reviewed the work entailed for Board members and proclaimed that the members of the new board "would be very, very busy".

[10:13:25 AM](#)

Senator Stedman noted that the issue of modifying a particular employee group is addressed in the bill in that "those types of changes are to be run through the actuary" so that the Legislature could more fully comprehend the financial impact of the decision.

Senator Stedman also commented that in this yearlong review of this issue, it should be noted that Mr. Sullivan's appointment to and chairmanship of the Board was considered "a positive".

Mr. Sullivan stated that when he joined the Board, two matters were particularly disconcerting: one was a summer 2003 letter from the Municipality of Anchorage asking that the Employer Contribution rate "be leveled off" rather than decreased, as it was anticipated that the next year's contribution rate would significantly increase. The decision to lower the contribution rate was the suggestion of the actuarial. In addition, in April 2005, the Boards would be determining the Contribution rates for FY 07 based on June 30, 2004 figures. "That's horrible" as no business could be successfully run utilizing aging data. Unfortunately, no solution to resolving this scenario has been determined.

Co-Chair Green communicated that she had asked that same question: how are private enterprises able to derive "more current information for making decisions" and make immediate changes to address the problem.

Mr. Sullivan stated that, otherwise, they would go bankrupt.

Senator Hoffman, noting that the TRS Board consists of fewer members than the PERS Board, suggested that the proposed make-up of the new "super board" be revised in order to provide fairer representation of those boards.

[10:19:14 AM](#)

RICHARD SOLIE SR., Vice-Chair, Teachers Retirement System Board, addressed the Committee to continue his previous day's presentation.

Senator Stedman commented that Dr. Solie has been working with his staff to address several areas of concern.

[10:20:34 AM](#)

Dr. Solie recalled the previous' days discussion regarding "the social security (SS) floor that exists" for private and some public sector employees. This SS floor does not exist for teachers who have worked their entire professional career in that field and thus have not contributed to SS. This is "a significant concern" on his part.

Dr. Solie reminded that the PERS/TRS Boards' Tier Review Subcommittee had conducted a employer/employee survey in which employers cited concerns about two elements: reducing overall costs to include the Past Service unfunded liability and to "share" rather than "shift" the risk totally to the employees". While the

Subcommittee could not address the unfunded liability issue, potential tier revisions might "at least help in the ability to deal with that".

Dr. Solie stated that the plan [Alternative 1] recommended by the Subcommittee "was carefully crafted to address these two elements: ...a significant shifting of the risk to the employees" as well as a reduction in costs. He reviewed the employer and employee contribution rate components of the Subcommittee's Alternative 1 tier redesign recommendation for TERS and PERS. Overall, in regards to both the medical and pension components the Subcommittee's proposal would equate to approximately a 39-percent reduction in Normal Cost for PERS and approximately a 30-percent reduction for TRS. In addition, the Subcommittee recommended that the employer would pay an amount less than or equal to that of the employee. A PERS employee would pay ten percent and the employer would pay 8.75-percent. Each would pay eight-percent in TRS. He spoke in support of the concept of equal sharing of Normal Cost.

Dr. Solie voiced some concern about SB 141's 100-percent DCP proposal. The Subcommittee "had voted unanimously against the 100-percent DC plan" even though it was presented to the full PERS/TRS Boards as Alternative 2. In contrast, Alternative 1, which was a blend of a Defined Contribution Plan and a Defined Benefit Plan, preferred to as either the Blended Plan or the Hybrid Plan, had unanimous Subcommittee support. However, many of the full PERS/TRS Board members did not support Alternative 1 due to the inclusion of "any element of a DC plan". He reiterated that he is supportive of the Hybrid Plan concept. While most public plans are currently DC plans, there is growing movement toward Hybrid plans. "It would behoove Alaska not to get too far out in front of the other employers" with whom we compete nationwide, particularly in regards to teachers as recruitment in that arena is already experiencing difficulties.

[10:27:30 AM](#)

Co-Chair Wilken asked for further information regarding the Hybrid Plan, specifically language in subsection (C) on page three of Dr. Solie's written testimony [copy on file] that reads, "(C). I personally pressed for a hybrid plan that included both a 1% DB and a DC component..."

[10:28:03 AM](#)

Dr. Solie explained that Alternative 1 proposed a one-percent Defined Contribution (DC) component rather than the two-percent multiplier utilized in the current plan.

In response to a question from Co-Chair Wilken, Dr. Solie replied that the one or two-percent applies to the percentage of base salary. Currently "that salary is based on the high three years. That engenders all kinds of problems". Currently an employee with 20-years of service would receive 40-percent of his or her retirement base salary. A longer-term employee could receive as much as 2.5-percent of their retirement base salary.

Dr. Solie stressed that the Alternative 1 proposal would have implemented a multiplier of one-percent of base salary. The base salary would be based on the employee's career average as opposed to being based on the employee's high three years. Under Alternative 1, a 20-year employee would receive 20-percent of their retirement base salary. The calculation would be indexed on the Anchorage Consumer Price Index (CPI), and the resulting base salary would be "very close" to the base salary calculated in the current manner. The high three years would not be an issue were it not "for the distortions that occur..." It should be noted that the Alternative 1 base salary formula would have been "significantly lower" than the current formula were the Anchorage CPI not utilized in the calculation.

Dr. Solie expressed that the problem inherent with the current high three-year base "is that there is a logical tendency for people to load up those last years" through such things as overtime and working in areas that have high cost of living allowances. It has been reported that, "some employees have doubled their average pay in their last three years by loading on overtime". The Division of Retirement and Benefits requested an Attorney General's letter to address the issue of bonuses that have been provided to encourage people to retire, being included in the base salary calculation. A variety of things "have been used to ramp up those high three years". Under the current plan, a \$10,000 pay increase in a 25-year employee's final year, would increase the annual retirement benefit by \$1,750. Other examples were provided. While a \$10,000 increase in the final year would also affect the benefit calculation proposed in Alternative 1, the base salary would be calculated on a career average.

[10:36:42 AM](#)

Co-Chair Wilken understood therefore that a blended plan would have two components: the percentage of base salary monthly pension component and the new defined contribution system component, which would be the 401(K) style component.

[10:37:27 AM](#)

Dr. Solie agreed and further expressed that the important element is the fact that the DB component would factor the retirement base salary differently than the current plan. Overall, most public entities are offering 100-percent DB plans, many are offering hybrid or blended plans, "and very few are total DC".

Dr. Solie noted that studies indicate that individually managed plans experience "significantly lower rates of return" than pooled accounts and that some people are utilizing "their retirement funds for purposes other retirement". While this is a concern, he has chosen not to focus on this during this presentation. However, on the risk side, it should be noted that "individual investors face risks that are significantly greater than those for a pooled fund" for several reasons: first of all "the volatility of the funds is such that there is a significant possibility that the individual's planned retirement will coincide with a down market". While an employee might decide at that time to delay retirement, a long term down market would "pose serious problems". In contrast, since only a small percent of employees in a pooled fund might retire each year, "the pooled fund can balance or level that off over a long period of time". Therefore, "an individual investor would be in much more severe risk" than a person in a pooled fund.

Dr. Solie stated that another risk is referred to as the "longevity risk or longevity factor". In a total DC plan, even were an individual prudent in handling their finances and had achieved a reasonable rate of return, the fact that people are living longer could present a problem in that they might run out of money before they die. This would not be a problem in a pooled fund because individuals who outliving the life expectancy would be balanced by those who do not. While it has been suggested that the individual investor could purchase an annuity, there is a problem in that an annuity is subject to the interest at the time it was drawn, and, were this to coincide with a down market, the individual would experience a low interest rate. This would result "in a low level of annuity". In contrast, a pooled fund would be able to spread interest rate levels over a long period of time.

[10:42:13 AM](#)

Dr. Solie reiterated his support for a hybrid plan that would encompass elements of both a DC and a DB plan.

Co-Chair Green asked for clarification regarding whether the blended DB/DC plan "would allow for cost sharing between the employee and the employer".

Dr. Solie replied that in TRS, the employee would pay ten percent and the employer would pay 8.75 percent of the total cost. The split would be eight percent employee and eight percent employer in PERS. He understood that, according to law, the employee's contribution could not be directed toward the health plan. The proposed Health Reimbursement Account (HRA) would be a 100-percent employer paid fund. It should be noted that the employee risk and cost was increased in Alternative 1 while the employer risk and cost was decreased. The ability of an employee to access the retirement fund would be directly related to their retiring from the system. In other words, were an employee to leave the plan prior to retirement age, they would be ineligible for retirement benefits. "This is a significant factor". It would also be a significant factor in retaining employees. In addition, how the plan coordinates with Medicaid would be redesigned. In the current plan, once an employee reaches Medicaid eligibility, there is essentially no co-pay even though "the plan suggests" otherwise. He reviewed how the current plans coordinate with the Medicaid eligible expense" levels in that the plans calculations typically result in there being no co-pay on the part of the member. Alternative 1 would change the plan's calculation formula in that "the co-pays and deductibles would be the same for Medicaid eligible members as they are for the pre-Medicaid eligible members so that there is a true 20-percent co-pay".

Co-Chair Green asked for further explanation.

Mr. Solie exemplified that was \$600 of a \$1,000 medical bill recognized as Medicaid eligible, the doctor could not legally hold the patient liable for the difference. Therefore, Alternative 1 would specify that 20-percent of the \$600 would be the employee's co-pay. This would serve two purposes: it would reduce the cost of the plan and, more importantly, would encourage the employee to monitor those costs. The current calculation does not provide any incentive to the employee to review charges or refrain from going to the doctor, as "it doesn't cost them a dime". The HRA would also provide an additional incentive "as it takes money that is in the individual's health savings account as it is akin to spending the employee's own money". Placing responsibilities on the individual in this manner would provide the incentive to carefully monitor expenses.

[10:49:52 AM](#)

Co-Chair Green understood therefore that in the aforementioned \$1,000 medical scenario, in which Medicaid recognized \$600 as being the legitimate charge, Medical would pay \$480, the employee would pay \$120, and the secondary carrier would pay nothing.

Dr. Solie concurred. There are some things that Medicaid would not cover and in those instances the present plan would address them. Nonetheless, the co-pay would be expected.

[10:50:43 AM](#)

Senator Bunde understood that the unfunded liability being experienced is the result of there being a DB plan. To that point, he asked whether the State would continue to experience underfunding as long as there was a DB component active in the system.

[10:52:13 AM](#)

Senator Stedman hypothetically stated that were the State to implement the hybrid plan, the improvements provided in the DB portion of the plan would assist in lessening the unfunded liability "were a similar mess to occur" in the future. It could be better managed. There are different costs associated with each of the existing tiers.

Senator Bunde surmised therefore that the opportunity for the liability to grow would continue to exist, proportionate to the ratio between the DC and the DB.

Senator Stedman concurred.

Dr. Solie added, for prospective, that the Normal Cost associated for Alternative 1, was five-percent; the current average for TRS is 13.9-percent; its 12.33 for Tier 2. The exposure would be significantly less with the one percent of base salary proposed in Alternative 1. Furthermore, while the actuary had no mechanism through which to calculate this, the career average salary would significantly reduce some of the abuses that have occurred.

Dr. Solie hoped that "the future boards would be more conscious of monitoring the assumptions". "Added care" would be applied in that regard. "Some of what is being proposed in this bill would certainly facilitate and encourage that". Some of the "build-up" resulting from "unrealistic assumptions extending for an unrealistic period of time ... would be eliminated in the future". This is a separate issue than the investment returns.

[10:55:34 AM](#)

Co-Chair Wilken clarified that a Medicare eligible person would be required to pay a Medicare premium expense each month.

Dr. Solie concurred that, "there are costs there". Medicare premium would be increasing this year.

Co-Chair Wilken asked whether there was any significance associated with the one-percent of base salary recommendation.

Dr. Solie replied that rather than being proposed for discussion, the one-percent of base calculation "was a specific recommendation". The Subcommittee reviewed several scenarios and determined that generally Alternative 1 "compared very favorably with the existing plan in terms of the retirement benefits that it would produce at the end. It is more favorable for males than for females", as DCP favor males due to their shorter life expectancy, and were a male to buy an annuity plan, he would receive a higher annuity than a female. In one scenario calculation, it amounted to a ten-percent difference. Alternative 1 "performed well with reasonable assumptions". He reviewed some of the scenarios that were calculated. Costs would be higher in a 100-percent DCP as sufficient additional money must be deposited into the plan to account for the fact that the employee would generally earns less than what would be earned by pooled plans. Therefore the employer must provide the employee "more to make up for that lower than expected rate of return". Nonetheless, while a 100-percent DCP might be more expensive in that regard, "it would have less risk". Alternative 1 had a reduction in costs and "a spreading of risk..."

Senator Stedman revisited the scenario in which an employee who was 100-percent vested in equities faced a downturn in the market at the time of retirement. He opined that being 100-percent in equities at that stage of their life "would probably not be the appropriate situation for the vast majority of people as they end their earnings careers". However, the risk assumed by an individual when they select their allocations would not be as well conducted, as it would be were it being professionally managed.

Dr. Solie responded that the rate of return could be 6.73-percent for a self-conducted plan verses an 8.25 return otherwise. It would "be roughly 1.5-percent" lower.

[11:00:34 AM](#)

Senator Stedman voiced that "generally speaking" that might be true for individual investors. He shared that how people have chosen to allocate their investments through SBS has not been evaluated in regards to what percent of stocks verses bonds people have chosen. One option, the Alaska Balance Fund, is 60-percent stocks and 40-percent bonds. From the employer standpoint, were the employee to choose to be "completely risk adverse", the question is should "the

employer escalate his contributions to make up for that". Some spread between stocks and bonds should be the goal through which to achieve sufficient returns.

[11:01:48 AM](#)

Senator Stedman stated in regards to the person who retires and buys an annuity, that annuity is not inflation proofed.

Dr. Solie concurred and noted that he had inadvertently omitted to specify that in his earlier comments.

Senator Stedman continued that inflation would erode the annuity "substantially" were one to have longevity.

Senator Stedman acknowledged that substantial improvements were presented in the DB portion of the hybrid, or Alternative 1 proposal developed by the Tier Review Subcommittee.

Senator Stedman noted that in moving forward with the DCP proposed in SB 141, the attempt is to provide fixed rate investment selections for the risk adverse as well as a blend of stock/bond and equity selections for others. Many of the issues raised by Dr. Solie are being recognized and addressed. In addition, he voiced appreciation for the interest in cost control expressed by Mr. Sullivan and Dr. Solie.

Senator Hoffman asked whether the one-percent of base salary proposed in the hybrid plan increased after the 20-year mark, as is the case with the current plan. The two-percent of base salary increases upward to 2.5 percent of base salary for years served after the 20-year mark.

Dr. Solie responded that there would be no increase; it would be a flat one-percent regardless.

Senator Hoffman asked whether an increase might serve as an incentive to retaining employees.

[11:05:25 AM](#)

Dr. Solie informed the Committee that once a person has worked 20 years, the requirement that they must retire from the plan in order to receive the health benefits would be an incentive to stay, in itself. From the position of cost, the flat one-percent of base salary would incur additional cost savings.

Dr. Solie disclosed that, while it was not formally proposed due to

there being the possibility of legal challenges, the Tier Review Subcommittee had determined that, were Alternative 1 furthered, the SBS that is currently available to a number of State employees, could be eliminated. Alternative 1 would have been "a comprehensive plan in and of itself" and the SBS would not be necessary. Its elimination would result "in a huge savings". Furthermore, there are currently "some inequities", as the SBS is not offered to all State employees. While the Subcommittee chose not to further the elimination of SBS, the Legislature would have the resources to examine this option. There was strong support for eliminating the SBS in both the Subcommittee and the PERS/TRS Boards in general.

Dr. Solie concluded his remarks.

RECESS TO THE CALL OF THE CHAIR [11:08:07 AM](#) / [4:38:23 PM](#)

[4:38:29 PM](#)

Discussion Topic: Medical benefits program for defined contribution plan members.

[4:39:15 PM](#)

TRACI CARPENTER, Staff to Co-Chair Green, referenced a handout titled, "Retirement Security Act, SB 141, Discussion Topic: Medical Benefits Program for DC Plan Members, March 31st, 2005" [copy on file].

[4:39:21 PM](#)

Page 3

Eligibility for medical benefits ("Retirement")

- A member is eligible for medical benefits when
 - The member has been an active member for at least a year; and
 - Meets the requisite age and/or service requirements of
 - Age 65 with 10 years of service; or
 - 25 years of service for peace officers/firefighters; 30 years of service for all others
- The surviving spouse of an eligible member is also eligible for medical benefits

Ms. Carpenter stated the intent of this presentation is to reemphasize information from previous discussions and address some possible changes to the legislation. She read the information of this page.

[4:40:21 PM](#)

Page 4

Proposed change to eligibility

- Remove the requirement for a member to "retire directly from the system"
 - Concept originated in tier redesign initiative
 - Purpose: recruitment management tool for hiring managers who might be aware of a person's history in the retirement system
 - Suggest this is a management decision and should not be legislated

Ms. Carpenter noted that Dr. Solie had addressed this issue in his testimony. The concern related to hiring managers who may be unaware that an individual had only a short amount of time before becoming vested; and that individual retiring as soon as the eligibility requirement is met. However, it was determined to be more appropriate as a management decision rather than a statutory provision.

[4:41:42 PM](#)

Co-Chair Green requested clarification of the eligibility for medical benefits upon retirement as shown on page 3 of the handout.

[4:42:00 PM](#)

Ms. Carpenter explained that a Public Employees Retirement System (PERS) member must be employed for at least 12 months before becoming eligible for retirement upon reaching retirement age.

[4:42:23 PM](#)

Senator Hoffman clarified that an employee aged 64 or older when hired must work for twelve months before becoming eligible to retire, regardless of whether that person has reached the age of 65.

Ms. Carpenter affirmed.

[4:42:39 PM](#)

Co-Chair Green understood that this employee would not necessarily receive "a lifetime" of full benefits.

Ms. Carpenter agreed and explained that the employee must reach the

age of 65 to be eligible for the medical coverage in conjunction with Medicare; however the employee is also required to have ten years of service to qualify.

[4:43:13 PM](#)

Page 5

Proposed changes to election of benefits

- Add a deferral election of medical benefits to date specified
- Member must make irrevocable decision of coverage by age 70 1/2 or termination of employment, whichever is later
- Clarify that participation in the retiree major medical insurance plan is not required to participate in health reimbursement arrangement

Ms. Carpenter explained this provision would allow a retired employee to defer participation in the medical insurance plan until a later date. This would be applicable in situations in which that employee may be receiving health benefits through another employer, through a spouse's participation in a health plan, etc. This could be addressed through regulation rather than statute.

[4:44:12 PM](#)

MELANIE MILLHORN, Director, Division of Retirement and Benefits, Department of Administration, informed that the Division of Retirement and Benefits has authority to adopt regulations and in this case would do so to ensure that individuals could defer participation. This provision would likely include a stipulation that the individual provide proof of other insurance coverage to demonstrate no gap in coverage to avoid allowing a member to "pre-select", which could result in increased costs to the plan.

Co-Chair Green clarified that an employee would not be required to receive the medical benefits immediately upon retirement from the system.

Ms. Millhorn affirmed, so long as the member could prove they had other medical coverage with no lapse in coverage.

[4:45:54 PM](#)

Ms. Carpenter listed the second portion of the proposed changes shown on page 5, which provides that participation in the major medical plan is not a requirement to participate in the Health Reimbursement Arrangement (HRA). This option might appeal to individuals in good health, individuals with a spouse who has

medical coverage, etc. The HRA could be used to fund out-of-pocket medical expenses.

[4:46:37 PM](#)

Co-Chair Green asked if the employer solely funds the HRA program.

Ms. Carpenter answered yes.

Co-Chair Green understood the employee benefits in the HRA are not transferable or portable.

Ms. Carpenter again affirmed.

[4:46:56 PM](#)

Co-Chair Wilken asked why a member would defer their medical benefits.

[4:47:04 PM](#)

Ms. Carpenter exemplified young person entering the system at age 25 who worked 30 years until the age of 55 then retired. Under the current language of the bill, this individual would be required at the time of retirement to pay a monthly premium for the health benefits. The individual could prefer to not participate, due to good health or access to other insurance through a spouse, etc.

Co-Chair Wilken asked for further explanation.

Ms. Carpenter explained that the employer would contribute to the health benefit costs once the individual has reached the age of 65 or becomes Medicare eligible.

[4:47:54 PM](#)

Senator Hoffman asked how this proposal differs from the existing benefit system.

[4:48:02 PM](#)

Ms. Millhorn described the medical plan currently in statute. Upon retirement, a qualified individual receives a pension benefit, which includes a medical benefit. She gave as an example a tier I employee who retires at age 55 and receives a pension benefit as well as a medical benefit for themselves and their dependants.

[4:48:54 PM](#)

Co-Chair Green understood the Division has implemented changes to the retired medical benefits program in recent years that have resulted in some savings. She asked what legislative changes would further enable the Division to reduce expenses, and what proposed statutory changes would hamper that effort.

[4:50:04 PM](#)

Ms. Millhorn detailed the current process in which health evaluation committees comprised of PERS and Teachers Retirement System (TRS) members, as well as the Department, make recommendations to the commissioner of the Department of Administration. Commissioner Matiashowski has issued a mandate to identify and consider potential cost savings. The commissioner has the authority to implement certain changes to the system. This process provides flexibility to implement changes in a timely manner. If statutory amendments were required, the amount of time required could negate some of the potential savings.

[4:51:39 PM](#)

Co-Chair Green stressed the importance that the statutory changes proposed in this legislation not become too restrictive to the Department.

Co-Chair Green knew of changes to the plan involving greater use of generic drugs and a requirement that beneficiaries submit proof of eligibility. She asked about other efforts.

[4:52:13 PM](#)

Ms. Millhorn told of the preferred provider provision enacted in the year 2003. This stipulates that active members who receive hospital treatment in the Anchorage area must receive that treatment at Providence Medical Center. Before this requirement was enacted, 80 percent of the Anchorage resident members had already received any hospital care at that facility. This provision results in a cost savings of \$1.5 million. The intent is to implement this provision for the retiree medical plan as well.

Ms. Millhorn told of another major initiative implemented for the first time. This involves an "open enrollment plan" and would require proof of eligibility for dependants, such as marriage licenses. This would be implemented in July 2005 for active members and in January 2006 for retiree members. An auditor predicted this would reduce the number of dependants receiving benefits by 15 percent and would save \$4 million annually for the active member

plan and \$16 million annually for the retiree plan.

[4:54:18 PM](#)

Co-Chair Green directed the Division to inform the Committee of any matters that should be legislated or not legislated to facilitate further cost savings. She exemplified a requirement for the use of generic brand drugs. She had understood the Division already has the authority to implement such a requirement.

[4:54:55 PM](#)

Ms. Millhorn affirmed the Division has this authority. She agreed that flexibility to implement cost reductions is beneficial.

[4:55:06 PM](#)

Page 6

What are the medical benefits?

- Access to the retiree major medical plan and the health reimbursement arrangement (HRA)
- "Access" to the major medical plan means a person may not be denied coverage except for failure to pay the required premium
- Coverage of an eligible member includes the member, member's spouse, and member's dependent children
- Coverage of a surviving spouse includes the surviving spouse and dependent children of surviving spouse

Ms. Carpenter overviewed the information on this page.

[4:55:50 PM](#)

Page 7

Proposed change to coverage

- Change language to cover only "the dependent children of the eligible member who are dependent on the surviving spouse"
- Prevents coverage of second family dependents that had no relation to the member
- Keeps plan qualified under federal regulations

26 U.S.C. 152 defines a dependent child as: a son, daughter, stepson, stepdaughter, eligible foster child, or adopted child who lives with the member, is less than age 19 (less than age 24 if a student), and has not provided more than one-half of their own support during the year

Ms. Carpenter explained that this provision was excluded from the bill due to a drafting oversight.

[4:56:29 PM](#)

Co-Chair Green assumed that benefits provided to persons who are not dependents of the member would constitute income that must be claimed on federal income tax filings.

Ms. Carpenter affirmed that this practice would be out of compliance with federal tax regulations.

[4:56:53 PM](#)

Page 8

Major medical plan premiums

- "Early retirees" are members and surviving spouses who meet the service requirements for eligibility but are not eligible for Medicare
 - Pays one of the full monthly group premiums for coverage (retiree only, retiree + spouse, retiree + family, retiree + children)
- Medicare eligible (currently age 65) members and surviving spouses pay a portion based on the member's years of service
 - 30% for 10-14 years
 - 25% for 15-19 years
 - 20% for 20-24 years
 - 15% for 25-29 years
 - 10% for 30+ years

Ms. Carpenter overviewed this information

Co-Chair Green noted that this plan would not have one rate for every retiree.

Ms. Carpenter affirmed.

[4:57:41 PM](#)

Ms. Carpenter continued that the premium amount would be less for Medicare eligible benefits than the premium for pre-Medicare benefits.

Co-Chair Green asked if a member who worked at least 30 years would pay only ten percent of the premium.

Ms. Carpenter affirmed.

[4:58:19 PM](#)

Page 9

Major Medical premiums cost example

- FY 2004 Medicare projected claim cost: \$2,667
- Defined health benefit contribution % based on length of service of the member
 - Member's Years of Service: 10-14
 - Annual Employee Contribution: 30% \$800
 - Annual Employer Contribution: 70% \$1,867
 - Member's Years of Service: 15-19
 - Annual Employee Contribution: 25% \$667
 - Annual Employer Contribution: 75% \$2,000
 - Member's Years of Service: 20-24
 - Annual Employee Contribution: 20% \$533
 - Annual Employer Contribution: 80% \$2,134
 - Member's Years of Service: 25-29
 - Annual Employee Contribution: 15% \$400
 - Annual Employer Contribution: 85% \$2,267
 - Member's Years of Service: 30+
 - Annual Employee Contribution: 10% \$267
 - Annual Employer Contribution: 90% \$2,400

Ms. Carpenter noted this information was calculated based on information provided by Mercer Consulting, Inc.

[4:58:42 PM](#)

Senator G. Stevens, referring to the provision stipulating qualifying dependents, asked if adopted children would qualify.

Ms. Carpenter replied that this provision would include these dependants so long as the dependant is an adopted child of the member.

[4:59:12 PM](#)

Page 10

Employer contribution for major medical coverage

- Employer pays 3.75% of employee compensation into a health trust fund
 - o Current bill language calls for deposit into active group life and health insurance trust fund
 - o A legal opinion is presently being sought on accounting methods vs. true separation of assets
 - o Anticipated that language will have to be changed in some way

- Employer contribution was projected based on the tier redesign initiative which contains separate rates for TRS (3.75%) and PERS (3.5%)

Ms. Carpenter overviewed the information on this page. The language in the bill regarding deposit of employer contributions into one trust fund may not be allowable. Although it may be desirable to pool these funds; however the exclusive benefit rules governing each may prevent this practice.

[5:00:24 PM](#)

Senator Bunde pointed out that if these funds could not be pooled in the formation of the new tier, the fund would start from zero. He asked how monies would be immediately generated to pay benefits for tier 4 members.

[5:00:51 PM](#)

Ms. Carpenter responded that the members of the new tier system would not be eligible for benefits for ten years.

[5:01:09 PM](#)

Senator Hoffman asked the status of funds invested in the trust accounts for an employee who works nine years then terminates from the system.

[5:01:19 PM](#)

Ms. Carpenter replied that those funds would remain in the health trust fund, as those funds are designated for the exclusive benefit of the plan. It is anticipated that if an individual returned to work, their account would be reactivated and interest would accrue.

[5:01:52 PM](#)

Senator Hoffman remarked that a percentage of these employees would never return and asked if the funds contributed on their behalf would remain in the trust account.

[5:02:07 PM](#)

Ms. Carpenter affirmed. The bill has no provision to address these funds, and therefore the funds would continue to be held in the trust account in perpetuity.

[5:02:25 PM](#)

Senator Hoffman clarified that the benefits would only be received upon retirement and to those members who worked at least ten years for a participating employer.

Ms. Carpenter affirmed.

[5:02:43 PM](#)

Co-Chair Green asked if the Committee was awaiting legal advice on the matter of employer contributions to the health reimbursement arrangement (HRA) account for employees who do not become vested.

Ms. Carpenter answered that legal counsel is being sought on the trust fund issue and whether contributions must be made to separate funds. The issue Senator Hoffman spoke to was the status of funds contributed by employers to the health reimbursement account on behalf of employees who leave the system before working ten years and becoming vested.

[5:03:37 PM](#)

Ms. Carpenter announced that the current employer contribution rate of 3.75 percent was derived from the tier redesign initiative and is used for both PERS and TRS members through this legislation for ease of comparison. Because the employer does not share medical benefit costs with the employee until the employee reaches the age of 65 or becomes Medicare eligible, Mercer Consulting was asked the impact of this. The consultant reported that the projection for medical normal costs is reduced by approximately two percent. The new medical cost rate for TRS is therefore projected to be 1.5 percent and 1.4 percent for PERS, which is demonstrated on Page 11.

[5:04:36 PM](#)

Page 11

Rationale for cost sharing only after Medicare

- 25 states have a normal retirement age of 65, including
 - o Arizona, Idaho, Nevada and Washington
- 75% of the retiree medical costs for the AlaskaCare Plan are from normal retirement age until members are Medicare eligible
- Eliminating the cost sharing between ages 60 and 65 reduces the medical normal cost rates to 1.5% (TRS) and 1.4% (PERS)

Ms. Carpenter stated this is the rationale for choosing this method of cost share program. She overviewed the remainder of the

information on this page. During the five-year period between the normal retirement age of 60 and the age of Medicare eligibility of 65, the plan incurs 75 percent of its costs.

[5:05:28 PM](#)

Senator G. Stevens asked if this is because retirees beyond the age of 65 are covered by federal insurance.

Ms. Millhorn answered yes, that when a member reaches the age of 65, the Alaska plan coordinates with Medicare for coverage. This results in significant cost savings for post age 65 members compared to pre age 65 members. Pre age 65 members, regardless of their tier, incur 75 percent of the costs. In the year 2004, the total medical claims costs for the retiree program was \$225 million, with only 25 percent being paid for post age 65 members.

[5:06:33 PM](#)

Senator Bunde remarked that although this may provide a good medical plan, many members might be unable to locate a physician willing to accept Medicare payment. He asked if members must participate in the Medicare program to receive benefits through the State plan. He suggested this proposal would result in "selling them a service they can't use."

Co-Chair Green replied that participating in Medicare is not an option.

Senator Bunde noted that people over the age of 65 have the option of continuing to work, in which case they would not be required to enroll in Medicare.

Co-Chair Green agreed.

[5:07:34 PM](#)

Page 12

Medical costs

- Every 1% of base payroll = \$21.6 million

[Spreadsheet showing Medical Normal Cost Rates as follows:

PERS

Total FY 06 Estimated Base Payroll: \$1,587,594,875

Current DB Plans: 8.68%

Medical Cost in Dollars: \$137,803,235

Tier Redesign Initiative: 3.5 %

Medical Cost in Dollars: \$55,565,821

SB 141 (implied): 1.4%

Medical Cost in Dollars: \$22,226,328
TRS
Total FY 06 Estimated Base Payroll: \$573,410,095
Current DB Plans: 9.07%
Medical Cost in Dollars: \$52,008,296
Tier Redesign Initiative: 3.75%
Medical Cost in Dollars: \$21,502,879
SB 141 (implied): 1.5%
Medical Cost in Dollars: \$8,601,151
Total Annual Medical
Current DB Plans: \$189,811,531
Tier Redesign Initiative: \$77,068,699
SB 141 (implied): \$30,827,480
Total Payroll: \$2,161,004,970
Savings:
Tier Redesign Initiative: \$112,742,832
SB 141 (implied): \$158,984,051

Ms. Carpenter explained this is a demonstration of the medical costs.

[5:08:29 PM](#)

Senator Hoffman savings because changing from prepaid medical program to the proposed program.

Ms. Carpenter correct. This legislation would provide that members pay a "great deal more of the cost" in that they would pay the insurance premium from the date of employment termination until they reach the age of eligibility for Medicare.

[5:09:08 PM](#)

Senator Bunde asked if a member retires after 30 years of service at the age of 55 whether that member would receive no insurance until they reach the age of 65.

Ms. Carpenter replied that the member would be eligible to participate in the plan and pay the plan premium.

Senator Bunde asked if the member would be required to pay \$400 as indicated on page 9.

Ms. Carpenter corrected that the information of page 9 pertains to individuals eligible for Medicare. The premium is considerably higher for pre Medicare eligible individuals. Those individuals would bear the full cost of the premium. She estimated the premium at approximately \$800 current dollar value.

[5:10:15 PM](#)

Senator Bunde stated that a member who retires at age 55, who seeks medical coverage would be required to pay \$800 per month for ten years.

Ms. Carpenter answered this is correct; however, the member could utilize funds from their HRA account to offset the premium costs.

[5:10:45 PM](#)

Senator Bunde asked if the health reimbursement arrangement is solely the responsibility of the employee or if the employer matches contributions.

Ms. Carpenter replied that the HRA involves employer contribution only. She stated that the current version of the bill provides that one percent of the average employer group salary is contributed by the employer into the fund.

[5:11:14 PM](#)

Co-Chair Green pointed out that in the years after a person has retired and before becoming eligible for Medicare, the ability to purchase health insurance is a significant issue. This proposal guarantees that members could participate in a health insurance plan.

[5:11:53 PM](#)

Senator G. Stevens questioned Senator Bunde's earlier comment asking for clarification that if a member retires and becomes eligible for Medicare benefits, the impact is less to the State system; however, if that person continues to work for a participating employer, a "drain" is made to the system.

Ms. Carpenter clarified that if a member continues to work for a participating employer, that member is covered as an active employee.

Senator G. Stevens asked if this applies to active employees age 65 and over.

[5:12:54 PM](#)

Senator Bunde clarified his earlier statement, saying that the Medicare program is comprised of two components, one relating to

catastrophic insurance coverage, and the other a more general health care coverage. At the age of 65, an individual is required to "take" the catastrophic coverage but is not required to enroll in the other service at a cost of \$50 per month if that individual has other insurance coverage.

[5:13:24 PM](#)

Senator G. Stevens commented that the practice of members continue to work and not enroll in the extended Medicare benefits is a cost to the State system.

[5:13:30 PM](#)

Co-Chair Wilken asked how long the funds in the health reimbursement agreement account would last for a member who worked 30 years, retired at age 55 and paid the approximately \$800 monthly premium for continued health coverage.

Ms. Carpenter replied that the amount of members' HRA account would be at the age of retirement is still being calculated. She estimated the amount to be \$25,000 ore more, dependant upon the rate of return and the employer average wage group growth from year to year. Presently, the legislation contains a provision limiting the annual contribution to no more than \$500. This would limit the growth of the funds, because within five to seven years, this \$500 limit would be reached.

[5:15:03 PM](#)

Senator Hoffman asked if no past service rate would be imposed to recover medical costs.

[5:15:18 PM](#)

Ms. Carpenter answered, no.

[5:15:20 PM](#)

Senator Hoffman asked if the past service rate would only be imposed for the retirement program.

Ms. Carpenter explained that no past service cost is included in this plan, "just by the nature of it being a defined contribution plan."

[5:15:40 PM](#)

Senator Hoffman referenced testimony citing the losses of \$5.7 billion have been directly attributed to medical costs. This is the State's responsibility, but asked why no past costs are included in the proposed plan.

[5:16:28 PM](#)

Senator Stedman replied that under the current tier structure, the employer and employee makes contributions and make an estimated contribution rate that is intended to pay the benefits of the future. If the estimations are insufficient, the deficit accumulates as a past service cost.

[5:17:11 PM](#)

Senator Bunde calculated that a retired member at age 55 could utilize funds from their HRA account to approximately three to four years of the premium for health insurance coverage. An option for the member would be to subsidize those payments from other sources and spread the HRA account over a longer period.

Ms. Carpenter agreed based on the estimate figures she provided. She stressed there would be no requirement to pay these premiums with funds from the HRA, a member could utilize other funding sources available to them and chose to utilize the HRA funds for other medical expenses.

Senator Bunde predicted that age 62 would become a standard retirement age.

[5:18:28 PM](#)

Ms. Millhorn commented that SB 141 "does an excellent job at redesigning the medical plan." Testimony, as well as Division research has indicated that a primary driver associated with the underfunded status is the medical portion of the plan. Many states have increased the retirement age to 65 years, therefore reducing their medical costs. This proposal includes the "element of consumer driven health care attached to it". This shares responsibility for these costs with the employee, thus providing incentive for employees to give consideration to costs for health services. She pointed out that when purchasing a new vehicle, consumers research the options and the costs of vehicles in making a purchasing decision. This is not done for health care services. This bill would change this practice.

[5:20:07 PM](#)

Senator Bunde mentioned a formula to determine whether an individual is able to retire, using the age multiplied by the number of years worked and other factors. She asked if the witness knew this formula.

[5:20:31 PM](#)

Ms. Millhorn indicated she would research the matter.

[5:20:47 PM](#)

Senator Bunde suggested this would be helpful for comparative purposes.

[5:20:58 PM](#)

Ms. Carpenter asked if Senator Bunde was referencing a "rule" whereby retirement is dependent upon a combination of age plus service equaling a set number. She had information regarding this calculation for every state.

Senator Bunde noted that age 55 is a young age to retire, and wanted comparison information of other states.

[5:21:44 PM](#)

Senator Stedman requested an explanation of how the State would finance its portion of the premium, which could assist in answering Senator Hoffman's question.

[5:22:17 PM](#)

Ms. Carpenter detailed the cost-sharing plan implemented once a member reaches the age of 65 or becomes Medicare eligible. Based on the number of years a member worked for a participating employer, the member would pay a maximum of 30 percent of the insurance premium after becoming Medicare eligible. The employer would pay the remaining amount of 70 percent or less for employees with fewer years of service.

Senator Stedman asked where the employer would secure funds for its portion of the cost sharing.

Ms. Carpenter replied these funds would be paid from the retiree health trust. Currently, employers contribute 3.75 percent of each employee's salary to the retirement trust, although it is estimated that only 1.5 percent would be required for medical benefits, based on information provided by Mercer Consultants, Inc., as well as

data garnered from the existing medical plan. The proposed retirement management board would manage the health trust.

[5:23:55 PM](#)

Senator Stedman asked if management of the health trust account would involve an actuary analysis process to calculate the necessary contribution rates to fund the benefit liability.

[5:24:15 PM](#)

Ms. Carpenter replied this would occur due to requirements for actuarial evaluation stipulated in the bill; however, the current language establishes the employer contribution rate.

[5:24:44 PM](#)

Senator Stedman stated that if health care costs accelerated higher than anticipated, a situation could occur in which the health trust would have an unfunded liability. In this event, the legislature could amend statute to increase employer contribution rates.

Ms. Carpenter affirmed.

Senator Stedman noted this is a "difference in the magnitude, but the concept is the same."

[5:25:29 PM](#)

Senator Hoffman asked how health care benefits are paid for current retiree members.

[5:25:40 PM](#)

Ms. Carpenter replied that the monthly premium amounts for insurance for current members are transferred from the PERS or TRS trust funds into the retiree health trust account.

Senator Hoffman asked if funds for both current and future employees would be held in the same retiree health trust.

Ms. Carpenter answered this is not the intent, as legal constraints likely would prohibit the pooling of funds in this manner.

[5:26:34 PM](#)

Kathleen Strasbaugh spoke out of range of the microphone.

[5:26:50 PM](#)

Ms. Millhorn informed that the Division has many initiatives underway. A pending lawsuit pertaining to medical costs is challenging current practice. The Alaska Supreme Court issued a decision in the year 2003.

[5:27:27 PM](#)

KATHLEEN STRASBAUGH, Assistant Attorney General, Labor and State Affairs Section, Civil Division, Department of Law, testified that the Division of Retirement and Benefits made changes to the retiree health plan in 1999 and 2000 intending to be balanced in increased benefits and detriments. The changes affected out-of-pocket expenditures, maximum lifetime benefits, issuance of drugs, stop-loss provisions, travel requirements and coordination of benefits with the Medicare program.

Ms. Strasbaugh informed that the National Education Association, the American Federation of State, County and Municipal Employees, and another retiree affiliated organizations filed a class action suit challenge these changes on the grounds they constitute a diminishment of benefits. The Alaska Superior Court found, on summary judgment, that the changes did violate constitutional provisions. This decision was made without production of significant evidence and without a "trial-type proceeding".

Ms. Strasbaugh continued that the Alaska Supreme Court accepted the case on petition from the State for review to settle the constitution question. The Supreme Court held that while the constitutional provision does apply to health benefits and therefore benefits and detriments must be offset, but also that this determination must be made on a group basis, rather than individual perception allowing members to "pick and choose". The case was considered to have prevailed because the summary judgment was not reversed.

Ms. Strasbaugh listed next task is to evaluate the events of 1999 and 2000 to determine whether the benefits and detriments are actually balanced. Both parties would likely file motions or a trial would be held on this issue. No stay was issued, but inspection of any proposed change to ensure that any impacts would be offset by benefits to members, would be appropriate.

[5:30:44 PM](#)

Co-Chair Green asked if the witness knew the timeframe in which this matter would be resolved.

[5:30:51 PM](#)

Ms. Strasbaugh did not. A trial order has not been issued and the parties have been exchanging information and holding depositions of experts. This work is yet to be completed.

[5:31:20 PM](#)

Co-Chair Green announced that amendments would be introduced and would be included in discussion.

Co-Chair Green ordered the bill HELD in Committee.
#

ADJOURNMENT

Co-Chair Green adjourned the meeting at 05:32 PM