

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
April 1, 2005  
9:13 a.m.

**CALL TO ORDER**

Co-Chair Green convened the meeting at approximately [9:13:12 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:** SENATOR GARY STEVENS; SENATOR TOM WAGONER; NEIL SLOTNICK, Assistant Attorney General, Labor and State Affairs Section, Civil Division (Juneau), Department of Law; MILES BAKER, Staff to Senator Bert Stedman

**Attending via Teleconference:** There were no teleconference participants.

**SUMMARY INFORMATION**

SB 141-PUBLIC EMPLOYEE/TEACHER RETIREMENT

The Committee heard a presentation from the Department of Law regarding the Alaska Resident Cost of Living Adjustment class action lawsuit and its relationship to this legislation. In addition, the bill's sponsor discussed the contribution rate component of the proposed Defined Contribution Plan. 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 eighth hearing for this bill in the Senate Finance Committee.

Co-Chair Green stated that the Department of Law would be explaining the A. John Gallant, et.al, Plaintiff, vs. Public Employees' Retirement System, et.al., Defendant, Case No. 3AN-02-9748 Civil class action lawsuit regarding the Alaska resident ten-percent Cost of Living Adjustment (COLA) and its possible impact on the State of Alaska.

NEIL SLOTNICK, Assistant Attorney General, Labor and State Affairs Section, Civil Division (Juneau), Department of Law, stated that the Gallant V. Public Employees Retirement System class action lawsuit (Lawsuit) is relevant to SB 141, and, in addition, might require "Legislative attention in the future". The Class referenced in this Class Action Lawsuit consists of the entirety of the current members of the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS). The Lawsuit challenges the Constitutionality of the Alaska resident COLA, which, as a feature of both retirement systems, "adds ten percent to the retirement income of anyone who" physically resides in the State. It is not paid to a retiree or disability recipient who resides outside the State or who is absent from the State for more than a 90-day period. The Lawsuit contends that such withholding of the ten-percent COLA is unconstitutional under the State's Equal Protection Clause on the basis "that it burdens their right to travel" outside the State. Furthermore, the cost of living in many areas outside of the State is as high or higher than the cost of living in Alaska, and, therefore, a person moving to those areas is penalized.

Mr. Slotnick stated that one of the first issues addressed by the Department in regards to this Lawsuit was "the question of severability". The Department's argument before the Judge was that, were the withholding of COLA found unconstitutional, "the right remedy would be that no one" would receive it. "The Legislature would never intended there to be an unconstitutional provision given to retirees, and therefore, what we should do is just strike it completely, if in fact, it turns out to unconstitutional".

[9:16:25 AM](#)

Mr. Slotnick stated that were Superior Court Judge John Suddock to agree to the Order of Severability argument in advance, the Lawsuit might not move forward "as there would be no advantage to anyone" in doing so. However, the Judge did not agree with the State's argument in this regard. The Alaska Superior Court Summary Judgment ruling on this issue is depicted on page five of the Department's information packet titled "A. John Gallant et. al. Plaintiff, vs. Public Employees' Retirement System, et. al., Defendant" [copy on file]. The basis for the ruling was Article XII, Section 7 of the State's Constitution, which reads as follows.

Retirement Systems. Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired.

Mr. Slotnick read the Judge's aforementioned ruling as follows.

Plaintiff's Motion for Partial Summary Judgment, on Article XII, Section 7 grounds, is styled as a request for a finding of constitutionally required severability. The Court instead grants partial summary judgment on the related rationale that Article XII, Section 7 prohibits reduction of the ten percent supplement as to class members, while they are Alaska residents.

Mr. Slotnick stated that, "what the Court held was that we cannot take away this COLA to Alaskan residents under the Constitution because it is in fact a vested right in their pension". Were this ruling upheld by the Alaska Supreme Court, it would "certainly affect SB 141 and any attempt to do away with the COLA as to everybody". The Superior Court has ruled that the COLA as "a vested right for Alaska residents cannot be diminished either Legislatively or by a Court", even were the residency issue found to be unconstitutional.

[9:18:52 AM](#)

Senator Stedman understood that System retirees "living in high cost areas relative to Alaska" such as Seattle Washington or Phoenix Arizona are interested in this issue, even though he considered it "odd that the intent was to have a cost of living for living in Alaska. Now it is being twisted around and trying to be made applicable to golfing in Phoenix".

Mr. Slotnick responded that would be the State's argument when the State takes "this case to the Alaska Supreme Court and appeals" Judge Suddock's ruling. "The COLA doesn't penalize someone's right to travel." People who remain in the State, which has "generally higher costs than the Lower 48", would receive this supplement to their retirement income. However, that is not how Judge Suddock viewed it. His ruling was based on a 1984 Workers Compensation (WC) case in which a formula calculates the compensation payments based on the average wage rate of the state in which the injured worker resided. "The formula that was in effect at the time had a huge affect on workers who left this State because average pay up here at the time, during the pipeline, was so much greater than the average pay down in the Lower 48. The Court found that that was in fact a burden on the workers right to travel" as some WC compensation payments were reduced by more than 50 percent. Judge Suddock deemed the denial of the COLA to be similar to the WC case as it would reduce someone's retirement income by ten percent, and the individual might be moving to an area with higher cost of living than Alaska. The State does not agree with the COLA/WC comparison because rather than diminishing someone's retirement income, COLA pays "someone an extra ten percent because they do live in the State of Alaska which is, in general, more expensive than the rest of the Lower 48".

SENATOR GARY STEVENS asked whether the COLA would be eliminated for the entire year or only for the length of time that an individual is outside of the State for more than 90 days.

Mr. Slotnick responded that the COLA would be withheld only for the period of time an individual were absent from the State for more than 90 days. COLA would be reinstated at the time of their return to the State.

Mr. Slotnick noted that Judge Suddock's order that was issued in August 2003 "clearly" indicates that eliminating the COLA for all Alaskans would be unconstitutional. The litigation as it stands today is in regards to a question that arose to the effect of "if the cost of living adjustment being limited to Alaska residents is an unconstitutional residency requirement, what's the remedy?" Were the State required to provide "the COLA to all retirees, then it should not be viewed as a Cost of Living Adjustment at all". The Judge disagreed and stated that the State should find out where the retirees live, and compute the cost of living for that area, "and if it is in fact as high or higher than the cost of living" in Alaska, then the State would be required to pay the COLA. The State has argued that this should be done on a state-by-state average rather than individual areas' averages. The Judge ruled otherwise: the cost of living must be conducted by the metropolitan service

area (MSA) in which the person resides. Were the MSA study not conducted, the Judge stated that all retirees, regardless of place of residence, must receive the ten percent COLA. Furthermore, were the Supreme Court to uphold Judge Suddock's ruling, the State would be required to develop a new formula for a Constitutional cost of living adjustment formula within one Legislative session plus six months for regulations, after that ruling.

[9:24:31 AM](#)

Mr. Slotnick warned the Committee that the subsequent ruling on the COLA might occur within the next two Legislative sessions, and could result in another unfunded liability the size of which is unknown. A "worst case scenario", which would include both payments going forward, and, as specified in the class action lawsuit, "past damages going back at least six years to make everyone whole for this unconstitutional act" could amount to approximately \$33 million per year. The reply to the State's argument that, "you don't get payment for unconstitutional statutes." was that "It's a contract." The State then argued, "No, there was no contract to pay retirees who don't live in the State ten percent, there was no offer and acceptance. The offer that was always made was ten percent more if you lived in the State of Alaska. That was the contractual provision. The Judge agreed with us". He said "no contract damages, no looking backward damages, only going forward would there have to be an increase in payment and that would depend" on whether the State develops a formula to determine the cost of living in the different MSAs.

Mr. Slotnick reiterated that the \$33 million per year figure was a worst-case scenario. Accurate costs are difficult to determine at this time.

Senator Hoffman asked the percentage of retirees who live in State.

Mr. Slotnick estimated that 68-percent of PERS retirees and 65-percent of TRS retirees reside in the State.

[9:27:33 AM](#)

Co-Chair Green asked for further information regarding the individuals who initiated the Lawsuit.

Mr. Slotnick explained that it is a class action lawsuit and all current and retired PERS/TRS employees have been certified as participants. The basis being that any Alaska resident member's right to travel would be burdened because, were they to leave, they would lose the ten percent COLA.

Co-Chair Green asked for further information regarding the individual(s) who originally filed the Lawsuit.

Mr. Slotnick replied that the named plaintiffs are a retired Department of Corrections officer who lives in Hawaii, and two teachers who lived in Kenai and wanted to leave the State but had not left at the time the case was filed.

[9:28:32 AM](#)

Senator Stedman theorized therefore that an out-of-state retiree could move from a low cost of living area to one with a high cost of living and receive what could be likened to a ten percent raise. There is a problem.

Co-Chair Green asked how often the MSA comparison must be conducted. She suggested that the retirement payment should be reduced were the area deemed to have a lower cost of living.

SENATOR TOM WAGONER echoed Co-Chair Green's suggestion that a reduction in the retirement payment could be considered were the out-of-state retiree to reside in an area with a lower cost of living. He disclosed being a recipient of the ten-percent COLA, and stated that it was a factor in his decision to retire early and remain in the State. The COLA allows other retirees to remain in the State and, as such, has an economic impact.

Senator Wagoner asked what solution to the issue is being considered and whether it might require a Constitutional amendment that specifies that anyone who retires and remains in the State would be entitled to a ten-percent cost of living adjustment.

[9:30:12 AM](#)

Mr. Slotnick recommended that no further action on the part of the State occur until after the Supreme Court ruling is made. There is "already a Constitutional amendment that tells us that any residency preference granted by the Legislature to residents of the State of Alaska shall be treated the same under Alaska Constitutional standards as under federal Constitutional standards ... Under federal standards, this kind of COLA would not be viewed as a burden on anyone's right to travel". One argument presented to the Superior Court was that the people of the State, through their action of adopting the Constitutional amendment, have approved treating this type of "preference for Alaska residents as leniently as possible under all Constitutional standards. The Court did not agree that that Constitutional amendment applied here, and viewed

this "not as a preference as meant under that amendment". Therefore the Court applied Alaska law.

Mr. Slotnick stated that the discussion of adopting "yet another amendment to the Alaska Constitutional saying that this time we mean it ... would only work if in fact the decision is under Alaska law. If it's a federal equal protection standard that says this COLA were unconstitutional, that type of amendment wouldn't work". To date, there is no indication "that the federal Constitution would require this result; it is only under Alaska Constitutional law". The Legislature and the people of the State have already provided the Department of Law "the weapons we need to defend it". The Department would do its "best to defend it in the Supreme Court".

[9:32:36 AM](#)

Senator G. Stevens asked whether this situation could be likened to someone being refused a Permanent Fund Dividend (PFD) due to their being out of state.

[9:33:08 AM](#)

Mr. Slotnick noted that the State has argued that there is a connection. The issue of denying a PFD to someone who did not meet the residency requirements has been addressed by the Alaska Supreme Court "and the Court has held that when you leave the State you are not eligible for a PFD even if in fact you are an Alaskan resident" which is defined by the 180-day requirement. The Court decision "upheld that as not being violative of someone's right to travel even though they're as every bit an Alaska resident on the one hundredth and eighty-first day as on the one hundredth and seventy ninth ... doesn't matter ... it's a benefit, it's not a burden". The State likes this connection. However the Superior Court Judge did not recognize this connection; he did not view his decision in the COLA case as overturning the PFD ruling.

Senator Bunde suggested that, were the State to not prevail in this case, one options would be to reduce everyone's retirement by ten percent rather than increasing everyone's retirement by that amount. Were that to occur, the names of the persons who filed this suit should be released to PERS/TRS members.

[9:34:31 AM](#)

Senator Dyson recounted that numerous class action suits have been filed in the past few years, and, he himself, "had ended up being a part of" two cases. He shared that, in those instances, those in

the "class" had been provided an opportunity to opt out of the suit. Therefore, he asked whether an opt-out clause could be included in this case.

Mr. Slotnick expressed that, "there are such things as non opt-out class actions". Research would be conducted to clarify the mechanics of the law in regard to this case. Typically the opt-out ability is provided when damage claims are a component, as is the case here.

[9:36:02 AM](#)

Co-Chair Green asked whether the upholding of the Superior Court Judge's decision by the Supreme Court would eliminate the possibility of repealing the COLA benefit "for all members of the existing retirement system", both active and retired.

Mr. Slotnick affirmed that it would. Were the Superior Court's ruling to hold, repealing the existing COLA "would be a difficult task, given our Supreme Court precedence".

Co-Chair Green understood that that ruling would apply to members of Tiers 1, 11, and 111 of PERS and Tiers I and II of TRS.

Mr. Slotnick agreed.

Co-Chair Green stated that the interpretation of the COLA provision is "clearly not what was intended by anyone. It was the incentive to stay here ...". There are financial implications that are of concern to this Committee. The Committee should be made aware of any action that might be required on its part to assist the State's legal staff in this issue.

Mr. Slotnick acknowledged the request. He reiterated that, "the Constitution has a provision that says you cannot diminish or impair the accrued rights of members of the State Retirement Systems. The Courts take a very liberal interpretation of that provision. I think it would be very difficult to defend repealing the COLA for existing employees, regardless of whether they've retired already or not because once they have accepted employment with the State or with the member employers, then part of their contractual rights includes that COLA upon retirement should they choose to stay in the State".

Co-Chair Green commented that, "the key issue is whether the employee stays within the State".

Senator Bunde surmised therefore that his earlier suggestion to

eliminate COLA would not an option.

Senator Bunde asked regarding the financial impact of the Lawsuit were the State not to prevail.

Co-Chair Green stated that the worst-case scenario could be approximately \$33 million annually.

Mr. Slotnick clarified that the \$33 million amount would include back damages, as there is the possibility that the Supreme Court could reverse the decision made in the State's favor in that regard. While the State is hopeful that the Supreme Court would reverse the Superior Court Judge's ruling, the claimants are hopeful that the Supreme Court might reverse the back damages ruling. Were that to occur, the State would face an unfunded liability of \$33 million per year. The financial impact of the Supreme Court's ruling would be "very difficult to compute until we have done a lot more research on the cost of living in the MSAs; where people are living; who would be eligible for what."

Co-Chair Green pointed out that the process involved in the MSA study and the gathering of information "would be costly". Additional expenses would be incurred were someone to move to another MSA. She viewed this as "an unreasonable burden".

Mr. Slotnick responded that the cost of conducting studies was argued in Court. The Judge "just shook his head and said, 'No, its not going to be the sky is falling, Mr. Slotnick'". Twenty-five to thirty-five high-cost MSAs could be identified and surveyed. It would be "Constitutionally permissible for you to make an assumption that its lower costs than Alaska until proven otherwise". "Even that burden though is not insignificant". There would be an additional burden related to the tracking procedures.

Co-Chair Green concurred that the "targets are ever-changing".

Mr. Slotnick concluded his remarks.

[9:42:13 AM](#)

Senator Stedman, the sponsor of SB 141, stated that today's hearing would concentrate on the Contribution Rate component of the proposed Defined Contribution Plan (DCP). A seven-page handout, titled "Contribution Rates for New Defined Contribution (DC) Plan", dated April 1, 2005, along with a fourteen-page handout titled "Comparison of the States Normal Retirement by Age/Service" [copies on file] were distributed to complement the presentation. The 14-page handout provided examples of retirement benefit levels as

influenced by retiree age and length of service.

Senator Stedman voiced appreciation for the laborious work being conducted by his Finance Aide, Miles Baker, in developing the bill and the handout materials.

Senator Stedman reviewed the "Contribution Rates for New Defined Contribution (DC) Plan" handout as follows.

[9:43:51 AM](#)

Page three

Defined Benefit Plan

- \*Benefit level is fixed
- \*Benefit is based on a formula involving salary, years of service, age, etc.
- \*Benefit is paid for life and to qualified survivors
- \*Future benefit payments are NOT driven by investment performance.

Defined Contribution Plan

- \*Contribution level is fixed
- \*Benefit is based on the amount of money invested and earned in employee's account
- \*Benefit is paid until account runs out
- \*Future benefit payments are driven by investment performance

Senator Stedman discussed the side-by-side comparison of a Defined Benefit Plan (DBP) and a Defined Contribution Plan (DCP). As discussed during Mr. Slotnick's presentation, there are certain legal obligations that must be considered when endeavoring to modify the State's current DBP retirement plan.

Senator Stedman noted that while the contribution level would be fixed in a DCP, the level could be increased or decreased "in the future if need be". Rather than being a pooled investment, each DCP employee would have their own account and would receive the benefit until either the account is empty; or there were "a separation of service and the employee decides to transfer the funds to his new employer"; or, were the employee to die, the funds were transferred to the heirs.

Co-Chair Green concluded therefore that this portability factor is "the distinction between" a DBP and a DCP.

Senator Stedman concurred and stated that in today's working environment, it would not be unusual for an employee to have three or four different careers throughout their life. A DCP with its portability component would allow an employee, with multiple careers, to move his/her funds from one employer's retirement plan

to another. A DCP would therefore, not penalize an employee "at the end when they want to retire".

Senator Stedman stated that the State's current Supplemental Benefit System (SBS) and the Deferred Compensation Plan are examples of future benefit payments driven by investment performance.

Senator Stedman explained that page four compares the differences between the investment accounts of a DCP and a DBP: a DBP pools employee and employer contributions and the benefits are paid out as determined by a set formula; a DCP establishes individual employee accounts with the retirement money being a combination of employee and employer contributions during his/her working years and the cumulative investment earnings.

Senator Stedman further explained that, in a DBP, the "cumulative benefit payout over a member's retired lifetime is not necessarily representative of what they deposited during their active career". A "classic example" is someone who works in a "system for five or ten years" and "gets health care for life" at age 60. "There is no way" the employee could have contributed enough to cover the cost of health care for life. Therefore "the obligation to meet the payments ... is borne by the employer".

Senator Stedman noted that in a DCP, both the employee and the employer contribute into an individual account. Whatever amount of money that is accumulated in that account by the time the employee retires, is dispersed.

[9:49:44 AM](#)

Senator Bunde asked whether the "Constitutional prohibitions" afforded the DBC would allow a current employee's contribution to be adjusted upward in order to support the increased liabilities the plan would experience due to increased life expectancy.

Senator Stedman replied that when a new actuarial assumption table is brought forward that indicates that life expectancy has increased the increased cost of that liability is borne solely by the employer. No mechanism is included in the DBP that would allow working or retired employee contributions to be increased to offset the increased costs. It was difficult in 1960, 1970, and 1980 to forecast the expenses associated with health care costs in the year 2004.

Senator Bunde stated that, considering the Constitutional prohibitions, Senator Stedman's response that current employees

could not be asked to increase their contribution was not unexpected. While understanding the difficulty in forecasting but given the fact that for the past fifty years life-spans have been steadily increasing, he asked whether new employee contributions could be increased, or "hedged", regardless of current figures, in anticipation of future liabilities resulting from their longer life expectancies.

Senator Stedman responded that the most recently adopted actuarial tables, which are supported by actuarial reports, did reflect an increase in liabilities. While he was unsure of the extent, he hoped that some "migration" is built into the actuarial table. Asking the actuaries how they incorporate, from the adoption of the table, the slow migration to whatever the table might be in the future would be a good question. To that point, he recalled TRS Board member, Richard Solie's, March 31, 2005 testimony before the Committee in which he voiced concern that the actuarial assumptions regarding the growth of health care were low. The Board is discussing the issue and asking the actuarial consultant for further information. Were that assumption found to be low, it would increase the Fund's liabilities.

[9:54:07 AM](#)

Senator Bunde asked whether there is any legal prohibition to hedging calculations going forward two or three years, in anticipation of assumption increases, rather than using today's figures.

Senator Stedman voiced being unaware of any.

Senator Stedman stated that, as described on page four, the funds invested by both the employee and the employer in a DCP and the rate of return on those investments, would be available for retirement. In a DCP, the employee would choose his/her investment strategy from a selection of options similar to the current process for SBS. There is a difference between the current DBP pooled investment account and the individual accounts proposed in the DCP.

Page five

Normal Cost Comparisons - TRS Tier II & PERS Tier III  
Vs. Proposed DC Plan

	FY 06 Normal Cost Rates		
	TRS II	PERS III	DC Plan
Medical normal cost rate	7.93%	7.23%	3.75%
Defined contribution rate	12.43%	10.32%	11.50%

HRA contribution rate	0.0 %	0.0%	1.0%
Gross normal cost rate	20.36%	17.55%	16.25%
Member contribution rate	(8.65)%	(6.81)%	(8.00)%
Employer normal cost rate	12.71%	10.74%	8.25%

Senator Stedman stated that in order to simplify the variety of concepts and the volumes of information, "a blended rate", which is an average of the PERS Tiers I, II, and III and TRS Tiers I and II, was used. In order to compare the current tiers, PERS Tier III and TRS Tier II, to the proposed plan, the table on page five was developed. The medical cost rate in the current tiers ranges from 7.23% to 7.93% as compared to 3.75% in the proposed DCP.

Senator Stedman stated that the Health Reimbursement Account (HRA) currently does not exist under the current plan; therefore, it is reflected as zero in the PERS/TRS table and as one percent in the DCP. The total of the three cost elements, or the Gross normal cost rate, is 20.36% for TRS Tier II, 17.55% for PERS Tier III, and 16.25% for the DCP. The amount that the employee pays as the Member Contribution Rate must be subtracted from this amount. Therefore the Employer normal cost rate equates to 12.71% for TRS, 10.74% for PERS and 8.25% for the DCP, even though there is no employer normal cost component in the DCP as "there is no past service cost for the retirement side", since the DCP "is technically not a pension plan".

Page six

Factors that drive the contribution rate discussion

- Investment Return Assumptions
- Cost/Benefit Balance for the Employer
- Total Acceptance Normal Cost
- Keeping Competitive in Northwest Region

Senator Stedman stressed that the discussion should focus on these four elements; specifically what might be a reasonable rate of return range and keeping the State competitive in recruitment and retention of employees, particularly in regards to teachers.

Senator Bunde asked, were the DCP in effect, whether the process might be similar to Amerada Hess, in that the employee money might be managed and invested as a subset of the Permanent Fund Corporation.

[10:00:26 AM](#)

Senator Stedman imagined that the investment strategy would be

crafted along the lines of the State's Supplemental Benefit System. The question about the management of monies has been raised several times during the discussion, and the Finance Committee should delve into the issue of whether the Permanent Fund Corporation should manage the existing systems' pooled accounts rather than the accounts being managed by the Department of Revenue.

[10:01:27 AM](#)

Senator Bunde reasoned that consolidating the accounts under the Permanent Fund Corporation management would result in cost savings resulting from opportunities such as volume purchasing.

Page seven

Normal Cost Comparisons - Proposed DC Plan vs. Existing TRS/PERS (all Tiers)

	FY 06 Normal Cost Rates		
	TRS	PERS	DC Plan
Medical normal cost rate	9.07%	8.68%	3.75%
Defined contribution rate	13.90%	11.37%	11.50%
HRA contribution rate	0.0 %	0.0%	1.0%
Gross normal cost rate	22.97%	20.05%	16.25%
Member contribution rate	(8.69)%	(6.81)%	(8.00)%
Employer normal cost rate	14.28%	13.24%	8.25%

Senator Stedman reiterated that even though the desire is to develop a DCP plan that would be comparable with PERS Tier III and TRS Tier II, blended rates consisting of both TRS I and II and PERS Tier I, II, and III are used in this table comparison to provide consistency.

[10:02:42 AM](#)

Page five

Normal Cost Comparisons - TRS Tier II & PERS Tier III Vs. Proposed DC Plan

	FY 06 Normal Cost Rates		
	TRS II	PERS III	DC Plan
Medical normal cost rate	7.93%	7.23%	3.75%
Defined contribution rate	12.43%	10.32%	11.50%
HRA contribution rate	0.0 %	0.0%	1.0%
Gross normal cost rate	20.36%	17.55%	16.25%
Member contribution rate	(8.65)%	(6.81)%	(8.00)%
Employer normal cost rate	12.71%	10.74%	8.25%

Senator Stedman revisited the table presented on page five, and noted that the DCP's Normal Cost Rate of 3.75% "includes some pre-65 health care costs", as provided by the actuary. Since the medical component in a DCP becomes effective at age 65, the pre-65 health care costs amounting to approximately two-percent, should be removed. Therefore, when determining the Defined Contribution amount as a percentage of payroll, "there is roughly two percent to work with", without changing the potential contribution rate of the employer or the employee. Therefore, the Defined Contribution rate could be increased from 11.5% to 13.5% or a portion of the two percent could be factored into the HRA component. This two-percent flexibility would provide options that could be undertaken before the targeted rate structure were changed.

Senator Stedman referred the Committee to the aforementioned 14-page handout titled "Comparison of PERS Tier III & TRS Tier II Pension Benefits vs Defined Contribution Investment Account". He noted that TRS Board Member, Richard Solie, had spent a significant amount of time discussing the proposed legislation with his staff person, Miles Baker, and the modeling forecast tool Mr. Solie had developed when he was a member of the PERS/TRS Tier Review Subcommittee was incorporated into these comparison tables.

[10:05:44 AM](#)

Senator Stedman stated that definitions of the headings and language included in the handout are depicted on page two. "Samplings" of retirement variables including such things as age, years of service, and defined contribution amounts has been developed and included in the handout. Other age and variable samplings could be provided as desired by the Committee.

Senator Stedman explained that the page three retirement sampling examples a PERS employee who was hired at the age of 25 and retired at the age of 55 with ten years of service. This individual has an expected life expectancy of 23.8 years beyond his retirement age of 55. His salary was \$39,128. There is an inflation factor, based on the Anchorage Consumer Price Index (CPI) of 3.50-percent. Another factor in this retirement scenario is "the high five salary years" component equating to \$55,397. Other than the "High Five" variable, the criteria listed at the top of the pages could vary.

Senator Stedman continued that the sampling tables depict a variety of scenarios based upon the combination of such things as a Contribution Levels column that utilizes retirement contribution levels ranging from 11.50-percent to 14.5 percent; a Total Return column reflecting total returns on the selected investments ranging

from 4.5-percent to 8.75-percent; a Real Return column indicating the real return on the investment after inflation ranging from 1.00-percent to 5.25-percent; a Final Salary column; an Account Balance at Termination column; a Beginning Annuity column; an Annuity as percent of Final Salary column; the Existing PERS Pension Benefit; and the DC verses DB column. As an aside, he noted that the Alaska State Pension Investment Board (ASPIB) and the Permanent Fund Board utilize a five-percent real rate of return.

[10:11:36 AM](#)

Senator Stedman noted that the difference between the retirement sampling table his staff had developed and that of Mr. Solie was that Mr. Solie had incorporated an Annuity, developed at the point of retirement, into his model in order to compare that amount to the current system. Currently, the DBP system incorporates inflation into the money being drawn in retirement. It should be noted that one of the challenges with annuities is that they provide a fixed payment until one dies and are not inflation-proofed. To that point, were one to exceed the life expectancy of the annuity, inflation would erode its purchasing power. This would be detrimental over the long run. While such an annuity is not available, inflation is factored into the annuity in Mr. Solie's table in order to provide a better comparison between TRS II/PERS III and the proposed DCP. This would serve to more realistically compare "apples to apples".

Senator Stedman mentioned that a number higher than 100.00 percent in the "DC vs DB" column on the sampling table would indicate that the DCP would be more beneficial to the retiree. A number less than 100.00 percent would indicate that the current DBP structure would be more beneficial.

[10:13:33 AM](#)

Senator Dyson asked for further information regarding the "Existing PERS Pension Benefit" column; specifically whether the amount depicted was a monthly or annual pension benefit.

MILES BAKER, Staff to Senator Bert Stedman, responded that the amount depicted in that column is the annual pension benefit amount.

Senator Dyson questioned the fact that this person's annual pension would only amount to approximately \$6,000.

Mr. Baker explained that in this scenario the person was hired at the age of 25 and retired at the age of 55 with "only ten-years of

service". The term of service and the individual's salary levels would affect the annual pension amount. It should be noted that under the existing DBP, this person would be guaranteed the pension for life.

Senator Dyson acknowledged.

Co-Chair Green interjected that the pension amount is based on a standard formula that calculates the number of years of service multiplied by two percent, multiplied by the high three-year salary.

Mr. Baker pointed out that the pension amount calculation formula for the PERS/TRS pensions are detailed in Item #10 at the bottom of the definitions page, page two.

[10:15:19 AM](#)

In response to a question from Co-Chair Wilken, Mr. Baker stated that the individual in the aforementioned scenario would receive an annual pension of \$6,625 per year under the current DBP, were the Contribution Level 13.00 percent with an 8.25 percent Total Return rate, and a \$95,312 Account Balance at Termination. Were the proposed DCP in effect, the individual would receive \$5,780 per year.

Co-Chair Wilken calculated that, under the DCP, the individual would receive \$5,780 annually for 16-years: the \$95,312 account balance divided by \$5,780 equates to sixteen.

Mr. Baker responded that in this scenario the DCP pension calculation was based on a life expectancy is 23.8 years.

Co-Chair Wilken understood therefore that the \$5,780 payment would be received until either the account was depleted or the individual died.

Mr. Baker expressed that in order to compare the DBP and the DCP, the projected life expectancy rather than an actual age of death is utilized. The "Account Balance at Termination" amount is divided by the number of years of life expectancy after retirement to determine the annual pension amount under the DCP.

Co-Chair Green concluded therefore, that "for the purposes of the formula", the life expectancy of 23.8 years is used in the calculations.

Mr. Baker noted that the life expectancy numeral is based on the

male mortality table, and as such, "is a dynamic number depending on the scenario" being run.

Senator Hoffman asked regarding the formula for determining the "DC vs DB" percentage calculation.

Mr. Baker pointed out that in this particular scenario, the percent in the "DC vs DB" column was calculated incorrectly.

Mr. Baker stated that to determine which plan would be more beneficial to the individual, one should compare the amount in the "PV 2004" subheading under the "Beginning Annuity" column to the Existing PERS Pension Benefit. In this case, those numbers would be \$5,780 and \$6,625, respectively.

Senator Hoffman acknowledged and voiced that, in this scenario, the 118.90 percent reflected in the "DC vs DB" column is incorrect.

Mr. Baker agreed and reiterated that the percent calculation was inadvertently reversed in this scenario.

Senator Hoffman concluded therefore that under the given scenario, the individual would not achieve 100-percent until the Total Return was greater than 8.75 percent.

Mr. Baker agreed.

[NOTE: Further clarification regarding the correct methodology for the "DC vs DB" ratio is located at Time Stamp 10:26:59 am.]

Co-Chair Green suggested that the amount in the termination year, or "Term Yr.", column might be the number applicable to the "DC vs DB" column calculation. The columns could have been inadvertently reversed.

Mr. Baker stated that, as depicted in the "Final Salary Term Yr." column, the value of the final salary in the year the individual terminated was \$59,825. That amount would be the equivalent of \$22,060 today, as depicted in the Present Value (PV) column. He reminded the Committee that this individual was only employed for ten years.

Co-Chair Green furthered her previous suggestion by stating that, at the 12.50% Contribution Level with a 8.75% Total Return, the \$8,116 amount in the "Term Yr." subheading under the "Beginning Annuity" column, is 122.49% of the \$6,625 Existing PERS Pension Benefit, depicted in the "DC vs DB" column. That column might be the proper one to be used in the calculation. Perhaps those columns

were inadvertently reversed.

Mr. Baker stated that he would revisit the information presented in the tables as he might have inadvertently used incorrect information. The correct methodology would have been to use a ratio of the amount in the "PV 2004" subheading under the "Beginning Annuity" heading to the Existing PERS Pension Benefit" column.

Co-Chair Green acknowledged.

[NOTE: Co-Chair Green was correct in suggesting that the "DC vs DB" ratio should be that of comparing the "Beginning Annuity Term Yr." to the "Existing PERS Pension Benefit". This clarification occurs at Time Stamp 10:26:59 am.]

[10:20:56 AM](#)

Senator Dyson, continuing the line of questioning begun by Co-Chair Wilken, asked whether, under a DCP, a retiree would receive monies based on the balance of their account plus the money earned annually on the investment and their life expectancy. He questioned what would occur were the individual to live longer than their life expectancy and the balance of their account to reach zero.

[10:21:56 AM](#)

Mr. Baker replied that "there is a finite amount of money" in the account under the DCP concept. As argued by Richard Solie in his presentation, that "would be one of the risks" the employee would bear under the DCP. Individuals must plan for such things or face the possibility of deleting the funds in their retirement account. This is the reason that Mr. Solie "argued for the floor". This would not be an issue for someone in a DBP.

Senator Dyson asked whether a person with a life expectancy of 78, as projected in this scenario, could have their payment amount readjusted when they reached, for example, the age of 73.

Mr. Baker replied that under the conditions of the current DBP, the person would continue to receive the benefit until their death. At that time, the spouse and dependents would continue to receive the benefit. Upon termination of an employee under the DCP, the individual would receive a lump sum amount of which he/she could choose how to disperse it. There is no mechanism through which to provide an individual more money were their life expectancy to increase.

Co-Chair Green emphasized that a person who works for only ten

years should not have the expectation of receiving a lifetime pension.

Mr. Baker acknowledged that the ratio in the "DC vs DB" column should be that of the value of the "Term Yr" under the "Beginning Annuity" column as compared to the "Existing PERS Pension Benefit" as earlier suggested by Co-Chair Green. An 11.50% "Contribution Level" with an 8.25% "Total Return" with a Beginning Annuity Term Yr." of \$6,969 and an Existing PERS Pension Benefit of \$6,625 would equate to a 105.18% "DC vs DB" ratio. This indicates that the DCP plan payments would exceed the DBP pension benefit by five percent.

AT EASE [10:25:26 AM](#) / [10:26:59 AM](#)

Senator Stedman stated that while the equation is correct in the "DC vs DB" column, the chart would be revised before the next Committee hearing on this bill in order to more clearly reflect that the "Beginning Annuity Term Yr." Column amount is being compared to the Existing PERS Pension Payment amount. He apologized for the confusion.

Co-Chair Green voiced that this discussion clearly reflects the reason that the current DBP "is quickly under-funded and will always be as long as this system is in place". Under the current DBP, retirees "receive an infinite amount of return for a limited amount of investment during the service years".

Senator Stedman continued that the table depicted on page four reflects the DCP/DBP scenario for a PERS person who was hired at the age of 25, retired at age 55, and who worked for 20 years. This scenario is one in which the person took "Early Retirement" at the age of 55 rather than at the age of 60, as denoted on the top right hand side of the page. The Early Retirement scenario would provide "a more conservative comparison" as, in this case, a penalty in the formula that would result in a slightly lower pension. He noted that "the retirement age concept" would dissipate under the DCP.

Senator Stedman stated that in the page four scenario, the DCP would be more beneficial to the employee than the DBP at the 12.5 percent Contribution Level and a Total Return level of 7.00% or higher. The DBP would be more beneficial at a Contribution Level of 14.00% and a lower Total Return level of 6.50%.

Senator Stedman stated that page five depicts a scenario in which a PERS employee was hired at the age of 25 and retired at age 55 after 30 years of service. Being able to retire at age 55 is still ten earlier than the normal retirement age of 65.

Mr. Baker explained that under the current PERS DBP, anyone with 30 years of service could retire at any age without penalty. The individual in the page five scenario would, upon retirement, be able to immediately draw his full retirement pension benefit without penalty.

Senator Stedman stated that in the page five scenario, the DCP would be equivalent to the benefits of the DBP at the 11.50% Contribution Rate with an 8.75% Total Return. As reflected in the "DC vs DB" column, the ratio is basically "dead even" at 100.76%. Another example would be the 13.00% Contribution Level where the "DC vs DB" ratio is 100.28% at the 8.25% Total Return level.

Senator Stedman pointed out that these tables example how the plans are affected by such factors as age, life expectancy, and years of service.

Mr. Baker commented that the page five scenario is a good example of how the DBP system favors a long-term employee, even at a 14.50% Contribution Level. Even at the "optimistic" Total Return rate of 8.25%, "it would be hard to beat" the current benefit being provided.

Co-Chair Green asked whether the major factor in the level of benefits paid to a 30-year employee is due to including in the pension calculation formula, the employee's highest five salary years.

Mr. Baker expressed that the "high-five" salary and the fact that a person who retires at the age of 55 has a life expectancy of another 23.8 years, enhance the benefit. They could receive the pension benefit for approximately 24 years after retirement.

Co-Chair Green asked whether the five-year salary consideration would be included in the DCP.

Mr. Baker responded that, in the DCP, nothing except the annual employee/employer contributions and their earnings would fund the plan.

Senator Hoffman asked whether the outcome of the 8.00% Member contribution rate being proposed in the DCP plan when compared to the current TRS/PERS Member contribution rates, as depicted on page five of the "Contribution Rates for New Defined Contribution (DC) Plan" handout would be that TRS II employees would receive a .65 percent salary increase and PERS III employees' would experience a slight salary decrease.

Senator Stedman asked for further clarification.

Senator Hoffman understood that under the proposed DCP, the PERS III Member Contribution Rate would be higher than their current contribution rate and the TRS Member contribution rate would be lower than the current contribution rate.

Co-Chair Green asked for further clarification of the question.

Senator Hoffman stated that his desire was to better understand how the proposed DCP would affect the Member Contribution Rates of both TRS and PERS employees and the subsequent affect on their paychecks.

[10:35:21 AM](#)

Senator Stedman replied that Senator Hoffman was correct, in that were salaries and other factors equal, the DCP Member contribution rate for a PERS III employee would be more than being paid under the current plan and less than the rate currently paid by a TRS II employee.

Senator Hoffman acknowledged the information.

Senator Stedman stated that the table on page six of the "Comparison of PERS Tier III & TRS Tier II Pension Benefits vs Defined Contribution Investment Account" handout depicts the scenario for a PERS employee who was hired at the age of 30, worked 20 years and took early retirement at the age of 55. The 100% DCP and DBP break even point for this individual would be at the 12.50% Contribution Level with a 7.00% Total Return level. This point would equate, under the DCP to "a 3.50% Real Return which is substantially less than the five-percent ... that would be the target for the pooled investor".

Senator Stedman continued that the table depicted on page eight reflects a TRS Tier II employee, hired at the age of 25, who works for 15 years and takes Early Retirement at the age of 55. As denoted by the "ASD Teacher BA Step I" notation at the top of the page, there would be a base salary increase tied into the salary schedule. The breakeven point would be at the 12.50% Contribution Level with a 6.75% Total Return rate. A 14.00% Contribution Level would allow the breakeven point to drop to a 6.00% Total Return rate. "They are all inter-related".

Senator Stedman stated that the Police and Fire Employees tables are separated from other PERS/TRS employees because their Normal Retirement age and other factors differ.

Senator Stedman commented that while the repetition of the tables might appear to be "redundant", the objective of the various examples is to provide Legislators sufficient information from which they could formulate their own thoughts about how a plan should be developed.

Senator Stedman communicated that page twelve reflects a police or fire employee who is hired at the age of 25 and who retires with full benefits at age 50 after twenty years of service. The normal retirement age for police/fire is 45 years of age.

Mr. Baker reminded the Committee that police and fire employees could retire, with full benefits, at any age after 20 years of service.

Senator Dyson pointed out that the life expectancy information has not changed from one Normal Age retirement scenario to another.

Mr. Baker stated that this element would be revisited.

Co-Chair Green asked whether any discrepancy in the tables might be experienced due to this life expectancy component.

Mr. Baker responded that because the life expectancy factor is not a component of the pension benefit calculation formula, it should not affect the table. It is included on the page for general information purposes only.

Senator Stedman communicated that a master template was used to develop the spreadsheets in this presentation. While such things as age, length of service, and life expectancy are included in the model heading, they are for presentation purposes and do not affect the numbers in the table. The numbers in the table are correct.

Senator Stedman and Mr. Baker assured the Committee that this would be rechecked. Were their understanding proven differently, the information would be modified. He noted that the multitude of information related to this legislation is immense and, during the next few bill hearings, it would become evident that, due to time constraints, it would be difficult to modify all the various components.

Senator Stedman, referencing the Police/Fire table on page twelve, commented that it would "be difficult" for the DCP to match the benefits currently provided to police and fire employees under the DBP. The current plan is "pretty attractive" to the employee, but "expensive to the employer".

Co-Chair Green concurred and commented that, "it's no wonder it's vastly under-funded".

Senator Stedman reiterated that models could be developed to reflect any scenario a Legislator might want to review. The influence of the life expectancy factor would be rechecked.

Senator Stedman stated that the current version of the bill "targets" an 11.50% Defined Contribution rate. The Committee might wish to revisit that component, as there is a range of numbers that could be incorporated. In addition, as mentioned earlier in this hearing, there is a two-percent buffer that could absorb some of the need to change the dollar contributions for either the employer or the employee.

Co-Chair Wilken observed that as long as the TRS employee who was hired at the age of 25, and took Early Retirement at the age of 55 with 20 years of service, as depicted on page nine, received a minimum of 7.50% Total Return at the 11.50% Contribution Level, the DCP would be "roughly equivalent" to the current DBP. The plans would also be equivalent at a Contribution Level of 13.00% with a 6.50% Total Return. A DCP with a Total Return at or exceeding 7.00% would be a better plan for this teacher.

Senator Stedman affirmed. He shared that the Finance Committee had approved the purchase of a historical data book depicting the United States financial market return data since 1925. This book, which was used as a resource in the development of this legislation, includes information on such things as blended formulas of 50 percent stocks/50 percent bonds and 70 percent stocks/30 percent bonds. The 70/30 stock/bond split resembles the Alaska Balance Fund, which is the most commonly selected fund option, offered in the SBS program. The book provided rolling averages for five, ten, 15, and 20 years since 1926. He noted that, nationwide, individuals managing their own retirement portfolios "don't have the risk tolerance that the pooled investments" such as the DBP, have. Therefore, "there is the tendency for the individual investments to under-perform the pooled investment". Pooled investments currently have a targeted return of 8.25 percent. Thus the reason that most of the return range is below 8.25 percent. Therefore, it is a reasonable assumption that the average participant would not get "too fancy" and would pick a balanced fund. The expectation would be that the performance numbers over time would be in the upper end rather than the lower end of the range, were the forward financial markets to continue the trends existing from 1925.

Co-Chair Wilken understood therefore that the generalization of page nine is that, if returns had followed the historical trend of the last 70 years, the DCP is better. The downside is that that money would be depleted "because it is a finite amount of money". The DBP would provide money until the individual died.

Senator Hoffman opined that the DCP money would run out at the end of the person's life expectancy timeframe.

Co-Chair Wilken commented that he was attempting to compare the issues in generalities.

Senator Stedman asked that the life expectancy issue not be focused upon as he wished to further investigate whether the "life expectancy link would change the numbers. Nonetheless, he voiced certainty that the numbers in the table were correct.

Senator Stedman, responding to Co-Chair Wilken's comment, stated that a person experiencing a short life span would be "disadvantaged" in a DBP; however, a person with a long life expectancy would be advantaged because they would receive pension payments for a long time. Therefore, in a DCP, a person with a long life expectancy would strive to achieve a rate of return that would exceed the 100.00% DBC/DCP equivalency point.

[10:51:23 AM](#)

Senator Bunde commented that contrary to the conditions of a DBP, the retirement funds of a person in a DCP who dies at an early age would belong to the person's estate and have transportability to heirs or other survivors. Unless the person in the DCP had chosen survivor benefits, their funds would not be transferable.

Senator Stedman expanded on Senator Bunde's remarks by theorizing that were a person in a DCP, to retire knowing that he would have a shortened life span, he could roll his retirement into an IRA and upon his death, that IRA could be rolled into his child's IRA. This would provide "generational portability". The DCP could provide a mechanism through which the funds could be transferred to a spouse or to children.

Senator Bunde interjected that his point was that there are two sides to the equation.

Co-Chair Green commented that at retirement, were a person to withdraw the entirety of their benefits, the person with a DBP would be entitled only to the amount of money that had been contributed. The person in the DCP would be able to take all the

money that had been contributed along with any investment growth on that money. The person in the DCP would experience much "greater flexibility".

AT EASE [10:54:59 AM](#) / [10:55:28 AM](#)

Co-Chair Green reviewed the week's hearing schedule for the bill.

[10:56:56 AM](#)

Senator Bunde noted that a handout titled "Comparison of the States Normal Retirement by Age/Service" [copy on file] that compares other states' retirement policies has also been provided to Members.

#

**ADJOURNMENT**

Co-Chair Green adjourned the meeting at 10:57 AM.