

MINUTES
SENATE FINANCE COMMITTEE
April 2, 2005
10:16 a.m.

CALL TO ORDER

Co-Chair Green convened the meeting at approximately [10:16:04 AM](#).

PRESENT

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

Also Attending: KEVIN RITCHIE, Executive Director, Alaska Municipal League; TRACI CARPENTER, Staff to Co-Chair Green; MELANIE MILLHORN, Director, Division of Retirement and Benefits, Department of Administration; KATHY LEA, Retirement Manager, Health Benefits Section, Division of Retirement and Benefits, Department of Administration; KEVIN BROOKS, Deputy Commissioner, Department of Administration;

Attending via Teleconference: From Fairbanks: LESLIE TEDERS, University of Alaska employee, and, President, Higher Education Crafts and Trades;

SUMMARY INFORMATION

SB 141-PUBLIC EMPLOYEE/TEACHER RETIREMENT/BOARDS

The Committee heard from members of the public and discussed the proposed Health Reimbursement Arrangement program, conversion from the Defined Benefits plan to a Defined Contribution plan for existing employees and Containing Liability in Our Current System. The bill was held in Committee.

#SB 141

[10:16:17 AM](#)

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 bill had been previously heard in the Senate Finance Committee.

Co-Chair Wilken moved for adoption of CS SB 141, 24-LS0637\F, as a working document.

There was no objection and the committee substitute was ADOPTED.

Co-Chair Green noted this committee substitute includes changes discussed at previous hearings. This is the version to which amendments would be taken.

[10:18:25 AM](#)

KEVIN RITCHIE, Executive Director, Alaska Municipal League, testified that the League formed a focus group approximately one year prior comprised of school board members, elected officials, business leaders and others to address the issue with municipal leaders. He spoke to the task of educating these people on this issue. In general, the League supports the direction of this legislation; however because a proposal has not been finalized, the League could not yet endorse it. He supported the defined contribution concept, surmising it is a way to ensure stabilization of future costs.

Mr. Ritchie attributed health benefits as a key problem with the system's unfunded liability. He informed that retirees incur 75 percent of health care costs before they reach the age of 65. The solution is to limit access for those who are not actually paying toward the cost of this benefit.

Mr. Ritchie spoke to two proposed conceptual amendments included in a letter provided by the League [copy on file]. He stated that it

is not widely known that the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS) are not strictly a State of Alaska program, but rather that municipalities and school districts comprise a significant portion of the program. This fact has never been structurally tied into the operation of the PERS/TRS system. While this has allowed the municipalities and school districts to not be found at fault for the unfunded liability situation, these local governments must become involved in the future operation. He suggested that one or two seats be added to the proposed oversight board and be designated for municipal and school board representatives. He further suggested that school boards could submit three nominees to the governor for appointment to one of the designated seats.

Mr. Ritchie gave another recommendation that a structural system be created to secure an actuarial analysis of the impacts of any proposed changes in benefits. This would allow employers to make informed recommendations on those proposed changes. Benefits provided to existing PERS/TRS members can never be reduced. The current process allows the costs of any changes to be reflected in fiscal notes, which does not allow adequate time for the impacts to be analyzed.

[10:25:34 AM](#)

Co-Chair Green asked if the rates were "blended between municipalities" in any way or if the rates were set "per entity".

[10:25:46 AM](#)

Mr. Ritchie explained the blended rate, or normal rate, that is assessed. If the amount of that rate is insufficient to cover the unfunded liability of a local government, a past unfunded liability rate is added for that community.

[10:26:10 AM](#)

Mr. Ritchie reported on analysis done the previous year on the financial impact of changing benefits provided for public safety employees. The actuaries never tested their data with employers and as a result, a number of municipal governments disputed the findings based on actual experience. A process allowing for better review should be implemented for future analyses.

[10:27:14 AM](#)

Mr. Ritchie reemphasized the "critical nature" of providing at least two years of assistance from the State to municipalities and

school districts to offset the five percent increase to PERS rates that would be incurred regardless of actions taken on this legislation. Approximately 75 percent of municipalities' budgets are paid in salaries. A five percent increase to the retirement system is therefore significant. In addition, fuel costs and insurance rates are increasing and impacting budgets. Local governments could not increase property taxes sufficiently to offset these increased costs.

[10:29:00 AM](#)

Senator Stedman understood Mr. Ritchie's comments about representation of school districts and municipalities on the proposed board. Senator Stedman was amenable to consider changes the current proposed structure, as his concern was for adequate representation for both PERS and TRS issues. However, the State has bears most of the burden for funding the systems. Local governments commonly seek funding from the State to offset their shortfalls.

[10:30:10 AM](#)

Co-Chair Green remarked that a committee with many members would become unwieldy. Her intention is to frame the proposed board similar to the Alaska Permanent Fund Board of Trustees with regard to expertise and objectivity. Potential for conflict exists between the beneficiary and payer.

[10:30:53 AM](#)

Senator Stedman identified the priority in sufficient involvement with the actuary and in implementing necessary statutory changes in a timely manner. These issues would be likely addressed in the following legislative session. He noted that the FY 04 fiscal note funding PERS and TRS increases demonstrated significant cost fluctuation.

[10:31:48 AM](#)

Co-Chair Wilken appreciated the witness's involvement in this issue. Co-Chair Wilken asked if Mr. Ritchie would be amenable to changing the provision in Section 42 relating to the powers and duties of the proposed board and the required 90-day comment period before changes to the system could be made. Co-Chair Wilken noted that a proposed change presented on the first day of a legislative session could not be acted upon until near the completion of the 121-day session. He suggested a 60-day comment period, given the length of time required for legislation to complete the legislative process.

[10:32:39 AM](#)

Mr. Ritchie was agreeable to such a change.

[10:32:41 AM](#)

Co-Chair Green pointed out that the cost of the election process is approximately \$100,000, which is excessive. Other methods would be better than an election. The Legislature has "observed with displeasure" the appointees made by the governor.

[10:33:34 AM](#)

Mr. Ritchie qualified he was not suggesting an election process. This would not be fiscally beneficial for employers. A structural connection with management would have an advantage. Although the costs are primarily and ultimately born by the State, municipal governments must account for these expenses in the issuance of bond debt.

[10:34:19 AM](#)

LESLIE TEDERS, University of Alaska employee, and, President, Higher Education Crafts and Trades, testified via teleconference from Fairbanks, that although this legislation would not directly affect University employees, the members of the organization are taxpayers. He expressed concern that this proposal punishes employees who are not at fault for the current situation. A defined contribution system would make retirement uncertain. Studies show that most 401K plan members are not financially educated and therefore select the investment options with the least risk, which results in a large segment not prepared for retirement. Other options are available for future consideration.

[10:37:00 AM](#)

TRACI CARPENTER, Staff to Co-Chair Green gave a presentation utilizing a handout titled, "Retirement Security Act, SB 141, Discussion Topic: Health Reimbursement Arrangement, April 2, 2005" [copy on file].

[10:37:45 AM](#)

Page 2

What is a Health Reimbursement Arrangement?

- Reimburses employees for qualified medical expenses during retirement years

- Intended as a supplement for medical expenses or a bridge between "early" retirement and Medicare
- Employer paid group (or pooled) fund
- Funds accumulate over working lifetime of employee
- Tax-free to employer and employee
- Employer-determined flexible plan design (Contributions, covered expenses, termination provisions)

Ms. Carpenter overviewed these items.

[10:38:50 AM](#)

Page 3

Alaska plan-specific design

- Employer contributes 1% of the average employer group compensation -- maximum \$500
- Annual payment on behalf of each active employee into group fund
- Contributions recorded to individual account balances (also tracked by employer)
- Fund managed by Alaska Retirement Management Board (ARMB)
- Interest credited annually to individual accounts, rate determined by ARMB

Ms. Carpenter read the proposed components into the record.

Co-Chair Green noted the maximum contribution of \$500 would be an annual amount.

Ms. Carpenter affirmed.

[10:39:37 AM](#)

Page 4

Alaska plan-specific design continued

- Total Reimbursements limited to member's individual account balance until exhausted
- Terminated employees forfeit rights to individual account
 - Individual account reinstated if person returns to work within 5 years
 - Account balance restored as of date of termination (accrues no additional interest)
- Employer may use surplus funds held in the trust for future credit to individual employee accounts

Ms. Carpenter noted that SB 141 currently provides that an employee must return to employment with the same employer. However, if an employee returns to work for a different employer that participates in the PERS/TRS program, the years of initial service are credited, although the account balance is not restored. She suggested the Committee discuss whether to provide the same benefits to an employee who returns to a different employer that also participates in PERS/TRS.

[10:40:59 AM](#)

Co-Chair Green exemplified an employee of a municipality who accepts future employment with the State.

Ms. Carpenter relayed discussions on this matter. At issue is the intention that surplus funds would be held in trust and available for the employer to apply towards future debt. This could be problematic if former employees were allowed to reinstate their initial account balance with a different participating employer.

[10:42:09 AM](#)

Co-Chair Wilken asked the definition of "terminated" as it relates to this topic.

Ms. Carpenter defined termination in this context as ending employment for any reason, including retirement or taking a position with a different employer.

Co-Chair Wilken clarified this includes both voluntary and involuntary separation.

Ms. Carpenter affirmed.

[10:42:47 AM](#)

Ms. Carpenter continued outlining the final item on Page 4.

[10:43:18 AM](#)

Page 5

Who is eligible for reimbursements?

- Members of the DC plan who meet the age and/or service requirements for medical benefits under AS 14.25.480 or AS 39.35.880
 - 25 years of service for peace officers/firefighters; 30 years of service all others; OR

- o age 65 and have at least 10 years of service
- Surviving spouse of an eligible member
- Dependent children of an eligible member if both the member and surviving spouse have died

Ms. Carpenter pointed out that the language of the current version of SB 141, Version "F", inadvertently omitted language relating to dependant eligibility. This error would be corrected

[10:44:16 AM](#)

Senator Hoffman, returning to information on Page 4, asked if the individual account balance of a terminated employee would be held in trust until that former employee reaches age 65 and does not return to employment. He asked if at that time, the employer could access those funds.

[10:44:55 AM](#)

Ms. Carpenter affirmed and explained the provision relating to access to the fund by former employees, which she indicated should be corrected.

[10:45:17 AM](#)

Page 6

Benefits Payable

- Monthly premiums for a major medical plan (participation in State's retiree medical plan is not required)
- Qualified medical expenses under 26 U.S.C. 213(d) of
 - o An eligible member, member's spouse and dependent children
 - o A surviving spouse of a qualified member and the member's dependent children if dependent on the surviving spouse

Ms. Carpenter stated that further clarification is needed on the requirement of participation in a major medical plan.

[10:46:13 AM](#)

Ms. Carpenter continued outlining the items on Page 6.

[10:46:37 AM](#)

Co-Chair Green asked for an example of a procedure that would be eligible for reimbursement from the Health Reimbursement Account

(HRA).

[10:47:03 AM](#)

Ms. Carpenter replied the eligible procedures are comparable to those eligible for reimbursement through the existing Health Care Reimbursement Account (HCRA), a flexible savings account available to active employees. Medical expenses accrued by a participating employee could be reimbursed from the employee's HCRA account.

Co-Chair Green asked whether co-payments required under a major medical plan would be eligible.

Ms. Carpenter affirmed those plus annual deductible payments qualify for HCRA reimbursement. She explained the application process, noting the HRA process would likely be similar.

Co-Chair Green asked if a qualifying retiree would have to actively seek reimbursements from the proposed HRA account.

Ms. Carpenter affirmed, unless the Division of Retirement and Benefits made other arrangements.

[10:48:29 AM](#)

Page 7

Projected individual account balances

- HRA is a retention tool as it clearly favors longevity

[Spreadsheet depicting the Projected HRA Account Balances for 10, 15, 20, 25, and 30 years of services at 8.25% interest and 6% interest rates and with the following contributions: SB 141 1%, \$500 cap, and, 1%, 1.5%, 2%, 2.5% and 3.5% with no cap.

Highlighted amounts are as follows.

Interest: 8.25%

Year 2026, 20 years of service, 2% no cap = \$49,261

Year 2036, 30 years of service, 1% \$500 cap = \$56,465

Year 2036, 30 years of service, 1.5% no cap = \$103,884

Year 2036, 30 years of service, 3.5% no cap = \$242,397

Interest: 6.00%

Year 2026, 20 years of service, 2.5% no cap = \$48,979

Year 2036, 30 years of service, 1% \$500 cap = \$37,762

Year 2036, 30 years of service, 2% no cap = \$96,741

Year 2036, 30 years of service, 3.5% no cap = \$169,296

A notation reads as follows.

Other assumptions: FY 06, beginning salary \$35,000

Salary inflation 5.5% first 5 years; 4% thereafter

Projected Anchorage CPI (1.8017% to 4.8859%)]

Ms. Carpenter outlined the benefit amounts listed in five-year increments.

[10:49:46 AM](#)

Page 8

Spend down scenarios

- Example 1: age 65, 30 yrs service, 10% contribution

[Spreadsheet depicting the balance of a retiree's account for each year between the ages of 65 and 86 with reimbursements, or deductions, made for Annual Health Premium estimates, Annual Deductibles of \$500 and Annual Interest Credited. This data assumes the account is not accessed before the participant reaches the age of 65 and utilizes the beginning balance of \$56,465 received from a 1% contribution rate with a \$500 annual cap as shown on Page 7.

Notations read as follows

Life expectancy*: Males = 16.3 yrs
Females = 17.9 yrs

*Source: National Vital Statistics Reports, Vol. 51, No.3, December 19, 2002, p. 29. The tables used are for all races based on year 2000 data.]

Ms. Carpenter overviewed this information in relation to the information on Page 7.

[10:51:01 AM](#)

Senator Stedman noted that the current proposal would provide for a 1.5 percent contribution rate with a \$500 annual maximum. Other options are available due to an additional two percent that is available, including increasing the contribution to the HRA to two percent with no cap, or increasing the contribution rate to the retirement account by two percent from the current proposed 8.25 percent, or smaller increases to both the HRA and retirement accounts.

Senator Stedman asked whether reimbursements made from the HRA would be taxable at the time of withdrawal.

Ms. Carpenter answered these funds would not be subject to taxation.

Senator Stedman clarified the monies would be tax-free.

Ms. Carpenter affirmed.

Senator Stedman asked if funds drawn from the retirement account would be taxable at the time of receipt.

Ms. Carpenter replied these monies would be subject to taxation.

Senator Stedman concluded the matter of increasing contribution to the HRA should be considered, as it could be more beneficial to the employee. This could provide a significant tax savings to employees.

[10:53:48 AM](#)

Senator Bunde asked whether funds in a participant's HRA could be accessed between the age the employee retires and age 65.

Ms. Carpenter replied that the funds would be available to a retired employee if that member satisfied the years of service requirement.

Senator Bunde commented the dependency of employees retiring before the age of 65 on the HRA to cover health insurance premiums until they become eligible to receive Medicare benefits. Health insurance premiums have increased significantly in the past ten years and would likely continue to increase. He asked if these projected increases have been calculated and whether the HRA account would provide sufficient funding for this period.

[10:55:25 AM](#)

Ms. Carpenter responded such calculations have been made and are presented on Page 11. The annual health premium represented in the data is the current premium rate adjusted for inflation according to the projected trend calculated by [Mercer Human Consulting](#). A maximum amount of \$20,000 was imposed, as it was determined that health insurance premiums of this amount would comprise the majority of an employee's income and that changes to the insurance system would therefore be required to address the issue.

[10:56:22 AM](#)

Senator Hoffman asked how the premiums would be paid while the participant is still employed.

Ms. Carpenter replied that the employer would pay the premiums, although the employee shares the cost.

[10:56:46 AM](#)

Senator Hoffman noted this is similar to the current practice and asked if the same health coverage provided to current employees would be provided for new employees included in the defined contribution plan.

Ms. Carpenter understood this would be the case.

[10:57:19 AM](#)

MELANIE MILLHORN, Director, Division of Retirement and Benefits, Department of Administration, testified to the indicated intent that members of the proposed defined contribution plan would receive the same coverage as currently provided to all employees.

[10:57:57 AM](#)

Senator Hoffman asked if the medical costs incurred after retirement have been averaged to determine the adequacy of the estimated HRA balance and whether the contribution rate should be one or two percent or greater. He cautioned against under funding these accounts, as most medical expenses occur later in a person's life.

[10:58:59 AM](#)

Ms. Carpenter reported the average FY 04 health cost experience for pre-Medicare age retirement was approximately \$5400 per person.

[10:59:37 AM](#)

Ms. Carpenter then asked Ms. Millhorn whether retirees with health insurance coverage through an entity other than the State, such as through another employer or a spouse, could qualify for HRA reimbursements.

Ms. Millhorn affirmed that retirees would not be required to participate in the State insurance plan, but would have the option of obtaining a different policy and utilizing the HRA towards the premium on that policy.

Co-Chair Green asked for clarification.

Ms. Millhorn specified that this practice would be allowable provided the retiree satisfied the service requirements.

Ms. Carpenter reiterated that reimbursements from the HRA could

provide for the premiums of any health insurance policy regardless of whether it is offered through the State.

[11:01:19 AM](#)

Page 9

Spend down scenarios

- Example 2: age 65, 20 yrs service, 20% contribution

[Spreadsheet depicting the balance of a retiree's account for each year between the ages of 65 and 75 with reimbursements, or deductions, made for Annual Health Premium estimates, Annual Deductibles of \$500 and Annual Interest Credited. This data assumes the account is not accessed before the participant reaches the age of 65 and utilizes the beginning balance of \$49,261 received from a 2% contribution rate with no annual cap as shown on Page 7.

Notations read as follows

Life expectancy*: Males = 16.3 yrs
Females = 17.9 yrs

*Source: National Vital Statistics Reports, Vol. 51, No.3, December 19, 2002, p. 29. The tables used are for all races based on year 2000 data.]

Ms. Carpenter noted this table demonstrates a scenario of an account with less accumulation.

[11:02:17 AM](#)

Page 10

Spend down scenarios

- Example 3: age 65, 30 yrs service, 10% contribution

[Spreadsheet depicting the balance of a retiree's account for each year between the ages of 65 and 89 with reimbursements, or deductions, made for Annual Health Premium estimates, Annual Deductibles/Expenses of \$3000 and Annual Interest Credited. This data assumes the account is not accessed before the participant reaches the age of 65 and utilizes the beginning balance of \$103,884 received from a 1.5% contribution rate with no annual cap as shown on Page 7.

Notations read as follows

Life expectancy*: Males = 16.3 yrs
Females = 17.9 yrs

*Source: National Vital Statistics Reports, Vol. 51, No.3, December 19, 2002, p. 29. The tables used are for all races based on year 2000 data.]

Ms. Carpenter noted the higher contribution rate resulted in a larger beginning account balance. Therefore, as depicted on this spreadsheet, reimbursement was available for additional expenses.

[11:02:49 AM](#)

Page 11

Spend down scenarios

- Example 4: age 55, 30 yrs service, pays full premium

[Spreadsheet depicting the balance of a retiree's account for each year between the ages of 55 and 66 with reimbursements, or deductions, made for Annual Health Premium estimates, Annual Deductibles of \$500 and Annual Interest Credited. This data assumes the account is not accessed before the participant reaches the age of 55 and utilizes the beginning balance of \$242,397 received from a 3.5% contribution rate with no annual cap as shown on Page 7.

Notations read as follows

Life expectancy*: Males = 16.3 yrs
Females = 17.9 yrs

*Source: National Vital Statistics Reports, Vol. 51, No.3, December 19, 2002, p. 29. The tables used are for all races based on year 2000 data.]

Ms. Carpenter pointed out this scenario demonstrates the use of the HRA to reimburse the full cost of a health insurance premium for an employee retiring at age 55. The account could be utilized to pay the premiums on the insurance coverage required for qualification of health care benefits beginning at age 65.

Senator Hoffman asked if consideration had been given to contribution rate of one percent with a \$500 annual cap. If such a rate were adopted, he wanted to know if the funds would be taxable.

Ms. Carpenter stated the amount of employer contribution in such a fund is optional, although employees are not allowed to contribute.

Senator Hoffman noted the matter of determining the appropriate level of funding and subsequent contribution rate. He asked if an employee could contribute to the HRA as well and whether those contributions would be taxable.

Ms. Carpenter replied that federal regulations stipulate that an employee could not contribute to a HRA.

Co-Chair Green understood that the account would lose its tax-

exempt status if employee contributions were allowed.

[11:05:52 AM](#)

Ms. Carpenter was unsure if the account would lose its tax exempt status, but that it would be considered a health savings account, which is more similar to a 401K account that is owned by the employee and accessible to the employee at any time. Under the proposed HRA plan, the employee could not access the funds until retirement and the funds could only be utilized for qualifying medical expenses.

[11:06:37 AM](#)

Senator Bunde spoke to benefits provided by the State of Alaska to those provided by other states. He understood that other states have higher age requirements for retirement.

Ms. Carpenter affirmed.

Senator Bunde pointed out that 38 states appear to have more rigid retirement requirements for its public employees than Alaska has.

[11:08:01 AM](#)

Ms. Carpenter detailed that 25 states stipulate a retirement age of at least 65. Other states have a higher age requirement than Alaska.

Senator Bunde noted the requirement for retirement in Alaska of age 60 with eight years of service. Other states establish the retirement age of at least 62 or 65 with ten years of service or allow retirement for teachers at any age with 20 years of service. He heard the argument that changes to the TRS plan would make recruiting teachers more difficult. However, Alaska's system is currently more flexible than most states and the proposed changes to it would not be less flexible than the national average, rather closer to the systems of other states.

Ms. Carpenter understood the same. The national trend is a retirement age requirement of 65. This is the requirement of the states located nearest to Alaska.

[11:10:56 AM](#)

Senator Bunde informed that at age 66 he has been retired from the TRS plan for 13 years. He has benefited from the current system.

[11:11:14 AM](#)

Co-Chair Wilken pointed out that the State of Arizona does not have a specified teachers retirement system and asked what category of public employees teachers were placed.

Ms. Carpenter answered that teachers are categorized as "other" employees, separate from public safety employees.

[11:11:55 AM](#)

Ms. Carpenter gave the next presentation utilizing a handout titled, "Retirement Security Act, SB 141, Discussion Topic, Conversion Option from DB to DC, April 2, 2005" [copy on file.]

Page 2

Discussion: Conversion Option from Defined Benefit plan to Defined Contribution plan

[11:12:24 AM](#)

Ms. Carpenter pointed out that provisional language to allow for such conversion has not been included in SB 141 to date, although the intent is to proposed language in a future draft Committee substitute.

[11:12:44 AM](#)

Page 3

Eligibility for members to convert from the DB plan to the DC plan

- An employer must first choose to allow their DB plan employees to transfer into the DC plan.
- Only unvested members of the DB plan will be eligible to transfer into the DC Plan
 - PERS members with less than 10 years of service
 - TRS members with less than 8 years of service
- Participation in the defined contribution retirement plan is in lieu of participation in the defined benefits plan.
- There is no option to return to the DB plan if you opt into the DC plan.

Ms. Carpenter stated that the employer must chose whether to allow members to convert, given the significant cost of this option. Transferring vested members from the existing trust account is unadvisable.

[11:13:29 AM](#)

Co-Chair Green asked if this is detailed in the memorandum addressed to the Division of Retirement and Benefits from Deloitte Consulting LLP dated April 1, 2005 [copy on file.] The subject of this communication is "SB 141 - New PERS and TRS Operating Costs; Asset and Liability Commingle Issues".

Ms. Carpenter affirmed.

Co-Chair Green advised Committee members to review this letter.

[11:13:44 AM](#)

Senator Bunde asked if the defined contribution plan could be made available for vested members.

Senator Hoffman replied that benefits for existing employees could be changed but not reduced.

Senator Bunde asked if any requirement exists to extend the defined contribution plan to current members.

Ms. Carpenter answered there is no such requirement.

[11:14:22 AM](#)

Senator Bunde did not anticipate a significant number of transfers would occur if allowed. He asked the projected impact of transfers on the current system.

Senator Stedman understood that transfers would have no impact on the unfunded liability of the existing system, as it is based on accrued liability. Depending on the age and number of years of service of an existing member, transferring to the defined contribution plan could be beneficial. Employees in the Tier 1 and Tier 2 plans would likely not benefit, although younger employees included in the Tier 3 system could benefit if they did not already have many years of service. The benefits received through the proposed defined contribution plan would be comparable to those provided to Tier 2 members.

[11:16:23 AM](#)

Senator Bunde surmised that allowing existing members to transfer out of the defined benefit system would further impact the financial situation of the current system, as deposits on behalf of

those members would no longer be contributing to the payout of benefits to current retirees.

Co-Chair Green corrected that the transfer of existing employees out of the current system would reduce the future liability of the fund.

[11:17:05 AM](#)

Senator Stedman detailed the impact in ratios and actual cash flow. An existing employee who opted to transfer from the defined benefits plan to a defined contribution plan would receive some credit from the years of service towards the new plan. However, the unfunded liability of the existing plan would be reduced, as future benefits for that employee would not be paid through the defined benefits plan and therefore not calculated into the total unfunded liability.

[11:18:12 AM](#)

Ms. Carpenter continued that the intention is to only offer transfers to those employees not already vested. Benefits from the defined benefits plan would not be paid to those employees. If an existing member elected to transfer to the defined contribution plan, that transfer would be irrevocable and the employee would forfeit all rights under the current system.

[11:19:09 AM](#)

Page 4

Mechanics of Conversion

- Present value of the member contribution account balance held in DB trust will be transferred to a new account.
- A 100% matching employer contribution will be made on behalf of the employee to the new account; however, this must be new money.
- Service credit earned under the DB plan will be credited for purposes of vesting in medical benefits.

Ms. Carpenter outlined this information.

[11:20:02 AM](#)

Senator Hoffman asked if the employee would be allowed a period of time before making a decision whether to transfer from the defined benefit plan to a defined contribution plan.

Ms. Carpenter replied that a time limit has not been proposed;

however once an employee becomes vested in an existing tier plan, the opportunity would be eliminated.

[11:20:57 AM](#)

Ms. Carpenter acknowledged the complexity in implementing a deadline for transferring, as a Tier 3 PERS member becomes vested for retirement benefits after five years, but does not become vested for medical benefits until ten years of service has been completed.

[11:21:45 AM](#)

Page 5

Potential Cost to Employers

[Spreadsheet indicating the costs for participants of Tier 1, 2 and 3 based on the number of years of service for both PERS and TRS members as follows.

PERS

Service Years <5

Tier 1	\$ 9,910,842
Tier 2	55,804,740
Tier 3	101,423,157
Total System	130,265,858

Service Years 5 to <10

Tier 1	\$ 55,804,740
Tier 2	128,224,601
Tier 3	96,023,581
Total System	280,052,923

Service Years 10 to <15

Tier 1	\$ 79,577,922
Tier 2	216,672,102
Tier 3	99,905
Total System	296,349,928

Service Years 15 to <20

Tier 1	\$166,029,809
Tier 2	199,618,440
Tier 3	0
Total System	285,648,249

Service Years 20 to <25

Tier 1	\$246,455,352
Tier 2	1,033,437
Tier 3	0
Total System	247,488,789

Service Years 25 and >

Tier 1	\$141,721,266
Tier 2	123,906

Tier 3	0
Total System	141,845,172
Totals	
Tier 1	\$ 699,499,932
Tier 2	484,604,344
Tier 3	197,546,643
Total System	1,381,650,918
TRS	
Service Years <8	
Tier 1	\$ 9,622,483
Tier 2	91,841,386
Total System	102,463,869
Service Years 8 to <10	
Tier 1	\$ 11,597,202
Tier 2	41,796,620
Total System	53,393,822
Service Years 10 to <15	
Tier 1	\$ 35,530,960
Tier 2	106,276,667
Total System	141,807,626
Service Years 15 to <20	
Tier 1	\$136,923,592
Tier 2	6,547,816
Total System	143,471,408
Service Years 20 and >	
Tier 1	\$221,422,095
Tier 2	0
Total System	221,722,095
Totals	
Tier 1	\$415,096,333
Tier 2	247,462,488
Total System	662,558,821
Grand Total By Tier	
Tier 1	\$1,114,596,264
Tier 2	732,066,832
Tier 3	197,546,643
Total System	2,044,209,739
Limit Conversion Option to: \$290,288,124]	

Ms. Carpenter pointed out that the total dollar amount would be over \$2 billion if all current members were allowed and subsequently opted to transfer from the defined benefits plan to the defined contribution plan.

Co-Chair Green clarified this is the scenario if the transfer option were extended to all existing PERS and TRS members.

Ms. Carpenter affirmed emphasizing this is the reason the option

would be limited to unvested members.

[11:23:03 AM](#)

Co-Chair Wilken, returning to page 4 and the reference to "present value of the member", asked for an explanation of the provision that 100 percent of matching employer contribution made on behalf of a transferring employee must be "new money".

Ms. Carpenter exemplified that if a member has invested \$10,000 into the current system, the employer must match that amount so the new account for that employee would hold \$20,000.

Co-Chair Wilken questioned the requirement that the employer funds must be new money.

Ms. Carpenter spoke of the inadvisability of transferring funds from the existing trust account.

[11:24:15 AM](#)

Senator Bunde correlated this to the need to address concerns about the increasing deficit of the current system.

[11:24:23 AM](#)

Page 6

Example of retirement lifetime benefits under DB plan

- PERS "Other" member, Tier III
- Beginning salary \$35,000
- Member Contribution rate = 6.75%
- Semi-annual interest = 4.25%
- Works 30 years
- Normal Retirement at age 60
- Male Life Expectance = 23.8 years

30 Years of Member Contributions and Interest	\$ 209,269	11.48%
Average Highest Consecutive 5 years Benefit Formula = (2% x 10 yrs) x (2.25% x 10 yrs) + (2.5% x 10 yrs)	68,750	67.5%
Annual Benefit	46,406.25	
Annual Benefit x Life Expectancy	1,104,469	
Lifetime Medical Premiums	394,514	
Total Employer Benefits Payments	\$1,823,408	88,52%

Ms. Carpenter outlined this information.

[11:27:27 AM](#)

Senator Stedman corrected the male life expectancy to age 78, and recalculated the total employer benefits payment to be \$1.4 million.

[11:27:58 AM](#)

Ms. Carpenter indicated the spreadsheet would be corrected. The purpose of this information is to compare the payout of the employer and the employee.

[11:28:15 AM](#)

Senator Bunde clarified this information represents the conversion of an existing member of Tier 3.

Ms. Carpenter affirmed.

Senator Bunde asked the representation of the percentages listed to the right of the dollar amounts on the spreadsheet.

Ms. Carpenter explained the percentages demonstrate the ratio of the employee payout to the employer payout. The employee contribution is 11.48 percent and the employer contribution is 88.52 percent of the total benefit amount. Statute dictates that the member contribution is paid out first.

[11:30:02 AM](#)

Senator Stedman announced the next presentation would follow the handout titled, "Retirement Security Act, SB 141, Discussion Topic, Containing Liability in Our Current System, April 2nd, 2005" [copy on file.]

[11:30:40 AM](#)

MILES BAKER, Staff to Senator Stedman gave the presentation. He noted he would address three items intended to limit the growth of the fund's liability and allow for prediction of future growth. One suggestion is included in the bill and other items are proposed for inclusion and have been discussed previously.

[11:31:58 AM](#)

Page 2
Refunded Accounts

Mr. Baker indicated this is the first proposal.

Page 3

Refunded Accounts By System

PERS

Tier 1	
>5	5,251
3-5	5,292
<3	31,179
Tier 2	14,999
Tier 3	7,667
Total	64,388

TRS

Tier 1	
>8	388
6-8	369
<6	10,008
Tier 2	2,534
Total	13,299

PERS/TRS Total 77,687

All these members refunded their contributions when they left state service.

However, they can come back, set up their indebtedness, serve until vested and then get a benefit from the system.

5,639 members are already vested.

They can be rehired, pay their indebtedness, leave immediately and have 100% system paid medical at retirement.

Refunded Accounts Represent a Looming Liability for the System

Mr. Baker outlined this information and noted that of the 77,687 members eligible for this option, it is unknown how many would chose to participate.

[11:35:01 AM](#)

Senator Bunde asked if statute could be adopted to prevent those unvested members who cashed out their benefits from returning to employment and repaying their indebtedness to receive the retirement benefits. He asked if such a change to the existing tiers would be constitutional.

[11:35:47 AM](#)

Mr. Baker elaborated on the different opinions on the matter. He

relayed a viewpoint opposing such a rule change, noting various circumstances including an employee leaving to raise a family. These circumstances are one basis for providing limited benefits to rehired employees in the proposed Health Reimbursement Account system.

[11:38:05 AM](#)

Senator Bunde suggested that although the practice could remain permissible, the employer could be made to understand that the legislature would be unlikely to provide funding for the increased costs an employer would incur from the rehiring of these members.

[11:38:37 AM](#)

Page 4

[Line chart showing "Age Distribution of PERS & TRS Refunded Accounts". A notation points out the "27,000+ Refunded Accounts in the Retirement Age Eligibility Zone" of ages 50 to 61. A statement reads "Refunded Accounts Represent a Looming Liability for the System.]"

Mr. Baker cited the Division of Retirement and Benefits estimation that two percent of the unvested members with refunded accounts would return to employment in the system. This is based in part on demographics, age distribution and other factors. He noted that several employees working in the State Capital Building are rehired members aiming to secure medical retirement benefits.

[11:39:54 AM](#)

Mr. Baker referenced a separate spreadsheet titled "Examples of Refunded Accounts" provided by the Division of Retirement and Benefits dated April 2, 2005 [copy on file.] This spreadsheet examples various refunded accounts in which the member has been rehired and has repaid, or is in the process of repaying, indebtedness.

[11:41:41 AM](#)

Mr. Baker detailed the rules for Tier 1 members to become vested through employment with the State Legislature. The normal service requirement for Tier 1 members is five years, although one regular legislative session is accounted as one year of service for legislative employees. Current statute provides that service of at least 60 days during a regular legislative session constitutes service of one regular session and subsequently one year of service. As a result, some members are allowed to work 60 days,

regardless of the length of the session, to fulfill the requirement and achieve one year of service. To address this discrepancy, a change to require at least 120 days of service for legislative employees is proposed.

[11:42:49 AM](#)

Senator Stedman directed attention the reference on the spreadsheet of a member who worked only one day upon being rehired to qualify for the retirement benefits. He asked if this is an error.

[11:43:05 AM](#)

Mr. Baker explained the individual in question had 10 years of service prior to separation from State employment and had chosen to withdraw the benefits in cash at that time. To become eligible to repay the debt and receive the medical retirement benefits, a member must be rehired into the system. This member worked one day, repaid the debt and then retired. The hiring manager did not necessarily know of this member's intention and could have chosen the most qualified applicant for the position. However, the new employer must share in the retirement costs of this employee, even if the amount is small.

[11:45:52 AM](#)

Co-Chair Wilken alleged that in some instances a hiring manager could be aware of the member's intentions and deliberately hire the member for that member's benefit regardless of the best interest of the State or municipality affected.

Senator Hoffman understood the benefit to Tier 1 employees to return to service. He asked the advantage to the one Tier 2 employee listed on the spreadsheet.

[11:46:56 AM](#)

Mr. Baker replied that although the benefits are different for Tier 2 employees, they are substantial. The age at which a qualifying member becomes eligible to receive the retirement medical benefits is later than the age required for Tier 1 members; however, the total benefits remains substantial.

[11:48:38 AM](#)

Senator Bunde noted the majority of the rehire dates listed on the spreadsheet occur during or after the year 2000. He asked if this practice is a current trend and that as the advantages become well

known whether more members would participate, causing an increased debt for the system. The legislature and State agencies must become aware of this situation and the possibility of a significant deficit. He asked if this situation could be monitored on a monthly basis in the event of a "hiring rush".

[11:49:55 AM](#)

Mr. Baker expressed uncertainty as to whether the data on the spreadsheet is representative of the history of this program. The information is intended to present examples of the practices. Utilizing the assumptions included on Page 4 of the presentation, the demographics indicate increased participation as more Tier 1 and some Tier 2 members are reaching retirement age.

Mr. Baker could not speak to whether this discussion would alert members to potential benefits they were previously unaware existed. The Division of Retirement and Benefits regularly educates members on all aspects of the benefit program.

[11:51:23 AM](#)

Senator Bunde asked whether participation in this aspect of the program is a growing trend.

[11:51:34 AM](#)

Ms. Millhorn replied that the Division had analyzed the data of the previous five years for this report. She offered to review a longer time period. She emphasized that the indebtedness of the PERS and TRS systems is unusual and not contained in other public retirement systems.

[11:52:34 AM](#)

Senator Bunde asked if the witness' opinion on whether the current provisions could be changed to disallow members who have been refunded from participating in the benefit program in this manner.

[11:52:49 AM](#)

Ms. Millhorn responded that the issue has been studied and that the Department of Law would need to review the legality of the options. However, given the costs incurred over the previous five years, the cost of any legal challenges could be mitigated by the savings that would be realized by eliminating this practice.

[11:53:21 AM](#)

Senator Bunde recalled assertions that the current unfunded liability situation of the retirement program is not the result of a "perfect storm". He listed the current deficit, the lawsuit requiring the system to retroactively pay large cost of living increases and the "rush to reclaim" benefits by former employees as an indication that "the clouds are certainly gathering."

[11:53:37 AM](#)

Senator Stedman further noted the existence of "a couple more skeletons laying around."

[11:53:56 AM](#)

Senator Stedman suggested a phasing out of this practice over a period of five years as an option for discussion. He opposed policies that would disadvantage former employees. He asked if a mechanism could be implemented to stop the abuse of this provision. He asked if length of employment requirements could be instated in a manner to be fair to both the employee and employer.

[11:56:15 AM](#)

Ms. Millhorn replied that the Division of Retirement and Benefits could convey heightening awareness of the instances involving manipulation of the system to hiring managers. The Division of Personnel within the Department of Administration could also participate in educating and monitoring hiring managers. She noted Co-Chair Wilken suggestion that a hiring manager knowingly engaging in this practice could be considered culpable and reckless.

[11:57:25 AM](#)

Co-Chair Wilken directed attention to the data of one member who returned to service at the Fairbanks North Star Borough School District. He requested additional information on this instance.

Ms. Millhorn replied that the information is confidential.

Co-Chair Wilken clarified he did not need the name of the employee, only information about the position the member was hired into and the reason employment was terminated after one day of service.

[11:58:43 AM](#)

Senator Bunde commented on the potential usefulness of determining whether "clusters" of this practice occur in certain State

departments.

[11:58:54 AM](#)

Co-Chair Green referencing the case Co-Chair Wilken questioned, noted that the termination date of this member's first separation was in the 1970s.

[11:59:23 AM](#)

KATHY LEA, Retirement Manager, Health Benefits Section, Division of Retirement and Benefits, Department of Administration, testified that the Division could consult the employer to obtain information regarding the circumstances of this member without disclosing the identity of the member.

[11:59:48 AM](#)

Co-Chair Wilken requested details of this case.

[12:01:05 PM](#)

The discussion returned to the Containing Liability in Our Current System handout.

Page 5

Fix Proposed in SB 141 (Sec 111 pg 90)

- AS 14.25.062 and AS 39.35.350
- The change would repeal the provision for letting people repay their indebtedness to the state - effective June 30, 2010
- This provides for a 5 year window for members to reinstate their accounts and begin paying the indebtedness

Mr. Baker outlined this page.

[12:01:55 PM](#)

Senator Bunde questioned the viability of providing a five-year window warning that this could result in more members participating than would otherwise opt to do so.

[12:02:17 PM](#)

Mr. Baker replied that the entire issue should be discussed. He shared that variations have been considered including a provision to allow for accrued benefits. Another option would be to terminate

the refunded benefits program immediately under the argument that an employee's decision to withdraw from the system is final. The language proposed in the committee substitute is designed to indicate the legislature's intent that the repayment option would be eliminated.

[12:04:01 PM](#)

Co-Chair Green asked how the five-year time period was determined.

[12:04:06 PM](#)

Mr. Baker responded that five years was deemed equitable based on the separate provisions relating to the Health Reimbursement Account and the five years of service required to qualify for benefits under that program.

[12:04:21 PM](#)

Senator Bunde encouraged the securing of legal advice on this matter.

[12:04:37 PM](#)

Page 6
Benefit Enhancing Legislation

Mr. Baker indicated this is the second suggestion for containing liability. He noted that Kevin Ritchie spoke to this matter in his testimony provided earlier in this meeting.

[12:04:59 PM](#)

Page 7
Benefit enhancing legislation added \$37.7 Million to our unfunded liability in 2001 alone
Passed in 2001, HB 242

Enhanced medical benefits to existing employees by providing full system paid medical to retired members over age 60 and all members who retire with at least 25 years of service (TRS & Police/Fire) and 30 years of service (PERS) regardless of hire date

- When it passed, the bill increased our system liabilities by \$23.7 Million
- Using today's health cost trends, that number has grown to \$37.7 Million

This Session, there are several new bills that if passed would enrich benefits for existing employees and increase our

unfunded liability:

HB 6 - Allowing Fish & wildlife enforcement officers to [claim] credit as peace officers

HB 40 - Allowing retired peace officers medical benefits after 20 years instead of 25

SB 21 - Adding child or vulnerable adult probation workers to the police/fire employee class

We Need Better Fiscal Analysis Before Enacting Legislation Affecting Benefits

Mr. Baker emphasized that the legislature has limited ability to reduce benefits. He remarked that the fiscal impact of HB 242 was not reflected in any fiscal note at the time of its passage.

Mr. Baker stressed the need for legislators to have better information on the cost implications when considering legislation to increase benefits.

[12:08:34 PM](#)

Senator Bunde asked about different legislation adopted in a previous session that provided medical benefits for patients with certain preexisting conditions.

[12:09:02 PM](#)

Mr. Baker qualified that Page 7 did not contain an exhaustive list of all legislation that would affect the retirement system's unfunded liability. He stated that such information is available through the Division of Retirement and Benefits website.

[12:09:34 PM](#)

Senator Bunde opined that if currently pending legislation impacting PERS and TRS were heard in the Senate Finance Committee, the members would be remiss if accurate fiscal notes were not secured

[12:09:54 PM](#)

Co-Chair Wilken added that SB 24 should be included on the list.

[12:10:10 PM](#)

Page 8

Fix Proposed

- Establish enhanced Fiscal Note reporting procedures for any legislation introduced that affects existing benefits

- Fiscal impact would have to be based on an actuarial analysis of the impact on future cash flows and liability to the system

Mr. Baker noted that provisions for this are not included in the bill, but could be inserted. He spoke to the proposed 60-day review period of legislation affecting the system as requested by Mr. Ritchie.

[12:12:06 PM](#)

Page 9
Post Pension Retirement Adjustments

This is the final of the suggestions for containing liability.

[12:12:20 PM](#)

Page 10
Current Retirement Pension Adjustments

1. COLA - the greater of 10% or \$50 increase in base benefit amount paid to retirees living in Alaska
2. Post Pension Retirement Adjustment (PRPA) AS 39.45.475
 - Automatic - annual increase given to eligible retirees based [on] a percentage of the year to year change in Anchorage CPI - 50% pre-65, 75% post-65
 - Discretionary ("Ad Hoc") - Tier 1 members only. Awarded "when the administrator determines that the cost of living has increased and that the financial condition of the retirement fund permits"

Mr. Baker stated that both the COLA (Cost of Living Adjustment) and the PRPA are intended to inflation-proof pension payments.

Mr. Baker informed that the Ad Hoc provision was established in 1966. The criteria of whether the financial condition permitted such distributions were not defined. COLA increases are easier to determine; however the ability of the fund to support continued increases is in question.

[12:15:46 PM](#)

Page 11
[Table detailing PRPA Eligibility and Calculation as follows
Ad Hoc
PRPA Issued
July 1st of every year. Members must meet

eligibility requirements as of July 1st.

Eligibility Requirements

Must be a Tier 1 PERS or TRS member. (Appx 24,500)
Must be a change in the Consumer Price Index (CPI)
from the date of retirement to date of PRPA
issuance.

Calculation

3 Step calculation:

- 1) Determine the % difference in the current CPI%
less the CPI% at retirement. Multiply the base
benefit by this percentage.
- 2) Determine the 4% compounded rate for each month
the member has been on retirement. Multiply the
base benefit ties this percentage.
- 3) The Ad Hoc amount granted is the lesser of the
results of steps 1 and 2.

Automatic

PRPA Issued

July 1st of every year. Members must meet
eligibility requirements as of July 1st.

Eligibility Requirements

- 1) Must be age 60, or
- 2) have been receiving retirement benefits for 5yrs
(PERS), 8 yrs (TRS), or
- 3) be receiving disability benefits

Calculation

If member meets minimum age or service eligibility,
receives 50% of the % change in CPI applied to the
base benefit plus any prior PRPAs granted.
Disability recipients and members who are age 65
receive 75% of the % change in CPI.

Notation reads, "AdHoc PRPA's Have a Huge Effect on Future
Liabilities".]

Mr. Baker outlined this information. He noted that the Ad Hoc
applied to all retirees. An attempt was made in the establishment
of the Automatic distributions to limit the eligibility pool. The
Ad Hoc also had contained a limit of a four percent increase, which
is different from the current calculation provisions.

[12:17:17 PM](#)

Mr. Baker concluded that the Automatic distribution program is
operating adequately. The program is applied annually and actuarial
trends for economies are figured into the models. The difficulty is
encountered with the Ad Hoc distribution program, as it is
discretionary and because when it would be awarded is unknown. If
an Ad Hoc is awarded after several years of no award, the amount is

calculated from the date of retirement for the recipients.

[12:19:07 PM](#)

Co-Chair Green asked if the provision stipulating that the awards could only be made as the financial condition of the fund permits would provide that such retroactive payments could be avoided.

Mr. Baker identified this as the "crux" of the issue. The provision allowed Ad Hoc awards to be granted at the discretion of the administrator. Such awards had been granted in all but two years of the Ad Hoc program's inception in 1960 until the year it was repealed. He told of a lawsuit arguing for retroactive payment for the period when an Ad Hoc award had not been provided. A settlement was reached in this case and retroactive payments were made.

Page 12

[Spreadsheet detailing "Ad Hoc and Automatic PRPA Example" for Tier 1 and Tier 2 retirees based on age.]

This page was not discussed.

[12:20:42 PM](#)

Page 13

[Spreadsheet showing "PRPA Awarding History" for PERS and TRS and the "Total 12 Month Increase" and "Resulting Actuarial Loss" for each of the years 1995 through 2002. A notation reads, "Ad Hoc PRPA's Have a Huge Effect on Future Liabilities."]

Mr. Baker pointed out that awards were not paid in 1995 and 1996 but were retroactively paid in 1997 in conjunction with the award for that year.

Mr. Baker stressed that the retirement system was not designed to allow for the increased pension for all Tier 1 retirees for the remainder of their lives.

[12:24:07 PM](#)

Senator Stedman remarked upon the substantial amount of money. He suggested that because the system is under funded no Ad Hoc award likely paid for many years until the fund is again solvent. However, past Ad Hoc awards have significantly increased the unfunded liability.

Co-Chair Green asked about court decisions that caused the retroactive awards to be required.

[12:25:39 PM](#)

Mr. Baker cited the situation as an example of the impacts of a seemingly simple language change from "may" to "shall". Statutory language initially read as "may" and had provided discretion in granting awards. The language was later amended to "shall". This created a situation that required the awards regardless of the absence of a definition of "financial condition" as it relates to the retirement system.

[12:26:56 PM](#)

Page 14

Fix Proposed

- AS 39.35.475 - Include language that defines what is meant by "the financial condition of the retirement fund".
- Proposal is to set a minimum funding ratio of 110%.

Mr. Baker told of the "total benefit funding level" in 1995 was 94.8 percent for the PERS fund and 89.6 percent for the TRS fund. No Ad Hoc award was granted in that year, but the system was required to pay out retroactively for that year when it gave an award in 1997.

Co-Chair Green asked if statutory language could be adopted that would provide a clearer definition of the funding level and when an award would be appropriate.

Mr. Baker replied that the funding ratio must be at least 110 percent of the future liability.

[12:29:35 PM](#)

Co-Chair Green asked if statute should dictate that Ad Hoc awards would not be retroactive. She asked if the proposed 110 percent ratio applies to the financial condition of the fund at any given year or rather reflect a longer term.

[12:30:07 PM](#)

Mr. Baker responded that the 110 percent ratio would be calculated for the previous year in which an Ad Hoc award was under consideration. Many years would pass before the condition of the fund would return to a status of higher assets to liability

[12:31:19 PM](#)

Co-Chair Wilken remarked that the payments provided by the 1997 award was not insignificant. A friend received a check in the amount of approximately \$300,000.

[12:31:55 PM](#)

Senator Bunde suggested the friend's check was for different reasons, as Senator Bunde received a check in the amount of \$3,000. This payment was the result of a class action lawsuit.

[12:32:19 PM](#)

Mr. Baker relayed the understanding that changes could not be made to prevent retroactive payments to retirees. The Division has exercised fiscal constraint for two years and has not issued an Ad Hoc award. However, if an award were ever issued in the future, the system would be required to "make whole" to the date of retirement for those eligible to receive the award.

[12:34:10 PM](#)

Senator Hoffman asked the number of Tier 1 employees.

[12:34:17 PM](#)

Mr. Baker answered the number is approximately 24,500.

[12:34:28 PM](#)

Co-Chair Green characterized the Ad Hoc award program as a "destructive plan" because if the financial condition of the fund ever reached a level to permit an annual award, such an award would not only be required but awards must be retroactively made for past years when the fund was not in a position to make payments.

[12:34:41 PM](#)

Senator Bunde understood that the determination whether a payout would be awarded is made by the administrator and not by the PERS or TRS boards.

[12:34:57 PM](#)

Mr. Baker explained the commissioner of the Department of Administration appoints the fund administrator.

Senator Bunde asked whether the actuarial consultant carries insurance to cover losses incurred because of errors and omissions.

[12:37:03 PM](#)

Senator Stedman surmised the consultants likely carry some form of insurance. The issue with the Ad Hoc awards is problematic because the provisional language is so "imbedded" as to prevent "rational business practices". The goal is to make the system totally funded. When this is accomplished however, it would be "hit with a huge liability" by the requirement to pay Ad Hoc awards retroactively.

Co-Chair Green asked if the retroactive payments would be required for deceased retirees.

Senator Stedman replied that if eligible for the benefits before becoming deceased, the future payments would be considered an asset of the retiree's estate.

[12:39:12 PM](#)

Co-Chair Green asked if a solution could be found.

[12:39:16 PM](#)

Senator Stedman answered that this is the goal.

[12:39:27 PM](#)

Senator Stedman announced this concluded the presentations for this hearing.

[12:39:44 PM](#)

KEVIN BROOKS, Deputy Commissioner, Department of Administration, testified to implementation issues that could be expected in enacting this legislation.

[12:41:16 PM](#)

Mr. Brooks reminded that the State of Alaska is but one employer participating in the PERS and TRS systems. To date only the State has been considered in the analysis of the impact of this bill. However, the implications are far reaching and would affect all school districts and other public employers.

Mr. Brooks, speaking to the impacts to the State, informed that

adjustments to the payroll system would be necessary to address the different benefit structure for new hires. He noted a funding request was included in the Governor's proposed FY 06 capital budget to overhaul the State payroll system. Due to changes resulting from recent bargaining unit contract agreements, the accounting structure must be revised. This is one of a multitude of issues that would make the July 1, 2005 effective date of this legislation an "insurmountable" deadline.

[12:43:52 PM](#)

[Note: The witness references information not provided to the Finance Committee Secretary for recordkeeping purposes.]

Mr. Brooks listed the 4,362 new hires in the PERS system and 1,231 in the TRS system during FY 04. During the first six months of FY 05 of July 1 to December 31, 2,862 new hires were made in the PERS system and 1,088 in the TRS system. The majority of new hires in the TRS system occur in late summer, as school districts are staffing for the upcoming school year. Implementing the new tier under these circumstances would present a "huge" challenge.

Mr. Brooks continued on the time required in establishing the new board system, including identification of potential members. He estimated that the board members could be seated within the first 90 days of the fiscal year by October 1, 2005. By January 1, 2006, the systems could be implemented to accommodate the defined contribution program of the new tier.

Co-Chair Green asked if implementation could be accomplished earlier.

Mr. Brooks assured the Department of Administration would work as expeditiously as possible to address the issue.

[12:47:34 PM](#)

Co-Chair Green noted that the transition requirements have been addressed in committee substitute.

[12:47:40 PM](#)

Mr. Brooks understood this to be correct.

[12:47:56 PM](#)

Co-Chair Green pointed out that the FY 06 budget would provide funding to allow a significant number of new hires. She asked if

the new hires could be categorized as tier 4 even if full implementation of the provisions were not completed.

[12:48:34 PM](#)

Mr. Brooks had reviewed this.

Mr. Brooks could not speak for all employers as to how they would report and submit withholding information. Participating employers consist of some larger municipal governments and many smaller entities. The primary concern is implementation for school districts. Many districts cease operation after the school season is completed and remain closed until shortly before the new season begins. The Department would need to coordinate with the districts to implement the new tier.

[12:50:29 PM](#)

Co-Chair Green asked if the implications of any other provisions of this bill have been overlooked and should be addressed.

[12:50:47 PM](#)

Mr. Brooks told of a legal opinion forthcoming relating to contribution changes for current employees.

[12:51:11 PM](#)

Senator Bunde noted a reference to the number of terminated employees as zero and asked if this represents a net increase. He presumed that some employees had left the system.

Mr. Brooks corrected the list represents participating employers. He qualified that because of the hurriedness in preparation of the information, some data should be regarded as unverified.

[12:51:55 PM](#)

Mr. Brooks stated the information reflects the number of hires into the tier 3 PERS and tier 2 TRS systems.

Senator Bunde asked the number of terminated employees during the time.

Mr. Brooks understood. The intent of the data is to calculate the estimated number of new hires that would be made during the first half of FY 06 and the impacts that a delay in implementation of this legislation would have.

[12:52:42 PM](#)

Senator Olson pointed out that the City of Hooper Bay is listed twice in the information.

Mr. Brooks replied that the listing is based on the PERS employer number, and that the City of Hooper Bay could have been issued two employer numbers.

[12:53:45 PM](#)

Ms. Millhorn commented on the "remarkable legislative process".

Co-Chair Green was impressed with the quality of work done on this bill.

AT EASE [12:55:05 PM](#) / [12:55:41 PM](#)

Co-Chair Wilken spoke to conceptual changes to the committee substitute.

[12:56:32 PM](#)

Co-Chair Wilken referenced the provisions relating to audit of the actuary "not less than once every four years" for the retirement portion of the plan and an annual audit of the health care portion. He considered the performance of the actuary that "hasn't served the State very well" as a contributor to the unfunded liability of the current system.

Co-Chair Wilken suggested that once this legislation is implemented the State would recruit and select an actuary, whether it remain Mercer Human Consulting or another firm. In addition a peer review system should be established with the State consulting both a primary and a secondary actuary. A provision for this should be in statute. Currently, the State expends approximately \$400,000 to \$900,000 annually for actuarial advice to manage a \$20 billion fund, as well as "people's lives". Relying on one company for this advice is "penny wise and pound foolish". Another firm should be consulted.

[12:59:13 PM](#)

Co-Chair Green directed the Department to write suggested language for such a provision.

[12:59:36 PM](#)

Mr. Brooks responded that such a peer review system is currently employed. Audits were conducted on the Mercer Human Consulting reports and adjustments to those reports were made accordingly. These audits are done every four years. He suggested the frequency could be increased.

[1:00:15 PM](#)

Co-Chair Green suggested the new board could be charged with addressing this issue.

[1:00:57 PM](#)

Co-Chair Wilken remarked that a decision was made in 1995 based on erroneous information that was not discovered until six years later. He surmised that if a peer review system were in place, the current situation could have been avoided. He concluded, "We have been burned by the current system."

[1:02:03 PM](#)

Co-Chair Green noted language on pages 39 and 40 of the committee substitute provide for audits of the actuarial reports.

Co-Chair Wilken agreed, but noted the stipulation that such audits would occur no less than every four years. He argued the audits should be conducted more often. He proposed that the primary actuary present information and make recommendations based on that information. A secondary auditor would review the findings of the primary actuary and provide a second opinion. The audit would not review past actions, but rather provide a second opinion on future predictions. Such audits could be conducted every other year, although annual reviews could be as efficient.

[1:04:22 PM](#)

Senator Stedman proposed for discussion purposes, increasing the number of audits to once every three years. In addition, a peer review would be conducted every other year. Allowing for too much oversight would be preferable to too little oversight at least for the next several years. The consequence of too little oversight could be understated liabilities.

Co-Chair Green cited language in Section 43 of the committee substitute providing for audits. She questioned the wisdom of inserting additional language that could make the provision convoluted.

[1:06:22 PM](#)

Co-Chair Wilken stated that the suggestion he proposed may not be appropriate in this Section.

[1:06:41 PM](#)

Senator Bunde shared another conceptual change to the committee substitute relating to the qualification requirements of board members. He suggested that the PERS and TRS member representatives be exempt from these requirements. PERS and TRS members could not be expected to have the same professional working experience.

Co-Chair Green disagreed. The two board members representing the PERS and TRS membership should have knowledge on the subject. Some background, or at least a "professed interest" would be beneficial. The existing board has included some members with experience and knowledge who have been able to influence other board members.

[1:09:04 PM](#)

Senator Bunde cited the current committee substitute language as requiring members to be "professionally credentialed or have recognized competence in investment management, finance banking, economics accounting, pension administration, and actuarial analysis." He asked if an "active interest" in those fields would be recognized as a recognized competence.

[1:09:29 PM](#)

Co-Chair Green was uncertain. She reiterated that a board member should not be without some knowledge on the subjects. She spoke to her difficulties in understanding this matter.

[1:10:06 PM](#)

Senator Bunde understood the requirement for a professed interest, but questioned the stipulation that an applicant must have recognized competence.

[1:10:28 PM](#)

Co-Chair Green remarked upon numerous teachers who have made personal financial investments.

[1:10:44 PM](#)

Senator Stedman predicted that many TRS members would meet the qualifications, as many are educators who have taught calculus, accounting, business and other relevant courses. Other educators teaching lower grade levels could also possess an interest in participating in the board process and would likely qualify. A teacher bringing real world experience into the classroom would be beneficial to students.

[1:12:00 PM](#)

Senator Dyson appreciated the inclusion of health reimbursement accounts in the proposed new tier. He also supported health savings accounts for all State employees and has sponsored separate legislation to do so. He asked why such a program could not be included in SB 141.

[1:12:44 PM](#)

Co-Chair Green asked if Senator Dyson has discussed this with the Division of Retirement and Benefits.

Senator Dyson replied he has not directly addressed the matter, although he has been requesting assistance from the Murkowski Administration for two years with no avail. Many other government entities and other employers are extending this benefit and insurance companies are offering "attractive packages". The State of Alaska should participate as well.

[1:13:58 PM](#)

Senator Stedman, returning to the topic of recognized competence in board members, offered language to provide that ten years professional experience would be a qualifier.

Senator Stedman then recalled review of whether to include a health savings account program in this legislation. It was determined that health reimbursement accounts have greater tax benefits because the accounts are employer controlled. Therefore the health reimbursement account is more advantageous to both the employee and the employer.

[1:15:50 PM](#)

Co-Chair Wilken asked about penalties on early withdrawal of employee contributions.

[1:16:18 PM](#)

Senator Stedman explained the vesting schedule for the employer. The employee contribution remains in that employee's account.

Co-Chair Wilken clarified that terminated employees could withdraw the amount of their contribution to transfer to another retirement account, or to purchase a vehicle and pay a tax penalty.

Senator Stedman affirmed.

Co-Chair Wilken asked about an employee who retires at the age of 55, then decides to withdraw the funds later.

Senator Stedman replied that the details of the variables involved would be established. One possibility would be to roll the funds into a private Individual Retirement Account (IRA) upon retirement. Generally, some flexibility would be allowed in the distribution of payouts.

Co-Chair Green furthered the federal government has established a retirement age of 59 and one-half to withdraw these funds without penalty from the Internal Revenue Service (IRS).

[1:18:50 PM](#)

Co-Chair Wilken asked if the committee substitute provides for existing employee contributions.

Senator Stedman outlined the basis points.

[1:19:47 PM](#)

Co-Chair Wilken asked whether this would establish a policy in which the employee would be expected to participate at 50 percent.

Senator Stedman affirmed clarifying this would address only the normal service cost and not the unfunded liability.

[1:20:22 PM](#)

Co-Chair Wilken understood that future legislation would allow the basis points to increase in varying amounts depending on the cost to the system.

AT EASE [1:20:47 PM](#)/[1:21:59 PM](#)

#

ADJOURNMENT

Co-Chair Green adjourned the meeting at 01:22 PM