

MINUTES
SENATE FINANCE COMMITTEE
April 6, 2005
9:06 a.m.

CALL TO ORDER

Co-Chair Green convened the meeting at approximately [9:06:55 AM](#).

PRESENT

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

Also Attending: MICHAEL O'LEARY, CFA, Executive Vice President, Callan Associates Inc.; GARY BADER, Chief Investment Officer, Treasury Division, Department of Revenue;

Attending via Teleconference: from an offnet location: MEG CORDUAN, Coordinator, Chancellor's Office, University of Alaska, Fairbanks Campus; JIM JOHNSEN, Vice President, Faculty and Staff Relations, University of Alaska; JOE BEEDLE, Vice President, Finance, University of Alaska; DORIS ROBBINS; ROBERT STRAHAN, Finance Director, City of Bethel; From Kenai: MELODY DOUGLAS, Chief Financial Officer, Kenai Borough School District;

SUMMARY INFORMATION

SB 141-PUBLIC EMPLOYEE/TEACHER RETIREMENT/BOARDS

The Committee heard from the University of Alaska, a financial consultant and took public testimony. A committee substitute and four amendments were adopted. The bill was reported from Committee.

SB 144-EMISSION CONTROL PROGRAM PERMITS/REGS

This bill was scheduled but not heard.

HCR 2-IN-STATE NATURAL GAS NEEDS

This bill was scheduled but not heard.

#SB141
[9:07:26 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 was the 11th hearing for this bill in the Senate Finance Committee.

Co-Chair Green explained the proposed committee substitute, Version "Y", incorporates the amendments adopted during the previous hearing on this bill.

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

Without objection the committee substitute was ADOPTED.

Co-Chair Green next informed that representatives of the University of Alaska have requested inclusions of certain provisions in this legislation. These relate to questions raised regarding collective bargaining. A legal opinion was obtained, which determined that statutory language was not required to address the issue for most agencies with Public Employees Retirement System (PERS) and Teachers Retirement System (TRS) members, as the practice was standard operations. However, the University operates somewhat differently and would require a statutory provision. To date, the collective bargaining practices of the University have operated under the direction of legislative intent.

[9:10:21 AM](#)

Senator Olson asked if the current collective bargaining practice has been upheld in court challenges.

Co-Chair Green responded that the practice has not been challenged since the original court finding was issued in 1978. The practice has continued in the current manner since that date. The longer the standard is maintained, the more validity the standard has.

Senator Olson surmised the issue has been argued in a court of law only one time.

Co-Chair Green affirmed.

[9:11:21 AM](#)

Amendment #20: This amendment inserts "relating to university retirement programs" into the title on page 1, line 4.

This amendment also inserts "participates in a" to AS 14.25.040(a) amended in Section 5. The amended language reads as follows.

(a) Unless a teacher or member participates in a [HAS ELECTED TO PARTICIPATE IN THE OPTIONAL] university retirement program under AS 14.40.330 - 14.40.799, [OR] has filed an election under AS 14.25.043(b), or has elected to participate in the plan established in AS 14.25.310 - 14.25.590, a teacher or member contracting for service with a participating employer is subject to AS 14.25.009 - 14.25.220 [THIS CHAPTER].

This amendment also inserts a new bill section on page 10, following line 22 to read as follows.

Sec. 16. AS 14.25.115(a) is amended to read:

(a) A teacher in membership service on or after July 1, 1977, who is appointed to retirement on or after July 1, 1978, may elect to apply unused sick leave credit in computing the total number of years of credited service under AS 14.25.110(d) except for sick leave earned while participating in a [THE OPTIONAL] university retirement program under AS 14.40.661 - 14.40.799. To obtain service credit for unused sick leave, a teacher must apply to the administrator not [NO] later than one year after appointment to retirement. Unused sick leave shall be credited on a day-for-day basis in accordance with the table for service after July 1, 1969, contained in AS 14.25.220(45). Teacher contributions may not be required for credited unused sick leave.

This amendment also inserts a new bill section on page 13, following line 18 to read as follows.

Sec. 30. AS 14.25.220(42) is amended to read:

(42) "teacher" and "member" are used interchangeably under this chapter and mean a person eligible to participate in the system and who is covered by the system, limited to

(A) a certified full-time or part-time elementary or secondary teacher, a certified school nurse, or a certified person in a position requiring a teaching certificate as a condition of employment in a public school of the state, the Department of Education and Early Development, or the Department of Labor and Workforce Development;

(B) a full-time or part-time teacher of the University of Alaska or a person occupying a full-time administrative position at the University of Alaska that requires academic standing; the approval of the administrator must be obtained before an administrative position qualifies for membership in the system; however, a teacher or administrative person at the university who is participating in a [THE OPTIONAL] university retirement program under AS 14.40.661 - 14.40.799 is not a member under this system;

(C) a state legislator who elects membership under AS 14.25.040(b);

This amendment deletes "has elected to participate in the optional" and inserts "is participating in a" to Sec. 14.25.330. Membership. (b) added through Section 30 on page 14, line 14. The amended language reads as follows.

(b) A teacher who is participating in a university retirement program under AS 14.40.660 - 14.40.799 may not participate as a member of the defined contribution retirement plan.

This amendment also deletes the language of Section 35 on page 37, lines 25 - 30 and inserts 15 new bill sections to read as follows.

Sec. 35. AS 14.40.661 is amended to read:

Sec. 14.40.661. Authority of board. (a) The board may establish and maintain [AN OPTIONAL] university retirement programs [PROGRAMS] for eligible employees in which retirement, health, and death benefits are provided through the purchase of annuity contracts, either fixed, variable, or a combination of fixed and variable. Participation in a university retirement [THE] program is in place of participation in a state retirement system. The university may establish retirement programs for new employees in a participating position at any time. Retirement programs may be

optional or mandatory.

(b) The board shall

(1) provide for the administration of the retirement programs [PROGRAM], including procedures for resolving complaints from participating employees;

(2) designate the company or companies to which payment of the contributions required under AS 14.40.691 may be made, after considering the

(A) nature and extent of the rights and benefits that the contracts will provide to employees who elect to participate and to their beneficiaries;

(B) relation of the contractual rights and benefits to the contributions to be made under AS 14.40.661 - 14.40.799;

(C) suitability of the contractual rights and benefits to the needs and interests of employees who [ELECTING TO] participate and to the interest of the university in the employment and retention of employees;

(D) ability of the designated company or companies to provide rights and benefits under the contracts; and

(E) efficacy of the contracts in the recruitment and retention of faculty and administrators;

(3) take other actions required to ensure that the retirement programs comply with applicable provisions of 26 U.S.C. 401 - 417 [PROGRAM QUALIFIES AS A QUALIFIED TRUST UNDER 26 U.S.C. 401(a)] (Internal Revenue Code).

Sec. 36. AS 14.40.661 is amended by adding a new subsection to read:

(c) The university retirement programs established under this section are not subject to bargaining under AS 23.40.070 - 23.40.260 (Public Employment Relations Act).

Sec. 27. AS 14.40.671(b) is amended to read:

(b) An election under (a) of this section to participate in a university retirement [THE] program is irrevocable. The election shall be made in writing on a form provided by the board and approved for the state by the commission of administration. The form must be filed with the university not [BOARD NO] later than 30 days after the date on which the employee is notified by the university that the employee is [FIRST BECOMES] eligible to participate in the program. A copy of the form shall be delivered to the appropriate state retirement system. The election becomes irrevocable on the date it is received by the board.

Sec. 38. AS 14.40.671(c) is amended to read:

(c) Participation in a university retirement [THE ELECTION TO PARTICIPATE IN THE] program constitutes a waiver of all rights and benefits under the state retirement systems earned on or after the effective date of the election if the participation is optional, or the effective date of the participation if the participation is mandatory, and while the employee is participating in a university retirement [THE] program.

Sec. 39. AS 14.40.671(d) is amended to read:

(d) Except as provided in (e) of this section, if a nonvested member of a state retirement system participates [ELECTS TO PARTICIPATE] in a university retirement [THE] program, the employee may choose to transfer the amount in the employee's contribution account to a university retirement [THE] program. If the employee chooses to transfer the account, the appropriate state retirement system shall pay to the university on behalf of the employee an amount equal to the balance in the account. The payment must be made within 45 days after notice of the employee's decision to transfer the employee's contribution account to a university retirement program [THE ELECTION] is received by the state retirement system. The financial officer of the university shall [IMMEDIATELY] pay the amount received to the designated company or companies for the benefit of the employee as soon as possible. An employee who transfers assets under this subsection may not reclaim the corresponding service in the state retirement system if the employee is reemployed under the state retirement system.

Sec. 40. AS 14.40.671(e) is amended to read:

(a) An employee whose rights to transfer assets out of a state retirement system are subject to a qualified domestic relations order is entitled to transfer assets from the state retirement system to a university retirement [THE] program only if the requirements for receiving a refund under AS 14.25.150(b), 14.25.360, [OR] AS 39.35.200(c), or 39.35.760, as appropriate, are met.

Sec. 41. AS 14.40.671(f) is amended to read:

(f) If a vested member of a state retirement system participates [ELECTS TO PARTICIPATE] in a university retirement [THE] program, the employee ceases to be an active member of the state retirement system on the effective date of the participation in a university retirement [THE] program. The employee retains all benefits accrued in the state retirement system.

Sec. 42. AS 14.40.671(g) is amended to read:

(g) An employee who does not [ELECT TO] participate in a university retirement [THE] program under this section becomes or remains a member of the appropriate state retirement system.

Sec. 43. AS 14.40.671 is amended by adding new subsections to read:

(h) Notwithstanding (b) of this section, the university may establish a mandatory retirement program for new employees.

(i) Notwithstanding (b) of this section, the university may offer an employee who made an election not to participate in an optional university retirement program at the time the employee was eligible to participate in the program an option to enroll in a different university retirement program first established by the university after the effective date of this subsection.

Sec. 44. AS 14.40.681 is amended to read:

Sec. 14.40.681. Retirement system membership. An [ELIGIBLE] employee participating [ELECTING TO PARTICIPATE] in a university retirement [THE] program may not participate in a state retirement system during the time the employee is employed in a participating position. If the employee is later employed in a position covered by a state retirement system that is not a participating position, the employee may not continue to participate in a university retirement [THE] program and shall begin to participate in the state retirement system.

Sec. 45. AS 14.40.691(c) is amended to read:

(c) The board may specify that contributions required by this section are made by a reduction in salary under 26 U.S.C. 403(b) or 26 U.S.C. 414(h)(2) (Internal Revenue Code).

Sec. 46. AS 14.40.701 is amended to read:

Sec. 14.40.701. Benefits. Payment of benefits to participants of the program is the responsibility of the company or companies designated by the board and is not the responsibility of the board, the university or the state. The benefits are payable to participants or their beneficiaries in accordance with the terms of the applicable retirement plan document [ANNUITY CONTRACT OR CONTRACTS. HOWEVER, RETIREMENT BENEFITS MUST BE PAID IN THE FORM OF A LIFETIME INCOME. EXCEPT FOR DEATH BENEFITS, A SINGLE-SUM CASH PAYMENT IS NOT PERMITTED UNDER THIS SECTION.]

Sec. 47. AS 14.40.799(3) is amended to read:

(3) "contribution account" means the member contribution account under AS 14.25.009 - 14.25.220, the individual account under AS 14.25.310 - 14.25.590, [AS 14.25 OR] the employee contribution account under AS 39.35.095 - 39.35.680, or the individual account under AS 39.35.700 - 39.35.990 [AS 39.35], whichever is appropriate;

Sec. 48. AS 14.40.799(5) is amended to read:

(5) "participating position" means a position that is a permanent position that is at least a .5 full-time appointment and is included in the applicable retirement plan document [AS

(A) A FACULTY APPOINTMENT; OR

(B) AN ADMINISTRATOR AND THE POSITION HAS BEEN DESIGNATED BY THE BOARD FOR INCLUSION IN THE PROGRAM];

Sec. 49. AS 14.40.799(6) is amended to read:

(6) "program" means a [THE OPTIONAL] university retirement program;

Sec. 50. AS 14.40.799 is amended by adding a new paragraph to read:

(8) "university" means the University of Alaska.

This amendment also inserts a new bill section on page 61, following line 24 to read as follows.

Sec. 84. AS 39.35.120 is amended to read:

Sec. 39.35.120. Commencement of participation. (a) An employee of the state shall be included in this system upon commencement of employment with the state, or on January 1, 1961, whichever is later. Unless an employee participates in a [HAS ELECTED TO PARTICIPATE IN THE OPTIONAL] university retirement program under AS 14.40.661 - 14.40.799, an employee of a political subdivision or public organization that becomes an employer shall be included in the system on the effective date of the employer's participation or the date of the employee's commencement of employment with the employer, whichever is later.

(b) Inclusion in the system is a condition of employment for an employee except as otherwise provided for

(1) an elected official;

(2) an employee making an election under AS 39.35.150(b); and

(3) an employee of the university who participates in a [HAS ELECTED TO PARTICIPATE IN THE OPTIONAL] university retirement program under AS 14.40.661 - 14.40.799.

This amendment also inserts a new bill section on page 72, following line 28 to read as follows.

Sec. 117. AS 39.35.680(21) is amended to read:

(21) "member" or "employee"

(A) means a person eligible to participate in the system and who is covered by the system;

(B) includes

(i) an active member;

(ii) an inactive member;

(iii) a vested member;

(iv) a deferred vested member;

(v) a nonvested member;

(vi) a disabled member;

(vii) a retired member;

(viii) an elected public officer under AS 39.35.381;

(C) does not include

(i) former members;

(ii) persons compensated on a contractual or fee basis;

(iii) casual or emergency workers or nonpermanent employees as defined in AS 39.25.200;

(iv) persons covered by the Alaska Teachers' Retirement System except as provided under AS 39.35.131 and 39.35.381, or persons covered by a [THE OPTIONAL] university retirement program;

(v) employees of the division of marine transportation engaged in operating the state ferry system who are covered by a union or group retirement system to which the state makes contributions;

(vi) justices of the supreme court or judges of the court of appeals or of the superior or district courts of Alaska;

(vii) the administrative director of courts appointed under art. IV, sec. 16 of the state constitution unless the director becomes a member under AS 39.35.158;

(viii) members of the elected public officers' retirement system (former AS 39.37); and

(ix) contractual employees of the legislative branch of state government under AS 24.10.060(f);

(D) may include employees of the division of marine transportation excluded under (C)(v) of this

paragraph provided that

(i) the State of Alaska formally agrees to their inclusion through the process of collective bargaining; and

(ii) no collective bargaining agreement has the effect of obligating contributions made by the state under AS 39.30.150 in the event the state resumes participation in the federal social security system;

New Text Underlined [DELETED TEXT BRACKETED]

This amendment also makes conforming changes and renumbers bill sections as necessary.

MEG CORDUAN, Coordinator, Chancellor's Office, University of Alaska, Fairbanks Campus, testified via teleconference from an offnet location, to request this amendment be adopted to provide clarification. The unions covering University employees have never attempted to bargain the current practice; however it would be beneficial to include statutory language.

AT EASE [9:13:28 AM](#)

Co-Chair Green requested an explanation of the amendment.

JIM JOHNSEN, Vice President, Faculty and Staff Relations, University of Alaska, testified via teleconference from an offnet location that the proposed amendment would modify the statute that provides the optional retirement program for the University. The intent is to "provide a clear statement that the optional retirement plans and the University's pension programs are not subject to collective bargaining." This amendment would allow the Board of Regents to establish a system to allow or require new employees to participate in an optional retirement plan. The Board could also permit existing employees who had initially chosen to not participate, or were ineligible to participate in the optional retirement plan, an opportunity to do so. This would be a one-time availability for existing employees to change their retirement plan. Currently only faculty and executive administrators are able to participate in the optional retirement plan.

Mr. Johnsen continued that this amendment would also allow the Board of Regents to implement a health benefit provision in all or part of the plan. The current work plan is a limited defined contribution retirement plan without any health care coverage. A health care reimbursement account is one option for consideration.

Co-Chair Green moved for adoption of the amendment and objected for discussion.

[9:17:12 AM](#)

Senator Hoffman clarified that the witness stated that many employees had opted to participate in the optional retirement plan with the understanding that electing to participate was a one-time decision; and that this amendment would allow employees to change that decision to no longer participate in the optional retirement plan.

[9:17:55 AM](#)

Mr. Johnsen corrected the intent is not to provide an opportunity to allow employees participating in the optional retirement plan to chose to instead participate in the PERS or TRS plans. Rather the amendment would permit the Board to allow those employees who had opted to participate in PERS or TRS to instead participate in the optional retirement plan.

There was no objection and the amendment was ADOPTED.

[9:18:51 AM](#)

Amendment #17: This amendment to Section 110 on page 98 lines 18 - 20 deletes the new paragraph added to AS 44.64.030(a) and inserts two new paragraphs to read as follows.

(36) AS 14.25.006 (teachers' retirement system);
(37) AS 39.35.006 (public employees' retirement system).

Co-Chair Green moved for adoption and objected to the motion to provide an explanation.

Co-Chair Green relayed that an administrative law judge pointed out that the initial paragraph, which specified AS 37.10.210 - 37.10.390 (Alaska Retirement Management Board), would have inadvertently allowed the administrative law judge to hear appeals to Alaska Retirement Management Board decisions. Co-Chair Green stressed that this was not the intent and that this amendment would correct this. The appeals actually originate from TRS and PERS decisions.

The amendment was ADOPTED without objection.

[9:20:32 AM](#)

Amendment #18: This amendment deletes Sec. 39.35.975. Administrative director of courts., on page 92, lines 22 - 25, added by Section 101.

Co-Chair Green moved for adoption and objected to provide an explanation.

Co-Chair Green stated this amendment would remove the option of an administrative director or the Alaska Court System to withdraw from the Judicial Retirement System and participate in the public employees' defined contribution retirement plan. There is only one administrative director position within the Alaska Court System and "one can never envision them opting to move to the defined contribution plan."

Without objection the amendment was ADOPTED.

[9:21:49 AM](#)

Amendment #19: This amendment deletes "plan [SYSTEM]" and inserts "retirement fund" to the language of Section 17 on page 11, line 5. The amended language reads as follows.

Sec. 17. AS 14.25.143(a), as that subsection read following amendment by sec. 12, ch. 106, SLA 1988, until amended by sec. 12, ch 97, SLA 1990, is amended to read:

(a) When the administrator determines that the cost of living has increased and that the financial condition of the retirement fund permits, the administrator shall increase benefit payments to persons receiving benefits under this plan. For purposes of this subsection, the financial condition of the plan would only permit an increase in benefits when the ratio of total fund assets to the accrued liability meets or exceeds 110 percent. In this subsection, "accrued liability" means the present value of all member benefits accrued by member service in this plan [SYSTEM].

This amendment also changes the statutory reference in subsection (a)(5) of Sec. 14.25.440. Distribution Requirements., added through Section 30, on page 21, line 17. The amended language reads as follows.

(5) notwithstanding (a) of this section, a participant whose account has a balance of \$1,000 or less meets the requirements of AS 14.25.410, at which time the participant must take payment of the participant's account.

This amendment also deletes "working" following "professional" from subsection (3) of AS 37.10.390. Definitions., amended by Section 47 on page 46, line 7. The amended language reads as follows.

(3) "recognized competence" means a minimum of 10 years' professional experience working or teaching in the field of investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis;

New Text Underlined [DELETED TEXT BRACKETED]

Co-Chair Green moved for adoption and objected to offer an explanation. She stated that the changes proposed in the amendment are to correct drafting errors.

There was no objection and the amendment was ADOPTED.

[9:22:57 AM](#)

Senator Hoffman asked if a revised fiscal note would be prepared to reflect the amendments just adopted.

Co-Chair Green replied that the only fiscal changes relate to the University of Alaska system and that a fiscal note revision was not necessary.

Senator Hoffman contended that the legislature would be responsible for changes that impact the University budget and should therefore be reflected in a fiscal note.

Co-Chair Green indicated she would research the matter.

[9:23:56 AM](#)

MELODY DOUGLAS, Chief Financial Officer, Kenai Borough School District, testified via teleconference from Kenai, read into the record the following.

The District is the largest employer on the Kenai Peninsula and the fourth largest district in the State, employing approximately 11,000 people.

You're going in the right direction with much of the legislation contained in SB 141 for PERS and TRS employees and elected officials. Thank you for your hard work. I would like to bring a few issues to your attention today for further discussion and resolution.

Creating a new tier for both PERS and TRS is essential to the health of these systems. However, a significant issue in my mind is the unfunded liability of the nearly \$6 billion if paid today, most of which is coming from full health benefits for retirees younger than 65. I ask that pension bonds be explored to address this matter. I have heard it said that we (the state) can't commit those coming after us by such a financing arrangement. The fact is that the financial commitment is already here; we are just paying for it with increased employer contribution rates. It's not only prudent; it is our responsibility to address this matter. Pension bonds, for even a portion of the unfunded liability if not all, would have the affect of lowering employer contribution rates. Estimated bond rates of 5.5 to 6% would generate a savings as compared to the 8.25% currently charged to employers for the PERS and TRS unfunded liability. However, the benefit of this option will decline as interest rates rise.

New tiers should be based on a defined contribution retirement system for new employees. Corporate America has transitioned to a defined contribution system because they could no longer afford to incur all the risk of a defined benefit retirement system. The Public Sector must follow suit; the Kenai Peninsula Borough School District does not have the funds to address ongoing employer rate increases without draconian cuts in the classroom. I am concerned about attracting and retaining quality employees throughout the State. I don't see a defined contribution system and recruiting and retention as mutually exclusive if the system includes a combination of say 50% fixed (less risky) investing, and 50% flexible investing, in conjunction with a health care benefits. Requiring a fixed investment component will ensure a secure level of retirement benefits for individuals. Portability of an individual's retirement fund is an attractive feature of a defined contribution system, given that younger generations are expected to change jobs 7 or more times during their career.

[9:27:06 AM](#)

Co-Chair Green interrupted to request that the witness conclude her testimony, as the next speaker must depart shortly to catch an airplane. [Ms. Douglas resumed testifying later in the hearing.]

[9:27:19 AM](#)

MICHAEL O'LEARY, CFA, Executive Vice President, Callan Associates

Inc., gave his presentation highlighting portions of a handout titled "ASPIB Asset Allocation Background" [copy on file].

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Callan Associates Inc.

- Independent employee owned pure investment consulting firm serving 289 plan sponsor clients as of 12/31/04
- 171 employees including dedicated specialists in quantitative modeling, manager research, and performance monitoring
- Largest investment consulting practice serving public funds
 - o 88 public fund clients with aggregate assets of \$692 billion
 - o average more than 22 asset liability and 100 asset allocation studies annually
 - o last conducted an asset liability study in 2003
 - o annually update asset allocation only analysis

Mr. O'Leary told of the activities of the company he represents.

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Efficient Portfolios

- For any given rate of return, no other portfolio has less risk
- For any given level of risk, no other portfolio provides superior returns.
- Efficient portfolios lie somewhere on the efficient frontier.
- In practice, it is not uncommon to find portfolios that are inefficient in a risk-return context.

And

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Asset Liability Concepts

Benefits = Contributions + Earnings - Expenses

Benefits - traditional retirement benefits dependent on future inflation impacting salaries and post retirement adjustments
Contributions - dependent on funding status, plan demographics, expected earnings & discount rate, actuarial budgeting approach

Earnings - dependent on asset allocation policy, manager success and cost (frequently dominated by size factors but also varied by asset type).

Often misunderstood reality - actuarial loss is failure to achieve assumed actuarial return (8.25% per year for AK). Simply failing to earn anything over 3 years results in a \$1 million liability becoming a \$1.268 liability.

Mr. O'Leary gave a background of how the Alaska State Pension Investment Board (ASPIB) has established investment policy, which is similar to the policies governing the State's Supplemental Benefit System (SBS) and Deferred Compensation funds. Like most major public pension systems, modeling capital market theory is utilized to set policies.

Mr. O'Leary explained the method of managing a defined benefits plan by utilizing actuarial information to model the range of liabilities. Because the Alaska plans provide medical benefits, the modeling gives an "appearance that the liabilities are "incredibly sensitive" to health inflation; much more so than any of the other public funds" Callan Associates advises.

Mr. O'Leary described the formula shown on page 15 as "the given in pension funding". The typical defined benefit plan has significant inflation sensitivity because the benefit is defined in terms of final pay plus post-retirement cost of living adjustments. Therefore defined benefit plans are subject to both wage inflation and price inflation.

Mr. O'Leary continued that contribution is the "actuary's realm". He likened this to a budgeting process, in which it is determined how contributions would be made and the timeframe of those contributions. This affects the ability of a system to achieve earnings because earnings could only be achieved on funds available for investment.

Mr. O'Leary spoke of confusion heard in media reports over the definition of loss in this instance. He stated that from the actuarial perspective, a loss includes earnings less than the amount projected. The earnings assumption for the PERS and TRS systems is 8.25 percent; therefore earnings of any amount less than this percentage is considered a loss.

[9:32:11 AM](#)

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Efficient Frontier Mixes & Proposed Asset Mix Policies

[This table compares Expected Return, Standard Deviation, and Sharpe Ratio for the following portfolios:

Military
Mix 1
Mix 2
Mix 3
Mix 4
Judicial
PERS/TRS
Mix 5
Mix 6

By list the following components and corresponding maximums:

Large Cap	100
Small/Mid Cap	100
International Equity	100
Domestic Fixed	100
Non US Fixed	100
Real Estate	15
Private Equity	6
High Yield	10
Absolute Return	0
Other	0

A comment reads:

Please note that the optimizer was not allowed to select "absolute return" or "other". Liquid investments in private equity and "other" were not made available for use in the Judicial or Military mixes. Real estate & private equity were also excluded from consideration for the Military program.

Information for PERS/TRS portfolio reads as follows:

Large Cap	30
Small/Mid Cap	6
International Equity	15
Domestic Fixed	24
Non US Fixed	2
Real Estate	9
Private Equity	6
High Yield	2
Absolute Return	3
Other	3
Total	100
Expected Return	7.83
Standard Deviation	11.76
Sharpe Ratio	0.41]

Mr. O'Leary explained that the figures for each portfolio are "points along the efficient frontier". The ASPIB "studiously reviews" this information annually and alternatives are considered.

Policies are adopted annually and every several years a "full integrated asset liability study" is conducted. The last study was conducted in 2003.

Mr. O'Leary pointed out that the expected return of the current policy is 7.83 percent, which is below the actuarial earning assumption of 8.25 percent. In developing the projections, the actuary tends to consider long-term periods of 40 or more years; effectively the life expectancy of the youngest participant. The assumptions compiled by Callan Associates are focused on a five-year period. The inflation assumption is 2.6 percent rather than the 3.5 percent calculated into the actuarial evaluation. If the same inflation assumption were utilized, the nominal expected return for this policy would be higher. This issue has received considerable discussion at the PERS and TRS boards' annual meetings.

[9:35:01 AM](#)

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Efficient Frontier Graph

Efficient Frontier 2005 Adjusted Optimization Set

[This line graph shows the trend of Projected Return compared to the Projected Risk with PERS/TRS, Judicial and Military noted on the trend.]

Accompanying comment reads:

PERS/TRS is above the efficient frontier because asset categories not available to the optimizer are included in the policy (absolute return & other).]

Mr. O'Leary relayed that as a professional advisory, he "encourages" clients to place their funds "anywhere on the efficient frontier". The PERS/TRS funds have a slightly higher projected return because it includes asset categories that the Judicial and Military funds are restricted from participating in.

[9:35:59 AM](#)

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Unique Factors

- Medical program inclusion
 - o Extraordinary health inflation at a bad time
 - o Projecting medical inflation at rates well in excess of projected returns for any asset class (i.e. 10% or more for next 5 years)
 - o Terminal projected inflation rate = 5% versus

Callan CPI projection of 2.6%

- Embedded salary inflation assumption greater than Callan inflation projection & inflation embedded in current financial markets (e.g. TIPS)
- Actuary is assuming less than 5% "real return"

Mr. O'Leary noted this are some factors unique to the PERS and TRS system. The extraordinary health inflation and the timing of that inflation has had a significant impact. He was troubled by the implication made by Mercer Human Resource Consulting at a recent ASPIB meeting that inflation would be ten percent plus an average annual inflation over the next five years. More significantly, Mercer expressed an expectation that "going forward" the inflation would only decline to five percent over a very protracted period. By comparison, the general inflation expectation is 2.6 percent.

Mr. O'Leary added that the salary inflation embedded in the assumptions utilized by Mercer is 3.5 percent and in the long term, general prices would have to increase at a level "near the salary rate". A 3.5 percent salary increase has not been realized and Mr. O'Leary did not expect this to occur within the next five years.

Mr. O'Leary told of an investment option available to these plans that provide inflation-protected securities. Unfortunately no health care related inflation-protected securities exist. However, TIPS [acronym not defined] currently has an embedded inflation assumption of approximately 2.7 percent, which is similar to Callan Associates' five-year expectation. A system could be protected against inflation by investing solely in TIPS; however the real rate of return above the reported inflation rate, would be less than two percent.

[9:39:16 AM](#)

Page 21

Asset Allocation Versus Public Funds
Asset Class Weights vs. CAI Public Fund Sponsor Database
[Graph depicting the 10th, 25th, 75th and 90th Percentiles and the Median for Domestic Equity, Domestic Fixed, Short Term/Cash, Real Estate, International Equity, Int'l Fixed-Income, and Alternative, with Funds and Targets specified.
A comment states "Note that 'alternative' includes private equity, absolute return & other."]

Mr. O'Leary explained this chart depicts how the PERS/TRS funds are invested relative to Callan Associates' database of over 100 public fund systems. PERS/TRS funds are invested similar to other funds,

although with a higher percentage of real estate and international equity investments, both of which have benefited the system significantly.

[9:40:00 AM](#)

Page 22

Thirteen & 1/4 Year Attribution Analysis

[This page includes two spreadsheets titled "Thirteen And One-Quarter Year Annualized Cumulative Attribution Effect", one representing PERS and the other TRS, that lists the percentages of Effective Weight, Avg Trgt Weight, Actual Return, Target Return, Manager Effect and Asset Allocation for Domestic Equity, Domestic Fixed-Income, High Yield, Real Estate, International Equity, Int'l Fixed-Income, Private Equity, Other, Absolute Return, and Short Term/Cash asset classes. The Actual Return, Target Return, Manager Effect, and Asset Allocation total for PERS is 8.94% = 8.96% x (0.00%) x (0.02%), and for TRS is 9.00% = 8.96% x (1.01%) x 0.04%.]

Mr. O'Leary stated that 13.25 years is the length of time available to make the calculations. The long-term "record" has been above the actuarial earnings assumption, although it includes periods of "great strengths in the financial markets" particularly bond return. Given the current level of interest rates, returns of this magnitude could not likely be replicated in the future. However, a significantly lower "inflation environment" has occurred in the last several years and is predicted to continue for the following several years. The funds have achieved greater than a five-percent real return. This is important because the real return estimate embedded in the actuaries is approximately 4.75 percent. The current policy, which results in the expected return of 7.83 percent, is consistent with a real return in excess of five percent.

Mr. O'Leary concluded the presentation.

[9:42:08 AM](#)

Page 8

Measuring Risk

Standard Deviation - Measures the Variability of Returns from Their Mean

[Diagram of a bell curve showing the Broad Domestic Equity Range of Returns. The standard deviation of nine percent for 66 percent of the observations is 16.9 percent.]

Senator Stedman referenced this page and asked if the percentage of observations should be 68 percent rather than 66.

Mr. O'Leary answered that the amount is two-thirds.

[9:42:42 AM](#)

Senator Stedman next directed attention to Page 17 and recalled conversations on the five percent real return. He noted the use of two different growth rates: 7.8 percent for the short term of five years and 8.25 percent for the long term of 20 to 40 years and questioned why a "double shift growth model" was not used.

Mr. O'Leary replied that he knew current interest rates and inflation rates, but did not "have a clue" what those rates would be over the next 40 or 50 years. The bond market indicates investors' aggregate projected inflation rate, which Callan Associates utilizes as a basis for judgment. The actuary's predictions differ. Mr. O'Leary's preferred bond rates to be higher, as this would help all public funds. The current national average is eight percent and has been such for several years

[9:45:06 AM](#)

Page 5

Annual Stock Market Returns
1926 - 2003

[Bar graph showing the number of times returns have been: Below 0% (24), 0%-8% (7), 8%-12% (6), and Above 12% (41). A notation reads as follows

Graph & data obtained from Vanguard web site. Based on data from S&P (1926-1970) and Dow Jones Wilshire 5000 Composite Index (1971-2003). Over the 78 years, stocks were below their long-term average (10.4% plus or minus 2%) in 31 years.]

Mr. O'Leary stated over this time period, stocks have returned 10.4 percent on average. The "normal distribution" on a year-by-year basis is "a little funny", but the performance of years are linked to a five-year compound return.

[9:46:12 AM](#)

Senator Stedman then characterized the line graph on Page 18 as more like a "security market line" than an "efficient frontier", as it is labeled.

[9:46:37 AM](#)

Mr. O'Leary clarified this graph represents a segment of efficient frontier, and detailed that actual investments could be more or less conservative. The drivers are the expected future return, the volatility of the return and the correlation of the various asset classes with each other.

[9:47:12 AM](#)

Senator Stedman asked where the data was derived.

Mr. O'Leary replied that historical performance is used as a starting point. An extensive investigation of the historic return pattern is conducted including the nominal and volatility of each asset class over a "rolling five year period". The most recent five-year pattern is then compared to the historical data.

[9:48:11 AM](#)

Senator Stedman asked if Edmonson and Associates data is used as a source.

Mr. O'Leary affirmed this has been a valuable source from the 1920s through the 1950s. Many additional sources of index vendors are available for the years since. He listed Morgan Stanley, MSCI, S&P, and Lehman Brothers, as examples.

[9:49:07 AM](#)

Senator Stedman referenced the 13-year analysis on Page 22 and the witness' indication of the "five-year rolling average" and "comparisons to the index." Senator Stedman was not concerned that ASPIB "isn't within a reasonable range of where they should be on the return for their allocation." However it would be helpful to measure different timeframes. He predicted that with an annual return of 8.25 percent the liability would not exist.

Senator Stedman also expressed the benefit to decisions regarding appropriation for capital projects of knowing whether a higher than expected draw from the system would be necessary. A "trumpeter graph" i.e. "returns recessed to the mean going out in the future" would also be helpful. This information should be shown in dollars rather than standard deviation.

[9:51:37 AM](#)

Senator Stedman requested the witness' professional opinion of the outcome in the event that the current practices were unchanged. Questions were raised about the possible underestimations of the growth of the liabilities. He asked if investments could "grow us out of this problem" without increasing risk.

[9:52:23 AM](#)

Mr. O'Leary gave his personal opinion, which also is Callan Associates' opinion but not necessarily the opinion of ASPIB. He was "struck by the very significant growth in the liabilities," especially liabilities related to medical costs as discovered through the Asset Liability Study conducted in 2003. At that time, the consultant presented several investment options to ASPIB. The conclusion was reached that a policy similar to the current policy would be appropriate because higher return policies would have made significant use of liquid investments and higher risk investments, which would have increased the volatility.

Mr. O'Leary stated that given the contribution policy as understood from the actuary and the reality of public pensions plans, net cash flow is an important consideration. In the event of an aggressive investment policy and a poor short term return environment, the ability to maintain the policy is "highly questionable". He therefore did not recommend a more aggressive policy for ASPIB. Upon Callan Associates advice, ASPIB "accepted the notion" that broadly diversifying, while continuing to pursue a five-percent real return target, is important. This would more likely ensure that the consistency of performance would be enhanced, with fewer "peaks and valleys".

[9:55:11 AM](#)

Senator Stedman hypothesized a five-percent rate of return were assumed then realized, and asked if the liability would be eliminated over time.

[9:55:33 AM](#)

Page 20

PERS/TRS Multiple Time Horizons

Range of Projected Rates of Return

PERS/TRS

Optimization Set: 2006 adjusted

[Bar graph showing the percentages of Annual Rates of Return for 1 Year, 5 Years and 10 Years and listing the 10th, 25th,

75th and 90th Percentiles and the Median.

An accompanying comment reads:

By striving for a slightly higher expected return, the PERS/TRS policy achieves a slightly greater probability of exceeding a 5% real return.

The inclusion of "other" also slightly reduces the downside return possibility (90th percentile).]

Mr. O'Leary explained this graph demonstrates rates of return over different time periods utilizing current policy and Callan assumptions. Actual performance could be any point within the depicted range, and although returns higher than five percent would be preferred, it could not be guaranteed.

Senator Stedman understood from this information that earnings would need to be of a higher percentile.

Mr. O'Leary clarified this scenario is "driven my markets." He continued, "Given the inputs to the modeling, that is the expected return, the risk associated with each asset class and the correlation. This is the range of outcomes that is possible."

[9:57:49 AM](#)

Senator Stedman remarked that the "odds are against us". Distribution as it occurs in Las Vegas is slightly over the mean. It is highly unlikely that the current performance of the investment of PERS/TRS funds, despite the "reasonable job" of ASPIB, would be able to "close the gap."

[9:58:39 AM](#)

Senator Hoffman one of the goals discussed was to stop the "bleeding" or increasing liability. He asked if the witness' review of the assets indicate a high probability that the losses of the past four years would continue, or whether the portfolio would realize gains.

[9:59:27 AM](#)

Mr. O'Leary responded that the returns over the two previous calendar years have been in excess of 15.8 percent for both systems. The systems are "participating fully" in the market recovery. The situation is better than indicated from the data of FY 03. Despite the bear market, the systems have achieved a positive return of more than 3.3 percent over five years. However, this is an actuarial loss because the funds did not earn the anticipated 8.25 percent.

[10:01:07 AM](#)

Senator Hoffman cited the statement on Page 3 that Callan services "88 public fund clients with aggregate assets of \$692 billion". He also recalled that solvency of the PERS/TRS funds are in the top ten percentile. He asked if any of the other public funds are in the top ten percentile and whether the administrators of those funds were considering major changes to their programs.

[10:01:44 AM](#)

Mr. O'Leary replied that 12 states are considering shifting to a defined contribution plan. Several clients have a defined contribution as a tier.

[10:02:26 AM](#)

Senator Bunde asked for clarification that the rates of return on the PERS/TRS funds are statistically likely to occur in the tenth percentile rather than the median.

Mr. O'Leary affirmed and noted the probability is any percentile within the range indicated on the bar graphs on Page 20. He recommended a policy that provides at least a 50 percent chance of achieving the ten percentile.

[10:03:20 AM](#)

Senator Bunde surmised that this indicates the need for systemic change because the likelihood of a 14.7 percent return in five years is the same as a 1.3 percent.

Mr. O'Leary gave a different perspective pointing out that the funds have a 51.75 percent probability of earning 7.6 percent or higher. He noted the most recent asset liability study integrated the liabilities with the assets and he explained how investing for a higher expected return increases risk and visa versa. In understanding this, administrators of many public funds, including the Alaska Permanent Fund, adopt a policy similar to that adopted by ASPIB.

[10:04:50 AM](#)

Senator Dyson appreciated the emphasis on the risks associated with health care costs. He sensed that several organizations and entities nationwide are converting to some form a of health savings account. He asked if the witness had the same understanding.

Mr. O'Leary affirmed he shared Senator Dyson's sense, qualifying that although he has an interest in learning of these events, involvement in this aspect is not typical of Callan.

[10:05:28 AM](#)

Co-Chair Green referenced the data shown on Page 5 regarding annual stock market return percentages for the combined years 1926 through 2003 and asked whether the source, Vanguard, has this information available for each year.

Mr. O'Leary answered no but stated he would supply the Department of Revenue with a histogram that would demonstrate the annual returns.

[10:06:01 AM](#)

Senator Olson was encouraged by the projections of high returns but was concerned that the increasing price of oil would cause the inflation rate to "spiral out of control" and no realized actual rate of return would occur.

[10:06:44 AM](#)

Senator Olson also asked how this scenario would affect the PERS/TRS unfunded liability and whether it would also "spiral out of control."

[10:06:59 AM](#)

Mr. O'Leary explained that an increase in the general level of inflation above what actuarial has incorporated would make the liabilities greater. That is significant risk for defined benefit programs, and even greater for PERS/TRS because the "inflation sensitivity" of its liabilities is greater. In the long term, this scenario supports investments that are the least adversely affected by inflation.

[10:07:59 AM](#)

Senator Bunde continued on the topic. He noted the intent is to make systemic changes to avoid future liabilities as well as addressing the existing deficit. He asked if the issuance of pension bonds, which have been discussed as an option, would be significantly impacted by inflation.

[10:08:45 AM](#)

Mr. O'Leary stated that typically fixed income investments perform poorly in times of accelerated inflation due to the linkage of interest rates and inflation. If an acceleration of inflation were known and bonds could be issued immediately at the current interest rates, which are not based on such an acceleration, the proceeds from those bonds could be invested in assets less harmed by increased inflation. This would hedge against the affects of the accelerated inflation.

[10:09:45 AM](#)

Senator Stedman recognized that the performance of the PERS/TRS funds have been favorable since the market improvement. However, liabilities are continuing to increase at a rate greater than assets.

Mr. O'Leary characterized this as an illustration of the inflation sensitivity of the PERS/TRS liabilities, in that members have not realized a comparable increase in compensation.

[10:10:46 AM](#)

Senator Stedman noted that the markets appear favorably when viewed in a calendar year, but viewed as a fiscal year as compared to the liabilities, a "widening gap" continues. This must be addressed.

[10:11:26 AM](#)

Mr. O'Leary clarified that the calculations contained in his presentation incorporates data from FY 04. Mercer representatives reported a "slight improvement in funded status and funded ratio" at the recent ASPIB meeting.

[10:11:54 AM](#)

Senator Stedman respectively questioned the Mercer findings, citing the FY 04 "statements".

Mr. O'Leary relayed Mercer reported the actual market value funding ratio changed from 64.7 percent to 63.9 percent

Senator Stedman stated that data supplied to him demonstrate that the funding ratio dropped approximately two percent for both PERS and TRS. He would compare the market value to the real value to determine the actual figures. He understood the actuarial asset value was used for his findings compared to the use of market value in Mr. O'Leary's findings.

Mr. O'Leary affirmed that market value was utilized in his presentation.

[10:12:58 AM](#)

Ms. Douglas resumed testifying. She read the remainder of her statement into the record as follows.

The PERS and TRS Boards should include employer representation in their make-up. Since employers pay the lion share of the contribution rates to fund these systems, they should have a voice in the deliberations of these boards. It is prudent to evaluate the validity of what is done on a regular basis; consolidation of these boards and evaluation of their responsibilities and possible reassignment of some tasks is timely.

Future benefit changes, such as increasing health benefits for certain classes of employees, should be thoroughly reviewed for long-term financial impact before implemented. The lack of adequate analysis process contributed significantly to the unfunded liability. Please establish a 90 day review process, supported by a comprehensive long-term actuarial analysis, a public hearing process and a recommendation of the retirement boards prior to any legislative changes affecting PERS and TRS. We need to ensure that these systems don't continue to decline financially.

I recommend that actuarial services include a peer review component on a periodic basis and/or a new actuary be hired after a certain number of years. No matter that the concept of hindsight is significantly at play in this situation, common sense doesn't allow for decreased employer rates in a time when increased health care costs and declining or negative investment returns were being realized by nearly all entities nationally. Relying on the scheduled review timeline contained in the contract, to thoroughly actuarially evaluate these systems, in such times is unacceptable.

It is unlikely that any legislative decision made this year can be fully implemented by July 1. Please fund the 5% PERS and TRS employer rate increases in effect for FY 06 for all employers statewide. This rate increase equates to approximately \$2 million for the Kenai Peninsula Borough School District for FY 06. The Board of Education approved the FY 06 budget, which includes Governor Murkowski's proposed base student allocation of \$4880, Monday night. The District

will likely have to reduce this budget if additional funds are realized to address the retirement rate increases. To put \$2 million into perspective for the District, it would equate to approximately 35 teaching positions.

Thank you for your continued work on this critical issue facing the State of Alaska. I appreciate the opportunity to bring these important issues to your attention.

[10:15:00 AM](#)

AT EASE [10:16:11 AM/10:16:20 AM](#)

JOE BEEDLE, Vice President, Finance, University of Alaska, testified via teleconference from offnet location that the University of Alaska does not have a fiscal note related to Amendment #20. This amendment would incur no increased costs; rather implementation would result in a cost savings. "Modeling this savings will be deliberative and subject to our governance process contingent somewhat on the passage of this vehicle or replacement legislation." He gave an estimated "cost avoidance increase number" of a "seven to eight digit number" by FY 08.

[10:17:41 AM](#)

Senator Hoffman remarked that a negative fiscal note is still a fiscal note. If savings are expected, it should be documented.

[10:18:10 AM](#)

Mr. Beedle described the University process involving a retirement committee that makes recommendations to the University president, who then advises the Board of Regents on actions regarding the retirement system. Once the new programs have been modeled, more accurate cost estimations could be figured. At this time, those estimations are difficult to ascertain.

Mr. Beedle emphasized that upon passage of this legislation, the University would "immediately act" to avoid certain cost escalations.

[10:18:53 AM](#)

Senator Hoffman reiterated that the purpose of adopting Amendment #20 was to affect changes. If savings are anticipated, the legislature should have estimates on the amount of those savings.

[10:19:33 AM](#)

Co-Chair Green asked if any savings would be realized for FY 06.

[10:19:38 AM](#)

Mr. Beedle replied that some discretionary changes to the University retirement plan are under consideration that would result in savings for FY 06. The proposed changes are subject to the deliberations on this legislation. One option is to limit changes to only affect executive employees FY 06; however the final version of this bill could provide the "confidence" to implement those changes to other employee groups as the University continues to develop different options for the retirement plan.

[10:20:46 AM](#)

Co-Chair Green asked if Senator Hoffman would be satisfied with an indeterminate fiscal note.

Senator Hoffman indicated this would be possible, although the University should provide the best possible estimates to allow the legislature to judge whether the savings were accomplished.

Mr. Beedle stated he would prepare a document.

[10:21:44 AM](#)

DORIS ROBBINS testified via teleconference from an offnet location in Fairbanks on her own behalf that some of the changes proposed in this legislation are helpful, such as those affecting the rehiring of retired and previously employed PERS and TRS members. All retirees want the legislature to scrutinize the unfunded liabilities of the retirement funds because it would affect them. As a member of the Retired Public Employees Association (RPEA), she stated the organization has been educating members on this issue as well as the use of generic prescription drugs.

Ms. Robbins understood that the elected members of the PERS and TRS boards attempted to influence the recommendations of Mercer Human Resource Consulting, although the boards and retirees are being blamed for the unfunded liability. She contended that the board membership contains no more "rotten apples" than does the "legislative barrel". The Administration appointed all but two board members and the Administration advises the boards. Additionally, the boards must follow legislative directive. It is unfair to criticize the board and public employees when it is the legislature that enacts the laws that govern the system.

Ms. Robbins pointed out that members of PERS and TRS accepted salary increases in amounts smaller than cost of living increases partially because of the good medical plan received. Use of medical benefits has been considered a form of "back pay". She retired in the year 2000 on "1988 wages". She spoke of attracting new teachers.

[10:28:50 AM](#)

ROBERT STRAHAN, Finance Director, City of Bethel, testified via teleconference from an offnet location that the City has attempted to increased taxes, but voters rejected the proposals. Citizens correctly argue that the increases are too high, yet the issue of expenses must be addressed. He told of the projected loss of \$200,000 to the FY 05 budget and \$1 million for FY 06 given the facilities in need of repair. Water and sewer operations would continue to operate at a deficit. The City has "barely enough" reserves to cover these losses. However, residents are concerned about paying high water and sewer rates. Therefore, it is difficult for cities such as Bethel to meet the increased PERS and TRS costs and continue to function.

[10:33:34 AM](#)

GARY BADER, Chief Investment Officer, Treasury Division, Department of Revenue noted that members of the Alaska State Pension Investment Board (ASPIB) had been present earlier in the meeting, but were unable to remain due to other appointments.

[10:34:02 AM](#)

Senator Stedman asked the rate of return on investments for the previous year.

Mr. Bader estimated 15 percent.

Senator Stedman asked if this percentage was calculated before or after fees were deducted from the earnings.

Mr. Bader replied this amount is "before fees". Fees and administrative expenses average approximately 35 basis points.

Senator Stedman commended ASPIB in achieving this target and also in assuring assets and liabilities spread by .7 billion during that same timeframe. This accomplishment should not be negated.

Mr. Bader stated that the target would likely be reached, although the situation for six months was not ideal. With regard to

liability that continues to increase despite good earnings, he cautioned that if contributions "are not in the bank" to earn returns, a liability would result.

10:35:45 AM

Senator Olson asked Senator Stedman what is the solution to the increasing discrepancy despite the funds meeting a 15 percent realization.

Senator Stedman replied that SB 141 is the first step. The next step involves the newly created board to investigate restructuring of the liability and provide the legislature options to consider the following session. At that time the unfunded liability is projected to be over \$6 billion. Addressing this would also include efforts to contain health care costs. A multiple step process would be necessary.

10:36:50 AM

Co-Chair Green shared her and Senator Stedman's contention has been that having one body to review and govern the retirement system would allow the issue to be better addressed. This is not a criticism of any individual or board.

10:37:20 AM

GAYLE HARBO read her written testimony into the record as follows.

I know the legislature is trying to find solutions to a perceived problem with a retirement system that has worked well for almost 50 years. I respect your concern. I am not a political person, but I am an Alaskan for almost 50 years, a mother, a grandmother, a retired teacher and most recently a member of the TRS Board. I urge you to go slowly, get a second opinion from a credible actuary and talk with affected parties about the reasons for the decrease in the funding ratio before you impose devastating changes.

What affects the funding ratio? If you read the last valuation you will see that TRS is almost 92% funded without health care costs: PERS is 120% funded. Are these healthy systems???? What would your conclusion be? Has ASPIB done a great job??? What would your conclusion be?

Now look at the ratios with Medical costs factored in - remember Alaska is one of only 4 states that pre-funds medical costs. In FY 06, under GASB, all states will have to

acknowledge medical costs as a liability. With Medical the TRS ratio drops to about 63% and PERS ratio to 73%. What would your conclusion be? What is the major factor affecting the declining ratio?

Medical costs have been the main factor and if the Administration would make some allowable changes, matters of choice and convenience, they could save millions of dollars on the health plan for the current tiers. They can change the Health Benefits for new hires without legislation - prospective is the key word here. Ask them why they have not made significant changes in the last 4 or 5 years.

You may have received a memo from Mercer, dated March 18, which shows two items which have also contributed to the unfunded liability. One is the enhancement of benefits that various legislatures have passed in recent years; some which the actuary said would be cost neutral. Actuaries, like airlines, are cautious people and always have a disclaimer, "subject to change without notice." They told you Retirement Incentive Programs would not negatively affect the funding ratio. This past year they changed their story - they did not predict the impact of medical costs correctly. The Boards asked for an Actuarial Audit in 2002-2003 - In our Sept. '04 Joint Board minutes the auditor, Milliman, stated (on page 6) that Mercer's "starting point for projecting forward was a number that was 14 percent too low." The minutes also reflect that medical costs account for 50% of the increases in employer contribution rates these past years. The Joint Boards, these past two years, have asked the Legislature not to pass legislation which will enhance benefits for existing Tiers and you have held off.

The second item in the March 18th letter refers to the Ad Hoc PRPA which is recommended by the Boards only when the fund is healthy. The sheet attributes huge costs to the Ad Hoc PRPA, but fails to mention that dollars of that cost was the settlement of a lawsuit that made all living retirees whole, from their time of retirement, for ad hoc PRPA's that had not been awarded. Take that out and an ad hoc is a mere blip.

In the legislation proposing a DC plan teachers are more impacted than Public Employees. Teachers did not have the choice of an SBS plan when they were pulled from SS. Not only that, because they are public employees, even though they may earn SS credits, they will not get all that is due them because of two unfair Federal Provisions, GPO/WEP, which the Legislature last year recognized as unfair when they passed a

resolution urging our Congressional Delegation to seek repeal.

I urge you to take time to get a second opinion. I urge you to work with the Boards and the Employers and the AML and successful Health Care Trusts and Plans to see how medical costs can be properly managed.

While I respect Dr. Solie's opinion, it is a lofty one. He may not realize that many of the people I worked with every day did not earn enough to save and invest the minimum needed to start a mutual fund. These people need the security and assurance in their senior years that a Defined Benefit offers. People need a system which recognizes inflation, as SS does, to adjust their annual retirement income.

Dr. Solie erred in his testimony on HB 238. He implied, using a 2000 mortality table and other assumptions used by mercer, that a person retiring from the proposed DC plan would be better off than a Tier I employee. It is a devastating error to future retirees, that I, a humble, public school teacher must point out. If this legislature did what Dr. Solie suggested many retirees would run out of dollars long before they died.

It is a grave error to apply group assumptions of a DB plan to individual assumptions on which DC plans are based. You would do grievous harm to thousands of seniors if you relied on Dr. Solie's data. Please go slowly and check and recheck and ask for all the information... not selected sound bits.

Please work with the Boards these next years to solve the Medical cost problem, which is not unique to Alaska. We should be working together. The Legislature did not ask the opinions of the Boards before they introduced these bills. My late colleague, Bob Boko, a respected member of the Fairbanks Community, was not in favor of a Defined Contribution program. He knew it would be devastating to seniors. Though he chaired the Tier Committee and voted to recommend Option One of their proposed plan, he did so only because the Administration put pressure on him. After the vote in November, he wanted to meet and confer with the Joint Board members after our meeting with ASPIB on December 1st. He wanted to discuss the suggestions we all had made. We were not allowed to meet. I urge you to speak with his widow, Sharon, who shares his deep concern.

Please let us work together to make Alaska a place where young people want to come and work. We can be a role model for health care reform if we choose to work together. I do not

like the word "impose"; I prefer sitting down and discussion the problem and developing a solution which works for all. Thank you for your time.

10:45:59 AM

Co-Chair Green noted the distribution of language pertaining to the projected fiscal impact to the University of Alaska from the adoption of Amendment #20, as provided by Mr. Beedle.

Co-Chair Wilken offered a motion to permit the Division of Legal and Research Services to make necessary technical and conforming changes to this bill.

There was no objection and it was so ordered.

10:48:05 AM

Senator Bunde offered a motion to report CS SB 144, 24-LS0637/Y, as amended from Committee with individual recommendations and accompanying fiscal notes.

Senator Hoffman objected to comment on the need to address financial concerns, particularly the rising costs of health care. He indicated he would remove his objection after making a statement. The retirement fund is growing and the rate of return has almost doubled the targeted rate. He understood the efforts to "tighten up the programs", such as eliminating the incentive for employees to transfer to rural locations in their last years of service to bolster their retirement income. This practice costs the State millions of dollars and must be addressed.

Senator Hoffman referenced Dr. Solie's testimony in asserting that the State is "going out in the front on defined contributions". The amendment that Senator Hoffman had offered providing for a "blended plan" as well as actions tightening up the program would "more than accomplish" the goals of a viable fund. This approach would place the State in a better position to recruit and retain employees.

Senator Hoffman remarked that the major changes contained in the current version of this bill would have a "drastic" affect on the ability to attract and retain competent employees. The State would have difficulty competing for employees within the Pacific Northwest, especially teachers and other education professionals. Education is a "major point of contention" in Alaska. Legislators have all avowed that education is the highest priority and actions have been taken to fund education at higher levels.

Senator Hoffman announced he would not support this legislation. He withdrew his objection to the motion to report the bill from Committee.

[10:51:42 AM](#)

Co-Chair Wilken supported this bill. Although he shared concerns about recruitment and retention, Alaska has the "most liberal" retirement age requirements. This legislation would not place Alaska at the bottom of the list measuring state retirement benefits, but rather closer to the average. The benefits would be competitive with other states.

[10:53:26 AM](#)

Co-Chair Green corrected an impression that changing certain provisions of the current system would eliminate the increasing liability. All options have been considered and the conclusion was reached that the creation of a new tier system was the only solution.

[10:54:18 AM](#)

Senator Hoffman understood that benefits could not be reduced to current members of PERS and TRS. However, school districts in the State are already having difficulties recruiting teachers. Some areas of the State are unable to attract teachers. By reducing benefits to a level that is average in comparison with other states, higher salaries and hiring bonuses could be necessary to compensate.

[10:55:33 AM](#)

Co-Chair Green responded that the benefit structure would be changed, implying that it would not necessarily be reduced.

Co-Chair Green noted Senator Hoffman's objection to the motion to report the bill from Committee had been removed.

With no further objection CS SB 141 (FIN) MOVED from Committee with the following new fiscal notes: Department of Administration dated 3/29/05 for \$116,000; Department of Administration dated 4/5/05 for \$936,500; Department of Revenue #1 dated 4/5/05 for 214,500; Department of Revenue #2 dated 4/5/05 for -\$4,144,400; Department of Revenue #3 dated 4/5/05 for \$4,734,600; Department of Revenue #4 dated 4/5/05 for -\$31,916,600; Department of Revenue #5 dated 4/5/05 for \$31,916,600; and Department of Administration written by the Senate Finance Committee dated 3/17/05 for \$69,531,800.

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ADJOURNMENT

Co-Chair Green adjourned the meeting at 10:56 AM