

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

April 2, 2007

7:11 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Chair
Representative Anna Fairclough, Vice Chair
Representative Bob Roses
Representative Paul Seaton
Representative Peggy Wilson
Representative Sharon Cissna

MEMBERS ABSENT

Representative Max Gruenberg

COMMITTEE CALENDAR

HOUSE BILL NO. 204

"An Act relating to the public employees' and teachers' defined benefit retirement plans; relating to the public employees' and teachers' defined contribution retirement plans; relating to the judicial retirement system; relating to the health reimbursement arrangement plan for certain teachers and public employees; relating to the supplemental employee benefit program; relating to the public employees' deferred compensation program; relating to group insurance for public employees and retirees; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 206

"An Act relating to the accounting and payment of contributions under the defined benefit plan of the Public Employees' Retirement System of Alaska, to calculations of contributions under that defined benefit plan, and to participation in, and termination of and amendments to participation in, that defined benefit plan; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 204

SHORT TITLE: PUBLIC EMP./TEACHERS/JUDGES EMP. BENEFITS
SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

03/16/07	(H)	READ THE FIRST TIME - REFERRALS
03/16/07	(H)	W&M, FIN
03/28/07	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
03/28/07	(H)	Heard & Held
03/28/07	(H)	MINUTE(W&M)
03/30/07	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
03/30/07	(H)	Heard & Held
03/30/07	(H)	MINUTE(W&M)
04/02/07	(H)	W&M AT 7:00 AM HOUSE FINANCE 519

BILL: HB 206

SHORT TITLE: PERS CONTRIBUTIONS; UNFUNDED LIABILITY
SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

03/16/07	(H)	READ THE FIRST TIME - REFERRALS
03/16/07	(H)	W&M, FIN
03/28/07	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
03/28/07	(H)	Scheduled But Not Heard
03/30/07	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
03/30/07	(H)	Heard & Held
03/30/07	(H)	MINUTE(W&M)
04/02/07	(H)	W&M AT 7:00 AM HOUSE FINANCE 519

WITNESS REGISTER

ANNETTE KREITZER, Commissioner Designee
Department of Administration (DOA)
Juneau, Alaska

POSITION STATEMENT: Explained committee handouts related to HB 204 and the Department of Administration's position on aspects of HB 206. She responded to questions.

KATHLEEN LEA, Acting Director
Retirement Manager
Division of Retirement and Benefits (DRB)
Department of Administration
Juneau, Alaska

POSITION STATEMENT: Presented HB 206 on behalf of the Department of Administration and responded to questions.

ACTION NARRATIVE

CHAIR MIKE HAWKER called the House Special Committee on Ways and Means meeting to order at 7:11:11 AM. Present at the call to

order were Representatives Hawker, Fairclough, Wilson, Seaton, and Roses. Representative Cissna arrived as the meeting was in progress. Representative Gruenberg was excused.

[7:11:11 AM](#)

HB 204-PUBLIC EMP./TEACHERS/JUDGES EMP. BENEFITS

CHAIR HAWKER announced that the first order of business would be HOUSE BILL NO. 204, An Act relating to the public employees' and teachers' defined benefit retirement plans; relating to the public employees' and teachers' defined contribution retirement plans; relating to the judicial retirement system; relating to the health reimbursement arrangement plan for certain teachers and public employees; relating to the supplemental employee benefit program; relating to the public employees' deferred compensation program; relating to group insurance for public employees and retirees; making conforming amendments; and providing for an effective date."

ANNETTE KREITZER, Commissioner Designee, Department of Administration (DOA) provided the committee with a document titled "Comparison of Former HB 475 and HB 204". She went on to reference an email sent to her on March 31, 2007 which provides a synopsis of the participation of the National Education Association, Alaska branch (NEA-Alaska) in the Teachers' Retirement System (TRS) as requested by the committee.

REPRESENTATIVE SEATON relayed that, at the last meeting, there was discussion of the effect of allowing elected officials to participate in the Public Employees' Retirement System (PERS). He explained that his office did some research on different employment scenarios and their effect on PERS. He noted that the largest cost component is for medical costs.

CHAIR HAWKER confirmed that the aforementioned research was for PERS Tiers I, II, and III only.

REPRESENTATIVE SEATON reminded the committee that an employee's PERS participation tier is based on the date that person was first employed, so an elected official with previous employment with a PERS employer will fall under the system that applied at the time that person was first employed. He noted that while it is against the law for an employer to use retirement status in employment decisions, there is no prohibition against voters considering the retirement system status of a candidate when making their decision.

[HB 204 was held in committee.]

[7:18:20 AM](#)

HB 206-PERS CONTRIBUTIONS; UNFUNDED LIABILITY

CHAIR HAWKER announced that the next order of business would be HOUSE BILL NO. 206, "An Act relating to the accounting and payment of contributions under the defined benefit plan of the Public Employees' Retirement System of Alaska, to calculations of contributions under that defined benefit plan, and to participation in, and termination of and amendments to participation in, that defined benefit plan; making conforming amendments; and providing for an effective date."

KATHLEEN LEA, Acting Director, Retirement Manager, Division of Retirement and Benefits (DRB), Department of Administration, provided the committee with a PowerPoint presentation dated April 2, 2007. She said that employers have expressed concern regarding the current employer level accounting method used for the PERS defined benefit plan. Although PERS now has two plans, the defined benefit (DB) plan, and the defined contribution retirement (DCR) plan, today will only address concerns with the DB plan, she explained.

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MS. LEA reminded the committee that PERS is an agent multiple-employer plan which provides benefits to employees of more than one employer. Separate accounts are set up for each employer to pay for the benefits of only that employer's employees. She explained that there are some administrative and investment functions which are pooled to the advantage of the employer.

MS. LEA explained that AS 39.35.100(b)(3) requires that separate accounts be maintained for each employer and that these accounts be credited with that employer's contributions. Furthermore, AS 39.35.250 states that the past service rate portion of each employers' contribution rate is that "required to amortize the unfunded obligations of the employer" She relayed that the state's actuary, Buck Consultants, amortizes the unfunded obligations over a 25 year period. She went on to explain that PERS assets include contributions by employers and employees as well as investment income. Liabilities include pension benefits and health costs. If there is a deficit between assets and liabilities, the employers are liable for funding the shortfall.

MS. LEA explained that employer contributions are accounted for in two separate accounts. In the active account, all employer contributions are accounted for separately. However, the retiree account is one account and employer contributions are not accounted for separately. She explained that once funds are transferred into the retiree reserve account, the funds are no longer the employer's, but are used to pay benefits.

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REPRESENTATIVE ROSES asked what happens when a retiree is re-hired by a PERS employer after funds for that employee have been transferred to the retiree reserve account.

MS. LEA explained that a re-hired retiree will continue to receive retirement benefits. The employer will continue to pay any past service cost contributions, but the employee makes no contributions and does not accrue any additional service towards retirement.

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MS. LEA described the retiree reserve account as funded from employer and employee contributions, as well as a share of PERS net investment income. When actively employed, a member makes contributions to their own account. Once an eligible member retires, their contribution account transfers to the retirement reserve account. Benefits are first paid from the employee's contributions, then from the employer's contributions. This is because the employee's portion is transferred to the retiree reserve account immediately upon retirement, but the employer's share is calculated during the next valuation cycle, which can be up to a year later. She relayed that it is the calculation of the employer's share that has caused some concerns.

MS. LEA explained that the retiree reserve account is to be 100 percent funded. The DRB looks at the actuarial calculations and considers the amount of employee contributions to determine the employer's final liability. When members retire, their employee contributions will be transferred to the retiree reserve. Thereafter begins the statutory evaluation process to determine the amount the employer must contribute to fully fund benefits due its retired members. An employer's share is determined with reference to the total retiree liabilities and assets. The employer's allocated share of assets and liabilities is calculated to determine the amount necessary to fund the retiree

reserve account as determined by the actuary. In some cases, employers can over fund the account she explained, referring to slides 15 to 17 which show calculations from an actual situation.

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CHAIR HAWKER expressed his concern that the aforementioned example provided by DRB shows an employer with a potential unfunded liability of \$112,353 in 2004 becoming over-funded by \$192,428 one year later, after the completion of actuarial calculations.

MS. LEA agreed that the example helps explain why employers are concerned with the allocation method. She went on to explain that liabilities are annually calculated by employee and allocated to individual employers based on pro-rata service earned with an employer. However, this calculation does not take into account salary earned with an employer, which is another area of employer concern.

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MS. LEA said that the cost share model of the bill addresses concerns with accounting. She explained that under the current system, the retirement calculation is based on the employee's three highest salary years. Therefore, if a person worked for two different employers for five years each, earning \$150,000 total with employer A, and \$200,000 total with Employer B, employer A's liability is based on the higher salary paid by employer B. The effect of this rule becomes more extreme if a person is an elected official who earns a small stipend of \$1,000 for five years of elected service for City X. That person could then work for City Z and receive a wages of \$200,000 over a five year period. City X will share 50 percent of the total liability even though the retiree only received a small stipend from his or her time as an elected official with that city. She noted that scenario shown on slides 21 to 23 is extreme, but that there are approximately 735 persons, or about 1.2 percent of PERS members, who are elected officials and that the example clearly illustrates a problem with the allocation method.

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MS. LEA offered that the cost share model addresses concerns of account allocation and employer liability. She explained that,

in a cost share program, all employers share the costs of benefits, administration, and investment. Under HB 206, the PERS DB plan will be administered more like the TRS DB plan and the state will assume 65 percent of the unfunded liability, or approximately \$3.6 billion of \$5.5 billion total unfunded liabilities as of June 30, 2006. She opined this approach could simplify plan administration and allow the plan to avail itself of issuance of pension obligation bonds (POBs) to further reduce the unfunded liability. She described HB 206 as a long range plan which will allow a more uniform, less volatile contribution rate. She said that the Alaska Retirement Management Board (ARMB) and the Alaska Municipal League (AML) support the concept of the cost share approach.

[7:40:11 AM](#)

COMMISSIONER DESIGNEE KREITZER pointed out that AML does support a cost share approach, but indicated that AML would like the state to take a larger share of the unfunded liability. She went on to explain that HB 206 as proposed allows municipalities 90 days after the bill's effective date to choose whether to be covered by the cost share legislation. She explained that under the bill's provisions, costs are shared among employers and it is estimated that it will bring employer contribution rates down and save local governments money by fiscal year (FY) 2008. She said that the bill allows the state to intercept funds bound for non-paying employers. She opined that this tool, while it may sound drastic, should be available to the state since the state is ultimately responsible for payment of benefits. The bill also has a provision that requires local governments to pay for termination studies, which she opined would save the state and employers from paying for unnecessary accounting costs.

COMMISSIONER DESIGNEE KREITZER offered that in considering this issue, DOA has considered methods to take a longer range view that will have a positive effect on FY 08 budgets and still pay down the unfunded liability. She referred to HB 204, which she said allows the state to calculate the employer contribution rate across the entire wage base. She opined that although this would not have an effect for several years, it would help lower the contribution rates. Employers would be contributing the same amount, but the rate will appear lower, she explained.

COMMISSIONER DESIGNEE KREITZER said that if the state adopts the cost share plan, pays 65 percent of the unfunded liability, holds harmless employers who would have to pay more in FY 08, and pays 30 percent of the unfunded liability through POBs, it

will save the state \$10 million. She opined that the cost share approach offers a long term solution, noting that POBs are "not without risk." She told the committee that Governor Palin is concerned that local governments not be unduly over-burdened. She opined that this solution does not cause undue burden to local governments when taken as a whole. In response to a comment, she reiterated that she is continuing to meet with interested parties to discuss the cost share approach until "we come to a solution."

[7:46:27 AM](#)

CHAIR HAWKER emphasized that HB 206 has some significant components. First is the calculation of the employer rate across all public employees, not just those in the DB plan. Second, the intercept provision recognizes the need for a mechanism for the state to pursue recovery of payments if municipalities fail to pay. Furthermore, the bill proposes that employers pay termination study costs. Last, Section 7 proposes the state assume 65 percent of the unfunded actuarial unfunded liability as of June 30, 2006. He noted that as of 2006 the state had not been fully funding the pension plans due in part to a state law which limited increase to the annual rate of employer contributions to 5 percent. He asked why that date was chosen to calculate the state's proposed assumption of liabilities.

COMMISSIONER DESIGNEE KREITZER explained that she wanted to use the "worst case, known scenario" which is the June, 2006 determination that there is approximately \$8.8 billion in unfunded pension plan costs.

CHAIR HAWKER noted that the unfunded liability will grow in FY 07 and FY 08, and perhaps stabilize after that. He asked how the anticipated, but unknown, growth will be considered in determining municipal contribution rates.

[7:50:25 AM](#)

COMMISSIONER DESIGNEE KREITZER told the committee she has discussed the aforementioned issue with AML and agreed that there are various ways to approach the likely, but currently unknown, increases in the amount of unfunded liabilities. She explained that for FY 07 and 08, DOA is aware of the level of assistance rate relief necessary to hold communities harmless. She opined that one approach to "leveling it out" would be to offer a percentage of that assistance in the future. She opined

that much of the discussion of funding issues will take place in the House and Senate Standing Finance Committees.

REPRESENTATIVE WILSON asked which section of the bill contains the hold harmless provisions and whether it is for one year.

COMMISSIONER DESIGNEE KREITZER explained that the "hold harmless" aspects of the proposed cost share plan have not yet been presented to this committee. She explained that DOA has considered different approaches to a cost share plan. In one scenario, if the state goes to a cost share plan without giving some relief to employers, it would save the state money, but cost plan participants. However, holding communities to their FY 07 rates would require a state contribution of \$82 million to the unfunded liabilities. The budget as introduced by the governor proposes to provide \$115 million in rate relief for municipalities. She indicated that it would cost the state \$82 million to hold the communities harmless; however the state would still save \$10 million in FY 08. She agreed that the hold harmless process is for one year. She explained that in her discussions with AML, she has broached the possibility that for future years the state could pay a percentage of what it is paying this year to hold communities harmless.

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REPRESENTATIVE SEATON asked whether the hold harmless discussions concern an individual employer's calculated rate, or a blended rate. He explained that while discussion of pension issues often refers to general rates, employers actually pay based on their individual rates, which may vary. He sought clarification as to what rate the hold harmless provisions would be based on, noting that some employers are paying at high rates.

COMMISSIONER DESIGNEE KREITZER noted that HB 204 allows the state to spread the cost across the entire wage base of both DB and DCR employees.

REPRESENTATIVE SEATON noted he was not asking about which salaries are included in the wage base. He sought further information as to how the state would determine which rate an employer will be held to for purpose of the hold harmless provision.

COMMISSIONER DESIGNEE KREITZER indicated she believed it was the individual employer rate.

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CHAIR HAWKER summarized that his understanding is that the state will take responsibility for a fixed amount as a way to provide some rate predictability and stability for municipal employers so that they can afford to pay the escalating pension obligation rates. He noted that the one approach, as taken by HB 206, has the state taking responsibility for a fixed amount of the unfunded pension obligations. Under this approach, individual employer's rates would be reduced to a reasonable rate. However, since the state is only taking responsibility for a fixed amount for one year, the future rates are still unknown, he observed. An alternate approach would have been for the state to take responsibility to guarantee a fixed rate for municipal employers, with the state having responsibility for any amount over the fixed rate.

[8:01:55 AM](#)

REPRESENTATIVE SEATON offered his understanding that the hold harmless approach will hold municipalities to their current individual contribution rate.

COMMISSIONER DESIGNEE KREITZER agreed with the aforementioned explanation.

COMMISSIONER DESIGNEE KREITZER referred to an exhibit titled "Cost Share Exhibits" and explained that it presents the various results that a change to a cost share system will have on different employers. She reminded the committee that if the state moves to cost share without providing some type of hold harmless relief, the state will save approximately \$36 million. However, she said this approach will cost the municipalities approximately \$52 million, a result she characterized as not fair. Therefore, the state considered other approaches, such as rate relief, to address negative impacts on employers. To hold municipalities to their FY 07 contribution rate would cost the state \$82 million, she said. This approach contemplates the state assuming 65 percent of the unfunded liability and potentially using other fund sources, such as POBs.

CHAIR HAWKER clarified that Exhibit 2a of the Cost Share Exhibit set forth the scenario under HB 206 where the state assumes 65 percent of the unfunded liability as of June 30, 2006 and pays \$1.7 billion of that liability through issuance of POBs.

COMMISSIONER DESIGNEE KREITZER clarified that it is the state and municipalities that pay as it is "built into the rate."

[8:12:23 AM](#)

REPRESENTATIVE FAIRCLOUGH expressed concern regarding municipalities that have not paid their contributions.

COMMISSIONER DESIGNEE KREITZER agreed that there seem to be some issues regarding the adequacy of payments by the City of Fairbanks, as well as issues to be addressed concerning cities that have paid additional amounts to reduce their unfunded pension liabilities. She stated that this may be an issue the legislature may address in a specific manner.

[8:14:00 AM](#)

REPRESENTATIVE SEATON asked if the various scenarios shown in the Cost Share Exhibit are affected by factors such as rate calculation across the entire wage base, not just the defined benefit portion of the wage base.

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COMMISSIONER KREITZER opined that it was likely the calculations referred to do take into account factors such as inclusion of the entire wage base in the determination of the employer contribution rate. She stated that her approach has been to work with AML and focus on the "worst case" scenario in trying to determine a solution. She explained that the Cost Share Exhibit shows how employers will be differently affected if the state assumes 65 percent of the unfunded liabilities.

REPRESENTATIVE FAIRCLOUGH reminded the committee that she previously requested information as to which communities are behind in their employer contributions.

REPRESENTATIVE ROSES asked how many employers are funded by the state, such as the university system, noting in those cases the state pays all the costs for that employer through the general fund. He noted that other employers have some type of tax base, but that the state ends up paying much of the obligation anyway through revenue sharing or area cost differentials allocated to those communities.

[8:24:59 AM](#)

MS. LEA agreed that at the point of allocation process, the employee's portion has already been transferred to the retiree reserve account. In response to further inquiry, she noted that at one point in the TRS system the state paid a contribution in addition to the employee and employer. The state did not make an additional contribution for the PERS, she clarified.

[8:26:22 AM](#)

REPRESENTATIVE ROSES asked whether there is a method to determine which PERS employers can be considered "stand alone" employers that have a tax base or other revenue source besides the state.

MS. LEA said DRB can provide information that shows how many employers are in different categories, such as how many are school districts. However, DRB is not aware of the funding sources for all employers.

CHAIR HAWKER noted that Exhibit 1 on page 5 of the Cost Share Exhibit delineates employers by category, which may help answer Representative Roses' query.

[8:29:09 AM](#)

REPRESENTATIVE FAIRCLOUGH relayed that there are likely communities that the state funds at 100 percent, therefore all employer contributions by those communities are really state funds.

REPRESENTATIVE WILSON opined that some communities impose local property taxes despite the burden it causes, while other larger communities do not impose local property taxation despite their ability to do so.

[8:31:34 AM](#)

COMMISSIONER KREITZER agreed that there are many issues to consider related to PERS/TRS funding. She offered that HB 206 is the administration's suggested long-term approach to address the unfunded liability. She expressed concern over the growing \$8.6 billion liability and stated the administration presented the cost share approach as a fair solution. She noted that there are concerns that some municipalities will receive debt relief under this approach. There are also concerns that other communities should receive acknowledgement of additional contributions made to their unfunded liabilities. Additionally,

she reminded the committee that market forces will determine the ability to issue pension obligation bonds to reduce the TRS indebtedness. In summary, while there are "six ways to Sunday" to criticize the cost share plan, she offered that it is an approach through which to address and pay down the unfunded liabilities.

[8:32:50 AM](#)

CHAIR HAWKER recapped that testimony indicates that municipal employers support the cost share approach, although details of the proposal remain to be determined. He noted that there is a significant issue regarding "winners and losers" that still needs to be considered as well as issues of the ability to intercept funds, and termination study costs. He expressed some concern over the payment mechanism proposed in Section 7 of HB 206, which he described as the single largest component of the bill. He noted that while Section 7 offers a sound approach, it is likely to undergo some changes as the bill moves through the system.

[HB 206 was held in committee.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at [8:37:25 AM](#).