

**ALASKA STATE LEGISLATURE**  
**HOUSE LABOR AND COMMERCE STANDING COMMITTEE**

March 18, 2009

3:20 p.m.

**MEMBERS PRESENT**

Representative Kurt Olson, Chair  
Representative Mark Neuman, Vice Chair  
Representative Bob Lynn  
Representative Robert L. "Bob" Buch  
Representative Lindsey Holmes

**MEMBERS ABSENT**

Representative Mike Chenault  
Representative John Coghill

**COMMITTEE CALENDAR**

HOUSE BILL NO. 30

"An Act repealing the defined contribution retirement plans for teachers and for public employees; providing a defined benefit retirement plan for teachers and public employees; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 30

SHORT TITLE: REPEAL DEFINED CONTRIB RETIREMENT PLANS

SPONSOR(s): REPRESENTATIVE(s) HARRIS, HAWKER, MUNOZ

01/20/09	(H)	PREFILE RELEASED 1/9/09
01/20/09	(H)	READ THE FIRST TIME - REFERRALS
01/20/09	(H)	L&C, STA, FIN
03/18/09	(H)	L&C AT 3:15 PM BARNES 124

**WITNESS REGISTER**

REPRESENTATIVE JOHN HARRIS  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Presented HB 30 as one of the joint prime sponsors of the bill.

REPRESENTATIVE CATHY MUNOZ  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Presented HB 30 and answered questions as one of the joint prime sponsors of the bill.

REPRESENTATIVE PAUL SEATON  
Alaska State Legislature  
Juneau, Alaska

Testified and answered questions during the discussion of HB 30.  
**POSITION STATEMENT:**

ILANA BOIVIE, Policy Analyst  
National Institute on Retirement Security (NIRS)  
Washington D.C.

**POSITION STATEMENT:** Testified during the discussion of HB 30.

KENDRA KLOSTER, Staff  
Representative Cathy Munoz  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Testified on HB 30 on behalf of one of the joint prime sponsors, Representative Cathy Munoz.

LARRY SEMMENS, City Manager  
City of Soldotna  
Soldotna, Alaska

**POSITION STATEMENT:** Testified and answered questions during the discussion of HB 30.

#### **ACTION NARRATIVE**

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**CHAIR KURT OLSON** called the House Labor and Commerce Standing Committee meeting to order at 3:20 p.m. Representatives Buch, Lynn, Holmes, Neuman, and Olson were present at the call to order. Representatives Doogan and Harris were also in attendance.

#### HB 30-REPEAL DEFINED CONTRIB RETIREMENT PLANS

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CHAIR OLSON announced that the only order of business would be HOUSE BILL NO. 30, "An Act repealing the defined contribution retirement plans for teachers and for public employees;

providing a defined benefit retirement plan for teachers and public employees; making conforming amendments; and providing for an effective date."

REPRESENTATIVE JOHN HARRIS, Alaska State Legislature, offered a brief overview of HB 30. He stated that HB 30 relates to the defined contribution (DC) retirement system versus defined benefit (DB) retirement system for state and municipal employees, teachers, and others in the system. He recalled state employees historically have had a defined benefit retirement plan (DB). A few years ago the legislature took action to change to a Tier IV, defined contribution retirement plan (DC). Thus, all new legislators and state employees are on a DC plan. He opined that the state reviewed its retirement plans, held much debate, and voted to support a DC retirement plan.

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REPRESENTATIVE HARRIS identified one reason that the legislature voted for a different retirement system was that state debt for the system could not be repaid and the state was accruing too much debt. He related that HB 30 was introduced to begin dialogue again. He recalled that the governor made strong statements against the DC plan. He related his understanding that the governor is interested in HB 30. He said he hopes to have the administration involved in the process and anticipates that reviewing the retirement plan will be a two-year process.

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REPRESENTATIVE HARRIS said that he would like honest dialogue about which system is best for the state and state employees. He opined that this is a big issue and relates to recruitment issues as well as how to retain employees. He said he anticipates that the Alaska State Trooper management and unions may also discuss issues they have had. He said he also hopes the committee will give the bill serious consideration. He indicated Representative Seaton is present and was involved in the details of the issues of DC plan versus the defined benefit plan and welcomed his expertise.

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REPRESENTATIVE NEUMAN recalled the governor discussed this issue during the campaign. He inquired as to whether Representative

Harris has personally held conversations with the administration on HB 30.

REPRESENTATIVE HARRIS offered that he has made overtures to the Commissioner of Department of Administration. Thus far, the official position is the department will examine the issue. He related his understanding some unofficial views are that the Department of Administration (DOA) commissioner is not too excited about the bill, but understood others in the DOA are more supportive.

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REPRESENTATIVE CATHY MUNOZ, Alaska State Legislature, introduced her staff, Kendra Kloster. She stated that HB 30 does three things. First, it would return the retirement system to a DB system. Next, it would provide a time certain for current DC employees to opt into the new system. Finally, it would preserve the Alaska Retirement Management Board (ARM). She mentioned that when the Teachers Retirement System (TRS) and Public Employees Retirement System (PERS) boards were dissolved in 2005 with the passage of Senate Bill 141, the Alaska Retirement Management Board (ARM) was established. She opined that the process for the new retirement system was incomplete. She surmised that conflicting information made it difficult to make a good decision and legislators were pressured to finish the job. She acknowledged that considering the bill was a difficult process and she would probably not have had any additional insight. However, she further opined the issue remains unresolved and until the legislature can effectively respond to its constituencies, the retirement system will continue to be a litmus test for candidates. Meanwhile, at all levels of government dissatisfaction remains, yet Alaskans rely on the work of teachers, firefighters, and other public servants. She offered current statistics such that 73,000 are members of the PERS and TRS systems and 11,600 are enrolled in the new DC system. She related that many of her constituents are members of these retirement systems.

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REPRESENTATIVE MUNOZ related that she has heard many of their stories. She offered that young teachers have shared their 401(k) reports and the depressing results. When these teachers extrapolate what they might earn at retirement time, they are uncertain about their future. Without social security benefits, government workers face a very uncertain future, she opined.

She related that their stories motivated her to attempt to restore a more reliable pension system. In 2005, the state's unfunded liability led to a change in the retirement system as well as concern for rising costs across the country. However, the state's unfunded liability is not a function of which type of retirement plan is in place. Instead, the state's unfunded liability is a result of it not making adequate investments in the retirement plan. She surmised that during the 1990s gross miscalculations were made for the amount of funding necessary to fund the state employees' retirement systems. Over time, she related, the state's unfunded liability has escalated.

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REPRESENTATIVE MUNOZ offered her belief that one far reaching aspect of Senate Bill 141 came to light after the bill was signed into law. She explained at two ARM Board meetings the longtime investment consultant told the board that since the DB plans were essentially closed, very soon the rate of return assumption would need to be reduced as the asset allocation investments will need to be geared toward more liquidity and less towards volatility. She opined that a lower rate of return on investments will impact the state's unfunded liability due to the DC retirement plans for state employees. She mentioned that in 2005 the debate on Senate Bill 141 surrounded the higher costs of the state's Tier I retirement plan. She pointed out that the system had changed to a Tier III retirement plan well before 2005. She offered that West Virginia faced similar issues. She highlighted that due to its state's unfunded liability of approximately \$5 billion West Virginia (WV) closed its DB retirement plan in 1991 and switched to a DC retirement system. Representative Munoz stressed like Alaska, WV supporters expected the state's unfunded liability to diminish. However, twelve years later, in 2003, WV's unfunded liability continued to grow and 70 percent of retirees had insufficient retirement funds. By 2007, the average annual returns for teachers in the plan trailed similar DB plans by 69 percent. She concluded by stating the greatest advantage of a DB retirement system is the opportunity to pool risks. In doing so, investments can be calculated to ensure all retirees would receive a monthly pension. She acknowledged retiree life spans are uncertain. Thus, the beauty of a DB retirement system is that employees do not need to save as if they will live to be 100 years old. Instead, employees' risk is pooled among all retirees and new hires provide the best source of cash flow, she opined.

REPRESENTATIVE MUNOZ emphasized that the current DC retirement plan is the single issue most often raised during her campaign and is the reason she introduced the bill. She said, "After hearing many personal accounts, I am convinced it is the right thing to do."

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REPRESENTATIVE NEUMAN recalled the discussion to change to a DC plan. He said, "It was a long hard bloody fight." He further recalled that the state was facing a \$16 billion debt and the legislature needed to "stop the bleeding." He related his understanding that with guaranteed benefits under the DB plan, the state must pay the costs. He offered his belief that nobody in the private sector must do so. He highlighted that as the state made reductions in employee benefits such that it has moved from Tier I to Tier IV retirement plans. He inquired as to whether the state should guarantee payments.

REPRESENTATIVE MUNOZ answered that the legislature should perform an analysis between the Tier III and DC plans. The analysis needs to be performed since it is hard to rely on information currently available or on the information legislators received at the time the decision was made to change to a DC retirement plan.

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REPRESENTATIVE NEUMAN remarked that the legislature reviewed analysis during the month long special session it spent on the issue. He referred to a study completed by the University of Alaska Anchorage, Institute of Social and Economic Research (ISER) that identified salaries and benefits were the number five reason why teachers did not stay in rural communities. He recalled the quality of life and similar items ranked higher in the study. He recalled one argument for a DB plan was that the state cannot attract employees due to the retirement system. He opined that he does not agree with that statement since the ISER studies did not support this.

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REPRESENTATIVE MUNOZ recalled a recent conversation with a Department of Transportation & Public Facilities (DOT&PF) engineer who stated the current combined salary and retirement benefits package could not attract engineers to fill critical positions. She related that the DC plan was implemented in

2005. Thus, only three years has lapsed so it is difficult to assess the issue of attracting and retaining employees. However, she related her understanding from discussions with various departments that they have difficulty in filling job vacancies.

REPRESENTATIVE NEUMAN referred to the state's policy for rehiring public employee retirees. He opined the policy did not seem to be a good policy in terms of "building a bench" by promoting lower level employees. He indicated that people who retired were rehired to do the same job but did not pay into the retirement system. Thus, the practice compounded the problems since the workforce stayed at the same level, but fewer employees paid into the system.

REPRESENTATIVE MUNOZ responded that the DB system is a closed plan, so new enrollees do not contribute to the DB plan. She opined this causes the state's unfunded liability rate to increase since the expected rate of return on the retirement plan investment is reduced. She related the current rate is an expected rate of 8.25 percent over the last 10 to 20 years. However, the expected rate will be reduced since the ARM board will be compelled to invest in more liquid and stable investments. She emphasized that will add to the state's unfunded liability. She highlighted that is one problem with the current system.

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REPRESENTATIVE NEUMAN inquired as to whether rehiring retired public employees creates a problem for the retirement system.

REPRESENTATIVE MUNOZ indicated she had been speaking to the issue of not having new enrollees paying into the plan. In further response to Representative Neuman, Representative Munoz offered to contemplate rehires and she offered to comment later.

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REPRESENTATIVE NEUMAN recalled hearing that if the state were to revert to the Tier III retirement system, the automatic implication would be that an employer contribution will be deposited into the employee's retirement system. He described his wife's experience as a union employee for the United Food and Commercial Workers International Union (UFCW). He stated that she receives a paycheck but funds are not contributed to her retirement system.

REPRESENTATIVE MUNOZ offered her belief that the DB plan has "lost steam" but not as much as the DC plan. She related her understanding that the DC losses were approximately 30 percent, whereas the DB plan losses were about 20 percent.

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CHAIR OLSON pointed out that employees affected by the state's retirement plans represent approximately 25 percent of the workforce in the state. He related his understanding that the remaining 75 percent of Alaska's employees have individual retirement accounts (IRAs), Simplified Employee Pensions (SEPs) plans, or have no retirement plan at all. He mentioned the state does not have a state sales or income tax either. He opined the state has saved over \$200 million since switching to the DC plan. He offered his belief that the state's unfunded liability was also reduced to \$7.5 billion. He further opined that in order to reduce the state's unfunded liability, the state would need to use general fund dollars. He recalled that \$550 million has been appropriated. However, the state's unfunded liability has continued to rise to approximately \$10.5 to \$11 billion. He reiterated that the plan applies to less than 25 percent of the state's workforce, which is a relatively small segment of the workforce.

CHAIR OLSON recalled a discussion with local government officials in his district, who indicated that they have not had problems filling job vacancies or positions under the current DC plan.

REPRESENTATIVE MUNOZ responded that as the employer, the state must consider issues which pertain to state employees. She mentioned that state employees do not receive social security benefits, although private sector businesses pay into the federal social security system. In "looking at the big picture," the goal should be to provide a state retirement plan that is predictable. She stated that HB 30 is the top priority of public employee groups in her district, which is the reason she has sponsored the bill.

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CHAIR OLSON opined that if he were a Tier II employee who had missed opting into Tier I retirement benefits he would be concerned as a Tier IV public employee who missed opting into Tier III retirement benefits. He remarked that the state has

changed its system approximately every ten years, although Tier I retirement system was in place about 26 years before the Tier II retirement plan was adopted. He further opined that the reasons for the changes to the state's retirement system were to keep the system competitive and to save money for the state. He indicated that his vote on Senate Bill 141 was the hardest vote he has made as a legislator.

REPRESENTATIVE LYNN said, "I said go, go, go. Keep defined benefits."

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REPRESENTATIVE MUNOZ said she appreciated the difficulty for legislators when considering the DC retirement plan. She remarked that she is not trying to be critical. She said she was not a member of the legislature in 2005 and cannot predict how she would have reacted. She said, "I do not think given what we know today, that it was the right thing to do at the time."

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REPRESENTATIVE DOOGAN related that the vote on Senate Bill 141 also predates his service to the state. He offered his belief that cost needs to be considered when attempting to evaluate retirement systems. He related his understanding that would require analysis of the relative cost of the DB retirement system which is Tier III for the PERS and Tier II for TRS. It would also require evaluating current DC retirement system, which is Tier IV for PERS and Tier III for TRS. He inquired as to whether any such evaluation has been conducted.

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REPRESENTATIVE MUNOZ recalled employer statistics but she did not recall that any in-depth analysis was performed. She agreed that such analyses would assist the state to make an informed decision of whether to reopen and reestablish the DB retirement plan.

REPRESENTATIVE DOOGAN related his understanding that it would also be helpful to determine whether more people are leaving the state, and if it is harder to obtain new employees under the DC plan. He said he hopes the legislature will have access to that information. He opined that any retirement system is a balance

between what it will cost the employer, and the employment effects. He surmised there would also be other considerations.

REPRESENTATIVE MUNOZ agreed that a number of issues should be analyzed and incorporated into an accurate study, such as direct and indirect costs.

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CHAIR OLSON recalled discussions with the administration on a number of occasions and offered his belief that he received accurate answers. Currently the administration has not taken an official position on the issue. He opined that several years ago the administration actively pushed in one direction. He observed that this administration has been more consensual.

REPRESENTATIVE MUNOZ commented that she did not mean to disparage the current administration. She simply would like to "see those numbers and that analysis," which she related would be very helpful.

CHAIR OLSON referred members to a one-page analysis from Legislative Research in the committee packets which provide information from the administration.

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REPRESENTATIVE PAUL SEATON, Alaska State Legislature, agreed that he would also like to see the analysis performed. He opined one reason the system was changed was that the state was not able to fill vacant positions such as electrical workers, special education, or other teachers under Tier III retirement plan. He related that is still the current complaint, and some suggest reverting back to Tier III retirement plan will cure the problem. He affirmed that research would be helpful. He inquired as to whether new employees represent the best choice of cash flow for the state.

REPRESENTATIVE MUNOZ clarified the rate of return on investments by the ARM board is currently about 8.25 percent. Since the DB plan is a closed plan, the expected rate of return will be reduced over time to about 6 percent. She speculated the difference will be significant, perhaps more than \$1 billion dollars will be added to the state's unfunded liability.

REPRESENTATIVE SEATON said he was relieved that the state was not asking its employees to move to the federal social security

system. He recalled that during consideration of Senate Bill 141 in 2005, the state hired Mercer Human Resource Consulting (Mercer), followed by Buck Consultants (Buck). He further recalled both consultants analyzed an alternative method. He stated the most recent predictions are that the state's unfunded liability was probably even larger than either Mercer or Buck had predicted. He offered his belief that the legislature tried to obtain accurate analysis. He recalled that at 8.25 percent, the projections were \$30 billion to pay scheduled payments of \$45.5 billion, which left us at \$15.6 billion of scheduled payments. He stated that some question exists about returning to the prior retirement system that would create new state unfunded liability. He opined that if the only way to reduce the unfunded liabilities would be general fund dollars, that would impact future budgets. He inquired as to how to balance consideration of the retirement system with the prospect of unfunded liabilities with other important needs of Alaskans.

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REPRESENTATIVE MUNOZ offered her belief the state's unfunded liability is not a direct function of whether it has a DC or DB retirement system. Instead, the state's unfunded liability is a direct function of investing the amount recommended by the actuaries into the state's retirement plan. She reiterated that the rate of return on closed plans will add to the state's unfunded liability. She recalled that West Virginia (WV) was compelled to go back to a DB plan. She further recalled that WV did not reduce its unfunded liability under a DC plan. Instead, WV's unfunded liability continued to worsen. She opined that a DB retirement plan is not directly linked with increased state's unfunded liability. She maintained her belief that funding the DB retirement plan means investing the proper amount recommended by the actuaries into the retirement plan.

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REPRESENTATIVE SEATON recalled stock market fluctuations only amounted to 11 percent of the state's unfunded liability. He surmised that the major portion of the state's unfunded liability is due to people living longer. Thus, health care costs subsequently increase, which he recalled was the source of the 56 percent of the state's unfunded liability. He opined that the DB system is exclusively the cause of the state's unfunded liability. He related that under a DB system the state guarantees to pay a certain amount, regardless of the cost, and burgeoning health care costs add to the state's unfunded

liability. He related that when people live longer, the DB plan continues to pay out retirement benefits to retirees, which increases the state's unfunded liability. He offered that under a DC plan a specific amount is contributed, which limits the unfunded liability. He emphasized that the state's unfunded liability is exclusively the result of a DB plan, in fact, is the definition of defined benefits.

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REPRESENTATIVE SEATON stated that the ARM board relies on structured investment advice. The majority of PERS and TRS Boards cases represented the adjudication of challenges. He inquired as to how the current investment board will spend 80 percent of its time on PERS and TRS claims since qualifications for the ARM board do not provide that expertise.

REPRESENTATIVE MUNOZ opined that the current ARM Board is working well, which is one of the most positive results of Senate Bill 141. She related her understanding that the Department of Revenue commissioner is also involved in the appeals process. She said she cannot answer the specifics, but offered to provide the information later. She further related her understanding that all parties seem happy with the structure.

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REPRESENTATIVE BUCH said he welcomes discussions on these issues. He opined that a major component of the retirement system issue is the employer contribution rate. He recalled in the early 1990s, changes were made to employer contributions. He said that he agrees with Representative Seaton's assessment of the task before the legislature. He related his own retirement plan eliminated health care benefits. He recalled that every state has suffered, driven by health care costs, which he characterized as divisive. He stated when people turn 65 years old they are mandated to use Medicare, which is essentially socialized medicine. He further opined the current health care system needs to be revamped. He related that the process of evaluating retirement benefits will likely be a long endeavor and he offered to "roll up his sleeves."

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REPRESENTATIVE DOOGAN offered his belief that the state has two roles, one as the payer and the other as the employer. He

offered that the two roles may be in conflict. He related that one goal of this committee should be to bring those two roles into alignment to the extent possible. He pointed out his discovery does not persuade him one way or the other. He recalled someone once said the most difficult decisions are not between a right and a wrong but between two rights.

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ILANA BOIVIE, Policy Analyst, National Institute on Retirement Security (NIRS), stated that she hopes the committee finds the NIRS research helpful. She referred to a PowerPoint previously distributed to the committee labeled "Pensionomics" and "A Better Bang for the Buck". She explained that the first few slides provide background information on the NIRS. She related that "pensionomics" refers to measuring the economic impact of state and local pension plans.

MS. BOIVIE referred to slide 5, labeled "Why we did This Study" and related that the NIRS wanted to measure the "economic footprint" of state and local pension plans to quantify how much and where pension benefit expenditures make an impact. She related that economists know defined benefit (DB) plans act as an "automatic stabilizer" for the economy. She explained that retirees with a reliable pension can maintain spending for basic needs even in tough economic times. Thus, the report provides a sense of stabilizing effect state and local pensions may have on the U.S. economy.

MS. BOIVIE explained the report compiled state-by-state data compiled in state fact sheets. She reviewed NIRS's findings in Alaska, and referred to slide 6, titled "What We Found - Nationally". She stated the NIRS found a large footprint, specifically in 2006, when expenditures of state and local retirement benefits supported 2.5 million jobs nationwide that paid \$92 billion in income which supported \$358 billion in economic output with \$186 billion in "value-added" and \$57 billion in federal, state, and local tax revenue.

MS. BOIVIE referred to slide 7, titled "What We Found - Alaska". She related in 2006, retirement benefits supported 6,270 jobs that paid \$385 million in income, \$1 billion in economic output statewide, and \$155 million in federal, state, and local tax revenue. She explained Alaska also had a significant multiplier effect, such that for every \$1 paid out in benefits \$1.25 in total output was generated. For every \$1 contributed by Alaska taxpayers to pensions, \$6.35 in economic output was generated.

MS. BOIVIE referred to slide 10, titled "Overview of State and Local DB Pensions in Alaska" which provides background information. She referred to slide 11, titled "Financing of State and Local Pension Plans in Alaska" demonstrates the funding sources for Alaska's pension plans. She offered that 82 percent is garnered from investment earnings and employer contributions made between 1993 and 2006. She pointed out that the chart demonstrates investment earnings which provided nearly 70 percent of the retirement benefits.

MS. BOIVIE referred to slide 15, titled "Alaska Results: Total Economic Impact". She opined that purchases have a ripple effect through the state's economy, so one person's spending becomes another person's income, which is magnified by subsequent expenditures. She referred to slide 21, titled "Conclusions". She related that state and local pension plans have a large economic footprint in the U.S. and Alaska. She reiterated that state and local pensions have significant ripple effects such that one retiree's spending becomes another person's income. She further opined that state and local pensions have sizeable multipliers.

MS. BOIVIE referred to slide 22, also titled "Conclusions". She stated that state and local pensions provide a critical source of reliable income for 7.3 million retired Americans and 35,000 retired Alaskans. She emphasized that pensions support the macro economy and support 6,270 Alaskan jobs, \$358 billion in national activity, and \$1 billion in Alaska economic benefits. She opined that pensions are "automatic stabilizers" since retirees spend money on basic needs whereas people in a 401 (k) plan defer their spending. Thus, the retirees tend to stabilize the economy and act as a stimulus during tough economic times, she concluded.

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MS. BOIVIE explained that the second part of the study is titled "A Bigger Bang for the Buck". She recalled claims that "DC plans save money." She offered that the NIRS wanted to address the claim by evaluating retirement benefits costs for the DB and DC plans. She explained that the NIRS worked with a pension actuary and performed an "apples to apples" comparison of the two plans for any given benefit level.

MS. BOIVIE referred to slide 26, titled "Results: What We Found". The NIRS determined that the DB approach is more cost

effective than the DC approach for three reasons. First, the DB pension pools longevity risks so that the plan can save for the average life expectancy. Secondly, the DB pension plans maintain a better diversified portfolio and do not need to make more conservative investments. Third, DB pension plans consistently achieve better investment returns.

MS. BOIVIE referred to slide 27, titled "DB Plan Can Deliver Same Benefit at About Half the Cost of DC Plan". She pointed out that the chart demonstrates the DB plan offers a 46 percent savings over the DC plan. She referred to slide 28, titled "DB Plan Can Do More with Less" which is for members' reference. She concluded by stating the DB plan has built in economic efficiencies and provides a "better bang for the buck" in terms of savings for taxpayers. She highlighted that clearly cutting employee benefit levels will always save money, no matter what retirement system is used. However, this study shows that for any given benefit level, the DB plan is the most cost efficient retirement plan.

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REPRESENTATIVE SEATON referred to slide 27. He remarked that the slide states "Less Balanced Performance and Lower Returns/Higher Fees". He inquired as to whether the NIRS reviewed the Alaska retirement system or DC plans in general such as a 401 (k) or another plan that allows employees to direct their own investments.

MS. BOIVIE recalled that the NIRS used their own scenario and models for both the DB and DC plans. She referred to slide 29, titled "Methodology: What We Did" and stated that the model was based on a scenario in which 1,000 female teachers worked for 30 years and using a final salary of \$50,000.

REPRESENTATIVE SEATON recalled several analyses that examined a DC plan and the historic lesser return rates. He pointed out that in Alaska a person cannot invest their own retirement funds but must choose between professionally managed accounts with different methodologies. He reiterated that Alaskan retirees cannot direct their own portfolio. He related his understanding that the DC plans were much lower. He inquired as to whether the NIRS reviewed historic views of all DC plans, not professionally managed account, but only portfolio managed accounts.

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MS. BOIVIE recalled that the NIRS used a difference of 80 basis points or approximately .8 percent per year, which represented the lower end of the spectrum. She explained that the NIRS performed a brief review of estimates ranging from 80 to 200 basis points. Thus, the NIRS selected the lower range of estimates to arrive at the difference between the returns for DB and DC plans. She noted with interest that the DC accounts are professionally managed in Alaska. She affirmed that it would be interesting to do a study solely in Alaska. She countered that professional management may still not take advantage of economies of scale the DB plan would achieve, such as investment opportunities that very large pools of funds have access to which are not likely to be available to smaller investors. She surmised that the gap would likely be much smaller, but she said she imagined a gap might still exist.

REPRESENTATIVE SEATON inquired as to whether the DB plan takes into account state's unfunded liability. He inquired as to whether the scenario assumed contributions were made at the appropriate level, but pointed out that would also change when circumstances change. He inquired as to whether he was "missing something."

MS. BOIVIE agreed the model was an idealized view of both structures. She explained that for the DB plan, NIRS arrived at the 12.5 percent payroll but did not differentiate between contributions made by the employer or the employee and also assumed deposits were consistently made. The analysis of the DC cost of 22.9 percent did not consider any unfunded liability. She offered that consideration of unfunded liability was beyond the scope of the study. She said, "It's kind of like an idealized setting. Everyone's going to get to that retirement level, but how much does it take to get them there, year to year."

CHAIR OLSON responded, "I think that's the big question."

[4:26:04 PM](#)

KENDRA KLOSTER, Staff, Representative Cathy Munoz, Alaska State Legislature, speaking on behalf of a joint prime sponsor of HB 30, Representative Cathy Munoz, referred to the Buck consultant letter dated February 12, 2009, which compares the state's defined benefit plan and DC plan. She referred to page 1, to employer's contributions. She related that the costs for the DB plan for Tier III were 10.95 percent, while the costs for the DC

plan were 9.23 percent. Thus, the DB plan costs were higher. She referred to page 2, and related the TRS costs under the DB plan were 8.96 percent, but under the DC plan were 11.4 percent. Thus, the overall pension plan employer contributions differences were less than one percent between the retirement plans. She emphasized that this data was derived from Buck Consultants, but the administration has reviewed the information and agreed with the analysis. She related that she would not review the sectional analysis of HB 30, since most members are familiar with the bill.

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REPRESENTATIVE SEATON referred to page 1 of the Buck Consultant's letter dated February 12, 2009 to the DB plan employer normal cost rate contribution rate of approximately three percent. He inquired as to whether this refers to the average cost. He opined that means a five percent contribution could be made into the health reimbursement account (HRA), depending on where the employee is in terms of his/her longevity. Thus, the average overall amount would be three percent. However, he recalled that federal law requires everyone to be treated the same. He surmised that new employees would initially receive almost five percent in their HRA which will grow over time and have a much greater effect.

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LARRY SEMMENS, City Manager, City of Soldotna, provided a brief work history, offered that he previously served as the city manager for eight months, was the finance director for City of Kenai for 12 years, and held various other positions in the finance department at the Kenai Peninsula Borough. He offered that he served as a trustee of the ARM Board, but due to a technicality, he is no longer eligible to serve. He lamented that he can no longer serve on the ARM board, which he found very rewarding. He indicated that he has extensive knowledge PERS and TRS retirement systems and is also a certified public accountant (CPA). He read from a prepared statement, occasionally providing additional comments. He said:

My name is Larry Semmens and I am the City Manager of the City of Soldotna. I was also a Trustee on the Alaska Retirement Management Board for the first three years of its existence and have fairly extensive knowledge of PERS and TRS issues. I am a certified

public accountant with over 25 years experience in local government in Alaska.

I am against repealing the pension plans commonly known as the 'defined contribution plans' PERS tier IV and TRS tier III, which were effective July 1, 2006. I will refer to these plans as the DC plans, but in reality these plans are blended plans that have both defined contribution and defined benefits attributes.

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MR. SEMMENS continued:

I want to say upfront that the City of Soldotna is not having problems hiring or retaining personnel with the current Tier IV retirement plan. Since implementation we have successfully hired several police officers, both inexperienced and experienced, equipment operators, and office personnel. The vacancies were created primarily from retirements.

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MR. SEMMENS, in response to Representative Doogan agreed that everyone's retirement statements look bleak. He also pointed out that one position the city was not able to fill was its engineer position. He related that the salary was not set high enough to attract an engineer.

MR. SEMMENS continued:

The reason I am against going back to the full DB plans is that they are too costly and the total cost cannot be known until the last person in the plans dies, let alone at the time wages are paid. Our current situation is a case in point. Prior to a few years ago we were all blithely going along thinking our pension plans were fully funded. Surprise - they were not and recently the investment markets have dealt us another staggering blow. The result was, is and may continue to be, skyrocketing contribution rates. With the DC plan the cost is known, the employer pays it one time at the same time that the services are rendered. If we find it difficult to hire employees we will need to raise wages, but at least that is a local control decision.

MR. SEMMENS opined that he has always been in favor of raising wages. He said he has favored the DC plan since it was first discussed. He offered his belief that in order for a public retirement system to be competitive with the private sector, wages also need to be competitive. The key is wages. However, the level of wages for employees is under local control, and is not the result of a retirement system "wagging the whole decision-making process."

MR. SEMMENS continued:

At June 30, 2007, which is the date of the last Actuarial Valuation, the total state's unfunded liability for PERS and TRS was \$7.5 billion. Since then investment returns have not met the actuarial assumption of 8.25 percent. Although we do not have a more current actuarial valuation, I think it is reasonable to predict that the state's unfunded liability will be up at June 30, 2008 because investment returns were negative, about 3 percent. That is over 11 percent short of the actuarial assumption. This fiscal year investment returns are over 20 percent negative and if it doesn't turn around I can absolutely predict that the state's unfunded liability will be up at June 30, 2009.

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MR. SEMMENS added that the actuarial evaluation for June 30, 2009 will not be available until April 2010, and the rates will "kick in" in 2012. Thus, a long lag time exists as a result of the investment returns. He said:

This will put upward pressure on the 2012 contribution rates. At June 30, 2007 total assets of the PERS and TRS pension funds were \$15.8 billion. At June 30, 2008 assets were \$15.5 billion and as of January 31, 2009 the latest available financial statements show total market value of assets to be \$12.1 billion, a decrease of \$3.7 billion since the last valuation. Clearly, assets are going in the wrong direction. Ideally we would have been making progress on paying down the state's unfunded liability, but we have not. I do not want to be critical of the investment performance, nearly every pension system in the country is experiencing similar returns.

MR. SEMMENS acknowledged that the investment team is phenomenal and are frequently in the top-tier. He related that the whole country is experiencing problems. In response to Chair Olson, he agreed the investment team has routinely outperformed the permanent fund. He said:

As an employer I like the DC plan for the certainty of cost that such a plan provides. The employer is responsible to pay the retirement contribution one time only and the cost is known.

MR. SEMMENS offered a scenario in which a city manager prepares a budget setting snow plowing costs at \$800,000 ten years later discovers the costs were actually \$900,000. He said:

Ten years from now employers will not be asked to make additional contributions to cover investment losses or for the many other reasons that DB pension plans become underfunded. The private sector has fled DB plans because they need to know how much it costs to produce their products. They cannot go to their customer 10 years later and say they should have charged them more because it has come to light that pension benefits earned back then actually cost more than they figured into the sales price. Should the public sector be any different?

Shouldn't we tell our constituents how much it will cost to plow the streets or run the ice rinks without the specter of revising that cost years later due to changes in retirement costs?

MR. SEMMENS opined that one would need to search long and hard to find a private sector employer who offers a retirement plan similar to the PERS Tier III or the TRS Tier II retirement plans.

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MR. SEMMENS said:

Please consider carefully before you make promises to future employees that the residents of Alaska will provide them with guaranteed retirement benefits the cost of which you cannot possibly know. My experience

of the last several years tells me that even the experts may not be able to reasonably predict such costs.

MR. SEMMENS related that he has observed many actuarial evaluations. He opined that one year they say one thing and the next year they say something else. He opined that it is not exact science. He stated he has heard the process characterized as an art. He said:

Please ask yourselves the question - is it right to require future generations of Alaskans to pay the cost increases that seem to inevitably beleaguer defined benefit plans?

MR. SEMMENS stated that he has been "in the business" for 25 years. He opined that his children will be responsible for the cost of \$10 billion in unfunded liability of his retirement benefit. He said, "Personally, I don't think it's right."

Major corporations have gone bankrupt due to their inability to fund these pension plans. I am very concerned that governments are headed down the same path. I am very concerned that the City of Soldotna will not be able to continue the service levels that our residents enjoy today if our PERS contribution rates increase any more than they already have. Remember that in 2004 the PERS rate was about 6 percent, currently it is 35 percent. It is true that currently the City's contribution rate is capped at 22 percent, but I wonder if the State will be able to afford to pay the difference in 22 percent and the actuarially required rate if State revenue streams remain under pressure. Usually something has to give and it wouldn't surprise me if this rate went up in the next 5 years.

To me, it seems unwise and perhaps even irresponsible to change course on our pension plans, especially now when it is abundantly clear that investment returns are volatile and may not produce the returns that our defined benefit plans depend upon. Imagine the contribution rates that will be necessary to pay off the state's unfunded liability in the event that investment returns do not return to normal quickly. Just last year the TRS rate was 54 percent of payroll.

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MR. SEMMENS said:

The contribution of the State of Alaska and the employer of a teacher making \$50,000 was \$27,000 to the retirement system. This does not seem sustainable to me.

I would also ask that you consider carefully whether it is right, in a moral sense, for you to promise new employees benefits that may be impossible to pay for 30 to 50 years from now. If the answer is yes, then I must ask is it right, in a moral sense, to make such a promise not knowing what future generations of Alaskans will have to sacrifice in order to pay for this promise. This is the time for conservatism. The private sector has certainly embraced defined contribution plans. You will be hard pressed to find private sector employers that offer defined contribution plans similar to tiers II and III.

Please hold this bill in your committee and let the rest of the U.S. catch up to the pioneering and difficult work that the Alaska legislature did when it adopted the blended retirement plans we have now. This is the fiscally responsible thing to do, and in my opinion it is the right thing to do.

Thank you for hearing me today. I would be happy to try to answer any questions.

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REPRESENTATIVE SEATON referred to page 2, line 7 of HB 30, which read, "The employer shall transmit the contributions calculated in (a) of this section." He also referred to page 2, lines 10, which read: (1) the actuarially determined employer normal cost for the plan and all contributions required by the former AS 14.25.350 and by AS 39.30.370 for the fiscal year. He inquired as to whether that refers to the full normal cost and the contributions required under the former DB plan would then "fall back to the employer" or if he is misinterpreting proposed Section 4 of the bill.

MR. SEMMENS answered that he was not able to interpret the specific provision of the bill. He surmised that employers would be responsible for the normal cost rate of past service liability. He related the state makes payments based on the rate that the ARM board sets.

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REPRESENTATIVE SEATON referred to the fiscal note which assumes that the liability is 22.5 percent for PERS and 12.5 percent for TRS. He offered his belief the liability supersedes legislation that would bring state's unfunded liability cost on the employers.

REPRESENTATIVE SEATON next referred to a document in members' packets titled, "Retention Rates as a Percentage: Comparison of Final 2 years of Defined Benefit Retirement Plan to the First 2 years of Defined Contribution Plan." He referred to the last two sets of boxes, and noted that the two year PERS retention rate was 55 percent, and under the DC plan the rate was 57 percent. He related that the TRS retention rate increased from 59 percent to 64 percent. He inquired as to whether Mr. Semmens experienced similar results in his experience.

MR. SEMMENS answered that the City of Soldotna has had several new Tier IV employees, but none have retired.

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MR. SEMMENS, in response to Representative Doogan, explained that state's unfunded liability is the difference between the actuarial value of the assets, which is slightly different than the market value and the calculated liability, which is present value for the benefits when due. He explained the job of the actuarial is to calculate the liability. He related that it is just an arithmetic calculation to determine the difference between the assets and the liability. He related a scenario in which there is \$25 billion in liability with assets of \$15 billion. Thus, the state's unfunded liability would be \$10 billion. He explained that each year results in either liability or surpluses. The actuarial will project over 25 years, similar to a how a mortgage is calculated and will arrive at a rate. He opined that the normal rate for earnings currently is about 14 percent, and the difference is the state's unfunded liability, which would be paid off in about 25 years.

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REPRESENTATIVE DOOGAN inquired as to whether his scenario was based on assumptions of the cost of the retirement plan for a specific set of beneficiaries for a specific time.

MR. SEMMENS answered yes. He related that every single person is reviewed by the actuarial during the process.

REPRESENTATIVE DOOGAN related his understanding that the assumptions represent an attempt to determine the cost of the plan.

MR. SEMMENS agreed.

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REPRESENTATIVE DOOGAN related his understanding that the public sector should not be treated differently from private sector. He raised the question of whether a DB plan is an effective way to retain state employees who might earn more in the private sector. He inquired as to whether Mr. Semmens would advocate paying the "market rate" for employees instead.

MR. SEMMENS answered if the state were to use a "market type" of retirement system that it is likely the state would also need to have "market type" of salary. He offered his belief the only difference between the private and public sector is the "every day health benefits" the public sector enjoys that the private sector does not. He affirmed that Representative Doogan's point was "right on."

REPRESENTATIVE DOOGAN observed that if future generations must pay for retirement plans, the plans would probably be different than the current generation of Alaskans.

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REPRESENTATIVE BUCH asked if the actuarial history for the last 15 years was available. He inquired as to the state process for determining employer contributions prior to enacting Senate Bill 141 in 2005.

MR. SEMMENS acknowledged that he ignored the actuarial process for many years since the rates were low. However, after the state's unfunded liability rose in 2002, he then became involved. He related his understanding that the historical process is similar. He related that for 25 years the consultant

was Mercer. The process was for the consultant to review liability for each employee and arrive at a liability number, compare the figure to assets, and arrive at an outcome that was often fine. He opined that people questioned the assumptions and a review actuarial was hired. In 2005, another consultant disagreed with the assumptions the two other consultants used. That consultant increased the projections for the state's unfunded liability. He pointed out an actuarial gain in 2007, when health care costs were found not rising as quickly as the projections. He characterized the actuarial process as an expensive and extensive review process.

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CHAIR OLSON recalled that Mercer used an old table on life expectancy. Thus, people lived longer so the amount budgeted was insufficient. The state's unfunded liability contribution was also not sufficient, he related. He opined that the consultant was not totally liable. He related his understanding some political judgments were made that also affected the outcome. He offered his belief that the state is currently in litigation.

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REPRESENTATIVE BUCH related that he is able to serve in the legislature since he had a DB plan. He opined that the difference between his retirement system and the state's system is that his system retains 10 or 12 actuarial firms and several firms conduct an assessment every three months to further assess the projections. He said, "The ones that don't perform are gone." Additionally, the actuarial firms also project 100 years out. He opined what happened to the state's unfunded liability is a result of Senate Bill 141. He recalled an earlier scenario and commented that the snowplow budget is a function of the weather, which cannot be predicted.

[4:59:07 PM](#)

REPRESENTATIVE LYNN inquired as to why municipal employees are not paid the same wages as the private sector.

MR. SEMMENS answered one reason is that the public sector provides other benefits. Thus, lesser wages can be paid because other components make up the difference. He pointed out that municipal operators are paid 12 months a year instead of the private sector's seasonal summer or winter season.

REPRESENTATIVE LYNN recalled his military and teaching service. He said, "I put up with a lot of guff. One of the reasons is I had defined benefits."

MR. SEMMENS agreed. He asserted the difference is local control issue such that a city council can decide whether to pay an employee \$20 or \$25 per hour.

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REPRESENTATIVE SEATON recalled during the DB versus DC debate that a number of municipalities who feared they would be bankrupt with a 54 percent contribution rate for the retirement plan. He inquired as to whether that situation would emerge if the state went back to a DB plan.

MR. SEMMENS offered his belief that would depend on the local government's ability to pay. He opined that at some point a limit is reached. He predicted that as municipalities contribute a larger amount of the available resources for retirement benefit contributions, a limit is reached and municipalities will opt out. He opined that this could happen whether the plan continues to be a DC plan or if the state returns to a DB plan. He related that result could also happen with extremely poor investment returns or if legislators increased benefits and the state's unfunded liability continued to rise. He further related that the legacy DB plan will be affected by many decisions and the investment return. He offered his belief the greater risk is that the employer is clearly taking on all the risk for the 11,000 employees. He opined that a DB plan would likely cost more than a DC plan. He said he thought that it might be 15 or 20 years before the funds unfunded liability would need to be paid, which is what really bothers him. He questioned how the rates could be 54 percent, if the DB and DC plans are relatively the same costs. He asked whether anyone could guarantee that the rates would not rise to 54 percent again.

[5:04:09 PM](#)

REPRESENTATIVE SEATON referred to page 2, to proposed Section 6. He explained that the current law limits the cost of living adjustments unless the plan is funded at 105 percent. He expressed concern if the constraint is removed, that the state would be required to make additional post retirement cost of living adjustments. He inquired as to whether Mr. Semmens could

address the liability on the system given his experience on the ARM board.

MR. SEMMENS answered that it would depend entirely on the percentage of increases and the cumulative effect of the increases over time. Clearly every time a municipality or a school district increases teachers' salaries above the actuarial assumption, the state's unfunded liability increases, he stated. He remarked that in a cost share plan, everyone in the system shares the cost equally.

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REPRESENTATIVE SEATON related that the additional post-retirement cost of living adjustments would build each year. He inquired as to whether that would also affect retirees currently living out of state.

MR. SEMMENS answered that he was not certain.

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REPRESENTATIVE DOOGAN related his understanding that state's unfunded liability is due to higher costs such as medical cost increases, the system was not adequately funded to account for the increased health costs, and the investments did not perform. He inquired as to whether any other factors contributed to the state's unfunded liability.

MR. SEMMENS agreed with the broad categories. He acknowledged investment losses contribute to the state's unfunded liability. Additionally, the actuarial assumptions are extensive, including changes such as gender, life span, and the number of children. He opined that making a change in any of the assumptions would affect everything else. Further, he said that what actually happens matters such as that people are living longer than previously predicted. He emphasized the single item that has a huge impact on the state's unfunded liability is when retirement benefits are increased. He said, "Let's say five years from now, by some miracle, we're 105 percent funded. You will be getting a great deal of pressure to increase benefits because we've got the money to pay for it. When you do that it has a huge impact. That's another total unknown as an employer at the City of Soldotna."

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REPRESENTATIVE DOOGAN opined that when the state changed to a different retirement system, the state also shifted the risk. Thus, when medical or retirement costs increase, the risk falls on the individual rather than the state. Further, if the investments do not perform, the risks fall on the individual, as well. He related his understanding that making sufficient contributions to the fund remains the state's responsibility, although the employees in the DC plan will be solely limited to the amount of the state's contributions. He offered his belief if the state were to "shoulder the risks" that it would be easier to hire and retain employees than to expect them to bear the risk.

MR. SEMMENS answered yes. He said, "As a city manager, I would much rather be out here recruiting with this gold-plated retirement plan, but the question is, who is going to pay it?"

REPRESENTATIVE DOOGAN acknowledged that the state is both the payer and the employer, which he opined results in competing goals.

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REPRESENTATIVE SEATON remarked that at some point a job offer is made to an employee and he/she either takes the job or does not take the job. He related his understanding that Mr. Semmens does not wish to place the state's unfunded liability on future city councils to cover current employee wages and benefits, but would rather let the employee decide if the wages and benefits being offered are adequate.

MR. SEMMENS answered yes, that it is incumbent on the employer to put together an employment packet. He related that \$50 per hour would not be sufficient to attract an engineer. He concluded his whole point is that the DC plan allows for certainty, while the DB plan guarantees uncertainty.

CHAIR OLSON announced that HB 30 would be held over for further consideration.

[5:14:12 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 5:14 p.m.