

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

September 15, 2011

9:05 a.m.

MEMBERS PRESENT

Senator Bill Wielechowski, Chair
Senator Joe Paskvan, Vice Chair - via teleconference
Senator Kevin Meyer
Senator Cathy Giessel

MEMBERS ABSENT

Senator Albert Kookesh

OTHER LEGISLATORS PRESENT

Senator Hollis French
Representative Mike Hawker
Representative Bob Lynn

COMMITTEE CALENDAR

SENATE BILL NO. 121

"An Act relating to the public employees' retirement system and the teachers' retirement system; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 121

SHORT TITLE: TEACHERS & PUB EMPLOYEE RETIREMENT PLANS

SPONSOR(s): SENATOR(s) EGAN

04/07/11	(S)	READ THE FIRST TIME - REFERRALS
04/07/11	(S)	STA, FIN
04/14/11	(S)	STA AT 9:00 AM BUTROVICH 205
04/14/11	(S)	Heard & Held
04/14/11	(S)	MINUTE(STA)
09/15/11	(S)	STA AT 9:00 AM Anch LIO Rm 220

WITNESS REGISTER

JESSE KIEHL, Staff

Senator Dennis Egan
Alaska State Legislature
Juneau, AK

POSITION STATEMENT: Presented SB 121 on behalf of the sponsor.

DANIEL GRISWOLD, representing himself
Anchorage, AK

POSITION STATEMENT: Testified in support of SB 121.

BRIAN WILSON, representing himself
Anchorage, AK

POSITION STATEMENT: Testified in support of SB 121

ABRY RABY, representing herself
Anchorage, Alaska

POSITION STATEMENT: Testified in support of SB 121

WILLIAM B. FORNIA, President
Pension Trustee Advisors

POSITION STATEMENT: Provided an actuarial analysis in support of SB 121.

MIKE BARNHILL, Deputy Commissioner
Department of Administration (DOA)
Juneau, AK

POSITION STATEMENT: Testified on behalf of the Parnell Administration in opposition to SB 121.

ACTION NARRATIVE

[9:05:19 AM](#)

CHAIR BILL WIELECHOWSKI called the Senate State Affairs Standing Committee meeting to order at 9:05 a.m. Present at the call to order were Senators Davis, Meyer, Giessel, and Wielechowski; Senator Paskvan attended via teleconference. Senator French and Representatives Hawker and Lynn also attended the meeting.

SB 121-TEACHERS & PUB EMPLOYEE RETIREMENT PLANS

[9:05:43 AM](#)

CHAIR WIELECHOWSKI announced the committee was meeting to continue its discussion on the type of retirement plan the State of Alaska and its municipalities [and school districts] should offer their long-term employees. He reminded everyone that in 2006 the Alaska Legislature changed the retirement system from a defined benefit (DB) plan to a defined contribution (DC) plan.

Under a DB plan, retired employees receive a defined monthly check based on salary and years of service. He noted that most state, municipal, and school employees around the nation belong to such plans. To his knowledge, Alaska is the only state that offers its new employees neither a DB plan nor the opportunity to participate in the U.S. Social Security program.

CHAIR WIELECHOWSKI explained that under a DC system, employees and their employers contribute to a retirement account and the individual employees make their own investment decisions. If those investments perform poorly, the employee receives less money at retirement. While this system provides less security to workers, it has the advantage of portability; these employees have the ability to take their retirement accounts with them when they change jobs. This system works well for individuals who may wish to work for a particular employer for a relatively short period of time.

SB 121 will give Alaska public employees a choice between the two systems. The sponsor's objective was to design a system that would cost the State of Alaska and its municipalities and school districts less than the current Tier III DB system.

[9:07:48 AM](#)

JESSE KIEHL, Staff to Senator Dennis Egan, prime sponsor of SB 121, extended apologies on behalf of Senator Egan who was fulfilling a prior commitment to attend the Southeast Conference meeting in Ketchikan.

MR. KIEHL explained that SB 121 creates a new defined benefit tier in both the Teacher Retirement System (TRS) and the Public Employee Retirement System (PERS). While the accounting for TRS and PERS is separate, both are Alaska's public retirement systems that apply to state, municipal, and school district employees. The new tier created by SB 121 is designed to be more predictable and less costly than previous defined benefit tiers. It will be more stable and should provide fewer surprises in years to come.

[9:10:05 AM](#)

CHAIR WIELECHOWSKI recognized that Senator French had joined the committee.

MR. KIEHL explained that SB 121 aims to take a balanced approach and provide new employees a choice between the current defined contribution (DC) system and a new defined benefit (DB) tier. The bill also provides employees who were hired into the DC

system, one opportunity to switch to the new DB tier. He pointed out that each system has its strengths and each appeals to different employees. Giving new employees this choice increases the government's tools to deliver the best services for the same dollars.

MR. KIEHL stated that a DB system means security; the employee knows how much he or she will have at retirement and that employee knows whether health insurance will be part of the package. While a DB benefit is guaranteed, it takes a long time to earn and is not designed to be a windfall. Under the proposed new DB tier, employees will have to work a minimum of 10 years to earn the retirement-check benefit and a full [25 years for TRS employees] or 30 years for PERS employees (25 years for police officers and firefighters) or be Medicare eligible, before the retiree health insurance benefit kicks in. This reduces the cost of the benefit to the state and provides predictability to the employee.

[9:12:47 AM](#)

The DC system gives the employee control over his or her investments and provides a wide variety of investment options. This system offers portability and the potential to work the market and "beat the street." This is attractive to employees who do not intend stay over the long term. Retaining the option of a DC system gives public employers and school districts an additional tool to attract people that have unique skills and prefer to move from job to job. The down side to a DC system is that it provides no guarantees. The employee may not only not "beat the street," but actually lag the street dramatically and not have the funds to retire.

MR. KIEHL said it's important to point out that neither defined benefit employees nor defined contribution employees of the State of Alaska its municipalities or its school districts participate in Social Security. In fact, the PERS/TRS benefit reduces any Social Security benefit the employee may have earned before he or she came to public employment. This significant tradeoff does not change under SB 121.

The DB and DC systems appeal to different people and the sponsor wanted to ensure that the strengths of both systems were available to the employees who chose them.

[9:15:24 AM](#)

MR. KIEHL displayed a list of employees to demonstrate that the public servants that serve Alaska do so in different ways. The

list included: commissioner, highway maintenance worker, research biologist, management biologist, teacher, city manager, state trooper, eligibility tech, nurse, and investment officer.

He pointed out that the average tenure for a commissioner of the Department of Health and Social Services (DHSS) is just less than two years, and observed that someone coming into that position might reasonably expect they wouldn't stay in the job long enough to qualify for a pension check or medical benefits. The idea of a DC system where retirement money is portable may be very appealing in this instance and may, in fact, help future governors in recruiting the best commissioners.

By contrast, highway maintenance workers tend to have long careers in public service and their longevity is an asset. They fix potholes and plow the streets. These workers know where that raised manhole cover is so they don't catch the plow blade on it every time. This work can be physically demanding and these folks may very well find great appeal in the idea of health insurance as part of their retirement package.

Research biologists and management biologists provide additional examples of how employees differ. The state may decide it wants to do additional research to find out more about Polar Bear habitat, breeding habits, and eating habits. It may not matter if the very best research comes from internationally renowned biologists who may not want to spend their entire career as a state employee. By having a DC system, the state is well served and these folks are able to take their retirement money when they move on to do research for other entities.

By contrast, the longevity of a management biologist may be a great asset to the state. It may be important that he or she has great familiarity with moose stocks or the population of a given caribou herd. The institutional knowledge of how a particular population reacts in a particularly rough winter may be very important. In this case, the state derives greater benefit for the people of Alaska by having long-term employees and they may well choose a DB system.

MR. KIEHL said there are employees on the list that fit each category, but the point is that all Alaskans benefit from having both the DC and DB systems available. It will be beneficial for the state to have all the tools it can to attract the best teachers, the best scientists, and all the other best workers on that list to serve the people of Alaska.

[9:20:24 AM](#)

MR. KIEHL highlighted the things that stay the same under SB 121.

- The current defined contribution system remains intact.
- The defined benefit safeguards that were implemented about six years ago remain in place.
- The formulas and qualifications for the defined benefit pension do not change.

MR. KIEHL highlighted some differences under SB 121.

- It will take longer to earn the retiree health insurance benefit. Employees in the new DB tier must reach the Medicare age threshold and have 10 years of service before they get retiree medical. A public employee who has ten years of service, but is not yet Medicare eligible, can retire and receive a pension check, but not the health insurance benefit. In the old tiers the age threshold is younger than Medicare eligibility so the pension system is on the hook for the full cost of that retiree health until the retiree reaches Medicare age. That tremendous cost to the system goes away under the new tier.
- The retirement eligibility in the new DB tier is dramatically different than PERS/TRS Tier I. The state made responsible changes to that system some years back and those should be kept. The reason is straightforward; the actuarially accrued liabilities of PERS/TRS Tier I are roughly equivalent to the entire DB pension trust.
- The new DB tier operates at a lower cost as a function of the medical eligibility.
- Employees that were hired after July 1, 2006 are given a one-time opportunity to convert to the new DB plan. There is a 60-day window for making this choice. At the time of conversion, all employee and employer dollars in the DC accounts will be rolled into the DB trust funds. If there is a gap, the state would be required to make up the difference at the time of conversion. It is not the sponsor's intent to create any kind of liability problem with this bill.

MR. KIEHL noted that the Division of Retirement and Benefits raised questions as to whether it could process the conversions in 60 days as the bill requires. He assured the committee that the sponsor was willing to work with the division to make the mechanics work at the lowest administrative cost to the state.

[9:25:56 AM](#)

MR. KIEHL said SB 121 takes a responsible approach. The new DB tier for public employees and teachers has costs that are comparable to the DC tiers and it offers public servants the option to earn the retirement that best fits their public service. The changes to the retiree health insurance should make the system more predictable than past systems. He noted that medical cost escalation has been difficult to predict, and reminded the committee that it was one of the elements in an actuarial malpractice lawsuit that the state recently settled.

MR. KIEHL highlighted that all the 2004 safeguards for the pension system remain in place.

- A second actuary will continue to review the work of the first to ensure that the assumptions are reasonable and that the math is correct.
- There will still be a minimum salary threshold for elected officials to earn retirement credit. The days of serving on a school board with a \$100 per month honorarium and earning a full year of retirement credit for that are not returning under SB 121.
- Alaska experience studies will continue. Research based on Alaska data will show whether the mortality tables are correct and will ensure that the contribution rates are at the right level. Liabilities will be prefunded.
- The Alaska Retirement Management Board (ARM Board) will continue to be primarily disinterested members. This was contentious initially, but it has proven to be a very good reform and an important safeguard to the system.
- The law that requires payment of the normal costs as they accrue today will remain in effect. The trust funds will not be shorted.

MR. KIEHL said the sponsor firmly believes that under SB 121, the state and public employers will get more for Alaskans' money. A plethora of research shows that DB pension systems consistently earn more at lower cost and generally lose less in downturns than individual accounts. However, those public servants who prefer portability will have an excellent DC plan available to them. Running two systems will not add cost; the state is doing this today and will continue to do so for some time to come.

[9:29:58 AM](#)

MR. KIEHL highlighted that Alaskans receive \$800 million per year in defined benefit checks from state, federal, and private sources. This is a great shock absorber for the Alaska economy

because that money is spent in Alaska to support businesses and private sector jobs.

MR. KIEHL stressed that public employers in Alaska cannot eliminate the risks inherent in retirement. Some people will outlive their savings and others will pay into a defined benefit system for years and die young. There are risks of underfunding whether the risk is pooled and spread across thousands of employees in a DB system or whether an individual employee takes on that risk him or herself. But SB 121 shifts the risk and lets employees choose between the pooled risk system with potentially lower personal returns and the individual risk system with the potential to beat the numbers.

MR. KIEHL acknowledged that there is a 70-80 year horizon between the time that someone is hired right out of school and their retirement ends. But, he said, the State of Alaska is here for the long term and legislators, as the state's board of directors, have an obligation to get Alaskans the best return on their money and the best public service possible for their public dollars. SB 121 attempts to do that and to do it responsibly.

[9:33:09 AM](#)

SENATOR GIESSEL referred to the \$800 million per year in DB benefits that Alaskans receive and asked if he's asserting that retired Alaskans spend their retirement benefits in Alaska.

MR. KIEHL replied more and more Alaskans are staying in Alaska after retirement, which is better for families, communities, and the economy. An Alaska cost of living allowance is built into the current DB system and SB 121 does not change that. That system is designed to keep as many Alaskan retirees here as possible. He restated that the \$800 million per year is a combination of PERS/TRS benefits, federal employee retiree benefits including military, Social Security, and private sector defined benefit pension plans. It's an Alaska number; it is not extrapolated from national trends.

SENATOR GIESSEL said she found that 24 percent of the masters, pilots, and engineers in the Alaska Marine Highway System are not Alaska residents. Noting that the salaries for the positions start at \$120,000, she asked if those employees were accruing a defined benefit retirement.

MR. KIEHL replied he would follow up with specifics, but his understanding was that those are DOTPF employees. Depending on

their date of hire they would be earning either a DB retirement or a DC retirement under PERS. He cautioned that the bill was not a panacea. It was designed to attract and retain the best employees to Alaska's public service jobs, but it certainly did not fix all the problems.

[9:37:18 AM](#)

SENATOR MEYER said his understanding was that the State of Alaska opted out of Social Security and instead offered the SBS program to its employees. He asked how that factors into the public employee retirement program.

MR. KIEHL confirmed that the State of Alaska opted out of Social Security. The Supplemental Benefit System (SBS) was implemented for state employees as an attempted replacement for Social Security. It is a defined contribution system whereas Social Security is a defined benefit program. He added that it's important to understand that most Alaska municipalities do not provide a Social Security replacement and no Alaska school districts that he knows of provide a replacement. Those employees are dependent on PERS or TRS and personal savings for their retirement income. It is therefore particularly valuable in attracting and retaining teachers to offer the option of a defined benefit retirement system.

CHAIR WIELECHOWSKI observed that the actuary may add to that response when he testifies.

[9:39:50 AM](#)

REPRESENTATIVE LYNN asked if new employees would have the option of switching systems.

MR. KIEHL answered no. If employees were allowed to flip back and forth it would be difficult to predict today what it will cost to fund tomorrow's retirement benefits. Predictability is essential to the system.

REPRESENTATIVE LYNN said he wanted to be sure that was on the record.

CHAIR WIELECHOWSKI informed the committee that most of the hearing would be devoted to a review of the financial impacts of the bill, but first he wanted a couple of Alaskans to testify about how the DC system has affected them.

[9:41:45 AM](#)

DANIEL GRISWOLD, representing himself, said he was born and raised in Anchorage and was in his fifth year as a highly-qualified math teacher at East Anchorage High School. He comes from a teaching family; his mother was a teacher in the TRS Tier I plan, his sister is a teacher in the TRS Tier II plan and he is in the TRS Tier III plan.

MR. GRISWOLD said he had enjoyed Alaska's wonderful bounty over the years and he wanted to continue to live here, but under the current DC system it was hard not to explore other possibilities. The TRS Tier III DC system was designed such that at the end of the fifth year of teaching he can leave and take all the money he had contributed as well as the state match. He has to look at other options because his retirement is based on the things he does to make it work and he knows that the TRS Tier III plan offers no safeguards. As a math teacher he feels he's lucky that he can follow and work with the stock market, but a lot of teachers can't do that. They just trust that their funds are being managed adequately.

MR. GRISWOLD said all TRS Tier III teachers know that after their fifth year they will look at other options because there are states that have more attractive retirement systems. He said he likes the option that SB 121 offers and if he's presented with the option he will change to the defined benefit plan and spend his entire teaching career in Alaska.

[9:46:52 AM](#)

SENATOR GIESSEL noted that an article from the 9/13/11 Juneau Empire reported that in FY11 the defined benefit investments for TRS earned 21.51 percent and PERS earned 21.41 percent; the defined contribution investments for TRS earned 22.6 percent and for PERS 23.1 percent. She asked if he had any thoughts about the fact that the DC investments did better than the DB investments.

MR. GRISWOLD replied the plans are structured very differently and the real difference lies in what the two plans actually provide.

[9:48:39 AM](#)

BRIAN WILSON, representing himself, said he was an Anchorage police officer, a husband, a father, and a contributor to PERS Tier IV defined contribution retirement. He expressed enthusiasm at the potential to participate in a defined benefit program. That is a powerful retention tool for the state and municipalities. It provides financial security, reduces stress,

improves quality of life, and provides a more productive employee.

MR. WILSON said he was born in Fairbanks and when he graduated from high school he received a Chancellor's Scholarship, which was designed to retain Alaska's graduates. It certainly worked in his case; this is where he wants to live and raise his daughter.

He explained that he joined the Anchorage Police Department in 2007 with 30 other recruits and now just 20 of those officers are still in Anchorage. All the officers he's spoken to have said they've explored employment in other states because of the retirement system. When other officers learn that he's PERS Tier IV they question why he's still here. His response is that Alaska is his home and he wants to stay here.

MR. WILSON said police cadets are told that it takes about five years to become a productive police officer. He noted that he was about to enter year five at APD and at that point he and his academy mates will be vested. That means that all the money that he and the municipality have contributed is portable. But he wants to stay at APD and he'd like all his academy mates to stay as well. These are experienced officers and that experience enhances safety for the municipality and its citizens, he stated.

MR. WILSON highlighted that PERS Tier IV police officers do not contribute to Social Security. His retirement is reliant on his personal savings and his PERS DC account that ebbs and flows with the stock market. He noted that he's contributed to PERS for about four years and his account has just a little more in it than the bonus potential he gave up in 2007 to become a police officer. Watching the stock market isn't something he wants to do; he wants to focus on public safety, plan for his family, and retire in Alaska.

MR. WILSON said there are a lot of tradeoffs for a police officer who also tries to have a family life, but he loves his job. When he retires he hopes his family can count on a defined benefit. Incentives matter, he said, and a DB program is an incentive to retain experienced employees over the long term. It will help them make the decision to build their lives in Alaska and stay through retirement.

[9:55:16 AM](#)

SENATOR GIESSEL asked if he had an investment advisor to help determine where to invest his defined contribution money.

MR. WILSON replied he understands that he can pay extra to have someone rebalance his portfolio, but he doesn't know that person's credentials and isn't comfortable asking someone at the other end of a computer to rebalance his portfolio based on a questionnaire. He'd prefer to have something he can count on even if it returns less.

9:56:53 AM

ABRY RABY, representing herself, said she moved to Alaska three years ago and had worked for the Alaska Fire Standards Council since she arrived. She described herself as a model employee and noted that after the first year of employment she was nominated for the Governor's Denali Peak Performer award. The retirement package is the only thing that makes the job less than perfect, and had she understood it fully she would never have applied. However, she said, the job would be perfect if she were given the option to change to a defined benefit plan.

MS. RABY stated that SB 121 would give public service employees the ability to choose the plan that meets their career goals and retirement needs. She is motivated by security, consistency, and predictability and she would select the defined benefit plan, but she knows that everyone isn't similarly motivated. The key, she said, is to give employees the option to select the plan that best fits their needs. Meeting employees' needs makes them feel more valued, which makes them more committed and more inclined to stay.

Social Security gives retirees a stable means around which to budget and it also provides an off-work disability benefit. But the State of Alaska opted out of Social Security so that's not available and PERS Tier IV and TRS Tier II employees do not have the option of a defined benefit plan. They have neither a secure component in their retirement portfolio nor a disability benefit if they're injured after work hours. At this point, PERS Tier IV and TRS Tier III employees have less security than private sector employees.

10:01:16 AM

MS. RABY said when she's asked if the state is a good employer, she points out that the retirement package for new employees does not have a safeguarded component. She believes that without a defined benefit option, the state is losing valuable long-term employees and this hurts on many levels. The quality of service

to the public is diminished if only short-term workers are recruited because many don't stay long enough to become efficient. Continually hiring and training front-line workers makes it difficult to maintain the workload.

If the state were to again offer a defined benefit option, she would enthusiastically recommend state employment to her peers. Recruiting long-term employees will save the state money through increased productivity. She urged passage of SB 121 to give public service workers the option to choose the package that works best for them.

10:03:23 AM

SENATOR FRENCH commented that he's attended a lot of hearings over the years and it was gratifying to hear from a highly talented teacher, a highly motivated APD officer, and an award-winning state employee about the conscious choices they are making about their retirements and the difficult choices they're going to be forced to make if the Legislature doesn't do something.

CHAIR WIELECHOWSKI recognized Mr. Fornia and asked him to incorporate in his testimony responses to the questions that committee members posed earlier.

10:04:29 AM

WILLIAM B. FORNIA, President, Pension Trustee Advisors, stated that he was a fully credentialed actuary who had worked in Alaska off and on since 2002. He's a fellow of the Society of Actuaries, an enrolled actuary under ERISA - the Employee Retirement Income Security Act of 1976, a member of the American Academy of Actuaries, and he's active in several national actuarial organizations. He's currently vice chair of the Conference of Consulting Actuaries Public Plans Committee, the leading organization for public pension actuaries.

In 2008 he worked with the National Institute on Retirement Security to author the report "A Better Bang for the Buck;" in 2002 he spoke in Anchorage to the National Council on Teacher Retirement on the topic of new developments in DB/DC plans; and he frequently testifies before state legislatures and city councils as an expert witness. He described several ongoing cases and said he represents both sides in order to maintain a balanced perspective. He highlighted additional work history and said that for the past 15 years he's focused on governmental pensions.

10:07:41 AM

MR. FORNIA reminded the committee that one of the safeguards put in place by Senate Bill 141 was an independent and ongoing actuarial review. The Division of Retirement and Benefits hired Buck Consulting as the system actuary and the ARM Board hired him as the ongoing review actuary. The first review audit was in 2009 and he and his staff basically duplicated Buck's numbers. He opined that his comprehensive understanding of the system was the reason the Alaska Public Pension Coalition chose to hire him now.

10:13:07 AM

MR. FORNIA explained that his plan was to discuss the advantages of defined benefit plans and to analyze reverting to a DB plan as set forth in SB 121. The discussion would not include the fiscal note because it had been withdrawn.

He highlighted four basic findings: 1) Senate Bill 141 did not solve the unfunded liability; 2) defined benefit plans tend to be more economical; 3) defined contribution retirement costs are comparable to PERS Tier III and TRS Tier II costs; and 4) it's possible to structure a reversion to a defined benefit plan at very little or no additional cost.

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MR. FORNIA stated that DB plans are more appropriate for public servants than defined contribution plans. DB plans precisely define what the benefits will be when someone retires, they provide workers what they need for retirement, and they are also more efficient than DC plans. Alaska public employees and teachers do not have the Social Security safety net so it seems even more imperative to consider a defined benefit arrangement for these employees. He pointed out that Alaska is probably the largest employer in the country that offers neither Social Security nor a defined benefit plan to its employees.

10:16:02 AM

MR. FORNIA said that under DB arrangements employees don't need to be as worried about investment volatility. DB arrangements are professionally managed and the returns tend to be better than under DC arrangements. DB arrangements are therefore more economical.

MR. FORNIA paused to explain the basic concept of both the defined benefit and defined contribution retirement plans. A defined benefit is like a pension or Social Security. A formula is used to define what the benefit will be so an individual can

figure out exactly what he or she will get every month. Most public servants across the country have both a DB plan and Social Security. Alaskan public employees [and teachers] do not have Social Security.

The other type of retirement plan is a defined contribution. The classic example of this is a 401(k). The only thing that's defined is the amount that is contributed and put into a fund. It's up to the individual to figure out how much to take out over the course of his or her retirement. Many private sector workers have a defined contribution through their 401(k) and a defined benefit through Social Security.

Whereas an actuary helps the administrator of a defined benefit plan decide how much to put into the fund in order to pay out the promised benefits, it's the individual in a defined contribution arrangement that has to figure out how much to pay him or herself over the course of their retirement.

MR. FORNIA displayed a chart showing an analysis of the benefits available from the DCR program compared to those from the latest DB tier. The hypothetical employees match those who testified earlier: a teacher, a police officer or firefighter, and other PERS member.

SENATOR FRENCH asked for an explanation of the "latest DB tier."

MR. FORNIA replied TRS Tier II for teachers [and PERS Tier III for police & fire and other PERS employees] is what he refers to as the latest DB tier.

CHAIR WIELECHOWSKI asked him to continue the presentation.

[10:20:23 AM](#)

MR. FORNIA said employees in the defined contribution retirement (DCR) program knew anecdotally they didn't like it and he decided to prove why they didn't like it by using math. For example, a hypothetical teacher who was hired at age 34 and retired at age 59 would receive a retirement benefit equivalent to 58 percent of his or her final average compensation under the latest DB tier [TRS Tier II]. Under the DCR program, the teacher would only be able to pay him or herself 34 percent of their final average compensation. He applied the same analysis to police officers and firefighters and other PERS employees with similar results. [Benefits for these hypothetical employees showed a 33 percent reduction for police and fire and 25 percent reduction for other PERS.]

MR. FORNIA displayed a bar graph to illustrate hypothetical benefits for a teacher whose final average salary was \$50,000. A teacher under TRS DB Tier II would receive a \$29,000 defined benefit. He said his calculations show that the teacher would only be able to pay him or herself \$17,000 under the TRS Tier III defined contribution plan. As a point of reference, he calculated what Social Security the teacher would receive if he or she participated in that system. It wasn't a whole lot better than just the Social Security benefit.

10:22:54 AM

MR. FORNIA said he took a different approach than Mr. Kiehl in looking at the annual economic impact of defined benefit plans. He relied on a study by the National Institute on Retirement Security that concluded, based on 2006 data, that PERS/TRS pension benefits accounted for \$1.3 billion in economic output, including the roughly 25 percent multiplier effect. That means that money that comes into an economy is spent back and generates additional revenues. He acknowledged that there was no attempt to determine how many PERS/TRS retirees still lived in Alaska and how many had moved elsewhere.

CHAIR WIELECHOWSKI noted that Mr. Kiehl used a \$0.8 billion figure and asked Mr. Fornia where the \$1.3 billion figure came from and if it included more than just PERS/TRS pension payments.

MR. FORNIA replied the \$1.3 billion figure came from a study by the National Institute on Retirement Security, an entity that looks at state and local government pensions. In addition to annual PERS/TRS pension payments, the number probably also included the closed police and fire plan. He reiterated that the study used 2006 data so the figure was probably higher now.

SENATOR FRENCH asked if he was also including the multiplier effect.

MR. FORNIA confirmed that the study did include the 25 percent multiplier.

SENATOR FRENCH posed a hypothetical situation of a retired teacher living in one of his apartments. She receives a pension check and pays rent to him. He uses the money he received to buy groceries for himself. He asked if those grocery store expenditures would be measured as part of that pension economy.

MR. FORNIA replied that's correct and reiterated that he did not attempt to identify whether or not the pension recipients were still living in Alaska. Mr. Kiehl's research showed a different number, but the point was that it's good for the economy.

He continued to point out that defined benefit retirement systems also provide healthcare benefits. Given that the state is the "payer of last resort," there is some risk that the state will later on have to pick up healthcare or other social assistance costs for destitute retired individuals, regardless of whether they're former public servants or former private sector workers. That risk is greatly reduced if not eliminated for retired public workers that have a pension, whereas under the DCR approach it's certainly possible that the retiree will need public assistance

[10:26:57 AM](#)

MR. FORNIA said consistent with the testimony from the public servants, DCR plans do not encourage retention. They tend to be effective at rewarding workers early in their careers, whereas defined benefit plans are better at rewarding workers late in their careers. He understands that Alaska recruits a lot of young, adventure-seeking teachers, police officers and firefighters from the Lower 48, but having only a defined contribution retirement vehicle encourages them to work just 5-10 years before moving someplace that offers a better retirement plan. Having just a DC plan implicitly undermines worker retention. He noted that he helps employers design retirement programs that match what they want their workers to do. Some industries, like high tech, encourage workers to bring the knowledge they learned in school and then move on after a few years. A DC plan is perfect for that kind of group. But the police and fire group is completely different and employers may not want those employees to move someplace else just a few years after they've been trained. For that group, the DB plan tends to be more desirable.

SENATOR GIESSEL asked what percent of Alaska private sector employees have a defined benefit plan.

MR. FORNIA replied most oil companies have DB plans and manufacturing tends to have them, but he agrees with the implication. For a variety of reasons, the private sector generally does not have defined benefit plans. Many companies that have had DB plans have either frozen or eliminated them.

SENATOR GIESSEL asked him to cite the reasons that private companies don't have DB plans.

MR. FORNIA replied the federal government requires private sector plans to be nearly 100 percent funded at all times because large private companies, like General Motors for example, might go bankrupt and leave the federal government to pick up the liabilities. By comparison, state and local governments tend to last in perpetuity and can absorb the potential liability. No state that he's aware of requires their plan to be 100 percent funded and that makes costs more stable. This hasn't happened on the private sector side.

A second reason is that in the 90s investment returns were very high and workers tended to think that DC plans were better. This made it very easy for companies to shut down their pension plans and shift to 401(k)s. These workers were very pleased through the 90s.

A third reason is the profit and loss (P&L) impact of having pension costs on the books. In the 90s this was beneficial because the returns on the investments were higher than the cost of the benefits. Beginning in year 2000, investment returns turned the other way and pension funds began to drag down profits. At that point, shareholders and Wall Street became more sympathetic of companies that were freezing or abandoning pensions. The corporate culture of "You're on your own" also alive and well. Turnover was higher and employee terminations were more prevalent than in earlier decades. It became a good business decision to dump the pension plan and it wasn't the company's problem if these people later needed state assistance.

SENATOR WIELECHOWSKI asked if any corporations do not fall within Social Security.

MR. FORNIA answered no. Private sector workers are covered by Social Security and that helps employers justify cutting their defined benefit plans.

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SENATOR GIESSEL asked if he regards Social Security as adequate and solvent.

MR. FORNIA replied Social Security helps a lot but it's certainly not adequate. The hypothetical teacher whose average salary was \$50,000 would receive about \$12,000 in Social Security when she probably needs \$40,000. With respect to

solvency, he said he personally believes that the public is being misled. Social Security has been around since 1938 and will probably be around forever. In a few decades it will probably have problems if nothing is done, but the fixes are relatively minor. He warned that he isn't encouraging Alaska to join Social Security, but it is certainly a good safety net and a good start in benefits.

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MR. FORNIA directed attention to the report, "A Better Bang for the Buck" and noted that he adapted it a little for Alaska. That analysis indicates that the DB approach saves money compared to the DC approach for three reasons: 1) longevity risk pooling; 2) portfolio diversification is maintained because, unlike individuals, they do not age; and 3) superior investment returns by virtue of professional asset management and lower fees.

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Longevity Risk Pooling - the First Strength of DB Pension Plans
DB plans cover large groups of retirees and pay out over the actuarially determined average life expectancy of the individuals in the group, not the maximum life expectancy. This avoids both the chance of running out of money in retirement and the "over-saving" dilemma. For example, the actuary tables may show that a 62-year-old retired teacher will, on the average, live to age 88, but she may actually live to age 93. If she is dependent on a DC or 401(k) type plan, she may be worried about outliving her savings and decide to try to stretch her money. To do that, she'll live on less. If she over saves and doesn't live beyond the average, the kids will end up with what's left. That means that part of the money that taxpayers put into that fund won't go to the teacher but instead to pay benefits to the kids of that teacher. That's not bad; it's just that the money isn't used for retirement. In fact, about 25 percent of DCR funds actually go to the kids. That's one reason that DC plans tend to provide less benefit for the same dollar or cost more for the same benefit.

By comparison, DB plans pool the longevity risk. Actuaries are good at predicting longevity of a big group. They can't tell who in a group will die in a given year, but they can tell how many in the group will die that year. This means the pooled plan can be much more efficient and use more of the money each year to pay retirees than an individual who is worried about outliving his or her savings.

Maintenance of Portfolio Diversification - the Second Strength of DB Pension Plans This is similar to the first idea. The 62-year-old retired teacher realizes that even though she's been a really good investor, she can't absorb the risk that she could in her 20s, 30s, and 40s. She has to become a more conservative investor now that she's older. Target date funds exemplify this idea. He noted that the police officer mentioned this type of asset allocation.

MR. FORNIA highlighted that the report makes the assumption that individuals will allocate less of their portfolio to stocks between age 62 and age 97. He displayed a bar graph that demonstrated that at age 62 more than 60 percent of the portfolio was allocated to stocks and by age 97 the stock allocation had dropped to between 10 and 15 percent. He noted that expected returns drop when the allocation becomes more conservative. [The graph showed that an 8 percent expected return at age 62 dropped to a 6 percent expected return at age 97.]

Pooled, Professionally-Managed Assets - the Third Strength of DB Pension Plans He said the report assumed a one percent annual differential, based primarily on studies by Towers Watson and CEM Benchmarking. Towers Watson looked at 14 years of data and large DB plans versus large DC plans. Responding to Senator Giessel's earlier question, he said the Towers Watson study found that in the best year DB plans outperformed DC plans by 4.8 percent and in the best year for DC plans they outperformed DB plans by 1.5 percent. That's the nature of investment returns so it's not a surprise that the ARM Board reported a 21 percent return while the DC plan returned 22 percent, he said. It was quite the opposite the year before; the DB plan had bad returns and the DC plan had really, really bad returns. The Towers Watson study reported that in 2008 the DB plan returned 2.6 percent more than the DC plan; in 2007 the DB plan returned 0.3 percent more than the DC plan; in 2006 the DB plan returned 1.1 percent more than the DC plan. The fluctuation is wide but over several economic cycles defined benefit plans tend to outperform defined contribution plans.

MR. FORNIA said this makes sense for two reasons. One is that DB plans have lower investment expenses. There doesn't have to be an education expense to teach police officers and teachers how to invest; there doesn't have to be a phone line expense so that individuals can call in and transfer from one vehicle to another; and assets are typically sold in huge blocks, which is less expensive. The second reason is that the investment

managers are professionals. They tend to take a disciplined approach and don't overreact when the market rises and falls. Investment advisors tend to be better at investing than non-professionals.

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SENATOR GIESSEL observed that five years ago you didn't hear about states that were insolvent or cities and states that were looking to make changes to their pension plans because they couldn't afford them any longer. She asked how he can advocate for a DB plan when so many cities and states were drowning in debt. She further asked if he was prompted to suggest that DB plans were better for Alaska because it was one of just three or four states not considering bankruptcy.

MR. FORNIA replied he was advocating for a well-funded defined benefit plan. Going forward it's critical that the state monitor and fund the level of benefits it can afford and SB 121 structures a plan that will have costs comparable to that. While it's possible that the actuaries' assumptions will be worse than expected, it's equally possible that they will be better than expected. They could in fact help pay off the unfunded liabilities that are attributable to PERS/TRS Tier I and prior benefits. If you don't convert, he said, it's likely that the state will pay those benefits to workers later when they are in poverty given that the state is the payer of last resort.

He emphasized that converting back to a DB plan wasn't a panacea and it certainly put more risk on the state, but the expectation was that it will be a better economic decision for the state.

SENATOR GIESSEL asked if he was aware that the state pension plan lost \$1 billion this year and if that factored into his recommendation.

MR. FORNIA replied he wasn't aware of the exact amount, but he did know that markets were down this year. He stressed the importance of being disciplined and cautioned against being deceived by even a decade-long up-cycle. Markets are not certain but states are the classic investor to take on this type of risk because they are long-term entities. Alaska is reasonably prosperous and is in an excellent position to take on risk like this.

CHAIR WIELECHOWSKI asked Mr. Fornia to continue.

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MR. FORNIA said the next consideration is the state retirement system's unfunded liabilities, which are in excess of the assets. It comes as no surprise that the liabilities have increased in the last five years since the payoff is over a relatively long time horizon. While there was some hope that Senate Bill 141 would solve the unfunded liability problem, there really was nothing in the bill that had a chance of solving the problem. The unfunded liabilities clearly are a problem but they are attributable to the past, primarily to Tier I benefits. An ongoing, well-funded, well-managed defined benefit plan should not increase liabilities. Because the state is the payer of last resort, it potentially will have to pay the benefits anyway if it sticks with the DC plan. By switching to a DB plan, those payments will be advance-funded and will prevent the creation of future unfunded liabilities. The cost isn't left to future generations.

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MR. FORNIA said the idea behind SB 121 was to design a plan that had costs that were reasonably comparable to the costs in the DCR plan. He explained that the actuaries for the Division of Retirement and Benefits prepare annual reports on the financial status of PERS and TRS. They conduct an actuarial valuation of the people in the system to determine the normal cost to provide the benefit going forward. They look at things like when the employee might retire, if their compensation will rise, and if they'll quit. Once the actuaries calculate those costs they look at how much they'd have if all their assumptions were true (most important here was the 8 percent return) and that amount was funded to come up with the actuarial liability. The difference between the two is the unfunded liability.

MR. FORNIA said he used the normal costs that the DRB actuaries came up with to figure out the cost to convert from DCR to the new DB Tier. The pension benefits would be basically the same as PERS Tier III and TRS Tier II and the healthcare benefits would be in between. They'd be stronger than the DCR healthcare benefits, but not as strong as the PERS Tier III and TRS Tier II benefits.

He highlighted that the pre-2006 benefits were already fairly modest compared to other state and local governments around the country. The switch from Tier I for both PERS and TRS resulted in a substantial reduction in benefits for the subsequent tiers. Another feature is that the workers contribute to the plans at the same levels as pre-Senate Bill 141. But the retiree health benefits will be lower. Retirees will not be eligible to receive

coverage until age 65 unless they've had either 25 or 30 years of service.

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MR. FORNIA displayed a chart that compared cost estimates for teachers in three different tiers: TRS DB Tier II, TRS DCR Tier III, and the proposed TRS DB Tier IV. He noted that the new assumptions were probably a little higher, but not materially different.

The actuary calculated that the ongoing cost of pension benefits for TRS DB Tier II was 11.39 percent of payroll. The teachers contribute 8.65 percent so the net cost to the employer was 2.74 percent. He said it's his opinion that an ongoing contribution of 2.74 percent of payroll isn't really excessive for the state to pay for a retirement benefit for these people. The total contribution is lower than 12.4 percent, which is what Social Security would be. The healthcare plan for this tier is pretty good and should cost 5.33 percent so the total ongoing cost to the government is a little over 8 percent of pay. [8.07]

MR. FORNIA noted that Alaska is unique in that it is one of a very small number of states that has prefunded retiree healthcare benefits to any extent. The vast majority of states have almost nothing set aside. Alaska workers put in 8.65 percent and the state contributes 8.07 percent, which is way more than the pension costs and it covers a good chunk of the retiree healthcare cost. He noted that what the chart and subsequent bar graph doesn't break out is the amount the state is paying for Tier I workers, which is per the unfunded liabilities for the past.

MR. FORNIA said the revised fiscal note will confirm the numbers, but he assumed roughly a \$60 million payroll for FY11. From that he figured the total employer cost for TRS DB Tier II to be about \$4.8 million.

The cost for TRS DCR Tier III works quite differently. There is no such thing as a normal cost because no benefit is promised. The member contributes [8 percent] of pay and the employer contributes 7 percent. The occupational death and disability cost is 0.05 percent, the medical normal cost rate is 0.64 percent (mostly post age 65) and "you enable them to set aside 3 percent into an HRA, a healthcare retirement account, and so your total cost is 10.69 percent."

MR. FORNIA said he used the actual numbers that the actuary reported to develop the cost comparison charts. He opined that's probably what prompted the Alaska Public Pension Coalition to question why the state shouldn't switch back to a DB plan. Total employer cost under TRS DCR Tier III was 10.69 percent and only 8.07 percent under the previous TRS DB Tier II. He noted that the numbers for police and fire and other PERS employees were relatively similar.

What they proposed and what SB 121 does is establish a new TRS DB Tier IV [and PERS DB Tier V] with the same pension benefits as the previous DB tier. For teachers, the total retirement normal cost would be 11.39 percent; the teacher would contribute 8.65 percent and the employer would contribute 2.74 percent. The medical cost would be a little less at 4.52 percent because retirees would have to wait for the benefit until Medicare eligibility at age 65. The total cost to the employer would be 7.26 percent, which is a little lower than either TRS DB Tier II or TRS DCR Tier III. He said his analysis was that the new tier should be relatively cost-neutral or even save money.

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MR. FORNIA directed attention to the cost comparison chart for PERS police officers and firefighters and noted that the savings were not as substantial because the benefits under PERS DCR Tier IV were more significantly less than PERS DB Tier III. These costs might therefore be a couple of hundred thousand dollars a year more. The cost comparison chart for other PERS members showed a little savings. [Total employer cost under PERS DB Tier III was 9.83 percent, under PERS DCR Tier IV it was 8.72 percent, and under proposed PERS DB Tier IV it would be 6.43 percent.]

MR. FORNIA said his conclusion was that converting to a DB plan would be significantly better for the workers and, absent the transition costs, it could drop the total employer cost by a few million dollars. He noted that while the revised fiscal note wasn't out, his expectation was that it would be in the zero range.

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MR. FORNIA said the Department of Administration withdrew the initial fiscal note once they realized they'd misinterpreted some things. He explained that the confusion centered on the "normal cost rate" for retiree healthcare. The actuarial reports in 2009 and 2010 showed normal healthcare costs in the 5.5 percent range. He noted that his calculations indicated the

normal cost rate would be about 4.5 percent but the fiscal note showed they would be 12 percent to 15 percent of pay. He further explained that he was waiting for Buck Consultants to figure out the actual transition costs because they had better data on individual accounts. He reiterated his expectation that the revised fiscal note would show more comparable costs.

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MR. FORNIA summarized his conclusions:

- Senate Bill 141 did not solve the unfunded liability problem.
- DB plans are more economical in general and particularly in Alaska where the state doesn't participate in Social Security.
- DCR costs are comparable to the latest DB tier costs.
- SB 121 accomplished the goal to structure a new DB tier at very little or no additional cost.

CHAIR WIELECHOWSKI thanked Mr. Fornia and informed the committee that the administration would have an opportunity today and later in Fairbanks to give its perspective on the bill. The hearing in Fairbanks would be the reverse order of this one with the administration getting the bulk of the time.

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CHAIR WIELECHOWSKI announced a short recess.

[11:22:38 AM](#)

CHAIR WIELECHOWSKI reconvened the meeting.

[11:22:45 AM](#)

MIKE BARNHILL, Deputy Commissioner, Department of Administration (DOA), said he was testifying on behalf of the Parnell Administration in opposition to SB 121. He explained that DOA did submit a fiscal note earlier, but subsequently realized that the actuary had built past service costs into the transition costs. What the bill does instead is essentially create a new DB tier. It hits the reset button and eliminates any past service costs from the legacy of DB plans.

In opposing SB 121, the administration expresses the utmost respect and thanks to the dedicated public servants that work for the State of Alaska, its school districts, and municipalities around the state. As the witnesses today and in past hearings ably demonstrated, these public servants work hard and they deserve a good retirement.

It is out of that respect that forms the core basis for the administration's opposition to the bill. If the administration has learned anything from the past few decades of experience with the DB plan, it is that large unfunded liabilities can arise at any time for a large number of reasons. The Mercer case represented one of those reasons, and that was actuarial negligence. But unfunded liabilities can arise for other non-negligent reasons: investment losses, change in assumptions, change in mortality, increased longevity, and change in retirement behavior.

Pension benefits are long-term promises that the state and municipalities and school districts make to employees. Any DB promised made today to a 20-year-old will be relied upon in 40 years and for an additional 30 years after that. That's a 70 to 80-year promise.

The administration's primary concern is that right now the fiscal structure of the state is uncertain. It relies almost entirely on revenue from TAPS throughput to support the general fund. That throughput has been down consistently, with a few minor up ticks, every year since 1989. Until this state is back on a stable fiscal path, the administration believes it is imprudent to make promises that could last 70 to 80 years. He expressed personal concern that if an unfunded liability arose in the new plan 60-70 years from now, the state might not have the general fund resources to backstop those promises.

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Recent experience in other public plans demonstrates the danger. Since the last hearing on SB 121, there have been reports of two local public pension plans that have gone bankrupt and defaulted, one in Rhode Island and one in Alabama. The administration doesn't want to put public servants in that position 60-70 years from now. This isn't being pessimistic about the future of Alaska; it's being realistic about where the state is today. Although a DB plan has good characteristics, it's difficult to support making promises until the state's fiscal situation turns around.

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MR. BARNHILL said Alaska is different than other states because it doesn't have a state income tax or a statewide sales tax so the general fund revenues that backstop the PERS/TRS system come from oil funds. Other states don't have this and taxpayers are beginning to revolt and tell their legislatures they don't want to backstop these promises. That's what happened in Colorado,

South Dakota, Minnesota, and probably in New Jersey. While there's litigation challenging the authority of legislatures to make changes, the fact remains that taxpayers are saying, "Don't do it." He warned against putting Alaska in that position.

SENATOR MEYER asked if the state had seen higher turnover rates since the DC retirement program was put in place because the testimony indicated that would be the case.

MR. BARNHILL answered no. In FY06, the year before Senate Bill 141 went into effect, the separation rate was 15 percent. That reflects the fact that Alaska will always have a fair amount of transition in its working population. In FY11 the separation rate was 12 percent. He opined that the poor economy in the Lower 48 was the primary reason for the lower transition rate; employment opportunities in Alaska were relatively better even under a defined contribution plan. It's reasonable to assume that the number will again climb to 15 percent once the economy improves. He said he couldn't speak to municipalities or school districts over that time period. He offered to provide the link where DOA's Division of Personnel posts the state employee transition report.

SENATOR MEYER observed that a few municipalities did not join PERS and still had their own programs.

MR. BARNHILL responded that about 160 employers participate in PERS and the TRS population is comprised of about 60 school districts. The State of Alaska is a PERS employer.

SENATOR MEYER asked how SBS factors into the total retiree pay.

MR. BARNHILL explained that in the early 1980s after the federal government gave state and municipal governments the opportunity to opt out of Social Security, Alaska state employees voted on the issue. At that time the FICA or Social Security deduction was about 6 percent with an employer match and the combined total went into the Social Security Trust Fund. The SBS program was similarly structured; six percent was deducted from the employee check, the employer matched it and the total was placed in an account that the employee can manage.

He suggested that it's a stretch to say that folks in Alaska don't have a safety net. If another vote were held today, he'd be stunned if the majority voted for that so-called safety net and surrender their SBS account.

SENATOR FRENCH commented that the vote he'd find more interesting is whether PERS Tier IV employees and TRS Tier III employees would vote to join a defined benefit retirement program or stay in the defined contribution program. He pointed out that when the vote took place in the 80s, the Social Security-type program under SBS was PERS. That was the defined benefit retirement like Social Security.

MR. BARNHILL responded, "If the Legislature wants to put some sort of referendum in the bill and it passes, it would be interesting to see."

REPRESENTATIVE LYNN asked if he's disputing Mr. Fornia's testimony that defined benefit plans are more economical for Alaska and that the costs are comparable to PERS Tier III and TRS Tier II. He observed that if DB plans are more economical, there would be less chance of the state running out of money if it changed back.

MR. BARNHILL said he believes that Buck Consultants' revised fiscal note will show that normal costs for the proposed new DB tiers will be less. That's because the system-paid medical benefit is deferred five years until age 65 when the retiree is Medicare eligible. However, the experience over the past 20 years with DB plans shows that you can't look at just normal costs. You have to look at the total cost, which includes past service costs.

Normal costs are the calculated amount that the employer and the employee have to contribute and save now in order to pay the benefits that will come due later. That calculation relies on dozens of assumptions that the actuary makes in conjunction with the ARM Board. If all the assumptions are borne out, the system never has to pay any more than the normal costs. But that never happens and it certainly hasn't happened in the last 20 years here in Alaska.

CHAIR WIELECHOWSKI asked if the administration agreed with the three reasons that Mr. Fornia gave that a DB plan was more economically efficient. Those were longevity risk pooling, maintenance of portfolio diversification, and superior returns.

MR. BARNHILL replied he was building to the punch line. He pointed out that if you were to hit the reset button back to 2006 and create a new defined benefit tier that assumed an 8.25 percent return, that assumption would have already been frustrated. The system has had losses in 2 of the 5 fiscal years

since FY07. It lost 3 percent in FY08, 20 some percent in FY09, and it gained 21 percent in FY11, but the average return in that 5-year period was 4 percent. His perspective is that SB 121 creates a new system that will start with an unfunded liability.

MR. BARNHILL said he agreed with Mr. Fornia that by virtue of pooling DB plans have been able to outperform because they're less expensive to administer. It was for that reason that DOLPF enacted regulations for DC plans to require that employees default into different types of defined contribution options, one of which is the target date option. This option addresses the concerns. First, it provides pooling. Second, employees don't need investor education. Target date plans project when an individual is likely to retire and adjust the asset allocation in the account automatically as the individual gets older. He said he believes the target date plan may be one reason that the DC outperformed the DB in FY11. These plans address the concerns so it's not fair to say that they are issues going forward.

[11:43:17 AM](#)

MR. BARNHILL said he was gratified by Mr. Kiehl's balanced presentation and pleased that he recognized the benefits of the DC plan. Everyone can probably agree that DC plans are attractive to folks that have no intention to stay in a job. The disagreement is whether there is much benefit to an employee who stays for a long period of time in a DC plan. He challenged the assumption that it's a bad deal because it ignores the miracle of compounding in an investment portfolio. Even at low rates of return, the number gets fairly big when money is invested regularly over a period of 35-40 years.

He suggested that for the meeting in Fairbanks that Mr. Fornia and Buck Consultants work together to develop a model of a hypothetical employee so that the committee can look at a number of scenarios under both a DB plan and a DC plan. He opined that the committee will find that an employee under DC that works a long time and invests regularly will end up with enough money to get through retirement. It probably won't be as good as the defined benefit but it will be enough.

CHAIR WIELECHOWSKI said he liked the idea of the actuaries working together on a model.

SENATOR GIESSEL asked the current total of the unfunded liability in the pension program.

MR. BARNHILL replied the FY10 valuation showed \$11 billion.

CHAIR WIELECHOWSKI asked Mr. Fornia if he'd like to respond.

[11:47:50 AM](#)

MR. FORNIA pointed out that the miracle of compounding is equally effective for the retirement system itself. The ARM Board has a 70-80 year time horizon and it can periodically adjust contributions as the unfunded liability goes up or down. He said the idea that the future is uncertain is accurate. But employees have an equally uncertain future and they have a shorter future than the state. The philosophical question is whether the individual or the state is better to deal with the risk of the uncertain future. With regard to Social Security, he reminded everyone that teachers don't have SBS. He reiterated that he wasn't suggesting the state return to the Social Security system. It tends to favor lower wage workers and for Alaska it would be a less effective use of the money than either DB or DC. He agreed that target date funds accommodate some of the concerns put forth in his report but they still have higher expenses than a pooled DB plan. The 401(k) industry is working to get through the inherent hurdles but they still exist and the expenses are higher. He acknowledged that there will certainly be people who will have made the right decision in choosing DC. Finally, he said he'd be happy to work with Buck Consultant on a model.

CHAIR WIELECHOWSKI thanked the participants.

[11:52:25 AM](#)

There being no further business to come before the committee, Chair Wielechowski adjourned Senate State Affairs Standing Committee meeting at 11:52 a.m.