

**ALASKA STATE LEGISLATURE**  
**SENATE STATE AFFAIRS STANDING COMMITTEE**  
**FAIRBANKS, AK**

October 13, 2011  
12:04 p.m.

**MEMBERS PRESENT**

Senator Bill Wielechowski, Chair  
Senator Joe Paskvan, Vice Chair  
Senator Cathy Giessel

**MEMBERS ABSENT**

Senator Albert Kookesh  
Senator Kevin Meyer

**OTHER LEGISLATORS PRESENT**

Representative Bob Miller  
Representative Scott Kawasaki  
Representative David Guttenberg

**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
09/15/11	(S)	-- Testimony <Invitation Only> --
10/13/11	(S)	STA AT 12:00 AM Fairbanks

**WITNESS REGISTER**

JESSE KIEHL, Staff  
Senator Dennis Egan  
Alaska State Legislature  
Juneau, AK

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

SEAN M. GENSON, representing himself  
Fairbanks, AK

**POSITION STATEMENT:** Testified in support of SB 121.

ERIC DANIELSON, representing himself  
Fairbanks, AK

**POSITION STATEMENT:** Testified in support of SB 121.

BRIAN COOPER, representing himself  
Fairbanks, AK

**POSITION STATEMENT:** Testified in support of SB 121.

JEFF THOMAS, representing himself  
Fairbanks, AK

**POSITION STATEMENT:** Testified in support of SB 121.

MICHAEL LAMB, CFO  
Fairbanks North Star Borough  
Fairbanks, AK

**POSITION STATEMENT:** Testified in support of SB 121.

MICHAEL BARNHILL, Deputy Commissioner  
Department of Administration  
Juneau, AK

**POSITION STATEMENT:** Testified in opposition to SB 121.

DAVID H. SLISHINSKY, Principal and Consulting Actuary  
Buck Consultants, Inc.

**POSITION STATEMENT:** Responded to questions and explained the DOA's revised fiscal note for SB 121.

WILLIAM B. FORNIA, President  
Pension Trustee Advisors

**POSITION STATEMENT:** Commented on the revised fiscal note and responded to questions related to SB 121.

**ACTION NARRATIVE**

[12:04:57 PM](#)

**CHAIR BILL WIELECHOWSKI** called the Senate State Affairs Standing Committee meeting to order at 12:04 p.m. Present at the call to order were Senators Paskvan, Giessel, Thomas and Wielechowski. Representatives Miller and Kawasaki were also present.

**SB 121-TEACHERS & PUB EMPLOYEE RETIREMENT PLANS**

12:05:59 PM

CHAIR WIELECHOWSKI stated that the committee was meeting to continue the discussion regarding the type of retirement system the State of Alaska, 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) system to a defined contribution (DC) system. Under a DB system, retired employees receive a defined monthly check based on salary and years of service. He noted that most state, municipal, and school district 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; DC 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 is to design a system that would cost the State of Alaska, municipalities and school districts less than the current PERS Tier III DB system. He noted that based on the most recent fiscal note, that goal might not have been achieved. Therefore, one objective today is to discuss ways to move closer to that goal. Mr. Slishinsky from Buck Consultants, Inc. and Mr. Fornia with Pension Trustee Advisors will discuss the bill and its costs, he said.

CHAIR WIELECHOWSKI recognized that Representative David Guttenberg had joined the meeting.

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JESSE KIEHL, Staff to Senator Dennis Egan, prime sponsor of SB 121, extended apologies on behalf of Senator Egan. He was fulfilling a commitment to the Senate President and was therefore unable to attend the meeting today.

MR. KIEHL explained that SB 121 gives newly hired state, municipal and school district employees the opportunity to choose the type of retirement system that best fits their public service to Alaskans. Each system has its strengths, and each system has its weaknesses. The defined benefit (DB) system guarantees a formula-based retirement check and a healthcare benefit, but it takes a long time to earn that check, and longer still to earn the healthcare benefit.

In a defined contribution (DC) system, the employee gets to keep the money he or she put in, and after a certain amount of time the money that the employer put in also belongs to the employee. The employee controls the investments, and thus has the opportunity to beat Wall Street, but there are no guarantees.

In addition to the choice between a DB and a DC retirement system for a new hire, SB 121 creates a new tier for employees who choose a defined benefit. In the new tier it is harder still to earn the medical benefit; the employee has to either work a full career or be Medicare eligible at the time of retirement in order to qualify. This makes it easier to predict what to put away now, in order to fund those benefits in the future.

SB 121 gives employees currently working in the defined contribution system one opportunity to make an irrevocable election to convert to the new defined benefit tier. Any new hire that does not make a selection will be defaulted into the DB system, largely because it provides the public a better bang for the buck. The DB system is more economically efficient, provides a better stabilizer for the Alaska economy, and encourages retirees to stay in Alaska when their public service career ends.

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MR. KIEHL said SB 121 was designed to be, at worst, cost neutral to the state and public employers. While there hasn't been time to thoroughly review the updated fiscal note, he looks forward to hearing the analysis and the thinking that underlies it. He emphasized that Senator Egan is committed to making SB 121 a workable bill and a good deal for the state and Alaska's public servants. He said it appears that flexibility will be necessary,

and the sponsor looks forward to working cooperatively with the committee and the administration to accomplish this goal.

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REPRESENTATIVE DAVID GUTTENBERG asked if he's saying that he doesn't have the underlying details to fully understand the cost projections in the fiscal note.

MR. KIEHL replied he is casting no aspersions; it's just that more time is needed to delve into the underlying methodologies. It's possible that there will be questions, just as there were with the previous fiscal note. Listening to the testimony today and participating in the analysis should be informative for everyone, he said.

SEAN M. GENSON, representing himself, said he teaches history at West Valley High School in Fairbanks, but he might not be able to make this a long-term career in Alaska, unless he has a better retirement option. SB 121 will help in this decision-making process. Mr. Genson explained that he is 39 years old and has taught for four years as a TRS Tier III employee. Because he doesn't have a retirement plan he can count on, he does what he can to put aside extra money for retirement. Instead of saving for a down payment on a house, he lives in a cabin without running water. He knows that he's becoming a better teacher every year, but he doesn't know how he'll be able to continue for a full career. He doesn't want to leave Alaska, but he might have to if he wants to keep teaching. He doesn't want to quit teaching, but he might have to quit if he wants to stay in Alaska.

MR. GENSON said it takes a new teacher a few years to figure things out and get things working smoothly. The defined contribution plan is a huge disincentive for teachers to stay on after they've figured things out. In fact, it tends to push talented and experienced teachers out of the system after just a few years.

MR. GENSON said he won't leave teaching because he can't do it, or because he doesn't want to do it. He is honored to work with students as they develop into responsible and thoughtful citizens. But he might have to leave Alaska to teach in a state that offers a dignified retirement after a career spent working with kids. The DC plan isn't just harmful to plans for old age, and it isn't just harmful to the economic need to keep educated professionals in the state. It is also harmful to children's

education. He urged the committee to think about Alaska's future and advance SB 121.

12:22:16 PM

SENATOR GIESSEL asked how long he has lived in Alaska and in Fairbanks and what he did before becoming a teacher.

MR. GENSON replied he moved to Alaska in about 1995 and to Fairbanks in 2005. Before becoming a full-time teacher, he worked as a substitute teacher and in fine-dining restaurants. His work experience also includes sea kayak guide and commercial fishing.

REPRESENTATIVE BOB MILLER asked if he knows other teachers that have similar feelings about the defined contribution retirement system.

MR. GENSON answered yes.

REPRESENTATIVE MILLER asked if he would say a majority feel the same way.

MR. GENSON said yes.

REPRESENTATIVE BOB MILLER asked if he believes that if SB 121 were to pass, that he would have more free cash that he could use to help drive the economic engine in Fairbanks.

MR. GENSON said he believes that would be the case. Responding to a further question, he said he believes the same would hold for other teachers. He and his colleagues have had many conversations on the topic.

12:24:07 PM

REPRESENTATIVE GUTTENBERG asked if he feels it's more secure to make his own investment decisions, as opposed to having the state manage the account.

MR. GENSON replied he doesn't want to bet on his investing skills. He doesn't want to work towards what is essentially a gamble.

SENATOR THOMAS asked if he'd noticed that the DC statement shows that his account is automatically rebalanced on a regular basis.

MR. GENSON replied he looks at the statement, but he doesn't pay attention to allocations.

12:26:54 PM

ERIC DANIELSON, representing himself, said he is an airport police and fire officer and a PERS Tier IV defined contribution employee. He also serves as vice-president of the Public Safety Employee Association (PSEA) representing Alaska State Troopers, state fire marshals, the airport in Anchorage, and multiple municipal fire and police departments. In the past, the State of Alaska recognized that these professions are inherently dangerous and hazardous, but that is no longer the case. Under the DC plan, police and fire officers are expected to work until age 59 1/2; this ignores the fact that law enforcement officers and fire fighters have a lower life expectancy than the general population. The people that have chosen these professions exhibit the qualities of loyalty, integrity, and courage. The DC plan doesn't recognize this, but the DB plan would, he stated.

MR. DANIELSON said it takes very special individuals with select training to become part of the law enforcement and fire fighter communities. There is great demand for these skills. The state of Alaska provides this specialized training to DC employees and then it loses the training and skill when the employee moves on. Mr. Danielson said he'll vest next summer and he and other DC employees are looking at other options, because Alaska isn't competitive. He noted that in Fairbanks, the DC employees who want to stay in Alaska oftentimes transfer to the federal system, because it offers a pension.

MR. DANIELSON said about half of the front-line employees in his department are in the DC system. It's one of the main topics around the lunch table and a huge distraction. Some employees find it stressful to watch the market and some are already looking at other options. Defined benefit employees within the department question why DC employees stay around, even for the five years it takes to vest. They point out that the 18 months of training that costs tens of thousands of dollars is portable. For example, law enforcement officers in Austin, TX can retire after 23 years of service. The pay and benefits are comparable, but that system offers a pension after 23 years that is 73 percent of pay. Alaska can't compete; he can get experience and training here in Alaska, and after vesting in 5 years he can move to Texas where the cost of living is lower.

MR. DANIELSON said he realizes that his account goes up and down with the market, but right now his account is worth less than the combined total of what he and his employer have contributed over the past 4.5 years. This doesn't bode well for being able

to retire, particularly in Alaska where the cost of living is higher. He cautioned that there will be a huge leadership gap in departments if the state loses a generation of employees. He urged the committee to pass SB 121, and return to a defined benefit system.

[12:35:43 PM](#)

SENATOR GIESSEL observed that the discussion is about risk. In a defined contribution plan the employee assumes the risk, and they have the option of managing their account or having the state do it. She asked who bears that risk in a defined benefit plan.

MR. DANIELSON replied he would argue that both the employee and the state manage the risk. Great-West Retirement Services managed his account for about 3.5 years, and the returns were much worse than the stock market. Now he manages the money himself.

[12:38:55 PM](#)

BRIAN COOPER, representing himself, said he works for the Fairbanks Fire Department and is a PERS Tier IV defined contribution employee. He has lived in Fairbanks his entire life, and received his paramedic degree and associate degree in municipal fire control in Alaska. While going to school, he worked at the university fire department and received on-the-job training. He ran into burning buildings, drove and operated fire trucks, and served as lead medic. That experience gave him a significant advantage and the option of working anywhere in the nation, but he wanted to stay in Alaska and work for the Fairbanks Fire Department.

MR. COOPER said he's worked for the City of Fairbanks for about 2.5 years and he's questioning whether or not to stay. Two coworkers who were hired at the same time have already left or are in the process of leaving. Although it's said that portability is a benefit of the DC system, portability isn't a benefit in the firefighting profession. If he spends 5 years as a fire fighter in Fairbanks, he'll again be at the entry level if he moves to another state or even to another town in Alaska.

Being a fireman is a physically and mentally taxing career. Even the sticker in his helmet warns that firefighting is an ultra-hazardous occupation. One of the concerns with being a PERS Tier IV employee is that, even after decades of service, he won't receive the medical benefit in retirement. Moreover, he'll have to work longer to be eligible for retirement, even though there

aren't many fire fighters on the front lines that are older than age 60. Given the choice, he would convert to a defined benefit plan.

12:46:15 PM

JEFF THOMAS, representing himself, said he's been a heavy equipment operator with the Department of Transportation and Public Facilities (DOTPF) for 4.5 years. He's a defined contribution employee. Wintertime duties include snowplowing, keeping ice off the roads, and thawing culverts. Activity during the summer includes asphalt patching, brush clearing, and painting stripes on the roads.

MR. THOMAS said recruitment and retention has become a problem for the department with its Tier IV employees. He's heard that 7 of 10 prospective hires fail the entry-level test for an equipment operator. Retention is a particular problem with the DC system. The state puts a lot of time, effort, and money into training and it's probably 3 years before an operator has a good handle on both routes and equipment. He's seen a number of operators leave before they are fully vested, because they can move to the operating engineers union and get better pay and better benefits with a predictable retirement.

The defined contribution retirement is dependent on stock market returns, which has been frightening. He agreed with previous testimony that Great-West Retirement Services isn't doing a very good job, but he's not interested in learning about investing himself. Being an equipment operator is physically taxing and at the end of a career it would be nice to have a predictable retirement with healthcare benefits. He offered his belief that retention would improve, and it would save money in the long run, if the state were to return to a defined benefit system.

REPRESENTATIVE GUTTENBERG said Mr. Cooper affirmed a statement he's made correlating numbers of lost mailboxes to numbers of new equipment operators on the road.

12:50:39 PM

MICHAEL LAMB, Chief Financial Officer (CFO), Fairbanks North Star Borough, said he has spent an inordinate amount of time over the past six years studying and working on PERS/TRS issues. He acknowledged that there are differing and valid views on the defined benefit and defined contribution systems.

MR. LAMB concurred with all the points in the sponsor statement and warned that recruitment and retention will become a larger

issue as the economy improves and boomer demographics shift. Those employees who held off retirement during the downturn will begin to depart the labor force in above average numbers, leaving a profound hole in all labor forces. He said he has testified before, and continues to believe, that both DB and DC plans should be available. In some instances it's logical to use the DB plan, but there are also occasions where it is beneficial to both the employee and employer to use the DC plan. For example, Alaska has the highest per capita percentage of military retirees in the nation. These skilled and highly trained individuals already have the benefit of a federal DB retirement, so it's logical to offer them a DC plan.

MR. LAMB said he finds it troubling that the Division of Retirement and Benefits (DBR) has taken a formal position that any PERS employer that accesses short-term grant funds for any salary-related position could be subject to a 30 year termination cost. Employers were told to avoid any future liability by keeping those grant-related dollars out of the PERS system. He said he disagrees with that logic, and would argue that short-term positions that are paid for with grant dollars ought to be inside the PERS system, and under the umbrella of a DC plan. Many short-term employees would be far better off in a DC plan, and employers are happy to get those employees even if it's a short-lived relationship. However, there are also groups of employees that are career oriented and should have the DB option.

MR. LAMB opined that SB 121 is correct policy for the state and for employers, but it should go a step farther and amend the statutes. An employee who retires from a DB system and is rehired by any PERS employer should not be able to go back into a DB plan. A DB retiree, who chooses to return to work, should be in the DC plan. He acknowledged that there may have been instances of bad behavior with regard to the double-dip question, but in most instances there is absolutely nothing improper about an employee returning to work while they continue to draw their legitimately earned benefits. Anyone opposing that philosophy is essentially saying that a military retiree who is drawing a well-earned pension should not be able to return to work and draw a salary from another employer, especially a government employer. That doesn't make sense. He noted that he frequently hears about this issue from employers across the state.

MR. LAMB said that using both systems and allowing a retired DB employee to go back to work as a DC employee will go a long way toward helping employers recruit and retain needed workers.

MR. LAMB said it's important to understand that government employers are perpetually in a recruiting mode, competing for an ever shrinking labor force. He highlighted the following examples to support this position:

1) The borough had a good engineer resigned when his spouse was offered a good position in another state. In the end, the couple didn't like the new lifestyle and moved back to Alaska. Although the borough had an unfilled engineering position and tried to rehire the engineer, it wasn't possible to compete financially once the person left the borough. That was a major loss of skill and institutional knowledge for the borough. That is difficult to factor into a fiscal note as related to DB versus DC plans. It's also difficult to factor in that DB salaries are generally lower than DC salaries, but if it's necessary to raise salaries to cover the difference, that adds to the fiscal note component.

2) His nephew received a Washington state teaching degree, with an emphasis in math. His wife received a teaching degree with an emphasis in special education. They both got teaching jobs in Fairbanks; she had a full-time special education position and he was a substitute teacher. They left the state last summer, because it didn't pencil out to stay in Alaska and teach. The state lost two smart and dedicated teachers, because it offers neither Social Security nor a DB pension.

3) One Saturday morning he met Attorney General John Burns in the locker room and hoped to talk to him about the troubling legal advice that retirement and benefits was getting from the AG's office related to termination study regulations. However, the attorney general wanted to talk about the number of attorneys within his office that are eligible to retire, and he was questioning how he was going to recruit and hire attorneys under the current PERS system. Mr. Lamb opined that if some of those defined benefit attorneys could retire and then return as DC employees, if there were unfilled positions, John Burns could spend less time working out to relieve stress.

MR. LAMB said he read through the October 7, 2011 fiscal note, and the numbers and basis for the numbers gave him very little comfort as compared to the independent analysis provided to Senator Egan by Pension Trustee Advisors. The latter could be followed and actually incorporated DC plan reductions.

MR. LAMB said he's argued with a lot of CFOs who completely dismiss or are very suspect of the accuracy of actuarial reports. For a long time he was a holdout, but would now caution that unless you fully understand all the variables and assumptions being used in any actuarial projections, and unless you know who has influence in choosing the assumptions used in the projections, then you should take such estimates with a grain of salt when trying to establish, with certainty, which plan will cost more or less in the future. He opined that it's likely that both plans will cost about the same as laid out, since the medical component is no longer such a major variable. The unrecognized cost of not having a DB system is likely to far exceed any cost differential, he stated.

[1:01:07 PM](#)

SENATOR GIESSEL asked what the unfunded liability is today for the defined benefit program.

MR. LAMB replied the number as of June 30, 2011 was \$11 billion.

SENATOR THOMAS asked his professional opinion about how the state got into the hole, how it might get out of the hole, and if it would be beneficial to change the system.

MR. LAMB said the system became unfunded because the normal cost rate was set too low. When he reviewed a retirement and benefits presentation, he noticed that it included a chart that used financial statements from when the system was positive and whole. The problem is that those financial statements didn't use the correct actuarial numbers, because they did not show a decline in value until about 2000. In 1995 the state paid for a report that warned the state to look at the actuarial numbers that were being used, but that didn't happen. "Essentially, the biggest deal really had to do with incorrect actuarial numbers and incorrect medical component," he stated. Although there was a lot of argument that the market went bad, the truth is that it was the market starting in 2008/2009 that clearly had an impact.

MR. LAMB highlighted that when Callan Associates looked at the numbers going back nearly 15 years, they noted that the rates of return for both the PERS and TRS systems were right at 9 percent. Thus, the notion that the original problem was caused by bad market conditions simply isn't true. The reality is that the state does a very good job of investing. If it hadn't basically gotten 75 basis points above 8.25 percent, the numbers would have been even farther off.

MR. LAMB summarized that the normal cost rates were set way too low, and nobody did anything when the state was actually under water, because the financial statements didn't reflect that reality. The effect was cascading and cumulative.

He said now there's comfort is what the current normal cost rate really is because there are two reviewing actuaries. However, he'd now like to know if a study was ever done comparing just Tier III DB costs to the DC system, because originally the study compared the total Tier I, Tier II and Tier III costs to the DC system. He looked at the two actuary reports last night and one says it will cost less, and the other says it will cost more.

[1:05:21 PM](#)

SENATOR PASKVAN asked Mr. Lamb to give his thoughts on designing a system and why he might pick DB over DC for most employees.

MR. LAMB said he believes that SB 121 is a good proposal. If the numbers were crunched independently and all the assumptions were understood, the calculations would probably be pretty close. What can't be factored in is the cost of not having qualified employees doing the job in a timely and efficient manner. His perspective is that DB Tier III and the proposed DB Tier V are much the same. He said when a person retires the two big concerns are having money to live on and healthcare. Even under PERS Tier III, unless you fit a certain set of criteria, there won't be much healthcare benefit from the system so there isn't much backslide for the proposed Tier V. What is a big deal is that individuals that want to focus on their jobs rather than investing will know that they will have a pension check that is as large as it could be, because a qualified professional managed their money.

[1:09:42 PM](#)

SENATOR GIESSEL asked how regular people in the private sector manage without a defined benefit possibility.

MR. LAMB responded there are two things. First, people in the private sector generally are paid more over their lifetime, because salaries for private enterprise are generally higher than in government. Second, there are more or less options depending on the entity for which a person works. A large corporation clearly has the assets and incentive to help employees with long-term financial planning, whereas those resources generally aren't available to mom and pop type entities. However, the solution to that shouldn't be to take the

opportunity away from those that do have the advantage. He added that he would argue that anyone in the Social Security System actually is in a DB system and they should augment their "retirement stool" with more legs.

1:12:36 PM

CHAIR WIELECHOWSKI asked the administration or Mr. Slisinsky to discuss the revised fiscal note.

MICHAEL BARNHILL, Deputy Commissioner, Department of Administration (DOA), stated that it's true that the Parnell Administration opposes SB 121, but it's disturbing that someone would cast aspersions on DOA's numbers without having any basis.

MR. BARNHILL explained that he essentially opened the door to the state's actuary so that Mr. Forna, an actuary for a proponent of the bill, could ask questions about the assumptions. If he disagreed with any of the assumptions, he was free to bring them to the committee for discussion. He emphasized that at no time did the administration attempt to limit access to its actuary. That door will remain open so that this committee and the people of the state of Alaska can trust the numbers, he stated.

1:16:40 PM

MR. BARNHILL reminded the committee that at the last hearing he surmised that the fiscal note would go down, because of Mr. Forna's persuasive argument that the bill would reduce the normal cost of medical in the proposed DB tier. However, Buck Consultants, Inc. again came back with a positive fiscal note.

The fiscal note shows a total of [\$124.412] million for FY2013. That represents the cost for existing DCR members to transfer into the proposed DB tier. It's a positive number because it allows a one-for-one service credit for members potentially back to July 1, 2006. If the combined employer/employee contributions are insufficient to purchase the employee's service, the remainder will be made up from the general fund. This FY2013 expenditure is essentially an unfunded liability of \$124 million. The actuarial assumption is that 60 percent of current DCR members will convert to the proposed DB tier, and 40 percent will remain in the current DCR system. Going forward, the assumption is that 80 percent of future employees will select the DB plans, and 20 percent will select the DCR plan.

Beginning in FY2015, the fiscal note reflects the increased normal cost presented by the bill. He deferred the explanation to Mr. Slishinsky.

1:19:09 PM

DAVID H. SLISHINSKY, Principal and Consulting Actuary, Buck Consultants, Inc., ("Buck"), stated that Buck is the actuary for the State of Alaska and as such it performs the actuarial services on the state's retirement plans. The assumptions for SB 121 are that 60 percent of current DCR members will select the proposed DB plan, and 80 percent of new hires will select the proposed DB benefit. The fiscal note reflects the difference between the costs of the proposed DB benefits for the above 60 percent of members and the costs of the DCR benefits.

Importantly, the normal cost is a combination of the difference in costs for pension and for healthcare. The DB normal cost paid by the employers for pension is less than the employers are paying for the DCR plan, so there is a savings for pension. However, the healthcare benefit per member is higher for the DB plan than the current DCR plan. These calculations include expected future new hires into both PERS and TRS and reflect the impact of the difference in costs for those people. As this group grows over time, the increase in the normal cost goes up as well.

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SENATOR PASKVAN offered his understanding that the cost to the employer of the DB component is cheaper than the cost to the employer of the DC component.

MR. SLISHINSKY said he agrees if the discussion is specifically about the pension portion.

SENATOR PASKVAN said he assumes that the DB costs are still cheaper than the DC costs for FY2015 - FY2018.

MR. SLISHINSKY replied that's correct only when talking about the pension.

SENATOR PASKVAN asked if the totals on the fiscal note represent only the medical component.

MR. SLISHINSKY answered no; it reflects the increase in the total normal costs for both pension and healthcare benefits.

SENATOR PASKVAN offered his understanding that the number would be less than zero if it was just the pension, but it depicts 100 percent the cost of the medical component, which is greater than the credit for the defined benefit.

MR. SLISHINSKY said that's correct.

SENATOR PASKVAN offered his understanding that the expectation for new hires is that 80 percent would want a DB retirement.

MR. SLISHINSKY said that's correct.

SENATOR PASKVAN asked if the date for determination of the amount of assets in the account is different than June 30, 2010, which is when the unfunded liability was calculated.

MR. SLISHINSKY replied the data that was used in this analysis is the same data that was used in the latest actuarial valuations as of June 30, 2010, which contained an overall measure of the unfunded liability of \$11 billion.

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CHAIR WIELECHOWSKI asked him to elaborate on how he came up with 60 percent and 80 percent.

MR. SLISHINSKY explained that the 60 percent assumption reflects the fact that some people just don't want to make a decision about whether or not to change from one plan to another. A recent study of DB and DC systems showed that new hires selected DB between 75 percent and 97 percent of the time. Buck elected to use 80 percent, which is in the mid-range.

CHAIR WIELECHOWSKI asked if he had a breakdown for pension and healthcare that shows how much lower the DB pension benefit would be compared to the DC pension benefit.

MR. SLISHINSKY responded the employer normal cost rate for PERS was 2.86 percent of salary for the pension portion, and the employer contribution into DCR was 5.22 percent of salary.

CHAIR WIELECHOWSKI asked what the cost savings would be for pension and the cost increase for healthcare for FY2015. The fiscal note depicts the total as \$19.853 million.

MR. SLISHINSKY replied the savings on pension is about \$9.7 million and the cost on healthcare is about \$27.3 million.

[1:29:23 PM](#)

CHAIR WIELECHOWSKI asked how the healthcare costs can increase so much in FY2015.

MR. SLISHINSKY replied two things are happening. First, the healthcare benefit isn't a function of salary like it is for a pension benefit. Healthcare costs the same for an employee with an \$80,000 salary as it does for an employee with a \$40,000 salary. Second, when the current DCR group is compared with one of the previous tiers, there is a difference in the level of healthcare cost over the entire term of employment. The DCR group covers anybody hired on or after July 1, 2006, and the average age of that group is 34 with two years of service. The healthcare benefit for that relatively young group is projected to increase according to healthcare cost trend rates, which are roughly double the rates that are used as part of the pension valuation. Not only are the costs for healthcare expected to go up more relative to the pension benefit, these people are younger so their healthcare benefit will be provided over a period when healthcare costs are higher than for somebody in an earlier tier. That too adds to the cost of healthcare.

[1:32:10 PM](#)

MR. BARNHILL added that the healthcare experience of the PERS and TRS systems since 1978 has been an average annual increase of 9 percent. DOA is undertaking a number of efforts to bring that cost curve down because that's unsustainable, he said. Until there is some measure of success in doing that, the actuary has to continue to prudently project what the healthcare costs will be 30 or 40 years from now.

SENATOR PASKVAN asked if he agrees that the state should provide medical care to all its employees, regardless of whether they are in a DB or DC system.

MR. BARNHILL responded that is an appropriate policy question for the Governor and the Legislature to ultimately take up; it isn't an issue in this bill.

SENATOR PASKVAN asked if he would agree that the DB plan would cost the state less for the pension portion than the DC plan.

MR. BARNHILL replied that does appear to be the case.

SENATOR PASKVAN asked what percentage of the total PERS/TRS payroll the \$19.853 million represents.

MR. BARNHILL replied he didn't know, but it's a small percentage.

SENATOR PASKVAN asked if the total payroll is something just under \$3 billion

MR. BARNHILL replied the total is \$2 billion plus, but he didn't know if it was closer to \$2 billion or \$3 billion. He reiterated that it's a small percentage.

SENATOR PASKVAN asked if small means less than one-half of one percent.

MR. BARNHILL replied he'd accept that if that's what Senator Paskvan is representing.

[1:35:07 PM](#)

SENATOR THOMAS asked if the 9 percent increase in health cost is a general increase, or if it's specific to this group. His understanding is that it was a general increase in health costs over the last 10-15 years.

MR. BARNHILL replied it's the general increase that the retirement system has experienced. It's not a 9 percent increase every year, it's on an average basis.

SENATOR THOMAS asked if the thinking is based on the idea that the DC plan will, in general, only be insuring younger people.

MR. BARNHILL responded the rate of healthcare cost growth right now is 9 percent, and the basic point the actuary is trying to make is that healthcare is projected to be much more expensive in the future. It will be more expensive for people that are 30 years old now and retire in 40 years, than for people that are 50 years old now and retire in 10 years.

SENATOR THOMAS said he was having difficulty relating that to the two different plans.

CHAIR WIELECHOWSKI added that he was having the same difficulty.

SENATOR PASKVAN asked if, in part, he is saying that the administration's opposition to this bill is that it would just as soon not have new young employees come to the state because medical costs for that young population will be higher in the future.

MR. BARNHILL responded that is absolutely not correct; the basis for the administration's opposition to the bill is on the record and it isn't based on this recent information. Mr. Slishinsky is simply highlighting the fact that healthcare is increasing and projecting that it will be more expensive for this younger population in 30 years than it is for people that will retire in the next 10 years. There is considerable basis for this projection because of the experience the retirement system has had over the last 30 years.

[1:38:49 PM](#)

CHAIR WIELECHOWSKI asked if the administration's fundamental opposition to this bill is that it will cost more.

MR. BARNHILL responded the administration's fundamental opposition relates to the ability of the state to keep long-term promises, given the current revenue stream and that throughput in the Trans Alaska Pipeline System has been declining 5 percent each year for the last 10 years. That promise needs to be guaranteed because the nature of defined benefit systems is that unfunded liabilities can creep in at any time for any number of reasons. In the past 2 decades, the state has experienced unfunded liabilities due to investment loss; a change in assumptions such as people living longer or retiring at different ages than expected; and negligence in how the system is managed and advised. Right now, the general fund is backstopping the DB system; last year it took \$478 million and this next year it will potentially take \$610 million to keep the system healthy. The administration's concern is whether or not revenue of the same magnitude will be available 40-60 years from now. Nobody knows the answer to that question, he stated.

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CHAIR WIELECHOWSKI observed that both actuaries seem to agree that the pension portion of the bill would save the state money. He asked if the administration would support a bill that only returns to a pension system.

MR. BARNHILL answered no, because that savings only looks at normal costs. It doesn't consider the risk of additional past service costs, which is how to pay off the unfunded liability. Because the very nature of the DB system exposes the state and future taxpayers to the risk of having to pay off those past service costs, the Parnell Administration opposes SB 121.

CHAIR WIELECHOWSKI asked if the administration believes that the actuaries could be wrong with respect to the pension portion of the bill saving the state money.

MR. BARNHILL suggested he ask the actuaries, but he predicts that every actuary will say that, by nature, a defined benefit system can develop an unfunded liability at any time for the reasons previously identified.

CHAIR WIELECHOWSKI asked if that means that the committee should basically take the actuarial statements with a grain of salt as Mr. Lamb suggested.

MR. BARNHILL responded that's a different issue.

[1:43:10 PM](#)

SENATOR GIESSEL asked him to explain the October 7, 2011 letter to Mr. Puckett from Mr. Slishinsky regarding the revised fiscal note for SB 121.

MR. BARNHILL explained that the numbers the actuary sent to the Division of Retirement and Benefits were used to prepare the fiscal note. The only difference in the numbers is that the fiscal note advanced the \$124.412 million transfer cost to FY2013, because those costs would come due within 60 days after the effective date of the bill. Assuming the bill passes, that would be FY2013.

SENATOR PASKVAN asked how the fiscal note differentiates between the costs for the medical component that would be incurred for new young employees in the DC system (like Mr. Danielson who testified today) as opposed to the DB system.

MR. BARNHILL pointed to the document "State of Alaska summary of normal costs for new tier members under SB 121" and explained that it is subdivided into four categories: PERS others, PERS peace officer/firefighter, PERS total, and teachers.

CHAIR WIELECHOWSKI deferred discussion of the document until copies had been distributed.

[1:46:06 PM](#)

SENATOR THOMAS asked if it would be possible to devise a formula through payroll that would keep the state from incurring large debt over a period of years while ensuring that health and welfare costs that increase in the future are taken care of,

even by the employees if they are desirous of having the DB plan with healthcare in place.

MR. BARNHILL responded he's a bit unclear as to the point of the proposal, but he can say that with enough money, anything is possible.

SENATOR THOMAS clarified that what he is suggesting is that if people are desirous of having a DB plan in place, it would be reasonable to explore the option that employees pay for more and the state incurs a lesser percentage of the debt. He acknowledged this would be subject to negotiations by the bargaining units.

MR. BARNHILL said anything is possible if the suggestion is to gross up the paychecks.

SENATOR THOMAS responded the suggestion isn't to gross up the paychecks. It's that there is a solution if people were to take on more responsibility over a period of years.

MR. BARNHILL replied that's a valid point, and in the past decade employers across the country have expected employees to contribute more to pay for their healthcare benefits.

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CHAIR WIELECHOWSKI called a brief recess.

[2:02:04 PM](#)

CHAIR WIELECHOWSKI reconvened the meeting and asked Senator Paskvan to restate his earlier question.

SENATOR PASKVAN said the fiscal note shows \$19.853 million for FY2015, and he was trying to locate the \$27.3 million in healthcare costs and the \$9.7 million in pension costs.

MR. SLISHINSKY explained that the spreadsheet shows the detail and backup information for the amounts that were included in the fiscal note. PERS police officers and firefighters and all other PERS were separated and then the total is shown on the spreadsheet. The same analysis was done for TRS. He said his explanation will focus on the total for PERS and for TRS.

CHAIR WIELECHOWSKI asked him to explain how he arrived at \$19.853 million for FY2015.

MR. SLISHINSKY said that's the total amount for PERS and TRS. The breakdown is \$17.568 million for PERS and \$2.285 million for TRS. Focusing on just the PERS amounts for FY2015, he explained that the total employer normal cost, which is the pension amount, is \$53.256 million and the employer DCR contribution total amount is \$35.698 million. The difference is \$17.568 million.

CHAIR WIELECHOWSKI observed that for FY2015, the employer pension normal cost is \$11.735 million versus \$21.419 million for the employer DCR contribution pension amount. That difference is \$9.684 million.

MR. SLISHINSKY agreed.

CHAIR WIELECHOWSKI further observed that for FY2015, the healthcare normal costs are \$41.531 million versus \$14.279 million for the employer DCR contribution healthcare amount.

MR. SLISHINSKY agreed.

CHAIR WIELECHOWSKI asked if the PERS medical benefits will be different for the proposed Tier V than they are for current DCR Tier IV.

MR. SLISHINSKY said yes. There is an increase in the benefit under Tier V, whereby anyone can get the full cost of their medical benefit at Medicare age.

CHAIR WIELECHOWSKI asked if there wouldn't be a cost savings since SB 121 delays the medical benefit until age 65 at Medicare eligibility rather than age 60.

MR. SLISHINSKY responded there is a cost savings between PERS Tier III and the proposed Tier V, but the current DCR members have a separate healthcare benefit. The Tier V healthcare benefit proposed under SB 121 is less expensive than Tier III, but more expensive than Tier IV.

CHAIR WIELECHOWSKI asked what accounts for the \$27.252 million difference in healthcare cost.

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MR. SLISHINSKY explained that there is a reduction in the cost for healthcare from Tier III to Tier V because the medical benefit is delayed from age 60 until Medicare eligibility at age 65. Buck's calculations indicated that change would save

approximately 19 percent. However, in Tier IV the current DCR members pick up a portion of the cost depending on their years of service. They will pay 10 percent after 30 years of service at Medicare eligibility. That cost grades up to 30 percent if the member has less than 15 years of service. The Healthcare Reimbursement Account is also used to help pay premiums.

CHAIR WIELECHOWSKI asked Mr. Fornia to provide his opinion on the fiscal note.

2:11:21 PM

WILLIAM B. FORNIA, President, Pension Trustee Advisors, said he is working on behalf of the Alaska Public Pension Coalition. He summarized his credentials and work experience and noted that for the last 20 years he has focused on the public sector. Often he is a second-opinion actuary and feels strongly that it is an actuary's job to bring facts so that proper decisions can be made.

MR. FORNIA said he received the spreadsheet showing the detail and backup information for the fiscal note just last night, and looks forward to reviewing it more thoroughly. He expressed optimism that he and Mr. Slishinsky could work together and come to an understanding so that the committee can make the best decisions possible.

He summarized the controversy surrounding Senate Bill 141 that changed the state's retirement plan from defined benefit to defined contribution, and noted that it was particularly controversial since the State of Alaska does not participate in the Social Security System. It is the largest employer in the country that offers neither a defined benefit retirement nor Social Security to new hire employees.

MR. FORNIA confirmed that just as the testimony today indicated, DC plans tend to be better at attracting young people, and DB plans tend to be better at keeping people in mid-career until retirement age. He opined that Alaska certainly seems to be a state that would want a DB plan, because it isn't in the state's best interest to train people and then have them leave for a job in the Lower 48.

MR. FORNIA said that as the ongoing review actuary for the Alaska Retirement Management Board (ARM Board) he saw that the cost between PERS Tier III and Tier IV was about the same. Over the years he was asked about switching back to a DB system, and in January the Alaska Public Pension Coalition hired him to

figure out how to make a cost neutral bill. It seemed that a good way to do it would be to cut the healthcare feature of the bill. Under SB 121, the only healthcare benefit most people will receive is a supplement to Medicare. The state's actuary indicated that would result in approximately 19 percent savings.

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MR. FORNIA reiterated that he did not have ample time to review the fiscal note and supporting numbers, but they appear high. The spreadsheet shows that the FY2015 healthcare normal cost rate per member is \$4,940, which means that every young person should set that amount aside every year from now until retirement, just to pay for what Medicare doesn't cover.

CHAIR WIELECHOWSKI asked Mr. Fornia to talk about what would be covered for most people at age 65 as a Medicare supplement.

MR. FORNIA said that isn't his area of expertise, and he couldn't say for sure what things would be supplementary. However, \$4,940 seems like a lot of money to have to save year after year or a lot of money for the state to give to its workers year after year.

CHAIR WIELECHOWSKI asked if the big discrepancy centers on the column showing the healthcare normal cost rate per member.

MR. FORNIA said yes, and it is also reflected in the column that calculates the healthcare normal cost rate as a percentage of pay. For FY2015 that is 10.12 percent of pay, whereas the FY2015 employer DCR contribution healthcare rate is 3.48 percent. The difference is roughly 7 percent. According to these numbers, the bill is asking the equivalent of a 7 percent pay raise, and that makes the bill seem cost prohibitive. Even though there might be a percent or two savings on the pension, giving away 7 percent on medical creates a big gap.

MR. FORNIA said he wasn't in a position to make recommendations at this point, but ideally there will be a way to look at the differences, and get that 7 percent figure down to zero in order to start at a point that's a little more cost neutral. Mr. Fornia said he thought that substantial cuts to the healthcare plan would achieve Senator Egan's goal to have a cost neutral bill, but it now looks like that might not be the case.

CHAIR WIELECHOWSKI asked why there is such an increase between the FY2015 PERS employee headcount of 8,408 and the FY2019 headcount that is projected to be 17,012.

MR. FORNIA explained that each year after FY2015 includes some DCR employees. The number will continue to increase until eventually the entire population is in that group.

SENATOR PASKVAN observed that the TRS healthcare normal cost rate per member is \$5,930, and asked why it's higher than the rate for PERS.

MR. FORNIA replied the benefit structure is slightly different, but for any additional explanation he would defer to Mr. Slishinsky.

[2:25:18 PM](#)

SENATOR PASKVAN asked how Alaska compares to other states with regard to the medical benefits it provides to PERS/TRS employees.

MR. FORNIA replied he didn't have that data, but it's important to know that Alaska is one of a very few states that has made a substantial effort to fund its retiree healthcare plans. The vast majority of pension funds around the country do not cover healthcare; coverage is provided by a different department through a different vehicle with virtually no advance funding.

SENATOR PASKVAN asked if he's saying that other states are only booking the cost of their retiree healthcare for the year, not the present value.

MR. FORNIA clarified that all the states are booking about the same amount, but the only cash that most states are putting in is the cash of paying the retiree healthcare benefits for those retirees as they get sick. Alaska, by comparison, is putting in [on average 2.86 percent of pay for PERS DB employees and on average 3.48 percent for DCR employees]. Other states are waiting until the employees retire and then paying in cash.

REPRESENTATIVE GRUENBERG asked if when he mentioned switching back, if he was referring to switching from the DC plan to a DB plan.

MR. FORNIA answered yes, and Mr. Slishinsky is an expert on that issue. He described two states that put in DC plans and subsequently switched back to variations of DB plans, once it became clear that people weren't accumulating enough money to retire.

REPRESENTATIVE GRUENBERG asked for an example of how different assumptions for the same problem can create wide differences in a calculation.

MR. FORNIA responded the classic example is the discount rate. Some funds are using an 8.25 percent assumption while other funds are using 7.25 percent, and some economists are saying that the assumption should be 4 - 5 percent. Changing those numbers can quickly move billions of dollars from one side to the other. It's easy to see that if the assumption is for a higher rate of return, not as much has to be put in, and vice versa. Pension systems that use numbers that are on one extreme or the other can have a large impact, all other things being equal. This is particularly true when there is a liability. Pushing that number up or down by 5 - 10 percent on a fixed number of assets can make an amazing difference. He reiterated that is why it is so important that decision-makers get numbers they trust.

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CHAIR WIELECHOWSKI asked Mr. Slishinsky to discuss how Buck arrived at the \$4,940 healthcare normal cost rate per member.

MR. SLISHINSKY said he wanted to first clarify that the calculation is such that the number for healthcare is a level dollar amount. Over the course of someone's career, it's the payment each year to accumulate an amount to pay for the healthcare benefit in retirement. It's different than the pension benefit, which is calculated as a percentage of pay, and increases over time as pay increases. The healthcare cost for this group initially is a little higher because of the level dollar methodology.

CHAIR WIELECHOWSKI asked what it costs to purchase an equivalent supplement to Medicare.

MR. SLISHINSKY responded he didn't know.

CHAIR WIELECHOWSKI asked if the numbers essentially indicate that a person would have to contribute \$4,940 [every year] over an average lifespan to accumulate enough to buy supplemental Medicare insurance.

MR. SLISHINSKY replied that would be the cost from age 65 to the end of the person's life.

[2:35:20 PM](#)

MR. FORNIA said the average age of the DCR group is 34 and on average they won't retire for 31 years, so the number that's used today will be some multiple of that.

MR. SLISHINSKY reiterated that the effect of compounding healthcare costs is significant, and the current cost projections are for people that won't be receiving the benefit for another 30 years. In that time period the cost of healthcare is expected to escalate, and it continues in retirement.

CHAIR WIELECHOWSKI asked if the expected rate of increase is 9 percent per year.

MR. SLISHINSKY responded Buck's assumptions are about 7 percent for medical and little more for prescription drugs. The healthcare cost trend model indicates a gradual decrease over time, but the healthcare cost trend rates are still more than double normal inflation.

CHAIR WIELECHOWSKI asked what the expected rate of return is for the medical asset.

MR. SLISHINSKY replied the expectation is 8 percent per year, the same as the pension asset.

CHAIR WIELECHOWSKI asked for additional explanation, because it seems that an 8 percent return would cover medical costs that are projected to go up 7 percent per year.

MR. SLISHINSKY responded the return is only 1 percent, so a person would have to accumulate a lot more for there to be enough money to pay the healthcare benefit during retirement.

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MR. FORNIA again suggested the actuaries figure this out together.

MR. SLISHINSKY pointed out that if the healthcare cost trend rate is 6 percent per year, then it will be 5.7 times more in 30 years because of compounding. And the cost will continue to escalate during retirement.

CHAIR WIELECHOWSKI asked if it's realistic to think that healthcare insurance that costs \$15,000 per employee today might cost \$75,000 per employee in 30 years.

MR. FORNIA suggested the committee would probably be better served if the actuaries first signed off on the numbers, perhaps with input from the third actuary.

SENATOR PASKVAN expressed a desire to walk away today with everyone in agreement, on an actuarial basis, that if the state were to convert to a DB retirement system, that it could save money as compared to the current DCR system.

MR. FORNIA responded his position is that there is just as much chance of having a surplus by converting to a DB system as having a new unfunded liability..

MR. SLISHINSKY declined to give an answer without further analysis.

CHAIR WIELECHOWSKI asked Mr. Slishinsky how much confidence he had in his numbers.

MR. SLISHINSKY expressed great confident in the numbers he provided.

CHAIR WIELECHOWSKI asked if his numbers indicate that it will save the state money to switch to a new DB system, as proposed in SB 121, compared to the current [DCR] system.

MR. SLISHINSKY replied it will save the state money for pension only, not healthcare.

[2:43:07 PM](#)

MR. BARNHILL opined that the committee's goal is to get the actuaries to agree on a design where normal costs are equal to or less than the existing DC tiers. He cautioned that it wouldn't change the administration's position on the bill, but he would encourage the actuaries to work together on a set of assumptions and a design to attain that goal.

REPRESENTATIVE GUTTENBERG asked what would change the administration's position.

MR. BARNHILL replied the only thing at this point is a crystal ball that would give the administration confidence in the actuarial projections going forward. Those don't exist. The nature of the DB system is that there will always be a risk of unfunded liabilities creeping into the system.

MR. BARNHILL assured the committee that the administration had no objection to Mr. Fornia working with the state's actuary. He is free to call and trade thoughts with Mr. Slishinsky and try to identify any differences between actuarial views. They can bring that to the committee and provide an explanation.

MR. SLISHINSKY said he and Mr. Fornia are willing to work together and develop a bill that meets Senator Egan's objective of being cost neutral.

CHAIR WIELECHOWSKI thanked the participants and opined that it will be a big step forward if the actuaries can agree on the numbers to a high degree of certainty. [SB 121 was held in committee.]

[2:46:23 PM](#)

There being no further business to come before the committee, Chair Wielechowski adjourned the Senate State Affairs Standing Committee meeting at 2:46 pm.