

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

April 1, 2014

9:05 a.m.

MEMBERS PRESENT

Senator Fred Dyson, Chair
Senator Cathy Giessel, Vice Chair
Senator John Coghill
Senator Bill Wielechowski

MEMBERS ABSENT

Senator Bert Stedman

COMMITTEE CALENDAR

SENATE BILL NO. 30

"An Act relating to new defined benefit tiers in the public employees' retirement system and the teachers' retirement system; providing certain employees an opportunity to choose between the defined benefit and defined contribution plans of the public employees' retirement system and the teachers' retirement system; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 30

SHORT TITLE: TEACHERS & PUB EMPLOYEE RETIREMENT PLANS

SPONSOR(S): SENATOR(S) EGAN

01/22/13	(S)	READ THE FIRST TIME - REFERRALS
01/22/13	(S)	STA, FIN
03/27/14	(S)	STA AT 9:00 AM BUTROVICH 205
03/27/14	(S)	Heard & Held
03/27/14	(S)	MINUTE(STA)
04/01/14	(S)	STA AT 9:00 AM BUTROVICH 205

WITNESS REGISTER

LIZ LUCAS, Executive Director
Alaska Retired Educators Association (AKREA)
Juneau, Alaska

POSITION STATEMENT: Testified in strong support of SB 30.

ANDY HOLLEMAN, President
Anchorage Education Association (AEA)
Anchorage, Alaska

POSITION STATEMENT: Testified in support of SB 30.

KATHY LEA, Chief Pension Officer
Division of Retirement Benefits
Department of Administration
Juneau, Alaska

POSITION STATEMENT: Answered questions during the discussion of SB 30.

FATE PUTMAN, Lobbyist
Alaska State Employees Association (ASEA)
Juneau, Alaska

POSITION STATEMENT: Provided supporting information for SB 30.

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

POSITION STATEMENT: Offered information and answered questions related to SB 30 on behalf of the sponsor.

WILLIAM FORNIA, Consultant
Alaska Public Pension Coalition
Washington, DC

POSITION STATEMENT: Answered questions related to SB 30.

ACTION NARRATIVE

[9:05:30 AM](#)

CHAIR FRED DYSON called the Senate State Affairs Standing Committee meeting to order at 9:05 a.m. Present at the call to order were Senators Coghill, Wielechowski, Giessel, and Chair Dyson.

SB 30-TEACHERS & PUB EMPLOYEE RETIREMENT PLANS

[9:05:57 AM](#)

CHAIR DYSON announced the consideration of SB 30. He noted this was the second hearing.

[9:07:06 AM](#)

LIZ LUCAS, Executive Director, Alaska Retired Educators Association (AKREA), stated strong support for SB 30. She said

that AKREA members are committed to improving the quality of life for Alaska's educators. She recapped the previous hearing and stated that time is of the essence and she would respectfully suggest the committee agree to support SB 30.

[9:09:59 AM](#)

ANDY HOLLEMAN, President, Anchorage Education Association (AEA), Anchorage, Alaska, stated support for SB 30. He reminded the committee that the defined benefit system started as a way to bring significant value to employees over a long period at a reasonable cost to the employer. He said the AEA wants to attract top quality educators who want to make a life in Alaska and the employment conditions ought to reflect that. Retirement isn't that important to educators first entering the system, but as they start looking more long term they realize that making a career in Alaska comes up short. He noted that Mr. Forna, who testified during the previous hearing, pointed out that Alaska uniquely stands out as a major employer that neither allows participation in Social Security nor offers a defined benefit retirement plan. When defined contribution employees realize this shortcoming, they often opt to move to a state where they don't have to face such an uncertain retirement. This is a huge negative for retaining good teachers in Alaska, he said.

SENATOR GIESSEL asked for clarification of his statement that Alaska doesn't allow teachers to participate in Social Security because it was her understanding that it was the federal government that made that decision in the 1930s.

MR. HOLLEMAN replied he wasn't sure of the history but his understanding is that it was a decision made in the 1960s relative to the state providing its own retirement system.

[9:15:33 AM](#)

SENATOR GIESSEL recapped Mr. Barnhill's explanation of the history of Social Security during the previous hearing.

CHAIR DYSON asked Mr. Holleman if he heard the discouraging statistics about employee turnover in the Tier IV system.

MR. HOLLEMAN replied he is familiar with the statistics.

CHAIR DYSON asked if his understanding is that current Tier IV retirement benefits are portable, but that portability is gone under the structure of SB 30.

MR. HOLLEMAN replied it's not that there's no portability, but the decision to move is more difficult after a number of years in the system.

CHAIR DYSON said he doesn't agree with structuring a benefit system that has a tendency to force people to stay here against their will.

[9:22:26 AM](#)

KATHY LEA, Chief Pension Officer, Division of Retirement Benefits, Department of Administration, addressed Senator Geisel's question about Social Security. She explained that the Territory of Alaska started providing a teacher's retirement system in 1947 and in 1955 the State of Alaska had an opportunity to join Social Security. The state could opt in all employees who were not covered by a retirement system and those who were already covered by a retirement system. Since the teachers retirement system was already in place, the Territory of Alaska opted to cover only those employees who didn't have another retirement system. The Public Employees Retirement System (PERS) came into being in 1960 and the Territory employees and later the State of Alaska employees did participate in Social Security until February 1980. The employees held a referendum in 1979 when there was an opportunity to go with a Social Security replacement plan. The State of Alaska employees and 16 other participating municipalities have been in the Alaska Supplemental Annuity Plan since February 1980.

CHAIR DYSON asked her to repeat what she said about teachers.

MS. LEA said that Alaska teachers were provided with a retirement system starting in 1947 so they didn't vote to opt in or out of Social Security. The Territory of Alaska made that decision in their Social Security agreement in 1955. She offered to provide a copy of that agreement.

CHAIR DYSON asked if the state was constrained in any way by federal law.

MS. LEA answered that the federal government gave the state a choice of including all employees who were not otherwise covered by a retirement system in Social Security. The state could also include those who were covered by a retirement system (teachers) but the Territory chose not to do that.

[9:25:18 AM](#)

SENATOR WIELECHOWSKI asked if there is vesting under the current system for Tier IV PERS and Tier III TRS employees.

MS. LEA explained that under both PERS Tier IV and TRS Tier III there's a staggered vesting system. After two years the employee is 25 percent vested, after three years 50 percent vested, after four years 75 percent vested, and after five years of service the employee is fully invested in the employer contributions. The teachers vesting schedule works the same way.

SENATOR WIELECHOWSKI summarized her answer and Ms. Lea agreed with the characterization.

SENATOR WIELECHOWSKI asked if employees under the PERS Tier III and TRS Tier II systems are able to cash out their contributions if they leave prior to five years of service.

MS. LEA answered yes. Under the defined benefit system the employee can cash out their contributions plus interest at termination regardless of vesting, but the employer contributions revert to the employer prior to vesting. She added that the contributions earn four percent interest that is compounded semiannually.

SENATOR WIELECHOWSKI asked if the data shows that large numbers of employees under PERS Tier IV and TRS Tier III are leaving their jobs after they vest.

MS. LEA replied the division just completed a query for Senator Giesel's office on the retention schedule comparing the defined benefit retention against the defined contribution retention. She offered to provide the members with the information.

CHAIR DYSON expressed irritation with a system that allows people to choose a rural assignment for three years in an area that has a significant cost of living differential primarily for the purpose of boosting their average high salary years. He asked her perception.

[9:30:04 AM](#)

MS. LEA replied that phenomena is seen in both in the defined benefit and defined contribution plan systems. In the defined benefit system for PERS only, there is a restriction of using any geographic differential in calculating a retirement. It has to be half the employees service served in an area with a differential before it can be used. In the teachers retirement there is no restriction on any type of differential because

that's simply the pay for that area. In the defined benefit plan, if a teacher serves three years in an area with a high salary, their retirement will be calculated on the average of those three years. In the defined contribution plan, it is attractive to work in an area with a higher salary because it means higher contributions into the employee's account. Since the defined contribution benefit is based on the contribution balance, it is attractive to work in Bush areas. The division sees those large salaries working to attract both defined benefit and defined contribution employees, she said.

CHAIR DYSON commented that Tier IV employees have that advantage as well as the advantage of more complete portability.

MS. LEA agreed; once the employee has two years of service they can start accessing the employer contributions and once they have five years of service they're 100 percent vested in the employer contributions and they can withdraw it all.

[9:32:39 AM](#)

CHAIR DYSON offered his understanding that almost all retirement systems are designed and operate on the assumption that the account will earn enough to pay the demand for the retirees. He observed that part of the State of Alaska's problem is that the investments didn't grow and pay the dividends according to the assumptions. He asked if SB 30 assumes an eight percent return on investments.

MS. LEA answered yes.

CHAIR DYSON noted that Mr. Kiehl nodded in agreement. He said that's a concern because the recent history doesn't reflect those returns. He asked if she could calculate the returns at four percent, six percent, and eight percent.

MS. LEA related that the division has a spreadsheet that's able to run those calculations.

CHAIR DYSON asked how long it would take to run the calculations.

MS. LEA estimated it would take three days. She asked if he wanted just balances or balances and the eight options for disbursement, one of which is a lifetime annuity.

CHAIR DYSON solicited input from the committee.

SENATOR WIELECHOWSKI said he'd be curious to know the historical average of the S&P 500 Index since 1926. He said he believes it's 9.77 percent, but he'd be interested to know if she comes back with a different number. He also expressed interest in knowing what number the administration uses in calculating the returns and what number the Alaska Retirement Management Board (ARM) Board uses.

MS. LEA agreed to provide the information.

CHAIR DYSON asked Mr. Putman for help checking the veracity of the information the committee receives.

[9:37:16 AM](#)

FATE PUTMAN, Lobbyist, Alaska State Employees Association (ASEA), said that William Forna, the consultant who testified at the previous hearing, will hopefully be able to provide the information.

CHAIR DYSON asked if there is a better way of asking Ms. Lea for calculations.

MR. PUTMAN responded that the question of the long-term projection for growth for investments is correct. He agreed with Senator Wielechowski that historically it's been 9.7 percent. SB 30 estimates an 8 percent return in anticipation that growth will exceed expectations.

SENATOR COGHILL recalled the market corrections since the 1970s and suggested looking at trend lines on both disbursement and income.

SENATOR GIESSEL noted that Ms. Lea's question pertained to the various disbursements and she believes that the detail is valuable information.

SENATOR WIELECHOWSKI suggested it would be helpful if the returns were broken down in five year increments over the last 25 years, because his research indicates that an 8 percent return is reasonable over time.

SENATOR COGHILL added that seeing both trend lines will show income and outgo and where the lines cross.

[9:42:26 AM](#)

MR. PUTTMAN noted that healthcare cost is the component that drives the retirement system and that the bill is designed to

shift to the employee the healthcare costs that aren't covered by investment growth.

SENATOR COGHILL said it would be interesting to know the legal ramifications of shifting those costs to the retired employee.

CHAIR DYSON asked his staff to send the question to Legislative Research. His understanding is that all retirement benefits are contract law and there is no basis on which the employer can avoid that.

SENATOR GIESSEL suggested it would be interesting to hear from Legislative Finance Director David Teal on the subject.

CHAIR DYSON asked, assuming the bill passes, if contributions from the employer would go into a separate account.

MS. LEA answered yes they would go into a new account and employee and employer contributions would not be mixed.

CHAIR DYSON asked if contributions for the new defined benefit plan would go into a different account than the current defined benefit account.

[9:45:45 AM](#)

MS. LEA answered no; those contributions would go into the Defined Benefit Trust.

CHAIR DYSON reiterated that he wanted to see a spreadsheet and graph that shows the employer and employee contributions for this new group of defined benefit employees and the cost of those people retiring and getting benefits, discrete from the existing account of all the defined benefit employees.

MS. LEA agreed and noted that the funds within the PERS Trust are accounted for by Tier.

CHAIR DYSON asked for a graph that shows the growth of the account, the anticipated growth of the account, and the anticipated growth of demand on the account.

[9:47:00 AM](#)

SENATOR WIELECHOWSKI asked the amount of the unfunded liability that is caused by the defined benefit and the amount that is caused by healthcare costs.

MS. LEA offered to follow up with updated figures.

SENATOR WIELECHOWSKI asked for her general sense.

MS. LEA replied she believes it's generally the healthcare costs that account for the rise in the unfunded liability.

SENATOR WIELECHOWSKI asked if her sense is that the vast majority is healthcare.

MS. LEA answered no.

SENATOR WIELECHOWSKI asked her to follow up with the numbers.

MS. LEA agreed.

CHAIR DYSON asked Mr. Kiehl if he had any comments to add to the discussion.

[9:48:34 AM](#)

JESSE KIEHL, Staff, Senator Dennis Egan, Alaska State Legislature, Juneau, Alaska, addressed several questions that arose during the foregoing discussion. He explained that the stability of the pension benefit can be addressed and enhanced through plan design. For example, the average five high years of salary for public employees Tier III was designed as a provision to reduce or eliminate late career moves to spike the pension amount. Some plans go further and use lifetime average earnings.

CHAIR DYSON asked if pension benefits are bargained in union contracts.

MR. KIEHL explained that things like the geographic differentials are bargained by unions, but the pension benefit is not. He understands that the Alaska Public Employee Relation Act is explicit about that.

MR. KIEHL supplemented the discussion of the history of Alaska teachers and Social Security. He relayed that Alaska is 1 of 14 states that does not include teachers in Social Security, whereas 36 other states elected to include teachers in their Social Security agreements with the federal government.

With regard to the discussion about portability, he said he appreciates Ms. Lea's context that employees who decide to leave the defined benefit system, whether before or after they vest, are entitled to take all their contributions plus a four percent guaranteed rate of return. He added that another element of plan

design is that the defined benefit pensions in SB 30, like Alaska's legacy systems, have a 10 percent cost of living adjustment for those retirees who live in Alaska. It is deliberately designed to keep retirees living in the state and it's worked. In FY2011, 90 percent of the \$921 million in PERS and TRS pension checks went to Alaska residents and into the Alaska economy. According to the National Institute for Retirement Research, the total economic impact to Alaska is more than \$1.4 billion.

CHAIR DYSON asked Mr. Fornia to respond to the questions he heard during the foregoing discussion.

[9:53:05 AM](#)

WILLIAM FORNIA, Consultant, Pension Trustee Advisors, said he is working for the Alaska Public Pension Coalition. Addressing the question about the consequence of long term returns of only 4-6 percent, he warned that it would be problematic for all tiers, not just the defined benefit tier structured under SB 30.

With regard to the question about contract law and whether benefits can be reduced, he said it depends on how the contract is written. If the benefit is described up front as able to be reduced, there is no contract problem. The State of Wisconsin does that with its cost of living adjustment and other states have similar benefit provisions.

CHAIR DYSON asked about the membership of the Alaska Public Pension Coalition.

MR. FORNIA replied it is a collection of unions. He deferred to Mr. Kiehl and Mr. Putman for the actual list.

CHAIR DYSON asked if he is an independent contractor.

MR. FORNIA answered yes, and he tries hard to work both sides of the issue.

[9:57:21 AM](#)

CHAIR DYSON asked if he heard correctly that the risk to the state would be less under SB 30 than under the current Tier IV system.

MR. FORNIA clarified that under the current proposal the risk would be more secondary if returns were poor. Individuals wouldn't be able to retire and those that had retired would have lower benefits, which might cause public assistance problems.

The fact is that the traditional defined benefit plans generally place more risk on employers than employees, he said. The largest risk under a low investment return scenario is to the existing defined benefit Tiers I, II, and III because of the large unfunded liability.

SENATOR WIELECHOWSKI asked if he could talk about how much of the unfunded liability is comprised of healthcare and if the greatest risk lies with healthcare or defined benefit pensions.

MR. FORNIA posited that a substantial amount of the unfunded liability is due to increased healthcare costs as opposed to low investment return. SB 30 is designed to fix that problem by shifting the costs to employees.

CHAIR DYSON asked if he sees a trend, because he understands that many sovereigns and municipalities are considering a defined contribution system going forward.

MR. FORNIA replied there are concerns and considerations of hybrid systems, but there haven't been any new defined contribution plans. Even Detroit's proposed plan of adjustment under their bankruptcy is going to be a defined benefit plan, albeit lesser. He cited other examples.

SENATOR GIESSEL stated that she intended to ask the Department of Administration to break out the healthcare component of the unfunded liability. The FY2011 data the committee received last year is outdated.

CHAIR DYSON asked his staff to compile the requests and questions from each committee member. He restated his desire to see the information in graph form.

[10:05:07 AM](#)

SENATOR COGHILL asked for the anticipated pool of employees, the different benefit options in order to extrapolate the benefit to the state and employee of pooling the money, and the expected healthcare risk under the options.

MR. KIEHL said he would argue that the risk of rising healthcare costs falls almost entirely to the employee pool. Another benefit to the state from pooling investments is that an open trust fund into which new money is put to cover future benefits can maintain an almost permanent time horizon and thus a higher rate of return as opposed to a closed trust fund that must gradually take less risk in its investments as the need for cash

becomes more immediate. With an open trust fund and new benefits being accrued and paid for, the state can continue to gain a tremendous portion of the economic benefit of pensions from the global economy instead of Alaskans.

SENATOR COGHILL asked if the new money coming into the trust fund could only be paid out only to the new tier, and never go to the unfunded liability.

MR. KIEHL explained that the bill puts the contributions from the new defined benefit employees and the employer into the same trust. If they were split into a separate trust fund, the legacy defined benefit trusts would have the same issue with their time horizon. To get the benefit of that open trust fund and the near permanent time horizon, both assets and liabilities would need to be pooled, although they could be accounted for separately.

[10:09:19 AM](#)

CHAIR DYSON asked if the new tier would be a draw on the legacy trust funds if it doesn't work as anticipated.

MR. KIEHL explained that if they're invested together, they would move in tandem. If they were invested separately, the same market forces and changes that might occur in the world would affect both.

CHAIR DYSON asked how a disproportionate draw in one tier would affect people in the other tiers.

MR. KIEHL replied his initial response is that any given tier of hires is comprised of a variety of people of a variety of ages, but he'd give more thought to a worst case scenario.

SENATOR WIELECHOWSKI asked if it would alleviate some of the unfunded liability problem by opening things up so that all public employees are contributing to the system.

[10:12:08 AM](#)

MR. KIEHL answered that he believes it does, particularly in the out years, because an open system has a longer time horizon and can potentially gain greater returns.

SENATOR COGHILL offered his understanding of the risk if returns are less than eight percent.

CHAIR DYSON held SB 30 in committee.

10:13:16 AM

There being no further business to come before the committee, Chair Dyson adjourned the Senate State Affairs Standing Committee hearing at 10:13 a.m.