HOUSE FINANCE COMMITTEE
April 21, 2021
9:04 a.m.

9:04:44 AM

CALL TO ORDER

Co-Chair Merrick called the House Finance Committee meeting to order at 9:04 a.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Kelly Merrick, Co-Chair
Representative Dan Ortiz, Vice-Chair
Representative Bryce Edgmon
Representative DeLena Johnson
Representative Andy Josephson
Representative Bart LeBon
Representative Sara Rasmussen
Representative Steve Thompson
Representative Adam Wool

MEMBERS ABSENT

Representative Ben Carpenter

ALSO PRESENT

Representative Andy Josephson, Sponsor; Elise Sorum-Birk, Staff, Representative Andy Josephson; Senator Jesse Kiehl.

PRESENT VIA TELECONFERENCE

William "Flick" Fornia, Pension Trustee Advisors

SUMMARY

HB 55 PEACE OFFICER/FIREFIGHTER RETIRE BENEFITS

HB 55 was HEARD and HELD in committee for further consideration.

Co-Chair Merrick reviewed the meeting agenda.

#hb55

HOUSE BILL NO. 55

> "An Act relating to participation of certain peace officers and firefighters in the defined benefit and defined contribution plans of the Public Employees' Retirement System of Alaska; relating to eligibility of peace officers and firefighters for medical, disability, and death benefits; relating to liability of the Public Employees' Retirement System of Alaska; and providing for an effective date."

9:05:08 AM

REPRESENTATIVE ANDY JOSEPHSON, SPONSOR, introduced the legislation and thanked the committee for hearing the bill. He believed it was a historic opportunity for the committee and legislature to do something very positive for first responder public employees. He read from a prepared statement:

> In Alaska there are about 44,000 active public employees. These are people that make the wheels of government function so that we can have peace, our roads cleared, our trash removed, our children educated, and make the economy and wheels of the economy run. From 1961 to 2005 these workers were eligible for a defined benefit. This is the term used for what I call an old school pension - something you could rely on that would be there until you die. After 2005, the eligibility for new employees to receive a defined benefit was permanently closed and it's remained closed for 16 years. Instead, new public employees receive a defined contribution, commonly called a 401k or 403a. These benefits become portable at the time of vesting, usually in five years and that is a critical part of the problem. It's great to be vested, but it’s the power of vesting.
>
> Alaska went into a period of retrenchment because of an unfunded liability and through a combination of bad actuarial advice and our own lack of vigilance, the unfunded liability was there but not really known until 2004 or 2005. At its height, that unfunded liability was $11 billion. Thankfully, it's now about $5 billion. The retrenchment - and I think we swung the pendulum too far - came at a cost. It was a very

heavy cost. The cost is the hollowing out of the workforce. This must be true across the workforce. You see older people, probably in their late 40s, 50s, 60s and you see the young (late teens and 20s) and the middle group are gone. Not totally gone, of course not, but they're gone, and you'll hear testimony about that. They've gone to other states because they have skills and they have shopped, and they've seen that they can do better elsewhere. They don't want to leave, and they'll tell you that, but they're leaving.

There is a lack of ability to compete in the current system. There's a lack of ability to hire in the current system. We lose significant training revenue, especially for our first responders and you will hear testimony, it won't be argued, it won't be contested. You'll hear numbers ranging from about $90,000 to about $200,000 to train these individuals (paramedics, fire, police, troopers, corrections officers). Remember that those dollars are borne by the state and the local governments. They fund that training and when it leaves to Washington or Colorado or Wisconsin, it takes the training with it, in a perfectly lawful and competitive way. What we do is we train up these folks, and you may wonder how it can be so expensive, many of them return to get additional certification. There are fire fighters who go back to get paramedic certification, for example. There's a massive disruption to the quality of life of the workforce we have.

Representative Josephson shared that he had met with the commissioner designee of the Department of Public Safety (DPS) an hour earlier. He had been reminded that it was not possible to hire replacement workers at the needed rate, which had real world impacts. For example, the previous week, the commissioner designee had told the Special Committee on Tribal Affairs that DPS had a class of 36 troopers; however, 33 other troopers had left. He noted that the commissioner designee had highlighted the need for a defined benefit for first responders in the Judiciary Committee as well.

9:10:14 AM

Representative Josephson shared that the bill applied to about 3,000 individuals, some of whom already had a defined benefit. He stressed that the bill was not risky, but it reduced risk because it was a cohort of 3,000 out of 44,000 public employees. He underscored that it was a risk worth taking. He stated that to get to the desired outcome it was necessary to allow for a new defined benefit. He reiterated that the risk was small. He pointed out that the fiscal note identified Alaska as one of the only states without defined benefits for its public safety employees.

Representative Josephson discussed the bill's cost saving features. He noted that members would only receive a health reimbursement account upon retirement. He relayed that it would not generally prove adequate between the period of retirement and Medicare eligibility. He highlighted that the provisions were written by and for members. He acknowledged that while he was the bill sponsor, the ideas included had been fine tuned by members by looking at other states and other models. Members were willing to give on the health reimbursement issue.

Representative Josephson reported that the bill would fix the age of retirement at 55, meaning members could not draw on the benefits as soon. He discussed that public safety officers' bodies wore down and they may retire in their early 40s, meaning they would likely have to find other work to fill the gap before they could actually receive a pension. He remarked that members would have to do 20 years of service and could do much less if they waited to age 60.

Representative Josephson continued to address the bill's cost saving features. He explained that instead of a high three [years used to determine retirement benefits] there would be a high five. He referenced testimony that it was hard to go to the North Slope for five years to try to seek a high five due to a cost of living adjustment (COLA). He detailed that COLA was the 10 percent workers received if they were in a previous defined benefit. He added there was no COLA in the bill. There were also plan asset enhancement adjustments. He detailed that employee contributions could be increased where the actuary found the plan to be beneath 90 percent solvency. He clarified that 90 percent solvency was considered to be very solvent. He recalled that Representative Rasmussen had stated the previous day that 60 percent was barely passing. He remarked that 90 percent was an A- and should be thought of that way.

Representative Josephson elaborated that the bill contained the ability for the Alaska Retirement Management Board (ARMB) to withhold the post-retirement pension adjustment (an inflation adjuster). The effect was that what a person received in their pension on a given month could be smaller than the amount received the preceding month. He informed the committee that the first responders were willing to suffer that possibility to get the plan benefit they sought. He emphasized that the issue was selfless for many of the members. The members were looking to stop the hollowing out of their workforce.

9:14:03 AM

Representative Josephson stated there was much desire to return to a defined benefit for all public employees, a desire he shared. He detailed that he is the grandson of the man who founded AFSCME in 1932 and became its president in 1936 for 30 years. He shared that he had been in Detroit, Michigan in 1997 to see his grandfather posthumously inducted into the hall of fame with people like John L. Lewis and Franklin Roosevelt and some of the great labor people in history. He shared the interest. He believed the public would understand that first responders were unique. He stated that the legislature had been burned in 2005. He highlighted that the bill was not a steppingstone and stood on its own. He believed the legislature was entitled to see how the plan worked and whether it would be solvent the way the state's retirement officials said it would be. Additionally, the legislature could look in the outyears at other options. He believed the stars were aligned and the bill had bipartisan support. He thanked the committee for hearing the bill.

9:15:29 AM

ELISE SORUM-BIRK, STAFF, REPRESENTATIVE ANDY JOSEPHSON, introduced herself. She provided a PowerPoint presentation titled "House Bill 55" (copy on file). She began with a sectional analysis of the bill on slide 2:

> Section 1: Amends AS 37.10.220(a) regarding the powers and duties that the Alaska Retirement Management (ARM) board shall carry out including:
>
> - Adding new duties to account for appropriate employer contributions for peace officers and fire

fighters and adjustments to these employees' contributions; and

- Determining the amount of the monthly employer contributions under new subsection AS 39.35.255(i) for peace officers and firefighters participating in the defined benefit plan after June 30, 2006.

Section 2: Amends AS 37.10.220(b) regarding the powers and duties of the Alaska Retirement Management (ARM) board, adding the ability to adjust the post-retirement pension adjustment (PRPA) amounts and the employee contribution rates for peace officers and firefighters participating in the defined benefit plan after June 30, 2006.

Section 3: Adds to the ARM board statute the definitions for "peace officer" and "firefighter" the existing in AS 39.35.680 (the PERS defined benefit definitions section).

Section 4: Amends AS 39.30.090(a) by adding the AS 39.37.537 (the new health reimbursement arrangement (HRA) medical benefit for peace officers and firefighters participating in the defined benefit plan after June 30, 2006 found in section 29) to the list of retiree medical benefit programs that the Department of Administration has the power to procure group insurance for.

Section 5: Amends AS 39.30.097(a) regarding Alaska retiree health care trusts. Adds the new AS 39.35.537 (the peace officer/firefighter HRA found in section 29) to the list of medical benefit programs that the Department of Administration commissioner is authorized to prefund.

Section 6: Amends AS 39.30.097(b) regarding Alaska retiree health care trusts. Adds the new AS 39.35.537 (the peace officer/firefighter HRA found in section 29) to the list of medical benefit programs that the Department of Administration commissioner is authorized to prefund.

Section 7: Makes a Revisor's type technical change by using the new preferred term for referring to the state retirement system.

Section 8: Amends AS 39.30.380 regarding how the HRA medical benefits are handled for terminated employees who leave prior to retiring. A person who terminates employment prior to meeting the eligibility requirements under the new AS 39.35.537 (proposed peace officer and firefighter HRA found in section 29) lose rights to their contribution to the HRA trust fund, in line with other Tier IV HRAs.

Section 9: Amends AS 39.30.390 regarding eligibility for reimbursement under the HRA. Adds the new AS 39.35.537 (proposed peace officer and firefighter HRA found in section 29) as eligible for reimbursements from the HRA.

Section 10: Amends AS 39.30.400(a) regarding benefits payable from individual HRA accounts. The new AS 39.35.537 (proposed peace officer and firefighter HRA found in section 29) is added as a plan from which the administrator may deduct the cost of monthly premiums.

Section 11: Amends AS 39.30.495 which contains the definitions for the HRA statutes. Adds the new AS 39.35.537 (proposed peace officer and firefighter HRA found in section 29) to the definition of "eligible person" found in AS 39.30.495(5).

Section 12: Amends AS 39.35.095 which lays out the applicability of the defined benefit retirement plan statutes found in AS 39.35.095-39.35.680 to include peace officers and firefighters participating in the defined benefit plan after June 30, 2006.

Section 13: Conforming amendment to AS 39.35.160(a) which outlines the employee contribution rates for peace officers or firefighters hired before June 30, 2006, excepting the new AS 39.35.160(e) (found in section 14). Deletes material on page 9, lines 18-25 that is reproduced in a new AS 39.35.160(f) (found in section 14).

Ms. Sorum-Birk continued to review the sectional analysis. She noted that Section 14 was the first section shown on slide 2.

Section 14: Creates new subsection AS 39.35.160 (e) setting the employee contribution rate for peace officers and firefighters participating in the defined benefit plan after June 30, 2006, at 8 percent of the employee's compensation. The ARM board may adjust the contribution rate from 8 to 10 percent. Subsection (f) reproduces the deleted material from page 9, lines 18-25 in section 13 of the bill, ensuring that contributions conform with the federal Internal Revenue Code.

Section 15: Amends AS 39.35.255(a) by referring to a new subsection (i) and by doing so makes clear that the total employer contribution remains 22% for peace officer and fire fighter employers.

Section 16: Amends AS 39.35.255(d) and is a technical conforming change to accommodate the new subsection (i) of this statute.

Section 17: Amends AS 39.35.255(e) and is a technical conforming change to accommodate the new subsection (i) of this statute.

Ms. Sorum-Birk moved to Section 18, which was where the cost of the bill came from:

Section 18: Adds new subsections (i) and (j) to AS 39.35.255.

- New subsection (i) establishes one of the new features that aim to make this new tier financially viable. It specifies that the employer contribution to the employee retirement benefit will remain constant at 12%. And, that the difference between the 12% contribution dedicated to employee benefits and the 22% total employer contribution will be available for the past liability of the PERS system.
- New subsection (j) states that the ARM board may increase the employer contribution to the employee retirement benefit based on the board's decision to increase employee contributions. This is also a new feature, or "lever," added to help make the new tier financially viable.

9:22:25 AM

Ms. Sorum-Birk continued to review the sectional analysis:

Section 19: Amends AS 39.35.282 regarding employer contributions for medical benefits, conforming that section to changes in the bill affecting peace officers and firefighters first participating in the defined benefit plan after June 30, 2006.

Section 20: Conforming amendment to AS 39.35.370(a) which outlines the years of service requirements to become eligible for retirement benefits under the defined benefit retirement plan. The conforming language specifies that the credit service requirements in subparagraphs 1-3 only apply to persons who became members of the defined benefit retirement plan prior to July 1, 2006.

Section 21: Amends AS 39.35.370 by adding a new subsection (l) detailing the service requirements for peace officers and firefighters participating in the defined benefit plan after June 30, 2006. Members are eligible for a normal retirement benefit:

- At age 60 with at least five years of credited service as a peace officer or firefighter, or
- At age 55 with at least 20 years of credited service as a peace officer or firefighter.

Section 22: Amends AS 39.35.381 concerning the alternative benefits for elected public officials. The new AS 39.35.537 (proposed peace officer and firefighter HRA found in section 29) is added to the list of plans that elected public officials are not entitled to under the alternative benefit for elected public officials.

Section 23: Conforming amendment to AS 39.35.475(a) concerning the schedule for making the annual postretirement pension adjustments (PRPA), making those payments subject to the exceptions in the new subsection (g) (found in section 25).

Section 24: Conforming amendment to AS 39.35.475(b) concerning the calculation of the annual postretirement pension adjustments (PRPA), making those payments subject to the new subsection (h) (found in section 25).

Section 25: This section contains one of the new features, or "levers," added to help keep the new tier financially viable. The section is intended to allow the ARM board to reduce a benefit, the automatic post-retirement pension adjustment, to keep the new tier financially viable. The proposed new subsections:

- Subsection (g) sets up the adjustment feature of the next subsection.
- Subsection (h) allows the ARM board to reduce PRPA payments to peace officers and firefighters participating in the defined benefit plan after June 30, 2006, if the plan has an unfunded liability greater than 10 percent and clarifies that the feature can be used if the liability to PERS is attributable to the employees of this new tier.

Section 26: Conforming amendment to AS 39.35.535(a) concerning the medical benefits for employees under the defined benefit retirement plan. Adds a new subsection (g) (found in section 28) as an exception to the defined benefit retirement plan medical benefits for peace officers and firefighters participating in the defined benefit plan after June 30, 2006.

Section 27: Conforming amendment to AS 39.35.535(c) concerning the major medical insurance coverage for those under the defined benefit retirement plan. It specifies that the section only applies to those members or their surviving spouse who joined prior to July 1, 2006.

Section 28: Amends AS 39.35.535 by adding a new subsection (g) that states peace officers and firefighters participating in the defined benefit plan after June 30, 2006, are to receive benefits under the HRA as allowed under the new AS 39.25.537 (found in section 29).

Section 29: Adds a new section AS 39.35.537 creating an HRA medical benefit for peace officers and firefighters first participating in the defined benefit plan after June 30, 2006. The section specifies the eligibility, cost of premiums for the major medical insurance, and procedures for participation.

Section 30: Amends AS 39.35.680 (4) which contains the definitions for the defined benefit retirement plan statutes. Adds a new paragraph (F) under the definition of "average monthly compensation" that states the calculation for peace officers and firefighters first participating in the defined benefit plan after June 30, 2006, will be based on the highest five consecutive payroll years during the employee's career.

9:26:38 AM

Ms. Sorum-Birk continued to review the sectional analysis:

Section 31: Conforming amendment to the definition of "employer" under AS 39.35.680(18) to include peace officers and firefighters participating in the defined benefit plan after June 30, 2006.

Section 32: Conforming amendment to the definition of "normal retirement" under AS 39.35.680(26) to include AS 39.35.370(l) detailing the service requirements for peace officers and firefighters participating in the defined benefit plan after June 30, 2006.

Section 33: Conforming amendment to AS 39.35.720 regarding the membership in the defined contribution retirement system, stating that all employees who become members on or after July 1, 2006, except as provided in AS 39.35.095, are part of the defined contribution plan, thus excepting peace officers and firefighters participating in the defined benefit plan after June 30, 2006.

Section 34: Adds a new subsection to AS 39.35.750 regarding employer contributions to the defined contribution retirement plan, stating those contribution requirements do not apply to peace officers and firefighters participating in the defined benefit plan after June 30, 2006, whose employer contribution requirements are found in the new AS 39.35.255(i) (found in section 18).

Section 35: Adds a new section to the uncodified law of the State of Alaska allowing peace officers and firefighters hired after June 30, 2006 and before the bill's effective date to elect, within 90 days of the effective date of this section, to transfer their contributions to their defined contribution retirement plan to the defined benefit retirement plan. Those transfers will be used to purchase credited service under the defined benefit retirement plan on an actuarially equivalent basis set by the ARM board.

Section 36: Adds a new section to the uncodified law of the State of Alaska creating procedures set out by the Department of Administration for employees to transition their contributions under the defined contribution retirement plan to the defined benefit retirement plan. This section also states that the election to transition from the defined contribution to the defined benefit plan is irrevocable. If there is a difference between the actual years of service and the equivalent years of service calculated by an employee's contributions to the defined benefit retirement plan, then the Department of Administration will allow persons to buy the difference. If the equivalent years of service are in excess of the actual years of service, then the excess remains under the defined contribution retirement plan.

Section 37: Adds a new section to the uncodified law of the State of Alaska instructing the Department of Administration commissioner to make conforming regulations.

Section 38: States that section 37 takes immediate effect under AS 01.10.070(c).

Section 39: Sets effective date of July 1, 2021

9:28:29 AM

Representative Wool understood there was a significant amount of detail in the bill. He asked if there was detailed information about the benefit system. He stated his general understanding of the benefit system. He wondered when the first recipient would be eligible to receive a benefit if the program started immediately. He asked for more detail about the solvency and triggers in the bill.

Ms. Sorum-Birk replied that the actuary Flick Fornia would give a presentation next. She shared that Mr. Fornia had helped with the plan design and would go into the details of solvency and models. She noted that only individuals who had been in the defined contribution plan since 2006 could buy into the plan - they would have 14 or 15 years of service currently and would need at least five more years before they could retire. Additionally, they would have to be 55 years old to retire. She relayed that the soonest the plan would pay out would be in five or six years.

Representative LeBon stated his concern about upside risk and how the risk was shared. He asked for verification that the employee contribution rate was capped at 10 percent. He referenced Section 14 of the legislation, which specified the employee contribution rate may be increased up to 10 percent.

Representative Josephson agreed.

Representative LeBon asked if the decision would be made by ARMB.

Representative Josephson replied affirmatively.

Representative LeBon highlighted his understanding that the state would contribute 22 percent as its maximum contribution. He pointed out there was currently an unfunded liability of about $5 billion in the existing retirement system.

Representative Josephson agreed.

Representative LeBon asked how to prevent the unfunded liability from happening again. He understood adjustments had been made and protections were in place to keep the situation from happening again, but he was concerned about an unfunded liability in 30 years. He asked how to craft a plan so that employees shared in the upside risk more than just a cap at 10 percent.

Representative Josephson answered that the state's actuary, Mr. [David] Kershner testified 13 months earlier that he perceived the bill was 99.3 percent funded. He elaborated that Mr. Kershner had testified that the plan did not add to the existing liability. There was some cost associated with the state needing to contribute a bit more to the unfunded liability (between $3 million to $4 million in the early years). He clarified it was not a cost directly associated with a new cohort the bill would create. He explained that the employee was the proxy for the amount that went to the unfunded liability and the state would be contributing marginally more. He noted that the $3 million to $4 million was far less than the training and recruitment cost associated with lost employees.

Representative Josephson recognized that the government took the risk in a defined benefit system, but he believed the plan proposed in the bill was very low risk. He referenced Representative LeBon's mention of the employees' participation in the risk. He explained that the employees' risk was identified in several things. First, the plan did not include a COLA. Second, an adjustment may be made to employees' paychecks if ARMB decided the performance was below 90 percent. Similarly, there was a loss of the inflation adjuster, the PRPA, when the performance was less than 90 percent. He highlighted that the plan was far less generous than Tiers I, II, and III. He explained that a person could not retire after 20 years at any age (he did not believe 20 years was required for Tier I) and employees did not have the health guarantee that active employees enjoyed. Employees would have a health reimbursable arrangement they would have to leverage and make do with. He conceded it would be difficult to do, especially for people who retire at a young age because they would have to cover the gap between retirement and age 65.

9:35:24 AM

Representative LeBon referenced the 99.3 percent certainty of success, which he observed was high.

Representative Josephson confirmed the 99.3 percent figure.

Representative LeBon asked why there was a fear of structuring the bill in a way where the employee shared a bit of the risk with the state if success was certain.

Ms. Sorum-Birk answered that the employee was already sharing in the risk. She highlighted that the normal employee contribution was 8 percent under the plan. She explained that the percentage would increase to 10 percent if the plan dropped below 90 percent funded.

Representative LeBon believed the risk needed to be shared in a way that made it easier for legislators to collectively support the bill. He remarked that in the past the state noted they had an $11 billion shortfall in the defined benefit plans (Tiers I, II and III). He discussed that about 10 years back the gap had been closed by the governor and legislature; the existing gap was currently about $5 billion. He wanted to ensure the program was set up in the correct way to avoid a multi-billion funding gap in the future.

9:37:20 AM

Vice-Chair Ortiz looked at Section 25 of the bill that allowed ARMB to reduce PRPA payments to peace officers and firefighters participating in the defined benefit plan after June 30, 2006, if the plan had an unfunded liability greater than 10 percent. He referenced the 99.3 percent solvency referenced by the presenters. He asked for verification that the likelihood of an unfunded liability was less than 1 percent.

Representative Josephson agreed; however, he noted that stocks and bonds were doing better at present than they typically did. He elaborated that when the testimony had been offered that the plan was 99.3 percent solvent at a March 2020 hearing, COVID had struck, and stock had been performing miserably. He believed the actuary may be the best person to respond to the question. He did not want to claim that there was a 1 percent chance the PRPA would be withdrawn; however, he noted the possibility was unlikely.

Vice-Chair Ortiz appreciated the concerns expressed by Representative LeBon and he agreed he did not want the state to be responsible for a further unfunded liability. He asked for verification that under the plan included in the legislation, once a person retired, the benefit was the same every year.

Representative Josephson replied in the negative. He clarified that the PRPA was an inflation adjuster.

Vice-Chair Ortiz asked for verification there was an inflation adjustment aspect to the bill.

Representative Josephson agreed. He noted that the PRPA could be suspended.

Representative Rasmussen thanked Representative Josephson for bringing the bill forward and remarked on its importance. She asked for the number of current public safety employees in Alaska.

Representative Josephson recalled the number was 3,000, based on a previous bill hearing and numerous documents associated with the bill. He noted the number may be closer to 4,000, but it did not exceed that amount.

Representative Rasmussen asked how many state employees were covered in Tiers I, II, and III.

Representative Josephson responded that there were approximately 12,000 active employees in the defined benefit Tiers I through III. He noted that including the Teachers' Retirement System (TRS) Tiers I and II (TRS did not yet have a Tier IV) increased the number to about 16,000 active employees.

Representative Rasmussen referenced the previous $11 billion unfunded liability. She asked what the state's collective obligation had been for active and retired employees under Tiers I, II, and III.

Representative Josephson answered that retired Tiers I, II, and III was in the range of 47,000 people. He noted the number was almost two years old, but he did not believe the current number was substantially different. He asked Representative Rasmussen to repeat her second question.

Representative Rasmussen combined the PERS, TRS, and retired employees and estimated there were roughly 75,000 people who contributed to the $11 billion unfunded liability. She asked for verification that the bill included about 3,400 people at present.

Representative Josephson replied affirmatively. He stated it was the reason he believed it was where the state should pivot and turn the corner to a new defined benefit. He pointed to the cost of recruiting and training the employees, the difficulty of retaining employees because they left for other opportunities, the small cohort size, and the affordability of the plan. He added that the plan was low risk.

9:42:59 AM

Representative Rasmussen believed that with the low number of personnel and Representative LeBon's concerns, she thought it seemed possible to find a slight compromise to assuage concerns about the risk the state may incur, while recognizing the number of employees was substantially lower than the previous membership in the defined benefit program. She believed the issue was incredibly important. She hoped they could find a solution to get all members on board due to the importance of the issue.

9:44:00 AM

WILLIAM "FLICK" FORNIA, PENSION TRUSTEE ADVISORS (via teleconference), introduced himself and shared that he was working on behalf of the firefighters. He provided a PowerPoint presentation titled "Shared Risk Hybrid Retirement Program for Public Safety: HB 55 - Actuarial Implications," dated April 21, 2021 (copy on file). He characterized the plan in the bill as a hybrid because it was not a pure defined benefit plan and was not a defined contribution plan like the current tier.

Mr. Fornia began on slide 2 and provided his credentials. He detailed that he was a fully credentialed actuary and had been in the business for over 40 years. He was currently the board-elected secretary/treasurer of the Society of Actuaries. He shared that he had authored a few well known pieces on defined benefit and defined contribution plans. He had frequently testified to legislatures and city councils and had traveled to Juneau to testify to the legislature in-person on multiple occasions in the past. He listed other states he had testified in as well.

Mr. Fornia turned to slide 3 and gave a sample of his work history on slide 3. He shared that he did not work for labor all of the time. He historically worked for a coalition of public employees in Alaska and was currently working for the firefighters. His largest client was the State of Ohio where he advised the state oversight board. Additionally, he was currently helping the City of Austin, Texas in its negotiations with police, firefighters, and other employees regarding pension issues. He added that he had worked for the banks in the Detroit, Michigan bankruptcy. He had been a corporate actuary for Boeing for a couple of years about 40 years back and had started his own firm just over 10 years back. He shared that just before he started his firm, he had been hired by ARMB as its first ongoing review actuary for a couple of years. He relayed that he had testified in Juneau in February 2009 to present his results of an audit of the Alaska PERS and TRS systems. Additionally, he had been the head of Buck Consultants Denver retirement practice. He had advised many groups since founding his firm.

9:47:54 AM

Mr. Fornia advanced to slide 4 titled "Shared-Risk Hybrid Retirement Program for Public Safety." He would try to answer questions asked by Representative Wool and Representative LeBon. He addressed the question "why is change necessary?" He explained that the current benefit tier was not providing adequate benefits and workers were leaving.

Mr. Fornia turned to a bar chart on slide 5 titled "Illustration of hypothetical police/fire benefits: $80,000 final average salary." He explained that under the state's Tier III (defined benefit), the tier for police and firefighters hired just before 2005, a typical firefighter with average pay of $80,000 and a full career would get a benefit of a little over $45,000. He reported that the benefit would be substantially less for employees in Tier IV (defined contribution) because their investment return was not likely to be as good as the return under a defined benefit program and they did not know how long they would live so they did not know how quickly to draw down the benefit. The third bar on the slide showed that even if employees were just in social security (which they are not), the benefit would be almost as good as Tier IV.

9:49:38 AM

Mr. Fornia turned to slide 6 titled "Why is change necessary?" He provided some of the numbers behind the data. He detailed that a typical person used in the data had 25 years of service, retired at 56, and had been hired at 31. He detailed that an employee whose benefit was 57 percent of their pay under the defined benefit plan fell to 31 percent under the defined contribution plan. He detailed it was a 26 percent pay reduction. He explained it meant that individuals were running out of money in retirement. He understood the committee had heard information a year earlier from Bob Mitchell [CIO, Treasury Division, Department of Revenue] who had done some work showing very similar results. He pointed out that the data did not cover medical. He clarified that the program in the bill did not change the retiree healthcare program for people hired since 2005. He noted that one of the reasons the state's [defined benefit] plan had the higher unfunded liability was because it included the healthcare program. He informed committee members that most states did not offer retiree healthcare in their pension program. He detailed that when comparing an unfunded liability member in Alaska with an unfunded liability member in another state, the other state was likely not counting healthcare. He reported that Alaska and Ohio were the only two major states that funded retiree healthcare through their pension program.

9:51:01 AM

Mr. Fornia moved to slide 7 and reviewed defined benefit and defined contribution plans. He stated that a defined benefit plan was what Representative Josephson referred to as an old-school pension and a defined contribution plan could be thought of typically like a 401k. He noted a 401k was the most prominent plan in the private sector; it was a plan for people like himself who saved for their own retirement.

Mr. Fornia explained that a defined benefit plan paid over the life expectancy of the average employee. He noted that actuaries were mostly accurate when predicting the number of people who would be alive the following year, which was a pretty easy thing to predict on a group basis. However, on an individual basis it was very difficult to predict. For example, he shared that his mom was 88 and she was saving for retirement - he did not know whether she would live one more year or 12 more years. He stated it was very difficult for someone to plan on how long they have to pay themselves. Additionally, defined benefit plans had a diversified portfolio and could maintain a very well diversified portfolio of stocks and bonds throughout the entire period. He shared that he was 62 years old and was retiring in several years; therefore, he was starting to have to be more conservative in his investment. He stated that defined benefit plans were also better managed. He detailed that the investors ARMB worked with to invest the money were much better than the average 401k owner investing on their own.

Mr. Fornia reported that defined contribution plans were very consistent with the individual responsibility theme. He detailed that the employer paid a given amount and it was up to the employee to figure it out. He elaborated that the plan was portable and under the employee's full control. He explained that the situation was currently shooting the state in the foot. He highlighted that a firefighter or police officer could work five years in Alaska at the beginning of their career, have a pretty decent balance and go to another state to buy into a new plan. He explained that the individual got the best of both worlds - they received a portable benefit early in their career and a guaranteed benefit later in their career. The advantage of a defined contribution plan for the employer was there was no risk of an unfunded liability. Under a defined benefit plan there was a real risk of an unfunded liability, which Alaska had seen with its $11 billion unfunded liability.

Mr. Fornia discussed that the bill used a shared-risk hybrid plan, which had features of defined benefit and defined contribution plans. The plan had the cost-effectiveness of the defined benefit plan, while the risk (of things not turning out as well as the actuary predicted) was borne by the employer and employee. Under the proposed plan, an employee would receive a lower benefit than Tier III, and their contribution would increase from 8 to 10 percent (a 25 percent cost increase)[if the plan funded rate dropped below 90 percent], and if the plan fell below 90 percent funded the post-retirement inflation adjustment could be suspended by ARMB until solvency improved. He stated that many plans around the country were currently going through changes and were using COLAs. He explained that if investments were terrible, it was fairly easy to suspend a cost of living adjustment compared to making other changes.

9:55:10 AM

Co-Chair Merrick informed the presenter there were about 15 minutes remaining in the hearing.

Mr. Fornia replied that he would wrap up in five minutes. He looked at slides 8 and 9. The plan included a fixed contribution, and the goal was to manage the plan that covered the target as well as possible. He looked at a table showing a plan comparison on slide 9. He relayed contributions would be about the same for employees to start with, but the number may increase if needed. The employer contributions and vesting were the same. The retirement age was a substantial change from any age to age 55. The benefit multiplier was essentially the same and the final pay was about the same.

9:56:34 AM

Mr. Fornia continued with a plan comparison on slide 10 and noted that the disability and death benefits were the same. He addressed an earlier question about how soon there would be money going out of the program. He explained that in theory, if an employee bought into the plan and later became disabled or died, there could be some monies going out; therefore, the plan would have a small outflow in the first few years. He turned to slide 11 and noted that when the plan had been designed, they wanted to make sure it would be okay; therefore, they had opted to use a more conservative rate of return than the return used by ARMB.

9:57:18 AM

Mr. Fornia looked at slide 12 and shared that current Tier IV members could take their money from Tier IV and use it to purchase equivalent benefits on a cost neutral basis and the plan would start out at 100 percent funded. He added that ARMB and its actuaries would calculate formulas to make certain it was the case. He skipped slides 13 and 14 and explained that the bill included a lower pension than Tier III. He briefly highlighted slide 15 and reported there were three safeguards in place that resulted in a low risk of being poorly funded. Slide 15 showed the first safeguard, which was the benefit reduction. Slide 17 showed the second safeguard related to actuarial methods. He explained that the plan was designed to be over funded. He detailed that if things turned out to meet the predictions, the plan would be more than 100 percent funded.

9:58:43 AM

Mr. Fornia advanced to slide 19 titled "Benefit Plan Simulations - Historical." He referenced Representative LeBon's earlier question about the likelihood of the plan becoming poorly funded. He had modelled how the plan would have looked for each 20-year period from 1980 to 2000 and 2000 to 2020. He highlighted the worst case scenario where the plan started just before the burst of the dot-com bubble, the first two or three years followed the burst of the bubble, and eight years in the financial crisis occurred. Under the scenario the average return had been 8.6 percent. He pointed to a line graph on slide 20 showing examples of what might have happened to the plan's funding ratio in the past. He directed attention to the gray line representing the worst case scenario. He detailed that if the plan had started in 2000, the funding ratio would have dipped close to 90 percent in three years due to the bursting of the dot-com bubble. The funding ratio would have returned to 100 percent and in 2009 it would have dropped below 90 percent. In 2009 it would have been necessary to raise the employee contributions by 0.25 percent and suspend the PRPA. He noted the action would not have done much because there would not be a significant number of people collecting benefits at that time. He estimated that the [employee] contributions would likely have been close to 10 percent by 2013. He explained that the contribution increase would have been unwound by the present time because the plan would be over 100 percent funded.

Mr. Fornia explained that ARMB would be the entity responsible for making decisions related to employee contributions and responding to changes in the solvency of the plan. He noted his modelling showed increasing half of a percent [0.005] each time the plan dipped below [90 percent funded]. He looked at other scenarios shown on slide 20. The orange reflected the average scenario where the plan started in 1995. The plan would have looked great in the first years and would have dipped down close to 90 percent in 2009 as the Great Recession hit and would be back to 100 percent funded at present. He highlighted one of the better cases (reflecting the fifth best out of 20 modelled cases) shown in yellow. He characterized the scenario as fantastic where the plan would get up to 140 percent funded and then begin to dip down.

Mr. Fornia highlighted that in the real world, the solvency percentage would be somewhat volatile. He detailed there was a strong chance solvency would reach 90 percent occasionally; however, there was not much chance the plan would dip below 90 percent funded. He stressed that under the bad scenarios, the scenarios were bad for everything. He elaborated that under the scenarios where the plan would be under 90 percent funded for an extended period of time, it would mean a Great Depression type of situation.

Mr. Fornia turned to slide 21 titled "How have other states operated?" He highlighted a somewhat similar plan in Wisconsin that had been around for decades and had worked well immediately following the Great Recession. He elaborated that Wisconsin had suspended some if its COLAs for several years, but everything was back in place at present. He noted that South Dakota had a similar plan, and the two plans were very well funded. He noted that Colorado and Ohio were not so well-funded, and they had similar mechanisms in place. He moved to slide 22 showing a case study of Wisconsin as a good example of what other states had done.

10:03:24 AM

Representative Wool addressed the concern about unfunded liability. He remarked that the bill applied only to the public safety component of public employees at around 3,000 or $4,000. He estimated the number as one-tenth or less of the total number of state employees. He noted that many people would like to include all public employees. He stated that in the event of a loss, using a smaller population would reduce the size of the loss. He asked if the inverse worked. He referred Mr. Fornia's reference to years where the plan was funded at 133 percent. He asked if the economy of scale would add benefit. He understood they did not want to lose with 3,400 or 30,000. He asked if a larger pool was better. He understood it was not the goal for the bill and he was not pushing for it at the time.

Mr. Fornia answered in the affirmative. However, he underscored that he did not want temporary euphoria to cause a reduction in contributions or an increase in benefits, because markets went down as well as up. He stressed that there was nothing wrong with a plan that was 120 percent funded. He characterized the situation as a desirable position. He agreed that the inverse was true, if the plan worked well for a small group, it would work even better for a larger group.

Representative LeBon stated that the program was identified as a shared risk hybrid retirement program for public safety. He was still trying to wrap his head around the shared risk component. He stated his understanding that the shared risk was limited to the employee, but it was 100 percent the responsibility of the state if the future did not pan out in the desired way and an unfunded liability occurred. He referenced the employee contribution rate that capped at 10 percent. He asked about increasing the cap to 12 percent to share some of the risk.

10:06:59 AM

Mr. Fornia answered that it would be a reasonable approach. He clarified that based on the modelling, the chances of the employee contribution going above 12 percent were very remote. He encouraged the state's actuary, Buck, to do similar projections. He guessed the scenario was possible. Under the scenario, the state's $5 billion unfunded liability would likely have increased to $15 billion to $20 billion because it would take really terrible returns to get to the point of raising the members' contribution rate. He considered that if in 15 years there had been disastrous returns, he believed it would be very reasonable to change the law to a 12 percent cap. He emphasized that the plan had been designed so the scenario was a very unlikely event. He added that the legislature had the authority to change the law to increase the employee contribution, but it was not possible to go back and cut benefits in most states.

Representative LeBon communicated that he got nervous about being told not to worry about the future and that everything would be fine. He preferred to not count on future legislatures fixing something 15 years in the future when it could be fixed at present.

Representative Josephson surmised there was not time to hear from the other invited testifier.

Co-Chair Merrick replied they would hear the presentation from Mr. Miranda with the Alaska Professional Firefighters at the next hearing on the bill.

Representative Josephson shared Representative LeBon's concern with unfunded liabilities because they were an imposition on future generations; however, if the plan was overfunded, it was an imposition on the current generation. He stated that theoretically, if a plan was 120 percent funded, the employee was not getting the benefit they mathematically would be entitled to. He stood by the state's actuary who had testified the previous year that the plan was 99.3 percent funded. He noted that the employees would receive less pay if ARMB believed their contribution rate needed to increase. He pointed out that the employees would receive less pay than a typical pensioner if the performance was poor. He explained that the employees would suffer inflation and not have an inflation adjustment. He stressed that employees did have skin in the game. He underscored employees had to hang in there until they were 55 for retirement benefits and 65 for health benefits with inadequate healthcare. He pointed out that employees would need a second job if they retired in their 40s.

Co-Chair Merrick thanked the presenters.

HB 55 was HEARD and HELD in committee for further consideration.

Co-Chair Merrick reviewed the schedule for the afternoon.

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ADJOURNMENT

10:11:07 AM

The meeting was adjourned at 10:11 a.m.