

SENATE FINANCE COMMITTEE  
January 23, 2024  
1:33 p.m.

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CALL TO ORDER

Co-Chair Olson called the Senate Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Donny Olson, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Click Bishop  
Senator Jesse Kiehl  
Senator Kelly Merrick  
Senator David Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Cathy Giessel; Ken Alper, Staff, Senator Donny Olson; Senator Forest Dunbar.

PRESENT VIA TELECONFERENCE

Gene Kalwarski, CEO, Cheiron; Teresa Ghilarducci, Economist, Pension Coalition.

SUMMARY

SB 88 RETIREMENT SYSTEMS; DEFINED BENEFIT OPT.

SB 88 was HEARD and HELD in committee for further consideration.

Co-Chair Olson noted that former Speaker of the House John Harris was in the audience as well as former Representative Chuck Kopp.

#sb88

SENATE BILL NO. 88

"An Act relating to the Public Employees' Retirement System of Alaska 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 of Alaska and the teachers' retirement system; and providing for an effective date."

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Co-Chair Olson relayed that it was the first hearing for SB 88. The bill was heard during the previous session, at which time the committee heard public testimony. The committee adopted a Committee Substitute (Version 0) on May 12, 2023.

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KEN ALPER, STAFF, SENATOR DONNY OLSON, discussed a presentation entitled "Senate Bill 88 - Defined Benefit Pensions - Update on Process to Date, Senate Finance Committee - January 23, 2024" (copy on file). He relayed that at the end of his presentation there would be a motion to adopt a new Committee Substitute (CS).

Mr. Alper looked at slide 2, "Current Defined Contribution System in Place since 2006":

- Alaska's public employees (PERS) and teachers (TRS) had a traditional "defined benefit" pension system from 1961 (PERS) or 1955 (TRS) until 2006
- Beginning in 2002, Alaska started seeing growing "past service cost," driven in part by bad actuarial advice and under-contribution to the system
- SB141 passed in May 2005; the new "tier" for both PERS and TRS took effect for all new employees beginning on July 1, 2006
  - o New plans also changed the retirement health care system, putting most of the costs on retirees and the Medicare system
- Subsequent legislation from 2008 established a process for the state to make additional contributions to the system to help pay down the unfunded liability

Mr. Alper noted that the term "past service cost" was defined in statute and signified the difference between the future cost to pay pensions and the amount of funds currently available. He expanded that a synonymous term sometimes used was "unfunded liability."

Mr. Alper spoke to slide 3, "Various Proposals to Restore Defined Benefit in Recent Years":

- Proposals to return to Defined Benefit have been introduced in every legislature beginning in 2007
- There have been bills for full repeal/restoration, hybrid systems, and plans limited to certain worker groups such as teachers or public safety employees
- Proposals coalesced around principles of:
  - Restoring Defined Benefit for all employees
  - Minimizing chance of accruing new past service costs
  - Keeping the current retirement health system

Mr. Alper discussed attempts to go back to a defined benefit (DB) system.

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Mr. Alper referenced slide 4, "Specific Concerns on Recruitment and Retention":

- High vacancy rates/reduced customer service
- High turnover/high training & recruitment costs
- Increasing number of employees taking their training, and their portable retirement accounts, to jobs out of state
- Growing use of bonuses and other work-arounds

It is unclear to what extent this is related to the pension system, but many employers and employee groups believe there is a strong correlation. There is also a growing body of research indicating this.

Mr. Alper relayed that much of the conversation pertaining to the bill was related to recruitment and retention, and the state having a full workforce. He mentioned the presentation from the Office of Management and Budget (OMB) earlier in the day that had referenced vacancy rates in state agencies. He discussed the effects of high vacancy rates and increased training costs. He cited that the goal of the pension system was to eliminate the problems listed

on the slide. He stated that it was unclear to what extent the state's personnel problems were related to its pension system but thought many believed there was a strong correlation and he thought there was a strong connection.

Mr. Alper turned to slide 5, "Major Provisions of Bill":

SB88 was introduced on March 1, 2023 and has 11 co-sponsors

- Pension accrual of 2% to 2.5% per year of service comparable to pre-2006 tiers
- Variable employee contribution rate between 8% and 12% that can be increased by the ARM board when the fund is stressed
- Variable employer contribution that can be reduced when well funded
- Variable post-retirement (inflation) adjustments to keep the plan funded at greater than 90%
- No changes to the current retirement health system (both the "Health Reimbursement Arrangement" (HRA) and the share of major medical premium costs). Major savings vs. the legacy health plan
- New employees enrolled in new system
- Option for current active Defined Contribution employees to transition to new system. Division of Retirement and Benefits will calculate how to convert each employee's DC account balance into years of service

Mr. Alper discussed post-retirement inflation adjustment and cited that it was not automatic and only kicked in if there were adequate funds in the system. He cited that the current health plan, which was kept in place with passage of the bill, was a great savings to the state.

Mr. Alper noted that the Division of Retirement and Benefits (DRB) would have a short-term surge of activity to calculate the transition of current employees to the new system.

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Mr. Alper considered slide 6, "Process in Senate Labor and Commerce Committee":

- Eight hearings in March and April
- Major changes of Committee Substitute:

- Increased maximum employee contribution rate and made employer contribution rates able to flex lower when adequately funded
- TRS "high 5" years to determine basis for pension can be non-consecutive
- 50% reduction to post retirement inflation adjustment (PRPA) for nonresidents
- Tighter requirement for ARM Board to separately track the accounting for the new tier
- Provision added to allow employees transitioning from DC to the new plan to buy back any time if their funds are inadequate
- Former DC employees who return to service can also opt into new plan

Mr. Alper commented that Senator Jesse Bjorkman had heard the bill eight times in the Senate Labor & Commerce Committee. The bill would allow for purchase of years of service.

Mr. Alper displayed slide 7, "Process to Date in the Finance Committee":

- Five hearings between May 2 and the end of session, including public testimony
- Work draft Committee Substitute \O adopted on May 12. The CS made a handful of mostly technical changes
- Two additional amendments received, incorporated in new CS\T
- We've heard from three separate actuaries:
  - The Finance Committee hired an actuary, Gene Kalwarski (Cheiron), who presented his report and analysis on May 12
  - The stakeholders' actuary, Flick Fornia, also presented on May 12
  - The Department of Administration's actuary, David Kershner (Buck) presented his analysis and fiscal note on May 13

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Co-Chair Olson asked Mr. Alper to allow time for questions.

Senator Wilson asked if the Department of Administration (DOA) had created a new note for the forthcoming CS Version T.

Mr. Alper explained that the fiscal note the committee had was written to Version D of the bill, which had come from the Senate Labor & Commerce Committee. He explained that there would be new fiscal notes generated when the committee passed the bill. He explained that the changes made in committee were relatively small in fiscal impact. He thought some of the source data would be different and would result in a different analysis.

Senator Wilson asked about accounting being separate from the health trust and wondered about fiscal aspects of the bill being changed.

Mr. Alper did not know to what extent the assumption was built into the fiscal notes. He recalled that Senator Wilson had raised the question the previous session. He noted that the health plan in the bill and in the current system were the same. He referenced an inadvertent "diminishment issue," where people from one plan would pay for the people from another plan. He mentioned that the new CS contained an amendment that stipulated that the two plans would remain separate from each other.

Senator Wilson commented that the current plan was significantly overfunded and expressed concern about financial ramifications with a new plan. He wanted to know if the department had a way to contact the actuaries to see if the matter had been incorporated into the actuarial assumptions.

Mr. Alper cautioned that he was not qualified to substantively answer Senator Wilson's question. He relayed that invited testimony could better address the question. He noted that DRB would be in committee the following day and could address the topic.

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Co-Chair Stedman thought there was always confusion when there were dueling fiscal notes and dueling actuaries. He thought the legislation was significant. He understood that Buck Consulting was doing an updated analysis, which he thought would clear up some of the discussion. He thought there needed to be more of a comparison and contrast between the current system and the system proposed in the legislation. He thought both systems had pros and cons. He suggested that the committee ask the department to address

things with clarity during its presentation in committee the following day.

Mr. Alper agreed that having dueling actuaries was problematic and noted that his upcoming slides would address the topic. He thought upcoming testimony would also be addressing the topic. He noted that he had spent some time during the interim discussing the matter and had learned some interesting things.

Co-Chair Stedman commented on references to the causes of high vacancy rates. He thought salaries and housing were big issues. He wanted the committee to note that North Dakota had switched to a defined contribution (DC) plan, and had shut down its defined benefit (DB) plan, and were \$2 billion in deficit. He thought the vacancy issue was nationwide, regardless of the benefit plan.

Co-Chair Olson agreed that there was a workforce shortage nationwide.

Mr. Alper referenced the three actuaries listed on slide 7.

Mr. Alper highlighted slide 8, "Actuarial Analysis and Fiscal Notes":

- All analyses have separately modeled three different employee groups: PERS general, PERS public safety, and TRS
- Cheiron "base case" was more or less fiscally neutral
- Buck analysis showed a cumulative \$1.2 billion cost to the state over 16 years, with \$700 million for state employees and \$500 million in additional state contributions towards municipal and school district employees
- The first six years of the Buck analysis was used for the two major fiscal notes attached to the bill

Mr. Alper relayed that the Buck Consulting analysis had been surprising and was part of the two fiscal notes before the committee.

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Mr. Alper looked at slide 9, "General Concerns with Fiscal Notes":

Cheiron's analysis was an "apples to apples" comparison assuming the same employee base for both the status quo and if the bill passed Buck's analysis assumed rapid and substantial improvements to recruitment and retention should the bill pass. Because of this:

- The bill led to longer-tenured, higher paid employees and lower vacancy rates, and a significantly higher payroll than the status quo. By the last year of the analysis (2039), there was a \$250 million difference in payrolls
  - The Buck analysis also increases the state contribution rate when needed, without concurrently adjusting the employee contributions
- The bulk of the fiscal note cost is due to the larger payrolls and the bill's "success" in solving our workforce problems.

If it doesn't actually work, those costs won't be incurred

Mr. Alper discussed the assumptions behind the two actuaries' analyses.

Co-Chair Olson asked how Buck Consulting could be so certain about the improvement of the recruitment and retention rate.

Mr. Alper thought Co-Chair Olson posed a great question, and suggested that any such analysis would carry certain assumptions. He continued that there were two decisions before the committee: whether it wanted to pass the bill, and if the committee was ready to fund the outcome. He summarized that if the bill ended up not working, there would not be an additional cost. He pondered whether the legislature was prepared to take the chance of the new system working and then fund the solution. He relayed that he had been surprised at the substantial difference in payroll was in the "after" scenario.

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Senator Bishop asked Mr. Alper to define "fixing the problem."

Mr. Alper relayed that he had been led to understand that the problem was in recruitment and retention, high vacancy rates, and not being able to get qualified state employees. He mentioned the tremendous inefficiency of training employees at great cost, after which the employees left the positions after only a few years.

Senator Wilson affirmed that what Mr. Alper referenced were problems but did not think all the issues were tied to the pension problem. He referenced toxic workplace environments. He thought the state had not addressed the subject of workplace culture and that there was an issue of bad management. He commented on the fiscal notes. He considered past budgets and thought the state had paid more due to overtime and bonuses due to a diminished workforce. He thought the cost of full staffing would not necessarily be greater.

Mr. Alper referenced questions in committee when Buck Consulting was present regarding indirect costs such as bonuses, training costs, recruitment costs, and letters of agreement. He noted that the indirect costs were not baked into the personnel cost directly and were not in the fiscal note. He mentioned forthcoming invited testimony from an economist included economic impacts the state was currently absorbing that would go away if it solved its recruitment and retention problem.

Senator Wilson expressed confusion about whether the state would see savings or more costs if the bill was passed.

Mr. Alper identified that the payroll cost of salaries would go up. Some of the other costs absorbed by the agencies (recruitment, training, advertising) would go down. He mentioned the impact of the economy from reduced government service quality. He deferred further details to invited testifiers later in the meeting.

Senator Wilson wanted to understand the overall financial impacts of the bill.

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Co-Chair Stedman wondered why the bill was targeted as the answer to recruitment and retention issues when other states with DB plans had the same issues. He thought there were other issues beyond retirement.

Mr. Alper was not certain he had an answer to the question.

Co-Chair Stedman reiterated that both DB and DC plans had strengths and weaknesses. He thought a weakness of the DB plan was that the benefit structure could change in the future but not be adjusted. He mentioned the scenario happening under the old plan, which resulted in unfunded liability. He mentioned the constitutional protection of the benefits system and the concept of diminishment of benefits.

Mr. Alper relayed that he was not a part of the creation of the bill. He thought Co-Chair Stedman had brought up an important constitutional protection in the state, under which it was not possible to reduce a pension benefit. He asserted that the bill had certain flexibilities in order to prevent the system from "going underwater." He cited components such as the employee contribution rate, which started at a base 8 percent of salary, but could be raised up to 12 percent under the terms of the bill.

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Co-Chair Stedman wanted to clarify that the bill would not stop the plan from being underfunded. He understood that in the event that underfunding exceeded 90 percent, then the contribution rates changed to alleviate and eliminate the unfunded liability.

Mr. Alper believed Co-Chair Stedman's understanding was accurate.

Co-Chair Stedman thought the bill did not prevent unfunded liability, but did have a mechanism to have employees and retirees contribute more to pay off the unfunded liability. He thought the shared cost provision was a good part of the bill. He shared a concern about teachers, who were not in Social Security nor in the state's Supplemental Benefits System (SBS), which was a replacement for Social Security. He pondered that state retirees had the opportunity for 100 percent salary replacement in retirement, however teachers did not. He was concerned that Teacher's Retirement System (TRS) employees were not being offered a solution, regardless of the system that was adopted.

Co-Chair Olson thought every retirement system had different benefits.

Mr. Alper thought Co-Chair Stedman was correct regarding the teachers opting out of SBS and Social Security. He thought when there was a stronger pension system for teachers 20 to 30 years previously, but now in the DC system he thought teachers were feeling very underfunded. He thought a fundamental long-term difference in value between the DB and DC systems was that DB funds were professionally managed and tended to earn a stable rate of return and grow more where as a DC plans were left with individuals choosing investments. He agreed that the bill did not resolve the fact that a chunk of retirement stream was missing from TRS, and that the bill would not solve the matter.

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Senator Kiehl thought there had been good discussion. He thought Co-Chair Stedman was correct in looking to peers in other states. He mentioned West Virginia led with eliminating its DB plan for teachers and had soon after returned to the same system after a negative experience. He mentioned the committee having received a great deal of information the previous year on the returns from both DB and DC systems. He asked Mr. Alper to remind the committee if the DC returns were generally as good as the DB returns in projections. He recalled an average of 75 basis points lower.

Mr. Alper recalled that DC returns were lower to the magnitude of 75 to 100 basis points. He stressed that individuals would naturally not do as well as professional investors.

Senator Wilson pondered whether Mr. Alper was saying the purpose of the bill was to put state employees' money in the hands of professional money managers since the employees could not manage it wisely.

Mr. Alper appreciated Senator Wilson's framing of the concept with support of individual rights. He commented that it was fine to rely on those with a different level of expertise.

Senator Wilson was waiting to hear a yes or no.

Co-Chair Olson did not think Senator Wilson had asked a yes or no question.

Co-Chair Stedman relayed that he had asked the department to look at performance and update the DC plan data. He thought there were clearly some areas to improve upon. He thought there were some funds that outperformed the DB plan but agreed that a professional money manager had an edge over a novice, which needed to be addressed through education and fund selection. He thought the contribution rate could be adjusted to compensate.

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Mr. Alper went back to slide 9. He recounted that the Buck analysis made certain assumptions of growing state payrolls and increased costs and that the bill would succeed.

Mr. Alper showed slide 10, "Thank You":

Feel Free to Call or Email with Any Questions

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Mr. Alper recalled that at the end of the previous session there was a bill and a fiscal note, and pondered that the committee now knew the source behind the fiscal note pointed out that there was a CS that the committee could consider if so desired.

Co-Chair Stedman noted that there was a substantial number of people, including teachers and other employees not in the state system, that were not in SBS nor Social Security. He thought the matter was a local issue and mentioned many firefighters and police in the state. He referenced past updates to the retirement system and thought it was an oversight that employees were not required to be in Social Security, SBS, or some equivalent.

Mr. Alper noted that there was a series of documents that had been brought to committee the previous year that provided details regarding what Co-Chair Stedman referenced. He thought the Municipality of Anchorage and the Municipality of Juneau were still in Social Security.

He noted that the documents included a list of which jurisdictions were in which plan or neither plan, including teachers. There were a substantial number of local governments that were in neither plan, and the employees were worse off than the employees that were in one or the other. He thought the problem was not addressed in the bill and needed to be addressed in the years to come.

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Senator Kiehl MOVED to ADOPT proposed committee substitute for SB 88, Work Draft 33-LS0505\T (Klein, 1/22/24).

Co-Chair Olson OBJECTED for discussion.

Mr. Alper noted that the "T" version of the bill built upon the "O" version that had already been discussed. He addressed two changes to the bill. He mentioned that the underlying bill allowed for both the employer and employee contribution rates to increase when needed to keep the funding solvent. The CS provided that the costs would increase in sync with one another, thereby preventing increased costs being borne by one entity. The new CS would require that both the employers and employees would equally share costs of increased costs. Likewise, if the trusts were adequately funded and rates were going down, the contributions would do so in sync. The second change, referenced earlier by Senator Wilson, pertained to the health trust. The health plan was not being changed, but bill added language that the health trust for the new plan would be administered separately so there was no comingling or diminishment in value.

Senator Wilson referenced the first change pertaining to employer and employee contribution rates, and pondered why a governor experiencing financial constraints would want to fund 100 percent when employees and employers could contribute more and lower the deficit.

Mr. Alper reminded that employers were both the state and the local governments. He mentioned that the Alaska Retirement Management (ARM) Board was an independent fiduciary body that authorized the changes, and if the employer rate increased it would be shared by employers. If the rate was not increased and if the fund were left short, it would all fall to the state through the short-funded mechanism. He communicated that he was going beyond his

area of expertise and should end his remarks on the topic. He added that the intent was to not let the funding get below 90 percent, and he thought the language of the bill stipulated that if it fell below 90 percent, the rates were mandated to go up to prevent it getting worse.

Senator Wilson thought what Mr. Alper described was in the new bill in Section 69. He considered how often the ARM Board actuaries would review the rates.

Mr. Alper assumed that the director of DRB could answer Senator Wilson's question, and would be present in committee the following day.

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RECONVENED

Co-Chair Olson WITHDREW his OBJECTION. There being NO further OBJECTION, it was so ordered. The CS for SB 88 was ADOPTED.

Co-Chair Olson relayed that the committee would hear invited testimony from an actuary that would provide an analysis of the bill.

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GENE KALWARSKI, CEO, CHEIRON (via teleconference), relayed that as Mr. Alper had noted, back in May his organization performed an analysis that had come out cost neutral and had not performed further analysis since that time. He wanted to make some supplemental comments that were not shared the previous May.

Mr. Kalwarski discussed a presentation entitled "Senate Bill 88 - An Actuarial Perspective" (copy on file).

Mr. Kalwarski looked at slide 1, "Gene Kalwarski - Selected Work Experience":

- Founded Cheiron, September 2002
- Opened Washington DC office of Milliman Inc, in 1981 and served on the company's Board of Directors

- Chief Actuary policy department of the Pension Benefit Guaranty Corporation
- Substantial experience in testifying before Congress and Legislative bodies
  - Discussed legislative proposals to address the multiemployer pension crisis
  - Educated State and House congressional staff on the legislative proposals

Mr. Kalwarski reviewed slide 2, "Public Sector Experience," which listed numerous states, cities, and counties that he had worked with.

Mr. Kalwarski spoke to slide 3, "Specific Plan Experience," which showed six plans that that he considered examples of some of the worst-funded cities in the country at one time. He mentioned the city of San Diego, which had been a client of Cheiron since 2005. In 2012 the city had closed the system and created a DC system like Alaska. Two years ago, the city was forced by the state court to reopen the plan. He noted that it took about two years for most people to transition back to the DB plan.

Mr. Kalwarski referenced slide 4, "May 2023 Buck Analysis on SB 88":

- Adds \$1.2 billion in pension and health costs
  - Primary driver is change in member retention
  - In today's dollar the impact is \$660 million
  - Over the next five years, this impact is \$147 million
- Buck Analysis does not reflect substantial economic benefits of restoring DB pensions
- Actuarial Forecasts become less and less reliable in the out years

Mr. Kalwarski noted that the \$1.2 billion listed on the slide was a cumulative number, and the present value with a reasonable discount rate would be around \$660 million. He stressed the need for economic analysis.

Mr. Kalwarski turned to slide 5, "Buck Payroll and Benefit Cost Projections," which showed a line graph depicting payroll before and after the passage of SB 88, taken directly from the Buck analysis. The top showed the payroll Buck projected before SB 88, and the green line showed the

payroll after SB 88. The line showed increasingly divergent outcomes. The bottom graph showed the pension and health cost differential. He pointed out that not much was occurring until 2031 or 2032, when there was change because of the increase in payroll divergence. He did not know if the divergence could continue forever.

Mr. Kalwarski considered slide 6, "Buck Headcount Projections," which showed two bar graphs of new hires versus SB 88 plan transfers compared before and after SB 88. He noted that the slide was mislabeled and should be titled "Buck Payroll Projections." The point was to show new hires and members in the DC plan. He noted that the light blue on both graphs denoted new hires. He observed that there were far more new hires before SB 88 than the graph below, because of retention, which was shown by the red bars versus the green bars. He pointed out the last year (2039), showed twice as many people still there as compared to the top chart.

Mr. Kalwarski displayed slide 7, "Summary of Buck's Analysis":

- It is arithmetically accurate
- Reflects the benefit cost associated with increased retention of employees which is the goal of SB 88
- Does not reflect the substantial economic benefits resulting from increased employee retention

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Co-Chair Stedman referenced increased employee retention and thought there was previous testimony regarding employees that did not stay for 20 to 30 years. He wondered about the actual projected number of employees that would be retained. He did not think the data pertaining to retention of DC employees versus DB employees showed much difference.

Mr. Kalwarski thought the question should be asked of Buck Consulting the following day, since the retention assumption was made by Buck. He mentioned the difficulty in retaining teachers and public safety employees, who could leave the state for a better DB pension elsewhere. He thought the number was significant. He thought all states faced a retention problem but suspected that Alaska's

problem was more severe because public safety and teachers wanted a DB pension.

Co-Chair Stedman thought the question was straightforward. He thought a comparison of retention amongst states should not be difficult to obtain. He mentioned that Alaska's hiring data was public and imagined that other states' data was also public.

Mr. Kalwarski was certain that the ability to retain particularly public safety employees and teachers in Alaska was more difficult than in any other state that had a DB system. He suggested asking Buck Consulting for data on the turnover rate differential between having a DB system and not having a DB system, which was what produced higher payrolls.

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Senator Wilson mentioned Mr. Kalwarski's inclusion of slides from Buck Consulting. He asked if Mr. Kalwarski had done work for Cal PERS.

Mr. Kalwarski relayed that his agency had done work for Cal PERS but was not the system's actuary.

Senator Wilson relayed that he was in Los Angeles County and had visited a job fair and spent time in discussion with recruiters at a California Highway Patrol booth. He mentioned that he had discussed recruitment issues and retirement and benefits, and the recruiters had indicated that they had the same set of issues. The recruiter had mentioned issues with salaries. He discussed work with the National Conference of State Legislatures (NCSL) and learning about the changing workforce and the "gig economy." He asked if there was a generational difference that would cause higher turnover. He suggested that the new generation of workers coming into the workforce had a higher rate of turnover.

Mr. Kalwarski agreed that there was a much higher rate of turnover in younger workers, which was already in the assumptions. He reiterated that he had been discussing public safety employees and teachers that had reached mid-career where there was higher turnover without a DB plan. He noted that Buck had assumptions about the subject, and

should be able to answer the question directly the following day.

Senator Wilson asked Mr. Kalwarski about the number of years before someone became a longer-tiered employee.

Mr. Kalwarski noted that his sister was a teacher and had recently retired. He thought that when she had reached about age 40 she had realized that retirement and a DB system was important to her. He qualified that the information was anecdotal.

Senator Wilson asked if Mr. Kalwarski was saying that employees from age 24 to age 40 were entering the workforce before thinking about retirement.

Mr. Kalwarski clarified that he was not saying that the DB system helped hiring new employees, but rather he was discussing retention.

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Mr. Kalwarski returned to slide 7, and pointed out that the benefit cost was limited to pension and health and did not reflect economic benefits. He noted that actuaries were not skilled to quantify the economic benefits of increased employee retention.

Co-Chair Stedman discussed the concept of the DB and DC systems, and asked if there was an age group or time span that the DC plan would be of more interest to employees, or if the DB plan would always prevail.

Mr. Kalwarski relayed that he had seen from experience that people in their 20s and early 30s did not care that much about DB plans because they did not view their employment as a career, although public safety and teacher employees tended to be more career minded.

Co-Chair Stedman clarified that he was inquiring about the analysis. He asked about those working in a DC plan for five, ten, or twenty years; compared to working the same amount of time in a DB plan. He pondered whether there was a difference in the plans where one plan was better for a certain age group or length.

Mr. Kalwarski considered a person that worked five years in the DB plan. He estimated that at age 65 the DC program would be greater, but as time went on the DB plan would take over.

Co-Chair Stedman mentioned testimony that referenced work going past five years into the teens.

Mr. Kalwarski thought once an employee reached ten years, the DB plan would have taken over [to be better].

Co-Chair Stedman pointed out that the earnings potential from the DC plan was almost always less than that of the DB plan. He referenced comments made by Mr. Alper.

Co-Chair Stedman noted that once an employee separated from the DB plan, the benefits were frozen and did not increase. If one was in the DC plan, the money stayed with the employee and compounded for the next 30 years.

Mr. Kalwarski hypothesized about a DB plan frozen at \$1,000 per month, and the value of the \$1,000 increased with interest as the employee approached age 65. He summarized that the present value of \$1,000 per month payable at age 65 was much greater than the present value of \$1,000 per month at age 30, payable 30 years in the future.

Co-Chair Stedman thought the vast majority of employees did not stay for 30 years.

Mr. Kalwarski respectfully disagreed. He believed that for a person who left at 15 years, a DB pension at retirement was greater than accumulated contributions from a DC plan.

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Senator Kiehl thought it sounded as though, considering plan design and employee incentives, an employee working five to eight years in a DC plan and then left money in the plan and moved elsewhere for a DB plan would get a maximum individual retirement.

Mr. Kalwarski agreed because in the first five years the DC plan benefit could be greater. He qualified that it was not common for employees that worked only five or six years in a DC plan environment to leave money for 30 years. Many individuals took the money out to use for expenses.

Senator Kiehl considered plan design and estimated the average age of a new employee in Alaska was 44 or 45. He mentioned the state's desire to recruit young Alaskans into public service, and thought it sounded like for the average individuals coming in mid-career would be better off with the DB plan. He thought that without a DB plan there was an incentive for the employees to go.

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Co-Chair Stedman wanted to hear from Mr. Kalwarski regarding when a DC plan might be preferential to a DB plan.

Mr. Kalwarski thought there was no one answer, and that Co-Chair Stedman's question was dependent upon the plan provisions. He asked for an example of a DC plan formula versus a DB plan formula.

Co-Chair Stedman thought Mr. Kalwarski's testimony made it sound as though the DB plan was always preferential. He recalled other testimony in committee that suggested there were pros and cons to each plan, depending upon the structure and retention issues. He mentioned the structure of the economy, and generations and how they viewed employment.

Mr. Kalwarski noted that his early comments were not meant to indicate that a DB plan was always better, and he had expressed that in the short term a DC plan could provide a better benefit.

Mr. Kalwarski turned to slide 8, "What The Forest Includes":

- Extra \$2.7 billion in payroll
  - Where will the money be spent?
  - Where will the higher pensions be spent?
  - How much more taxes will the state receive?
  - Higher income => Improved Morbidity
  - What will be the impact of improved services?
- Significant cost savings in employee recruitment and training
- Etc.....

Mr. Kalwarski noted that actuaries were not trained in economics, and he had urged all parties to seek out an economist that could speak to the issues listed on the slide.

Senator Bishop commented that the third biggest cost driver in the budget was health care. He mentioned living with dignity in one's retirement years. He commented on the cost of staying in a retirement home. He mentioned his father, whose DB plan was paying his way in a retirement home.

Co-Chair Olson relayed that the next presenter was an economist on contract with the Pension Coalition. He noted that she had provided the committee a report on the fiscal and economic impact of SB 88 (copy on file).

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TERESA GHILARDUCCI, ECONOMIST, PENSION COALITION (via teleconference), introduced herself and explained that many of the questions that Co-Chair Stedman had asked had been asked and answered by economists over the previous 20 years, especially from data from the University of Michigan. The university had utilized a survey on health and retirement that had looked at how people fared in old age and stayed connected to their jobs throughout their lives. She mentioned references in her report to factors such as the generational turnover rate, and experience and productivity profiles of police and teachers. She discussed pension design that was appropriate to high peak careers versus shorter careers. She thought she had anticipated an answered many of Co-Chair Stedman's questions. She noted that her testimony would hone in on about 50 years of research by labor economists that want to help employers align compensation to the needs to the employee.

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Ms. Ghilarducci referenced her biography (copy on file) and noted that she had been teaching for about 40 years, with 25 years at the University of Notre Dame as a full professor. She was an economist and had advised former California Governor Arnold Schwarzenegger on pension design, and had worked for eight years as a trustee of the Indiana Public Employees System to oversee employees move from a DC plan to a DB plan. She mentioned similarities with Alaska including high turnover and fear of poverty in

old age. She thought DC plans could work on paper, but in real life people tended to draw from the plans before retirement and studies showed that those with only DC plans had a high risk of poverty in old age. Those with a DB plan, even in the plan for 10 to 15 years, had almost zero risk of poverty in old age.

Ms. Ghilarducci shared that she had been appointed by the President of the United States for 12 years a pension advisory board for design. She had recently consulted for the government of Puerto Rico and had testified in Congress over 15 times as well as before the state legislatures in multiple states. She noted that Nebraska was another state that had gone to a DC plan, and because of problems with turnover in occupations where experience mattered had moved over to a DB plan.

Ms. Ghilarducci emphasized that employee recruitment and retention would cost more money. She pondered that the state could raise pay quite a bit to overcome incentive that DC plans gave before moving on. She considered that a less costly way of keeping people was to change the design and adopt a DB plan, which she thought was the best design for employers who employees had productivity that increased over time and were essential for training and onboarding new employees. She noted that a state that cared about the efficiency of the pension dollar would choose a DB plan, which earned on average .7 percent more than a DC plan. If one added risk and fees, a DB plan earned even more; primarily because of scale. A DB plan had scale and could have much more of a diverse portfolio, which could offer a much higher return for lower risk than a DC plan. She added that DC plans had almost all liquid assets. She thought that matching employees' contributions through liquid assets (when they were supposed to save long term) was a mismatch of the appropriate assets to the goals of the savings.

Ms. Ghilarducci relayed that her much longer report showed that there were four sources of economic savings from switching from a DC plan to a DB plan. She would speak to two of the sources, which were the most direct and added up to about \$76 million in savings per year to the Alaska treasury. She cited that the biggest direct cost savings from reducing the hiring, training, and separation costs of employees. She noted that there were many studies that

showed a DB plan design was very much causal of a lower turnover rate, especially for those in their seventh year.

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Ms. Ghilarducci continued that employee's tenure and age made people highly sensitive to what their future was. She added that Buck consultants had access to the same literature and research and agreed. The second source of direct cost savings was a higher rate of return that would yield about about \$14 million per year in savings. She noted that the indirect costs that Senator Bishop referred to was that a DB plan kept people in the job and if people stayed in jobs they were more likely to retire in the state. She cited that a city or state employee that stayed in the state was quite valuable for the stability of neighborhoods and for the small businesses. A DB plan had a larger economic multiplier because the spendings stayed in the state, rather than a DC plan retiree that might leave the state.

Ms. Ghilarducci continued that a DB plan kept people in jobs longer, particularly teachers, and those in public service, public health, and public safety. She discussed the quality of schools and public safety being an important aspect of private investment. An economic benefit of the DB plan was to attract private investment, but it was not quantifiable and not in her report. She continued that were three ways employee turnover became important to decrease. The high turnover lowered productivity, which meant the cost of the employee was higher than it should be. She discussed productivity levels. She provided examples. Higher turnover led to lower morale of longer-term employees, and having to train people frequently led to lower morale.

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Ms. Ghilarducci stated that the third reason it was important to lower turnover was that it distracted highly productive employees that were called on to do on-the-job training. She referenced an earlier question by Co-Chair Stedman or Senator Wilson regarding a generational change in attitudes towards retirement security, and whether younger people were less concerned about employment security and pensions. She noted that studies showed the opposite, and that the current generation was one of the

most financially literate. She commented that Generation X and Generation Y were more financially literate, perhaps because they have had to take on substantial student debt. She shared she had talked to a 15-year-old the previous day who was interested to know how to manage debt later on. She shared that there was a lot of literature that showed that attitudes towards economic security led to more attraction towards better benefits, including a DB plan. She added that the DC plan, which included the ability to withdraw funds after five years, signaled to an applicant that perhaps the employment structure was not as hospitable to someone who wanted a long-term career. Conversely, a DB plan signaled that the employer had a high commitment to have an experienced workforce.

Ms. Ghilarducci began to conclude her remarks and noted that economic research found that a DB plan was best in the situation that an employer needed trusted and experienced workers. It was especially true when the employee's work depended upon trust because it was not easily monitored and quality was not measured hour by hour or day by day. Aligning compensation and benefits with productivity was consistent with the principles of strategic human resource management. She emphasized that if one's organizational goal was to have an experienced and productive workforce, then it would need a compensation that indicated as much. She emphasized that a DB plan dollar was much more efficiently invested than a DC dollar.

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Senator Wilson clarified his earlier question. He asked if the younger generation was more astute, if it was not as easily tricked by "golden handcuffs."

Ms. Ghilarducci thought that the younger generation knew that DB plans were more secure, and many of them had said they do not want to repeat the mistakes of their parents. The information came from studies of the Pew Commission and was especially true of those that wanted to go into public safety, public health, and teaching. She qualified that the information was empirical and not ideological.

Senator Wilson looked at page 5 of the study provided by Ms. Ghilarducci. He discussed recruitment of teachers and considered university slots for job openings. He thought

the same could be said for attorneys and doctors. He considered how teachers in New Jersey and New York had the highest paid teachers in the nation and also had social security. He wondered if Alaska was able to pay more and secure Social Security for teachers if it would be able to retain them as employees.

Ms. Ghilarducci considered which part of the pay package would connect a worker to the position, and thought it was very difficult to decompose and quantify. She was convinced that the DB plan design and pay were particularly interesting for workers who were trying to decide whether to move from a profession or employer. She referenced Senator Wilson's mention of golden handcuffs, but thought it was often welcome for people that wanted to stay in their career. She thought all of the elements helped to retain employees, but considered that the DB plan design was of particular strength in keeping people in their jobs.

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Co-Chair Olson asked if Ms. Ghilarducci had any additional remarks.

Ms. Ghilarducci explained that after 40 years of 401k DC-like plans, there was a lot of data about what such designs did. She noted that a lot of people tended to withdraw from the plans, almost entirely before retirement, and thought it was one of the biggest failures of the American DC system. She thought the plans looked good on paper but people tended to access the cash. She made note of a trend in the U.S. for DC providers to try to make them more like DB plans. Unfortunately, the providers were going towards more of a commercial annuity, which were high-priced and did not provide the services that a DB plan could. She mentioned the struggle in advising Congress to determine a way to figure out a way of lifetime benefits to people to supplement Social Security. Advisors had found that the DB plan prevented poverty in a way that the DC plan did not.

Co-Chair Stedman asked about the private workplace and what corporations were doing with retirements.

Ms. Ghilarducci answered that several months earlier IBM had declared its 30-year experiment with a DC plan did not work in terms of keeping its engineers and it was switching over to a DB plan. She shared that the DC plan at the

university she worked at was being changed. She thought there seemed to be real concern that too many people were coming into retirement without enough income to last. She continued that even if coming to retirement with \$500,000 the ability to handle the money caused a considerable amount of anxiety and mental depression when compared to people with a DB plan. The head of benefits for Delta Airlines had told her that they had a 10 percent contribution to the DC plan. The airline knew employees stayed about 10 years and spent the money after leaving the airline. He wished they had not left their DB plan behind.

Co-Chair Stedman observed that Ms. Ghilarducci felt that the employer was responsible for the employees' well-being until the employees' death.

Ms. Ghilarducci clarified it was not her who felt that way. She elaborated that employers wanted to align compensation to the needs of the employer but were concerned that when they spent so much money it did not help their employees. She mentioned the concern about whether or not the money was being used well, and constant concern about health care spending.

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Senator Wilson asked whether it was an employer's responsibility how former employees used their money in retirement. He asked if it was the employer's role and responsibility.

Ms. Ghilarducci did not think private companies took on the responsibility, unless there was a union or collective bargaining engagement. She thought a public employer was really concerned about whether its retirees stayed in the state. She continued that public employers were also concerned because they did not want to pay for emergency housing or an increase in Medicaid funding. She explained that if public middle class employees could stay middle class retirees, there would be fiscal savings.

Senator Wilson relayed that the committee had been hearing from many people about the life events that arose such as divorce, major medical events, and bankruptcy. He wondered how individuals could address problems in they could not use DC funds. He asked if it would switch one problem for another later on.

Ms. Ghilarducci replied that she had spent two years on a bipartisan policy center commission that looked at emergency savings and retirement. The commission had concluded after two years that employees needed to have an untouchable retirement fund (to earn compound interest) and a credit union emergency savings fund. She expressed that combining the two items would always short the long-term needs. She pondered that [in a DC plan] the employer spent substantial money on retirement that would only be used to fund emergency needs. She mentioned research on workers in Chicago and Los Angeles, which showed that women especially viewed emergencies according to the needs of their children and drew from their liquid source of retirement for their families. She noted that 401k accounts were particularly susceptible for leakage for woman, which was especially true for divorce and family medical needs.

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Senator Wilson thought it appeared the state should consider a credit union emergency fund for employees.

Co-Chair Stedman remarked that the State of Alaska had a supplemental employee benefits system (SBS) as a replacement of social security, which was in effect a DC plan with 16.13 percent of every paycheck from the employer and employee to compound until retirement. He had not heard any complaints about the SBS system. He noted that the funds travelled with the employee after leaving service and stayed with the family upon the employee's demise. He thought the fact ran contrary to the current discussion. He had spoken with numerous employees over the years and they were happy with the SBS system. He added they were virtually the same thing.

Ms. Ghilarducci recalled being asked the question by a congressman about 20 years earlier. She knew people loved their 401k plans, in which they could see accumulation of wealth. She continued that people that were most satisfied were those with a DB plan and a supplementary plan to use for emergencies. She thought SBS was not a supplement but rather they were complimentary.

Co-Chair Olson noted that SBS was taxed when one started to withdraw money.

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Senator Kiehl agreed that it was not necessarily the employers' job to get a retired employee to the grave. He thought the notion of getting the most benefits for the dollar and for employee retention was an important part of plan design. He mentioned the 401a plan, a Social Security replacement and supplemental benefit, was designed when the state had a DB pension system. He referenced the term "leakage" and how to get the dollars into the state. He pondered how plan design could do better. He asked about the different retiree inflation adjustments for those who were long-term residents of the state versus individuals who were "snow birds." He discussed the notion of going back to Social Security and the guaranteed leakage of the windfall elimination and government pension offset that radically eroded the benefits for people with PERS or TRS.

Ms. Ghilarducci responded that the DB plan helped prevent leakage in a number of ways. She emphasized one could not withdraw DB benefits before retirement, and most people took money out of 401k plans. She mentioned a contribution holiday, which could really put a dent in the long-term balance. There was leakage in terms of short-term employees taking the Alaska contribution and leaving the state permanently. Other leakage could be employees leaving and taking the pension elsewhere. She thought the principle of the Permanent Fund Dividend (to be a resident and keep the dollars in the state) had been violated and did not seem to be consistent.

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Senator Kiehl asked about the guaranteed erosion of the Social Security benefit.

Ms. Ghilarducci noted that she tracked bills that altered the Social Security System and answered that every year for the past 15 years there had been bills in Congress but had been little accomplished. She thought the system really had to change and was hurting teachers across the country.

Co-Chair Olson thanked the presenters.

Mr. Alper provided closing comments on the bill. He thought the committee was considering huge issues and cited the role of the state in regulating the relationship between

employers and employees, and the well being of workers. He pondered the issue how to build a high-functioning workforce in the state. He thought there were strong and well-informed opinions around the table. He thought the bulk of workers appeared to want to go to a DB system. He thought the legitimate fear was the cost. He thought the bill was built to minimize the risk of future costs that were the downfall of the prior system. He pondered whether the state could find a mechanism to meet the wishes of its public employees.

SB 88 was HEARD and HELD in committee for further consideration.

Co-Chair Olson reviewed the schedule for the following day.

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ADJOURNMENT

3:25:01 PM

The meeting was adjourned at 3:24 p.m.