

SENATE FINANCE COMMITTEE
April 7, 2025
9:10 a.m.

[9:10:33 AM](#)

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:10 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Donny Olson, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Mike Cronk
Senator James Kaufman
Senator Jesse Kiehl
Senator Kelly Merrick

MEMBERS ABSENT

None

ALSO PRESENT

Kathy Lea, Director, Division of Retirement and Benefits, Department of Administration.

PRESENT VIA TELECONFERENCE

David Kershner, Actuary, Arthur J. Gallagher and Company.

SUMMARY

SB 57 APPROP: CAPITAL/SUPPLEMENTAL/FUNDS

SB 57 was SCHEDULED but not HEARD.

HB 56 APPROP: SUPPLEMENTAL; FUND CAP

HB 56 was SCHEDULED but not HEARD.

PRESENTATION: DEPARTMENT OF ADMINISTRATION, DIVISION OF RETIREMENT and BENEFITS - DEFINED CONTRIBUTION ACCOUNT PERFORMANCE

[9:11:23 AM](#)

AT EASE

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RECONVENED

^PRESENTATION: DEPARTMENT OF ADMINISTRATION, DIVISION OF RETIREMENT and BENEFITS - DEFINED CONTRIBUTION ACCOUNT PERFORMANCE

[9:12:16 AM](#)

KATHY LEA, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, introduced herself and discussed her background. She relayed that she had worked in the division for 34 years and had worked in an executive position for 22 years. She discussed a presentation entitled "Funding Status Update: Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS)," (copy on file).

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Ms. Lea looked at slide 2, "Defined Benefit vs Defined Contribution, which showed a comparison of factors between the defined benefit (DB) and defined contribution (DC) plans:

Defined Benefit (DB) plan

- Is 'defined' in the sense that the "benefit" formula is defined
- Employer contributions (Normal Cost and Past Service payment) will fluctuate annually based on the actuarial valuation*
- Benefit calculated on set formulas such as the multiplier (percentage), salary history, and duration of employment
- Provide a guaranteed benefit for employees at retirement based on the formula. Inflation-protection is also provided vis PRPAs
- Benefits can be paid as monthly payments for a lifetime

Defined Contribution (DC) plan

- Is defined in the sense that the "contributions" are defined

- Contributions are maintained in an individual account
- These contributions are invested on the employee's behalf
- Provide an account balance that will fluctuate due to the changes in the value of investments; the employee will ultimately receive the balance in their account based on contributions plus or minus investment gains or losses
- Benefits can be a lump sum, rollover to another retirement plan, or conversion to annuity payments

* Actuarial valuation: A retirement plan estimates a plan's financial position at a specific point in time.

Ms. Lea expounded on the comparisons between the two plans.

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Ms. Lea spoke to slide 3, "Contribution Rates," which showed tables of contribution rates for Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) as well as for the Supplemental Annuity Plan (also known as the Supplemental Benefits System (SBS)):

PERS: Defined Benefit Tier 3

Employee

7.50 percent - Peace Officers/Firefighters

6.75 percent - All Others

9.60 percent - School District Alternate Option

Employer* - Normal Cost & Past Service Cost

PERS: Defined Contribution Tier 4

Employee - 8 percent

Employer - 5 percent

TRS: Defined Benefit Tier 2

Employee - 8.65 percent

Employer* - Normal Cost & Past Service Cost

TRS: Defined Contribution Tier 3

Employee - 8 percent

Employer - 7 percent

Supplemental Annuity Plan (Supplemental Benefits System (SBS)) - not included in illustrations

Employee - 6.13 percent
Employer 6.13 percent

* Effective July 2008, total employer contributions are 22% for PERS Non-State employers and 12.56% for TRS employers. Under SB 55 effective July 2021, PERS State-as-Employer contributes the full actuarial rate based on the payroll of its employees.

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Co-Chair Stedman mentioned that there would be an upcoming presentation on the Supplemental Annuity Plan and the issues surrounding the state's successful replacement of Social Security.

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DAVID KERSHNER, ACTUARY, ARTHUR J. GALLAGHER AND COMPANY (via teleconference), noted that he would not be controlling the slide presentation.

Co-Chair Stedman requested that the presenter communicate which slide he was speaking to and to pause for questions.

Mr. Kershner referenced slide 4, "Comparison."

- **What are we comparing?**
 - o DB Plan provides monthly benefits based on pre-defined formulas, including Postretirement Pension Adjustments (PRPAs) based on annual changes in Anchorage Consumer Price Index (CPI); Alaska residents also receive 10% Cost Of Living Adjustments (COLA) (applied to their base benefits), but these COLAs have been excluded from the illustrations

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Mr. Kershner continued to discuss slide 4:

- o DC Plan account balance will fluctuate due to changes in the value of the investments; amount of annuitized benefit also depends on the interest rate at the time of annuitization, in addition to other factors as determined by insurers

- **Is it a true or fair comparison?**

- These comparisons are illustrated based on DC account balances assuming two alternative rates of return (5% and 7%), and assuming an average interest rate for annuity conversions; the DC account balances and annuity conversions are sensitive to these assumptions

- These illustrations compare the DB single life annuity with a single life annuity that could be purchased with the DC account balances at retirement; DB and DC members could elect to purchase an annuity other than a single life annuity, but the amount of the annuity would be different than what is illustrated

- The same assumptions are used for both DB and DC to assist in making comparisons; other assumptions could be used and would produce different results

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Mr. Kershner turned to slide 5, "Formulas and Assumptions":

- **Defined Benefit Plan Formulas:**

- PERS - Peace Officers/Firefighters Tier 3
 - $[(2.00\% \times \text{service up to 10 years}) + (2.50\% \times \text{service} > 10 \text{ years})] \times 3\text{-year average salary}$
- PERS - All Others Tier 3
 - $[(2.00\% \times \text{service up to 10 years}) + (2.25\% \times \text{next 10 years of service}) + (2.50\% \times \text{service} > 20 \text{ years})] \times 5\text{-year average salary}$
- TRS Tier 2
 - $[(2.00\% \times \text{service up to 20 years}) + (2.50\% \times \text{service} > 20 \text{ years})] \times 3\text{-year average salary}$

- **Assumptions and Common Variables:**

- Hire age = 25
- Salary at hire = \$60K with 2.75% annual salary increases
- Retirement ages: 50, 55, 60 and 65 for PERS Peace Officers/Firefighters and TRS; 55, 60 and 65 for PERS All Others
- Annual inflation (CPI) for PRPAs = 2.50%
- DC account balance annual rate of returns (ROR) = 5% and 7%

- o DC annuity conversion interest rate and interest rate for DB present values = 3.74% (based on 30-year average of 10-year constant maturity Treasury yields 1995-2024)
- o Life expectancy based on unisex (50% male/50% female) Pub-2010 General Retiree table with MP-2021 mortality improvement scale

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Mr. Kershner solicited questions on slide 5.

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Senator Kiehl wondered why the age of 25 had been chosen as the average hiring age.

Mr. Kershner responded that 25 felt like a reasonable representative age.

Co-Chair Stedman asked whether Ms. Lea had anything to add.

Ms. Lea believed the age had been used in prior comparisons had been used here for continuity.

Senator Kiehl asked about the average salary at hiring.

Ms. Lea noted that the number had been used in prior comparisons and had been used here for continuity.

Mr. Kershner relayed that when projections were run an assumption had to be made for future hires. He continued that that a new entrance profile was created based on various factors. He said that starting salaries differed but for simplicity the \$60,000 number was used. For the three groups, PERS Peace Officers/Firefighters starting salary was higher than \$60,000, TRS tended to be above \$60,000, and PERS All Others was generally at \$60,000.

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Senator Kaufman looked at slide 5 and asked about the three-year and five-year averages for high salaries. He asked what window of time those averages were drawn from.

Mr. Kershner relayed that the window as the last three-years or five-years before retirement.

Co-Chair Stedman asked whether Mr. Kershner was using a linear growth of salaries. He pointed out that some employees three- or five-year highs might not be during their last years of employment.

Mr. Kershner relayed that for calculation purposes a 2.75 percent salary increase, per year, was assumed, which would result in the last three- or five-year wage as the highest.

Senator Kaufman wondered whether the average highest years could include overtime and be reflective of the actual linear increase.

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Mr. Kershner considered slide 6, "Observations":

- The DB plans offer guaranteed lifetime income to members; post-retirement survivor benefits can be elected by the member, but the amount of the annual benefit would be less than what is shown in the exhibits
- The DB plans also provide inflation protection via the PRPAs; this can be seen by the increases in the DB benefits at 10 and 20 years after retirement; the inherent value of the PRPAs is reflected in the present value of the DB benefits
- Alaska residents also receive 10% COLAs based on their base benefits (excluding PRPAs); these were not included in the illustrations
- DC benefits at retirement largely depend on two factors:
 - o DC account investment earnings based on the member's investment elections
 - o If annuitized, the prevailing annuitization interest rates (and other factors as determined by insurers) can affect the amount of the annuitized benefit; for example, lower interest rates result in lower annuitized benefit amounts (and vice versa)
- PERS DC members contribute more over their careers than PERS DB members; the opposite is true for TRS

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Co-Chair Stedman asked Mr. Kershner to refrain from using acronyms.

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Mr. Kershner displayed slide 7, "PERS - Peace Officers/Firefighters," which showed tables comparing the Tier 3 (DB) versus Tier 4 (DC). The slide offered 4 different scenarios depending on retirement plan. The first three blocks showed common items for both DB and DC participants. He shared that the slide showed the assumed retirement age, years of service at retirement, and salary at retirement. He clarified that the salary at retirement was not the average salary. He said that a \$60,000 salary, starting at age 25 under the PERS system and retiring at age 50 with at 2.76 percent annual increase, would result in a retirement salary of \$118,222. He said that determining the defined benefit would require taking the average over the previous four years of the retirement salary. He noted that each of the four boxes on the slide showed the annual benefit at retirement, annual benefit at 10 years after retirement, annual benefit at 20 years after retirement, present value of benefit at retirement, and total employee contributions, for both the DB and DC plans. He discussed the projected benefit payments under the four scenarios in each box.

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Mr. Kershner noted the footnote on the slide, the present Value of the DB benefit includes future PRPAs. The present Value of DC benefit does not include future increases. If the DC member were to use the accumulated account balance to purchase an increasing annuity, the amount of the initial benefit would be less than what is shown in this exhibit.

Mr. Kershner continued to address the tables on slide 7.

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Co-Chair Stedman asked how to deal with the unfunded liabilities that accumulated, and how that was factored into the scenarios.

Mr. Kerchner relayed that on the DB side, assets were not allocated to participants because there was one pool of

assets within the pension trust and one within the healthcare trust. The projected calculations and liabilities were done individually for all active and inactive in the plan, and then summed up as a group. That number was then compared with the invested assets, which determined the unfunded liability.

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Mr. Kershner explained that there was no actuarial value associated with contributions in the DC plan. He shared that the only actuarial costs used for DCR were occupational death and disability benefits, and health benefits, which were excluded from the illustrations on the slide. He said that for the DC plans for PERS and TRS, both the occupational death and disability were currently overfunded, and the liability was zero.

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Mr. Kershner highlighted slide 8, "PERS - All Others," which showed a similar comparison as the previous slide, but without the numbers for retirement at age 50. He directed attention to the last row on the tables, which showed the total employee contributions for DC at 18 percent more than their DB counterparts.

Senator Kiehl noted that two out of three of the boxes showed the annual benefit 20 years after retirement, which exceeded the average lifetime of Alaskans after retirement.

Mr. Kershner replied that the 10- and 20-years' timeline was chosen randomly. The life expectancy was reflected in the present value calculation. The fact that some members may not be alive 20 years after retirement should be considered, but the annual benefits at 10 years and 20 years were illustrative amounts to show the impacts of the post-retirement benefit adjustment, but the life expectancy was reflected in the present value calculations.

Senator Kiehl thought that without factoring in the life-expectancy delta there might be a disparity between total employee contributions and the annual benefits. He considered that the disparity was not so great when the pooling effect was considered.

Mr. Kershner asked what Senator Kiehl meant by "pooling effect".

Senator Kiehl thought that with DB there was the ability to pay the benefits 20 years after retirement to those who were still living, but some of the money used came from those who lived the average life-expectancy or less.

Mr. Kershner agreed that there would be some members that died before their life-expectancy and some members who outlived the life-expectancy. The decrease in benefit for those who dies would be used to pay for those that lived longer. On the DC plan, if someone took their accumulated DC balance upon retirement, that would be the total amount they would ever receive.

Mr. Kershner continued that if a member chose to annuitize the benefit, there was a risk that they may not receive the full worth of the benefit. There were options DC members could elect, to annuitize to ensure that the participant would receive their DC balance paid out as benefits.

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Senator Kiehl considered how few people would have 35 years of service and still be receiving a benefit 20 years after retirement, and how many fewer would do the same with 40 years of service. He understood that the age 25 at the beginning of service was used for consistency with past comparisons, but suggested that the average age should be 35, realistically. He felt that very few people would be receiving benefits 20 years after retirement.

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Senator Kaufman thought Mr. Kershner had indicated that the numbers were based on single survivorship.

Mr. Kershner agreed.

Senator Kaufman wondered what a spouse would get in the event of the death of the primary account holder, assuming there was a survivor benefit.

Mr. Kershner said it would depend on the participants age and gender, as well as the age and gender of the beneficiary. He used the example of a male participant with

a female spouse who was three years younger, a 50 percent survivor benefit would pay a fixed amount for as long as the participant was alive. When the participant died, their spouse would receive 50 percent of the amount the participant had been paid when alive, for the remainder of their lifetime. He provided several options available for survivor benefits.

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Co-Chair Stedman thought it would be helpful to look at benefit comparisons for the average PERS employee in 5-year increments. He stated that most people did not stay in state employment for 30 years. He recognized that there was interest in excluding workers that did not make it 25 or 30 years but felt the impacts of those employees was important.

Ms. Lea agreed.

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Mr. Kershner looked at slide 9, "TRS," which showed a comparison for DB Tier 2 versus DC Tier 3; a similar layout as reflected in slide 7. He noted a difference in employee contributions where DB members contributed 8.65 percent, while TRS DC members contributed 8 percent. The total contributions for DB members were greater than those for DC.

Senator Cronk relayed that he was a 25-year TRS retiree. He thought there was no way that he'd paid in the amount he would be drawing out. He likened the retirement plan to a "legalized Ponzi scheme". He wondered how the system could sustain itself.

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Mr. Kershner clarified that Senator Cronk was referring to DB.

Senator Cronk answered in the affirmative.

Mr. Kershner pointed out that the top left box showed a TRS retiree who retired at age 50 and contributed \$183,134, over 25 years. He asked to keep in mind that the DB plan had three sources of contributions: members, employers, and

the state. He shared that the excess of the actuarial determined contribution rate that was not paid by members or employees was paid by the state. He said that additional state contributions fluctuate every year. He said that there was a large portion of the DB plan, not reflected on the slide, that came from the employers and the state.

Co-Chair Stedman recalled that Ms. Lea had given a presentation to the other body that contained up-to-date tables on the unfunded liability payments. He thought that it would be beneficial to incorporate the data into upcoming presentations. He wondered whether the Tier 1 and 2 numbers for TRS could be bifurcated, as their unfunded liabilities differed.

Mr. Kershner replied that it was possible. He said that the evaluation reports provided the expected normal cost, by tier. He lamented that there was no way to allocate the unfunded liability by tier because there was one pool of assets used for all participant beneficiaries. He said there was no way to allocate assets by tier.

Co-Chair Stedman felt that it was important to recognize that older tiers were more expensive.

Senator Kiehl asked Mr. Kershner about his use of the term "normal cost."

Mr. Kershner explained that there were two components of the actuarial defined contribution rate for DB and DC. The normal cost was the actuarial value of benefits expected to accrue in the upcoming year as active employees earned one more year of benefit.

Senator Kiehl asked about the employer normal cost for a TERS Tier 2 member.

Mr. Kershner relayed that for TRS Tier 2, the employer normal cost as percentage of the Tier 2 compensation for FY 25, the pension normal cost was about 7.8 percent of pay and the healthcare was about 7 percent of pay, for 14.8 percent total. He added that was net of the member contribution of 8.65 percent.

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Co-Chair Stedman mentioned the supplemental benefits system (SBS) and noted that TRS was not included in SBS or Social Security. He asked Mr. Kershner to incorporate what the numbers would look like with fewer in PERS with SBS versus TRS. He mentioned that some members were concerned that TRS was deficient without Social Security or SBS.

Ms. Lea agreed to provide the information.

Co-Chair Hoffman asked for the percentage of state employees under the DB plan at the end of the previous year.

Co-Chair Stedman believed Ms. Lea had the information.

Ms. Lea cited that there were about 7,900 active DB members currently.

Co-Chair Stedman asked for the charts to be given to the committee.

Senator Cronk to clarify that the employer was the state and the TRS retirement benefits came from the state.

Co-Chair Stedman relayed that years ago when the retirement plan had been rewritten, the constitutional obligation for the state was for education, which was why the state picked up the TRS balance. He thought another issue of interest was the amount of non-state employers that were not paying PERS obligation, and who was paying for it. He thought the matter should be looked at.

Senator Kiehl identified that in municipalities that had school districts, 45 percent to 50 percent of the education funding came from local tax dollars.

Co-Chair Stedman solicited any closing comments from the presenters. He discussed housekeeping.

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ADJOURNMENT

10:23:49 AM

The meeting was adjourned at 10:23 a.m.

