

Supplemental Benefits System

February 18, 1988

Dear SBS Participant:

Major changes will be required in the Supplemental Benefits System (SBS) beginning January 1, 1989. These changes are required as a result of the federal Tax Reform Act of 1986. Legislation has been introduced by the governor and must be enacted this session to provide for the changes. Information is being requested from you to help determine the direction the change will take.

The SBS was created in 1980 to replace Social Security by providing future retirement benefits and current insurance benefits supplemental to the state health plan. Currently, the SBS consists of two major parts; insurance benefits and retirement money accumulation (annuity). Under today's SBS, 6.13% of your salary is deducted from your wages before taxes are calculated. This percentage is matched by the State for a total contribution to the SBS of 12.26% of your gross wages. This contribution is made to the SBS on each employee's behalf and is used to first pay the SBS administrative fees and insurance premiums for each employee, with the

remainder being deposited into the employee's annuity account.

Since each employee chooses his or her own insurance election and insurance premiums vary with each employee's age and salary, the result is that different percentages of salary are contributed to the annuity accounts for each employee.

This structure will not be allowed under the Tax Reform Act. A pre-set, uniform, and non-discretionary percentage of salary must be contributed to the annuity account for each employee.

In an effort to maintain as much consistency with the current SBS plan and ideals, the proposed legislation establishes two separate plans; a free-standing insurance plan and a free standing annuity plan. Each plan will be qualified under separate provisions of the Internal Revenue Tax Code. The entire employer contribution (6.13%) will go into the annuity plan.

The question that remains, and on which we would ask your advice, is: What should each employee's percentage contribution be to the annuity plan?

The answer could be all, or some portion, of the current 6.13% employee contribution. Whatever portion of this amount is not paid into the annuity account would increase the employee's "pre-taxable income" (income before federal taxes are calculated). It would then be available to help pay premiums under the separate insurance plan, or to increase take-home pay.

The separate insurance plan will allow each employee to select from any or all of the insurance options (including dependent care coverage) and to pay for those selections with dollars from "pre-taxable income". Of course, the total cost of the options selected will ultimately affect your net taxable income.

We have selected three sample alternatives to illustrate the effects on the annuity account and on gross salary of various employee contribution

percentages paid to the annuity account. These examples assume a monthly salary of \$2100.00 and monthly insurance premiums of \$50.00. The examples do not include administrative costs.

SAMPLE ALTERNATIVES

Employer 6.13% Annuity Contribution	Employee Annuity Contribution Percent	Employee Contribution Amount	Total Monthly Contribution to Annuity	Amount of Increase to "Pre-Taxable Income" Before Insurance Premiums	Net Effect on Taxable Income After Insurance Premiums of \$50/mo.
\$128.73	6.13	\$128.73	\$257.46	\$ 0	-\$50.00
128.73	4.25	89.25	217.98	39.48	- 10.52
128.73	2.37	49.77	178.50	78.96	+ 28.96

Enclosed is a survey form on which you may indicate your preference on the level of contributions all employees would make to their annuity accounts. Remember this is in addition to the "employer" contribution of 6.13%. If you choose a high amount, such as 6.13%, you are indicating your preference for pre-tax savings for retirement or other purposes for use after your termination. If you choose a low amount, such as 2.37%, you are indicating your preference for current-year income which you may use for the purchase of insurance premiums or to increase your regular taxable payroll.

The survey is for information purposes only. The results of the

information will be used by both the legislature and the administration in determining the direction of the final legislation. The final employee's annuity contribution rate will ultimately be set by the legislature. However, your input will help provide needed information for the legislature's consideration.

These are important decisions. There will be future correspondence on this subject as events develop. If you have any questions, please contact the Supplemental Benefits System at 465-4460.

Sincerely,

Robert F. Stalnaker

Acting Director

RFS/MBC/LMT/cam/9

Enclosure

DIVISION OF RETIREMENT AND BENEFITS

SUPPLEMENTAL BENEFITS SYSTEM SURVEY

Please indicate your preference for the "employee's" annuity contribution rate that should be established by the State by checking one of the following alternatives and returning this survey form by March 11, 1988 to: *Division of Retirement & Benefits, P.O. Box CR, Juneau, Alaska 99811* or *2600 Denali, Suite 401, Anchorage, Alaska 99503*. You may also return your ballot to your personnel office for delivery to Mail Stop 0203.

1. Maximum Annuity Contribution (6.13%):
Under this alternative, the entire current contribution of 6.13% will go to your annuity account. If you wish to purchase insurance benefits, your taxable income will decline by the amount of your insurance costs.

2. Middle Annuity Contribution (4.25%):
Under this alternative, 4.25% of your earnings will go to your annuity account. The balance, 1.88% of your earnings, will be available for purchasing insurance benefits or take-home pay. You will experience an increase (decrease) in your taxable income depending on whether your insurance purchases are smaller (greater) than 1.88% of your earnings.

3. Low Annuity Contribution (2.37%):
Under this alternative, 2.37% of your earnings will go to your annuity account. The balance, 3.76% of your earnings, will be available for purchasing insurance benefits or take-home pay. You will experience an increase (decrease) in your taxable income depending on whether your insurance purchases are smaller (greater) than 3.76% of your earnings.

EXAMPLE:

Assumptions: Annual Salary = \$35,000; Annual Insurance Purchases = \$800.

Under the *existing* SBS program, your total annual SBS contribution is allocated as follows:

Total Contribution (\$35,000 X .0613)	=	\$2,146
Insurance Purchases	=	<u>\$800</u>
Employee's Annuity Contribution	=	<u>\$1,346</u>

Under the 3 *revised* alternatives described above, the annual allocation would be as follows:

	Employee Annuity Contribution <u>Percent</u> <u>Amount</u>	Available for Insurance or Wages <u>Percent</u> <u>Amount</u>	Insurance <u>Purchases</u>	Pre-tax Change in <u>Annual Wages</u>
1. High Annuity	6.13% \$2,146	0.0% \$0	\$800	-\$800
2. Middle Annuity	4.25% \$1,488	1.88% \$658	\$800	-\$142
3. Low Annuity	2.37% \$830	3.76% \$1,316	\$800	\$516



Alaska Public
Employees Association **APEA**

State Headquarters: 340 N. Franklin, Juneau, AK 99801 (907) 586-2334

MEMORANDUM

TO: Representative Fran Ulmer, Chairman
House State Affairs Committee

FROM: Cherie Shelle *CS*

SUBJECT: Proposed SBS Legislation

DATE: February 5, 1988

As a result of the work session on HB 252, please find attached for your consideration a draft of an advisory ballot. This ballot is recommended by the APEA Executive Committee and provides for three options as follows:

Option 1: Under this option the entire employee contribution of 6.13% would be placed in the employee annuity account. All employees wishing to purchase insurance would do so out of pretax payroll dollars.

Option 2: Under this option, 4.53% of employee's contributions would be placed in the annuity account. The balance of 1.6% would be available for insurance purchases. This percentage was selected as 1.6% is the average cost of insurance purchased for all employees.

Option 3: Under this option, 4% of the employees' contribution would be placed in the annuity account. The balance of 2.13% would be available for insurance purchase. This percentage was selected as 80% of all employees could purchase insurance at this level without affecting their current payroll.

APEA Executive Committee believes that the options set forth above provides the employee an opportunity for individual preferences, while preserving the integrity of SBS as a retirement system, replacing social security.

As I indicated at the hearing, APEA is also concerned about automatic provision of the legislation which would reduce employer and employee contributions to the annuity program for mandatory social security contributions. APEA believes each social security change should be scrutinized carefully for its impact on the SBS and change should then be made as the legislature deems as

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appropriate.

In the present case, APEA opposes reducing employees' benefits by 1.45%. The state's contributions to the SBS and the 1.45% to social security for those employees hired after April 1986 is approximately the same as the current level of social security contributions. The increased cost of \$800,000, which the state is currently paying is more than offset by the millions of dollars in employer savings resulting from participation in the SBS rather than social security.

I would be happy to answer any questions you may have.

DIVISION OF RETIREMENT AND BENEFITS
SUPPLEMENTAL BENEFITS SYSTEM ADVISORY BALLOT

Please indicate your preference for the "employee's" annuity contribution rate that should be established by the State by checking one of the following alternatives and returning this information ballot by January 29, 1988 to: Division of Retirement and Benefits, P.O. Box CR, Juneau, Alaska 99811 or 2600 Denali, suite 401, Anchorage, Alaska 99503. You may also return your ballot to your personnel office for delivery to Mail Stop 0203.

1. Annuity Contributions of 6.13%
Under this alternative, the entire current contribution of 6.13% will go to your annuity account. If you wish to purchase insurance benefits, your paycheck and taxable income will decline by the amount of your insurance costs.

2. Annuity Contributions of 4.53
Under this alternative, 1.6% of your earnings, will be available for purchasing insurance benefits. You will experience an increase (decrease) in your paycheck and taxable income depending on whether your insurance purchases are smaller (greater) than 1.6% of your earnings.

3. Annuity Contributions of 4%
Under this alternative 4% of your earnings will go to your annuity account. The balance 2.13% of your earnings, will be available for purchasing insurance benefits. You will experience an increase (decrease) in your paycheck and taxable income depending on whether your insurance purchases are smaller (greater) than 2.13 of your earnings.

Supplemental Benefits System (SBS) Overview

The current Supplemental Benefits System (SBS) offers five types of insurance coverage and an annuity benefit. The five types of insurance are: health, life, accidental death and dismemberment, survivor, and disability. Insurance selections become effective on February 1 each year and run through January 31. This period is called the SBS benefit year. Premium costs for the various types of insurance are guaranteed for the benefit year. All displayed premiums in this report are monthly.

I. SBS Health Insurance

A. The current SBS Health Program--The SBS presently offers two health plans for employees. They are called SBS Health Option I and SBS Health Option II.

1. The current SBS Health Option I is a supplement to the employer provided major medical coverage. It is available only to employees with State-sponsored major medical coverage. Essentially it pays an additional 10% of covered medical expenses. It does not cover Dental-Visual-Audio (D-V-A) expenses. In addition, this plan will pay for an annual physical, immunizations, well-baby care, inpatient rehabilitative care, 80% of outpatient or skilled nursing facility costs, and increases the maximum lifetime benefit for major medical from \$250,000 to \$1,000,000.
2. The current SBS Health Option II is a major medical plan which pays 80% of covered medical expenses after a \$200 deductible per covered family member (maximum of \$600 per family) and an unlimited out-of-pocket limit. SBS Health Option II is available only to employees who are not covered by State-sponsored major medical coverage (nonpermanents, etc.). It does not cover D-V-A expenses.

Costs for the current SBS health options are as follows:

	Benefit Year 1987	Benefit Year 1988	Benefit Year 1989 (estimated)
SBS Health Option I:			
Employee Only	\$ 8.75	\$ 11.03	\$ 13.24
Employee and Family	\$ 23.80	\$ 29.99	\$ 35.99
SBS Health Option II:			
Employee Only	\$ 44.80	\$ 72.16	\$ 86.59
Employee and Family	\$108.50	\$176.74	\$212.09

B. The future SBS Health Program--The SBS could potentially add some new plans in the SBS benefit year 1989.

1. The current version of SBS Health Option I could be expanded to cover 20% or 30% of covered medical expenses instead of the current 10%. This expansion could occur in the event that the major medical coverage is reduced to an 80% or 70% co-insurance level.

2. A new health plan could be added to provide the opportunity for employees to elect D-V-A coverage for themselves and/or their families under the SBS. Again, this would be a response to a possible reduction in the current medical plan provided to employees.

	Benefit Year 1987	Benefit Year 1988	Benefit Year 1989 (estimated)
SBS Health Option I, 20% Proposal			
Employee Only	N/A	N/A	\$ 22.44
Employee and Family	N/A	N/A	\$ 61.04
SBS Health Option I, 30% Proposal			
Employee Only			\$ 30.97
Employee and Family			\$ 84.24
SBS D-V-A Proposal			
Employee Only			\$ 34.06
Employee and Family			\$ 98.52

II. SBS Life Insurance

- A. The current SBS Life Program offers term life insurance for the employee only. Coverage can be elected for \$10,000, \$20,000, \$30,000, \$40,000, or \$48,000. No more than \$48,000 of term life is currently offered because in conjunction with the \$2,000 basic life, this amount reaches the \$50,000 maximum for employer funded life insurance, life insurance premiums for a life volume beyond \$50,000 causes the premiums paid to become taxable income.

Costs for SBS Life Insurance per \$1,000 of coverage are as follows:

Age of Employee	Benefit Year 1987	Benefit Year 1988	Benefit Year 1989 (estimated)
Under 30	.12	.12	.13
30-39	.15	.15	.16
40-44	.24	.24	.25
45-49	.35	.35	.37
50-54	.52	.52	.55
55-59	.78	.78	.82
60-64	1.12	1.12	1.18
65-69	1.61	1.61	1.69
70-74	3.57	3.57	3.75
75-79	6.80	6.80	7.14
80-84	9.64	9.64	10.12
85 and Over	14.83	14.83	15.57

- B. There are no changes currently being considered under the life coverages for benefit year 1989.

III. SBS Accidental Death and Dismemberment Insurance

- A. The current SBS Accidental Death and Dismemberment (AD&D) Program offers AD&D coverage for employee or employee and family. AD&D pays \$100,000 for the death of an employee or for the loss of both eyes, feet, or hands or any combination thereof, if due to accidental causes. AD&D pays reduced amounts for spouse and children and for lesser losses (one eye, one hand, etc.).

Costs for SBS AD&D are as follows:

	Benefit Year 1987	Benefit Year 1988	Benefit Year 1989 (estimated)
Employee Only	\$6.00	\$6.00	\$6.30
Employee and Family	\$8.00	\$8.00	\$8.40

- B. There are no changes currently being considered under the AD&D coverages for benefit year 1989.

IV. SBS Survivor Insurance

- A. The current SBS Survivor Program offers survivor's benefits which provide monthly payments to an employee's chosen survivor. The employee chooses payout periods that range from five to 30 years. The present value of all payouts is \$38,000. An SBS participant cannot elect more than \$10,000 of SBS Life if the participant elects SBS Survivor. Coverage is for the employee only.

Costs for SBS Survivor insurance are as follows:

Age of Employee	Benefit Year 1987	Benefit Year 1988	Benefit Year 1989 (estimated)
Under 30	\$ 4.94	\$ 4.94	\$ 5.19
30-39	\$ 5.70	\$ 5.70	\$ 5.99
40-44	\$ 9.12	\$ 9.12	\$ 9.58
45-49	\$13.68	\$13.68	\$14.36
50-54	\$20.14	\$20.14	\$21.15
55-59	\$30.40	\$30.40	\$31.92
60-64	\$43.32	\$43.32	\$45.49
65 or over	\$62.70	\$62.70	\$65.84

- B. There are no changes currently being considered under the Survivor coverage for benefit year 1989.

V. SBS Disability Insurance

- A. The current SBS Disability Program offers three disability plans. Plan A pays \$200 a week for four months following a 31-day waiting period. Plans B and C pay 50% and 70% of salary respectively

following a five-month waiting period, minus "other income benefits" such as salary, other disability, retirement, unemployment, and social security. Plans B and C pay a maximum of \$4,000 a month and a minimum of \$100.

Plans B and C pay until age 65 and have extended limited durations for employees 62 or older. A 63-year-old employee can receive three years of coverage, and a 67-year-old employee can receive 1-1/2 years of coverage.

Costs for SBS Disability insurance are as follows:

	Benefit Year 1987	Benefit Year 1988	Benefit Year 1989 (estimated)
Plan A	\$5.44	\$5.44	\$6.26
Plan B	.37 per \$100 salary	.75 per \$100 salary	.86 per \$100 salary
Plan C	.61 per \$100 salary	1.22 per \$100 salary	1.40 per \$100 salary

- B. There are no changes currently being considered under the Disability coverage for benefit year 1989.

VI. Annuity Benefit

- A. The current annuity benefit operates as a default election. That is, if an employee does not elect any insurance coverages under the SBS, the total current contribution of 12.26% of salary up to the wage base, less administrative fees, is allocated to the Annuity Benefit. If insurance is selected, whatever contribution remains after administrative fees and any insurance premiums are deducted is allocated to the Annuity Benefit. A separate account is established for each employee to record annuity balances, interest earnings and other accounting. Annuity accounts are currently earning 11.3%. The SBS Annuity Plan is an Internal Revenue Service approved plan under Part 401(a) of the Internal Revenue Code (IRC).
- B. Some changes to the Annuity Benefit will be required in 1989 in order to preserve the tax-deferred status of the current Annuity Benefit.
1. As discussed in the attached letter from the State's consultant, the Tax Reform Act (TRA) of 1986 requires the Annuity Benefit to be "free-standing" from the insurance part of the SBS. Instead of residual contributions being allocated to annuities, TRA requires a fixed contribution to annuities or, in other words, a contribution that cannot be affected by individual employee discretion. The State must determine the amount of the contribution.

2. In setting the level of contributions to annuities, a second factor may well be considered in this section: mandatory contributions of the Medicare portion of Social Security. For each employee hired on or after April 1, 1986, both the State and the employee are required to make contributions. These contributions currently total 2.9% of wages up to the Social Security wage base in effect (\$45,000 for 1988). The employee and employer each contribute 1.45% of this total. This requirement has created a discrepancy in the cost of benefit packages of State employees. Since Medicare contributions are required on behalf of each of these newer employees and SP contributions are also being paid for these individuals, the question of parity in the benefit package arises. The table below shows the total contribution (SBS and Medicare) for these two classes of employees.

State Contribution Rate SBS and Medicare		
	<u>"Old" Employee (Hired before April 1, 1986)</u>	<u>"New" Employee (Hired on or after April 1, 1986)</u>
SBS	6.13%	6.13%
Medicare	<u>0%</u>	<u>1.45%</u>
Total State Contribution	6.13%	7.58%

Parity might be achieved by adjusting the State's SBS contribution by 1.45%, as illustrated in the following table.

Possible State Contribution Rates Adjusted for Parity
SBS and Medicare

	<u>"Old" Employee</u>	<u>"New" Employee</u>		<u>"Old" Employee</u>	<u>"New" Employee</u>
SBS	6.13%	4.68%		7.58%	6.13%
Medicare	<u>0%</u>	<u>1.45%</u>	OR	<u>0%</u>	<u>1.45%</u>
Total State Contribution	6.13%	6.13%		7.58%	7.58%

As shown by the examples above, there is nothing to prohibit the State from setting a different SBS annuity contribution from group to group as long as the distinctions are rational and do not serve to discriminate against lower paid employees. Clearly, for those employees for whom Medicare is required, a lower SBS rate might be established.

3. Finally, whatever the contribution to annuities, two general guidelines for the restructuring of SBS contributions should be mentioned:
 - a. All employer contributions should go to the annuity plan along with a fixed, additional, pre-tax employee contribution.
 - b. The contributions for the purchase of insurance benefits (IRC 125 cafeteria plan) should be variable, pre-tax employee contributions.

This is discussed in the attached letter from the State's consultant. The reason for such a structure is to maximize the choices available to the greatest number employees with a minimum of confusion and red tape. In this way, those employees who want no insurance benefits simply make that election and that is all there is to it. Those who want insurance elect a wage reduction in just the right amount to cover the premiums for the coverage they selected. If any employer contributions were directed to the insurance side of SBS, a person who wanted no insurance could not put these employer dollars into annuities and they would have to be paid out at the end of the year as taxable earnings.

VII. Dependent Care Benefit

There is no dependent Care Benefit available under the current SBS Program. Assuming that the SBS is restructured under Part 125 IRC, a Dependent Care Benefit could be made available under the SBS in 1989.

This benefit would allow employees to utilize pre-tax dollars to assist in dependent care expenses up to limits imposed by the Internal Revenue Service. Generally, an employee can elect to exclude from their gross income up to \$500 per month not to exceed the employee's earned income in the case of a single employee. A married employee may exclude up to the lesser of the employee's earned income or his or her spouse's earned income.

The Supplemental Benefits System as a Replacement of Social Security

The SBS was originally designed as a benefit program to be offered in lieu of Social Security following the State's decision to opt out of that program. It can be reasonably asked at this point what was given up by that decision? Social Security would provide a fully vested employee a lifetime monthly pension based on time in the system and contributions to the system. Survivors of the employee would also be eligible for a pension. In addition, Medicare Part A, or hospital coverage would be available at no charge. Active employees would also be eligible for disability protection under Social Security.

The benefits offered through Social Security were abandoned by the State in 1980 and replaced by those described earlier. Each employee by using individual election could avail himself or herself of all the insurance options described while they were actively working. Contributions that were allocated to the SBS annuity account could serve as supplemental income during retirement just as a Social Security pension is designed to do. Unlike Social Security, this income can be distributed in a wide range of pension options or even in a lump sum.

The cost to the State today, had it remained in the Social Security system, would be dramatically higher than under the current SBS. For example, the 1987 employer contribution under Social Security, is 7.15% of wages up to the 1987 wage base of \$43,800. Assuming a workforce of 12,000 employees, and an average annual wage of \$25,000, this difference in contribution rates would have required an additional \$3.0 million in employer contributions during 1987. Next year, when the Social Security contribution rate increases to 7.51%, this incremental difference would increase to \$4.1 million. Clearly, the SBS legislation that froze the contribution rate at the 1980 Social Security level of 6.13% has resulted in considerable savings to the State since 1980.

The initial program design of the SBS has served the State quite well given the decision to leave Social Security. Much work was put into the design at that time with input from the legislature, employee groups and the administration. At that time, the idea of a cafeteria style benefit program was quite unique and viewed as being on the leading edge of such programs. Cafeteria style benefit plans have now become quite standard with large employers throughout the country, and are fully recognized by the IRS under Section 125 of the Internal Revenue Code (IRC). Since the State finds itself in the position of having to make programmatic changes due to the Tax Reform Act of 1986, it can be viewed as an opportune time to qualify our benefit plan under Section 125 IRC and allow the annuity plan to remain qualified under Section 40(a). Revenue Code (IRC).

To demonstrate the powerful effects of compounding on annuity account balances and the difference between the current SBS contribution rate and the 1988 Social Security contribution rate consider these examples:

1. A 35-year-old individual is hired by the State of Alaska at a salary of \$45,000. He or she works for 20 years and retires at age 55. Assuming the same salary for the entire period, all contributions being allocated to the annuity account and a 10% interest rate, this individual would have accumulated an annuity account balance of \$315,000.

2. Using the same example and assumptions as above except a smaller salary of \$22,000, an account balance of \$155,000 would exist at retirement age.
3. Using the same example as in 1 above except that the 1988 Social Security contribution rate of 7.15% instead of the SBS rate of 6.13%, the balance, of course, becomes considerably higher: \$386,600.
4. The lower salaried example in 2 above using the Social Security rate would, of course, also result in a higher account balance: \$189,000.

Under the SBS, the individual could elect to take these balances as a lump sum or elect a continuing pension. For example, the balances above would yield a lifetime monthly benefit as follows:

1. \$2,303	2. \$1,133	3. \$2,827	4. \$1,382
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or a continuing pension for 10 years only:

1. \$3,604	2. \$1,773	3. \$4,424	4. \$2,163
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Other options are available under the SBS. A major distinction that should be made between Social Security and the SBS is the amount and the form of an individuals return.

A Social Security pension is not calculated based on the amount of money contributed. It is based on the length of time under the system and the salary. The SBS returns whatever was contributed plus interest with a choice in the form of payment. The examples above point out how much money might have accumulated in an individual account under Social Security. Unfortunately, the individual has no choice in the form of payment, is not eligible for any pension until age 65, and has no guarantee of ever receiving full value of his or her contributions.

WILLIAM M.
MERCER - Meldinger
INCORPORATED

August 31, 1987

Mr. Michael B. Coughlin
Deputy Director
State of Alaska
Department of Administration
Division of Retirement & Benefits
Pouch CR
Juneau, Alaska 99811

Re: SBS Chances

Dear Mike:

I, too, share your concern about the changes which may be required to the Supplemental Benefits System. From what I have heard, SBS is one of the smoothest operating, most appreciated employee benefits for State employees. Certainly, "if it ain't broke, don't fix it". I will answer the questions in your August 20 letter in the same order:

- (1) Yes, the Tax Reform Act of 1986 (TRA) does require changes to SBS. Even though SBS only allows election among non-taxable benefits, it will be considered a cafeteria plan and must comply with cafeteria rules (IRC Section 125) effective January 1, 1989 (assuming regulations are not issued by October 1, 1987). However, on this score, there is some very good information. The Technical Corrections Bill (HR 2636 and S 1350) contains a provision which would reverse the change required by TRA. In other words, if the Technical Corrections Bill passes with this provision intact, plans that allow choices of only non-taxable benefits (like SBS) will not be considered "cafeteria plans". Unfortunately, it is very unlikely this bill will pass this year, and may not pass, if at all, until late next year.

Is it possible for the Alaska Legislature to pass a bill, contingent on federal law requiring a change? Then, if the Technical Corrections Bill passes after the Alaska Legislature convenes, but before January 1, 1989, the remedial legislation for SBS would not be effective. 2

- (2) There can be no employee discretion regarding contributions to a qualified money purchase plan. In general, contributions to a money purchase plan must be fixed. We believe that depositing "residual" amounts from a cafeteria plan would not meet the fixed contribution requirements.

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Mr. Michael B. Coughlin
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If the new SBS program limits the amount of contribution for group benefits, it will be necessary for some employees to reduce take-home pay in order to obtain their desired group benefits. This might cause a hardship for a small number of employees.

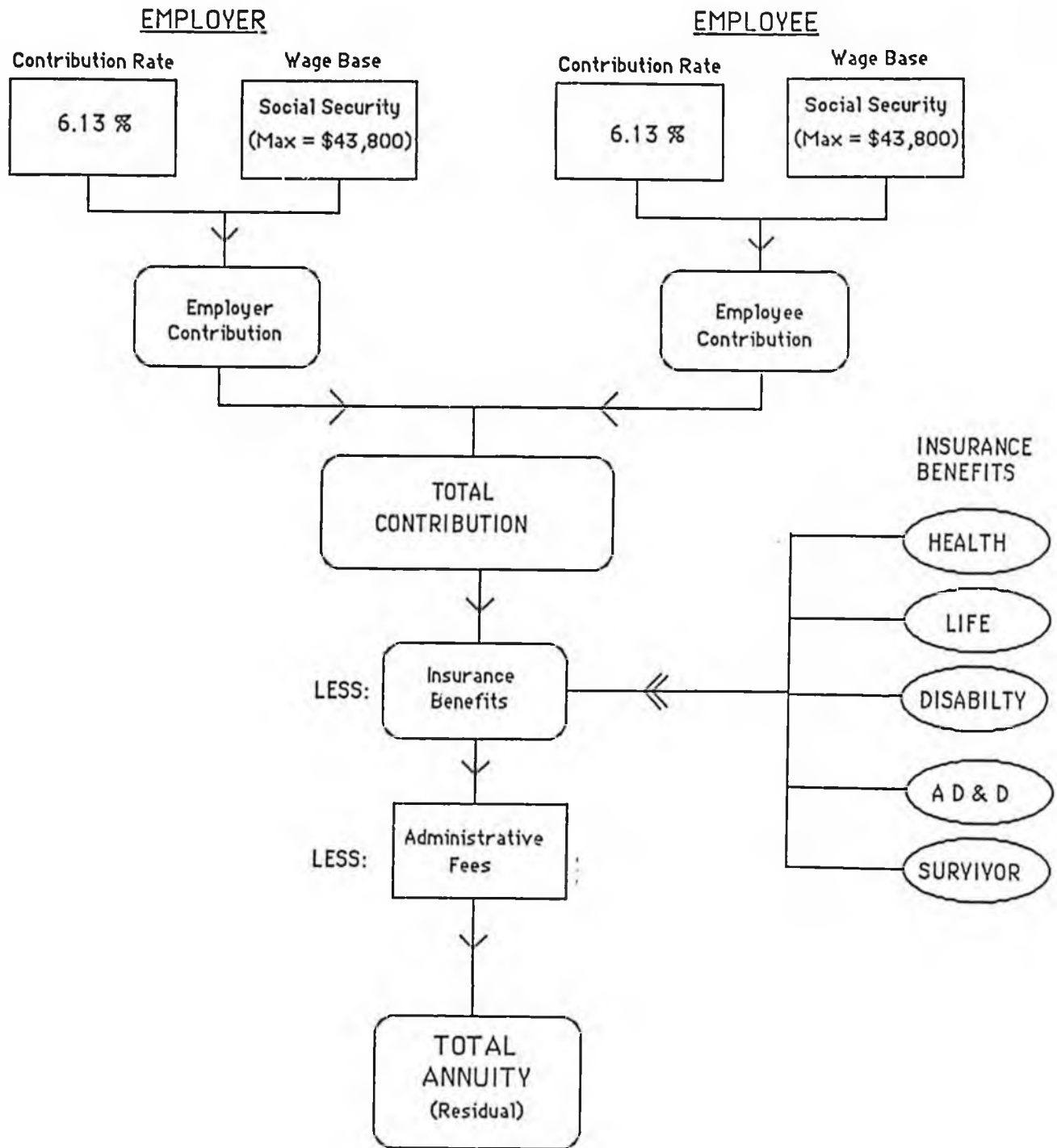
- (3) Several employees are currently putting all of their SBS contributions into the Annuity Plan, as well as deferring the maximum under the Deferred Compensation Program. These employees will be upset if their tax deferral capabilities are diminished. The redesigned SBS Program could have an automatic 12.26% contributed to a free-standing 401(a) plan. Then, a variable, before-tax employee contribution could be used to pay for the group benefits under the cafeteria plan. This approach preserves the maximum tax advantage but also requires most employees to reduce their take-home pay to pay for the desired group benefits.
- (4) You could add a dependent care benefit to the current SBS. However, employees cannot fund a dependent care benefit through salary reduction contributions to the current SBS. If the Technical Corrections Bill passes, SBS could be left alone and a separate 125 cafeteria plan could be established for taxable life insurance benefits and any other benefits you wish to fund with salary reduction contributions (i.e., dependent care).
- (5) An offset to SBS contributions by the amount of any required Medicare contribution would not cause a problem. This is because the contribution rate would be based upon date of hire, rather than employee discretion. We have considered this situation and believe that the best approach would be to have two different contribution rates to the free-standing annuity plan.
- (6) As stated before, employees may not have discretion on the amount of contributions made to the 401(a) annuity plan.

Staying within the current basic contribution structure of SBS (12.26% up to the wage base), and meeting the requirements of the Tax Reform Act will disadvantage a group of employees . . . thus leading to dissatisfaction. The particular group of employees that is disadvantaged depends on how the State elects to correct SBS. At this time, it may be appropriate to rethink the contribution structure under SBS. In any event, we envision that you will end up with an annuity plan with a fixed contribution rate and a separate 125 cafeteria plan. The annuity plan need not limit contributions to the wage base. For example, the annuity plan might have a 10% contribution on all salary (6.13% up to the wage base from the employer, and the rest from the employee).

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CHART I
CURRENT SBS PROGRAM



STATE DECISION

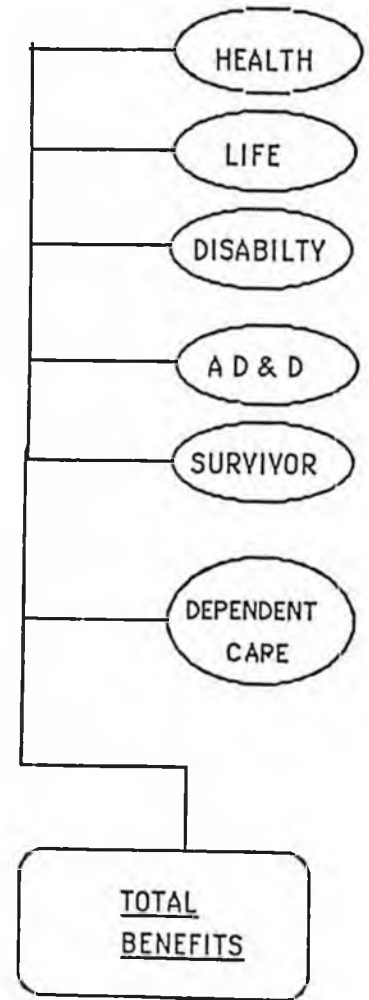
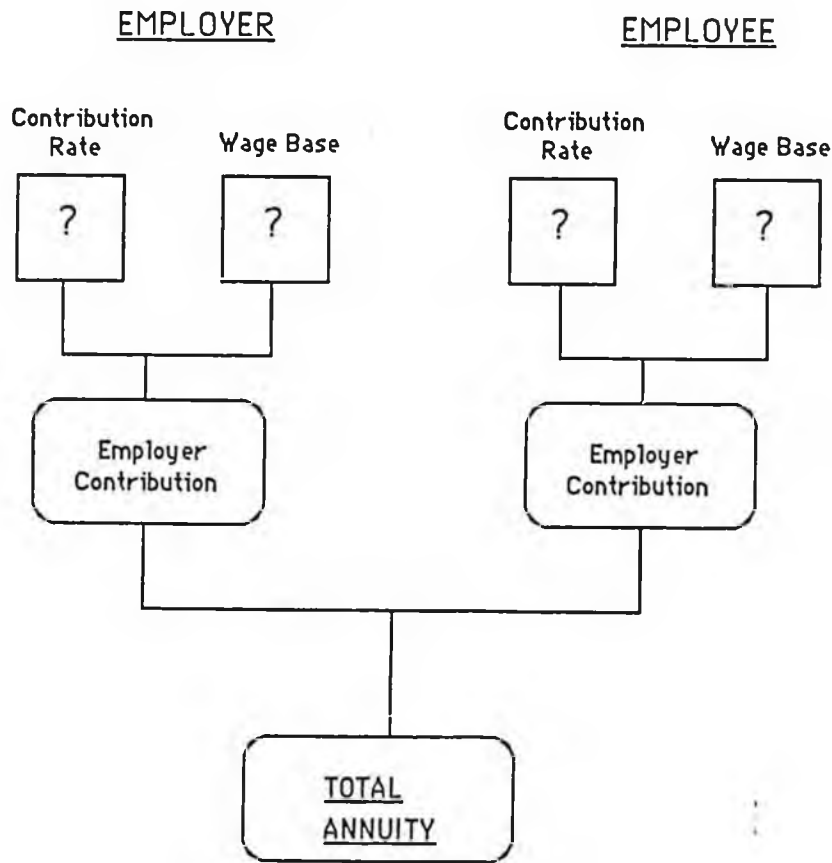
EMPLOYEE DECISION

RESIDUAL/ DERIVED

CHART 2.
NEW SBS PROGRAM

ANNUITY PLAN

BENEFIT PLAN

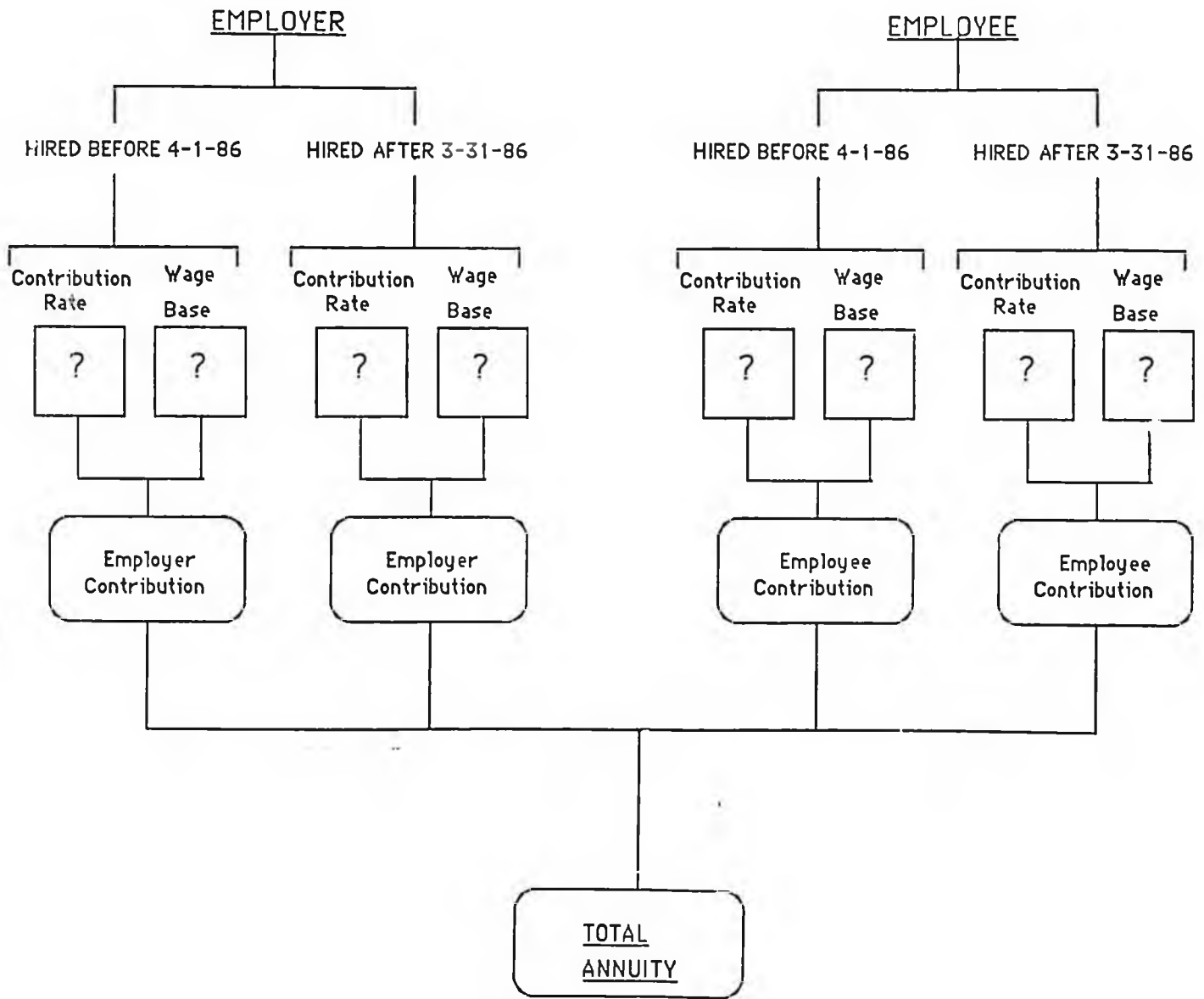


STATE DECISION

EMPLOYEE DECISION

RESIDUAL/ DERIVED

CHART 3.
NEW SBS PROGRAM
ANNUITY PLAN



STATE DECISION
 EMPLOYEE DECISION
 RESIDUAL/ DERIVED

January 4, 1988

SBS REVISIONS

(SPONSOR SUBSTITUTE FOR HB-252)

Recommendation-decisions made so far:

- 1) State contribution to annuity -- 6.13% minus mandated Social Security payments (e.g. 1.45% Medicare portion)
- 2) Wage base -- Social Security Wage Base, for both employer and employees (\$43,900)
- 3) Add "Dependant Care" to cafeteria menu

Remaining decisions:

- 1) Employee contribution to annuity
Sample options: maximum -- 6.13%
middle -- 4.25%
minimum -- 2.37%
rock bottom -- 0.00 %

Need to do:

- 1) Prepare a 2-page explanatory handout
 - why some change is necessary; potential loss if not changed
 - necessary structure of revised system
 - effect of sample options on taxable income
 - effect of sample options on annuity balance
- 2) Ask consultant to look over handout for compliance with federal law
- 3) Present the issue, for their advice, to:
 - employees, for "poll"
 - departmental personnel officers
 - union groups
- 4) Bring the press into it early, for reporting accuracy
- 5) Draft bill with employee % specified as 6.13%, to open discussions
- 6) Summarize employee attitudes for presentation to State Affairs committees, along with statistical data on current employee insurance-purchasing patterns

STATE OF ALASKA

DRAFT

DEPARTMENT OF ADMINISTRATION

DIVISION OF RETIREMENT & BENEFITS

PLEASE REPLY TO:

P.O. BOX CR
JUNEAU, ALASKA 99811-0203
PHONE: (907)465-4460

2600 DENALI ST. SUITE 401
ANCHORAGE, ALASKA 99503-2740
PHONE: (907) 277-7504

Public Employees Retirement System
Teachers' Retirement System
Judicial Retirement System
Elected Public Officers Retirement System
National Guard Retirement System
Territorial Retirement System
Retirees Voluntary Dental-Vision-Audio Plan
Supplemental Benefits System
Group Health/Life Insurance Benefits
Deferred Compensation Plan
Public Employers Social Security Contributions

STEVE COWPER, GOVERNOR

January 8, 1988

Dear SBS Participant:

Major changes will be required in the Supplemental Benefits System (SBS) beginning January 1, 1989. These changes are required as a result of the federal Tax Reform Act of 1986. Legislation must be enacted this session to provide for the changes. Information is being requested from SBS participants to help determine the direction the change will take.

Currently the SBS consists of two major parts. These are: 1) insurance, and 2) retirement money accumulation (annuity). Under the current plan, 12.26% (6.13% employer and 6.13% employee) of salary (up to the Social Security Wage Base) is contributed to the SBS on behalf of each eligible employee. The contribution is used to pay first the administrative fees and insurance premiums. The remaining contribution is then deposited in the employee's annuity account.

Since each employee chooses his or her own insurance enrollment, and insurance premiums vary with the employee's age and salary for certain insurance coverages, the result is that different percentages of salary are contributed to the annuity accounts for each employee. This current structure will not be allowed under the Tax Reform Act. A pre-set and uniform percentage of salary must be contributed to the annuity account for each employee.

In an effort to maintain as much consistency with the current SBS plan and ideals, we are proposing to establish separate, freestanding insurance and annuity plans under two separate provisions of the federal tax laws. The entire "employer" contribution (6.13%) will go to the annuity plan. The "employer" contribution will be reduced for mandatory employer contributions to Social Security plans. Currently, Social Security requires a 1.45% employer contribution for medicare for employees hired on or after April 1, 1986.

The main question is what to do with the "employee wage reduction" contribution (the other 6.13%). All, a portion, or none of the "wage reduction" contribution can be paid into the annuity account. If a portion of the "wage reduction" contribution is not paid into the annuity account, that portion will be available to pay or help pay premiums under the freestanding insurance plan. Any portion of the "wage reduction" not paid into annuities, or used to pay insurance premiums, will be paid directly to the employee as part of regular taxable income, thereby

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SBS Participant

-2-

January 8, 1988

increasing their take-home pay. Any amount necessary to pay for insurance premiums over and above the amount available after the annuity contribution can be provided for by additional tax-free salary deductions.

The following example illustrates effects on the SBS monthly annuity contribution under the various wage reduction percentages. This example assumes a monthly salary of \$2,100.00 and that the employee was hired before April 1, 1986, and not subject to Medicare contributions.

Employer 6.13% Annuity Contribution	Employee Annuity Contribution Percent	Employee Contribution Amount	Total Monthly Contribution to Annuity	Amount Available for Insurance, or for Additional Payroll
128.73	6.13	128.73	257.46	Ø
128.73	4.25	89.25	217.98	39.48
128.73	2.37	49.77	178.50	78.96
128.73	Ø	Ø	128.73	128.73

After 20 years of employment, at 10% annual interest, the approximate value of an annuity account would be as follows:

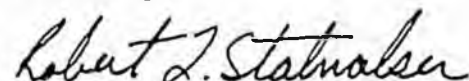
Monthly Contribution	Account Balance
\$450.00	\$325,000.00
400.00	288,000.00
300.00	216,000.00
250.00	180,000.00
200.00	144,000.00
100.00	72,000.00

Enclosed is a ballot on which you may indicate your choice on levels of your contribution to your annuity account. If you choose a high amount you are indicating your preference for pre-tax savings for retirement or other post-termination uses. If you choose a low amount you are indicating your preference for current-year income which you may use for insurance premiums or regular taxable payroll.

The ballot is for informational purposes only. The final employee's annuity contribution rate will be ultimately set by the legislature. However, your input could make a difference.

These are very important decisions. There will be future correspondence on this subject as events develop. If you have any questions, please contact the Supplemental Benefits System at 465-4460.

Sincerely



Robert F. Stalnaker
Acting Director

RFS/MEH/cam/7
Enclosure

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DIVISION OF RETIREMENT AND BENEFITS

SUPPLEMENTAL BENEFITS SYSTEM BALLOT

Please indicate your preference for the "employee's" annuity contribution rate that should be established by the State by checking one of the following alternatives and returning this information ballot at the earliest to: *Division of Retirement & Benefits, P.O. Box CR, Juneau, Alaska 99811* or *2600 Denali, Suite 40, Anchorage, Alaska 99503*. You may also return your ballot to your personnel office for delivery to Mail Stop 0203.

1. _____ Maximum Annuity Contribution (6.13%):
Under this alternative, the entire current contribution of 6.13% will go to your annuity account. If you wish to purchase insurance benefits, your paycheck and taxable income will decline by the amount of your insurance costs.

2. _____ Middle Annuity Contribution (4.25%):
Under this alternative, 4.25% of your earnings will go to your annuity account. The balance, 1.88% of your earnings, will be available for purchasing insurance benefits. You will experience an increase (decrease) in your paycheck and taxable income depending on whether your insurance purchases are smaller (greater) than 1.88% of your earnings.

3. _____ Low Annuity Contribution (2.37%):
Under this alternative, 2.37% of your earnings will go to your annuity account. The balance, 3.76% of your earnings, will be available for purchasing insurance benefits. You will experience an increase (decrease) in your paycheck and taxable income depending on whether your insurance purchases are smaller (greater) than 3.76% of your earnings.

4. _____ Zero Annuity Contribution (0.0%):
Under this alternative, you will not contribute to your annuity account; your entire current contribution of 6.13% will be available to you for purchasing insurance benefits. Your paycheck and taxable income will increase (decrease) depending on whether your insurance purchases are smaller (greater) than 6.13% of your earnings.

EXAMPLE:

Assumptions: Annual Salary = \$35,000; Annual Insurance Purchases = \$800.

Under the *existing* SBS program, your total annual SBS contribution of is allocated as follows:

Total Contribution (\$35,000 X .0613)	=	\$2,146
Insurance Purchases	=	\$800
Employee's Annuity Contribution	=	<u>\$1,346</u>

Under the *revised* SBS program the annual allocation will be as follows:

	Employee		Available for Insurance		Insurance	Pre-tax
	Percent	Amount	Percent	Amount	Purchases	Change in Annual Wage
1. High Annuity	6.13%	\$2,146	0.0%	\$0	\$800	-\$800
2. Middle Annuity	4.25%	\$1,488	1.88%	\$658	\$800	-\$142
3. Low Annuity	2.37%	\$830	3.76%	\$1,316	\$800	\$516
4. Zero Annuity	0.0%	\$0	6.13%	\$2,146	\$800	\$1,346

TABLE II.4.
POPULARITY OF INSURANCE OPTIONS
BY SALARY RANGE

April '87 U

		----- MONTHLY SALARY (\$) -----												
		1001-2000			2001-3000			3001-4000			4001-5000		OVER 5000	
		TOTAL	NUMBER	PCT	NUMBER	PCT	NUMBER	PCT	NUMBER	PCT	NUMBER	PCT		
TOTAL		11,959	1,894	100%	4,319	100%	3,465	100%	1,432	100%	849	100%		
NUMBER OF OPTIONS	0	2,014	340	18%	755	17%	580	17%	215	15%	124	15%		
	1	2,371	430	23%	898	21%	644	19%	263	18%	136	16%		
	2	1,997	302	16%	714	17%	585	17%	240	17%	156	18%		
	3	2,724	445	23%	976	23%	779	22%	308	22%	216	25%		
	4	2,115	292	15%	732	17%	629	18%	294	21%	168	20%		
	5	738	85	4%	244	6%	248	7%	112	8%	49	6%		
SURVIVOR BENEFITS	NOT SELECTED	9,692	1,574	83%	3544	82%	2,769	80%	1112	78%	693	82%		
	SELECTED	2,267	320	17%	775	18%	696	20%	320	22%	156	18%		
A D & D	NOT SELECTED	6,835	1,134	60%	2525	58%	1,945	56%	779	54%	452	53%		
	MEMBER	1,556	244	13%	572	13%	462	13%	159	11%	119	14%		
	FAMILY	3,568	516	27%	1222	28%	1,058	31%	494	34%	278	33%		
HEALTH INSURANCE	NOT SELECTED	3,472	515	27%	1224	28%	1,046	30%	429	30%	258	30%		
	OPT I MEMBER	2,424	460	24%	907	21%	685	20%	234	16%	138	16%		
	OPT I FAMILY	5,950	902	48%	2130	49%	1,704	49%	764	53%	450	53%		
	OPT II MEMBER	61	11	1%	28	1%	17	0%	4	0%	1	0%		
	OPT II FAMILY	52	6	0%	30	1%	13	0%	1	0%	2	0%		
DISABILITY	NOT SELECTED	8,462	1,487	79%	3174	73%	2,344	68%	917	64%	540	64%		
	DISABILITY A	381	126	7%	159	4%	66	2%	19	1%	11	1%		
	DISABILITY B	285	34	2%	98	2%	81	2%	45	3%	27	3%		
	DISABILITY C	2,831	247	13%	888	21%	974	28%	451	31%	271	32%		
LIFE INSURANCE	NOT SELECTED	4,647	798	42%	1726	40%	1,314	38%	520	36%	289	34%		
	10 K	2,956	500	26%	1060	25%	871	25%	345	24%	180	21%		
	20 K	460	107	6%	214	5%	94	3%	29	2%	16	2%		
	30 K	391	78	4%	160	4%	112	3%	30	2%	11	1%		
	40 K	450	49	3%	161	4%	161	5%	53	4%	26	3%		
	48 K	3,055	362	19%	998	23%	913	26%	455	32%	327	39%		