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*No action taken  
by House Finance  
Committee.*

BY THE FINANCE COMMITTEE

1 IN THE HOUSE

2

HOUSE BILL NO. 579

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - SECOND SESSION

5

A BILL

6 For an Act entitled: "An Act establishing the defined contribution plan  
7 for retirement for public employees; requiring the  
8 preparation of certain actuarial valuations and  
9 actuarial and financial experience analyses of the  
10 teachers' retirement system; requiring the teachers'  
11 retirement system and the public employees' retire-  
12 ment system to be fully funded before granting a post  
13 retirement pension adjustment; and providing for an  
14 effective date."

15 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

16 \* Section 1. AS 39 is amended by adding new sections to read:

17

CHAPTER 38. RETIREMENT DEFINED CONTRIBUTION PLAN.

18

ARTICLE 1. ADMINISTRATION.

19

Sec. 39.38.010. PURPOSE AND EFFECTIVE DATE. (a) The purpose of

20

this chapter is to encourage qualified personnel to enter and remain

21

in the service of the state or a political subdivision or public

22

organization of the state by establishing a plan for the payment of

23

retirement and death benefits to or on behalf of the employees.

24

(b) The program created becomes effective on July 1, 1990, at

25

which time contributions by the state and its employees begin.

26

Sec. 39.38.020. RETIREMENT BOARD. (a) The Retirement Board

27

composed of five members is established.

28

(b) Three board members shall be members of the personnel board

29

of the Department of Administration. Two board members shall be

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1 members of the plan, elected by a majority of votes cast by members of  
2 the plan. Elections shall be conducted by the board. The term of  
3 office of an elected member is six years. A vacancy in an unexpired  
4 elective term shall be filled by election for a new six-year term.

5 (c) Members of the board serve without compensation, but are  
6 entitled to per diem and transportation expenses authorized for boards  
7 under AS 39.20.180 to carry out the duties set out in this chapter.

8 Sec. 39.38.030. DEFINED CONTRIBUTION PLAN. The board shall  
9 establish a defined contribution plan for employees in which retire-  
10 ment and death benefits are provided through the purchase of annuity  
11 contracts, either fixed, variable, or a combination of fixed and  
12 variable, shares of a mutual fund, guaranteed investment contracts, or  
13 other investment vehicles that are determined by the board to be  
14 suitable pension savings investments. Participation in the plan is in  
15 place of participation in a state retirement system.

16 Sec. 39.38.040. POWERS AND DUTIES OF THE BOARD. (a) The board  
17 shall

18 (1) appoint an administrator of the plan and provide for  
19 the administration of the plan, including procedures for resolving  
20 complaints from participating employees;

21 (2) act as an appeals board, hold hearings at the request  
22 of an employer, employee, surviving spouse or a beneficiary on deci-  
23 sions made by the administrator, and submit its findings to the admin-  
24 istrator;

25 (3) prescribe the policies for the proper operation of the  
26 plan and carry on other activities that are considered necessary to  
27 carry out the intent and purpose of the plan under this chapter;

28 (4) designate the company or other entity to which payment  
29 of the contributions required under AS 39.38.210 may be made, after

1       considering the

2                       (A) nature and extent of the rights and benefits that  
3       the contracts will provide to employees who participate and to  
4       their beneficiaries;

5                       (B) relation of the contractual rights and benefits to  
6       the contributions to be made under this chapter;

7                       (C) suitability of the contractual rights and benefits  
8       to the needs and interests of participating employees and to the  
9       interest of the employer in the employment and retention of  
10      employees;

11                      (D) ability of the designated company or other entity  
12      to provide rights and benefits under the contracts; and

13                      (E) efficacy of the contracts in the recruitment and  
14      retention of employees;

15                      (5) take other actions required to ensure that the plan  
16      qualifies as a qualified trust under 26 U.S.C. 401(a) (Internal Reve-  
17      nue Code).

18                      (b) The board may

19                           (1) hold regular meetings and special meetings considered  
20      necessary; all meetings are open to the public and the board shall  
21      keep a full record of all its proceedings;

22                           (2) adopt, with modifications it considers proper, regula-  
23      tions recommended by the administrator for carrying out this chapter;

24                           (3) consider and adopt resolutions on matters referred to  
25      it by the administrator in connection with changes in policy and  
26      revisions of this chapter.

27                      Sec. 39.38.050. DUTY OF EMPLOYERS TO FURNISH RECORDS. Each  
28      employer shall furnish the administrator with records concerning the  
29      periods of service, dates of birth, compensation, new entrants into

1 service, death, withdrawals, and other employee data necessary for the  
2 proper and effective operation of the plan.

3 Sec. 39.38.060. ATTORNEY GENERAL. The attorney general of the  
4 state is the attorney for the plan and shall represent it in a legal  
5 proceeding.

6 ARTICLE 2. PARTICIPATION.

7 Sec. 39.38.110. PARTICIPATION. (a) An employee of the state  
8 first hired on or after July 1, 1990, shall be included in the plan  
9 upon commencement of employment with the state. Unless the employee  
10 has elected to participate in the optional university retirement  
11 program under AS 14.40.661 - 14.40.799 or was first hired before  
12 July 1, 1990, an employee of a political subdivision, including a  
13 school district, regional educational attendance area, and the Univer-  
14 sity of Alaska, or a public organization that becomes an employer  
15 shall be included in the plan on the effective date of the employer's  
16 participation or the date of the employee's commencement of employment  
17 with the employer, whichever is later.

18 (b) Inclusion in the plan is a condition of employment for an  
19 employee first hired on or after July 1, 1990, except as otherwise  
20 provided for an elected official and for an employee of the university  
21 who has elected to participate in the optional university retirement  
22 program under AS 14.40.661 - 14.40.799.

23 Sec. 39.38.120. PARTICIPATION BY MEMBERS OF A STATE RETIREMENT  
24 SYSTEM. (a) A person who is a member of a state retirement system  
25 may elect to participate in the defined contribution plan. An elec-  
26 tion to participate in the plan is irrevocable. The election shall be  
27 made in writing on a form provided by the board and approved for the  
28 state by the commissioner of administration. The form must be filed  
29 with the board and a copy of the form shall be delivered to the

1 appropriate state retirement system. The election becomes irrevocable  
2 on the date it is received by the board. The election to participate  
3 in the plan constitutes a waiver of all rights and benefits under the  
4 state retirement systems earned on or after the effective date of the  
5 election.

6 (b) Except as provided in (c) of this section, if a nonvested  
7 member of a state retirement system elects to participate in the plan,  
8 the member may choose to transfer the amount in the employee's contri-  
9 bution account to the plan. If the member chooses to transfer the  
10 account, the appropriate state retirement system shall pay to the plan  
11 on behalf of the employee an amount equal to the balance in the ac-  
12 count. The payment must be made within 45 days after the election is  
13 received by the state retirement system. The administrator of the  
14 plan shall immediately pay the amount received to the company or other  
15 entity designated by the board for the benefit of the employee.

16 (c) An employee whose right to transfer assets out of a state  
17 retirement system is subject to a qualified domestic relations order  
18 is entitled to transfer assets from the state retirement system to the  
19 plan only if the requirements for receiving a refund under AS 14.-  
20 25.150(b) or AS 39.35.200(c), as appropriate, are met.

21 (d) If a vested member of a state retirement system elects to  
22 participate in the plan, the employee ceases to be an active member of  
23 the retirement system on the effective date of the participation in  
24 the plan. The employee retains all benefits accrued in the state  
25 retirement system.

26 (e) An employee first hired before July 1, 1990, who does not  
27 elect to participate in the plan under this section remains a member  
28 of the appropriate state retirement system.

29 Sec. 39.38.130. PARTICIPATION OF ELECTED OFFICIALS. (a)

1 Service as an elected official with an employer constitutes employment  
2 as a member in the plan as long as a written waiver of coverage has  
3 not been filed with the administrator. A waiver under this subsection  
4 waives coverage of future employment as an elected official, regard-  
5 less of any change of employer. An elected official may file a waiver  
6 under this subsection at any time after election to office, including  
7 the period before taking the oath of office. An elected official may  
8 revoke a waiver under this subsection by filing a written revocation  
9 with the administrator. A revocation under this subsection operates  
10 prospectively only, and the elected official may not receive coverage  
11 in the plan for service as an elected official while the waiver was in  
12 effect. There is no limit on the number of times an elected official  
13 may file a waiver or revocation under this subsection.

14 (b) An elected official included in the plan and that person's  
15 employer are liable for contributions whenever that person is an  
16 elected official unless a waiver of coverage under (a) of this section  
17 is in effect.

18 Sec. 39.38.140. PARTICIPATION BY OTHER EMPLOYEES. (a) A regu-  
19 lar full-time civilian employee of the Alaska Army National Guard and  
20 Air National Guard, whose entire salary is paid from allotted federal  
21 funds, is included in the plan if the federal or state government pays  
22 the employer's contributions. If the amount that the federal govern-  
23 ment may legally contribute to the plan is less than the required  
24 employer's contribution, the state government may contribute the  
25 difference. If the state chooses not to pay the difference, the  
26 employee's participation shall be based on the amount paid by the  
27 federal government.

28 (b) An employee of the North Pacific Fishery Management Council  
29 appointed under 16 U.S.C. 1852(f)(1) (Sec. 302(f)(1) of P. L. 94-265),

1 whose compensation is paid from allotted federal funds, is included in  
2 the plan if the council pays the employer's contributions.

3 (c) An administrative director of the Alaska court system who  
4 withdraws from the judicial retirement system under AS 22.25.012 is  
5 eligible for membership in the plan.

6 (d) An employee of the National Education Association of Alaska  
7 may participate in the plan if the employee possesses or is eligible  
8 to possess a teacher certificate under AS 14.20.020.

9 (e) An employee of the Special Education Service Agency may  
10 participate in the plan if the employee possesses or is eligible to  
11 possess a teacher certificate under AS 14.20.020.

12 (f) If an employer of an employee required or permitted to  
13 participate in the plan under this section does not pay the employer's  
14 contributions when due, coverage in the plan for the period of the  
15 delinquency may not be granted until the contributions are paid.

16 ARTICLE 3. CONTRIBUTIONS, RIGHTS, AND BENEFITS.

17 Sec. 39.38.200. EMPLOYMENT CONTRIBUTIONS MANDATORY. Contribu-  
18 tions of employees shall be made by payroll deductions. Every includ-  
19 ed employee shall be considered to consent to payroll deductions. It  
20 is of no consequence that a payroll deduction may cause the compen-  
21 sation paid in cash to an employee to be reduced below the minimum  
22 required by law. Payment of an employee's compensation, less payroll  
23 deductions, is a full and complete discharge and satisfaction of all  
24 claims and demands by the employee relating to remuneration of ser-  
25 vices during the period covered by the payment.

26 Sec. 39.38.210. CONTRIBUTIONS. (a) Except as provided in  
27 AS 39.38.140(a), the employer shall contribute to the plan on behalf  
28 of each employee participating in the plan an amount equal to 9.65  
29 percent of the employee's compensation.

1 (b) An employee participating in the plan shall contribute to  
2 the plan an amount set by the administrator. The amount may not be  
3 less than one-half the amount of the employer contribution.

4 (c) The administrator may increase or decrease the contributions  
5 required of employees under this section during the course of a per-  
6 son's employment. The administrator may specify that contributions  
7 required by this section are made by a reduction in salary under 26  
8 U.S.C. 414(h)(2) (Internal Revenue Code).

9 (d) The administrator shall pay the contributions required by  
10 this section to the designated investment entities, company, or com-  
11 panies for the benefit of each participant.

12 Sec. 39.38.220. INVESTMENT BY PERMANENT FUND BOARD OF TRUSTEES.  
13 If investment entities have not been designated to receive the contri-  
14 butions, the board may request the Board of Trustees of the Alaska  
15 Permanent Fund Corporation, under AS 37.13.125 to manage and invest  
16 the contributions for a limited period of time.

17 Sec. 39.38.230. BENEFITS. (a) Payment of benefits to partici-  
18 pants of the plan is the responsibility of the company or other entity  
19 designated by the board and is not the responsibility of the board,  
20 the employer, or the state. The benefits are payable to participants  
21 or their beneficiaries in accordance with the terms of the annuity  
22 contract or contracts or other investments.

23 (b) The board may purchase and offer participation in a group  
24 health plan to members who have retired.

25 Sec. 39.38.240. RIGHTS UNDER QUALIFIED DOMESTIC RELATIONS ORDER.  
26 A former spouse shall be treated as a spouse or surviving spouse to  
27 the extent required by a qualified domestic relations order. Rights  
28 under the order do not take effect until the order is filed with the  
29 administrator.

1           Sec. 39.38.250. SAFEGUARD OF EMPLOYEE FUNDS HELD BY THE PLAN.  
2       Employee contributions and other amounts held in the plan are exempt  
3       from Alaska state and local taxes. Amounts held on behalf of, or  
4       payable to, any employee or other person who is or may become eligible  
5       for benefits under the plan are not subject to anticipation, aliena-  
6       tion, sale, transfer, assignment, pledge, encumbrance, or charge of  
7       any kind, either voluntary or involuntary, before being received by  
8       the person entitled to the amount under the terms of the plan. An  
9       attempt to anticipate, alienate, sell, transfer, assign, pledge,  
10      encumber, charge, or otherwise dispose of a right to amounts held  
11      under the plan is void. However, an employee's right to receive  
12      benefits may be assigned under a qualified domestic relations order.

13           Sec. 39.38.260. EXEMPTION OF EMPLOYEE FUNDS AND BENEFITS.  
14      Employee contributions and other amounts held in the plan and retire-  
15      ment benefits payable under the plan are exempt from levy to enforce  
16      the collection of a debt as provided in AS 09.38 (exemptions).

17           ARTICLE 4. POLITICAL SUBDIVISIONS AND PUBLIC ORGANIZATIONS.

18           Sec. 39.38.300. REQUEST TO PARTICIPATE. (a) A municipality or  
19      other political subdivision of the state may request to become an  
20      employer in the plan. The request shall be made after adoption of a  
21      resolution by the legislative body of the political subdivision and  
22      after approval of the resolution by the person required by law to  
23      approve it. A certified copy of the resolution shall be filed with  
24      the administrator. If the administrator approves the request for  
25      participation, the political subdivision is an employer of the plan.

26           (b) A public organization may request to become an employer in  
27      the plan. The request shall be made after adoption of a resolution by  
28      the governing body of the public organization. A certified copy of  
29      the resolution shall be filed with the administrator. If the

1 administrator approves the request for participation, the public  
2 organization is an employer of the plan.

3 Sec. 39.38.310. SURVEY TO DETERMINE ESTIMATED COST. A political  
4 subdivision or public organization contemplating participation in the  
5 plan may request a preliminary survey to determine the estimated cost  
6 of participation, the benefits derived, and other information that is  
7 appropriate. The political subdivision or public organization re-  
8 questing the survey shall pay the cost of it.

9 Sec. 39.38.320. PARTICIPATION. (a) The effective date of  
10 participation in the plan by a political subdivision or public orga-  
11 nization is the first day of any month acceptable to the governing  
12 body of the political subdivision or public organization and to the  
13 Retirement Board.

14 (b) The political subdivision or public organization shall  
15 designate the departments, groups, or other classifications of employ-  
16 ees eligible to participate in the plan, and shall agree to make the  
17 contributions each year that are required by the administrator.

18 (c) The eligible employees of a participating political subdivi-  
19 sion or public organization are bound by the provisions of this plan  
20 and are entitled to the benefits provided under it.

21 Sec. 39.38.330. TRANSMITTAL OF CONTRIBUTIONS TO ADMINISTRATOR.  
22 The contributions of an employer and the contributions of its employ-  
23 ees shall be transmitted to the administrator as soon as practicable  
24 after the close of the payroll period for which the contributions are  
25 made. If an employer is delinquent in transferring the contributions  
26 for more than 15 days, interest and other penalties shall be assessed  
27 on the outstanding contributions at the rate and in the amount estab-  
28 lished by the board.

29 Sec. 39.38.340. TERMINATION OF PARTICIPATION. (a) If the

1 contributions are not transmitted to the administrator within the pre-  
2 scribed time limit, the administrator may grant an extension. If the  
3 political subdivision or public organization is in default at the end  
4 of the extension, participation in the plan is terminated, and the  
5 employer shall be sent notice of termination.

6 (b) Termination of an employer's participation in the plan does  
7 not bar future participation in the plan by that employer.

8 Sec. 39.38.350. EFFECT OF TERMINATION BY AMENDMENT OF AGREEMENT.

9 (a) A political subdivision or public organization may request that  
10 its participation agreement be amended. The request may be made only  
11 after adoption of a resolution by the legislative body of the politi-  
12 cal subdivision and approval of the resolution by the person required  
13 by law to approve the resolution, or, in the case of a public organi-  
14 zation, after adoption of a resolution by the governing body of that  
15 public organization. A certified copy of the resolution shall be  
16 filed with the administrator.

17 (b) Termination of coverage of a department, group, or other  
18 classification of employees does not bar future coverage of that  
19 department, group, or classification.

20 ARTICLE 5. GENERAL PROVISIONS.

21 Sec. 39.38.450. NONGUARANTEED EMPLOYMENT. This chapter is not  
22 a contract of employment between an employer and an employee, nor does  
23 it confer a right of an employee to be continued in the employment of  
24 an employer, nor is it a limitation of the right of an employer to  
25 discharge an employee with or without cause.

26 Sec. 39.38.460. FRAUD. A person who knowingly makes a false  
27 statement, or falsifies or permits to be falsified a record of this  
28 plan, in an attempt to defraud the plan, is guilty of a misdemeanor,  
29 and upon conviction is punishable by a fine of not more than \$500, or

1 by imprisonment for not more than 12 months, or by both.

2 Sec. 39.38.900. DEFINITIONS. In this chapter,

3 (1) "administrator" means the administrator of the retire-  
4 ment defined contribution plan;

5 (2) "appropriate state retirement system" means the state  
6 retirement system that includes the employee's position;

7 (3) "board" means the Retirement Board established under  
8 AS 39.38.020;

9 (4) "compensation" means the total remuneration earned by  
10 an employee for personal services rendered to an employer, including  
11 employee contributions under AS 39.38.210, cost-of-living differen-  
12 tials, payments for leave that is actually used by the employee, the  
13 amount by which the employee's wages are reduced under AS 39.30.-  
14 150(c), and any amount deferred under an employer-sponsored deferred  
15 compensation plan, but does not include retirement benefits, severance  
16 pay or other separation bonuses, welfare benefits, per diem, expense  
17 allowances, workers' compensation payments, incentive cash awards  
18 under AS 39.51.120, or payments for leave not used by the employee  
19 whether those leave payments are scheduled payments, lump-sum pay-  
20 ments, donations, or cash-ins;

21 (5) "contribution account" means the member contribution  
22 account under AS 14.25, the employee contribution account under  
23 AS 39.35, or, for an administrative director of the Alaska Court  
24 System electing to participate in the plan, the total maintained by  
25 the judicial retirement system of the administrative director's manda-  
26 tory contributions, indebtedness principal, contributions of interest  
27 on indebtedness, interest credited to each of those accounts, and  
28 adjustments to the accounts, whichever is appropriate;

29 (6) "elected official" means a person whose compensation

1 results from personal services rendered to an employer as an elected  
2 representative;

3 (7) "employer" means the State of Alaska, a political  
4 subdivision or public organization of the state that participates in  
5 the plan, or an employer under AS 39.38.130 or 39.38.140 that partici-  
6 pates in the plan;

7 (8) "member" or "employee"

8 (A) means a person who is eligible to participate in  
9 the plan and who is covered by the plan;

10 (B) includes an elected public officer under AS 39.-  
11 38.130 and other employees participating under AS 39.38.140;

12 (C) does not include

13 (i) former members;

14 (ii) persons compensated on a contractual or fee  
15 basis;

16 (iii) casual or emergency workers or nonpermanent  
17 employees as defined in AS 39.25.200;

18 (iv) members of the Alaska teachers' retirement  
19 system, the judicial retirement system, the public employ-  
20 ees' retirement system, the elected public officers' retire-  
21 ment system (former AS 39.37), or the optional university  
22 retirement program;

23 (v) employees of the division of marine transpor-  
24 tation engaged in operating the state ferry system who are  
25 covered by a union or group retirement system to which the  
26 state makes contributions; and

27 (vi) the administrative director of courts ap-  
28 pointed under art. IV, sec. 16 of the state constitution  
29 unless the director becomes a member under AS 39.38.120;

1 (D) may include employees of the division of marine  
2 transportation excluded under (C)(v) of this paragraph provided  
3 that

4 (i) the State of Alaska formally agrees to their  
5 inclusion through the process of collective bargaining; and

6 (ii) no collective bargaining agreement has the  
7 effect of obligating contributions made by the state under  
8 AS 39.30.150 in the event the state resumes participation in  
9 the federal social security system;

10 (9) "plan" means the defined contribution plan;

11 (10) "public organization" means an organization or entity

12 (A) created by the constitution or laws of the state  
13 for the purpose of administering state programs;

14 (B) whose officers and employees are paid by a method  
15 other than by the state payroll prepared by the Department of  
16 Administration; and

17 (C) whose employees are not required by law to partic-  
18 ipate in the plan;

19 (11) "qualified domestic relations order" has the meaning  
20 given in AS 39.35.680;

21 (12) "state retirement system" means the teachers' retire-  
22 ment system under AS 14.25, the public employees' retirement system  
23 under AS 39.35, or, for an administrative director of the Alaska Court  
24 System who elects to participate in the plan under AS 22.25.012, the  
25 judicial retirement system.

26 \* Sec. 2. AS 14.25.035(c) is amended to read:

27 (c) The board shall

28 (1) confer with the commissioner of administration regard-  
29 ing the administration of the system and may make recommendations that

1 it considers necessary;

2 (2) have prepared, at least biennially, an actuarial val-  
3 uation of the total obligations under the system of each employer and,  
4 on the basis of the valuation, shall certify to the appropriate bud-  
5 getary authorities of each employer:

6 (A) an appropriate contribution rate for all employ-  
7 ers; and

8 (B) an amount appropriate for each employer to liqui-  
9 date the employee's past service liability; the board shall have  
10 an actuarial and financial experience analysis of the system  
11 conducted at appropriate intervals, but no less frequently than  
12 once every six years; the actuarial valuations and the actuarial  
13 and financial experience analysis shall be prepared and certified  
14 by a member of the American Academy of Actuaries.

15 \* Sec. 3. AS 14.25.040(a) is amended to read:

16 (a) Unless a teacher or member has elected to participate in the  
17 optional university retirement program under AS 14.40.661 - 14.40.799  
18 or the defined contribution plan under AS 39.38, a teacher or member  
19 contracting for service with a participating employer who became a  
20 member of this system before July 1, 1990, is subject to this chapter.

21 \* Sec. 4. AS 14.25.045(a) is amended to read:

22 (a) An employee or former employee of the National Education  
23 Association of Alaska first hired before July 1, 1990, may participate  
24 in the system under this chapter if

25 (1) the employee or former employee possesses or is eligi-  
26 ble to possess a teacher certificate under AS 14.20.020; and

27 (2) the employee or former employee of the National Educa-  
28 tion Association of Alaska pays all retroactive contributions required  
29 to be made under this chapter.

1 \* Sec. 5. AS 14.25.047 is amended to read:

2           Sec. 14.25.047.     PARTICIPATION BY SPECIAL EDUCATION SERVICE  
3     AGENCY EMPLOYEES. An employee of the Special Education Service Agency  
4     first hired before July 1, 1990, may participate in the retirement  
5     fund under this chapter if

6                     (1) the employee possesses or is eligible to possess a  
7     teacher certificate under AS 14.20.020; and

8                     (2) the employee pays all retroactive contributions re-  
9     quired to be made under this chapter.

10 \* Sec. 6. AS 14.25.115(a) is amended to read:

11           (a) A teacher in membership service on or after July 1, 1977,  
12     and before July 1, 1990, who is appointed to retirement on or after  
13     July 1, 1978, may elect to apply unused sick leave credit in computing  
14     the total number of years of credited service under AS 14.25.110(d)  
15     except for sick leave earned while participating in the optional  
16     university retirement program under AS 14.40.661 - 14.40.799 or in the  
17     defined contribution plan under AS 39.38. To obtain service credit  
18     for unused sick leave, a teacher must apply to the administrator no  
19     later than one year after appointment to retirement. Unused sick  
20     leave shall be credited on a day-for-day basis in accordance with the  
21     table for service after July 1, 1969, contained in AS 14.25.220(43).  
22     Teacher contributions may not be required for credited unused sick  
23     leave.

24 \* Sec. 7. AS 14.25.143(a) is amended to read:

25           (a) If the system is determined to be fully funded for the year  
26     and if [WHEN] the administrator determines that the cost of living has  
27     increased and that the financial condition of the system permits, the  
28     administrator shall increase benefit payments to persons receiving  
29     benefits under this system.

1 \* Sec. 8. AS 14.25.220(40) is amended to read:

2 (40) "teacher" or "member" means a person first hired before  
3 July 1, 1990, who is eligible to participate in the system and who is  
4 covered by the system, other than a person who is participating in the  
5 defined contribution plan, limited to

6 (A) a certificated full-time or part-time elementary  
7 or secondary teacher, a certificated school nurse, or a certif-  
8 icated person in a position requiring a teaching certificate as a  
9 condition of employment in a public school of the state;

10 (B) the commissioner of education and all supervisory  
11 positions in the Department of Education;

12 (C) a full-time or part-time teacher of the University  
13 of Alaska or a person occupying a full-time administrative posi-  
14 tion at the University of Alaska which requires academic stand-  
15 ing; the approval of the administrator must be obtained before an  
16 administrative position qualifies for membership in the system;  
17 however, a teacher or administrative person at the university who  
18 is participating in the optional university retirement program  
19 under AS 14.40.661 - 14.40.799 is not a member under this system;

20 (D) a state legislator who elects membership under  
21 AS 14.25.040(b);

22 \* Sec. 9. AS 22.25.012(c) is amended to read:

23 (c) An administrative director first hired before July 1, 1990,  
24 who withdraws from the judicial retirement system under (b) of this  
25 section is eligible for membership in the public employees' retirement  
26 system (AS 39.35) and shall receive credited service in that system  
27 for service rendered as administrative director. An administrative  
28 director hired on or after July 1, 1990, who withdraws from the judi-  
29 cial retirement system is eligible for membership in the defined

1     contribution plan (AS 39.38) from the date of withdrawal. To be  
2     eligible for membership in the public employees' retirement system  
3     under this subsection, the administrative director must contribute to  
4     the public employees' retirement system

5             (1) the amount that would have been contributed if the  
6     administrative director had been a member during the period of the  
7     membership in the judicial retirement system; and

8             (2) any contributions for service as administrative director  
9     refunded from the public employees' retirement system at the time  
10    the administrative director became a member of the judicial retirement  
11    system.

12    \* Sec. 10. AS 22.25.012 is amended by adding a new subsection to read:

13             (d) An administrative director who chooses to withdraw from the  
14    judicial retirement system and participate in the defined contribution  
15    plan must contribute to the plan the amount required under (c) of this  
16    section for participation in the public employees' retirement system.  
17    The judicial retirement system shall transfer to the defined contribu-  
18    tion plan the amount in the employee contribution account, the amount  
19    of the employer contributions, and interest earned on both employee  
20    and employer contributions as required of the public employees' re-  
21    tirement system for members of that system.

22    \* Sec. 11. AS 37.13 is amended by adding a new section to read:

23             Sec. 37.13.125. ASSETS OF THE DEFINED CONTRIBUTION PLAN. If  
24    requested by the Retirement Board under AS 39.38.220, the board of  
25    trustees may manage and invest the assets of the defined contribution  
26    plan for a limited period of time. The board of trustees may impose  
27    conditions to its acceptance of the responsibility. The board of  
28    trustees shall comply with AS 37.13.120 in the investment of the  
29    assets and shall separately account for the earnings of the assets.

1 \* Sec. 12. AS 37.13.125 is repealed and reenacted to read:

2       Sec. 37.13.125. ASSETS OF THE DEFINED CONTRIBUTION PLAN. If  
3 requested by the State Investment Board under AS 39.38.220, the board  
4 of trustees may manage and invest the assets of the defined contribu-  
5 tion plan for a limited period of time. The board of trustees may  
6 impose conditions to its acceptance of the responsibility. The board  
7 of trustees shall comply with AS 37.13.120 in the investment of the  
8 assets and shall separately account for the earnings of the assets.

9 \* Sec. 13. AS 39.35.120 is amended to read:

10       Sec. 39.35.120. COMMENCEMENT OF PARTICIPATION. (a) Unless the  
11 employee has elected to participate in the defined contribution plan  
12 under AS 39.38, an [AN] employee of the state who was first hired  
13 before July 1, 1990, shall be included in this system upon commence-  
14 ment of employment with the state, or on January 1, 1961, whichever is  
15 later. Unless an employee has elected to participate in the optional  
16 university retirement program under AS 14.40.661 - 14.40.799 or the  
17 defined contribution plan under AS 39.38, an employee of a political  
18 subdivision or public organization that becomes an employer who was  
19 first hired before July 1, 1990, shall be included in the system on  
20 the effective date of the employer's participation or the date of the  
21 employee's commencement of employment with the employer, whichever is  
22 later.

23       (b) Inclusion in the system is a condition of employment for an  
24 employee who was first hired before July 1, 1990, except as otherwise  
25 provided for an elected official, an employee who has elected to  
26 participate in the defined contribution plan under AS 39.38, and for  
27 an employee of the university who has elected to participate in the  
28 optional university retirement program under AS 14.40.661 - 14.40.799.

29 \* Sec. 14. AS 39.35.158 is amended to read:

1           Sec. 39.35.158. ADMINISTRATIVE DIRECTOR OF COURTS. An adminis-  
2           trative director of the Alaska Court System first hired before July 1,  
3           1990, [COURT SYSTEM] who withdraws from the judicial retirement system  
4           under AS 22.25.012 and who has not elected to participate in the  
5           defined contribution plan is eligible for membership in the system  
6           and shall receive credited service in the system for service rendered  
7           as administrative director. To be eligible for membership in the  
8           system under this subsection, the administrative director must con-  
9           tribute to the system

10           (1) the amount the director would have contributed if the  
11           director had been a member during the director's period of membership  
12           in the judicial retirement system; and

13           (2) any contributions for services as administrative direc-  
14           tor refunded by the system at the time the director became a member of  
15           the judicial retirement system.

16 \* Sec. 15. AS 39.35.475(a) is amended to read:

17           (a) If the administrator determines that the system is fully  
18           funded for the year, [ONCE EACH YEAR] the administrator shall increase  
19           benefit payments to eligible disabled members, to persons age 60 or  
20           older receiving benefits under this system in the preceding calendar  
21           year, and to persons who have received benefits under this system for  
22           at least five years who are not otherwise eligible for an increase  
23           under this section.

24 \* Sec. 16. AS 39.35.680(21) is amended to read:

25           (21) "member" or "employee"

26           (A) means a person eligible to participate in the  
27           system who was first hired before July 1, 1990, and who is cov-  
28           ered by the system;

29           (B) includes

- 1 (i) active member;
- 2 (ii) inactive member;
- 3 (iii) vested member;
- 4 (iv) deferred vested member;
- 5 (v) non-vested member;
- 6 (vi) disabled member;
- 7 (vii) retired member;
- 8 (C) does not include
- 9 (i) former members;
- 10 (ii) persons compensated on a contractual or fee
- 11 basis;
- 12 (iii) casual or emergency workers or nonpermanent
- 13 employees as defined in AS 39.25.200;
- 14 (iv) persons covered by the Alaska Teachers'
- 15 Retirement System, the defined contribution plan, or the
- 16 optional university retirement program;
- 17 (v) employees of the division of marine transpor-
- 18 tation engaged in operating the state ferry system who are
- 19 covered by a union or group retirement system to which the
- 20 state makes contributions;
- 21 (vi) justices of the supreme court or judges of
- 22 the court of appeals or of the superior or district courts
- 23 of Alaska;
- 24 (vii) the administrative director of courts ap-
- 25 pointed under art. IV, sec. 16 of the state constitution
- 26 unless the director becomes a member under AS 39.35.158; and
- 27 (viii) members of the elected public officers'
- 28 retirement system (former AS 39.37);
- 29 (D) may include employees of the division of marine

1 transportation excluded under (C)(v) of this paragraph provided  
2 that

3 (i) the State of Alaska formally agrees to their  
4 inclusion through the process of collective bargaining; and

5 (ii) no collective bargaining agreement has the  
6 effect of obligating contributions made by the state under  
7 AS 39.30.150 in the event the state resumes participation in  
8 the federal social security system;

9 \* Sec. 17. AS 39.38.900(3) is repealed and reenacted to read:

10 (3) "board" means the State Investment Board;

11 \* Sec. 18. AS 39.50.200(b) is amended by adding a new paragraph to  
12 read:

13 (50) Defined Contribution Retirement Board (AS 39.38.020).

14 \* Sec. 19. Section 7, ch. 26, SLA 1986, as amended by sec. 7, ch. 104,  
15 SLA 1989, is further amended to read:

16 Sec. 7. INDEBTEDNESS ON REEMPLOYMENT. If a participant in the  
17 retirement incentive program is reemployed as a member of the Public  
18 Employees' Retirement System under AS 39.35, the optional university  
19 retirement program under AS 14.40.661 - 14.40.799, the defined contri-  
20 bution plan under AS 39.38, or the Teachers' Retirement System under  
21 AS 14.25 after appointment to retirement under the program, the par-  
22 ticipant loses the incentive credit received under sec. 5 (c) of this  
23 Act and is indebted to the system. The amount of the indebtedness is  
24 equal to 110 percent of the amount the participant received as a  
25 result of participation in the program for which the participant was  
26 not otherwise entitled, including the cost of health insurance. The  
27 participant is entitled to a credit to be applied against the re-  
28 employment indebtedness in the amount the participant has paid under  
29 sec. 5(d) of this Act. Interest accrues on the indebtedness at the

1 rate established by regulation from the date of reemployment until the  
2 member is appointed to retirement and accepts an actuarial adjustment  
3 to the member's future benefits or until the amount is paid in full.

4 \* Sec. 20. Section 9(a), ch. 89, SLA 1989, is amended to read:

5 (a) If a participant in the retirement incentive program is  
6 reemployed as a member of the public employees' retirement system  
7 under AS 39.35, [OR] the teachers' retirement system under AS 14.25,  
8 or the defined contribution plan under AS 39.38, after appointment to  
9 retirement under the retirement incentive program, the participant  
10 loses the incentive credit received under sec. 2(g) of this Act and is  
11 indebted to the system. The amount of the indebtedness is equal to  
12 110 percent of the amount the participant received as a result of par-  
13 ticipation in the program to which the participant was not otherwise  
14 entitled, including the cost of health insurance. The participant is  
15 entitled to a credit to be applied against the reemployment indebted-  
16 ness in the amount the participant has paid under sec. 2(e) or (f) of  
17 this Act. Interest accrues on the indebtedness at the rate estab-  
18 lished by regulation from the date of reemployment until the member is  
19 appointed to retirement and accepts an actuarial adjustment to the  
20 member's future benefits or until the amount is paid in full.

21 \* Sec. 21. AS 39.38.020 is repealed.

22 \* Sec. 22. Notwithstanding AS 39.38.210, enacted by sec. 1 of this Act,  
23 the employee contribution rate in effect for a position on June 30, 1990,  
24 shall be the employee contribution rate for that position until the rate is  
25 amended by the Retirement Board.

26 \* Sec. 23. Except for secs. 12, 17, and 21 of this Act, this Act takes  
27 effect July 1, 1990.

28 \* Sec. 24. Sections 12, 17, and 21 of this Act take effect only if an  
29 Act is enacted by the Sixteenth Alaska State Legislature that creates a

1 State Investment Board to manage and invest state retirement funds. If  
2 those sections take effect, they take effect on the later of July 1, 1990,  
3 and the date on which the State Investment Board assumes its duties to  
4 manage and invest the assets of the public employees' retirement system.

Attachment 2

HB 579

4/9/90

STATE OF ALASKA

ANALYSIS OF RETIREMENT PLANNING ALTERNATIVES

OCTOBER, 1989

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**SECTION 1**  
**INTRODUCTION**

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The purpose of this analysis is to review alternative retirement programs available to the State of Alaska and discuss the advantages of each type of program. Section 2 discusses the traditional defined benefit and defined contribution plans. Section 3 describes some hybrid plans, combining features from both defined benefit and defined contribution plans. Section 4 contains some basic questions on retirement needs which should be addressed before a change in retirement program is made. Section 5 contains other issues which will affect employees' retirement benefits depending on the type of plan used. Section 6 contains a description of the types of retirement vehicles available to the State of Alaska.

## SECTION 2

### DEFINED BENEFIT VS. DEFINED CONTRIBUTION

---

The Employee Retirement Income Security Act of 1974 coined the terms defined benefit and defined contribution and then classified all retirement plans as one or the other. Since ERISA, innovations in retirement planning have breached the wall between defined benefit and defined contribution plans by dressing up plans on one side with attractive features from the other side. Today, many kinds of hybrid plans have been developed, combining features of both approaches. The basic categories, however, are still valid.

#### Defined Benefit

Defined benefit plans promise to pay participants a specified benefit, usually a percentage of final pay, at retirement for the participant's lifetime. Therefore, defined benefit plans provide security of retirement income. Employees do not share the risk of poor investment performance, so there are no problems with participants making the wrong investment decisions and suffering as a result. Generally, money buys more retirement income for retirees in a defined benefit plan because benefits build up more slowly and employees who leave the system take away smaller entitlements as separation benefits. Employers are spared the expense and trouble of complicated recordkeeping and allocations and have a certain degree of flexibility in their plan contributions. For example, when an employer enters PERS, the employer may choose the amount of past service, if any, to grant employees, which will affect the employer's contribution rate.

### Defined Contribution

Defined contribution plans specify an annual contribution to a participant's account, with no guarantee as to the ultimate retirement benefit. These plans may be easier for employees to understand because they resemble bank accounts with individual balances. Periodic account statements keep the plans visible to employees. Such plans can easily accept employee contributions, encouraging people to save for their own retirement and take some of the burden off the employer's shoulders. Defined contribution plans can offer investment options, so that employees can attempt to choose the risk/reward profile best suited to their own financial circumstances. Benefits usually build up faster and vesting tends to be more rapid, which is attractive to employees who intend to change jobs. They can usually take lump-sum settlements with them to another employer plan or roll them over into an IRA. The SBS System is an example of a defined contribution plan.

While it is more common for defined contribution plans to accept employee contributions, in the public sector defined benefit plans also commonly require employee contributions. This is because of Section 414(h) of the Internal Revenue Code, which allows public entities to "pick up" employee contributions, converting them to pre-tax contributions, in any qualified retirement program. The State of Alaska is taking advantage of this in PERS, TRS and SBS.

SECTION 3  
HYBRIDS

---

A number of hybrid plans have been developed since ERISA, which combine the advantages of defined benefit and defined contribution plans.

Target Defined Contribution Plan

A target plan is a defined contribution plan which sets the employer contribution rate such that contributions are expected to accumulate to a target replacement income at retirement. The contribution for each individual is changed every year as the individual's salary changes. Younger employees, since they have a longer time in which to build up account balances, will be allocated smaller contributions. Older employees may receive higher contributions due to the shorter time frame in which to build up the account balance to the target level. This type of plan combines the advantages of targeting a replacement percentage of income with the advantages of an account-based plan.

Floor/Offset Plan

This is actually two plans, a defined benefit and a defined contribution plan working together. The defined benefit plan provides a minimum retirement benefit. If contributions and investment performance are acceptable, the defined contribution plan will provide an adequate retirement income and the defined benefit "floor" plan will not activate. However, if the defined contribution plan does not provide sufficient income at retirement, the floor plan makes up the difference to the minimum level. This is basically a defined contribution plan with a guaranteed minimum benefit if the defined contribution balance is not adequate.

Account-based Plan

An account-based plan is a defined benefit plan which is communicated to employees as a defined contribution plan, with individual account balances. Employee accounts are credited with a specified contribution annually and a specified investment return, both of which may be different than the actual contribution to and investment performance of the fund. Any differences between credited investment performance and actual investment performance, as well as other assumptions as to salary increases and turnover, are made up through changes in the required employer contribution level. This type of plan was first publicized a few years ago when the Bank of America adopted it for its retirement program.

SECTION 4  
THE BASICS

---

The economic, political and social environment in which retirement plans are conceived and executed has changed greatly in the 1980's and no doubt will continue to change. The global economy seems volatile and unpredictable. Congress makes significant changes in employee benefit law with practically every year's tax bill. The federal income tax structure is radically changed by tax reform, but few observers believe that the new low rates will stay low. The demographics of the work force, already in flux, will have even more dramatic changes in the years ahead as the Baby Bust generation follows the Baby Boom into the work place.

How can employers make reasonable decisions about long-term commitments, such as retirement plans, when so many factors affecting these plans are in flux? This is a far more critical question than the old, simplistic choice between defined benefit and defined contribution plans.

When seas are stormy, it becomes even more important to have a good compass and an accurate understanding of where you want to go. Similarly, employers trying to make difficult decisions about retirement plans in an environment of change and confusion need to start at a more fundamental level: exactly what do they want to accomplish with their retirement program?

This question requires analysis from two, sometimes different, perspectives. Analysis of employer needs and assessment of employee needs must both be weighed before a unified course can be charted.

Employer priorities can be determined by answering several questions:

- What composition of work force am I looking for? (experience, age, etc.)
- Can I attract targeted specialists to employ with my organization through drafting specialized benefits?
- Are the current retirement plans satisfying my organization's needs?
- What can the organization afford vs. benefit gained?
- Can I expect future revenues to satisfy future funding needs?

Retirement planning for employee needs involves several questions:

- How much retirement income is needed?
- At what age should full benefits be paid?
- How quickly in an employee's career should benefits build up?
- How should the cost of providing retirement income be divided between employer and employee?

Only after these questions have been answered is it time to move on the last question:

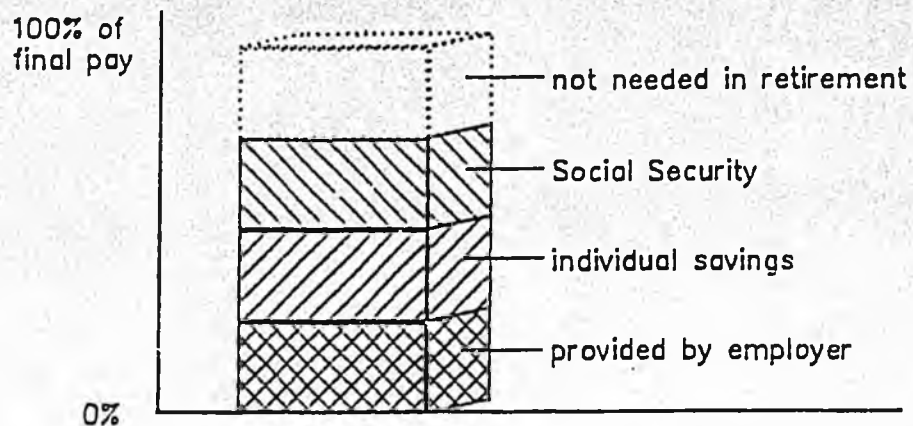
- What kind of plan, or combination of plans, will accomplish these goals?

One way to answer this question is to use a financial model to calculate retirement income in terms of replacing the employee's final pay at retirement age. We start with the assumption that for an individual employee, "total adequacy" in retirement income means 100% replacement of final earnings after taxes. (Some employers may decide that it is alright for employees to have a slightly lower standard of living after retirement.)

In this model, 100% replacement includes four components, as shown in Chart 1. The first is a reduction element, since after retirement people do not generally need as much money to maintain the same standard of living. The

next three components are the three sources of retirement income: Social Security, personal savings and employer-provided pensions. (For the State of Alaska, Social Security may be replaced by the SBS System.)

Chart 1  
Four components of replacing income in retirement



Of the four components, reduction in need and personal savings are the most difficult to quantify - and for employers to plan for. Retirement age is another important variable.

The answer to the question as it concerns employers is more appropriately financial in nature. A determination must be made whether the employer can use the retirement plan, in conjunction with other employer sponsored benefits to attract and retain quality employees.

Is the strength of the operation or funding source strong enough to guarantee funds into the future?

Can a defined contribution plan attract the specialists that the organization needs? If not, should there be a combination with a defined benefit plan or sole use of a defined benefit plan?

With this basic model, employers can determine need and answer the above questions based on their individual circumstances.

SECTION 5  
OTHER ISSUES

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There are many issues and circumstances which may arise that will affect the retirement benefits differently for the employee. The success of securing quality employees for the employer depends upon these circumstances and the type of plan implemented.

Issues which the State must keep in mind in determining the best type of plan to serve it's future needs are as follows:

Geographic Variances

Throughout a state as large and diverse as Alaska, there are vast differences in the cost of living from one area to another. There are also major socioeconomic differences between the few major urban areas and the numerous rural (bush) communities. Not only are all consumer goods and housing costlier in a rural setting, social adjustment for those reared in an urban setting tend to deter many qualified employees from locating in the "bush".

The defined benefit plan can be crafted including provisions which would provide incentives, recognizing employment in rural communities. A defined contribution plan would be more difficult to craft for providing incentives to rural employees, especially if the plan covered employees in both urban and rural communities.

Investment Performance

Who should suffer if investment performance is poor, or receive the windfall if returns are higher than anticipated? In traditional defined contribution plans, the employee bears the entire investment risk. In

defined benefit plans, the employer bears this risk through changes in future contribution rates. In the defined benefit portion of a floor/offset arrangement, the employer bears the investment risk. The defined contribution portion of this arrangement shifts the risk to the employees. Account-based plans can place the risk on the employer or the employee, depending on plan design. Employees bear the entire risk in target plans.

### Costs

A primary consideration in retirement planning is the cost to the employer to provide a certain level of benefits. Obviously, the first determinant of cost is the level of income replacement the company wants to provide. Secondly, where should the line be drawn between employer and employee responsibilities? Then there is the build-up pattern. It costs considerably more to build up benefits early than late. A final determinant of cost is how the risk for unforeseen events is assigned.

As discussed earlier, defined benefit plans generally cost less than defined contribution plans to provide the same target benefit at retirement. This is because of the early build-up pattern of a defined contribution plan versus the late build-up pattern of a defined benefit plan.

### Plan Complexity

Whether a plan can be easily communicated is an issue that should be considered in the early stages of planning. It is possible to design a plan that perfectly fits the income replacement objectives and allows plenty of flexibility for fine tuning, but is almost impossible for employees to understand. Overly-complicated plans also tend to be difficult to

administer, another issue that should be considered in the planning stages.

Defined contribution plans tend to be more easily understood by employees because of the account-based nature of the plan. Many of the hybrid defined benefit plans attempt to express benefits in an account-based manner to help overcome this issue. Good communication can often overcome the complexities of any retirement program.

#### Local Area Growth or Decline

Employers may be impacted by a growth or decline in population or radical shifts in the economic stability of the area. This is especially true in Alaska where the "Boom or Bust" economy seems traditional in the "bush" communities. This action can result in a continuous swing of the number of employees working for a public employer as the community service needs vacillate by population changes.

A traditional defined contribution plan will be affected less by dramatic shifts in employee numbers. The contribution rate is set by plan document and the cost to the employer will always be in direct proportion to the number of employees working. There are advantages for employees under these circumstances because of the portability of the contributions from one employer to another or to a private tax qualified plan.

Issues which the State must keep in mind in determining the best type of plan to serve the future needs of it's employees are as follows:

### Unexpected Salary Increases

Fast-track employees do not have the standard salary progression that retirement planners anticipate. Under certain kinds of plan design, particularly the traditional defined contribution plan, they will be penalized compared to other employees who have achieved the same final salary in a more predictable fashion. Under the defined benefit design, the plan compensates to make up the difference. All of the hybrid types of plans mentioned help compensate for unexpected salary changes.

### Special Benefit Increases

This would include paying additional benefits for early retirement or disability, providing post-retirement increases in benefits, or changing overall objectives for adequate retirement income. Defined benefit plans have traditionally been a better vehicle for providing immediate changes in benefit levels. This is primarily because the employer can pay for these "unfunded liabilities" after the fact through increased contributions. It would be practically impossible to provide post-retirement pension adjustments in a defined contribution type of plan.

### Portability

The State has over 40,000 employees in a variety of jobs. Currently there are numerous retirement programs covering these employees, including PERS, TRS, JRS, National Guard, EPORS, UVPARP and SBS. Many employees also moved to Alaska to take jobs, bringing with them service and retirement benefits from other State and private retirement plans. Employees move among the retirement systems, creating a need for effective portability.

Traditional defined contribution plans generally provide portability easier than defined benefit plans. Account balances may simply be withdrawn

from one system and rolled into another system without loss of earnings or years of service. This also keeps all of an employee's money in the system in which he or she is currently employed.

Defined benefit plans are more difficult to make portable. Particularly final average pay plans, such as PERS and TRS, raise issues of equity. If an employee works under TRS for ten years and then PERS for ten years, should the ultimate benefit be split 50/50 between the two systems or should PERS pay a larger portion of the benefit if the employee's final average earnings are larger than earnings under TRS? This and other issues may be resolved in a defined benefit plans, however, the defined contribution plan provides a more effective vehicle for portability.

#### Plan Complexity

The same issues raised above under Plan Complexity are appropriate for the employee as well as the employer. As discussed, defined contribution plans tend to be more easily understood by employees because of the account-based nature of the plan. Many hybrid defined benefit plans, however, are overcoming this issue by expressing benefits in an account-based manner. Good communication is a key to helping employees understand the plans.

#### Other Pre- and Post-Retirement Medical Benefits

PERS and TRS currently provide both death and disability benefits to participants. These benefits are equal to a percentage of salary regardless of age and service, and are generally paid as annuities. Defined contribution plans have no mechanism for providing similar types of benefits which are not related to benefits accrued under the plan. The benefits could be purchased outside the plans from an insurance carrier or be self-insured.

Currently, post-retirement medical benefits are provided under PERS and TRS. The cost of these benefits are borne by the employers and have been a major influence on the volatility of employer contribution rates year to year. A defined contribution plan has no mechanism for protecting employees from the volatile cost of medical benefits. On the other hand, part of the contribution to a defined contribution plan could be earmarked to pay for post-retirement medical benefits. This would shift the risk of volatility to the employee unless a mechanism for special one-time contributions to retired participant accounts could be made to help make up deficiencies.

SECTION 6  
RETIREMENT VEHICLES

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The State of Alaska is a public entity with the following types of retirement plans available to it:

401(a) Qualified

The State of Alaska can have any type of defined benefit or defined contribution money purchase plan which is qualified under Internal Revenue Code Section 401(a). The State may not implement a 401(k) (cash or deferred arrangement) profit-sharing plan. PERS, TRS and SBS are all retirement programs qualified under Internal Revenue Code Section 401(a).

Section 457

The State may have a nonqualified deferred compensation arrangement under Internal Revenue Code Section 457. The Deferred Compensation Plan (DCP) qualifies under this section of the code. Any nonqualified retirement plan established by the State must meet the qualifications of Code Section 457.

Tax Sheltered Annuities

The State may implement a tax sheltered annuity (TSA) program which allows employees to contribute money to a qualified plan on a tax deferred basis.

# MERCER MEIDINGER HANSEN

Attachment 2  
HB 579  
4/9/90

March 19, 1990

Mr. Robert F. Stalnaker  
Deputy Director  
State of Alaska  
Department of Administration  
Division of Retirement & Benefits  
P.O. Box CR  
Juneau, AK 99811

Re: House Bill 579

Dear Bob:

House Bill 579 would effectively establish a two-tiered retirement structure in the State of Alaska. All new employees would be covered by a defined contribution plan, while current employees could elect to remain in the defined benefit plan or transfer to the new defined contribution plan. The purpose of this letter is to comment on the bill and its affect on the State retirement programs.

The ultimate cost of the new defined contribution plan will simply equal the contribution rate established for the plan, 9.65% of payroll. The initial cost to the State will be a blending of the current defined benefit and new defined contribution rates, as participation in the defined benefit plan declines and participation in the defined contribution plan rises.

Since current employees in the defined benefit plan will be able to opt into the defined contribution plan, we would expect some anti-selection to occur: employees who would benefit most will elect to transfer. Offsetting this is the lower contribution rate required under the defined contribution plan. Therefore, we would expect the overall contributions to State retirement programs would be approximately the same as they are now. Over time, the rates will decrease to 9.65%.

I have taken an informal survey of Mercer consultants and have found no other state or local retirement system which has established a two-tiered structure with a defined contribution and defined benefit plan. There are, however, numerous city retirement systems, both in the States of Washington and Colorado, which have two-tiered defined benefit plans for police and firefighters. These systems sometimes occur when a change is made in the agency responsible for funding the plan. Both the plan for "old hires" and the plan for "new hires" are defined benefit plans in these cases.

Mr. Robert F. Stalnaker  
March 19, 1990  
Page 2

In addition, we found in Maryland that a two-tiered defined benefit structure exists as the result of cost containment measures. This is similar to the situation in the Alaska Public Employees' Retirement System from the changes implemented in '86. Some other public sponsors have hybrid plans, combining features of defined benefit and defined contribution plans.

The following are some thoughts on the structure of the bill and how it might affect retirement benefits in the State:

- (1) Will health benefits continue to be provided for employees participating in the defined contribution plan? Health benefits are currently funded in the defined benefit plan. This approach would not be possible in a defined contribution plan. A portion of the employee's account may be set aside to provide for health benefits, but the full amount needed won't be known and may not be available at retirement.
- (2) The bill amends AS 14.25.143(a) and AS 39.35.475(a), allowing for increased retirement benefits if the System is determined to be fully funded. What does "fully funded" mean?

Is this section of the statutes going to apply to the defined contribution plan? If so, how would the additional benefit payments be funded? In a defined contribution plan, all gains and losses from investment return are allocated to individual accounts, so there are no excess assets or unfunded liabilities at any time. The same is true for COLA's. There would be no excess assets which could be used to fund the additional 10% for State residency.

- (3) Both PERS and TRS currently provide for minimum benefits in the defined benefit plan. A defined contribution plan could not provide for minimum retirement benefits, since there are no actuarially funded benefits. In addition, a defined contribution plan cannot grant past service benefits.

*good point*

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- (4) The bill does not set an employee contribution rate, and limits whatever rate is chosen to at least one-half of the employer contribution rate. Why is this rate not spelled out in the statute? In a defined contribution plan, the benefit at retirement simply equals the amount of money accumulated in an employee's account. The risk associated with gains and losses from year to year is shifted from the employer to the employee. Contribution rates are not actuarially determined, and therefore do not fluctuate from year to year.
- (5) The employer contribution rate is fixed at 9.65% of pay in the statute. Where does this rate come from? Is it tied to the amount of benefit expected to be provided at retirement?
- (6) AS 39.38.230 should be expanded to provide how and when benefits can be paid. The investment contracts for a defined contribution plan typically will not dictate the payment options. Instead, they can be set by the statutes. Payment of benefits in a defined contribution plan is usually a detailed section of the plan provisions. For example, lump sum benefits are a common payment option under a defined contribution plan.
- (7) AS 14.25.035(c) is amended to include actuarial valuations of the System and a determination of contribution rates and unfunded liabilities. Is this section applicable to the defined contribution plan? Actuarial valuations are not required for defined contribution plans, since there are no unfunded liabilities and the contribution rates do not vary from year to year.
- (8) There is no mention of vesting in the new defined contribution plan. If vesting is not immediate, forfeitures from non-vested terminated employees should be addressed. This money could be used to offset employer contributions or it could be reallocated to remaining participant accounts.
- (9) There appears to be a conflict with the new University of Alaska optional University retirement program. Employees will be able to choose between two defined contribution plans. If the State plan provides a larger contribution, no employees will elect the University plan, effectively eliminating it.

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The bill as drafted, Bob, would be difficult to administer without some of these questions clarified. In addition, significantly different levels of benefits would be payable under the new plan compared to the current plans for most employees. A task force could be established to study the ramifications of a defined contribution plan for the State before proceeding with legislation. As you recall, the TRS Board requested some information to study this issue at their 1989 Fall Board Meeting. Much of that material is germane to the issue, including the possibility of certain hybrid arrangements, like floor/offset, target benefit or cash balance plans. A task force should be able to identify the problems with the current system and propose appropriate ways to solve them.

Bob, these are my initial thoughts on this Bill. I'll keep you informed as additional information is available. If you have any further questions, please let me know.

Sincerely,



Brian R. McGee, FSA  
Principal

BRM/HPG/js