

**HB**

**579**

**HOUSE COMMITTEE ON STATE AFFAIRS**

**RECAP OF  
HB 579**

**Defined Contribution Retirement Program**

Received March 12, 1990  
by The Finance Committee

Heard March 20, 1990

Letter of Intent Adopted March 20, 1990

Passed Out of Committee March 20, 1990  
3 Do Not Pass  
2 No Recommendation

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# HOUSE COMMITTEE REPORT

(7)

Date Referred: March 12, 1990

FURTHER REFERRALS:

FINANCE

Date of Committee Action: \_\_\_\_\_

The STATE AFFAIRS Committee considered:

HB 579

HOUSE BILL NO. 579 DEFINED CONTRIBUTION RETIREMENT PROGRAM

"An Act establishing the defined contribution plan for retirement for public employees; requiring the preparation of certain actuarial valuations and actuarial and financial experience analyses of the teachers' retirement system; requiring the teachers' retirement system and the public employees' retirement system to be fully funded before granting a post retirement pension adjustment; and providing for an effective date."

[ ] be replaced with \_\_\_\_\_ [ ] the same title  
[ ] a new title

[ ] have attached amendment(s)

- [ ] do pass
- [X] do not pass
- [ ] no recommendation
- [ ] individual recommendations
- [ ] additional referral to the \_\_\_\_\_ Committee

ADOPTS: HSA 3/20/90 letter of intent

ATTACHES NEW FISCAL NOTE(S):

- [X] fiscal impact
- [ ] zero fiscal note
- [ ] zero with analysis

APPROVES PREVIOUS:

- [ ] fiscal note(s) published: \_\_\_\_\_
- [ ] zero fiscal notes(s) published: \_\_\_\_\_

SIGNING DO PASS:

SIGNING OTHER THAN DO PASS:  
(Do Not Pass, No Recommendation, Amend)

\_\_\_\_\_  
 \_\_\_\_\_  
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George Hendley - No Rec  
David F. ... - No Rec  
Jim ... - DO NOT PASS  
... - SERIOUS INTERIMMOR...  
... - DO NOT PASS WITHOUT THOROUGH REVIEW  
Eileen P MacLean Do not Pass

[Signature]  
 Chairman's signature



# Alaska State Legislature

House of Representatives  
COMMITTEE ON STATE AFFAIRS

LETTER OF INTENT  
TO ACCOMPANY  
HB 579

March 20, 1990

The House State Affairs Committee requests that HB 579 be placed in a Finance subcommittee for further review this session. The Committee further requests that no action be taken until a thorough review of this legislation's impact on the states' retirement and benefit program is completed.

A handwritten signature in cursive script, appearing to read "Red Boucher".

Rep. H.A. "Red" Boucher, Chair  
House State Affairs Committee



## Alaska State Legislature

House of Representatives  
COMMITTEE ON STATE AFFAIRS

### MEMORANDUM

TO: Representative Ron Larson  
Representative Lyman Hoffman

FROM: Representative H.A. "Red" Boucher, Chair  
House State Affairs Committee

DATE: March 20, 1990

RE: HB 579

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House Bill 579 passed out of the House State Affairs Committee on March 20th as promised. However, a number of questions and concerns were raised by all members. You should note that this bill received two "no recommendations" and three "do not pass".

The attached "Letter of Intent" expresses the concerns of the Committee and requests that HB 579 receive considerable scrutiny and review during the interim.

Thank you.

Item 2

STATE OF ALASKA  
1990 LEGISLATIVE SESSION

Bill Version: HB 579  
Publish Date: \_\_\_\_\_

FISCAL NOTE - A

REQUEST:

Revision Date: \_\_\_\_\_ Agency Affected: Defined Contribution Retirement (DCRP)  
 Title: An Act creating a defined contribution plan. BRU: DCRP  
 Sponsor: House Finance Committee Components: DCRP  
 Requestor: \_\_\_\_\_

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES	1,405.9	1,476.2	1,550.0	1,627.5	1,708.9	1,794.3
TRAVEL	108.0	84.0	84.0	84.0	84.0	84.0
CONTRACTUAL	1,658.5	1,658.5	658.5	658.5	658.5	658.5
SUPPLIES	110.0	110.0	110.0	110.0	110.0	110.0
EQUIPMENT	464.1	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
<b>TOTAL OPERATING</b>	<b>3,746.5</b>	<b>3,328.7</b>	<b>2,402.5</b>	<b>2,480.0</b>	<b>2,561.4</b>	<b>2,646.8</b>

CAPITAL						
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REVENUE						
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FUNDING: (Thousands of Dollars)

GENERAL FUND	3,746.5	3,328.7	(707.7)	(707.5)	(707.5)	(707.5)
FEDERAL FUNDS						
OTHER			3,110.2	3,187.5	3,268.9	3,354.3
<b>TOTAL</b>	<b>3,746.5</b>	<b>3,328.7</b>	<b>2,402.5</b>	<b>2,480.0</b>	<b>2,561.4</b>	<b>2,646.8</b>

POSITIONS:

FULL-TIME	28	28	28	28	28	28
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

See page three for a more detailed analysis.

This fiscal note proposes that the State prefund the start-up costs in the first two years and that the system pay the State back over the following 10 years.

Prepared by: Sally Smith *Sally Smith* Phone: 465-4470  
 Division: Retirement and Benefits Date: March 16, 1990  
 Approved by Commissioner: Frank S. Baxter, CPA *Frank M. Baxter for* Date: 3/19/90  
 Agency: Department of Administration

Distribution (by preparer):  
 Legislative Finance  
 Legislative Sponsor  
 Requestor  
 Office of Management and Budget  
 Impacted Agency(ies)

FISCAL NOTE - B

REQUEST:

Revision Date: \_\_\_\_\_  
Title: An Act creating a deferred contribution plan.  
Sponsor: House Finance Committee  
Requestor: \_\_\_\_\_

Agency Affected: Department of Administration  
BRU: Retirement and Benefits  
Components: Retirement and Benefits

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES	102.0	107.1	112.5	118.1	124.0	130.2
TRAVEL	50.0	50.0	50.0	50.0	50.0	50.0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	.4	.4	.4	.4	.4	.4
EQUIPMENT	46.0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	198.4	157.5	162.9	168.5	174.4	180.6

CAPITAL						
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REVENUE						
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER	198.4	157.5	162.9	168.5	174.4	180.6
TOTAL	198.4	157.5	162.9	168.5	174.4	180.6

POSITIONS:

FULL-TIME	2	2	2	2	2	2
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Sally Smith  
Division: Retirement and Benefits

Phone: 465-4470  
Date: March 16, 1990

Approved by Commissioner: Frank S. Baxter, CPA  
Agency: Department of Administration

Date: 3/19/90

Distribution (by preparer):  
Legislative Finance  
Legislative Sponsor  
Requestor  
Office of Management and Budget  
Impacted Agency(ies)

House Bill 579  
Fiscal Note Analysis  
Prepared by Division of Retirement & Benefits  
Department of Administration  
March 19, 1990

Analysis: The provisions concerning the administration of this plan are very vague. The attached fiscal note represents our estimation of the administration required by this bill. The fiscal note is premised on the following assumptions:

**Concerning the new plan: (Fiscal Note A)**

- \* A completely new and autonomous board.
- \* A board with the authority to appoint an administrator and establish the administration of the plan as a separate Public Corporation.
- \* A board with full oversight authority to make policy decisions regarding operation of the plan.
- \* A board with autonomous budget approval authority with oversight from the legislature.
- \* Administration of the Plan which is not subject to the Alaska procurement code or the personnel rules.
- \* Complete development of automated systems to manage the plan.
- \* Participation by the employers who currently participate in the Public Employees' (PERS) and Teachers' Retirement Systems (TRS).
- \* Participation by the same number of members who currently participate in the PERS and TRS.
- \* A start up time of at least two years and the costs would be paid by the state in the first two years and repaid by the system over the next ten years.

**Concerning the PERS and TRS: (Fiscal Note B)**

- \* Additional staffing for five years to answer the questions the current members will have concerning transfer to the new plan.
- \* A reduction in new membership, however, continued effort provided to current membership and retired members.
- \* Increases in the PERS and TRS appropriations of \$100.0 each.

The total estimated administrative cost to the DCRP (Fiscal Note A) by fiscal year is as follows:

Personnel services costs:	<u>FY 91</u>	<u>FY 92</u>
FY 90		
1 Executive Director	\$ 90.0	
1 Administrative Officer II	70.0	
1 Secretary II	33.7	
1 Administrative Assistant	45.8	
1 Clerk IV	45.8	
1 Micrographics Machine Operator	45.8	
2 Clerk III	60.0	
1 Retirement & Benefits Supervisor	70.0	
2 Retirement Specialist III	104.0	
2 Retirement Specialist I/II	91.6	
2 Retirement Tech. I/II	74.6	
1 Accounting Supervisor V	70.0	
1 Accountant III	52.0	
1 Accounting Tech III	45.8	
2 Accounting Tech II	74.6	
2 Accounting Clerk III	67.4	
1 Accounting Clerk II	30.0	
1 Data Processing Manager I	70.0	
1 Programmer/Analyst V	63.6	
2 Programmer/Analysts III/IV	110.6	
1 Programmer/Analyst I/II	<u>90.6</u>	
Total FY 91	\$1405.9	
Total FY 92		\$1476.2
Travel:		
Board Meetings 8 time in first year		
6 time each year thereafter	72.0	48.0
Field Travel by Staff		
Counseling	24.0	24.0
Auditing	<u>12.0</u>	<u>12.0</u>
Total FY 91	108.0	
Total FY 92		84.0

Contractual:	<u>FY 91</u>	<u>FY 92</u>
<b>COMPUTER SYSTEM DESIGN</b>		
New Computer system design. This system will much more complex than the State's SBS system, due to the participation of approximately 200 different employers. For each of fiscal years 91 and 92 the system design will cost \$1000.0.		
<b>ONGOING CONTRACTUAL NEEDS</b>		
These costs include services for the following: telephone, actuarial consulting, annual CPA audit, computer hookup, long distance charges, office rent, etc. The ongoing contractual needs will cost \$658.5 for each fiscal year.		
Total Contractual	\$1658.5	\$1658.5
<b>Supplies:</b>		
These cost will be ongoing for the 28 employees and include; office supplies, newsletters, postage, paper, copy machine, board meeting supplies, etc.		
	110.0	110.0
Equipment:	<u>464.1</u>	<u>0.0</u>
<b>TOTAL SYSTEM COSTS:.....</b>	<u><u>\$ 3746.5</u></u>	<u><u>\$3328.7</u></u>

The office staff will need constant access to the DCRP computer files. They will need terminals or personal computers, microfiche viewers, calculators, office furniture, chairs, board furniture, filing cabinets, copy machines, a microfiche machine for file maintenance and other necessary equipment. We propose the purchase of personal computers to be used as terminals because they will be compatible with the system's Local Area Network.



# NEA-ALASKA

AFFILIATED WITH THE NATIONAL EDUCATION ASSOCIATION

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(907) 456-4435

March 19, 1990

To: Representative Red Boucher, Chair  
Members, House State Affairs Committee

Re: House Bill No. 579  
"An Act establishing the defined contribution plan for retirement for public employees; requiring the preparation of certain actuarial valuations and actuarial and financial experience analyses of the teachers' retirement system; requiring the teachers' retirement system and the public employees' retirement system to be fully funded before granting a post retirement pension adjustment; and providing for an effective date."

NEA-Alaska has grave concern relative to HB 579 and urges cautious and extensive consideration by the Committee.

It prospectively changes the Teachers' Retirement System (TRS) from a defined benefit system to a defined contribution system.

We strongly feel that any changes of this magnitude require extended study, analyses, and review before consideration by the Legislature of possible statutory revision.

To the best of our knowledge, very few states utilize defined contribution systems for their public school teacher retirement programs.

Absent any specificity in HB 579 relative to a benefit structure we respectfully disagree with the statement in the Purpose section of the bill which suggests that this new defined contribution system will "encourage qualified personnel to enter and remain in public service." It may in fact become a disincentive.

There are far too many unanswered questions regarding the need for this legislation and, most importantly, employee contribution rates and specific retirement benefit provisions.

In regard to Section 7 on page 16 we call to the Committee's attention the fact that legislation is currently being considered on the Senate side, SB 53, which specifically addresses matters pertaining to the full funding of post retirement pension adjustments under the TRS.

It is our hope that this legislation will receive favorable consideration and become the vehicle to resolve this specific concern.

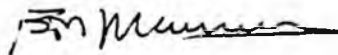
This particular bill will provide for an increase in the employee contribution rate from the current 7% to 8.65%.

After only limited review we have a number of concerns regarding HB 579, including but not limited to the nature of selection and composition of the Board, its authority and responsibility, employer and employee contribution rates, and of course, the benefit system.

NEA-Alaska is willing to work with the Committee in seeking the best options and opportunities to improve upon our retirement systems.

Thank you for your consideration of our position.

Respectfully submitted,



Bob Manners  
Executive Secretary



Don Oberg  
President

cc: TRS Board Members

Item 4

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

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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

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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 crucial 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:

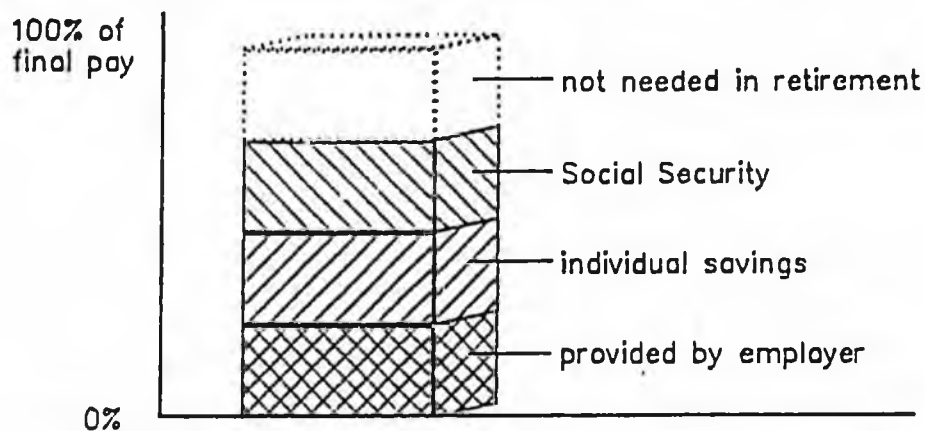
- What kind of plan, or combination of plans, will accomplish these goals?

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.

2 AAC 36.210 repealed and readopted to read:

2 AAC 36.210. ALASKA COST OF LIVING ALLOWANCE. (a) The Alaska cost of living allowance established under AS 14.25.142 accrues from the first day of the month after written application from the member, on a form prescribed by the administrator, is either hand-delivered to the division of retirement and benefits, or is mailed to the division of retirement and benefits and postmarked from within Alaska. If a mailed application has a postmark on which the date is missing or illegible, the postmark day is rebuttably presumed to be five working days before the day the application was received by the division.

(b) Except as otherwise provided by AS 14.25.142, a member must be domiciled and physically present in Alaska to receive a cost of living allowance under AS 14.25.142. A member is not domiciled and physically present if the member is not actually present in Alaska for either: 1) at least 183 days during any 365 day period; or 2) at least 183 days during any calendar year. A member, forfeits the cost of living allowance retroactively to his or her last day in Alaska on failure to meet this requirement. Upon request by the administrator, the member must provide evidence of periods that the member has been present in the state.

(c) If a member whose Alaska cost-of-living allowance is removed because of an absence expected to exceed 90 days returns to Alaska in less than 91 days and otherwise meets the requirements of this section, the Alaska cost-of-living allowance will be awarded retroactively to the date it was removed. (In effect before 10/21/83, Register 93; am 5/3/89, Register )

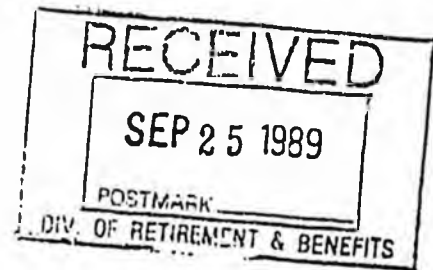
Authority: AS 14.25.022  
AS 14.25.035  
AS 14.25.142

WILLIAM M.  
**MERCER MEIDINGER HANSEN**

INCORPORATED

September 22, 1989

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



Re: Proposed PRPA

Dear Bob:

Based upon a proposed 4% PRPA, we have developed the following statistics:

	<u>PERS</u>	<u>TRS</u>
Number of Retirees	6,967	3,098
Average Benefit Increase	\$ 38/mo.	\$ 72/mo.
Aggregate Monthly Benefit	\$ 266,549	\$ 224,214
Increase in Unfunded Liability	\$26,100,000	\$20,821,000
Decrease in Funding Ratio	1.1%	1.5%
Percent Living in Alaska	66%	62%
Cost as a Percentage of Payroll	.26%	.54%
State Payroll (includes U of A and GEO)	\$492,685,000	\$56,607,000
Annual State Cost	\$ 1,281,000	\$ 306,000

Sincerely,

A handwritten signature in cursive script, appearing to read "Brian R. McGee".

Brian R. McGee, FSA  
Principal

BRM/GTM/js

September 29, 1989

'89 OCT -2 P3:47

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

DIVISION  
AND UNIT

Re: Automatic PRPA for TRS

Dear Bob:

The TRS Board has requested an analysis to determine the impact on TRS for converting the current ad hoc PRPA program to an automatic PRPA. Automatic adjustments could be provided by either of the following methods:

- (1) Adopt the current method for providing ad hoc PRPAs.
- (2) Adopt an automatic PRPA similar to the provisions under PERS.

Ad Hoc PRPA Method

This method would provide the current ad hoc PRPA on an automatic basis. The maximum adjustment would be 4% compounded annually from retirement. Lesser adjustments will occur if the cost-of-living increase is less than 4%.

We have calculated that passage of such a bill will increase the employer contribution rate by 18.00% of TRS payroll and reduce the funding ratio by 25.9%. As you can see, Bob, without any limits, this is a very costly provision.

PERS Automatic PRPA Method

Another method would be to adopt an automatic PRPA similar to the provision PERS adopted in 1986. Under this provision, the increase in benefit payments applies to total benefits, except for the cost-of-living allowance. The amount of the increase is equal to the lesser of 75% of the increase in the cost of living, or 9%, for pensioners at least age 65 and older or receiving disability benefits. The increase would be the lesser of 50% of the increase in the cost of living or 6% for pensioners who are at least age 60 but less than age 65, or for pensioners who are less than age 60 but who have been receiving benefits for at least five years.

Mr. Robert F. Stalnaker  
September 29, 1989  
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We have calculated that passage of such a bill will increase the employer contribution rate by 6.66% of TRS payroll and reduce the funding ratio by 10.9%.

Other Alternatives

More than half of the cost of the PERS type automatic PRPA is attributable to nonactive members of TRS (current retirees and terminated vested members). PRPAs for these members presumably will always be subject to ad hoc adjustments. Therefore, you could implement the automatic PRPA for only current active members of TRS, with continuation of the ad hoc PRPA's for inactive members, at less than half of the 6.66% cost.

Similarly, you could reduce the cost of converting the 4% ad hoc PRPA to automatic by applying it only to active employees. The cost savings is about one-third in this case.

Please call, Bob, if you have any questions.

Sincerely,



Brian R. McGee, FSA  
Principal

BRM/js

# MERCER MEIDINGER HANSEN

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.

William M. Mercer Meidinger Hansen, Incorporated

Mr. Robert F. Stalnaker  
March 19, 1990  
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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 1986. 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.

- good point*
- (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.

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Mr. Robert F. Stalnaker

March 19, 1990

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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.

William M. Mercer Meidinger Hansen, Incorporated

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March 19, 1990  
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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

STEVE COWPER, GOVERNOR

**DEPARTMENT OF ADMINISTRATION**

**DIVISION OF PIONEERS' BENEFITS**

P.O. BOX CL  
JUNEAU, ALASKA 99811-0211  
PHONE: (907) 465-4400

March 19, 1990

The Honorable Fran Ulmer  
Alaska State Representative  
P.O. Box V  
Juneau, AK 99811

ATTN: Kate Tesar

Dear Representative Ulmer:

The Division of Pioneers' Benefits recently amended its FY 91 budget request to include a \$400,000 increment to fund the design and implementation of a data processing system for the Longevity Bonus program. This was not approved for inclusion in the operating budget. You asked what would happen if the increment were not approved. In responding, I avoid technical detail; if you want a technical explanation of the situation, I will be happy to provide it.

As you know, the mainframes operated by the Department of Administration and the Legislative Affairs Agency are being consolidated in an attempt to expand the State's data processing capacity. The vendor is phasing out support for operating systems which support the Longevity Bonus application. When this occurs, the Longevity Bonus can no longer be run.

In a worst case scenario, lack of hardware/software support would prevent the division from issuing monthly checks to 20,000 Longevity Bonus recipients. In January, the Division of Information Services (DIS) informed me that support would cease in September 1990 and that converting our program to coding compatible with the new operating system would take about six months and cost nearly \$100,000.

The current program code is nearly twenty years old, largely undocumented and subject to frequent breakdown. The Director of DIS compared the Longevity Bonus system to an old car, with the September deadline analogous to an auto manufacturer's decision to halt production of parts; one can continue to drive the car, but only until a critical part fails. Given that check production has been on an emergency basis in two of the last four months, it should be obvious that a critical breakdown can occur at any time.

This situation demands immediate action, hence you may question the Department's decision to submit an FY 91 budget amendment

rather than an FY 90 supplemental request. You should be aware that documentation of the system is underway and that we are exploring options involving the payroll, Permanent Fund dividend and unemployment insurance programs as well as a mini or micro computer-based system. Given the programming requirements and the possibility of major legislative changes to the Longevity Bonus program, we determined that we would not be ready to formally begin the RFP process until FY 91.

The more likely "no funding" scenario is that the current system will continue to operate on a "band-aid" basis. However, the cost of maintaining the system, both in dollars and in resources diverted from other applications, would be high. In addition, a critical breakdown can occur at any time and delay payments for an indefinite period. Without additional funding, the DIS simply does not have the staff or the budget to convert or reliably maintain the current system.

You may wish to know why the estimate for conversion has grown from \$100,000 to \$400,000. The original estimate was a "quick and dirty" figure reflecting the anticipated cost of recoding the existing system to do no more than it now does. The existing system simply writes checks; it provides virtually no management information, security, financial audit capability or ability to analyze the potential impact of program revisions. Data scrolls off the screen after six months and is lost forever.

Given this lack of scrutiny and control over a program which distributes nearly \$60 million annually, our decision was to replace the existing system with a "solution package" rather than to simply keep the checks rolling. One such solution is to take advantage of the capabilities of the new payroll system. Price Waterhouse estimated that incorporating the Longevity Bonus system into the payroll system would cost from \$250,000 to \$320,000. This estimate was based on continued use of the existing IRS reporting system and the reapplication tracking system. These programs are primary components of the existing system and need conversion/revision, at substantial additional cost.

We continue to explore options and are not yet in a position to explain exactly what solution will be achieved at exactly what cost. In size and level of complexity, the Longevity Bonus system is bracketed by two programs which were recently upgraded at a cost of \$250,000 and \$660,000. I hope that \$400,000 is sufficient to allow the design and implementation of a system worthy of a \$60 million program.

Sincerely,



David Teal  
Administrator  
Longevity Bonus Program

Representative Fran Ulmer -3-

cc: Commissioner Frank Baxter  
Department of Administration

Jim Fox, Deputy Commissioner  
Department of Administration

Barbara Bathony, Director  
Division of Pioneers' Benefits

Mike Maher, Director  
Division of Administrative Services

Paul Monette, Director  
Division of Information Services