HB

179

HCUSE COMMITTEE REPC T

(7)
Date Referred to Committee: March 5, 2007 **FURTHER REFERRALS: Finance**

Date of Committee Action: 4-3-07

The STATE AFFAIRS Committee considered: **HB 179**

HOUSE BILL NO. 179 **PUBLIC EMPOYEE/TEACHER RETIREMENT SYSTEMS**

"An Act relating to insurance for public employees, teachers, and certain retired public employees and teachers and to supplemental employee benefits; relating to teachers' and public employees' defined benefit retirement plans, to teachers' and public employees' defined contribution retirement plans, to employee and employer contributions to the teachers' retirement system and the public employees' retirement system, and to the administration of the Public Employees' Retirement System of Alaska and the deferred compensation program for state employees; establishing in the Department of Revenue the teachers' retirement system past service cost liability account and the public employees' retirement system past service cost liability account; relating to benefits of, references to federal law in, and investments in the teachers' retirement system and the public employees' retirement system; modifying the jurisdiction of the independent office of administrative hearings as related to retirement and related personnel benefits; and providing for an effective date."

Recommends it be replaced with [ ] HCS *or* [X] CS *for* HB 179 (STA)
For Senate Bills with new title: [ ] Technical Title / [ ] New Title: HCR_____ **[ ] Same Title [ ] New Title**

[ ] attach amendments
[ ] add new referral to _____Committee
[ ] Letter of Intent_____Committee

List of Abbrev for Depts.:
ADM
CED
COR
CRT
EED
DEC
DFG
GOV
HSS
LWF
LAW
LEG
MVA
DNR
DPS
REV
DOT
UA

***NEW* FISCAL NOTES** *Assigned by Chief Clerk's Office

List by Dept(s):	*FN#	Fiscal	Indet.	Zero
Admin				X
Admin				X
Revenue				X

***PREVIOUS* FISCAL NOTES**

List by Dept(s):	FN#	Fiscal	Indet.	Zero

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
Craig Johnson	Johnson				X
Kyle Johansen	JOHANSEN			X	
Bob Roses	Roses	X			
Mike Hawker	Gruenberg			✓	
John Coghill	Coghill			✓	
Jay Ogg	Dahl			✓	
Chair: Bill Wielechowski	LYNN			X	
Chair:					

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MEMORANDUM April 4, 2007

SUBJECT: CSHB 179(STA) (Work Order No. 25-LS0252\L)

TO: Representative Bob Lynn
Attn: Nancy Manly

FROM: Dan Wayne
Legislative Counsel

You have requested that I provide the committee with a CS (in final form) for HB 179, based on version 25-LS0252\M but with the deletion of sections 1 and 34 (the sections which would have raised the employee contribution rate in PERS and TRS, respectively). You further instructed that I not add any language from amendment number 1 that would cause an increase in the employee contribution rate.

Enclosed is a CS, in final form, as requested. If I may be of further assistance, please advise.

DCW:lmb
07-099.lmb

Enclosure

library

Alaska State Legislature

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State Affairs Committee

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Economic Development, Trade & Tourism Committee

Member
Judiciary Committee
Joint Armed Services Committee

Finance Subcommittees
Corrections
Labor and Workforce Development
Military and Veterans' Affairs
Public Safety

A Communication From
REPRESENTATIVE BOB LYNN
District 31 Anchorage

E-Mail: Representative_Bob_Lynn@legis.state.ak.us
"Bob Lynn's Alaska Blog" RepBobLynnBlog.com

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Fax: (907) 269-0207

FAX

To: Legal Services

Fax #: 2029

From: Nancy Manly x2794
Alaska State Capitol, room 104
Juneau, AK 99801-1182

Phone: 907-465-4931
Fax: 907-465-4316

# of Pages (including cover): 3

Re: HB 179 Version M - Public Employees/Teacher's Retirement System

4/03/07 – The House State Affairs Committee passed out HB 179 Version M with two amendments. Please draft a Final CS for HB 179 Version M as amended. Thank you!

Amendment #1 passed with one amendment (Roses)
25-LS0252\M.1

Amendment #1 to Amendment #1 (Doll)
Rep.Doll's amendment is attached

25-LS0252\M.1
Wayne
4/2/07

AMENDMENT #1 As amended
(passed)

OFFERED IN THE HOUSE BY REPRESENTATIVE ROSES

TO: HB 179

9 yes 1 no

Page 2, line 3:

Delete "a new subsection"

Insert "new subsections"

Page 2, line 4:

Delete "2007"

Insert "2010"

Page 2, line 6:

Delete "five"

Insert "one"

Page 2, following line 6:

Insert new bill subsections to read:

"(f) Beginning with the payroll for the first pay period in July 2011, a member shall contribute to the plan, in addition to the combined total of the amounts calculated in (a) and (e) of this section, an amount equal to two percent of the member's base salary.

(g) Beginning with the payroll for the first pay period in July 2012, a member shall contribute to the plan, in addition to the combined total of the amounts calculated in (a), (e), and (f) of this section, an amount equal to two percent of the member's base salary."

Amendment 1 to Amendment 1

AMENDMENT

CS HB 179 BY Rep. Dell

6 Yea 1 Nay

Page 2, lines 3-6

Delete all language

[(E) BEGINNING WITH THE PAYROLL FOR THE FIRST PAY PERIOD IN JULY 2007, A MEMBER SHALL CONTRIBUTE TO THE PLAN, IN ADDITION TO THE AMOUNT CALCULATED IN (A) OF THIS SECTION, AN AMOUNT EQUAL TO FIVE PERCENT OF THE MEMBER'S BASE SALARY]

Page 17, lines 17-19

Delete all language

[(E) BEGINNING WITH THE PAYROLL FOR THE FIRST PAY PERIOD IN JULY 2007, A MEMBER SHALL CONTRIBUTE TO THE PLAN, IN ADDITION TO THE AMOUNT CALCULATED IN (A) OF THIS SECTION, AN AMOUNT EQUAL TO FIVE PERCENT OF THE MEMBER'S BASE SALARY]

TRANSACTION REPORT

APR-02-2007 10:17 PM

FOR: REP LYNN 4654316

SEND

DATE START	RECEIVER	PAGES	TIME	NOTE
APR-02 10:16 PM	2029	3	48"	OK

25-LS0252\M.1
Wayne
4/2/07

AMENDMENT #1

OFFERED IN THE HOUSE BY REPRESENTATIVE ROSES

TO: HB 179

Page 2, line 3:
Delete "a new subsection"
Insert "new subsections"

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Insert "2010"

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#3
Rep. Dell

AMENDMENT

CS HB 179 BY

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REPRESENTATIVE MIKE KELLY
HOUSE DISTRICT 7

Member
House Finance Committee
Legislative Budget & Audit

March 28, 2007

Dear AG ~~Colberg~~ Talis,

I appreciate you and Ms. Behr meeting with us Tuesday in preparation for hearings on HB179 – PERS/TRS. Since we have a new AG in you, I thought a chat to get your perspective would be appropriate. Our discussion concerning how beneficiaries, including legislators, administrators, judges, teachers, public employees, etc. might share a greater portion of the cost of providing their defined benefits was helpful. I've set forth some of the comments and questions which arose during our meeting in order to make research and response by your office easier and more focused.

Comments:

1) The all-in cost of providing old tier PERS/TRS benefits has tripled since 2000. The old tier unfunded liability is expected by Legislative Finance to climb as high as $12 billion ($250,000 for each currently active beneficiary) before it's over.
2) Beneficiaries used to pay roughly one half the all-in cost of providing their benefits.
3) Beneficiaries now pay less than one-sixth of the cost for benefits which Buck Consultants has described as "rich," and which we have learned are unsustainable.
4) I believe the partnership to extinguish the unfunded liability as well as the current cost should involve the State, local employers and the beneficiaries.
5) The challenge is to figure out how to bring beneficiaries to the payment table to pay an appropriate share without unduly risking overturn by the Court.
6) I believe if we give up on changing benefits or increasing employee contributions based on a realistic assessment that the Court is likely to rule it unconstitutional, then other measures such as a constitutional amendment, hiring freezes, wage reductions, wage freezes, denial of coverage for new procedures, drugs, therapies, prostheses, etc. should be considered in order to protect the interests of non-beneficiary Alaskans.
7) Recall my comments about Amerada Hess and the "conflict, or perceived conflict of the Court regarding the potential impact of their pending decision on the individual judges' PFD's"? One wonders if a non-beneficiary Alaskan might have cause for action against the State because of the tremendous negative impact on him or her caused by past decisions of the "benefits cartel" including legislators, administration and judges. The $400 million we are chasing the actuaries for may be small change compared to eligibility, benefit enrichment and contribution rate rulings over time.

Questions:

1) Can the State declare financial exigency to trigger benefit and/or contribution rate changes based on the huge unfunded liability and the forecast decade of deficits ahead? Or would the permanent fund and CBR have to be first exhausted?
2) Do you believe the Court will permit the raising of employee benefit rates associated with the unfunded liability?
3) How about employee rates for the current period benefit costs?
4) If 3) is "No," how about if an equivalent benefit enhancement is involved?
5) If 4) is "Yes," would The Court consider elimination of the $12 billion unfunded liability and return of the plan to solvency regarding its ability to pay 100% of future benefits, to be an enhancement justifying a 5% beneficiary contribution rate increase?
6) New medical procedures, drugs, therapies, replacement joints, MRI imaging, CT scanning, ultrasound, heart stents, new organs and longer life are all enhancements achieved since current rates were set. Would the court consider them an enhancement justifying to a 5% contribution rate increase for beneficiaries?
7) Could the State prevail in a statute providing that all future growth in the current period cost of health care shall be borne equally by the beneficiary and the employer?

I enjoyed our chat and wish you well in your new endeavors. I've put HB179 on the table. Like SB141 that some of us worked so hard to pass into law, this one involves some grown-up decisions considering the unbelievable unfunded liability and the deficit decade ahead. Since the Court looms large, I need your help related to incorporating the most effective mechanism for bringing the beneficiaries to the payment table. Incidentally, I opted not to enter PERS because I knew I'd be advocating tough choices for our system. Please call if you have any questions. I have distributed copies of this letter to committee members and interested others.

Best regards,

Representative Mike Kelly
House District 7

Library

25-LS0252\M.2
Wayne
4/2/07

Not offered

AMENDMENT #2

OFFERED IN THE HOUSE BY REPRESENTAT E ROSES

TO: HB 179

Page 17, following line 15:

Insert a new bill section to read:

"* **Sec. 34.** AS 39.35.100(b) is amended to read:

(b) All income of the pension fund and all disbursements made by the fund shall be credited or charged, whichever is appropriate, to the following accounts:

(1) An individual account shall be maintained for each employee to record the amount of the employee's mandatory contributions collected under **AS 39.35.160** [AS 39.35.160(a)]. As of the last day of each calendar year and each fiscal year beginning with June 30, 1969, this account shall be credited with interest, by applying the prescribed rate of interest as determined by the board to the balance in the account as of that date. Within one year following retirement, the amount actuarially determined as necessary to fully fund the benefits to be received shall be transferred first from the employee contribution account and, after the employee contribution account has been exhausted, then from the employer contribution account into the retirement reserve account.

(2) An individual account shall be maintained for each employee to record the amount of the employee's voluntary contributions. As of the last day of each calendar year and each fiscal year beginning with June 30, 1969, this account shall be credited with interest, by applying the prescribed rate of interest as determined by the board to the balance in the account as of that date. Amounts that, before termination of employment, are withdrawn by an employee from the employee's savings account shall be charged to that account. Upon retirement, the amount actuarially determined as necessary to fully fund the benefits to be received shall be

transferred first from the employee savings account and, after the employee savings account has been exhausted, then from the employer contribution account into the retirement reserve account.

(3) A separate account for each employer shall be maintained. The account shall be credited with contributions of the employer. This account shall be charged with the employer's actuarial charge for pension, death benefits, and other benefits paid under this plan to or on behalf of the employee of the employer. After an allowance for interest credited to employee contribution accounts and employee savings accounts, the investment income of the pension fund shall be allocated to the retirement reserve account and to each employer asset share account according to the ratio that the average of the assets in the account as of the beginning and as of the end of the fiscal year bears to the total of the average balance of the retirement reserve account and all employer accounts.

(4) An expense account shall be maintained for the plan. This account shall be charged with all disbursements representing administrative expenses incurred by the plan. At the end of the year the expense account shall be allocated to each employer in accordance with (3) of this subsection. Expenditures from this account shall be included in the governor's budget for each fiscal year and are subject to approval by the legislature."

Renumber the following bill sections accordingly.

Page 17, line 16:

Delete "a new subsection"

Insert "new subsections"

Page 17, line 17:

Delete "2007"

Insert "2010"

Page 17, line 19:

Delete "five"

Insert "one"

Page 17, following line 19:

Insert new bill subsections to read:

"(f) Beginning with the payroll for the first pay period in July 2011, a member shall contribute to the plan, in addition to the combined total of the amounts calculated in (a) and (e) of this section, an amount equal to two percent of the member's base salary.

(g) Beginning with the payroll for the first pay period in July 2012, a member shall contribute to the plan, in addition to the combined total of the amounts calculated in (a), (e), and (f) of this section, an amount equal to two percent of the member's base salary."

Page 34, line 17:

Delete "37, and 38"

Insert "38, and 39"

Page 34, line 18:

Delete "sec. 70"

Insert "sec. 71"

Library

Conceptual

Amend to Amend (1)

8

Rep. Dell

AMENDMENT

CS HB 179 BY

Page 2, lines 3-6

Delete all language

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Conv to Day

Apr 1

Derek Miller

From: Andy Warwick [warwick@gci.net]
Sent: Friday, March 30, 2007 2:56 PM
To: Derek Miller
Subject: hb 179

I am in support of HB 179 as it provides a solution to the $10 billion shortfall in PERS/TRS retirement system. One can argue that the employees or municipalities should pay more or pay less, but the bill provides a reasonable solution that all can live with. I believe it is important to restore the State's retirement system to fiscal soundness so that we are not burdening future generations of Alaskans,

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Deliveries to: 129 6th St., Rm. 329

MEMORANDUM January 29, 2005

SUBJECT: Accrued benefits of public employment retirements systems and legislative changes to the employee contribution rate (Work Order No. 24-LS0429)

TO: Representative Mike Kelly
Attn: Heath Hilyard

FROM: [redacted]
Legislative Counsel

You have asked questions regard the scope of Article XII, sec. 7 of the Alaska constitution[1] and how it affects the legislature's ability to amend the employee contribution rates of the teacher's retirement system (TRS) and the public employee's retirement system (PERS).[2] In our conversations about this request you asked about changing the contribution rates of vested employees.[3]

---

[1] Alaska Constitution Article XII, Sec. 7:

> SECTION 7. Retirement Systems. Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired.

This provision protects the "accrued benefits" of the systems. The question considered here is whether the employee contribution rate is part of the "accrued benefits."

[2] AS 14.25.050 and AS 39.35.160 respectively.

PERS has three tiers; at this time, the contribution rates are the same for employees in all tiers, but the benefits are increased in Tier I and Tier II:

police and fire employees = 2% (last increased in 1987)
"other" employees = 2% (last increased in 1987)
school district employees = 2.0% (last increased in 1999)

Tier I is for employees first employed between January 1, 1961 and June 30, 1986.
Tier II is for employees entering service between July 1, 1986 through June 30, 1996,
and Tier III applies to employees entering service July 1, 1996 and later.

TRS has two tiers, the employee contribution is 8.65%, last increased in 1991.
Tier I is for teachers first employed between July 1, 1955 and June 30, 1990.

Employee contribution rates have been raised on several occasions in the past without creating a new tier of employees. In 1986 the PERS employee contribution rates were changed from 5% to 7.5% for firefighters and police officers, and the contribution rates for all others were raised from 4.25% percent to the current 6.75%.[4] In 1990 the TRS employee contribution rates were raised from 7% to 8.65%.[5] Both of these changes in compensation rates were made after the Hammond v. Hoffbeck decision in 1981. Hammond v. Hoffbeck, 627 P.2d 1052 (Alaska 1981).[6] These increases in contribution rates apparently did not result in legal challenges. This memorandum, thus, considers whether a new law which raises the employee contribution rates in TRS and PERS while maintaining the accrued benefits in each Tier would be subject to constitutional challenge.

While such a challenge may certainly be brought, it is not a foregone conclusion that the argument would prevail. A strong counter argument can be made that the employee contribution rates are not part of the "accrued benefit" to which members are entitled. The accrued benefits are the rights to receive the retirement and medical plan offered upon employment; the rights accrue as they are earned. A person's contribution rate cannot be changed retroactively for benefits that have already accrued, however, it can be argued that the employee contribution rate can change prospectively to pay for vested benefits.

An employee facing an increased contribution rate for vested benefits can reject the increase by terminating emp' yment while ..ill preserving the employee's vested right to "accrued benefits."[7] An accrued benefit is one that has already been earned, it is not one

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Tier II is for teachers first employed on July 1, 1990 and later.

[4] sec. 15, ch. 82 SLA 1986.

[5] sec. 1, ch. 97 SLA 1990. There was at least one other change in PERS for noncertificated employees of school districts to 9.6% in 1999.

[6] The reductions in benefits in the Hammond v. Hoffbeck case involved a reduction in occupational disability benefits for public safety employees, a requirement that an employee be totally unemployable in order to be eligible for an occupational disability pension rather than "incapacitated for service in the position held" and reducing occupational death benefits from one hundred per cent to forty per cent of monthly salary at the time of death.

[7] A New York case (New York has constitutional protection of pension benefits like Alaska) involving diminution of disability benefits to employees in the public service makes this point, that employees do not have a constitutional right to stay in public employment:

that has not yet been earned. The constitutional promise is that earned benefits cannot be diminished, and the future right to a specified benefit is vested, however Hoffbeck recognized that "rigid adherence to labels like "gratuity," "compensation," "contract," and "vested rights" has not allowed courts the flexibility necessary to deal properly with legitimate legislative response to changing economic and social conditions."[8] The Hoffbeck court found the following language in a California case to be "instructive."

> An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case **what constitutes a permissible change. To be sustained as reasonable,** alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages. [9]

Following that discussion the decision found:

> We agree with this analysis and hold that the fact that rights in PERS vest on employment does not preclude modifications of the system; that fact does, however, require that any changes in the system that operate to a given employee's disadvantage must be offset by comparable new advantages to that employee.

An important qualification is found in note 11 of Hoffbeck. It may apply to the situation at hand where the system finds that failing to increase employee contributions, and thus increasing the projected unsupportable burden on employers, will threaten the fiscal future of the system as a whole:

> It is long settled, however, that the fact that there can be no constitutional impairment of pension system benefits does not create a constitutional right to stay in public employment. To do this would place the regulation of public employment beyond the control of any authority, which certainly was not intended by our Constitution (Gorman v. City of New York, 280 App Div 39, 45, affd 304 NY 865).

Cook v. Binghamton, 48 N.Y.2d 323, 332 (N.Y., 1979)

[8] Hammond v. Hoffbeck, 627 P.2d at 1057

> We are not called upon to consider the problem, which has frequently arisen in other jurisdictions, presented by a pension fund that is insufficient to satisfy all employee claims brought under its provisions. We intimate no view as to the appropriate legal analysis of any legislative alteration in employee benefits systems made in response to such circumstances.

In this case, it may not be that the system is currently insufficient to handle current claims, and no alteration in the benefits to be received is contemplated. However, the continued fiscal health of the plan for future claims by current beneficiaries may reasonably require a prospective increased contribution rate. Such an argument is not precluded by Hammond v. Hoffbeck.

Four other states have constitutional protection for public employee retirement benefits very similar to Alaska: Hawaii,[10] Michigan,[11] New York and Illinois[12]. There is a case from Michigan which is squarely on point. The Michigan Supreme Court was asked to determine whether a statute increasing the employee contribution rate for certain employees was constitutional. Advisory Opinion re Constitutionality of 1972 PA 258, 389 Mich. 659, (Mich. 1973). The court found that "the Legislature cannot diminish or impair accrued financial benefits, but we think it may properly attach new conditions for earning financial benefits which have not yet accrued."[13] The Michigan court found that raising the employee contribution rate was a "new condition" which was not "a diminishment or impairment of such accrued benefits unless the new conditions were unreasonable and hence subversive of the constitutional protection."

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[10] Art. XVI, Section 2 of the Hawaii Constitution, provides:

> Membership in any employees' retirement system of the State or any political subdivision thereof shall be a contractual relationship, the accrued benefits of which shall not be diminished or impaired.

[11] Michigan's constitution, art 9, sec. 24 reads:

> The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby. Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities.

[12] While the constitutional provisions are similar in Illinois and New York the cases have focused on the time of vesting, not relevant to this discussion.

[13] Advisory Opinion re 1972 PA 258, 389 Mich. 659, emphasis added.

A case in Hawaii involved determining the date a firefighter was considered to have begun his retirement. Chun v. Employee's Retirement Sys., 607 P.2d 415, 421 (Hawaii 1980). The court discussed its constitutional protection of public employee retirement systems and found that although benefits attributable to past services could not be reduced, the legislature could make general changes in the retirement system. While not discussed in that case, it could be argued that the employee compensation rate for continued benefits may be a condition that can be changed without violating the constitutional protection of accrued benefits.[14]

After Hoffbeck the next discussion of Article XII, sec. 7 by the Alaska Supreme Court occurred in 2003 where the court considered how to evaluate changes to public employee benefits, specifically health plans. Duncan v. Retired Public Employees of Alaska, Inc. (Duncan) 71 P.3d 882, (Alaska 2003) The state argued that health insurance benefits were not covered by Article XII, sec. 7, and if they were, the dollar amount of the

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[14] Id. at 421, citations omitted.

> This court has never been called upon to examine or construe this particular provision of the Hawaii Constitution. It was proposed from the floor of the 1950 Constitutional Convention and adopted by the Committee of the Whole. The Committee of the Whole Report states:
>
> > It should be noted that the above provision would not limit the legislature in effecting a reduction in the benefits of a retirement system provided the reduction did not apply to benefits already accrued. In other words, the legislature could reduce benefits as to (1) new entrants into a retirement system, or (2) as to persons already in the system in so far as their future services were concerned. It could not, however, reduce the benefits attributable to past services. Further, the section would not limit the legislature in making general changes in a system, applicable to past members, so long as the changes did not necessarily reduce the benefits attributable to past services.
>
> The Committee of the Whole's interpretation of the provision, which we accept, indicates that a member of the retirement system is entitled to the benefits available under the system that have been accrued by the member. From the Committee of the Whole Report, we conclude that the provision was meant to protect an employee from a reduction in accrued benefits. However, the extent of such benefits as well as the conditions under which an employee should receive benefits, are governed by applicable statutory provisions. . . .

premium was all that was protected, not the type of coverage, and third if the first two arguments failed, that changes could be made to vested health benefits so long as any disadvantages from changes were outweighed by advantages, as considered from a group perspective. The court agreed with the third argument only, and found that health benefits could be changed without violating the constitution. Duncan states that "[t]he natural and ordinary meaning of "benefits" in a health insurance context refers to the coverage provided rather than the cost of the insurance."[15]

The language in Duncan does not preclude an argument that the employee contribution rate, applied prospectively, does not diminish accrued benefits. The Michigan case illustrates the argument that employee contribution rates are a condition of current and prospective employment and do not diminish accrued rights. Because the Alaska court has not spoken in regard to the rate of employee contributions in public retirement systems, there can be no certainty. However, there have been changes in employee contribution rates since Hoffbeck none of them generating a constitutional challenge. Increasing the contribution rates of employees prospectively is not explicitly barred by Hoffbeck, or Duncan. Other states with similar constitutional protections have either allowed increases in contribution rates or have acknowledged the need for some flexibility in administering the retirement programs while protecting accrued benefits of public employees.

If I may be of further assistance, please advise.

BRC:med
05-066.med

[15] Duncan, 71 P.3d 882 at 888 - 889. One of the issues in Duncan was whether health benefits consisted of a certain level of coverage, or only a certain dollar amount applied towards health insurance premiums.

MEMORANDUM

State of Alaska

Department of Law

TO: Ray Matiashowksi, Commissioner
Department of Administration

DATE: April 20, 2005

OUR FILE: 663-05-0192

Thru: Scott Nordstrand
Deputy Attorney General - Civil
Attorney General's Office

TELEPHONE NO: 465-3600

FROM: Virginia B. Ragle
Assistant Attorney General
Labor & State Affairs Section - Juneau

SUBJECT: Retirement system amendments - constitutional issues

You have asked three questions regarding application of proposed legislative modifications of the state's public employees' (PERS) and teachers' (TRS) retirement systems to current members of the systems. Those questions are:

1. Is it allowable to increase PERS and TRS contribution rates for individuals who became members of the systems before the effective date of the rate increases?

2. Is it allowable to discontinue pre-funding the medical component or set a rate that targets less than 100 percent funding for existing members or new members?

3. Is it allowable to prospectively not pay existing members new [or additional] ad hoc post retirement pension adjustments (PRPAs)? If not, could a new statutory provision reduce the existing number of members eligible for this benefit prospectively to reduce costs to the system?

While we believe that definitive answers to these questions will only be provided by the Alaska Supreme Court, based on our review of existing case law our, short answers to these questions are:

1. PERS and TRS contribution rates may be increased for individuals who became members of the systems before the effective date of the rate increases if the increases are accompanied by comparable enhancements to benefits.

2. Pre-funding of the medical component of PERS and TRS benefits, to the extent that pre-funding would be considered an accrued benefit, may not be discontinued for members who were employed during the period that statutes required pre-funding. Funding of medical benefits may be set at less than 100% funding for new members.

3. If the financial condition of the funds does not permit payment of the PRPA, it is allowable to prospectively not pay existing members new [or additional] ad hoc PRPAs. A new statutory provision cannot reduce the existing number of members who retain a vested right to a PRPA if one is awarded, unless the new statutory provision includes comparable enhancements to benefits.

The above responses might be different if it were established that application of modification of the retirement systems to current members is necessary to allow the retirement systems to pay current benefit claims.

ALASKA CASE LAW

Each of these questions raises substantial legal issues under Alaska Constitution article XII, section 7, as interpreted by the Alaska Supreme Court. That constitutional provision provides:

> **Retirement Systems.** Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of those systems shall not be diminished or impaired.

There is a substantial body of Alaska jurisprudence interpreting article XII, section 7 of the Alaska Constitution. Since this case law guides our advice on the issues you have raised, we provide the following synopses of the most pertinent Alaska Supreme Court cases.

State ex rel. Hammond v. Allen, 625 P.2d 844 (Alaska 1981)

The Alaska Supreme Court first interpreted Alaska Constitution article XII, section 7 in the case of *State ex rel. Hammond v. Allen*, 625 P.2d 844 (Alaska 1981). That case involved the Elected Public Officers' Retirement System (EPORS), which was established by the enactment of chapter 205, SLA 1975. A referendum petition to repeal the Act was filed in September 1975, before the Act became effective on

January 1, 1976.[1] Following passage of the referendum by a substantial majority of the voters in an election on August 24, 1976 (effective October 14, 1976), the state filed an action for declaratory judgment, arguing that article XII, section 7 did not apply and that the repeal was effective as to "officials who were participating in EPORS at the time of its repeal, but who were not then entitled to benefits." 625 P. 2d at 845.

The court held that article XII, section 7 did apply, and that even "the extreme likelihood of the subsequent repeal" of EPORS did not constitute an implicit condition subsequent that would extinguish the state's contractual obligation to provide benefits under EPORS.[2] The court concluded that "[a]ll elected officials who were participating in EPORS at the time its repeal became effective will, therefore, be entitled to the benefits provided by that system upon retirement." Under this holding, the state was required to permit even those EPORS members who had not met the minimum age or service requirements for retirement to continue to participate in the repealed retirement system.

***Hammond v. Hoffbeck*, 627 P.2d 1052 (Alaska 1981)**

Later in 1981, the court issued its opinion in *Hammond v. Hoffbeck*, 627 P.2d 1052 (Alaska 1981). In that case, public safety employees challenged statutory changes enacted in 1976 regarding PERS occupational disability and death benefits. Two of the challenged statutory changes reduced the amount of benefits, and one modified the eligibility requirements for occupational disability benefits.

The court first had to address whether an employee's rights to benefits under PERS vest on employment and enrollment in the system or only at the time when the employee becomes eligible to receive those benefits. The court ruled that under the Alaska Constitution, the former applied.[3] The court stated

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[1] The repealed provisions of EPORS are set out in the editor's notes to AS 39.37.

[2] The court observed "[w]e believe that if the possibility of repeal of a law could function as an implicit condition subsequent to a contract formed under that law, the protection of contract rights afforded by article XII, section 7, would be seriously eroded."

[3] The court noted that it had "previously held that the phrase 'accrued rights' is synonymous with 'vested' rights. *Bidwell v. Scheele*, 355 P.2d 584, 586 (Alaska 1960)." *Id.* at n.4.

> We are of the view that the plain meaning of Alaska Const. Art. XII, § 7, as well as the purposes underlying its adoption, compels such a conclusion. Furthermore, a review of the relevant case authority from several jurisdictions has persuaded us that this rule represents the better reasoned of the alternative approaches that have been adopted. The rule that regards members' rights in public employees' benefits systems as vested only at the time which an individual employee is eligible to receive payment of those benefits necessarily depends in some degree upon the anachronistic notion that such benefits are in the "nature of a bounty springing from the appreciation and graciousness of the sovereign." . . . Under the rule mandated by Alaska's Constitution, on the other hand, these benefits are regarded as an element of the bargained-for consideration given in exchange for an employee's assumption and performance of his employment. This approach, in our view, more accurately reflects the realities of public employment in Alaska.

Id. at 1056-57 (citations omitted). Therefore, the court held

> that benefits under PERS are in the nature of deferred compensation and that the right to such benefits vests immediately upon an employee's enrollment in that system.

Id. at 1057.

Recognizing that "rigid adherence to labels like 'gratuity,' 'compensation,' 'contract,' and vested rights' has not allowed the courts the flexibility necessary to deal properly with legitimate legislative response to changing economic and social conditions," the court found California's "'limited vesting' approach to be instructive." *Id.* The court agreed with the California court's analysis[4] and held

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[4] *Citing Betts v. Board of Administration of the Public Employees' Retirement System*, 582 P.2d 614, 617 (1978) (1974 amendment changing "fluctuating" computation method to less beneficial "fixed" computation method included no comparable new advantages and could not constitutionally be applied to official whose employment was performed before the amendment); *Allen v. City of Long Beach*, 287 P.2d 765 (CA 1955) (invalidating city's increase in employee contribution rate, change in method of computing benefits, and change in contribution requirements upon reinstatement of employment following absence for military service).

> the fact that rights in PERS vest on employment does not preclude modifications of the system; that fact does, however, require that any changes in the system that operate to a given employee's disadvantage must be offset by comparable new advantages to that employee.

Id. The court reserved judgment on changes to the retirement system that might be needed to sustain a retirement system that could not pay all the benefits it owed. In footnote 11, the court stated:

> We are not called upon to consider the problem, which has frequently arisen in other jurisdictions, presented by a pension fund that is insufficient to satisfy all employee claims brought under its provisions. We intimate no view as to the appropriate legal analysis of any legislative alteration in employee benefits systems made in response to such circumstances.

Id.

Addressing the amendment to the method of computation of PERS occupational disability benefits, the court held that "at least as to some individuals, the new system cannot be said to offer advantages which outweigh its obvious disadvantages." *Id.* at 1058.

Regarding the change in eligibility requirements for occupational disability benefits, the court rejected the state's argument that eligibility standards were not part of the vested benefits protected by article XII, section 7. The court stated that the protected vested benefits "necessarily include not only the dollar amount of the benefits payable, but the requirements for eligibility as well." The court regarded "it as self-evident that this change will entail serious disadvantage" to certain injured public safety employees. *Id.*

The court rejected the state's argument that modification to PERS death benefits could be applied to current employees because rights to those benefits do not vest until the death of an employee. The court reasoned

> It is not the vesting of survivors' benefits that is at issue; it is rather the vesting of employee benefits. The fact that part of an employee's benefit package is, effectively, a life insurance policy, the proceeds of which will never be received by the employee, does not make that whole package any less an element of the consideration that the state contracts to tender in exchange for services rendered by the employee.

Id. at 1059.

The court concluded that the three challenged modifications to PERS "violate Alaska Const. Art. XII, § 7, as to those public safety employees who are adversely affected by them." The court noted "that a determination of whether vested rights to benefits have been diminished must be made on a case-by-case basis" and that the "choice is best made by each affected individual." *Id.* However, the court reversed the superior court's holding that the amendments were invalid as to all public safety employees. The court's interpretation rendered "the 1976 amendments . . . constitutional except as to public safety employees hired before July 1, 1976, who opt to receive benefits under the system in effect at the time they were hired." *Id.*

***Sheffield v. APEA*, 732 P.2d 1083 (Alaska 1987)**

The court next interpreted Alaska Constitution article XII, section 7 in the case of *Sheffield v. APEA*, 732 P.2d 1083 (Alaska 1987). That case involved statutes allowing employees to take early retirement, and also requiring that early retirement benefits be actuarially adjusted. "Actuarial adjustment" was statutorily defined as "equality in value of the aggregate expected payments under two different forms of pension payments, considering expected mortality and interest earnings on the basis of tables adopted from time to time by the board."

A new, more accurate table of early retirement factors adopted by the board in 1981 resulted in computation of slightly lower early retirement benefits than the 1972 table of factors previously in effect. APEA sued to prevent application of the factors in the new table to employees hired before the board adopted the new table. APEA also stipulated that the factors set out in the new table came "closer to achieving equality in value of aggregate payments as between early and normal retirement than would be possible under the old factors." *Id.* at 1084

The court quoted favorably from a case interpreting Massachusetts' law regarding contractual rights to public employee retirement benefits:

> The minimal meaning ... is that the "contract" is formed when a person becomes a member by entering the employment, and he is entitled to have the level of rights and benefits then in force *preserved in substance in his favor without any modification downwards*.... When we speak of the level of rights and benefits protected by [this statute] we mean the *practical effect of the whole complex of provisions* not excluding the [employees' contributions], for an increase in the [rate thereof] is little different from a diminution of the allowance.

Id. at 1087, *quoting Opinion of the Justices*, 303 N.E.2d 320, 327 (Mass. 1973) (emphasis added by court). Adhering to its case-by-case diminishment analysis in *Hoffbeck*, the court held that employees had a vested right to application of the more-favorable factors in effect during their employment. The court noted that

If the PERS board repeatedly revises the tables during the course of an employee's employment, we think the employee should be permitted to elect which of those tables will apply to the computation of his or her PERS early retirement benefits. *Cf. Hoffbeck*, 627 P.2d at 1059 n. 13 ("Upon remand the state is to give requisite notice to and a reasonable time for all those public safety employees affected to exercise their right to choose which system they desire to come under.").

Id. at 1089 n.13. The court explained

To hold that employees have a right only to early retirement benefits which are subject to actuarial changes until retirement would vitiate Alaska's constitutional protection of accrued benefits for those employees who anticipate early retirement: they could not count on any particular amount of pension but only that they will receive one. We therefore hold that the plain meaning of Alaska Const. Art. XII, § 7 should be interpreted to cover the diminution in early retirement benefits at issue, without regard to the fact that the diminution is accomplished through regulations (the actuarial factors) contemplated by the PERS statutes.

Id. at 1089.

***Flisock v. State, Div. of Retirement and Benefits*, 818 P.2d 640 (Alaska 1991)**

In 1991, the court again interpreted Alaska Constitution article XII, section 7 in the case of *Flisock v. State, Div. of Retirement and Benefits*, 818 P.2d 640 (Alaska 1991). That case involved a claim by a TRS member that the determination of the "base salary" to be used in the computation of his benefit should include a lump sum payment he received for unused leave he accrued during a six year period of employment with one of his employers.

The court stated the first issue in the case as being whether the Alaska Constitution required "that Flisock's retirement benefits be calculated in accordance with the law and practice in 1969, the year in which he first entered" TRS. *Id.* at 643. Citing the *Hoffbeck* and *Sheffield* cases, the court held that "Flisock is entitled to have his benefits calculated according to 1969 law." *Id.* The court interpreted the law in effect in 1969 as allowing Flisock to include in his base salary the portion of the lump sum that represented compensation for unused leave accrued during the three years used for computation of his benefit. *Id.* at 644.

***Municipality of Anchorage v. Gallion*, 944 P.2d 436 (Alaska 1997)**

In 1997, the Alaska Supreme Court issued its opinion in the case of *Municipality of Anchorage v. Gallion*, 944 P.2d 436 (Alaska 1997). That case involved a challenge to a Municipality of Anchorage (MOA) ordinance that affected the funding of the Anchorage Police and Fire Retirement System (APFRS). APFRS consisted of three plans with different levels of benefits and eligibility requirements, and with membership based primarily on date of hire. In 1994, Plans I and II were more than 100 percent funded, and Plan III was 89 percent funded. Although MOA had historically funded the plans separately under its ordinances, in 1994 MOA enacted an ordinance providing that contributions were not required if "the Board's actuary determines that the funds necessary to pay the actuarial liability for the benefits for system members contained herein are available from the total assets of the system." *Id.* at 439. MOA had already suspended contributions to Plans I and II. Based on the new ordinance, and the fact that the system considered as a whole was funded at over 100 percent of projected liabilities, MOA discontinued contributions to Plan III.

Anchorage Police and Fire Retirement System members sued on behalf of Plans I and II, contending that MOA's diversion of funds from those plans violated Alaska Constitution article XII, section 7. In discussing the constitutional standard to be applied, the court pointed out that, in the *Sheffield* case, it had adopted the reasoning of the Massachusetts Supreme Court when

> we made it clear that the benefits in force at the time of enrollment in the system will be protected, stating:
> [A member] is entitled to have the level of rights and benefits then in force *preserved in substance in his favor without any modification downwards*. ... When we speak of the level of rights and benefits protected by [this statute] we mean the *practical effect of the whole complex of provisions*....
> *Id.* at 1087 (quoting *Opinion of the Justices*, 364 Mass. 847, 303 N.E.2d 320, 327 (1973) (emphasis added)).

Id. at 441. Dispelling any notion that rights protected by the constitution are limited to the amount of and eligibility requirements for benefits,[5] the court held that MOA's ordinance impaired

> the vested right of members of Plans I and II to have the actuarial soundness of those plans evaluated and maintained separately without being affected by the soundness of other plans. That failure impairs the ability of Plans I and II to withstand future contingencies, such as increases in plan obligations, declines in investment revenue, and inability by MOA to fund any shortfall. It is therefore unconstitutional.

Id. at 444. The court declined to adopt the reasoning of case law from other jurisdictions that upheld allocations of fund earnings or surpluses to supplemental benefits because those allocations did not diminish or impair payment of full benefits[6] or to an underfunded plan because the system remained actuarially sound.[7] Instead, the court was persuaded by *Valdes v. Cory*, 139 Cal. App.3d 773, 189 Cal. Rptr. 212 (1983). In *Valdes*, the Court of Appeal for the Third District of California held that provisions of emergency

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[5] In the 1988 case of *Rice v. Rice*, 757 P.2d 60 (Alaska 1988), the court mentioned that "[t]he modifications to PERS which we have found to operate to disadvantage an employee are those changes which reduce the dollar amount of the benefits payable or the requirements for eligibility." 757 P.2d at 62 (citations omitted).

[6] *Poggi v. City of New York*, 109 A.D.2d 265, 491 N.Y.S.2d 331 (1985), *aff'd*, 67 N.Y.2d 794, 501 N.Y.S.2d 397 (1986); *Halstead v. City of Flint*, 127 Mich. App. 148, 338 N.W.2d 903 (1983).

[7] *State ex rel. Dadisman v. Caperton*, 413 S.E.2d 684 (W. Va. 1991).

legislation passed by the California legislature suspending employer contributions to the state's retirement systems for three months during a budget crisis interfered "with vested contractual rights of PERS members." 189 Cal. Rptr. at 223. The Alaska Supreme Court explained that, although the California legislature's action

> had not reduced employee benefits under the system, the [California] court determined that the state could not suspend its statutorily defined contributions absent actuarial input to insure that the system would remain actuarially sound. *Id.* at 223. The court stated that although an employee may not suffer out of pocket expenses, "the interest of the employee at issue here is the security and integrity of the funds available to pay future benefits." *Id.* at 222.

944 P.2d at 445.

***Duncan v. Retired Public Employees of Alaska*, 71 P.3d 882 (Alaska 2003)**

The Alaska Supreme Court's most recent case interpreting Alaska Constitution article XII, section 7 is *Duncan v. Retired Public Employees of Alaska*, 71 P.3d 882 (Alaska 2003). In that case, Retired Public Employees of Alaska and other plaintiffs challenged modifications to the retiree health plan made by the state in 1999 and 2000. Some of the modifications "provided greater benefits; others were disadvantageous to retirees." *Id.* at 885 In its overview of article XII, section 7, the court quoted from its *Hoffbeck* analysis of the vesting of an employee's right to benefits upon employment and enrollment in the system, and explained that "[t]his means that system benefits offered to retirees when an employee is first employed and as improved during the employee's tenure may not be 'diminished or impaired.'" *Id.* at 886-87. The court reiterated that vested benefits are subject to reasonable modification, "[b]ut to be sustained as reasonable, changes that result in disadvantages to employees should be accompanied by comparable new advantages." *Id.*

The court rejected the state's argument that health insurance benefits, which were not provided by territorial retirement systems when the Alaska Constitution was ratified, were not intended to constitute "accrued benefits." The court observed that its "case law suggests that 'accrued benefits' should be defined broadly." *Id.* at 887. The court concluded

> that the term "accrued benefits" is not limited to just the benefits that were provided to public employees at the time of ratification of the constitution. Instead, the term includes all retirement benefits that make up the retirement benefit package that becomes part of the contract of employment when the public employee is hired, including health insurance benefits.

Id. at 888. The court acknowledged "that medical costs are rapidly rising, making health insurance increasingly difficult to provide. But we do not believe that this fact is of sufficient weight to change the meaning of the plain language of article XII, section 7." *Id.*

The court also rejected the state's argument that the "accrued benefit" was not the level of coverage provided, but was the highest amount of the monthly premium for retiree health coverage in effect during an employee's employment. The court stated

> The natural and ordinary meaning of "benefits" in a health insurance context refers to the coverage provided rather than the cost of the insurance. Further, the various employee publications promise coverage, not merely payment of a particular premium.

Id. at 888-89. The court acknowledged that "[t]he state's argument that the pension system may at some point be threatened by increasing costs of health care is a serious one. Again however, we do not believe that this argument is sufficient to change the meaning of the constitutional language in question." *Id.*

The court agreed with the state's third argument, concluding that the determination of whether detrimental changes in retiree health coverage are offset by comparable new beneficial changes must be made from a group standpoint rather than on an individualized basis. The court reasoned that

> Changes to fixed streams of income such as occupational disability and pension payments can be much more readily evaluated on an individual basis to determine whether they result in a net benefit than can changes to health insurance. Pension and occupational disability payments are, for the most part, predictable and fixed, while health insurance benefits change according to the unpredictable, changing medical needs of each individual.

Id. at 891. The court cautioned that

> equivalent value must be proven by reliable evidence. Just as with an individual comparative analysis, offsetting advantages should be established under the group approach by solid, statistical data drawn from actual experience--including accepted actuarial sources--rather than by unsupported hypothetical projections.

Id. at 892. The court indicated that some individuals could suffer serious hardship from changes in medical coverage that are constitutionally acceptable from a group standpoint. Contrasting the serious hardship established in *Hoffbeck* with the examples of detriments offered in the *Duncan* case, which amounted to "at most several hundred dollars a year, without consideration of [offsetting] benefits," the court stated that individuals who showed serious hardship caused by substantial detriments that are not offset by comparable advantages "should be allowed to retain existing coverage." *Id.*

RESPONSE TO QUESTIONS

1. PERS and TRS contribution rates may be increased for individuals who became members of the systems before the effective date of the rate increases if the increases are accompanied by comparable enhancements to benefits.

Alaska Supreme Court case law summarized above is clear in establishing the date of enrollment in a public retirement system as the date upon which an employee's rights are "vested" or "accrued" under the retirement system. [8] That case law also establishes that "accrued benefits" protected by article XII, section 7 broadly include not just the amount of and eligibility requirements for benefits, but also "the practical effect of the whole complex of provisions" of the systems. *Gallion*, 944 P.2d at 441; *Sheffield*, 732 P.2d at 1087 (both quoting *Opinion of the Justices*, 303 N.E.2d 320, 327 (Mass. 1973)).

Although a majority of the Alaska Supreme Court has not addressed the specific issue of the circumstances under which the state's retirement systems may be amended to raise employee contribution levels, cases that the court has cited, and on which the court has relied, do address the issue.

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[8] Following the Alaska Supreme Court's issuance of its opinion in *Hoffbeck*, this office advised the commissioner of administration that the state could not, by statute, raise the employee contribution rate for teachers employed before the rate increase. 1983 Inf. Op. Att'y. Gen. (366-329-83; February 14).

The Alaska Supreme Court cited the 1955 case of *Allen v. City of Long Beach*, 287 P.2d 765 (CA 1955), in *Hoffbeck*, adopting the California Supreme Court's "limited vesting" and "comparable advantage" approach. *Hoffbeck*, 627 P.2d at 1057. In the *City of Long Beach* case, the California court specifically considered the 1951 modification of a pension plan by the city, increasing the contribution rate of employees hired before March 29, 1945, from 2 percent to 10 percent. The court stated that the change to the city's charter:

> substantially decreases plaintiffs' pension rights without offering any commensurate advantages, and there is no evidence or claim that the changes enacted bear any material relation to the integrity or successful operation of the pension system established by section 187 of the charter.
>
> The provision raising the rate of an employee's contribution to the city pension fund from 2 percent of his salary to 10 percent obviously constitutes a substantial increase in the cost of pension protection to the employee without any corresponding increase in the amount of the benefit payments he will be entitled to receive upon his retirement.

287 P.2d at 767. The court invalidated the city charter provision increasing the contribution rate.[9]

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[9] Other California contribution rate cases include *Wisley v. City of San Diego*, 188 Cal.App.2d 482, 10 Cal. Rptr. 765 (1961) (successive amendments gradually increasing employee contribution rates from one percent to eight percent were obviously detrimental and there was no showing of commensurate benefit or that increases were necessary to the integrity or successful operation of the pension program; holding that the contribution rate increases could not be sustained as reasonable as applied to the plaintiffs); and *City of Downey v. Board of Administration, Public Employees Retirement System*, 47 Cal. App.3d 621, 121 Cal. Rptr. 295 (1975) (detrimental change in contribution rate from individual actuarial computation of portion of benefits employee would receive to flat seven percent of salary was outweighed by increase in retirement allowance, reduction in mandatory retirement age, and option of benefit for spouse).

The Massachusetts case *Opinion of the Justices*, 303 N.E.2d 320 (Mass. 1973), on which the court relied in adopting the interpretation that "accrued benefits" include "the practical effect of the whole complex of provisions" of the retirement systems (*Gallion*, 944 P.2d at 441; *Sheffield*, 732 P.2d at 1087) also involved proposed legislation to raise the employee contribution rate.[10] The Massachusetts court explained that a proposed increase in the employee contribution rate from five percent to seven percent

> would mean a forty percent increase of the member contributions providing the annuity share of the yearly allowance, and a comparable decrease in the pension share provided by the government, for the pension share represents roughly the difference between what the member has created in the way of an annuity and the fixed yearly retirement to which he is entitled. The member would pay more without any enlargement of the benefits.

303 N.E.2d at 324. The Massachusetts court stated

> Legislation which would materially increase present members' contributions without any increase of the allowances finally payable to those members or any other adjustments carrying advantages to them, appears to be presumptively invalid--invalid, that is to say, unless saved by the reserved police powers. . . . That the maintenance of a retirement plan is heavily burdening a governmental unit has not itself been permitted to serve as justification for a scaling down of benefits figuring in the 'contract,' although no case presenting proof of a catastrophic condition of the public finances has been put.

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[10] Massachusetts does not have a constitutional provision comparable to Alaska Constitution article XII, section 7. The court applied Massachusetts statute section 25(5) of G.L. c. 32, which provided that the retirement system statutes "shall be deemed to establish . . . membership in the retirement system as a contractual relationship under which members who are or may be retired for superannuation are entitled to contractual rights and benefits, and no amendments or alterations shall be made that will deprive any such member or any group of such members of their pension rights or benefits provided for thereunder, if such member or members have paid the stipulated contributions . . . ." 303 N.E.2d at 322-23.

Id. at 329-30 (citations omitted). The Massachusetts court concluded that the proposed increase in contribution rate of members of the retirement system was presumptively invalid. *Id.* at 331. The court also concluded that the contribution rate could be applied to employees hired after enactment of the new rate. *Id.*

In addition to these cases from other jurisdictions on which the Alaska Supreme Court has relied, the case of *Hudson v. Johnstone*, 660 P.2d 1180 (Alaska 1983), provides insight as to the probable outcome of a challenge to application of increased contribution rates to current employees. In *Johnstone*, the Alaska Supreme Court considered amendments to the Judicial Retirement System (JRS). Before July 1, 1978, judges were not required to make contributions to JRS. Amendments enacted in 1978 kept JRS non-contributory for judges appointed before July 1, 1978, and made JRS contributory for judges hired after that date. AS 22.25.011. The court upheld the amendments, without citing Alaska Constitution article XII, section 7. Justice Rabinowitz wrote a concurring opinion analyzing that constitutional provision, and opined:

> . . . . under the provisions of article XII, section 7, justices and judges appointed on or before July 1, 1978, are constitutionally entitled to receive benefits under the non-contribution retirement system established prior to the enactment of AS 22.25.011. Thus the legislature is precluded from requiring such judges to contribute toward their retirement benefits even when they commence new "terms of office."

Id. at 1187. Justice Rabinowitz reviewed the 1981 cases of *State v. Allen* and *Hammond v. Hoffbeck*, and stated his view that those cases "preclude the legislature from requiring the members of the judiciary appointed on or before July 1, 1978, from contributing toward their retirement benefits, absent some offsetting comparable new advantage." *Id.* at 1188.

In your request for advice, you mention a memorandum dated January 29, 2005, from the Legislative Affairs Agency's Division of Legal and Research Services ("LAA memorandum") to Representative Mike Kelly regarding "[a]ccrued benefits of public employment retirements systems and legislative changes to the employee contribution rate." That memorandum acknowledges that, under *Hoffbeck*, a challenge may be raised to an increase in employee contribution rates, but states that

> [a] strong counter argument could be made that the employee contribution rates are not part of the 'accrued benefit' to which members are entitled. The accrued benefits are the rights to receive the retirement and medical plan offered upon employment; the rights accrue as they are earned. A person's contribution rate cannot be changed retroactively for benefits that have already accrued, however, it can be argued that the employee contribution rate can change prospectively to pay for vested benefits.

These statements and the analysis that follows them in the LAA memorandum are not consistent with the Alaska Supreme Court's repeated rulings that an employee's rights under the retirement systems vest – i.e., are "accrued" – at the time the employee first enrolls in the system, and that those accrued rights include not only the amount of and eligibility requirements for benefits, but also "the practical effect of the whole complex of provisions" of the systems.[11] In the one case cited by the LAA memorandum in which an increase in the contribution rate of a group of teachers was approved, the Michigan Supreme Court relied on Michigan constitutional history indicating that the framers intended to protect retirees from diminishment of rights "after the service has been performed." *Request for Advisory Opinion, In re Enrolled Senate Bill 1269*, 389 Mich. 659, 209 N.W.2d 200, 202 (Mich. 1973). There is no comparable Alaska constitutional history, and this is contrary to Alaska case law regarding accrual of benefits under the Alaska Constitution.[12]

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[11] The LAA opinion discusses the *Hoffbeck* case, then states that "the next discussion of Article XII, sec. 7 by the Alaska Supreme Court occurred in 2003" citing the *Duncan* case. The LAA memorandum does not address the earlier *Hammond v. Allen* case, or the intervening *Sheffield v. APEA*, *Flisock v. State*, and *MOA v. Gallion* cases.

[12] The case cited in the LAA memorandum in support of the proposition that public employees could choose to resign instead of paying increased contributions did not construe a retirement statute. In *Cook v. City of Binghamton*, 398 N.E.2d 525 (N.Y. 1979), the court upheld changes to a general law that provided for continued payment of salary and medical benefits to certain firemen who were disabled by injuries while performing their duties.

The LAA memorandum correctly points out that increases in contribution rates have been applied to current employees in the past – specifically in 1986 for PERS members and in 1990 for TRS members – without creating a new tier and without drawing legal challenges.[13] However, the 1986 and 1990 legislation that raised the contribution rates included provisions intended to enhance benefits to offset the rate increases. For example, in addition to increasing the PERS contribution rate, the 1986 legislation added the automatic actuarially funded PRPA, increased some of the multipliers for computation of benefits, and made contributions pre-tax. Ch. 82, SLA 1986.

The bill review that the attorney general's office provided to the Governor in 1986 described the increase in the contribution rates for PERS members, and explained that because of the pre-tax treatment, little if any change in the take-home pay of employees would result.[14] The bill review also explained that the bill provided "additional benefits to . . . offset any diminution in benefits resulting from the increase in the contribution rate. The most significant and valuable of these additional benefits is the automatic, actuarially funded (PRPA) . . . ." Other provisions of the 1986 legislation that would constitute diminishments of benefits, such as the increase in early and normal retirement ages, the requirements that retirees under the age of 60 pay full premiums and retirees between the ages of 60 and 65 pay half premiums for medical coverage, and limits on inclusion of geographic cost of living differentials in computation of benefits, were made applicable only to employees hired after July 1, 1986 (this created PERS Tier II).

Similarly, Ch. 97, SLA 1990 raised the TRS contribution rates, and also made offsetting changes making the contributions pre-tax, increasing a multiplier, and adding the automatic actuarially funded PRPA. Again, the increase in the early and normal retirement ages for teachers with less than 20 years of service and the medical coverage premium requirement applied only to teachers hired after June 31, 1990 (this created TRS Tier II).

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[13] Footnote 3 of the LAA memorandum mentions that the contribution rate was "last increased in 1999" for PERS school district employees. However, the 1999 contribution rate increase was not imposed on school district PERS employees. Under the 1999 legislation, noncertificated PERS employees of school districts who worked during the school year, and therefore did not accrue a whole year of service credit under PERS each year, were allowed to elect to pay a higher contribution rate in exchange for accrual of a full year of service credit. Ch. 22, SLA 1999.

[14] File no. 883-86-0140.

In applying Alaska Supreme Court case law interpreting Alaska Constitution article XII, section 7 to your first question, we conclude that legislation increasing the PERS and TRS contribution rates for employees who became members of the systems before the effective date of the rate increases is likely to face a serious legal challenge. Because this kind of dispute is resolved on a case-by-case basis, only a definitive opinion of the Alaska Supreme Court will provide certainty as to the outcome of the challenge. However, we can say that if the increases are accompanied by comparable enhancements to benefits, the prospects of prevailing are increased.

2. Pre-funding of the medical component of PERS and TRS benefits may not be discontinued for members who were employed during the period that the statutes required pre-funding. Funding of medical benefits may be set at less than 100 percent funding for new members.

State law requires employer contribution rates to be calculated in amounts sufficient, when combined with employee contributions, "to provide the benefits earned . . . . " AS 39.35.250; *see also* AS 14.25.070. Under PERS each employer, including the state, is required to provide in its budget for the payment of the contributions, and to remit the payments monthly. AS 39.35.260, 39.35.270, and 39.35.280. Additionally, AS 39.30.095(b), requires the commissioner of administration, after obtaining the advice of an actuary, to determine and set the rate of employer contribution and employee contribution, if any, required for payment to the group health and life benefits fund for payment of benefits including retiree health benefits.

As explained in the summary of the *Duncan* case above, the Alaska Supreme Court has held that health benefits provided by the state's retirement system statutes are part of "the retirement benefit package that becomes part of the contract of employment when the public employee is hired." 71 P.3d at 888. As such, retiree health benefits are among the benefits that must be included in the PERS and TRS employer contribution rates under AS 14.25.070, AS 39.30.095, and AS 39.35.220-39.35.290. We understand that, in accordance with these statutes, employer contribution rates have historically been set to fully fund retiree health benefits.

In a memorandum of advice dated December 2, 1992, this office addressed the question of "whether the governor is constitutionally or statutorily mandated to include in the budget, and the legislature is constitutionally mandated to appropriate, those employer contributions that are prescribed by the boards of the various retirement systems to keep the systems actuarially sound." 1992 Inf. Op. Att'y Gen. (663-92-0073; December 2). We advised that "we believe the court would hold that article XII,

section 7, requires the funding of the retirement systems . . . ." *Id.* at 3. That advice was tempered by the lack of Alaska case law directly addressing the question, and by the fact that recent case law from other jurisdictions created some uncertainty.

Since 1992, the Alaska Supreme Court decided the *Gallion* case, holding that employees' vested interest in the integrity and security of their plans could not be diminished by combining the plans with a plan that was less actuarially sound. In *Gallion*, the court was persuaded by the California Court of Appeal case relied upon in our 1992 memorandum of advice, *Valdes v. Cory*.[15] The court also declined to adopt the rationale of one of the cases that created uncertainty, *State ex rel. Dadisman v. Caperton*, *supra*, n.7.

We adhere to the advice we gave in 1992. We believe that the Alaska Supreme Court would hold that the "the practical effect of the whole complex of provisions" of the systems in which employees have accrued rights includes the statutory provisions for employer contributions and the state's practice of establishing employer contribution rates that fully fund retiree medical benefits in accordance with those statutes.

The legislature may change the employer contribution statutes to provide for less than full funding of the retiree medical benefits of employees hired after the effective date of the legislation.[16] We understand that no Governmental Generally Accepted Accounting Principle requires a public entity to fully actuarially fund retiree medical benefits. If the legislature chooses to enact such a change, in accordance with the court's holding in the *Gallion* case, past and future contributions for fully funded medical benefits for employees hired before the effective date of the legislation should be kept separate from contributions for underfunded medical benefits in the trust fund, in order to maintain the integrity and security of the fully funded benefits.

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[15] 139 Cal. App.3d 773, 189 Cal. Rptr. 212 (1983). *See also Board of Administration of the Public Employees' Retirement System v. Wilson*, 52 Cal. App.4th 1109, 61 Cal. Rptr.2d 207 (1997) (state PERS employees' contractual right to an actuarially sound system was unconstitutionally impaired by amendment to employer contribution portion of funding methodology).

[16] It is also possible that such a change could be applied to benefit recipients whose benefits are based solely on service performed before the legislature first enacted legislation providing for employer-paid retiree medical benefits in 1975. Ch. 200, SLA 1975. Those benefit recipients would not have a contractual right to pre-funded medical benefits arising from employment with the state.

3. **If the financial condition of the funds does not permit payment of the PRPA, it is allowable to prospectively not pay existing members new [or additional] ad hoc PRPAs. A new statutory provision cannot reduce the existing number of members who retain a vested right to a PRPA if one is awarded, unless the new statutory provision includes comparable enhancements to benefits.**

Before July 1, 1986, for PERS, and before July 1,1990, for TRS, the retirement system statutes provided for granting of post retirement pension adjustments to retirees if the administrator determined that the cost of living had increased, and that the financial condition of the funds permitted. AS 14.25.143 (TRS); AS 39.35.475 (PERS). The amount of the PRPA was based on the increase of the cost of living since retirement, with a cap of four percent of the base benefit compounded for each year of retirement. The PRPAs were not automatic, and were considered discretionary or "ad hoc." Potential future PRPAs were not included in the actuarially-determined employer contribution rates.

In 1986 for PERS, and in 1990 for TRS, the legislature repealed the ad hoc PRPAs, and replaced them with actuarially funded automatic PRPAs. Sec. 41, ch. 82 SLA 1986; sec.12, ch. 97 SLA 1990. The automatic PRPAs are paid to retirees age 60 or older, or who have been retired for at least five years from PERS or eight years from TRS. The amount of the PRPA for members who are at least 65 years old or who are receiving disability benefits is the lesser of 75 percent of the cost of living increase in the preceding calendar year or nine percent. For other retirees eligible for PRPAs, the amount is the lesser of 50 percent of the cost of living increase in the preceding calendar year or six percent.

Following repeal of the PERS ad hoc PRPA and enactment of the automatic PERS PRPA in 1986, this office advised the commissioner of administration that the PERS and TRS ad hoc PRPAs could be withheld "if the administrator of the systems makes appropriate, factually supported findings regarding the condition of the retirement funds." 1990 Inf. Op. Att'y Gen. (663-90-0206; January 19). In that memorandum of advice, we

acknowledged that "[b]ecause the right to receive a specific type of retirement benefit, including the PRPA, vests upon the date of employment, the ad hoc PRPA remains viable for members of PERS hired before the effective date of ch. 82, SLA 1986." *Id.* at 1.[17]

Based on the Alaska Supreme Court case law summarized above, the administrator must continue to consider annually whether the cost of living has increased and whether the financial condition of the retirement funds permits awarding of ad hoc PRPAs to retirees. It is not constitutionally allowable for legislation to reduce the existing number of members eligible to receive an ad hoc PRPA if one is awarded, unless that legislation provides comparable offsetting benefits. However, as we noted in our memorandum of advice in 1990,

> [t]o the extent possible, the division should also weigh other advantages provided by ch. 82, SLA 1986 [and ch. 97 SLA 1990] (such as the increased [PERS] "multipliers" in the benefit formula applied to service accrued after June 30, 1986 in excess of 10 and 20 years) in determining whether a retiree is actually disadvantaged by the change in the . . . PRPA.

Id. at 2.[18]

Legislation that limits the administrator's discretion – for example, legislation that allows award of an ad hoc PRPA only if a retirement fund is actuarially funded at over 100 percent and employer contribution rates are set at less than eight percent – would also be subject to challenge under the Alaska Supreme Court cases summarized above.

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[17] We also acknowledged this in pleadings filed in litigation filed by and on behalf of retirees after the TRS ad hoc PRPA was repealed. *National Education Association – Alaska v. Usera*, Case No. 3AN-91-8274 Civil. That litigation was settled in October 1996. Each year since then, the administrator has considered whether to grant an ad hoc PRPA based on the increase of the cost of living and the financial conditions of the retirement funds. The administrator denied ad hoc PRPAs for 2003 and 2004.

[18] As with medical benefits, it is possible that there are benefit recipients whose benefits are based solely on service performed before the PRPA was first enacted for TRS in 1966 (ch. 151 SLA 1966) or for PERS in 1968 (ch. 235 SLA 1968). Such a benefit recipient would not have a contractual right to the ad hoc PRPA arising from employment with the state, and would be eligible only for the automatic PRPA.

The constitutional rights of members regarding the ad hoc PRPA include the right to consideration of award of a PRPA based on the discretion existing under the repealed statutes.[19]

4. The above responses might be different if it were established that application of modification of the retirement systems to current members is necessary to allow the retirement systems to pay current benefit claims

As explained above, the Alaska Supreme Court has not ruled on application to current members of changes to the retirement systems that might be necessary if a pension fund were "insufficient to satisfy all employee claims brought under its provisions." *Hoffbeck*, 627 P.2d at 1057 n.11. Although the Alaska Supreme Court has not established standards to be applied in such a case, analysis by the California court in the *Valdes* case may be instructive:

> On the other hand, a substantial impairment may be constitutional if it is "reasonable and necessary to serve an important public purpose." . . .
>
> Both the California and United States Supreme Courts have identified factors which may warrant legislative impairment of vested contract rights on the grounds of necessity: "(1) the enactment serves to protect basic interests of society, (2) there is an emergency justification for the enactment, (3) the enactment is appropriate for the emergency and (4) the enactment is designed as a temporary measure, during which the vested contract rights are not lost but merely deferred for a brief period, interest running during the temporary deferment."

189 Cal. Rptr. at 225-26 (citations omitted).

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[19] Using the above example of potential legislative restrictions, if the administrator historically awarded a PRPA when a retirement fund was at least 95 percent funded, employer contribution rates were set at 10 percent, and no other facts existed that would cause the administrator to determine that the condition of the fund did not permit the award of a PRPA, the legislative restrictions would diminish or impair the vested rights of retirees if those historical conditions were ever achieved again.

If the Alaska Supreme Court adopted these standards for approving impairments based on reasonableness and necessity, it would consider the facts specific to the legislative enactment. We are not in a position to express an opinion as to the adequacy under these standards of the reasons advanced by legislators in support of amendments to the retirement systems currently under consideration. We must emphasize the importance of establishing as complete a record as possible for any justifications supporting the change if we are to conduct an effective defense.

Please let us know if you need additional advice regarding these matters.

VBR:rca

25-LS0252\M

HOUSE BILL NO. 179

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FIFTH LEGISLATURE - FIRST SESSION

BY REPRESENTATIVE KELLY

Introduced: 3/5/07
Referred: State Affairs, Finance

A BILL

FOR AN ACT ENTITLED

"An Act relating to insurance for public employees, teachers, and certain retired public employees and teachers and to supplemental employee benefits; relating to teachers' and public employees' defined benefit retirement plans, to teachers' and public employees' defined contribution retirement plans, to employee and employer contributions to the teachers' retirement system and the public employees' retirement system, and to the administration of the Public Employees' Retirement System of Alaska and the deferred compensation program for state employees; establishing in the Department of Revenue the teachers' retirement system past service cost liability account and the public employees' retirement system past service cost liability account; relating to benefits of, references to federal law in, and investments in the teachers' retirement system and the public employees' retirement system; modifying the jurisdiction of the independent office of administrative hearings as related to retirement and related personnel benefits;

and providing for an effective date."

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

*** Section 1.** AS 14.25.050 is amended by adding a new subsection to read:

(e) Beginning with the payroll for the first pay period in July 2007, a member shall contribute to the plan, in addition to the amount calculated in (a) of this section, an amount equal to five percent of the member's base salary.

*** Sec. 2.** AS 14.25.070(a) is amended to read:

(a) An employer shall make contributions to the plan **in accordance with this section and as certified by the board** in an amount sufficient, after subtracting member contributions, to provide the benefits of AS 14.25.009 - 14.25.220. The amount shall be calculated by applying **the employer normal cost rate to the sum total of the base salaries paid to members in the plan and by applying the past service rate to the sum total of the base salaries paid to members in the system** [AN EMPLOYER CONTRIBUTION RATE, CERTIFIED BY THE BOARD, AGAINST THE SUM TOTAL OF THE BASE SALARIES PAID TO MEMBERS], including any adjustments to contributions required by AS 14.25.173(a). **The employer shall remit this amount to the administrator in accordance with AS 14.25.065.**

*** Sec. 3.** AS 14.25.070 is amended by adding new subsections to read:

(d) In (a) of this section, "employer normal cost rate" means the percentage of compensation of all active members in the plan that, when combined with the member contribution rate of active members in the plan, is sufficient to provide the benefits that are expected to be credited with respect to service during the year beginning after the last valuation date. This percentage is uniformly determined for all employers and is applicable to each employer.

(e) In (a) of this section, "past service rate" means the percentage of compensation of all active members in the system necessary to provide the annual amount required to amortize the unfunded obligations of the employers for benefits earned by members in the plan before the date of the last actuarial valuation over a period not to exceed the maximum period allowed by generally accepted accounting

principles of the Governmental Accounting Standards Board. This percentage is uniformly determined for all employers and is applicable to each employer.

* **Sec. 4.** AS 14.25.125(c) is amended to read:

(c) Membership service for which contributions were refunded is not creditable under this section [UNLESS THE REFUNDED CONTRIBUTIONS HAVE BEEN REPAID. FOR PURPOSES OF THIS SECTION, A MEMBER OR FORMER MEMBER DOES NOT HAVE TO BE REEMPLOYED UNDER THIS PLAN IN ORDER TO REPAY REFUNDED CONTRIBUTIONS. COMPOUND INTEREST AT THE RATE PRESCRIBED BY REGULATION MUST BE ADDED TO THE REINSTATEMENT INDEBTEDNESS FROM THE DATE OF THE REFUND TO THE DATE OF REPAYMENT].

* **Sec. 5.** AS 14.25.310 is amended to read:

Sec. 14.25.310. Applicability of AS 14.25.310 - 14.25.590. The provisions of AS 14.25.310 - 14.25.590 apply only to teachers who first become members on or after July 1, 2006, **to members who are employed by employers that do not participate in the retirement benefit plan established under AS 14.25.009 - 14.25.220, to former members as that term is defined under AS 14.25.220,** or to members who transfer into the defined contribution plan under AS 14.25.540.

* **Sec. 6.** AS 14.25.320(c) is amended to read:

(c) The defined contribution retirement plan is intended to qualify under 26 U.S.C. 401(a), [AND] 414(d), **and 414(k)** (Internal Revenue Code) as a qualified retirement plan established and maintained by the state for its employees and for the employees of school districts and regional educational attendance areas in the state.

* **Sec. 7.** AS 14.25.350 is amended by adding a new subsection to read:

(e) An employer shall make annual contributions to a trust account in the plan, applied as a percentage of each member's compensation from July 1 to the following June 30, in an amount determined by the board to be actuarially required to fully fund the cost of providing occupational disability and occupational death benefits under AS 14.25.310 - 14.25.590.

* **Sec. 8.** AS 14.25.380 is amended to read:

Sec. 14.25.380. Limitations on contributions and benefits. Notwithstanding

any other provisions of this plan, the annual additions to each member's individual account under this plan and under all defined contribution plans of the employer required to be aggregated with the contributions from this plan under the provisions of 26 U.S.C. 415 may not exceed, for any limitation year, the amount permitted under 26 U.S.C. 415**(c)** at any time. If the amount of a member's **individual account** [DEFINED CONTRIBUTION PLAN] contributions exceeds the limitation of 26 U.S.C. 415(c) for any limitation year, the administrator shall take any necessary remedial action to correct an excess contribution. **A fixed benefit provided under this plan may not exceed, for or during a limitation year, the amount permitted under 26 U.S.C. 415(b). If a fixed benefit provided under this plan exceeds, for or during a limitation year, the amount permitted under 26 U.S.C. 415(b), the administrator shall take remedial action necessary to comply with the limits on the benefit amount in 26 U.S.C. 415(b).** The provisions of 26 U.S.C. 415, and the regulations adopted under that statute, as applied to qualified [DEFINED CONTRIBUTION] plans of governmental employees are incorporated as part of the terms and conditions of the plan.

*** Sec. 9.** AS 14.25.400(b) is amended to read:

(b) A participant may direct investment of plan funds held in an **individual** account among available investment funds in accordance with rules established by the board.

*** Sec. 10.** AS 14.25.485(b) is amended to read:

(b) The occupational disability benefits accrue beginning the first day of the month following termination of employment as a result of the disability and are payable the last day of the month. If a final determination granting the benefit is not made in time to pay the benefit when due, a retroactive payment shall be made to cover the period of deferment. The last payment shall be for the first month in which the disabled member

(1) dies;

(2) recovers from the disability;

(3) fails to meet the requirements under (f), **(h),** or **(j)** [(h)] of this section; or

(4) reaches normal retirement age.

* **Sec. 11.** AS 14.25.485(d) is amended to read:

(d) The monthly amount of an occupational disability benefit is 40 percent of the disabled member's gross monthly compensation at the time of termination due to disability. **Notwithstanding AS 14.25.390(b), at the time a member is appointed to disability, the member becomes fully vested in the employer contributions made under AS 14.25.350(a). A disabled member is fully vested in the contributions to the member's individual account made under this subsection. A member is not entitled to elect distributions from the member's individual account under AS 14.25.410 while the member is receiving disability benefits under this section.** While a member is receiving disability benefits, based on the disabled member's gross monthly compensation at the time of termination due to disability, the employer shall make contributions to the

(1) member's individual account under AS 14.25.340 on behalf of the member, without deduction from the member's disability payments; and

(2) appropriate accounts and funds on behalf of the member under AS 14.25.350.

* **Sec. 12.** AS 14.25.485(g) is amended to read:

(g) A disabled member's occupational disability benefit terminates **the last day of the month in which** [WHEN] the disabled member first **qualifies** [ATTAINS ELIGIBILITY] for normal retirement. At that time, the member's retirement benefit shall be determined under the provisions of AS 14.25.420 - 14.25.440, 14.25.470, and 14.25.480. A member **whose occupational disability benefit terminates under this subsection** [RECEIVING DISABILITY BENEFITS UP UNTIL ELIGIBILITY FOR RETIREMENT] shall be considered to have retired directly from the plan.

* **Sec. 13.** AS 14.25.485(i) is amended to read:

(i) Upon the death of a disabled member who is receiving or is entitled to receive an occupational disability benefit, the administrator shall pay the surviving spouse a surviving spouse's pension, equal to 40 percent of the member's monthly compensation at the termination of employment because of occupational disability. If there is no surviving spouse, the administrator shall pay the survivor's pension in equal

parts to the dependent children of the member. **While the monthly survivor's pension is being paid, the survivor is not entitled to elect distributions from the employee's individual contribution account under AS 14.25.410.** The first payment of the surviving spouse's pension or of a dependent child's pension shall accrue from the first day of the month following the member's death and is payable the last day of the month. The last payment shall be made **the last day of** [FOR] the last month in which there is an eligible surviving spouse or **dependent** child**, or the last day of the month in which date the member would have first qualified for normal retirement if the member had survived, whichever day comes sooner. A retirement benefit shall be determined under the provisions of AS 14.25.420 - 14.25.440, 14.25.470, and 14.25.480 based on** [. ON] the date the **member would have first qualified for** normal retirement [OF THE MEMBER WOULD HAVE OCCURRED] if the member had **survived. In addition to the payment of the member's individual account, the surviving spouse or, if there is no surviving spouse, the surviving dependent children of the member, shall receive an additional benefit in an amount equal to the accumulated contributions that would have been made to the deceased member's individual account under AS 14.25.340(a) and 14.25.350(a), based on the deceased member's gross monthly compensation at the time of occupational disability, from the time of the member's death to the date the member would have first qualified for normal retirement if the member had survived. Earnings shall be allocated to the additional benefit calculated under this subsection based on the actual rate of return, net of expenses, of the trust account established under AS 14.25.350(e) over the period that the contributions would have been made. This additional amount shall be paid in the same manner as determined for the member's individual account under AS 14.25.420 – 14.25.460. For the purpose of determining eligibility of a survivor who is receiving a benefit under this subsection for medical benefits under AS 14.25.470 - 14.25.480, a** [LIVED, THE RETIREMENT BENEFIT SHALL BE DETERMINED UNDER THE PROVISIONS OF AS 14.25.420 - 14.25.440, 14.25.470, AND 14.25.480. A] member who died while receiving disability benefits shall be considered to have retired directly from the

plan on the date the **member would have first qualified for** normal retirement [OF THE MEMBER WOULD HAVE OCCURRED] if the member had **survived. The period during which the member was eligible for a disability benefit and the period during which a survivor's pension is paid to a survivor under this subsection each constitute membership service for the purposes of determining vesting in employer contributions under AS 14.25.390(b) and eligibility for retirement and medical benefits under this chapter and AS 39.30.300 - 39.30.495** [LIVED].

* **Sec. 14.** AS 14.25.485(j) is repealed and reenacted to read:

(j) For the purposes of this section, a condition qualifies as an occupational disability if

(1) the condition is a physical or mental condition that the administrator determines presumably permanently prevents an employee from satisfactorily performing the employee's usual duties or the duties of another comparable position or job available to the employee and for which the employee is qualified by training or education; and

(2) the proximate cause of the condition is a bodily injury sustained, or a hazard undergone, while in the performance and within the scope of the employee's duties and is not the proximate result of the wilful negligence of the employee.

* **Sec. 15.** AS 14.25 is amended by adding a new section to read:

Sec. 14.25.486. Disability benefit adjustment. (a) Once each year, the administrator shall increase disability benefits. The amount of the increase is a percentage of the current disability benefit equal to the lesser of 75 percent of the increase in the cost of living in the preceding calendar year or nine percent.

(b) If a disabled member was not receiving a benefit during the entire preceding calendar year, the increase in the benefit under this section shall be adjusted by multiplying it by a fraction, the numerator of which is the number of months for which the benefit was received in the preceding calendar year and the denominator of which is 12.

(c) An increase in benefit payments under this section is effective July 1 of each year and is based on the percentage increase in the Consumer Price Index for

urban wage earners and clerical workers for Anchorage, Alaska, during the previous calendar year, as determined by the United States Department of Labor, Bureau of Labor Statistics.

(d) Benefit adjustments under this section shall terminate the last day of the month following the date on which a disabled member is no longer receiving a disability benefit under AS 14.25.485.

* **Sec. 16.** AS 14.25.487(b) is amended to read:

(b) The first payment of the surviving spouse's pension or of a dependent child's pension shall be made for the month following the month in which the member dies**. Payments** [, AND PAYMENT] shall cease **on the last day of the month in which there is no longer an eligible spouse or eligible dependent child, or the last day of the month following the earliest date** [TO BE MADE BEGINNING WITH THE MONTH IN WHICH] the member would have first qualified for **normal** retirement **if the member had survived, whichever day is earlier**.

* **Sec. 17.** AS 14.25.487(c) is amended to read:

(c) The monthly survivor's pension in (b) of this section for survivors of members is 40 percent of the member's monthly compensation in the month in which the member dies. **While the monthly survivor's pension is being paid, the survivor is not entitled to elect distributions from the member's individual contribution account under AS 14.25.410, except as required by AS 14.25.440.** While the monthly survivor's pension is being paid, the employer shall make contributions on behalf of the member's **surviving spouse and member's surviving dependent children** [BENEFICIARIES BASED ON THE DECEASED MEMBER'S GROSS MONTHLY COMPENSATION AT THE TIME OF OCCUPATIONAL DEATH

(1) TO THE MEMBER'S INDIVIDUAL ACCOUNT UNDER AS 14.25.340, WITHOUT DEDUCTION FROM THE SURVIVOR'S PENSION; AND

(2)] to the appropriate accounts and funds [ON BEHALF OF THE MEMBER] under AS 14.25.350**(b) - (e)**.

* **Sec. 18.** AS 14.25.487(e) is amended to read:

(e) On the date the **member would have first qualified for** normal retirement

[OF THE MEMBER WOULD HAVE OCCURRED] if the member had **survived** [LIVED], the retirement benefit shall be determined under the provisions of AS 14.25.420 - 14.25.440, 14.25.470, and 14.25.480. **In addition to payment of the member's individual account, the surviving spouse or, if there is no surviving spouse, the surviving dependent children of the member, shall receive an additional benefit in an amount equal to the accumulated contributions that would have been made to the deceased member's individual account under AS 14.25.310(a) and 14.25.350(a), based on the deceased member's gross monthly compensation at the time of the member's occupational death, from the time of the member's death to the date the member would have first qualified for normal retirement if the member had survived. Earnings shall be allocated to the additional benefit calculated under this subsection based on the actual rate of return, net of expenses, of the trust account established under AS 14.25.350(c) over the period that the contributions would have been made. This additional amount shall be paid in the same manner as determined for the member's individual account under AS 14.25.420 – 14.25.460.** A member who died and whose survivors receive occupational death benefits under this section shall be considered to have retired directly from the plan on the date the [NORMAL RETIREMENT OF THE] member would have **first qualified for normal retirement** [OCCURRED] if the member had **survived. The period of time during which a survivor's pension is paid under this section constitutes membership service for the purposes of determining vesting in employer contributions under AS 14.25.390(b) and eligibility for retirement and medical benefits under this chapter and AS 39.30.300 - 39.30.495** [LIVED].

*** Sec. 19.** AS 14.25 is amended by adding new sections to read:

Sec. 14.25.488. Survivor's pension adjustment. (a) Once each year, the administrator shall increase payments to a person 60 years of age or older receiving a survivor's pension under AS 14.25.485(i) or 14.25.487(c), and to a person who has received a survivor's pension under AS 14.25.485(i) or 14.25.487(c) for at least eight years if the person is not otherwise eligible for an increase under this section.

(b) The amount of the increase is a percentage of the current survivor's

pension equal to the lesser of 50 percent of the increase in the cost of living in the preceding calendar year or six percent.

(c) If a survivor was not receiving a pension during the entire preceding calendar year, the increase in the survivor's pension under this section shall be adjusted by multiplying it by a fraction, the numerator of which is the number of months for which the pension was received in the preceding calendar year and the denominator of which is 12.

(d) The administrator shall increase the initial survivor's pension paid to a survivor of a member who died while receiving disability benefits by a percentage equal to the total cumulative percentage that has been applied to the member's disability benefit under AS 14.25.486.

(e) An increase in benefit payments under this section is effective July 1 of each year and is based on the percentage increase in the Consumer Price Index for urban wage earners and clerical workers for Anchorage, Alaska, during the previous calendar year, as determined by the United States Department of Labor, Bureau of Labor Statistics.

(f) Pension adjustments under this section shall terminate the last day of the month following the date on which a survivor is no longer receiving a survivor's pension under AS 14.25.485(i) or 14.25.487(c).

Sec. 14.25.489. Premiums for retiree major medical insurance coverage upon termination of disability benefits or survivor's pension. The premium for retiree major medical insurance coverage payable by a member whose disability benefit is terminated under AS 14.25.485(g) or by an eligible survivor whose survivor pension is terminated under AS 14.25.485(i) or 14.25.487(c) when the member would have been eligible for normal retirement if the member had survived shall be determined under AS 14.25.480(g)(2) as if the member or survivor were eligible for Medicare.

*** Sec. 20.** AS 14.25.510 is amended to read:

Sec. 14.25.510. Nonguarantee of returns, rates, or benefit amounts. The plan created by AS 14.25.310 - 14.25.590 is**, with respect to individual accounts, treated as** a defined contribution **plan and** [PLAN,] not **as** a defined benefit plan. The

amount of money in the **individual** account of a participant depends on the amount of contributions and the rate of return from investments of the account that varies over time. If benefits are paid in the form of an annuity, the benefit amount payable is dependent on the amount of money in the account and the interest rates applied and service fees charged by the annuity payor at the time **the annuity is purchased from the carrier and** benefits are first paid. Nothing in this plan guarantees a participant

(1) a rate of return or interest rate other than that actually earned by the account of the participant, less applicable administrative expenses; or

(2) an annuity based on interest rates or service charges other than interest rates available from and service charges by the annuity payor in effect at the time the annuity is paid.

*** Sec. 21.** AS 14.25.540(c) is amended to read:

(c) Each eligible member who elects to participate in the defined contribution retirement plan shall have transferred to a new **individual** account the member contribution account balance held in trust for the member under the defined benefit retirement plan of the teachers' retirement system. A matching employer contribution shall be made on behalf of that employee to the new account. The employer shall make the matching contribution from funds other than the trust funds of the defined benefit retirement plan. **The amount of the matching employer contribution shall be subject to, and may not exceed, the limitation of 26 U.S.C. 415(c) during the applicable limitation year in which the contribution is made.**

*** Sec. 22.** AS 14.25.540(d) is amended to read:

(d) Upon a transfer, all membership service previously earned under the defined benefit retirement plan shall be nullified for purposes of entitlement to a future benefit under the defined benefit retirement plan but shall be credited for purposes of **determining vesting in employer contributions under AS 14.25.390(b) and** eligibility to elect medical benefits under AS 14.25.470. Membership service allowed for credit toward medical benefits does not include any service credit purchased under AS 14.25.075 for employment by an employer who is not a participating employer in this chapter.

*** Sec. 23.** AS 14.25.540(h) is amended to read:

(h) **A member who is eligible to elect transfer to the defined contribution plan must make the election not later than 12 months after the first day of the month following the administrator's receipt of notification that the member's employer consents to transfers of its members under (i) of this section.** The election to participate in the defined contribution retirement plan must be made in writing on forms and in the manner prescribed by the administrator. Before accepting an election to participate in the defined contribution retirement plan, the administrator must provide the employee planning on making an election to participate in the defined contribution retirement plan with information, including calculations to illustrate the effect of moving the employee's retirement plan from the defined benefit retirement plan to the defined contribution retirement plan as well as other information to clearly inform the employee of the potential consequences of the employee's election. An election made under this subsection to participate in the defined contribution retirement plan is irrevocable. Upon making the election, the participant shall be enrolled as a member of the defined contribution retirement plan, the member's participation in the plan shall be governed by the provisions of AS 14.25.310 - 14.25.590, and the member's participation in the defined benefit retirement plan under AS 14.25.009 - 14.25.220 shall terminate. The participant's enrollment in the defined contribution retirement plan shall be effective the first day of the month after the administrator receives the completed enrollment forms. An election made by an eligible member who is married is not effective unless the election is signed by the individual's spouse.

* **Sec. 24.** AS 14.25.590(7) is amended to read:

(7) "compensation"

(A) means

(i) the total remuneration earned by an employee for personal services rendered, including cost-of-living differentials, as reported on the employee's Federal Income Tax Withholding Statement (Form W-2) from the employer for the calendar year;

(ii) the member contribution to the teachers' retirement system under AS 14.25.340;

(B) does not include retirement benefits, severance pay or other separation bonuses, welfare benefits, per diem, expense allowances, workers' compensation payments, payments for leave not used whether those leave payments are scheduled payments, lump-sum payments, donations, or cash-ins, any remuneration contributed by the employer for or on account of the employee under this plan or under any other qualified or nonqualified employee benefit plan, **or** any remuneration not specifically included above that would have been excluded under 26 U.S.C. 3121(a) (Internal Revenue Code) if the employer had remained in the Federal Social Security System [, OR ANY REMUNERATION PAID BY THE EMPLOYER IN EXCESS OF THE SOCIAL SECURITY TAXABLE WAGE BASE FOR THE CALENDAR YEAR];

(C) notwithstanding (B) of this paragraph, includes any amount that is contributed by the employer under a salary reduction agreement and that is not includible in the gross income of the employee under 26 U.S.C. 125, 132(f)(4), 402(e)(3), 402(h)(1)(B), or 403(b) (Internal Revenue Code); the annual compensation limitation for the member, which is so taken into account for those purposes, may not exceed $200,000, as adjusted for the cost of living in accordance with 26 U.S.C. 401(a)(17)(B) (Internal Revenue Code), with the limitation for a fiscal year being the limitation in effect for the calendar year within which the fiscal year begins;

*** Sec. 25.** AS 37.10 is amended by adding new sections to read

Article 4A. Teachers' and Public Employees' Retirement System Past Service Cost Liability Accounts.

Sec. 37.10.200. Teachers' retirement system past service cost liability account. (a) There is established in the Department of Revenue the teachers' retirement system past service cost liability account, consisting of appropriations to the account. The commissioner of revenue shall develop and adopt regulations necessary to accomplish the requirements of this section and shall manage the account according to the requirements of AS 37.10.071.

(b) At the end of each fiscal year, after all distributions under (c) of this

section are completed, money appropriated for use in that fiscal year reverts to the general fund and all income earned on the money shall be paid to the general fund.

(c) During each fiscal year, the commissioner of revenue shall distribute from the account established in (a) of this section, to each employer other than the state that is a member of the Teachers' Retirement System of Alaska, a payment that the employer shall pay to the state for that fiscal year toward eliminating the employer's past service cost liability to the Teachers' Retirement System of Alaska.

(d) A payment to an employer under (c) of this section must be based on 80 percent of the payroll on which employer contributions to the Teachers' Retirement System of Alaska were required and that the employer reported to the Department of Administration for the fiscal year preceding by three fiscal years the fiscal year for which a distribution is made under this section, and the past service cost rate of the system for the fiscal year preceding by three fiscal years the fiscal year for which a distribution is made under this section.

(e) For any fiscal year that the money available for distribution from the account is insufficient to pay every eligible employer the amount due under this section, the amount distributed in that fiscal year to every eligible employer shall be decreased pro rata.

(f) An employer who receives an overpayment in excess of a distribution authorized by this section or in excess of the employer's past service cost liability shall immediately return the overpayment to the commissioner of revenue, who shall cause it to be returned to the account.

Sec. 37.10.202. Public employees' retirement system past service cost liability account. (a) There is established in the Department of Revenue the public employees' retirement system past service cost liability account, consisting of appropriations to the account. The commissioner of revenue shall develop and adopt regulations necessary to accomplish the requirements of this section and shall manage the account according to the requirements of AS 37.10.071.

(b) At the end of each fiscal year, after all distributions under (c) and (d) of this section are completed, money appropriated for use in that fiscal year reverts to the general fund and all income earned on the money shall be paid to the general fund.

(c) During each fiscal year, the commissioner of revenue shall distribute from the account established in (a) of this section, to each municipal employer or school district employer member of the Public Employees' Retirement System of Alaska, a payment that the employer shall pay to the state for that fiscal year toward eliminating the employer's past service cost liability to the Public Employees' Retirement System of Alaska.

(d) A payment to an employer under (c) of this section must be based on the payroll on which employer contributions to the Public Employees' Retirement System of Alaska were required and that the employer reported to the Department of Administration for the fiscal year preceding by three fiscal years the fiscal year for which a distribution is made under (c) of this section and 80 percent of the employer's past service cost rate during the fiscal year that precedes the distribution fiscal year under (c) of this section by three fiscal years.

(e) In addition to the distribution under (c) of this section, an employer that paid to the Public Employees' Retirement System of Alaska in excess of the amount the employer was required to pay for the fiscal year preceding by three fiscal years the fiscal year that a distribution is made under this section shall receive, in unrestricted funds, an incentive distribution from the account in an amount equal to 50 percent of the excess.

(f) For any fiscal year that the money available for distribution from the account is insufficient to pay every eligible employer the amount due under this section, the amount distributed in that fiscal year to every eligible employer shall be decreased pro rata.

(g) An employer who receives an overpayment in excess of a distribution or incentive distribution authorized by this section shall immediately return the overpayment to the commissioner of revenue, who shall cause it to be returned to the account.

Sec. 37.10.204. Definition. In AS 37.10.200 - AS 37.10.204, "past service cost rate" means the annual payment required to eliminate an employer's unfunded liability over the amortization period, divided by the payroll for which employer contributions are required and that is reported by the employer to the Department of Administration

for the fiscal year preceding by three fiscal years the fiscal year that a distribution is made under AS 37.10.200 or 37.10.202.

* **Sec. 26.** AS 39.30 is amended by adding a new section to read:

Sec. 39.30.097. Regulations. The administrator may adopt regulations to administer AS 39.30.090 - 39.30.095. Regulations adopted under this section relate to the internal management of a state agency and are not subject to AS 44.62 (Administrative Procedure Act).

* **Sec. 27.** AS 39.30.154 is amended to read:

Sec. 39.30.154. Powers and duties of the administrator. The administrator has the same powers and duties with regard to the plan as those set out in **AS 14.25.003 and 14.25.004** [AS 14.25.004].

* **Sec. 28.** AS 39.30.160(a) is amended to read:

(a) The Department of Administration shall, in accordance with policies prescribed by regulations **adopted by the commissioner** [OF THE ALASKA RETIREMENT MANAGEMENT BOARD], provide to employees for whom special individual employee benefit accounts are established under AS 39.30.150(c) the following benefit options:

(1) supplemental health benefits;

(2) supplemental death benefits;

(3) supplemental disability benefits; and

(4) supplemental dependent care benefits.

* **Sec. 29.** AS 39.30.160(e) is amended to read:

(e) Regulations adopted by the **commissioner** [BOARD] implementing AS 39.30.150 and this section are not subject to AS 44.62 (Administrative Procedure Act).

* **Sec. 30.** AS 39.30 is amended by adding a new section to read:

Sec. 39.30.165. Appeals. A final decision made under AS 39.30.150 - 39.30.180 is subject to appeal under AS 44.64.

* **Sec. 31.** AS 39.30 is amended by adding a new section to read:

Sec. 39.30.335. Appeals. A final decision made under AS 39.30.300 - 39.30.495 is subject to appeal under AS 44.64.

* **Sec. 32.** AS 39.30.340 is amended to read:

Sec. 39.30.340. Powers and duties of the administrator. The administrator shall establish a teachers' and public employees' retiree health reimbursement arrangement plan trust fund in which the assets of the plan shall be deposited and held. The administrator has the same powers and duties with regard to the plan and the trust fund as provided in **AS 14.25.003 and 14.25.004** [AS 14.25.004].

* **Sec. 33.** AS 39.30.370 is amended to read:

Sec. 39.30.370. Contributions by employers. For each member of the plan, an employer shall contribute to the teachers' and public employees' retiree health reimbursement arrangement plan trust fund an amount equal to three percent of the **average annual compensation of all employees of employers in the plan** [EMPLOYER'S AVERAGE ANNUAL EMPLOYEE COMPENSATION]. The administrator shall maintain a record for each member to account for employer contributions on behalf of that member. The board shall establish by regulation the rate of interest to be applied annually to the amount in a member's individual account.

* **Sec. 34.** AS 39.35.160 is amended by adding a new subsection to read:

(e) Beginning with the payroll for the first pay period in July 2007, a member shall contribute to the plan, in addition to the amount calculated in (a) of this section, an amount equal to five percent of the member's base salary.

* **Sec. 35.** AS 39.35.250 is amended to read:

Sec. 39.35.250. Calculation of employer's contribution rate. (a) An employer shall make contributions to the plan in amounts determined in accordance with this section. For the purposes of this section **and AS 39.35.270**, the [PAST SERVICE DATE FOR EACH EMPLOYER IS THE ENTRY DATE OF THE EMPLOYER OR DECEMBER 31, 1972, WHICHEVER IS LATER. AFTER DECEMBER 31, 1972, IF AMENDMENTS TO AS 39.35.095 - 39.35.680 ARE ENACTED THAT SUBSTANTIALLY AFFECT BENEFITS ACCRUED BEFORE THE EFFECTIVE DATE OF THE AMENDMENT, THE PAST SERVICE DATE WILL BE CHANGED TO DECEMBER 31 OF THE YEAR IMMEDIATELY PRECEDING THAT IN WHICH THE AMENDMENT IS ENACTED. THE] contribution rate is the sum of the consolidated employer **normal cost** rate and the

past service rate **as certified by the board**.

(b) In (a) of this section, "consolidated employer **normal cost** rate" means the percentage of compensation of all active **members** [EMPLOYEES] in the plan which, [IF PAID OVER THE PERIOD OF THEIR CREDITED SERVICE AFTER THEIR PAST SERVICE DATE AND] when combined with all employee contributions **to the plan**, is sufficient to provide the benefits earned **during the year beginning after the last valuation date** [AFTER SUCH PAST SERVICE DATES]. This percentage is [UNIFORMLY] determined **at the plan level** for all employers and is applicable to each employer.

(c) In (a) of this section, "past service rate" means the percentage of compensation of all active **members** [EMPLOYEES] in the **system** [PLAN] necessary to provide the annual amount required to amortize the unfunded obligations of the **plan** [EMPLOYER] for benefits earned **by members in the plan** before the **date of the last actuarial valuation** [EMPLOYER'S PAST SERVICE DATE] over a period not to exceed **the maximum allowed by generally accepted accounting principles of the Governmental Accounting Standards Board** [40 YEARS. THE PERIOD OF AMORTIZATION BEGINS AT THE PAST SERVICE DATE OF EACH EMPLOYER. THE PERCENTAGE IS SEPARATELY DETERMINED FOR EACH EMPLOYER.]

*** Sec. 36.** AS 39.35.270(a) is amended to read:

(a) The amount of each employer's contributions shall be determined by applying the **consolidated employer normal cost** [EMPLOYER'S CONTRIBUTION] rate [, AS CERTIFIED BY THE BOARD,] to the total compensation paid to the **employer's** active **members** [EMPLOYEES] of the **plan and by applying the employer's past service rate to the total compensation paid to the employer's active members in the system** [EMPLOYER] for each payroll period, [AND BY] including any adjustments to contributions required by AS 39.35.520(a). This amount shall be remitted by the employer to the administrator in accordance with AS 39.35.610.

*** Sec. 37.** AS 39.35.375(a) is amended to read:

(a) An active or inactive member who has never been vested in this plan or in

the teachers' retirement plan under AS 14.25.009 - 14.25.220, who has at least two years of credited service in this plan, and who has membership service in the teachers' retirement system may claim credited service in this plan in an amount equal to the membership service the member has in the teachers' retirement system. The claimed credited service may be added to service earned under AS 39.35.095 - 39.35.680 to enable the member to qualify for a public service benefit under this section. The member may not claim credited service for membership service for which the member has received a refund under AS 14.25.150 [UNLESS THE MEMBER FULLY PAYS THE INDEBTEDNESS AS ESTABLISHED UNDER AS 14.25.063]. The member may not claim credited service in this plan based on unused sick leave under AS 14.25.115.

*** Sec. 38.** AS 39.35.385(c) is amended to read:

(c) Credited service for which contributions were refunded is not creditable under this section [UNLESS THE REFUNDED CONTRIBUTIONS HAVE BEEN REPAID. FOR PURPOSES OF (a) AND (b) OF THIS SECTION, A MEMBER OR FORMER MEMBER DOES NOT HAVE TO BE REEMPLOYED UNDER THIS PLAN IN ORDER TO PAY REFUNDED CONTRIBUTIONS. COMPOUND INTEREST AT THE RATE PRESCRIBED BY REGULATION SHALL BE ADDED TO THE REINSTATEMENT INDEBTEDNESS FROM THE DATE OF THE REFUND TO THE DATE OF REPAYMENT].

*** Sec. 39.** AS 39.35.522(d) is amended to read:

(d) **A ruling of the** [THE] commissioner of administration **denying a waiver under this section may be appealed under AS 44.64. The administrative law judge may reverse the ruling of the commissioner and** may impose conditions on the granting of a waiver that **the administrative law judge** [WHICH IT] considers equitable. These conditions may include requiring the member or beneficiary to make additional contributions to the plan.

*** Sec. 40.** AS 39.35.680(3) is amended to read:

(3) "administrator" means [THE PERSON APPOINTED BY] the commissioner of administration **or the commissioner's designee appointed** under **AS 39.35.003** [AS 39.35.050];

* **Sec. 41.** AS 39.35.700 is amended to read:

Sec. 39.35.700. Applicability of AS 39.35.700 - 39.35.990. The provisions of AS 39.35.700 - 39.35.990 apply only to members first hired on or after July 1, 2006, **to members who are employed by employers that do not participate in the retirement benefit plan established under AS 39.35.095 - 39.35.680, to former members as that term is defined under AS 39.35.680,** or to members who transfer into the defined contribution plan under AS 39.35.940.

* **Sec. 42.** AS 39.35.710(c) is amended to read:

(c) The retirement plan established by AS 39.35.700 - 39.35.990 is intended to qualify under 26 U.S.C. 401(a), [AND] 414(d), **and 414(k)** (Internal Revenue Code) as a qualified retirement plan established and maintained by the state for its employees, for the employees of political subdivisions, public corporations, and public organizations of the state, and for the employees of other employers whose participation is authorized by AS 39.35.700 - 39.35.990 and who participate in the plan set out in AS 39.35.700 - 39.35.990.

* **Sec. 43.** AS 39.35.750(e) is amended to read:

(e) An employer shall make annual contributions to **a trust account in** the plan, **applied as a percentage of each member's compensation from July 1 to the following June 30,** in an amount determined by the board to be actuarially required to fully fund the cost of providing occupational disability and occupational death benefits under **AS 39.35.700 - 39.35.990 and retirement benefits elected by disabled peace officers and fire fighters under AS 39.35.890(h)(2)** [AS 39.35.890 AND 39.35.892]. The contribution required under this subsection for peace officers and fire fighters and the contribution required under this subsection for other employees shall be separately calculated based on the actuarially calculated costs for each group of employees.

* **Sec. 44.** AS 39.35.780 is amended to read:

Sec. 39.35.780. Limitations on contributions and benefits. Notwithstanding any other provisions of this plan, the annual additions to each member's individual account under this plan and under all defined contribution plans of the employer required to be aggregated with the contributions from this plan under the provisions of 26 U.S.C. 415 may not exceed, for any limitation year, the amount permitted under 26

U.S.C. 415**(c)** at any time. If the amount of a member's **individual account** [DEFINED CONTRIBUTION PLAN] contributions exceeds the limitation of 26 U.S.C. 415(c) for any limitation year, the administrator shall take any necessary remedial action to correct an excess contribution. **A fixed benefit provided under this plan may not exceed, for or during a limitation year, the amount permitted under 26 U.S.C. 415(b). If a fixed benefit provided under this plan exceeds, for or during a limitation year, the amount permitted under 26 U.S.C. 415(b), the administrator shall take remedial action necessary to comply with the limits on the benefit amount in 26 U.S.C. 415(b).** The provisions of 26 U.S.C. 415, and the regulations adopted under that statute, as applied to qualified [DEFINED CONTRIBUTION] plans of governmental employees are incorporated as part of the terms and conditions of the plan.

*** Sec. 45.** AS 39.35.890(b) is amended to read:

(b) The occupational disability benefits accrue beginning the first day of the month following termination of employment as a result of the disability and are payable the last day of the month. If a final determination granting the benefit is not made in time to pay the benefit when due, a retroactive payment shall be made to cover the period of deferment. The last payment shall be for the first month in which the disabled employee

(1) dies;

(2) recovers from the disability;

(3) fails to meet the requirements under (f), **(j),** or **(l)** [(j)] of this section; or

(4) reaches normal retirement age.

*** Sec. 46.** AS 39.35.890(d) is amended to read:

(d) The monthly amount of an occupational disability benefit is 40 percent of the disabled employee's gross monthly compensation at the time of termination due to disability. **Notwithstanding AS 39.35.790(b), at the time a member is appointed to disability, the member becomes fully vested in the employer contributions made under AS 39.35.750(a). A disabled member is fully vested in the contributions to the member's individual account made under this subsection. An employee is not**

entitled to elect distributions from the employee's individual account under AS 39.35.810 while the employee is receiving disability benefits under this section. While an employee is receiving disability benefits, based on the disabled employee's gross monthly compensation at the time of termination due to disability, the employer shall make contributions

(1) to the employee's individual account under AS 39.35.730 on behalf of the employee, without deduction from the employee's disability payments; and

(2) on behalf of the employee under AS 39.35.750.

*** Sec. 47.** AS 39.35.890(g) is amended to read:

(g) A disabled employee's occupational disability benefit terminates **the last day of the month in which** [WHEN] the disabled employee first **qualifies** [ATTAINS ELIGIBILITY] for normal retirement. At that time, the employee's retirement benefit shall be determined under the provisions of AS 39.35.820 - 39.35.840, 39.35.870, and 39.35.880. An employee **whose occupational disability benefit terminates under this subsection** [RECEIVING DISABILITY BENEFITS UP UNTIL ELIGIBILITY FOR RETIREMENT] shall be considered to have retired directly from the plan.

*** Sec. 48.** AS 39.35.890(h) is amended to read:

(h) Notwithstanding (g) of this section, at the time a peace officer or fire fighter receiving occupational disability benefits under this section first attains eligibility for normal retirement, the employee shall irrevocably elect to receive retirement benefits in the amount calculated as the

(1) employee's retirement benefit calculated under the provisions of AS 39.35.820 - 39.35.840; or

(2) employee's retirement benefit calculated as if the provisions of AS 39.35.370(c) were to apply; however, retirement benefits paid under this paragraph **must be paid first from the peace officer's or fire fighter's individual account, and the remaining benefits must be paid from the trust account established under AS 39.35.750(c); the peace officer or fire fighter may not elect other distributions from the peace officer's or fire fighter's individual account under AS 39.35.810 while receiving retirement benefits under this paragraph** [MAY NOT BE MADE

FROM THE TRUST FUND OF THE PUBLIC EMPLOYEES' DEFINED BENEFIT RETIREMENT PLAN].

* Sec. 49. AS 39.35.890(k) is amended to read:

(k) Upon the death of a disabled employee who is receiving or is entitled to receive an occupational disability benefit, the administrator shall pay the surviving spouse a surviving spouse's pension, equal to 40 percent of the employee's monthly compensation at the termination of employment because of occupational disability. If there is no surviving spouse, the administrator shall pay the survivor's pension in equal parts to the dependent children of the employee. **While the monthly survivor's pension is being paid, the survivor is not entitled to elect distributions from the employee's individual account under AS 39.35.810.** The first payment of the surviving spouse's pension or of a dependent child's pension shall accrue from the first day of the month following the employee's death and is payable the last day of the month. The last payment shall be made **the last day of** [FOR] the last month in which there is an eligible surviving spouse or **dependent** child**, or the last day of the month in which the employee would have first qualified for normal retirement if the employee had survived, whichever day comes sooner. A retirement benefit shall be determined under the provisions of AS 39.35.820 - 39.35.840, 39.35.870, and 39.35.880 based on** [. ON] the date the **employee would have first qualified for** normal retirement [OF THE EMPLOYEE WOULD HAVE OCCURRED] if the employee had **survived. In addition to payment of the member's individual account, the surviving spouse or, if there is no surviving spouse, the surviving dependent children of the member, shall receive an additional benefit in an amount equal to the accumulated contributions that would have been made to the deceased member's individual account under AS 39.35.730(a) and 39.35.750(a), based on the deceased member's gross monthly compensation at the time of occupational disability, from the time of the member's death to the date the member would have first qualified for normal retirement if the member had survived. Earnings shall be allocated to the additional benefit calculated under this subsection based on the actual rate of return, net of expenses, of the trust account established under AS 39.35.750(c) over the period that the contributions**

would have been made. This additional amount shall be paid in the same manner as determined for the member's individual account under AS 39.35.820 – 39.35.860. For the purpose of determining eligibility of an employee's survivor who is receiving a benefit under this subsection for medical benefits under AS 39.35.870 - 39.35.880, an employee [LIVED, THE RETIREMENT BENEFIT SHALL BE DETERMINED UNDER THE PROVISIONS OF AS 39.35.820 - 39.35.840, 39.35.870, AND 39.35.880. AN EMPLOYEE] who died while receiving disability benefits shall be considered to have retired directly from the plan on the date the **employee would have first qualified for normal retirement if the employee had survived. The period during which the employee was eligible for a disability benefit and the period during which a survivor's pension is paid to a survivor under this subsection each constitute membership service for the purposes of determining vesting in employer contributions under AS 39.35.790(b) and eligibility for retirement and medical benefits under this chapter and AS 39.30.300 - 39.30.495** [NORMAL RETIREMENT OF THE EMPLOYEE WOULD HAVE OCCURRED IF THE EMPLOYEE HAD LIVED].

* **Sec. 50.** AS 39.35.890(*l*) is repealed and reenacted to read:

(*l*) For the purposes of this section, a condition qualifies an occupational disability if

(1) the condition is a physical or mental condition that the administrator determines presumably permanently prevents an employee from satisfactorily performing the employee's usual duties or the duties of another comparable position or job available to the employee and for which the employee is qualified by training or education; and

(2) the proximate cause of the condition is a bodily injury sustained, or a hazard undergone, while in the performance and within the scope of the employee's duties and not the proximate result of the wilful negligence of the employee.

* **Sec. 51.** AS 39.35 is amended by adding a new section to read:

Sec. 39.35.891. Disability benefit and disabled peace officer or fire fighter retirement benefit adjustment. (a) Once each year, the administrator shall increase disability benefits and retirement benefits elected by disabled peace officers or fire

fighters under AS 39.35.890(h)(2). The amount of the increase is a percentage of the current disability benefit or retirement benefit equal to the lesser of 75 percent of the increase in the cost of living in the preceding calendar year or nine percent.

(b) If a disabled member was not receiving a benefit during the entire preceding calendar year, the increase in the benefit under this section shall be adjusted by multiplying it by a fraction, the numerator of which is the number of months for which the benefit was received in the preceding calendar year and the denominator of which is 12.

(c) If a disabled peace officer or fire fighter elects to receive a retirement benefit in the amount calculated under AS 39.35.890(h)(2), the administrator shall, at the time the disabled peace officer or fire fighter is appointed to retirement, increase the retirement benefit by a percentage equal to the total cumulative percentage that has been applied to the disabled peace officer's or fire fighter's disability benefit under this section.

(d) An increase in benefit payments under this section is effective July 1 of each year and is based on the percentage increase in the Consumer Price Index for urban wage earners and clerical workers for Anchorage, Alaska, during the previous calendar year, as determined by the United States Department of Labor, Bureau of Labor Statistics.

(e) Benefit adjustments under this section shall terminate the last day of the month following the date on which a disabled member is no longer receiving a disability benefit under AS 39.35.890, unless the member is a disabled peace officer or fire fighter and has chosen a retirement benefit under AS 39.35.890(h)(2).

*** Sec. 52.** AS 39.35.892(b) is amended to read:

(b) The first payment of the surviving spouse's pension or of a dependent child's pension shall be made for the month following the month in which the employee dies. **Payments** [, AND PAYMENT] shall cease **on the last day of the month in which there is no longer an eligible spouse or eligible dependent child, or the last day of the month following the earliest date** [TO BE MADE BEGINNING WITH THE MONTH IN WHICH] the employee would have first qualified for **normal** retirement **if the employee had survived, whichever day is**

earlier.

*** Sec. 53.** AS 39.35.892(c) is amended to read:

(c) The monthly survivor's pension in (b) of this section for survivors of employees who were not peace officers or fire fighters is 40 percent of the employee's monthly compensation in the mon h in which the employee dies. The monthly survivor's pension in (b) of this section for survivors of employees who were peace officers or fire fighters is 50 percent of the monthly compensation in the month in which the employee dies. **While the monthly survivor's pension is being paid, the survivor is not entitled to elect distributions from the employee's individual contribution account under AS 39.35.810, except as required by AS 39.35.840.** While the monthly survivor's pension is being paid, the employer shall make contributions on behalf of the employee's **surviving spouse and employee's surviving dependent children** [BENEFICIARIES BASED ON THE DECEASED EMPLOYEE'S GROSS MONTHLY COMPENSATION AT THE TIME OF OCCUPATIONAL DEATH

(1) TO THE EMPLOYEE'S INDIVIDUAL ACCOUNT UNDER AS 39.35.730, WITHOUT DEDUCTION FROM THE SURVIVOR'S PENSION; AND

(2)] to the appropriate accounts and funds under AS 39.35.750**(b) - (e)**.

*** Sec. 54.** AS 39.35.892(e) is amended to read:

(e) On the date the **employee would have first qualified for** normal retirement [OF THE EMPLOYEE WOULD HAVE OCCURRED] if the employee had **survived** [LIVED], the retirement benefit shall be determined under the provisions of AS 39.35.820 - 39.35.840, 39.35.870, and 39.35.880. **In addition to payment of the member's individual account, the surviving spouse or, if there is no surviving spouse, the surviving dependent children of the member, shall receive an additional benefit in an amount equal to the accumulated contributions that would have been made to the deceased member's individual account under AS 39.35.730(a) and 39.35.750(a), based on the deceased m mber's gross monthly compensation at the time of occupational death, from the time of the member's death to the date the member would have first qualified for normal**

retirement if the member had survived. Earnings shall be allocated to the additional benefit calculated under this subsection based on the actual rate of return, net of expenses, of the trust account established under AS 39.35.750(e) over the period that such contributions would have been made. This additional amount shall be paid in the same manner as determined for the member's individual account under AS 39.35.820 – 39.35.860. An employee who died and whose survivors receive occupational death benefits under this section shall be considered to have retired directly from the plan on the date the [NORMAL RETIREMENT OF THE] employee would have **first qualified for normal retirement** [OCCURRED] if the employee had **survived. The period of time during which a survivor's pension is paid under this section constitutes membership service for the purposes of determining vesting in employer contributions under AS 39.35.790(b) and eligibility for retirement and medical benefits under this chapter and AS 39.30.300 - 39.30.495** [LIVED].

*** Sec. 55.** AS 39.35 is amended by adding new sections to read:

Sec. 39.35.893. Survivor's pension adjustment. (a) Once each year, the administrator shall increase payments to a person 60 years of age or older receiving a survivor's pension under AS 39.35.890(k) or 39.35.892(c), and to a person who has received a survivor's pension under AS 39.35.890(k) or 39.35.892(c) for at least five years if the person who is not otherwise eligible for an increase under this section.

(b) The amount of the increase is a percentage of the current survivor's pension equal to the lesser of 50 percent of the increase in the cost of living in the preceding calendar year or six percent.

(c) If a survivor was not receiving a pension during the entire preceding calendar year, the increase in the survivor's pension under this section shall be adjusted by multiplying it by a fraction, the numerator of which is the number of months for which the pension was received in the preceding calendar year and the denominator of which is 12.

(d) The administrator shall increase the initial survivor's pension paid to a survivor of a member who died while receiving disability benefits by a percentage equal to the total cumulative percentage that has been applied to the member's

disability benefit under AS 39.35.891.

(e) An increase in benefit payments under this section is effective July 1 of each year and is based on the percentage increase in the Consumer Price Index for urban wage earners and clerical workers for Anchorage, Alaska, during the previous calendar year, as determined by the United States Department of Labor, Bureau of Labor Statistics.

(f) Pension adjustments under this section shall terminate the last day of the month following the date on which a survivor is no longer receiving a survivor's pension under AS 39.35.890(k) or 39.35.892(c).

Sec. 39.35.894. Premiums for retiree major medical insurance coverage upon termination of disability benefits or survivor's pension. The premium for retiree major medical insurance coverage payable by an employee or survivor shall be determined under AS 39.35.880(g)(2) as if the employee or survivor were eligible for Medicare

(1) if the employee's disability benefit is terminated under AS 39.35.890(g);

(2) if the survivor pension paid to an eligible survivor under AS 39.35.892(c) is terminated;

(3) if the survivor pension paid to an eligible survivor is terminated under AS 39.35.890(k).

* **Sec. 56.** AS 39.35.910 is amended to read:

Sec. 39.35.910. Nonguarantee of returns, rates, or benefit amounts. The plan created by AS 39.35.700 - 39.35.990 is**, with respect to individual accounts, treated as** a defined contribution **plan and** [PLAN,] not a defined benefit plan. The amount of money in the **individual** account of a participant depends on the amount of contributions and the rate of return from investments of the account that varies over time. If benefits are paid in the form of an annuity, the benefit amount payable is dependent on the amount of money in the account and the interest rates applied and service fees charged by the annuity payor at the time **the annuity is purchased from the carrier and** benefits are first paid. Nothing in this plan guarantees a participant

(1) a rate of return or interest rate other than that actually earned by the

account of the participant, less applicable administrative expenses; or

(2) an annuity based on interest rates or service charges other than interest rates available from and service charges by the annuity payor in effect at the time the annuity is paid.

* **Sec. 57.** AS 39.35.940(c) is amended to read:

(c) Each eligible member who elects to participate in the defined contribution retirement plan shall have transferred to a new account the employee contribution account balance held in trust for the member under the defined benefit retirement plan of the public employees' retirement system. A matching employer contribution shall be made on behalf of that employee to the new account. The employer shall make the matching contribution from funds other than the trust funds of the defined benefit retirement plan established under AS 39.35.095 - 39.35.680. **The amount of the matching employer contribution shall be subject to, and may not exceed, the limitation of 26 U.S.C. 415(c) during the applicable limitation year.**

* **Sec. 58.** AS 39.35.940(d) is amended to read:

(d) Upon a transfer, all membership service previously earned under the defined benefit retirement plan shall be nullified for purposes of entitlement to a future benefit under the defined benefit retirement plan but shall be credited for purposes of **determining vesting in employer contributions under AS 39.35.790(b) and** eligibility to elect medical benefits under AS 39.35.870. Membership service allowed for credit toward medical benefits does not include any service credit purchased for employment by an employer who is not a participating employer in this chapter.

* **Sec. 59.** AS 39.35.940(h) is amended to read:

(h) **An employee who is eligible to elect transfer to the defined contribution plan must make the election not later than 12 months after the first day of the month that follows the administrators receipt of the notification that the employee's employer consents to transfers of its employees under (i) of this section.** The election to participate in the defined contribution retirement plan must be made in writing on forms and in the manner prescribed by the administrator. Before accepting an election to participate in the defined contribution retirement plan, the administrator must provide the employee planning on making an election to participate

in the defined contribution retirement plan with information, including calculations to illustrate the effect of moving the employee's retirement plan from the defined benefit retirement plan to the defined contribution retirement plan as well as other information to clearly inform the employee of the potential consequences of the employee's election. An election made under this subsection to participate in the defined contribution retirement plan is irrevocable. Upon making the election, the participant shall be enrolled as a member of the defined contribution retirement plan, the member's participation in the plan shall be governed by the provisions of AS 39.35.700 - 39.35.990, and the member's participation in the defined benefit retirement plan under AS 39.35.115 shall terminate. The participant's enrollment in the defined contribution retirement plan shall be effective the first day of the month after the administrator receives the completed enrollment forms. An election made by an eligible member who is married is not effective unless the election is signed by the individual's spouse.

* **Sec. 60.** AS 39.35 is amended by adding new sections to read:

Sec. 39.35.957. Designation of eligible employees, agreement to contribute, and amendment of participation. (a) A political subdivision or public organization participating in the defined contribution retirement plan under AS 39.35.700 - 39.35.990 shall designate the departments, groups, or other classifications of employees eligible to participate in the plan and, by participating, shall legally be presumed to have agreed to make contributions each year in the amounts required for members of the plan under AS 39.35.750.

(b) If the employer does not participate in the defined benefit retirement plan under AS 39.35.095 - 39.35.680, an employee who is eligible under (a) of this section and who is a member of the defined benefit retirement plan under AS 39.35.095 – 39.35.680 does not accrue credited service or make contributions under that defined benefit retirement plan, but shall be a member of the defined contribution retirement plan under AS 39.35.700 - 39.35.990 and make contributions under that plan.

(c) An employer may request to amend its participation in the plan to add or exclude departments, groups, or other classifications of employees by filing a resolution as provided by AS 39.35.950 or 39.35.955 with the administrator.

Sec. 39.35.958. Termination of participation in the plan. (a) A political subdivision or public organization may request that its participation in the plan be terminated. The request may be made only after adoption of a resolution by the legislative body of the political subdivision and approval of the resolution by the person required by law to approve the resolution, or, in the case of a public organization, after adoption of a resolution by the governing body of that public organization. A certified copy of the resolution shall be filed with the administrator.

(b) If contributions are not transmitted to the plan within the prescribed time limit, the commissioner of administration may grant an extension and shall assess interest on the outstanding contributions at the rate established under AS 39.35.610. If the political subdivision or public organization is in default at the end of the extension, participation in the plan is terminated, and it shall be sent notice of termination.

(c) When an employer's participation in the plan is terminated, or when an employer terminates coverage of a department, group, or other classification of employees under AS 39.35.957(c), the administrator shall assess the employer an amount that the administrator determines is actuarially required to fully fund the costs to the plan for employees whose coverage is terminated, including the cost of providing the employer's share of retiree health benefits under AS 39.35.880, occupational disability and occupational death benefits under AS 39.35.890 and 39.35.892, and retirement benefits elected under AS 39.35.890(h)(2).

(d) An employee whose coverage under the plan is terminated as a result of termination of an employer's participation under this section or amendment of the employer's agreement under AS 39.35.957(c) shall be considered fully vested in employer contributions under AS 39.35.790(b) and in the individual account established for the employee under AS 39.30.370. If the employee is later employed with a participating employer, the employee's membership service earned under the plan during employment with a terminated employer shall be credited for purposes of determining vesting in employer contributions under AS 39.35.790(b) and eligibility for retirement and medical benefits under this chapter and AS 39.30.300 - 39.30.495.

* **Sec. 61.** AS 39.35.990(7) is amended to read:

(7) "compensation"

(A) means

(i) the total remuneration earned by an employee for personal services rendered, including cost-of-living differentials, as reported on the employee's Federal Income Tax Withholding Statement (Form W-2) from the employer for the calendar year;

(ii) the member contribution to the public employees' retirement system under AS 39.35.730, employee deferrals under AS 39.45.010, the wage reduction amount contributed to the Alaska Supplemental Annuity Plan under AS 39.30.150(a), and the wage reduction amount contributed to the Alaska Supplemental Benefit Plan under AS 39.30.150(c), as those statutes may be amended from time to time;

(B) does not include retirement benefits, severance pay or other separation bonuses, welfare benefits, per diem, expense allowances, workers' compensation payments, payments for leave not used whether those leave payments are scheduled payments, lump-sum payments, donations, or cash-ins, any remuneration contributed by the employer for or on account of the employee under this plan or under any other qualified or nonqualified employee benefit plan, **or** any remuneration not specifically included above which would have been excluded under 26 U.S.C. 3121(a) (Internal Revenue Code) if the employer had remained in the Federal Social Security System [, OR ANY REMUNERATION PAID BY THE EMPLOYER IN EXCESS OF THE SOCIAL SECURITY TAXABLE WAGE BASE FOR THE CALENDAR YEAR];

(C) notwithstanding (B) of this paragraph, includes any amount that is contributed by the employer under a salary reduction agreement and that is not includible in the gross income of the employee under 26 U.S.C. 125, 132(f)(4), 402(e)(3), 402(h)(1)(B), or 403(b) (Internal Revenue Code); the annual compensation limitation for the member, which is so taken into account for those purposes, may not exceed $200,000, as adjusted for the cost of living in accordance with 26 U.S.C. 401(a)(17)(B) (Internal Revenue Code), with the

limitation for a fiscal year being the limitation in effect for the calendar year within which the fiscal year begins;

* **Sec. 62.** AS 39.35.990(16) is amended to read:

(16) "member" **or "employee"** means **a person who is eligible to participate in the plan and who is covered by** [AN EMPLOYEE OF AN EMPLOYER OR FORMER EMPLOYEE OF AN EMPLOYER WHO RETAINS A RIGHT TO BENEFITS UNDER] the plan, **including the governor, the lieutenant governor, or a member of the legislature,** but does not include full-time or part-time instructors of the Department of Labor and Workforce Development **and the Department of Education and Early Development in positions that require a teaching certificate**;

* **Sec. 63.** AS 39.35.990(20) is amended to read:

(20) "peace officer" or "fire fighter" **means an employee occupying a position as a peace officer, chief of police, regional public safety officer, correctional officer, correctional superintendent, fire fighter, fire chief, or probation officer, but does not include a village public safety officer employed by a village public safety officer program established under AS 18.65.670** [HAS THE MEANING GIVEN IN AS 39.35.680];

* **Sec. 64.** AS 39.45.020(a) is amended to read:

(a) The administration of the deferred compensation program for state employees is under the direction of the Department of Administration, **and the administrator has the same powers and duties with regard to the plan and the program as those set out in AS 14.25.003.** A political subdivision coming under the provisions of this chapter shall designate the office or official to **manage** [ADMINISTER] its program.

* **Sec. 65.** AS 39.45.020(c) is amended to read:

(c) The **manager** [ADMINISTRATOR] of a deferred compensation program may contract with a private person for providing consolidated billing and other administrative services [. THE ADMINISTRATOR] may contract with an insurance carrier to reimburse the state or political subdivision of the state for the cost of administering the [DEFERRED COMPENSATION] program.

* **Sec. 66.** AS 39.45 is amended by adding a new section to read:

Sec. 39.45.055. Appeals. A final decision made under AS 39.45.010 - 39.45.060 is subject to appeal under AS 44.64.

* **Sec. 67.** AS 44.64.030(a) is amended by adding new paragraphs to read:

(35) AS 14.25.175 (waiver of adjustments under teachers' defined benefit plan);

(36) AS 39.30.165 (supplemental benefits system);

(37) AS 39.30.335 (teachers' and public employees' health reimbursement arrangement plan);

(38) AS 39.35.522 (waiver of adjustments under public employees' defined benefit plan);

(39) AS 39.45.055 (public employees' deferred compensation program).

* **Sec. 68.** AS 14.25.045, 14.25.340(b), 14.25.570; AS 39.35.050(a), 39.35.375(f), and 39.35.730(b) are repealed.

* **Sec. 69.** Section 107, ch. 9, FSSLA 2005, is repealed.

* **Sec. 70.** Sections 4, 37, and 38 of this Act take effect July 1, 2010.

* **Sec. 71.** Except as provided in sec. 70 of this Act, this Act takes effect July 1, 2007.

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Sponsor Statement
HB 179

The State of Alaska's retirement system unfunded liability is approaching $10 billion. PERS is currently 65% funded and TRS is 60% funded.

HB 179 would implement a comprehensive plan to return the State's crippled retirement system to soundness. It establishes a cost-sharing plan to eliminate the unfunded liability in the defined benefit plans. It obligates the state to pay 80% of the unfunded liability. The other employers would come to the table with 20%. Included in the bill is a plan to raise contribution rates for active legislators, Governors, commissioners, judges, police officers, firefighters, teachers, equipment operators, clerks, accountants, etc...in the defined benefit plans 5% above current levels. Employee contributions would go towards the cost of providing employee benefits in the current period. This three-way partnership ensures that everyone has skin in the game and actively participates in the sacrifice involved in funding the defined benefit plans and returning them to financial soundness. It also makes required technical changes to the state's defined contribution plan.

The Alaska Retirement Management Board recently adopted employer average contribution rates of 54% of wages for TRS and 39% for PERS for FY '08. These employer contribution rates required to eliminate the unfunded liability are simply unsustainable. Bankruptcies and elimination of critical services in our communities will be averted by implementing HB 179. If the state agrees to pick up 80% of the tab, these rates will level off at a high, but sustainable level. HB 179 sets up the accounts necessary to receive payments to extinguish the unfunded liability. It would also accommodate infusions of cash or lump-sum payments at any time the parties choose to use these methods to take advantage of temporary surpluses or debt instruments.

In wrap up, it is important to understand what this bill does and what it does not pretend to do. It does not look back to how we got in this mess. It does not create a single dollar to pay down the $10 billion unfunded liability. What it does provide is a cost-sharing mechanism for completing the tough task of restoring health to our defined benefit plans. You may argue it is too high for the state at 80%. You may argue that it will upset the active plan members that are covered. I would argue that when the all-in cost of

providing benefits in the old defined benefit plans have tripled since 1999, the legislature would be derelict in our duties if we did not look to all parties to assist us, including the beneficiaries who enjoy the benefits of the old systems which have proven over-rich and unsustainable.

MEMORANDUM

State of Alaska

Department of Law

TO: Ray Matiashowksi, Commissioner
Department of Administration

DATE: April 20, 2005

OUR FILE: 663-05-0192

Thru: Scott Nordstrand
Deputy Attorney General - Civil
Attorney General's Office

TELEPHONE NO: 465-3600

FROM: Virginia B. Ragle
Assistant Attorney General
Labor & State Affairs Section - Juneau

SUBJECT: Retirement system amendments - constitutional issues

You have asked three questions regarding application of proposed legislative modifications of the state's public employees' (PERS) and teachers' (TRS) retirement systems to current members of the systems. Those questions are:

1. Is it allowable to increase PERS and TRS contribution rates for individuals who became members of the systems before the effective date of the rate increases?

2. Is it allowable to discontinue pre nding the medical component or set a rate that targets less than 100 perc.. funding for existing members or new members?

3. Is it allowable to prospectively not pay existing members new [or additional] ad hoc post retirement pension adjustments (PRPAs)? If not, could a new statutory provision reduce the existing number of members eligible for this benefit prospectively to reduce costs to the system?

While we believe that definitive answers to these questions will only be provided by the Alaska Supreme Court, based on our review of existing case law our, short answers to these questions are:

1. PERS and TRS contribution rates may be increased for individuals who became members of the systems before the effective date of the rate increases if the increases are accompanied by comparable enhancements to benefits.

2. Pre-funding of the medical component of PERS and TRS benefits, to the extent that pre-funding would be considered an accrued benefit, may not be discontinued for members who were employed during the period that statutes required pre-funding. Funding of medical benefits may be set at less than 100% funding for new members.

3. If the financial condition of the funds does not permit payment of the PRPA, it is allowable to prospectively not pay existing members new [or additional] ad hoc PRPAs. A new statutory provision cannot reduce the existing number of members who retain a vested right to a PRPA if one is awarded, unless the new statutory provision includes comparable enhancements to benefits.

The above responses might be different if it were established that application of modification of the retirement systems to current members is necessary to allow the retirement systems to pay current benefit claims.

ALASKA CASE LAW

Each of these questions raises substantial legal issues under Alaska Constitution article XII, section 7, as interpreted by the Alaska Supreme Court. That constitutional provision provides:

> **Retirement Systems.** Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of those systems shall not be diminished or impaired.

There is a substantial body of Alaska jurisprudence interpreting article XII, section 7 of the Alaska Constitution. Since this case law guides our advice on the issues you have raised, we provide the following synopses of the most pertinent Alaska Supreme Court cases.

State ex rel. Hammond v. Allen, 625 P.2d 844 (Alaska 1981)

The Alaska Supreme Court first interpreted Alaska Constitution article XII, section 7 in the case of *State ex rel. Hammond v. Allen*, 625 P.2d 844 (Alaska 1981). That case involved the Elected Public Officers' Retirement System (EPORS), which was established by the enactment of chapter 205, SLA 1975. A referendum petition to repeal the Act was filed in September 1975, before the Act became effective on

January 1, 1976.[1] Following passage of the referendum by a substantial majority of the voters in an election on August 24, 1976 (effective October 14, 1976), the state filed an action for declaratory judgment, arguing that article XII, section 7 did not apply and that the repeal was effective as to "officials who were participating in EPORS at the time of its repeal, but who were not then entitled to benefits." 625 P. 2d at 845.

The court held that article XII, section 7 did apply, and that even "the extreme likelihood of the subsequent repeal" of EPORS did not constitute an implicit condition subsequent that would extinguish the state's contractual obligation to provide benefits under EPORS.[2] The court concluded that "[a]ll elected officials who were participating in EPORS at the time its repeal became effective will, therefore, be entitled to the benefits provided by that system upon retirement." Under this holding, the state was required to permit even those EPORS members who had not met the minimum age or service requirements for retirement to continue to participate in the repealed retirement system.

***Hammond v. Hoffbeck*, 627 P.2d 1052 (Alaska 1981)**

Later in 1981, the court issued its opinion in *Hammond v. Hoffbeck*, 627 P.2d 1052 (Alaska 1981). In that case, public safety employees challenged statutory changes enacted in 1976 regarding PERS occupational disability and death benefits. Two of the challenged statutory changes reduced the amount of benefits, and one modified the eligibility requirements for occupational disability benefits.

The court first had to address whether an employee's rights to benefits under PERS vest on employment and enrollment in the system or only at the time when the employee becomes eligible to receive those benefits. The court ruled that under the Alaska Constitution, the former applied.[3] The court stated

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[1] The repealed provisions of EPORS are set out in the editor's notes to AS 39.37.

[2] The court observed "[w]e believe that if the possibility of repeal of a law could function as an implicit condition subsequent to a contract formed under that law, the protection of contract rights afforded by article XII, section 7, would be seriously eroded."

[3] The court noted that it had "previously held that the phrase 'accrued rights' is synonymous with 'vested' rights. *Bidwell v. Scheele*, 355 P.2d 584, 586 (Alaska 1960)." *Id.* at n.4.

> We are of the view that the plain meaning of Alaska Const. Art. XII, § 7, as well as the purposes underlying its adoption, compels such a conclusion. Furthermore, a review of the relevant case authority from several jurisdictions has persuaded us that this rule represents the better reasoned of the alternative approaches that have been adopted. The rule that regards members' rights in public employees' benefits systems as vested only at the time which an individual employee is eligible to receive payment of those benefits necessarily depends in some degree upon the anachronistic notion that such benefits are in the "nature of a bounty springing from the appreciation and graciousness of the sovereign." . . . . Under the rule mandated by Alaska's Constitution, on the other hand, these benefits are regarded as an element of the bargained-for consideration given in exchange for an employee's assumption and performance of his employment. This approach, in our view, more accurately reflects the realities of public employment in Alaska.

Id. at 1056-57 (citations omitted). Therefore, the court held

> that benefits under PERS are in the nature of deferred compensation and that the right to such benefits vests immediately upon an employee's enrollment in that system.

Id. at 1057.

Recognizing that "rigid adherence to labels like 'gratuity,' 'compensation,' 'contract,' and vested rights' has not allowed the courts the flexibility necessary to deal properly with legitimate legislative response to changing economic and social conditions," the court found California's "'limited vesting' approach to be instructive." *Id.* The court agreed with the California court's analysis[4] and held

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[4] *Citing Betts v. Board of Administration of the Public Employees' Retirement System*, 582 P.2d 614, 617 (1978) (1974 amendment changing "fluctuating" computation method to less beneficial "fixed" computation method included no comparable new advantages and could not constitutionally be applied to official whose employment was performed before the amendment); *Allen v. City of Long Beach*, 287 P.2d 765 (CA 1955) (invalidating city's increase in employee contribution rate, change in method of computing benefits, and change in contribution requirements upon reinstatement of employment following absence for military service).

> the fact that rights in PERS vest on employment does not preclude modifications of the system; that fact does, however, require that any changes in the system that operate to a given employee's disadvantage must be offset by comparable new advantages to that employee.

Id. The court reserved judgment on changes to the retirement system that might be needed to sustain a retirement system that could not pay all the benefits it owed. In footnote 11, the court stated:

> We are not called upon to consider the problem, which has frequently arisen in other jurisdictions, presented by a pension fund that is insufficient to satisfy all employee claims brought under its provisions. We intimate no view as to the appropriate legal analysis of any legislative alteration in employee benefits systems made in response to such circumstances.

Id.

Addressing the amendment to the method of computation of PERS occupational disability benefits, the court held that "at least as to some individuals, the new system cannot be said to offer advantages which outweigh its obvious disadvantages." *Id.* at 1058.

Regarding the change in eligibility requirements for occupational disability benefits, the court rejected the state's argument that eligibility standards were not part of the vested benefits protected by article XII, section 7. The court stated that the protected vested benefits "necessarily include not only the dollar amount of the benefits payable, but the requirements for eligibility as well." The court regarded "it as self-evident that this change will entail serious disadvantage" to certain injured public safety employees. *Id.*

The court rejected the state's argument that modification to PERS death benefits could be applied to current employees because rights to those benefits do not vest until the death of an employee. The court reasoned

> It is not the vesting of survivors' benefits that is at issue; it is rather the vesting of employee benefits. The fact that part of an employee's benefit package is, effectively, a life insurance policy, the proceeds of which will never be received by the employee, does not make that whole package any less an element of the consideration that the state contracts to tender in exchange for services rendered by the employee.

Id. at 1059.

The court concluded that the three challenged modifications to PERS "violate Alaska Const. Art. XII, § 7, as to those public safety employees who are adversely affected by them." The court noted "that a determination of whether vested rights to benefits have been diminished must be made on a case-by-case basis" and that the "choice is best made by each affected individual." *Id.* However, the court reversed the superior court's holding that the amendments were invalid as to all public safety employees. The court's interpretation rendered "the 1976 amendments . . . constitutional except as to public safety employees hired before July 1, 1976, who opt to receive benefits under the system in effect at the time they were hired." *Id.*

***Sheffield v. APEA*, 732 P.2d 1083 (Alaska 1987)**

The court next interpreted Alaska Constitution article XII, section 7 in the case of *Sheffield v. APEA*, 732 P.2d 1083 (Alaska 1987). That case involved statutes allowing employees to take early retirement, and also requiring that early retirement benefits be actuarially adjusted. "Actuarial adjustment" was statutorily defined as "equality in value of the aggregate expected payments under two different forms of pension payments, considering expected mortality and interest earnings on the basis of tables adopted from time to time by the board."

A new, more accurate table of early retirement factors adopted by the board in 1981 resulted in computation of slightly lower early retirement benefits than the 1972 table of factors previously in effect. APEA sued to prevent application of the factors in the new table to employees hired before the board adopted the new table. APEA also stipulated that the factors set out in the new table came "closer to achieving equality in value of aggregate payments as between early and normal retirement than would be possible under the old factors." *Id.* at 1084

The court quoted favorably from a case interpreting Massachusetts' law regarding contractual rights to public employee retirement benefits:

> The minimal meaning ... is that the "contract" is formed when a person becomes a member by entering the employment, and he is entitled to have the level of rights and benefits then in force *preserved in substance in his favor without any modification downwards*.... When we speak of the level of rights and benefits protected by [this statute] we mean the *practical effect of the whole complex of provisions* not excluding the [employees' contributions], for an increase in the [rate thereof] is little different from a diminution of the allowance.

Id. at 1087, *quoting Opinion of the Justices*, 303 N.E.2d 320, 327 (Mass. 1973) (emphasis added by court). Adhering to its case-by-case diminishment analysis in *Hoffbeck*, the court held that employees had a vested right to application of the more-favorable factors in effect during their employment. The court noted that

> If the PERS board repeatedly revises the tables during the course of an employee's employment, we think the employee should be permitted to elect which of those tables will apply to the computation of his or her PERS early retirement benefits. *Cf. Hoffbeck*, 627 P.2d at 1059 n. 13 ("Upon remand the state is to give requisite notice to and a reasonable time for all those public safety employees affected to exercise their right to choose which system they desire to come under.").

Id. at 1089 n.13. The court explained

> To hold that employees have a right only to early retirement benefits which are subject to actuarial changes until retirement would vitiate Alaska's constitutional protection of accrued benefits for those employees who anticipate early retirement: they could not count on any particular amount of pension but only that they will receive one. We therefore hold that the plain meaning of Alaska Const. Art. XII, § 7 should be interpreted to cover the diminution in early retirement benefits at issue, without regard to the fact that the diminution is accomplished through regulations (the actuarial factors) contemplated by the PERS statutes.

Id. at 1089.

***Flisock v. State, Div. of Retirement and Benefits*, 818 P.2d 640 (Alaska 1991)**

In 1991, the court again interpreted Alaska Constitution article XII, section 7 in the case of *Flisock v. State, Div. of Retirement and Benefits*, 818 P.2d 640 (Alaska 1991). That case involved a claim by a TRS member that the determination of the "base salary" to be used in the computation of his benefit should include a lump sum payment he received for unused leave he accrued during a six year period of employment with one of his employers.

The court stated the first issue in the case as being whether the Alaska Constitution required "that Flisock's retirement benefits be calculated in accordance with the law and practice in 1969, the year in which he first entered" TRS. *Id.* at 643. Citing the *Hoffbeck* and *Sheffield* cases, the court held that "Flisock is entitled to have his benefits calculated according to 1969 law." *Id.* The court interpreted the law in effect in 1969 as allowing Flisock to include in his base salary the portion of the lump sum that represented compensation for unused leave accrued during the three years used for computation of his benefit. *Id.* at 644.

***Municipality of Anchorage v. Gallion*, 944 P.2d 436 (Alaska 1997)**

In 1997, the Alaska Supreme Court issued its opinion in the case of *Municipality of Anchorage v. Gallion*, 944 P.2d 436 (Alaska 1997). That case involved a challenge to a Municipality of Anchorage (MOA) ordinance that affected the funding of the Anchorage Police and Fire Retirement System (APFRS). APFRS consisted of three plans with different levels of benefits and eligibility requirements, and with membership based primarily on date of hire. In 1994, Plans I and II were more than 100 percent funded, and Plan III was 89 percent funded. Although MOA had historically funded the plans separately under its ordinances, in 1994 MOA enacted an ordinance providing that contributions were not required if "the Board's actuary determines that the funds necessary to pay the actuarial liability for the benefits for system members contained herein are available from the total assets of the system." *Id.* at 439. MOA had already suspended contributions to Plans I and II. Based on the new ordinance, and the fact that the system considered as a whole was funded at over 100 percent of projected li abilities, MOA discontinued contributions to Plan III.

Anchorage Police and Fire Retirement System members sued on behalf of Plans I and II, contending that MOA's diversion of funds from those plans violated Alaska Constitution article XII, section 7. In discussing the constitutional standard to be applied, the court pointed out that, in the *Sheffield* case, it had adopted the reasoning of the Massachusetts Supreme Court when

> we made it clear that the benefits in force at the time of enrollment in the system will be protected, stating:
> [A member] is entitled to have the level of rights and benefits then in force *preserved in substance in his favo without any modification downwards.* ... When we speak of the level of rights and benefits protected by [this statute] we mean the *practical effect of the whole complex of provisions....*
> *Id.* at 1087 (quoting *Opinion of the Justices*, 364 Mass. 847, 303 N.E.2d 320, 327 (1973) (emphasis added)).

Id. at 441. Dispelling any notion that rights protected by the constitution are limited to the amount of and eligibility requirements for benefits,[5] the court held that MOA's ordinance impaired

> the vested right of members of Plans I and II to have the actuarial soundness of those plans evaluated and maintained separately without being affected by the soundness of other plans. That failure impairs the ability of Plans I and II to withstand future contingencies, such as increases in plan obligations, declines in investment reven , and inability by MOA to fund any shortfall. It is therefore unconstitutional.

Id. at 444. The court declined to adopt the reasoning of case law from other jurisdictions that upheld allocations of fund earnings or surpluses to supplemental benefits because those allocations did not diminish or impair payment of full benefits[6] or to an underfunded plan because the system remained actuarially sound.[7] Instead, the court was persuaded by *Valdes v. Cory*, 139 Cal. App.3d 773, 189 Cal. Rptr. 212 (1983). In *Valdes*, the Court of Appeal for the Third District of California held that provisions of emergency

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[5] In the 1988 case of *Rice v. Rice*, 757 P.2d 60 (Alaska 1988), the court mentioned that "[t]he modifications to PERS which we have found to operate to disadvantage an employee are those changes which reduce the dollar amount of the benefits payable or the requirements for eligibility." 757 P.2d at 62 (citations omitted).

[6] *Poggi v. City of New York*, 109 A.D 2d 265, 491 N.Y.S.2d 331 (1985), *aff'd*, 67 N.Y.2d 794, 501 N.Y.S.2d 397 (1986); *Halstead v. City of Flint*, 127 Mich. App. 148, 338 N.W.2d 903 (1983).

[7] *State ex rel. Dadisman v. Caperton*, 413 S.E.2d 684 (W. Va. 1991).

legislation passed by the California legislature suspending employer contributions to the state's retirement systems for three months during a budget crisis interfered "with vested contractual rights of PERS members." 189 Cal. Rptr. at 223. The Alaska Supreme Court explained that, although the California legislature's action

> had not reduced employee benefits under the system, the [California] court determined that the state could not suspend its statutorily defined contributions absent actuarial input to insure that the system would remain actuarially sound. *Id.* at 223. The court stated that although an employee may not suffer out of pocket expenses, "the interest of the employee at issue here is the security and integrity of the funds available to pay future benefits." *Id.* at 222.

944 P.2d at 445.

***Duncan v. Retired Public Employees of Alaska*, 71 P.3d 882 (Alaska 2003)**

The Alaska Supreme Court's most recent case interpreting Alaska Constitution article XII, section 7 is *Duncan v. Retired Public Employees of Alaska*, 71 P.3d 882 (Alaska 2003). In that case, Retired Public Employees of Alaska and other plaintiffs challenged modifications to the retiree health plan made by the state in 1999 and 2000. Some of the modifications "provided greater benefits; others were disadvantageous to retirees." *Id.* at 885. In its overview of article XII, section 7, the court quoted from its *Hoffbeck* analysis of the vesting of an employee's right to benefits upon employment and enrollment in the system, and explained that "[t]his means that system benefits offered to retirees when an employee is first employed and as improved during the employee's tenure may not be 'diminished or impaired.'" *Id.* at 886-87. The court reiterated that vested benefits are subject to reasonable modification, "[b]ut to be sustained as reasonable, changes that result in disadvantages to employees should be accompanied by comparable new advantages." *Id.*

The court rejected the state's argument that health insurance benefits, which were not provided by territorial retirement systems when the Alaska Constitution was ratified, were not intended to constitute "accrued benefits." The court observed that its "case law suggests that 'accrued benefits' should be defined broadly." *Id.* at 887. The court concluded

> that the term "accrued benefits" is not limited to just the benefits that were provided to public employees at the time of ratification of the constitution. Instead, the term includes all retirement benefits that make up the retirement benefit package that becomes part of the contract of employment when the public employee is hired, including health insurance benefits.

Id. at 888. The court acknowledged "that medical costs are rapidly rising, making health insurance increasingly difficult to provide. But we do not believe that this fact is of sufficient weight to change the meaning of the plain language of article XII, section 7." *Id.*

The court also rejected the state's argument that the "accrued benefit" was not the level of coverage provided, but was the highest amount of the monthly premium for retiree health coverage in effect during an employee's employment. The court stated

> The natural and ordinary meaning of "benefits" in a health insurance context refers to the coverage provided rather than the cost of the insurance. Further, the various employee publications promise coverage, not merely payment of a particular premium.

Id. at 888-89. The court acknowledged that "[t]he state's argument that the pension system may at some point be threatened by increasing costs of health care is a serious one. Again however, we do not believe that this argument is sufficient to change the meaning of the constitutional language in question." *Id.*

The court agreed with the state's third argument, concluding that the determination of whether detrimental changes in retiree health coverage are offset by comparable new beneficial changes must be made from a group standpoint rather than on an individualized basis. The court reasoned that

> Changes to fixed streams of income such as occupational disability and pension payments can be much more readily evaluated on an individual basis to determine whether they result in a net benefit than can changes to health insurance. Pension and occupational disability payments are, for the most part, predictable and fixed, while health insurance benefits change according to the unpredictable, changing medical needs of each individual.

Id. at 891. The court cautioned that

> equivalent value must be proven by reliable evidence. Just as with an individual comparative analysis, offsetting advantages should be established under the group approach by solid, statistical data drawn from actual experience--including accepted actuarial sources--rather than by unsupported hypothetical projections.

Id. at 892. The court indicated that some individuals could suffer serious hardship from changes in medical coverage that are constitutionally acceptable from a group standpoint. Contrasting the serious hardship established in *Hoffbeck* with the examples of detriments offered in the *Duncan* case, which amounted to "at most several hundred dollars a year, without consideration of [offsetting] benefits," the court stated that individuals who showed serious hardship caused by substantial detriments that are not offset by comparable advantages "should be allowed to retain existing coverage." *Id.*

RESPONSE TO QUESTIONS

1. **PERS and TRS contribution rates may be increased for individuals who became members of the systems before the effective date of the rate increases if the increases are accompanied by comparable enhancements to benefits.**

Alaska Supreme Court case law summarized above is clear in establishing the date of enrollment in a public retirement system as the date upon which an employee's rights are "vested" or "accrued" under the retirement system. [8] That case law also establishes that "accrued benefits" protected by article XII, section 7 broadly include not just the amount of and eligibility requirements for benefits, but also "the practical effect of the whole complex of provisions" of the systems. *Gallion*, 944 P.2d at 441; *Sheffield*, 732 P.2d at 1087 (both quoting *Opinion of the Justices*, 303 N.E.2d 320, 327 (Mass. 1973)).

Although a majority of the Alaska Supreme Court has not addressed the specific issue of the circumstances under which the state's retirement systems may be amended to raise employee contribution levels, cases that the court has cited, and on which the court has relied, do address the issue.

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[8] Following the Alaska Supreme Court's issuance of its opinion in *Hoffbeck*, this office advised the commissioner of administration that the state could not, by statute, raise the employee contribution rate for teachers employed before the rate increase. 1983 Inf. Op. Att'y. Gen. (366-329-83; February 14).

The Alaska Supreme Court cited the 1955 case of *Allen v. City of Long Beach*, 287 P.2d 765 (CA 1955), in *Hoffbeck*, adopting the California Supreme Court's "limited vesting" and "comparable advantage" approach. *Hoffbeck*, 627 P 2d at 1057. In the *City of Long Beach* case, the California court specifically considered the 1951 modification of a pension plan by the city, increasing the contribution rate of employees hired before March 29, 1945, from 2 percent to 10 percent. The court stated that the change to the city's charter:

> substantially decreases plaintiffs' pension rights without offering any commensurate advantages, and there is no evidence or claim that the changes enacted bear any material relation to the integrity or successful operation of the pension system established by section 187 of the charter.
>
> The provision raising the rate of an employee's contribution to the city pension fund from 2 percent of his salary to 10 percent obviously constitutes a substantial increase in the cost of pension protection to the employee without any corresponding increase in the amount of the benefit payments he will be entitled to receive upon his retirement.

287 P.2d at 767. The court invalidated the city charter provision increasing the contribution rate.[9]

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[9] Other California contribution rate cases include *Wisley v. City of San Diego*, 188 Cal.App.2d 482, 10 Cal. Rptr. 765 (1961) (successive amendments gradually increasing employee contribution rates from one percent to eight percent were obviously detrimental and there was no showing of commensurate benefit or that increases were necessary to the integrity or successful operation of the pension program; holding that the contribution rate increases could not be sustained as reasonable as applied to the plaintiffs); and *City of Downey v. Board of Administration, Public Employees' Retirement System*, 47 Cal. App.3d 621, 121 Cal. Rptr. 295 (1975) (detrimental change in contribution rate from individual actuarial computation of portion of benefits employee would receive to flat seven percent of salary was outweighed by increase in retirement allowance, reduction in mandatory retirement age, and option of benefit for spouse).

The Massachusetts case *Opinion of the Justices,* 303 N.E.2d 320 (Mass. 1973), on which the court relied in adopting the interpretation that "accrued benefits" include "the practical effect of the whole complex of provisions" of the retirement systems (*Gallion,* 944 P.2d at 441; *Sheffield,* 732 P.2d at 1087) also involved proposed legislation to raise the employee contribution rate.[10] The Massachusetts court explained that a proposed increase in the employee contribution rate from five percent to seven percent

> would mean a forty percent increase of the member contributions providing the annuity share of the yearly allowance, and a comparable decrease in the pension share provided by the government, for the pension share represents roughly the difference between what the member has created in the way of an annuity and the fixed yearly retirement to which he is entitled. The member would pay more without any enlargement of the benefits.

303 N.E.2d at 324. The Massachusetts court stated

> Legislation which would materially increase present members' contributions without any increase of the allowances finally payable to those members or any other adjustments carrying advantages to them, appears to be presumptively invalid--invalid, that is to say, unless saved by the reserved police powers. . . . That the maintenance of a retirement plan is heavily burdening a governmental unit has not itself been permitted to serve as justification for a scaling down of benefits figuring in the 'contract,' although no case presenting proof of a catastrophic condition of the public finances has been put.

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[10] Massachusetts does not have a constitutional provision comparable to Alaska Constitution article XII, section 7. The court applied Massachusetts statute section 25(5) of G.L. c. 32, which provided that the retirement system statutes "shall be deemed to establish . . . membership in the retirement system as a contractual relationship under which members who are or may be retired for superannuation are entitled to contractual rights and benefits, and no amendments or alterations shall be made that will deprive any such member or any group of such members of their pension rights or benefits provided for thereunder, if such member or members have paid the stipulated contributions . . . ." 303 N.E.2d at 322-23.

Id. at 329-30 (citations omitted). The Massachusetts court concluded that the proposed increase in contribution rate of members of the retirement system was presumptively invalid. *Id.* at 331. The court also concluded that the contribution rate could be applied to employees hired after enactment of the new rate. *Id.*

In addition to these cases from other jurisdictions on which the Alaska Supreme Court has relied, the case of *Hudson v. Johnstone*, 660 P.2d 1180 (Alaska 1983), provides insight as to the probable outcome of a challenge to application of increased contribution rates to current employees. In *Johnstone*, the Alaska Supreme Court considered amendments to the Judicial Retirement System (JRS). Before July 1, 1978, judges were not required to make contributions to JRS. Amendments enacted in 1978 kept JRS non-contributory for judges appointed before July 1, 1978, and made JRS contributory for judges hired after that date. AS 22.25.011. The court upheld the amendments, without citing Alaska Constitution article XII, section 7. Justice Rabinowitz wrote a concurring opinion analyzing that constitutional provision, and opined:

> . . . . under the provisions of article XII, section 7, justices and judges appointed on or before July 1, 1978, are constitutionally entitled to receive benefits under the non-contribution retirement system established prior to the enactment of AS 22.25.011. Thus the legislature is precluded from requiring such judges to contribute toward their retirement benefits even when they commence new "terms of office."

Id. at 1187. Justice Rabinowitz reviewed the 1981 cases of *State v. Allen* and *Hammond v. Hoffbeck*, and stated his view that those cases "preclude the legislature from requiring the members of the judiciary appointed on or before July 1, 1978, from contributing toward their retirement benefits, absent some offsetting comparable new advantage." *Id.* at 1188.

In your request for advice, you mention a memorandum dated January 29, 2005, from the Legislative Affairs Agency's Division of Legal and Research Services ("LAA memorandum") to Representative Mike Kelly regarding "[a]ccrued benefits of public employment retirements systems and legislative changes to the employee contribution rate." That memorandum acknowledges that, under *Hoffbeck*, a challenge may be raised to an increase in employee contribution rates, but states that

> [a] strong counter argument could be made that the employee contribution rates are not part of the 'accrued benefit' to which members are entitled. The accrued benefits are the rights to receive the retirement and medical plan offered upon employment; the rights accrue as they are earned. A person's contribution rate cannot be changed retroactively for benefits that have already accrued, however, it can be argued that the employee contribution rate can change prospectively to pay for vested benefits.

These statements and the analysis that follows them in the LAA memorandum are not consistent with the Alaska Supreme Court's repeated rulings that an employee's rights under the retirement systems vest – i.e., are "accrued" – at the time the employee first enrolls in the system, and that those accrued rights include not only the amount of and eligibility requirements for benefits, but also "the practical effect of the whole complex of provisions" of the systems.[11] In the one case cited by the LAA memorandum in which an increase in the contribution rate of a group of teachers was approved, the Michigan Supreme Court relied on Michigan constitutional history indicating that the framers intended to protect retirees from diminishment of rights "after the service has been performed." *Request for Advisory Opinion, In re Enrolled Senate Bill 1269*, 389 Mich. 659, 209 N.W.2d 200, 202 (Mich. 1973). There is no comparable Alaska constitutional history, and this is contrary to Alaska case law regarding accrual of benefits under the Alaska Constitution.[12]

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[11] The LAA opinion discusses the *Hoffbeck* case, then states that "the next discussion of Article XII, sec. 7 by the Alaska Supreme Court occurred in 2003" citing the *Duncan* case. The LAA memorandum does not address the earlier *Hammond v. Allen* case, or the intervening *Sheffield v. APEA*, *Flisock v. State*, and *MOA v. Gallion* cases.

[12] The case cited in the LAA memorandum in support of the proposition that public employees could choose to resign instead of paying increased contributions did not construe a retirement statute. In *Cook v. City of Binghamton*, 398 N.E.2d 525 (N.Y. 1979), the court upheld changes to a general law that provided for continued payment of salary and medical benefits to certain firemen who were disabled by injuries while performing their duties.

The LAA memorandum correctly points out that increases in contribution rates have been applied to current employees in the past – specifically in 1986 for PERS members and in 1990 for TRS members – without creating a new tier and without drawing legal challenges.[13] However, the 1986 and 1990 legislation that raised the contribution rates included provisions intended to enhance benefits to offset the rate increases. For example, in addition to increasing the PERS contribution rate, the 1986 legislation added the automatic actuarially funded PRPA, increased some of the multipliers for computation of benefits, and made contributions pre-tax. Ch. 82, SLA 1986.

The bill review that the attorney general's office provided to the Governor in 1986 described the increase in the contribution rates for PERS members, and explained that because of the pre-tax treatment, little if any change in the take-home pay of employees would result.[14] The bill review also explained that the bill provided "additional benefits to . . . offset any diminution in benefits resulting from the increase in the contribution rate. The most significant and valuable of these additional benefits is the automatic, actuarially funded (PRPA) . . . ." Other provisions of the 1986 legislation that would constitute diminishments of benefits, such as the increase in early and normal retirement ages, the requirements that retirees under the age of 60 pay full premiums and retirees between the ages of 60 and 65 pay half premiums for medical coverage, and limits on inclusion of geographic cost of living differentials in computation of benefits, were made applicable only to employees hired after July 1, 1986 (this created PERS Tier II).

Similarly, Ch. 97, SLA 1990 raised the TRS contribution rates, and also made offsetting changes making the contributions pre-tax, increasing a multiplier, and adding the automatic actuarially funded PRPA. Again, the increase in the early and normal retirement ages for teachers with less than 20 years of service and the medical coverage premium requirement applied only to teachers hired after June 31, 1990 (this created TRS Tier II).

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[13] Footnote 3 of the LAA memorandum mentions that the contribution rate was "last increased in 1999" for PERS school district employees. However, the 1999 contribution rate increase was not imposed on school district PERS employees. Under the 1999 legislation, noncertificated PERS employees of school districts who worked during the school year, and therefore did not accrue a whole year of service credit under PERS each year, were allowed to elect to pay a higher contribution rate in exchange for accrual of a full year of service credit. Ch. 22, SLA 1999.

[14] File no. 883-86-0140.

In applying Alaska Supreme Court case law interpreting Alaska Constitution article XII, section 7 to your first question, we conclude that legislation increasing the PERS and TRS contribution rates for employees who became members of the systems before the effective date of the rate increases is likely to face a serious legal challenge. Because this kind of dispute is resolved on a case-by-case basis, only a definitive opinion of the Alaska Supreme Court will provide certainty as to the outcome of the challenge. However, we can say that if the increases are accompanied by comparable enhancements to benefits, the prospects of p. vailing are increased.

2. Pre-funding of the medical component of PERS and TRS benefits may not be discontinued for members who were employed during the period that the statutes required pre-funding. Funding of medical benefits may be set at less than 100 percent funding for new members.

State law requires employer contribution rates to be calculated in amounts sufficient, when combined with employee contributions, "to provide the benefits earned . . . . " AS 39.35.250; *see also* AS 14.25.070. Under PERS each employer, including the state, is required to provide in its budget for the payment of the contributions, and to remit the payments monthly. AS 39.35.260, 39.35.270, and 39.35.280. Additionally, AS 39.30.095(b), requires the commissioner of administration, after obtaining the advice of an actuary, to determine and set the rate of employer contribution and employee contribution, if any, required for payment to the group health and life benefits fund for payment of benefits including retiree health benefits.

As explained in the summary of the *Duncan* case above, the Alaska Supreme Court has held that health benefits provided by the state's retirement system statutes are part of "the retirement benefit package that becomes part of the contract of employment when the public employee is hired." 71 P.3d at 888. As such, retiree health benefits are among the benefits that must be included in the PERS and TRS employer contribution rates under AS 14.25.070, AS 39.30.095, and AS 39.35.250-39.35.290. We understand that, in accordance with these statutes, employer contribution rates have historically been set to fully fund retiree health benefits.

In a memorandum of advice dated December 2, 1992, this office addressed the question of "whether the governor is constitutionally or statutorily mandated to include in the budget, and the legislature is constitutionally mandated to appropriate, those employer contributions that are prescribed by the boards of the various retirement systems to keep the systems actuarially sound." 1992 Inf. Op. Att'y Gen. (663-92-0073; December 2). We advised that "we believe the court would hold that article XII,

section 7, requires the funding of the retirement systems . . . ." *Id.* at 3. That advice was tempered by the lack of Alaska case law directly addressing the question, and by the fact that recent case law from other jurisdictions created some uncertainty.

Since 1992, the Alaska Supreme Court decided the *Gallion* case, holding that employees' vested interest in the integrity and security of their plans could not be diminished by combining the plans with a plan that was less actuarially sound. In *Gallion*, the court was persuaded by the California Court of Appeal case relied upon in our 1992 memorandum of advice, *Valdes v. Cory*.[15] The court also declined to adopt the rationale of one of the cases that created uncertainty, *State ex rel. Dadisman v. Caperton*, *supra*, n.7.

We adhere to the advice we gave in 1992. We believe that the Alaska Supreme Court would hold that the "the practical effect of the whole complex of provisions" of the systems in which employees have accrued rights includes the statutory provisions for employer contributions and the state's practice of establishing employer contribution rates that fully fund retiree medical benefits in accordance with those statutes.

The legislature may change the employer contribution statutes to provide for less than full funding of the retiree medical benefits of employees hired after the effective date of the legislation.[16] We understand that no Governmental Generally Accepted Accounting Principle requires a public entity to fully actuarially fund retiree medical benefits. If the legislature chooses to enact such a change, in accordance with the court's holding in the *Gallion* case, past and future contributions for fully funded medical benefits for employees hired before the effective date of the legislation should be kept separate from contributions for underfunded medical benefits in the trust fund, in order to maintain the integrity and security of the fully funded benefits.

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[15] 139 Cal. App.3d 773, 189 Cal. Rptr. 212 (1983). *See also Board of Administration of the Public Employees' Retirement System v. Wilson*, 52 Cal. App.4th 1109, 61 Cal. Rptr.2d 207 (1997) (state PERS employees' contractual right to an actuarially sound system was unconstitutionally impaired by amendment to employer contribution portion of funding methodology).

[16] It is also possible that such a change could be applied to benefit recipients whose benefits are based solely on service performed before the legislature first enacted legislation providing for employer-paid retiree medical benefits in 1975. Ch. 200, SLA 1975. Those benefit recipients would not have a contractual right to pre-funded medical benefits arising from employment with the state.

3. If the financial condition of the funds does not permit payment of the PRPA, it is allowable to prospectively not pay existing members new [or additional] ad hoc PRPAs. A new statutory provision cannot reduce the existing number of members who retain a vested right to a PRPA if one is awarded, unless the new statutory provision includes comparable enhancements to benefits.

Before July 1, 1986, for PERS, and before July 1,1990, for TRS, the retirement system statutes provided for granting of post retirement pension adjustments to retirees if the administrator determined that the cost of living had increased, and that the financial condition of the funds permitted. AS 14.25.143 (TRS); AS 39.35.475 (PERS). The amount of the PRPA was based on the increase of the cost of living since retirement, with a cap of four percent of the base benefit compounded for each year of retirement. The PRPAs were not automatic, and were considered discretionary or "ad hoc." Potential future PRPAs were not included in the actuarially-determined employer contribution rates.

In 1986 for PERS, and in 1990 for TRS, the legislature repealed the ad hoc PRPAs, and replaced them with actuarially funded automatic PRPAs. Sec. 41, ch. 82 SLA 1986; sec.12, ch. 97 SLA 1990. The automatic PRPAs are paid to retirees age 60 or older, or who have been retired for at least five years from PERS or eight years from TRS. The amount of the PRPA for members who are at least 65 years old or who are receiving disability benefits is the lesser of 75 percent of the cost of living increase in the preceding calendar year or nine percent. For other retirees eligible for PRPAs, the amount is the lesser of 50 percent of the cost of living increase in the preceding calendar year or six percent.

Following repeal of the PERS ad hoc PRPA and enactment of the automatic PERS PRPA in 1986, this office advised the commissioner of administration that the PERS and TRS ad hoc PRPAs could be withheld "if the administrator of the systems makes appropriate, factually supported findings regarding the condition of the retirement funds." 1990 Inf. Op. Att'y Gen. (663-90-0206; January 19). In that memorandum of advice, we

acknowledged that "[b]ecause the right to receive a specific type of retirement benefit, including the PRPA, vests upon the date of employment, the ad hoc PRPA remains viable for members of PERS hired before the effective date of ch. 82, SLA 1986." *Id.* at 1.[17]

Based on the Alaska Supreme Court case law summarized above, the administrator must continue to consider annually whether the cost of living has increased and whether the financial condition of the retirement funds permits awarding of ad hoc PRPAs to retirees. It is not constitutionally allowable for legislation to reduce the existing number of members eligible to receive an ad hoc PRPA if one is awarded, unless that legislation provides comparable offsetting benefits. However, as we noted in our memorandum of advice in 1990,

> [t]o the extent possible, the division should also weigh other advantages provided by ch. 82, SLA 1986 [and ch. 97 SLA 1990] (such as the increased [PERS] "multipliers" in the benefit formula applied to service accrued after June 30, 1986 in excess of 10 and 20 years) in determining whether a retiree is actually disadvantaged by the change in the . . . PRPA.

Id. at 2.[18]

Legislation that limits the administrator's discretion – for example, legislation that allows award of an ad hoc PRPA only if a retirement fund is actuarially funded at over 100 percent and employer contribution rates are set at less than eight percent – would also be subject to challenge under the Alaska Supreme Court cases summarized above.

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[17] We also acknowledged this in pleadings filed in litigation filed by and on behalf of retirees after the TRS ad hoc PRPA was repealed. *National Education Association – Alaska v. Usera*, Case No. 3AN-91-8274 Civil. That litigation was settled in October 1996. Each year since then, the administrator has considered whether to grant an ad hoc PRPA based on the increase of the cost of living and the financial conditions of the retirement funds. The administrator denied ad hoc PRPAs for 2003 and 2004.

[18] As with medical benefits, it is possible that there are benefit recipients whose benefits are based solely on service performed before the PRPA was first enacted for TRS in 1966 (ch. 151 SLA 1966) or for PERS in 1968 (ch. 235 SLA 1968). Such a benefit recipient would not have a contractual right to the ad hoc PRPA arising from employment with the state, and would be eligible only for the automatic PRPA.

The constitutional rights of members regarding the ad hoc PRPA include the right to consideration of award of a PRPA based on the discretion existing under the repealed statutes.[19]

4. The above responses might be different if it were established that application of modification of the retirement systems to current members is necessary to allow the retirement systems to pay current benefit claims.

As explained above, the Alaska Supreme Court has not ruled on application to current members of changes to the retirement systems that might be necessary if a pension fund were "insufficient to satisfy all employee claims brought under its provisions." *Hoffbeck*, 627 P.2d at 1057 n.11. Although the Alaska Supreme Court has not established standards to be applied in such a case, analysis by the California court in the *Valdes* case may be instructive:

> On the other hand, a substantial impairment may be constitutional if it is "reasonable and necessary to serve an important public purpose." . . .
>
> Both the California and United States Supreme Courts have identified factors which may warrant legislative impairment of vested contract right on the grounds of necessity: "(1) the enactment serves to protect basic interests of society, (2) there is an emergency justification for the enactment, (3) the enactment is appropriate for the emergency and (4) the enactment is designed as a temporary measure, during which the vested contract rights are not lost but merely deferred for a brief period, interest running during the temporary deferment."

189 Cal. Rptr. at 225-26 (citations omitted).

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[19] Using the above example of potential legislative restrictions, if the administrator historically awarded a PRPA when a retirement fund was at least 95 percent funded, employer contribution rates were set at 10 percent, and no other facts existed that would cause the administrator to determine that the condition of the fund did not permit the award of a PRPA, the legislative restrictions would diminish or impair the vested rights of retirees if those historical conditions were ever achieved again.

If the Alaska Supreme Court adopted these standards for approving impairments based on reasonableness and necessity, it would consider the facts specific to the legislative enactment. We are not in a position to express an opinion as to the adequacy under these standards of the reasons advanced by legislators in support of amendments to the retirement systems currently under consideration. We must emphasize the importance of establishing as complete a record as possible for any justifications supporting the change if we are to conduct an effective defense.

Please let us know if you need additional advice regarding these matters.

VBR:rca

Since being limited to only 3-minutes of on-air Testimony today and not being able to finish what I had to say I would like to present each member on the House State Affairs Committee a copy of my full Testimony for their review at their convenience.

Good Morning Chairman Lynn & House State Affairs Committee,

My Name is Gavin D. Charrier.
I reside at 1390 Woodside Drive Ketchikan.
My mailing Address is P.O. Box 8692 Ketchikan, Alaska 99901.

I'm a 34 year Resident in the State of Alaska and a 20 year 7 month Employee of the Ketchikan Gateway Borough as an Airport Equipment Mechanic II / Aircraft Rescue Fire Fighter and 7.5% contributor to the PERS Retirement System.

I would like to Testify today in "non-support" of increasing Employee Contributions as proposed by Representative Mike Kelley in House Bill 179.

As a 19 year Collective Bargaining Negotiator for our Employee Group, Local 6137 of the Alaska Public Employees Association/American Federation of Teachers (APEA/AFT), historically Ketchikan is noted as being one of the "Highest Cost of Living Regions" while also being the "Lowest Paying Political Subdivision" in the State.

Over the years our members have suffered substandard wages in lieu of a generous Benefit Package that we have collectively been able to maintain through negotiations with the Ketchikan Gateway Borough. PERS/TRS Retirement is considered to be one of those Benefits that is under constant erosion. Tier I, II, III, IV, and now a proposed increase in contribution rates with nothing other than status quo in return.

If Employee Contribution Rates are successfully increased 5% from the current 9.6% School District, 7.5% Police & FireFighters, and 6.75% of all others to 14.6%, 12.5% and 11.75% respectively, then this will certainly create a financial hardship for many whose current substandard wage is barely enough to make ends meet.

PERS/TRS Employees have had no option but to contribute every pay period to their Retirement Account.

The explanation that I've been given by PERS is that the Employer, on the other hand, dosen't have to contribute a plug nickel into the Tier I, II or III Employees Account until the day comes when that Employee retires and starts drawing their hard earned retirement at the PERS Boards designated percentage amount calculated at 2.0% per year for their first 10 years of employment + 2.5% per year for all years after 10 x the average of the 3 highest consecutive years of salary. With the creation of the Tier IV Employee Group, last year, there is no new money coming in to help offset the deficit Retirement Account Balance.

When the Retiree draws their monthly retirement check from PERS, PERS simultaneously sends the Employer a bill for their portion of what they owe the Account to proportionally fund that Retiree's Retirement at what has already been determined by the PERS Board as previously mentioned. Thus, "The Unfunded Liability".

I believe its time for Employers to take fiduciary responsibly, step up to the plate, and begin "actively participating" in match funding PERS/TRS Tiers I, II & III Defined Benefit Groups "upfront" alongside the Employees Contributions bi-monthly as they currently are with the new Tier IV Defined Contribution Group.

Had this happened in the very beginning would the current unfunded deficit be so great, simply considering the compounding interest that the Retirement Account Balance would have earned on early invested monies? Would the need have been so extreme and painful as to move from a Defined Benefit to a Defined Contribution Retirement System?

5% increases to Employee Contribution Rates now would be no more than camouflaged funding for what the Employer duly owes their current and retired Tiers I, II and III Employees. Those Employees always have kept their end of the PERS/TRS Retirement Collective Bargain from the very beginning...

As Representative Gruenberg stated, the Employee knew when they were hired what their Contribution Rate would be that goes into their Retirement Account. The Employee also had the opportunity to know at what percentage rate of their base pay they would be paid as a retiree, they knew what their contributed cost was buying as a return in retirement funding.

Any increase to Employee Contribution Rates may be more palatable if it they were matched by Employer funding "upfront" and the PERS/TRS Board would increase their set percentage rates commensurately for the purposes of Retirement Calculation. But to increase the current Employees Contribution Rates now with no increases to their Retirement Check, when they are eligible, is not fair, honorable and in my opinion a Bad Faith Bargain that is not morally right...

Please, consider removing the proposed increases to Employee Contribution Rates into the PERS/TRS Retirement System under Representative Kelley's HB-179.

Thank-You for providing me time to explain my viewpoint and express my opinion of resolve to the Committee before voting HB-179.

If you have any questions you would like to ask on my Testimonial Statements, or to correct my understanding, Please, feel free to contact me

Sincerely,

Gavin D. Charrier

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Member
House Finance Committee
Legislative Budget & Audit

Representative Mike Kelly

House District 7

Sponsor Statt

Sponsor Statement

HB 179

The State of Alaska's retirement system unfunded liability is approaching $10 billion. PERS is currently 65% funded and TRS is 60% funded.

HB 179 would implement a comprehensive plan to return the State's crippled retirement system to soundness. It establishes a cost-sharing plan to eliminate the unfunded liability in the defined benefit plans. It obligates the state to pay 80% of the unfunded liability. The other employers would come to the table with 20%. Included in the bill is a plan to raise contribution rates for active legislators, Governors, commissioners, judges, police officers, firefighters, teachers, equipment operators, clerks, accountants, etc...in the defined benefit plans 5% above current levels. Employee contributions would go towards the cost of providing employee benefits in the current period. This three-way partnership ensures that everyone has skin in the game and actively participates in the sacrifice involved in funding the defined benefit plans and returning them to financial soundness. It also makes required technical changes to the state's defined contribution plan.

The Alaska Retirement Management Board recently adopted employer average contribution rates of 54% of wages for TRS and 39% for PERS for FY '08. These employer contribution rates required to eliminate the unfunded liability are simply unsustainable. Bankruptcies and elimination of critical services in our communities will be averted by implementing HB 179. If the state agrees to pick up 80% of the tab, these rates will level off at a high, but sustainable level. HB 179 sets up the accounts necessary to receive payments to extinguish the unfunded liability. It would also accommodate infusions of cash or lump-sum payments at any time the parties choose to use these methods to take advantage of temporary surpluses or debt instruments.

In wrap up, it is important to understand what this bill does and what it does not pretend to do. It does not look back to how we got in this mess. It does not create a single dollar to pay down the $10 billion unfunded liability. What it does provide is a cost-sharing mechanism for completing the tough task of restoring health to our defined benefit plans. You may argue it is too high for the state at 80%. You may argue that it will upset the active plan members that are covered. I would argue that when the all-in cost of

providing benefits in the old defined benefit plans have tripled since 1999, the legislature would be derelict in our duties if we did not look to all parties to assist us, including the beneficiaries who enjoy the benefits of the old systems which have proven over-rich and unsustainable.

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Member
House Finance Committee
Legislative Budget & Audit

Representative Mike Kelly

House District 7

MEMORANDUM

DATE: **March 27, 2007**

TO: **Representative Kelly**

FROM: **Derek Miller**

RE: **Sectional Analysis for HB 179 (Version 25-LS0252\M)**

A sectional summary of a bill should not be considered an authoritative interpretation of the bill. The bill itself is the best statement of its contents. If you would like an interpretation of the bill as it may apply to a particular set of circumstances, please advise.

Section 1. Requires employees in the defined benefit teachers' retirement plan to contribute in additional 5% above current employee contribution rates.

Section 2. Changes calculation of the employer contributions to the TRS defined benefit (DB) plan so that the employer rate is applied to the employer's entire system payroll base.

Section 3. Adds definitions for "employer normal cost rate" and "past service rate" and clarifies the rate is applied to the employer's entire TRS payroll base.

Section 4. Effective July 1, 2010, removes the provisions that allow members to repay refunded contributions for the purpose of obtaining a conditional service benefit.

Section 5. Adds a provision for TRS DB plan members who employ with new employers that join the TRS after July 1, 2006, and that do not participate in the TRS DB plan to participate in the TRS DCR plan.

Section 6. Clarifies that the TRS defined contribution plan is a qualifying hybrid plan.

Section 7. Requires employers in the TRS to pay occupational disability and death benefits through contributions calculated actuarially. Contributions will be deposited to a separate trust account for this purpose.

Section 8. Clarifies that the defined contributions paid into a member's individual account are subject to the limitations of 26 USC 415(c) and fixed benefits paid under the DCR plan (occupational disability, survivor's pension) are subject to the limitations of 26 USC 415(b).

Section 9. Clarifies that a member may direct investment of an individual account among available investment funds as set out by the Alaska Retirement Management Board.

Section 10. Clarifies the termination of a disability benefit when a person no longer meets the requirements to receive occupational disability benefits or recovers from disability.

Section 11. Provides that a member who receives disability benefits from the plan is 100% vested in all the employer contributions made to the members' individual account, regardless of years of service worked, once the member is appointed to disability. This subsection also clarifies that a member may not elect a distribution from the member's individual account while receiving disability benefits.

Section 12. Clarifies the termination of disability benefits when a disabled member first qualifies for normal retirement.

Section 13. Changes made to this subsection, which is related to the benefits for a survivor of a disabled member who dies while receiving disability benefits, mirror other changes being made to the disability and death statutes throughout this bill. The changes are: (1) clarifies the termination of a survivor's pension; (2) clarifies that a survivor cannot access the member's individual account while receiving a survivor's pension; (3) clarifies the normal retirement benefits available to a survivor; (4) clarifies that the period of disability benefits and the period of survivor benefits constitute membership service for eligibility for medical benefits and the Health Reimbursement Arrangement; and (5) establishes a tax qualified mechanism for the employer to continue to make employer and employee contributions to provide benefits to a survivor when the member would have reached normal retirement, had the member survived.

Section 14. Clarifies the definition of occupational disability.

Section 15. Adds an annual adjustment to occupational disability benefits equal to 75% of the increase in the Anchorage Consumer Price Index or 9%, whichever is less.

Section 16. Clarifies the termination of a survivor's pension under the occupational death benefit provisions, including the end of death benefits when a dependent child no longer meets the definition of dependent.

Section 17. Clarifies that a survivor of a member who died from occupational causes is not entitled to elect distributions from the member's individual account while receiving survivor benefits. Clarifies that the continuing contributions required by the employer are made on behalf of the surviving spouse and members dependent children rather than "beneficiaries." Directs all continuing contributions by the employer into the occupational disability and death trust account and other appropriate account and funds in accordance with the IRC.

Section 18. The amendment to this subsection (1) clarifies the normal retirement benefits available to survivors of members who died occupationally; (2) establishes a tax qualified mechanism for the plan to provide benefits to a survivor when the member would have reached normal retirement, had the member survived; and (3) clarifies that the period of death benefits constitutes membership service for determining vesting in employer contributions and eligibility for medical benefits and the Health Reimbursement Arrangement.

has 3 parts

Section 19. **AS 14.25.488.** Adds an annual adjustment to the survivor's pension benefit equal to 50% of the increase in the Anchorage Consumer Price Index or 6%, whichever is less. Persons who are receiving a survivor's pension who are age 60 or older and persons who have received a survivor's pension for at least 8 years are eligible for the COLA.

AS 14.25.489. Adds a provision that a person whose disability or survivor benefits are terminated due to eligibility for a normal retirement benefit will be treated as if that person is eligible for Medicare, regardless of age, for the purpose of cost-sharing medical premiums with the plan.

Section 20. Clarifies that the nonguarantee clause relates only to the defined contribution portion of the TRS DCR plan. The fixed benefits contained under the plan are defined by statute.

Section 21. Clarifies that IRC section 415(c) limits apply to employer matching contributions when a DB member elects to convert to the DCR plan.

Section 22. Clarifies that transferred membership service from the TRS DB plan to the TRS DCR plan will be applied to vesting in both the employer's matching contribution and subsequent employer contributions.

Section 23. Provides a time limit – 12 months from the date the employer consents to the conversion – within which an eligible member must make the decision to transfer from the TRS DB plan to the TRS DCR plan.

Section 24. Removes the Social Security Taxable Wage Base cap from the definition of eligible compensation for contribution purposes.

has 3 parts cost sharing component of the bill

Section 25. **AS 37.10.200.** Establishes the Teachers' retirement system past service cost liability account within the Department of Revenue. Clarifies the Commissioner of Revenue distribute a payment to each employer in the TRS system an amount based on 80% of the payroll base for each employer.

AS 37.10.202. Establishes the Public employee's retirement system past service cost liability account within the Department of Revenue. Clarifies the Commissioner of Revenue distribute a payment to each employer in the PERS system an amount based on 80% of the payroll base for each employer.

AS 37.10.204. Clarifies the definition of "past service cost rate."

Section 26. Authorizes the commissioner of administration to promulgate regulations to implement the state's group life and health insurance statutes, including the new Alaska retiree health trust statute.

Section 27. Clarifies the duties of the administrator for the Alaska Supplemental Benefits System (SBS)

Section 28. Returns the authority for adopting regulations for the SBS from the Alaska Retirement Management Board (ARMB) to the commissioner of administration.

Section 29. Changes the reference from "board" to "commissioner".

Section 30. Adds a provision under the SBS for a member, annuitant, or beneficiary to appeal a decision of the administrator to the Office of Administrative Hearings (OAH).

Section 31. Adds a provision under the Health Reimbursement Arrangement Plan for a member to appeal a decision of the administrator to the Office of Administrative Hearings.

Section 32. Clarifies the administrator to establish a teachers' and Public employees' retiree health reimbursement arrangement plan trust fund.

Section 33. Changes the employer contribution from an individual employer contribution amount to a uniform employer contribution amount for all participants of the Health Reimbursement Arrangement Plan.

Similar to Sec. 1

Section 34. Requires employees in the defined benefit public employees' retirement plan to contribute in additional 5% above current employee contribution rates.

Section 35. Amends the calculation of the employer contribution rate. Clarifies the definition of Normal Cost Rate and Past Service Cost Rate as it applies to the employer contribution rate.

Section 36. Clarifies the employer contribution rate shall be calculated by applying the Normal Cost Rate and the Past Service Cost Rate to the employers entire, active members.

Section 37. Effective July 1, 2010, removes the provision that allows employees to repay refunded contributions for the purpose of obtaining a public service benefit.

Section 38. Effective July 1, 2010, removes the provision that allows employees to repay refunded contributions for the purpose of obtaining a conditional service benefit.

Section 39. Adds a provision for appeal to the Office of Administrative Hearings of the commissioner's decisions on waiver requests under PERS.

Section 40. Incorporates the reference to the new administrator section AS 39.35.003 into the definition of "administrator" under the PERS DB plan.

Section 41. Adds a provision for PERS DB plan members who employ with new employers that join the PERS after July 1, 2006, and that are not eligible to participate in the PERS DB plan, to participate in the PERS DCR Plan.

Section 42. Clarifies that the PERS defined contribution plan is a qualifying hybrid plan. Provides that retiree medical benefits are provided by the DCR plan.

Section 43. Clarifies that the employer contributions for the defined benefits under this subsection (occupational disability, occupational death and disabled peace officer/fire fighter pension benefits) will be deposited to a separate trust account in the plan.

Section 44. Clarifies that the defined contributions paid into a member's individual account are subject to the limitations of 26 U.S.C. 415(c) and the fixed benefits paid under the DCR plan (occupational disability, survivor's pension) are subject to the limitations of 26 U.S.C. 415(b).

Section 45. Clarifies the termination of a disability benefit when a person no longer meets the requirements to receive occupational disability benefits.

Section 46. Provides that a member who receives disability benefits from the plan is 100% vested in all the employer contributions made to the member's individual account, regardless of years of service worked, once the member is appointed to disability. This subsection also clarifies that a member may not elect distributions from the member's individual account while receiving disability benefits.

Section 47. Clarifies the termination of disability benefits when a disabled member first qualifies for normal retirement.

Section 48. Specifies that the monthly pension benefit election upon eligibility for normal retirement by a disabled peace officer or fire fighter under (2) of this subsection

will be paid first from the member's individual account and then from the trust account established for this purpose. Also clarifies that a member who is a peace officer or fire fighter is not entitled to elect distributions from the member's individual account while receiving disability benefits.

mirror other changes - 5 changes...

Section 49. Changes made to this subsection, which is related to the benefits for a survivor of a disabled member who dies while receiving disability benefits, mirror other changes being made to the disability and death statutes throughout this bill. The changes are: (1) clarifies the termination of a survivor's pension; (2) clarifies that a survivor cannot access the member's individual account while receiving a survivor's pension; (3) clarifies the normal retirement benefits available to a survivor; (4) specifies that the period of disability benefits and the period of survivor benefits constitute membership service for eligibility for medical benefits and the Health Reimbursement Arrangement; and (5) establishes a tax qualified mechanism for the employer to continue to make employer and employee contributions to provide benefits to a survivor when the member would have reached normal retirement, had the member survived.

Section 50. Clarifies the definition of occupational disability and establishes the eligibility requirements.

Section 51. Adds an annual adjustment to occupational disability benefits, and to retirement benefits elected by disabled peace officers and fire fighters under AS 39.35.890(h) (2), equal to 75% of the increase in the Anchorage Consumer Price Index or 9%, whichever is less.

Section 52. Clarifies the termination of a survivor's pension under the occupational death benefit provisions, including the end date of survivor benefits when a dependent child no longer meets the definition of dependent.

Section 53. Clarifies that a survivor of a member who died from occupational causes is not entitled to elect distributions from the member's individual account while receiving survivor benefits. Clarifies that the continuing contributions required by the employer are made on behalf of the surviving spouse and member's dependent children rather than "beneficiaries." Directs all continuing contributions by the employer into the occupational disability and death trust account and other appropriate accounts and funds in accordance with the IRC.

Section 54. The amendment to this subsection (1) clarifies the normal retirement benefits available to survivors of members who died occupationally; (2) establishes a tax qualified mechanism for the plan to provide benefits to a survivor when the member would have reached normal retirement if the member had survived; and (3) clarifies that the period of death benefits constitutes membership service for determining vesting in employer contributions and eligibility for medical benefits and the Health Reimbursement Arrangement.

has 2 parts

Section 55. **AS 39.35.893.** Adds an annual cost-of-living adjustment (COLA) to the survivor's pension benefit equal to 50% of the increase in the Anchorage Consumer Price Index or 6%, whichever is less. Persons who are receiving a survivor's pension who are age 60 or older and persons who have received a survivor's pension for at least 5 years are eligible for the COLA.

AS 39.35.894. Adds a provision that a person whose disability or survivor benefits are terminated due to eligibility for a normal retirement benefit will be treated as if that person is eligible for Medicare, regardless of age, for the purpose of cost-sharing medical premiums with the Plan.

Section 56. Clarifies that the nonguarantee clause relates only to the defined contribution portion of the PERS DCR plan. The fixed benefits contained under these plans are defined by statute.

IRC = Internal revenue code

Section 57. Clarifies that IRC section 415(c) limits apply to employer matching contributions when a DB member elects to convert to the DCR plan.

Section 58. Clarifies that transferred membership from the PERS DB plan to the PERS DCR plan will be applied to vesting in both the employer's matching contribution and subsequent employer contributions

Section 59. Provides a time limit – 12 months from the date the employer consents to the conversion – within which an eligible member must make the decision from the PERS DB plan to the PERS DCR plan.

has 2 parts

Section 60. **AS 39.35.957.** Adds a provision for employers to designate classes or groups of employees eligible to participate in (or to be excluded from) the PERS DCR plan. Clarifies that a member of the DB plan will become a member of the DCR plan if employed by an employer that participates only in the DCR plan.

AS 39.35.958. Adds the process by which an employer may terminate participation from the DCR plan and outlines the rights of employees and the costs to the employer upon termination.

Section 61. Removes the Social Security Taxable Wage Base cap from the definition of eligible compensation for contribution purposes.

Section 62. Clarifies that a "member" and "employee" have the same meaning throughout the PERS DCR statutes. Includes as member the governor, lieutenant governor and legislators. Excludes instructors at the Department of Labor and Workforce Development and the Department of Education and Early Development in position requiring a teacher certificate.

Section 63. Provides a clear definition of peace officer and fire fighter under the DCR plan.

Section 64. Adds language for the powers and duties of the Deferred Compensation program administrator.

Section 65. Clarifies that the administrator of the Deferred Compensation program may contract with a private person to administer the plan.

Section 66. Adds a provision under the Deferred Compensation program for a member to appeal a decision of the administrator to the Office of Administrative Hearings.

Section 67. Adds the Supplemental Benefit-Annuity Plan, Health Reimbursement Arrangement Plan, Deferred Compensation Plan, and waivers of adjustment under the PERS and TRS defined benefit plans to the jurisdiction of the Office of Administrative Hearings.

Section 68. Removes the National Education Association as a participating employer in the TRS. Repeals the voluntary contribution provision of the TRS DCR plan. Repeals participation of NEA in the TRS DCR plan. Repeals duplicative statute which provides commissioner of administration authority to appoint the administrator of the PERS and the Supplemental Benefits System. Repeals the subsection relates to reinstating service associated with refunded contributions for obtaining a public service benefit, effective July 1, 2010 under sec. 118 of the bill. Repeals the voluntary contribution provision of the PERS DCR plan.

Section 69. Repeals AS 39.35.375(f) – reinstatement of service in the TRS plan for which a member received a refund of contributions.

Section 70. Effective dates for Sections 4, 37 and 38, July 1, 2010.

Section 71. Effective date for remainder of bill, except as provided in section 70, takes effect July 1, 2007.

25th Alaska State Legislature
Representative Mike Kelly
State Capitol, Room 513
465-4976 (Fax) 465-3883
www.housemajority.org

HB 179 Walkthrough

Contact: Derek Miller, 465-6879

Version: 25-LS252\M

Summary: This bill makes necessary technical changes to the state's defined contribution (DC) plan and provides a mechanism to pay off the $10 billion unfunded liability associated with the state's defined benefit (DB) plan. Total cost to the state, employers and employees for providing the benefits has tripled since 2000 and will remain at or above that level for the next 25 years.

HB 179 would obligate the state to pay 80% of the unfunded liability associated with the old DB plan and would obligate local school districts and public employers to pay 20%. Two accounts would be established within the Department of Revenue, a Teachers' Retirement Past Service Cost Liability Account and a Public Employees' Retirement Past Service Cost Liability Account. The accounts are necessary to receive payments to extinguish the unfunded liability. The final component of the plan would increase contributions required of public employees by 5% for the current period.

Terminology:

Employer – In PERS an employer may be a political subdivision of the state like the city of Fairbanks or the Municipality of Anchorage. It can also include the University of Alaska or school districts. In TRS an employer may be a school district, the University of Alaska or the State Department of Education. There are 160 participating employers in the state.

Employee – An employee, also know as "member", may be a police officer, firefighter, teacher, legislator, legislative staff, Commissioner, judge, Governor, grader operator, clerk, accountant, etc…

The State – The state is the State of Alaska. Contributions from the state of Alaska come from the General Fund.

It's important to understand the difference between the **Normal Cost Rate (NCR)** and the **Past Service Cost Rate (PSR)** for employers. The NCR is the rate necessary for employers to fund benefits to accrue in the current year after employee or "member" payroll deductions are accounted for. The PSR is the rate necessary for employers to pay off the actuarially determined unfunded liability. If there were no unfunded liability, there would be no PSR and

employers would only be assigned an NCR. Unfortunately, we will face both for the next 25 years.

Here is a breakdown of current employer rates for the PERS and TRS system:

	PERS	TRS
NCR	14.48%	12.56%
PSR	25.28%	41.47%

This chart demonstrates that for every dollar in salaries the PERS system pays on behalf of its DB employees, the employer must pay current benefit costs plus 25 cents towards the unfunded liability over a 25-year period. For TRS it's 41 cents for every dollar in salaries going towards the unfunded liability.

HB 179 obligates the state to pay 80% and employers to pay 20% of the PSR. The new employer rates for PERS and TRS would look like this:

	PERS	TRS
NCR	14.48%	12.56%
PSR (20%)	5.06%	8.29%

This reduction of over 20% for PERS and almost 34% for TRS employer contributions would amount to huge savings for Public employers. This will free up money for local governments to provide essential local services like education, fire protection, public safety and road maintenance.

Active Beneficiary Contributions under HB 179: DB plan member contributions would rise 5% from current levels set out in AS 14.25.050 and AS 39.35.160. These rates are currently 8.65% for members in the Teachers Retirement System, 7.50% for peace officers and firefighters in the PERS system and 6.75% for legislators, judges, the Governor, Commissioners, public employees and all "other" PERS members.

In 2000, employees paid nearly half the all-in costs of providing benefits in PERS and 42% for TRS. Without the 5% increase in contribution rates for employees in 2008, their contributions provide only 15% of the all-in costs. Non-retired beneficiaries need to come to the payment table.

The 5% increase (3% - 4% after tax) would translate into rates of 13.65% for TRS members, 12.50% for peace officers/firefighters and 11.75% for all "other" PERS members. This 5% increased deduction from a beneficiaries payroll would be collected by employers to help offset the increasing costs associated with providing current period benefits in the defined benefit plan. Their contributions

would equate to roughly 25% of the all-in costs of providing the DB plan benefits which Buck Consultants described as "rich" and which have proven to be unsustainable.

Constitutional Issues: Increasing the active beneficiary contribution raises the concern that we may violate Article XII; section VII of our constitution which states: "Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired." Because of this concern, HB 179 assigns additional beneficiary cost responsibility only to the current period.

While a beneficiary contribution rate may not be able to be changed retroactively for benefits that have already accrued, it can be argued that employee rates can be changed prospectively to pay for benefits yet to accrue. A California case found:

> An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system.

That's what this bill aims to do, maintain the integrity of Alaska's retirement system.

Furthermore, a Michigan Supreme Court opinion found:

> The legislature cannot diminish or impair accrued financial benefits, but we think it may properly attach new conditions for earning financial benefits which have not yet accrued.

Calculation of PERS Employer Rate: The PERS defined benefit plan has an individual employer rate that results in a different rate for each employer. The TRS defined benefit plan is a cost-sharing single rate retirement plan. As a result, there are 160 different employer contribution rates for PERS, but the 58 employers participating in TRS pay the same rate.

Sections 35 and 36 of the bill convert the PERS employer rate to a single rate cost-sharing calculation. With passage of this legislation, the 160 individual employers in PERS will be assigned a single rate, like TRS.

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: HB179-DOA-OAH-3-20-07
Bill Version: HB 179
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Administration
Title: An act relating to insurance for public employees
RDU: Central Administrative Services
Component: Office of Administrative Hearings
Sponsor: Representative Kelly
Requester:
Component No.: 2771

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0
Travel	0.0	0.0	0.0	0.0	0.0	0.0
Contractual	0.0	0.0	0.0	0.0	0.0	0.0
Supplies	0.0	0.0	0.0	0.0	0.0	0.0
Equipment	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ( )	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0
1003 GF Match	0.0	0.0	0.0	0.0	0.0	0.0
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0
1037 GF/Mental Health	0.0	0.0	0.0	0.0	0.0	0.0
Other (Specify Type--Do not abbreviate)	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2007) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill provides for the Office of Administrative Hearings (OAH) to conduct the hearings in SBS, Deferred Compensation and Health Reimbursement administrative appeals, in addition to the PERS and TRS appeals already heard by OAH. The Division of Retirement and Benefits estimates that this may generate two additional hearings per year. OAH presently has the capacity to handle these cases without increasing personnel. The cost of doing so would be recovered from the division through interagency receipts under OAH's cost allocation plan, based on the time commitment required for the hearings. OAH does not anticipate increased expenditures for its operation due to the addition of these three, low volume case types.

Prepared by: Terry L. Thurbon, Chief Administrative Law Judge
Phone 465-1886
Division: Office of Administrative Hearings
Date/Time 03/20/2007 3:26 p.m.

Approved by: Kevin Brooks, Deputy Commissioner
Date 3/20/2007 4:30pm
Agency: Department of Administration

(Revised 9/18/2006 OMB)

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: HB179-DOR-TRE-3-28-07
Bill Version:
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Revenue
Title: PUBLIC EMPLOYEE/TEACHER RETIREM'T SYSTE
RDU: Taxation and Treasury
Component: Treasury
Sponsor: Kelly
Requester: House State Affairs
Component No.: 121

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0
Travel	0.0	0.0	0.0	0.0	0.0	0.0
Contractual	0.0	0.0	0.0	0.0	0.0	0.0
Supplies	0.0	0.0	0.0	0.0	0.0	0.0
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2007) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal: 0.0

POSITIONS

Full-time	0	0	0	0	0	0
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill establishes 2 accounts into which annual appropriations could be made, and amounts would be distributed by the department each year to 2 distinct groups of employers. The department would pay each TRS employer, other than the state and the University, the amount the employer is expected to pay that fiscal year toward its past service liability. However the amount paid to each employer is based upon a formula looking back 3 years. Similarly, municipal and school district PERS employers would be paid for their annual past service liability payment using a different formula. The department would manage the accounts, make distributions and adopt regulations. Account earnings and money not needed for appropriation as provided by the formulae would be deposited in the general fund annually.

Prepared by: Jerry Burnett
Phone: 465-2312
Division: Adminstrative Services
Date/Time: 3/28/07 12:00 AM
Approved by: Jerry Burnett
Date: 3/28/2007
Agency: Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2007 LEGISLATIVE SESSION

Fiscal Note Number: HB179-DOA-R&B-3-27-07
Bill Version: HB179
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Administration
Title An Act relating to public employees' and teachers' retirement defined contribution retirement plans.
RDU Centralized Administrative Services
Component Retirement and Benefits
Sponsor Rep. Kelly
Requester House State Affairs
Component No. 64

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0
Travel	0.0	0.0	0.0	0.0	0.0	0.0
Contractual	0.0	0.0	0.0	0.0	0.0	0.0
Supplies	0.0	0.0	0.0	0.0	0.0	0.0
Equipment	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ( )	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0
1003 GF Match	0.0	0.0	0.0	0.0	0.0	0.0
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0
1037 GF/Mental Health	0.0	0.0	0.0	0.0	0.0	0.0
Other (Specify Type--Do not abbreviate)	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2007) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill provides clarifying revisions to SB 141 passed by the 24th Alaska Legislature and enacted as ch. 9, FSSLA 2005. Some of the provisions include the following: identifies a funding source for teachers' disability and death benefits; adds annual cost of living increases to disability benefits, survivor pensions, and peace officer/fire fighter pensions provided by the new PERS and TRS plans; clarifies that a member or survivor is not entitled to elect distributions from the member's individual account while receiving disability or death benefits; makes clarifying changes to maintain Internal Revenue Code requirements.

This bill has no fiscal impact on the Division of Retirement and Benefits. Please see page two for the analysis required by AS 24.08.036.

Prepared by: Kathy Lea, Acting Director
Phone 465-4817
Division Retirement and Benefits
Date/Time 3/27/07 2:45pm
Approved by: Rachael Petro, Deputy Commissioner
Date 3/27/07 3:15pm
Agency Department of Administration

FISCAL NOTE

STATE OF ALASKA **BILL NO.** HB179
2007 LEGISLATIVE SESSION

ANALYSIS CONTINUATION

Sec. 24.08.036. Fiscal notes on bills affecting state retirement systems. Before a bill which would have an effect on the retirement systems of the state is reported to the rules committee, there shall be attached to the bill an analysis of the long-term and short-term costs to the state if the bill is adopted, as well as the impact of the bill on the actuarial soundness of the fund. The analysis is in addition to the fiscal note requirements of AS 24.08.035.

The legislature passed Senate Bill 141, enacted as Ch. 9 FSSLA 2005, establishing defined contribution retirement plans for new members of the PERS and TRS first enrolled on or after July 1, 2006. It was important to the legislature that members of the defined contribution retirement plans receive death and disability benefits commensurate with the death and disability benefits available to members of the defined benefit plans. As a result of this plan structure combining certain guaranteed fixed benefits with defined contribution benefits, these plans are hybrid plans under the Internal Revenue Code sec. 414(k).

There were some oversights in the drafting of the original legislation that resulted in the exclusion of explicit statutory authority for funding of some of the fixed benefits contained in the plans. This bill contains the conforming amendments necessary to pay all the benefits required in accordance with the intent of the new defined contribution retirement plans as enacted by the legislature and adds the following:

- Annual COLA for recipients of disability benefits.
- Annual COLA for recipients of a survivor's pension.
- Medical premium cost-sharing for disabilitants and survivors at normal retirement.
- Funding for disabled police/fire figher members who choose a monthly retirement pension.
- Annual COLA for disabled police/fire fighter members who choose a monthly retirement pension.

The State's actuary, Buck Consultants, developed cost estimates for these benefits. The total combined increase to the employers of the PERS and TRS in FY 2008 is approximately $147,200. The table below breaks out the dollar cost estimates for each retirement system based on the projected payroll for the PERS and TRS Defined Contribution Retirement Plans in 2008:

Benefit	PERS "Others" Rate	PERS Others Costs (Payroll $133.4 m)	PERS P/F Rate	PERS P/F Costs (Payroll $17.0 m)	Total PERS Costs	TRS Rate	TRS Costs (Payroll $69.8 m)
COLA Disabled P/F	0.048%	$ 64,032	0.214%	$ 36,380	$ 100,412	0.038%	$ 26,524
Pension at Normal Retirement	N/A	N/A	0.119%	$ 20,230	$ 20,230	N/A	N/A
Medical cost-sharing at Normal Retirement	0.019%		0.176%			0.025%	

The FY08 rates for retiree medical benefits, as well as all costs related to occupational disability, occupational death, and disabled P/F retirement, were based upon actuarial calculation and adopted by the Alaska Retirement Management Board [per AS 14.25.350(b) and AS 39.35.750(b)]. The long-term costs will vary by plan experience. However, Buck made these cost estimates based on PERS Tier 3 and TRS Tier 2 members, expecting the experience of the new tiers to be reflective of that population. As PERS Tier 4 and TRS Tier 3 plan membership grows annually, these rates (as actuarially calculated) would be applied to the annual payroll base.

Separate trust accounts will be established in which all contributions and earnings will be deposited to pay the guaranteed fixed benefits associated with the occupational disability and occupational death provisions (including disabled P/F retirement) of the defined contribution retirement plans. Absent the increased rates as noted above, the employers will not contribute in FY 2008 to these trust accounts an amount sufficient to pay for the death and disability benefits for their members. As a result, the initial health of the trust funds for death and disability benefits may be considered not actuarially sound in order to properly pay future benefits to members from these trust funds.